A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Report on Internal Control and Compliance

Pinal County

Year Ended June 30, 2009

Debra K. Davenport
Auditor General

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Pinal County
Report on Internal Control and Compliance
Year Ended June 30, 2009

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Report Issued Separately

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Basic Financial Statements Performed in Accordance with *Government Auditing Standards*

Members of the Arizona State Legislature

The Board of Supervisors of
Pinal County, Arizona

We have audited the financial statements of the governmental activities, business-type activities, each major fund, and aggregate remaining fund information of Pinal County as of and for the year ended June 30, 2009, which collectively comprise the County's basic financial statements, and have issued our report thereon dated January 28, 2010. Our report was modified to include a reference to our reliance on other auditors. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the Housing Department, Employee Benefit Trust, and Long Term Care Fund, as described in our report on the County's financial statements. The financial statements of the Employee Benefit Trust and Long Term Care Fund were not audited by the other auditors in accordance with *Government Auditing Standards*. This report includes our consideration of the results of the other auditors' testing of internal control over financial reporting and compliance and other matters that are reported on separately by those other auditors. However, this report, insofar as it relates to the results of the other auditors, is based solely on the reports of the other auditors.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the County's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the County's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the County's basic financial statements that is more than inconsequential will not be prevented or detected by the County's internal control. We consider items 09-01, 09-02, 09-03, 09-04, 09-05, 09-06, 09-07, 09-08, 09-10, and 09-11 described in the accompanying summary to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the basic financial statements will not be prevented or detected by the County's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 09-01 through 09-04 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the County's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, and which are described in the accompanying summary as items 09-06, 09-09, 09-10, and 09-11.

Pinal County's responses to the findings identified in our audit are presented on pages 15 through 20. We did not audit the County's responses and, accordingly, express no opinion on them. We noted certain matters that we may report to the County's management in a separate letter at a future date.

This report is intended solely for the information and use of the members of the Arizona State Legislature, the Board of Supervisors, management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record, and its distribution is not limited.

Jay Zsorey, CPA
Financial Audit Director

January 28, 2010

Financial Statement Findings

09-01
The County should strengthen access controls to its general ledger accounting system

Criteria: The County should have effective computer access controls to prevent and detect unauthorized use, damage, loss, or modification of programs and data, including sensitive and confidential information.

Condition and context: Auditors tested access controls and determined that there were inadequate internal controls over logical access to the County's general ledger accounting system. Specifically, auditors noted the following deficiencies:

- For 7 of 17 employees tested, the employee's system access was not compatible with the employee's job responsibilities. Six of these employees had unlimited system access, which allowed them the ability to change data, such as adding vendors or employees and changing their own pay rate. Auditors determined that there were 2 additional employees with unlimited system access rights.
- For 5 employees, the County was unable to provide documentation authorizing the employee's system access rights and approval by a supervisor.
- The County did not use logging capability or other methods to identify who initiated and approved transactions processed within the system. In addition, the County did not monitor employees who had unlimited system access or limit this access to only those essential individuals needing it.
- For 7 of 10 terminated employees tested, the County was unable to provide documentation that it had terminated the employee's access to the system in a timely manner.

Effect: There is an increased risk of theft, manipulation, or misuse of financial, sensitive, or confidential information by unauthorized users or by users who were not properly being monitored. This finding is a material weakness in internal control over financial reporting.

Cause: The County did not have written policies and procedures for granting logical access to its general ledger accounting system. In addition, the County has not dedicated financial resources to monitor logical access controls and activities of those employees with unlimited system access.

Recommendation: The County should establish policies and procedures that require supervisory approval for all requests of system access. Requests should contain all necessary information for assigning the appropriate level of system access rights that is compatible with their current job responsibilities. In addition, the County should periodically perform a comprehensive review of all existing system users to ensure that employees have access rights that are compatible with their current job responsibilities. Further, the County should limit granting complete system access only to those individuals needing it and develop procedures for monitoring and reviewing the activities of those who have unlimited system access. Finally, the access rights of terminated employees should be immediately removed from the system.

This finding was similar to a prior-year finding.

09-02
The County should strengthen change management controls for its general ledger accounting system

Criteria: The County should have effective policies and procedures to ensure that computer systems function properly and that the integrity of the systems' financial, sensitive, or confidential information is protected against unauthorized system and program changes.

Condition and context: The County did not have formal policies and procedures for logging, documenting, and managing changes made to its general ledger accounting system. Changes to the County's system were initiated and recorded through multiple sources, including through the County's e-mail system. Because of this method, the County was not able to effectively track the changes made to its system and could not ensure that all changes were documented, tested, reviewed, and approved prior to putting the changes into use. Consequently, auditors were unable to select a sample of changes to the system to determine if the changes were reasonable and properly approved. In addition, the County did not ensure that the responsibilities for making changes to the system were adequately separated so that no one person had complete control over the process.

Effect: The County is exposed to the risk of unauthorized changes to its general ledger accounting system that could lead to potential theft, manipulation, or misuse of financial information, including sensitive and confidential data. This finding is a material weakness in internal control over financial reporting.

Cause: The County did not have written policies and procedures for making program changes to its general ledger accounting system and ensuring these responsibilities were adequately separated.

Recommendation: The County should establish effective policies and procedures for controlling all changes made to its general ledger accounting system. The County should require all changes to its system be documented, authorized, tested, reviewed, and approved prior to being put into use. In addition, the responsibilities for developing and implementing changes to the system should be adequately separated from the responsibilities of authorizing, testing, and approving the changes.

This finding is similar to a prior-year finding.

09-03
The County Treasurer's Office should strengthen controls over its computer system

Criteria: The County Treasurer's Office should have effective computer access and change management controls to properly restrict and limit access to the financial information, enhance accountability, safeguard assets and data, and prevent unauthorized changes to the system.

Condition and context: Auditors tested internal controls and determined there were inadequate access and change management controls for the Treasurer's system. The Treasurer's Office did not always ensure that employees' responsibilities were adequately separated when assigning access rights and making changes to the system. Specifically, auditors noted that two employees had unlimited system access, which allowed them the ability to make changes to the system and data without an independent review. This activity and all other changes to the system were not monitored during the year. One of these employees, the system's developer, was heavily involved in the day-to-day operations of the Treasurer's Office, including having the ability to sign checks. Additionally, auditors noted two other employees who were authorized to sign checks that also had the ability to create, record, review, and approve disbursements and transfers without an independent review. Finally, access rights were often granted or removed without written documentation from an authorized supervisor.

Effect: The County Treasurer's Office is exposed to an increased risk of unauthorized access and changes to its system, including its financial and sensitive data, which could result in the theft, manipulation, or misuse of assets and information. This finding is a material weakness in internal control over financial reporting.

Cause: The County Treasurer's Office did not have written policies and procedures for granting and terminating access and making changes to its computer system. In addition, the Treasurer's Office has not created a log to track and monitor program changes to its system. Further, the Treasurer's Office does not have its own information technology (IT) staff and has not worked with the County's IT Department to help correct these deficiencies.

Recommendation: The County Treasurer's Office should establish policies and procedures for granting and terminating access and making changes to its system. These policies and procedures should ensure the proper separation of duties so that no individual initiates transactions and also controls the functions of authorization, recordkeeping, and asset custody. Specifically, the Treasurer's Office should:

- Log and periodically monitor the activity of employees with unlimited system access. This high level of access should be restricted and should not conflict with employees' job responsibilities.
- Assign system development and programming responsibilities to individuals not involved in the day-to-day operations of the Treasurer's Office.
- Separate change management responsibilities so no one person can develop, test, review, and authorize changes made in the system.
- Monitor key changes to the system such as those affecting critical fields.
- Review all employees' access periodically to their job responsibilities to ensure that the appropriate level of access is granted to the system. Eliminate unnecessary or incompatible access rights to the system.
- Ensure that the employee's supervisor documents and approves access granted to and removed from the system.

This finding is similar to a prior-year finding.

09-04
The County should develop and test comprehensive disaster recovery plans for its computer systems

Criteria: It is critical for the County to have an up-to-date contingency plan in place for all significant computer systems to ensure the continuity of operations and that electronic data files are not lost in the event of a system or equipment failure or other interruption. In addition, backup files containing sensitive or confidential data should be encrypted so that unauthorized individuals will not have access to such data.

Condition and context: The County has preliminary planning documents addressing the stages of a disaster recovery plan for its general ledger accounting and Treasurer's systems; however, no documented disaster recovery or continuity plan exists for these systems. In addition, auditors noted that the County's backup tapes that contained sensitive or confidential data were not protected by encryption.

Effect: The County could experience the loss of computer operations in the event of a system or equipment failure or interruption. Further, sensitive and confidential data on the County's backup files could be compromised. This finding is a material weakness in internal control over financial reporting.

Cause: The County has not dedicated the financial resources to develop a complete disaster recovery plan for its computer systems. In addition, the County did not have policies and procedures in place to help ensure backup files were adequately safeguarded.

Recommendation: The County should include the following policies and procedures in its disaster recovery plans for all significant computer systems and appropriately safeguard backup files:

- Perform a risk analysis identifying and prioritizing the critical applications to determine which applications should be recovered first.
- Communicate and distribute a copy of the disaster recovery plan to all affected employees.
- Maintain a copy of the disaster recovery plan off-site.
- Make arrangements for a designated physical recovery facility.
- Make arrangements with vendors to support hardware and software requirements.
- List procedures for processing critical applications.
- Test and document the plan annually and update the plan for any problems noted.
- Encrypt backup files.

This finding is similar to a prior-year finding.

09-05
The County needs better procedures for ensuring its financial statements are accurate and complete

Criteria: The County should prepare complete and accurate financial statements that are supported by its accounting records in accordance with generally accepted accounting principles.

Condition and context: The financial statements, note disclosures, and detailed supporting schedules provided to auditors contained errors because they were not always independently reviewed for accuracy and completeness. Specifically, auditors noted the following errors:

- For one of two bank account reconciliations tested, the County did not properly prepare or review the reconciliation. As a result of errors, cash reported for the Agency Funds was overstated by almost $279,000.
- The County did not correctly prepare its deposits and investments note disclosure because of errors in its supporting schedules. Specifically, 5 of 20 investment accounts were overstated by approximately $1.6 million, and $56,000 of cash was excluded from the cash in bank balance. In addition, the credit risk was incorrectly presented as AAA for $5 million of unrated U.S. agency securities. Furthermore, money market deposits totaling $20 million were double-counted because they were reported as both deposits and investments.
- The County's note disclosure for the County Treasurer's Investment Pool underreported assets by approximately $1.2 million and required several adjustments to the Fiduciary Funds' financial statements.
- The County did not have procedures for allocating the change in its investments' fair market value at June 30, 2009. As a result, investments and investment earnings reported in the financial statements were understated by $1.3 million for the year.

Effect: The County did not have adequate internal controls to detect and correct misstatements that were noted in the condition and context above to its financial statements and to ensure that all required adjustments and resulting changes to financial statement note disclosures were made. The financial statements and note disclosures were adjusted for all significant errors. This finding is a significant deficiency in internal control over financial reporting.

Cause: The County did not adequately and completely review the financial statements, notes to financial statements, and supporting schedules to ensure that they agreed with the accounting records and were accurately prepared.

Recommendation: To help ensure that the financial statements are accurate, complete, and prepared in accordance with generally accepted accounting principles, the County should establish procedures to ensure that the financial statements, note disclosures, and supporting schedules agree to the accounting records. These procedures should include having a supervisor review the financial statements, notes, and supporting schedules for accuracy.

This finding is similar to a prior-year finding.

09-06
The County should improve procedures for making principal and interest payments on its loans to ensure that it complies with loan agreements

Criteria: The County should make principal and interest payments on its loans payable when due to ensure that it complies with loan agreements. Loans payable should be reduced during the fiscal year in which the principal payments are made, in accordance with generally accepted accounting principles.

Condition and context: The County incorrectly recorded loan principal and interest payments as being paid during fiscal year 2009 when they were not paid until after year-end, in July 2009. Also, the County was in noncompliance with one of its loan agreements with the Greater Arizona Development Authority (GADA) because it should have been making the payments 2 months earlier. However, the County did not incur penalties and implemented procedures to ensure future compliance with the loan agreement.

Effect: Cash and loans payable at June 30, 2009, were understated by $3.7 million. In addition, the County did not comply with its loan agreement with GADA and did not disclose this noncompliance in its financial statements. The financial statements and note disclosures were adjusted for these errors. This finding is a significant deficiency in internal control over financial reporting and an instance of noncompliance.

Cause: The County had been making the loan's principal and interest payments in January and July of each year when the trustee sent invoices. However, the County did not realize until after the fiscal year that these payments were instead due each November and May, as required by the loan agreement with GADA. In addition, the County incorrectly reduced its loans payable balance during the year for when the principal payment was due rather than when it was paid.

Recommendation: The County should improve its procedures for making and recording its loan principal and interest payments. Specifically, the County should obtain and review all loan agreements and make a list of the payment dates to help ensure that loans are paid when required by the agreements. All significant violations with such agreements should be disclosed in the financial statements. Further, the County should accrue principal and interest payments that have been incurred but not paid at fiscal year-end.

09-07
The County needs to improve internal controls over capital assets reporting

Criteria: The County should accurately report capital assets in its financial statements in accordance with generally accepted accounting principles. To accomplish this, the County should maintain a reliable capital assets system and have procedures in place to accurately identify, record, and value capital assets.

Condition and context: Capital assets comprise 71 percent of the County's total assets. The County reconciled and properly reported the capital assets that were recorded on its main capital assets system. However, the County did not prepare complete reconciliations of capital assets maintained on separate systems at the Housing and Public Works Departments. As a result, capital assets recorded on the Housing Department's system did not agree to the amounts reported in the financial statements. Auditors also noted various errors in the Public Works Department's balances for land, infrastructure, and construction in progress. In addition, auditors were initially provided with detailed supporting schedules for capital assets that were incomplete and contained numerous errors.

Effect: As a result of the errors identified for the Housing Department's capital assets, beginning balances were restated by $6.3 million to correct errors from prior periods. As a result of the errors identified for the Public Works Department, the County's donated roads were undervalued by approximately $475,000, and land and constructed infrastructure assets were understated by another $1.1 million. In addition, many of the supporting capital assets schedules that were provided to auditors had to be corrected during the audit. Unless the County improves its internal controls, there is the potential for misstatements to occur in the financial statements that could remain undetected with the County's existing procedures for compiling the capital asset balances from departments that maintain separate records, such as the Housing and Public Works Departments. This finding is a significant deficiency in internal control over financial reporting.

Cause: The County's Finance Department, which prepares the financial statements, did not assign personnel to reconcile capital asset schedules maintained at the Housing and Public Works Departments to ensure that all assets were properly included in the capital asset listings. In addition, the schedules that support the capital asset balances and transactions reported in the financial statements were not reviewed for accuracy and completeness by someone with knowledge of generally accepted accounting principles.

Recommendation: To help the County ensure that its capital assets are properly reported in the financial statements, the County should prepare a complete reconciliation of its capital asset balances to supporting records maintained by individual departments annually and make all necessary corrections. In addition, the County should enforce its existing internal control policies and procedures, which require departments to perform an annual physical inventory of capital assets and submit supporting schedules and records for capital asset balances, additions, and disposals to the Finance Department. The Finance Department should review all schedules for accuracy and completeness.

This finding was similar to a prior-year finding.

09-08
The County should require supervisors to approve employees' time sheets

Criteria: The County should require that supervisors review and approve employees' time sheets to verify that the hours charged are accurate. This should be done prior to processing payroll.

Condition and context: Almost 60 percent of the County's total expenses consist of payroll and related expenses. While testing these expenses, auditors noted that for 5 of 48 payroll transactions tested, the employee's time sheet was not reviewed and approved by a supervisor.

Effect: There is a potential that employees may be paid incorrectly and that errors could remain undetected, resulting in misstated payroll expenses reported in the County's financial statements. This finding is a significant deficiency in internal control over financial reporting.

Cause: The County did not have policies and procedures requiring supervisors to review and approve employees' time sheets for accuracy prior to payroll being processed.

Recommendation: To help ensure that employees are accurately paid and payroll expenses are properly reported, the County should revise its existing payroll policies and procedures to require supervisors to review employees' time sheets prior to payroll processing. The County should then make sure that all supervisors are familiar with and follow these policies and procedures.

09-09
The County's Health and Human Services Department should issue contracts in compliance with county policies and procedures and retain records in accordance with the State's public records' retention requirements

Criteria: The County's purchasing policies and procedures help promote open and fair competition among vendors by ensuring that county contracts are properly approved and discussed by the Board of Supervisors in a public forum. Additionally, Arizona Revised Statutes provides authority to the Arizona State Library, Archives, and Public Records—Records Management Division for establishing standards and procedures for effective recordkeeping for state agencies, counties, and other local governments. In particular, the Records Management Division prescribes records' retention and disposal schedules for counties and mandates the minimum and maximum time that purchasing and procurement records should be retained.

Condition and context: As a result of investigating the contract discussed in item 09-10, auditors determined that the County's Health and Human Services Department improperly allowed a vendor to provide consulting services prior to the contract's approval and effective date. Additionally, the Health and Human Services Department failed to comply with county policies and state records' retention requirements since it did not retain the purchasing file related to a fiscal year 2008 request for proposal when procuring these services.

On December 14, 2007, the County's Health and Human Services Department—Pinal/Gila Long Term Care Division issued a request for proposal for consulting services to assist the County with the review, preparation, and submission of its proposal for the State's Acute Care Program. On March 26, 2008, the Board of Supervisors approved the contract for consulting services not to exceed $45,000; however, prior to this date, the consultant began providing services to the County in January 2008. Despite the contract's approval date of March 26, 2008, the consultant issued an invoice to the County for nearly $36,000 for work performed from January 23, 2008 to March 31, 2008. This contract was awarded to the same consultant as discussed in item 09-10.

Other than the request for proposal and the contract negotiated between the County and the consultant, the County was unable to provide other documentation relating to this purchase to evidence that the services were fairly procured, such as the consultant's initial proposal, unsuccessful proposal submissions, evidence noting the public opening of the proposals, evaluation committee ratings and interviews, best and final offers, and other related records.

Effect: The County Health and Human Services Department did not comply with county policies and state records' retention requirements. As a result, auditors were unable to determine if these services were properly procured or whether the contract was awarded to the firm most advantageous to the County. This finding is an instance of noncompliance.

Cause: The County's Health and Human Services Department failed to follow county policies when entering into contracts for consulting services. It also failed to monitor its contracts to ensure that services were provided to the County and paid for in accordance with the contract's terms and not prior to the contract's approval and effective date. Additionally, the Department failed to follow county policies and state requirements for retaining supporting documents related to the purchase of consulting services.

Recommendation: To help ensure the County properly contracts for professional services, the County should monitor departments to ensure adherence with established purchasing policies and procedures. The County and Health and Human Services Department should ensure that contracted services are not awarded, provided, or paid for prior to the Board of Supervisors' approval and the contract's effective date. In addition, the County should provide ongoing training to all county employees with record maintenance responsibilities. Further, the County's contract files, including requests for proposals, evaluation committee interviews and scoring documents, best and final offers, and award records must be retained for 6 years following the purchase or contract expiration. Unsuccessful bids must be retained for 3 years following the fiscal year received, if filed separately from the contract records.

09-10
The County's Health and Human Services Department should comply with state statutes and the County's purchasing policies and procedures

Criteria: Arizona Revised Statutes and the County's purchasing policies and procedures help to promote open and fair competition among vendors and help to ensure that the County receives the best possible value for the public monies it spends.

Condition and context: County employees and the County's Internal Audit Department informed our Office of possible violations of state laws and county policies and procedures when contracting for a particular consultant in fiscal year 2009. As a result of investigating this contract, auditors noted that two county employees failed to comply with these requirements when contracting for consulting services expected to exceed $50,000, the threshold above which competitive purchasing is required.

Specifically, an assistant county manager and a contract/grant coordinator awarded an additional contract for up to $60,000 to the same consultant discussed in item 09-09 to evaluate workflows and procurement processes within the County's Health and Human Services Department–Pinal/Gila Long Term Care–Network Development Division. This contract was awarded without issuing an invitation for bids or a request for proposals, as required by Arizona Revised Statutes §11-254.01 and the County's own policies. In fact, the employees awarded the contract as a sole source procurement. The County may award a contract for materials, services, or construction items without following the normal competitive purchasing procedures if it determines in writing that there is only one source for the required material, service, or construction item. County policy further states that sole source procurements should be avoided except when no reasonable alternative source exists. However, the consultant's services could have been provided by numerous other management consultants familiar with the healthcare industry. In fact, in March 2007, the County contracted with another consultant under similar circumstances to provide management consulting services to the County's Public Works Department.

Further, on March 18, 2009, the assistant county manager requested the Board of Supervisors' approval of the consultant's contract; however, the agenda item incorrectly presented the contract as an amendment instead of as a new contract and failed to provide the required written justification to use the sole source designation. The Board of Supervisors approved the agenda item as presented.

Effect: Because the County's Health and Human Services Department did not follow state statutes and county policies when procuring these services, the contract may not have been awarded to the firm most advantageous to the County. In August 2009, the County canceled the consultant's newest contract; however, the County had already paid approximately $25,406 to the consultant prior to canceling the contract. The consultant has yet to provide a written report or any other comprehensive document resulting from its services. Subsequently, the County has taken disciplinary action against both employees, and it has limited the assistant county manager's procurement authority to procuring only health professional and client service contracts. This finding is a significant deficiency in internal control over financial reporting and an instance of noncompliance.

Cause: The County's Health and Human Services Department did not follow state laws and established purchasing policies that required written justification for procuring this contractor as a sole source provider, including documenting reasons why no other vendor could provide the requested consulting services. Further, the County did not have procedures in place to prevent employees from circumventing its purchasing policies by using the sole source designation.

Recommendation: To help ensure that state statute and county purchasing policies and procedures are followed, the County should provide ongoing training to all county employees with purchasing responsibilities. The County should also monitor departments to ensure adherence with established procedures. In addition, the County's Health and Human Services Department should ensure that all employees adhere to the County's purchasing policies and procedures.

This finding is similar to deficiencies reported to county administrators and the Board of Supervisors in a fiscal year 2005 management letter and a December 2008 special investigative report. Additionally, in August 2009, the Pinal County Internal Audit Department issued a Memorandum to the County outlining similar findings.

09-11
The County Sheriff's Office should not violate the State's laws and Constitution related to public monies

Criteria: The Pinal County Sheriff's Office (PCSO) operates with public monies and, therefore, has a fiduciary responsibility to prudently manage money entrusted to it. Article IX, Section 7, of the Arizona Constitution, prohibits the County from making donations, grants, or subsidies to any individual, association, or corporation unless it benefits a public purpose and the public purpose is not far exceeded by the amount being paid. Further, Arizona Revised Statutes §35-301 prohibits the unlawful disbursement of public monies. In addition, documentation should be retained to substantiate that disbursements of public monies are for a county or other public purpose.

Condition and context: In November 2009, the County informed our Office about a $12,000 donation made by the PCSO to a private, nonprofit corporation. As a result of investigating this donation, auditors determined that the County and the former PCSO administration improperly made this donation and two additional donations, totaling $130,110. Specifically, auditors noted three instances in which the County donated public monies and failed to document the public purpose for the donation or require a written agreement between the County and the nonprofit corporations:

- On April 19, 2007, the PCSO improperly donated County Peace Officer Memorial Fund (Memorial Fund) monies totaling $60,474 to a private, nonprofit corporation. The monies were purportedly given to the nonprofit to help support and construct the Peace Officer Memorial, which has been constructed on land adjacent to the PCSO administration building. This Memorial acknowledges all Pinal County law enforcement and corrections officers who have died in the line of duty. The Memorial Fund was established in May 1999 to account for memorial-related revenues and expenditures. Monies in the Memorial Fund were held by the County Treasurer and considered public monies, which were subject to state laws, regulations, and procurement policies and procedures, unless specifically exempted. As of January 2010, the Memorial Fund contained $940.

- On October 3, 2007, the County improperly donated General Fund monies totaling $12,000 to a second nonprofit corporation. On August 21, 2007, the PCSO requested the Board of Supervisors' approval of a $12,000 donation to a private, nonprofit corporation, purportedly to help construct the Peace Officer Memorial. The Board of Supervisors subsequently approved the $12,000 donation during a board meeting on August 29, 2007, without discussing the public purpose for this donation and requiring a written agreement between the County and the nonprofit corporation.

- On November 20, 2007, the PCSO improperly donated a portion of its unused balance from the County Posse Fund totaling $57,636 to the same nonprofit corporation discussed in the second item above. The PCSO's Posse Fund was established in July 2003 to account for posse-related revenues and expenditures. Beginning in fiscal year 2004 and occurring each fiscal year thereafter, the County budgeted approximately $23,750 to $25,000 to the PCSO Posse to be used for various items, including ammunition, police equipment, and other miscellaneous items. These county monies, combined with other posse-related donations and revenues, were deposited into the Posse Fund held by the County Treasurer's Office. Any unspent monies at the end of each fiscal year remained in the Posse Fund and were available for use in the following year. Monies in the Posse Fund were public monies and were subject to state laws, regulations, and procurement policies and procedures, unless specifically exempted. As of January 2010, the Posse Fund contained $3,830.

Effect: By donating more than $130,000 of public monies to two private, nonprofit corporations, the County violated the State's laws and Constitution governing the use of public monies, did not fulfill its responsibility to prudently manage the monies entrusted to it, and did not design and implement sufficient internal controls to protect these monies. Because the County could not provide documentation to support these expenditures, auditors were unable to determine if the nonprofit corporations spent these monies for the intended purposes. This finding is a significant deficiency in internal control over financial reporting and an instance of noncompliance.

Cause: The County did not have any policies and procedures in place to ensure compliance with state laws related to the use of public monies.

Recommendation: To fulfill its fiduciary responsibility and to help ensure compliance with all applicable state laws, including those governing the use of public monies, the County should establish policies and procedures that prohibit gifts or loans to benefit any individual, association, or corporation. Instead of donating monies directly to nonprofit corporations, the County should negotiate and purchase items directly from the vendors responsible for the projects. The County should also require a written agreement between the County and any nonprofit corporation with which it does business. The agreement should document all services to be provided by the nonprofit corporation, establish accountability for those services, and restrict expenditures to only intended purposes. Finally, the County should retain supporting documentation for all county expenditures as required by its policies and procedures and state records' retention requirements.

Manuel González
Assistant County
Manager

Administrative
Services

PINAL • COUNTY
wide open opportunity

Terry Doolittle
County Manager

March 25, 2010

Debbie Davenport
Auditor General
2910 North 44th Street, Suite 410
Phoenix, AZ 85018

Dear Ms. Davenport:

The accompanying responses to the financial statement findings are providing you with the names of the contact persons responsible for corrective action, the corrective action planned, and the anticipated completion date for each audit finding included in the current year's financial statement findings.

Sincerely,

Yiannis Kalaitzidis, CPA
Finance Deputy Director

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Responses to Financial Statement Findings

09-01
The County should strengthen access controls for its general ledger accounting system
Contact Person: Richard Jones, Chief Information Officer
Anticipated completion date: See below

Concur.

The Pinal County IT Department will work with the financial system owners to develop written policies and procedures that govern system access to the general ledger system. A process is currently in place which requires each Department's supervisor and Finance Department approval.

1. Review of existing user access rights. Current system limitations prevent security permissions to be viewed comprehensively. This issue will be addressed when the new financial system is put in place. Estimated completion date is 12/31/2014.
2. Limit complete access to only those individuals needing it and develop procedures for monitoring and reviewing the activities of those who have complete access to the system. Current system limitations prevent security permissions to be viewed comprehensively. Implemented change management procedures do address the review and change of production system objects. Anticipated completion date is 12/31/10.
3. Access rights of terminated employees should be immediately removed from the system. IT currently has a process in place that removes system access within one business day of notification. We expect this Policy and Procedure to be completed by 6/30/10.

09-02
The County should strengthen change management controls for its general ledger accounting system
Contact Person: Richard Jones, Chief Information Officer
Anticipated Completion date: 4/30/10

Concur.

The Pinal County IT Department has been operating under IT Change Management Policy and Procedure since June of 2009. The IT Policy was submitted for BOS approval on 3/15/2010.

09-03
The County Treasurer's Office should strengthen controls over its computer system
Contact person: Levi Gibson, Chief Deputy Treasurer
Anticipated completion date: 12/31/10

The Pinal County Treasurer's Office is committed to safeguarding confidential financial information and data, as well as all monies entrusted to our office by participating political subdivisions within the county through developing and implementing adequate policies and procedures to ensure internal controls are in place and being followed. However, due to system and staffing limitations caused by the specialized knowledge requirements of the current system we have not been able to fully address all the auditors concerns.

As a result, the Treasurer's Office is in the process of developing a new information system to support the daily operations of our office. This system is being developed by Treasurer's IT Staff in conjunction with County IT Staff. This cross training between County IT Staff and Treasurer's IT Staff will allow for proper segregation of system development and programming function. In addition the system is being developed with greater functionality to allow better control of user access and the logging of changes to key tables within the system. Policies and procedures are also currently being developed to support this new system and ensure the proper segregation of duties so that no individual initiates transactions and also controls the authorization, recordkeeping, and asset custody for that transaction.

These policies and procedures will be implemented during the 2010-2011 fiscal year as the new Treasurer system is implemented.

09-04
The County should develop and test comprehensive disaster recovery plans for its computer systems
Contact Person: Richard Jones, Chief Information Officer
Anticipated completion date: 12/31/14

Concur.

On March 1st 2010 the Pinal County IT Department performed a system recovery test of the financial application and hardware. The test was successful as system and hardware were failed and restored to a separate location within the County. Policy and Procedures are being developed. The estimated due date for system recovery policy and procedures is June 30th. A copy of the completed system recovery plan will be distributed to all affected employees.

System encryption of backup tapes is limited to the version of the operating system. Encryption would require a major operating system upgrade or external software to complete the encryption; this is not feasible at this time. This issue will be addressed when the new financial system is put in place. Estimated completion date is 12/31/2014.

09-05
The County needs better procedures for ensuring its financial statements are accurate and complete
Contact person: Yiannis Kalaitzidis, Finance Deputy Director
Anticipated completion date: 06/30/11

The Finance Department has limited resources available for the preparation of the financial statements. Budget cuts at the beginning of fiscal year 2010 resulted in the loss of an Accounting Manager position dedicated to the task of preparing and reviewing the financial statements.

The Finance Department will be examining the current process to identify ways that will allow the County to produce accurate financial statements in fiscal year 2010. In addition, we will be asking for an additional position that will help ensure the proper segregation of duties during the preparation and review of the financial statements. Further, we will be coordinating with the auditor's and reviewing the supporting schedule preparation process to ensure the information being provided is consistent with the information necessary for the audit process.

09-06
The County should improve procedures for making principal and interest payments on its loans to ensure that it complies with loan agreements
Contact person: Tina Lawson, Business Manager
Anticipated completion date: N/A - Implemented July 2009

Concur.

Payment schedules and bank invoicing have been adjusted in accordance with the GADA loan agreement as of July 2009.

Further, the Finance Department is tracking all debt service payments to ensure payments are made in accordance with all loan agreements.

09-07
The County needs to improve internal controls over capital assets reporting
Contact person: Yiannis Kalaitzidis, Finance Deputy Director, Tina Lawson, Business Manager
Anticipated completion date: 6/30/11

Concur.

The Department of Finance has drafted an updated Capital Asset Policy which will provide guidance to all County departments to clarify and assign responsibility regarding the recording and valuation of capital assets.

In addition, the Department of Finance and the Department of Housing have been working to reconcile the capital assets recorded by the Housing Department to the assets recorded in the main capital asset system. This will help ensure that the amounts reported for the Department of Housing will be accurately reflected on the financial statements.

The Department of Finance will be reviewing the supporting schedule preparation process to ensure the information being provided is consistent with the information necessary for the audit process. Additionally, Finance will implement a review process to ensure the supporting schedules are consistent with the amounts being reported in the financial statements.

Further, the Public Works Department will implement additional processes & procedures to verify accuracy of asset specifications and asset valuations as well as asset listings.

09-08
The County should require supervisors to approve employees' time sheets
Contact person: Mike Arnold, Director, Human Resources
Anticipated completion date: 12/31/10

Pinal County Policy 3.50 Hours of Work discusses employee responsibility as it relates to Payroll timekeeping.

The policy not only requires that all time sheets be certified by the appropriate appointing authority, but also requires that time worked by non-exempt employees be reported on an hour by hour basis, that sick and vacation time be specifically recorded, and all absences be charged to the appropriate time off category.

The policy further discusses how overtime is to be counted and recorded.

Exempt employees should schedule their workdays with their supervisor so that at least 80 hours are worked in each two-week reporting period. Any time less than 80 hours must be reported and the appropriate leave time taken.

We will revise the policy, as follows, to provide further explanation as to the "certification" process.

"To certify the payroll, the employee's immediate supervisor, or the Supervisor/Manager most knowledgeable of the employees time worked, must review and sign the time sheet. Such signature will attest that the time entered is complete and accurate."

The County will also provide training on the updated payroll policy to all payroll coordinators and department directors.

09-09
The County's Health and Human Services Department should issue contracts in compliance with County policies and procedures and retain records in accordance with the State's public records' retention requirements
Contact person: Lisa Garcia, Assistant County Manager, Health and Human Services
Anticipated completion date: 12/31/10

Concur.

Health and Human Services (HHS) is developing a policy regarding records retention and destruction.

Health and Human Services along with the Purchasing Manager and the County Attorney is developing a training for contract and procurement staff to include; procurement code, purchasing, HHS specific contracting and procurement policies and procedures and desk tops.

09-10

The County's Health and Human Services Department should comply with state statutes and the County's purchasing policies and procedures
Contact person: Lisa Garcia, Assistant County Manager, Health and Human Services
Anticipated completion date: 12/31/10

Concur.

Health and Human Services (HHS) is developing a policy regarding monitoring of the contract and procurement processes.

Health and Human Services along with the Purchasing Manager and the County Attorney are developing a training for contract and procurement staff to include; procurement code, purchasing, HHS specific contracting and procurement policies and procedures and desk tops.

09-11

The County Sherriff's Office should not violate the State's laws and Constitution related to public monies
Contact person: Paul Babeu, Sheriff
Anticipated completion date: N/A - Implemented

The Sheriff's Office would like to note that all instances of state rule violations occurred in 2007 under a previous administration.

The Sheriff concurs with the auditor's finding and would like to note that there is no longer any commingling of public monies with private funds.

All funds raised for the Police Memorial and the Sheriff's Posse are raised privately and then deposited with a 501(c)(3) organization known as the Pinal County Justice Foundation.

It should be noted that the completed Peace Officer Memorial, constructed on County property, has the legitimate public purpose of honoring all peace officers who continually risk their lives to enforce the law and to protect the life, property and civil rights of the inhabitants of Pinal County, and of specifically honoring those peace officers who have lost their lives in the line of duty.