

REPORT HIGHLIGHTS
 SINGLE AUDIT

Subject

The State of Arizona spent \$9.7 billion of federal monies for federal programs administered, by 46 state agencies. The largest awards were for welfare, education, student financial aid, highway construction, research and development, and health services. The State must be accountable for its use of both federal and state monies, maintaining strong internal controls, and compliance with federal program requirements.

Our Conclusion

During the compliance audit, 27 federal programs were tested. The State maintained adequate internal controls over, and complied with, the federal compliance requirements for 5 of the 27 federal programs tested. However, for 22 federal programs tested, auditors found that the State did not maintain adequate internal controls or comply with one or more of the compliance requirements. In addition, auditors identified 42 deficiencies in internal control over financial reporting. See pages 2 through 4 for further information.



2007

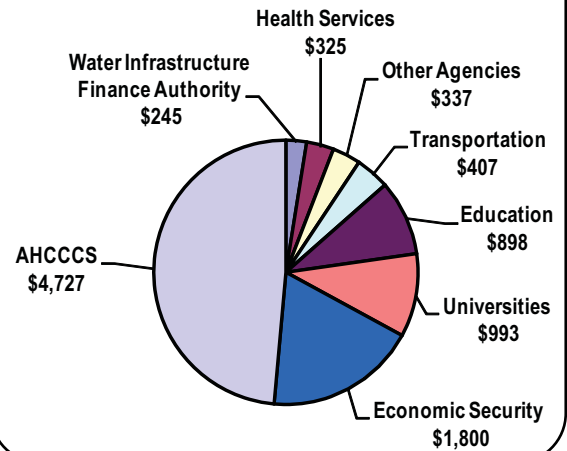
Year Ended June 30, 2007

Expenditures of Federal Monies Increased by \$365 Million

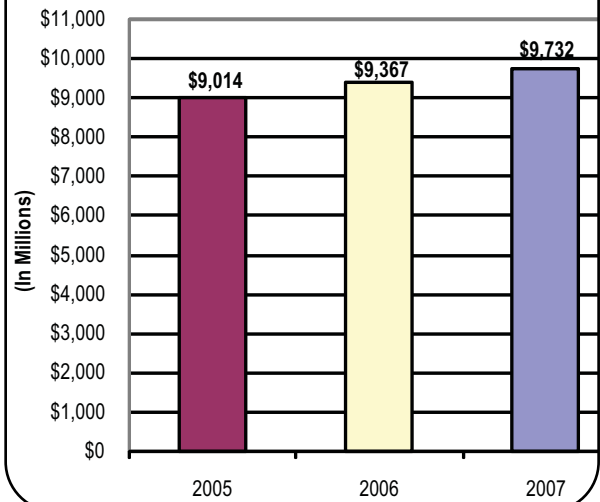
During fiscal year 2007, the State spent \$9.7 billion of federal monies. As shown in the chart to the right, seven entities administered 97 percent of these monies.

Overall, expenditures increased \$365 million, or 4 percent, from the \$9.4 billion expended in fiscal year 2006. The largest increase occurred in programs for indigent medical care, child nutrition and unemployment insurance. Combined expenditures for these programs increased by \$359 million from the prior year. This increase was attributable to inflationary increases in healthcare and food costs, and increases in unemployment payments. The largest increase, \$305 million, occurred in federal monies expended for indigent medical care by the Arizona Health Care Cost Containment System. As shown in the graph to the right, expenditures of federal monies have increased \$718 million between fiscal years 2005 and 2007. Expenditures for indigent medical care, education, child nutrition, and food stamps accounted for \$656 million of the increase.

State Agencies that Administer Federal Awards (In Millions)



Federal Programs Expenditures Fiscal Years 2005-2007



The State Did Not Always Comply with Federal Program Requirements

Auditors identified and tested 27 federal programs, including 11 program clusters, under the guidelines established by the Single Audit Act. Audit tests included evaluating the State's compliance with each program's federal regulations generally related to expending, monitoring, matching, and reporting federal awards. Auditors noted internal control weaknesses and instances of noncompliance with program requirements for 22 of the programs tested (see table below). For 15 of the 22 programs, the internal control weaknesses and instances of noncompliance with program requirements were considered to be material. As a result, our audit opinion

on federal compliance was modified because of noncompliance with federal requirements for the following programs: Food Stamp Cluster, Child Nutrition Cluster, Child and Adult Care Food Program, Emergency Food Assistance Cluster, WIA Cluster, Special Education Cluster (IDEA), Title I Grants to Local Educational Agencies, Migrant Education—State Grant Program, Rehabilitation Services—Vocational Rehabilitation Grants to States, Reading First State Grants, Improving Teacher Quality State Grants, Temporary Assistance for Needy Families (TANF), Foster Care—Title VI-E, Urban Areas Security Initiative, and Homeland Security Grant Program Cluster.

Summary of Internal Control Weaknesses and Instances of Noncompliance for Major Federal Programs

Program	Responsible Department	Activities ¹	Cash ²	Costs ³	Type of Compliance Requirement					
					Eligibility ⁴	Match ⁵	Monitor ⁶	Report ⁷	Special ⁸	Procurement ⁹
Child Support Enforcement	Economic Security	X		X			X			
Emergency Food Asst.	Economic Security						X			
Food Stamp Cluster	Economic Security			X					X	
Foster Care—Title IV-E	Economic Security	X		X						
SSBG	Economic Security	X		X						
RS	Economic Security				X			X		
SSDI	Economic Security							X		
TANF	Economic Security	X		X	X					
Unemployment Insurance	Economic Security	X		X	X					
WIA Cluster	Economic Security							X		X
CACFP	Education	X		X				X	X	
Child Nutrition Cluster	Education	X		X	X			X	X	
Improving Teacher Quality	Education		X	X				X		X
Migrant Education	Education		X	X				X	X	
Reading First	Education			X				X		
Special Education Cluster	Education		X	X		X		X		
Title I Grants	Education		X	X				X		X
WIC	Health Services			X						
CDCP	Health Services			X						
Homeland Security Cluster	Military Affairs		X	X				X		
Urban Areas Security	Military Affairs		X	X				X		
Research & Development	Universities			X						

- SSBG – Social Services Block Grant
- RS – Rehabilitation Services—Vocational Rehabilitation Grants to States
- SSDI – Social Security—Disability Insurance
- TANF – Temporary Assistance for Needy Families
- CACFP – Child and Adult Care Food Program
- WIC – Special Supplemental Nutrition Program for Women, Infants, and Children
- CDCP – Centers for Disease Control and Prevention—Investigations and Technical Assistance

- ¹Activities: Federal monies were expended for unallowable activities.
- ²Cash: Federal monies requested and received were in excess of, or not sufficient for, immediate program needs.
- ³Costs: Federal monies were expended for unallowable costs.
- ⁴Eligibility: Benefits were awarded to ineligible participants.
- ⁵Match: Federal monies were not matched with state monies or a specified level of service was not maintained.
- ⁶Monitor: Subrecipients were not monitored to ensure they administered awards in compliance with federal requirements.
- ⁷Report: Financial or program data reported to federal grantors was not accurate or timely.
- ⁸Special: Noncompliance with special requirements unique to the program.
- ⁹Procurement: Noncompliance with procurement and suspension and debarment requirements.

The Department of Economic Security Did Not Materially Comply with Program Requirements for Six Programs

The Department of Economic Security receives federal monies to help administer assistance programs to recipients throughout the State of Arizona. For the period of July 1, 2006 through June 30, 2007, the Department received almost \$1.8 billion in federal financial assistance. However, for the audit period, the Department did not materially comply with federal requirements for six of its programs tested. Our report indicates the following programs had material internal control weaknesses and material instances of noncompliance with federal requirements:

- The Division of Benefits and Medical Eligibility, Family Assistance Administration offices did not comply with special tests and provisions requirements for the Food Stamp Cluster, as it did not always follow the internal control policies and procedures for activating and issuing electronic benefits transfer (EBT) cards. In addition, three employees manipulated the eligibility verification system to issue EBT cards for personal use. This resulted in known questioned costs of \$75,185. The Department referred these matters to the Arizona Attorney General's Office for further investigation and prosecution.
- The Division of Benefits and Medical Eligibility, Family Assistance Administration offices did not comply with activities allowed or unallowed, allowable costs/cost principles, and eligibility requirements for the TANF program, since it did not always follow the internal control policies and procedures for activating and issuing EBT cards. This resulted in known questioned costs of \$2,127.
- The Division of Employment and Rehabilitation Services, Rehabilitation Services Administration did not comply with eligibility requirements for the Rehabilitation Services—Vocational Rehabilitation Grants to States program.
- The Division of Children, Youth, and Families did not comply with activities allowed or unallowed and allowable costs/cost principles requirements for the Foster Care—Title IV-E program. These instances of noncompliance resulted in a questioned cost of approximately \$4,615,756.
- The Division of Employment and Rehabilitation Services did not comply with suspension and debarment requirements for the WIA Cluster.
- The Office of Community Partnerships and Innovative Practices did not comply with subrecipient monitoring requirements for the Emergency Food Assistance Cluster.

The Department of Education Did Not Materially Comply with Subrecipient Monitoring Requirements

The Department of Education expended approximately \$898 million in federal awards on various education and assistance programs during the fiscal year. Most of these federal awards are passed through to charter schools and school districts. Accordingly, the Department is responsible for monitoring schools' use of these monies, as required by OMB Circular A-133, §.400(d), to ensure they comply with federal requirements. Specifically, the

Department's Audit Unit is responsible for obtaining and reviewing the single audit reports from charter schools and school districts that expend more than \$500,000 in federal awards. However, as indicated in our report, the Department did not always comply with these monitoring requirements, since the following internal control weaknesses and instances of noncompliance were noted:

- Single audit reports were not always received within 9 months of the subrecipient's fiscal year-end.
- Documentation supporting the Department's action taken for ensuring that the audit requirements were met was not always maintained.
- Management decisions were not issued on subrecipients' audit findings within 6 months after receipt of the subrecipient's audit.

These items were noted for the following federal programs: Child Nutrition Cluster, Child and Adult Care Food Program, Title I Grants to Local Educational Agencies, Migrant Education—State Grant Program, Special Education Cluster, Reading First State Grants, and Improving Teacher Quality State Grants. In addition, this finding could potentially impact other federal programs administered by the Department.

Fifteen Material Weaknesses Were Identified in Internal Control over Financial Reporting

Auditors identified 42 deficiencies in internal control over financial reporting. Fifteen of these deficiencies were material weaknesses. A material weakness is a weakness in internal controls that could lead to a material misstatement of the State's financial statements. The more significant material weaknesses were as follows:

- The Department of Administration's Director lacked the authority to enforce rules over financial reporting.
- The Department of Economic Security did not comply with its computer access policies and procedures.
- The Department of Economic Security's Division of Developmental Disabilities did not have effective internal control policies and procedures over its claims processing system. In addition, the Division did not ensure its financial statements were accurate, had weak computer access controls and program change controls, and did not implement previously reported recommendations.
- The Department of Revenue did not establish effective controls over tobacco taxes and did not accurately record and report taxpayer receivables.

TO OBTAIN MORE INFORMATION

A copy of the full report can be obtained by calling
(602) 553-0333



or by visiting our Web site at:
www.azauditor.gov

Contact person for this report:
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Single Audit Fact Sheet

- Forty-two weaknesses in financial reporting internal controls, including 15 material weaknesses.
- Twenty-eight findings identifying weaknesses in federal compliance internal controls, including 13 material weaknesses.
- Twenty-seven findings identifying violations of federal program compliance requirements, including 12 material violations.
- Program costs totaling \$5,145,358 were questioned as a result of our audit.