



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Procedural Review

Arizona State Schools for the Deaf and the Blind

As of June 20, 2012



Debra K. Davenport
Auditor General

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AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

August 10, 2012

Robert Hill, Superintendent
Arizona State Schools for the Deaf and the Blind
P.O. Box 88510
Tucson, AZ 85754

Subject: Procedural Review Letter

Dear Mr. Hill:

We have performed a procedural review of the Arizona State Schools for the Deaf and the Blind's (ASDB) internal controls in effect as of June 20, 2012. Our review consisted primarily of inquiries, observations, and selected tests of internal control policies and procedures, accounting records, and related documents. The review was more limited than would be necessary to give an opinion on internal controls. Accordingly, we do not express an opinion on the effectiveness of internal controls or ensure that all deficiencies in internal controls are disclosed.

Specifically we reviewed cash receipts, cash disbursements, purchasing, payroll, journal entries and transfers, and capital assets.

The Office of the Auditor General is also conducting a performance audit and sunset review of the ASDB. The results of that audit will be issued on a subsequent date.

As a result of our review, we noted certain deficiencies in internal controls that the ASDB's management should correct to ensure that it fulfills its responsibility to establish and maintain adequate internal controls. Our findings are described below. Our review also disclosed minor internal control deficiencies that we have communicated directly to your staff.

The ASDB should adhere to its and the State's procurement policies

Accounting for expenditures is a critical activity in any governmental organization and ASDB must comply with all applicable statutory and State of Arizona Accounting Manual (SAAM) requirements related to purchasing. Arizona Revised Statutes (A.R.S.) §41-2513(E), requires that payment for any services shall not be made unless pursuant to a fully approved written contract. Furthermore, the SAAM, Section II-H-1, Subsection IV.B.9, requires that all purchases be approved by the appropriate levels of management.

During the period July 1, 2011 through December 31, 2011, ASDB expended \$4.6 million in non-payroll related charges. However, auditors determined that the ASDB purchased various services from a vendor without an active written contract. Purchased services consisted of education and special training for blind

or visually handicapped preschool children as well as other counseling services for parents and families of blind or visually handicapped children. The most recent written contract with this vendor expired on June 30, 2010, but the ASDB continued to use this vendor in accordance with the terms of the expired contract. Auditors identified all cash disbursements made to the vendor during the 6-month procedural review period and determined that these transactions totaled approximately \$526,000. The ASDB's management indicated that this vendor was the sole Phoenix-area provider of these services, and the contract was not extended because of service concerns. However, the ASDB continued to use this vendor because it determined these services were necessary to fulfill its statutory mission.

Furthermore, the ASDB ordered and received various goods and services prior to obtaining the appropriate approvals. Specifically, for 5 of 32 disbursement transactions tested, purchases were made before receiving purchasing department approval. These purchases were retroactively approved before payments were made to the vendors.

Recommendation

To help ensure that expenditures are adequately controlled and to comply with Arizona Revised Statutes, the ASDB should prepare a written contract that is signed by the appropriate parties in accordance with the State's procurement code prior to purchasing goods or services. Further, to help comply with the SAAM, the ASDB should enforce its internal policy to hold violating employees liable for the cost of unauthorized purchases.

The ASDB should establish effective logical access controls and separate responsibilities for payroll processing

Effective controls over payroll processing and information technology require management to adopt sound accounting policies and to establish and maintain internal controls that will help the ASDB initiate, authorize, record, process, and report accurate payroll transactions. However, auditors determined that the ASDB granted various employees excessive logical access to important payroll information. Specifically, payroll staff had the authority to change employee pay rates in the ASDB's payroll system, and there was a lack of effective and consistently applied controls to ensure that only authorized and appropriate changes were made. Furthermore, employees other than the payroll staff had the ability to change certain spreadsheets housed on the ASDB's network that payroll staff used to help ensure accurate payroll processing. As a result, errors could occur. Management indicated that pay rates stored in the ASDB payroll system were compared to pay rates in the State's HRIS payroll and personnel system periodically; however, auditors determined this comparison was not an effective control since it was not performed consistently and there was no documented evidence that it was done.

Recommendation

To help strengthen controls over payroll processing and over information technology, the ASDB should limit logical access to its payroll system and related files to as few employees as possible. The ASDB should also evaluate its separation of responsibilities for personnel and payroll and alter assignments to help prevent under- or over-payments due to error or fraud.

The ASDB should strengthen its controls over capital assets

The ASDB has invested a significant amount of money in its capital assets, which consist of land, buildings, and equipment. As of December 31, 2011, the ASDB had \$12,675,413 reported on the State's Fixed Assets Subsystem (FAS). This investment of public monies should be safeguarded. The SAAM, Section II-G-1, requires each agency to safeguard and report capital assets, and provides policies for the agency to follow. However, auditors were unable to determine the completeness and accuracy of ASDB's capital assets reported on FAS as the ASDB had not conducted a physical inventory of its capital assets in over a decade. Auditors also identified additional deficiencies related to capital assets described below.

Capital Assets Listing Was Not Accurate

The SAAM allows assets to be entered on the FAS at any cost. This allows agencies to maintain lists of assets that include capital assets, those assets that cost \$5,000 or more, and for noncapital assets, those assets that cost less than \$5,000, for stewardship purposes. If an agency enters assets that are under \$5,000 for stewardship purposes, those assets should be designated as noncapital assets, rather than capital assets, on the FAS. This designation is vital for accurate financial statements, since it affects capital assets and accumulated depreciation balances as well as depreciation expense. Further, the SAAM indicates that capital assets that have been purchased or retired should be recorded as added or disposed of on the FAS within 5 working days from the date the asset was paid for or within 5 working days of the disposal date. In order to maintain an accurate listing on the FAS and to help safeguard capital assets, the SAAM requires each agency to perform a physical inventory of its capital assets annually.

Auditors selected 23 assets for test work and noted the following errors: one asset could not be located, one asset was not at the location identified on the FAS, one asset was tagged with the incorrect property control tag number, and one asset had an incorrect serial number recorded on the FAS. Auditors also noted that the ASDB purchased ten capital assets totaling \$109,984 between 2007 and 2011 that were designated as noncapital on the FAS. Consequently, the capital assets, related accumulated depreciation, and related depreciation expense have not been included in the State's financial statements since their purchase. Additionally, auditors found a tractor the ASDB owned that was tagged as a capital asset; however, it was not included on the FAS. Misstatements related to the tractor are unknown because the vendor's invoice could not be located.

The ASDB reported that there were no capital asset disposals for the period July 1, 2011 through December 31, 2011; however, auditors examined the Property Disposal Request and Authorization forms submitted during this period and determined there were seven capital assets retired totaling \$100,965 that were not removed from the FAS. Of the seven, only three capital assets totaling \$50,791 were entered on the FAS when acquired. In addition, auditors noted that five capital assets totaling \$80,038 had been disposed of but were not removed from the assets listing when the disposals occurred between 2000 and 2011. All of these assets were fully depreciated at December 31, 2011.

Fixed Assets Closing Package Was Not Prepared

The Arizona Department of Administration General Accounting Office (GAO) requires state agencies to submit financial and other data on annual Closing Package forms to assist the State in preparing its annual financial statements. ASDB was required to submit the Fixed Assets Closing Package at June 30, 2011, to the GAO by August 19, 2011; however, this information was never prepared and submitted.

Recommendations

To help strengthen controls over capital assets and help ensure that capital assets are recorded, maintained, and disposed of properly, the ASDB should enforce the following policies outlined in the SAAM, Section II-G-1:

- Report all capital assets on the FAS.
- Add new capital assets to the FAS within 5 working days from the date the asset was paid for.
- Remove assets from the FAS within 5 working days of the disposal date.
- Remove assets from the FAS that are damaged, thrown away, or turned over to Surplus Property in a timely manner.
- Retain all documentation relating to capital assets' acquisition and disposal for 3 years after the end of the fiscal year in which the assets were disposed of.
- Tag or specifically identify all capital asset items to the extent practicable.
- Perform a physical inventory of capital assets annually.
- Update the FAS for asset location changes.
- Submit a Fixed Assets Closing Package to the GAO annually by the required deadline.

This letter is intended solely for the information and use of the Arizona State Schools for the Deaf and the Blind and is not intended to be and should not be used by anyone other than the specified party. However, this letter is a matter of public record, and its distribution is not limited.

Should you have any questions concerning our procedural review, please let us know.

Sincerely,

Jay Zsorey, CPA
Financial Audit Director

cc: Board of Directors Members, Arizona State Schools for the Deaf and the Blind
Terry Pritchard, Operations Manager
Maria Murphy, Director of Human Resources
Lee Bergman, Purchasing Manager
Tammy Kelly-Meixner, Funds/Grants Manager
Leah Morris-Towle, Payroll Manager

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August 10, 2012

Mr. Jay Zsorey
Financial Audit Director
Office of the Auditor General
2910 N 44th Street, Suite 410
Phoenix, AZ 85018

Subject: Procedural Review Letter

Dear Mr. Zsorey:

I am in receipt of your procedural review of the Arizona State Schools for the Deaf and the Blind's (ASDB) internal controls in effect for the period of July 1, 2011 through December 31, 2011. The review identifies three specific areas in which ASDB could continue to improve in:

1. The ASDB should adhere to its and the State's procurement policies.

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

ASDB will assure that all required contracts are prepared and executed in a timely manner. The situations that made this an issue have been and will continue to be addressed to prevent such events in the future.

ASDB will eliminate unauthorized purchases through a variety of means over the coming fiscal year. This will include staff training on procurement rules, working with individuals to identify roadblocks to submitting requisitions prior to ordering, then develop new procedures to eliminate those roadblocks, notifying staff members (and their supervisors) in writing each time a violation of procurement requirements occur, and appropriate discipline for repeat violators.

2. The ASDB should establish effective logical access controls and separate responsibilities for payroll processing.

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Steps have been taken to address the concerns identified by the audit.

3. The ASDB should strengthen its controls over capital assets.

The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

ASDB has established an improved mechanism to ensure the management of our capital assets. Procedures to allow that mechanism to fully meet that task are currently being developed, and will be implemented shortly.

I would like to thank you and your team for their work in identifying specific areas ASDB can focus our resources upon to improve our agency.

Sincerely,

Robert E. Hill
Superintendent

