



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Report on Internal Control and Compliance

Arizona State Treasurer

Year Ended June 30, 2008



Debra K. Davenport
Auditor General

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Arizona State Treasurer
Report on Internal Control and Compliance
Year Ended June 30, 2008

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**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

DEBRA K. DAVENPORT, CPA
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 Financial
Statements Performed in Accordance with *Government Auditing Standards***

Members of the Arizona State Legislature

The Honorable Dean Martin, State Treasurer

We have audited the financial statements of the fiduciary funds of the Office of the Arizona State Treasurer, as of and for the year ended June 30, 2008, and have issued our report thereon dated October 30, 2008. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Office's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements of the fiduciary funds, but not for the purpose of expressing an opinion on the effectiveness of the Office's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Office'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 that might be significant deficiencies or material weaknesses. However, as discussed below, we identified one deficiency in internal control over financial reporting that we consider to be a significant deficiency.

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 Office'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 Office's financial statements of the fiduciary funds that is more than inconsequential will not be prevented or detected by the Office's internal control. We consider the deficiency described in the accompanying summary to be a significant deficiency 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 financial statements of the fiduciary funds will not be prevented or detected by the Office'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 material weaknesses. However, we do not believe the significant deficiency described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Office's financial statements of the fiduciary funds are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Office's response to the finding identified in our audit has been included herein. We did not audit the Office's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the members of the Arizona State Legislature, the Arizona State Treasurer, and management 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.

Debbie Davenport
Auditor General

October 30, 2008

Arizona State Treasurer
Schedule of Findings and Recommendations
Year Ended June 30, 2008

08-01

The Office of the Arizona State Treasurer needs to fully develop and test a disaster recovery plan for its investment system

The Office of the Arizona State Treasurer uses the Q2 System, including its various modules (IT System), to record all deposit, withdrawal, transfer, purchase, reinvestment, and sale transactions for all participants in the various Treasurer's investment pools and accounts. Therefore, it is vital for the Office to ensure that it can continue to operate in the event of a system or equipment failure by developing, implementing, and testing a disaster recovery plan. A written and properly designed disaster recovery plan helps ensure that proper procedures are in place to provide for continuity of operations and that electronic data files are not lost in the event of a disaster or other interruption. The Office had agreements for an off-site recovery and data storage facility, and for the necessary hardware and software. Further, the Office had identified the key personnel required for the IT System recovery effort. However, the Office had not documented these elements and other necessary procedures in a formal written plan.

To help ensure that the Office can continue its operations in the event of a major system or equipment failure, the Office should fully develop, document, maintain, and test a written disaster recovery plan. Although the Office has established certain elements of disaster recovery, the Office should ensure the plan is complete by including the following:

- A risk analysis identifying the critical functions, exposures, and an assessment of the impact on the State and investment pool participants.
- The list of key personnel assigned to the recovery effort, including names, telephone numbers, assignments, and responsibilities.
- Specific operating procedures, including detailed steps documenting how critical functions would be restored.
- A testing schedule of the disaster recovery plan.
- Details of the off-site storage and recovery location.
- A follow-up action plan from test results.

Further, this plan should be approved by the necessary management, be stored off-site with the backup data files, and be updated and tested annually.



OFFICE OF THE
ARIZONA STATE TREASURER



HON. DEAN MARTIN
TREASURER

November 26, 2008

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

Dear Ms. Davenport,

The following is our response and corrective action plan to your report on internal control over financial reporting for finding 08-01:

The Arizona State Treasurer needs to fully develop and test a disaster recovery plan for its IT system.

We concur with finding 08-01 and understand the importance of a fully tested and up to date IT disaster recovery plan. We had requested and received funds in the original 2008 budget for purchase of needed equipment for disaster recovery implementation. However later budget cuts eliminated the funding.

Because of the importance of disaster recovery, I have shifted resources so we could continue to move forward with this effort despite losing funding for it during last fiscal year's budget cuts. The lack of funds has slowed implementation, but we can report significant progress. We anticipate completion this fiscal year.

Currently, we have arrangements with the Department of Emergency & Military Affairs and the Arizona State Retirement System to establish temporary off site operations in the event of disaster. Daily backups are performed and the data is stored off site in a secured location on a monthly basis. We are in the process of establishing an offsite SAN (storage area network). Trading room personnel have successfully operated remotely via secured laptops and biometric access units that allow them to complete their duties at any offsite location with internet access. We will continue to strive to complete existing efforts, documentation and testing as resources will allow.

If you have any questions, please contact me at the number listed below.

Sincerely,

Dean Martin
State Treasurer