



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

Apache County

Year Ended June 30, 2002



Debra K. Davenport
Auditor General

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

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

September 9, 2003

Board of Supervisors
Apache County
P.O. Box 428
St. Johns, AZ 85936

Members of the Board:

In planning and conducting our single audit of Apache County for the year ended June 30, 2002, we performed the following as required by *Government Auditing Standards* (GAS) and Office of Management and Budget (OMB) Circular A-133:

- Considered the County's internal controls over financial reporting,
- Tested its internal controls over major federal programs, and
- Tested its compliance with laws and regulations that could have a direct and material effect on its financial statements and major federal programs.

All audit findings that are required to be reported by GAS and OMB Circular A-133 have been included in the County's Single Audit Reporting Package for the year ended June 30, 2002. In addition, our audit disclosed internal control weaknesses that do not meet the reporting criteria. Management should correct these deficiencies to ensure that it fulfills its responsibility to establish and maintain adequate internal controls. Our recommendations are described in the accompanying summary.

This letter is intended solely for the information of the Apache County Board of Supervisors 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 its contents, please let us know.

Sincerely,

Dennis L. Mattheisen, CPA
Financial Audit Director

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The County needs to improve its capital assets reporting

The County's capital assets represent a major investment of taxpayer monies. Maintaining complete and accurate accounting records is essential to safeguard those assets against theft and misuse; to provide documentation for insurance purposes; to effectively plan future acquisitions, replacements, and maintenance; and to accurately report them in the financial statements. However, the County had not established adequate internal control policies and procedures that would ensure that capital assets were accurately reported. Specifically, the County's capital assets listing included \$1.2 million of assets that did not meet the County's capitalization policy. In addition, the capital assets listing was not updated for all current year acquisitions or deletions, and costs related to completed construction projects were not transferred to the appropriate capital assets account. Finally, the capital assets physical inventory was performed by an employee who was responsible for maintaining capital assets records. A similar deficiency was reported in last year's management letter. The County adjusted the general purpose financial statements for all errors noted by auditors.

To help ensure that capital assets are adequately controlled, safeguarded, and reported, the County should establish and follow policies and procedures that include the following:

- Prepare and maintain a current capital assets listing for land, buildings, improvements other than buildings, and machinery and equipment. Include all assets costing more than the County's capitalization threshold.
- Reconcile items added to the list each year to capital expenditures, and the current year capital assets listing to the prior year listing, taking into account assets acquired and disposed of during the year. Document all reconciling items, and make all necessary corrections onto the listing.
- Transfer costs for completed construction projects to the appropriate capital assets accounts.
- Inform employees of capital assets control policies and procedures, and perform periodic checks to ensure that employees are following policies and procedures.
- Perform a complete physical inventory of capital assets every 3 years. Assign an employee who is not responsible for asset custody or maintaining the capital assets listing.

The County needs to improve controls over its information system

The County uses a computerized accounting and information system to record and process its financial transactions critical to the County's continuing operations. A small number of employees manage the County's computer operations; therefore written policies and procedures over its computer operations should serve as a reference guide and ensure the accuracy and continuity in processing transactions in the event of employee extended leave or turnover. In addition, it is vital that the County have a disaster recovery plan in place so it will be able to process its financial transactions should a major computer hardware or software failure occur. However, the County lacked detailed written policy and procedures, and had not prepared a disaster recovery plan. Further, procedures for making changes to computer programs allowed one employee to approve, design, test, document, and implement computer program changes which no single individual should control.

Written policies and procedures provide guidance for controlling daily operations, help ensure continuity in processing transactions, and serve as a reference guide for employees. Therefore, the County should develop written policies and procedures that address security of sensitive information recorded on the system; protection of the system from physical and logical unrestricted or unauthorized access; program changes and maintenance; computer operations; database management; and input, output, and processing controls to ensure the completeness and accuracy of transactions processed.

In addition, the County should prepare a disaster recovery plan as soon as possible. The plan should be stored off-site, and updated and tested regularly. Also, the plan should include the following:

- Personnel assigned to disaster teams with operating procedures and emergency phone numbers to reach them.
- Written equipment backup agreements to help ensure processing continuity of critical financial transactions, including a designated physical facility.
- System backup procedures and a backup site facility.

Finally, the County should ensure that no one employee be allowed to approve, design, test, document, and implement changes to computer programs.

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KARLA F. JAMES
Finance Director
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September 2, 2003

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

Dear Ms. Davenport:

The following is the County's response to the findings outlined in the Management Letter for the year ended June 30, 2002.

The County needs to improve its capital assets reporting.

We concur that asset records do contain items that are showing values less than the threshold. At any given time most of these asset items will be purchases relating to construction in progress and, therefore, are a part of what will be consolidated into one asset item once construction is completed. At this time, reclassification of construction in progress to buildings is in process.

In addition to the construction in progress purchases, there will be some individual items on the listing valued at less than the threshold but capitalized due to tracking and liability considerations. Policy for this action was adopted by the County Board of Supervisors on May 20, 2003.

The County has been reconciling current year additions and deletions to current year ledger activity on an annual basis. These reconciliations show reconciling items incorporated in the listing valuations and identified by code.

The County no longer uses employees involved in the assets record keeping for the taking of physical inventories. Roads related assets are inventoried by an employee from the County Roads Engineering Office. All other inventories are taken by the assigned property control officer and the department head for each department. Inventories are being taken on a three year rotating schedule.

The County needs to improve controls over its information system.

We concur. The weakness concerning a single employee making programming changes will no longer exist once the County has implemented the new software package scheduled for mid year FY2004. Programming changes will no longer be made in-house.

The County recognizes the need for written policies and procedures. It is expected that this documentation will not be produced until sometime after the new software has been implemented and sufficient time has passed to become thoroughly familiar with it.

Currently, weekly backup tapes are stored off site at a secure location. In the event of a major shutdown of hardware at one site, there is duplicate hardware at a second site which can be used. In the event of a more major breakdown, the County would seek assistance in the nature of equipment sharing from our neighboring county.

The writing of policies and procedures in regards to disaster plans as well as daily operations will be done as staffing and time allows.

Sincerely,

Karla F. James
Finance Director