



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

Pima County

Year Ended June 30, 2006



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

May 29, 2007

Board of Supervisors
Pima County
130 West Congress Street, 11th Floor
Tucson, AZ 85701-1317

Members of the Board:

In planning and conducting our single audit of Pima County for the year ended June 30, 2006, 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 in the GAS and OMB Circular A-133 reports have been included in the County's Single Audit Reporting Package for the year ended June 30, 2006. In addition, our audit disclosed internal control weaknesses and instances of noncompliance with laws and regulations 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 and comply with laws and regulations. Our recommendations are described in the accompanying summary.

This letter is intended solely for the information of the Pima 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

TABLE OF CONTENTS



Recommendation 1: Pima County should strengthen
controls over investment activities

1

Recommendation 2: The Public Fiduciary's Office
should properly administer wards' assets

2

County Response

Pima County should strengthen controls over investment activities

The Pima County Treasurer's Office is entrusted with managing and investing more than \$600 million in public monies. Of these monies, approximately 55 percent is for Pima County, and the remainder is for other political subdivisions, including school and fire districts. Historically, the County Treasurer only invested in the Arizona State Treasurer's investment pools. However, in April 2006 the County Treasurer began investing in mortgage-backed securities, repurchase agreements, and commercial paper. At June 30, 2006, the County Treasurer had \$420 million dollars in these investments and \$195 million invested in the State Treasurer's investment pools.

To fulfill the responsibility of managing these monies, the County Treasurer's Office has the responsibility to ensure that internal controls are in place and functioning properly to safeguard public monies, promote overall operating efficiency and effectiveness, and ensure compliance with investment laws and regulations. However, at June 30, 2006, the County Treasurer's Office did not have written investment policies and procedures to ensure that incompatible investment responsibilities were separated among employees and to independently verify the reliability of investment advice from its investment advisors. In addition, investment services, including investment advice, buying and selling securities, and the safekeeping and handling of purchased securities were provided by the County's servicing bank through a contract that did not include any investment services provisions. Furthermore, the County had not obtained competitive bids for these types of investment services and could not ensure it received the best value for the public monies it spent for investment services. Finally, Arizona Revised Statutes (A.R.S.) §35-327 requires county treasurers to deposit securities with trust departments to reduce the risk of investment losses in the case of failures of investment brokers or issuers. However, the County's investments were held by its servicing bank that also purchased and sold investments for the County. The servicing bank also recommended and sold its own investments to the County. Therefore, the County was at risk of losing a large portion of its invested monies if its servicing bank failed.

Because the County Treasurer's Office invests monies in mortgage-backed securities, repurchase agreements, commercial paper, and other investments outside of the Arizona State Treasurer, it should have adequate policies and procedures in place to safeguard investments. Therefore, to help ensure that the County Treasurer's Office adequately manages public monies of the County and related political subdivisions, the County should implement the following:

Investment Policies and Procedures—Establish written investment policies and procedures for controlling, reviewing, and authorizing investment transactions. The policies should include procedures to separate investment responsibilities among employees, such as making investment decisions, maintaining custody of investment-related documents, and recording investment activity in the accounting records. The policies should also require that the Treasurer’s Office obtain investment information from an independent source, such as an on-line investment data service, to provide the Treasurer’s Office with up-to-the-minute prices, current and historic economic indicators, and other information necessary to evaluate investment advice of contract providers and should also specify the necessary verification procedures to help make sound investment decisions.

Investment Services Contract—Ensure that its investment services are specified under the terms of enforceable, competitively procured contracts.

Custody of Securities—Procure the services of its servicing bank’s trust department or an independent third-party trust department to hold purchased securities to ensure compliance with A.R.S. §35-327.

The Public Fiduciary’s Office should properly administer wards’ assets

State statutes require counties to provide the monies necessary to operate a public fiduciary’s office and require fiduciaries to exercise extreme care and diligence when making decisions on behalf of wards. However, the Pima County Public Fiduciary’s Office did not always follow state statutes because it did not distribute interest earned on the wards’ shared checking account to the wards’ accounts. Instead, the Office used interest earned on the wards’ shared checking account to pay a portion of the Office’s operating costs. In addition, the Office did not follow the County’s competitive purchasing policies and procedures to procure the banking agreement for the wards’ shared checking account. Because the Office did not use competitive procurement practices, it could not ensure that the wards received the highest possible return on their deposits. Recommendations to correct deficiencies in the administration of wards’ assets have been provided to the Pima County Public Fiduciary’s Office since fiscal year 2001.

To help ensure the Public Fiduciary’s Office properly administers wards’ assets, the Office should implement the following:

Procurement—Competitively bid banking services following the County’s purchasing policies and procedures to ensure the wards receive the best possible value and the highest interest earnings on the shared wards’ checking account.

Interest Earnings—Distribute interest earnings on the wards' shared checking account to the wards' balances at least quarterly based on their average balances. Interest earnings should not be used to pay for the Office's operating expenditures.

Operating Costs—Budget operating expenditures so that the monies the County provides are adequate to operate the Office as required by A.R.S. §14-5601. If the Office finds it necessary to charge the wards reasonable service fees as allowed by A.R.S. §14-5604, the Office must obtain court approval for all costs charged to a ward, report the charges to the court, and then deposit any fees collected into the County's General Fund. All office operating costs should be paid from the County's General Fund.



PIMA COUNTY
FINANCE AND RISK MANAGEMENT DEPARTMENT
130 WEST CONGRESS STREET
TUCSON, ARIZONA 85701-1317
(520) 740-8041 FAX (520) 243-2329

Thomas E. Burke, Director

May 29, 2007

Ms. Debra K. Davenport
Office of the Auditor General
2910 N. 44th St., Suite 410
Phoenix, AZ 85018

Dear Ms. Davenport:

The following is Pima County's response to the Management Letter for Fiscal Year Ending June 30, 2006.

Sincerely,

Thomas E. Burke

Attachment

Pima County should strengthen controls over investment activities

The Pima County Treasurer has implemented several changes to establish a stronger control environment over investments. Investment responsibilities have been segregated by the hiring of an investment officer. Investment services contracts currently exist with ten broker/dealers and the procurement process has begun for obtaining services related to the custody of securities. Additionally, for obtaining current investment information, the County Treasurer is receiving information from an on-line investment data service. The Treasurer has prepared written investment policies for consideration by the Board of Supervisors and is preparing written investment procedures to implement those policies.

The Public Fiduciary's Office should properly administer wards' assets

The Public Fiduciary has implemented several changes to address the recommendations from the Office of the Auditor General. Currently, the Public Fiduciary has initiated a competitive procurement process for banking services. In addition, in fiscal year 2007/2008, an appropriation of \$100,000 has been provided for the selection and acquisition of a comprehensive fiduciary accounting and case management system. The selected system is intended to facilitate the calculation of wards' interest earnings and identify the operating costs incurred for each ward.