Maricopa County

Report on Internal Control and on Compliance

Year Ended June 30, 2018

A Report to the Arizona Legislature

Lindsey A. Perry
Auditor General

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Independent auditors' report on internal control over financial reporting and on compliance and other matters based on an audit of basic financial statements performed in accordance with *Government Auditing Standards*

Members of the Arizona State Legislature

The Board of Supervisors of
Maricopa County, Arizona

We have audited, 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, the financial statements of the governmental activities, business-type activities, discretely presented component unit, each major fund, and aggregate remaining fund information of Maricopa County as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the County's basic financial statements, and have issued our report thereon dated December 20, 2018. Our report includes a reference to other auditors who audited the financial statements of the Stadium District, Risk Management, Employee Benefits Trust, Housing Authority, and Industrial Development Authority, as described in our report on the County's financial statements. This report includes our consideration of the results of the other auditors' testing of internal control over financial reporting and compliance and other matters that are reported on separately by those other auditors. However, this report, insofar as it relates to the results of the other auditors, is based solely on the reports of the other auditors.

Internal control over financial reporting

In planning and performing our audit of the financial statements, we considered the County's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control. Accordingly, we do not express an opinion on the effectiveness of the County's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying schedule of findings and recommendations, we and the other auditors did identify certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and significant deficiencies.

A deficiency in internal control 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 and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the County's basic financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and recommendations as items 2018-02 and 2018-03 to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and recommendations as items 2018-01 and 2018-04 to be significant deficiencies.

Compliance and other matters

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

Maricopa County response to findings

Maricopa County's responses to the findings identified in our audit are presented in its corrective action plan at the end of this report. The County's responses were not subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we express no opinion on them.

Purpose of this report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the County's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the County's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Lindsey Perry, CPA, CFE
Auditor General

December 20, 2018

Financial statement findings

2018-01

Managing risk

Condition and context—The County's process for managing risks did not include identifying, classifying, and inventorying sensitive information that might need stronger access and security controls and evaluating and determining the business functions and information technology (IT) systems that would need to be restored quickly if disasters or other system interruptions impacted the County.

Criteria—The process of managing risks should address the risk of unauthorized access and use, modification, or loss of sensitive information and the risk of losing the continuity of business operations in the event of a disaster or system interruption. In addition, the County's risk assessment process should identify, classify, and inventory sensitive information.

Effect—The County's administration and IT management may put the County's operations and IT systems and data at unintended and unnecessary risk.

Cause—The County's policies and procedures did not adequately address data classification and the impact system interruptions could have on its critical IT resources.

Recommendations—The County should identify, analyze, and reduce risks to help prevent undesirable incidents and outcomes that could impact business functions and IT systems and data. It also should plan for where resources should be allocated and where critical controls should be implemented. To help ensure it has effective entity-wide policies and procedures to achieve these objectives, the County should follow guidance from a credible IT security framework such as that developed by the National Institute of Standards and Technology. Responsible administrative officials and management over finance, IT, and other entity functions should be asked for input in the County's process for managing risk. The County should conduct the following as part of its process for managing risk:

- Evaluate and manage the risks of holding sensitive information by identifying, classifying, and inventorying the information the County holds to assess where stronger access and security controls may be needed to protect data in accordance with State statutes and federal regulations.
- Evaluate and determine the business functions and IT systems that would need to be restored quickly given the potential impact disasters or other IT system interruptions could have on critical organizational functions such as public safety and operations such as payroll and accounting and determine how to prioritize and plan for recovery.

The County's responsible officials' views and planned corrective action are in its corrective action plan included at the end of this report.

This finding is similar to prior-year finding 2017-01.

2018-02

Information technology (IT) controls—access, configuration and change management, security, and contingency planning

Condition and context—The County has written policies and procedures over its IT resources; however, the County's control procedures were not sufficiently designed, documented, and implemented to respond to risks associated with its IT systems and data. The County lacked adequate procedures over the following:

- **Restricting access to its IT systems and data—**Policies were not consistently implemented to prevent or detect unauthorized or inappropriate access.
- **Configuring systems securely and managing system changes—**Procedures did not ensure IT systems were securely configured and all changes were adequately managed. For example, we tested 40 County changes to its IT network and systems and for 11 of those changes, we found a lack of supporting documentation demonstrating the change was authorized, reviewed, tested, and approved by an employee other than the employee making the change.
- **Securing systems and data—**IT security policies and procedures lacked controls to help prevent unauthorized or inappropriate access or use, manipulation, damage, or loss.
- **Testing and updating a contingency plan—**The plan was not properly tested and lacked key elements related to restoring operations in the event of a disaster or other system interruption.

Criteria—The County should have effective internal controls to protect its IT systems and help ensure the integrity and accuracy of the data it maintains:

- **Logical and physical access controls—**Help to ensure systems and data are accessed by users who have a need, systems and data access granted is appropriate, key systems and data access is monitored and reviewed, and physical access to system infrastructure is protected.
- **Well-defined, documented configuration management process—**Ensures the County's IT systems are configured securely and that changes to the systems are identified, documented, evaluated for security implications, tested, and approved prior to implementation. This helps limit the possibility of an adverse impact on the system security or operations. Separation of responsibilities is an important control for system changes; the same person who has authority to make system changes should not put the change into production. If those responsibilities cannot be separated, a post-implementation review should be performed to ensure the change was implemented as designed and approved.
- **IT security internal control policies and procedures—**Help prevent, detect, and respond to instances of unauthorized or inappropriate access or use, manipulation, damage, or loss to its IT systems and data.
- **Comprehensive, documented, and tested contingency plan**—Provides the preparation necessary to place the plan in operation and helps to ensure business operations continue and systems and data can be recovered in the event of a disaster, system or equipment failure, or other interruption.

Effect—There is an increased risk that the County may not adequately protect its IT systems and data, which could result in unauthorized or inappropriate access and the loss of confidentiality and integrity of systems and data. It also increases the County's risk of not being able to effectively continue daily operations and completely and accurately recover vital IT systems and data in the event of a disaster or system interruption.

Cause—The County did not have adequate policies and procedures or did not consistently implement its policies and procedures.

Recommendations—To help ensure the County has effective policies and procedures over its IT systems and data, the County should follow guidance from a credible IT security framework such as that developed by the National Institute of Standards and Technology. To help achieve these control objectives, the County should develop, document, and implement control procedures, as applicable, in each IT control area described below:

Access

- Assign and periodically review employee, contractor, and other nonentity user access, ensuring appropriateness and compatibility with their responsibilities.
- Remove terminated employees' access to IT systems and data.
- Evaluate the use and appropriateness of accounts shared by 2 or more users and manage the credentials for such accounts.
- Enhance authentication requirements for IT systems.
- Protect IT systems and data with session time-outs after defined period of inactivity.
- Manage remote access to the County's systems and data.
- Review data center physical access periodically to determine whether individuals still need it.
- Develop security measures to protect sensitive information, such as implementing controls to prevent unauthorized access to that information.

Configuration and change management

- Establish and follow a documented change management process.
- Review proposed changes for appropriateness, justification, and security impact.
- Separate responsibilities for the change management process or, if impractical, perform a post-implementation review to ensure the change was implemented as approved.
- Configure IT resources appropriately and securely and maintain configuration settings.
- Manage software installed on employee computer workstations.

Security

- Perform proactive key user and system activity logging and log monitoring, particularly for users with administrative access privileges.
- Update the incident-response plan clearly indicating how to handle and report incidents.
- Provide all employees ongoing training on IT security risks and their responsibilities to ensure systems and data are protected.
- Perform IT vulnerability scans and remediate vulnerabilities in accordance with a remediation plan.
- Develop, document, and follow a process for awarding IT vendor contracts.

Contingency planning

- Test and update the contingency plan and ensure it includes all required elements to restore critical operations.
- Train staff responsible for implementing the contingency plan.
- Back up and securely maintain backups of systems and data.

The County's responsible officials' views and planned corrective action are in its corrective action plan included at the end of this report.

This finding is similar to prior-year finding 2017-02 (access), 2017-03 (configuration and change management), 2017-01 (security), and 2017-04 (contingency planning).

2018-03

County Treasurer should reconcile its accounting records, resolve uncorrected errors, and properly manage accounts

Condition and context—The County Treasurer's Office (Treasurer) is responsible for safeguarding and accounting for almost $4.7 billion in assets for the County and other local governments, such as municipalities, school districts, community colleges, and special districts, and processed over $11 billion in additions and $10.6 billion in deductions during fiscal year 2018. However, during fiscal year 2018, the Treasurer did not reconcile its accounting records with bank records, resolve uncorrected errors, and properly manage the County's and local governments' accounts. Consequently, the Treasurer did not maintain accurate records for each local government's revenues, expenditures, and account balances and did not inform them of 1- to 3-week delays in posting transactions. As a result, local governments had a difficult time reconciling their accounting records to the Treasurer's records. The Treasurer provided some training to local governments on its new accounting system, but the training was inadequate. These deficiencies occurred because during the fiscal year, the Treasurer implemented a new accounting system without taking the necessary steps to ensure that it would process information correctly. Specifically, the Treasurer did not:

- Reconcile its accounting records with its main bank accounts for the period of March 1 through June 30, 2018, until November 2018. After the Treasurer completed those reconciliations, several accounts remained unreconciled as of the end of our audit work in December 2018.
- Post transactions to accounting records in a timely manner; instead, numerous transactions were placed in a suspense account because those transaction had various unresolved discrepancies.
- Correctly allocate interest to local governments for the period March through May 2018. The Treasurer corrected the interest allocations in July 2018 but did not communicate the errors and subsequent corrections to the local governments until October 2018.
- Reconcile investment activity within its accounting records. The Treasurer's accounting records include separate general ledger and investment systems. The general ledger system includes County and local government account revenue, expenditure, and transfer activity along with the entities' cash and investment balances. The investment system is used to monitor investments and earnings. The Treasurer did not properly reconcile the investment system amounts with those recorded in its general ledger system, causing additional errors to the County's financial statements.

Criteria—The Treasurer is the custodian of public monies maintained for Maricopa County and its local governments, including municipalities, school districts, community colleges, and special districts as authorized by Arizona Revised Statutes (A.R.S.) §11-491. The Treasurer must follow its duties outlined in A.R.S. §11-493 that require safeguarding all monies deposited with the Treasurer, maintaining electronic records for each entity in separate accounts and funds, and reconciling accounting records to bank records. In addition, A.R.S. §15-996 requires the Treasurer to specifically safeguard and account for school districts' monies and allocate interest earned on a quarterly basis.

Effect—The County Finance Department worked with the Treasurer to correct the financial statement errors that resulted from errors identified within the Treasurer's system and made $99.1 million in audit adjustments to its fiscal year 2018 financial statements. However, the County's fiduciary fund financial statements that report the total monies the County holds for other local governments included $27.6 million in potential

misstatements because of unaccounted-for reconciling differences. In addition, it is likely that the local governments have other unresolved errors and unreconciled accounts in their own systems. Finally, the Treasurer was not compliant with A.R.S. §§11-493 and 15-996.

Cause—The Treasurer did not properly plan and implement its new accounting system and ensure that the system would be able to generate reports and process transactions accurately. In addition, the Treasurer did not adequately ensure that its accounting staff reconciled the accounting records daily and investigated unposted transactions ensuring they were posted to the correct accounts in a timely manner.

Recommendations—To ensure the County and local governments cash and investments are properly accounted for and comply with A.R.S. §§11-493 and 15-996, the Treasurer should:

- Reconcile its accounting records daily and monthly, as applicable, to bank and investment account records and between its general ledger and investment systems to ensure that all transactions are properly posted and accounted for and investigate and correct any differences noted.
- Investigate any unposted transactions in the suspense account and ensure those transactions are posted to the proper accounts in a timely manner.
- Communicate to local governments how to properly ensure the Treasurer posted their transactions correctly on the Treasurer's accounting system and that the local governments have proper balances in their accounting records.
- Allocate interest equitably to the local governments' accounts in a timely manner and communicate any changes in the allocation process to the local governments.
- Ensure that its new accounting system can produce the necessary reports to maintain accurate financial records for the County and local governments.

The County's responsible officials' views and planned corrective action are in its corrective action plan included at the end of this report.

2018-04

The County should ensure capital assets are accurately recorded

Condition and context—The County did not properly account for capital assets and related depreciation expenses to ensure its capital assets were accurately reported in its financial statements. Specifically, the County did not sufficiently reconcile its separate capital assets inventory listings for items such as infrastructure and buildings to its financial system to ensure that capital assets were properly reported and classified in the financial statements. As a result, several assets were not capitalized when placed in service or disposed of in the proper fiscal year. In addition, the County did not accurately depreciate various asset types, affecting reported accumulated depreciation and expenses.

Criteria—Capital assets comprise approximately 68 percent of the County's total assets. Therefore, it is essential that the County follow its established internal control policies and procedures to comply with generally accepted accounting principles and accurately reconcile and report its capital assets in its financial statements to ensure its lenders, the public, and other interested parties have accurate financial information.

Effect—The County's beginning capital assets balances were overstated by $34.6 million. The County corrected all errors to accurately report the balances in its fiscal year 2018 financial statements.

Cause—County departments maintained capital asset inventory listings separate from the County's financial system and did not perform a complete reconciliation of these listings to ensure they properly recorded assets in the County's financial system. In addition, the County made errors in its depreciation expense calculations when implementing its new capital asset module of its financial system during fiscal year 2018.

Recommendations—The County should follow its established policies and procedures to help ensure capital assets reported in its financial statements are sufficiently reconciled to its separate capital assets inventory listings for items such as infrastructure and buildings; capital assets are capitalized when placed in service or are disposed of in the proper fiscal year; and capital assets are accurately depreciated.

The County's responsible officials' views and planned corrective action are in its corrective action plan included at the end of this report.

COUNTY RESPONSE

Maricopa County

Department of Finance

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February 8, 2019

Ms. Lindsey Perry
Auditor General
2910 North 44th Street, Suite 410
Phoenix, Arizona 85018

Dear Ms. Perry,

The accompanying Corrective Action Plan has been prepared as required by *Governmental Auditing Standards*. Specifically, we are providing you with the name of the contact person responsible for the corrective action, the corrective action planned, and the anticipated completion date for the finding included in the Report on Internal Control and Compliance.

Sincerely,

Shelby L. Scharbach, CPA, CGFM
Assistant County Manager – Chief Financial Officer

2018-01
Managing Risk
Contact person(s): Kevin Westover, Business Engagement Manager, Office of Enterprise Technology, (602) 506-1667
Anticipated completion date: December 15, 2019

Concur. The County takes all IT audit findings seriously and will take actions to improve management of risk, in part, by identifying, classifying, and inventorying data that may need stronger access and security controls. The County will further improve management of risk by determining business functions and IT systems that would require the quickest restoration in the event of a disaster to avoid affecting critical organizational functions.

2018-02
Information technology (IT) controls – access, configuration and change management, security, and contingency planning
Contact person(s): Kevin Westover, Business Engagement Manager, Office of Enterprise Technology, (602) 506-1667
Anticipated completion date: December 15, 2019

Concur. The County takes all IT audit findings seriously and will take actions to have effective IT system policies and procedures. The County will accomplish this, in part, by control procedures related to areas of access, configuration and change management, security and contingency planning.

2018-03
County Treasurer should reconcile its accounting records, resolve uncorrected errors, and properly manage accounts
Contact person(s): J. Blair Bradshaw, Financial Services Director, Maricopa County Treasurer's Office, (602) 506-6169
Anticipated completion date: December 31, 2019

Concur. The Maricopa County Treasurer implemented new accounting and investment systems four months prior to the fiscal year end. Short staffing and excessive conversion issues resulted in the audit findings outlined.

Response to recommendations:

1. The current staff may not be able to address the issues outlined. With additional staff, we should be able to perform the reconciliation of the bank accounts by June 30, 2019.

2. The timely posting of transactions for each entity is mostly dependent on the accuracy of the information we receive. Our staff has reached out and addressed individual issues with the external staff. Most have responded and made the necessary corrections. Others continue to require additional assistance. Without direction from the originating agency, we are unable to post transactions to the correct funds. We hope to have all posting issues resolved by June 30, 2019.

3. We have increased the communication to agencies as issues are identified and resolved. This item has been completed.

4. The interest apportionment program has not performed as the original requirements dictated. The interest apportionment process is not as efficient as needed, resulting in the necessity to utilize work-around solutions to mitigate the inefficiencies. We will be assessing solutions to resolve the challenges, which may include a replacement of the apportionment process. Once the interest apportionment assessment is complete, next steps and priority will determine when the selected solution will be provided. We hope to have these issues resolved by December 31, 2019.

5. There were vast quantities of reports that were developed over the past 30 years from the legacy system. The report inventory was reviewed and a list of reports were identified to be produced from the new Financial / Accounting System. These reports have been created, approved and in production. Since that time, there are a few additional reports that have been identified as necessary (late in the year-end audit), and have been placed on a priority list to be created. We hope to have these reporting issues resolved by December 31, 2019.

2018-04
The County should ensure capital assets are recorded accurately
Contact person(s): John Lewis, Finance Director, Department of Finance, (602) 506-1373
Anticipated completion date: June 2019

Concur. Accumulated depreciation errors were a result of the retroactive correction of depreciation and accumulated depreciation calculations in conjunction with the implementation of our ERP financial system. The remaining errors were due to departmental oversight, for which the County has existing internal control policies and procedures. The County updated the Capital Asset Policy, Capital Asset Manual, and Capital Project and Infrastructure Manual to further address any procedural deficiencies. In addition, the Department of Finance will more closely monitor the annual and monthly reconciliations, annual stewardship process, and capital project schedules to ensure assets are properly deleted or placed in service, as applicable.


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