A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Report on Internal Control and Compliance

Pima County

Year Ended June 30, 2007

STATE OF ARIZONA
OFFICE OF THE AUDITOR GENERAL

Debra K. Davenport
Auditor General

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Pima County
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Table of Contents

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 Basic Financial Statements Performed in Accordance with *Government Auditing Standards*

Members of the Arizona State Legislature

The Board of Supervisors of
Pima County, Arizona

We have audited the financial statements of the governmental activities, business-type activities, the discretely presented component unit, each major fund, and aggregate remaining fund information of Pima County as of and for the year ended June 30, 2007, which collectively comprise the County's basic financial statements, and have issued our report thereon dated December 19, 2007. Our report was modified to include a reference to our reliance on other auditors. 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. Other auditors audited the financial statements of the Stadium District, School Reserve Fund, Self Insurance Trust, Wastewater Management, Pima Health System & Services, Development Services, and Southwestern Fair Commission, 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, we considered the County's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the County'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 over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain 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 County's ability to initiate, authorize, record, process, or report

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financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the County's basic financial statements that is more than inconsequential will not be prevented or detected by the County's internal control. We consider item 07-01 described in the accompanying Schedule of Findings and Recommendations 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 will not be prevented or detected by the County'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 to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the County's basic financial statements are free of 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*.

Pima County's response to the finding identified in our audit is presented on page 5. We did not audit the County'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 Board of Supervisors, federal awarding agencies, and pass-through entities 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.

Dennis L. Mattheisen, CPA
Financial Audit Director

December 19, 2007

Pima County
Schedule of Findings and Recommendations
Year Ended June 30, 2007

07-01
Pima County should strengthen controls over investment activities

The Pima County Treasurer's Office manages and invests more than $775 million in public monies. Of these monies, approximately 50 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. In April 2006, the County Treasurer began investing in United States agency securities, repurchase agreements, and commercial paper. At June 30, 2007, 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 should have strong internal controls to safeguard public monies, promote overall operating efficiency and effectiveness, and ensure compliance with investment laws and regulations. However, at June 30, 2007, the County Treasurer's Office did not have adequate written investment policies and procedures to ensure that timely reviews of its investment brokers' investment activities were performed and documented by authorized employees. Furthermore, the County Treasurer's Office should require its securities to be held with an independent trust company or department in the County's name to reduce the risk of investment losses in case its investment broker failed. However, the County's investments were held by its investment broker who purchased and sold securities for the County in accordance with county investment policies. The investment broker 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 investment broker failed.

Because the County Treasurer's Office invests monies in United States agency securities, repurchase agreements, commercial paper, and other investments outside of the Arizona State Treasurer, it should have strong 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 other political subdivisions, the County should implement the following:

Investment Policies and Procedures—Improve written investment policies and procedures for controlling, authorizing, and reviewing investment activities. Specific examples of the activities requiring review include activities such as employee investment decisions, maintaining custody of investment-related documents, and review of investment activity performed by the Treasurer's external investment brokers.

Custody of Securities—Use the services of an independent trust company or department in the County's name to hold the purchased securities to minimize the risk of loss that could arise from the investment broker's failure.

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Thomas E. Burke, Director

February 8, 2008

Ms. Debbie Davenport
Auditor General
2910 N. 44th St., Suite 410
Phoenix, AZ 85018

Dear Ms. Davenport,

The following corrective action plan has been prepared as recommended by Government Auditing Standards. Specifically, we are providing you with the name of the contact person responsible for corrective action, the corrective action planned, and the anticipated completion date for each audit finding included in the current year's schedule of findings and questioned costs.

Sincerely,

Thomas Burke
Director

Pima County should strengthen controls over investment activities

Contact Person – Beth Ford, County Treasurer, Tom Burke, Director, Finance and Risk Management
Anticipated Completion Date – partially completed

The County agrees and has made modifications to improve the County Treasurer's investment policies and procedures. The modifications to the procedures specifically address the identified weaknesses in internal controls over the authorization, review and controlling of investment activities and documentation.

The County agrees that the risk of failure by the investment broker could be minimized by the use of an independent third-party trust company. However, the assessment of that risk will be performed by the County to evaluate whether the risk of failure of the current investment broker, its parent company and subsidiaries is significantly higher than the risk of failure of an independent third-party trust company.