Financial Statement Findings and State Responses
(Reformatted from FY 2011 Single Audit Report)

11-01
The Department of Administration should prepare accurate financial statements in a timely manner

Finding
Criteria: The Department of Administration should issue accurate and timely financial statements for the State to satisfy the audit requirements imposed by federal and state laws and regulations, grant contracts, and long-term debt agreements.

Condition and context: The director of the Department is responsible for establishing and maintaining the State's accounting systems and preparing accurate and timely financial reports, including the State's Comprehensive Annual Financial Report (CAFR). In accordance with Arizona Revised Statutes (A.R.S.) §41-703, the director has the authority to promulgate rules, regulations, and procedures to carry out his responsibilities. Further, A.R.S. §35-131(I) requires state agencies and other organizations included in the State's reporting entity to submit all necessary financial information to the Department in accordance with its policies and procedures. However, those statutes do not include provisions to enforce compliance, and as a result, state agencies and other organizations did not always comply with the established deadlines. To illustrate, state agencies and other organizations audited by contract auditors had a November 21, 2011, deadline to submit their audited financial statements and only four met this deadline; nine submitted their final audited financial statements from November 23, 2011 to February 8, 2012, and one failed to submit audited statements by the February 10, 2012, report date.

Effect: Since various state agencies and other organizations did not comply with state statutes or department rules and regulations, the State did not issue its CAFR by its December 31, 2011, deadline. Delays in financial reporting may result in rating agencies lowering the State's ratings for bonds and certificates of participation. This finding is a significant deficiency in internal control over financial reporting.

Cause: State statutes do not provide the director with enforcement power to ensure that state agencies and other organizations comply with department rules, regulations, and procedures for financial reporting.

Recommendation: To help ensure that the Department receives financial information necessary for timely issuance of the State's CAFR, the Department should:

- Seek the authority to enforce rules, regulations, and procedures over financial reporting.

- Establish enforcement actions for agencies and other organizations that fail to submit such information by the required deadlines.

This finding is similar to a prior-year finding.

Agency Response: Concur

Agency Corrective Action Plan: Timeliness is one of the fundamental thresholds of financial reporting and the timely issuance of the CAFR is vital to other reporting requirements and deadlines. A.R.S. §35-131 clearly requires State agencies and other organizations that are part of the State's reporting entity to submit all necessary financial statements and other information in accordance with the policies and procedures of the Arizona Department of Administration, General Accounting Office. This includes adherence to established time frames and deadlines. However, there are no specific provisions in the law for actions that may be taken to enforce such compliance. We are continuing to explore potential options for enforcement actions and will continue to work with State agencies to effectively resolve the issue of timely submission of financial information.

Administratively, we have addressed the specific issues resulting in delays with various State agencies and other organizations, and through these collective efforts have seen significant results in the past few years. The FY 2007, FY 2008, FY 2009, FY 2010, and FY 2011 CAFRs were issued June 16, 2008, May 26, 2009, May 7, 2010, March 4, 2011, and February 10, 2012, respectively. Further, despite the on-going challenges of additional reporting requirements amid limited resources, we expect to continue to improve our timeliness and intend to issue the FY 2012 CAFR by December 31, 2012.

11-02
The Industrial Commission of Arizona should maintain a record of all changes to its computer system

Finding
Criteria: The Industrial Commission of Arizona uses its computer system to record detailed financial transactions and generate monthly and year-end summary reports to support amounts reported in the financial statements. Therefore, it is essential that changes to the system and data be reviewed and documented.

Condition and context: When users made changes to system data, the changes were documented in the system; however, if the database administrator made changes to the system database, the changes would not be documented in the system. Additionally, any changes to key computer equipment, such as firewalls, routers, or switches, were made by the chief information officer, but were not reviewed or authorized by another employee.

Effect: Unauthorized changes could be made to the system or data without detection. This finding is a significant deficiency in internal control over financial reporting.

Cause: The Commission did not have effective controls over system and data changes since it plans to replace its computer system. Therefore, it has chosen not to invest additional time or resources into an outdated system.

Recommendation: To help strengthen controls over system and data changes to its computer system, the Commission should:

- Maintain a record of all system and data changes, including changes made directly to the system, to help monitor changes.

- Have an independent employee review and authorize all major changes to computer equipment.

This finding is similar to a prior-year finding.

Agency Response: Concur

Agency Corrective Action Plan: The finding requires that the PACE application log all system level database changes that could be made directly to the database by the PACE administrator. The PACE system was developed at a time when this was not a requirement, the system currently in place does not have a means to log direct database administrator changes, and the Commission does not have a means to modify the code to correct this issue.

The Commission is currently working with a developer to convert the PACE legacy system to a modern platform, which is scheduled to be deployed no later than June 2012 to resolve this problem.

Financial Statement Findings and State Responses
(Reformatted from FY 2011 Single Audit Report)

11-03
The Industrial Commission of Arizona should strengthen controls over payments made to the State Compensation Fund

Finding
Criteria: The Industrial Commission of Arizona should have strong internal controls in place to accurately process and record reimbursements to the State Compensation Fund (SCF).

Condition and context: In accordance with Arizona Revised Statutes §23-966, the Commission is required to have the SCF process and pay all workers' compensation claims for those insurance carriers that have become insolvent and reimburse the SCF for those payments. During fiscal year 2011, the Commission reimbursed the SCF for processed claims totaling approximately $11.9 million. When testing reimbursement payments to the SCF, auditors noted that the Commission did not adequately review the quarterly reimbursement billings; this resulted in an overpayment of $165,233 by the Commission for the second quarter's billing. Further, adequate reconciliations of the SCF billing statements were not prepared because the Commission's listing was inaccurate since some claimants were missing, claimants assigned in previous years were listed on the report as new claimants, and claimant names were misspelled.

Effect: The Commission overpaid the SCF by $165,233 for the second quarter billing. In addition, the Commission is unable to prepare adequate reconciliations of its listing to the SCF's detailed billings statement. The Commission adjusted its financial statements for the error noted above and received a credit from SCF for the overpayment in the subsequent fiscal year. This finding is a significant deficiency in internal control over financial reporting.

Cause: The SCF's second quarter billing statement was not accurate since the totals in the detailed billing statement were incorrect and the Commission's review of the billing statement failed to detect this error. In addition, the Commission was unable to reconcile its listing of current-year insolvent carriers and claimants to the detailed billing statement provided by the SCF because the Commission did not have adequate controls to ensure that information entered into its claims system was accurate. Also, the listing generated by the Commission's system included only information for current-year insolvent carriers, and therefore, any new claimants assigned under an existing insolvent carrier were not included. Further, the Commission was unable to match individual claims between its listing and the SCF's detailed billing statement since the billing statement did not provide a unique identifier such as the Commission's claim number or a date of assignment.

Recommendation: The Commission should revise its policies and procedures to help ensure that reimbursement payments to the SCF are accurately processed and recorded. This would also include procedures to enable the Commission to reconcile its listing of current-year insolvent carriers and claimants to the SCF's detailed billing statement. The procedures should include the following:

- Perform a detailed review of the billing statements, including verifying the total amount due. Further, a second employee should verify that the information is accurate.
- Perform validation procedures for all information entered into the Commission's claims system.
- Address the limitations in the Commission's claims system to ensure that a complete and accurate listing of current-year insolvent carriers and new claimants from previously assigned carriers can be generated, or develop sufficient alternative procedures.

- Request the SCF to provide the Commission with a unique identifier for each individual claim on the detailed billing statement.

Agency Response: Concur

Agency Corrective Action Plan: Prior to the audit, staff identified and worked out a resolution of the SCF payment error. However, to ensure that adequate reviews of SCF payment documents were being performed, management reviewed the invoice in question and determined that required documentation was not thoroughly reviewed at the time of payment. All issues noted in the finding were addressed with the appropriate staff member. In order to avoid an error like this occurring in the future, staff has been instructed to thoroughly review the transaction details and summary invoice provided by SCF, and to properly document all noted discrepancies and corrective actions. Staff has also strengthened the review and reconciliation process and is now utilizing spreadsheet tools to compare the information provided by SCF with information in the Claims System. With these new procedures and tools in place, we do not feel that a secondary staff review of the SCF invoice would be efficient use of staff time.

The Claims file is the official file of record and once a claim becomes a legal file it is not changed without supporting documentation. Some differences with SCF's records occur because SCF may enter different information into their system. Differences may include name changes due to marriage or divorce, different conventions for entering hyphenated names, use of abbreviations, use of initials and nicknames, etc. Some errors in the files are the result of the claimant submitting a handwritten claim that is hard to decipher. Other errors may be due to data processing errors by the Claims Division key punch operators.

The Claims System does not have an automated validation process so quality control verification of data entered into the system must be performed manually. The Claims Division has seven key punch operators; however, due to the hiring freeze three of these positions are currently vacant. Currently, the Commission lacks both the financial and staff resources to implement additional validation procedures over the Claims data input process. As a compensating control, on a quarterly basis, Accounting Division staff will now review the Claims Division reports as part of the review and reconciliation process discussed above. Accounting Division staff will communicate with Claims Division staff any noted discrepancies.

MIS has created two new reports for the Claims System, one that lists current-year insolvent carriers and one that lists new claimants from previously assigned carriers, and staff is now reviewing them as part of the quarterly reconciliation procedure discussed above. This information has always been maintained in the Claims System.

Staff has requested SCF add additional identifying information to their billing statements, such as the Commission's Claims number, to aid staff in identifying and reconciling the claimants listed on their bills. The Commission has long recognized that there are deficiencies with SCF's billing statements and has requested improvements be made by SCF; however, until SCF is able to address the deficiencies on their end we cannot fully resolve this issue.

11-04
The Department of Revenue's computer access controls should continue to be strengthened

Finding
Criteria: The Department of Revenue should have effective computer access controls to prevent and detect unauthorized use, damage, loss, or modification of programs and data, and misuse of sensitive or confidential information.

Condition and context: While performing test work over access controls to the Department's computerized financial information systems, auditors noted the Department did not always retain documentation to support its review and approval of users' access rights. For example, for 6 of 15 employees selected for test work, the Department was unable to provide documentation authorizing the employees' system access and approval of those rights by a supervisor. Also, the Department did not actively monitor database administrators with elevated user access privileges.

Effect: There is an increased risk of theft, manipulation, or misuse of sensitive or confidential data by unauthorized users or by users who were not being properly monitored. This finding is a significant deficiency in internal control over financial reporting.

Cause: The Department did not commit sufficient resources to ensure appropriate documentation of supervisory approval of employee access rights. In addition, the Department did not have policies and procedures in place to independently monitor and review the activities of database administrators with elevated system access.

Recommendation: To help ensure the integrity of the Department's computerized financial information systems, the Department should follow its policies and procedures, which require documentation of supervisory approval on all requests for system access. In addition, the Department should develop policies and procedures that require the activities of database administrators with elevated user access privileges to be independently monitored and reviewed for propriety.

This finding is similar to a prior-year finding.

Agency Response: Concur

Agency Corrective Action Plan:

Documentation of User Access Rights
It is the Department's policy and standard practice that only Information Security can set up system access. To initiate access to any system a fully completed System Access Request form is required. This form is stored with the Heat ticket that is also created as part of this process. The 6 employees who did not have this documentation are long term employees who were employed prior to the implementation of this documentation process. The Department has been working to address this issue and is currently about 50% complete. Necessary staff has been engaged and the targeted completion date is May 1, 2012.

DBA Monitoring Controls
The Department captures and retains activity logs for database administrators with elevated user access. These logs are reviewed on an as needed basis. Actively monitoring activity logs relies on technology upgrades that are planned in FY13 but are dependent on approval for supplemental funding. If FY13 funding is available and system upgrades are complete, and if funding is available in FY14, the department will implement a process to actively monitor database administrators with elevated user access. There are currently very few database administrators with elevated user access.

11-05
The Department of Revenue should continue to strengthen its procedures for processing income tax revenues

Finding
Criteria: The Department should improve procedures to ensure that it records and reports all tax revenues of the State.

Condition and context: The Department is responsible for collecting, recording, and reporting income taxes owed to the State. While testing procedures for income tax revenues, auditors noted additional procedures that the Department should perform. Because this finding is of sensitive nature, its specific details, including detailed recommendations, were verbally communicated to those officials directly responsible for implementing corrective action.

Effect: The State may not receive the proper amount of individual income taxes. This finding is a significant deficiency in internal control over financial reporting.

Cause: The computer system did not have the functionality to perform the identified omitted procedures.

Recommendation: The Department should implement additional procedures necessary to compensate for the omitted procedures.

This finding is similar to a prior-year finding.

Agency Response: Concur

Agency Corrective Action Plan: The Department understands and has prioritized the continual improvement of its operations including all departmental procedures and controls and will continue to do so. Where constrained by limited resources, the Department has instituted compensating controls to help minimize risks to tax revenues.

11-06
The Department of Revenue should better protect its computer network

Finding
Criteria: The Department of Revenue should have effective network security controls to prevent and detect unauthorized use, damage, loss, or modification of programs and data, and misuse of sensitive or confidential information.

Condition and context: The Department is the main tax collector for the State of Arizona, and in connection with those tax collections, the Department maintains a significant amount of confidential data on its computerized information systems. However, the Department did not have adequate controls in place to help identify and resolve vulnerabilities to its network. Because this finding is of a sensitive nature, its specific details, including detailed recommendations, were verbally communicated to those officials directly responsible for implementing corrective action.

Effect: There is an increased risk for unauthorized persons to obtain confidential data or make changes to computer programs or data. This finding is a significant deficiency in internal control over financial reporting.

Cause: The Department had insufficient internal control policies and procedures to address the potential vulnerabilities.

Recommendation: The Department should implement additional policies and procedures for network security to help prevent and detect unauthorized access or misuse of confidential information.

This finding is similar to a prior-year finding.

Agency Response: Concur

Agency Corrective Action Plan: During FY 2011 the Department implemented tools, including policies and procedures, to eliminate this finding. This was a multi-step process, with the final step being implemented on June 2, 2011.

11-07
The Department of Emergency and Military Affairs should strengthen internal controls to safeguard public monies

Finding
Criteria: Public officials with oversight authority are responsible for ensuring that internal controls are established and implemented to protect public monies. At a minimum, an internal control environment should allow management and employees, in the normal course of performing their assigned functions, to prevent or detect errors and fraudulent activity on a timely basis.

Condition and context: As discussed in federal award finding 11-129, the Department did not establish adequate policies and procedures to ensure that public monies were used solely for authorized purposes. Consequently, a department official embezzled monies from the Department between October 2007 and July 2011.

Effect: This finding is a significant deficiency in internal control over financial reporting that resulted in fraud, but did not affect our opinion on the State's financial statements.

Cause: There was inadequate review and supervision of the department official's activities.

Recommendation: The Department should establish adequate written policies and procedures governing the disbursement request process, which include the following:

- Outline the process for any requests made by management-level employees, which should include a review and approval from a supervisor or periodic review of their activities.

- Require expenditures to be supported by proper documentation, including claim requests, purchase orders, vendor invoices, and vendor contracts.

Agency Response: Concur

Agency Corrective Action Plan: The Department has instituted internal policies and procedures to ensure that all public funds within the Department's control are used solely for authorized purposes.

The Department has included in its internal policies and procedures the mandated requirements for claims disbursement. It includes the process to generate a disbursement and the required supporting documentation. The Department has given formal instruction and guidance to all finance staff on the requirements of a disbursement utilizing Section II H of the State Accounting Manual and its internal policies and procedures.

The Department is working on establishing an internal Whistle Blower policy which will maintain the anonymity and protect the individual reporting the fraud and formally document the complaint for review by the Department's Director, The Adjutant General (TAG). All complaints will be investigated by direction of TAG and the findings will be documented and reported as needed to the appropriate agencies.

The Department recently hired additional internal audit staff to allow for increased focus in the areas of procurement, human resources and finance. The staff is supervised on an operational basis by the Senior Executive Officer for the Department but they report directly to TAG. The Senior Executive Officer, with TAG's direction, works with the audit staff to develop the annual audit plan.

The Resource Manager now reports directly to TAG thereby creating segregation between financial management and regulatory oversight. The prior reporting structure created an almost self-regulating environment. With both positions reporting directly to TAG, it dissolves any bias and creates a direct line of communication.

Other auditors' findings:

The other auditors who audited the UA Healthcare, Inc. reported the following significant deficiencies:

11-08
Allowances for Patient Accounts Receivable

Finding
University Medical Center

- A letter of agreement from a third-party payor for a transplant patient was received by the medical records department but not sent to the business office until the following month. This created an overstatement in patient accounts receivable until the letter of agreement was received by the business office.
- A third-party payor was identified by the accounting department as a payor that the accounts receivable system prorates the gross charge to the expected net collectible amount. However, it was determined that the third-party payor's contract was not actually loaded into the system that generates these automatic adjustments, creating an overstatement in patient accounts receivable.

We did note that this payor was a very small percentage of overall patient accounts receivable.

University Physicians Healthcare Hospital

- We noted that there was a mathematical error in the calculation of allowances for patient accounts receivable at June 30, 2011. Subsequent to us identifying this calculation error, management corrected the amount by posting an adjustment to the June 30, 2011, financial statements.