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OFFICE OF THE PRESIDENT

Apache County

Management Letter

Year Ended June 30, 2004

July 14, 2006

Board of Advisors
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, 2004, 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 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, 2004. 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 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.

In addition, as required by Arizona Revised Statutes §41-1279.21(A)(1), we reviewed the County's financial records to evaluate whether the County used Highway User Revenue Fund monies and any other dedicated state transportation monies solely for authorized transportation purposes for the year ended June 30, 2004. Our review did not identify any instances of noncompliance.

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,

Fester & Chapman P.C.

The County needs to prepare accurate and timely financial statements.

The County must issue accurate and timely financial statements to satisfy the audit requirements imposed by federal and state laws and regulations, grant contracts, and long-term debt covenants. For fiscal year 2003, the County implemented Governmental Accounting Standards Board (GASB) Statement No. 34, which prescribes a new reporting model for state and local governments. However, the County was unable to prepare accurate and timely financial statements for that year because the County's finance department employees had not sufficiently planned and prepared to implement the new standard, including obtaining a thorough understanding of the new reporting model. As a result, it took the County over a year after the fiscal year-end to prepare its financial statements in accordance with the new reporting requirements. The June 30, 2003 financial statements were not issued until February 7, 2005. During 2005, the County contracted with an outside party to assist in the continuing implementation of the new standard for the preparation of the financial statements for the year ended June 30, 2004. However, it has still taken the County over a year after the issuance of the June 30, 2003 statements to prepare the 2004 statements in accordance with the new reporting requirements

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In addition, for the year ending June 30, 2007, the County will be required to report in its financial statements all infrastructure assets that were acquired by the County prior to July 1, 2002, in accordance with GASB Statement No. 34. The identification and valuation of these infrastructure assets will be a major endeavor for the County. To date, the County has not taken any significant action to identify and value its infrastructure assets acquired prior to July 1, 2002.

To help ensure that the County's financial statements are prepared accurately and issued in a timely manner, the County should develop a comprehensive plan for implementing new accounting standards and allocate resources to:

- Research all accounting and reporting requirements to ensure that the financial statements are properly presented in accordance with authoritative pronouncements, including the reporting requirements for infrastructure assets.
- Evaluate the accounting and reporting capabilities of the accounting and information systems and make system and programming modifications, if practical, to account for and report the critical information, such as infrastructure assets.
- Establish processes for obtaining information not readily available from the accounting and other information systems required for financial statement presentation. Examples of such information include current year increases and decreases in long-term debt.
- Establish a process for compiling the information and preparing the financial statements and the accompanying notes, including assigned employees and completion dates.
- Have an employee who did not prepare the financial statements and the accompanying notes review them to help ensure that the amounts are accurate and properly supported and the financial statements are presented in accordance with authoritative pronouncements.
- Identify and value all infrastructure assets acquired by the County prior to July 1, 2002, so that it will be prepared to report infrastructure assets in its June 30, 2007 financial statements.

A similar recommendation was previously provided in the Management Letter to the County dated February 7, 2005.

The County needs to prepare and maintain written policies and procedures for its information systems.

The County uses computerized accounting and information systems, including the County's and County Treasurer's systems, to record and process financial transactions critical to the County's daily operations. Therefore it is critical that the County prepare and maintain written policies and procedures for its computer operations, including a disaster recovery plan. Written policies and procedures over its computer operations serve as a reference guide and ensure accuracy and continuity in processing transactions. However, the County lacked detailed written policies and procedures over physical security of computer equipment, security controls over system access, and program changes. In addition, the County had not prepared a disaster recovery plan.

Written policies and procedures serve as a reference tool for employees seeking guidance on how to handle complex or infrequent transactions and situations. Additionally, they offer guidance for controlling daily operations. Reliance on appropriate written policies and procedures can enhance both accountability and consistency, safeguard assets and data, and help ensure that proper procedures are in place to provide for the continuity of operations and that electronic data files are not lost in the event of a disaster or other interruption. 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 and unauthorized access, and maintenance. Further, these policies and procedures should address approval, design, testing, documentation, and implementation of computer program changes.

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

- A listing of employees assigned to disaster teams, including telephone numbers to reach them.
- Employee assignments and responsibilities.
- Written equipment backup agreements to help ensure processing continuity of critical financial transactions, including a designated physical facility, machine time availability, application processing priorities, information exchanges regarding equipment configuration and system software changes, testing procedures, and cost.
- A listing of procedures for processing critical transactions, including forms and other documents to be used.

A similar recommendation was previously provided in the Management Letter to the County dated September 9, 2003 and February 7, 2005.

The Sheriff's Office should ensure payroll expenditures are proper and accurate.

Salaries, wages, and related payroll costs are a major portion of the County's total expenses. Therefore, it is critical for the County and its departments to have strong payroll controls to ensure that employees are paid accurately. However, neither the County nor the Sheriff's Office established adequate internal controls to ensure that the Sheriff's Office's payroll was processed correctly. Specifically, the applicable supporting documentation for hours worked and employee signatures were not submitted to the payroll department for each pay period. Instead it was retained at the Sheriff's Department. Additionally, the Sheriff's Office did not pay overtime in the pay period that it was earned. Employees were paid overtime semi-annually.

To help strengthen controls over payroll and ensure that Sheriff's Office employees are paid accurately, the County should implement the following procedures:

- Ensure that compensatory time payments are made for recorded balances.
- Ensure that employees complete a time summary for each pay period that is reviewed and approved by the employee's supervisor, and retained to support the payroll. If this is not practical, employees should submit time summaries to the Payroll Department no later than the following pay period so that the County can adjust that pay period's expenses.

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APACHE COUNTY FINANCE DEPARTMENT

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KARLA F. JAMES
Finance Director
337-7621

November 17, 2006

Debra K. Davenport, CPA
Auditor General
2910 N. 44th St., Ste 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, 2004.

The County needs to better prepare for implementation of new accounting standards.

We concur that the county finance department was not fully prepared for the implementation of the new reporting standards. Because this county does not have the resources to create separate staffing for audit purposes, it has contracted with an outside service to prepare the new types of documentation required. We used this service for the 2004 audit and will continue to use it for all future audits as long as it is needed. It is expected that each successive audit cycle will show improvement in this area.

The county engineering department has taken on the challenge of compiling information on infrastructure assets and the County intends to be able to satisfy the 2007 audit requirements in this area.

The County needs to improve controls over its information system.

Currently, weekly backup tapes are stored off site at a secure location. In the event of a major breakdown, the County would seek assistance in the nature of equipment sharing from our neighboring county.

The County recognizes the need for written policies and procedures. In regards to disaster plans as well as daily operations, it is expected that such documentation will be written as staffing and time allows.

The Sheriff's Office should ensure payroll expenditures are proper and accurate.

Approximately six months after the close of fiscal year 2004, the Sheriff's Office began to correct some of the deficiencies in their attendance reporting procedures. Time sheets submitted for the bi-weekly payroll processing were followed with copies of the same documents showing signature authorizations. Corrections to prior pay periods were being submitted in writing, again with authorizing signatures. In addition, the Office began including compensatory time on the bi-weekly reports. For the most part, compensatory time was being paid out as overtime every pay period.

Currently we are seeing some erosion of the progress that was being made. In early September 2006, Superior Court Judge Kenneth Fields of Maricopa County ruled that the County Board of Supervisors has no jurisdiction to discipline the Sheriff or members of that office. The implication of this ruling is that the county has no power to enforce policy and procedure in the office of an elected official. This ruling by Judge Fields is being appealed. Assuming the ruling will be over turned, we are expecting to see a return in efforts by that office to conform to county policy.

The Sheriff's Office should follow the County's purchasing policies and procedures.

The Sheriff's Office ceased using personal credit cards for purchases more than one year ago. Prior to that time, the county had established with them acceptable procedures which served to document pre-authorization of such purchases and independent verification of the receipt of goods.

The County does take seriously the need to ensure that employees are trained on purchasing policies and procedures. On December 27, 2004, the county Purchasing Department distributed to all departments a binder containing the current purchasing policies and fixed asset procedures. When it is observed that certain procedures are not being followed and verbal reminders are not producing the desired results, the Purchasing Department distributes to all departments a memorandum addressing the subject. The same procedure is used by the Finance Department.

The county will continue to work to correct all weaknesses uncovered in the audit of the year ended June 30, 2004.

Sincerely,

Karla James

Karla James
Finance Director