

Financial Statement Findings and State Responses **(Reformatted from the FY 2013 Report on Internal Control and Compliance)**

2013-01

Northern Arizona University should strengthen its policies and procedures over access controls and change management for its financial accounting system

Criteria: Effective system access controls help prevent and detect unauthorized use, damage, loss, or modification of programs and data, including sensitive and confidential information. In addition, no one employee should have the ability to record, review, and approve transactions within the system. Further, effective change controls should ensure that program changes and changes to data are valid, meet user needs, are reviewed and approved independently, and are implemented accurately.

Condition and context: The University did not have adequate policies and procedures in place to ensure user access roles within its financial accounting system were compatible with their job responsibilities. Specifically, the University assigned multiple personnel responsibility for approving access to different modules within its system. However, there was no additional review performed to ensure employees were not assigned any incompatible roles and responsibilities within the system. In addition, the University assigned multiple employees the ability to review and approve their own journal entries within the financial accounting system. Further, the Change Management Team was able to perform system updates or database changes using a universal login identification and these changes were not monitored.

Effect: There is an increased risk that users could gain inappropriate access with the ability to manipulate or intentionally misuse financial information or record unauthorized or inaccurate changes. In addition, transactions could have been inaccurately recorded in the system.

Cause: The University implemented a new financial system at the beginning of the fiscal year and did not develop policies and procedures for reviewing system access controls for incompatible duties or for monitoring changes made to the system.

Recommendation: The University should develop and implement policies and procedures for both reviewing system access controls to prevent incompatible duties from being assigned to an employee and monitoring changes made to the system. Specifically, the University should review its existing employees' system access to ensure that employees' access is proper based on their job description and correct any incompatible duties identified. In addition, the University should develop a system for monitoring changes made by the Change Management Team to ensure all system and program changes are authorized, reviewed, tested, and approved prior to being implemented. Further, each team member should have a separate login to make changes to the system.

Agency Response: Concur

Agency Corrective Action Plan: The University has reviewed the audit finding and recommendation associated with the annual audit of the University's Annual Financial Report for the year ended June 30, 2013. We concur with the audit finding and recommendation. The implementation of the University's new financial system presented many challenges, and we recognized the risks associated with our implementation decisions. We have since taken steps to mitigate the risks. Prior to the Auditor General's review, an internal security review was completed in April, 2013 which identified issues consistent with the audit findings and resulted in the removal of incompatible security roles and responsibilities from certain users. In addition, workflow approval was implemented in May, 2013 to limit the ability to self-approve journals within the central accounting office. In addition to these actions, we will take the following steps to further address the audit findings:

We will implement a 2nd level security access review to help ensure that system access is consistent with user job responsibilities and incompatible security access is not granted across system modules.

We will develop monitoring tools to help identify system access vulnerabilities and use the information to take corrective actions.

Financial Statement Findings and State Responses (Reformatted from the FY 2013 Report on Internal Control and Compliance)

NAU Information Technology Services recognizes the accountability issue associated with the use of a shared user ID in our change management procedures for modifications to our PeopleSoft systems. We will immediately begin investigating our options for providing a more granular level of accountability within the constraints of the Oracle/PeopleSoft application product as well as possible monitoring controls.

2013-02

The Industrial Commission of Arizona should strengthen controls over the insolvent carrier workers' compensation claims

Criteria: The Industrial Commission of Arizona used a service organization to process the workers' compensation claims for those insurance carriers that have become insolvent. Accordingly, the Commission should have internal controls in place to ensure the claims are processed for the accurate amounts.

Condition and context: During fiscal year 2013, the Commission processed \$11.1 million in insolvent carrier workers' compensation claims. Although the Commission had procedures in place to ensure that claims were not processed for claimants that should not have received payment, the Commission did not establish internal controls to ensure the claim amounts were reasonable and accurate.

Effect: The Commission could reimburse the service organization for insolvent carrier workers' compensation claims that were not reasonable or accurate.

Cause: The Commission received a monthly listing of the insolvent carrier claims that were processed by the service organization. The Commission reviewed the listing to determine the validity of the individual claimants; however, the Commission did not have controls in place to ensure that the claims were reasonable or accurate.

Recommendation: To help ensure that the Commission reimburses the service organization for accurate amounts, the Commission should establish internal controls to review insolvent carrier workers' compensation claims for reasonableness and accuracy.

Agency Response: Concur

Agency Corrective Action Plan: The Commission currently has strong internal controls over the insolvent carrier claims process and works closely with SCF Arizona, our third party service organization, to ensure submitted claims are proper. Commission Accounting Division staff performs a thorough review of SCF Arizona's detailed and summary invoice, and properly documents all noted discrepancies and corrective actions. Commission staff also compares the information provided by SCF Arizona against information in the Commission's Claims System and communicates all noted discrepancies to the Claims Division staff, Legal Division staff, or SCF Arizona staff as appropriate. These internal control procedures were in place during the entirety of fiscal year 2013.

In order to strengthen the reconciliation process and give it even greater internal controls, during fiscal year 2014, Commission staff will develop and implement a procedure to randomly test a sample of SCF Arizona's individual claims to ensure that SCF Arizona's internal controls are reasonable and accurate. Fifteen claims will be randomly selected from each SCF Arizona quarterly invoice. Commission Accounting Division staff will trace these fifteen claims back to SCF Arizona's records based on the following information listed on SCF Arizona's detailed invoice: SCF Claim Number, Claimant Name, Carrier Name, Date of Injury, Award Letter, Medical Invoice and Expense Invoice. All noted discrepancies will be investigated and resolved, and if needed, the sample size will be increased to ensure that SCF Arizona's internal controls are reasonable and accurate.

2013-03

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

Financial Statement Findings and State Responses **(Reformatted from the FY 2013 Report on Internal Control and Compliance)**

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

Condition and context: The Department is responsible for collecting and reporting income taxes owed to the State. While testing procedures for income tax revenues, auditors noted additional procedures that the Department should perform to help ensure this is achieved. 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: The State may not receive the proper amount of individual income taxes.

Cause: The Department's information 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 the need for improved procedures concerning the recording and reporting of tax revenues for the State. Staff reductions, imperative IT projects and other resource limitations have required the Department to carefully prioritize proposed improvements. As the Department works through the implementation of improvements to systems and procedures, it has instituted and continues to research compensating controls to minimize risks to tax revenue.

2013-04

Northern Arizona University should follow its policies and procedures when preparing financial statements

Criteria: The University should follow its policies and procedure to ensure its financial statements are prepared in accordance with U.S. generally accepted accounting principles. Accurate financial statements provide valuable information to those charged with governance, management, and other financial statement users, to make important decisions about the University's financial operations.

Condition and context: The University did not follow its policies and procedures to conduct a thorough review of its financial statements to ensure proper report presentation. Specifically, the University incorrectly reported approximately \$9 million in capital leases and capital assets on its Statement of Cash Flows for a capital lease and did not properly disclose approximately \$37 million in noncash transactions for its defeasance of bonds. Also, the University overstated accounts receivable and understated expenses, each by approximately \$5 million because information was not correctly set up in its new financial accounting system.

Effect: The University's financial statements were not initially prepared in accordance with U.S. generally accepted accounting principles. The University made recommended audit adjustments to the financial statements for all significant errors and misclassifications.

Cause: In an effort to help ensure the financial statements were issued in a timely manner and because of implementation delays with a new financial accounting system, the University's review time was reduced, which increased the risk of compilation errors.

Recommendation: To help ensure the accuracy of the University's financial statements, the University should strengthen its existing internal control policies and procedures by requiring a thorough review of

Financial Statement Findings and State Responses (Reformatted from the FY 2013 Report on Internal Control and Compliance)

the financial statements by someone who is independent of the person preparing the financial statements and knowledgeable of the University operations and reporting requirements.

Agency Response: Concur

Agency Corrective Action Plan: The University has reviewed the audit finding and recommendation associated with the annual audit of the University's Annual Financial Report for the year ended June 30, 2013. We concur with the audit finding and recommendation. The University will take the following corrective actions:

The University will improve the financial statement review process to ensure accounting standards and applicable NAU policies and procedures are followed, and that transactions are recorded and reported correctly. We will also consider the need to implement additional review procedures and checklists, shift staff responsibilities and or add staffing resources to help ensure timely and accurate financial reporting.

The University made recommended audit adjustments to the financial statements for all significant errors and misclassifications and the final financial statements were revised in time to report the accurate numbers for financial statement production.

While the findings represent certain financial reporting risks, we believe that with the corrective actions taken our annual financial report accurately reflects the University's financial position. In addition, we believe the risks were not the result of nor did not lead to any loss of assets through malfeasance or theft.

2013-05

The University of Arizona should strengthen access controls for its payroll system

Criteria: To help prevent and detect unauthorized use, damage, loss, or modification of programs and data, University policy IS-S702 requires effective payroll system access controls. Effective access controls include maintaining documentation showing that access granted to system users was appropriate for their job responsibilities and properly approved. Further, University policy IS-P702M requires a comprehensive review of user roles every 3 years.

Condition and context: Auditors found two deficiencies in the University's access controls over its payroll system: (1) For 3 of 15 payroll system users selected during our audit, the University could not provide documentation showing the system users' access was appropriate for their job responsibilities and properly approved prior to the users being granted access to the payroll system. (2) The University had not conducted a comprehensive review of payroll system user roles within the last 3 years.

Effect: There is an increased risk of inappropriate use of confidential information by unauthorized users and of financial statement errors when system access is not properly documented and user roles are not regularly reviewed. Although they were not properly documented, auditors determined that the three users were granted appropriate system access based on their job responsibilities.

Cause: The University has designed effective system access controls but these procedures were not followed during the audit period. As a result, the required comprehensive review was not performed. Further, the three payroll system users were given access through alternate procedures and the related supporting documents were not maintained.

Recommendation: To help ensure the University's payroll system is not vulnerable to misuse or abuse by unauthorized users, the University should maintain documentation showing that the access granted to system users was appropriate for their job responsibilities and properly approved. The University should also perform a comprehensive review of all payroll system user roles to ensure user roles remain current and appropriate.

Agency Response: Concur

Financial Statement Findings and State Responses **(Reformatted from the FY 2013 Report on Internal Control and Compliance)**

Agency Corrective Action Plan: Although the University is presently utilizing an Access Provisioning Tool (APT) system for common roles and the JIRA Ticketing system for specialty roles the exceptions found were from the initial conversion when these systems were not in place. The University will perform a comprehensive review of all UAccess Employee user roles and their designees to ensure user roles remain current and appropriate. The approvals notated in this review as well as the documentation contained in JIRA and APT will provide the required supporting documentation. This review will be completed by reviewing the entire population by the end of the next 3-year period.

2013-06

The University of Arizona should include all required information in its deposits and investments note disclosure

Criteria: Government financial reporting standards require the University to disclose certain investment risks in its notes to the financial statements. As part of their disclosure of investment risks, the University must report for most of its investments the maturity dates and the credit quality ratings provided by rating agencies such as Moody's or Standard & Poor's. In addition, the University must also report a risk when it invests more than 5 percent of its monies in one individual entity.

Condition and context: When classifying its \$753 million of deposits and investments by risk category, the University put \$153 million into the wrong risk categories. As a result, the University did not report maturity dates or credit quality ratings for nearly \$83 million of its investments and the University did not report that \$70 million was invested in one individual entity. Additionally, for 2 of 25 investments tested, the University did not report the correct credit quality rating.

Effect: The University did not originally disclose all of its investment risks. Because of this, the University's investments may have appeared more safe than they actually were. However, after auditors found the errors and omissions, the University made all necessary adjustments to accurately report its investment risks in its notes to the financial statements.

Cause: The University's established procedures were not adequate to ensure that all investments were properly classified by risk category so that all required risk information would be reported.

Recommendation: The University should improve its procedures over the preparation of the required investment risk information included in its notes to the financial statements. Specifically, these procedures should include a more detailed review of the classification of investments by risk category to help ensure that all required risk information is disclosed.

Agency Response: Concur

Agency Corrective Action Plan: The University will enhance its cash and investment reconciliation procedures and review process to ensure that its investment's credit and interest rate risk and concentration of credit risk are appropriately classified in the notes to the financial statements. The University anticipates implementing the enhanced procedure and review process by January 31, 2014.

Other auditors' findings:

The other auditors who audited the Arizona State Lottery, which is a department of the State, reported the following findings.

2013-07

Accounting and Reporting Components of Net Position

Criteria: We believe that paragraph 12.123 of the American Institute of Certified Public Accountants, (AICPA) State and Local Government Audit and Accounting Guide provides the relevant accounting guidance for liabilities for prizes and forfeitures of unclaimed prizes. Forfeitures of unclaimed prizes

Financial Statement Findings and State Responses (Reformatted from the FY 2013 Report on Internal Control and Compliance)

should be recognized as a gain (net against prize expense) as of the date the claim is forfeited according to the provisions of a State's stated regulations. Many States have regulations with regard to how forfeited unclaimed prizes must be utilized. For example some States require all forfeited unclaimed prizes to be transferred to another State fund or agency having a different mission. Arizona Revised Statutes 5-568 states the following:

Disposition of unclaimed prize money

Unclaimed prize money for the prize on a winning ticket or share shall be retained for the person entitled to the prize for one hundred eighty days after the drawing in which the prize was won in the case of a drawing prize and for one hundred eighty days after the announced end of the game in question in the case of a prize determined in any manner other than by means of a drawing. If a claim is not made for the money within the applicable period, seventy per cent of the prize money shall be held in the state lottery prize fund for use as additional prizes in future games and thirty per cent shall be transferred monthly to the court appointed special advocate fund established by section 8-524.

We believe the State's statute places a restriction on the use of forfeited prizes. Restricted net position should be reported when constraints placed on net position are either externally imposed by grantors, creditors, contributors or by laws or enabling legislation. The restriction to use unclaimed prizes that are forfeited represents a specific purpose, does not represent a liability in our view, rather it is the underlying exchange transaction resulting from the sale of lottery tickets for games in progress that creates a liability, defined by GASB's Concept Statement No. 4, Elements of Financial Statements, as the present obligation to sacrifice resources.

Condition: The previously balance reported as liabilities for prizes was comprised of several components of the Lottery's Prize Fund. These components consisted of unclaimed forfeited prizes, accumulated prize fund balance, accumulated investment earnings of the prize fund and flows of the prize fund. Certain of these components do not appear related to a present obligation for prizes. The Arizona Lottery retains and reports unclaimed prizes as a liability.

Context: The Lottery previously reported a liability for prizes of approximately \$30 million. Management's estimate of liability attributable to only prizes is approximately \$12 million. A portion of this estimate is attributable to forfeited prizes is approximately \$5 million.

Effect: We believe the liability for prizes has been overstated and that components of net position are understated or other liabilities exist.

Cause: We don't believe management had fully considered the applicable accounting and financial reporting guidance for prizes or components of net position.

Recommendation: We recommend that management review the underlying nature and agreements for each significant reported balance and assess reporting restricted components of net position and review/revise its accounting policies with regard to activities of the Prize Fund. Those policies should reflect the use of resources in conformity with State statute while also considering the financial condition of the Lottery.

Agency Response: Concur

Agency Corrective Action Plan: Management will review accounting policies for activities in the Prize Fund. The Lottery has been consistent in its reporting of prize liability since the Lottery's inception and that reporting is similar to reporting used by other state lotteries. We agreed with the auditor to revise the presentation of prize liability this year and will seek to find an appropriate presentation in future years.

The Lottery also believes that forfeited prizes are properly included in prize liability. Some of those forfeited prizes are committed to prize subsidies for Scratchers games that began in FY13 and are continuing into FY14 and the balance of forfeited prizes will be used to subsidize other games before the

Financial Statement Findings and State Responses (Reformatted from the FY 2013 Report on Internal Control and Compliance)

end of FY14. The Lottery has historically subsidized Scratchers by \$6 to \$8 million annually. The Lottery also has an ongoing commitment to fund a \$1 million jackpot for the Pick game. It is currently taking from twelve to fourteen draws to fully fund jackpot payouts from sales. Any subsidy would come from forfeited prizes.

2013-08

Improve cash management practices

Criteria: Cash management controls and procedures should ensure the accuracy of the funds that are disbursed.

Condition and context: Management self-reported to us an instance that an erroneous payment was issued for \$35,000,000 instead of the intended \$3,500,000 to another State agency.

Effect: A significant amount of funds were disbursed by the Lottery, however were subsequently returned. In addition, the Lottery also missed the opportunity to earn interest for a short period of time between when the funds were disbursed and then returned.

Cause: The Lottery's controls failed to detect a significant error in the cash disbursed.

Recommendation: We recommend that management review its controls to ensure the accuracy of cash disbursements.

Agency Response: Concur

Agency Corrective Action Plan: Management has reviewed the controls concerning cash disbursements and determined that controls are proper but that a significant error had been made. Employees involved have been counseled.

2013-09

Regularly review third party service reports

Criteria: Service organizations are entities that provide outsourcing activities that are relevant to the control environments at user organizations. A Type II SSAE 16 report is an independent report on the design and operating effectiveness of key controls at a service organization. A Type II SSAE 16 provides assurance to user organizations that the control objectives relating to the services provided by their service organization are suitably designed and operating effectively throughout the examination period.

Condition and context: The Lottery utilizes reports and systems of GTECH, a service organization; however GTECH does not currently provide a Type II SSAE 16 report to the Lottery.

Effect: Errors, if any, in the reports provided to the Lottery by GTECH may not be detected in a timely manner.

Cause: GTECH does not appear to have a Type II SSAE 16 report available for the Lottery.

Recommendation: We recommended that management obtain and review SSAE 16/SAS 70 annually to ensure service providers have sufficient controls in place and operating effectively given the significance of the information provided by GTECH to the Lottery.

Agency Response: Concur

Agency Corrective Action Plan: With the present on-line contract GTECH was required to provide, within the first year but not before six months, the Arizona Lottery with a SAS 70 report. This report was to study the controls put into place by GTECH Arizona. The Arizona Lottery was able to approve the contractor that GTECH proposed to use for the SAS 70 report. The cost associated with this project was placed on

Financial Statement Findings and State Responses
(Reformatted from the FY 2013 Report on Internal Control and Compliance)

the winner of the on-line contract. It was a built in expense as it is quite expensive to produce. The Lottery is always attempting to make sure all systems and processes are followed, not only by the rules set forth by the Lottery but, also with the rules set forth under the Multi State Lottery agreement. The Lottery's internal auditing department verifies all changes made to the GTECH process and programs. These changes are reviewed and tested before they are implemented. The Arizona Security department also observes the process several times a year to ensure compliance with existing rules and processes. To start a SSAE 16/SAS 70 report outside of the contract would place an undue financial burden upon the Lottery as it is not required by contract to be performed by GTECH. If it is indeed necessary this will be made an ongoing requirement placed in the upcoming RFP for the on-line contract.