



State of Mississippi
OFFICE OF THE STATE AUDITOR
PHIL BRYANT
Auditor

January 20, 2004

Financial Audit Management Report

Honorable Tate Reeves, State Treasurer
State Treasury Department
P. O. Box 138
Jackson, Mississippi 39205

Dear Mr. Reeves:

Enclosed for your review are the financial audit findings for the State Treasury Department for the Fiscal Year 2003. In these findings, the Auditor's Office recommends the State Treasury Department:

1. Review Resource Access Control Facility (RACF) settings to maximize control capabilities;
2. Strengthen controls over the statewide collateral pool;
3. Strengthen controls over the defacement of state warrants;
4. Strengthen controls over investments of the Educational Improvement Trust Fund; and
5. Strengthen controls over SAAS approval levels.

Please review the recommendations and submit a plan to implement them by February 10, 2004. The enclosed findings contain more information about our recommendations.

During future engagements, we may review the findings in this management report to ensure procedures have been initiated to address these findings.

This report is intended solely for the information and use of management and Members of the Legislature and is not intended to be and should not be used by anyone other than these specified parties.

I hope you find our recommendations enable the State Treasury Department to carry out its mission more efficiently. I appreciate the cooperation and courtesy extended by the officials and employees of the State Treasury Department throughout the audit. If you have any questions or need more information, please contact me.

Sincerely,

Phil Bryant
State Auditor

Enclosures

The Office of the State Auditor has completed its audit of selected accounts included on the

financial statements of the State Treasury Department for the year ended June 30, 2003. These financial statements are consolidated into the State of Mississippi's Comprehensive Annual Financial Report. The Office of the State Auditor's staff members participating in this engagement included Bill Doss, CPA, Sharon Smiley, CPA, CPM, Tonya Bierman, Kayla Jackson, Mary Jo Milner, Lucreta Walker, LaRondia Johnson, and Tangel Beddingfield.

The fieldwork for audit procedures and tests was completed on December 2, 2003. These procedures and tests cannot and do not provide absolute assurance that all state legal requirements have been met. In accordance with Section 7-7-211, Miss. Code Ann. (1972), the Office of the State Auditor, when deemed necessary, may conduct additional procedures and tests of transactions for this or other fiscal years to ensure compliance with legal requirements.

Internal Control over Financial Reporting

In planning and performing our audit of selected accounts included on the financial statements, we considered the State Treasury Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on these accounts and not to provide assurance on the internal control over financial reporting.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that require the attention of management. These matters are noted under the heading **IMMATERIAL WEAKNESSES IN INTERNAL CONTROL**.

Compliance

As part of obtaining reasonable assurance about whether selected accounts included on the financial statements of the State Treasury Department are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts and grants, 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. We are pleased to report the results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

IMMATERIAL WEAKNESSES IN INTERNAL CONTROL

Resource Access Control Facility (RACF) Settings Should Be Reviewed to Maximize Control Capabilities

Finding:

During our review of the State Treasury Department's Resource Access Control Facility (RACF) settings, we noted the following control weaknesses:

- For 36 of 40 user IDs, passwords had expired more than six months ago or the last access date was listed as "unknown" (meaning the user had never used the main frame computer).
- The user name was "vacant" for ten users.
- There were two generic user names.
- User IDs had not been disabled for two terminated employees.

Control Objectives for Information and Related Technology (CobiT) and the Mississippi Information Technology Security Policy, as well as recognized industry best practices, require adequate access controls to resources. Without these access controls in place, security could be compromised, allowing unauthorized access or fraud to occur without being detected.

Recommendation:

We recommend the State Treasury Department review all settings for RACF to ensure each employee has a unique password and user ID to the main frame computer that is set to expire on a regular basis. We further recommend management review all dormant user accounts and their attribute settings. If accounts are not deemed necessary, access IDs should be deactivated. The State Treasury Department should implement procedures to ensure retired or terminated employees' user IDs are disabled immediately when an employee leaves the agency's service.

Internal Controls over the Statewide Collateral Pool Should Be Strengthened

Finding:

Our review of the statewide collateral pool at the State Treasury Department (Treasury) revealed the following:

- The Public Funds Guaranty Pool Rules state the average daily balance should be used to determine a bank's required collateral pledging level. Three instances were noted in which Treasury did not use the average daily balance to determine the guaranty pool bank's required collateral pledging level. One of these errors resulted in a bank's deposits being understated by \$9,638,367 on the spreadsheet used by Treasury to monitor each bank's deposits and related collateral. However, these errors did not cause the banks to be under collateralized.

- A bank's monthly deposit information and Federal Deposit Insurance Corporation (FDIC) coverage is used in determining its required collateral pledging level. Four instances were noted in which FDIC calculations were in error. These errors ranged from \$39,760 to \$2,749,262. However, these differences did not cause the banks to be under collateralized.
- Treasury has developed a spreadsheet for monitoring each bank's deposits and related collateral to determine if each bank is adequately collateralized. In verifying accuracy of deposit information on the spreadsheet, one instance was noted in which an entity on the bank's monthly report was not an allowable public entity. Thus, this entity's deposit information should not have been included in determining the required pledging level of the bank.
- Treasury personnel perform monthly reconciliations of the collateral pledged by the banks which is recorded on the Treasury's system to the collateral held by third party safekeepers. Our review of these reconciliations revealed an instance in which the reconciliation was in error, however Treasury personnel marked it as correct for two consecutive monthly reconciliations. The error was not noted by Treasury personnel until three months after it was pledged. This error caused the bank to be under collateralized at June 30, 2003.

Good internal controls require the deposit information and FDIC coverage used to determine the required collateral pledging level of banks within the statewide collateral pool be correct. Furthermore, controls should be strengthened to ensure monthly reconciliations are correct. Outstanding items noted during the reconciliation process should be documented and resolved timely. Failure to properly determine the required pledging level of individual banks could result in banks being under collateralized.

Recommendation:

We recommend the State Treasury Department (Treasury) strengthen internal controls over the statewide collateral pool to ensure the required collateral pledging level of guaranty pool banks be properly determined based on rules approved by the Guaranty Pool Board. Also, the deposit and FDIC information used in determining the required collateral pledging level for banks within the statewide collateral pool should be accurate. Monthly reconciliations of collateral between Treasury's records and the third party safekeepers should be properly performed. Any outstanding items should be documented and resolved in a timely manner.

Internal Controls over the Defacement of State Warrants Should Be Strengthened

Finding:

Our review of bond principal and interest payments at the State Treasury Department revealed one instance in which a State warrant was not stamped as being paid after it was posted to the Statewide Automated Accounting System (SAAS) on June 30, 2003. Upon further review, it was noted all State warrants included in the batch of bond principal and interest payments that were posted as paid to SAAS on June 30, 2003, were also not stamped as being paid. The warrants included in this batch totaled \$15,613,850. Good internal controls require all State warrants be defaced after posting to SAAS. Failure to deface State warrants could result in warrants being presented for payment after they have cleared SAAS.

Recommendation:

We recommend the State Treasury Department strengthen controls to ensure State warrants are defaced to prevent a warrant from being presented for payment after being posted to the Statewide Automated Accounting System.

Internal Controls over Investments of the Educational Improvement Trust Fund Should Be Strengthened

Finding:

The State Treasury Department allocates money from the Educational Improvement Trust Fund to money managers to invest on behalf of the State. The State Treasury Department has established written guidelines for each money manager which details the type and duration of investments that are allowable in the money managers' portfolios. Our review of the investments of the Educational Improvement Trust Fund revealed the following:

- One instance was noted in which an investment's maturity date was July 2022. This exceeds the seven year maximum maturity of a single issue, as allowed in the guidelines.
- One instance was noted in which the weighted average duration of the portfolio was 2.4 years. This exceeds the maximum duration of 2.25 years, as allowed in the guidelines.

Good internal controls require guidelines established for investments made by money managers be followed.

Recommendation:

We recommend the State Treasury Department strengthen internal controls to ensure investments of the Educational Improvement Trust Fund are in compliance with written guidelines.

Internal Controls over SAAS Approval Levels Should Be Strengthened

Finding:

A review of authorized approval levels over disbursement transactions at the State Treasury Department revealed the internal auditor has been afforded input authority and the final levels of approval over disbursement transactions in the Statewide Automated Accounting System (SAAS), as well as authority to sign the agency's payment vouchers. Also, a contract worker hired to prepare the year-end financial statements has input authority and one level of approval over disbursement transactions.

Good internal controls require SAAS access and approval levels be reviewed to ensure duties are properly segregated to prevent employees charged with the task of verifying accuracy of the recording and posting of transactions also being allowed to input and approve those same transactions. Also, SAAS access and approvals should be updated to ensure contract workers do not retain unnecessary access to financial transactions of the entity's automated system. Failure to adequately segregate duties in an online system increases the potential for fraud to occur without being detected promptly.

Recommendation:

We recommend the State Treasury Department strengthen controls over SAAS approval levels to ensure employees charged with verifying accuracy of information are also not allowed to input and approve those same transactions. Also, contract workers should not retain unnecessary access to SAAS.