



STATE OF MISSISSIPPI
OFFICE OF THE STATE AUDITOR
STACEY E. PICKERING
AUDITOR

February 14, 2014

Honorable Phil Bryant, Governor
State of Mississippi
P.O. Box 139
Jackson, Mississippi 39205

Mr. Kevin J. Upchurch, Executive Director
Department of Finance and Administration
501 North West Street
Suite 1301, Woolfolk Building
Jackson, Mississippi 39201

Gentlemen,

The Office of the State Auditor has recently completed the *Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards* for the year ended June 30, 2013. This report, which provides information on controls and compliance by the state agencies as reported in the State of Mississippi's *Comprehensive Annual Financial Report*, contains information on an instance of noncompliance which was considered to be material to the State of Mississippi. This report also includes an appropriate recommendation for correction of this finding, as well as the agency's response to the finding and the intended corrective action.

Copies of this report will be available through the State Auditor's Office web site on the Internet at [Http://www.osa.state.ms.us](http://www.osa.state.ms.us). Should you have any questions, please feel free to contact Bill Doss, CPA, at (601) 576-2672.

Sincerely,

A handwritten signature in black ink, appearing to read "Stacey E. Pickering".

Stacey E. Pickering
State Auditor

enclosures

State of Mississippi

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

for the Fiscal Year Ended June 30, 2013

MISSISSIPPI



Stacey E. Pickering

State Auditor

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INDEX

Independent Auditor’s Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	1
Schedule of Findings and Questioned Costs	
Part 1 – Summary of Auditor’s Results	
Summary of Auditor’s Results	7
Part 2 – Financial Statement Findings	
Treasury	
Finding 2013-01	11
Part 3 - Management Responses	
Treasury	15
Auditor’s note to Treasury Response	17

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STATE OF MISSISSIPPI
OFFICE OF THE STATE AUDITOR
STACEY E. PICKERING
AUDITOR

INDEPENDENT AUDITOR'S REPORT ON
INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH *GOVERNMENT AUDITING STANDARDS*

The Governor, Members of the Legislature
and Citizens of the State of Mississippi

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of the State of Mississippi (the State), as of and for the year ended June 30, 2013, and the related notes to the financial statements which collectively comprise the State's basic financial statements, and have issued our report thereon dated December 19, 2013. Our report includes a reference to other auditors who audited the financial statements of the following, as described in our report on the State of Mississippi's financial statements:

■ Government-wide Financial Statements

● Governmental Activities

- the Department of Environmental Quality Clean Water State Revolving Loan Fund, the Department of Health Local Governments and Rural Water Systems Improvements Revolving Loan Fund, the Mississippi Authority for Educational Television, the State Agencies Self-Insured Workers' Compensation Trust Fund, and selected funds at the Department of Corrections, the Department of Employment Security, the Department of Environmental Quality, the Department of Finance and Administration – Office of Insurance, the Office of the Governor - Division of Medicaid, the Military Department, the Mississippi Development Authority, the Mississippi Emergency Management Agency, the Department of Rehabilitation Services and the Department of Wildlife, Fisheries and Parks which, in the aggregate, represent 8% and 40%, respectively, of the assets and revenues of the Governmental Activities;

● Business-type Activities

- the Port Authority at Gulfport, the Mississippi Prepaid Affordable College Tuition Program, the Veterans' Home Purchase Board, and the Unemployment Compensation Fund which, in the aggregate, represent 96% and 93%, respectively, of the assets and revenues of the Business-type Activities;

- Component Units
 - the Universities and the nonmajor component units.

- Fund Financial Statements
 - Governmental Funds
 - the Department of Environmental Quality Clean Water State Revolving Loan Fund, the Department of Health Local Governments and Rural Water Systems Improvements Revolving Loan Fund, the Mississippi Authority for Educational Television and selected funds at the Department of Corrections, the Department of Employment Security, the Department of Environmental Quality, the Office of the Governor - Division of Medicaid, the Military Department, the Mississippi Development Authority, the Mississippi Emergency Management Agency, the Department of Rehabilitation Services and the Department of Wildlife, Fisheries and Parks which, in the aggregate, represent 22% and 36%, respectively, of the assets and revenues of the General Fund;

 - Proprietary Funds
 - the Port Authority at Gulfport, the Mississippi Prepaid Affordable College Tuition Program and the Unemployment Compensation Fund which are considered major enterprise funds;

 - Aggregate Remaining Funds
 - the State Agencies Self-Insured Workers' Compensation Trust Fund and selected funds at the Department of Finance and Administration – Office of Insurance within the Internal Service Fund;
 - nonmajor enterprise funds for the Veterans' Home Purchase Board;
 - the Pension Trust Funds;
 - the Private-Purpose Trust Funds of the Mississippi Affordable College Savings Program;

all of which represent 99% and 98%, respectively, of the assets and revenues of the Aggregate Remaining Funds.

Except for the major component unit Universities, 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 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. This report does not include the results of the other auditor's testing of internal control over financial reporting and compliance and other matters for the major component unit Universities that are reported on separately by those auditors.

The financial statements of the Mississippi State University Foundation, Inc., the University of Mississippi Foundation, the University of Southern Mississippi Foundation, the University of Mississippi Medical Center Educational Building Corporation, the University of Mississippi Educational Building Corporation, the University of Mississippi Medical Center Tort Claims Fund, the State Institutions of Higher Learning Self-

Insured Workers' Compensation Fund, and the State Institutions of Higher Learning Tort Liability Fund, which were audited by other auditors upon whose reports we are relying, were not audited in accordance with *Government Auditing Standards*, and accordingly this report does not include reporting on internal control over financial reporting or instances of reportable noncompliance associated with these funds or entities.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we and other auditors considered the State of Mississippi's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Mississippi's internal control. Accordingly, we do not express an opinion on the effectiveness of the State of Mississippi's internal control.

A *deficiency in internal control* 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our and the other auditors' consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we and the other auditors did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

We and the other auditors also noted certain matters involving the internal control over financial reporting, which we have reported to management of the applicable state agencies and institutions of the State of Mississippi in separate communications.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Mississippi's financial statements are free from material misstatement, we and other auditors 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 disclosed an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards* and which is described in the accompanying "Schedule of Findings and Questioned Costs: Part 2 – Financial Statement Findings" as item 2013-01.

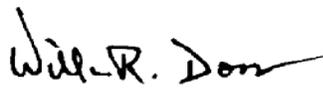
We and the other auditors also noted certain matters which we have reported to management of the State of Mississippi in separate communications.

Management's Response to Finding

Management's response to the finding identified in our audit is described in the accompanying "Management's Response and Corrective Action Plan" section. Management's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the State of Mississippi's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. However, this report is a matter of public record and its distribution is not limited.

A handwritten signature in black ink that reads "Will R. Doss". The signature is written in a cursive, slightly slanted style.

WILLIAM R. DOSS, CPA
Director, Financial and Compliance
Audit Division

Jackson, Mississippi
December 19, 2013

**Schedule of Findings and Questioned Costs:
Part 1
Summary of Auditor's Results**



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STATE OF MISSISSIPPI

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2013

PART 1 – SUMMARY OF AUDITOR’S RESULTS

Financial Statements

Type of auditor’s report issued:

Unqualified

Internal control over financial reporting:

- Material weaknesses identified? yes no

- Significant deficiencies identified? yes none reported

Noncompliance material to financial
statements noted?

yes no

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**Schedule of Findings and Questioned Costs:
Part 2
Financial Statement Findings**



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Finding Number **Finding and Recommendation**

TREASURY

Material Noncompliance

2013-01

Investment Ratios Should Be Maintained in Accordance with State Law

Finding:

Section 27-105-33, Miss. Code Ann. (1972), establishes guidelines for use in the maintenance of the state's investment pool portfolio. The law also states that at no time shall funds invested in United States Government agency, United States Government instrumentality, or United States Government sponsored enterprise obligations exceed 50 percent of all monies invested with maturities 30 days or longer. Testwork at the Office of the State Treasurer revealed the total of United States Government agency, instrumentality, and government sponsored enterprise obligations exceeded 50 percent of total investments for 12 of the 12 dates selected for testwork (one per month). The actual investment percentages for dates tested ranged from approximately 82 to 91 percent, resulting in investments in U.S. Government agency, instrumentality, and government sponsored enterprise obligations of approximately \$905 million to approximately \$1.1 billion in excess of statutory limits. Failure to maintain investment ratios in the State's investment pool portfolio within the required percentages resulted in violation of state law.

Recommendation:

We recommend the Office of the State Treasurer ensure the State's investment pool be maintained in accordance with Section 27-105-33 d. (iii), Miss. Code Ann. (1972). Agency personnel should periodically review the investment pool portfolio for compliance with state law and adjust the portfolio if required. This review should be documented as evidenced by the signature and date of the reviewer.

NOTE: See agency response on page 15 and auditor's note on page 17.

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**Schedule of Findings and Questioned Costs:
Part 3
Management Response**



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OFFICE OF THE STATE TREASURER
LYNN FITCH
TREASURER

January 30, 2014

Honorable Stacey E. Pickering
State Auditor
State of Mississippi
8th Floor, Woolfolk Building
Jackson, Mississippi 39201

Dear Mr. Pickering:

We have reviewed the audit finding below in reference to our fiscal year 2013 audit. Listed below is our individual response and plan for corrective action:

AUDIT FINDING
2013 - 01:

Investment Ratios Should be Maintained in Accordance with State Law

Response:

We do not concur with the audit finding. We fundamentally disagree with the application of the 50 percent limitation to certain Agency securities.

Corrective Action:

Under the conservatorship put in place on September 7, 2008, FNMA and FHLMC are being run by the Federal Housing Finance Agency. The US Treasury's actions on September 7th included the institution of Preferred Stock Purchase Agreements, which are the foundation of the direct financial support of the US government to the agencies. The Treasury secretary's speech highlighted the additional security and clarity that these agreements provide to debt holders of FNMA and FHLMC. There were other steps that provided additional security to the debt holders through the provision of greater market stability, but the Purchase Agreements are, in our view, the most important and direct source of financial support. Because FNMA and FHLMC are congressionally chartered, only Congress can effect a permanent change in the status of the companies – either making them entirely public or entirely private. That is a matter that has yet to be

determined. Reform will likely occur in some form over the next couple of years, and we will see what ultimately becomes of FNMA and FHLMC. The point put forth by Treasury is that what we know today is that the debt is for all intents and purposes fully supported by the US government, and therefore the debt of FNMA and FHLMC held in the portfolio should not be included in the 50 percent calculation. There is not an explicit legal guarantee, and there will not be – partly because of the balance sheet effects on the US as a whole and partly because of the congressional charters of these companies, to say nothing of the precedent set by the US assuming a public/private entity's debt. The net result of the conservatorship is financial support of the companies, which includes support to pay its debt obligations and amounts to a guarantee from the federal government on the debt.

Treasury does not believe it is in the best interest of the taxpayers to liquidate FNMA and FHLMC holdings in favor of Treasuries to lower the allocation to Agencies due to the large losses in income to the portfolio that would result from such a rebalancing. The allocation to FNMA and FHLMC securities does not represent additional risk vis-à-vis Treasuries to the State or the taxpayers but does offer meaningfully higher yields. As FNMA and FHLMC holdings mature and/or are called, US Treasury holdings will be added to the portfolio as market rates and pricing are compelling compared to prevailing market rates of securities of similar maturities. Since March 2012, \$440 million of US Treasury securities have been added to the portfolio.

In the 2013 legislative session, the Office of the State Treasurer (OST) proposed revisions to amend Miss. Code Ann. § 27-105-33, including the removal of the fifty percent required allocation to Treasury securities. The revisions were introduced and passed by the House of Representatives, but later died in conference. The OST has introduced the same legislation in the 2014 legislative session.

Sincerely,



Lynn Fitch
State Treasurer



**STATE OF MISSISSIPPI
OFFICE OF THE STATE AUDITOR
STACEY E. PICKERING
AUDITOR**

Auditor's note to the Response from Management

TREASURY

MATERIAL NONCOMPLIANCE

Finding Number

Finding Heading

2013-01

Investment Ratios Should Be Maintained in Accordance with State Law

Rebuttal to Agency Response:

We have reviewed the comments made by the agency in response to the above noted finding. We wish to place additional emphasis on the fact the agency remains in violation of Section 27-105-33, Miss. Code Ann. (1972). This statute makes no provision for the Treasurer's judgment to be substituted in lieu of strict compliance with its requirements.

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Office of the State Auditor
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