



OFFICE OF THE STATE TREASURER
LYNN FITCH
TREASURER

March 19, 2015

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 2014 audit. Listed below is our individual response and plan for corrective action:

AUDIT FINDING: 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 interests 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, \$750 million of US Treasury securities have been added to the portfolio.

In the 2014 legislative session, the Office of the State Treasurer (OST) proposed revisions to amend Miss. Code Ann. § 27-105-33. The proposed revisions included the removal of the fifty percent required allocation to Treasury securities. The revisions were introduced in HB 1027 (please see attached), which was passed by the House of Representatives, Senate, and signed by the Governor March 19, 2014. The revisions to Miss. Code Ann. § 27-105-33 were effective July 1, 2014. Due to the revision to Miss. Code Ann. § 27-105-33, the OST will no longer be non-compliant to the referenced audit finding.

AUDIT FINDING:

Strengthen Controls over Review of Taxes Receivable Classifications

Response:

We concur with this audit finding.

Corrective Action:

The Office of the State Treasurer will strengthen controls over the review of tax receivable account numbers. One digit out of five was incorrectly reported and was missed by the preparer and reviewer. The taxes themselves were properly handled and distributed to cities and counties as required by law. Cash was deposited into the correct account; this was a reporting error.

AUDIT FINDING: Strengthen Controls over Arbitrage Calculations

Response: We concur with this audit finding.

Corrective Action: The Bond Division has discussed Audit's concern regarding the monitoring of all issues requiring a calculation to be performed with the Arbitrage Rebate Consultant. A joint schedule and calendar are currently being compiled to include all bond issues that require the Consultant's attention.

AUDIT FINDING: Review Employee Approval Levels in the Statewide Automated Accounting System (SAAS)

Response: We concur with this audit finding.

Corrective Action: The Office of the State Treasurer has reviewed the SAAS Approval Level finding by the Office of the State Auditor and made note of it. Management believes that appropriate breaks in security existed during the fiscal year. The one employee who had approval levels for disbursements, revenues and journal vouchers did not have signature authority on any of these items and served as the agency emergency approver as well as the backup approver for many divisions. The other employees who could approve revenue transactions also did not have signature authority and many of the transactions performed by these employees are transfers and are required for daily work. By none of these employees having signature authority, OST believes the risk of potential fraud or error has been mitigated. Also, on July 1, 2014, a new statewide accounting system was implemented to process accounting transactions. The Mississippi Accountability System for Government Information and Collaboration (MAGIC) security features will ensure that no employee has the ability to enter and approve a transaction. Thus, this finding should be resolved.

Sincerely,



Lynn Fitch
State Treasurer