

# State of Mississippi

## **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, 2011

MISSISSIPPI



**Stacey E. Pickering**

State Auditor

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

**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 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, as of and for the year ended June 30, 2011, which collectively comprise the state's basic financial statements, and have issued our report thereon dated December 19, 2011. Our report was modified to include a reference to other auditors. Other auditors 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 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 Emergency Management Agency, the Department of Rehabilitation Services and the Department of Wildlife, Fisheries and Parks which, in the aggregate, represent 7% and 37%, 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 82% and 95%, 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, and selected funds at the Department of Corrections, the Department of Environmental Quality, the Office of the Governor - Division of Medicaid, the Military Department, the Department of Rehabilitation Services and the Department of Wildlife, Fisheries and Parks which represent 21% and 33%, 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

- selected nonmajor governmental funds at the Mississippi Emergency Management Agency and the Department of Employment Security;
- 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 96% and 94%, 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.

Report on Internal Control over Financial Reporting  
and on Compliance and Other Matters Based on an  
Audit of Financial Statements Performed in  
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We conducted our audit in accordance with 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 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 audited in accordance with auditing standards generally accepted in the United States of America, but not in accordance with *Government Auditing Standards*.

Internal Control over Financial Reporting

Management of the State of Mississippi is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we and other auditors considered the State of Mississippi's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Mississippi's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Mississippi's internal control over financial reporting.

Our and the other auditors' consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying "Schedule of Findings and Questioned Costs: Part 2 -- Financial Statement Findings", we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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. We consider the deficiency described in the accompanying "Schedule of Findings and Questioned Costs: Part 2 - Financial Statement Findings" as item 2011-04 to be a material weakness.

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 basic financial statements are free of 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.

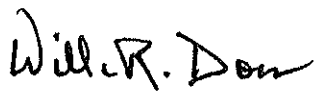
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The results of our tests disclosed an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards* and which is described in the accompanying "Schedule of Findings and Questioned Costs: Part 2 – Financial Statement Findings" as item 2011-01.

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 responses to the findings identified in our audit are described in the accompanying Management Responses and Corrective Action Plans section. We did not audit management's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Governor, Members of the Legislature, federal awarding agencies, pass-through entities and those charged with governance and is not intended to be and should not be used by anyone other than these specified parties. 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, flowing style.

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

Jackson, Mississippi  
December 19, 2011



**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, 2011

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PART 1 – SUMMARY OF AUDITOR'S RESULTS

*Financial Statements*

Type of auditor's report issued:

Unqualified

Internal control over financial reporting:

- Material weaknesses identified?                      X yes                      \_\_\_ no
- Significant deficiencies identified?                      \_\_\_ yes                      X none reported

Noncompliance material to financial  
statements noted?

X 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**

**EMPLOYMENT SECURITY**

***Material Weakness***

2011-04

**Controls Should Be Strengthened over the Review of Activity and Account Balances in Significant Transaction Areas**

***Finding:***

Management is responsible for designing and maintaining effective internal controls over financial reporting to provide reasonable assurance that financial statements are free from material misstatement.

The Mississippi Department of Employment Security's accounting process with respect to the preparation of annual financial statements lacks an effective level of review of activity and account balances in significant transaction areas in order to prevent and/or detect misstatements in a timely manner.

The design of internal controls over the preparation of financial statements in conjunction with annual financial reporting does not include all controls necessary to prevent and/or detect material misstatement.

Potentially material misstatements in the financial statements could occur and not be prevented or detected in a timely manner.

***Recommendation:***

We recommend the Mississippi Department of Employment Security strengthen controls over the review of activity and account balances in significant transaction areas with respect to the preparation of annual financial statements to provide reasonable assurance that they are free from material misstatement.

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**Finding  
Number**

**Finding and Recommendation**

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**TREASURY**

***Material Noncompliance***

2011-01

**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 Mississippi State Treasury Department revealed the total of United States Government agency, instrumentality, and government sponsored enterprise obligations exceeded 50 percent of total relevant investments for 12 of the 12 dates selected for testwork (one per month). The actual investment percentages for dates tested ranged from approximately 91 to 95 percent, resulting in investments in U.S. Government agency, instrumentality, and government sponsored enterprise obligations of \$823 million to approximately \$1.2 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 Mississippi State Treasury Department ensure the state's investment pool is 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.

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



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## MISSISSIPPI DEPARTMENT *of* EMPLOYMENT SECURITY

OFFICE OF THE GOVERNOR  
LES RANGE  
EXECUTIVE DIRECTOR

January 9, 2012

Stacey E. Pickering, State Auditor  
Office of the State Auditor  
State of Mississippi  
P.O. Box 956  
Jackson, MS 39205-0956

Dear Mr. Pickering:

The Mississippi Department of Employment Security (MDES) appreciates this opportunity to submit a response to the financial audit finding for the year ended June 30, 2011.

### **Audit Findings:**

Finding 2011-01: Management is responsible for designing and maintaining effective internal controls over financial reporting to provide reasonable assurance that financial statements are free from material misstatement.

Response: MDES accepts this finding and agrees that strengthened controls with regard to the annual financial statement preparation are necessary to fairly present its financial position.

### Corrective Action Plan:

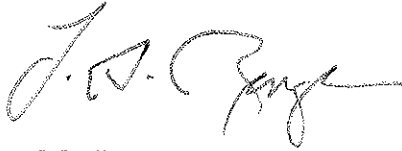
- A. An appropriate level of review of activity and account balances will be provided. MDES is committed to continuous improvement of its internal control structure. In support of this effort, MDES contracted with a highly regarded CPA firm to assist us in further defining and strengthening controls and recently added an Internal Audit Department. In addition, through a process team that is led by the Internal Audit Department, staff from a cross section of MDES have been assembled and meet periodically to discuss strengthening of MDES internal controls.

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January 9, 2012

Corrective Action Plan (continued):

- B. Contacts – Guy Martin – Business Manager and Jackie Turner – Director, Office of Comptroller.
- C. Currently in place.
- D. N/A

Sincerely,

A handwritten signature in dark ink, appearing to read "L. Range", written over a light blue horizontal line.

Mr. Les Range  
Executive Director

LR:jt



OFFICE OF THE STATE TREASURER  
LYNN FITCH  
TREASURER

January 11, 2012

Honorable Stacey Pickering  
State Auditor  
State of Mississippi  
8<sup>th</sup> Floor, Woolfolk Building  
Jackson, Mississippi 39201

Dear Mr. Pickering:

We have reviewed the audit finding below in reference to our fiscal year 2011 audit. Listed below is our individual response and plan for corrective action:

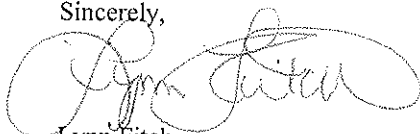
AUDIT FINDING:	Investment Ratios Should be Maintained in Accordance with State Law
Response:	We do not concur with the audit finding. We fundamentally disagree with the application of the 50 percent limitation to certain Agency securities.
Corrective Action:	Under the conservatorship put in place on 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, although it has been taken up in Congress recently. 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. But 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. Hopefully, some clarity will be given by Congress with regard to FNMA and FHLMC, at which time, we will review the status of the Agencies and act appropriately to ensure the safety and security of taxpayer dollars.

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.

If you have any question, please call Laura Jackson, Deputy Treasurer at 359-3765.

Sincerely,



Lynn Fitch  
State Treasurer





**Office of the State Auditor**  
**Post Office Box 956**  
**Jackson, Mississippi 39205-0956**  
**[www.osa.state.ms.us](http://www.osa.state.ms.us)**