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

February 6, 2018

Financial Audit Management Report

Honorable Lynn Fitch, State Treasurer
Office of the State Treasurer
P. O. Box 138
Jackson, MS 39205

Dear Treasurer Fitch:

Enclosed for your review are the financial audit findings for the Office of the State Treasurer for the Fiscal Year 2017. In these findings, the Auditor's Office recommends the Office of the State Treasurer:

1. Strengthen controls over cancelled warrants payable to ensure compliance with state law; and,
2. Strengthen controls over arbitrage calculations.

Please review the recommendations and submit a plan to implement them by February 20, 2018. 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.

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 Office of the State Treasurer'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 Office of the State Treasurer'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.

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

Sincerely,

Stephanie C. Palmertree

Stephanie C. Palmertree, CPA, CGMA
Director, Financial Audit and Compliance Division

Enclosures

FINANCIAL AUDIT MANAGEMENT REPORT

The Office of the State Auditor has completed its audit of selected accounts included on the financial statements of the Office of the State Treasurer for the year ended June 30, 2017. These financial statements will be consolidated into the State of Mississippi's *Comprehensive Annual Financial Report.* 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 Office of the State Auditor's staff members participating in this engagement included Thomas Wirt, CPA, Lee Alford, John Brandon, Phillip Chu, CPA, Katherine Landrum, CPA, and Clayton Southerland.

Our 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 Office of the State Treasurer'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 opinion on these accounts, but not for the purpose of expressing an opinion on the effectiveness of internal control. Accordingly, we do not express an opinion on the effectiveness of the Office of the State Treasurer'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 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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, identified in this letter as items 2017-019 and 2017-020, that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether selected accounts included on the financial statements of the Office of the State Treasurer are free of material misstatement, we 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted a certain immaterial instance of noncompliance that requires the attention of management identified in this letter as item 2017-019.

Findings and Recommendations

SIGNIFICANT DEFICIENCY
IMMATERIAL NONCOMPLIANCE

2017-019 Controls Should Be Strengthened over Cancelled Warrants Payable to Ensure Compliance with State Law.

Repeat Finding No

Criteria Section 7-7-42, Miss. Code Ann. (1972) states any warrant issued by the state against any fund in the State Treasury which has not been presented to the Office of the State Treasurer (OST) for payment within one year after the last day of the month in which it was originally issued, shall be null and void, the obligation thereafter shall be unenforceable. After which, the Department of Finance and Administration shall transfer the funds reflected by the cancellation of the warrant to the Abandoned Property Fund at OST where the funds shall remain for five years. After five years, if the funds are unclaimed, the OST shall transfer the funds back to the original source of funds.

Condition Based on testwork over cancelled warrants payable at OST, we noted OST maintained cancelled warrants in the Abandoned Property Fund for periods longer than five years after the warrants were originally expired and transferred into the Abandoned Property Fund.

During the lapse period of state fiscal year 2017 in July 2017, the agency returned $4,325,401 to the Department of Revenue for unclaimed income tax refunds; however, cancelled warrants payable at fiscal year-end 2017 was not adjusted with the Fund 3317800000 GAAP Packet by OST. Auditor proposed an adjustment, approved by OST management, to reclassify this liability as Due To Other Funds. The warrants were maintained in the Unclaimed Property Fund for longer than five years prior to June 30, 2017; therefore, these amounts should have been returned prior to fiscal year end.

Cause OST personnel stated that due to the implementation of a new statewide accounting system in fiscal year 2015, the return process for five-year cancelled warrants was delayed until July of 2017.

Effect The delay in returning funds to original agencies, after unclaimed in the Abandoned Property Fund for five years, results in an overstatement of cancelled warrants liability in the financial statements, as well as noncompliance with state law. In addition, the original agencies could use the funds to defray against costs incurred in current budget periods.

Recommendation We recommend the Office of the State Treasurer strengthen controls over cancelled warrants payable in the Abandoned Property Fund to ensure compliance with state law. After remaining unclaimed in the Abandoned Property Fund for five years, funds should be returned to the original agency sources in a timely manner to ensure efficient use of state resources.

SIGNIFICANT DEFICIENCY

2017-020 Controls Should Be Strengthened over Arbitrage Calculations

Repeat Finding Yes; OTH 16-01

Criteria Per Internal Revenue Service (IRS) guidance on the instructions for form 8038-T (arbitrage rebates), issuers must pay arbitrage rebates in installments for computation dates that occur at least once every five years. Rebate payments are due within 60 days after each computation date. The final rebate payment for an issue is due within 60 days after the issue is discharged. Also, good internal controls require supervisory review of accounting information submitted to a third party.

Condition During testwork performed over arbitrage calculations at the Office of the State Treasurer (OST), we noted OST did not prepare calculations for six of the nine bond issues within the timeframe specified by the Internal Revenue Service (IRS). The agency did send information to a third party in order to prepare arbitrage calculations for the bond issues; however, six calculations were received late ranging from 12 to 94 days. It should be noted that the calculations revealed there were no arbitrage payments due to the IRS. In addition, we noted no evidence of supervisory review of arbitrage cash flow schedules sent by OST to the consulting firm used as the basis for the arbitrage calculations.

Cause Agency personnel did not request arbitrage calculations from the third party in a timely manner. Also, accounting reports used as a basis for arbitrage liability calculations were sent by OST to the third party without supervisory review.

Effect Failure to ensure correct arbitrage calculations are prepared and rebates are paid within the timeframe specified by the Internal Revenue Service (IRS) could result in penalties and/or loss of tax exempt status for the bond issue. Failure to review accounting information sent to the consultant could result in an incorrect calculation of arbitrage liability.

Recommendation We recommend the Office of the State Treasurer strengthen controls to ensure all bonds are monitored for the timing of arbitrage calculations and rebate submissions, and that those calculations and rebate submissions occur timely, in accordance Internal Revenue Service regulations. In addition, we recommend the agency ensure that accounting information submitted to the third party is reviewed and approved by supervisory personnel.

End of Report