



STATE OF MISSISSIPPI
OFFICE OF THE STATE AUDITOR
SHAD WHITE
AUDITOR

March 27, 2019

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 is the financial audit finding for the Office of the State Treasurer for the Fiscal Year 2018. In this finding the Auditor's Office recommends the Office of the State Treasurer:

1. Strengthen controls over arbitrage calculations.

Please review the recommendation and submit a plan to implement it by April 10, 2019. The enclosed finding contains more information about our recommendation.

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

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 recommendation enables 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,

A handwritten signature in blue ink that reads "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, 2018. 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, LaSabre Charleston, Phillip Chu, CPA, Brianna Dang, Katherine Landrum, CPA, and Clayton Southerland, CPA.

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 a deficiency in internal control, identified in this letter as item 2018-028 that we consider to be significant deficiency.

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*.

Finding and Recommendation

SIGNIFICANT DEFICIENCY

2018-028	<u>Controls Should Be Strengthened over Arbitrage Calculations</u>
Repeat Finding	Yes - 2017-019 in 2017; OTH 16-01 in 2016; OTH 15-02 in 2015; OTH 14-02 in 2014; OTH 13-05 in 2013.
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.
Condition	<p>During testwork performed over arbitrage calculations at the Office of the State Treasurer (OST), we noted OST did not prepare calculations for five of 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, five calculations were received late ranging from 45 to 185 days. It should be noted that the calculations revealed no arbitrage payments were due to the IRS.</p> <p>In addition, we noted the agency owed an arbitrage rebate to the IRS for the Series 2009C General Obligation Note due by January of 2011. However, the agency did not request a final arbitrage calculation for 2009C until May of 2018 when the rebate of \$574,362 was paid from fiscal year 2018 funds. Therefore, accrued interest in the amount of \$161,092 was assessed and included in the final payment to the IRS.</p>
Cause	Agency personnel did not request arbitrage calculations from the third party in a timely manner.
Effect	Failure to ensure 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. The rebate paid during fiscal year 2018 included \$161,092 of accrued interest due to untimely preparation of the arbitrage calculation.
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.

End of Report



OFFICE OF THE STATE TREASURER
LYNN FITCH
TREASURER

FINANCIAL AUDIT FINDINGS

April 10, 2019

The Honorable Shad White
State Auditor
State of Mississippi
P. O. Box 956
Jackson, MS 39205-0956

Dear Auditor White:

In accordance with your correspondence dated March 27, 2019, the Office of the State Treasurer (OST) is providing the following response for the financial audit finding for the fiscal year ended June 30, 2018.

AUDIT FINDINGS:

2018-028 Controls Should Be Strengthened over Arbitrage Calculations

Response: We concur with this finding; however, we would like to emphasize that the arbitrage that was paid during the fiscal year ending June 30, 2018 was actually from a fiscal year 2011 transaction, was identified by OST precisely as a result of the strengthening of our controls over arbitrage calculations, and was resolved by OST prior to the audit.

Corrective Action Plan:

- A. Over the past several years, OST has worked to 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 with the Internal Revenue Service Regulations. And, we will continue to further strengthen controls in the upcoming year. Due to current interest rates being significantly lower than stated bond yields, there were no arbitrage payments due and no required filings with the IRS related to FY2018.

As part of our ongoing commitment to strengthening the controls, OST worked with the State's arbitrage consultant to ensure better efficiency, maintenance, and reporting for *all* bond issues requiring arbitrage rebate calculations. During this process, OST determined that a final arbitrage calculation was not performed on the \$40,252,000 State of Mississippi General Obligation Note, Series 2009C. This was a one-year short-term note issued November 18, 2009, with a maturity date of November 17, 2010. The 2009C Note was refunded with proceeds from the Series 2010F bonds, which were dated November 10, 2010.

Again, as a result of our ongoing commitment to strengthening controls in this area, OST determined in early May 2018 that no arbitrage calculation had been performed on this issue, though it should have been performed no later than January 16, 2011. OST promptly provided the information to the arbitrage consultant on May 7, 2018. The arbitrage consultant notified OST on May 14, 2018 of the arbitrage liability with the Form 8038-T to be filed with the IRS. OST immediately processed the transaction in MAGIC and mailed the required forms and check for the payment to the IRS on May 15, 2018.

It is important to note that OST received a letter dated August 14, 2018 from the IRS stating that the filing had been reviewed and the agency determined there was no willful neglect in filing late. In fact, the IRS accepted the OST request for a retroactive extension of time to file and thus there is no recorded late arbitrage filing related to this issue and no assessed penalty. A copy of that IRS letter is attached. All supporting documentation on this matter was provided without prompting to the Office of the State Auditor during their audit fieldwork.

OST has made substantial progress on strengthening controls on arbitrage calculations and will continue to do so.

- B. Yolanda Nash – Director of Accounting, Bonds and Financial Management
- C. July 1, 2019
- D. N/A

Sincerely,

A handwritten signature in black ink, appearing to read "Lynn Fitch", with a stylized flourish at the end.

Lynn Fitch
Treasurer
State of Mississippi