



STATE OF MISSISSIPPI
OFFICE OF THE STATE AUDITOR
SHAD WHITE
STATE AUDITOR

March 16, 2021

Financial Audit Management Report

Honorable David McRae, State Treasurer
Office of the State Treasurer
P. O. Box 138
Jackson, MS 39205

Dear Treasurer McRae:

Enclosed for your review are the financial audit findings for the Office of the State Treasurer for the Fiscal Year 2020. In these findings the Auditor's Office recommends the Office of the State Treasurer:

1. Agency Should Strengthen Controls to Ensure Compliance with State Law over Cancellation of Warrants, and over Maintenance of a Proper Audit Trail;
2. Agency Should Strengthen Controls for Accruals to Properly Record Transfers in the Correct Fiscal Year;
3. Agency Should Strengthen Controls to Ensure Arbitrage Calculations are Performed in a Timely Manner; and
4. Agency Should Strengthen Controls to Ensure Compliance with State Laws Over Public Depository Information.

Please review the recommendations and submit a plan to implement them by March 31, 2021. 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 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, 2020. 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 Angela Mire, CPA; Clayton Southerland, CPA; Phillip Chu, CPA; and Michael Walker, 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 of the Office of the State Treasurer as of and for the year ended June 30, 2020, in accordance with auditing standards generally accepted in the United States of America, 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. In addition, because of the inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. 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 certain deficiency in internal control, identified in this letter as item **2020-017** that we consider to be a significant deficiency.

In addition, we noted certain control deficiencies involving internal control that require the attention of management. These matters are listed under the heading **OTHER CONTROL DEFICIENCIES** as items **OTH-20-03** and **OTH-20-04**.

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 an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards*. This matter is identified in this letter as item **2020-017**. We also noted certain immaterial instances of noncompliance that require the attention of management. These matters are noted under the heading **IMMATERIAL NONCOMPLIANCE AND OTHER MATTERS**.

Findings and Recommendations

SIGNIFICANT DEFICIENCY AND NONCOMPLIANCE

2020-017	<u>Controls Should Be Strengthened to Ensure Compliance with State Law over Cancellation of Warrants, and over Maintenance of a Proper Audit Trail.</u>
Repeat Finding	No.
Criteria	<p><i>The Internal Control – Integrated Framework</i> published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Control Activity principal specifies, “The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.”</p> <p><i>Section 7-7-42 of the Mississippi State Code of 1972, Annotated</i> states, “The State Fiscal Officer shall transfer the funds reflected by the cancellation of the warrant to the Abandoned Property Fund authorized by Section 89-12-37 of the Unclaimed Property Division of the State Treasury where the funds shall remain for five (5) years. After five (5) years, if the funds are unclaimed, the State Treasurer shall transfer the funds back to the original source of funds. This section is applicable to warrants issued on and after January 1, 2000.”</p>
Condition	During our review of 10 canceled warrants, we noted one instance in which the agency did not have supporting documentation for a canceled warrant and two instances in which the agency did not return the canceled warrant funds back to the original source within five (5) years, as required by MS Code. Warrant 700059016 for \$2,470 and Warrant 013364455 for \$5,000, for a total of \$7,470 were not returned within the required five (5) years.
Cause	Agency did not maintain source documentation. Agency did not process the funds back to the original source in a timely manner due to a weakness in internal controls.
Effect	Without proper controls over the cancellation of warrants, the Agency could misappropriate deposits due to the lack of appropriate records, or fail to properly record all applicable deposits. Additionally, canceled warrants could be paid after the five year statute of limitations, which could result in an misstatement in canceled warrants liability.
Recommendation	We recommend that the Office of the State Treasurer strengthen controls to ensure all documentation for unclaimed properties is preserved, and agency should strengthen controls to ensure all canceled warrants are returned to original source as prescribed by MS Code.

OTHER CONTROL DEFICIENCIES

OTH-20-03 Controls Should Be Strengthened Over Accruals to Properly Record Transfers in the Correct Fiscal Year.

Repeat Finding No.

Criteria Per *Codification of Governmental Accounting and Financial Reporting Standards* 33, "Government-mandated and voluntary nonexchange transactions should recognize revenues (recipients) and expenses/expenditures (providers) on the modified accrual basis. On the modified accrual basis, revenues should be recognized when all applicable eligibility requirements are met and the resources are available."

Per *Mississippi Senate Bill 2772, 2020*, "Upon the effective date of this act, the State Fiscal Officer shall transfer to the Budget Contingency Fund out of the DFA CARES ACT COVID 19 Fund (Fund Number 6820113000) \$900,000,000". The effective date of the bill was May 20, 2020.

Condition The Department of Finance and Administration (DFA) erroneously recorded the initial transfer of \$900,000,000 to the Budget Contingency Fund in fiscal year 2021 instead of 2020. DFA corrected this error in the Mississippi Accountability System for Government Information and Collaboration (MAGIC) . However, The Office of the State Treasurer personnel did not verify the accrual for the transfer of funds was posted to the correct fiscal year, resulting in an understatement of accruals for the fiscal year 2020 financial statements.

Cause Agency did not perform an adequate review of the GAAP packet and related schedules to verify that the accrual for the appropriations were posted into the correct fiscal year.

Effect Due to the failure to appropriately accrue revenue received in the short term after the end of the fiscal year, the State's revenue would be understated by \$900,000,000 in the current fiscal year, and overstated by the corresponding amount in the following fiscal year. These amounts would materially misstate the State's financials if the transaction had remained undetected.

Recommendation We recommend the Office of the State Treasurer strengthen controls to ensure revenue is recognized in the correct period.

OTH-20-04 Controls Should Be Strengthened to Ensure Arbitrage Calculations are Performed in a Timely Manner.

Repeat Finding Yes, 2018.

Criteria Per *United States Code 26(A)(1)(B)(IV)(B)(148)(f)(3)*, "Except to the extent provided by the secretary, the amount which is required to be paid to the United States by the issuer shall be paid in installments which are made at least once every 5 years. Each installment shall be in an amount which ensures that 90 percent of the amount described in paragraph (2) with respect to the issue at the time payment of such installment is required will have been paid to the United States. The last installment shall be made no later than 60 days after the day on which the last bond

of the issue is redeemed and shall be in an amount sufficient to pay the remaining balance of the amount described in paragraph (2) with respect to such issue.”

Per *AMTEC Contract* with Mississippi State Treasury, “The OST agrees to provide AMTEC with the required documentation necessary to fulfill its obligation under the scope of services.”

Per *AMTEC process*, “Subsequent 5-year computation dates do not have AMTEC requesting any information other than the financial data and records kept by the State for each fund and account.”

The *Mississippi Accountability and Transparency Act of 2008 (MATA)*, *SB2923* (2009 Regular Legislative Session), *SB3166* (2010 Regular Legislative Session), and the *American Recovery and Reinvestment Act of 2009 (Stimulus)* mandate agencies report contracts and grants at both the State and Federal levels and require that all grant and contract information be available for public access.

Condition	Agency did not complete the required arbitrage calculation for Bond 2015A and 2015C within 60 days after computation date of February 18, 2020 of the bonds’ five-year period. Financial statements provided to consultant to complete arbitrage calculations were incorrect or were missing information. Additionally, through other procedures, we also noted the consultant contract was not recorded on the Mississippi Transparency website as required by state law.
Cause	Agency does not have a process to provide secondary review of financial statements sent to the consultant. Additionally, Agency did not understand the requirements for transparency reporting requirements.
Effect	Tax exempt bonds or tax advantage bonds could lose their tax exempt status if arbitrage is not correctly and timely performed. Additionally, the State may be subject to fines and penalties.
Recommendation	We recommend the Office of the State Treasurer strengthen controls and processes to adhere to all requirements relating to arbitrage.

IMMATERIAL NONCOMPLIANCE AND OTHER MATTERS

OTH-20-02	<u>Controls Should Be Strengthened to Ensure Compliance with State Laws Over the Public Depository Information.</u>
Repeat Finding	No.
Criteria	<p><i>Section 27-105-5 (4)(e) Mississippi State. Code Annotated. (1972)</i> states, “The State Treasurer is authorized and empowered to...Compare public deposit information reported by qualified public funds depositories and public depositors. That comparison shall be conducted for qualified public depositories based on established financial condition criteria of record on September 30.”</p> <p><i>The Internal Control – Integrated Framework</i> published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Control Activity principal specifies, “The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.”</p>

Condition	<p>During review of “Collateralization of State Funds”, we noted five instances out of a sample of 10 in which the Office of the State Treasurer did not properly verify the primary capital ratio, statutory numerator, statutory denominator, and pro-rata allocation to qualify banks as public depositories to Federal Deposit Insurance Corporation (FDIC) call reports.</p> <p>Additionally, through inquiry and review of support, we could not determine if “safekeeper reconciliations” were performed for the months of May and June 2020. Safekeeper reconciliation is the process of reconciling the pledged assets submitted to the Office of the State Treasurer and tracked in the internal system (QED) to the assets submitted to the safekeeping bank.</p>
Cause	<p>Agency placed reliance on banks to use correct FDIC call report numbers on their applications, but did not have internal controls in place to verify third party reported information. Additionally, Agency lacked proper documentation to maintain audit trail.</p>
Effect	<p>Failure to properly review public depository applications could lead to the State depositing monies into an unqualified bank which could cause the inability to appropriately collateralize funds. Additionally, lack of an audit trail can create gaps in financial information allowing for fraud or misappropriations to occur.</p>
Recommendation	<p>We recommend the Office of the State Treasurer strengthen controls to ensure adherence to applicable laws, and maintain proper audit trails.</p>

End of Report



FINANCIAL AUDIT FINDINGS

March 29, 2021

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

Dear Mr. White:

In accordance with your correspondence dated March 16, 2021, the Office of the State Treasurer (OST) is providing the following responses for the financial audit findings for the fiscal year Ended June 30, 2020.

AUDIT FINDINGS:

2020-017 Controls Should Be Strengthened to Ensure Compliance with State Law over Cancellation of Warrants, and over Maintenance of a Proper Audit Trail.

Response: We concur with this finding and will strengthen controls over compliance with State Law over cancellation of warrants and maintenance of a proper audit trail.

Corrective Action Plan:

- A. OST has strengthened controls to ensure compliance with state law over cancelled warrants by reviewing OST's processes, updating original IMS fund information and Business Areas to match updated MAGIC funds and Business Areas allowing for processing of cancelled warrants received prior to the implementation of MAGIC.
- B. Laura Law-Director of Accounting & Bonds
- C. July 1, 2021

OTH-20-03 Controls Should Be Strengthened over Accruals to Properly Record Transfers in the Correct Fiscal Year.

Response: We concur with this finding and will strengthen controls over accruals to properly record transfer in the correct fiscal year.

Corrective Action Plan:

- A. OST has strengthened controls to ensure accruals are processed in the correct fiscal year. In the event there is a delayed, or lapse transaction recorded in July or a month following the end of a fiscal year, OST staff will escalate to appropriate internal and external Agency leadership to confirm effective date and correct fiscal year.
- B. Justin Smith – Director of Investments, Cash Management, & Collateral
- C. July 1, 2021

OTH-20-04 Controls Should Be Strengthened to Ensure Arbitrage Calculations are Performed in a Timely Manner.

Response: We concur with the finding and will strengthen controls over Arbitrage Calculations.

Corrective Action Plan:

- A. OST has worked to strengthen controls to ensure all bonds are monitored for the timing of arbitrage calculations and rebate submissions happen in accordance with the Internal Revenue Service Regulations. We will further strengthen controls in the upcoming year.
- B. Laura Law - Director of Accounting & Bonds
- C. July 1, 2021

OTH-20-02 Controls Should Be Strengthened to Ensure Compliance with State Laws over the Public Depository Information.

Response: We concur with this finding and will strengthen controls to ensure compliance with state laws over the public depository information.

Corrective Action Plan:

- A. OST has strengthened controls to ensure compliance with state laws by enhancing the annual review of qualified public depositors' applications to include a comparison of reported data to the Federal Deposit Insurance Corporation (FDIC). An audit trail for all monthly safekeeper reconciliations has been established to ensure all proper documentation has been collected and completed.
- B. Justin Smith – Director of Investments, Cash Management, & Collateral
- C. July 1, 2021

Sincerely,

A handwritten signature in black ink, appearing to read "David McRae", with a stylized, cursive script.

David McRae
Treasurer
State of Mississippi