#347

Report To
The Mississippi Legislature

FY 1996 Financial and Compliance Audit of the Office of the State Auditor

November 12, 1996

State law requires an audit of the Office of the State Auditor every four years. PEER contracted with a certified public accounting firm to conduct a financial and compliance audit of the office for FY 1996. The contract auditor issued an unqualified audit opinion regarding the financial statements of the Office of the State Auditor, and noted several audit findings regarding internal controls and operations.

The PEER Committee

PEER: The Mississippi Legislature's Oversight Agency

The Mississippi Legislature created the Joint Legislative Committee on Performance Evaluation and Expenditure Review (PEER Committee) by statute in 1973. A standing joint committee, the PEER Committee is composed of five members of the House of Representatives appointed by the Speaker and five members of the Senate appointed by the Lieutenant Governor. Appointments are made for four-year terms with one Senator and one Representative appointed from each of the U. S. Congressional Districts. Committee officers are elected by the membership with officers alternating annually between the two houses. All Committee actions by statute require a majority vote of three Representatives and three Senators voting in the affirmative.

Mississippi's constitution gives the Legislature broad power to conduct examinations and investigations. PEER is authorized by law to review any public entity, including contractors supported in whole or in part by public funds, and to address any issues which may require legislative action. PEER has statutory access to all state and local records and has subpoena power to compel testimony or the production of documents.

PEER provides a variety of services to the Legislature, including program evaluations, economy and efficiency reviews, financial audits, limited scope evaluations, fiscal notes, special investigations, briefings to individual legislators, testimony, and other governmental research and assistance. The Committee identifies inefficiency or ineffectiveness or a failure to accomplish legislative objectives, and makes recommendations for redefinition, redirection, redistribution and/or restructuring of Mississippi government. As directed by and subject to the prior approval of the PEER Committee, the Committee's professional staff executes audit and evaluation projects obtaining information and developing options for consideration by the Committee. The PEER Committee releases reports to the Legislature, Governor, Lieutenant Governor, and the agency examined.

The Committee assigns top priority to written requests from individual legislators and legislative committees. The Committee also considers PEER staff proposals and written requests from state officials and others.

FY 1996 Financial and Compliance Audit of the Office of the State Auditor

November 12, 1996

The PEER Committee

Mississippi Legislature

The Mississippi Legislature

Joint Committee on Performance Evaluation and Expenditure Review

PEER Committee

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November 12, 1996

Honorable Kirk Fordice, Governor
Honorable Ronnie Musgrove, Lieutenant Governor
Honorable Tim Ford, Speaker of the House
Members of the Mississippi State Legislature

MISS. CODE ANN. Section 7-7-216 requires the Legislature to contract once every four years with a certified public accounting firm to conduct an audit of the Office of the State Auditor. The PEER Committee engaged Eubank and Betts, PLLC, to conduct the audit for FY 1996. PEER released this report entitled **FY 1996 Financial and Compliance Audit of the Office of the State Auditor** at its November 12, 1996, meeting.

Bill Canon

Senator Bill Canon, Chairman

This report does not recommend increased funding or additional staff.

FY 1996 Financial and Compliance Audit of the Office of the State Auditor

November 12, 1996

Executive Summary

Background

Every four years, the Legislature contracts with a certified public accounting firm to conduct an audit of the Office of the State Auditor in compliance with MISS. CODE ANN. Section 7-7-216, which states:

> *No less than once during each four-year term of the State Auditor, the Legislature shall receive bids from an independent, certified public accounting firm for an opinion and a legal compliance audit of the Office of the State Auditor. Such firm, so selected, shall report its findings and recommendations to the Legislature and the Governor. The cost of this audit shall be paid from funds appropriated for this purpose by the Legislature.*

PEER received five bids in response to its request for proposals for an opinion and legal compliance audit of the Office of the State Auditor. PEER contracted with Eubank and Betts, PLLC, to conduct the audit.

Eubank and Betts issued an unqualified audit opinion which states that the general purpose financial statements present fairly, in all material respects, the financial position of the Office of the State Auditor at June 30, 1996, and the results of its operations for the year then ended, in conformity with generally accepted accounting principles. The following material audit findings were noted during the audit.

Material Audit Findings

Audit Costs and Interest Not Collected

MISS. CODE ANN. Section 7-7-211(g) and Section 7-7-213 (1972) state that the State Auditor shall collect audit costs and interest for investigations resulting in collections of audit exceptions. In twenty-two cases tested, the Office of the State Auditor did not collect audit costs and interest. In some of those cases, the State Auditor's Office calculated costs and interest but included no documentation to explain why the collection was waived. In other cases, the State Auditor's Office waived costs without documentation.

In its response, the State Auditor's Office agreed to review policies regarding collection of costs and interest to ensure that such policies are in compliance with legal requirements.

Exception Clearing (Bank) Account

The State Auditor's Office should review internal controls over the Exception Clearing Account to address the following weaknesses:

- The State Auditor's Office allows field staff to make verbal requests for repayment of audit exceptions and to accept money for repayments while in the field. This process could allow one individual to determine exceptions amount(s), initiate the claim(s), accept the payment and deliver the funds to the agency.

- The State Auditor's Office does not maintain a control log tracking the status of investigations in progress. Upon determination of an audit exception, the agency does not document the status of claims or assessments for which payments are pending to ensure that control over incoming receipts is established at the earliest possible moment.

The State Auditor's Office should take appropriate action to correct these weaknesses by adopting or changing appropriate policies in writing.

In its response, the State Auditor's Office agreed to take corrective action.

Inaccurate General Ledger

During the fiscal year ended June 30, 1996, the Office of the State Auditor attempted to implement an interface of its purchase order system with its general ledger system. The interface was not implemented correctly, causing inaccurate entries to the general ledger and misstatement of expenditures. Agency personnel were aware of the situation and were reconciling the State Auditor cash accounts to the Department of Finance Administration (DFA) monthly. However, the remainder of the general ledger was incorrect and not reconciled to DFA.

During the course of the audit, State Auditor personnel prepared a reconciliation of the revenue and expense accounts to DFA records and made correcting entries to the general ledger as determined necessary. Effective October 1, 1996, the State Auditor's Office became an on-line user of the Statewide Automated Accounting System (SAAS).

Because SAAS now serves as the agency's general ledger, further recommendations or corrective action were not required.

Inadequate Segregation of Duties for Contract Audit Review Fees

The State Auditor's Office reviews workpapers for school district audits that it contracts out to independent certified public accounting firms. The State Auditor's Office then bills such firms for the reviews. The office does not segregate the review, billing, and receipt of remittance functions. One individual performs the reviews, prepares the invoices, and receives the remittances directly. While the audit contained no indication of mishandled funds, the potential for abuse exists because of the lack of duty segregation.

The State Auditor's Office has taken action to segregate these duties.

Travel Policies

The audit noted the following weaknesses in internal controls regarding travel:

- Travel policies for the State Auditor's Office regarding the reimbursement of commuting expenses do not appear to be in compliance with Internal Revenue Service regulations which require that any reimbursement for commuting expenses be included in the employee's taxable wages. Some employees received mileage reimbursements for commuting to the State Auditor's Office from their homes on a regular basis while other employees did not, creating the appearance of favoritism.

- One agency employee received reimbursement for over 5,000 miles of travel per month. According to a review of travel vouchers, the individual did not plan the travel in regions.

Eubank and Betts recommended that the State Auditor's Office require proper planning of work procedures to minimize travel expenses, review travel reimbursement policies, and document the basis for compliance with applicable Internal Revenue Service regulations. The agency recently changed its travel policies to eliminate reimbursement of commuting expenses in most cases.

The State Auditor's Office responded that it has reviewed travel policies, consulted with the Department of Finance and Administration, and is confident that its travel policies and positions are in compliance with Internal Revenue Service regulations.

For More Information or Clarification, Contact:

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STATE OF MISSISSIPPI
OFFICE OF THE STATE AUDITOR

GENERAL PURPOSE FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 1996

CONTENTS

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INDEPENDENT AUDITORS' REPORT

Honorable Kirk Fordice, Governor
Honorable Ronnie Musgrove, Lieutenant Governor
Honorable Tim Ford, Speaker of the House
Members of the Mississippi State Legislature
State of Mississippi

We have audited the accompanying general purpose financial statements of the State of Mississippi Office of the State Auditor as of and for the year ended June 30, 1996, as listed in the table of contents. These financial statements are the responsibility of the State of Mississippi Office of the State Auditor's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall general purpose financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the State of Mississippi Office of the State Auditor at June 30, 1996, and the results of its operations for the year then ended, in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 18, 1996 on our consideration of the State of Mississippi Office of the State Auditor's internal control structure and a report dated October 18, 1996 on its compliance with laws and regulations.

Eubank & Betts

EUBANK & BETTS, PLLC

Jackson, Mississippi
October 18, 1996

STATE OF MISSISSIPPI
OFFICE OF THE STATE AUDITOR
Combined Balance Sheet - All Fund Types and Account Groups
June 30, 1996

ASSETS

	Governmental Fund Type General	Fiduciary Fund Type Agency Fund	Account Groups: General Fixed Assets	Account Groups: General Long-term Debt	Totals (Memorandum Only) 1996
Cash	$ 732,973	$ 19	$ -	$ -	$ 732,992
Due from other governments	329,596	-	-	-	329,596
Due from other state agencies	277,870	-	-	-	277,870
Fixed assets	-	-	1,171,620	-	1,171,620
Amount to be provided for accrued compensated absences	-	-	-	538,982	538,982
Total assets	$1,340,439	$ 19	$1,171,620	$538,982	$3,051,060

LIABILITIES AND FUND EQUITY

	Governmental Fund Type General	Fiduciary Fund Type Agency Fund	Account Groups: General Fixed Assets	Account Groups: General Long-term Debt	Totals (Memorandum Only) 1996
Warrants payable	$ 378,889	$ -	$ -	$ -	$ 378,889
Accounts payable	116,633	19	-	-	116,652
Accrued compensated absences	-	-	-	538,982	538,982
Due to other state agencies	16,883	-	-	-	16,883
Total liabilities	512,405	19	-	538,982	1,051,406
Investment in fixed assets	-	-	1,171,620		1,171,620
Fund balance:					
Reserve for encumbrances	35,852	-	-	-	35,852
Unreserved, undesignated	792,182	-	-	-	792,182
Total fund equity	828,034	-	1,171,620	-	1,999,654
Total liabilities and fund equity	$1,340,439	$ 19	$1,171,620	$538,982	$3,051,060

See accompanying notes to financial statements.

STATE OF MISSISSIPPI
OFFICE OF THE STATE AUDITOR

Combined Statement of Revenues, Expenditures and Changes in Fund Balance - General Fund
Year Ended June 30, 1996

Revenues:	
State appropriation	$5,735,604
Audit fees	3,894,037
Other revenues	5,737
Total revenues	9,635,378
Expenditures:	
Personal services:	
Salaries and benefits	7,701,404
Travel and subsistence	951,160
	8,652,564
Contractual services	622,790
Commodities	67,012
Capital outlay	63,623
Total expenditures	9,405,989
Excess of revenues over expenditures	229,389
Fund balance, July 1, 1995	598,645
Fund balance, June 30, 1996	$ 828,034

See accompanying notes to financial statements.

STATE OF MISSISSIPPI
OFFICE OF THE STATE AUDITOR

Combined Statement of Revenues, Expenditures, and Changes in Budgetary Fund Balance - Budget and Actual (Non-GAAP Basis)
Year Ended June 30, 1996

	Budget	General Fund Actual	Special Funds Actual	Total Actual	Variance Favorable (Unfavorable)
Revenues:					
State appropriation	$5,735,614	$5,735,604	$ -	$5,735,604	$ (10)
Special funds	4,222,074	-	3,871,028	3,871,028	(351,046)
Total revenues	9,957,688	5,735,604	3,871,028	9,606,632	(351,056)
Expenditures:					
Personal services:					
Salaries and benefits	8,010,271	5,649,876	2,050,811	7,700,687	309,584
Travel and subsistence	1,108,012	75,228	876,401	951,629	156,383
	9,118,283	5,725,104	2,927,212	8,652,316	465,967
Contractual services	707,318	10,500	631,551	642,051	65,267
Commodities	67,360	-	67,195	67,195	165
Capital outlay	64,277	-	64,265	64,265	12
Subsidies, loans and grants	450	-	-	-	450
Total expenditures	9,957,688	5,735,604	3,690,223	9,425,827	531,861
Excess of revenues over expenditures	-	-	180,805	180,805	180,805
Budgetary fund balance, July 1, 1995	-	-	598,645	598,645	598,645
Budgetary fund balance, June 30, 1996	$ -	-	779,450	779,450	$ 779,450
Reconciliation to GAAP basis:					
Net accrued revenues and related receivables		-	28,746	28,746	
Net accrued expenditures, related payables and encumbrances		-	19,838	19,838	
Fund balance, June 30, 1996 (GAAP basis)		$ -	$ 828,034	$ 828,034	

See accompanying notes to financial statements.

STATE OF MISSISSIPPI
OFFICE OF THE STATE AUDITOR
Notes to Financial Statements
Year Ended June 30, 1996

Note 1 - Summary of significant accounting policies:

Basis of presentation:

The accompanying financial statements of the Office of the State Auditor have been prepared in conformity with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). GASB is the accepted standard-setting body for governmental accounting and financial reporting principles.

Financial reporting entity:

The Office of the State Auditor (State Auditor or Agency) is an agency of the State of Mississippi created by the Legislature for the primary purpose of performing financial and legal compliance post audits of the state agencies, county governments, school districts, colleges and universities. The State Auditor also provides technical assistance to state and local government entities and conducts average daily attendance counts in Mississippi public schools.

The State Auditor is subject to the review and appropriation authority of the Legislature. The Agency is not an autonomous entity, but is rather a part of the oversight unit of the State of Mississippi. The accompanying financial statements present the assets, liabilities, fund equity and operations for which the State Auditor is responsible as a component of the State of Mississippi.

Fund accounting and measurement focus/basis of accounting:

The accounts of the State Auditor are organized and operated on the basis of funds and account groups. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds are maintained consistent with legal and managerial requirements. Account groups are a reporting device to account for certain assets and liabilities of the governmental funds not recorded directly in those funds.

The Agency has the following fund types and account groups:

Governmental funds are used to account for the State Auditor's general government activities. Governmental fund types use the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting revenues are recognized when susceptible to accrual (i.e., when they are "measurable and available"). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures are recorded when the related fund liability is incurred. The governmental fund included in this report is the *General Fund*, which is the State Auditor's primary operating fund. It accounts for all financial resources of the Agency, except those required to be accounted for in another fund.

Note 1 - Summary of significant accounting policies (Continued):

Fiduciary funds account for assets held by the State Auditor as an agent on behalf of others. The fiduciary fund included in this report is the *Agency fund*, which is custodial in nature and does not present results of operations or have a measurement focus. This fund is used to account for audit exceptions that the State Auditor collects for others in an agency capacity, and is accounted for using the modified accrual basis of accounting.

Account groups are accounting entities used to establish control over and accountability for the State Auditor's general fixed assets and accrued compensation absences. Two account groups are used.

The *general fixed assets account group* is used to account for fixed assets acquired or constructed for use by the State Auditor. The *general long-term debt account group* is used to account for the compensated absences not recorded in other funds.

Budgets:

Budgetary information - The State Auditor follows these procedures in establishing and accounting for the budgetary data reflected in the financial statements:

1. Approximately one year before a fiscal year begins, the Agency prepares a proposed operating budget for that year. The operating budget includes proposed expenditures and the means of financing them.

2. At the beginning of August, this proposed budget for the fiscal year commencing the following July is submitted to the Department of Finance and Administration and the Joint Legislative Budget Committee. Budget hearings are conducted, resulting in recommendations for changes.

3. In January the proposed budget and the recommendations proposed by the Department of Finance and Administration and the Joint Legislative Budget Committee are presented to the Legislature. The Legislature makes any revisions it deems necessary or appropriate and then legally enacts the Agency's budget in the form of an appropriations bill.

4. The Agency is authorized to transfer budgeted amounts between major expenditure classifications on a limited basis, subject to approval of the Department of Finance and Administration. The final budget is used for budget comparison purposes in this report.

Note 1 - Summary of significant accounting policies (Continued):

Budgetary accounting - The State Auditor's annual budget is prepared principally on the cash basis utilizing encumbrance accounting. Encumbrances represent executed but unperformed purchase orders. In the accompanying financial statements, encumbrances are recorded as expenditures for budgetary purposes if presented for payment in the 60-day lapse period immediately following the end of the fiscal year and as reservations of fund balance for GAAP purposes. Since the budgetary basis differs from generally accepted accounting principles, budget and actual amounts in the accompanying Combined Statement of Revenues, Expenditure and Changes in Budgetary Fund Balance - Budget and Actual (Non-GAAP Basis) are presented on the budgetary basis. A reconciliation of the excess of revenues over expenditures on a budgetary basis at June 30, 1996 to the excess of revenues over expenditures presented in conformity with generally accepted accounting principles is provided on the financial statements.

Unexpended appropriations at June 30 are available for subsequent expenditure only to the extent that encumbrances have been established and they are presented for payment during the succeeding 60-day lapse period. Lapse period expenditures are reported as expenditures in the current-year budgetary presentation.

The State Auditor has two budgetary fund groups to account for its budgetary activities and functions.

General - accounts established to receive and distribute general revenues appropriated by the State.

Special - accounts established to receive federal grants, fees and proceeds from the sale of goods and services to support the functional activities of the Agency.

Fixed assets:

General fixed assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisition and construction are reflected as expenditures in governmental funds, and the related assets are reported in the general fixed assets account group. All purchased fixed assets are valued at cost. Donated fixed assets are valued at their estimated fair market value on the date received. No depreciation has been recorded on these assets.

Accumulated personnel leave and major medical leave:

Section 25-3-97, Miss. Code Ann. (1972), authorizes payment for a maximum of 30 days accrued personnel leave in a lump sum upon termination of employment. No payment is authorized for accrued major medical leave unless the employee presents medical evidence that his or her physical condition is such that he or she can no longer work in a capacity of state government.

Note 1 - Summary of significant accounting policies (Continued):

Accumulated unpaid personal leave is not accrued in governmental funds under the modified accrual basis of accounting. At June 30, 1996, accumulated unpaid personal leave up to a maximum of 30 days per employee is reported in the general long-term debt account group as accrued compensated absences. The liability for compensated absences is a long-term liability that is required to be reported in the general long-term debt account group because governmental fund balance sheets reflect only current liabilities. There are no amounts left unpaid at June 30, 1996, that normally would be liquidated with expendable available financial resources. Therefore, no current liability for compensated absences is reported in the governmental fund type.

Accumulated unpaid major medical leave is not accrued in any fund nor in the general long-term debt account group, because it is not probable that the compensation will be paid.

Short-term Intergovernmental receivables/payables:

During the course of operations, numerous transactions occur between individual funds for goods provided or services rendered. These receivables and payables are classified as "due from other state agencies" or "due to other state agencies" on the balance sheet.

Fund equity:

The equity section of the governmental fund balance sheet is comprised of two major fund balance elements: reserved and unreserved, undesignated. The reserved fund represents outstanding commitments at year end that will be liquidated in the lapse period, as explained under *Budgets*, in this note. Unreserved, undesignated funds represent accumulations of revenues in excess of expenditures.

Memorandum only - Total column:

The total column on the general purpose financial statement is captioned as "memorandum only" because it does not represent consolidated financial information and is presented only to facilitate financial analysis. The column does not present information that reflects financial position, results of operations or cash flows in accordance with generally accepted accounting principles.

Note 2 - General fixed assets:

The following is a summary of changes in general fixed assets:

	Balance July 1, 1995	Additions	Deletions	Balance June 30, 1996
Furniture and equipment	$1,191,475	$125,265	$145,120	$1,171,620

Note 3 - Changes in long-term debt:

The following is a summary of changes in long-term debt:

	Balance July 1, 1995	Additions	Deletions	Balance June 30, 1996
Accrued compensated absences	$546,186	$385,530	$392,734	$538,982

Note 4 - Defined benefit pension plan:

Plan description:

The State Auditor participates in the Public Employees' Retirement System of Mississippi (PERS), a cost-sharing multiple-employer defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefit provisions are established by state law and may be amended only by the State of Mississippi Legislature. PERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Public Employees' Retirement System of Mississippi, PERS Building, 429 Mississippi Street, Jackson, MS 39201 or by calling (601) 359-3589 or 1-800-444-PERS.

Funding policy:

PERS members are required to contribute 7.25% of their annual covered salary and the State Auditor is required to contribute at an actuarially determined rate. The current rate is 9.75% of annual covered payroll. The contribution requirements of PERS members and employers are established and may be amended only by the State of Mississippi Legislature. The Agency's contributions to PERS for the fiscal year ended June 30, 1996 was approximately $610,000 which equaled the required contributions for the fiscal year.

Note 5 - Operating lease:

The Agency leases office space at 3750 Interstate 55 North Frontage in Jackson, Mississippi under an agreement having the following terms:

Length of lease:	June 18, 1992 - July 31, 1997
Annual lease cost:	$198,896, payable monthly
Monthly rent payment:	$16,575

Rent expense for the year ended June 30, 1996, included in contractual services in the financial statements, amounted to $225,762, and was comprised of payments due under the above agreement and other amounts due under agreements having lease terms of less than twelve months.

Note 5 - Operating lease (continued):

The following is a schedule of minimum future rentals due under leases having terms of one year or more at June 30, 1996:

Year Ended June 30:	
1997	$198,896
1998	16,575
	$215,471

Note 6 - Subsequent event:

On October 10, 1996, the elected official serving as State Auditor resigned his position, effective November 1, 1996. Governor Kirk Fordice appointed Phil Bryant to serve as State Auditor for the unexpired term on October 16, 1996.

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE BASED ON AN AUDIT OF THE GENERAL PURPOSE FINANCIAL STATEMENTS

Honorable Kirk Fordice, Governor
Honorable Ronnie Musgrove, Lieutenant Governor
Honorable Tim Ford, Speaker of the House
Members of the Mississippi State Legislature
State of Mississippi

We have audited the general purpose financial statements of the State of Mississippi Office of the State Auditor (the Agency or State Auditor) as of and for the year ended June 30, 1996, and have issued our report thereon dated October 18, 1996.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to the State of Mississippi Office of the State Auditor is the responsibility of the Agency's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Agency's compliance with certain provisions of laws. regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests indicate that, with respect to the items tested, the State Auditor complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that the State Auditor had not complied, in all material respects, with those provisions.

Although the results of or tests of compliance disclosed no material instances of noncompliance, we did note certain conditions and occurrences that we believe constitute immaterial instances of noncompliance. Such conditions and occurrences are described below.

Deposits Not Made Timely

Section 7-9-21, Miss. Code Ann. (1972), requires that funds received should be deposited into the State Treasury the day collected when receipts total $1,000 or more. Our audit of cash revealed that the Office of the State Auditor was not always making deposits on the same day when receipts totaled $1,000 or more. Furthermore, it was the State Auditor's practice to allow certain personnel to take the deposits home overnight for deposit into the State Treasury the following morning.

We also found instances in which deposits were more than one day late. Agency employees stated that internal processing may have caused the delays. We did not observe indications of improprieties nor were we unable to account for any deposits.

Recommendation: The State Auditor should develop policies and procedures to ensure that deposits are made in a timely manner in accordance with State laws. During the course of our fieldwork, we recommended that the Agency discontinue the practice of deposits being taken home overnight. We were informed that this practice was discontinued.

Audit Costs and Interest Not Collected

Sections 7-7-211(g) and 7-7-213, Miss. Code Ann. (1972) state that audit costs and interest shall be collected for investigations resulting in collections of audit exceptions. We noted that audit costs and interest were not collected in 22 cases we tested. In some of these cases, we found that the costs and interest were calculated; however, there was no documentation as to why the collection was waived. We were informed that it is the Agency's policy to make oral demands when an exception is determined. If the repayment is made within 10 days, then interest is not added. We also found that, in some instances, these costs were waived at management's decision without documentation of the basis.

Recommendation: We recommend that the Agency review their procedures regarding the collection of audit costs and interest for audit exceptions. The policy should comply with Section 7-7-211(g) and 7-7-213, Miss. Code Ann. (1972) and the State of Mississippi Constitution regarding no forgiveness of debts. The State Auditor's Office should document any legal authority to waive these costs.

Certain Travel Expenditures Not Approved in Advance

The State Auditor's Office did not always require personnel to obtain "... prior approval in writing from the department head ..." for travel expenditures for attending a convention, association, or meeting as required by Section 25-1-83, Miss. Code Ann. (1972). The Agency required prior written approval for travel only when a travel advance was requested.

Recommendation: We recommend that the State Auditor begin requiring prior written approval for attendance to a convention, association, or meeting in accordance with Section 25-1-83, Miss. Code Ann. (1972).

We also noted other matters involving the internal control structure and its operation that we have reported to the management of the State Auditor in a separate letter dated October 18, 1996.

This report is intended for the information of the State Auditor, management, and PEER Committee members. However, this report is a matter of public record and its distribution is not limited.

Eubank & Betts

EUBANK & BETTS, PLLC

Jackson, Mississippi
October 18, 1996

EUBANK & BETTS
A Professional Limited Liability Company
CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL STRUCTURE

Honorable Kirk Fordice, Governor
Honorable Ronnie Musgrove, Lieutenant Governor
Honorable Tim Ford, Speaker of the House
Members of the Mississippi State Legislature
State of Mississippi

We have audited the general purpose financial statements of the State of Mississippi Office of the State Auditor (the Agency or State Auditor) as of and for the year ended June 30, 1996, and have issued our report thereon dated October 18, 1996.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the general purpose financial statements of the State of Mississippi Office of the State Auditor for the year ended June 30, 1996, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control structure.

The management of the State of Mississippi Office of the State Auditor is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- Cash in State Treasury
- Cash in bank
- Revenue/billing
- Payroll
- Cash disbursements/payables

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the general-purpose financial statements. These reportable conditions are identified below.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the general-purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we noted the following matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above. These conditions were considered in determining the nature, timing, and extent of the procedures to be performed in our audit of the financial statements of the State of Mississippi Office of the State Auditor for the year ended June 30, 1996.

MATERIAL WEAKNESSES

Inaccurate General Ledger

During fiscal year ended June 30, 1996, the Agency attempted to implement an interface of it's purchase order system with it's general ledger system. The interface was not implemented correctly, causing inaccurate entries to the general ledger resulting in the misstatement of expenditures. Agency personnel were aware of this and were reconciling the State Auditor cash accounts to the DFA reports on a monthly basis. However, the remainder of the general ledger was incorrect and unreconciled to the Department of Finance and Administration (DFA). Consequently, the Agency's general ledger was not usable for reporting the financial position correctly in accordance with Generally Accepted Accounting Principles.

Recommendation: During the course of our audit, we recommended that State Auditor personnel prepare a reconciliation of the revenue and expense accounts to DFA records. This reconciliation was prepared, and correcting entries made to the general ledger as determined necessary. Furthermore, effective October 1, 1996 the State Auditor's Office became an on-line user of the Statewide Automated Accounting System(SAAS). Since this system now serves as the Agency's general ledger, no further recommendations are considered necessary.

Weak Controls Over the Exception Clearing (Bank) Account

Internal controls over the Exception Clearing Account should be reviewed to address the following weaknesses that were noted.

1. Field staff are allowed to make verbal requests for repayment of audit exceptions and also to accept money for repayments while in the field, thereby enabling one individual to determine exceptions amount(s), initiate the claim(s), accept the payment and deliver the funds to the State Auditor. Furthermore, repayments accepted by field staff are delivered directly to the employee who makes the deposits, records the receipt into the ledger, and makes the related disbursement to the Agency for whom the repayment was collected.

2. A control log tracking the status of investigations in progress is not maintained. Upon determination of an audit exception, the State Auditor does not document the status of claims or assessments for which payments are pending to ensure that control over incoming receipts are established at the earliest possible moment.

3. When an audit exception is collected, the State Auditor's Office is acting as an agent on behalf of the parties. The funds collected should be forwarded to the appropriate party in a timely manor. We noted two instances in which receipts into the clearing account were held for over five months before disbursement to the appropriate parties. Management indicated that these instances occurred when additional funds were expected to be received in the case.

4. The financial statement balances were erroneously reported using the bank statement balance. Financial statements in accordance with Generally Accepted Accounting Principles requires the Agency's book balance to be reported. Audit adjustments were made to correctly state the balances.

Recommendation: We recommend that the State Auditor's Office take appropriate action to correct the weaknesses noted above. Policies adopted/changed should be documented in writing.

REPORTABLE CONDITIONS

Incorrect Financial Statement Balances Reported

We noted the following errors in the State Auditor's Office financial statements:

1. The State Auditor's Office erroneously reported approximately $32,800 of encumbrances as accounts payable in the General Fund. Encumbrances represent formal commitments for the future purchase of goods or services. Accounts payable represent obligations for payment of goods or services received or rendered as of the balance sheet date.

2. Upon completion of a lease agreement for the Agency's telephone system, the lease was added to the General Fixed Assets Account Group. However, the value of the lease was incorrectly reported by including interest costs in the lease value. The General Fixed Assets Account Group presented in the financial statements was overstated by approximately $1,700.

Recommendation: Agency personnel should prepare financial statements in accordance with Generally Accepted Accounting Principles. Encumbrances and payables should be reviewed for proper presentation. Furthermore, the value of leases added should only include the principle payments. The Division of Property records should be corrected to reflect the adjusted balance.

Inadequate Segregation of Duties For Contract Audit Review Fees

School district audits that are contracted out to independent Certified Public Accounting (CPA) firms are reviewed by the State Auditor's Office personnel. The State Auditor's Office bills the CPA firm for this review. The review, billing and receipt of remittance functions are not segregated. One individual performs the reviews, prepares the invoices, and receives the remittances directly. While no indication of mishandled funds was noted, the potential for abuse exists because of the lack of duty segregation. The revenue collected related to these reviews during fiscal year 1996 was approximately $40,200.

Recommendation: We recommend that there be segregation of duties related to these review fees. The State Auditor's Office should require the review fees to be billed, collected and deposited in accordance with the State Auditor's standard policies for billings and remittances. The person responsible for the audit reviews should not receive payments directly. Subsequent to year-end, the Agency identified the lack of controls over this area.

This report is intended for the information of the State Auditor, management, and PEER Committee members. However, this report is a matter of public record and its distribution is not limited.

Eubank & Betts

EUBANK & BETTS, PLLC

Jackson, Mississippi
October 18, 1996

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MANAGEMENT LETTER

Honorable Kirk Fordice, Governor
Honorable Ronnie Musgrove, Lieutenant Governor
Honorable Tim Ford, Speaker of the House
Members of the Mississippi State Legislature
State of Mississippi

In planning and performing our audit of the financial statements of the State of Mississippi Office of the State Auditor (The Agency) as of and for the year ended June 30, 1996, we considered the Agency's internal control structure to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control structure.

However, during our audit we became aware of certain matters that are opportunities for strengthening internal controls and operating efficiency. Summarized below are our comments and suggestions regarding those matters. We have already discussed many of these comments and suggestions with various Agency personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations. This letter does not affect our report dated October 18, 1996, on the financial statements of the State Auditor.

Travel Policies Should be Reviewed

We noted the following weaknesses in internal controls regarding travel:

1. Travel policies for the Agency do not appear to be in compliance with IRS regulations regarding the reimbursement of commuting expenses. IRS regulations do not permit reimbursement for commuting expenses unless the amounts are included in the employees taxable wages.

2. Some employees received mileage reimbursements for commuting to the State Auditor's Office from their homes on a regular basis, supported by the Agency's policy to reimburse travel for field staff, while others did not. This creates the appearance of favoritism.

3. We found one individual who was reimbursed for travel in excess of 5,000 miles per month. This appeared to be an excessive amount of travel. The State Auditor's Office should establish policies that would require such travel reimbursement requests to be scrutinized carefully. Our review of the travel vouchers indicated that the individual did not plan the travel in regions. Some instances showed travel to the northern part of the state on one day, and to the southern part on the next day.

Recommendation: The State Auditor's Office should review the instances noted above and determine if the expenditures are properly supported. The Agency should require proper planning in work procedures as to minimize the travel expenses. Also, the Agency should review it's travel reimbursement policies and document the basis for compliance with applicable IRS regulations. We noted that the State Auditor has recently changed it's travel policies to eliminate commuting expenses is most cases. Also, we noted that the Agency now requires odometer readings for mileage reimbursement.

Payroll Elections Should be Entered Correctly

One instance in our sample of payroll revealed that the state withholding elections on the employee's exemption certificate on file did not agree with the information entered into the payroll system. The resulting deduction for the individual was more than the required amount. This is an unresolved finding from the prior audit.

Recommendation: We recommend that the State Auditor's Office review payroll elections on a regular basis to ensure that information in the payroll system is properly supported by the personnel file documents. Changes to payroll deductions should be reviewed by someone independent of the person responsible for data entry to minimize the possibility of future errors.

This report is intended for the information of the State Auditor, management, and PEER Committee members. However, this report is a matter of public record and its distribution is not limited.

Eubank + Betts

EUBANK & BETTS, PLLC

Jackson, Mississippi
October 18, 1996

State of Mississippi
OFFICE OF THE STATE AUDITOR
STEVEN A. PATTERSON
AUDITOR

October 24, 1996

Mr. Hogan Allen, CPA
Eubank and Betts, PLLC
Post Office Box 16090
Jackson, Mississippi 39236-6090

Dear Mr. Allen:

We are pleased to review your findings related to the audit of this office for the fiscal year ended June 30, 1996. In accordance with this audit we offer the following responses and corrective action plans based on your recommendations.

LEGAL COMPLIANCE

1) Deposits Not Made Timely

Response: The department will ensure that deposits are made in a timely manner in accordance with state law. It should be noted that all checks and warrants are restrictively endorsed "for deposit only" upon receipt and are thus non-negotiable.

2) Audit Costs and Interest Not Collected

Response: It has been the Agency's policy to make an oral demand when an exception is determined and if repayment is made at that time no interest is added. Waiver of costs and interests has been done on a case by case basis with the cost effectiveness of collection being the main factor. We agree that procedures should be reviewed insuring that these policies are in compliance with Mississippi Code Ann. § 7-7-211 and § 7-7-213, and with the State of Mississippi Constitution. All settlements should be documented with legal authority.

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3) Certain Travel Expenditures Not Approved in Advance

Response: The department will require prior written approval for attendance at a convention, association or meeting.

INTERNAL CONTROL

1) Inaccurate General Ledger

Response: On October 1, 1996 the department became an on-line user of the Statewide Automated Accounting System (SAAS). This system precludes the need to reconcile the general ledger making this a moot question in the future.

2) Weak Controls over Exception Clearing Account

Response: We agree with the recommendations and will take the appropriate actions to correct the problems.

3) Incorrect Financial Statement Balances

Response: Encumbrances and payables will be reviewed for proper presentation in accordance with Generally Accepted Accounting Principles. The value of lease-purchased equipment will include only principle payments. These adjustments have been made.

4) Inadequate Segregation of Duties for Contract Audit Review Fees

Response: We concur with the finding. We will establish a procedure whereby the person who reviews the reports will submit a notification of a completed audit review to our administrative department. They will generate a bill to be sent to the CPA firm. The revenue generated from this source will be received and accounted for as revenue received from any other audit process.

MANAGEMENT LETTER

1) Travel Policies Should be Reviewed

Response: Regarding the suggestion that we review the IRS's position on "commuting" expenses, please be sure that we have thoroughly reviewed and considered our travel policies with this scope. We have also had extensive discussions with DFA regarding their opinions and concurrence on these same matters. We feel very confident that our policies and positions are in compliance with IRS regulations.

Those specific instances noted regarding travel had been corrected prior to the beginning of this audit.

Thank you for the opportunity to respond to these findings and suggestions. We have sincerely appreciated the opportunity to work with you on this important undertaking.

Sincerely,

STEVEN A. PATTERSON
Auditor

SAP:cml

PEER Staff

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