South Carolina State Treasurer's Office
Performance Audit

For the year ended
June 30, 2011

South Carolina State Treasurer's Office

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South Carolina Office of the State Treasurer
The Honorable Curtis M. Loftis, Jr.

We have completed a performance audit of the processes and procedures related to financial recordkeeping, reporting and transaction processing occurring within the primary functions and divisions of the South Carolina Office of the State Treasurer. The audit was performed for the period from July 1, 2010 through June 30, 2011.

We conducted the performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and recommendations based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and recommendations based on our audit objectives.

It is the responsibility of the Treasurer and his staff to establish internal controls over the divisions and primary functions of the Treasurer's Office, including financial reporting, the processing of transactions, compliance with laws, regulations, contracts, debt agreements, and the policies and procedures of the Treasurer's Office. It is also the responsibility of the Treasurer and his staff to monitor the internal controls established over these areas to ensure that the Treasurer's Office is in compliance with applicable laws, regulations, contracts, debt agreements and established policies. Because of the inherent limitations in any internal control system, including collusion, management override of the control system or neglect to follow established policies could result in errors, irregularities, or fraud occurring without being detected.

The Treasurer's Office has provided responses from management to some (but not all) of the findings related to the following divisions and functions: Local Government Investment Pool, Investments, Office Administration, Debt Management, College Savings Plans, Information technology, and Unclaimed Property. These responses are presented in the respective report sections for each division or function. We did not audit management's responses and, accordingly, we express no opinion on them.

The performance audit did not constitute an audit of financial statements in accordance with *Government Auditing Standards*.

This report is solely for the information and use of the South Carolina State Treasurer and his staff and is not intended to be and should not be used by anyone other than those specified parties.

We appreciate the cooperation and assistance provided to us by the Treasurer's staff during the course of our work.

Elliott Davis, LLC

Columbia, South Carolina
December 5, 2011

I. AUDIT SCOPE, OBJECTIVE, AND METHODOLOGY

A. *General* - At the request of the South Carolina State Treasurer (the Treasurer), we have completed a performance audit of certain processes and procedures related to the primary functions within the Treasurer's Office (the Office). We conducted our performance audit in accordance with generally accepted government auditing standards. We limited our work to the divisions and primary functions specified below for the period from July 1, 2010 through June 30, 2011:

   A. Treasury Management
   B. Local Government Investment Pool
   C. Investments
   D. Office Administration
   E. Debt Management
   F. College Savings Plans
   G. Tobacco Settlement Revenue Management Authority
   H. Court Fines and Fees
   I. Information Technology
   J. Unclaimed Property
   K. General

   The objective of the audit is to identify improvements to strengthen internal controls over financial recordkeeping and reporting and transaction processing. In addition, it is the intent of the Treasurer that the audit demonstrates openness and transparency related to operations and performance, and that it provides opportunities to improve efficiency and effectiveness.

   Our audit procedures focused on testing the Treasurer's key internal controls over financial reporting and recordkeeping, and transaction processing. We also performed inquiries and observations to gage the adequacy of staff levels within each division, and the extent of training and experience in developing, implementing and monitoring internal controls over financial reporting, recordkeeping, and transaction processing.

   Our audit approach consisted of three overall phases: Information gathering, systems documentation, and audit testing.

B. *Information Gathering* - For each primary function, we interviewed division heads and other key individuals in order to gain a sufficient understanding of the processes and procedures for each respective area. We supplemented our understanding by conducting walkthroughs of selected transactions. The walkthroughs consisted of following a transaction from its initiation to its final approval and its recording in the general ledger. The walkthrough process included inquiries of the individuals who were involved in processing and authorizing transactions as well as observing related supporting documentation, and re-performing portions of the transactions.

C. *Systems Documentation* - We prepared memorandums to document our understanding of each of the respective functions and their related processes and procedures. These memorandums included responses to our interviews, as well as narratives describing the results of our walkthroughs. We then submitted the memorandums to the division heads for their review. The memorandums were edited as necessary to ensure that we had documented an accurate understanding of the primary functions of each area.

I.   AUDIT SCOPE, OBJECTIVE, AND METHODOLOGY (continued)

D.   Audit Testing - In order to test the accuracy and validity of our documented understanding of each area's functions, we identified the Treasurer's key transaction cycles. We then developed criteria for evaluating the transaction cycles and designed our audit tests based on these criteria. Our audit tests consisted of specific attributes which were applied to a sample of transactions selected from populations identified during the systems documentation phase. These attributes included determining proper authorization of transactions, accurate reconciliation of subsidiary ledgers to the general ledger, adequate supporting documentation for disbursements, and sufficient review and segregation of duties. Based on our testing, we identified exceptions and related findings and provided recommendations for each. Whenever possible, we utilized the results of our testing and the responses to our inquiries to provide feedback for improving the efficiency and effectiveness of the areas examined.

II. EXECUTIVE SUMMARY

As noted previously, our audit tests were designed to identify the significant transaction cycles within the Office's primary functions and the activities occurring in each. We considered whether internal controls over these activities had been developed and documented, and whether such controls were operating effectively.

Where applicable, we recommended best practices to improve efficiency and effectiveness based on the results of our audit tests and responses to our inquiries. Our detailed findings and our recommendations are reflected in the individual sections of the report which are presented by the primary functions of the Treasurer's Office as listed previously.

The following is a summary of our findings and includes overall observations based on our audit procedures:

A. *Longevity of Current Management Team-* We noted that the division leaders within the Office bring long-term service and experience to their positions. As a result, these individuals have extensive knowledge of their functions and responsibilities. This experience serves as strength in the processing and monitoring of transactions within their respective areas. However, this condition presents the risk that the effectiveness of internal control is assumed based on the knowledge and longevity of the division leaders and is not subjected to a sufficient level of periodic scrutiny and documentation. Division leaders should document their key processes and procedures in writing and re-assess them on a regular basis. This documentation and periodic re-assessment should be subject to the review and approval of the Treasurer and his Executive Staff.

B. *Succession Planning and Cross-training* - Each division leader and personnel in key positions should develop a succession plan to allow for an effective transition of leadership roles and knowledge of key functions, in the event of retirement or unexpected separation from service. In addition to developing written policies and procedures for key roles and functions, division leaders and executive staff should identify one or more employees who are best suited to serve as potential successors. Criteria for these individuals should include not only technical skills and knowledge of key functions, but also leadership ability and long-term vision to improve and enhance operations within their respective functions and the Office overall.

   Many of the objectives of a succession plan can be achieved through an effective cross-training policy. The Office does not currently maintain such a policy. This condition poses the risk of a single individual knowing all parts of a potentially sensitive function or system. In addition, certain services provided by the Office could be interrupted with the unanticipated absence of a key employee. The Office should increase its level of cross-training between divisions and functions and develop a written policy to help ensure continuity of services. Such a policy should address all aspects of the Office's operations and initiate cross-training between job functions wherever reasonable and practical. The policy should also require that personnel in sensitive positions be required to take compulsory uninterrupted vacations of sufficient length to periodically test the Office's ability to cope with the absence of key personnel and to prevent and detect fraudulent activity.

C. *Segregation of Duties* - Our test results indicated instances of lack of segregation of duties and insufficient documentation that certain control procedures were taking place. The signing and dating of transactions and reconciliations to indicate secondary review was often not available. As a result, there was no assurance that the review occurred. Such documentation also serves to indicate that there is adequate segregation of duties for any given function. Most notably, we found that in some cases one individual was ultimately approving their own work, or authorizing a transaction that they also initiated.

II. <u>EXECUTIVE SUMMARY</u> (continued)

Adequate segregation of duties should effectively prohibit a single individual from initiating, approving, or recording a transaction, reconciling balances, handling assets, and reviewing statements and reports. Segregation of duties is critical to effective internal control as it reduces the risk of both erroneous and inappropriate actions. In general, the approval function, the accounting/reconciling function, and the asset custody function should be separated among the Office's employees. When these functions cannot be separated, a detailed supervisory review of related activities should be required as a compensating control activity. Segregation of duties is a deterrent to fraud as it requires collusion to perpetrate a fraudulent act.

D. *Multiple General Leger Systems* - Three divisions within the Office utilize separate general ledger systems (other than STARS) to record and report transactions and account balances. Sufficient understanding required to operate and monitor these systems is limited to a few individuals working within the respective divisions. This results in a "silo" effect which prohibits oversight of general ledger activity by outside Office personnel. The ability of the Office to facilitate effective and efficient financial reporting is also limited. Preparation the Office's annual closing package and audited financial statements requires consolidating and integrating transactions and balances from multiple general ledgers.

To the extent possible, all accounts and transactions under the Treasurer's responsibility should be recorded in a single general ledger system which can be accessed by designated personnel in any given division or function. This commonality would allow for periodic oversight of general ledger activity by individuals who are removed from the daily initiation and approval of transactions. In addition, a single general ledger system would facilitate a clearer audit trail as all transactions could be accessed in a more consistent manner and report generation for items such as journal entries and subsidiary ledgers could be standardized.

E. *SCEIS Conversion* - The Treasurer's Office is significantly behind schedule in converting to the SCEIS enterprise resource plan. Nearly all of the Treasurer's core processes still rely on Legacy mainframe applications. We have been informed that only two individuals within the Office's IT Department are available to work on the SCEIS interface project. These individuals only work on the project during certain times of the week. Most Office personnel have not had substantial SCEIS training and are not fully aware of the project and its objectives.

The position of the IT Division is that they require additional assistance from the SCEIS Implementation Team in order to have effective support for the Office's conversion to SAP. Division staff members contend that there has not been sufficient staffing to facilitate an effective transition. However, we noted that the IT Division has yet to develop a comprehensive list of specific resources needed to facilitate the transition, including number of personnel and level of training and experience. Based on our discussions with DSIT personnel, the majority of other State agencies designated to utilize SCEIS are substantially ahead of the Treasurer's Office in their implementations.

F. *Information Technology Risk Assessment* - There has not been a recent risk assessment or audit of the Office's IT processes and procedures. Policies for the IT department have not been updated to reflect a rapidly changing technological environment, including increased world-wide instances of major compromises to databases containing sensitive information. The Office is currently without a comprehensive security policy for its mainframe applications. In addition, user access reviews for the mainframe applications have not been performed since 2008.

II. __EXECUTIVE SUMMARY__ (continued)

G.   *IT User Access* - In our review of mainframe access for functional applications, we noted that there were a total of 458 user ID's in the Office's five primary mainframe applications. In discussion with the Office's IT DBA/Security Administrator, there were some ID's that could not be identified as needing access to a particular mainframe application.   Based on discussions the State Division of Information Technology personnel, there is "UPDATE" and "READ" file access within the mainframe applications that personnel automatically receive when granted access to the application.

H.   *Utilization and Workflow* - We noted that division leaders expressed concern regarding personnel utilization and capacity. Specifically, we were informed of certain personnel that are under-utilized at certain times of the day. Alternatively, some division leaders felt their department was understaffed compared to the assigned workload. Our observations of workflow management revealed there is no system in place to regularly monitor and measure productivity within the Office. This condition prevents the Office from effectively managing resources and prioritizing responsibilities. A timekeeping and scheduling system would allow division leaders to track time devoted to day-to-day tasks and special projects and to assign them to appropriate employees. Division leaders may then make decisions to adjust for utilization and capacity.

III. **DIVISIONS AND FUNCTIONS**

A. **Treasury Management**

1. *Overview*

    Primary functions of the Treasury Management division include providing banking services to state agencies, performing daily accounting ledger reconciliations and monthly bank reconciliations, processing Department of Revenue transactions, and processing distributions of funds to other State Agencies. The primary control risks related to these functions include maintaining proper segregation of duties and ensuring that account reconciliations and transactions are reviewed and approved in a timely manner. In addition, these review and approval procedures should be adequately documented.

2. *Audit Approach*

    In order to test controls within the division, we selected a sample of transactions and reconciliations to evaluate. We noted that key functions take place on a on a daily, weekly, monthly, or quarterly basis. We selected our samples based on the occurrence of these functions.

3. *Findings and Recommendations*

    (A) Review and Approval of Bank Reconciliations

    Finding – We noted that there is no review of daily reconciliations. We also noted that review of monthly reconciliations is inconsistent. We observed a monthly reconciliation prepared during fiscal year 2011 which had not been reviewed by someone other than the preparer. The Division processes a large volume of cash transactions on a daily basis. Without out a consistent review process in place for daily and monthly reconciliations, the risk of error and misappropriation increases substantially.

    Recommendation – In order to generate a sufficient audit trail, we recommend that a second individual review all monthly reconciliations. The individual should sign and date the reconciliation to document that the review has taken place. While it may not be feasible to review all daily reconciliations, the division should adopt a policy to "spot-check" a designated number of daily reconciliations each month and document that these reviews have occurred.

    Establishing such a policy will help maintain the quality of the reconciliation process, as preparers will be aware that their work is being scrutinized by the reviewer. It will also serve as a deterrent to manipulate or falsify information presented in the reconciliation.

    (B) Local Government Investment Pool (LGIP)

    Findings - We noted a lack of segregation of duties regarding distributions from the LGIP. Specifically, the individual who prepares the manual check payments also performs the monthly LGIP bank reconciliation. As a mitigating factor, we considered that the manual check stock is pre-numbered and that a log of check numbers is maintained by a designated individual. However, four other staff members have access to the manual check stock.

    Recommendation - Bank reconciliations should always be performed by a person independent of the check writing function. In addition, we recommend that access to the manual check stock be limited to one individual and a designated back up.

III. DIVISIONS AND FUNCTIONS (continued)

3. *Findings and Recommendations*, (continued)

Management Response - A manual check request, on a very infrequent basis, is submitted by LGIP (PD) and it is prepared by one individual who happens to reconcile the bank statement as well. But the check request along with the check is sent to another employee in Accounting/Banking for audit and then for a signature to a Senior Assistant State Treasurer. After the signature it comes back to LGIP PD where it is noted. A serial log of the checks is kept. If there is a break in the number it is caught right away which is normally for a void check. A notation is made for it. Once the bank reconciliation is completed, it is reviewed by Investment Operations Supervisor.

(C) Sustainability

Finding - We noted that the Department keeps paper copies of substantially all accounting ledger and bank account reconciliations. We were informed that the Department is planning to image these documents in the future but a timeline has yet to be established.

Recommendation – This issue further illustrates the need for the Treasurer's Office to implement SCEIS. Implementation will allow users to research individual transactions to the source-document level resulting in a significant reduction in processing and handling hardcopies. It will also facilitate "paperless" imaging of ledgers and reconciliations.

Until the Office has this capability, we recommend that whenever possible, reconciliations be prepared and stored using an electric format such as Excel or PDF. This will result in more efficient access and will eliminate materials and storage costs associated with archiving hard copies.

(D) Automation

Finding - We noted that division personnel are required to perform a significant number of manual interface postings with the mainframe systems of STARS (accounting) and FMS (banking) primarily through batch processing of deposits and check payments. We also noted a significant number of manual interface postings with aid to subdivision disbursements and bank reconciliation processes.

Recommendation - This condition is primarily the result of the division utilizing two general ledger systems. Based on responses to our inquiries, FMS has capabilities and applications that are not available through STARS. Until the Office implements a single general ledger system, inefficiencies will continue to exist as interfacing and reconciliations between the two systems will be required. In connection with the future SCEIS conversion, the division should develop a list of capabilities that they will require from the SAP application in order to accomplish the tasks currently executed by the combination of STARS and FMS.

We recommend that the division and the Treasurer's Office accelerate its SCEIS implementation. The use of a real-time system application will create significant efficiencies compared to the batch system currently in place under STARS.

III. DIVISIONS AND FUNCTIONS (continued)

B. Local Government Investment Pool

1. *Overview*

The Local Government Investment Pool (LGIP) is an investment mechanism established to provide local governments (participants) an opportunity to achieve maximum returns on investments by pooling available funds with funds from other political subdivisions. Its mission is to provide professional portfolio management and investment services to local governments throughout the State. The LGIP's operations are currently maintained by the Investments division of the Office of the State Treasurer.

LGIP operations are divided into two primary areas: the participant desk (PD) and investments desk (ID). The PD is responsible for the participants' accounts, including executing transactions (deposits, disbursements and transfers) requested by participants, maintaining a ledger of transactions for each participant's account, and preparing monthly statements for participants. The ID is responsible for investing and managing monies received by the participants. The LGIP maintains its funds in two accounts. The Bank of America (BOA) account is used for daily transactions, and the BNY Mellon (BNY) consists of the LGIP's investments, including daily REPOs.

The LGIP participant data is managed via QED software, and the general ledger is maintained in the FMS system. The LGIP also allows participants to use the QED Internet Participant Access System (IPAS) to initiate transactions, check account balances, and receive monthly statements.

The primary control risks related to these functions include ensuring that account transactions and reconciliations are properly prepared and reviewed in a timely manner so that participant balances are accurately stated.

2. *Audit Approach*

We performed inquiries of key Investment Division personnel to gain an understanding of the processes in place surrounding the LGIP. For each process, we identified key controls and performed walkthroughs of these controls. For the PD, these controls included participant approval of deposits and withdrawals, review of daily participant QED transactions, review of QED to FMS reconciliations, review of QED to bank reconciliations and review of participant interest earnings allocations. For the ID, these controls included review of daily investment transactions posted in QED, review of daily transaction reconciliations of QED to BNY Workbench, and review of QED to FMS reconciliations. We then attempted to corroborate these procedures where possible by testing a sample of the population.

For our walkthrough procedures, we obtained daily work packages from the ID and PD for August 2, 2011, which included support for the underlying transactions, and randomly selected individual items to corroborate the aforementioned key controls. We also performed walkthrough procedures on the key controls pertaining to daily reconciliations using the August 2, 2011 daily work packages.

For attribute testing, we randomly selected ID and PD daily work packages for 16 days throughout the July 1, 2010 to June 30, 2011 fiscal year. For each day selected, we randomly selected a sample of transactions to test. We also used the daily reconciliations for the days selected to perform tests on the applicable key controls regarding transactions processed via the LGIP's computer systems.

III. DIVISIONS AND FUNCTIONS (continued)

3. *Findings and Recommendations*

   (A) Deposit and Withdrawal Policy

   Finding - One of the 28 participant deposits examined was received by the LGIP in a manner inconsistent with the LGIP's policy. Per LGIP policy, a $5,214,131.45 deposit made via check should have been remitted to the LGIP via wire transfer.

   In addition, one of the 27 participant withdrawals examined was disbursed in a manner inconsistent with policy. Per policy, the $20,000 wire transfer should have been disbursed via check.

   We noted that the LGIP is a service oriented organization, and per inquiry of the LGIP PD, exceptions to these policies are typically participant driven.

   Recommendation - Based on the current policies and procedures of the LGIP, we recommend that additional education on LGIP policies be provided to participants to ensure their compliance with such policies and procedures when depositing or withdrawing monies. We further recommend that the LGIP encourage participants to make all deposits and withdrawals via wire transfers.

   Management Response - LGIP is a service oriented organization. Participants cannot be required to make the payments via wire transfers**.** There is a cost involved not only for STO (State Treasurer's Office) but also for the participants. If a participant sends a check for deposit no matter what the amount, STO cannot refuse it. Anytime a check for a large sum is received, a copy of the policy about the wire transfer is sent with the transaction confirmation. This is also true for wire transfers smaller than $20,000. STO makes an exception if the entity makes a special request. STO does use ACH to transfer funds. However, that service may not be available for all of the entities that send us deposits. The wire transfer cost sometimes is more than the interest the entity would earn, especially in the present interest rate environment.

   (B) Transaction Threshold

   Finding - The LGIP's current policy is that monies received or disbursed under $25,000 are to be remitted via check, while receipts and disbursements in excess of $25,000 are to be remitted via wire transfer. Per inquiry of the Investments Division Director, this threshold was an attempt to limit bank wire charges for smaller transactions. The LGIP currently uses ACH transactions for most wire transfers which still incur a bank fee. However, this fee is lower than the wire charges previously incurred.

   Recommendation - We recommend the LGIP update this policy to require all disbursements and remittances be performed via wire transfer unless specifically requested by the participant. The use of wire transactions allows participant funds to be deposited into LGIP accounts timely, resulting in little delay with regard to when a participant can begin earning interest on their deposits; while participants will also have quicker access to their withdrawals.

   Management Response - LGIP is a service oriented organization. Participants cannot be required to make the payments via wire transfers**.** There is a cost involved not only for STO but also for the participants. If a participant sends a check for deposit no matter what the amount, STO cannot refuse it. Anytime a check for a large sum is received, a copy of the policy about the wire transfer is sent with the transaction confirmation. This is also true for wire transfers smaller than $20,000. STO makes an exception if the entity makes a special request. STO does use ACH to transfer funds. However, that service may not be available for all of the entities that send us deposits. The wire transfer cost sometimes is more than the interest the entity would earn, especially in the present interest rate environment.

III. DIVISIONS AND FUNCTIONS (continued)

3. *Findings and Recommendations,* (continued)

(C) Daily Cash Worksheet - Cash to Accrual Conversion

Finding - The PD daily cash worksheet is prepared using the cash basis of accounting. Attached to the cash worksheet is a calculator tape that reconciles the cash worksheet to the daily cash position under the accrual method of accounting, taking into consideration checks and deposits that have not cleared the bank, or cleared after the daily cutoff.

Recommendation - We recommend that the daily cash sheet be modified to incorporate outstanding checks and deposits to provide a clearer picture of the LGIP's daily cash balance. This information is currently presented in the daily cash work. However it is presented in a manner that is difficult for a knowledgeable third party to easily determine what transactions have been initiated but remain outstanding. Modifying the actual form used to prepare the daily cash sheet to include known outstanding items would present the information already being recorded in a more useful manner. This will also eliminate the need to generate the calculator tape used to reconcile between the cash and accrual basis.

Management Response - The cash sheet will be modified although it still will not eliminate the calculator tape for daily reconciliation purpose.

(D) Daily Cash Worksheet - Outstanding Checks and Deposits

Finding - Outstanding checks are currently documented on the PD's desk calendar, and are not easily identifiable as part of the daily cash reconciliation.

Recommendation - As stated above, we recommend the LGIP's daily cash sheet be modified to incorporate outstanding checks and outstanding deposits to consolidate this information in a more useful location.

Management Response - The cash sheet will be modified although it still will not eliminate the calculator tape for daily reconciliation purpose.

(E) Daily Cash Worksheet - Tracking Late Deposits

Finding - The PD daily cash worksheet is completed based on transactions initiated and recorded prior to the determination of the daily REPO amount. The daily overnight REPO amount is typically set around 1:00 PM, which is essentially a bank driven deadline as the bank requires enough time to ensure that sufficient collateral exists for the amount being invested. On occasions in which the PD identifies deposits that clear the bank subsequent to the calculation of the daily overnight REPO, the PD will identify the late deposit on the cash worksheet in red pencil. Since the REPO has already been calculated, these "red" items are not calculated into the daily balance on the cash sheet.

Recommendation - As stated above, we recommend the LGIP's daily cash sheet be modified to incorporate outstanding checks and outstanding deposits to consolidate this information in a more useful location.

Management Response - The cash sheet will be modified although it still will not eliminate the calculator tape for daily reconciliation purpose.

III. **DIVISIONS AND FUNCTIONS (continued)**

3. *Findings and Recommendations,* (continued)

(F) QED/FMS Reconciliation

Finding - Participant transactions loaded into QED are imported into and reconciled with the FMS system. However this process does not consistently take place on a daily basis. Seven of the 16 days examined during our procedures were batched and reconciled with transactions from other days. Per our inquiry of the LGIP PD, the batching of transactions from multiple days for importing into FMS is generally driven by heavier workloads resulting from increased levels of daily transactions and/or the PD serving as back up for the Investment Division Cash Management Desk. It should be noted that at times the LGIP/FMS reconciliation is intentionally not performed on a daily basis. For example, on Mondays the LGIP processes Saturday and Sunday transactions; also, there may be a lag of two or more days at the beginning of the month due to the income allocation process.

Recommendation - Per our inquiry of the Investment Division Director, the GDDO supervisor has been cross-trained so that she can run the appropriate import process from QED to FMS and perform the reconciliation. The CMD is also trained as the current backup for the PD, and is also knowledgeable of the QED/FMS reconciliation process.   We recommend that the LGIP leverage these cross-trained resources to ensure that the QED/FMS reconciliation be performed on a daily (business day) basis, in accordance with current LGIP policies and procedures.

Management Response - FMS does not run ahead of time and weekend work has to be processed on Monday afternoon. Month end processing sometimes can take more than one day especially if the month end falls on weekend. The processing of month end income allocation has to be done on the next business day after the weekend work has been processed.

(G) IPAS - Mandatory Participation

Finding - The LGIP currently offers its participants the ability to use its online IPAS system to initiate transactions and view account activity and statements. This system is integrated with the LGIP's QED system, which serves as the book of record for LGIP participant accounts. As such, transactions initiated through IPAS require no additional data entry by the PD. Use of the IPAS system is currently voluntary for LGIP participants; and not all participants are currently taking advantage of this system.

Recommendation - We recommend that the LGIP strive for 100% conversion of participants to the IPAS system. This would eliminate data entry responsibilities for the PD with regard to withdrawals, deposits and transfers, as well as eliminate the need to generate and retain authorized participant transaction request forms.

Management Response - We can encourage entities to use IPAS whenever possible. But we absolutely cannot make it mandatory. Similar to on-line banking, it takes time for participants to become comfortable using it.

(H) IPAS – Transactional Confirmations

Finding - Each week the LGIP PD prepares and mails transaction confirmations for each participant as documentation of transactions clearing their accounts for that period. The LGIP PD also prepares and mails monthly participant account statements. (Note that IPAS members are not sent monthly statements but are sent weekly confirmations as it is currently not practical to separate IPAS generated transactions from non-IPAS transactions during the confirmation process) The LGIP currently allows participants to view cleared transactions and monthly statements online via its IPAS system; however, there is not full participation in the use of the IPAS system by participants.

III. DIVISIONS AND FUNCTIONS (continued)

3. *Findings and Recommendations,* (continued)

(H) IPAS – Transactional Confirmations, continued

Recommendation - We recommend that the LGIP strive to eliminate transactional confirmations and monthly account statements in paper form by persuading all participants to access this information via the IPAS system. In doing so, we recommend setting up email alerts to notify participants of daily transactional postings to their account and the availability of account statements online.

Management Response - We can encourage entities to use IPAS whenever possible. But we absolutely cannot make it mandatory. Similar to on-line banking, it takes time for participants to become comfortable using it.

(I) Staffing

Finding - The LGIP is currently staffed by two individuals, one at each desk, and two additional individuals who are responsible for reviewing the daily work of each desk. Since the LGIP is operated out of the Investments Division, additional employees are available for cross-training purposes and desk back up when absences occur. However, because the combined Investment Division and LGIP staff consists of only seven individuals, the system can easily be stressed by a high volume of daily transactions and one or more individuals performing back up duties due to personnel absences.

The LGIP is facing a potential personnel issue in that a key PD staff member and the individual who is cross-trained as his backup are both near retirement. These retirements could adversely affect the LGIP's daily operations if an adequate replacement is not found and properly trained prior to the exit of these two employees.

Recommendation - We recommend the Investments Division effectively communicate with key employees as they near their retirement to ensure that adequate time is available to identify and train successors. We further recommend that the Investments Division add the equivalent of a half-time employee. The Office should consider cross-training an employee from another division in order to meet this need.

Management Response - Investment Division has always put great emphasis on cross-training due to the nature of our job duties. Yes it would be great to have another person in the department. This person will have to be on full time basis and willing to cross-train for every job duty in the department and to help out in special projects and research.

III. **DIVISIONS AND FUNCTIONS** (continued)

C. **Investments**

1. *Overview*

   The primary function of the Investments Division is to manage and invest state funds. Investments are monitored and purchased by the Investment Division Director and the Program Manager of the Investments Desk. Recording and reporting of investment transactions is performed by the General Deposit Daily Operations (GDDO) Desk.

   Another significant aspect of the Investments Division is the Cash Management Desk (CMD). The CMD is responsible for ensuring that the State's accounts are properly funded for disbursements.

   The primary control risks related to these functions include ensuring that investment activity is properly recorded and reviewed in a timely manner so that investments are accurately stated.

2. *Audit Approach*

   We performed inquiries of key Investment Division personnel to gain an understanding of the processes in place. For each process, we identified key controls and performed walkthroughs of these controls. For the GDDO, these controls included approval of daily investment purchases, review of daily investment purchases and maturities recorded in STARS, and review of reconciliation between daily activity per STARS and BNY records. For the CMD, these controls included proper recording of daily cash transactions. We then attempted to corroborate these procedures where possible by testing a sample of the population.

   For our walkthrough procedures for the GDDO, we obtained the daily work package for July 15, 2011, which included support for the underlying transactions therein recorded, and randomly selected individual items to corroborate the aforementioned key controls. We also performed walkthrough procedures on the key controls pertaining to daily reconciliations using the July 15, 2011 daily work package.

   For our walkthrough procedures for the CMD, we obtained the daily work package for July 12, 2011, and inquired of key personnel to identify and inspect the support for the underlying transactions therein recorded to corroborate the aforementioned key controls.

   For attribute testing, we randomly selected GDDO and CMD daily work packages for 16 days during the July 1, 2010 to June 30, 2011 fiscal year. From each day selected, we randomly selected additional transactions recorded for testing purposes, and also used the daily reconciliations for these days to perform tests on the applicable key controls regarding transactions processed to the Investment Division's computer systems.

3. *Findings and Recommendations*

   (A) Review of Investment Transactions Posting to STARS - General Deposit Daily Operations Desk

   Finding -We noted that the review of the GDDO's daily work for July 15, 2011 occurred on the same day that the work was performed. Due to the nature of the Investment Division's operations, proper review of transactions posted to STARS on any given day cannot be performed until postings are processed that night. The GDDO supervisor then receives a FMS/IMS reconciliation report generated by the IT department, (TFM160ND) that shows the overnight postings and identified any potential errors from the previous day's work.

III. DIVISIONS AND FUNCTIONS (continued)

3. *Findings and Recommendations*, (continued)

Recommendation - We recommend that the approved TFM160ND report be reviewed and included in the GDDO's daily work package for the appropriate day. We also recommend that the TFM160ND report be made accessible via the OnBase document management system to the GDDO, as this report is necessary for the GDDO to address any issues that may occur during the overnight posting, thus reducing the GDDO's reliance on receiving this report from the supervisor.

Management Response - The TFM 160 ND report is scheduled to be put on OnBase. But the same function is accomplished daily by utilizing TFM170ND and TIM11OND. A spreadsheet is updated daily with the Total Cost of portfolios and any differences are research and reconciled daily.

(B) *Review of Cash Management Desk Daily Work - Cash Management Desk*

Finding - There is no formal review of the CMD's daily work regarding the cash sheet created. The cash sheet helps drive the State's cash management by analyzing future cash requirements needed for scheduled disbursements while ensuring that adequate monies are available to fund these disbursements and excess funds are properly invested. The daily cash sheet serves as the CMD's primary tool in determining the daily cash requirements and REPO amounts while reconciling from beginning to ending daily bank balances.

Recommendation - Current processing of the daily cash sheet relies on the premise that a significant error by the CMD would be identified by individuals in other divisions and corrected after their communication of the error to the CMD. We recommend that the CMD's daily work be reviewed within the Investments Division to ensure that all available monies are being captured for use against daily funding of disbursements, while excess amounts over daily expenditures are properly invested.

Management Response - The cash management function involves a lot of judgment work. It is more of a function of gathering of information from different sources and making sure that all bank accounts are fully funded to make the payments. It affects banking, investments and accounting. It is true that the worksheet is not reviewed daily by another employee but it is being monitored to a certain extent by all other areas affected by it.

(C) *A Single Software Solution for Investments*

Finding - The Investments Division, including the LGIP, currently manages investments via two separate systems: QED and IMS. The use of QED for LGIP was driven by the need for a software solution that could adequately handle the income allocation for participant accounts. However, division personnel cite limitations within the QED system which prevent them from moving all managed portfolios onto QED, despite the system's superior reporting features over IMS. The use of two systems for managing the same type of information creates added work in order to train staff to become proficient in using both.

Recommendation - We recommend that the division consolidate the reporting and recording of investment and LGIP transactions under one system such as SCEIS.

According to division personnel, SCEIS does not have the capability to properly account for certain investments and therefore would not be adequate for such a consolidation. However, because SCEIS utilizes modular accounting software (SAP) there should be some flexibility in its application. Therefore, we recommend that the division fully evaluate and consider the adaptability of SAP including obtaining input from the SCEIS implementation team regarding the capabilities and limitations of SAP in accounting for investments.

3. *Findings and Recommendations*, (continued)

Management Response - That is the ultimate goal. As it stands SCEIS can only handle the general ledger side and that is kept on one system FMS. It is the Investment Portfolios that are kept on QED and IMS until SCEIS can handle different types of securities.

(D) Utilization of OnBase Document Management System

Finding - During the 2011 fiscal year, the Investment Division used the OnBase document management system to access some reports in an electronic format instead of printing them as hard copies. Since this is a relatively new system, it is not being fully utilized as there are still instances in which multiple employees may receive hard copies of the same report.

Recommendation - We recommend that the division effectively evaluate which reports are currently being printed to determine if they can be more efficiently accessed electronically. By reducing the number printed reports and further utilizing the OnBase system, the Investments Division will be able to move towards a more paperless environment and limit related expenses incurred by the creating non-essential hard copies of reports.

Management Response - It is an ongoing project and work in progress.

(E) Staffing

Finding - The Investment Division, excluding the LGIP, is currently staffed by five individuals. This includes the division's director and two supervisors who also review the work of the LGIP. The Investment Division, with the use of LGIP employees, has cross-trained two individuals to be proficient at each position. However, since the entire Investment Division and LGIP are comprised of seven individuals, the system can easily be stressed by a high volume of daily transactions and one or more individuals performing back up duties if there are personnel absences.

The Investments Division is also facing a potential personnel issue in that the division director, CMD, GDDO supervisor and LGIP PD (currently cross-trained as the CMD's backup) are all nearing retirement. The departure of any one of these individuals unexpectedly could adversely affect the Investment Division's daily operations if adequate steps are not taken to ensure that a competent replacement is available prior to their departure to receive adequate training.

Additionally, the division director plays a major role in determining which securities are purchased and in ensuring that they are in line with LGIP investment guidelines. The director also performs certain administrative functions and communicates vital information to other managers within the Treasurer's Office and throughout state government. The director has attempted to train suitable replacements; however retaining these employees has proven difficult. Similar positions in the private sector offer significant financial incentives which lure these employees to other opportunities.

Recommendation - We recommend the division effectively communicate a transparent timeline with key employees as they near their retirement to ensure that adequate time is available to identify and train successors. We recommend that the division consider making an additional investment to retain employees capable of replacing the current director.

III. DIVISIONS AND FUNCTIONS (continued)

D. Office Administration

1. *Overview*

The Office Administration Division handles all internal functions for the Office including human resources, accounts payable, accounts receivable, procurement, payroll, budgeting and other general disbursements such as employee travel reimbursements and supplies purchases. Based on our interviews and walkthroughs, we identified payroll processing and general disbursements as the most significant transaction cycles within the division. We concentrated our testing in these areas.

2. *Audit Approach*

We obtained all payroll registers for fiscal year 2011 and selected a sample of employees and pay dates. For each sample item, we compared the employees' authorized pay rates to amount paid per the payroll register for that pay period, and compared the total payroll for a particular pay period to the general ledger.

We also obtained the fiscal year 2011 check register for general disbursements and travel reimbursements. We selected a sample from the check register and compared the distribution amounts to their supporting documentation, verified that the distribution was approved and deemed reasonable, and that it was recorded in the proper general ledger account.

We noted no exceptions as a result of procedures performed related to payroll and general reimbursements. However, we did have the following findings based on our inquiries and observations.

3. *Findings and Recommendations*

(A) *Cross-training*

Finding - Based on our interviews with division staff members, only one individual has been trained to perform certain day-to-day functions, including accounts payable, payroll, receivables and journal entries. This condition may lead to bottlenecks and slow response times if key employees are absent for an extended amount of time.

Recommendation - Management should consider the benefits of cross-training individuals within the division to perform certain duties that are currently performed by only one employee.

Management Response - It should be noted that the manager is knowledgeable and able to perform any of day-to-day functions necessary to prevent bottlenecks and slow response times. Also, we have just hired a new employee who is cross-trained to perform these key functions.

(B) *Budget Process*

Finding - The Treasurer's annual operating budget is prepared almost exclusively by Office Administration personnel with limited input from the division leaders. We also noted that budget versus actual reports reflect little or no variances from actual revenues and expenditures. This is due to the fact that the original budgeted amounts are adjusted throughout the year to accommodate conditions and events that were not accounted for during development of the initial budget. As a result, division leaders are not fully accountable for variances and are not incentivized to manage their resources and achieve efficiencies. In addition, the effectiveness of budget versus actual reports is limited as they do not report variance from plan and do not promote scrutiny of why overages and shortfalls occurred.

III. **DIVISIONS AND FUNCTIONS** (continued)

3. *Findings and Recommendations,* (continued)

Recommendation - Division leaders should review the drafted budget as prepared by Office Administration and provide feedback as to the accuracy of budgeted amounts based on knowledge of their respective operations. Prior to the budget being finalized, the Treasurer should obtain "buy-in" from division leaders that the budget is reflective of their input and that they are committed to achieving the planned revenues and expenditures. Variances from the original budget should be monitored monthly and should be discussed with division leaders as necessary to clarify overages and shortfalls. Historical variances and related explanations should be considered in preparing future budgets.

Management Response - The State Treasurer's Office budget is not currently budgeted by division, but rather by two major programs of the Office, Administration and Programs and Services. The State Government budgetary/expenditure process not only allows, but mandates budget transfers to meet agency needs. Internally, we do track expenditures by cost center in order to track and account for revenue sources to fund our agency budget, but we do not budget by division. Each division director is asked to provide projections for budgetary needs, but again the budget is maintained at two major program levels, not by division. Historical variances and related explanations are considered in preparing future budgets. The Office does maintain internal budgetary/expenditure reports and variances of costs are monitored monthly. If any unforeseen variances occur, these are verified and discussed with division directors. We have been reviewing and developing a process to provide more detailed data to division directors, but with the small size of our agency budget and the low variance rate, this is still a work in progress.

III. DIVISIONS AND FUNCTIONS (continued)

E. Debt Management

1. *Overview*

   General - The objective of the Debt Management Division is to structure and manage the debt obligations of the State and its agencies. The Division assists with forming a plan to borrow, receive and repay monies in a timely manner. The key functions of the Division are debt structuring and issuance, debt reporting, fee payment, agency draw requests and debt payment. Each of these functions includes specific responsibilities as summarized below.

   The Division has the responsibility to assist an agency in developing a suitable debt plan. Different scenarios are considered based on the agency's needs, the term of the debt, the cost of the debt and the ability of the agency to repay according to agreed upon terms. Each debt plan is collectively reviewed by the Division, its bond attorneys and the agency until all parties agree to terms that are most practical for the agency. The debt plan is then converted into a bond resolution, which requires approval by the Joint Bond Review Committee and the Secretary of the State Budget and Control Board. The debt is eventually sold to the bidder offering the lowest interest cost. Bond proceeds are subsequently coded to the respective agency's sub fund accounts maintained by the Division.

   After the settlement date, the Division enters all terms and conditions of the issuance into its Debt Management System. This information is then used for tracking of agency draws and principal and interest payments.

   The Division receives invoices from bond attorneys for closing costs associated with debt issuances. The invoices are keyed into the Debt Management System and the Division authorizes the Treasury Management Division to process the invoices. Checks are then generated at the Office of the Comptroller General and returned to the Division. The Division is responsible for mailing the checks to the bond attorneys.

   The Division also receives and processes agency draw requests which are entered to the Capital Improvement Projects System. Division personnel review the draw requests and authorize the Treasury Division to transfer the funds to the appropriate agency.

   The Division reviews the debt amortization schedules for each issuance in order to keep track of principal and interest payments. When payments are due, the paying agent is then notified by the Division that funds will be transferred on the designated due date via an Automated Clearinghouse Notification.

2. *Audit Approach*

   We developed our understanding of processes and procedures related to the above functions through inquiries and discussions with division personnel. We also performed a walkthrough of a 2010 bond issuance, including examining supporting documentation indicating the amount and approval of the issuance. Once we developed a sufficient understanding of the primary functions through our interviews and walkthroughs, we identified separate populations for testing from each of the following areas: (1) debt issuance and structuring, (2) fee payments, (3) agency draws, and (4) debt payments. We selected samples from these populations and examined each selection for certain criteria.

   Our test procedures included examining documentation to support the amount and approval of the fee payments and the agency draws. We also examined a sample of debt service payments from the Division's "Principal and Interest Due by Agency Report" for proper review and approval. We then compared certain information related to debt issuances to the Debt Management System. Based on our test procedures, we noted certain findings and recommendations as reflected below.

III. **DIVISIONS AND FUNCTIONS** (continued)

3. *Findings and Recommendations*

   (A) *Secondary Review and Approval – Selected Reports*

   Finding - The following reports which are generated by the Division do not include supporting documentation to indicate the preparer of the report, and whether it was reviewed and approved by a second individual:

   - DBC Finance Report
   - Cash Deposit Sheet
   - Cash Status Report

   The *DBC Finance Report* is prepared by a Division staff member to verify the bond pricing-model provided by the bidder. This verification helps ensure that the borrowing agency has committed to the repayment terms that were agreed upon during the debt structuring process.

   The Comptroller General's office authorizes the sub-funds to be used for tracking proceeds, issuance costs, and debt service payments for any given bond issuance. The *Cash Deposit Sheet* is prepared by a division staff member from the Comptroller General's authorization. The Cash Deposit sheet helps ensure that the authorized sub-funds are accurately uploaded to the debt management system.

   Posting of bond proceeds to the general ledger is initiated by Treasury Management and is communicated to the Division through the *Cash Status Report.* The report is used to ensure that bond proceeds are accurately recorded in the debt management system.

   Recommendation - We recommend that the above reports be initialed and dated by the preparer. A second individual should be designated to review the work of the preparer. This person should also initial and date the reports to indicate his or her review. This will enhance segregation of duties and increase the likelihood of errors being detected and prevented.

   (B) *Secondary Review and Approval – Disbursements*

   Finding - We noted that review and approval is not documented for disbursement transactions including fee payments, agency draws, and debt payments.

   Recommendation - Initial processing of a vendor invoice should be performed by a staff member prior to it being reviewed and approved for payment by the Assistant State Treasurer. This will allow corroboration by a second employee that the expenditure is for a proper purpose. In addition, before agency draw requests are processed, they should be reviewed by the Assistant State Treasurer to help ensure that the draws are being disbursed only for activities permitted by the bond resolution.

   A similar process should also be adopted for the Division's fee payments. Voucher packages supporting these transactions should include indication of who initiated the disbursement and who reviewed and approved it. This will help ensure that payments are for a proper purpose. It will also mitigate the risk of disbursements being made to unauthorized vendors.

III. DIVISIONS AND FUNCTIONS (continued)

3. *Findings and Recommendations*, (continued)

(C) IT Resources

Finding – Based on our inquiries, the division requires additional IT resources and must currently compete with other departments for adequate system and technology support. In addition, there is a need for more efficient systems and reporting tools as transaction processing requires the division to maintain both its Debt Management System and the Treasurer's Legacy system.   Under these conditions, transactions must initially be entered and batched in one system and then uploaded to a second system for final processing and recording in the general ledger. These conditions also require extensive "hard copy" record retention for transactions and reports.

Recommendation – The systems and technology needs of the division should be evaluated as part of an overall assessment of the Treasurer's IT resources. The division's Debt Management System and interface with Legacy should specifically be evaluated for consolidation and conversion to the State's SCEIS system. This conversion should be implemented with the objective of shifting to a single general ledger system in which much of the division's record retention and audit trail will become "paperless".

Management Response - While the debt division (and many others) requires additional IT resources, it is our understanding that the IT director did a review of the debt division several years ago. According to the IT director there was no movement/action as a result of the review.

III. **DIVISIONS AND FUNCTIONS** (continued)

F. College Savings Plans

1. *Overview - Future Scholar Program*

The Future Scholar Program is a 529 college savings plan offered by the Treasurer's Office to residents and non-residents of South Carolina. The Treasurer has contracted substantially all of the plan's operations to Columbia Management, a third-party administrator. Services to be provided under the contract include recordkeeping, disbursement of funds, marketing the plan, and corresponding with participants. Participants access the plan primarily through a link maintained on the Treasurer's Website. The Treasurer's Office is ultimately responsible for how plan assets contributed by participants are invested and distributed.

2. *Audit Approach - Future Scholar Program*

We developed our understanding of the plan through inquiry of the Program Director, an employee of the Treasurer's Office. We supplemented our understanding through review of the plan's audited annual financial statements and the annual service auditor report performed on the operations of Boston Financial Data Services, a record keeper hired by Columbia Management.

We attempted to observe monitoring procedures performed by the State Treasurer's Office over the services performed by Columbia Management. We also attempted to examine documentation of the policies and procedures for investment decisions related to plan assets.

3. *Findings and Recommendations - Future Scholar Program*

(A) Lack of Monitoring

Finding - The Treasurer does not currently have procedures in place to sufficiently monitor the services provided by Columbia Management. Responsibilities of Columbia Management include participant recordkeeping, distributing plan assets, and addressing issues and concerns of participants. The Treasurer's involvement in the plan is limited to assisting with marketing strategy and providing some input regarding investment decisions. Treasurer personnel do not review Columbia Management's processing of transactions such as participant contributions and disbursements. This poses the risk that unauthorized distributions could occur or that participant contributions may be mismanaged.

Recommendation - The Treasurer endorses this plan and is perceived to have fiduciary responsibility for the participant funds. Therefore, sufficient review procedures should be implemented to ensure that Columbia Management is providing the services specified in its contract with the Treasurer's Office and that participant account balances are being properly managed. In addition, the Treasurer should request and review service auditor reports on Columbia Management (and its subcontractors) for exceptions related to internal controls. The Treasurer should periodically select a sample of contributions and distributions processed by Columbia Management and review supporting documentation to ensure that these transactions are being initiated and approved by participants.

Management response - While we may be able to perform this review, it should be noted that Columbia Management is audited each year by Pricewaterhouse Coopers.

III. **DIVISIONS AND FUNCTIONS (continued)**

3. _Findings and Recommendations - Future Scholar Program_, (continued)

   (B) Investment Policy

   Finding - The plan held approximately $1.4 billion in assets as of June 30, 2010. However, the Treasurer does not maintain a formal investment policy for the plan. Investment options are substantially determined by Columbia Management with limited input from Treasurer personnel. Without such a policy, there is the risk that Columbia Management will provide investment offerings that are not in accordance with the risk tolerance that the Treasurer deems appropriate for plan assets.

   Recommendation - The Treasurer should establish a formal investment policy for plan assets to include parameters for the type of investments to be offered and the acceptable level of risk. Based on this policy, investment offerings should be reviewed on a periodic basis by qualified personnel. The Treasurer should consider establishing an investment committee to perform this review. Committee meeting notes should serve as documentation that the review occurred. Compliance with this policy should be incorporated into any future contract with a third party administrator. This process is similar to those practiced by other State plans, including the States contributory 401k and 457 plans.

   (C) Fee Policy

   Finding - The plan generates quarterly fees of approximately $250,000 for the Treasurer's Office. As of May 2011, the balance of total fees collected was approximately $1,729,000. These fees are contractually obligated by Columbia Management to the Treasurer and are determined based on a calculation defined in the contract. There is no review of the quarterly fee amount to determine that it has been calculated in accordance with the contract. In addition there is no formal policy as to how these fees should be used.

   Recommendation - The division should fully evaluate the allowable uses for these accumulated fees. The fees should then be budgeted as permitted for use by the Treasurer's Office including offsetting plan costs. Also, a designated individual should be responsible for determining that quarterly fee revenue has been accurately calculated according to the terms reflected in the contract with Columbia Management.

   Management Response - The contract with Columbia Management states the fee is to be used by the STO and the STO does in fact use the fees to offset costs to the program.

III. DIVISIONS AND FUNCTIONS (continued)

1. *Overview - Tuition Prepayment Plan*

The plan which was first opened for enrollment in 1997, allows families to pre-pay college tuition at current period rates with future benefits available to the participant in the form of 100% tuition payments (subject to certain criteria). The plan was frozen in 2006 at which time it ceased admitting new entrants.

Currently the plan holds assets for account owners that are partially paid or paid in full and receiving benefits. An annual valuation is performed to estimate the current unfunded liability of the plan. The Treasurer's Office has contracted with NBSC to provide lockbox services in which payments to the plan go directly to the bank for deposit. The Treasurer has contracted with Intuition Company to serve as record keeper for the plan. The primary responsibilities of the Treasurer's Office are to ensure the following: 1.) the record keeper is performing duties appropriately according to the contract, 2.) payments continue to be collected timely by the bank and are properly recorded in the Treasurer's general ledger, 3.) transactions and participant data are accurately transmitted to Intuition, 3.) cash balances are properly held and invested in the assets of the program, 4.) All disbursements from the plan are authorized and are for a proper purpose.

Based on the above responsibilities, the plan is organized as follows: The bank holds the plan's assets, Intuition keeps the participant records of the plan and authorizes disbursements, and the Treasurer controls the plan assets and records the financial transactions of the plan.

The greatest areas of risk to the plan include participants not satisfying their obligation prior to receiving benefits, benefits being paid to improper individuals, and inability to satisfy the future unfunded obligation of the plan.

2. *Audit Approach - Tuition Prepayment Plan*

We developed our understanding of the plan through inquiry of the Program Director, an employee of the Treasurer's Office, and representatives of Intuition. To supplement our understanding, we selected five transactions and performed walkthroughs for each. These transactions consisted of a single lockbox deposit and four disbursement transactions. The disbursements included a tuition payment to an in-state public university, a tuition payment to an out-of-state university, an overpayment refund to a contributor, and a scholarship refund payment to a contributor. Additionally we inspected the service audit report for intuition and the most recent valuation performed for the plan.

To perform our testing, we randomly selected a sample of five disbursement transactions from the check register provided by the Comptroller General's office. For each sample item, we inspected the voucher package which includes the Intent to Enroll Form and the invoice from Intuition, and performed the following procedures: 1) we matched the invoice data to the disbursement voucher data, 2) we verified the beneficiary information directly with Intuition, 3) we verified that the voucher was appropriately authorized, and 4) we matched the check listing data, including payee and amount, to the invoice.

III. DIVISIONS AND FUNCTIONS (continued)

3. *Findings and Recommendations - Tuition Prepayment Plan*

   (A) Verification of Intuition Transactions

   Finding - We noted that participant account transactions reported by Intuition are not periodically compared to contributions and benefit payments recorded in the general ledger of the Treasurer's Office.

   Recommendation – A monthly reconciliation should be performed to help ensure that plan activity per Intuition is accurate based on the Treasurer's records. All reconciling items should be researched and traced to clearing.

   (B) Access to Intuition

   Finding - Access to the Intuition system is available to only one individual in the Treasurer's Office. This condition prevents developing backup responsibilities and limits adequate segregation of duties, thus increasing the risk of errors and misappropriation.

   Recommendation - We recommend that a second employee be provided access to the Intuition system and that this individual receive adequate cross-training to allow for back up in the event of prolonged absence or termination. This would also facilitate additional oversight and dual-control over participant account activity.

   (C) Termination of Key Personnel

   Finding - Subsequent to our site visit we were informed that the Program Manager resigned from the Treasurer's Office. This employee had sole access to benefit payment activity within the Intuition software package.

   Recommendation - The Treasurer should take advantage of the opportunity to review the activities of a key employee who had sole access to the Intuition system and who abruptly resigned. We recommend that a sample of benefit payments from the plan be examined to verify that they were appropriately disbursed to qualified plan participants

   Management Response - We asked Intuition to review their records for unusual activity and nothing was found.

   (D) Secondary Review and Approval

   Finding - We noted there was no indication that daily deposits reported by Intuition were compared to actual daily bank deposits reported by NBSC.

   Recommendation- We recommend that the daily deposit report generated by Intuition be reviewed by designated Treasurer personnel to ensure that all reported deposits clear the bank. The daily deposit report should be initialed and dated by the individual performing this function to document that the review occurred.

III. DIVISIONS AND FUNCTIONS (continued)

3. *Findings and Recommendations - Tuition Prepayment Plan*, (continued)

(E) Funding of Plan Liability

Finding – The June 30, 2010 valuation of the Plan indicates that the Plan is underfunded by approximately $53 million. Further, the valuation indicates that the Plan is projected to exhaust its assets in fiscal year 2018. There was no indication that a plan is in place to fund this liability.

Recommendation – The Treasurer should develop and formalize a long-term strategy for addressing the unfunded liability, including identifying a funding source, and estimating a conservative discount rate for the return on plan assets.

Management Response - The State Treasurer keeps the Legislature appraised of the unfunded liability and encourages the Legislature to address the unfunded liability.

(F) Participant Delinquencies

Finding – We noted that some plan participants financed their initial contribution at the time they enrolled in the program. However, many of these individuals are no longer making payments to meet their obligation.

Recommendation - We recommend that the Office establish policies to facilitate re-payment of these obligations including: 1) charging late fees for missed payments, 2) declaring an account "delinquent" after a defined number of missed payments, and 3) notifying the participants that their delinquent account has been scheduled for termination and that any available account balance will be applied towards their outstanding obligation.

(G) Lack of Monitoring

Finding – By endorsing this Plan, the Treasurer is perceived to have fiduciary responsibility for over $179 million in plan assets and an unfunded liability just under $53 million at June 30, 2010.   However, as described in the findings above, there are no specific procedures in place to monitor and evaluate the services provided by Intuition.

Recommendation – Sufficient review procedures should be implemented to ensure that Intuition is providing the services specified in its contract with the Treasurer's Office and that participant account balances are being properly managed. In addition, the Treasurer should request and review service auditor reports on Intuition for exceptions related to internal controls

III. DIVISIONS AND FUNCTIONS (continued)

G. Tobacco Settlement Revenue Management Authority

1. *Overview*

   The Tobacco Settlement Revenue Management Authority was created in 2001 when the State transferred to the Authority, its entitlement to certain payments due from the Master Settlement Agreement (MSA). The MSA represents the settlement of damages resulting from cigarette smoking-related litigation. Bonds were sold that were secured by the payments receivable from the MSA. The State chose this route (1) to receive a substantial lump sum in the beginning to fund existing programs and (2) to shift the risks associated with the settlement to the bondholders (i.e. even if the bonds are not repaid, the State keeps all of the money received from the bond issuance since only the MSA payments are pledged to repay the bonds).

   According to SC Code of Laws Section 11-49-30 the Authority is to receive the state's tobacco receipts, issue bonds payable secured by these receipts, and to manage the receipts for the purposes stipulated in the law. These purposes include providing funding to various allowable programs and providing funding for enforcement of the MSA.

   The Authority is governed by a board consisting of the Governor or her designee, the State Treasurer, the Comptroller General, the Chairman of the Senate Finance Committee, and the Chairman of the House Ways and Means Committee. The Board can obtain administrative assistance from the Office of the State Treasurer and the State Budget and Control Board. However, the Board retains responsibility and must provide proper oversight for the implementation of the code.

2. *Audit Approach*

   In order to gain a sufficient understanding of the Authority's activities, we inquired of key employees responsible for initiating, processing and approving Authority transactions. Significant activities of the Authority include review and approval of payments to vendors, and preparation and review of the Monthly Cash Flow worksheet. We tested these activities by selecting a sample of transactions from the population of Authority disbursements provided by the Treasurer's Office.

3. *Findings and Recommendations*

   (A) Separate General Ledger System

   Finding - Authority transactions are accounted for using Microsoft Office Accounting software. We noted that the IT Division does not manage this application and that access to the software is confined to a single individual. As a result, oversight and review of Authority transactions is limited. The Treasurer relies on a year-end financial statement audit as an internal control over Authority activity.

   Recommendation – Authority activity should be recorded in the Legacy general ledger system to allow for access to transactions by more than one individual. If a separate general ledger is maintained, the software application should be managed by the IT Division to ensure proper administration and security over data.

III. **DIVISIONS AND FUNCTIONS** (continued)

3. *Findings and Recommendations*, (continued)

(B) Recording of General Ledger Activity

Finding – We noted that there is no general ledger activity posted for the Authority until year-end. The majority of the Authority's transactions are recorded from the monthly trustee statements detailing activity reflected in various trustee accounts. These statements are accumulated throughout the year for one-time posting to Microsoft Office Accounting. As a result, the examination of monthly trustee statements and the Authority's monthly financial activity is limited to one individual, with little or no oversight and review. These conditions pose the risk of increased errors and potential misappropriation.

Recommendation – General ledger activity for the Authority should be recorded as transactions are processed. The general ledger should then be reconciled to trustee statements on a monthly basis.

III. DIVISIONS AND FUNCTIONS (continued)

H. Court Fines

1. *Overview*

    The Court Fines division is responsible for ensuring that county and municipal courts collect and remit to the Treasurer's Office certain fines and fees as required by state law. The process is initiated when a County or Municipal court submits a revenue remittance form to the division. The division accepts, processes, and transfers payments of fines and fees from the county and local courts to the appropriate agencies.

    The most significant risks associated with collection of court fines are in three areas. First, the Treasurer's Office is currently relying on the individual county and municipal courts to accurately collect, record, and remit the fees. The second area of risk is related to ensuring all counties and municipalities submit their filing with the Treasurer each month. The last area of risk is the accurate depositing and recording of daily transactions.

2. *Audit Approach*

    We developed our understanding of Court Fines through inquiry of key division personnel. We supplemented our understanding by performing a walkthroughs of a county court submission where funds were transferred via ACH, and a city court submission where funds were transferred via check.

    To perform our testing we haphazardly selected one county court and one municipal court. We then randomly selected one month for each court. For each sample item we obtained the revenue remittance form and performed the following: 1) we matched the total amount per the form to the deposit to the bank, 2) we verified that the amount was properly posted to the general ledger by matching the payee and amount, 3) we verified that the transfer of funds to the appropriate state agency by agreeing the amount remitted by category to the Distribution System Court Transaction Report.

3. *Findings and Recommendations*

    (A) Court Submission

    Finding - The Treasurer does not currently have procedures in place to sufficiently monitor the submission of the revenue remittance form for courts. All courts are required by statute to submit the forms and remit payment on a monthly basis, even when no court session is held. This condition poses the risk that several reporting periods may pass without the required forms and associated payments being submitted to the Treasurer's Office.

    Recommendation - The Treasurer should establish a system to verify that all county and municipal courts have submitted the form on a monthly basis. When noncompliance with the requirement has been identified, the Treasurer's Office should formally notify the respective court of the violation and compel them to comply.

III. DIVISIONS AND FUNCTIONS (continued)

3. *Findings and Recommendations, (continued)*

(B) Revenue Remittance Form

Finding - We noted that certain courts submitted out of date revenue remittance forms. The Treasurer updates the revenue remittance form on an annual basis to ensure the most recent legislation for Court Fines and Fees are referenced. Accepting outdated forms poses the risk that inaccurate fines and fees have been collected and remitted to the Treasurer's Office.

Recommendation - The Treasurer should ensure all county and municipal courts have complied with currently enacted law by enforcing use of the current revenue remittance form.

(C) Multiple Submissions

Finding – The Treasurer receives multiple submissions for certain counties and municipalities that have several courts. Each court system is required to submit a revenue remittance form with payment to the Treasurer. Receiving a revenue remittance form from several courts within one system creates inefficiencies within the Treasurer's Office.

Recommendation – We recommend creating a policy to establish guidelines for submission of the revenue remittance form. Such a policy would include a requirement for a county or municipality with multiple courts to consolidate the form and payment to one submission. Creating such a policy would reduce the effort of the Treasurer's Office in recording transactions and ensuring compliance.

(D) Verification of Submission Data and Reporting Accuracy

Finding – The Treasurer's current system for verifying reported fines and fees indicated an estimated $12,000,000 unexplained variance between the amounts reported on the revenue remittance form and a check figure for fiscal year 2010. The Treasurer requires counties and municipalities to include a Court Fines and Fees schedule with their audited financial statements. The Treasurer's Office has relied on this schedule to verify the yearly totals reported on the revenue remittance form. However, this schedule is not required to be included in the scope of the audit opinion. This condition poses the risk that inaccurate information is being reported, and inaccurate payments are being made to the Treasurer's Office.

Recommendation – We recommend that the Treasurer coordinate with the Judiciary Office to obtain a Court Management System (CMS) Report for a sample of court submissions on a monthly basis. The CMS is an accounting information system which has been implemented for nearly all county and municipal courts within the state. The CMS system would allow for timely verification of data from a source which is closer to its origin. Revenue remittance form data would be matched to the data extracted from CMS. Significant variances could be identified and resolved with a detailed plan to follow up with the respective court. Systemic errors will be identified and corrected on a timely basis.

(E) Cross-Training

Finding – The Court Fines division relies heavily on one person to receive and record payments. The extended absence or termination of this key employee could result in a high volume of errors in receiving and recording court fines and fee payments.

Recommendation – We recommend designating at least one individual as a backup to perform the receipt and recording of court fines and fees. Monthly performance of these tasks by key individuals will ensure a reliable replacement in the event of extended absence or termination of the key employee.

III. DIVISIONS AND FUNCTIONS (continued)

I. Information Technology

1. *Overview*

   The Information Technology Division of the Treasurer's Office is located in the 2nd floor of the Wade Hampton Building. The primary role of the division is to support certain mainframe and client server applications utilized by the Treasurer's various functions and divisions as listed below:

   1) Court fines/Aid to Subdivisions and STO Vouchering - TDISTAID (mainframe)
   2) Debt Management – TDEBTMS (mainframe)
   3) Collateral/Debt Lease Management – TRECOLL (mainframe)
   4) Investment Management – TIMPROD (mainframe) and QED (client server)
   5) Financial Management – TFMPROD (mainframe)
   6) Local Government Investment Pool – QED (client server)
   7) Tobacco Settlement Revenue Management Authority – STARS (mainframe)/spreadsheets
   8) Treasury Management – STARS (mainframe)
   9) Unclaimed Personal Property – Wagers (client server)
   10) College Savings Plan – Intuition (client server)

   Day-to-day tasks include help desk support, data entry, programming, disaster recovery oversight, and security set-up and maintenance for the applications. The Division of State Information Technology (DSIT) performs primary network support, backup and recovery and mainframe maintenance with input from the division.

   As a state agency, the Treasurer's Office has made only limited progress in completing its conversion to SCEIS. As of this report, the Office continues to rely primarily on the legacy mainframe system, which is almost 30-years old and has been deemed antiquated by the State and scheduled to be phased out. As part of the SCEIS conversion, the State mandated that some financial applications will be transitioned from the STARS mainframe to the SAP client server system. Major applications housed by SCEIS/SAP include payroll, procurement and human resources.

   Help desk support provided by the division consists primarily of maintenance for hardware and software applications. The division also directs DSIT in its network support role. Users typically contact the division via e-mail or phone to request assistance.

   Two division staff members have been designated for data entry related to bank transmissions and SCEIS/SAP production jobs submitted by the various departments within the Treasurer's Office. These two staff members report to the division's DBA/Security Administrator. Their duties also include scanning documentation for imaging-based record retention.

   The division's staff includes six programmers who have access to the mainframe environment and the Treasurer's website. The client server applications (QED, Wagers and Intuition) are not accessible as they are vendor supplied applications.

   The DBA/Security Administrator is responsible for security and maintenance of the Treasurer's mainframe applications. Security for the client server applications are set up by the vendor of the application. Security for the majority of banking functions is controlled by the Treasurer's Security Administrator in order to allow designated individuals to complete wire transfers.   Wire transfers are processed via access to on-line administrator rights with the separate banking institutions.

III. DIVISIONS AND FUNCTIONS (continued)

1. *Overview*, (continued)

New user access to the mainframe is initiated via an email request from the new user's supervisor to the DBA/Security Administrator. The DBA/Security Administrator uses the mainframe libraries to grant limited access capabilities to personnel based on their job function or specific requests from the user's supervisor. An email is sent to the user's supervisor confirming that access has been granted. The request and confirmation emails are retained.

In order to access the mainframe using the Natural Security package, a user will be provided one of three linking capabilities: 1) a special link, 2) a regular link, or 3) no link. A special link user will have full access to the library. A regular link will have limited capabilities and no link will have restricted capabilities. User configurations are set up by the DBA/Security Administrator.

Upon terminating employment from the Treasurer's Office, a user's access to the mainframe is revoked via an email request from the user's supervisor to the DBA/Security Administrator. The DBA/Security Administrator will then send an email the supervisor confirming that the revocation is complete.

New user access to one the Treasurer's client server applications is provided by the vendor of the application. The access request is made via a phone call to the vendor's support line. The vendor grants access based on the job responsibilities user and the available number of licenses for the application.

2. *Audit Approach*

In order to develop a sufficient understanding of the Treasurer's IT function, we performed inquiries of the IT Director and other key personnel within the department. We also inquired of certain personnel within the Division of State Information Technology) (DSIT) regarding the support that they provide to the division and their overall interaction with the Treasurer's Office.

Our testing consisted of observing division personnel performing key functions at various times during the months of July and August 2011. We also inspected certain documentation of the division and DSIT including IT-related policies and procedures and security documentation.

3. *Findings and Recommendations*

(A) Conversion to SCEIS

Finding – Based on our inquiries and observations, Treasurer's Office personnel have not embraced implementation of the SCEIS enterprise resource planning system mandated by the General Assembly. The State began implementation of the system in 2003 with a timeline for completion of five years. The Treasurer's Office was originally scheduled to implement the system in November of 2007. SCEIS capabilities are touted to include efficiencies achieved through consolidation of systems and reduction of paper through imaging. While we have been told these are these are primary objectives of the Treasurer's Office, as of this report, little progress has been made towards implementation. The Treasurer's core functions and processes are still executed using legacy-based mainframe applications.

Per our discussions with Treasurer and DSIT personnel, the majority of the state agencies served by the Treasurer's Office have substantially completed their implementation of SCEIS and the related SAP financial applications. However, progress by the Treasurer's Office been limited to running selected SAP applications through the backend mainframe systems for processing and then back to the SAP frontend at the agencies. If SAP workflow capabilities were properly leveraged by the Treasurer's Office, transactions could flow from initiator to completion through a structured process, allowing for increased efficiencies including reduced personnel required for data entry.

III. **DIVISIONS AND FUNCTIONS (continued)**

3. *Findings and Recommendations*, (continued)

We noted that there is a project list for the SCEIS implementation with the Budget and Control Board. Based on our discussions with Treasurer's Office personnel there does not appear to be "buy-in" to the list and the underlying objectives. We have noted distinct differences of opinion regarding the progress and benefits of the SCEIS. Specifically, there appear to be those who believe the implementation is not progressing fast enough while others see little or no advantage to its completion.

Only two personnel within the IT division have been assigned to the SAP/SCEIS interface project. They only work on the project during certain times of the week.

Many personnel do not have SAP/SCEIS training and are not fully aware of the project and it's potential.

Recommendation – It may be difficult for some personnel to adapt to a system conversion if their skills and abilities are closely aligned with the outgoing system. We noted sentiment from some personnel that the legacy mainframe "is and always will be the way to go". This perspective appears to be eroding support for SAP. If it is the objective of the Treasurer to adopt SAP, the leadership in the Treasurer's Office must effectively address this lack of support, including making personnel changes as needed.

Considering the current status of the SCEIS implementation, and based on our observations and discussions with Treasurer and DSIT personnel, we have noted the following potential scenarios going forward:

1) "Stay the Course"
2) "Gradual Escalation", or
3) "All in to Complete"

Under "Stay the Course", the direction and limited progress of the project would continue as is. At this time, there are two IT personnel working on the SCEIS implementation. One of these individuals works on interfaces part-time, and is learning "on the job" with the main SCEIS implementation team. The other works on reporting functions while taking training classes.

Under this scenario, the mainframe would still be used for backend processing and those with entrenched feelings toward the mainframe would still be utilized. The timeframe for completion would be at least three years. We believe that an optimistic estimate for percentage of completion would be 30% for year one, 30% for year two and 40% for year three. This is based on the premise that the Treasurer's Office would still be scheduled as one of the last State agencies to fully implement. Under these circumstances, it is likely that resources would continue to be shifted to agencies that are moving forward with their conversions at a faster pace.

Under "Gradual Escalation", the focus of the project would be to convert the Treasurer's critical functions to SAP as soon as possible. These would include Treasury, Investments and Debt Management. SCEIS personnel that have completed other projects would be directed to the Treasurer to advance interfaces and assist in reporting conversions. This would involve a concerted effort to reprioritize the SCEIS implementation list. Training on the system would be given to those who are deemed critical to the future of the Treasurer's Office. This training is currently taking place with SCEIS team personnel in the limited areas that have been converted. Treasurer personnel deemed critical to the future of SCEIS would be those with customer service skills, knowledge of key Treasurer functions and experience in information technology beyond the mainframe. The estimated timeframe to complete would be a year to 18 months.

III. **DIVISIONS AND FUNCTIONS (continued)**

3. *Findings and Recommendations*, (continued)

Under the "All in to Complete" scenario, the Treasurer's Office would contract with SAP consultants to complete the conversion. This would be the most expensive option, but the estimated timeline to complete would be less than a year. As this scenario progresses, Treasurer personnel deemed to be critical for implementing SAP would be given comprehensive training. A stipulation within the contract with the SAP consultants would be that certain members of the IT staff would be "shadowing" the consultants to gain knowledge on the system. This would include administration and help desk duties related to the applications.

Management Response - (1) the implementation of SCEIS within the STO accounting system has been delayed because of the shortage of personnel on the SCEIS side. We have had written documentation prepared for the implementation since 2006. We have met with SCEIS team members on numerous occasions to begin converting STO statewide functions. However, SCEIS staff members have been committed to the implementation of the user agencies first. We set up links which enabled SCEIS to assist the user agencies in meeting deadlines rather than directing our staff to supporting STO functions. (2) We have supplied two staff members to assist in the implementation of SCEIS, but they were not utilized to their full potential. Assigning more staff would have been a waste, as these individuals could otherwise be used to prepare for when SCEIS team members do become available to support STO's implementation. We are working on transitioning from the STARS tables and converting the unclaimed personal property division to SAP while waiting for SCEIS support. Other behind the scenes coding is taking place to prepare for our conversion. (3) We have emails dating back 5 years requesting training and support. (4) A timeline on implementation cannot be developed properly until an initial phase has been completed. This phase has been documented in a notebook developed by the STO IT staff to convert the STARS system to SAP.

(B) IT Risk Assessment and Evaluation

Finding - The IT Division is not subjected to a periodic risk assessment and evaluation.   As a result, the division's policies and procedures have not been updated to keep step with technological changes and evolving security risks. Some versions of policies and procedures go back to the late 1990's

Recommendation – The Division should be evaluated annually to identify security, client-service, and efficiency issues and to obtain a benchmark of performance in relation to other IT groups. The evaluation should include an assessment of overall organizational structure, policies and procedures and functions. Also, an understanding of key risks should be developed in order to direct management's focus on the ever-changing IT landscape. This would facilitate a renewed emphasis on the division's clients; the Treasurer's divisions and functions and the key applications related to each.

The results of the evaluation should include a concise set of written policies and procedures which address the primary risks identified, including security of libraries and server applications, and change management for both mainframe and SAP applications.

(C) Lack of Security Policy

Finding - A security policy does not exist for the Treasurer's mainframe applications.

Recommendation – A comprehensive policy should be developed to address security risks related to primary mainframe applications. The policy should state specific guidelines for access to mainframe application access. It should also describe procedures for setting up users within the Division's mainframe security program.

III. DIVISIONS AND FUNCTIONS (continued)

3. *Findings and Recommendations*, (continued)

(D) User Access Review

Finding - User access reviews for the mainframe applications have not been performed since 2008.

Recommendation – A user access review should be performed annually by the Division to recertify users with access to the mainframe applications. In addition to confirming appropriate access, these reviews will facilitate expedient termination of user capabilities if access does not conform to an individual's job functions.

(E) Excessive Users and Capabilities

Finding - In our review of mainframe access for the Treasurer's functional applications, we noted that there were a total of 458 user id's in the five primary mainframe applications. Per discussion with the DBA/Security Administrator, there were some ids that did not appear to require access to a particular mainframe application. Also, based on discussions with DSIT Mainframe personnel, there is UPDATE and READ file access within the mainframe applications that personnel receive when granted access to the application.

Recommendation – For all active users, the Division should evaluate employee job responsibilities annually to determine if there are roles that are incompatible with individual access capabilities. User access should be limited to that required for employees to meet their roles and responsibilities. In addition, the Division and DSIT should discontinue providing blanket access to new users for UPDATE and READ capabilities. New-user access should be assessed on an individual basis and granted based on job responsibilities.

III. **DIVISIONS AND FUNCTIONS** (continued)

J. **Unclaimed Personal Property**

1. *Overview*

The primary functions within the Unclaimed Personal Property division are to receive deposits of unclaimed cash property and re-distribute the property once claims are made. The Assistant State Treasurer over the division approves higher dollar claims (exceeding $10,000) and assists staff with complicated claims. The division has a staff of processors who input deposit information and approve and process claims for payment.

Regarding the deposit process, we noted that the Wagers system includes certain controls to prevent an employee from making modifications to the owner deposits. We noted that if changes are made to property for any reason, such as changes to the holder, social security number or amount, Wagers will list the entire report of deposits as "out-of-balance." Going forward, when an employee needs to process a claim from this report, another employee will have to unlock or balance the report to proceed. The division's Assistant Director, runs the out-of-balance report monthly to look for any changes to property data. The intent is to mitigate the risk of an employee changing holder information in order to process fraudulent claims on an internal basis.

2. *Audit Approach*

We inquired of division staff to gain an understanding of the processes and procedures currently in place. For each process, we identified key controls and performed walkthroughs of selected transactions. Some of the division's controls include sequentially numbered deposits, claims approval levels based on employee's position, documented voucher (claims payment) process and review of monthly bank reconciliations. We attempted to corroborate these procedures where possible by testing a sample of transactions.

We obtained a listing of all claims paid during the month of June 2011 from Wagers and selected one claim for our walkthrough procedures. We traced the claim through the approval process to the check payment and reconciliation of the bank account. Additionally, we noted when the property related to that claim was originally remitted to the State. We then walked through controls over the deposit process and the deposit reconciliation process.

We obtained a listing of all deposits received and claims paid during the months of March 2011 and June 2011. We chose a sample size of sixteen deposits and sixteen claims for testing purposes. We were provided access to the Treasurer's check register and we selected four of our sixteen claims from this check register. For claims testing, we examined the original paper claims to verify appropriate levels of review, and to determine that proper identification was presented. We then tested the claims controls to the point at which the claim was paid and the funds were remitted to the claimant. In order to test deposits, we examined the paper record of the funds transfer and vouched the transfer of funds to the UPP bank account.

We noted no exceptions as a result of the above procedures. However, we did have the following findings based on our inquiries and observations:

III. DIVISIONS AND FUNCTIONS (continued)

3.   *Findings and Recommendations*

(A) Fraud Training

Finding - In order to request unclaimed property, the division requires proof of identification. There is risk that these documents could be falsified in order to submit a fraudulent claim. We noted that personnel do not receive formalized fraud training.

Recommendation - We recommend that claims processors receive fraud training in order to develop their ability to identify falsified documents.

(B) Claims Backlog

Finding - We noted that there is a claims back-log that consists largely of claims that are considered overly complicated for some staff. Division personnel do not appear to be adequately trained to respond to these claims.

Recommendation - While hiring additional experienced claims processors is an option, the division should also make every effort to train current employees and expose them to as many of these types of claims as is practical in order for them to gain sufficient experience.

(C) Access to Wagers System

Finding - The Assistant Treasurer over the division has full rights to Wagers which allows her to initiate and approve claims and also to change property data.

Recommendation – Segregation of duties should be established in which claims are initiated by someone other than the person who is approving them.

Management Response - The new Wagers system requires two system approvals by separate users for all claims. In the old Wagers system, one approver was indicated on paper and the other was reflected in the system.

III. **DIVISIONS AND FUNCTIONS** (continued)

K. General

1. *Overview*

    In the course of performing our interviews and testing, we noted certain circumstances and conditions described below. These additional findings and recommendations are based on general observations that are not specific to one division or area of operation. Rather they relate to issues that meet one or more of the following criteria:

    - Pervasive in more than one division or function
    - Strategic in scope and potentially affecting all areas of operations
    - Related to a position or function that provides Office-wide support

2. *Findings and Recommendations*

    (A) Staffing - Financial Reporting and Internal Controls Knowledge

    Finding - The Treasurer's staff does not include individuals who have substantive experience and training in developing, implementing and monitoring internal controls over financial reporting and record keeping. The Treasurer's operations include a high volume of transactions that vary widely in type and scope and are processed on a daily basis. These transactions, whether related to debt, treasury or investment, require formalized procedures for adequate secondary review, and proper authorization. These procedures, once established, should be adequately monitored for compliance and proper execution.

    In addition, the transactions discussed above must be effectively extracted and summarized for periodic reporting to the Treasurer in a manner that will make them valuable for strategic decision-making and executive oversight.

    Recommendation - We recommend that the Treasurer recruit at least one individual who is a certified public accountant with ten or more years of experience in the following areas:

    - Performance of monthly closing procedures and reconciliation of detail reports to the general ledger including bank balances and subsidiary ledgers for all control accounts
    - Preparation and review of financial reports, including periodic internal reports for management's use, and external reports prepared in accordance with generally accepted accounting principles
    - Performance of financial statement audits in accordance with generally accepted auditing standards, including evaluation and reporting on the internal controls of an entity, preferably in a treasury or investment environment

    This individual should have responsibility for developing formalized policies and procedures and for monitoring compliance with them. He or she should have unfettered access to the Treasurer and the deputy treasurers regarding reporting on compliance and any deficiencies that are noted.

    This individual should also be integral in an effort to recruit other staff members who have training and experience in internal controls over financial reporting and recordkeeping. As previously discussed, our test results indicated instances of lack of segregation of duties and insufficient documentation that certain control procedures were taking place. These circumstances pose a significant risk that errors or irregularities could occur and not be detected. The Treasurer's Office will require additional personnel who have an understanding and a working knowledge of the above concepts in order to establish a sufficient level of monitoring and review over the Office's operations.

III. DIVISIONS AND FUNCTIONS (continued)

2. *Findings and Recommendations, (*continued)

(B) Transition of IT Director Position

The individual who has headed the Treasurer's IT Division for over 25 years is scheduled to retire in December of 2011. The Office has only recently begun a search to recruit and transition a new director. As of this report, an individual has not been identified to fill the position. This process should be initiated with ample time to allow the current director to work with and train a successor. The director's position is crucial to the Treasurer's Office as it affects all aspects of the Office's operations and will require someone with the technical, communication and leadership skills to meet significant IT-related issues that currently exist and those that are impending as a result of the SCEIS conversion. Based on the remaining term of the current director, and the apparent status of the recruiting process, it does not appear that a successor will be identified and hired in time to permit a valuable "on-the-job training period" with the current director.

Recommendation - Because of the significance of this position, we recommend that the Treasurer intensify recruiting efforts to hire a highly qualified successor. The successful candidate will need to possess a uniquely advanced skill set that will allow him or her to "jump right in" to a challenging IT environment with little or no guidance from the individual who has held the position for over 25 years. The Treasurer's search to fill this position should be comprehensive and not limited to internal State postings. Premium candidates should be identified through use of trade journals and private sector contacts. If necessary, use of a personnel recruiter should be considered.

Under these circumstances, we further recommend that the Treasurer consider contracting with the current director to provide transition assistance for a limited period of time beyond December 2011. Such an arrangement would allow the new director to gain specific knowledge regarding the strengths and weaknesses of current IT staff members. It would also provide him or her valuable insight into significant issues that are being addressed by the department. Finally, it would allow for a smoother introduction to staff, both inside and outside the IT department, and would increase the probability of the new director developing productive working relationships with Office personnel.

(C) Maximizing Utilization

Finding - Based on responses to our inquiries, we understand that it is a primary objective of the Treasurer's Office to maximize utilization of all staff members. There currently is not a formalized system in place to measure individual productivity based on job responsibilities and established goals and expectations. In addition, the Treasurer does not currently maintain a timekeeping system that allows for daily tracking of employee attendance and reporting of tasks performed. Determining the performance and productivity of any given employee appears to be dependent primarily on division leaders making general observations about the presence and daily activity of employees within their departments. Responses to our inquiries indicate lack of clarity as to whether some employees have job responsibilities that require an 8-hour work day. We are also aware of at least one full-time employee that works primarily from home and therefore cannot be observed by supervisors on a daily basis.

We also noted that the evaluation process conducted by the Treasurer's Office does not stress performance measurement tied to specific goals and objectives. Instead individuals are primarily evaluated against general performance expectations that are the same for all employees.

III. **DIVISIONS AND FUNCTIONS** (continued)

2. *Findings and Recommendations, (*continued)

Recommendation - We recommend that the Office formalize goals and objectives that are tailored to expectations for each employee and his or her related job responsibilities.   In addition, we recommend implementation of a timekeeping system that not only reports total hours worked, but time devoted to specific activities.

As noted above, there is uncertainty as to whether some employees are being fully utilized. In order to gain a clear understanding of how staff members are spending their time, we recommend that the Treasurer request written narratives from employees describing day-to-day tasks and time estimates associated with each.   In addition, the narratives should cite the challenges and obstacles that the employee faces in meeting individual goals and objectives.   The narratives should also include recommendations from the employees as to tools and resources that would help them perform their responsibilities with greater effectiveness and efficiency.   A questionnaire should be developed to assist employees in generating their responses and to help ensure that they are providing the requested feedback.

(D) Investment in Skilled Personnel

Finding - As previously discussed, the Treasurer's Office has identified certain skill sets that are needed to assist the Office in meeting key objectives and achieving an increased level of operating effectiveness. Attracting individuals with the proper level of training and experience to meet these needs may require an additional investment in compensation.   However, acquiring these skills could result in significant future value by engaging individuals who will help drive procedural and cultural and changes required to move the Office forward on crucial initiatives such as the SCEIS conversion, increased utilization, and enhanced internal controls and financial reporting.

Recommendation - When hiring for these positions, the Office should take advantage of the opportunity to develop effective performance expectations and communicate them to new staff members at the outset of their employment.   This will help ensure clarity as to what the Treasurer expects to be achieved by these individuals.   It will also facilitate accountability on the part of the new hires by providing specific criteria against which to evaluate their performance.   The expectations and performance criteria should reflect the higher levels of responsibility and accountability associated with these positions.   At the same time, in order maximize the potential for success, these new staff members should be sufficiently empowered with the authority to affect change and to shape policy and procedure as necessary to accomplish their assigned goals and objectives.