

STATE OF WEST VIRGINIA

REPORT

OF

SECURITIES HELD BY THE STATE TREASURER

AS OF

MARCH 24, 2008



OFFICE OF THE LEGISLATIVE AUDITOR

CAPITOL BUILDING

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WEST VIRGINIA LEGISLATURE
Joint Committee on Government and Finance

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December 29, 2008

To the Joint Committee on Government and Finance:

Chapter 12, Article 5, Section 3 of the West Virginia Code, as amended, states:

“Before the first day of July, two thousand one and at least every two fiscal years thereafter, the legislative auditor shall examine and list all of the securities in the custody of the state treasurer. A copy of the list so examined and certified shall be transmitted to the state treasurer and the department of administration.”

In compliance with the provisions of Chapter 12, Article 5, Section 3 of the West Virginia Code, as amended, we have examined and listed all of the securities in the custody of the State Treasurer as of March 24, 2008. A copy of this list so examined and certified shall be transmitted to the State Treasurer and the Department of Administration in accordance with the above statute.

Our examination included the securities on deposit with the State Treasurer and duly executed receipts for securities held in escrow by custodial banks for the State Treasurer. We obtained an inventory report of securities held by the State Treasurer at March 24, 2008. We performed a physical inventory count of all non-cash securities located in the State Treasurer’s vault, determined amounts of cash on deposit in State accounts, as well as obtained confirmation of securities held in escrow at banks and reconciled our count to the inventory report. Letters of confirmation were sent to State agencies remitting securities for safekeeping by the State Treasurer’s Office and any differences were reconciled. The results of our reconciliation process are noted in the General Remarks section of this report.

Because the above procedures do not constitute an audit conducted in accordance with generally accepted auditing standards, we do not express an opinion on the items referred to above. Had we performed additional procedures or had we conducted an audit of the State Treasurer’s Office in accordance with such standards, matters might have come to our attention that would have been reported to you. This report relates only to the items specified above and does not extend to the State Treasurer’s Office taken as a whole.

Respectfully submitted,

A handwritten signature in cursive script that reads "Stacy L. Sneed".

Stacy L. Sneed, CPA, CICA, Director
Legislative Post Audit Division

SLS/cdo

SECURITIES HELD BY THE STATE TREASURER

AS OF MARCH 24, 2008

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AS OF MARCH 24, 2008

EXIT CONFERENCE

We held an exit conference on January 6, 2009, with the Assistant State Treasurer, the Deputy State Treasurer of Administration and the Director of Internal Audit of the West Virginia State Treasurer's Office and all findings and recommendations were reviewed and discussed. The State Treasurer's Office responses are included in bold and italics after our findings in the General Remarks section of this report.

SECURITIES HELD BY THE STATE TREASURER

AS OF MARCH 24, 2008

INTRODUCTION

Among the numerous duties of the State Treasurer of West Virginia is that of being custodian of all securities belonging to the State of West Virginia or by law required to be deposited with the State or held in legal custody by the State. Chapter 12, Article 5, Section 1 of the West Virginia Code, as amended, defines a security as:

“The term securities when used in this article shall include all bonds, securities, debentures, notes or other evidences of indebtedness, and for purposes of this chapter all cash received by any state spending unit intended to serve as security for a legal obligation, whether pursuant to court order or otherwise.”

Further, Chapter 12, Article 5, Section 2(a) of the West Virginia Code, as amended, sets forth the Treasurer’s duties as follows:

“The treasurer of this state, unless otherwise expressly provided by law, shall be custodian of all securities required by law to be deposited with the state or held in legal custody by the state, and all departments of this state, commissioners or agents of the state, who hold any such securities, shall transfer and deliver the same to the state treasurer to be kept and held by him as legal custodian thereof until released in the manner provided by law:”

The duty of the Treasurer to maintain an accurate accounting of all securities is promulgated in Chapter 12, Article 5 Section 4 of the West Virginia Code, as amended, which states,

“It shall be the duty of the treasurer to keep an accurate account of all securities received by him or her and collect and account for the interest as it becomes due and payable and the principal whenever it is due.”

Responsibility for maintaining security over securities is provided for in Chapter 12, Article 5, Section 5(a) of the West Virginia Code, as amended, which states:

“The noncash securities retained in the treasury shall be kept in a vault. The treasurer shall use due diligence in protecting the securities against loss from any cause. The treasurer shall designate certain employees to take special care of the securities. Only the treasurer and the designated employees may have access to the securities, and at least two of these persons shall be present whenever the securities are handled in any manner. The treasurer may contract with one or more banking institutions in or outside the state for the custody, safekeeping and management of securities. The contract shall prescribe the rules for the handling and protection of the securities.”

Finally the authority for the establishment of the Treasurer’s Safekeeping Fund is provided for in Chapter 12, Article 5, Section 5(b) of the West Virginia Code, as amended, which states:

“The Treasurer’s Safekeeping Fund is established in the state treasury. The treasurer shall deposit moneys received pursuant to this article in the Treasurer’s Safekeeping Fund. The treasurer is authorized to invest the money in accordance with this code and the restrictions placed on the money, with earnings accruing to the moneys in the fund. The treasurer shall prescribe the forms and procedures for processing the moneys.”

SECURITIES HELD BY THE STATE TREASURER

AS OF MARCH 24, 2008

ADMINISTRATIVE OFFICERS AND STAFF

John Perdue..... State Treasurer
Paul HillAssistant State Treasurer
Blair Taylor.....Deputy State Treasurer for Administration
Caroline Chamness Safekeeping Specialist
Kevin Brown, CPA Accountant
Timothy Richards.....Administrative Assistant
Richard Fisher..... Investigator
Wilma Harrison.....Legal Assistant

SECURITIES HELD BY THE STATE TREASURER

AS OF MARCH 24, 2008

GENERAL REMARKS

INTRODUCTION

A listing of the Securities held by the State Treasurer as of March 24, 2008 has been completed. The list includes the cash and non-cash securities on deposit with the State Treasurer's Office (STO) and duly executed receipts for securities held in escrow by custodial banks for the Treasurer of the State of West Virginia.

SPECIAL REVENUE ACCOUNTS

Chapter 12, Article 5, Section 5 of the West Virginia Code provides for the protection and handling of securities which states in part,

“. . . noncash securities retained in the treasury shall be kept in a vault . . . The treasurer may contract with one or more banking institutions in or outside the state for the custody, safekeeping and management of securities . . . The "Treasurer's Safekeeping Fund" is established in the state treasury. The treasurer shall deposit moneys received pursuant to this article in the Treasurer's Safekeeping Fund"

In accordance with the above statute, the STO deposits such moneys in WV Financial Information Management System (WVFIMS) Fund 1346 which are subsequently invested with the West Virginia Board of Treasury Investments.

RECORDS

The securities on deposit with the State Treasurer were in good order and readily available. We performed a physical inventory count of all non-cash securities located in the STO

vault, determined amounts of cash deposited in the State's investment and FIMS accounts, as well as obtained confirmation from the custodial bank of securities being held in escrow and reconciled our count to the STO "Safekeeping Active Securities" inventory report (inventory). Letters of confirmation were also sent to State agencies remitting securities to the STO and any differences reported by the agencies were also reconciled with the STO's inventory. The results of our reconciliation process follows:

1. Inaccurate Inventory

The State Treasurer's Office (STO) did not maintain an accurate account of all securities in noncompliance with Chapter 12, Article 5, Section 4 of the West Virginia Code states:

"12-5-4. Treasurer to keep accounts and make collections.

It shall be the duty of the treasurer to keep an accurate account of all securities received by him or her and collect and account for the interest as it becomes due and payable and the principal whenever it is due."

During the reconciliation of our inventory count of securities to the STO inventory, we found 35 securities located in the STO vault or held in escrow by custodial banks as well as monies on deposit in State accounts that were not listed on the STO inventory provided to us on March 24, 2008. We also noted two securities recorded on inventory but the securities had been released from escrow by the custodial bank in 2005 without STO authorization. Finally, we found four securities listed as "active" on the STO inventory but the securities had been released back to the State agencies that originally submitted them. Without an accurate account of securities, securities are not protected from unauthorized use or disposition. The following is a list of securities accounted for by us but were not listed on the STO inventory:

<u>No.</u>	<u>State Agency Name</u>	<u>Face Value of Instrument</u>	<u>Description of Instrument</u>
1	DEP - Mining & Reclamation	\$ 37,320.00	CD#07410554301
2	DEP - Mining & Reclamation	10,720.00	CD#12890
3	DEP - Mining & Reclamation	114,400.00	CD# 5900011828
4	DEP - Mining & Reclamation	10,000.00	CD#5877019731
5	DEP - Mining & Reclamation	14,400.00	CD#5877156593
6	DEP- Oil & Gas	5,000.00	CD 2624675
7	DEP- Oil & Gas	50,000.00	CD 07410470838
8	DEP- Oil & Gas	2,500.00	CD#23133
9	Division of Labor	12,000.00	LOC#293
10	Division of Labor	1,472.00	CD#12914
11	Division of Labor	10,000.00	CD#5877268065
12	Division of Labor	7,000.00	CD#5877255044
13	Division of Labor	7,600.00	LOC# 1171
14	Division of Labor	25,000.00	CD# 19877
15	Division of Labor	3,500.00	LOC#1792
16	Division of Labor	25,000.00	LOC# 9531213510-0001
17	Division of Labor	2,208.00	CD# 43590
18	Division of Labor	50,000.00	LOC# 9570165884-00002
19	Division of Labor	5,000.00	LOC 60004275925
20	Division of Labor	15,000.00	LOC 71464
21	Insurance Commission	75,000.00	GNMA Pool #781762
22	Insurance Commission	100,000.00	3133XNG52
23	Insurance Commission - Self Insured	300,000.00	GNMA II Pool 3611 CUSIP#36202EAL3
24	Insurance Commission - Self Insured	2,000,000.00	GNMA Pool #587026
25	Purchasing Division	2,930.00	Cash
26	Purchasing Division	3,350.00	Cash
27	Purchasing Division	24,000.00	Cashier's Check#00523721
28	DEP	3,017.06	Cash
29	DEP	538,253.05	Cash
30	DEP	861,875.16	Cash
31	DEP	11,592.13	Cash
32	Division of Forestry	45,000.00	Cash
33	Higher Education - Marshall University	1,589,827.33	Cash
34	Higher Education - West Virginia University	2,554,218.67	Cash
35	WV Attorney General's Office	<u>19,597.62</u>	Cash
		<u>\$8,536,781.02</u>	

The STO also has two securities listed on its inventory as being held in escrow at a custodial bank on behalf of the WV Division of Highways (DOH); however, we were told the bank released the securities back to the company originally submitting them without STO

authorization sometime during the second half of calendar year 2005. These securities, totaling approximately \$35,000, were being held for the DOH as bonding (retainage fee) from a company for performing “right-of-way” services. According to an Administrative Services Manager for the DOH Right-of-Way Division, the company owed the DOH approximately \$92,000 in 2005 based on DOH desk audits of completed projects. The DOH would have applied the \$35,000 to amounts due them if the securities had not been released by the bank. When the unauthorized release occurred, the company had two additional securities (treasury bonds) in STO safekeeping with a market value totaling approximately \$73,000 or \$19,000 less than the amount due. The DOH Administrative Services Manager stated “the company notified us to keep the two securities on file to cover the amount due. They do not have enough assets to cover the amount.”

Because of the unauthorized release of \$35,000 in securities, it was necessary for the DOH to leave the two additional securities in investment status in order for the securities to earn enough value to cover the \$92,000. At December 26, 2008, the market value of these securities had increased to \$107,350 which, if sold on the secondary market at market value, should yield enough money to pay amounts owed the DOH.

Using a 3% rate, we estimate the State lost \$8,550 in interest revenue on the \$92,000 for the three-year period ended December 31, 2008. We asked the DOH if they anticipated recovery of the full amount of lost revenue including interest which could have been earned on these monies. The DOH Administrative Services Manager replied “We expect to have full recovery within the next quarter. I have been in contact with the Treasurer’s Office and we feel the entire amount can be recovered.”

Due to the lack of supporting documentation as evidence of the events that occurred during the unauthorized release, we are relying on assertions made by the Deputy State

Treasurer. The Deputy State Treasurer stated the STO did not attempt to recover the \$35,000 from the custodial bank because of the company's request to substitute the two existing securities to fulfill the requirements of the unauthorized released securities. The STO does not have any explanation for the unauthorized release by the bank and further told us the bank did not follow the STO procedures in place for receiving and for releasing securities. The unauthorized released was one of the key reasons the safekeeping custodial bank contract was rebid in calendar year 2006; a different bank was awarded the contract.

The following four securities were listed on the STO inventory but were not inventoried by us. Upon subsequent review, we found "release" documents indicating the securities had been returned to the State agency which submitted them for safekeeping but the securities were not removed from inventory.

<u>No.</u>	<u>State Agency Name</u>	<u>Face Value Of Instrument</u>	<u>Description</u>
1.	Labor	\$12,972.00	CD#915819164
2.	Labor	25,000.00	CD#915827302
3.	Labor	20,000.00	LOC#25240098
4.	Labor	<u>25,000.00</u>	LOC#174
		<u>\$82,972.00</u>	

The Deputy Treasurer told us some of the differences noted above were caused by a computer programming error in relation to dates which resulted in an inaccurate inventory report being supplied to us for use in our reconciliation process. Further, the STO does not record cash securities on deposit in State investment accounts on the inventory. We also believe some differences occurred because the STO does not perform regular reconciliations between securities recorded on inventory to securities held in escrow by the custodial bank or monies on deposit in the State's FIMS account. Finally, no explanation could be provided by the STO for

other differences. We believe the STO should strengthen internal controls over inventory by performing regular reconciliations, accurately account for all active securities held for safekeeping, and perform periodic physical inventory counts of securities held in safekeeping and reconcile such counts to the computerized inventory system.

We recommend the STO comply with Chapter 12, Article 5, Section 4 of the West Virginia Code and maintain an accurate inventory of securities by performing regular reconciliations and periodic physical inventory counts as well as recording the addition or disposition of all securities in the computerized safekeeping inventory system. We further recommend the STO make any adjustments necessary to the safekeeping inventory based upon our count.

Spending Unit's Response:

The STO agrees and has complied. Of the 35 securities listed in this report which the Legislative Post Audit Division indicated were not in the STO's inventory report, seven (7) are accounted for in spreadsheets maintained separately from the static safekeeping database. These seven (Items 28, 29, 30, 31, 33, 34, and 35) are all escrow agreements the STO entered into with state agencies and companies. The STO does not charge any escrow fees to state agencies or companies for this escrow agreement service. The STO began listing the escrow agreements in the safekeeping database on January 5, 2009, while continuing to maintain separate spreadsheets on each escrow account for cash balances and monthly reconciliations. The safekeeping computer database is a static system used to list the securities, escrow agreements, and cash bid bonds/performance bonds held by the STO at any given time. Twenty-five (25) of the securities (items 1, 2, 3, 4, 5, 6, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26 and 32) listed in this report are listed in the safekeeping

computer database and subsequently were provided to the Legislative Post Audit Division staff in the report dated 12/4/2008 titled "Safekeeping Active Securities – Run for 3-23-08 due to Programming Error". The three (3) securities not listed and not entered into the safekeeping computer database are items seven (7), eight (8), and twenty-seven (27). Items seven (7) and eight (8) have been entered into the safekeeping computer database as of January 5, 2009. Item twenty-seven (27) was released on June 11, 2008 at the request of the agency placing it in safekeeping on June 22, 2005. For audit purposes, item twenty-seven (27) was entered and released from the safekeeping system on January 9, 2009.

The two securities held on behalf of the Division of Highways totaling \$35,009.88 were released from the safekeeping database at the request of the Division of Highways on November 3, 2008. These two securities were previously returned to the company by the STO's then custodial bank, without the authority of either the STO or the Division of Highways. In lieu of these two securities, the STO accepted two remaining securities from the company that were already safekept by the STO on behalf of DOH. These two securities are US Treasury Notes Stripped. They do not earn periodic interest, however at maturity are redeemed at face value. They are being held at the STO's current custodial bank. They are identified as collateral key 1999-0168 (CUSIP #912833KW9) with a face value at maturity of \$75,000 and a market value on January 2, 2009 of \$52,701.75; and collateral key 2000-0228 (CUSIP #912833KT6) with a face value at maturity of \$70,000 and a market value of \$51,333.80 as of January 2, 2009. These two securities will be maintained at the STO's custodial bank until such time as the DOH directs the STO to have its custodial bank sell the securities on the secondary market to yield an amount equal to or greater than the amount due the DOH including interest for the past 3 years. Ironically, had the two original

securities (valued at \$35,009.88) been retained by the State and deposited in DOH accounts, the State would have lost \$56,990.12. The two US Treasury Notes Stripped (market value on January 2, 2009 of \$104,034.55) will be sufficient to cover the loss incurred by the DOH (\$92,000) as well as the interest lost by the State (\$8,550) in the ensuing three years.

The four securities listed on the STO inventory report but not inventoried had been physically released and were also listed in the computer database as released. The Crystal report initially given to the Legislative Post Audit Division on March 23, 2008 contained errors as was noted on December 4, 2008 report given to the Post Audit Division auditors. This issue is resolved.

The STO has strengthened internal controls over inventory by writing and implementing new procedures to perform monthly reconciliations. The reconciliations will include cash based securities held in fund 1346 and those invested with the Board of Treasury Investments (BTI). Copies of the draft procedures were previously provided to Post Audit auditors and the procedures have been finalized and have been implemented by the STO. As of January 5, 2009, the two (2) securities that were not accounted for properly in the safekeeping database are now entered into the database. The STO has provided screen shots of these two securities and their entry to Post Audit auditors. The third security not listed in the database was released to the state agency in June, 2008 and therefore is not entered into the database.

The Safekeeping Supervisor will be performing periodic inventory counts each month by randomly selecting 25 securities each month for a physical inventory count and reconciliation to the computerized inventory system. At the conclusion of 12 months, 300 randomly selected securities will have been physically inventory verified which accounts for

approximately ten percent (10%) of all securities held. Further, the STO's Internal Audit Division has committed to performing a 100% physical inventory and reconciliation to the computerized inventory system during the years that the Legislative Post Audit Division does not Audit the safekeeping inventory.

Finally, the STO has had discussions with its Information Technology Systems (ITS) staff about creating a new computerized database inventory system as the current system was created in 1999. The ITS agreed to begin writing design specifications in January 2009 with implementation to begin in the first quarter of 2009. The STO anticipates having the new system ready for testing in the third quarter of Calendar Year 2009. Internal Audit will conduct their audit and verify the new system implemented.

The STO agrees and has complied with Chapter 12, Article 5, Section 4 of the West Virginia Code by maintaining an accurate inventory of securities. The STO has created additional procedures, implemented monthly reconciliations, trained staff as required, and is beginning monthly physical inventory counts to strengthen its internal controls in the Safekeeping area. The STO has made adjustments to the safekeeping computerized database as required to accurately reflect all securities held by the STO which on the date of the audit totaled 2161 securities. The three (3) securities which were not in the count and are now added represent 0.139% of the total securities.

2. Notification Process of Acceptable Securities

Chapter 12, Article 5, Section 2(a) of the West Virginia Code provides for the State Treasurer to notify all state agencies of a list of acceptable securities as follows:

“...the state treasurer shall establish a list of which securities shall be acceptable securities and notify all state agencies of the contents of that list.”

Based on our inquiries with the Deputy Treasurer for Administration, no formal process has been implemented for notifying all State agencies of acceptable securities. In the past, the STO has notified only those agencies currently using the STO's safekeeping services; therefore, it is possible that some State agencies receiving securities may not be remitting them to the STO for safekeeping.

We were also informed by the Deputy Treasurer that the statute does not provide any type of enforcement provisions to ensure State agencies are submitting securities received by them for safekeeping. We believe the STO should seek to amend the statute or promulgate by rule enforcement provisions to ensure State agencies remit securities for safekeeping.

We recommend the State Treasurer's Office comply with the provisions of Chapter 12, Article 5, Section 2(a) of the West Virginia Code, as amended, and notify all State agencies of the list of acceptable securities. We also believe the STO should seek to amend the statute, or promulgate by rule, enforcement provisions to ensure State agencies are submitting securities for safekeeping.

Spending Unit's Response:

The STO agrees and will comply with the provisions of Chapter 12, Article 5, Section 2(a) of the West Virginia Code, as amended, by notifying all State agencies of the list of acceptable securities. In January 2009, the STO will post on its internet site, www.wvsto.com/taxdistribution/safekeeping (not a working site as of 1-12-2009) the list of acceptable securities and all of the procedures its Safekeeping section requires agencies to follow when posting collateral with the State Treasurer. Further, the STO will annually send a letter to all Cabinet Secretaries; State Agency Directors; and Chapter 30 Boards,

Commissions, and Authority's notifying them of the requirements of §12-5-2(a) of the West Virginia Code.

3. **Security Not Safeguarded in Vault**

Chapter 12, Article 5, Section 5 of the West Virginia Code, as amended, which states in part:

“(a) The noncash securities retained in the treasury shall be kept in a vault. The treasurer shall use due diligence in protecting the securities against loss from any cause. The treasurer shall designate certain employees to take special care of the securities. Only the treasurer and the designated employees may have access to the securities, and at least two of these persons shall be present whenever the securities are handled in any manner....”

After performing our inventory count, we were contacted by the Deputy State Treasurer who told us an additional non-cash security had been located; a \$79,200 certificate of deposit was found in an employee's desk in a “pending file” instead of the vault in noncompliance with the above statute. We returned to the STO and inventoried the security. We believe all non-cash securities should be retained in the vault to protect them from unauthorized use or disposition.

We recommend the State Treasurer's Office comply with the provisions of Chapter 12, Article 5, Section 5 of the West Virginia Code, as amended, and maintain all securities located at the STO in the vault.

Spending Unit's Response:

The STO agrees and has complied. The STO has strengthened internal controls by creating a “Safekeeping Receipts Pending” file stored within the vault that contains securities that have not been entered into the safekeeping database, yet have been accepted by the STO from an agency for safekeeping. In addition, the “Safekeeping Releases

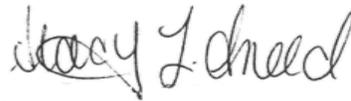
Pending” file has been created to hold securities that an agency has contacted the STO about releasing. The safekeeping staff, when receiving a request to release a security retrieved the security from the vault file and places it into the Safekeeping Releases Pending file, also located within the vault, for retrieval by the state agency personnel when they are physically present outside the STO vault. Finally, the STO is creating a “Safekeeping Receipts Rejected” file which will contain copies of securities that have been delivered to the STO for safekeeping, but are being rejected back to the state agency because of some defect in the security. This file (located in the vault) will also be monitored during the monthly reconciliation performed by the Safekeeping Supervisor so that outstanding issues can be resolved with individual agencies.

STATE OF WEST VIRGINIA

OFFICE OF THE LEGISLATIVE AUDITOR, TO WIT:

I, Stacy L. Sneed, CPA, CICA, Director of the Legislative Post Audit Division, do hereby certify that the report appended hereto was made under my direction and supervision, under the provisions of the West Virginia Code, Chapter 4, Article 2, as amended, and that the same is a true and correct copy of said report.

Given under my hand this _____ day of _____ 2009.



Stacy L. Sneed, CPA, CICA, Director
Legislative Post Audit Division

Copy forwarded to the Secretary of the Department of Administration to be filed as a public record. Copies forwarded to the West Virginia State Treasurers Office; Governor; Attorney General; State Auditor; and, Director of Finance Division, Department of Administration.