

**DEPARTMENT OF FINANCIAL SERVICES**

**PUBLIC DEPOSITS PROGRAM**

---

**Operational Audit**

For the Period January 2008 Through December 2008,  
and Selected Actions Through May 21, 2009



## CHIEF FINANCIAL OFFICER

Pursuant to Article IV, Section 4(c) of the State Constitution, and Section 17.001, Florida Statutes, the Chief Financial Officer is the chief fiscal officer of the State, responsible for settling and approving accounts against the State and keeping all State funds and securities. The Chief Financial Officer also heads the Department of Financial Services, which as an agency, has a wide range of statutory responsibilities including those relating to the Public Deposits Program. The Honorable Alex Sink served as the Chief Financial Officer during the audit period.

The audit team leader was Aaron Franz, CPA, and the audit was supervised by Allen Weiner, CPA. Please address inquiries regarding this report to Nancy Tucker, CPA, Audit Manager, by e-mail at [nancytucker@aud.state.fl.us](mailto:nancytucker@aud.state.fl.us) or by telephone at (850) 487-4370.

This report and other reports prepared by the Auditor General can be obtained on our Web site at [www.myflorida.com/audgen](http://www.myflorida.com/audgen); by telephone at (850) 487-9024; or by mail at G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

**DEPARTMENT OF FINANCIAL SERVICES**

## Public Deposits Program

**SUMMARY**

This operational audit of the Department of Financial Services (Department) focused on the operations of the Public Deposits Program administered by the Bureau of Collateral Management (Bureau) during the period January 2008 through December 2008, and selected actions through May 21, 2009. The Department has implemented rules, policies, and procedures to carry out the requirements and otherwise operate the Public Deposits Program. Our review disclosed that, generally, such policies and procedures were effective in protecting the public deposits of government entities; however, some areas were in need of improvement, as noted in the following findings.

**OVERSIGHT OF THE PUBLIC DEPOSITS PROGRAM**

**Finding No. 1:** The Qualified Public Depository Oversight Board created pursuant to Section 280.071, Florida Statutes, has been inactive since holding an initial meeting in December 2001.

**QUALIFIED PUBLIC DEPOSITORY COLLATERAL PLEDGING LEVELS**

**Finding No. 2:** Department rules did not enumerate the circumstances under which collateral pledging levels can differ from those computed under law and existing rule.

**Finding No. 3:** The supervisory review and approval of Bureau financial analyses of the financial condition of selected Qualified Public Depositories (QPDs), and any resulting changes in collateral pledging levels, was not always documented.

**Finding No. 4:** The Bureau had not established written policies and procedures describing the types and timing of actions necessary to respond to a QPD receiving the lowest quarterly financial condition ranking.

**Finding No. 5:** The Bureau allowed some QPDs with the lowest quarterly financial condition rankings lengthy periods to meet the required increased collateral pledging levels.

**COLLATERAL ADMINISTRATION**

**Finding No. 6:** Bureau staff responsible for resolving custodial collateral reconciling items were also responsible for processing collateral transactions, resulting in conditions under which errors may occur and be concealed from timely detection. Additionally, custodial collateral reconciliations did not include Federal Home Loan Bank letters of credit and the resolution of reconciling items was not always timely.

**Finding No. 7:** Bureau procedures for pricing collateral needed improvement as not all collateral was priced in a timely manner.

**PROGRAM REPORTING**

**Finding No. 8:** The Bureau did not conduct a comparison of public deposit information reported by QPDs and public depositors for all those QPDs ranked in the lowest financial condition ranking category, based on established financial condition criteria of record on September 30.

**INFORMATION TECHNOLOGY**

**Finding No. 9:** Effective security controls include access controls that ensure that users have only the access privileges needed to perform their duties and users are restricted from performing incompatible functions. Our audit disclosed deficiencies in certain security controls.

**Finding No. 10:** We noted certain other deficiencies in the Bureau's security controls related to the Collateral Administration Program, the details of which have been disclosed to Department management.

---

**BACKGROUND**

---

The Public Deposits Program (Program), established by the Florida Security for Public Deposits Act (Act),<sup>1</sup> is administered by the Bureau of Collateral Management (Bureau), an organizational unit within the Department of Financial Services (Department). The Act outlines the powers and duties of the Chief Financial Officer (CFO), as head of the Department, as well as the requirements that must be met by qualified public depositories (QPDs)<sup>2</sup> and public depositors.<sup>3</sup> The Act provides that all public deposits<sup>4</sup> shall be made in a QPD unless exempted by law and that all public deposits shall be considered secured when public depositors comply with the requirements of the law.<sup>5</sup> Public deposits include, but are not limited to, time deposit accounts, demand deposit accounts, and nonnegotiable certificates of deposit.<sup>6</sup> To provide protection of public deposits, each QPD is required to pledge collateral at a level commensurate with the amount of public deposits held and a measure of its financial stability, as determined by the CFO. On a monthly basis, QPDs are to provide the CFO with reports regarding the amounts of public deposits held. The measure of financial stability for each QPD is to be determined by the CFO based on nationally recognized financial rating services information and established performance guidelines.<sup>7</sup> The most financially stable depositories, as determined through these measures, are required to pledge collateral equal to 25 percent of the public deposits held. Those determined to be less financially stable are required to pledge collateral equal to as much as 200 percent of the public deposits held.

Securities eligible to be pledged as collateral include obligations of the United States Government, Federal agencies, and any state or political subdivision or municipality; Federal Home Loan Bank letters of credit; tax anticipation certificates; public housing authority obligations; revenue bonds of any state of the United States or political subdivision or municipality; corporate bonds; and other securities designated allowable by law.<sup>8</sup> Table 1 shows, for each month of the 2008 calendar year, the number of QPDs, the average monthly balance of public deposits, and the market value of collateral held by custodians.

---

<sup>1</sup> Chapter 280, Florida Statutes.

<sup>2</sup> A qualified public depository means any bank, savings bank, or savings association that meets the requirements of Chapter 280, Florida Statutes, and has been so designated by the CFO.

<sup>3</sup> A public depositor is the official custodian of funds for a governmental unit who is responsible for handling public deposits.

<sup>4</sup> A public deposit is defined as the moneys of the State or of any State university, county, school district, community college, special district, metropolitan governments, or municipality, including agencies, boards, bureaus, commissions, and institutions of any of the foregoing, or of any court, and includes the moneys of all county officers, including constitutional officers, that are placed on deposit in a bank, savings bank, or saving association and for which the bank, savings bank, or savings association is required to maintain reserves.

<sup>5</sup> Section 280.03, Florida Statutes.

<sup>6</sup> Section 280.02(23), Florida Statutes.

<sup>7</sup> Section 280.04, Florida Statutes.

<sup>8</sup> Section 280.13, Florida Statutes.

**Table 1**  
**Public Deposits Program**  
**2008 Calendar Year**

Month	Number of QPDs	Total Average Monthly Balance of Public Deposits Held (in dollars)	Non-FDIC Insured Public Deposits (in dollars)	Market Value of QPD Collateral (in dollars)	Percent Collateralized Non-FDIC Insured Public Deposits
January	198	23,754,921,868	23,425,508,480	18,922,121,726	80.78
February	198	22,168,908,248	21,834,207,966	16,606,095,625	76.06
March	200	21,015,486,361	20,681,124,414	15,371,290,587	74.33
April	202	20,108,944,998	19,775,121,316	15,386,904,683	77.81
May	203	19,146,997,304	18,808,487,227	14,457,867,926	76.87
June	204	18,967,307,342	18,634,480,685	13,976,764,193	75.00
July	204	17,476,850,865	17,142,392,639	13,657,491,893	79.67
August	205	16,640,740,282	16,303,450,379	12,269,831,564	75.26
September	206	16,328,234,591	15,993,538,048	11,437,120,548	71.51
October	207	15,513,044,554	13,920,781,287	11,865,572,659	85.24
November	208	17,822,154,344	15,774,480,113	16,144,931,149	102.35
December	209	24,786,898,394	20,967,326,439	20,461,624,947	97.59

Source: Bureau of Collateral Management reports.

Pursuant to law, a QPD, with the approval of the CFO, may deposit eligible collateral with a custodian but shall not act as its own custodian.<sup>9</sup> The CFO may also require the deposit or transfer of collateral into a custodial account established in the CFO's name at a designated custodian. The CFO may also demand payment under a letter of credit or direct a custodian to deposit or transfer collateral and proceeds of securities not previously credited upon the occurrence of one or more triggering events as provided for in law.<sup>10</sup> Examples of triggering events include those instances in which the CFO determines that an immediate danger to the public health, safety, or welfare exists; the QPD defaults or becomes insolvent; the QPD fails to pay an administrative penalty; the QPD fails to meet financial condition standards; and the QPD pledges, deposits, or has issued insufficient or unacceptable collateral to meet required collateral within the required time.

The law provides that when the CFO determines that a QPD default or insolvency has occurred, the loss to public depositors is to be satisfied, insofar as possible, first through any applicable deposit insurance<sup>11</sup> and then through demanding payment under letters of credit or the sale of collateral pledged or deposited by the defaulting QPD.<sup>12</sup> The CFO is to provide coverage of any remaining loss by use of amounts assessed and collected from the other QPDs. During the period January 1, 2009, through August 31, 2009, four QPDs failed; however, as all were acquired outright by other entities, with all deposits transferring to the entities, there were no public deposit losses incurred.

To assist the Bureau in performing its daily business operations, an electronic application, the Collateral Administration Program (CAP) was developed and placed in operation in December 2004. CAP consists of browsers (Web pages) for each of the Bureau's main business processes, including the Confirmation Browser (one each for

<sup>9</sup> Section 280.041(2), Florida Statutes.

<sup>10</sup> Section 280.041(6), Florida Statutes.

<sup>11</sup> The Federal Deposit Insurance Corporation (FDIC) pays public depositors for any losses up to the insured amount prior to any claims being filed with the Bureau.

<sup>12</sup> Section 280.08, Florida Statutes.

certificates of deposit, QPD custodians, CFO custodians, and letters of credit), the Financial Analysis Browser, and the Transaction Browser.

**FINDINGS AND RECOMMENDATIONS**

The Department has implemented rules, policies, and procedures to carry out the requirements and otherwise operate the Public Deposits Program. Our review disclosed that, generally, such policies and procedures were effective in protecting the public deposits of government entities; however, some areas were in need of improvement, as noted in the following findings.

**Oversight of the Public Deposits Program**

The Qualified Public Depository Oversight Board (Board) was created by law, effective October 1, 2001.<sup>13</sup> As codified in State law, the purpose of the six-member Board is to represent the interests of all QPDs in safeguarding the integrity of the Program and preventing the realization of loss assessments that could be imposed upon the default or insolvency of a QPD.<sup>14</sup> The Board has numerous responsibilities including, but not limited to:

- Establishing standards for QPD Program entry requirements, reporting standards, financial condition requirements, collateral pledging levels, and adequacy of the required collateral.
- Recommending CFO approval or rejection of QPD variances from established standards.
- Issuing approvals or rejections of Alternative Participation Agreements<sup>15</sup> referred to the Board by the CFO.
- Reviewing Program violations and recommending that the CFO impose penalties and fines or issue corrective actions and administrative orders.

State law requires that the CFO initiate the selection of Board representation on July 31 of each year and as vacancies occur.<sup>16</sup> After categorizing QPDs into three groups according to asset size, the CFO is to identify two QPDs in each grouping that have the greatest shares of contingent liability and notify the six identified QPDs. Each of the six QPDs is to provide to the CFO within 30 days a Board member and alternate selection, or if declined, the CFO is to notice the Florida Bankers Association, which shall select a member and alternate.

**Finding No. 1: QPD Oversight Board**

Our audit disclosed that since its creation, the Board has been largely inactive. While a Board was appointed and an initial meeting was held in December 2001, Bureau staff stated that the Board members had questioned the liability of the represented QPDs in carrying out decisions affecting competitor QPDs and voiced their reluctance to participate in making recommendations as part of their responsibility. Subsequent to this initial meeting, no further Board meetings have taken place.

Without an established Board, the safeguards envisioned by the 2001 legislation cannot be fully realized. Particularly during the current economic downturn, the increased level of expertise realized through a functional Board may be of great assistance in safeguarding the interests of the public depositors and QPDs. Notwithstanding the reluctance by the initial Board members to participate in making the recommendations enumerated in law that affect specific QPDs, many of the findings in this report underscore the potential benefits to be gained by Board participation in

<sup>13</sup> Chapter 2001-230, Laws of Florida.

<sup>14</sup> Section 280.071, Florida Statutes.

<sup>15</sup> Alternative Participation Agreements are used to memorialize the requirements for QPDs with poor quarterly average financial condition rankings that choose not to withdraw from the Program.

<sup>16</sup> Section 280.071(1), Florida Statutes.

establishing standards for QPD program entry requirements, reporting standards, financial condition requirements, collateral pledging levels, and adequacy of the required collateral.

**Recommendation:** To effectuate the reestablishment of an active Board, we recommend that the Department examine the impediments to establishing a functional Qualified Public Depository Oversight Board and, in consultation with the Legislature, propose changes as needed to Section 280.071, Florida Statutes.

**Qualified Public Depository Collateral Pledging Levels**

As noted previously, the CFO is required by law to determine the collateral requirements and collateral pledging levels for each QPD following procedures established by rule.<sup>17</sup> Relative to each QPD, the objective of the procedures is to set a collateral pledging level at 25, 50, 125, or 200 percent based on CFO staff evaluation of nationally recognized financial rating services information and established performance guidelines. The established performance guidelines to be used by the CFO in administering and protecting the integrity of the Program are described in Department rule and include an analysis of:<sup>18</sup>

- Ratios derived from the QPD’s quarterly regulatory reports;
- The trends experience by each QPD;
- An average financial condition ranking from two national recognized financial rating services, published quarterly;
- Other pertinent information relating to the overall condition of the QPD.

Based upon guidelines recommended by both banks and savings association advisory committees, the Department rule specifies numerical parameters for the collateral pledging levels for all QPD’s, as shown in Table 2.

**Table 2**  
**Collateral Pledging Levels Based Upon**  
**Quarterly Average Financial Condition Rankings**

Applicable Paragraph of Department Rule 69C-2.024	Quarterly Average Financial Condition Ranking	Collateral Pledging Level (Percent)	Additional Requirements
(3)(b)	0 – 15	200	QPD must withdraw from the Program or enter into an agreement (Alternative Participation Agreement) with the CFO that establishes a maximum amount of public deposits that may be held. The QPD’s 200 percent pledged collateral must be deposited into a custodial account in the CFO’s name.
(3)(c)	0 – 20	125 – 200	QPD must deposit collateral into custodial account established in the CFO’s name.
(3)(d)	0 – 29	125	Unless paragraph (3)(b) applies.
(3)(e)	30 – 69	50	
(3)(f)	70 and above	25	QPD’s ranking must be based on an average of the most recent four quarterly rankings.
(3)(g)	QPD < 3 years old	125	Unless paragraph (3)(b) applies.

Source: Department Rule, 69C-2.024, Florida Administrative Code.

<sup>17</sup> Section 280.04(1), Florida Statutes.

<sup>18</sup> Department Rule 69C-2.024, Florida Administrative Code.

During the audit period, the computation of the quarterly average financial condition rankings began with the uploading of data for the prior quarter from two nationally recognized rating services into CAP. The data was then processed in CAP to compute the QPD rankings and collateral pledging levels based upon statute and rule.<sup>19</sup> Typically, there was a one-quarter lag between the end of the quarter and the receipt of the rankings from the rating services. Recognizing the wide range of fiscal changes that can occur during such a time interval, a Bureau financial analyst routinely selected QPDs meeting certain criteria for additional analysis, utilizing the latest quarterly financial data and news from media and other sources.

---

**Finding No. 2: QPD Financial Analysis and Pledging Levels**

---

As previously noted, CAP was used to compute quarterly average financial condition rankings based upon information from financial rating services and then correlate the rankings to applicable pledging levels established by rules. The rule, however, also provides that the CFO use ratios, trends, and other pertinent information in determining the financial condition of QPDs.

In accordance with Bureau procedures, the financial analyst selected QPDs meeting certain criteria, such as a material change in quarterly average financial condition rankings computed by CAP, for additional analysis. Depending on the results, the financial analyst may have changed the collateral pledging level to a level that differed from the CAP computation. For example, the most recent financial data may have shown a continued deterioration in the QPD's financial condition, resulting in the analyst increasing the pledging level beyond that recommended by CAP. Conversely, new data may have shown that the QPD's condition had stabilized, resulting in the analyst decreasing the pledging level below CAP's recommendation. Our review disclosed that no written procedures had been established that provided guidance to the analyst on using and evaluating ratios, trends, or other pertinent information in the analysis of a QPD's financial condition and collateral pledging level.

While we recognize that the additional quarterly analyses are essential to establishing fair and equitable collateral pledging levels, Department rules, as currently established, do not enumerate the circumstances under which such analyses should result in modifications to CAP's computed quarterly average financial condition rankings and recommended collateral pledging levels. Additionally, written procedures that describe the methodology, criteria, and benchmarks to be used in analyzing current financial data would provide assurance to Program management that the financial condition of QPDs are analyzed and evaluated on a consistent basis.

---

**Recommendation:** We recommend that the Department amend its rule as necessary to enumerate the circumstances under which collateral pledging levels can differ from those computed using quarterly average financial condition rankings. To ensure consistent treatment of QPDs, the Bureau should establish written procedures to include the methodology, criteria, and benchmarks to be used in analyzing and evaluating the financial condition of QPDs and the sufficiency of collateral pledging levels.

---

---

**Finding No. 3: Approval of Collateral Pledging Level Changes**

---

As previously noted, Bureau procedures required that for each selected QPD, the financial analyst perform an additional analysis utilizing current financial data, compare the results to the CAP computed collateral pledging level and, based upon this comparison, enter an effective collateral pledging level percentage into CAP. The effective

---

<sup>19</sup> For the quarterly average financial condition rankings listed in Table 2, CAP computes a collateral pledging level of 200 percent for average rankings of 0 to 15, and 125 percent for rankings of 16 to 29.

collateral pledging level was then to be used by CAP to calculate the amount of collateral the QPD was required to provide.

Our testing of collateral pledging levels derived from September 2008 quarterly ratings for 21 QPDs disclosed that Bureau staff conducted analyses for 17 of these QPDs between February 17, 2009, and April 10, 2009. For 15 of the 17 QPDs subjected to the additional financial analyses, supervisory reviews of the analyses were not documented, including those analyses and recommendations that resulted in the setting of collateral pledging levels below that required by rule. We noted that in some cases, the supervisor had personally performed the analysis, but with no documented follow-up review by another supervisor. In response to our audit inquiry, Bureau management stated that while supervisory review of analyses and approval of the resulting QPD pledging level changes were not required as a matter of policy or procedure, the results of the analyses were discussed by the financial analyst with the immediate supervisor prior to finalizing a decision. However, absent a documented supervisory review, the Department cannot demonstrate that a supervisory review occurred and undetected errors may lead to inappropriate changes in required collateral pledging levels.

---

**Recommendation:** We recommend that the Department require and document supervisory reviews of analyses and recommended collateral pledging levels.

---



---

#### **Finding No. 4: Enforcement of Collateral Pledging Levels**

---

As previously noted, Department rule provides that QPDs with quarterly financial condition rankings of 0 to 15 must withdraw from the Program or may choose to meet the following conditions as an alternative to withdrawing:<sup>20</sup>

- Limit the amount of public deposits held to an amount mutually agreed to by the CFO and the QPD;
- Deposit into an account in the CFO's name eligible collateral equal to 200 percent of the amount of public deposits;
- Submit each month, or whenever requested by the CFO, a certified report listing all public deposits held for the credit of all public depositors.

The Bureau uses Alternative Participation Agreements (Agreements) to memorialize the requirements imposed by this rule for QPDs that do not withdraw from the Program.

As part of its calculation of the September 2008 quarterly financial condition rankings, performed in January 2009,<sup>21</sup> CAP reports identified 15 QPDs that had average quarterly financial condition rankings of 15 or less. At the time of our review, 1 of the 15 QPDs was in the process of withdrawing from the Program. Table 3 provides details for the remaining 14 QPDs that had not elected to withdraw from the Program, and discloses that as of May 26, 2009:

- Two of 14 QPDs had experienced financial rankings of 15 or less for three or more consecutive quarters and had continued in the Program without negotiation of an Agreement.
- Nine of 14 QPDs had not entered into Agreements with the Department, nor had collateral pledging levels been raised to 200 percent, as required by rule.
- Three of 5 QPDs that entered into Agreements still had actual collateral pledging levels at 150 percent or less, contrary to the 200 percent requirement of rule.
- Only 2 of the 14 QPDs had pledged collateral equal to 200 percent of the amount of public deposits.

---

<sup>20</sup> Department Rule 69C-2.024, Florida Administrative Code.

<sup>21</sup> Financial ranking data is received from contracted service providers one quarter in arrears.

**Table 3**  
**QPDs with Financial Rankings of 15 or Less as of January 2009<sup>a</sup>**  
**Program Status as of May 26, 2009**

QPD	Average Monthly Public Deposits <sup>b</sup> (in dollars)	Number of Consecutive Quarters with Rankings of 15 or Less	Required Collateral Pledging Level Percentage	Actual Collateral Pledging Level Percentage	Date of Alternative Participation Agreement	Number of Months Without Agreement, as of May 2009
1	250,237,090	1	200	125	No Agreement	4 <sup>c</sup>
2	51,107,498	1	200	125	No Agreement	4
3	248,749	1	200	125	No Agreement	4
4	40,967,706	1	200	125	No Agreement	4
5	118,353,488	1	200	125	No Agreement	4
6	33,256,817	1	200	125	No Agreement	4
7	15,647,413	1	200	125	No Agreement	4
8	17,577,372	3	200	125	No Agreement	12
9	13,643,835	4	200	125	No Agreement	15
10	5,448,591	2	200	125	12/08/2008	3
11	608,350,484	1	200	125	01/15/2009	1
12	13,750,000	1	200	200	04/03/2009	4
13	12,250,000	2	200	150	01/21/2009	4
14	8,461,576	2	200	200	12/05/2008 <sup>d</sup>	3

<sup>a</sup> January 2009 pledging levels were based upon average quarterly financial rankings provided by two nationally recognized financial rating services for the quarter ended September 2008.  
<sup>b</sup> As of December 31, 2008, net of FDIC-insured amounts.  
<sup>c</sup> Institution was purchased by another financial institution subsequent to May 26, 2009.  
<sup>d</sup> Institution was purchased by another financial institution after Agreement was put in place.

Source: Bureau records.

In response to our audit inquiries, Bureau staff stated that written policies and procedures had not been developed that described the nature and timing of the actions to be taken in response to QPD quarterly financial condition rankings of 15 or less. Such written policies and procedures would better ensure the timely enforcement of the requirements of the applicable laws and rules.

---

**Recommendation:** We recommend that the Bureau establish written policies and procedures describing and assigning the responsibility for the actions that must be taken in response to a QPD quarterly financial condition ranking of 15 or less. Such policies and procedures should ensure that prescribed actions lead to timely, consistent, and documented compliance with applicable laws and rules.

---

**Finding No. 5: Hardship Requests**

As previously noted, DFS rule provides that QPDs with quarterly financial condition rankings of 0 to 15 must withdraw from the Program or, as an alternative to withdrawing and among other requirements, deposit into an account in the CFO’s name eligible collateral equal to 200 percent of the amount of public deposits.<sup>22</sup>

<sup>22</sup> Department Rule 69C-2.024(3)(b), Florida Administrative Code.

Our audit disclosed that, for three Agreements referenced in finding No. 4, the Department accepted and incorporated provisions to address hardships described in requests submitted by the QPDs.<sup>23</sup> According to Bureau staff, hardship requests were usually submitted by those QPDs for which an immediate increase in collateral pledging level would create or exacerbate funding issues. We noted that the resulting hardship concessions that were granted and incorporated into the Agreements provided transitional collateral pledging levels of less than the required 200 percent pledging level and provided lengthy time periods for the QPD to increase collateral to the 200 percent pledging level. The three QPDs with hardship provisions incorporated in the Agreements and the number of months provided to meet the 200 percent collateral pledging level are shown in Table 4. Even with these extended time periods, for two of the three QPDs, pledging levels were not increased until after the Agreement deadline, providing additional time for the QPDs to meet the required 200 percent pledging level.

**Table 4**  
**QPDs with Hardship Provisions as of June 19, 2009**

QPD No. from Table 3	Effective Date of Alternative Participation Agreement (with Hardship Provisions)	Date Agreement Requires 200 Percent Pledging Level	Number of Months Provided to Meet Collateral Pledging Level
10	12/08/2008	05/01/2009	4.75 Months
11	01/15/2009	04/30/2009	3.5 Months
13	01/21/2009	09/15/2009	7.75 Months

Source: Bureau Management and Records.

While the three QPD’s listed above, were collateralized at over 100 percent, the acceptance of hardship requests and delay of increasing collateral may result in the under-collateralization of QPDs that are already showing financial distress. In the event the financial difficulties experienced by these QPDs escalate and cause a default or insolvency, any loss to public depositors not satisfied through deposit insurance and the sale of collateral is, by law, covered through assessment against other QPDs.

State law does not limit the CFO’s discretion to specify when additional collateral must be deposited in order to satisfy the 200 percent requirement of rules. However, we noted that Department rules did not establish the conditions under which a hardship request may be submitted by a QPD, the criteria to be used by the Department to evaluate a hardship request, and a maximum timeframe within which the transition to the required collateral level must be completed.

---

**Recommendation:** We recommend that the Department, by rule, establish the conditions under which a hardship request may be submitted by a QPD, and a maximum timeframe within which the transition to the required collateral level must be completed. Furthermore, the Department should develop written procedures that establish objective criteria for evaluating hardship requests.

---

**Collateral Administration**

Florida law provides the CFO with the authority to maintain a perpetual inventory of collateral, obtain monthly market valuations and credit quality ratings, and monitor and confirm collateral with custodians and letter of credit issuers.<sup>24</sup> Accordingly, selected staff within the Bureau were assigned duties to process, approve, and record collateral

<sup>23</sup> Six additional hardship requests were received during this period, with five requests (QPDs Nos. 2, 3, 5, 6, and 8, from Table 3) pending management’s further deliberation, as of June 19, 2009, and one request (QPD No. 1 from Table 3) dismissed as the QPD was subsequently acquired by another institution.

<sup>24</sup> Sections 280.05(7) and (8), Florida Statutes.

transactions in CAP. Staff were also responsible, upon CAP's detection of deficiencies in the value of collateral provided, for timely notifying QPDs and requesting the deposit of additional securities to restore collateral to an amount above the minimum required collateral amount.

Upon receipt of a Deposit of Collateral notice from a QPD, Bureau staff were to manually record each collateral security, including the CUSIP number,<sup>25</sup> in CAP in a hold (pending) status. Staff were also to file applicable transaction documents in a pending file to await verification from the custodian bank<sup>26</sup> that the collateral securities were received. Once such verification was received, staff were to remove the security from pending status and file all the documentation in a completed transaction file. If verification was not received within 10 business days, the deposit transaction was to be removed from pending status and deleted from CAP.

Pursuant to law, when the market value of a QPD's collateral is in excess of the minimum required collateral, the QPD can request a withdrawal of the excess using a withdrawal form prescribed by the CFO.<sup>27</sup> As provided by Department rule, the Bureau has 5 business days upon receiving the request to approve or disapprove the withdrawal.<sup>28</sup> Once the withdrawal is approved, Bureau staff are to input the withdrawal in CAP and send copies of the approved withdrawal form to the QPD's custodian, evidencing CFO approval which allows the custodian to release the pledged collateral.

The law also provides that a QPD may substitute eligible collateral for pledged collateral without the prior approval of the CFO provided that the QPD certifies the market value of the securities to be substituted is at least equal to the market value of the securities withdrawn, the QPD simultaneously provides notice to the Bureau, and the CFO has not provided notice to the custodian prohibiting the substitution.<sup>29</sup> Substitutions were to be processed in CAP by the Bureau in the same manner as deposits and withdrawals.

Another provision of law empowers the CFO to decline to accept, or reduce the reported value of, collateral in order to ensure the pledging or depositing of sufficient marketable collateral and acceptable letters of credit.<sup>30</sup> Thus, by reducing the reported value of illiquid collateral, the CFO can effectuate the QPD's substitution of liquid for illiquid collateral.

During the course of our audit, we noted instances in which the processing and reconciliation of collateral transactions could be improved.

#### **Finding No. 6: Reconciliations**

The Department was to receive from each collateral custodian a monthly inventory report. A Bureau financial examiner was then to reconcile the custodian reports to the data recorded in CAP to ensure that the data recorded in CAP was reliable, securities were accounted for, and data discrepancies were timely detected and corrected. To accomplish the reconciliation, the financial examiner uploaded all monthly custodian inventory reports into CAP and, utilizing each of the collateral securities' CUSIP numbers, CAP electronically compared securities from the inventory reports to the securities recorded within CAP. Reports identifying reconciling items (items that did not match) were

<sup>25</sup> The Committee on Uniform Securities Identification Procedures (CUSIP) number refers to the nine-character alphanumeric security identifier for all North American securities.

<sup>26</sup> As previously noted, the Act provides that a QPD, with the approval of the CFO, may deposit eligible collateral with a custodian but may not act as its own custodian. The CFO may require deposit or transfer of collateral into a custodial account established in the CFO's name at a designated custodian.

<sup>27</sup> Section 280.041(2)(a)6.e., Florida Statutes.

<sup>28</sup> Department Rule 69C-2.006(5)(b), Florida Administrative Code.

<sup>29</sup> Section 280.041(2)(a)6.b., Florida Statutes.

<sup>30</sup> Section 280.05(6), Florida Statutes.

then generated by CAP. The financial examiner was responsible for resolving any reconciling items for the inventory reported by CFO custodians, while other Bureau staff were responsible for resolving reconciling items for the inventory reported by QPD custodians.

Our tests of 24 collateral deposit and withdrawal transactions totaling approximately \$3.2 billion, and 24 custodial reconciliations (one for each custodian with active collateral inventory as of September 30, 2008), disclosed the following matters:

- Bureau staff responsible for resolving reconciling items for QPD custodian accounts were also responsible for processing collateral security transactions. Such duties are considered incompatible in that they could allow the concealment of fraud or errors.
- A properly performed reconciliation should identify securities in pending status beyond the 10-business-day limit and should include steps to timely investigate and resolve any such discrepancies. As shown in Table 5, we found that six collateral securities had remained in pending status for periods ranging from 69 to 173 days. We found that five of the six securities were in pending status because incorrect CUSIP numbers had been recorded in CAP and, as a result, the numbers could not be matched to the correct numbers reported by the custodians. Contributing to these types of errors was the absence in CAP of an edit check to identify CUSIP number input errors. An automated edit check in CAP that tests the ninth digit of the CUSIP numbers would better ensure that related input errors were immediately detected as securities were entered into CAP, and thereby, help reduce the number of these types of reconciling items.<sup>31</sup>

**Table 5**  
**Securities in Pending Status**

Number of Securities	Market Value (in dollars)	Date Placed in Pending Status	Date Removed from Pending Status	Number of Days in Pending Status	Error in Recording CUSIP No. in CAP
1	200,000,000	01/03/2008	05/02/2008	137	No
1	20,000,000	11/28/2007	04/09/2008	133	Yes
3	5,000,000	09/04/2008	02/24/2009	173	Yes
1	1,000,000	01/17/2008	03/21/2009	69	Yes

Source: Department records.

- As of September 30, 2008, we confirmed with the Federal Home Loan Bank (FHLB) in Atlanta that letters of credit totaling approximately \$2.115 billion were held as collateral for QPDs. However, custodial collateral reconciliations performed by Bureau staff did not include the FHLB letters of credit. Absent periodic reconciliation of the letters of credit reported by the FHLB to the letters of credit recorded in CAP, the Bureau has limited assurance that it has properly accounted for all letters of credit. For example, our tests identified a \$100,000 letter of credit issued on August 8, 2008, that was unrecorded in CAP until October 29, 2008. Bureau staff discovered the error when a withdrawal request by a QPD was rejected by CAP for having insufficient excess collateral available in the QPD account to support a withdrawal. The insufficient collateralization shown by CAP was due to the letter of credit not being recorded in CAP.

---

**Recommendation:** We recommend that the Bureau implement procedures whereby collateral reconciling differences are timely resolved by employees independent of collateral transaction processing and that letters of credit are included in the reconciliation process. Furthermore, to reduce input errors, we recommend that the Bureau implement an automated edit check that tests the ninth digit of CUSIP numbers.

---

<sup>31</sup> The first six characters of the CUSIP number identify the issuer, the seventh and eighth digits identify the particular issue, and the ninth digit is generated from a computation using the first eight digits.

**Finding No. 7: Collateral Pricing**

Monthly, Bureau staff updated the market values of collateral recorded in CAP by uploading the inventory of collateral securities to a subscription service provider to obtain the most recent market value pricing. An inventory-pricing file was returned from the service provider, generally on the same day, and uploaded to CAP. After the pricing file was uploaded to CAP, any security from the pricing file that did not have a price was listed on a CAP exception report. The pricing process was generally conducted on the last day of the month. Pursuant to State law, the CFO may disapprove any security for which no current market price can be obtained from a nationally recognized source or which cannot be converted to cash.<sup>32</sup>

Our audit included a review of collateral deposits, withdrawals, and pricing, and disclosed some areas that needed improvement, as discussed below.

- Within CAP, there was a “Send for Market Update” check box indicating whether a specific security should be submitted for pricing, with the default set to “submit.” Certain collateral that did not require pricing, such as letters of credit, were to have the “Send for Market Update” check box unselected.<sup>33</sup> During our testing of deposits, we noted one security with a recorded fair value of approximately \$45 million that, as of April 22, 2009, had the “Send for Market Update” box improperly unselected in CAP. Consequently, the security which should have been submitted for monthly pricing had not been priced since February 26, 2009. Our analysis of Bureau procedures disclosed that the Bureau did not have in place a methodology, such as a check box exception report, to facilitate an efficient determination that all applicable securities were subjected to monthly pricing.
- The CAP exception report for September 2008 identified 17 QPD-related securities on the service provider’s pricing file that were not priced. We tested 5 of the 17 securities to determine how long the securities remained in CAP without updated pricing and whether, as of February 2009, there had been any documented attempt by the Bureau to price the securities using alternative pricing sources. As shown in Table 6, current market values for 4 of the 5 securities tested had not been obtained for extended periods, ranging from 5.5 to 31 months. Additionally, the Bureau was unable to provide documentation of any efforts to price the securities using alternative pricing sources.

**Table 6  
Example Collateral Securities Lacking Current Pricing  
as of February 2009**

Security No.	Date of Last Market Valuation	Market Value at Last Pricing (in dollars)	Number of Months Without Pricing Through February 2009
1	07/25/2008	999,700	6
2	06/02/2008	2,485,185	8
3	09/19/2008	2,818,437	5.5
4	08/01/2006	3,504,380	31
<b>Total</b>		<b><u>9,807,702</u></b>	

Source: Department records.

By ensuring that all collateral securities are currently priced by the service provider or through alternative means, the CFO can better assure that QPDs continue to meet their minimum required collateral levels. QPDs with deposits that are not properly collateralized may put other QPDs in the Program at risk in the event of an insolvency or default.

<sup>32</sup> Section 280.13(7), Florida Statutes.

<sup>33</sup> The Bureau’s securities pricing contract requires the Bureau to pay a fee for each market price provided. As a consequence, the Bureau endeavors to send for pricing only those securities which required the attention of the service provider.

**Recommendation:** We recommend that the Bureau implement procedures to ensure that alternative market prices are obtained in a timely manner when not provided by the service provider. In instances where pricing cannot be readily obtained, the QPD should be provided an opportunity to replace the collateral security. Additionally, the Bureau should establish a methodology to ensure that, prior to sending inventory files to the service provider for pricing, all applicable securities are correctly coded for updated pricing.

### Program Reporting

State law requires each public depositor to submit, not later than November 30, an annual report to the CFO to include:<sup>34</sup>

- The official name, mailing address, and Federal employer identification number (FEIN) of the public depositor;
- Verification that QPD confirmation of public deposit information as of September 30 has been completed;
- Confirmation that a public deposit identification and acknowledgment form has been completed for each account and is in the possession of the public depositor;
- Public deposit information in a report format prescribed by the CFO. The public deposit information required by the prescribed format included the name and FEIN of each QPD in which the public depositor had open public deposit accounts.

State law provides that public depositor failure to comply with respect to a public deposit account will result in the protection from loss not being effective for that account.<sup>35</sup>

State law also requires each QPD to prepare and submit to the CFO annually, not later than November 30, a report of all public deposits held for the credit of public depositors at the close of business on September 30.<sup>36</sup>

QPD and public depositor annual reports are to consist of public deposit information in a format prescribed by the CFO. The QPD and public depositor reports may be submitted as a signed writing (hard copy) or by electronic media, at the discretion of the CFO.

### Finding No. 8: Annual Reports

In accordance with the authority provided to the CFO, the Bureau has created annual report formats for public depositors and QPDs. As permitted by law, annual reports were submitted in both electronic and hard copy formats.

State law provides that the CFO shall compare public deposit information reported by QPDs and public depositors; that the comparison will be conducted for QPDs that are ranked in the lowest category (financial condition ranking of 0 to 15) based on established financial condition criteria of record on September 30; and that additional comparisons may be performed as Program resources permit.<sup>37</sup> In response to our audit inquiries, Bureau staff stated that while comparisons of annual reports were conducted for those QPDs that were in eminent danger of failure, a full comparison of the annual reports of all QPDs that fell below a ranking of 15 was not conducted.

<sup>34</sup> Section 280.17(6), Florida Statutes.

<sup>35</sup> Section 280.17(8), Florida Statutes.

<sup>36</sup> Section 280.16(1)(d), Florida Statutes.

<sup>37</sup> Section 280.05(16)(c), Florida Statutes.

The lack of a comparison of public deposit information for all QPDs with a ranking of 15 or less, with that of public depositors, may allow a QPD's under-reporting and under-collateralization of public deposits to escape timely detection and corrective action by the Bureau.

---

**Recommendation:** We recommend that the Department perform all the comparisons required by Section 280.05(16)(c), Florida Statutes.

---

<b>Information Technology</b>
-------------------------------

---

**Finding No. 9: Management of User Access Privileges**

---

An important aspect of information technology (IT) security management is the establishment of system access privileges that restrict users to only those system functions necessary to perform their assigned duties. Properly configured access privileges also help enforce an appropriate separation of duties and minimize the risk of unauthorized system actions. Effective access controls include the use of access authorization requests documented on standard forms that are submitted for review and approval by senior management. Using these forms, senior management communicates to the security administrator all approved requests for user access, and the security administrator provides the appropriate system access privileges to users. All requests for user access are maintained on file. In addition, management's periodic review of access authorizations helps ensure that privileges remain commensurate with employee job duties.

During the audit period, the Department used an Information Technology Access and Resource Request form (access request form) to document both access requests and senior management approvals. Our review of CAP user access privileges and related access request forms disclosed the following matters indicating the need for improvement in user access controls:

- Two senior managers for the Bureau functioned as CAP security administrators, but also had update access privileges and performed operational functions in CAP. Such incompatible duties increase the risk that unauthorized system actions could occur without detection.
- Two CAP users had been granted access privileges to certain CAP functions although CAP access was not requested on the access request forms. Failure to document access authorizations increases the risk of inappropriate access and unauthorized use, disclosure, or modification of data and programs.
- As part of a CAP user review and clean-up process, five user accounts were disabled by the Bureau on February 24, 2009. These accounts included:
  - Accounts for three system developers (two internal and one contracted) who had access throughout the audit period to the live data in CAP through various edit functions. The access of system developers should be limited to a test environment where systems are designed and tested prior to being placed into live production by personnel independent of system development.
  - An account for one IT employee who had access to live data in CAP through various update functions that did not appear necessary.
  - An account for one employee who had transferred two years earlier from the Bureau to another organizational unit of the Department, where CAP was not used.
- One user had been granted access privileges to areas of CAP that were inappropriate for the user's job duties. Specifically, the user was responsible for reconciling collateral received from QPDs and other entities with collateral recorded in CAP. The user was also provided access privileges that allowed the user to update transactions and edit collateral transactions in CAP. Under such circumstances, the risk is increased that errors or fraud could occur without timely detection.

---

**Recommendation:** We recommend that the Department ensure that staff access privileges to CAP are commensurate with their job duties through a documented and periodic review of user access privileges.

---



---

### **Finding No. 10: CAP Security Controls**

---

Security controls are intended to protect the confidentiality, integrity, and availability of data and IT resources. Our audit disclosed certain security controls related to CAP and the supporting network environment that needed improvement. The specific details of these issues are not disclosed in this report to avoid the possibility of compromising CAP data and IT resources. However, we have notified appropriate Department management of the specific issues. Without adequate security controls, CAP data and IT resources may be subject to increased risk of improper access, disclosure, destruction, or modification.

---

**Recommendation:** We recommend that the Department implement appropriate security controls to ensure the continued confidentiality, integrity, and availability of CAP data and IT resources.

---



---

## **OBJECTIVES, SCOPE, AND METHODOLOGY**

---

The Auditor General conducts operational audits of governmental entities to provide the Legislature, Florida's citizens, public entity management, and other stakeholders unbiased, timely, and relevant information for use in promoting government accountability and stewardship and improving government operations.

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

This operational audit focused on the Public Deposits Program. The overall objectives of the audit were:

- To evaluate the effectiveness of established internal controls in achieving management's control objectives in the categories of compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the relevance and reliability of records and reports; and the safeguarding of assets.
- To evaluate management's performance in achieving compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the relevance and reliability of records and reports; and the safeguarding of assets.
- To identify statutory and fiscal changes that may be recommended to the Legislature pursuant to Section 11.45(7)(h), Florida Statutes.

Our audit included examinations of various records and transactions (as well as events and conditions) occurring during the period January 2008 through December 2008, and selected actions through May 21, 2009. In conducting our audit we:

- Obtained an understanding of selected IT controls, assessed the risks related to those controls, and evaluated whether selected general and application IT controls were in place.
- Tested records related to 21 financial institutions approved as QPDs to determine whether the institutions were properly authorized as QPDs in accordance with laws and rules.
- Tested 12 collateral deposits totaling \$1,795,842,895 (market value) to determine whether the collateral met eligibility criteria set by Chapter 280, Florida Statutes, and was properly priced and correctly recorded in CAP.

- Tested 12 collateral withdrawals totaling \$1,367,655,843 (market value) to determine whether the withdrawals were properly authorized and did not result in a QPD becoming under-collateralized.
- Tested 40 securities selected from the Bureau’s periodic inventory reports to determine whether the securities with a market value of \$3,778,217,777 were correctly priced and rated as to credit quality.
- Tested 3 securities recorded in CAP at \$4,983,627 that did not receive pricing from the Bureau’s subscription service to determine whether the Bureau used alternative measures to price the securities.
- Tested 5 securities from the CAP exception report to determine whether the Bureau used alternative measures to price the securities.
- Confirmed the existence and valuation of four letters of credit totaling \$2.115 billion.
- Tested 24 custodial reconciliations for one month to determine whether the reconciliations were timely and accurately prepared by an independent employee.
- For 21 QPDs, recalculated and compared average financial condition rankings and corresponding collateral pledging levels to those shown in CAP to determine accuracy and compliance with applicable laws and rules.
- For QPD monthly reporting, QPD annual reporting, and public depositor annual reporting, analyzed the number and timing of reports received to determine whether all QPDs or public depositors filed reports timely, and whether the Bureau took appropriate action for reports not received.
- Randomly selected and examined 30 QPD monthly reports and 30 public depositor annual reports to determine whether the reports were provided in the manner specified by the Bureau.
- Evaluated QPD Oversight Board compliance with the provisions of Section 280.071, Florida Statutes, which govern the operations of the Board.
- Performed various other auditing procedures, including analytical procedures, as necessary, to accomplish the objectives of the audit.

**AUTHORITY**

Section 11.45, Florida Statutes, requires that the Auditor General conduct an operational audit of each State agency on a biennial basis. Pursuant to the provisions of Section 11.45, Florida Statutes, I have directed that this report be prepared to present the results of our operational audit.

David W. Martin, CPA  
Auditor General

**MANAGEMENT’S RESPONSE**

In a response letter dated November 16, 2009, the Chief Financial Officer concurred with our audit findings and recommendations. The Chief Financial Officer’s response is included as EXHIBIT A.

**EXHIBIT A**  
**MANAGEMENT'S RESPONSE**



CHIEF FINANCIAL OFFICER  
STATE OF FLORIDA

ALEX SINK

November 16, 2009

Mr. David W. Martin  
Auditor General  
State of Florida  
Claude Pepper Building  
111 West Madison Street  
Tallahassee, Florida 32399-1450

Dear Mr. Martin:

Pursuant to Section 11.45(4)(d), Florida Statutes, the enclosed response is provided for the preliminary and tentative audit findings included in the Auditor General's Operational Audit of the Department of Financial Services, Public Deposits Program, for the period January 2008 through December 2008, and selected actions through May 21, 2009.

If you have any questions or would like to discuss the matter further, please contact Bob Clift, Inspector General, at (850) 413-4960.

Sincerely,

A handwritten signature in cursive script, appearing to read "Alex Sink", is written over a horizontal line.

Alex Sink

Enclosure

**EXHIBIT A**  
**MANAGEMENT'S RESPONSE (CONTINUED)**

**Florida Department of Financial Services**  
**Audit Response**  
**Public Deposits Program**  
**Operational Audit**  
**Preliminary and Tentative Audit Findings**  
**For the Period January 2008 through December 2008, and**  
**Selected Actions through May 21, 2009**

---

**OVERSIGHT OF THE PUBLIC DEPOSITS PROGRAM**

**Finding No. 1: The Qualified Public Depository Oversight Board created pursuant to Section 280.071, Florida Statutes, has been inactive since holding an initial meeting in December 2001.**

**Recommendation:** To effectuate the reestablishment of an active Board, we recommend that the Department examine the impediments to establishing a functional Qualified Public Depository Oversight Board and, in consultation with the Legislature, propose changes as needed to Section 280.071, Florida Statutes.

**Response:** We concur. The initial Qualified Public Depository Oversight Board members had refused to make judgments on other Qualified Public Depositories (QPDs) as required under Section 280.071, Florida Statutes. The Bureau of Collateral Management (Bureau) has drafted a change to Chapter 280, Florida Statutes, to eliminate the provisions calling for a Qualified Public Depository Oversight Board and providing instead for the use of an advisory committee. An advisory committee standard had existed in the statute prior to the change implementing the oversight board and we believe committee members would not be reluctant to act in an advisory role. The proposed statutory change will be pursued in the 2010 legislative session with an implementation date of July 1, 2010. The Bureau will also seek input from the banking industry as to whether the change to an advisory committee approach has their support.

**QUALIFIED PUBLIC DEPOSITORY COLLATERAL PLEDGING LEVELS**

**Finding No. 2: Department rules did not enumerate the circumstances under which collateral pledging levels can differ from those computed under law and existing rule.**

**Recommendation:** We recommend that the Department amend its rule as necessary to enumerate the circumstances under which collateral pledging levels can differ from those computed using quarterly average financial condition rankings. To ensure consistent treatment of QPDs, the Bureau should establish written procedures to include the methodology, criteria, and benchmarks to be used in analyzing and evaluating the financial condition of QPDs and the sufficiency of collateral pledging levels.

**Response:** We concur. Although the statute provides authority to require collateral from a QPD pursuant to special instructions, the administrative rules of the program do not detail the circumstances under which discretion may be used in establishing collateral requirements. The Bureau is drafting changes to the administrative rules of the public deposits program that would describe the circumstances under which a QPDs collateral pledge level may differ from the level

**EXHIBIT A**  
**MANAGEMENT'S RESPONSE (CONTINUED)**

generally prescribed for in the rule. The proposed changes to the administrative rules do not require a change in the statute. The Bureau expects to begin the formal rulemaking process in November 2009 with an estimated completion date of March 1, 2010.

**Finding No. 3: The supervisory review and approval of Bureau financial analyses of the financial condition of selected Qualified Public Depositories (QPDs), and any resulting changes in collateral pledging levels, was not always documented.**

**Recommendation:** We recommend that the Department require and document supervisory reviews of analyses and recommended collateral pledging levels.

**Response:** We concur. While not required by either statute or administrative rule, we agree that a process that ensures a supervisory review of any collateral pledge level that differs from that recommended under the administrative rules of the program is prudent. Therefore, the Bureau implemented an internal policy on October 21, 2009, that requires the lead analyst to propose to the financial administrator any QPD collateral pledge level that differs from the level prescribed for by rule. The policy further provides that the financial administrator will forward the proposal to the bureau chief with a recommendation. The bureau chief will render a final decision, except for cases in which the bureau chief deems that concurrence from the division director is warranted. The lead analyst's proposal and all recommendations or decisions made by supervisory staff will be documented in writing and recorded in the official records of the bureau.

**Finding No. 4: The Bureau had not established written policies and procedures describing the types and timing of actions necessary to respond to a QPD receiving the lowest quarterly financial condition ranking.**

**Recommendation:** We recommend that the Bureau establish written policies and procedures describing and assigning the responsibility for the actions that must be taken in response to a QPD quarterly financial condition ranking of 15 or less. Such policies and procedures should ensure that prescribed actions lead to timely, consistent, and documented compliance with applicable laws and rules.

**Response:** We concur. Bureau staff members are developing policies and procedures that will ensure an orderly process dealing with low ranking QPDs and that each case is well documented. The policies and procedures will be implemented by December 31, 2009.

**Finding No. 5: The Bureau allowed some QPDs with the lowest quarterly financial condition rankings lengthy periods to meet the required increased collateral pledging levels.**

**Recommendation:** We recommend that the Department, by rule, establish the conditions under which a hardship request may be submitted by a QPD, and a maximum timeframe within which the transition to the required collateral level must be completed. Furthermore, the Department should develop written procedures that establish objective criteria for evaluating hardship requests.

**Response:** We concur. The Bureau is in the process of drafting changes to the administrative rules of the public deposits program that would establish the circumstances under which a QPD

**EXHIBIT A**  
**MANAGEMENT'S RESPONSE (CONTINUED)**

might make a hardship request, the objective criteria that would be considered in evaluating such requests, and the timeframe for rendering a decision on such requests. Additionally, any procedures that might be necessary in carrying out this process will be established in writing. Bureau staff members believe that the 125% and 200% collateral levels for lower ranked QPDs are punitive and unnecessary and are proposing legislative changes that will be pursued in the 2010 legislative session with an implementation date of July 1, 2010. The Bureau expects to begin the formal rulemaking process in November 2009 with an estimated completion date of July 1, 2010.

**COLLATERAL ADMINISTRATION**

**Finding No. 6: Bureau staff responsible for resolving custodial collateral reconciling items were also responsible for processing collateral transactions, resulting in conditions under which errors may occur and be concealed from timely detection. Additionally, custodial collateral reconciliations did not include Federal Home Loan Bank letters of credit and the resolution of reconciling items was not always timely.**

**Recommendation:** We recommend that the Bureau implement procedures whereby collateral reconciling differences are timely resolved by employees independent of collateral transaction processing and that letters of credit are included in the reconciliation process. Furthermore, to reduce input errors, we recommend that the Bureau implement an automated edit check that tests the ninth digit of CUSIP numbers.

**Response:** We concur. The reconciliation process will be amended to require that an independent financial examiner identifies reconciling items for the inventories of both the Chief Financial Officer's (CFO) custodians and the QPD custodians. Resolution of the reconciling items will continue to be performed by the transaction staff and transaction staff supervisors will verify items have been reconciled. Clear timeframes for completion of the resolution will be included in written desk-top procedures to ensure that appropriate actions are consistently performed by Bureau staff. Written policies and procedures will be implemented by January 31, 2010.

To ensure that Federal Home Loan Bank (FHLB) letters of credit are properly accounted for, monitoring of all incoming Letters of Credit will be performed by the Accountant Supervisor and/or Financial Administrator to confirm that letters of credit are initially recorded into the Bureau's Collateral Administration Program (CAP) in a timely manner. Also, in addition to an annual confirmation that is currently performed on all FHLB letters of credit, the Bureau will implement a quarterly reconciliation process. The initial quarterly reconciliation is scheduled for January 2010 for information as of December 31, 2009.

Implementation of an automated edit check that tests the ninth digit of Committee on Uniform Security Identification Procedures (CUSIP) numbers will require an application change to CAP. The CAP application change will be finalized by March 31, 2010.

**Finding No. 7: Bureau procedures for pricing collateral needed improvement as not all collateral was priced in a timely manner.**

**Recommendation:** We recommend that the Bureau implement procedures to ensure that alternative market prices are obtained in a timely manner when not provided by the service provider. In instances where pricing cannot be readily obtained, the QPD should be provided an

**EXHIBIT A**  
**MANAGEMENT'S RESPONSE (CONTINUED)**

opportunity to replace the collateral security. Additionally, the Bureau should establish a methodology to ensure that, prior to sending inventory files to the service provider for pricing, all applicable securities are correctly coded for updated pricing.

**Response:** We concur. Written procedures will be developed to ensure Bureau staff obtains alternative market prices in a timely manner. In cases where alternative market prices are not obtained or when appropriate actions are not taken by the QPD to replace the collateral, Bureau staff will not allow credit for the reported value of the unpriced collateral. The policies and procedures will be finalized by January 31, 2010.

It is anticipated that development of a new CAP report that identifies unpriced collateral will assist in the resolution of outstanding items. This report development will be finalized by March 31, 2010.

**PROGRAM REPORTING**

**Finding No. 8: The Bureau did not conduct a comparison of public deposit information reported by QPDs and public depositors for all those QPDs ranked in the lowest financial condition ranking category, based on established financial condition criteria of record on September 30.**

**Recommendation:** We recommend that the Department perform all the comparisons required by Section 280.05(16)(c), Florida Statutes.

**Response:** We concur. The Bureau has established a process by which the financial specialist will compare the public depositors disclosed in the annual reports of QPDs in the lowest financial condition category (0-15) to the annual reports filed by such public depositors. Public depositors will be reviewed to ensure that they disclose the QPD(s) in question. Public depositors identified by the QPD that fail to file an annual report will be contacted regarding their compliance and protection under chapter 280, Florida Statutes. Public depositors identified by the QPD which do file an annual report will also be contacted in order to verify records.

**INFORMATION TECHNOLOGY**

**Finding No. 9: Effective security controls include access controls that ensure that users have only the access privileges needed to perform their duties and users are restricted from performing incompatible functions. Our audit disclosed deficiencies in certain security controls.**

**Recommendation:** We recommend that the Department ensure that staff access privileges to CAP are commensurate with their job duties through a documented and periodic review of user access privileges.

**Response:** We concur. CAP security administration is being reviewed and will be a part of the department-wide Access Control Administration policy and procedure that is currently being evaluated to ensure compliance with appropriate security procedures. Access deficiencies that existed during the audit period have already been reviewed and corrected, for proper authority consistent with current job responsibilities.

**EXHIBIT A**  
**MANAGEMENT'S RESPONSE (CONTINUED)**

**Finding No. 10:** We noted certain other deficiencies in the Bureau's security controls related to the Collateral Administration Program, the details of which have been disclosed to Department management.

**Recommendation:** We recommend that the Department implement appropriate security controls to ensure the continued confidentiality, integrity, and availability of CAP data and IT resources.

**Response:** We concur. Additional security controls are being developed to protect the confidentiality, integrity and availability of data and IT resources department-wide. Analysis and implementation of additional security controls will be completed by March 31, 2010.