

# DEPARTMENT OF FINANCIAL SERVICES

## TREASURY INVESTMENT POLICIES AND PRIOR AUDIT FOLLOW-UP

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### Operational Audit



## CHIEF FINANCIAL OFFICER

Pursuant to Article IV, Sections 4(c) and 5(a) of the State Constitution, the Chief Financial Officer is an elected member of the Cabinet and serves as the chief fiscal officer of the State. Pursuant to Section 20.121(1), Florida Statutes, the Chief Financial Officer is the head of the Department of Financial Services. During the period of our audit the following individuals served as Chief Financial Officer:

Honorable Jeff Atwater      From January 2011

Honorable Alex Sink        July 2009 to December 2010

The audit team leader was Jacqueline Joyner, CPA, and the audit was supervised by Frank Belt, CPA. Please address inquiries regarding this report to Lisa Norman, CPA, Audit Manager, by e-mail at [lisanorman@aud.state.fl.us](mailto:lisanorman@aud.state.fl.us) or by telephone at (850) 487-9143.

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) 487-9175; or by mail at G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450.

**DEPARTMENT OF FINANCIAL SERVICES**

Treasury Investments and Prior Audit Follow-Up

**SUMMARY**

This operational audit of the Department of Financial Services (Department) focused on Division of Treasury (Treasury) investment policies, procedures, and disclosures. Our audit also included a follow-up on the findings included in audit report Nos. 2009-091, 2010-049, and 2010-074.

**TREASURY INVESTMENT POLICIES AND PROCEDURES**

**Finding No. 1:** The Treasury’s investment policies, procedures, and Web site disclosures could be improved by amending them to include certain provisions recommended by Government Finance Officer Association guidance.

**QUALIFIED PUBLIC DEPOSITORIES**

**Finding No. 2:** The Department should continue its efforts, in consultation with the Legislature, to affect changes to current Florida law that would allow for a functional Qualified Public Depository Oversight Board.

**Finding No. 3:** The Department had not adopted rules to enumerate the circumstances under which collateral pledging levels may differ from levels computed under existing law and rule.

**Finding No. 4:** The Department had not adopted rules identifying the conditions under which a Qualified Public Depository with low financial condition rankings may submit a request to delay the provision of additional collateral, criteria to evaluate such a request, or the time frame within which a hardship case must ultimately meet a required collateral level.

**UNCLAIMED PROPERTY**

**Finding No. 5:** As similarly noted in audit report No. 2009-091, subsidiary worksheets used to track and value abandoned securities continued to contain inaccurate and incomplete information.

**FINDINGS AND RECOMMENDATIONS**

**Treasury Investment Policies**

State law<sup>1</sup> requires full investment of all State moneys consistent with the cash requirements of the State. State law<sup>2</sup> also allows the Treasury to invest the moneys of certain other entities upon their request. The accounts of such entities are identified within Treasury’s Investment Pool as Special Purpose Investment Accounts (SPIA). As of May 31, 2011, the cost of the State Treasury investments totaled \$18.1 billion, with approximately \$11.2 billion related to State accounts and \$6.9 billion related to SPIA participants. The amounts invested by participants had increased significantly since June 30, 2009, when SPIA accounts totaled \$4.1 billion. As a significant amount of liquidity must be reserved for SPIA investor withdrawals, Treasury policy limits SPIA investments to 40 percent of the total value of the Pool’s shares.

The Treasury’s Pool consisted of three internally managed portfolios and one externally managed portfolio, each of which carried its own objectives, minimum investment amounts, qualified investments, and corresponding risks. The four portfolios included: a liquidity portfolio to meet the State’s disbursement needs; a bridge portfolio which allows for higher returns than the liquidity portfolio, but which is still focused on liquidity; an intermediate portfolio which is

<sup>1</sup> Section 17.57(1), Florida Statutes.

<sup>2</sup> Section 17.61(1), Florida Statutes.

structured to enhance long-term capital value, and an externally managed portfolio which is structured to enhance overall returns. In addition to a General Investment Policy, the Treasury maintains a separate written investment policy for each of these investment portfolios.

To evaluate the content of Treasury investment policies, we compared them to guidelines issued by the Government Finance Officers Association (GFOA), as well as to the policies of five other states.<sup>3</sup> The GFOA is a professional association of state, provincial, and local finance officers in the United States and Canada. The GFOA's mission is to enhance and promote the professional management of governments for the public benefit by identifying, developing, and promoting the use of financial policies and best practices. To that end, the GFOA has issued various types of best practices and advisory statements. GFOA best practices statements recommend or suggest certain enhanced techniques and strategies that state and local governments may employ, while GFOA advisories warn state and local governments of potential exposures to certain types of losses and identify steps that can be taken to mitigate the risks from such exposures.

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**Finding No. 1: Treasury Investment Policies, Procedures, and Web Site Disclosures**

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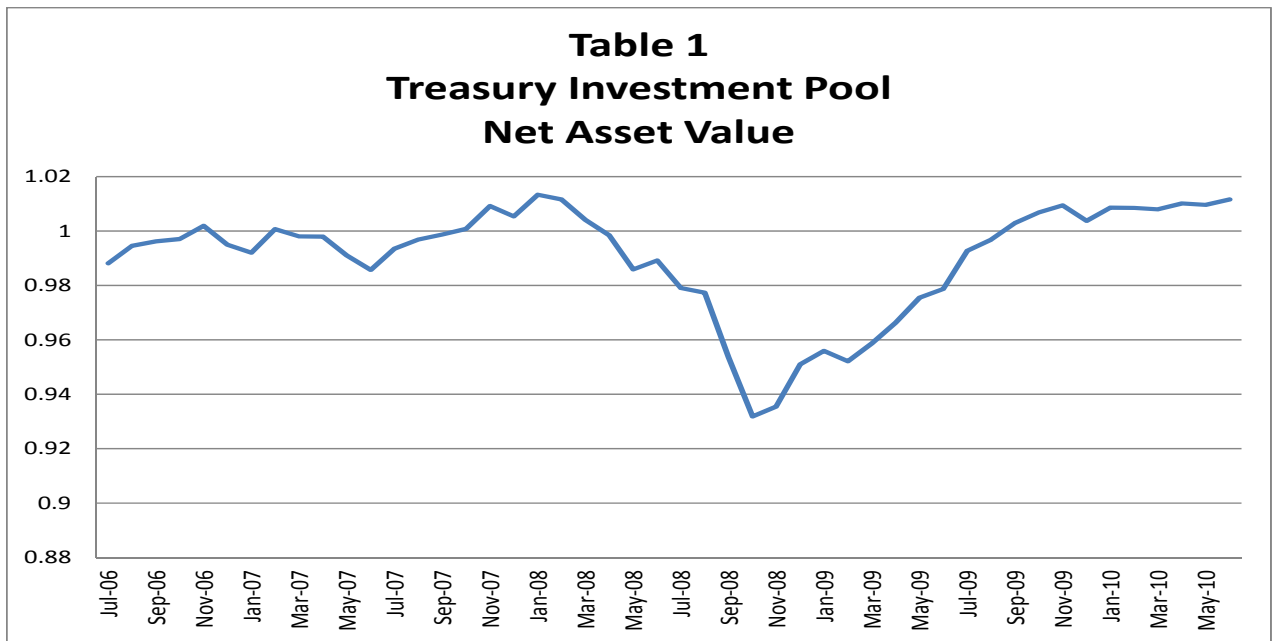
As noted under the **Treasury Investment Policies** heading above, to mitigate its investment risks and ensure compliance with State law,<sup>4</sup> the Treasury had adopted policies governing each of the Pool's investment portfolios. The Treasury had also established a Web site that provided certain pertinent investment information, such as a listing of all investments showing, for each holding, where applicable, asset type and description, coupon rate, maturity date, market value, par value, and cost, and reports on the performance of those investments, to current and potential investors and the public. The GFOA Best Practices statement, *Creating an Investment Policy*, most recently updated in 2010, states that a written investment policy is the single most important element of a government's investment program. The statement goes on to recommend that governments adopt a comprehensive written investment policy that, at a minimum, includes procedures to require periodic reviews of the investment policy and, when applicable, policy updates. To complement the best practices statement, GFOA issued a Sample Investment Policy (SIP). Our comparison of the Treasury's investment policies and Web site disclosures to the SIP and other applicable GFOA Best Practices statements and advisories, as well as to the published investment policies and Web sites of five other states, indicated that the Treasury's written policies and Web site could be improved by addressing the following issues:

- The GFOA Best Practices statement, *Considerations for Using Local Government Investment Pools*, provides that in order for entities to properly assess the pool's risk, the type of investment pool should be considered. To allow such a consideration, available pool information should describe the net asset value (NAV) type as, for example, a constant NAV type or a variable NAV type. Constant NAV investment pools typically invest in short-term investments, making constant NAV pools more suitable for investors seeking a high degree of liquidity and stability. Variable NAV investment pools typically invest in more long-term investments, making variable NAV pools more suitable for investors seeking to maximize returns. Our review disclosed that, while the Treasury's Web site did not characterize the Pool's NAV type, four of the five other states' investment Web sites provided such information. The Treasury's Web site indicated that the SPIA seeks to maintain a \$1.00 value. However, the data reflected in Table 1, below, is also included on the Treasury Web site and does show, particularly in recent years, what could be interpreted by investors as a variable NAV.

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<sup>3</sup> California, Ohio, Oregon, Texas, and Virginia.

<sup>4</sup> Section 17.57(1), Florida Statutes.



- Notwithstanding the variations in NAV, the Treasury has maintained a policy of valuing shares in the Pool, including those of SPIA participants, at \$1 per share. Our audit disclosed that the Treasury’s policy for valuing amounts deposited in the Pool at investment and divestment was not explicitly disclosed in its agreement with SPIA participants or on its Web site. We also noted that the Treasury did not have procedures in place outlining the steps to be taken should the net asset value of the pool decline significantly. Such procedures should include establishment and publication of the amount of the allowable NAV variation from \$1 per share, and in the event that NAV variations exceed the allowable amount, requirements to timely communicate such information to Department management, investment committee members, and SPIA participants so that corrective actions may be taken. To ensure fair treatment of all Pool participants, corrective actions may include, for example, revaluing all participant accounts to amounts based upon daily NAV valuations.
- Structured investments and derivatives are complex investments that can be used to enhance a portfolio’s overall rate of return. In their simplest form, structured investments are bundled investments such as asset-backed securities, mortgage-backed securities, and collateralized debt obligations. Examples of derivatives include investments such as, but not limited to, futures, options, and swaps. According to Treasury staff, at March 31, 2011, structured investments comprised approximately 14 percent of total Treasury investments, while derivatives comprised approximately 3 percent. In March 2010, GFOA elevated its former best practices document related to derivatives and structured investments to an advisory<sup>5</sup> that recommends state and local finance officers use extreme caution when considering such investments. To mitigate the risks associated with these investments, the advisory recommended governments implement certain investment policies and procedures. Our audit disclosed that the Treasury’s written investment policies and procedures could be improved by including the following provisions recommended by the GFOA advisory:
  - A written statement of the purpose and objectives for the use of derivatives. For example, the objectives might restrict the use of derivatives to hedging and specifically prohibit their use as speculative investments.
  - Guidelines and documentation requirements for counterparty selection.
  - Guidelines to review with ratings agencies the potential impacts of derivative use on the Pool.

<sup>5</sup> GFOA Advisory “Use of Derivatives and Structured Investments by State and Local Governments for Non-Pension Fund Investment Portfolios” (1994, 2002, and 2010).

- Monitoring procedures, including procedures regarding how often derivatives and structured investments will be priced and what pricing services will be used.
  - Required documentation of stress testing and scenario analyses for derivatives and structured investments. According to the advisory, every possible effort should be made to determine worst case scenarios when using derivatives or structured investments, as well as, the likelihood or probability of these outcomes and the government's ability to weather them.
- The GFOA SIP *Standards of Care* section recommends a standard-of-prudence provision be included as part of an investment policy. A standard-of-prudence provision generally states that investments shall be made with judgment and care, under prevailing circumstances, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of the capital as well as the probable income to be derived. Our review disclosed that, while the Treasury policies did not include such a provision, all five of the other states' investment policies provided some form of standard-of-prudence coverage.
- The GFOA SIP *Safekeeping and Custody* section includes the following recommended policy provisions: 1) all trades of marketable securities be executed through a delivery as opposed to a payment as a way to provide assurance that the securities have been deposited in an eligible financial institution prior to allowing the funds to be released; 2) securities be held by an independent third-party custodian and the custodianship be documented by safekeeping receipts; and 3) the safekeeping institution annually make available a copy of its most recent internal control report. Our review disclosed that while the Treasury's policies did not provide such information, three of the four applicable states' policies did.
- The GFOA SIP *Internal Controls* section provides guidance for creating an internal control policy, including provisions designating the investment officer as the party responsible for the internal controls and a requirement for annual review of the controls by an independent external auditor. Our review disclosed that four of the other five states' investment policies provided a general description of established internal controls and two included provisions requiring audits by independent external auditors. However, the Treasury's policies did not address internal controls or audits.
- The GFOA SIP *Reporting* section recommended the types of performance reports that should be prepared and provided to investment committee members and investment pool participants. The Reporting section indicates performance reports should include a listing of securities held at the end of the reporting period, the realized and unrealized gains or losses of all investments held during that period, the average weighted yield to maturity of portfolio investments as compared to applicable benchmarks, a listing of investments by maturity date, and the percentages of total portfolio investments held by investment type. Our review disclosed that, although it was the Treasury's practice to publish certain performance reports on the Treasury Web site, the Treasury's written policies did not specifically address performance reporting. We found that four of the other five states' investment policies addressed performance reporting.
- The GFOA SIP *Approval of Investment Policy* section recommends the investment committee's annual review and approval of the investment policy. We noted that only one of Treasury's five current investment policies required regular approval. An annual review requirement promotes a periodic objective review of investment policies and ensures that the policies endure as a living document that is constantly updated to reflect and disclose changing investment objectives, standards, strategies, and vehicles. We noted that three of the five other states required their respective investment committees to annually review and approve the state's investment policies.

While we found no indications that Treasury staff had not applied an appropriate standard of care or improperly managed or controlled Pool operations, the update of the Treasury's written investment policies and procedures, as applicable, to more fully address the matters described above, would provide a means for the Treasury to better communicate Treasury practice to investors and help to ensure that, in the event of staff turnover, policies and controls are applied uniformly. Treasury staff indicated that a new comprehensive investment policy will address several of the issues noted. The policy was under review as of June 2011. Further, the Treasury has contracted with

an investment consultant to provide services including a review of the Treasury’s investment guidelines and procedures, consultation on financial markets and the financial industry, and asset allocation recommendations.

Our comparison of the Treasury’s Web site content to that of the other five states also disclosed that the four applicable states’ Web sites identified the members of their Investment Committee, and two of the four applicable states’ Web sites included minutes from prior investment committee meetings. All five states also included copies of their investment policies on their respective Web sites. The Treasury’s Web site did not identify its Investment Committee members, include prior investment committee meeting minutes, nor include its investment policies. The Web site publication of such information would enhance Pool disclosure.

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**Recommendation:** We recommend that the Treasury amend its investment policies, procedures and Web site disclosures, as applicable, to incorporate coverage of share valuation, structured investments and derivatives, standards of care, safeguarding and custody of securities, internal controls, reporting, investment policy review and approval, Investment Committee members, and Investment Committee meeting minutes. We also recommend that the Treasury submit its policies, procedures, and Web site disclosures to its investment consultant for review and that the Department’s Inspector General be tasked with the conduct of periodic internal audits of the effectiveness of Pool internal controls.

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**PRIOR AUDIT FOLLOW-UP**

Except as discussed in the succeeding paragraphs, the Department had taken corrective actions to address the findings included in report Nos. 2009-091, 2010-049, and 2010-074.

**Qualified Public Depositories**

The Treasury, through its Bureau of Collateral Management, administers the Public Deposits Program (Program), a program established by the Florida Security for Public Deposits Act (Act) to protect the public deposits of governmental entities.<sup>6</sup> The Act outlines the powers and duties of the Chief Financial Officer (CFO) as well as the requirements that must be met by qualified public depositories (QPDs)<sup>7</sup> and public depositors.<sup>8</sup> Unless specifically exempted by law, the Act requires all public deposits<sup>9</sup> be made in a QPD. Public deposits include, but are not limited to, time deposit accounts, demand deposit accounts, and nonnegotiable certificates of deposit.<sup>10</sup>

QPDs must submit a monthly report to the CFO of the public deposits held and are required to secure public deposits by pledging collateral at a level commensurate with the amount of the QPD’s public deposits and the QPD’s financial stability. A QPD’s financial stability is determined by taking into consideration such factors as the QPD’s financial rating (a rating based on nationally recognized financial rating services information) and other CFO-established performance guidelines.<sup>11</sup> The most financially stable QPDs are required to pledge collateral equal

<sup>6</sup> Chapter 280, Florida Statutes.

<sup>7</sup> A qualified public depository is a bank, savings bank, or savings association that meets the requirements of Chapter 280, Florida Statutes, and has been so designated by the CF.

<sup>8</sup> A public depositor is the official custodian of funds for a governmental unit who is responsible for handling public deposits.

<sup>9</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 government, 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>10</sup> Section 280.02(23), Florida Statutes.

<sup>11</sup> Section 280.04, Florida Statutes.

to 25 percent of the public deposits held, while less financially stable QPDs must pledge collateral equal to as much as 200 percent of the public deposits held.

Pledged collateral can include obligations of the United States Government, Federal agencies, 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>12</sup>

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### **Finding No. 2: QPD Oversight Board**

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The QPD Oversight Board (Board) was created by law,<sup>13</sup> effective October 1, 2001, as a six-member Board to represent the interests of all QPDs in safeguarding the integrity of the Program and to prevent the realization of loss assessments that could be imposed on all QPDs upon the default or insolvency of a QPD.<sup>14</sup> In audit report No. 2010-049, we noted that since its creation, the Board had been largely inactive. The Board was appointed and an initial meeting was held in December 2001; however, because of concerns Board members had regarding possible conflicts of interest, no further Board meetings had taken place. We recommended that the Department, in consultation with the Legislature, take actions to comply with the law.

In response, the Department stated that it had drafted a change to Chapter 280, Florida Statutes, creating an advisory committee, which would eliminate the need for a QPD Oversight Board. The proposed change had not yet been submitted to the Legislature.

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**Recommendation:** We recommend that the Department continue to pursue the establishment of an advisory committee.

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### **Finding No. 3: QPD Financial Analysis and Pledging Levels**

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The Department's Bureau of Collateral Management (Bureau) utilized the Collateral Administration Program (CAP), an electronic application, to perform its daily business operations. Using ratings provided by nationally recognized rating services, CAP computed the QPD rankings and collateral pledging levels based upon statute and rule. According to Bureau procedures, financial analysts select those QPDs that require additional analyses and, depending on the circumstances in each case, the financial analysts had the ability to change the collateral pledging level to a different level than that computed by CAP. In audit report No. 2010-049, we noted that Department rules did not enumerate the circumstances under which analysts could change the collateral pledging levels from those computed by CAP.

Our current audit disclosed that staff had considered administrative rule changes to address our finding. However, according to Bureau personnel, no changes were made, pending the passage of proposed legislation that may have affected the need to make the changes. However, the proposed legislation did not pass.

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**Recommendation:** We again recommend that the Department amend its rules as necessary to enumerate the circumstances under which analysts may change the collateral pledging levels from those computed by CAP.

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<sup>12</sup> Section 280.13, Florida Statutes.

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

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

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**Finding No. 4: Hardship Requests**


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Department rules provide that QPDs with very low quarterly financial condition rankings must either withdraw from the Public Deposits Program or deposit collateral amounts equal to 200 percent of the public deposit amounts held into an eligible account designated by the CFO. State law<sup>15</sup> does not limit the CFO's discretion to specify when a hardship may exist or the time period in which additional collateral must be deposited to satisfy the 200 percent requirement. However, as similarly noted in report No. 2010-049, Department rules did not specify the conditions under which a QPD may submit a hardship request, the criteria to be used by the Department to evaluate such a request, or the maximum time frame within which a transition to a required collateral level must be completed. As similarly noted in finding No. 5, the Department had not pursued amendment of its administrative rules, pending legislative consideration of related proposed legislation, which ultimately did not pass.

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**Recommendation:** We again recommend that the Department establish by rule the conditions under which a hardship request may be submitted by a QPD, the criteria to be used by the Department to evaluate hardship requests, and the maximum time frame within which a transition to a required collateral level must be completed.

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**Unclaimed Property**

The Department, through its Bureau of Unclaimed Property (Bureau), administers the Florida Disposition of Unclaimed Property Act.<sup>16</sup> The Disposition of Unclaimed Property Act makes the Bureau responsible for receiving and maintaining accurate unclaimed property records, locating owners of reported unclaimed property accounts, safeguarding unclaimed property, and verifying the validity of unclaimed property account claims.

Unclaimed property consists of funds or other property that have remained inactive, unclaimed, or abandoned by an owner for some set period of time, usually 5 years. Examples of unclaimed property include dormant bank accounts, unclaimed insurance proceeds, stocks, dividends, mutual fund shares, uncashed checks, deposits, credit balances, and abandoned safe-deposit box contents. State law<sup>17</sup> requires holders of unclaimed property, which typically include institutions such as banks, investment firms, and insurance companies, to periodically report and remit unclaimed property items to the Bureau. The Bureau maintains the Unclaimed Property Management Information System (UPMIS), a searchable database of unclaimed property records that can be accessed from the Department's Unclaimed Property Web site.<sup>18</sup>

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**Finding No. 5: Investment Worksheets**


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In report No. 2009-091, we noted that UPMIS could not track and value abandoned securities that were being held by outside holders. To compensate, the Bureau used investment worksheets as a subsidiary record-keeping system to track and value the abandoned securities. Our prior audit also disclosed that a large portion of the 60 investment worksheets we tested (over 70 percent) contained inaccurate and incomplete information. The inaccuracies and incomplete information generally went undetected because the Bureau had not performed periodic reconciliations of relevant UPMIS data to the corresponding investment worksheet data.

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<sup>15</sup> Section 280.04, Florida Statutes.

<sup>16</sup> Chapter 717, Florida Statutes.

<sup>17</sup> Section 717.117, Florida Statutes.

<sup>18</sup> [www.fltreasurehunt.org](http://www.fltreasurehunt.org).

As of March 10, 2011, there were 341 active investment worksheets showing securities with a total recorded fair value of approximately \$2.5 million. Our follow-up procedures disclosed that UPMIS had not been updated to facilitate the management of abandoned securities held by outside holders. Our follow-up procedures also disclosed that the Bureau had not performed periodic reconciliations of UPMIS data to the investment worksheets and had not updated procedures to require such reconciliations. In response to our audit inquiries, Bureau personnel indicated that they were still in the process of performing the abandoned security reconciliations. Without reconciliations, management cannot provide sufficient assurances that the worksheets are complete and accurate. Our audit also disclosed that much of the information contained in the investment worksheets continued to be inaccurate and incomplete. We tested the completeness and accuracy of 5 investment worksheets with asset fair values totaling \$837,651 (33 percent of the total fair value recorded on the 341 active investment worksheets). Based on our review of relevant investment statements or, when such statements were not available, published market prices, the actual fair value of the assets on the 5 worksheets totaled \$524,073, a difference of \$313,578 (37.4 percent). Maintaining accurate fair value information for abandoned securities is necessary for both account management and financial statement reporting.

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**Recommendation:** We again recommend that the Bureau reconcile all investment worksheets to UPMIS. Additionally, the Bureau should continue its efforts to determine the feasibility of making changes to UPMIS to accommodate the tracking and valuation of investments held by outside holders. Additionally, the Bureau should ensure that investments are appropriately valued.

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### 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 Division of Treasury's investment policies and procedures. The overall objectives of the audit were:

- To evaluate whether selected investment policies, procedures, and guidelines were consistent with available information describing best practices.
- To evaluate whether participant agreements and the Treasury Web-site provided sufficient information on the nature and types of investments.
- To determine whether the Treasury properly allocated interest income.
- To identify statutory and fiscal changes that may be recommended to the Legislature pursuant to Section 11.45(7)(h), Florida Statutes.

Our audit also included steps to determine whether management had corrected, or was in the process of correcting, all applicable deficiencies disclosed in the prior audits (report Nos. 2009-091, 2010-049, and 2010-074).

In conducting our audit we:

- Obtained an understanding of selected internal controls and evaluated the processes and procedures related to areas within the scope of the audit by:

- Interviewing selected Department personnel.
  - Observing Department processes.
  - Examining Department documentation and records.
- Performed inquiries and inspections relating to the establishment and terms of the Treasury's investment program review agreement to determine whether the Treasury had secured adequate review of its investment program to include an evaluation of investment performance and compliance with Treasury investment policies, and periodic reviews of Treasury investment policies.
- Reviewed Treasury investment policies for compliance with selected State laws and rules.
- Determined whether the Treasury had established effective compliance monitoring procedures by testing Treasury processing of five daily compliance reports judgmentally selected from daily compliance reports provided by the custodian during the period July 2009 through February 2011.
- Performed inquiries and inspections of documents sufficient to gain an understanding of the Treasury's interest allocation process and SPIA investment restrictions. Reviewed Treasury interest allocation procedures for compliance with applicable laws and rules.
- Compared Treasury investment policies with those of five other states. Also, compared Treasury investment policies to GFOA guidance documents, *Considerations for Using Local Government Investment Pools* and *Creating an Investment Policy*, the GFOA Sample Investment Policy, and the GFOA advisory entitled *Use of Derivatives and Structured Investments by State and Local Governments for Non-Pension Fund Investment Portfolios*.
- Compared the content and detail of participant agreement and the Treasury's Web site investment disclosures to the disclosures included on the Web sites of government investment pools of the states of California, Ohio, Oregon, Texas, and Virginia.
- Reviewed laws and rules governing the Public Deposits Program along with updated policies and procedures, collateral reconciliations, and documentation supporting the review and approval of public depository quarterly rankings.
- Performed an analysis of claims filed by property locators during the period July 2009 through February 2011 to determine whether the Department had appropriately denied the payment of claims filed by unclaimed property locators who contracted with owners of unclaimed property before the 45 day time frame prescribed by Section 717.1381, Florida Statutes, had expired.
- Determined whether Bureau of Unclaimed Property investment worksheets were updated to reflect the fair value and any dividends received at December 31, 2010, by testing the accuracy of the values included on five investment worksheets.
- Performed various other procedures, including analytical procedures, as necessary, to accomplish the objectives of the audit.
- Communicated on an interim basis with applicable Department officials to ensure the timely resolution of issues involving controls and noncompliance.
- Prepared and submitted for management response the findings and recommendations that are included in this report and which describe those matters requiring corrective actions.

**AUTHORITY**

Section 11.45, Florida Statutes, requires that the Auditor General conduct an operational audit of each State agency. 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 September 23, 2011, the Chief Financial Officer concurred with our audit findings and recommendations. The Department's response is included as **EXHIBIT A**.

**EXHIBIT A  
MANAGEMENT'S RESPONSE**



CHIEF FINANCIAL OFFICER  
**JEFF ATWATER**  
STATE OF FLORIDA

September 23, 2011

Mr. David W. Martin  
Auditor General  
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, Treasury Investment Policies and Prior Audit Follow-Up*.

If you have any questions concerning this response, please contact Ned Luczynski, Inspector General, at (850) 413-4960.

Sincerely,

A handwritten signature in blue ink that reads "Jeff Atwater".

Jeff Atwater

JA:LI

Enclosure

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

**Florida Department of Financial Services  
Operational Audit - Treasury Investment Policies and  
Prior Audit Follow-up**

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**DIVISION OF TREASURY**

**Finding No. 1: Treasury Investment Policies, Procedures, and Web Site Disclosures**

The Treasury’s investment policies, procedures, and Web site disclosures could be improved by amending them to include certain provisions recommended by Government Finance Officer Association guidance.

**Recommendation:** We recommend that the Treasury amend its investment policies, procedures and Web site disclosures, as applicable, to incorporate coverage of share valuation, structured investments and derivatives, standards of care, safeguarding and custody of securities, internal controls, reporting, investment policy review and approval, Investment Committee members, and Investment Committee meeting minutes. We also recommend that the Treasury submit its policies, procedures, and Web site disclosures to its investment consultant for review and that the Department’s Inspector General be tasked with the conduct of periodic internal audits of the effectiveness of Pool internal controls.

**Response:** We concur. Prior to the start of this audit, Treasury staff was actively working to finalize a Comprehensive Investment Policy (CIP). The purpose of the CIP is to update the individual portfolios’ investment policies and combine them into one overall policy. The CIP also documents the Treasury’s investment operating structure and general operational policies. In developing the CIP, Treasury staff worked closely with the Treasury Investment Committee and our external investment consultant. Based on recommendations from the Investment Committee and our external investment consultant, the CIP was approved effective August 26, 2011, and has been published on the Treasury’s Web site.

Providing an appropriate level of investment disclosures is a dynamic and continuous process. Over the past year, Treasury staff have greatly clarified and enhanced the investment information and disclosures provided on the Treasury Web site and will continue with these efforts.

Treasury staff, working with the Treasury Investment Committee and external investment consultant, will conduct further analysis of our Comprehensive Investment Policy, investment procedures, and Web site disclosures and implement any further changes deemed appropriate.

Pursuant to Section 20.055, Florida Statutes, the Office of Inspector General establishes annual and long-term audit plans based on the results of an annual risk assessment. The Department’s Inspector General will conduct periodic internal audits of Treasury’s internal controls consistent with the results of such risk assessments.

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

**PRIOR AUDIT FOLLOW-UP**

**DIVISION OF TREASURY**

**Finding No. 2: QPD Oversight Board**

The Department should continue its efforts, in consultation with the Legislature, to affect changes to current Florida law that would allow for a functional Qualified Public Depository Oversight Board.

**Recommendation:** We recommend that the Department continue to pursue the establishment of an advisory committee.

**Response:** We concur. Treasury staff is working with the Florida Bankers Association (FBA) concerning revisions to Chapter 280, Florida Statutes. The proposed changes will include the removal of the Bank Oversight Board and the reestablishment of the Qualified Public Depository Advisory Board. The Department will bring these changes to the Legislature’s attention in the upcoming session.

**Finding No. 3: QPD Financial Analysis and Pledging Levels**

The Department had not adopted rules to enumerate the circumstances under which collateral pledging levels may differ from levels computed under existing law and rule.

**Recommendation:** We again recommend that the Department amend its rules as necessary to enumerate the circumstances under which analysts may change the collateral pledging levels from those computed by CAP.

**Response:** We concur. We will revise the appropriate Rule to enumerate the circumstances under which analysts may change the collateral pledging levels from those computed by CAP. However, we will delay this action pending the anticipated revision of Chapter 280, Florida Statutes, in the upcoming legislative session. At that time, we will include the Rule change as part of a larger rulemaking initiative we will undertake to implement the expected statutory revisions.

**Finding No. 4: Hardship Requests**

The Department had not adopted rules identifying the conditions under which a Qualified Public Depository with low financial condition rankings may submit a request to delay the provision of additional collateral, criteria to evaluate such a request, or the time frame within which a hardship case must ultimately meet a required collateral level.

**Recommendation:** We again recommend that the Department establish by rule the conditions under which a hardship request may be submitted by a QPD, the criteria to be used by the Department to evaluate hardship requests, and the maximum time frame within which a transition to a required collateral level must be completed.

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

**Response:** We concur. We will revise the appropriate Rule to establish the conditions and guidelines for the hardship requests and maximum time frames for completion of the required actions. However, we will delay this action pending the anticipated revision of Chapter 280, Florida Statutes, in the upcoming legislative session. At that time, we will include the Rule change as part of a larger rulemaking initiative we will undertake to implement the expected statutory revisions.

**DIVISION OF ACCOUNTING AND AUDITING**  
**BUREAU OF UNCLAIMED PROPERTY**

**Finding No. 5: Investment Worksheets**

As similarly noted in audit report No. 2009-091, subsidiary worksheets used to track and value abandoned securities continued to contain inaccurate and incomplete information.

**Recommendation:** We again recommend that the Bureau reconcile all investment worksheets to UPMIS. Additionally, the Bureau should continue its efforts to determine the feasibility of making changes to UPMIS to accommodate the tracking and valuation of investments held by outside holders. Additionally, the Bureau should ensure that investments are appropriately valued.

**Response:** The Bureau concurs. The Bureau has worked diligently with its new contracted securities custodian to liquidate as many securities as possible, resulting in a decrease in the number of investment worksheets from 341 to 11. The Bureau will review its current procedures and make changes to require periodic reconciliation and proper valuation of the investment worksheets. Lastly, the Bureau will continue its efforts to determine the feasibility of making changes to the Unclaimed Property Management Information System (UPMIS) to accommodate the tracking and valuation of investments held by outside holders. This enhancement is one of many UPMIS-related priorities for the Bureau.