



Dave Yost
Auditor of State

From: Auditor of State's Center for Audit Excellence
To: All IPA Firms
Subject: AOS State Region Memo over TOS - OPCS
Date: May 25, 2018

The annual report (memo) over the Office of the Ohio Treasurer of State (TOS) – Ohio Pooled Collateral System (OPCS) (referred to in Ch. 2-9 of the 2018 OCS) from the Auditor of State (AOS) State Region is now available (attached).

Below is the guidance we sent to AOS auditors relating to this memo. IPAs should determine the audit implications for their specific audits.

Auditors should review and include this memo in the working papers for audits where the auditee had significant deposits with financial institutions enrolled in the Ohio Pooled Collateral System (OPCS). To aide in consistency, auditors should understand the implications of the noted errors as follows:

- **Issue 1 summary:** The error indicates that the OPCS did not have controls in place in order to allow the State Region to obtain sufficient assurance over the accuracy of the daily bank information.
 - **Implication:** OCS 2-9 indicated this assurance would be provided by this memo; however, since it is unattainable via central testing, auditors should perform their own comparisons. Auditors should compare bank balance information in the OPCS to available confirmations (and/or bank statement information) and investigate any discrepancies with the client, with CFAE, and if necessary with the Financial Institution and the TOS (administrator of OPCS).
- **Issue 2 summary:** Fifth Third Bank was identified as non-compliant at fiscal year-end because their collateral was only equal to 91.5% of uninsured deposits rather than the required 102%. However, the deficiency was promptly corrected the next day.
 - **Implication:** Entities with uninsured deposits in Fifth Third bank at 12/29/17 (last week day of the fiscal year, where the issue was identified) should include in the custodial credit risk footnote disclosure language similar to the following:

“At December 31, 2017, the \$xx,xxx of [Entity]’s bank balance of \$ xxx,xxx was exposed to custodial credit risk. Certain timing issues related to fluctuations in depository balances contributed to the uncollateralized balance. These insufficiencies were corrected the next business day.”

Additionally, auditors should consider this situation (and others like it) as non-compliance, and report it in the schedule of findings or the management letter depending on the following:

1. Is it an isolated occurrence (were other instances noted throughout the year)? There may be issues at a bank on a given day that impact some entities and not others depending on a multitude of factors, so auditors will need to observe their auditee accessing the OPCS for some other days during the fiscal year to determine this.
2. Was it corrected immediately (i.e. within one business day)? In this instance the answer is yes.
3. Is the uncovered balance significant (based on applicable benchmarks)? If the uncovered balance is less than trivial, no non-compliance will need to be reported.

Generally, it can be limited to a Management Letter comment if the uncovered balance is greater than trivial, but it is isolated and corrected immediately. However, if the uncovered balance is material, or it persists longer than one day and/or it happens multiple times throughout the year, then it likely should be elevated to the Schedule of Findings.

- **Issue 3 summary:** Accrued interest was not properly calculated for some pledged collateral.
 - **Implication:** None. The effect of the identified issues, while noteworthy to the OPCS as a whole, is not expected to materially impact any individual entities or auditor's respective risk/ non-compliance considerations.

The remainder of the guidance and procedures in OCS 2-9 are unchanged (with one exception being the first error noted above), and should be followed during annual audits.

Questions related to the Ohio Pooled Collateral System can be directed to Jesse Carroll at JMCarroll@ohioauditor.gov.



Dave Yost • Auditor of State

MEMORANDUM

TO: Bob Hinkle, Chief Deputy Auditor
FROM: Debbie Liddil, Chief Auditor, State Region
DATE: May 23, 2018
RE: Office of the Ohio Treasurer of State (TOS) – Ohio Pooled Collateral System (OPCS)

As requested by senior management, the State Region performed audit procedures over OPCS for the period of July 1, 2017 through December 31, 2017 to support local audits. The procedures and results of the work performed are summarized below.

1. Control Procedures: We completed a systems narrative and determined key controls over the OPCS had been implemented/placed in operation. Control procedures were tested over application approval, collateral position, collateral compliance, and collateral sufficiency. The specific automated controls related to *RCEC Part 5.2 Development of New Applications & Systems* were tested by the ISA auditors. *Note: The automated control testing was performed as part of the SFY17 annual TOS audit and extended through the Go-Live date of July 1, 2017.*
2. Substantive Procedures:
Note: Procedures were performed over the collateral only. Confirmation of the deposit balances should be completed at the local level.
 - Collateral – As of December 31, 2017, 41 financial institutions (FI) were enrolled** in OPCS. We obtained the Pooled Collateral report, which included the collateral sufficiency analysis for the main pools of all 41 financial institutions in OPCS, and scanned the report to ensure all the pools were collateralized in accordance with their collateral floor (all at 102% as of December 31, 2017).
 - We then selected a sample of 25 pledged securities out of 2,425 total pledged securities as of December 31, 2017 (note: we selected each security from a different FI) and tested to ensure:
 - A. The collateral was appropriately priced.
 - B. The securities pledged as collateral were eligible per ORC 135.182(E)
 - Perfected Security Interested – Perfecting of the security interest is established as part of the application process. AOS Legal reviewed TOS' legal opinion and agreed that the application and executed security agreement sufficiently addressed the perfecting of the security agreement.

** - *The enrollment date and the go-live date are the same.*

3. Conclusion

We noted the following errors:

- The TOS had planned procedures to confirm the deposit balance reported by the FI via negative confirmation by the public unit on a periodic basis. However, due to the very limited participation of the public units in OPCS as of the period end date, TOS management postponed the confirmation until September 2018.
- For one of 41 (or 2.4%) of the OPCS pools, the financial institution did not pledge sufficient collateral to meet the collateral floor requirement. The pledged collateral was 91% of uninsured deposits or 11% less than the required 102%. The financial institution (Fifth Third) corrected the deficiency on the next business day.
- For three of 25 (or 12.0%) pledged securities tested, the accrued interest was not properly calculated, resulting in a total overstatement of \$30,850 for the pledged collateral value. *Note: the total variance amount was less than 2% of the total collateral price for each of the three securities.*

No other errors were identified during testing.