AUDITOR OF STATE

Annual Financial Report

June 30, 2017

LEGISLATIVE JOINT AUDITING COMMITTEE

AUDITOR OF STATE
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Arkansas

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Senate Chair
Sen. Lance Eads
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House Vice Chair

Roger A. Norman, JD, CPA, CFE, CFF
Legislative Auditor

LEGISLATIVE JOINT AUDITING COMMITTEE
ARKANSAS LEGISLATIVE AUDIT

INDEPENDENT AUDITOR'S REPORT

Auditor of State
Legislative Joint Auditing Committee

Report on the Financial Statements

We have audited the accompanying financial statements of the major fund of the Auditor of State, an office of Arkansas state government, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Auditor of State's departmental financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the major fund of the Auditor of State as of June 30, 2017, the respective changes in financial position, and the respective budgetary comparison for the general fund for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As indicated above, the financial statements of the Auditor of State are intended to present the financial position, the changes in financial position, and budgetary comparisons of only that portion of the major fund of the State that is attributable to the transactions of the Auditor of State. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2017, the changes in its financial position, and budgetary comparisons for the year then ended, in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

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Other Matters

The Governmental Accounting Standards Board requires that a Management's Discussion and Analysis be presented to supplement government-wide financial statements. However, as discussed in the "Emphasis of Matter" paragraph above, the financial statements of the Auditor of State are only for the specific transactions and activity of the Agency and not for the State as a whole. Therefore, the Management's Discussion and Analysis is not required to be presented for the Auditor of State individually. Our opinions on the departmental financial statements is not affected by the omission of this information.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Auditor of State's departmental financial statements. The Schedule of Selected Information and Other General Information are presented for purposes of additional analysis and are not a required part of the departmental financial statements.

The Schedule of Selected Information and Other General Information have not been subjected to the auditing procedures applied in the audit of the departmental financial statements, and accordingly, we do not express an opinion or provide any assurance on this information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards,* we have also issued our report dated October 10, 2018, on our consideration of the Auditor of State's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Auditor of State's internal control over financial reporting and compliance.

ARKANSAS LEGISLATIVE AUDIT

Roger Norman

Roger A. Norman, JD, CPA, CFE, CFF
Legislative Auditor

Little Rock, Arkansas
October 10, 2018
SA0405917

Arkansas

Sen. Jimmy Hickey, Jr.
Senate Chair
Sen. Lance Eads
Senate Vice Chair

Rep. Richard Womack
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LEGISLATIVE JOINT AUDITING COMMITTEE
ARKANSAS LEGISLATIVE AUDIT

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

INDEPENDENT AUDITOR'S REPORT

Auditor of State
Legislative Joint Auditing Committee

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the major fund of the Auditor of State (the "Agency"), an office of Arkansas state government, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Auditor of State's departmental financial statements, and have issued our report thereon dated October 10, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Agency's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control. Accordingly, we do not express an opinion on the effectiveness of the Agency's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies; therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying Schedule of Findings and Responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings and Responses to be significant deficiencies [2017-1, 2017-2, 2017-3, and 2017-4].

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Agency's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and are described below in the Schedule of Findings and Responses as items 2017-1, 2017-2, 2017-3, and 2017-4.

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SCHEDULE OF FINDINGS AND RESPONSES

2017-1 Between September 2017 and June 2018, the Agency paid $40,171 for 24 fraudulent unclaimed property claims and prevented the payment of an additional $20,301 for 17 fraudulent unclaimed property claims after identifying a scheme by unknown perpetrator(s) to defraud the Agency through the apparent use of stolen identities. The Agency discovered this matter on June 26, 2018, but did not notify ALA until July 11, 2018, in noncompliance with Ark. Code Ann. § 25-1-124, which requires that ALA be notified of theft of property within five business days. The matter has been forwarded to the Arkansas State Police for investigation.

Recommendation: We recommend that the Auditor of State's office adhere to Ark. Code Ann. § 25-1-124 and inform ALA as quickly as possible when any theft of state property occurs.

Management Response: *The Auditor of State Office (AOS) detected suspicious activity which led to the identification of an international identity theft scheme. AOS alerted law enforcement authorities. Our own internal investigation was thorough and complete, and so much so that law enforcement authorities have not required any further information or assistance – all the while using evidence we provided to identify and locate a prime suspect. Law enforcement is currently working with UK Metropolitan Police Services as a part of an ongoing investigation. Further, because of our diligence, our office has been able to help several other States find similar fraud in their unclaimed property programs. We contacted ALA as soon as practical.*

2017-2 Numerous unclaimed property records for stock securities are inaccurate, resulting in claimants being either overpaid or underpaid when collecting their property. Ark. Code Ann. § 18-28-210(b) states that upon payment or delivery of property to the administrator, the State assumes custody and responsibility for the safekeeping of property. The Agency held $17.6 million in unclaimed property in the form of stock securities at June 30, 2017.

The Agency has comingled stock security dividend payments among the owners of this unclaimed property. During our initial testing, we noted the current unclaimed property manager recorded 1,092 transaction errors to the accounts of unclaimed property owners, affecting 19,682 shares of stock. Subsequent testing revealed numerous additional errors made to the accounts of other property owners. Haphazard and backdated attempts at error corrections resulted in inaccurate records and inaccurate distribution of dividends based on incorrect stock records. The extent of the errors and the passage of time since they occurred make it difficult to determine the number or dollar amount of total errors.

The errors made were compounded by a lack of management oversight, the absence of reconciliations between Agency records and the security custodian's records, and a lack of segregation of duties that allowed the same employee to process and post stock transactions as well as record subsequent error corrections. Specifically, we identified instances in which individuals making claims were given cash, instead of the stock to which the claimants were entitled. Additionally, the existing inaccuracy of unclaimed property records continues to cause distribution of stock dividends to the wrong property owners' accounts.

Ark. Code Ann. § 18-28-212 releases the Agency from tracking unclaimed security market value, dividends, and interest for individual property owners of unclaimed stock after three years from the original date it was received. Thereafter, the Agency may liquidate the stock, fix the dollar value that the owner can claim, and allow the State to earn interest on the principal of the liquidated stock. Historically, the Agency has sold the stock it has held for over three years on an annual basis. The Agency did not sell the stock it held over three years in fiscal year 2018, depriving the State of interest income that would have been earned.

Recommendation: We recommend the Agency implement the following procedures to maintain the integrity of the unclaimed property stock records:

- Develop internal control procedures to ensure all unclaimed property transactions recorded have been reviewed by someone not involved in the process and segregate the duties of processing, posting, and correcting transactions to separate individuals.
- Perform monthly reconciliations between Agency records and the security custodian's records.
- Record transactions timely to ensure Agency records agree with the custodian's records.
- Ensure identified errors are corrected timely to prevent misapplied dividends issued on stock.
- Sell all stock that has been in the Agency's possession for more than three years so that the State is not deprived of interest income.

The degradation of the unclaimed property security records continues to compound itself with the passage of time, resulting in additional overpayments or underpayments to those claiming their property.

Management Response: *The Unclaimed Property manager incorrectly posted transaction details of a securities sell-off. Upon discovering his mistake, he worked with the software vendor to systematically, not "haphazardly", identify and correct the mistakes. We recognized the mistake and continue to implement succession training and procedure documentation so as to mitigate a future occurrence. ALA recommendations reflect the corrective processes AOS had put into place prior to the start of this audit.*

However, the majority of this finding is mischaracterized or inaccurately depicted because of ALA's elementary understanding of the management of stocks and securities in an unclaimed property database. Our office attempted to educate ALA with regard to the mistake and how we worked to correct it. For example in the second paragraph, ALA states, "1092 transaction errors". However, it was only one batch-transaction error which ultimately affected 15 property owners prior to corrections being made. In this same example, ALA identified 19,682 shares being impacted, but actually only 302 shares were impacted.

In the course of this audit we discovered that ALA had never conducted an in-depth audit of our stocks and securities prior to this year. Moving forward, it is our respectful opinion that ALA provide stocks/securities training to their auditors for more accurate audits.

Audit Note: In August 2018, ALA supervisory staff met with Agency management during audit fieldwork to discuss the severity of errors ALA staff was finding in the Agency's property owner records during testing. ALA staff also notified the Agency of examples of specific errors to accounts found during testing. ALA did not tabulate the total number of property owners affected by Agency errors because of the numerous errors discovered. The Agency's assertion that only 15 property owners were impacted by Agency errors is inaccurate. Many of the discrepancies tested by ALA during audit fieldwork resulted in the discovery of additional errors to property owner accounts. ALA noted the Agency recorded 5,175 "adjustment/correction" transactions to property owners' accounts between July 2016 and June 2018. Furthermore, ALA discovered that 1,401 of the "adjustments/corrections" were made between 6 and 12 months after the error was first recorded, and an additional 1,699 were made more than 12 months after the error was recorded. The time lapse between when an error was recorded and when it was "adjusted/corrected" would result in lost dividends to the property owner affected, if a dividend was declared. Backdating "adjustments/corrections" makes it appear the correction was made the same day the error was recorded, resulting in the fact that owners of unclaimed stock and securities did not receive all the dividends due to them. The Agency had not implemented all of the corrective actions recommended by ALA as of the end of audit fieldwork in October 2018.

ALA routinely adapts auditing procedures from one audit to another, and because something was not tested in the past does not preclude it from being reviewed in the future. New audit software technology continues to improve ALA's ability to examine large data sets, and ALA staff will continue to adjust auditing procedures as deemed necessary. Until the Agency introduces and adheres to fundamental controls and procedures, property owner accounts and the State remain at a high risk of loss of assets.

2017-3 Agency professional service expenditures exceeded authorized appropriations by $47,233 due to costs totaling $52,633 that the Agency incurred with a vendor hired to assist in the management of unclaimed property. These expenditures circumvented controls in AASIS because the costs were netted against proceeds from the sale of stock securities. Invoices, journal entries, and other related documentation for these transactions do not exist.

Recommendation: We recommend the Agency obtain invoices for all services provided by vendors, limit expenditures to amounts appropriated, and process all expenditures incurred through AASIS.

Management Response: *It is our regular practice to obtain invoices from vendors and process expenditures through AASIS. This was an isolated incident AOS discovered and rectified immediately.*

Audit Note: The Agency's overpayment to this vendor was not an isolated incident. The Agency circumvented expenditure controls in AASIS to pay this vendor on six separate occasions between February and October 2017. The Agency did not start correctly processing expenditures for this vendor until after fiscal year 2017 ended. The Agency had not taken corrective action for the six occasions noted as of the end of audit fieldwork in October 2018.

2017-4 Failure to maintain accurate records, an insufficient review process, and inaccurate reporting in AASIS resulted in the following errors:

- Unclaimed property assets held by third-party custodians were understated by $569,151.
- Net unclaimed property received was understated by $418,115.
- Interest income on unclaimed property holdings was understated by $410,425.

Recommendation: We recommend the Agency maintain proper records of all transactions processed within the Agency and develop a review process to ensure all transactions are properly calculated and accurately recorded in AASIS.

Management Responses: *All funds and account balances are correct and monies accounted for. Upon AOS discovering these data-entry mistakes, adjustments were made. A new Employee was hired in Unclaimed Property who prepares the calculations and maintains proper documentation for the transactions in question. The Unclaimed Property Manager reviews those calculations and documentation for accuracy and approves the transactions to be recorded in AASIS. Additionally, the Accounting Manager reviews transactions for accuracy before being posted to AASIS.*

Audit Note: The Agency was notified of these errors during ALA's preliminary audit exit conference in September 2018. The Agency could not provide support for these year-end account balances, and these amounts were not corrected at the end of audit fieldwork in October 2018.

Agency's Response to Findings

The Agency's response to the findings identified in our audit, are described above. The Agency's response was not subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. However, pursuant to Ark. Code Ann. § 10-4-417, all reports presented to the Legislative Joint Auditing Committee are matters of public record, and distribution is not limited.

ARKANSAS LEGISLATIVE AUDIT

Jon Moore

Jon Moore, CPA, CFE, CFF
Deputy Legislative Auditor

Little Rock, Arkansas
October 10, 2018

AUDITOR OF STATE
BALANCE SHEET – GOVERNMENTAL FUND
JUNE 30, 2017

Exhibit A

		General Fund
ASSETS		
Cash and cash equivalents	$	83,207,461
Unclaimed property awaiting distribution:		
Certificates of deposit		13,727,428
Assets held by third-party custodian		17,574,894
Accounts receivable		29,931
Due from other state agencies		128
Prepaid expenses:		
Maintenance contracts		32,501
Postage		3,000
Security		179
Subscriptions		1,182
TOTAL ASSETS	$	114,576,704
LIABILITIES AND FUND BALANCE		
Liabilities:		
Accounts payable - vendors	$	87,835
Due to other state agencies		39,453
Accrued and other current liabilities		1,318,603
Unclaimed property claims payables		93,457,095
Total Liabilities		94,902,986
Fund Balances:		
Nonspendable		
Prepaid expenses		36,862
Committed for program requirements		301,448
Assigned		21,928
Unassigned		19,313,480
Total Fund Balances		19,673,718
TOTAL LIABILITIES AND FUND BALANCES	$	114,576,704

The accompanying notes are an integral part of these financial statements.

AUDITOR OF STATE

Exhibit B

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE – GOVERNMENTAL FUND

FOR THE YEAR ENDED JUNE 30, 2017

	General Fund
REVENUES	
Real estate transfer tax	$ 162,707
Fees for continuing education	82,994
Unclaimed property received/distributed	12,804,968
Investment earnings	7,442,584
Collections for district judges' salaries	2,813,810
TOTAL REVENUES	23,307,063
EXPENDITURES	
Personal services - payroll	57,117,158
Employee benefits - matching	14,803,471
Communication and transportation of commodities	127,174
Printing and advertising	89,135
Repairing and servicing	147,742
Utilities and rent	260,852
Travel and subsistence	503,282
Professional services	18,974
Insurance and bonds	3,167
Other expenses and services	54,091
Commodities for household, office, and institutions	86,498
Assistance, grants, and aid	4,400
Refunds, taxes and claims	379
Capital outlay	77,613
TOTAL EXPENDITURES	73,293,936
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(49,986,873)

AUDITOR OF STATE

Exhibit B

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE – GOVERNMENTAL FUND

FOR THE YEAR ENDED JUNE 30, 2017

OTHER FINANCING SOURCES (USES)		
Inter-agency transfers:		
General/Special revenue allocation	$	67,500,000
Uniform filing fees and court costs		1,223,210
Funding provided by County Aid Fund (MLC)		5,010,011
Excess unclaimed property transferred to General Revenue Allotment Fund (AGA)		(20,593,851)
Excess mineral proceeds transferred to County Aid Fund (MLC)		(1,500,000)
Transfer to the Constitutional Officers Fund (Ark. Code Ann. § 19-5-205)		(3,483,356)
Unclaimed property expense reimbursement to State Central Services Fund (Ark. Code Ann. § 18-2		(1,040,166)
Transfers to the Administration Office of the Courts		(676)
Other		900
Prior-year warrants outlawed and cancelled		79,635
TOTAL OTHER FINANCING SOURCES (USES)		47,195,707
NET CHANGE IN FUND BALANCE		(2,791,166)
FUND BALANCE - JULY 1		22,464,884
FUND BALANCE - JUNE 30	$	19,673,718

The accompanying notes are an integral part of these financial statements.

AUDITOR OF STATE

Exhibit C

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE – BUDGET AND ACTUAL - GENERAL FUND

FOR THE YEAR ENDED JUNE 30, 2017

	General Fund			
	Budgeted Amount			Variance With Final Budget Positive
	Original	Final	Actual	(Negative)
REVENUES				
Real estate transfer tax	$ 150,000	$ 150,000	$ 162,707	$ 12,707
Fees for continuing education	225,000	225,000	82,994	(142,006)
Cash funds	25,278,000	25,278,000	23,061,362	(2,216,638)
TOTAL REVENUES	25,653,000	25,653,000	23,307,063	(2,345,937)
EXPENDITURES				
Regular salaries	18,026,668	18,978,712	57,117,158	(38,138,446) *
Extra help	60,713	713	-	713
Operating expenses	1,359,950	2,024,750	1,264,879	759,871
Personal services matching	5,489,662	5,771,881	14,798,671	(9,026,790) *
Conference fees and travel	41,500	41,500	18,515	22,985
Professional fees and services	22,500	22,500	17,100	5,400 #
Capital outlay	55,000	125,000	77,613	47,387
Expense allowance	1,024,800	281	-	281
TOTAL EXPENDITURES	26,080,793	26,965,337	73,293,936	(46,328,599)
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(427,793)	(1,312,337)	(49,986,873)	43,982,662
OTHER FINANCING SOURCES (USES)				
Inter-agency transfers:				
General/Special revenue allocation	25,702,793	25,702,793	67,500,000	41,797,207
Uniform filing fees and court costs			1,223,210	1,223,210
Funding provided by County Aid Fund (MLC)			5,010,011	5,010,011
Excess unclaimed property transferred to General Revenue Allotment Fund (AGA)			(20,593,851)	(20,593,851)
Excess mineral proceeds transferred to County Aid Fund (MLC)			(1,500,000)	(1,500,000)
Transfer to the Constitutional Officers Fund (Ark. Code Ann. § 19-5-205)			(3,483,356)	(3,483,356)
Unclaimed property expense reimbursement to State Central Services Fund (Ark. Code Ann. § 18-28-213)			(1,040,166)	(1,040,166)
Transfers to the Administration Office of the Courts			(676)	(676)
Other			900	900
Prior-year warrants outlawed and cancelled			79,635	79,635
TOTAL OTHER FINANCING SOURCES (USES)	25,702,793	25,702,793	47,195,707	21,492,914
NET CHANGE IN FUND BALANCES	25,275,000	24,390,456	(2,791,166)	65,475,576
FUND BALANCES - JULY 1	22,464,884	22,464,884	22,464,884	
FUND BALANCES - JUNE 30	$ 47,739,884	$ 46,855,340	$ 19,673,718	$ 65,475,576

* Negative variance was the result of Ark. Const. amend. 94 prohibiting the General Assembly from setting its own salaries and the salaries of elected constitutional officers, justices, and judges.

Variance does not reflect $47,313 not reported as expenditures. (Finding 2017-3)

The accompanying notes are an integral part of these financial statements.

NOTE 1: Summary of Significant Accounting Policies

A. Reporting Entity/History

Ark. Const. art. 6 provides for the Auditor of State as an office of Arkansas state government. The Auditor of State holds office for a term of four years until a successor is elected by qualified electors of the State at-large at the time and places of voting for members of the General Assembly.

Ark. Code Ann. § 25-16-510 provides that the Auditor of State shall be the general accountant of the State and keep all public accounts, books, vouchers, documents, and all papers relating to the contracts of the State and its debts, revenue, and fiscal affairs not required by law to be placed in some other office or kept by some other person.

The Auditor of State also acts as the disbursing officer for designated state appropriations to constitutional officers, counties, and other public organizations. Funds are received and distributed as prescribed by Arkansas Code Annotated, in a disbursing capacity, with varying degrees of managerial control as determined by Code.

B. Basis of Presentation – Fund Accounting

The accounting system is organized and operated on a fund basis. A *fund* is defined as a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances and changes therein, which are segregated for purposes of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. The following types of funds, if applicable to this Agency, are recognized in the accompanying financial statements.

Governmental Funds

General Fund – General Fund is the general operating fund and is used to report all financial resources, except those required to be accounted for in another fund.

C. Basis of Accounting

Basis of accounting refers to when revenues and expenditures or expenses are recognized and reported in the financial statements. Financial statements for governmental funds are presented using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they become both measurable and available. “Available” means collectible within the current period or soon enough thereafter to pay current liabilities (i.e., 45 days). Expenditures are generally recognized under the modified accrual basis when the related fund liability is incurred.

D. Cash and Cash Equivalents

Cash and cash equivalents include demand accounts, imprest accounts, cash on hand, cash in State Treasury, all certificates of deposit with maturities at purchase of 90 days or less, and all short-term instruments with maturities at purchase of 90 days or less. All short-term investments are stated at fair value.

E. Deposits and Investments

State Board of Finance Policies

Ark. Code Ann. § 19-4-805 requires that agencies holding monies not deposited in the State Treasury, other than the institutions of higher learning, abide by the recommendations of the State Board of Finance. The State Board of Finance promulgated cash management, collateralization, and investments policies and procedures, effective July 14, 2012, as referenced in the Financial Management Guide issued by the Department of Finance and Administration for use by all state agencies.

NOTE 1: Summary of Significant Accounting Policies (Continued)

E. Deposits and Investments (Continued)

State Board of Finance Policies (Continued)

The stated goal of state cash management is the protection of principal, while maximizing investment income and minimizing non-interest earning balances. Deposits are to be made within the borders of the State of Arkansas and must qualify for Federal Deposit Insurance Corporation (FDIC) deposit insurance coverage. Policy requires a minimum of four bids to be sought on interest-bearing deposits in order to obtain the highest rate possible.

Policy states that funds are to be in transactional and non-transactional accounts as defined in the Financial Management Guide. Funds in excess of immediate expenditure requirements (excluding minimum balances) should not remain in non-interest bearing accounts.

State Board of Finance policy states that cash funds may only be invested in accounts and investments authorized under Ark. Code Ann. §§ 19-3-510, -518. All noncash investments must be held in safekeeping by a bank or financial institution. In addition, all cash funds on deposit with a bank or financial institution that exceed FDIC deposit insurance coverage must be collateralized. Collateral pledged must be held by an unaffiliated third-party custodian in an amount at least equal to 105% of the cash funds on deposit.

Deposits

Deposits are carried at cost and consist of cash in bank, cash in State Treasury, and certificates of deposit totaling $78,293,377, $5,568,331 and $13,727,428, respectively. State Treasury Management Law governs the management of funds held in the State Treasury, and the Treasurer of State is responsible for ensuring these funds are adequately insured and collateralized.

Custodial Credit Risk – Custodial credit risk for deposits is the risk that, in the event of the failure of a depository institution, the Agency will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Agency has adopted the State Board of Finance Policy requiring the use of depository insurance and collateralization procedures to manage the risk that deposits may not be returned. As of June 30, 2017, none of the Agency's bank balance of $92,020,805 was exposed to custodial credit risk.

Uninsured and collateralized with securities held by the pledging financial institution's trust department or agent but not in the Agency's name	$ 90,882,176
Total	$ 90,882,176

Investments

The Agency only invests in interest-earning investment contracts (certificates of deposits). As of June 30, 2017, the Agency has the following investment balances and segmented maturities:

		Investment Maturities (In Years)			
Investment Type	Fair Value	Less than 1	1-5	6-10	More than 10
Certificates of Deposit	$ 13,727,428	$ 12,727,428	$ 1,000,000		

NOTE 1: Summary of Significant Accounting Policies (Continued)

E. Deposits and Investments (Continued)

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Agency does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The summary shown above indicates that $1,000,000 of the Agency's investment maturities are one year or longer.

F. Prepaid Expenses

Prepaid expenses generally represent the cost of consumable supplies on hand or unexpired services at year-end. The cost of these items is included with expenditures at the time of purchase. Prepaid expenses, as reported in the general fund financial statements, are also recorded as a nonspendable component of fund balance indicating that they do not constitute "available, spendable financial resources."

G. Fund Equity

Fund Balance

In the financial statements, fund balance is reported in one of five classifications, where applicable, based on the constraints imposed on the use of the resources.

The nonspendable fund balance includes amounts that cannot be spent because they are either (a) not in spendable form (e.g., prepaid items, inventories, long-term amount of loans and notes receivables, etc.) or (b) legally or contractually required to be maintained intact.

The spendable portion of fund balance, where applicable, comprises the remaining four classifications: restricted, committed, assigned, and unassigned.

Restricted fund balance. This classification reflects constraints imposed on resources either (a) externally by creditors, grantors, contributors, or laws or regulations of other governments or (b) by law through constitutional provisions or enabling legislation.

Committed fund balance. These amounts can only be used for specific purposes according to constraints imposed by legislation of the General Assembly, the government's highest level of decision-making authority. Committed amounts cannot be used for any other purpose unless the General Assembly removes or changes the constraint by the same action that imposed the constraint.

Assigned fund balance. This classification reflects amounts constrained by the State's "intent" to be used for specific purposes but are neither restricted nor committed. The General Assembly has the authority to assign amounts to be used for specific purposes by legislation or approved methods of financing.

Unassigned fund balance. This amount is the residual classification for the general fund.

When more than one spendable classification is available for use, it is the State's policy to use the resources in this order: restricted, committed, assigned, and unassigned.

AUDITOR OF STATE
SCHEDULE OF SELECTED INFORMATION
FOR THE FIVE-YEAR PERIOD ENDED JUNE 30, 2017
(UNAUDITED)

Schedule 1

	For the Year Ended June 30,				
	2017	2016	2015	2014	2013
General Fund					
Total Assets	$ 114,576,704	$ 101,697,608	$ 89,394,768	$ 79,879,089	$ 73,317,735
Total Liabilities	94,902,986	79,232,724	62,750,162	51,329,589	41,383,787
Total Fund Equity	19,673,718	22,464,884	26,644,606	28,549,500	31,933,948
Total Revenues	23,307,063	18,229,344	16,379,045	12,765,597	21,221,550
Total Expenditures	73,293,936	75,098,911	85,077,067	82,837,208	81,446,691
Total Other Financing Sources (Uses)	47,195,707	52,689,845	66,793,128	66,687,163	60,715,798

A. Capital Assets

Capital assets purchased and in the custody of this Agency were recorded as expenditures at the time of purchase. Assets with costs exceeding $5,000 and an estimated useful life exceeding one year are reported at historical cost, including ancillary costs (such as professional fees and costs, freight costs, preparation or setup costs, and installation costs). Infrastructure or public domain fixed assets (such as roads, bridges, tunnels, curbs and gutters, streets and sidewalks, drainage systems, and lighting systems) are also capitalized. Gifts or contributions are generally recorded in the accounts at acquisition value at the time received. Acquisition value is the market value if the Agency would have purchased the item. In accordance with current accounting principles generally accepted in the United States of America, general capital assets and depreciation are reported in the State's "Government-Wide" financial statements but are not reported in the governmental fund financial statements. Depreciation is reported for proprietary fund capital assets based on a straight-line method, with no salvage value. Estimated useful lives generally assigned are as follows:

Assets:	Years
Equipment	5-20
Buildings and building improvements	20-50
Infrastructure	10-40
Land improvements	10-100
Intangibles	4-95
Other capital assets	10-15

Capital assets activity for the year ended June 30, 2017, was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Governmental activities:				
Improvements	$ 187,070			$ 187,070
Equipment	633,724	$ 77,613		711,337
Intangibles	354,792			354,792
Total governmental activities	$ 1,175,586	$ 77,613	$ 0	$ 1,253,199

B. Pension Plans

Arkansas Public Employees Retirement System

Plan Description – The Agency contributes to the Arkansas Public Employees Retirement System (APERS), a cost-sharing, multiple-employer defined benefit pension plan administered by the APERS Board of Trustees. APERS provides retirement and disability benefits, annual redetermination of benefit adjustments, and survivor benefits to plan members and beneficiaries. The Constitution of Arkansas, Article 5, vests with the General Assembly the legislative power to enact and amend benefit provisions of APERS as published in Chapters 2, 3, and 4 of Title 24 of the Arkansas Code Annotated. APERS issues a publicly available financial report that includes financial statements and required supplementary information. This report may be obtained by writing to Arkansas Public Employees Retirement System, One Union National Plaza, 124 West Capitol, Little Rock, Arkansas, 72201 or by calling 1-501-682-7855.

Funding Policy – Contributory plan members are required to contribute 5% of their annual covered salary. The Agency is required to contribute for all covered state employees at the rate of 14.50% of annual covered payroll. The contribution requirements of plan members are established and may be amended by the Arkansas General Assembly. The contribution requirements of the Agency are established and may be amended by the APERS Board of Trustees. The Agency's contributions to APERS for the years ended June 30, 2017, 2016, and 2015, were $5,212,704, $5,063,477, and $6,293,972, respectively, equal to the required contributions for each year.

B. Pension Plans (Continued)

Arkansas Judicial Retirement System

Plan Description – The Arkansas Judicial Retirement System (AJRS) provides retirement and disability benefits, annual redetermination of benefit adjustments, and survivor benefits to plan members and beneficiaries. The Constitution of Arkansas, Article 5, vests the General Assembly with legislative power to enact and amend benefit provisions of AJRS as published in Chapter 8 of Title 24 of the Arkansas Code Annotated. AJRS is included in the Arkansas Public Employees Retirement System (APERS) financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Arkansas Public Employees Retirement System, One National Plaza, 124 West Capitol, Little Rock, Arkansas 72201 or by calling 1-501-682-7855.

The Agency contributes to AJRS, a single-employer defined benefit pension plan administered by APERS that covers all Chancery, Circuit, and Court of Appeals Judges and Supreme Court Justices, whether elected or appointed. Act 399 of 1999 created a Tier Two benefit plan for all judges or justices elected or appointed on or after July 30, 1999. Existing members of the plan in effect prior to this date (hereafter referred to as Tier One) had until the end of their current term to elect coverage under Tier Two.

Under Tier One, members are eligible for full retirement benefits (1) at any age with 20 years of credited service or (2) at age 65 with 10 years of credited service. Persons who became members after June 30, 1983, must also have at least eight years of actual service as a Supreme Court Justice or as a judge of the Circuit Courts or the Court of Appeals. Members are eligible for reduced benefits (1) at any age if they were a member before July 1, 1983, and have at least 18 but less than 20 years of credited service or (2) are between the ages of 62 and 65 with 14 years of credited service. The normal retirement benefit, paid monthly, is 60% of the annual salary payable to the last judicial office held. For any person who was a member on or before June 30, 1983, the retirement benefits are increased or decreased as the salary for the particular judicial office is increased or decreased. For all judges or justices who were first elected or appointed on or after July 1, 1983, the redetermined amount is the amount of the benefit payable as of the immediately preceding July 1, increased by 3%. The plan also provides for disability and survivor benefits.

Under Tier Two, members are eligible for full retirement benefits (1) at any age with 20 years of actual service or (2) at age 65 with eight years of actual service. Members are eligible for reduced benefits if they are between the ages of 62 and 65 and have eight years of actual service. The normal retirement benefit, paid monthly, is 3.2% of the salary of the last judicial office held multiplied by the number of years of actual service, not to exceed 80% of the salary of the last judicial office held. Retiree benefit increases are calculated each year on July 1 for the following 12 months. The redetermined amount is the amount of the benefit payable as of the immediately preceding July 1, increased by 3%. The plan also provides for disability and survivor benefits.

The benefit provisions provided by the judicial plan are established by state law and may be amended only by the General Assembly.

Contributions – Employer contribution provisions for AJRS are established by Ark. Code Ann. § 24-8-210 for Tier One and by Ark. Code Ann. § 24-8-707 for Tier Two at 12% of active member payroll. Contributory members are required to contribute 6% of their annual salary for Tier One and 5% for Tier Two. Employee contributions are no longer required for Tier One members when a judge is certified eligible for retirement or for Tier Two when a judge or justice has sufficient service to receive the maximum benefit under the plan provisions.

Additionally, in accordance with Ark. Code Ann. § 24-8-210(b), the State makes an annual transfer to the plan by computing the dollar amount required based on the actuarially-determined employer rate in the most recent annual actuarial valuation and subtracting from that amount the employer statutory contribution amount and the court cost revenue received. The State's supplemental contribution during fiscal year 2017 under this provision of law amounted to $5,210,693.

B. Pension Plans (Continued)

Arkansas Judicial Retirement System (Continued)

Detailed historical information about the pension liabilities for which the pension plan's assets are being held and managed and the significant assumptions used to measure these liabilities are as follows:

	Arkansas Judicial Retirement System
Contribution rates:	
Employer	12%
Employee	Tier One - 6%, Tier Two - 5%
Contributions valuation date	June 30, 2015
Actuarial cost method	Entry age normal
Amortization method	Level percent of payroll
Remaining amortization period	28-year closed
Asset valuation method	4-year smoothed market with 25% corridor
Actuarial assumptions:	
Investment rate of return	6.25%
Projected salary increases	3.25%
inflation rate	3.25%
Post retirement cost-of-living adjustments:	
Pre July 1, 1983, hires	Increased with active judges' pay
Post June 30, 1983, hires	3.00% annual compounded increase
Mortality Table	RP-2000 Mortality Tables
Summary of population statistics:	
Retirees and beneficiaries currently receiving benefits including DROP participants	147
Terminated members entitled to but not yet receiving benefits	5
Current active members	140
Total plan members	292

Schedule of the Net Pension Liability

Fiscal Year Ending June 30,	Total Pension Liability	Plan Net Position	Net Pension Liability	Plan Net Position as a % of Total Pension Liability	Covered Payroll	Net Pension Liability as a % of Covered Payroll
2017	$ 270,381,518	$ 240,819,648	$ 29,561,870	89.07%	$ 22,917,870	128.99%

B. Pension Plans (Continued)

Arkansas Judicial Retirement System (Continued)

Schedule of Contributions

Fiscal Year Ending June 30,	Actuarially Determined Contribution	Actual Contribution	Contribution Deficiency (Excess)	Covered Payroll	Actual Contribution as a % of Covered Payroll
2017	$ 8,706,499	$ 8,485,361	$ 221,138	$ 2,917,870	37.03%

Schedule of the Investment Returns

Fiscal Year Ending June 30,	Annual Money-Weighted Rate of Return, Net of Investment Expense
2017	12.93%

C. Compensated Absences – Employee Leave

Annual leave is earned by all full-time employees. Upon termination, employees are entitled to receive compensation for their unused accrued annual leave up to 30 days. Liabilities for compensated absences are determined at the end of the year based on current salary rates.

Sick leave is earned by all full-time employees and may be accrued up to 120 days. Compensation up to a maximum of $7,500 for unused sick leave is payable to employees upon retirement.

Compensated absences are reported in the State's "Government-Wide" financial statements but are not reported as liabilities or expenditures in the governmental funds. However, the compensated absences payable attributable to this Agency's employee annual and sick leave as of June 30, 2017 and 2016, amounted to $132,813 and $135,967, respectively. The net changes to compensated absences payable during the year ended June 30, 2017, amounted to ($3,154).