AUDITOR OF STATE

Annual Financial Report

June 30, 2018

LEGISLATIVE JOINT AUDITING COMMITTEE

AUDITOR OF STATE
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Arkansas

Sen. Jason Rapert
Senate Chair
Sen. Eddie Cheatham
Senate Vice Chair

Rep. Richard Womack
House Chair
Rep. DeAnn Vaught
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, 2018, 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 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, 2018, 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, 2018, 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.

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 opinion 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 November 26, 2019, 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, and 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 the effectiveness of the Auditor of State's 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 A. Norman

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

Little Rock, Arkansas
November 26, 2019
SA0405918

Arkansas

Sen. Jason Rapert
Senate Chair
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House Chair
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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, 2018, 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 November 26, 2019.

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.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses as items **2018-1**, **2018-2**, **2018-3**, and **2014-4**, that we consider to be significant deficiencies.

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 **2018-1**, **2018-2**, **2018-3**, and **2018-4**.

SCHEDULE OF FINDINGS AND RESPONSES

2018-1 *REPEAT FINDING:* The Agency is the administrator of unclaimed property of Arkansas citizens for the State. Ark. Code Ann. § 18-28-210(b) deems that upon payment or delivery to the administrator, the State assumes custody of and responsibility for the safekeeping of property. The Agency held $19.4 million in unclaimed property in the form of stock at June 30, 2018. During the prior-year audit, numerous unclaimed property stock records were noted as inaccurate, resulting in claimants being either overpaid or underpaid when collecting their property. The extent of the errors made it difficult to determine the number or dollar amount of total errors. During current-year testing, we noted that some of the prior-year errors have not been corrected and discovered the same types of errors continue to occur. Below is a list of the types of errors noted during current testing:

- The Agency continues to make undocumented adjustments to owners' accounts that are not reviewed or approved by management. For example, the Agency incorrectly made five adjustments to stocks in the unclaimed property system that resulted in excess cash balances on 607 owners' accounts totaling $13,474. As of June 2019, these errors resulted in overpayments to 17 claimants and a loss to the State totaling $376. If a review/approval process over adjustment entries into the system is not implemented, overpayments or underpayments may continue to occur.
- The Agency continues to make adjustments to owners' accounts that result in negative stock balances. For example, on May 23, 2018, the Agency backdated an adjustment on an account to April 9, 2013, resulting in a negative balance of 56 shares of Comcast stock and $63 in negative dividends. This transaction will result in continued negative Comcast dividends being added to this account and excess Comcast stock dividends added to other owners' accounts until the negative shares are removed. At June 30, 2019, the negative shares remained in the Agency's records, and any excess dividends claimed will result in a loss to the State.
- The Agency continues to misapply dividends to owners' accounts. For example, in February 2017, Verizon Communications Inc., issued dividends that the Agency misapplied, overpaying 21 owners' accounts $1,272 and underpaying 73 other owners' accounts. Inaccurate dividends continued to be applied during the current fiscal year. As of June 2019, 5 of the owners of the overpaid accounts have claimed their property, at a loss to the State of $432. Until corrected, inaccurate claims will continue to be paid.
- The Agency continues to not apply dividends to owner's accounts in a timely manner. Our testing identified 9 separate occasions in which dividends were applied to 3,528 owners' accounts in excess of a year after the dividend occurred and an additional 5 instances in which dividends were applied to 756 owners' accounts more than 2 years after the dividend occurred. The delay in recording is not in compliance with generally accepted accounting practices and may result in additional costs to the State to subsequently process claims on the same property.
- The Agency still lacks adequate reconciliation procedures. The Agency has contracted with an outside third party to hold unclaimed stocks. The absence of Agency procedures to periodically reconcile the Agency's unclaimed property records to the statements of the holder of the stocks has resulted in unaccounted for differences between the two. For example, the Agency had an extra 2,492 shares of Verizon Communications, Inc., stock on its books that were not on hand with the third party holder. Over a period of time, this difference resulted in an excess $4,356 in dividends applied to owners' accounts at a risk of loss to the State.

The Agency's internal controls related to unclaimed stocks remain deficient and place the State's assets at risk of loss or misappropriation. Factors contributing to the deficiencies are as follows:

- Management oversight is insufficient (e.g., Agency stock recordings are not reviewed or approved).
- Stock transactions are not always documented or performed timely.
- Agency records are not properly reconciled.
- Lack of segregation of duties allows the same employee to process and post stock transactions as well as record subsequent error corrections.

<u>Recommendation:</u> We again recommend the Agency implement the following procedures to maintain the integrity and accuracy of the unclaimed property stock records:

- Develop and implement written internal control procedures to ensure (a) all stock transactions and error corrections are recorded timely, are supported by adequate documentation, and have been reviewed by someone not involved in the process and (b) the duties of processing and posting transactions are segregated to separate individuals.

- Perform periodic reconciliations between Agency records and the stockholder's records. The reconciliation should be performed by an individual removed from the transaction process.

Management Response: *The Office acknowledges inadequate segregation of duties, a lack of written procedures, and training shortcomings, which have led to a repeat finding of the above-mentioned adjustments, misapplied dividends, and untimely application of dividends. Management is striving to prevent future errors from occurring by strengthening the system of internal control within the Office and is also working diligently to detect and correct previous errors.*

Management has hired a Securities Agent to specialize in the proper management of securities and provide appropriate segregation of duties within the unclaimed property system. An Internal Auditor has also been hired to provide guidance on strengthening the Office's system of internal control.

Furthermore, after the results of the 2017 Legislative Audit Report, Management began exploring options for an enhanced unclaimed property system. The Office has now undergone a system conversion to a new system, which has significantly improved system controls, reporting capabilities, and the ability to house supporting documentation within the system. In the previous system, all transactions, on the approximate 19,000,000 shares being held by the Office, required manual data entry. The new system allows the upload of data from the Office's custodian bank, significantly reducing the amount of manual data entry. The new system's vendor also provides training services to ensure staff understands how to properly utilize the system. The Deputy Auditor and Internal Auditor have worked with the vendor to establish proper access and the utilization of system controls, which will ensure appropriate segregation of duties

Management has also drafted policies and procedures, which provide guidelines for the handling and proper documentation of security sales, transfers, reregisters, adjustments/error corrections, dividends, worthless securities, and reconciliations. The Office has begun performing monthly reconciliations of the Office's unclaimed property system records to the custodian bank records. The Securities Agent is utilizing data from these reconciliations, as well as system generated reports, to research and correct previous errors.

2018-2 *REPEAT FINDING:* The Agency's correction of errors noted in the prior-year audit did not accurately restore owners' account balances. During the prior-year audit, we identified 14 stocks erroneously recorded as "sold" in the unclaimed property system. Before the Agency was able to correct the error, the property was claimed by the rightful owner/heir. In addition, the change in stock value on the date the property was claimed was not taken into account, thus depriving the owner of any increased value that may have occurred.

Recommendation: Stock values fluctuate daily and should be taken into account whenever stock is sold. Owners' accounts should be updated to reflect the current market value of the stock owned on the date the stock was sold.

Management Response: *The Office recognizes that stock values fluctuate on a daily basis; however, as stated previously, the Office acts only as a custodian. After this error was identified, the Office met with Legislative Audit to discuss the plan to correct the error, including a discussion of the date to be utilized. Management has hired a Securities Agent to research and resolve errors in the unclaimed property system, to ensure property owner's receive accurate payouts on their claims.*

2018-3 While information is not removed from the unclaimed property system, the Agency is overwriting the detailed history of stock transactions on owners' property accounts. Overwriting accounts has the effect of removing the transaction history from the account, including the transaction's date, amount, and unique identification number. The original and all subsequent transactions must be retained at the property owner level to maintain complete accounting records for the needs of the Agency and to leave a proper audit trail. For example, the Agency overwrote 133 owners' accounts that contained Verizon Communications stock on September 5, 2018, and again on May 7, 2019. These actions altered the balance of the owners' accounts without explanation or supporting documentation.

Recommendation: We recommend the Agency develop and implement written internal control procedures to prevent the future overwriting of owners' account transaction history and to ensure the detail of original and subsequent stock transactions are retained on owners' property accounts.

Management Response: *This was a software issue in the previous unclaimed property system, which allowed transactions to be removed from view at the property owner level; however, such transactions were available to be viewed when utilizing the audit trail feature of the previous software.*

As of December 2019, the Office has implemented a new unclaimed property system, which ensures all transactions are visible at the property owner level.

2018-4 Due to a lack of management oversight, the Agency's calculation of excess unclaimed property transferred to the Department of Finance and Administration (DFA) was understated by $3,043,582.

Recommendation: We recommend the Agency implement a review process to ensure the accuracy of the amount calculated and transferred. Furthermore, due to recent changes in Arkansas legislation, we also recommend the Agency consult with DFA on how future transfer amounts should be determined.

Management Response: *The Office has met with DFA and the consensus is that we will most likely need a Legislative change.*

Agency's Response to Findings

The Agency's response to the findings identified in our audit is 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

Tom Bullington

Tom Bullington, CPA
Deputy Legislative Auditor

Little Rock, Arkansas
November 26, 2019

Exhibit A

AUDITOR OF STATE
BALANCE SHEET – GOVERNMENTAL FUND
JUNE 30, 2018

		General Fund
ASSETS		
Cash and cash equivalents	$	65,973,416
Certificates of deposit		25,034,536
Assets held by third-party custodian		18,939,766
Accounts receivable		260,156
Due from other state agencies		85
Prepaid items		88,159
TOTAL ASSETS	$	110,296,118
LIABILITIES AND FUND BALANCE		
Liabilities:		
Accounts payable - vendors	$	42,880
Due to other state agencies		29,183
Accrued and other current liabilities		1,259,766
Unclaimed property claims payables		99,933,852
Total Liabilities		101,265,681
Fund Balances:		
Nonspendable		
Prepaid items		88,159
Committed for program requirements		287,433
Unassigned		8,654,845
Total Fund Balances		9,030,437
TOTAL LIABILITIES AND FUND BALANCES	$	110,296,118

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, 2018

	General Fund
REVENUES	
Real estate transfer tax	$ 162,539
Fees for continuing education	81,061
Unclaimed property received/distributed	9,220,771
Investment earnings	2,219,737
Collections for district judges' salaries	3,158,465
TOTAL REVENUES	14,842,573
EXPENDITURES	
Salary and benefits - payroll	59,702,929
Employee benefits - matching	15,502,615
Communication and transportation of commodities	145,526
Printing and advertising	132,197
Repairing and servicing	131,117
Utilities and rent	275,531
Travel and subsistence	480,685
Professional services	156,802
Insurance and bonds	3,160
Other expenses and services	56,178
Commodities, materials, and supplies	88,368
Assistance, grants, and aid	1,250
Capital outlay	25,971
TOTAL EXPENDITURES	76,702,329
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(61,859,756)

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, 2018

OTHER FINANCING SOURCES (USES)		
Interagency transfers in:		
General/Special revenue allocation	$	70,800,000
Uniform filing fees and court costs		1,223,210
Funding provided by County Aid Fund (MLC)		4,986,612
Excess unclaimed property transferred to General Revenue Allotment Fund (AGA)		(21,389,378)
Transfer to the Constitutional Officers Fund (Ark. Code Ann. § 19-5-205)		(3,537,487)
Unclaimed property expense reimbursement to State Central Services Fund (Ark. Code Ann. § 18-28-213)		(990,821)
General revenue reclaimed		(21,928)
Other, net		971
Prior-year warrants outlawed and cancelled		145,296
TOTAL OTHER FINANCING SOURCES (USES)		51,216,475
NET CHANGE IN FUND BALANCE		(10,643,281)
FUND BALANCE - JULY 1		19,673,718
FUND BALANCE - JUNE 30	$	9,030,437

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, 2018

	General Fund			
	Budgeted Amount			Variance With Final Budget Positive
	Original	Final	Actual	(Negative)
REVENUES				
Real estate transfer tax	$ 150,000	$ 150,000	$ 162,539	$ 12,539
Fees for continuing education	225,000	225,000	81,061	(143,939)
Cash funds	27,555,750	27,555,750	14,598,973	(12,956,777)
TOTAL REVENUES	27,930,750	27,930,750	14,842,573	(13,088,177)
EXPENDITURES				
Regular salaries	18,544,823	19,544,823	59,700,521	(40,155,698) *
Extra help	30,000	30,000	2,408	27,592
Operating expenses	1,359,950	1,914,750	1,341,617	573,133
Personal services matching	5,672,685	5,922,685	15,497,815	(9,575,130) *
Conference fees and travel	41,500	21,500	10,065	11,435
Professional fees and services	22,500	162,500	123,932	38,568
Capital outlay	40,000	40,000	25,971	14,029
Expense allowance	1,024,800	146		146
TOTAL EXPENDITURES	26,736,258	27,636,404	76,702,329	(49,065,925)
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	1,194,492	294,346	(61,859,756)	35,977,748
OTHER FINANCING SOURCES (USES)				
Interagency transfers in:				
General/Special revenue allocation	25,569,900	25,569,900	70,800,000	45,230,100
Uniform filing fees and court costs			1,223,210	1,223,210
Funding provided by County Aid Fund (MLC)			4,986,612	4,986,612
Excess unclaimed property transferred to General Revenue Allotment Fund (AGA)			(21,389,378)	(21,389,378)
Transfer to the Constitutional Officers Fund (Ark. Code Ann. § 19-5-205)			(3,537,487)	(3,537,487)
Unclaimed property expense reimbursement to State Central Services Fund (Ark. Code Ann. § 18-28-213)			(990,821)	(990,821)
General revenue reclaimed			(21,928)	(21,928)
Other, net			971	971
Prior-year warrants outlawed and cancelled			145,296	145,296
TOTAL OTHER FINANCING SOURCES (USES)	25,569,900	25,569,900	51,216,475	25,646,575
NET CHANGE IN FUND BALANCE	26,764,392	25,864,246	(10,643,281)	61,624,323
FUND BALANCE - JULY 1	19,673,718	19,673,718	19,673,718	
FUND BALANCE - JUNE 30	$ 46,438,110	$ 45,537,964	$ 9,030,437	$ 61,624,323

* 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.

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.

<u>Governmental Funds</u>

<u>General Fund</u> – 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

<u>State Board of Finance Policies</u>

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 $61,510,860, $5,592,692, and $25,034,536, 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, 2018, $15,075 of the Agency's bank balance of $86,545,396 was exposed to custodial credit risk as follows:

Uninsured and uncollateralized	$	15,075
Uninsured and collateralized with securities held by the pledging financial institution's trust department or agent but not in the Agency's name		88,232,591
Total	$	88,247,666

Investments

The Agency only invests in interest-earning investment contracts (certificates of deposits). As of June 30, 2018, 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	$ 25,034,536	$ 1,000,000	$ 24,034,536		

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 $24,034,536 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, 2018
(UNAUDITED)

Schedule 1

	For the Year Ended June 30,				
	2018	2017	2016	2015	2014
General Fund					
Total Assets	$ 110,296,118	$ 114,576,704	$ 101,697,608	$ 89,394,768	$ 79,879,089
Total Liabilities	(101,265,681)	94,902,986	79,232,724	62,750,162	51,329,589
Total Fund Equity	(9,030,437)	19,673,718	22,464,884	26,644,606	28,549,500
Total Revenues	14,842,573	23,307,063	18,229,344	16,379,045	12,765,597
Total Expenditures	76,702,329	73,293,936	75,098,911	85,077,067	82,837,208
Total Other Financing Sources (Uses)	51,216,475	47,195,707	52,689,845	66,793,128	66,687,163

AUDITOR OF STATE
OTHER GENERAL INFORMATION
JUNE 30, 2018
(UNAUDITED)

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, 2018, was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Governmental activities:				
Improvements	$ 187,070			$ 187,070
Equipment	711,337	$ 16,161	$ 404,929	322,569
Intangibles	354,792	9,810		364,602
Total governmental activities	$ 1,253,199	$ 25,971	$ 404,929	$ 874,241

B. Pension Plan

Arkansas Public Employees Retirement System (APERS)

Plan Description – The Agency contributes to 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 14.75% 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, 2018, 2017, and 2016, were $5,633,284, $5,212,704, and $5,063,477, respectively, equal to the required contributions for each year.

B Pension Plan (Continued)

Arkansas Judicial Retirement System (AJRS)

Plan Description - The judicial retirement plan is 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 to office. Act 399 of 1999 created a Tier Two benefit program 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 retirement plan are established by state law and may be amended only by the General Assembly

Contributions - Employer contribution provisions for the judicial retirement plan 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 FY2018 under this provision of law amounted to $5,075,248.

B Pension Plan (Continued)

Arkansas Judicial Retirement System (AJRS)

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, 2016
Actuarial cost method	Entry age normal
Amortization method	Level percent of payroll
Remaining amortization period	27-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	2.50%
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	139
Total plan members	291

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
2018	$ 279,174,680	$ 256,508,130	$ 22,666,550	91.88%	$ 23,434,639	96.72%

B Pension Plan (Continued)

Arkansas Judicial Retirement System (AJRS)

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
2018	$ 8,757,525	$ 8,421,173	$ 336,352	$ 23,434,639	35.93%

Schedule of the Investment Returns

Fiscal Year Ending June 30,	Annual Money-Weighted Rate of Return, Net of Investment Expense
2018	7.94%

C. Postemployment Benefits Other Than Pensions (OPEB)

Arkansas State Employee Health Insurance Plan (Plan)

Plan Description – The Department of Finance and Administration – Employee Benefits Division (DFA-EBD) provides medical and prescription drug benefits for eligible state employees and retirees. Policies for DFA-EBD related to medical and prescription drug plans are established by the State and Public School Life and Health Insurance Board (Board) and may include ad hoc benefit changes or annual cost redeterminations. For the current year, no ad hoc or cost redetermination changes occurred. The Constitution of Arkansas, Article 5, vests the General Assembly with legislative power to enact and amend duties of and benefit provisions of the Board and DFA-EBD, respectively, as published in Subchapter 4, Chapter 5 of Title 21 of the Arkansas Code Annotated. DFA-EBD is included in the State of Arkansas's Comprehensive Annual Financial Report (CAFR), which includes all applicable financial information, notes, and required supplementary information. That report may be obtained by writing to Department of Finance and Administration, 1509 West Seventh Street, Suite 403, Little Rock, Arkansas 72201 or by calling 501-682-1675.

The Agency contributes to the Plan, a single employer defined benefit OPEB plan administered by DFA-EBD, on a monthly basis. The Board establishes medical and prescription drug benefits for three classes of covered individuals: active employees, terminated employees with accumulated benefits, and retires and beneficiaries. The Plan is established on the basis of a pay-as-you-go financing requirement, and no assets are accumulated in a trust, as defined by Governmental Accounting Standards Board (GASB) Statement No. 75. The State's annual OPEB cost for the Plan is based on an actuarially-determined calculated amount made in accordance with GASB Statement No. 75.

Funding Policy – Employer contributions to the Plan are established by Ark. Code Ann. § 21-5-414 and may not exceed $450 per budgeted position. Employees, retirees, and beneficiaries contribute varying amounts based on the type of coverage and inclusion of family members. Benefits for Medicare-eligible retirees are coordinated with Medicare Parts A and B, and the Plan is the secondary payer.

D. 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, 2018 and 2017, amounted to $143,691 and $132,813, respectively. The net changes to compensated absences payable during the year ended June 30, 2018, amounted to $10,878.