



REPRESENTING
ALEX SINK
CHIEF FINANCIAL OFFICER
STATE OF FLORIDA

May 14, 2010

The Honorable Alex Sink
Chief Financial Officer
The Capitol, PL-11
Tallahassee, Florida 32399-0301

Dear CFO Sink:

Pursuant to Section 20.055 (5)(h), Florida Statutes, the enclosed response provides a six-month follow-up on the status of corrective actions taken by the Department regarding the findings and recommendations included in the Auditor General's Report No. 2010-049, Public Deposits Program Operational Audit.

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

Sincerely,

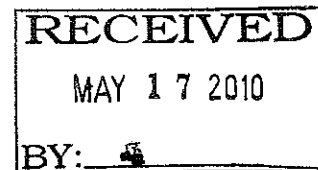
A handwritten signature in cursive script that reads "Robert E. Clift".

Robert E. Clift

REC:sc

Enclosure

cc: Nancy Tucker, CPA, Audit Manager, Office of the Auditor General
✓Kathy DuBose, Staff Director, Joint Legislative Auditing Committee



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

OVERSIGHT OF THE PUBLIC DEPOSITS PROGRAM

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

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

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

Six-Month Status: The Department was unsuccessful in making changes to the Oversight Board consistent with the recommendations during the 2010 Regular Session of the Legislature.

QUALIFIED PUBLIC DEPOSITORY COLLATERAL PLEDGING LEVELS

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

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

Response: We concur. Although the statute provides authority to require collateral from a QPD pursuant to special instructions, the administrative rules of the program do not detail the circumstances under which discretion may be used in establishing collateral requirements. The

Bureau is drafting changes to the administrative rules of the public deposits program that would describe the circumstances under which a QPDs collateral pledge level may differ from the level generally prescribed for in the rule. The proposed changes to the administrative rules do not require a change in the statute. The Bureau expects to begin the formal rulemaking process in November 2009 with an estimated completion date of March 1, 2010.

Six-Month Status: Staff has prepared the required changes to Administrative Rule 69C-2. However, legislation was proposed in the 2010 Legislative Session that would have substantially changed Chapter 280. Therefore, we did not pursue these updates until the outcome of the legislation was determined. The proposed changes introduced by the legislation were not adopted and we are proceeding with our changes to Administrative Rule 69C-2.

Finding No. 3: The supervisory review and approval of Bureau financial analyses of the financial condition of selected Qualified Public Depository (QPD) and any resulting changes to collateral pledge levels was not always documented.

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

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

Six-Month Status: The new process was implemented in October 2009.

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

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

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

Six-Month Status: The procedures were implemented in December 2009.

Finding No. 8: The Bureau allowed some QPDs with the lowest quarterly financial condition ratings longer periods to meet the requirement to raise collateral pricing levels.

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

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

Six-Month Status: Staff has prepared the required changes to Administrative Rule 69C-2. However, legislation was proposed in the 2010 Legislative Session that would have substantially changed Chapter 280. Therefore, we did not pursue these updates until the outcome of the legislation was determined. The proposed changes introduced by the legislation were not adopted and we are proceeding with our changes to Administrative Rule 69C-2.

COLLATERAL ADMINISTRATION

Finding No. 9: Bureau staff responsible for resolving collateral reconciling items were also responsible for processing collateral transactions, resulting in conditions under which errors may occur and be concealed from timely detection. Additionally, collateral reconciliations did not include Federal Home Loan Bank letters of credit and the resolution of reconciling items was not always timely.

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

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

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

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

Six-Month Status: The reconciliation process has been amended so that an independent financial examiner identifies all reconciling items. Resolutions of the reconciling items are performed by the transaction staff and transaction staff supervisor within the designated timeframe of 15 days after receipt of notification of the discrepancy from the independent financial examiner.

Procedures have been implemented to facilitate proper tracking of all incoming Federal Home Loan Bank (FHLB) Letters of Credit from the point of receipt in the Bureau to final processing into the Bureau's Collateral Administration Program (CAP). Annual confirmations continue to be performed on all FHLB Letters of Credit; in addition, a quarterly reconciliation process has been implemented.

A system request has been submitted to the Department's Information System area (DIS) for an application change to CAP for implementation of an automated edit check that tests the ninth digit of Committee on Uniform Security Identification Procedures (CUSIP) numbers.

Finding No. 3: Bureau procedures for pricing collateral needed improvement as not all collateral was priced in a timely manner.

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

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

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

Six-Month Status: Procedures have been implemented to ensure that Bureau staff obtains alternative market prices within 20 days after initial notification that a collateral item is not pricing. In cases where current prices can not be obtained; or in cases where the Qualified Public Depository does not replace or release the un-priced collateral, procedures have been implemented to require that Bureau staff not allow credit for the value of the collateral.

A system request has been submitted to the Department's Information System area (DIS) for an application enhancement to CAP for development of a new report which will identify applicable collateral items requiring pricing updates.

PROGRAM REPORTING

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

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

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

Six-Month Status: The Bureau has established the process by which staff compares public depositories' reports with Public Depositories ranked 0-15 during each analysis cycle. Depositors identified by the QPD that have not filed their annual report are contacted regarding their compliance with Chapter 280.

INFORMATION TECHNOLOGY

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

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

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

Six-Month Status: CAP security administration is reviewed monthly by the financial administrators and the Bureau Chief in order to ensure each CAP user has only those access privileges required by their job duties.

Finding No. 19: We noted certain other deficiencies in the Bureau's security controls related to the Collateral Administration Program, the details of which have been discussed to Departmental management.

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

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

Six-Month Status: The DFS Access Control Administration Policy Team is reviewing the Department's Application Access Control Policies and Procedure. Once these policies and procedures are finalized, we will conform to their requirements.