

STATE OF CONNECTICUT



*AUDITORS' REPORT
OFFICE OF THE ATTORNEY GENERAL
FOR THE FISCAL YEARS ENDED JUNE 30, 2016 AND 2017*

AUDITORS OF PUBLIC ACCOUNTS
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AUDITORS' REPORT OFFICE OF THE ATTORNEY GENERAL FOR THE FISCAL YEARS ENDED JUNE 30, 2016 AND 2017

We have audited certain operations of the Office of the Attorney General in fulfillment of our duties under Section 2-90 of the Connecticut General Statutes. The scope of our audit included, but was not necessarily limited to, the fiscal years ended June 30, 2016 and 2017. The objectives of our audit were to:

1. Evaluate the office's internal controls over significant management and financial functions;
2. Evaluate the office's compliance with policies and procedures internal to the office or promulgated by other state agencies, as well as certain legal provisions; and
3. Evaluate the economy and efficiency of certain management practices and operations, including certain financial transactions.

Our methodology included reviewing written policies and procedures, financial records, minutes of meetings, and other pertinent documents; interviewing various personnel of the department, as well as certain external parties; and testing selected transactions. We obtained an understanding of internal controls that we deemed significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We tested certain of those controls to obtain evidence regarding the effectiveness of their design and operation. We also obtained an understanding of legal provisions that are significant within the context of the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of contracts, grant agreements, or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting instances of noncompliance significant to those provisions.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

The accompanying Résumé of Operations is presented for informational purposes. This information was obtained from the department's management and was not subjected to the procedures applied in our audit of the department. For the areas audited, we identified:

1. Deficiencies in internal controls;
2. Apparent noncompliance with legal provisions; and
3. Need for improvement in management practices and procedures that we deemed to be reportable.

The State Auditors' Findings and Recommendations in the accompanying report presents any findings arising from our audit of the Office of the Attorney General.

COMMENTS

FOREWORD

The Attorney General is an elected constitutional state officer whose duties are set forth in Title 3, Chapter 35 of the Connecticut General Statutes. The Attorney General is the chief civil legal officer of the state, serves as legal counsel to all state agencies, and is authorized to represent the people of the state to protect the public interest. George Jepsen served as the Attorney General during the audited period and continues to serve in that capacity.

The mission of the office is to represent and advocate for the interests of the state and its citizens, ensure that state government acts within the law, protect public resources for present and future generations, preserve and enhance the quality of life for all state citizens, and ensure that the rights of the most vulnerable citizens are safeguarded. The office is divided into 16 departments that serve as legal counsel to state agencies. The departments are:

Antitrust	Child Protection
Civil Rights/Torts	Collections & Child Support
Consumer Protection	Employment Rights
Environment	Energy
Finance	Health and Education
Health care Fraud/Whistleblower/Health Care Advocacy	Privacy and Data Security
Public Safety & Special Revenue	Special Litigation
Transportation, Housing & Public Works	Workers' Compensation & Labor Relations

Significant New Legislation

There were no legislative changes with any significant effect on the operations of the Office of the Attorney General during the audited period.

RÉSUMÉ OF OPERATIONS

Revenues

Revenues for the Office of the Attorney General for the fiscal years ended June 30, 2015, 2016 and 2017, are summarized below by fund:

	2014-2015	2015-2016	2016-2017
General Fund	\$ 38,559,845	\$ 5,444,428	\$ 63,102,008
Federal and Other Restricted Accounts Fund	2,273,308	1,672,535	1,283,360
Total Revenues Listed by Fund	\$ 40,833,153	\$ 7,116,963	\$ 64,385,368

The Office of the Attorney General collects revenue from the litigation of civil cases, which is transferred directly to the General Fund as well as collections on behalf of other state agencies, which are subsequently transferred to those agencies. Office operations are primarily funded through a General Fund appropriation. General Fund receipts fluctuate due to the size of settlements, which can vary substantially from year to year. The majority of the revenue during the 2014-2015 fiscal year was due to a settlement with Standard and Poor’s for \$36 million. The case involved charges that Standard and Poor’s misled investors during the 2008 financial collapse. In the 2016-2017 fiscal year, there was also a \$31.5 million settlement with Moody’s regarding charges of misleading investors as a result of its rating of structured financial securities. The office also collected \$14.8 million from Volkswagen through a multistate settlement resolving claims that the company violated environmental laws when it equipped vehicles with devices designed to circumvent emissions standards.

Revenues for the Office of the Attorney General by revenue account are presented below:

	2014-2015	2015-2016	2016-2017
Negotiated Settlements	\$ 37,426,035	\$ 5,222,696	\$ 62,956,136
Civil Penalties for Court Judgments	127,111	184,504	-
Recoveries for Attorney Fees	949,826	2,000	134,970
Other Revenues	2,330,181	1,707,763	1,294,262
Total Revenues Listed by Account	\$ 40,833,153	\$ 7,116,963	\$ 64,385,368

Expenditures

Expenditures by fund for the Office of the Attorney General for the fiscal years ended June 30, 2015, 2016, and 2017, are summarized below:

	<u>2014-2015</u>	<u>2015-2016</u>	<u>2016-2017</u>
General Fund	\$ 31,840,605	\$ 30,574,461	\$ 30,095,649
Federal and Other Restricted Accounts Fund	484,935	847,645	689,855
Capital Improvements Fund	81,913	401,868	25,849
Total Expenditures Listed by Fund	\$ 32,407,453	\$ 31,823,974	\$ 30,811,353

Personal services costs represent the majority of General Fund expenditures year after year. Total expenditures from the General Fund decreased 4% and 1.6% during the audited period, primarily due to employee retirements and positions remaining vacant. The Federal and Other Restricted Accounts Fund includes several smaller accounts that are used to record expenses incurred for specific types of cases, such as consumer protection, client agency costs, tobacco regulations, and the Second Injury Fund. Also within this fund category, the office pays law firms providing specialized services using funds transferred by the state agency that required the specialized service. These amounts are netted within the Federal and Other Restricted Accounts Fund and presented as an expenditure on the related state agency's accounting records. The expenditures for these law firms totaled \$2.2 million and \$2.4 million for the fiscal years ended June 30, 2016 and 2017, respectively. The increase in the capital improvements fund in the 2015-2016 fiscal year was primarily associated with the purchase of the iManage document storage system that is integrated with the Lawbase case management system.

Expenditures by account for the Office of the Attorney General are presented below:

	<u>2014-2015</u>	<u>2015-2016</u>	<u>2016-2017</u>
Personal Services & Employee Benefits	\$ 30,757,883	\$ 29,986,904	\$ 29,553,832
Employee Expenses, Allowance & Fees	191,667	255,590	167,139
Purchases & Contracted Services	527,626	649,190	502,387
Motor Vehicle Cost	14,636	16,560	15,249
Premises & Property Expenses	105,813	100,116	97,451
Information Technology	302,000	607,460	327,084
Purchase Commodities	169,902	121,136	138,236
Grant Refunds	13	12,803	
Capital Outlay Equipment	214,473	74,215	9,975
GAAP Expenditure	123,440		
Total Expenditures Listed by Account	\$ 32,407,453	\$ 31,823,974	\$ 30,811,353

Total expenditures decreased 1.8% between the fiscal years ended June 30, 2015 and 2016 and decreased 3.2% between the fiscal years ended June 30, 2016 and 2017. Personal services and employee benefits decreased 2.5% and 1.4% for the fiscal years ended June 30, 2014 and 2015, respectively. In the 2015-2016 fiscal year, the office implemented a new document storage software called iManage, which caused an increase in information technology expense. The other expenditure categories remained relatively consistent.

Second Injury Fund Costs

All expenses incurred by the office on behalf of the Second Injury Fund managed by the State Treasurer were paid from the Second Injury and Compensation Assurance Fund in accordance with Section 31-355 subsection (d) of the General Statutes. Personal services for employees charged directly to the Second Injury Fund totaled \$2,053,353 and \$1,937,402 for the fiscal years ended June 30, 2016 and 2017, respectively.

Funds Awaiting Distribution and Escrow Account for Settlements

The Funds Awaiting Distribution Fund and an escrow account were used to delineate the collection and distribution of settlements due to the office, other state agencies, or consumers. The Funds Awaiting Distribution Fund is a temporary suspense account for receipts awaiting final distribution to consumers. The escrow account is a bank account used to deposit receipts for contingencies in cases in which the outcome is dependent on factors yet to occur. Distributions are made in accordance with the corresponding court orders. The Funds Awaiting Distribution Fund's balances for the fiscal years ended June 30, 2016 and 2017 were \$2,802 and \$57,851 respectively. The escrow account was rarely used during the audit period and carried a minimal balance.

STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

Our audit identified the following reportable conditions:

Accounts Receivable Record Keeping:

Background: The business office maintains a master log of accounts receivables which includes the balance and account activity on all of the office's receivables. This log is used as a documentation tool for the annual report of receivable balances provided to the State Comptroller. The 16 divisions within the Office of the Attorney General are each separately responsible to notify the business office to add balances to the log when judgments are awarded. Each division has separate procedures for tracking receivable balances. The office also maintains a case tracking system, called Law Base, through which activity reports can be run.

Criteria: The management of the Office of the Attorney General is responsible for establishing and maintaining effective internal controls in order to provide for accurate and complete reporting of accounts receivable balances. The office should record accounts receivable at the time monetary litigation settlements are awarded to the state, as there is normally a lag between the settlement date and the date that the state receives the funds.

Condition: We reviewed the settlement report from Law Base for closed cases and found 9 instances in which a receivable should have been established, but the business office was never notified to record the amounts on the master accounts receivable log. Additionally, there were 21 transactions, totaling approximately \$30 million that the office recorded in the general ledger under settlement revenue. However, these transactions were not included in the settlement report. In addition, the office did not perform a reconciliation between judgment amounts received and amounts that should have been received.

Effect: We were unable to verify the completeness of the receivables balance reported at the end of the audit period. When accounting records are incomplete, there is an increased risk that receivables are not accounted for or are improperly reported.

Cause: Management has not established office-wide procedures for managing and reporting accounts receivable balances to the business office. Each division is separately responsible for recording and reporting its own receivables.

Recommendation: The Office of the Attorney General should improve internal controls over the accounting and reporting of its accounts receivable balances to ensure that the business office is notified of all accounts receivable activity. (See Recommendation 1.)

Agency Response: “Going forward each department will be required to send a copy of an awarded monetary disposition to the business office in cases where the Attorney General's Office is receiving and depositing the funds. This will be done when the disposition is awarded. The business office will record these awards as receivables until the funds are collected and deposited thus ensuring the accuracy of the receivable logs. In order to address the accuracy of the dispositions in Law Base, a report is being developed that will show any incomplete dispositions in Law Base. Each department will be required to run this report on a monthly basis and complete any missing information.”

Asset Management Reporting:

Criteria: Section 4-36 of the General Statutes requires that agencies establish and maintain inventory records as prescribed by the Office of the State Comptroller. The agency is required to transmit a property control report (CO-59) annually to the State Comptroller as of June 30th and maintain its inventory in Core-CT, the state accounting system. The CO-59 should reconcile to the Core-CT inventory listing. The State Property Control Manual establishes the capitalization rules and thresholds for reporting asset categories such as software and equipment.

The State Property Control Manual also requires reporting of licensed software meeting the capital threshold on the CO-59, excluding maintenance fees. Agencies should remove any assets that are no longer in service from the records in a timely manner.

Condition: The Core-CT inventory records of the Office of the Attorney General were inaccurate in the annual inventory report as of June 30, 2017, as a result of the following exceptions:

- The office overstated licensed software by a net amount of \$154,528 due to reporting licenses beneath the capitalization threshold, including maintenance fees in error, and omitting 1 software item that was missing from the inventory.
- The office overstated capital equipment by \$42,244, due to the inclusion of licensed software within the capital equipment balance, and the failure to remove 1 disposed item from the inventory records.

Effect: The office misstated its equipment inventory and software inventory records. There is an increased risk of loss of state property when complete inventory records are not maintained.

Cause: There was a lack of management oversight over the maintenance of accurate equipment and software inventory records. In addition, the office did not the properly account for newly purchased software.

Recommendation: The Office of the Attorney General should improve internal controls over asset management and purchasing in order to comply with the requirements of the State Property Control Manual. (See Recommendation 2.)

Agency Response: “We agree with these findings. These exceptions are in the process of being corrected. Going forward staff will properly create purchase orders in conjunction with the Property Control Manual and the Office of the State Comptroller if necessary. All deleted assets and purchase orders for assets will be reviewed by the Business Office Manager. This additional oversight will detect any errors before the preparation of the property control report (CO-59).”

RECOMMENDATIONS

Our prior audit report on the fiscal years ended June 30, 2014 and 2015 contained a total of 2 recommendations. Of those recommendations, 2 have been repeated or restated with modifications during the current audit. The status of the recommendations in the prior report and a summary of current audit recommendations is presented below.

Status of Prior Audit Recommendations:

- **The Office of the Attorney General should improve internal controls over the accounting and reporting of its accounts receivable balances.** Our review disclosed similar exceptions in this area. This recommendation is being repeated. (See Recommendation 1.)
- **The Office of the Attorney General should improve internal controls over asset management and purchasing to comply with the requirements of the State Property Control Manual.** Our review disclosed similar exceptions in this area. This recommendation is being repeated. (See Recommendation 2.)

Current Audit Recommendations:

1. **The Office of the Attorney General should improve internal controls over the accounting and reporting of its accounts receivable balances.**

Comment:

Our review disclosed weaknesses in internal control over the accurate recording and reporting of accounts receivable balances

2. **The Office of the Attorney General should improve internal controls over asset management and purchasing in order to comply with the requirements of the State Property Control Manual.**

Comment:

Our review disclosed errors in the preparation of the CO-59 property control report.

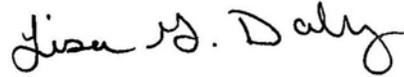
ACKNOWLEDGEMENT

The Auditors of Public Accounts would like to recognize the auditors who contributed to this report:

Jessica Landino
Matthew Wood

CONCLUSION

In conclusion, we wish to express our appreciation for the courtesies and cooperation extended to our representatives by the personnel of the Office of the Attorney General during the course of our examination.



Lisa G. Daly
Administrative Auditor

Approved:



John C. Geragosian
State Auditor



Robert J. Kane
State Auditor