

STATE OF CONNECTICUT



*AUDITORS' REPORT
STATE TREASURER - DEPARTMENTAL OPERATIONS
FOR THE FISCAL YEARS ENDED JUNE 30, 2007 AND 2008*

AUDITORS OF PUBLIC ACCOUNTS

KEVIN P. JOHNSTON ❖ ROBERT G. JAEKLE

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November 6, 2009

**AUDITORS' REPORT
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FOR THE FISCAL YEARS ENDED JUNE 30, 2007 AND 2008**

We have made an examination of the financial records of the Office of the State Treasurer (State Treasurer, or Treasury) as they pertain to the Agency's departmental operations for the fiscal years ended June 30, 2007 and 2008. This report on that examination consists of the Comments, Condition of Records, Recommendations and Certification that follow. We also issued separate audit reports covering the State Treasurer - State Financial Operations for the fiscal years ended June 30, 2007 and 2008.

This audit has been limited to assessing the State Treasurer's compliance with certain provisions of financial-related laws, regulations and contracts, and evaluating the internal control policies and procedures established to ensure such compliance. Financial statement presentation and auditing are done on a Statewide Single Audit basis to include all State agencies, including the State Treasurer.

COMMENTS

FOREWORD:

The State Treasurer operates primarily under the provisions of Article Fourth of the State Constitution and Title 3, Chapter 32 of the General Statutes. The Treasury is organized into several divisions and performs a number of functions. This report is concerned with the departmental operations of the Treasury and includes our review of the Business Office, Personnel, Informational Services, and the Unclaimed Property Division. Our review of financial operations of the Treasury that have Statewide impact has been issued under separate cover to include the Pension Funds Management Division, the Debt Management Division, the Cash Management Division, the Connecticut Higher Education Trust, and the Second Injury Fund. A listing of officers and officials and a description of the major functions of the divisions covered in this report follows.

Officers and Officials:

The officers and officials of the State Treasury as of June 30, 2008, were as follows:

Denise L. Nappier, State Treasurer
Howard G. Rifkin, Deputy Treasurer
Linda Hershman, Assistant Deputy Treasurer and Chief of Staff
Maria M. Greenslade, Asst. Deputy Treasurer, Second Injury Fund and Unclaimed Property
Lee Ann Palladino, Acting Chief Investment Officer
Lawrence Wilson, Assistant Treasurer Cash Management
Meredith A. Miller, Assistant Treasurer, Policy
Sarah Sanders, Assistant Treasurer, Debt Management

New Legislation:

Public Act 07-01, Section 96, of the June 2007 Special Session, amended Section 3-69a, subsection (a)(2) of the General Statutes, and allocated \$17,300,000 of escheat revenues for the fiscal year ended June 30, 2008, to the Citizens' Election Fund, instead of having the amount determined by the change in the consumer price index. Thereafter, transfer amounts will be adjusted using the changes in the consumer price index. The State Elections Enforcement Commission administers this fund, which is a publicly-financed campaign fund from which payments are made to participating candidates. Funds would have been previously deposited into the General Fund. This Act was effective June 26, 2007.

RÉSUMÉ OF OPERATIONS:

Department Revenues:

Departmental revenues were mainly from the Second Injury and Compensation Assurance Fund (SIF), Workers' Compensation Administration Fund (WCA), Grants and Restricted Accounts Fund and the General Fund. The Second Injury Fund's revenues consisted mainly of assessments levied against self-insured employers and companies writing workers' compensation or employers' liability insurance and totaled \$56,654,098 and \$45,049,929 for the fiscal years ended June 30, 2007 and 2008, respectively. WCA Fund assessment receipts totaled \$19,865,392 and \$20,585,759 for the fiscal years ended June 20, 2007 and 2008, respectively. More detailed information concerning the SIF and the WCA Fund is included in our Auditors' Reports on the State Treasurer – State Financial Operations. The General Fund's and Grants and Restricted Accounts Fund's revenues, a large percentage of which consisted of restricted account and special revenue fund transfer receipts to cover charges from the Combined Investment Fund, Second Injury Fund and Unclaimed Property Division's receipts, amounted to \$315,674,733 and \$550,033,696 for the fiscal years ended June 30, 2007 and 2008, respectively. General Fund – Unclaimed Property receipts decreased since June 30, 2006, as there was less property escheated to the Treasury, and General Fund – All other Receipts increased then decreased as the amounts represent income on General Fund balances invested in the Short-Term Investment Fund and the Tax Exempt Proceeds Fund. Income fluctuates based upon cash balances and rates of return. The changes in the Grants and Other Restricted Account Fund represent deposit of funds associated with the operating expenses of

the Pension Funds Management Division, Second Injury Fund, Unclaimed Property Division, Short-Term Investment Fund and the Debt Management Division. The largest variances appear in the Debt Management Division's accounts, which will fluctuate from year to year based on activity.

	<u>Fiscal Year Ended June 30,</u>		
	<u>2006</u>	<u>2007</u>	<u>2008</u>
Other Restricted Account	\$132,357,395	\$156,667,554	\$412,175,621
General Fund - All other Receipts	78,978,820	118,881,273	96,244,037
General Fund – Unclaimed Property	<u>57,779,706</u>	<u>40,125,906</u>	<u>41,614,038</u>
Total Revenues	<u>\$269,115,921</u>	<u>\$315,674,733</u>	<u>\$550,033,696</u>

Public Act 05-05, of the October 25, 2005 Special Session, and effective December 7, 2005, allocated \$17,000,000, \$16,000,000, and \$17,300,000 of escheat revenues for the fiscal year ended June 30, 2006, 2007 and 2008, respectively, to the Citizens' Election Fund. These amounts, as well as administrative expenses for the program, have already been deducted from the General Fund – Unclaimed Property amounts noted above. The Treasury also receives noncash (unclaimed) property, including shares of stock and mutual funds. The noncash property is not reflected in the General Fund's cash receipts until it is sold. As of June 30, 2007 and 2008, the Treasury estimated the market value of unclaimed securities to be \$100,308,559 and \$95,346,284.

Department Expenditures:

The operations of the Treasury for the fiscal years ended June 30, 2007 and 2008, excluding expenditures classified as debt service paid and workers' compensation awards that are included in the separate audit report on State financial operations, are summarized below:

	<u>Fiscal Year Ended June 30,</u>		
	<u>2006</u>	<u>2007</u>	<u>2008</u>
Net Expenditures by Fund:			
Special Revenue Fund	\$ 85,519,170	\$ 94,934,024	\$ 86,669,379
General Fund-Non-Functional	26,035,261	25,681,204	30,683,282
General Fund-Budgeted	3,770,933	3,890,612	3,818,529
Capital Projects Fund	<u>13,840</u>	<u>2,262</u>	<u>-0-</u>
Net Expenditures	<u>\$115,339,204</u>	<u>\$124,508,102</u>	<u>\$121,171,190</u>

The Special Revenue Fund was the major funding source for the Treasurer's Pension Funds Management Division, Second Injury Fund, Bond Issue Costs, and a Bank Compensation Account. Operating Expenditures of the Unclaimed Property Division and a Special Assessment account are also paid from the Special Revenue Fund. General Fund – Non-Functional expenditures were for reimbursements of unclaimed property. A comparison of departmental expenditures categorized by account code is as follows:

	<u>Fiscal Year Ended June 30,</u>		
	<u>2006</u>	<u>2007</u>	<u>2008</u>
Net Expenditures by Major Object:			
Purchased & Contractual Services	\$ 71,275,136	\$ 79,827,934	\$ 72,454,187
Unclaimed Property Returned to Owners	26,035,261	25,681,204	30,683,282
Personal Services & Employee Benefits	17,523,978	18,297,907	17,380,656
Purchased Commodities	90,433	161,696	153,650
Employee Expenses, Allowances & Fees	122,299	123,940	135,469
Premises & Property Expenses	86,728	99,799	133,023
Information Technology	141,656	157,118	132,473
Capital Outlays - Equipment	21,754	126,973	56,832
Motor Vehicle Costs	41,959	31,531	41,618
Net Expenditures	<u>\$115,339,204</u>	<u>\$124,508,102</u>	<u>\$121,171,190</u>

Contractual and personal services are the major expenditures of the Treasury, other than debt service cost, which has been excluded from our summary as it is reviewed in our Auditors' Report on Financial Operations. The most significant item included in contractual services is the payments of the investment advisor performance fees by the Pension Funds Management Division. Payment processing procedures made pursuant to these contracts were reviewed as part of the financial statement audit. Returns of unclaimed property increased during the fiscal year ended June 30, 2008, because the Treasury reduced backlogs related to the loading of property to the database and paying claims for property. Personal services expenditures were paid from the following sources:

	<u>Fiscal Year Ended June 30,</u>		
	<u>2006</u>	<u>2007</u>	<u>2008</u>
General Fund:			
Budgeted Accounts	\$ 3,485,301	\$3,607,668	\$3,513,115
Grants and Restricted Accounts Funds			
Second Injury Fund	6,687,561	5,702,446	5,435,083
Pension Funds Management Division	3,088,219	4,799,726	4,781,041
Unclaimed Property	3,154,130	3,262,785	2,836,468
Short-Term Investment Fund	1,094,927	923,020	814,948
Capital Projects Fund	13,840	2,262	-0-
Totals	<u>\$17,523,978</u>	<u>\$18,297,907</u>	<u>\$17,380,655</u>

Total personal services expenditures increased 4.4 and decreased 5.0 percent in the fiscal years ended June 30, 2007 and 2008, respectively. The increase for the fiscal year ended June 30, 2007, was due primarily to a combination of contractual general wage and cost of living increases as well as managerial PARS increases, and an increase in the fringe benefit rate. The Unclaimed Property Division also had overtime costs, which were related to that Division's need to update its database of owners' names to a current status. For the fiscal year ended June 30, 2008, the average number of employees (not positions) decreased by six and the fringe benefit rate also decreased slightly. Employment statistics for the Treasury for full-time permanent positions are as follows:

	<u>June 30,</u>	
	<u>2007</u>	<u>2008</u>
General Fund:		
Budgeted Accounts	45	45
Other Restricted Accounts Funds:		
Second Injury Fund	38	41
Unclaimed Property	27	28
Pension Funds Management Division	25	22
Short-Term Investment Fund	8	8
Other Funds	<u>4</u>	<u>4</u>
Total Positions	<u>147</u>	<u>148</u>

Unclaimed Funds:

The administration and disposition of property held by banking and other organizations for the benefit of owners who cannot be located is provided for in Sections 3-56a to 3-74a of the General Statutes. The Statutes provide for all escheat cash receipts to be deposited into the General Fund with the exception of periodic transfers to the Citizens Election Fund and a restricted unclaimed property account within the General Fund. Transfers to the Citizens Election Fund totaled \$16,000,000 and \$17,300,000 for the fiscal years ended June 30, 2007 and 2008. The restricted account funds are used to pay the Unclaimed Property Division's administrative costs. These transfers totaled \$9,000,000 and \$5,000,000 for the fiscal years ended June 30, 2007 and 2008, respectively. The receipts presented below show revenues prior to their reallocation to adjust for these transfers.

Unclaimed property includes unclaimed bank accounts and insurance policies as well as uncashed checks, customer overpayments held by businesses, and various court deposits. A comparison of unclaimed property receipts as presented in the Treasurer's Annual Report for the fiscal years ended June 30, 2007 and 2008, is as follows:

	<u>Fiscal Year Ended June 30,</u>		
	<u>2006</u>	<u>2007</u>	<u>2008</u>
Unclaimed Property Receipts:			
Business corporations	\$35,493,021	\$33,525,530	\$26,290,387
Financial institutions	15,993,361	12,600,393	19,285,223
Insurance companies	10,248,539	9,799,185	11,999,735
Governmental and public agencies	7,336,064	4,589,034	4,271,153
Dividends on securities held	837,416	1,183,394	1,672,493
Reciprocal exchange with other states	734,910	2,763,399	368,655
Miscellaneous	364,623	507,724	150,011
Securities liquidated	13,617,580	-0-	-0-
Miscellaneous	<u>108,807</u>	<u>-0-</u>	<u>-0-</u>
Totals	<u>\$84,734,321</u>	<u>\$64,968,659</u>	<u>\$64,037,657</u>

The fiscal year ended June 30, 2006, included proceeds from the sales of securities in the amount of \$13,617,380 that were previously held by the Unclaimed Property Division. There have been no sales during the fiscal years ended June 30, 2007 or 2008. In addition to the cash receipts

listed above, the Division also receives abandoned stocks, bonds and mutual funds as authorized under Section 3-56a and Section 3-56b of the General Statutes. According to the Treasurer's Annual Report, the estimated market values of these securities were as follows:

	<u>As of June 30,</u>		
	<u>2006</u>	<u>2007</u>	<u>2008</u>
Securities Inventory	\$58,800,685	\$100,308,559	\$95,346,284

During the fiscal year ended June 30, 2005, over \$89 million of securities were sold and the proceeds forwarded to the General Fund. This sale preceded the lower inventory value for June 30, 2006. The subsequent increase was generally due to escheated shares during the fiscal year ended June 30, 2007. The decrease in the value as of June 30, 2008, was because of the decline in market conditions, which continued subsequent to June 30, 2008, consistent with market conditions.

The Unclaimed Property Division's claim payments made in cash, transfers to the Citizens' Election Fund to support the State Elections Enforcement Commission, and administrative expenses as reported in the Treasurer's Annual Report are as follows:

	<u>Fiscal Year Ended June 30,</u>		
	<u>2006</u>	<u>2007</u>	<u>2008</u>
Claim Payments	\$25,990,877	\$25,280,243	\$30,626,832
Transfers to Citizens Election Fund	17,000,000	16,000,000	17,300,000
Salaries and fringe benefits	3,154,315	3,896,514	3,396,050
Data processing and hardware	3,237,913	2,826,339	3,018,137
All other	<u>266,173</u>	<u>220,355</u>	<u>449,575</u>
Totals	<u>\$49,649,278</u>	<u>\$48,223,451</u>	<u>\$54,790,594</u>

During the fiscal year ended June 30, 2008, the State Treasury published owners' names as required in accordance with Section 3-66a of the General Statutes, which requires the Treasurer to publish the names of unclaimed property owners (that have not previously been published) at least once every two years. This caused more claim inquiries and more property was returned to owners during that fiscal year.

Second Injury and Compensation Assurance Fund:

The operations of this fund are provided for by various statutes of the Workers' Compensation Act, Chapter 568, of the General Statutes (notably Sections 31-310 and 31-349 through 31-355b). This Act provides protection for employees suffering occupational injuries or diseases and establishes criteria determining whether benefits due employees are to be paid by the employers (or their insurance carrier) or out of the Second Injury Fund (Fund). The Treasurer is the custodian of the Fund. In accordance with the provisions of Section 31-349e of the General Statutes, there is an advisory board to advise the custodian of the Fund on matters concerning administration, operation, claim handling and finances of the fund. Comments regarding the financial operations of this fund are included under separate cover in our Reports on the State Treasurer – State Financial Operations for the fiscal years ended June 30, 2007 and June 30, 2008.

CONDITION OF RECORDS

The following recommendations resulted from our current review of the Office of the State Treasurer's departmental operations.

Transferring Positions:

Criteria: Section 3-13a of the General Statutes, allows the Treasurer to appoint employees to assist the Chief Investment Officer (CIO) in investing the retirement pension and trust funds (investment-related functions). Section 5-216 of the General Statutes states that the Commissioner of the Department of Administrative Services shall establish the candidate lists for the various positions in classified service.

Condition: Employees were appointed to positions established for investment-related functions. However, the job duties do not appear to always meet the criteria established within Section 3-13a of the General Statutes. One particular appointment was made to a position now located in the Unclaimed Property Division, whose duties do not include assisting the Chief Investment Officer in investment-related functions. Unclaimed property-related positions generally must be filled by competitive selection while investment-related positions are not subject to competitive selection rules.

Cause: The Treasury indicated it transferred certain positions, which were established to assist the CIO, to meet its needs in other Divisions.

Effect: It may appear that other eligible candidates may not have been given the opportunity to apply for classified-service positions containing certain job duties now being performed by appointees.

Recommendation: The Treasurer's Office should not use positions established to assist the Chief Investment Officer in investing pension funds to perform duties unrelated to that purpose. (See Recommendation 1.)

Agency Response: "CGS §3-13a states that the CIO shall perform such other duties as the Treasurer may direct. One of the CIO's duties has always been to assist Unclaimed Property with respect to its investment assets. CGS §3-13a further states that the Treasurer may appoint investment officers and other personnel to assist the CIO.

The unclaimed property analyst is, of course, one of such personnel that assist the CIO in meeting this duty, and was therefore hired, after approval by the Department of Administrative Services, to handle escheated securities backlogs that existed prior to December 2006 when a new computer system and other changes were implemented.

Recognizing that the on-going handling of escheated securities requires full time attention, the Office of the Treasurer sought and received approval from both DAS and OPM to fill a Securities Analyst position to address the securities issues with escheated property. The Treasury Office did post and advertise the opportunity to apply for the Security Analyst position. A number of candidates responded, were interviewed, and were offered the position. While the Agency believes that the appointment was made consistent with current statutory authority, the Treasury will work with DAS to clarify this authority and approve the establishment of a new classified position specifically to address the securities needs of the escheats program.”

Auditors’ Concluding

Comment: The Treasurer’s response is misleading. In this case, this employee (a) does not assist the CIO of the Pension Fund, (b) reports directly to the Unclaimed Property Division’s (UPD’s) Assistant Treasurer, and (c) worked more with claim reimbursements than the securities portfolio on a full-time basis. The Pension Funds Management Division has assisted the UPD to sell UPD’s securities in the past; however, assisting the UPD is not a routine function of the CIO, and does not justify the need for a full-time appointed position. If there was justification, you would expect the position to be funded from the Pension Fund, not the General Fund.

Timesheet Errors:

Criteria: Timesheets prepared by employees and approved by supervisors should be an accurate representation of actual hours worked.

Condition: Two employees in the Pension Funds Management Division failed to accurately record leave time on their timesheets for five days that they were not at work. Corrections were made in that three days were retroactively charged against the employees’ accumulated sick leave time and two days were paid back in cash to the State.

Cause: The employees failed to record leave time on their timesheets and supervisory approval was not an effective control in preventing or detecting the errors.

Effect: Two employees received five days of regular pay, estimated to be \$2,181, without working and accrued leave time balances were overstated by three days, until corrected.

Recommendation: The Treasury should ensure that internal controls are effectively implemented by supervisors to prevent or detect errors made by employees on time and attendance records. (See Recommendation 2.)

Agency Response: “The two employees were counseled about properly recording leave on timesheets. The “Request for Leave” slips were approved by the supervisor and notification was given to the supervisor for the sick days, but were mistakenly not entered onto their timesheets. Of the five days not entered onto the timesheets, four days were mistakenly left off by a new employee unfamiliar with timesheet accounting. The recording of time off requests and sick time previously verified and approved by various department assistants are now verified directly by the supervisor.”

Unclaimed Property Division Revenues:

Criteria: Section 3-65a, subsection (g), of the General Statutes, authorizes the Treasurer to examine the records of any holder of property presumed abandoned to determine whether the holder has complied with the Statutes relating to the Unclaimed Property Division. Section 3-65b, subsection (a), of the General Statutes, indicates that any failure to report or deliver abandoned property within the time prescribed shall pay interest to the Treasurer at the rate of fifteen percent per annum. The Treasurer is authorized to waive the interest. Section 3-68a of the General Statutes, allows the Treasurer to sell unclaimed stock certificates at the Treasurer’s discretion.

Condition: Since March 2005, examinations of holder records have been put on hold for companies within Connecticut, and interest charges related to companies who have not reported or delivered abandoned property have not been assessed. Previous collections averaged \$1,300,000 per year.

The Treasury did not sell any stocks or other securities for cash during the audited period. Generally, the proceeds from any sale would benefit the General Fund. The value of the securities as of May 30, 2009, was \$47,977,050. The Treasury did begin selling certain mutual funds during the fiscal year ended June 30, 2009.

Cause: The Division has reassigned the examiners to reconcile and update stock information in the database. The sales process was hampered somewhat by the reconciliation process that needed to occur. The Division has historically tried to encourage rather than penalize holders to report and deliver property.

Effect: The State is not receiving the benefit of cash from examinations of Connecticut companies, interest charges, or proceeds from sale of stocks.

Recommendation: The Treasurer should consider resuming examinations of Connecticut companies as allowed under Section 3-65a, subsection (g), of the General Statutes, assessing interest in accordance with Section 3-65b, subsection (a),

and completing its overall plan to liquidate shares of stock as allowed in accordance with Section 3-68a of the General Statutes. (See Recommendation 3.)

Agency Response: “An administrative decision was made to reassign examiners to the reconciliation of securities held by the State in an effort to minimize the delays in payments to claimants. It is the intention of the Division to pursue timely in-state auditing as the effort to reconcile securities begins to wind down. Concurrently, the Division has been reviewing and updating the procedures and practices for the examination of holder records in anticipation of reassigning the examiners.”

Claims Processing Issues in the Unclaimed Property Division:

Criteria: Section 3-62g and Section 3-66a of the General Statutes, requires the Treasurer to assume custody of property, publish owner names and to be responsible for all claims to unclaimed property owners. Section 3-70a, subsection (b), specifies that the Treasurer shall consider each claim within ninety days after it is filed. Proper internal controls ensure that rightful owners are paid accurately and that the database of owners’ names (database) is updated accordingly.

Condition: Many of our concerns relate to severe backlogs in many areas within the Unclaimed Property Division that existed prior to December 2006 (the conversion), when a new computer system and other changes were implemented. The Division is making continual efforts to address the issues related to these backlogs that existed some time before the conversion. Our concerns are as follows:

- The database is not completely updated. As of June 1, 2009, 132 claims were waiting for the updates to occur. Property updates, including stock sales, spinoffs, stock splits, and other corporate actions, total \$25,575,650 in cash and 642,370 shares of stock as of June 30, 2008. Owners may file claims for the property; however, the Division is unable to pay the claims until the property is updated in the database.
- The database does not contain all escheated property. The Treasury received cash of \$996,376, which has not been loaded into the database as of March 1, 2009. These amounts cannot be published by the Treasury or claimed by the owners until the property is loaded into the database. The Division continues to address the backlog of loading property, which was greatly reduced since our prior audit.
- The database is not always accurate. The Division’s procedure is to pay

claims directly from its database; however, the database does not always contain accurate information. Most of the inaccuracies relate to property escheated prior to the conversion. Posting errors made on the older property caused stock sale proceeds and dividend information to not always be accurate in the database. One error made in the database will usually affect all owners of a particular property. For example, one claim we tested was overpaid \$868, and the Treasury estimated that 58 other owners of that property were overpaid a total of \$17,337. In other cases, seven claims were underpaid for dividends and fractional shares in the amount of \$121. Treasury is working to either collect from, or pay, those owners who were affected. One claim was marked paid in the system but was never actually paid. Fifteen of 31 claims we tested were processed beyond the 90-day consideration period; however, this was generally expected due to the backlog of claims that the Division continues to address.

- **Summary of Loss Reports:** The Treasury reported that payments were made in error totaling \$105,209 during the audited period. The database contained inaccurate information or property that belonged to one owner was paid to another person. As of June 1, 2009, \$19,800 was not recovered and the file was referred to the Office of Attorney General.
- **Stock Claim Approvals:** Claims for stock valued in excess of \$24,999 do not include an approval higher than the Claims Supervisor, which may be necessary. Claims for cash in excess of \$24,999 were reviewed at two additional levels in accordance with the policy. We believe the policy should be extended to stock claims as well.
- **Overriding of System Controls:** In one case the Division overrode the system to facilitate a payment to a claimant whose property was previously paid to another person in error. The second case involves the posting of mutual fund dividends, which requires certain paid claims to be marked unpaid in order for updates to post properly.

Cause: Backlogs that existed prior to the conversion, as well as a decision to transfer old data to a new system without reconciling the information first, contributed to certain conditions.

Effect: Certain claims were underpaid, overpaid or delayed, and one claim was paid to the wrong person. There is a risk that other improper payments could occur and not be detected.

Recommendation: The Unclaimed Property Division should comply with Sections 3-62g, 3-66a, and 3-70a, subsection (b), of the General Statutes, and follow internal control procedures designed to prevent improper payments. (See Recommendation 4.)

Agency Response: “The Division agrees with the recommendation. The Division is continuing its work updating and reconciling stock holdings. During the audit period more than \$55.9 million in unclaimed property was returned to 37,717 claimants.”

Database Management and Contractual Services in the Unclaimed Property Division:

Criteria: The Division should be monitoring system changes and audit trails related to its database for sufficient information technology (IT) controls. The Division also contracts with a vendor who should provide the ability to produce 1099 reporting on bank and stock claims and who should update the owners’ names posted to the website to include all owners whose information meets the State’s criteria for publication.

Condition: We found areas where controls over certain areas of database management needed improvement:

- The Division is working on formalizing a written disaster recovery plan.
- More effective monitoring of the database is necessary to review system changes or audit trails for data integrity or other issues.
- 1099 reporting was not processed according to requirements until we brought it to the Division’s attention.
- The website did not include some owners’ names that were to be posted until we brought it to the Division’s attention.

Cause: Management has not determined the extent of procedures it needs to best monitor and maintain its database of information and needs to better monitor its vendor’s compliance with contractual provisions.

Effect: Certain Federal and State reporting requirements were not met and there is less assurance the data managed by the Division is reliable and secure.

Recommendation: The Unclaimed Property Division should determine the procedures it needs to best monitor its database and its vendor’s compliance with contractual provisions. (See Recommendation 5.)

Agency Response: “The Division agrees with the recommendation and has begun working with the vendor to implement procedures that ensure the most current programs are being utilized.”

Executive Search Consulting Services:

- Criteria:* The Pension Funds Management Division contracted with an executive search firm to find candidates for a Chief Investment Officer (CIO) and a Deputy Chief Investment Officer. The contract was for two separate searches, which were to be done in succession.
- Condition:* The contract called for a \$70,000 fee for the CIO search and a \$65,000 fee for the Deputy CIO search. Although the contract's scope of services stated that the two searches would be done in succession and payment was not due until each search had commenced, the fee for the Deputy CIO search was paid before the CIO search was concluded. The contract states that the commencement of the Deputy CIO search shall not be more than five days after the conclusion of the search for CIO. Fees for the Deputy CIO search were paid in November 2007 while the CIO search was ongoing in June 2008.
- Cause:* Lack of administrative control.
- Effect:* The State paid out \$65,000 in fees that were not due to be paid.
- Recommendation:* The Treasurer's Pension Funds Management Division should refrain from paying amounts that are not yet due to contractors. (See Recommendation 6.)
- Agency Response:* "The Agency agrees with the finding of the Auditors. The oversight and management of this contract rested in the Office of the Deputy Treasurer. He inadvertently signed off on the payment of a fee for the Deputy CIO search before the conclusion of the search for a CIO."

Outdated Regulations:

- Criteria:* The Regulations of State Agencies help to clarify the General Statutes and should reflect current information.
- Condition:* The Regulations of State Agencies related to certain divisions within the State Treasury do not reflect current information.
- Cause:* The Treasurer's Office has not made the updating of its regulations a priority.
- Effect:* Regulations do not serve to clarify information in the General Statutes.
- Recommendation:* The State Treasurer's Office should update its Regulations of State Agencies. (See Recommendation 7.)
- Agency Response:* "A review of the Regulations will be conducted by each division in order to determine whether any proposed change must be reflected."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

Our prior audit examination resulted in nine recommendations, of which three are repeated or restated in our current audit report. The following is a summary of those recommendations and the action taken by the Office of the State Treasurer.

- In accordance with Sections 3-62g, 3-66a, 3-65a, subsection (d), and 3-67a, subsection (c), of the General Statutes, the Unclaimed Property Division should act responsibly to assume, account for, update, publish, and keep a permanent record of unclaimed property. This area showed significant improvements and this recommendation will not be repeated.
- The Unclaimed Property Division should comply with Section 3-62g and Section 3-70a, subsection (b), of the General Statutes, and should follow internal control procedures designed to prevent improper payments. We noted improvements, however, certain conditions persisted in this area. As a result this recommendation is repeated in Recommendation 4.
- The Treasurer's Office should comply with Section 4-33a of the General Statutes and report all illegal, irregular or unsafe handling of State funds promptly. We found evidence of compliance so this recommendation will not be repeated.
- The Unclaimed Property Division should improve controls and comply with Sections 3-62g and 3-66a of the General Statutes, for its inventory of bonds and safe deposit boxes, and should also comply with Sections 3-68a, subsection (a), 3-69a, and 4-32 of the General Statutes for its inventory of safe deposit box items. The Division has addressed our concerns in this area so this recommendation will not be repeated.
- The Treasurer should resume examinations of Connecticut companies as allowed under Section 3-65a, subsection (g), of the General Statutes, should comply with Section 3-67a, subsection (c), in a timely manner, and should establish a plan to liquidate securities and forward the proceeds to the General Fund. This recommendation is repeated in Recommendation 3.
- The Treasurer's Office should allow companies to self-report their unclaimed property, comply with all statutory requirements when contracting for services provided by outside vendors and collect contractual overpayments in cash. Although the overpayment was not collected in cash, the other issues did not reoccur; therefore, we are not repeating this recommendation.
- The Treasury should require and review SAS 70 audit reports on the processes of outside service organizations that it hires to perform certain services, and the Treasurer should seek to obtain the complete report that was not made available during our audit. Current reports are now being made available for review. This recommendation is not being repeated.
- The Treasurer's Office should enforce contractual provisions with the proxy voting service that clearly delineates the responsibilities for calculating available shares for voting and require more complete reporting on shares voted. We found the Treasury has made some

improvements in this area so we are not repeating this recommendation.

- The Treasurer's Office should not use Section 3-13a, of the General Statutes as authority to make appointments to Divisions unrelated to the Pension Funds Management Division and should update its Regulations. No action appeared to be taken by the Treasury so this recommendation was separated and repeated in Recommendations 1 and 7.

Current Audit Recommendations:

The following recommendations resulted from our current review.

1. **The Treasurer's Office should not use positions established to assist the Chief Investment Officer in investing pension funds to perform duties unrelated to that purpose.**

Comments:

Positions established for investment-related functions were not used for that purpose and competitive-selection rules may have been circumvented.

2. **The Treasury should ensure that internal controls are effectively implemented by supervisors to prevent or detect errors made by employees on time and attendance records.**

Comments:

Employees were paid for time they did not work. Corrections were processed to charge the appropriate leave balances or repayments were made to the State.

3. **The Treasurer should resume examinations of Connecticut companies as allowed under Section 3-65a, subsection (g), of the General Statutes, should assess interest in accordance with Section 3-65a, subsection (b), and should establish a plan to liquidate its shares of stock.**

Comments:

The General Fund does not receive the full cash benefit of the held stocks until they are sold by the Unclaimed Property Division.

4. **The Unclaimed Property Division should comply with Sections 3-62g, subsection (d), 3-66a, and 3-70a, subsection (b), of the General Statutes, and follow internal control procedures designed to prevent improper payments.**

Comments:

Generally our concerns related to the effect that backlogs had on the information included in the current database, and, that it is not always accurate, complete or updated. Since the Division relies on its database to process claims associated with the older data, there is less assurance that improper payments are not likely to occur.

- 5. The Unclaimed Property Division should monitor its vendor's compliance with contractual provisions and determine the procedures it needs to best monitor and maintain its database.**

Comments:

Certain mandatory reporting did not occur and the Division needs to establish a regular process to review information in, or changes to, its database.

- 6. The Treasurer's Pension Funds Management Division should refrain from paying amounts that are not yet due to contractors.**

Comments:

The Treasury paid out \$65,000 in fees that were not due to be paid. The amount represents fees paid for a vendor to search for a Deputy CIO. The contract indicated these amounts were to be paid after the search for the CIO concluded. The search for the CIO was ongoing as of June 2008.

- 7. The Treasurer's Office should update its Regulations of State Agencies.**

Comments:

Certain of the Regulations do not serve to clarify the General Statutes.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes we have audited the books and accounts of the Office of the State Treasurer for the fiscal years ended June 30, 2007 and 2008. This audit was primarily limited to performing tests of the Agency's compliance with certain provisions of laws, regulations, contracts and grant agreements and to understanding and evaluating the effectiveness of the Agency's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grant agreements applicable to the Agency are complied with, (2) the financial transactions of the Agency are properly initiated, authorized, recorded, processed, and reported on consistent with management's direction, and (3) the assets of the Agency are safeguarded against loss or unauthorized use. The financial statement information related to the Departmental Operations of the Office of the State Treasurer for the fiscal years ended June 30, 2007 and 2008, is included as a part of our Statewide Single Audits of the State of Connecticut for those fiscal years.

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 Office of the State Treasurer complied in all material or significant respects with the provisions of certain laws, regulations, contracts and grant agreements and to obtain a sufficient understanding of the internal controls to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

Internal Control over Financial Operations, Safeguarding of Assets and Compliance:

In planning and performing our audit, we considered the Office of the State Treasurer's internal control over its financial operations, safeguarding of assets, and compliance with requirements as a basis for designing our auditing procedures for the purpose of evaluating the Agency's financial operations, safeguarding of assets and compliance with certain provisions of laws, regulations, contracts and grant agreements, but not for the purpose of providing assurance on the effectiveness of the Agency's internal control over those control objectives.

Our consideration of internal control over financial operations, safeguarding of assets, and compliance requirements was for the limited purpose described the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial operations, safeguarding of assets and compliance with requirements that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial operations, safeguarding of assets and compliance with requirements that we consider to be significant deficiencies

A *control deficiency* 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 on a timely basis unauthorized, illegal, or irregular transactions or the breakdown in the safekeeping of any asset or resource. A *significant deficiency* is a control deficiency, or

combination of control deficiencies, that adversely affects the Agency's ability to properly initiate, authorize, record, process, or report financial data reliably, consistent with management's direction, safeguard assets, and/or comply with certain provisions of laws, regulations, contracts, and grant agreements such that there is more than a remote likelihood that a financial misstatement, unsafe treatment of assets, or noncompliance with laws, regulations, contracts and grant agreements that is more than inconsequential will not be prevented or detected by the Agency's internal control. We consider the following deficiencies, described in detail in the accompanying "Condition of Records" and "Recommendations" sections of this report, to be significant deficiencies in internal control over financial operations, safeguarding of assets and compliance with requirements: Recommendations one through seven, which detail our concerns with personnel serving in a capacity unrelated to the Statutory authority allowed, employees paid for time not worked, paying a contractor early, the need to update Regulations, and unclaimed property issues relating to resuming examinations of holders, assessing interest, liquidating stocks for cash, improper payments and database maintenance.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that noncompliance with certain provisions of laws, regulations, contracts, and grant agreements or the requirements to safeguard assets that would be material in relation to the Agency's financial operations, noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions, and/or material financial misstatements by the Agency being audited will not be prevented or detected by the Agency's internal control. Our consideration of the internal control over the Agency's financial operations, safeguarding of assets, and compliance with requirements, was for the limited purpose described in the first paragraph of this section and would not necessarily disclose all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider the following item to be a material weakness: Recommendation four, which details the risk that improper unclaimed property payments could occur and not be detected.

Compliance and Other Matters:

As part of obtaining reasonable assurance about whether the Office of the State Treasurer complied with laws, regulations, contracts and grant agreements, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Agency's financial operations, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements. 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 no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards. However, we noted certain matters which we reported to Agency management in the accompanying "Condition of Records" and "Recommendations" sections of this report. The Office of the State Treasurer's responses to the findings identified in our audit are described in the accompanying "Condition of Records" section of this report. We did not audit the Agency's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of Agency management, the Governor, the State Comptroller, the Appropriations Committee of the General Assembly and the Legislative Committee on Program Review and Investigations. However, this report is a matter of public record and its distribution is not limited.

CONCLUSION

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

Maura F. Pardo
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts