

# STATE OF CONNECTICUT



*AUDITORS' REPORT  
STATE TREASURER  
STATE FINANCIAL OPERATIONS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005*

**AUDITORS OF PUBLIC ACCOUNTS**  
KEVIN P. JOHNSTON ❖ ROBERT G. JAEKLE

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May 30, 2007

**AUDITORS' REPORT  
STATE TREASURER  
STATE FINANCIAL OPERATIONS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

We have made an examination of the financial records of the Treasurer of the State of Connecticut as they pertain to State financial operations for the fiscal year ended June 30, 2005. Throughout this report, we will refer to various financial statements and schedules contained in the Annual Report of the Treasurer, State of Connecticut, including its statutory appendix (Annual Report) for the fiscal year ended June 30, 2005.

This report on the above examination consists of the following Comments, Recommendations and Certification.

Separate reports will be issued covering the activities of the Investment Advisory Council and the internal operations of the State Treasury.

**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. Major duties include responsibilities for the receipt and investment of State moneys, disbursements and, when authorized, issuances of State obligations (borrowing).

In addition to the Executive Office of the Treasurer, the Treasury is organized into several divisions. This report includes our review of the Pension Funds Management Division, the Cash Management Division, the Debt Management Division, the Second Injury Fund and administrative requirements for the Connecticut Higher Education Trust. Comments on some of the major functions of these Divisions are presented in various sections of this report.

**Officers and Officials:**

The officers and officials of the Treasury Department as of June 30, 2005, were as follows:

State Treasurer: \*

Denise L. Nappier

Deputy Treasurer:

Howard G. Rifkin

Assistant Deputy Treasurer:

Linda Hershman

Chief Investment Officer

Susan Sweeney

Assistant Treasurer, Cash Management:

Lawrence A. Wilson

Assistant Treasurer, Debt Management:

Catherine Boone

Assistant Treasurer, Policy:

Meredith A. Miller

Assistant Treasurer, Second Injury Fund:

Alberta Mendenhall

Assistant Treasurer, Unclaimed Property:

Madelyn Colon

\* As used in ensuing comments of this report, the term "Treasurer" refers to the State Treasurer.

## **RÉSUMÉ OF OPERATIONS:**

### **Cash Management Division:**

The Cash Management Division is responsible for the coordination of core banking services for all State agencies, receipt and disbursement tracking and reporting, bank account reconciliation, check administration, cash forecasting, cash control, outreach to State agencies, and the administration and investment of the Short Term Investment Fund.

Cash management is defined as "the proper collection, disbursement and control of cash resources." Through four units, the Cash Management Division works to (a) speed and secure deposits of State revenues, (b) control disbursement of State funds in conjunction with the Comptroller's Office and other agencies, (c) minimize banking costs, (d) maintain accurate and timely records, and (e) productively use and invest available funds.

Deposits made to local depository accounts are regularly transferred electronically to concentration accounts for disbursement and investment purposes. Section 3-27e of the General Statutes allows the Treasury the option of paying for fees directly. During the audited period, fees for bank-provided depository, disbursement and cash management services for all State agencies were managed through a combination of direct payment and compensating balance arrangements whereby banks provide credits to pay bank fees in exchange for balances left on account with the bank by the Treasury. The direct payment option allows the Treasury to invest the cash balances in the State's Short Term Investment Fund (STIF), which returns greater interest than that earned under compensating balance arrangements. The direct payments of bank fees are made using the interest earned on the cash balances invested in STIF. During the 2004-2005 fiscal year, the Treasury incurred approximately \$3,321,726 of bank service fees, of which approximately \$545,502 was covered by compensating balance arrangements. The Division continues to implement procedures to accelerate the collection of State receipts through the use of lock-boxes, electronic transfers and increased use of concentration account deposit tracking services.

The Cash Management Division also approves and tracks all banking relationships and bank service charges for all State agencies. When necessary, the Treasury will coordinate cash management service enhancements for individual agencies and will assist in the development and review of Requests for Proposals for more complicated cash management banking needs. The Division meets regularly with State agencies and recommends improvements in the agencies' banking relationships.

Schedules on pages S-32 through S-34 and pages O-13 to O-16 of the Annual Report deal with the Civil List Funds, which are the responsibility of the Cash Management Division.

### **Short Term Investment Fund (STIF):**

STIF was established and is operated under Sections 3-27a through 3-27i of the General Statutes. It provides State agencies, funds, political subdivisions and others with a mechanism for investing at a daily-earned rate with interest from day of deposit to day of withdrawal. STIF also provides participants with daily access to their account balances. Investments are mainly in money market instruments. The administrative functions and the actual investing of cash are the responsibility of

the Cash Management Division. STIF maintained its AAAM rating by Standard and Poor's throughout the audited period.

The Treasurer's Office holds an annual meeting for STIF shareholders, where information such as fiscal year performance of STIF, investment strategies and administrative enhancements are discussed. The latest meeting was held March 24, 2006 and included a demonstration of the on-line account inquiry capabilities of the Short Term Investment Fund website implemented during January of 2006.

As of June 30, 2005, STIF had total net assets of \$4,313,863,837. Participant distributions paid and payable during the 2004-2005 fiscal year were \$93,828,235 and STIF's expenses were \$1,083,961. According to the Annual Report, STIF reported an annual total return of 2.32 percent, exceeding its main benchmark, the MFR (First Tier Institutions-Only Money Fund Report) index, by .41 percent.

Statements and notes on pages F-30 through F-38 of the Annual Report deal with the Short Term Investment Fund. Also, STIF has an independent review of its Schedules of Rates of Return. This information is included on pages F-39 through F-43 of the Annual Report.

#### **Medium-Term Investment Fund:**

The 1997 Regular Session of the General Assembly passed Public Act 97-212, Section 3, codified in Section 3-28a of the General Statutes, creating a medium-term investment fund to be administered by the State Treasurer. As of June 30, 2005, the fund was not open. Due to economic conditions, expected yields for a medium-term investment fund have not generated sufficient interest among potential investors. However, during the 2005-2006 fiscal year, the master custodian bank on contract with the Treasury has been instructed to begin planning for the implementation of a medium-term investment fund.

#### **Pension Funds Management Division:**

In general, the Pension Funds Management Division (PFMD) operates under the provisions contained primarily in Part I, Chapter 32, of the General Statutes, particularly Sections 3-13a, 3-13b, 3-13d, 3-31a and 3-31b.

The Division's responsibilities include the development, execution and management of investment programs of the pension and trust funds. The Division is also charged with the responsibility of making sure that pension and trust fund investments are made in compliance with State statutes and guidelines. This includes administering State law regarding corporations doing business in Northern Ireland or Iran. The Investment Advisory Council (IAC), which is within the State Treasurer's Office for administrative purposes only, reviews investments authorized by statute, recommends investment policies to the Treasurer, examines investments of the State as of June 30, and reports the value of such to the Governor. A separate report is issued on the Investment Advisory Council.

The Pension Funds Management Division is responsible for managing the assets of six pension funds and eight trust funds having total net assets of \$21,299,000,000, as of June 30, 2005. The

Division invests the assets of these funds in accordance with an investment program through the purchase of ownership interests in a Combined Investment Fund. Each asset class (i.e., Fixed Income, U.S. Equity, etc.) within the Fund holds investments of the Combined Investment Fund. During the audited fiscal years, and as of June 30, 2005, the Combined Investment Fund (CIF) consisted of the Mutual Fixed Income (MFIF), Mutual Equity (MEF), Real Estate (REF), International Stock (ISF), Private Investment (PIF), Commercial Mortgage (CMF), and the Cash Reserve (CRF) Funds. Record keeping and custody of most assets is provided by a master custodian (State Street Bank). As of June 30, 2005, the Division employed 83 external advisors to manage and invest the assets of the Combined Investment Fund.

The cost of operating the Treasury's Pension Funds Management Division, including the cost of personnel and professional investment advisors retained, is charged against the investment income of the Combined Investment Fund. Transfers are made from the investment funds to a Special Revenue Fund account from which Pension Funds Management Division operating expenses (salaries, advisor and management fees, supplies, etc.) are paid. Expenses of the Combined Investment Funds, excluding external advisor expenses, were approximately \$9,000,000 for the 2003-2004 fiscal year and \$6,000,000 for the 2004-2005 fiscal year.

During the fiscal years ended June 30, 2005 and 2004, outside advisors managed all of the CIF portfolios. The number of outside advisors and advisor expenses by fund, as reported in the Combined Investment Funds financial statements and notes included in the State Treasurer's Annual Report, for services rendered during the 2004-2005 and 2003-2004 fiscal years are summarized below:

<u>CIF</u>	<u># of Advisors- June 30, 2005</u>	<u>Expenses 2004-2005</u>	<u># of Advisors- June 30, 2004</u>	<u>Expenses 2003-2004</u>
MFIF	11	\$ 6,734,104	8	\$ 8,384,224
MEF	6	22,668,229	6	6,459,864
ISF	10	23,670,373	13	17,336,519
CRF	1	298,665	1	313,350
CMF	1	249,911	1	327,489
PIF	44	29,929,307	37	36,936,260
REF	10	4,757,757	8	4,692,019
<b>Total</b>	<b><u>83</u></b>	<b><u>\$88,308,346</u></b>	<b><u>74</u></b>	<b><u>\$ 74,449,725</u></b>

The above consists of the Mutual Fixed Income (MFIF), Mutual Equity (MEF), International Stock (ISF), Cash Reserve (CRF), Commercial Mortgage (CMF), Private Investment (PIF), and the Real Estate (REF) Funds.

The performance-based fee structures for investment advisors of the MEF and ISF resulted in the expense fluctuations that occurred over the two-year period in those Funds.

The management fees for the MFIF, MEF and ISF as reported in the Annual Report are based on estimates of the performance bonus, which is paid subsequent to June 30. The actual advisor fee expense differed from the reported amount, due to these performance bonus estimations.

**Asset Allocation Policy:**

The Treasurer's Asset Allocation Policy is presented below. The policy was in force during the period under review.

<u>Investments</u>	<u>Asset Class</u>	<u>Target Policy</u>	<u>Holdings as of June 30,</u>	
			<u>2005</u>	<u>2004</u>
<i>U.S. Equity</i>	<b>36%: MEF</b>	36%	38%	38%
<i>International Equity</i>	<b>18%: ISF</b>	18%	20%	20%
Developed Markets	15% ISF			
Emerging Markets	3% ISF			
<i>Fixed Income</i>	<b>30%: MFIF, CRF, CMF</b>	30%	33%	31%
Cash	1% CRF			
Core Bonds	20% MFIF, CMF			
Inflation-linked Bonds	1% MFIF			
High-yield Bonds	5% MFIF			
Non-U.S. Emerging Markets	3% MFIF			
<i>Real Estate and Alternative</i>	<b>16%: REF, PIF</b>	16%	9%	11%
Equity Real Estate	5% REF			
Alternative Investments	11% PIF			

The Treasury's Asset Allocation Policy includes lower and upper ranges for the investment allocations. All variations above are within the established ranges except for the Real Estate Fund which is below the intended lower range as of June 30, 2004 and the Fixed Income Fund which is over the intended upper range as of June 30, 2005.

During the fiscal year ended June 30, 2005, the Combined Investment Funds realized an annual total return of 10.46 percent, according to the Annual Report. The fund return of 10.46 percent is slightly higher than the calculated benchmark of the Connecticut Multiple Market Index of 10.02 percent. The Connecticut Multiple Market Index is a blended index calculated by the Treasury to compare the overall return of the fund against market conditions using the weighted averages of various indexes associated with the asset classes. These indexes represent "benchmarks" used by the Division to evaluate investment return. Another benchmark is the actuarially determined assumed rate of return of 8.5 percent. During the previous fiscal year ended June 30, 2004, the Combined Investment Funds realized an annual total return of 15.23 percent which was lower than that year's calculated benchmark of the Connecticut Multiple Market Index of 16.27 percent.

A summary of the percentage returns of the Combined Investment Funds and the retirement and trust funds that are invested in the Combined Investment Funds, as reported in the State Treasurer's Annual Report, for the fiscal years ended June 30, 2005 and 2004 are presented below.

**Percentage Return**

<b><u>Combined Investment Funds:</u></b>		<b><u>2004-2005</u></b>	<b><u>2003-2004</u></b>
Net Total Combined Investment Funds		10.46 %	15.23 %
Mutual Equity	MEF	8.06 %	20.84 %
International Stock	ISF	19.23 %	29.69 %
Real Estate	REF	27.74 %	0.67 %
Mutual Fixed Income	MFIF	7.70 %	2.79 %
Commercial Mortgage	CMF	6.95 %	7.87 %
Private Investment	PIF	9.58 %	20.21 %
Cash Reserve	CRF	2.38 %	1.30 %

**Retirement and Trust Funds:**

Net Total Return Retirement and Trust Funds		10.46 %	15.23 %
Teachers' Retirement Fund (TRF)		10.49 %	15.34 %
State Employees' Retirement Fund (SERF)		10.44 %	15.06 %
Municipal Employees' Retirement Fund (MERF)		10.10 %	14.28 %
Probate Court Retirement Fund (Probate)		10.50 %	14.49 %
Judges' Retirement Fund (Judges')		9.77 %	13.42 %
State's Attorneys' Retirement Fund (St. Atty.)		7.16 %	12.71 %
Trust Funds		7.64 %	5.09 %

Investment performance for individual retirement funds varies based on the mixture of asset class types held by each. The investment performance for trust funds is a composite of returns earned by nine trust funds that participate in the Treasurer's Combined Investment Fund. During the fiscal year, Trust Funds included the School and Agricultural College Funds, The Soldiers' Sailors' and Marines' Fund, the Police and Fireman's Survivors' Benefit Fund, Endowment for the Arts, Hopemead Fund, Ida Eaton Cotton Fund and the Andrew Clark Fund.

A more thorough discussion of the Combined Investment Funds, including performance during the 2004-2005 fiscal year, can be found on pages 18 through 58 of the Annual Report.

Statements and notes on pages F-14 through F-29 of the Annual Report deal with the Combined Investment Funds. Supplemental information on the pension plans and trust funds is included on pages S-1 through S-28 of the Annual Report.

**Debt Management Division:**

The Treasurer has the responsibilities to manage the debt of the State and to administer the financial needs of the bonding programs enacted by the State legislature and authorized by the Bond Commission. These responsibilities are carried out through the Debt Management Division.

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A summary of bonds issued, paid, or refunded in the 2004-2005 fiscal year and the obligations outstanding, as of June 30, 2005, is presented in the schedule entitled "Changes in Debt Outstanding" shown on page S-29 of the Annual Report, while additional information is contained in the Annual Report pages S-30 and O-1 through O-11. A brief summary follows:

Bonds Outstanding June 30, 2004	\$13,784,939,356
Add - Issuances	1,828,960,000
Deduct - Payments at maturity	1,139,057,794
- Bonds refunded or defeased	<u>540,925,000</u>
<b>Bonds Outstanding June 30, 2005</b>	<b><u>\$13,933,916,562</u></b>

**Interest paid** **\$679,235,861**

Bonds issued in 2004-2005 by type are shown below:

General Obligation - Tax Supported	\$1,315,550,000
Debt Service Commitment – UCONN 2000	98,110,000
Special Tax Obligation	289,725,000
Bradley International Airport	30,640,000
Connecticut Development Authority Incremental Financing	22,435,000
Capital City Economic Development Authority	<u>72,500,000</u>
<b>Total Bonds Issued, 2004-2005</b>	<b><u>\$1,828,960,000</u></b>

True interest cost rates for new bonds issued during the 2004-2005 fiscal year ranged from 3.57 percent to 4.28 percent. Bonds issued during the 2004-2005 fiscal year were comprised of new money issues amounting to \$1,350,610,000 and refunding issues amounting to \$478,350,000.

In addition to the interest paid totaling \$679,235,861, during the 2004-2005 fiscal year, the Treasury also made arbitrage rebate payments to the Federal government totaling \$738,478. Such rebates represent the excess earnings of nontaxable bond proceeds that were invested in STIF prior to project disbursement.

Bonds outstanding at June 30, 2005 include \$22,795,000 of Certificates of Participation for the Middletown Courthouse and \$18,110,000 of Certificates of Participation for the Connecticut Juvenile Training School Energy Center project. These Certificates are not debt of the State; however, the State is obligated to pay a base rent under leases for these facilities, subject to the annual appropriation of funds or the availability of other funds therefor. The base rent is appropriated as debt service. The Certificates of Participation are included on the Treasurer's Debt Management System for control purposes.

Further, the Connecticut Development Authority issued \$9,275,000 of its lease revenue bonds for the New Britain Government Center in the 1994-1995 fiscal year, of which \$5,660,000 is outstanding at June 30, 2005. The State is obligated to pay the base rent subject to the annual appropriation of funds. These payments are budgeted in the Treasurer's debt service budget as lease payments and are included in the above summary.

For the purpose of funding the deficit in the General Fund for the fiscal year ending June 30, 2002, Section 111, of Special Act 02-1, of the May 9 Special Session, effective August 15, 2002, authorized the Treasurer to issue economic recovery notes of the State in an amount not to exceed the amount of such deficit plus the costs of issuance of such notes. During the 2002-2003 fiscal year, economic recovery notes amounting to \$219,235,000 were issued of which \$131,360,000 remained outstanding as of June 30, 2005.

Section 1 of Public Act 03-1, of the September 8 Special Session, authorized the issuance of economic recovery notes for the purpose of funding the deficit in the General Fund for the fiscal year ended June 30, 2003, plus the amount of funding needed to pay any remaining retrospective reimbursements billed by medical providers for services rendered to recipients of medical assistance in the State Administered General Assistance and General Assistance programs. During the 2003-2004 fiscal year, economic recovery notes amounting to \$97,700,000 were issued pursuant to this authority, of which \$78,200,000 remained outstanding at June 30, 2005.

Under Section 3-16 of the General Statutes, the Governor on April 10, 1990, authorized the Treasurer to enter into short-term borrowing of up to \$550,000,000. On April 4, 1991, the Governor increased this amount by \$200,000,000. Therefore, the authorized limit on short-term borrowing outstanding at any given time as of June 30, 1995, could total \$750,000,000. There were no short-term borrowings outstanding at June 30, 1995. On August 30, 1995, the Governor approved short-term borrowing in a principal amount up to, but not exceeding, a total of \$400,000,000 at any one time. He further stated that "Upon issuance of any such obligations any such approvals for any previous temporary borrowings not outstanding shall be revoked and shall cease and terminate and be of no further effect." As of June 30, 2005, there was no issuance of short-term debt under this authority.

Public Act 03-5, of the June 30 Special Session, effective August 20, 2003, authorized a loan by the State to the Connecticut Resource Recovery Authority (CRRA) of up to \$22,000,000 for the fiscal years ending June 30, 2004 and 2005, and for subsequent fiscal years, an additional aggregate amount of \$93,000,000. As of June 30, 2005, CRRA had borrowed \$21,500,176 from the State pursuant to the loan of which \$18,558,663 remained outstanding. Loan receivable records for the CRRA loan are maintained by the State Treasurer's Debt Management Division.

### **Special Obligation Rate Reduction Bonds:**

Public Act 03-6 of the June 30 Special Session required that assessments collected from electric utility customers in the State originally intended for the implementation of conservation and load management programs and renewable energy investment programs be disbursed instead to the State General Fund during the period from July 1, 2003 to July 1, 2005, unless the Department of Public Utility Control authorized a financing order to allow the issuance of rate reduction bonds the proceeds of which would be substituted for the disbursement of the aforementioned assessments. Pursuant to Sections 16-245e to 16-245k of the General Statutes, as amended by Public Act 03-6 of the June 30 Special Session, and Public Act 03-1 of the September 8 Special Session, the Department of Public Utility Control approved a financing order dated October 28, 2003, to allow the issuance of \$220,000,000 of tax exempt rate reduction bonds as securitization to sustain the funding of conservation and load management programs and renewable energy investment programs. In accordance with this financing order, special obligation bonds of the State amounting

to \$205,345,000 were issued during the 2003-2004 fiscal year secured by and payable solely from a rate reduction bond charge collected from the customers of electric utilities in the State. As of June 30, 2005, Special Obligation Rate Reduction Bonds outstanding amounted to \$179,765,000.

Financial statements related to the Special Obligation Rate Reduction Bonds are presented on pages F-64 through F-70 of the Annual Report.

**Tax Exempt Proceeds Fund (TEPF):**

The Tax Exempt Proceeds Fund, codified as Sections 3-24a through 3-24h of the General Statutes, serves as a vehicle to allow the State Treasurer to comply with "arbitrage" requirements of the Tax Reform Act of 1986 with regard to the proceeds of nontaxable bond issues passed through to municipalities, nonprofit organizations and others as grants and loans. The "arbitrage" provision of the Tax Reform Act requires that any earnings on bond proceeds in excess of the interest rate on the bonds be "rebated" to the Federal government unless those proceeds are invested in other tax-exempt securities. Under the Tax Reform Act, such pass-throughs are not considered expended when the State advances the funds to the recipient. Accordingly, without TEPF the State would have to track the investment of proceeds of some bond issues until they are ultimately disbursed to contractors and vendors. Proceeds deposited into the fund can leave it only for a payment to a contractor, a vendor, or as a reimbursement.

The TEPF was incorporated as a regulated investment company and is managed by a firm retained by the State Treasurer. In addition to State agencies, TEPF may be used by authorities, municipalities and others. The TEPF was audited by a firm of independent public accountants for the 2004-2005 fiscal year.

According to the Annual Report of the TEPF, net assets of the fund totalled \$150,783,524 at June 30, 2005, and the return on investment was 1.34 percent for the 2004-2005 fiscal year. Participants in the fund at June 30, 2005, included civil list funds and recipients of State agency grant and loan programs as well as others.

At June 30, 2005, a total of \$38,141,474 of State funds was invested in the TEPF as shown below:

<u>Fund Classification</u>	<u>Amounts</u>	<u>Annual Report Page No.</u>
Special Revenue	\$23,692,311	O-13
Capital Projects	285,460	O-14
Enterprise	14,163,703	O-15
<b>Total</b>	<b><u>\$38,141,474</u></b>	O-15

**Second Injury Fund (SIF):**

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 31-355a). 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 (SIF). The Treasurer is the custodian of SIF. Per Section 31-349e of the General Statutes, there is an advisory board to advise the custodian

of SIF on matters concerning administration, operation, claim handling and finances of the fund.

Fund revenues consisted mainly of assessments levied against self-insured employers and companies writing workers' compensation or employers' liability insurance and totaled \$95,796,021 for the 2004-2005 fiscal year.

Second Injury Fund claim payments amounted to \$34,712,582 on a modified accrual basis for the 2004-2005 fiscal year.

A comparison of claim expenditures by category follows:

	<u>2004-2005</u>	<u>2003-2004</u>
Stipulations	\$8,251,120	\$ 10,875,739
Indemnity (lost wages)	20,598,325	20,138,780
Medical	<u>5,863,137</u>	<u>5,481,782</u>
Totals	<u><b>\$34,712,582</b></u>	<u><b>\$ 36,496,301</b></u>

The number of stipulated agreements to settle claims decreased during the current audited period. According to the Treasurer's Annual Reports, the number of settled claims totaled 170 and 169 for the fiscal years ended June 30, 2004 and 2005, respectively.

Additional comments concerning the operations of the Second Injury Fund are included in the "Condition of Records" section of this report.

Financial statements and notes for the SIF are presented on pages F-49 through F-56 of the Annual Report.

**Workers' Compensation Commission - Administrative Expenses:**

As authorized under the Workers' Compensation Act of the General Statutes, the Second Injury and Compensation Assurance Fund and the administrative expenses of the Workers' Compensation Commission (WCC), are financed by assessments against companies writing workers' compensation or employers' liability insurance and by assessments against self-insured employers.

Assessments are based on workers' compensation benefits paid by the applicable companies. Data concerning the companies writing workers' compensation insurance is furnished by the State Insurance Department. Self-insurers report directly to the Treasury Department. A list of such companies is supplied by the Workers' Compensation Commission (WCC). ("Certificates of Solvency" are issued by that Commission.) By far, the greater portion of assessments is levied against insurance companies rather than self-insured employers.

Under Section 31-345 of the General Statutes, the Treasurer must assess and collect from the above insurance carriers and self-insurers amounts to reimburse State expenses incurred by the WCC in the administration of workers' compensation benefits.

In accordance with Section 31-345, the WCC's chairman notified the Treasurer that \$21,084,235 was needed to meet the expenses of the WCC for the 2004-2005 fiscal year. Based on the above projection, less the balance in the WCC account, the Treasurer assessed insurance companies and

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self-insured employers during the audited period at a rate of 2.20 percent of their preceding fiscal year's payments for workers' compensation benefits. Collections of these assessments are deposited into the Workers' Compensation Administration Fund.

A summary of Workers' Compensation Administration (WCA) Fund assessment receipts and total WCA Fund receipts for fiscal years 2004-2005 and 2003-2004 follows:

	<u>2004-2005</u>	<u>2003-2004</u>
Assessment collections	\$14,098,574	\$17,918,436
Other receipts	36,400	16,879
Total Receipts - WCA Fund	<u>\$14,134,974</u>	<u>\$17,935,315</u>

### **Connecticut Higher Education Trust (CHET):**

The Connecticut Higher Education Trust (CHET) was established pursuant to Public Act 97-224, codified as Sections 3-22e through 3-22o of the General Statutes. CHET is a trust, available for participants to save and invest for higher education expenses, that is privately managed under the supervision of the Treasurer. The Trust is an instrumentality of the State, however; the assets of the Trust do not constitute property of the State and the Trust shall not be construed to be a department, institution or agency of the State. CHET is a qualified State tuition program in accordance with guidelines contained in Section 529 of the Internal Revenue Service code. While money is invested in CHET, there are no taxes (Federal or State) on the earnings. Amounts can be withdrawn to pay for tuition, room and board, or other qualified higher education expenses. There are no State taxes paid on qualified withdrawal earnings. The program began accepting applications in January 1998.

The Connecticut Higher Education Trust was audited by a firm of independent public accountants for the 2004-2005 fiscal year.

As of June 30, 2005, the CHET program had net assets of \$595,718,177, and 46,516 participant accounts. Operating results for the 2004-2005 fiscal year taken from the Annual Report were as follows:

Net assets at June 30, 2004	\$ 472,562,759
Net Participant Contributions	89,440,616
Investment income	36,199,693
Management fees	<u>(2,484,891)</u>
<b>Net assets at June 30, 2005</b>	<b><u>\$595,718,177</u></b>

Financial statements and notes for CHET are presented on pages F-57 through F-63 of the Annual Report.

### **Trust Funds:**

In addition to investment-type trust funds of the Pension Funds Management Division (described earlier in this report) and those in CHET, the Treasurer is also responsible for the administration of certain other trust funds which fall within her statutory jurisdiction. Some of these funds are described in the ensuing section.

### **School and Agricultural College Funds:**

The administration of these two trust funds is provided for in Sections 3-40 through 3-55 of the General Statutes. Under Article Eighth, Section 4, of the Constitution of Connecticut, the School Fund is a perpetual fund whose interest is to be used in support of State assistance to public schools. Annually, fund earnings are transferred to the General Fund from which public education grants are made. Under Section 10a-115 of the General Statutes, net income of the Agricultural College Fund is transferred to the University of Connecticut.

Investments consisted of participation in the Treasurer's major investment funds discussed earlier. No direct individual investments were held by the two trust funds. Total fund balances (at cost), on June 30, 2005, amounted to \$6,555,219 for the School Fund and \$422,254 for the Agricultural College Fund. The total fund balances on June 30, 2005, at fair value, amounted to \$9,084,326 for the School Fund and \$586,079 for the Agricultural College Fund. Statements and notes for these two funds and other non-civil list trust funds are included on pages F-44 through F-48 of the Annual Report. Investment activity is presented on pages S-7 through S-9.

### **Insurance Companies Trusteed Securities:**

Pursuant to Section 38a-83 of the General Statutes, securities are deposited with the Treasurer to be held in trust for policy holders of insurance companies as a prerequisite to such companies transacting business in any state requiring such protection. A listing of insurance companies and their security deposits, as of June 30, 2005, is presented starting on page O-17 of the Annual Report.

Each company depositing these securities is required, per Section 38a-11, subsection (e), to pay \$250 annually to defray the cost of custodial services, which is collected by the Insurance Department.

### **Subsequent Events:**

#### **Termination of Association with Investment Advisor:**

The Treasurer severed all ties with Triumph Capital Group on July 21, 2005. Triumph Capital Group, its managing partner and general counsel were convicted on Federal charges of bribery, racketeering, conspiracy and obstruction of justice. The Fund, which held a total of four limited partnership investments managed by Triumph Group (three in the Private Investment Fund and one in the Mutual Fixed Income Fund), received cash proceeds totalling \$48,957,048 from a sale of these limited partnership interests, resulting in a total liquidation of this partnership. The adjusted cost basis for the four limited partnership investments at the time of the liquidation was \$201,755,523.

**Second Injury Fund Calculation of Interest Penalties:**

The Second injury Fund had requested an Attorney General's Opinion regarding the calculation of interest penalties related to unpaid assessments that were uncovered by compliance reviews. The Attorney General's Opinion was adverse to the Fund and resulted in the need to return approximately \$12 million of previously collected penalties.

**Establishment of Medium-Term Investment Fund:**

The Treasurer's Office established client accounts for the Medium-Term Investment Fund during the 2006-2007 fiscal year.

### **Performance Review:**

In accordance with Section 2-90 of the General Statutes, audits conducted by the Auditors of Public Accounts may include an examination of performance in order to determine an Agency's effectiveness in achieving expressed legislative purposes. We have conducted such a review of the Advisory Board for the Second Injury Fund. Our objective was to determine whether the Advisory Board advises the Treasurer on "matters concerning administration, operation, claim handling and finances" of the Fund in accordance with Section 31-349e of the General Statutes.

We reviewed the many aspects of the Board including the legislative mandate that originally established the Board, legislative objectives, attendance, statutory makeup of the Board, meeting minutes and continued relevance of the Board.

### **Second Injury Fund Advisory Board:**

Pursuant to Section 31-349e, of the General Statutes, the Second Injury Fund Advisory Board, as of June 30, 2005, should consist of eight members. The Treasurer shall appoint six of the eight members to the Board. Of those appointees, three shall represent employers and insurers who pay into the Fund and three shall represent employees receiving benefits paid or reimbursed by the Fund. Two remaining members shall be the chairpersons of the labor and public employees committee of the General Assembly (or their designees).

Each of the Treasurer's appointees shall be appointed for a term of four years, with vacancies filled in the same manner as the original appointment. Members of the Board serve without compensation, and the members shall elect a chairperson from among its members. The Board was given authority under Section 31-349e to adopt any rules of procedure that it deems necessary to carry out its duties. The Treasurer provides staff as is necessary for the performance of the functions and duties of the Board.

The Fund continues to be liable for payments of claims involving widows, uninsured employers, and other claims. Public Act 95-277 originally established the Second Injury Fund Advisory Board, effective July 29, 1995, to advise the Treasurer concerning the Fund's operations and finances.

### **Background of the Second Injury Fund**

The Second Injury Fund was originally established in 1945 to help discourage discriminatory hiring practices against veterans and to encourage the assimilation of workers with a pre-existing injury into the workforce. The Fund would pay the injured worker's payroll and medical costs (workers' compensation benefits) should the employee suffer a "second injury" while at work. By doing this the State helped mitigate the financial disincentives of employing persons with prior injuries. Prior to the Second Injury Fund, employers were obligated to provide for workers' compensation benefits for their employees, even if their second injury was made substantially worse due to a preexisting injury. As a result, insurance costs for workers' compensation insurance increased, and employers had a financial incentive for refusing to hire employees, especially veterans, with a preexisting injury. In order to promote the hiring of veterans returning from the war, the State developed the Second Injury Fund. The Fund compensates workers if a second injury

occurs. The Fund's revenue was generated through an assessment among all insurer and self-insured employers and served its purpose of reducing the disincentives of hiring veterans with injuries or disabilities. Today, the Federal Americans with Disabilities Act of 1990 prohibits employers from discriminating against qualified individuals because of disability in all aspects of employment. Because of this and several other reasons, Public Act 95-277 closed the Fund to all new "second injury" claims sustained on or after July 1, 1995. The same act established the Second Injury Fund Advisory Board, in order to advise the Treasurer on matters concerning "administration, operation, claim handling and finances of the fund."

Our Auditors' Report for the State Treasurer – Departmental Operations for the fiscal year ended June 30, 1996, disclosed several issues relating to the operations of the board:

- Members were not appointed in a timely manner.
- The Board did not meet biannually as required.
- The Board failed to elect a chairperson from among its members.
- No formally approved minutes were available from the meetings that were held, and
- The regular meeting schedule was not filed with the Secretary of the State as required by Section 1-21 (now 1-225) of the Freedom of Information Act.

Our Auditors' Reports for the State Treasurer for four subsequent reporting periods, for the fiscal years ended June 30, 1997, 1998, 1999 and 2000, each repeated issues related to the Board's requirements not being met including:

- The Board did not elect a chairperson.
- The Board did not adopt any rules of procedure, or effect any other actions.
- Not enough members were present to obtain the six votes needed for any action of the board.

The Treasury responded in our Auditors' Report State Treasurer – State Financial Operations for the Fiscal Year Ended June 30, 1999:

Since its creation in 1995, by the passage of Public Act 95-277, the Second Injury Fund Advisory Board, despite several attempts to fulfill the statutory requirement to meet at least twice a year, has consistently failed to meet the requirement of six members voting in the affirmative in order to conduct business. We are, therefore, recommending that the General Assembly lower the voting requirement to pass an action by the Board from six members to a simple majority of the members present and voting.

In our Auditors' Report State Treasurer – State Financial Operations for the Fiscal Year Ended June 30, 2000, the Treasury, in part, responded:

The Treasurer intends to again propose legislation to the General Assembly in the 2001 session to lower the quorum requirement or abolish the Board.

Public Act 01-31, reduced the quorum to a simple majority of members present and voting, provided at least four members are present and voting.

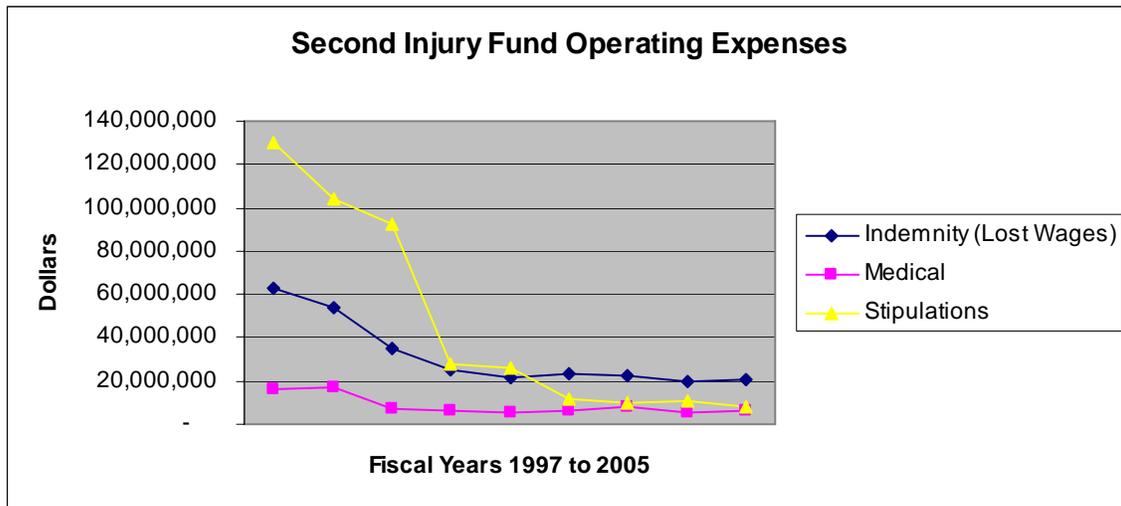
By 2001, the Second Injury Fund had already taken steps to reduce the long-term liabilities of the Fund by establishing estimated reserves for injured workers’ case files and actively settling with injured workers by one-time “stipulation” payments. Special Assessment Revenue Bonds were issued on November 7, 1996, for \$100 million and on October 1, 2000, for \$124,100,000. Commercial Paper was also used as an alternative financing method. The debt was secured by a pledge of fund revenues from fees and charges of the Second Injury Fund. During this time, the Fund formalized an assessment audit program to verify the revenue amounts paid to the Fund. According to the Treasurer’s Annual Report for the fiscal year ended June 30, 2001, 5,519 settlements to injured workers were negotiated since January 1, 1995, at a cost of \$412 million. The estimated reserve value for these claims was \$1.562 billion. The 1996 and 2000 bonds were totally defeased in June 2004 and June 2005, respectively. This process has helped reduce the overall operating expenses within the Fund and lowered the assessment rates to insurance companies and self-insured employers.

The table below shows the operating expenses for the fiscal years ended June 30, 1995 to June 30, 2005.

**Operating Expenses for the fiscal years ended June 30, 1995 to 2005 (\$ in millions)**

June 30,	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Indemnity (Wages)	72.0	69.3	62.8	54.0	34.9	25.0	21.2	23.7	22.5	20.1	20.6
Medical	19.3	16.0	16.2	17.3	7.5	6.6	5.8	6.3	7.8	5.5	5.9
Stipulation	28.5	27.0	130.5	104.0	92.5	27.4	25.6	11.6	10.1	10.9	8.3
Total	119.8	112.3	209.5	175.3	134.9	59.0	52.6	41.5	40.4	36.5	34.8

The chart below shows the changes in the operating expenses for the fiscal years ended June 30, 1997 to June 30, 2005.



Based on Section 31-349e of the General Statutes, the Second Injury Fund Advisory Board was established to advise the Treasurer on “matters concerning administration, operation, claim handling and finances” of the Fund. However, during the most significant years of reorganization within the Second Injury Fund the Advisory Board was not actively engaged. Significant program initiatives including the early retirement of bonds, extensive claims settlements, audit reviews that facilitate accurate collection of revenues, expense reductions, and reductions in the assessment rates that

occurred with limited input from the Second Injury Fund Advisory Board.

During the audited period, the Advisory Board became increasingly more active. We noted one regular meeting occurred during the audited period as well as two special meetings which consisted of round table discussions which included representatives from the insurance industry, self-insured employers and municipalities as well as Treasury personnel to discuss current issues and make recommendations for improvement. We noted that while Advisory Board participation has increased, not all meetings were properly announced and noticed to the Secretary of the State. Proper notification of the Secretary of the State allows for public participation at the meetings.

We therefore have the following recommendation to include in our report:

### **Second Injury Fund Advisory Board Meeting Requirements**

*Criteria:* Section 31-349e of the General Statutes requires that there shall be an Advisory Board for the Second Injury Fund to advise the custodian of the Fund on certain matters detailed in that Section. Section 1-225, subsection (b), of the General Statutes requires the Treasurer to file the schedule of regular meetings for the ensuing year no later than January 31<sup>st</sup> of each year, and no such meeting of any such public agency shall be held sooner than thirty days after such schedule has been filed.

*Condition:* The Treasury did not file the Annual Schedule of Meetings for the Second Injury Fund Advisory Board (Board), due January 31, 2005, until June 17, 2005. The Board met four days later despite the law stating a 30-day notice was necessary. Meeting minutes did not reflect those in attendance and lacked detail of what happened at the meeting.

*Cause:* The Treasury did not take the necessary steps to ensure the Second Injury Fund's Advisory Board's meeting disclosures were in compliance with Section 1-225 of the General Statutes.

*Effect:* Public meeting disclosure requirements under Section 1-225 of the General Statutes were not met by the Second Injury Fund.

*Recommendation:* The Treasury should comply with Section 1-225 and provide information about the Second Injury Fund's Advisory Board meetings as required. (See Recommendation 1.)

*Agency Response:* "It should be noted that during the period in question (which was a period of transition in the leadership at the Fund and the Advisory Board members terms of office) a good deal of time and effort was spent working with the Advisory Board chairman and board members to enhance the role of the Advisory Board at the Fund. This included the Advisory Board members convening with the Treasurer on two Round Table meetings that included representatives from industry and other state agencies (Workers' Compensation Commission, Attorney General's Office, and the Department

of Insurance) to review and revise legislation governing the Fund. In order to insure a quorum and for the convenience of members, one or two meetings were held by teleconference. A consequence of this effort included some last minute meeting postponements and lack of timely notification of meeting changes to the Office of the Secretary of the State.

The Second Injury Fund will continue to provide information to the Secretary of the State as mandated in Section 1-225 of the General Statutes and will post any last minute postponement or changes in the schedule on the Treasurer's web site."

## CONDITION OF RECORDS

Our review of the financial operations of the State Treasury disclosed some areas requiring additional attention. These areas are described on the following pages.

### **Negotiating with Uninsured Employers in the Second Injury Fund:**

*Criteria:* According to Section 31-355, of the General Statutes, the Workers' Compensation Commissioner may order the Second Injury Fund (the Fund) to provide benefits to an injured worker if an employer fails to carry insurance and is unable to pay benefits in accordance with a finding and award. Section 31-355a, subsection (a), requires that whenever the Fund is required to pay such benefits, the amount shall be collectible by any means provided by law. Tax warrants, including liens on property are allowed in accordance with subsection (b), of the same section. Section 31-288 of the General Statutes states that the principals of a business that knowingly and willingly fails to provide Workers' Compensation liability coverage shall be guilty of a class D felony.

*Condition:* During our review of stipulation payments made from the Second Injury Fund, we noted one case where the Fund negotiated a \$70,000 settlement with the uninsured employer on a claim that cost the State \$934,475, as of August 18, 2005. According to the Fund, this case involved an uninsured employer who employed an illegal alien from Guatemala whose injury resulted in paraplegia. We found no provision for the Fund to negotiate or waive any amount due from any uninsured employers. Section 31-355a allows the Treasurer "any means by law," including tax warrants, to enforce collection against uninsured employers. The Workers' Compensation Commissioner approved the settlement after the Fund had already agreed to the negotiated terms and the employer was not charged with a felony for failure to provide coverage.

The Fund's negotiated settlement represents 7.5 percent of the nearly \$1 million paid out by the Fund.

*Cause:* The Fund believes it was in the Fund's best interest to negotiate with the uninsured employer.

*Effect:* The Fund did not follow Section 31-355a, of the General Statutes for collecting amounts due from uninsured employers.

*Recommendation:* The Second Injury Fund should seek legal action against uninsured employers for noncompliance with the Workers' Compensation Act and not negotiate receivable amounts due to the Fund. (See Recommendation 2.)

*Agency Response:* "We disagree with this finding and recommendation. The Fund did not

negotiate the amount received from the uninsured employer. At the request of a Commissioner, the Fund informally discussed the collection of funds from the uninsured employer. The Fund also conducted asset searches, surveillance and searches for property to attach liens, to no avail.

With regard to seeking legal action against uninsured employers, the Fund is guided and to some extent constrained by the requirement that there be willful misconduct (CGS 31-288 (a)) on the part of the employer. In this case, the respondent had no prior history with the Fund and there was no precedent for willful misconduct. The employer secured Workers' Compensation Insurance after the incident. In this case, the respondent employer was a Limited Liability Corporation with no assets available to be attached. Without evidence of assets and a finding of malicious intent by the Commissioner, the Fund had no basis on which to refer this case to the Chief State's Attorney or continue pursuing amounts due from the uninsured employer."

*Auditors' Concluding  
Comment:*

The statement that the Fund did not negotiate the terms of this agreement with the uninsured employer is not accurate. Evidence gathered during our audit indicates the employer offered the Fund \$35,000, but the Fund refused the offer; later, the Fund agreed to accept \$70,000 in full settlement from the employer. The Fund most certainly did negotiate when it should not have negotiated with the uninsured employer.

**Late Claim Payments by the Second Injury Fund:**

*Criteria:* Section 31-303 of the General Statutes requires the Second Injury Fund (the Fund) to make settlement payments to claimants in a timely manner after receiving a fully-executed agreement. The Workers' Compensation Commissioner shall impose a 20 percent penalty against the Fund for benefits not paid in a timely manner.

*Condition:* During our audit of the Second Injury Fund, it was found that the Fund was ordered to pay a total of \$10,796 in penalties by the Workers' Compensation Commissioner as a result of two late claim payments. These penalties were paid by the Fund due to a lack of communication from the Attorney General's Office in one case and the inability to readily provide a replacement check in the other.

*Cause:* The Fund believes a settlement check was "lost in the mail," and, in another case, the representative from the Attorney General's Office failed to promptly submit the approved agreement so the Fund could process the payment.

*Effect:* The Fund paid \$10,796 in penalties that we believe could have been avoided.

*Recommendation:* The Second Injury Fund, in concert with the Attorney General's Office, should improve controls over the processing of settlement payments to avoid the late payment penalty imposed under Section 31-303 of the General Statutes. (See Recommendation 3.)

*Agency Response:* "The Fund has been formally notified by the AG's Office that any order that requires the payment of money by the Fund will be immediately forwarded to the Fund for payment. In addition, any mail opened in the AG's Office that looks like an order will be immediately sent to the SIF as a back up measure, and any AG member not following this directive will be held accountable by the AG.

Following the "lost in the mail" settlement check incident, the Fund has reviewed its internal mailing procedures. The Fund determined that the original check was timely mailed as instructed by the attorney representing the injured party. However the Workers' Compensation Commissioner ordered the payment of the penalty. It should be noted however that 167 out of 169 stipulated agreements were paid in a timely manner in fiscal year 2005."

#### **Payment Errors by the Second Injury Fund:**

*Criteria:* Section 31-308b of the General Statutes (that was in effect on March 5, 1990, but subsequently repealed for future claims) allowed each injured worker who was totally incapacitated a dependency allowance of ten dollars per week for each dependent child who was generally either under age 18, or under age 22, but a full-time student. Claimant's whose dependents do not meet this criteria are not eligible for the benefit.

*Condition:* Our audit found the Fund had been paying an injured worker for a dependency exemption for a child that since October 1, 2001, was not documented to meet the established criteria for a dependency exemption. Over four years, the amount overpaid totaled \$2,069. The Fund has already begun to collect this overpayment from the claimant.

*Cause:* The Fund did not recognize the need to reduce this claimant's benefits in accordance with the General Statutes.

*Effect:* The Fund paid \$2,069 to a claimant that was not eligible to receive dependency benefits.

*Recommendation:* The Second Injury Fund should pay dependency benefits in accordance with the General Statutes. (See Recommendation 4.)

*Agency Response:* "The Fund has reminded claims personnel of their responsibility to keep files

up to date and to promptly remove dependents who become ineligible for benefits. All such files have been reviewed. Currently, only one such claim is active.”

**Unreconciled Interagency Transfer Account within the Cash Management Division:**

*Criteria:* The Interagency Transfer Account (10436) by definition is a clearing account that agencies use to pay other agencies for services rendered. This account should have a zero balance at the end of each monthly cycle. Variances found are due to timing differences and should clear the following month.

*Condition:* During our review of year-end closing procedures, we noted that significant dollar variances in the Interagency Transfer Account were not researched and reconciled during fiscal years 2004 and 2005. We found numerous postings that were not appropriate uses of the account which went uncorrected. Although the Interagency Transfer Account is technically not a bank account, it is listed as a bank account in the chart of accounts. The Interagency Transfer Account is more accurately classified as a due to/due from account in the chart of accounts.

*Effect:* Unresolved interagency billing and payments cause a cumbersome reconciling at year-end closing. In addition, not reconciling in a timely manner may not detect errors in recording of interagency transfer transactions.

*Cause:* The Interagency Account had not been reconciled for fiscal years 2004 and 2005 because neither the Treasury nor the Comptroller’s Office took responsibility for reconciling the account.

*Recommendation:* State agencies’ ability to post to the Interagency Transfer Account should be restricted to ensure proper usage. Reconciliation of the Interagency Transfer Account should be undertaken by the Comptroller’s Office since it is technically not a bank account and has no effect on bank balances. (See Recommendation 5.)

*Agency Response:* “We agree with the Auditors’ description of the Interagency Transfer Account and also concur with the Auditors’ conclusion that the Treasurer’s Office should not be responsible for the reconciliation of the account. We will formally notify the State Comptroller of the auditors’ finding and recommendation.”

**Processing of Check Cancellations:**

*Criteria:* According to the State Comptroller's written procedures for check cancellations, a list of outstanding checks along with cancellation forms should be sent to the Treasurer's Cash Management Division for cancellation authorization. After Treasury approves the cancellation request, the State Comptroller's Accounts Payable Division may proceed with the cancellation process.

*Condition:* We noted the Comptroller's Accounts Payable Division cancelled 48 checks originally issued for the Treasurer's Unclaimed Property Division totaling \$104,344 that had already been cashed by the rightful owners. The Comptroller's Accounts Payable Division cancelled 44 out of the 48 checks without the proper authorization from Treasury. Treasury authorized the cancellation of the four remaining checks which had already been cashed. The Core-CT accounting system does not record the status of checks that have been issued. Consequently, the Cash Management Division must use a month-old outstanding checklist to determine the status of the checks.

*Cause:* The Treasurer's Cash Management Division and the Comptroller's Accounts Payable Division did not follow proper internal control procedures in expediting the check cancellation process.

The Treasurer's Cash Management Division utilized a month-old manually produced outstanding check list to determine the status of a check because the Core-CT accounting system did not utilize the software module that allows for the electronic downloading of check clearance information from the bank. Use of this module could have prevented the cancellation of checks that had already been cashed.

*Effect:* The Comptroller's Accounts Payable Division was able to cancel checks that had already been cashed. The State's Core-CT accounting system's inability to identify cancelled checks may result in overpayments.

*Recommendation:* The Treasurer's Cash Management Division should employ the most efficient manner of check verification and ensure that established internal control procedures for check cancellation are followed. (See Recommendation 6.)

*Agency Response:* "The previously-used two-step process which properly identified the issue noted by the Auditors was revised and streamlined in July 2006 to include use of the bank's on-line system. As a further enhancement, a bank feed of check status information has been available to Core-CT since March 2006, but implementation of the feed has been delayed by Core-CT due to a large system upgrade."

**Unreconciled Cash Accounts within the Cash Management Division:**

*Criteria:* The Cash Management Division is responsible for maintaining proper internal control over cash and completion of bank reconciliations in a timely manner. The State’s Core-CT accounting system has the potential to perform automated bank reconciliations which would identify all outstanding items to date and amount.

*Condition:* During our audit of the Cash Management Division, we found that 5 of 21, or 23 percent of cash account reconciliations were not completely reconciled to the general ledger in a timely manner. Of these accounts, two are relatively significant accounts that include transactions for most of the State’s payroll and vendor payments. Payroll and vendor accounts were reconciled on a monthly basis from the bank to the payment warrants but not directly to the general ledger cash accounts in the Core-CT accounting system. These reconciliations were not conducted in a manner which resolves all variances between the bank records and the Core-CT accounting record. Comprehensive payroll and vendor account reconciliations that agreed with the Core-CT accounting records for the fiscal year ending June 30, 2005, were not completed for our review until July 2006.

We noted that unreconciled outstanding items with dates as far back as August 2003 exist in the vendor account, as of August 2006. Although Treasury responded to our prior year audit report that “All prior year outstanding items have been resolved”, our current audit revealed unresolved issues continued to exist.

*Cause:* Lack of supervisory oversight of the bank reconciliation process together with complications from the State’s new accounting system contributed to the delay in the Cash Management Division reconciliation of the payroll and vendor accounts.

*Effect:* Errors in the recording of cash transactions may not be detected and could increase the risk of loss if reconciliations are not completed in a timely manner.

*Recommendation:* The Cash Management Division should improve internal control over cash and ensure that reconciliations of State cash accounts are performed completely resolving all variances between the bank and Core-CT records in a timely manner. (See Recommendation 7.)

*Agency Response:* “We concur with the importance of timely bank reconciliations. Of the accounts noted by the Auditors, we reconcile the payroll and vendor master accounts (the other three accounts are reconciled by the Department of Motor Vehicles, the Labor Department, and the Teachers Retirement Board) monthly using Core-CT payment documentation as accurately stated by the Auditors. Thus, our first priority is to verify that funds are not leaving those

bank accounts other than to cover valid state payments.

In fiscal years 2004 and 2005, reconciliations to the Core-CT general ledger accounts, which include non-cash transactions that do not affect our bank accounts, have taken longer to complete. Over the past three years, as agency errors in Core-CT have lessened and transaction documentation provided by Core-CT has improved, we have reduced the time to complete the general ledger reconciliations significantly.

We maintain a list of outstanding vendor account transactions and provide it to the Auditors. The Auditors correctly noted that some of the items on the list were from fiscal year 2004. We had previously stated that the items were “resolved” because we had completed our work by finalizing our research, determining the necessary adjustments to Core-CT, and requesting the appropriate agencies to make the proper corrections (Core-CT does not allow us to make the adjustments). The list now includes one item with a value of \$2,700. The item is being corrected at Core-CT and we will continue to monitor for timely resolution.”

**Late Submission of Bank Confirmations to the Cash Management Division:**

*Criteria:* Section 4-33(b) of the General Statutes requires that every public official who deposits funds or monies shall submit to the Treasurer and the Comptroller on a form provided by the Treasurer on or before September first of each year, a list of all accounts in which funds were deposited, as of the preceding June 30.

*Condition:* We found 7 of 25 of agencies tested did not submit their bank confirmations in a timely manner. We noted 4 of the 25 sampled bank authorization forms were not on hand in Cash Management Division files.

*Cause:* Treasury reported that agencies failed to submit the required forms. Treasury failed to retain a complete record of source documentation in the form of authorized bank account forms.

*Effect:* Bank confirmations were not submitted in a timely manner as required by 4-33(b) of the General Statutes. Failure to monitor the establishment of agencies’ bank accounts could result in undetected unauthorized bank accounts.

*Recommendation:* State agencies should submit the list of accounts on or before September first, each year as required by Section 4-33(b) of the General Statutes. Treasury should maintain accurate records of authorized bank account forms. (See Recommendation 8.)

*Agency Response:* “We agree that State agencies should submit the required documentation by the statutory deadline, and when they do not, we follow-up until we receive

the necessary information. Ultimately, however, the delays are the responsibility of the noncompliant agencies. Five of the seven late submissions were received by the end of September, and the other two were received by January. In the future, the Treasurer will notify the Governor's Office of any non-compliance by an agency.

Of the four authorization forms noted by the Auditors as not being "on hand," three were misfiled and one was for an account whose account number had changed due to a bank merger. Periodic reviews of the files will be conducted to ensure authorization forms are properly filed."

### **Investment Advisor Fees Incurred Without a Contract:**

*Criteria:* The Pension Fund Management Division within the Office of the State Treasurer contracts with investment managers to manage funds on behalf of the State's Pension Fund. In accordance with Section 3-11a of the General Statutes, the Treasurer may enter into contractual agreements in accordance with established procedures. Section 3-117 of the General Statutes requires that claims against the State be covered by contracts properly drawn and executed.

*Condition:* The Pension Fund Management Division entered into a partnership agreement with an investment manager to manage funds included in the Private Investment Fund. The investment management agreement expired on January 15, 2003, yet the manager continued to control investments valued at \$2,435,153, as of June 30, 2004; but, did not manage any investments as of June 30, 2005. In June and August of 2003, the investment manager "recommended," and the Treasury agreed that without a written contract, the manager should be paid a fee \$3,500 per month, retroactive to January 15, 2003. The original agreement provided for an extension; however, provision for a \$3,500 per month management fee was not part of the original agreement. In July and October 2003, \$31,250 was taken from the cash-on-hand at the partnership (investment) level. Although we disclosed this issue to the Treasury in our prior audit for the fiscal year ended June 30, 2004, amounts for fees continued to be taken from the cash-on-hand by the manager during the fiscal year ended June 30, 2005, totaling \$82,250. Although it is not unusual that managers be compensated in this manner, compliance with established procedures is still required.

The original agreement contained a requirement that the aggregate rate of return on investment must meet or exceed ten percent before the manager could participate in any of the profits. This requirement is referred to as the "hurdle rate". Treasury informed us that this manager failed to attain its contractual "hurdle" rate on investments, and, therefore, was not supposed to retain approximately \$143,000 of fees. The manager claims that prior oral agreements and/or side letters outside of the normal contractual provisions were made to nullify this contractual provision.

Although the original agreement allowed for an extension, it did not specify the terms and conditions of the extension period. A fully executed contract amendment in writing which addressed the terms of payment during the extension period could have prevented the manager from taking fees out of the partnership cash-on-hand and reinforced the need for the manager to meet the contractual hurdle rate.

*Cause:* There does not appear to have been sufficient management oversight to ensure that this contract was amended, extended or enforced in accordance with its contractual provisions.

*Effect:* Obligating the State without having a contract in place could result in contractual disagreements and overpayments for services.

*Recommendation:* The Treasurer's Office should improve contract management procedures, recover amounts due and not agree to compensate vendors until a fully executed contract is in place. (See Recommendation 9.)

*Agency Response:* "As we responded to the auditors in the prior audit for the fiscal year ended June 30, 2004, we fully agree with the auditors' conclusions about the need to have fully executed agreements in place before vendor payments are made, however, this matter does not involve a vendor contract, but a limited partnership agreement.

The circumstances in the situation cited in this audit finding regarding the investment in the limited partnership Connecticut Greene Ventures were somewhat unique as described below. Under the terms of the limited partnership agreement ("LPA"), the General Partner ("GP") has the sole and exclusive right and obligation to manage the partnership assets in the best interest of the partnership. As the Partnership's originally stated expiration date of January 15, 2003 approached, Pension Fund Management Division ("PFM") communicated to the GP the desire to liquidate all investments, dissolve the Fund and halt all management fees by January 15, 2003. However, in a letter dated November 17, 2002, the GP noted that there was a possibility that it would exercise the two one-year extension options if it proved impractical to liquidate the Fund by the expiration date. Although the GP claims the term of the LPA was extended, the adequacy of this notice is a matter of dispute. The need for the extension was due to delays relating to two of the partnership's investments; one of which was involved in a protracted litigation, and the other one was in the process of being sold. The partnership agreement, which was negotiated and drafted by a prior administration, did not specify a form of extension notice. Nor did the partnership agreement specify a methodology for the reduction of management fees during the partnership's wind down period. The terms and conditions of the CRPTF's investments in limited partnerships are the subject of vigorous negotiation. Pension fund professionals and legal counsel have

made every effort to negotiate clear terms with respect to the exercise of a GP's rights under partnerships agreements.

It has been the consistent policy and practice during the Nappier Administration to document all matters involving the management of the Connecticut Retirement Plans and Trust Funds. This should have been the case with the General Partner responsible for this private investment. The terms of this investment relationship were originally established in 1993. This administration is making every effort to expedite the winding up of this investment to minimize payment of management fees. In this regard, we have solicited the assistance of the Office of the Attorney General ("OAG").

Regarding the matter of the General Partner's failure to attain its contractual "hurdle" rate on investments and the subsequent inappropriate retention of approximately \$143,000 of fees, the Treasury disputes these claims and has referred this matter to the OAG for recovery of the disputed amount. The OAG has contacted the General Partner regarding the amounts due and is pursuing the matter on behalf of the State of Connecticut."

**Financial Reporting Delayed:**

- Criteria:* In accordance with Section 3-37 of the General Statutes, the Treasurer is required to submit a final audited report for the year ended June 30, 2005, to the Governor and the Investment Advisory Council on or before October 15, 2005. The report usually includes data concerning the State's cash receipts and disbursements processed by the Cash Management Division within the Treasurer's Office, among other information. The Treasury uses information provided by the Comptroller's Office to reconcile accounting, or "book" balances to the actual cash, or "bank" balances.
- Condition:* The Treasurer was unable to submit a final audited report for the fiscal year ended June 30, 2005, as required by Section 3-37 of the General Statutes. Apparently, there were delays in receiving accounting information regarding the "book" balances from the Comptroller's Office; and, without this information, the Treasury was unable to complete their reconciliations to the cash, or "bank" balances by October 15, 2005.
- Cause:* Accounting or "book" balances were not available from the Comptroller's Office within the necessary time frame.
- Effect:* The Treasurer was unable to comply with Section 3-37 of the General Statutes to publish a final audited report by October 15, 2005.
- Conclusion:* We have no recommendation at this time as the Treasurer's Office must rely on the Comptroller's Office for final data before continuing their work to meet the requirements for publishing a final audited report in accordance with Section 3-37 of the General Statutes.

## RECOMMENDATIONS

### *Status of Prior Audit Recommendations:*

Our prior audit examination resulted in fourteen recommendations. The following is a summary of those recommendations and the action taken by the State Treasury.

- The Second Injury Fund should consider contesting liability when further information is needed to validate a claim and should adhere to Section 31-355 and Section 3-7 of the General Statutes and the related Regulations of State Agencies when dealing with uninsured employers. This recommendation is presented in modified form as Recommendation 2.
- The Second Injury Fund should improve internal controls over payments to claimants to provide reasonable assurance that such payments are correctly calculated, appropriately approved and related to the claimant's compensable injury. We noted an overpayment of benefits in our current review which is presented as Recommendation 4.
- The Second Injury Fund should review credit balances related to insurance company assessment collections and return overpayments on a timely basis. This recommendation is not repeated.
- The Second Injury Fund should revoke their current policy and take steps to ensure that claims are substantiated with the appropriate level of backup documentation before making any payments to vendors. This recommendation is not repeated.
- The Second Injury Fund should consider maintaining a record of the status of each citation issued by the investigation unit to be sure payments made for penalties are deposited in a timely manner. Efforts have been made to track the status of citations. This recommendation is not repeated.
- The Cash Management Division should follow established internal controls to ensure payments are independently verified and accurately recorded in the State's accounting system prior to the processing of an expenditure. This finding has been resolved.
- The Cash Management Division should comply with existing procedures over cash and ensure that reconciliations of State bank accounts are completed in a timely manner. This condition has continued and is presented as Recommendation 7.
- The Cash Management Division should improve internal control over zero balance accounts to ensure that confirmation letters are sent and reconciliations are reviewed in a timely manner. This recommendation is not repeated.
- The Cash Management Division should review and improve procedures over the calculations of, and distributions from the Interest Credit Program to ensure that the participant funds are credited appropriately. This finding has been resolved.

- The Cash Management Division should resolve outstanding items that originated in prior fiscal years and employ the most efficient manner of bank reconciliation available. This recommendation is restated as part of Recommendation 7.
- The Cash Management Division should research all cancelled payroll checks for the period of July 2004 through July 2005 to verify that no duplicate payments occurred. This recommendation is restated to reflect current conditions and is presented as Recommendation 6.
- The Pension Fund Management Division of the Treasurer’s Office should improve contract management procedures and comply with Section 4-98 of the General Statutes and not agree to payments to vendors until a fully executed contract is in place. This recommendation is restated as Recommendation 9.
- Financial statements should reflect the revenues and expenses of the period for which they are reporting. This finding has been resolved.
- The Treasury should realize losses on impaired investment assets in the year in which the losses are apparent. This finding has been resolved.

*Current Audit Recommendations:*

The following recommendations resulted from our current review.

**1. The Treasury should comply with Section 1-225 and provide information about the Second Injury Fund’s Advisory Board meetings as required.**

Comments:

The Treasury did not file the Annual Schedule of Meetings for the Second Injury Fund Advisory Board, due January 31, 2005, until June 17, 2005. The Board met four days later despite the law stating a 30-day notice was necessary. Meeting minutes did not reflect those in attendance and lacked detail of what happened at the meeting.

**2. The Second Injury Fund should seek legal action against uninsured employers for noncompliance with the Workers’ Compensation Act and not negotiate receivable amounts due to the Fund.**

Comments:

During our review of stipulation payments made from the Second Injury Fund, we noted one case where the Fund negotiated a \$70,000 settlement with the uninsured employer on a claim that cost the State \$934,475, as of August 18, 2005. Section 31-355a allows the Treasurer “any means by law,” including tax warrants, to enforce collection against

uninsured employers. Section 31-288 of the General Statutes states that employers that fail to provide Workers' Compensation liability coverage are guilty of a felony. Criminal charges were not filed against this employer. The Fund's negotiated settlement represents only 7.5 percent of the nearly \$1 million paid out by the Fund.

- 3. The Second Injury Fund, in concert with the Attorney General's Office, should improve controls over the processing of settlement payments to avoid the late payment penalty imposed under Section 31-303 of the General Statutes.**

Comments:

During our audit of the Second Injury Fund, it was found that the Fund was ordered to pay a total of \$10,796 in penalties by the Workers' Compensation Commissioner as a result of two late claim payments. These penalties were paid by the Fund due to a lack of communication with the Attorney General's Office in one case and the inability to readily provide a replacement check in the other.

- 4. The Second Injury Fund should pay dependency benefits in accordance with the General Statutes.**

Comments:

Our audit found the Fund had been paying an injured worker for a dependency exemption for a child that since October 1, 2001, was not documented to meet the established criteria for a dependency exemption. Over four years, the amount overpaid totaled \$2,069. The Fund has already begun to collect this overpayment from the claimant.

- 5. State agencies' ability to post to the Interagency Transfer Account should be restricted to ensure proper usage. Reconciliation of the Interagency Transfer Account should be undertaken by the Comptroller's Office since it is technically not a bank account and has no effect on bank balances.**

Comments:

During our review of year-end closing procedures, we noted that significant dollar variances in the Interagency Transfer Account were not researched and reconciled during fiscal years 2004 and 2005. We found numerous postings that were not appropriate uses of the account which went uncorrected. Although the Interagency Transfer Account is technically not a bank account, it is listed as a bank account in the chart of accounts. The Interagency Transfer Account is more accurately classified as a due to/due from account in the chart of accounts.

- 6. The Treasurer's Cash Management Division should employ the most efficient manner of check verification and ensure that established internal control procedures for check cancellation are followed.**

Comments:

We noted the Comptroller's Accounts Payable Division cancelled 48 checks originally issued by the Treasurer's Unclaimed Property Division totaling \$104,344 that had already been cashed by the rightful owners. The Comptroller's Accounts Payable Division cancelled 44 out of the 48 checks without the proper authorization from Treasury. Treasury authorized the cancellation of the four remaining checks which had already been cashed. The Core-CT accounting system does not record the status of checks that have been issued. Consequently, the Cash Management Division must use a month-old outstanding checklist to determine the status of the checks.

- 7. The Cash Management Division should improve internal control over cash and ensure that reconciliations of State cash accounts are performed completely resolving all variances between the bank and Core-CT records in a timely manner.**

Comments:

During our audit of the Cash Management Division, we found that 5 of 21, or 23 percent of cash account reconciliations were not completed in a timely manner. The reconciliations were not conducted in a manner which resolved all variances between the bank records and the Core-CT accounting record. Comprehensive payroll and vendor account reconciliations that agreed with the Core-CT accounting records for the fiscal year ending June 30, 2005, were not completed for our review until July 2006. We noted that unreconciled outstanding items with dates as far back as August 2003 existed in the vendor account as of August 2006.

- 8. State agencies should submit the list of accounts on or before September first, each year as required by Section 4-33(b) of the General Statutes. Treasury should maintain accurate records of authorized bank account forms.**

Comments:

We found 7 of 25 of agencies tested did not submit their bank confirmation in a timely manner. We noted 4 of 25 bank authorization forms were not in Cash Management Division files.

9. **The Treasurer’s Office should improve contract management procedures, recover amounts due and not agree to compensate vendors until a fully executed contract is in place.**

Comments:

An investment management contract between the Pension Fund Management Division and an investment manager (vendor) expired on January 15, 2003, yet the vendor continued to manage investments valued at \$2,435,153, as of June 30, 2004. In June and August of 2003, the investment manager “recommended,” and the Treasury agreed that without a written contract, the manager should be paid a fee \$3,500 per month, retroactive to January 15, 2003. In July and October 2003, \$31,250 was taken from the cash-on-hand at the partnership (investment) level. Although we disclosed this issue to the Treasury in our prior audit for the fiscal year ended June 30, 2004, amounts for fees continued to be taken from the cash-on-hand by the manager in our current audit for the fiscal year ended June 30, 2005, totaling \$82,250. The vendor did not manage any investments as of June 30, 2005.

In addition, the Treasury stated to us that this manager failed to attain its contractual “hurdle” rate on investments, and, therefore, was not entitled to retain approximately \$143,000 of fees. The manager claims that prior oral agreements and/or side letters outside of the normal contractual provisions were made to nullify this contractual provision.

## INDEPENDENT AUDITORS' CERTIFICATION

### Financial Statements:

We have audited the statement of net assets of the Combined Investment Funds, as of June 30, 2005, the related statements of operations for the fiscal year then ended and the statement of changes in net assets for the fiscal years ended June 30, 2005, and 2004. We have audited the statement of net assets of the Short Term Investment Fund as of June 30, 2005, and the statement of changes in net assets for the fiscal years ended June 30, 2005, and 2004. Further, we have audited the balance sheet of the Second Injury Fund and the statements of condition of the other Non-Civil List Trust Funds as of June 30, 2005, together with the related statements of revenue and expenditures and statements of changes in fund balance for each and the statement of cash flows for the other Non-Civil List Trust Funds, for the fiscal year ended June 30, 2005. We have also examined the schedules of Civil List Funds investments, the Civil List Funds cash receipts and disbursements and debt outstanding, as of June 30, 2005, and changes in debt outstanding during the fiscal year ended June 30, 2005. These financial statements and schedules, which are presented in the Annual Report of the State Treasurer for the fiscal year ended June 30, 2005, are the responsibility of the management of the State Treasury. Our responsibility is to express an opinion on the financial statements and schedules based on our audit.

We did not audit the financial statements of the Tax Exempt Proceeds Fund or the Connecticut Higher Education Trust. These financial statements were audited by other auditors.

We conducted our audit in accordance with *Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and schedules.

Our procedures included confirmation of securities owned as of June 30, 2005, by correspondence with the custodians. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in the notes to the financial schedules, the State Treasury has prepared the schedules of Civil List Funds investments, as of June 30, 2005, the Civil List Funds cash receipts and disbursements for the fiscal year ended June 30, 2005 and debt outstanding, as of June 30, 2005, and changes in debt outstanding during the fiscal year ended June 30, 2005, using accounting practices prescribed by the State Comptroller which practices differ from accounting principles generally accepted in the United States of America. The effects on the financial schedules of the variances between these regulatory accounting practices and accounting principles generally accepted in the United States of America although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the schedules referred to above do not present fairly, in conformity with accounting principles generally

accepted in the United States of America, the cash and investments of the Civil List Funds as of June 30, 2005, the Civil List Funds cash receipts and disbursements for the fiscal year ended June 30, 2005, the balance of bonds outstanding as of June 30, 2005, and bonds issued, retired and refunded, and bond interest payments made during the year ended on that date.

In our opinion, the schedules referred to above present fairly, in all material respects the cash and investments of the Civil List Funds as of June 30, 2005, the Civil List Funds cash receipts and disbursements for the fiscal year ended June 30, 2005, the balance of bonds outstanding as of June 30, 2005, and bonds issued, retired and refunded, and bond interest payments made during the year ended on that date, all in accordance with the modified cash basis of accounting, a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Combined Investment Funds, Short Term Investment Fund, Second Injury Fund and other Non-Civil List Trust Funds as of June 30, 2005, and the results of their operations, the changes in net assets for the Combined Investment Funds, the Short Term Investment Fund, changes in fund balance for the Second Injury Fund and other Non-Civil List Trust Funds and cash flows for the other Non-Civil List Trust Funds for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As explained in Note 1B to the financial statements of the Combined Investment Funds, the State Treasurer's policy is to present investments at fair value. The fair value of most of the assets of the Real Estate Fund, the Commercial Mortgage Fund and the Private Investment Fund and the limited partnership investment of the Mutual Fixed Income Fund are estimated by investment advisors in the absence of readily ascertainable market values, and reviewed and adjusted, when appropriate, by the State Treasurer. The fair value of most of the assets of the Real Estate Fund and the Private Investment Fund and the limited partnership investment of the Mutual Fixed Income Fund are presented at the cash adjusted fair values, which utilize the investment advisors' March 31, 2005, quarter ending estimated values adjusted for cash flows of the Funds during the subsequent quarter that affect the value at the Funds' level. Adjustments are made for underlying investments that experienced significant changes in value during the quarter, if deemed appropriate. We have reviewed the investment advisors' values, the relevant cash flows and the procedures used by the State Treasurer in reviewing the estimated values and have read underlying documentation and, in the circumstances, we believe the procedures to be reasonable and the documentation appropriate. However, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the investments existed, and the differences could be material.

**Compliance:**

Compliance with the requirements of laws, regulations, contracts and grants applicable to the State Treasury is the responsibility of the State Treasury's management.

As part of obtaining reasonable assurance about whether the Agency complied with laws, regulations, contracts, and grants, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on

whether the financial statements referred to above are free of material misstatements, we performed tests of its compliance with certain provisions of laws, regulations and contracts. However, providing an opinion on compliance with these provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests did not disclose any instances of noncompliance that are required to be reported herein under *Government Auditing Standards*.

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

The management of the State Treasurer's Office is responsible for establishing and maintaining effective internal control over its financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations and contracts applicable to the Agency. In planning and performing our audit, we considered the Agency's internal control over its financial operations, safeguarding of assets, and compliance with requirements that could have a material or significant effect on the Agency's financial operations in order to determine our auditing procedures for the purpose of evaluating the State Treasury's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations and contracts, and not to provide assurance on the internal control over those control objectives.

However, we noted certain matters involving the internal control over the Agency's financial operations, safeguarding of assets, and/or compliance that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over the Agency's financial operations, safeguarding of assets, and/or compliance that, in our judgment, could adversely affect the Agency's ability to properly record, process, summarize and report financial data consistent with management's authorization, safeguard assets, and/or comply with certain provisions of laws, regulations, contracts, and grants. We believe the following finding represents a reportable condition; the need to perform cash reconciliations in a more timely manner.

A material or significant weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with certain provisions of laws, regulations, contracts, and grants or the requirements to safeguard assets that would be material in relation to the Agency's financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions to the Agency being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over the Agency's financial operations and over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material or significant weaknesses. However, we do not believe that the reportable condition described above is a material or significant weakness.

We also noted other matters involving internal control over the Agency's financial operations and over compliance which are described in the accompanying "Condition of Records" and "Recommendations" sections of this report.

*Auditors of Public Accounts*

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This report is intended for the information of 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.

Thomas W. Willametz  
Administrative Auditor

Approved:

Kevin P. Johnston  
Auditor of Public Accounts

Robert G. Jaekle  
Auditor of Public Accounts