

STATE OF CONNECTICUT



*Independent Auditors' Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in
Accordance with Government Auditing Standards*

*Office of the State Treasurer
for the Fiscal Year Ended June 30, 2013*

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN ❖ ROBERT M. WARD

Table of Contents

Letter of Transmittal	1
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	2
Schedule of Findings and Responses	5
Investment Advisory Council Authorization of Trust Fund Allocation.....	5
Zero Balance Account Reconciliation.....	5

STATE OF CONNECTICUT



AUDITORS OF PUBLIC ACCOUNTS

JOHN C. GERAGOSIAN

State Capitol
210 Capitol Avenue
Hartford, Connecticut 06106-1559

ROBERT M. WARD

December 31, 2013

Governor Dannel P. Malloy
Members of the General Assembly
State Treasurer Denise L. Nappier:

Letter of Transmittal

We have audited the financial statements and certain other information of the Treasurer of the State of Connecticut pertaining to the combined investment funds, short-term investment funds, second injury fund, non-civil list trust funds, civil list funds, and debt. We have issued our Independent Auditors' Report dated December 31, 2013, which is included within the Treasurer's Annual Report and accompanies the financial statements and related notes to the financial statements. The Treasurer's Annual Report and our audit work were required in accordance with Sections 3-37, and 2-90, subsection (b), of the General Statutes, respectively.

We have conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. We considered internal control over financial reporting as well as compliance with laws, regulations and other requirements that could have a direct and material effect on the financial statement amounts, in accordance with these standards. We are issuing our Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards dated December 31, 2013. Also within this report is the Schedule of Findings and Responses, which detail the findings and recommendations for corrective action.

We wish to express our appreciation for the cooperation and courtesies shown to our representatives by the personnel of the Office of the State Treasurer during the course of our examination.

A handwritten signature in black ink, appearing to read "John C. Geragosian".

John C. Geragosian
Auditor of Public Accounts

A handwritten signature in black ink, appearing to read "Robert M. Ward".

Robert M. Ward
Auditor of Public Accounts

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

Governor Dannel P. Malloy
Members of the General Assembly
State Treasurer Denise L. Nappier:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, the financial statements of the Combined Investment Funds, which comprise the statement of net position as of June 30, 2013, the statements of changes in net position for the fiscal years ended June 30, 2013 and 2012, and the related notes to the financial statements. We have audited the financial statements of the Short-Term Investment Fund, which comprise the statement of net position as of June 30, 2013, the statements of changes in net position for the fiscal years ended June 30, 2013 and 2012, and the related notes to the financial statements. We have audited the financial statements of the Short-Term Plus Investment Fund, which comprise the statement of net position as of June 30, 2013, the statements of changes in net position for the fiscal years ended June 30, 2013 and 2012, and the related notes to the financial statements. We have audited the financial statements of the Second Injury Fund, which comprise the statements of net position as of June 30, 2013 and 2012 and the related statements of revenues, expenses and changes in net position and the statements of cash flows for the fiscal years ended June 30, 2013 and 2012, and the related notes to the financial statements. We have audited the statements of condition of the other Non-Civil List Trust Funds as of June 30, 2013, together with the related statements of revenue and expenditures, and statements of changes in fund balance and the statements of cash flows for the other Non-Civil List Trust Funds and the related notes to the financial statements for the fiscal year ended June 30, 2013. We have audited the schedules of Civil List Funds investments and the summary schedule of cash receipts and disbursements of the Civil List Funds for the fiscal year ended June 30, 2013. We have audited the schedule of debt outstanding and the changes in debt outstanding for the fiscal year ended June 30, 2013. This information is included in the State Treasurer's Annual Report for the fiscal year ended June 30, 2013. We have issued our report thereon dated December 31, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State Treasurer's internal control over financial reporting (internal control) as a basis for designing auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Treasurer's internal control. Accordingly, we do not express an opinion on the effectiveness of the Treasurer's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did identify the following deficiency in internal control described further in the accompanying Schedule of Findings and Responses: Recommendation – Zero Balance Account Reconciliation. We do not consider the deficiency described within the accompanying schedule of findings and responses to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State Treasurer's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Agency's Responses to Findings

The State Treasurer's responses to the findings identified in our audit are included in the accompanying schedule of findings and responses. These responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing and not to provide an opinion on the effectiveness of the Treasurer's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Treasurer's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. This report is intended solely for the information and use of the Governor, General

Assembly and the State Treasurer; however, this report is a matter of public record and its distribution is not limited.



Thomas W. Willametz
Administrative Auditor

Approved:



John C. Geragosian
Auditor of Public Accounts



Robert M. Ward
Auditor of Public Accounts

December 31, 2013
State Capitol
Hartford, Connecticut

Schedule of Findings and Responses

Our review identified the following areas that required disclosure or corrective action.

Investment Advisory Council Authorization of Trust Fund Allocation

- Criteria:* Section 3-13b(c)(1) of the General Statutes requires the Treasurer to generally obtain approval from the Investment Advisory Council (IAC) and make public any changes to the Investment Policy Statement.
- Condition:* A portion of the assets of the Other Post-Employment Benefits (OPEB) Trust Fund were reallocated to certain Combined Investment Funds within the Connecticut Retirement Plans and Trust Funds on March 1, 2013, prior to approval by the Investment Advisory Council of revisions to the Investment Policy Statement on March 13, 2013.
- Cause:* Management directed staff to reallocate investments before receiving approval from the Investment Advisory Council to amend the Investment Policy Statement.
- Effect:* There was noncompliance with Section 3-13b(c)(1) of the General Statutes.
- Conclusion:* The Treasury received approval from the Investment Advisory Council at a later date; therefore, we have no recommendation at this time.

Zero Balance Account Reconciliation:

- Criteria:* The Treasurer's Cash Management Division is responsible for funding the zero balance accounts and maintaining proper internal control for the reconciliation of the accounts in a timely manner. The zero balance accounts are not actual cash accounts but are accounts that are established to track disbursement activity for certain state agency programs.
- Condition:* The Cash Management Division reviews, analyzes and assists agencies with their zero balance account reconciliation. Agencies are required to report and explain any discrepancies between their records and Cash Management records. Our review disclosed that the Department of Social Services had drawn down funds in excess of its spending authority totaling \$576,816,262 in error for two of its zero balance accounts. The discrepancies resulted from misapplication of procedural changes implemented by the Comptroller's Office

memorandum number 2012-29. The Comptroller memorandum required agencies to upload quarterly cash held journals in Core-CT to adjust the expenditures transactions that occurred through the zero balance accounts. The Department of Social Services reported the error along with the details to the Comptroller's Office and Cash Management Division in a timely manner. However, we noted the discrepancy remained past September 1, 2013 after the accounting records had been closed to any further adjustments.

Effect: Unresolved discrepancies in the zero balance account resulted in the overstatement of funds available to the Department of Social Services in the Core-CT accounting record. This error resulted in a non-cash adjustment totaling \$576,816,262 to the state accounting records which was made after the adjustment period closed.

Cause: Cash Management Division failed to review and resolve discrepancies in the Department of Social Service zero balance appropriation account in a timely manner. In addition, the Cash Management Division and the Comptroller failed to resolve the zero balance account error in a timely manner.

Recommendation: The Cash Management Division should improve internal controls over the review of the zero balance account reconciliation to ensure all variances between Treasury and the agencies are resolved completely. In addition, the Cash Management Division should communicate with the Comptroller's Office regarding large variances that would have an effect on the state accounting records.

Agency Response: "The Treasurer's responsibility regarding zero balance accounts is to fund actual agency disbursements and to monitor those disbursements against the expenditure authority approved by the Comptroller's Office, which we did. The Comptroller's Office monitors expenditures against appropriations. The "non-cash" transactions in question were not created or posted by the Treasurer's Office, and the Office is not capable of making such adjustments or corrections. The Treasury, upon learning of the variance, had several conversations and meetings with the Comptroller's Office to resolve the issue. Going forward, the Treasury will ensure that there is appropriate documentation of efforts to resolve variances within the zero balance account."