

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, 2017*

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN ❖ ROBERT J. KANE

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STATE OF CONNECTICUT



AUDITORS OF PUBLIC ACCOUNTS

JOHN C. GERAGOSIAN

State Capitol
210 Capitol Avenue
Hartford, Connecticut 06106-1559

ROBERT J. KANE

December 29, 2017

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 29, 2017, 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 29, 2017. Also within this report is the State Auditors' Findings and Recommendations, 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 "R. J. Kane".

Robert J. Kane
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, 2017, the statements of changes in net position for the fiscal years ended June 30, 2017 and 2016, 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, 2017, the statements of changes in net position for the fiscal years ended June 30, 2017 and 2016, 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, 2017 and 2016 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, 2017 and 2016, and the related notes to the financial statements. We have audited the statements of net position of the other Non-Civil List Trust Funds as of June 30, 2017, together with the related statement of revenue and expenditures, and statement of changes in net position 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, 2017. 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, 2017. We have audited the schedule of debt outstanding and the changes in debt outstanding for the fiscal year ended June 30, 2017. This information is included in the State Treasurer's Annual Report for the fiscal year ended June 30, 2017. We have issued our report thereon dated December 29, 2017.

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. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses or significant deficiencies. However, material weaknesses or significant deficiencies may exist that have not been identified.

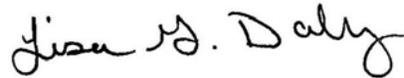
Compliance and Other Matters

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*.

We noted certain other matters that we have reported to management in the following State Auditors' Findings and Recommendations. The State Treasurer's responses to the findings identified in our audit 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.



Lisa G. Daly
Administrative Auditor

Approved:



John C. Geragosian
Auditor of Public Accounts



Robert J. Kane
Auditor of Public Accounts

December 29, 2017
State Capitol
Hartford, Connecticut

State Auditors' Findings and Recommendations

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

Inadequate Reconciliations

Background: The Treasury contracts with a master custodian that is responsible for accounting for the activity of the combined investment funds and with investment managers that are responsible for investment activities. The investment managers are required to reconcile their records to the custodian records on a monthly basis. The reconciliation includes investment values and holdings, income and other key financial data. The Treasury has a procedure in place to review these reconciliations monthly.

Criteria: Sound internal controls require the timely review of reconciliations in order to detect and correct errors on a timely basis. For reconciliations to be effective, they must clearly identify differences. Treasury staff should analyze those differences to determine if any adjustments to the accounting records are necessary.

Condition: Our review of investment manager reconciliations found that Treasury staff did not complete timely reviews of reconciliations for the fiscal year ended June 30, 2017. Generally, Treasury staff reviewed reconciliations 3 to 4 months after they were received. In addition, the Pension Fund Investment Technician completed the reviews without documented supervisory review or approval. Although the reconciliations identified differences, we noted that for the pending trades account, they did not always provide the level of detail as the other accounts and they did not include sufficient information to determine if adjustments should be made to the accounting records.

In addition, during our testing of year-end pending trades, we found that the custodian posted several transactions late and, as a result, were not included in the accounting records used to prepare the annual financial statements. We could not determine if the agency identified the late postings.

Cause: The Treasury has not developed procedures to adequately identify and analyze differences between custodian records and manager records.

- Effect:* Inadequate reconciliation procedures increases the risk that errors will go undetected, and could result in financial statements being misstated.
- Recommendation:* The Office of the State Treasurer should develop procedures that ensure reconciliations are reviewed timely and contain the detail necessary to determine if adjustments should be made to the accounting records. (See Recommendation 1.)
- Agency Response:* “Although there are internal control procedures in place to identify and analyze differences between custodian records and investment manager records, the sign-offs on completed reviews were not completed timely. Pension Funds Management will clearly document the review of the reconciliations in a timely manner going forward.”

Recommendations

We presented no recommendations in our Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters for the Fiscal Year Ended June 30, 2016 Office of the State Treasurer.

Current Audit Recommendations:

- 1. The Office of the State Treasurer should develop procedures that ensure reconciliations are reviewed timely and contain the detail necessary to determine if adjustments should be made to the accounting records.**

Comment:

Our review disclosed that Treasury staff did not complete timely investment manager reconciliations, did not include documented supervisory review, and did not include sufficient detail for the pending trades account. We also noted instances in which the custodian posted pending trades late and we could not determine if the agency identified these postings.