

# STATE OF CONNECTICUT



*AUDITORS' REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2018*

*STATE OF CONNECTICUT  
COMPREHENSIVE ANNUAL FINANCIAL REPORT*

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

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# STATE OF CONNECTICUT



## AUDITORS OF PUBLIC ACCOUNTS

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JOHN C. GERAGOSIAN

ROBERT J. KANE

January 15, 2019

Governor Ned Lamont  
Members of the General Assembly

We have audited the financial statements and certain other information of the Comptroller of the State of Connecticut as they pertain to the central accounting of state financial operations, on a budgetary basis of accounting, for the fiscal year ended June 30, 2018. The auditors' report on the Comptroller's civil list financial statements, the audited civil list financial statements themselves, and the related auditors' report on compliance and internal control over civil list financial reporting are included in a separate report entitled *Annual Report of the State Comptroller – Budgetary/Statutory Basis* for the fiscal year ended June 30, 2018, issued November 30, 2018.

We have also audited the financial statements and certain other information of the Comptroller of the State of Connecticut as they pertain to the State of Connecticut's financial position and results of operations on the basis of generally accepted accounting principles (GAAP). The auditors' report on the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, the aggregate remaining fund information, the respective budgetary comparison for the General Fund and the Transportation Fund, the respective changes in financial position and cash flows, where applicable, and the related notes to the financial statements of the State of Connecticut, which collectively comprise the state's basic financial statements are included in a separate report entitled *Comprehensive Annual Financial Report* (known as the state's CAFR) for the fiscal year ended June 30, 2018, issued January 15, 2019.

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*.

During our audit, we became aware of a matter that is considered an internal control weakness not deemed significant or material, but is an opportunity to strengthen controls and improve operating efficiencies. The accompanying State Auditors' Findings and Recommendations details this finding and recommendation for corrective action.

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



Vincent Filippa  
Administrative Auditor

Approved:



John C. Geragosian  
State Auditor



Robert J. Kane  
State Auditor

January 15, 2019  
State Capitol  
Hartford, 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**

Governor Ned Lamont  
Members of the General Assembly

We have audited 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, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of the State of Connecticut as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the state's basic financial statements and have issued our report thereon dated January 15, 2019. Our report includes a reference to other auditors. Other auditors audited the financial statements of certain funds and discretely presented component units of the state, as described in our report on the State of Connecticut's financial statements. This report does not include the results of the other auditors' testing of internal controls over financial reporting or compliance and other matters that are reported on separately by those auditors. The audits of the financial statements of the Bradley International Airport Parking Facility, Connecticut State University System, Connecticut Community Colleges, and the University of Connecticut Foundation were not conducted in accordance with *Government Auditing Standards*.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the State of Connecticut's internal control over financial reporting (internal control) as a basis for designing our 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 State of Connecticut's internal control. Accordingly, we do not express an opinion on the effectiveness of the State of Connecticut'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 of Connecticut'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 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's management responses to 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 it. In addition, we have reported or will report to management findings in separately issued departmental audit reports covering the fiscal year ended June 30, 2018.

### **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 entity'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 entity's internal control and compliance. Accordingly, this report is intended solely for the information and use of the Governor, the State Comptroller, the Appropriations Committee of the General Assembly, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.



John C. Geragosian  
State Auditor



Robert J. Kane  
State Auditor

January 15, 2019  
State Capitol  
Hartford, Connecticut

## OTHER MATTERS

### Implementation of GAAP-Based Budgeting

The *Annual Report of the State Comptroller – Budgetary/Statutory Basis* for the fiscal year ended June 30, 2018, reflects the fifth year of GAAP-based budgeting. The move to GAAP-based budgeting resulted from the passage of Public Act 11-48 and the 2013-2014 and 2014-2015 biennial budget plan in Public Act 13-184, as adjusted by Public Acts 13-247 and 14-47; as well as the passage of the 2015-2016 and 2016-2017 biennial budget plan in Public Act 15-244. The intent of GAAP-based budgeting was to narrow the difference between the accounting for the state budget and the CAFR, which would allow for the CAFR to be the single accounting report for the State of Connecticut.

Passed as part of the *Plan for Conversion to GAAP-Based Budgeting Developed in Accordance With Governor Dannel P. Malloy’s Executive Order No. 1*, the details of Public Act 11-48 and the history of efforts leading to its passage were described in our *Auditors’ Report Office of the State Comptroller* for the fiscal year ended June 30, 2011, as well as for fiscal year ended June 30, 2012. The results of the first year of GAAP-based budgeting and issues with its implementation were described in our *Auditors’ Report on Internal Control Over Financial Reporting and on Compliance and Other Matters* for the fiscal year ended June 30, 2014.

As described in our previous reports, the statutory basis of accounting adopted by the Office of the State Comptroller is not GAAP reporting as recognized by the Government Accounting Standards Board. It is not on a GAAP basis in that it does not carry forward accruals from each fiscal period to the next on the Core-CT accounting system. Instead, it continues to utilize the modified cash basis of accounting as a compromise to avoid significant operational changes in Core-CT processes. As a result, budgets are not being controlled on a GAAP basis, and monthly reporting on the Core-CT system is not on a GAAP basis. Prior reports also noted that the University of Connecticut, University of Connecticut Health Center, Connecticut State University, Connecticut Community Colleges, Office of Legislative Management, and Judicial Department are allowed to operate as limited scope Core-CT agencies. These agencies may process their transactions through their own accounting systems and then periodically enter the information into the Core-CT system. As a result, significant receivables and payables can accrue at month or year-end that are not promptly reported on the Core-CT system.

Because the state’s budget deficit is projected by monthly financial reports, it is unclear which amount should be utilized to apply the statutory requirements related to the Governor’s submission of a deficit mitigation plan. To provide GAAP reporting for the CAFR that is compliant with the modified accrual basis of accounting required by the Government Accounting Standards Board, the manual entry of miscellaneous accounting information not available on the Core-CT system is still required. To properly monitor budgetary compliance on a modified accrual basis, the Core-CT system would need to provide periodic information on accrued revenues and expenditures without a “close” of the system.

**Reconciliation of Fund Balance - General Fund**

As described in our previous reports, the difference in accounting basis results in a deficit in the Unreserved Fund Balance of the General Fund when adjustments are made to reflect the modified accrual basis used under GAAP, as required for the CAFR. A reconciliation of the net change in fund balances for the General Fund, as reported under the budgetary and GAAP basis of accounting, is presented in the Required Supplementary Information (RSI) section of the CAFR. A schedule illustrating the differences in adjustments for the past 3 fiscal years is presented below:

<i>(In millions)</i>	<u>2015-2016</u>	<u>2016-2017</u>	<u>2017-2018</u>
<b>Unreserved Fund Balance (Deficit)</b>			
<b>Modified Cash Basis</b>	\$ 116.1	\$ 116.1	\$ 116.1
<b>GAAP Based Adjustments</b>			
<b>Additional Assets</b>			
Taxes Receivable			
Income Tax	(447.1)	(387.5)	(425.0)
Eliminate Corporation Tax Accrual	(18.5)	(39.6)	(17.7)
Additional Taxes Receivable	<u>4.3</u>	<u>5.1</u>	<u>2.8</u>
Net Increase (Decrease) Taxes	(461.3)	(422.0)	(439.9)
Net Accounts Receivable	388.0	449.5	448.7
Federal and Other Grants Receivable	46.2	21.9	537.3
Due From Other Funds	46.4	43.7	45.0
GAAP Conversion Bonds	<u>-</u>	<u>-</u>	<u>-</u>
Total Additional Assets	19.3	93.1	591.1
<b>Additional Liabilities</b>			
Salaries and Fringe Payable	90.8	113.6	135.6
Accounts Payable - Social Services	(42.9)	(11.4)	(9.9)
Accounts Payable - Trade and Other	(728.6)	(681.1)	(706.2)
Payable to Federal Government	(360.8)	(357.7)	(288.7)
Due to Other Funds	<u>(92.8)</u>	<u>(93.7)</u>	<u>(79.1)</u>
Total Additional Liabilities	(1,134.3)	(1,030.3)	(948.3)
<b>Unreserved Fund Balance (Deficit)</b>			
<b>GAAP Basis</b>	<u>\$ (998.9)</u>	<u>\$ (821.1)</u>	<u>\$ (241.1)</u>

As shown above, the most significant adjustments each year are reducing the income tax accrual, recording other receivables, and recording payables incurred prior to fiscal year end. The \$116,101,695 Unreserved Fund Balance under the budgetary basis for the 2017-2018 fiscal year, reported as “Fund Balance Related to Statutory GAAP Budgeting” on the *Annual Report of the State Comptroller*, represents the \$47,580,846 GAAP deficit amortization described below net against the \$598,500,000 in GAAP Conversion Bonds and (\$529,979,151) fund balance due to a change in accounting method from the initial year of GAAP-based budgeting.

In this fifth year of GAAP-based budgeting, we again observe that actual GAAP budgeting would have properly recognized the July tax accruals and salaries, fringe benefits and accounts payable at the end of the fiscal year. If a more comprehensive method of GAAP-based budgeting was instituted, the year-end fund balances under the statutory basis (GAAP-based budgeting) would more closely resemble the GAAP basis fund balances.

### **Revision to Amortized GAAP Deficit and to Sections 2-35 and 4-72 of the General Statutes**

In order to implement GAAP-based budgeting, the General Assembly passed Public Act 11-48 that revised Section (b) of Section 2-35 and Section 4-72 of the General Statutes to require that the Governor propose, and General Assembly enact, a state budget that excludes as revenues the estimated unappropriated prior year surplus, and includes as expenditures, the amount necessary to extinguish any unreserved negative balance in any budgeted fund as reported by the prior year CAFR. Public Act 11-48 also revised Section 3-115 of the General Statutes and required the annual report of the State Comptroller to be prepared in accordance with GAAP.

The 2013-2014 fiscal year budget was the initial year of GAAP-based budgeting, and under Section 235 of Public Act 13-247, the GAAP deficit that accumulated over many years was to be addressed. Starting with the June 30, 2013 GAAP deficit of \$1,217,051,000 as reported in the CAFR and then applying the \$598,500,000 in GAAP Conversion Bonds proceeds, an adjusted GAAP deficit of \$618,551,000 resulted for June 30, 2013, which by Public Act 13-247 was to be amortized in equal amounts of \$47,580,846 during the 2016 through 2028 fiscal years. However, after adoption of the 2013-2014 fiscal year budget, and at the close of that fiscal year, it was noted that the June 30, 2014 GAAP deficit totaled \$727,209,000 as reported in the CAFR. This \$108,658,000 unforeseen increase in the GAAP deficit was due partly to the income tax accrual period for that fiscal year containing more payroll days, which increased the variance between the GAAP basis of accounting and the statutory (budgetary) basis. This added \$64,000,000 to the GAAP deficit because more General Fund revenue was attributed to the statutory accrual period, which ends no later than 5 business days after the last day of July. The remaining \$44,700,000 variance was attributed to various closing adjustments made to accounts payable and receivable as part of preparing the CAFR, including errors caused by the transfer of the federal portion of the Medicaid program from the General Fund to the Restricted Grants and Accounts Fund.

To address this condition, the General Assembly revised the 2015-2016 and 2016-2017 biennial budget with the passage of Public Act 15-1 in the December 2015 Special Session. It amended Section 3-115b Subsection (c) of the General Statutes to require the additional GAAP deficit to be amortized in equal increments in each fiscal year of each biennial budget, during the 2017 through 2028 fiscal years. Subsequently, Public Act 16-3, passed in the May 2016 Special Session, changed the amortization of the additional GAAP deficit to equal increments of \$9,878,000 in each fiscal year of each biennial budget, during the 2018 through 2028 fiscal years. The amortization requirements were again changed with the passage of Public Act 17-51, which required the Secretary of the Office of Policy and Management to annually publish an amortization schedule to fully reduce the negative unassigned balance by June 30, 2028. This requirement commenced in the 2017-2018 fiscal year and continues through the succeeding 10 years.

Public Act 15-1 also revised Section (b) of Section 2-35 and Section 4-72 of the General Statutes to again require estimated revenues to cover the negative unassigned fund balance as reported by the *Annual Report of the State Comptroller* rather than the CAFR. We note that although it is required by Public Act 11-48, the annual report is not prepared in accordance with GAAP but instead reflects the state's budget act and reporting on a statutory basis of accounting.

**Accumulated GAAP Deficit**

As reported in the *Comprehensive Annual Financial Report*, on a government-wide basis, which takes into account all non-fiduciary state assets and liabilities (for the primary government including all funds in addition to the General Fund), the total net position of the state as of June 30, 2018 was a deficit of \$47,564,350,000. This increase of \$8,903,690,000 in the deficit, as compared to the amount reported as of June 30, 2017, was primarily caused by an \$8,733,000,000 increase in the non-current portion of the state's long term liabilities.

A schedule presenting the deficit on a government-wide basis, from the CAFR Statement of Net Position, since such information has been presented in the CAFR follows:

Fiscal Year Ended, June 30, 2002	\$ (816,926,000)
Fiscal Year Ended, June 30, 2003	\$ (1,471,912,000)
Fiscal Year Ended, June 30, 2004	\$ (1,780,341,000)
Fiscal Year Ended, June 30, 2005	\$ (1,392,024,000)
Fiscal Year Ended, June 30, 2006	\$ (784,864,000)
Fiscal Year Ended, June 30, 2007	\$ (242,540,000)
Fiscal Year Ended, June 30, 2008	\$ (2,203,449,000)
Fiscal Year Ended, June 30, 2009	\$ (5,065,237,000)
Fiscal Year Ended, June 30, 2010	\$ (9,388,402,000)
Fiscal Year Ended, June 30, 2011	\$ (9,856,474,000)
Fiscal Year Ended, June 30, 2012	\$(10,555,813,000)
Fiscal Year Ended, June 30, 2013	\$(10,457,941,000)
Fiscal Year Ended, June 30, 2014	\$(12,589,951,000)
Fiscal Year Ended, June 30, 2015	\$(35,326,113,000)
Fiscal Year Ended, June 30, 2016	\$(37,858,651,000)
Fiscal Year Ended, June 30, 2017	\$(38,660,660,000)
Fiscal Year Ended, June 30, 2018	\$(47,564,350,000)

The significant increases in the deficit starting with the fiscal year ended June 30, 2008 and in succeeding fiscal years resulted from increases in total bonded debt and poor economic conditions that lead to budget deficits, the exhaustion of the Budget Reserve Fund, and declines in the valuation of state pension investments. The most recent significant increases were the result of the implementation of Government Accounting Standards Board Statement No. 68 in the 2014-2015 fiscal year and Government Accounting Standards Board Statement No. 75 in the 2017-2018 fiscal year, which required employers to post to their Statement of Net Position, their net liabilities for pensions and other postemployment benefits (retiree health care costs), respectively.

## STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

Our review of statewide financial reporting identified internal control weaknesses as defined by auditing standards generally accepted in the United States of America. Although they are not deemed significant deficiencies or material weaknesses per those standards, they are areas that require corrective action. These areas are detailed in the following pages:

### **Inadequate Financial Reporting Process – Agency Prepared GAAP Adjustment Forms**

*Criteria:* The Office of the State Comptroller has a long established procedure of requiring state agencies to prepare and submit adjustment forms to report various account balances, accruals, liabilities, contingencies and other information required to report the state's financial position on a GAAP basis to the State Comptroller. These forms are required to be submitted with accurate information by certain deadlines.

*Condition:* Prior audits have revealed that various state agencies did not submit accurate GAAP adjustment forms. The review of agency prepared forms by our field audit staff for the 2017-2018 fiscal year again revealed significant errors and omissions in the amounts reported. The material errors found and corrected were as follows:

- The Office of the State Comptroller understated the liability related to the SEBAC vs. Rowland settlement by \$12,250,211.
- The Department of Social Services (DSS) understated its contractual obligations by \$71,478,153. Also, DSS neglected to include in its reported amounts, certain medical payments owed to Medicaid services providers, understating liabilities by \$4,539,186, as well as cash advances to a services provider, understating receivables by \$4,470,000.
- The Department of Transportation (DOT) overstated its contractual obligations by \$4,880,874,384. Also, DOT understated infrastructure by \$34,801,319 and construction in progress by \$6,803,934, and incorrectly calculated rail car rental payments, overstating operating leases (state as lessee) by \$1,800,000.
- The Department of Administrative Services overstated its construction in progress ending balance by \$135,416,498, and also understated its contractual obligations, mainly for school construction grants, by \$44,847,808.

- The Teachers' Retirement Board reported contributions totaling \$51,540,282 in its retirement benefit fund although they were already reported in its health insurance premium fund, effectively overstating revenues.
- The Department of Energy and Environmental Protection (DEEP) overstated receivables by not appropriately identifying nearly \$20,000,000 in receivables estimated to be uncollectible. Also, DEEP overstated its contractual obligations by \$1,089,395.
- The Department of Economic and Community Development overstated its contractual obligations by \$8,980,443.

*Effect:* The audit and correction of these errors results in the delay of the preparation and issuance of the state's CAFR and adds to the risk for error.

*Cause:* For some of the conditions noted above, our previous audit revealed almost identical types of errors. There continues to be a need for the Office of the State Comptroller to follow up on agencies that make repeated errors.

*Prior Audit Finding:* This finding has been previously reported in the last 5 audit reports covering the 2012-2013 to 2016-2017 fiscal years.

*Recommendation:* The Budget and Financial Analysis Division of the Office of the State Comptroller should continue its efforts to provide training and monitoring in the preparation and submission of accurate GAAP adjustments. (See Recommendation 1.)

*Agency Response:* "The Office of the State Comptroller (OSC) agrees with this audit finding. The OSC Budget and Financial Analysis Division (BFA) will continue to work with state agencies to improve the quality and accuracy of their financial reporting. As in past years, these efforts will include additional clarification and written instructions as well as on-site visits, training and telephone access for specific questions. More recently, BFA added an on-line Power Point presentation to assist agencies in the proper submission of accounting information. These efforts have reduced errors in specific reporting areas, although challenges remain. One major obstacle outside of OSC's control is the ongoing effort to reduce the size of the state workforce, which has resulted in considerable transfer of reporting responsibilities to new staff at many agencies. As a result, agency staff that were trained and reporting correctly have been replaced with less experienced staff.

OSC continues to be grateful to the Auditors of Public Accounts (APA) for helping to identify agencies and financial issues that require additional explanation and intervention by the division. An additional step OSC intends to take for next year's reporting cycle will be to provide copies of the audit findings APA has identified with the closing GAAP packages for FY 2019. OSC will also offer to facilitate meetings between agency staff responsible for GAAP reporting and APA field auditors to review reoccurring reporting errors. By highlighting these specific issues, BFA hopes to remind agencies of past problems in an effort to avoid repeating similar mistakes in the future."

## RECOMMENDATIONS

One recommendation was presented in our *Auditors' Report on Internal Control Over Financial Reporting and on Compliance And Other Matters for the Fiscal Year Ended June 30, 2017 State of Connecticut Comprehensive Annual Financial Report*. This recommendation is being repeated for the fiscal year ended June 30, 2018. The previous recommendation and its current status are as follows:

### Status of Prior Audit Recommendation

1. **The Budget and Financial Analysis Division of the Office of the State Comptroller should continue its efforts to provide training and monitoring in the preparation and submission of accurate GAAP adjustments.** Continued errors were noted, for certain agencies, during our current review. Therefore, the recommendation is being repeated with modification to reflect our current audit findings.

### Current Audit Recommendation

1. **The Budget and Financial Analysis Division of the Office of the State Comptroller should continue its efforts to provide training and monitoring in the preparation and submission of accurate GAAP adjustments.**

Comment:

Our examination revealed that the State Comptroller had continuing problems accumulating accurate GAAP adjustment data from certain state agencies.