

STATE OF CONNECTICUT



**AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS
FOR THE FISCAL YEAR ENDED JUNE 30, 2013
STATE OF CONNECTICUT
COMPREHENSIVE ANNUAL FINANCIAL REPORT**

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

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STATE OF CONNECTICUT



AUDITORS OF PUBLIC ACCOUNTS

JOHN C. GERAGOSIAN

State Capitol
210 Capitol Avenue
Hartford, Connecticut 06106-1559

ROBERT M. WARD

February 28, 2014

Governor Dannel P. Malloy
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, 2013. 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 Basis*, for the fiscal year ended June 30, 2013, issued December 31, 2013.

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 - Fiscal Year Ended June 30, 2013*, known as the state's CAFR.

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 consider 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 several matters that are considered internal control weaknesses not deemed significant or material but are opportunities to strengthen controls and improve operating efficiencies. The accompanying State Auditors' Findings and Recommendations details these findings and recommendations for corrective action.

We also wish to express our appreciation of the courtesies shown to our representatives during the course of our audit. The assistance and cooperation extended to them by the personnel of the Office of the State Comptroller in making their records readily available and in explaining transactions as required greatly facilitated the conduct of our examination.



Matthew Rugens
Administrative Auditor

Approved:



John C. Geragosian
Auditor of Public Accounts



Robert M. Ward
Auditor of Public Accounts

February 28, 2014
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 Dannel P. Malloy
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, 2013, and the related notes to the financial statements, which collectively comprise the state's basic financial statements and have issued our report thereon dated February 28, 2014. 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, John Dempsey Hospital, Connecticut State University System, Connecticut Community Colleges and the University of Connecticut Foundation and University of Connecticut Law School 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, 2013

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, the Legislative Committee on Program Review and Investigations, 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
Auditor of Public Accounts



Robert M. Ward
Auditor of Public Accounts

February 28, 2014
State Capitol
Hartford, Connecticut

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:

Cross Check and Validation of Central Accounting Journal Entries:

Criteria: Proper internal controls require that all journal entries, including those considered nonstandard or nonroutine, have adequate supporting documentation and are reviewed and approved independently prior to posting. There should be appropriate segregation of duties among those who initiate, approve and post journal entries to the Core-CT general ledger.

Condition: The central accounting function within the Budget and Financial Analysis Division of the State Comptroller prepares and posts journal entries to the Core-CT general ledger for statewide budgetary and GAAP accounting, fiscal year-end close and financial statement preparation. We found that certain duties were segregated in appearance only within Core-CT. Our current examination found occurrences with GAAP basis entries in which a single individual is preparing and posting journal entries of significant amounts without a second person to review and approve the journal prior to posting it to the GAAP basis general ledger. In other cases, the reviewer may not have a sufficient understanding or the experience to complete the review of the work performed by management.

There were no compensating controls to ensure that errors and omissions in the journal entries would be detected and corrected.

Effect: Our annual audits of the financial statements have identified errors in journal entries posted to the Core-CT system. Errors not identified and corrected by the audit process can result in a material misstatement in the financial statements.

Cause: Statewide central accounting is performed by a small staff that does not readily lend itself to the establishment of segregated duties and the cross checking of work. In response to our previous audit, the Budget and Financial Analysis Division stated that it had implemented corrective action to require the validation of GAAP journal entries by the division director prior to posting. Our current audit found complete corrective action had not been implemented.

Recommendation: The Budget and Financial Analysis Division of the Office of the State Comptroller should ensure that all centrally posted journal entries have adequate supporting documentation and are reviewed and approved independently prior to posting. (See Recommendation 1.)

Agency Response: “Due to a prior audit recommendation, we have implemented a journal validation process. We found the implementation of this recommendation to be useful in broadening staff knowledge and cross training. We agree that a limited number of specialized entries have no formal cross validation. We emphasize that since implementing your recommendation, all journal entries posted to Core-CT must have formal sign-off approval, and these entries represent the overwhelming majority of all accounting adjustments. The knowledge of approvers will continue to expand through cross training. The budget based entries are manually approved; the GAAP based entries require an automated approval in order to post within Core-CT. The absence of sign-off validation for entries is limited to the GASB 34 entity wide presentation. The small size of the GAAP unit and the specialized nature of the entity wide adjustments have inhibited our ability to implement a formal sign-off for each entry. Instead, changes in trend from prior years are analyzed in aggregate and any significant variances are examined as a method of validation. The dramatic expansion in GASB reporting requirements has outpaced staff resources. In light of the unrelenting pace of additional work introduced by GASB, it may be necessary to supplement existing GAAP resources moving forward.”

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 by certain deadlines, with accurate information.

Condition: Our examination found that various state agencies did not make their submissions of GAAP adjustment forms in a timely manner and were inaccurate. The Office of the State Comptroller has established deadlines for the reports to be submitted. In addition, from the original deadline of September 6, 2013, the Office of the State Comptroller granted extensions to seven state agencies that ranged from September 30th to December 6th.

The review of agency prepared forms by our field audit staff found significant errors and omissions in the amounts reported. Some of the significant errors found were as follows:

- The Department of Energy and Environmental Protection understated contractual obligations by \$112,948,063.
- The Office of Policy and Management understated contractual obligations by \$35,981,267.
- The Department of Developmental Services failed to report a total of \$10,493,877 in bank balances associated with fiscal intermediaries.
- The Department of Administrative Services failed to completely identify and report the contractual obligations for the large number of statewide contracts that it administers. No estimate of the amount was determined.
- The Department of Transportation overstated the highway system infrastructure by \$58,858,923 and its inventory of railroad cars by \$9,506,369.

Effect: The preparation and issuance of the state's CAFR is unnecessarily delayed and annual financial reporting is at additional risk for error.

A burden is added to the financial statement audit function by the number of errors made. The time required to audit and correct agency GAAP reports increases the preparation time for the CAFR.

Cause: The Office of the State Comptroller, responsible for statewide financial reporting, and the Office of Policy and Management, responsible for the management and coordination of statewide financial policies, did not provide state agencies with the direction and supervision to ensure the forms are properly prepared and submitted on time.

The calculation of contractual obligations, which appears to cause the most difficulties, is not by an automated method.

Recommendation: The Budget and Financial Analysis Division of the Office of the State Comptroller should provide for additional training and monitoring in the preparation and submission of GAAP adjustments in a timely manner, and should engage the Office of Policy and Management in enforcing the deadlines. (See Recommendation 2.)

Agency Response: “The state’s financial reporting process must balance the risk of disseminating misleading fiscal information against the cost of bringing that risk to zero. We believe that a proper balance of the two competing concerns currently exists. We rely heavily on your field auditors to validate the information provided on the GAAP closing packages. We work to ensure that the instructions provided to agencies are clear, and we consult directly with agencies that have specific reporting issues. We understand the need to remain attentive to agency training. The significant errors and omissions that you report finding are primarily with respect to future contractual obligations. This figure is reported exclusively in a single financial note within the CAFR. Due to change orders and ongoing contract modifications this number can be difficult to quantify and is subject to significant change. With respect to the seven extensions granted to specific agencies, those agencies were informed that GAAP budgeting will require timely reporting and extensions will not be provided in the future. We currently work closely with OPM to incorporate their budget requirements into our GAAP reporting process.”

Inadequate Financial Monitoring and Reporting – Capital Project Funds:

Background: Accounting and administration of capital projects financed with bond funding falls under the purview of three state agencies. The Office of Policy and Management is responsible for the allotment of funds in accordance with project approvals granted by the State Bond Commission. The Office of the State Treasurer is responsible for retaining bond council, overseeing the sale of approved bonding and ensuring adequate cash flows to cover project expenses. The Office of the State Comptroller is responsible for the accurate financial reporting of capital project funds activity for the fiscal year and balances at fiscal year-end.

Criteria: Management of the State of Connecticut is responsible for establishing and maintaining effective internal control over the financial administration, accounting, and financial reporting of capital projects.

Condition: Procedures for the interaction of the three cognizant agencies have not been established in a manner which ensures adequate oversight and centralized financial administration and accounting of capital projects funds.

Our examination identified one capital project fund that was allowed to carry a negative cash balance for many years. Upon our request, the Office of the State Treasurer investigated the matter and it was discovered that errors in work performed by a previous bond counsel caused one project to be omitted from the appropriate records. According to the State Treasurer's office, approximately \$10,000,000 in bonds authorized to fund the project remained unissued as a result of the error. This caused the total authorized expenditures to exceed the total bond issue resulting in the negative cash balance.

There is no comprehensive system in place to track project allotments, expenditures and completion. Consequently, funds unspent at the conclusion of a project may not be returned by the expending agency and improperly remain as continuing appropriations. As a result of our review, the Office of the State Comptroller has requested expending agencies review \$83,998,093 in Capital Project Bond Fund appropriations greater than 10 years old in an effort to identify funds which should be unallotted due to project completion.

Effect: The design of the controls related to capital project bond funding

financial administration do not allow management or employees, in the normal course of performing their assigned functions, to prevent, detect or correct misstatements on a timely basis.

Bonds remained unissued while expenditures had been incurred and at least one fund reported a negative cash balance for several periods. Other funds administered by the same bond counsel are currently being reviewed by the Office of the State Treasurer.

Since there is no comprehensive tracking system in place, it is unfeasible to verify which projects are authorized to be charged to a particular fund, and that unexpended funds for a particular fund are unallotted at the conclusion of a project. Funds that are not unallotted at the conclusion of a project are inaccurately reported as continuing appropriations, resulting in possible misstatement.

Because the return of unexpended funds is not monitored and it is difficult to ascertain the approved use of the funds, there is an increased risk that funds will be used for unauthorized purposes.

Cause: Compliance has rested with individual state agencies administering varied capital projects. The State Treasurer's role is only to monitor cash balances. The Office of Policy and Management only monitors to ensure that it makes allocations in accordance with Bond Commission approvals. There is no centralized monitoring to verify which projects are authorized to be charged to a particular fund and that unexpended funds are returned at the conclusion of a project.

Recommendation: The Office of the State Comptroller, the Office of the State Treasurer and the Office of Policy and Management should implement procedures to ensure adequate oversight and centralized financial administration and accounting of capital projects funds. (See Recommendation 3.)

Agency Response: "We disagree with this finding. The Treasurer, OPM and this office have distinct and separate statutory roles with respect to capital project funds that are well defined and understood. We currently work closely with the Treasurer's Office and OPM in meeting our obligations as well as addressing their specific accounting and reporting needs. It is our understanding that the Treasurer's Office monitors the cash position of projects and considers negative balances in their cash management planning. OPM is responsible for the allotment process and coordinates coding and allotments through this office. There are numerous options within Core-CT that will allow agencies to track specific projects and to determine when

allotment reductions should be processed through OPM. Sufficient reporting is available through Core-CT to determine both the cash position of projects and remaining allotments.”

*Auditors’ Concluding
Comments:*

Our examination found, as noted above, that state agencies were not properly administering capital project funding on their own. Currently, there are no written procedures or guidance which explains how the components in the process are linked together and how the various pieces of project information can be obtained from Core-CT, so that central agencies can easily monitor projects from the beginning to the completion and agencies can know when and whom to report the completion of the project and unallotment of funds. As part of its powers and duties to maintain the accounts of state government, the State Comptroller should establish procedures to ensure adequate oversight and centralized financial administration and accounting of capital projects funds.

Quarterly Journal Reconciliations of Cash Held in Agency Bank Accounts:

Criteria:

Office of the State Comptroller Memorandum No. 2012-29, issued December 20, 2012, instituted the procedure of making quarterly adjustments to adjust expenditures reported in Core-CT for those agencies with agency checking accounts and expenditure transactions that take place outside of the Core-CT central accounting system. The procedure was to replace the reconciliation at year-end that was previously used.

Condition:

Memorandum No. 2012-29 required agencies to post their own quarterly journal adjustments to report cash held and to adjust expenditures in Core-CT to the amount actually expended through their checking accounts. The cash drawdowns made for the agency checking account are funded from a line item appropriation for that activity, the cash on hand balance represents an excess cash draw and the over reporting of recorded expenditures.

The State Treasurer has established zero balance appropriation accounts that are not actual cash accounts but are used to track disbursement activity for certain agencies. Actual cash disbursements for these accounts are made from other bank accounts on a zero balance account basis. The ledgers for these tracking accounts are adjusted by external transactions prepared from data download from the bank into Core-CT and payment warrants from the Office of the State Comptroller. The State Treasurer will review, analyze and assist agencies with their bank account reconciliation.

Agencies are required to report and explain any discrepancies between their records and those of the Treasurer.

The Department of Social Services (DSS) intended to adjust its cash held by state agencies account for cash held at the end of the quarter. Because DSS considered this a cash account, they believed that the journal adjustment made reduced the amount of cash they had available. The correct account to adjust was the vendor disbursement account. At the beginning of each quarter, DSS would reduce the amount of cash available by the amount of the adjusting entry (previous quarter's cash held amount) and would therefore show no available cash in its checking accounts. Because of this appearance, DSS would redraw funds at the beginning of the next quarter in order to cover its expenditures.

Effect: Cash held in the Core-CT general ledger was overstated by \$576,816,262 in the cash held by state agencies account and understated by the same amount in the vendor disbursement account. The error also resulted in DSS drawing down excess funds from the State Treasury because the account balance erroneously showed insufficient funds to cover expenditures.

Cause: The Department of Social Services misinterpreted the intent of the quarterly cash held adjustments required by the memorandum. The Department of Social Services did discover and report the error to the State Comptroller and State Treasurer. However, neither agency was able to resolve the account error in a timely manner.

There were no internal controls to ensure that the accounts were reconciled and errors and omissions in the journal entries would be detected and corrected.

Conclusion: The Budget and Financial Analysis Division of the Office of the State Comptroller has rescinded the instructions of Memorandum No. 2012-29 and eliminated the quarterly adjustments. It has also reinforced its end of year reconciliation. We are not making a recommendation at this time.

SUMMARY OF RECOMMENDATIONS

Status of Prior Audit Recommendations:

Three recommendations were presented in our *Auditors' Report Office of the State Comptroller - State Financial Operations for the Fiscal Year Ended June 30, 2012*. One of these recommendations is being restated for the fiscal year ended June 30, 2013. A list of the previous recommendations and their resolution are as follows:

1. The Office of the State Comptroller should promptly complete the remaining portions of its revision to the State Accounting Manual. Our current examination found that as of May 2013, the State Accounting Manual was updated to integrate Core-CT applications. The Recommendation is considered implemented.
2. The Office of the State Comptroller and the Department of Administrative Services should continue to work together to ensure that the General Services Revolving Fund financial statements are accurately presented. Our current audit found the financial reporting for the fund to be improved. However, our departmental audit of the Department of Administrative Services will continue to recommend that the accounting for the fund be done using the Core-CT centralized accounting system.
3. The Budget and Financial Analysis Division of the Office of the State Comptroller should ensure that all centrally posted journal entries are reviewed and approved independently prior to posting. Our current audit found corrective action had not been implemented for the GAAP based entries. (See Recommendation 1.)

Current Audit Recommendations:

- 1. The Budget and Financial Analysis Division of the Office of the State Comptroller should ensure that all centrally posted journal entries are reviewed and approved independently prior to posting.**

Comment:

Our examination found journal entries posted to the GAAP basis general ledger that were not given proper review and approval.

- 2. The Budget and Financial Analysis Division of the Office of the State Comptroller should provide for additional training and monitoring in the preparation and submission of GAAP adjustments in a timely manner, and should engage the Office of Policy and Management in enforcing the deadlines. It should also consider the automation of the identification of contractual obligations.**

Comment:

Our examination found the State Comptroller had continuing problems accumulating accurate GAAP adjustment data from state agencies in a timely manner.

- 3. The Office of the State Comptroller, the Office of the State Treasurer and the Office of Policy and Management should implement procedures to ensure adequate oversight and centralized financial administration and accounting of capital projects funds.**

Comment:

Our examination found weaknesses in the monitoring of capital project fund activity among the state agency managing the project and the Office of the State Comptroller, the Office of the State Treasurer and the Office of Policy and Management.