

STATE OF CONNECTICUT

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

AUDITORS OF PUBLIC ACCOUNTS
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February 21, 2007

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

We have examined the records 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, 2005. This report on that examination consists of the Comments and Recommendations, which follow. The audit certification 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, 2005. Throughout this report we will refer to various financial statements and schedules contained in this annual report, which is hereinafter referred to as the "Comptroller's 2005 Annual Report."

COMMENTS

FOREWORD:

The financial position as of June 30, 2005, and the 2004-2005 cash transactions of all State civil list funds, accounted for centrally in the records of both the State Comptroller and State Treasurer, are shown in Exhibit A and Schedule A-1, respectively, of the Comptroller's 2005 Annual Report. The financial position of the General Fund at June 30, 2005, together with a summary of operations for the year then ended, are shown in Exhibit B and Schedule B-1, respectively, of the Comptroller's 2005 Annual Report. Corresponding statements for the Special Transportation Fund are shown in Schedules C-2 and C-3, respectively, of the Comptroller's 2005 Annual Report. A summary of State bonds and notes outstanding as of June 30, 2005, the changes thereto, and the authorizations for future borrowings are shown in Schedules E-3, E-4, and E-5 of the Comptroller's 2005 Annual Report.

The Comptroller prepares the financial statements of the State's civil list funds on a modified cash basis of accounting, consistent with the prior year. The accounting basis used by the State of Connecticut was adopted by the Comptroller under the authority granted by Article Fourth, Section 24, of the Constitution of the State of Connecticut and with the recognition of legislative authorizations. The modified cash basis of accounting permits an accrual of revenues at fiscal year end which includes the collections in July of Indian gaming payments and certain taxes levied as of June 30, and requires that expenditures be recorded in the year in which disbursements are made provided recognition is given to continuing appropriations.

Those taxes for which July collections are accrued include sales and use taxes, gross earnings taxes on utility and petroleum companies, real estate conveyance taxes and taxes on alcoholic beverages, cigarettes, gasoline and special motor fuel. The modified cash basis of accounting also permits the accrual of all corporation tax payments collected in July and August that are postmarked by August 15, as well as the accrual of all personal income tax payments collected in July and postmarked by July 31, whether or not they were payments withheld by employers.

Under the modified cash basis of accounting used by the Comptroller, restricted revenues of certain funds are recognized when earned through the expenditure of grant funds, rather than when received or awarded. This accounting method was adopted to facilitate the Comptroller's conversion to reporting under generally accepted accounting principles (GAAP), as discussed later in this section.

Receivables which are reported by the Comptroller include Federal and other grants receivable recorded in connection with Federally supported programs or capital projects for which Federal or other outside participation is available, loans and notes receivable from local governments, nonprofit corporations, businesses or individuals and the accounts receivable of the University Health Center. Such receivables have been reported by the Comptroller as assets of the funds financing the projects or programs involved and are fully reserved on the balance sheet, except within the Grants and Restricted Accounts Fund and the Transportation Grants and Restricted Accounts Fund where the Federal and other grants receivable are the source of financing for restricted appropriations established for the purposes of the grants involved. These restricted revenues are recognized by the Comptroller when earned through the expenditure of grant funds, rather than when received or awarded. In addition, loans made from the General Fund to the Connecticut Student Loan Foundation, pursuant to Section 10a-213 of the General Statutes, are accrued at fiscal year end, as is interest income of the Special Transportation Fund, which is accrued pursuant to the terms of a Special Tax Obligations Bond Indenture dated September 15, 1984.

This report covers the financial operations of the 2004-2005 fiscal year under a biennial budget adopted by the 2004 General Assembly, and subsequently revised by the 2005 General Assembly, including the financial accounting for the budget plans of the General Fund and Special Transportation Fund, as it applies to the 2004-2005 audit period.

In maintaining State accounting records and in preparing financial statements, the Comptroller, consistent with prior years, was guided by the aforementioned requirements and authorizations of State fiscal statutes as regards the method of accounting and fund classification. For this reason, therefore, the financial statements contained in the *Report of the State Comptroller - Budgetary Basis* are not, nor are they intended to be, in accordance with generally accepted accounting principles. In order for the Comptroller to follow such principles, among other things, expenditures would have to be recorded on an accrual rather than cash basis, all non-civil list funds and component units of the State would have to be included in the financial statements, all agencies' assets and contingent and long term liabilities would have to be recognized, and appropriate footnote disclosures would have to be made in the financial statements.

In March 2005, the American Institute of Certified Public Accountants issued an interpretation of its professional auditing standards that affects those governments that prepare financial statements using the cash, or modified cash basis of accounting, rather than the reporting their financial activity in accordance with GAAP. As a result, those statements must conform to the applicable disclosure requirements of GAAP in order to avoid receiving an adverse audit opinion. As discussed in the Condition of Records section of this report, we have been required to render such an opinion on the *Report of the State Comptroller - Budgetary Basis* for the Fiscal Year Ending June 30, 2005.

In order to comply with GAAP, the Office of State Comptroller has issued a separate *Comprehensive Annual Financial Report* (CAFR) showing the State of Connecticut's financial position and results of operations in accordance with GAAP requirements. It has done so since the fiscal year ended June 30, 1990. This report, however, was always made in addition to the *Annual Report of the State Comptroller - Budgetary Basis*, which presents the State's financial operations as budgeted by the General Assembly. Because differing accounting bases are followed in preparing the two reports, substantial variances can occur in the presentation of the State's financial position, as well as, its operations.

For the State's *Comprehensive Annual Financial Report* to gain widespread use and acceptance, the legislative budget plan must be prepared and enacted in accordance with GAAP. In that way, the CAFR will present, in a unified format, both the budgetary and actual financial operations of the State of Connecticut.

To accomplish this end the General Assembly, during the 1993 Regular Session, passed Public Act 93-402. This Act, effective with the fiscal year commencing July 1, 1995, authorized the State Comptroller and the Office of Policy and Management to implement the use of GAAP with respect to the preparation of the biennial budget and financial statements of the State of Connecticut. These two agencies worked to implement the provisions of a conversion plan that was developed in accordance with Public Act 93-402, and submitted to the Appropriations Committee of the General Assembly on February 1, 1994. Implementation plans were subsequently adjusted, however, when the General Assembly, through a succession of Public Acts, postponed the State's conversion to GAAP budgeting from the fiscal year commencing July 1, 1995, to the fiscal year commencing July 1, 2005. Most recently, Section 92 of Public Act 05-251, passed during the 2005 Session of the General Assembly, postponed the State's

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conversion to GAAP budgeting to the fiscal year commencing July 1, 2007. Section 92 of Public Act 05-251 also provides that the amortization of accrued and unpaid expenses and liabilities and other adjustments necessary for implementation begin with the fiscal year ending June 30, 2009, and continue in equal annual installments to the fiscal year ended June 30, 2023. It should be noted that the above provisions were codified in Section 3-115b of the General Statutes.

OFFICERS:

Nancy S. Wyman and Mark E. Ojakian served as State Comptroller and Deputy Comptroller, respectively, during the 2004-2005 fiscal year.

GENERAL FUND:

The General Fund is the chief operating fund of the State. It is used to account for all financial resources which are not required to be accounted in other funds and which are spent for those services normally provided by the State.

The financial position of the General Fund at June 30, 2005, together with a summary of operations recorded for the year then ended, are shown in Exhibit B and Schedule B-1, respectively, of the Comptroller's 2005 Annual Report.

General Fund operations were conducted under a biennial budget plan, which estimated revenues and provided for expenditures of the 2003-2004 and 2004-2005 fiscal years. Public Act 03-01 (June Special Session), the Budget Act, enacted by the 2003 General Assembly, included appropriations for the 2003-2004 and 2004-2005 fiscal years and revenue estimates of its Committee on Finance, Revenue and Bonding. Certain revisions were made to the biennial budget plan by the passage of Public Act 04-216 and Public Act 04-2 (May Special Session) and by the passage of Public Act 05-251, which were enacted by the 2004 and 2005 General Assembly, respectively, in order to provide for policy changes and address appropriation deficiencies for certain State agencies.

Under budget procedures customarily in effect, the estimates of revenues and the budgeted appropriations, taken in conjunction with whatever surplus or deficit was carried over from the preceding fiscal period, after consideration of any statutorily required transfers, give rise to an anticipated surplus or deficit projected through the end of the fiscal year. The budget plan for the 2004-2005 fiscal year as reported by the Comptroller may be expressed as follows:

| | | |
|--|----------------------|-----------------------------|
| Estimated Revenues, 2004-2005, as | | |
| Revised by the Committee on Finance, | | |
| Revenue and Bonding | | \$13,310,000,000 |
| Budgeted Appropriations, 2004-2005, | | |
| As revised | \$13,336,206,383 | |
| Estimated lapsing appropriations | <u>(109,850,000)</u> | |
| Net Appropriations | | <u>13,226,356,383</u> |
| Anticipated Surplus (Deficit), June 30, 2005 | | <u><u>\$ 83,643,617</u></u> |

The actual results of the operations of the 2004-2005 fiscal year are presented in Schedule B-1 of the Comptroller's 2005 Annual Report. An analysis of budgeted General Fund accounts follows:

| | | |
|--|------------------|-------------------------|
| Actual Budgeted Revenues, 2004-2005 | | \$14,062,862,751 |
| Appropriations, 2004-2005 | \$14,210,717,864 | |
| Add/(Deduct) | | |
| Appropriations lapsed | (182,592,679) | |
| Net Appropriations | | 14,028,125,185 |
| Balance | | 34,737,566 |
| Prior Year Budgeted Appropriations | | |
| Continued to 2004-2005 Fiscal Year | | 212,862,057 |
| Unappropriated Surplus, July 1, 2004 | | 150,300,000 |
| Reserve for Fiscal Year 2005-2006 | | (15,851,490) |
| Reserve for Statutory Transfer to | | |
| Budget Reserve Fund | | (363,863,247) |
| Miscellaneous adjustments | | (18,184,886) |
| Unappropriated Surplus, June 30, 2005, per Schedule B-1 | | \$ 0 |

The variances between the actual results of operations and the original budget plan may be explained as follows:

1. *Actual revenues were some \$903,163,000 greater than originally estimated. Those revenue categories that showed the greatest changes were personal income taxes, \$439,724,000, corporations taxes, \$177,269,000, inheritance and estate taxes \$87,807,000, real estate conveyance taxes \$61,831,000, and oil companies taxes \$53,948,000. Other revenue categories showing significant increases were rents, fines and escheats, insurance company taxes, and Federal grants. These increases were partly offset by a reduction of \$40,000,000 in transfers to the General Fund, as well as shortfalls in sales and use taxes, \$29,934,000, and Indian gaming payments, \$12,162,000.*
2. *Appropriations showed an increase of approximately \$874,511,000 from the budget plan reported by the Comptroller. The net increase was primarily from additions resulting from the passage of Public Acts 04-216 and 05-251. Public Act 04-216 provided for increases in appropriations of \$15,467,000, \$58,169,000, \$38,227,000 and \$23,748,000 for the Department of Social Services, the Department of Education, the Department of Children and Families, and the Commission on Culture and Tourism, respectively. In addition, there was an increase in appropriations of \$43,510,000 for retired State employees' health costs. Public Act 05-251 provided for the carry forward of \$647,730,000 in appropriations to ensuing fiscal years, as well as deficiency appropriations of \$78,600,000 for various State agencies, notably \$28,500,000 for the Department of Correction and \$11,825,000 for the Department of Children and Families.*
3. *Lapsed appropriations were some \$72,743,000 greater than estimated, primarily*

from a reduction in debt service. In addition, there were other operating factors such as net operating transfers to and from other State funds, as well as the continuing and carry forward of appropriations to and from other fiscal years.

A statement of changes in the unappropriated surplus account of the General Fund for the fiscal year ended June 30, 2005, is presented in Schedule B-1 of the Comptroller's 2005 Annual Report. It should be noted that Section 4-30a of the General Statutes provides that the unappropriated surplus that remains in the General Fund at the end of the fiscal year, after any amounts required by law to be transferred for other purposes have been deducted, shall be deposited to the Budget Reserve Fund, provided that the amount so transferred shall not cause the balance in such fund to exceed ten percent of the net General Fund appropriations for the fiscal year in progress. In accordance with the statute, a total of \$363,863,247 was transferred to the Budget Reserve Fund at the close of the fiscal year.

General Fund Revenues:

As previously explained in this report, the State Comptroller follows a practice of recording within the General Fund the accrual of certain revenues, without a corresponding accrual of expenditures. This accounting practice resulted in the accrual of more than \$957,362,000 in revenues, which would, under a cash basis system of accounting, be recorded in the 2005-2006 fiscal year. If there had been a similar accrual of expenditures as required by generally accepted accounting principles (GAAP), there would have been added to General Fund expenditures a total estimated to be as high as \$1,407,800,000 during the first year only of any conversion to GAAP budgeting by the State. It should be noted that these expenditure accruals would be offset in part by additional revenue accruals of some \$370,100,000 under GAAP.

Total budgeted revenues in the General Fund for the 2004-2005 fiscal year amounted to \$14,062,862,751, as shown in Schedule B-1 of the Comptroller's 2005 Annual Report. This represented an increase of some \$939,087,681 over the budgeted revenue total reported by the Comptroller for the preceding 2003-2004 fiscal year.

The budgeted revenue categories, which showed the greatest change during the fiscal year under audit, were as follows:

| | Nearest Thousand Dollars |
|-----------------------------|---|
| Taxes: | |
| Personal income | \$ 627,294,000 |
| Sales and use | 156,478,000 |
| Corporations | 160,960,000 |
| Inheritance and estate | 106,293,000 |
| Insurance companies | 23,740,000 |
| Public service corporations | 3,175,000 |
| Cigarettes and tobacco | (5,593,000) |
| Real estate conveyance | 30,888,000 |

| | |
|---|-----------------------|
| Oil companies | 36,654,000 |
| All others (net) | 4,434,000 |
| Refunds of Taxes - increase | (28,951,000) |
| Total Increase (Decrease) in Taxes | 1,115,372,000 |
| Other Revenues and Sources: | |
| Transfers - Special Revenue | (12,804,000) |
| Indian gaming payments | 15,104,000 |
| Licenses, permits and fees | (11,335,000) |
| Sales of commodities and services | (5,843,000) |
| Rents, fines and escheats | 53,014,000 |
| Investment income | 13,514,000 |
| Miscellaneous | 42,845,000 |
| Federal grants | (66,396,000) |
| Statutory transfers to/from other funds - net | (204,383,000) |
| Total Increase (Decrease) in Other Revenues and Sources | (176,271,000) |
| Total Increases (Decreases) | \$ 939,088,000 |

The above increase was generally attributed to tax increases enacted by Public Act 03-2 and Public Act 03-1 (June Special Session) by the 2003 General Assembly, and from tax changes enacted by the passage of Public Act 04-216 by the 2004 General Assembly. In addition, an improvement in general economic conditions provided an increase in overall tax revenues.

General Fund Expenditures:

Total budgeted expenditures of the General Fund for the 2004-2005 fiscal year amounted to \$13,333,702,717, as shown in Schedule B-1 of the Comptroller's 2005 Annual Report. This latter amount represented an increase of some \$786,783,649 over the total budgeted expenditures reported by the Comptroller for the preceding 2003-2004 fiscal year. General Fund expenditures classified by current expenses, fixed charges and capital outlay are detailed on Schedule I of the Comptroller's 2005 Annual Report. A summary of the areas of significant changes in expenditures from budgeted accounts of the General Fund follows:

| | Nearest Thousand Dollars |
|---|---|
| Personal Services | \$ 123,378,000 |
| Other Current Expenses: | |
| State Employees' Retirement Contributions | 32,572,000 |
| State Employees' Health Service Costs | 42,294,000 |
| Retired State Employees' Health Service Costs | 56,346,000 |
| All Other - primarily contractual services and commodities, net of reclassification of state aid grants noted below | (38,885,000) |
| Fixed Charges: | |
| Debt Service | 125,581,000 |
| UConn 2000 Debt Service | 6,183,000 |
| State Aid Grants: | |

| | |
|---|-----------------------------|
| Education - charter schools, magnet schools, equalization grants and priority school districts | 84,868,000 |
| Higher Education - Higher Education State Matching Grant | 25,300,000 |
| Mental Retardation - primarily residential and day services | 29,108,000 |
| Mental Health and Addiction Services - special populations, medications, and Community Mental Health Strategy Board | 17,816,000 |
| Social Services - Medicaid, independent living assistance, pharmaceutical assistance to the elderly, child care assistance and other public assistance programs | 121,772,000 |
| Children and Families - primarily board and care of children | 27,021,000 |
| All Other State Aid Grants- Reflects reclassification of certain grants formerly listed as other current expenses. | 132,893,000 |
| Capital Outlay | 537,000 |
| Total Net Increase | <u><u>\$786,784,000</u></u> |

Increased costs for personal services, debt service and health care services, as well as budget deficiency adjustments to cover increased costs for public assistance programs, primarily for Medicaid and the board and care of children, accounted for the majority of the increase.

SPECIAL TRANSPORTATION FUND:

The Special Transportation Fund operates in accordance with the provisions of Title 13b, Chapter 243, Part I, of the General Statutes. The Special Transportation Fund was established in 1984 as part of a continuous program of planning, construction and improvement of the State's transportation infrastructure. Such infrastructure includes the State's highways and bridges, the State's share of the local bridge program, mass transportation and transit facilities, waterway and aeronautic facilities other than Bradley International Airport, and maintenance garages and administrative facilities of the Department of Transportation.

The Special Transportation Fund is used for the purpose of budgeting and accounting for all transportation related taxes, fees and revenues that are used to secure the payment of debt service on Transportation Infrastructure bonds which are issued in accordance with the provisions of Chapter 243, Part II, of the General Statutes, as special tax obligation bonds. After providing for such debt service, the balance of the resources of the Fund are available for the payment of debt service on other transportation related bonds issued by the State, and for the funding of appropriations for the Department of Transportation and the Department of Motor Vehicles.

Revenues credited to the Special Transportation Fund are, among other items, certain motor fuel taxes, portions of the oil companies tax and the sales tax on motor vehicles, motor vehicle receipts for licenses, registrations and titles, fees for safety marker plates, motor vehicle related fines and penalties, transportation related Federal aid, late fees for the emission inspection of motor vehicles, and revenues from the sale of information by the Department of Motor Vehicles.

The financial position of the Special Transportation Fund as of June 30, 2005, excluding those resources held by the Trustee under the Indenture of Trust for the Transportation Infrastructure special tax obligation bonds, is presented in Schedule C-2 of the Comptroller's

2005 Annual Report. A statement of the changes in unappropriated surplus of the Fund for the fiscal year then ended is shown in Schedule C-3 of the Comptroller's 2005 Annual Report. It should be noted that cash and investments totaling \$676,450,460, which are being held by the Trustee, are reported on Exhibit A of the Comptroller's 2005 Annual Report under Debt Service Funds.

Special Transportation Fund operations, like the General Fund, were conducted under a biennial budget plan, which estimated revenues and provided for expenditures of the 2003-2004 and 2004-2005 fiscal years. Public Act 03-01 (June Special Session), the Budget Act for the Special Transportation Fund, enacted by the 2003 General Assembly, included revenue estimates and appropriations for the 2003-2004 and 2004-2005 fiscal years. The biennial budget plan was revised by the passage of Public Act 03-4 (June Special Session) by the 2003 General Assembly, by passage of Public Act 04-182 by the 2004 General Assembly and by passage of Public Act 05-251 by the 2005 General Assembly.

Under budget procedures customarily in effect, the estimates of revenues and the budgeted appropriations, taken in conjunction with whatever surplus or deficit was carried over from the preceding fiscal period give rise to an anticipated surplus or deficit projected through the end of the fiscal year. The budget plan for the 2004-2005 fiscal year as reported by the Comptroller may be expressed as follows:

| | | |
|--|---------------------|-------------------------------|
| Estimated Revenues, 2004-2005, as Revised by the Committee on Finance, Revenue and Bonding | | \$944,600,000 |
| Budgeted Appropriations, 2004-2005, as revised | \$940,340,266 | |
| Estimated lapsing appropriations | <u>(11,000,000)</u> | |
| Net Appropriations | | <u>929,340,266</u> |
| Anticipated Operating Surplus, 2004-2005 | | 15,259,734 |
| Less - Allocated Revenue to the Transportation Strategy Board | | <u>(26,000,000)</u> |
| Anticipated Surplus, June 30, 2005 | | <u>\$ (10,740,266)</u> |

The actual results of the operations of the 2004-2005 fiscal year are presented in Schedule C-3 of the Comptroller's 2005 Annual Report. An analysis of the Special Transportation Fund surplus follows:

| | | |
|--|---------------------|--------------------|
| Actual Budgeted Revenues, 2004-2005 | | \$939,797,781 |
| Appropriations, 2004-2005 | \$984,021,226 | |
| Add/(Deduct) | | |
| Appropriations lapsed | <u>(13,846,894)</u> | |
| Net Appropriations | | <u>970,174,332</u> |
| Balance | | (30,376,551) |
| Unappropriated Surplus, June 30, 2004 | | 129,271,828 |
| Prior Year Budgeted Appropriations Continued to 2004-2005 Fiscal Year | | 34,166,222 |

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| | |
|--|-----------------------------|
| Miscellaneous adjustments | <u>5,992</u> |
| Unappropriated Surplus, June 30, 2005, per Schedule C-3 | <u>\$133,067,491</u> |

The variances between the actual results of operations and the original budget plan may be explained as follows:

- 1. Actual revenues were some \$4,800,000 less than anticipated. This was primarily the result of an increase of \$23,700,000 in the transfer of Special Transportation Fund receipts to the Transportation Strategy Board, as required by Public Act 04-182. This was offset by increases of \$12,800,000 and \$7,650,000 in motor vehicle receipts and interest income, respectively.*
- 2. Appropriations showed an increase of approximately \$43,680,000 from the budget plan reported by the Comptroller. The increase was primarily from an appropriation of \$15,500,000 to fund the costs of an integrated transaction processing system at the Department of Motor Vehicles, in accordance with the passage of Public Act 05-251. Partially offsetting the costs was a reduction of \$8,500,000 in appropriations for debt service. In addition, there was the continuing of appropriations from the previous fiscal year.*

Special Transportation Fund Revenues:

Total budgeted revenues in the 2004-2005 fiscal year for the Special Transportation Fund amounted to \$939,797,781, as shown in Schedule C-3 of the Comptroller's 2005 Annual Report. This represented an increase of some \$35,879,648 over the budgeted revenue total reported by the Comptroller for the preceding 2003-2004 fiscal year. Budgeted revenue categories which showed the greatest change during the fiscal year under audit were as follows:

| | <u>Nearest Thousand Dollars</u> |
|---|--|
| Taxes: | |
| Motor fuels tax | \$19,325,000 |
| Oil company tax | 2,500,000 |
| Sales tax collected by Department of Motor Vehicles | (692,000) |
| Refunds of taxes - decrease | 1,767,000 |
| Other Revenues: | |
| Motor vehicle receipts | 14,693,000 |
| Licenses, permits and fees | 9,000 |
| Interest income | 8,156,000 |
| Release from Debt Service | (3,729,000) |
| Transfers to Other Funds - increase | (5,877,000) |
| Refunds of payments - increase | (272,000) |
| Total Net Increase (Decrease) | <u>\$35,880,000</u> |

The above increase was primarily attributable to an increase in the collection of motor fuel and oil company taxes, in interest income, and an increase in the receipts collected by the Department of Motor Vehicles resulting from fee increases provided for in Public Act 04-182. This increase was partially offset by the reduced level of receipts released from debt service and an increase in the amount of receipts transferred to the Transportation Strategy Board, in accordance with Public Act 03-1 (June Special Session).

Special Transportation Fund Expenditures:

Total budgeted expenditures of the Special Transportation Fund for the 2004-2005 fiscal year amounted to \$932,756,482, as shown in Schedule C-3 of the Comptroller's 2005 Annual Report. This represented an increase of some \$39,449,183 from the total budgeted expenditures reported by the Comptroller for the preceding 2003-2004 fiscal year. A summary of the areas of significant changes in expenditures from budgeted accounts of the Special Transportation Fund follows:

| | Nearest Thousand Dollars |
|---|---|
| State Comptroller: | |
| State employee retirement contributions and health services costs - employer share | \$ 7,231,000 |
| Department of Motor Vehicles: | |
| Personal services | 2,357,000 |
| Department of Transportation: | |
| Personal services | 10,705,000 |
| Other expenses | 8,985,000 |
| Highway and bridge renewal equipment | 2,938,000 |
| Handicapped Access Program | 1,349,000 |
| Town Aid Road Grants | 7,470,000 |
| Highway and bridge renewal | (1,541,000) |
| All other (net) | (45,000) |
| Total Net Increase (Decrease) | <u><u>\$39,449,000</u></u> |

The above increase in expenditures was primarily attributable to increases in personal services costs, employee retirement and fringe benefit costs, and town aid road grants.

SPECIAL REVENUE FUNDS:

This category of funds was established to group those funds accounting for the expenditure of revenues that have been restricted to specific programs. Included in this category is the Special Transportation Fund. However, because of the size and importance of this Fund, it has been incorporated into this report under a separate heading preceding this section.

The financial position of the combined Special Revenue Funds at June 30, 2005, together with the cash transactions for the fiscal year ended on that date, are shown in Exhibit C and Schedule C-1, respectively, of the Comptroller's 2005 Annual Report. At June 30, 2005, there were 61 authorized funds within this category, with the Special Transportation Fund being by far the largest. Of these 61 funds, the following nine funds operate under legislatively enacted budget plans:

- Special Transportation Fund (12001)
- Banking Fund (12004)
- Insurance Fund (12005)
- Consumer Counsel and Public Utility Control Fund (12006)
- Workers' Compensation Administration Fund (12007)
- Mashantucket Pequot and Mohegan Fund (12009)
- Soldiers', Sailors' and Marines' Fund (12010)
- Regional Market Operation Fund (12013)
- Criminal Injuries Compensation Fund (12014)

Grants and Restricted Accounts Fund:

In the 2003-2004 fiscal year the State Controller established the Grants and Restricted Accounts Fund (12060), to account for certain Federal and other revenues associated with activities of the General Fund.

Receipts and transfers amounting to \$1,304,471,789 for the 2004-2005 fiscal year were credited to the Fund, as shown on Schedule C-1 of the Comptroller's 2005 Annual Report. This represented an increase of some \$154,815,364 less than the total reported by the Comptroller in the preceding 2003-2004 fiscal year. These represented Federal and other grant receipts, restricted and not available for general use. As mentioned previously in this report, such restricted revenue is recognized by the Comptroller when earned through the expenditure of grant funds, rather than when received or awarded.

Disbursements of Federal and other grants from the Grants and Restricted Accounts Fund for the 2004-2005 fiscal year amounted to \$1,338,815,741, as shown in Schedule C-1 of the Comptroller's 2005 Annual Report. This represented an increase of some \$103,658,059 over the total reported by the Comptroller for the preceding 2003-2004 fiscal year.

Transportation Grants and Restricted Accounts Fund:

The State Comptroller also established the Transportation Grants and Restricted Accounts Fund (12062), to account for certain restricted Federal and other revenues associated with activities of the Special Transportation Fund.

Receipts and transfers amounting to \$85,308,102 for the 2004-2005 fiscal year were credited to the Transportation Grants and Restricted Accounts Fund, as shown on Schedule C-1 of the Comptroller's 2005 Annual Report. This represented a decrease of some \$16,557,543 over the total reported by the Comptroller for the preceding 2003-2004 fiscal year. Disbursements of Federal and other grants from the Transportation Grants and Restricted Accounts Fund for the 2004-2005 fiscal year amounted to \$95,736,924, as shown in Schedule C-1 of the Comptroller's 2005 Annual Report. This represented an increase of some \$19,716,420 over the total reported by the Comptroller for the preceding 2003-2004 fiscal year.

Additional comments concerning the operations of each individual Special Revenue Fund will be contained in audit reports covering the various State agencies administering or using such funds.

DEBT SERVICE FUNDS:

This category of funds was established to account for the accumulation of resources for, and payment of, principal and interest on certain State issued bonds and notes. While as a rule the bulk of general obligation bonds of the State are liquidated from General Fund and Special Transportation Fund appropriations, most so-called self-liquidating general obligation bond issues are retired by payment from these funds.

The financial position of the combined Debt Service Funds at June 30, 2005, together with the cash transactions for the fiscal year ended on that date, are shown in Exhibit D and Schedule D-1, respectively, of the Comptroller's 2005 Annual Report. At June 30, 2005, there were five authorized funds within the Debt Service Funds category. The largest debt service fund, entitled "Transportation Special Tax Obligations" (14005), is used to account for cash and investments held by a Trustee for debt service payments on bonds issued to finance the State's infrastructure program.

CAPITAL PROJECTS FUNDS:

This category of funds was established to group those funds that account for financial resources used to acquire or construct major capital facilities, including highways and bridges. The major source of financing for these funds is the proceeds of various State bond issues. Other sources include Federal aid and other restricted contributions available to meet a portion of the capital outlay costs.

The financial position of the combined Capital Projects Funds at June 30, 2005, and the cash transactions of the 2004-2005 fiscal year, are set forth in Exhibit E and Schedule E-1, respectively, of the Comptroller's 2005 Annual Report. At June 30, 2005, there were 75

authorized funds within the Capital Projects Funds category.

The total unreserved fund balances of the Capital Projects Funds increased by \$170,502,387 during the 2004-2005 fiscal year to a deficit balance of \$3,942,290,993, as of June 30, 2005. It should be pointed out that the issuance of bonds already authorized, as shown in Schedule E-5, as well as the collection of those receivables fully reserved in Exhibit A and Exhibit E, will eliminate this deficit balance.

Under the provisions of Sections 3-39a and 13a-166 of the General Statutes, the State Comptroller is authorized to record certain receivables and such amounts are deemed to be appropriated for the purposes designated in the written agreements establishing the receivables (Section 3-39a) or for the financing of the Federal share of highway projects approved by the Federal Highway Administration (Section 13a-166). During the 2004-2005 fiscal year, net receivables totaling \$342,806,320 were recorded in the Infrastructure Improvement Fund (13033). These receivables, for the most part, were in connection with Department of Transportation projects for mass transportation and highway and bridge construction and repair.

INTERNAL SERVICE FUNDS:

This category of funds was established to group those funds accounting for the costs and billings for goods and services provided by State agencies to other agencies or governmental units. These costs are recovered by transfer charges to user agencies so that authorized working capital of the funds is kept intact.

The financial position of the combined Internal Service Funds at June 30, 2005, together with the cash transactions for the fiscal year then ended are shown in Exhibit F and Schedule F-1, respectively, of the Comptroller's 2005 Annual Report. At June 30, 2005, there were four authorized funds within the Internal Service Funds category.

Exhibit A of the Comptroller's 2005 Annual Report recognizes, as reserved within fund balances and related reserves, the allotment and appropriation balances in force at June 30, 2005, and which have been carried forward to the 2005-2006 fiscal year on the records of the State Comptroller. This has resulted in additional deficit unreserved fund balances being reported in Exhibit A and Exhibit F of the Comptroller's 2005 Annual Report because the assets and resources to meet these allotment balances are already reserved or, more likely, are not recorded by the Comptroller. Those assets and resources not recorded include inventories and receivables reported only by the agencies administering the funds involved.

Additional comments concerning the operations of each individual Internal Service Fund will be contained in audit reports covering the various State agencies administering such funds.

ENTERPRISE FUNDS:

This category of funds was established to group those proprietary funds that provide for the financing of goods and services to the public and recover costs by user charges.

The financial position and fiscal year cash transactions of the combined Enterprise Funds, as accounted for in the records of the State Comptroller, are shown in Exhibit G and Schedule G-1, respectively, of the Comptroller's 2005 Annual Report. At June 30, 2005, there were 20 authorized funds within the Enterprise Funds category. Additional comments concerning the operations of each individual Enterprise Fund will be contained in audit reports covering the various State agencies administering such funds.

FIDUCIARY FUNDS:

The financial position of the combined Fiduciary Funds at June 30, 2005, and the cash transactions for the year then ended are shown in Exhibit H and Schedule H-1, respectively of the Comptroller's 2005 Annual Report. The funds included under this caption may be classified into three types:

- Receipts held pending distribution to State funds, municipalities, private companies or individuals.
- Deposits held by the State for security, guarantees, awards or distributions.
- Retirement funds for State and municipal employees held in trust by the State Treasurer.

At June 30, 2005, there were 30 authorized funds within the Fiduciary Funds category. Additional comments concerning the operations of each individual Fiduciary Fund will be contained in audit reports covering the various State agencies administering or using such funds.

STATE BOND AND NOTE INDEBTEDNESS:

The State's bond and note indebtedness at June 30, 2005, payable from future revenue of State funds is shown in Exhibit A of the Comptroller's 2005 Annual Report. A summary of bonds and notes outstanding and maturity schedules, detailing the funding requirements of specific bond and note issues, are presented in Schedule E-3 and Schedule E-4, respectively, of the Comptroller's 2005 Annual Report.

The State's bond and note indebtedness aggregated \$13,795,147,000 at June 30, 2005, an increase of \$139,077,000 over the total of \$13,656,070,000 at June 30, 2004. This was the net result of the issuance during the 2004-2005 fiscal year of new bonds of the State in the amount of \$1,828,960,000, while scheduled principal payments and refunded and defeased bonds during the period amounted to \$1,689,883,000. In addition to this indebtedness there was an additional \$63,655,000 in economic recovery notes retired during the 2004-2005 fiscal year, resulting in a total of \$209,560,000 in economic recovery notes outstanding at June 30, 2005. Scheduled interest costs through maturity on the aforementioned bond and note indebtedness, as shown in Schedule E-4 of the Comptroller's 2005 Annual Report, totaled \$5,660,235,000. Accordingly, as of June 30, 2005, the State was committed to future debt service on bonds and notes outstanding in the aggregate of \$19,455,382,000. This total represented an increase of \$7,547,000 over the corresponding amount as of June 30, 2004.

Included in the totals of bond and note indebtedness are revenue and refunding bonds outstanding in the amount of \$288,430,000 for improvements to Bradley International Airport.

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The proceeds of such bonds are being held and disbursed by a Trustee and all revenue of the airport's operations is being deposited with the Trustee. Principal and interest payments on such bonds are being met from funds held by the Trustee. Similarly included in the totals of bond and note indebtedness are the revenue bonds outstanding of \$3,101,518,000 for the State's Transportation Infrastructure Program. While the proceeds of such bonds are held and accounted for in the usual manner, debt service reserve amounts and principal and interest payments on such bonds are being handled by a Trustee.

Partially offsetting the aforementioned indebtedness were unreserved fund balances of \$723,290,984 within the debt service fund group, which were available for debt service at June 30, 2005.

In addition to the foregoing bond indebtedness at June 30, 2005, there was in force as of that date unused borrowing authorizations totaling \$1,755,424,000 and prospective authorizations, subject to Bond Commission approval, totaling \$1,287,824,000. These authorization balances, which are detailed in Schedule E-5 of the Comptroller's 2005 Annual Report, may be summarized as follows:

| <u>Purpose or Agency</u> | <u>In Force</u> | <u>Subject to Approval of State Bond Commission</u> |
|---|------------------------|---|
| Municipal and Economic Development | \$ 333,156,000 | \$ 130,018,000 |
| Capital Improvements and Other Purposes | 329,011,000 | 646,838,000 |
| Industrial Building Mortgage Insurance | 19,450,000 | 1,000,000 |
| Highway and Bridge Construction Repair | 4,067,000 | 0 |
| Transportation Infrastructure Improvement | 433,933,000 | 10,930,000 |
| Student Loan Foundation | 5,000,000 | 0 |
| Elimination of Water Pollution | 303,516,000 | 180,506,000 |
| Grants to Local Governments and Others | 179,753,000 | 127,228,000 |
| Local Capital Improvements | 10,000,000 | 21,100,000 |
| Preservation of Agricultural Lands | 8,501,000 | 750,000 |
| Higher Education Endowment Fund | 0 | 10,500,000 |
| Housing Programs | 24,113,000 | 21,774,000 |
| State Equipment Purchases | 28,782,000 | 0 |
| School Construction | 72,001,000 | 134,430,000 |
| All other purposes | 4,141,000 | 2,750,000 |
| Total Authorizations | <u>\$1,755,424,000</u> | <u>\$1,287,824,000</u> |

It should be noted that, in accordance with the debt limitation provisions contained in Section 3-21 of the General Statutes, no bonds, notes, or other evidences of indebtedness for borrowed money payable from General Fund tax receipts of the State shall be authorized by the General Assembly except as shall not cause the aggregate amount of (1) the total amount of such indebtedness authorized by the General Assembly but not yet issued and (2) the total amount of such indebtedness which has been issued but remains outstanding, to exceed 1.6 times the total estimated General Fund tax receipts of the State for the fiscal year in which any such authorization will become effective, as estimated by the joint standing committee of the General

Assembly having cognizance of finance, revenue and bonding. Such tax receipts for the fiscal year ended June 30, 2005, were estimated as of December 16, 2005, to total \$10,455,400,000. As of December 16, 2005, the State Treasurer determined that authorizations for bonds, notes, and other obligations subject to such limit, net of debt retirement fund resources related to certain self-liquidating bond issues, totaled \$12,977,522,343. Accordingly, as of this date, the State's debt incurring margin totaled \$3,790,204,965.

In addition to the indebtedness previously mentioned, there were other obligations that, although not in the form of State bonds or notes, constituted long-term indebtedness or the guarantee of existing indebtedness. Such obligations included:

- 1. Obligations of the State to towns for participation in the construction and alteration of school buildings, under Section 10-287 of the General Statutes (installment payments) in the amount of some \$610,000,000, and Sections 10-287g and 10-287h (interest subsidy) in the amount of some \$150,000,000, as of June 30, 2005. It should be noted that Sections 10-287g and 10-287h were repealed by Public Act 97-11 (June Special Session) for construction projects approved subsequent to July 1, 1997. With regard to projects approved after July 1, 1997, this same Public Act established a new financing method, which provides for the State to pay for its share of school construction costs on a "progress payment" basis. As of June 30, 2005, the State Board of Education estimates that current grant obligations under this latter program will total some \$3,000,000,000.*
- 2. The obligation of Section 5-156a of the General Statutes to fund the State Employees' Retirement System on an actuarial reserve basis over a remaining period of 26 years. The last actuarial survey of the system was performed as of June 30, 2004, and showed an unfunded accrued liability of \$6,890,251,830.*
- 3. The obligation of Section 51-49d of the General Statutes to fund the Judges' and Compensation Commissioners' Retirement System on an actuarial reserve basis over a remaining period of 26 years. The last actuarial survey of the system was performed as of June 30, 2004, and showed an unfunded accrued liability of \$68,974,850.*
- 4. The obligation of Section 10-183z of the General Statutes to fund the Teachers' Retirement System on an actuarial reserve basis over a remaining period of 24 years. The last actuarial survey of the system was performed as of June 30, 2004, and showed an unfunded accrued liability of \$5,223,799,619.*
- 5. Loans under the "Insurance and "Umbrella" programs, insured by the State (\$25,000,000 maximum limit) through the Connecticut Development Authority, which totaled \$9,291,988 as of June 30, 2005. In addition, loans of the Authority under the "Umbrella" Loan Program are also insured under this program. These, however, are contingent indebtedness of the State; actual indebtedness would result only in the event of a loan default or the inability of the Authority to make the payment of bonds and notes. The Authority has extended loan guarantees under the Connecticut Works*

and Connecticut Works Guarantee Fund, as provided for in Section 32-261 of the General Statutes. The State has authorized the issuance of up to \$134,000,000 in bonds allocated to the Funds, of which \$86,243,853 has been distributed and \$15,141,147 has been recorded as a reimbursement to the Authority for uncollectible loans. Any losses on guarantees made by the Authority are reimbursable by the State until the remaining bond allocation has been utilized. The Authority also provides portfolio insurance to participating financial institutions under the Connecticut Capital Access Fund. The State has authorized the issuance of \$5,000,000 in bonds allocated for the purpose, of which \$2,000,000 has been distributed. Any losses associated with this Fund are reimbursable by the State until the remaining bond allocation has been utilized.

- 6. The State of Connecticut is contingently liable to the Connecticut Housing Finance Authority, the Connecticut Resources Recovery Authority and the Connecticut Higher Education Supplemental Loan Authority for amounts needed annually to maintain debt service reserves for one year's principal and interest on certain Authority bonds in the event Authority funds are insufficient to do so. As of December 16, 2005, the principal amount of outstanding bonds, secured by special capital reserve funds, for the Housing Finance Authority, the Resources Recovery Authority, and the Higher Education Supplemental Loan Authority totaled \$2,994,200,000, \$129,800,000, and \$120,500,000, respectively.*
- 7. The State of Connecticut is contingently liable to the Connecticut Health and Educational Facilities Authority for amounts needed annually to maintain debt service reserves for one year's principal and interest on those Authority bonds used to finance projects at participating nursing homes or to finance dormitories or facilities for the provision of student housing at public and private institutions of higher education, in the event Authority funds are insufficient to do so. As of December 16, 2005, the principal amount of outstanding bonds secured by special capital reserve funds totaled some \$394,700,000.*
- 8. Pursuant to Section 10a-109g, subsection (i), of the General Statutes, the State of Connecticut is contingently liable to the University of Connecticut for amounts needed annually to maintain debt service reserves for one year's principal and interest on certain University bonds in the event University funds are insufficient to do so. As of December 16, 2005, the principal amount of outstanding bonds, secured by special capital reserve funds for the University totaled \$28,400,000.*
- 9. In accordance with the provisions of Special Act 01-1, as subsequently amended by Special Act 01-2 of the June Special Session, the State of Connecticut is authorized to guarantee debt issued by the City of Waterbury in an amount not to exceed \$100,000,000. As of December 16, 2005, the amount of the City's obligations guaranteed by the State totaled \$87,500,000.*

CONDITION OF RECORDS

Findings:

During the 2003-2004 fiscal year the State Comptroller implemented a new accounting system statewide, referred to as Core-CT. Core-CT is intended to provide an integrated business process covering requisition, purchasing, appropriations and commitment control, accounts payable, and cash disbursements; accounts receivable, billing and cash receipts, as well as personnel and payroll processes. It is also the basis of the State's general ledger based reporting. Following its initial implementation in July 2003, the Core-CT system was enhanced by the addition of the billing module in January 2005, the asset management and inventory modules in July and August 2005, respectively, and an upgrade of the personnel and payroll module in May 2006. There are further enhancements of the financial module scheduled for the 2006-2007 fiscal year, with the projects and contracts module to be implemented thereafter. At the time of our review (September 2006), the cost of implementing the new system was reported to be over \$120,000,000.

Our previous audit, covering the fiscal year ended June 30, 2004, reported significant deficiencies in the State's financial accounting and reporting as a result of problems with the implementation of the Core-CT accounting system. We found significant posting errors made to accounts, monthly financial reporting was incomplete, and annual financial reports were not provided within statutory and regulatory requirements. Our current audit has covered the corrective action taken since that time and recommends further action required.

Other deficiencies found in the Core-CT system have and will be addressed as part of separate audits conducted by the Information Systems Audit Unit of the Auditors of Public Accounts. The following are findings of conditions that directly affected the State's monthly and annual financial reporting, and for which corrective action is necessary.

Incomplete Monthly Financial Reporting:

Criteria: Section 3-115 of the General Statutes establishes that "The Comptroller shall prepare all accounting statements relating to the financial condition of the state as a whole, the condition and operation of state funds, appropriations, reserves and costs of operations; shall furnish such statements when they are required for administrative purposes; and shall issue cumulative monthly financial statements concerning the state's General Fund which shall include a statement of revenues and expenditures to the end of the last completed month together with the statement of estimated revenue by source to the end of the fiscal year and the statement of appropriation requirements of the state's General Fund to the end of the fiscal year...including estimates of lapsing appropriations, unallocated lapsing balances and unallocated appropriation requirements. The Comptroller shall provide such statements, in the same form and in the same categories as appears in the budget act

enacted by the General Assembly, on or before the first day of the following month. The Comptroller shall submit a copy of the monthly trial balance and monthly analysis of expenditure run to the Office of Fiscal Analysis.”

Condition: During the entire 2004-2005 fiscal year the Budget and Financial Analysis Division was unable to produce a complete set of monthly financial statements. Because of problems with the reporting of revenues, in particular the reconciliation of cash receipts, no balance sheet for the General Fund, and on occasion, the Special Transportation Fund could be produced. This condition continued throughout the entire fiscal year. At the time of our review (September 2006), the State Comptroller was still unable to produce a monthly balance sheet for the General Fund. In addition, as detailed below, because of system problems with the Core-CT commitment control ledger, financial statements for the month of October 2005 were never produced.

Effect: The State Comptroller was not in compliance with Section 3-115 of the General Statutes.

Cause: With the implementation of the Core-CT system State departments and agencies were made responsible for entering their own revenue records onto the general ledger. This resulted in continued problems with recording and reporting cash transactions. In particular, the inability of the State Treasurer to perform timely cash reconciliations made it impossible to prepare a monthly balance sheet.

There were also problems with the timing of transaction postings between the commitment control ledgers and the general ledger. The resolution of differences between the two sets of ledgers for closed accounting periods is essential to the production of a balance sheet.

Recommendation: The State Comptroller should take whatever measures necessary to comply with Section 3-115 of the General Statutes and produce a complete set of monthly financial statements. (See Recommendation 1.)

Agency Response: “Significant progress has been made with regard to producing timely monthly financial statements for the General Fund and the Transportation Fund as required by Section 3-115 of the Connecticut General Statutes. For most of Fiscal Year 2004, The Comptroller’s Office was unable to produce stable monthly financial data. As detailed in the agency response of last year, this condition arose from numerous transaction posting errors by state agencies,

problems with revenue reconciliation resulting from integration of Core-CT to the Department of Revenue Services Integrated Tax Administration System (ITAS), payroll posting problems, budget checking problems and related cash reconciliation problems. Extraordinary progress was made over the year in correcting each of these problems and financial statements were produced throughout Fiscal Year 2005 with the exception of balance sheets for the General Fund. It should also be noted that due to a budget posting problem in October, financial statements were not produced on the first of the month. A decision was made to delay release of these statements, as the budget posting errors would have created known errors in those statements.

The Comptroller's Office agrees with your finding that "the inability of the State Treasurer to perform timely cash reconciliations made it impossible to prepare a monthly balance sheet". The Office also agrees with your finding that agencies performing direct entry of revenue to the general ledger has made the production of balance sheets more challenging; however, increased monitoring of agency revenue entries and the implementation of a monthly closing process in November of 2004 for billing and accounts receivable has resulted in more timely and accurate revenue postings."

Failure to Provide Timely Annual Financial Reports:

Criteria: Section 3-115 of the General Statutes requires the State Comptroller to, "...On or before September first, annually, ... submit a report to the Governor which shall include (1) a statement of all appropriations and expenditures of the public funds during the fiscal year next preceding itemized by each appropriation account of each budgeted agency; (2) a statement of the revenues of the state classified as far as practicable as to budgeted agencies, sources and funds during such year; (3) a statement setting forth the total tax receipts of the state during such year; (4) a balance sheet setting forth, as of the close of such year, the financial condition of the state as to its funds; and such other information as will, in his opinion, be of interest to the public or as will convey to the General Assembly and the Governor the essential facts as to the financial condition and operations of the state government. The annual report of the Comptroller shall be published and made available to the public on or before the thirty-first day of December."

Condition: Our review of the preliminary financial statements for the fiscal year ended June 30, 2005, which were issued on September 1, 2005, found that they did not meet the provisions of the Statute. The

statement of revenues did not reflect final revenues accruals and closing adjustments; and there was no balance sheet for the State's General Fund.

The Comptroller did not prepare and issue its *Annual Report of the State Comptroller - Budgetary Basis* for the 2005 fiscal year until September 2006, some 15 months after the fiscal year end and nine months after the date required by Statute.

Effect: The State Comptroller was not in compliance with Section 3-115 of the General Statutes.

Cause: The preparation of the annual financial statements has been a difficult process that required extensive manual corrections and adjustments. Because of the extensive delay in reporting for the 2003-2004 fiscal year, the Budget and Financial Analysis Division of the State Comptroller's Office was not able to begin the process of preparing the financial statements for the 2004-2005 fiscal year until January 2006.

In addition, there were significant problems in the Core-CT system itself. Account posting errors being made by various system users; the identification and the correction of which required a significant amount of time and effort by the Budget and Financial Analysis Division.

Recommendation: The State Comptroller should take whatever measures necessary to comply with Section 3-115 of the General Statutes and produce its annual financial reports in an efficient and timely manner. (See Recommendation 2.)

Agency Response: "The time required to produce audited annual financial statements was shortened considerably in Fiscal Year 2005. In Fiscal Year 2004, eighteen months was required to generate final audited financial statements. In Fiscal Year 2005, this timeframe was shortened to nine months.

It should also be noted that unaudited annual financial reports were produced in both Fiscal Year 2004 and Fiscal Year 2005 prior to the February 28th continuing disclosure requirement of the Securities Exchange Commission. Both legal basis and GAAP based annual reports were provided prior to that date. These unaudited statements proved to be highly reliable for trending and comparative analysis purposes and were used by rating agencies.

As you note in your findings, delays in the finalization of Fiscal Year 2004 report necessitated postponing work on Fiscal Year 2005. This combined with significant manual corrections required to accurately post agency transactions explains the Fiscal Year 2005 timeline.”

Failure to Provide Timely CAFR Financial Statements:

Criteria:

Section 2200.101 of the Government Accounting Standards Board - *Codification of Governmental Accounting and Financial Reporting Standards* states that “every governmental entity should prepare and publish, as a matter of public record, a comprehensive annual financial report (CAFR) that encompasses all funds of the primary government.” Section 2200.104 of those Standards adds “It should be prepared and published promptly after the close of the fiscal year...” and, “Timely and properly presented financial reports are essential to managers, legislative officials, creditors, financial analysts, the general public, and others having need for governmental financial information.”

Governmental Accounting Standards Board - Statement No. 34, *Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments* - requires general purpose governments to present basic financial statements and required supplemental information in order to be in compliance with generally accepted accounting principles (GAAP). The basic financial statements must include a management discussion and analysis, government-wide financial statements, fund financial statements and notes to the financial statements.

With respect to its debt issuance, the State has a continuing disclosure obligation to provide audited financial statements in order to be in compliance with certain Securities and Exchange Commission regulations. In order to be in compliance with those requirements, the Office of the State Treasurer must receive audited CAFR financial statements by the end of February of each year.

In addition, Office of Management and Budget Circular A-133 states that recipients of Federal grant awards “...shall prepare financial statements that reflect its financial position, results of operations or changes in net assets, and where appropriate, cash flows for the fiscal year audited.” These statements are due to the Federal government by the end of March of each year.

The significant cost of the Core-CT system was partly justified by

the planned improvements in financial reporting. Preparation of required financial reports was to be in a much more automated method that would not require the extensive use of manual worksheets.

Condition: Our review found that the Core-CT system, although improved, did not provide financial information that would facilitate the timely preparation of year-end financial statements. Preparation of required reports was problematic and filled with delays.

The Comptroller did not prepare and issue audited financial statements for its CAFR until September 2006, some 15 months after the fiscal year end, seven months after the date they were needed by the State Treasurer and six months after the date they were required by the Federal government.

Effect: The Comptroller was only able to provide preliminary and unaudited financial statements to meet the February 28, 2006, SEC continuing disclosure requirement. Credit rating agencies will consider this deficiency when assessing the creditworthiness of the State of Connecticut.

The State did not meet the deadline for complying with the reporting requirements for Federal financial assistance. The financial statement audit required by the Federal government could not be completed and reported on by the required date.

In March 2006, the Office of Policy and Management requested and received an extension from the U.S. Department of Health and Human Services, to extend the State's reporting deadline from March 31 to September 1, 2006. The request for this extension was based on the Comptroller's projected date of providing a complete set of financial statements by the end of May 2006. Subsequently, after it became apparent that the completed financial statements would not be produced and available for audit in time to meet the September 1, deadline, on July 31, 2006, the Office of Policy and Management requested and subsequently received an additional extension to September 30, 2006.

Cause: As noted above, because of the extensive delay in reporting for the 2003-2004 fiscal year, the Budget and Financial Analysis Division of the State Comptroller's Office was not able to begin the process of preparing the financial statements for the 2004-2005 fiscal year until January 2006.

As described above, there were delays in issuing the *Annual Report*

of the State Comptroller - Budgetary Basis upon which the preparation and audit of the CAFR is based. By necessity, the preparation of CAFR financial statements is reliant upon the extensive manual compilation and adjustments necessary to produce the budgetary basis report, which was the result of problems in the Core-CT system as detailed below.

Recommendation: The State Comptroller should take whatever measures necessary to ensure that the financial statements for its Comprehensive Annual Financial Report are prepared in an efficient and timely manner. (See Recommendation 3.)

Agency Response: “Same as above response to *Failure to Provide Timely Annual Financial Reports.*”

Administration of Statewide Accounting and Financial Reporting Functions:

Criteria: Section 3-112 of the General Statutes provides that the Comptroller shall “establish and maintain the accounts of the State government...prescribe the mode of keeping and rendering all public accounts of departments or agencies of the State and of institutions supported by the State or receiving State aid by appropriation from the General Assembly... prepare and issue effective accounting and payroll manuals for use by the various agencies of the State.”

The *State Accounting Manual*, issued by the State Comptroller, provides formal written accounting policies and procedures, and establishes the definitions of authority and responsibility between State departments and agencies, and the State Comptroller.

Condition: Our previous audit found that the implementation of the Core-CT system decentralized many of the State’s accounting functions and procedures and eliminated many of the controls the State Comptroller had previously maintain over postings onto statewide accounting records. Internal controls over the posting of interagency transfers, correct account coding, and budgetary accounting, as well as the availability of needed financial reports to State agencies was significantly diminished with the implementation of the Core-CT system in July 2003.

Our current review found some improvements have been implemented, as described below. A chartfield combination edit has been implemented over general ledger postings; State agencies are now required to perform a fiscal closeout each month, controls were implemented over the recording of transaction dates and over the

change or adjustment of past posted transactions. However, our current review found that staff members of the Budget and Financial Analysis Division were still required to expend a significant amount of their time working on Core-CT problems with user agencies, and identifying and correcting accounting errors, rather than being available to address the needs of statewide financial reporting.

In addition, the State Comptroller has still not provided user agencies with an updated version of its *State Accounting Manual*, some three years after the Core-CT conversion. The first revision, an online chart of accounts for the Core-CT system, was not made available to agency users until January 2006.

Our previous report noted that the Office of State Comptroller had relinquished a significant amount of the control it previously maintained over the accounting of the State's financial transactions. We also noted that the Budget and Financial Analysis Division were frequently in the position of accepting what the Core-CT project could provide, rather than the system meeting their needs.

In response, effective April 2006, the Core-CT Financials Team was placed as part of the Budget and Financial Analysis Division on the organizational charts of the Office of State Comptroller. At the time of our review (September 2006) it was too early to notice any improvements resulting from this change.

The implementation of Core-CT project itself was managed by a joint committee consisting of the Office of State Comptroller, the Department of Information Technology, the Department of Administrative Services, and the Office of Policy and Management; working with the software vendor PeopleSoft, and the Accenture and other consultants employed to install the system. Our previous audit concluded that the Office of State Comptroller, although statutorily given its responsibilities for statewide financial reporting, did not maintain the role of primary participant in the project.

We still note that the Core-CT project is still under the administration of the joint committee responsible for the system's initial implementation. Because the Core-CT project has not yet met completion, and with consultants still completing significant work on the implementation of the projects and contracts modules for the 2007-2008 fiscal year, it will be some time before the Core-CT system could actually be "handed over" to the State Comptroller. Even after that point, the Core-CT system will remain an adaptation from the commercial accounting environment, and will not be able to close annual budgets, and maintain budget controls,

appropriations, encumbrances, purchase orders and other transactions in an efficient manner within the decentralized environment of numerous State agencies.

In May 2006, a settlement agreement was reached between the software vendor Oracle/PeopleSoft and the Office of State Comptroller and Department of Administrative Services regarding certain quality, performance and functional features of the Core-CT system. In exchange for \$1,625,000 in technical support credits, the Office of State Comptroller and Department of Administrative Services agreed to release Oracle/PeopleSoft from any or all claims for damages arising from the dispute.

Effect:

With the decentralization inherent in the Core-CT system, the State Controller has relinquished a significant amount of the control it previously maintained over accounting of the State's financial transactions. State agencies can enter data onto statewide accounting ledgers without the review and authorization of the State Comptroller. As a result, accounting entries made by various State agencies did not conform to proper governmental accounting practices. This included numerous journal entry errors and numerous transactions posted to the wrong fund or account. It has now become established practice for the Budget and Financial Analysis Division to spend an inordinate amount of time on review and clean up of agency posted transactions before any financial reporting could be accomplished.

Cause:

Following our previous audit, we observe that the Core-CT system, although improved, has not met the needs of the State Comptroller, the State Treasurer and user agencies and departments of the State to provide for the efficient and accurate processing and recording of financial transactions.

In its implementation of a decentralized statewide accounting system, the State Comptroller did not mandate the establishment of internal controls to review and approve certain journal entries before they were posted to the general ledger. The establishment of the most basic "edit checks" to prevent erroneous transactions from being entered to the wrong account and fund combinations was not implemented until January 2006, two and one half years after the Core-CT system was brought on line.

Recommendation:

The State Comptroller should reemphasize its role as the agency responsible for maintaining the accounts of the State, and apply adequate controls and direction over Statewide financial accounting and reporting, which should include the revision of the *State Accounting Manual*. (See Recommendation 4.)

Agency Response: “Core-CT was designed and implemented to subsume the functions of various costly and technologically disparate financial systems and subsystems that the state had been using. Therefore, Core-CT in design and nature went well beyond the demands of the Comptroller’s Office as a central user by also incorporating agency based financial and human resources needs. To capture the full scope of both central and agency based needs, and to balance these –at times—competing requirements, an oversight organization was formed. Oversight of Core-CT implementation was provided by the Comptroller, DAS, OPM, and the Department of Information and Technology (DOIT). It was essential to receive input and guidance from these other three agencies during the design and configuration phase of the Core-CT module implementations. The final module addition to Core-CT, which is referred to as Projects and Contracts, will be implemented in Fiscal Year 2008. Throughout this collaborative period, the Comptroller continued to exercise her authority relative to the mode and method of statewide accounting and reporting. Staff working on the statewide accounting and payroll applications of Core-CT are Comptroller’s employees and accountable to the State Comptroller. As noted in your findings, effective April 2006 the Core-CT financial team was placed within the organizational structure of the Comptroller’s Budget and Financial Analysis Division to further integrate the Comptroller’s central financial and accounting operations with Core-CT system operations.

As with any financial system that is incorporating both the needs of central reporting with the needs of user departments or divisions, a large degree of decentralization is required. Without that decentralization the system would not meet the needs of agency users. Inherent in decentralization is a certain loss of data entry control and, as noted in this report, the need to increase internal controls and monitoring of system entries.

Substantial progress has been made in strengthening internal controls and system monitoring. To better monitor and control system entries, in November 2004 a monthly closing process was implemented for accounts receivable, billing, accounts payable and the general ledger. This process allows both agency users and the Comptroller’s Office to more readily identify transaction errors and control posting dates. Incremental improvements have been made in reporting functionality to provide added reconciliation tools. Edits added to the system in January 2006 ensure that certain invalid coding combinations can not be processed. Also in January, the Core-CT chart of accounts with usage guidance was placed on-line

for agencies. The Comptroller's Office reviews all direct journal entries (spreadsheet and online journals) entered by agencies prior to posting. The Comptroller's Office recently implemented a process for the review of journal vouchers on a monthly basis to ensure that proper cash lines are added and that the vouchers are using acceptable account coding. Agency training in the form of on-line assistance, access to help desk functionality, transaction specific labs and general informational sessions are ongoing tools designed to limit agency errors. You cite many of these improvements within this report.

The Comptroller's Office plans to implement additional system edits subsequent to the upgrade to version 8.9 software in November 2006. System edits can impact the overall performance of Core-CT. Therefore, it is essential to fully test edits and to weigh the benefits of the edit against the potential negative impact on system performance."

Failure to Provide Needed Reports to System Users:

Criteria:

Section 1100.101 of Government Accounting Standards Board - *Codification of Governmental Accounting and Financial Reporting Standards* states that a governmental entity's accounting system should be designed to achieve the following: "Present fairly and with full disclosure the funds and activities of the governmental unit in conformity with generally accepted accounting principles" and, "Determine and demonstrate compliance with legal and contractual provisions."

An accounting system is designed to assemble, classify, record and report financial data. To be useful to end users, that system must be able to present data in reports that meet their needs and provide for the reconciliation of accounts.

Section 3-115a of the General Statutes provides that "The Comptroller, in carrying out accounting processes and financial reporting that meet constitutional needs, shall provide for the budgetary and financial reporting needs of the executive branch as may be necessary through the Core-CT system."

Condition:

Our previous audit cited the failure of the Core-CT system to provide reports detailing agency cash receipts and available cash, as well as the detail of Federal grant expenditures, and other reporting deficiencies. Our current review noted some corrective action taken. Existing reports have been made functional or otherwise improved;

and a “flexible ledger analysis” feature was introduced for system users to obtain reports that can be sorted and subtotaled by chartfield. However, as noted in our previous report, the manual manipulation of data is still required to “roll up” accounts among the numerous department codes. The solution for many problems encountered by the Budget and Financial Analysis Division has been manual “work arounds” rather than Core-CT system changes.

Our previous audit noted that it was not possible for user departments and agencies to receive reports that identified personnel positions paid out of selected accounts off the chartfields, making it particularly difficult for management to budget and account for those positions funded by Federal grants. We also noted that the distribution of personal services costs among accounts by the Core-CT financials component would not match actual employee time distribution. The distribution of payroll costs required the use of separately maintained worksheets and ledgers, requiring additional time and labor. This condition continued throughout the audited period.

The management advisory letter in connection with the Independent Public Auditor report for the Special Transportation Fund for the fiscal year ended June 30, 2005, states that “...none of the agencies of the Special Transportation Fund could readily determine from the Core-CT system the amounts for grant expenditures, grant receipts and related grants receivable and deferred grant revenue.” The Independent Public Auditor report contained a reportable condition that “...grant and contract revenues for the year ended June 30, 2005, and related grants and contracts receivable and deferred revenue as of June 30, 2005, could not be fully substantiated.” In addition, the Independent Public Auditor report stated that, as of June 30, 2005, billings to grants and contracts for payroll expenditures were not current.

Our prior audit noted that, because of Core-CT reporting difficulties, the Department of Transportation failed to bill and collect from the Federal government over \$100,000,000 in payroll charges that originated since the implementation of Core-CT. At the time of this review (September 2006) the Department of Transportation, by employing additional resources and developing its own computer program, was able to bill over \$94,000,000 of these charges, collecting approximately \$75,000,000 at the 80 percent reimbursement rate.

From the time that the Core-CT system has been operational, reports detailing agency cash receipts and available cash, as well as the

detail of Federal grant expenditures and the estimated revenues commitment control ledger, were not available for use or provided erroneous information.

In addition, as described elsewhere in this report, the Core-CT system cannot provide reports that accurately account for interagency expenditure, revenue and grant transfers.

Effect:

Extensive manual labor was required to maintain chartfield mapping as employee changes were made and to reconcile between separately maintained records and those on the Core-CT system, as well as between the financial and human resources modules of Core-CT. Proper accounting for grant expenditures related to person services remains problematic.

Our previous audit noted that the Core-CT system would allow continual changes or previously posted transactions. Adjustments and corrections entered by user agencies would affect totals for past periods, change previously reconciled amounts and reported totals. To eliminate this problem and to improve the accuracy of information reported from the Core-CT system, the State Comptroller established monthly close outs of the accounts payable, accounts receivable and general ledgers. Beginning in November 2004, State departments and agencies were required to review the month's activity, close out pending, open or unmatched items, and reconcile data and correct errors on the various ledgers. This monthly close out has been successful in improving financial reporting accuracy, but at the cost of additional manual time and labor that should not be required of Core-CT users.

Cause:

The Core-CT system is based on PeopleSoft computer software that is an adaptation from the commercial accounting environment. That adaptation to the accounting needs of the State for budgetary and modified cash basis accounting resulted in certain deficiencies in financial reporting. Although significant improvements have been made, the basic system design has left system users with certain reports and features that still do not function properly.

Recommendation:

The State Comptroller should seek continued improvements in financial reporting from the Core-CT system. (See Recommendation 5.)

Agency Response:

“The Comptroller’s Office disagrees with the substance of this finding. Since implementation of Core-CT, the Comptroller has been leading the effort to improve Core-CT financial reporting. The Comptroller’s Office and designated Core-CT project staff have

enhanced numerous reports including the Expenditure Detail Report, the Available Cash Trial Balance, the Detail and Summary Revenue Report, the Trial Balance of Appropriations, and the Grant Appropriation Trial Balance. In addition, most reports have been enhanced to allow them to be easily downloaded into Excel.

At the direction of the Comptroller, a Core-CT team began the Report Catalog initiative in November 2004 to develop and implement a catalog of reports to help central and line agency users extract and manage financial information. In order to meet the needs of all the Core-CT users, a focus group was formed representing a broad cross-section of state agencies by size and mission. Feedback from training sessions, user labs, and user group meetings was also reviewed. This effort helped to identify reports that would be most helpful to users in various functional areas.

Several of these reports were enhanced to meet requirements that were suggested by the focus group. Also, a flexible analysis report was added under the general ledger to allow users to review ledger balances by account code based on parameters they define. In September, the new report catalog website went online. Initially, this site includes 30 production reports covering six financial modules. Each report starts with an introduction to the report stating the purpose, type references the legacy CAS/SAAAS report it replaces, role(s) required for access, navigation path, and suggested run times. It also provides detailed instructions to initiate the report and a sample of the information generated by the report. This catalog has been well received by the entire user community and is being expanded upon. It should also be noted that prior to Core-CT, data processing employees were required to extract certain financial information that is now readily accessible to Core-CT users through basic reporting functionality.

All information essential to financial reporting is available in either delivered report format or through custom extracts. The flexible analysis report provides chartfield roll-up capabilities and allows customized reporting from the general ledger”

*Auditors’ Concluding
Comments:*

It has been the experience of our audit staff, and that of numerous Core-CT users at State agencies and departments that further improvements in financial reporting are necessary in the Core-CT system. The difficulty in preparing financial statements in a timely manner, and time and resources spent to identify and correct accounting problems attest to the need. To locate a problem transaction can require the search of hundreds of lines of journal

entries; to “drill down” and research the specific entry requires the navigation of a succession of data screens, all of which is time consuming. Because the Core-CT system requires users to prepare their own reports, system users that fail to initiate a report with the correct information entered in all fields on a consistent basis will receive differing results. As such it can be difficult to obtain reliable and repeatable totals that can be reconciled to other records. With the previous accounting system (CAS), an accurate and consistent hard copy report was made available to State agencies.

Inability to Promptly and Accurately Reconcile Cash Activity:

Criteria: An accounting system is designed to assemble, classify, record and report financial data. To be useful to end users, that system must be able to present data in reports that meet their needs and provide for the reconciliation of accounts.

Section 3-115a of the General Statutes provides that “The Comptroller, in carrying out accounting processes and financial reporting that meet constitutional needs, shall provide for the budgetary and financial reporting needs of the executive branch as may be necessary through the Core-CT system.”

The Cash Management Division of the Office of State Treasurer is responsible to maintain proper internal control over cash and complete bank reconciliations in a timely manner.

Condition: Our previous audit cited the failure of the Core-CT system to process online data on cleared and outstanding checks to allow for the prompt reconciliation of the State’s checking accounts. As a result of this deficiency, the State Treasurer could not reconcile its cash accounts promptly after year-end, which caused delays in preparation of both the State Comptroller’s Annual and CAFR financial reports and the State Treasurer’s Annual Report for that year.

Our current audit observed that the Budget and Financial Analysis Division of the State Comptroller’s Office has still encountered problems with adjustments resulting from the bank reconciliation process performed by the State Treasurer. In its preparation of financial statements for the 2004-2005 fiscal year, the Budget and Financial Analysis Division of the State Comptroller’s Office was required to use information on cash accounts that were not fully reconciled to the bank. In July 2006, when the financial statements for the 2004-2005 fiscal year were being prepared, the State

Treasurer had not completed its bank reconciliations of vendor and payroll accounts to the Core-CT general ledger.

An Interagency Transfer Account (10436) was established in the Core-CT system as a clearing account to process transfers between State agencies. This account should, after all pending items have been processed, maintain a net zero balance. Our review found that this account has not been reconciled since the inception of the Core-CT system in July 2003. Outstanding billings and payments are not researched and resolved in a timely manner.

In addition, there were continued problem with the communication between the Offices of State Comptroller and Treasurer regarding the entry of corrections to the Core-CT general ledger. Adjustments entered by the State Treasurer would reflect corrections to the proper bank account without utilizing the proper fund and account designations required by the State Comptroller. Adjustments entered by personnel of the State Comptroller would affect totals for past periods in previously reconciled accounts, complicating the Treasurer's monthly bank reconciliations.

Effect:

Because the Core-CT system cannot provide information on cleared and outstanding checks on an automated basis, the State Treasurer was unable to reconcile its cash accounts promptly, which resulted in delays in preparation of the *Annual Report of the State Treasurer for the Fiscal Year Ended June 30, 2005*, and the failure to meet the statutory requirement for submission of that report by October 15, 2005. The inability to reconcile cash accounts also contributed to difficulties in the preparation of the State Comptroller's Annual and CAFR financial reports as noted earlier in this report.

The reconciliation of the Treasurer's payroll and vendor cash accounts for the fiscal year ended June 30, 2005, was not fully completed until July 2006.

The failure to promptly reconcile outstanding items in the Interagency Transfer Account created problems in correctly reporting interagency activity, particularly with grant transfers.

Personnel of the Office of State Treasurer are required to maintain a manual ledger to reconcile from the bank account and adjust the Core-CT general ledger to reflect bank activity.

Cause:

The Core-CT system, as implemented by the State did not include the "treasury module" that was part of the package offered by the

software vendor. This module would help to automate the bank reconciliation process by providing information on cleared and outstanding checks using bank statement data that is directly transferred from the bank. During the 2005-2006 fiscal year the State Treasurer and the State Comptroller had considered jointly purchasing and implementing that module, but due to projected costs, rejected the proposal. At the time of our review (September 2006) the State Treasurer was investigating the possibility of writing its own program for this function. A projected date for implementation of such a program could not be provided. Arrangements were also being made to utilize a daily file of cleared checks supplied by the bank to provide data to facilitate the timely reconciliation of the payroll and vendor accounts.

In addition, a general failure of communication between the Offices of State Comptroller and Treasurer was the cause significant difficulties in reconciling cash accounts. We noted that neither agency assumed the responsibility of reconciling the Interagency Transfer Account.

Recommendation: The State Comptroller, working with the Office of the State Treasurer, should provide a system to reconcile cash activity and post necessary cash adjustments in a timely manner that provides adequate internal control over ledger adjustments. It should also address the need to review and reconcile the Interagency Transfer Account. (See Recommendation 6.)

Agency Response: “Additional controls have been added to improve cash reconciliation activities. Two transaction types that create cash reconciliation problems—journal vouchers and on-account receipts—have undergone business process changes to better control cash activity. With respect to journal vouchers, effective for Fiscal Year 2007 agencies will no longer add cash lines to these transactions. Instead, the Comptroller’s Office will centrally add cash lines to such transactions on a monthly basis. Online account transactions will be automatically coded to Funds Awaiting Distribution (Pending Receipts) and tracked monthly to ensure that operations reflect these changes in cash.

During the course of Fiscal Year 2006, the Treasurer’s Office evaluated the benefits of adding the Treasury Module to Core-CT. The Comptroller’s Office extended an offer to share in the cost of this additional module implementation. At this writing, the Treasurer’s Office had not opted to add this functionality and was pursuing other options to speed the reconciliation of cash to bank accounts.

The high volume of interdepartmental accounting transactions has made it difficult to maintain a net zero balance within the interagency cash account. Subsequent to the implementation of the upgrade of Core-CT financial software to version 8.9, the Comptroller's Office will pursue hard edits to limit the use of the interagency cash account.

Communication between the Treasurer's Office and the Comptroller's Office occur daily with respect to cash reconciliation and both agencies share the common goal of expediting accurate cash reconciliation."

Failure to Consistently and Properly Record Interagency Transfers:

Criteria:

An accounting system is designed to assemble, classify, record and report financial data. To be effective, that system must have internal controls that provide assurance that the accounting system and its underlying data are reliable. An accounting system that utilizes computer processed data in a decentralized environment must have standardized procedures and training to ensure that transactions are processed in a consistent manner.

Section 3-115a of the General Statutes, as amended by Public Act 04-87, provides that "the Comptroller, in carrying out accounting processes and financial reporting that meet constitutional needs, shall provide for the budgetary and financial reporting needs of the executive branch as may be necessary through the Core-CT system."

Condition:

Our previous audit found the decentralized controls in the Core-CT system allowed agency personnel to directly enter interagency transfers onto the State's general ledger coded to the incorrect accounts of its own or the recipient agency.

Deficiencies in the system controls, and limited enforcement of compliance with standard policies and procedures allowed users to believe that if a transaction could be entered into the system, it was properly coded.

Effect:

Transfers of State and Federal funds were inaccurately recorded. State agencies could not provide an accurate accounting of grant receipts; grant expenditures, grants receivable and deferred grant revenue.

We also found that State agencies will at times not approve

interagency transfers that were posted to their accounts by billing agencies. This would leave the transaction uncompleted, resulting in outstanding charges and incomplete or incorrect transactions posted to accounts.

Cause: The State Comptroller did not effectively train system users to use a standard method of entry and establish a procedure to prevent miscommunication between agencies. It was not until February 2005, with the implementation of the billing module of Core-CT that interagency transfers were assigned specific default codes. However, our audit found that even after this change, user agencies were still improperly coding interagency transfers. At the time of our review (September 2006) no system controls have been implemented to prevent system users from miscoding interagency transfers.

Recommendation: The State Comptroller should correct deficiencies in the internal controls in the Core-CT system that governs the entry of interagency transfers. (See Recommendation 7.)

Agency Response: “At the time of Core-CT implementation, the decentralized recording of interagency transfers was not expected to be problematic. Three account codes were developed to identify such transfers and the proper use of the codes was communicated to agency users in multiple forums. However, as noted in this report, numerous coding errors did arise.

In February 2005 with the implementation of the billing module, a billing type was created to capture such transactions with an established default account coding. Unfortunately, in some cases agencies have inaccurately changed the default coding.

These coding problems have made interagency transfer reporting a labor intensive activity. The Comptroller’s Office is in the process of reevaluating the business procedures for such transfers. Recentralizing this activity within the Comptroller’s Office would require an increased staffing level and additional agency work.”

Failure to Consistently and Properly Record Account Codes:

Criteria: An accounting system is designed to assemble, classify, record and report financial data. To be effective, that system must have internal controls that provide assurance that the accounting system and its underlying data are reliable. An accounting system that utilizes computer processed data in a decentralized environment must have

standardized procedures and training to ensure that transactions are processed in a consistent manner.

Section 3-115a of the General Statutes as amended by Public Act 04-87 provides that “the Comptroller, in carrying out accounting processes and financial reporting that meet constitutional needs, shall provide for the budgetary and financial reporting needs of the executive branch as may be necessary through the Core-CT system.”

Condition:

Our previous audit, and our current review, encountered problems with the manner that revenue and expenditure transactions were processed in the Core-CT accounting system. Because of the decentralized control environment in the Core-CT system State agencies have had the ability to easily enter erroneously coded transactions onto the State’s general ledger.

In a limited solution to this condition, the State Comptroller, in January 2006, implemented combination editing for certain fund and special identification (s.i.d.) codes. Transactions entered by State agencies will have the fund and s.i.d. codes validated; those transactions with improper codes will be rejected by the Core-CT system. This control only ensures that, in general, the proper appropriation code was selected for a particular fund group. It does not apply to revenue, expenditure, asset or liability account codes or to whether the correct code in a combination was selected.

At the time of our review (September 2006) there were still only limited controls in place to ensure that department and agency users code transactions to the proper accounts, and significant numbers of transactions are still miscoded. The State Comptroller has emphasized continued training of agency users in order to address the problem; however, it has still not made the necessary changes to address the new decentralized environment.

Effect:

Transactions were posted to incorrect budgetary accounts, restricted accounts and State fund accounts. In order to close and report on the fiscal year, personnel of the Budget and Financial Analysis Division were required to devote significant resources to review and correct numerous improperly coded transactions.

As one example, when posting grant receivables in the 2004 fiscal year, the Office of Policy and Management entered transactions that posted cash receipts directly to cash accounts without the necessary postings to the applicable receivable and revenues accounts. The errors totaled \$6,705,055; they affected 51 specific accounts and involved 186 accounts receivable invoices, 83 direct journals, and

ten journal entries, involving hundreds of entered lines. To correct the errors, adjustments were made to the financial statements for both the 2004 and 2005 fiscal years, and a reconciling item must be posted to the general ledger for the 2006 fiscal year. The identification and correction of these types of errors added significant difficulties and additional hours to the preparation of the annual financial statements.

To eliminate the problem of State agencies entering journal vouchers with improperly coded cash accounts, the State Comptroller is centralizing this function by requesting user agencies not to enter these transactions. The State Comptroller will code the cash accounts itself and post the journal voucher for the user agency. However, hard edits have not been implemented to prevent user agencies from continuing to enter their own coding.

Cause: The Core-CT system is decentralized and by necessity, the State Comptroller must rely on department and agency users to make the correct accounting entries onto the system. Deficiencies in the system design and failure to initially establish standardized procedures allowed users to enter erroneous transaction account information.

Recommendation: The State Comptroller should correct deficiencies in the internal controls in the Core-CT system over the entry of recording account codes. (See Recommendation 8.)

Agency Response: “It is impossible to fully guard against human input error in any accounting system. The Comptroller’s Office has taken the following steps to minimize the types of errors discussed in this finding. In November 2004, a monthly closing process for the financial modules was implemented to allow for review of static transaction postings. This has assisted in identifying coding errors in a timely manner. A monthly reconciliation of the general ledger to budget ledgers is performed to identify aberrant transaction postings. In January 2006, additional combination editing for invalid chartfield coding was implemented eliminating many of the most common coding errors. Beginning in Fiscal Year 2007, the Comptroller’s Office began to centrally code cash lines on journal vouchers on a monthly basis to reduce cash reconciliation coding errors. The Comptroller’s Office makes contact with agencies that have repeatedly processed coding errors to assist them in rectifying these problems. Comptroller memoranda, electronic daily mailings, on-line job aids, ongoing training sessions, transaction specific labs, and help desk availability are some of the methods used to educate agency users to utilize proper account codes.”

Failure of System Controls Over Budgetary Accounting:

Criteria: An accounting system is designed to assemble, classify, record and report financial data. To be effective, that system must have internal controls that provide assurance that the accounting system and its underlying data are reliable. An accounting system that utilizes computer-processed data in a decentralized environment must have application controls that prevent the inaccurate entry of data.

Condition: Our previous audit noted a deficiency in system controls that affected commitment and general ledger reporting. The Core-CT system is based on multiple ledgers to provide for budgetary accounting. In addition to general ledgers that are on the modified accrual and modified cash accounting basis, a commitment control ledger is also used, which was intended to provide for budgetary control used by State government. We found that an internal control, established as a budget check, which was designed to prevent the posting of transactions to the general ledger without first being posted to the commitment control (budget) ledger, and being subjected to its controls, was being bypassed or causing other problems.

This condition has continued, during the month of October 2005, a system error caused many entries that bypassed budget check, and were never entered into the commitment control ledger. This resulted in the expense never being charged to agency appropriations, although the vendors received payments. This condition lasted the entire month, until the software vendor produced a patch for the system, and the entries could be reprocessed.

More recently, in April 2006 a payment was processed by the Department of Transportation that, because of a data entry error, totaled \$671,534,249.14. The correct posting was intended to be to account 167153 in the amount of \$4,249.14. Although the payment greatly exceeded the available budget balance of \$10,609,097, the transaction bypassed the budget check control and was posted. The actual payment was never issued, however. Neither Core-CT system administrators nor personnel of the State Comptroller could explain this failure of internal controls. It is very likely that errors of a similar type, in lesser amounts, were made on the system and never discovered.

We also found State agencies and departments frequently miscoded expenditures to balance sheet accounts, which would cause budget check controls to be bypassed. Other than the combination edits for fund and s.i.d. coding that was implemented in January 2006, there

are no internal controls in the Core-CT system to prevent this type of error.

When certain journal vouchers were entered, the Core-CT system did not automatically generate the proper entries to the cash accounts. User departments and agencies were required to prepare them manually, which resulted in numerous errors and omissions.

When user departments and agencies issued a change order to an existing purchase order that has been already fully expended, as the expenditures pertaining to the change order were processed, the Core-CT system duplicated the original encumbrance. Also, when system users mixed individual online and batched budget checking on a group of scheduled payments, a doubling of encumbrances would result.

Effect:

Accounting records were not accurate and were unreliable. The staff of the Budget and Financial Analysis Division is required to periodically identify and correct differences that result between the modified accrual and modified cash general ledgers, and manually adjust the commitment control ledger to equal the balances in the general ledger.

For the month of October 2005, the State Comptroller was unable to produce a set of monthly financial statements.

State agencies and departments can miscode expenditures to a certain account on the Core-CT system and avoid having their appropriations encumbered, thereby being able to overspend their legal appropriations, which may not be promptly detected.

Cause:

Deficiencies in the system design and failure to initially establish standardized procedures allowed users to enter erroneous transaction account and date information. The State Comptroller has assessed the feasibility of building hard edits into various module applications to minimize the ability of agencies to enter errant coding; however, action to do this has not been taken.

As partial corrective action, in November 2004, the State Comptroller implemented a monthly closeout and reconciliation process for the accounts payable, accounts receivable and general ledgers. State departments and agencies are required to review each month's activity and close out pending, open or unmatched accounts payable vouchers prior to the last business day of the month. Agencies must correct accounts payable and receivable errors prior to the close of the general ledger. The monthly closeout also

includes a process to reconcile the commitment control ledger to the general ledger in order to detect posting and system errors and keep the separate ledgers in balance.

Recommendation: The State Comptroller should correct deficiencies in the internal controls of the Core-CT system to eliminate “budget check” problems, and the bypassing of the commitment control ledger. (See Recommendation 9.)

Agency Response: “The Comptroller’s Office has been concerned about the automated budget checking features of PeopleSoft version 8.4, and it has been the source of multiple cases opened with PeopleSoft for resolution. Many aspects of the budget checking process have become manual in order to strengthen the internal controls. The budget checking problem of October 2005 that you cite related to the upload of an upgrade bundle. After the upgrade, the volume of budget checking became a problem. That problem has since been resolved.

With respect to the budget check error on the DOT voucher that you cite, a PeopleSoft case was filed. No resolution was obtained from PeopleSoft as the problem could not be duplicated. It appears that the transaction may have been erroneously overridden.”

Preparation of Budgetary Basis Financial Report in Compliance with GAAP:

Criteria: On February 2, 2005, the American Institute of Certified Public Accountants (AICPA) issued an interpretation of one of its auditing standards that affects governments that issue financial statements prepared on a basis of accounting other than GAAP.

Interpretation No. 14, Evaluating the Adequacy of Disclosure and Presentation in Financial Statements Prepared in Conformity With an Other Comprehensive Basis of Accounting (OCBOA), Special Reports - Auditing Interpretations of Section 623 states that “if OCBOA financial statements contain elements, accounts or items for which GAAP would require disclosure, the statements should either provide the relevant disclosure that would be required for those items in a GAAP presentation or provide information that communicates the substance of that disclosure.”

If a government does issue financial statements that do not comply with the above requirement, auditing standards preclude the use of a standard audit opinion, and an explanatory paragraph, with a qualified or adverse audit opinion is required.

Condition: The Comptroller did not prepare and issue its *Annual Report of the State Comptroller - Budgetary Basis* in a format that meets AICPA standards. The report for the fiscal year ended June 30, 2005 did not contain a complete financial statement presentation, a management discussion and analysis and other required supplementary information, as well as notes to the financial statements, and information regarding component units and a disclosure of the cost and depreciation of infrastructure assets.

Effect: The *Annual Report of the State Comptroller - Budgetary Basis* for the fiscal year ended June 30, 2005, was not presented in compliance with accounting standards generally accepted within the United States of America. As a result the audit opinion provided by our office was modified to reflect that those statements were not prepared in accordance with GAAP.

Cause: The Budget and Financial Analysis Division of the Office of State Comptroller did not have the necessary time and resources to prepare and incorporate a management discussion and analysis, notes to the financial statements, or disclosure of infrastructure assets into the report.

Recommendation: The State Comptroller should correct its *Annual Report of the State Comptroller - Budgetary Basis* to conform to generally accepted accounting principles. (See Recommendation 10.)

Agency Response: “The state’s mode and method on the legal basis of accounting are constitutionally designated to the Comptroller. State statute further defines the reporting elements of the legal basis of accounting. The AICPA may provide guidance, but may not dictate the state’s legal reporting standards. This recommendation is not consistent with Connecticut state law and no corrective action is required.”

Auditors’ Concluding Comments: The AICPA interpretation of auditing standards is a requirement for additional disclosure to meet accounting standards generally accepted within the United States of America. The OCBOA provisions provide for reporting on the State’s budgetary basis of accounting and do not conflict with either the State’s Constitutional or statutory requirements.

RECOMMENDATIONS

Status of Prior Audit Recommendations:

State Comptroller - State Financial Operations Audit Report -

Nine recommendations were presented in our prior report. Of the nine, one is considered implemented, and eight are being repeated in our current report. A list of the previous Recommendations and their resolution are as follows:

1. The State Comptroller should take whatever measures necessary to comply with Section 3-115 of the General Statutes and produce a complete set of monthly financial statements – our current review found the monthly statements still did not present a balance sheet for the General Fund. The Recommendation is repeated. (See Recommendation 1.)
2. The State Comptroller should take whatever measures necessary to comply with Section 3-115 of the General Statutes and produce its annual financial reports in an efficient and timely manner – the State Comptroller again failed to meet the statutory deadlines for financial reporting. The Recommendation is repeated. (See Recommendation 2.)
3. The State Comptroller should take whatever measures necessary to ensure that the financial statements for its Comprehensive Annual Financial Report and Schedule of Expenditures of Federal Awards are prepared in an efficient and timely manner – the State Comptroller again failed to prepare its CAFR financial statements by the required date. The Recommendation is repeated. (See Recommendation 3.)
4. The State Comptroller should reemphasize its role as the agency responsible for maintaining the accounts of the State, and apply adequate controls and resources to the task of Statewide financial accounting and reporting, which should include the revision of the *State Accounting Manual* – our current review found that some improvements were made, including staffing changes and additions implemented at the Budget and Financial Analysis Division. However, sufficient controls are not in place to eliminate the problem of user agencies generating misposted transactions to the State’s general ledger. In addition, the State Accounting Manual has not received a revision to reflect the changes under the Core-CT system. The Recommendation is repeated. (See Recommendation 4.)
5. The State Comptroller should recognize its primary role in providing financial reporting for the State, and demand improved financial reporting from the Core-CT system – Our current review noted some corrective action taken. Existing reports have been made functional or otherwise improved; and a “flexible ledger analysis” feature was introduced for system users to produce “roll up” reports that summarized data among the numerous chartfield codes. However financial reporting under the

- Core-CT system still requires additional improvement. The Recommendation is repeated. (See Recommendation 5.)
6. The State Comptroller should correct deficiencies in the internal controls in the Core-CT system that governs the entry of interagency transfers - our current review again found that internal controls, although some improvements were made, were still inadequate. The Recommendation is repeated. (See Recommendation 6.)
 7. The State Comptroller should correct deficiencies in the internal controls in the Core-CT system over the entry of recording account codes and transaction dates – our current review found that system fixes were implemented with regard to the entry of proper transaction dates. However, the system has only minimal controls to prevent erroneous account codes to be entered by user agencies. The Recommendation is repeated in a modified form. (See Recommendation 7.)
 8. The State Comptroller should correct deficiencies in the internal controls of the Core-CT system to eliminate the bypassing of the commitment control ledger - problems with the budget check and commitment control ledger have continued. The Recommendation is repeated. (See Recommendation 8.)
 9. The State Comptroller should continue to make the necessary changes to the Core-CT system to provide for an efficient fiscal year end close - our current review found, as compared to the previous fiscal year, the fiscal year end close for June 30, 2005, was more efficiently conducted. With the limitations inherent in the Core-CT system software, the fiscal year end close will continue to be a more difficult process than originally intended. Given the progress shown, and the limited possibilities for further improvement, we are not repeating the Recommendation.

State of Connecticut - Single Audit Report -

Six recommendations were included in our Single Audit Report for the fiscal year ended June 30, 2004; these are detailed as items three through eight above. The same recommendations are being repeated in our current audit.

Current Audit Recommendations:

- 1. The State Comptroller should take whatever measures necessary to comply with Section 3-115 of the General Statutes and produce a complete set of monthly financial statements.**

Comment:

The State Comptroller has not produced monthly financial statements that contain a balance sheet for the general fund for the entire audited period.

- 2. The State Comptroller should take whatever measures necessary to comply with Section 3-115 of the General Statutes and produce its annual financial reports in an efficient and timely manner.**

Comment:

The State Comptroller did not prepare the State's budgetary basis financial statements in time to meet statutory requirements.

- 3. The State Comptroller should take whatever measures necessary to ensure that the financial statements for its Comprehensive Annual Financial Report are prepared in an efficient and timely manner.**

Comment:

The State Comptroller did not prepare the financial statements for the State's Comprehensive Annual Financial Report in time to meet significant legal and regulatory requirements.

- 4. The State Comptroller should reemphasize its role as the agency responsible for maintaining the accounts of the State, and apply adequate controls and direction to the task of Statewide financial accounting and reporting, which should include the revision of the *State Accounting Manual*.**

Comment:

We found that user agencies are not subject to the centralized control previously enforced by the State Comptroller over transactions entered onto State's accounting records.

- 5. The State Comptroller should seek continued improvements in financial reporting from the Core-CT system.**

Comment:

The Core-CT system has been unable to provide system users financial reports in formats and with information that was previously provided by the system it replaced, and with an ease of use that justifies the cost of the new system.

- 6. The State Comptroller, working with the Office of the State Treasurer, should provide a system to reconcile cash activity and post necessary cash adjustments in a timely manner that provides adequate internal control over ledger adjustments. It should also address the need to review and reconcile the Interagency Transfer Account.**

Comment:

Throughout the audited period the State Treasurer was unable to promptly reconcile cash activity from the general ledger to the bank statements.

- 7. The State Comptroller should correct deficiencies in the internal controls in the Core-CT system that governs the entry of interagency transfers.**

Comment:

The Core-CT system did not provide effective internal controls over the interagency grant transfers posted to the State's accounting records.

- 8. The State Comptroller should correct deficiencies in the internal controls in the Core-CT system over the entry of recording account codes.**

Comment:

The Core-CT system did not provide effective internal controls to ensure transactions are posted to the State's accounting records with the correct fund and account codes.

- 9. The State Comptroller should correct deficiencies in the internal controls of the Core-CT system to eliminate "budget check" problems, and the bypassing of the commitment control ledger.**

Comment:

Deficiencies in the Core-CT system design allowed users to enter transactions with erroneous account information and potentially defeat the budgetary internal controls.

- 10. The State Comptroller should correct its *Annual Report of the State Comptroller - Budgetary Basis* to conform to generally accepted accounting principles.**

Comment:

The *Annual Report of the State Comptroller - Budgetary Basis* for the fiscal year ended June 30, 2005, did not include all of the elements to be in compliance with accounting standards generally accepted within the United States of America.

CONCLUSION

In conclusion, we 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 State Comptroller's Office in making their records readily available and in explaining transactions as required greatly facilitated the conduct of this examination.

Matthew Rugens
Administrative Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts