

STATE OF CONNECTICUT

**AUDITORS' REPORT
CONNECTICUT DEVELOPMENT AUTHORITY
FOR THE FISCAL YEARS ENDED JUNE 30, 2002, and 2003**

**AUDITORS OF PUBLIC ACCOUNTS
KEVIN P. JOHNSTON ♦ ROBERT G. JAEKLE**

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July 20, 2005

**AUDITORS' REPORT
CONNECTICUT DEVELOPMENT AUTHORITY
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We have made an examination of the books, records and accounts of the Connecticut Development Authority (CDA), as provided in Section 2-90, as amended, and Section 32-11a of the General Statutes, for the fiscal years ended June 30, 2002 and 2003.

SCOPE OF AUDIT:

The CDA is a quasi-public agency as provided for by Chapter 12 of the General Statutes. In addition to receiving annual financial audits by independent public accounting firms, the Authority received compliance audits, as required by Section 1-122 of the General Statutes. After having reviewed the reports and work of the outside firm and having satisfied ourselves as to the firm's independence, professional reputation, and qualifications, we have relied on those financial and compliance audits, in addition to internal control documentation. Comments in the independent auditor's reports are presented under the heading "Independent Audits" in this report. Financial statements of the CDA are included in its annual reports for the fiscal years ended June 30, 2002 and 2003.

In accordance with Section 32-11a, subsection (l), of the General Statutes, the CDA has the authority to create subsidiaries to carry out the remediation, development, and financing of contaminated property within the State. As a result, the CDA established the Connecticut Redevelopment Authority, Inc. (CRA). The CRA was incorporated as a non-stock corporation on May 17, 1999, as a subsidiary of the Connecticut Development Authority. We will report on the activities of the CRA and other subsidiaries in the course of the audit of the CDA.

We have limited our examination to such procedures as reviewing selected internal controls, adherence to various compliance requirements, and resolution of prior audit recommendations. This report on our examination consists of the Comments and Recommendations which follow.

COMMENTS

FOREWORD:

The Connecticut Development Authority, hereinafter referred to as the CDA or the Authority, operates primarily under the provisions of Title 32, Chapter 579, Sections 32-11a through 32-23zz of the General Statutes. The CDA is a body politic and corporate, constituting a political instrumentality and political subdivision of the State. The Authority's mission is to maintain and create jobs within the State by stimulating industrial and commercial development, primarily through financial assistance to businesses. In addition, the Authority has been responsible for operations at the Hartford Civic Center since September 1993.

Board of Directors and Administrative Officials:

Members of the CDA Board of Directors as of June 30, 2003, were as follows:

Ex officio Members:

Denise L. Nappier	- State Treasurer
Marc S. Ryan	- Secretary, Office of Policy and Management
James F. Abromaitis	- Commissioner, Dept. of Economic and Community Development

Appointed Members:

Anthony J. Campanelli
L. Scott Frantz, Chairman
Richmond W. Glover
Dennis Hrabchak
Steve Maloney
Richard T. Mulready, Vice Chairman
Scott H. Smith

Arthur H. Diedrick served on the Board as the Chairman until February 10, 2003. On that date Governor John G. Rowland, in a letter to the General Assembly, withdrew the nomination of Mr. Diedrick to be Chairman and a member of the Connecticut Development Authority. L. Scott Frantz, was sworn in as Chairman on May 21, 2003.

The chief executive officer (Executive Director) of the Authority is appointed by the Board. Antonio Roberto served in that capacity throughout the audited period. Arthur H. Diedrick served as President of the CDA, a paid position, during the audited period. Mr. Diedrick left his position with the CDA, effective August 1, 2004. Ms. Marie O'Brien currently serves as the President of the Connecticut Development Authority.

Recent State Legislation:

During the audited period the General Assembly passed the following legislation which affected the CDA:

- Public Act 02-5 which amended Section 32-23ll, subsection (a), of the General Statutes decreased bonding authorization from one hundred twenty eight million dollars to ninety five million dollars, effective July 1, 2002.

- Public Act 04-106 amended Section 32-23d, subsection (ii) (1), of the General Statutes to include in the definition of “Remediation project” the productive reuse of real property, effective May 21, 2004.

Independent Audits:

As noted previously, the CDA has been subject to annual audits by independent public accountants (IPAs) covering its financial statements and the compliance matters described in Section 1-122 of the General Statutes.

In conjunction with the examination of the 2001-2002 and 2002-2003 financial records, the IPA’s prepared and issued a report on compliance with Governmental standards and State compliance requirements. These reports did not cite any material noncompliance.

Connecticut Redevelopment Authority:

As mentioned previously, the Connecticut Redevelopment Authority (CRA) is a quasi-public agency created by the Connecticut Development Authority in accordance with Section 32-11a, subsection (l), of the General Statutes. This subsidiary was created in May 1999 to carry out the remediation, development, and financing of contaminated property within the State. The CDA authorized \$1,500,000 in financial resources to the CRA in May 1999. The expenses associated with the entity during the audited period were administrative in nature and amounted to \$285,475 and \$165,360 for the fiscal years ended June 30, 2002 and June 30, 2003, respectively.

RÉSUMÉ OF OPERATIONS:

The Department of Economic and Community Development (DECD) provides the CDA with advance funding to operate certain programs. This advance funding is financed with the proceeds of State bonds. Additional financing is obtained through the collection of various fees. The CDA is also authorized to issue general obligation bonds for certain programs. Pursuant to Section 32-23j, subsection (a), of the General Statutes, those bonds "...shall not be deemed to constitute a debt or liability of the state..." These bonds, except for issues totaling \$30,560,000 associated with the purchase of the assets of the Hartford Whalers, are secured by special capital reserve funds. The CDA is required to maintain, in these funds, a minimum balance at least equal to the greatest principal and interest payments becoming due in the succeeding calendar year. If the CDA is unable to maintain a sufficient balance in the special capital reserve fund, the State's General Fund could be required to restore the special capital reserve fund to its minimum balance if the specific bond indenture calls for such State reimbursement. (No such State payment was required during the audited period.) As of June 30, 2002 and 2003, the CDA's bonds payable amounted to \$54,320,000 and \$48,625,000, respectively.

In addition, the CDA is authorized under its Self-Sustaining Bond Program to accommodate the financing for specific industrial and certain recreational and utility projects through the issuance of special obligation industrial revenue bonds. These bonds are payable solely from participating companies and are not otherwise a debt or liability of the CDA or the State. Accordingly, the balances and activity of the Self-Sustaining Bond Program are not included in the CDA's financial statements. Total bonds outstanding as of June 30, 2002 and 2003, were \$1,122,285,934 and \$1,058,062,340, respectively.

The CDA maintains the following funds to account for its operations and various programs:

General Operating Fund:

The CDA's operating expenses are recorded in its General Operating Fund and allocated net of Operating Fund revenue to its various programs. In addition, the Operating Fund is used to account for the CDA's operation of the Hartford Civic Center.

Based on the Authority's financial statements, receipts of the Operating Fund totaled \$20,680,999, \$20,601,145 and \$17,855,720 for the 2000-2001, 2001-2002 and 2002-2003 fiscal years, respectively. Operating expenses for the same periods amounted to \$23,977,295, \$23,928,117 and \$21,799,916. The Operating Fund's respective net income/(loss), exclusive of unrealized holding gains/losses, amounted to \$(3,296,296), \$(3,326,972) and \$(3,944,196) for the same periods. The Hartford Civic Center's operations account for 100 percent of the losses.

Exclusive of the costs of running the Civic Center and interest payments, payroll and related fringe benefits were the single largest line-item expenditure category. Payroll and related charges for the 2000-2001, 2001-2002 and 2002-2003 fiscal years were \$3,407,808, \$3,337,812 and \$3,593,110, respectively.

Umbrella Program Fund:

Under the Umbrella Program, the CDA is authorized to issue bonds to provide financial assistance for the acquisition of land, buildings, new machinery, equipment and pollution control facilities. Loans up to \$800,000, with up to a 20-year term, can be made for each approved project. Of this amount, up to \$500,000 can be used for machinery and equipment (term may not exceed ten years) and up to \$800,000 can be used for pollution control facilities (term may not exceed ten years.) Loans in this program are insured under the Insurance Program (discussed later.) During the 2001-2002 and 2002-2003 fiscal years, \$115,869 and \$379,848 in defaulted loans were absorbed by the Insurance Program Fund from the Umbrella Fund.

Insurance Program Fund:

Authorized by Section 32-14 of the General Statutes, the Authority may insure loans made by other lending institutions to companies for the acquisition of industrial land, buildings, machinery, and equipment located within the State. In addition, all of the Authority's Umbrella Program loans are insured under this program.

As of June 30, 2001, 2002 and 2003, loans totaling \$28,300,922, \$22,051,146, and \$16,334,599, respectively, were insured as follows:

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Loans by other lending institutions	\$ 6,895,000	\$ 6,721,250	\$ 6,545,000
Umbrella Program loans	21,405,922	15,329,896	9,789,599

Growth Fund:

In accordance with Section 32-23v of the General Statutes, the CDA is authorized to issue individual Growth Fund loans up to a maximum of \$4,000,000 with a maximum loan term of 20 years. The program provides financial assistance for any purpose the Authority determines will materially contribute to the economic base of the State by creating or retaining jobs, promoting exports, encouraging innovation or supporting existing activities. Financing may be used to purchase real property, machinery and equipment, or for working capital.

The Authority has established a maximum 90 percent loan-to-value ratio for real property loans and 80 percent loan-to-value ratio for machinery and equipment loans. Working capital loans are limited to a term of up to seven years.

A summary of the Growth Fund's lending activity for the last three years is as follows:

Fiscal Year Ended <u>June 30,</u>	Number of Entities <u>Receiving Assistance</u>	Assistance <u>Provided</u>
2001	43	\$11,332,856
2002	64	17,789,999
2003	78	7,444,416

Connecticut Works Fund:

The Connecticut Works Fund, also known as "Fund A", is established in accordance with Section 32-23ii of the General Statutes. The Fund is used for either direct loans or loan guarantees. Eligible projects include most manufacturing-related projects and any project that supports the economic base of the State through jobs, defense diversification, exporting and the development of innovative products or services.

The State has authorized the issuance of up to \$95,000,000 in State bonds allocated to Fund A. Of this amount, \$82,485,000 has been distributed to Fund A. In the event direct loans are uncollectible, the CDA can use any remaining bond funds to reimburse itself for such losses, subject to the total allocation limit.

A summary of Fund A's lending activity for the last three years is as follows:

Fiscal Year Ended <u>June 30,</u>	Number of Entities <u>Receiving Assistance</u>	Guarantee <u>Provided</u>
	<u>Loan Guarantees:</u>	
2001	1	\$292,500
2002	0	-0-
2003	0	-0-
	<u>Direct Loans:</u>	
2001	8	\$16,707,000
2002	17	12,447,060
2003	19	5,992,622

Connecticut Works Guarantee Fund:

The Connecticut Works Guarantee Fund, also known as "Fund B", is established in accordance with Section 32-261 of the General Statutes. The purpose of Fund B is to provide commitments to guarantee loans made by participating financial institutions. Projects financed by the program are intended to encourage growth and the retention of businesses unable to obtain suitable financing and to stimulate an increase in jobs and tax revenue throughout the State. Eligibility is determined by the due diligence principles set forth in the Connecticut Works Fund.

The State has authorized up to \$39,000,000 in State bonds allocated to Fund B. Of this amount, \$10,000,000 has been distributed. In the event a direct loan is uncollectible by the participating financial institution, the CDA can use any remaining bond funds to reimburse itself for such losses, up to the total allocation.

A summary of the Fund B's activity for the last three years is as follows:

Fiscal Year Ended <u>June 30,</u>	Number of Entities <u>Receiving Assistance</u>	Guarantee <u>Provided</u>
2001	1	\$ 123,750
2002	1	36,000
2003	0	-0-

Connecticut Capital Access Fund:

In accordance with Section 32-265 of the General Statutes, the Connecticut Capital Access Fund provides portfolio insurance to participating financial institutions to assist them in making loans that are somewhat riskier than conventional loans. These loans are of two types, referred to as Urbank Program loans and Entrepreneurial Program loans. Project eligibility is usually determined by the financial institution making the loan, subject to requirements specified in the participation agreements.

The State has authorized the issuance of up to \$5,000,000 in State bonds allocated to this Fund. Of this amount, \$2,000,000 has been distributed. In addition, any insurance losses associated with this Fund are reimbursable from those bonds up to the \$5,000,000 allocated.

A summary of the Fund's lending activity during the last three fiscal years is as follows:

Fiscal Year Ended <u>June 30,</u>	Number of Entities <u>Receiving Assistance</u>	Amount of Assistance <u>Provided</u>
2001	44	\$ 1,004,088
2002	32	935,608
2003	50	1,057,725

Business Environmental Clean-Up Revolving Loan Fund:

Established in accordance with Section 32-23z of the General Statutes, this Fund provides direct loans to assist businesses in the containment or removal of property contamination. To be eligible, the business must have been established at least one year in the State, have sales of less than \$3,000,000 or less than 150 employees, and be unable to obtain conventional financing. Loan amounts cannot exceed \$200,000.

No loans were made from this fund during the audit period and there is no additional funding available for this program.

Environmental Assistance Revolving Loan Fund:

Established under Section 32-23qq of the General Statutes, the CDA can use the Environmental Assistance Revolving Loan Fund to provide direct loans and guarantees to businesses to assist in financing pollution prevention activities or purchases and costs associated with the installation of stage II vapor recovery systems. To be eligible, an entity must have revenues of less than \$25,000,000, or fewer than 150 employees. There has been no loan or guarantee activity since August 1996.

Job Training Fund:

This Fund was established to account for the Connecticut Job Training Finance Program authorized by Section 32-23uu of the General Statutes. Assistance under this program is provided to manufacturing or economic base businesses seeking to provide educational upgrades to their production workers. Performance grants of up to \$25,000 are available, covering up to 25 percent of the amount borrowed by each business.

Funding for this program is provided by the bond issue authorized under Sections 32-23ll and 32-235 of the General Statutes.

Fiscal Year Ended <u>June 30,</u>	Number of Entities <u>Receiving Assistance</u>	Amount of Assistance <u>Provided</u>
2001	28	\$672,557
2002	28	622,155
2003	5	125,000

Summary of Revenues, Expenses and Net Income:

Based on the CDA's audited financial statements, the following is a summary of the revenues, expenses and income of the consolidated operations for the fiscal years ended June 30, 2001, 2002 and 2003:

Revenues:	<u>2001</u>	<u>2002</u>	<u>2003</u>
Civic Center revenues	\$14,648,671	\$ 15,797,293	\$14,013,684
Premiums earned	566,388	507,534	438,942
Interest on loans	8,877,159	8,118,245	7,108,247
Investment income	6,023,609	3,119,510	2,019,703
Other	<u>849,322</u>	<u>2,047,813</u>	<u>1,235,770</u>
Total Revenues	<u>30,965,149</u>	<u>29,590,395</u>	<u>24,816,346</u>
Expenses:			
Civic Center expenses	17,944,967	19,124,265	17,957,880
Interest	5,535,348	3,664,476	2,589,840
Payroll and fringe benefits	3,407,808	3,337,812	3,593,110
Other	<u>2,540,914</u>	<u>2,193,599</u>	<u>3,546,031</u>
Total Expenses	<u>29,429,037</u>	<u>28,320,152</u>	<u>27,686,861</u>
Net Income (Loss):	<u>\$ 1,536,112</u>	<u>\$ 1,270,243</u>	<u>(\$ 2,870,515)</u>

Summary of Loan Write-Offs and Guarantee Claims Paid:

Based on data in the CDA's internal financial reporting package, the following is a summary of the loan amounts written-off and guarantee payments made and the written-off loans recovered and written-off guarantees recovered for the fiscal years ended June 30, 2001, 2002 and 2003:

<u>Fiscal Year Ended June 30,</u>	<u>Direct Loans Written-off</u>	<u>Guarantees Paid</u>	<u>Loans Recovered</u>	<u>Guarantees Recovered</u>
2001	\$ 979,476	\$ 361,645	\$ 15,536	\$ 68,823
2002	4,849,241	1,021,148	113,179	61,066
2003	3,727,063	84,163	151,714	307,018

CONDITION OF RECORDS

Our limited examination of the records of the Connecticut Development Authority revealed certain areas requiring attention. These areas are detailed in this section of the report.

Board Vacancies:

- Criteria:* Section 32-11a, sub-section (c), of the General Statutes states that “The board of directors of the authority shall consist of the Commissioner of Economic and Community Development, the Treasurer of the State and the Secretary of the Office of Policy and Management, each serving ex officio, four members appointed by the Governor who shall be experienced in the field of financial lending or the development of commerce, trade and business and four members appointed as follows: One by the president pro tempore of the Senate, one by the minority leader of the Senate, one by the speaker of the House of Representatives and one by the minority leader of the House of Representatives.”
- Condition:* The Board of the Connecticut Development Authority had one vacancy throughout the audited period. Further, our review revealed that two vacancies remained at January 31, 2005. These vacancies represent legislative appointments.
- Effect:* A quorum is more difficult to attain when there are vacancies on the Board. A full Board gives the Connecticut Development Authority the optimum pool of knowledge and experience from which to make their decisions.
- Cause:* It may be difficult to find candidates for these positions due to the filing requirements.
- Recommendation:* The Connecticut Development Authority should endeavor to have the two vacancies on their Board filled as soon as possible to optimize the effectiveness of the board. (See Recommendation 1.)
- Authority Response:* “The Connecticut Development Authority agrees with this finding. The CDA will contact the appointing parties and notify them of the current vacancies on the CDA Board.”

Defaulted Loans:

- Criteria:* In accordance with Section 32-11a, subsection (e), part (6), the Board of Directors of the Authority shall adopt written procedures for awarding loans, grants and other financial assistance, including eligibility criteria and the application process.
- Condition:* We noted a marked increase in defaulted loans for the 2001-2002 and 2002-2003 fiscal years as compared with the prior audited period. Written-off loans totaled \$554,253, \$979,476, \$4,849,242 and \$3,727,063 for the fiscal years ended June 30, 2000, 2001, 2002 and 2003, respectively. In addition, we determined that five of the 20 loans written-off from July 1, 2001 to June 30, 2003 represented 100 percent write-offs of principal. These five defaulted loans totaled \$5,189,500 or approximately 60 percent of total funds defaulted in the two-year period ended June 30, 2003. Personal loan guarantees were not a requirement in loaning CDA funds.
- Effect:* The Connecticut Development Authority lost funds totaling \$8,576,305 over a two-year period.
- Cause:* It appears that procedures for awarding loans may be inadequate.
- Recommendation:* The Connecticut Development Authority should review their written loan award procedures and determine if additional controls such as personal loan guarantees would prove effective in decreasing the loan default rate. The Connecticut Development Authority loan award procedures should be revised to reflect the results of the review. (See Recommendation 2.)
- Authority Response:* “The Connecticut Development Authority disagrees with this finding. The CDA has procedures for awarding loans including but not limited to Board approval of all loans as well as associated terms and conditions. In regards to personal guarantees, the CDA does receive personal guarantees for all individuals who own over 10 percent of the company on substantially all financing transactions. However, in an effort to encourage investment in Connecticut, personal guarantees are not always practical, in particular when dealing with equity investors and in transactions that the CDA receives an equity upside potential. Overall, the CDA’s percentage of loan losses as compared to our entire portfolio has averaged just 2 percent over the last 10 years.

*Auditors’ Concluding
Comment:*

A review and revision of the Connecticut Development Authority written loan award procedures is necessary given that the Connecticut Development Authority lost funds totaling \$8,576,305 over a two year period.

Severance Policy:

- Criteria:* In accordance with Section 1-121 of the General Statutes, the Authority has established written policies for most payroll/personnel matters.
- Condition:* Our prior audits have noted inconsistent severance procedures. It was determined, through discussions with Authority management, that a formal severance policy with guidelines and procedures has not yet been established. There were no severance payments made during the fiscal years ended June 30, 2002 and 2003. Our review further determined that no severance payments were made through December 31, 2004.
- Effect:* The lack of a formal policy governing severance payments could lead to the appearance of favoritism, discrimination or other inconsistencies.
- Cause:* The Authority has preferred to have the Board of Directors approve severance payments on an individual basis.
- Recommendation:* The Authority should set policy and establish written procedures relative to the severance process. (See Recommendation 3.)
- Authority Response:* “The CDA agrees with this finding. The Human Resources Committee of the Board has been made aware of the situation and will establish a written procedure regarding a severance policy in the near future.”

Sales Tax Waiver Notification:

- Background:* Sales tax waivers are granted and monitored by Connecticut Development Authority (CDA). If the company defaults and doesn't meet the stipulated requirements per the sales tax waiver grant agreement, the amount waived must be refunded by the company and payment of this amount must be made to the Department of Revenue Services.
- Criteria:* Companies doing business in the State of Connecticut are subject to the State sales tax. Sales tax payments are monitored by the Department of Revenue Services. The Connecticut Development Authority may provide State sales tax relief on the purchase of tangible personal property for qualifying economic development projects to encourage and promote business. This relief is provided in the form of a State sales tax waiver.
- Condition:* The Connecticut Development Authority does not have a reporting mechanism that notifies the Department of Revenue Services, the

companies granted sales tax waivers by the CDA and the amounts of those waivers.

Effect: The Department of Revenue Services does not have accountability of the companies granted sales tax waivers. There is a lack of efficient reporting.

Cause: The CDA internal report of sales tax waivers granted has not been made into a report that is forwarded to the Department of Revenue Services.

Recommendation: A reporting mechanism should be designed to ensure that the Department of Revenue Services is notified of companies granted sales tax waivers by the Connecticut Development Authority. (See Recommendation 4.)

Authority Response: “The CDA agrees with this finding. The CDA will send to the Department of Revenue Services the complete activity report on the sales tax waivers granted by the CDA on an annual basis.”

RECOMMENDATIONS

Our prior audit contained five recommendations, four of which have been adequately resolved. The one remaining recommendation has been repeated.

Status of Prior Audit Recommendations:

- The Authority should design and implement an expenditure payment process that requires review of credit card bills including written confirmation of charges and collection and retention of documentation supporting all expenditures. This recommendation has been satisfied.
- The employee and rent costs associated with the operation of the Governor's Bridgeport and Norwich offices and charged to the CDA should be properly allocated and charged to the Office of the Governor. The CDA no longer supports the operation of the Governor's Bridgeport and Norwich offices. This recommendation is not being repeated.
- The Authority should establish written guidelines and procedures relative to the payment of severance benefits. This recommendation is being repeated. (See Recommendation 3.)
- The Authority should improve the collection procedures of key financial data including borrower and guarantor financial statements when processing loan applications. This recommendation is not being repeated.
- The Authority should develop, approve and implement a formal written disaster recovery plan that addresses prompt business resumption in the event of an interruption of business. This recommendation is not being repeated.

Current Audit Recommendations:

- 1. The Connecticut Development Authority should endeavor to have the two vacancies on their Board filled as soon as possible to optimize the effectiveness of the Board.**

Comment:

The Connecticut Development Authority has had two board vacancies for an extended period.

2. **The Connecticut Development Authority should review their written loan award procedures and determine if additional controls such as personal loan guarantees would prove effective in decreasing the loan default rate. The Connecticut Development Authority loan award procedures should be revised to reflect the results of the review.**

Comment:

We noted a marked increase in the dollar amount of defaulted loans and the corresponding loss to the Connecticut Development Authority.

3. **The Authority should set policy and establish written procedures relative to the severance process.**

Comment:

We noted the continuing lack of written procedures relating to severance.

4. **A reporting mechanism should be designed to ensure that the Department of Revenue Services is notified of companies granted sales tax waivers by the Connecticut Development Authority.**

Comment:

We noted that the Connecticut Development Authority does not have a reporting mechanism that notifies the Department of Revenue Services of the companies granted sales tax waivers by the CDA and the amounts of those waivers.

CONCLUSION

In conclusion, we wish to express our appreciation for the cooperation and courtesies extended to our representatives by the personnel of the Connecticut Development Authority during the course of our examination.

Josepha M. Brusznicki
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts