

STATE OF CONNECTICUT

**AUDITORS' REPORT
DEPARTMENT OF REVENUE SERVICES
DIVISION OF SPECIAL REVENUE
FOR THE FISCAL YEARS ENDED JUNE 30, 2001 AND 2002**

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

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September 24, 2003

**AUDITORS' REPORT
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We have made an examination of the financial records of the Department of Revenue Services, Division of Special Revenue, for the fiscal years ended June 30, 2001 and 2002. This report on that examination consists of the Comments, Condition of Records, Recommendations and Certification, which follow. Financial statements pertaining to the operations and activities of the Department of Revenue Services, Division of Special Revenue, are presented on a Statewide Single Audit basis to include all State Agencies. This examination has been limited to assessing the Division's compliance with certain provisions of laws and regulations, contracts and grants and evaluating the Division's internal control structure, policies, and procedures established to ensure such compliance.

COMMENTS

FOREWORD:

The Division of Special Revenue is responsible for the administration and regulation of legal gaming activities in the State under the provisions of Title 12, Chapters 226 and 226b, and Title 7, Chapter 98, Sections 7-169 through 7-186q, of the General Statutes. Throughout this report, we also refer to such activities as "gambling." The Division had administered the State lottery through the 1995-1996 fiscal year. Effective July 1, 1996, the Connecticut Lottery Corporation has administered the lottery as a quasi-public agency, as provided by Section 229a of the General Statutes.

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In accordance with Section 12-557c, subsection (b), of the General Statutes, the Division is under the direction and control of an Executive Director. George Wandrak served as Acting Executive Director until January 15, 1999, when he assumed the position of Chief Executive Officer and President of the Connecticut Lottery Corporation. Thomas Rotunda, Jr. was appointed Executive Director of the Division of Special Revenue on January 1, 1999 and served in that capacity until June 1, 2001. Susan G. Townsley, was appointed Executive Director of the Division of Special Revenue on July 6, 2001 and continues to serve in that capacity.

Gaming Policy Board:

In accordance with Sections 12-557e, 7-169, subsection (c), and 7-185 of the General Statutes, the Gaming Policy Board assists the Division of Special Revenue in overseeing legalized gambling within the State of Connecticut. Among its duties and powers, the Gaming Policy Board is responsible for advising the Governor on Statewide plans and goals for legal gambling and for assisting in the development and approval of regulations for gaming activities.

The Gaming Policy Board was comprised of the following members as of June 30, 2002:

Nelson C. L. Brown, Chairperson
Gilbert Lebovitz
William F. Farrell
Richard P. Antonetti,
William J. LaVelle

Legislative Changes:

Notable legislative changes that took effect during the audited period, are presented below:

- Public Act 00-229 – Section 6 amended Section 12-575 subsection (m), of the General Statutes, to increase the amount paid to municipalities that contain a dog race track from eight-tenths of one percent to one percent of the total money wagered on dog racing events at such dog track, effective July 1, 2000.
- Public Act 01-9 - Section 34 enacted by the *June 2001 Special Session* of the General Assembly amended Section 12-564 subsection (b) of the General Statutes, to extend from at least five years, to at least seven years, the requirement to conduct studies concerning the effect of legalized gambling on the citizens of the State of Connecticut. This Public Act became effective on July 1, 2001.
- Public Act 01-9 - Section 87 enacted by the *June 2001 Special Session* of the General Assembly amended Section 12-575 subsection (m) of the General Statutes, to include all the existing provisions of the statute, and to add that in the event a licensee incurs a loss from the operation of a pari-mutuel facility, as determined by the executive director, the legislative body of the city or town in which such facility is located may direct the executive director to credit or rebate all or a part of the revenue otherwise due to the municipality back to the facility. In no case shall such credit and such reimbursement exceed the amount of the licensee's loss, and in no fiscal year shall these provisions

affect the total fees paid to the State by the authorized operator of the off-track betting system on its off-track betting activities. This Public Act became effective on July 1, 2001.

- Public Act 01-45 amended Section 53-278g of the General Statutes to allow both the Mohegan and Mashantucket tribes to use and possess gaming equipment at any location in the State, solely for the purpose of training individuals in skills required for employment by the tribe or testing a gambling device, any gambling device which the tribes are authorized to utilize on their reservations pursuant to the Federal Indian Gaming Regulatory Act; provided no money or other thing of value shall be paid to any person as a result of the operation of such gambling device in the course of such training or testing at locations outside of the reservation of the tribe. The tribes shall give prior notice of such testing to the Division of Special Revenue. This Public Act became effective on October 1, 2001.

- Public Act 02-7 - Section 65 enacted by the *May 2002 Special Session* of the General Assembly effective August 15, 2002, provides that each licensee subject to the provisions of subsections (e) and (m) of Section 12-575 of the General Statutes shall receive a rebate of the amount paid by such licensee during such fiscal year according to the schedule of payments established by the executive director of the Division of Special Revenue. This Section was omitted from the 2003 revision of the General Statutes as special in nature, but remains in full force and effect according to its terms.

RÉSUMÉ OF OPERATIONS:

General Fund:

General Fund receipts totaled \$12,055,837 and \$12,064,842 during the fiscal years ended June 30, 2001 and 2002, respectively. A comparative summary of receipts for the audited years and the preceding year are presented below:

	1999-2000	2000-2001	2001-2002
Taxes on off track betting	\$ 5,616,495	\$ 5,674,281	\$ 5,736,901
Taxes on jai alai	324,365	294,562	137,764
Taxes on dog racing	245,907	208,670	204,914
Charitable games receipts	1,283,767	1,236,580	1,359,763
Recovery of regulatory costs	4,006,493	2,672,705	2,631,533
Registrations and licenses	69,940	67,600	61,240
Refunds of current year expenditures	1,526,365	1,438,997	1,604,100
All other receipts	555,189	462,442	328,627
Total	\$ 13,628,521	\$ 12,055,837	\$ 12,064,842

Revenues remained fairly consistent throughout the audited period. The major portion of revenue is received from taxes on off track betting. Charitable games receipts included payments for sealed tickets, fees to hold bingo games and payments for permits to hold other games of chance. Receipts from the recovery of regulatory costs resulted from assessments on the Mashantucket Pequot and Mohegan Tribes in accordance with provisions of Section 12-586f of the General Statutes. We noted that in the prior fiscal year ended June 30, 2000, the Division

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recovered regulatory costs totaling \$4,006,493, this was due to the settlement by mutual agreement of a dispute. The dispute was between the Mashantucket Pequot Tribe and the Division. More specifically, a disagreement over whether indirect costs of the Division should be recovered was at issue. The dispute was settled by mutual agreement on March 24, 2000. The Tribes then reimbursed regulatory costs totaling \$4,006,493 in the fiscal year ended June 30, 2000.

Section 17a-713, subsection (b), of the General Statutes provides that the Division collect fees assessed on jai alai and dog racing to provide funding for the Chronic Gamblers Treatment and Rehabilitation program administered by the Department of Mental Health and Addiction Services (DMHAS.) The Division collected and deposited to a DMHAS General Fund restricted account, fees totaling \$234,832 and \$208,011, during the 2000-2001 and 2001-2002 fiscal years, respectively.

Expenditures from budgeted appropriations of the Division and the Gaming Policy Board totaled \$8,588,706 and \$8,503,791, during the fiscal years ended June 30, 2001 and 2002, respectively. Comparative summaries of these General Fund expenditures for the fiscal years under review and the preceding fiscal year are presented below.

	<u>1999-2000</u>	<u>2000-2001</u>	<u>2001-2002</u>
Personal services	6,624,750	6,986,841	6,708,562
Contractual services	1,355,833	1,405,505	1,619,756
Commodities	132,444	163,184	171,292
Sundry charges	0	0	0
Equipment	55,717	30,756	1,000
Gaming Policy Board	2,847	2,420	3,181
Total Budgeted Appropriations	<u>8,171,591</u>	<u>8,588,706</u>	<u>8,503,791</u>
Indian Gaming Regulation			
Mashantucket – Pequot	2,673,268	1,508,619	1,618,868
Mohegans	1,044,410	1,164,140	1,193,871
Total Restricted Accounts	<u>3,717,678</u>	<u>2,672,759</u>	<u>2,812,739</u>
Total Expenditures	<u>\$11,889,269</u>	<u>\$11,261,465</u>	<u>\$11,316,530</u>

As presented by the analysis above, total expenditures remained fairly consistent during the fiscal years ended June 30, 2001 and 2002. Personal services expenditures represent the largest category of expenditures from budgeted appropriations. The following summary presents the average number of filled positions during the audited period.

	<u>1999-2000</u>	<u>2000-2001</u>	<u>2001-2002</u>
Full-time positions	174	175	171
Part-time positions	8	8	9
Temporary positions	3	2	4
Durational positions	2	3	0
Total	<u>187</u>	<u>188</u>	<u>184</u>

Expenditures from budgeted appropriations also included payments charged to the Gaming Policy Board appropriation for travel expenses and per diem amounts to members, in accordance with the provisions of Section 12-557d, subsection (a), of the General Statutes.

Expenditures for equipment in the amount of \$87,557 and \$307,079 were charged to the Capital Equipment Purchase Fund during the 2000-2001 and 2001-2002 fiscal years, respectively.

Funds Awaiting Distribution (7013):

During the audited period, the Division held certain monies received in an Agency suspense fund until the final disposition was determined.

Deposits to the account totaled \$79,191 and \$66,410, during the fiscal years ended June 30, 2001 and 2002, respectively. Such receipts were comprised of charitable games license and permit fees pending application decisions and bingo fees to be distributed to towns in accordance with Section 7-169, subsection (j), of the General Statutes.

Disbursements from the account totaled \$77,715 and \$66,775, during the fiscal years ended June 30, 2001 and 2002, respectively. Such disbursements included payments to towns as noted above and transfers of charitable games revenues to the General Fund, or the return of such to applicants.

Betting Taxes Fund (7016):

This agency fund was used throughout the audited period to account for the deposit of taxes and other moneys paid by pari-mutuel licensees. Certain distributions were made prior to the transfers of remaining balances to the General Fund.

Betting Taxes Fund activity during the audited fiscal years and the preceding fiscal year, is summarized below.

	<u>1999-2000</u>	<u>2000-2001</u>	<u>2001-2002</u>
Receipts:			
Taxes on wagering	\$ 11,137,922	\$ 11,082,044	\$ 10,817,077
Total	<u>\$ 11,137,922</u>	<u>\$ 11,082,044</u>	<u>\$ 10,817,077</u>
Disbursements:			
Transfers to General Fund	6,186,767	\$ 6,177,513	\$ 6,079,579
Payments to towns	4,922,024	4,929,366	4,767,801
Other	<u>38,920</u>	<u>7,879</u>	<u></u>
Total	<u>\$ 11,147,711</u>	<u>\$ 11,114,758</u>	<u>\$ 10,847,380</u>

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Betting Taxes Fund receipts decreased during the audited period and included taxes levied upon moneys wagered in pari-mutuel pools at the licensed jai alai, dog track and off-track betting facilities operating in the State. A tax equal to half the breakage to the dime resulting from such wagering at these facilities, in accordance with Section 12-575 of the General Statutes is also deposited to this Fund. Breakage to the dime is the odd cents left over from each payoff after it is rounded down to the next lowest dime.

Disbursements from the Betting Taxes Fund also decreased during the audited period and included payments to towns for amounts wagered pursuant to the requirements of Section 12-575, subsection (m) of the General Statutes. Disbursements presented as "Other" in the above summary represented payments to the Northeast Connecticut Economic Alliance, Inc., from amounts wagered on dog racing events in accordance with this same subsection. Beginning in July 2001 payments to Northeast Connecticut Economic Alliance, were made directly by the municipalities. Section 12-573 of the General Statutes requires the Executive Director of the Division to transfer excess funds in the Betting Taxes Fund, these transfers are represented by transfers to the General Fund.

CONDITION OF RECORDS

Our review of the financial records of the Division of Special Revenue disclosed matters of concern requiring disclosure and Agency attention.

Late Filing of Travel Documentation:

- Criteria:* Petty cash requirements as set forth in the State Accounting Manual call for the reporting and settlement of employee travel advances by means of the submission of form CO-17XP with the required supporting documentation. The employee is required to file the form within five working days of the return from the trip.
- Condition:* Our review of employee travel advances revealed that for four of the five advances examined, CO-17XP employee vouchers were not submitted in a timely manner, within the required five working days. The employee vouchers were filed between one and 19 working days late. In one of the cases, \$9 in unused advance money was returned late with the documentation.
- Effect:* Delays such as those presented above, prevent replenishment of the petty cash fund in a timely manner, jeopardize the availability of a travel advance balance adequate for Division needs, and prevent the timely return of unspent funds.
- Cause:* The Division apparently does not have adequate procedures in place to monitor petty cash travel advances.
- Recommendation:* The Division should implement procedures to effectively monitor travel advances and ensure compliance with the State Comptroller's petty cash employee travel advance requirements. (See Recommendation 1.)
- Agency Response:* "We agree with the finding as the instances of lateness occurred prior to May 2, 2002 when we instituted a procedure to minimize this from happening in the future."

Failure to Fully Implement Disaster Recovery Plan:

- Background:* The Division of Special Revenue (DOSR) is responsible for overseeing legalized gambling within the State of Connecticut. Receipts associated with this regulatory function generally total in excess of \$12,000,000 per year.
- Criteria:* A disaster recovery plan that addresses resumption of Division of Special Revenue (DOSR) business operations in the event of an emergency is a necessary planning element in the efficient operation of State of Connecticut government.

Condition: We determined that at the time of our field examination, December 2002, back-up information was not being sent to any off site location.

The previous DOSR disaster recovery plan for the period through August 12, 2002, states that “back-up tape is kept at Connecticut Lottery Corporation (CLC). The DOSR has a reciprocal back-up tape retention arrangement with CLC.” Our review revealed that the Division does not send the back-up tape of information from their servers to the Connecticut Lottery Corporation.

The new disaster recovery plan, dated August 12, 2002, which had not been completely implemented at the time of our examination, states that “the primary back-up site for Headquarters is the DOSR Warehouse and the primary back-up site for the DOSR Warehouse is Headquarters.” Our review revealed that the Division of Special Revenue does not follow the disaster preparations detailed in the DOSR August 2002 disaster recovery plan. Back-up information is not sent from Headquarters to the DOSR Warehouse.

Effect: If an emergency situation should arise, information that should have been stored at the alternate site would not be available, making it difficult to resume the business operations of DOSR.

Cause: This condition may exist due to management oversight and delays connected with implementing the electronic transmission of information to the DOSR Warehouse.

Recommendation: The Division of Special Revenue should fully implement its disaster recovery plan by storing information offsite to ensure timely successful retrieval of back up information in the event of an emergency. (See Recommendation 2.)

Agency Response: “We agree with this finding. The Division’s Network Administration Section has since drafted detailed procedures that are adjuncts to the Division’s disaster recovery plan. The new procedures include specific responsibilities for the rotation of the tapes that contain the back-up information. The Division has implemented these procedures and is storing the back-up tapes at the DOSR Warehouse.”

Failure to File Annual GAAP Form 2 – Accounts Receivable:

Criteria: The State Comptroller annually distributes fiscal year end instructions pertaining to Generally Accepted Accounting Principals (GAAP) to all State agencies. These instructions detail the GAAP forms required to be filed at year-end and specifics

regarding the forms. The GAAP information reported by the agencies enables the Comptroller to issue a Comprehensive Annual Financial Report (CAFR). The timely completion of the GAAP forms by the agencies is essential to allow for the analysis and recording of data and subsequent audit, certification and publication of the CAFR by December 31. The GAAP instructions require reporting of accounts receivable balances over \$100,000.

Condition: The Division did not file the GAAP Form 2 - Accounts Receivable for the fiscal year ended June 30, 2002. The accounts receivable amount due to the Division at June 30, 2002 was \$108,713.

Effect: Prior to audit adjustments the Comprehensive Annual Financial Report for the State did not reflect the correct balance of DOSR's accounts receivable.

Cause: The cause was not determined.

Recommendation: The Division should review State Comptroller fiscal year end instructions and file all required GAAP forms in a timely manner. (See Recommendation 3.)

Agency Response: "We agree with this finding and have since had the Division's Pari-Mutuel Accounting Section add to its year-end procedures a check to ascertain whether the pari-mutuel tax due but not yet paid in the previous fiscal year is \$100,000 or more. The procedure further provides that if the amount of the outstanding tax is \$100,000 or more, then the Pari-Mutuel Accounting Section will file a GAAP Form 2 with the Comptroller."

Purchasing/Expenditures:

Criteria: The State Accounting Manual mandates accounting and preparatory requirements that must be met by State agencies. The Manual requires that payments to vendors be made from an original vendor invoice. The invoice should be properly authorized and the receipt of goods verified. In addition, the Manual also details how commitment documents for leases should be completed, specifically, that the lease indicator is a required element.

Condition: Our testing revealed the following errors concerning the completion of purchase orders and the processing of transfer invoices and payments.

A payment was processed from a delivery ticket instead of an original vendor invoice. The payment resulted in a duplicate payment of \$35 to the vendor.

Three purchase orders totaling \$55,467 for the long-term lease of equipment did not have the “lease type” entered in the appropriate space.

A transfer invoice for services valued at \$1,224 lacked the required supervisor’s signature authorizing payment.

Two invoices were not processed in a timely manner. One resulted in the State being charged for, and paying late fees totaling five dollars. The other resulted in the payment for goods to be made late. The goods totaling \$684 were received in April of one fiscal year and paid for in July of the following fiscal year.

Effect:

The processing of a payment from a delivery document in place of an original vendor invoice resulted in a duplicate payment to the vendor.

The completion of the lease indicator is crucial for the generation of accurate reports that are integral to annual financial reports.

The lack of a supervisor’s signature indicates lack of managerial oversight to ensure the accuracy of and proper processing of payments.

Not processing invoices in a timely manner can result in the State incurring and paying late fees, which are an unnecessary expenditure of State funds.

The payment for goods and services received in one fiscal year and paid for in the following fiscal year result in the expenditures being misstated in both years.

Cause:

The duplicate payment was the result of a payment being made from a delivery ticket instead of from a properly authorized original vendor invoice.

We were not able to determine why the lease indicator was not entered.

We were unable to determine why the transfer invoice lacked a supervisor’s signature.

The late fees were paid due to late payment.

Computer items were delivered directly to the Information Technology (IT) unit. A completed receiving report was not sent

to the accounts payable department. This resulted in delays processing the payment.

Recommendation: The Division should improve controls over the procurement/payment process to ensure that commitments and expenditures are processed in accordance with established requirements. (See Recommendation 4.)

Agency Response: “We agree with this finding and have adopted preventative procedures and have requested employees to be more diligent in matters regarding the audit recommendations.”

RECOMMENDATIONS

Our prior report on the fiscal years ended June 30, 1999 and 2000, contained a total of four recommendations. Of those recommendations, three have been implemented or otherwise resolved. One recommendation is being repeated. The status of recommendations contained in this prior report is presented below.

Status of Prior Audit Recommendations:

- The Division should implement procedures to monitor and ensure compliance with the State Comptroller's petty cash employee travel advance requirements. This recommendation is being repeated. (See Recommendation 1.)
- The Division should improve controls over the time and attendance system. This recommendation has been satisfied.
- The Division should better monitor and enforce the formal policy concerning the scheduling of staff to control overtime costs. This recommendation has been satisfied.
- The Division should take the steps necessary to ensure compliance with the State Comptroller's pending receipts annual reporting requirements. This recommendation has been satisfied.

Current Audit Recommendations:

1. **The Division should implement procedures to effectively monitor travel advances and ensure compliance with the State Comptroller's petty cash employee travel advance requirements.**

Comment:

Our current review disclosed that employee vouchers were not being submitted within the required five working days.

2. **The Division of Special Revenue should fully implement its disaster recovery plan by storing information offsite to ensure timely successful retrieval of back up information in the event of an emergency.**

Comment:

At the time of our review, the Division was not sending back-up tapes of information from its computer server to the offsite storage area as required in its disaster recovery plan.

- 3. The Division should review State Comptroller fiscal year end instructions and file all required GAAP forms in a timely manner.**

Comment:

We found that the Division failed to file GAAP Form 2-Accounts Receivable for the fiscal year ended June 30, 2002.

- 4. The Division should improve controls over the procurement/payment process to ensure that commitments and expenditures are processed in accordance with established requirements.**

Comment:

We determined that several errors occurred concerning the completion of purchase orders and the processing of transfer invoices and payments by the Division.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes we have audited the books and accounts of the Department of Revenue Services, Division of Special Revenue, for the fiscal years ended June 30, 2001 and 2002. This audit was primarily limited to performing tests of the Agency's compliance with certain provisions of laws, regulations, contracts and grants, and to understanding, and evaluating the effectiveness of the Agency's internal control structure policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grants applicable to the Agency are complied with, (2) the financial transactions of the Agency are properly recorded, processed, summarized and reported on consistent with management's authorization, and (3) the assets of the Agency are safeguarded against loss or unauthorized use. The financial statement audits of the Department of Revenue Services, Division of Special Revenue for the fiscal years ended June 30, 2001 and 2002, are included as a part of our Statewide Single Audits of the State of Connecticut for those fiscal years.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial-related audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Division of Special Revenue complied in all material or significant respects with the provisions of certain laws, regulations, contracts and grants and to obtain a sufficient understanding of the internal control to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

Compliance:

Compliance with the requirements of laws, regulations, contracts and grants applicable to the Division of Special Revenue is the responsibility of the Division of Special Revenue's management.

As part of obtaining reasonable assurance about whether the Agency complied with laws, regulations, contracts and grants, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Agency's financial operations for the fiscal years ended June 30, 2001 and 2002, we performed tests of its compliance with certain provisions of the laws, regulations, contracts and grants. However, providing an opinion on compliance with these provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial or less than significant instances of noncompliance, which are described in the accompanying "Condition of Records" and "Recommendations" sections of this report.

Internal Control over Financial Operations, Safeguarding of Assets and Compliance:

The management of the Division of Special Revenue is responsible for establishing and maintaining effective internal control over its financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations, contracts and grants applicable to the Agency. In planning and performing our audit, we considered the Agency's internal control over its financial operations, safeguarding of assets, and compliance with requirements that could have a material or significant effect on the Agency's financial operations in order to determine our auditing procedures for the purpose of evaluating the Division of Special Revenue's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objectives.

Our consideration of the internal control over the Agency's financial operations and over compliance would not necessarily disclose all matters in the internal control that might be material or significant weaknesses. A material or significant weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with certain provisions of laws, regulations, contracts, and grants or failure to safeguard assets that would be material in relation to the Agency's financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions to the Agency being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control that we consider to be material or significant weaknesses.

However, we noted certain matters involving the internal control over the Agency's financial operations, safeguarding of assets, and/or compliance, which are described in the accompanying "Condition of Records" and "Recommendations" sections of this report.

This report is intended for the Governor, the State Comptroller, the Appropriations Committee of the General Assembly and the Legislative Committee on Program Review and Investigations. However, this report is a matter of public record and its distribution is not limited.

CONCLUSION

We wish to express our appreciation for the cooperation and courtesies extended to our representatives by the officials and staff of the Division of Special Revenue during the examination.

Josepha M. Brusznicki
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts

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