STATE OF CONNECTICUT

AUDITORS' REPORT
STATE COMPTROLLER - STATE FINANCIAL OPERATIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

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

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April 26, 2006

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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, 2004. 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, 2004. 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 2004 Annual Report."

COMMENTS

FOREWORD:

The financial position as of June 30, 2004, and the 2003-2004 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 2004 Annual Report. The financial position of the General Fund at June 30, 2004, 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 2004 Annual Report. Corresponding statements for the Special Transportation Fund are shown in Schedules C-2 and C-3, respectively, of the Comptroller's 2004 Annual Report. A summary of State bonds and notes outstanding as of June 30, 2004, the changes thereto, and the authorizations for future borrowings are shown in Schedules E-3, E-4, and E-5 of the Comptroller's 2004 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 the General and Special Transportation 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 General Fund and Special Transportation 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 2003-2004 fiscal year under a biennial budget adopted by the 2003 General Assembly, including the financial accounting for the budget plans of the General Fund and Special Transportation Fund, as it applies to the 2003-2004 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 order to comply with GAAP, the Comptroller has instituted a separate reporting function which enables her Office to issue a separate *Comprehensive Annual Financial Report* (CAFR) showing the State of Connecticut's financial position and results of operations in accordance with generally accepted accounting principles. Such a report, however, is 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.

As a result, the State's *Comprehensive Annual Financial Report* will probably gain widespread use and acceptance only if the legislative budget plan is prepared and enacted in accordance with GAAP and necessary changes made to State fiscal statutes. 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. This plan was submitted to the Appropriations Committee of the General Assembly on February 1, 1994. Implementation plans were adjusted accordingly, however, when the General Assembly, through the passage of Public Act 95-178, Public Act 97-305, Public Act 99-1 (June Special Session) and Public Act 03-1 (June Special Session), successively postponed the State's conversion to GAAP budgeting from the fiscal year commencing July 1, 1995, to the fiscal year commencing July 1, 2005. This conversion has been postponed further by the passage of Public Act 05-251 in the 2005 session of the General Assembly. Section 92 of this Act establishes the implementation date for the preparation of the State’s financial statements in accordance with GAAP to be July 1, 2007, with the amortization of accrued and unpaid expenses and liabilities and other adjustments to 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 2003-2004 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, 2004, 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 2004 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 Acts 03-3 and 03-6 in the June Special Session of the 2003 General Assembly in order to implement the adopted budget and make other adjustments, and by the passage of Public Act 04-216 by the 2004 General Assembly in order to 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 2003-2004 fiscal year as reported by the Comptroller may be expressed as follows:

Estimated Revenues, 2003-2004, as Revised by the Committee on Finance, Revenue and Bonding		$12,452,100,000
Budgeted Appropriations, 2003-2004, As revised	$12,712,266,000	
Estimated lapsing appropriations	(260,311,000)	
Net Appropriations		12,451,955,000
Anticipated Surplus (Deficit), June 30, 2004		**$ 145,000**

The actual results of the operations of the 2003-2004 fiscal year are presented in Schedule B-1 of the Comptroller's 2004 Annual Report. An analysis of budgeted General Fund accounts follows:

Actual Budgeted Revenues, 2003-2004	$13,123,775,070

Appropriations, 2003-2004	$13,050,275,756	
Add/(Deduct)		
Appropriations lapsed	(290,494,631)	
Net Appropriations		12,759,781,125
Balance		363,993,945
Prior Year Budgeted Appropriations Continued to 2003-2004 Fiscal Year		86,646,558
Reserve for Fiscal Year 2004-2005		(150,300,000)
Reserve for Statutory Transfer to Budget Reserve Fund		(302,155,301)
Miscellaneous adjustments		1,814,798
Unappropriated Surplus, June 30, 2004, per Schedule B-1		**$ 0**

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

1. *Actual revenues were some $671,675,000 greater than originally estimated. Those revenue categories that showed the greatest changes were personal income taxes, $467,530,000, sales and use taxes, $41,787,000, real estate conveyance taxes, $46,343,000, and rents, fines and escheats $40,419,000. In addition, there was a change of some $93,200,000 in the budgeted and realized refunds of taxes. Other revenue categories showing increases were inheritance and estate taxes, public service corporation taxes, and oil company taxes; as well as Federal grants. These increases were partly offset by certain revenue categories that had receipts less than originally estimated, such as taxes on corporations, $89,490,000, insurance companies, $14,488,000, and cigarettes and tobacco $21,228,000; as well as in other revenues such as investment income, $10,721,000, and Indian gaming payments, $7,266,000.*

2. *Appropriations showed an increase of approximately $338,009,000 from the budget plan reported by the Comptroller. The net increase was primarily from additions resulting from the passage of Public Acts 03-3 and 03-6 (June Special Session), and Public Act 04-216. Significant increases in appropriations totaled $95,533,000, $25,546,000, $26,669,000, and $20,266,980, for the Department of Social Services, the Department of Higher Education, the Department of Children and Families and the Commission on Arts, Tourism, Culture, History and Film, respectively. In addition, there were increases in appropriations of $28,981,000 for salary adjustments and $38,500,000 for retired State employees' health costs.*

3. *Lapsed appropriations were some $30,180,000 greater than estimated. 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, 2004, is presented in Schedule B-1 of the Comptroller's 2004 Annual

Report. It should be noted that Section 4-30a of the General Statutes, as revised by Section 56 of Public Act 03-2, 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 $302,155,301 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 $906,657,000 in revenues, which would, under a cash basis system of accounting, be recorded in the 2004-2005 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 $1,428,700,000 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 $528,100,000 under GAAP.

Total budgeted revenues in the General Fund for the 2003-2004 fiscal year amounted to $13,123,775,070, as shown in Schedule B-1 of the Comptroller's 2004 Annual Report. This represented an increase of some $1,100,450,048 over the budgeted revenue total reported by the Comptroller for the preceding 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	$ 680,360,000
Sales and use	108,144,000
Corporations	10,034,000
Inheritance and estate	(36,707,000)
Insurance companies	(5,946,000)
Public service corporations	(4,316,000)
Cigarettes and Tobacco	23,519,000
Real estate conveyance	27,425,000
Oil companies	(10,557,000)
All others (net)	2,613,000
Refunds of Taxes - decrease	158,179,000
Total Increase (Decrease) in Taxes	952,748,000
Other Revenues and Sources:	
Transfers - Special Revenue	23,923,000
Indian gaming payments	15,478,000

Licenses, permits and fees	29,414,000
Sales of Commodities and Services	8,121,000
Rents, Fines and Escheats	36,229,000
Investment income	(5,304,000)
Miscellaneous	(71,250,000)
Federal grants	245,685,000
Statutory transfers to/from other funds - net	(134,594,000)
Total Increase (Decrease) in Other Revenues and Sources	147,702,000
Total Increases (Decreases)	**$1,100,450,000**

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, as well as increased Federal aid and an improvement in general economic conditions.

General Fund Expenditures:

Total budgeted expenditures of the General Fund for the 2003-2004 fiscal year amounted to $12,546,919,068, as shown in Schedule B-1 of the Comptroller's 2004 Annual Report. This latter amount represented an increase of some $336,586,068 over the total budgeted expenditures reported by the Comptroller for the preceding 2002-2003 fiscal year. General Fund expenditures classified by current expenses, fixed charges and capital outlay are detailed on Schedule I of the Comptroller's 2004 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	$ (56,498,000)
Other Current Expenses:	
Commission on Arts, Tourism, Culture and Film - primarily grants	17,046,000
State Employees' Retirement Contributions	36,135,000
State Employees' Health Service Costs	29,307,000
Retired State Employees' Health Service Costs	78,085,000
All Other - primarily contractual services and commodities	(17,916,000)
Fixed Charges:	
Debt Service	63,312,000
UConn 2000 Debt Service	73,368,000
State Aid Grants:	
Policy and Management - tax relief for veterans, manufacturing machinery and economic development	17,771,000
Education - charter schools, magnet schools, equalization grants and priority school districts	23,511,000
Mental Retardation - primarily residential and day services	12,716,000
Social Services - Medicaid, independent living assistance, pharmaceutical assistance to the elderly, child care assistance and other public assistance programs	70,564,000

Children and Families - board and care of children	30,870,000
All Other	(37,991,000)
Capital Outlay	(3,694,000)
Total Net Increase	**$336,586,000**

Increased costs for 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, 2004, 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 2004 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 2004 Annual Report. It should be noted that cash and investments totaling $637,237,598, which are being held by the Trustee, are reported on Exhibit A of the Comptroller's 2004 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, and passage of Public Acts 04-149 and 04-182 by the 2004 General Assembly in order to provide funding for projects of the Transportation Strategy Board.

Public Act 03-1 (June Special Session) also established the Transportation Strategy Board projects account, a nonlapsing account within the Special Transportation Fund. The purpose of the account is to provide funding for the projects and purposes of the Transportation Strategy Board. The account is funded by increases in license, registration and other motor vehicle fees, and transfers from the resources of the Special Transportation Fund.

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 2003-2004 fiscal year as reported by the Comptroller may be expressed as follows:

Estimated Revenues, 2003-2004, as Revised by the Committee on Finance, Revenue and Bonding		$901,500,000
Budgeted Appropriations, 2003-2004, as revised	$939,495,000	
Estimated lapsing appropriations	(22,064,000)	
Net Appropriations		917,431,000
Anticipated Operating Surplus, 2003-2004		(15,931,000)
Add - Anticipated Surplus at June 30, 2003		19,866,000
Anticipated Surplus, June 30, 2004		**$ 3,935,000**

The actual results of the operations of the 2003-2004 fiscal year are presented in Schedule C-3 of the Comptroller's 2004 Annual Report. An analysis of the Special Transportation Fund surplus follows:

Actual Budgeted Revenues, 2003-2004		$903,918,133
Appropriations, 2003-2004	$939,495,302	
Add/(Deduct)		
Appropriations lapsed	(12,021,781)	
Net Appropriations		927,473,521
Balance		(23,555,388)
Unappropriated Surplus, June 30, 2003		132,948,201
Prior Year Budgeted Appropriations Continued to 2003-2004 Fiscal Year		19,866,409
Miscellaneous adjustments		12,606
Unappropriated Surplus, June 30, 2004, per Schedule C-3		**$129,271,828**

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

1. *Actual revenues were some $2,418,000 greater than anticipated. This was primarily the result of an increase of $20,800,000 in motor vehicle receipts and in licenses, permits and fees. This was partly offset by a $12,850,000 increase in the transfer of Special Transportation Fund receipts to the Transportation Strategy Board as required by Public Act 04-182. There were also declines of $2,475,000 and $3,300,000 in interest income and Federal grants, respectively.*

2. *Lapsed appropriations were some $10,000,000 less than estimated. The shortfall was the result of projected reductions and economies that were not realized.*

Special Transportation Fund Revenues:

Total budgeted revenues in the 2003-2004 fiscal year for the Special Transportation Fund amounted to $903,918,133, as shown in Schedule C-3 of the Comptroller's 2004 Annual Report. This represented an increase of some $76,813,449 over the budgeted revenue total reported by the Comptroller for the preceding 2002-2003 fiscal year. Budgeted revenue categories which showed the greatest change during the fiscal year under audit were as follows:

	Nearest Thousand Dollars
Taxes:	
Motor fuels tax	$ 6,481,000
Oil company tax	10,500,000
Sales tax collected by Department of Motor Vehicles	4,889,000
Refunds of taxes - increase	(1,577,000)
Other Revenues:	
Motor vehicle receipts	14,335,000
Licenses, permits and fees	18,476,000
Interest income	(2,874,000)
Federal Grants	(3,305,000)
Release from Debt Service	1,095,000
Transfers to Other Funds - decrease	29,150,000
Refunds of payments - increase	(357,000)
Total Net Increase (Decrease)	**$ 76,813,000**

The above increase was primarily attributable to an increase in the collection of sales taxes, licenses, permits and fees for motor vehicles, and a reduction in the amount of receipts transferred to the General Fund. This increase was partially offset by the reduced level of interest income and in Federal grants received.

Special Transportation Fund Expenditures:

Total budgeted expenditures of the Special Transportation Fund for the 2003-2004 fiscal year amounted to $893,307,299, as shown in Schedule C-3 of the Comptroller's 2004 Annual Report. This represented an increase of some $1,127,677 from the total budgeted expenditures reported by the Comptroller for the preceding 2002-2003 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 Treasurer:	
Debt service	$ 9,616,000
State Comptroller:	
State employee retirement contributions and health services costs - employer share	7,771,000
Department of Motor Vehicles:	
Personal services	(2,643,000)
Reflective license plates	(1,486,000)
Department of Transportation:	
Personal services	(7,889,000)
Other expenses	1,426,000
Highway and bridge renewal equipment	(1,157,000)
Transit equipment	(5,253,000)
Handicapped Access Program	1,586,000
Rail and Bus operations	1,549,000
Town Aid Road Grants	(3,486,000)
Highway and bridge renewal	3,418,000
All other (net)	(2,324,000)
Total Net Increase (Decrease)	**$ 1,128,000**

The above increase in expenditures was primarily attributable to increases in debt service costs and employee retirement and fringe benefit costs. These increases were offset by reductions in personal services costs and equipment purchases.

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, 2004, 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 2004 Annual Report. At June 30, 2004, 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 (12003)
- Insurance Fund (12004)
- 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:

As part of the implementation of its new accounting system, the State Controller has made changes that established separate accounts for certain restricted revenues. During the 2003-2004 fiscal year the State Comptroller established the Grants and Restricted Accounts Fund (12060), to account for certain Federal and other revenues associated with activities of the General Fund. Section 81 of Public Act 04-2 (May Special Session) authorized the establishment of this Fund.

Receipts and transfers amounting to $1,459,287,153 for the 2003-2004 fiscal year were credited to the Fund, as shown on Schedule C-1 of the Comptroller's 2004 Annual Report. This represented an increase of some $204,577,672 over the total Restricted Federal and Other Revenue reported by the Comptroller in the General Fund for the preceding 2002-2003 fiscal year (per Schedule B-2 of that year's report). These represented Federal and other grant receipts, restricted and not available for general use, that were formerly accounted for in restricted accounts within the General Fund. 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 2003-2004 fiscal year amounted to $1,235,157,682, as shown in Schedule C-1 of the Comptroller's 2004 Annual Report.

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. Section 80 of Public Act 04-2 (May Special Session) authorized the establishment of this Fund.

Receipts and transfers amounting to $101,865,645 for the 2003-2004 fiscal year were credited to the Transportation Grants and Restricted Accounts Fund, as shown on Schedule C-1 of the Comptroller's 2004 Annual Report. This represented an increase of some $8,106,417 over the total Restricted Federal and Other Grant Revenue reported in the Transportation Fund by the Comptroller for the preceding 2002-2003 fiscal year. Disbursements of Federal and other grants from the Transportation Grants and Restricted Accounts Fund for the 2003-2004 fiscal year amounted to $76,020,504, as shown in Schedule C-1 of the Comptroller's 2004 Annual Report.

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, 2004, 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 2004 Annual Report. At June 30, 2004, 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, 2004, and the cash transactions of the 2003-2004 fiscal year, are set forth in Exhibit E and Schedule E-1, respectively, of the Comptroller's 2004 Annual Report. At June 30, 2004, there were 75 authorized funds within the Capital Projects Funds category.

The total unreserved fund balances of the Capital Projects Funds decreased by $2,287,697,821 during the 2003-2004 fiscal year to a deficit balance of $4,112,793,380, as of June 30, 2004. 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 2003-2004 fiscal year, net receivables totaling $498,795,326 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, 2004, 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 2004 Annual Report. At June 30, 2004, there were four authorized funds within the Internal Service Funds category.

Exhibit A of the Comptroller's 2004 Annual Report recognizes, as reserved within fund balances and related reserves, the allotment and appropriation balances in force at June 30, 2004, and which have been carried forward to the 2004-2005 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 2004 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 2004 Annual Report. At June 30, 2004, 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, 2004, and the cash transactions for the year then ended are shown in Exhibit H and Schedule H-1, respectively of the Comptroller's 2004 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, 2004, 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, 2004, payable from future revenue of State funds is shown in Exhibit A of the Comptroller's 2004 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 2004 Annual Report.

The State's bond and note indebtedness aggregated $13,656,070,000 at June 30, 2004, an increase of $523,618,000 over the total of $13,132,452,000 at June 30, 2003. This was the net result of the issuance during the 2003-2004 fiscal year of new bonds of the State in the amount of $3,825,945,000, while scheduled principal payments and refunded and defeased bonds during the period amounted to $3,302,327,000. In addition to this indebtedness there was an additional $97,700,000 in economic recovery notes issued and $43,720,000 retired during the 2003-2004 fiscal year, resulting in a total of $273,215,000 in economic recovery notes outstanding at June 30, 2004. Scheduled interest costs through maturity on the aforementioned bond and note indebtedness, as shown in Schedule E-4 of the Comptroller's 2004 Annual Report, totaled $5,791,765,000. Accordingly, as of June 30, 2004, the State was committed to future debt service on bonds and notes outstanding in the aggregate of $19,447,835,000. This total represented an increase of $430,893,000 over the corresponding amount as of June 30, 2003.

Included in the totals of bond and note indebtedness are revenue and refunding bonds outstanding in the amount of $305,820,000 for improvements to Bradley International Airport.

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 $3,142,058,000 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 $684,627,862 within the debt service fund group, which were available for debt service at June 30, 2004.

In addition to the foregoing bond indebtedness at June 30, 2004, there was in force as of that date unused borrowing authorizations totaling $1,600,641,000 and prospective authorizations, subject to Bond Commission approval, totaling $1,427,758,000. These authorization balances, which are detailed in Schedule E-5 of the Comptroller's 2004 Annual Report, may be summarized as follows:

Purpose or Agency	In Force	Subject to Approval of State Bond Commission
Municipal and Economic Development	$ 394,129,000	$ 102,754,000
Capital Improvements and Other Purposes	220,557,000	686,406,000
Industrial Building Mortgage Insurance	19,450,000	1,000,000
Highway and Bridge Construction Repair	3,903,000	0
Transportation Infrastructure Improvement	432,863,000	13,500,000
Student Loan Foundation	5,000,000	0
Elimination of Water Pollution	252,010,000	327,012,000
Grants to Local Governments and Others	128,753,000	124,758,000
Local Capital Improvements	5,000,000	67,500,000
Preservation of Agricultural Lands	5,497,000	1,754,000
Higher Education Endowment Fund	0	10,500,000
Housing Programs	37,226,000	8,646,000
State Equipment Purchases	17,087,000	9,000,000
School Construction	75,951,000	69,250,000
All other purposes	3,215,000	5,678,000
Total Authorizations	**$1,600,641,000**	**$1,427,758,000**

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, 2004, were estimated as of January 1, 2005, to total $9,441,100,000. As of January 1, 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 $12,486,173,948. Accordingly, as of this date, the State's debt incurring margin totaled $2,619,586,052.

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 $700,000,000, and Sections 10-287g and 10-287h (interest subsidy) in the amount of some $190,000,000, as of June 30, 2004. 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, 2004, the State Board of Education estimates that current grant obligations under this latter program will total some $2,900,000,000.*

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 27 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 27 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 25 years. The last actuarial survey of the system was performed as of June 30, 2004, and showed an unfunded accrued liability of $5,223,836,729.*

5. *Loans under the "Insurance and "Umbrella" programs, insured by the State ($25,000,000 maximum limit) through the Connecticut Development Authority, which totaled $12,032,797 at June 30, 2004. In addition, bonds 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. In addition to the above, other loan guarantees totaling $4,088,124 have been extended by the Authority under the Connecticut Works Guarantee Fund, as provided for in Section 32-261 of the General Statutes, as of June 30, 2004.

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 January 1, 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 $2,765,000,000, $220,000,000, and $105,200,000, 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 January 1, 2005, the principal amount of outstanding bonds secured by special capital reserve funds totaled some $361,200,000.*

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 January 1, 2005, the principal amount of outstanding bonds, secured by special capital reserve funds for the University totaled $29,100,000.*

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 January 1, 2005, the amount of the City's obligations guaranteed by the State totaled $92,600,000.*

10. *Under a contractual agreement with a management company to operate local transit service in and adjacent to the cities of Hartford, New Haven, and Stamford, the State of Connecticut, upon termination of such agreement, is obligated to assume all existing liabilities of the management company, including but not limited to all liabilities for past, present and future pension plan obligations. Such liabilities and obligations totaled $1,857,454, as of January 1, 2004.*

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 considered an ERP or enterprise resource planning system, which is intended to enable an integrated business process covering requisition, purchasing, appropriations and commitment control, accounts payable, and cash disbursements, cutting across all of the State central business functions. It also covers accounts receivable, billing and cash receipts, as well as personnel and payroll processes and is designed to provide automated general ledger based reporting. Core-CT is based on an accounting system that has been commonly used in private industry. It replaced a number of individual and disparate computer systems that were previously used by State agencies. This new system was intended to promote significant administrative efficiencies and provide improved financial reporting. The financials component of Core-CT was made operational on July 8, 2003, with the human resources and payroll component being made operational on October 27, 2003.

The direct cost of development and implementation of the Core-CT system was reported to be approximately $102,000,000 through June 30, 2004. The system is based on software that was originally purchased from PeopleSoft, and which is now serviced by Oracle Corporation. To implement the Core-CT system, the State of Connecticut contracted with Accenture, a management consulting, technology services and outsourcing company to adapt the software package to meet the State's needs. The Core-CT project has been guided by a steering committee and directed by a management team comprised of officials from the Office of the State Comptroller, the Office of Policy and Management, the Department of Administrative Services, and the Department of Information Technology.

The Budget and Financial Analysis Division of the State Comptroller, which is responsible for statewide accounting and financial reporting, including the recording of receipts and expenditures, the monthly reporting on the State's budget, and preparation of monthly and annual financial reports, encountered significant difficulties as a result of the implementation of the new Core-CT accounting system.

During the 2003-2004 fiscal year significant posting errors were made to accounts, monthly financial reporting was incomplete, and annual financial reports were not provided within statutory and regulatory requirements. We acknowledge that certain problems were to be expected in such a massive conversion. We observed that significant efforts were made to identify and correct a wide variety of problems that occurred. However, our audit has identified a number of significant concerns pertaining to accurate and timely financial reporting that, at the time of this report, have not been resolved.

Other deficiencies found in the Core-CT system 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 2003-2004 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 or statement of estimated and realized revenues for either the General Fund, or Special Transportation Fund could be produced. This condition continued throughout the entire fiscal year. Revenues reported on the monthly statements were based not from the Core-CT system, but from numbers obtained "off system" from the Office of Policy and Management.

It was not until later in the 2004-2005 fiscal year that a statement of estimated and realized revenues for the General Fund and Special Transportation Fund, and a balance sheet for the Special Transportation Fund could be produced. At the time of our review (December 2005), the State Comptroller was still unable to produce a monthly balance sheet for the General Fund.

Copies of a monthly trial balance and a monthly analysis of expenditure run were not submitted to the Office of Fiscal Analysis for the entire 2003-2004 fiscal year.

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. There were significant problems with revenue recording and reporting, including miscoding of transactions and reconciliation of accounts. In addition, there were problems with reconciling the interface with the new Integrated Tax Administration System implemented by the Department of Revenue Services. These problems with revenues reporting and reconciliation made it impossible to prepare revenue statements or 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: "As you have noted in this report, with implementation of Core-CT numerous revenue posting problems occurred. Some of the problems related to agencies entering inaccurate account coding for both revenues and expenditures. Agencies, with substantially reduced staffing levels due to layoffs and early retirements, were attempting to learn an entirely new chart of accounts structure without the benefit of the coding edits that existed in the legacy systems. As a result, numerous transactions posted containing coding errors. Additionally, reconciling Core-CT receipts to the Department of Revenue Service's (DRS) new Integrated Tax Administration System (ITAS) was challenging. Problems with revenue reconciliation continued throughout most of Fiscal Year 2004. In addition, initial problems with the accurate posting of payroll to the general ledger and various budget checking problems within commitment control further hindered efforts to produce monthly financial statements. In short, for most of Fiscal Year 2004 it was difficult to produce stable monthly financial data.

With corrections to or improvement in many of the above referenced problem areas, in Fiscal Year 2005 the Comptroller's Office once again began to issue monthly financial statements. These statements are complete with the exception of the General Fund balance sheet. The Comptroller's Office has been prioritizing the completion of financial statements. Because monthly balance sheets provide less information necessary for monthly financial management decision making, they received lower prioritization. Production of the monthly General Fund balance sheet will be addressed early in 2006. We are currently attempting to coordinate the timing of transaction postings between the commitment control ledgers and the general ledger. Having the two sets of ledgers in balance for closed accounting periods is essential to the production of a balance sheet.

We will also be soliciting suggestions from the Treasurer's Office on improvements to their monthly cash reconciliation issues."

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 financial statements for the fiscal year ended June 30, 2004, which were issued on September 1, 2004, found that they did not meet the provisions of the Statute. There was no statement of revenues, statement of tax receipts or balance sheet for the State's General Fund or Special Transportation Fund. It was been explained to us that the Core-CT system could not provide the required financial data to produce the required statements.

The financial statements for the fiscal year ended June 30, 2005, issued on September 1, 2005, showed improvements. However, a balance sheet for the State's General Fund could not be produced, again because of problems caused by the implementation of the Core-CT system.

The Comptroller did not prepare and issue its *Annual Report of the State Comptroller - Budgetary Basis* for the 2004 fiscal year until December 31, 2005, one year after the due date.

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

The preparation of the annual financial statements was a difficult process that required extensive manual corrections and adjustments.

Cause: As we understand, the cause of these conditions was the result of problems in the Core-CT system itself, as detailed below. In addition, there were problems reconciling Core-CT revenues information with the records maintained by the Department of Revenue Services, and problems with the reconciliation of bank statements to Core-CT records at the State Treasurer.

In addition, a lack of training, and the absence of the previously available State accounting manual led to 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: "Layoffs and early retirements that occurred just prior to Core-CT implementation had a significant impact on the production of timely financial reports. A considerable number of financial staff within state agencies that had been fully trained in Core-CT applications was suddenly gone due to layoffs and retirements. There was limited time before the July 1st Core-CT implementation date to fully train agency employees who had replaced staff lost to layoff or early retirement. This resulted in numerous accounting errors being entered into the system by staff that had not been adequately trained. At the same time, the Budget and Financial Analysis (BFA) Division lost ten of twenty-eight highly trained and experienced employees making it difficult to detect and correct system coding errors in a timely fashion.

The Comptroller's Office requested additional resources for the BFA Division in her Fiscal Year 2004 budget request. Over $185,000 of the Comptroller's requested funding for BFA was cut from the Governor's budget and was not restored by the Legislature. Additional funding was again requested in Fiscal Year 2005 and was denied. The funding that was eliminated would have assisted the division in detecting accounting posting errors early thus expediting the production of the legal basis statements and Comprehensive Annual Financial Report (CAFR). It should also be noted that personnel actions were difficult to execute even where funding was available and approved for expenditure by the Comptroller.

Additionally, due to the large number of accounting errors entered by state agencies in Fiscal Year 2004, the state's books were left open for an extra six weeks to allow for agency corrections. Both DRS and the Treasurer's Office were given more than six additional months to correct problems with their entries to Core-CT. The added time granted to agencies to fix accounting entries inevitably impacted the timeliness of financial reporting.

To correct these problems, Core-CT made training and retraining agency staff a priority. Training workshops were open to state agency personnel in most major Core-CT applications. In addition, a series of job aides were put online to assist agency users, and when continuing problems were detected agencies were either notified by phone or daily mail. This action has helped to reduce the volume of user errors. The BFA Division has added four employees (three through internal transfers) and has gained approval to hire an additional employee. While this has left the BFA Division five employees short of its staffing level prior to the layoffs and retirements, the additional staffing should help to expedite financial reporting. Finally, Core-CT has added reporting functionality that will allow data to roll-up to the proper reporting level."

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 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 did not provide financial reports in a format that would facilitate the preparation of year end financial statements. Preparation of required reports was problematic and filled with delays.

The Core-CT system could not properly account for numerous Federal grant transfers. The preparation of the Schedule of Expenditures of Federal Awards required significant manual compilation and reconciliation. Its completion was delayed until just prior to the date it was due to the Federal government.

The Comptroller did not prepare and issue audited financial statements for its CAFR until December 31, 2005, some ten months after the date they were needed by the State Treasurer and some nine months after the date they were required by the Federal government.

Effect: The State was not in compliance with the continuing disclosure requirements of the Securities and Exchange Commission, and was at risk of not complying with the reporting requirements for Federal financial assistance.

The State was not in compliance with the provisions of Office of Management and Budget Circular A-133. The financial statement audit required by the Federal government, including the Schedule of Expenditures of Federal Awards, could not be completed and reported on by the required date.

In March 2005, 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 30, 2005. Subsequently, after the September 30th reporting deadline was missed, the Office of Policy and Management requested and received an additional extension to December 31, 2005.

Cause: As described above there were delays in issuing the *Annual Report of the State Comptroller - Budgetary Basis* upon which the CAFR is based. By necessity, the preparation of both the CAFR financial statements and the Schedule of Expenditures of Federal Awards was 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. In addition, reduced staffing levels in the Budget and Financial Analysis Division of the State Comptroller's Office, as well as at State departments and agencies further served to delay the process.

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

Agency Response: "Same response as was provided above."

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: The scale and scope of the implementation of the Core-CT project required the resources of the Department of Information Technology, the Office of Policy and Management, the software vendor PeopleSoft, the Accenture consultants employed to install the system and numerous other participants. The Core-CT project evolved into almost a separate entity, which in many respects required the Office of State Comptroller to be subordinate to what the Core-CT organization, the software vendor and consultants needed or could provide.

The Core-CT system decentralized some of the accounting procedures that were formerly the responsibility of the State Comptroller. The design of the Core-CT system eliminated many of the controls the State Comptroller had previously established over those transactions State agencies entered onto Statewide accounting records.

The State Comptroller has not updated its State Accounting Manual to reflect the changes brought by the Core-CT system. System users do not have an authoritative source of information that ensures accounting transactions are processed in compliance with government accounting principles and consistently throughout the State.

The State Comptroller did not have adequate resources to provide to its Budget and Financial Analysis Division in order for it to review agency-entered transactions and prepare monthly and annual financial reports in a timely manner.

Effect: The Office of State Controller has relinquished a significant amount of the control it previously maintained over the accounting of the State's financial transactions. It no longer has exclusive control over this function; a responsibility it has been assigned by Statute. The Core-CT project has evolved into an entity separate from the State Comptroller, and not directly under its control. In operational and reporting needs, the personnel of the Budget and Financial Analysis Division are frequently in the position of accepting what the Core-CT project can provide, rather than the system working to meet their needs.

State agencies can now enter data onto statewide accounting ledgers without the supervision of the Budget and Financial Analysis Division. 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.

In addition, essential staff members of the State Comptroller ended up assigned to work on Core-CT problems, rather than being available to address the needs of statewide financial reporting.

Cause: We observed that the relationship between partners in the implementation of the Core-CT project did not clearly show the State Comptroller in the role of the primary participant. Core-CT system administrators, and the private consultants employed to implement the project, did not meet the needs of the State Comptroller 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 certain "edit checks" and other controls would have prevented erroneous transactions from being entered was not done. Procedures for regular analytical analysis to identify reported transactions that do not match historical norms were not established.

We also observed that inadequate resources were applied to the task of statewide financial reporting. During the entire audit period a significant amount of the resources of the Budget and Financial Analysis Division were devoted to the Core-CT project or other duties. As a result, much of the work compiling, reconciling and correcting data for Statewide financial reporting was assigned to a single individual, with no backup if that individual was made unavailable. In addition, the State Comptroller had inadequate resources available to update its *State Accounting Manual*.

This is related to a problem noted throughout the State, as the effects of layoffs, the early retirement incentive, and the training demands of the new Core-CT system have placed additional burdens on accounting staff, resulting in errors and weaknesses in internal controls. Personnel assigned to the Budget and Financial Analysis Division were required to face increasing demands of State departments and agencies to resolve processing and posting problems and correct errors, and were unavailable for the financial reporting function.

In a related matter, personnel from the Budget and Financial Analysis Division encountered problems with the adjustments resulting from the bank reconciliation process performed by the State Treasurer. As part of its reconciliation of bank statement information to the general ledger, the State Treasurer provided accounting adjustments for the general ledger in a manner that did not recognize the need to account for the various fund designations established in the State's financial reporting system.

In addition, the demands that the Core-CT system places on agency and department users to process routine transactions leaves them less time to work on resolving accounting problems.

Recommendation: 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*. (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, the Department of Administrative Services, the Office of Policy and Management, and the Department of Information and Technology. It was essential to receive input and guidance from these other three agencies during the design and configuration phase of the Core-CT project. Throughout this 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 Office's employees.

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. This is not a loss of control due to policy changes, but to the inherent nature of the design and system entry functionality.

To better monitor 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. In addition, reporting functionality has been improved incrementally to provide added reconciliation tools.

Updates to the State Accounting Manual (SAM) are currently underway. A section of the Core-CT web site will be dedicated to an on-line SAM. The BFA Division is utilizing a reemployed retiree to assist in this effort and is actively seeking additional help within limited resources. It is anticipated that postings for the new SAM will begin to appear at the end of 2005 beginning with the Core-CT coding conventions. Additional information will be posted on an ongoing basis until the SAM is complete. The Accounts Payable Division, the Policy Services Division and BFA will work closely to complete the SAM. Existing on-line job aides and related information will be incorporated within the SAM.

Finally, it should be noted that two employees within the BFA Division have been reassigned on a part-time basis to budgetary reporting to provide back up and to facilitate the production of the budgetary report, which is essential to CAFR reporting. We are hoping to add staff due to the critical nature of this matter."

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: Financial reports that were readily available on the previous accounting system were not functional in Core-CT. For the two years the Core-CT system has been operational, reports detailing agency cash receipts and available cash, as well as the detail of Federal grant expenditures, were not available for use or provided erroneous information.

Expenditure detail reports from the Core-CT system could not summarize activity for a single agency on a complete basis, because reporting could only be made on account codes for subunits within the agency as they were entered onto the account chartfields. The available reports would only detail activity by all of the subagency accounts, which resulted in a lengthy and unusable presentation.

The EPM (Enterprise Performance Management) module, designed to allow custom designed queries by system users, did not meet its promise to be user friendly and reliable.

Account chartfields were set up to be unnecessarily complex and unmanageable, and frequently, the distribution of personal services costs among accounts by the Core-CT financials component would not match actual employee time distribution. The Core-CT human resources and financial modules utilize different account coding conventions that require translation between them. In many cases the distribution of payroll costs required the use of worksheets and ledgers separately maintained, and not a part of the Core-CT system.

In addition, 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 difficult for management to budget and account for what is generally the largest single expenditure of a department or agency.

The Core-CT system allowed the change or adjustment of past-posted transactions. Adjustments entered in the system to correct previously made errors would cause continual changes in reported data for past accounting periods.

The Core-CT system does not process online data on cleared and outstanding checks to allow for the prompt reconciliation of the State's checking accounts.

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: Agency personnel were not able to receive reports in formats and with information they were previously accustomed to. Requested reports required extensive manual "roll up" to summarize information at higher levels. In addition, reporting deficiencies prevented user agencies from readily reviewing the results of accounting entries, and identifying and reconciling differences that eventually would affect statewide reporting.

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, and between the financial and human resources modules of Core-CT.

Because of the inability to efficiently manage the distribution of payroll and fringe benefit costs, State departments and agencies encountered considerable difficulty in calculating the Federal share of personal services costs. As one example, at the Department of Transportation over $100,000,000 in payroll charges that are eligible for Federal reimbursement remain unbilled and uncollected (as of September 2005). These charges have accumulated from the implementation of the Core-CT payroll system in October 2003.

Because of the continual changes in data from past accounting periods, the Office of the State Treasurer was unable to perform accurate forecasting of cash balances, which resulted in investment returns being managed less effectively.

Because information on cleared and outstanding checks was not presented on an automated basis, and because its personnel had difficulties understanding accounting entries in the new Core-CT system, the State Treasurer was unable to reconcile its cash accounts promptly after year end, which resulted in delays in preparation of the *Annual Report of the State Treasurer for the Fiscal Year Ended June 30, 2004* and the failure to meet the statutory requirement for submission of that report by October 15, 2004. The inability to reconcile cash accounts also delayed the preparation of the State Comptroller's Annual and CAFR financial reports as noted above. The reconciliation of the Treasurer's cash accounts for the fiscal year ended June 30, 2004, was not fully completed until August 2005.

Cause: The Core-CT system is based on PeopleSoft computer software that is an adaptation from the commercial accounting environment. That adaptation to the State's accounting needs did not address reporting at certain agency levels. The Core-CT system does not interface with certain department or agency specific systems used for Federal billing. We found that certain financial reports that were custom designed for the State's needs did not function properly. In addition, the EPM module required significant training and skill for users to develop a query that will provide the needed financial information.

The addition of modified cash and estimated revenues ledgers also required adaptation of the PeopleSoft computer software. Core-CT project personnel have had to overcome significant difficulties in programming to make these features operational.

The Core-CT system will allow continual changes in transactions that were posted in previous months. Adjustments and corrections entered will affect totals for past periods, affect reconciled amounts and reported totals. To address these problems, in November 2004, the State Comptroller established monthly close outs of the accounts payable, accounts receivable and general ledgers. State departments and agencies are now required to review the month's activity, close out pending, open or unmatched items, reconcile data and correct errors on the various ledgers.

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. The additional cost of this package would have been offset by a reduction in the personal services costs of the manual process currently used.

Recommendation: 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. (See Recommendation 5.)

Agency Response: "The Comptroller has been leading the effort to improve Core-CT financial reporting. The Comptroller's Office and the Core-CT project staff have worked closely with the Treasurer's Office to modify the Average Daily Balance Report. We have also worked closely with the Auditors of Public Accounts to meet those reporting needs. Based on specific requests, we have modified several system generated reports. The reports we have been enhancing include the Expenditure Detail Report, the Available Cash Trial Balance, the Detail & Summary Revenue Report, the Trial Balance of Appropriations, and the Grant Appropriation Trial Balance. In addition, several reports have been enhanced to allow them to be easily downloaded into Excel. These include the General Ledger (GL) Trial Balance, Encumbrance, Pre-Encumbrance, and Budget Transaction detail.

At the direction of the Comptroller's Office, the 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 us 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 new flexible analysis report has been 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. 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. 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.

With respect to the decision not to purchase the treasury module, the Treasurer's Office as an independent constitutional office made that choice. They opted to use an in-house subsystem.

Regarding the Department of Transportation's (DOT) failure to bill over $100,000,000 in payroll charges eligible for federal reimbursement, DOT has had the Core-CT source data that they requested in order to process these claims for over one year. It is now DOT's responsibility to cross-walk that data to their billing system. DOT has developed a plan to complete these billings by May 2006."

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: The Core-CT system implemented a significant change in the manner that interagency transfers were processed in the State's accounting system. It decentralized the process of interagency transfers from the State Comptroller to individual State agencies. Formerly, the Comptroller processed such transfers by coordinating between agencies, reviewing the transfer for accuracy, and entering the transaction. The decentralized process allowed agency personnel to directly enter interagency transfers that were not subject to the internal controls previously employed, and the function of coordinating these transactions between agencies was lost.

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 prepared.

Effect: This resulted in the State Comptroller losing control of transactions entered onto the State's general ledger. A State agency processing a transfer can and would post transfers coded to the incorrect accounts of the recipient agency.

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. Amounts reported on financial statements were compiled using manual analysis.

Cause: The State Comptroller did establish certain account codes to be used to identify for grant transfers; however, there were no internal controls in the Core-CT system to enforce their use.

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 also failed to update its *State Accounting Manual* to address the new environment.

With the implementation of the billing module in Phase II of Core-

CT in February 2005, certain improvements were implemented; interagency transfers are now processed with standard billing types.

However, after this change was made to address problems with interagency transfers, we noted that State agencies still had the ability to enter erroneous transactions. The State Comptroller has continued to stress training of system users in an attempt to prevent these errors. At the time of our review (September 2005) no system controls have been implemented to ensure that system users do not make these types of errors.

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 6.)

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 and is evaluating the feasibility of recentralizing this function. Additional resources have been made available to address this issue."

Failure to Consistently and Properly Record Account Codes and Transaction Dates:

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: During the audited period our review encountered problems with the manner that revenue and expenditure transactions were processed in the State's accounting system. Formerly, the Comptroller processed transactions by posting them from hard copy documents that were prepared by State agencies under long established procedures detailed in the *State Accounting Manual*.

The procedures adopted under the Core-CT system allowed agency personnel to directly enter transactions that included information such as account coding and transaction dates. These entries were not subject to the controls and procedures previously employed and inconsistent information on account codes and transaction dates were recorded.

The Core-CT system is based on a multiple set of general ledgers to provide for the modified accrual and modified cash basis of accounting used by the State. Errors in spreadsheet journals entered by user agencies and departments frequently created differences between the two ledgers.

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 review and correct numerous improperly coded transactions.

This condition also resulted in State agencies being unable to properly account for receivables and payables at fiscal year end. Receipts collected and payments made during the end periods of the fiscal year would be improperly recorded as applicable to the prior or following fiscal year. At the Department of Transportation, accounts payable, as computed by the Core-CT system, were understated by $10,920,628 at the beginning of the 2003-2004 fiscal year (as of June 30, 2003), and by $4,394,954 at the close of that year (as of June 30, 2004).

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.

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 and date information.

It was not until well into the 2003-2004 fiscal year, that Core-CT system administrators established a corrected and consistent procedure for recording receipt and payment dates. Further changes to procedures and to the computer software were implemented well in the 2004-2005 fiscal year.

We note that State agencies still have the ability to enter erroneously coded transactions. At the time of our review (December 2005) there were limited controls in place to ensure that department and agency users code transactions to the proper accounts. The identification and correction of these errors is continuing to place a significant burden on the resources of the Budget and Financial Analysis Division. The Comptroller has emphasized continued training of agency users in order to address the problems; however, it has still not updated its *State Accounting Manual* to address the new environment.

Related to this matter, we found some of the instructions provided to user agencies on how to properly code or create transactions on the Core-CT system did not conform to the procedures previously established by the State Comptroller, and instead created accounting errors. We noted that the Core-CT team, and not the accounting staff of the Budget and Financial Analysis Division of the State Comptroller, was preparing the materials for user group meetings and daily mail communications.

Recommendation: 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. (See Recommendation 7.)

Agency Response: "The Comptroller's Office did assist in the preparation and presentation of materials for user group meetings and daily mail communications. On several occasions the Accounts Payable Division created materials and gave presentations on subject matter relating to transaction processing, including the proper use of accounting date. In addition, the Comptroller's Office implemented a monthly closing process in November 2004 for accounts payable, accounts receivable, billing and the general ledger. This closing process is allowing the Comptroller's Office to more quickly identify and resolve posting errors. The Comptroller's Office continues to dedicate substantial resources to monitoring and correcting agency posting errors. As noted above, four of the ten BFA employees lost at the time of Core-CT implementation have been replaced and an additional hire has been approved. All of these employees are dedicated to monitoring Core-CT system entries and to correcting errant postings.

In addition, the BFA Division has recently implemented a process to reconcile the commitment control ledgers to the general ledger on a monthly basis. This reconciliation or "true-up" of the ledgers should also help to detect posting problems and system errors as well as keeping the multiple ledgers in balance."

Failure of System Controls Over Ledger Posting:

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: We noted there was 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.

State agencies and departments frequently miscoded expenditures to balance sheet accounts, which would cause budget check controls to be bypassed. There were no internal controls in the Core-CT system to prevent this type of error. In addition, when journal vouchers were entered, the Core-CT system did not automatically generate the proper entries to the cash accounts. Users were required to prepare them manually, which resulted in numerous errors and omissions.

In addition, when user departments and agencies issued a change order to an existing purchase order that has been already fully expended, as expenditures pertaining to the change order are processed, the Core-CT system duplicated the original encumbrance.

Effect: Accounting records were not accurate and were unreliable. Erroneous transactions were posted, which require extensive time and labor to identify and correct.

Transactions were posted to the general ledger, bypassing the commitment control ledger. As a result the commitment control ledger has to be manually adjusted to equal the balances in the general ledger.

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 transactions with erroneous account information.

To partly solve this condition, 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 now 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. Monthly reports are made available after the close of the general ledger.

We noted that in May 2004, a memorandum was issued that described the implementation of a software change to validate account codes; this would only allow purchase orders to be coded to expenditure accounts. However, our review found no documentation to establish that such a change was made. Despite repeated efforts to train department and agency personnel, purchase orders continue to be coded to nonoperating accounts, which result in problems that require correction.

In its response to the request to change system controls to prevent this type of occurrence, Core-CT project personnel responded that the most feasible solution to the problem was to establish queries to identify purchase orders coded in error, so that they can be manually corrected as part of the "month end clean-up."

Recommendation: The State Comptroller should correct deficiencies in the internal controls of the Core-CT system to eliminate the bypassing of the commitment control ledger. (See Recommendation 8.)

Agency Response: "An evaluation is currently underway to assess the feasibility of building hard edits into various module applications to minimize the ability of agencies to enter errant coding. However, at this time the Comptroller's Office must rely on the reconciliation and monitoring controls discussed above to validate system postings."

Design and Execution of Fiscal Year End Close:

Criteria: 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 observation of the process used to develop the fiscal year end close found many conditions that were clearly not addressed when the system was designed. As noted above, the original PeopleSoft system software was not designed for State government accounting requirements. It became apparent that the fiscal year end close was not adequately addressed during the implementation of the new system; there were particular problems found when the State's method of lapsing funds was applied to it. The State Comptroller, working with Core-CT project personnel from other agencies and its consultant contractors, was forced to develop a procedure and make system changes on an ad hoc basis to close the accounts at fiscal year end.

There were problems with the application of the budget reference value (fiscal year designation) to control transactions at certain chartfield levels. The difference between State and Federal fiscal years, and the processing of purchase orders or grants that covered more than one fiscal year, resulted in problems with transactions passing the budget check control. The Budget and Financial Analysis Division estimated that approximately 90 percent of the budget check errors encountered by system users were the result of budget reference problems.

The process to close prior year purchase orders and reenter them in the following year was problematical and labor intensive. To provide for the fiscal year end close, State agencies working with the Accounts Payable Division of the State Comptroller, were required to "clean-up" over 74,000 open purchase orders because the continuation of them to the ensuing fiscal year was not an automated process. After the "clean-up," there were over 16,000 agency purchase orders that remained; of these, approximately 8,000 could be "rolled over." The remaining 8,000 failed to roll and were manually closed out and reentered for the new fiscal year, a significant administrative burden for users.

The "roll over" of existing purchase orders to the new fiscal year required significant manual labor, and was beset with problems of purchase orders being stuck in "mid roll," being omitted from budget check or other errors. Certain transactions and balances pertaining to encumbrances of appropriated funds were not closed out at the end of the fiscal year.

Prior year transactions cannot be adjusted while the ensuing fiscal year is on line. There were corrections entered as spreadsheet journals that could not be processed by the system. The year end close process was time consuming and prone to errors.

Effect: The Core-CT project team was forced to employ "work arounds" and ad hoc software patches to process the fiscal year end close. These conditions affected both the financial and human resources modules of Core-CT.

Financial reports were not available to meet statutory deadlines; errors were produced that prevented accurate reporting and which required significant manual labor to correct.

The State's accounting system was disrupted for some time while the year end close process was in progress. Vendor payments were disrupted resulting in hardships to both user agencies and vendors.

Cause: The Core-CT system is based on PeopleSoft computer software that was an adaptation from the commercial accounting environment. It was not originally designed to close annual budgets while carrying forward appropriations, encumbrances, purchase orders and other transactions in a method applicable to governmental accounting.

It has been explained to us that resources are not available to redesign the Core-CT system to allow for a more efficient fiscal year end close. In planning the June 30, 2005 fiscal year end close, the State Comptroller and Core-CT project personnel determined that the "rollover" of such a large number of purchase orders was not feasible. The Core-CT system now requires State agencies to close out old year purchase orders and reestablish them for the following fiscal year, a process that will be required at the end of each fiscal year going forward.

At the time of our review (September 2005) we noted that the year end close for June 30, 2005, was concluded with improvements in efficiency for both the State Comptroller and State department and agency users. However, a number of issues did arise concerning the closing of purchase orders, which in general, were caused by the inefficient design of the Core-CT system, and the inability of department and agency users to observe the exact procedures required for the process. We also note that the use of the budget reference control at the legal ledger level was eliminated in the beginning of 2005-2006 fiscal year.

Recommendation: The State Comptroller should continue to make the necessary changes to the Core-CT system to provide for an efficient fiscal year end close. (See Recommendation 9.)

Agency Response: "The Comptroller agrees with the comment that the Fiscal Year 2005 close was "concluded with improvements in efficiency for both the State Comptroller and State department and agency users." It is also agreed that post system implementation it was discovered that the PeopleSoft product had budgetary control problems. The Comptroller is continuing to work with the vendor to resolve the multiple problems that have been detected within commitment control."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

State Comptroller - State Financial Operations Audit Report

- There were no recommendations presented in our prior audit report.

State of Connecticut - Single Audit Report

- There were no recommendations presented in our prior Single Audit Report

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 been able to provide a complete set of monthly financial statements since the implementation of the Core-CT system in July 2003. Progress has been made, however, at the time of our review (December 2005), the State Comptroller has yet to produce a balance sheet for the State's general fund.

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 preparation of the annual financial statements was a difficult process that required extensive manual corrections and adjustments.

3. **The State Comptroller should take whatever measures necessary to ensure that its Comprehensive Annual Financial Report financial statements and Schedule of Expenditures of Federal Awards are prepared in an efficient and timely manner.**

   Comment:

   The State Comptroller did not prepare the State's financial statements 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 resources to the task of Statewide financial accounting and reporting, which should include the revision of the *State Accounting Manual*.**

   Comment:

   We found that it was Core-CT system designers and project staff that set many of the accounting procedures and internal controls for the State's new accounting system. State statutes provide that the State Comptroller has this responsibility. User agencies are not subject to the centralized control previously enforced over transactions entered onto the State's accounting records.

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.**

   Comment:

   Throughout the audited period the Core-CT system was unable to provide system users financial reports in formats and with information that was previously provided, or that justifies the cost of the new system. A set of standardized reports would meet the needs of a vast majority of users, without requiring each of those users to run their own queries.

6. **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.

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.**

   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 transaction dates, and fund and account codes.

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.**

   Comment:

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

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.**

   Comment:

   The Core-CT system design did not adequately address governmental accounting requirements for processing the State's fiscal year end close.

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	Robert G. Jaekle
Auditor of Public Accounts	Auditor of Public Accounts