STATE OF CONNECTICUT

AUDITORS' REPORT
OFFICE OF STATE COMPTROLLER - STATE FINANCIAL OPERATIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

AUDITORS OF PUBLIC ACCOUNTS
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July 20, 2007

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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, 2006. 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 Office of State Comptroller – Budgetary Basis*, for the fiscal year ended June 30, 2006. 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 2006 Annual Report."

COMMENTS

FOREWORD:

The financial position as of June 30, 2006, and the 2005-2006 cash transactions of all State civil list funds, accounted for centrally in the records of both the Office of State Comptroller and State Treasurer, are shown in Exhibit A and Schedule A-1, respectively, of the Comptroller's 2006 Annual Report. The financial position of the General Fund at June 30, 2006, 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 2006 Annual Report. Corresponding statements for the Special Transportation Fund are shown in Schedules C-2 and C-3, respectively, of the Comptroller's 2006 Annual Report. A summary of State bonds and notes outstanding as of June 30, 2006, the changes thereto, and the authorizations for future borrowings are shown in Schedules E-3, E-4, and E-5 of the Comptroller's 2006 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 Grants and Restricted Accounts Fund and the Transportation Grants and Restricted Accounts Fund where the Federal and other grants receivable are the source of financing for restricted appropriations established for the purposes of the grants involved. These restricted revenues are recognized by the Comptroller when earned through the expenditure of grant funds, rather than when received or awarded. In addition, loans made from the General Fund to the Connecticut Student Loan Foundation, pursuant to Section 10a-213 of the General Statutes, are accrued at fiscal year end, as is interest income of the Special Transportation Fund, which is accrued pursuant to the terms of a Special Tax Obligations Bond Indenture dated September 15, 1984.

This report covers the financial operations of the 2005-2006 fiscal year under a biennial budget adopted by the 2005 General Assembly, and subsequently revised by the 2006 General Assembly, including the financial accounting for the budget plans of the General Fund and Special Transportation Fund, as it applies to the 2005-2006 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 Office of State Comptroller - Budgetary Basis* are not, nor are they intended to be, in accordance with generally accepted accounting principles. In order for the Comptroller to follow such principles, among other things, expenditures would have to be recorded on an accrual rather than cash basis, all non-civil list funds and component units of the State would have to be included in the financial statements, all agencies' assets and contingent and long term liabilities would have to be recognized, and appropriate footnote disclosures would have to be made in the financial statements.

In March 2005, the American Institute of Certified Public Accountants issued an interpretation of its professional auditing standards that affects those governments that prepare financial statements using the cash, or modified cash basis of accounting, rather than the reporting their financial activity in accordance with GAAP. As a result, those statements must conform to the applicable disclosure requirements of GAAP in order to avoid receiving an adverse audit opinion. This would require management to prepare and incorporate a management discussion and analysis, notes to the financial statements, and disclosure of infrastructure assets into the budgetary basis report. As discussed in the Condition of Records section of this report, because the Office of State Comptroller has not done such, we have been required to render such an opinion on the *Report of the Office of State Comptroller - Budgetary Basis* for the fiscal year ending June 30, 2006.

In order to comply with GAAP, the Office of State Comptroller has issued a separate *Comprehensive Annual Financial Report* (CAFR) showing the State of Connecticut's financial position and results of operations in accordance with GAAP requirements. It has done so since the fiscal year ended June 30, 1990. This report, however, was always made in addition to the *Annual Report of the Office of 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 explained above the Office of State Comptroller is required by statute to follow a practice of recording the accrual of certain revenues without a corresponding accrual of expenditures in the General Fund. This accounting practice resulted in the accrual of more than $984,866,000 in revenues, which would, under a cash basis system of accounting, be recorded in the 2006-2007 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 $1,449,000,000 over the cash basis of accounting 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 $390,200,000 under GAAP. The net result of these effects is an estimated deficit in the unreserved Fund Balance of the General Fund (GAAP Basis) totaling $1,058,800,000 as of June 30, 2006.

For the State's *Comprehensive Annual Financial Report* to gain widespread use and acceptance, the legislative budget plan must be prepared and enacted in accordance with GAAP. In that way, the CAFR will present, in a unified format, both the budgetary and actual financial operations of the State of Connecticut. To accomplish this end the 1993 General Assembly passed Public Act 93-402. This Act, effective with the fiscal year commencing July 1, 1995, authorized the Office of 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. A conversion plan was developed in accordance with Public Act 93-402, and was submitted to the Appropriations Committee of the General Assembly in 1994. Implementation plans were subsequently adjusted, however, when the General Assembly, through a succession of Public Acts, continued to postpone the State's conversion to GAAP budgeting from the fiscal year commencing July 1, 1995, to the fiscal year commencing July 1, 2005. Most recently, Section 92 of Public Act 05-251, passed during the 2005 session of the General Assembly, postponed the State's conversion to GAAP budgeting to the fiscal year commencing July 1, 2007. Section 92 of Public Act 05-251 also provides that the amortization of accrued and unpaid expenses and liabilities and other adjustments necessary for implementation, begin with the fiscal year ending June 30, 2009, and continue in equal annual installments to the fiscal year ended June 30, 2023. It should be noted that the above provisions were codified in Section 3-115b of the General Statutes.

OFFICERS:

Nancy S. Wyman and Mark E. Ojakian served as State Comptroller and Deputy Comptroller, respectively, during the 2005-2006 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, 2006, 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 2006 Annual Report.

General Fund operations were conducted under a biennial budget plan, which estimated revenues and provided for expenditures of the 2005-2006 and 2006-2007 fiscal years. Public Act 05-251, the Budget Act, enacted by the 2005 General Assembly, included revenue estimates and appropriations for the 2005-2006 and 2006-2007 fiscal years and revenue estimates of its Committee on Finance, Revenue and Bonding. Certain revisions were made to the biennial budget plan by the passage of Public Act 06-186 by the 2006 General Assembly, respectively, in order to provide for policy changes and address appropriation deficiencies for certain State agencies.

Under budget procedures customarily in effect, the estimates of revenues and the budgeted appropriations, taken in conjunction with whatever surplus or deficit was carried over from the preceding fiscal period, after consideration of any statutorily required transfers, give rise to an anticipated surplus or deficit projected through the end of the fiscal year. The budget plan for the 2005-2006 fiscal year as reported by the Comptroller may be expressed as follows:

Estimated Revenues, 2005-2006, as Revised by the Committee on Finance, Revenue and Bonding		$14,133,700,000
Budgeted Appropriations, 2005-2006, As revised	$14,237,061,745	
Estimated lapsing appropriations	(105,400,000)	
Net Appropriations		14,131,661,745
Anticipated Surplus (Deficit), June 30, 2006		**$ 2,038,255**

The actual results of the operations of the 2005-2006 fiscal year are presented in Schedule B-1 of the Comptroller's 2006 Annual Report. An analysis of budgeted General Fund accounts follows:

Actual Budgeted Revenues, 2005-2006		$14,998,721,435
Appropriations, 2005-2006	$15,382,862,326	
Add/(Deduct)		
Appropriations lapsed	(180,391,699)	
Net Appropriations		15,202,470,627
Balance		(203,749,192)
Prior Year Budgeted Appropriations Continued to 2005-2006 Fiscal Year		694,422,468
Unappropriated Surplus, July 1, 2005		15,851,490
Reserve for Fiscal Year 2006-2007		(41,000,000)
Reserve for Statutory Transfer to Budget Reserve Fund		(446,489,568)
Miscellaneous adjustments		(19,035,198)
Unappropriated Surplus, June 30, 2006, per Schedule B-1		**$ 0**

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

1. *Actual revenues were some $865,021,000 greater than originally estimated. Those revenue categories that showed the greatest changes were personal income taxes, $370,373,000, corporations taxes, $141,402,000, inheritance and estate taxes $63,058,000, real estate conveyance taxes $31,958,000, and oil companies taxes $79,791,000. Other revenue categories showing significant increases were investment income, rents, fines and escheats, insurance company and public service company taxes, and in transfers to the General Fund. These increases were partly offset by a reduction of $51,823,000 in Federal grants, and a $30,234,000 shortfall in sales and use taxes.*

2. *Appropriations showed an increase of approximately $1,145,800,000 from the budget plan reported by the Comptroller. The net increase was primarily from*

$694,422,468 in appropriations carried forward from the previous fiscal year. In addition, there were appropriation increases resulting from the passage of Public Act 06-186. Section 8 of Public Act 06-186 provided for additional appropriations totaling $394,462,000 for the 2005-2006 fiscal year. Included in that amount, among other items, was $245,650,000 in additional contributions for the teachers' retirement system, $85,500,000 in additional debt service, and $33,000,000 in local property tax relief. Section 53 of Public Act 06-186 provided for $26,038,000 in deficiency appropriations for various purposes.

3. *Lapsed appropriations were some $74,992,000 greater than estimated, primarily from a reduction in debt service. In addition, there were other operating factors such as net operating transfers to and from other State funds, as well as the continuing and carry forward of appropriations to and from other fiscal years.*

A statement of changes in the unappropriated surplus account of the General Fund for the fiscal year ended June 30, 2006, is presented in Schedule B-1 of the Comptroller's 2006 Annual Report. It should be noted that Section 4-30a of the General Statutes provides that the unappropriated surplus that remains in the General Fund at the end of the fiscal year, after any amounts required by law to be transferred for other purposes have been deducted, shall be deposited to the Budget Reserve Fund, provided that the amount so transferred shall not cause the balance in such fund to exceed ten percent of the net General Fund appropriations for the fiscal year in progress. In accordance with the statute, a total of $446,489,568 was transferred to the Budget Reserve Fund at the close of the fiscal year.

General Fund Revenues:

Total budgeted revenues in the General Fund for the 2005-2006 fiscal year amounted to $14,998,721,435, as shown in Schedule B-1 of the Comptroller's 2006 Annual Report. This represented an increase of some $935,858,684 over the budgeted revenue total reported by the Comptroller for the preceding 2004-2005 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	$585,648,000
Sales and use	111,601,000
Corporations	108,733,000
Inheritance and estate	(57,649,000)
Insurance companies	12,750,000
Public service corporations	28,444,000
Oil companies	68,543,000
Nursing Home Providers	123,893,000
All others (net)	(17,233,000)

Refunds of Taxes - increase	(47,415,000)
Total Increase (Decrease) in Taxes	917,315,000
Other Revenues and Sources:	
Transfers - Special Revenue	16,051,000
Indian gaming payments	9,689,000
Licenses, permits and fees	14,150,000
Rents, fines and escheats	(79,277,000)
Investment income	38,408,000
Miscellaneous	22,004,000
Federal grants	51,905,000
Statutory transfers to/from other funds - net	(54,400,000)
Total Increase (Decrease) in Other Revenues and Sources	18,530,000
Total Increases (Decreases)	**$935,845,000**

The above increase was generally attributed to tax increases enacted by Public Act 05-251 by the 2005 General Assembly. These included revisions to the income tax, corporation tax, oil companies tax and the estate tax. A significant addition was the implementation of a resident day user fee on revenues generated by nursing homes in the State. In addition an improvement in general economic conditions provided for an increase in overall tax revenues.

General Fund Expenditures:

Total budgeted expenditures of the General Fund for the 2005-2006 fiscal year amounted to $14,499,616,247, as shown in Schedule B-1 of the Comptroller's 2006 Annual Report. This latter amount represented an increase of some $1,165,913,530 over the total budgeted expenditures reported by the Comptroller for the preceding 2004-2005 fiscal year. General Fund expenditures classified by current expenses, fixed charges and capital outlay are detailed on Schedule I of the Comptroller's 2006 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	$ 108,813,000
Other Current Expenses:	
State Employees' Retirement Contributions	92,809,000
State Employees' Health Service Costs	36,765,000
Retired State Employees' Health Service Costs	16,212,000
All Other - primarily contractual services and commodities	131,356,000
Fixed Charges:	
Debt Service	40,398,000
UConn 2000 Debt Service	6,326,000
Teachers' Retirement Board – Retirement Contributions	210,900,000
State Aid Grants:	
Education - charter schools, magnet schools, equalization grants and priority school districts	123,482,000
Higher Education - Higher Education State Matching Grant	(23,300,000)

Mental Retardation - primarily residential and day services	53,117,000
Mental Health and Addiction Services - special populations, medications, and Community Mental Health Strategy Board	12,822,000
Social Services - Medicaid, independent living assistance, pharmaceutical assistance to the elderly, child care assistance and other public assistance programs	257,523,000
Children and Families - primarily board and care of children	47,033,000
Department of Correction - inmate medical services and community support services.	11,487,000
All Other Fixed Charges	40,054,000
Capital Outlay	117,000
Total Net Increase	**$1,165,914,000**

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

SPECIAL TRANSPORTATION FUND:

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

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

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

The financial position of the Special Transportation Fund as of June 30, 2006, 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 2006 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. It should be noted that cash and investments totaling $688,405,211, which are being held by the Trustee, are reported on Exhibit A of the Comptroller's 2006 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 2005-2006 and 2006-2007 fiscal years. Public Act 05-251, the Budget Act for the Special Transportation Fund, enacted by the 2005 General Assembly, included revenue estimates and appropriations for the 2005-2006 and 2006-2007 fiscal years.

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 2005-2006 fiscal year as reported by the Comptroller may be expressed as follows:

Estimated Revenues, 2005-2006, as Revised by the Committee on Finance, Revenue and Bonding		$986,200,000
Budgeted Appropriations, 2005-2006, as revised	$993,638,160	
Estimated lapsing appropriations	(11,000,000)	
Net Appropriations		982,638,160
Anticipated Surplus, June 30, 2006		**$ 3,561,840**

The actual results of the operations of the 2005-2006 fiscal year are presented in Schedule C-3 of the Comptroller's 2006 Annual Report. An analysis of the Special Transportation Fund surplus follows:

Actual Budgeted Revenues, 2005-2006		$ 979,196,323
Appropriations, 2005-2006	$1,053,319,227	
Add/(Deduct)		
Appropriations lapsed	(15,241,907)	
Net Appropriations		1,038,077,320
Balance		(58,880,997)
Unappropriated Surplus, June 30, 2005		133,067,491
Prior Year Budgeted Appropriations Continued to 2005-2006 Fiscal Year		37,417,850
Miscellaneous adjustments		21,774,810
Unappropriated Surplus, June 30, 2006, per Schedule C-3		**$ 133,379,154**

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

1. *Actual revenues were some $7,000,000 less than anticipated. This was primarily the result of a decline of $19,132,000 in motor fuel taxes, and $7,581,000 in sales tax*

collections at the Department of Motor Vehicles. This was offset by increases of $15,000,000 and $11,125,000 in oil company taxes and interest income, respectively.

2. *Appropriations showed an increase of approximately $59,681,000 from the budget plan reported by the Comptroller. The net increase was primarily from $37,417,850 in appropriations carried forward from the previous fiscal year. In addition, there were increases in appropriations of $7,888,000, and $7,974,000, for town aid road grants and salary adjustments, respectively.*

Special Transportation Fund Revenues:

Total budgeted revenues in the 2005-2006 fiscal year for the Special Transportation Fund amounted to $979,196,323, as shown in Schedule C-3 of the Comptroller's 2006 Annual Report. This represented an increase of some $39,398,542 over the budgeted revenue total reported by the Comptroller for the preceding 2004-2005 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	$(2,930,000)
Oil company tax	30,500,000
Sales tax collected by Department of Motor Vehicles	(1,301,000)
Refunds of taxes - increase	(523,000)
Other Revenues:	
Motor vehicle receipts	(6,591,000)
Licenses, permits and fees	5,359,000
Interest income	7,445,000
Transfers to Other Funds - decrease	7,327,000
Refunds of payments - decrease	113,000
Total Net Increase (Decrease)	**$39,399,000**

The above increase was primarily attributable to an increase in the collection of oil company taxes, in interest income, and a reduction in the amount of receipts transferred from the Special Transportation Fund to the Emissions Enterprise Fund and the Transportation Strategy Board. This was offset by reductions in revenues received from motor vehicle receipts and motor fuels taxes.

Special Transportation Fund Expenditures:

Total budgeted expenditures of the Special Transportation Fund for the 2005-2006 fiscal year amounted to $999,010,446, as shown in Schedule C-3 of the Comptroller's 2006 Annual Report. This represented an increase of some $66,253,964 from the total budgeted expenditures reported by the Comptroller for the preceding 2004-2005 fiscal year. A summary of the areas of significant changes in expenditures from budgeted accounts of the Special Transportation Fund follows:

	Nearest Thousand Dollars
Office of State Comptroller:	
State employee retirement contributions and health services costs - employer share	$13,660,000
Department of Motor Vehicles:	
Personal services	3,255,000
Department of Transportation:	
Personal services	3,231,000
Other expenses	8,436,000
Highway and bridge renewal equipment	(1,718,000)
Handicapped Access Program	2,185,000
Rail and Bus Operations	16,551,000
Town Aid Road Grants	7,968,000
Debt Service	9,489,000
All other (net)	3,197,000
Total Net Increase (Decrease)	**$66,254,000**

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

SPECIAL REVENUE FUNDS:

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

The financial position of the combined Special Revenue Funds at June 30, 2006, 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 2006 Annual Report. At June 30, 2006, there were 61 authorized funds within this category, with the Special Transportation Fund being by far the largest. Of these 61 funds, the following nine funds operate under legislatively enacted budget plans:

- Special Transportation Fund (12001)

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

Grants and Restricted Accounts Fund:

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

Receipts and transfers amounting to $1,485,115,631 for the 2005-2006 fiscal year were credited to the Fund, as shown on Schedule C-1 of the Comptroller's 2006 Annual Report. This represented an increase of some $180,643,842 greater than the total reported by the Comptroller in the preceding 2004-2005 fiscal year. These represented Federal and other grant receipts, restricted and not available for general use. As mentioned previously in this report, such restricted revenue is recognized by the Comptroller when earned through the expenditure of grant funds, rather than when received or awarded.

Disbursements of Federal and other grants from the Grants and Restricted Accounts Fund for the 2005-2006 fiscal year amounted to $1,441,374,944, as shown in Schedule C-1 of the Comptroller's 2006 Annual Report. This represented an increase of some $102,559,203 over the total reported by the Comptroller for the preceding 2004-2005 fiscal year.

Transportation Grants and Restricted Accounts Fund:

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

Receipts and transfers amounting to $117,781,485 for the 2005-2006 fiscal year were credited to the Transportation Grants and Restricted Accounts Fund, as shown on Schedule C-1 of the Comptroller's 2006 Annual Report. This represented a decrease of some $32,473,383 over the total reported by the Comptroller for the preceding 2004-2005 fiscal year. Disbursements of Federal and other grants from the Transportation Grants and Restricted Accounts Fund for the 2005-2006 fiscal year amounted to $95,575,912, as shown in Schedule C-1 of the Comptroller's 2006 Annual Report. This represented a decrease of some $161,012 over the total reported by the Comptroller for the preceding 2004-2005 fiscal year.

Additional comments concerning the operations of an individual Special Revenue Fund will be found 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, 2006, 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 2006 Annual Report. At June 30, 2006, 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, 2006, and the cash transactions of the 2005-2006 fiscal year, are set forth in Exhibit E and Schedule E-1, respectively, of the Comptroller's 2006 Annual Report. At June 30, 2006, there were 68 authorized funds within the Capital Projects Funds category.

The total unreserved fund balances of the Capital Projects Funds increased by $746,235,072 during the 2005-2006 fiscal year to a deficit balance of $4,688,526,065, as of June 30, 2006. 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 Office of 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 2005-2006 fiscal year, net receivables totaling $448,256,174 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, 2006, 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 2006 Annual Report. At June 30, 2006, there were four authorized funds within the Internal Service Funds category.

Exhibit A of the Comptroller's 2006 Annual Report recognizes, as reserved within fund balances and related reserves, the allotment and appropriation balances in force at June 30, 2006, and which have been carried forward to the 2005-2006 fiscal year on the records of the Office of State Comptroller. This has resulted in additional deficit unreserved fund balances being reported in Exhibit A and Exhibit F of the Comptroller's 2006 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 Office of State Comptroller, are shown in Exhibit G and Schedule G-1, respectively, of the Comptroller's 2006 Annual Report. At June 30, 2006, there were 17 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, 2006, and the cash transactions for the year then ended are shown in Exhibit H and Schedule H-1, respectively of the Comptroller's 2006 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, 2006, there were 29 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, 2006, payable from future revenue of State funds is shown in Exhibit A of the Comptroller’s 2006 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 2006 Annual Report.

The State's bond and note indebtedness aggregated $14,179,299,000 at June 30, 2006, an increase of $174,592,000 over the total of $14,004,707,000 at June 30, 2005. This was the net result of the issuance during the 2005-2006 fiscal year of new bonds of the State in the amount of $1,423,165,000, while scheduled principal payments and refunded and defeased bonds during the period amounted to $1,248,573,000. During the 2005-2006 fiscal year there was the retirement of $63,470,000 in economic recovery notes, resulting in a total of $146,090,000 in economic recovery notes outstanding at June 30, 2006. In addition to this indebtedness there was the issuance of $10,000,000 in bond anticipation notes during the 2005-2006 fiscal year. Scheduled interest costs through maturity on the aforementioned bond and note indebtedness, as shown in Schedule E-4 of the Comptroller’s 2006 Annual Report, totaled $5,612,553,000. Accordingly, as of June 30, 2006, the State was committed to future debt service on bonds and notes outstanding in the aggregate of $19,635,264,000. This total represented an increase of $179,882,000 over the corresponding amount as of June 30, 2005.

Included in the totals of bond and note indebtedness are revenue and refunding bonds outstanding in the amount of $276,250,000 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 $3,081,098,000 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 $735,703,643 within the debt service fund group, which were available for debt service at June 30, 2006.

In addition to the foregoing bond indebtedness at June 30, 2006, there was in force as of that date unused borrowing authorizations totaling $2,272,023,000 and prospective authorizations, subject to Bond Commission approval, totaling $1,173,253,000. These authorization balances, which are detailed in Schedule E-5 of the Comptroller’s 2006 Annual Report, may be summarized as follows:

Subject to

Purpose or Agency	In Force	Approval of State Bond Commission
Municipal and Economic Development	$ 289,821,000	$ 177,534,000
Capital Improvements and Other Purposes	350,342,000	645,723,000
Industrial Building Mortgage Insurance	19,450,000	1,000,000
Highway and Bridge Construction Repair	4,067,000	0
Transportation Infrastructure Improvement	422,783,000	10,930,000
Student Loan Foundation	5,000,000	0
Elimination of Water Pollution	489,692,000	43,945,000
Grants to Local Governments and Others	208,732,000	213,596,000
Local Capital Improvements	10,000,000	21,100,000
Preservation of Agricultural Lands	5,080,000	9,171,000
Housing Programs	40,998,000	35,739,000
State Equipment Purchases	21,157,000	11,625,000
School Construction	154,571,000	1,890,000
University and State University Facilities	295,000	0
Contaminated Property Remediation	0	1,000,000
Total Authorizations	**$2,021,988,000**	**$1,173,253,000**

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, 2006, were estimated as of February 1, 2007, to total $11,250,700,000. As of February 1, 2007, 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 $13,522,166,537. Accordingly, as of this date, the State's debt incurring margin totaled $4,519,518,165.

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 $550,000,000, and Sections 10-287g and 10-287h (interest subsidy) in the amount of some $120,000,000, as of June 30, 2006. 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, 2006, the State Board of Education estimates that current grant obligations under this latter program will total some $3,100,000,000.

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 25 years. The last actuarial survey of the system was performed as of June 30, 2006, and showed an unfunded accrued liability of $7,879,019,254.*

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 25 years. The last actuarial survey of the system was performed as of June 30, 2006, and showed an unfunded accrued liability of $77,205,261.*

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 23 years. The last actuarial survey of the system was performed as of June 30, 2006, and showed an unfunded accrued liability of $6,922,454,893.*

5. *Loans under the "Insurance and "Umbrella" programs, insured by the State ($25,000,000 maximum limit) through the Connecticut Development Authority, which totaled $6,901,974 as of June 30, 2006. However, these are contingent indebtedness of the State; actual indebtedness would result only in the event of a loan default or the inability of the Authority to make the payment of bonds and notes. The Authority has extended loan guarantees under the Connecticut Works and Connecticut Works Guarantee Fund, as provided for in Section 32-261 of the General Statutes. The State has authorized the issuance of up to $134,000,000 in bonds allocated to the Funds, of which $101,385,000 has been distributed and $15,141,147 has been recorded as a reimbursement to the Authority for uncollectible loans. The Authority also provides portfolio insurance to participating financial institutions under the Connecticut Capital Access Fund. The State has authorized the issuance of $5,000,000 in bonds allocated for the purpose, of which $2,000,000 has been distributed. Any losses on guarantees made by the Authority under either of these Funds are reimbursable by the State until the remaining bond allocation has been utilized.*

6. *The State of Connecticut is contingently liable to the Connecticut Housing Finance Authority, the Connecticut Resources Recovery Authority and the Connecticut Higher Education Supplemental Loan Authority for amounts needed annually to maintain debt service reserves for one year's principal and interest on certain Authority bonds in the event Authority funds are insufficient to do so. As of February 1, 2007, 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 $3,419,900,000, $71,000,000, and $134,800,000, 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 February 1, 2007, the principal amount of outstanding bonds secured by special capital reserve funds totaled some $324,600,000.*

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 February 1, 2007, the principal amount of outstanding bonds, secured by special capital reserve funds for the University totaled $27,600,000.*

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 was authorized by Special Act to guarantee debt issued by the City of Waterbury in an amount not to exceed $100,000,000. As of February 1, 2007, the amount of the City's obligations guaranteed by the State totaled $82,400,000.*

CONDITION OF RECORDS

Findings:

During the 2003-2004 fiscal year the Office of State Comptroller implemented a new accounting system statewide, referred to as Core-CT. Core-CT is intended to provide an integrated business process covering requisition, purchasing, appropriations and commitment control, accounts payable, and cash disbursements; accounts receivable, billing and cash receipts, as well as personnel and payroll processes. It is also the basis of the State's general ledger based reporting. Following its initial implementation in July 2003, the Core-CT system was enhanced by the addition of the billing module in January 2005, the asset management and inventory modules in July and August 2005, respectively, and an upgrade of the personnel and payroll module in May 2006. There was an upgrade of the financials module implemented in November 2006; and the final phase of the project, the projects and contracts module, is to be implemented in the 2007-2008 fiscal year. At the time of our review (March 2007), the direct cost of implementing the new system was reported to be over $124,000,000.

Core-CT is an adaptation of an enterprise resource planning (ERP) package that has been commonly used in private industry. 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 Budget and Financial Analysis Division of the Office of 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, has encountered significant difficulties as a result of the implementation of the new Core-CT accounting system.

Our audit covering the initial year of the Core-CT system, completed in December 2005 and covering the fiscal year ended June 30, 2004, reported significant deficiencies in the State's financial accounting and reporting as a result of problems with the implementation of the Core-CT system. We found significant posting errors made to accounts, monthly financial reporting was incomplete, and annual financial reports were not provided within statutory and regulatory requirements. Our audit covering the fiscal year ended June 30, 2005, completed in September 2006, repeated those findings and again noted that monthly financial reporting was incomplete and annual financial reports were not provided within statutory and regulatory requirements. In that report we also noted some corrective action that was made. Our current audit has covered the corrective action implemented since the completion of that report, and recommends further action is required.

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…and itemized as far as practical for each budgeted agency, 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: Since the Core-CT system was implemented in July 2003, the Budget and Financial Analysis Division of the Office of State Comptroller has been unable to produce a complete set of monthly financial statements. Because of problems with the reconciliation of cash activity, no balance sheet for the General Fund, and frequently none for the Special Transportation Fund, could be produced.

Our review of the monthly statements for the 2005-2006 and 2006-2007 fiscal years, (through the monthly statements for December 2006) found that the Office of State Comptroller was still unable to prepare a monthly balance sheet for either fund. It was not until the January 2007 monthly statements that this condition was corrected, and at the time of our review (March 2007) a pattern of compliance has not been established.

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

Cause: The decentralized environment of the Core-CT system made State departments and agencies responsible for entering their own revenue records onto the general ledger. This resulted in continued problems with the proper recording and reporting of cash transactions. In addition, for most of the period in question the State Treasurer was unable to complete its monthly bank reconciliations in a timeframe that made it possible for the State Comptroller to prepare a monthly balance sheet.

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

Agency Response: "The one missing statement that you identify, the balance sheet, is now being produced and, therefore, this finding has been addressed.

In addition, this finding overstates the significance of the initial deficiency in monthly financial reporting. Since Fiscal Year 2005, the Comptroller's Office has been providing all statutorily required financial reporting essential to a comprehensive analysis of state's monthly operating position. The clear legislative intent cited in this finding requires the Comptroller to furnish statements that facilitate financial analysis of the state's monthly operations in the General and Transportation Funds. This information has been consistently provided.

The statement not included in the monthly reporting had been the balance sheet, which as constructed for the purposes of monthly reporting, repeats several of the estimates contained on the operating statements that had been routinely provided, and gives the changing cash totals against receivables and payables.

While this information assists in reconciliation, it provides little analytical value in determining the state's monthly operating position."

Failure to Provide Timely Annual Financial Reports:

Criteria: Section 3-115 of the General Statutes requires the Office of 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."

For the Office of State Comptroller to receive an audit opinion on its financial statements on or before December 31, the statements must be provided to auditors within a sufficient timeframe to allow for a complete examination in accordance generally accepted governmental auditing standards. In practice this has meant that in order for the Auditors of Public Accounts to be able to render an audit opinion by the thirty-first day of December, audit staff must receive final general ledger trial balance information by November 1, to be followed by a full set of budgetary basis financial statements by December 1.

Condition: Our previous audits, covering the fiscal years ended June 30, 2004 and 2005, cited the Office of State Comptroller for failure to provide preliminary and annual financial reports within the statutory deadlines.

The preliminary financial statements for the fiscal year ended June 30, 2006, were not issued by the Office of State Comptroller until October 2, 2006, or 30 days after the date they were required by Statute.

The Comptroller did not prepare and issue its *Annual Report of the Office of State Comptroller - Budgetary Basis* for the 2006 fiscal year until February 28, 2007, some eight months after the fiscal year end and two months after the date required by Statute.

Effect: For the past three fiscal years the Office of State Comptroller has not maintained compliance with Section 3-115 of the General Statutes.

Cause: The preparation of the annual financial statements has been a difficult process that required extensive manual corrections and adjustments. Because of the extensive delay in reporting for the 2003-2004 and 2004-2005 fiscal years, the Budget and Financial Analysis Division of the State Comptroller's Office was not able to begin the process of preparing the financial statements for the 2005-2006 fiscal year until October 2006. The Auditors of Public Accounts did not receive the full set of budgetary basis financial statements for audit until the end of January 2007, one month after the statutory deadline.

The delay in issuing the preliminary financial statements for the 2006 fiscal year was primarily caused by the failure of the Department of Revenue Services to provide its statutory revenue accruals to the Office of State Comptroller on a timely basis.

In addition, there were the continuing problems resulting from the Core-CT system implementation in 2003. A significant amount of additional time and effort was required of the State Comptroller's Budget and Financial Analysis Division in order to identify and correct account posting errors made by system users and posting problems within the Core-CT system itself. These corrections must be made prior to the issuance of accurate financial statements.

Conclusion: We note that given the record of improvement, it appears that the *Annual Report of the Office of State Comptroller – Budgetary Basis*, for the fiscal year ended June 30, 2007, which is required by December 31, 2007, is likely to be made in a timely manner. However, we observe that the preparation of preliminary financial statements, due by September 1, 2007, or only 60 days after the close of the fiscal year, will be more problematic. In order for the State Comptroller to comply with the statutory requirement, it will require the cooperation of the Department of Revenue Services to provide the statutory revenue accruals before the September 1st, deadline. At this time we will not repeat the previous Recommendation.

Agency Response: "We agree with your statement that "given the record of improvement, it appears that the Annual Report of the Office of the Comptroller- Budgetary Basis, for the fiscal year ended June 30, 2007, which is required by December 31, 2007, is likely to be made in a timely manner".

The time required to produce annual audited budgetary basis statements has been cut dramatically each fiscal year. In Fiscal Year 2004, the first year of reporting under Core-CT, the statements were a year and a half late; in Fiscal Year 2006, the statements were two months late. The delay that you note in providing preliminary estimates for Fiscal Year 2006 was caused by the late posting of revenue accruals by the Department of Revenue Services, as you have stated.

Because of the significant delay in reporting on Fiscal Year 2004, work on the preparation of financial statements in subsequent years had to be delayed. A new year could not be closed until the old year was closed. Therefore, the initial Fiscal Year 2004 problem created a "snowball" effect moving forward. It is anticipated Fiscal Year 2007 will be on time.

Unaudited annual financial reports were produced in Fiscal Years 2004, 2005 and 2006 prior to the February 28th SEC continuing disclosure requirement. Both legal basis and GAAP based annual reports were provided prior to that date. These unaudited statements proved to be highly reliable for trending and comparative analysis purposes and were accepted and utilized by credit rating agencies. The final audited statements contained no changes of a material nature.

Numerous edits, monthly closing procedures and business process changes have been implemented in Core-CT to reduce the number of agency coding errors to the general ledger that must be corrected at year end. Additional edits are being evaluated. It is anticipated that the delays will not recur in Fiscal Year 2007."

Failure to Provide Timely CAFR Financial Statements:

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

Governmental Accounting Standards Board - Statement No. 34, *Basic Financial Statements and Management's Discussion and*

Analysis for State and Local Governments - requires general purpose governments to present basic financial statements and required supplemental information in order to be in compliance with generally accepted accounting principles (GAAP). The basic financial statements must include a management discussion and analysis, government-wide financial statements, fund financial statements and notes to the financial statements.

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

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

For an audit to be conducted in accordance with generally accepted governmental auditing standards, sufficient time must be provided to completely audit and render an opinion on the financial statements published in the State's *Comprehensive Annual Financial Report*. In order to be able to issue an audit opinion by a specific date, it is generally expected that it will take a minimum of six or more weeks from the time a complete set of draft statements are received by the Auditors of Public Accounts to the time those financial statements will be available for publication.

Condition: The Comptroller did not prepare and issue audited financial statements for its CAFR until April 25 2007, almost ten months after the fiscal year end, two months after the date they were needed by the State Treasurer and one month after the date they were required by the Federal government.

Effect: The Comptroller was only able to provide unaudited CAFR financial statements to meet the February 28, 2007, SEC continuing disclosure requirement. Credit rating agencies may consider this deficiency when assessing the creditworthiness of the State of Connecticut.

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

As a result, in March 2007, the Office of Policy and Management requested and received an extension from the U.S. Department of Health and Human Services, extending the State's reporting deadline from March 31 to May 31, 2007.

Cause: As noted above, because of the extensive delay in reporting for the 2003-2004 and 2004-2005 fiscal years, the Budget and Financial Analysis Division of the State Comptroller's Office was not able to begin the process of preparing the financial statements for the 2005-2006 fiscal year until October 2006. The full set of final CAFR financial statements were not presented for audit to the Auditors of Public Accounts until February 28, 2007.

As described above, there were delays in issuing the *Annual Report of the Office of State Comptroller - Budgetary Basis* upon which the preparation and audit of the CAFR is based. By necessity, the preparation of CAFR financial statements must follow the extensive manual compilation and adjustment effort necessary to produce accurate budgetary basis statements. The cause of such efforts was the result of various problems in the Core-CT system as detailed below.

Conclusion: We note that given the record of improvement, it appears that the *Comprehensive Annual Financial Report*, for the fiscal year ended June 30, 2007, which is required by February 28, 2008, is likely to be made in a timely manner. At this time we will not repeat the previous Recommendation.

Agency Response: "The response provided above with respect to budgetary based statements also applies to CAFR statements. It is anticipated that those statements will be on-time for Fiscal Year 2007."

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 Office of State Comptroller, provides formal written accounting policies and procedures, and establishes the definitions of authority and responsibility between State departments and agencies, and the Office of State Comptroller.

Condition: Previous audits, covering the fiscal years ended June 30, 2004 and 2005, have disclosed that many of the controls the Office of State Comptroller had previously maintained over account postings were eliminated with the implementation of the Core-CT system. Internal controls over the posting of interagency transfers, correct account coding, and budgetary accounting to statewide account records was significantly diminished since the Core-CT system went on line in July 2003.

To address these findings some corrective action has been made. 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 State Comptroller's Office to better monitor and control system entries, identify transaction errors and control posting dates. Transaction changes by user agencies must now be made during the current accounting period (month) rather than affecting past posted transactions.

In January 2006 edits were added to the Core-CT system to ensure that certain invalid coding combinations cannot be processed. In July 2006, the State Comptroller's Office implemented the review of all user agency journal vouchers on a monthly basis in order to add the proper cash account coding and ensure that other account coding is correct.

However, our current review found that staff members of the Budget and Financial Analysis Division were still required to expend a significant amount of their time working on Core-CT problems with user agencies, and identifying and correcting accounting errors made by Core-CT system users. The Budget and Financial Analysis Division has proposed further system edits, but these have yet to be implemented by the Core-CT project staff.

At the time of our review (March 2007), the Office of State Comptroller has still not provided user agencies with an updated version of its *State Accounting Manual,* almost four years after the Core-CT conversion. The first revision, an on line chart of accounts for the Core-CT system, was not made available to agency users until January 2006. As an alternative, other on line information for system users has been provided; these include copies of training materials, job aids, and daily emails. However, a unified document providing a complete set of standards and instructions for Core-CT system users to follow has not been made available.

Our previous reports also noted that the Office of State Comptroller had relinquished a significant amount of the control it previously maintained over the accounting of the State's financial transactions. We also noted that the Budget and Financial Analysis Division of the Office of State Comptroller, which is empowered to establish accounting controls and standards on a statewide basis, was frequently in the position of accepting what the Core-CT project could provide, rather than the system more directly meeting their needs.

In response, effective April 2006, the Core-CT Financials Team was, placed as part of the Budget and Financial Analysis Division on the organizational charts of the Office of State Comptroller. It is our observation that this change did not significantly improve the responsiveness of the Core-CT project staff to the needs of the State Comptroller in implementing system changes. It may not be until the final module is implemented (planned for the 2007-2008 fiscal year), with the role of consultant contractors minimized, and with the final disposition of project management settled, will the reorganization actually show significant improvements resulting from this change.

We note that in November 2006, the Gartner Group, a private information technology consultant, made a historical and forward-looking study of the Core-CT implementation. Their report, issued in February 2007, concluded that the Core-CT team needed reorganization to better respond to line agency users. The report also stated that a new strategy is needed to improve the training offered to system users, that improvements are needed in the reporting and query functionality, and key and mandatory line agency functions required better support. More specifically, the report cited the problems with inconsistencies in the commitment control function, and the lack of field level edits and validation over those transactions entered by agency users.

Accordingly, we also note that at the time of our review (March 2007) the Governor's biennial budget proposal for the 2007-2009 fiscal years included plans to transfer the operation of the Core-CT system (105 employee positions) to the supervision of the State Comptroller by creating a Core-CT Division within the Office of State Comptroller. At the same time we noted legislation was proposed to establish a Core-CT Support System Division within the Office of State Comptroller, and to establish a Core-CT Policy Board.

Effect: With the decentralization inherent in the Core-CT system, we found State agencies can enter data onto statewide accounting ledgers without the review and authorization of the Office of State Comptroller. As a result, accounting entries are frequently made by user State agencies that do not conform to proper governmental accounting practices.

The Core-CT system has not adequately served line State agency users. The State of Connecticut has not received the full benefit of its significant investment in the Core-CT system. The consultant report included a list of Core-CT functionality gaps that included the areas of commitment control, Federal billing, reporting and the lack of screen edits and validation controls.

Cause: Because the Core-CT project is still under the administration of the joint committee responsible for the system's initial implementation, with no organizational plan established for ongoing administration, and with consultants still completing significant work on the implementation of the projects and contracts modules for the 2007-2008 fiscal year, it will be some time before the Core-CT system could actually be "handed over" to the Office of State Comptroller. Even after that point, the Core-CT system will remain an adaptation from the commercial accounting environment, and will not be able to close annual budgets, and maintain budget controls, appropriations, encumbrances, purchase orders and other transactions in an efficient manner within the decentralized environment of numerous State agencies.

Our previous audit recommended the establishment of basic "edit checks" to prevent erroneous transactions from being entered to the wrong account and fund combinations. We found the basic version of these controls was not implemented until January 2006, two and one half years after the Core-CT system was brought on line.

Recommendation: The Office of State Comptroller should reemphasize its role as the agency responsible for maintaining the accounts of the State, and apply adequate controls and direction over Statewide financial accounting and reporting, which should include the revision of the State Accounting Manual to address the Core-CT environment. (See Recommendation 2.)

Agency Response: "Core-CT was designed and implemented to subsume the functions of various costly and technologically disparate financial systems and subsystems that the state had been using. Therefore, Core-CT in design and nature went well beyond the demands of the Comptroller's Office as a central user by also incorporating agency based financial and human resources needs.

To capture the full scope of both central and agency based needs, and to balance these –at times—competing requirements, an oversight organization was formed. Oversight of Core-CT implementation was provided by the Comptroller, DAS, OPM, and the Department of Information and Technology (DOIT). It was essential to receive input and guidance from these other three agencies during the design and configuration phase of the Core-CT module implementations. The final module addition to Core-CT, which is referred to as Projects and Contracts, will be implemented in Fiscal Year 2008. At that point, Core-CT will be emerging from its implementation phase and entering its support and enhancement phase.

As you observe, the Gartner Group produced a report in February 2007 that, among its many findings, recommended elimination of the multiple director group management of Core-CT in favor of a single director. This organizational change was reflected in the Governor's biennial budget proposal for Fiscal Years 2007-2009, with the single director and Core-CT division consolidated in the Comptroller's Office. As the Core-CT system stabilizes under new management, redeployed resources will be available to implement new system edits, validations, and business process enhancements.

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 central data entry control and, as noted in this report, the need to increase internal controls and monitoring of system entries.

The Comptroller's office has already implemented numerous system and business process enhancements designed to both increase internal controls and better monitor transactions. In November 2004, a monthly closing process was implemented that eliminated the post dating of accounting transactions thus facilitating monthly reconciliations. In February 2005, a billing module was added to the system that, among other functionality, implemented hard coding of revenue based on billing type, thus enhancing central tracking of interagency transfers. In January 2006, combination edits were implemented that eliminated some of the most common agency coding errors. Also in January 2006, an on-line chart of accounts user guide was made available to agencies to assist them in determining proper central coding requirements. This coding guide supplements state accounting practice detail for each of the Core-CT modules that is contained within the job aides, training material, user group material and Q&A topics presented on the financial user section of the Core-CT web page.

In July 2006, the Comptroller's Office centralized the process of entering cash lines on Journal Vouchers in order to ensure proper coding and balancing of such journals.

As noted above, as Core-CT evolves from a system implementation project to a more stable support and enhancement function, opportunities will exist to implement additional edits and controls. The Comptroller's Office will continually seek enhancements to better meet agency needs and will continue to ensure that necessary internal controls and edits are incorporated within those enhancements."

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: Previous audits, covering the fiscal years ended June 30, 2004 and 2005, have cited the failure of the Core-CT system to provide reports detailing agency cash receipts and available cash, as well as the detail of Federal grant expenditures. Although significant improvements have been made in respect to general reporting, the basic system design of Core-CT has left users with the inability to obtain reports in certain areas.

Our current audit conducted an informal survey among a number of users of the Core-CT system. Several reported a need for a grants receivable trial balance, which was a functionality lost with the Core-CT system. Without it proper Federal grant billing and accounting is made more difficult. In addition, respondents stated that it is still not possible for users to receive reports that identified s.i.d. (special identification code) that pertains to restricted appropriations, particularly Federal grants. It is still difficult for users to receive delivered reports that are sorted by fund and/or s.i.d. code. Certain on line reports, particularly revenue and available reports, were described as difficult to run by the average user, and where a delivered report was desired.

Complaints were also made about the difficulty and time required to "drill down" and find detailed information on a ledger entry, as well as inconsistencies observed when running a report with the same criteria successive times results in differing totals.

The Independent Public Auditor report for the Special Transportation Fund for the fiscal year ended June 30, 2006, reported the condition that "There was no automated procedure in place to properly account for grant expenditures, grant receipts, grants receivable and deferred grant revenue. The previous accounting system tracked grant expenditures and grant receipts and automatically determined grant revenue based on those amounts. During our audit, we noted that none of the agencies of the Special Transportation Fund could readily determine from the Core-CT system the amounts for grant expenditures, grant receipts, and related grants receivable and deferred grant revenue. Consequently, a manual analysis had to be prepared using various reports from the Core-CT system to determine the required amounts for grants."

Effect: Proper accounting for grant expenditures related to personal services costs, and certain cash, receivables and revenues reporting has continued to be problematic. Extensive manual labor was required to maintain chartfield mapping as employee changes were made and to reconcile between separately maintained records and those on the Core-CT system, as well as between the financial and human resources modules of Core-CT.

Cause: The Core-CT system is based on PeopleSoft computer software that is an adaptation from the commercial accounting environment. That adaptation to the accounting needs of the State resulted in certain deficiencies in financial reporting.

Recommendation: The Office of State Comptroller should seek continued improvements in financial reporting from the Core-CT system, with specific emphasis on the accounting of grant revenues, expenditures and transfers. (See Recommendation 3.)

Agency Response: "The Comptroller's Office disagrees with the emphasis of this finding. Essential reporting functionality has been available to Core-CT users throughout the audit period. Since implementation of Core-CT, the Comptroller has been leading the effort to improve Core-CT financial reporting. The Comptroller's Office and designated Core-CT project staff have enhanced numerous reports including the Expenditure Detail Report, the Available Cash Trial Balance, the Detail & Summary Revenue Report, the Trial Balance of Appropriations, and the Grant Appropriation Trial Balance. In addition, most reports have been enhanced to allow them to be easily downloaded into Excel.

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

Several of these reports were enhanced to meet requirements that were suggested by the focus group. Also, a flexible analysis report was added under the general ledger to allow users to review ledger balances by account code based on parameters they define. In September 2005, the new report catalog website went online. Initially, this site included over 30 production reports covering six financial modules. At this writing, the number of reports has grown to over seventy. Each report starts with an introduction to the report stating the purpose, type references the legacy CAS/SAAAS report it replaces, role(s) required for access, navigation path, and suggested run times. It also provides detailed instructions to initiate the report and a sample of the information generated by the report. This catalog has been well received by the entire user community and is being expanded upon. It should also be noted that prior to Core-CT, data processing employees were required to extract certain financial information that is now readily accessible to Core-CT users through basic reporting functionality.

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

You note that certain reports are not sorted as desired. However, since the reports are downloadable to Excel, they can be sorted by the user as desired. You also note deficiencies in grant reporting. It is true that historical data, including cumulative receipts, are not available on a single report and compiling this information is time consuming. Efforts have been made to develop improved reporting in this area, but have not yet been fully achieved.

As in any financial environment, change is a constant. Reporting functionality will be revised and enhanced on an ongoing basis to adapt to change and to enhance the ease of user reporting functionality. Improved grant reporting remains a priority issue."

Inability to Promptly and Accurately Reconcile Cash Activity:

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

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

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

Condition: Our previous audits cited the failure of the Core-CT system to process on line data on cleared and outstanding checks to allow for the prompt reconciliation of the State's checking accounts. As a result of this deficiency, the State Treasurer could not reconcile its cash accounts promptly after year-end, which contributed to the delays in preparation of both the State Comptroller's Annual and CAFR reports and the State Treasurer's Annual Report for the fiscal years ended June 30, 2004 and 2005.

In response to our previous audit, the Office of State Comptroller has added additional controls to reduce the problems encountered in reconciling cash activity. Effective with the 2006-2007 fiscal year, user agencies were prevented from entering cash postings to journal voucher transactions. Instead, this process has been recentralized by having the Budget and Financial Analysis Division manually add the cash lines to such transactions each month. In addition, the Core-CT system was modified to automatically code "on account" items, which are receipts pending identification as to the proper account to be credited to (referred to as "OA" items or pending receipts) directly to the Funds Awaiting Distribution Fund (34003 Fund). The State Comptroller planned to track these items monthly to ensure that revenue accounts reflect changes in cash. These changes have resulted in some improvement; however, as described below, it has also caused problems with the Accounts Receivable Maintenance/ Transfer Control Account (11500). At the time of our review (March 2007) an improvement to the method of handling on account receipt items was a matter still pending with the Core-CT project staff.

Our current audit observed that the State Treasurer has made progress in completing its monthly bank reconciliations in a timely manner. At the time of our review (March 2007) the State Treasurer was generally completing its bank reconciliations within the 15th day of the following month for the smaller accounts, and within the end of the following month for the payroll and vendor accounts. For the fiscal year ended June 30, 2006, there were still offsetting items between accounts that the State Treasurer could not reconcile or explain. These items did not affect the overall financial reporting of cash balances by the State Comptroller, but still require correction

We also observed that the implementation of an on line process discussed in our prior report remains to be accomplished. The State Treasurer is relying upon a manual alternative that uses downloaded bank information. This method is more labor-intensive, and information on cleared and outstanding items is not available to users on the Core-CT system. We note that the State Treasurer is required to reconcile 17 different bank accounts each month, with an additional six being reconciled by various State agencies.

Our prior audit also noted deficiencies with the Interagency Transfer Account (10436) used as a clearing account to process transfers between State agencies. This account should, once all pending items have been processed, maintain a net zero balance. Our previous audit found that this account has not been reconciled on a current basis by the State Comptroller. Our current audit again found outstanding billings and payments have not been researched and resolved in a timely manner, and no edit controls have been implemented to enforce the proper use of this account.

During the initial preparation of the financial statements for the 2005-2006 fiscal year, the Budget and Financial Analysis Division of the Office of State Comptroller encountered erroneous balances in the Core-CT Accounts Receivable Maintenance/Transfer Control Account (11500). This was the result of on account revenue items being automatically posted to the 11500 account in the general ledger by the accounts receivable module of the Core-CT system, as described above. The Office of State Comptroller explained that changes in the method of processing on account receipt items, or the elimination of their use would eliminate this problem. As noted above, the State Comptroller was requesting such changes from the Core-CT project staff.

Effect: Personnel of the Office of State Treasurer are required to maintain a manual ledger to reconcile from the bank account and adjust the Core-CT general ledger to reflect bank activity; a more labor intensive method that should have been automated as part of the Core-CT conversion.

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

The problems with the Accounts Receivable Maintenance/Transfer Control Account involved numerous transactions, which required the attention of two staff accountants for two months to be identified and corrected. Without the correction of these mispostings, it would be impossible to prepare accurate cash statements. The additional time required for this effort contributed to the delays in financial reporting.

Cause: The design of the Core-CT system contains deficiencies pertaining to the efficient reconciliation of bank accounts and the processing of interagency transfers and online account receipt items. In addition a lack of controls over account mispostings by department and agency users contributed to the conditions noted.

Recommendation: The Office of State Comptroller, working with the Office of the State Treasurer, should provide an automated method to reconcile cash activity within the Core-CT system. It should also address the need to review and reconcile the Interagency Transfer Account, and the need to improve the processing of on account receipt items. (See Recommendation 4.)

Agency Response: "Reconciliation of cash to bank totals is a function of the State Treasurer's Office. The Comptroller's Office and Core-CT staff have been working jointly with the Treasurer's Office to resolve the general ledger cash to bank reconciliation problems that have existed since the implementation of Core-CT. As you discuss, numerous business process and system changes have been implemented to facilitate cash reconciliation.

It should be recognized that from a combined cash perspective, cash flows are materially in balance in all funds. The problem is within specific cash account reconciliations. Therefore, it is logical to assume imbalances between accounts are offsetting.

The Treasurer's Office reached agreement with Bank of America to receive daily cleared and outstanding check data in file format. This file must be configured to Core-CT. The final agreement with Bank of America for provision of this file coincided with the upgrade of Core-CT, and sufficient resources were not available to configure the file at that time. At this writing, the configuration of the file is a high priority task. Although this file provides an additional reconciliation tool, it will not result in a spontaneous reconciliation of cash accounts by fund since it contains no information on the accounting code distribution of cash.

With respect to interagency cash, despite exhaustive research, no system based edits have been found to ensure the consistent recording of interagency cash transfer transactions. Centralization within the Comptroller's Office of all interagency cash transactions was considered. The system functionality that allows agencies to move money without central oversight cannot be readily eliminated from the Core-CT system option. In addition, agencies have come to depend on this functionality. Therefore, even if a policy decision was made to centralize the transfer process, it could not be effectively enforced.

Substantial resources have been dedicated to ensure that depository cash accounts can be balanced for Fiscal Year 2007 reporting. Additional controls are being sought for interagency cash transactions."

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: Previous audits, covering the fiscal years ended June 30, 2004 and 2005, have found that the decentralized controls in the Core-CT system allowed agency personnel to directly enter interagency transfers onto the State's general ledger coded to the incorrect accounts of its own or the recipient agency. With the implementation of the billing module of Core-CT in February 2005, improvements were made in system controls.

However, our current audit found department and agency users were still improperly coding interagency transfers. Prior audits have also noted that billed State agencies will at times not approve interagency transfers that were posted to their accounts by a billing agency. This would leave the transaction uncompleted, resulting in outstanding charges and incomplete or incorrect transactions posted to accounts.

At the time of our review (March 2007) there were no system controls implemented to positively prevent system users from miscoding interagency transfers or to prevent uncompleted ones.

Effect: Transfers of State and Federal funds were inaccurately recorded. State agencies could not provide an accurate accounting of grant receipts; grant expenditures, grants receivable and deferred grant revenue. Coding problems have made interagency transfer reporting an error prone and labor-intensive activity.

Cause: Deficiencies in the system controls, and a decentralized environment that did not enforce compliance with standard policies and procedures allowed users to believe that if a transaction could be entered and processed through the system, it was properly coded.

Recommendation: The Office of State Comptroller should correct deficiencies in the internal controls in the Core-CT system that governs the entry of interagency transfers. (See Recommendation 5.)

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 as discussed above. Despite these problems the Comptroller’s Office has been able to provide required reports and reconciliations on federal and state interagency transfers. Additional controls are being sought for interagency cash transactions.”

Failure to Consistently and Properly Record Account Codes:

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

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

Condition: Previous audits, covering the fiscal years ended June 30, 2004 and 2005, have encountered problems with the manner that revenue and expenditure transactions were processed in the Core-CT accounting system. Because of the decentralized control environment in the Core-CT system, State agencies have had the ability to enter onto the State's general ledger many types of erroneously coded transactions without being blocked by internal controls that include edits and validation based at the field level.

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

At the time of our review (March 2007) there were still only limited controls in place to ensure that department and agency users code transactions to the proper accounts, and significant numbers of transactions are still miscoded. The Office of State Comptroller has relied upon and emphasized continued training of department and agency users in order to address the problem. However, it has still not made the necessary changes to address the new decentralized environment.

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

To eliminate the problem of State agencies entering journal vouchers with improperly coded cash accounts, the State Comptroller's Office must maintain a manual process to apply the proper account code itself and then post the journal voucher for the user agency. Hard edits or other controls have not been built into the Core-CT system to prevent department and agency users from continuing to enter erroneous account coding.

Cause: The Core-CT system is decentralized and by necessity, the Office of State Comptroller must rely on department and agency users to make the correct accounting entries onto the system. Reliance was placed on the training of Core-CT users, rather than fixed system edits. Deficiencies in the system design and the failure to initially establish standardized procedures have allowed users to enter erroneous account or date information.

Recommendation: The Office of State Comptroller should improve the internal controls over the entry of account codes in the Core-CT system. (See Recommendation 6.)

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

Additional system edits and controls are periodically examined. The benefits of additional system edits must be fully tested and weighed against the potential negative impact on system performance and user requirements."

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: Previous audits have noted a deficiency in Core-CT system controls that affected commitment and general ledger reporting. The Core-CT system uses a system of a general ledger and a commitment control ledger to provide for the budgetary control used by State government. We found that the "budget check" that was established as an internal control to prevent the posting of transactions to the general ledger without first being posted to the commitment control (budget) ledger, was being affected by various "system bugs" or other problems causing it to be bypassed and/or creating other posting problems.

Our current audit noted some improvement has been made. However, throughout the audited period certain budget check problems would appear. The Core-CT system would, at times, allow a payment to be posted prior to the posting of the applicable voucher, leaving vouchers in the system that were not associated with an applicable payment, and possibly deleted after a payment was made. Also, the Core-CT system did not always automatically generate the proper entries to all accounts when a journal voucher was entered into the system. Department and agency users were required to prepare them manually, which sometimes resulted in their failure to be properly posted to budgetary or other accounts.

Effect: System users and the staff of the Budget and Financial Analysis Division are required to manually identify and correct differences that result between the general ledger and the commitment control ledger as part of a monthly closeout and reconciliation process.

Department and agency users of the Core-CT system have reported inconsistent and cumbersome functionality when processing purchase orders and applying the budget check process.

Cause: Deficiencies in the system design ("system bugs") and the failure to adequately control user-entered transactions have created weaknesses in internal controls that allowed erroneous transactions to be processed in the system. The Office of State Comptroller has studied the feasibility of building hard edits into various Core-CT module applications to eliminate the ability of agencies to enter coding that would bypass budget check. However, other than the combination edits for fund and s.i.d. coding that was implemented in

January 2006, no corrective action has been implemented. We do note that beginning in July 2006, the accounts payable module in Core-CT was modified to prevent payments from being processed on an unposted voucher.

Recommendation: The Office of State Comptroller should correct deficiencies in the internal controls of the Core-CT system to eliminate "budget check" problems, and the bypassing of the commitment control ledger. (See Recommendation 7.)

Agency Response: "The Comptroller's Office has been aggressive in seeking vendor resolution of the commitment control "system bugs" that you discuss. The upgrade to PeopleSoft version 8.9 addressed many of the deficiencies within commitment control.

The problem that you identify with payments in some cases posting prior to the voucher has been resolved. The system will no longer permit payment posting prior to voucher posting. In addition, and as not above, in July 2006 a manual review of journal vouchers was implemented by the Comptroller's Office to limit posting errors.

The version 8.9 software will be closely monitored to ensure that the promised improvements in commitment control functionality are realized. Other corrective steps as noted in the response have already been implemented."

Administration of Refunds of Payments:

Criteria: An accounting system is designed to assemble, classify, record and report financial data. For a system of administration and accounting to accurately report financial activity related to revenues received and subsequently refunded, internal controls must be provided to correctly charge the revenues received and properly account for the expenditure refunding those revenues, by identifying their source.

Condition: Sections 4-37, 14-159, 22a-10 and other sections of the General Statutes authorized the Office of State Comptroller to refund overpayment of fees paid by corporations and individuals and to refund moneys to persons equitably entitled to the refund of any money paid to the State. The State Comptroller's Office had, previous to the implementation of the Core-CT system, administrative control over the refunds of payments received by most State agencies, utilizing a specific appropriation for refunds of payments.

In July 2003, when the legacy accounting system was replaced by the Core-CT system, a system of centralized controls and procedures that reviewed, authorized and accounted for refunds of payments received by State agencies was dismantled. State agencies, with the exception of the Department of Motor Vehicles, now process their own refunds of payments. The special appropriations administered by the State Comptroller for such refunds were eliminated, and refunds of payments are now automatically processed by the Core-CT system and paid directly from the revenues of the Office of State Comptroller. The State Comptroller does not review and approve these payments.

These payments are charged to a single accounting string that is charged as a refund of revenues of the Office of State Comptroller, without regard to the source of the original revenue other than the specific fund. During the 2005-2006 fiscal year, refunds of overpayments and other payments totaling $437,821 and $2,665,871, from the General Fund and Special Transportation Fund, respectively, were charged to the revenues of the Office of State Comptroller (account 46200 Other Refunds) without regard to the specific State agency or department they were initially deposited to. This refund of revenues is not charged to the agency account, or to the rest of the specific accounting string from which it originated.

Cause: It appears that this condition was not addressed at the time of the Core-CT conversion.

Effect: Refunds are paid by State agencies from the revenues of the Office of State Comptroller without the review and authorization of that agency. Statewide financial reporting of revenue refunds is inaccurate, as the reported revenues of State agencies did not reflect refunded amounts, and the revenues reported by the Office of State Comptroller reflect activity related to other State agencies.

Recommendation: The Core-CT system should be modified to ensure that refunds of payments are made under proper internal controls and correctly coded to the applicable agency and revenue accounts. (See Recommendation 8.)

Agency Response: "This office is not in total agreement with this finding. With regards to payments being charged to the revenues of the State Comptroller without regard to their origin, there is no appropriated fund for refunds. Resources are simply deposited into the General Fund or the Transportation Fund. We are, in fact, matching the fund where the money was deposited to the fund where it initially was dispersed.

To further refine identification of the refunds made for Fiscal Year 2007, we have implemented an accounting string with a specific program code for each type of refund. At this point, Core-CT EPM reports can be generated for a specific type of refund by a specific agency – a modification which as been well received by all impacted agencies. In addition, our Office is implementing a post audit procedure to properly control and account for the refunds."

Preparation of Budgetary Basis Financial Report in Compliance with GAAP:

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

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

This AICPA interpretation of auditing standards is a requirement for additional disclosures to meet the same accounting standards as currently applied to the *Comprehensive Annual Financial Report* produced by the Office of State Comptroller. The OCBOA provisions provide for reporting on the State's budgetary basis of accounting and do not conflict with either the State's Constitutional or statutory financial reporting requirements.

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

Condition: The Comptroller has not been able to prepare and issue its *Annual Report of the Office of State Comptroller - Budgetary Basis* in a format that meets AICPA standards. The report for the fiscal year ended June 30, 2006, did not contain a complete financial statement presentation, a management discussion and analysis and other required supplementary information, as well as notes to the financial statements, and information regarding component units and a disclosure of the cost and depreciation of infrastructure assets.

Effect: The *Annual Report of the Office of State Comptroller - Budgetary Basis* for the fiscal year ended June 30, 2006, was not presented in compliance with accounting standards generally accepted within the United States of America. As a result the audit opinion provided by our office was modified to reflect that those statements were not prepared in accordance with GAAP.

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

Recommendation: The Office of State Comptroller should prepare its *Annual Report of the Office of State Comptroller - Budgetary Basis* to include those elements required by generally accepted accounting principles. (See Recommendation 9.)

Agency Response: "The State's mode and method on the legal basis of accounting are constitutionally assigned to the Comptroller. State statute further defines the reporting elements of the legal basis of accounting. The AICPA may provide guidance, but may not dictate the State's legal reporting standards. This recommendation is not consistent with Connecticut state law and no corrective action is required. As you note, the Comptroller's Office produces a Comprehensive Annual Financial Report (CAFR) that is fully compliant with the provisions of Generally Accepted Accounting Principles (GAAP). The CAFR contains a reconciliation of the legal based reporting to GAAP."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

Office of State Comptroller - State Financial Operations Audit Report -

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

1. The Office of State Comptroller should take whatever measures necessary to comply with Section 3-115 of the General Statutes and produce a complete set of monthly financial statements – our current review found that the monthly statements have not included a balance sheet for either the General Fund or the Special Transportation Fund for the entire audited period. It was not until the January 2007 monthly statements that this condition was corrected. At this time we are repeating the Recommendation until continuing compliance is shown. (See Recommendation 1.)

2. The Office of State Comptroller should take whatever measures necessary to comply with Section 3-115 of the General Statutes and produce its annual financial reports in an efficient and timely manner - the Office of State Comptroller again failed to meet the September 1st, and December 31st, statutory deadlines for financial reporting. However, given the record of improvement, it appears that the *Annual Report of the Office of State Comptroller – Budgetary Basis*, for the fiscal year ended June 30, 2007, which is required by December 31, 2007, is likely to be made in a timely manner. We also observe that meeting the deadline for preparation of preliminary financial statements will be more difficult. These statements are due by September 1st, only 60 days after the close of the fiscal year, and require data from the Department of Revenue Services for their completion. Given the record of improvement shown by the Office of State Comptroller, we are not repeating the Recommendation at this time.

3. The Office of State Comptroller should take whatever measures necessary to ensure that the financial statements for its Comprehensive Annual Financial Report are prepared in an efficient and timely manner – the Office of State Comptroller again failed to prepare its CAFR financial statements to meet the February 28th deadline. However, given the record of improvement, it appears that future financial reporting is likely to be made in a timely manner. We are not repeating the Recommendation at this time.

4. The Office of State Comptroller should reemphasize its role as the agency responsible for maintaining the accounts of the State, and apply adequate controls and resources to the task of Statewide financial accounting and reporting, which should include the revision of the *State Accounting Manual* – our current review found some improvements made, staffing changes and additions were made at the Budget and Financial Analysis Division. However, sufficient controls are not in place to eliminate the problem of user agencies generating misposted transactions to the

State's general ledger. In addition, the State Accounting Manual has not received a revision to reflect the changes under the Core-CT system. The Recommendation is revised and repeated. (See Recommendation 2.)

5. The Office of State Comptroller should seek continued improvements in financial reporting from the Core-CT system – Our current review noted some corrective action taken. However financial reporting under the Core-CT system still requires additional improvement. The Recommendation is repeated. (See Recommendation 3.)

6. The Office of State Comptroller, working with the Office of the State Treasurer, should provide a system to reconcile cash activity and post necessary cash adjustments in a timely manner that provides adequate internal control over ledger adjustments. It should also address the need to review and reconcile the Interagency Transfer Account – Our current reviews found the monthly bank reconciliations were made on a more timely basis. However, no corrective action has been implemented as to automating this function, or addressing the problems of the Interagency Transfer Account. The Recommendation is repeated in a modified form. (See Recommendation 4.)

7. The Office of State Comptroller should correct deficiencies in the internal controls in the Core-CT system that governs the entry of interagency transfers - our current review again found that internal controls, although some improvements were made, were still inadequate. The Recommendation is repeated. (See Recommendation 5.)

8. The Office of State Comptroller should correct deficiencies in the internal controls in the Core-CT system over the entry of account codes – our current review found that the system still has only basic controls to prevent erroneous account codes from being entered by department and agency users. The Recommendation is repeated. (See Recommendation 6.)

9. The Office of State Comptroller should correct deficiencies in the internal controls of the Core-CT system to eliminate "budget check" problems and the bypassing of the commitment control ledger – our current review noted that various problems with the budget check and commitment control ledger have continued to occur. The Recommendation is repeated. (See Recommendation 7.)

10. The Office of State Comptroller should correct its Annual Report of the Office of State Comptroller - Budgetary Basis to conform to generally accepted accounting principles. The Recommendation is repeated. (See Recommendation 9)

State of Connecticut - Single Audit Report -

Seven recommendations were included in our Single Audit Report for the fiscal year ended June 30, 2005; these are detailed as items three through nine above. Recommendations four through nine above are repeated in our current Single Audit Report.

Current Audit Recommendations:

1. **The Office of State Comptroller should comply with Section 3-115 of the General Statutes and consistently produce a complete set of monthly financial statements.**

   Comment:

   The Office of State Comptroller was unable to produce monthly financial statements that contain a balance sheet for either the General Fund or Special Transportation Fund until December 2007.

2. **The Office of State Comptroller should reemphasize its role as the agency responsible for maintaining the accounts of the State, and apply adequate controls and direction over Statewide financial accounting and reporting, which should include the revision of the *State Accounting Manual* to address the Core-CT environment.**

   Comment:

   We found that user agencies are not subject to the centralized control previously enforced by the Office of State Comptroller over transactions entered onto State's accounting records. In addition, the *State Accounting Manual* has not been updated to provide Core-CT users effective guidance.

3. **The Office of State Comptroller should seek continued improvements in financial reporting from the Core-CT system, with specific emphasis on the accounting of grant revenues, expenditures and transfers.**

   Comment:

   The Core-CT system has been unable to provide system users financial reports in formats and with information that was previously provided by the system it replaced, and with functionality that justifies the over $124,000,000 cost of the new system.

4. **The Office of State Comptroller, working with the Office of the State Treasurer, should provide an automated method to reconcile cash activity within the Core-CT system. It should also address the need to review and reconcile the Interagency Transfer Account, and the need to improve the processing of on account receipt items.**

Comment:

Throughout the audited period the State Treasurer was unable to promptly reconcile cash activity from the Core-CT general ledger to the bank statements. At the time of our review (March 2007) unreconciled and unexplained differences between the two records still existed.

5. **The Office of 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.

6. **The Office of State Comptroller should improve the internal controls over the entry of account codes in the Core-CT system.**

   Comment:

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

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

   Comment:

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

8. **The Core-CT system should be modified to ensure that refunds of payments are made under proper internal controls and correctly coded to the applicable agency and revenue accounts.**

   Comment:

   Deficiencies in the Core-CT system design did not allow for the accurate reporting and control of refunds of payments.

9. **The Office of State Comptroller should prepare its *Annual Report of the Office of State Comptroller - Budgetary Basis* to include those elements required by generally accepted accounting principles.**

   Comment:

   The *Annual Report of the Office of State Comptroller - Budgetary Basis* for the fiscal year ended June 30, 2006, did not include all of the elements to be in compliance with accounting standards generally accepted within the United States of America.

CONCLUSION

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

Matthew Rugens
Administrative Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts