STATE OF CONNECTICUT

AUDITORS' REPORT
OFFICE OF STATE COMPTROLLER - STATE FINANCIAL OPERATIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

AUDITORS OF PUBLIC ACCOUNTS
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June 15, 2009

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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, 2008. 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, 2008. 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 2008 Annual Report."

COMMENTS

FOREWORD:

The financial position as of June 30, 2008, and the 2007-2008 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 2008 Annual Report. The financial position of the General Fund at June 30, 2008, 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 2008 Annual Report. Corresponding statements for the Special Transportation Fund are shown in Schedules C-2 and C-3, respectively, of the Comptroller's 2008 Annual Report. A summary of State bonds and notes outstanding as of June 30, 2008, the changes thereto, and the authorizations for future borrowings are shown in Schedules E-3, E-4, and E-5 of the Comptroller's 2008 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 fuels. 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 2007-2008 fiscal year under a biennial budget adopted by the 2007 General Assembly, with minor revisions by the 2008 General Assembly including the financial accounting for the budget plans of the General Fund and Special Transportation Fund, as it applies to the 2007-2008 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 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. 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, 2008.

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 $378,200,000 in revenues, which would, under the modified cash basis system of accounting, be recorded in the 2008-2009 fiscal year. If there had been a similar accrual of expenditures as required by GAAP, there would have been added to General Fund liabilities salaries and fringe benefits payable and accounts payable that are estimated to be as high as $1,503,400,000 over the modified 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 by additional revenue accruals, primarily Federal grant receivables, of some $732,400,000 under GAAP. The net result of these effects is an estimated deficit in the unreserved Fund Balance of the General Fund (GAAP Basis) totaling $1,149,200,000 as of June 30, 2008.

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. In an attempt to accomplish this end the 1993 General Assembly passed Public Act 93-402, codified as Section 3-115b of the General Statutes. 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. In accordance with Statute a conversion plan was developed and submitted to the Appropriations Committee of the General Assembly in 1994. However, the Plan was never implemented because the General Assembly continually postponed the State's conversion to GAAP budgeting. Through a succession of Public Acts, the original objective of implementing GAAP budgeting for the fiscal year commencing July 1, 1995, was extended by the General Assembly to the fiscal year commencing July 1, 2009.

Section 3-115b of the General Statutes was significantly revised by the passage of Public Act 08-111 during the 2008 Session of the General Assembly. This Public Act, effective with the fiscal year commencing July 1, 2008, eliminated the requirements to implement GAAP and to amortize the accrued and unpaid expenses and liabilities by a certain date. Instead, it provides that …"the Comptroller, in the Comptroller's sole discretion, may initiate a process intended to result in the implementation of the use of generally accepted accounting principles, as prescribed by the Governmental Accounting Standards Board, with respect to the preparation and maintenance of the annual financial statements of the State pursuant to Section 3-115 by making incremental changes consistent with such generally accepted accounting principles." Public Act 08-111 also establishes a similar provision for the Secretary of the Office of Policy and Management with respect to the preparation of the annual budget of the State; and provides that if the Comptroller and the Secretary of the Office of Policy and Management do decide to prepare annual conversion plans, those plans shall be submitted to the Appropriations Committee of the General Assembly.

OFFICERS:

Nancy S. Wyman and Mark E. Ojakian served as State Comptroller and Deputy Comptroller, respectively, during the 2007-2008 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, 2008, 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 2008 Annual Report.

General Fund operations were conducted under a biennial budget plan, which estimated revenues and provided for expenditures of the 2007-2008 and 2008-2009 fiscal years. Public Act 07-1, the Budget Act, enacted by the June Special Session of the 2007 General Assembly, included revenue estimates and appropriations for the 2007-2008 and 2008-2009 fiscal years and revenue estimates of its Committee on Finance, Revenue and Bonding. Minor revisions were made to the biennial budget plan by the passage of Special Act 08-1 of the June Special Session of the 2008 General Assembly, in order to address appropriation deficiencies for the University of Connecticut Health Center and the Department of Correction.

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 2007-2008 fiscal year as reported by the Comptroller may be expressed as follows:

Estimated Revenues, 2007-2008, as Revised by the Committee on Finance, Revenue and Bonding		$16,315,600,000
Budgeted Appropriations, 2007-2008,	$16,431,351,899	
Estimated lapsing appropriations	(116,480,000)	
Net Appropriations		16,314,871,899
Anticipated Surplus (Deficit), June 30, 2008		**$ 728,101**

The actual results of the operations of the 2007-2008 fiscal year are presented in Schedule B-1 of the Comptroller's 2008 Annual Report. An analysis of budgeted General Fund accounts follows:

Actual Budgeted Revenues, 2007-2008		$16,418,785,569
Appropriations, 2007-2008	$17,279,807,550	
Add/(Deduct)		
Appropriations lapsed	(148,261,783)	
Net Appropriations		17,131,545,767
Balance		(712,760,198)
Prior Year Budgeted Appropriations Continued to 2007-2008 Fiscal Year		831,070,395
Reserve for Fiscal Year 2008-2009		(16,000,000)
Reserve for Transfer to Fiscal Year 2008-2009		(83,419,919)
Miscellaneous adjustments		(18,890,278)
Unappropriated Surplus, June 30, 2008, per Schedule B-1		**$ 0**

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

1. *Actual revenues were some $103,186,000 greater than originally estimated. Those revenue categories that showed the greatest changes were personal income taxes, $318,788,000, oil companies, $70,783,000, and Federal grants $58,503,000. These increases were partly offset by a reduction of $136,058,000 in corporations taxes, $41,456,000 in real estate conveyance taxes, and a $39,384,000 increase in refunds of taxes.*

2. *Appropriations showed an increase of approximately $848,456,000 from the budget plan reported by the Comptroller. The net increase was primarily from $831,070,395 in appropriations carried forward to the 2008-2009 fiscal year.*

3. *Lapsed appropriations were some $31,782,000 greater than estimated, primarily from a reduction in expected expenditures for debt service and an effort to reduce general State expenditures near the end of the fiscal year.*

A statement of changes in the unappropriated surplus account of the General Fund for the fiscal year ended June 30, 2008, is presented in Schedule B-1 of the Comptroller's 2008 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. For the fiscal year ended June 30, 2008, there was no surplus 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 2007-2008 fiscal year amounted to $16,418,785,569, as shown in Schedule B-1 of the Comptroller's 2008 Annual Report. This represented an increase of some $676,224,661 over the budgeted revenue total reported by the Comptroller for the preceding 2006-2007 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	$763,226,000
Sales and use	86,207,000
Corporations	(156,788,000)
Cigarettes and Tobacco	65,672,000
Insurance companies	(25,795,000)
Real Estate Conveyance	(52,677,000)
Oil companies	61,079,000
All others (net)	(7,322,000)

Refunds of Taxes - increase	(111,025,000)
Total Increase (Decrease) in Taxes	622,577,000
Other Revenues and Sources:	
Indian gaming payments	(19,066,000)
Transfers - Special Revenue	3,795,000
Licenses, permits and fees	20,001,000
Rents, fines and escheats	8,141,000
Investment income	(19,688,000)
Miscellaneous	(53,664,000)
Federal grants	98,828,000
Statutory transfers to/from other funds - net	15,300,000
Total Increase (Decrease) in Other Revenues and Sources	53,647,000
Total Increases (Decreases)	**$676,224,000**

The above increase was generally attributed to positive economic conditions for most of the fiscal year, which provided for a significant increase in income tax revenues.

General Fund Expenditures:

Total budgeted expenditures of the General Fund for the 2007-2008 fiscal year amounted to $16,627,447,407, as shown in Schedule B-1 of the Comptroller's 2008 Annual Report. This latter amount represented an increase of some $1,333,712,342 over the total budgeted expenditures reported by the Comptroller for the preceding 2006-2007 fiscal year. General Fund expenditures classified by current expenses, fixed charges and capital outlay are detailed on Schedule I of the Comptroller's 2008 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	$ 140,642,000
Other Current Expenses:	
Colleges, Universities and Health Center – Operating Expenses	54,434,000
State Employees' Health Service Costs	39,008,000
Retired State Employees' Health Service Costs	35,018,000
Employers' Social Security Tax	15,123,000
Funding of Other Post Employment Benefits	10,000,000
All Other - primarily contractual services and commodities	53,988,000
Fixed Charges:	
Debt Service	(71,148,000)
State Treasurer - Defeasance of Rate Reduction Bonds	85,000,000
Policy and Management – property tax relief	(33,000,000)
Teachers' Retirement Board - Retirement Contributions	106,458,000
State Aid Grants:	
Education - charter schools, magnet schools, equalization grants and priority school districts	226,493,000
Developmental Services - primarily residential and day services	52,560,000

Mental Health and Addiction Services - special populations, and Grants for substance abuse services, and mental health services	19,823,000
Social Services - Medicaid, Hospital Hardship Fund, pharmaceutical assistance to the elderly, general assistance and child care assistance	393,507,000
Higher Education – Student Aid	21,801,000
Children and Families - board and care of children	27,545,000
Corrections – Inmate Medical Services	16,568,000
Judicial – Alternative Incarceration and Youthful Offenders	15,940,000
Child Protection Commission – Training for Contracted Attorneys	10,829,000
All Other Fixed Charges	112,896,000
Capital Outlay	227,000
Total Net Increase	**$1,333,712,000**

Increased costs for personal services, debt service, education and property tax relief, 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, 2008, 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 2008 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 $683,666,949, which are being held by the Trustee, are reported on Exhibit A of the Comptroller's 2008 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 2007-2008 and 2008-2009 fiscal years. Public Act 07-1, the Budget Act for the Special Transportation Fund, enacted by the June Special Session of the 2007 General Assembly, included revenue estimates and appropriations for the 2007-2008 and 2008-2009 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 2007-2008 fiscal year as reported by the Comptroller may be expressed as follows:

Estimated Revenues, 2007-2008, as Revised by the Committee on Finance, Revenue and Bonding		$1,126,900,000
Budgeted Appropriations, 2007-2008, as revised	$1,109,835,226	
Estimated lapsing appropriations	(11,000,000)	
Net Appropriations		1,098,835,226
Anticipated Surplus, June 30, 2008		**$ 28,064,774**

The actual results of the operations of the 2007-2008 fiscal year are presented in Schedule C-3 of the Comptroller's 2008 Annual Report. An analysis of the Special Transportation Fund surplus follows:

Actual Budgeted Revenues, 2007-2008		$1,063,609,649
Appropriations, 2007-2008	$1,167,177,684	
Add/(Deduct)		
Appropriations lapsed	(31,548,808)	
Net Appropriations		1,135,628,876
Balance		(72,019,227)
Unappropriated Surplus, July 1, 2007		192,946,329
Prior Year Budgeted Appropriations Continued to 2007-2008 Fiscal Year		40,661,458
Miscellaneous adjustments		16,681,006
Unappropriated Surplus, June 30, 2008, per Schedule C-3		**$ 178,269,566**

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

1. *Actual revenues were some $63,290,000 less than anticipated. This was primarily the result of a decline of $62,937,000 in sales tax collections, a decline of $20,877,000 in motor fuels taxes and declines of $11,076,000 in miscellaneous receipts and $10,238,000 in receipts for licenses, registrations, and title fees, respectively, at the Department of Motor Vehicles. This was partly offset by an increase of $55,800,000 in oil company taxes.*

2. *Appropriations showed an increase of approximately $57,342,000 from the budget plan reported by the Comptroller. The net increase was primarily from $40,661,458 in appropriations carried forward from the previous fiscal year as well as increases in town aid road grants and other expenses at the Department of Transportation.*

3. *Lapsed appropriations were some $20,549,000 greater than estimated, primarily from a reduction in expected expenditures for the reflective license plate program at the Department of Motor Vehicles.*

Special Transportation Fund Revenues:

Total budgeted revenues in the 2007-2008 fiscal year for the Special Transportation Fund amounted to $1,063,609,649, as shown in Schedule C-3 of the Comptroller's 2008 Annual Report. This represented a decrease of some $26,734,677 over the budgeted revenue total reported by the Comptroller for the preceding 2006-2007 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	$ 16,873,000
Sales Tax – Collected at the Department of Motor Vehicles	(3,026,000)
Oil company tax	(13,200,000)
Other Revenues:	
Licenses, permits and fees	(16,698,000)
Interest income	(9,444,000)
Transfers to other Accounts or Funds - increase	(3,000,000)
All other taxes and other revenue	1,760,000
Total Net Increase (Decrease)	**$(26,735,000)**

The above decrease was primarily attributable to a decrease in the collection of licenses, permits and fees, oil company taxes, and interest income. This was partially offset by an increase in revenues received from motor fuels taxes.

Special Transportation Fund Expenditures:

Total budgeted expenditures of the Special Transportation Fund for the 2007-2008 fiscal year amounted to $1,096,935,392, as shown in Schedule C-5 of the Comptroller's 2008 Annual Report. This represented an increase of some $59,752,575 from the total budgeted expenditures reported by the Comptroller for the preceding 2006-2007 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	$3,963,000
Debt Service	5,086,000
Department of Motor Vehicles:	
Personal services	1,772,000
Department of Transportation:	
Personal services	14,375,000
Other expenses	11,338,000
Highway and bridge renewal equipment	(2,429,000)
Rail operations	9,669,000
Bus operations	11,887,000
Elderly / Handicapped transportation	3,822,000
All other (net)	270,000
Total Net Increase (Decrease)	**$59,753,000**

The above increase in expenditures was primarily attributable to increases in personal services costs, employee retirement and fringe benefit costs, transit operations and other expenses.

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, 2008, 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 2008 Annual Report. At June 30, 2008, there were 64 authorized funds within this category, with the Special Transportation Fund being by far the largest. Of these 64 funds, the following nine funds operate under legislatively enacted budget plans:

- Special Transportation Fund (12001)

- Banking Fund (12003)
- Insurance Fund (12004)
- Consumer Counsel and Public Utility Control Fund (12006)
- Workers' Compensation Administration Fund (12007)
- Mashantucket Pequot and Mohegan Fund (12009)
- Soldiers', Sailors' and Marines' Fund (12010)
- Regional Market Operation Fund (12013)
- Criminal Injuries Compensation Fund (12014)

Grants and Restricted Accounts Fund:

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 $1,886,165,763 for the 2007-2008 fiscal year were credited to the Fund, as shown on Schedule C-1 of the Comptroller's 2008 Annual Report. This represented an increase of some $366,689,735 greater than the total reported by the Comptroller in the preceding 2006-2007 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 2007-2008 fiscal year amounted to $1,534,159,310, as shown in Schedule C-1 of the Comptroller's 2008 Annual Report. This represented an decrease of some $32,426,937 over the total reported by the Comptroller for the preceding 2006-2007 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 $515,139,171 for the 2007-2008 fiscal year were credited to the Transportation Grants and Restricted Accounts Fund, as shown on Schedule C-1 of the Comptroller's 2008 Annual Report. This represented an increase of some $37,052,752 over the total reported by the Comptroller for the preceding 2006-2007 fiscal year. For the purpose of construction of any highway or bridge, the Office of State Comptroller is authorized under the provisions of Section 13a-166 of the General Statutes to record as a receivable that portion of a Federal grant apportionment for the financing of the Federal share of highway projects approved by the Federal Highway Administration, and such amounts are deemed to be appropriated for said purposes.

Disbursements of Federal and other grants from the Transportation Grants and Restricted Accounts Fund for the 2007-2008 fiscal year amounted to $542,907,719, as shown in Schedule C-1 of the Comptroller's 2008 Annual Report. This represented an increase of some $108,520,493 over the total reported by the Comptroller for the preceding 2006-2007 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, 2008, 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 2008 Annual Report. At June 30, 2008, there were six 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. Included in this category are additional funds authorized for capital improvements and other purposes by specific fiscal year. The most significant of these funds is the Infrastructure Improvement Fund (13033) which is used to account for highway and transit construction project expenditures at the Department of Transportation. The major source of financing for Capital Projects Funds is the proceeds of various State bond issues. Other sources include Federal aid and other restricted contributions receivable to meet a portion of the capital outlay costs.

The financial position of the combined Capital Projects Funds at June 30, 2008, and the cash transactions of the 2007-2008 fiscal year, are set forth in Exhibit E and Schedule E-1, respectively, of the Comptroller's 2008 Annual Report. At June 30, 2008, there were 77 authorized funds within the Capital Projects Funds category.

The total unreserved fund balances of the Capital Projects Funds increased by $435,358,650 during the 2007-2008 fiscal year to a deficit balance of $5,622,000,134, as of June 30, 2008. 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.

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, 2008, 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 2008 Annual Report. At June 30, 2008, there were four authorized funds within the Internal Service Funds category.

Exhibit A of the Comptroller's 2008 Annual Report recognizes, as reserved within fund balances and related reserves, the allotment and appropriation balances in force at June 30, 2008, and which have been carried forward to the 2007-2008 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 2008 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 2008 Annual Report. At June 30, 2008, there were 20 authorized funds within the Enterprise Funds category. Additional comments concerning the operations of each individual Enterprise Fund will be contained in audit reports covering the various State agencies administering such funds.

FIDUCIARY FUNDS:

The financial position of the combined Fiduciary Funds at June 30, 2008, and the cash transactions for the year then ended are shown in Exhibit H and Schedule H-1, respectively of the Comptroller's 2008 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, 2008, there were 35 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, 2008, payable from future revenue of State funds is shown in Exhibit A of the Comptroller’s 2008 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 2008 Annual Report.

The State's bond and note indebtedness aggregated $16,493,378,000 at June 30, 2008, an increase of $2,226,331,000 over the total of $14,267,047,000 at June 30, 2007. This was the net result of the issuance during the 2007-2008 fiscal year of new bonds of the State in the amount of $3,919,708,000, while scheduled principal payments and refunded and defeased bonds during the period amounted to $1,693,377,000. The significant increase in bond and note indebtedness over the preceding fiscal year was primarily due to the issuance of bonds to fund the pension liability of the Teachers Retirement System. Scheduled interest costs through maturity on the aforementioned bond and note indebtedness, as shown in Schedule E-4 of the Comptroller’s 2008 Annual Report, totaled $8,185,629,000. Accordingly, as of June 30, 2008, the State was committed to future debt service on bonds and notes outstanding in the aggregate of $24,679,007,000. This total represented an increase of $4,874,240,000 over the corresponding amount as of June 30, 2007.

Included in the totals of bond and note indebtedness are revenue and refunding bonds outstanding in the amount of $254,740,000 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 $2,789,345,000 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 $733,945,234 within the debt service fund group, which were available for debt service at June 30, 2008.

In addition to the foregoing bond indebtedness at June 30, 2008, there was in force as of that date unused borrowing authorizations totaling $3,905,649,000 and prospective authorizations, subject to Bond Commission approval, totaling $2,945,013,000. These authorization balances, which are detailed in Schedule E-5 of the Comptroller’s 2008 Annual Report, may be summarized as follows:

Purpose or Agency	**In Force**	**Subject to Approval of State Bond Commission**
Municipal and Economic Development	$ 273,592,000	$ 165,631,000
Capital Improvements and Other Purposes	499,842,000	737,063,000
Industrial Building Mortgage Insurance	19,450,000	1,125,000
Highway and Bridge Construction Repair	4,067,000	0
Transportation Infrastructure Improvement	1,439,122,000	1,122,579,000
Student Loan Foundation	5,000,000	0
Elimination of Water Pollution	695,282,000	61,743,000
Grants to Local Governments and Others	274,941,000	598,224,000
Local Capital Improvements	5,000,000	21,100,000
Preservation of Agricultural Lands	15,676,000	12,575,000
Housing Programs	92,028,000	69,163,000
State Equipment Purchases	38,942,000	37,735,000
Magnet Schools	16,001,000	0
University and State University Facilities	295,000	115,000,000
Connecticut Innovations Incorporated	511,000	0
Bradley Parking Garage	0	1,200,000
Contaminated Property Remediation	0	2,000,000
Second Injury Fund	525,900,000	0
Total Authorizations	**$3,905,649,000**	**$2,945,013,000**

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, 2008, were estimated as of February 1, 2009, to total $12,971,100,000. As of February 1, 2009, 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 $14,906,446,241. Accordingly, as of this date, the State's debt incurring margin totaled $5,876,833,123

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 $376,000,000, and Sections 10-287g and 10-287h (interest subsidy) in the amount of some $75,000,000, as of June 30, 2008. 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, 2008, the State Board of Education estimates that current grant obligations under this latter program will total some $2,640,000,000.*

2. *The obligation of Section 5-156a of the General Statutes to fund the State Employees' Retirement System on an actuarial reserve basis. The unfunded actuarial liability is amortized as a level percent of payroll over a declining period of years, starting with 40 years as of July 1, 1991. A full actuarial survey of the system was performed as of June 30, 2008, and showed an unfunded accrued liability of $9,253,125,542.*

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 40 year period commencing July 1, 1991. The last actuarial survey of the system was performed as of June 30, 2007, and showed an unfunded accrued liability of $78,823,297.*

4. *The obligation of Section 10-183z of the General Statutes to fund the Teachers' Retirement System on an actuarial reserve basis over a 40 year period commencing July 1, 1992. The last actuarial survey of the system was performed as of June 30, 2008, and showed an unfunded accrued liability of $6,530,008,206.*

5. *Loans under the "Insurance and "Umbrella" programs, insured by the State ($25,000,000 maximum limit) through the Connecticut Development Authority, which totaled $5,450,919 as of June 30, 2008. However, in accordance with Section 32-17a of the General Statutes, 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.*

6. *Loan guarantees under the Connecticut Works Fund, insured by the State through the Connecticut Development Authority, as provided for in Section 32-23ii of the General Statutes. The State has authorized the issuance of up to $95,000,000 in bonds allocated to the Fund, of which as of June 30, 2008, $82,485,000 has been distributed. Loan guarantees were also extended under the Connecticut Works Guarantee Fund, as provided for in Section 32-261 of the General Statutes. The State has authorized the issuance of up to $30,000,000 in bonds allocated to the Funds, of which as of June 30, 2008, $18,900,000 has been distributed. The Connecticut Development Authority also provides portfolio insurance to participating financial institutions under the Connecticut Capital Access Fund, as provided for in Section 32-265 of the General Statutes. 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 any of these Funds are reimbursable by the State until the remaining bond allocation has been utilized.

7. *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, 2009, the principal amount of outstanding bonds, secured by special capital reserve funds, for the Connecticut Housing Finance Authority, the Connecticut Resources Recovery Authority, and the Connecticut Higher Education Supplemental Loan Authority totaled $3,869,800, $60,700,000, and $143,750,000, respectively.*

8. *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, 2009, the principal amount of outstanding bonds secured by special capital reserve funds totaled some $324,600,000.*

9. *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, 2009, the principal amount of outstanding bonds, secured by special capital reserve funds for the University totaled $26,010,000.*

10. *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, 2009, the amount of the City's obligations guaranteed by special capital reserve funds totaled $45,745,000.*

11. *Notes and bonds of the Southeastern Connecticut Water Authority guaranteed by the State in the amount of $1,530,000, as of February 1, 2009.*

CONDITION OF RECORDS

Findings:

Beginning with 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, and billing and cash receipts functions. It also provides personnel and payroll management and accounting, and inventory and fixed asset reporting. Core-CT is the foundation of the State's general ledger accounting and reporting. The implementation of the Core-CT system was a project lasting approximately seven years with a reported direct cost of over $129,000,000. Operating costs for the system, charged to appropriations of the Office of State Comptroller and the Department of Information Technology (DOIT), totaled approximately $4,000,000 for the 2007-2008 fiscal year.

The Budget and Financial Analysis Division of the Office of State Comptroller has encountered significant difficulties as a result of the implementation of the 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. Our audits covering the fiscal years ended June 30, 2005, 2006 and 2007, completed in September 2006, March 2007, and February 2008, respectively, repeated many of the original findings and noted corrective action that was made. Our current report covers the corrective action implemented since March 2008, and recommends some further action required.

In July 2007, the Information Systems Audit Unit of the Auditors of Public Accounts issued a report on the general controls of the Core-CT system. That report recommended the following corrective action:

- Access security for the Core-CT system should be reviewed and modifications should be made to comply with the State of Connecticut's Information Security Policy.
- The Core-CT security administration group should develop procedures to ensure that a periodic review of each agency's user IDs is conducted and any unnecessary user accounts are deactivated in a timely manner.
- Core-CT staff should follow the Department of Information Technology's Security Policy and promptly collect ID badges from all State employees or contractors that no longer require access to the building. A periodic review of all access IDs for Core-CT staff and contractors should be conducted to ensure that only necessary IDs remain active.
- A written service-level agreement detailing the responsibilities of the Core-CT Project team and the DOIT should be developed and implemented.
- A comprehensive disaster recovery plan for the Core-CT system should be developed and completely tested. The Core-CT management and DOIT should draft a memorandum of understanding to identify each entity's responsibility in the event of a disaster.
- Core-CT management should develop procedures to ensure that background checks are completed for all employees working on the Core-CT project.

The following are findings of conditions that directly affected Statewide financial reporting, and for which corrective action is necessary:

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.

Section 3-115e of the General Statutes, effective July 1, 2005, provides that the Comptroller shall "report, on an annual basis, to the Governor and the General Assembly, on the Core-CT system. Such reports shall include, but not be limited to, the status of the implementation of the system, the anticipated completion date, the total cost to date and projected costs for the next three fiscal years, other required software or hardware necessary for successful implementation and any associated costs, the date and costs of future upgrades, the level of cooperation from vendors and state agencies, any administrative or legislative obstacles to implementation, and any other issues surrounding the Core-CT system."

Condition: Our audits of State financial operations for the fiscal years ended June 30, 2004, 2005, 2006 and 2007 have each disclosed certain deficiencies in the Core-CT system. We have noted that the Office of State Comptroller has not provided user agencies with an updated version of its *State Accounting Manual*. We note that other than an online presentation of Core-CT chartfields, job aids and training materials little progress has been made. We still find that although it has been over five years since the Core-CT system went on line, a unified document providing a complete set of standards and instructions for State agency users to follow, replacing the original *State Accounting Manual* has not been prepared.

Past audits have 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. Since the implementation of the decentralized Core-CT system in

2003 the Office of State Comptroller lost the exclusive control it had maintained over this function; a responsibility assigned by statute. Our prior audit, covering the 2006-2007 fiscal year, cited the findings of the Gartner Group, a private information technology consultant that issued a study of the Core-CT implementation in February 2007. Among other items, that report concluded that, to address the issues of effective governance and providing better service to user agencies, the consultants recommended that the State: "Define a formal and distinct Core-CT Enterprise Resource Planning Competency Center within the State agency structure, complete with its own employees, service catalog, reporting structure, and efficient processes.

- Eliminate the Director group and establish a clear Director in charge of the Competency Center.
- Create a clear Competency Center service catalog as the foundation for service level agreements that will evolve.
- Create a Project Management Office within the Competency Center to support governance, administrative, and communications activities
- Develop and continuously improve governance processes in support of the Competency Center"

The Gartner report also contained a recommendation that the State: "Expand the Core-CT steering committee and improve the Core-CT governance processes through expanded line agency involvement.

- The purpose and goals of the steering committee must evolve as the Core-CT services shift from milestone driven implementation to enhanced service delivery to all agencies.
- The steering committee should be expanded to include additional major stakeholders of the Core-CT application. Line agencies have a vested interest in the evolution of Core-CT and should be formally incorporated into Core-CT governance processes.
- Line agencies should play a central role in the following decisions:
    - Functionality enhancement demand and prioritization; release management
    - Funding for desired services
    - Business process standardization
    - Training delivery"

In an attempt to reorganize the Core-CT team, the Governor's biennial budget proposal for the 2007-2009 fiscal years included plans to transfer the operation of the Core-CT system to the supervision of the State Comptroller; however, it was not enacted by the General Assembly. A similar proposal has been made in the Governor's biennial budget proposal for the 2009-2011 fiscal years to be considered by the 2009 General Assembly.

Our audit also observed that the State Comptroller has not prepared and issued an annual report on the Core-CT system, as required by Section 3-115e of the General Statutes.

Effect: The failure to provide an updated State Accounting Manual has resulted in user errors, miscoded and misposted transactions, and general user frustration in managing the complexities of the Core-CT system.

Without a unified management structure under the Office of State Comptroller, the Core-CT organization fails to meet the intention of Section 3-112 of the General Statutes. In addition the Comptroller was not in compliance with the annual reporting requirement on the Core-CT system.

Cause: Our previous audits, as well as the consultant report, concluded that because the Core-CT project is still under the administration of the joint committee responsible for the system's initial implementation, with no final organizational plan that would address the evolution from a system implementation project to a more stable support and enhancement function.

As described in our previous audits and at the time of our review (March 2009) the Core-CT project consisted of eight project teams staffed by persons from the Office of State Comptroller, the Department of Information Technology, the Department of Administrative Services and independent consultants. The project teams operate under the direction of the Core-CT Project Management Team which consists of four Directors, one each from the Office of State Comptroller, the Office of Policy and Management, and from the Departments of Administrative Services and Information Technology. This mix of multiple agency personnel managed by a group of directors from central agencies does not provide a single responsible entity that was intended by Section 3-112 of the General Statutes, nor is it as responsive to the needs of user agencies.

We have also noted in previous reports that the Core-CT system is based on a version of PeopleSoft computer software that has been adapted from the commercial accounting environment. That adaptation to the specialized accounting needs of State government resulted in certain deficiencies encountered by system users.

Recommendation: The Office of State Comptroller should reemphasize its role to prescribe the mode of keeping and rendering all public accounts of the State by providing a revised State Accounting Manual, a reorganization of the Core-CT management structure and further improvements in system functionality so that user departments and agencies can more efficiently operate in the decentralized Core-CT environment. (See Recommendation 1.)

Agency Response: "The State Accounting Manual (SAM) contains both accounting policy and procedural information. With the implementation of Core-CT, little or no change occurred with respect to State accounting policy and the guidance contained within the manual. However, significant change occurred with respect to procedural application of accounting policy.

Utilizing the functionality of Core-CT, procedural changes have been communicated to agencies in the form of on-line job aids within each accounting application categorized by the specific module (e.g. purchasing, accounts payable, billing, accounts receivable etc.). In addition, daily mailings update users with respect to any significant changes. Agencies also have access to a help desk as well as to on-site training.

Combining the accounting policy information contained within the existing SAM with the procedural application tools described above give state agencies exceptional guidance with respect to accounting policy and specific business operating procedures.

The last step in the process will be to cross reference the Core-CT tools within the SAM. The resource requirements of this final step are significant. At present the cost to benefit ratio has kept this from rising to a high priority item.

With respect to administration of Core-CT, the Gartner Group produced a report in February 2007 that, among its many findings, recommended elimination of the multiple agency management of Core-CT in favor of a single agency with one director. At present Core-CT is managed by four agency directors: The Comptroller's Office, The Department of Administrative Services, The Department of Information and Technology and The Office of Policy and Management.

The consolidation of Core-CT and its placement within a single agency was reflected in the Governor's biennial budget proposal for the Fiscal 2008-2009. The Governor recommended placing the Core-CT division and its employees in the Comptroller's Office. This proposed change in management structure was not enacted by the

General Assembly. The Governor's budget revisions for Fiscal Year 2009 recommend the consolidation of Core-CT within the Comptroller's Office and the Department of Administrative Services. This proposal was not enacted and has been repeated within the Governor's Fiscal 2010-2011 biennial budget.

Failure to place the consolidated management of Core-CT within the Comptroller's Office, as you note, appears to violate the intent of Connecticut General Statutes, Section 3-112 and impedes efficient management of Core-CT service delivery. Despite the challenges presented by the existing group management approach, significant improvements have been made in central accounting and reporting functions.

The following summarizes some of the major initiatives that were enacted to address past audit findings and to better manage the financial systems. In November 2004, a monthly closing process was implemented that eliminated the post dating of accounting transactions thus facilitating monthly reconciliations and comprehensive monthly financial reporting. In February 2005, a billing module was added to the system that, among other functionality, implemented hard coding of revenue by 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 supplemented existing state accounting information 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. In November 2006, an updated version of the financial software was implemented with notable improvements to budget control functionality. In July 2007, an additional edit was added to ensure that service transfers were properly differentiated from expenditure credits and the proper account category was applied to these transactions.

Within the existing management structure, the Comptroller's Office has effectively balanced central accounting requirements and legal controls with specific agency business needs."

Inability to Provide Automated Grant Reporting Functionality:

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 will 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."

Financial reporting for Federal grant activity requires award recipients to be able to identify and report awards received and expended, with the ability to identify such activity by specific program and year.

Condition: Our current review found that the Core-CT system still has certain deficiencies in functionality that were cited in our previous reports, but never fully addressed. Previous audits cited the specific need for Core-CT to provide a grants receivable trial balance report, which was a functionality lost with the Core-CT system. Without it proper Federal grant billing and accounting requires additional manual effort to compile information. Our previous audit also noted a similar deficiency in the associated revenues ledger used to account for grant receivables.

Independent Public Accountant reports for the Special Transportation Fund for the fiscal years ended June 30, 2005, 2006, 2007 and 2008, all reported the condition that "There was no automated procedure in place to properly account for grant receipts, grant expenditures, 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." At the time of our review (March 2009) this condition had not been corrected.

Related to Federal grant accounting, our current audit noted that there were Federal grant award programs that were not assigned proper and distinct special identification codes that reflected the different Catalog of Federal Domestic Assistance (CFDA) numbers.

Effect: The Independent Public Accountant report stated “The effect of the condition is that grant and contract revenues for the fiscal year end June 30, 2008 and related grants and contracts receivable and deferred revenue as of June 30, 2008 had to be manually calculated.”

Combining different Federal programs within a single accounting string made accounting and reporting of certain Federal grant expenditures more difficult.

Cause: The commitment control functionality of Core-CT did not contain sub-ledgers to accumulate prior year receipts and disbursements; therefore, users must obtain prior year grant balances by manually querying and accumulating the activity for each year.

User agencies did not communicate changes in CFDA numbers to the Office of State Comptroller, which assigns the special identification codes.

Recommendation: The Office of State Comptroller should provide an automated functionality for financial reporting of grant receivables, revenues, expenditures and transfers in the Core-CT system. It should also insure that all Federal grant award programs are assigned proper and distinct special identification codes. (See Recommendation 2.)

Agency Response: “Since implementation of Core-CT, the Comptroller has been leading the effort to improve 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 well 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 has been continually 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.

With respect to the grant trial balance, in implementing the Core-CT financial software as delivered by PeopleSoft, the State attempted to minimize customization in order to reduce State costs. The commitment control functionality of Core-CT did not contain sub-ledgers to accumulate prior year receipts and disbursements; therefore, prior year grant balances are accumulated manually by using prior year reporting. While this was not the optimal solution in terms of automation, it was cost effective. The Comptroller's Office has been in the process of capturing historical data for the creation of a customized grant trail balance report. This would eliminate the need to run multiple year reports and to manually consolidate that data."

Inability to Provide an Automated Reconciliation of 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 will 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.

The Core-CT system sends to the bank a daily listing detailing checks issued. The bank is required to verify checks presented for payment to this active file of outstanding checks. In addition, the Accounts Payable Division of the Office of State Comptroller sends to the bank a daily report of the number of checks written and the total amount. The bank is required to reconcile the two reports.

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. Our current audit 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.

During the audited period the Office of State Treasurer has been working with the Core-CT project team to download a file of monthly bank information onto the Core-CT system. At the time of our review (March 2009) problems were still being encountered in implementing this improvement and no fully automated method has been implemented. Instead the State Treasurer is relying upon a manual alternative that uses on line access to the banks computer records. This method is more labor-intensive, and information on cleared and outstanding items is not readily available to users on the Core-CT system.

Related to this matter, our audit found that in August 2008, the Cash

Management Division within the Office of State Treasurer entered a $10,343,462 net adjustment between its vendor and payroll accounts. The overall cash balance was not affected; however, the adjustment was not properly documented or explained. This was an attempt to clear out long standing differences that were never reconciled between the bank records and the Core-CT system.

Our current review also noted other matters occurring during the past year that indicated the need for further improvements in internal controls over cash activity. In November 2008, it was discovered that a Core-CT employee was able to override security procedures and change the amount of a deposit that was downloaded onto Core-CT directly from the bank. This was an identified weakness in internal controls that was subsequently corrected when it was brought to the attention of the Core-CT systems management.

In February 2009, it was found that a list of escheated checks that had been previously removed from the active file of outstanding checks was added back into the payment information for January 6, 2009 in error. This caused the amount of issued checks for that day to be overstated by $1,509,286. We found the bank did not notice or investigate this difference between the Core-CT listing and the Comptroller’s report. It also came to our attention that one of the escheated checks, over four years old and listed as escheated to the State over 18 months prior, was cashed by the bank on January 6, 2009.

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. This is a labor intensive method that should have been automated as part of the Core-CT conversion.

The failure to provide an automated process of reconciling bank accounts is preventing the State from realizing the full value of the significant investment made in the Core-CT system.

Deficiencies in the Core-CT system have resulted in weakened internal controls over cash activity.

An escheated check was cashed in violation of established internal controls that require checks presented for payment to be matched with the file of issued and escheated checks.

Cause: The design of the Core-CT system contains deficiencies pertaining to the automated reconciliation of bank accounts.

The bank failed to investigate the difference between the issued check information provided by Core-CT and the issued check information provided by the State Comptroller.

Recommendation: The Core-CT system should be modified to provide the Office of State Treasurer with an efficient and automated method to reconcile cash activity. (See Recommendation 3.)

Agency Response: "A prior review cited the failure of the Comptroller's Office to reconcile interagency cash. The Comptroller's Office is now reconciling interagency cash on a monthly basis and has performed prior year reconciliations. The Comptroller's Office has also created a procedure manual for such reconciliations.

With respect to the State Treasurer's cash reconciliation, problems that were impeding the timely reconciliation of bank balances to Core-CT cash balances have been resolved. The Treasurer is currently able to reconcile bank balances to Core-CT cash balances within an acceptable period of time. To enhance automation of the reconciliation process, the Comptroller's Office and the Treasurer have been working with Bank of America to make cleared and outstanding check information available on-line within Core-CT. While obtaining a consistent file format from Bank of America has been a continual challenge. The files are available and accessed in the reconciliation process.

Other processing issues you sight were detected and corrected. No automated financial system will be error free. The challenge is to detect errors in a timely fashion and to ensure that they will not be repeated. We have been extremely successful in meeting this goal."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

Office of State Comptroller - State Financial Operations Audit Report -

Six recommendations were presented in our prior report. Of the six, one is considered implemented, two have been dropped as current findings and three are being restated in our current report. A list of the previous Recommendations and their resolution are as follows:

1. 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 recommended organizational changes were never implemented. In addition, the State Accounting Manual has not been revised to reflect the Core-CT system environment. There are other continuing issues with the Core-CT implementation. The Recommendation is revised and repeated. (See Recommendation 1.)

2. The Office of State Comptroller should seek continued improvements in financial reporting of grant receivables, revenues, expenditures and transfers from the Core-CT system – Our current review noted additional corrective action needs to be made. The Recommendation is repeated in a modified form. (See Recommendation 2.)

3. The Core-CT system should be modified to provide the Office of State Treasurer with an efficient and automated method to reconcile cash activity Our current review noted partial corrective action has been implemented in automating the bank reconciliation function. The Recommendation is repeated in a modified form. (See Recommendation 3.)

4. 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. Our current review found that the internal controls over the refunds of payments were adequate, however, revenue refunds are still charged to the revenues accounts of the State Comptroller, rather than the originating agency. Further improvements require the State’s implementation of GAAP based budgeting and certain statutory changes to allow refunds to be credited against the original revenue account. At this time we are not repeating the Recommendation.

5. 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. Our current review found no change has been made to the report format. A qualified opinion to the budgetary basis financial statements has been issued and pending the State's implementation of GAAP based budgeting, we are not repeating the Recommendation.

6. State agencies should comply with Section 4-98 of the General Statutes by properly encumbering purchases. The State Comptroller has established, and indicated that it will continue its audit of the purchase orders entered by State agencies to ensure such compliance. At this time we consider the Recommendation implemented. However, we note that the enforcement of Section 4-98 of the General Statutes requires the establishment of some type of deterrent or sanction to those State agencies that continually fail to comply with the Statute.

State of Connecticut - Single Audit Report -

Three recommendations were included in our Single Audit Report for the fiscal year ended June 30, 2007; of these, Recommendation 1 above has been repeated in our current Single Audit Report.

Current Audit Recommendations:

1. The Office of State Comptroller should reemphasize its role to prescribe the mode of keeping and rendering all public accounts of the State by providing a revised State Accounting Manual, a reorganization of the Core-CT management structure and further improvements in system functionality so that user departments and agencies can more efficiently operate in the decentralized Core-CT environment.

Comment:

We found that under the Core-CT system, user agencies are not subject to sufficient centralized control and direction by the Office of State Comptroller. A specific aspect is the failure to produce an updated *State Accounting Manual* to provide Core-CT users effective guidance. We also note that necessary organizational changes have not been implemented, and the required annual report has not been prepared.

2. **The Office of State Comptroller should provide an automated functionality for financial reporting of grant receivables, revenues, expenditures and transfers in the Core-CT system. It should also insure that all Federal grant award programs are assigned proper and distinct special identification codes.**

   Comment:

   The grant accounting process under the Core-CT system requires manual compilation and analysis to provide grant reporting, a procedure that should not be required given the over $129,000,000 investment in a new accounting system.

3. **The Core-CT system should be modified to provide the Office of State Treasurer with an efficient and automated method to reconcile cash activity.**

   Comment:

   The bank reconciliation process under the Core-CT system requires significant manual intervention, a result not in keeping with the significant investment that was made in a new accounting system.

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