STATE OF CONNECTICUT

AUDITORS' REPORT
OFFICE OF STATE COMPTROLLER - STATE FINANCIAL OPERATIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

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

Table of Contents

June 25, 2010

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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, 2009. 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, 2009. 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 2009 Annual Report."

COMMENTS

FOREWORD:

The financial position as of June 30, 2009, and the 2008-2009 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 2009 Annual Report. The financial position of the General Fund at June 30, 2009, 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 2009 Annual Report. Corresponding statements for the Special Transportation Fund are shown in Schedules C-2 and C-3, respectively, of the Comptroller's 2009 Annual Report. A summary of State bonds and notes outstanding as of June 30, 2009, the changes thereto, and the authorizations for future borrowings are shown in Schedules E-3, E-4, and E-5 of the Comptroller's 2009 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, corporation taxes, gross earnings taxes on utility and petroleum companies, real estate conveyance taxes and taxes on alcoholic beverages, cigarettes, gasoline and special motor fuels. As provided by various subsections of Section 3-114 of the General Statutes, these taxes are accrued if received by the Commissioner of Revenue Services not later than five business days following the last day of July.

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, interest income of the Special Transportation Fund is accrued at fiscal year end pursuant to the terms of a Special Tax Obligations Bond Indenture dated September 15, 1984.

This report covers the financial operations of the 2008-2009 fiscal year under a biennial budget adopted by the 2008 General Assembly, with minor revisions by the 2009 General Assembly including the financial accounting for the budget plans of the General Fund and Special Transportation Fund, as it applies to the 2008-2009 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, 2009.

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, notably income and corporation tax payments, without a corresponding accrual of expenditures in the General Fund. This accounting practice resulted in the accrual of more than $375,300,000 in revenues, which would normally, under the modified cash basis system of accounting, be recorded in the 2009-2010 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 $1,969,800,000 over the modified cash basis of accounting during the first year only of any conversion to GAAP budgeting by the State.

As noted above grant receivables are recorded as revenues when earned through the expenditure of grant funds. As a result these expenditure accruals would be offset by additional revenue accruals, totaling $989,300,000 under GAAP. The net result of these effects is an estimated deficit in the unreserved Fund Balance of the General Fund (GAAP Basis) totaling $2,303,400,000 as of June 30, 2009. This is compared to an estimated deficit totaling $1,149,200,000 as of June 30, 2008. The significant year to year increase in the GAAP basis estimated deficit was largely caused by the $947,600,000 budgetary basis deficit. A schedule illustrating these differences, with a comparison to the previous fiscal year, is presented below:

Nearest Thousand Dollars	June 30, 2008	June 30, 2009
Unreserved Fund Balance (Deficit) - Modified Cash Basis	$ -	$ (947,600,000)
Adjustments to GAAP Basis:		
Additional Assets:		
Reduction of Income Tax Accrual	(380,700,000)	(364,100,000)
Eliminate Corporation Tax Accrual	(3,600,000)	(11,200,000)
Additional Taxes Receivable	6,100,000	4,100,000
Net Accounts Receivable	237,600,000	199,600,000
Federal and Other Grants Receivable	474,500,000	758,500,000
Due From Other Funds	20,300,000	27,100,000
Total Additional Assets	$ 354,200,000	$ 614,000,000
Additional Liabilities:		
Salaries and Fringe Benefits Payable	(299,100,000)	(242,500,000)
Accounts Payable - Dept. of Social Services	(508,000,000)	(585,000,000)
Accounts Payable - All Other	(473,200,000)	(891,000,000)
Payable to the Federal Government	(121,100,000)	(146,100,000)
Due to Other Funds	(102,000,000)	(105,200,000)
Total Additional Liabilities	$(1,503,400,000)	$(1,969,800,000)
Unreserved Fund Balance (Deficit) - GAAP Basis	$(1,149,200,000)	$(2,303,400,000)

As explained later in this report, the $947,600,000 budgetary basis deficit was eventually funded by State borrowing in December 2009.

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 this 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. Public Act 08-111, 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.

Our current examination reviewed the progress made in preparing a conversion plan. At the time of our review (March 2010) we found that management of the Office of State Comptroller and the Office of Policy and Management did have a preliminary discussion of the topic, but because of current State budgetary conditions no further progress was considered feasible. The State Comptroller has however, under her constitutional authority, directed the Department of Revenue Services to record the statutory corporation tax accruals in accordance with the methodology used for other tax accruals, by changing the date from August 15, to the fifth business day following the last day of July.

OFFICERS:

Nancy S. Wyman and Mark E. Ojakian served as State Comptroller and Deputy Comptroller, respectively, during the 2008-2009 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, 2009, 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 2009 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.

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 2008-2009 fiscal year as reported by the Comptroller may be expressed as follows:

Estimated Revenues, 2008-2009, as Revised by the Committee on Finance, Revenue and Bonding		$17,073,100,000
Budgeted Appropriations, 2008-2009,	$17,190,499,475	
Estimated lapsing appropriations	(117,480,000)	
Net Appropriations		17,073,019,475
Anticipated Surplus (Deficit), June 30, 2009		**$ 80,525**

Minor revisions were made to the biennial budget plan by the passage of Public Act 08-51 during the Regular Session of the 2008 General Assembly in order to provide additional resources to the criminal justice system. Further revisions were made during the August Special Session of the 2008 General Assembly by the passage of Public Acts 08-1 and 08-2, which provided $79 million for energy assistance and home heating cost relief.

More significant changes to the budget were made during the 2008-2009 fiscal year to address projected budget deficits caused by unfavorable economic conditions. On October 21, 2008, in response to a $302,400,000 projected deficit for the 2008-2009 fiscal year, the Governor presented a deficit mitigation plan as required by Section 4-85 of the General Statutes. After revision, it was passed during the November 24, Special Session of the 2008 General Assembly as Public Act 08-1; the plan implemented $9.1 million in expenditure reductions, $5.5 million in interfund transfers, reduced appropriations carried forward from the 2007 fiscal year by $14.5 million, and initiated a tax amnesty plan estimated to add $40 million in revenues.

A second deficit mitigation plan was presented by the Governor on December 17, 2008, and after revision it was passed as Public Act 09-1 by the 2009 General Assembly. It consisted of $39.2 million in expenditure reductions and $61.8 million in transfers from special accounts and funds to the General Fund. It also requires those collecting deposits on returnable bottles to pay any unclaimed deposits to the state each quarter; adding an estimated $13.8 million in revenues.

A third deficit mitigation plan was presented by the Governor on February 19, 2009, and after revision was passed as Public Act 09-2 by the 2009 General Assembly. It provided a $10.9 million reduction in expenditures and transferred $54.3 million from non-appropriated funds and accounts into the General Fund. It also expanded the collection of bottle deposits to noncarbonated beverages and reduced the commission paid to lottery agents, adding an estimated $6.3 million in revenues.

Deficit mitigation suggestions were presented by the Governor on April 7, 2009, and parts thereof were passed as Public Act 09-111, by the 2009 General Assembly. It transferred $110 million from available balances in various non-appropriated funds and accounts and $18.6 million from other State Special Revenue and Fiduciary funds to the resources of the General Fund. It also provided a $25.1 million reduction in expenditures from various State agencies.

To address appropriation deficiencies for the 2008-2009 fiscal year, Public Act 09-2 was passed during the June 19 Special Session of the 2009 General Assembly. It reduced appropriations for numerous State agencies by $81.3 million and provided $110.7 million in deficiency appropriations for the Departments of Social Services, Education, Corrections, Administrative Services and the University Health Center. It also provided $30.3 million dollars to the Department of Labor for a Workforce Investment Act program.

In addition, under the authority of Section 4-85(b) of the General Statutes, the Governor implemented a series of budget rescissions in July, September and December of 2008, and in February and March of 2009, which rescinded $178,200,000 in appropriation allotments.

The actual results of the operations of the 2008-2009 fiscal year are presented in Schedule B-1 of the Comptroller's 2009 Annual Report. An analysis of budgeted General Fund accounts follows:

Actual Budgeted Revenues, 2008-2009		$15,700,800,884
Appropriations, 2008-2009	$17,772,791,372	
Add/(Deduct)		
Appropriations lapsed	(449,164,957)	
Net Appropriations		17,323,626,415
Balance		(1,622,825,531)
Prior Year Budgeted Appropriations Continued to 2008-2009 Fiscal Year		504,098,360
Statutory Transfer from Restricted Purposes		179,419,918
Miscellaneous adjustments		(8,271,251)
Unappropriated Surplus, June 30, 2009, per Schedule B-1		**$ (947,578,504)**

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

1. *Actual revenues were some $1,276,299,000 less than originally estimated. Those revenue categories that showed the greatest declines were personal income taxes, $1,290,543,000, sales and use tax $428,948,000, corporations taxes $175,579,000, real estate conveyance taxes $113,198,000, Indian gaming payments $71,195,000 and investment income $66,194,000. The decline in revenues was partly offset by an increase of $851,390,000 in Federal grants, and a $238,331,000 increase in transfers from other funds.*

2. *Appropriations showed an increase of approximately $582,292,000 from the budget plan reported by the Comptroller. The increase was primarily from $504,098,000 in prior year appropriations carried forward to the 2009-2009 fiscal year.*

3. *Lapsed appropriations were some $331,685,000 greater than estimated, primarily from an effort to reduce general State expenditures.*

A statement of changes in the unappropriated surplus account of the General Fund for the fiscal year ended June 30, 2009, is presented in Schedule B-1 of the Comptroller's 2009 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 (12056), 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. At the close of the fiscal year ended June 30, 2009, the balance in the Budget Reserve Fund totaled $1,381,748,346. For the fiscal year ended June 30, 2009, there was no surplus available to be transferred to the Budget Reserve Fund at the close of the fiscal year.

For the purpose of funding the 2008-2009 fiscal year deficit, the State Treasurer issued $915,795,000 in Economic Recovery Notes at a premium of $80,586,983, on December 3, 2009. They were authorized in accordance with Public Act 09-2, which was passed during the June Special Session of the 2009 General Assembly. The Notes are structured to mature in annual installments during the years 2012 to 2016 at an interest rate from two to five percent.

General Fund Revenues:

Total budgeted revenues in the General Fund for the 2008-2009 fiscal year amounted to $15,700,800,884, as shown in Schedule B-1 of the Comptroller's 2009 Annual Report. This represented a decrease in revenues of $717,984,685 as compared to the budgeted revenue total reported by the Comptroller for the preceding 2007-2008 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	$(1,126,832,000)
Sales and use	(263,565,000)
Corporations	(118,021,000)
Cigarettes and Tobacco	(17,422,000)
Insurance companies	(25,004,000)
Public Service Corporations	31,382,000
Real Estate Conveyance	(67,742,000)
Inheritance and Estate	67,718,000
Oil companies	(101,070,000)
All others (net)	5,009,000
Refunds of Taxes - increase	(200,102,000)
Total Increase (Decrease) in Taxes	(1,815,649,000)
Other Revenues and Sources:	
Indian gaming payments	(33,605,000)
Licenses, permits and fees	(9,265,000)
Rents, fines and escheats	4,095,000
Investment income	(45,137,000)
Miscellaneous	25,357,000
Federal grants	917,888,000

Statutory transfers to/from other funds - net	238,331,000
Total Increase (Decrease) in Other Revenues and Sources	1,097,664,000
Total Increases (Decreases)	**$ (717,985,000)**

The significant decreases noted were attributed to worsening economic conditions for most of the fiscal year. This was significantly offset by increased Federal grants, primarily from Medicaid, and by the transfer of monies from other State funds.

General Fund Expenditures:

Total budgeted expenditures of the General Fund for the 2008-2009 fiscal year amounted to $17,234,854,884, as shown in Schedule B-1 of the Comptroller's 2009 Annual Report. This latter amount represented an increase of some $607,407,477 over the total budgeted expenditures reported by the Comptroller for the preceding 2007-2008 fiscal year. General Fund expenditures classified by current expenses, fixed charges and capital outlay are detailed on Schedule I of the Comptroller's 2009 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	$ 64,410,000
Other Current Expenses:	
University of Connecticut Health Center – Operating Expenses	13,515,000
State Employees' Health Service Costs	23,144,000
Retired State Employees' Health Service Costs	(15,842,000)
State Employees Retirement Contributions	(27,031,000)
Funding of Other Postemployment Benefits	(10,000,000)
All Other - primarily contractual services and commodities	(3,263,000)
Fixed Charges:	
Debt Service	52,289,000
Teachers' Retirement Board - Retirement Contributions	20,742,000
State Aid Grants:	
Education - charter schools, magnet schools, Sheff settlement and equalization grants	103,096,000
Developmental Services - early intervention, day services and community residential services	35,646,000
Mental Health and Addiction Services - Special Populations	7,036,000
Social Services – Medicaid and Home Care Program, general assistance and child care assistance	402,405,000
Judicial - Alternative Incarceration and Victim Security Account	8,107,000
State Treasurer – prior year defeasance of rate reduction bonds	(85,000,000)
All Other Fixed Charges	18,156,000
Capital Outlay	(3,000)
Total Net Increase	**$607,407,000**

Increased costs for personal services, debt service, education, as well as budget deficiency adjustments to cover increased costs for public assistance programs, primarily for Medicaid, accounted for the majority of the increase. They were partially offset by reductions in retirement contributions, payments for debt defeasance, and grants for conservation and development, priority school districts and the Hospital Hardship Fund.

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, 2009, 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 2009 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 $679,384,390, which are being held by the Trustee, are reported on Exhibit A of the Comptroller's 2009 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 2008-2009 fiscal year as reported by the Comptroller may be expressed as follows:

Estimated Revenues, 2008-2009, as Revised by the Committee on Finance, Revenue and Bonding		$1,157,000,000
Budgeted Appropriations, 2008-2009, as revised	$1,165,226,399	
Estimated lapsing appropriations	(11,000,000)	
Net Appropriations		1,154,226,399
Anticipated Surplus, June 30, 2009		**$ 2,773,601**

The actual results of the operations of the 2008-2009 fiscal year are presented in Schedule C-3 of the Comptroller's 2009 Annual Report. An analysis of the Special Transportation Fund surplus follows:

Actual Budgeted Revenues, 2008-2009		$1,032,704,135
Appropriations, 2008-2009	$1,206,229,557	
Add/(Deduct)		
Appropriations lapsed	(40,703,876)	
Net Appropriations		1,165,525,681
Balance		(132,821,546)
Unappropriated Surplus, July 1, 2008		178,269,566
Prior Year Budgeted Appropriations Continued to 2008-2009 Fiscal Year		38,693,484
Miscellaneous adjustments		9,428,926
Unappropriated Surplus, June 30, 2009, per Schedule C-3		**$ 93,570,430**

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

1. *Actual revenues were some $124,296,000 less than anticipated. This was primarily the result of a decline of $28,575,000 in motor fuels taxes, a decline of $16,866,000 in sales tax collections, a decline of $20,519,000 in miscellaneous receipts, a decline of $10,238,000 in receipts for licenses, registrations, and title fees, respectively, at the Department of Motor Vehicles. In addition, there was a $31,417,000 decline in interest income.*

2. *Appropriations showed an increase of approximately $41,003,000 from the budget plan reported by the Comptroller. The net increase was primarily from $38,693,484 in appropriations carried forward from the previous fiscal year.*

3. *Lapsed appropriations were some $29,704,000 greater than estimated, primarily from an effort to reduce general State expenditures.*

Special Transportation Fund Revenues:

Total budgeted revenues in the 2008-2009 fiscal year for the Special Transportation Fund amounted to $1,032,704,135, as shown in Schedule C-3 of the Comptroller's 2009 Annual Report. This represented a decrease of some $30,905,514 over the budgeted revenue total reported by the Comptroller for the preceding 2007-2008 fiscal year. Budgeted revenue categories which showed the greatest change during the fiscal year under audit were as follows:

	Nearest Thousand Dollars
Taxes:	
Sales Tax – Collected at the Department of Motor Vehicles	$ (7,730,000)
Oil company tax	14,100,000
Other Revenues:	
Licenses, permits and fees	(11,331,000)
Interest income	(20,973,000)
All other taxes and other revenue	(4,972,000)
Total Net Increase (Decrease)	**$(30,906,000)**

The above decrease was primarily attributable to a decrease in the collection of sales taxes, licenses, permits and fees, and interest income.

Special Transportation Fund Expenditures:

Total budgeted expenditures of the Special Transportation Fund for the 2008-2009 fiscal year amounted to $1,128,201,531, as shown in Schedule C-5 of the Comptroller's 2009 Annual Report. This represented an increase of some $31,266,139 from the total budgeted expenditures reported by the Comptroller for the preceding 2007-2008 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	$ 4,984,000
Debt Service	7,352,000
Department of Transportation:	
Rail operations	13,783,000
Bus operations	3,678,000
All other (net)	1,469,000
Total Net Increase (Decrease)	**$31,266,000**

The above increase in expenditures was primarily attributable to increases in employee retirement and fringe benefit costs, transit operations and debt service.

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, 2009, 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 2009 Annual Report. At June 30, 2009, there were 56 authorized funds within this category, with the Special Transportation Fund being by far the largest. Of these 56 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:

The Grants and Restricted Accounts Fund (12060), was established to account for certain Federal and other revenues associated with activities of the General Fund, primarily Federal grant assistance.

Receipts and transfers amounting to $1,689,974,761 for the 2008-2009 fiscal year were credited to the Fund, as shown on Schedule C-1 of the Comptroller's 2009 Annual Report. 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. Receipts and transfers decreased by some $196,191,002, as compared to the total reported by the Comptroller in the preceding 2007-2008 fiscal year. The decrease in receipts and transfers, as compared to the preceding fiscal year, was the result of a one time receipt of $245,678,000 in the 2007-2008 fiscal year applicable to the capitalized interest of a bond issuance to fund the Teachers Retirement System.

Disbursements of Federal and other grants from the Grants and Restricted Accounts Fund for the 2008-2009 fiscal year amounted to $1,763,494,127, as shown in Schedule C-1 of the Comptroller's 2009 Annual Report. This represented an increase of some $229,334,817 over the total reported by the Comptroller for the preceding 2007-2008 fiscal year.

Transportation Grants and Restricted Accounts Fund:

The Transportation Grants and Restricted Accounts Fund (12062), was established to account for certain restricted Federal and other revenues associated with activities of the Special Transportation Fund, primarily Federal grant assistance related to highway and transit projects.

Receipts and transfers amounting to $673,678,840 for the 2008-2009 fiscal year were credited to the Transportation Grants and Restricted Accounts Fund, as shown on Schedule C-1 of the Comptroller's 2009 Annual Report. This represented an increase of some $158,539,669 over the total reported by the Comptroller for the preceding 2006-2008 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 2008-2009 fiscal year amounted to $639,408,536, as shown in Schedule C-1 of the Comptroller's 2009 Annual Report. This represented an increase of some $96,500,817 over the total reported by the Comptroller for the preceding 2007-2008 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, 2009, 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 2009 Annual Report. At June 30, 2009, 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 positions of the combined Capital Projects Funds at June 30, 2009, and the cash transactions of the 2008-2009 fiscal year, are set forth in Exhibit E and Schedule E-1, respectively, of the Comptroller's 2009 Annual Report. At June 30, 2009, there were 52 authorized funds within the Capital Projects Funds category.

The total unreserved fund balances of the Capital Projects Funds increased by $1,138,841,924 during the 2008-2009 fiscal year to a deficit balance of $4,483,158,210, as of June 30, 2009. The significant increase in unreserved fund balances, as compared to the previous fiscal year, was the result of the elimination of continued appropriations for the University of Connecticut 2000 Fund (13045). 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, 2009, 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 2009 Annual Report. At June 30, 2009, there were four authorized funds within the Internal Service Funds category.

Exhibit A of the Comptroller's 2009 Annual Report recognizes, as reserved within fund balances and related reserves, the allotment and appropriation balances in force at June 30, 2009, and which have been carried forward to the 2008-2009 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 2009 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 2009 Annual Report. At June 30, 2009, 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, 2009, and the cash transactions for the year then ended are shown in Exhibit H and Schedule H-1, respectively of the Comptroller's 2009 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, 2009, there were 37 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, 2009, payable from future revenue of State funds is shown in Exhibit A of the Comptroller's 2009 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 2009 Annual Report.

The State's bond and note indebtedness aggregated $17,338,664,000 at June 30, 2009, an increase of $845,286,000 over the total of $16,493,378,000 at June 30, 2008. This was the net result of the issuance during the 2008-2009 fiscal year of new bonds of the State in the amount of $2,662,575,000, while scheduled principal payments and refunded and defeased bonds during the period amounted to $1,817,289,000. Scheduled interest costs through maturity on the aforementioned bond and note indebtedness, as shown in Schedule E-4 of the Comptroller's 2009 Annual Report, totaled $8,326,247,000. Accordingly, as of June 30, 2009, the State was committed to future debt service on bonds and notes outstanding in the aggregate of $25,664,911,000. This total represented an increase of $985,904,000 over the corresponding amount as of June 30, 2008.

Included in the totals of bond and note indebtedness are revenue and refunding bonds outstanding in the amount of $243,585,000 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 $2,817,015,000 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 $732,252,512 within the debt service fund group, which were available for debt service at June 30, 2009, and which are detailed in Exhibit D of the Comptroller’s 2009 Annual Report.

In addition to the foregoing bond indebtedness at June 30, 2009, there was in force as of that date unused borrowing authorizations totaling $3,367,780,000 and prospective authorizations, subject to Bond Commission approval, totaling $3,132,590,000. These authorization balances, which are detailed in Schedule E-5 of the Comptroller’s 2009 Annual Report, may be summarized as follows:

Purpose or Agency	**In Force**	**Prospective Authorizations**
Student Loan Foundation	$ 5,000,000	$ 0
Municipal and Economic Development	123,748,000	192,856,000
Local Capital Improvements	10,000,000	16,100,000
State Equipment Purchases	126,000	63,651,000
Grants to Local Governments and Others	61,391,000	737,327,000
Contaminated Property Remediation	0	3,000,000
Housing Programs	98,394,000	107,163,000
Highway and Bridge Construction Repair	4,067,000	0
Magnet Schools	88,451,000	0
Preservation of Agricultural Lands	25,676,000	7,575,000
Transportation Infrastructure Improvement	1,556,672,000	1,117,428,000
University and State University Facilities	108,015,000	0
Capital Improvements and Other Purposes	155,411,000	885,286,000
Connecticut Innovations Incorporated	500,000	0
Bradley Parking Garage	0	1,200,000
Elimination of Water Pollution	581,384,000	4,000
Industrial Building Mortgage Insurance	19,450,000	1,000,000
Connecticut Development Authority	3,595,000	0
Second Injury Fund	525,900,000	0
Total Authorizations	**$3,367,780,000**	**$3,132,590,000**

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, 2009, were estimated as of February 1, 2010, to total $10,927,600,000. As of February 1, 2010, 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 $15,110,494,784. Accordingly, as of this date, the State's debt incurring margin totaled $2,373,665,216.

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 $314,000,000, and Sections 10-287g and 10-287h (interest subsidy) in the amount of some $57,000,000, as of June 30, 2009. 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, 2009, the State Board of Education estimates that current grant obligations under this latter program will total some $2,450,000,000.*

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, Family Support Magistrates 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, 2008, 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 $5,036,248 as of June 30, 2009. 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, 2009, $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, 2009, $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 provided for in Sections 8-252a(b), 22a-272(b) and 10a-232(b), respectively, of the General Statutes. As of February 1, 2010, 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 $3,969,700,000, $51,600,000, and $160,290,000, 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 provided for in Section 10a-186a of the General Statutes. As of February 1, 2010, the principal amount of outstanding bonds secured by special capital reserve funds totaled some $281,110,000.*

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, 2010, the principal amount of outstanding bonds, secured by special capital reserve funds for the University totaled $25,140,000.*

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, 2010, the amount of the City's obligations guaranteed by special capital reserve funds totaled $40,535,000.*

11. *In accordance with the provisions of Special Act 67-381, as subsequently amended by Special Acts 73-95 and 90-28, $1,470,000 in bonds of the Southeastern Connecticut Water Authority are guaranteed by the State, as of February 1, 2010.*

CONDITION OF RECORDS

Findings:

Beginning with the 2003-2004 fiscal year the Office of State Comptroller used a new accounting system statewide, referred to as Core-CT. Core-CT provides 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, project costing 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 $130,000,000. Operating costs for the system, charged to appropriations of the Office of State Comptroller and the Department of Information Technology, totaled approximately $4,800,000 for the 2008-2009 fiscal year.

The Budget and Financial Analysis Division of the Office of State Comptroller encountered significant difficulties as a result of the implementation of the Core-CT accounting system. Our audits covering the initial implementation of the Core-CT system reported significant deficiencies in the State's financial accounting and reporting that are now considered resolved. Our current report covers the corrective action implemented since March 2009, and addresses some items that require corrective action:

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, originally provided a formal set of accounting policies and procedures, and established the definitions of authority and responsibility between State departments and agencies, and the Office of State Comptroller.

Condition: Our audits of State financial operations for the fiscal years ended June 30, 2004, 2005, 2006, 2007 and 2008 have each disclosed certain deficiencies in the Core-CT system. All have noted that the Office of State Comptroller has not provided user agencies with an updated version of its *State Accounting Manual.* We found the manual was last updated in May 2001. We noted that other than an online presentation of Core-CT chartfields, job aids and training materials within the Core-CT web site, little progress has been made on the manual itself. Our use of the chartfields section of the *State Accounting Manual* that is presented on the Core-CT website found the information presented was not kept current.

During the Core-CT implementation process numerous daily mails, training guides, user group meetings and other efforts were made available. However, no unified document has been issued that would provide a complete set of standards and instructions for State agency users to follow, summarizing the information and properly replacing the original *State Accounting Manual*.

Our audit report 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. In that report and in our audit report covering the 2007-2008 fiscal year we noted two items that should be implemented:

1. "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."

2. "Expand the Core-CT steering committee and improve the Core-CT governance processes through expanded line agency involvement."

The objectives of these recommendations were to establish a single unit with a clear Director in charge of the Core-CT project, and formally incorporate into Core-CT governance processes the line agencies that have a vested interest in the evolution of Core-CT.

In a reorganization of the Core-CT team, the Governor's biennial budget proposal for the 2009-2011 fiscal years included the transfer of 21 employees and the operation of the Core-CT system to the Office of the State Comptroller. In September 2009, seven employees from the Financials team, six employees from the Human Resources team, and seven employees from the Technical team within the Core-CT project were assigned to the Budget and Financial Analysis, Payroll Services and Information Technology Divisions within the Office of State Comptroller, respectively. However, implementation of the specific Gartner Group recommendations we noted above, similar to our own audit findings in previous years - the distinct Core-CT unit and the expanded line agency involvement, were not implemented. Given the current fiscal environment, we are not recommending further corrective action in this area at this time.

Effect:	The failure to provide an updated State Accounting Manual has contributed to user errors and miscoded and misposted transactions. The absence of line agency input into the governance process has contributed to general user frustration in managing the complexities of the Core-CT system.
Cause:	In prior reports the State Comptroller has responded to our recommendation by citing a lack of resources and competing priorities which prevented corrective action. It has also referred to the online information available in the Core-CT web site as an adequate alternative to an updated State Accounting Manual.
Recommendation:	The Office of State Comptroller should promptly complete its revision of the State Accounting Manual. (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, Comptroller's numbered memoranda and Core-CT communications update users with respect to any significant changes. Agencies also have access to a help desk as well as to on-site training. We do not believe that agencies are committing processing errors as a result of inadequate policy and procedural guidance. Combining the accounting policy information contained within the existing SAM with the procedural application tools described above give State agencies exceptional resources 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 critical priority level, although some incremental updating of SAM is occurring as resources permit."

Miscellaneous Internal Control Deficiencies in Core-CT:

Criteria:

An accounting system is designed to assemble, classify, record and report financial data. An accounting system needs to provide accurate information regarding the recording of the proper Federal grant program number, the accounting of receivables pertaining to payroll overpayments and the billing of non-wage payroll costs to programs and projects.

An accounting system requires proper internal controls to minimize the possibility for errors. Internal control is a process that relies upon policies and procedures that are to provide reliable and accurate financial reporting, security of assets, operating efficiencies and compliance with laws and regulations. Effective internal controls should be established over the interagency transfers of funds, the entry of direct deposit bank account information, and the accounting of deposits from recovered payroll overpayments.

The Office of Management and Budget (OMB) Circular A-87 includes factors affecting allowability of costs. For a cost to be allowable under Federal awards they must meet the following general criteria:

- Be allocable to Federal awards under the provisions of OMB Circular A-87. A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with the relative benefits received.
- Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- Be adequately documented.

Condition:

Our current audit identified a condition involving interagency grant transfers that were not properly coded to the grant revenue and disbursement accounts by the State agencies entering the transaction. Transfers between State agencies, and particularly grant transfers, were coded to accounts and funds that were incorrect. In addition, non-grant transactions were posted to the grant transfer account codes.

Related to Federal grant accounting, our current audit noted that there were Federal grant award programs that were assigned an incorrect Catalog of Federal Domestic Assistance (CFDA) number in the Core-CT system.

Our audit noted instances where bank information for certain employee or vendor direct deposits was erroneously changed in the Core-CT system by user agencies, resulting in direct deposit payments being deposited to the wrong accounts.

Our audit also noted the State Treasurer has difficulty reconciling its payroll account because journal entries to adjust payroll overpayments and workers' compensation recoveries in the Core-CT system are not reflected in the cleared cash transactions downloaded from the bank. User agencies may not have properly entered journals to reclassify the deposits of these recovered overpayments, or the journal entries may not have been processed. In addition, there is no receivable balance in the Core-CT system to track payroll overpayments.

A review of Department of Transportation project billings by the Federal Highway Administration disclosed a flaw in the functionality of the Core-CT system. The audit found that the allocation of fringe benefit costs and employer payroll taxes charged to each project on the basis of employee wages does not reflect that certain non-wage costs paid as wages, such as travel reimbursements, are not attributable to the actual time the employee spent on the project. In addition, fringe benefits costs that are fixed to a standard full time work week, such as medical insurance, are allocated in excess when overtime hours are charged.

Effect: As a result of the grant transfer miscodings, we found a reported imbalance between grant revenue and disbursement accounts that totaled approximately $40,223,000.

Federal program expenditures were reported under incorrect CFDA numbers, which were identified and corrected.

Audits of State agencies have identified several occasions where payroll or vendor direct deposits were made to the wrong employee's or vendor's bank account.

The State Treasurer's payroll account had an unexplained variance of $597,842 as of June 30, 2009, that the State Treasurer could not completely and accurately reconcile.

Costs that were fixed in relation to employee hours worked were erroneously allocated extra overhead costs that were billed to Federal-aid projects at the Department of Transportation. This condition does not only affect the Department of Transportation, but may affect all State agencies using Core-CT system to charge projects or programs with non-wage personal service costs. We do not have an estimate as to the total costs involved.

Cause: There were no controls to ensure that State agencies posted grant transfers to the proper Core-CT account codes and within the same Special Revenue Fund. Effective January 14, 2010, the Office of State Comptroller implemented an internal control in the form of a "hard edit" to restrict grant transfer billings to the Federal and Other Restricted Account (12060) and Transportation and Restricted Account (12062) Funds, and within grant revenue (47100 and 47200) and disbursement (55110) accounts.

Erroneous CFDA numbers that were identified in our audit of the 2007-2008 fiscal year were never corrected by the Office of State Comptroller, which assigns the special identification codes used to identify grant programs. As part of our current examination we have reminded the Office of State Comptroller that all Federal grant award programs should be assigned proper and distinct special identification codes.

There is weakness in the internal controls over access and changing bank account information used for employee and vendor direct deposits. In the decentralized Core-CT system, agency users are responsible for most of the data entry and security of bank account information; changes to that information were not reviewed and verified prior to processing.

State agencies deposit payroll overpayments or workers' compensation recoveries into one of the State Treasurer's main depository accounts. The agency is instructed to enter a journal in Core-CT system coded to the payroll account instead of the depository account. As a result nonbank activities are being posted to the payroll account (10419) instead of an available payroll correction account (10446). We also found inconsistent processing of the data from the payroll check reversal (COP-9 Form) which is used to adjust the payroll account, the deductions and taxes related to the overpayment and the employee's balances in Core-CT. There is no internal control to ensure State agencies or the State Comptroller properly and promptly enter and process journals to reclassify these deposits on the payroll account ledger. In addition, there is no accounts receivable balance to track payroll overpayments due the State.

The Core-CT system design did not allow for the proper cost allocation of miscellaneous payroll payments. It allocates payroll fringe benefits and employer payroll taxes to projects based on the employee hours charged to the project; costs that are fixed in relation to employee hours worked such as travel, and medical and life insurance costs that are fixed in relation to employee hours worked, are included in the same allocation.

Recommendation: The Office of State Comptroller should address deficiencies in Core-CT system internal controls that affect user agency access to Core-CT bank account information, the posting of payroll account adjustments, and the cost allocation applied to non-wage payroll payments. It should also establish a receivable account for payroll overpayments. (See Recommendation 2.)

Agency Response: "You detail four areas of general concern within this recommendation: 1) inappropriate coding of grant transfers between State agencies; 2) several occurrences of State agencies changing deposit information resulting in erroneous deposits; 3) problems in the reconciliation of payroll cash due to payroll correction processing; and, 4) the inappropriate allocation of fringe benefit recoveries to non-reportable wage payments such as travel.

As you have noted with respect to item number one above, in early January Core-CT implemented a number of system edits designed to resolve the improper posting of grant transfers. In addition to system edits a new monthly reconciliation process was implemented to ensure proper agency coding in this area. We thank the Auditors of Public Accounts for assisting in identifying this problem and for reviewing possible system solutions. We are confident that the modifications outlined above will substantially improve grant transfer accounting and reporting.

With respect to item number two, direct deposit account numbers related to vendor payments are centrally controlled through Core-CT security functionality. However, as with any system, human error may occur. Payroll direct deposit entries are decentralized by necessity and again are subject to human input error. We do not believe that this is a system control issue.

With respect to item number three, the Comptroller's Office is working with the State Treasurer's Office to better isolate and reconcile payroll corrections and recoveries to actual bank deposits. We expect to have a new reconciliation process in place by the start of Fiscal Year 2011.

The final item regarding the inappropriate allocation of fringe benefit charges to non-reportable wages is caused by a system anomaly.

There are several possible modifications to the existing system process that would correct the problem; however, each fix requires substantial resources that are not available at this time. Until resources are available to modify the processing of non-reportable wages, the Comptroller's Office is recommending utilizing a correction process that would create an average rate of fringe benefit overcharges attributable to non-reportable wages and reimburse this amount to the appropriate source. While this does not correct the source of the problem, it does compensate for its fiscal impact and is the most cost effective solution."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

Office of State Comptroller - State Financial Operations Audit Report -

Three recommendations were presented in our prior report. Of the three, two are considered implemented and one is 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 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 – Our current review found some organizational changes recommended in the Gartner consultant's report that were implemented. We note, effective in September 2009, the Financials and Human Resources teams within the Core-CT project were assigned to the Budget and Financial Analysis and Payroll Services Divisions within the Office of State Comptroller. However, other improvements recommended by the consultant's report have not been implemented. At this time we are not repeating the Recommendation pertaining to that finding; however we again recommend that the Office of State Comptroller promptly complete its revision of the *State Accounting Manual*. (See Recommendation 1.)

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 – Our current review noted a problem with a number of grant transfers that were not properly coded, creating a misstatement of approximately $40,223,000. Corrective action, including the improvement in Core-CT internal controls has been made. For certain State agencies the implementation of the Projects module in Core-CT has improved Federal grant accounting; it allows for the difference between the State and Federal fiscal years, and helps prevent charges being made after a grant's end date. It also facilitates timekeeping for those employees charged to Federal programs. At this time we are not recommending the system changes necessary to establish the functionality of sub-ledgers to accumulate prior year receipts and disbursements. Agency users will continue to use the established manual work around. We are not repeating the Recommendation.

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 – In general, the Office of State Treasurer is able to maintain prompt bank reconciliations using the manual process it adopted. At this time, we are not recommending the system changes necessary to automate this function and we are not repeating the Recommendation.

Our current examination did note deficiencies in internal controls that affected the security of direct deposit bank account information and the reconciliation of payroll overpayments in the Treasurer's payroll account. They are described as miscellaneous internal control deficiencies in Core-CT in the Condition of Records section of this report.

State of Connecticut - Single Audit Report -

Three recommendations were included in our Single Audit Report for the fiscal year ended June 30, 2008; no recommendations are presented in our current Single Audit Report.

Current Audit Recommendations:

1. The Office of State Comptroller should promptly complete its revision of the State Accounting Manual.

Comment:

We found that under the Core-CT system, user agencies require sufficient centralized direction by the Office of State Comptroller. A specific need is an updated *State Accounting Manual* reflecting the current procedures and practices.

2. The Office of State Comptroller should address deficiencies in Core-CT system internal controls that affect user agency access to Core-CT bank account information, the posting of payroll account adjustments, and the cost allocation applied to non-wage payroll payments. It should also establish a receivable account for payroll overpayments.

Comment:

We found the following internal control deficiencies that require attention in the Core-CT system:

1. There were inadequate controls in the Core-CT system over the access and entry of bank direct deposit information by agency users.
2. There was no internal control to ensure State agencies or the State Comptroller enters journals to properly reclassify deposits resulting from payroll overpayments.
3. The Core-CT system does not properly allocate payroll fringe benefits and employer payroll taxes to miscellaneous payroll payments charged to projects and grants.

CONCLUSION

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

Matthew Rugens
Administrative Auditor

Approved:

Kevin P. Johnston	Robert G. Jaekle
Auditor of Public Accounts	Auditor of Public Accounts