STATE OF CONNECTICUT

AUDITORS' REPORT
DEPARTMENT OF ECONOMIC AND COMMUNITY DEVELOPMENT
FOR THE FISCAL YEARS ENDED JUNE 30, 2007 and 2008

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

Table of Contents

October 21, 2009

AUDITORS' REPORT
DEPARTMENT OF ECONOMIC AND COMMUNITY DEVELOPMENT
FOR THE FISCAL YEARS ENDED JUNE 30, 2007 and 2008

We have examined the financial records of the Department of Economic and Community Development for the fiscal years ended June 30, 2007 and 2008. This report on that examination consists of the Comments, Recommendations and Certification that follow.

This audit examination of the Department of Economic and Community Development, hereinafter referred to as DECD, has been limited to assessing compliance with certain provisions of financial related laws, regulations, contracts and grants, and evaluating internal control structure policies and procedures established to ensure such compliance. Financial statement presentation and auditing are being done on a Statewide Single Audit basis to include all State agencies.

COMMENTS

FOREWORD:

DECD operates under the provisions of Title 8, Chapters 127b, 127c, 128, 130, 131, 133, 135, 136, 137c, 138b, 138c, 138e through 138k and Title 32, Chapter 578 of the General Statutes. DECD administers programs and policies to promote business, housing, and community development and is responsible for policies and programs for the preservation and improvement of housing and neighborhoods, business assistance and development. James F. Abromaitis served as Commissioner of DECD until March of 2007. Joan McDonald was appointed Commissioner in May of 2007, and currently serves as Commissioner.

RÉSUMÉ OF OPERATIONS:

General Fund:

Revenues:

General Fund revenues for the fiscal years examined and the prior fiscal year are summarized below:

	Fiscal Year Ended June 30,		
	2006	**2007**	**2008**
Loan interest	$ 458,735	$ 435,224	$ 488,293
Loan principal	0	198,720	0
Refunds of expenditures	881,609	592,425	617,471
All other	50,206	7,450	21,701
Total General Fund Revenue:	$1,390,550	$1,233,819	$1,127,465

Total General Fund revenues decreased by $156,731 and $263,085 during the fiscal years ended June 30, 2007 and 2008, respectively, compared to the fiscal year ended June 30, 2006. The decrease in revenues was primarily attributable to a decrease in General Fund grant expenditures refunded from prior fiscal years.

Expenditures:

A summary of General Fund expenditures during the audited period, along with those of the preceding fiscal year, follows:

	Fiscal Year Ended June 30,		
	2006	**2007**	**2008**
Personal Services	$ 6,578,696	$ 7,066,494	$ 6,959,045
Other Expenditures	1,570,061	1,699,913	1,307,211
Elderly Rental Registry & Counselors	549,621	603,722	592,674
Assisted Living Demonstration	770,400	1,445,400	1,851,037
Congregate Facilities Operating Costs	5,160,683	5,719,918	5,808,045
Housing Assistance & Counseling	497,000	500,250	438,500
Elderly Congregate Rent Subsidy	1,460,389	1,515,243	2,183,965
Tax Abatement	1,704,890	1,704,890	1,704,890
Payments in Lieu of Taxes	2,204,000	2,204,000	2,204,000
CONNSTEP	0	1,000,000	1,000,000
Home-CT	0	0	3,600,000
Residential Service Coordinators	0	0	574,933
All Other	167,500	940,147	3,174,010
Total Expenditures	$20,663,240	$24,399,977	$31,398,310

Total General Fund expenditures increased by $3,736,737 and $10,735,070 during the fiscal years ended June 30, 2007 and 2008, respectively, compared to the fiscal year ended June 30, 2006. The increase in expenditures was primarily attributable to the addition of several new program initiatives and increased expenditures in existing Department programs during the audited period.

Special Revenue Funds:

In addition to the Fund that accounts for Federal and other restricted monies, the Department utilized 12 other Special Revenue funds during the audited period. These Funds were mainly used for providing financial assistance in the form of grants or loans for economic development and housing projects approved by the State Bond Commission.

Revenues:

Revenues from Special Revenue Funds during the audited fiscal years and the preceding fiscal year are summarized below:

	Fiscal Year Ended June 30,		
	2006	**2007**	**2008**
Principal and interest on loans	$ 9,494,135	$ 7,172,088	$ 8,709,521
Refunds of expenditures	(15,343)	(206,050)	0
Federal contributions	37,328,964	50,517,687	32,397,877
Non-Federal contributions	966,196	1,235,805	302,391
All other	126,238	4,011	2,408
Total Revenue	$47,900,190	$58,723,541	$41,412,197

Total Special Revenue Fund revenues increased by $10,823,351 during the fiscal year ended June 30, 2007, compared to the fiscal year ended June 30, 2006. The increase in revenues was primarily attributable to increased reimbursements received in the Federal Home Investment Partnerships (Home) and Community Development Block Grant – State Administered Small Cities (Small Cities) programs. Total revenues decreased by $17,311,344 during the fiscal year ended June 30, 2008, compared to the earlier year. The decrease in revenues was due to decreases in Federal reimbursements in the Home and Small Cities programs. Revenues for these programs can fluctuate from year to year based on construction activity and the flow of sponsor requests for payment. Also contributing to the decrease in revenues was a decision by the Federal Department of Housing and Urban Development (HUD) to assign several housing assistance payment contracts, formerly administered by the Department, to their performance-based contract administrator. Revenue formerly received from these contracts is now received by the administrator.

Expenditures:

A summary of expenditures from Special Revenue Funds during the audited period, along with those of the preceding fiscal year, follows:

	Fiscal Year Ended June 30,		
	2006	**2007**	**2008**
Loans	$10,650,032	$ 27,850,136	$ 27,796,936
Grants	57,339,073	79,006,200	66,793,810
Administration	7,265,352	7,535,429	6,937,361
Total Expenditures	$75,254,457	$114,391,765	$101,528,107

Included in the above totals are Federal expenditures totaling $36,080,501, $50,527,115 and $31,777,514 for the fiscal years ended June 30, 2006, 2007 and 2008, respectively.

Total Special Revenue Fund expenditures increased by $39,137,308 during the fiscal year ended June 30, 2007, compared to the fiscal year ended June 30, 2006. The increase in expenditures was primarily attributable to an increase in grants made from the Hartford Downtown Development, Federal and Other Restricted Accounts and Housing Assistance Taxable Funds. Also contributing to the increase was an increase in loans made from the Economic Assistance Bond and Federal and Other Restricted Accounts Funds.

Total expenditures decreased by $12,863,658 during the fiscal year ended June 30, 2008, compared to the earlier year. The decrease in expenditures was due primarily to a decrease in grant expenditures in the Federal and Other Restricted Accounts Fund.

Capital Project Funds:

Total expenditures from Capital Projects Funds were $54,766,244 and $24,410,552 for the fiscal years ended June 30, 2007 and 2008, respectively, compared to $34,112,787 expended in the fiscal year ended June 30, 2006. Capital Project Fund expenditures were made from the Community Conservation and Development Fund under the Urban Act Program during the audited period. Under this program, funds are provided to municipalities, non-profits and for-profit entities to improve and expand State activities that promote community conservation and development and improve the quality of life for urban residents of the State.

CONDITION OF RECORDS

Our testing of the Department of Economic and Community Development records noted the following reportable matters.

Cost Allocation:

Background: The Department allocates payroll costs to the various programs it administers through a cost allocation process. Each employee is assigned to a position with a pre-established appropriation expenditure account in Core-CT. Payroll expenditures are initially charged to the individual's assigned appropriation expenditure account. The Department utilizes its Time Processing System (TPS) to identify and allocate total hours charged to each program. Work distribution information and data is periodically exported from TPS to spreadsheets by the Department's Office of Finance and Administration (OFA). OFA staff manually recalculate payroll costs using salary and time allocation information housed in TPS. OFA then prepares an accounting adjustment in Core-CT allocating the re-calculated payroll costs to the various appropriation expenditure accounts in the general ledger.

Criteria: Total payroll costs allocated by cost allocation systems should be reconciled to amounts recorded in the general ledger.

Condition: We reviewed one (1) payroll adjustment consisting of nine (9) pay periods for seven (7) employees. We compared the payroll costs of the seven employees initially charged in the general ledger ($223,442) to the re-calculated costs prepared from information in TPS ($222,490) and noted a variance of $952. We found that salary and wage costs in TPS were different than salary and wages charged to the general ledger. We also noted that an additional four hours were incorrectly charged to two accounts that should not have been. We did not note any variances in fringe benefit costs. The recalculated costs prepared from TPS information forms the basis of the accounting adjustment in the general ledger.

Effect: Payroll costs allocated to the Department's programs were not accurate. The Community Conservation and Development Fund was overcharged $735. Six other funds were collectively undercharged $735.

Cause: The Department does not reconcile re-calculated payroll allocations prepared with TPS salary and work distribution information to payroll costs recorded in Core-CT's general ledger.

Recommendation: The Department should reconcile total payroll costs allocated by its Time Processing System to total payroll costs reflected in appropriation expenditure accounts in Core-CT's general ledger. Payroll costs allocated by the Time Processing System should ultimately be recorded in general ledger appropriation accounts, or alternately, if not recorded, be sufficiently documented by the Department explaining the reason(s) why the costs were not recorded. (See Recommendation 1.)

Agency Response: "We agree with this finding.

The Department did not have a system in place to project staffing needs and to reconcile the staffing needs with the appropriate funding sources. The Department has simplified and improved its work distribution system which will facilitate the needed reconciliation.

Based on the changes made to TPS/work distribution the Department now produces a report which will be used to reconcile total payroll costs allocated by its Time Processing System to total payroll costs reflected in appropriation expenditure accounts in Core-CT's general ledger."

Performance Appraisals:

Criteria: Employee performance appraisals are a method by which job performance of an employee is evaluated. Generally, the aims of a performance appraisal are to:

- Give feedback on performance to employees.
- Indentify training needs.
- Form a basis for personnel decisions.
- Provide an opportunity for organizational diagnosis and development.
- Facilitate communication between employee and management.

Condition: We inquired with the Department's Human Resources office on whether the Department conducted periodic performance appraisals on its employees. We were informed that they did. We reviewed 13 employee personnel files from approximately 150 employees for evidence that performance appraisals were performed. Our review noted the following:

1. A performance appraisal was not completed for one employee for the period covering July 1, 2007 through June 30, 2008.

2. A performance appraisal was not on file for one employee for the period covering February 16, 2007 through August 31, 2007.

3. Performance appraisals were not prepared for one employee during the audited period.

Effect: Management's ability to measure employee performance and training needs are significantly diminished in the absence of written performance evaluations.

Cause: Administrative controls for ensuring that performance evaluations were performed were inadequate relative to Conditions 1 and 2. Relative to Condition 3, performance appraisals are not required for this employee's position class as he is in unclassified service and serves at the pleasure of the Commissioner. However, performance appraisals would benefit both the employee and the Department.

Recommendation: The Department should ensure that periodic performance appraisals are performed on all of its employees. (See Recommendation 2.)

Agency Response: "We do not agree with this finding.

The Department performs periodic performance appraisals for its employees.

Specific circumstances relative to conditions 1, 2, and 3 impacted the Department's completion of those performance appraisals.

The performance appraisal cited in Condition 1, covering the period of July 1, 2007 through June 30, 2008, pertains to an employee included in the Performance Assessment and Recognition System (PARS). The performance appraisal was not completed due to anticipated organizational changes. The PARS Program is currently under review by the agency.

The performance appraisal cited in Condition 2, covering the period of February 16, 2007 through August 31, 2007, pertains to an employee who is part of the Commissioner's Office. At that time the former Commissioner had left the Department and the new Commissioner had been recently appointed. The performance appraisal for this employee has been completed and is on file.

The performance appraisal cited in Condition 3 pertains to an unclassified employee. As noted by the Auditors unclassified employees are not required to have a performance appraisal. The Department will take the Auditors recommendation under consideration for unclassified employees."

Auditors' Concluding Comments: Organizational changes should not preclude an agency from completing performance evaluations on its employees. Completion of interim performance appraisals in anticipation of organizational changes assists the reorganized agency's new management team in evaluating employees placed under their supervision.

In addition, while performing risk assessment procedures in connection with our fiscal year 2009 CAFR audit at the Department, we reviewed three employee personnel files to determine whether the employees' most recent performance appraisal had been performed. Our review noted that two of the employees did not have performance appraisals on file for the fiscal year ended June 30, 2008.

Relative to the Department's response to Condition 2, the former Commissioner completed an interim performance appraisal on the employee through February of 2007. The new Commissioner was appointed in May of 2007. The performance appraisal referred to by the Department as being completed was performed in February of 2009 by the Deputy Commissioner who was at the Department throughout the entire period.

Compensatory Time:

Criteria: Compensatory time must be requested at least 24 hours in advance and authorized in the Time Processing System by an employee's administrator/supervisor. The request must include the date, the hours and the reason for the compensatory time. (DECD's Time Keeping and Leave Policy).

Condition: We tested 10 instances of compensatory time earned by 10 employees during the period from July 1, 2008 through March 18, 2009. Total instances of compensatory time earned and number of employees earning time during this period were 51 and 10, respectively. The results of our test disclosed the following:

- Written approval of compensatory time was approved by supervisors after the hours had been worked in five instances.

- Requests for compensatory time failed to specify the reason for the time in five instances.

Effect: Management has lessened assurance that compensatory time policies are being adhered to.

Cause: Administrative controls over the earning of compensatory time were inadequate.

Recommendation: The Department should ensure that compensatory time earned is documented in accordance with Department compensatory time polices. (See Recommendation 3.)

Agency Response: "We agree with this finding.

The Department is in the process of updating its Timekeeping and Leave Policy. The policy will ensure that compensatory time is approved in advance of the date the time is earned.

The Department wishes to note that due to the nature of its business there may be a need for eligible employees to be authorized for compensatory time after the date the time is earned. These instances will be properly documented."

Appropriation Transfers:

Background: The Department has a master contract with local housing authorities and nonprofit corporations for the provision of rental assistance to elderly persons and families living in State-financed elderly rental housing.

The master contract is updated annually through the execution of a certification and tenant rent role which reflects updated tenant and rental cost and subsidy data to determine the amount of the subsidy needed for each eligible resident for the upcoming program year. This information is typically updated in May or June and forms the basis of the subsidy payment in the following fiscal year beginning on July 1st.

Criteria: Section 4-87 of the Connecticut General Statutes provides that whenever any specific appropriation of a budgeted agency proves insufficient to pay the expenditures required for the statutory purposes for which such appropriation was made, the Governor may, at the request of the budgeted agency, transfer from any other specific appropriation of such budgeted agency such amount as the Governor deems necessary to meet such expenditures. Transfers to or from any specific appropriation of a sum or sums over $50,000 require the consent of the Finance Advisory Committee (FAC). Section 4-86(d) states that except as provided in Section 4-87, no money shall be transferred or appropriated from one specific appropriation to another, otherwise than by authority of the General Assembly.

Condition: In May of 2008 the Department received FAC approval to transfer $361,221 from three of its other appropriations to its Elderly Congregate Rent Subsidy appropriation. The justification provided for the transfer stated that interest in the program was greater than anticipated and that changes in tenant turnover, tenant contributions due to income and tenant eligibility required additional funds.

Our review of payments charged to the appropriation determined that available funds in the appropriation before the transfer would have been sufficient to pay program expenditures for the fiscal year ended June 30, 2008, had the Department not made $439,251 in subsidy payments that pertained to the following fiscal year. We noted that certifications and tenant rent roles received in May and June of 2008 that applied to the fiscal year beginning July 1, 2008, were used to make fiscal year 2009 payments using fiscal year 2008 appropriations.

Effect: The Department did not comply with the provisions of Sections 4-86(d) and 4-87 of the Connecticut General Statutes.

Cause: The Department anticipated a deficit in program funding for the fiscal year ended June 30, 2009, and decided to mitigate the shortfall by using available fiscal year ended June 30, 2008, appropriations.

Recommendation: The Department should ensure that appropriation transfers are made in accordance with the provisions of Sections 4-86(d) and 4-87 of the Connecticut General Statutes. (See Recommendation 4.)

Agency Response: “We disagree with this finding.

There were shortfalls in both fiscal years 2008 and 2009. The Elderly Rental Assistance Payments (ERAP) program operates under a Master Contract between a sponsor and the State (DECD).

This Master Contract carries with it a standing obligation for rental assistance subsidy payments when specific conditions are met. That is, by virtue of the execution of the Master Contract, an approved Management Plan and Budget, and a Certification and Tenant Rent Roll, the obligation to provide such subsidies exists at the time of such approval. Statutory obligation, regulatory requirements, and case law related to tenant notification of rent increases all require that approvals and notification occur at least 30 days in advance of any period before implementation can occur. Therefore, the obligation to provide such subsidies under ERAP exists on or before 30 days prior to the first day of any month. Funds were transferred in accordance with the provisions of 4-87 CGS, and were expended consistent with such obligation.

Furthermore, in accordance with the provisions of Section 4-87 of the Connecticut General Statutes, and with the consent of the Finance Advisory Committee, whenever any specific appropriation of a budgeted agency proves insufficient to pay the expenditures required for the statutory purpose for which such appropriation was made, the Department may request that the Governor transfer sufficient funds, from available sources, in order to meet the statutory obligations of that program. In consultation with the Office of Policy and Management, the Department requested the transfer of funds into the Elderly Rental Assistance Payments program (ERAP), and such request was granted, in order to meet the statutory and contractual obligations of ERAP."

Auditors' Concluding Comments:

There was not a shortfall in the 2008 fiscal year. Funding for the program is predicated upon tenant rent role submissions covering a 12 month fiscal year period. The annual appropriation is based on the same 12 month period.

Payments made under this program have historically been made in two installments. The first payment occurs early in the fiscal year (July or August) representing rental subsidies from July to December. The second payment is usually made in January and represents rental subsidies from January to June. The timing of the payments can be deferred if agreed upon information is not provided to the Department. The timing of the subsidy payments coincide with the schedule stated in the master contract.

The payments made to housing providers in June of 2008 represented at least a third payment to all providers receiving payments. The payments represented rental subsidies for the ensuing fiscal year (July 1, 2009 to December 31, 2009) that should have been charged to the new fiscal year's appropriation. This resulted in the providers receiving 18 months of subsidy payments from one annual budgeted appropriation thus circumventing the budget process.

In regards to the Department's comments that they consulted the Office of Policy and Management (OPM) about this transfer, the Department, not OPM, is responsible for the Department's compliance with State laws and regulations applicable to it.

Expenditure Classification:

Criteria: The State Comptroller's Office has developed a uniform chart of accounts to assist State agencies in coding expenditure transactions. Coding assigned to expenditure transactions should reflect coding that most accurately identifies the type of expenditure made. Payments made to grantees should be coded to a grant expense category. Payments made to vendors should be coded to a contractual services or commodities expense category depending on the type of goods/or services provided.

A provider of services can be a grantee or a vendor. In making the determination of whether a grantee or a vendor relationship exists, the substance of the relationship is more important than the form of the agreement. (OMB Circular A-133, Audits of State, Local Governments and Non-Profit Organizations). A factor to consider in such situations is whether the State agency making the expenditure is purchasing goods or services rather than transferring all or a part of a grant program to another State agency/entity.

Condition: We reviewed seven contracts with a total value of $6,962,562 to determine whether expenditures paid against these contracts were appropriately coded. Our review noted the following:

1. Expenditures made from two contracts were coded to the contractual services expense category of "Management Consultant Services" rather than a grant expense category. Separate contracts were executed with the same provider to provide assistance in establishing and administering two Department grant programs. The contracts provide for the service provider to receive $470,000 to administer the programs and $4,530,000 to provide grants to qualifying entities.

2. Expenditures made from two contracts were coded to the contractual services expense category of "Management Consultant Services" rather than a grant expense category. Separate Memorandums of Agreement were executed with the same State agency for the transfer of $550,000 in funds to be used by the State agency to administer DECD initiatives.

3. Administrative expenditures made from one contract were incorrectly coded to the expense category of "Service of Process". Service of process is the procedure employed to give legal notice to a person (such as a defendant) of a court or an administrative body's exercise of it's jurisdiction over that person so as to enable that person to respond to the proceeding before the court, body or tribunal. Usually, notice is furnished by delivering a set of court documents (called process) to the person to be served. The contractor provides loan processing and servicing for one of the Department's loan programs. The contract provides for the contractor to be paid $566,312 for these services.

Effect: Expenditures totaling $1,339,150 were inaccurately recorded on the State's general ledger.

Cause: The Department believes that the transactions were properly coded in Conditions 1 and 2. For Condition 1, they indicated that coding assigned to the contract was based on the fact that the funding is provided via a personal services agreement. Personal services agreements are used to contract with outside consultants. For Condition 2, they indicated that because the State agency was providing a service to the Department by administering programs for them, that this represented a management/consultant service. The Department agreed with the auditor that Condition 3 coding was inappropriate and indicated that they will change it.

Recommendation: The Department should review expenditure coding assigned to its contracts to ensure that appropriate coding has been assigned. (See Recommendation 5.)

Agency Response: "We disagree with this finding.

The Department does review expenditure coding to ensure that appropriate coding has been assigned as stated in the recommendation. Coding selections can be subjective, particularly when there is no clear choice for the Core-CT options. The Department, based on available criteria, reviews the expenditure codes and selects the appropriate expenditure code for the particular expenditure.

The Department contacted the State Comptroller's Office for clarification of the expenditure code assigned by the Department for the three conditions cited in this finding. The State Comptroller agreed with the Department's selection of the expenditure code for condition 1 and the State Comptroller agreed with the Auditors of Public Accounts selection of the expenditure code for condition 2 and condition 3. Going forward, the Department will change the expenditure coding based on the State Comptroller's direction for conditions 2 and 3 to ensure that the appropriate expenditure code will be assigned."

Auditors' Concluding Comments: Regardless of what the agreement is titled, grants may appear as subagreements, subrecipient agreements, purchase orders, subgrants or personal services agreements in name, format and language. Nevertheless, if the features of a grant are present, they remain forms of state financial assistance and should be coded as such. In making these determinations, the Department is advised that the substance of the relationship is more important than the form of the agreement.

Purchasing and Receiving:

Criteria: Section 4-98 of the General Statutes provides that no budgeted agency shall incur any obligation, by order, contract or otherwise, except by the issuance of a purchase order.

Commodities are received by the requester. The requester is required to sign-off on the packing or receiving slip received from the vendor. The requester goes into Core-CT and enters that the goods have been received and the date received. (Department internal control procedures for receiving office supplies)

Condition: We tested 25 expenditure transactions, other than payroll, grants or loans, totaling $19,435 that were expended in the fiscal years ending June 30, 2007 and 2008. The purpose of our testing was to determine the effectiveness of the Department's internal controls and compliance with State purchasing laws, regulations and policies. The results of our testing noted the following:

- Purchase orders were prepared after goods or services were received for seven (7) of the 25 transactions.

- Two (2) out of five (5) office supplies purchases were not supported with signed packing slips, receiving reports or equivalent documentation.

Effect: The Department has lessened assurance that internal controls are operating effectively and expenditure transactions are being processed in accordance with State purchasing laws.

Cause: Internal controls over purchasing and receiving were inadequate.

Recommendation: The Department should ensure that purchases are obligated in accordance with Section 4-98 of the General Statutes and received in accordance with its internal control procedures. (See Recommendation 6.)

Agency Response: "We agree with this finding.

The Department will send a reminder to all staff concerning compliance with purchasing requirements and procedures to ensure that purchases are obligated in accordance with Section 4-98 of the General Statutes.

The Department will be reviewing its internal control procedures to ensure that they are appropriate and follow the current Core-CT requirements.

Upon completion of the review applicable staff will be notified as to the proper process for ordering and accepting goods from the office supply vendor.

The Department wishes to provide the following additional information. The Department requested of the Auditors of Public Accounts if the total number of expenditure transactions other than payroll, grants, or loans processed during the audited period was identified. The auditor indicated that the total number of expenditure transactions processed during the audited period was not determined.

Based upon a request by the Department the auditor indicated that the total value of expenditure transactions for other than payroll, grants and loans processed by the Department during the fiscal years ended June 30, 2007 and 2008, was $3,740,877 and $4,342,755, respectively. Expenditure transactions totaling $19,435 out of $8,083,632 processed by the Department were reviewed by the Auditors of Public Accounts."

Petty Cash:

Criteria: Petty cash funds are intended to facilitate departmental or agency purchases of small, but necessary operating items, not to exceed $50.00, except for emergencies or specific exceptions granted by the State Comptroller, based upon the peculiar needs of an agency. (State Comptroller Accounting Manual)

Condition: We noted that the Department issued four petty cash checks totaling $3,320 to the Federal Department of Homeland Security for background checks performed on a potential new hire to obtain a non-immigrant visa. An exemption to exceed the $50.00 threshold was not obtained from the State Comptroller.

Effect: Petty cash funds were used for items that should have been processed through the State's regular accounting system.

Cause: The Department sought to expedite the receipt of services by using petty cash funds.

Recommendation: The Department should ensure that petty cash fund transactions are processed in accordance with the State Accounting Manual. (See Recommendation 7.)

Agency Response: "We agree in part with this finding.

The Department did not obtain the exemption to exceed the $50.00 threshold from State Comptroller as cited by the Auditors.

The Department needed to expedite the process of having a background check performed on a potential new hire by the Federal Department of Homeland Security in order to obtain a non-immigrant visa.

To expedite the payments to the Federal Department of Homeland Security for background checks performed the Department decided to use petty cash. Payments processed through the State's regular accounting system would take a longer time to complete than utilizing petty cash.

The Department wishes to note that this was an unusual circumstance and that future use of petty cash will not include this type of transaction."

Undocumented Expenditures:

Background: The control environment of an organization reflects agency management's awareness and commitment to the importance of controls throughout the organization, and encompasses management integrity, ethical values, and operating philosophy. The key to successful internal control is having a control environment that sets a tone of integrity which influences the ethical and control consciousness of employees.

Criteria: Authorized cash advances made to employees for travel expenses require the employee to submit an employee reimbursement voucher with supporting documentation within five working days after return. (State Comptroller Accounting Manual)

The purchasing card program offers an alternative to a variety of departmental processes such as the use of petty cash, travel reimbursement, check requests and low dollar purchase orders. One of the cardholder's responsibilities is maintaining and providing to the agency's business office all supporting documentation for expenditures made with their State issued purchasing card. (State Comptroller's Purchasing Card Coordinator Manual)

Condition: Our review of petty cash and purchasing card transactions of one upper-level management employee disclosed the following:

- A cash advance for travel made to the employee in October of 2007 for $1,512 remained outstanding as of our review in early March of 2009. The employee submitted a reimbursement voucher and supporting documentation to the Department's business office on March 26, 2009.

- During the time period of October 2007 through June 2008 the employee incurred $885 in purchasing card charges for which the employee did not submit supporting documentation to the business office. We requested supporting documentation for all $885 in charges directly from the employee and were provided supporting documentation for $446 in charges on May 27, 2009. Additional supporting documentation totaling $361 was provided on June 16, 2009. Supporting documentation for the remaining $78 in charges was not provided.

Effect: Management's non-adherence to State policies and procedures weakens the Department's control environment.

Cause: The cause was not determined.

Recommendation: The employee should provide the business office with the required documentation supporting the remaining purchasing card transactions, or alternatively, reimburse the Department the amount of the undocumented expenditures paid through the purchasing card. In addition, the Department should design and implement internal controls that prohibit travel advances and purchasing card usage to any employees who have supporting documentation outstanding on travel advances and/or purchasing card transactions until such time as the supporting documentation is submitted to the business office. (See Recommendation 8.)

Agency Response: "The employee has reimbursed the Department for the remaining undocumented expenditures.

The Office of Finance and Administration (OFA) will be sending a reminder notice to all purchasing card holders of the requirements established for use as contained in the State Comptroller's Purchasing Card Coordinator Manual."

Monitoring of Unused Bond Allocations:

Background: The Department finances a variety of economic, housing and community development projects using State bond funds approved by the State Bond Commission. The State Bond Commission requires that all unused balances from prior State Bond Commission approvals must be returned to the unallotted balance under the fund and section of origin once a project is completed or cancelled.

Criteria: Written policies and procedures on bond-funded projects should include procedures to monitor unexpended balances on bond-funded projects that are completed or cancelled.

Condition: In our prior audit we identified several projects with unexpended balances on completed and/or cancelled projects that had not been returned to the unallotted fund balance. As a result of this finding, the Department returned or reallocated unexpended balances to the appropriate funding sources for the identified projects. We recommended that the Department implement formal policies and procedures that address the administration of unexpended balances on bond-financed projects. The Department responded that it agreed that it needed to implement formal policies and procedures and indicated that a process review was currently being conducted by the Department to develop such policies and procedures. Based on our inquires with staff during our current audit, we determined that no such formal policies and procedures had been developed as the result of this review.

Effect: The lack of written procedures to monitor unexpended balances on bond-funded projects lessens the Department's assurance that unused bond funds are being returned to their original funding source in a timely manner.

Cause: The cause was not determined.

Recommendation: The Department should establish written policies and procedures that ensure that unused balances from prior State Bond Commission approvals are identified in a timely manner and returned to the unallotted balance under the fund once a project is completed or cancelled. (See Recommendation 9.)

Agency Response: "We agree with this finding.

The Department has developed a draft policy that will ensure unused balances from the State Bond Commission are returned to the unallotted balance under the fund once a project is completed or cancelled.

This policy is currently under review and will be implemented once it is finalized by the Department."

Loan Receivable Reporting:

Background: Each year the Department reports its loan receivable principal balances to the State Comptroller as of June 30th. Balances reported include energy conservation loan receivables serviced by a private contractor. Loan receivable principal balances reported to the State Comptroller as of June 30, 2008, amounted to \$140,620,166 and included \$6,872,463 in energy conservation loans serviced by the private contractor.

Criteria: Entities reporting loan receivables administered by third-party loan servicers should ensure that reported amounts reflect loan receivable balances carried by the loan servicer.

Condition: The Department reported energy conservation loan receivable balances of \$6,872,463 to the State Comptroller as of June 30, 2008. Energy conservation loan receivable balances carried by the private contractor as of June 30, 2008, totaled \$6,815,296, a difference of \$57,167.

Effect: Financial disclosures on the State's financial statements are inaccurate.

Cause: The Department does not reconcile energy conservation principal loan balances accounted for in its records to amounts recorded on the loan servicer's records.

Recommendation: The Department should reconcile energy conservation principal loan receivable balances recorded on its records to amounts recorded by its loan servicer prior to reporting such balances to the State Comptroller. (See Recommendation 10.)

Agency Response: "We agree with this finding.

Commencing in the next fiscal year the Department will reconcile energy conservation loan receivable balances recorded on its records to amounts recorded by its loan servicer prior to reporting such balances to the State Comptroller."

Urban Act Program:

Background: The Department of Economic and Community Development administers various construction and rehabilitation projects through Urban Act bond funds approved by the State Bond Commission. Urban Act projects can be initiated in one of two ways: the applicant contacts the Office of Policy Management and the potential project is passed onto the Department of Economic and Community Development or the applicant applies directly to DECD.

Criteria: Department project managers must prepare an Urban Act analysis and eligibility review on all Urban Act projects. The review is designed to be an objective written evaluation of the project that highlights the positive aspects but also addresses any serious flaws, issues and/or risks about the project. (DECD Client Services Manual)

The Department enters into assistance agreements (contracts) with grantees for the administration of Urban Action grant projects. The assistance agreement imposes several reporting requirements on grantees as a condition for receiving grant funds. Many assistance agreements require grantees to submit periodic financial reports at specific time intervals.

Condition: We reviewed the Department's internal control procedures for administering Urban Act projects. Our review was conducted for the purpose of determining whether internal control procedures were effectively designed and implemented. We selected five projects to review from an audit universe of 27 projects. Our audit universe consisted of projects in which assistance agreements were executed by the Department and grantees within our audited period. Our review of these projects identified the following.

- The Department did not perform an eligibility analysis on one project.

- The Department did not obtain two semi-annual reports from one grantee.

Effect: Failure to perform an analysis and eligibility review lessens the Department's assurance that the project is viable.

Failure by the Department to receive periodic financial reports lessens the Department's assurance that the project is on schedule and within budget.

Cause: Internal controls were not implemented as designed.

Recommendation: The Department should ensure that an eligibility analysis is performed on all Urban Act projects and that required financial reports are obtained. (See Recommendation 11.)

Agency Response: "We agree with this finding.

Effective immediately, DECD will prepare Urban Act eligibility forms for all Urban Act funded projects, or request that the Office of Policy and Management (OPM) prepare and forward said forms to DECD for OPM generated projects.

The Office of Responsible Development (ORD) has assigned a staff member to have the responsibility for ensuring that agency clients submit the periodic reports in a timely manner. Also, the staff member will be responsible for coordinating with DECD audit and compliance staff to ensure that these reports are received and properly filed in agency records."

Disaster Recovery Plan:

Criteria: Contingency plans should be established to provide for continuance of information technology in the event of a disaster or major interruption in information systems. Contingency plans should include the following:

- Identification of critical application software and data files.
- Preparation of a formalized written contingency plan with copies of the plan stored offsite.
- Provisions for a backup site and computer hardware and software have been made.
- Tests of the contingency plan are required and performed.

Condition: We inquired with the Department as to their contingency plans in the event of a major interruption of information systems. We were informed that the Department's disaster recovery plan consists of weekly scheduled back-ups of their servers and data and tape rotations kept at an off-site storage facility.

Effect: A lack of a formalized contingency plan extends the time required to recover and resume critical infrastructure and application systems.

Cause: Management has not adequately assessed the risks associated with major interruptions in its information systems.

Recommendation: The Department should determine the risks associated with the loss of information systems, evaluate its options and costs to mitigate the risks, and make decisions on the most cost effective way to invest in information systems disaster recovery planning solutions. (See Recommendation 12.)

Agency Finding: "We disagree with this finding.

The Department of Information and Technology (DOIT) currently does not have a requirement that State Agencies establish a disaster recovery plan. Nor is there a statutory requirement that State agencies establish a disaster recovery plan. Therefore the Department believes the criteria as cited by the Auditors of Public Accounts cannot be supported.

The Department has begun its own initiative working with DOIT, CT Homeland Security, and other State agencies to prepare a disaster recovery plan.

The Department wishes to note that this finding was not included in the preliminary draft audit findings presented to the Department on June 1, 2009. This preliminary draft audit finding was presented to the Department on June 22, 2009."

Auditors' Concluding Comments:

This matter is a risk assessment issue rather than a compliance issue. Risk assessment is an entity's identification and analysis of relevant risks to the achievement of its objectives, forming a basis for determining how the risks should be managed. Appropriate disaster recovery planning enables management to effectively respond and mitigate the loss or major interruption to its information systems.

Relative to the Department's concluding paragraph, the submission of this finding at the later date did not adversely affect the Department's opportunity to provide its response to this finding. The exact version of the finding was communicated to the Department's Fiscal Administrative Manager and Internal Auditor on April 29, 2009.

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- The Department should implement formal policies and procedures that address the administration of unexpended balances on bond-funded projects. Unexpended balances for projects that are cancelled, completed or otherwise concluded should be returned to the appropriate fund through the reversion allotment process. The Department did not implement formal policies and procedures that address the administration of unexpended balances on bond-funded projects. Thus, the recommendation is repeated, as amended. (See Recommendation 9.)

- Organized, complete and updated records should be maintained for the grants and loans that the Department administers. We were informed that the Department's disparate database systems have been under review and analysis for the feasibility of consolidating within the Department's HDS Funds Management System. We were also informed that the Department is in the midst of implementing software that will allow the Department to consolidate their various systems into one centralized access point. Thus, this recommendation has been resolved.

- The Department should institute procedures to ensure that payroll expenditures are charged to the appropriate funding. Our current review of payroll expenditures identified conditions similar to those disclosed in our prior audit. Thus, the finding is repeated, as amended. (See Recommendation 1.)

- DECD should improve its inventory recordkeeping and reporting, establish more effective controls for managing assets in Core-CT and ensure that the necessary personnel are informed of information needed for maintaining inventory records and preparing inventory reports. Our current review did not identify any exceptions relative to property control. Thus, the recommendation has been implemented.

- The Department should ensure that all of its financial assistance is properly documented by written agreements and that adequate monitoring is performed to ensure that State funds were used as intended. We reviewed three transactions coded to the sponsorship expenditure account during the fiscal year ended June 30, 2009, and concluded that the expenditures were made for sponsorship activities that did not represent financial assistance. Thus, the recommendation has been resolved.

- For compensatory time to be earned, written approval should be obtained in advance and include the reason for the compensatory time. Our current review of compensatory time identified conditions similar to those disclosed in our prior audit. Thus, the finding is repeated, as amended. (See Recommendation 3.)

Current Audit Recommendations:

1. **The Department should reconcile total payroll costs allocated by its Time Processing System to total payroll costs reflected in appropriation expenditure accounts in Core-CT's general ledger. Payroll costs allocated by the Time Processing System should ultimately be recorded in general ledger appropriation accounts, or alternately, if not recorded, be sufficiently documented by the Department explaining the reason(s) why the costs were not recorded.**

   Comment:

   Our review of the Department's cost allocation process disclosed that the Department does not reconcile payroll costs allocated by its time processing system to costs recorded on Core-CT's general ledger.

2. **The Department should ensure that periodic performance appraisals are performed on all of its employees.**

   Comment:

   Our review of personnel files disclosed that performance appraisals were not completed for three employees.

3. **The Department should ensure that compensatory time earned is documented in accordance with Department compensatory time polices.**

   Comment:

   Our review of compensatory time earned noted several instances in which compensatory time earned was not pre-approved in writing and/or the reasons for the compensatory time was not disclosed as required by Department policy.

4. **The Department should ensure that appropriation transfers are made in accordance with the provisions of Sections 4-86(d) and 4-87 of the Connecticut General Statutes.**

   Comment:

   We noted that the Department transferred funding from three of its appropriations to one appropriation that had sufficient funding in place to meet program operating costs for the fiscal year ended June 30, 2008. The transfer was made in order to mitigate an anticipated program shortfall in the subsequent fiscal year.

5. **The Department should review expenditure coding assigned to its contracts to ensure that appropriate coding has been assigned.**

   Comment:

   We noted several contractual agreements were assigned incorrect expenditure accounting codes.

6. **The Department should ensure that purchases are obligated in accordance with Section 4-98 of the General Statutes and received in accordance with its internal control procedures.**

   Comment:

   Our review of expenditure transactions noted seven transactions in which purchase orders were prepared after goods and services were received and two transactions that were not supported with signed packing and/or receiving reports.

7. **The Department should ensure that petty cash fund transactions are processed in accordance with the State Accounting Manual.**

   Comment:

   We noted that the Department issued four petty cash checks totaling $3,320 for transactions that should have been processed through the State's regular accounts payable process.

8. **The employee should provide the business office with the required documentation supporting the remaining purchasing card transactions, or alternatively, reimburse the Department the amount of the undocumented expenditures paid through the purchasing card. In addition, the Department should design and implement internal controls that prohibit travel advances and purchasing card usage to any employees who have supporting documentation outstanding on travel advances and/or purchasing card transactions until such time as the supporting documentation is submitted to the business office.**

   Comment:

   We noted that one management employee had not submitted supporting documentation for several purchasing card transactions and one travel advance at the time of our review. It was only after inquiries made by us that the employee provided supporting documentation for all but $78 worth of purchasing card transactions to the business office. The employee continued to use her purchasing card and receive travel advances despite having outstanding documentation due the business office.

9. **The Department should establish written policies and procedures that ensure that unused balances from prior State Bond Commission approvals are identified in a timely manner and returned to the unallotted balance under the fund once a project is completed or cancelled.**

   Comment:

   In our prior audit, the Department responded that it agreed that it needed to implement formal policies and procedures and indicated that a process review was currently being conducted by the Department to develop such policies and procedures. Based on our inquires with staff during our current audit, we determined that no such formal policies and procedures had been developed as the result of that review.

10. **The Department should reconcile energy conservation principal loan receivable balances recorded on its records to amounts recorded by its loan servicer prior to reporting such balances to the State Comptroller.**

    Comment:

    We noted that the Department reported energy conservation principal loan receivable balances to the State Comptroller as of June 30, 2008, that varied from balances accounted for by its loan servicer on the servicer's trial balance.

11. **The Department should ensure that an eligibility analysis is performed on all Urban Act projects and that required financial reports are obtained.**

    Comment:

    We noted that the Department did not perform an eligibility analysis on one project and did not obtain two semi-annual reports from one grantee.

12. **The Department should determine the risks associated with the loss of information systems, evaluate its options and costs to mitigate the risks, and make decisions on the most cost effective way to invest in information systems disaster recovery planning solutions.**

    Comment:

    We noted that the Department did not have a formalized disaster recovery plan in place in the event of a major interruption to its information systems.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 of the General Statutes, we have audited the books and accounts of the Department of Economic and Community Development for the fiscal years ended June 30, 2007 and 2008. This audit was primarily limited to performing tests of the Agency's compliance with certain provisions of laws, regulations, contracts and grant agreements and to understanding and evaluating the effectiveness of the Agency's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grant agreements applicable to the Agency are complied with, (2) the financial transactions of the Agency are properly initiated, authorized, recorded, processed, and reported on consistent with management's direction, and (3) the assets of the Agency are safeguarded against loss or unauthorized use. The financial statement audits of the Department of Economic and Community Development for the fiscal years ended June 30, 2007 and 2008, are included as a part of our Statewide Single Audits of the State of Connecticut for those fiscal years.

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

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

In planning and performing our audit, we considered the Department of Economic and Community Development's internal control over its financial operations, safeguarding of assets, and compliance with requirements as a basis for designing our auditing procedures for the purpose of evaluating the Agency's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grant agreements, but not for the purpose of providing assurance on the effectiveness of the Agency's internal control over those control objectives.

Our consideration of internal control over financial operations, safeguarding of assets, and compliance requirements was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial operations, safeguarding of assets and compliance with requirements that might be significant deficiencies or material weaknesses. However as discussed below, we identified certain deficiencies in internal control over financial operations, safeguarding of assets, and compliance with requirements that we consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis unauthorized, illegal, or irregular transactions or the breakdown in the safekeeping of any asset or resource. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the Agency's ability to properly initiate, authorize, record, process, or report financial data reliably, consistent with management's direction, safeguard assets, and/or comply with certain provisions of laws, regulations, contracts, and grant agreements such that there is more than a remote likelihood that a financial misstatement, unsafe treatment of assets, or noncompliance with laws, regulations, contracts and grant agreements that is more than inconsequential will not be prevented or detected by the Agency's internal control. We consider the following deficiencies, described in detail in the accompanying "Condition of Records" and "Recommendations" sections of this report, to be significant deficiencies in internal control over financial operations, safeguarding of assets and compliance with requirements: Recommendation 1 – cost allocation and Recommendation 6 – preparing purchase orders after goods and services are received.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that noncompliance with certain provisions of laws, regulations, contracts, and grant agreements or the requirements to safeguard assets that would be material in relation to the Agency's financial operations, noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions, and/or material financial misstatements by the Agency being audited will not be prevented or detected by the Agency's internal control.

Our consideration of the internal control over the Agency's financial operations, safeguarding of assets, and compliance with requirements, was for the limited purpose described in the first paragraph of this section and would not necessarily disclose all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that neither of the significant deficiencies described above is a material weakness.

Compliance and Other Matters:

As part of obtaining reasonable assurance about whether the Department of Economic and Community Development complied with laws, regulations, contracts and grant agreements, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Agency's financial operations, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

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

The Department of Economic and Community Development's response to the findings identified in our audit are described in the accompanying "Condition of Records" section of this report. We did not audit the Department of Economic and Community Development's response and, accordingly, we express no opinion on it.

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

CONCLUSION

We wish to express our appreciation for the cooperation and courtesies extended to our representatives by the personnel of the Department of Economic and Community Development during this examination.

Joe Faenza
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts