STATE OF CONNECTICUT

AUDITORS' REPORT
DEPARTMENT OF ECONOMIC AND COMMUNITY DEVELOPMENT
FOR THE FISCAL YEARS ENDED JUNE 30, 2009 and 2010

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN ❖ ROBERT M. WARD

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January 14, 2013

AUDITORS' REPORT
DEPARTMENT OF ECONOMIC AND COMMUNITY DEVELOPMENT
FOR THE FISCAL YEARS ENDED JUNE 30, 2009 and 2010

We have examined the financial records of the Department of Economic and Community Development for the fiscal years ended June 30, 2009 and 2010. 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 (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. Joan McDonald served as commissioner during the audited period.

RÉSUMÉ OF OPERATIONS:

General Fund Receipts:

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

	Fiscal Year Ended June 30,		
	2008	**2009**	**2010**
Loan Principal and Interest	$ 488,293	$ 577,554	$ 573,953
Refunds of Expenditures	617,471	962,282	780,304
All Other	21,701	5,202	2,197
Total Receipts	$1,127,465	$1,545,038	$1,356,454

Refunds of expenditures consisted primarily of grant refunds.

General Fund Expenditures:

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

	Fiscal Year Ended June 30,		
	2008	**2009**	**2010**
Personal Services	$6,959,045	7,177,742	5,731,590
Other Expenditures	1,307,211	574,355	724,961
Congregate Facilities	5,808,045	6,076,724	6,233,888
Deferred Maintenance Public Housing	0	3,591,110	0
Home CT	3,600,000	0	0
Payments in Lieu of Taxes	2,204,000	2,204,000	2,204,000
Elderly Rental	2,776,639	2,212,439	2,640,135
Other Housing Assistance	1,363,433	1,423,576	971,945
Tax Abatement	1,704,890	1,704,890	1,704,890
Assisted Living Demonstration	1,851,037	2,068,000	1,623,550
CONNSTEP	1,000,000	950,000	518,889
All Other	2,824,010	5,721,429	954,134
Total Expenditures	$31,398,310	$33,704,265	$23,307,982

The personal services expenditures were lower in the 2010 fiscal year because the department had fewer employees. Other expenditure fluctuations were primarily attributable to the change in program initiatives and variances in existing 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.

Special Revenue Funds Receipts:

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

	Fiscal Year Ended June 30,		
	2008	**2009**	**2010**
Principal and Interest on Loans	$ 8,709,521	$ 7,164,628	$ 8,046,247
Federal Contributions	32,397,877	41,226,620	50,616,963
Restricted Contributions, Other	302,391	1,302,188	1,134,970
Other	2,408	68,617	0
Total Receipts	$41,412,197	$49,762,053	$59,798,180

The increase in revenues was primarily attributable to increased reimbursements received from the federal Community Development Block Grant Program.

Special Revenue Funds Expenditures:

A summary of expenditures from Special Revenue Funds during the audited fiscal years and the preceding fiscal year follows:

	Fiscal Year Ended June 30,		
	2008	**2009**	**2010**
Loans	$ 27,796,936	$ 45,958,535	$ 37,735,463
Grants	66,793,810	81,917,353	79,187,912
Administration	6,937,361	7,557,308	9,321,827
Total Expenditures	$101,528,107	$135,433,196	$126,245,202

Included in the above totals are federal expenditures totaling $31,777,514, $41,881,012 and $50,676,064 for the fiscal years ended June 30, 2008, 2009 and 2010, respectively. The fluctuations in loans and grants were mainly in the following funds: Economic Assistance Bond Fund, Economic Assistance Revolving Fund, Grants to Local Governments and Others, Housing Trust Fund, and Federal and Other Restricted Accounts Fund.

Capital Project Funds:

Total expenditures from Capital Project Funds were $30,477,639 and $25,120,704 for the fiscal years ended June 30, 2009 and 2010, respectively, compared to $24,410,552 expended in the fiscal year ended June 30, 2008. 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's records noted the following reportable matters.

Cash Management:

Background: DECD disburses grant funds for housing and economic development programs. Assistance agreements between the department and clients provide that the clients submit audit reports to the department. After DECD reviews the audit reports and is satisfied with the accuracy of the total grant expenditures, it issues a Certificate of Approved Program Costs and State Funding. The certificates summarize department payments to the client for the specific project, total client expenditures, any adjustments and the amount due to or from DECD. DECD then bills the client for any amounts due.

Criteria: Cash management procedures should ensure that payments to clients are based on immediate needs and that refunds of overpayments are received as soon as possible.

Condition: DECD's cash management procedures appeared in need of improvement. During the audited period, the department issued 136 Certificates of Approved Program Costs and State Funding that reflected amounts due to DECD totaling $2,517,425.

The length of time that clients held unexpended state funds before returning them to DECD seems excessive. For the 15 projects we reviewed, the time between DECD's last payment and receipt of a refund was less than one year for five projects, one to two years for five projects, two to three years for three projects, and more than three years for two projects. The amounts of the two refunds due over three years were $108,814 and $560,694.

Effect: DECD clients received funding in excess of their needs and are not returning those excess funds to the department in a timely manner.

Cause: The department has not ensured that clients only receive amounts necessary to meet cash needs of the funded project or those refunds of overpayments were received in a timely manner.

The assistance agreements are worded so that the client only owes refunds to DECD after the certificate is issued. The client does not have the responsibility for refunding at the end of the budget period or upon project completion.

We were informed that instead of receiving a return of funds, it is much easier for the department to allow the grantees to hold the funds, with the department aware they have the funds, and suggest to the grantees that they may want to expand the funded project with those DECD funds or use the DECD funds for another project. This circumvents the established procedures for processing applications and review of payments to clients.

Recommendation: DECD should improve its cash management procedures by disbursing funds for only immediate needs and reducing the time to receive refunds of overpayments. Re-wording assistance agreements should be considered to require earlier refunds. (See Recommendation 1.)

Agency Response: "The Department does not agree with this finding.

The Department disburses funds to a client either as an advance for projected expenditures or as a reimbursement of expenditures already incurred.

Funds are advanced to a client for a short term, which in most instances will be no more than three months, based on the eligible expenditures being funded by a particular program. A second advance will not be approved by the Department until the client has provided documentation to the Department that initial advance has been expended.

Refunds due to the Department based on a Certificate of Approved Program Costs and State Funding are impacted by various factors.

Upon completion of a project the project manager submits to the Audit Section a request to close the project. To be able to close the project, the Audit Section must have received from the client all of the audits that include the project's expenditures. The Audit Section may have to wait for a final audit which could take several months thereby lengthening the process.

Once the Certificate of Approved Program Costs and State Funding is completed it is sent to the client with a copy being forwarded to the Office of Finance and Administration (OFA). If funds are due to the State OFA will bill the client.

The Department recognizes the fact the time involved to receive the return of funds by clients identified by the Auditors as lengthy. However, the Department makes every effort to ensure that funds owed to the State are returned in a timely manner.

The Department believes that its cash management system provides reasonable assurance that excessive funds are not disbursed to a client and that a client provides a refund to the State in a timely manner."

Auditors' Concluding Comments: If DECD's cash management procedures were adequate, in a two-year period it would not have identified 136 refunds due totaling over $2.5 million.

The department acknowledges that it has a lengthy process to follow before billing clients for refunds. Consideration should be given to changing that process.

Monitoring of Unused Bond Allocations:

Background: DECD 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 approvals 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 for bond-funded projects should include procedures to monitor unexpended balances from bond-funded projects that are completed or cancelled.

Condition: In our two prior audits, we found that the department had not implemented formal policies and procedures to address the administration of unexpended balances on bond-financed projects. Our current review found that condition continued.

Effect: The lack of written procedures for monitoring 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: In the current audit period, DECD drafted policies and procedures, but they were never approved by the commissioner.

Recommendation: DECD should implement formal policies and procedures to 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 2.)

Agency Response: "The Department agrees with this finding.

The Department will develop and implement a procedure that will ensure unused balances from prior State Bond Commission approvals are reviewed. The procedure will ensure that unused balances for projects that have been completed or cancelled will be returned to the Bond Funded source of the project.

It should be noted that the timely manner for the Department must take into account various factors that extend the time to return unexpended balances to its original bond funded source.

Until a project is closed the unexpended balance amount is unknown. The closeout process requires the project manager to submit a request to the Audit Section to close a project upon completion.

The Audit Section closes projects based on audits provided by the clients which must include all of the project's expenditures. The clients have up to six months after the end of their fiscal year to provide their audit to the Department. Also, clients are frequently granted time extensions to submit an audit.

The entire process requires the following:

- Project manager's request of Audit Section to close a project;
- Audit Section closes project when the client has provided all of the audits covering project expenditures;
- Office of Finance and Administration bills client for any unexpended funds;
- Upon return of funds to DECD the Office of Finance and Administration returns funds to original bond fund.

Considering all the above factors it would not be unreasonable that funds returned to the original bond fund could very easily extend beyond one year past the original request by the project manager to close the project."

Receivables Reconciliation:

Background: Each year, DECD reports its June 30th receivable balances to the State Comptroller. Balances reported include grant overpayments and energy conservation loan (ECL) receivables serviced by a private contractor.

Criteria: An adequate system of internal controls should include at least annual reconciliations of beginning balances, activity and ending balances.

Reconciliations should identify any errors or improper entries made to receivable balances so that corrections to balances and accurate reporting can be performed.

Entities reporting loan receivables administered by third-party loan servicers should ensure that reported amounts reflect loan receivable balances carried by the loan servicer. Sound internal controls provide for receipt of a report on controls at the service organization. For the audited period, the applicable auditing standard was Statement on Auditing Standards No. 70 (SAS 70). For report periods ending on or after June 15, 2011, Statement on Standards for Attestation Engagements No. 16 (SSAE 16) is applicable.

Condition:

Grant refunds:
No reconciliations were performed of grant refund activity and reported receivable balances. We identified unreconciled variances of $20,720 in 2008-2009 and $257,996 in 2009-2010.

ECL Loans:
The amount reported by DECD as its largest ECL loan program balance as of June 30, 2011, was $9,039,460. Although the Department attempts monthly reconciliations of ECL principal balances accounted for in its records to amounts reported monthly by the loan servicer, these reconciliations include unresolved reconciling items.

Although DECD did obtain a report of a limited review of its loans with the ECL loan servicer under an agreed-upon-procedures review, the department did not require that the ECL loan servicer provide a report on its controls pursuant to SAS 70.

Effect:

Financial disclosures on the state's financial statements may be inaccurate. Loans administered by a third-party servicer may not be properly accounted for or reported.

Cause:

Reconciliations of grant refund receivables were apparently not considered.

Monthly reconciliations of ECL principal balances were not reviewed periodically by an employee independent of the reconciliations to ensure their accuracy.

DECD receives annual audit reports from the ECL loan servicer. However, those audit reports do not specifically identify the DECD funding. DECD did not require SAS 70 reviews of the loan servicer.

Recommendation: DECD should perform complete reconciliations of receivable activity and balances before reporting balances to the State Comptroller.

For Energy Conservation Loan balances, DECD should request from the loan servicer its annual reconciliations of beginning balances, activity and ending balances, and reconcile with department records. When preparing its next contract with the loan servicer, DECD should require a report prepared pursuant to Statement on Standards for Attestation Engagements No. 16 (SSAE 16). (See Recommendation 3.)

Agency Response: "The Department agrees with this finding.

The Department agreed with the previous finding presented in the prior audit report. Based on that finding the Department, in the next fiscal year, commenced reconciling the Energy Conservation Loan receivable balances recorded on its records to amounts recorded by its loan service provider prior to reporting such balances to the State Comptroller. DECD based its reconciliation on a spreadsheet created by a previous state auditor.

For the ECL Balances, we agree to request from the loan servicer its annual reconciliations of beginning balances, activity and ending balances, and to reconcile with DECD records. The current Reconciliation format will be reviewed to determine if it can be simplified. The first change will be that the ECL Help balance will no longer be reported separately, but will be merged with the ECL Program Funds. Monthly and total transactions made during the fiscal year will be included.

In FY 13 the service provider will be asked to provide monthly reports of its ECL loan fund activities and availability including beginning fund balance, loans disbursed and ending balance. This information will be reconciled to DECD's disbursement records and fund balance.

Monthly reconciliations of ECL principal balances will be reviewed periodically by an employee independent of the reconciliations to ensure accuracy.

The Department appreciates the value of and agrees that the use of the Statement on Standards for Attestation Engagements No. 16 (SSAE 16) would be beneficial going forward. At this time, however, we do not believe that it is in the state's best interests to request this discretionary report from the current loan service provider. For the duration of the current contract, which expires March 31, 2013, we will continue to rely on the annual audit, and the agreed-upon audit procedures as outlined in the current Personal Service Agreement (PSA) with the loan service provider.

The Department intends to re-bid this PSA in the next six months, and will include the requirement that any new loan service provider submit the SSAE 16 report for all reporting periods, as applicable."

Employee 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.
- Identify training needs.
- Form a basis for personnel decisions.
- Provide an opportunity for organizational diagnosis and development.
- Facilitate communication between employee and management.

Condition: In our prior audit, we found that performance appraisals were not completed for all DECD employees. During the current audited period, the department had not completed performance appraisals for any of its 16 managerial employees.

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.

Recommendation: DECD should ensure that periodic performance appraisals are performed on all of its employees. (See Recommendation 4.)

Agency Response: "The Department agrees with this finding.

The Department participates in the Performance Assessment and Recognition System (PARS) for managers administered by the Department of Administrative Services (DAS).

To assist state agencies with the implementation of the PARS Program a handbook is provided by DAS outlining the requirements for a participating agency.

The PARS handbook in the Progress Reviews Section states that: “Formal quarterly progress reviews are strongly recommended”.

Therefore the agency has discretion as to when a performance review should be conducted.

Based on the guidance provided in the PARS Handbook the Department will conduct annual performance reviews of all its managers.

The Department will continue to have regularly scheduled meetings with all Department managers to discuss expectations and evaluate the performance of the managers.”

Payroll Cost Allocation:

Background: DECD 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. Time 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: Payroll costs allocated by cost allocation systems should be reconciled to amounts recorded in the general ledger. Costs initially charged to the appropriate funding source need no reallocation.

Section 3-18 of the Implementation Guide for Office of Management and Budget (OMB) Circular A-87 provides that year-end bonuses, if amounts are significant, must be allocated based on the entire year’s activity.

Condition: In our prior audit report, we recommended that total payroll costs allocated by cost allocation systems should be reconciled to amounts recorded in the general ledger. We found improvement in this area; however, we identified errors.

In the current audit, we reviewed one payroll adjustment covering 12 employees and all 26 pay periods in the 2010 fiscal year. We found a variance of over $16,000 between salaries in the department's cost allocation calculation and the total in the Core-CT general ledger. The department did not include lump-sum payments (e.g. merit bonuses, longevity) in its cost allocation calculations. Additionally, the department did include in its calculations overtime, which does not need reallocation because it is originally entered into the payroll system specifically for the program towards which the overtime was worked. Because of these calculation errors, $12,686 was incorrectly charged to the HOME Program.

We reviewed a sample of payroll transactions for 20 employees. One employee in that sample recorded work hours to two programs other than for which the expenditure was coded, but did not have his payroll costs reallocated to the two programs worked.

Effect: Payroll costs allocated to the department's programs were not accurate.

Cause: When devising its method of calculating costs to be allocated, the department did not consider the proper allocation for all the types of pay. We were informed that some employees did not have their payroll reallocated because of lack of staff to perform the reallocations.

Recommendation: DECD should ensure that payroll cost allocations are completed accurately for all employees and reflect all payroll costs in the Core-CT general ledger. (See Recommendation 5.)

Agency Response: "The Department does not agree with this finding.

We do not agree that the lump sum payments identified should be included in the cost allocation.

Based on employees' entries of number of hours worked on specific programs, the work distribution program calculates the cost using the employees' hourly rates. Merit bonuses, annual increases and longevity amounts were not included in the payroll cost because they are paid by lump sum, and not associated with a number of hours or program.

Longevity payments are made to employees based on length of state service, regardless of the program currently being worked on by the employee.

Merit bonus payments are paid in lieu of an additional pay step (usually paid in January) and are made as a salary increase for the next 12 months. We could not accurately project the programs and associated hours for the first 6 months of the new FY.

DECD will review the possibility of charging these lump sum payments to the General Fund, since payments cannot be distributed by program. This will depend upon the availability funds in the General Fund."

Auditors' Concluding Comments: By not reallocating the lump sum payments, the HOME program was charged for those payments, even when the employees actually worked on other programs.

Payroll – Overtime:

Criteria: Section 5-245 of the General Statutes provides that employees receive overtime pay for a period in addition to the hours of the employee's regular, established workweek when the work performed is authorized by the employee's appointing authority, in this case the DECD commissioner. DECD policy requires that paid overtime hours receive written approval prior to the work being performed.

Condition: A review of 20 employees revealed that one employee worked overtime for approximately one hour a day for almost the entirety of fiscal year 2009. The agency had correspondence of the supervisor's request for the employee to be approved for the overtime, but no commissioner's approval.

Effect: Inappropriate payments for overtime may have been made.

Cause: A lack of attention to recordkeeping apparently caused the condition.

Recommendation: DECD should maintain required recordkeeping for overtime approval. (See Recommendation 6.)

Agency Response: "The Department agrees with part of the comments made pertaining to overtime.

The Department requires prior approval by the commissioner of all overtime worked by any Department employee. Therefore the employee had the commissioner's authorization to work the overtime during fiscal year 2009. This employee would not have worked the overtime without the commissioner's approval.

The Auditors stated that the documentation of the commissioner's approval of overtime for the aforementioned employee could not be provided by the Department.

Going forward the Department will ensure that all required documentation approving overtime will be kept on file."

Adherence to Travel Policies:

Criteria:

Out-of-State Travel:
In May 2008, the Governor instituted a ban on out-of-state travel by all personnel unless the trip was paid by non-state funds.

In January 2009, the Governor extended the travel ban to include federal funding, unless the funds were specifically allocated to the state for travel or if travel was a condition of receiving the federal funds. This order did not apply to union travel, travel paid for by outside organizations, or travel requests previously approved by the Governor's office.

State-funded out-of-state travel was allowable if approved by the Governor's office.

State Vehicles:
Each employee is required to record their usage of a state car on a Monthly Usage Report Form CCP-40.

Condition:

Out-of-State Travel:
The commissioner's office bypassed internal controls regarding out-of-state travel expenditures and did not obtain approval from the Governor's office.

We reviewed the period from May 6, 2008 through September 15, 2010. Department records indicate that employees made more than 40 out-of-state trips during that period. None of those trips had approval from the Governor's office. Unapproved expenditures totaled $111,844.

State Vehicles:
During the entire audited period, the DECD commissioner did not complete vehicle usage reports for the state-owned vehicle assigned to her. Daily mileage, places visited and overnight parking location were not documented.

Effect:

Top management's override of internal controls caused both unauthorized expenditures to be incurred and weakened the department's control environment.

Cause:

Disregard of state policies caused the conditions.

Conclusion: As of February 9, 2011, the travel policy was changed to allow agency heads to approve out-of-state travel. In March 2011, a new commissioner began at DECD.

Because the above conditions no longer exist we are not presenting a recommendation in this report.

Agency Response: "DECD disagrees with the finding. It is the department's understanding that verbal approvals were secured for the out-of-state travel noted above. Because at the time there were few protocols on how to administer the travel restrictions, a verbal approval was thought to be sufficient."

Auditors' Concluding Comments: Approvals of transactions should be in a form that can be reviewed. The department could not produce evidence of any approvals for audit review.

Purchasing:

Criteria: Section 4-98(a) of the General Statutes states that no budgeted agency may incur any obligation except by the issuance of a purchase order and a commitment transmitted to the State Comptroller.

Proper internal controls related to purchasing require that commitment documents be properly authorized prior to receipt of goods or services.

The State Accounting Manual establishes guidelines for processing vendor payments. The guidelines include criteria for determining the correct receipt date to be used in processing state invoices. Proper entry of receipt dates into the Core-CT accounting system is important because receipt dates are used to calculate vendor accounts payable for inclusion in year-end GAAP Reporting.

Condition: In our review of 56 expenditure transactions, we found:

- Receipt dates were recorded incorrectly for nine transactions.
- Sixteen purchase orders were created and/or approved after the receipt of goods or services

Effect: When obligations are incurred prior to the commitment of funds, there is less assurance that funding will be available at the time of payment.

Receipt dates posted to the wrong fiscal year may result in the improper reporting of year-end accounts payable, and expenditures would be recorded and reported in the wrong fiscal year.

Cause: We were informed that, for grant and loan transactions, program staff approve contracts before providing the department's Office of Finance and Administration all the information necessary to prepare the purchase orders.

Recommendation: DECD should strengthen its internal controls to ensure that funds are committed prior to purchasing goods and services, and receipt dates are recorded accurately. (See Recommendation 7.)

Agency Response: "The Department agrees with this finding,

The Department agrees on the details presented regarding receipt dates. Staff will be instructed to review related purchasing procedures and staff will be instructed to follow the receipt dating process agreed upon for grant and loan documents.

The Department agrees on the details presented regarding purchase orders created and/or approved after the receipt of goods or services. The DECD OFA [Office of Finance and Administration] Business Office adheres to state purchasing procedures; however, there are unavoidable circumstances when documents are submitted to OFA after the fact. This is especially true with the flow of documents related to DECD grant and loan contracts.

DECD Program Managers are instructed to submit original contractual documents to the DECD Master File Library; one of these documents is a summary Contract Face Sheet. The DECD Master File Librarian forwards a copy of the Face Sheet to OFA and OFA distributes the Face Sheet to appropriate accounting staff. Based on the Face Sheet, a Core-CT contract…and purchase order are generated (PO to Office of the State Comptroller if > $1m) in advance of a receipt of a request for payment. However, if OFA receives a payment request before the receipt of the Face Sheet, the contract and PO are generated afterward. OFA does not control the submission of documents by line production program staff.

It is extremely important to note ***in no circumstance specified*** was a grant or loan payment processed without receipt of a Face Sheet and creation of a Core-CT contract and purchase order."

Disaster Recovery Plan:

Background: Our prior audit report contained a recommendation regarding development of a disaster recovery plan. Part of that recommendation was implemented with the development of the department's

Information Technology Disaster Recovery Plan. Continuing deficiencies identified in our current review are presented below.

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

- Provisions for backup site, computer hardware and software.
- Tests of the contingency plan.

Condition: DECD management has neither made provisions for a backup site, computer hardware and software, nor performed a test of its information technology disaster recovery plan.

Effect: Without testing the information technology disaster recovery plan, the department cannot accurately determine whether the plan provides for continuance of operations in the event of a disaster or major interruption in information systems. An inadequate disaster recovery plan extends the time required to recover and resume critical infrastructure and application systems.

Cause: The cause was not determined.

Recommendation: DECD management should test its Information Technology Disaster Recovery Plan and properly coordinate all contingency provisions within the plan. (See Recommendation 8.)

Agency Response: "The Department agrees with this finding.

The Department will be using its Constitution Plaza site in Hartford for backup for its hardware and software in the event of a disaster at its 505 Hudson St. Hartford site.

The Department will be replacing its servers at its 505 Hudson St. site and will be moving the servers to the Constitution Plaza site to be used as the backup equipment. Once this is completed the Department will then test its ITDR plan."

Other Matters:

In addition to the preceding findings, we reviewed the following matter pertaining to the Department of Economic and Community Development:

Since November 2007, DECD has employed an economist in a federal H-1B status. This is an employment-based nonimmigrant Visa for a specialty occupation. The H-1B status can be approved for a maximum of six years unless an extension is approved by the U.S. Department of Homeland Security.

DECD paid federal fees totaling more than $6,000 ($3,328 in 2008 and $3,050 in 2011) in order to employ the individual and did not seek any reimbursement from that individual.

The state's public higher education units sponsor nonimmigrants through the H-1B program in accordance with written policies. Neither the Department of Administrative Services nor existing collective bargaining agreements address the issue of paying fees in order to hire an employee. Therefore, we are referring this matter to the Department of Administrative Services and the Office of Labor Relations within the Office of Policy and Management for their review and consideration.

RECOMMENDATIONS

Twelve recommendations were presented in our prior report. As indicated below, seven of those recommendations have been complied with. Five of the recommendations have not been fully resolved and are therefore repeated in this report.

Status of Prior Audit Recommendations:

- DECD 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.

  Although we noted improvement, we are repeating this recommendation in a modified form. (See Recommendation 5.)

- DECD should ensure that periodic performance appraisals are performed on all of its employees.

  This recommendation was not implemented and is being repeated. (See Recommendation 4.)

- DECD should ensure that compensatory time earned is documented in accordance with department compensatory time polices.

  This recommendation was implemented.

- DECD 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.

  We did not identify a similar situation for the current audit period. This recommendation will not be repeated.

- DECD should review expenditure coding assigned to its contracts to ensure that appropriate coding has been assigned.

  This recommendation was implemented.

- DECD 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.

  This recommendation was partially implemented. We are repeating our recommendation on obligations of purchases. (See Recommendation 7.)

- DECD should ensure that petty cash fund transactions are processed in accordance with the State Accounting Manual.

  This recommendation was implemented.

- An 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.

  This recommendation was implemented.

- DECD should establish written policies and procedures to 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.

  This recommendation was not implemented and will be repeated. (See Recommendation 2.)

- DECD 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.

  This recommendation was not adequately addressed and will be repeated. (See Recommendation 3.)

- DECD should ensure that an eligibility analysis is performed on all Urban Act projects and that required financial reports are obtained.

  This recommendation was implemented.

- DECD 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.

  This recommendation was partially implemented. We are presenting a recommendation on disaster recovery. (See Recommendation 8.)

Current Audit Recommendations:

1. **DECD should improve its cash management procedures by disbursing funds for only immediate needs and reducing the time to receive refunds of overpayments. Re-wording assistance agreements should be considered to require earlier refunds.**

   Comment:

   During the audited period, the department identified 136 instances in which it had paid clients in excess of their funded project needs which resulted in refunds due to DECD totaling $2,517,425.

   The length of time that clients held unexpended state funds before returning them to DECD appeared excessive.

2. **DECD should implement formal policies and procedures to 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 two prior audits, we found that the department had not developed formal policies and procedures to address the administration of unexpended balances on bond-financed projects. Our current review found that condition continued.

3. **DECD should perform complete reconciliations of receivable activity and balances before reporting balances to the State Comptroller.**

   For Energy Conservation Loan (ECL) balances, the department should request from the loan servicer its annual reconciliations of beginning balances, activity and ending balances, and reconcile with department records. When preparing its next contract with the loan servicer, DECD should require a report prepared pursuant to Statement on Standards for Attestation Engagements No. 16 (SSAE 16).

   Comment:

   <u>Grant refunds</u>:
   No reconciliations were performed of grant refund activity and reported receivable balances. We identified unreconciled variances of $20,720 in 2008-2009 and $257,996 in 2009-2010.

ECL Loans:
Department reconciliations of ECL principal balances in its records to amounts reported monthly by the loan servicer include unresolved reconciling items.

The department did not require that the ECL loan servicer provide a report on its controls pursuant to Statement on Auditing Standards No. 70 (SAS 70). (For report periods ending on or after June 15, 2011 Statement on Standards for Attestation Engagements No. 16 (SSAE 16) is applicable.)

4. DECD should ensure that periodic performance appraisals are performed on all of its employees.

Comment:

In our prior audit, we found that performance appraisals were not completed for department employees. During the current audited period, the department had not completed performance appraisals for any of its 16 managerial employees.

5. DECD should ensure that payroll cost allocations are completed accurately for all employees and reflect all payroll costs in the Core-CT general ledger.

Comment:

We found a variance of over $16,000 between payroll in the department's cost allocation calculation and the total in the Core-CT general ledger. The department did not include lump-sum payments (e.g. merit bonuses, longevity) in its cost allocation calculations. Additionally, the department did include in its calculations overtime, which does not need reallocation because it is originally entered into the payroll system specifically for the program towards which the overtime was worked. Because of these calculation errors, $12,686 was incorrectly charged to the HOME Program.

Also, one sampled employee recorded work hours to two programs other than for which the expenditure was coded, but did not have his payroll costs reallocated to the two programs worked.

6. DECD should maintain required recordkeeping for overtime approval.

Comment:

The department did not have the commissioner’s approval on file for an employee who was paid overtime for approximately one hour a day for almost the entirety of fiscal year 2009.

7. **DECD should strengthen its internal controls to ensure that funds are committed prior to purchasing goods and services, and receipt dates are recorded accurately.**

   Comment:

   We found receipt dates were recorded incorrectly for nine transactions and 16 purchase orders were created and/or approved after the receipt of goods or services.

8. **DECD management should test its Information Technology Disaster Recovery Plan and properly coordinate all contingency provisions within the plan.**

   Comment:

   Management has neither made provisions for a backup site, computer hardware and software, nor performed a test of its information technology disaster recovery plan.

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, 2009 and 2010. This audit was primarily limited to performing tests of the department's compliance with certain provisions of laws, regulations, contracts and grant agreements and to understanding and evaluating the effectiveness of the department's internal control policies and procedures for ensuring that (1) the provisions of certain laws, regulations, contracts and grant agreements applicable to the department are complied with, (2) the financial transactions of the department are properly initiated, authorized, recorded, processed, and reported on consistent with management's direction, and (3) the assets of the department 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, 2009 and 2010 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:

Management of the Department of Economic and Community Development is responsible for establishing and maintaining effective internal control over financial operations, safeguarding of assets, and compliance with the requirements of laws, regulations, contracts, and grants. 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 department's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grant agreements, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control over those control objectives. Accordingly, we do not express an opinion on the effectiveness of the Department of Economic and Community Development's internal control over those control objectives.

A *deficiency in internal control* 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 and correct on a timely basis, unauthorized, illegal or irregular transactions, or breakdowns in the safekeeping of any asset or resource. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions and/or material noncompliance with certain provisions of laws, regulations, contracts, and grant agreements that would be material in relation to the Department of Economic and Community Development's financial operations will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control over financial operations, safeguarding of assets, and compliance with requirements was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial operations, safeguarding of assets, and compliance with requirements that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over the Department of Economic and Community Development's financial operations, safeguarding of assets, or compliance with requirements that we consider to be material weaknesses, as defined above.

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 department'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 department 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.

Elaine C. O'Reilly

Elaine O'Reilly
Principal Auditor

Approved:

John C. Geragosian
Auditor of Public Accounts

Robert M. Ward
Auditor of Public Accounts