STATE OF CONNECTICUT

AUDITORS' REPORT
OFFICE OF THE STATE COMPTROLLER
STATE FINANCIAL OPERATIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

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

Table of Contents

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August 27, 2012

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OFFICE OF THE STATE COMPTROLLER - STATE FINANCIAL OPERATIONS
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We have examined the records of the Comptroller of the State of Connecticut as they pertain to the central accounting of state financial operations, on a budgetary basis of accounting, for the fiscal year ended June 30, 2011. The audit certification on the Comptroller's civil list financial statements, the audited civil list financial statements themselves, and the related auditors' report on compliance and internal control over civil list financial reporting are included in a separate report entitled *Annual Report of the State Comptroller – Budgetary Basis*, for the fiscal year ended June 30, 2011. Throughout this report, we will refer to various financial statements and schedules contained in this annual report, which is hereinafter referred to as the Comptroller's 2011 Annual Report.

We have also examined the records of the Comptroller of the State of Connecticut as they pertain to the State of Connecticut's financial position and results of operations on the basis of generally accepted accounting principles. The audit certification on the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, the aggregate remaining fund information and the respective budgetary comparison for the General Fund and the Transportation Fund, and the respective changes in financial position and cash flows, where applicable, of the State of Connecticut, which collectively comprise the state's basic financial statements are included in a separate report entitled *Comprehensive Annual Financial Report* (CAFR) as of and for the year ended June 30, 2011.

This report consists of the Comments and Recommendations, which follow. This report contains an explanation of the difference between the two reports and includes certain findings pertaining to those reports and with the internal controls and procedures applied to the state's financial reporting.

COMMENTS

OFFICERS:

Nancy S. Wyman and Mark E. Ojakian served as State Comptroller and Deputy Comptroller, respectively, during the 2010-2011 fiscal year and until January 5, 2011. Effective that date and currently, Kevin Lembo and Martha Carlson serve as State Comptroller and Deputy Comptroller, respectively.

BUDGETARY BASIS REPORT:

The Comptroller's 2011 Annual Report covers the financial operations of the 2010-2011 fiscal year under a biennial budget adopted by the 2009 General Assembly, as revised by the 2010 General Assembly, including the financial accounting for the budget plans of the General Fund and Special Transportation Fund, as it applies to the 2010-2011 audit period.

The financial position as of June 30, 2011, and the 2010-2011 cash transactions of all state civil list funds, accounted for centrally in the records of both the Office of the State Comptroller and State Treasurer, are shown in Exhibit A and Schedule A-1, respectively, of the Comptroller's 2011 Annual Report. The financial position of the General Fund at June 30, 2011, together with a summary of operations for the year then ended, are shown in Exhibit B and Schedule B-1, respectively, of the Comptroller's 2011 Annual Report. Corresponding statements for the Special Transportation Fund are shown in Schedules C-2 and C-3, respectively, of the Comptroller's 2011 Annual Report. A summary of state bonds and notes outstanding as of June 30, 2011, the changes thereto, and the authorizations for future borrowings are shown in Schedules E-3, E-4, and E-5 of the Comptroller's 2011 Annual Report.

The Comptroller prepares the financial statements of the state's civil list funds on a modified cash basis of accounting, consistent with the prior year. The accounting basis used by the State of Connecticut was adopted by the Comptroller under the authority granted by Article Fourth, Section 24, of the Constitution of the State of Connecticut and with the recognition of legislative authorizations. The modified cash basis of accounting permits an accrual of revenues at fiscal year end, which includes the collections in July of Indian gaming payments and certain taxes levied as of June 30, and requires that expenditures be recorded in the year in which disbursements are made, provided recognition is given to continuing appropriations.

Those taxes for which July collections are accrued include sales and use taxes, corporation taxes, gross earnings taxes on utility and petroleum companies, real estate conveyance taxes and taxes on alcoholic beverages, cigarettes, gasoline and special motor fuels. As provided by various subsections of Section 3-114 of the General Statutes, these taxes are accrued if received by the Commissioner of Revenue Services not later than five business days following the last day of July.

Under the modified cash basis of accounting used by the Comptroller, restricted revenues of the General and Special Transportation Funds are recognized when earned through the expenditure of grant funds, rather than when received or awarded. Receivables reported by the Comptroller include federal and other grants receivable recorded in connection with federally supported programs or capital projects for which federal or other outside participation is available; loans and notes receivable from local governments, nonprofit corporations, businesses or individuals; and the accounts receivable of the University of Connecticut Health Center. Such receivables have been reported by the Comptroller as assets of the funds financing the projects or programs involved and are fully reserved on the balance sheet, except within the Grants and Restricted Accounts Fund and the Transportation Grants and Restricted Accounts Fund where the federal and other grants receivable are the source of financing for restricted appropriations established for the purposes of the grants involved. These restricted revenues are recognized by the Comptroller when earned through the expenditure of grant funds, rather than when received or awarded. In addition, interest income of the Special Transportation Fund is accrued at fiscal year end pursuant to the terms of a Special Tax Obligations Bond Indenture dated September 15, 1984.

In maintaining state accounting records and in preparing financial statements, the Comptroller, consistent with prior years, was guided by the aforementioned requirements and authorizations of state fiscal statutes as regards the method of accounting and fund classification. For this reason, therefore, the financial statements contained in the *Annual Report of the State Comptroller - Budgetary Basis* are not, nor are they intended to be, in accordance with generally accepted accounting principles (GAAP). In order for the Comptroller to follow such principles, among other things, expenditures would have to be recorded on an accrual rather than cash basis, all non-civil list funds and component units of the state would have to be included in the financial statements, all agencies' assets and contingent and long term liabilities would have to be recognized, and appropriate footnote disclosures would have to be made in the financial statements.

The use of the modified cash basis of accounting for the budgetary basis report has inherent weaknesses in that all financial activity for the fiscal year is not being accounted for within that fiscal year. Under the modified cash basis of accounting, revenues are not being recognized when they are measurable and available for use in the fiscal period, and expenditures are not being recognized as soon as they create a demand on current financial resources (when the liability is incurred). This results in reported financial performance being based on the timing of cash inflows or outflows. The timing of these transactions is set by statute or by management.

In March 2005, the American Institute of Certified Public Accountants issued an interpretation of its professional auditing standards that affects those governments that prepare financial statements using the cash, or modified cash basis of accounting, rather than reporting their financial activity in accordance with GAAP. As a result, those statements must conform to the applicable disclosure requirements of GAAP in order to avoid receiving an adverse audit opinion. This would require management to prepare and incorporate a management discussion and analysis, notes to the financial statements, and disclosure of infrastructure assets into the budgetary basis report. Because the Office of the State Comptroller has not done such, we have been required to render such an opinion on the *Annual Report of the State Comptroller - Budgetary Basis* for the fiscal year ending June 30, 2011.

COMPREHENSIVE ANNUAL FINANCIAL REPORT:

In order to comply with GAAP, the Office of the State Comptroller has issued a separate *Comprehensive Annual Financial Report* showing the State of Connecticut's financial position and results of operations in accordance with GAAP requirements. It has done so since the fiscal year ended June 30, 1988. This report, however, was always issued in addition to the *Annual Report of the Office of the State Comptroller - Budgetary Basis*, which presents the state's financial operations as budgeted by the General Assembly. Because differing accounting bases are followed in preparing the two reports, substantial variances can occur in the presentation of the state's financial position as well as its operations. The CAFR uses the modified accrual basis of accounting for all governmental activities, and the full accrual basis for business type activities. Under the modified accrual basis, revenues are recognized when they are both measurable and available to finance expenditures of the fiscal period. Expenditures for each agency are recognized in the period in which a transaction creates a demand on current financial resources, as compared to when cash is disbursed in the modified cash basis.

As explained above, the Office of the State Comptroller is required by statute to follow a practice of recording the accrual of certain revenues, notably income and corporation tax payments, without a corresponding accrual of expenditures in the General Fund. This accounting practice resulted in the accrual of more than $526,000,000 in revenues, which under a cash basis system of accounting would be recorded in the 2011-2012 fiscal year. If there had been a similar accrual of expenditures as required by GAAP, there would have been added to General Fund liabilities salaries and fringe benefits payable and accounts payable that are estimated to be as high as $2,092,000,000 over the modified cash basis of accounting during the first year only of any conversion to GAAP budgeting by the state.

As also explained above, grant receivables are recorded as revenues when earned through the expenditure of grant funds. If there had been a similar accrual of grant receivables and accounts receivable as required by GAAP, these expenditure accruals would be offset by additional revenue and receivable accruals totaling $869,000,000 under GAAP. The net result of these effects is an estimated deficit in the Unreserved Fund Balance of the General Fund (GAAP Basis) totaling $1,749,000,000 as of June 30, 2011. This is compared to an estimated deficit totaling $1,679,000,000 as of June 30, 2010. A schedule illustrating these differences, with a comparison to the previous fiscal year, is presented below:

Nearest Thousand Dollars	June 30, 2010	June 30, 2011
Unreserved Fund Balance (Deficit) -		
Modified Cash Basis	$ 0	$ 0
Adjustments to GAAP Basis:		
Additional Assets:		
Reduction of Income Tax Accrual	(377,400,000)	(525,300,000)
Eliminate Corporation Tax Accrual	(12,600,000)	(5,400,000)
Additional Taxes Receivable	3,800,000	4,200,000
Net Accounts Receivable	218,000,000	307,900,000
Federal and Other Grants Receivable	645,400,000	542,100,000
Due From Other Funds	24,800,000	19,600,000
Total Additional Assets	$ 502,000,000	$ 343,100,000

Additional Liabilities:		
Salaries and Fringe Benefits Payable	(250,300,000)	(245,900,000)
Accounts Payable - Dept. of Social Services	(573,000,000)	(711,900,000)
Accounts Payable - All Other	(1,131,200,000)	(844,100,000)
Payable to the Federal Government	(124,500,000)	(186,900,000)
Due to Other Funds	(102,000,000)	(103,200,000)
Total Additional Liabilities	$(2,181,000,000)	$(2,092,000,000)
Unreserved Fund Balance (Deficit) - GAAP Basis	$(1,679,000,000)	$(1,748,900,000)

As reported in the *Comprehensive Annual Financial Report,* on a government-wide basis which takes into account all non-fiduciary state assets and liabilities (all funds, in addition to the General Fund), the deficit for the 2010-2011 fiscal year totaled $9,856,474,000. This is compared to a deficit of $9,388,402,000 for the 2009-2010 fiscal year. The $468,072,000 increase in the deficit was primarily caused by the expenditure of the remaining accumulated balance in the Budget Reserve Fund, and by an increase in the non-current portion of the state's long term liabilities, which include the issuance of debt and pension and other post retirement liabilities. These increases were offset by a reduction in the current portion of the state's long term liabilities, notes payable, and an increase in the state's noncurrent restricted assets and capital assets.

A schedule presenting the deficit on a government-wide basis, from the CAFR Statement of Net Assets - Total Net Assets, for the past nine fiscal years is presented below:

Fiscal Year Ended, June 30, 2003	$(1,471,912,000)
Fiscal Year Ended, June 30, 2004	$(1,780,341,000)
Fiscal Year Ended, June 30, 2005	$(1,392,024,000)
Fiscal Year Ended, June 30, 2006	$ (784,864,000)
Fiscal Year Ended, June 30, 2007	$ (242,540,000)
Fiscal Year Ended, June 30, 2008	$(2,203,449,000)
Fiscal Year Ended, June 30, 2009	$(5,065,237,000)
Fiscal Year Ended, June 30, 2010	$(9,388,402,000)
Fiscal Year Ended, June 30, 2011	$(9,856,474,000)

The significant increase in the deficit for the fiscal year ended June 30, 2008 was partly the result of the implementation of GASB 45, which required the posting of the state's post employment health care liability. The increases in the deficit in the succeeding years was the result of poor economic conditions that resulted in budget deficits, the exhaustion of the Budget Reserve Fund, increased borrowing and declines in the valuation of state pension investments.

Implementation of GAAP Basis Budgeting:

A major impediment to the widespread use and acceptance of the State's *Comprehensive Annual Financial Report* was the failure of the legislative budget plan to be prepared and enacted in accordance with GAAP. In that way, the CAFR will present, in a unified format, both the budgetary and actual financial operations of the State of Connecticut. In an attempt to accomplish this end, the 1993 General Assembly passed Public Act 93-402, codified as Section 3-115b of the General Statutes. This act, effective with the fiscal year commencing July 1, 1995, authorized the Office of the State Comptroller and the Office of Policy and Management to implement the use of GAAP with respect to the preparation of the biennial budget and financial statements of the State of Connecticut. In accordance with this statute, a conversion plan was developed and submitted to the Appropriations Committee of the General Assembly in 1994. However, the plan was never implemented because the General Assembly continually postponed the state's conversion to GAAP budgeting. Through a succession of public acts, the original objective of implementing GAAP budgeting for the fiscal year commencing July 1, 1995, was extended by the General Assembly to the fiscal year commencing July 1, 2009.

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

Section 3-115b of the General Statutes was again significantly revised by the passage of Public Act 11-48, during the 2011 Session of the General Assembly. Passed as part of the *Plan for Conversion to GAAP Based Budgeting Developed in Accordance With Governor Dannel P. Malloy's Executive Order No. 1,* Public Act 11-48 makes the following changes:

Section 43 of Public Act 11-48, requires the Governor to propose, and the General Assembly to enact, beginning with the fiscal year ended June 30, 2014, a state budget that must exclude as revenues the estimated unappropriated prior year surplus, and include as expenditures, the amount necessary to extinguish any unreserved negative balance in any budgeted fund as reported by the *Comprehensive Annual Financial Report* for the prior year.

Section 44 of Public Act 11-48 requires the Comptroller to issue a report, by September 30th of each year, prepared in accordance with GAAP, of all appropriations and expenditures for the fiscal year itemized by each appropriation account of each budgeted agency; a statement of the revenues of the state classified as far as practicable as to budgeted agencies, sources and funds during such year; a statement setting forth the total tax receipts of the state during such year; and a balance sheet as of the close of the fiscal year.

Section 45 of Public Act 11-48 requires rather than allows the Secretary of the Office of Policy and Management to start implementing GAAP in the preparation of the state's annual budget. It requires the Comptroller to establish an opening combined balance sheet for all budgeted funds based on GAAP as of July 1, 2013, and aggregate and set up a charge on the opening combined balance sheet the accrued and unpaid expenses and liabilities as of June 30, 2013. This credit is intended to cover the accrued liabilities of the initial year of GAAP budgeting caused by the shift in timing of expenditures to the appropriate fiscal year. It also requires the state to begin to amortize the $1.5 billion accumulated GAAP deficit beginning with the 2013-2014 fiscal year and continuing for a total of 15 years, similar to the 1994 legislation.

The required amount is estimated to total $150 million per year.

Section 46 of Public Act 11-48 requires the Comptroller to reserve from any unappropriated General Fund surplus at the end of any fiscal year the annual increment of the accumulated GAAP deficit prior to allocating it for any other purpose. It also requires the biennial budget for the 2011-2012 and 2012-2013 fiscal years, to contain a reserve of $75 million and $50 million, respectively, if necessary to ensure that those budgets will remain balanced on a GAAP basis when year-end GAAP adjustments are made. This requirement was implemented by Public Act 11-6, as amended by Public Act 11-61, which incorporated this requirement in the *Connecticut State Budget for the FY '12 & FY'13 Biennium*. However, due to the lack of any General Fund surplus at the close of the 2011-2012 fiscal year, the $75 million reserve was not established.

Section 48 of Public Act 11-48 provides that, if at the close of the fiscal year a shortfall of revenue relative to expenses, a negative unreserved balance in the balance sheet would result, illustrating a budget deficit. In addition, it requires the following year's budget the sum of anticipated revenue plus the unreserved fund balance, as determined by the audited financial statements, to be equal to or greater than appropriation requirements for that fiscal year; if they do not do so, a budget deficit would be identified for that following year. Therefore, the requirements of Section 4-85 of the General Statutes requiring that the Governor propose measures to bring the budget back into balance should a General Fund deficit of more than one percent be forecast would be, in effect, requiring implementation of a deficit mitigation plan.

Financial Reporting Under GAAP Basis Budgeting:

Under the revisions of Public Act 11-48, the Comptroller's financial reporting will, starting on July 1, 2013, consist of:

1. Cumulative monthly statements that present revenues and expenditures to date for the General Fund and Special Transportation Fund. Although issued by the State Comptroller, these statements will reflect revenues and expenditures on a GAAP basis as provided by the Office of Policy and Management. They will include a statement of estimated revenue by source to the end of the fiscal year and a statement of appropriation requirements to the end of the fiscal year that will correspond to the budget act.
2. Unaudited annual financial statements to be issued by September 30th by the State Comptroller for all budgeted funds, on a GAAP basis. These will include a statement of all appropriations and expenditures for the fiscal year itemized by each appropriation account of each budgeted agency; a statement of the revenues of the state classified as far as practicable as to budgeted agencies, sources and funds during such year; a statement setting forth the total tax receipts of the state during such year; and a balance sheet as of the close of the fiscal year. For the purpose of preparing the next year's budget, and for certifying the surplus or deficit for the budgeted funds, an audited set of these statements will be made available by December 31st of that year.
3. The current *Comprehensive Annual Financial Report,* which will be supplemented by a detailed schedule of appropriations and expenditures by agency that will correspond with the budget act. The *Comprehensive Annual Financial Report* includes an auditor's report and discloses statewide activity on a GAAP basis. It will include the audited statements for the budgeted funds, all other funds and the component units, a

management discussion and analysis, notes to the financial statements, and the disclosure of fixed assets, pension liabilities and statistical information.

The Core-CT System, Other State Accounting Systems and GAAP Basis Budgeting:

Our previous audit noted certain technical issues and complications in the Core-CT system that need to be resolved prior to the July 1, 2013 implementation of GAAP based budgeting. Our current audit has reviewed the progress made toward resolving these issues. At the time of our review (May 2012), the Office of Policy and Management and the Office of State Comptroller were still in the process of determining the needed changes to Core-CT processes to accrue receivables and payables and provide for budgetary control and reporting on a GAAP basis. In the most recent discussions, the proposed conversion plan considered adopting the current method used to prepare the CAFR, and within existing features of the Core-CT system, produce:

1. A combination of the existing Core-CT modified accrual and modified cash ledgers to create a single budgetary basis general ledger that would reflect end of year receivables. In the modified accrual ledger expenditures are recognized when payment vouchers, payrolls, or general ledger journal entries are posted. Revenues are recognized when billings or accounts receivable (bank deposit) journal entries are posted. The modified cash ledger reverses certain revenue accrual transactions that occur in the modified accrual ledger.
2. An automated accrual of the salary and fringe benefits payable at the close of the fiscal year that is entered into the modified accrual ledger.
3. An automated accrual of the accumulated liability for sick and vacation leave benefits payable at the close of the fiscal year.
4. A table in Core-CT that provides an accounts payable accrual that will, at the close of the fiscal year, identify transactions posted with receipt dates in the old fiscal year but paid within the first 45 days of the new fiscal year.

By the combination of these items with the entry of an existing series of manual reports that are received from state agencies providing information not available on the Core-CT system, revenue and expenditure accruals are generated that would convert the budgetary basis ledger to GAAP. This method is proven, and does not require the implementation of a new Core-CT general ledger, or require the ledgers for both old and new fiscal years to be open at the same time.

Certain issues exist with this plan. One consideration is that this method is not conducive to providing monthly GAAP basis reporting. It is not feasible to require state agencies to produce the series of manual reports that are currently prepared at fiscal year end each month to provide monthly reporting. The use of a 45 day accounts payable period would excessively delay the issuance of monthly financial reports. Consideration is being made to use posted encumbrances to establish the month end payable, but recorded encumbrances overstate the actual accounts payable.

Preparing the budget for the ensuing fiscal year will require the accounts payable accrual information to be applied to the specific line item appropriations at each agency for all budgeted funds. There is a close timeline for this process as state agencies by statute must submit their budget proposals to the Office of Policy and Management by September 1st of each year.

In the Core-CT system, open purchase orders for prior year expenditures are rolled into the following fiscal year. The purchase order is closed when the expenditure is processed. Under GAAP accounting, prior year purchases must be charged back to the prior fiscal year, and sufficient funds must be encumbered from the old budget year to cover those payments. The method currently under consideration follows this existing practice. Under this decentralized method, it is essential that state agencies properly assign the correct receipt dates to vouchers posted to the Core-CT system so that the proper accounting period is charged. There has been a history of problems with agencies not properly entering receipt dates into Core-CT transactions. Relying on the receipt dates for GAAP based budgeting will require significant training for agency employees so that the proper dates are entered. Using this method would also require effective internal controls to ensure the decentralization of the accounting date entry function does not result in either deliberate or inadvertent postings with the wrong date.

Our previous report noted a significant complication to implementing GAAP based budgeting. It was the failure to adopt the Core-CT system completely across all state agencies in its initial implementation. Currently, the University of Connecticut, the University of Connecticut Health Center, the Connecticut State University, the Connecticut Community Colleges, the Office of Legislative Management and the Judicial Department are allowed to operate as limited scope Core-CT agencies. These agencies process their transactions through their own accounting systems and will then periodically enter the information into the Core-CT system. We note that in the upgrade to the 9.1 version of PeopleSoft for the Core-CT financials module that is scheduled for Spring 2013, this condition will not be remedied. In fact, the University of Connecticut invested in its own accounting system in lieu of adopting Core-CT, and the University of Connecticut Health Center has adopted the Banner accounting software used by the rest of the higher education system. This condition will result in problems in maintaining compliant accounting dates, calculating accruals on-line, and obtaining the most current on-line information to provide financial reporting to meet the requirements of GAAP based budgeting.

We also observe that the Departments of Social Services, Children and Families, Mental Health and Addiction Services and Developmental Services all make benefit or provider payments from agency checking accounts that are not directly reflected in the Core-CT system. The Medicaid program at the Department of Social Services is a particular problem, due to the significant dollar amounts involved, and the variable nature of the bimonthly billings. The current proposal is for accounting information to be loaded from the agency-specific payment systems onto Core-CT.

A similar issue is found to affect accounting for tax revenues. Deposits made in July and August earned in the prior fiscal year must be posted with that year's accounting date. The data system at the Department of Revenue Services must be able to provide the tax period or other determining date information in order to apply correct accruals. This information must be reflected in the information entered in the Core-CT system.

FUND FINANCIAL DATA – BUDGETARY BASIS

The State of Connecticut uses fund accounting that places all related assets, liabilities and residual equity within a single self balancing set of accounts to ensure and demonstrate fiscal accountability and legal compliance. The following is a summary of activity for the state's major funds and fund groups, on the budgetary basis, for the 2010-2011 fiscal year:

GENERAL FUND:

The General Fund is the chief operating fund of the state. It is used to account for all financial resources that are not required to be accounted for in other funds and which are spent for those services normally provided by the state.

The financial position of the General Fund, on a budgetary basis at June 30, 2011, together with a summary of operations recorded for the year then ended, are shown in Exhibit B and Schedule B-1, respectively, of the Comptroller's 2011 Annual Report.

General Fund operations were conducted under a biennial budget plan, which estimated revenues and provided for expenditures of the 2009-2010 and 2010-2011 fiscal years. Public Act 09-3, the budget act, included revenue estimates and appropriations for the 2009-2010 and 2010-2011 fiscal years and revenue estimates of the General Assembly's Committee on Finance, Revenue and Bonding. The budget was enacted by the June Special Session of the 2009 General Assembly. It was passed August 31, 2009 and became law September 9, 2009, two months after the fiscal year began and without the Governor's signature.

Under budget procedures customarily in effect, the estimates of revenues and the budgeted appropriations, taken in conjunction with whatever surplus or deficit was carried over from the preceding fiscal period, after consideration of any statutorily required transfers, give rise to an anticipated surplus or deficit projected through the end of the fiscal year. The original budget plan for the 2010-2011 fiscal year as reported by the Comptroller may be expressed as follows:

Estimated Revenues, 2010-2011, as Revised by the Committee on Finance, Revenue and Bonding		$17,667,370,000
Budgeted Appropriations, 2010-2011	$17,963,514,306	
Estimated Lapsing Appropriations	(296,344,007)	
Net Appropriations		17,667,170,299
Anticipated Surplus (Deficit), June 30, 2011		**$ 199,701**

Changes were made in the 2010-2011 budget by Public Acts 10-3 and 10-179, passed during the regular session of the 2010 General Assembly, and by Public Acts 10-1 and 10-2, passed during the June Special Session of the 2010 General Assembly. Public Act 10-3 reduced General Fund appropriations for various state agencies by $120,724,389, made changes to the Medicaid program to realize additional federal revenues, and transferred monies from various special funds and accounts to the General Fund. It also reduced the transfer from the Budget Reserve Fund to the General Fund from $342,000,000 to $103,225,120. Public Act 10-179 made additional transfers from various special accounts and funds to the General Fund; it also reduced

General Fund appropriations for various state agencies by $41,247,229 and reduced the anticipated year end lapse of the General Fund by $294,614,007. Public Act 10-179 also established an economic recovery rate bond plan to raise $955,900,000 in revenues for the General Fund by the issuance of rate replacement bonds. This program was not implemented. Public Acts 10-1 and 10-2, passed during the June Special Session of the 2010 General Assembly, made changes to the Medicaid program and miscellaneous revenues, appropriations and lapse that resulted in a minor fiscal impact. The 2010-2011 budget was further revised by the 2011 General Assembly by the passage of Public Act 11-61, which increased General Fund appropriations by $329,195,000, primarily to cover deficiencies in the Medicaid program. A provision in Public Act 11-61 also eliminated the aforementioned economic recovery rate bond plan. Subsequent to these changes, the final budget plan for the 2010-2011 fiscal year may be expressed as follows:

Estimated Revenues, 2010-2011,		$18,082,900,000
Budgeted Appropriations, 2010-2011	$18,353,937,759	
Estimated Lapsing Appropriations	(426,300,000)	
Net Appropriations		17,927,637,759
Anticipated Surplus (Deficit), June 30, 2011		**$ 155,262,241**

The actual results of the operations of the 2010-2011 fiscal year are presented in Schedule B-1 of the Comptroller's 2011 Annual Report. We have previously described the differences between the resulting financial operations by accounting on the budgetary basis as compared to the GAAP basis. An analysis of budgeted General Fund accounts follows:

Actual Budgeted Revenues, 2010-2011		$17,707,454,327
Appropriations, 2010-2011	$18,475,412,234	
Add/(Deduct)		
Appropriations Lapsed	(429,302,891)	
Net Appropriations		18,046,109,343
Balance		(338,655,016)
Prior Year Budgeted Appropriations		
Continued to 2010-2011 Fiscal Year		121,475,234
Miscellaneous Adjustments		4,233,708
Surplus (Deficit)		(212,946,074)
Release of Reserved Fund Balance		449,868,589
Reserve for 2011-2012 Fiscal Year		(236,922,515)
Unappropriated Surplus, June 30, 2011,		
per Schedule B-1		**$ 0**

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

1. *Actual revenues were some $40,084,000 greater than originally estimated. The revenue categories that showed the greatest increase were personal income taxes $563,931,000; sales and use taxes $188,330,000; corporation taxes $131,572,000; inheritance and estate taxes $138,573,000; oil company taxes $61,462,000; and rents, fines and escheats, $58,271,000. In addition, tax refunds were $53,246,000*

less than budgeted. The increase in revenues was partly offset by a reduction in transfers to the General Fund totaling $1,130,484,000, and decreases of $18,347,000 in real estate conveyance taxes and $20,822,000 in federal grants.

2. *Appropriations showed an increase of approximately $511,898,000 from the budget plan reported by the Comptroller. The increase was primarily from a total of $390,422,764 in appropriation adjustments, and $121,475,234 in prior year appropriations carried forward to the succeeding fiscal year.*
3. *Lapsed appropriations were some $132,959,000 greater than estimated, the result of an effort to reduce general state expenditures.*

A statement of changes in the unappropriated surplus account of the General Fund for the fiscal year ended June 30, 2011, is presented in Schedule B-1 of the Comptroller's 2011 Annual Report. It should be noted that Section 4-30a of the General Statutes provides that the unappropriated surplus that remains in the General Fund at the end of the fiscal year, after any amounts required by law to be transferred for other purposes have been deducted, shall be deposited to the Budget Reserve Fund, provided that the amount so transferred shall not cause the balance in such fund to exceed ten percent of the net General Fund appropriations for the fiscal year in progress. At the close of the fiscal year ended June 30, 2011, the balance in the Budget Reserve Fund totaled $48,346. For the fiscal year ended June 30, 2011, there was no surplus transferred to the Budget Reserve Fund at the close of the fiscal year. In accordance with a labor agreement, $14.5 million of this surplus is to be deposited in the Other Post Employment Benefit Trust Fund, and in accordance with Public Act 12-104, passed during the 2012 session of the General Assembly, $222.4 million is to be transferred to the resources of the General Fund for the 2011-2012 fiscal year.

General Fund Revenues:

Realized budgeted revenues in the General Fund for the 2010-2011 fiscal year totaled $17,707,454,327, as shown in Schedule B-1 of the Comptroller's 2011 Annual Report. This represented an increase in revenues of $18,925,744 or 0.1 percent as compared to the realized budgeted revenue total reported by the Comptroller for the preceding 2009-2010 fiscal year.

The budgeted revenue categories that showed the greatest change during the fiscal year under audit were as follows:

	Nearest Thousand Dollars
Taxes:	
Personal Income	$ 660,333,000
Sales and Use	149,243,000
Corporations	127,340,000
Cigarettes and Tobacco	16,676,000
Inheritance and Estate	59,972,000
Oil Companies	46,145,000
All Others (net)	(9,755,000)
Refunds of Taxes - Decrease	105,380,000
Total Increase (Decrease) in Taxes	1,155,334,000
Other Revenues and Sources:	

Indian Gaming Payments	(24,666,000)
Rents, Fines and Escheats	(95,021,000)
Miscellaneous	29,594,000
Federal Grants	168,864,000
Statutory Transfers to/from Other Funds - Net	(1,215,179,000)
Total Increase (Decrease) in Other Revenues and Sources	(1,136,408,000)
Total Increases (Decreases)	**$ 18,926,000**

The increases in income, business and other taxes were attributed to improved economic conditions, as well as the statutory changes in tax rates that were enacted by Public Act 09-3 in the June Special Session of the 2009 General Assembly. The increase in federal grants was primarily from increased Medicaid reimbursements. These were partially offset by the decline in federal American Recovery and Reinvestment Act funds. Offsetting the increase of tax revenues was a reduction in Indian gaming revenues, a reduction in monies escheated to the state, and most significantly, the elimination of the economic recovery rate bond plan and a reduction in the amount of monies transferred from the Budget Reserve Fund to the General Fund.

General Fund Expenditures:

Total budgeted expenditures of the General Fund for the 2010-2011 fiscal year amounted to $17,845,124,215, as shown in Schedule B-1 of the Comptroller's 2011 Annual Report. This latter amount represented an increase of some $637,103,231 or 3.7 percent over the total budgeted expenditures reported by the Comptroller for the preceding 2009-2010 fiscal year. General Fund expenditures classified by current expenses, fixed charges and capital outlay are detailed on Schedule I of the Comptroller's 2011 Annual Report. A summary of the areas of significant changes in expenditures from budgeted accounts of the General Fund follows:

	Nearest Thousand Dollars
Personal Services:	
Department of Correction	$ 12,594,000
Judicial Department	12,344,000
Department of Developmental Services	(7,829,000)
All Other -	9,278,000
Other Current Expenses:	
State Employees Retirement Contributions	85,232,000
Retired State Employees Health Service Cost	(36,978,000)
Refunds of Escheated Property	18,533,000
Judicial Department	8,105,000
All Other - Primarily Contractual Services and Commodities	(29,540,000)
Fixed Charges:	
Teachers' Retirement Board - Retirement Contributions	22,369,000
Judicial - Probate Courts, Youthful Offender Program	10,992,000
State Aid Grants:	
Mental Health and Addiction Services - Managed Care	69,984,000
Developmental Services - Community Residential Services	25,740,000

Social Services - Medicaid	610,794,000
Social Services - State Administered General Assistance	(199,616,000)
Social Services - Pharmaceutical Assistance to the Elderly	(19,125,000)
Social Services - Connecticut Home Care Program	(19,849,000)
Education - Charter Schools	28,297,000
All Other Fixed Charges	35,044,000
Capital Outlay	734,000
Total Net Increase	**$ 637,103,000**

Increased costs for personal services and certain state aid grants, especially Medicaid, accounted for the majority of the increase. In addition, there was a significant increase in state employee retirement contributions. They were partially offset by decreases in other state aid grants and the funding of retiree health care obligations.

SPECIAL TRANSPORTATION FUND:

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

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

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

The financial position of the Special Transportation Fund as of June 30, 2011, excluding those resources held by the trustee under the Indenture of Trust for the Transportation Infrastructure special tax obligation bonds, on a budgetary basis, is presented in Schedule C-2 of the Comptroller's 2011 Annual Report. A statement of the changes in unappropriated surplus of the fund for the fiscal year then ended is shown in Schedule C-3. It should be noted that cash and investments totaling $708,645,368, which are being held by the trustee, are reported on Exhibit A of the Comptroller's 2011 Annual Report under Debt Service Funds.

Special Transportation Fund operations, like the General Fund, were conducted under a biennial budget plan, Public Act 09-3, the budget act for the Special Transportation Fund enacted by the June Special Session of the 2009 General Assembly, and included revenue estimates and appropriations for the 2010-2011 and 2011-2012 fiscal years.

Under budget procedures customarily in effect, the estimates of revenues and the budgeted appropriations, taken in conjunction with whatever surplus or deficit was carried over from the preceding fiscal period give rise to an anticipated surplus or deficit projected through the end of the fiscal year.

The budget plan for the 2010-2011 fiscal year, as reported by the Comptroller, may be expressed as follows:

Estimated Revenues, 2010-2011, as Revised by the Committee on Finance, Revenue and Bonding		$1,180,000,000
Budgeted Appropriations, 2010-2011	$1,229,860,890	
Estimated Lapsing Appropriations	(11,000,000)	
Net Appropriations		1,218,860,890
Anticipated Surplus, June 30, 2011		**$ (38,860,890)**

The actual results of the operations of the 2010-2011 fiscal year are presented in Schedule C-3 of the Comptroller's 2011 Annual Report. An analysis of the Special Transportation Fund surplus follows:

Actual Budgeted Revenues, 2010-2011		$1,167,207,643
Appropriations, 2010-2011	$1,229,860,890	
Add/(Deduct)		
Appropriations Lapsed	(22,677,482)	
Net Appropriations		1,207,183,408
Balance		(39,975,765)
Unappropriated Surplus, July 1, 2010		105,363,688
Prior Year Budgeted Appropriations Continued to 2010-2011 Fiscal Year		41,977,035
Miscellaneous Adjustments		174
Unappropriated Surplus, June 30, 2011, per Schedule C-3		**$ 107,365,132**

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

1. *Actual revenues were some $12,792,000 less than anticipated. This was primarily the result of decreases of $6,174,000 in motor fuels taxes, $9,494,000 in interest income, and $5,056,000 in motor vehicle receipts. The decreases were partly offset by an increase of $6,643,000 in sales tax collections and $3,560,000 in federal grants.*

2. *Lapsed appropriations were some $11,677,000 greater than estimated, primarily*

from an effort to reduce general state expenditures.

Special Transportation Fund Revenues:

Realized budgeted revenues in the 2010-2011 fiscal year for the Special Transportation Fund totaled $1,167,207,643, as shown in Schedule C-3 of the Comptroller's 2011 Annual Report. This represented an increase of some $49,319,252 over the budgeted revenue total reported by the Comptroller for the preceding 2009-2010 fiscal year. Budgeted revenue categories that showed the greatest change during the fiscal year under audit were as follows:

	Nearest Thousand Dollars
Taxes:	
Motor Fuels Tax	$ (20,109,000)
Oil Companies Tax	23,400,000
Other Revenues:	
Transfers from Other Funds	36,350,000
Federal Grants	6,358,000
All Other Taxes and Other Revenue	3,320,000
Total Net Increase (Decrease)	**$ 49,319,000**

The above increase was primarily attributable to an increase in the collection of oil companies tax and transfers from other funds. It was offset by decreases in collections for motor fuels tax.

Special Transportation Fund Expenditures:

Total budgeted expenditures of the Special Transportation Fund for the 2010-2011 fiscal year amounted to $1,166,629,733, as shown in Schedule C-5 of the Comptroller's 2011 Annual Report. This represented an increase of some $65,187,118 from the total budgeted expenditures reported by the Comptroller for the preceding 2009-2010 fiscal year. A summary of the areas of significant changes in expenditures from budgeted accounts of the Special Transportation Fund follows:

	Nearest Thousand Dollars
Department of Transportation:	
Personal Services	13,569,000
Other Expenses	5,107,000
Rail Operations	9,059,000
Bus Operations	8,325,000
Office of the State Comptroller:	
Debt Service	9,851,000
State Employees Retirement Contributions	12,024,000
All Other (net)	7,252,000

Total Net Increase (Decrease)	**$ 65,187,000**

The above increase in expenditures was primarily attributable to increases in personal services costs at the Department of Transportation and state employees retirement contributions.

SPECIAL REVENUE FUNDS:

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

The financial position of the combined Special Revenue Funds at June 30, 2011, on a budgetary basis, together with the cash transactions for the fiscal year ended on that date, are shown in Exhibit C and Schedule C-1, respectively, of the Comptroller's 2011 Annual Report. As of June 30, 2011, there were 56 authorized funds within this category, with the Special Transportation Fund by far being the largest. Of these 56 funds, the following nine funds operate under legislatively enacted budget plans:

- Special Transportation Fund
- Banking Fund
- Insurance Fund
- Consumer Counsel and Public Utility Control Fund
- Workers' Compensation Administration Fund
- Mashantucket Pequot and Mohegan Fund
- Soldiers', Sailors' and Marines' Fund
- Regional Market Operation Fund
- Criminal Injuries Compensation Fund

Grants and Restricted Accounts Fund:

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

Receipts and transfers amounting to $1,970,226,896 for the 2010-2011 fiscal year were credited to the fund, as shown on Schedule C-1 of the Comptroller's 2011 Annual Report. These represented federal and other grant receipts, restricted and not available for general use. As mentioned previously in this report, such restricted revenue is recognized by the Comptroller when earned through the expenditure of grant funds, rather than when received or awarded. Receipts and transfers increased by some $22,422,254, as compared to the total reported by the Comptroller in the preceding 2009-2010 fiscal year.

Disbursements of federal and other grants from the Grants and Restricted Accounts Fund for the 2010-2011 fiscal year amounted to $2,111,206,585, as shown in Schedule C-1 of the Comptroller's 2011 Annual Report. This represented an increase of some $169,749,782 over the total reported by the Comptroller for the preceding 2009-2010 fiscal year.

Transportation Grants and Restricted Accounts Fund:

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

Receipts and transfers amounting to $804,893,772 for the 2010-2011 fiscal year were credited to the Transportation Grants and Restricted Accounts Fund, as shown on Schedule C-1 of the Comptroller’s 2011 Annual Report. This represented an increase of some $68,548,920 over the total reported by the Comptroller for the preceding 2009-2010 fiscal year. For the purpose of construction of any highway or bridge, the Office of the State Comptroller is authorized under the provisions of Section 13a-166 of the General Statutes to record as a receivable that portion of a federal grant apportionment for the financing of the federal share of highway projects approved by the Federal Highway Administration, and such amounts are deemed to be appropriated for said purposes.

Disbursements of federal and other grants from the Transportation Grants and Restricted Accounts Fund for the 2010-2011 fiscal year amounted to $775,745,429, as shown in Schedule C-1 of the Comptroller’s 2011 Annual Report. This represented a decrease of some $18,416,260 over the total reported by the Comptroller for the preceding 2009-2010 fiscal year.

Additional comments concerning the operations of an individual Special Revenue Fund will be found in audit reports covering the various state agencies administering or using such funds.

DEBT SERVICE FUNDS:

This category of funds was established to account for the accumulation of resources for, and payment of, principal and interest on certain state issued bonds and notes. While, as a rule, the bulk of general obligation bonds of the state are liquidated from General Fund and Special Transportation Fund appropriations, most so-called self-liquidating general obligation bond issues are retired by payment from these funds.

The financial position of the combined Debt Service Funds at June 30, 2011, together with the cash transactions for the fiscal year ended on that date, on a budgetary basis, are shown in Exhibit D and Schedule D-1, respectively, of the Comptroller’s 2011 Annual Report. As of June 30, 2011, there were six authorized funds within the Debt Service Funds category. The largest debt service fund, entitled Transportation Special Tax Obligations is used to account for cash and investments held by a trustee for debt service payments on bonds issued to finance the state's infrastructure program.

CAPITAL PROJECTS FUNDS:

This category of funds was established to group those funds that account for financial resources used to acquire or construct major capital facilities, including highways and bridges. Included in this category are additional funds authorized for capital improvements and non-capital improvements or other purposes by specific fiscal year. The most significant of these funds is the Infrastructure Improvement Fund, which is used to account for highway and transit construction project expenditures at the Department of Transportation. The major source of financing for Capital Projects Funds is the proceeds of various state bond issues. Other sources include federal aid and other restricted contributions receivable to meet a portion of the capital outlay costs.

The financial positions of the combined Capital Projects Funds at June 30, 2011, and the cash transactions of the 2010-2011 fiscal year, on a budgetary basis, are set forth in Exhibit E and Schedule E-1, respectively, of the Comptroller's 2011 Annual Report. As of June 30, 2011, there were 52 authorized funds within the Capital Projects Funds category.

The total unreserved fund balances of the Capital Projects Funds decreased by $23,973,326 during the 2010-2011 fiscal year to a deficit balance of $4,369,034,017, as of June 30, 2011. It should be noted that the issuance of bonds already authorized, as shown in Schedule E-5, as well as the collection of those receivables fully reserved in Exhibit A and Exhibit E, will eliminate this deficit balance.

INTERNAL SERVICE FUNDS:

This category of funds was established to group those funds accounting for the costs and billings for goods and services provided by state agencies to other agencies or governmental units. These costs are recovered by transfer charges to user agencies so that authorized working capital of the funds is kept intact.

The financial position of the combined Internal Service Funds at June 30, 2011, together with the cash transactions for the fiscal year then ended, on a budgetary basis, are shown in Exhibit F and Schedule F-1, respectively, of the Comptroller's 2011 Annual Report. As of June 30, 2011, there were four authorized funds within the Internal Service Funds category.

Exhibit A of the Comptroller's 2011 Annual Report recognizes, as reserved within fund balances and related reserves, the allotment and appropriation balances in force as of June 30, 2011, and which have been carried forward to the 2011-2012 fiscal year on the records of the Office of the State Comptroller. This has resulted in additional deficit unreserved fund balances being reported in Exhibit A and Exhibit F of the Comptroller's 2011 Annual Report because the assets and resources to meet these allotment balances are already reserved or, more likely, are not recorded by the Comptroller. Those assets and resources not recorded include inventories and receivables reported only by the agencies administering the funds involved.

Additional comments concerning the operations of each individual Internal Service Fund will be contained in audit reports covering the various state agencies administering such funds.

ENTERPRISE FUNDS:

This category of funds was established to group those proprietary funds that provide for the financing of goods and services to the public and recover costs by user charges.

The financial position and fiscal year cash transactions of the combined Enterprise Funds, as accounted for in the records of the Office of the State Comptroller, on a budgetary basis, are shown in Exhibit G and Schedule G-1, respectively, of the Comptroller's 2011 Annual Report. As of June 30, 2011, there were 20 authorized funds within the Enterprise Funds category.

Additional comments concerning the operations of each individual Enterprise Fund will be contained in audit reports covering the various state agencies administering such funds.

FIDUCIARY FUNDS:

The financial position of the combined Fiduciary Funds at June 30, 2011, and the cash transactions for the year then ended, on a budgetary basis, is shown in Exhibit H and Schedule H-1, respectively of the Comptroller's 2011 Annual Report. The funds included under this caption may be classified into three types:

- Receipts held pending distribution to state funds, municipalities, private companies or individuals.
- Deposits held by the state for security, guarantees, awards, endowments or distributions.
- Retirement and post employment benefit funds for state and municipal employees held in trust by the State Treasurer.

As of June 30, 2011, there were 37 authorized funds within the Fiduciary Funds category. The total liabilities, reserves and fund balances of the Fiduciary Funds increased by $194,092,205 during the 2010-2011 fiscal year to a balance of $38,499,592,688, as of June 30, 2011. The increase was the result of a $758,854,329 increase in the amount of long term investments for retirement funds during the 2010-2011 fiscal year, which are reported at cost. In addition, there was also a $337,798,730 increase in deposits to the U.S. Department of the Treasury for the Unemployment Compensation Fund. Offsetting these increases was $809,875,583 loaned from the U.S. Department of the Treasury for the Unemployment Compensation Fund. The amounts reported as resources to be provided in future years for retirement funds were as of June 30, 2010, and were based on the currently available actuary reports. The Fiduciary Funds financial statements did not report actuarially determined resources to be provided in future years for other post employment benefits.

Additional comments concerning the operations of each individual fiduciary fund will be contained in audit reports covering the various state agencies administering or using such funds.

STATE BOND AND NOTE INDEBTEDNESS:

The state's bond and note indebtedness at June 30, 2011, payable from future revenue of state funds is shown in Exhibit A of the Comptroller's 2011 Annual Report. A summary of bonds and notes outstanding and maturity schedules, detailing the funding requirements of specific bond and note issues, are presented in Schedule E-3 and Schedule E-4, respectively, of the Comptroller's 2011 Annual Report.

The state's bond and note indebtedness aggregated $19,242,640,000 as of June 30, 2011, an increase of $36,575,000 over the total of $19,206,065,000 at June 30, 2010. This was the net result of the issuance during the 2010-2011 fiscal year of new bonds of the state in the amount of $2,367,810,000, while scheduled principal payments and refunded and defeased bonds during the period amounted to $2,331,235,000. Scheduled interest costs through maturity on the aforementioned bond and note indebtedness, as shown in Schedule E-4 of the Comptroller's 2011 Annual Report, totaled $8,539,627,000. Accordingly, as of June 30, 2011, the state was committed to future debt service on bonds and notes outstanding in the aggregate of $27,782,267,000. This total represented an increase of $1,770,997,000 over the corresponding amount as of June 30, 2010.

Included in the totals of bond and note indebtedness are revenue and refunding bonds outstanding in the amount of $210,340,000 for improvements to Bradley International Airport. The proceeds of such bonds are being held and disbursed by a trustee and all revenue of the airport's operations is being deposited with the trustee. Principal and interest payments on such bonds are being met from funds held by the trustee. Similarly, included in the totals of bond and note indebtedness are the revenue bonds outstanding of $3,357,595,000 for the state's Transportation Infrastructure Program. While the proceeds of such bonds are held and accounted for in the usual manner, debt service reserve amounts and principal and interest payments on such bonds are being handled by a trustee.

Partially offsetting the aforementioned indebtedness were unreserved fund balances of $768,653,258 within the debt service fund group, which were available for debt service at June 30, 2011, and which are detailed in Exhibit D of the Comptroller's 2011 Annual Report.

In addition to the foregoing bond indebtedness at June 30, 2011, there was in force as of that date unused borrowing authorizations totaling $4,238,606,000 and prospective authorizations, subject to Bond Commission approval, totaling $2,008,251,000. These authorization balances, which are detailed in Schedule E-5 of the Comptroller's 2011 Annual Report, may be summarized as follows:

Purpose or Agency	In Force	Prospective Authorizations
Student Loan Foundation	$ 5,000,000	$ 0
Municipal and Economic Development	135,294,000	90,590,000
Local Capital Improvements	15,000,000	20,000,000
State Equipment Purchases	26,427,000	35,000,000
Grants to Local Governments and Others	194,092,000	503,589,000
Contaminated Property Remediation	0	2,000,000
Housing Programs	37,321,000	66,361,000

Highway and Bridge Construction Repair	1,452,000	0
Magnet Schools	52,701,000	265,200,000
School Construction	11,200,000	0
Preservation of Agricultural Lands	15,751,000	0
Transportation Infrastructure Improvement	2,098,473,000	496,453,000
University and State University Facilities	236,691,000	95,000,000
Capital Improvements and Other Purposes	290,406,000	431,858,000
Connecticut Innovations Incorporated	500,000	0
Bradley Parking Garage	0	1,200,000
Elimination of Water Pollution	569,353,000	0
Industrial Building Mortgage Insurance	19,450,000	1,000,000
Connecticut Development Authority	3,595,000	0
Second Injury Fund	525,900,000	0
Total Authorizations	**$4,238,606,000**	**$2,008,251,000**

It should be noted that, in accordance with the debt limitation provisions contained in Section 3-21 of the General Statutes, no bonds, notes, or other evidences of indebtedness for borrowed money payable from General Fund tax receipts of the state shall be authorized by the General Assembly except as shall not cause the aggregate amount of (1) the total amount of such indebtedness authorized by the General Assembly but not yet issued and (2) the total amount of such indebtedness which has been issued but remains outstanding, to exceed 1.6 times the total estimated General Fund tax receipts of the state for the fiscal year in which any such authorization will become effective, as estimated by the joint standing committee of the General Assembly having cognizance of finance, revenue and bonding. Such tax receipts for the fiscal year ended June 30, 2012 were estimated, as of February 1, 2012, to total $14,019,100,000. As of February 1, 2012, the State Treasurer determined that authorizations for bonds, notes, and other obligations subject to such limit, net of debt retirement fund resources related to certain self-liquidating bond issues, totaled $15,180,509,723. Accordingly, as of this date, the state's debt-incurring margin totaled $7,250,050,277.

In addition to the indebtedness previously mentioned, there were other obligations that, although not in the form of state bonds or notes, constituted long-term indebtedness or the guarantee of existing indebtedness. Such obligations included:

1. *Obligations of the state to towns for participation in the construction and alteration of school buildings, under Section 10-287 of the General Statutes (installment payments) in the amount of some $243,000,000, and Sections 10-287g and 10-287h (interest subsidy) in the amount of some $41,000,000, as of June 30, 2011. It should be noted that Sections 10-287g and 10-287h were repealed by Public Act 97-11 (June Special Session) for construction projects approved subsequent to July 1, 1997. With regard to projects approved after July 1, 1997, this same public act established a new financing method, which provides for the state to pay for its share of school construction costs on a "progress payment" basis (Section 10-287i of the General Statutes). As of June 30, 2011, the State Board of Education estimates that current grant obligations under this latter program will total some $2,505,000,000.*

2. *The obligation of Section 5-156a of the General Statutes to fund the State Employees*

Retirement System on an actuarial reserve basis. The unfunded actuarial liability is amortized as a level percent of payroll over a declining period of years, starting with 40 years as of July 1, 1991. A full actuarial survey of the system was performed as of June 30, 2010, and showed an unfunded accrued liability of $11,704,591,789.

3. *The obligation of Section 51-49d of the General Statutes to fund the Judges, Family Support Magistrates and Compensation Commissioners Retirement System on an actuarial reserve basis over a 40-year period commencing July 1, 1991. The last actuarial survey of the system was performed as of June 30, 2010, and showed an unfunded accrued liability of $97,107,583.*

4. *The obligation of Section 10-183z of the General Statutes to fund the Teachers' Retirement System on an actuarial reserve basis over a 40-year period commencing July 1, 1992. The last actuarial survey of the system was performed as of June 30, 2010, and showed an unfunded accrued liability of $9,065,729,000.*

5. *Loans under the Insurance program, insured by the state ($25,000,000 maximum limit) through the Connecticut Development Authority, which totaled $4,233,749 as of June 30, 2011. However, in accordance with Section 32-17a of the General Statutes, these are contingent indebtedness of the state; actual indebtedness would result only in the event of a loan default or the inability of the Authority to make the payment of bonds and notes.*

6. *Loan guarantees under the Connecticut Works Fund, insured by the state through the Connecticut Development Authority, as provided for in Section 32-23ii of the General Statutes. The state has authorized the issuance of up to $95,000,000 in bonds allocated to the fund, of which as of June 30, 2011, $82,485,000 has been distributed. Loan guarantees were also extended under the Connecticut Works Guarantee Fund, as provided for in Section 32-261 of the General Statutes. The state has authorized the issuance of up to $30,000,000 in bonds allocated to the funds, of which as of June 30, 2011, $18,900,000 has been distributed. The Connecticut Development Authority also provides portfolio insurance to participating financial institutions under the Connecticut Capital Access Fund, as provided for in Section 32-265 of the General Statutes. The state has authorized the issuance of $5,000,000 in bonds allocated for the purpose, of which as of June 30, 2011, $2,000,000 have been distributed. Any losses on guarantees made by the Authority under any of these funds are reimbursable by the state until the remaining bond allocation has been utilized.*

7. *The State of Connecticut is contingently liable to the Connecticut Housing Finance Authority, the Connecticut Resources Recovery Authority and the Connecticut Higher Education Supplemental Loan Authority for amounts needed annually to maintain debt service reserves for one year's principal and interest on certain authority bonds in the event authority funds are insufficient to do so, as provided for in Sections 8-252a(b), 22a-272(b) and 10a-232(b), respectively, of the General Statutes. As of February 1, 2012, the principal amount of outstanding bonds, secured by special capital reserve funds, for the Connecticut Housing Finance Authority, the Connecticut Resources Recovery Authority, and the Connecticut Higher Education Supplemental Loan Authority totaled $3,751,000,000, $26,900,000, and*

$169,600,000, respectively.

8. *The State of Connecticut is contingently liable to the Connecticut Health and Educational Facilities Authority for amounts needed annually to maintain debt service reserves for one year's principal and interest on those authority bonds used to finance projects at participating nursing homes or to finance dormitories or facilities for the provision of student housing at public and private institutions of higher education, in the event authority funds are insufficient to do so, as provided for in Section 10a-186a of the General Statutes. As of February 1, 2012, the principal amount of outstanding bonds secured by special capital reserve funds totaled some $277,200,000.*

9. *Pursuant to Public Act 11-84, the State of Connecticut is contingently liable to the Connecticut Airport Authority for amounts needed annually to maintain debt service reserves for one year's principal and interest on certain University bonds in the event university funds are insufficient to do so. As of February 1, 2012, the principal amount of outstanding bonds, secured by special capital reserve funds for the university totaled $0. The legislation authorizes the issuance of revenue bonds, including bonds backed by a Special Capital Reserve Fund.*

10. *Pursuant to Section 10a-109g, subsection (i), of the General Statutes, the State of Connecticut is contingently liable to the University of Connecticut for amounts needed annually to maintain debt service reserves for one year's principal and interest on certain university bonds in the event university funds are insufficient to do so. As of February 1, 2012, the principal amount of outstanding bonds, secured by special capital reserve funds for the university totaled $0, as the related special capital reserve fund bonds were refunded during the 2010 fiscal year.*

11. *In accordance with the provisions of Special Act 01-1, as subsequently amended by Special Act 01-2 of the June Special Session, the State of Connecticut was authorized by special act to guarantee debt issued by the City of Waterbury in an amount not to exceed $100,000,000. As of February 1, 2012, the amount of the city's obligations guaranteed by special capital reserve funds totaled $30,110,000.*

12. *In accordance with the provisions of Special Act 67-381, as subsequently amended by Special Acts 73-95 and 90-28, $1,300,000 in bonds of the Southeastern Connecticut Water Authority are guaranteed by the state, as of February 1, 2012.*

CONDITION OF RECORDS

Our review of statewide financial reporting identified some areas that require corrective action. These areas are detailed in the following pages:

State Accounting Manual Update to Reflect the Core-CT Environment:

Criteria: Section 3-112 of the General Statutes provides that the Comptroller shall "establish and maintain the accounts of the state government…prescribe the mode of keeping and rendering all public accounts of departments or agencies of the state and of institutions supported by the state or receiving state aid by appropriation from the General Assembly… prepare and issue effective accounting and payroll manuals for use by the various agencies of the state."

The State Accounting Manual, issued by the Office of the State Comptroller, originally provided a formal set of accounting policies and procedures, and established the definitions of authority and responsibility between state departments and agencies, and the Office of the State Comptroller.

Condition: Our audits of state financial operations for the fiscal years ended June 30, 2004, 2005, 2006, 2007, 2008, 2009 and 2010 have noted that the Office of the State Comptroller has not provided user agencies with an updated version of its State Accounting Manual. We found the manual was last updated in May 2001. It was not until October 2011 that a revised version was made available to system users. At the time of our review (May 2012), we noted that the following sections of the State Accounting Manual were not available to users and were listed as currently under review:

1. General State Accounting Policies and Procedures
2. Funds
3. GAAP Acceptance in Connecticut
4. Inter & Intra State Transfers and Adjustments
5. Management of Receivables
6. Year End
7. Core-CT Coding for Business Units, Funds, and Department ID

In addition, we noted that the chartfield section of the State Accounting Manual that is available on the Core-CT website had not been updated since 2006.

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

Cause: The Budget and Financial Analysis Division of the State Comptroller has indicated that time and resources were still a consideration.

Recommendation: The Office of the State Comptroller should promptly complete the remaining portions of its revision to the State Accounting Manual (See Recommendation 1.)

Agency Response: "As you note, updating the State Accounting Manual (SAM) to reflect Core-CT implementation has presented significant resource challenges as other higher priority tasks directed at preventing user errors were implemented. We also note that several sections of the manual have been updated and work will continue on the remaining sections.

You state that certain chartfield information has not been updated on the Core-CT website; however, up-to-date chartfield coding is readily available in Core-CT through developed EMP queries and also through various production report functionality. Due to the rapid changes occurring with respect to system coding, it is important that agencies access coding changes in real time. The information posted in 2006 should only be used as a general guide to coding usage, which remains generally consistent over time.

We disagree with the assertion that the absence of an updated SAM has contributed to agency processing errors in Core-CT. In fact, processing errors have been steadily declining since 2004 due to the proactive approach taken by this office in developing new accounting guidance tools within Core-CT.

Agencies presently have an abundance of resources available to prevent system processing errors. For example, utilizing the on-line functionality of Core-CT, financial guidance has been communicated to agencies in the form of on-line job aids within each Core-CT accounting application categorized by the specific module (e.g. purchasing, accounts payable, billing, accounts receivable etc.). In addition, Comptroller's numbered memoranda and Core-CT communications update users with respect to any significant accounting or processing changes. Agencies also have access to a help desk as well as to on-site training and labs and accounting operations staff within this office. Finally, multiple hard edits have been incorporated within various modules to prevent errors. These initiatives have required significant time and resources, and have slowed the finalization of the SAM; however, we are confident that these dynamic resources have been more effective in preventing errors than the more static guidance provide in the SAM."

Failure to Comply with Governmental Accounting Standards Board Statement #45:

Criteria: Governmental Accounting Standards Board (GASB) – Statement No. 45, regarding accounting and financial reporting for post-employment benefits other than pensions (OPEB), requires the state to obtain an analysis of the unfunded actuarial accrued liability of such post-retirement health care and life insurance benefits and to recognize the annual required contribution to fund that actuarial liability in its financial statements commencing with those for fiscal year ending June 30, 2008.

Statement No. 45 also requires actuarial valuations of pension or OPEB plans to be performed as of a date not more than two years prior to the date of financial statements in order for the results of the valuation to be reflected in those financial statements.

Condition: In December 2010, the state received an actuarial valuation as of April 1, 2008 with respect to the state's liability for post-retirement health care benefits (not including life insurance benefits) for persons covered under the State Employees Retirement System and other state retirement systems, excluding the Teachers' Retirement System. The December 2010 valuation indicates an OPEB actuarial accrued liability as of April 1, 2008 of $26.6 billion on an unfunded basis. The State Comptroller posted an estimate of the 30-year annual amortized OPEB actuarial liability totaling $4,150,866,000 to the CAFR.

Because of the April 1, 2008 valuation date, the April 2008 actuarial report did not reflect the impact of the 2009 retirement incentive program or the mandatory OPEB contribution of three percent of salary by certain employees implemented in 2009. It did not reflect the changes in health care benefits for state employees and retired state employees that resulted from negotiation with the State Employees Bargaining Agent Coalition in 2011, or the improvement in the performance of the state's pension investments over the past two years.

On May 16, 2012, the State Comptroller received a new actuarial valuation for the State of Connecticut other post-employment benefits program. The new valuation is as of June 30, 2011, and it reflects the changes in benefits, eligibility requirements, contribution requirements and the introduction of the health enhancement program, which have occurred since 2008. The new valuation indicates an OPEB actuarial accrued liability as of June 30, 2011 of $17.9 billion on an unfunded basis, and a 30-year annual amortized State Employee OPEB liability (net OPEB obligation) of $4,930,493,882.

Effect: Because the latest actuarial valuation with respect to the state's liability for post-retirement health care benefits for persons covered under the State Employees Retirement System was as of April 1, 2008 and not within such two-year period, required disclosures for the plan on funded status, funding progress, and actuarial methods and assumptions could not be included in Note 14 of the June 30, 2011 Basic Financial Statements or in the required Public Employee Retirement System Supplementary Information accompanying the Basic Financial Statements in the CAFR. Certain estimates were made to include the net OPEB obligation in the liabilities of the state's Basic Financial Statements. As a result, a qualified audit opinion on the CAFR was issued.

Cause: The Comptroller's Healthcare Policy and Benefit Services Division did not contract to have the actuarial valuation in time to be incorporated in the CAFR.

Conclusion: It is expected that the State Comptroller will be able to issue its Comprehensive Annual Financial Report for the 2012 fiscal year in compliance with Governmental Accounting Standards Board standards.

Revolving Fund Accounting - Department of Administrative Services:

Background: The Department of Administrative Services submits financial statements for the General Services Revolving Fund to the Office of the State Comptroller to be included in CAFR, and to document indirect costs for the Statewide Cost Allocation Plan.

Criteria: OMB Circular A-87, Appendix C, Section E(3)(b)(1) requires the inclusion of financial statements for proprietary funds within the Statewide Cost Allocation Plan.

Governmental Accounting Standards Board - Statement No. 34 (GASB 34) specifies that financial statements compiled for governmental proprietary funds statements include a statement of cash flows. GASB 34 further requires that internal service funds, such as the General Services Revolving Fund, use the current economic resources measurement focus and the full accrual basis of accounting. In a memorandum dated August 2007, the Office of the State Comptroller mandated that the Department of Administrative Services comply with GASB 34.

Sound business practice suggests that the personnel assigned to a task should have sufficient skills to be able to accomplish that task in the time frame allotted.

Condition: The Department of Administrative Services did not include a statement of cash flows with the financial statements it prepared for the fund for the 2011 fiscal year.

In order to create financial statements that are compliant with OMB Circular A-87, the Department of Administrative Services must create accounting entries to convert the accounting information maintained on a modified accrual basis to information that may be presented on a full accrual basis. Our review of internal documentation indicated that not all of the required entries were made.

The Department of Administrative Services did not recognize certain adjustments centrally entered by the Office of the State Comptroller, which involved certain legacy accounts that carried forward balances from the prior accounting system into Core-CT. The Office of the State Comptroller includes the adjustments and legacy accounts in its presentation of the fund financial information in the Comprehensive Annual Financial Report.

The financial statements for the General Services Revolving Fund prepared by the Department of Administrative Services for the 2011 fiscal year presented a positive fund position of approximately $7 million, while those from the Office of the State Comptroller presented a deficit fund position of approximately $61 million; a gross disparity in excess of $68 million. This disparity presents two vastly different interpretations of the financial state of the fund. It was not clear that either set of financial statements was an accurate or reasonable presentation of the financial condition of the fund.

Effect: The Department of Administrative Services is not in compliance with generally accepted accounting procedures and the instructions of the Office of the State Comptroller. The errors in presentation indicate that the information presented in the financial statements, which are used to compile billing rates for services, is unreliable.

Cause: The Department of Administrative Services did not appear to develop or implement reasonable controls at any level over the preparation of the financial statements for the fund. It did not allocate sufficient and appropriate resources to the tasks associated with the preparation of the financial statements for the fund, or sufficiently work with the Office of the State Comptroller toward appropriately adjusting the accounts within the fund to allow the financial statements to reasonably reflect the current financial status of the fund.

Recommendation: The Office of the State Comptroller and the Department of Administrative Services working together, should ensure that the

General Services Revolving Fund financial statements are prepared in a manner compliant with state and federal regulations, and accounting standards and pronouncements and resolve the disparities in reported financial position of the fund. (See Recommendation 2.)

Agency Response: "We are in agreement with this finding. As you state, this office mandated compliance with GASB Statement #34 by revolving fund agencies. For the reasons that you outline, the Department of Administrative Services was not compliant with these requirements.

As recommended, the Comptroller's Office has been assisting DAS in the proper preparation of GASB compliant statements and expects the Fiscal Year 2012 statements to reflect the required adjustments. In addition, changes are being made within Core-CT to ensure that adjusting entries are processed to the accrual ledger in Fiscal Year 2013 activity."

Cross Check and Validation of Central Accounting Journal Entries:

Criteria: Proper internal controls require all journal entries, including those considered nonstandard or nonroutine, have adequate supporting documentation and are reviewed and approved independently prior to posting. There should be appropriate segregation of duties among those who initiate journal entries, approve journal entries and post journal entries to the Core-CT general ledger.

Condition: The central accounting function within the Budget and Financial Analysis Division of the State Comptroller prepares and posts journal entries to the Core-CT general ledger for statewide budgetary and GAAP accounting, fiscal year end close and financial statement preparation. A single individual is frequently preparing and posting journal entries of significant amounts without a second person to review and approve the journal prior to posting it to the general ledger. There were no compensating controls to ensure that errors and omissions in the journal entries would be detected and corrected.

Effect: Our annual audits of the financial statements have identified errors in journal entries posted to the Core-CT system. Errors not identified and corrected by the audit process can result in a material misstatement in the financial statements.

Cause: Statewide central accounting is performed by a small staff that does not readily lend itself to the establishment of segregated duties and the cross checking of work.

Conclusion: Effective May 2012, the Budget and Financial Analysis Division has implemented corrective action to require the validation of GAAP journal entries by the division director prior to posting. In addition, the Budget and Financial Analysis Division is requesting recruitment of an additional staff accountant to assume responsibility for journal entries which would allow lower level management to review entries.

RECOMMENDATIONS

Status of Prior Audit Recommendations:

Office of the State Comptroller - State Financial Operations Audit Report -

Four recommendations were presented in our prior report. Two of these recommendations are being restated in our current report. A list of the previous recommendations and their resolution are as follows:

1. The Office of the State Comptroller should promptly complete and issue or publish its revision of the State Accounting Manual. Our current examination found partial corrective action made with the revision of major portions of the manual effective October 17, 2011. However, we note that significant portions are not completed. We again recommend that the Office of the State Comptroller promptly update and complete the remaining portions of the State Accounting Manual. (See Recommendation 1.)

2. The Office of the State Comptroller should, with the Office of the State Treasurer, work to improve and provide automation of the cash reconciliation process in the Core-CT system. Our current audit found the Core-CT system still does not provide for the State Treasurer to efficiently reconcile cash accounts. However, we note that the Office of the State Treasurer is successfully resolving all variances on a manual basis and it is not requesting the automation of this function.

3. Office of the State Comptroller should address deficiencies in the Core-CT system internal controls that affect the cost allocation applied to non-wage payroll payments. On January 20, 2012 the Federal Highway Administration closed its review of the Core-CT federal aid billing at the Department of Transportation and has considered the findings resolved.

4. The Office of the State Comptroller should take the measures necessary to ensure that its Comprehensive Annual Financial Report contains all of the information required by Governmental Accounting Standards Board. Our current audit found that the State Comptroller again failed to include the required OPEB disclosures in the 2011 Comprehensive Annual Financial Report. However, after the 2011 fiscal year CAFR was released, the required actuarial information was obtained. We have concluded that the Office of the State Comptroller will be compliant with the requirements of GASB 45 for the 2012 fiscal year.

Current Audit Recommendations:

1. **The Office of the State Comptroller should promptly complete the remaining portions of its revision to the State Accounting Manual.**

   Comment:

   We found that the task of revising the documentation of state accounting policies and procedures was still incomplete.

2. **The Office of the State Comptroller and the Department of Administrative Services working together, should ensure that the General Services Revolving Fund financial statements are prepared in a manner compliant with state and federal regulations, and accounting standards and pronouncements, and resolve the disparities in reported financial position of the fund.**

   Comment:

   As a result of the failure to establish proper accounting polices and procedures, the financial statements of the General Services Revolving Fund required extensive reworking to make them acceptable for the state's CAFR.

CONCLUSION

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

Matthew Rugens
Administrative Auditor

Approved:

John C. Geragosian
Auditor of Public Accounts

Robert M. Ward
Auditor of Public Accounts