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February 2, 2015

The Honorable Dannel P. Malloy
Governor of the State of Connecticut
State Capitol
Hartford, Connecticut

Dear Governor Malloy:

I write to provide you with financial statements for the General Fund and the Transportation Fund through December 31, 2014.

On January 20th, the Office of Policy and Management (OPM) projected a potential Fiscal Year 2015 General Fund deficit of \$120.9. This was an increase in the deficit of \$89.3 million from the prior month. The larger deficit resulted from: 1) January consensus forecast figures that reduced General Fund revenue by a net amount of \$39.3 million and, 2) an increase in the Medicaid shortfall of \$50 million.

The largest change to revenues this month relates to a decline in oil company tax receipts due to lower oil prices. The original Fiscal Year 2015 budget anticipated receipts of \$413.9 million with \$379.1 million going to the Transportation Fund and \$34.8 million retained in the General Fund. The General Fund portion had already been reduced by \$10 million in last month's deficit projection, leaving the General Fund amount at \$24.8 million. The new consensus estimate projects total oil company revenue at \$360.3 million, a drop of \$53.6 million from the original budget. This completely eliminates the \$24.8 million in General Fund revenue anticipated last month and requires an additional transfer of \$18.8 million from the General Fund to the Transportation Fund to bring that fund to its legally required level.

The Department of Social Services has provided information on the \$50 million dollar increase in the Medicaid deficiency this month. This brings the total General Fund deficiency in Medicaid for Fiscal Year 2015 to \$120 million. The Department is continuing to work through retroactive settlement payments to hospitals. These settlements are expected to grow from the \$42.9 million in November outlays. The Department has adopted a new payment system that will eventually eliminate the need for such settlements. In addition, during the early months of the current fiscal year, enrollment on the state General Fund portion of the Medicaid program advanced at a stronger than expected rate. Over the past several months there has been some leveling off in enrollment. Finally, the Department continues to work with the federal government on the portion of the Medicaid population that qualifies for a 100 percent federal reimbursement. That portion of the population disqualified will only be reimbursed at 50 percent and that number is projected to be higher than initially anticipated.

After the release of the January 20th OPM deficit estimate, additional allotment reductions of \$31.5 million were announced. This follows reductions of \$54.7 million in November. If fully attained, the additional allotment reductions would lower OPM's General Fund deficit estimate to \$89.4 million. This is below the \$174.6 million target that would trigger the need for a Deficit Mitigation Plan to be submitted to the legislature.

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It should be noted that the Office of Fiscal Analysis released a report on January 26th projecting that inclusive of the new allotment reductions if fully realized, the Fiscal Year 2015 General Fund deficit stands at \$170.9 million. The difference between the OPM and OFA estimates are on the spending side of the equation. Both agencies are utilizing consensus revenue numbers. OFA's deficiency forecast exceeds OPM's by \$7.8 million. More significantly OFA is using a lapse figure that is \$60.2 million below the OPM target. OPM's lapse target is now \$290.5 million.

Based on current spending trends and realized lapses over the past five fiscal years, I believe that the OPM savings target is attainable. I am, therefore, in general agreement with OPM's deficit projection for the General Fund. Through December we have continued to note a general deceleration in spending across major appropriated line-items from the initial months of Fiscal Year 2015. Through December, planned General Fund spending that had not yet been disbursed totaled \$9.2 billion dollars. OPM's unallocated lapse figure is about one percent of that total. Over the past five fiscal years, annual realized lapses have averaged \$511.2 million. Although the current lapse target is a significant challenge, it is not inconsistent with past performance in difficult budget circumstances.

The Transportation Fund is expected to close Fiscal Year 2015 with a balance of \$166.3 million. This is a reduction to fund balance of \$2.5 million through Fiscal Year 2015 operations. The most significant shortfall is in the Department of Transportation's Rail Operations account related to Metro North costs.

The state posted another month of job growth in December. The Department of Labor's preliminary payroll employment number for December shows the addition of 4,800 positions. The state has posted job gains in ten of the past eleven months reversing an earlier trend of inconsistent job additions. Connecticut has regained 96,300 positions or 80.9 percent of the jobs lost to the 2008 recession. Wages in Connecticut are beginning to show some upward movement after a long period of stagnation. Average private weekly pay in the state was up 6.1 percent in November and 2 percent in December from the same months last year. Wages outpaced inflation, which rose 0.8 percent in December.

According to a report from the Warren Group released on January 13th, single-family home sales in Connecticut were relatively flat rising just 0.4 percent from November of 2013. Prices also declined for the ninth consecutive month.

At this writing the stock market was up over the past twelve month period; however, it was showing weakness during January. Gross Domestic Product was up 2.6 percent in the fourth quarter after posting a strong gain of 5 percent in the third quarter. Corporate profits remained positive in the third quarter rising 3.1 percent from the second quarter. This is down from the 8.4 percent second quarter results.

I also issue a Comprehensive Annual Financial Report (CAFR) as an accounting supplement to the budgetary report. The CAFR includes financial statements for all state funds that are prepared in accordance with Generally Accepted Accounting Principles (GAAP). From a balance sheet perspective, the GAAP shortfall or unreserved fund balance in the General Fund was \$1.217 billion as of June 30, 2013. GAAP deficit reduction bonds in the amount of \$598,500,000 were issued in Fiscal Year 2014 to reduce the shortfall.

If you have any questions on this report, please do not hesitate to contact me.

Sincerely,

Kevin Lembo
State Comptroller

