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Why Ignore Over Half of the Illinois State Budget Picture? Consolidation of General and Special Fund Reporting

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This is excerpted from a longer report with the permission of the Institute of Government and Public Affairs at the University of Illinois. The full report is available online http://igpa.uillinois.edu/fiscalfutures/research/. *The Fiscal Futures Project is currently supported by a generous grant from the John D. and Catherine T. MacArthur Foundation. The start up of the project was supported by a number of civic and advocacy organizations, including the Taxpayers' Federation of Illinois. Professors Dye and Merriman are co-directors of the project and Dr. Hudspeth is its resource and policy analyst.*

The state of Illinois has hundreds of separate funds for budget accounting purposes. But most discussion of the state budget concentrates only on the four General Funds, which represent less than half of the total state budget.

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NOTES FROM THE INSIDE. . .

By J. Thomas Johnson

This edition of Tax Facts reviews an issue that has become a greater and greater frustration to "numbers geeks" like me, the lack of transparency around the presentation of how the state raises and spends the taxpayer's money. We all hear about the state budget but the numbers that are usually talked about represent less than 50% of what the state actually spends. Has that always been the case, I think not. I don't know how long ago it was but most of the state's spending, other than for transportation purposes, was in fact reflected in the General Funds, obviously that was awhile ago. I think the most telling example of today's lack of transparency in the state's fiscal management reports reflected in this article, is that the Medicaid program is not just the $6.8 billion program that is reflected in General Funds spending but the $14 billion program reflected in the total state funds spending.

The IGPA Fiscal Futures Project is doing a great job of providing us a roadmap on how our budgetary reporting could be more forthcoming with how we raise and spend the taxpayer's money. One of the instructions we gave our children as they were entering their young adult lives, is that it was their duty to be forthcoming with the truth about things we needed to know as parents. Don't think you can get by with just answering the questions we asked. Well I think that we could be a little more forthcoming with the state's finances. More consolidated budgetary reporting is a good start.

The *Fiscal Futures Project* seeks to develop and present a broad picture of Illinois' past and current fiscal choices and to provide information that would help plan for future fiscal challenges. Like most public entities, Illinois' budget accounting relies heavily on "funds" dedicated to specific purposes. Designated funds make it easier to track and monitor the receipt and use of public money and to assure the financial integrity of Illinois government. If properly used, fund-by-fund accounting can bolster public trust and help policy makers make decisions about the use of scarce resources. However, the complexity and multiplicity of funds can also be used to mystify, obscure and even distort true budgetary actions. This report identifies some of the problems and suggests alternatives to current reporting procedures that we believe have the potential to increase transparency and limit the opportunities to manipulate public opinion through misleading reporting practices.

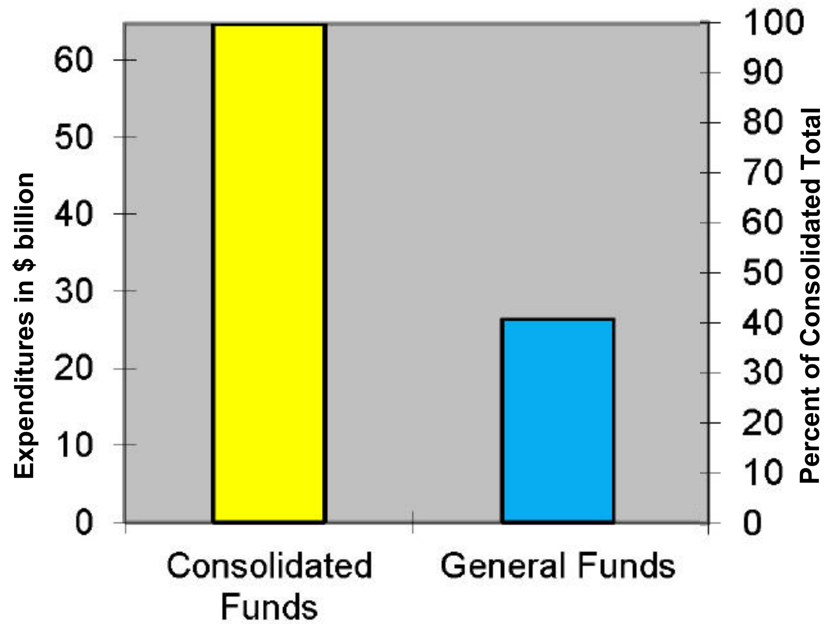
CONSOLIDATED VERSUS GENERAL FUNDS

Most policy discussion and media attention regarding the state budget focuses on the state's four General Funds. These funds are important, but as Figure 1 shows, they account for only two-fifths of the total Illinois budget. The rationale for excluding non-general funds in budget presentations is that the revenues in these funds are often derived from federal or other earmarked sources, which means that the legislature's use of these monies is constrained. For example, in introducing his all-funds *State of*

Illinois Budget for Fiscal Year 2011, Governor Quinn stated:

"Although the upcoming budget for the state of Illinois is more than 55 billion dollars, about half of that money comes from federal dollars and special funds. That means we don't have the authority to decide how most of those dollars are spent. Our spending power is pretty much limited to the dollars in our General Revenue Fund—that's about 27 billion dollars in the coming year.[1] "

FIGURE 1. Illinois Consolidated Funds Budget versus General Funds FY10



This argument is overstated for several reasons. First, while the Illinois General Assembly in past years has earmarked certain revenue sources and linked them to particular expenditures, current and future legislatures *do* have the right to reconsider past decisions. But if special funds are not explicitly considered in the annual budgetary process such reconsideration is unlikely. Second, while it is true that the federal government limits the Governor's or legislature's discretion over the use of federal dollars, these funds do have impacts on the rest of the budget. State programs are often substitutes for, or companions to, federally funded programs. The Illinois General Assembly should be very attentive to federal funds, because if federal grant programs are reduced or eliminated, the state may be politically obligated to maintain some of the programs. Federal funds and earmarked taxes are very important sources of the state's cash receipts and should be an explicit part of discussions about the state budget.

It is very difficult to understand the state's budget situation from official reports, but limiting the analysis to General Funds makes the task much harder. The *Fiscal Futures Project* team implemented a detailed process to construct a more inclusive concept that we call Consolidated Funds. This budget concept consistently represents all spending and revenue categories in the Illinois budget over almost two decades. The consolidated measure presents a better picture of the state's fiscal situation for a number of reasons:[2]

[1] Governor Pat Quinn, FY 2011 State of Illinois Budget Address, March 10, 2010, Transcript Final Draft. http://www2.illinois.gov/budget/Documents/FY%202011%20Transcript.pdf, accessed 4-4-11

[2] For more on the justification, categorization, and criteria for inclusion of funds in our consolidated funds budget see "Fiscal Futures Project Documentation," downloadable from our website: http://igpa.uillinois.edu/content/fiscal-futures-project.

- **Breadth of coverage**. Consolidation explicitly includes important categories of state spending—like transportation, debt service, transfers to local governments, and many programs supported by federal grants—in the analysis and discussion of budget priorities. We consistently categorize spending by purpose (e.g., low income health care) rather than by agency so that administrative reorganizations do not distort budgetary reporting.

- **Consistent definition over time**. It is not unusual for an item to be assigned to General Funds in one year and a special fund in the next (or vice versa). Looking only at General Funds, it might appear that spending went down, while a consolidated budget tracks the actual change in total spending. Reassignment is not confused with real change.

- **Inter-fund transfers.** Some reported General Fund receipts are actually *transfers in* from non-general funds and some reported General Fund expenditures are actually *transfers out* to non-general funds. Such transfers can obscure the magnitude of real changes in the state's budget situation. With a broad budget frame, most inter-fund transfers net out.

Table 1 shows the differences between the consolidated funds and General Funds measures. The first column in Table 1 shows the amount of FY 2010 General Fund spending in the fifteen spending categories and sixteen revenue categories designated by the *Fiscal Futures Project*. The second column shows the General Funds share of the Consolidated Funds amount in each category. The third column shows the amounts for the broader Consolidated Funds budget. The fourth column in Table 1 shows the number of non-general funds that contribute to each category.

In FY 2010 total spending from the four General Funds was $26.3 billion, but this represented just over 40 percent of the $64.4 billion in direct spending from the over 600 consolidated funds.[3] The table clearly shows that non-general funds are very important in the overall budget.

Note the very large number of non-general funds involved in most consolidated spending categories. Readers who have examined state budgets before should note that the $26.3 billion figure shown in Table 1 represents just *direct expenditures* of the General Funds. Often the General Funds total is presented as direct expenditures plus *transfers out*, which totaled $30.5 billion in FY 2010. If the General Funds are compared to or consolidated with other state funds, reporting transfers to those funds as expenditures leads to double counting. Similarly, *transfers in* to the General Funds from other state funds are not net new receipts of the state government sector and should not be double counted. In the Fiscal Futures project and in this paper, inter-fund transfers are not counted as expenditures or receipts.

[3] See the longer version of this report for additional details on and sources for these examples.

Table 1: General Funds versus Consolidated Funds Budget for Illinois in FY 2010[a]

Spending Category[b]	General Funds ($ million)	General Funds Pct. Share of Consolidated	Consolidated Funds ($ million)	Number of Non-General Funds in Consolidation
Medicaid	6,803.8	47.1	14,438.7	29
Elementary & Secondary Education	7,272.4	73.9	9,847.2	15
Human Services (expanded)	6,048.2	64.9	9,313.9	45
Transfer of Revenue to Local Govts.	0.0	0.0	5,121.7	13
Transportation (including Tollway)	74.1	1.5	5,008.8	16
Debt Service[c]	0.0	0.0	4,767.0	4
Pensions	0.0	0.0	3,451.6	3
Higher Education	2,198.7	86.8	2,532.3	29
State Employee Health Care	0.0	0.0	1,679.2	1
Management, Legislative & Judicial	879.7	49.8	1,765.7	100
Corrections	1,156.3	94.2	1,227.7	1
Public Safety & Health	435.0	42.3	1,028.3	105
Environment, Nat. Resource & Agric.	83.9	9.8	857.7	98
Economic Development	49.3	3.8	1,299.4	51
Other Expenditures	1,316.0	55.9	2,354.2[d]	200 + [d]
Total Expenditures	26,317.5[e]	40.7[e]	64,693.3	612
Receipt Category[b]				
Federal Funds	5,840.3	31.9	18,322.3	195
Personal Income Tax[f]	8,510.4	100.0	8,510.4	0
General Sales Tax	6,308.0	74.2	8,497.2	4
Bond Issue Proceeds	0.0	0.0	9,005.5	15
Business Income Tax[f]	1,360.4	62.0	2,195.8	2
Motor Fuel/Vehicle/Operator	121.5	4.3	2,810.5	49
Short-Term Borrowing	1,250.0	83.4	1,499.6	1
Public Utility Tax	984.0	62.5	1,573.1	9
Healthcare Provider Taxes/Fees	0.0	0.0	1,574.9	4
Gambling	3.6	0.2	1,523.7	18
Excise Taxes (other)	866.0	69.1	1,253.2	27
Licenses, Fees & Registrations	11.9	2.4	502.4	214
Investment Income	25.9	56.0	46.2	210
Fines, Penalties & Violations	11.9	11.4	105.0	121
Corporate Franchise Taxes	208.1	97.7	213.0	2
Other Cash Receipts	1,146.9	24.9	4,603.6[d]	100 + [d]
Total Receipts	26,440.8[e]	42.5[e]	62,236.6	380

[a] Preliminary, final *Detailed Annual Report* for FY10 not yet released.

[b] See *Documentation* at http://igpa.uillinois.edu/fiscalfutures/research for category definitions.

[c] Includes principal and interest payments for short-term borrowing. Excludes escrow payments.

[d] Estimate.

[e] Excludes transfers from or to non-general funds. *Comptroller's Quarterly, July 2010,* p. 3 reports total expenditures plus transfers out of $30,479 million and total receipts plus transfers in of $30,329 million.

[f] Net of transfers to Refund Fund.

Rather, receipts are assigning to the fund making the initial collection and expenditures are assigned to the fund making the final payment.

The results for the receipts side of the budget, shown in the bottom half of Table 1, are similar. Total General Fund receipts for FY 2010 are $26.4 billion or 42.5 percent of the $62.2 billion of Consolidated Fund receipts. Five receipts categories have General Funds shares of less than 5 percent. Hundreds of non-general funds contribute to several of the categories.

The key points of this paper are (1) that special funds are a crucial component of the state budget that merit more visible reporting and (2) that special funds and General Funds affect each other in important ways—substitution, inter-fund transfers, year-to-year changes in fund assignment—so that looking at just the General Funds gives a misleading picture of the state's true fiscal situation. We are arguing for combined *reporting* of special and General Funds, not their merger. Rules for *accountability and control* that restrict the use of certain special revenues can still be maintained if reporting procedures are changed so that the use of both special and General Funds are documented in a comprehensive, coherent and consistent fashion.

EXAMPLES OF HOW THE CHOICE OF THE BUDGET FRAME CAN CONFUSE THE FISCAL PICTURE[4]

Fund sweeps: There are many instances in which focus on the General Funds budget has obscured Illinois' true budgetary choices. For example, in recent years the state of Illinois has transferred balances from special funds into the General Funds, so-called fund sweeps. In FY 2010 fund sweeps totaled $287 million.[5] Including fund sweeps in the General Funds budget ignores the fact that fund sweeps are not a recurring source of revenue, and in many cases the special funds that were swept have to be reimbursed.

Did Illinois spending really go down by $3.5 billion in 2010? A second example is a case that did not fool experienced budget watchers inside the state, but seriously confused outsiders trying to compare Illinois with other states. To make its scheduled FY 2010 payments into the pension system the state issued about $3.5 billion in bonds, and deposited the proceeds into a special fund, which made the payments. Since in earlier years the state's pension contributions came from the General Funds, there was a dramatic reduction in the General Funds budget between FY 2009 and 2010 without any real change in spending. The National Conference of State Leg-

4 See the longer version of this report for additional details on and sources for these examples.

5 COGFA, *Monthly Briefing*, June 2010, at http://www.ilga.gov/commission/cgfa2006/Resource.aspx?id=2. "Sweeps" are the net amount after repayment to special funds; inter-fund borrowing has to be repaid within 18 months.

islatures (NCSL) compared the budgets of all 50 states and—misleadingly—observed:[6]

> Thirty-four states reported year-over-year drops in FY 2010 spending. Eight states reported double-digit declines with the biggest drops in Louisiana (-16.8 percent), **Illinois (-15.5 percent)** and Alabama (-14.9 percent).

But this reassignment caused barely a ripple in Illinois' broader consolidated funds budget.

Was education spending set to go down? Really? Earlier we quoted from Governor Quinn's speech introducing his FY 2011 budget his argument that the General Funds are what matter. Accordingly, Governor Quinn focused on the General Funds portion of the budget in arguing for a tax increase to avoid big cuts in school aid. But the same budget on a consolidated funds basis showed only tiny cuts.

Did spending for Human Services go down too much? Too little? Or not at all? In debates over the FY 2012 General Funds budget for the Department of Human Services, advocates on one side decried declines, while others argued that given the brutal realities of the state's fiscal situation the cuts should have been even deeper. By focusing on just the General Funds, neither side seems aware that 2012 on a consolidated funds basis and after adjusting for inflation DHS expenditures have remained fairly constant since 1998.

WHAT TO DO? POLICY OPTIONS FOR REPORTING MORE THAN JUST GENERAL FUNDS

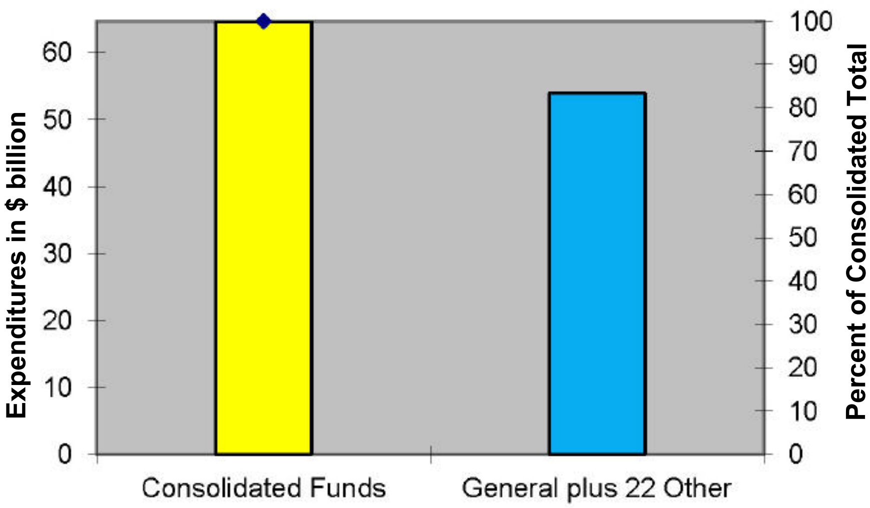
The above examples illustrate why it is inaccurate and misleading to portray year-to-year expenditure shifts into or out of the General Funds as substantive budgetary changes. Illinois' current focus on the General Funds alone can obscure the true budget picture in important ways. A more consolidated presentation of the Illinois state budget is desirable. That said, full consolidation of all 670-plus state funds is not appropriate, because some special funds hold money that, in a very real sense, does not belong to the state. Examples include funds that hold payroll deductions from employees, or receipts from locally levied sales taxes. Almost everyone would agree that it is not appropriate to consider the dollars in these funds part of the state's total resources and expenditures.[7]

The full consolidation of all 600-plus funds currently in the IGPA Fiscal Futures Model presents some practical difficulties. Reviewing hundreds of funds is a time-consuming task, as the consolidation process requires careful review of the criteria used, the application of those criteria to each fund, and adjustments to account for fund "births" and "deaths" from year

[6] NCSL, "State Budget Update," July 2010, pages 9 and 14. Note these calculations are based on the budget as of the beginning of FY 2011. Half way through the fiscal year, in January 2011, the General Assembly authorized borrowing for the pension contribution.

[7] See Fiscal Futures Project, *Documentation*, Appendix 2: "Criteria for Including Funds in the Consolidation," available at: http://igpa.uillinois.edu/fiscalfuturesproject/.

FIGURE 2. Illinois Consolidated Funds Budget versus General Funds and 22 Other Funds FY10



to year. Real-time analysis means generating estimates more quickly, with less than complete information. So, in the full report we examine the intermediate policy of combined reporting of 20 to 50 of the state's 670-plus non-general funds along with the General Funds budget. This would be a vast improvement over the General Funds-only presentation of the budget and would achieve most of the benefits of full consolidated reporting. The resulting improvement in budget clarity can be of benefit to both policymakers and the public in understanding, and addressing, the state's serious fiscal problems.

General Funds combined with 22 special funds. The first alternative we examine is combined reporting of the largest appropriated funds—those with greater than $600 million of expenditures or receipts—and the General Funds.[8] Also including two large non-appropriated funds—the Local Government Tax Fund and the State Toll Highway Revenue Fund—results in a count of 22 special funds in addition to the four General Funds. As shown in Figure 2, this method results in total expenditure of $54.0 billion or about 84 percent of the Fiscal Futures 600+ fund consolidated spending (and 81 percent of receipts) for FY 2010.[9]

General Funds combined with 55 special funds. To go farther toward the goal of full consolidation, 33 additional non-general funds were added for a total of 55. Figure 3 shows that in FY 2010, combined reporting of the General Funds and 55 funds totals $58.9 billion and accounts for about 91.2 percent of total Fiscal Futures consolidated expenditures (and 95.1 percent of consolidated receipts).

The two possible scenarios outlined here are potential policy options, but whether to include any particular fund is a judgment call. Before adopting either of these reporting schemes, there are some additional issues that should be considered.

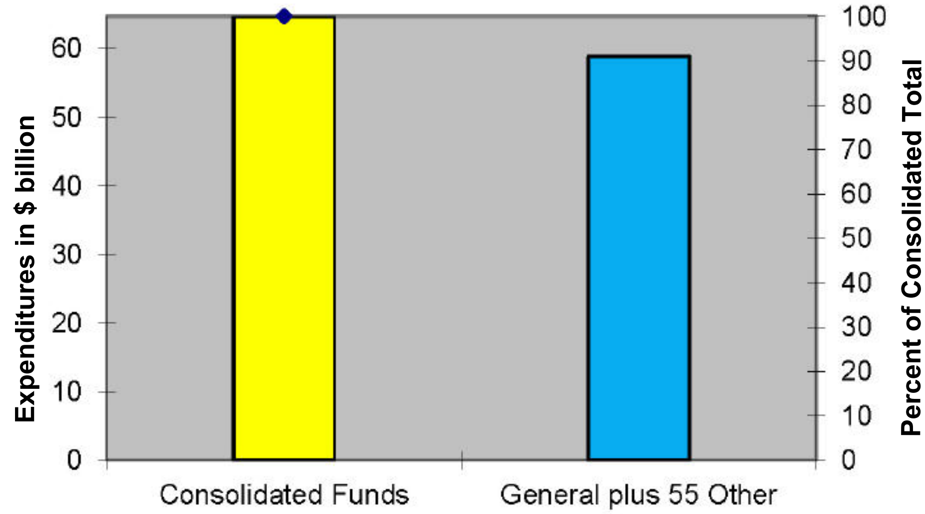
The Special Case of Transportation. There are several reasons to ask whether the transportation budget should be excluded from

8 The exception to this rule is the Income Tax Refund Fund, which was not included because we measure income tax receipts net of

9 See Table 2 in the full report for the details on "General Funds plus 22" and "General Funds plus 55" for each expenditure and receipt category. See Table 3 in the full report for a list of all 55 funds.

expanded budget reporting. First, on the revenue side, the majority of transportation receipts come from either earmarked taxes and fees or from federal funds. The counter argument is that all special funds have federal or dedicated revenues. Moreover, excluding transportation would impact other expenditure and receipt categories. For example, the transfer of motor fuel tax revenues back to local governments to pay for road construction is an important component of all revenue transfers to local governments.

FIGURE 3. Illinois Consolidated Funds Budget versus General Funds and 55 Other Funds FY10



Second, on the spending side, a reason for keeping transportation separate is the particular nature of appropriations for road projects. It is routine to appropriate roughly 2 ½ times more for roads than is actually spent in a fiscal year. Presumably this over-authorization preserves flexibility as to which of many potential projects eligible for a federal match are actually undertaken in the coming year. With this routine over-appropriation, it could be confusing to combine transportation with other spending categories when proposing budgets.

Trade-Offs in Choosing How Many and Which Funds to Include. For a point-in-time analysis of a single fiscal year, whether to use 4 funds, 22 funds, or 55 funds is a judgment call. And whether to exclude or include any particular fund or group of funds—like the transportation funds—is a separate judgment. It is not difficult to calculate expenditures using 20 or 50 funds (or 22 or 55 or any other number). The broader the scope, the larger the number of funds included, the greater is the completeness and accuracy of the budget picture presented. On the other hand, from the perspective of budget presentation, it might be clearer and more understandable to show 20 funds rather than 50, especially for those who are unfamiliar with any funds outside of the General Funds.

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A Third Policy Option: Redefining the List of General Funds. The two policy options presented above expand the list of funds included in budget reports and differ only in the number of additional funds brought into the frame. Another alternative is to formally redefine which funds are designated as General Funds. This would have the advantage of greater understandability and clarity in budget presentation. Any list of funds re-designated as General Funds would, of course, have to be carefully considered. It is important to note that re-designation of some special funds as General for *reporting purposes* does *not* mean that any *accountability and control restrictions* on the use of particular funds have to be changed. Giving greater scrutiny to additional funds does not mean throwing all the dollars in the same pot.

ESTABLISHING A CONSISTENT BUDGET FRAME

By using fund amounts from a particular and already completed year we have illustrated that 80 to 90 percent of full consolidation could be achieved with around 20 or 50 additional funds. But to be meaningful over time, the reporting budget needs to be framed as more than just a list of specified funds. That is because anything short of full consolidation leaves possible the types of confusion or manipulation shown in the examples earlier in this paper.

For year-to-year expenditure and revenue comparisons, the budget-reporting frame needs to be consistent. From one year to the next, the magnitude, purpose, expenditure objectives, or sources of receipts for any particular fund can change. Transfers can be made between funds inside and outside the reporting frame. Every year, the state creates new funds and deactivates others. Periodically, as with a new administration, agencies are renamed and programmatic responsibilities are reassigned. For this reason, each fiscal year it will be necessary to evaluate objectively each of the important revenue and expenditure categories to determine how these align with the state's fund structure. Starting from a list of existing funds is a very practical way of deciding how to implement consolidated budget reporting, but the list of funds cannot stay the same over time. Adjustments will have to be made each year based on new funds, dead or dormant funds, reassignments of programs from one fund to another, and transfers.

CONCLUSION

The state of Illinois has over 670 separate funds for accounting purposes. However, most discussion of the state budget concentrates just on the four General Funds. While the General Funds do represent most discretionary spending and unrestricted revenue, the special funds are very important to the overall fiscal picture of the state, because in total, the General Funds account for less than half of all spending and cash receipts in the state. Ignoring the more than half accounted for by special funds gives a narrow, and thus distorted, picture of the state's fiscal situation. A governor who knows that the public attention will be focused almost exclusively on the General Funds can manipulate the discussion of fiscal conditions by mere accounting changes.

Transfers between General and non-general funds or year-to-year changes in whether an item is assigned to a General or non-general fund can make it very hard to distinguish which fiscal changes are real and which are merely changes in accounting. We have illustrated these problems with a number of examples.

In our *Fiscal Futures Project* we have addressed these concerns by creating a Consolidated Funds Budget for the state of Illinois that combines over 600 separate funds. Consolidated reporting means transfers between funds net out, so that the comprehensive budget measures genuine changes. Likewise, changes in assignment from General to non-general funds do not change the consolidated total. Full consolidation is most feasible after the end of a fiscal year when full detail on the receipts, spending, transfers in, transfers out, and changes in fund balances are available for all funds. It would be very difficult to present and report a fully consolidated budget prior to the beginning of a fiscal year—the data and information needs are just too great.

In this paper we examined three practical alternatives to full consolidated fund reporting. We demonstrate that reporting just 22 to 55 funds in combination with the four General Funds would capture 80 to 90 percent of the dollar amount of full consolidation. General Funds plus 22 or General Funds plus 55 would eliminate many of sources of confusion and opportunities to intentionally mislead that go with General Funds-only reporting.

As a third alternative, we suggest formally changing the designation of 15 or so of the largest non-highway funds to General Funds. This would have the advantage of greater simplicity in presentation. While we present a number of arguments why highway funds should be included in any consolidation, the exclusion of highway funds does avoid problems of interpreting routine over-appropriation for highway construction.

We emphasize that combined or consolidated *reporting*—or even re-designation of some special funds as General—does *not* mean that any *accountability and control restrictions* on the use of particular funds have to be changed. Rather we are suggesting that those funds be brought fully into view.

It is important to note that with anything short of full consolidation, transfers or reassignments between on-budget and off-budget funds can still distort or be used to misrepresent the actual fiscal situation. For that reason, a 20-fund, or 50-fund, or expanded General Fund reporting frame cannot be static and must be constantly monitored to achieve the intent of consistent reporting.

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