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BUDGET AND PROGRAM PLANNING  
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TO: Janet Kelly, Director  
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FROM: David Ewer, Budget Director

SUBJECT: HB 9 – Intent of Section 6(1)(b)(ii)

It has come to my attention that the underlying assumptions used to define which receipts are labeled general fund revenue in SABHRS are different from the assumptions underlying those used in developing the receipts considered general fund revenue in the budget and legislative process. This creates differences in the measurement and categories of receipts recognized as general fund revenue. If the definitions used in making policy and implementing policy are inconsistent, the result will be:

- Schools will receive only about \$7 million of the capital investment and deferred maintenance one-time-only school appropriation totaling \$30 million for FY 2008.
- Montana citizens who are homeowners not receiving \$27.8 million in individual income tax credits that both the legislature and the Governor intended for them to receive under HB 9.

This memo is written to give you the background on the general fund revenue estimate laws and the intent of both the legislature and the Governor in establishing the "official" general fund revenue trigger for implementing HB 9 (2007 special session). This background material is critical as the Department of Administration is to certify to the budget director on August 1, 2007 the amount of unaudited general fund revenue received in fiscal year 2007 as recorded when the statewide accounting, budgeting, and human resources system (SABHRS) records were closed in July 2007.

After reviewing the laws and related materials, it appears that the underlying assumptions need to be consistent in defining the FY 2007 general fund revenue for both policy setting by legislation and implementing the legislation policy.

### **Official General Fund Revenue Estimates**

The legislature established the "official estimates" through its power in 5-5-227 (2) and (3), MCA. These sections read as follows:

(2) The committee must have prepared by December 1 for introduction during each regular session of the legislature in which a revenue bill is under consideration an estimate of the amount of revenue projected to be available for legislative appropriation.

(3) The committee's estimate, as introduced in the legislature, constitutes the legislature's current revenue estimate until amended or until final adoption of the estimate by both houses. It is intended that the legislature's estimates and the assumptions underlying the estimates will be used by all agencies with responsibilities for estimating revenue or costs, including the preparation of fiscal notes. (emphasis added)

The title to HJR 2 read in past as follows: "A joint resolution of the senate and the house of representatives of the state of Montana establishing an official estimate of the state's anticipated general fund revenue for fiscal year 2007...." (emphasis added)

### **Legal Criteria for Standards for "Official" General Fund Revenue Estimate**

The law provides a process for cooperation between the Budget director and the Legislative Fiscal Analyst to establish standards, formats, and other matters necessary to ensure that information is consistent and accurate for the preparation of the state's budget. The law requires that for revenue estimates the budget director prepare a detailed analysis of receipts by accounting entity within each fund type indicating classification and source of funds. For the general fund revenue estimate this was done in volume 2 of the Governor's Budget. The Revenue and Transportation Interim Committee's "official" general fund revenue estimate and the underlying assumptions are presented in volume 2 of the Legislative Budget Analysis.

Section 17-7-111 (1)(a)(b), MCA, states that:

To prepare a state budget, the executive branch, the legislature, and the citizens of the state need information that is consistent and accurate. Necessary information includes detailed disbursements by fund type for each agency and program for the appropriate time period, recommendations for a creating a balanced budget, and recommended

disbursements and estimated receipts by fund type and fund category.  
(emphasis added)

Section 17-7-111(1)(b)(i), MCA, states that:

Subject to the requirements of this chapter, the budget director and the legislative fiscal analyst shall by agreement:

(i) establish necessary standards, formats, and other matters necessary to share information between the agencies and to ensure that information is consistent and accurate for the preparation of the state's budget;

In preparation of the state budget, the budget director under 17-7-111, MCA, is required to produce the following information as stated in Section 17-7-111 (3)(b), MCA:

a schedule of the actual and projected receipts, disbursements, and solvency of each fund for the current biennium and estimated for the subsequent biennium;

Section 17-7-124, MCA, reads as follows:

**Additional budget data.** In addition to the budget required in 17-7-123, the governor shall prepare and make available on request a detailed analysis of receipts by accounting entity within each fund type indicating classification and source of funds. (emphasis added)

These laws show that the legislature sets the standards for the "official" general fund revenue estimate they will use to establish state budget policy. The Revenue and Transportation Interim Committee, defines the general fund revenue detail, utilizing the Legislative Analyst staff, for legislation and thus policy decisions considered during the legislative session. The executive branch is required to use this detail. The legislature used its definition of general fund revenue when establishing the financial criteria for the Montana homeowner's individual income tax credit for property taxes assessed on homes. This is illustrated in the fiscal note, which references the general fund revenue, under assumption 11. The assumption reads:

11. General fund revenue for FY 2007 is projected to be \$1.762 million.  
Thus, the multiplier will be zero and there will be no credits.

### **Rational for Legislative Definition of "Official" General Fund Revenue**

HJR 2, the revenue resolution that contains the Revenue and Transportation Interim Committee's statutorily required general fund revenue estimate on page 5, line 7, contains the \$1,762 million general fund revenue estimate. The HJR 2 title and whereas clauses read as follows:

A JOINT RESOLUTION OF THE SENATE AND THE HOUSE OF REPRESENTATIVES OF THE STATE OF MONTANA ESTABLISHING AN OFFICIAL ESTIMATE OF THE STATE'S ANTICIPATED GENERAL FUND REVENUE FOR FISCAL YEAR 2007 AND EACH FISCAL YEAR OF THE 2008-2009 BIENNIUM FOR THE PURPOSE OF ACHIEVING A BALANCED BUDGET AS REQUIRED BY ARTICLE VIII, SECTION 9, OF THE MONTANA CONSTITUTION; ACCEPTING A PRELIMINARY JUNE 30, 2006, UNRESERVED GENERAL FUND BALANCE THAT WAS ESTABLISHED BASED ON GENERALLY ACCEPTED ACCOUNTING PRINCIPLES; ESTABLISHING OFFICIAL ESTIMATES OF CERTAIN NONGENERAL FUND REVENUE; AND REQUESTING THAT THE GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING USE THE REVENUE ESTIMATES CONTAINED IN THIS RESOLUTION AS OFFICIAL REVENUE ESTIMATES FOR FISCAL YEARS 2007, 2008, AND 2009.

WHEREAS, Article VI, section 9, of the Montana Constitution requires the Governor to submit to the Legislature a budget for the ensuing fiscal period, containing in detail for all operating funds the proposed expenditures and estimated revenue of the state; and

WHEREAS, Article VIII, section 9, of the Montana Constitution prohibits the Legislature from appropriating funds in excess of the anticipated revenue of the state; and

WHEREAS, section 5-5-227(2), MCA, requires the Revenue and Transportation Interim Committee to estimate the amount of revenue projected to be available for legislative appropriation and to introduce a resolution setting forth the Committee's current revenue estimate; and

WHEREAS, section 5-5-227(3), MCA, expresses the Legislature's intent that its revenue estimates and the underlying assumptions used to derive those estimates be used by all agencies in the development of fiscal notes; and

WHEREAS, section 5-12-302(6), MCA, requires the Legislative Fiscal Analyst to assist the Revenue and Transportation Interim Committee in its revenue estimating duties; and

WHEREAS, the Revenue and Transportation Interim Committee obtained the assistance of the Legislative Fiscal Analyst in the development of the revenue estimates; and

WHEREAS, the Revenue and Transportation Interim Committee also obtained the assistance of Executive Branch agencies in the development of the revenue estimates; and

WHEREAS, the Revenue and Transportation Interim Committee has adopted revenue estimates and the underlying assumptions used to derive those estimates for the general fund and for specific non general fund sources that are significant in the development of the state budget for fiscal year 2007 and the 2008-2009 biennium; and

WHEREAS, section 5-5-227(3), MCA, provides that the Revenue and Transportation Interim Committee's estimate, as introduced in the Legislature, constitutes the Legislature's current revenue estimate until amended or until final adoption of the estimate by both houses; and

WHEREAS, the amount of estimated revenue and the general fund balance affects policy decisions of the Executive Branch and the Legislative Branch; and

WHEREAS, the revenue estimates and the underlying assumptions contained in this resolution provide the basis for a comprehensive analysis of the state's revenue condition. (emphasis added)

In writing the language in HB 9 (2007 special session), drafters referred to the revenue recorded in SABHRS using generally accepted accounting principles. The numbers used in the legislature's revenue estimate is derived from the numbers in SABHRS. The SABHRS system relies on generally accepted accounting principles in applying accounting principles, for example, the rules for accruing revenue and recording revenue to prior years so that the current revenue can be identified, etc. These rules govern the consistency and integrity of the numbers recorded in SABHRS. These principles are important to the legislature to ensure that the integrity of the numbers used in policy decisions is maintained. However, the technical names applied to the different sources of receipts used to derive an "official estimate of the state's anticipated general fund revenue for fiscal year 2007" of the state for making policy decisions are not all labeled revenue in SABHRS. For the state's annual financial report (CAFR), there are technical names used for defining revenue which do not correspond to the underlying assumptions used in establishing the "official estimate of the state's anticipated general fund revenue" which is used by the legislature when establishing state policy.

The state CAFR report will define revenue as being \$1,769 million for FY 2007. The official estimate of the state's anticipated general fund revenue with the underlying assumptions contained in HJR 2 for FY 2007 are \$1,830 million. This is a difference of \$61 million.

### **Policy Impact of Changing the Underlying Criteria of the "Official" General Fund Revenue Estimate**

The policy impact of having the FY 2007 general fund revenue defined differently than the definition statutorily required for policy decisions when implementing HB 2 (2007 special session) and HB 9 (2007 special session) is that (1) schools will receive only \$7 million of the \$30 million appropriation for capital investment and deferred maintenance and (2) Montana homeowners would not receive \$28 million in individual income tax credits on their 2007 individual income tax returns.

### **Other Implication – Balanced Budget/ Reduction in Spending**

Utilizing the legislature's method of determining general fund revenue in the statewide perspective of the budget, (Volume 1 – Statewide Perspectives, Page 37) results in a project fund balance of \$183.791 million for June 30, 2009. Not utilizing the legislature definition of general fund revenue (which applies generally accepted accounting principles for the measurement and proper fiscal year recording of receipts) and assuming the difference between the technical terms used in CAFR and the "official general fund revenue estimate" continues to be about \$61 million a year, would result in no fund balance by June 30, 2009. This result would:

- Violate Article VIII, Section 9, of the Montana Constitution which requires that appropriations by the legislature not exceed anticipated revenue.
- Require the Governor to consider implementing section 17-7-140, MCA, for a reduction in spending as the "the Governor shall ensure that the expenditure of appropriations does not exceed available revenue." Using the CAFR definition of revenue, results in a projected fund balance for June 30, 2009 which is lower than allowed under this law.

### **HB 9 House Hearing**

On May 14, 2007, the Legislative Fiscal Division staff person noted his office said in regular session that the general fund revenue had the potential to exceed the HJR 2 revenue estimate of \$1,762 million by \$63 million. The staff person noted the appropriation for the school in HB 2. The appropriation reads as follows:

If the unaudited general fund revenue received in fiscal year 2007 exceeds \$1,762,355,000 then the amount of the general fund unaudited revenue for fiscal year 2007 that exceeds \$1,762,355,000, up to \$30 million, is appropriated to the office of public instruction for distribution to schools in accordance with [LC 4] for the capital investment and deferred maintenance one time-only payment.

He noted that the next \$10 million of revenue in excess of \$1,762 million would increase the general fund balance and any addition revenue above this level would be used as authorized in HB 9 for tax credits to homeowners.

The testimony referred to the "official" general fund revenue estimate as defined by HJR 2. He clearly left the expectation that the revenue would be measured in the same manner as the HJR 2 revenue estimate was determined.

### **Conclusion**

- By law, the legislature through the Revenue and Transportation Interim Committee's work and the introduction of HJR 2 has established the "official"

general fund revenue estimates and the underlying assumptions used to derive those estimates.

- The “official” general fund revenue estimate is based on having generally accepted accounting principles applied for the proper measurement and proper time period in which to record the revenue.
- The “official” general fund revenue estimate was used as the basis for policy decisions for both education in HB 2 (2007 special session) and homeowner tax credits in HB 9 (2007 special session).
- If the “official” general fund revenue estimate is not utilized in implementing policy and the financial overview of the general fund, the Montana Constitution’s requirement of a balanced budget is not met.
- If the “official” general fund revenue estimate is not utilized in implementing policy, the Governor would need to consider the implication of section 17-7-140, MCA, for budget reductions.
- If the “official” general fund revenue estimate is not utilized, Montana homeowners will not receive \$28 million in tax credit.
- It is not logical to ignore the basis for the “official” general fund revenue estimate due to technical names applied within SABHRS or a format required in the CAFR.

It appears to be the intent of the Legislature that the “official” state general fund revenue for FY 2007 be determined according to the underlying assumptions used to derive the HJR 2 general fund revenue estimate. Thus, the FY 2007 “official” general fund revenue is \$1,830 million when the generally accepted accounting principles are applied for proper measurement and timing of the receipts.