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State of Illinois

ECONOMIC AND FISCAL COMMISSION
703 Stratton Ofc. Bldg., Springfield, IL 62706

DEPUTY DIRECTOR

Trevor J. Clatfelter

March 15, 2004

MEMORANDUM

TO: The Honorable Rod Blagojevich, Governor, State of Illinois
The Honorable Emil Jones, Jr., President of the Senate
The Honorable Michael Madigan, Speaker of the House of Representatives
The Honorable Tom Cross, Minority Leader of the House of Representatives
The Honorable Frank Watson, Minority Leader of the Senate

FROM: Dan R. Long, Executive Director

RE: FY 2005 GAAP (Generally Accepted Accounting Principles) Report

Introduction

Included in this memorandum is the Illinois Economic and Fiscal Commission's revenue estimates formulated on a modified accrual basis in accordance with generally accepted accounting principles (GAAP). Public Act 90-0479, a synopsis of which is included in the Appendix, requires modified accrual basis estimates for the general funds, the Agricultural Premium Fund, the Road Fund, and the Motor Fuel Tax Fund.

Recognition of revenue and liability in the fiscal year of collection or payment has been the premise for formulating the Illinois budget and is known as cash basis budgeting. Estimates formulated on a modified accrual basis instead recognize revenue and liability in the fiscal year of accrual and provide an alternative perspective to the budget process.

Modified Accrual Basis Estimates

The Economic and Fiscal Commission estimates that fiscal year 2005 revenue to the general funds on a modified accrual basis will be \$7.8 million lower than on a cash basis. The small differential between the two estimates is largely due to increases in the income taxes and the sales tax being offset by losses in the federal sources forecasts. The Commission estimates that there will be no difference between modified accrual basis

revenue to the Agricultural Premium Fund, the Road Fund, and the Motor Fuel Tax Fund in fiscal year 2005. The following table summarizes the Commission's estimates, while tables at the back of this document provide more detail of the analysis.

| FY 2005 REVENUE ESTIMATES | | | |
|----------------------------------|---|---|------------|
| Summary Table | | | |
| (\$ in Millions) | | | |
| Estimated Revenue by Fund | IEFC Cash Basis vs. Modified Accrual Basis | | |
| | IEFC FY 2005 Cash Basis | IEFC FY 2005 Modified Accrual Basis | Difference |
| General Funds | \$26,338.0 | \$26,330.2 | -\$7.8 |
| Agricultural Premium Fund | \$25.1 | \$25.1 | \$0.0 |
| Road Fund | \$2,162.4 | \$2,162.4 | \$0.0 |
| Motor Fuel Tax Fund | \$1,351.6 | \$1,351.6 | \$0.0 |

In past years, the Governor's Office of Management and Budget (formally, Bureau of the Budget) included their modified accrual revenue and expenditure estimates in each fiscal year's Budget Book. However, the 2005 Budget Book did not include these estimates. As a result, the Commission is unable to compare the general funds modified accrual basis revenue estimates of the Governor's Office of Management and Budget with those of the Commission. The GOMB's fiscal year 2005 cash basis revenue estimate is \$26,392 million (adjusted to include \$276 million in Budget Stabilization Fund transfers), \$54 million above the Commission's fiscal year 2005 cash basis estimate of \$26,338 million. **Both estimates include the Governor's proposed fiscal year 2005 deficit reduction sources estimated by the GOMB to be \$803 million. Obviously, if these sources are not made available in FY 2005, available spending would also be impacted.**

Methodology for Modified Accrual Basis Revenue Estimates

In general, the Economic and Fiscal Commission's modified accrual revenue estimates were formulated as follows:

- 1) obtained historical amounts of revenue accrued in a given fiscal but received during July and August of the following fiscal year, or later during the following fiscal year in the case of federal reimbursements associated with Section 25 of the State Finance Act;
- 2) used historical data to calculate the percentage of a fiscal year's cash basis receipts attributable to the previous fiscal year;
- 3) used data described above and additional insight from relevant agencies to formulate estimates of accrued revenue to be received after the close of fiscal years 2004 and 2005;
- 4) used these estimates of accrued revenue received after the close of fiscal years 2004 and 2005 to convert fiscal year 2005 cash basis revenue estimates to modified accrual basis estimates by subtracting fiscal year 2005 cash receipts

attributable to fiscal year 2004 and adding fiscal year 2006 cash receipts attributable to fiscal year 2005.

It should also be noted that:

- 1) for federal revenues to the general funds, the Governor's Office of Management and Budget estimates were used given GOMB's role in coordinating federal receipts and the estimates' similarity to such receipts in previous fiscal years;
- 2) in accordance with Public Act 90-0479, the Commission also formulated fund balance estimates – however, GOMB's estimated fiscal year 2005 beginning cash basis fund balances were utilized for the Agricultural Premium Fund, the Road Fund, and the Motor Fuel Tax Fund;
- 3) the Governor's Office of Management and Budget's estimates of expenditures were utilized for fund balance calculations given the Commission does not routinely estimate expenditures.

Background

The Comptroller's office produces the *Comprehensive Annual Financial Report (CAFR)* at the end of each fiscal year. The CAFR is the official annual report of the State's financial position as of June 30 each year. This report is prepared on a modified accrual basis in accordance with GAAP. However, the Governor and the General Assembly construct each fiscal year's budget on a cash basis.

Cash basis budgets are based on estimates of the cash balance available at the beginning of the fiscal year, the amount of revenue actually received during July through June of the fiscal year, the amount of expenditures actually made during July through June of the fiscal year, and the ending cash balance. Budgeting on a modified accrual basis instead recognizes revenues and expenditures as they accrue.

Funds

Below is a brief description of the funds for which modified accrual estimation is required.

- General Funds - The general funds support operations and programs of numerous State agencies with revenues from various sources, the largest of which include income taxes, sales taxes, and federal sources.
- Agricultural Premium Fund – The Agricultural Premium Fund has been used to meet numerous expenses including those of the Racing Board, the State Fairs, and the Department of Agriculture. Revenues to this fund include a portion of the horse racing privilege tax, transfers from the General Revenue Fund (GRF), and other miscellaneous sources such as proceeds from the sale of advertising at the DuQuoin State Fair and fees paid to the State Police for racetrack investigative services.

- Road Fund – Uses of the Road Fund have included retiring principal and interest on highway construction bonds issued by the State, administering certain chapters of the vehicle code, meeting administrative expenses of the Illinois Department of Transportation, construction of highways and bridges, and patrolling and policing highways. Examples of Road Fund revenue sources are motor vehicle and operator license fees and transfers from the Motor Fuel Tax Fund.
- Motor Fuel Tax Fund – The Motor Fuel Tax Fund is a holding fund for all revenue to the State from the motor fuel tax. Revenue is used for such purposes as deposits to the State Boating Act Fund, deposits to the Grade Crossing Protection Program, and for State and local road programs, including a deposit to the Road Fund.

FY 2005 GAAP REPORT

Supplementary Notes

March, 2004

Cash Basis Revenue Estimate vs. Modified Accrual Basis Revenue Estimate

- It is estimated that there will be a relatively small difference between fiscal year 2005 revenue measured on a cash basis and fiscal year 2005 revenue measured on a modified accrual basis. The modified accrual basis general funds estimate is \$7.8 million lower than the cash basis estimate. The small differential between the two estimates is largely due to increases in the income taxes and the sales tax being offset by losses in federal sources.
- Fund balance estimates were made utilizing both cash basis and modified accrual basis revenue and expenditure estimates.
 - The cash basis fund balance calculation starts with an estimated fiscal year 2005 beginning cash balance of \$73 million, calculated by adding IEFC's fiscal year 2004 estimated cash basis revenues to the fiscal year 2004 beginning cash balance and by subtracting GOMB's fiscal year 2004 cash basis spending estimate.

| | |
|---|--------------------------|
| FY 2004 Beginning Cash Balance: | \$317.0 million |
| FY 2004 IEFC Est. Cash Revenue: | \$26,843.0 million |
| *FY 2004 Est. Cash Spending: | (\$27,457.0 million) |
| FY 2004 Ending/FY 2005 Beginning Cash Balance: | (\$297.0 million) |

* Fiscal year 2004 estimated cash spending utilizes GOMB spending estimate of \$27,087 million and adds \$226 million for the Budget Stabilization re-transfer and \$144 million for related spending from fiscal year 2004 funds sweeps.

While the fiscal year 2004 ending cash balance results in a deficit of \$297.0 million, in reality, the balance cannot fall below \$0. To account for this, fiscal year 2004 lapse period spending would increase by approximately the same \$297.0 million. In other words, lapse period spending allows spending to be put off until necessary revenues are available, thereby keeping the cash balance above \$0. (For the purpose of this analysis, the cash balance will remain at -\$297.0 million, with no further adjustments to lapse spending. However, even if these adjustments were taken, the fiscal year 2005 ending balance, shown on the following page, would have the same result).

- The “modified accrual basis” fund balance calculation starts by adjusting the estimated fiscal year 2005 beginning balance for outstanding revenues and liabilities not accounted for in the cash basis beginning balance.

| | |
|---|----------------------------|
| FY 2004 Ending/FY 2005 Beginning Cash Balance: | (\$297.0 million) |
| FY 2005 Cash Receipts Attributable to FY 2004: | \$1,203.3 million |
| FY 2004 Lapse Period/Section 25 Spending: | (\$2,044.0 million) |
| FY 2004 Ending/FY 2005 Beginning Modified Accrual Balance: | (\$1,137.7 million) |

The estimated fiscal year 2005 modified accrual basis ending balance is calculated by adding estimates of fiscal year 2005 modified accrual basis revenue and subtracting GOMB estimated fiscal year 2005 expenditures, adjusted to a modified accrual basis by subtracting GOMB’s estimates of prior year lapse period and Section 25 spending and adding GOMB’s estimates of current year lapse period and Section 25 spending.

| | |
|--|----------------------------|
| FY 2005 Estimated Beginning Modified Accrual Balance: | (\$1,137.7 million) |
| FY 2005 Estimated Modified Accrual Revenue: | \$26,330.2 million |
| FY 2005 Estimated Modified Accrual Expenditures: | (\$26,487.0 million) |
| FY 2005 Estimated Ending Modified Accrual Balance: | (\$1,294.5 million) |

- The estimated fiscal year 2005 modified accrual basis ending balance results in a deficit of \$1,294.5 million. This figure is \$966.5 million lower than the estimated cash basis ending balance. This is mostly because FY 2004 lapse period / Section 25 spending is much higher than FY 2005 cash receipts attributable to FY 2004.

IEFC FY 2005 REVENUE ESTIMATE - ANALYSIS OF CASH BASIS VS. MODIFIED ACCRUAL BASIS

(General Funds - \$'s in Millions)

March '04

| <u>Estimated General Funds Revenue</u> | <u>FY 2004 Est. Lapse Period Collections</u> | <u>FY 2004 Lapse Period % of FY 2005 Cash Basis</u> | <u>FY 2005 Est. Cash Basis Collections</u> | <u>FY 2005 Est. Lapse Period Collections</u> | <u>FY 2005 Est. Modified Accrual Basis</u> |
|--|--|---|--|--|--|
| <u>State Taxes</u> | | | | | |
| Individual Income Tax | \$219.6 | 2.6% | \$8,320.0 | \$226.1 | \$8,326.6 |
| Corporate Income Tax | \$46.9 | 4.1% | \$1,138.0 | \$43.6 | \$1,134.8 |
| Sales Taxes | \$320.2 | 5.0% | \$6,408.0 | \$327.7 | \$6,415.4 |
| Public Utility Taxes | \$10.3 | 1.0% | \$1,055.0 | \$10.6 | \$1,055.3 |
| Cigarette Tax | \$11.2 | 2.8% | \$400.0 | \$11.2 | \$400.0 |
| Liquor Gallonage Taxes | \$11.2 | 9.2% | \$122.0 | \$11.2 | \$122.0 |
| Vehicle Use Tax | \$2.1 | 6.1% | \$35.0 | \$2.1 | \$35.0 |
| Inheritance Tax | \$26.0 | 11.3% | \$230.0 | \$27.8 | \$231.8 |
| Insurance Taxes & Fees | \$11.6 | 3.3% | \$352.0 | \$12.0 | \$352.3 |
| Corporate Franchise Tax & Fees | \$12.6 | 7.7% | \$165.0 | \$13.0 | \$165.4 |
| Interest on State Funds & Investments | \$5.2 | 10.3% | \$50.0 | \$5.2 | \$50.0 |
| Cook County Intergovernmental Transfer | \$0.0 | 0.0% | \$450.0 | \$0.0 | \$450.0 |
| Other Sources | \$3.5 | 0.4% | \$988.0 | \$4.0 | \$988.4 |
| Subtotal | \$680.5 | 3.5% | \$19,713.0 | \$694.5 | \$19,727.0 |
| <u>Transfers</u> | | | | | |
| Lottery | \$0.0 | 0.0% | \$550.0 | \$0.0 | \$550.0 |
| Gaming Fund Transfer | \$0.0 | 0.0% | \$634.0 | \$0.0 | \$634.0 |
| Other | \$0.0 | 0.0% | \$870.0 | \$0.0 | \$870.0 |
| Total State Sources | \$680.5 | 3.1% | \$21,767.0 | \$694.5 | \$21,781.0 |
| Total Federal Sources | \$563.5 | 11.8% | \$4,772.0 | \$539.2 | \$4,747.7 |
| Total Federal & State Sources | \$1,244.0 | 4.7% | \$26,539.0 | \$1,233.7 | \$26,528.7 |
| <u>Refund Fund</u> | | | | | |
| Personal Income Tax | (\$25.7) | 2.6% | (\$973.0) | (\$26.5) | (\$973.8) |
| Corporate Income Tax | (\$15.0) | 4.9% | (\$307.0) | (\$11.8) | (\$303.8) |
| Subtotal General Funds Revenue | \$1,203.3 | 4.8% | \$25,259.0 | \$1,195.5 | \$25,251.2 |
| Proposed Deficit Reduction Sources (FY 2005) | \$0.0 | 0.0% | \$803.0 | \$0.0 | \$803.0 |
| Budget Stabilization Fund Transfer | \$0.0 | 0.0% | \$276.0 | \$0.0 | \$276.0 |
| Pension Contribution Fund Transfer | \$0.0 | 0.0% | \$0.0 | \$0.0 | \$0.0 |
| Total General Funds Revenue | \$1,203.3 | 4.6% | \$26,338.0 | \$1,195.5 | \$26,330.2 |
| Regular and Section 25 Expenditures | (\$2,044.0) | 7.8% | (\$26,369.0) | (\$2,162.0) | (\$26,487.0) |

| FY 2005 Estimated General Funds Balance | Expenditures | Beginning Balance | Revenue | Expenditures | Ending Balance | | | |
|--|---------------------|--------------------------|----------------|---------------------|-----------------------|------------|---|-------------|
| Cash Basis | | (\$297.0) | + | \$26,338.0 | - | \$26,369.0 | = | (\$328.0) |
| FY 2005 Cash Receipts Attributable to FY 2004 | | \$1,203.3 | | | | | | |
| FY 2004 Lapse Period / Section 25 Spending (-\$850-\$1,194) | | (\$2,044.0) | | | | | | |
| Modified Accrual Basis | | (\$1,137.7) | + | \$26,330.2 | - | \$26,487.0 | = | (\$1,294.5) |

NOTES:

FY 2005 estimated beginning modified accrual balance was derived by subtracting the Governor's Office of Management and Budget's (GOMB) FY 2004 lapse period and other Section 25 spending estimate from the estimated beginning FY 2005 cash balance and adding the estimated FY 2005 cash receipts attributed to FY 2004.

Fund balances are calculated using the Governor's Office of Management and Budget spending estimates as the Economic and Fiscal Commission does not formulate estimates of expenditures.

The GOMB's spending estimates were converted to modified accrual basis by subtracting prior year lapse period and other estimated Section 25 spending and adding current year lapse period and other Section 25 spending.

FY 2005 REVENUE ESTIMATES - ANALYSIS OF CASH BASIS VS. MODIFIED ACCRUAL BASIS

Agricultural Premium Fund, Road Fund, & Motor Fuel Tax Fund

\$'s in Millions

Agricultural Premium Fund

| | FY 2005 | | FY 2005 Cash Receipts | Attributable to FY 2004 | | FY 2006 Cash Receipts | | FY 2005 |
|-------------------------------|----------------------------------|---|-----------------------|-----------------------------------|---|---------------------------------------|---|-------------------------------|
| | <u>Cash Basis</u> | - | <u>\$'s</u> | <u>% of FY 2004 Cash Receipts</u> | + | <u>Attributable to FY 2005 - \$'s</u> | = | <u>Modified Accrual Basis</u> |
| Estimated Revenue | \$25.1 | | \$0.1 | 0.5% | | \$0.1 | | \$25.1 |
| Estimated Fund Balance | FY 2005 Beginning Balance | | Revenue | | | Expenditures | | FY 2005 Ending Balance |
| Cash Basis | \$8.6 | + | \$25.1 | | - | \$23.8 | = | \$9.9 |
| Modified Accrual Basis | \$8.6 | + | \$25.1 | | - | \$23.8 | = | \$9.9 |

Road Fund

| | FY 2005 | | FY 2005 Cash Receipts | Attributable to FY 2004 | | FY 2006 Cash Receipts | | FY 2005 |
|-------------------------------|----------------------------------|---|-----------------------|-----------------------------------|---|---------------------------------------|---|-------------------------------|
| | <u>Cash Basis</u> | - | <u>\$'s</u> | <u>% of FY 2004 Cash Receipts</u> | + | <u>Attributable to FY 2005 - \$'s</u> | = | <u>Modified Accrual Basis</u> |
| Estimated Revenue | \$2,162.4 | | \$164.3 | 7.6% | | \$164.3 | | \$2,162.4 |
| Estimated Fund Balance | FY 2005 Beginning Balance | | Revenue | | | Expenditures | | FY 2005 Ending Balance |
| Cash Basis | \$117.3 | + | \$2,162.4 | | - | \$2,162.5 | = | \$117.2 |
| Modified Accrual Basis | \$117.3 | + | \$2,162.4 | | - | \$2,162.5 | = | \$117.2 |

Motor Fuel Tax Fund

| | FY 2005 | | FY 2005 Cash Receipts | Attributable to FY 2004 | | FY 2006 Cash Receipts | | FY 2005 |
|-------------------------------|----------------------------------|---|-----------------------|-----------------------------------|---|---------------------------------------|---|-------------------------------|
| | <u>Cash Basis</u> | - | <u>\$'s</u> | <u>% of FY 2004 Cash Receipts</u> | + | <u>Attributable to FY 2005 - \$'s</u> | = | <u>Modified Accrual Basis</u> |
| Estimated Revenue | \$1,351.6 | | \$229.8 | 17.0% | | \$229.8 | | \$1,351.6 |
| Estimated Fund Balance | FY 2005 Beginning Balance | | Revenue | | | Expenditures | | FY 2005 Ending Balance |
| Cash Basis | \$115.0 | + | \$1,351.6 | | - | \$1,405.8 | = | \$60.8 |
| Modified Accrual Basis | \$115.0 | + | \$1,351.6 | | - | \$1,405.8 | = | \$60.8 |

NOTES:

- * The Governor's Office of Management and Budget (GOMB) estimated FY 2005 beginning cash balances are utilized for the Agricultural Premium Fund, the Road Fund, and the Motor Fuel Tax Fund.
- * FY 2005 estimated beginning modified accrual balances were assumed to equal FY 2005 estimated beginning cash balances.
- * Fund balance calculations utilize the GOMB's spending estimates as the IEFC does not formulate estimates of expenditures.
- * Estimates of modified accrual basis spending equal the GOMB's estimates of cash basis spending as FY 2004 and FY 2005 lapse period spending are assumed to be equal.

APPENDIX

Synopsis of Public Act 90-0479, Pertaining to Budget Formulation

Public Act 90-0479, effective August of 1997, requires that the State budget, both underlying revenue and spending estimates, for the following funds be formulated on a modified accrual basis in concert with generally accepted accounting principles (GAAP):

- 1) General Funds;
- 2) Agricultural Premium Fund;
- 3) Road Fund;
- 4) Motor Fuel Tax Fund.

Revenue estimates for a fiscal year are to include:

- 1) the estimated beginning fund balance;
- 2) plus the revenues estimated to be received from July through June of the fiscal year;
- 3) plus receipts due to the state as of June 30 but expected to be collected during the lapse period;
- 4) minus the receipts collected during the first two months of the fiscal year that are attributable to the previous fiscal year;
- 5) plus federal reimbursements associated with State expenditures made in accordance with Section 25 of the State Finance Act.

Spending estimates for a fiscal year are to include:

- 1) expenditures estimated to be made from July through June of the fiscal year;
- 2) plus expenditures estimated to be incurred in the fiscal year but paid in the following fiscal year;
- 3) minus costs paid in the fiscal year which were incurred in the previous fiscal year.

Both revenue and expenditure estimates for a fiscal year are to include all transfers between funds that are based on revenues received or costs incurred during the fiscal year.

The Economic and Fiscal Commission is to prepare revenue and fund transfer estimates in accordance with Public Act 90-0479 each year. These estimates are to be reported to the General Assembly and the Governor.

For other funds not specified in Public Act 90-0479, proposed expenditures and appropriations are not to exceed estimated available funds for the budgeted fiscal year.

BACKGROUND

The Illinois Economic and Fiscal Commission, a bipartisan, joint legislative commission, provides the General Assembly with information relevant to the Illinois economy, taxes and other sources of revenue and debt obligations of the State. The Commission's specific responsibilities include:

- 1) Preparation of annual revenue estimates with periodic updates;
- 2) Analysis of the fiscal impact of revenue bills;
- 3) Preparation of "State Debt Impact Notes" on legislation which would appropriate bond funds or increase bond authorization;
- 4) Periodic assessment of capital facility plans; and
- 5) Annual estimates of the liabilities of the State's group health insurance program and approval of contract renewals promulgated by the Department of Central Management Services.

The Commission also has a mandate to report to the General Assembly ". . . on economic trends in relation to long-range planning and budgeting; and to study and make such recommendations as it deems appropriate on local and regional economic and fiscal policies and on federal fiscal policy as it may affect Illinois. . . ." This results in several reports on various economic issues throughout the year.

The Commission publishes two primary reports. The "Revenue Estimate and Economic Outlook" describes and projects economic conditions and their impact on State revenues. "The Illinois Bond Watcher" examines the State's debt position as well as other issues directly related to conditions in the financial markets. The Commission also periodically publishes special topic reports that have or could have an impact on the economic well being of Illinois.

These reports are available from:

Illinois Economic and Fiscal Commission
703 Stratton Office Building
Springfield, Illinois 62706
(217) 782-5320
(217) 782-3513 (FAX)

Reports can also be accessed from our Webpage:

http://www.legis.state.il.us/commission/ecfisc/ecfisc_home.html