Truth and Integrity in State Budgeting: Objectives

- Identify five key budgeting and financial reporting procedures
- Grade all states’ performance in each area
- Propose best practices for states to follow
- Continue evaluations annually in cooperation with university partners
- Help bolster university teaching of public budgeting and finance
- Encourage further university-based research based on Volcker Alliance research and findings
Drivers of Best Budgeting Practices

• When the Volcker Alliance first began examining state fiscal and financial reporting practices in 2014, we were driven by one question: *What makes up a balanced budget?* That led us in 2015 to report on California, New Jersey, and Virginia, and now, all 50 states.

• Even the nation’s third-longest recovery since 1858 has not warded off fiscal crises for some states. Weak revenue growth challenges states’ ability to pay bills for infrastructure, Medicaid, education, and public worker pensions and retiree health care. Unpaid obligations in these areas probably exceed the $2.2 trillion in annual state revenue.

• Cash-based budgeting allows states to push some costs to future generations to keep budgets balanced in accordance with constitutions, statutes, or traditions.

• Best practices for state budgeting cannot successfully bolster fiscal stability and informed policymaking without political will to adopt and apply them for the long term. Establishing and maintaining strong and transparent budget processes and practices is a concern not only for the states themselves but for the entire economy.
The Volcker Alliance Research Network

Universities
Arizona State
Cornell
CUNY
Fla. International
Georgia State
U of Kentucky
U of Minnesota
U of California-Berkeley
U of Illinois-Chicago
U of Illinois-Springfield
U of Utah

Consultants
MMA
Barrett & Greene

New Research:
- Debt Management
- Transparency
- Infrastructure
- Economic Health

Truth and Integrity in State Budgeting:
Phase II (2018)
The State Fiscal Framework

- Record US recovery; modest, steady growth (GDP +~2.2%/yr)
- Low inflation (CPI +~2.1%/yr)
- Low unemployment (~4%)
- Slowly rising interest rates (10-year Treasuries @ 2.5% ‘17, 3.1% ‘18). Means muni rates may stay low, but tax reform may diminish demand
- Slow revenue growth (~3-3.5%); revenues/GDP ~2005 level of 10%
- Modest spending growth, still < historical 5.5% avg. State infrastructure spending lowest since mid-1990s.
- Budget pressure points: Federal tax bill, Pensions/OPEB, Medicaid, Infrastructure, K-12
- Likely restrictions on new muni debt (issuance $315b in ‘18 vs. $405b in ‘17)

Sources: Volcker Alliance, Bloomberg, Rockefeller Institute of Government, MMA, NASBO, Urban Institute, PNC
The State Fiscal Squeeze

Components of Direct General State Expenditures

- Education
- Health and hospital
- Public welfare
- Other
- Highways

% of GDP

Source: Urban Institute, from US Census data
5 Budgetary Best Practices & Areas of Inquiry

1. Budget Forecasting
   Use a consensus approach to establishing single, binding numbers for revenues and expenditures. Provide long-term estimates. (Example: Washington)

2. Budget Accounting
   Pay for expenditures in the same year they are accrued; avoid deferring them. Shift from cash-based accounting to modified accrual accounting techniques used in state/local CAFRs. (Example: NYC)

3. Legacy Costs (Pensions & OPEB)
   Consistently make contributions actuaries determine to be necessary. (Example: Wisconsin). While some states may find it a crippling burden to fully cover costs of future benefits and past underfunding, they should consider committing to move toward full funding in the future. OPEB plans should be adequately funded to ensure benefits can be paid when bills come due (Example: Utah)

4. Fiscal Reserve Funds
   Enact clear policies for withdrawals from rainy day and other fiscal reserves, as well as rules for replenishing spent funds and tying the size of fund balances to revenue volatility. (Example: Indiana)

5. Transparency
   Construct a consolidated budget website (Colorado). Include full disclosure of cost to replace depreciated infrastructure (Examples: Alaska, California).
Key Findings: Best-Graded States

- **Forecasting:** 9 states graded A
- **Maneuvers:** 22 states graded A
- **Legacy Costs:** 8 states graded A
- **Reserve Funds:** 15 states graded A
- **Transparency:** 2 states graded A

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**2015-17 Average**
Key Findings: Lowest-Graded States

- **Forecasting**: 4 states graded D
- **Maneuvers**: 6 states graded D
- **Legacy Costs**: 9 states graded D-
- **Reserve Funds**: 3 states graded D
- **Transparency**: 3 states graded D
Tax Expenditure Transparency

- Tax breaks may cost states & localities $80-300 billion or more/year. Nevada tax expenditures totaled $41 billion in FY 2016.
- And yet... *Truth and Integrity in State Budgeting* survey shows 11 states did not disclose tax expenditures in FY 2017 as part of budget (AL, AR, IN, IA, MO, MS, NM, ND, OH, SC, WY)
- Utah, Virginia made partial disclosures
- Illinois tax expenditures disclosed by Comptroller (not since 2015); in Texas disclosure by Comptroller in report to governor, lt. governor, and legislature
- Breadth, depth of disclosure varies widely (GA, NJ post exemplary reports)
- No reconciliation with GASB #77 yet
Examples of Tax Expenditures

• Deductions mirroring federal ones (mortgage and business interest, muni bond interest in some states, charitable donations, medical costs, depreciation and other business expenses)
• Senior-citizen property tax rebates; child credits
• Some educational benefits
• Sales-tax rate cuts or exemptions (often enterprise zones, food, clothing, services, prescription meds, purchases by governments and nonprofits
• Economic-development credits/loan guarantees targeting job creation (factories, Amazon warehouses, movie and TV production), R&D credits
• Exemptions/credits for universities, churches, housing creation, historical structure and farmland preservation
• Tax Increment Financing (TIF), in which a builder may receive a rebate and pay only on the added value of a development

Source: Volcker Alliance research
GASB #77: Critical Data but Mind the Gaps

Overview
On Oct. 30, 2014, the Government Accounting Standards Board (GASB) proposed new reporting standards for state and local governments. The proposal, GASB Statement No. 77, is intended to improve transparency and accountability in financial reporting. The proposed standards aim to ensure that governments provide comprehensive and comparable financial information to taxpayers and other stakeholders.

GASB Proposes New Reporting Standards for State and Local Governments
February 17, 2015
American Cities Project, Economic Development


GASB Statement No. 77 of the Governmental Accounting Standards Board

GASB 77 Response to Decrease in Tax Abatement Agreements

The tax codes of federal, state, and local governments contain many provisions that give taxpayers a “tax break” based on something that the taxpayer does or agrees to do. “Tax expenditures” are revenues foregone. If not disclosed in financial statements, the economic plight of a community or state might be further weakened. GASB 77 requires the disclosure of tax expenditures through the new standard. GASB 77 is a critical piece of the larger puzzle of understanding how reduced revenue affects the financial condition of an entity. GASB 77 is effective for financial periods beginning after December 31, 2015. The Office of the State Auditor (OSA) will continue to issue guidance on this critical topic as the time for implementation approaches.

How Will GASB 77 Data Be Used?

Tax expenditures usually come about because lawmakers want to encourage a “tax break” that may reward companies that create jobs, attract new consumers, or encourage other behavior. However, New Mexico has yet to engage in a complete tax expenditure inventory and the need for such an inventory is becoming increasingly apparent. The most recent effort—understandably, with a tax break in works to create its intended effect—is a more complex, but...
GASB Statement No. 77 Defined

• A step toward standardized disclosure in Comprehensive Annual Financial Reports (CAFRs) so that journalists, taxpayers, planners, and investors can benchmark programs. GASB 77 is for fiscal years beginning after 12/30/15

• Statement No. 77 defines a tax abatement and contains required disclosures about a reporting government’s own tax abatement agreements and those agreements that are entered into by other governments and that reduce the reporting government’s tax revenues.

• Not every tax break is included! GASB 77 requires disclosure of abatements when there is an agreement between a specific entity and the government. Many breaks are general. Sometimes disclosure is a matter of interpretation.
GASB #77 Required Responses

• Purpose of the tax abatement program
• Tax being abated and dollar amount
• Provisions for recapturing abated taxes
• Commitments made by tax abatement recipients
• Other commitments made by a government in tax abatement agreements, such as to build infrastructure assets
• What other governments’ tax abatements may cost a city or county in foregone tax revenue. Disclosure includes name of the government entering into the abatement agreement, tax being abated, and how much

A Note on *Truth and Integrity* Methodology

The Volcker Alliance joined with professors and students in public finance and budgeting programs at eleven US universities who answered a standardized set of research questions on budget procedures. University research network gathered data from a variety of sources, interviewed current and former state budget and financial officials, and examined budget documents and financial disclosure filings. Responses to questions were reviewed by faculty advisers at the universities and Alliance consultants and revised, if necessary. Responses were then reviewed and normalized to account for any discrepancies among researchers’ findings. The focus on states’ adherence to best practices, combined with the normalization process, resulted in a relatively high level of comparability among the fifty states’ budgetary performance.

States received a grade ranging from A to D-minus for each of the five budget categories for fiscal 2015, 2016, and 2017. Every state’s average category score over the period was used to determine a three-year average grade. Sustained improvement or decline in a state’s score over the three fiscal years was used to identify trends in budgetary performance in each category:

**Budget Forecasting** was graded on five indicators, each representing 20% of the category score. We asked if a state used a consensus revenue forecast; employed a reasonable rationale for revenue growth projections (based on historical revenue and economic growth trends); successfully avoided having to make a negative midyear budget adjustment; and produced multiyear revenue and expenditure forecasts.

**Budget Maneuvers** was graded on a state’s use of one-time actions to create short-term budget fixes. States received 25% of the category grade for each type of one-time budget maneuver they successfully avoided. They included funding recurring expenses with debt; funding recurring expenses with the proceeds of asset sales or by tapping future revenues; deferring a current year’s recurring expenditures; and covering general fund expenditures with transfers from other funds.

**Legacy Costs** was graded on a state’s willingness to meet public employee pension and OPEB obligations. Thirty percent of a grade was determined by a state’s making its OPEB actuarially required or determined contribution. Seventy percent of the category grade was scored on whether the state made its pension ADC or ARC contribution and on its pension funding ratio as of 2015, which represents the amount of assets available to cover promised benefits.

**Reserve Funds** was graded on a state’s performance on four equally weighted budget indicators: If a state had a reserve fund disbursement policy; existence of a reserve fund replenishment policy; if reserves were tied to historic trends in revenue volatility; whether there was a positive reserve or general fund balance at the beginning of each fiscal year.

**Transparency** was graded on the extensiveness and usefulness of a state’s fiscal disclosure practices. States received 25% of their grade for each of four transparency measures: providing the public with a consolidated budget website; disclosing outstanding debt and debt-service cost tables; providing information on deferred infrastructure maintenance costs; and providing cost estimates for tax expenditures.
Discussion and Questions