Requested Budget Issues:

A Report on Restricted Fund Balances and Revenue Transfers

September 17, 2002

A Report to the Executive Appropriations Committee
Of the Utah State Legislature

Prepared by
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Executive Summary

Restricted accounts are established to ensure that specific revenue streams are used to fund specific programs. Since the last major fund consolidation effort in 1967, the number of funds have grown from ten to more than 120.[1] Restricted funds limit flexibility, but in many cases this limitation is appropriate to ensure that specific revenue sources are dedicated to the projects that directly impact those paying a tax, fee or surcharge.

A perception exists that agencies receiving restricted funds are treated differently than general revenue agencies in the budget process. If true, this may be a two-edged sword that insulates agencies in times of budget difficulty while keeping them from sharing in new funds available during times of revenue expansion. Even though agencies with restricted funds may seem to be treated differently in the budget process, the Analyst does not find any additional budget flexibility in restricted fund agencies.

Another revenue source "Revenue Transfers" has been used in the past, but it has not been used consistently. Over the last five years the Legislature and its staff have streamlined the use of Revenue Transfers but never adopted a formal definition to guide the process. The Analyst is concerned that the lack of statutory definition of Revenue Transfers lends ambiguity to the Budgetary Procedures Act and makes it difficult to compile historical data. It may also allow given line items to exceed appropriated Revenue Transfer levels and enable agencies to increase programs and personnel without appropriate Legislative approval.

Recommendation One

The Legislative Fiscal Analyst recommends that the Executive Appropriation Committee direct budget subcommittees to closely consider balances and expenditures in restricted funds prior to presenting committee recommendations for funding. The Analyst further recommends that, where appropriate, the Legislature consider placing statutory caps on unencumbered balances in restricted accounts.

Recommendation Two

The Analyst recommends that Legislative staff, the Governor's Office of Planning and Budget, and the Division of Finance develop an acceptable definition of Revenue Transfers to be considered in the next General Session of the Legislature.

Recommendation Three

The Analyst recommends that the Legislature and Executive Branch investigate on a case-by-case basis Revenue Transfers that are generated by "internal service" and propose creation of new Internal Service Funds or new rates in existing Internal Service Funds to properly account for such transactions.

[1] Pratt, Spencer. (October 17, 200) *Funds Consolidation*. Office of the Legislative Fiscal Analyst.

Recommendation Four

The Analyst recommends that the definition of Revenue Transfers limits, where appropriate, future instances in which agencies use transfers to increase programs and personnel. The Analyst further recommends that Legislative appropriation subcommittees review Revenue Transfers on a case-by-case basis to determine those occasions in which Revenue Transfers would be more properly characterized as reallocations. In such cases, the Analyst recommends that subcommittees submit to the Executive Appropriations Committee negative appropriations from one or more line items and equally offsetting positive appropriations in other line items.

Introduction

In balancing the FY 2002 and 2003 budgets, the Legislature relied heavily on budget reductions, position eliminations, conversion of capital cash to bonds and use of one time sources that may not be generally available for ongoing appropriation. In April of 2002 the Executive Appropriation Committee requested information on agency reserve accounts and asked for ways in which these balances can be reported. Beginning with this report, the Legislative Fiscal Analyst will regularly report on fund balances in restricted accounts and provide information on how transfers impact budget expenditures.

In response to a Legislative Fiscal Analyst Report during the 2000 interim, the 2001-2002 Legislature eliminated eight funds that were statutorily established but were no longer needed. Other funds remained, but balances in those funds came into question as revenue faltered and General Fund/Uniform School Fund budgets were cut to meet the Constitutional requirement of a balanced budget.

In the October, 2000 report the Analyst listed the following advantages and disadvantages of consolidating restricted funds.[2]

Advantages of Consolidation

- Fewer Funds to understand and handle;
- Better able to control growth of government programs;
- Decrease inequity between "General Fund" agencies and "Non-General Fund" Agencies;
- Funding for State Agencies would be more stable.

Disadvantages of Consolidation

- The General Fund would become the funding base for more programs
- State agencies' collection efforts may not receive the same level of emphasis;
- Restricted Funds allow the isolation of assets;
- Agencies would have less flexibility in increasing program expenditures;
- Agencies could encounter problems with groups for whom they provide services;
- Fee changes may be considered tax increases.

Some funds (such as Dedicated Credits) are considered "non-binding" and may be expended in amounts that exceed appropriated amounts if collections are higher than expected.[3] Federal Funds are also considered non-binding, as the Federal and State government are on different fiscal years and state agencies cannot precisely estimate every Federal grant or program size.

[2] *Ibid*. The report offers an explanation for each advantage/disadvantage.
[3] Dedicated Credit expenditures are limited to one-hundred twenty-five percent of the appropriated amount.

A misperception that restricted funds are "non-binding" may be due to Utah's focus on balancing general revenue. Budget procedures in both the Executive and Legislative Branches concentrate on balancing the three major tax funds – Uniform School Fund, General Fund and Transportation Fund. Yet, even though they are not necessarily a primary focus for the purpose of balancing, restricted funds are binding for purposes of expenditure – agencies may not exceed appropriations in any restricted fund category.

Perhaps because it is not yet defined in law, the funding source known as "Revenue Transfers" is also treated a non-binding. Depending upon its definition, it may be subject to appropriated limits, or may be allowed to exceed those limits. Regardless of its categorization, the use of Revenue Transfers as a financing source may unintentionally allow movement of state funds across established line items. It also may allow agencies to increase governmental programs without prior approval by the Legislature.

In responding to a request from the Executive Appropriation Committee regarding fund balances, the Analyst in this report asks the following questions:

1. How much money is carried forward in Restricted Accounts?
2. Do agencies with restricted funds have more flexibility in establishing budget priorities?
3. Do "Revenue Transfers" create ambiguity in regard to statutory budget controls?

How much money is carried forward in Restricted Accounts?

At the end of each fiscal year the Division of Finance calculates carry forward balances for all restricted funds. In aggregate there is more than $157 million left in the various accounts to begin FY 2003. The money is spread over three funds and located in 94 different accounts that are tied to specific statutes that define how the money may be used. Fund balances vary greatly – from as little as $40 in the Mineral Bonus Account to more than $23.3 million in the Transportation Corridor Preservation Revolving Loan Fund. A full listing of account balances is provided in Appendix A.

FY 2002 Restricted Fund Balances and Expenditures

	Fund Balance	Expenditures
General Fund Restricted	$113,132,112	$231,211,987
Uniform School Fund Restricted	228,927	3,565,276
Transportation Fund Restricted	49,833,373	80,265,453
	$163,194,412	$315,042,716

Source: Division of Finance, Utah Department of Administrative Services

Balances can not be equated with "free revenue"

The fact that there is a carry-forward balance is not an indication that there is "free" one-time revenue available. As stated above, statute directs the use of each account and it would take a statutory revision to eliminate the fund and the program. Furthermore, many accounts are tied to specific user fees. If the program were eliminated the money would revert to the users and not the General Fund.

Some funds show low expenditures in relation to fund balance. For many accounts there are legal, regulatory or statutory reasons to maintain large balances (i.e., payments may not be due for several years or expenditures may be limited to interest earnings). However, the Legislature through its appropriation process should analyze these funds to ensure that balances are appropriate for the purpose that the fund is designed to serve. The table below shows a sample of funds that may have large balances for FY 2003 but do not necessarily provide revenue for future general appropriation.

Fund	Legal Name	Fund Balance	Expenditures	Difference
85	Factory Built Housing Fees Account	$199,355	$84,549	$114,806
161	Petroleum Storage Tank Restricted Account	$202,432	$22,332	$180,100
142	Drug Forfeiture Account	$179,370	$0	$179,370
99	Tourism Marketing Performance Fund	$200,000	$0	$200,000
198	Homeless Trust Account	$572,468	$131,960	$440,508
166	Sovereign Lands Management Account	$3,599,676	$1,568,100	$2,031,576
87	Cigarette Tax Restricted Account	$1,258,502	$250,000	$1,008,502
172	Wildlife Resource Trust Account	$1,193,752	$69,926	$1,123,826
170	Stripper Well - Petroleum Violation Escrow	$1,668,751	$108,276	$1,560,475
151	Youth Corrections Victim Restitution Account	$2,604,887	$500,000	$2,104,887
152	Trust Fund for People With Disabilities	$2,372,964	$200,000	$2,172,964
79	Airport to University of Utah Light Rail Restricted Account	$1,983,080	$0	$1,983,080
196	CDBG Loan Advances	$3,440,895	$0	$3,440,895
185	Exxon Oil Overcharge	$7,215,760	$1,120,150	$6,095,610
92	Special Administrative Expense Fund	$8,774,801	$1,168,577	$7,606,224
293	Public Transportation System Tax Highway Fund	$10,767,406	$938,815	$9,828,591
195	Industrial Assistance Fund	$20,372,417	$3,450,751	$16,921,666
289	Transportation Corridor Preservation Revolving Loan Fund	$23,329,137	$2,228,421	$21,100,717

Source: Division of Finance, Utah Department of Administrative Services

Recommendation One

The Legislative Fiscal Analyst recommends that the Executive Appropriation Committee direct budget subcommittees to closely consider balances and expenditures in restricted funds prior to presenting committee recommendations for funding. The Analyst further recommends that, where appropriate, the Legislature consider placing statutory caps on unencumbered balances in restricted accounts.

Do agencies with restricted funds have more flexibility in establishing budget priorities?

Since restricted funds are required by statute to be used for specific programs within specific departments the ability of the Legislature to direct use of these funds is limited. Given the wide array of restricted fund types, it is impossible to generalize about flexibility. It could be argued that during the budget trimming work for FY 2002 and 2003 Restricted Fund Agencies did not see as large a reduction in their budgets as most state agencies.[4] It can also be argued that Restricted Fund Agencies grew more slowly during the expansion of the 1990s and, in some cases, actually shrank during that time as General Fund appropriations were replaced with anticipated restricted funds.

However, some funds seem to allow agencies more flexibility because they have such a large base funding amount. In particular, the Liquor Control Fund and Commerce Service Fund seem to offer wide latitude in appropriating funds. Since surpluses in these accounts roll into the General Fund following budget requests and estimates of income, it may be easier for agencies funded through these accounts to increase personnel or enhance programs without appearing to impact the General Fund.

Do "Revenue Transfers" create ambiguity in regard to statutory budget controls?

The three branches of state government have implemented and upheld statutory budget controls to assure "checks-and-balances" over expenditure of taxpayers' money. Specifically, law limits the Executive Branch from spending funds intended for one purpose or activity on another unrelated purpose or activity. However, the Legislature has also appropriated "Revenue Transfers" between certain agencies for specific purposes. The Legislative Fiscal Analyst has found that, in some cases, such transfers may unintentionally weaken statutory budget controls.

Each year in various appropriations acts, the Legislature includes Revenue Transfers that move specified amounts of money from one item of appropriation to another. As is demonstrated in Figure 1, the use of Revenue Transfers has been increasing, and therefore, merits further exploration.

For FY 2003, Revenue Transfers exceeded $250 million state-wide. A large part of this is related to Medicaid and other federal programs, as noted below.

[4] A similar argument was made regarding Internal Service Funds.

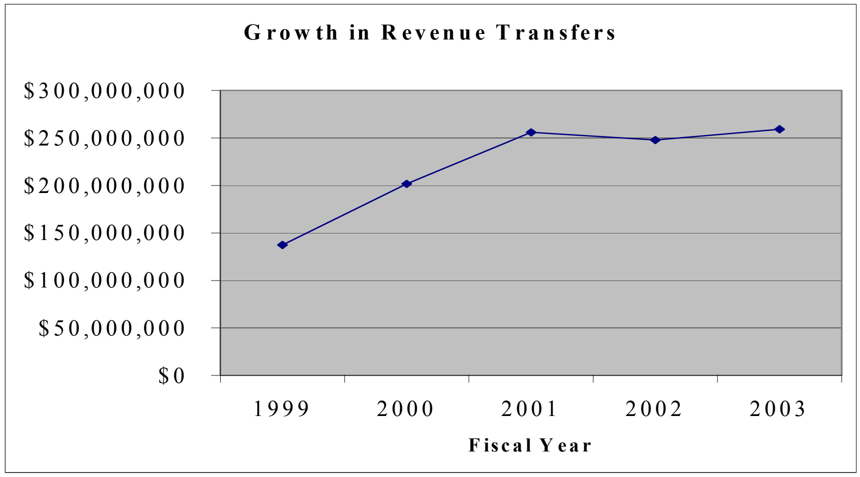


Figure 1[5]

Revenue Transfers Are in Some Cases a Useful Accounting Tool

The use of Revenue Transfers is not in itself alarming. As the money is appropriated by the Legislature, enacted by the Executive, and at least tacitly approved by the Courts, it does not undermine governmental checks and balances.

The bulk of Revenue Transfers involve federal funds. For example, various Medicaid-eligible services are provided by the Department of Health, University of Utah, and the Department of Human Services, among others. Federal regulations require that the State identify one state entity with which federal agencies will interact. The Department of Health is Utah's fiscal agent under the Medicaid program. Agencies other than the Department of Health that provide Medicaid-eligible services use their own General Fund appropriations as the state seed for the federal Medicaid match. They do this using Revenue Transfers to allocate some of their General Fund appropriations to the Department of Health, which uses the funds to draw down the matching federal funds, and then transfers the total back to the original agency.

The management of federal funds in a way that benefits state and local government is not of immediate concern to the Legislative Fiscal Analyst. What is of concern is the lack of a legal definition for Revenue Transfers, which complicates tracking historical data, inflates the actual size of the total state budget, facilitates unintended reallocation of funds across line items, and potentially allows increases in the size of state government without Legislative approval.

No Legal Definition of Revenue Transfers Exists

The Budgetary Procedures Act (BPA) and the Revenue Procedures and Control Act contain consistent definitions of revenue types. Neither explicitly defines Revenue Transfers.

[5]Figure 1 shows almost all of the growth in Revenue Transfers occurring in the fiscal years 1999 through 2001. These are the years for which the State has "actual" expenditure data. The data for FY 2002 represent estimated expenditures prior to June 30, 2002. The figures for FY 2003 are as appropriated by the Legislature. The Legislative Fiscal Analyst anticipates that actual data will reflect an even greater increase in the transfer of funds across line items once fiscal year accounts are closed.

Section 63-38-9 of the Budgetary Procedures Act delineates four major revenue types: restricted revenue; fixed collections; free revenue; and dedicated credits. As discussed later, each type is treated differently in statute and in practice.

The BPA's definitions of restricted revenue and fixed collections are rather narrow and do not seem to relate to Revenue Transfers.

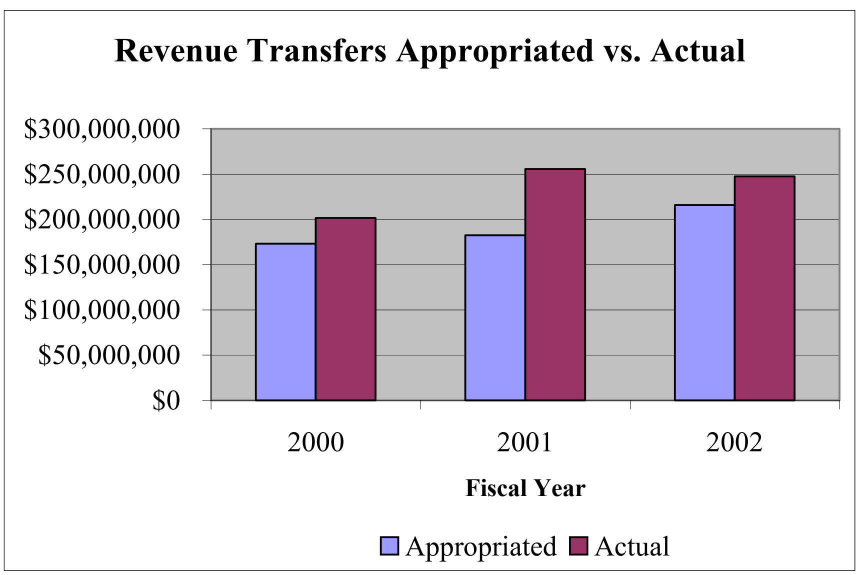
In its designation of free revenue, the BPA states that "free revenue includes…collections that are not otherwise designated by law."[6] Given that Revenue Transfers are not defined by law, it seems that "free revenue" may be a logical revenue type in which to categorize them.

On the other hand, statute also states that "free revenue includes:…collections that are not included in an approved work program."[7] In many cases, Revenue Transfers are included in approved work programs. Whether or not this excludes them from the free revenue type is unclear.

In practice, the State Division of Finance treats Revenue Transfers as if they fell into the dedicated credits revenue type. This further complicates one's understanding of Revenue Transfers given that a majority of Revenue Transfers involve federal funds and their related state match, and given that "dedicated credits", as defined by law, "does not mean: federal revenues and the related state match paid by one agency to another."[8]

Revenue Transfers Exceed Appropriation

As demonstrated in Figure 2, the State, in the past three years, has used more Revenue Transfers than was appropriated. As noted previously, a majority of these transfers serve a legitimate purpose for government operations. However, it appears that the ambiguous definition of Revenue Transfers has led agency money managers to conclude that revenue transfer appropriations are guidelines that can be exceeded without Legislative approval.



[6] UCA 63-38-9(3)(a)
[7] *Ibid*.
[8] UCA 63-38a-102(2)(b)

Figure 2: The bulk of transfers are Federal Funds.

If Revenue Transfers are to be categorized as free revenue, the Budgetary Procedures Act clearly states that "an agency may expend free revenue up to the amount specifically appropriated by the Legislature."[9] Thus, Revenue Transfers in excess of appropriation is inconsistent with law.

If Revenue Transfers are categorized as dedicated credits, agencies may expend such funds in excess of the amount appropriated by up to 25% of the amount appropriated.[10] As such, the mere expenditure in excess of appropriation is not inconsistent with statute.

Recommendation Two

The Analyst recommends that Legislative staff, the Governor's Office of Planning and Budget, and the Division of Finance develop an acceptable definition of Revenue Transfers to be considered in the next General Session of the Legislature.

In Some Cases, Internal Service Funds More Adequately Control Inter-agency Transactions

Beyond federal matching activities, Revenue Transfers are also utilized in cross-agency service provision. In these cases, money is moved from one line item, in exchange for a product or service, to another line item.

The Budgetary Procedures Act states that "it is the intent of the Legislature to limit the amount of money to be expended from each appropriations item for certain specified purposes."[11] To assure such limitation, the Act mandates that "an appropriation or any surplus of any appropriation may not be diverted from any department, agency, institution, or division to any other department, agency, institution, or division."[12] It further states "monies may not be transferred from one item of appropriation to any other item of appropriation."[13]

Lacking a definition of Revenue Transfers, it is difficult to ascertain whether Revenue Transfers for the purpose of cross-agency transactions violates the provisions of the BPA noted above.

However, a more legitimate vehicle for the cross-agency transactions is an Internal Service Fund (ISF). In fact, an Internal Service Fund is defined as "an agency that provides goods or services to other agencies of state government or to other governmental units on a capital maintenance and cost reimbursement basis, and which recovers costs through interagency billings."[14] Statute contains controls on Internal Service Funds, but does not address Revenue Transfers.[15]

[9] UCA 63-38-9(3)(c)
[10] UCA 63-38a-104
[11] UCA 63-38-3(2)(a)
[12] UCA 63-3-3(2)(c)
[13] UCA 63-38-3(2)(f)
[14] UCA 63-38-3.5
[15] See Allred, Steve, et al. (August 2002) *Internal Service Funds Cost Structure & Budget Impacts*, Report to the Executive Appropriations Committee. Salt Lake City: Office of the Legislative Fiscal Analyst

Recommendation Three

The Analyst recommends that the Legislature and Executive Branch investigate on a case-by-case basis Revenue Transfers that are generated by "internal service" and propose creation of new Internal Service Funds or new rates in existing Internal Service Funds to properly account for such transactions.

Revenue Transfers Are Used to Increase or Create New Programs

As stated earlier, current statute limits the expenditure of free revenue to the amounts distinguished in appropriated line items. While statute allows an agency to expend dedicated credits in excess of appropriation, excess dedicated credits may not be used to "permanently increase personnel within the agency."[16] Statute also limits movement of funds across line items without Legislative approval.

Yet, the Analyst found limited cases in which the use of Revenue Transfers has allowed executive agencies to reallocate funds across line items, create new government programs, and increase government personnel without assumed checks and balances.

Chief Information Officer (CIO) May Use Revenue Transfers to Add New Deputies

In an August 2 "Dear Colleague" letter, Governor Leavitt announced the consolidation and reorganization of executive branch information technology personnel and structures. As part of this reorganization, the Governor stated that "the following organization changes will be implemented by September 1, 2002... Create Deputy CIO (DCIO) for IT Position…Create Deputy CIO for eGovernment Position."[17] Position descriptions for these new personnel are posted on the Department of Human Resources web site with an hourly wage of as much as $48.

These two new high-level state government officials' combined annual salary and benefits costs will exceed one quarter of a million dollars. According to initial indications from Executive Branch officials, funds for these new positions would be generated by an assessment on other state agencies -- an assessment that is predicated on the appropriation of "Revenue Transfers" to the Governor's Office. Subsequently, on September 13, the CIO indicated these may be two half time positions, funded by vacancy savings.

Administrative Services Used Transfers to Fund Internal Auditors

In another example, the Department of Administrative Services (DAS) created within its Executive Director's Office a team of internal auditors. The positions were funded through Revenue Transfers from Internal Service Funds (ISF). The use of Revenue Transfers, treated as dedicated credits, circumvented appropriated caps on free revenue. Hiring ISF-related positions in an appropriated agency avoided legislated limits on Full Time Equivalent Employees in ISFs.

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[16] UCA 63-38-9 and 63-38a-104

[17] The entire letter can be found at Appendix C.

As stated in an earlier report on Internal Service Funds, the Legislature has attempted to address this example.[18] The chairs of the Capital Facilities and Administrative Services appropriation subcommittee requested that such transfers be clearly reported as part of the annual budget process. However, this solution relies upon a clear definition of Revenue Transfers.

Again, lacking a statutory definition of Revenue Transfers it is difficult to argue that the actions described above conflict with the Budgetary Procedures Act. If Revenue Transfers are treated as free revenue, and the above actions increase expenditure of free revenue beyond the level appropriated to a given line item, the actions would appear contrary to law. If Revenue Transfers are treated as dedicated credits, and the above actions spend such dedicated credits in excess of the appropriated level, and they permanently increase personnel, the actions also appears to clash with the Budgetary Procedures Act.

However Revenue Transfers are categorized, the examples described above did not allow for Legislative participation. A more apposite approach may have been to reallocate funds, through a legislated appropriation, from one line item to another. This approach would avoid confusion over Revenue Transfers and allow full participation by all three branches of government.

Recommendation Four

The Analyst recommends that the definition of Revenue Transfers limits, where appropriate, future instances in which agencies use transfers to increase personnel. The Analyst further recommends that Legislative appropriation subcommittees review Revenue Transfers on a case-by-case basis to determine those occasions in which Revenue Transfers would be more properly characterized as reallocations. In such cases, the Analyst recommends that subcommittees submit to the Executive Appropriations Committee negative appropriations from one or more line items and equally offsetting positive appropriations in other line items.

Conclusions

The Analyst concludes in this report that, while the number and size of restricted funds has increased, each restricted fund must be considered separately in determining whether balances at a given point in time are appropriate. The Analyst further finds that agencies receiving appropriations from restricted funds may grow more than tax fund agencies during periods of revenue contraction, but also do not grow as rapidly in times of expansion. Finally, the Analyst concludes that the lack of a legal definition of Revenue Transfers introduces unnecessary ambiguity into the budget process, and may limit the Legislature's participation in decisions regarding the size and structure of state government.

[18] See Allred, Steve, et al. (August 2002) *Internal Service Funds Cost Structure & Budget Impacts*, Report to the Executive Appropriations Committee. Salt Lake City: Office of the Legislative Fiscal Analyst