ILLINOIS BUDGET TRANSPARENCY PROJECT

The governor and general assembly of the state of Illinois have the obligation of balancing the budget every year. Using deficient accounting and budgeting techniques, the state annually evades that responsibility. This report investigates the state's responsibility to report to citizens, the means and manner used to elude its responsibilities and the state's resulting fiscal condition. It reports consensus on elements that should be included and excluded in the state's annual budget and the development of new legislation that would require the governor to report the full accrual implications of the annual budget proposal.

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I. EXECUTIVE SUMMARY

This Institute for Truth in Accounting study is a result of the Institute's interest in our home state's budgeting and accounting processes and an anonymous donor's interests in examining the notion of public sector transparency, generally. It reports how the state of Illinois plans its expenditures through the budgeting process and to a smaller degree how it reports the results to the public in its Comprehensive Annual Financial Report. With its focus on accounting, it is the Institute's opinion that society makes the best decisions when public policy choices are informed by facts supported by truthful financial reporting.

The compelling reason for this study comes directly from our continuing work on state budgets. This study greatly expands the scope of inquiry that the Institute began with its earlier report, The Myth of Balanced Budgets: a Fifty State Study which was released in 2009. That work found that all but one of the states has some form of a balanced budget requirement but nearly all of them spend more than they receive in revenues. Illinois is a particularly pointed example suffering from what is arguably the worst financial condition of any of the states and a worthy target to study.

As foundation we searched for the antecedents of transparency finding them in The Declaration of Independence and the Constitution of the United States. Our founders realized that the public must have dependable information for a self-governing nation to succeed. This duty to hold itself accountable to the public extends to states and municipalities and becomes ever more important as government takes an ever-larger share of the economy.

Specific findings of the study include:

- The duty of government to operate transparently is a functional requirement of a self-governing society. Nevertheless, transparency, by itself, is no guaranty of accountability.
- We believe the Illinois Constitution's limit on spending is intended to promote intergenerational equity.
- Accounting principles available only to governments (and prohibited in the private sector by government) are woefully anachronistic given the missions Illinois has undertaken and the benefits it has promised its employees. These are the tools of opacity.
- Budgeting practices as well as elastic definitions of "funds available", revenues, expenses and even the passage of time are the means and manner by which Illinois' governors and General Assemblies have systematically evaded their responsibility to posterity. This has covered up more than $100 billion in unfunded liabilities.

- The Government Accounting Standards Board is not as independent as it should be and should lead the move to better accounting principles.
- There is little a citizen can do to force Illinois' politicians to act more responsibly.

These disturbing findings obliged the Institute to examine potential remedies. The first step was to assemble a panel of individuals representing a wide range of social and political interests to determine what consensus there might be on the components of a transparent budget. We found a great deal of agreement between the parties and surprisingly, comports with our views as accountants. This effort became the groundwork for the development of a new approach to governmental accounting that we have named Full Accrual Calculations and Techniques (F.A.C.T.SM)-based accounting. It is a common sense, multi-point program to more truthfully assess public sector budgeting and reporting processes. It can be applied to any public sector entity.

Another outcome of the study was the creation of model legislation that used the Institute's expertise to educate legislators and other interest groups to create and support the "Truth in Accounting Act of 2010" which was introduced into the Illinois General Assembly. While the proposed legislation attracted 19 sponsors it did not reach a floor vote. The bill was re-introduced in the current legislative session as House Bill 3231 and we hope for a better outcome.

The study also set in motion an outreach effort known as the Fiscal Information, Standards, Concepts and Laboratory (F.I.S.C.A.L) Tour which the Institute is developing and seeking funding to expand. The tour recognizes there is a wide variance of understanding about deficient budgeting and accounting ranging from command of the subject to literal innumeracy. The Tour presents history and answers for legislators, the media and interested citizens. The first Fiscal Tour will occur in New Jersey in May 2011, visiting four cities and will be a joint effort of the Institute and local partners. In the meantime, we have presented grant requests to other interested parties and foundations to bring the tour to other states.

At the conclusion of this project, we become more convinced that transparency is a first but necessary step to more accountable government. Budgeting and accounting principles that are designed to work together so that intent and results are transparently produced and usefully comparable. This should be the minimum standard that government applies to itself.

The Institute would like to thank those who participated in the budget consensus process. Their names appear in the Consensus Report, included in the appendix.

May 5, 2011

PART I

I. INTRODUCTION

Over the last several years, Americans in every state have come to recognize that governmental entities at all levels are financially declining or even failing. Individuals and organizations have responded with calls for wider disclosure of governments' financial information in more detail, including checkbook registers, employment specifics and contract details. Collectively the goal of these social movements is to increase public sector "transparency". The objective of transparency is to secure more information that will penetrate the perceived opacity of existing public sector financial reporting. Concerned citizens have petitioned their governments to become more forthcoming with their financial data. Advocates believe that exposing the raw, un-summarized data will attract the attention of the public which will, in turn, scrutinize the operations of the public sector and uncover the reasons for its financial woes.

Governmental entities have always been subject to extensive financial reporting requirements. What's becoming apparent to citizens, the media and creditors, however, is the notion that the existing financial reporting systems and the financial statements they produce are not adequately disclosing the governments' true financial positions. In other words an increasing number of citizens believe that the financial information states and localities produce is not only uninformative but may also be objectively wrong. Some also believe that the budgeting policies and accounting systems are designed to actually mislead the public and evade constitutional and statutory "balanced budget" requirements.

Activists advocating transparency have met with varying degrees of success in prying the check registers and employee rosters from state and local governments. Missouri is a notable success, releasing its information transparently and inexpensively. This was accomplished by then-governor Roy Blunt who used an executive order to make Missouri the first state to do so. Across the Mississippi River in Illinois grass roots activists have worked hard with some success to mount a "bottom up" campaign to convince governmental units to release their data. The champion of this effort, Adam Andrzejewski, leveraged his transparency work and ran for governor on what might be called the "Transparency Platform" of "every dime, on line, in real time".

What those demanding more information are saying is that they do not trust their governments to transmit information, which is sufficient to judge either the finances or the stewardship elected officials are exercising. The Institute for Truth in Accounting has reason to agree. Our recent publication *The Truth About Balanced Budgets: A Fifty State Study* (the Fifty State Study)[i] showed that citizens have reason to be worried. Despite the fact that all states, except

Vermont, have "balanced budget" requirements in their constitutions or statutes, the idea that the states actually balance their budgets in any meaningful way is largely a myth.

In addition to the myth of balance, the Fifty State Study revealed a number of systematic shortcomings in state-level accounting practices used to prepare Comprehensive Annual Financial Reports (CAFRs). Among these are their tardiness and "accounting gimmicks" which, while completely within generally accepted accounting principles (GAAP) for state and local governments, seem to be designed to obscure financial conditions rather than illuminate them. The tardiness of CAFRs limits their usefulness. In fact the Illinois CAFR is usually issued more than a year after the close of the fiscal year reported. This means the subsequent fiscal year has passed and the next one has already started. For example the Illinois CAFR for fiscal year (FY) 2008 was not published until the FY2010 period had already started.

Another observation the Institute made while producing the Fifty State Study was the importance of the state budget process. It is the principal vehicle through which the state legislatures and governors annually allocate resources. This spending plan, which results from the budget process, will eventually be reported in the CAFR. Given the accounting shortcomings we found in the CAFRs and the bad financial news most of them contain, it was evident that a look into the budget process was in order. Given the fact that the Institute is located in Illinois and our state's reputation of having one of the worst financial conditions in the nation, we approached a donor, who wishes to remain anonymous, to support a study of the transparency of the budgeting process of the state government of Illinois.

Due to the tardiness of the Illinois CAFR we chose FY2008 as our exemplar because it was the latest available. Initially our proposal included the examination of the budget and a survey of the process shortcomings. When we began our work, it quickly became evident that a larger commitment of both time and money was required to do the project justice. Therefore we expanded the project's objectives to include:

- An examination of the accounting considerations and the long-running debate among government accountants on the role and relationship between budgeting and financial reporting.

- The establishment of the duty of governments, including the state of Illinois, to report its activities to its citizens. It is the Institute's opinion that public policy decisions must be based on the best and most accurate information possible. This starts with the governor and general assembly constructing a budget in a transparent and truthful manner.

- A review of other civic organizations' work. The Institute is aware of the fine work that other civic organizations have undertaken to measure the fiscal hole Illinois has dug for itself. At first glance these studies indicate that it is ludicrous to believe that our state budget meets any possible definition of "balance" and we will use this estimable work to understand how far Illinois has missed balancing its budget.

- An investigation of the reasons the state has come to find itself in its current financial position, especially with respect to the legislature's budgeting process. This will focus on and test our premise that accounting principles are used to obscure the state's true financial position.

- The determination of the revenues and costs that should be included in the preparation of the state's budget to more accurately reflect its true financial implications.

- Suggestion of remedies to the problem that would apply to the specific situation in Illinois and to other states with a branded, model legislative approach.

This expansion of the original scope necessarily increased the time required to complete the project, especially with respect to the development of remedies. The additional costs have been—and continue to be borne—by the Institute for Truth in Accounting.

The accomplishments of the project include:

- The discovery of accounting techniques that have produced one of the largest accumulated deficit of any state in the United States;

- A consensus of the revenues and expenses that should be included in a "proper" budget;

- A new FACT based approach to the state's budgeting process; and

- Authorship of the legislation that has been introduced into the Illinois general assembly. This legislation would require the governor to prepare full accrual estimates of the budget. In the 2010 legislative session the legislation, titled the Truth in Accounting Act of 2010, attracted 19 sponsors including 17 Republicans and two Democrats in the Illinois House, but was not adopted. A new version, improved by legislators' and others' suggestions, was introduced in the 2011 legislative session as the Long-Term Accounting Act of 2011. In addition, the legislation was modified and introduced into the Florida general assembly.

II. THE DUTIES OF GOVERNMENT TO REPORT

A. DISCLOSURE AS THE BASIS OF SELF-GOVERNANCE

The duty of a political jurisdiction to report its activities is a central pillar of self-government. Our country's founders recognized this necessity. Thomas Jefferson observed that an informed electorate is a required ingredient of a democracy. One of Illinois' former congresswomen, Melissa Bean, is reported to have said "Mr. Speaker, democracy works best when the American electorate is engaged and informed." [ii]

Recently essayist Christian Camerota, writing on the First Amendment, made this observation:

> *"Democracy, after all, is about self-government and demands that its populace elect, monitor and replace its representatives as it deems necessary. In such a society, the value of information is paramount because information empowers a citizenry to assess its government and ensure it remains accountable and effective."*[iii]

The Association of Government Accountants (AGA) has twice surveyed the public's attitude towards the financial information that local, state and federal governmental entities produce. The latest survey, conducted in late 2009 by Harris Interactive, confirmed earlier findings that the "public believes overwhelmingly that government officials should be accountable to citizens about financial management and that government officials should provide transparent financial information. At least 85 percent of respondents agreed 'strongly' or 'somewhat strongly' across all levels of government."[iv]

The concept of transparency in the guise of making governments' actions evident to the governed is as old as the republic. In the Declaration of Independence the Second Continental Congress complained to a candid world that the British king "…has called together Legislative Bodies at Places unusual, uncomfortable and distant from the Depository of their public Records…". This charge clearly shows that the founders understood the importance of reliable and understandable public documents, at least to the legislature. The fact that this is the fourth of the Declaration's 24 major indictments also illustrates the importance its authors placed on accessible records to fair and proper governance.

The Constitution of the United States also requires a degree of transparency. Article I lists the powers and duties of the legislature. Section 9 states "…a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time". Article II concerns executive power and it also makes transparency demands on the executive branch. Starting in the very first section, on elections, the Constitution states: "And they shall make a List of All Persons voted for and of the Number of Votes for Each." These basic requirements were affirmed when the XII Amendment was ratified in 1804.

B. THE STATE'S DUTY TO REPORT ITS BUSINESS

The duty to report the state's activities to the public is contained in the Illinois Constitution as Article 4 Section 7 of the 1970 version. It requires the general assembly to disclose its activities and make them available to the public:

SECTION 7. TRANSACTION OF BUSINESS

(a) Committees of each house, joint committees of the two houses and legislative commissions shall give reasonable public notice of meetings, including a statement of subjects to be considered.

(b) Each house shall keep a journal of its proceedings and a transcript of its debates. The journal shall be published and the transcript shall be available to the public.

(c) Either house or any committee thereof as provided by law may compel by subpoena the attendance and testimony of witnesses and the production of books, records and papers.

This requirement strengthened the duty of the legislature to disclose its proceedings, verbatim. Earlier Illinois constitutions only required summaries of the debate. [v]

The executive branch also has an obligation to report, but only to the governor, under Article 5:

SECTION 19. RECORDS—REPORTS

All officers of the Executive Branch shall keep accounts and shall make such reports as may be required by law. They shall provide the governor with information relating to their respective offices, either in writing, under oath, or otherwise, as the governor may require.

C. BUDGETING: INFORMATION AS THE FOUNDATION OF PUBLIC POLICY

The Institute for Truth in Accounting believes that all governments should report their activities in a comprehensive and transparent manner, because citizens and their representatives choose public policy based on their knowledge, or what they think they know about the state's fiscal condition. At the state level the budget and the annual report of activities are the primary sources of information used to decide all manner of public policy questions. These documents include the type and level of taxes we will impose on ourselves, what resources we think these levies will produce, our priorities expressed in our spending plans and what infrastructure we'll leave to posterity.

To that end state governments, include Illinois, produce a wide variety of information designed to meet the needs of its citizens, taxpayers and legal systems. These include:

- Requests from the state's agencies and bureaus;

- The requirements of departments established to undertake specific tasks;
- The costs of mandates imposed by the federal government;
- The funding collected by the state, but promised to inferior levels of government; and
- The funding of tasks outsourced to private contractors.

The plan for all these activities is contained in the budget, while the results of the state's operations are reported in the audited Comprehensive Annual Financial Report.

The annual budget is the primary method by which the governor sets the state's spending priorities. While the legislature has wide prerogatives, the budget process is not an unlimited power. The Illinois Constitution imposes limits on the amount of money the general assembly can spend each year. From Article 8 of the Illinois Constitution:

> *SECTION 2. STATE FINANCE*
>
> (a) *The governor shall prepare and submit to the general assembly, at a time prescribed by law, a State budget for the ensuing fiscal year. The budget shall set forth the estimated balance of funds available for appropriation at the beginning of the fiscal year, the estimated receipts, and a plan for expenditures and obligations during the fiscal year of every department, authority, public corporation and quasi-public corporation of the State, every State college and university, and every other public agency created by the State, but not of units of local government or school districts. The budget shall also set forth the indebtedness and contingent liabilities of the State and such other information as may be required by law. Proposed expenditures shall not exceed funds estimated to be available for the fiscal year as shown in the budget.*

One might think these instructions to be comprehensive and obligatory. But as described in the Fifty State Study we found this language to be open to interpretation. A contentious element of this requirement is in the last sentence, which limits the governor's proposed budget only to the "funds estimated to be available for the fiscal year". Many think this imposes a duty on the governor to propose "balanced budgets". Others think this is not a limit, but a license to spend whatever funds the state can obtain, from whatever source. In a later section of this report we will show that the latter opinion prevails in Springfield.

D. THE BUDGET'S CONSTITUTIONAL AND STATUTORY OBLIGATIONS

The controlling constitutional requirement for the budgets is found in Article 8, Section 2 (b) of the 1970 Constitution:

> *The general assembly by law shall make appropriations for all expenditures of public funds by the State. Appropriations for a fiscal year shall not exceed funds estimated by the general assembly to be available during that year.*

As the Annotated Illinois Constitutions says, "This provision does not mean as much as it may appear to".[vi] That is an understatement that several reform senators attempted to remedy with the "Truth in Budgeting Act of 1997." One of its authors, Illinois State Senator Chris Lauzen stated:

> *"Basically the thrust of this legislation is that the budget that we report to the citizens of Illinois is calculated in the same manner under the same types of accounting rules, generally speaking, as the financial statements that we report to the New York bankers when we go for the bond rating. The funds that are covered under the plan are the ones that are most affected by a difference in accounting methods. Those are the General Revenue Fund, Common School Fund, Education Assistance Fund, Road Fund, Motor Fuel Tax Fund and Agricultural Premium."*

Senator Lauzen reiterated "that expenses would be recognized when incurred. So if we establish a liability for greater Medicaid or greater expense in a certain area, even though we don't anticipate paying it, we would include that expense in this year's budget".[vii]

In addition, there is a statutory requirement that both houses of the general assembly explicitly recognize the amount available to spend with joint resolutions to be adopted before appropriations are made. This ILCS Section 25 requirement is more fully described in Section F, below, but the intent is clear. By requiring an estimate of the amount available to spend, an upper limit on spending is set and the estimate should serve as the guidance as to whether the yearly budget meets the constitutional requirement. As we view the situation this requirement has not been observed in recent memory and it may be one of the reasons Illinois has such large accumulated debts and unfunded obligations.

E. THE CHANGING NATURE OF GOVERNMENT

The nature of government has changed in the last half century and that change has created financial pressure that has encouraged public officials to view the Constitution's requirements in the most elastic terms. These mission changes add to the confusion of what a budget should include. Each year it seems the size of government expands as does the definition of what it will empower itself to undertake. Unlike the federal government, Illinois empowers itself to do almost anything not prohibited it by the federal constitution. Here's what Article 2 of the state's 1970 Constitution says:

> *SECTION 2. POWERS OF GOVERNMENT*
>
> *The enumeration in this Constitution of specified powers and functions shall not be construed as a limitation of powers of state government.* [viii]

When Illinois joined the Union in 1818, it was a frontier territory with little evidence of what it would become as a state. Accordingly the tasks the state set for itself were primarily those of building the infrastructure necessary for Illinois to become the populous, wealthy state it has been. In that simpler time the state's primary responsibility was to build roads, bridges, canals, colleges and other forms of infrastructure. The accounting for these projects was accomplished by creating funds into which the general assembly appropriated money to pay for specific projects. These funds limited the state's exposure, because when a fund exhausted its resources the general assembly had no further obligation to continue funding the underlying project unless it appropriated money again. In many cases a separate fund was established for each project.

This was a method of management as much as it is an accounting practice. It served to ensure that administrators used the resources to meet the legislators' intent and that the spending in relation to those projects was limited to the resources devoted to the specific project. In that way resources could not be "overspent". This funding method has resulted in the existence of more than 600 separate legislatively-created funds. Of these the most important is the General Fund, the appropriation of which many view as the "state budget". This is a limited view, because the General Fund accounts for less than 60% of the dollars that flow through the state's accounts. Moreover resources that are generated or contained in other funds are regularly emptied by the governor or the general assembly and "swept" into the General Fund, regardless of the designated purpose of the funds being swept.

Over time the fund system grew into an expanded and more formal accounting system known as Fund Accounting. This system primarily recognizes the existence of cash balances in the various funds and the spending of these balances for the various purposes established by the legislature. This may explain the primary focus on cash, as opposed to accrual, methods for managing the state's affairs long after the rest of the world has embraced accrual accounting.[A] It may also help explain the disconnection with the requirement of the constitution regarding "funds available". Where "funds available" may have at one time meant the cash available to the legislature in what were essentially bank accounts (and what might have been reasonably expected to flow into the accounts during the fiscal year), the requirement seems to have morphed into meaning any funds from any source the general assembly can identify, sweep or imagine. This variable understanding of what "funds available" really means is fundamentally unsatisfactory and is a signal that a more formal and prescriptive definition is required.

Independent of the sources of state revenues, the purposes to which those revenues are appropriated have fundamentally changed over the past half-century. Since the middle of the twentieth century, the missions that Illinois has defined for itself have significantly increased. The changes in American society that occurred in the 1960's were also evident in Illinois and some of these dynamics were codified in the 1970 Constitution's grant of powers, referenced above.

Among these changes is the very nature of the tasks the state government chooses to do. When once the state was primarily in the business of funding/building infrastructure and operating the rather limited machinery of the state's internal bureaucracy, it is now as concerned with the health, welfare and lifestyle of its citizens. These changes involve committing to citizens and employees programs, services and benefits not just for the current period, but for years to come.

The consequence of these changes in the state's missions has also meant changes in the nature of the state's expenditures. Specifically expanded entitlements obligate the state to pay beneficiaries for as long as the programs exist. The obligations the state now undertakes are not necessarily payable during the period a specific budget covers. For example the state has made a decision to include in employees' compensation and benefits, a considerable portion of which will only be payable in the future. State vendors may perform Medicaid services in one budget period, but not be paid until a future budget period. Some of the delay in Medicaid payments results from the state vendors waiting for the reimbursement of the federal government's portion of these costs. These ongoing human costs have proven to be attractive to citizens and workers. The consequence is that these sorts of costs grow faster the state's underlying economy.

(A) Cash accounting records receipts when deposited and payments (sometimes referred to as expenditures) when cash is paid. Accrual accounting recognizes events and transactions when they occur, regardless of when cash changes hands.

The focus on budgeting using short-term cash basis numbers when making long-term commitments is a recipe for financial disaster. The governments' cash-based accounting systems do not meet the most basic objective of accounting which is to match costs with revenues. Budgeting techniques and, more pointedly, the lack of accounting standards applied to the budgeting process, means governments' budgets are prepared using rules that simply don't recognize economic reality as exists in the second decade of the Twenty-First Century. This is true at all levels of government; federal, state and local. We will outline the resulting fiscal consequences of such budgeting practices specifically for Illinois later in this report.

F. STATUTORY ATTEMPTS AT TRANSPARENT GOVERNANCE

Illinois' legislators have recognized that the very complexity of the state's business makes its activities generally opaque to itself and to the citizens in Illinois. In response the legislature has enacted several laws that seek to provide information that is understandable and accessible to the public.

To increase the transparency of the legislative process and to help the general assembly meet its constitutional duties, the legislature established the Commission on Government Forecasting and Accountability (CGFA). Because this organization is a creation of the legislature, it reports to the general assembly rather than the executive branch. CGFA has several duties that can be helpful to individuals and organizations interested in knowing more about their government. An example of the numerous economic reports CGFA is responsible for producing is the "FY 2011 Economic Forecast and Revenue Estimate FY 2010 Revenue Update" [ix]. In relation to reports on both revenues and expenditures CGFA's tasks include, among others, those outlined under the Commission on Government Forecasting and Accountability Act in the following section of the Illinois Compiled Statutes (ILCS):

> *(25 ILCS 155/4) (from Ch. 63, par. 344)*
>
> *Section 4.*
>
> *(a) The Commission shall publish, at the convening of each regular session of the general assembly, a report on the estimated income of the State from all applicable revenue sources for the next ensuing fiscal year and of any other funds estimated to be available for such fiscal year. On the third Wednesday in March after the session convenes, the Commission shall issue a revised and updated set of revenue figures reflecting the latest available information. The House and Senate by joint resolution shall adopt or modify such estimates as may be appropriate. The joint resolution shall constitute the general assembly's estimate, under paragraph (b) of Section 2 of Article VIII of the Constitution, of the funds estimated to be available during the next fiscal year.*

(b) On the third Wednesday in March, the Commission shall issue estimated:

(1) pension funding requirements under P.A. 86 273; and

(2) liabilities of the State employee group health insurance program.

These estimated costs shall be for the fiscal year beginning the following July 1.

(c) The requirement for reporting to the general assembly shall be satisfied by filing copies of the report with the Speaker, the Minority Leader and the Clerk of the House of Representatives and the President, the Minority Leader and the Secretary of the Senate and the Legislative Research unit, as required by Section 3.1 of the general assembly Organization Act, and filing such additional copies with the State Government Report Distribution Center for the general assembly as is required under paragraph (t) of Section 7 of the State Library Act.

Note: The statute calls for CGFA to distinguish between "revenues" and other funds "available" to the legislature during the fiscal year. In Part VI, Section E of this report we will discuss this distinction in greater detail as a part of the consensus definition of what funds should be included in the annual budget calculations.

In addition, this portion of the statute requires CGFA to report its findings to the general assembly in March and requires the House and the Senate to adopt a joint resolution either to accept CGFA's estimates or to modify the findings. The apparent purpose of this requirement is to put an explicit "upper limit" on the "funds available" to the legislature as they decide which expenses the state should undertake in the next fiscal year. CGFA's estimate of "funds available" should serve as the best estimate available, because it is fresher than the Consolidated Annual Financial Report that's available during the legislature's budgeting process. Due to the consistent tardiness, the CAFR that is available during the budget process usually contains information that is almost two years old.

In addition, to calculating the funds available to the legislature, CGFA is also charged with monitoring money the state is planning to spend. The CGFA Act requires that one month after the fiscal year starts the Commission should summarize the new fiscal year's expenses the legislature authorized and to compare those figures to previous years. The Act mandates that the report be written in "plain language" and to be designed for "readability". Specifically Section 2 of the CGFA Act states:

> *By August 1st of each year, the Commission must prepare and cause to be published a summary report of State appropriations for the State fiscal year beginning the previous July 1st. The summary report must discuss major*

categories of appropriations, the issues the general assembly faced in allocating appropriations, comparisons with appropriations for previous State fiscal years, and other matters helpful in providing the citizens of Illinois with an overall understanding of appropriations for that fiscal year. The summary report must be written in plain language and designed for readability. Publication must be in newspapers of general circulation in the various areas of the State to ensure distribution statewide. The summary report must also be published on the general assembly's web site. [x]

Illinois' Constitution and statutes require the state to report the people's business. There are additional statutes that require Illinois to make regular efforts to inform the public in comprehensible ways. The combination of the Constitutional requirement to spend no more than the "funds available" with a "neutral" party's estimate of those funds available should serve to provide the information needed to determine if the budget meets the equitable goal of balanced which provides for intergenerational equity.

With this legal framework in mind, one wonders how and why the Illinois budget has not balanced.

III. PUBLIC SECTOR BUDGETING AND ACCOUNTING STANDARDS

A. THE EVOLUTION OF ACCOUNTING STANDARDS

Creating accounting standards for public sector entities and their budgeting processes has been underway for more than a century. [xi] Beginning in 1906 the National Association of Comptrollers and Accounting Officers began to formulate accounting standards for states and municipalities. Successor organizations have continued that process. Governmental accounting standards were of little interest beyond the profession until the bankruptcies of New York City in 1975 and Cleveland in 1978 underscored the necessity for better understanding of the financial conditions of our public entities.

A quarter century ago the National Council on Governmental Accounting (NCGA), one of the successor organizations, began to wrestle with the reality of public pensions as well as the accounting treatment of these benefits. By 1981 the organization's agenda included questions regarding the differences between budgeting and accounting. [xii] Key areas of inquiry included:

- The differences between accounting for governmental and commercial entities;
- The functions and boundaries between budgeting and accounting;
- Who should control these separate functions; and

- “The problem of ‘actuals’”.

Indeed the governmental accountants of 1981 wondered why such questions were still outstanding after more than a half-century of debate. Even then they reported that accounting and budgeting had not kept up with changes in the nature of government. [xiii] The existing paradigm for the governmental accounting function was to “make it possible to determine whether there has been compliance by those charged with the administration of government programs”. The long-term effects of those programs were apparently unconsidered.

A big step towards answering these questions occurred in March 1984 when the NCGA proposed an interpretation of the principles of state and local budgets and how they should be handled. [xiv] This document substantially increases the scope of our understanding of the issues relating to the difference between the budgeted amounts and the actual amounts reported in the Comprehensive Annual Financial Report.

The presumption in the 1984 document is that in the government’s CAFR there are to be comparisons of the budgeted amounts and the resulting amounts. The objective was to clarify the need for comprehensive financial reporting that specifically recognized financial events that were not part of the annual appropriation process.

The first issue that the interpretation made was to recognize the relationship between financial accounting and public sector budgeting. The interpretation recognized that the authority for budgeting is a power granted by constitutions, statutes and ordinances; and that the creation of a budget is beyond the scope of the accountants.[xv] Nevertheless the document does find that budgetary comparisons are within the scope of financial guidance. We take this to mean that in order for budgetary comparisons to be useful, the budgets should reflect good accounting principles at the outset. In other words the “budget” at its creation should be founded on accounting principles that will be compatible to the GAAP presentations which will be reported in that fiscal year’s CAFR.

B. FOUR DEFINITIONS OF THE "BUDGET"

The NCGA paper describes four types of budgets. These definitions help us understand the confusion that accompanies any discussion of the "budget".

First is the Executive Budget which, in Illinois, is the product of the governor's office and is presented to the general assembly each January. It is the plan the governor proposes for spending the money he estimates will be available during the subsequent fiscal year. The plan covers the state's activities which begin on the following July 1st and continue until the following June 30th. The executive budget includes "the aggregate of information proposals and estimates prepared and submitted to the legislative body by the chief executive and the budget office." [xvi]

The Appropriated Budget is the second conceptual element of the "budget". It is the product of the legislature's deliberation and the authority it provides to the executive branch to fulfill the legislature's will. This would include all appropriations signed into law. These include all reserves, transfers, allocations, sub-allocations and supplemental appropriations resulting from formal action by the general assembly or by other means permitted by law.

The third element is the Non-Appropriated Budget which includes any activity or function that has a financial effect but for which there is no specific appropriation and, as a consequence, is outside the notion of an appropriated budget. This would include financial events for which the state has obligated itself but do not require instant funding. Pensions are such an obligation. They are legally authorized and earned by the beneficiaries, but are payable in the future.

Finally there is the Execution and Management Budget which includes all other sub-allocations, rescissions, deferrals, transfers, conversions, allotments, etc., which are established or undertaken by the executive branch, but which do not require formal legislative action. This would include such activities as the collection of license fees and the execution of the associated regulatory activities. For example the state collects fishing license fees and from these funds game wardens are paid to enforce the fishing laws. These are not subject to a specific appropriation, but are instead executive functions for which the governor has authority.

This variety of definitions for the "budget" helps explain why analysts often have difficulty in creating a common definition of what the "budget" actually is, let alone deciding if it is objectively balanced. When the interpretation was written in 1984 NCGA mandated that the minimum standard for financial reporting purposes should include just the appropriated budget, as described above. [xvii] The Council noted that public sector entities are free to exceed this minimum and that previous pronouncements did not "preclude the presentation" or other disclosures that provide a more comprehensive presentation of the budget reporting activity”. [xviii]

C. REPORTING AND FRAMES OF REFERENCE

In addition to the various definitions of the budget itself, the NCGA paper also concluded that there is a number of what might be described as “frames of reference” that can affect our understanding of the state’s budget. These frames of reference arise because of the differences between Illinois’ budgeting process and the GAAP reporting model. They include:

> **Basis differences** arise when the budget’s basis of accounting differs from the basis required by GAAP for financial reporting purposes. In addition, it’s likely that basis differences are exacerbated in Illinois by reporting requirements imposed on the five largest funds and those allowed for smaller funds. For example Illinois’ General Fund is to be prepared under the requirements of the state’s “Truth in Budgeting Act” but smaller funds are allowed to operate on a cash basis of accounting. In addition, there may be funds that have subordinate funds which have differing basis of accounting. As will be identified by the consensus process described later, the basis differences in accounting are primarily the difference between the cash, modified accrual and FACT bases of accounting.
>
> **Perspective Differences** result from the way information is structured and for what purpose it is to be used. The grouping of activities, personnel, equipment and other resources may be logical from a utility point-of-view, yet conflict with a proper presentation from the GAAP perspective. An example of perspective differences would be the fund structure for the highway department, which uses a capital budget to repair potholes that GAAP would classify as operating expenses. On the other hand a department may purchase computers with its budget and immediately expense them when, under GAAP, they would be capitalized. Organizational or program structure of the reporting can also induce perspective differences.
>
> **Entity Differences** occur when the appropriated budget includes entities or activities that may be included or excluded for reporting purposes. This would include such activities as prepaid college tuition, in which the state simply acts as the collection agency but does not have an equitable interest in the transaction. Another example is the operation of a state court that collects fines—which we believe should be included as revenue in the budget. On the other hand wage garnishments, which simply flow through the state’s cash accounts to third

parties, are entity differences that should not be included in the state's revenues or expenses.

Timing Differences are also a form of reference which result in different budgetary interpretations. Timing of when transactions should be reported is one of the major concerns of accrual accounting which matches revenues with expenses regardless of the period in which each might occur. Examples of timing differences would include continuing appropriations, automatic re-appropriations and other activities that occur in one period and are paid in another.

While not specifically naming these frames of reference except for timing, our consensus panel found evidence of each of these types of budget complications. How they were resolved is reported in Section VI of this document.

D. HOW THE ILLINOIS COMPTROLLER DEFINES A "BALANCED BUDGET"

Former Illinois Comptroller, Dan Hynes, has also defined a "balanced budget". Here, verbatim, is how he describes three possible versions of a balanced budget: [xix]

"Defining a Balanced Budget"

"On a cash basis, the question of a balanced budget can be examined using three views. Ideally, the answer should be affirmative regardless of the view."

"The first view involves a comparison of receipts and expenditures over the course of a twelve-month fiscal year. If receipts exceed expenditures, there is an operational surplus and the end-of-year available balance increases. If not, there is an operational deficit that can only be financed by drawing down the end-of-year balance."

"The second and third views are based on the budgetary balance concept. View two compares the end-of-year balance to lapse period spending. Although state agency budgets are enacted on the basis of a 12-month fiscal year, agencies are permitted to spend their appropriations over a 14-month period (formerly 15 months). The additional two months (July and August) are collectively referred to as the lapse period. During this period agencies are allowed to use last year's spending authority (appropriations) to pay for bills incurred during the prior year."

"If the end-of-year balance is high enough to cover lapse period spending, the budget is technically said to be balanced. If the opposite occurs, the budget is out of balance. When this happens, it effectively means that next year's money is used to pay last year's bills. This comparison produces a number that is commonly referred to as the budgetary balance."

"The third view compares changes in the budgetary balance. If the budgetary balance improves, the budget is balanced. This holds even when the budgetary balance goes from a large negative to a smaller negative. In that case there is a cash improvement."

"Of these three views, the first is of limited use in judging the overall fiscal health of the state because it can be impacted by any number of timing factors. Although the third view shows whether the fiscal situation is moving in the right direction, it too is of limited value because it does not indicate whether the budget is actually balanced."

"The second measure, called the budgetary balance, is the most comprehensive because it views a budget as balanced in any given year when the available resources meet or exceed the uses of those resources."

E. DIFFERENCES BETWEEN GOVERNMENT AND PRIVATE ENTITIES

The differences between governmental and private sector entities, with respect to their accounting policies, rise for several reasons. Chief among these is the assumption that government and its subdivisions have a permanent life, as a going concern. Unlike private companies that are far more likely to go "out of business", a governmental unit has the power to coerce taxes to fund itself and thereby preserve its existence. This presumption is that the power to tax is unlimited and enough to satisfy any public undertaking.

It is this idea, perhaps, that allows some in government to choose not to recognize currently accruing costs, because there will always be the opportunity to tax and pay them in the future. At one time GAAP and its predecessors allowed public entities to balance their accounts with an account entitled "Amounts to be provided in the future". This asset would essentially act like an imaginary account receivable from posterity and increase an entity's total assets, so that they could be balanced against today's very real liabilities. Only by assuming that a governmental unit has eternal life and unlimited future taxing power can this sort of accounting be conceived, let alone justified.

Another reason for the differences in accounting policies is the ability of states and municipalities to issue debt for long periods of time. Debt that is issued for long periods of time allows public issuers, who are large participants in the credit markets, to enjoy the effect inflation has on monetizing the value of bonds. Issuers repay in substantially "smaller" dollars than those they borrowed and, while states are not able to print money, like the Federal Reserve, they benefit from inflation, nonetheless. For example the cash paid to redeem a 30 year bond maturing in 2009 has almost exactly one-third the purchasing power that the owner invested a generation and a half ago. [xx] This obligation should be easy for the state to liquidate, because it is probably collecting at least three times the amount of revenues as it did 30 years ago.

Another difference between the private sector and governments is the progressive forms of taxation. This so-called "fiscal dividend" occurs when taxable income, including salaries, increase in inflationary periods. [xxi] Taxpayers know this as "bracket creep". This does not apply directly to Illinois, because the state's constitution mandates only "flat" income tax regimes. Nevertheless, tax plans proposed by the state's political leaders have elements of progressivity which they achieve through deductions and exemptions. As these deductions and exemptions are not adjusted for inflation, they serve to create a form of fiscal dividend. Indeed one of the motivators for politicians to increase the minimum wage is to rebase all salaries and wages, and thereby increase the government's revenues.

The other difference between government and the private sector is that the government may coerce taxation and also serves at the pleasure of the governed. The tension between these two facts creates an unavoidable conflict of interest. This impedes transparency, because what's good for those in government might not always be good for those who pay for it. The choice of what information to release can affect how the public will decide to regard its government. Those in government who prefer the status quo will naturally prefer to release information that confirms the desirability of things as they are. On the other hand those who advocate for change will focus on very different information.

For example the governor may choose to present a budget that is "balanced" on a cash basis, which only considers checks written. Political opponents will draw attention to the fact that this presentation ignores a portion of the state workers' compensation cost. Such a presentation does not include the retirement benefits earned by the state workers in the budgeted year. Another example is the increase in debt that arises from the issuance of state bonds. Under current state law proceeds from bond issuances can be included in the budget as "revenues", but some people will challenge this classification.

These differences and many others result in different budget calculations. While the governor and most legislators will assert that the budget is balanced, others will calculate large budget deficits. It is difficult to decide sound public policies, when uncertainty about the budget numbers exists during the budget process. Some question whether the budget is based on sustainable economics. The Institute asserts that equitable decisions depend on getting all the facts disclosed. We believe that should be the standard on which we judge the quality of information the government releases.

F. BUDGETARY PROBLEMS REMAIN

Setting the standards for public sector records and reports is the province of accounting even if the state has the sovereignty to accept or reject them. Despite the quarter century since the now defunct National Council on Governmental Accounting reported their proposed interpretation, the issues they identified are still evident. In fact there is no "unified theory of public sector budgeting" and the discovery of one may be as elusive as Einstein's search for a unifying theory in physics. The difference is one of will, rather than understanding, because all the elements to create a more useful budgeting process are known—or at least it's known how to make budget information more accurate. The problem is political not intellectual and the reason is clearly revealed in the Institute's Fifty State Study. According to our research the budget is unbalanced, but the legislature says the budget is to excuse them from making tough decisions about the level of services and benefits that can be provided to the citizens and the extent that they will have to tax voters to pay for them.

How this happens is also fairly obvious. A minimal definition of what needs to be included in the budget allows the public sector to ignore very real obligations because they are not appropriated. The significance of this concept cannot be overstated as the collapsing Illinois finances—as well as similar woes in other states—demonstrates.

It is important to recognize that the state can exercise its powers, yet fail to take financial responsibility for those actions. It is like an individual who contracts to have his house painted, but never makes the down payment to start the process. Under the agreement with the painter, the home owner is obligated to make the payment and the painter has every right to expect payment before he starts the job. If the painter doesn't receive that deposit, it is unlikely he will start the job. Similarly legislators can create a financial benefit or entitlement for its citizens, but until the funds are appropriated, the benefit or entitlement remains theoretical in their minds.

The most egregious example is the state's pension plans. The Illinois Constitution establishes that an employee has a contractual right to a pension, but retirees will receive their benefits only if the general assembly actually funds them. As will be examined in more detail later, the Illinois general assembly appears to be following the NCGA's minimal standard from 1982, using the "appropriated budget", the narrowest possible definition. This treatment allows the legislature to ignore accruing pension and other post-employment costs by simply failing to appropriate the funds to pay them. Apparently public sector budgeting hasn't made much progress since the early 1980s.

G. CONTEMPORARY OBJECTIVES AND SCOPE OF TRANSPARENCY EFFORTS

The public's increasing concern about the financial conditions of their state governments has put transparency on many minds. As responsible governments and agencies begin to release their raw financial information, transparency advocates must be beginning to wonder if transparency will actually lead to accountability. After all California has been a leader in transparency, but is also one of the most financially-challenged of our states.

The Association of Government Accountants' survey on public attitudes on government financial reporting shows that the current flow of information does not fully satisfy the public. AGA is beginning to make the distinction between simple transparency and accountability, and should be applauded for it. The Association notes "…that the traditional government communication—reams of audited financial statements that, though essential, have little relevance to the taxpayer—must be supplemented by government financial reporting that expresses complex financial information in understandable form."[xxii]

AGA's recommendations relate to historical financial statements—presumably the CAFRs—which help us understand what happened *in the past*. As AGA correctly observes, audited financial information is "essential", but the typical delay in producing CAFRs means that the information they contain—no matter how transparent—is fundamentally "ancient history". The key to accountability is for citizens to understand the activities their governments *intend* to take. The place to do this is in the budgeting process and with the budget documents, because that is where the seeds of irresponsibility flourish. As discussed above the Executive Budget, the Appropriated Budget and the Non-Appropriated Budgets are differing expression of the state's intentions and are subject to change.

One of the inescapable conclusions of the Institute's Fifty State Study is that there is a systematic problem in the states' financial performances. Our investigation of the CAFRs from every state, recognizing that all but one has a constitutional or statutory requirement to balance budgets, clarified that the problem would not be solved merely by "fixing" historical financial reports.

AGA's recommendations for financial reporting are sound and are also applicable to the budgeting process. The objective of providing reports that express complex financial conditions in comprehensible terms is especially poignant. From our discussions with legislators we found they are often as confused by the scale and complexity of the budget documents as the public is.

As will be discussed in Section V of this report, there are a number of reasons Illinois is in the condition in which it finds itself. One of the primary causes is the opacity of the budget process. It is not that the budget process is hidden (although much of it is), but rather the accounting policies used to create the budget fall short of recognizing the actual financial effects of the general assembly's decisions.

To address this issue and improve transparency, we believe the minimum requirement should be to impose the principles used to compile the audited Comprehensive Annual Financial Reports on the state's annual budgeting process. The utility of this requirement would be to set minimal expectations for the processes used to calculate the elements in the budget and to create standards to enforce them. As we found in the Fifty State Study these accounting standards are not perfect and there is a serious question of the independence of GASB, which establishes public entity accounting principles. Nevertheless the budgeting process is so dysfunctional that almost any improvement is welcome.

Our belief is that the financial distress that afflicts Illinois and other states is due at least in part to a faulty budget process. Budgeting is a time -- the best time-- for the legislators to plan for state's coming year and its future. The budget should include a reliable estimate of the revenues that will be available to be spent during the period. It should also fully recognize all costs of government that will actually be paid in the fiscal year. Costs for which the state will become obligated, but will not pay in cash during the fiscal year, should also be included.

Because all costs are not taken into account, the state's current budget simply does not reflect financial reality. This explains why the process *always* underestimates the true costs of government. Proof is the state's growing bonded debt and the very real unfunded promises.

In the absence of rational budgeting standards, the Institute asked a number of institutions in Illinois to think about what elements should be part of a more transparent budget process. This accord and the process we used to arrive at the consensus is reported in a later section of this report.

H. CURRENT ACCOUNTING STANDARDS DO NOT SUPPORT TRANSPARENCY

Accounting standards for state and local governments are set by the Government Accounting Standards Board (GASB) located in Norwalk CT. Created in 1984, GASB holds that it needs to exist because governments are "different" from for-profit businesses:

> O*ne of the most important aspects of GASB's mission involves establishing high-quality standards that result in making essential information about state and local governments' finances available, so that users of financial reports can make better informed decisions and government officials can provide public accountability for their stewardship of public resources.* [xxiii]

GASB sets these accounting standards by exposing reporting concepts and sponsoring public debate on their necessity and application. These standards primarily relate to financial reporting in the CAFR and do not directly apply to the transparency of the state's budget setting process. The disconnection between the budgeting process and financial reporting standards should be a fertile area for reform by GASB. Progress in aligning these two processes has proven difficult because, as the Institute for Truth in Accounting's earlier Fifty State Study found, balanced budgets are largely a myth. We believe the reason is that the

GASB's constituency prefers the status quo and that GASB is beholden to its members. As we reported in the Fifty State Study:

> *"Numerous examples raise doubts about the independent nature of GASB. For instance, in the early 1990's GASB issued Statement 11 which would have required a full accrual system similar to systems used by business. Some of the governmental organizations that were involved in the formation of the GASB were adamantly against switching from the traditional cash basis fund accounting. To give time for this debate to be resolved, GASB chose to not give Statement 11 an implementation date, effectively ending this important improvement."*
>
> *"Another suspicious example occurred in 1994 when some of the original GASB members' terms ended. Possibly because governmental organizations dominate GASB board member selection process, the incoming members were accountants who strongly favored the traditional cash basis fund accounting system.* [xxiv] *In 1999 the new board issued Statement 34, "Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments". The board resolved the debate between those who wanted to use a full accrual accounting system and those who wanted to continue to use the traditional cash basis fund system by requiring that both systems be used. As discussed later in this document, using both systems has resulted in annual reports that are too complicated and cumbersome."*
>
> *"Another instance where GASB's governmental constituency appears to have impacted the independent standard setting process involves the reporting of post-employment benefits. As detailed in this Study, GASB lags far behind the FASB when it comes to reporting on retirement costs. GASB allows an extended period of time for governments to amortize the prior under-funding of post-employment benefits. The standards for pension and other post-employment benefits, including health care costs, enable governments to leave significant liabilities off-balance sheet. GASB standards are also lax on the evaluation of pension fund assets. GASB GAAP allows actuaries to value assets on an average of their market price over five years. This "smoothing" of the assets' value obscures the plan's risk profile. GASB also permits each state to choose the way the pension plan actuaries will calculate pension expenses and liabilities, including the actuarial cost methods, assumptions and amortization periods.* [xxv] *This makes it difficult, if not impossible, to compare pension plans from state to state."*

Overall it's our sense that GASB should involve itself in creation of standards for building annual budgets. This should start with rational definitions of a budget's component parts including classification of revenues and expenses that produces a reliable connection between the budget and the CAFR. More detail and other recommendations follow in Section VI.

IV. THE SITUATION IN ILLINOIS

A. OUR FINANCIAL POSITION

The seriousness of Illinois' financial situation may have been expressed best by Ralph Martire, the executive director of the Center for Tax and Budget Accountability. When asked for his estimate of the state's 2008 budget deficit at the Institute for Truth in Accounting's budget consensus meeting, he replied "Well, it ain't zero and it ain't infinity!". Mr. Martire's comment was as accurate as it was amusing, because it spotlights the fundamental problem that frustrates any effort to understand Illinois' true financial condition. No one knows how big it is nor how to calculate it.

This mystery continues, because the state is apparently required to balance its budget each year, which is defined as a restriction from spending more than the "funds available" to the general assembly.[xxvi] Nonetheless a staggeringly large debt has accumulated from a long history of these "balanced budgets". The trouble is in the definitions of what "funds available" means and what expenditures should be included. Clearly our political leaders and the common man have fundamentally different ideas of what "balanced" really means.

Moreover it appears the individuals who create the annual budget are not simply ignoring the Illinois Constitutional requirements. By approving the appropriations and sending them on to the governor, the general assembly tells us that the budget meets the state's constitutional and statutory requirements. One of the former constitutional officers did express concern about the budget not meeting statutory requirements. In the footnotes of the state's audited financial report former Comptroller Hynes quotes the balanced budget law, then asserts, "The State has not presented revenue and expenditure estimated in accordance with these provisions".[xxvii]

Regardless of the tensions between the financial realities in which the state finds itself and the means and manner by which these problems have occurred, the first step in effective transparency is to determine the extent or depth of the problem Illinois faces. We are fortunate that a number of civic groups have studied Illinois' budgetary and financial woes and regularly report on them.

The focus of this paper is not the actual calculation of the accumulated deficits. Instead it is to find a method to effectively define the budget process by deciding which elements should be included to meet the letter and the spirit of our state's constitutional and statutory mandates. Accordingly we will use the annual budget figures and the accumulated debt that these established civic groups have calculated. We believe the magnitude of these estimates, offered by a wide variety of credible organizations, transmits notional proof that the state's budgets are not, and have not been, balanced for some time. The long series of "balanced budgets" adopted under the 1970 Illinois Constitution clearly have not been balanced in any sensible or generationally equitable way.

Exhibit 1: Estimates of Illinois' Financial Position and Deficits *(in millions)*

Organization	Fiscal Year	Cash Basis Annual Deficit	"Accrual" Basis Annual Deficit	Accumulated Debt and Commitments
Civic Committee of the Commercial Club of Chicago[xxviii]	2007		**$5,900**	**$106,000**
Center For Tax and Budget Accountability(CTBA)[xxix]	2007		**$3,092**	
CTBA[xxx] [(B)]	2008	**$357**	**$3,800**	
State of Illinois[xxxi]	2008	**$456**		
Civic Committee[xxxii]	2009	**$2,400**	**$8,100**	**$116,000**
Civic Federation[xxxiii]	2010	**$2,245**		
Civic Committee[xxxiv]	2010	**$8,800**	**$14,300**	**>$130,000**

The findings of several Illinois-based organizations can be found in the Appendix I of this document. Each organization has a long history of studying and reporting on the state's governance and its spending history. As one reads Exhibit I, it is important to recognize that each organization has a specific outlook which may or may not agree with any other organization's viewpoint. For that reason these figures are not comparable in a direct way. Nevertheless they do show a trend that utterly contradicts any idea that the state's annual budget is balanced.

Moreover the derived conclusion is that unbalanced budgets are a systematic problem, rather than a temporary difficulty caused by the economic downturn. The trend is always negative and the long term result is a staggering accumulated deficit that the Commercial Club estimates as much as $130 billion.

As dire as the headlines portray Illinois' fiscal condition, the obvious question is…why?

B. RETIREE BENEFITS: INVESTMENT ASSUMPTIONS AND GROWING LIABILITIES

Increasingly the actuarial estimates of the state's pension liabilities have become a concern for the public. These calculations are important, because they form the basis for estimating the funding required to pay state employees' retirement benefits.

[(B)] *This is CTBA's "Structural Deficit" calculation which is not an accrual number, but does indicate the organization's basic perception of the future budget shortcomings.*

There are two primary benefit promises the state has made to its employees. These are pensions and other post employment benefits, which are primarily medical benefits.

Pensions

With respect to pension benefits most state employees are part of defined benefit plans which have actuaries calculate the expected liability the state will face as its employees serve their time and retire. The state and employees contribute through time to accumulate assets to be available to pay these benefits. Because these accumulating funds earn interest and investment returns, to have a "fully funded plan" the state has to only contribute enough to fund the benefits based upon these estimated returns.

Exhibit II: Selected Pension Fund Actuarial Assumptions for FY2009

Fund Name	Investment Return Rate Assumption	Asset Valuation	Unfunded Actuarial Accrued Liabilities (UAAL) *(in millions)*	UAAL Compound Growth	GASB 25 Compliance
SERS	8.5%	5 Yr. Smoothed	$14,298	11.1%	No
SURS	8.5%	5 Yr. Smoothed	$12,034	25.0%	No
TRS	8.5%	5 Yr. Smoothed	$73,027	8.2%	No
JRS	8.0%	5 Yr. Smoothed	$931	8.5%	No
GARS	8.0%	5 Yr. Smoothed	$174	6.7%	No
			$100,464	**10.7%**	

Exhibit II[xxxv] on the following page shows a number of important facts about Illinois' five retirement funds, which include the State Employees' Retirement System (SERS), the State University Retirement System (SURS), the Teachers' Retirement System (TRS), the Judicial Retirement System (JRS) and the General Assembly Retirement System (GARS).

Exhibit II shows why the public has reason to be concerned about the actuarial assumptions used to calculate the state's real pension liability. While a critique of the actuarial report is well beyond the scope of this report, the facts presented here are helpful in making a valid judgment about the condition of the funds.

The higher the interest or investment return rate assumption, the less the state must contribute. Conversely the lower the assumed rates, the more the state (and its employees) will have to contribute to meet pension payments. In the schedule above the second column shows the investment return assumption for the five Illinois public pension funds. These rates range from 8-8.5% which appears to be high to many observers given recent market performance and the generally accepted estimates of the future performance of markets. In fact Illinois' investment return assumptions are especially high when compared to other states. Other states use 7-8% and many are reconsidering reducing these rates. Moreover some academic researchers are recommending that the discount rate applied to future obligations should be the risk-free rate. If such a rate was used, the state's pension liabilities would massively increase.

While the assumptions Illinois uses may be historically justified, future performance will likely be lower than past experience. Reason for this include depressed rates of return from equities, generationally low interest rates for investment grade debt and the mathematical effect of the funds' probable asset allocations.

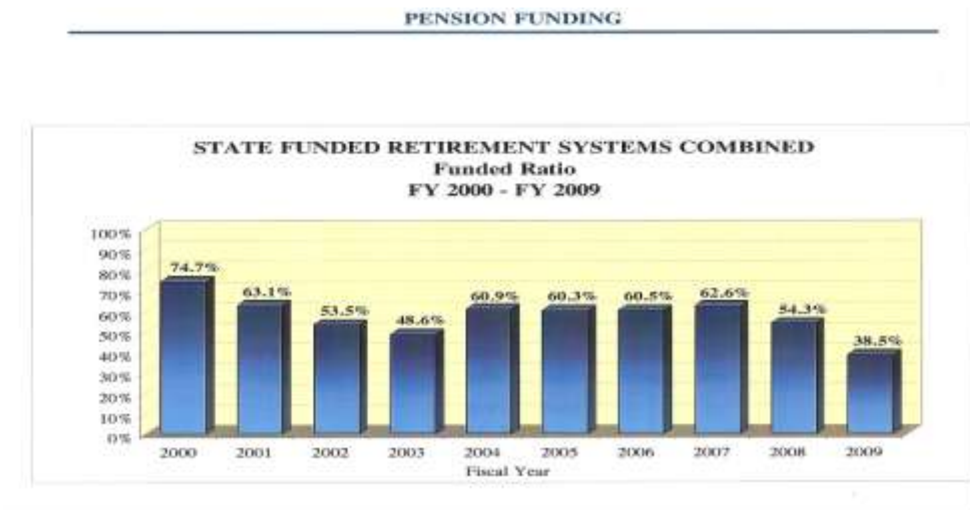
Another consideration is the method used to evaluate the value of the assets held to fund future payments. Prior to FY2009 the state customarily valued its assets at their fair market prices. In 2009, however, the state changed the method that it uses to value assets. This new valuation method "smoothes" the value of assets over five years. This process allows the state to "amortize" gains and losses over five years, so the volatility in the markets is not reflected in the valuation of plan assets. The problem with this is that in a falling market, as occurred during the periods these statements report, the amount of the *actual* losses are opaque to an outside observer. To change to a smoothed method during a large market decline appears to be self-serving and, in addition, the change in method eliminates the ability to compare statements over time. The effect of this may be to have fewer assets on which the state will earn returns. Illinois's 2009 CAFR highlights this phenomenon stating that pensions were 50.6% funded using the "smoothing" method, but that they were only 38.4% funded using the fair market value of the assets.[xxxvi] In addition, the funds themselves report significantly higher liabilities in their individual actuarial reports than is referenced in the CAFR's Management Discussion and Analysis (MD&A).[xxxvii]

That said one way we might be able to tell if the state's assumptions and performance in funding its pension obligations is reasonable by looking at the pension plans' Unfunded Actuarially Accrued Liabilities based upon the different valuation methods. This is the difference between the assets available—however valued—less the actuarially calculated pension liabilities. A positive number means the actuaries believe the assets exceed the present value of the promised pension liabilities, while a negative number reports the opposite condition.

Illinois' pension plans' UAAL is negative by $100 billion, according to the five funds' FY2009 reports. This is due primarily to the state's failure to make timely pension fund payments and the failure to achieve the assumed investment returns.

One way to grasp the importance of this deficit is to calculate its growth rate. If the unfunded pension liability is an undesirable condition, how fast is it getting worse? From the reports filed by the funds, this undesirable condition is growing at nearly 11% with the rates in the individual funds ranging from 6.7% to a staggering 25%. This would lead most reasonable observers to conclude that the basic assumptions and performance of the funds are clearly inadequate.

Finally the state does recognize that past pension funding performance was inadequate and that catch-up payments are required to adequately fund the pensions. This condition is not unique to Illinois and to address it the Government Accounting Standards Board established an acceptable method for states to catch up. The method is outlined in GASB Opinion 25 which requires that these catch up programs be completed within 30 years. Illinois' catch up program, which was started in 1995 does not comport with this GASB requirement. Consequently each of the funds is required to report this accounting and performance deficiency. In addition, the general assembly has substantially modified their own catch up plan over the years, so there has essentially been no progress in reducing the unfunded pension liabilities over the past 15 years. Instead there has been a significant deterioration in the state's financial condition largely due to the pension funding deficiencies.



The chart[xxxviii] above shows the funding ratio of all Illinois's state sponsored pension funds. The decline in "funded ratio" can be due to a number of reasons, some of which are under the control of fund managers, some not. These reasons include:

- Failure to fund current costs which is a consequence of decisions made by the general assembly. The general assembly has an incomplete record of making these contributions.

- Failure to fund prior service costs and/or deferral of scheduled "catch-up costs" for amortization of prior service costs. This is most likely a consequence of the many modifications made to the 1995 law which recognized the problem and prescribed a remedy to reach 90% funding by the mid-21st century. The assumption that future general assemblies would adhere to the plan has proven to be optimistic.

- Changes in plan features including changing retirement eligibility, service purchase plans and even benefit reductions, such as the plan the general assembly imposed on new state employees.

- Declining rates of return on plan assets and over-estimated fund performance. The collateral effect is that the funding requirement the general assembly faces under a "high return" assumption is considerably less than is the case when more realistic rates of return are used by the actuaries.

Other Post Employment Benefits (OPEB)

"OPEB" is the other "family" of state employees' retirement benefits that are not pensions. The major of these benefits relate to retirees' health care. Here's Illinois' FY 2009 CAFR's MD&A disclosure on the subject:

> *"In Fiscal Year 2009, the State performed an actuarial valuation of health, dental vision and life insurance benefits promised to retirees. The valuation reported a $27.124 billion actuarial liability with no assets currently set aside to fund the liability as the State uses a "pay as you go" method to make payments to make payments to retirees."* [xxxix]

The assumptions about paying for OPEB benefits is clear—the state assumes it can raise the money as it needs it. Like pension benefits, these benefits are a part of current employees' compensation packages, which should be recognized and funded in the year the compensation costs are incurred. Under the "pay-as-you-go" method the expense for these benefits will not be recognized until the current employees retiree and receive the benefits. Even though future taxpayers will be required to pay these deferred costs, they will receive no related governmental services or benefits.

V. CAUSES OF ILLINOIS' FISCAL DILEMMA

A. TAXING TOO LITTLE OR SPENDING TOO MUCH?

The root cause of any budgetary problem at home, in business or in the state capitol is simply spending more than there are resources available. This is obviously the problem in Springfield, but with the constitutional requirement to balance the budget, how does this happen? If it was a problem of accurately estimating resources available, one would expect that there would be an occasional surplus; since honest estimates are as likely to be too high as often as they are too low. Over time one would also expect that the errors would tend towards a sum of zero. In other words even if the state had to borrow in lean years, the fat years would produce a surplus of revenues over expenses that would be used to extinguish any debt.

Instead Illinois' operating deficits are chronic and produce continually expanding public debt. There never seems to be a year when the demands of the state's resources, approved by the general assembly, are less than the funds produced by the state's own-source revenues. Accordingly there must be a systematic problem in the budgeting process that always allows the general assembly to appropriate and spend more, every year, than a truly "balanced" budget would allow.

Estimates by several civic organizations, the recent downgrade in Illinois' credit rating and the state's mounting pile of unpaid bills provides convincing evidence that the state's fiscal problems are no longer in the abstract future. *They have arrived.* The cause is easily identified whether one believes taxes are too low or spending is too high. Illinois' public sector chronically grows at a rate faster than available revenue. It is clear that the current leadership expects future generations to pay for costs incurred currently, despite the state's Constitution's limits on spending--which is the primary guarantee of intergenerational equity. Illinois' financial structure and fiscal condition have so deteriorated that current taxpayers cannot liquidate its obligations. This calls into question the ability of the state to honor its promises to its people and creditors. This situation continues, because there is no check and balance available to Illinois' citizens other than the ballot box. This has the effect of making the petitioning of Illinois' government a losing proposition. The burdens this places on business—and the fear of future burdens—helps to explain why Illinois is 48th in population development beating only Ohio and Michigan over the last decades.[xl] There is evidence that outside forces—the bond market and the Securities and Exchange Commission (SEC)—may place limits on the state's spending and borrowing options. The interest rates Illinois pays have been rising, because the markets are beginning to recognize the state's fiscal problems. The SEC has begun policing the official statements of public sector bond issuers to make sure all the problems are disclosed.

B. THE MEANS AND MANNER OF ILLINOIS' FINANCIAL DISTRESS

The Institute for Truth in Accounting believes there are several main causes to Illinois financial distress. Many of these causes follow under three categories which are presented below:

- Human nature;
- Unlimited state sovereignty; and
- Misleading accounting practices.

Human Nature

Regardless of one's political viewpoint, basic human traits help explain Illinois' financial peril. Near-universal characteristics of human beings exhibit themselves in our politicians and consequences should be expected. America's founders explicitly recognized human nature when they limited the powers the federal government. In fact the primary difference between the state and federal government is that limitation. The following human attributes contribute to Illinois' fiscal problems:

- *Human beings seek the approval and respect of others.* This can be achieved by word or deed, but a certain way of building the regard of others is to provide an unexpected benefit. Politicians learned this lesson long before our republic materialized.
- *People treat their own property in a different manner than they treat others.* This is true for someone else's tools, their mule or rental cars. The same is true for politicians who look after taxpayers' money, regardless of *their* political viewpoint. It is always easier to spend others' money. Allocation of state resources—and their expansion—is the purpose of state government.
- *The sheer size of government spending must anesthetize our legislators at the margin.* After all what's another couple million after one has already spent fifty billion? The economic principal of marginality applies and tends to expand budgets.
- *Humans will seek ways to justify their behavior even when they know they are in error.* There is much to learn from the young child who says "but everyone does it!" State laws insulate elected officials from any personal liability.
- *Human beings enjoy belonging to groups and hesitate to challenge group behavior even when recognizing potential detrimental effects.*

The existence of these factors does not mean they cannot be controlled. Expressions of human nature are to be expected in our politicians and their appearance warrants taking extraordinary measures to ensure that the public interest is served first. Public primacy is the ostensible purpose of state's extensive reporting, even if the evidence demonstrates it does not work particularly well, if at all.

Sovereignty

In any discussion of Illinois' fiscal condition and the transparency in which it operates, it is important to remember the federal government is a creation of the state governments, not the other way around. The powers not enumerated for the federal government are reserved to the states, or the people. To put this distinction into perspective, consider that states describe corporations chartered in other states to be *foreign* corporations. This idea is important, because it spotlights the extraordinary powers the states have to conduct their financial affairs. This sovereignty is one of the reasons that states, including Illinois, have the financial troubles they are experiencing.

States have the power to do anything their constitutions permit. In Illinois that power is unlimited as long as it does not conflict with the federal constitution. These powers include the prerogative to account for its public activities in any way it chooses. Unlike the accounting and reporting requirements the state and federal government have imposed on the private sector, there is no form of power that constricts the accounting practices a state government may use.

The Government Accounting Standards Board (GASB) has been organized to develop accounting policies for state and local government. The accountants agree that these governments should produce more revealing, i.e. more transparent information:

> *"One of the most important aspects of GASB's mission involves establishing high-quality standards that result in making essential information about state and local governments' finances available, so that users of financial reports can make better informed decisions and government officials can provide public accountability for their stewardship of public resources."* [xli]

As noble as this mission is, it is without effect if a state chooses to ignore the standards GASB has created. States are sovereign powers and can simply refuse to follow GASB's mandates. As a consequence GASB must seek voluntary compliance from states and that means accommodating their fiscal realities. Here is GASB's assessment:

> *"GASB is not a government entity; instead, it is an operating component of the [Financial Accounting Foundation] FAF, which is a private sector not-for-profit entity. Funding for GASB comes in part from sales of its own publications and in part from state and local governments and the municipal bond community. Its standards are not federal laws or regulations and the organization does not have enforcement authority. Compliance with GASB's standards, however, is enforced through the laws of some individual states and through the audit process, when auditors render opinions on the fairness of financial statement presentations inconformity with GAAP."* [xlii]

This is in stark contrast to the accounting practices of the private sector. Private sector accounting standards are created by the Financial Accounting Standards Board (FASB) and are much more effective because they are essentially compulsory. Publicly traded corporations and smaller companies, who use banks, prepare their financial statements using FASB's Generally Accepted Accounting Principles. All, but the smallest companies, have the statements audited by outside, independent certified public accountants. Auditors apply Generally Accepted Accounting Principles consistently, and, when they find evidence of violation, they are required to reveal the finding and compel changes.

If the audited company refuses to change its accounting practices, auditors are obligated to declare that the company's financial statements are not representative of its financial condition. A "qualified statement" has immediate and negative consequences to a company's market price, its listing on stock exchanges, its contracting power, banking relationships and the attention of taxing authorities. These reasons are why qualified statements are exceptionally rare in the private sector.

No such leverage exists in the public sector, because the sovereign power of states trumps the power of any accounting standards organization. As mentioned in the Fifty State Study, the Governmental Accounting Standards Board was created due to pressure from organizations made up of governmental officials who did not want to adhere to FASB standards. These organizations include the Government Finance Officers Association; the National Association of State Auditors, Comptrollers and Treasurers; and the seven other groups representing state and local government officials. These organizations still have a great influence over GASB, because they dominate GASB funding and the board member selection process.

The stark difference between FASB and GASB standards is in the recognition of deferred compensation costs associated with retirement benefits. FASB required the reporting of these liabilities long before GASB. In fact GASB did not require states to even calculate OPEB liabilities until 2008. As mentioned previously, by the time this calculation and disclosure was required Illinois had accumulated $27.1 billion of liabilities related to retirees' health care and other post employment benefits. Recognizing the payroll costs associated with retirement benefits in the same way corporation would have highlighted the need to deal with these costs and accumulating liabilities earlier. Instead these costs are recognized far in the future, when the employees expect payment of these benefits and the legislators who promised the benefits are probably no longer in office.

The lack of adequate recognition and reporting of unfunded retirement benefits gives states, including Illinois, the ability to claim observance of GAAP *for government,* while not including tens of billions of dollars of the state's obligations on its Statement of Net Assets, the equivalent of a corporation's balance sheet. Instead these liabilities are presented in footnotes and required supplemental information---off the balance sheet. The effect of this is to encourage a similar approach to the budget process. If there is no requirement to report the majority of pension and OPEB obligations in the state's financial statements, what reason is there to provide for them in the budget? Illinois continually engages in this opaque treatment of promises made to its employees.

Another area where the state has used its powers to maintain the current budgeting and reporting *status quo* has been in the area of immunity from the law. In the case of the governor and the legislators responsible for creating and approving the budget, no personal legal jeopardy attaches to their actions, regardless of how fiscally foolish they might be. This creates a moral hazard for legislators who must be tempted to behave differently than they might if they were exposed to any legal risk. The result is that legislators believe that they will fare better electorally if they promise and spend as much as possible, instead of prudently managing their electors' resources and following the state budget law and the intent of the Constitution's requirement of a balanced budget.

Illinois law limits the ability of concerned citizens to legally challenge the legislature's actions. The state's Code of Civil Procedure,[xliii] included in the Illinois Compiled Statutes (applicable excerpts can be found in Appendix II), gives any citizen or taxpayer the right to sue the state, but require litigants to obtain permission from the state's attorney general to sue the state. These hurdles have essentially eliminated any suits. In addition, the Illinois Supreme Court has held that state employees cannot sue the state for not adequately funding their pension plans. According to the Court, retirees can only sue for underfunded pensions, if ever, when their pension checks are about to be dishonored.[xliv]

This statist attitude combines with another feature, which is found in Illinois' constitution Article XIII. Section 5 outlines:

> *"Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired."*

Misleading Accounting Practices

While transparency should be the guiding principle of all public entities and operations, significantly better accounting practices are also necessary to achieve true budget reform. As weak as they are, the CAFR is prepared using accounting principles imposed by the Government Accounting Standards Board. When the state prepares its CAFR, it observes these Generally Accepted Accounting Principles. The state's auditor checks for their use as he prepares his opinion on the fairness of the state's annual financial statement.

Unfortunately there are no GAAP standards for the front-end budgeting process. This means programs with accruing, non-cash costs can—and are—presented under different accounting practices for budget calculations than when they are reported in the CAFR. Because there are no accounting requirements to fairly present estimates of current costs to be paid in future periods in the current budget, the choices the governor and the general assembly make when presenting the budget are accounting *practices*, rather than accounting principles.

In practice the general assembly makes no effort to systematically and fairly present deferred costs in the budget. This practice structurally misrepresents the state's financial position and its future obligations. Its consequence is over $100 billion in unlegislated obligations current and future generations of Illinois face.

The Institute for Truth in Accounting has come to believe these structural accounting misrepresentations are the means and manner by which a parade of governors and legislatures have evaded the intent of the constitutional requirement to balance the budget. The Institute also believes that the current budget process does not represent the best interests of Illinois' residents; rather it represents the preferences of the politicians who operate it. This is not to indict the process as intentionally corrupt—although it may be—but to recognize the natural result of a sovereign monopoly.

Setting aside the question of intent, it is also clear to us that the budget process, as it currently exists, is the best tool our leaders have to appear to balance the budget, yet spend much more than any common-sense definition of "funds available" would include. As long as Springfield uses the most elastic financial definitions available, the greater the moral hazard becomes and the more state debt will be heaped on future generations.

C. LONG TERM TRENDS COMPLICATE THE BUDGET PROCESS

As dire as the newspaper headlines reporting the Illinois state budgets are, even larger problems loom according to the academicians who study Illinois' fiscal future. Not only are we facing the problem of liquidating the debts that the state is accumulating now, the demographic situation in Illinois—and nearly all other states—predicts increased demand for government services and entitlements. These realities make accurate forecasting and truthful budgeting even more important.

Analysts have identified three major areas of concern. According to the scholars at the Institute of Government and Public Affairs at the University of Illinois at Chicago[xlv] (IGPA), the state's problems consist of excessive current spending, a tax system that does not reflect the economic realities of the state's actual economic situation and a persistent "*structural deficit*".

In their opinion, confirmed above, the state has a history of spending beyond its means that existed before the current economic recession. This chronic condition has denied the state any "cushion" when recession-driven demand for more human services materialized and put additional pressures on the state's budget. Given this situation IGPA and others have concluded that the state's taxation system isn't properly constructed to raise enough revenue. In their view Illinois' entire taxation system is *structurally* inadequate to meet the state's needs. They illustrate this by pointing to a sales taxes system that doesn't tax services or goods purchased on the internet. They also believe there is an over-reliance on income tax collections, which are eroding. The mis-match they identify is on a cash basis and would be worse if all accrued costs, such as deferred compensation, were included.

What's most disturbing; however, are future trends the IGPA's report predicts. Beyond the current situation, demographic trends they identify foretell even larger fiscal challenges for

Illinois. The *future* "structural deficit" is the consequence of projected demographic developments that will change the complexion of services the state is expected to offer.

The IGPA chart showing some of these changes is reproduced below. The major categories of state spending as well as personal income are included. What stands out is the number of categories which are expected to grow faster than the state's personal income is forecasted to increase.

Overall the total expenditures are expected to increase at a 5.2% rate versus personal income growth of 3.4%. Over the next decade these growth rates forecast that spending levels will have increased by 67%, while personal income will be up only 40%.

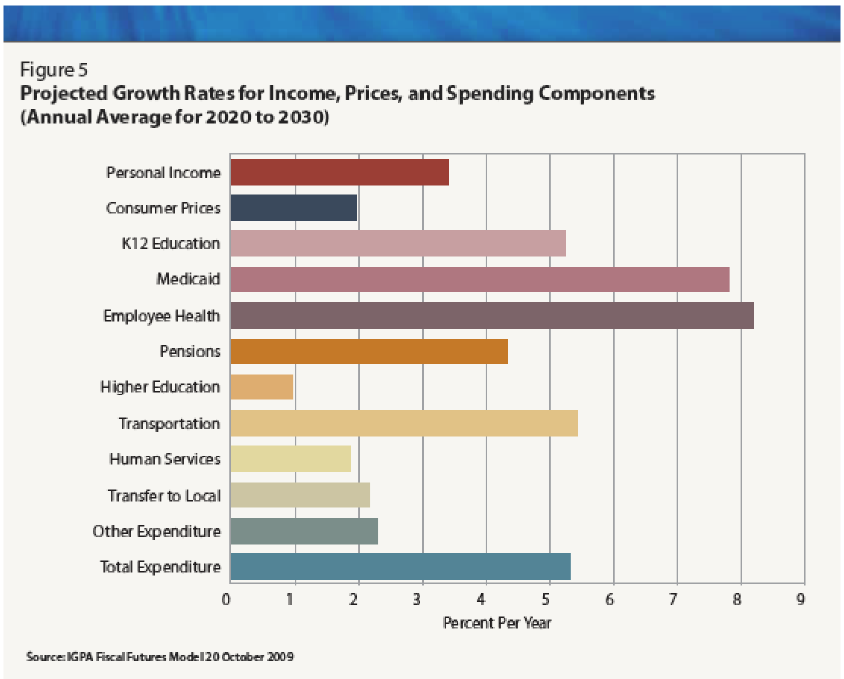


Figure 5
Projected Growth Rates for Income, Prices, and Spending Components (Annual Average for 2020 to 2030)

Source: IGPA Fiscal Futures Model 20 October 2009

Moreover they project that the spread between the state's revenue growth and expenditure growth of just below 1% (5.3% growth for expenditures versus 4.4% for revenues). This spread "may not seem like much" but this differential compounds over many years.[xlvi]

The major reasons for this are the aging of Illinois' population. As we age, two profound events occur. Individuals retire and begin paying less in taxes. Illinois does not tax pensions and this is one of the "structural" reasons the state's system of taxation does not raise enough revenues. In addition, the infirmities of age mean that demand for health care also increases. The state has taken responsibility (or has been mandated by the federal government) to provide health care for a growing number of citizens and as demand rises total costs do too.

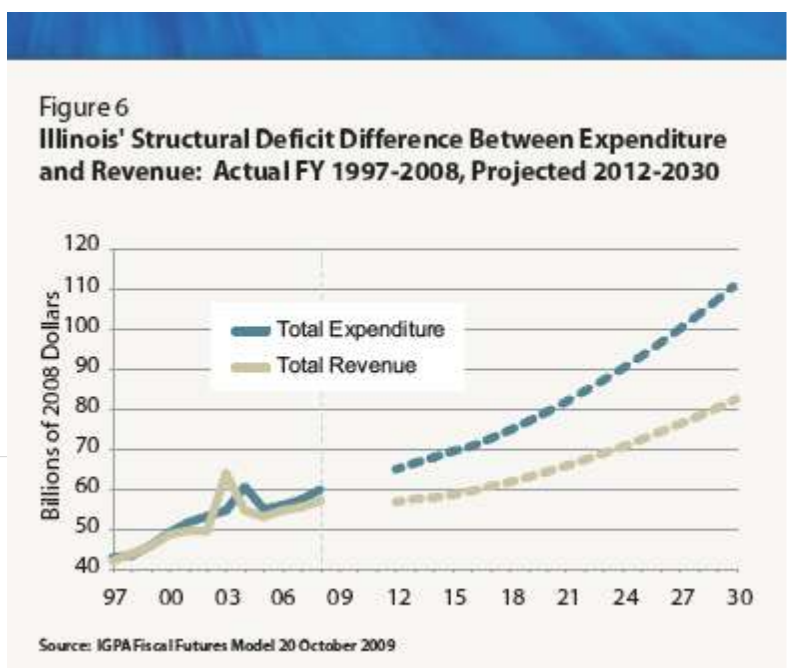


Figure 6
Illinois' Structural Deficit Difference Between Expenditure and Revenue: Actual FY 1997-2008, Projected 2012-2030

Source: IGPA Fiscal Futures Model 20 October 2009

As the IGPA chart here shows a plot of the state's expenditures and its total revenues shows that costs are expected to grow substantially faster than revenues. In the IGPA's opinion these two facts imply that the state's tax rates and tax base must substantially increase, if the annual budget deficits we are already experiencing can be decreased.

Regardless of one's view of whether the state should cut costs or raises taxes, the challenge for legislative budgeting is clear. Chronic, willful ignorance of accruing costs and exploding entitlements have built a $100 billion debt that will come due in the form of rising retirement and social services costs.

On top of these demographic changes will raise demand for and the costs of services the state provides. This combination makes it all the more important that the state's legislators tell themselves and the public the truth when constructing the state's annual budget. Even in the best of developing circumstances, Illinois will have great difficulty overcoming its fiscal challenges. Fixing what's wrong will be possible only if we comprehend and recognize the real costs of running government. These trends tell us our leaders should develop a comprehensive approach to the budgeting process if Illinois is to remain financially viable.

PART TWO

VI. TOWARDS A TRANSPARENT BUDGET PROCESS

A. ACCOUNTING TRICKS USED TO SPEND BEYOND AUTHORITY

Illinois' appalling financial condition is partially due to fundamental accounting deficiencies discussed previously. These deficiencies are found in the state's financial reporting system and annual budget calculations. The accumulated deficit, now reliably estimated to be more than $100 billion, results from years of annual budgets that simply have not recognized the state's explicit and implicit costs. While the state is perfectly within its sovereign rights to use the modified accrual basis of accounting for its annual report (CAFR) and to use expedient standards when preparing its annual budget, the reality is that without proper accounting, the legislature will exceed the constitutional intent of a balanced budget. The reasons for the balanced budget requirement are to avoid overspend that has resulted in the unsustainable debt the state currently has, and to maintain intergenerational equity; this means one generation should not pass its bills onto future generations.

B. ACCOUNTING OPACITY BY OMISSION

The central idea of transparency is disclosure. The purpose of the transparency movement is to expose the government's operations and spending, so citizens might better understanding and have a basis for criticizing or petitioning their government. Once revealed it is thought that the populace will self-organize, based on individual interests, to examine the data, identify objections and to pressure the government to improve. Lately the transparency movement has met with considerable success convincing administrative agencies to publish data that has previously been considered "private". This data had been kept secret without much basis in accepted public policy or for any other compelling reasons.

While some government agencies have been hesitant to publicize their expenditures, policymakers include a vast amount of information in the state's budget. But what happens when the information conveyed by the budget is misleading, false, missing or so complex as to seem purposely be opaque?

As all these conditions can be applied to the Illinois budget, the information it contains is not as revealing as its readers might think. In fact the deficiencies are so fundamental that a fair observer could conclude that the mis-information is intentional. Whether the budget is intentionally misleading or not, the undeniable effect is that Illinois' annual budget clearly fails to present reliable information about the state's real spending plans. Even though the budget is a very public document, its deficient disclosures have the same effect as if the details were concealed. It is opacity by omission. The result is that one reader can come to a completely different conclusion than another reader and the proof is often seen in interviews with state legislators. They deduce mutually exclusive understandings of the same budget—when they are able to answer budget questions at all.

C. WHAT'S MISSING?

At the outset of this project it was the Institute's sense that the major defect in state budgeting has been its failure to properly recognize the current costs of employing the state's workers. This includes the portion of compensation cost that is earned and incurred in the current period, but whose payment is not schedule for years to come. Employees have agreed to receive portion of their current compensation in the future in the form of pension and retiree health care benefits. The deferral of these current costs allows legislatures to reduce the current costs that are included in the budget. The omission of these costs are so evident and so large that one may question the intent of those who prepare the annual budget calculations.

Even if the budget has no GAAP-like standards and the state has the sovereign power to ignore them even if they existed, it is hard to believe that any legislator is ignorant of these growing obligations. Apparently that is not universally true. On November 18, 2009 the Institute's Sheila Weinberg testified before Illinois House Bi-Partisan Task Force on Budget Reform and Spending Reductions. She highlighted the fact that at that time if you included the retirement systems' liabilities, Illinois was more than $82 billion in debt. After her testimony three members of the general assembly questioned her estimate of the state's accumulated deficit. They asserted that the State was only $25 billion in debt. This amount appears to match the amount on the State's balance sheet, which does not include the full amount owed to the retirement plans.

Further confirmation of the lack of knowledge of the state's total liabilities came later in a meeting attended by members of the Institute and officials from the Commission on Government Forecasting and Accountability. The CGFA officials seemed less than aware of the need to include accruing employee service costs in their fiscal estimates and seemed somewhat resistant to considering them as part of a truly transparent process. The most interesting observation reported by the Institute's member was the opinion that this oversight was not due to any intention to mislead, but one arising from the intense pressure stemming from the annual deficit state lawmakers face. Nevertheless continued willful ignorance will not remedy the state's fiscal condition.

Reinforcing this impression are the activities of the Government Accounting Standards Board. On August 31, 2009 Sheila Weinberg and Ralf Seiffe, an IFTA member, appeared at the GASB hearing on state and municipal treatment of pension fund assets and liabilities. The purpose of this hearing was for testifiers to provide verbal comments on the Board's *Preliminary Views (PV) - Pension Accounting and Financial Reporting by Employers*. The PV highlighted that after more than 20 years of existence GASB is still grappling with concepts such as whether governmental pension plans' Unfunded Accrual Accrued ***Liabilities*** (UAAL) should be recorded as ***liabilities*** on the face of governments' balance sheets.

There is no pension liability reported on the face of the state's 2009 Statement of Net Assets (the governmental equivalent to a corporate balance sheet). A sophisticated user of the state's financial report may be able to find a $21 billion "Net Pension Obligation" included on page 84 in a schedule titled, "Changes in Long Term Obligations". The incomplete disclosure of pension liabilities, done in accordance with GASB GAAP, makes it difficult for most financial statement readers to know find the pension liability. A very sophisticated user may know that the truer liability numbers are found within a section titled "Required Supplemental Information". This schedule can be found deep in the 2009 CAFR on page 143. On this page a schedule titled, "Schedule of Funding Progress" reveals that despite the fact that the pension benefits are set forth in contract and some believe are "constitutionally guaranteed", more than $62 billion of these liabilities are maintain "off-balance sheet". More than $27 billion of the ***liability*** related to state retirees' health care benefits is also not included as a ***liability*** on the face of the state's balance sheet.

To determine "what's missing" given the complexity of the budget and the varying degrees of understanding of what constitutes a *transparent* budget, the Institute decided to survey a number of interested individuals and organizations for their opinions. The survey's purpose was to expose the missing pieces of the budget and to come to a consensus on what we recommend should be included in this report. Our sense was (and was later confirmed) that there are many accounts, funds and accounting treatments that are long on promises, but provide woefully inadequate disclosure of state financial activity.

In addition to the technical details of reaching a better definition of "what's missing", we determined that to attract the attention of the general assembly the definition must be supported by a wide variety of opinions, provided by organizations with differing and sometimes conflicting missions.

D. BUILDING CONSENSUS FOR BUDGET TRANSPARENCY: THE PROCESS

During the early autumn of 2009 the Institute's founder and CEO, Sheila Weinberg, reached out to opinion leaders to draft a panel of experts who had differing opinions and viewpoints on the budget problem. An array of potential panelists was drawn to include academics, taxpayers' advocates, trade unionists and business people. The resulting group was named the "Consensus Panel" (the Panel). In addition, Institute members attended the presentations and reviewed the documents which included various Illinois civic organizations' discussion and calculations of Illinois budget deficits. The object of the project was to bring together these experts to obtain agreement on the items that should be and should not be included in the budget calculations.

When presenting the items to the civic and various organizations, the Institute approached the task strictly from an accounting point of view. The Institute has developed significant expertise in public sector accounting practices and relied on the target organizations' expertise in specific state activities. The idea was to examine how the data should be presented, not to discuss or decide on the data's implications. By focusing only on the accounting considerations, we felt we could bring normally contentious organizations to the same table. This comports with the Institute's core value that it is solely concerned with truthful accounting and not with the policy decisions that are made as a result of better information. Given this foundation we found a surprising amount of agreement to participate on the consensus panel.

With this basic construct in mind throughout the fall Weinberg and Institute members created and circulated several proposed draft agendas for the consensus meeting,. Potential members of the panel and other interested parties provided valuable help in both expanding the scope of the proposed meeting and at the same time focusing the expanded number of topics to their most important elements. The final agenda consisted of queries on the nature of revenue and expense items as well as cash management practices used by the state within its accounts. The order of the agenda was arranged so the earliest items considered were those we believed would attract the most agreement and the later items the most disagreement.

E. CONSENSUS FINDINGS

The Consensus Panel met for a half-day on November 10, 2009 with the express purpose of obtaining a consensus on which revenues and costs should be included and which should be excluded from Illinois' annual state budget calculations. We were impressed with the degree of mutual courtesy and pleased to see near unanimous agreement on the items that should be included in the state's annual budget. The meeting's attendees included Joe Calomino, Americans for Prosperity; Kate Campaigne Piercy, Illinois Policy Institute; John Nothdurft, Heartland Institute; Nancy Hudspeth, University of Illinois at Chicago Institute of Government and Public Affairs (IGPA)[C]; Tom Johnson, Taxpayers' Federation of Illinois; Ralph Martire, Center for Tax and Budget Accountability; Jeff Mays, Illinois Business Roundtable; and Institute for Truth in Accounting Staff: Sheila Weinberg, Ralf Seiffe, Nancy Mathieson.

The panels' consensus included these findings:

- In general all agreed that the state's budget is a work of fiction. The proof being that the state's accumulated deficit is as large as it is.

[C] *IGPA later asked that their name not be associated with the Panel's findings. Although the staff of the Heartland Institute in theory agreed with the Panel's findings, Heartland's board of directors never gave its formal approval.*

- With regard to revenues that should be included in a transparent estimate of “funds available”, the group agreed that “earned” funds are described as “own source revenues” which include revenues that result in the state exercising its sovereignty by imposing taxes, fees, fines, etc. Twenty-eight such impositions exist including:
    - Personal Income Tax
    - Corporate Income Tax
    - Corporate Personal Property Replacement Tax
    - Sales Tax retained by the state (see more later)
    - Excise Taxes (e.g. alcohol, gasoline, energy)
    - User Fees
    - Fines and Penalties
    - Gaming Taxes
    - Investment Income

There was unanimous agreement that the proceeds of debt ***should not*** be considered funds available for purposes of meeting the statutory requirement with respect to the operating budget. Recognizing that “debt” is a vague definition that can be classified as funds, revenues or expenses, the group discussed these forms of debt:

- Bonded debt which is the result of explicit borrowing of which any portion is expected to be outstanding for more than one year;
- What was characterized as “working capital debt” which has been incurred under the “failure of revenue” provision in the Illinois Constitution;
- Failure to pay maturing obligations, e.g. Section 25 payments; and
- Willful ignorance of current and past accruing costs.

In addition to the debt described above, the group also agreed that funds received, those that are held in trust or have a fiduciary element, should not be included in the funds available category. These funds include pass-through funds and funds received by the state when acting as an agent or collector for another entity. Specific examples of these “non-own source” receipts include:

- Pension contributions made by state employees;
- That portion of sales tax collections which retailers pay to the state but which will be remitted to home rule and local governments;
- Court-ordered collections of child support; and
- Prepaid tuition plans.

The Panel came to a number of other conclusions and a complete report, *“Illinois Budget Transparency Workshop: Summary of First Workshop”,* on these findings is included as Appendix III.

F. RECALCULATION OF THE ILLINOIS' FY 2011 BUDGET

One of the project's main objectives is to use the findings to calculate a budget based on the Panel's consensus. Consensus Panel member, the Center for Tax and Budget Accountability (CTBA), made this calculation of the deficit resulting from Illinois' FY 2011 Budget:[xlvii]

Spending:	
Carry Forward of Unpaid Bills	$ 6.00
Repayment of Debt/Prior Fund Transfers	4.61
General Fund Appropriations	24.90
Required Pension Payment	3.52
Total Revenue Needed	$ 39.03
Revenue:	
Recurring Revenues:	
Estimated 2011 Own Source	
General Fund Revenue	$ 21.26
Estimated 2011 Federal Transfers	5.30
Total Recurring Revenue	$ 26.56
FY 2011 Operating Deficit	**$ (12.47)**
One-Time, Nonrecurring Revenue/Debt	
Securitization of Tobacco Litigation Proceeds	$ 1.20
Tax Amnesty Program	0.25
Raiding Special Funds	1.00
Carry Forward of Federal ARRA Transfers	0.55
Total One-Time Nonrecurring Revenue	$ 3.00
Minimum Remaining Deficit	**$ (9.47)**

As mentioned in our report (See Appendix III) there may be some disagreement as to the treatment of "Other Post-Employment Benefits". Never the less the CTBA analysis sends a clear message. The calculated deficit is 46% of general fund revenues. Even general fund appropriations exceed the amount available from the general fund by nearly $5 billion or 23% of the entire general fund revenues. This is clearly an unsustainable fiscal situation.

VII. REMEDIES AND INITIATIVES

A. ILLINOIS' BUDGETING PROCESS IS DYSFUNCTIONAL

All evidence indicates that Illinois' budgeting and financial reporting systems are dysfunctional. The current situation is not sustainable and without significant changes in the process and the practical results, Illinois' taxpayers and residents can expect the state's financial position to continue to deteriorate. As it does the state's bond ratings will continue to decline, state payables will grow larger, and state employees will wonder whether their pensions and other benefits can be paid. Crain's Chicago Business points out that the state's bond ratings have been repeatedly cut since 2008. Standard & Poor's has reduced the rating three notches and Fitch Ratings has reduced it by four notches. According to the Civic Federation these rating reduction will cost Illinois "an extra" $551 million in interest payments over the life of the $9.6 billion in bonds the state sold the fiscal year ended June 30, 2010.[xlviii]

As the people of Illinois confront the state's financial challenges, the most important ingredient they will need is ***information***. The Institute for Truth in Accounting believes that the budget and fiscal problems facing Illinois are exasperated by a *deficiency* of truthful and useful information issued by the state government. Any remedy must flow from timely and accurate information that is consistently prepared. This should be the hallmark of the state's financial statements. For Illinois to have a chance of overcoming its financial troubles, transparency and accuracy must extend to the general assembly's budget work.

The format of the state's audited financial report, which reports the financial consequences of an enacted budget, is useful because it is prepared using constant and more transparency standards. To allow users to better understand and compare the budgeted amounts to the actual revenues earned and expenses incurred, the budget should be prepared using the same accounting principles as its financial reports. To facilitate greater transparency and accountability, the growth in unfunded liabilities related to retirement benefits must be included in the budget deficit calculation. Transparency and honest estimates of the state's ongoing obligations to its citizens and employees must be presented *at the beginning of the process*, when the budget is being designed. Such disclosure would present the people of Illinois with real choices and would reflect the real consequences of the general assembly's choices.

B. A MORE TRANSPARENT BUDGET IN A POLITICAL CLIMATE

The Institute's position is that truthful budgeting—and truthful financial reporting—is its own reward. Nevertheless we recognize that reforming the budget process must be accomplished within the political climate with powerful, entrenched constituencies for the status quo. One constituency defends government services, benefits and entitlements, while another constituency pushes for low taxes and smaller government. The attempt to improve accounting policies should recognize this political reality. In addition to creating a new, more transparent state budgeting standard, we must review ways to convince politicians to adopt it. Both tasks are considered in this project.

C. FACT™ BASED BUDGETING AND ACCOUNTING [xlix]

With respect to accounting standards the path to improvement is clear to the Institute. Our recommendation is for full accrual accounting to replace the "modified accrual accounting" that has facilitated so much fiscal havoc for the state. To encapsulate these notions, the Institute has developed a program and acronym called "F.A.C.T." which stands for *Full Accounting Calculations and Techniques.* Appendix IV provides a description of the features of FACT based budgeting and accounting.

This conceptual framework brings a variety of reforms to the budget process that is already common in the private sector. State and federal governments require many taxpayers to maintain their records in this manner.[l] FACT based accounting would primarily require the state to recognize all costs when incurred and all revenues when earned. "Funds available" would exclude money borrowed for operating expenses. Revenues and expenses would be matched in the year they are incurred. Generally the FACT based approach can be considered a "holistic approach", which would consolidate the budgeting process and eliminate the legislature's incentive to create "funds available" by transferring cash from one fund to another.

FACT based techniques resolves the problems former Comptroller Dan Hynes identifies in his "three different definitions of a balanced budget" that was reported earlier in this report. All of these definitions of a balanced budget are based on a "cash basis" accounting system. The reason three definitions exist for the same fundamental transactions is that they relate to the balances in the state's checkbooks rather than the debts for which the state has obligated itself during the fiscal year. Each of the definitions focuses on the *paying* of obligations, rather than the *owing* of obligations.

The importance of this distinction is demonstrated in the state's current financial picture. Since the cash basis only recognizes expenditures when disbursed, no budget recognition is required when the obligation arises. This means that budgets are constructed on the basis of disbursements (checks written) and, if nothing is to be disbursed during the budget period, no amount need appear in the budget. Since there is no line item, there is no consumption of the "funds available". Indeed the more expenses that can be turned into accruals, rather than appropriated as cash during the fiscal year, the more "funds available" *will be* available for spending, as cash, this year. The most prolific exploitation of these fiscal manipulations is the masking of this year's total compensation cost by means of deferring a portion of the cost by creating pensions and OPEB obligations which will be paid in future years.

Under the state's budgeting practices contractual benefits that will be paid in future budget years need not be recognized until they are actually paid. A *reductio ad absurdum* example might be seen in the example in which a $25,000 special pension benefit is included in this year's labor contract. The contract outlines that this benefit is promised to be paid in the first month of the next fiscal year. In the typical set of private sector books of account this transaction would result in the entity recording and expense and an obligation of $25,000 multiplied by the number of people who will receive the payment. A liability would be reported on the company's year-end balance sheet and then be removed as the benefits are paid.

In contrast the state would record no expense or liability in the current year, because no cash changed hands. That does not mean the state's managers are ignorant of this obligation. Rather they just do not include it in the state's current budget. Instead the details of the future payment are noted elsewhere, only coming to light in the state's budget in the year the cash will actually be paid to beneficiaries. This is the very definition of "off-balance sheet financing" for which many private companies have been dissolved and their executives have been fined and/or jailed. One wonders why the states and our elected officials are treated so differently.

Using FACT based accounting would require the budget (as well as any financial statements) to report an expense and a liability for the $25,000 special pension payment at the instant that Illinois agrees to pay it to its workers. These costs would be included in the budget and would be counted as a use of the state's "funds available" calculation. Accordingly the obligation would never be filed away in some Springfield bureaucrat's office, but rather be placed on the budget for all to see…and worry about.

We emphasize again that the state's payroll costs include employees' salaries and employees benefits, such as health insurance, vacation pay, pensions and retirees' health care. The fact that the state chooses to defer the payment of some of these benefits does not reduce the state's current payroll costs. One can presume that if the benefits were not offered, employees would expect their current pay checks to be higher, so they could pay for these needs themselves. The budget should include the total payroll costs incurred, not just the amounts the legislators desire to pay now.

D. DEFICIENCIES IN THE COMPTROLLER'S DEFINITION OF "BALANCED BUDGETS"

With regard to the three balanced budget definitions of which former Comptroller Hynes wrote, FACT based accounting trumps each, because none of these approaches fully recognize the changes in total obligations. In the first of Hynes' definitions, balance is achieved when receipts and expenditures are equal. That's the equivalent of saying a household budget is balanced when an entire paycheck is spent this week on a new television, but the bills due this week are simply not paid.

The second of Hynes "balances" considers the budget compared to the "lapse period" expenses. This approach assumes balance can be achieved by paying last year's bills in the first two months of the next year. Again this is a cash based viewpoint. It is the same as paying prior months' credit card bills with this month's paycheck and considering it balanced, disregarding this month's charges that are accumulating.

Finally Hynes stated that a positive change in year-end cash balances meant the budget is balanced and goes so far as to say that a "less negative" cash balance is also to be considered a balanced budget. Putting aside the question of how a cash balance could be negative; this concept is flawed if he can just put off paying bills. For example assume one goes out to purchase holiday presents in December under this theory. Our jolly soul maxes his credit cards out starting the day after Thanksgiving, but because he used his credit cards the balance in his checking account is not affected. But his checking account balance would not be affected. Now on this New Year's Eve former Comptroller Hynes would judge matters improved by simply inspecting the checking account, ignoring the gigantic credit card bill that will arrive on January 2. Indeed our spendthrift could go out and enjoy a pricey New Year's Eve and still be "in balance" if his checkbook balance at the end of this year is higher than the end of last year.

At the risk of repetition, these inferior definitions of "balance" are the means and manner that are used to evade the Illinois' constitutional requirement to spend only "funds available". As long as these means and manner are available to the governor and the general assembly, it is unlikely the state's fiscal situation will improve. To be fair the Institute's research has revealed that these practices are typical in most states[li] and that there are huge accumulations of obligations in nearly every state. And to be fair to former Comptroller Hynes the state's CAFR contains his judgment that the budget is not only inaccurate but essentially illegal.[lii]

VIII. THE LEGISLATIVE INITIATIVE

E. THE BUDGET PLIGHT IS NO MYSTERY

One fact we learned in the course of this project is the widespread knowledge of the state's fiscal plight. As we have reviewed earlier in this document, many civic organizations, of all political persuasions, have come to similar conclusions regarding the size of the annual budget shortfall and the fiscal deficits that have accumulated over time. There may be differences in the actual estimates of the size of these two figures, but there is no argument that the state's deteriorating financial situation is unsustainable.

Putting aside the willfully ignorant in Springfield, our legislators are also aware of the problems facing the state. This begs the question of why our leaders would pursue policies that will clearly lead to insolvency and the eventual inability of the state to meet its constitutional responsibilities. The simple answer is that they have figured out how to provide the maximum amount of constituent benefits, while imposing the least amount of taxes possible. Thereby they receive the *quid pro quo* of votes from those they have pleased. There is nothing new in that observation, but the means and manner of using the budgeting process as a systematic method to evade the common-sense meaning of the state's balanced budget, a constitutional imperative, is relatively new.

As currently structured the budget process motivates our legislators to use any technique they can invent to expand spending beyond revenues available. Because there are no accounting standards for creating the budget, there are no real restrictions on the creativity of our legislators. State budget documents are not prepared using the rules used to prepare corporation financial statements, which are prepared using FASB's Generally Accepted Accounting Standards ***and*** are subject to governmental oversight. The release of Illinois' annual financial report is almost irrelevant, because it is published so long after the close of the fiscal year.

The temptation to spend too much money is too great to expect the legislature or the governor to make any significant effort to reform the budget process. As it exists budgeting simply provides too many political benefits for those who control it, so, there is no incentive to change. Absent some compelling reason, such as closure of the bond market to state borrowing or a countervailing political force, it will not change. Our Fifty State Study found that this political deviousness and the use of shoddy/misleading accounting techniques appear to be nearly universal among the states.

F. HALLMARKS OF A BETTER BUDGETING SYSTEM

The remedy is to modify the current system or create a new one. We believe that legislation that curtails the existing incentives is required to truly reform the state's budgeting system substantially enough to be considered transparent. Among the hallmarks of a better system would be standards that would create comprehensive and comprehensible budgets that truthfully estimates the state's available resources and accurately forecast the state's activities. The process should also be synchronized with the state's annual financial reports to facilitate the comparison and measurement of the effectiveness of Illinois' management systems. As effective managers, know improvement comes from meaningful estimates and measurements, but the current system does not such information.

In general, and at the root, reforming the budget process should have the primary objective of supporting the state government's responsibilities to provide information to its residents. This information should be provided so the state's residents have a basis to give their permission to be governed. Only when the state's residents have sufficient information to make this decision can the most basic bargain between the people and their government be credible. And it is incumbent on the state to meet this standard.

Another general objective should be to establish a better budgeting system that will provide warnings and incentives to improve the state's finances before a "compelling reason" materializes. Illinois' bond ratings have already been reduced and further deterioration is likely as long as the state continues on its current path. If so the state will find itself shut out of the credit markets. If that were to happen, disastrous consequences will occur. In addition, the state will find it difficult to borrow the funds needed to create infrastructure, to purchase of long-lived assets and for other necessary purposes.

Another general objective should be to expose the public and the media to the state's fiscal situation by proposing that the state be compelled to tell the truth. By raising this grievance we establish the existence of a problem that many residents will not be aware of. As will be discussed later in this section the interest of the public is a critical element in making any progress on this initiative.

G. SUPPORT FOR THE CURRENT PROCESS

In Section V we identified the major drivers of excessive spending to be human nature, unlimited state sovereignty and misleading accounting practices that structurally misrepresent Illinois' financial position. These three legs support the continuous accumulation of debt that should be prohibited by the state's constitutional limits on spending. Seen that way, the removal of any of these supports should upset the platform that supports the process.

It is unlikely that any change in human nature is possible; because the very nature of politicians is of self-interest. This was pointed out on very first page of the Federalist Papers. Alexander Hamilton warns:

> *"Among the most formidable of the obstacles which the new Constitution will have to encounter may readily be distinguished by the obvious interest of a certain class of men in every state to resist all changes which may hazard a diminution of the power, emolument, and consequence of the offices they hold under the State establishments…"*

This is powerful advice has survived for ten generations since it first appeared in the New York newspapers and it applies as clearly now as it did then. It informs us of the strategy necessary for change and it also warns us that any substantial improvement will require real change in the attitudes of that "certain class of men" now controlling and benefiting from the budget process.

Another leg of the platform is the accounting standards themselves. One possible strategy to bring about improvement in the Illinois' budget process would be to change the accounting standards for budgeting on the national level. This would involve the Government Accounting Standards Board and mean a substantial enhancement of their mission. This self-governing organization is mostly concerned with financial reporting standards, not budgeting. Expanding their portfolio is unlikely.

Indeed the Institute's research conducted for the Fifty State Study, as well as the information presented in Section III of this report, show that a strategy for change through GASB is likely to be unproductive for at least two reasons. First GASB represents a wide spectrum of deeply held, but conflicting views on the subject. These differences create an organizational paralysis that is illustrated by the fact that the budget debate has been underway since the 1980's. If the past is a predictor of the future, it's not likely that this debate will end any time soon. Second, even if GASB did come to a decision, it could be unfavorable, because GASB was created precisely as an alternative to the Financial Accounting Standards Board, which generates more conservative accounting principles.

H. POSSIBLE STRATEGIES FOR CHANGE

Lawsuit

Another possible strategy would be to file a lawsuit against the governor, the general assembly and/or the comptroller. This strategy is essentially precluded by a number of defenses the state could raise including standing, which in this case means the legal right to initiate a lawsuit. The state can declare that a citizen, group of citizens or organization do not have standing, because they cannot prove they were sufficiently affected by the state not following a state law. We also understand that the state requires a plaintiff seeking to sue the state to ask and receive the permission of the state attorney general before any action can proceed. Our initial exploration of a lawsuit strategy convinced us that it would be fruitless, because we could not gain standing in the courts. And such a strategy is beyond the scope of our mission.

Others have taken note of the budget situation and have concluded that the state's spending plan is both unlawful and unconstitutional. John Bambenek filed suit against Comptroller Hynes on that allegation, pleading that the former comptroller's own words and publications make a prima facie case. A prima-facie case is a lawsuit that alleges facts adequate to prove the underlying conduct supporting the cause of action and thereby prevail.[liii] The action is attached as Appendix V. The suit is now in "legal limbo" according to Bambenek's lawyer, Bruno Berhend. The state attorney general has not given permission for this lawsuit to proceed.

One possible related outcome of the Consensus Panel's work to define the meaning of "funds available" could be the convergence of interest groups that could find standing in the state's courts. Given the wide variety of the groups' outlooks, we have been informed that they may meet the tests of standing.

Legislative Approach

More likely then is a legislative approach. After all we cannot change human nature—only recognize it—and changes in accounting policies to be applied to the budget seems highly unlikely. It is an appropriate approach, because the state is allowed to use deficient budgeting processes because it is sovereign. So even if GASB should decide to set new budgeting principles, there is nothing prohibiting Illinois from flexing its sovereignty and simply ignoring them. By enacting legislation the general assembly itself would come to believe it must budget more honestly.

I. REFORM OBJECTIVES

The primary objective of a transparency movement is to create access to information that citizens can use to assess the performance of their government or other institutions that are releasing government information. From that the overall objective of budget reform must be to make the government accountable to the people.

In addition to improving budgeting transparency, any legislative approach should also include some improvements to the state's financial reporting process. The scale and difficulty of actually passing legislation demands this coordinated approach to actually accomplish any increased transparency and improved accountability. To that end the Institute has created an A*ccountability Checklist* that serves as the foundation for any legislative initiative. This checklist can be found in Appendix VI. The key points of the Accountability Checklist include:

Better Financial Reporting

Citizens have the right to receive reliable facts from their government. These facts are necessary to support debate between citizens and their elected officials. It is impossible for citizens to effectively interact with their government without truthful information. As we examined in the first section of this report, acceptable information includes financial reports that express the state's operations as clearly as possible. Financial reports should be reliable, free from bias and faithful to the facts they represent. Reports should also be comprehensive. Meaning nothing material should be omitted.

Accounting Basics

Financial reports and budgets should be relevant, timely and consistent. These qualities are the hallmarks of a proper accounting foundation that we believe the State of Illinois should adopt. The intent of this objective is to ensure the reports concern only germane information and that this information is consistent period to period. This permits comparisons to be made. For information to be useful it must be timely. As has been reported in this document and in the Institute's earlier reports, the State of Illinois habitually releases its CAFR more than a year after the expiration of its fiscal year. To be useful we've defined "timely" as a CAFR that is issued less than 180 days after the end of the fiscal year it reports. In any event it should be available to the governor and the general assembly prior to the convention of the new general assembly session every year. As a practical matter, this means it should be ready by January 1st for the prior year ending June 30th.

Audited Statements

The statements should be audited and to be transparent, the auditors' opinion should be unqualified. Any statement that is issued with a qualified opinion should be sent back to the agency that produced it and no new appropriations should be created until the opinion is clean. No change in auditor should be permitted during this period.

Financial Discipline

The primary purpose of spending and budget limitations, like the one in Illinois' Constitution, is to preserve *intergenerational equity*. This concept holds it to be improper for one generation to obligate future generations for benefits that the current generation consumes. Primarily this means the prohibition of spending on current costs for which implicit or explicit debt is created. It does not include issuing debt to pay for long-lived assets and infrastructure for which the costs can be spread over the years of the assets' useful life. The IFTA Consensus Panel examining the budget purposely avoided confronting capital expenses, but the lessons on current expenses are clear.

F.A.C.T. Based Budgeting™

With respect to budgeting, specifically, the object of the legislative approach is to ensure that any new budgeting process includes accrual accounting principles. The Institute has collected these principles as Full Accrual Calculation and Techniques which impose many of the private sector disciplines on the public sector.

J. THE LEGISLATIVE PROCESS

The essence of the legislative process is the marshalling of public opinion that influences the governor and the legislature to make changes that—at least in this case—directly conflict with the legislators' perceived prerogatives to freely spend the public's money.

Expectations

Over the several years that the Institute has been studying the budgeting and financial reporting habits of our federal and state governments. We have come to the conclusion that the accounting practices are one of the sources of the governmental opacity. In assessing the likelihood of changing this situation a legislative approach is a long-term strategy.

Our expectations are tempered by looking at the history of any reform movement. One very similar situation is the effort to improve Illinois' basic governmental transparency which was passed during the last legislative session. It was a three year effort and took significant convincing of the state's legislators. The Illinois general assembly is an extraordinarily busy place with some 6,000+ bills, resolutions and other items filed with the clerk each year. This places incredible demands on legislators' time and it is unrealistic for any legislative initiative to make any progress without significant public support. Creating support for a bill that does not provide specific, concentrated benefits for an identified group is a very hard task.

Lessons from Social Movements

Social science research indicates that one way to change a grievance like the opacity of Illinois' budgeting process is to approach the task as a social movement. The three primary elements of a social movement are to spotlight the problem of the opaque budget; to create a solution that is credible to those concerned; and finally to build support for the solution with the public that has potential to participate in changing the situation.

The issue which the Institute has wrestled with since its founding is how to establish the existence and severity of the accounting problem as a public grievance. The good news on this transparency project is that the members of the Consensus Panel ***do*** understand the nature of the problem. Even more interesting and promising is the general agreement as to the specific items to be included.

In addition, the dynamics have substantially changed in the last several years. There is no doubt that there is growing awareness in the public's mind of the financial predicament in which the state finds itself. In our opinion the combination of visible budget pressures and the current economic recession have made the situation plain for many Illinoisans.

With regard to the creation of a credible solution we realize that the complexity of "accounting" makes the assessment of the "credibility" of our recommendation difficult. On the other hand the credibility threshold is whether the eventual legislation is workable and constitutional.

Finally we also recognize that the creation of a social movement requires the identification of those potentially interested in the issue (i.e. grievance), accept the solution and are willing to make a personal commitment to moving the issue along. The IFTA has limited expertise in this area.

The Team

Following the identification of the consensus budget items, Joe Calomino, the state director of the Americans for Prosperity's Illinois chapter of and a member of the budget Consensus Panel, approached IFTA with the idea that their efforts on transparency could be significantly expanded with a statutory requirement for a transparent budget process. Americans for Prosperity and Calomino had been successful in creating the bill to increase Illinois' state level transparency during the previous legislative session and felt that a budget approach would be the next step.

At the same time IFTA was considering what use could be made and what positive action could be taken with the consensus items and the legislative process. We were already engaged with this report and had spent time testifying at the Illinois House Bi-Partisan Task Force on Budget Reform and Spending Reductions to "spread the word" on the value of a transparent budget process. In addition, we also had to consider our 501(c)(3) status, which impose limits on the amount of advocacy in which we may engage.

Recognizing a match between IFTA's power to educate and Americans for Prosperity's ability to assemble audiences that want to learn about the issue surrounding the state's budgeting process, we decided to pursue related strategies to introduce the notion to individuals, civic organizations, legislators and bureaucrats. We began to find IFTA and Americans for Prosperity's common goals.

One of these intersections was with State Representative Mike Tryon (R-Crystal Lake). A successful businessman and former McHenry County Board president, Tryon was the chief sponsor of the successful transparency law. Because he is a businessman who is subject to the more stringent accounting policies in the private sector, Tryon understood the troubles that the current system is accumulating for future Illinoisans. Accordingly he agreed to meet with us and explore a legislative remedy.

We did meet soon after the conclusion of the Consensus Panel's work and before the start of the 2010 legislative session to discuss with Tryon what the panel had decided should be –and shouldn't be—included in the state's budget. As is evident from this list and from the broad agreement of the Consensus Panelists, there isn't much that is very controversial. Tryon agreed with most of the Consensus Panel's findings and also agreed to work with Calomino and Americans for Prosperity to create a follow-up to their transparency bill. IFTA agreed to provide any accounting-related expertise to educate legislators and to inform any prospective legislation.

Subsequently we met with a republican caucus staff member, Frank Strauss. Mr. Strauss expertise is in writing legislation that is congruent with Illinois' legislative system and would be both constitutional and enforceable. It soon became clear that the implementation of a comprehensive Truth in Accounting Act would be a disastrous strategy, given the entrenched interest in the current system. The alternative we developed was to create an advisory system that would require the governor to inform the legislature of an estimate of revenues and costs of the budget proposed using what amounts to F.A.C.T. based budgeting. Put simply the legislation would answer the question: If the budget was enacted, what would the resulting financial statements look like using full accrual calculations.

Given the extraordinary resource that Mr. Strauss represented and the findings of the Fifty State Study, both Mr. Calomino and IFTA soon concluded that any legislative output could serve as a template for other states that have similar budgeting problems. Preliminary results of our second Fifty State Study confirm this is the case in almost every state.[liv]

During late 2009 and the early part of 2010 we met with Mr. Strauss to integrate the objectives of budget transparency, as well as the IFTA/Americans For Prosperity's objectives into a new proposed bill. Using the consensus findings as a guide, a bill was created to address the many concerns of both organizations, potential legislative sponsors and many citizens-at-large.

Elements of the Proposed Legislation

The reality of the state's financial condition and its budgeting process indicates that real reform is a long-term process. Accordingly the purpose of the legislation that came from these activities is to add *disclosure* of an accurate assessment of Illinois' financial condition as part of the budgeting process. The legislation allows the governor and legislators to justify their balanced budget calculations using their past accounting practices. While we would prefer all future budgets be prepared in a transparent and constitutional manner, the political will to do so simply does not exist at this time. It is our sense that changing the situation in Springfield begins with disclosure that engenders concern, which begins to open minds that are now closed to reform.

On February 3, 2010 HB5212 the "Truth in Accounting Act", was introduced by Rep. Tryon. On February 24, 2011 the purely disclosure bill was introduced as HB3231, the "Long-Term Accounting Act". The text of HB3231 can be found in Appendix VII. The Act improves the disclosure of the financial consequences of public policy choices. One of its goals is to enhance legislators' and the public's ability to understand the long term financial consequences of budget decisions. The Act also:

- Promotes greater transparency, disclosure and accountability in the budget process.
- Provides the general assembly and Illinois citizens with information to better understand the true costs of programs and services.
- Presents a clear picture of the direct impact a proposed budget would have on the state's current and future financial condition.
- Requires additional budget documents be created using Full Accrual Calculation and Techniques.

Synopsis as Introduced

Creates the Long-Term Accounting Act of 2011. Provides that the purpose of the Act is to improve transparency and accountability during the state budget process. Contains provisions concerning the passage of appropriation bills and the electronic publication of appropriation bills. Amends the State Comptroller Act. Requires that the Comptroller publish a comprehensive annual financial report. Amends the Commission on Governmental Forecasting and Accountability Act. Provides that the Commission on Governmental Forecasting and Accountability must publish fiscal budget statements. Sets forth the requirements for the fiscal budget statements.

Specific Legislative Intent

It is the intent of this Act to improve transparency and accountability during the State budget process that:

1) Confirms and strengthens the State's special responsibility to disclose its actions and results of those actions in a timely and useful way.

2) *Establishes the concept that state budgeting disclosures and financial reporting are created primarily for the purpose of informing the public of government activity and creating widespread understanding of these actions.*
3) *Adopts the use of a consolidating budget documents to facilitate the public's ability to understand the State's annual and accumulated shortfalls despite the relative scale of the State's financial operations and, the volume and complexity of budget and financial data.*
4) *Establishes the State's duty to report the best estimate of its own financial condition.*
5) *Requires a comprehensive indication of the total activity of government and the long-term effects of current policy.*
6) *Calls for the calculation of the long-term financial implications to the state and others of the budgetary decisions.*
7) *Provides the full costing information to necessary to accurately calculate performance measurements.*
8) *Establishes definitions of existing statutory language to strengthen the Governor's and the General Assembly's ability to determine compliance with the intent of Section 8 Article 2 of the Illinois Constitution requirement, which is to preserve intergenerational equity.*
9) *Requires explicit disclosure and accurate reporting by the Governor and the General Assembly of:*
   a) *Debt incurred to fund current operating expenses;*
   b) *Current and past costs shifted to future budgets and imposed upon future taxpayers;*
   c) *State obligations, including but not limited to current and future personnel benefit costs and lapse-period expenditures; and*
   d) *A fiscal deficit in terms of the excess of full accrual expenses over full accrual revenues and a budget surplus in terms of the excess of full accrual revenues over full accrual expenses at the time the final budget is sent to the Governor.*
10) *Calls for the Governor and the General Assembly to determine if future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.*
11) *Acknowledges costs when incurred during the budget year regardless of when they are paid.*
12) *Injects the expertise and knowledge of the State Comptroller's Office into the preparation of budget calculations.*
13) *Unveils the State's unusual reliance upon the use of more than 600 special funds.*
14) *Requires the Annual Budget and the State's Comprehensive Annual Financial Report to be prepared to facilitate a simple comparison of budgeted amounts to the actual amounts spent and received.*
15) *Requires State agencies to report to the Comptroller all fiscal information necessary to prepare a comprehensive annual financial report in a timely manner.*
16) *Mandates the production of the State's Comprehensive Annual Financial Report within six months after the State's fiscal year end.*

K. SUPPORT FOR THE EFFORT AND RESULTS IN SPRINGFIELD

We believe accomplishing these sixteen objectives would fundamentally change the budget process for the better. If adopted the informational output would increase awareness of the problem beginning immediately and would grow over time. Indeed the very ambitiousness of the objectives are a serious threat to the status quo that exists in Springfield.

During the 2010 legislative session Representative Tryon and Joe Calomino worked to develop support for HR 5212 and secured 18 state representatives as co-sponsors, 16 Republicans and two Democrats.

As we expected 2010 was not the year that the Truth in Accounting Act would be adopted in Illinois. Nevertheless the fact that the bill was able to attract the support of one out of every six House members is gratifying and shows that a growing number of our legislators are beginning to understand the state's fiscal condition and the part that budgeting has, and continues to play.

In 2011 we anticipate additional legislators will co-sponsor the Long-Term Accounting Act. To educate legislators about the provisions and advantages of the Act the Institute will be holding legislative workshops. As of March 2011 three workshops have been held; one in Springfield and two in the suburbs of Chicago. As the legislators become familiar with the Act we are hopeful it will gain the approval of the legislators and will be signed into law by the governor.

IX. FOOTNOTES

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[xiv] NCGA, "State and Local Budgetary Reporting-Proposed Interpretation", 2 March 2 1984.

[xv] *Ibid.,* paragraph 6.

[xvi] *Ibid,* paragraph 11.

[xvii] *Ibid,* paragraph 12.

[xviii] *Ibid.*, paragraph 12.

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> "If Nixon chooses to keep taxes at present levels—without the surtax—he will enjoy the benefit of "a fiscal dividend." This dividend is created by the automatic rise in federal revenues that accompanies the economy's growth; automatic, that is, so long as the economy does grow, for recessions have not yet become unconstitutional. If the gross national product continues to advance at a rate of an average 6-7% annually, tax revenues will increase faster than federal expenses. This will produce a dividend of $8 billion in 1971 and thereafter climb impressively to $35-$40 billion by 1974. By applying the fiscal dividend as he sees fit, Nixon will have discretionary power to fund new programs, increase old ones, reduce taxes—or indeed, some combination of these."

[xxii] Association of Government Accountants, *op cit.,* P. 4.

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[xxxvi] *Ibid.,* Page X.

[xxxvii] *Ibid.,* Page X.

[xxxviii] Commission on Government Forecasting and Accountability, "Report on the Condition of Illinois Retirement Systems: Financial Condition as of June 30, 2009," Page 22, <http://www.ilga.gov/commission/cgfa2006/Upload/FinCondILStateRetirementSysMar2010.pdf> (Accessed 15 March 2011).

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XI. APPENDIX

B

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www.ctbaonline.org

ILLINOIS FY2011 OPERATING AND TOTAL DEFICIT REMAINING UNDER HB 859, SA 1, 2, 3.

Updated: October 18, 2010

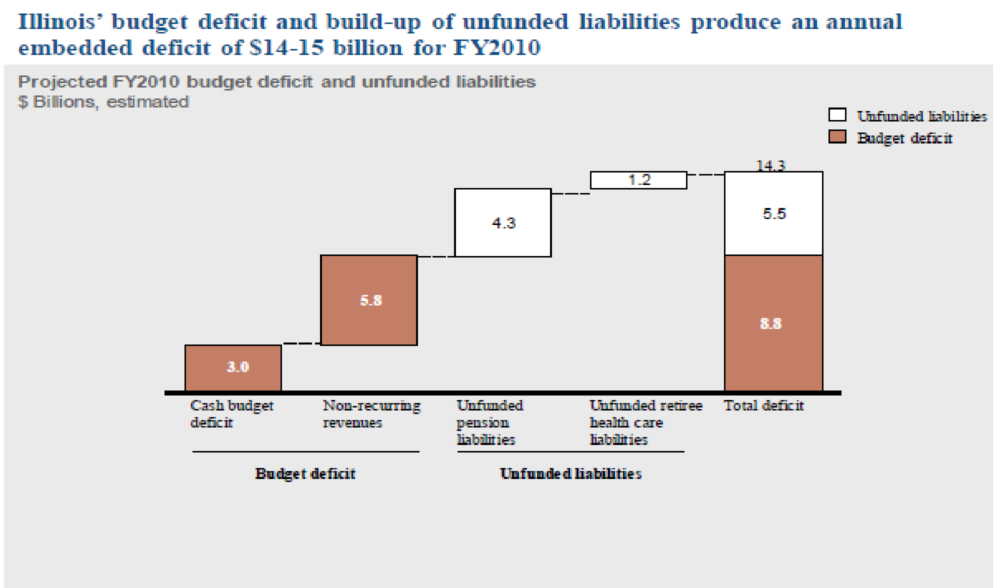
(i) Revenue Needs in FY 2011	
• Carry Forward of Unpaid Bills from FY2010	$ 6.0 B
• Repayment of Debt/Prior Fund Transfers	$ 4.61 B
• Required Pension Payment	$ 3.52 B
• Initial General Fund Approps FY2011	$26.32 B
• **Total Revenue Initially Needed in FY 2011**	**$40.45 B**
(ii) Anticipated FY 2011 Recurring Revenue	
• Estimated 2011 Own Source Gen Fund Revenue	$21.26 B
• Estimated 2011 Federal Transfers	$ 5.30 B
• Total Recurring Revenue	$26.56 B
(iii) Initial FY2011 Operating Deficit	**(-$13.89 B)**
• Initial Operating Deficit as % of Initial GF Approps	**(-52.8%)**
(iv) Cuts From Initial GF Approps	
• Initial FY2011 Spending Cuts Announced in July 2010	$1.42 B
(v) FY2011 General Fund Approps Remaining after July 2010 Cuts	$24.9 B
(vi) FY2011 Operating Deficit After July 2010 Cuts	**(-$12.47B)**
• Remaining Operating Deficit as % of Revised GF Approps	50.1%
(vii) One-Time, Nonrecurring Revenue/Debt Created for FY2011 GF	
• Securitization of Tobacco Litigation Proceeds	$1.20 B
• Tax Amnesty Program	$ 0.25 B
• Raiding Special Funds	$1.00 B
• Carry Forward of Federal ARRA Transfers	$0.55 B
• **Total One-Time Nonrecurring Revenue**	**$3.00 B**
• One-Time Revenue as % of Revised FY2011 GF Approps	12.0%
(viii) Remaining FY2011 Deficit	**(-$9.47 B)**
• As Percentage of GF Approps (After July 2010 Cuts)	**(-38.0%)**

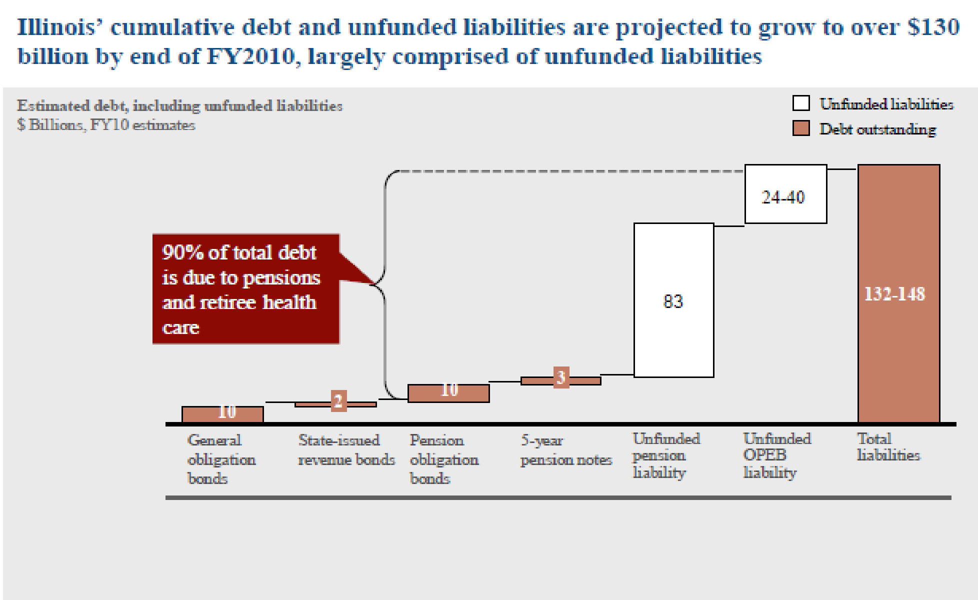
Page 1

For reference to source document see footnote xlvii.

Civic Committee of the Commercial Club of Chicago
Illinois State Finance – A Study in Failure

COMMERCIAL CLUB MEETING - Tuesday, January 12, 2010
W. James Farrell, Chairman, The Commercial Club of Chicago
Retired Chairman and CEO, Illinois Tool Works Inc.
R. Eden Martin, President, The Commercial Club of Chicago





For reference to source document see footnote xxxiv.

The Institute for Illinois' Fiscal Sustainability

AT THE CIVIC FEDERATION

STATE OF ILLINOIS FY2011 RECOMMENDED
OPERATING AND CAPITAL BUDGETS:
Analysis and Recommendations
April 26, 2010

State of Illinois General Funds Budget Surplus (Deficit): FY2010 (in $ millions)		
Revenues		
State Sources	$	19,085
Federal Sources	$	6,743
Statutory Transfers-In	$	2,117
Total Revenues	**$**	**27,945**
Expenditures		
Appropriations	$	(26,309)
Unspent Appropriations	$	400
Subtotal Expenditures	**$**	**(25,909)**
Statutory Transfers Out		
Legislatively Required Transfers to Other Funds	$	(2,002)
Pension Obligation Bond Debt Service	$	(564)
Debt Service Transfers for Capital Projects	$	(670)
Subtotal Statutory Transfers Out	**$**	**(3,236)**
Total Expenditures and Transfers Out	**$**	**(29,145)**
Budget Operating Surplus (Deficit)	**$**	**(1,200)**
Short-term Borrowing Proceeds, net of Repayment	**$**	**(1,045)**
Budget Basis Surplus (Deficit) for FY2010	**$**	**(2,245)**
Carry Forward of FY2009 Year-end Deficit	**$**	**(3,673)**
Total Year-end Deficit FY2010	**$**	**(5,918)**

Source: Illinois State FY2011 Budget, p. 2-10 and 4-16. Statutory Transfers-In were adjusted by the Civic Federation to reflect the $50 million loss in Riverboat Gaming Taxes discussed in the text on 4-16.

For reference to source document see footnote xxxiii.

APPENDIX II - EXCERPTS FROM ILCS CODE OF CIVIL PROCEDURE

(735 ILCS 5/11‑301) (from Ch. 110, par. 11‑301)

Sec. 11‑301. Who may file action. An action to restrain and enjoin the disbursement of public funds by any officer or officers of the State government may be maintained either by the Attorney General or by any citizen and taxpayer of the State.

(Source: P.A. 82‑280.)

(735 ILCS 5/11‑302) (from Ch. 110, par. 11‑302)

Sec. 11‑302. Action by Attorney General. Such action may be maintained by the Attorney General, by filing in the office of the clerk of the circuit court of the proper county a complaint in the name of the People of the State of Illinois. When such complaint is filed, it shall be presented to the court and an order shall be entered thereon showing the day of presentation and the day, which shall not be less than 5 days and not more than 10 days thereafter, when the court will hear the same.

(Source: P.A. 83‑707.)

(735 ILCS 5/11‑303) (from Ch. 110, par. 11‑303)

Sec. 11‑303. Action by private citizen. Such action, when prosecuted by a citizen and taxpayer of the State, shall be commenced by petition for leave to file an action to restrain and enjoin the defendant or defendants from disbursing the public funds of the State. Such petition shall have attached thereto a copy of the complaint, leave to file which is petitioned for. Upon the filing of such petition, it shall be presented to the court, and the court shall enter an order stating the date of the presentation of the petition and fixing a day, which shall not be less than 5 nor more than 10 days thereafter, when such petition for leave to file the action will be heard. The court shall also order the petitioner to give notice in writing to each defendant named therein and to the Attorney General, specifying in such notice the fact of the presentation of such petition and the date and time when the same will be heard. Such notice shall be served upon the defendants and upon the Attorney General, as the case may be, at least 5 days before the hearing of such petition.

Upon such hearing, if the court is satisfied that there is reasonable ground for the filing of such action, the court may grant the petition and order the complaint to be filed and process to issue. The court may, in its discretion, grant leave to file the complaint as to certain items, parts or portions of any appropriation Act sought to be enjoined and mentioned in such complaint, and may deny leave as to the rest.

APPENDIX III - ILLINOIS BUDGET TRANSPARENCY WORKSHOP

Summary of First Workshop

Date: November 10, 2009

Workshop Purpose: Obtain a consensus among these organizations as to which costs and revenues should be included or excluded from the Illinois budget calculation

Attendees:
- Joe Calomino - Americans for Prosperity
- Kate Campaigne Piercy- Illinois Policy Institute
- Nancy Hudspeth - UI- Institute of Government and Public Affairs
- Tom Johnson - Taxpayers' Federation of Illinois
- Ralph Martire - Center for Tax and Budget Accountability
- Jeff Mays - Illinois Business Roundtable
- John Nothdurft - Heartland Institute
- Institute for Truth in Accounting Staff: Sheila Weinberg, Ralf Seiffe, Nancy Mathieson

The ground rules for this and subsequent meetings are simple: the only concern is to develop consensus definitions and methods to refine the calculation of Illinois' annual budget. All discussion of policy was discouraged and this approach produced a remarkable degree of agreement.

Overall, there is a degree of discomfort as to what the "budget" actually is. The group felt that most analyses focus on the General Fund, almost to the exclusion of the other funds which number more than 600. We would describe this feeling to be a general disconnect between a conventional understanding of what "budgeting" is and that process in which the Governor and the General Assembly annually engage.

To help the group understand the issues, it first constructed a summary, presented here and more fully discussed below:

REVENUES:

I. State Owned Sourced Revenue
- Personal income tax
- Corporate income tax
- Sales tax
- Excise tax (motor fuel, public utility)
- User fees
- Fines, penalties, violations

- Investment income
- Corporate personal property replacement tax
- Gaming

(Should not include sale of asset proceeds, debt loan proceeds, pass backs (trust funds*), prepaid tuition funds, employee pension contributions, child support funds, locally imposed taxes collected by states)

II. Federal Transfers

EXPENDITURES:

I. Current service costs
II. Debt service
- Loans (interest and principal on capital assets)
- Interest on pensions (unfunded liability)
- Prior year's debt service (principal and interest)**

III. Unpaid bills incurred in prior years

General Observations and Consensus

1. The group agreed that one of the primary reasons for a balanced budget is to preserve intergenerational equity, that is, to prohibit one generation from obligating future generations. This comports with the Government Accounting Standards Board's interpretation of the purpose of "balanced public budgets".

2. No one believed that the state's annual budget is "balanced" in any reasonable context. The consensus regarding the annual deficit was that it is "greater than zero but less than infinity".

3. There was consensus regarding a distinction between operating budgets and capital budgets and that it is proper to incur long-term obligations to acquire long-lived assets.

4. There was general agreement that the definitions for "capital expense" is nebulous and that some "capital expenditures" are actually operating expenses. This confusion arises because some operating expenses come from accounts that are considered "capital". One example would be the building of a road versus its maintenance. There was general agreement that the initial building of a road is a capital expense but that pothole patching is not, even though these sorts of repairs are classified as "capital expenses" because of the source of funding.

5. The opposite case may be true, as well; state purchases that would typically be considered capital expenditures may be reported as operating expenses because of the source of funds used to make the acquisition.

6. The members of the group recommended that the State develop comprehensive definitions of "capital expenditures" and "capital assets".

7. Given the complexity of the capital budget and its nature, the group decided to defer an assessment of the capital budget and concentrate on the operating budget.

8. The amount of data, its complexity, the relative scale of the state's financial operations and the reporting systems make it difficult to grasp the state's annual shortfall or its accumulated deficits. Generally, the group expressed concern that the financial reporting systems are inadequate and that it sometimes double counts revenues and expenses. To remedy this, we agreed that a consolidating budget document should be part of the budgeting process which would eliminate this source of uncertainty. In practice, the idea is to have an elimination column to consolidate situations in which one agency collects revenues and pays them to another and then the second agency reports those same payments as revenues and reports its expenses against the revenues.

9. The state's fiscal construct differs from other states in that we have an unusually large number of specific purpose funds. Where other states handle most of their functions via the General Fund, Illinois makes do with more than 600 supposedly "restricted funds".

10. "Trust fund" should be defined as those which have a fiduciary component.

11. The group found the Consolidated Annual Financial Report to be of little value in any budgeting cycle because it is not produced on a timely basis and questionable presentation of long term liabilities. Nevertheless, they believe it should be produced within 90 days of the state's fiscal year end. (Post-meeting note: If the CAFR was available within 90 days it would be available prior to the November veto session.)

12. As a consequence of these issues, the group decided that any analysis of the state' budget should be conducted in a holistic fashion. This means the gross cash flowing into the state's accounts should be adjusted to meet the consensus definition of what is properly "available" to the state and expenditures flowing out should be similarly modified. This will permit the calculation of a consensus "minimum annual surplus (deficit)" that the group believes will be meaningful when testing the constitutional requirement. The following sections examine the revenue and expense separately.

Revenue Related Consensus

The root question regarding the operating budget revolves around the Illinois Constitution's requirement that the governor and the general assembly spend no more than the "funds available" to it. The proper identity, definition and the treatment of "funds available" and the corresponding state expenditures are the subject of this effort.

2. With respect to "funds available", the group found consensus that the term is too elastic to have much meaning. The natural tension between the General Assembly—or any legislative body—to spend and the limitation of the scarce resources available to it, means a better definition of "funds available" is required.

3. The group concurred that a more conservative standard—in an accounting sense rather than a political sense—would be helpful. The group agreed that only those funds the state "earns" should be included in the calculation of funds available.

4. The group agreed that "earned" funds are described as "own source revenues" which include revenues that result in the state exercising its sovereignty by imposing taxes, fees, fines, etc. Twenty-eight such impositions exist including:
   - Personal Income Tax
   - Corporate Income Tax
   - Corporate Personal Property Replacement Tax
   - Sales Tax retained by the state (see more later)
   - Excise Taxes (e.g. alcohol, gasoline, energy)
   - User Fees
   - Fines and Penalties
   - Gaming Taxes (Lottery?)
   - Investment Income

5. Items that should not be included in funds available are those which result from the actions of another entity or government; funds received that are held in trust or have a fiduciary element; pass-through funds or funds received by the state when acting as an agent or collector for another entity. Examples of these "non-own source" receipts include:
   - Pension contributions made by state employees
   - That portion of sales tax collections which retailers pay to the state but which will be remitted to home rule and local governments
   - Court-ordered collections of child support,
   - Prepaid tuition plans

6. With regard to trust funds, more specifically, the group agreed that proceeds swept from trust funds should not be included in the calculation of funds available. They identified four such fund categories: appropriated and non appropriated funds and federal and state related funds.

7. There was discussion, but not complete agreement on the propriety of some fund sweeps. On the one hand, the funds were established to accomplish certain state functions such as licensures, regulatory and other functions. Initially, the fees collected and deposited into these special purpose funds were to be used to accomplish the

legislature's ostensible purpose in creating the fund. Once created, there are a range of outcomes. Some funds that regularly produce a surplus after accomplishing their statutory purpose. Sweeping these was more acceptable to the group than the sweeping of funds from accounts that are not meeting their statutory responsibilities, are dormant or are outside much public scrutiny. There was general disgust for the change in statute that permits the executive branch to breach what one member would surely consider the fiduciary duty of purposed state fund accounts to be spent on other purposes.

8. There was unanimous agreement that the proceeds of debt should not be considered funds available for purposes of meeting the statutory requirement with respect to the operating budget. Recognizing that "debt" is a nebulous definition that can be classified as funds, revenues or expenses, the group discussed these forms of debt:

   - Bonded debt which is the result of explicit borrowing of which any portion is expected to be outstanding for more than one year;
   - What was characterized as 'working capital debt" which has been incurred under the "failure of revenue" provision in the Illinois Constitution.
   - Failure to pay maturing obligations, e.g. Section 25 payments;
   - Willful ignorance of current and past accruing costs.

9. The concern is that debt pollutes a proper understanding of "funds available" because counting debt proceeds as "available" or not recognizing legitimate expenses take pressure off "own source revenues". That expands the ability of the state to spend currently—in exchange for creating obligations that will have to be paid in the future. Classifying debt as "funds available" is one of the primary methods the state uses to evade its balanced budget requirements.

10. Following on, the group resisted the entire notion of a balance sheet approach but it was clear that each expert was familiar with at least some accrued or funded liability. The fact that these liabilities exist would seem to indicate a systematic failure to develop and live under a "balanced budget".

11. Federal Funds are either restricted or unrestricted; only unrestricted funds can be counted as funds available.

Expense Related Consensus

1. In relation to personnel costs we concurred that:
   a. Current cash disbursements should be and are included in the budget.
   b. The current service costs for pensions should be included in the budget but are not now considered "spending". These are the pension benefits that are earned in the current year but which will not be paid until some future year. The reason for agreement is that these are actuarially sound and constitutionally guaranteed payments due state workers.

c. The payments required by the 1995 pension reform act should be included in the current year's budget. These are the payments required to bring the funding level to 90%.
d. Alternatively, the state budget could recognize the earning power of the pension fund assets had the required payments been made. The assumption is that these assets would nominally earn 8.5% so, in lieu of making the pension "catch-up payments" , the state could simply make up the earnings these assets would have earned. Then, over time (and assuming the state funds the current actuarial liability in each subsequent year), inflation eventually overcome the problem as ever larger, inflated contributions are made to fully fund current service costs. Then, over a long period of time, the effects of even mild inflation would make the funded portion of the pension obligation grow to meet the 90% objective. The group also recognized that this strategy is moot as long as the state continues to take pension obligation holidays.
e. The group concurred that the actual, expected OPEB costs that will be paid in the budget year should be included n the budget.

2. There was strong disagreement on the actuarial validity of future OPEB obligations. On the one hand, there is the "Social Security" argument which holds that the program is not guaranteed to be offered future beneficiaries and like Social Security, could be discontinued by a future General Assembly. This makes OPEB significantly different than the contractual rights associated with pensions. The other argument holds that the existing benefit schedule creates the obligation to pay certain and estimable future payments. As long as that policy exists, the actuarial benefits it implies should be included in the current budget. If some future General Assembly does change the benefit structure, then the obligation should be recalculated to reflect the then current terms.

3. In the case of changes in benefit that have retroactive effects—such as the early retirement feature provided to teachers several years ago-- the group agreed that the increase or decrease in the future, actuarially-calculated obligation should be recognized and budgeted in the year the benefits are granted.

4. There was discussion that the state is recognizing pension costs that include the undifferentiated liquidation of previous service costs. The group was not able to estimate the amount of these earlier costs but to the extent that they exist, the accounting for them should be presented separately and budgeted separately.

5. There was some discussion that exchanging unfunded obligations for funded debt has some appeal because it makes the associated debt service an explicit part of the budget calculation. Current interest rates would also tend to support that concept.

6. The group concurred that lapse period payments should be budgeted in the year that they are incurred. These obligations are a form of debt and manipulating the period in which they are recognized permits evasion of the General Assembly's duties to pass a

balanced budget. The consensus was that there should be a "catch-up year" in which the previously accumulated lapse period expenditures are liquidated and that accrued payables which will be paid in a subsequent year should be provided for in the budget for the year in which they are incurred.

7. The group also expressed concern that the character of lapse period expenditures is changing in the sense that the original purpose of these accounts was to recognize that there would be some level of federal funds due and that the invoices should be held until the federal government made its payments. Over time, and more especially in the last two(?) fiscal years, the type of invoice that is in the lapse period accounts is not typically going to reimbursed by the government. This has the effect of masking the state's true obligations, a sort of Gresham's Law of debt.

Other Discussion Items

There were several other points the group discussed and while they may not concur on every one of these discussion points, they provide insight into the group's thinking.

1. There was substantial objection to the practice of "sweeping" the minor accounts for resources to be budgeted for purposes other than the ostensible reason for the fund. This begs the question of how to distinguish between "fees" which are supposed to be imposed to carry out the regulatory and oversight purposes for which the funds were established versus money "swept" and used elsewhere. This transforms the money paid under the fee schedules into what might be describes as unlegislated taxes. One of the panel members believes that such transfers are a violation of law but others believe the General Assembly has empowered itself to make these sweeps.

2. It was the group's sense that the General Assembly is wary of the word "accrual" because they realize that moving towards an accrual system would have significant effects on the General Assembly. As these involve policy, the panel did not discuss specifics beyond the notions of "spend less" and/or "tax more".

Next Steps

The Institute for Truth in Accounting (the IFTA) will develop some budget process proposals in several venues:

1. On November 18, the IFTA will appear before the Illinois House Bi-Partisan Task Force on Budget Reform and Spending Reductions and report the view of the panel. (We will not address any issues surrounding spending reductions.)
2. We will incorporate the information developed here in an ongoing project on transparency that has been sponsored by the State Policy Network.
3. The IFTA will also begin to develop recommendations for changes to the budget process that reflect these findings. Among the objectives will be to create a budgeting

model which will be able to be applied to the state's FY2011 budget which will be presented to the General Assembly in January, 2010. Another objective will be to calculate a consensus minimum deficit for FY2011 to be announced in a press release issued by the IFTA with mention of the panel members.

4. We will reconvene the panel in the near future to construct that model, based on these initiatives.

APPENDIX IV – FEATURES OF F.A.C.T.

F.A.C.T. Based Accounting and Budgeting

Full Accrual Calculations and Techniques

Governments have evolved from being in the business of funding/building infrastructure and operating the rather limited machinery of the state's internal bureaucracy to being concerned with the health, welfare and lifestyle of its citizens. These changes involve committing to citizens and employees programs, services and benefits not just for the current period but for years to come. Full Accrual Calculations and Techniques (FACT) will allow governments' accounting and budgeting systems to evolve to provide a comprehensive indication of the total activity of Government and the long-term effects of currently policy.

Accrual-based measurement records revenues and expenses in the period the activity generating revenues, increasing liabilities or consuming resources occurs, regardless of when associated cash is actually received or paid. Accrual measurement is useful in budgeting and accounting for situations where transactions are not completed in one period.

By recording accounts payable and receivable, and thus the change in value of the assets and liabilities, FACT accounting keeps a running tally of what a government owns and owes in economic terms. If a government promises pension benefits in the current period and must pay retirement claims in future periods, the liability and expense is recorded when the event occurred. When the cash is actually paid, the liability is removed.

F.A.C.T. Based Accounting and Budgeting:

- Presents a complete picture of your governments' financial conditions, especially long term commitments.
- Illuminates the long term effects of current decisions.
- Limits elected officials' ability to expand programs and services by deferring the payment of current costs.
- Recognizes all costs and all legitimate revenues regardless of when money is paid or received.
- Provides full costing information, including government employees' retirement benefits.
- Supplies information necessary for accurate performance measurements.
- Adopts the use of a consolidating budget documents to facilitate the public's ability to understand governmental financial consequences of the budget.
- Produces financial statements that people are familiar with similar to the balance sheets and income statements companies use.
- Facilitates the evaluation of budgeted amounts versus the actual revenues earned and costs incurred, because budget documents are presented in the same format as the government's financial statements.
- Promotes accountability.

- Produces financial information that is comprehensive, comparable and consistent.
- Is harder to manipulate.
- Provides information is necessary to evaluate intergenerational fairness.
- Provides better information for decision making.

APPENDIX V – LAWSUIT ALLEGING UNCONSTITUTIONAL BUDGET

Budget Related Lawsuit filed in Sangamon County IL by John Bambenek against the state Comptroller alleging unconstitutionality of the budget.

IN THE CIRCUIT COURT OF CHAMPAIGN COUNTY, ILLINOIS
COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF

John C. A. Bambenek)
)
Plaintiff,) Case No. 09-MR-136
V)
)
Daniel W. Hynes,)
in his official capacity as)
Comptroller of the State of Illinois)
Respondent)

Now comes Plaintiff John C. A. Bambenek, a citizen of the state of Illinois, by and through his Attorney, Bruno Behrend, complaining of the Respondent, THE HONORABLE DANIEL W. HYNES, COMPTROLLER OF THE STATE OF ILLINOIS, in his official capacity, state as follows;

COUNT 1

Parties and Jurisdiction

1. Plaintiff John C. A. Bambenek lives in the city of Champaign, County of Champaign, State of Illinois, and therefore enjoys the rights and is subject to the responsibilities
of a citizen living under the Constitution of the State of Illinois.

2. Defendant Daniel W. Hynes is the duly elected Comptroller of the State of Illinois, an office created under Article V of the Constitution of the State of Illinois.

3. Plaintiff has standing to sue under 735 ILCS 5/11-301 of the Illinois Code of Civil Procedure.

Sec. 11-301. Who may file action. An action to restrain and enjoin the disbursement of public funds by any officer or officers of the State government may be maintained either by the Attorney General or by any citizen and taxpayer of the State.

4. This Court has jurisdiction and venue to decide the issues raised in this Complaint as a court of competent jurisdiction to decide constitutional questions. This Court has jurisdiction over the Defendant, who is a Constitutional Officer of the State of Illinois.

5. The Honorable Daniel W. Hynes, as the Comptroller of Illinois, is empowered by Article V, Section 17 of the Constitution of the State of Illinois to "maintain the State's central fiscal accounts, and order payments into and out of the funds held by the Treasurer."

6. The Constitution of the State of Illinois, Article VIII, Section 2(b) further states that "The General Assembly by law shall make appropriations for all expenditures of public funds by the State. Appropriations for a fiscal year shall not exceed funds estimated by the General Assembly to be available during that year."

7. That sometime during early February of 2009, the Comptroller issued a report entitled *Transitional Fiscal Report/FY 2010 Budgetary Outlook* on the official website of the Office of the Comptroller (Exhibit A - http://www.ioc.state.il.us/ioc-pdf/dwhreportFeb2009.pdf). This report indicates that "According to the Governor's Office of Management and Budget (GOMB), the 2009 budget, as initially approved by the General Assembly, authorized spending in excess of $2.1 billion over then-anticipated revenues."

8. The *Transitional Fiscal Report/FY 2010 Budgetary Outlook* continues by stating "As illustrated in the accompanying chart, this amount exceeds sustainable spending authority by
$8.95 billion**,** without *any* growth in General Funds appropriations for the rest of state government. The magnitude of this number represents the deep financial hole in which we now find ourselves *after many years of avoidance and gimmicks*, made worse by a struggling economy."

9. The *Transitional Fiscal Report/FY 2010 Budgetary Outlook* concludes with
"Faced with a record $8.95 billion deficit for FY 2010, Illinois now stands at the precipice of the worst fiscal crisis in the state's history. If the recession is prolonged beyond this summer and/or revenues erode further, the state's fiscal situation will deteriorate even more than the bleak assessment presented here. It cannot be over emphasized that the federal government will be unable to rescue Illinois from these severe financial difficulties. The reality is that even with substantial federal assistance, Illinois will likely confront at least a $6 billion dollar deficit that requires action over the next few weeks and months."

10. The publication of the *Transitional Fiscal Report/FY 2010 Budgetary Outlook* constitutes an incontrovertible admission by the Constitutional Officer responsible for maintaining "the State's central fiscal accounts" that the budget of the State Illinois is out of balance. Such admission indicates that any funds disbursed by the State of Illinois in its current financial condition constitute actions that are prohibited by Article VIII, Section 2(b), and are therefore unconstitutional.

11. The publication of the *Transitional Fiscal Report/FY 2010 Budgetary Outlook* constitutes an admission that "years of avoidance and gimmicks" resulted in the act of passing out-of-balance budgets for years prior to Fiscal Years 2008 and 2009, and that such behavior has led to a significant fiscal crisis that damaged every citizen of this state.

12. The *Comprehensive Annual Financial Report for Fiscal Year 2008* (http://www.apps.ioc.state.il.us/ioc-pdf/CAFR_2008.pdf) was published on July 10, 2009 by the Office of the Comptroller. A key portion of this document is a review of past budgets. A telling statement from the Comptroller is found on Page IX which reads:

Cash flow continues to be an issue as Illinois has had a running General Revenue Fund deficit defined as bills on hand exceeding available cash, with few exceptions, since November of 2000. Fiscal year 2008 marked the sixth consecutive year that Illinois has had to engage in short-term borrowing to address various cash flow needs.

Not only is the current budget unbalanced, but the State has been using unbalanced (and unconstitutional) budgets for *years*. This, in no small part, has lead to the State's unconstitutional fiscal position.

13. On or about July 15th, 2009, Governor Quinn signed into law SB 1216, SB 1292, and SB 1912 which constitute the fiscal year budget for this fiscal year starting July 1.

Among other things, this budget builds in a structural deficit of *at least* $10 billion dollars into next year's budget. This is before any shortfall in revenue due to the economy or shortfalls due to errant economic forecasting for revenue sources such as video poker.

14. After this budget was signed, lawmakers and the Governor admitted this budget was *still* unbalanced by approximately $5 billion dollars. As of the time of this filing, no official has provided the public with definitive range of estimated revenues or expenditures. In fact, many officials openly dispute the amount of the budget deficit. By implication, all officials, including the Defendant, tacitly admit that the budget is not balanced. (See Exhibit __)

15. While it is typical that a Plaintiff would present more detailed evidence and facts for claims in a complaint, this Plaintiff requests lenience in this regard. If the state's elected officials cannot determine with any specificity the size of the budget deficit despite access to numerous staff members and accounting experts, combined with access to all the data the State of Illinois possesses regarding its finances, it clearly places an undue burden on this Plaintiff to do so.

16. On July 16th, 2009, Moody Investor Services put the State of Illinois on a "negative credit watch" (http://online.wsj.com/article/SB124775413237351801.html).

During this "watch' period it will review the State's finances to determine whether to downgrade the State's credit rating. They concluded immediately that not only is the State's budget out-of-balance, but that the introduction of such large structural deficits into next year's budget would make it all but impossible to craft a balanced budget for next year. It is clear that the financial experts outside of the employ of the State of Illinois noticed the unbalanced (and unconstitutional) budget.

17. The Office of the Comptroller may only disperse funds when he has legal authority to do so. Due to the aforementioned clause in the Constitution of the State of Illinois requiring balanced budgets, any budget legislation that is not balanced is unconstitutional. A consistent feature of the American system of law is that an unconstitutional law is no law at all. Therefore, the Comptroller lacks any authority to disburse funds except as otherwise authorized by another law or court order.

WHEREFORE, the Plaintiff prays for this Court to provide Plaintiff with the following relief.

A. Order injunctive relief permanently enjoining the Comptroller from authorizing any disbursements until the State passes a budget that fulfills the requirements of the Constitution of the State of Illinois, which is to present a balanced budget. In the interest of justice and stable governance, this order shall give the Defendant 14 days to inform the Constitutional and Legislative branches of this Court's order, offering said branches an opportunity to provide a budget that complies with the Constitution.

B. That this Court retain jurisdiction to enforce the above order, including jurisdiction to order the Comptroller to make available any applicable public information regarding the State's financial records and accounting processes available for public review to verify compliance with the Constitution of the State of Illinois, any applicable legislation, and the order of this Court.

C. Due to the ongoing and pervasive nature of using unbalanced and unconstitutional budgets, that this Court appoint a special monitor to ensure that future budgets are balanced and provide any necessary guidance to policy makers to ensure that Illinois Citizens are informed as to whether a proposed budget is balanced. This order should specify that;

    1. The special monitor shall report to the Court and that the Court make all findings available to the public.

    2. The special monitor shall be empowered to do a full review of the State's finances, determine precisely what the budget deficit is, what the precise balance of all forms of state debt is, and compel the State to produce a binding plan by which the State will end its budget deficits and pay off its debt.

    3. This Court appointed monitor shall have such authority for a period of not less than 10 years.

D. That this Court award fees and costs for this suit and the administration of whatever remedies the Court so orders.

Respectfully submitted,
John C.A. Bambenek
Plaintiff,
By____________________________
Plaintiff's Attorney
BRUNO BEHREND
Attorney at Law
823 Forest Avenue
River Forest, Illinois 60305
ARDC No. 6205385
Dated: ________________

APPENDIX VI – ACCOUNTABILITY CHECKLIST

- **Financial reporting**
    - Citizens have the right to receive openly declare facts that may lead to public debate by citizens and their elected representatives.
    - Financial reports must be have the following characteristics:
        - Understandability
            - Information should be expressed as simply as possible
        - Reliability
            - Information should be verifiable and free from bias and should faithfully represent what it purports to represent
            - Financial reporting needs to be comprehensive; noting material should be omitted
        - Relevance
        - Timeliness
            - CAFR available during the budget process
        - Actuarial date of pension/OPEB plans correspond to CAFR date
        - Consistency
        - Comparability
    - Financial Report (CAFR)
    - Clean audit
- **Budgeting**
    - Fiscal discipline is maintained
        - Inter-period equity
            - Current generation of citizens does not shift the burden of paying for current-years services on to future-year taxpayers
    - F.A.C.T. Based Accounting is used to calculate the budgeting
    - The budget is prepared on an accounting basis consistent with standards used to prepare the entity's the financial statements
    - All funds included in budget calculation
    - The total unfunded liabilities of retirement systems are reported
    - Retirement systems' liabilities are calculated using reasonable assumptions
    - Adequate funding of retirement systems is included in the budget
    - Balanced budget required and implemented
    - Balanced budget maintained throughout the fiscal year

APPENDIX VII – LONG-TERM ACCOUNTING ACT

97TH GENERAL ASSEMBLY
State of Illinois
2011 and 2012
HB3231

Introduced 2/24/2011, by Rep. Michael W. Tryon

SYNOPSIS AS INTRODUCED:
New Act
15 ILCS 405/6.01 from Ch. 15, par. 206.01
15 ILCS 405/19.5 new
15 ILCS 405/30 new
25 ILCS 155/4 from Ch. 63, par. 344

Creates the Long-Term Accounting Act of 2011. Provides that the purpose of the Act is to improve transparency and accountability during the State budget process. Contains provisions concerning the passage of appropriation bills and the electronic publication of appropriation bills. Amends the State Comptroller Act. Requires that the Comptroller publish a comprehensive annual financial report. Amends the Commission on Governmental Forecasting and Accountability Act. Provides that the Commission on Governmental Forecasting and Accountability must publish fiscal budget statements. Sets forth the requirements for the fiscal budget statements. Contains other provisions. Effective immediately.

LRB097 10921 RLJ 51479 b

FISCAL NOTE ACT MAY APPLY

A BILL FOR

HB3231 LRB097 10921 RLJ 51479 b

AN ACT concerning State government.

Be it enacted by the People of the State of Illinois, represented in the General Assembly:

Section 1. Short title. This Act may be cited as the Long-Term Accounting Act of 2011.

Section 5. Legislative intent. It is the intent of this Act to improve transparency and accountability during the State budget process that:

(1) Confirms and strengthens the State's special responsibility to disclose its actions and results of those actions in a timely and useful way.

(2) Establishes the concept that state budgeting disclosures and financial reporting are created primarily for the purpose of informing the

public of government activity and creating widespread understanding of these actions.

(3) Adopts the use of a consolidating budget documents to facilitate the public's ability to understand the State's annual and accumulated shortfalls despite the relative scale of the State's financial operations and, the volume and complexity of budget and financial data.

(4) Establishes the State's duty to report the best estimate of its own financial condition.

(5) Requires a comprehensive indication of the total activity of government and the long-term effects of current policy.

(6) Calls for the calculation of the long-term financial implications to the state and others of the budgetary decisions.

(7) Provides the full costing information to necessary to accurately calculate performance measurements.

(8) Establishes definitions of existing statutory language to strengthen the Governor's and the General Assembly's ability to determine compliance with the intent of Section 8 Article 2 of the Illinois Constitution requirement, which is to preserve intergenerational equity.

(9) Requires explicit disclosure and accurate reporting by the Governor and the General Assembly of:

(a) Debt incurred to fund current operating expenses;

(b) Current and past costs shifted to future budgets and imposed upon future taxpayers;

(c) State obligations, including but not limited to current and future personnel benefit costs and lapse-period expenditures; and

(d) A fiscal deficit in terms of the excess of full accrual expenses over full accrual revenues and a budget surplus in terms of the excess of full accrual revenues over full accrual expenses at the time the final budget is sent to the Governor.

(10) Calls for the Governor and the General Assembly to determine if future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.

(11) Acknowledges costs when incurred during the budget year regardless of when they are paid.

(12) Injects the expertise and knowledge of the State Comptroller's Office into the preparation of budget calculations.

(13) Unveils the State's unusual reliance upon the use of more than 600 special funds.

(14) Requires the Annual Budget and the State's Comprehensive Annual Financial Report to be prepared to facilitate a simple comparison of budgeted amounts to the actual amounts spent and received.

(15) Requires State agencies to report to the Comptroller all fiscal information necessary to prepare a comprehensive annual financial report in a timely manner.

(16) Mandates the production of the State's Comprehensive Annual Financial Report within six months after the State's fiscal year end.

Section 10. Definitions.

"Amounts Due to Pension Funds" means as the Unfunded Actuarial Accrued Liability for the State Pension Plans, including the portion of Multiple-employer plans attributed to the State.

"Benefit Enhancements" means as the Actuarial Present Value of Total Projected Benefits attributed to the estimated increase in the benefits of retirees or beneficiaries granted by the proposed budget or, proposed or enacted changes to the State Pension Law. The benefit enhancements that result from plan members' expected future service amount may be reduced by the amount of specified revenue sources enacted into law.

"Capital Assets" shall be defined using Governmental Accounting Standards Board concepts outlined in GASB Statement 34.

"Comptroller's Budget Statements" shall be the estimated Balance Sheet, the estimated Statement of Activities and the estimated Statement of Cash Flow,

"Estimated Balance Sheet" means as the estimated Statement of Net Assets prepared using the GASB concepts outlined in GASB 34.

"Estimated Retirement Plans' Assets Gain or Loss" means the change in the Actuarial Value of Assets at the beginning of the budget period and the Actuarial Value of Assets at the end of the budget period.

"Fiscal Budget Statements" means the estimated Statement of Fiscal Balance, the estimated Statement of Fiscal Deficit and the estimated Financial State of the State.

"Fiduciary funds" shall be defined using GASB concepts outlined in Governmental Accounting Standards Board Statement 34.

"Government-Wide Generally Accepted Accounting Principles (Government Wide GAAP)" means as the accounting standards used in the preparation of the State's government-wide financial statements, using GASB concepts outlined in the Governmental Accounting Standards Board Statement 34. While the Governmental Accounting Standards Board does not prescribe standards for preparing governmental budgets, the accounting standards' concepts shall be applied to the fiscal budget statements prepared under this section.

Increase (Decrease) in Other Post Employment Benefits (OPEB) Due" means the change in the State's OPEB plans' estimated Actuarial Accrued Liability at the beginning of the budget period and the State's OPEB plans' estimated Actuarial Accrued Liability at the end of the budget period.

"Increase (Decrease) in Pension Benefits Due" means the change in the State's pension plans' estimated Actuarial Accrued Liability at the beginning of the budget period and the sum of each pension plan's estimated Actuarial Accrued Liability at the end of the budget period.

"Net Pension Obligation (Asset)", "Net Other Post Employment Obligation (Asset)", "Actuarial Value of Assets", "Actuarial Accrued Liability" and "Unfunded Actuarial Accrued Liability (UAAL)" "Actuarial Present Value of Total Projected Benefits" shall be defined using GASB concepts outlined in GASB Statement 45, GASB Statement 25 and GASB Statement 27, as amended by GASB 50.

"Off Balance Sheet Other Post Employment (OPEB) Liabilities" means the difference between the State OPEB plans' Estimated UAAL and the estimated Net OPEB Obligation (Asset) included in the estimated Balance Sheet.

"Off Balance Sheet Pension Liabilities" means the difference between the State pension plans' Estimated unfunded actuarial accrued liability (UAAL) and the estimated Net Pension Obligation (Asset) included in the estimated Balance Sheet.

"Retirees' Health Care Benefits" means defined as the unfunded actuarial accrued liability (UAAL) for the State OPEB Plans, including the portion of Multiple-employer plans attributed to the State.

"State Other Post Employment Benefit (OPEB) Plans" include the State's Single-Employer Other Post Employment Benefit (OPEB) plans, and shall also include the portion of Agent Multiple-Employer OPEB plans attributed to the State.

"State Pension Plans" mean the State's Single-Employer pension plans and the portion of Agent Multiple-Employer pension plans attributed to the State.

Section 15. Electronic publication of appropriation bills; publication deadlines with respect to second and third readings. The General Assembly shall publish, by means of the Internet on a web page controlled by the General Assembly, the texts of all appropriations bills. Each publication shall include an embedded time stamp setting forth the time of electronic publication. No amendment to an appropriation bill shall be considered on second reading until at least 72 hours after the amendment has been published electronically and no bill to appropriate funds shall be passed on third reading until at least 72 hours after the time of electronic publication in final form.

Section 20. Passage of appropriation bills prohibited before adoption of joint resolution. The General Assembly shall not enact any bill to appropriate funds within any fiscal year prior to their adoption of the joint resolution reflecting the estimate of funds available for that fiscal year as required under Section 4 of the Commission on Government Forecasting and Accountability Act.

Section 25. State funds as fiduciary funds. All State funds shall be fiduciary funds unless explicitly provided otherwise by law.

Section 90. The State Comptroller Act is amended by changing Sections 6.01 and by adding Sections 19.5 and 30 as follows:

(15 ILCS 405/6.01) (from Ch. 15, par. 206.01)

Sec. 6.01. Specification and establishment of accounting standards and principles. The Comptroller shall specify and establish the financial accounting and reporting standards and principles to be used by all State government and State agencies. The standards and principles shall be effective upon filing by the Comptroller with the Auditor General. The Comptroller shall maintain and publish the standards and principles as a public document. These standards and principles shall be known as the Generally Accepted Accounting Standards and Principles for Illinois State Government, and shall be compatible with generally accepted accounting standards and principles for government as prescribed by the Governmental Accounting Standards Board (GASB). ~~, whenever possible be compatible with an similar nationally existing general accepted accounting standards and principles for government.~~

In establishing the Generally Accepted Accounting Standards and Principles for Illinois State Government, the Comptroller shall consult with the Governor and the other members of the Executive Branch, the Chief Justice of the Supreme Court, and the leadership of the General Assembly and shall provide to these officials, and publish on the Comptrollers web site, draft copies of any proposed standards at least 90 days prior to their adoption and shall consider any responses or suggestions that these officials or the public may present.

(Source: P.A. 86-1415.)

(15 ILCS 405/19.5 new)

Section 19.5. Timely reporting. On or before October 31 of each year, the director or secretary of each State agency shall report to the Comptroller all agency's fiscal information necessary to prepare a comprehensive annual financial report (CAFR) for the fiscal year ending June 30 of that year. The Comptroller may require certain State agencies to report the information prior to October 31 under a schedule established by the Comptroller. Whenever the Comptroller determines that a State agency director or secretary is delinquent in reporting the information, the Comptroller shall notify in writing the Office of the Auditor General, the Office of the Governor, the Speaker and Minority Leader of the House of Representatives, and the President and Minority Leader of the Senate of the delinquency.

(15 ILCS 405/30 new)

Section. 30. Comprehensive annual financial reports. The Comptroller shall publish each comprehensive annual financial report (CAFR) within 6 months after the end of the fiscal year to which the report relates. At a minimum the Comptroller shall publish the CAFR by on a web page controlled by the Comptroller. If the report is not published within that period, the Comptroller must promptly give notice of the delay to the Governor, the Speaker and Minority Leader of the House of Representatives, and the President and Minority Leader of the Senate and post notice of the delay on a web page controlled by the Comptroller.

Section 95. The Commission on Governmental Forecasting and Accountability Act is amended by changing Section 4 as follows:

(25 ILCS 155/4) (from Ch. 63, par. 344)

Sec. 4. (a) The Commission shall publish, at the convening of each regular session o the General Assembly, a report on the estimated income of the State from all applicable revenue sources for the next ensuing fiscal year and of any other funds estimated to be available for such fiscal year. The Commission, in its discretion, may consult with the Governor's Office of Management and Budget in preparing the report. On the third Wednesday in March after the session convenes, the Commission shall issue a revised and updated set of revenue figures reflecting the latest available information. The House and Senate by joint resolution shall adopt or modify such estimates as may be appropriate. The joint resolution must include all applicable revenue and other funds available. The joint resolution shall constitute the General Assembly's estimate, under paragraph (b) of Section 2 of Article VIII of the Constitution, of funds estimated to be available during the next fiscal year. The report must estimate all applicable revenue and must estimate other funds available. The report shall clearly separate distinguish all applicable revenues and other funds available when estimating the funds estimated to be available for purposes of calculating funds estimated to be available as required under paragraph (b) of Section 2 of Article VIII of the Constitution.

(a-5) The annual March estimates issued by the Commission shall include an estimated balance sheet, an estimated statement of activities, and an estimated statement of cash flow. The March estimates shall include a variance report of the ongoing fiscal year's budget and appropriations.

(a-10) The Commission shall also prepare:

(1) The estimated statement of fiscal balance, which shall include:

(A) The columns used in the estimated balance sheet.

(B) The total net assets, as determined in the estimated balance sheet.
(C) The off-balance sheet pension liability.
(D) The off-balance sheet OPEB liability.
(E) The resulting fiscal balance.

(2) The estimated statement of fiscal deficit, which shall include:
(A) The columns used in the estimated statement of activities.
(B) The change in net assets, as determined in the estimated statement of activities.
(C) Benefit enhancements.
(D) Retirement plans' assets gain or loss.
(E) Increase (decrease) in pension benefits due.
(F) Increase (Decrease) in OPEB benefits due.
(G) The resulting fiscal deficit.

(3) The estimated financial state of the state, which shall include:
(A) Amounts reported on the State's Comprehensive Annual Financial Report (CAFR) for the State's fiscal year 2 years prior to the current budget year.
(B) The estimated values from last period's budget.
(C) The estimated values from the current budget period.
(D) What the State owns:
(i) Capital assets.
(ii) Other assets which is derived from the total assets reported on the statement of net assets/balance sheet minus capital assets.
(iii) State assets shall equal the total assets.
(E) What the State owes:
(i) The amount of State bonds, including, but not limited to, General Obligation Bonds and Special Revenue Bonds.
(ii) Amounts due pension funds.
(iii) Retirees' health care benefits (OPEB).
(iv) Other Liabilities which is derived by subtracting the State bonds, the Net Pension Obligation and the Net OPEB Obligation from the Total Liabilities reported on the Statement of Net Assets/Balance Sheet.
(v) State bills.
(F) Where the State stands:
(i) Illinois' financial position.
(ii) Each Illinois family's share, which is derived by dividing Illinois' financial position divided by the Illinois population estimate as determined by the U.S. Census Bureau divided by national average size of a family as determined by the U.S. Census Bureau.

(a-20) In conjunction with the State Comptroller, the Commission shall publish the fiscal budget statements outlined in(a-5) in concert with Government Wide-GAAP. The fiscal budget statements should include information about the State as a whole. The fiscal budget statements should include the primary government and its component units, expect for the fiduciary funds of the primary government and component units that are fiduciary in nature. The fiscal budget statements should be prepared using the economic resources measurement focus and the accrual basis of accounting. The fiscal budget statements should not be presented using the current financial resources measurement focus and the modified accrual basis of accounting, which are used to prepare the State's governmental funds financial statements. The Commission shall obtain from each of the State's pension and OPEB plans' actuaries to determine the pension and OPEB amounts needed to prepare the fiscal budget statements.

(b) On the third Wednesday in March, the Commission shall issue estimated:

(1) pension funding requirements under P.A. 86-273; and

(2) liabilities of the State employee group health insurance program.

These estimated costs shall be for the fiscal year beginning the following July 1.

(c) The requirement for reporting to the General Assembly shall be satisfied by filing copies of the report with the Speaker, the Minority Leader and the Clerk of the House of Representatives and the President, the Minority Leader and the Secretary of the Senate and the Legislative Research unit, as required by Section 3.1 of the General Assembly Organization Act, and filing such additional copies with the State Government Report distribution Center for the General Assembly as is required under paragraph (t) of Section 7 of the State Library Act.

(d) For each fiscal year, the General Assembly shall adopt a joint resolution accepting the amounts reported on the fiscal budget statements.

(e) For purposes of this Section: "all applicable revenues" means "own serce revenues;, including:

(1) personal income tax;
(2) corporate income tax;
(3) corporate personal property replacement tax;
(4) sales tax retained by the state;
(5) excise taxes, such as excise taxes on alcohol, gasoline, or energy;
(6) user fees;
(7) fines and penalties;
(8) gaming taxes;
(9) investment income;
(10) unencumbered funds provided by other governmental units; or
(11) any other revenue source for which the state has no ongoing or unfulfilled obligation to any other party.

For the purposes of this Section, "other funds available" means:

(1) funds which result from the actions of another entity or government;
(2) funds received that are held in trust or have a fiduciary element;
(3) pass-through funds or funds received by the state when acting as an agent or collector for another entity;
(4) pension contributions made by state employees not used to pay pensions or used to purchase assets for the state's pension funds;
(5) that portion of sales tax collections which retailers pay to the state but which will be remitted to home rule and local governments;
(6) court-ordered collections of child support;
(7) inter-period borrowings;
(8) prepaid tuition plans; or
(9) any other source of funds for which the state has an unfulfilled or ongoing obligation.

The definitions set forth in Section 10 of the Truth in Accounting Act of 2010 are incorporated.

(Source: P.A. 96-958, eff. 7-1-10.)

Section 99. Effective date. The Act takes effect upon becoming law.

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