
CONCLUSIONS

INFORMATION NECESSARY TO MAKE KNOWLEDGEABLE DECISIONS IS NOT AVAILABLE

Budgeting is the process that states use to resolve the large number of often-conflicting objectives that citizens and their representatives address through government action. Nothing could be more important than these debates. To make these critical decisions about allocating the public's resources, truthful and transparent information must be available.

Unfortunately, state legislatures, governors and the public do not have the information needed to make knowledgeable decisions during state budget processes. State budget calculations are flawed because unrealistic revenue estimates are included, and the cash measures used to document expenditures leave out massive amounts of costs, including pension and post-employment health care expenses. The standards used to prepare state annual reports are also faulty because they also do not include all of the post-employment costs which have been incurred during the accounting period but will not be paid until future periods.

One of the consequences of these deficiencies is that the public and their elected officials cannot make knowledgeable decisions about state finances and state government accountability. In the longer term faulty information is, and has been, a significant enabler of the public policies that are now becoming evidently unsustainable.

BALANCED STATE BUDGETS ARE LARGELY A MYTH

The primary purpose of a state government's budget is to allocate to it the scarce resources available. Since there will always be more demand for resources than there are funds available, the government must set priorities and rank those projects it undertakes by some priority hierarchy. The state budget expresses those priorities in the form of a spending plan.

To ensure that governors and legislatures live within its means, state constitutions and statutes impose balanced budget requirements. The plain meaning of "balance" indicates that operating the state will not incur additional debt that must be repaid in a future period and that obligations for services consumed today--but to be paid in the future--have been provided for today. When politicians claim they have "balanced the budget" they imply that they will spend only the amount of resources available and that no new debt will be incurred.

Regrettably, our review of budget information included in state annual reports revealed that the majority of states report that their budgets are **not** balanced, regardless of the requirements that revenues and spending be matched to obviate new debt. It is the sense of this Study that most governmental officials are aware that their spending exceeds their revenues and the effect is that states have accumulated billions of dollars in debt, even though they claim to have balanced their budgets for years.

STATE GOVERNMENTS CIRCUMVENT THE INTENT OF BALANCED BUDGET LAWS

Every state, except Vermont, has a balanced budget requirement to prevent financial difficulties and to improve public accountability. When demand for state services exceeds the limited resources, balanced budget laws impose legal limits on spending. The GASB believes that balanced budget laws are tools to maintain inter-period equity, because these requirements reduce

incumbents' ability to promise current taxpayers benefits and services by shifting the burden of paying for these costs onto future year taxpayers.

When supply and demand of public resources collide, it upsets the political status quo. In turn, it motivates politicians to find ways to escape the spending limitations. They have discovered that deficiencies in budgeting and accounting principles provide convenient ways to evade the legal limitations on spending. The ambiguous ways these laws are written makes it easy for legislatures and governors to play word games and to prepare unrealistic calculations that produce budgets that are clearly not balanced.

They accomplish this by overestimating revenues, underestimating costs or a combination of both. The cash basis method used to calculate budget allows these accounting shenanigans. For example, it permits borrowed money to be included as inflows (revenues). It also allows proceeds from one-time sales of state assets to be used to pay current expenditures. Cash basis budgeting allows easy manipulation by government officials who postpone cash payments of current bills. Legislatures avoid an immediate effect on the current state budget by promising retirement benefits rather than increase state employees' currently payable salaries. All these techniques are used to evade the intent of balanced budget requirements.

The net effect of these circumvention techniques is to excuse the legislature from making tough decisions about the level of benefits and the extent that they will have to tax voters to pay for them. These tricks have costs however; they transfer today's obligations to future taxpayers who have no voice in the current deliberations. It is the very definition of taxation without representation.

Since this Study commenced, it has become apparent that these tricks may no longer be working. Governors of some of the largest states are asking the federal government for hundreds of billions of dollars in "bail out" money. In late October 2008, New York Gov. David Paterson told a House Ways and Means Committee that "States need direct and immediate relief", especially for state health care. New Jersey Gov. Jon Corzine also asked for federal relief.^{xliii} In an October 21, 2008 letter to congressional leaders, California Gov. Arnold Schwarzenegger joined the state-bailout campaign.^{xliv} Each of these states has a balanced budget requirement yet they are asking the rest of the nation to fund operating expenses. The reason may be that the federal government does not have a balanced budget requirement and can print or borrow the money as needed adding to the existing \$60 trillion in debt and unfunded promises the federal government has accumulated.^{xlv}

MOST STATES DO NOT ISSUE COMPREHENSIVE ANNUAL REPORTS ON A TIMELY BASIS

Each Comprehensive Annual Financial Report provides crucial data about the execution of the budgets, so it is essential to have the annual report available when creating a new budget. Scrutiny of the CAFR by legislators and the governor can provide valuable input when working to allocate the state resources.

The CAFR contains the preparer's transmittal letter. The date on this letter was used in this Study to determine when the annual report was published. Our study found that most states' annual reports were not published until six months after the end of the prior fiscal year. Nine states routinely published their annual reports more than eight months after the fiscal year end, which we assume is after the states' budget processes are complete. Therefore, the annual reports are most likely not available during the states' most critical decision making process.

USING GAAP TO CALCULATE BUDGETS WOULDN'T RESULT IN A TRUER PRESENTATION

As previously discussed, state annual reports are calculated using Generally Accepted Accounting Principles (GAAP) as established by the GASB. Because the GASB is supposedly an independent board, we assumed that if state budgets were calculated in concert with GASB GAAP, then state budget numbers would be more accurate than the numbers produced using cash basis accounting.

When we compared state budget surplus/deficit numbers to the GAAP surplus/deficit numbers, we were surprised to find that while most states reported budget deficits, the states' Statement of Net Activities reported GAAP surpluses. This was especially astonishing in light of news articles reporting that the states are in extreme financial trouble and that state officials have asked Congress for bail outs.

Because we found that states reported GAAP surpluses, we expanded our research to determine if state financial statements, done in accordance with GASB GAAP, report accurate pictures of state finances. An extensive review of the GASB standards used to prepare the financial statements revealed major accounting deficiencies that result in enormous amounts of liabilities not being reported on state balance sheets. These off-balance sheet liabilities, which could amount to more than \$2 trillion, include pension and other post-employment benefits, such as health care.

This determination has led us to conclude that the use of GAAP as it currently exists, as a basis for budget calculations, would not provide states with a true picture of the financial consequences that would result from current budget decisions. Therefore, we searched for other budgeting models that may produce more accurate budget numbers and that would enable legislatures and the public to understand the long term consequences of current budget decisions. As a part of this research we evaluated the accrual budgeting methods used by other countries. We have concluded that, in addition to cash basis measures, state governments' budget calculations should include full accrual basis⁴ measures.

State governmental officials will resist these necessary improvements to budget calculations because they are trapped in a dilemma. They need to meet balanced budget requirements while providing the greatest amount of state services and benefits at the lowest amount of taxes. GASB GAAP allows them to accomplish these conflicting goals—only on paper.

⁴ Full accrual accounting is not the same as accrual accounting under GASB GAAP. Full accrual accounting recognized all expenses included the actuarially determined cost of post employment benefits.