

## Iowa's Expenditure Limitation Process

### ISSUE

This **Issue Review** provides a review of Iowa's expenditure limitation law and recent statutory and session law changes that have changed the process. This **Issue Review** also includes examples from the FY 2013 budget enacted during the 2012 Legislative Session to help explain how the various aspects of the expenditure limitation law are applied to legislative decision-making. At the end of this **Issue Review** is a schematic showing the distribution of FY 2012 General Fund surplus revenues when the expenditure limitation provisions are applied.

### CODE AUTHORITY

Iowa Code sections [8.22A](#) and 8.54 through 8.57

### BACKGROUND

The expenditure limitation law was created in 1992 through the enactment of 1992 Iowa Acts, Chapter 1227 (SF 2351 – State Budget and Financial Control Act) and was first used for development of the FY 1994 budget. In addition to placing a 99.0% limit on expenditures, the law required the General Assembly and the Governor to use certain revenue estimates of the Revenue Estimating Conference (REC), created the Cash Reserve Fund, established a mechanism to eliminate the Generally Accepted Accounting Principles (GAAP) deficit, amended provisions of the Economic Emergency Fund, and redirected the flow of the General Fund surplus to fund the reserve funds and the GAAP deficit.

### REVENUE ESTIMATING CONFERENCE

Iowa Code section [8.22A](#) establishes the REC, a three-person panel with two individuals representing the legislative and executive branches and a third member of the general public chosen by the other two. The following outlines the revenue estimating process:

- The REC meets at least three times per year to review and establish estimates for General Fund revenues, refunds, and accruals of revenue collected but not remitted by June 30.
- The REC estimate established at the meeting prior to December 15 is required to be used by the Governor and the General Assembly in preparation of the General Fund budget for the fiscal year beginning on the subsequent July 1.
- If the REC sets a higher revenue estimate at its meeting held during the regular legislative session compared to the December estimate, the Governor and the General Assembly are required to use the lower December estimate.
- If the REC sets a lower revenue estimate after the December meeting, but prior to the end of the regular legislative session, the Governor and the General Assembly are required to use the lower estimate when calculating the expenditure limitation for the next fiscal year.

If this occurs, the Governor has 14 days to resubmit a budget using the lower estimate. This has happened five times since the inception of the expenditure limitation law. This most recently occurred on March 20, 2009, when the REC lowered the FY 2010 estimate by \$269.9 million compared to the December estimate, requiring the Governor to resubmit a General Fund budget in early April 2009.

- Use of the lower estimate also applies to the General Assembly during a special session that is held before the start of the new fiscal year.
- Although the REC may agree to other preliminary estimates, only the December estimate or a subsequent lower estimate can be used for the purpose of calculating the expenditure limitation.

**2012 Legislative Session:** The REC adopted a net General Fund revenue estimate of \$6,251.6 million for FY 2013 at the December 15, 2011, meeting. The REC met again on March 12, 2012, and revised the estimate upward to \$6,280.6 million. Because the December estimate was lower than the March estimate, the Governor and the General Assembly were required to use the December estimate in establishing the expenditure limitation for FY 2013.

### **ADJUSTED REVENUE ESTIMATE**

Iowa Code section [8.54](#) defines the Adjusted Revenue Estimate as the *appropriate revenue estimate* for the General Fund for the following fiscal year as determined by the REC, adjusted by subtracting estimated tax refunds, and adding any new revenues considered to be eligible for deposit in the General Fund. The term “*appropriate revenue estimate*” is used to indicate the revenue estimate used in establishing the State budget.

The Adjusted Revenue Estimate is a calculation that is used to help determine the following components related to the budget:

- The expenditure limitation for establishing the budget that begins on July 1.
- The maximum balances of the Cash Reserve Fund and the Economic Emergency Fund.
- The amount from the General Fund surplus that can be deposited in the Taxpayer Trust Fund.

The Adjusted Revenue Estimate is arrived at by adding the net General Fund revenue estimate of the REC (adopted at the December meeting, or a subsequent meeting if the subsequent estimate is lower) to the law changes that increase or decrease the net General Fund revenue estimate that are enacted by the General Assembly and signed into law by the Governor. Changes in federal tax laws can also impact State income taxes, primarily due to Iowa's federal deductibility law. Changes in State tax revenue due to federal law changes are incorporated into the REC estimate if the changes are in place at the time the REC meets. If the federal law changes are enacted after the REC meets, the changes are treated as new revenue for purposes of calculating the expenditure limitation.

**2012 Legislative Session:** The General Assembly enacted law changes that reduced General Fund revenues by \$30.4 million during the 2012 Legislative Session. The Governor vetoed a \$3.1 million reduction resulting in total adjustments of \$27.3 million. The following table shows the calculation of the FY 2013 Adjusted Revenue Estimate:

<b>FY 2013 Adjusted Revenue Estimate Calculation</b>	
(Dollars in Millions)	
	FY 2013
Dec 2011 REC Estimate	\$ 6,251.6
Enacted Revenue Adjustments	-27.3
Adjusted Revenue Estimate	\$ 6,224.3

**EXPENDITURE LIMITATION**

The primary goal of the expenditure limitation law is to ensure that General Fund revenues exceed expenditures to help to ensure a balanced budget and to build sufficient cash reserves for cash flow and emergencies. Iowa Code section 8.54 requires the Governor to submit a budget and the General Assembly to pass a budget where the total General Fund appropriations do not exceed the expenditure limitation. Additionally, the Governor cannot approve or disapprove appropriation bills or items of appropriation bills passed by the General Assembly in a manner that would cause the final budget approved by the Governor to exceed the General Fund expenditure limitation. The steps involved in calculating the expenditure limitation include the following:

- The base revenue estimate adopted by the REC is multiplied by 99.0%.
- Estimates of new revenue enacted by the General Assembly that were not included in the REC estimate are multiplied by 95.0%.
- All estimated revenue decreases enacted by the General Assembly that were not included in the REC estimate are applied at 100.0%.
- Any excess funds from the prior year’s General Fund surplus (after the reserves are filled to their maximum balance), is added to the expenditure limitation at 100.0%.

**2012 Legislative Session:** The results of the above calculations are added together to arrive at the expenditure limitation for the next fiscal year. For FY 2013, the total resources available to the General Fund were estimated at \$6,519.6 million. The resulting expenditure limitation is calculated at \$6,457.0 million. The following table shows how the FY 2013 expenditure limitation was calculated:

<b>Calculation of the FY 2013 Expenditure Limitation</b>			
(Dollars in Millions)			
	FY 2013		Expenditure Limitation
REC Estimate (Dec. 2011)	\$ 6,251.6	X 99%	\$ 6,189.1
Enacted Revenue Increases	2.6	X 95%	2.5
Enacted Revenue Decreases	-29.9	X 100%	-29.9
Total Revenue Adjustments	-27.3		-27.4
Economic Emergency Fund Excess	295.3	100%	295.3
Total	\$ 6,519.6		\$ 6,457.0

### **CURRENT FISCAL YEAR**

The REC also estimates revenues for the remaining months of the current fiscal year, although the expenditure limitation provisions do not apply to the fiscal year in progress. Significant changes in the revenue estimate for the current fiscal year that occur in December or later months affect the State budget process in the following ways:

- Excess revenues are eligible to fund supplemental appropriations. In FY 2012, the General Assembly enacted supplemental appropriations totaling \$17.5 million.
- A significant increase in the revenue estimate can also increase the projected General Fund surplus for the current fiscal year in progress. The surplus has been used in prior years by the General Assembly and the Governor to fund appropriations in succeeding fiscal years and has assisted in balancing the General Fund budget. Under current statute, the surplus is to first be distributed to the reserve funds. If the reserve funds are at their maximum balances, an increase in the current year's surplus will carry forward to the next fiscal year and is available for appropriation by the Governor and General Assembly.
- If the REC lowers the current year estimate to a level that a deficit is projected, the Governor may use that information to order across-the-board cuts to General Fund appropriations or the General Assembly may implement deappropriations. In FY 2002, FY 2003, and FY 2010, Iowa's economy experienced severe downturns causing tax receipts to drop significantly. As a result, the REC lowered estimates to a level that required across-the-board reductions and significant deappropriations.

### **DISTRIBUTION OF SURPLUS REVENUES**

**Cash Reserve Fund (CRF)** – Iowa Code sections [8.56](#) and [8.57](#) establish the CRF and dictate the flow of surplus revenues to the CRF, as well as uses of the Fund.

- The General Fund surplus is transferred to the CRF until the Fund reaches 7.5% of the Adjusted Revenue Estimate.
- If the CRF is not at the maximum of 7.5% of the Adjusted Revenue Estimate, a General Fund appropriation of up to 1.0% of the Adjusted Revenue Estimate is made to the Fund.
- The General Assembly may appropriate from the CRF for nonrecurring, emergency expenditures if the appropriation is the only subject matter in the bill, and the appropriation does not cause the Fund's balance to be less than 3.75% of the Adjusted Revenue Estimate. An appropriation that reduces the balance below 3.75% must be approved by a three-fifths majority in both the Senate and the House, and signed by the Governor.
- The CRF excess is transferred to the GAAP Deficit Reduction Account if a GAAP deficit exists; otherwise the excess is transferred to the Economic Emergency Fund.
- The CRF interest is credited to the Rebuild Iowa Infrastructure Fund.
- The CRF can be used for General Fund cash flow purposes if the funds are returned to the CRF by the close of the fiscal year.

**2012 Legislative Session:** The maximum balance for the CRF for FY 2013 is \$466.8 million and is calculated as follows:

Cash Reserve Fund Calculation	
Adjusted Revenue Est.	\$ 6,224.3
% set by Iowa Code	X 7.5%
FY 2013 Maximum Balance	\$ 466.8

The beginning balance in the CRF for FY 2013 is \$446.6 million and the General Fund ended FY 2012 with a surplus of \$688.1 million that was transferred to the CRF. Because only \$20.2 million was needed to bring the CRF balance to the \$466.8 million threshold, the remaining \$667.9 million of the surplus was transferred through the GAAP Deficit Reduction Account and to the Economic Emergency Fund.

Cash Reserve Fund	
(Dollars in Millions)	
	FY 2013
Beginning Balance	\$ 446.6
FY 2012 General Fund Surplus Transfer	688.1
Total Funds Available	\$ 1,134.7
Excess Transferred to EEF	-667.9
Ending Balance	\$ 466.8

**GAAP Deficit Reduction Account** – Iowa Code section [8.53](#) requires the Governor and the General Assembly to provide sufficient funds to eliminate any deficit that is reported in the State's Comprehensive Annual Financial Report. This requirement was enacted in the 1992 Legislative Session in SF 2351 (State Budget and Financial Control Act) with the purpose of transitioning the State to conforming to Generally Accepted Accounting Principles (GAAP) by the end of FY 1995.

The purpose of GAAP is to ensure that financial reporting is consistent between state and local governments. The principles of GAAP for state and local governments are established by the Governmental Accounting Standards Board (GASB).

Any excess moneys from the Cash Reserve Fund are directed to GAAP Deficit Reduction Account for the purpose of eliminating any identified GAAP deficit. The State now uses accounting procedures that are consistent with GAAP. The State's GAAP deficit was eliminated in 1994, a year earlier than required, and therefore, the excess funds from the Cash Reserve Fund flow to the Economic Emergency Fund.

**Iowa Economic Emergency Fund (EEF)** – Iowa Code section [8.55](#) establishes the EEF and specifies the flow and uses of the funds.

- The EEF receives the excess revenue from the CRF, via the GAAP Deficit Reduction Account, until the Fund reaches 2.5% of the Adjusted Revenue Estimate.
- Prior to FY 2010, the excess revenue from the EEF was transferred to the Senior Living Trust Fund until a cumulative total of \$300.0 million was transferred to the Fund. The \$300.0 million transfer requirement was met at the end of FY 2010.
- Up to \$50.0 million of the EEF may be appropriated through a standing appropriation for the purpose of preventing a deficit in the General Fund; however, all of the following conditions must be met:

- Either the fourth quarter REC estimate was, or actual year-end receipts were 0.5% less than the third quarter REC estimate.
- The Governor implemented across-the-board reductions during the fiscal year that were not sufficient to prevent the deficit. This condition does not apply if the Governor could not implement the reductions due to the lateness of the realization of the deficit.
- The year-end General Fund balance was negative.
- The Governor must issue an official proclamation and notify the Legislative Fiscal Committee and the Legislative Services Agency that a deficit occurred and that across-the-board reductions were insufficient to eliminate the deficit or could not be implemented.
- In the event that an appropriation is made to eliminate a year-end deficit, a standing appropriation from the General Fund is made to the EEF in the succeeding fiscal year to reimburse the EEF.
- The EEF can be used for General Fund cash flow purposes if the funds are returned to the EEF by the close of the fiscal year.
- 2011 Iowa Acts, Chapter 131 ([SF 533 – Standing Appropriations Act](#)) established a standing appropriation from the EEF for the Performance of Duty costs. In prior years, these costs were funded from the General Fund. The primary purpose of the Performance of Duty appropriation is to provide funding for emergency repairs to State property if sufficient funds are not available in a State agency budget. The appropriation can also be used for disaster-related costs of governmental subdivisions. All expenditures from the Performance of Duty appropriation must be approved by the Executive Council.
- The EEF interest is credited to the Rebuild Iowa Infrastructure Fund.

**2012 Legislative Session:** The maximum balance for the EEF for FY 2013 is \$155.6 million and is calculated as follows:

Economic Emergency Fund Calculation		
Adjusted Revenue Est.	\$	6,224.3
% set by Iowa Code	X	2.5%
FY 2013 Maximum Balance	\$	155.6

The following table shows the projected activity of the EEF for FY 2013. The EEF has beginning balance of \$148.9 million for FY 2013 and received \$667.9 million of excess funds from the CRF. Because only \$6.7 million will be needed to bring the EEF balance to the \$155.6 million maximum, the remaining \$661.2 million is allocated as follows:

- The first \$60.0 million will be allocated to the Taxpayer Trust Fund. An explanation of how the Taxpayer Trust Fund is determined is discussed below.
- The next \$28.6 million will be used to fund the Performance of Duty appropriation. This is an estimate and can fluctuate significantly from year to year.
- The General Assembly provided a one-time transfer of \$20.0 million from the EEF to the Rebuild Iowa Infrastructure Fund for FY 2013 to fund a variety of infrastructure and environmental-related projects.
- The remaining \$552.6 million was transferred to the General Fund and made available for appropriation in FY 2013. It should be noted that these excess funds are considered one-time revenues that can carry-forward from one fiscal year to the next. The transfer

amounts can be unpredictable from one year to the next as is illustrated on the chart in **Appendix A**. Reliance on these revenues for ongoing operational expenses of government programs can result in budget shortfalls if an economic downturn causes a drop in annual tax revenue.

<b>Economic Emergency Fund</b>	
(Dollars in Millions)	
	FY 2013
Beginning Balance	\$ 148.9
Excess from Cash Reserve/GAAP Account	667.9
Total Funds Available	<u>\$ 816.8</u>
Excess Revenue Transferred (See Below)	-661.2
Ending Balance	<u>\$ 155.6</u>
<b>Excess Revenue from FY 2012 Surplus</b>	
(Dollars in Millions)	
	FY 2013
Allocation of Excess Revenue	
Taxpayer Trust Fund Transfer	\$ 60.0
Executive Council - Performance of Duty (Est.)	28.6
Transfer to Rebuild Iowa Infrastructure Fund	20.0
Transferred to the General Fund	552.6
Total Allocations of Excess Revenue	<u>\$ 661.2</u>

**Taxpayer Trust Fund** – Iowa Code section [8.57E](#) establishes the Taxpayer Trust Fund. The Trust Fund is a new fund that takes effect in FY 2013 and was created for the purpose of providing tax relief to Iowans.

- Moneys in the Trust Fund can only be used pursuant to appropriations made by the General Assembly for tax relief.
- The Trust Fund can be used for General Fund cash flow purposes if the funds are returned to the Trust Fund by the close of the fiscal year.
- The interest earned by the Trust Fund is retained in the Taxpayer Trust Fund.
- The Fund can receive up to \$60.0 million in a given fiscal year from the excess General Fund surplus dollars after the reserves funds are fully funded. The actual amount that the Taxpayer Trust Fund can receive in a given fiscal year is limited to the difference between the actual net General Fund revenue for the preceding fiscal year and the adjusted revenue estimate used in establishing the budget for that fiscal year. For example, the amount that the Fund will receive in FY 2013 is calculated by subtracting the Adjusted Revenue Estimate for the FY 2012 budget from the actual year-end net General Fund receipts for FY 2012.

**2012 Legislative Session:** At the close of FY 2012, net General Fund receipts exceeded the FY 2012 Adjusted Revenue Estimate by \$357.0 million. This exceeds the statutory cap of \$60.0 million. Therefore, the Taxpayer Trust Fund is estimated to receive the maximum \$60.0 million from the excess surplus dollars in FY 2013.

<b>Taxpayer Trust Fund Calculation</b>	
(Dollars in Millions)	
	FY 2012
Actual Net General Fund Revenue	\$ 6,311.1
Adjusted Revenue Estimate	- 5,954.1
Difference	\$ 357.0

### **SIGNIFICANT CHANGES TO THE EXPENDITURE LIMITATION LAW**

There have been numerous changes to the expenditure limitation law since it was originally enacted.

- In FY 2001, changes were made to provisions of the EEF to allow up to \$50.0 million from the Fund to be used for deficit reduction if certain conditions are met.
- In FY 2003, the requirement directing excess moneys of the EEF to be transferred to the General Fund was changed to require the excess be transferred to the Endowment for Iowa's Health Account and the Senior Living Trust Fund until a certain level of transfers were reached. The Senior Living Trust Fund amount was originally set at \$51.0 million and changed to \$300.0 million in the 2006 Legislative Session. The requirement to transfer funds to the Endowment was repealed in FY 2005 and the \$300.0 million transfer requirement for the Senior Living Trust Fund was met at the end of FY 2010.
- In FY 2005, the CRF percentage goal was increased from 5.0% to 7.5% and the EEF percentage goal was decreased from 5.0% to 2.5% of the Adjusted Revenue Estimate.
- In FY 2005, a provision was added to require the use of the expenditure limitation during special sessions that commence prior to the end of the fiscal year. Prior to this change, the General Assembly was not required to adhere to the expenditure limitation during a special session.
- During the 2011 Legislative Session, the General Assembly enacted 2011 Iowa Acts, Chapter 123 ([SF 209 - Tax Changes and Supplemental Appropriations Act](#)) that created the Taxpayer Trust Fund and the mechanism to transfer up to \$60.0 million per year from the excess General Fund surplus after the reserves funds have reached their maximum statutory balance. The provision included a delayed effective date, and as a result, the first year that the Fund will receive revenue is FY 2013.
- In FY 2012, the General Assembly permanently moved the funding for the Performance of Duty standing appropriation to the EEF. Prior to FY 2012, the Performance of Duty appropriation was funded from the General Fund, although other funding sources had been used periodically in place of General Fund dollars.

### **SUMMARY**

While the 99.0% expenditure limitation law has been adhered to since inception, other provisions of the law have been notwithstanding (temporarily suspended) by the General Assembly and the Governor to help balance the budget. Provisions notwithstanding in recent Legislative Sessions include:

- For FY 2006 and FY 2007, the provision requiring the General Assembly to use the December REC estimate was notwithstanding to allow the use of later estimates that were



higher than the respective December estimates. This allowed the General Assembly to appropriate an additional \$84.2 million in FY 2006 and \$45.7 million in FY 2007.

- During the 2005 and 2006 legislative sessions, the General Assembly notwithstanding the requirement to have the General Fund surplus transferred to the Cash Reserve Fund, and instead transferred approximately \$160.0 million from each year's surplus to the Property Tax Credit Fund to fund property tax credits for the subsequent fiscal years (FY 2006 and FY 2007).
- For FY 2006, the General Assembly notwithstanding the requirement that an appropriation of up to 1.0% of the Adjusted Revenue Estimate be made to the Cash Reserve Fund if the Fund is not at 7.5% of the Adjusted Revenue Estimate. During the 2005 Legislative Session, the estimated balance in the Cash Reserve Fund was approximately 6.0% of the Adjusted Revenue Estimate. If this provision had not been notwithstanding, an appropriation of \$49.9 million would have been required for FY 2006.
- For FY 2002 through FY 2004, the General Assembly notwithstanding the requirement to have the interest from the reserve funds transferred to the Rebuild Iowa Infrastructure Fund and instead directed the funds to the General Fund. This provided additional General Fund revenue of \$31.1 million in FY 2002, \$15.5 million in FY 2003, and \$7.6 million in FY 2004.

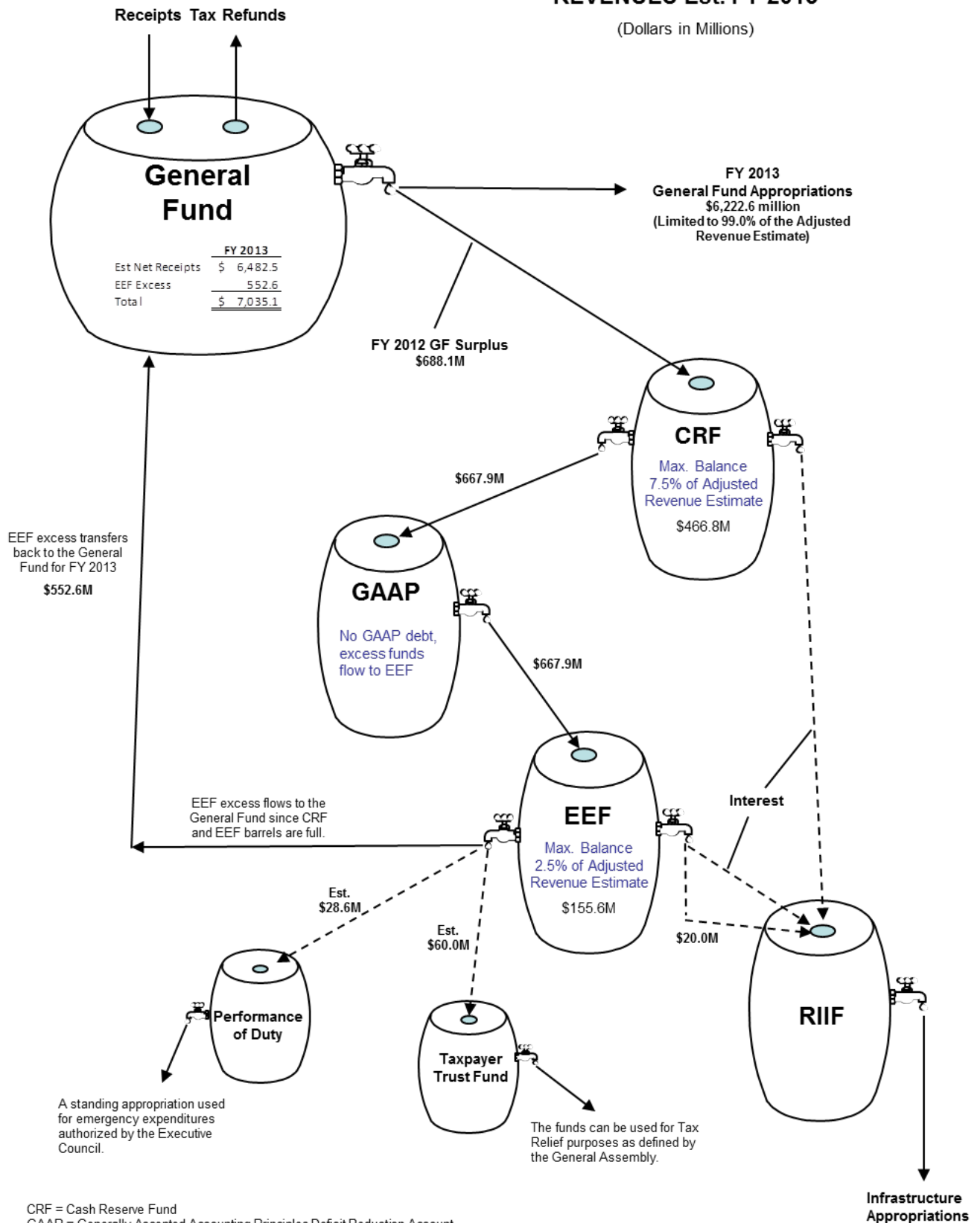
The expenditure limitation law has allowed the State to establish two reserve funds that have provided several benefits to the State that have included:

- Providing cash flow for State expenditures so the General Fund maintains a positive cash balance throughout the fiscal year. This has significantly reduced the need for the State to borrow funds on a short-term basis for cash-flow purposes.
- At the close of FY 2009, the General Fund budget was experiencing a deficit of \$45.3 million due to a drop in tax revenue brought on by the economic recession of 2008. As a result, provisions of Iowa Code section [8.55](#) were implemented and \$45.3 million was transferred from the EEF to the General Fund to balance the budget. In FY 2010, a General Fund appropriation of \$45.3 million was made to reimburse the EEF.
- Providing sources of revenue that policymakers have used to assist in balancing the budget during fiscal years that experience significant tax revenue declines. This allowed lawmakers to maintain funding for government services without raising taxes. In FY 2011, \$268.8 million was appropriated from the CRF in place of General Fund appropriations due to a revenue shortfall in the General Fund. The chart in **Appendix B** shows the combined balances and statutory goals of the Cash Reserve and Economic Emergency Funds back to FY 2000.

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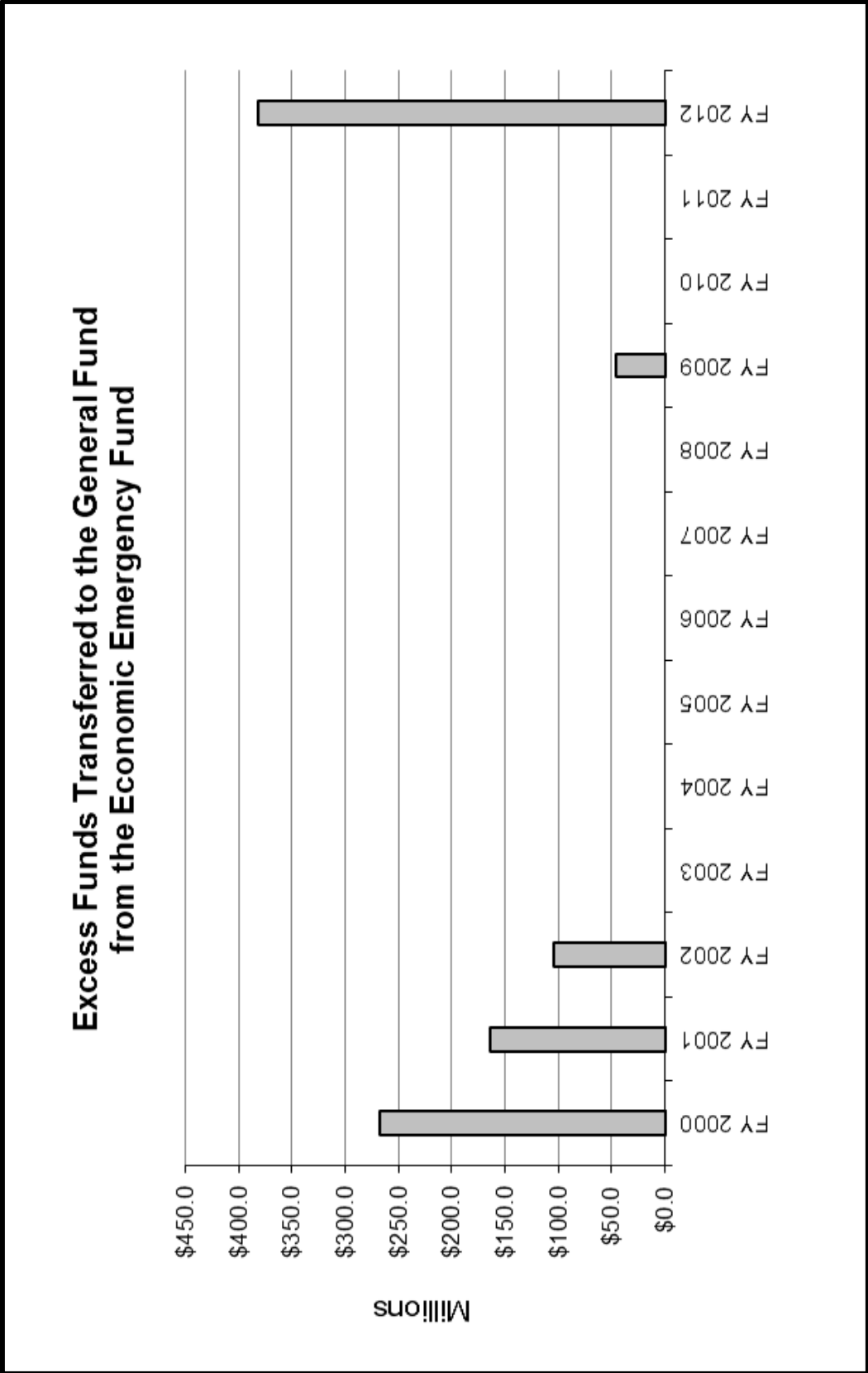
### FLOW OF GENERAL FUND SURPLUS REVENUES Est. FY 2013

(Dollars in Millions)



CRF = Cash Reserve Fund  
 GAAP = Generally Accepted Accounting Principles Deficit Reduction Account  
 EEF = Economic Emergency Fund  
 RIIF = Rebuild Iowa Infrastructure Fund

**APPENDIX A**



# APPENDIX B

