



# THOMAS A. SCHWEICH

## Missouri State Auditor

August 19, 2011

Honorable Jeremiah W. (Jay) Nixon  
Governor  
State Capitol  
Jefferson City, Missouri

Dear Governor Nixon:

As you know, the extraordinary events and damage associated with the Joplin tornado, other storms, and the flooding on the both the Missouri and Mississippi rivers have created a significant financial obligation on our state. While I firmly agree with your position that communities and citizens affected by these disasters should receive state and federal assistance needed for a comprehensive and rapid recovery, I also want to ensure necessary resources are provided in a transparent and lawful manner.

This letter, in fulfillment of our duties under Chapter 29, RSMo, communicates the results of our comprehensive review of your actions to withhold state fiscal year (FY) 2012 appropriated expenditures. The objectives of our review were to determine whether:

1. The amount withheld from FY 2012 appropriated expenditures was accurately calculated and adequately supported.
2. The methods used to make the withholdings were in compliance with applicable legal provisions.
3. The budgetary process, as it relates to withholdings, is in need of improvement.

Our review has determined that my office cannot audit the accuracy of amounts withheld because your office prepared no calculation. Additionally, the reason provided for the withholdings does not appear to meet constitutional provisions. We are aware of no constitutional or statutory authority to withhold from appropriated expenditures based on state obligations that were unanticipated at the time the budget was passed by the General Assembly. To the contrary, the relevant constitutional provision allowing withholdings deals only with shortfalls of revenue, not increased costs. In addition, budgetary and related withholding processes need to be re-evaluated and/or state law revised.

### **Applicable Legal Provisions**

Article IV, Section 24, Missouri Constitution, requires the Governor to submit to the General Assembly, within 30 days of it convening, a budget that contains the estimated available revenues and a complete and itemized plan of proposed expenditures of the state, with any recommendations of laws necessary to provide sufficient revenues to meet expenditures.

Article IV, Section 27, Missouri Constitution, grants the Governor the power to reduce the expenditures below appropriated amounts (withhold) when actual revenues are less than the revenue estimates upon which the appropriations were based. Article IV, Section 27(a), Missouri Constitution, also establishes the Budget Reserve Fund (commonly referred to the Rainy Day Fund). The Governor may request the General Assembly to appropriate emergency funds from this fund with certain restrictions, if there is a budget need due to a disaster. In addition, Article IV, Section 28, and Article III, Section 36, Missouri Constitution, allow monies in the state treasury to be spent only if appropriated.

### **Recent Disasters**

Prior to the beginning of FY 2012, citizens and communities in the state suffered significant disasters. In April and May, flooding occurred in the southeastern section of the state along the Mississippi River, on May 22 a massive tornado destroyed a significant portion of Joplin, and beginning in June flooding occurred in the northwestern section of the state along the Missouri River. On June 10, 2011, you directed the Office of Administration (OA) to withhold over \$172 million, approximately \$57 million from the state General Fund (to be used for disaster recovery) and \$115 million from FY 2012 appropriated expenditures of other funds. On July 1, 2011, based on your instructions, the OA committed an additional \$100 million for disaster aid to be paid for with the better-than-expected revenues carried forward from FY 2011. You subsequently ordered the release of over \$1.2 million of withholdings.

### **Withholding Procedures and Methodology**

According to the state Budget Director, assumptions/predictions from the following categories are considered when determining withholdings: 1) actual and estimated revenues, 2) state spending obligations, 3) approved legislation which involves revenues/costs not considered in the current budget, and 4) legislation which involves revenues/costs considered in the budget but not approved. Obligations are items, with and without appropriations, which involve the state's share of expenses/costs, and may involve items difficult to estimate/predict such as natural disaster expenditures. Obligation/spending issues may be handled in several ways, including using an estimated (E) appropriation, supplemental budgets, withholdings, or a combination of these items. An example of an item approved by the General Assembly but not considered in FY 2012 appropriations is the legislation which approved the gradual repeal of the franchise tax. An example of an item not approved by the General Assembly, but included in the FY 2012 available revenue amount, is the tax amnesty program estimated to generate approximately \$34 million.

According to the Budget Director, the OA does not prepare a formal documented withholding calculation, and does not use a formula to establish withholding amounts. Instead the Governor's office and the Budget Director negotiate withholding amounts and the amount is ultimately based on what the Governor believes is necessary. Each month the OA tracks and evaluates the actual revenues and predictions for future revenues to determine if revenue estimates are on target for the year. The OA also evaluates gaming and lottery revenues monthly because these monies affect the appropriations for education. Withholdings may also be necessary due to the amount of actual expenditures from E appropriations and supplemental budgets, according to the Budget Director. The Governor and General Assembly use E appropriations in the budgetary process. A \$1 E appropriation is typically used for expenditures that cannot be readily estimated such as disasters or costs of the National Guard when ordered by the Governor to respond to emergency situations. Disaster recovery costs often are partially funded by federal monies; however, the federal participation rate is often unknown until weeks after the disaster occurred.

Since the early 1990s, the state has used a consensus revenue estimate (CRE) to estimate General Fund revenues. The CRE is an amount agreed upon by the Governor and the General Assembly, based on

recommendations prepared by the state Budget Director and the Directors of the House Appropriations and Senate Appropriations Committee Staff. The CRE comprises a significant portion of the resources available from the General Fund for appropriations by the General Assembly. A meeting is held in December each year to agree upon a CRE for the next fiscal year's budget and to revise the CRE for the current fiscal year.

### **State Auditor Methodology**

The methodology to accomplish our objectives included:

1. Interviewing key personnel from the Governor's office, the OA, House Appropriations, and the Senate (including Appropriations Committee staff) regarding the budgetary and withholding process;
2. Reviewing and evaluating certain applicable legal provisions;
3. Reviewing Governor withholdings and related release of withholdings for FY 2012 and FY 2011; and
4. Reviewing the FY 2012 state budget, including the General Revenue summary of the estimated resources and obligations, and the FY 2011 consolidated revenue report which provides the actual revenues by type for the current and prior fiscal years.

### **Results and Conclusions**

Because the OA did not document a calculation of the necessary withholding amount, it was not possible for us to determine whether the amount withheld from fiscal year 2012 appropriated expenditures was accurately calculated.

The method used to make FY 2012 withholdings does not appear to comply with constitutional provisions. When the Governor ordered the withholdings in June 2012, FY 2012 had not begun, and therefore, actual revenues could not have been lower than anticipated FY 2012 revenues. In addition, there is no provision in the Missouri Constitution, that allows the Governor to withhold amounts from appropriated expenditures based on obligations that were unanticipated at the time the budget was passed by the General Assembly. Your actions are troubling because the legislative branch of government was not provided appropriate checks and balances, and could result in the Governor basically rewriting the budget without recourse by the General Assembly. To address withholding issues and the constitutional separation of powers question, on July 22, 2011, several members of the General Assembly requested a legal opinion from the Office of Attorney General. The Attorney General has not yet issued an opinion related to this request.

One option available under state law would be to use the Rainy Day Fund to fund disaster related costs. This would require you to request an emergency appropriation to be approved by two-thirds of the members of the General Assembly. Utilizing the Rainy Day Fund would require both the Governor and General Assembly to make budgetary decisions and provide greater accountability and transparency for decisions related to funding unanticipated obligations needed for disaster recovery efforts.

State law provides little guidance regarding the proper manner and method to determine withholding amounts, whether withholdings must be released should actual revenues subsequently exceed revenue estimates, or how to determine if actual revenue shortfalls occur. During FY 2011, actual revenues were less than the CRE by about \$97 million yet withholdings totaled over \$301 million, of

which only \$17.5 million were ultimately released. Also, withholdings and subsequent release of withholdings may be based on the revised CRE; however, case law provides that a revenue estimate prepared after passage of the budget has no legal significance. Also, determining when actual revenue shortfalls occur is problematic. While actual revenues for a current year cannot be determined until June 30, the current practice of comparing year-to-date revenues to prior years actual amounts and the CRE appears reasonable.

Several mechanisms currently used in the budgetary process are not authorized by state law. Neither, the CRE nor the E appropriations are authorized by state law. The use of the CRE appears to be a reasonable method to estimate revenues for budget purposes. However, the utilization of E appropriations is subject to misuse as the executive branch has no spending limit as long as cash is available in the State Treasury.

### **Recommendations**

As noted above, my office does not question the need for the swift actions taken by you, as Governor, to address the unprecedented disasters faced by the citizens of the state and the state's responsibility for certain costs. However, the method you used to make FY 2012 withholdings does not appear to comply with constitutional provisions, and amounts withheld were not supported by adequate documentation. In addition, I believe you need to work with the legislature to propose legislation to clarify and/or address the following issues:

1. Whether the Governor can withhold due to spending based on obligations resulting from a disaster or emergency, and were unanticipated at the time the budget was passed by the General Assembly.
2. The establishment of well defined and measurable criteria to determine 1) when to initiate withholdings, 2) required documentation to support withholding amounts, and 3) whether and/or when withholding amounts are to be released.
3. Amending state law to provide for the use of the CRE and E appropriations in the budget process.
4. Consideration of a cap for estimated appropriations.

Sincerely,



Thomas A. Schweich  
State Auditor

CC: Members of the General Assembly