



EXECUTIVE BUDGET-INTRODUCTION

PURPOSE

This chapter is an overview of the budget submitted for the 2009 biennium by the Governor, pursuant to statute. This overview provides a summary of the more detailed agency budget presentation contained in Volumes 3 through 7 of the Legislative Budget Analysis, as well as statewide issues such as the pay plan. It is intended to provide the reader with a general understanding of the major components and priorities of the Governor's budget proposal. This and subsequent sections of this chapter include the following:

- Budget comparisons with the previous biennium
- Executive revenue proposals summary
- Executive expenditure proposals summary
- Statewide budget proposals and issues
- Other executive budget issues identified through Legislative Fiscal Division analysis

A number of relatively minor amendments to the original budget submitted by the Governor were submitted by letter to the Legislative Fiscal Analyst on December 15, 2006. These amendments were not received in time to be included in this analysis. The amendments are summarized on page 170 and amendment items will be addressed individually during the legislative process at the prerogative of the legislature.

EXECUTIVE BUDGET OVERVIEW

Montana state government general fund revenues are strong, primarily due to growth in income taxes and oil and gas tax revenues. Available revenues after funding present law are estimated to be just under \$1 billion. The Governor has submitted a budget proposing commitments of over \$700 million of the available funds, leaving \$100 million for a fund balance reserve, and place just under \$125 million into a new rainy day fund. The Governor's proposals provide for a 24 percent increase in general fund spending over the current biennium.

The Governor's general fund proposals address issues of unfunded liabilities in the pension plans and a large deferred maintenance deficit for state infrastructure, amongst other one-time funding demands. The Governor also commits large increases to human services and corrections in response to significant caseload/population increases. Large increases in K-12 education generally continue and support the school funding commitments and increases approved in the 2005 regular and special sessions. Higher education increases are primarily to address access to higher education and stem tuition increases for two years. While caseload increases in human services are a significant factor, the budget also addresses federal fund cutbacks. Altogether, nearly 85 percent of the budget increases are for K-12 and higher education, human services, corrections, and the administrative agencies of Revenue and Public Defender. The increases in Department of Revenue are largely related to an initiative to become

significantly more aggressive on tax compliance and audit functions to yield higher tax collections. But there are also general increases in Department of Revenue operating costs. Perhaps the most interesting aspect of the executive budget increases are that the agencies of state government other than education, corrections, and human services would receive the largest percentage increases in their budgets, with an average of 50 percent increases, significantly increasing their share of the general fund priorities. These increases are for a wide range of initiatives.

Almost \$500 million of the Governor's proposals are the use of one-time-only moneys, in order to maintain structural balance in the general fund. This includes the use of cash only for capital projects and infrastructure maintenance (no bonding program for the next biennium), as well as property tax rebates and cash infusions to reduce pension plan unfunded liabilities.

On the revenue and tax policy side, the executive budget does not propose tax increases, but includes numerous proposals through over 20 bill drafts to address the emphasis on tax compliance and audit. The Governor also proposes a significant property tax rebate to Montana property holders.

While the executive budget does not rely on increased taxes, it is still an unprecedented commitment of general fund increases, and the increases are in nearly all programs of state government, with every executive branch agency receiving a proposed increase of 10 percent or more. All but three agencies are requesting significantly increased numbers of state employees that would result in nearly 500 additional state employees in the 2009 biennium.

The priorities and details of the executive budget proposal are summarized in this section as part of the Legislative Fiscal Division (LFD) independent analysis of the Governor's budget. Also included are issues the LFD raise with the executive budget. The more significant issues include:

- The budget classifies over \$75 million in new initiatives as present law adjustments, and misrepresents the amount of government expansion included in this budget
- The present law budget is overstated by over \$24 million as compared to LFD estimates of the amount needed to continue existing services
- A number of the executive proposals submitted with the budget had no description, justification, or any supporting documentation. Budget development continued well past the statutory submission deadline, making it difficult for the legislature to have their staff do a pre-session analysis of the entire executive proposal
- Although the executive budget is structurally balanced (existing revenues equal or exceed proposed on-going expenditures), it is based on a moderate revenue outlook that may not continue into future biennia. Consequently, the issue of sustainability of a large increase in on-going general fund commitments is a concern

The remainder of this section will address the budget components and priorities highlighted above, and the statewide proposals and issues related to the Governor's budget initiatives.



EXECUTIVE BUDGET COMPARISONS

COMPARISON METHODS

The total 2009 biennium executive budget request is \$3.8 billion general fund and \$8.8 billion total funds. The budget reflects a 24.0 percent general fund increase and a 12.1 percent increase in total funds as compared to the 2007 biennium. The overall net increase reflects the improved revenue picture and growing demands for services in almost all sectors of state government, in addition to some instances of recovery effects of the most recent recession. Nearly 85 percent of the general fund dollar increases appear in 6 agencies – Public Health and Human Services, Revenue, Public Education, Corrections, Higher Education, and Public Defender. The largest total fund increases occur in Transportation and Public Health and Human Services. Highlights of the executive budget proposal are presented on page 102.

The legislature and the public use comparisons to prior budgets as a benchmark for assessing budget growth and stability. There are two common methods utilized in the state budget process:

- Base year comparison – this method is used because the state budget is developed from a base year, but is not a good measure of true growth
- Biennial comparison – this is the method prescribed in statute for budget comparisons, and is a better measure because it takes into consideration the cyclical nature of the state budget

A discussion of each of these budget comparison methodologies follows. Please read the “Comparison Caution” on page 73 for a better understanding of the merits of these differing methodologies.

BASE LEVEL BUDGET COMPARISONS

In this volume and Volumes 3 through 7, the reader will see references to base budget, present law budget, and the executive budget. It is important to understand the relationship between these different categorizations of the budget. Base budget describes the actual costs for the base year (FY 2006) adjusted for one-time-only costs that were designated as such by the previous legislature. The present law budget is the amount of funding needed to maintain government services at the level authorized by the previous legislature for FY 2008 and 2009. The executive budget is the total budget that is submitted to the legislature for the upcoming biennium, and by statute, must include the components of base and present law, plus the addition of any new proposals or initiatives that the Governor wishes to pursue. These three levels of the budget are compared in Figures 1, 2, 3, and 4.

General Fund - The base is merely the base budget times two. Since the FY 2008 and 2009 budgets are developed from the base data, this amount is used to compare the present law budgets on a biennium basis. Figure 1 shows that the present law budget exceeds the base budget by \$471.0 million, reflecting adjustments to the base for such things as annualization of the 2007 biennium pay plan and caseload increases, as well as changes in fixed costs and inflation (or deflation). The total

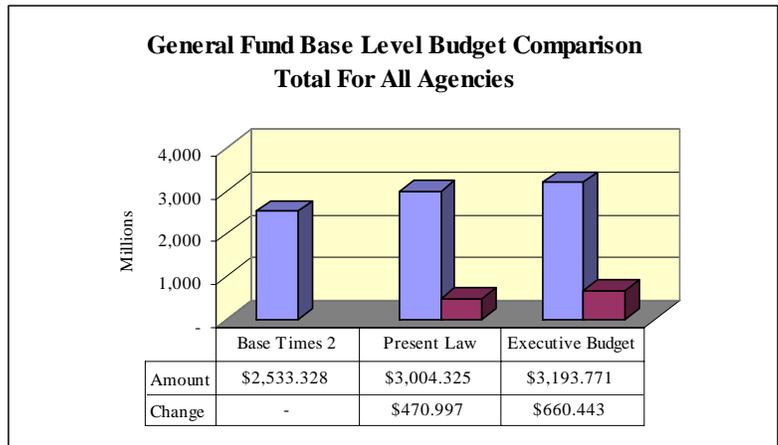


Figure 1

executive budget is \$189.4 million greater than the present law budget, an increase that reflects the various new proposal requests by agencies, described in detail throughout Volumes 3 through 7. The total executive budget is \$660.4 million greater than the base budget.

State Special Fund - The base is merely the base budget times two. Since the FY 2008 and 2009 budgets are developed from the base data, this amount is used to compare the present law budgets on a biennium basis. Figure 2 shows that the present law budget exceeds the base budget by \$134.1 million, reflecting adjustments to the base for such things as annualization of the 2007 biennium pay plan and caseload increases, as well as changes in fixed costs and inflation (or deflation). The total executive budget is

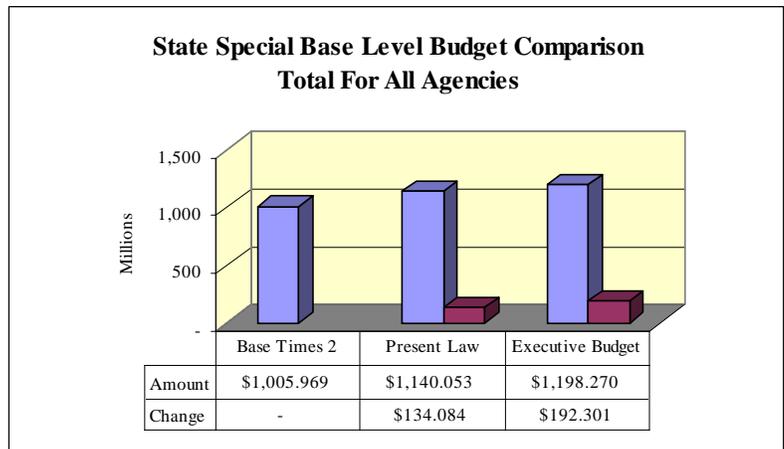


Figure 2

\$58.2 million greater than the present law budget, an increase that reflects the various new proposal requests by agencies, described in detail throughout Volumes 3 through 7. The total executive budget is \$192.3 million greater than the base budget.

Federal Special Fund - The base is merely the base budget times two. Since the FY 2008 and 2009 budgets are developed from the base data, this amount is used to compare the present law budgets on a biennium basis. Figure 3 shows that the present law budget exceeds the base budget by \$406.4 million, reflecting adjustments to the base for such things as annualization of the 2007 biennium pay plan and caseload increases, as well as changes in fixed costs and inflation (or deflation). The total executive budget is \$127.5 million greater than the present law budget, an increase that reflects the various new proposal requests by agencies, described in detail throughout Volumes 3 through 7. The total executive budget is \$534.0 million greater than the base budget.

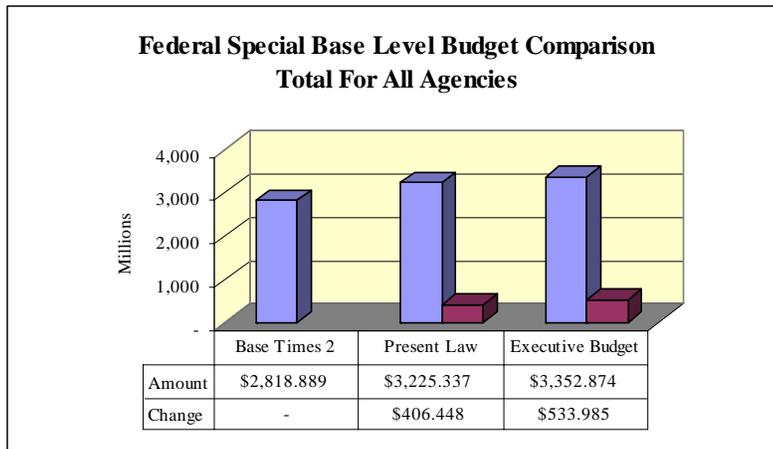


Figure 3

Total Funds - The base is merely the base budget times two. Since the FY 2008 and 2009 budgets are developed from the base data, this amount is used to compare the present law budgets on a biennium basis. Figure 4 shows that the present law budget exceeds the base budget by \$1,011.5 million, reflecting adjustments to the base for such things as annualization of the 2007 biennium pay plan and caseload increases, as well as changes in fixed costs and inflation (or deflation). The total executive budget is \$375.2 million greater than the present law budget, an increase that reflects the various new proposal requests by agencies, described in detail throughout Volumes 3 through 7. The total executive budget is \$1,386.7 million greater than the base budget.

greater than the present law budget, an increase that reflects the various new proposal requests by agencies, described in detail throughout Volumes 3 through 7. The total executive budget is \$1,386.7 million greater than the base budget.

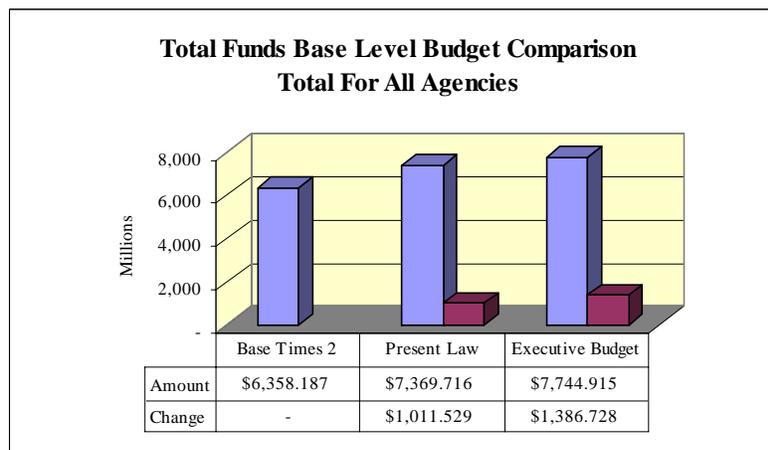


Figure 4

BIENNIAL BUDGET COMPARISON

This section summarizes the executive recommendations for the 2009 biennium and compares it to expenditures/appropriations for the 2007 biennium.

The executive is recommending a 2009 biennium budget that includes an additional \$736.1 million in general fund expenditures, a 24.0 percent increase. Total increases (all funds) amount to \$947.0 million, a 12.1 percent increase. The executive proposal for general fund and total spending increases are supported by existing sources of revenue, with the large general fund and federal funds increases being indicative of substantial general fund and federal revenue increases estimated for the 2009 biennium. Transfers, including the one-time transfers of general fund, are not included as required by the statutory comparison methodology.

METHODOLOGY

The state budget is highly complex, and the methods used to compute comparisons within the context of that budget can vary considerably. Without consistent comparison methodology, the comparisons can also be subject to manipulation. The Legislative Finance Committee (LFC) developed a budget comparison methodology that measures budget performance using total state expenditures for state general operations funded by taxpayer taxes, licenses, and fees. This method helps ensure proper representation, fairness, balance, and consistency. Adopted by the 1997 Legislature, use of the comparison procedures became a statutory requirement at that time. These procedures provide consistency of application and help avoid the potential for manipulation when comparing information.

The comparisons on the following pages were prepared using the statutory methodology found in 17-7-150 & 151, MCA.

COMPARISON TO 2007 BIENNIUM

Figures 5 and 6 compare expenditures/appropriations between the 2007 and 2009 biennia for general fund and total funds. As shown in the figures, the largest HB 2 general fund increases are found in the Department of Public Health and Human Services (DPHHS) (\$148 million), Office of Public Instruction (\$140 million), and the Department of Corrections (\$100 million). However, the largest increases in percentage terms occur in the departments of Agriculture, Commerce, Administration, and the Office of the Public Defender. The general fund in these agencies more than doubles from the preceding biennium. Only the Judiciary Branch shows a decline, due to transfer of public defender functions to the new Office of the Public Defender.

Figures 5 and 6 are divided into three sections:

1. The top part of the table includes all appropriations recommended to be included in HB 2 (the General Appropriations Act), by agency.
2. Because HB 2 does not include all appropriations authorized by the legislature, the second part of the table includes additional appropriations. This section is referred to as "Comparable Adjustments" because the items can be compared across biennia. The total shown in the "Total Exec. Budget Fiscal 08-09" (the 2009 biennium) column represents all recommendations made by the executive, with the exception of the non-cash portion of long-range building program, budget amendments, and transfers. Long-range building proposals are specifically excluded because spending and timing vary considerably on most building projects. The building expenditures are reflected by the debt service paid over the term of any bonding/leasing

agreement. Statutory appropriations represent the executive estimates for non-general fund. General fund statutory appropriations are estimates of the Legislative Fiscal Division. (Note: The total in the "Total Adjusted Fiscal 06-07" (the 2007 biennium) column does not represent all contingent appropriations in that biennium, which are included in the third section.)

3. The third section, "Non Comparable Adjustments", includes all 2007 biennium expenditure/appropriations, including budget amendments, supplemental appropriations, and disaster/emergency costs that cannot be estimated for the next biennium. Excluded from the "Comparable Adjustments" total are probable 2009 biennium expenditures that belong in this category. Consequently, the increases of 21.1 percent for general fund and 8.7 percent for total funds do not represent a true picture of potential growth between biennia.

House Bill 2 Comparisons

As shown in Figures 5 and 6, general fund appropriations in HB 2 increase \$576.0 million or 22.0 percent. All funds increase \$909.9 million or 13.2 percent, with \$100.9 million of increases in state special revenue and \$229.6 million in federal special revenue. These are primarily due to additional state special appropriations in the Department of Public Health and Human Services (\$49 million), Department of Justice (\$20 million), Department of Fish, Wildlife and Parks (\$16 million), Department of Natural Resources and Conservation (\$13 million), and the State Auditor's Office (\$11 million), and additional federal funds appropriations in DPHHS (\$153 million), Commissioner of Higher Education (\$31 million), and the Department of Transportation (\$23 million). Reductions of \$56 million in state special revenue occur in the Department of Transportation and reductions of \$21 million in federal funds occur in the Board of Crime Control.

Appropriation increases are summarized in the "Executive Expenditure Proposals Summary" section of this volume, page 101, and are detailed in the narratives of the specific agencies in Volumes 3 through 7.

Comparable Adjustments

Comparable adjustments include HB 2 appropriations, all miscellaneous appropriation bills including the employee pay plan bill, statutory appropriations, and other appropriation and expenditure adjustments. The executive recommends \$736 million in increased general fund appropriations for the 2009 biennium million as compared to the 2007 biennium, an increase of 24.0 percent. The increase in total all funds spending over comparable 2007 biennium spending is \$947 million, or 12.1 percent.

Non-Comparable Adjustments

Non-comparable Adjustments, the third section, shows increases of 21.1 percent general fund and 8.7 percent total funds between biennia. As stated earlier, this comparison tends to be distorted by the lack of comparable information for the 2009 biennium. This section and these comparisons are shown for informational purposes only and to complete the listing of 2007 biennium expenditures\appropriations.

COMPARISON CAUTION

Comparisons vs. Budget Base Adjustments

This volume compares the 2009 biennium executive budget to actual expenditures and expenditures/appropriations for the 2007 biennium. The methodology used is that prescribed by the budget comparison statute, and upholds the concept of a comparison of the total state budget from biennium to biennium. This is a particularly useful practice due to the cyclical nature of annual budgets.

However, because the Executive Budget is prepared using a different statutorily defined process, there is a difference between the total changes indicated in this volume and those indicated in the individual agency and program budgets discussed in the Agency Budgets and Analysis Section in Volumes 3 through 7.

Because present law adjustments are added to the base year (fiscal 2006) to determine a present law budget for the 2009 biennium and budget growth as prescribed by total adjustments, the intermediate year (fiscal 2007) is ignored. This method facilitates budget development from a vantage point of recent, actual experience, but overstates true budget growth because all increases are measured from the base year.

Conversely, using the base year (fiscal 2006) plus fiscal 2007 appropriations for budget comparisons more accurately reflects true budget growth. This is because the increases/decreases are measured from a biennial perspective that takes into account the annual increase from the base year to the fiscal 2007 appropriated amount.

While consideration of increases over the base year is necessary to making budgetary decisions, the adjustments should not be used as measures of growth or for comparative purposes. When making comparisons, the total budget for the 2009 biennium should be examined in comparison with the total 2007 biennium, as described above.

Figure 5					
General Fund Comparison					
2007 Biennium Versus Executive Budget 2009 Biennium					
Agcy		Total	Total	Difference	% Change
Code	Agency Name	Adjusted	Exec. Budget	2009 Biennium	2009 Biennium
		Fiscal 06-07	Fiscal 08-09	- 2007 Biennium	2007 Biennium
House Bill 2					
1104	Legislative Branch	\$16,918,601	\$19,174,046	\$2,255,445	13.33%
2110	Judicial Branch	65,525,334	65,023,418	(501,916)	-0.77%
3101	Governor's Office	10,648,658	12,898,205	2,249,547	21.13%
3202	Comm Of Political Practices	668,416	893,832	225,416	33.72%
3501	Office Of Public Instruction	1,144,208,181	1,284,609,121	140,400,940	12.27%
4107	Board of Crime Control	3,490,857	4,508,581	1,017,724	29.15%
4110	Department Of Justice	43,849,583	54,870,400	11,020,817	25.13%
5101	Board Of Public Education	343,879	426,526	82,647	24.03%
5102	Commissioner Of Higher Education	305,684,403	336,656,989	30,972,586	10.13%
5113	School For The Deaf & Blind	9,516,222	10,856,309	1,340,087	14.08%
5114	Montana Arts Council	791,291	962,951	171,660	21.69%
5115	Montana State Library	3,441,709	4,444,256	1,002,547	29.13%
5117	Montana Historical Society	4,120,487	4,962,070	841,583	20.42%
5201	Department Of Fish, Wildlife & Parks	0	1,255,644	1,255,644	
5301	Department Of Environmental Quality	7,785,101	14,683,186	6,898,085	88.61%
5401	Department Of Transportation	0	3,000,000	3,000,000	
5603	Department Of Livestock	1,165,319	2,213,521	1,048,202	89.95%
5706	Dept Of Natural Resources & Conserva	32,101,504	53,114,258	21,012,754	65.46%
5801	Department Of Revenue	67,701,657	101,336,420	33,634,763	49.68%
6101	Department Of Administration	7,715,423	29,694,085	21,978,662	284.87%
6102	Appellate Defender	0	0	0	
6106	Mt Consensus Council	137,870	152,139	14,269	10.35%
6108	Office Of The Public Defender	14,661,634	38,294,749	23,633,115	161.19%
6201	Department Of Agriculture	1,179,033	6,678,070	5,499,037	466.40%
6401	Department Of Corrections	240,621,022	340,868,235	100,247,213	41.66%
6501	Department Of Commerce	3,989,046	20,305,188	16,316,142	409.02%
6602	Department Of Labor & Industry	3,332,516	4,350,691	1,018,175	30.55%
6701	Department Of Military Affairs	9,486,110	10,664,309	1,178,199	12.42%
6901	Dept Of Public Health & Human Service	<u>618,684,824</u>	<u>766,873,724</u>	<u>148,188,900</u>	<u>23.95%</u>
	Total	<u>\$2,617,768,680</u>	<u>\$3,193,770,923</u>	<u>\$576,002,243</u>	<u>22.00%</u>
Comparable Adjustments					
	Employee Pay Proposal	In Above	58,605,000	58,605,000	
	Statutory Appropriations	269,994,314	281,081,492	11,087,178	4.11%
	Legislative Session Costs *	9,786,115	11,020,000	1,233,885	12.61%
	Miscellaneous Appropriations **	113,290,061	66,357,540	(46,932,521)	-41.43%
	One-Time Only Costs	111,551,819	206,766,460	95,214,641	85.35%
	Anticipated Reversions	<u>(48,476,000)</u>	<u>(7,548,000)</u>	<u>40,928,000</u>	<u>-84.43%</u>
	Total With Comparable Adjustments	<u>\$3,073,914,989</u>	<u>\$3,810,053,415</u>	<u>\$736,138,426</u>	<u>23.95%</u>
Non Comparable Adjustments					
	Budget Amendments	0		0	
	Supplementals	76,425,000		(76,425,000)	-100.00%
	Disaster/Emergency Costs (SA)	<u>16,500,000</u>	<u>25,500,000</u>	<u>9,000,000</u>	<u>54.55%</u>
	Total With All Adjustments	<u>\$3,166,839,989</u>	<u>\$3,835,553,415</u>	<u>\$668,713,426</u>	<u>21.12%</u>
* Reversions of \$2,280,000 and \$3,420,000 are expected in the 2007 and 2009 biennia, respectively.					
** Excluding transfers & Non-HB 2 OTO					

Figure 6
All Funds Comparison
2007 Biennium Versus Executive Budget 2009 Biennium

Agcy Code	Agency Name	Total Adjusted Fiscal 06-07	Total Exec. Budget Fiscal 08-09	Difference 2009 Biennium - 2007 Biennium	% Change 2009 Biennium
House Bill 2					
1104	Legislative Branch	\$21,084,638	\$23,606,286	\$2,521,648	11.96%
1112	Consumer Council	2,565,505	2,987,438	421,933	16.45%
2110	Judicial Branch	69,202,057	68,760,604	(441,453)	-0.64%
3101	Governor's Office	10,789,009	12,953,805	2,164,796	20.06%
3201	Secretary Of State's Office	0	1,040,000	1,040,000	
3202	Commissioner Of Political Practices	668,416	893,832	225,416	33.72%
3401	State Auditor's Office	22,441,691	33,627,488	11,185,797	49.84%
3501	Office Of Public Instruction	1,444,663,923	1,596,415,644	151,751,721	10.50%
4107	Board of Crime Control	37,780,071	18,245,919	(19,534,152)	-51.70%
4110	Department Of Justice	114,339,010	145,734,498	31,395,488	27.46%
4201	Public Service Regulation	5,868,098	6,224,815	356,717	6.08%
5101	Board Of Public Education	729,630	771,319	41,689	5.71%
5102	Commissioner Of Higher Education	426,577,125	496,555,300	69,978,175	16.40%
5113	School For The Deaf & Blind	10,283,928	11,771,037	1,487,109	14.46%
5114	Montana Arts Council	2,419,682	2,566,847	147,165	6.08%
5115	Montana State Library	7,566,828	9,257,720	1,690,892	22.35%
5117	Montana Historical Society	7,556,866	8,230,745	673,879	8.92%
5201	Department Of Fish, Wildlife & Parks	117,929,330	136,034,393	18,105,063	15.35%
5301	Department Of Environmental Quality	103,402,022	119,968,187	16,566,165	16.02%
5401	Department Of Transportation	1,094,928,258	1,065,157,082	(29,771,176)	-2.72%
5603	Department Of Livestock	16,713,375	19,460,057	2,746,682	16.43%
5706	Dept Of Natural Resources & Conservation	77,500,479	111,764,584	34,264,105	44.21%
5801	Department Of Revenue	73,838,459	108,344,965	34,506,506	46.73%
6101	Department Of Administration	34,422,378	59,563,128	25,140,750	73.04%
6102	Appellate Defender	0	0	0	
6106	Mt Consensus Council	482,117	385,291	(96,826)	-20.08%
6108	Office Of The Public Defender	14,661,634	38,444,749	23,783,115	162.21%
6201	Department Of Agriculture	25,947,844	33,301,625	7,353,781	28.34%
6401	Department Of Corrections	247,536,048	349,808,036	102,271,988	41.32%
6501	Department Of Commerce	44,877,997	85,767,445	40,889,448	91.11%
6602	Department Of Labor & Industry	133,175,074	138,901,699	5,726,625	4.30%
6701	Department Of Military Affairs	36,187,989	56,367,883	20,179,894	55.76%
6901	Dept Of Public Health & Human Services	<u>2,659,756,179</u>	<u>3,009,881,549</u>	<u>350,125,370</u>	<u>13.16%</u>
	Total	\$6,865,895,660	\$7,772,793,970	\$906,898,310	13.21%
Comparable Adjustments					
	Employee Pay Proposal	In Above	100,741,177	100,741,177	
	Statutory Appropriations	796,364,232	645,288,462	(151,075,770)	-18.97%
	Legislative Session Costs	9,786,115	11,020,000	1,233,885	12.61%
	Miscellaneous Appropriations *	113,290,061	66,357,540	(46,932,521)	-41.43%
	One-Time Only Costs (general fund)	111,551,819	206,766,460	95,214,641	85.35%
	Anticipated Reversions (general fund)	<u>(48,476,000)</u>	<u>(7,548,000)</u>	<u>40,928,000</u>	<u>-84.43%</u>
	Total With Comparable Adjustments	\$7,848,411,887	\$8,795,419,609	\$947,007,722	12.07%
Non Comparable Adjustments					
	Budget Amendments	163,585,517	0	(163,585,517)	-100.00%
	Supplementals	76,625,000		(76,625,000)	-100.00%
	Disaster/Emergency Costs (SA)	<u>30,038,213</u>	<u>25,500,000</u>	<u>(4,538,213)</u>	<u>-15.11%</u>
	Total With All Adjustments	\$8,118,660,617	\$8,820,919,609	\$702,258,992	8.65%
* Only the general fund portion is shown. All funds cannot be determined based on existing accounting records.					

AGENCY BUDGET COMPARISONS BY FUND

This section provides a comparison, by agency, of the Governor's executive budget recommendations for HB 2 as compared to the 2005 biennium. For each fund type, a table shows the comparison by agency. Also included for each fund type is a pie chart showing the amount and percent of each fund by major program area, and a bar graph that shows the percentage increase by major program area. The narrative describes the primary reasons for the budget changes, by fund type.

GENERAL FUND

As defined in 17-2-102, MCA, the general fund "accounts for all financial resources except those required to be accounted for in another fund." The general fund provides funding for the general operations of state government.

In Figure 7, the general fund increases by \$576.0 million, or 22.0 percent. While 6 agencies account for about 84 percent of the total increase, almost all agencies show significant percentage increases.

- Office of Public Instruction - \$140.4 million. Major increases are due to annualization of November 2005 Special Session increases, as well as:
 - Inflationary increases
 - Increased per educator entitlements, special education, and facility reimbursements
 - Curriculum specialists and data systems
 - A proposal for full day kindergarten
- Public Health and Human Services - \$148.2 million. This increase is due primarily to:
 - Maintenance of services to current recipients through caseload adjustments, provision of funding due to changes in federal requirements, and replacement of funding due to a reduction in the federal Medicaid match rate
 - Provider rate increases
 - Expansion of services for the mentally ill, including forensics patients
- Corrections - \$100.2 million. This increase is due to:
 - Annualization of 2007 biennium initiatives and expansion of contract beds and probation and parole officers to address projected population increases
 - Provision of provider rate increases
- Montana University System (Commissioner of Higher Education) - \$31.0 million. The Governor proposes to:
 - Increase the extent to which the state funds present law adjustments
 - Expand student assistance
 - Provide for equipment and other funding for high demand programs
- Revenue - \$33.6 million. Department funding would increase by 49.7 percent, primarily due to the provision of funding for various measures to increase taxpayer compliance.
- Office of the Public Defender - \$23.6 million. This increase is due to transfer of funding for this function from the Judiciary in FY 2007, cost annualization, and caseload.

Figure 7

General Fund Comparison 2007 Biennium Versus Executive Budget 2009 Biennium								
Agency Name	Adjusted Expenditures Fiscal 2006	Adjusted Authorized Fiscal 2007	Total Exec. Budget Fiscal 2008	Total Exec. Budget Fiscal 2009	Total Adjusted Fiscal 06-07	Total Exec. Budget Fiscal 08-09	Difference - 07 Biennium	% Change 07 Biennium
Legislative Branch	\$7,730,017	\$9,188,584	\$9,507,883	\$9,666,163	\$16,918,601	\$19,174,046	\$2,255,445	13.33%
Judicial Branch	37,410,432	28,114,902	32,602,570	32,420,848	65,525,334	65,023,418	(501,916)	-0.77%
Governor's Office	5,044,574	5,604,084	6,659,357	6,238,848	10,648,658	12,898,205	2,249,547	21.13%
Comm Of Political Practices	298,431	369,985	487,846	405,986	668,416	893,832	225,416	33.72%
Office Of Public Instruction	531,682,484	612,525,697	635,171,797	649,437,324	1,144,208,181	1,284,609,121	140,400,940	12.27%
Crime Control Division	1,722,131	1,768,726	2,244,291	2,264,290	3,490,857	4,508,581	1,017,724	29.15%
Department Of Justice	21,194,347	22,655,236	28,889,465	25,980,935	43,849,583	54,870,400	11,020,817	25.13%
Board Of Public Education	167,682	176,197	210,716	215,810	343,879	426,526	82,647	24.03%
Commissioner Of Higher Education	149,076,830	156,607,573	168,396,490	168,260,499	305,684,403	336,656,989	30,972,586	10.13%
School For The Deaf & Blind	4,675,386	4,840,836	5,353,970	5,502,339	9,516,222	10,856,309	1,340,087	14.08%
Montana Arts Council	399,976	391,315	529,178	433,773	791,291	962,951	171,660	21.69%
Montana State Library	1,671,787	1,769,922	2,205,178	2,239,078	3,441,709	4,444,256	1,002,547	29.13%
Montana Historical Society	2,010,433	2,110,054	2,493,679	2,468,391	4,120,487	4,962,070	841,583	20.42%
Department Of Fish, Wildlife & Parks	0	0	639,032	616,612	0	1,255,644	1,255,644	
Department Of Environmental Quality	3,780,841	4,004,260	7,812,902	6,870,284	7,785,101	14,683,186	6,898,085	88.61%
Department Of Transportation	0	0	3,000,000	0	0	3,000,000	3,000,000	
Department Of Livestock	572,665	592,654	1,181,322	1,032,199	1,165,319	2,213,521	1,048,202	89.95%
Dept Of Natural Resources & Conservation	18,140,525	13,960,979	27,105,104	26,009,154	32,101,504	53,114,258	21,012,754	65.46%
Department Of Revenue	32,716,886	34,984,771	50,202,547	51,133,873	67,701,657	101,336,420	33,634,763	49.68%
Department Of Administration	3,645,471	4,069,952	15,724,402	13,969,683	7,715,423	29,694,085	21,978,662	284.87%
Appellate Defender	0	0	0	0	0	0	0	
Mt Consensus Council	69,041	68,829	75,632	76,507	137,870	152,139	14,269	10.35%
Office Of The Public Defender	713,444	13,948,190	19,195,625	19,099,124	14,661,634	38,294,749	23,633,115	161.19%
Department Of Agriculture	578,626	600,407	5,881,180	796,890	1,179,033	6,678,070	5,499,037	466.40%
Department Of Corrections	127,238,338	113,382,684	168,325,029	172,543,206	240,621,022	340,868,235	100,247,213	41.66%
Department Of Commerce	1,960,812	2,028,234	12,764,909	7,540,279	3,989,046	20,305,188	16,316,142	409.02%
Department Of Labor & Industry	1,623,914	1,708,602	2,170,431	2,180,260	3,332,516	4,350,691	1,018,175	30.55%
Department Of Military Affairs	4,662,368	4,823,742	5,355,000	5,309,309	9,486,110	10,664,309	1,178,199	12.42%
Dept Of Public Health & Human Services	307,876,614	310,808,210	375,191,753	391,681,971	618,684,824	766,873,724	148,188,900	23.95%
Total	\$1,266,664,055	\$1,351,104,625	\$1,589,377,288	\$1,604,393,635	\$2,617,768,680	\$3,193,770,923	\$576,002,243	22.00%

Figure 8

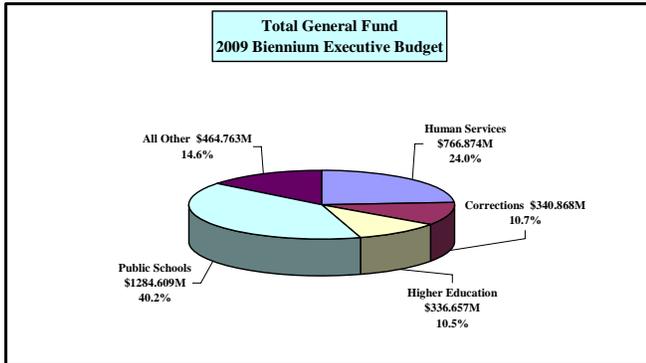
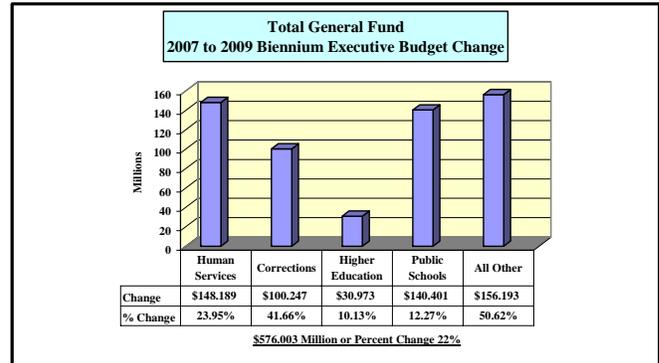


Figure 9



STATE SPECIAL REVENUE

As defined in 17-2-102, MCA, the state special fund “consists of money from state and other non-federal sources deposited in the state treasury that is earmarked for the purposes of defraying particular costs of an agency, program, or function of state government and money from other non-state or non-federal sources that is restricted by law or by the terms of an agreement, such as a contract, trust agreement, or donation.”

State special revenue would increase by \$100.9 million, or over 9.2 percent from the 2007 biennium. As with general fund, increases are widespread across state government. Five agencies account for over half of the increase, partially offset by a large reduction in the agency with the most significant expenditure of state special revenue, the Department of Transportation. The primary changes are due to the following.

- Transportation – (\$55.7 million). The executive proposes to reduce the highway construction program expenditures from the highways state special revenue account to the minimum required for the state to receive the maximum federal participation rate to assist with maintenance of positive cash flow in the account
- Public Health and Human Services - \$49.0 million. The Governor would add additional health and Medicaid initiatives fees (tobacco revenues) for a number of purposes, cigarette tax revenue for support of veterans homes, nursing home utilization fee revenue, and alcohol taxes for substance abuse programs.
- Justice - \$20.1 million. The increase is due primarily to increases in highway patrol salaries (the updated executive budget will appropriately fund a portion of these increases with a statutory appropriation established for that purpose) and operating expenses, as well as debt service and operating expenses in the Motor Vehicle Division.
- Fish, Wildlife, and Parks - \$15.9 million. The increase is due primarily to a number of general license account funded activities throughout the department.
- Natural Resources and Conservation - \$13.4 million. This increase is predominantly the addition of funding for state land management, Board of Oil and Gas activities, water rights appropriations and adjudication, and forest protection fees.
- State Auditor’s Office - \$11.2 million. The increase is due almost entirely to annualization of the Insure Montana program, which assists small businesses to provide health coverage to employees.

Figure 10

State Special Revenue Fund Comparison
2007 Biennium Versus Executive Budget 2009 Biennium

Agcy Code	Agency Name	Adjusted Expenditures Fiscal 2006	Adjusted Authorized Fiscal 2007	Total Exec. Budget Fiscal 2008	Total Exec. Budget Fiscal 2009	Total Adjusted Fiscal 06-07	Total Exec. Budget Fiscal 08-09	Difference 09 Biennium - 07 Biennium	% Change 09 Biennium
1104	Legislative Branch	\$2,264,782	\$1,901,255	\$2,515,297	\$1,916,943	\$4,166,037	\$4,432,240	\$266,203	6.39%
1112	Consumer Council	1,114,501	1,451,004	1,486,461	1,500,977	2,565,505	2,987,438	421,933	16.45%
2110	Judicial Branch	1,209,268	1,599,376	1,741,358	1,744,569	2,808,644	3,485,927	677,283	24.11%
3101	Governor's Office	6,711	91,980	27,800	27,800	98,691	55,600	(43,091)	-43.66%
3401	State Auditor's Office	7,127,010	15,314,681	16,760,268	16,867,220	22,441,691	33,627,488	11,185,797	49.84%
3501	Office Of Public Instruction	970,495	976,344	980,014	980,265	1,946,839	1,960,279	13,440	0.69%
4107	Crime Control Division	9,349	93,483	99,739	99,872	102,832	199,611	96,779	94.11%
4110	Department Of Justice	30,563,970	33,318,301	41,551,801	42,408,388	63,882,271	83,960,189	20,077,918	31.43%
4201	Public Service Regulation	2,849,155	2,989,096	3,133,854	3,050,959	5,838,251	6,184,813	346,562	5.94%
5101	Board Of Public Education	180,817	204,934	169,872	174,921	385,751	344,793	(40,958)	-10.62%
5102	Commissioner Of Higher Education	14,296,001	14,640,000	18,661,355	16,994,297	28,936,001	35,655,652	6,719,651	23.22%
5113	School For The Deaf & Blind	281,148	282,752	419,101	294,101	563,900	713,202	149,302	26.48%
5114	Montana Arts Council	185,091	193,284	200,390	202,058	378,375	402,448	24,073	6.36%
5115	Montana State Library	1,081,518	1,082,210	1,216,517	1,216,517	2,163,728	2,433,034	269,306	12.45%
5117	Montana Historical Society	90,381	170,162	88,116	88,143	260,543	176,259	(84,284)	-32.35%
5201	Department Of Fish, Wildlife & Parks	41,524,440	44,297,628	50,830,452	50,859,469	85,822,068	101,689,921	15,867,853	18.49%
5301	Department Of Environmental Quality	17,501,602	26,361,320	26,821,248	26,842,589	43,862,922	53,663,837	9,800,915	22.34%
5401	Department Of Transportation	233,537,178	270,343,160	227,167,089	220,968,102	503,880,338	448,135,191	(55,745,147)	-11.06%
5603	Department Of Livestock	6,068,235	6,492,910	7,112,052	7,011,652	12,561,145	14,123,704	1,562,559	12.44%
5706	Dept Of Natural Resources & Conservation	20,004,366	21,517,820	28,447,658	26,510,039	41,522,186	54,957,697	13,435,511	32.36%
5801	Department Of Revenue	616,073	642,827	1,026,465	866,824	1,258,900	1,893,289	634,389	50.39%
6101	Department Of Administration	4,210,892	5,416,474	6,798,481	6,910,924	9,627,366	13,709,405	4,082,039	42.40%
6106	Mt Consensus Council	84,417	259,830	116,476	116,676	344,247	233,152	(111,095)	-32.27%
6108	Office Of The Public Defender	0	0	75,000	75,000	0	150,000	150,000	
6201	Department Of Agriculture	8,683,632	9,736,678	10,435,386	10,443,758	18,420,310	20,879,144	2,458,834	13.35%
6401	Department Of Corrections	2,501,435	2,590,582	3,760,674	3,648,217	5,092,017	7,408,891	2,316,874	45.50%
6501	Department Of Commerce	1,892,461	3,134,162	7,840,832	5,893,014	5,026,623	13,733,846	8,707,223	173.22%
6602	Department Of Labor & Industry	29,089,380	31,611,698	33,512,197	34,964,606	60,701,078	68,476,803	7,775,725	12.81%
6701	Department Of Military Affairs	789,003	1,094,662	1,421,905	1,426,038	1,883,665	2,847,943	964,278	51.19%
6901	Dept Of Public Health & Human Services	74,251,264	96,547,816	109,411,158	110,337,305	170,799,080	219,748,463	48,949,383	28.66%
Total		\$502,984,575	\$594,356,429	\$603,829,016	\$594,441,243	\$1,097,341,004	\$1,198,270,259	\$100,929,255	9.20%

Figure 11

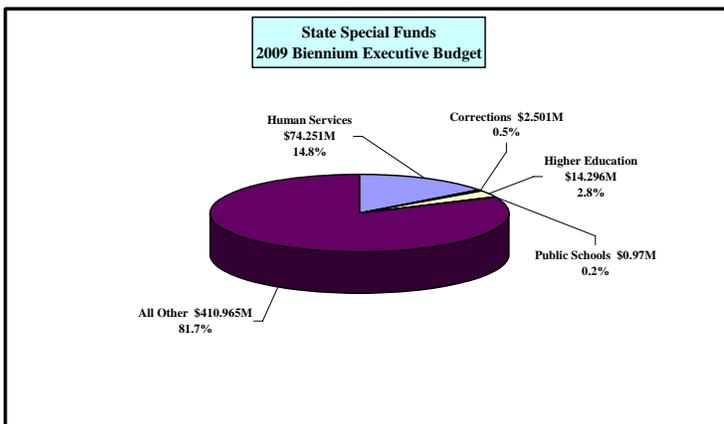
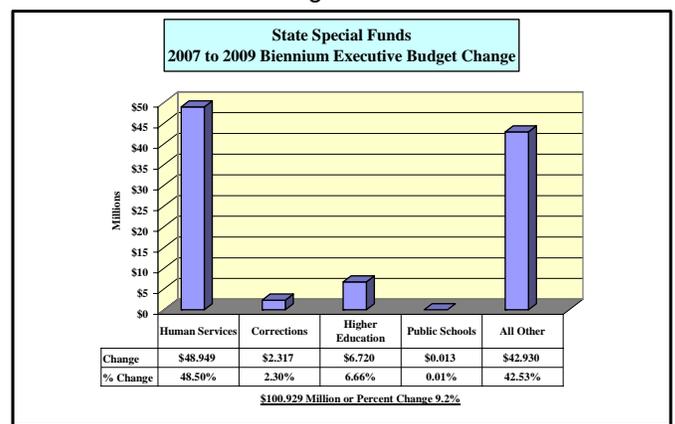


Figure 12



FEDERAL SPECIAL REVENUE

As defined in 17-2-102, MCA, the federal special fund “consists of money deposited in the treasury from federal sources, including trust income that is used for the operation of state government.”

Federal funds increase by 7.4 percent, or \$229.6 million. Most agencies receive some federal funds. However, the Departments of Public Health and Human Services and Transportation account for over 78 percent of the federal funds proposed in the Governor’s budget and the Department of Public Health and Human Services would receive about two-thirds of the proposed increase.

Significant changes in that agency are due to:

- Rising caseloads and service utilization, most notably in Medicaid and food stamps, partially offset by a reduction in the percent of Medicaid expenditures the federal government will pay
- Continued use of hospital provider tax, bed tax, and intergovernmental transfers to secure additional federal funds
- Anticipated increases in categorical grants

The increase in the Commissioner of Higher Education is primarily the expansion of the loan portfolio of the Montana Guaranteed Student Loan Program. The increase in the Department of Commerce is largely an accounting change to allow expenditure of accrued federal funds. Authority to expend all anticipated federal funds in the Department of Transportation and the Office of Public Instruction are provided in the Governor’s budget.

Figure 13

Federal Special Revenue Fund Comparison
2007 Biennium Versus Executive Budget 2009 Biennium

Agcy Code	Agency Name	Adjusted Expenditures Fiscal 2006	Adjusted Authorized Fiscal 2007	Total Exec. Budget Fiscal 2008	Total Exec. Budget Fiscal 2009	Total Adjusted Fiscal 06-07	Total Exec. Budget Fiscal 08-09	Difference 09 Biennium - 07 Biennium	% Change 09 Biennium
2110	Judicial Branch	\$170,487	\$697,592	\$125,380	\$125,879	\$868,079	\$251,259	(\$616,820)	-71.06%
3101	Governor's Office	20,458	21,202	0	0	41,660	0	(41,660)	-100.00%
3201	Secretary Of State's Office	0	0	1,040,000	0	0	1,040,000	1,040,000	
3501	Office Of Public Instruction	144,092,986	154,415,917	151,959,097	157,887,147	298,508,903	309,846,244	11,337,341	3.80%
4107	Crime Control Division	6,840,461	27,345,921	6,765,560	6,772,167	34,186,382	13,537,727	(20,648,655)	-60.40%
4110	Department Of Justice	1,901,636	2,273,655	1,747,683	1,751,661	4,175,291	3,499,344	(675,947)	-16.19%
4201	Public Service Regulation	14,401	15,446	20,001	20,001	29,847	40,002	10,155	34.02%
5102	Commissioner Of Higher Education	38,616,825	53,339,896	60,244,925	63,116,140	91,956,721	123,361,065	31,404,344	34.15%
5113	School For The Deaf & Blind	100,941	102,865	100,763	100,763	203,806	201,526	(2,280)	-1.12%
5114	Montana Arts Council	570,342	679,674	600,101	601,347	1,250,016	1,201,448	(48,568)	-3.89%
5115	Montana State Library	884,758	1,076,633	1,552,065	828,365	1,961,391	2,380,430	419,039	21.36%
5117	Montana Historical Society	535,304	800,226	633,221	636,232	1,335,530	1,269,453	(66,077)	-4.95%
5201	Department Of Fish, Wildlife & Parks	15,655,039	16,452,223	16,535,052	16,553,776	32,107,262	33,088,828	981,566	3.06%
5301	Department Of Environmental Quality	19,979,748	31,774,251	25,759,255	25,861,909	51,753,999	51,621,164	(132,835)	-0.26%
5401	Department Of Transportation	241,657,586	349,390,334	303,781,929	310,239,962	591,047,920	614,021,891	22,973,971	3.89%
5603	Department Of Livestock	1,459,382	1,527,529	1,561,977	1,560,855	2,986,911	3,122,832	135,921	4.55%
5706	Dept Of Natural Resources & Conservation	1,710,830	2,165,959	1,855,229	1,837,400	3,876,789	3,692,629	(184,160)	-4.75%
5801	Department Of Revenue	302,685	313,092	404,817	404,017	615,777	808,834	193,057	31.35%
6101	Department Of Administration	147,422	849,471	887,293	87,333	996,893	974,626	(22,267)	-2.23%
6201	Department Of Agriculture	1,911,040	3,723,245	2,173,048	2,547,214	5,634,285	4,720,262	(914,023)	-16.22%
6401	Department Of Corrections	219,056	648,436	223,376	223,376	867,492	446,752	(420,740)	-48.50%
6501	Department Of Commerce	17,485,722	18,376,606	33,913,758	17,814,653	35,862,328	51,728,411	15,866,083	44.24%
6602	Department Of Labor & Industry	30,904,462	37,004,476	33,595,158	32,309,384	67,908,938	65,904,542	(2,004,396)	-2.95%
6701	Department Of Military Affairs	12,034,336	12,783,878	21,370,202	21,485,429	24,818,214	42,855,631	18,037,417	72.68%
6901	Dept Of Public Health & Human Services	872,228,807	998,043,468	991,977,182	1,031,282,180	1,870,272,275	2,023,259,362	152,987,087	8.18%
Total		\$1,409,444,714	\$1,713,821,995	\$1,658,827,072	\$1,694,047,190	\$3,123,266,709	\$3,352,874,262	\$229,607,553	7.35%

Figure 14

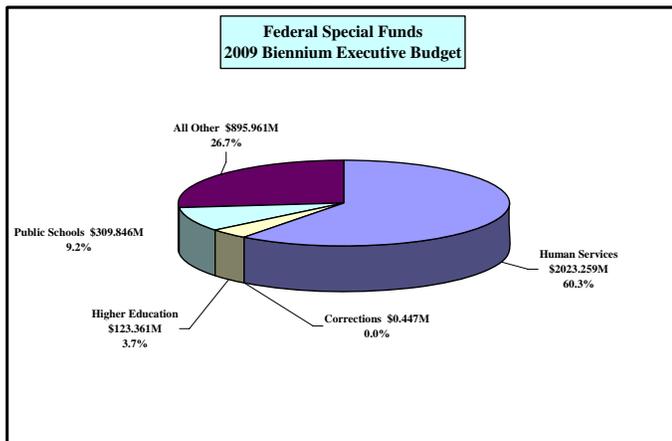
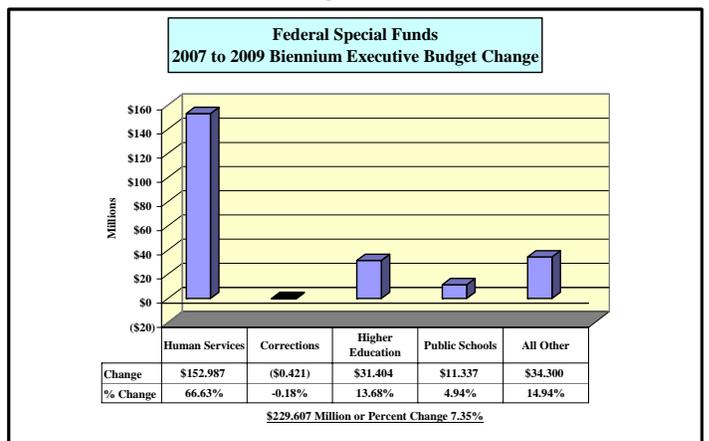


Figure 15



PROPRIETARY FUNDS

As defined in 17-7-102, MCA, proprietary funds are designated as either enterprise or internal service funds. Enterprise funds “account for operations: (A) that are financed and operated in a manner similar to private business enterprises whenever the intent of the legislature is that costs (i.e. expenses, including depreciation) of providing goods or services to that general public on a continuing basis are to be financed or recovered primarily through user charges; or (B) whenever the legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.” Internal service funds “account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost reimbursed basis.”

Statute does not require that most proprietary funds be appropriated. Therefore, any increases in the programs supported with these proprietary funds are not reflected in the table.

Figure 16
Proprietary Fund Comparison
2007 Biennium Versus Executive Budget 2009 Biennium

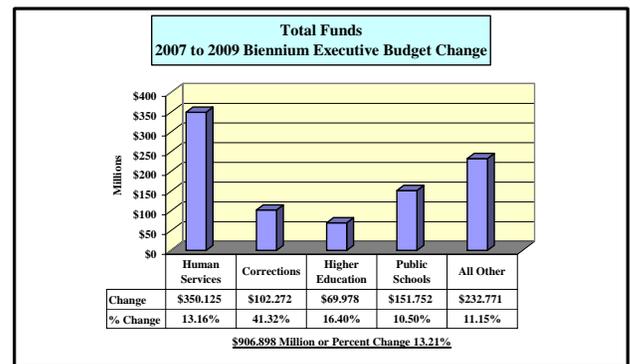
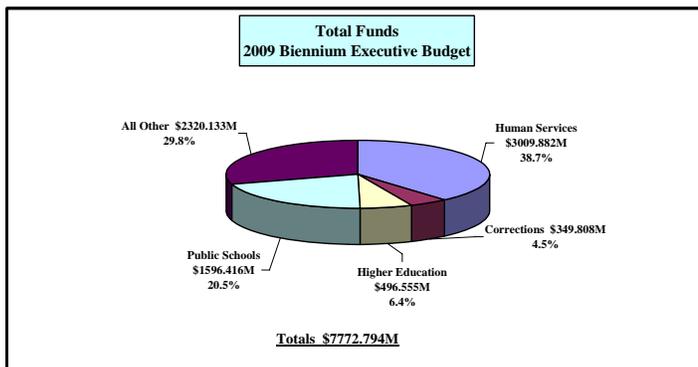
Agcy Code	Agency Name	Adjusted Expenditures Fiscal 2006	Adjusted Authorized Fiscal 2007	Total Exec. Budget Fiscal 2008	Total Exec. Budget Fiscal 2009	Total Adjusted Fiscal 06-07	Total Exec. Budget Fiscal 08-09	Difference 09 Biennium - 07 Biennium	% Change 09 Biennium
3101	Governor's Office	\$0	\$0	\$0	\$0	\$0	\$0	\$0	
3501	Office of Public Instruction	0	0	0	0	0	0	0	
4110	Department of Justice	921,555	1,510,310	1,714,630	1,689,935	2,431,865	3,404,565	972,700	40.00%
5102	Commissioner of Higher Ed	0	0	440,935	440,659	0	881,594	881,594	
5117	Historical Society	857,008	983,298	903,722	919,241	1,840,306	1,822,963	(17,343)	-0.94%
5401	Department of Transportation	0	0	0	0	0	0	0	
5801	Department of Revenue	2,029,943	2,232,182	2,159,981	2,146,441	4,262,125	4,306,422	44,297	1.04%
6101	Department of Administration	7,445,040	7,637,656	7,638,048	7,546,964	15,082,696	15,185,012	102,316	0.68%
6201	MT Dept of Agriculture	317,587	396,629	555,491	468,658	714,216	1,024,149	309,933	43.39%
6401	Dept of Corrections	461,274	494,243	542,069	542,089	955,517	1,084,158	128,641	13.46%
6602	Labor & Industry	<u>70,564</u>	<u>1,161,978</u>	<u>83,527</u>	<u>86,136</u>	<u>1,232,542</u>	<u>169,663</u>	<u>(1,062,879)</u>	<u>-86.23%</u>
Total		\$12,102,971	\$14,416,296	\$14,038,403	\$13,840,123	\$26,519,267	\$27,878,526	\$1,359,259	5.13%

ALL FUNDS

The following figure is a composite by agency of the preceding tables, and shows a \$906.9 million, or 13.2 percent increase in total funds.

Figure 17

All Funds Comparison 2007 Biennium Versus Executive Budget 2009 Biennium									
Agcy Code	Agency Name	Adjusted Expenditures Fiscal 2006	Adjusted Authorized Fiscal 2007	Total Exec. Budget Fiscal 2008	Total Exec. Budget Fiscal 2009	Total Adjusted Fiscal 06-07	Total Exec. Budget Fiscal 08-09	Difference 09 Biennium - 07 Biennium	% Change 09 Biennium
1104	Legislative Branch	\$9,994,799	\$11,089,839	\$12,023,180	\$11,583,106	\$21,084,638	\$23,606,286	\$2,521,648	11.96%
1112	Consumer Council	1,114,501	1,451,004	1,486,461	1,500,977	2,565,505	2,987,438	421,933	16.45%
2110	Judicial Branch	38,790,187	30,411,870	34,469,308	34,291,296	69,202,057	68,760,604	(441,453)	-0.64%
3101	Governor's Office	5,071,743	5,717,266	6,687,157	6,266,648	10,789,009	12,953,805	2,164,796	20.06%
3201	Secretary Of State's Office	0	0	1,040,000	0	0	1,040,000	1,040,000	
3202	Comm Of Political Practices	298,431	369,985	487,846	405,986	668,416	893,832	225,416	33.72%
3401	State Auditor's Office	7,127,010	15,314,681	16,760,268	16,867,220	22,441,691	33,627,488	11,185,797	49.84%
3501	Office Of Public Instruction	676,745,965	767,917,958	788,110,908	808,304,736	1,444,663,923	1,596,415,644	151,751,721	10.50%
4107	Crime Control Division	8,571,941	29,208,130	9,109,590	9,136,329	37,780,071	18,245,919	(19,534,152)	-51.70%
4110	Department Of Justice	54,581,508	59,757,502	73,903,579	71,830,919	114,339,010	145,734,498	31,395,488	27.46%
4201	Public Service Regulation	2,863,556	3,004,542	3,153,855	3,070,960	5,868,098	6,224,815	356,717	6.08%
5101	Board Of Public Education	348,499	381,131	380,588	390,731	729,630	771,319	41,689	5.71%
5102	Commissioner Of Higher Education	201,989,656	224,587,469	247,743,705	248,811,595	426,577,125	496,555,300	69,978,175	16.40%
5113	School For The Deaf & Blind	5,057,475	5,226,453	5,873,834	5,897,203	10,283,928	11,771,037	1,487,109	14.46%
5114	Montana Arts Council	1,155,409	1,264,273	1,329,669	1,237,178	2,419,682	2,566,847	147,165	6.08%
5115	Montana State Library	3,638,063	3,928,765	4,973,760	4,283,960	7,566,828	9,257,720	1,690,892	22.35%
5117	Montana Historical Society	3,493,126	4,063,740	4,118,738	4,112,007	7,556,866	8,230,745	673,879	8.92%
5201	Department Of Fish, Wildlife & Parks	57,179,479	60,749,851	68,004,536	68,029,857	117,929,330	136,034,393	18,105,063	15.35%
5301	Department Of Environmental Quality	41,262,191	62,139,831	60,393,405	59,574,782	103,402,022	119,968,187	16,566,165	16.02%
5401	Department Of Transportation	475,194,764	619,733,494	533,949,018	531,208,064	1,094,928,258	1,065,157,082	(29,771,176)	-2.72%
5603	Department Of Livestock	8,100,282	8,613,093	9,855,351	9,604,706	16,713,375	19,460,057	2,746,682	16.43%
5706	Dept Of Natural Resources & Conservation	39,855,721	37,644,758	57,407,991	54,356,593	77,500,479	111,764,584	34,264,105	44.21%
5801	Department Of Revenue	35,665,587	38,172,872	53,793,810	54,551,155	73,838,459	108,344,965	34,506,506	46.73%
6101	Department Of Administration	15,948,825	18,473,553	31,048,224	28,514,904	34,422,378	59,563,128	25,140,750	73.04%
6102	Appellate Defender	0	0	0	0	0	0	0	
6106	Mt Consensus Council	153,458	328,659	192,108	193,183	482,117	385,291	(96,826)	-20.08%
6108	Office Of The Public Defender	713,444	13,948,190	19,270,625	19,174,124	14,661,634	38,444,749	23,783,115	162.21%
6201	Department Of Agriculture	11,490,885	14,456,959	19,045,105	14,256,520	25,947,844	33,301,625	7,353,781	28.34%
6401	Department Of Corrections	130,420,103	117,115,945	172,851,148	176,956,888	247,536,048	349,808,036	102,271,988	41.32%
6501	Department Of Commerce	21,338,995	23,539,002	54,519,499	31,247,946	44,877,997	85,767,445	40,889,448	91.11%
6602	Department Of Labor & Industry	61,688,320	71,486,754	69,361,313	69,540,386	133,175,074	138,901,699	5,726,625	4.30%
6701	Department Of Military Affairs	17,485,707	18,702,282	28,147,107	28,220,776	36,187,989	56,367,883	20,179,894	55.76%
6901	Dept Of Public Health & Human Services	1,254,356,685	1,405,399,494	1,476,580,093	1,533,301,456	2,659,756,179	3,009,881,549	350,125,370	13.16%
Total		\$3,191,696,315	\$3,674,199,345	\$3,866,071,779	\$3,906,722,191	\$6,865,895,660	\$7,772,793,970	\$906,898,310	13.21%





EXECUTIVE REVENUE PROPOSALS - SUMMARY

INTRODUCTION

The executive budget is based on revenue estimates developed by the executive and not on the revenue estimates adopted by the Revenue and Transportation Interim Committee (RTIC) on November 15, 2006. This is because there are statutory requirements that the executive must submit a preliminary executive budget to the Legislative Fiscal Division (LFD) by November 15. Regardless, the executive and LFD worked throughout the fall in a cooperative but independent manner to develop revenue estimate recommendations to the RTIC that had mirrored differences. For the three year period, FY 2007 through 2009, the total difference in the general fund revenue estimates was \$29.8 million or about 0.5 of one percent. The revenue source with the largest difference was corporation income tax. The executive general fund revenue estimates are higher by \$29.8 million than those adopted by the RTIC. For a discussion of the general fund revenue estimates see page 34 of this volume or for a more detailed explanation by individual source see "Volume 2 – Revenue Estimates".

This section presents a description of the revenue and tax policy proposals contained in the executive budget. The budget as submitted contains a number of tax policy proposals, primarily focused on increased tax compliance measures and more aggressive tax audit emphasis. Each of these proposals is shown in Figure 1, which includes the anticipated general fund revenue impact as well as the anticipated cost to implement the proposal. Figure 1 categorizes the initiatives as "compliance proposals", "auditing proposals", and "other tax initiatives".

LFD ISSUE

The executive budget, as submitted, did not include any explanation or justification for their revenue proposals nor did it include many of the necessary details to analyze the executive's revenue proposals. The LFD was forced to rely on data prepared after the statutory budget submission date, and supplied by the Department of Revenue (DOR) and draft legislation being prepared by the Legislative Services Division. The summation of the detailed data provided by DOR did not correspond to the aggregate data published in the executive budget. In addition, the executive's general fund balance sheet reflected anticipated additional revenue in aggregate but after further analysis it was determined that additional expenditures were "netted" with the additional revenue. This practice not only distorts the impacts of the revenue proposals but also has the effect of understating the executive's expenditure proposals. Further, the lack of availability of the description, justification, and supporting documentation for budget proposals on the statutory deadline for budget submission exacerbates the ability of the legislature to have their staff conduct an independent analysis and summarization of the data.

REVENUE AND TAX POLICY PROPOSALS

Figure 1

Executive Budget Revenue Proposals - 2009 Biennium							
Estimated Revenue and Anticipated Costs For General Fund - In Millions							
		Revenue	Revenue	Biennium	Cost	Cost	Biennium
Compliance Proposals		FY 2008	FY 2009	Revenue Total	FY 2008	FY 2009	Cost Total
LC0503	Abusive Tax Avoidance Transactions	5.100	3.200	8.300	-	-	-
LC0505	Withholding for Nonresident sales of Property	10.429	11.326	21.755	0.156	0.134	0.290
LC0506	Withholding for Nonresident Mineral and Oil a	1.113	2.226	3.339	0.443	0.129	0.572
LC0507	Real Estate Investment Trusts	5.971	7.262	13.233	-	-	-
LC0508	Grantor Trusts	-	-	-	-	-	-
LC0509	Improve Collections Management	1.681	1.624	3.305	0.767	0.756	1.523
LC0511	Store Value Cards	-	-	-	-	-	-
LC0512	Insurance Stuffing	2.250	2.250	4.500	-	-	-
LC0513	Endowment Credit Clarification	-	(3.012)	(3.012)	-	-	-
LC0515	Direct Interstate Distribution	-	-	-	-	-	-
LC0516	Residency Requirements for Liquor Licenses	-	-	-	-	-	-
LC0519	Follow Federal Practice of Withholding for Rei	0.150	0.150	0.300	-	-	-
LC0520	Make Corporation Tax Statute of Limitations E	0.965	1.930	2.895	-	-	-
LC0521	Lodging Tax Base Definition	0.327	0.331	0.658	-	-	-
LC0522	Generally Revise Tax Code	0.960	0.979	1.939	0.223	0.211	0.434
Total		\$28.946	\$28.266	\$57.212	\$1.589	\$1.230	\$2.819
Auditing Proposals							
DP 0701	Compliance - Legal	0.479	0.931	1.410	Costs in Biennium Budget		
DP 7012	Tax Gap Analysis	0.797	1.502	2.299	Costs in Biennium Budget		
DP 7019	Compliance - Audit & Collections	3.883	7.769	11.652	Costs in Biennium Budget		
Total		\$5.159	\$10.202	\$15.361	-	-	-
Other Tax Initiatives							
LC0905	Property Tax Reserve Fund	-	-	-	14.500	-	14.500 *
LC0906	Water Fee Rebate	-	-	-	20.428	-	20.428 *
LC0907	Governor's Rebate	4.022	-	4.022	98.381	-	98.381 *
LC????	Personal Property Reduction	-	-	-	15.000	15.000	30.000
Total		\$4.022	\$0.000	\$4.022	\$148.309	\$15.000	\$163.309
Total All Initiatives		\$38.127	\$38.468	\$76.595	\$149.898	\$16.230	\$166.128

* Detail submitted by Department of Revenue does not match the published executive budget.

Below are summary descriptions of the bill drafts (designated by LC___, as they have not yet been assigned a bill number) and expenditure decision packages for executive revenue and tax policy proposals. At present, 23 bills will be introduced in the 2007 session to implement these proposals. The descriptions of the bill drafts for the compliance and auditing revenue proposals were obtained from the Department of Revenue, but edited by the LFD. The descriptions of the other tax initiative bill drafts were written by the LFD. LFD issues with these proposals are also presented. The bills for these proposals will likely be considered by the taxation committees and the expenditure proposals will go to the appropriations committees.

COMPLIANCE PROPOSALS

LC0503 - Illegal Tax Avoidance Transactions

The purpose of this proposal is to provide the tools needed to address cases of illegal tax sheltering based on the Multi-state Tax Commissioner's model proposal.

Background: Illegal tax shelters artificially reduce federal and state taxes, shifting the tax burden to other taxpayers. Inconsistent filing positions taken on state returns by multi-state businesses artificially reduce the state tax base. State legislation is proposed to mirror the provisions of the federal law related to illegal tax shelters because the Internal Revenue Service (IRS) does not adequately share information about out-of-state filers engaging in illegal shelters affecting Montana, and because some shelters are established solely to evade state taxes. A uniform state solution to inconsistent filing positions is proposed to prevent state-level abuse. The Multi-state Tax Commission is proposing model legislation that addresses both areas, which, if enacted in Montana, would be intended to protect the state's tax base, bring tax evaders to justice, and promote uniformity in state tax treatment.

Fiscal Impact: This proposal requests legislation that provides the department with the tools to address illegal tax avoidance schemes, resulting in increased general fund revenue. Additional revenue eventually received will depend on a variety of factors, including the amount of audit resources dedicated to addressing specific abusive tax sheltering schemes. It is estimated that an additional \$8.3 million of general fund revenue would be received in the 2009 biennium and \$6.4 million in the 2011 biennium. No additional funding is needed to implement this proposal.

LC0505 - Withholding for Nonresident Sales of Property

The purpose of this proposal is to ensure that taxes are properly paid on Montana source income in cases where a nonresident sells Montana property for a net capital gain.

Background: Each year nonresidents are involved in sales of property located in Montana. These nonresidents may or may not be reporting the net gain or loss from the sale in their state of residency, but may not understand that they have a legal obligation to file an income tax return with the State of Montana and report the gain or loss in Montana. Reporting in Montana is required because any income earned on the sale of Montana property is Montana-source income and subject to Montana income tax. In many cases, nonresidents never file in Montana and don't pay the tax legally owed the state. Research for tax year 2003 indicated that 70 percent of nonresidents failed to file a Montana tax return and pay taxes on gains from the sale of Montana property. This legislation would require withholding on any net gain from the sale of Montana property by a nonresident at the time of sale to ensure that: (1) the nonresident is aware of a legal requirement to pay tax on the Montana gain; and (2) tax legally owed the state on the transaction is actually collected. Withholding would not apply to sales where the gains are deferred for tax purposes or where the sales price is less than \$100,000.

Fiscal Impact: Requiring withholding on sales of Montana property by a nonresident will increase state general fund revenue by the amount of tax liability currently not being paid on these transactions. It is estimated that an additional \$21.8 million of general fund revenue would be received in the 2009 biennium and \$25.7 million in the 2011 biennium. Additional general fund costs of \$0.3 million for the 2009 biennium and \$0.3 for the 2011 biennium are anticipated.

LC0506 - Withholding for Nonresident Mineral/Oil and Gas Royalty Pmts

Background: Nonresidents who have Montana oil and gas royalty source income fail to file income taxes at a rate of 78 percent. In a study of oil and gas royalty payments, 85 percent of Montana residents receiving payments filed an income tax form, only 22 percent of nonresidents did. A total of 1,030 individuals received royalty income, but 844 failed to file a return. Those failing to file received a total of \$1.9 million in royalty income. Wage earners who have money withheld from their paychecks

file at a rate of 97 percent. A system of tax withholding for royalty payments beginning January 1, 2008, is intended to ensure that nonresident royalty owners pay the appropriate tax.

Fiscal Impact: Withholding will increase the filing rate of nonresident royalty recipients and increase general fund revenue by an estimated \$3.3 million in the 2009 biennium and \$4.5 million in the 2011 biennium at an estimated general fund cost of \$0.6 million in the 2009 biennium and \$0.3 million in the 2011 biennium.

LC0507 - Real Estate Investment Trusts (REIT)

The purpose of this legislation is to promote fairness in taxation by closing a business loophole that allows certain income received and paid by REIT to escape state taxation entirely.

Background: REIT do not pay taxes on the income they earn in Montana to the same degree as other businesses. This occurs because of the unique deduction that REIT receive under federal law for dividends they pay to their owners. The dividends-paid deduction effectively eliminates most, if not all, of their income tax in Montana, even though they operate in the same manner as other businesses in the state and enjoy the benefits of state and local services. The dividends received by corporations or nonresident individuals from REIT are also not taxable in Montana. This REIT loophole can be closed either by requiring the REIT to pay taxes directly by disallowing the unique REIT dividends-paid deduction or requiring the REIT owners to pay the tax to Montana. One or the other of these measures may be used depending on whether the REIT is a publicly traded corporation or is privately held.

Fiscal Impact: Disallowing the dividends-paid deduction for REIT would subject the income of REIT to state income tax and increase general fund revenue by an estimated \$13.2 million in the 2009 biennium and \$19.6 million in the 2011 biennium. No additional funding is needed to implement this proposal.

LC0508 - Grantor Trusts

The purpose of this proposal is to establish income reporting requirements for grantor trusts to ensure proper reporting and payment of taxes.

Background: Grantor trusts are defined in Section 671 of the Internal Revenue Code. Trusts are typically categorized as grantor trusts when the person who created them continues to exercise so much control over trust assets that the normal trust tax provisions do not apply – the trust is disregarded and the trust income, deductions, and credits are reported in the income tax return of the grantor.

Various grantor trusts are used, in some cases, to hide illegal tax shelters or income, or to prevent the discovery of assets that can be used to satisfy tax debts. While many grantor trusts are used for legitimate purposes, they constitute a problem in the income tax reporting system. Current Montana statutes are unclear about when grantor trusts and nonresident owners of grantor trusts must file both trust returns and income tax returns. Because grantor trusts do not owe tax, there is no penalty for failure to file a return. Without a return, nonresident grantors who should be filing Montana tax returns cannot be identified. Sale of Montana property by grantor trusts owned by nonresidents is also part of the larger problem of which many nonresidents fail to file Montana tax returns and pay tax on Montana source income.

Fiscal Impact: Although there would likely be a positive revenue impact by correcting the underreporting of income and improving the collection of receivables, the amount cannot be quantified.

LC0509 - Improve Collections Management

The purpose of this proposal is to provide the Department of Revenue with the statutory tools needed to effectively manage Montana's accounts receivable.

Background: The department proposes adding or strengthening the following tools to manage accounts receivable more effectively:

- Electronic Filing of Wage and Fund Levies - Provide the department the ability to file wage and fund levies electronically with lending institutions and businesses that have the capability to receive these documents electronically
- Increase Authority to Collect on Non-Tax Debt - Allow the department to file warrants for distraint and initiate levy actions for all debts owed to the state that the department collects
- Out-of-State-Debt Collections - Seek legislation and appropriation authority that would improve the department's collection capabilities for out-of-state taxpayers' delinquent tax liabilities by allowing the department to hire, on a contingency basis, out-of-state collection professionals
- Trust Taxes - Include retail telecommunication excise tax, rental vehicle tax, and lodging facilities taxes as trust taxes for which officers and owners of business are liable for trust taxes

Fiscal Impact: Due to increases in collections from out of state taxpayers, general fund revenue will increase by an estimated \$3.3 million in the 2009 biennium and \$1.9 million in the 2011 biennium at a biennial cost of \$1.5 million general fund. Collections of lodging facilities taxes (state special revenue) is expected to increase significantly. The general fund expenses will be statutorily appropriated and are estimated to be \$1.5 million for the 2009 biennium and \$0.9 million for the 2011 biennium.

LFD ISSUE

Funding administrative costs through a statutory appropriation rather than in HB 2 does not meet the statutory criteria set forth by the legislature in 17-1-508, MCA. The legislature may want to scrutinize whether providing a statutory appropriation is the appropriate option.

LC0510 - Prohibition of Sale of Tax Information

The purpose of this proposal is to prohibit tax preparers from selling any taxpayer information gathered through the filing of tax returns.

Background: Some tax preparers are not regulated by state law and information gathered in the preparation of tax returns could be sold. This legislation would not amend provisions relating to licensed CPAs.

Fiscal Impact: There are no identified fiscal impacts of this proposed legislation.

LC0511 - Create Equity in Gift Certificates

The purpose of this proposal is to reclaim funds from unclaimed store-value cards.

Background: Currently, all unclaimed value on store value cards sold in Montana is remitted to the card owner's state of domicile. Legislation is proposed to require all unused value on lost gift cards purchased in Montana to be sent to the state in which the card was purchased or last used. Gift card sales are in the billions of dollars each year and it is estimated that between 8 percent and 12 percent of all value in gift cards is never used.

Fiscal Impact: Although the increase in unclaimed property may eventually become general fund money, the amount cannot be quantified.

**LFD
Comment**

Although the Department of Revenue states that the fiscal impact cannot be determined, it estimates that additional general fund revenues of \$5.7 million will be received beginning FY 2011 at a general fund cost of \$0.1 million.

LC0512 - Insurance Stuffing

The purpose of this proposal is to close a business loophole that allows certain businesses to channel income that normally would be subject to state income taxes into wholly owned insurance subsidiaries that pay tax only on the insurance premiums issued during the tax year.

Background: The net income of corporations operating in Montana is subject to the state corporate license (income) tax. But insurance companies are subject to the insurance premium tax (a tax paid on the amount of premiums issued during the year) and state law generally exempts these types of companies from all other taxes. Because corporations may control a variety of wholly-owned subsidiaries, such as a wholly-owned insurance company, some have taken the income of non-insurance company subsidiaries and channeled that income into the wholly-owned subsidiary (insurance stuffing). Because the insurance subsidiary pays only the premium tax in Montana or other states, the otherwise taxable income from the non-insurance subsidiaries escapes taxation. This tax avoidance scheme reduces general fund revenue and provides an unfair competitive advantage to firms with wholly-owned insurance company subsidiaries, relative to similarly situated firms that do not have an insurance subsidiary. California has proposed legislation that could serve as a model for Montana. The proposed legislation would exempt any captive insurer with a net capitalization of \$10 million or less for application of this legislation.

Fiscal Impact: Preventing insurance stuffing requires corporations to report and pay tax on income that otherwise would escape income taxes, thereby increasing state general fund revenue by an estimated \$4.5 million in the 2009 biennium and \$4.5 million in the 2011 biennium.

LC0513 - Endowment Credit Clarification

The purpose of this proposal is to renew the income tax credit for contributions to a qualified charitable endowment and ensure the appropriate use of the credit by amending state laws to make taxpayer contribution directed specifically toward real or personal property owned or held by the charitable organization ineligible for the credit.

Background: On December 29, 2005, the department, at the request of the Commissioner of Higher Education, issued a preliminary memorandum opinion finding that contributions to a qualified endowment for the specific purpose of building real property for the charitable organization sponsoring the qualified endowment qualified for the charitable endowment tax credit. This legislation would provide that contributions for buildings, equipment, and other facilities for charitable organizations would be explicitly ineligible for the credit. The endowment credit sunsets on December 31, 2007, so the 2007 session is an appropriate time to consider this change.

Fiscal Impact: Renewing the credit decreases general fund revenue, but to the extent that this amendment to state law results in a reduction in contributions qualifying for the charitable endowment

tax credit, revenues will increase. It is estimated the net effect on general fund revenue in the 2009 biennium will be a loss of \$3.0 million, and a loss of \$6.5 million in the 2011 biennium.

LC0514 - Clarify Confidentiality Laws

The purpose of this proposal is to clarify the type of information the Department of Revenue can share with the Legislative Fiscal Division, Legislative Auditor, and OBPP.

Background: The executive contends that some ambiguity exists as to what information may be provided to the LFD and OBPP. This legislation would clarify Montana's disclosure laws as they relate to tax information exchanged between these agencies and the department.

Fiscal Impact: There are no identified fiscal impacts of this proposed legislation.

LFD ISSUE

Limiting data or access to data used by the Legislative Fiscal Division to estimate revenues for the legislature will lessen the accuracy of the estimates upon which the legislature relies to approve billions of dollars in appropriations and may prevent legislative staff from conducting tax analysis requested by legislators. The Revenue and Transportation Interim Committee has introduced a committee bill to clarify information data exchange. The executive proposal goes further to reduce legislative and executive access to tax data currently provided.

LC0515 - Direct Interstate Distribution

The purpose of this proposal is to amend provisions in the liquor code to address the U.S. Supreme Court decision in *Granholm v. Heald* concerning the constitutionality of state restrictions on access by out-of-state wineries to their markets.

Background: In 2005, the U.S. Supreme Court determined the laws in Michigan and New York restricting access to their respective markets by out-of-state wineries violated the Commerce Clause. In particular, Michigan's law required out-of-state wineries to sell, in general, only to Michigan wholesale distributors, while Michigan wineries could ship directly to retail outlets. Montana's statutes may be subject to challenge based upon this decision. Legislation is proposed to provide, subject to defensible limits, access by out-of-state wineries to Montana retailers comparable to the access allowed for Montana small wineries.

Fiscal Impact: The fiscal impact cannot be quantified.

LC0516 - Residency Requirements for Liquor Licenses

The purpose of this proposal is to amend provisions in the liquor code to address a Montana district court decision concerning the constitutionality of state residency requirements for liquor licensees and to establish standards to qualify publicly traded companies as licensees.

Background: In 2005, the First Judicial District Court of Montana determined that Montana's laws requiring liquor licensees to be residents of Montana violated Holiday Inn's rights under the Commerce Clause. Montana's statutes require revision based upon this decision.

Fiscal Impact: There are no identified fiscal impacts of this proposed legislation.

LC0517 - Clarify Jurisdiction of Courts of Limited Jurisdiction Regarding Sales of Liquor to Minors

The purpose of this proposal is to clarify that all courts of limited jurisdiction have jurisdiction in prosecutions involving violations of the liquor code.

Background: Currently, 16-6-201,MCA, provides that in misdemeanor criminal actions brought pursuant to violation of the liquor code district courts and justice of the peace courts have concurrent jurisdiction. A question has arisen as to the power of other courts of limited jurisdiction, such as municipal courts, to hear these cases. This legislation would clarify that all courts of limited jurisdiction have the power to decide cases alleging criminal violation of the liquor code.

Fiscal Impact: There are no identified fiscal impacts of this proposed legislation.

LC0518 - Trust Tax Refunds

The purpose of this proposal is to establish provisions on the handling of trust tax refunds in regards to withholding, retail telecommunications excise tax, and lodging facility use tax.

Background: Clearly establish that, in cases of refunds for trust taxes, the refund must be refunded to the individual who paid the tax. If the individual cannot be found, the refund becomes unclaimed property or state general fund money.

Fiscal Impact: Although the increase in unclaimed property may eventually become general fund money, the amount cannot be quantified.

LC0519 - Follow Federal Practice of Withholding for Retirement Fund Withdrawals

Background: The purpose of this proposal is to require withholding of taxes on lump sum payments on early withdrawal of retirement funds. Retirees who receive a lump sum payment on an early withdrawal have a federal requirement for withholding of taxes. There is no similar state requirement. Retirees often spend the distribution only to find out too late that they owe state taxes. Withholding would make it clear to retirees that taxes are owed at the state level and would ensure funds are available.

Fiscal Impact: The estimated general fund revenue increase is \$0.3 million for the 2009 biennium.

LC0520 - Make Corporation Tax Statute of Limitations Equal to Individual Income Tax

The purpose of this proposal is to increase the corporate statute of limitations from 3 to 5 years to make the corporate limit the same as the 5-year statute for individuals.

Background: This is intended to provide the department the necessary time to examine corporation tax returns and improve audit coverage of corporations. It will correct an inequity where individuals are subject to audit for a longer period than corporations. This inequity is further underscored by the fact that some limited liability companies file as corporations and some under the individual income tax, making the statute of limitations subject to taxpayer manipulation through a choice of law.

Fiscal Impact: It is estimated that general fund revenue would increase \$2.9 million in the 2009 biennium and \$3.9 million in the 2011 biennium.

LC0521 - Lodging Tax Base Definition

The purpose of this proposal is to clarify who pays, and how the payment is made, for lodging facility and accommodations sales taxes in situations involving intermediaries.

Background: 15-65-111, MCA, provides that "[t]here is imposed on the user of a facility a tax at a rate equal to 4 percent of the accommodation charge collected by the facility." This definition would be amended to clarify who collects and pays the tax in transactions that involve service fees paid to hotel intermediaries, such as Expedia.com or Hotels.com. For example, a traveler may book a room at a motel in Montana through an intermediary. The cost of the room is \$80 but the intermediary charges a \$20 fee to book the room. The intermediary then charges the traveler \$100 plus tax, with the tax applied to the entire \$100, including the cost of the room and the intermediary's fee. Under current law, the motel operator remits to the state the accommodations and sales tax owed on the \$80 room charge, but the intermediary retains the amount of tax initially paid by the traveler on the \$20 fee. Legislation is proposed to clarify that the hotel intermediary fee is subject to the lodging facility tax and accommodation tax, and that the intermediary is responsible for remitting the tax to the state.

Fiscal Impact: Clarifying that intermediaries are responsible for remitting to the state any lodging facility or accommodations sales taxes collected on intermediary fees would increase revenue from these sources. It is estimated that general fund revenue would increase \$0.7 million in the 2009 biennium and \$0.7 million in the 2011 biennium.

LC0522 - Generally Revise Tax Code

LFD ISSUE

Although the Department of Revenue has identified \$1.9 million of additional general fund revenue in the 2009 biennium and \$2.0 million in the 2011 biennium from this proposed legislation, it has failed to identify which of the following 10 pieces is associated with the revenue. Costs to implement the proposal are estimated to be \$0.4 million in the 2009 biennium and \$0.4 million in the 2011 biennium.

1. Penalty and Interest Clean-Up

The purpose of this proposal is to amend existing penalty and interest statutes where warranted, and provide new and consistent penalty statutes.

Background: (1) Interest on overpayments. 15-30-149, MCA, addresses situations in which taxpayers have paid more than their legal liability. Subsection (4) provides that interest is due on an overpayment from the due date of the return or from the date of the overpayment, whichever date is later. For delinquent returns (late filing), this is not an issue where the taxpayer pays the taxes due when the return is filed; the date of the overpayment is the date the return is filed, and the taxpayer is entitled to interest only from the time when the taxpayer actually paid tax. An issue of fairness arises when the taxpayer files a delinquent return for a tax year in which excess withholding or quarterly estimated tax had been paid. Subsection (4) of 15-30-149, MCA, states that "[w]ith respect to taxes paid by withholding or by estimate, the date of overpayment is the date on which the return for the tax year is due." Currently, a taxpayer who has excess taxes withheld in tax year 2003, but does not file a tax year 2003 return until April 15, 2006, would be entitled to interest from the date the return is due, April 15,

2004. In this case the state is holding harmless a taxpayer who files a delinquent return. To eliminate this perverse taxpayer incentive, Montana statute would be modified to reflect federal law, which provides that "in the case of a return of tax for a return which was filed after the last date prescribed for filing such return (determined with regard to extensions), no interest shall be allowed or paid before the date the return is filed." (2) Penalties. Penalties for fraud, substantial underreporting, and failure to file returns or out-of-state federal Revenue Agent Reports (RARs) must be established or strengthened and be consistent for all tax types and programs. This would include penalties for not filing the actual federal tax return where required. (3) All penalties and interest should be reviewed for consistency.

Fiscal Impact: Although eliminating the fundamental unfairness in current law overpayment interest rules, and strengthening fraud and other penalty provisions will result in enhanced compliance with the tax code and additional revenue for the state general fund, the amount cannot be quantified.

2. S Corp Conformity

The purpose of this proposal is to require S corporations to conform to federal rules for taxpayer simplicity and proper tax compliance.

Background: The executive contends that failure of Montana law to follow federal rules on special entity owners of S corporations causes confusion and opens Montana to income abuses.

Fiscal Impact: There are no identified fiscal impacts of this proposed legislation.

3. Definition of Person

The purpose of this proposal is to update the definition of a person, and coordinate the general definition found in 1-1-201, MCA, with 15-1-201, MCA, in order to remove any ambiguities found in current law and make application of the term "person" consistent across statutes.

Background: Person, as defined in 1-1-201, MCA, currently includes only corporations and natural persons. This general definition would be amended to include pass-through entities, such as partnerships, and limited liability companies. If the controlling definition in 1-1-201, MCA, cannot be amended through a code commissioner bill, then the definition of person at 15-1-201, MCA, should be amended to include limited liability companies.

Fiscal Impact: There are no identified fiscal impacts of this proposed legislation.

4. Definition of a Qualifying Child

The purpose of this proposal is to eliminate some confusion and enhance simplicity and compliance with the tax code by amending the state definition of a qualifying child to correspond to the federal definition of qualifying child for individual income tax purposes, while controlling for known problems with the federal definition.

Background: The federal definition of a qualifying child for federal income tax purposes changed for 2005 and is inconsistent with Montana's definition. In order to be considered a qualifying child for federal income tax purposes an individual must meet the following four tests: (1) relationship; (2) age; (3) residency (the child must live with the taxpayer for more than half of the year); and (4) support (the child did not provide over half of his or her own support for the

year). This legislation will clarify the definition of a qualifying child for state tax purposes to make it generally consistent with the federal definition while fixing known problems with the federal definition. For example, Montana statute requires the support test to be met by the taxpayer (the parent) and not the qualifying child. This eliminates a problem with the federal definition that technically allows one sibling to claim another sibling as a dependent for federal tax purposes, thereby artificially reducing the sibling's federal tax liability.

Fiscal Impact: There are no identified fiscal impacts of this proposed legislation.

5. SB 407 Clean Up Limit on Federal Tax Deduction for Trusts

The purpose of this proposal is to clean up some of the SB 407 provisions.

Background: Effective January 1, 2005, there is a federal tax limitation of \$5,000 single/\$10,000 joint for individuals. However, no similar provision was set forth for trusts, even though all other provisions of SB 407 apply. This has caused confusion but, at this time, the position was taken that the federal tax deduction was not limited for trusts.

Fiscal Impact: There are no identified fiscal impacts of this proposed legislation.

6. Clarify Filing Requirements of Estates

The purpose of this proposal is to clarify filing requirements for estates.

Background: Section 72-16-906, MCA, requires filing with Montana only estates that are required to file if the death was before January 1, 2005. It is silent on what to do for anything after that, so presumably that means there isn't a filing requirement. However, the law still exists stating that if they have a probate and the estate filed a federal estate tax return, the department has to certify that no taxes are due. Even though there effectively is not a state estate tax because of how the laws calculate it, sound audit procedures mean that some type of written submission should be reviewed before a certificate specific to an estate can be issued.

Fiscal Impact: There are no identified fiscal impacts of this proposed legislation.

7. Extension of Time for Individual Income Tax Returns

The purpose of this proposal is to clarify and coordinate with the federal extension to file individual income tax return.

Background: Section 15-30-144, MCA, currently provides for an automatic four-month Montana extension and an additional two-month Montana extension upon applying for a federal extension. Beginning with tax year 2005, the Internal Revenue Service is granting an automatic extension of six months, provided that federal Form 4868 is filed before April 15. The Internal Revenue Service has eliminated the four-month and two-month extensions beginning with 2005. In addition, federal law provides that an individual who resides outside the United States or Puerto Rico and is a U.S. citizen is granted an automatic six-month extension of time to file a tax return without having to apply for an extension using Form 4868. Individuals living outside the U.S. are not eligible for a Montana extension, as the Montana statute specifically states that the taxpayer must apply for a federal extension.

Fiscal Impact: There are no identified fiscal impacts of this proposed legislation.

8. Municipal Corporations

The purpose of this proposal is to repeal 15-1-201(3), MCA. This section requires the department to collect certain information annually from the municipal corporations to assist the department in conducting its work. The information required is either not necessary or is not useful. Therefore, the department recommends repealing this subsection in statute.

Background: Legislative Audit recommendation #5C in the financial compliance audit for the two years ended June 30, 2004, recommended legislation be sought to amend 15-1-201, MCA, to reflect the current information needs of the department. As written, the statute requires the department to collect information annually from municipal corporations. The requirements in this section of law do not assist the department in conducting its duties, as the information is unnecessary and does not lend itself to be useful in how the department conducts its business.

Fiscal Impact: There are no identified fiscal impacts of this proposed legislation.

9. Improved Exchange of Information Among State Agencies

Various state agencies are responsible for licensing and/or monitoring of individuals and businesses throughout the state. Currently, the Department of Revenue uses a small portion of this data to identify non-filers or underreporting of income. This proposal enacts legislation to clarify and improve the use of state agency information to ensure equitable and effective compliance with state and local tax laws. The legislation would also clarify and improve the use of revenue information by other agencies for their administrative purposes, consistent with federal and state laws on confidentiality of tax information. Finally, the legislation would grant the department access to confidential criminal justice information for the purposes of alcohol compliance and tax fraud investigations.

Fiscal Impact: Matching files with other state agencies will identify non-filers. Follow-up will increase general fund revenue.

10. Audit Report Funding

- a) Repeal of 15-30-116(1), MCA - Section 15-30-116(1), MCA, describes military payments that are exempt from income tax. The subsection of statute should be repealed because the military payments described are no longer paid.
- b) Repeal of 15-1-113, MCA - The Revenue and Transportation Committee, approved a motion to seek legislation in the upcoming session to repeal 15-1-113, MCA. The department follows the guidance under 15-1-121, MCA, for HB124 entitlement share payments, which includes reimbursement for lost revenues due to reductions in property tax rates under Title 61, chapter 3, part 5 (which includes 61-3-529, MCA). Section 15-1-113, MCA, includes reimbursement for lost property tax revenues specifically under 61-3-529, MCA.
- c) Amend 15-35-104, MCA, to review reporting requirements for coal mine operators -Section 15-1-201, MCA, requires the department to collect certain information annually from municipal corporations (local governments). The statute should be repealed because the department does not need this information to conduct its business.
- d) Revise 15-30-112(5)(a)(i), MCA - Update 15-30-112(5)(a)(i), MCA, so the dependant exemption amount is consistent with gross income levels.

Fiscal Impact: There are no identified fiscal impacts of this proposed legislation.

AUDITING PROPOSALS

DP 701 - Compliance - Legal

An increase of \$1.9 million (\$1.7 million general fund and \$0.2 million state special revenue) for the 2009 biennium is requested in HB 2 to add 7.00 FTE and pay operating costs to provide in-house legal resources in support of tax compliance activities. The increase also funds \$472,500 per year in contracted legal services or 2,000 hours per year to supplement staff legal work. The executive recommends designating \$23,550 of the FY 2008 general fund amount as one-time-only. The additional funding is expected to increase 2009 biennium general fund revenue by \$1.4 million.

DP 7012 - Tax Gap Analysis

An increase of \$0.8 million general fund for the 2009 biennium is requested for personal services and operating costs to add 6.00 FTE to conduct the targeted auditing necessary for a comprehensive, state-specific tax gap study program. The purpose of the program would be to provide the information needed to estimate the tax gap associated with current and emerging issues related to a wide variety of taxes, while at the same time generating additional revenue from the audits conducted. The executive recommends the legislature designate \$23,550 in FY 2008 as one-time-only. The additional funding is expected to increase 2009 biennium general fund revenue by \$2.3 million.

DP 7019 - Compliance - Audit & Collections

An increase of \$4.5 million (\$4.1 million general fund and \$0.4 million state special revenue) for the 2009 biennium is requested to enhance tax compliance activities in Montana. This funding would fund personal services and operating costs to add 23.00 FTE in FY 2008 and 33.00 FTE in FY 2009 to address several key compliance issues in areas such as pass-through entity audits, oil and gas tax audits, issues related to Montana source income, and issues associated with nonresident taxpayers. Funding would include \$1.0 million contracted services to hire specific experts for the targeted compliance areas. The executive recommends the legislature designate \$78,500 in FY 2008 and \$39,250 in FY 2009 as one-time-only. The additional funding is expected to increase 2009 biennium general fund revenue by \$11.7 million.

OTHER TAX INITIATIVES

LC0905 - Property Tax Reserve Fund

Under current law, when a centrally assessed taxpayer protests property taxes, the county retains the local taxes and in most cases, holds them in escrow, although counties may distribute them to schools and cities. The university system share (6 mill share) and the state school equalization share (95 mill share) is distributed half to the general fund, where they are spent, and half to a state special account, (property tax protest fund), where they are saved in case the state loses the property tax case.

LC0905 would create a new centrally assessed property tax protest risk management fund for protests going forward, and would discontinue deposits into the property tax protest fund. A county that elects to participate in the risk management program would retain 90 percent of the protested local taxes for distribution to schools, cities, and the county, and send 10 percent to the state for deposit in the new risk management fund. Half of the protested university system taxes and protested school equalization taxes would be deposited in the new account and half in the general fund. LC0905 transfers \$14.0 million general fund to the new protested property tax risk management account. The account will be

managed by the Board of Investments and earn interest. Deposits over time are expected to be \$2.4 million and include the 6 mill share, the 95 mill share, and 10 percent of the counties' share. This is based on the assumption \$11.6 million in property taxes will be protested by centrally assessed companies every year. The local share is assumed to be 74.5 percent of the total.

The amount of money in the new fund will increase over time. In the future, if the state wins the case and is awarded 90 percent or less of the protested taxes, the state retains the money in the new account. If the state wins the case and the award is greater than 90 percent of the protested amount, the state will share the excess above 90 percent of the local share with the local jurisdiction. If the state loses the case, the state will pay back the protested taxes to the company, including the local share, from the new account.

The current law protest fund would remain in existence with nearly \$5.3 million in deposits. It would remain in existence in order to pay protested taxes in case the state loses on protests for tax years 2000 through 2006.

**LFD
ISSUE**

As shown in the executive budget, the property tax reserve fund transfer is estimated to cost \$14.5 million for the 2009 biennium. The fiscal note prepared for LC0905 shows a general fund impact of \$14.0 million.

LC0906 – Water Fee Rebate

Under current law, water rights owners are required to pay a fee to fund the water rights adjudication process by January 31 of each even numbered year through 2014. Fees are assessed on a sliding scale based on size and type of each water right and the number of water rights. The fees were first paid in 2005 and 2006. The executive would refund these fees to water rights owners who were assessed fees of \$400 or less, utilizing general fund. The total number of water rights holders who paid less than \$400 in the first billing was 90,858, who paid a total of \$4,069,166. Assuming 99 percent of the refunds are deliverable, the amount refunded is expected to be \$4,028,474. The payment of future water fees through 2014 would be eliminated, and \$15.9 million would be transferred from the general fund to the water adjudication fund to fund the water adjudication process through 2014.

An additional \$500,000 would be needed by the Department of Revenue and the Department of Natural Resources and Conservation for printing and mailing refund checks and other operating expenses.

**LFD
ISSUE**

The executive is requesting to spend \$0.5 million to issue 90,858 refund checks totaling \$4.1 million for an average cost of \$5.50 per refund check. The original operating budget adopted by the 59th Legislature was only \$150,000. Before the water rebate proposal is endorsed, the legislature should consider the public policy of spending \$0.5 million of taxpayer monies to rebate \$4.1 million in water fees. In addition, an analysis prepared by the Legislative Services Division questions the constitutionality of this proposal. According to the analysis, the equal protection clause is violated since there is no legal basis for discriminating among classes of fee payers.

LC0907 – Governor's Rebate

The executive requests a one-time-only general fund appropriation up to \$100 million in FY 2008 for property tax refunds. The property tax refund would be up to \$400 per household. The refund would be distributed to property owners on the residence they owned and occupied as their principal residence for at least 7 months during calendar 2006. The refund would be claimed by the taxpayer on

a form provided by the department on or before September 1, 2007. Approximately 250,000 owner occupied residences would qualify for the refund. The refund would be subject to state and federal income taxes. The executive estimates that income tax revenues would increase by \$4 million in FY 2008.

**LFD
ISSUE**

Since the executive budget did not provide specific details on this proposal, the Department of Revenue was contacted for more detailed financial information. Although the department did provide a total cost estimate of \$98.4 million, it was unclear whether this amount included costs for printing and mailing refund checks and any other operating expenses. Further examination of the proposed legislation suggests the \$100 million appropriation would be limited specifically to property tax refunds. If this is the case, the department would be required to fund operating costs of the rebate program within existing budget.

LC [not assigned] – Personal Property Reduction

The executive budget is proposing to increase the market value exemption amount for class 8 business equipment from \$20,000 to \$150,000, beginning January 1, 2007. The proposal will reduce statewide taxable value in FY 2008 by \$24.1 million, or by 1.2 percent. The proposal will result in an annual property tax reduction in FY 2008 and FY 2009 to the general fund (95 mills and 1.5 mills) of \$2.3 million and to the university system account (6 mills) of \$144,000. Local jurisdictions, unless reimbursed by the state, will lose \$10.1 million per year.

**LFD
ISSUE**

As shown in the executive budget, the personal property tax reduction is estimated to cost \$30 million for the 2009 biennium. Supporting documentation from the department (discussed above) estimates the cost at \$12.5 million per year or \$25 million for the 2009 biennium. Since there is a \$5.0 million difference in anticipated costs, the specifics of the executive proposal are unclear. In addition, local jurisdictions, unless reimbursed by the state, will likely raise local mills to make up for the loss in tax base. This will result in a tax burden shift to other classes of property. While the executive budget indicates their proposal will not shift additional property taxes to homeowners, their budget does not specify how local governments including schools will be reimbursed.

It also does not indicate, if reimbursement is proposed, whether these costs will be increased in subsequent biennia.

With reimbursement, the state will bear the \$10.1 million cost and local taxes will not shift to other classes of property. Reimbursements to school district general funds will result in a guaranteed tax base savings of approximately \$1.1 million per year in FY 2008 and FY 2009. These potential savings have not been included in the executive budget.

**LFD
ISSUE**

The executive budget states “The \$30 million in small business tax reduction for this and future biennia would be financed by tax compliance measures that ask non-residents and out-of-state companies to pay a fair share of taxes on the income they earn in Montana ...”.The executive budget proposes at least 15 different bills addressing tax compliance issues. The executive does not specify whether they will support a personal property tax reduction if one or all of these bills fail during the legislative process.



EXECUTIVE EXPENDITURE PROPOSALS - SUMMARY

INTRODUCTION

This section discusses the major expenditures in the 2009 biennium proposed by the Governor. The purpose of this document is to provide the reader with a summary view of major trends and policies proposed. It is divided into two parts:

- A brief overview of general fund in total, including all appropriations made by both temporary and statutory appropriations, and all executive proposals that are contained in legislation separate from the general appropriations act (HB 2)
- A more detailed discussion of executive proposals in HB 2, which would appropriate almost 80 percent of all general fund expended by state government under the Governor's proposal. Because the Governor has included significant expenditures of general fund for one-time tax rebates, an infusion of funding into the Teachers Retirement System, deferred maintenance and new building projects, as well as standard non-HB 2 items such as the state employee pay plan and statutory appropriations, this percentage is temporarily and uncharacteristically low. These other proposals are discussed in more detail in the relevant sections of this report. However, HB 2 remains the primary vehicle for the on-going costs of state government and as such the best gauge of overall government direction and policy. A detailed discussion of each agency's proposed budget is included in Volumes 3 through 7 of the LFD 2009 Biennium Legislative Budget Analysis.

ALL GENERAL FUND – HIGHLIGHTS

COMPARISON TO THE 2006 BASE

FY 2006 is used as the starting point, or base, for all budget development, rather than the 2007 biennium. Therefore, spending proposals are presented as changes to that base in this section.

Figure 1 shows the Governor’s priorities from the doubled 2006 base. As shown, the Governor has provided funding for a large and diverse number of purposes, including a significant number that do not fall into any of the categories shown, but total over \$46 million. Please note that this table includes \$30 million in property tax reimbursements to school districts and \$2.8 million in Department of Revenue compliance funding that were included as offsets to revenue in the executive budget. Please note that the totals include a slight revision in the property tax and water adjudication relief proposals than those contained in the original executive budget, and \$16.0 million in statutory appropriations for emergencies classified as a transfer in the “2009 Biennium Projection” section of this report. This table does not include any other changes in estimated statutory appropriations.

Figure 1 Major Factors - General Fund Increases From the Doubled 2006 Base 2009 Biennium (Millions)			
Activity	Amount	--- General Fund ---	
		Percent of Total	Cumulative Percent
Doubled 2006 Base	\$2,533.33	---	---
<u>Major Adjustments - \$1,121.33 million</u>			
K-12 Total Present Law	\$156.27	12.8%	12.8%
Tax Rebates/Replacement/Relief - Property/Water Adjudication	148.81	12.2%	25.0%
Pensions - TRS/Defined Contribution/Ongoing Actuarial Funding	130.72	10.7%	35.7%
Capital Projects - Deferred Maintenance	80.80	6.6%	42.3%
K-12 New Proposals	64.98	5.3%	47.6%
Corrections Populations - Annualize Costs/New Beds and FTE	60.04	4.9%	52.5%
State Employee Pay Plan	58.60	4.8%	57.3%
Statewide Present Law Adjustments	58.33	4.8%	62.1%
Capital Projects - New Projects	50.25	4.1%	66.2%
Caseload Adjustments - DPHHS	44.71	3.7%	69.9%
Fire Emergency and Funding	36.00	2.9%	72.8%
DPHHS Various IT Systems	30.21	2.5%	75.3%
Increase Tax Compliance	29.85	2.4%	77.7%
DPHHS - FMAP Replacement	28.48	2.3%	80.1%
Change in Federal Funds Availability	28.14	2.3%	82.4%
Higher Ed Present Law Adjustments/Funding Change	27.29	2.2%	84.6%
E-911/Public Safety Radio/Other LRB IT	24.26	2.0%	86.6%
New Mental Health/Addiction Expansions	17.61	1.4%	88.0%
Property Tax Reserve Fund	14.50	1.2%	89.2%
Economic Development	14.26	1.2%	90.4%
Miscellaneous Major Present Law Additions - DPHHS	8.65	0.7%	91.1%
Provider Rate Increases - DPHHS/Corrections	8.62	0.7%	91.8%
Protective Services/Medical/Welfare/Seniors - DPHHS	8.22	0.7%	92.5%
Litigation	6.70	0.5%	93.0%
Other Higher Education Initiatives	6.05	0.5%	93.5%
Office of the Public Defender	5.87	0.5%	94.0%
Higher Ed Student Assistance	5.85	0.5%	94.5%
Noxious Weed Trust Fund	5.00	0.4%	94.9%
Miscellaneous Other IT - HB 2	4.57	0.4%	95.3%
Major Environmental Remediation	4.50	0.4%	95.6%
DD Reduce Waiting List	4.01	0.3%	96.0%
Manufactured Home Trust	3.10	0.3%	96.2%
All Other	46.06	3.8%	100.0%
Total Increases	<u>\$1,221.33</u>	---	---
2009 Biennium	<u>\$3,754.66</u>	---	---

As shown, the largest increase would be for present law adjustments in K-12 education (\$156.3 million), which would be on-going costs. The next highest additions are for tax rebates or relief (\$148.8 million), including \$30.0 million for property tax reimbursements for schools that would be on-going; funds to supplement pension plans (\$130.7 million), of which about \$30 million would be on-going; and deferred maintenance on state buildings (\$80.8 million), of which \$14.3 million would be on-going.

This increase of \$1.2 billion is almost 50 percent higher than the doubled base (the increase is smaller when compared to the 2007 biennium). About 40 percent of the increase is due to one-time-only proposals. However, most of the increase would be for on-going initiatives, and consequently carried forward into the next biennium.

Further discussions of the initiatives not included in HB 2, most of which (with the notable exception of the state employee pay plan) are one-time-only, are included in the relevant sections of this volume. HB 2 proposals, most of which are on-going, are discussed in the following sections. More detailed discussion of HB 2 proposals are contained in the relevant sections of the individual agency analyses in Volumes 3 through 7.

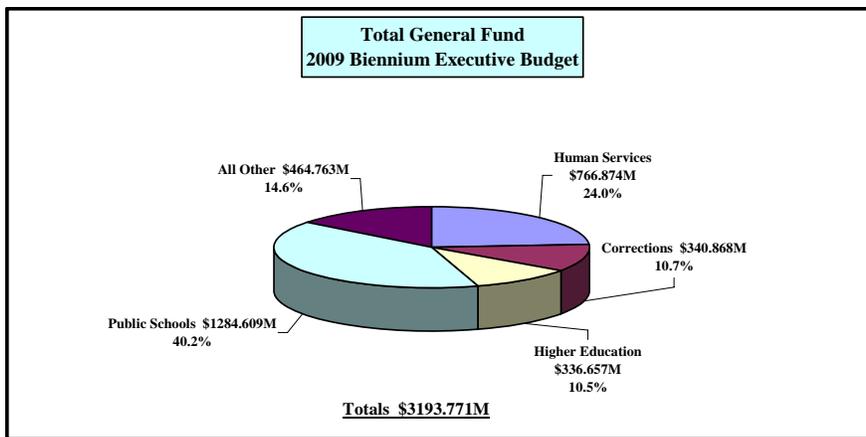
HB 2 PROPOSALS – HIGHLIGHTS

OVERVIEW

The Governor proposes to spend \$3.2 billion general fund and \$7.8 billion total funds in HB 2 in the 2009 biennium. Figure 2 shows proposed general fund expenditures in the 2009 biennium by functional area of government.

K-12 education, human services, higher education, and corrections would consume 85.4 percent of the general fund budget in the 2009 biennium, compared to 88.2 percent in the 2007 biennium. This reduction is due primarily to large increases for a number of other agencies, including the Department of Revenue.

Figure 2



Because K-12 education, the HB 2 portion of higher education, and corrections are primarily funded with general fund, the picture changes significantly when looking at total funds. Human services, transportation, and environmental functions (including fish and wildlife management) all have either a significant state special revenue and/or federal funding presence. Figure 3

shows the total funds proposed by the Governor in the 2009 biennium. Human services and “all other government” (which includes transportation and environmental functions) would be 68.6 percent of the total, compared to 69.1 percent in the 2007 biennium.

Figure 3

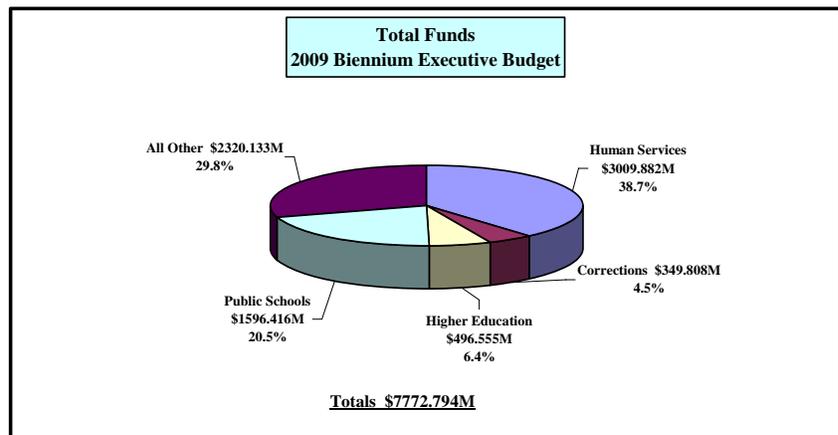
INCREASES OVER THE 2007 BIENNIUM

The 2009 biennium totals in HB 2 are an increase in general fund of \$576.0 million and in total funds of \$906.9 million over the 2007 biennium.

General Fund Increases

Figure 4 shows the Governor’s allocation of the increases, by functional area of government.

In that figure, the largest areas of increase in general fund are public schools, primarily for maintenance of December 2005 Special Session and other present law increases and a number of new initiatives; and “All Other” for a number of purposes over several agencies, including increased tax compliance,



statewide present law adjustments, fire and deferred maintenance funding, and economic development measures. Increases in the Departments of Corrections and Public Health and Human Services, as well as the Offices of Public Instruction and the Commissioner of Higher Education, are discussed in “Executive Proposals by Funding Area” beginning on page 114 of this section.

Striking about the Governor’s proposal is not only its size, but its breadth. The smallest general fund percentage increase provided to any executive branch agency is 10.1 percent to the Commissioner of Higher Education (which still equates to a \$31.0 million increase over the 2007 biennium level)¹. The average general fund increase for all agencies is 22.0 percent.

If all one-time-only proposals of the Governor are removed from the calculation, the increase is still 20 percent.

Figure 4

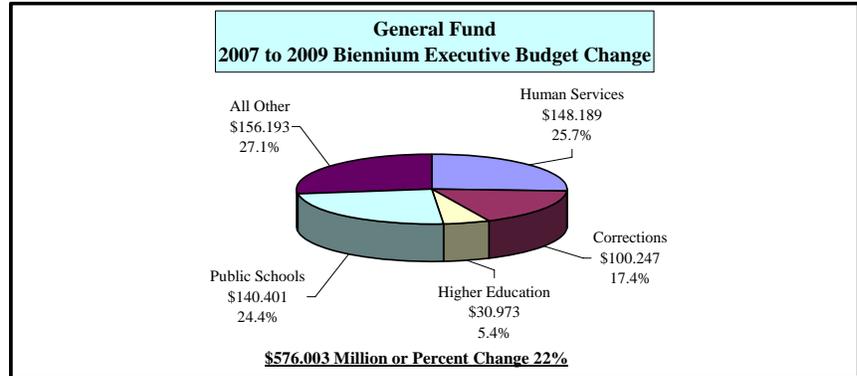
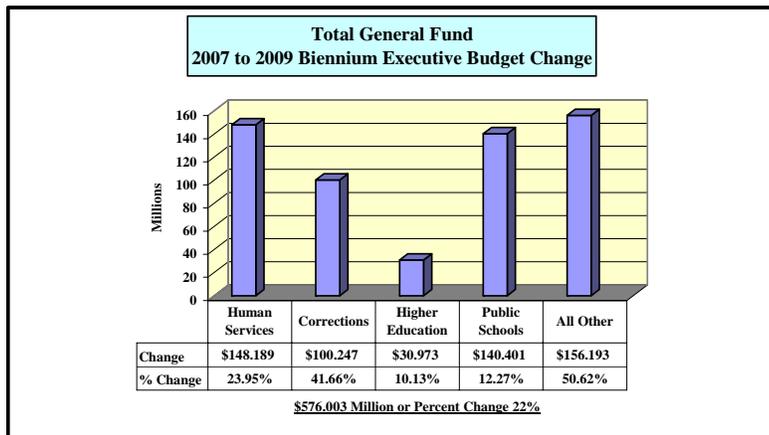


Figure 5



Many of the largest increases are in the Departments of Corrections and Public Health and Human Services, agencies with population and caseload increases. K-12 education shows large increases in part to annualize increases made by the legislature in special session in December 2005. If these agencies and the Montana University System (the four largest functional areas) are taken out of the comparison, the increase for “All Other” agencies totals an average of 50 percent. If only present law is compared, the average

is still about 30 percent for those agencies. For total funds, the total increase for “All Other” agencies is about 6.5 percent comparing the proposed 2009 biennium present law to the 2007 biennium, and 11.2 percent if new proposals are included. Figure 5 graphically shows this increase.

Total Funds Increases

Figure 6 shows the allocation of increases in total funds. As shown, human services shows the largest increase, primarily for Medicaid, food stamps, and TANF expenditures. “All Other” follows for a number of increases over several agencies.

¹ The decrease in the judicial branch is due to transfer of all public defender functions to the new executive branch Office of the Public Defender in FY 2007.

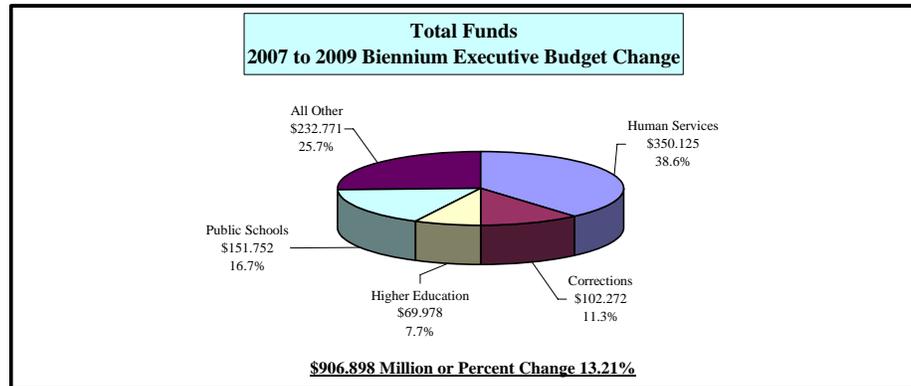
Figure 6

GOVERNOR'S SPENDING

General Priorities

Several priorities are evidenced by the spending proposals of the executive. The Governor funds:

- All inflationary increases and special session initiatives in K-12 education, as well as a number of new initiatives
- Measures designed to increase access to the Montana University System
- All caseload and population increases in human services and corrections
- All projected federal funds for highway construction
- All statewide present law adjustments, including all salary adjustments made to convert positions to the broadband pay plan, partially offset by vacancy savings on most positions
- Maintenance of all economic development and student assistance programs begun by the last legislature, with many programs receiving a significant proposed increase
- A significant expansion in the Department of Revenue for taxpayer compliance measures
- Some on-going infrastructure deferred maintenance and fire suppression costs



LFD ISSUE

General Fund Priorities/Expansion

The prioritization of the use of general fund is a foundational public policy issue. Inherent in this prioritization is a definition of what state government is that comes through a determination of what state government should do and who should pay for it. One of the primary tasks of budgeting is determining the appropriate definition of what constitutes a statewide interest and consequently should be funded by the general taxpayer. The Governor would expand the (current, derived) definition of statewide interest by funding a number of functions not funded or not entirely funded with general fund in the past, and/or where past definitions have placed a higher financial burden on those either responsible for the issue or receiving the benefit of the service.

The following is only a partial list. All but the additional funds for substance abuse treatment and wildlife grants are classified as one-time-only by the Governor.

- Environmental remediation (i.e. state Superfund)
- Additional substance abuse treatment
- The weed trust
- Fish, Wildlife and Parks wildlife grants
- Water rights adjudication
- Housing through the manufactured home trust
- Board of Horseracing
- Energy assistance
- Payment for some implementation costs of the defined contribution plan

**LFD
ISSUE
(CONT)**

Each of these proposals would not only set a precedent for future decision makers, but in some cases have a very high potential for future expenditures. For example, there are 210 state Superfund sites in Montana, and the weed and manufactured home trusts could only address a fraction of the perceived need. The legislature may want to carefully scrutinize the proposed policy of expanding general fund spending into these new areas, from the standpoint of cost prioritization, precedent, and future general fund commitments. Each is discussed in more detail in the relevant sections of Volumes 3 through 7.

**Governor’s Priorities -
Comparison to the Base**

FY 2006 is used as the starting point, or base, for all budget development, rather than the 2007 biennium. Therefore, spending proposals are presented as changes to that base. The following discusses the Governor’s priorities from the doubled 2006 base. The general fund increase from the base year is \$660.4 million, compared to \$576.0 million using a biennial comparison.

Increases by Activity

Figure 7 lists the major increases in the proposed budget by specific type of activity. The figure shows that over 43 percent of the total general fund increase would fund additions for both present law and new initiatives in K-12 education and correctional population projections.

Figure 7
Major Factors - General Fund HB 2 Increases From the Doubled 2006 Base
2009 Biennium Executive Budget (Millions)

Activity	Amount	--- General Fund ---	
		Total	Cumulative Percent
Doubled 2006 Base	\$2,533.33		
<u>Major Adjustments - \$660.44 million</u>			
K-12 Total Present Law Adjustments	\$156.27	23.7%	23.7%
K-12 Total New Proposals	64.98	9.8%	33.5%
Corrections Populations - Annualize Costs/New Beds and FTE	61.04	9.2%	42.7%
Statewide Present Law Adjustments	58.33	8.8%	51.6%
Caseload Adjustments - DPHHS	44.71	6.8%	58.3%
DPHHS - FMAP Replacement	28.48	4.3%	62.7%
Change in Federal Funds Availability	28.14	4.3%	66.9%
Higher Ed Present Law Adjustments/Funding Change	27.29	4.1%	71.0%
Increase Tax Compliance	27.03	4.1%	75.1%
New Mental Health/Addiction Expansions	17.61	2.7%	77.8%
Capital Projects - Deferred Maintenance	14.30	2.2%	80.0%
Economic Development	14.26	2.2%	82.1%
Ongoing Fire Costs/Equipment	11.00	1.7%	83.8%
Miscellaneous Major Present Law Additions - DPHHS	8.65	1.3%	85.1%
Provider Rate Increases - DPHHS/Corrections	8.62	1.3%	86.4%
Protective Services/Medical/Welfare/Seniors - DPHHS	8.22	1.2%	87.7%
Litigation - Transportation/Justice	6.70	1.0%	88.7%
Other Higher Education Initiatives	6.05	0.9%	89.6%
Office of the Public Defender Caseload	5.87	0.9%	90.5%
Higher Ed Student Assistance	5.85	0.9%	91.4%
Noxious Weed Trust Fund	5.00	0.8%	92.1%
Miscellaneous Other IT - HB 2	4.57	0.7%	92.8%
DD Reduce Waiting List	4.01	0.6%	93.4%
Manufactured Home Trust	3.10	0.5%	93.9%
Major Environmental Remediation	2.50	0.4%	94.3%
All Other	37.85	5.7%	100.0%
Total Increase	\$660.44		
2009 Biennium	\$3,193.77		

Figure 8

Major Factors
General Fund HB 2 Increases From the Doubled 2006 Base
2009 Biennium Executive Budget by Functional Area (Millions)

Component	Amount	Percent of Cumulative	
		Total	Percent
Doubled 2006 Base	\$2,533.33	---	---
<u>Major Adjustments - \$660.44 million</u>			
K-12 Education	221.24	33.5%	33.5%
Higher Education	38.50	5.8%	39.3%
Corrections	86.39	13.1%	52.4%
Human Services	151.12	22.9%	75.3%
All Other Government Agencies	163.18	24.7%	100.0%
Total Increase	660.44	---	---
Total 2009 Biennium	\$3,193.77	---	---

Increases by Functional Area of Government

The proposed general fund increases can also be examined by general functional area, which shows that K-12 education would total about one-third of the increase. When human services, corrections, and higher education are added, the total is over 75 percent. Figure 8 illustrates.

Governor’s Priorities in HB 2 – Summary

The following provides a reference to the major changes proposed by the Governor, and their impact on source and allocation of funding. Please note that all present law adjustments are as classified by the Governor, including over \$78 million for which the LFD has raised an issue that the proposals should be considered new initiatives.²

² Including provider rate increases in the Department of Corrections, expansions of economic development and student higher education assistance.

FTE	
FTE would increase by 454.38 in FY 2008 and 481.32 in FY 2009, of which 102.25 each year are to convert contracted services to state employees in the public defender office. All but eight agencies would receive an increase, and all but 25.50 in FY 2008 and 22.50 in FY 2009 would be on-going.	
General Fund/Total Funds	
General Fund	General fund increases by \$576.0 million, or 22.0 percent, over the 2007 biennium to \$3.2 billion
Total Funds	Total funds increase by \$906.9 million, or 13.2 percent, to \$7.8 billion
Major Present Law Adjustments	
Human Services	<ul style="list-style-type: none"> ○ Maintenance of Medicaid and other services by funding caseload increases and providing state funds to replace reductions in federal participation rates ○ Funds to address other known or anticipated federal changes
K-12 Education	<ul style="list-style-type: none"> ○ Inflationary increases and adjustments for enrollment changes ○ Continuation of all 2005 special session increases ○ Utilization of all anticipated federal funding increases
Higher Ed	<ul style="list-style-type: none"> ○ Increased access through an increase in general fund for present law to eliminate tuition increases and for student assistance
Corrections	<ul style="list-style-type: none"> ○ Address rising populations through increases in private contract beds, private pre-release beds, and probation and parole officers ○ Annualize all 2007 biennium initiatives and supplemental increases ○ Replace or provide new IT capabilities ○ Increase provider rates
All Other Gov't	<ul style="list-style-type: none"> ○ Increased tax compliance and collections ○ Maintain solvency of state highway fund while maximizing federal funds ○ Maintain and expand various economic development programs ○ Fund anticipated costs of the new public defender system
All Agencies	<ul style="list-style-type: none"> ○ Fund all statewide present law adjustments, including personal services adjustments made during the interim related to the broadband pay plan ○ Generally replace any reductions in federal funds while maximizing other federal funds receipt
Major New Initiatives	
Human Services	<ul style="list-style-type: none"> ○ Services for the mentally ill, including community services and STEP program for forensics patients ○ Provider rate increases and rate rebasing ○ Reduction in DD waiting list and increase in energy assistance
K-12 Education	<ul style="list-style-type: none"> ○ Full time kindergarten ○ Quality educator increase ○ Additional curriculum specialists
Higher Ed	<ul style="list-style-type: none"> ○ Quality educator loan forgiveness ○ Access enhancement through transferability and distance learning
Corrections	<ul style="list-style-type: none"> ○ Interoperability communications
All Other Gov't	<ul style="list-style-type: none"> ○ On-going deferred maintenance ○ On-going fire suppression funding ○ Weed trust fund balance enhancement
Fund Source	
General fund would increase as a percent of the total budget, reversing a general trend of higher federal participation for all but one of the last several biennia.	
Functional Share of the Budget	
All areas of the budget show large increases over the 2007 biennium. "All Other" would increase as a share due to a large number of additions over a number of agencies. Despite the large increase, the share of the budget for K-12 decreases.	

EXECUTIVE NEW INITIATIVES (NEW PROPOSALS)

The Governor proposes just over \$189.4 million in general fund new expenditure initiatives in HB 2, and an additional \$560.1 million outside of HB 2 for a total of \$750.3 million³. The Governor’s new initiatives are presented in more detail beginning on page 151, including an issue with the characterization of about \$78.3 million of new initiatives as present law in the Governor’s budget that would increase the total in HB 2 to about \$267.7 million, with a corresponding decrease in present law. The following figure shows major new proposals as presented by the Governor. A further discussion begins on page 151 of this volume. Please note the figure includes \$16.0 million in statutory appropriations for emergencies included in transfers in the “2009 Revenue Projection” section and a slight adjustment in property tax and water adjudication relief than those included in the original executive budget.

Agency/Initiative	On-Going	Biennial One-Time	Total
Non-HB 2			
Property Tax Rebate/Water Adjudication/Compliance***	\$32.82	\$118.81	\$151.63
Actuarial Funding - Retirement Systems/TRS Infusion	29.34	100.00	129.34
Long-Range Building - Deferred Maintenance	0.00	66.50	66.50
State Employee Pay Plan	58.61	0.00	58.61
Long-Range Building - IT	0.00	54.47	54.47
Long-Range Building - Projects, including Parks	0.00	50.25	50.25
Increase Funding for Fires/Governor's Emergency Appropriation*	0.00	25.00	25.00
Property Tax Reserve Fund	0.00	14.50	14.50
Miscellaneous Other Non-HB 2	<u>0</u>	<u>10.56</u>	<u>10.56</u>
Total Non-HB 2	\$120.77	\$440.09	\$560.86
HB 2			
K-12 Full-Time Kindergarten	\$25.17	\$0.00	\$25.17
K-12 Per Education and Entitlement	19.80	0.00	19.80
K-12 Various Other, including School for the Deaf and Blind	17.06	0.48	17.53
DPHHS Protective Services/Medical/Welfare/Seniors/Other DD	11.77	4.90	16.67
Deferred Maintenance - Ongoing	14.30	0.00	14.30
DPHHS Mental Health/Addiction Expansions	13.26	1.00	14.26
Emergency (Fires/Hazmat)	10.58	1.00	11.58
Changes in Federal Law or Availability	10.08	0.00	10.08
Various Data Systems	5.24	3.27	8.52
Pension - Defined Contribution Implementation Costs	0.00	1.38	1.38
Higher Education Other	0.00	6.95	6.95
Litigation (Justice/Transportation)	0.20	6.00	6.20
Provider Rate Increases	5.62	0.00	5.62
Various Environmental/Wildlife	2.76	2.25	5.01
Weed Trust Seed Money	5.00	0.00	5.00
Economic Development**	1.52	2.00	3.52
Manufactured Home Seed Money	0.00	3.10	3.10
Higher Education Student Assistance**	2.06	0.00	2.06
Corrections Various**	1.90	0.00	1.90
Various Judicial (staff, safety and security, fitness to proceed)	0.73	0.30	1.03
All Others	<u>9.77</u>	<u>0.00</u>	<u>9.77</u>
Total HB 2	<u>\$156.82</u>	<u>\$32.63</u>	<u>\$189.45</u>
Total New Initiatives	<u>\$277.59</u>	<u>\$472.72</u>	<u>\$750.31</u>
*Would increase available statutory appropriations. **Most proposed expenditures in present law. ***Includes \$30 million in property tax reimbursements to school districts and \$2.8 million in compliance funding included as a revenue offset in the executive budget.			

³ This total includes \$30 million in property tax reimbursements to local school districts and about \$2.8 million in property tax compliance spending presented as an offset to revenue in the Governor’s budget.

EXECUTIVE PROPOSALS BY PROGRAM AREA

Figure 10 summarizes expenditures of state government as proposed by the Governor and compares these totals to the 2007 biennium, by function of government. For a graphic display (pie charts) of the data in Figure 10, see Figure 2 (General Fund Budget), Figure 3 (Total Funds Budget), Figure 4 (General Fund Increases), and Figure 6 (Total Fund Increases).

Each of the program areas, along with the Department of Transportation, is discussed in the narrative that follows. Further discussion is included in the individual agency narratives in Volumes 3 through 7.

Figure 10 Proposed Executive Budget by Program Area - HB 2 2009 Biennium				
Component	Executive Budget	Increase Over 2007	Percent Increase	Percent of Increase
-- General Fund --				
K-12 Education	\$1,284,609,121	\$140,400,940	12.3%	24.4%
Higher Education	336,656,989	30,972,586	10.1%	5.4%
Corrections	340,868,235	100,247,213	41.7%	17.4%
Human Services	766,873,724	148,188,900	24.0%	25.7%
All Other Government Agencies	464,762,854	156,192,604	50.6%	27.1%
Total	\$3,193,770,923	\$576,002,243	22.0%	
Component	Executive Budget	Increase Over 2007	Percent Increase	Percent of Increase
-- Total Funds --				
K-12 Education	\$1,596,415,644	\$151,751,721	10.5%	16.7%
Higher Education	496,555,300	69,978,175	16.4%	7.7%
Corrections	349,808,036	102,271,988	41.3%	11.3%
Human Services	3,009,881,549	350,125,370	13.2%	38.6%
All Other Government Agencies	2,320,133,441	232,771,056	11.2%	25.7%
Total	\$7,772,793,970	\$906,898,310	13.2%	

K-12 Education

The increase in general fund appropriations for OPI between the 2007 biennium and the 2009 biennium is \$140.4 million or 12.3 percent. There are two key assumptions made in deriving these numbers. First, all one-time-only spending in FY 2006 and FY 2007 is removed. Second, payments of BASE aid made from the guarantee account (interest and income (I&I) on school lands) are not included. If a more consistent comparison between biennia is to be made, both should be included in each biennium. Between the 2007 biennium and the 2009 biennium BASE aid payments from the guarantee account are expected to fall by \$20.8 million, or 16.6 percent. Combining the two funds, the increase in authority between biennia is 9.4 percent. Adding the one-time only appropriations to biennia, the inter-biennial increase drops to 8.0 percent.

The increase between biennia is due to the executive's request for full day kindergarten, continuation (annualization) of funding for the 4 new components that were created in the 2005 special session, an increase in the per educator payment, state funding of retirement costs for school employees paid with federal money, inflation for the entitlements and special education, diversion of interest and income on state lands into a school facility trust fund, continuation of the student data information system, 6 new curriculum specialists, and more money for Indian education for all.

The increase in all fund appropriations for OPI between the 2007 biennium and the 2009 biennium is \$151.8 million or 10.5 percent. Again, one-time-only appropriations are removed and the guarantee account is not included in either biennium's numbers. If the guarantee account is included in both biennia, the increase between biennia for the combined funds is 8.3 percent.

The additional increases for all funds, in addition to the increase outlined above for the general fund, are increases for federal funds, primarily for special education and at risk children.

For a further discussion, see the Office of Public Instruction narrative beginning on page E-1 of Volume 7.

Higher Education

Overall funding for the Montana University System (MUS) increases a total of \$70 million in the proposed 2009 biennium executive budget compared to the 2007 biennium budget in HB 2. This overall funding increase is allocated as follows:

- \$31 million general fund
- \$6.6 million six-mill property tax levy revenue
- \$0.9 million proprietary revenue
- \$31 million federal revenue

Access to higher education is the primary theme for the Governor's proposals.

- The College Affordability Plan (CAP) would increase general fund spending by \$25.6 million in the 2009 biennium; the CAP is intended to freeze tuition rates for Montana resident students at the FY 2007 level through an increase in the percent of general fund and types of on-going costs for which the state will contribute funding, although the Board of Regents have exclusive authority over tuition rates, so that neither the executive nor the legislature could guarantee that the CAP proposal would indeed freeze tuition
- Proposed expansion of the Governor's Postsecondary Scholarship program includes \$4.0 million
- Funding to support equipment and technology purchases to support two-year degree programs includes \$2.0 million general fund and \$2.0 million six-mill levy revenue
- A proposed new teacher loan forgiveness program includes \$1.0 million
- An initiative to improve transferability of academic credits for students includes \$1.5 million
- Additional funding for Community College assistance includes \$1.7 million

The proposed increase to federal funding levels is primarily the expansion of the loan portfolio of the Montana Guaranteed Student Loan Program, as well as an increase in the federal funding level for a renewal of the GEAR UP program that targets at-risk students with academic assistance and skills-building.

For a further discussion, see the narrative for the Office of the Commissioner of Higher Education beginning on page E-92 in Volume 7.

Corrections

Funding for the Department of Corrections increases \$102 million when the 2009 and 2007 biennia are compared. Of this increase about \$100 million is general fund and \$2 million is state special revenue. General fund increases include:

- \$59.7 million due to population growth, including annualization of programs implemented or to be implemented in the 2007 biennium, expansion of programs, contract beds and increased probation and parole officers due to projected population growth, and a new prerelease center
- \$27.0 million for a projected supplemental appropriation for costs that will be on-going
- \$10.0 million for operations of Montana State Prison and requests for information technology projects

State special revenue grows primarily due to increases in the inmate canteen revolving fund, anticipated increases in offender restitution, and interest and income related to Pine Hills Youth Correctional Facility.

The department estimates offender population increases throughout the system, including an overall increase of 6.7 percent:

- 6.0 percent per year in male secure care
- 17 percent in female secure care
- 7.2 percent in FY 2008 and 10.0 percent in FY 2009 in male community placements
- 12.0 percent in FY 2008 and zero percent in FY 2009 in female community placements
- 6 percent per year in probation and parole cases

The department anticipates a supplemental appropriation of about \$27 million. In FY 2006 costs exceeded appropriations by about \$13 million, which was partially offset by \$1.5 million of Juvenile Delinquency Intervention Program (JDIP) funds that were unexpended. The balance of the additional appropriation needed for FY 2006 was provided by moving funding from the biennial appropriation for secure care from FY 2007 to FY 2006 and transferring funds among programs as necessary. Larger than projected population growth is the primary driver of the cost over-run although other items such as lack of vacancy savings, increased outside medical costs, and replacement of federal funds supporting the juvenile re-entry program also contribute to the department's supplemental.

For a further discussion, see the narrative for the Department of Corrections beginning on page D-61 of Volume 6.

Human Services

The executive budget request for the Department of Public Health and Human Services (DPHHS) grows \$350.1 million total funds (\$148.2 million general fund) from the 2007 biennium to the 2009 biennium. Budget growth is driven largely by changes in services for individuals, which add \$290.5 million over the biennium or 83.0 percent of the total. FTE increase 141.59.

The major differences between the biennia are:

- Medicaid eligibility and service increases, annualization of 2007 biennium initiatives, a reduction in the federal Medicaid match rate, and some 2009 biennium expansions, including provider rate increases, add \$233.8 million total funds, including \$77.1 million general fund
- Other service increases for larger benefit programs are:
 - Foster care - \$16.5 million, including \$8.2 million general fund
 - Food stamp benefits - \$12.3 million
 - Low-income Energy and Commodities - \$10.0 million, including \$2.1 million general fund
 - TANF - \$8.6 million, including \$4.2 million general fund
 - Children's Health Insurance Program (CHIP) - \$7.7 million total funds, including a reduction of \$1.3 million general fund, which was shifted to tobacco state special revenue
 - Child care - \$6.7 million, including \$4.1 million general fund
 - Institutional increases for overtime, operational cost inflation, and a new 120 bed program for mentally ill forensic patients support 90.90 new FTE and add \$23.8 million total funds, including \$18.1 million general fund

Other major FTE increases in the executive budget include:

- 20.00 FTE for foster care field staff
- 5.00 FTE for DPHHS to administer the CHIP program
- 5.00 FTE to help persons transition from the state hospital to community services

For a further discussion, see the narrative for the Department of Public Health and Human Services beginning on page B-1 of Volume 4.

Transportation

The Department of Transportation 2009 biennium total funds budget request has decreased by \$29.8 million from the 2007 biennium. The total funds decrease is a net of increased federal funds and reduced state special revenue. Federal funds are increasing primarily due to the August 2005 passage of the new multi-year federal-aid highway funding legislation, in which Montana receives significantly higher federal funds than under the previous legislation. The proposals that contribute significantly to the federal funds increase are:

- Increases in payments to highway construction contractors and for other related construction activities for the federal-aid construction program
- Increases in pass-through transit funding for local governments

State special revenue is reduced from the 2007 biennium to address fund balance and revenue limitations. The proposals that contribute significantly to the state special revenue reduction are:

- Decreases in payments to highway construction contractors for the state funded (no federal match) construction program
- Unspecified decreases in highway maintenance activities

For a further discussion, see the narrative for the Department of Transportation beginning on page A-94 of Volume 3.

All Other Agencies

All other agencies (including the Department of Transportation) total a 50.6 percent increase in proposed general fund spending over the 2007 biennium level, and an 11.2 percent increase in total funds. Major changes in other agencies comprise a large share of the increase in both general fund and total funds. Major general fund changes include:

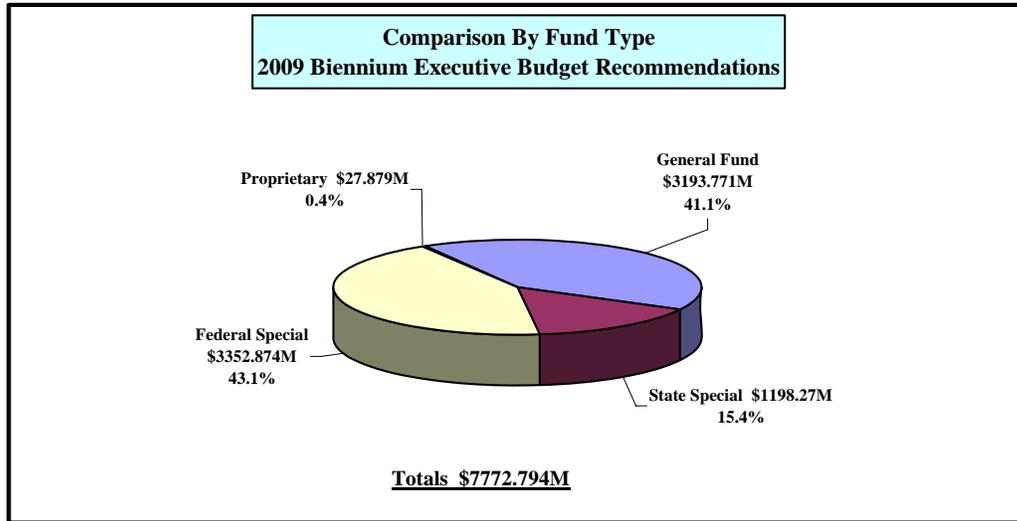
- Expansion of tax compliance activities in the Department of Revenue, including auditors, legal compliance, free e-filing, and general operations of the agency
- Maintenance and expansion of economic development activities in the Governor's office and the Department of Commerce
- On-going funding for fire suppression and deferred maintenance
- Use of general fund for environmental remediation and other expansions in environmental programs
- Funding for the new Office of the Public Defender
- Funding of all statewide present law adjustments

Further discussion of all of these initiatives is contained within the individual agency narratives in Volumes 3 through 7 of the LFD *2009 Biennium Legislative Budget Analysis*.

EXECUTIVE PROPOSALS BY FUND SOURCE

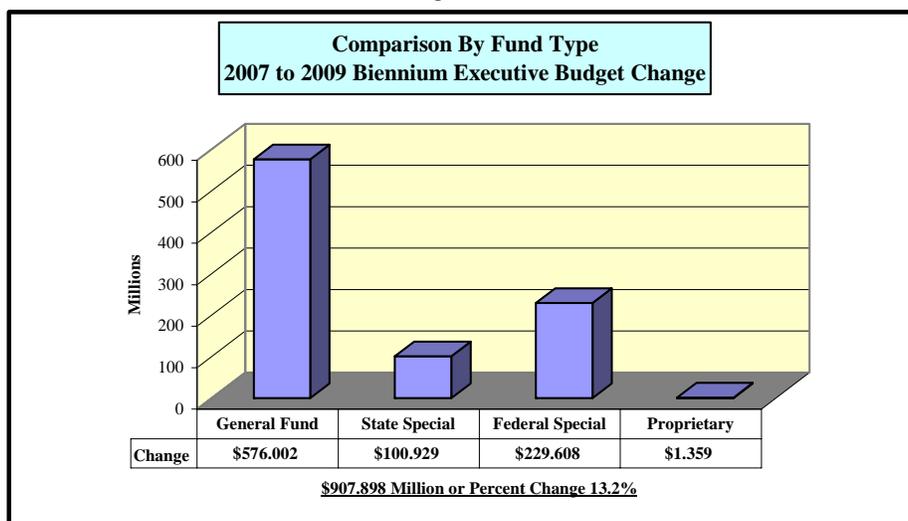
Figure 11 shows the allocation by funding source of state government in HB 2 in the 2009 biennium. This pie chart graphically displays the heavy reliance of this state on the use of federal funds for state services, as federal funds have grown to nearly half of the total budget. Reversing a trend of all but one of the last several biennia, the general fund would increase as a share of the total state budget due to the proposed 22 percent increase in general fund spending.

Figure 11



As shown in Figure 12, general fund would increase by \$576.0 million, or 22.0 percent. State special would increase by \$100.9 million, or 9.2 percent. Federal funds would increase by \$229.6 million, or 7.4 percent. Major reasons for the increases are discussed below, by fund type.

Figure 12



General Fund

General fund would increase by \$576.0 million, or 22.0 percent. While 6 agencies account for about 84 percent of the total increase, almost all agencies show significant percentage increases.

- Office of Public Instruction - \$140.4 million. Major increases are due to annualization of November 2005 Special Session increases, as well as
 - Inflationary increases
 - Increased per educator entitlements, special education, and facility reimbursements
 - Curriculum specialists and data systems
- Public Health and Human Services - \$148.2 million. This increase is due primarily to
 - Maintenance of services to current recipients through caseload adjustments, provision of funding due to changes in federal requirements, and replacement of funding due to a reduction in the federal Medicaid match rate
 - Provider rate increases
 - Expansion of services for the mentally ill, including forensics patients
- Corrections - \$100.2 million. This increase is due to:
 - Annualization of 2007 biennium initiatives and expansion of contract beds and probation and parole officers to address projected population increases
 - Provision of provider rates
- Montana University System (Commissioner of Higher Education) - \$31.0 million. The Governor proposes to:
 - Increase the extent to which the state general fund supports present law adjustments
 - Expand student assistance
 - Provide for equipment and other funding for high demand programs
- Revenue - \$33.6 million. Department funding would increase by almost 50 percent, primarily due to the provision of funding for various measures to increase taxpayer compliance.
- Office of the Public Defender - \$23.6 million. This increase is due to transfer of funding for this function from the Judiciary in FY 2007, cost annualization, and caseload increases.

Figure 13

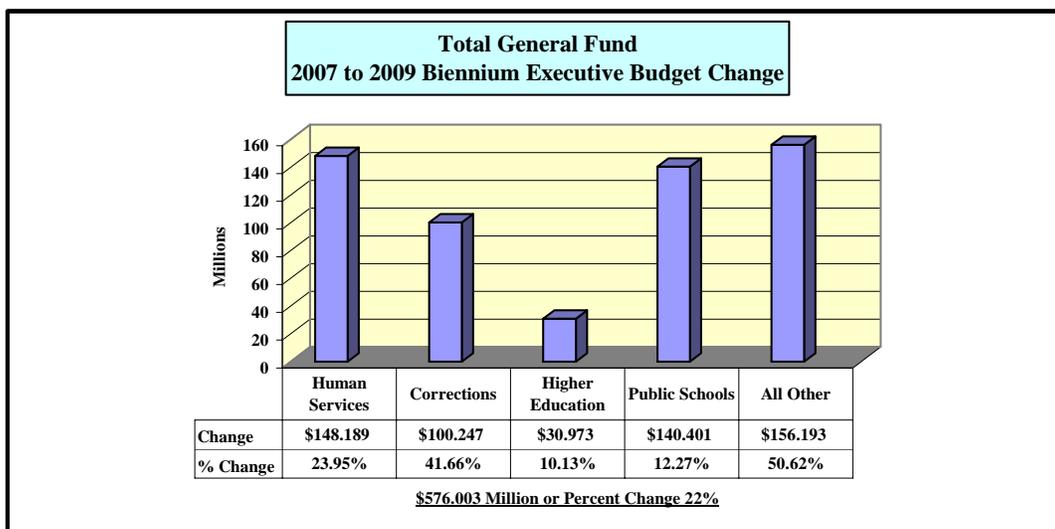
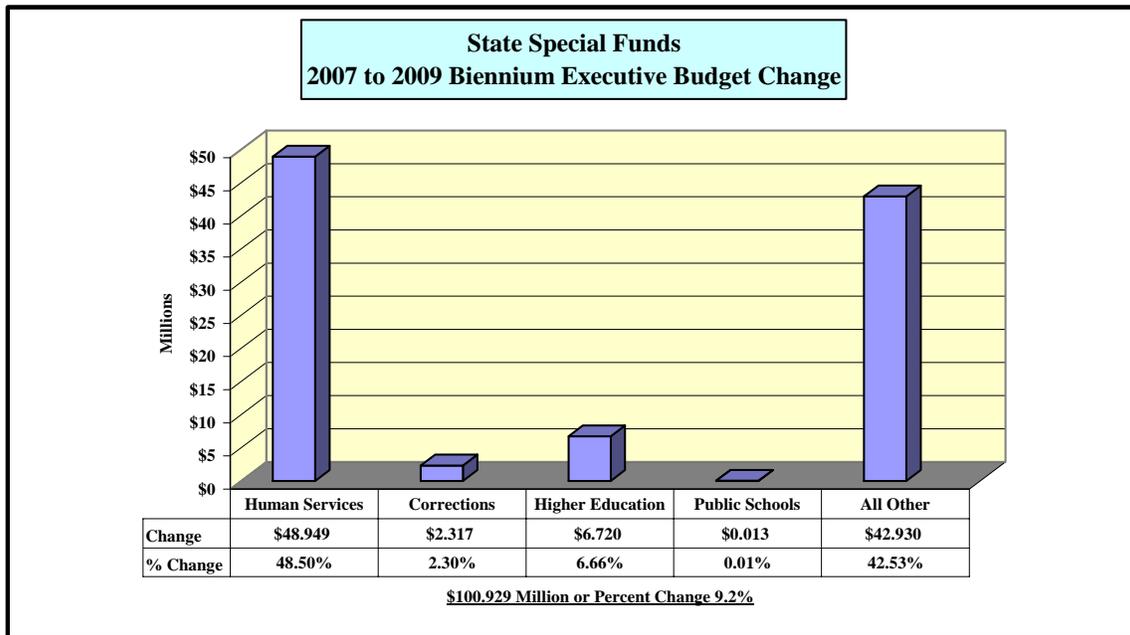


Figure 14



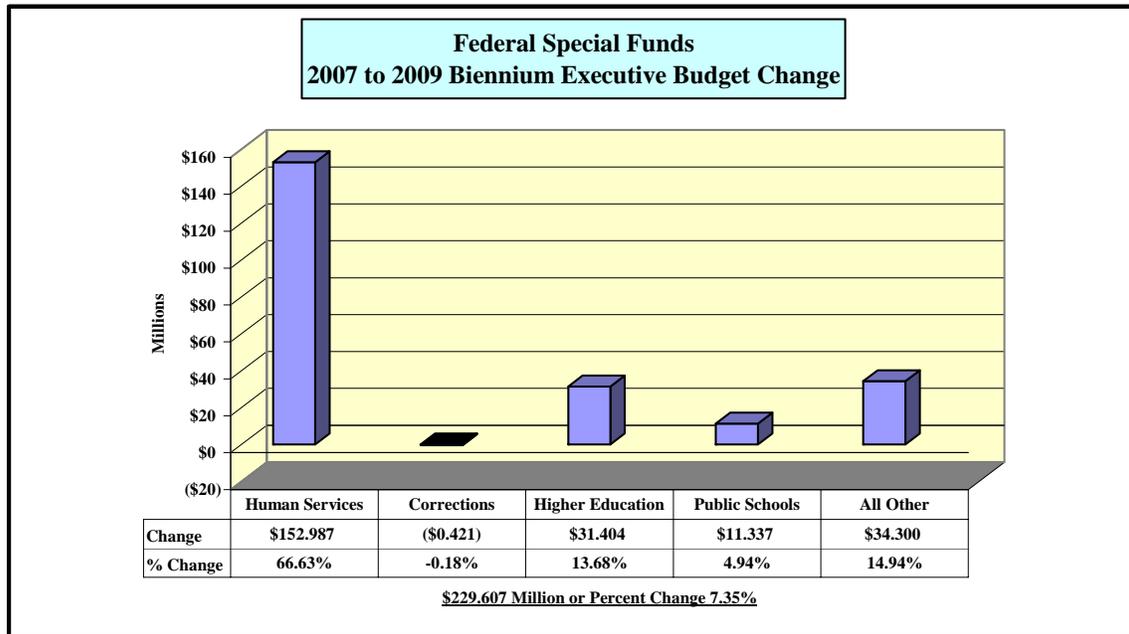
State Special Revenue

State special revenues would increase by \$100.9 million, or 9.2 percent.

While most agencies receive funding from one or more state special revenue accounts, five areas of government account for over 70 percent of the increase. Increases are offset by a reduction in the Department of Transportation, as the Governor reduces the state funded construction projects to the minimum level necessary to continue to receive the most advantageous federal matching rate.

- Public Health and Human Services - \$49.0 million. The Governor would add additional health and Medicaid initiatives fees (tobacco revenues) for a number of purposes, cigarette tax revenue for support of veteran’s homes, nursing home utilization fee revenue, and alcohol taxes for substance abuse programs.
- Justice - \$20.1 million. The increase is due primarily to increases in highway patrol salaries (the updated executive budget will appropriately fund a portion of these increases with a statutory appropriation established for that purpose) and operating expenses, as well as debt service and operating expenses in the Motor Vehicle Division.
- Fish, Wildlife, and Parks - \$15.9 million. The increase is due primarily to increases in a number of general license account related activities throughout the department.
- Natural Resources and Conservation - \$13.4 million. This increase is predominantly the addition of funding for state land management, Board of Oil and Gas activities, water rights appropriations and adjudication, and forest protection fees.
- State Auditor’s Office - \$11.2 million. The increase is due almost entirely to annualization of the Insure Montana program, which assists small businesses to provide health coverage to employees.

Figure 15



Federal Funds

Federal funds increase by 7.4 percent, or \$229.6 million. Most agencies receive some federal funds. However, the Departments of Public Health and Human Services and Transportation account for over 78 percent of the federal funds proposed in the Governor’s budget and the Department of Public Health and Human Services would receive about two-thirds of the proposed increase.

Significant changes in that agency are due to:

- o Rising caseloads and service utilization, most notably in Medicaid and food stamps, partially offset by a reduction in the percent of Medicaid expenditures the federal government will pay
- o Continued use of hospital provider tax, bed tax, and intergovernmental transfers to secure additional federal funds
- o Anticipated increases in categorical grants



EXECUTIVE STATEWIDE BUDGET PROPOSALS/ISSUES

INTRODUCTION/HIGHLIGHTS

INTRODUCTION

This section discusses several stand-alone features of the executive budget that either do not pertain to any one agency, or which impact several agencies. These items are listed below and discussed in more detail in the following pages.

HIGHLIGHTS

- **Supplemental Appropriations – Fiscal 2007.** The executive's preliminary supplemental recommendation totals \$76.4 million general fund, with requests for public defender, corrections, fires, and human services dominating the total. On December 12, the executive submitted a revised budget request that included a supplemental request for the Office of Public Instruction of \$0.2 million.
- **Executive Pay Plan Proposal.** The executive includes funding for a 3 percent per year salary increase beginning October 1 each year, and an increase in insurance contributions each year of \$33 per month for FY 2006 and \$36 per month for FY 2007. The Governor has included \$58.6 million general fund and \$42.2 million other funds for these and other one-time increases.
- **Broadband Pay Plan.** The executive budget proposes making the broadband pay plan the state's primary compensation system. There are issues that experience to date revealed for the legislature to consider as 63 percent of state positions have already converted to broadband pay systems.
- **Other Personal Services Issues**
 - *FTE.* Total FTE would increase by 454.38 in FY 2008 and 481.32 in FY 2009 over the FY 2006 level. All but eight agencies would receive additional FTE.
 - *Statewide Present Law.* Statewide present law personal services adjustments are those adjustments applied to each agency to fully fund all "authorized" positions in the next biennium (a vacancy savings rate is applied separately). As such, a number of potential adjustments might be funded.
 - *Vacancy Savings.* The executive has applied a 4 percent vacancy savings rate to all personal services budgets, including insurance contributions, with only a few exceptions.
- **Pension Funds.** The Montana Constitution provides that public retirement plan shall be actuarially sound and, as of the June 30, 2006 actuarial valuations, four retirement plans do not meet that requirement. The executive budget includes a number of action items intended to resolve the issue.
- **Fee Changes.** The Governor proposes \$8.4 million in additional fees.

- **Fund Switches.** The executive has included a number of funding switches in the executive budget, including replacement of reduced federal funds, totaling \$23.9 million.
- **One-Time Only Expenditure Proposals.** The executive proposes almost \$500 million in one-time expenditures. This is an unusually high number and reflects in large measure the significant amount of non-recurring revenues projected. Some of these proposals are likely to be on-going.
- **Executive Present Law Adjustments.** The Governor would add \$471 million in present law adjustments, which, based on the LFD analysis, is as much as \$110 million higher than the amount necessary to maintain government at the level authorized by the last legislature.
- **Executive New Initiatives (New Proposals).** The Governor proposes over \$750 million in general fund new initiatives (new proposals) in the 2009 biennium. The Governor includes a number of new initiatives in present law. Appropriate classification of the major initiatives in present law would increase this total to \$829 million.
- **Proposals with Increased Future Impact.** The executive budget includes several proposals that are phased-in in the 2009 biennium, and will consequently cost more in the 2011 biennium. The legislature will need to be aware of the future cost commitments in scrutinizing these proposals.
- **STEP Proposal.** An executive proposal for a 120 bed program for persons with a mental illness, the Secure Treatment and Examination Program (STEP), was only recently announced and not all is known about the proposal. The legislature will need to seek more details in an effort to assess this requested program.
- **Fixed Costs.** Fixed costs increase by over \$9 million in the 2009 biennium over 2007 biennium appropriations. The Governor did not include adequate justification for many of these increases.
- **Inflation/Deflation.** Inflation or deflation was applied to 26 expenditure items for the 2009 biennium. Five were deflationary and the rest were inflationary. Natural gas experienced the largest increase.
- **Long-Range Planning Proposals.** The Governor's request for Long-Range Planning includes a total of \$408.6 million for capital projects, grants, and loans. Projects in the Long-Range Building Program make up the largest portion, with \$304 million, with no projects financed by the issuance of bonds.

SUPPLEMENTAL APPROPRIATIONS

Supplemental appropriations are used to increase existing spending authority for a fiscal year. The supplemental appropriations requested by the executive are for additional funding applicable to the current year, FY 2007. The original budget for FY 2007 was approved by the 2005 Legislature. Figure 1 shows supplemental appropriations since the 1987 biennium.

Figure 2 provides detail on the executive’s original \$76.4 million in requested general fund supplemental appropriations. As shown, funds are being requested for a number of agencies and the level of supplemental appropriations requested, if approved, would be the second highest in the last 11 biennia.

Figure 1
General Fund Supplementals
1987 to 2007 Biennium

Biennium	Millions
1987	\$32.7
1989	17.1
1991	20.4
1993	82.2
1995	19.9
1997	14.2
1999	11.5
2001	68.2
2003	12.5
2005	12.7
2007 (requested)	76.4

REQUESTED SUPPLEMENTAL APPROPRIATIONS

The following briefly discusses each request. The individual supplemental requests are discussed in more detail in the individual agency narratives in the Agency Budget Analysis section of the Legislative Fiscal Division (LFD) *2009 Biennium Legislative Budget Analysis*, Volumes 3 through 7.

Corrections

The Department of Corrections seeks a \$27 million supplemental due to population increases greater than the level funded included in the 2007 biennium budget, the addition of new programs, increased per diem rates for providers, and other costs drivers. For a further discussion, see the Volume 6, of the LFD *2009 Biennium Legislative Budget Analysis*.

Department of Public Health and Human Services

The Governor recommends a total of \$11.0 million for the Department of Public Health and Human Services (DPHHS) for the following purposes:

- o Montana State Hospital additional staff due to population increases - \$3.0 million
- o Change in the percentage of Medicaid costs paid for by the federal government - \$7.0 million
- o Administrative leave costs at the Montana Development Center - \$0.7 million

The department may also be impacted by the federal Deficit Reduction Act, which made several changes to programs administered by the division. For a further discussion, see the DPHHS agency narrative in Volume 4, beginning on page B-1 of the LFD *2009 Biennium Legislative Budget Analysis*.

Figure 2
Supplemental Appropriations Requests
Executive Budget - 2007 Biennium

Agency/Program	General Fund	Other Funds
Corrections		
Various costs increases	\$27,000,000	
Public Health and Human Service		
Montana State Hospital populations/ FMAP/Admin leave	11,000,000	
Judiciary/Public Defender		
Public Defender Costs	5,800,000	
Justice		
Major Litigation/Debt Service	200,000	200,000
Public Defender Settlement	375,000	
Livestock		
Meat Inspection	97,534	
Transportation		
Motor Pool Subsidy	1,330,000	
Natural Resources and Conservation		
Fires Costs*	30,062,271	
Trust Lands	560,598	
Total	<u>\$76,425,403</u>	<u>\$200,000</u>

*\$5,062,271 will be requested in HB 10 to allow consideration for immediate action by the legislature. The balance will be requested in HB 3.

Judiciary/Office of the Public Defender

The state is responsible for the provision of legal services to indigent persons. In FY 2007 these duties were expanded to include Courts of Limited Jurisdiction, formerly funded by local governments, and transferred to a new Office of the Public Defender. Both the Judiciary in FY 2006, when it was still responsible for these costs, and the Office of the Public Defender in FY 2007 are seeking additional authority for costs in excess of the appropriation.

The Judiciary transferred \$2.5 million from FY 2007 to FY 2006 in March, 2006 for costs in excess of the appropriation and seeks replacement of these funds in FY 2007. The Judiciary may need expedited funding. For a further discussion, see the Judiciary narrative in Volume 3, page A-21 of the LFD 2009 Biennium Legislative Budget Analysis.

The Office of the Public Defender seeks \$3.3 million for both additional FY 2007 costs, and to replace funds transferred from FY 2007 to FY 2006 for additional start-up costs. For a further discussion, see the Office of the Public Defender narrative in Volume 3, beginning on page A-310 of the LFD 2009 Biennium Legislative Budget Analysis.

Department of Justice

The department is seeking additional funding in FY 2007 for three purposes:

- Additional major litigation costs of \$200,000 general fund. The department receives a biennial appropriation for costs of major litigation undertaken by the Attorney General on behalf of the state. This appropriation will be exceeded in the 2007 biennium. The Governor also proposes additional, on-going funding in HB 2 for some of these costs in the 2009 biennium.
- Legal fees of the American Civil Liberties Union (ACLU) as part of the negotiated settlement for the public defender lawsuit. Prior to the 2005 legislative session the ACLU had suspended legal action against the state for failure to provide consistent and adequate legal services to indigent persons pending action by the legislature. The legislature created the Office of the Public Defender.
- Additional state special revenue authority for debt service costs for loans taken to develop the Motor Vehicle Division's MERLIN project.

For additional information, see both the agency section and the Motor Vehicle Division narrative in the Department of Justice in Volume 6, beginning on page D-6 of the LFD 2009 Biennium Legislative Budget Analysis.

Department of Livestock

The Governor proposes general fund to pay a larger portion of the cost of meat inspectors in the Department of Livestock due to declining federal participation. The department also received additional funding in the 2005 biennium for this purpose from one-time federal funds, but the executive did not request additional general fund of the 2005 Legislature. For a further discussion, see the Department of Livestock narrative in Volume 5, page C-111 of the LFD 2009 Biennium Legislative Budget Analysis.

Department of Transportation

The executive proposes to add general fund to provide contributed capital to the state motor pool proprietary account for operating losses suffered in FY 2006 due to higher than anticipated fuel prices. The motor pool is funded through charges to agencies for long-term lease and short-term rental of state vehicles, and pays all fuel costs. The maximum rate than can be charged agencies is set by the legislature in HB 2. For a further discussion, see the Department of Transportation narrative in Volume 3, beginning on page A-127 of the LFD 2009 Biennium Legislative Budget Analysis.

Department of Natural Resources and Conservation – Trust Lands

The Department of Natural Resources and Conservation (DNRC) manages state lands and deposits revenues to several trusts. The department's practice of using trust revenues to pay for administration of certain trusts has been questioned on constitutional grounds. One of the trusts for which revenues were diverted to pay for administrative costs is the Morrill trust, the proceeds of which benefit the Montana University System. The executive proposes to repay the Morrill trust with general fund, and reimburse other trusts for the costs incurred when diversions from those trusts were increased when diversions from the Morrill trust were ceased. For a further discussion, including issues with this proposal, see the DNRC narrative in Volume 5, page C-147 of the LFD 2009 Biennium Legislative Budget Analysis.

Department of Natural Resources and Conservation - Fire Costs

Montana does not appropriate funds for future fire costs. Instead, any costs incurred by state government (the Department of Natural Resources and Conservation and the Department of Military Affairs) are paid by the agencies as they become due, and the legislature then provides a supplemental appropriation to both pay all outstanding claims and to reimburse the agency[s] for any costs already paid that are the responsibility of the state. Consequently, each legislative session the legislature is asked to provide a supplemental appropriation to pay for all state costs of fighting fires in the current biennium. Figure 3 shows fire supplemental costs since the 1983 biennium.

Figure 3
Supplemental Appropriations for Fire Suppression
1983 to 2007 Biennium

Biennium	Supplemental Appropriation	Statutory Appropriations	Total
1983	\$0.80	\$0.00	\$0.80
1985	2.90	0.00	2.90
1987	3.74	0.00	3.74
1989	12.64	0.00	12.64
1991	3.00	0.50	3.50
1993	7.94	1.96	9.90
1995	15.50	8.92	24.42
1997	4.47	3.10	7.57
1999	10.55	0.00	10.55
2001	33.22	6.20	39.42
2003	9.07	7.01	16.08
2005	0.00	0.00	0.00
2007	\$30.06	\$13.69	\$43.75

Montana had a severe fire season in FY 2006, coupled with declining federal participation and generally increasing costs of fighting individual fires. The department will seek a supplemental appropriation of \$30.1 million for the biennium. A portion of this cost will be requested in a separate bill to allow for expedited action by the legislature. For a further discussion, see the Agency Narrative section of the Department of Natural Resources and Conservation narrative in Volume 5, page C-132 of the LFD 2009 Biennium Legislative Budget Analysis.

Office of Public Instruction

On December 12, the executive indicated his intention to request an additional \$200,000 for tuition and state placement payments as a result of HB 83 from the December 2005 Special Session. Due to the lateness of its receipt, it is not included in the agency narratives in the LFD budget analysis, but will be discussed in the context of the presentation of the supplemental appropriations bill (HB 3).

EXECUTIVE PAY PLAN PROPOSAL

The executive is recommending a state employee pay plan with multiple components, including the following:

- Compensation and benefits elements of salary, insurance, and longevity
- Completion of conversion to the statewide broadband pay plan, along with funding to bring all employees to a targeted market percentage
- Contingency and minor training funding

The executive has submitted four proposed increases in compensation and benefits:

- A 3.0 percent per year salary increase beginning October 1 (for most employees) each year
- A 0.6 percent “flexibility” component
- An increase in the way longevity payments are calculated for employees with 10 continuous years of service
- An increase in per employee insurance contributions of \$33 per month beginning January 1, 2008 and an additional \$36 per month beginning January 1, 2009. The same increases are applied to the university system employees beginning July 1 of each year

The executive is also recommending that the legislature provide:

- Funding to bring agencies up to 80 percent of market for all employees as part of the conversion to the broadband pay plan (discussed below)
- A personal services contingency for distribution to agencies that cannot meet vacancy savings targets
- A small training allowance

The executive also proposes the elimination of one of the statewide (pay plan 60) and several of the smaller pay matrices that are the basis of state employee pay and make the broadband pay plan (pay plan 20) the only statewide pay matrix. The current teacher matrix and other minor matrices would also be eliminated, while the blue collar matrix and statutes governing exempt positions would be maintained.

The executive applies a 4 percent vacancy savings rate to the 3.0 and 0.6 percent funding calculations, but does not apply vacancy savings to the insurance or longevity calculations.

There are a number of issues with this proposed pay plan and how it relates to the broadband proposal. A discussion of this proposal and the related issues follow this summary discussion of elements of the proposal.

PAY PLAN COMPONENTS

The following figure details the funding in the Governor’s proposal, by receiving entity.

Figure 4
Proposed Pay Plan Appropriations - Executive Budget
2009 Biennium

Entity	--- FY 2008 ---			--- FY 2009 ---			--- 2009 Biennium ---		
	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds	General Fund	Other Funds	Total Funds
3.0 Percent/Longevity/Insurance									
Legislative Branch	\$200,389	\$44,742	\$245,131	\$462,984	\$92,250	\$555,234	\$663,373	\$136,992	\$800,365
Consumer Counsel	0	12,502	12,502	0	28,965	28,965	0	41,467	41,467
Judiciary	601,880	27,673	629,553	1,437,967	66,623	1,504,590	2,039,847	94,296	2,134,143
Executive Branch	6,295,995	9,732,127	16,028,122	14,945,346	22,195,176	37,140,522	21,241,341	31,927,303	53,168,644
University System	<u>6,721,057</u>	<u>128,372</u>	<u>6,849,429</u>	<u>15,194,084</u>	<u>279,930</u>	<u>15,474,014</u>	<u>21,915,141</u>	<u>408,302</u>	<u>22,323,443</u>
Subtotal	\$13,819,321	\$9,945,416	\$23,764,737	\$32,040,381	\$22,662,944	\$54,703,325	\$45,859,702	\$32,608,360	\$78,468,062
0.6 Percent									
Legislative Branch	\$30,883	\$6,315	\$37,198	\$74,329	\$13,973	\$88,302	\$105,212	\$20,288	\$125,500
Consumer Counsel	0	2,030	2,030	0	4,817	4,817	0	6,847	6,847
Judiciary	97,429	4,539	101,968	231,499	10,767	242,266	328,928	15,306	344,234
Executive Branch	935,251	1,393,501	2,328,752	2,237,827	3,297,003	5,534,830	3,173,078	4,690,504	7,863,582
University System	<u>944,684</u>	<u>15,629</u>	<u>960,313</u>	<u>2,210,575</u>	<u>37,157</u>	<u>2,247,732</u>	<u>3,155,259</u>	<u>52,786</u>	<u>3,208,045</u>
Subtotal	\$2,008,247	\$1,422,014	\$3,430,261	\$4,754,230	\$3,363,717	\$8,117,947	\$6,762,477	\$4,785,731	\$11,548,208
80% of Market Adjustment									
Judiciary	\$148,750	\$33,690	182,440	\$198,333	\$44,919	\$243,252	\$347,083	\$78,609	\$425,692
Executive Branch	<u>\$1,097,186</u>	<u>\$730,365</u>	<u>1,827,551</u>	<u>\$1,462,913</u>	<u>\$973,820</u>	2,436,733	2,560,099	1,704,185	4,264,284
Subtotal	\$1,245,936	\$764,055	\$2,009,991	\$1,661,246	\$1,018,739	\$2,679,985	\$2,907,182	\$1,782,794	\$4,689,976
Training Allowance*	75,000		75,000	0	0	0	75,000	0	75,000
Personal Services Contingency*	<u>3,000,000</u>	<u>3,000,000</u>	<u>6,000,000</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>3,000,000</u>	<u>3,000,000</u>	<u>6,000,000</u>
Total Proposed Funding	<u>\$20,148,504</u>	<u>\$15,131,485</u>	<u>\$35,279,989</u>	<u>\$38,455,857</u>	<u>\$27,045,400</u>	<u>\$65,501,257</u>	<u>\$58,604,361</u>	<u>\$42,176,885</u>	<u>\$100,781,246</u>

*Biennial appropriation.

LFD COMMENT In the 2007 biennium, funding for the university system pay plan was about 39 percent general fund, and about 80 percent of operations funded in HB 2. The Governor proposes to increase this percentage to about 84 percent for both the pay plan and in HB 2.

Salary Increase

The executive proposes to increase state employee salaries by 3 percent each year of the biennium, beginning on October 1. According to the Personnel Division of the Department of Administration, this increase is an attempt to get all salaries closer to market.

Flexibility Component

The Governor proposes to add the equivalent of 0.6 percent to allow agencies with established policies to provide salary adjustments for such things as progression, competencies, and performance. According to the Personnel Division, employees in agencies without demonstrated policies for these adjustments would likely receive a total 3.6 percent increase.

Longevity Calculation

Longevity is an increase given to state employees after a set number of years of uninterrupted service. Currently, an employee receives an increase of 1.5 percent of base salary for each 5 years of service. Employees who have completed either 15 or 20 years of uninterrupted service receive an additional 0.5 percent increase (total 2.0 percent) for each of those 5 year increments. The Governor proposes to reduce the uninterrupted years of service required before the additional 0.5 percent increase kicks in to 10 years from the current 15. According to the Personnel Division, this adjustment was made to improve retention of new employees, the average age of which is 41.

Insurance Increase

The employer contribution to the health insurance costs of employees would be increased an additional \$33 to \$590 per month beginning January 1, 2008, and by another \$36 to \$626 per month beginning January 1, 2009 for most state employees. University system increases are effective July 1 of each year.

Future Costs

Because the pay and insurance increases would be phased in over the biennium, costs in the next biennium for this pay plan would be significantly higher – about \$83.5 million general fund and \$63.5 million other funds (excluding positions for which the legislature does not appropriate funds).

OTHER COST COMPONENTS

The Governor provides funding for three other purposes: 1) a personal services contingency; 2) training; and 3) aid in transitioning to the broadband pay plan.

Personal Services Contingency

The executive is proposing a contingency pool of \$3.0 million general fund and \$3.0 million other funds, a doubling of the general fund contingency provided in the 2007 biennium. The funds would be allocated by the Office of Budget and Program Planning to agencies when sufficient personnel vacancies do not occur, retirement costs exceed agency resources, or other contingencies arise.

A total of \$191,989 general fund and \$1,059,252 other funds had been spent from the 2007 biennium contingency as of the writing of this report. The largest recipient was the Department of Labor and Industry. The largest recipient of general fund was the Montana Historical Society.

Training

As in the 2007 biennium, the Governor includes \$75,000 general fund to continue an initiative from the 2007 biennium to encourage a positive relationship between the Office of Labor Relations and labor.

Aid in Transition to Broadband Pay Plan

The executive also proposes \$2.9 million general fund and \$1.8 million other funds over the biennium to assist agencies to achieve at least 80 percent of market salaries for all of their employees as part of the conversion to the broadband pay plan (pay plan 20). This proposal is discussed in the overall context of the broadband pay plan that follows.

OTHER ISSUES

Military Deployments

Numerous Montana state employees who are also members of the national guard or other reserve units, have been called to duty for periods often times in excess of one year and for as long as two or more years. From a state fiscal perspective, there are potential impacts that need to be kept in mind relative to the budget. While there might be an expectation of increased vacancy savings for individual agencies, this is not necessarily the case, as agencies tend to fill these positions with temporary replacements. Many positions fall into the category of being “24/7” coverage positions, and agencies cannot afford to leave them vacant. Therefore, a decrease in costs resulting from the deployments is not necessarily a reliable expectation.

On the other hand, when a deployed soldier returns, he or she has certain rights that might increase costs for state agencies. Under the Uniformed Services Employment and Reemployment Rights Act (USERRA), for example, a returning soldier can purchase the service time that he or she would have earned if working. If that employee pays the cost of his or her share of the retirement costs, then the state as employer must pay its cost. There is no way to anticipate how many returning soldiers will do this, but the potential is there.

Costs can vary in other ways also. Temporary replacements would typically be hired at entry rates, so costs might be lower. On the other hand, if a replacement is not found, overtime costs might come into play, resulting in higher costs.

BROADBAND PAY PLAN

The 2009 biennium pay plan proposed by the executive includes a request to make the broadband pay plan the state's primary compensation system and eliminate the statewide pay plan 60 matrix. The Governor has already required that all executive employees move to the broadband pay plan by July 1, 2007. Conversion over the years has been neither cheap nor easy. Most of these transition decisions and initial expenditures to adjust salaries have been made without legislative oversight and review. While a thorough study of the implementation issues requires substantially more analysis, there are a number of issues with the implementation of the broadband pay plan and this request presented in the context of the Governor's pay plan proposal. Four are discussed in the narrative that follows:

- The degree of legislative involvement in the primary determinates of salary changes for most state employees is reduced.
- Inconsistency in implementation, coupled with continued inconsistency in application, promotes inequity and creates artificial competition and further upward pressure on salaries.
- While the 2009 biennium pay plan proposed by the Governor eliminates any statewide alternative to the broadband pay system and provides funds to get all remaining employees to at least 80 percent of market for their positions, with a small exception the salary adjustments as requested do not incorporate the basic tenets of a broadband pay system or specifically address the critical personnel issues facing the state, exacerbating the first issue above.
- There are no performance criteria for gauging the success of implementation of a broadband pay plan.

BROADBAND PAY PLAN – HISTORY AND EXPLANATION

The state is facing major challenges in the area of human resources in the short and long-term. The state government workforce is aging, and a significant percentage of state employees, representing many years of experience, are nearing retirement age. At the same time, the number of workers to take their place is not keeping pace. The state faces the real possibility not only of a great loss of expertise, but of having to replace those experienced workers with less experienced personnel at salary levels that reflect high demand.

In part as a means of addressing this reality, the state has embarked upon a means of classifying and paying personnel called a broadband pay plan, which is part of a larger human resource classification and pay initiative called the Montana Human Resources Competency Project. The Governor has ordered all executive branch agencies to convert to the broadband pay plan for all relevant positions by July 1, 2007.⁴

The state currently has two major statewide pay matrices that provide the framework for determination of the rate of pay for the great majority of employees of the executive branch: 1) pay plan 60; and 2) pay plan 20, the broadband pay matrix. In both instances, an employee's pay is based upon the classification of the position they hold into a grade in the matrix, and entry and market salaries for that grade. The legislative and judicial branches have their own broadband-based pay plans.

⁴ Certain exceptions exist, such as blue collar workers, who are on their own pay system.

Pay plan 60, which is the primary pay plan used for decades by the state, is a classification based system with narrow grades and pay bands. The pay plan was initially established in part to address discrepancies among agencies in pay for the same skill levels. While exceptions existed and could be (and frequently were) granted, generally the employee’s pay was based on pay increases granted by the legislature and his or her longevity, which may or may not have been related to market salaries. The primary option for major change in salary was either a reclassification of the job the employee was currently doing, or promotion into another job and grade.

A broadband pay plan is a market based plan that allows greater pay flexibility to adjust pay levels based on job content, competency, market salary data, and situational pay, with less emphasis on position classification. Rather than 25 narrow bands, the broadband pay plan has 9 bands, each with a maximum and minimum salary range. One of the primary reasons for moving to a broadband pay schedule is to address recruitment and retention issues through greater flexibility in pay and changes in pay over time. Therefore, individuals or groups of employees may be moved closer to market salary, and individual employees can be rewarded for excellence. Managers can adjust salaries for five purposes: 1) market; 2) competency; 3) performance; 4) results; and 5) strategic.

Information compiled by the Personnel Division indicates that salaries of state employees on pay plan 20 are significantly closer to market for certain classifications than under pay plan 60. While not inherent or unavoidable, the adoption of a broadband pay plan for state employees has generally increased salaries and related costs.

Conversion

Agencies have been converting to the broadband pay system since FY 2000. The figure that follows shows the number of executive branch agencies in each of the pay matrices as of December, 2006. This information was compiled by the Personnel Division of the Department of Administration.

Generally, conversion entails three factors for all agencies: 1) classification of positions and placement into appropriate pay bands, which are bounded by minimum and maximum salary levels; 2) determination of market for each classified occupation; and 3) articulation of a philosophy of what percentage of market the positions should be (target market percentage) at various experience levels. The Personnel Division is responsible for two of these critical tasks: 1) providing consistent classification of positions; and 2) determining or approving the department determined market rates that determine salaries. A further discussion is in the “Issues” section below.

Figure 5
Allocation of State Employees by Pay Plan
December-06
Regular Employees

Pay Plan	Positions	Percent
Broadband (20)	7,745	63.0%
Statewide (60)	2,680	21.8%
Exempt	375	3.0%
Blue Collar	645	5.2%
Teachers	31	0.3%
Medical Professionals	22	0.2%
IT and Engineering	87	0.7%
State Fund	263	2.1%
Judicial	335	2.7%
Legislative	113	0.9%
Total	<u>12,296</u>	

Source: Personnel Division, Dept of Admin

ISSUES

As stated earlier, there are four main issues addressed:

- o The degree of legislative involvement in the primary determinates of salary changes for most state employees is reduced
- o Inconsistency in implementation, coupled with continued inconsistency in application, promotes inequity and creates artificial competition and further upward pressure on salaries

- While the 2009 biennium pay plan proposed by the Governor eliminates any statewide alternative to the broadband pay system and provides funds to get all remaining employees to at least 80 percent of market for their positions, with a small exception the salary adjustments as requested do not incorporate the basic tenets of a broadband pay system or specifically address the critical personnel issues facing the state, exacerbating the first issue above
- There are no performance criteria for gauging the success of implementation of a broadband pay plan

Degree of Legislative Involvement

As stated, implementation of broadbanding has generally increased salaries and related costs, primarily through attempts to get salaries closer to a target market percentage. These adjustments have generally taken place without legislative review and outside of or as an adjunct to the legislatively funded pay increases. While it is still and will likely continue to be the primary determinate of the salary changes for most state employees, the adoption of the broadband pay plan over the last several years has meant that the legislative pay increases (generally funded in HB 13) have become and are likely to continue to be a smaller part of the determination of how much a state employee is paid, particularly in hard-to-fill or retain positions.

While it exists in all pay plans, pay increases outside the legislatively approved pay plan increases are intermixed within statewide adjustments of agency budget requests and become an on-going portion of agency personal services funding. The broadband pay plan provides more opportunity for agencies to increase personal services costs through budget adjustments that are not transparent to the legislature.

Using system data, the LFD estimates that impacts on the 2009 biennium budget of increases provided to employees outside of the legislatively funded pay plan for changes made in FY 2006 alone are between \$12 and \$13 million, of which about \$5 million is general fund. If compounded by the salary increases funded by the last legislature, the total would be about \$14 million. These figures do not include the on-going impacts of any salary changes made prior to FY 2006. (Please note that some of these adjustments will also be due to re-classification of positions and changes in grade.)

The structure of the Governor's pay plan proposal exacerbates this situation, as discussed within the content of the next two issues.

Inconsistency of Implementation and Application

As stated, a broadband pay system gives great flexibility to managers to make salary adjustments within a broad range for any of five different purposes. This flexibility raises opportunities for inconsistencies between and even within agencies. Setting a floor level of percent of market and requiring movement to a higher percentage, as the Governor is doing with the initial requirement that salaries be 80 percent of market with movement to 85 percent, is in many ways an attempt to achieve greater equity among agencies on salaries paid while addressing overall issues of recruitment and retention.

There are three basic issues with the conversion that result in inconsistencies and potential inequities: 1) the range of opportunities to agencies for making adjustments and the lack of overall policy direction and consistency on agency capability; 2) use of different target market percentages by different agencies; and 3) differing abilities to pay among agencies. Among other impacts, these factors place artificial upward pressures on salaries due to inequities within and between agencies.

Range of Opportunities for Application and Agency Capability Differences

As stated, agencies can make five different adjustments to salaries within the broad pay ranges: 1) market; 2) competency; 3) performance; 4) results; and 5) strategic. Most adjustments have been made to get salaries closer to market, and the Personnel Division is responsible for consistent determination of both classification and appropriate market. However, the other potential adjustments require policies and training that have not been required or provided to all agencies, and require significant changes in the way agencies and managers do things. Therefore, personnel in some agencies are more likely to have an opportunity to receive pay adjustments for those other purposes, and to have them consistently applied.

Different Target Market Percentages

The Governor includes funds in the 2009 pay plan proposal to assist all agencies in getting all positions to 80 percent of the market for that classification. Having a standard market percent encourages consistency. However, agencies have been allowed to set their own targets, including starting salaries and progression to market with experience gained, in excess of this level. Two agencies are highlighted for example:

- Department of Labor and Industry – The department has a goal of 80 percent of market for all entry positions, and that employees will progress to 95 percent of market over the subsequent 5 years of employment. As pointed out in the narrative in Volume 6 of the LFD *2009 Biennium Legislative Budget Analysis*, the department is undertaking its conversion effort while experiencing a reduction in some federal funds, and is funding it in part through increased general fund and taxes on employers.
- Department of Transportation – The department has established a policy of bringing employees in at 100 percent of market with no market progression. Because this department spends no general fund for personal services, the availability of funding has always been perceived to be greater than other agencies. However, the primary state special revenue source (highways state special revenue account) is in a very tenuous position and the federal fund from which Montana gets the majority of its funding is nearing depletion.

The agency with a philosophy or ability to hire at 85 percent of market cannot equally compete against the agency that has the ability, both financially and in policy, to offer 95 or 100 percent of market. Therefore, inter-agency discrepancies (within state control), as well as the general market (outside state control), put upward pressure on salaries.

Agencies have long competed against one another for employee skills. As overall availability is constrained, this competition heats up and becomes more widespread. Because state employees maintain vacation, sick leave, and pensions as long as they remain in state government, they can switch jobs amongst agencies without fear of losing vested benefits, further increasing the competition for resources and favoring those agencies that can offer higher compensation.

As more and more state employees retire and as overall competition for jobs increases, particularly in the western part of the state, the competition for positions intensifies and exacerbates this artificial competition.

Differing Abilities to Pay

As alluded to above, the ability of agencies to set different target market percentages is linked in many ways to the agency’s ability to fund those targets. The ability to pay can be linked to a couple of primary issues: 1) consistency of funding sources; and 2) the degree of vacancy savings and other factors that free up funding.

Status of Agencies to Market

The following shows how close agencies are to paying employees at market. As shown, there are significant differences among agencies. This information was provided by the Personnel Division of the Department of Administration.

Pay Plan Doesn’t Address Basic Tenets of Broadband or Critical Issues

The Governor is proposing that employees receive a standard 3 percent pay increase regardless of skills or skill levels, with a 0.6 percent flexibility adjustment. While this ensures that all employees will at least receive a cost of living increase and moves all employees generally closer to market, in some cases over market, it does not utilize the primary advantage of a broadband pay plan – to provide flexibility to adjust pay based upon multiple factors, including those deemed necessary to address recruitment and retention issues in general and for those positions for which competition is highest, and to recognize excellence.

Because this flexibility is not part of the pay plan, agencies will continue to make these adjustments as they can, outside of the legislatively reviewed pay plan and funding and as funds are available. This also makes the legislative pay plan less of a factor in changes in personal services costs of state government.

Performance Criteria

The LFD 2007 Biennium Legislative Budget Analysis included the following statement:

“The legislature may wish to examine broadbanding more thoroughly during the interim to address these and other questions:

- How is broadbanding impacting the state’s ability to recruit and retain employees
- How does the administration plan to address the actual and potential fairness issues among agencies of state government as broadbanding becomes the norm--Can broadbanding be made more equitable among agencies both as a general employee fairness issue, and to reduce other issues of recruitment and retention between and among agencies
- How can the pay plan addressed by each legislative session more effectively take into account broadbanding and its effect on pay levels
- What impact is broadbanding having on the state personal services budget”

Agency	Average Base as % of Market
Governor's Office	95%
Secretary of State	100%
Commissioner of Political Practices	72%
Office of Public Instruction	92%
Justice	93%
Board of Crime Control	91%
Board of Public Education	103%
School for the Deaf and Blind	92%
Montana Arts Council	114%
State Library	100%
Fish, Wildlife, and Parks	94%
Environmental Quality	96%
Transportation	106%
Livestock	86%
Natural Resources and Conservation	101%
Revenue	94%
Administration	95%
Office of the Public Defender	87%
Corrections	100%
Commerce	98%
Labor and Industry	98%
Military Affairs	101%
Public Health and Human Services	95%
Average All	98%

According to a report published November 2006 by the Legislative Audit Division (LAD), since that time the Department of Administration has not defined any performance criteria or gathered any information that could be used to determine the effectiveness of the plan. According to LAD:

“...there is no information available indicating whether the alternative pay plan is achieving desired outcomes. Resources and information on pay systems indicate effective implementation includes an on-going review of the system.”

Gauging Performance

In order to effectively gauge whether the desired outcomes are appropriately defined and are being met, a number of steps must be taken:

- Goals of the project must be defined and agreed upon, including such elements as improvement in employee recruitment and retention and inter- and intra-agency equity
- Performance criteria for identifying the desired outcomes that would indicate progress towards goals must be determined; the criteria should meet the SMART criteria, in that they are **s**pecific, **m**easurable, **a**ttainable, **r**ealistic, and **t**ime-bound
- Milestones should be established that allow for tracking of progress

OPTIONS

The legislature may wish to make several requirements as a condition of any pay plan bill. None of the options are mutually exclusive.

Option 1 - Require that goals, performance criteria that meet SMART criteria, and milestones to monitor and ensure successful outcomes be defined and measured for presentation to the next legislature, and that the Department of Administration begin to collect the data necessary for this definition and measurement. The legislature may also wish to designate the appropriate interim committee to aid in defining the performance criteria and to track milestones throughout the 2009 interim and beyond.

Option 2 – Require the Department of Administration to explore options for requiring agencies to adopt consistent target market ratios across all agencies.

Option 3 – Change statute to require that any future pay plan proposal incorporate funding proposals that recognize the managerial flexibility and lack of consistent availability of other funds to agencies.

Option 4 – Require that the Department of Administration ensure appropriate on-going training to all state agencies on the elements necessary for consistent application of other pay adjustments available to managers, including performance, competency, results, and strategic pay adjustments.

Option 5 – In order to promote consistent information, require that the Personnel Division provide guidelines on characterization of pay increases on the state accounting system.

Option 6 – Investigate alternatives and provide recommendations for adopting the methodology for determining and presenting personal services funding to the legislature that recognizes the complexities of the broadband pay plan.

OTHER PERSONAL SERVICES ISSUES

Personal services represents the costs of salaries and benefits for state employees, and comprises about 40 percent of total state agency operating costs (excluding grants and benefits, capital outlay, and transfers). The following discussion addresses two major components of personal services: total FTE and vacancy savings.

FTE

The proposed executive budget will have a significant impact on the number of state government FTE (full-time equivalent employees). As shown in Figure 7 total FTE would increase over the FY 2006 level by 454.38 in FY 2008 and 481.32 in FY 2009.

Figure 7 Total Proposed FTE Levels 2009 Biennium Executive Budget						
Section/Agency	Base FY 2006	Net Change FY 2008	Total FY 2008	Net Change FY 2009	Total FY 2009	Change FY 2006-FY2009
Section A*						
Legislative Branch**	124.97	3.00	127.97	8.17	133.14	6.5%
Consumer Counsel	5.54	0.00	5.54	0.00	5.54	0.0%
Judiciary	392.13	5.45	397.58	5.45	397.58	1.4%
Governor's Office	59.07	3.30	62.37	3.30	62.37	5.6%
Commissioner of Political Practices	5.00	0.00	5.00	0.00	5.00	0.0%
State Auditor	76.50	1.00	77.50	1.00	77.50	1.3%
Transportation	2,238.56	-52.22	2,186.34	-102.60	2,135.96	-4.6%
Revenue	611.03	88.00	699.03	102.50	713.53	16.8%
Administration	149.72	11.90	161.62	12.90	162.62	8.6%
Consensus Council	2.50	0.00	2.50	0.00	2.50	0.0%
Office of the Public Defender	90.25	102.25	192.50	102.25	192.50	113.3%
Section B						
Public Health and Human Services	2,780.42	94.90	2,875.32	141.59	2,922.01	5.1%
Section C						
Fish, Wildlife, and Parks	659.85	19.75	679.60	20.75	680.60	3.1%
Environmental Quality	362.79	19.50	382.29	19.50	382.29	5.4%
Livestock	135.99	2.00	137.99	2.00	137.99	1.5%
Natural Resources and Conservation	531.37	13.00	544.37	13.00	544.37	2.4%
Agriculture	112.54	5.00	117.54	6.00	118.54	5.3%
Commerce*	42.66	9.50	52.16	10.00	52.66	23.4%
Section D						
Public Service Commission	39.00	0.00	39.00	0.00	39.00	0.0%
Board of Crime Control	20.00	0.00	20.00	0.00	20.00	0.0%
Justice	723.30	26.50	749.80	26.50	749.80	3.7%
Corrections	1,169.64	55.00	1,224.64	63.00	1,232.64	5.4%
Labor and Industry	726.58	3.50	730.08	3.50	730.08	0.5%
Military Affairs	172.90	9.25	182.15	9.25	182.15	5.3%
Section E						
Office of Public Instruction	135.23	22.13	157.36	22.13	157.36	16.4%
Board of Public Education	4.00	0.00	4.00	0.00	4.00	0.0%
School for the Deaf and Blind	84.03	4.58	88.61	4.58	88.61	5.5%
Commissioner of Higher Education***	100.06	4.54	104.60	4.00	104.06	4.0%
Arts Council	7.00	0.00	7.00	0.00	7.00	0.0%
State Library	29.50	1.00	30.50	1.00	30.50	3.4%
Historical Society	<u>59.59</u>	<u>1.55</u>	<u>61.14</u>	<u>1.55</u>	<u>61.14</u>	2.6%
Totals	11,651.72	454.38	12,106.10	481.32	12,133.04	4.1%

*The Office of the Secretary of State and a significant number of Department of Administration and Department of Commerce staff are funded with proprietary funds not included in HB 2.
 **FY 2009 includes session staff.
 ***Includes only staff within the Office of the Commissioner of Higher Education.

The reduction in the Department of Transportation is due to a change in assumed construction activities, and is primarily an accounting change. The increase in the Office of the Public Defender is due to the conversion of contracted public defender counsel to state employees under the newly created centralized public defender system. For a further discussion, see the Office of the Public Defender beginning on page A-310 of Volume 3 of the LFD *2009 Biennium Legislative Budget Analysis*.

When these two agencies are factored out, FTE would increase by 404.35 in FY 2008 and 481.67 in FY 2009, or 5.2 percent over the FY 2006 totals. Of these totals, all but 25.50 FTE in FY 2008 and 22.50 FTE in FY 2009 would be on-going positions. Noteworthy in addition to the size of the increase is its widespread nature. Of the 29 remaining agencies, only 7 would not gain FTE under the Governor's budget. The Departments of Commerce and Revenue and the Office of Public Instruction show the largest percentage increases.

Major Increases

The following summarizes some of the major increases in FTE recommended by the Governor. For a further discussion, see the individual agency narratives in Volumes 3 through 7 of the budget analysis.

- Largest net increase in FTE
 - Department of Public Health and Human Services – The increase is due primarily to three factors: 1) the maintenance of staff added during the interim due to population issues at Montana State Hospital; 2) the creation of a new secure forensic facility at Montana State Hospital (STEP Program); and 3) provision of additional field case workers (social workers)
 - Department of Revenue – The Governor proposes to add 30.00 FTE for increased audits and legal compliance, 32.00 FTE for reappraisal and parcel count in the property tax arena, and additional staff to address workload issues and provide tax gap analysis and free electronic filing
 - Department of Corrections – The Governor would add 36 additional probation and parole officers in FY 2009, add IT staff and school to work functions at the juvenile facilities, and take over inmate transportation from a contracted firm
- Largest percentage increase in FTE
 - Department of Commerce – The Governor would primarily expand several economic development programs begun or maintained by the 2005 Legislature
 - Office of Public Instruction – FTE would be added for curriculum specialists and continuance of data management, and due to increased federal grants

NON-PAY PLAN ADJUSTMENTS TO COMPENSATION/LEGISLATIVE OPTIONS

For most state employees, the state pay plan provided by the legislature is the major driver of pay changes. However, other measures authorized by the legislature, in part to address changing recruitment and retention issues, as well as flexibility needs of state managers, have meant that the legislative pay plan has been only a part, and potentially a smaller part, of the factors that impact pay for many state employees.

Over the last several biennia the legislature has given the executive authority to make various personal services adjustments. The legislature has long allowed:

- Upgrades and downgrades of positions based upon changes in or reexamination of job duties or descriptions, etc.

- Promotions
- Some flexibility to the Department of Administration (DOA) to manage the provided pay plan for merit, internal equity, and competitiveness factors
- Options for addressing significant issues with specific classes of employees, specifically:
 - Development of programs that allow the DOA to “mitigate problems associated with difficult recruitment, retention, transfer, or other exceptional circumstances”
 - Criteria for adjustment of pay where “substantial problems exist with recruitment and retention because of inadequate salaries when compared to competing employers”
- The DOA to delegate authority for implementation of various personnel policies to agencies that have demonstrated appropriate ability to perform this task

In recent biennia the legislature has also given statutory authorization to make other changes:

- Development of an alternate pay and classification plan based on demonstrated competencies and accomplishments, on the labor market, and on other situations defined by the DOA
- A temporary provision, no longer in statute, to develop special compensation packages for professions deemed hard to recruit and retain, as determined by the DOA (e.g. engineers)

Alternate Pay Plan

The 1999 Legislature provided authority for the DOA to begin demonstration projects for an alternate pay and classification system. Since then, a number of agencies have converted to the broadband pay plan, so called as the pay bands are broadened to, among other things, allow for greater flexibility of salaries, primarily for market adjustments and to reward performance. All executive agencies are adopting the uniform broadband pay system. While pay increases are not inevitable or inherent in the adoption of a broadband pay system, increased costs have often accompanied implementation, and it has the potential to increase the volatility of salaries within and among programs and agencies. For a further discussion of the broadband pay plan initiative, see the “Executive Pay Plan” narrative beginning on page 124 of this volume.

STATEWIDE PERSONAL SERVICES ADJUSTMENTS

When determining the on-going costs of state government, the development of the personal services budgets for state agencies includes funding for all legitimate changes in employee compensation, including both the legislatively authorized pay plan and other authorized adjustments. These changes are shown in an adjustment called the “statewide personal services present law adjustments”, and are those adjustments applied to each agency to fully fund all “authorized”⁵ positions in the next biennium (a vacancy savings rate is applied separately). As such, a number of potential adjustments are funded, such as:

1. Assumption that the position will be filled for the entire year (vacancy savings is taken out in a separate calculation), regardless of whether the position has been vacant for any portion of the year;
2. Annualization of any pay plan approved by the last legislature – because the base year includes only a portion of only the first year of any biennial pay plan, the base year contains only a portion of the total costs for full implementation;

⁵ The legislature does not approve FTE. Rather, it appropriates funding for personal services based upon a certain level and mix of FTE. This level of FTE is then used to determine the next biennium budget request, as is what is meant by “authorized” positions as used above.

3. Funding for all classification upgrades or downgrades – if an individual or class of positions has been upgraded or downgraded, the adjusted salary is included in the statewide adjustments; and
4. Merit or other increases outside of the legislative pay plan, including implementation of the alternate pay plan (broadband – pay plan 20).

Therefore, there can be a significant difference between actual expenditures for personal services in the base and the adjusted base after making the statewide personal services adjustment. These adjustments are presented, and the legislature is asked to approve these adjustments, in total.⁶

Statewide personal services present law adjustments are significantly higher in the Governor's 2009 biennium budget than in the last several biennia for two primary reasons:

1. The 2007 biennium pay plan included the largest combination of salary and insurance adjustments provided in several biennia, and was phased in over the biennium, meaning that the base year includes only a fraction of the full two year cost; and
2. Agencies have embarked on conversion to a broadband pay plan. While conversion does not make increases in compensation inevitable, this has been the result of this conversion in most instances.

The broadband pay plan is discussed in more detail in the "Executive Pay Plan Proposal" narrative beginning on page 128 of this volume.

Information in the LFD Budget Analysis

While in past analyses the LFD analyst has highlighted comments to aid the legislature in understanding the dynamics underlying the changes in the statewide personal services present law adjustment, the agency analyses in Volumes 3 through 7 contain additional information for the 2009 biennium executive budget.

For those statewide personal services present law adjustments considered significant in percentage increase (or decrease), the LFD analyst has examined the following factors:

1. How much of the increase is due to annualization of the 2007 biennium pay plan authorized by the 2005 Legislature?
2. Are there long-term and/or significant vacancies?
3. How much of the increase is due to other factors (merit, upgrades, adoption of broadbanding, etc.)

Any relevant comments then follow the present law adjustments table.

Options

The legislature has limited but real options for addressing changes in the cost of personal services contained in the statewide adjustments. Among the underlying realities are the following. The legislature:

1. Has appropriations power, and can provide any level of funding it determines appropriate;

⁶ The Legislative Finance Committee is charged in statute with making recommendations to the House Appropriations Committee (HAC) and the Senate Finance and Claims Committee (SF&C). As in the past, the committee recommends that HAC and SF&C fund statewide present law adjustment, in order to maintain consistency between and within subcommittees and agencies. This recommendation does not preclude subcommittees from further examination and action on the adjustments.

2. Does not approve or appropriate FTE, although it uses “assumed” FTE as the basis for the personal services appropriation, and the FTE used to calculate the personal services appropriation in one biennium is used as the basis for the next present law budget;
3. Cannot dictate whether or not certain positions can be hired and/or filled, except in certain limited exceptions;⁷
4. Provided a pay plan that qualified persons are legally entitled to receive and that cannot now be rescinded;
5. Has provided the legal sanction for the executive and other staff to make certain compensation adjustments, as well as to the Department of Administration to determine the mechanisms by which upgrades and downgrades are determined; and
6. Has given legal sanction for the Governor to pursue movement to broadbanding, which provides greater flexibility for movement of an employee within a pay band to a higher salary and to agencies to provide increases for factors such as merit.

The following discusses the types of options available to the legislature.

What the Legislature Can Do

1. Reduce the appropriation by an amount equivalent to any specified amount, i.e.:
 - o Any merit or other increases outside of the pay plan
 - o Any specific positions
 - o Any other compensation adjustments (broadband, etc.)

This option essentially requires the agencies to fund any of these factors within existing appropriations. While the legislature can set the appropriation for personal services at any level it wishes, the agency still has an obligation to pay affected employee(s) at the level authorized, and may still opt to continue any positions for which funding has not been provided. Since funds can be moved from other programs or areas of the budget to continue to fund personal services in any affected programs, the agency may make allocation decisions that do not reflect legislative priorities.
2. Remove FTE from the totals that will be used to determine the present law base in the next biennium, along with the funding. The agency could still hire FTE through modified positions, but would have to determine where the funding was coming from, and neither the positions nor the funding would be included in the next base budget. The same caveat as discussed above would apply.
3. Condition appropriations in HB 2, or provide expectations or other expressions of intent through other legislation that would dictate the expectations of program performance, and thereby influence the assignment of FTE.
4. Change personal services statutes, including authorizations for adjustments to salaries and/or development or implementation of pay plans.

What the Legislature Can't Do

1. Adjust salaries of individuals or groups of employees;
2. State that any increases provided to annualize the existing pay plan or any other pay adjustments allowed under statute must be rescinded;
3. Down or upgrade positions;

⁷ Exceptions are for any positions statute requires exist and be filled, such as the Code Commissioner.

4. Make or rescind any grade, pay plan (i.e. broadband), or other compensation decisions lawfully made under current statutes; and
5. Require the elimination of any particular positions (see above for legislative options).

As stated, the LFD budget analysis for each agency within Volumes 3 through 7 include information that the legislature can use to examine when determining personal services appropriations within each of the agencies.

VACANCY SAVINGS

Vacancy Savings is the difference between the cost of fully funding a position for the entire year and the actual cost of authorized employee positions during that period. A vacancy savings reduction, usually a percentage reduction from full funding, has been applied to budgets in prior years in recognition of the fact that staff turnover and vacancies often result in personal services expenditures that are lower than appropriated. This section outlines the executive's proposal for vacancy savings.

Executive Budget Proposed Vacancy Savings

The executive budget has applied a 4 percent vacancy savings rate to all personal services including insurance contributions. The rate is applied to all positions in state government with the following exceptions:

- o Agencies with fewer than 20 FTE
- o Highway Patrol
- o University system faculty
- o Elected officials
- o The legislative branch
- o The judicial branch

The executive has applied vacancy savings to on-going positions and those proposed for inclusion by present law adjustments or new proposals. Vacancy savings reductions total \$49.7 million over the 2009 biennium, of which an estimated \$19.2 million is general fund.

Personal Services Contingency

In order to assist agencies that have insufficient authority to meet all personal services costs in the 2009 biennium, the executive is proposing, in the pay plan bill, a contingency fund including \$3 million general fund and \$3 million other funds. Agencies experiencing this problem would have to apply to the Office of Budget and Program Planning for these funds during the biennium.

PENSION PLANS - UNFUNDED LIABILITIES

EXECUTIVE RECOMMENDATIONS

The actuarial valuations of the state's retirement plans as of June 30, 2006 show that there are still four plans that do not meet the constitutional requirement that public retirement plans be "actuarially sound". Of the eight defined benefits plans under the administration of the Public Employee Retirement Board, three continue to have unfunded liabilities that cannot be amortized within a 30-year period, as required by statute. Similarly, the Teachers' Retirement System (TRS), which is separate from the Public Employees Retirement System (PERS), is in the same actuarial condition. In total, the unfunded actuarial accrued liability (UAAL) of these four funds is \$1.3 billion. Of this amount, a solution must reduce the UAAL by about \$600 million in order for the remaining liability to be amortized within a 30-year period.

These retirement plans have still not recovered from the downturn of the equity markets that occurred in 2001 and 2002, a recovery that was hindered as well by the past enactment of benefit enhancements that were funded by apparent surpluses rather than by employee and/or employer contribution rate increases. The 2006 valuation reflects the recent market gains plus action taken by the legislature in the December 2005 special session, specifically a \$100 million infusion of cash into the TRS plan and \$25 million into the PERS plan.

Public Employees Retirement System Plans

Three plans under PERS are in need of attention:

- Public Employees Retirement System (PERS)
- Sheriffs' Retirement System (SRS)
- Game Wardens' and Peace Officers' Retirement System (GWPORS)

The other five defined benefits plans under the PERS board meet the statutory requirement for being actuarially sound.

The executive budget proposal suggests 2 actions related to PERS plans: 1) the reduction of the guaranteed annual benefit adjustment (GABA) from 3 percent to 1.5 percent for new hires after July 1, 2007, and 2) closing the remaining gap by increasing the employer contribution rate for the PERS plan and the SRS plan. The GWPORS plan would not require the contribution rate increase. These changes are incorporated in proposed legislation, LC 908.

The impact of these actions can best be illustrated in Figure 8 in terms of the amortization period and the employer contribution rate increase needed to make the plans actuarially sound. The first two columns show the period of time necessary to amortize the unfunded liability given the level of contributions being made to the retirement plan, first under the 2006 actuarial valuation without the GABA change and second under the executive proposal to reduce the GABA for new hires. As shown, neither the PERS plan nor the SRS plan can even be amortized currently. However, after the GABA reduction, both can be amortized, although the time period still exceeds the 30-year requirement. The third and fourth columns show the contribution rate increase needed to bring the amortization period in line with the statutory requirement, first under the 2006 valuation without the GABA change and then

with the GABA change. As shown, the PERS plan with the GABA reduction would require a 0.27 percent employer contribution rate increase, but would require a 1.01 percent increase without the GABA change for new hires.

The estimated cost of these two proposals can be discussed in two ways: 1) the direct cost to state and local government, and 2) the actuarial cost or savings in relation to the actuarial valuation of the retirement plans. First, the GABA rollback for new hires has no direct cost to state or local government, but results in an actuarial savings that is significant in resolving the unfunded actuarial liability issue for the three plans. It could be argued, however, that it avoids a significant portion of a potential employer contribution rate increase, and in that sense results in a significant cost savings in the long-term.

Figure 8
Pension Fund - Unfunded Liability
Impact of Executive Budget Proposal on June 30, 2006 Valuation

Plan	Amortization Period		Contribution Rate Incr. Needed	
	6/30/06 Valuation	Under Executive Budget Proposal	6/30/06 Valuation	Under Executive Budget Proposal
PERS	(a)	35.6 years	1.01%	0.27%
SRS	(a)	56.9 years	1.84%	0.58%
GWPORS	31.4 years	13.4 years	0.04%	0.00%

Note: (a) Cannot be amortized

On the other hand, the increase in the employer contribution rate has a direct cost on state and local government, albeit not a huge cost. It is a cost, however, that would be on-going for as long as necessary to assure that the retirement plans remain actuarially sound, depending not only on the effect of the rate increase, but also on how other actuarial assumptions play out. The estimated general fund portion of the cost to the state of the 0.27 percent employer rate increase would be about \$1.0 million in each year of the biennium, including costs that are assumed by the state on behalf of school districts for school employees that participate in PERS. The estimated cost of the employer rate increase for local governments covered by PERS, for which the state does not assume payment of the increase, would also approximate \$1.0 million each year. The estimated cost of the employer rate increase for local government employees participating in SRS would be approximately \$215,000 in FY 2008 and \$225,000 in FY 2009. Again, these costs would be on-going well into the future.

In addition, under the Department of Administration, Financial Services Division, the executive budget includes a new proposal that would provide \$1,382,000 general fund to pay off the start-up loan for establishing the defined contribution plan.

Teachers’ Retirement System

The executive budget recommendations, provided for in LC 288, for the Teachers’ Retirement System are:

- o A cash infusion of \$100 million in FY 2008
- o An employer contribution rate increase beginning July 1, 2007 (phase-in shown in Figure 9) funded by state dollars to pay the increased costs and to avoid increased property taxes at the school district level
- o Legislation to close “loopholes that allow for ‘gaming’ the system”

The first two of these would have a direct cost to the state. The estimated cost for FY 2008 is \$113.4 million general fund and \$35,198 other funds. The estimated cost for FY 2009 is \$14.0 million general fund and \$36,648 other funds. The actuarial savings over the long-term is significant as well, as the cash infusion increases TRS assets and investment earning, and the increased contributions increase the amount of contribution available to amortize the remaining unfunded liability.

The third recommendation would result in actuarial savings, reducing assumptions for the ultimate benefits paid to some members who retire in the future.

OTHER PROPOSALS

There are a few other proposals that would impact the retirement systems if enacted that should be at least mentioned here. Besides “housekeeping bills” from PERS (LC 287) and TRS (LC 289), the following bills have been reviewed and approved by the State Administration and Veterans’ Affairs Interim Committee during the interim:

Figure 9
Pension Fund - Unfunded Liability
Phase-in of Employer Contribution to TRS

Plan	Current Rate	TRS Employer Contribution Rate Incr. Phase-in	
		2009 Biennium	2011 Biennium
Teachers Retirement System *	7.47%	9.47%	9.85%
Optional Retirement Plan - USystem **	4.04%	4.72%	4.72%

Note: * The employee contribution rate remains at 7.15 percent
 ** This rate pays for past service liability of TRS for the university system members that chose to move to the Optional Retirement Plan

Senate Bill 11 – This bill provides that legislative session employees can work up to 10 months (increased from 6 months) without being required to participate in PERS.

LC 285 – This bill is the Public Employees’ Retirement Board (PERB) proposal to provide actuarial funding of the PERS, SRS, and GWPORS by increasing the employer contribution rates for each plan. The rate increase for the PERS plan would be phased-in with an additional 0.56 percent beginning July 1, 2007 and 1.13 percent beginning July 1, 2009. The rate increase for the SRS plan would be phased-in with an additional 1.03 percent beginning July 1, 2007 and 2.05 percent beginning July 1, 2009. The GWPORS would only require an additional 0.04 percent in each year of the biennium. Under this proposal, the employer contribution rate increase also applies to the PERS defined contribution (DC) plan with the increased contribution being earmarked for the payoff of the DC plan startup loan mentioned earlier. Once the startup loan is paid off, the moneys would go to eliminate the “plan choice rate unfunded liability” which is the portion of the PERS unfunded liability that is assigned to those DC plan members that transferred from the defined benefits plan. Once that liability is eliminated, then the moneys from the rate increase would go to the long-term disability plan trust fund in effort to build up that part of the retirement plan.

LFD COMMENT	LC 285 is the PERS Board recommendation to address the unfunded liability issue of the three PERS retirement plans (PERS, SRS, and GWPORS). As of this writing, the board had not expressed support of the executive proposal to reduce the guaranteed annual benefit adjustment (GABA) for new hires. Therefore, LC 285 can be viewed as an alternative to the executive budget proposal on this issue. The primary difference in the two approaches is that LC 285 increases employer contribution and increases the revenue coming in over the long-term while the executive proposal decreases the GABA for new hires, resulting in a reduction of moneys being paid out of the retirement system over the long-term. The executive’s approach also includes a smaller employer contribution rate increase as a part of its solution, however, but with much smaller on-going costs.
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LC 286 – This PERB bill would simply appropriate \$1.4 million general fund to pay off the DC plan startup loan mentioned twice before. This would be a vehicle for doing the same thing that the new proposal would do, and is an alternative to having the increased rates of the DC plan used to pay these costs off. Any unused portion would revert to the general fund.

There are numerous other bill draft requests that deal with retirement issues but only a few would directly impact the unfunded actuarial accrued liability issue. It is not known as of this writing which proposals might be brought forward as introduced legislation.

FEE CHANGES

Fee changes are often proposed by the executive as a means to do either of the following:

- Shift all or a part of the cost of functions from one funding source to another. These shifts can be done in order to ensure that those receiving the service are the persons paying for it, or a reexamination of the relationship between those who currently pay and the service; and/or
- Provide additional resources either to meet rising costs, address lower revenues, or begin new initiatives.

EXECUTIVE RECOMMENDATION

The Governor proposes a limited number of new fees in the 2009 biennium, as shown in Figure 10

Figure 10 New Fees or Charges Executive Budget 2009 Biennium			
Section/Agency	Source/Purpose	Biennial Total	Require Legislation?
Natural Resources and Commerce			
FWP - Field Services	Expansion of Supertag	\$100,000	Yes
DNRC - Forestry	Increase Forest Protection Fee	1,200,000	Yes
Corrections and Public Safety			
Justice - MVD	Driver's License - increased fee to cover cost increase	2,466	Yes
Justice - MVD	Additional e-government applications	1,050,000	No
Justice - MVD	Increased Debt for MERLIN	<u>6,000,000</u>	Yes
Total		<u>\$8,352,466</u>	

The following is a brief summary of the major increases:

- Increase forest protection fee is an increase in the fees certain landowners pay for fire protection to allow several program expansions while maintaining the current general fund to fee revenue ratio. Further information begins on page C-178 of Volume 5.
- Additional government applications would provide e-government applications to allow individuals to access certain motor vehicle information online for a fee. Page D-31 of Volume 6 contains further information.
- Increased debt for the MERLIN system (an overhaul of the motor vehicle computer system and business processes) will be funded with a continuance of the current increases on certain driver-related fees that were scheduled to terminate at the end of this biennium. A discussion begins on page D-6 of Volume 6.

The following fee related issue is also noted for reference purposes. A change in federal law requires states to either charge a fee for child support enforcement activities on behalf of non-TANF clients or replace the lost revenue with state funds. The Governor proposes to replace the revenue with general fund. For a further discussion, see the Child Support Enforcement Division in the Department of Public Health and Human Services in Volume 4.

FUND SWITCHES

The executive budget includes a number of funding switches. The first figure shows federal funds that would be replaced, while the second figure shows other funds. Please note that the list does not include the reduction in federal funds due to a reduction in the Medicaid match rate the federal government will pay that the Governor proposes be replaced with state funds. This reduction is due to a change in the relative standing of Montana compared to the rest of the nation in per capital income, rather than a change in federal policy or grant levels. This reduction totals over \$28.4 million over the biennium and is discussed in several divisions of the Department of Public Health and Human Services in Volume 4.

Figure 11 Requests to Replace Federal Funds Reductions* Executive Budget 2009 Biennium				
Section/Agency	Purpose	--- Replacement Funds ---		
		General Fund	Other Funds	Total
Human Services				
Child Support Enforcement	DRA - Elimination of federal incentive funds match	\$3,775,353	\$0	\$3,775,353
Child Support Enforcement	DRA - Reduction of paternity testing federal match	38,588		38,588
Child and Family Services	DRA - Targeted Case Management	3,600,000		3,600,000
Child and Family Services	DRA - Targeted Case Management	172,000		172,000
Child and Family Services	DRA - Targeted Case Management / Mental Health	375,000		375,000
Child and Family Services	CMS - Potential change in Medicaid billing process	1,000,000		1,000,000
Quality Assurance	Third Party Liabilities from 25% to 50% GF	116,571		116,571
Natural Resources and Commerce				
Natural Resources and Conservation	Urban Forestry Program	0	200,000	200,000
Natural Resources and Conservation	Fuels for Schools	500,000		500,000
Livestock	Meat Inspection	82,572		82,572
Corrections and Public Safety				
Department of Labor & Industry	Carl Perkins funds for Career Resource Network	300,000		300,000
Department of Labor & Industry**	Research and Analysis	400,000		400,000
Corrections	Juvenile Re-entry	1,756,892		1,756,892
Total		<u>\$12,116,976</u>	<u>\$200,000</u>	<u>\$12,316,976</u>

*Reductions refers also to instances where funds do not keep up with inflation/program costs.
 ** Department of Labor and Industry federal funds decline overall from 50 percent of the overall budget to 47 percent. Had the percentages remained the same, state special revenues and general fund would have been reduced \$3.5 million over the 2009 biennium.

The following provides a brief explanation of the largest proposed switches of federal funds.

- Deficit reduction Act (DRA) replacements are due to several provisions of the federal Deficit Reduction Act of 2005, which placed additional costs on states. For an expanded explanation, see the Child and Family Services and Child Support Enforcement Division narratives in Volume 4.
- Juvenile re-entry is a federal grant provided for community based programs for youth released from secure facilities that will no longer be provided and for which the Governor recommends continuance with general fund. Page D-118 in Volume 6 provides additional information.

The following figure shows other fund switches proposed by the Governor.

Figure 12 Other Funding Switches Executive Budget 2009 Biennium			
Section/Agency	Purpose	General Fund	Other Funds
General Government and Transportation Administration			
General Services	Rental rate subsidy/Replace Capitol Land Grant	\$400,000	(\$236,000)
Natural Resources and Commerce			
Commerce			
Business Services	Main Street Program	247,044	(247,044)
Livestock			
Diagnostic Lab	Replace current fee income	412,698	(412,698)
Corrections and Public Safety			
Justice			
Victims Services Restitution	Redirect to SSR for use as federal match	(300,000)	300,000
Executive Protection (MHP)	Executive Protection	351,729	(351,729)
Labor			
Unemployment Insurance	Unemployment Trust Fund		(2,300,000)
Unemployment Insurance	Employment Security Account		2,300,000
Education			
MUS increase gf share of PL adjst.	Increase general fund contribution to present law*	<u>10,694,926</u>	<u>(10,694,926)</u>
Total		<u>\$11,806,397</u>	<u>(\$11,642,397)</u>
*Approximate			

The replacement of other funds with general funds in the Montana University System represents the Governor’s proposal to increase both the scope and percentage of present law adjustments funded with general fund in order to reduce tuition increases.

ONE-TIME-ONLY EXPENDITURE PROPOSALS

The executive proposes almost \$500 million in one-time expenditures. This is an extremely high amount for one-time proposals, and reflects the Governor’s priorities for using one-time revenues from a high beginning general fund balance for one-time purposes, in order to maintain structural balance in the general fund. These one-time expenditures are in HB 2, other legislation, and proposed transfers as noted in Figure 13. The following details each of the proposed increases, using categories developed by the LFD. Please note that this total includes a slight revision in the totals for property tax and water adjudication relief than those included in the original executive budget.

Figure 13 One-Time Only Expenditures - Executive Budget 2009 Biennium (Millions)				
Expenditure Description	Biennial Amount	In HB 2?	HB 2 Agency	Analysis Page #
<u>Information Technology Related* - \$70.8 million</u>				
DOA Bring DPHHS to Biennial Level	\$30.21	No		---
DOA Data Center	20.50	No		---
DOA Network Expansion	7.82	No		---
DOA Supercomputer Challenge Grant	7.00	No		---
Judiciary Information Technology	3.94	No		---
Miscellaneous Other IT	1.28	---	Various	N/A
<u>Emergency/Safety - \$41.4 million</u>				
DNRC Emergency (fires)	25.00	No		---
DOA Statewide E911 Network	4.00	No		---
DOA Public Safety Radio	8.50	No		---
Corrections Interoperable Communication Project	2.62	Yes	Corrections	D-79
Judiciary District Court Safety and Security	0.30	Yes	Judiciary	A-39
DNRC Fire Fighting Equipment	1.00	Yes	DNRC	C-186
<u>Economic Development - \$12.4 million</u>				
New Worker Training	8.00	Yes	Commerce	C-227
Biomedical Research Grant	2.00	Yes	Commerce	C-233
Tribal Economic Development	1.60	Yes	Commerce	C-230
Other Economic Development	0.82	Yes	Commerce	C-227
<u>Environmental - Access/Remediation/Enhancement - \$22.0 million</u>				
FWP Purchase Access/Parks	15.00	No	FWP	C-7
DEQ Enhanced/Accelerated Reclamation and Remediation	4.00	Yes	DEQ	C-93
Miscellaneous Other (DEQ/FWP/DNRC)	3.03	---	Various	N/A
<u>Reduce Taxes - \$118.9 million</u>				
Property Tax Rebate**	98.38	No		---
Water Adjudication**	20.43	No		---
<u>Deferred Maintenance and Capital - \$74.3 million</u>				
Deferred Maintenance	38.00	No		---
MUS Gaines Hall	28.50	No		---
Purchase Crime Lab Building	7.75	No		---
<u>Fund, etc. Balances - \$21.0 million</u>				
Revenue Property Tax Reserve Fund	14.50	No		---
Arts Council Cultural Trust	1.50	No		---
Agriculture Noxious Weed Trust Fund	5.00	Yes	Agriculture	C-206
<u>Pensions - \$101.4 million</u>				
TRS Transfer	100.00	No		---
DOA PERS Defined Contribution Transfer	1.38	Yes	Administration	A-215
<u>Other Major - \$29.6 million</u>				
Litigation - Justice Major Litigation and Transportation Rates	6.50	Yes	Justice/MDT	D-20, A-113
DPHHS Low Income Energy Assistance	2.60	Yes	DPHHS	B-40
OCHE Distance Learning/Training/Transferability	3.95	Yes	OCHE	E-111
Various - Equipment	5.48	Yes	Various	N/A
Commerce Create Manufactured Home Trust	3.10	Yes	Commerce	C-248
Revenue Collection Related	7.93	Yes*	Revenue	A-Variou
All Other	7.82	---	Various	N/A
Grand Total	<u>\$499.44</u>			

*May include specific goals, such as emergency preparedness.

Each of the proposed HB 2 increases is discussed in further detail in the appropriate agency narrative in Volumes 3 through 7, as referenced in the far right column in the above figure. Other proposals are discussed in the relevant section, including Long-Range Building (Volume 7), and other sections of this volume as appropriate.

This list only contains those proposals the Governor recommends be approved with one-time-only funding. Throughout the agency budget analysis (Volumes 3 through 7) the analyst has noted when certain proposals by the executive might be designated OTO due to either the uncertainty of whether it should be on-going, or to allow the next legislature to specifically review the function.

**LFD
ISSUE****On-going Nature of Some Proposals**

A number of the one-time-only expenditure proposals would seek funding that may not be truly OTO. Some of the proposals seek to reinstate funding provided in the 2007 biennium as one-time-only, or appear to be either of an on-going nature or risk creating demand for continued or additional funding. This list includes but is not limited to:

- The economic development proposals in the Department of Commerce, which maintain or expand already existing programs designated as one-time only by the 2005 Legislature
- Major litigation in the Department of Justice, in particular the litigation with Wyoming over water rights, which could extend for several years depending upon efforts in this biennium
- Wildlife grants, which request funding in some measure for on-going types of activities for which the executive has determined general license account is not appropriate
- Fire fighting equipment
- Department of Natural Resource and Conservation emergency appropriations for future firefighting costs, as the executive only includes \$5.0 million each year for on-going costs, and the average cost for a fire season is now over \$13.0 million
- Miscellaneous supplies and equipment in various agencies
- Energy assistance for low-income persons
- On-going Department of Public Health and Human Services lab equipment replace and maintain
- Military family relief fund
- Transferability and student data in the Montana University System
- Accelerated comprehensive environmental remediation and cleanup (CERCA) and enhanced reclamation and remediation (state Superfund)
- Information technology in the Judiciary

The legislature may wish to query the executive as to whether these proposals are truly OTO, as these expenditures should otherwise be requested as on-going proposals and prioritized accordingly. In addition, the legislature may wish to discuss with the executive any future costs of any of these proposals.

**LFD
ISSUE****Other Costs or Impacts**

The Governor also requests certain appropriations that will likely result in other costs or impacts in the future, including:

- Purchase of additional parks would result in increased maintenance costs not requested in the executive budget
- SABHRS readiness assessment would determine courses of action for the future of the state's accounting and human resource system (currently SABHRS), with the likelihood of either replacement or major upgrade (the Governor's budget revisions indicated this request would be pulled)
- Various database and other IT systems requested would likely require on-going maintenance not included in the executive budget
- The Governor's proposal to allow certain Montanans to fish for free would impact the general license account, which is the main account that funds the Department of Fish, Wildlife, and Parks, and decrease the length of time before other fee increases may be required

The legislature may wish to have the executive identify any future costs for consideration by the legislature.

Some of the proposals would either augment current funding sources or pay the entire cost of functions not previously paid for with general fund, or for which other funding sources might be available, including:

- Rail litigation in the Department of Transportation
- Augmentation of the weed trust in the Department of Agriculture
- The cost recoverable portion of CECRA (state Superfund) costs
- Wildlife grants in the Department of Fish, Wildlife, and Parks
- Contribution to administration of the defined contribution option in the Public Employees Retirement System (PERS)

Each of these proposals are discussed in the relevant agencies in Volumes 3 and 5.

EXECUTIVE PRESENT LAW PROPOSALS

Present law is defined in statute as “that level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature, including but not limited to:

- Changes resulting from legally mandated workload, caseload, or enrollment increases or decreases;
- Changes in funding requirements resulting from constitutional or statutory schedules or formulas;
- Inflationary or deflationary adjustments; and
- Elimination of nonrecurring appropriations.”

As such, it incorporates a number of elements, with changes in caseload, enrollments, and populations; as well as annualizations of previous actions (i.e. the state employee pay plan) the most likely to cause the greatest change.

The executive proposes \$471.0 million in general fund present law adjustments in the 2009 biennium. This is an unusually high amount compared to recent biennia. Two of the out-of-the-ordinary factors that contribute to this large increase are:

- Increases for K-12 education provided during the December 2005 Special Session
- Changes in the percentage of Medicaid costs that the federal government will pay.

There are also two primary factors that inflate this total beyond the amount necessary to maintain services at the level established by the last legislature:

- The executive includes at least \$78 million general fund for proposals that should have been classified as new initiatives for legislative prioritization; this issue is discussed in more detail in the “Executive New Initiatives” section that follows, page 151
- LFD analysis concludes that the executive overstates the amount of present law adjustments necessary to maintain services in five areas, as shown in the following table; the table includes both general fund and I-149 (tobacco tax) funds, which have flexibility of use for a number of purposes for legislative prioritization for which general fund is the primary alternative; please note that this table includes only the major overstated present law adjustments

Each of these elements is discussed in more detail in the relevant sections of the agency narratives in Volumes 3, 4, and 6.

LFD ISSUE As a result of both the mischaracterization of certain new proposals and overstatement of present law required, the executive has overstated the amount of funds necessary to maintain government at the level authorized by the last legislature by at least \$100 million.

Figure 14
Executive Present Law Adjustments
in Excess of LFD Estimates
General Fund and I-149 Funding, Only
2009 Biennium

Functions	Amount
Corrections Populations	\$20,000,000
Medicare Buy-In	600,000
Nursing Homes	*
Foster Care	3,000,000
Big Sky Rx**	<u>8,400,000</u>
Total	<u>\$32,000,000</u>

*LFD estimates of nursing home days is lower than the executive. However, the source of the funding is not clear.
**I-149 (tobacco tax) funds

EXECUTIVE NEW INITIATIVES (NEW PROPOSALS)

The Governor proposes over \$750.3 million in general fund new initiatives (“new proposals”) in the 2009 biennium. (Please note this figure includes a statutory appropriation of \$16.0 million for emergencies that is classified as a transfer in the “2009 Biennium Projection” section of this report.) Of the total, over \$189 million is in HB 2 and the remainder is in other bills, language, or transfers. This does not include revenue initiatives. The Governor would add 191.33 FTE in FY 2008 and 239.02 in FY 2009 in new initiatives in HB 2. The amounts shown above and in the table are as characterized by the Governor in his budget proposal. However, the actual amount of new initiatives is higher, as discussed in the issue that follows. In addition, please note that some proposals include both one-time and on-going elements. Therefore, the classification will not be entirely precise for some of the smaller HB 2 initiatives. The difference between this total and the total on page 147 is due primarily to the inclusion by the Governor of some one-time-only proposals in present law. Please note the figure includes \$16.0 million in statutory appropriations for emergencies included in transfers in the “2009 Revenue Projection” section and a slight adjustment in property tax and water adjudication relief than those included in the original executive budget.

Figure 15 Major New Initiatives - Executive Budget As Presented by the Governor 2009 Biennium (Millions)			
Agency/Initiative	On-Going	Biennial One-Time	Total
Non-HB 2			
Property Tax Rebate/Water Adjudication/Compliance***	\$32.82	\$118.81	\$151.63
Actuarial Funding - Retirement Systems/TRS Infusion	29.34	100.00	129.34
Long-Range Building - Deferred Maintenance	0.00	66.50	66.50
State Employee Pay Plan	58.61	0.00	58.61
Long-Range Building - IT	0.00	54.47	54.47
Long-Range Building - Projects, including Parks	0.00	50.25	50.25
Increase Funding for Fires/Governor's Emergency Appropriation*	0.00	25.00	25.00
Property Tax Reserve Fund	0.00	14.50	14.50
Miscellaneous Other Non-HB 2	0	10.56	10.56
Total Non-HB 2	\$120.77	\$440.09	\$560.86
HB 2			
K-12 Full-Time Kindergarten	\$25.17	\$0.00	\$25.17
K-12 Per Education and Entitlement	19.80	0.00	19.80
K-12 Various Other, including School for the Deaf and Blind	17.06	0.48	17.53
DPHHS Protective Services/Medical/Welfare/Seniors/Other DD	11.77	4.90	16.67
Deferred Maintenance - Ongoing	14.30	0.00	14.30
DPHHS Mental Health/Addiction Expansions	13.26	1.00	14.26
Emergency (Fires/Hazmat)	10.58	1.00	11.58
Changes in Federal Law or Availability	10.08	0.00	10.08
Various Data Systems	5.24	3.27	8.52
Pension - Defined Contribution Implementation Costs	0.00	1.38	1.38
Higher Education Other	0.00	6.95	6.95
Litigation (Justice/Transportation)	0.20	6.00	6.20
Provider Rate Increases	5.62	0.00	5.62
Various Environmental/Wildlife	2.76	2.25	5.01
Weed Trust Seed Money	5.00	0.00	5.00
Economic Development**	1.52	2.00	3.52
Manufactured Home Seed Money	0.00	3.10	3.10
Higher Education Student Assistance**	2.06	0.00	2.06
Corrections Various**	1.90	0.00	1.90
Various Judicial (staff, safety and security, fitness to proceed)	0.73	0.30	1.03
All Others	9.77	0.00	9.77
Total HB 2	<u>\$156.82</u>	<u>\$32.63</u>	<u>\$189.45</u>
Total New Initiatives	<u>\$277.59</u>	<u>\$472.72</u>	<u>\$750.31</u>
*Would increase available statutory appropriations. **Most proposed expenditures in present law. ***Includes \$30 million in property tax reimbursements to school districts and \$2.8 million in compliance funding included as a revenue offset in the executive budget.			

**LFD
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Governor Understates New Initiatives and Overstates Present Law

The Governor has included a number of HB 2 new proposals as present law adjustments. As a consequence, the totals used to determine the current on-going costs of government are overstated and the new functions of state government being proposed by the executive are understated.

Present law is defined in statute as "...that level of funding needed under present law to maintain operations and services at the level authorized by the previous legislature, including but not limited to:

- a) Changes resulting from legally mandated workload, caseload, or enrollment increases or decreases;
- b) Changes in funding requirements resulting from constitutional or statutory schedules or formulas;
- c) Inflationary or deflationary adjustments; or
- d) Elimination of nonrecurring appropriations."

Consequently, proposals to begin or expand programs for reasons other than those given above are not present law and should be requested as a new proposal. In addition, a request to reinstate any programs made one-time-only by the last legislature and not legally mandated would not meet the statutory criteria and should also be requested as a new proposal, as should any change in funding.

These distinctions are very important. The legislature mandated this distinction in statute to be able to ascertain when funding is needed to maintain government services and when government programs are being expanded. Because present law is used to determine what it costs to maintain on-going operations of state government, it is an important indicator of whether service reductions are likely if that level of funding is not maintained. Therefore, it is important that present law accurately reflect true costs of maintenance of state government operations. While there are always gray areas, the legislature should have confidence that the categorizations give a fairly accurate distinction between maintenance funding and funding for new initiatives. The executive budget as presented does not allow this confidence.

The following lists the major new proposals classified as present law adjustments by the executive, as identified by the Legislative Fiscal Division (LFD) analyst. This list is not all-inclusive, and the total misclassified amounts are higher.

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CONT.**

Figure 16
New Proposals Coded as Present Law
Executive Budget
2009 Biennium

Section/Agency	Purpose	General Fund	Other Funds
<u>General Government and Transportation</u>			
Revenue	Hearings officer (PL 1011)	\$115,369	
	Internal analyst (PL 1011)	114,112	
	Disaster coordinator (PL 1011)	103,395	
	Remodeling (PL 1011)	250,000	
	Tax Gap Analysis	774,049	
	Increase compliance audits and collections (PL 7019)	4,148,731	4,464,260
Governor's Office	Marketing Montana and Business Recruitment	400,000	
<u>Human Services</u>			
Public Health and Human Services	36.60 Modified FTE for State Hospital**	3,351,603	
<u>Natural Resources and Commerce</u>			
DEQ	Business Process Improvement	1,800,000	
	Enforcement Division - New FTE	140,598	
	Accelerated Remediation	2,000,000	
Commerce	New Worker Training Expansion (Increase)	5,200,000	
	Made in Montana	200,000	
	Main Street Program (Funding Switch)	247,047	
	Tribal Economic Development (Increase)	600,000	
	Community Technical Assistance	332,196	
DNRC	GIS Enterprise Equipment IT	130,000	
	GIS Enterprise System		375,000
	Inmate Fire Suppression Crew	41,000	21,000
	Interagency Fire Support	133,000	69,000
	Navigable River Management		114,000
FWP	Regional Investigators	255,644	
<u>Corrections and Public Safety</u>			
Justice	Medicaid Fraud Unit	51,306	
Corrections	Provider rate increases - Community Corrections	2,020,374	
	Provider rate increases - Secure Care	973,224	1,058,240
	Add institutions to canteen program*		
	Youth corrections inmate pay	37,546	
	Inmate Transportation*	993,062	
	MSP - OTO Supplies*	215,148	
Board of Pardons	Increase member per diem	26,681	
<u>Education</u>			
OPI	I&I revenue to school facility account	36,771,766	
Library Commission	GIS Portal	300,000	
	Natural Heritage Program	150,000	
OCHE/MUS	Tuition Waiver HS Honors	1,000,000	
	Increase Non-Beneficiary	500,000	
	Expand Governor's Postsecondary Scholarship Program	3,300,000	
	Community Colleges "Base" Funding (DP 4003)	900,000	
	Change present law adjustments funding (CAP proposal)	10,694,926	
Total All Agencies - HB 2		<u>\$78,270,777</u>	<u>\$6,101,500</u>

*A portion of the total is expansion of the program, but it is not possible to determine the exact amount.
**Some may be used for STEP (PL 33503)

The major new proposals classified as present law adjustments are included in the following figure to give a truer picture of the total new initiatives and priorities proposed by the Governor, and increase the total from \$189.45 million to \$267.7 million in HB 2, with a like reduction in present law adjustments. The total amount of new initiatives in the executive budget is \$828.6 million, as compared to \$750.3 million shown in the executive budget.

**LFD
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Figure 17
Major New Initiatives - Executive Budget
With New Proposals Presented as Present Law in Executive Budget
2009 Biennium
(Millions)

Agency/Initiative	Biennial		Total
	On-Going	One-Time	
Non-HB 2			
Actuarial Funding - Retirement Systems/TRS Infusion	\$29.34	\$100.00	\$129.34
Property Tax Rebate/Water Adjudication	0.00	118.81	118.81
Long-Range Building - Deferred Maintenance	0.00	66.50	66.50
State Employee Pay Plan	58.61	0.00	58.61
Long-Range Building - IT	0.00	54.47	54.47
Long-Range Building - Projects, including Parks	0.00	50.25	50.25
Property Tax Relief and Compliance	32.82	0.00	32.82
Increase Funding for Fires/Governor's Emergency Appropriation*	0.00	25.00	25.00
Property Tax Reserve Fund	0.00	14.50	14.50
Miscellaneous Other Non-HB 2	0	10.56	10.56
Total Non-HB 2	\$120.77	\$440.09	\$560.86
HB 2			
K-12 Various Other, including School for the Deaf and Blind	\$53.83	\$0.48	\$54.31
K-12 Full-Time Kindergarten	25.17	0.00	25.17
K-12 Per Education and Entitlement	19.80	0.00	19.80
Higher Education Other	11.59	6.95	18.54
DPHHS Protective Services/Medical/Welfare/Seniors/Other DD	11.83	4.90	16.72
Deferred Maintenance - Ongoing	14.30	0.00	14.30
DPHHS Mental Health/Addiction Expansions	13.26	1.00	14.26
Emergency (Fires/Hazmat)	10.58	1.00	11.58
Economic Development**	1.85	8.25	10.10
Changes in Federal Law or Availability	10.08	0.00	10.08
Various Environmental/Wildlife	3.33	6.05	9.38
Various Data Systems	5.24	3.40	8.65
Corrections Various**	7.92	0.00	7.92
Higher Education Student Assistance**	5.85	1.00	6.85
Various Tax Compliance Department of Revenue	5.36	0.95	6.31
Litigation (Justice/Transportation)	0.20	6.00	6.20
Provider Rate Increases	5.62	0.00	5.62
Weed Trust Seed Money	5.00	0.00	5.00
Manufactured Home Seed Money	0.00	3.10	3.10
Pension - Defined Contribution Implementation Costs	0.00	1.38	1.38
Various Judicial (staff, safety and security, fitness to proceed)	0.73	0.30	1.03
All Other	11.42	0.00	11.42
Total HB 2	\$222.97	\$44.75	\$267.72
Total New Initiatives	\$343.74	\$484.84	\$828.58

*Would increase available statutory appropriations.

**Most proposed expenditures in present law.

The LFD has raised the issue of misrepresentation of present law versus new proposals in nearly every session budget analysis report for several biennia. The 2009 biennium executive budget submission shows a serious disregard of this statutory requirement. For a further discussion see the individual agency narratives in Volumes 3 through 7 of the LFD 2009 Biennium Legislative Budget Analysis. The legislature may wish to revise the statutory requirement for making this distinction. If it is concluded that such a characterization is important, the legislature may wish to examine options to enforce compliance in future budget submissions, including amending the statutory definition of "present law adjustments" to close any loopholes.

MAJOR NEW PROPOSALS

As shown, the Governor has a large and wide range of proposed initiatives. The following briefly highlights some of the major proposals for funding.

- Pension plans unfunded liability – This includes \$100 million direct general fund transfer to the Teacher’s Retirement System and a \$29.3 million increase in the employer share of public employees retirement contributions, to reduce the unfunded liability in pension plans to within statutory allowances. See the discussion on page 140
- Over \$170 million in long range building programs for one-time deferred maintenance, and for information technology and other building projects. A discussion of long-range building proposals begins on page F-1 in Volume 7
- State Employee Pay Plan (\$58.6 million) – The Governor proposes a 3 percent increase in salary each year, with a small flexibility component, an increase in insurance contributions, and an expansion of payments for longevity for those with 10 years of uninterrupted service. The Governor also proposes that the broadband pay plan be the only statewide pay plan used by the executive branch. A further discussion begins on page 124 of this volume.
- Property tax relief (\$37.3 million) is proposed, in addition to the property tax rebate and water adjudication (\$118.9 million). For a further discussion, see the Executive Revenue Proposals narrative beginning on page 86 of this volume.
- Full-time Kindergarten (\$25.2 million) – The Governor provides an increase in BASE Aid funding for all children enrolled in full-time kindergarten at all school districts that choose to participate. A further discussion is in the Local Education Activities Program in the Office of Public Instruction (OPI) in Volume 7, page E-32 of this analysis.
- Increase in the Quality Per Educator Component and Create a Middle School Entitlement (\$19.8 million)– The executive proposes to increase the quality per educator component of BASE Aid created by the December 2005 Special Session and to create a middle school entitlement (this second component would be cost neutral). A further discussion is in the Local Education Activities Program in OPI.
- Various Departments of Public Health and Human Services (DPHHS) Services – Additional protective services field staff, a reduction in the Developmental Disabilities (DD) waiting list, and expanded energy assistance are among the major other initiatives in human services. Further discussion is included in various divisions of DPHHS in Volume 4, beginning on page B-1 of this analysis.
- Various Other K-12 (\$54.3 million)– The Governor proposes a number of initiatives, including increases for school facilities, special education, Indian education for all, and the provision of curriculum specialists in OPI and state funding of certain district retirement costs.
- On-going Deferred Maintenance (\$14.3 million) – The executive proposes to provide on-going funding from the general fund for deferred maintenance on state buildings. A further discussion is in the Architecture and Engineering Division of the Department of Administration in Volume 3, page A-230 of this analysis.
- Mental Health/Addiction Expansion (\$14.3 million) – The Governor proposes establishing a program for forensics patients, as well as an expansion of community services to reduce the incidence of admission or re-admission to the Montana State Hospital. A further discussion is in the Addictive and Mental Disorders Division of the Department of Public Health and Human Services (DPHHS) in Volume 4, beginning on page B-216 of this analysis.

- Provision of On-going Funding for Firefighting – the executive supports an initiative to establish separate funding for fire suppression by proposing both a \$16 million one-time addition to a new account for that purpose (non-HB 2) and on-going yearly funding of \$5 million to the fund, as well as \$1.0 million in one-time equipment funding. The Governor would also increase the emergency statutory appropriation by \$9.0 million. A further discussion is in the Forestry Division of the Department of Natural Resources and Conservation in Volume 5 of this analysis.
- Changes in Federal Law and Availability (\$10.1 million) – The executive proposes to replace reduced federal funding for a number of purposes, the largest of which is to offset changes in the 2005 Deficit Reduction Act in DPHHS, with some lost fund replacement in the Department of Labor and Industry and Corrections.

LFD ISSUE Some of the appropriations that the Governor requests be made OTO will likely either be on-going or require additional costs in future biennia. For a further discussion, see the “One-Time-Only Expenditure Proposals” discussion starting on page 147 of this volume.

Figure 18 shows the HB 2 new proposals by functional area of government.

Figure 18		
Expenditure New Initiatives by Functional Area		
Executive Budget		
2009 Biennium (Millions)		
Functional Area	Amount	Percent of Total
Education	\$73.70	38.9%
Corrections	7.27	3.8%
Human Services	43.37	22.9%
All Other Agencies	<u>65.10</u>	34.4%
Total	<u>\$189.45</u>	<u>100.0%</u>

PROPOSALS WITH INCREASED FUTURE COSTS

The Governor makes several proposals that are phased-in in the 2009 biennium, and will consequently cost more in the 2011 biennium. The following figure shows the phased-in programs funded in HB 2. The executive also phases in the proposed pay plan. It is included at the bottom of the table and discussed further beginning on page 124 of this volume.

Figure 19 Proposals with Increased Cost in the Next Biennium - Executive Budget 2009 Biennium			
Section/Agency	Purpose	2009 Biennium General Fund	2011 Biennium General Fund
HB 2			
Human Services			
STEP Program*		\$4,213,119	\$9,282,589
Corrections and Public Safety			
Corrections	80 Pre-Release Beds	1,898,000	3,796,000
Corrections	Provider Rate Increases	2,993,598	3,991,464
Corrections	Probation and Parole Officers	3,223,986	3,556,434
Corrections - BOPP	Increase board member per diem	26,681	26,681
Corrections	Population Growth - contract beds	21,541,023	26,861,446
Justice	Uniform Officer Pay Increase (statutory approp)	0	0
Education			
OPI	Full Time Kindergarten	25,168,700	29,886,000
Total HB 2		\$59,065,107	\$77,400,614
Non-HB 2			
All Agencies	State Employee Pay Plan**	\$55,529,361	\$84,506,717
Total		\$114,594,468	\$161,907,331
<p>*The 2011 biennium annualized cost of the STEP program is incomplete. It represents the executive estimate to fund 62.50 of the 121.50 FTE that will staff the facility and the operating costs for the 120 average daily population. The operating cost estimates are based on FY 2006 costs and do not include inflation for FY 2006 costs except outside medical. In addition, the estimated overtime, holiday, shift differential, and overtime are estimated based on a per FTE average of FY 2006 costs for the state hospital. The personal services costs may not include the impact annualization of pay increases between FY 2006 and FY</p> <p>**Excludes the proposed contingency and training appropriations.</p>			

- A summary discussion of the STEP program is on page 158 of this volume and is discussed in detail on page B-246 of Volume 5
- With the exception of the proposal to increase the per diem for Board of Pardons members, all of the increases in the Department of Corrections are to address projected increases in populations and are discussed beginning on page D-61 of Volume 6
- Full-time kindergarten is discussed beginning on page E-32 of Volume 7

As these proposals are discussed, the legislature may wish to have the agency provide specific information on future costs. It should be noted that a number of the “one-time only” initiatives in the executive budget could also have a future cost impact, as raised in an LFD issue, discussed on page 157 of this volume.

STEP PROPOSAL

The executive budget includes a proposal to start a 120 bed program for persons with a mental illness who are in the custody of the Department of Corrections (DOC) or the Department of Public Health and Human Services (DPHHS), due to a court determination that they are guilty of a crime but mentally ill. The Secure Treatment and Examination Program (STEP) proposal for 41.69 new FTE in FY 2009 and \$4.1 million general fund over the biennium is in the DPHHS budget request and funding to renovate buildings on the state hospital campus (\$5.8 million general fund) to house the new program are included in the long range building budget request.

STEP would become operational in FY 2009. State hospital patients and 59.00 hospital FTE would be transferred to the new facility in October 2008. New staff would be hired and trained between October and December 2008 and then persons would be transferred from prison facilities in January 2009. DOC and DPHHS are each allocated 60 of the 120 beds.

DOC and DPHHS began meeting to discuss DOC's need for more beds in January 2006. The STEP proposal evolved over several months. Executive branch staff discussed STEP in summary with advisory groups. However, the DPHHS budget request submitted to the Governor's budget office did not include STEP.

The initial information on STEP made its public debut in the Governor's budget request November 15, 2006. Some of the details of the proposal that have not yet been finalized are:

- Admission criteria to STEP
- The number of admissions anticipated compared to facility capacity
- The annualized cost of FTE transferred from the state hospital
- The need for and type of statutory amendments that may be required

The STEP program represents a significant new proposal for both the mental health and correctional systems. The proposal warrants careful scrutiny by the legislature in terms of both mental health policy issues and correctional system expansion as well as assessment of the cost effectiveness of the initiative. The legislature may want to ask agencies to explain in detail the process used to select this initiative, other options that were considered, cost-effectiveness, and long-term cost impacts.

For a detailed discussion of the proposal and issues raised by LFD staff, see page B-246 of Volume 4.

FIXED COSTS

Several programs within state government provide services to support other functions of state government, for which they charge a fee. These types of programs are commonly called internal service programs. The legislature does not appropriate funds for the provider programs because they are utilizing internal service funds, which do not require appropriations. Instead, the legislature approves the maximum level of fees the programs may charge to generate revenue to fund operations. The appropriation to pay these fees is then provided to the paying agencies in HB 2. The funding is allocated to the paying agencies based upon set criteria, anticipated usage, and expenditures of the internal services programs. This funding is referred to as “fixed costs” and is part of the statewide present law adjustments in each agency. Nearly \$100 million is assessed to state agencies in the executive budget to pay these inter-service fees. Controlling the rates charged and the level of services provided can significantly impact the rate of growth in state expenditures.

Figure 20 details each of the internal service programs and the total fixed costs included in the executive budget in support of those functions. The figure also compares total costs in the executive budget in the 2009 biennium with costs budgeted in the 2007 biennium. All internal services programs for which a fixed cost is charged are in the Department of Administration, with the exception of the statewide cost allocation plan and the legislative audit function.

Figure 20 Comparison of Fixed Costs 2007 to 2009 Biennium (in Millions)						
Subcommittee/Agency	Program	2007 Biennium	2009 Biennium	Difference	Percent	
General Government						
Administration	Insurance and Bonds	\$28.9	\$25.8	(\$3.1)	-10.7%	
	Warrant Writing Fees	1.6	2.0	0.4	25.0%	
	Payroll Service Fees	0.9	1.0	0.1	11.1%	
	Data Network Services	21.6	27.2	5.6	25.9%	
	SABHRS Operating	12.7	13.4	0.7	5.5%	
	Messenger Services	0.3	0.4	0.1	33.3%	
	Web Services*	0.0	0.4	0.4	---	
	Rent - Buildings	13.5	16.0	2.5	18.5%	
	Grounds Maintenance	0.7	1.0	0.3	42.9%	
Legislative Audit Division	Audit Fees	3.1	3.3	0.2	6.5%	
Various	Statewide Cost Allocation/State Fund Allocation	<u>3.7</u>	<u>5.6</u>	<u>1.9</u>	51.4%	
Total		<u>\$87.0</u>	<u>\$96.1</u>	<u>\$9.1</u>	10.5%	

*Beginning in FY 2009.

As shown, fixed costs increase by \$9.1 million (10.5 percent) in the 2009 biennium over the 2007 biennium appropriations. Funding for fixed costs is provided based upon the funding mix of the agency. Therefore, all funding sources of the agency are used. An estimated \$3.5 million of the costs in the table are funded with general fund.

There are two issues for legislative consideration: 1) the lack of justification for many of the fixed costs; and 2) the method used by the legislature for approving rates may need re-examination.

**LFD
ISSUE****Lack of Justification**

It is questionable whether the executive budget provides the information necessary for the legislature to make an informed decision when setting rate authority for internal services. As stated, the action of the legislature for internal service type proprietary funds is to approve the maximum level for fees and charges used by the program to bill customers for services and generate operating revenue to provide the services. According to the executive budget instructions, agencies were directed to “uniquely quantify the impact to the base rate as part of the decision package justification” for any issue that changes the legislatively-adopted rate. For nearly all programs of the Department of Administration, uniquely quantifiable impacts were not provided for any rate change. Instead, only information about which rate was impacted was provided. In many instances the response was that the funding change had little or no impact on the rate, yet the rate change was significant in terms of percentage change from the base rate.

Out-of-Date Information Provided

Key information provided by the executive for the legislature to make rate decisions is the biennium report on internal service and enterprise funds (fund report). In several cases the reports were not accurately completed, only partially completed, or did not reflect the final executive budget. In at least two cases, the Facilities and Maintenance Program in the Department of Administration and the State Motor Pool, the executive budget includes contributed capital from the general fund to support the operation of the program, but the rates and the fund report were not updated to reflect the contributed capital. In other instances, such as for the Information Technology Services Division of the Department of Administration, the rates that appeared in the executive budget were different than the rates included in the requested rates section of the fund report.

In this instance the fund report wasn't even included in the executive budget, but was published on the Governor's budget network directory and included in the LFD analysis as published and confirmed to be the official versions of the fund reports.

The legislature may want to direct the executive to provide quantifiable information to the LFD and the joint appropriations subcommittees prior to the rate hearings that fully explains the factors that cause the changes in rates from the FY 2006 levels approved by the legislature.

**LFD
ISSUE****Method for Approving Rates**

The current process and the information requirements and formats for the executive to provide information for proprietary fund rate approval by the legislature was developed through work and recommendations of the Legislative Finance Committee. The information submitted by the executive for legislative approval of funding for proprietary funded programs contained incomplete and erroneous information. Coupled with the lack of justification for changes, the proprietary rate setting process does not appear to have been taken seriously by the executive.

**LFD
ISSUE
CONT.**

The legislature may want to consider again reviewing the process for establishing spending authority for programs funded with proprietary funds. The following changes could be made via legislation in the 2007 Legislature to provide clarity in statute regarding fees and charges approved by the legislature and provision of rate change information:

- Specify that the maximum fees and charges approved by the legislature are the same fee and charge schedules actually billed to the customers of the program
- Specify that the report on fees and charges in the internal service fund type must include specific and quantifiable justifications for changes of fees and charges as compared to the base year fees and charges approved by the previous legislature

The legislature could also consider a bill for an interim study of the process that could include:

- A review of the legislative authority and powers for approving proprietary funding
- A review of the current statutory directions for developing and presenting budgets for proprietary funds
- A review of current information provided by the executive for requesting legislative approval of proprietary funding
- A review of the LFD process for presenting the information provided by the executive in the budget analysis
- Recommendations for revising the information requirements, the process, and state law

With the exception of the legislative audit costs, each of the fixed costs and related issues enumerated above are discussed in greater detail in the Department of Administration narrative in Volume 3 of the Legislative Budget Analysis 2009 Biennium.

INFLATION/DEFLATION

Statute requires the governor to submit a present law budget, with “present law” defined as “that additional level of funding needed to maintain operations and services at the level authorized by the previous legislature”. The statutory definition includes inflationary and deflationary adjustments. The executive budget does not include a general inflation factor for all operating expenses, but instead applies an inflation or deflation factor to fiscal 2006 expenditures for only 26 specific operating items out of the 531 items contained in the budget request.

Figure 21 shows the executive budget inflation and deflation factors and the items to which they are applied. Of the 26 items, the five deflated items are services purchased from other state agencies, and payments for these items or services go into a proprietary account. The legislature sets the rates that other state agencies must pay for the items or services, and thus determines the fund levels maintained in proprietary accounts. Of the 21 items that are inflated, 14 are related to food. The largest inflationary increase in percentage terms is for “In-state State Motor Pool” and “Motor Pool Leased Vehicles”. Although the Executive Budget noted increases of 19.6 and 14.7 percent for FY 2008 and FY 2009, respectively, for these two items, the actual increases are 39.0 percent and 41.0 percent. The largest inflationary increase in dollar terms is for natural gas, adding \$5.1 million to the total biennial budget.

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Account	Item Name	Percentage Change From Fiscal 2006 Base		State Agencies		University System		Total	
		Fiscal 2008	Fiscal 2009	Fiscal 2008	Fiscal 2009	Fiscal 2008	Fiscal 2009	Fiscal 2008	Fiscal 2009
Inflation									
62205	Food	4.60%	6.40%	\$40,418	\$56,233	\$6,045	\$8,411	\$46,463	\$64,644
62225	Books & Reference Material	14.00%	21.90%	130,610	204,311	362,883	567,652	493,492	771,963
62251	Meat	4.60%	6.40%	4,165	5,795	0	0	4,165	5,795
62252	Dairy	4.60%	6.40%	22,055	30,685	0	0	22,055	30,685
62253	Produce	4.60%	6.40%	9,253	12,874	0	0	9,253	12,874
62254	Bakery	4.60%	6.40%	1,803	2,508	0	0	1,803	2,508
62264	Grocery	4.60%	6.40%	49,696	69,143	0	0	49,696	69,143
62275	Poultry	4.60%	6.40%	2,603	3,622	0	0	2,603	3,622
62278	Beverages	4.60%	6.40%	6,536	9,094	383	533	6,919	9,626
62279	Red Meat	4.60%	6.40%	2,229	3,101	0	0	2,229	3,101
62288	Canned Goods	4.60%	6.40%	8,479	11,797	0	0	8,479	11,797
62289	Staples	4.60%	6.40%	10	14	0	0	10	14
62291	Sea Foods	4.60%	6.40%	1,997	2,778	0	0	1,997	2,778
62292	Pork	4.60%	6.40%	2,951	4,105	0	0	2,951	4,105
62298	Fish/Fish Eggs	4.60%	6.40%	1,370	1,907	1	1	1,371	1,908
62304	Postage & Mailing	8.60%	8.60%	444,630	444,630	89,890	89,890	534,520	534,520
62404	In-state State Motor Pool	39.03%	41.06%	843,782	887,668	1,984	2,087	845,766	889,756
62510	Motor Pool Leased Vehicle	39.03%	41.06%	1,114,207	1,172,158	0	0	1,114,207	1,172,158
62601	Electricity	5.20%	7.50%	272,274	392,703	277,055	399,598	549,328	792,301
62603	Natural Gas	31.00%	31.00%	1,095,432	1,095,432	1,462,357	1,462,357	2,557,790	2,557,790
63125	Library Books	14.00%	21.90%	45,985	71,934	592,358	926,617	638,343	998,551
Subtotal				\$4,100,484	\$4,482,491	\$2,792,956	\$3,457,147	\$6,893,440	\$7,939,638
Deflation									
62142	Disk Storage Charges DofA	-4.40%	-4.40%	(\$42,206)	(\$42,206)	(\$0)	(\$0)	(\$42,206)	(\$42,206)
62172	Batch CPU Seconds DofA	-4.50%	-4.50%	(37,229)	(37,229)	(73)	(73)	(37,302)	(37,302)
62177	TSO CPU Seconds DofA	-4.50%	-4.50%	(8,185)	(8,185)	0	0	(8,185)	(8,185)
62178	IDMS CPU Seconds DofA	-4.50%	-4.50%	(87,924)	(87,924)	0	0	(87,924)	(87,924)
62180	CICS CPU Seconds DofA	-4.50%	-4.50%	(10,738)	(10,738)	0	0	(10,738)	(10,738)
Subtotal				(\$186,281)	(\$186,281)	(\$73)	(\$73)	(\$186,355)	(\$186,355)
Net Change				\$3,914,202	\$4,296,209	\$2,792,883	\$3,457,074	\$6,707,085	\$7,753,283

The largest inflationary increase in dollar terms is for natural gas, adding \$5.1 million to the total biennial budget.

The total amounts shown for FY 2008 and 2009 (\$6.7 million and \$7.8 million, respectively) represent the total amount the “all funds” base budget was increased due to applying inflation adjustments. These amounts, by fiscal year, are shown in agency budgets as statewide present law adjustments in the present law adjustment table.

LONG-RANGE PLANNING

The Governor’s request for Long-Range Planning (LRP) includes a total of \$408.6 million for capital projects, grants, loans, and environmental cleanup. The executive request is summarized in Figure 16.

The executive budget includes four uses of “one-time-only” (OTO) monies from the general fund for LRP programs, which amount to \$172.7 million. The first recommendation is a \$101.8 million transfer to the Long Range Building Program (LRBP) capital projects account. The funds will to be used to address the severe backlog of deferred maintenance in the state complex and to purchase/construct three new buildings. The second transfer in the long-range building program is to fund Access Montana, a Fish, Wildlife, and Parks recommendation of \$15 million that will fund purchases of lands that will provide better public access for outdoors activities. A total of \$1.5 million will be transferred to the Cultural Trust, \$500,000 to complete the reimbursement of the trust for the state purchase of Virginia and Nevada Cities in 1997 and \$1.0 million to increase the interest and earnings available for the cultural grants program. Finally, a \$54.5 million transfer will fund the Long-Range Consolidated Information Technology program (LRCIT). LRCIT will enhance the process of “building” new information technology systems and purchasing equipment.

Figure 22
Executive Budget Request
Long-Range Planning Budgets
2009 Biennium

Program	Recommended Appropriation Cash	Recommended Appropriation Bond Proceeds	Total Long- Range Planning Appropriations	One-Time Only Transfers
Long-Range Building Program - Cash ¹	\$303,984,138		\$303,984,138	\$101,750,000
Access Montana Program				\$15,000,000
State Building Energy Coonservation Program		\$6,000,000	6,000,000	
Treasure State Endowment Program - Grants	18,100,000		18,100,000	
Treasure State Endowment Regional Water Projects ²	6,700,000		6,700,000	
Renewable Resource Grants	5,914,946		5,914,946	
Renewable Resource Loans ³		7,541,269	7,541,269	
Reclamation & Development Grants	5,196,500		5,196,500	
Cultural & Aesthetic Grant Program	728,770		728,770	1,500,000
Long-Range Consolidated IT Program	54,472,750		54,472,750	54,472,750
Total Long Range Planning Recommendations	\$395,097,104	\$13,541,269	\$408,638,373	\$172,722,750

¹ Includes an appropriation of \$3.5 million not included in the executive recommendation
² Also includes an one-time only appropriation of \$15.0 million for Access Montana
³ Omitted from the executive recommendation
³ Executive recommendation only included bond authority of \$3.65 million

The most significant funding request of LRP includes a total of \$304.0 million for projects included in the Long-Range Building Program (LRBP). The request is an increase of 10.3 percent from the projects approved in the 2007 session. Of the projects approved for the 2007 biennium, 19.3 percent were funded with bond proceeds. There will be no bonds issued for LRBP projects in the 2009 biennium. The executive recommendation includes the construction of three new buildings funded with cash.

Total funding for the LRBP cash program is recommended to increase significantly in the 2009 biennium as the result of two executive proposals. With a substantial portion of the OTO transfer of \$101.8 million, the executive would address the need for deferred maintenance statewide. Under this proposal, the deferred maintenance backlog, estimated at over \$240 million, would be reduced by approximately \$66.5 million. The largest single example of deferred maintenance reduction is the investment of \$28.5 million for the renovation of Gaines Hall at Montana State University in Bozeman. A second proposal included in the executive budget would provide an on-going transfer of \$7.15 million per year to increase the funds available in the LRBP for major maintenance. This increase in funding would reduce the growth of the deferred maintenance backlog by providing more adequate funding for the upkeep of state buildings. In short, both measures would serve to reduce the stresses on the LRBP, the state major maintenance program.

Four environmental grant and loan programs are included in the executive budget recommendation for long-range planning. The Treasure State Endowment grant program (TSEP), the Treasure State Endowment Program Regional Water System program (TSEPRW), the Renewable Resource Grant and Loan program (RRGL), and the Reclamation and Development Grant Program (RDGP). TSEP, a program providing grants for water and wastewater projects and bridge repair, is recommended to issue \$18.1 million in grant awards. TSEPRW was not recommended in the executive budget but has an estimated \$6.7 million of interest and earnings available for the construction costs of four large regional water projects. RRGL awards both grants and loans to organizations for projects that measurably conserve, develop, manage, or preserve resources. The request includes funds of \$5.9 million to fund 51 grants and bond issuance authority of \$7.5 million for 6 loans. The recommendation for the RDGP includes funding of \$5.2 million to fund the grant awards of 16 projects that will indemnify the people of the state for the effects of mineral development on public resources.

The OTO transfer of funds to the trust of the Cultural and Aesthetic (C&A) grant program would increase interest earnings available for grants. The C&A grants that are awarded to various Montana arts programs are recommended at \$728,770. For many years, the grant program has been unable to keep pace with the requests for cultural grants. The OTO funds would allow the program to award additional grants with an estimated \$166,410 of new interest earnings.

The executive budget includes a new category of request under LRP, the Long-Range Consolidated Information Technology Program. The consolidation of major information technology (IT) projects would satisfy several goals of the administration. First, IT projects are complex and require significant and time intensive planning, design, and management efforts. By designating the projects as "capital projects", the appropriation continues until completion of the project. Second, most of the project funds are appropriated to the Department of Administration for management by the state Chief Information Officer (CIO). This would enhance project management and foster stronger partnerships between agencies and the state CIO. Finally, having all the major projects in one piece of legislation would provide the legislature with a broad vision of the state IT program and related investments.

Section F, in Volume 7, includes detailed information regarding each of the programs related to Long-Range Planning.



EXECUTIVE BUDGET – OTHER LFD ISSUES

INTRODUCTION

This section contains LFD and reference to major LFD issues related to the executive budget as a whole. These issues are in addition to specific issues raised in the agency budget presentations and in other sections of this volume. Each item is listed here and discussed in further detail in this section or as referenced to other sections of this report.

HIGHLIGHTS

Undeveloped Budget Proposals. There are many items in the proposed executive budget that are not fully developed and lack the specific information needed for a comprehensive and sometimes even adequate analysis of the budget proposal.

Structural Balance. Structural balance refers to the matching of on-going expenditures of government with on-going revenues. If revenues equal or exceed expenditures, then structural balance is achieved. The executive budget appears to be structurally balanced. However, the amount by which on-going revenues exceed on-going expenditures might be argued in terms of a more in-depth long-term sustainability assessment.

Governor's Budget Revisions. The executive submitted several amendments to the original executive budget on December 15, with a total general fund impact of \$12.9 million. Although not included in the LFD analysis, the items will be brought to the attention of the applicable appropriations subcommittee.

Index to other Major LFD Issues:

- Sustainability of proposed budget levels page 193
- Present law is overstated/statutory distinction compromised page 152
- Many budget proposals underdeveloped/unexplained page 166
- Questionable procedure of general fund transfers page 199
- Some one-time proposals are likely on-going page 148
- Broadbanding pay initiative drives up costs/lacks legislative scrutiny page 128
- Several phased-in proposals would cost more in the future page 157

UNDEVELOPED BUDGET PROPOSALS

LACK OF SPECIFICITY

Section 17-7-123, MCA outlines the content and layout of the executive budget that is submitted to the Legislative Fiscal Analyst. Specifically, this statute requires the executive to submit budget recommendations of the governor for the ensuing biennium including explanations of appropriations and revenue measures included in the budget that involve policy changes.

The executive budget, as submitted for the 2009 biennium, contains a myriad of public policy proposals that requires significant research and analysis beyond what was presented in the written executive budget. Without this information, the legislative process is hampered and may preclude the legislature from performing its statutory duties. As delineated in 5-12-302, MCA, the legislative fiscal analyst and staff is charged with assisting the legislature, including preparing an analysis of the executive budget in advance of the legislative session.

There are a number of revenue and expenditure proposals contained in the executive budget that do not contain adequate details or specificity for staff to analyze the fiscal implications of the proposal. For example, the executive recommends numerous revenue enhancements (tax compliance measures) that are estimated to produce over \$57 million during the 2009 biennium. Nowhere in the executive budget are any details shown that document or substantiate the validity of these estimates, nor does the budget document describe the specifics of the proposals. The only clue staff had to work with was a line in the executive's balance sheet that showed up under the anticipated revenue section as "Department of Revenue Other".

To perform its statutory duty, the LFA contacted the executive budget office for an explanation of the balance sheet item and was referred to the Department of Revenue (DOR) for specifics. The DOR supplied a list of over 15 tax compliance proposals with descriptions of each and estimated impacts by proposal. Further analysis of the DOR information indicated that the executive budget had "netted" estimated tax compliance revenues with proposed expenditure items, giving the impression the item was strictly due to revenue proposals. In addition, the financial details provided on the DOR documents did not match the printed executive budget publication. Unfortunately for the legislature and the legislative process, it is unclear what the executive budget is.

The above is just one example of many where lack of specificity hampers staffs' ability to provide the necessary research and analysis for the legislature. The LFD analysis in this and other volumes point out several areas where budget proposals lacked specificity and were not fully developed prior to submitting the budget. Without this information, the legislature is constrained in its ability to formulate good public policy for the citizenry of Montana. The legislature may want to consider modifying current statute to clarify and/or expand the requirement that the Governor's Budget, when submitted by November 15, provide a full explanation and justification for the proposal, and that the budget concepts be fully developed before submission of the written budget proposal. This has been an issue not only with the budget submission, but with most budget submissions in at least the past decade.

STRUCTURAL BALANCE

GENERAL FUND

Structural balance refers to the balancing of on-going expenditures with on-going revenues. If revenues equal or exceed expenditures, then structural balance is achieved at least for the short-term. If expenditures exceed revenues, then structural *imbalance* occurs. General fund expenditures exceeded on-going revenues for 12 of the past 24 years (see Figure 1). In the mid- to late-1990's, the legislature placed a concentrated effort on achieving structural balance and made significant progress, reaching a sizable positive balance in FY 2000. It should be noted that during this time, Montana as well as other states were reaping the benefits of an information technology boom and the significant increase in individual income taxes due to capital gains income. However, the pendulum shifted the other way beginning in FY 2001, where revenues were slightly above expenditures. The unprecedented revenue shortfall in the 2003 biennium intensified the imbalance heading into the 2005 biennium. Historically, legislators have faced the ever-present difficulty of holding down budget growth when confronted with double-digit growth in corrections costs, increased human services demands, and pressures for increased education funding. In the 2007 session, legislators will enjoy what appears to be a structurally balanced executive spending proposal, although there is some debate as to whether some of the projected revenues are truly on-going, i.e., sustainable over the longer term.

Figure 1

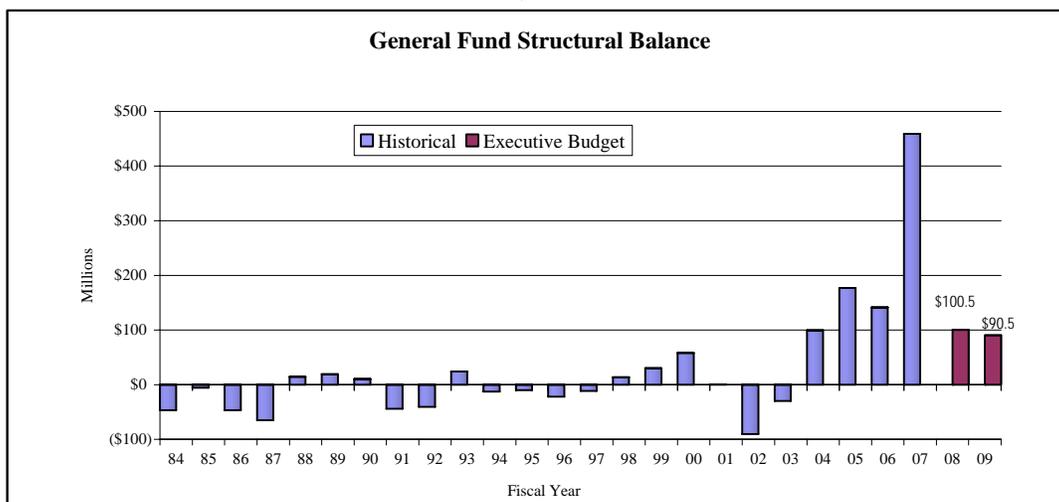


Figure 2 shows that the anticipated revenues, using revenue estimates in HJ 2, exceed on-going expenditures proposed in the executive budget for the 2009 biennium by \$191 million. However, one might argue that a portion of individual income taxes (due to high capital gains income), corporation income taxes (due to record natural resource commodity prices), and oil and gas production taxes should not be considered on-going revenue in the longer term, as these revenue sources are likely to go through a period of correction over the longer term that will result in a lower level of on-going revenues. Inclusion of one-time sources of revenue results in a misleading estimation of structural balance. Since the executive budget uses the total revenue estimate in its determination of structural balance, it may be necessary to make some adjustments. Further, the simple assessment of structural balance as matching on-going revenues to on-going expenditures, while useful to ensure short-term sustainability, is not a good measure of long-term sustainability on the expenditure side, unless issues

such as the likely reduction in federal fund support (due to federal action to reduce a huge deficit) or considerations of future funding pressures are factored in to the analysis (such as the cost of an aging population or the reversal of declining school populations). These adjustments require more in-depth analysis than is used in the current calculation of structural balance. These issues are discussed in more detail in an assessment of longer term sustainability of the general fund, beginning on page _____ of this volume.

Figure 2

Revenue and Disbursement History General Fund & School Equalization Accounts In Millions										
Fiscal Year	General Fund Revenue	General Fund Disburse.	Surplus / Deficit	School Equalization Revenue	School Equalization Disburse.	Surplus / Deficit	GF/SEA Revenue	GF/SEA Disburse.	Surplus / Deficit	Biennium Surplus/Deficit
A 84	\$330.305	\$357.387	(\$27.082)	\$242.384	\$261.753	(\$19.369)	\$572.689	\$619.140	(\$46.451)	
A 85	364.522	380.359	(15.837)	281.275	271.016	10.259	645.797	651.375	(5.578)	(\$52.029)
A 86	349.541	366.815	(17.274)	252.899	282.166	(29.267)	602.440	648.981	(46.541)	
A 87	346.690	391.325	(44.635)	263.052	283.428	(20.376)	609.742	674.753	(65.011)	(111.552)
A 88	391.152	370.853	20.299	276.216 *	281.886	(5.670)	667.368	652.739	14.629	
A 89	411.729	388.270	23.459	275.589 *	279.536	(3.947)	687.318	667.806	19.512	34.141
A 90	447.962	432.323	15.639	282.389	287.393	(5.004)	730.351	719.716	10.635	
A 91	420.257	457.612	(37.355)	385.031	391.500	(6.469)	805.288	849.112	(43.824)	(33.189)
A 92	487.036	523.072	(36.036)	393.591 *	398.059	(4.468)	880.627	921.131	(40.504)	
A 93	539.955	523.553	16.402	412.903	405.067	7.836	952.858	928.620	24.238	(16.265)
A 94	480.021	497.921	(17.900)	411.834	406.388	5.446	891.855	904.309	(12.454)	
A 95	646.149	535.461	110.688	289.199 *	409.822	(120.623)	935.348	945.283	(9.935)	(22.389)
A 96	963.193	984.997	(21.804)				963.193	984.997	(21.804)	
A 97	986.570	997.835	(11.265)				986.570	997.835	(11.265)	(33.069)
A 98	1,034.382	1,020.591	13.791				1,034.382	1,020.591	13.791	
A 99	1,068.111	1,037.961	30.150				1,068.111	1,037.961	30.150	43.941
A 00	1,163.641	1,105.599	58.042				1,163.641	1,105.599	58.042	
A 01	1,269.472	1,268.938	0.534				1,269.472	1,268.938	0.534	58.576
A 02	1,265.713	1,355.903	(90.190)				1,265.713	1,355.903	(90.190)	
A 03	1,246.381	1,275.827	(29.446)				1,246.381	1,275.827	(29.446)	(119.636)
A 04	1,381.565	1,282.038	99.527				1,381.565	1,282.038	99.527	
A 05	1,530.949	1,354.020	176.929				1,530.949	1,354.020	176.929	156.820
A 06	1,708.166	1,566.739	141.427				1,708.166	1,566.739	141.427	
F 07	1,762.355	1,303.427	458.928				1,762.355	1,303.427	458.928	876.811
F 08	1,835.891	1,735.381	100.510		Executive Budget **		1,835.891	1,735.381	100.510	
F 09	1,913.677	1,823.165	90.512		Executive Budget **		1,913.677	1,823.165	90.512	191.022

* Excludes Education Trust & General Fund Transfers.
 ** Excludes One-Time Appropriations/Transfers
 Note: The 1995 Legislature de-earmarked school equalization revenue to the general fund.

Expenditure Proposals

There are several ways in which structural balance can be adversely impacted in subsequent biennia, on the expenditure side:

- Expanded expenditure growth, such as is represented in the proposed budget (approximately 19.6 percent biennial growth), can adversely impact structural balance
- Realization of delayed implementation of expenditures. Annualization of the 2009 biennium pay plan, as proposed by the executive, will require an additional \$24.9 million general fund in the 2011 biennium
- Growth in services arising from expansions in such programs as Medicaid or from increases in prisoner populations supervised by the Department of Corrections. For any increase in annual expenditures, there must be on-going revenue with which to fund it. In order to attain or maintain a structural balance, annual revenue growth must equal or exceed expenditure growth
- Growth in services arising from known demographic or other economic changes, such as the cost of an aging population

GENERAL FUND-CONCLUSION

From the short-term view point of assessing structural balances related to matching on-going revenues with on-going expenditures in the next biennium, the executive budget is clearly structurally sound, as it proposes to not spend all available on-going revenues and to place some funds in a new rainy day fund. The executive budget meets this traditional simplistic measure of structural balance. Yet achieving long-term sustainability requires a more in-depth assessment and is a significant policy issue the legislature should address in order to make the budget process less problematic for both the legislative and executive branches in subsequent biennia. See the discussion of sustainability on page 186 of this volume.

OTHER FUNDS

In addition to issues of structural balance in the general fund, there are issues of structural balance in some of the state special revenue accounts included in the executive budget. A number of functions of state government are funded from accounts that receive their income from dedicated taxes and fees. One example is the highway special revenue account, which funds highway construction and maintenance and safety related costs. This fund is in a chronic state of structural imbalance due to an inelastic revenue source and inflationary construction costs. While the highways account is structurally balanced through the 2009 biennium, it is only because highway projects have been cut back to fully meet federal match opportunities, but reduce state funded projects. These are serious questions of long-term sustainability. In other parts of the executive budget, the legislature will find instances in which the executive has proposed expenditures that exceed revenue. By budgeting from these accounts at expenditure levels that exceed on-going revenues, the executive draws down the fund balance and creates program expenditure levels that cannot be sustained. Therefore, future legislatures would be faced with reducing program expenditure levels or increasing revenue. In agency sections of the Legislative Budget Analysis, staff has identified those instances in which expenditures from an account exceed anticipated on-going revenues.

GOVERNOR’S BUDGET REVISIONS

The executive submitted amendments to the original executive budget on December 15 as allowed under 17-7-112(9), MCA, with a total general fund impact of \$12.9 million in FY 2007 and the 2009 biennium, resulting from increases in estimated revenues of \$3.9 million and reductions on the expenditure side of \$9.2 million. Due to timing, these amendments are not included in the *Legislative Budget Analysis*, but are part of the official executive budget, and staff will bring them to the attention of the appropriations subcommittees and taxation committees as they act on agency budgets and revenue proposals. Figure 3 summarizes the various modifications to the executive budget on the expenditure side. Revenue changes are briefly described in the narrative.

Figure 3
2009 Biennium Executive Budget Adjustments
Adjustments Received December 15, 2006 - Per 17-7-112(9), MCA

Budget Component/Agency	General Fund		Other Funds		Comment
	FY 2008	FY 2009	FY 2008	FY 2009	
HB 2					
Administration	(\$270,000)	\$0	(\$30,000)		Withdraw three DPs for SABHRS readiness assessment
Administration	27,500	27,500	27,500	27,500	Correct funding of maintenance of eBenefits/Policy module
Administration	500,000	500,000	0	0	Supercomputer challenge grant project moved \$1 million to HB 2 from HB 5
Comm. of Higher Education	24,192	0	0	0	Add funding for community college audits
Comm. of Higher Education	(1,889,968)	(361,139)	0	0	Adjust base for MUS six-mill levy for RTIC estimates
Comm. of Higher Education	0	0	0	0	Add language for Community College Assistance
Governor's Office	(40,736)	(40,736)	0	0	Remove overlooked OTO from base
Justice	6,426	6,494	698,213	702,164	Highway Patrol vacancy savings restored
Justice	0	0	0	0	Correct funding for Highway Patrol - net change \$0
Military Affairs	(16,000)	0	0	0	Withdraw NP 2105 - Upgrade computers
Natural Resources & Cons	0	0	175,000	175,000	Add NP 2315 to clarify RIT special projects item (plus \$2.5M in LC1901)
Office of Public Instruction	260,138	260,138	0	0	Correct state tuition payments
Office of Public Instruction	(1,607,413)	(2,681,808)	0	0	Adjust BASE aid to include RTIC revenue estimates
Office of Public Instruction	0	158,156	0	0	Change inflation rate from 2.97% to 3%
Office of Public Instruction	680,000	765,000	0	0	Adjust kindergarten proposal for Quality Educator component
Public Health & Human Svcs	(103,099)	(103,093)	0	0	Correct funding for DP 10501 Disability Svcs Division
Public Health & Human Svcs	0	0	0	0	Revise DP 70005 for language to clarify newborn screening pgm legislation impact
Revenue	(810,000)	(253,000)	0	0	Update estimates for Dept of Revenue proposed legislation
Subtotal	(\$3,238,960)	(\$1,722,488)	\$870,713	\$904,664	
Supplemental Appropriation & Other FY 2007 Modifications					
Office of Public Instruction	---	---	---	---	Correct state tuition payments - add \$200,000 GF in FY 2007
Miscellaneous	---	---	---	---	Add \$175,000 GF nonbudgeted transfer in FY 2007 for HB 740
Miscellaneous	---	---	---	---	Reduce military life insurance in FY 2007 by \$200,000 GF
Statutory Appropriation					
Revenue	(1,298,270)	(1,298,270)	1,298,270	1,298,270	Correct funding for the coal gross proceeds distribution
Other					
Administration	(500,000)	(500,000)	---	---	Supercomputer challenge grant project move of \$1 million from HB 5 to HB 2
Military Affairs	(300,000)	(300,000)	---	---	Removed military life insurance (nonbudgeted transfer)
Revenue	(125,000)				Adjustments to estimate of tax rebate
Statewide PERS adjustment	43,349	32,827	---	---	Correct funding of employer contribution increase
Total	(\$5,418,881)	(\$3,787,931)	\$2,168,983	\$2,202,934	GF totals reflect change in GF Balance Sheet

Department of Administration – Three changes occur in the executive proposal:

- The executive has withdrawn requests reflected in three decision packages (PL 308, PL 2301, and PL 2103) related to the SABHRS readiness assessment because the vendor has stated that it will support the existing system longer than previously indicated
- The executive has also corrected funding of maintenance of a system called the eBenefits/Policy module
- The supercomputer challenge grant project continues to evolve as the executive modifies its request to shift \$1 million of the original \$7 million long range building request (in HB 5) to HB 2 for operating costs to develop the administrative program that would provide the structure and marketing of the supercomputer center.

Commissioner of Higher Education – The executive is changing its request by adding funding for community college audit costs in FY 2008, and by updating the base for the Montana university system six-mill levy and corresponding general fund has been updated to include the revenues adopted by the Revenue and Transportation Interim Committee (RTIC) for HJR 2. There is also the addition of some language for HB 2.

Governor's Office – Expenditures were inadvertently left in the base expenditures of the Centralized Services Division. This adjustment removes \$40,736 general fund from the base and each year of the budget request to correct this error.

Department of Justice – In accordance with provisions of HB 35 of the 2005 session, vacancy savings, which was incorrectly applied in the executive request is restored to the Highway Patrol Division. There is also a correction to the funding to align the programs funding with the intent of HB 35 as well.

Military Affairs – The executive withdraws a new proposal request (NP 2105) for \$16,000 general fund in FY 2008 for computer upgrades. The executive also removed a nonbudgeted transfer of \$300,000 general fund in each year related to military life insurance.

Natural Resources and Conservation – The executive adds a decision package (NP 2315) to its budget request to clarify the intended use of the item marked “special project” on the RIT table in the executive budget. Partial funding is included in the decision package and the remainder of the funding is found in legislation (LC 1901). In addition, RIT fund balances are updated to include current revenue estimates.

Office of Public Instruction – There are four adjustments by the executive in the 2009 biennium budget proposal:

- An increase of \$260,138 general fund each year to correct the funding of state tuition payments which were understated in the budget proposal (also a supplemental appropriation request for FY 2007 mentioned below)
- The adjusted base school BASE aid is updated to include revenues adopted by RTIC, and a second decision package is added to clarify the present law and new proposal portions of the budget
- The inflation rate for K-12 education has been updated to 3.0 percent from 2.97 percent
- The executive's full-time kindergarten proposal is adjusted to include the cost for the Quality Educator component for the new kindergarten teachers anticipated

Public Health and Human Services – The executive makes a correction to the funding for DP 10501 related to Disability Services Division, to make changes necessary to accurately reflect the provider rate increase, and revises DP 70005 for language to clarify newborn screening program legislation impact.

Revenue – The estimated fiscal impact on the expenditure side, for the Department of Revenue, is reduced by \$810,000 general fund in FY 2008 and \$235,000 general fund in FY 2009.

Supplemental Appropriation and Other FY 2007 Modifications – Adjustment to FY 2007 occur in three ways:

- An additional FY 2007 supplemental appropriation request of \$200,000 general fund to correct the understated state tuition payments of the Office of Public Instruction
- The addition of a transfer of \$175,000 general fund for HB 740 of the 2005 session regarding asbestos disease related programs
- A reduction of \$200,000 general fund from the appropriation for military life insurance (there is a similar reduction mentioned above relating to the 2009 biennium budget)

Statutory Appropriations – This change corrects the funding for the coal gross proceeds distribution statutory appropriation by moving it from the general fund to a state special revenue account (02232).

Rebates Adjustment – An adjustment is made by the executive to amounts estimated for two tax rebate proposals, property tax and water fee rebates for a net reduction of \$125,000 general fund.

Statewide PERS Adjustment – The employer contribution required to make the Public Employees' Retirement Board Systems actuarially sound have been updated to the most current numbers: 0.27 percent employer additional contribution for PERS and 0.58 percent for the Sheriffs' Retirement System.

Revenue Adjustments – Estimates of the revenue fiscal impact of Department of Revenue legislative proposals changes somewhat from the general fund balance sheet presented with the November 15 submission and the December 15 revisions. General fund revenues increase by \$2.48 million in FY 2008 and \$1.4 million in FY 2009.