Fiscal Focus

QUARTERLY • SEPTEMBER 2004 ISSUE

DANIEL W. HYNES
STATE OF ILLINOIS COMPTROLLER

Comptroller Hynes' office strives to assist taxpayers and the people of Illinois. This report is designed to provide fiscal information of general interest.

Financial Challenges Remain for the Fiscal Year 2005 Budget

After a record breaking overtime session, the Governor signed the fiscal year 2005 budget into law as Public Act 93-842 on July 30, 2004. Additionally, four other budget implementation bills were enacted that include fiscal year 2005 tax, fee, and other statutory changes needed for the budget. General Funds appropriations total approximately $23.7 billion, within an estimated appropriation total from all funds of $46 billion. However, the General Assembly and Governor have delayed the consideration of the state's multi-billion dollar capital program until the fall.

Crafting of the fiscal year 2005 budget presented numerous challenges due to ongoing revenue issues along with increasing debt service expenses, unexpectedly high pension costs for state employees and the continuing pressure to provide additional funding for priority areas. To address the disparity between revenues and spending plans, various tax and fee increases and alternative spending scenarios were considered. The final package included increases in some budget lines, cuts in other lines, alternative funding methods, and revenue enhancements.

Fiscal Year 2005 Appropriation Highlights

The General Funds budget reflects an increase in appropriations of approximately $231 million above fiscal year 2004. Increases are included for Elementary and Secondary education, the

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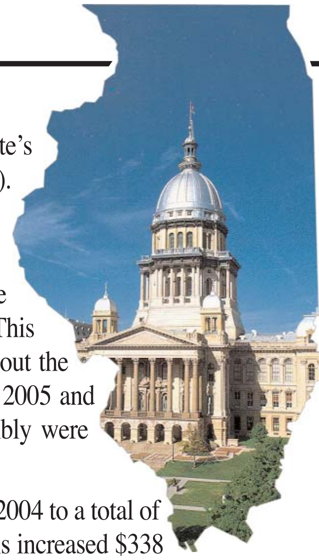
FROM THE COMPTROLLER

Dear Readers:

This issue of *Fiscal Focus* highlights some of the major components of the state's recently enacted budget for fiscal year 2005 (July 1, 2004 – June 30, 2005). Spending pressures and lackluster base revenue growth challenged the Governor and the General Assembly in the development of the budget.



General Funds base revenues for fiscal year 2004 were up by $3.7 billion above fiscal year 2003 as one-time revenue generating methods were utilized. This enabled the state to reduce, but not entirely eliminate, payment delays throughout the year. However, without the availability of these same resources in fiscal year 2005 and expected continued mild economic growth, the Governor and General Assembly were compelled to seek other methods to attempt to balance the budget.

General Funds appropriations are up an estimated $231 million over fiscal year 2004 to a total of $23.7 billion (see *Focus on Spending*). Department of Public Aid appropriations increased $338 million or 5.9%, while the Department of Human Services (up $197 million or 23.4%) received a significant increase for awards and grants. Elementary and Secondary education also fared well in the appropriations process as funding increased $289 million or 4.4%. Nearly $237 million of the increase was for General State Aid which pushed the foundation level of funding per student up $154 to $4,964.

As discussed in the *Cover Story,* the state's spending continues to grow even with minimal growth in the state's major revenue sources. The ultimate question is whether Illinois can make real improvements in its fiscal health while addressing continued pressures to fund state programs. Cash flow pressures are already impacting the state's ability to pay bills on a timely basis.

Your comments about this or our other publications are always welcome. Your input can be sent directly, or via the web site at **www.ioc.state.il.us**.

Sincerely,

Daniel W. Hynes
Comptroller

Fiscal Focus Features

Fiscal Focus

Fiscal Focus is one of the ways the Comptroller's Office strives to assist taxpayers and the people of Illinois. This monthly report is designed to provide fiscal information of general interest.

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Printed by Authority of the State of Illinois 9/8/04 - 3,043, Job 38000

Fiscal $marts

Budgeting for the Increasing Costs of Debt

One area of large growth in the state's budget is for the repayment of the state's outstanding debt. Debt service is comprised of principal and interest payments. Bond issuance has been high over the last five years due to the state's Illinois FIRST infrastructure program and a one-time issuance of bonds for funding the state's pension systems. [Note that the legislation authorizing the Illinois Pension Funding General Obligation Bonds had an unusual provision that reduces the state's contributions to the five retirement systems by the same amount that is required for debt service on the bonds.]

Most of the state's outstanding debt is in the form of general obligation (GO) bonds, which means that the state's "full faith and credit" is pledged to pay the bonds – essentially that the bonds will get paid before any other commitments the state has made.

Debt service on the state's GO bonds is primarily paid from the General Revenue Fund and the Road Fund. Therefore, growth in debt service payments limits the amount of revenues available to pay for other important state programs. As shown in the chart on page 4, GO debt service has grown from $717 million in fiscal year 2000 to $1.4 billion in fiscal year 2004, a 98% increase. Even after subtracting the $481 million payment on the state's pension funding GO bonds, the growth in debt service was almost 31%.

The fiscal year 2004 debt service total reflects a decrease in principal repaid due to debt restructurings that year that frontloaded the

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HOW Illinois Stacks Up

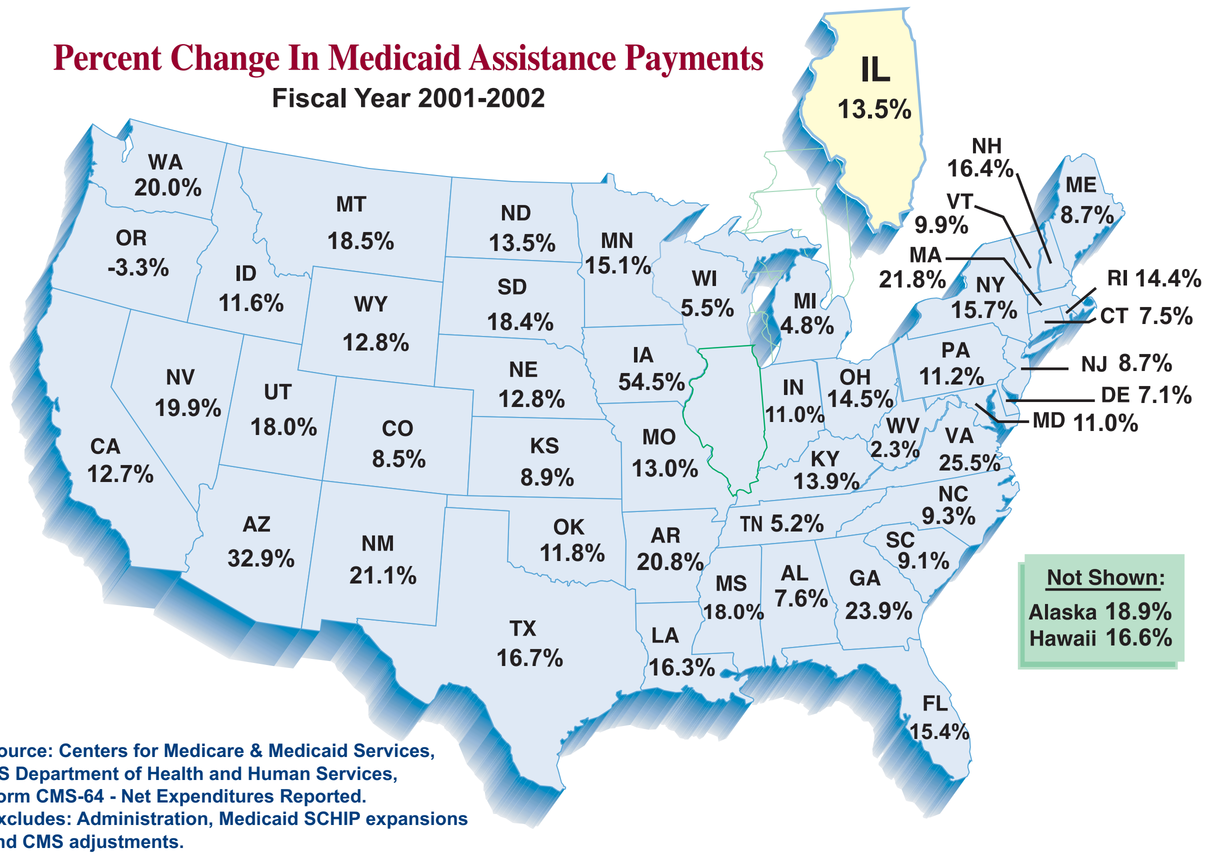
Medicaid Costs Escalate

A recent article by the National Conference of State Legislatures warns that Medicaid costs are "gobbling up" state budgets at an alarming rate. A survey of legislative fiscal officers shows that Medicaid costs are a major issue since they continue to escalate at a pace faster than the growth in state revenues. More specifically, the article points out that "nationwide, the program's costs soared 12.8 percent in 2002 . . . while states' revenues grew an average of only 1.2 percent."

Looking at the percent change in Medicaid payments made by the states from federal fiscal year 2001 to 2002 reveals surprisingly large increases. Iowa's program jumped 54.5 percent and Arizona's was up 32.9 percent. Five states had percent increases between 20 and 30 percent, while another 27 states saw increases in the 10-20 percent range. Only 15 states had increases of less than 10 percent.

Illinois' Medicaid payments increased 13.5 percent, ranking the state 26th out of all of the states.

The article points out that 70 percent of Medicaid spending is for low-income elderly people and people with serious disabilities or chronic debilitating diseases. Medicaid pays for about one-half of all U.S. nursing home costs. Most nursing home residents do not have long-term care insurance, and they end up relying on Medicaid once their personal savings are exhausted.



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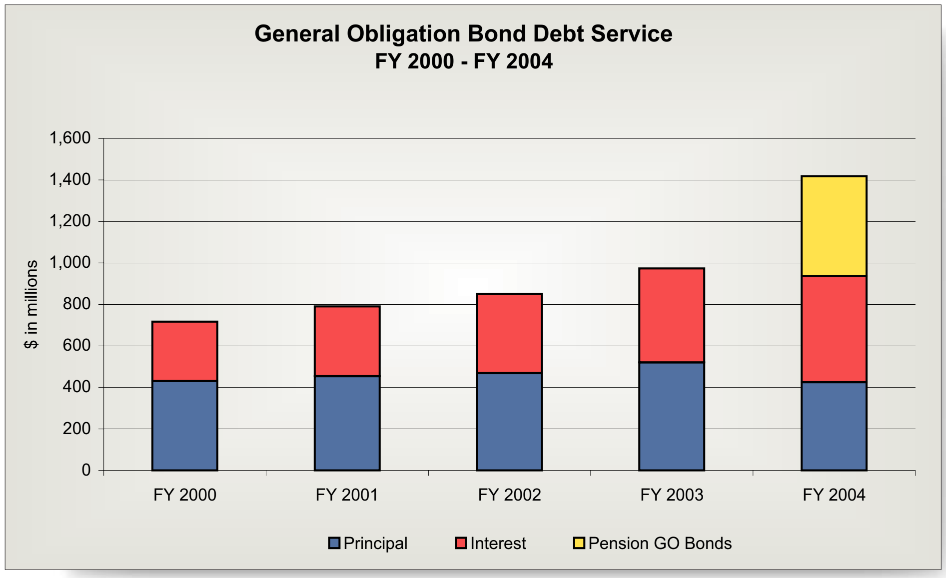
reflects a decrease in principal repaid due to debt restructurings that year that front-loaded the state's savings. This means that the amount of debt service paid in fiscal year 2004 is lower due to refunding bond issues that pushed principal payments off until later years. This practice will be limited under the debt issuance reforms contained in Public Act 93-839.

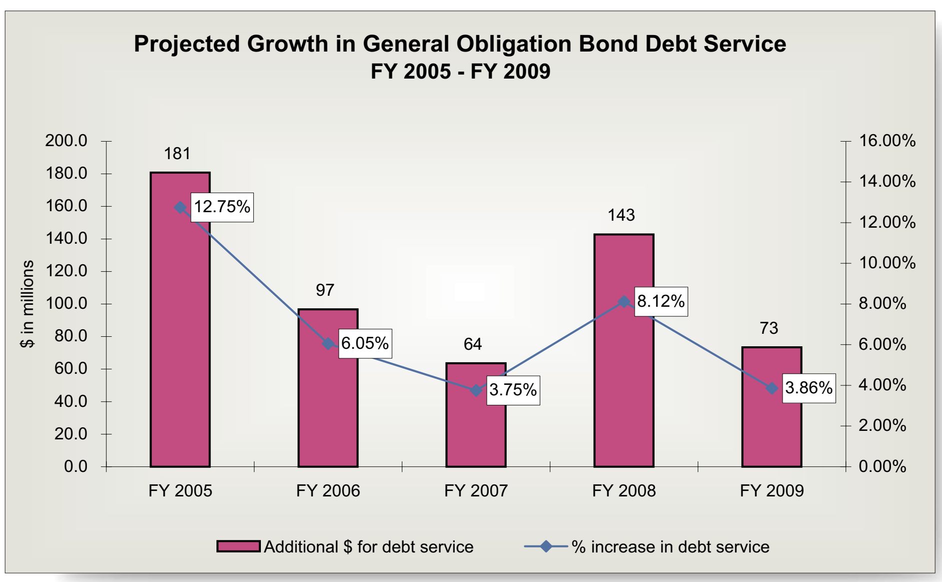
The state has continuing obligations to pay debt service on general obligation bonds. As more bonds are issued to fund the state's capital program, debt service costs will continue to grow. Although issuing bonds can be seen as an easier way to pay for programs and projects (since the cost is spread out over many years), the cost to pay the debt is added to the existing debt service schedule and will make the first claim on any revenue growth.

Working with the current debt service schedule for bonds that have already been issued, we can make projections on the amount of additional revenues that will be needed over the next few fiscal years to meet the state's GO debt obligations. Assuming that the state issues $1.2 billion in bonds in each of the next four fiscal years at a 5.5% interest rate (with 25-year level principal structure pursuant to Public Act 93-839), the state's general obligation debt service costs will increase from an estimated $1.6 billion in fiscal year 2005 to almost $2.0 billion in fiscal year 2009. The chart on the right shows the projected incremental increases in GO debt service by each fiscal year and the percent increase over the prior year that this amount represents. The increase in debt service is the automatic slice of state revenue growth that will not be available for other programs. In many years, the growth rate in debt service is likely to exceed the growth rate in state revenue.

There is an approximately $180 million increase in debt service costs projected for fiscal year 2005. This increase of almost 13% is attributable primarily to fiscal year 2004 debt restructurings.

Although the state is required to make its debt service payments once the bonds are issued, the impact on the state's budget can be minimized by careful planning prior to issuance. This can be accomplished by a careful evaluation of the size and affordability of the state's capital program compared to a realistic evaluation of the ability of the state's revenue stream to absorb additional debt service costs. (See "Trouble Down the Road" for a discussion of limits to available Road Fund resources.)





Cover Story continued from front page

Department of Public Aid and the Department of Human Services. General Funds appropriations for the State Board of Education totaled $5.8 billion, an increase of approximately $300 million, primarily for General State Aid, and grant reimbursements for such items as transportation, special education, and early childhood programs. The Department of Public Aid's new General Funds budget totals $6.04 billion, including an appropriation of $850 million for repayment of the June 2004 short-term borrowing. The Department of Human Services' General Funds budget increased by approximately $68 million over fiscal year 2004, primarily for child care, the Home Services Program, and Medicaid. Appropriations directly to the state's universities are essentially unchanged from fiscal year 2004.

Most of the other state agencies have decreases from fiscal year 2004. See the detail on appropriations included in *Focus on Spending*. In general, most agencies will need to absorb the costs of the recent union contracts and increased pension funding formulas into their individual budgets. An Alternative Retirement Cancellation Payment Program and a lump sum payment severance program are to be offered during fiscal year 2005 to further reduce headcount and manage agency expenditures. More details are included in the *Pension Funding* article on page 12.

Funding Changes

Included in the fiscal year 2005 budget is funding for a portion of the 2002 Early Retirement Incentive (ERI) program cost. Legislative language changes lower the fiscal year 2005 ERI payment to the State Employees Retirement System (SERS) from the original estimate of $380 million to $70 million. This change is estimated to save the General Funds $200 million (reflecting the General Funds share of total state payroll costs). Additionally, the future ERI payments to the system are restructured to equal approximately $260 million a year from fiscal year 2006 through fiscal year 2015. However, a portion of the debt service on Illinois' pension funding bonds issued in 2003 will be billed to the agencies in the form of an additional payment to SERS. This change is expected to provide $45 million in savings for the General Funds.

Other appropriation changes include increasing the portion paid to the State Universities Retirement System from other state funds by over $200 million, while reducing its appropriation from the General Funds. The limit on Road Fund appropriations for the Secretary of State and Department of State Police's operations was increased for the fiscal year to provide $145 million of additional funding for those agencies.

Revenue Changes

Updated revenue estimates for fiscal year 2005 have not been made available by the Governor's Office of Management and Budget. Several General Funds revenue enhancements were included in the final budget proposal, including some permanent changes and some providing only revenue for fiscal year 2005.

One-time transfers from other funds (so called "fund sweeps") are scheduled to total approximately $260 million along with potential transfers of up to $80 million from new Medicaid provider funds. The administrative chargebacks that began in fiscal year 2004 are to continue in fiscal year 2005, with estimated transfers of $220 million from other state funds. A statutory change was included that will allow 75% of the initial fund balance to be transferred (instead of 25%), but some funds such as the Road Fund are exempted from the charges. Language was added to sunset these chargebacks at the end of fiscal year 2007. Also, there is an allocation of an additional $50 million of cigarette tax receipts to the General Funds, a one-time source of relief for fiscal year 2005.

Income tax and sales tax changes include an offshore corporation tax shelter amnesty program and eliminating several corporate tax exemptions. The budget also depends on some new fee increases. As part of the budget agreement, a number of the fee and tax increases included in the fiscal year 2004 budget were reduced or eliminated. Additional detail on these revenue changes is included in *Focus on Revenue*.

Fiscal Position

The fiscal year 2005 budget may be viewed as the state's attempt to take at least an incremental step towards restoring its fiscal health. At the end of fiscal year 2004, the cash balance in Illinois' General Funds totaled $182 million, the lowest end of year cash balance since fiscal year 1993. However, the state did manage to end fiscal year 2004 with almost no backlog of bills in its General Funds and $276 million remaining in the Budget Stabilization Fund, conditions accompanied by $850 million in short-term borrowing issued in June 2004.

The likelihood of continued stability depends primarily on the soundness of the underlying revenue and spending estimates. The relatively weak cash position of the state entering fiscal year 2005 means that there is little room for error in the revenue forecasts. Revenue underperformance could quickly translate into a significant backlog of bills at the end of the fiscal year.

A critical area of spending concern is the Medicaid program; anticipated growth in spending beyond the amount appropriated in fiscal year 2005 will force the state to carry over unpaid bills into the next fiscal year. The Department of Public Aid's General Funds appropriations for Medicaid payments to providers are approximately $500 million below fiscal year 2004 levels and approximately $1.1 billion below the level the Governor recommended earlier in the year. This is partially attributable to

COVER STORY continued, page 10

LOCAL Government Line

Local Government Division Accomplishments 1999 - 2003

Since taking office in January 1999, Comptroller Hynes has been committed to increasing local government accountability, improving the quality of the financial data submitted in the Annual Financial Report (AFR), becoming more efficient in collecting and analyzing annual financial data, and introducing innovative programs and services to local government officials. In just five years, the Office of the Comptroller's Local Government Division has dramatically improved local government reporting compliance; offered more than 30 educational training programs; launched Comptroller Connect Internet Filing; partnered with numerous agencies and local government associations to streamline financial reporting; audited chronically delinquent units of government; passed legislation to save taxpayers from frivolous audit expenses and eliminate duplicative reporting requirements; and launched a toll-free Local Government Assistance Hotline.

The following items highlight some of the key accomplishments of the Local Government Division over the past few years:

Annual Financial Report (AFR)

- Created short and abbreviated forms, which allow local governments with less complex finances to file their annual financial data more efficiently and accurately.
- Developed and improved support documents to provide local government officials step-by-step instructions on how to fill out the AFR.
- Expanded expenditure and revenue categories to allow for more descriptive reporting of local government spending.

Educational and Training Programs

- Held the 1999 and 2003 County Treasurer's Training Programs, with interactive sessions on the property tax cycle, investment policy, mobile home taxation and bankruptcy.
- Annually conducted training seminars on AFR reporting, debt management, fiscal health & responsibility, Tax Increment Finance (TIF) reporting, Comptroller Connect Internet Filing, budgeting, GASB 34, and innovative funding sources. More than 2,500 local government officials and accounting professionals have attended these training seminars.
- More than 1,000 local government officials have attended the specialized AFR training seminars developed for statewide local government organizations.
- Members of the Local Government Division Staff have conducted more than 600 one-on-one help sessions with local government officials in all of Illinois' 102 counties.

Technology

- Developed and launched Comptroller Connect Internet Filing that allows local governments to file their annual financial data on-line. Currently, 70% of all financial data is submitted via Comptroller Connect.
- Improved and enhanced the Local Government Division's website which contains: all local government financial data, immediate access to submitted AFRs, access to the Fiscal Responsibility Report Card, Individual Data Summaries, and Comptroller Connect Internet Filing.
- Created an on-line download center, allowing local government officials and accounting professionals to download Annual Financial Reports, TIF Reports, Registration Forms and corresponding support documents.

Compliance

- In January 1999, only 65% of all local government fulfilled their annual financial reporting requirements to the Office of the Comptroller. Since then annual compliance has been 96%.
- More than 50 units of government have been audited, a result of their chronic non-compliance [three or more years delinquent].

LOCAL GOVERNMENT LINE continued, page 14

CEMETERY Care Corner

West Nile Reminder

With warm weather here, the threat of the West Nile Virus exists in Illinois. This is especially relevant to those who choose to visit their loved ones in cemeteries. Steps taken by local officials throughout the state significantly reduced cases of the virus during 2003 compared with the previous summer. However, Comptroller Hynes encourages all cemetery staff and visitors to be aware of the statistics from 2002 and continue their prevention efforts.

During the summer of 2002, Illinois led the nation in reported cases of the West Nile Virus. Eight hundred cases of the disease were confirmed, 64 of which resulted in fatalities. Surveys conducted by the Centers for Disease Control concluded that 10% of those infected had recently visited a cemetery. Given his responsibility for the oversight of more than 2,000 cemeteries and funeral homes throughout the state, the Comptroller launched an educational program to help prevent the spread of West Nile during the summer of 2003.

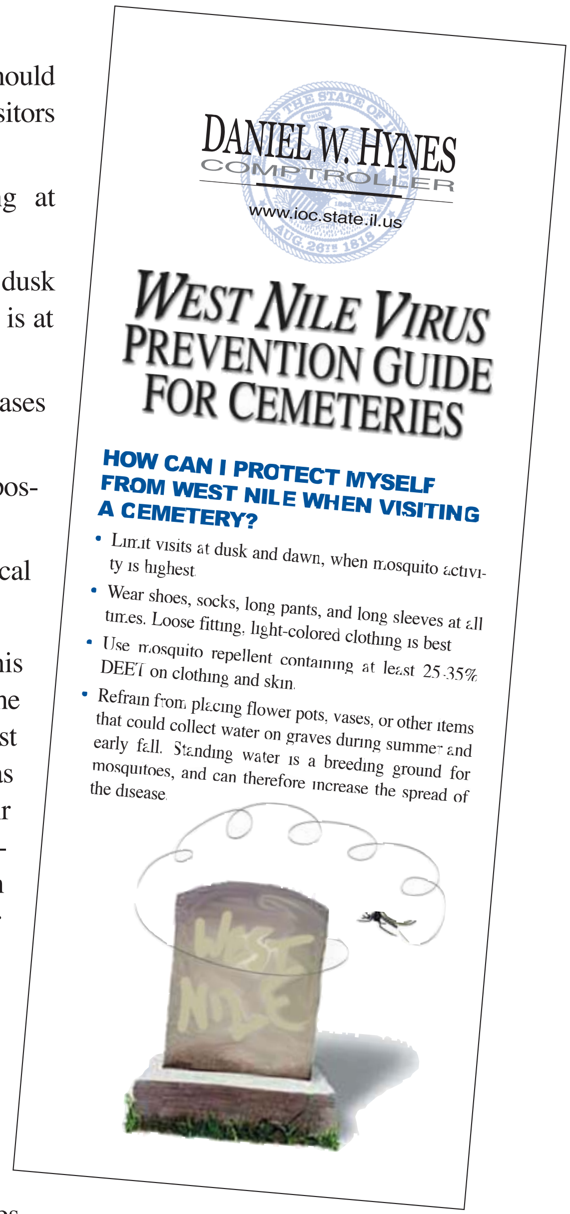
The West Nile Virus was first discovered in the United States during the summer of 2001. The disease is spread by mosquitoes that feed on infected birds. In many cases, people infected with West Nile never become ill. Those who do usually experience flu-like symptoms, or in very serious cases, high fever, muscle weakness and confusion.

The following are precautions that should be taken by all cemetery staff and visitors during the summer months:

- Wear insect repellant containing at least 25% DEET.
- Avoid cemetery grounds between dusk and dawn when mosquito activity is at its peak.
- Remove standing water from vases and flower pots.
- Keep grass and weeds as short as possible.
- Report any dead birds to the local health department.

Comptroller Hynes is renewing his warning to cemeteries regarding the dangers of standing water during West Nile season. While each cemetery has the authority to set and maintain their own policies, the Comptroller is suggesting that patrons refrain from bringing any flowers to be left on or near headstones. Fresh flowers placed in or out of vases, along with artificial flowers, collect standing water and serve as a breeding ground for mosquitoes. The elimination of flowers during the summer months may reduce the likelihood of infection in Illinois cemeteries.

More information about the West Nile Virus as it relates to cemeteries is available by contacting the Comptroller's Cemetery Care Hotline or visiting our website at www.ioc.state.il.us/ccbt.



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WEST NILE VIRUS
PREVENTION GUIDE
FOR CEMETERIES

HOW CAN I PROTECT MYSELF FROM WEST NILE WHEN VISITING A CEMETERY?

- Limit visits at dusk and dawn, when mosquito activity is highest.
- Wear shoes, socks, long pants, and long sleeves at all times. Loose fitting, light-colored clothing is best.
- Use mosquito repellent containing at least 25-35% DEET on clothing and skin.
- Refrain from placing flower pots, vases, or other items that could collect water on graves during summer and early fall. Standing water is a breeding ground for mosquitoes, and can therefore increase the spread of the disease.

FOCUS On Revenue

Revenue Enhancements

The fiscal year 2004 budget included wholesale increases in fee rates and eliminations of tax expenditures to provide additional revenues to help close the budget gap. The fiscal year 2005 budget includes a more modest package of revenue enhancements. These consist of the closing of selected income tax loopholes, a limited income tax amnesty program, several fee rate increases, and one new tax. To some extent, these revenue enhancements are offset by a reduction of some of the fiscal year 2004 fee rate increases and the restoration of several tax expenditures that were eliminated last fiscal year.

Illinois revenues from the corporate income tax have been a decreasing share of state revenues as multi-state corporations have taken advantage of tax strategies that either reduce taxable income or shift income to low tax localities. In a July 2003 study, the Multistate Tax Commission estimated that Illinois lost $693 million in corporate income tax revenues (including personal property replacement tax revenues) in fiscal year 2001 from domestic and international tax shelters. The budget implementation legislation adopts several strategies to recapture some of this income.

Limits are placed on several techniques that could allow multi-state and multinational corporate groups to reduce the portion of their income allocable to Illinois. These companies must apportion their business income to the states where they have operations. Income that is not from business activities such as income from investments need not be apportioned. The new law broadens the definition of business income to include all income that may be treated as apportionable income under the U.S. Constitution. It also allows Illinois to recapture part of the gain from the sale of assets that contributed to business income. When such an asset is sold and the gain is not counted as business income, three years worth of business expenses related to that asset must be added back to business income.

In Illinois, combined reporting is required for businesses related by common ownership and having integrated business activities (a "unitary business group"). However, under the waters edge method of reporting, members of the unitary business group whose business activities are primarily outside the U.S are not combined when apportioning income to Illinois. This provides an opportunity to avoid taxes by shifting income to the foreign members of the group. Under the new legislation, interest and intangible expenses and costs paid to foreign based operations of a unitary business group are no longer automatically deducted from adjusted gross income.

In recent years, the federal government has begun an initiative to combat abusive tax avoidance transactions. New federal regulations require promoters to register certain shelters with the IRS and maintain lists of investors in those transactions. Investors are also required to disclose shelter positions they claim on their tax returns. The Department of Revenue is allowed to take advantage of this federal initiative by requiring the registration of tax shelters and having taxpayers submit copies of their federal disclosures of tax shelters. Significant new penalties are to be levied against tax payers who fail to report abusive tax shelters.

A limited income tax amnesty program (the tax shelter voluntary compliance program) is created to give income tax payers who have been using illegal tax shelters the opportunity to amend their returns and avoid criminal penalties. The amnesty period runs from October 15, 2004 to January 31, 2005. Eligible taxpayers who are uncertain about their liability may participate with an appeal option.

The number of fees having rates increase in the fiscal year 2005 budget is far fewer than in the prior year budget. The Secretary of State's identification card fee (often used by individuals without drivers' licenses) is increased from $4 to $20 with the increment going to the General Revenue Fund. Senior citizens and the disabled can still get their identification cards without charge. Lottery agent fees are increased including an increase in the application fee for lottery agents from $10 to $50. Changes in the vehicle code include an increase in the fee for the replacement of vehicle plates from $19 to $39, the addition of a new $20 delinquent registration fee, and a boost in the fee for reinstating a license after a DUI conviction from $100 to $500 and to $1,000 for additional convictions.

The new tax is the 6.25% watercraft use tax created for private watercraft sales not covered by the sales taxes. Title to a vehicle cannot be obtained without evidence of payment of the tax. Charitable, religious, and educational organizations are exempt from the tax.

FOCUS ON REVENUE continued, page 14

FOCUS On Spending

Fiscal Year 2005 Spending Authority by Agency

General Funds appropriations passed by the General Assembly and signed by the Governor total $23.714 billion for fiscal year 2005, an increase of approximately $231 million, or less than 1.0% from fiscal year 2004.

Code departments' appropriations increased $222 million. Department of Public Aid appropriations increased $338 million or 5.9%, but this increase included $850 million to repay short-term borrowing issued in fiscal year 2004. Also receiving increases were the Department of Human Services (up $68 million or 1.8%) and the Department on Aging (up $58 million or 22.0%). The significant increase at Department on Aging is due to the transfer of the Circuit Breaker/Pharmaceutical Assistance program from the Department of Revenue. The Human Services increase was for awards and grants which were up $116 million. Most of the other code departments have reduced fiscal year 2005 General Funds appropriations.

Elementary and Secondary education also fared well in the appropriations process as funding increased $289 million or 4.4%. General Funds appropriations for State Board of Education were increased by approximately $300 million, while General Funds appropriations to the Teachers Retirement System were reduced. Nearly $237 million of the growth in education was for General State Aid, an increase of 6.9%. This raised the foundation level of funding per student by $154 to $4,964. The only other sector of state government which received increased appropriations was the elected officials. Fiscal year 2005 General Funds spending authority for the elected officials increased nearly $11 million or 4.4%. Of this total, approximately half is additional authority for the Treasurer to pay refunds.

Higher education appropriation reductions totaled $247 million or 10.2% from 2004 fiscal year. Almost all of this decrease was for the State Universities Retirement System, which received additional funding in fiscal year 2005 from another state fund. The majority of the universities had small increases from fiscal year 2004.

Judicial agency General Funds budgets were cut by $30 million or 8.2% with $11 million of the cuts occurring at the Supreme Court. The legislative branch also incurred a cut of 4.1% or $3 million. Included in these cuts were reductions to the judicial and legislative retirement systems which had part of their funding shifted to another state fund.

All other agencies of state government not included in the aforementioned sectors had their appropriations reduced by $11 million or 7.5%. The Environmental Protection Agency's General Funds spending authority was reduced by $2 million or 71.5%. Two agencies, Industrial Commission and Capital Development Board, received no General Funds appropriations in fiscal year 2005.

General Funds Appropriations by Agency
Fiscal Years 2004 and 2005
Dollars in Millions

	Fiscal Year 2004	Fiscal Year 2005*	$ Change	% Change
General Assembly	$44.408	$44.928	0.520	1.2
Other Legislative	28.210	24.724	(3.486)	(12.4)
Total, Legislative	72.618	69.652	(2.966)	(4.1)
Supreme Court	300.151	289.341	(10.810)	(3.6)
Judges Retirement System	34.996	15.090	(19.906)	(56.9)
Office of the State Appellate Defender	19.053	19.796	0.743	3.9
Other Judicial	8.096	8.198	0.102	1.3
Total, Judicial	362.296	332.425	(29.871)	(8.2)
Governor	8.552	8.141	(0.411)	(4.8)
Lt. Governor	2.516	2.419	(0.097)	(3.9)
Attorney General	39.639	41.223	1.584	4.0
Secretary of State	123.427	126.386	2.959	2.4
Comptroller	51.997	53.132	1.135	2.2
Treasurer	17.870	23.470	5.600	31.3
Total, Elected Officials	244.001	254.771	10.770	4.4
Aging	262.992	320.957	57.965	22.0
Agriculture	45.274	40.641	(4.633)	(10.2)
Central Management Services	1,052.498	1,034.498	(18.000)	(1.7)
Children and Family Services	818.814	781.151	(37.663)	(4.6)
Commerce and Community Affairs	65.230	57.581	(7.649)	(11.7)
Natural Resources	108.556	90.903	(17.653)	(16.3)
Corrections	1,269.566	1,192.613	(76.953)	(6.1)
Employment Security	16.773	20.769	3.996	23.8
Human Rights	6.816	7.184	0.368	5.4
Human Services	3,701.812	3,769.489	67.677	1.8
Labor	5.978	5.852	(0.126)	(2.1)
Military Affairs	15.149	12.581	(2.568)	(17.0)
Public Aid	5,704.193	6,041.849	337.656	5.9
Public Health	119.487	127.488	8.001	6.7
Revenue	172.285	133.241	(39.044)	(22.7)
State Police	198.409	171.732	(26.677)	(13.4)
Transportation	83.320	57.763	(25.557)	(30.7)
Veteran's Affairs	38.457	41.289	2.832	7.4
Total, Code Departments	13,685.609	13,907.581	221.972	1.6
Arts Council	18.894	18.865	(0.029)	(0.2)
Office of Inspector General	4.126	5.728	1.602	N/A
Capital Development Board	11.093	0.000	(11.093)	(100.0)
Court of Claims	37.596	36.688	(0.908)	(2.4)
Environmental Protection Agency	2.797	0.796	(2.001)	(71.5)
Historic Preservation	13.677	13.487	(0.190)	(1.4)
Illinois Violence Prevention	3.290	3.172	(0.118)	(3.6)
Industrial Commission	4.023	0.000	(4.023)	(100.0)
Emergency Management	7.899	5.421	(2.478)	(31.4)
All Other	37.282	45.909	8.627	23.1
Total, Other Agencies	140.677	130.066	(10.611)	(7.5)
Total, Elem. & Sec. Education	6,559.118	6,847.725	288.607	4.4
Board of Higher Education	61.770	40.669	(21.101)	(34.2)
Chicago State University	40.451	38.845	(1.606)	(4.0)
Eastern Illinois University	47.610	47.610	0.000	0.0
Governor's State University	24.180	24.280	0.100	0.4
Northeastern Illinois University	39.078	39.228	0.150	0.4
Western Illinois University	56.091	56.391	0.300	0.5
Illinois State University	80.452	80.452	0.000	0.0
Northern Illinois University	101.799	102.275	0.476	0.5
Southern Illinois University	217.204	217.429	0.225	0.1
University of Illinois	696.911	698.451	1.540	0.2
Community College Board	339.722	345.677	5.955	1.8
Student Assistance Commission	398.955	391.601	(7.354)	(1.8)
University Retirement System	299.181	71.834	(227.347)	(76.0)
All Other	15.613	17.086	1.473	9.4
Total, Higher Education	2,419.017	2,171.828	(247.189)	(10.2)
Total, General Funds	$23,483.336	$23,714.048	230.712	1.0

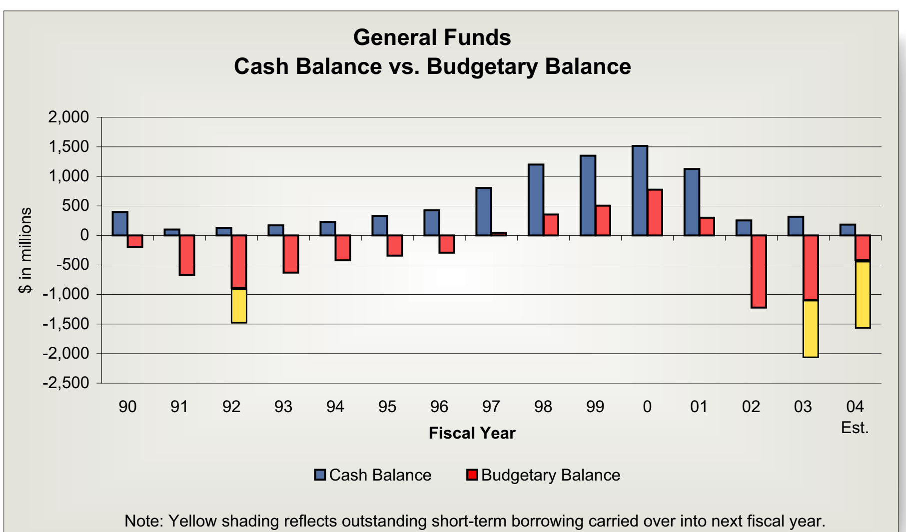
Source: Comptroller Records.

*Preliminary numbers.

Cover Story continued from page 5

$850 million in short-term borrowing in June 2004; however, past history combined with increasing levels of enrollment indicates that a significant amount of bills will likely be carried over into fiscal year 2006. While this carryover, referred to as Section 25 liabilities, is hardly a new phenomenon, insufficient appropriations will result again in payment delays for vendors, possibly of long duration.

Illinois is clearly not out of its fiscal difficulties yet. The chart below shows the cash balance and budgetary balance in the General Funds over the last 15 fiscal years. The budgetary balance is the cash balance at the end of the fiscal year less outstanding bills paid during the lapse period. There will be an improvement in the budgetary balance in fiscal year 2004, similar to the pattern of modest improvements in the early to mid 1990s. This approach to budgeting works only when there is continued improvement in the state's economic health. If no such improvement is seen, the state is not in the same position that it was in at the beginning of the current period of fiscal crisis to weather economic storms. If there is another downturn in the economy, the state could be quickly in distress.



Structural Deficits and One-Time Revenues

For the past few fiscal years, Illinois has depended on one-time revenue sources and spending diversions to cover General Funds budget deficits. This use of one-time measures masks the underlying inadequacy of the state's revenue base to support the ongoing expenditures of state government. The basic definition of a "structural deficit" is that base revenues collected are not enough to support the base spending. This is what has happened in Illinois. Base revenues are generally considered to be those collected regularly without needing special legal provisions in each fiscal year, such as income taxes or sales taxes. [Note that "base revenues" as used here is not the same as "base revenues" as used in the tables in this document that include all revenues aside from short-term borrowing. Here, base revenues mean those revenue sources that will be collected regularly by the state year to year without needing special legislative provisions.] This "structural deficit" creates difficulties each year in the development of the state's budget.

In theory, these base revenues are supposed to grow each year as the state's economy expands --- as individuals' and business incomes increase, collections of the income and sales tax are supposed to increase. Base spending is what is spent to cover the costs of state programs on an ongoing basis. Some program costs, such as spending on health care programs like Medicaid, funding of state employee pensions, or payments on state debt, have increased for several fiscal years at a measurably faster rate than revenues have grown. There is also ongoing pressure to provide additional state funding for programs such as elementary and secondary education.

The state constitution requires the state to have a balanced budget (although interpretations vary on what makes a budget balanced). Therefore, the state can increase spending at a faster rate than base revenues grow or not cut spending if revenues underperform only if another source of revenues is used to offset shortfalls. Budget crafters often look to one-time revenues (where money is only available for one year) to fill a shortfall, especially in times of fiscal crisis when there is always a hope that "it will be better next year."

The severity of the current fiscal crisis became apparent during fiscal year 2002. Illinois ended that year with a backlog of General Funds bills totaling $781 million that were paid in the lapse period. The fiscal position of the state did not improve during fiscal year 2003, as revenues continued to decline and the state ended the year with $874 million in unpaid bills carried over into the next fiscal year. Additionally, the state borrowed $1.5 billion at the end of fiscal year 2003 and carried over that debt into fiscal year 2004, along with an increased amount of Section 25 liabilities. Additional revenues were needed in fiscal years 2003 and 2004 to assist with the payment of the bills carried over. The chart contains the cash balance and budgetary balance in the General Funds to illustrate the state's situation. Furthermore, as mentioned earlier, there were predictable pressures to increase spending even during a period of financial stress.

Several one-time revenue sources were used to fill a portion of these budget gaps and these sources allowed the state to limit cuts to some services and in some cases increase funding for priority areas. (It should be noted that the additional fiscal year 2004 revenues tied to the Federal Jobs and Growth Tax Relief Reconciliation Act were not counted on when the budget was crafted, but offset the underperformance of other revenue sources. It can be argued that this windfall bailed out an otherwise failed fiscal year 2004 budget.) Additionally, state law was amended to increase allowed expenditures from the Road Fund for Secretary of State and Department of State Police operations to relieve pressure on the General Funds. The accompanying table includes a list of some of the larger one-time measures used in the last few fiscal years that helped balance the budget.

While the fiscal year 2004 budget relied heavily on one-time revenues such as tax amnesty and proceeds from the pension bond sales, the fiscal year 2005 budget contains one-time measures that shift expenditures to different fiscal years or to different state funds (i.e. non-GRF funds). For example, the $850 million short-term Medicaid borrowing in late fiscal year 2004 resulted in a corresponding reduction in Medicaid appropriations for fiscal year 2005. This was not a "cut" in Medicaid spending, but rather a one-year shifting of expenditures, much of which will "reappear" in future budgets. An additional $250 million in Medicaid appropriations were inexplicably cut from the fiscal year 2005 budget without reducing reimbursement rates or eligibility criteria (in fact, eligibility was expanded). This can only result in these Medicaid expenditures being shifted to fiscal year 2006.

Estimate of Major One-Time Sources Benefitting the General Funds
($ in millions)

	FY2003	FY2004	FY2005
Revenues			
"Sweeps" from Other State Funds	$ 165	$ 154	$ 260
Tax Amnesty Program	-	290	100
Proceeds from Pension Bond Sale	300	1,395	-
Cigarette Tax Adjustment	-	-	50
Estimated Federal "Bailout"	-	750	-
Subtotal, Major One-time Revenues	$ 465	$ 2,589	$ 410
Appropriation Adjustments			
Accelerated/Deferred Medicaid Payments	$ -	$ -	$ 1,100
FY 2005 Restructure of ERI Pension Payment	-	-	200
Increase in State Pensions Fund Appropriations	-	-	80
Increase in non-IDOT Road Fund Appropriations	95	145	145
Subtotal, Major Appropriation Adjustments	$ 95	$ 145	$ 1,525
Total, Major One-time Budget Sources	**$ 560**	**$ 2,734**	**$ 1,935**

The fiscal year 2005 budget was also "balanced" through the use of pension payment deferrals, once a commonly used budget gimmick that has caused Illinois to lead the nation in the category of underfunded pensions. While the 2002 early retirement program was originally to be repaid at a rate of $380 million a year ($245 million in General Funds) from fiscal year 2005 through fiscal year 2014, budget makers chose instead to pay just $70 million in fiscal year 2005. While this serves as $200 million in General Funds budget relief for fiscal year 2005, it further exacerbates the pension systems' troubles. GRF is also relieved of an estimated $80 million in pension payments through greater contributions from the State Pensions Fund.

Balancing a budget with one-time sources only disguises a structural deficit and systemic fiscal problems. While the $1.9 billion in one-time measures in the fiscal year 2005 budget is an improvement upon fiscal year 2004, it still results in a $1.9 billion problem for next year's budget. Absent a strong surge in the economy or some other fortuitous events, Illinois faces additional fiscal challenges in the coming years.

Comptroller Daniel W. Hynes is the chief fiscal officer for the state, managing its financial accounts, processing more than 18 million transactions a year, and performing a watchdog role to assure that all payments meet the requirements of the law. The Comptroller's Office also provides timely and accurate fiscal information and analysis to the Governor, the Illinois General Assembly, and local government officials so they can make informed budget decisions. In addition, the Office oversees the state's private cemetery and funeral home industry.

Pension Funding

Pension funding remains a millstone around the neck of Illinois budgeteers. Past underfunding continues to require significant payments above current costs to help reduce unfunded liabilities. This diverts monies that otherwise could be used to fund state operations. The fiscal year 2005 budget implementation legislation amends the formula for determining pension contributions to shift some of the payments that would have been required this year to future years.

The newest pension problem arises from the unexpectedly popular 2002 Early Retirement Initiative (ERI) that attracted approximately 11,000 early retirees. The state is required by law to make retirement contributions sufficient to have the state supported retirement systems reach a 90% funding level in fiscal year 2045. Without the additional liability from the ERI, the required state contribution from the five state retirement systems would have been almost $1.6 billion. The ERI legislation added a provision to fully fund the liability incurred by the ERI over a ten year period. It was originally estimated that the additional liabilities from ERI would total $622 million. Instead the actuarial estimate of the cost was over $2 billion which would have required a payment of $380 million to amortize the ERI expense in fiscal year 2005.

The fiscal year 2005 budget implementation legislation (PA 93-839) reworked the funding formula for ERI. The ERI contribution is reduced to $70 million for fiscal year 2005. The remaining ERI liability, which is recomputed using a different actuarial valuation basis, is to be funded over the succeeding ten years requiring a contribution of approximately $260 million each year. The State Employees Retirement System (SERS) will carry the burden of the new funding plan with certified employer contributions for fiscal year 2005 shrinking from an original $737 million to $432 million under the new funding plan. The employer contribution reduction will increase the amount that SERS will have to withdraw from its investments to pay retiree benefits during the fiscal year.

Termination Incentives

The fiscal year 2003 ERI allowed participating members to purchase up to five additional years of service and to add five years to their age when computing retirement benefits. The fiscal year 2005 budget includes two new plans with more modest incentives to further reduce the state workforce.

Under the SERS Alternative Retirement Cancellation Payment Program, eligible employees must terminate their employment with the state by October 31, 2004. If they elect to participate in this program, they will receive a retirement cancellation payment equal to double their contributions to the retirement system plus interest. In return they will forfeit all pension benefits other than any group health insurance benefits they have accrued. This program would be primarily of benefit to employees who have relatively little state retirement credit and have alternate employment opportunities. It would also be of interest to employees who are willing to leave state employment and gamble that they can receive a sufficiently high return from investing their cancellation payment to offset their lost pension benefits. The impact on SERS liability will depend on which group of employees participates in the program.

This option is only available to specific job titles listed in the legislation with the focus on management, not front line, jobs. The program will only accept the first 3,000 applicants from executive agencies. Letters to eligible employees have been mailed out and SERS has started accepting applications. Members in agencies under other Constitutional Officers, the Courts, or the Legislature can participate with the authorization of the head of the agency.

If the headcount reduction goal is not reached, the Department of Central Management Services (CMS) will offer a Lump Sum Severance Payment Plan. Employees need to apply for the program by October 31, 2004 and resign during the following two months. CMS would determine which job titles are eligible and could limit the number of individuals eligible for this plan. Employees of agencies not under the Governor's authority could participate with the approval of the head of their agency. Employees who resign from state employment under this program can receive a lump sum payment of up to one week for each year of state employment with a maximum severance pay of 6 months of salary. In addition, they could receive up to 6 months of additional insurance coverage. Payment would come from the same personal services appropriation line as the employee's salary. This program would be primarily of benefit to employees who already are eligible or who are close to being eligible to retire.

Trouble Down the Road

Whenever there have been fiscal problems, it has become almost common practice to implement Road Fund diversions. Approximately $395 million in road revenues have been diverted so far during the current fiscal crisis. The Illinois highway program is dependent upon motor fuel taxes and motor vehicle and operators licenses. It has been well documented that because of the nature of the taxes and licenses, the revenue generated fails to keep pace with inflation and the costs of Illinois' highway program. So once monies are diverted, it is almost impossible for the highway program to recoup the loss. Therefore, since fiscal year 1980, there have been various legislated changes and other efforts to reduce these diversions.

Legislation reducing the diversion of Road Fund spending was enacted for fiscal years 1980, 1981, 1982, 1984, 1991, 1994, 1995 and 2000. For fiscal year 2000 and thereafter, the Road Fund could be used for Department of Transportation spending, payment of workman compensation claims, and group insurance costs paid by the Department of Central Management Services. Appropriations to the Department of State Police Division of Operations were capped at the fiscal year 1990 appropriation level of $52.6 million and appropriations for the Secretary of State were specified at $80.5 million for fiscal years 2000 through 2003 and set at $30.5 million for fiscal year 2004 and thereafter. Current legislation has suspended these limits.

Legislation was passed for fiscal years 2003 and 2004 which set higher limits on spending for the Department of State Police and the Secretary of State. Appropriations were capped at $97.3 million for State Police and $130.5 million for the Secretary of State. The legislation also provides for the repayment to the Road Fund from the General Revenue Fund the additional amounts authorized for expenditure. Approximately $225 million is owed to the Road Fund. Repayment will occur when the General Revenue Fund has a positive budgetary balance. The last time there was a similar provision occurred in fiscal year 1991 and the repayment was done in fiscal year 1998.

This past year legislation authorized the transfer of monies from the Road Fund and State Construction Account Fund to the General Revenue Fund, primarily for administrative expenses. For fiscal year 2004, $132 million was transferred from the Road Fund and $36 million from the State Construction Account Fund. When motor vehicle licenses were increased in fiscal year 1983, the revenues generated were to be deposited in the new State Construction Account Fund and used only "for the construction, reconstruction and maintenance of the State maintained highway system." The law authorizing the transfer of State Construction Account Fund monies to the General Revenue Fund chose to ignore the original intent of the law which stipulated that the increase in license fees would only be used for maintaining the highway system.

License fees and the motor fuel tax are fixed and do not increase over time unless the fee or tax rate is increased. It has been shown in previous Fiscal Focus issues (most recently May 1999) that the revenue generated by these sources fails to keep pace with inflation and the costs of maintaining the highway system. From May 1996 through October 1999, the state issued no bonds for highway purposes because of the Road Fund's inability to support the additional debt service costs. Increased license fees for the Illinois FIRST program provided the funding for new bond authorization. Periodically, license fees and tax rates have been increased to meet the demands for maintaining the highway system.

For fiscal year 2005, legislation maintains the higher appropriation levels for the Department of State Police and the Secretary of State. There is no provision for repayment to the Road Fund. In addition, Road Fund spending for Department of Transportation public transportation operations is now per-

TROUBLE DOWN THE ROAD continued, back cover

Road Fund
Expenditures by Agency *
(millions)

	Fiscal Year 1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Warrants Issued:											
Transportation	$ 924	$ 1,156	$ 1,123	$ 1,140	$ 1,117	$ 1,142	$ 1,408	$ 1,456	$ 1,596	$ 1,808	$ 1,705
Secretary of State	130	127	130	129	129	127	76	79	78	127	124
State Police	53	53	53	53	53	53	53	53	53	97	94
Central Management Services	56	60	57	69	69	74	78	84	91	99	103
Other	2	3	2	8	3	2	4	3	3	2	3
Total Warrants Issued	1,165	1,399	1,365	1,399	1,371	1,398	1,619	1,675	1,821	2,133	2,029
Transfers Out:											
General Obligation B.R. & I.	177	194	201	200	191	188	183	192	211	225	228
General Revenue											132
Total Expenditures	$ 1,342	$ 1,593	$ 1,566	$ 1,599	$ 1,562	$ 1,586	$ 1,802	$ 1,867	$ 2,032	$ 2,358	$ 2,389

* Expenditures exclude interfund transfers with the State Construction Account Fund; warrants issued are from current year appropriations.

Local Government Line concluded from page 6

Local Government Assistance Hotline

- In February 2000, the Local Government Division introduced the toll free Local Government Assistance Hotline to encourage local officials to contact the Office of the Comptroller with their questions, concerns, issues, and comments. Since its implementation, the Local Government Assistance Hotline has assisted more than 12,000 local government callers.

Legislation

- Partnered with various local government organizations to draft and pass legislation eliminating duplicative reporting and annual reporting requirements that imposed an undue financial burden on local governments and taxpayers.

TIF Reporting

- Offered training programs for TIF administrators and TIF professionals throughout the state.
- Improved TIF compliance from 44% in 1999 reporting to 83% in 2002 reporting.

Fiscal Responsibility Report Card

- Developed the Individual Data Summaries which detail the financial activity of each local government filing an AFR including per capita analysis, fiscal indicators, and comparative data based on categorical groupings of similar units of government.
- Eliminated costly production of the Fiscal Responsibility Report Card through on-line access to the Individual Data Summaries and Executive Summary.

Outreach

- Formed partnerships with Township Officials of Illinois (TOI) to educate township officials about sound fiscal health practices and assisted townships in lowering their fund balances, resulting in more than $1 million in taxpayer savings.
- Presented and disseminated annual financial data at the annual conferences of the Illinois Municipal League, Township Officials of Illinois and Illinois Association of County Officials.
- Established long-term data sharing partnerships with the U.S. Census Bureau, eliminating duplicative reporting.
- Since 1999, the Local Government Division has presented more than 300 informational seminars on local government reporting, finance, compliance and fiscal health and responsibility.

More detailed information related to local government financial data is available at our website: www.ioc.state.il.us/office/localgovt/index.htm

Focus On Revenue concluded from page 8

Tax and Fee Relief

Offsetting these revenue enhancements is a reduction in the Industrial Commission Operations Fund surcharge from 1.5% to 1.01% of workers compensation premiums, while the Industrial Commission Operations Fee for self-insurers is decreased from .045% of wages to .0075% of wages. The EPA's controversial non-point discharge (NPDES) fees are significantly reduced for smaller discharge facilities. The sales tax exemption on graphic arts machinery and the manufacturer's purchase credit are reinstated. For the income taxes, the research and development tax credit which is equal to 6.5% of qualified research and development expenditures is restored for tax years ending on or after December 31, 2004 and pass through provisions for income from investment partnerships are clarified.

The Commercial Distribution Fee was created in fiscal year 2004 as a 36% surcharge to taxes and fees paid by commercial vehicle owners. In response to criticism about this new fee, the rate will be decreased to 21.5% for registrations during fiscal year 2006 and 14.35% for following fiscal years. The sales tax exemption on vehicles used in interstate commerce had been significantly tightened in fiscal year 2004. The new legislation adds additional options to qualify vehicles as being used in interstate commerce.

A Monthly Look At State Finance

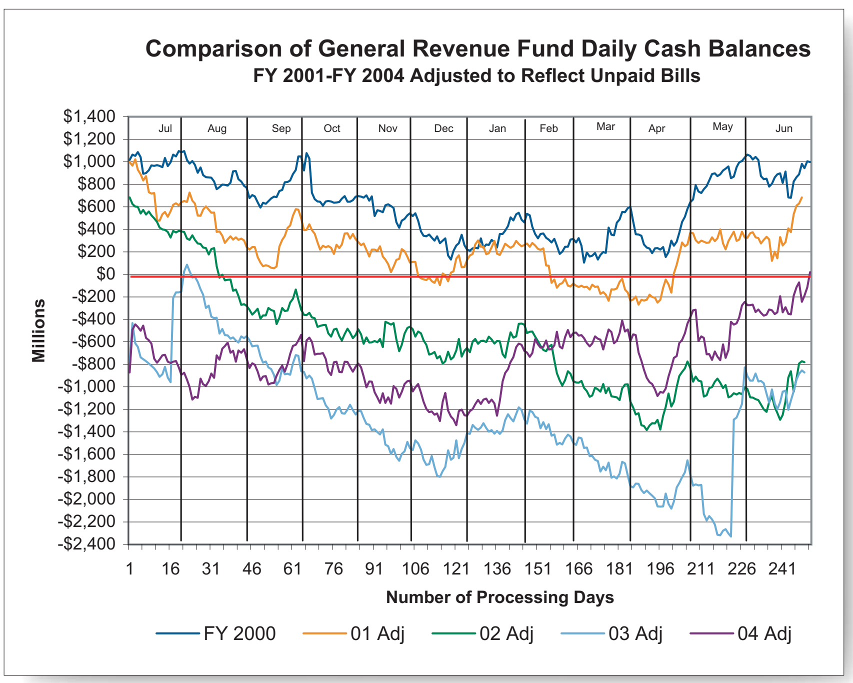
Vital Statistics

The Heartbeat of Illinois' Finance

Unusual Fiscal Year Ends

For fiscal year 2004, General Funds "base" revenues (total revenues less transfers from the Budget Stabilization Fund) totaled $26.823 billion, an increase of $3.737 billion or 16.2%. This followed two years of revenue decreases, but was due primarily to the implementation of several revenue enhancements, including various fee increases and one-time infusions of revenue.

In fiscal year 2004 there were several extraordinary General Funds revenues that were only available for this fiscal year. These included a $1.095 billion increase in bond proceeds from the 2003 sale of Pension Obligation bonds, $1.249 billion in additional federal revenues (tied to the Federal Jobs and Growth Tax Relief Reconciliation Act and additional spending on Medicaid) and approximately $290 million from a tax amnesty program. A portion of these revenues were used to repay $1.465 billion in short-term borrowing that had been issued in fiscal year 2003.



Fiscal year 2004 ended with $4 million in unpaid bills, down from $874 million at the end of fiscal year 2003. Payment delays continued for the General Funds throughout fiscal year 2004, starting out at 44 business days at the beginning of the fiscal year, but had been significantly, albeit temporarily, reduced by the end of the fiscal year.

At the end of June, the General Funds cash balance was $182 million, $135 million less than what was in the bank at the end of fiscal year 2003. The decrease in the cash balance was concentrated in the three school funds that are included in the General Funds group. In the General Revenue Fund (the state's largest operating fund), the cash balance increased from $1 million to $24 million over the year. With the $4 million in bills on hand, the effective General Revenue Fund (GRF) balance was a positive $20 million, a seemingly dramatic improvement versus the negative $873 million last year (see graph).

Illinois completed $850 million in short-term borrowing on June 23, 2004 to address Medicaid bills that would otherwise have been paid out of the General Funds in fiscal year 2005. The money raised was deposited into another state fund; therefore those revenues are not included in the General Funds numbers. However, the General Funds will be responsible for repaying the borrowing in fiscal year 2005.

Base Revenues Increase 16.2%

Total base revenues in the General Funds (excluding short-term borrowing and the transfer from the Budget Stabilization Fund) totaled $26.823 billion in fiscal year 2004, an increase of $3.737 billion or 16.2%. State sources increased $2.488 billion (13.0%) while federal sources were up $1.249 billion (31.7%).

Federal sources are up following $422 million in federal grants, increased Medicaid reimbursement rates, and a concerted effort by the state to process Medicaid payments to realize the benefit of those increased rates.

The increase in state sources is the result of a $1.669 billion increase in transfers in and an $819 million increase in cash receipts. The growth in transfers in stems from the increase of $1.095 billion from the Pension Contribution Fund. Lottery Fund transfers were up $30 million while riverboat gambling transfers to the Education Assistance Fund

VITAL STATS continued, page 16

Vital Statistics concluded from page 15

declined by $26 million. Riverboat gambling transfers were offset by the increase in gaming taxes which are deposited into the Common School Fund ($133 million). All other transfers were up $568 million including; $269 million in administrative chargeback transfers, $89 million in fee increase transfers, $59 million from the Efficiency Initiatives Revolving Fund, $50 million from the State Pensions Fund, $45 million increase from the Protest Fund and $36 million increase from theU. of I. Hospital Services Fund.

Sales tax cash receipts increased $272 million in fiscal year 2004 followed by corporate income tax (up $198 million), riverboat taxes ($133 million), public utility taxes (up $73 million), Cook County IGT (up $73 million) and insurance taxes (up $49 million). These increases were partially offset by declines of $69 million in individual income taxes, $15 million in inheritance taxes and $11 million in investment income. Other sources are up $91 million. Excluding an $88 million deposit in tobacco settlement escrow monies last year, other sources would have increased $179 million with most of this growth due to increased fees and the $46 million deposit of other state funds' retirement payments into the General Funds.

Cash receipts increased in part because $290 million from the tax amnesty program was deposited into the General Funds. While there was amnesty from various sources, the primary components were $152 million in corporate income taxes, $94 million in sales taxes, $35 million in individual income taxes, and $10 million in public utility taxes. If amnesty tax sources were excluded, the $819 million increase in state cash receipts would have been $529 million. Individual income taxes would have fallen by $104 million; corporate income taxes would have increased by only $46 million. Sales taxes which increased by 4.5% would have grown $178 million or 2.9%.

Base Expenditures Up 8.2%

At the end of fiscal year 2004, base General Funds spending (which excludes transfers to repay short-term borrowing) totaled $25.968 billion, $1.978 billion or 8.2% above the previous year. When short-term borrowing is included, General Funds expenditures totaled $27.184 billion, $2.258 billion or 9.1% above last year. Total General Funds appropriations are up $1.149 billion from last year and 94.1% of current year appropriations have been spent through the first twelve months of fiscal year 2004. Awards and grants spending is up $768 million or 5.0% while operational spending is down $204 million or 3.1%. General Funds expenditures were lowered by approximately $400 million due to 2004 legislation that used the money in the Pension Contribution Fund to cover most of the General Funds' retirement costs from March to June.

The largest increase in spending has occurred in Medicaid grant spending from the Department of Public Aid, up $604 million to $5.547 billion this year or 12.2% from $4.943 billion last year. The $604 million increase in Medicaid spending accounts for 78.6% of the total increase in grant spending. The spike in Medicaid spending in fiscal year 2004 is due to a $602 million increase in appropriations. This increase does not include the $850 million appropriated out of the Medicaid Relief Provider Fund in conjunction with the June 2004 short-term borrowing.

Other areas of grant spending which increased in fiscal year 2004 include State Board of Education grants (up $312 million or 6.2%) and Human Services grants (up $84 million or 3.3%). Appropriations are up $315 million and $111 million respectively. Of the $315 million increase in State Board of Education grant appropriations $304 million was for general state aid.

Areas of grant spending which declined were higher education grants (down $46 million or 5.6%) and teacher's retirement grants (down $186 million or 20.0%). Appropriations are down $44 million for higher education. The decline in teacher's retirement grants is misleading as the contributions to the system were made directly from the Pension Contribution Fund for a portion of the year.

Regular state operations expenditures decreased by $70 million or 1.4% despite the fact that appropriations were up $217 million for the year. Higher education operations decreased by $134 million or 8.0% with appropriations down $65 million for the year.

Total transfers out for fiscal year 2004 increased by $768 million over last year due to the significant amount of short-term borrowing that had to be repaid. There was also a $965 million increase in the vouchers payable adjustment as the amount of vouchers payable decreased significantly from the end of fiscal year 2003 to the end of fiscal year 2004.

GENERAL FUNDS REVENUES, EXPENDITURES AND BALANCES
(Dollars in Millions)

	April 2004	FY 2004	Ten Months Change From Prior Year $	%
Total General Funds				
Available Balance	$ 339	$ 317	$ 61	23.8 %
Revenues	2,528	22,480	2,918	14.9
Expenditures	2,377	22,307	2,703	13.8
Ending Balance	$ 490	$ 490	$ 276	129.0 %
General Revenue Fund				
Available Balance	$ 155	$ 1	$ 1	N/A %
Revenues	2,203	19,324	2,606	15.6
Expenditures	2,092	19,059	2,388	14.3
Ending Balance	$ 266	$ 266	$ 219	466.0 %
Common School Special Account Fund				
Available Balance	$ 64	$ 62	$ 25	67.6 %
Revenues	131	1,316	68	5.4
Expenditures	117	1,300	79	6.5
Ending Balance	$ 78	$ 78	$ 14	21.9 %
Education Assistance Fund				
Available Balance	$ 86	$ 209	$ 11	5.6 %
Revenues	114	938	(22)	(2.3)
Expenditures	70	1,017	(61)	(5.7)
Ending Balance	$ 130	$ 130	$ 50	62.5 %
Common School Fund				
Available Balance	$ 35	$ 44	$ 23	109.5 %
Revenues	197	2,348	(2)	(0.1)
Expenditures	216	2,376	28	1.2
Ending Balance	$ 16	$ 16	$ (7)	(30.4) %

Note: Total General Funds excludes interfund transfers while the individual funds include such transfers. Numbers may not add due to rounding.

GENERAL FUNDS REVENUES
(Dollars in Millions)

	April 2004	FY 2004	Ten Months Change From Prior Year $	%
Revenues:				
State Sources:				
Cash Receipts:				
Income Taxes:				
Individual	$ 945	$ 6,035	$ (45)	(0.7) %
Corporate	148	795	197	32.9
Total, Income Taxes	$ 1,093	$ 6,830	$ 152	2.3 %
Sales Taxes	525	5,267	252	5.0
Other Sources:				
Public Utility Taxes	99	905	39	4.5
Cigarette Taxes	33	333	0	0.0
Inheritance Tax (gross)	22	175	(30)	(14.6)
Liquor Gallonage Taxes	11	105	2	1.9
Insurance Taxes and Fees	63	291	42	16.9
Corporation Franchise Tax and Fees	11	131	13	11.0
Investment Income	5	47	(9)	(16.1)
Cook County IGT	58	338	50	17.4
Riverboat Gambling Taxes	13	102	102	N/A
Other	47	294	8	2.8
Total, Other Sources	$ 362	$ 2,721	$ 217	8.7 %
Total, Cash Receipts	$ 1,980	$ 14,818	$ 621	4.4 %
Transfers In:				
Lottery Fund	$ 45	$ 463	$ 36	8.4 %
State Gaming Fund	35	439	(31)	(6.6)
Pension Contribution Fund	0	1,395	1,395	N/A
Other Funds	186	849	370	77.2
Total, Transfers In	$ 266	$ 3,146	$ 1,770	128.6 %
Total, State Sources	$ 2,246	$ 17,964	$ 2,391	15.4 %
Federal Sources:				
Cash Receipts	$ 269	$ 4,236	$ 1,203	39.7 %
Transfers In	13	54	24	80.0
Total, Federal Sources	$ 282	$ 4,290	$ 1,227	40.1 %
Total, Base Revenues	**$ 2,528**	**$ 22,254**	**$ 3,618**	**19.4 %**
Short-Term Borrowing	0	0	(700)	(100.0)
Transfer from Budget Stabilization Fund	0	226	0	0.0
Total, Revenues	$ 2,528	$ 22,480	$ 2,918	14.9 %

GENERAL FUNDS ANALYSIS OF EXPENDITURES
(Dollars in Millions)

	April 2004	FY 2004	Ten Months Change From Prior Year $	%
Expenditures:				
Awards and Grants:				
Public Aid	$ 510	$ 4,970	$ 663	15.4 %
Elem. & Sec. Education:				
State Board of Education	521	4,320	355	9.0
Teachers Retirement	0	744	(32)	(4.1)
Total, Elem. & Sec. Education	$ 521	$ 5,064	$ 323	6.8 %
Human Services	216	2,286	39	1.7
Higher Education	32	654	(51)	(7.2)
All Other Grants	85	994	19	1.9
Total, Awards and Grants	$ 1,364	$ 13,968	$ 993	7.7 %
Operations:				
Other Agencies	$ 399	$ 4,022	$ (2)	0.0 %
Higher Education	89	1,478	(79)	(5.1)
Total, Operations	$ 488	$ 5,500	$ (81)	(1.5) %
Regular Transfers Out	$ 203	$ 1,602	$ 51	3.3 %
All Other	$ 1	$ 15	$ (4)	(21.1) %
Vouchers Payable Adjustment	$ (54)	$ 217	$ 1,114	N/A
Total, Base Expenditures	**$ 2,002**	**$ 21,302**	**$ 2,073**	**10.8 %**
Transfers to Repay Short-Term Borrowing	375	1,005	630	168.0
Total, Expenditures	$ 2,377	$ 22,307	$ 2,703	13.8 %

COMPARISON OF SPENDING FOR OPERATIONS BY OBJECT
(Dollars in Millions)

	April 2004	FY 2004	Ten Months Change From Prior Year $	%
Personal Services:				
Regular Positions	$ 189	$ 1,770	$ (157)	(8.1) %
Other Personal Services	20	193	(16)	(7.7)
Total, Personal Services	$ 209	$ 1,963	$ (173)	(8.1) %
Contribution Retirement	0	449	14	3.2
Contribution Social Security	13	128	(11)	(7.9)
Contribution Group Insurance	91	742	162	27.9
Contractual Services	39	423	(22)	(4.9)
Travel	2	14	(1)	(6.7)
Commodities	9	97	19	24.4
Printing	1	6	(1)	(14.3)
Equipment	1	15	(3)	(16.7)
Electronic Data Processing	2	40	2	5.3
Telecommunications	4	48	1	2.1
Automotive Equipment	1	16	0	0.0
Other Operations	116	1,559	(68)	(4.2)
Total, Operations	$ 488	$ 5,500	$ (81)	(1.5) %

COMPARISON OF SPENDING FOR AWARDS AND GRANTS
(Dollars in Millions)

	April 2004	FY 2004	Ten Months Change From Prior Year $	%
State Board of Education:				
General State Aid	$ 428	$ 2,741	$ 379	16.0 %
All Other	93	1,579	(24)	(1.5)
Public Aid	510	4,970	663	15.4
Human Services	216	2,286	39	1.7
Higher Education:				
Student Assistance Commission	20	362	0	0.0
Community College Board	9	266	(15)	(5.3)
Other	3	26	(36)	(58.1)
Teacher's Retirement	0	744	(32)	(4.1)
Children and Family Services	34	455	(10)	(2.2)
Aging	20	200	12	6.4
Revenue	0	30	26	650.0
All Other	31	309	(9)	(2.8)
Total, Awards and Grants	$ 1,364	$ 13,968	$ 993	7.7 %

GENERAL FUNDS REVENUES, EXPENDITURES AND BALANCES
(Dollars in Millions)

	May 2004	Eleven Months FY 2004	Change From Prior Year $	Change From Prior Year %
Total General Funds				
Available Balance	$ 490	$ 317	$ 61	23.8 %
Revenues	2,102	24,582	1,875	8.3
Expenditures	2,458	24,765	2,062	9.1
Ending Balance	$ 134	$ 134	$ (126)	(48.5) %
General Revenue Fund				
Available Balance	$ 266	$ 1	$ 1	N/A %
Revenues	1,815	21,139	1,556	7.9
Expenditures	2,047	21,106	1,554	7.9
Ending Balance	$ 34	$ 34	$ 3	9.7 %
Common School Special Account Fund				
Available Balance	$ 78	$ 62	$ 25	67.6 %
Revenues	126	1,442	64	4.6
Expenditures	139	1,439	89	6.6
Ending Balance	$ 65	$ 65	$ 0	0.0 %
Education Assistance Fund				
Available Balance	$ 130	$ 209	$ 11	5.6 %
Revenues	84	1,022	(26)	(2.5)
Expenditures	195	1,212	105	9.5
Ending Balance	$ 19	$ 19	$ (120)	(86.3) %
Common School Fund				
Available Balance	$ 16	$ 44	$ 23	109.5 %
Revenues	265	2,612	(47)	(1.8)
Expenditures	265	2,640	(15)	(0.6)
Ending Balance	$ 16	$ 16	$ (9)	(36.0) %

Note: Total General Funds excludes interfund transfers while the individual funds include such transfers. Numbers may not add due to rounding.

GENERAL FUNDS REVENUES
(Dollars in Millions)

	May 2004	Eleven Months FY 2004	Change From Prior Year $	Change From Prior Year %
Revenues:				
State Sources:				
Cash Receipts:				
Income Taxes:				
Individual	$ 606	$ 6,641	$ (69)	(1.0) %
Corporate	25	820	195	31.2
Total, Income Taxes	$ 631	$ 7,461	$ 126	1.7 %
Sales Taxes	507	5,774	238	4.3
Other Sources:				
Public Utility Taxes	73	977	24	2.5
Cigarette Taxes	33	366	0	0.0
Inheritance Tax (gross)	26	201	(19)	(8.6)
Liquor Gallonage Taxes	9	114	1	0.9
Insurance Taxes and Fees	1	292	40	15.9
Corporation Franchise Tax and Fees	17	148	16	12.1
Investment Income	5	52	(8)	(13.3)
Cook County IGT	67	405	73	22.0
Riverboat Gambling Taxes	15	117	117	N/A
Other	61	356	40	12.7
Total, Other Sources	$ 307	$ 3,028	$ 284	10.3 %
Total, Cash Receipts	$ 1,445	$ 16,263	$ 648	4.1 %
Transfers In:				
Lottery Fund	$ 42	$ 504	$ 35	7.5 %
State Gaming Fund	38	477	(33)	(6.5)
Pension Contribution Fund	0	1,395	1,395	N/A
Other Funds	29	879	338	62.5
Total, Transfers In	$ 109	$ 3,255	$ 1,735	114.1 %
Total, State Sources	$ 1,554	$ 19,518	$ 2,383	13.9 %
Federal Sources:				
Cash Receipts	$ 538	$ 4,774	$ 1,139	31.3 %
Transfers In	10	64	28	77.8
Total, Federal Sources	$ 548	$ 4,838	$ 1,167	31.8 %
Total, Base Revenues	**$ 2,102**	**$ 24,356**	**$ 3,550**	**17.1 %**
Short-Term Borrowing	0	0	(1,675)	(100.0)
Transfer from Budget Stabilization Fund	0	226	0	0.0
Total, Revenues	$ 2,102	$ 24,582	$ 1,875	8.3 %

GENERAL FUNDS ANALYSIS OF EXPENDITURES
(Dollars in Millions)

	May 2004	Eleven Months FY 2004	Change From Prior Year $	Change From Prior Year %
Expenditures:				
Awards and Grants:				
Public Aid	$ 276	$ 5,246	$ 414	8.6 %
Elem. & Sec. Education:				
State Board of Education	241	4,561	230	5.3
Teachers Retirement	0	744	(110)	(12.9)
Total, Elem. & Sec. Education	$ 241	$ 5,305	$ 120	2.3 %
Human Services	222	2,508	65	2.7
Higher Education	85	738	(55)	(6.9)
All Other Grants	53	1,047	(29)	(2.7)
Total, Awards and Grants	$ 877	$ 14,844	$ 515	3.6 %
Operations:				
Other Agencies	$ 407	$ 4,429	$ 26	0.6 %
Higher Education	29	1,507	(121)	(7.4)
Total, Operations	$ 436	$ 5,936	$ (95)	(1.6) %
Regular Transfers Out	$ 284	$ 1,886	$ 50	2.7 %
All Other	$ (35)	$ (19)	$ (41)	(186.4) %
Vouchers Payable Adjustment	$ 350	$ 567	$ 658	N/A
Total, Base Expenditures	**$ 1,912**	**$ 23,214**	**$ 1,087**	**4.9 %**
Transfers to Repay Short-Term Borrowing	546	1,551	975	169.3
Total, Expenditures	$ 2,458	$ 24,765	$ 2,062	9.1 %

COMPARISON OF SPENDING FOR OPERATIONS BY OBJECT
(Dollars in Millions)

	May 2004	Eleven Months FY 2004	Change From Prior Year $	Change From Prior Year %
Personal Services:				
Regular Positions	$ 179	$ 1,949	$ (154)	(7.3) %
Other Personal Services	32	225	(5)	(2.2)
Total, Personal Services	$ 211	$ 2,174	$ (159)	(6.8) %
Contribution Retirement	0	449	(28)	(5.9)
Contribution Social Security	13	140	(11)	(7.3)
Contribution Group Insurance	88	830	174	26.5
Contractual Services	47	471	(7)	(1.5)
Travel	1	16	0	0.0
Commodities	11	108	22	25.6
Printing	0	6	(2)	(25.0)
Equipment	1	16	(3)	(15.8)
Electronic Data Processing	3	42	1	2.4
Telecommunications	3	51	0	0.0
Automotive Equipment	1	17	0	0.0
Other Operations	57	1,616	(82)	(4.8)
Total, Operations	$ 436	$ 5,936	$ (95)	(1.6) %

COMPARISON OF SPENDING FOR AWARDS AND GRANTS
(Dollars in Millions)

	May 2004	Eleven Months FY 2004	Change From Prior Year $	Change From Prior Year %
State Board of Education:				
General State Aid	$ 142	$ 2,883	$ 260	9.9 %
All Other	99	1,678	(30)	(1.8)
Public Aid	276	5,246	414	8.6
Human Services	222	2,508	65	2.7
Higher Education:				
Student Assistance Commission	13	375	1	0.3
Community College Board	71	336	(14)	(4.0)
Other	1	27	(42)	(60.9)
Teacher's Retirement	0	744	(110)	(12.9)
Children and Family Services	9	465	(48)	(9.4)
Aging 22		221	16	7.8
Revenue	1	31	27	675.0
All Other	21	330	(24)	(6.8)
Total, Awards and Grants	$ 877	$ 14,844	$ 515	3.6 %

GENERAL FUNDS REVENUES, EXPENDITURES AND BALANCES
(Dollars in Millions)

	June	Twelve Months	Change From Prior Year	
Total General Funds	2004	FY 2004	$	%
Available Balance	$ 134	$ 317	$ 61	23.8 %
Revenues	2,467	27,049	2,062	8.3
Expenditures	2,419	27,184	2,258	9.1
Ending Balance	$ 182	$ 182	$ (135)	(42.6) %
General Revenue Fund				
Available Balance	$ 34	$ 1	$ 1	N/A %
Revenues	2,118	23,257	1,711	7.9
Expenditures	2,128	23,234	1,689	7.8
Ending Balance	$ 24	$ 24	$ 23	2,300.0 %
Common School Special Account Fund				
Available Balance	$ 65	$ 62	$ 25	67.6 %
Revenues	138	1,581	73	4.8
Expenditures	191	1,631	148	10.0
Ending Balance	$ 12	$ 12	$ (50)	(80.6) %
Education Assistance Fund				
Available Balance	$ 19	$ 209	$ 11	5.6 %
Revenues	105	1,127	(20)	(1.7)
Expenditures	0	1,212	76	6.7
Ending Balance	$ 124	$ 124	$ (85)	(40.7) %
Common School Fund				
Available Balance	$ 16	$ 44	$ 23	109.5 %
Revenues	569	3,181	(63)	(1.9)
Expenditures	563	3,203	(18)	(0.6)
Ending Balance	$ 22	$ 22	$ (22)	(50.0) %

Note: Total General Funds excludes interfund transfers while the individual funds include such transfers. Numbers may not add due to rounding.

GENERAL FUNDS REVENUES
(Dollars in Millions)

	June	Twelve Months	Change From Prior Year	
Revenues:	2004	FY 2004	$	%
State Sources:				
Cash Receipts:				
Income Taxes:				
Individual	$ 631	$ 7,272	$ (69)	(0.9) %
Corporate	117	936	198	26.8
Total, Income Taxes	$ 748	$ 8,208	$ 129	1.6 %
Sales Taxes	556	6,331	272	4.5
Other Sources:				
Public Utility Taxes	102	1,079	73	7.3
Cigarette Taxes	33	400	0	0.0
Inheritance Tax (gross)	21	222	(15)	(6.3)
Liquor Gallonage Taxes	13	127	4	3.3
Insurance Taxes and Fees	70	362	49	15.7
Corporation Franchise Tax and Fees	16	163	21	14.8
Investment Income	3	55	(11)	(16.7)
Cook County IGT	23	428	73	20.6
Riverboat Gambling Taxes	16	133	133	N/A
Other	118	474	91	23.8
Total, Other Sources	$ 415	$ 3,443	$ 418	13.8 %
Total, Cash Receipts	$ 1,719	$ 17,982	$ 819	4.8 %
Transfers In:				
Lottery Fund	$ 66	$ 570	$ 30	5.6 %
State Gaming Fund	53	530	(24)	(4.3)
Pension Contribution Fund	0	1,395	1,095	N/A
Other Funds	278	1,157	568	96.4
Total, Transfers In	$ 397	$ 3,652	$ 1,669	84.2 %
Total, State Sources	$ 2,116	$ 21,634	$ 2,488	13.0 %
Federal Sources:				
Cash Receipts	$ 351	$ 5,125	$ 1,221	31.3 %
Transfers In	0	64	28	77.8
Total, Federal Sources	$ 351	$ 5,189	$ 1,249	31.7 %
Total, Base Revenues	**$ 2,467**	**$ 26,823**	**$ 3,737**	**16.2 %**
Short-Term Borrowing	0	0	(1,675)	(100.0)
Transfer from Budget Stabilization Fund	0	226	0	0.0
Total, Revenues	$ 2,467	$ 27,049	$ 2,062	8.3 %

GENERAL FUNDS ANALYSIS OF EXPENDITURES
(Dollars in Millions)

	June	Twelve Months	Change From Prior Year	
Expenditures:	2004	FY 2004	$	%
Awards and Grants:				
Public Aid	$ 301	$ 5,547	$ 604	12.2 %
Elem. & Sec. Education:				
State Board of Education	822	5,383	312	6.2
Teachers Retirement	0	745	(186)	(20.0)
Total, Elem. & Sec. Education	$ 822	$ 6,128	$ 126	2.1 %
Human Services	137	2,645	84	3.3
Higher Education	31	769	(46)	(5.6)
All Other Grants	101	1,147	0	0.0
Total, Awards and Grants	$ 1,392	$ 16,236	$ 768	5.0 %
Operations:				
Other Agencies	$ 386	$ 4,815	$ (70)	(1.4) %
Higher Education	36	1,542	(134)	(8.0)
Total, Operations	$ 422	$ 6,357	$ (204)	(3.1) %
Regular Transfers Out*	$ 207	$ 2,519	$ 488	24.0 %
All Other	$ 3	$ (15)	$ (39)	(162.5) %
Vouchers Payable Adjustment	$ 304	$ 871	$ 965	N/A
Total, Base Expenditures	**$ 2,328**	**$ 25,968**	**$ 1,978**	**8.2 %**
Transfers to Repay GRF Short-Term Borrowing*	91	1,216	280	29.9
Total, Expenditures	$ 2,419	$ 27,184	$ 2,258	9.1 %

*Transfers to Repay Short-Term Borrowing are adjusted to exclude the Refund Fund portion which is included as a regular transfer out.

COMPARISON OF SPENDING FOR OPERATIONS BY OBJECT
(Dollars in Millions)

	June	Twelve Months	Change From Prior Year	
	2004	FY 2004	$	%
Personal Services:				
Regular Positions	$ 190	$ 2,139	$ (143)	(6.3) %
Other Personal Services	21	245	(6)	(2.4)
Total, Personal Services	$ 211	$ 2,384	$ (149)	(5.9) %
Contribution Retirement	0	449	(70)	(13.5)
Contribution Social Security	13	153	(10)	(6.1)
Contribution Group Insurance	81	912	103	12.7
Contractual Services	30	501	(3)	(0.6)
Travel	2	17	(1)	(5.6)
Commodities	9	117	5	4.5
Printing	1	7	(2)	(22.2)
Equipment	2	17	(2)	(10.5)
Electronic Data Processing	2	45	0	0.0
Telecommunications	3	54	0	0.0
Automotive Equipment	2	19	1	5.6
Other Operations	66	1,682	(76)	(4.3)
Total, Operations	$ 422	$ 6,357	$ (204)	(3.1) %

COMPARISON OF SPENDING FOR AWARDS AND GRANTS
(Dollars in Millions)

	June	Twelve Months	Change From Prior Year	
	2004	FY 2004	$	%
State Board of Education:				
General State Aid	$ 562	$ 3,446	$ 304	9.7 %
All Other	260	1,937	8	0.4
Public Aid	301	5,547	604	12.2
Human Services	137	2,645	84	3.3
Higher Education:				
Student Assistance Commission	8	382	6	1.6
Community College Board	1	338	(13)	(3.7)
Other	22	49	(39)	(44.3)
Teacher's Retirement	0	745	(186)	(20.0)
Children and Family Services	48	513	(23)	(4.3)
Aging 19		241	14	6.2
Revenue	1	32	27	540.0
All Other	33	361	(18)	(4.7)
Total, Awards and Grants	$ 1,392	$ 16,236	$ 768	5.0 %

Why a Structural Deficit is Troublesome

With a structural deficit, the state may meet its obligations for that year with the use of one-time revenues. However, the next year a new revenue source must found to replace the one-time revenue or spending must be reduced. Even the imposition of additional flat taxes or fees will generate a set amount of new revenues, but these fail to grow over time to meet increasing spending demands.

The problem with a structural deficit is that since spending exceeds the ability of the underlying revenue base to support those obligations, the state has essentially promised a level of service that it cannot afford to cover long term with the current revenue stream.

An illustration of this phenomenon would be if a family is faced with reduced income. This family could continue to spend the same amount of money on groceries and other basic expenses as before by using a credit card or winning a small lottery prize. However, after that money is spent, the family's spending patterns will need to be revised unless an alternative source of income can be found. If the family's expenses have increased more than their base income due price increases for groceries or rent payments, then their problems have been compounded. Illinois is facing a similar situation.

Trouble Down The Road concluded from page 13

mitted. In an attempt to address legislative concerns about Road Funds diversions, authorization to transfer from other funds to the General Revenue Fund (so called "fund sweeps") did not include the Road Fund this year. Also, administrative chargeback authority specified that no amounts may be transferred from the Road Fund and State Construction Account Fund for fiscal years 2005 through 2007. From fiscal years 2003 through 2005, approximately $537 million in highway monies will be diverted; absent restoration, approximately $312 million will be lost to the highway program forever.

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