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The Honorable Frank Lautenberg  
Ranking Minority Member  
Committee on the Budget  
United States Senate

Subject: Emergency Criteria: How Five States Budget for Uncertainty

Dear Senator Lautenberg:

We are currently conducting a study at your request examining how states deal with uncertainty in their budget processes. To address this question, we selected five states—California, Delaware, Florida, Missouri, and Oklahoma—that have established reserve and/or contingency funds for emergencies or other uncertain costs. In our upcoming report, we will describe the use of these reserve funds and identify state practices that might help inform the federal debate.

In a recent progress briefing to your office, we were asked to provide answers to questions regarding state criteria designed to control the use of reserve funds and how state criteria compared with criteria being proposed at the federal level. It is important to recognize that the criteria used by our study states is generally for the release of funds previously set aside or appropriated by the state legislatures. In contrast, the federal debate about criteria has focused on legislative decision-making prior to designating funds as an “emergency.” To answer these questions, we drew on information we had collected to date and made follow-up calls to state budget officials in the five states for clarification on certain points. Our upcoming report will address these questions more fully. We conducted this work in accordance with generally accepted government auditing standards.

***How do states plan for budgetary uncertainty?***

The five states use reserves as a way to anticipate and plan for uncertainty in their budgets. These states worry most about budget uncertainty related to revenue shortfalls and significant increases in program spending and are less concerned with natural-disaster emergencies due to the assistance they expect to receive from the federal government.

In the enclosed table, we have grouped state reserves into three categories based on information provided by state budget officials. The first are governmentwide reserves for general purposes such as budget stabilization (“rainy day”) funds and/or nonappropriated revenue designed to provide a cushion for a state’s general fund in times of fiscal stress. For example, Florida must set aside at least 5 percent, and could reserve up to 10 percent, of the

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preceding year's net general fund revenue collections in its "Budget Stabilization Fund." The second group consists of governmentwide reserves for specific purposes, such as natural disasters and large unanticipated legal expenses. For example, Oklahoma annually makes an appropriation to a state emergency fund for costs related to damage caused by natural disasters. Finally, one state in our study, Missouri, uses agency-specific reserves to provide a cushion in case program spending exceeds regular appropriation levels due to increased caseloads or other uncontrollable costs. For example, Missouri established the "Missouri Medicaid Supplemental Pool" for unanticipated costs related to its Medicaid program.

***How does proposed federal emergency criteria compare to criteria used by the states?***

The federal government currently does not have clear criteria for what constitutes "emergency" spending. Some believe that the lack of federal criteria makes use of the emergency designation overly subjective and may also lead to the increased use of the emergency designation in appropriation bills.<sup>1</sup> In 1991, the Office of Management and Budget (OMB) proposed a set of conditions for emergency spending which has been included in proposed legislation. Under the OMB proposal, any emergency spending would have to meet all of the following five conditions to qualify for the emergency designation: (1) the expenditures are "necessary," (2) the situation requiring the emergency appropriation was "sudden," (3) the situation was "unforeseen," (4) the need for emergency appropriations was "urgent," and (5) the situation requiring the emergency appropriations is "not permanent." We found that some states have similar conditions for use of emergency reserves with the added requirement that emergency spending be for certain types of events.

Large governmentwide reserves, primarily budget stabilization funds and nonappropriated revenue, are the first type of reserve shown in the enclosed table. These reserves typically have very general criteria because their primary purpose is to provide a fiscal cushion for a state's general fund during periods of fiscal stress.<sup>2</sup> For example, Delaware's "Budget Reserve Account" can be used in the event of a revenue shortfall or if legislation is enacted that results in reduced general fund revenue. Once these funds are transferred to the general fund they are available to any state program or activity included in the general fund budget. As another example, Missouri's Supplemental Reserve sets aside approximately \$80 million nonappropriated revenue for supplemental funding needs. Criteria related to "rainy day" funds and nonappropriated revenues may have little relevance to establishing "emergency" criteria at the federal level because these funds simply flow into the general fund and are not targeted to specific agencies or emergencies. Access to these large governmentwide reserves is generally controlled by the state legislature.

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<sup>1</sup>For a discussion of the lack of federal criteria, see Congressional Budget Office Memorandum entitled Emergency Spending Under the Budget Enforcement Act (December 1998).

<sup>2</sup>Although not their primary purpose, some large governmentwide reserves can also be used during natural-disaster type emergencies.

The second type of reserves, smaller governmentwide reserves with specific criteria, are emergency or contingency funds for clearly defined events. As in the OMB proposal, use of these reserves is tied to specific conditions. However, unlike the OMB proposal, they also identify specific events for allowable uses. For example, Oklahoma's "State Emergency Fund" has two conditions for use: expenditures must be "necessary" and for needs that were "unforeseen" at the time regular appropriations were enacted. The fund's use is further restricted to cover events causing destruction of public property (floods, fires, and other natural disasters), National Guard costs when activated in cases of emergency, to protect public health, and matching Federal Emergency Management Agency disaster relief funds. Another example is the "Governmental Emergency Fund" in Missouri that can only be used for expenditures that are "essential" and "not foreseeable or predictable" and that "insure the proper functioning of state government and to render essential state services." Because these funds normally represent general fund appropriations made at the time the budget is passed, the governor and/or a controlling board can usually authorize their use during the fiscal year without further legislative action.

In addition to the criteria identified above, smaller governmentwide reserves may have additional constraints that are not included in the OMB proposal. Florida and Missouri expect state agencies to exhaust funds from already appropriated emergency related accounts before asking for additional emergency funds. In Oklahoma, the "State Emergency Fund" cannot be used for spending items considered, but not approved, by the legislature. In California and Florida, "emergency" funds should not be used to fund new programs or initiatives.

The third type included in the table, agency-specific reserves, provide a cushion if regular agency appropriations are insufficient to meet legislated obligations. For example, the "Missouri Medicaid Supplemental Pool" provides additional funds to the state health agency if caseloads or utilization are higher than the department's budget assumptions. This fund can only be used to address cost increases in existing programs and cannot be used for new initiatives. This type of reserve could be relevant to the federal budget process if contingency accounts were established at those federal agencies that normally respond to emergencies

Two of the states we reviewed also control a reserve fund's use through passage of emergency bills that require a larger majority. For example, Oklahoma's "Constitutional Reserve Fund," half of which is available for emergencies, can be used if the Governor declares an emergency and two-thirds of the legislature agree or the legislative leaders can designate spending as an emergency without the Governor's declaration with a three-fourths super-majority approval of both houses. Delaware requires a three-fifths super-majority to spend from either their "Budget Reserve Account" or nonappropriated revenue reserves.

### ***How do states determine that the criteria have been met?***

The states in our study have both formal and informal practices to ensure that emergency criteria are met. Codified procedures can provide transparency and a degree of scrutiny by requiring a formal written explanation of how the emergency criteria are met. These procedures apply to state agencies requesting emergency funds or to the governor after declaring an emergency and wishing to use funds not yet appropriated by the legislature.

In four of the five states we reviewed, when a state agency submits a request to access emergency reserves, it generally submits a written request explaining the nature of the emergency and how it meets the specific criteria related to the fund. The request is then reviewed by the governor, budget director, or a review board to determine if the request meets the criteria. For example, agencies in Oklahoma that request funds from the emergency fund must submit written findings to the Governor if the emergency situation is specifically identified in statute (for example, floods) or to the fund's contingency review board if the specific need is not covered by the criteria. In California, the Director of the Department of Finance is required to review agency requests for emergency funds and, if requests are approved, must send a report to the Joint Legislative Budget Committee and the appropriating committee chairpersons stating that the expenditures satisfy the criteria for emergency funding.

In addition to the formal review processes, informal channels are also used to determine if "emergency" criteria have been met. For example, in Florida, budget officials told us the Governor's budget office may inform legislative staff prior to releasing emergency funds from its "Working Capital Fund" to assure that a consensus is reached. Similarly, in Delaware, officials told us that the Governor will work with the legislature to agree on use of its nonappropriated revenue reserve.

***Do state criteria contain any escape clauses, i.e., ways to circumvent the criteria?***

In cases of funds for which there are specific criteria, we did not find alternative ways or explicit "escape clauses" to access those funds. However, the states we reviewed have other ways to obtain funds for emergencies, such as supplemental appropriations or interfund transfers.<sup>3</sup>

***How useful are the states' criteria in controlling emergency spending?***

Officials in our study states said emergency reserve criteria are useful in limiting "emergency" spending to the established criteria. In cases where specific emergency criteria were established in statute and the executive branch or a controlling board had the authority to release reserve funds, emergency spending was generally limited to conditions and events defined within the reserve criteria. For example, the "State Emergency Fund" in Oklahoma is designed to fund emergency situations such as storm damage, range fires, and floods, and spending from this account seems to be restricted by these criteria. Similarly, when the Florida "Working Capital Fund" is used for governor-declared emergencies, spending is limited to "conditions that were unforeseen at the time the General Appropriations Act was adopted...and that constitute an imminent threat to public health, safety, or welfare." State officials told us that the criteria had been adhered to.

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<sup>3</sup>Budget officials in three states in our study said that supplemental appropriations could be passed for any purpose. However, California does not allow funding for new programs or initiatives through the supplemental appropriations process, and Delaware has not used supplementals for several years.

According to one official we interviewed, the existence of emergency criteria may also subject state agencies to more scrutiny. First, agencies are expected to closely review their budgets before requesting emergency funds. Second, agency requests for additional funding can be evaluated based on the emergency criteria, thus making it easier to defer additional spending requests for existing programs or new initiatives until consideration of the next fiscal year's budget. Finally, agencies requesting emergency appropriations open themselves to additional scrutiny and visibility by the legislature and the executive branch, which can affect future budget decisions.

Officials told us that where there were no established criteria for using emergency reserves, spending was not limited to what people would generally believe to be emergencies. In the emergency component of Oklahoma's "Constitutional Reserve Fund," for example, emergency spending ranged from providing funds for Historical Society repairs and maintenance to Medicaid managed care. Also, California's "Special Fund for Economic Uncertainties," which is available for emergencies, does not have any criteria and can be used for any purpose the Governor and the legislature agree upon.

As agreed with your office, unless you publicly announce the contents of this letter earlier, we plan no further distribution until 7 days from the date of this letter. At that time, we will send copies of this letter to the Chairman of the Senate Committee on the Budget and the Chairmen and Ranking Minority Members of the House Committee on the Budget and the Senate and House Committees on Appropriations. Copies will also be made available to others upon request.

Please contact me at (202) 512-9573 if you or your staff have any questions concerning this letter.

Sincerely yours,



Paul L. Posner  
Director, Budget Issues

Enclosure

**State Budget Reserves in Five Site Visit States**

Category 1: Governmentwide Reserves for General Purposes

<b>Reserve type</b>	<b>Purpose/criteria</b>	<b>Access/control</b>
<i>Cash on hand set aside for any agency into general operating fund.</i>	<i>Meets unanticipated revenue shortfalls or cash flow needs. In some cases, may also be used for emergencies.</i>	<i>Funds generally appropriated by the legislature with governor's consent.</i>
Budget Stabilization Fund (Missouri)	Meets unanticipated revenue shortfalls. Fund contains about 2.5 percent of prior year receipts in the general fund but not to exceed 5 percent. Fund can only be used to replenish existing appropriations.	Legislature appropriates fund but only with authorization from the governor.
Cash Operating Reserve Fund (Missouri)	Meets annual cash-flow needs by allowing the state to make timely payments. Fund is maintained at 5 percent of general fund revenues.	Commissioner of Administration controls its use and ensures that its balance remains at 5 percent of general fund revenues.
Budget Reserve Account (Delaware)	Meets unanticipated revenue shortfalls or if revenue is reduced by legislation. May not exceed 5 percent of general revenues received in the preceding fiscal year (not including interest).	Legislature authorizes spending. Release of funds requires a three-fifths majority vote.
Constitutional Reserve Fund (Oklahoma)	Half of fund meets unanticipated revenue shortfalls. Half of the fund may be used if the governor declares an emergency—although specific emergency criteria have not been established.	If the governor declares an emergency, funds can be appropriated through a two-thirds approval from both houses of the legislature. The legislature may declare an emergency and access the fund if it obtains a three-fourths majority vote.
Special Cash Fund (Oklahoma)	Sets aside unspent funds from the previous fiscal year that are reappropriated for general purposes.	Legislature authorizes spending through regular or supplemental appropriations.
Cash Flow Reserve Fund (Oklahoma)	Meets annual cash-flow needs by helping to reduce borrowing and allowing the state to make timely payments. If the balance of this fund exceeds cash needs, then the legislature may appropriate all or a portion of this fund.	Executive branch controls this fund. The legislature may appropriate unneeded portions of the fund.

<b>Reserve type</b>	<b>Purpose/criteria</b>	<b>Access/control</b>
Working Capital Fund (Florida)	Sets aside monies in the general revenue fund in excess of the amount needed to meet general revenue fund appropriations.	Legislature authorizes spending through regular appropriations. The governor can access these funds by evoking emergency powers through an executive order.
Budget Stabilization Fund (Florida)	Meets unanticipated revenue shortfalls. Also available for funding an emergency with criteria provided in Florida law. The fund must be replenished after use.	The legislature provides direction in the appropriations act for use of these funds.
<i>Nonappropriated revenue set aside for general operating fund.</i>	<i>Meets unanticipated spending needs or revenue shortfalls.</i>	<i>Funds generally appropriated by the legislature with governor's consent.</i>
Supplemental Reserve (Missouri)	Nonappropriated general revenues set aside for general purposes.	Legislature authorizes spending after governor's supplemental recommendation. Legislature cannot add new items to governor's recommendations but can increase dollar amounts.
Nonappropriated revenues (Delaware)	Two percent of the revenue estimate is set aside in this reserve. Fund's use is limited to emergencies.	Legislature authorizes spending and governor must sign. Release of these funds requires a three-fifths majority.
Special Fund for Economic Uncertainties (California)	Sets aside unreserved and undesignated revenues for general purposes. Normally used to (1) augment general fund cash flows (2) cover general fund deficits, and (3) fund emergency-related expenses.	CA Department of Finance oversees use of this fund.
Nonappropriated revenue (Oklahoma)	Five percent of revenue forecast is set aside for general purposes. This reserve is not available during the current fiscal year but is available for general fund use in the next fiscal year. If more than 100 percent of revenue is collected during the year, the remainder is deposited in the "Constitutional Reserve Fund."	Legislature authorizes spending.

Category 2: Governmentwide Reserves for Specific Purposes

<b>Reserve type</b>	<b>Purpose/criteria</b>	<b>Access/control</b>
<i>General or special fund appropriation available to any agency but limited to defined purposes.</i>	<i>Addresses specific events or situations meeting established criteria.</i>	<i>Usually controlled by executive branch or controlling board.</i>
Governmental Emergency Fund (Missouri)	An appropriation to provide emergency funds for state services when the legislature is not in session.	Must be approved by a majority vote of the full membership of the governmental emergency fund committee.
Augmentation for Emergencies and Contingencies (California)	An appropriation used to cover unanticipated but necessary obligations not covered in regular budget act. Not to be used for capital outlays.	Controlled by the CA Department of Finance.
Emergency Appropriation (Florida)	An appropriation whose funds can be released if they meet certain "emergency" criteria contained in Florida law.	The Administration Commission can approve release of these funds after requested in writing by a state agency. The governor's office then determines whether the request meets the emergency requirements specified in Florida law.
Deficiency Appropriation (Florida)	An appropriation for state agency operations when regular appropriations are inadequate because the workload or cost of the operation exceeds that anticipated by the legislature.	The Administration Commission authorizes these funds under specified circumstances.
Agricultural Emergency Eradication Trust Fund (Florida)	Primarily designed to eradicate the citrus canker emergencies. Financed by a fuel sales tax and the general fund.	Commissioner of Agriculture can use funds with notice to the legislature.
Legal Fees Fund (Delaware)	Appropriation to finance the anticipated cost of judgments or settlements against the state during the fiscal year.	State budget office and Controller General may release these funds for approved purposes.
Self-Insurance Fund (Delaware)	Appropriation to finance emergency repairs/ replacement of state buildings, schools, etc., which are damaged due to natural or other disasters (i.e., arson and bombings). State purchases an insurance policy for damage costs exceeding \$10 million.	State budget office and Controller General may release these funds when criterion is met.
State Emergency Fund (Oklahoma)	Appropriation for destruction of property due to natural disasters or other disasters, or matching federal disaster relief program funds or for situations not foreseen or reasonably foreseeable by the legislature.	Governor can approve expenditures from the fund that meet the criteria. State agencies must submit written findings to the governor that emergency request was not foreseen or reasonably foreseeable by the legislature.



Category 3: Agency-Specific Reserves for Specific Purposes

<b>Reserve type</b>	<b>Purpose/criteria</b>	<b>Access/control</b>
<b>Contingency appropriations designated to a specific agency.</b>	<b>Provides a cushion if agency appropriations are insufficient.</b>	<b>Governor controls release of funds.</b>
Missouri Disaster Fund (Missouri)	Appropriation for the MO State Emergency Management Agency for emergency expenditures caused by disasters and to provide required state match for federal grants.	Governor can release funds to the State Emergency Management Agency when the legislature is not in session.
Missouri Corrections Growth Pool (Missouri)	Appropriation for the MO Department of Corrections for costs associated with increased inmate populations.	Governor can release funds when regular appropriation fails to cover costs.
Missouri Youth Services Growth Pool (Missouri)	Appropriation for the MO Department of Social Services for costs associated with increased caseloads.	Governor can release funds when regular appropriation fails to cover costs.
Missouri Medicaid Supplemental Pool (Missouri)	Appropriation for the MO Division of Medical Services to cover additional costs beyond those covered by its regular Medicaid appropriation.	Governor can release funds when regular appropriation fails to cover costs.
Missouri Work First Pool (Missouri)	Appropriation for the MO Department of Social Services for costs associated with the Temporary Assistance for Needy Families, child care, Work First Initiatives, and other purposes related to welfare reform.	Governor can release funds when regular appropriation fails to cover costs.

Source: Information provided by state budget officials.



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