

March 9, 2010

MEMORANDUM

To: Representative Luciano “Lucky” Varela, Chairman, LFC
Senator John Arthur Smith, Vice-Chairman, LFC

Through: David Abbey, Director, LFC

From: Thomas Clifford, Chief Economist, LFC
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Subject: **General Fund Revenue Tracking Report Methodology**

Background:

For several years, LFC staff has prepared a monthly report to compare actual General Fund revenue collections with the most recent forecast by the consensus revenue estimating group. Given the depth of the current budget crisis, and the heightened interest in the revenue outlook, it seems appropriate that the monthly tracking information should be shared with a wider audience. To that end, a monthly revenue tracking report will be published on the LFC’s website for the information of legislators and others.

Many assumptions must be made to prepare a tracking report, and therefore its results should be interpreted with caution. This memo describes methods used to prepare the report. In addition, each monthly report will discuss significant deviations of actual revenue from the expected amounts.

Report methodology:

Monthly revenue forecasts are prepared by multiplying the latest annual consensus forecast of each revenue by a fraction representing the average share of total annual collections typically collected in each month. Once monthly forecast values have been determined, the report is updated each month with new information on actual revenue collections.

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Monthly shares of some taxes are relatively even but for others there is a “lumpy” pattern. A good example is the personal income tax, for which there are large refund claims and also large amounts paid with returns during tax filing season (January through April). Also, some revenues, like the Insurance Premiums Tax and the Oil and Gas Withholding Tax are paid quarterly.

Monthly forecasts of revenues based on oil and gas production are prepared differently. Since these revenues depend primarily on the prices of oil and natural gas, a monthly price forecast is prepared using the annual price forecast of the consensus group. A monthly pattern of prices is based on traditional seasonal patterns as well as information on current year patterns from futures markets. Monthly prices are used to calculate monthly revenue estimates using the appropriate tax and royalty rates, deductions, etc.

How to read the table:

Actual receipts recognized by DFA for accrual to the General Fund are shown in blue while preliminary amounts are shown in italics. A column toward the right hand side of the table titled “FY10 Actual + Forecast” provides the total of actual collections for the year to date plus the forecast monthly amounts for the remainder of the year. The next column compares this amount with FY09 collections. The next three columns titled “Tracking Error” compare this amount with the latest consensus forecast for annual collections. Differences from the forecast are shown both in percentage terms and in actual dollar amounts. The final column shows the FY09 total collections for purposes of comparison.

Accounting procedures:

General Fund revenues are reported according to modified accrual methods as recommended in Generally Accepted Accounting Principles. For most revenues, this means that they are recognized in the month the cash is transferred to the General Fund by the agency that first collected the money. For some revenues, the revenue is accrued in the period when the revenue is “earned.” For example, gross receipts tax (“GRT”) revenue is accrued in the month prior to the receipt of the revenue by the Taxation and Revenue Department (“TRD”), which is typically two months before the cash is received by the General Fund. This reflects the fact that the sales that give rise to the liability generally occur in the month prior to the due date of the tax return. It then takes approximately a month for TRD to process returns and distribute cash to the General Fund. The same treatment is applied to withholding revenue. Some other revenues – including personal and corporate income tax payments – are accrued in the month the payments are received by TRD, or one month before cash is received by the General Fund. Oil and gas emergency school taxes are accrued in the period two months before the revenue is received by TRD – three months before the General Fund receives the cash – because taxpayers are permitted a two-month delay before returns are due for the tax.

A new complication has been added to the revenue tracking process in the last two years. In the past, most revenue collected by the Taxation Department was transferred to the General Fund the following month. When new accounting software was implemented, the Department decided to delay distribution until a tax payment has been matched to a

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return. Since payments of some taxes come in without documentation this results in amounts being withheld temporarily by the department. Under section 7-1-6.1, the department is required to distribute to the General Fund any such amounts that have been withheld for 60 days. Thus, all amounts due to the General Fund are eventually transferred, but the actual amount transferred in a given month is a combination of amounts received in the current period that were matched to a return plus amounts held for over 60-days and less amounts previously distributed to the General Fund subsequently found to belong in other funds. These procedures sometimes result in General Fund distributions that are substantially different from cash received by the Department in a given month. As more experience is gained, it may be possible to predict the impacts of these adjustments on distributions, but at the present time they still cause substantial uncertainty, especially in the distributions of corporate income tax and personal income tax final settlements and estimated payments.

Limitations of the revenue tracking method:

The revenue tracking report is not intended to provide a new revenue forecast every month. Thus, for example, the forecast monthly values are not revised each month. Only the actual amounts received are changed. In addition, the report does not attempt to incorporate new information about future energy prices. The report is intended to provide information on how actual revenue collections for the year-to-date compare with the forecast amounts for the same period. Given the uncertainties associated with the process, there are likely to be fluctuations from month to month in the projected shortfall or excess of revenues compared with forecast amounts. Thus the report provides only general guidance on revenue trends, not a precise estimate of likely shortfalls or excesses.

TC:BG:DW/svb