COLORADO GENERAL ASSEMBLY
JOINT BUDGET COMMITTEE

FY 2010-11 STAFF FIGURE SETTING

TOBACCO SETTLEMENT FUNDED PROGRAMS

JBC Working Document - Subject to Change
Staff Recommendation Does Not Represent Committee Decision

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February 3, 2010

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FY 2010-11 FIGURE SETTING
PROGRAMS FUNDED WITH TOBACCO SETTLEMENT PAYMENTS

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Tobacco Settlement Funded Programs

	FY 2007-08 Actual Allocation	FY 2008-09 Actual Allocation	FY 2009-10 Projected Allocation	FY 2010-11 Recommended Allocation	% change from FY 09-10 to FY 10-11
This table shows the transfer of tobacco settlement money to settlement supported programs or to the cash funds that support those programs. The appropriations are cash funds exempt in FY 2007-08 and cash funds thereafter.					
OVERSIGHT					
State Auditor's Office	79,958	14,126	103,640	112,831	8.9%
Public Health and Environment Administration Division	28,000	28,000	28,000	28,000	0.0%
SUBTOTAL - OVERSIGHT	107,958	42,126	131,640	140,831	7.0%
EDUCATION					
Assistance to Public Schools					
Read to Achieve Grant Program	4,502,622	5,174,508	4,990,663	4,801,594	-3.8%
HEALTH CARE POLICY AND FINANCING					
Indigent Care Program					
Children's Basic Health Plan Trust	22,483,015	26,674,098	24,955,183	24,680,764	-1.1%
Comprehensive Primary And Preventive Care Fund	4,154,235	5,227,305	1,169,398	5,125,957	338.3%
Pediatric Specialty Hospital	174,085	317,000	283,000	307,000	8.5%
Medical Services Premiums					
Children with Autism	273,607	726,393	1,000,000	1,000,000	0.0%
SUBTOTAL - HEALTH CARE POLICY AND FINANCING	27,084,942	32,944,796	27,407,581	31,113,721	13.5%

	FY 2007-08 Actual Allocation	FY 2008-09 Actual Allocation	FY 2009-10 Projected Allocation	FY 2010-11 Recommended Allocation	% change from FY 09-10 to FY 10-11
MILITARY AND VETERANS AFFAIRS					
Division of Veterans Affairs					
State Veterans	900,525	998,551	998,133	960,319	-3.8%
PUBLIC HEALTH AND ENVIRONMENT					
Local Public Health Planning and Support					
Local, District and Regional Health Department Distribution	1,218,597	2,421,973	2,450,000	2,286,355	-6.7%
Disease Control and Environmental Epidemiology Division					
Immunizations	696,341	1,469,168	1,400,000	1,306,489	-6.7%
AIDS and HIV Prevention Grants	1,801,049	1,997,101	1,996,265	1,920,638	-3.8%
Prevention Services Division					
Short Term Innovative Health Program Grants	1,044,511	2,203,751	358,429	1,959,733	446.8%
Dental Loan Repayment Program	200,000	200,000	200,000	200,000	0.0%
Nurse Home Visitor Program	9,995,323	12,361,408	13,453,724	13,444,464	-0.1%
Tony Grampsas Youth Services Program	3,560,387	4,074,033	3,992,530	3,841,275	-3.8%
Disease Control and Environmental Epidemiology Division					
Ryan White HIV/AIDS Program	3,151,836	3,400,575	3,493,464	3,361,116	-3.8%
SUBTOTAL - PUBLIC HEALTH AND ENVIRONMENT	19,753,106	24,236,868	27,344,412	28,320,070	3.6%
HIGHER EDUCATION					
Regents of the University of Colorado					
University of Colorado Health Sciences Center	8,530,175	17,997,300	17,150,000	16,004,485	

	FY 2007-08 Actual Allocation	FY 2008-09 Actual Allocation	FY 2009-10 Projected Allocation	FY 2010-11 Recommended Allocation	% change from FY 09-10 to FY 10-11
HUMAN SERVICES					
Mental Health and Alcohol and Drug Abuse Services					
Residential Mental Health Treatment for Youth	300,000	280,387	300,000	300,000	0.0%
Treatment, Detoxification, and Prevention Contracts	522,256	1,101,875	1,050,000	979,866	-6.7%
Offender Mental Health Services	2,089,023	4,407,502	4,200,000	3,919,466	-6.7%
SUBTOTAL - HUMAN SERVICES	2,911,279	5,789,764	5,550,000	5,199,332	-6.3%
PERSONNEL AND ADMINISTRATION					
Supplemental State Contribution Fund	783,383	1,652,813	1,575,000	1,469,800	-6.7%
CAPITAL CONSTRUCTION					
Department of Higher Education					
Fitzsimons Lease Purchase Payments	7,215,933	8,000,000	8,000,000	7,698,527	-3.8%
TOTAL	59,837,086	71,649,236	93,119,429	95,680,679	2.8%

FY 2010-11 Figure Setting
Programs Funded with Tobacco Settlement Payments

Purpose of this document: This document recommends a forecast for the amount of tobacco settlement revenue that will be received during FY 2009-10. This forecast serves as the basis for the recommended allocation of settlement revenues among settlement-supported programs that is shown in the number pages. Staff will convey the approved allocation of settlement dollars to other analysts who will use it as the basis for their own recommendations for FY 2010-11 appropriations to settlement-supported programs.

This document also recommends legislation that would transfer approximately $1.6 to the General Fund to augment FY 2010-11 revenues.

Background

Most appropriations depend on prior-year tobacco-settlement revenue. As described in more detail in the appendix, appropriations of tobacco-settlement moneys to settlement-supported programs are largely governed by statute, with the key provisions contained in Section 24-75-1104.5, C.R.S. A review of these statutory formulas indicates that for most programs, appropriations in a given year depend upon the amount of settlement money that the state receives during the prior year. The Treasury uses these formulas to divide settlement moneys among the various tobacco programs and the General Assembly then appropriates the allocated funds. Without such appropriations, the programs can't spend the settlement money that they have been allocated.

Appropriations must be based on a tobacco-revenue forecast. Because most of the appropriations in the Long Bill to settlement-supported programs depend upon the amount of settlement revenue received in the prior fiscal year, and because the bulk of settlement revenue arrives in April after the Long Bill is written, each year's Long Bill must be based upon a forecast of settlement payments, a forecast that inevitably proves incorrect. Supplementals are then required the following January to correct resulting inaccuracies.

The diligent-enforcement dispute adds to forecast uncertainty. The inherent imprecision of the forecasting process has been exacerbated in recent years by the "diligent enforcement" dispute between the states and the tobacco manufacturers who participate in the Master Settlement Agreement. As a consequence of this dispute, some, but not all, of the participating tobacco manufacturers have been withholding a portion of the payments they otherwise would have paid to Colorado.

When the Master Settlement Agreement was signed in 1998, participants recognized that the extra costs that the settlement imposed on participating manufacturers would place them at a competitive disadvantage when compared with manufacturers who have not joined the agreement. In an effort to level the playing field, the agreement required states to enact "qualifying statutes" that force non participating manufacturers to make payments into escrow accounts that are comparable to what they would have paid had they participated in the agreement. House Bill 99-1208 added the qualifying statute to Colorado law. The Master Settlement Agreement requires states to "diligently enforce" their qualifying statutes. If certain preconditions are met, settlement payments to states that do not diligently enforce are reduced.

In 2006 a diligent-enforcement dispute led manufacturers to begin withholding part of their scheduled payments. Prior to the 2003 settlement payment, which was made in April 2004, participating manufacturers and states handled diligent-enforcement disagreements in an informal fashion and reached negotiated settlements that did not employ the formal arbitration process specified in the Master Settlement Agreement. By 2003, the market share of the major tobacco manufacturers had slipped notably. The participating manufacturers went ahead and made the 2003 payment but they also set the agreement's payment-reduction process in motion. This process cumulated in 2006 in the decision by Reynolds and Lorillard, the second and third largest tobacco manufacturers, to reduced their April 2006 payment by the amount of the potential 2003 diligent-enforcement adjustment. However the largest tobacco manufacturer, Philip Morris, did not withhold, though it asserts that it is also entitled to the adjustment.

In 2007, $7.2 million of disputed payments were released to Colorado. In February 2009, during negotiations concerning the ground rules for the arbitration proceeding, the tobacco manufacturers authorized the release of a portion of the payments previously withheld, with Colorado's share of the release equal to approximately $7.2 million. This one-time payment is not expected to be repeated.

Arbitrators must now decide whether the states diligently enforced. When a diligent-enforcement question arises, it is settled by a panel of arbitrators who, according to the Master Settlement Agreement, must decide the issue in a unified national proceeding in which a separate decision will be made on the diligent-enforcement efforts of each participating state. Thus the arbitrators might decide that one state should receive a reduced payment because it failed to diligently enforce while another state, which diligently enforced, is entitled to its full payment.

It proved to be very difficult to get the parties to the Master Settlement Agreement to agree upon ground rules and agree upon a date for arbitration but it now appears very likely that arbitration will begin within six months. However, the arbitration proceeding is likely to take at least a year, which means that resolution of the dispute and the possible release of disputed payments is unlikely before mid 2011at the earliest. Section 27-75-1104.5 (5) requires that any payments received prior to July 1, 2011 related to this dispute be deposited in the General Fund. It should be remembered that an adverse decision is possible, which would probably result in the loss of amounts withheld and could reduce Colorado's future tobacco-settlement payments, possibly by a substantial amount, possibly for several years.

The Legislative Council Staff forecast. The following table presents the Legislative Council Staff forecast of tobacco-settlement revenues along with actual tobacco-settlement revenues in recent years. This forecast assumes that the same group of manufacturers who have withheld in the past, namely Reynolds, Lorillard, and some smaller manufacturers, will continue withholding this year and next and it assumes that no further special payments will be received. It also assumes that the diligent enforcement dispute will not be resolved during the forecast period. The column titled "Full payment" is the amount Colorado should have received had no withholding occurred.

Table 1
Tobacco Settlement Revenues

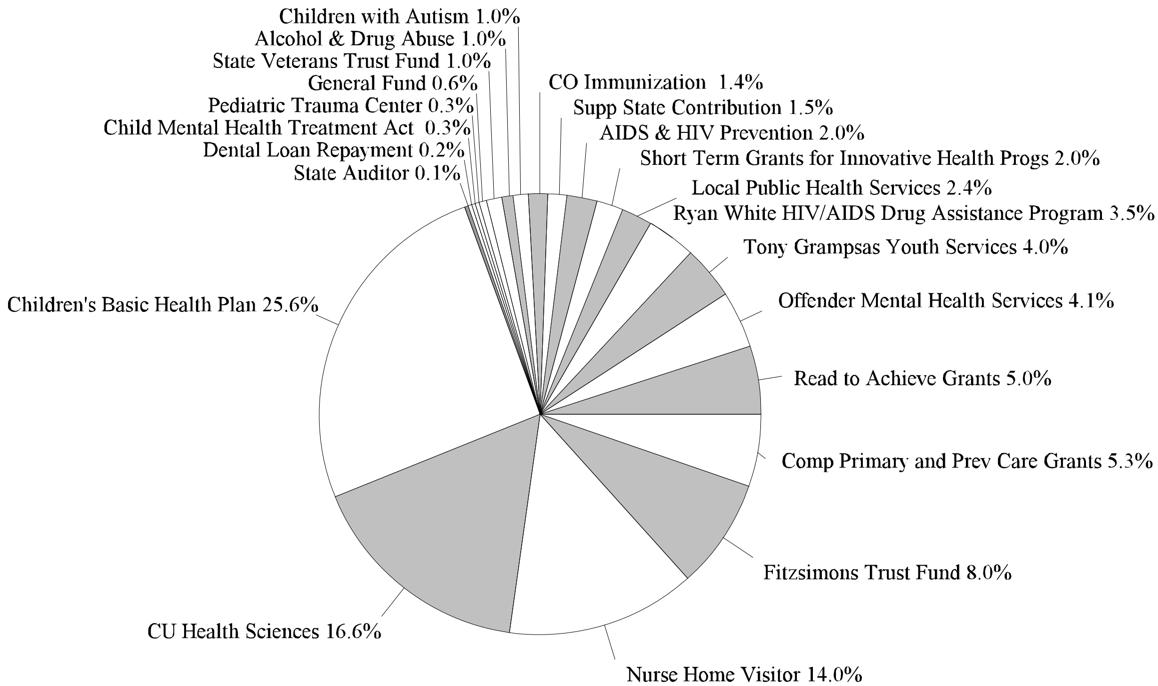
FY Payment Is Received	This Payment Determines Approps in FY:	Full Payment	Amount Withheld	Total Received Before Special Payments	% Change of Total Before Special Payments	Special Payments
Actual Payments:						
2003-04	2004-05	$86.1	$0.0	$86.1		$0.0
2004-05	2005-06	87.4	0.0	87.4	1.5%	0.0
2005-06	2006-07	91.1	(10.9)	80.2	-8.2%	0.0
2006-07	2007-08	92.7	(8.8)	83.9	4.6%	0.0
2007-08	2008-09	111.4	(7.7)	103.7	23.6%	0.0
2008-09	2009-10	112.5	(7.1)	105.4	1.6%	7.4
Legislative Council Staff Forecast:						
2009-10	2010-11	104.0	(7.8)	$\boxed{96.2}$	-8.7%	0.0
2010-11	2011-12	101.0	(8.7)	92.3	-4.1%	0.0
2011-12	2012-13	100.9	(8.1)	92.8	0.5%	0.0

Amounts are in millions of dollars.

A review of the "Total Received Before Special Payments" column in this table shows that tobacco settlement revenues have been somewhat volatile. The FY 2005-06 decline of settlement revenues was due to the start of withholding by participating manufacturers. The FY 2007-08 surge was due to the start of a series of "Strategic Contribution" payments, which the Master Settlement Agreement requires manufacturers to make for ten years. The FY 2010-11 decline is due to the effects of the recession and of the 61.6¢ per pack federal excise tax that was placed on cigarettes in April 2009.

The boxed forecast in Table 1 serves as the basis for the recommended allocation of settlement revenues among settlement-supported programs that is shown in the number pages. This allocation is based upon statutory rules that are described in the Appendix. These rules leave the Committee with little room for discretion. The following pie chart shows the recommended allocation of settlement revenues.

Allocation of Settlement Payments for Expenditure in FY 2010-11



Staff recommends that the Committee approve the above forecast and the resulting allocation of settlement revenue in the numbers pages. Staff will convey this allocation to other analysts who will use it as the basis for their own recommendations for FY 2010-11 appropriations to tobacco-settlement-supported programs. In some cases, an amount indicated in the numbers pages will directly translate into a single Long Bill appropriation. In other cases, an amount in the numbers pages will translate into several appropriations within the Long Bill. In still other cases, a balance in a cash fund that supports a program may supply additional revenues that for the appropriation.

Legislation. During the 2009 session, the JBC introduced S.B. 09-269 as a part of its budget balancing package. Among its provisions, this bill:

- ❏ Capped the amount of tobacco settlement revenue allocated among tobacco settlement programs in FY 2009-10 at $100 million and transfer the excess to the General Fund, a provision that generated approximately $5.5 million of General Fund revenue.

- ❏ Transferred to the General Fund $1.1 million of tobacco-settlement revenue that would otherwise have been allocated to the Short-term Innovative Health Program Grant Fund. Though this grant program has been in existence since 2007, it has made few grants and this transfer did not reduce grant making.

- ❏ Delayed for one year the one percentage point growth of the allocation of settlement moneys to the Nurse Home Visitor Program that is mandated in statute, while keeping funding for the program at its FY 2008-09 level. To accomplish this, $0.5 million of the money directed to the General Fund as a result of the $100 million cap was transferred back to the Nurse Home Visitor Program.

- ❏ Kept funding for the tobacco-settlement-supported AIDS Drug Assistance Program at its FY 2008-09 level. To accomplish this, the bill included an appropriation from the AIDS and HIV Prevention Cash Fund to the AIDS Drug Assistance Program.

During the December 2009 briefing for the Department of Public Health and Environment, Staff recommended that the Committee carry a similar bill this session in order to generate additional revenue for the General Fund in FY 2010-11. Last week, when staff received the settlement-revenue forecast from Legislative Council, staff realized that much of this recommendation is no longer viable. In particular, it makes no sense to cap distributions among settlement-supported programs at $100 million when settlement revenues are forecast to equal $96.2 million and there is little likelihood that will reach $100 million. In view of this fact, staff now recommends the following more limited transfer bill:

Recommended Legislation: Staff recommends that the Committee carry a bill that will transfer approximately $1.6 million from the Short-term Innovative Health Program Grant Fund to the General fund in April 2011. This transfer equals the $1.95 million of settlement money that the grant fund is expected to receive, less $311,000 of statutory transfers that must be made from the Grant Fund to other programs, as described in the appendix. The Grant Fund also receives transfers of the following amounts at the end of each fiscal year: (1) income earned during the year by the cash funds that support most of the other tier 2 programs; and (2) moneys that were allocated to some of the other settlement programs but were not expended. Thus it is likely that more than $1.6 million will be available for transfer in April 2011, but the exact amount cannot be forecast more accurately. A properly drafted bill would sweep the maximum possible amount into the General Fund. As noted above, the Short-term Innovative Health Program Grant program is not currently making any grants.

Because this bill would involve unique tobacco-settlement provisions, staff doubts that this transfer would fit under the title of a broader transfer bill that transferred moneys from several cash funds to the General Fund. However, it is probably possible to include this transfer within LSS 10-801, a tobacco bill that the Committee has already voted to carry.

APPENDIX

Tobacco-settlement Background and Allocation Rules

This appendix provides background information concerning the allocation of tobacco-settlement moneys, should the Committee need explanations that go beyond those provided in the main text of this document.

Basics of the Master Settlement Agreement: The Master Settlement Agreement (MSA) was signed in 1998 by 52 settling states and territories and the (then) four major U.S. tobacco companies. In the agreement, the participating manufacturers agreed to

1. Abide by a variety of public health restrictions on the advertising and marketing of cigarettes,
2. Create and fund the American Legacy Foundation, which conducts anti-tobacco advertising, and
3. Make specified payments to the settling states *in perpetuity*.

In return, the settling states agreed to release the participating manufacturers from health-related claims by the states and their local governments related to the use, manufacture and marketing of tobacco products. There is also a separate agreement with smokeless tobacco companies.

A number of smaller tobacco companies subsequently joined the Master Settlement Agreement, agreeing to abide by its provisions. The tobacco companies that are now parties to the agreement are collectively known as Participating Manufacturers while tobacco companies that have not joined are called Non Participating Manufacturers.

The three categories of settlement payments: Colorado began receiving master-settlement payments in 1999. These receipts are exempt from TABOR since they result from a damage award. The settlement payments that Colorado has received and will receive in the future are the sum of three components:

1. A series of initial payments, which ended in 2003.
2. A *perpetual* stream of "base" payments, which began in 2000 and are adjusted each year.
3. A series of "strategic contribution" payments, which began in April 2008 and will continue until 2017. These payments are to be allocated among the states based on each state's contribution to the MSA litigation. Colorado receives a disproportionate share of these payments because of its significant contribution to the litigation effort.

The settlement payments for a given calendar year are due the following April 15th, but the exact amount of each year's payment is often subject to dispute. Disputed amounts are directed into disputed payments accounts and are only sent to Colorado when the disagreement is resolved. As a consequence, Colorado often receives two or more settlement payments in the course of a fiscal year, with the vast majority of the payments arriving in mid April.

Statutory formulas control appropriations and leave little room for discretion. Appropriations for tobacco-settlement-supported programs are controlled by formulas that are scattered through statute. The core rules are contained in Sections 24-22-115 through 24-22-116, C.R.S., and in Sections 24-75-1101 through 24-75-1105, C.R.S., with Section 25-75-1104.5, C.R.S., containing the most important formulas. These formulas leave the JBC and the General Assembly with relatively little discretion regarding the amounts appropriated in the Long Bill.

Determining the total amount allocated among settlement-supported programs. Table A1 presents the rules for determining the amount of tobacco-settlement revenue allocated among settlement programs. As the table shows, in most fiscal years, the total amount allocated equals the total settlement payments received by the State during the prior year, though the dollars distributed are a combination of moneys received during the prior fiscal year and the current fiscal year. However, in some years, the allocation differs from the prior year's revenues.

Table A1

Fiscal Year	Total Allocation to Tobacco-Settlement Programs
2008-09	Payments received during FY 2007-08, excluding $15.4 million + $15.4 million of the payments received during FY 2008-09
2009-10	$84.6 million of the payments received during FY 2008-09 + $15.4 million of the payments received during FY 2009-10 (Payments received during FY 2008-09 in excess of $100.0 million were transferred to the General Fund to augment FY 2008-09 General Fund revenues.)
2010-11 and 2011-12	Non-disputed payments received during the prior fiscal year, excluding $80.4 million + $80.4 million of the payments received during the current year ($65.0 million of the non-disputed payments received during FY 2009-10 will be transferred to the General Fund to augment FY 2009-10 revenues.)
2012-13 to 2016-17	Payments received during the prior year, excluding $80.4 million + $80.4 million of the payments received during the current year
2017-18	Payments received during FY 2016-17, excluding $80.4 million + $65.0 million of the payments received during the current year (The mismatch between the $80.4 million exclusion from the FY 2016-17 payment and the $65.0 million inclusion from the FY 2017-18 payment reflects the ending of Strategic Contribution Payments.)
2017-18 and later	Payments received during the prior year, excluding $65 million + $65.0 million of the payments received during the current year

The funding arrangement in Table A1, under which the settlement dollars distributed to programs in a given fiscal year are a combination of dollars received during the prior year and dollars received during the current year, began when tobacco manufacturers withheld disputed amounts from the April 2007 payment. Knowing that strategic contribution payments would begin in April 2008 and wanting to minimize the impact of the withholding upon settlement programs, the General Assembly enacted H.B. 07-1359, which distributed $15.4 million of the April 2008 strategic contribution payment to programs in FY 2007-08 rather than FY 2008-09 and continued to annually "accelerate" the use of $15.4 million of strategic contribution payments until the payments ended in April 2017. During the 2009 legislative session, the General Assembly enacted S.B. 09-269 which accelerated the use of another $65.0 million dollars of settlement payments during FY 2009-10 and transferred the accelerated moneys to the General Fund. This acceleration will continue indefinitely.

Determine the amount of settlement revenue to allocate to individual tobacco-settlement programs. Section 24-75-1104.5, C.R.S., divides tobacco-settlement programs into two tiers. Settlement moneys are first allocated among the tier 1 programs, which will collectively utilize about 66 percent of the total during FY 2010-11, and the remainder is then allocated among the tier 2 programs. Table A2 lists the Tier 1 settlement programs and provides an overview of each program's statutory funding rule:

Table A2
Allocation Rules for Tier 1 Programs

Tier 1 Program	Portion of the Total Amount Allocated
Children's Basic Health Plan	24%, not to exceed $30 million and not less than $17.5 million.
Nurse Home Visitor Program	14% in FY 2010-11, rising 1% annually to 19% in FY 2015-16, never to exceed $19 million annually.
Fitzsimons lease purchase	8%, not to exceed $8 million
Read-to-achieve Grant Program	5%, not to exceed $8 million
Tony Grampsas Youth Services Program	4%, not to exceed $5 million
HIV/AIDS Drug Assistance Program	3.5%, not to exceed $5 million
Comprehensive Primary and Preventive Care Grant Program	3%, not to exceed $5 million
HIV and AIDS Prevention Grant Program	2%, not to exceed $2 million
State Veterans	1%, not to exceed $1 million.
Autism Treatment Fund	$1,000,000 annually (fixed)
Child Mental Health Treatment Act	$300,000 annually (fixed)
Dental Loan Repayment Program	$200,000 annually (fixed)

For simplicity, Table A2 excludes the allocation to the Office of the State Auditor, for auditing settlement programs. The Auditor's allocation equals 0.1 percent of the settlement payment received in the prior calendar year and is subtracted proportionately from the allocations to most tier 1 programs.

Actual appropriations of settlement moneys to Tier 1 programs closely track the allocation of settlement dollars prescribed in the Table A2, though these appropriations sometimes deviate modestly due to the presence of a cash fund that supports a program. These cash funds serve as buffers between the allocation and the appropriation.

The allocations in Table A2 do not utilize 100 percent of the prior-year settlement payment. The remainder, is allocated among tier 2 programs in the percentages detailed in Table A3:

Table A3
Allocation Rules for Tier 2 Programs

Tier 2 Program	Percentage of Remainder
University of Colorado Health Sciences Center	49.0%
Mental health services for juvenile and adult offenders	12.0%
Comprehensive Primary and Preventive Care Grant Program	8.5%
Local public health services	7.0%
Children's Basic Health Plan	5.0%
Supplemental state contribution for group benefit plans	4.5%
Colorado Immunization Program	4.0%
Alcohol and drug abuse and treatment programs	3.0%
Medicaid shortfalls at Children's Hospital	1.0%
Short-term Grants for Innovative Health Programs	6.0%
Total	**106.0%**

The cash fund that supports Short-term Grants for Innovative Health Programs also receives transfers of the following amounts at the end of each fiscal year: (1) income earned during the year by the cash funds that support most of the other tier 2 programs; and (2) moneys that were allocated to some of the other settlement programs but were not expended.

Note that these allocations utilize 100 percent of the remaining settlement payments. Because these programs are unable to carry unexpended balances forward, appropriations to most of these Tier 2 programs track the above allocations dollar-for-dollar. Also note that Tables A2 and A3 have ignored small appropriations to the Department of Public Health and Environment's Administration division which come out of the appropriations to each program.

Special allocation rules. Periodically, the General Assembly adds special rules to statute that temporarily alter the general allocation rules described above. For FY 2010-11 there are four special rules in statute:

Table A4
Special Allocation Rules

C.R.S. Source	Special Rule
24-75-1104.5 (1.5) (a) (III) (C)	The transfer for FY 2010-11 Comprehensive Primary and Preventive Care Grants equals $2,245,000, with the savings transferred to the General Fund in FY 2010-11.
24-75-1104.5 (1.5) (a) (X) (B)	The transfer for FY 2010-11 Medicaid shortfalls at Children's Hospital equals $307,000, with the savings transferred to the General Fund.
26-22-103 and 25-36-101 (3)	The transfer for FY 2010-11 Short-term Grants for Innovative Health Programs is reduced by $221,717 and the savings is to be appropriated to the Juvenile Justice Family Advocate Program in the Departments of Human Services and Public Safety.
25-20.5-706 and 25-36-101 (10)	The transfer for FY 2010-11 Short-term Grants for Innovative Health Programs is reduced by $90,070 and the savings is to be appropriated to the Health Care Professional Loan Repayment Program in the Department of Public Health and Environment.

Long Bill appropriations are based on settlement-revenue forecasts. Once actual payments are known, a supplemental is often needed. Because most of the appropriations in the Long Bill to settlement-supported programs depend upon the amount of settlement revenue received in the prior fiscal year, and because the April payment is not known at the time the Long Bill is written and approved, each year's Long Bill must be based upon a forecast of settlement payments, a forecast that almost always proves incorrect. Supplementals are then required the following January to correct resulting inaccuracies.