RIPEC

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Preliminary Analysis of FY 2010 Year-end Statement and Out-year Projections

Introduction

The Office of Accounts and Control released its preliminary, unaudited year end statements for FY 2010 on September 1, 2010. The statements reflect a projected $17.7 million surplus for the fiscal year ending June 30, 2010. Table 1 shows the budget statement as passed by the General Assembly for FY 2010, and the changes to it based on the State Controller's preliminary analysis. Although revenues were lower than enacted by $3.4 million, general revenue expenditures were $24.4 million lower than enacted, resulting in the net surplus of $17.7 million. One should note that these numbers are preliminary and subject to change in the final audit.

Table 1
Preliminary Budget Statement ($ millions)

	Budget	Audit
Opening Surplus/Deficit	$ (62.3)	$ (62.3)
Reappropriated Surplus	1.0	1.0
General Revenues	3,019.1	3,015.6
Total Available FY 2010 Revenues	*$ 2,957.8*	*$ 2,954.4*
General Revenue Expenditures	$ 2,886.8	$ 2,862.4
Reappropriations (carried forward to 2011)	-	3.4
Total FY 2010 Expenditures	*$ 2,886.8*	*$ 2,865.8*
Balance	*$ 71.0*	*$ 88.6*
Transfer to Budget Reserve	$ (70.9)	$ (70.9)
Closing Surplus/Deficit	**$ 0.1**	**$ 17.7**

Source: State Controller Preliminary Audit; House Fiscal Staff "Budget as Enacted"

Although FY 2010 appears to have closed with a slight surplus, out-year budget deficits are projected. Based on RIPEC estimates, the State faces a projected deficit of $360 to $370 million in FY 2012 due to federal stimulus funds running out, revenues that have not yet recovered from the economic downturn and increased spending requirements. These estimates will be updated after the November Revenue and Caseload Estimating Conference

Revenue Changes

Table 2 provides an overview of the revised revenue situation. Overall, FY 2010 audited revenues were slightly lower than in the FY 2010 enacted revised budget. Total FY 2010 audited revenues were $3,015.6 million – $3.4 million (0.1 percent) less than enacted revenues of $3,019.1 million.

Significant revenue changes include:

- Net tax collections were $20.8 million higher than enacted;
- Personal income tax collections were $20.4 million (2.2 percent) lower than enacted;
- The net increase in general business taxes of $26.4 million (7.4 percent) was primarily attributable to a $28.6 million increase in business corporations tax collections;
- Declines in tax collections for public utility gross earnings, insurance

October 2010

companies and bank deposits slightly lowered total general business tax collections;

- The net increase in sales and use taxes of \$13.6 million (1.4 percent) was the result of higher-than-anticipated general sales and use collections, which were slightly offset by declines in the other categories of sales and use taxes; and

- Other miscellaneous and lottery revenues were lower than enacted by \$22.4 million and \$3.0 million, respectively.

Table 2
General Revenues (Preliminary-Unaudited)
for the Fiscal Year Ended June 30, 2010 ($ millions)

	Final Budget	Actual	Variance	Percent Variance
Personal Income Tax	$ 918.5	$ 898.1	$ (20.4)	-2.2%
General Business Taxes				
Business Corporations	$ 115.0	$ 143.6	$ 28.6	24.9%
Public Utilities Gross Earnings	97.0	95.8	(1.2)	-1.2%
Financial Institutions	2.9	4.1	1.2	40.0%
Insurance Companies	98.0	95.9	(2.1)	-2.1%
Bank Deposits	2.2	1.9	(0.3)	-15.5%
Health Care Provider Assess.	40.0	40.3	0.3	0.6%
Sales and Use Taxes				
Sales and Use	$ 787.5	$ 803.4	$ 15.9	2.0%
Motor Vehicle	49.0	48.3	(0.7)	-1.5%
Motor Fuel	1.0	1.0	(0.0)	-3.1%
Cigarettes	139.6	138.3	(1.3)	-0.9%
Alcohol	11.5	11.3	(0.2)	-2.0%
Other Taxes				
Inheritance and Gift	$ 28.0	$ 29.1	$ 1.1	3.8%
Racing and Athletics	1.5	1.5	(0.0)	-0.5%
Realty Transfer Tax	6.9	7.0	0.1	1.4%
Total Taxes	$ 2,298.6	$ 2,319.4	$ 20.8	0.9%
Departmental Revenue	$ 332.2	$ 333.1	$ 0.9	0.3%
Total Taxes and Departmentals	$ 2,630.8	$ 2,652.5	$ 21.7	0.8%
Other Sources				
Gas Tax Transfer	$ -	$ 0.0	$ 0.0	-
Other Miscellaneous	34.9	12.5	(22.4)	-64.1%
Lottery	347.7	344.7	(3.0)	-0.9%
Unclaimed Property	5.6	5.9	0.3	4.8%
Total Other Sources	$ 388.2	$ 363.1	$ (25.1)	-6.5%
Total	**$ 3,019.1**	**$ 3,015.6**	**$ (3.4)**	**-0.1%**

Source: State Controller

- The miscellaneous revenue change was related to land sales that did not occur, developmental disabilities provider donations that did not occur, and the federal reimbursement for Family Court/Child Support enforcement reimbursement that was not received by June 30, 2010.

Budget Reserve and Cash Stabilization Fund

Rhode Island's Budget Reserve and Cash Stabilization Fund, commonly known as the "rainy day fund", was established in 1985. State spending was limited to 98.0 percent of estimated unencumbered general revenues for each fiscal year. The two percent balance was appropriated into the Budget Reserve and Cash Stabilization account provided that no payment into the account would increase the balance above three percent of the estimated general revenues. Any deposit which would increase the balance of the account above three percent of general revenues was used exclusively for reduction of the State's debt, payment of debt service or funding of capital projects.

In 2006, a constitutional amendment revised the structure of the account and formalized the capital fund structure by creating the Rhode Island Capital Plan Fund (RICAP). As part of this change, appropriations in excess of the cap on the fund's assets will flow primarily into the State's RICAP fund. The amendment also increases the cap on the budget reserve fund from three percent of general revenues to five percent by FY 2013. In addition, the amendment reduces the amount of revenues that can be spent from 98.0 percent of revenues to 97.0 percent of revenues by FY 2013.

The FY 2009 deficit was partially solved through a $22.0 million transfer from the Budget Reserve Fund. This appropriation was paid back in FY 2011 to the RICAP fund in order to provide funding for certain capital projects instead of new debt.

As shown on Table 3, the Budget Reserve Fund had an opening balance of $80.1 million. The estimated transfer from the General Fund of $70.9 million left a balance of $151.0 million in FY 2010. After transferring $38.8 million to the Capital Fund, a balance of $112.2 million was left. Based on statutory requirements, the plan is currently fully funded.

Table 3
State Budget Reserve
and Cash Stabilization Account
FY 2010 Preliminary - Unaudited ($ million)

Opening Balance	$	80.1
Calculated transfer from General Fund		70.9
Subtotal	*$*	*151.0*
Transfer to Capital Fund	$	38.8
Ending Balance	**$**	**112.2**

Source: RIPEC calculations based on State Controller Preliminary Audit

Expenditures

Total general revenue expenditures based on the preliminary audited budget for FY 2010 were $2,886.8 million, a decrease of $24.4 million compared to the appropriated level. The majority of the savings – $13.3 million – was from human services agencies (i.e. Department of Human Services, Department of Behavioral Health, Developmental Disabilities and Hospitals, and Department of Health).

Of the 42 state agencies (within the five general categories), 35 ended FY 2010 with expenditures that were lower than enacted. The largest surplus was in the Department of Human Services, which spent $10.4 million less than their enacted budget. The second-largest surplus was in the Department of Elementary and Secondary Education, which spent $4.1 million less than their FY 2010 appropriation. The Legislature had the third largest variance between enacted and final expenditures ($3.4 million).

Table 4
General Revenue Expenditures (Preliminary-Unaudited)
for the Fiscal Year Ended June 30, 2010 ($ millions)

	Final Budget	Actual	Variance	Percent Variance
General Government	$ 517.7	$ 511.1	$ (6.6)	-1.3%
Human Services	1,018.0	1,004.8	(13.3)	-1.3%
Education	979.8	975.3	(4.6)	-0.5%
Public Safety	335.8	335.6	(0.2)	0.0%
Natural Resources	35.5	35.6	0.2	0.5%
Total	**$ 2,886.8**	**$ 2,862.4**	**$ (24.4)**	**-0.8%**

Source: State Controller Preliminary Audit for FY 2010

Based on early reports, savings within state agencies appear to be due to unfilled vacancies, building maintenance savings and lower utility costs. Savings within health and human services agencies are related to lower Medicaid costs, savings on pharmaceuticals, some federal reimbursements and lower-than-projected caseloads.

Forecast

Table 5 shows RIPEC's budget projections for FY 2011 to FY 2015. The projections assume revenue and expenditure growth at rates consistent with the State Budget Office projections in the FY 2011 budget as proposed, and the House Fiscal Staff FY 2011 budget as enacted. Both estimates are adjusted to account for revenue changes resulting from the FY 2010 preliminary closing numbers, as well as expenditure changes resulting from the lower than expected enhanced Federal Matching Assistance Percentage (FMAP) payment.

The FY 2010 surplus of $17.7 million and the reappropriated surplus of $3.4 million may provide a measure of fiscal relief for the State in FY 2011. At the same time, however, increased Medicaid costs as a result of the lower than expected enhanced FMAP has resulted in $38.0 million in additional expenditure payments. As a result, the State is projected to have a FY 2011 deficit of $16.9 million dollars, assuming no other revenue or expenditure changes.

Potential changes to FY 2011 revenues include the land sales that did not occur in FY 2010, as well as the federal reimbursement for Family Court/Child Support Enforcement. Additionally, as outlined on Table 6, year-to-date revenue collections appear to be ahead of enacted estimates. Revenue projections will be updated at the November Revenue Estimating Conference.

On the expenditure side, the Governor has proposed to use the federal Edujob funding to balance the projected FY 2011 shortfall. The General Assembly will decide if the funds are to be used for that purpose. Additionally, the November Caseload Estimating Conference will provide an update on projected caseloads and expenditures for TANF/RIWP, child care, SSI disability, general public assistance (GPA), and Medicaid spending.

Based on current information, FY 2011 revenues appear to be better than enacted estimates. However, future revenues are not currently projected to increase on pace with future expenditure growth, particularly in FY 2012 when supplementary funding through the American Recovery and Reinvestment Act (ARRA) is projected to expire.

RIPEC projects a FY 2012 deficit ranging from $361.5 million (12.1 percent of available FY 2012 revenues) using House Fiscal Staff growth estimates to $369.9 million (12.5 percent of available FY 2012 revenues) using State Budget Office growth rates. The projected deficit is the result of an adjusted projected expenditure increase of approximately 12 percent between FY 2011 and FY 2012 due to the expiration of ARRA funds, and adjusted projected revenue growth of between 0.2 and 0.6 percent.

Using House Fiscal Staff growth rates, deficits are expected to increase to $411.5 million (12.4 percent of available revenues) in FY 2015. The State Budget Office used lower projected revenue growth rates than the House Fiscal Staff, and similar expenditure growth rates. As a result, projected deficits using the State Budget Office growth rates are projected to increase to $555.0 million, or 17.4 percent of available revenues, by FY 2015.

Table 5
Projected Deficits FY 2011 - 2015 ($ million)

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
State Budget Office Estimated Growth Rates					
Available Revenues	$2,963.2	$2,967.9	$3,057.0	$3,132.4	$3,187.7
Total Expenditures	2,980.1	3,337.8	3,488.5	3,606.8	3,742.7
(Deficit)/Surplus*	$ (16.9)	$ (369.9)	$ (431.5)	$ (474.4)	$ (555.0)
As a % of Available Revenue	0.6%	12.5%	14.1%	15.1%	17.4%
House Fiscal Office Estimated Growth Rates					
Available Revenues	$2,963.2	$2,980.8	$3,108.2	$3,223.2	$3,326.4
Total Expenditures	2,980.1	3,342.2	3,475.9	3,597.6	3,737.9
(Deficit)/Surplus*	$ (16.9)	$ (361.5)	$ (367.7)	$ (374.4)	$ (411.5)
As a % of Available Revenue	0.6%	12.1%	11.8%	11.6%	12.4%

SOURCE: RIPEC calculations based on State Budget Office and House Fiscal Staff budget documents

* FY 2012 revenues account for the projected FY 2011 deficit; subsequent years assume the resolution of the prior year deficit.

Year-to-Date Revenues

The Department of Revenue releases monthly reports on year-to-date estimates to actual revenue collections. Based on the September report, total revenue collections are $38.1 million higher than projected. The two largest components of the increase are the personal income tax ($9.1 million, or 3.8 percent over projected), and the general sales and use tax ($9.1 million, and 4.2 percent over estimated). Business Corporations tax collections and Departmental receipts also exceeded enacted expected revenues by more than $5.0 million ($5.1 million and $7.6 million, respectively).

The Department notes that these estimates are based on historical collections patterns and actual collections may vary significantly. As such, caution should be exercised when interpreting the report. In addition, enacted and adopted revenue estimates are based on an accrual, not cash, basis. This may have an effect on overall revenue collections as they are presented in the report.

Table 6
FY 2011 General Revenue Collections
Estimate to Actual, September 2010 ($ millions)

	Estimate	Actual	Variance	Percent Variance
Taxes				
Personal Income Tax	$ 238.4	$ 247.5	$ 9.1	3.8%
General Business Taxes	24.1	30.1	6.0	25.0%
Sales and Use Taxes	261.5	276.5	15.0	5.8%
Other Taxes	9.9	9.3	(0.6)	-6.4%
Total Taxes	*$ 533.9*	*$ 563.4*	*$ 29.5*	*5.5%*
Departmentals	$ 36.9	$ 44.6	$ 7.6	20.7%
Other				
Other Misc.	$ 0.1	$ 0.1	$ -	0.0%
Lottery	58.9	59.8	0.9	1.6%
Unclaimed Property	-	-	-	-
Total Other	*$ 59.0*	*$ 59.9*	*$ 0.9*	*1.5%*
Total	**$ 629.8**	**$ 667.9**	**$ 38.1**	**6.0%**

Source: Rhode Island Department of Revenue "State of Rhode Island Revenue Assessment Report Year-to-Date FY 2011 through September 2010"

Next Steps

The preliminary surplus and better-than-estimated revenue collections for the fiscal year to date appear to be positive signs that the State may be able to conclude FY 2011 without a shortfall despite the additional $38.0 million increase in general revenue expenditures. However, FY 2010 figures are not yet finalized and there are a number of variables that may negatively affect revenue collections as the fiscal year progresses. It is thus important for the State to remain cautious with regard to its fiscal situation.

Moreover, FY 2012 will represent a significant challenge as ARRA funds run out. RIPEC recommends that the government take a proactive approach to the FY 2012 budget. The State should also consider whether potential changes in FY 2011 might ease the impact of the loss of ARRA funding in FY 2012 and create long-term structural change that will have an impact on out-year deficits.

While there are a number of indications that the worst of the recession is over, the economic impacts will be long-lasting. Thus far, revenues appear to be rebounding but full recovery may be slower than in the past. As such, revenue projections should take into account the severity of the recession and the potential for continued slow growth in revenues. Additionally, high unemployment has had, and may continue to have, an effect on demand for social services which will impact the budget on the expenditure side.

How the State addresses the FY 2012 budget will set the course for the next few years. As such, it is important that the process take into account the following questions:

- Are expenditure priorities responsive to the needs of citizens?
- Is this program/activity mandated by State or federal law?

- What are the State's policy goals and what are the procedures to ensure they are met?

- Are revenue projections based on a realistic set of assumptions?

- Has the State assessed and ranked critical functions and developed cost reductions based on this prioritization?

- If so, what is the level of service that is mandated and should the mandate be maintained?

- Are services being provided in the most cost-effective manner?

- Are department resources being duplicated within the State?

- Does the State raise revenue in the most effective manner?

- Can the process or processes be improved or streamlined?

- Would a change result in cost-savings or cost-shifting?

- What is the long-term financial impact?

- How will change impact service delivery?

- What are the actual savings that will be gained in year one and out-years?