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Analysis of Fiscal Year 2015 Preliminary Closing

Introduction

On August 31, 2015, the Rhode Island Office of Accounts and Control released the preliminary, unaudited closing statement for Fiscal Year (FY) 2015. This document, which is subject to change after an audit is completed, found that FY 2015 concluded with a closing surplus of \$166.4 million. This represents an increase of \$47.8 million above the closing surplus anticipated in the FY 2015 revised budget approved by the General Assembly. Table 1 displays the preliminary budget statement for the FY 2015 revised budget and the preliminary closing amounts based on the State Controller's report.

The greater-than-anticipated closing surplus included in the FY 2015

preliminary closing statement is the result of general revenues exceeding final estimates and general revenue expenditures falling short of budgeted appropriations. General revenues, a category which includes personal and corporate income taxes, sales taxes, lottery proceeds and other sources, totaled \$3,640.7 million in the FY 2015 closing statement, an increase of \$23.9 million above the final estimates from the revised budget. General revenue expenditures totaled \$3,455.1 million (not including a reappropriation of \$6.9 million that will be carried forward to FY 2016), which was \$21.5 million below the total amount appropriated in the revised budget. After accounting for a \$0.3 million increase in the amount of the transfer to the state's "rainy day fund," there is a closing surplus of \$166.4 million for FY 2015.

The FY 2016 enacted budget, adopted by the General Assembly during the 2015 legislative session, assumed an opening surplus of \$118.6 million and anticipated ending the fiscal year with a free surplus of \$0.5 million. The larger closing surplus included in the preliminary closing statement can now potentially be carried forward to FY 2016. However, even after accounting for the larger closing surplus from FY 2015, the state is still projected to experience increasing

Table 1
FY 2015 Preliminary Budget Statement (\$ millions)

	FY 2015 Revised	FY 2015 Final	Change
Free Opening Surplus	\$ 67.8	\$ 67.8	\$ -
Reapportioned Opening Surplus	7.4	7.4	-
<i>Total Opening Surplus</i>	75.2	75.2	-
General Revenues	3,616.7	3,640.7	23.9
Repeal of Prior Year Transfer to RI Retirement*	14.2	-	(14.2)
Transfer to Budget Stabilization Fund	(111.0)	(111.3)	(0.3)
<i>Total Available</i>	3,595.2	3,604.6	9.4
General Revenue Expenditures	(3,476.6)	(3,455.1)	21.5
Reapportioned Closing Surplus	-	(6.9)	(6.9)
Repeal of Prior Year Transfer to RI Retirement*	-	13.8	13.8
Transfer from Accelerated Depreciation Fund**	-	10.0	10.0
<i>Free Closing Surplus</i>	\$ 118.6	\$ 166.4	\$ 47.8

*Treated as General Revenues in the Revised Budget; Closing treats as fund transfers not subject to 3.0% Budget Stabilization assessment

**Included as General Revenues in the Revised Budget

Source: Rhode Island State Controller; House Fiscal Staff

budget deficits between FY 2017 and FY 2020. Although the larger FY 2015 closing surplus will reduce the projected deficit in FY 2017 from approximately \$131.7 million to \$86.7 million, it will not impact budget deficits in the outer-years.¹

In addition to the larger-than-expected FY 2015 closing surplus, the Rhode Island Department of Revenue (DOR) recently announced that the state’s general revenue collections have outpaced projections by 2.9 percent through the first quarter of FY 2016. According to DOR’s Revenue Assessment Report as of September 2015, general revenue sources that have exceeded year-to-date projections include business corporate taxes (43.6 percent), estate and transfer taxes (13.2 percent) and lottery transfers (7.6 percent). In total, general revenues are currently \$21.8 million greater than was expected through the first quarter of FY 2016.

Preliminary FY 2015 Closing

General Revenues

According to the FY 2015 preliminary closing statement, actual FY 2015 general revenues were greater than estimated in the FY 2015 revised budget. Actual total general revenues were \$3,640.7 million, \$23.9 million (0.7 percent) greater than the estimated revenue total of \$3,616.7 million included in the revised budget. Table 2 provides an overview of FY 2015 budgeted and actual state general revenues.

The preliminary year-end statement indicates that several general revenue sources exceeded the estimates included in the FY 2015 revised budget. The revised budget estimated that tax revenues for FY 2015 would total approximately \$2,865.9 million. Actual tax revenues were \$2,882.6 million, representing a \$16.7 million (0.6 percent) increase over the revised budget estimate.

More than half of the \$16.7 million increase in tax revenues can be attributed to greater-than-expected

Table 2
FY 2015 General Revenues (\$ millions)

	FY 2015 Revised	FY 2015 Final	Change	% Change
Personal Income Tax	\$ 1,226.8	\$ 1,227.6	\$ 0.8	0.1%
General Business Taxes				
Business Corporations	\$ 143.2	\$ 148.0	\$ 4.8	3.3%
Public Utilities Gross Earnings	103.6	104.0	0.4	0.3%
Financial Institutions	22.0	22.7	0.7	3.4%
Insurance Companies	123.1	120.3	(2.8)	-2.3%
Bank Deposits	1.9	2.3	0.4	18.9%
Health Care Provider Assess.	44.3	44.1	(0.2)	-0.4%
Sales and Use Tax				
Sales and Use	\$ 954.0	\$ 963.5	\$ 9.5	1.0%
Motor Vehicle	49.9	49.1	(0.8)	-1.6%
Motor Fuel	(0.2)	(0.1)	0.1	37.7%
Cigarettes	136.9	138.0	1.1	0.8%
Alcohol	18.8	18.4	(0.4)	-2.3%
Other Taxes				
Inheritance and Gift	\$ 31.5	\$ 34.2	\$ 2.7	8.6%
Racing and Athletics	1.1	1.1	0.0	0.7%
Realty Transfer Tax	9.0	9.5	0.5	5.5%
Total Taxes	\$ 2,865.9	\$ 2,882.6	\$ 16.7	0.6%
Departmental Revenue	\$ 350.9	\$ 353.7	\$ 2.8	0.8%
Total Taxes and Departmentals	\$ 3,216.8	\$ 3,236.2	\$ 19.5	0.6%
Other Sources				
Lottery	\$ 378.6	\$ 381.9	\$ 3.3	0.9%
Unclaimed Property	12.3	13.7	1.4	11.5%
Other Miscellaneous	9.1	8.8	(0.3)	-3.4%
Total Other Sources	\$ 400.0	\$ 404.4	\$ 4.4	1.1%
Total General Revenues	\$ 3,616.7	\$ 3,640.7	\$ 23.9	0.7%

Source: Rhode Island State Controller; House Fiscal Staff

¹ Note: These projections do not account for changes in revenue/expenditure patterns that resulted in the increased FY 2015 surplus.

sales and use tax collections, which exceeded the revised budget estimate by \$9.5 million (a 1.0 percent increase). Additionally, business corporation tax collections were higher than expected, exceeding the revised budget estimate by \$4.8 million (a 3.3 percent increase). By contrast, revenues from four tax sources were lower than estimated in the revised budget: insurance company taxes (\$2.8 million), motor vehicle license and registration fees (\$0.8 million), alcohol excise taxes (\$0.4 million) and health care provider assessments (\$0.2 million).

Revenue collections from non-tax general revenue sources also exceeded the estimates included in the FY 2015 revised budget. Departmental revenue totaled \$353.7 million in the closing statement, an increase of \$2.8 million above the budgeted estimate. Lottery revenues reached \$381.9 million in the closing statement, an increase of \$3.3 million above the revised budget estimate, while unclaimed property totaled \$13.7 million, an increase of \$1.4 million above the budgeted estimate. Other miscellaneous revenue sources totaled \$8.8 million, a decrease of \$0.3 million below the budgeted estimate. Overall, non-tax general revenue sources were \$7.3 million (1.0 percent) greater in the closing statement than the FY 2015 revised budget estimate.

General Revenue Expenditures

According to the FY 2015 preliminary closing statement, general revenue expenditures totaled \$3,455.1 million, which was \$21.5 million (0.6 percent) less than the final revised budget appropriation of \$3,476.6 million. FY 2015 general revenue revised budget appropriations and preliminary actual expenditures are summarized by function in Table 3.

	FY 2015 Revised	FY 2015 Final	Change	% Change
General Government	\$ 437.2	\$ 426.3	\$ (10.9)	-2.5%
Human Services	1,378.3	1,367.7	(10.6)	-0.8%
Education	1,194.7	1,194.3	(0.4)	0.0%
Public Safety	427.9	428.4	0.4	0.1%
Natural Resources	38.418	38.424	0.006	0.0%
Transportation	-	-	-	0.0%
Total	\$ 3,476.6	\$ 3,455.1	\$ (21.5)	-0.6%

Source: Rhode Island State Controller; House Fiscal Staff

Of the six government functions that Rhode Island uses to organize state agencies for budgetary purposes, the preliminary closing statement found that general revenue expenditures for three functions were less than the appropriation included in the FY 2015 revised budget while general expenditures for two functions were greater than the appropriation included in the revised budget. General government, human services and education general revenue expenditures were all found to be less than the budgeted appropriation. By contrast, public safety and natural resources general revenue expenditures were found to have exceeded the budgeted appropriation. Transportation does not receive any general revenue funding, instead relying on federal funds and other funds, such as the gasoline tax and license and registration fees.

General government general revenue expenditures totaled \$426.3 million in the closing statement; this was \$10.9 million less than the \$437.2 million appropriation included in the FY 2015 revised budget. Among state agencies included in the general government function, the Department of Administration (\$5.3 million) and Legislature (\$4.4 million) spent the least relative to their budgeted appropriation. However, all state agencies included in the general

government function spent less in general revenue expenditures than was provided in the FY 2015 revised budget.

Lower-than-anticipated spending for human services also accounts for a substantial portion of the difference between FY 2015 revised budget appropriations and actual expenditures. Human services expenditures were \$1,367.7 million, approximately \$10.6 million (0.8 percent) less than anticipated in the final budget as enacted. Every agency within the human services function was appropriated more in general revenue than it spent in FY 2015. However, the majority of the \$10.6 million human services surplus can be attributed to the Executive Office of Health and Human Services, which spent \$9.2 million (1.0 percent) less than expected, primarily due to lower-than-anticipated expenditures for medical assistance.

Budget Reserve and Cash Stabilization Fund

Rhode Island’s Budget Reserve and Cash Stabilization Fund, commonly referred to as the “rainy day fund,” was established in 1985. Since FY 2013, annual state spending has been limited to 97.0 percent of unencumbered general revenues – that is, the free opening surplus plus general revenues collected during that fiscal year. The remaining 3.0 percent balance of general revenue is transferred to the Budget Reserve and Cash Stabilization Fund.

The Budget Reserve has a maximum legal balance, which has been set at 5.0 percent of unencumbered general revenues since FY 2013. Transfers to the Budget Reserve in excess of this maximum cap are instead transferred to the Rhode Island Capital Plan Fund (RICAP) account. The RICAP account was established in the early 1990s to fund capital projects, debt reduction, and debt service. The use of excess reserve funds deposited into RICAP has been strictly limited to funding capital projects (as opposed to debt reduction or debt service) since FY 2008.

As shown in Table 4, the Budget Reserve had an opening balance of \$176.7 million. Based on the Controller’s preliminary report, FY 2015 unencumbered revenues totaled \$3,708.5 million (\$67.8 million in free opening surplus and \$3,640.7 million in revenues). The required 3.0 percent transfer from general revenues of \$111.3 million increased the Budget Reserve balance to a total of \$288.0 million. The reserve is fully funded at 5.0 percent of unencumbered revenues, or \$185.4 million, leaving a total of \$102.5 million in excess revenues to be transferred to RICAP.

Opening Balance	\$ 176.7
Calculated transfer from General Fund	111.3
<i>Subtotal</i>	<i>\$ 288.0</i>
Legal Limit	\$ 185.4
Transfer to RI Capital Fund	\$ 102.5
Ending Balance	\$ 185.4
Source: Rhode Island State Controller	

Balance Forward	\$ 124.5
Budget Reserve Transfer	102.5
Bond Premium	6.4
Investment Earnings	0.1
Total Available	\$ 233.5
Expenditures	\$ 100.9
Available Balance	\$ 132.6
Source: Rhode Island State Controller	

Rhode Island Capital Plan Fund

As displayed in Table 5, the Rhode Island Capital Plan Fund began FY 2015 with a balance of \$124.5 million. After a transfer of \$102.5 million from surplus general revenues and additional earnings of \$6.5 million from bond premiums and investment earnings, the Fund had a total of \$233.5 million available. FY 2015 expenditures from the Fund totaled \$100.9 million, leaving an available balance of \$132.6 million.

Out-Year Budget Deficits

A closing surplus from one fiscal year may be carried forward from one fiscal year to the next. When the General Assembly enacted the FY 2016 budget, it anticipated that FY 2015 would have a closing surplus of \$118.6 million that would be carried forward. However, the FY 2015 preliminary closing statement indicates that the closing surplus will actually total \$166.4 million. As a result, the projected closing surplus for FY 2016 will also change from the figures included in the enacted budget if these funds are carried forward. Table 6 displays the FY 2016 budget as enacted, and the FY 2016 budget adjusted to take into account the preliminary FY 2015 closing.² The adjusted opening surplus is \$166.4 million, \$47.8 million higher than expected.

	FY 2016 Enacted	FY 2016 Adjusted	Change	% Change
Opening Surplus	\$ 118.6	\$ 166.4	\$ 47.8	40.3%
General Revenues	\$ 3,543.8	\$ 3,543.8	\$ -	0.0%
<i>Total FY 2016 Revenues</i>	<i>\$ 3,662.3</i>	<i>\$ 3,710.1</i>	\$ 47.8	1.3%
General Revenue Expenditures	\$ 3,552.0	\$ 3,552.0	\$ -	0.0%
<i>Balance</i>	<i>\$ 110.3</i>	<i>\$ 158.2</i>	\$ 47.8	43.3%
Transfer to Budget Reserve	\$ 109.9	\$ 111.3	\$ 1.4	1.3%
Closing Surplus	\$ 0.5	\$ 46.9	\$ 46.4	10008.2%

Source: Rhode Island State Controller; House Fiscal Staff

If the additional FY 2015 surplus is carried forward to FY 2016 (and not reallocated for other purposes) and there are no changes made to the enacted FY 2016 general revenue and expenditure estimates, FY 2016 is projected to close with a surplus that is \$46.4 million higher than currently anticipated. However, closing FY 2016 with a \$46.4 million higher-than-expected surplus will have limited impact on the long-term projected budget deficit. Table 7 displays out-year forecasts based on the FY 2016 budget as enacted and an adjusted forecast that includes the impact of the larger-than-expected FY 2015 closing surplus being carried forward to FY 2016. If estimated revenues and expenditures do not change, FY 2017 will close with a smaller deficit

² Note: These projections do not account for changes in revenue/expenditure patterns that resulted in the increased FY 2015 surplus.

totaling \$86.7 million, approximately \$45.0 lower than currently projected. It should be noted that the projected deficits from FY 2018 through FY 2020 remain unchanged, however, changes in revenue and expenditures reflected in the preliminary closing may change the bases used for each moving forward.

Table 7
Out-Year Forecasts based on FY 2016 Budget as Enacted (\$ millions)

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
Opening Surplus	\$ 118.6	\$ 0.5	\$ -	\$ -	\$ -
General Revenues	\$ 3,543.8	\$ 3,595.4	\$ 3,653.9	\$ 3,733.9	\$ 3,813.1
Transfers to Budget Reserve	\$ (109.9)	\$ (107.9)	\$ (109.6)	\$ (112.0)	\$ (114.4)
<i>Usable Revenues</i>	<i>\$ 3,552.5</i>	<i>\$ 3,488.0</i>	<i>\$ 3,544.3</i>	<i>\$ 3,621.8</i>	<i>\$ 3,698.7</i>
Expenditures	\$ 3,552.0	\$ 3,619.7	\$ 3,776.7	\$ 3,862.0	\$ 4,019.2
Closing Surplus	\$ 0.5	\$ (131.7)	\$ (232.4)	\$ (240.1)	\$ (320.5)

Out-Year Forecasts Adjusted for Preliminary FY 2015 Closing (\$ millions)

	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
Opening Surplus	\$ 166.4	\$ 46.9	\$ -	\$ -	\$ -
General Revenues	\$ 3,543.8	\$ 3,595.4	\$ 3,653.9	\$ 3,733.9	\$ 3,813.1
Transfers to Budget Reserve	\$ (111.3)	\$ (109.3)	\$ (109.6)	\$ (112.0)	\$ (114.4)
<i>Usable Revenues</i>	<i>\$ 3,598.8</i>	<i>\$ 3,533.0</i>	<i>\$ 3,544.3</i>	<i>\$ 3,621.9</i>	<i>\$ 3,698.7</i>
Expenditures	\$ 3,552.0	\$ 3,619.7	\$ 3,776.7	\$ 3,862.0	\$ 4,019.2
Closing Surplus	\$ 46.9	\$ (86.7)	\$ (232.4)	\$ (240.1)	\$ (320.5)

Source: Rhode Island State Controller; House Fiscal Staff; RIPEC Calculations

RIPEC Comments

The larger-than-anticipated closing surplus from FY 2015, as reported in the FY 2015 preliminary, unaudited closing statement, is positive for Rhode Island's budgetary outlook. It is encouraging that the state's revenue collections are exceeding previous estimates and that most departments appear to have remained within budgeted amounts. However, it is important that policymakers recognize that the state budget still has a long-term, structural deficit that will not be solved through one-time fixes. The larger FY 2015 closing surplus provides temporary budget relief, but does not have a major impact on projected deficits in the outer years.

Capital Projects

Utilizing the FY 2015 projected additional surplus as a one-time revenue source will not provide the structural changes necessary to reduce the state's structural deficit and achieve a balanced budget. However, the availability of surplus funding in the short-term provides Rhode Island with an opportunity to make vital investments in infrastructure, education or other economic development initiatives. Therefore, RIPEC suggests that the state would be better served by using the surplus to fund one-time expenses or projects that contribute to economic development in Rhode Island, such as infrastructure projects, while prioritizing return on investment. An important qualifier is that policymakers should avoid using surplus funds to establish programs that will require an ongoing financial commitment by the state.

With the increased funding available from the larger-than-anticipated surplus, as well as additional funding that will be transferred into RICAP, the state has an opportunity to make investments in reducing out-year costs or making needed investments sooner than anticipated. Infrastructure requirements such as information technology, road or bridge work and other necessary capital items could provide efficiencies or cost reduction as the capital projects are done sooner or without borrowing funds. With these thoughts in mind, it may make sense to reallocate the surplus for capital needs rather than carrying it forward to help balance the state's operating budget in FY 2016.

Expenditure Uncertainty

As policymakers consider potential uses of the FY 2015 closing surplus, they should be mindful of the fact that significant uncertainty exists with regards to expenditure levels by several state agencies. The FY 2016 budget as enacted includes a variety of reforms to the state's Medicaid program that are intended to reduce program expenditures in the Executive Office of Health and Human Services (EOHHS). At the present time, it is not yet clear if these reforms will achieve the level of financial savings that the FY 2016 enacted budget assumes. In addition, the Department of Children, Youth and Families (DCYF) and Department of Behavioral Healthcare, Developmental Disabilities and Hospitals (BHDDH) each exceeded their budgeted appropriation in FY 2015 and required additional funding beyond what was provided in the enacted budget.

During the first day of testimony at the November 2015 Revenue and Caseload Estimating Conference, EOHHS indicated that Medicaid general revenue expenditures in FY 2016 are currently projected to exceed the budgeted amount by \$14.7 million. This deficit was attributed to higher-than-forecast enrollment in RiteCare and Rhody Health Options, increasing nursing home costs, unexpected increases in Medicare Part B premium payments made for Medicaid enrollees and a shortfall in meeting Medicaid reform savings targets. Although this deficit may decline over the course of the fiscal year, it remains possible that EOHHS, or other state agencies, may later require supplemental funding above the amounts included in the FY 2016 enacted budget. With this in mind, RIPEC urges policymakers to act cautiously when exploring options for utilizing the FY 2015 closing surplus.

Rainy Day Fund

A third consideration for policymakers concerns the size of Rhode Island's rainy day fund. The Rhode Island Constitution currently limits the size of the rainy day fund to 5.0 percent of unencumbered general revenues (the free opening surplus plus general revenue collections) in each fiscal year. Among the New England states, Rhode Island and Vermont currently have the lowest cap on the size of their respective rainy day funds. Holding sufficient financial reserves to cover potential revenue shortfalls is important to ensure the fiscal health of the state and to ensure that revenue enhancements or expenditure reductions that reduce economic growth are not necessary during recessions. With additional resources available, now may be an opportune time to reassess the size of the rainy day fund to determine if it is appropriate or if changes should be considered.

Research conducted by the New England Public Policy Center (NEPPC) suggests that Rhode Island’s rainy day fund is not large enough to protect the state during periods of reduced revenue collections. According to an October 2015 report released by the NEPPC, Rhode Island’s current 5.0 percent cap prevents the state’s rainy day fund from accumulating sufficient resources to protect the state budget against “worst-case” or “middle-case” revenue shortfalls relative to the long-term revenue trend in the state. The report finds that Rhode Island would require a reserve equal to 14.6 percent of general revenues or expenditures to completely offset the worst-case revenue shortfall from the period FY 1988 to FY 2012. For the middle-case scenario, which represents the average revenue shortfall during the same time period, Rhode Island would require a reserve equal to 7.5 percent of general revenues or expenditures.

Table 8
New England Rainy Day Fund Caps and Projected Need During Revenue Shortfalls

State	Current Cap	Worst-Case*	Middle-Case*
Connecticut	10.0%	15.7%	11.1%
Massachusetts	15.0%	14.3%	7.7%
Maine	12.0%	14.9%	9.6%
New Hampshire	10.0%	19.1%	5.6%
Rhode Island	5.0%	14.6%	7.5%
Vermont	5.0%	13.1%	6.7%

*As a percentage of state-reported general revenues or expenditures

SOURCE: New England Public Policy Center

The NEPPC report notes that the size of the rainy day fund required to protect against revenue shortfalls varies between states based on the economy of the state and the sensitivity of state tax revenues to changes in economic conditions. For example, collections from broad-based personal income taxes or general sales taxes may be more susceptible to decline during economic recessions than other revenue sources. New Hampshire, which does not have a broad-based personal income tax or a general sales tax, experienced less volatility in revenue collections between FY 1988 and FY 2012 than the other New England states, each of which relies heavily on those two revenue sources. Rhode Island policymakers should be aware that the state relies heavily on revenue sources that are volatile during economic recessions and, while recognizing that such a change would require revisions to the state constitution, it may be prudent to increase the size of the budget reserve account.