

MEMORANDUM

December 1, 2011

TO: Education Committee

FROM: Craig Howard,^{CH} Senior Legislative Analyst
Kristen Latham, Legislative Analyst ^{KL}
Aron Trombka, Senior Legislative Analyst ^{AT}
Office of Legislative Oversight

SUBJECT: **Worksession on OLO Report 2012-2: *A Review of Montgomery County Public Schools' Budget Category 12***

On December 5th, the Education Committee will hold a worksession on OLO Report 2012-2. The Council received and released this report on November 29th.

This report responds to the Council's request for an analysis of the revenue and expenditures trends in Montgomery County Public Schools' Budget Category 12. It includes a review of the contributions, spending, and year-end fund balances in MCPS' employee benefit trust funds.

Board of Education members and MCPS representatives expected to attend the Committee worksession include:

- Christopher Barclay, President, Board of Education
- Shirley Brandman, Vice-President, Board of Education
- Larry Bowers, Chief Operating Officer
- Sue DeGraba, Chief Financial Officer
- Marshall Spatz, Director, Department of Management, Budget, and Planning

A. SUMMARY OF OLO REPORT 2012-2

A four-page executive summary of OLO's major findings and recommendations is attached at ©1. Key findings from the OLO report include:

- MCPS' Budget Category 12 consists of nine expenditure components, primarily to fund employee benefits.
- During the past decade, MCPS' Category 12 budget expenditures doubled and the relative portions of the various expenditure components changed.
- In FY12, MCPS will contribute \$77.8 million to its County-funded pension fund. This is a 369% increase from the \$16.6 million contribution made a decade ago.
- The most recent valuation (October 2011) reports that MCPS' pension fund assets are sufficient to cover 70% of its current liabilities.
- In 2011, the Board of Education made changes to reduce its future pension plan liabilities. Even with these reforms, MCPS' required annual pension contributions are likely to continue to increase at least in the short-term.
- At the end of FY11, MCPS had a \$21.6 million (or 8.6%) fund balance in its Active Employee Group Insurance Fund.
- Monthly FY11 data show that total Active Employee Group Insurance Fund expenditures were trending lower than projected. In February/March, MCPS was advised that a significant end-of-year Fund surplus was likely.
- MCPS develops its annual budget for group insurance based upon projections prepared by a health benefits consultant. MCPS has not adopted a fund balance policy for either the Active Employee or Retiree Group Insurance Fund.
- In FY08, FY09, and FY10, MCPS increased the ending balance in the Active Employee Group Insurance Fund through year-end transfers into the Fund.

B. MCPS COMMENTS

OLO circulated a draft of this report to the Chief Operating Officer of Montgomery County Public Schools. The written comments received on the draft report from the Chief Operating Officer are attached at ©5. Of note, the MCPS' written comments state that:

“MCPS agrees with the report's recommendations for Council actions. The Board of Education can submit supplemental information, including information on the Pension and Group Insurance funds, to the County Council in April and October of each year.”

C. WORKSESSION ON OLO'S RECOMMENDATIONS AND DISCUSSION ISSUES

The Office of Legislative Oversight's review of Montgomery County Public Schools' budget Category 12 evidences opportunities to improve the substance and timing of fiscal information provided by the Board of Education to the County Council. The Council's ongoing attention to the status of revenues and expenditures in Category 12 is especially warranted because:

- Substantial public dollars are allocated to Category 12 spending - \$472 million in FY12;
- Over the past decade, Category 12 spending increased by \$237 million, growing from 18% to 23% of MCPS' total tax-supported operating budget; and
- The primary Category 12 cost drivers are expenditures for group insurance and pension benefits, which are significant fiscal and policy issues across all County-funded agencies.

RECOMMENDATIONS FOR COUNCIL ACTION

- A. Request the Board of Education to submit supplemental information to the Council in April and October of each year related to Category 12 revenues and expenditures.**
- B. Integrate this additional information about Category 12 into the Council's annual budget decision making and ongoing oversight of funds appropriated to MCPS.**

The Council should formally request that the Board of Education provide supplemental information in April (to integrate into annual operating budget decisions) and October (to integrate into ongoing year-end financial oversight) about the status of revenues and expenditures in budget Category 12.

Additional Information for Operating Budget Worksessions. The Board of Education already provides certain documents to the Council that contain financial information related to pension and group insurance. These documents include:

- The Board of Education's annual operating budget request in January;
- Year-end categorical transfer request(s) in June; and
- The annual Comprehensive Annual Financial Report, typically completed in September.

The data provided in these documents are valuable, but do not necessarily provide a complete and current picture of the financial status, cost drivers, and budgetary impact of MCPS pension and group insurance programs at the time when the Council is required to make budget decisions.

In exercising its budget oversight responsibilities, the Council would benefit from receiving updated financial information on the pension and group insurance funds (which together account for \$329 million or 71% of Category 12 spending). As the fiscal condition of pension and group insurance funds can vary over the course of the year, this information would allow the Council to base its budget decisions on the most current measures of actual revenue and spending.

OLO recommends the Council request the Board of Education to provide the following Category 12-related information on April 1st of each year:

Pension Fund

- Estimated future year MCPS pension fund contributions. This summary should identify and explain the major factors that drive changes in annual contribution amounts, such as investment performance, plan changes, or changes in actuarial assumptions.
- The Board’s current strategy to achieve a desired pension funding level (“funded ratio”) and the short- and long-term effects of this strategy on the Category 12 budget.

Active Employee and Retiree Group Insurance Funds

- A comparison of budgeted versus actual group insurance fund revenues and expenditures to date for both the Active Employee and Retiree Group Insurance Fund.
- The projected year-end balance for both group insurance funds with an accompanying explanation if the projected balance differs from what was assumed at the beginning of the fiscal year (e.g., claims experience, plan enrollment, etc.).

OLO recommends the Council request similar pension and group insurance financial information from the other County-funded agencies.

Additional Year-End Financial Information. The Board of Education annually submits for Council approval an end-of-year categorical transfer request to align budgeted appropriations with actual expenditures. In these annual requests, MCPS provides information on each budget category’s status and transfer needs, sometimes including information on intra-category transfers.

In exercising its financial oversight responsibilities, the Council would benefit from a more detailed year-end update on Category 12 expenditures. The Council should request that the Board of Education provide the following Category 12-related information on October 1st of each year:

- A comparison of budgeted vs. actual expenditures for each Category 12 component;
- A written summary of any intra-fund transfers that occurred within Category 12 (i.e., transfers between Category 12 components) during the prior fiscal year; and
- An explanation of the need or policy decision that led to each transfer.

This information will enhance the Council’s ability to track trends in Category 12 spending by component. Given the size of certain Category 12 components (in particular group insurance, retirement, and FICA), even a small percent variation from the budget can have a large bottom-line dollar impact.

RECOMMENDED ISSUES FOR COUNCIL AND MCPS DISCUSSION

OLO recommends three Category 12-related issues for the Council to discuss with MCPS representatives. Although the following issues focus on MCPS' Category 12 budget, OLO recommends the Council hold parallel discussions with the other County-funded agencies.

Issue #1: Category 12 cost drivers and expenditures trends

During the past decade, Category 12 expenditures increased \$227 million, growing from 18% to 23% of MCPS' total tax-supported operating budget. The primary cost drivers within Category 12 are expenditures for group insurance (for active and retired employees) and pension benefits. When combined, these health and retirement benefits account for approximately 71% of the total FY12 Category 12 budget.

OLO recommends the Council and MCPS representatives discuss the Board of Education's past and present approach to controlling projected future increases in employee benefits costs. This should include discussion of actions to mitigate overall increases in health and retirement benefits costs as well as decisions regarding how benefit costs are shared between MCPS and its employees. An example of Board actions that affected total benefit costs as well as the employer/employee cost share occurred in May 2011 when the Board of Education: (1) changed the eligibility and cost share for retiree health benefits for new hires; (2) increased employees' annual pension contribution; and (3) lowered the cap on pension cost-of-living adjustments.

Specific recommended discussion questions include:

- Looking ahead, how does MCPS see the projected growth in employee benefits costs affecting the school system's ability to fund competing priorities?
- What type of group insurance and/or pension benefit changes are currently being considered by MCPS for implementation in FY13 or future years?
- What specific employee benefits issues should be identified for ongoing discussion between the Council and MCPS representatives?

Issue #2: Status of the "funded ratio" for MCPS' County-funded pension fund

Over the past ten years, the "funded ratio" for the MCPS pension fund has declined from 102% to 70%. In other words, a decade ago MCPS' pension fund had sufficient assets to cover all of its liabilities; today, the Fund holds only about 70 cents for every dollar it is obligated to pay MCPS retirees.

OLO recommends the Council and MCPS representatives discuss the marked decline in the "funded ratio" that occurred over the past decade. Recommended discussion questions include:

- Does the current 70% "funded ratio" suggest a need to modify any of MCPS' pension management policies and practices?
- What are the Board of Education's strategies to improve the "funded ratio" over both the short- and long-term?

Issue #3: Fund balance policy for group insurance funds for active and retired employees

As reviewed earlier, the Board of Education has not adopted a formal policy to establish a target fund balance (or reserve) in the Active Employee Group Insurance Fund and/or Retiree Group Insurance Fund. The purpose of maintaining a fund balance in a group insurance fund is to protect against unanticipated expenditures in any given year. The County Council’s 2003 resolution of policy guidance for agency group insurance programs recommended that agencies adhere to a fund balance target of 5%.

The Council should discuss with MCPS representatives the school system’s reasoning for not adopting a formal fund balance policy, especially since the agency’s practice has been to maintain a fund balance in both group insurance funds. Recommended discussion questions include:

- What are the advantages and disadvantages from either a practical or financial perspective to adopting a formal fund balance policy?
- How would having a formal fund balance policy affect MCPS’ decision-making regarding whether to make additional contributions (or not) to the Active Employee Group Insurance Fund at the end of each fiscal year?

LIST OF ATTACHMENTS

Item	Begins at:
Summary of Report	©1
Written Comments from MCPS’ Chief Operating Officer, dated November 16, 2011.	©5

Montgomery County Public Schools' Budget Category 12

OFFICE OF LEGISLATIVE OVERSIGHT REPORT 2012-2: EXECUTIVE SUMMARY NOVEMBER 29, 2011

This Office of Legislative Oversight report responds to the County Council's request for an analysis of the revenue and expenditure trends in Montgomery County Public Schools' Budget Category 12. It includes review of the contributions, spending, and year-end fund balances in MCPS' employee benefit trust funds.

Overview of Budget Category 12, Fixed Charges

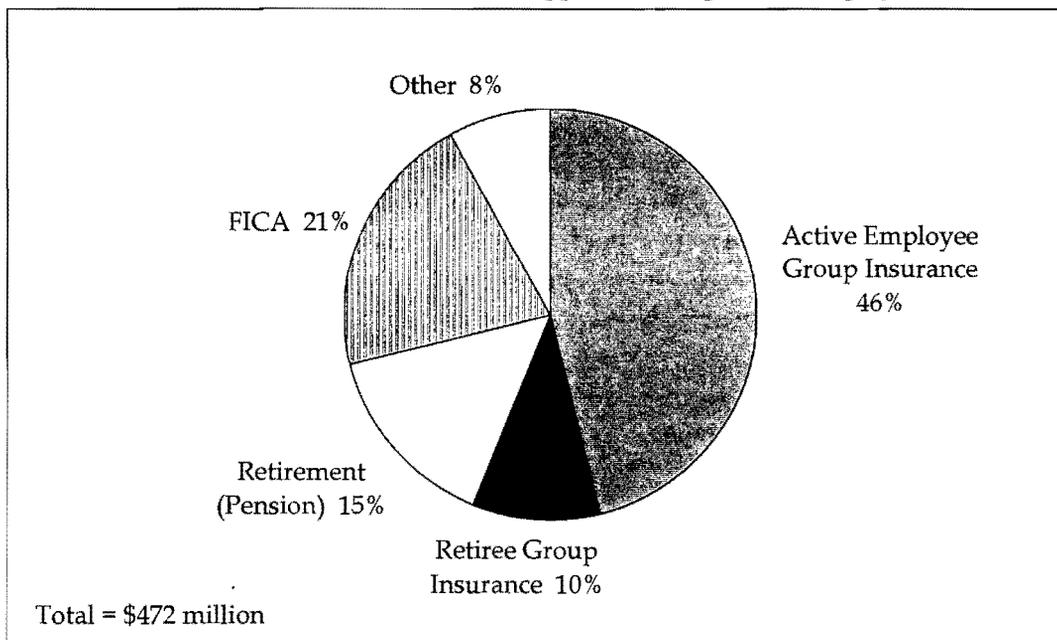
State law requires that the County Council appropriate funds to MCPS in standardized budget categories. One of the standardized categories is Budget Category 12; titled "Fixed Charges." Funds appropriated to Category 12 are primarily for employee benefits, i.e., retirement, health insurance, and social security.

After the Council determines how much to appropriate to each standardized budget category, it is within the Board of Education's purview to make final decisions on how to allocate the funds within each category. The Board of Education allocates Category 12 funds to nine expenditure components:

- Group Insurance (for Active and Retired employees)
- FICA (Social Security and Medicare)
- Retirement (Pension Fund Contribution)
- Non-Tax Supported Grants
- Risk Management
- Tuition Reimbursement
- Partnership Tuition
- Other Post-Employment Benefits (OPEB)
- Miscellaneous

MCPS' approved FY12 budget for Category 12 is \$472 million, more than double what it was ten years ago. As shown in the chart below, pension and group insurance benefits account for approximately 71% of all budgeted FY12 Category 12 spending.

FY12 MCPS Board of Education Approved Budget for Category 12*



In FY03, Category 12 expenditures represented 18% of MCPS' total operating budget; in FY12, Category 12 expenditures are 23% of MCPS' total operating budget.

The complete OLO Report 2012-2 is available at: www.montgomerycountymd.gov/olo

Retirement Benefit Budget and Pension Fund

Pension Fund Overview

About three-quarters of MCPS' permanent employees (mostly teaching positions) participate in a State-funded "core" pension plan. All other MCPS permanent employees (mostly non-teaching positions) participate in a County-funded "core" pension plan. In addition, all permanent employees (both teaching and non-teaching positions) receive a County-funded "supplemental" pension benefit. Each year, contributions from MCPS and MCPS employees are deposited into MCPS' "pension fund," a fiduciary account established to pay current and future pension benefits and associated expenses.

For FY12, the Board of Education approved a pension fund contribution of \$77.8 million. This amount represents a 369% increase over the \$16.6 million contribution made in FY03. The growth in pension costs results from multiple factors, including salary increases, growth in workforce size, lower than assumed investment returns, and pension benefit enhancements.

MCPS Pension Fund Contributions: FY03 and FY12

Fiscal Year	Contribution Amount
FY03	\$16,639,493
FY12	\$77,788,472

Source: FY03 and FY11 Pension System Actuarial Valuations

Funded Ratio

The "funded ratio" of a pension plan measures the extent to which a plan's assets cover the accrued pension benefits of its members. As of June 30, 2011, MCPS' pension fund had assets of \$1.02 billion and an accrued liability of \$1.45 billion. Because MCPS' pension fund assets are sufficient to cover 70% of its current liabilities, the fund has a funded ratio of 70%. In comparison, the funded ratio of MCPS' pension fund ten years ago (FY03) was 102%. Two primary factors contributed to the decline in funded ratio:

Plan Enhancements. In 2006, the Board increased the core pension benefit (for participants in the locally-funded plan) and made the increase retroactive to 1998. This enhancement mirrored the 2006 changes adopted by the General Assembly for employees in the State-funded pension plan. In addition, the Board increased the supplemental pension benefit (also retroactive to 1998) for all permanent MCPS employees. Concurrent with these enhancements, the Board increased the required employee contributions for both the core and supplemental pension benefits. Even with higher employee contributions, the 2006 enhancements greatly increased MCPS' liability for future pension benefits, causing a decline in the plan's funded ratio.

Investment Performance. MCPS' actuary calculates the agency's annual pension contributions based on the assumption of a 7.5% annual rate of return on investments. In years that investment returns are below 7.5%, the pension fund experiences an increase in its unfunded liability that negatively affects the funded ratio. Similar to other pension funds across the country, MCPS' pension fund incurred large losses during FY08 and FY09. Making up for these losses will affect the annual MCPS pension fund contribution through FY15.

Future Pension Costs

In 2011, the Board of Education raised the employee contribution for the locally-funded core benefit from 5% to 7% of salary. In addition, the Board lowered the cap on pension cost-of-living adjustments and reduced the pension calculation for new hires. According to MCPS' actuary, these modifications will contain the agency's FY13 pension fund payment to an amount similar to the FY12 contribution.

While annual MCPS total pension costs may change little from FY12 to FY13, the historic trend of large annual increases is projected to return, at least in the short term. MCPS' actuary estimates that the agency will need to significantly increase its annual contribution in FY14 and FY15, by as much as 17% over the two-year period. Growth in MCPS' payroll that results from pay increases and/or workforce growth will further increase required pension plan contributions. Moreover, as with any pension system, MCPS pension costs also are subject to change if actual experience differs from other actuarial assumptions, such as retiree life expectancy or investment performance.

Group Insurance Expenditures

Group Insurance Overview

MCPS maintains two separate funds for their active and retired employees' group insurance benefits: the Active Employee Group Insurance Fund and the Retiree Group Insurance Fund. Both funds receive "revenue" from agency and participants' premium contributions. Both funds make "expenditures" that are primarily the health care claims incurred under MCPS' self-insured plans.

Group Insurance Budgeting. MCPS uses projections from an outside health benefits consultant to develop the agency's annual budget request for group insurance (for each fiscal year) and annual group insurance plan premiums (for each calendar year). A number of factors complicate budgeting for group insurance expenditures, all of which can lead to variances between budgeted and actual expenditures. These factors (listed below) are not unique to MCPS, and similarly apply to other County-funded agencies.

- MCPS is largely self-insured and group insurance expenditures result from actual health care use by plan participants. In any given year, health care use can vary unexpectedly for multiple reasons.
- Group insurance plans operate on a calendar year basis while budgets operate on a fiscal year basis.
- MCPS develops its recommended budget for group insurance each fall. By the time the fiscal year for that budget begins the following July, expenditure trends may have changed from the fall projection.

FY11 Active Employee Group Insurance Fund Balance

At the beginning of FY11, MCPS' Active Employee Group Insurance Fund had an \$8.5 million balance or "reserve." During FY11, total revenues into the Fund exceeded expenditures by \$13.1 million, which led to a FY11 year-end fund balance of \$21.6 million. The primary reason for the \$13.1 million surplus in the Active Employee Group Insurance Fund during FY11 was the fact that actual health care claims were \$9.1 million lower than projected in the approved FY11 budget.

FY11 Beginning Fund Balance (July 1, 2010)	Fund Activity During FY11		FY11 Ending Fund Balance (June 30, 2011)
\$8,541,533	Revenues	\$263,353,334	\$21,598,686
	Expenditures	\$250,296,181	
	Difference	\$13,057,153	

To be more specific, while total Active Employee Group Insurance Fund expenditures increased by 4% in FY11, the actual increase was less than the budgeted increase. Monthly Fund data indicate that the savings accumulated over the first three quarters of FY11, and that the cumulative expenditures from the Fund were running \$7.6 million lower than budgeted midway through the fiscal year (12/31/2010). MCPS reports that in the February/March 2011 time frame, the agency's actuaries advised that the Fund would likely have a significant surplus by the end of FY11. In their comments on the FY11 surplus, MCPS notes that the "pattern of expenditures during FY 2011 differed greatly from previous years," and further that "it paralleled similar unexpected patterns in other governmental organizations."

Fund Balance Policy and Trends

Similar to other agencies, MCPS' practice is to maintain a balance (or reserve) in both the Active Employee and Retiree Group Insurance Funds to protect against unanticipated expenditures in any given year. MCPS has not, however, adopted a formal policy to establish a target fund balance amount in either group insurance fund.

Compared with recent years, the \$21.6 million balance in the Active Employee Group Insurance Fund at the end of FY11 is relatively large both in terms of total dollars and as a percent of expenditures. The balance in the Fund has fluctuated considerably from year-to-year, and in FY08, FY09, and FY10, MCPS increased the ending balance through year-end transfers.

Fiscal Year	End of Fiscal Year Balance	Balance as % of Expenditures
FY08	\$11,818,442	5.6%
FY09	\$2,797,995	1.2%
FY10	\$8,541,533	3.5%
FY11	\$21,598,686	8.6%



Recommendations for Council Action

The Office of Legislative Oversight's analysis of MCPS' Budget Category 12 evidences opportunities to improve the substance and timing of fiscal information provided by the Board of Education to the County Council. In turn, this additional information will position the Council to enhance its understanding and oversight of the substantial public dollars appropriated to Category 12. OLO recommends the Council:

- A. Request the Board of Education to submit supplemental information to the Council in April and October of each year related to Category 12 revenues and expenditures.
- B. Integrate this additional information into the Council's annual budget decision making and ongoing oversight of funds appropriated to MCPS.

The Board of Education already provides certain documents that contain financial information related to the agency's pension and group insurance benefits. However, the timing and substance of these documents do not give the Council a complete and current picture of the financial status, cost drivers, and budgetary impact of MCPS pension and group insurance programs when the Council is required to make budget decisions. OLO recommends the Council request the following Category 12-related information be provided by the Board of Education to the Council by April 1st of each year:

- **Pension Fund:** (1) Estimated future year pension fund contributions, including the major factors driving changes in annual contribution amounts; (2) Any updates to the Board's strategy for achieving a desired funding level for current and future pension liabilities (the "funded ratio").
- **Active and Retiree Group Insurance Funds:** (1) A comparison of budgeted versus actual group insurance fund revenue and expenditures to date; (2) Projected year-end fund balances with an explanation if any projections differ from what was assumed at the beginning of the fiscal year.

In addition, the Council should ask the Board of Education to provide the following information by October 1st of each year: (1) A comparison of budgeted vs. actual expenditures for each Category 12 component; (2) A written summary of any intra-fund transfers that occurred within Category 12 during the previous fiscal year; and (3) An explanation of the financial need or policy decision that led to each transfer.

OLO recommends the Council integrate the supplemental information received in April of each year into its annual operating budget deliberations. OLO recommends the Council use the supplemental information received in October to enhance its ongoing fiscal oversight of funds appropriated to MCPS.

Recommended Discussion Issues

OLO recommends three issues for the Council to discuss with MCPS representatives. While these issues focus on MCPS' Category 12 budget, OLO recommends the Council hold parallel discussions with the other County-funded agencies, i.e., County Government, Montgomery College, M-NCPPC, WSSC.

1. **Category 12 cost drivers and expenditures trends.** The Council and MCPS representatives should discuss the Board's past and present approach to addressing future increases in employee benefit costs, and how projected growth in total compensation costs affects funding for its competing priorities.
2. **Status of the "funded ratio" for MCPS' County-funded pension fund.** The Council should ask MCPS representatives about the Board's strategies to improve the "funded ratio" and whether the current 70% "funded ratio" suggests a need to modify any pension management policies and practices.
3. **Fund balance policy for group insurance funds for active and retired employees.** The Council and MCPS representatives should discuss the school system's reasons for not adopting a fund balance policy, especially since the agency's practice is to maintain a balance in its group insurance funds.



November 16, 2011

Ms. Karen Orlansky, Director
Office of Legislative Oversight
Stella B. Werner Council Office Building
100 Maryland Avenue, Room 509
Rockville, Maryland 20850

Dear Ms. Orlansky:

Thank you for providing Montgomery County Public Schools (MCPS) staff with the opportunity to review and comment on the draft Office of Legislative Oversight (OLO) Report Number 2012-2, *A Review of Montgomery County Public Schools' Budget Category 12*. Comments and suggestions for technical changes were provided and incorporated into the draft report. MCPS staff members who participated in this review appreciate the collaborative process used throughout the study and review of the report.

Since comments and suggestions provided by MCPS staff during the technical review were incorporated, the following comments are offered upon final review:

Management Improvements

Category 12 expenditures have been a major driver of budget increases over the past 10 years (fiscal years 2003–2012). This is particularly the case for group insurance (health and life insurance) for both active and retired employees and for retirement contributions. Previous OLO reports have noted that the pattern of increased employee benefits expenditures is common for other county agencies and for employers in general.

During the same period, the Board of Education has implemented a variety of management actions, with the active cooperation of employee associations and the retiree association, which have introduced cost-saving improvements and mitigated cost increase trends. Major cost-saving improvements include the following:

- Finding #5 notes that the Board of Education has made changes to reduce future pension plan liabilities and taxpayer obligations. In 2011, the Board raised the employee contribution for the locally-funded “core” benefit from five percent to seven percent of salary. This meant that employees who participate in the locally funded plan received the equivalent of a two percent take-home pay reduction. These employees also face the prospect of an additional two percent pay reduction when current FICA tax rates increase as scheduled on January 1, 2012. These employees also have received no pay increases for the last two years and no negotiated general wage increase for three years. The Board also reduced the defined benefit as a percentage of salary and lengthened the minimum vesting period for new employees. The cap on cost-of-living increase was tightened for all employees for service

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credits earned after July 1, 2011. These changes reduce required local contribution and future contribution growth.

- In 2005, the Board of Education reduced the assumption of future investment earnings from 8 percent to 7.5 percent annually (Finding #4). This reflects the likelihood of lower investment performance. The Board of Education acted to adopt a more conservative approach before many other public pension plans. This prudent approach resulted a decrease of the funded ratio of the MCPS pension fund of approximately six percent and an increase of \$3.0 million in required budget contribution. The report notes the connection between the change in the assumption of investment earnings and the increase in required local contribution.
- MCPS also has undertaken major cost containment steps in group insurance with the active leadership of the Joint Employee Benefits Committee, which includes MCPS's employee associations. MCPS provides a valuable incentive for employees to choose lower-cost health plans by providing a higher percentage of premium support. As a result, 64 percent of plan participants have enrolled in Health Maintenance Organizations (HMOs). In contrast, only 33 percent of County Government employees are enrolled in HMOs. This reduces the total health care costs for MCPS and means that the contribution by MCPS per employee is approximately the same as for county government.
- MCPS has undertaken a variety of other plan design changes in recent years that reduce the increase in health care costs. These steps encourage the use of generic and mail order prescription drugs, reduce incentives to visit hospital emergency rooms for nonemergency care, and increase incentives to use lower-cost urgent care centers. MCPS also has acted to promote employee wellness through "MCPS On the Move," in-house wellness activities, and discount memberships for external wellness programs. The goal is to reduce costs while increasing employee productivity through reduced absenteeism.
- MCPS has limited the use of expensive lifestyle drugs, including erectile dysfunction drugs, eliminating coverage for retirees entirely.
- MCPS has taken the lead to reduce health care administrative costs through joint bidding with other county agencies. Joint bidding in Fiscal Year (FY) 2011 realized \$914,000 in annual administrative savings. MCPS undertook a dependent audit in 2009 to verify the eligibility of all dependents. Annual savings are estimated at \$2.5 million.
- County officials have repeatedly praised the Board of Education for its aggressive and collaborative actions to limit the growth of group insurance costs and have suggested that other county agencies can benefit from adopting some of the best practices already implemented by MCPS.

Retirement Plan

- MCPS agrees with Finding #3 that county contribution to the Pension Fund has increased significantly over the last decade. The report clearly demonstrates (Table 3-1) that the main factor behind the increased contribution was the enhanced benefits retroactive to 1998 that were adopted in 2006 based on state legislation. This change helped to reduce the funded status of the plan from 80.5 percent in FY 2005 to 71.8 percent in FY 2006. Since FY 2006,

despite the difficult investment environment beginning in 2008, the funded status of the plan decreased only from 71.8 percent in FY 2006 to 70.1 percent in FY 2011. Since MCPS has to maintain equity for employees between state and local core plans, this change was necessary and not initiated by MCPS.

Group Insurance

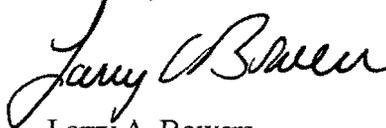
- MCPS agrees with Finding #2 that actual Category 12 expenditures have varied only slightly from budgeted expenditures. This is a challenging goal for group insurance expenditures, primarily because large claims in self-insured plans are unpredictable and can vary greatly from year to year. In seven of the last nine years, the variance between budgeted and actual expenditures in Category 12 was no more than two percent in any year (Table 2-1).
- MCPS agrees with Finding #8 that several factors complicate budgeting for group insurance expenditures, including the extended amount of time that elapses between when the budget must be developed and the subsequent changes in expenditures. Costs vary because of actual health care use and price changes, because group insurance plans operate on a calendar year basis, and because trends can change after the budget is developed and adopted. The internal service fund operates as a valuable management control tool for providing the possibility of a fund balance that can handle unavoidable “shocks.” Finding #9 notes that MCPS has worked to increase the reserve in the internal service fund and has informed the County Council of planned reserve increases through year-end categorical transfer requests.
- Finding #6 notes that the group insurance fund balance has fluctuated based on actual expenditures and generally has fallen below desired levels. The Council’s consultant has suggested that MCPS should increase its “shock reserve” to be able to absorb unexpected changes.
- MCPS agrees with Finding #6 that FY 2011 was a very atypical year for group insurance expenditures. Because actual expenditures remained lower than the FY 2011 budget, the fund balance in the internal service fund increased to 8.6 percent of expenditures, the highest percentage during the decade. Many other employers, including the Montgomery County Government, federal government agencies, and Frederick County Public Schools, also had unusually favorable experiences during FY 2011. Consultants have offered a variety of reasons for the favorable experiences. A recent federal Government Accountability Office review of Veterans Administration (VA) health costs examined a variety of possibilities for the causes of similar experience during FY 2011 and concluded that “budgeting for VA health care is inherently complex because it is based on assumptions and imperfect information used to project the likely demand and cost of the health care services VA expects to provide.” Other group insurance plans face similar complexity in predicting health care costs.
- The surplus for FY 2011 came late in the fiscal year, after the implementation of “open season” enrollment shifts. The pattern of expenditures during FY 2011, as shown in the previous analysis, differed greatly from previous years. This difference meant that the reliability of positive expenditure information was in doubt until late in the fiscal year. Health benefit consultants continued to project that claims experience would increase during

the second half of the fiscal year and warned that the apparent surplus was unlikely to continue. Only in February and March did the consultants revise projections to show a significant surplus for the full fiscal year. This fact is explained in memoranda written by the president of the Board of Education after County Council questions were raised.

MCPS agrees with the report's recommendations for Council actions. The Board of Education can submit supplemental information, including information on the Pension and Group Insurance funds, to the County Council in April and October of each year. This can include updated information on the pension and group insurance funds similar to the information requested by OLO and supplied by MCPS during preparation of the OLO report. This information can be integrated into budget decision making and ongoing oversight. MCPS staff will work with OLO staff to make changes in the format of this information to address County Council needs and is ready to provide requested information to County Council staff.

Thank you again for the opportunity to review the draft report and discussion topics. I believe the collaborative work between MCPS and OLO will result in improved information and budget decision making for Category 12.

Sincerely,



Larry A. Bowers
Chief Operating Officer

LAB:mcs

Copy to:
Dr. Starr
Mrs. DeGraba
Dr. Spatz