

**MEMORANDUM**

September 15, 2016

TO: Education Committee

FROM: Craig Howard, Senior Legislative Analyst 

SUBJECT: **Worksession – Resolution to Approve Categorical Transfers of \$4,200,000 for the Montgomery County Public Schools FY16 Operating Budget; and Discussion – MCPS Fund Balance**

Today the Education Committee will discuss the FY16 Year-end Financial Report of the Montgomery County Public Schools (MCPS), consider a resolution to approve categorical transfers of \$4,200,000 for the MCPS FY16 Operating Budget, and discuss MCPS Fund Balance. Dr. Jack Smith, Superintendent of Schools and Nicky Diamond, Chief Strategy Officer, from MCPS will participate in today's discussion.

**1. Categorical Transfer**

The Board of Education requested the categorical transfers on July 25, 2016. A draft resolution to approve the requested transfers is attached on circles 1-2. The Council introduced this transfer resolution on September 13.

The FY16 Year-end Financial Report was presented to the Board of Education on July 25 (attached at circles 3-8). **The report shows that MCPS ended FY16 with a year-end surplus of \$31.4 million.** This total consists of \$33.8 million in projected expenditure surplus less a \$2.4 million projected revenue deficit.

The Committee last reviewed the MCPS financial report in April, which at that time reflected financial conditions through February 29. The final year-end total surplus is \$2.7 million higher than was projected at that time.

This year-end report shows that as of the end of FY16, MCPS has a total fund balance of \$35.4 million, including unappropriated fund balance from prior years. The Council appropriated \$33.2 million of MCPS fund balance as a resource for the FY17 operating budget. This action leaves an unappropriated balance of \$2.2 million going forward.

Every category ended the year in surplus with the exception of Category 11, Maintenance of Plant and Equipment and Category 12, Fixed Charges. These surpluses are primarily the result of the expenditure restrictions and other savings measures that the school system implemented as part of the Council's approved saving plan for FY16 as well as efforts to generate additional resources to fund the FY17 Operating Budget.

The table below shows the year-end balance for each category as a percent of the total category appropriation.

**MCPS FY16 Budget Appropriation and Year-End Balance by State Category**

| State Budget Category                   | FY16 Budget Appropriation | FY16 Year-End Balance |                   |
|---|---------------------------|-----------------------|-------------------|
|   |                           | \$'s                  | % of Appropriated |
| 1, Administration                       | \$43,856,066              | \$2,715,300           | 6.2%              |
| 2, Mid-Level Administration             | \$143,088,984             | \$4,186,692           | 2.9%              |
| 3, Instructional Salaries               | \$916,514,351             | \$13,088,861          | 1.4%              |
| 4, Textbooks and Instructional Supplies | \$23,493,620              | \$2,673,873           | 11.4%             |
| 5, Other Instructional Supplies         | \$12,422,284              | \$2,197,600           | 17.7%             |
| 6, Special Education                    | \$316,243,063             | \$3,370,380           | 1.1%              |
| 7, Student Personnel Services           | \$11,834,726              | \$415,006             | 3.5%              |
| 8, Health Services                      | \$3,590                   | \$2,754               | 76.7%             |
| 9, Student Transportation               | \$104,486,639             | \$4,155,493           | 4.0%              |
| 10, Operation of Plant and Equipment    | \$133,317,401             | \$4,672,386           | 3.5%              |
| 11, Maintenance of Plant and Equipment  | \$34,317,401              | (\$93,573)            | -0.3%             |
| 12, Fixed Charges                       | \$514,610,561             | (\$3,595,665)         | -0.7%             |
| 14, Community Services                  | \$849,020                 | \$47,775              | 5.6%              |

MCPS anticipated the deficit in Category 11, Maintenance of Plant and Equipment, earlier this year although the final deficit of \$93,572 was much lower than the \$500,000 deficit MCPS projected in the April 30, 2016 financial report. The deficit in Category 11 is largely related to snow removal costs and radon testing in all schools. MCPS was able to lower the deficit from what was projected by delaying the purchase of tractors.

MCPS also anticipated the deficit in Category 12, Fixed Charges, related to an ongoing deficit in the Employee Group Insurance Fund, and the Committee discussed this issue as part of its FY17 budget discussions this spring. MCPS began FY16 with an \$8.8 million deficit in the Group Insurance Fund due to higher than anticipated health claims in prior years. In addition, the Council's FY15 action to draw down the FY14 fund balance further than the Board's budget had anticipated left a lower balance in the fund to cover unanticipated cost increases during FY15.

During FY16, revenue into the Fund exceeded expenditures by \$1.1 million, primarily due to increased revenue from prescription drug rebates, to reduce the overall Fund deficit to \$7.7 million. The deficit in Category 12 assumes a \$4.0 million transfer from the Category to the Group Insurance Fund, decreasing the FY16 year-end fund-balance deficit to \$3.7 million. The Education Committee's recommendation in April was to support the transfer of \$4.0 million to help address the deficit if funds allowed.

**Council staff recommends approval of the requested categorical transfers for the FY16 operating budget.**

## 2. MCPS Fund Balance

Any funds unspent by MCPS at the end of the fiscal year fall to a fund balance. These funds cannot be spent by MCPS unless reappropriated by the Council. Typically, MCPS requests appropriation of fund balance as a resource for the following year's operating budget. In recent years, MCPS has ended the fiscal year with a relatively large fund balance. This is primarily due to:

- Formal savings plans and hiring freezes implemented by MCPS along with all other County agencies in response to the severe economic downturn and lower than expected revenues in certain years; and
- Internal expenditure restrictions and other savings measures that the school system implemented in an effort to generate additional resources to fund future year operating budgets.

The table below summarizes MCPS' year-end fund balance and Council reappropriations over the past 10 years, which cover the "great recession" years and the subsequent years of slow and prolonged recovery. The data show:

- A relatively steady increase in MCPS' year-end balance and the Council's use of that balance in funding a portion of the following year's operating budget.
- In some years, MCPS ended the year with a much larger fund balance than projected in May when the Council approved the following year's budget. Over the past three years, however, the actual balance has aligned much more closely with what was projected.

**MCPS Year-End Fund Balance and Council Reappropriations, FY07-FY16 (\$'s in Millions)**

|   | FY07   | FY08   | FY09    | FY10     | FY11   | FY12   | FY13   | FY14   | FY15   | FY16   |
|---|--------|--------|---------|----------|--------|--------|--------|--------|--------|--------|
| <b>MCPS Year-End Fund Balance</b>               | \$12.3 | \$17.9 | \$20.7* | \$31.2** | \$27.0 | \$28.6 | \$49.1 | \$39.3 | \$37.0 | \$35.4 |
| <b>Amount Reappropriated (next fiscal year)</b> | \$7.3  | \$17.9 | \$20.0* | \$10.3** | \$17.0 | \$17.0 | \$27.0 | \$38.2 | \$33.2 | \$33.2 |

\*Does not include \$24.2 million in FY09 funds MCPS received from the State to correct a calculation error made in the original allocation of FY09 State Aid. These resources were added to the ending fund balance, and were also assumed by the Council as available FY10 resources.

\*\*As part of the FY10 Savings Plan, \$19.7 million was not reappropriated to MCPS for FY11; instead it was added to FY10 County Government general fund undesignated reserves.

While it is not unusual for an agency the size of MCPS to maintain some level of fund balance to cushion against unanticipated expenditures in any given year, the use of fund balance to support the next year's budget is not a sustainable long-term practice. In fact, it creates a structural "hole" in the next year's budget that needs to be filled with new dollars unless the same level of fund balance is generated once again. Additionally, since approximately 90% of MCPS' operating budget funds personnel costs, generating savings to create a fund balance typically results from hiring freezes on vacant positions.

**FY17 Budget.** The FY17 budget for MCPS resulted from an historic collaboration between the Board of Education and the Council. Together they agreed to redirect significant resources to reduce class size and address the opportunity gap. Specifically, the Council's appropriation for MCPS was \$89 million above the Maintenance of Effort level with \$37.9 million redirected within the budget directly for class size reductions and closing educational disparities by adding instructional and support staff.

**Fund Balance Discussion**

While a savings plan has not been requested for FY17, the financial picture for the FY18 budget remains uncertain and the Council’s approved FY17-22 Fiscal Plan projects continued low expenditure growth for all agencies. However, counting on MCPS to once again produce a \$30+ million year-end balance to help fund the FY18 budget could diminish the impact of the Council’s additional funding (depending on where the savings would be achieved).

During budget deliberations, both Councilmembers and Board of Education members identified fund balance and the expectations for future budgets as an important topic to address during the Fall timeframe. **The purpose of this discussion is to initiate a conversation on how MCPS fund balance might be used as part of the operating budget in FY18 and beyond, and what a reasonable fund balance target should be for MCPS moving forward in years without a savings plan.**

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Resolution No.: \_\_\_\_\_  
Introduced: September 13, 2016  
Adopted: \_\_\_\_\_

**COUNTY COUNCIL  
FOR MONTGOMERY COUNTY, MARYLAND**

By: County Council

**SUBJECT:** Categorical Transfer, FY16 Operating Budget  
Montgomery County Public Schools, \$4,200,000

**Background**

1. Section 5-105 of the Education Article of the Annotated Code of Maryland provides for transfers among major categories of the Operating Budget of the Montgomery County Public Schools only with the approval of the County Council.
2. The County Council received the Board of Education's action of July 25, 2016, requesting a transfer among state categories as follows:

| <u>Category</u> | <u>Description</u>     | <u>To</u>   | <u>From</u> |
|-----------------|------------------------|-------------|-------------|
| 3               | Instructional Salaries |             | \$4,200,000 |
| 11              | Maintenance of Plant   | \$200,000   |             |
| 12              | Fixed Charges          | \$4,000,000 |             |
|                 | Total                  | \$4,200,000 | \$4,200,000 |

3. The Board of Education has requested authorization to make an FY16 categorical transfer to align budgeted appropriations with actual expenditures. This request would offset deficits in Category 11, Maintenance of Plant and Category 12, Fixed Charges, by transferring surpluses from Category 3, Instructional Salaries.
4. The deficits in Category 11, Maintenance of Plant primarily related to snow removal costs and radon testing in all schools.
5. The deficits in Category 12, Fixed Charges, primarily related to a higher than anticipated claims experience for health benefits, which led to a projected deficit in the MCPS Employees Group Insurance Fund.

**Action**

The County Council for Montgomery County, Maryland approves the following resolution:

The FY16 Operating Budget of the Montgomery County Public Schools is hereby amended, and a transfer of appropriation is approved as follows:

| <u>Category</u> | <u>Description</u>     | <u>To</u>   | <u>From</u> |
|-----------------|------------------------|-------------|-------------|
| 3               | Instructional Salaries |             | \$4,200,000 |
| 11              | Maintenance of Plant   | \$200,000   |             |
| 12              | Fixed Charges          | \$4,000,000 |             |
|                 | Total                  | \$4,200,000 | \$4,200,000 |

This is a correct copy of Council action.

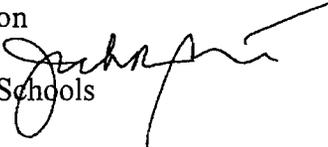
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Linda M. Lauer, Clerk of the Council

Office of the Superintendent of Schools  
MONTGOMERY COUNTY PUBLIC SCHOOLS  
Rockville, Maryland

July 25, 2016

MEMORANDUM

To: Members of the Board of Education

From: Jack R. Smith, Superintendent of Schools 

Subject: Fiscal Year 2016 Operating Budget End-of-Year Categorical Transfer

Montgomery County Public Schools (MCPS) is required to request transfers among state categories to align the budgeted appropriation with actual expenditures. Categorical transfers are subject to approval by the County Council. Fiscal Year (FY) 2016 categorical transfers total \$4.2 million, which is 0.2 percent of the total operating budget.

The current projection is that the FY 2016 MCPS Operating Budget ended the year with an expenditure surplus of \$33,836,881. This amount is preliminary and not final until the books are closed for the fiscal year. At this time, there are surpluses in Category 1, Administration; Category 2, Mid-level Administration; Category 3, Instructional Salaries; Category 4, Textbooks and Instructional Supplies; Category 5, Other Instructional Costs; Category 6, Special Education; Category 7, Student Personnel Services; Category 8, Health Services; Category 9, Student Transportation; Category 10, Operation of Plant and Equipment; and Category 14, Community Services. Category 11, Maintenance of Plant, and Category 12, Fixed Charges, ended the year with a deficit. As of June 30, total revenue was \$2,421,287 less than our budgeted amount for FY 2016. This shortfall increased by \$319,287 compared to the amount estimated in the April 30, 2016, financial report to the Board. As a result, the overall revenue shortfall reduced the end-of-year MCPS fund balance by \$2,421,287.

Due to concerns about the funding shortfall that was projected for the MCPS FY 2017 Operating Budget, the interim superintendent of schools determined that it was necessary to impose restrictions on expenditures for FY 2016 in order to generate MCPS fund balance at the end of FY 2016. Expenditure restrictions were placed on central services in a memorandum dated July 15, 2015. Subsequently, the offices prepared spending plans for the remainder of FY 2016 reflecting savings that were submitted and approved. Following the opening of schools for the 2015–2016 school year, these expenditure restrictions were expanded to all schools on September 17, 2015. In addition, on March 24, 2016, MCPS issued additional restrictions for the remainder of FY 2016. All remaining operating budget funds allocated to schools, including instructional materials, media and textbook funds, were frozen effective April 8, 2016.

As a result of cumulative savings from prior years, and after the County Council appropriated \$33,162,633 of the MCPS fund balance to fund the FY 2016 Operating Budget, the FY 2016 beginning MCPS fund balance as of July 1, 2015, was \$3,962,275. That amount, combined with the current estimated end-of-year expenditure surplus of \$33,836,881, and revenue deficit of \$2,421,287, reflects that the FY 2016 end-of-year MCPS fund balance is \$35,377,869. The actual amount will be determined in mid-August 2016. On May 26, 2016, the County Council approved the use of \$33,162,633 from the MCPS fund balance to fund the FY 2017 MCPS Operating Budget, the same amount that it used to fund the FY 2016 Operating Budget.

During the past fiscal year, staff closely monitored revenues and expenditures. This financial monitoring process is extremely careful, comprehensive, and detailed. Primary and secondary account managers reviewed each of their accounts on a monthly basis and reported expenditure projections for the remainder of the fiscal year. Department of Management, Budget, and Planning staff reviewed and analyzed these projections using quantitative models, as well as knowledge of previous expenditure patterns and changing circumstances. The MCPS Financial Management System, a comprehensive financial system integrated with the Human Resources Information System, provided data that enabled staff to monitor and control expenditures.

The Board received detailed monthly financial status reports throughout FY 2016. Each month, beginning in November 2015, the interim superintendent of schools presented an overview of the monthly financial report to Board at its public meetings. These reports were subsequently transmitted to the county executive, the county's Office of Management and Budget, and the County Council. Overall, final FY 2016 expenditures are consistent with the trends indicated in the monthly reports. The following summary presents the results for expenditures and how the end-of-year results differ from the appropriation.

### **Categorical Expenditures**

The current projection for the FY 2016 expenditure surplus is \$33,836,881, 1.5 percent of budgeted expenditures. An explanation of the results by state category follows.

Category 1, Administration, reflected a surplus of \$2,715,300. This is \$215,300 more than the amount reported in the April 30, 2016, financial report. Most of the surplus (\$2,603,960) was related to position salaries, which is \$203,960 more than the projected surplus in the April 30 report. This surplus change was due to greater than budgeted lapse and turnover savings due to hiring restrictions placed in effect for FY 2016. There was a net surplus of \$111,340, approximately the same as projected in the April 30 financial report, for temporary part-time salaries, contractual services, supplies and materials, and local travel mileage reimbursement. Savings in Category 1 were 6.1 percent of budgeted expenditures.

Category 2, Mid-level Administration, reflected a surplus of \$4,186,692. This is an increase of \$186,692 from the amount reported to the Board in the April 30, 2016, financial report. Most of the surplus (\$4,194,850) was a result of greater than budgeted lapse and turnover savings

due to hiring restrictions placed in effect for FY 2016. There was a net deficit of \$8,158 for temporary part-time salaries, contractual services, supplies and materials, and local travel mileage reimbursement. Savings in Category 2 were 3.0 percent of budgeted expenditures.

Category 3, Instructional Salaries, reflected a surplus of \$13,088,861, which is \$911,139 less than the projected surplus reported in the April 30, 2016, financial report. Most of the surplus (\$11,761,188) was related to position salaries, which is \$1,661,188 more than the projected surplus in the April 30 report. In addition, there is a surplus of \$1,327,673 that is related to temporary part-time salaries, which is \$2,572,327 less than the April 30 projected amount. The surplus change for temporary part-time salaries was primarily a result of more than anticipated substitute usage, substitute bonuses, and sick and annual leave reimbursements. Savings in Category 3 were 1.5 percent of budgeted expenditures.

Category 4, Textbooks and Instructional Supplies, reflected a surplus of \$2,673,873. This is \$526,127 less than the amount that was reported to the Board in the April 30, 2016, financial report. The difference was a result of additional spending for textbooks, instructional supplies and materials, and media materials for school-based activities. Savings in Category 4 were 11.8 percent of budgeted expenditures.

Category 5, Other Instructional Costs, reflected a surplus \$2,197,600, which was \$697,600 more than the amount projected in the April 30, 2015, financial report. This change is the result of several factors including additional surpluses in contractual services; out-of- area travel and dues, registration and fees. Savings in Category 5 were 19.0 percent of budgeted expenditures.

Category 6, Special Education, reflected a surplus of \$3,370,380, which was \$970,380 more than the surplus reported in the April 30, 2016, financial report. Most of the surplus (\$3,046,089) was related to position salaries, which is \$431,089 more than the projected surplus in the April 30 report. Actual expenses were lower than projected for long-term substitutes, long-term leave, and overtime resulting from services provided during the school day added at the end of the school calendar to make up for school closures. In addition, the surplus change of \$766,674 for temporary part-time salaries was primarily a result of less than anticipated substitute usage, stipend pay, and workers' compensation payments. Offsetting these surplus changes is a deficit of \$264,154 in contractual services due to higher than anticipated contractual legal services for special education and additional contractual services provided for occupational, physical, and speech therapy due to expenditure restrictions limiting permanent position hiring throughout the year.

The deficit of \$863,329 for tuition for students with disabilities in nonpublic schools was \$36,771 less than the \$900,000 deficit projected in the April 30, 2016, financial report. The overall change was mainly due to lower than anticipated costs for the students enrolled in school-age day programs during the year. The surplus in Category 6 was 1.2 percent of budgeted expenditures.

Category 7, Student Personnel Services, reflected a surplus of \$415,006. There is no significant change from the \$400,000 reported to the Board in the April 30, 2016, financial report. The net surplus consisted of a surplus of \$304,977 in position salaries for lapse and turnover savings due to hiring restrictions in place for FY 2016. In addition, there was a surplus of \$110,029 for temporary part-time salaries, contractual services, supplies and materials, and local travel mileage reimbursement due to the spending restrictions in place for FY 2016. Savings in Category 7 were 3.7 percent of budgeted expenditures.

Category 8, Health Services, reflected a surplus of \$2,754 due to slightly lower than anticipated program needs.

Category 9, Student Transportation, reflected a surplus of \$4,155,493. This is \$544,507 less than the amount projected in the April 30, 2016, financial report. There was a position salary surplus of \$3,338,185 related to approximately 61 vacant combined Full-time Equivalent (FTE) bus operator and bus route supervisor positions. There was a deficit of \$5,189,853 for temporary part-time school bus operator salaries, including costs for overtime incurred during the year. The combined actual deficit for position and non-position salaries was \$526,566 more than what was projected in the April 30 financial report. The primary reason was due to more substitute bus operators and attendants as a result of position vacancies than previously projected. There was a net surplus of \$5,284,302 for contractual services, bus fuel, bus parts, and supplies. This was an increase in savings of \$49,713 from the projected amount in the April 30 financial report. The majority of the surplus is related to savings in bus fuel, as the current price for diesel fuel of \$1.83 per gallon was lower than the budgeted amount of \$3.00 per gallon. There also was a surplus of \$266,399 for other expenditures primarily related to after-school activities, and \$456,460 in savings to purchase school buses as a result of not purchasing 20 buses related to enrollment growth this year. The surplus in Category 9 was 4.0 percent of budgeted expenditures.

Category 10, Operation of Plant and Equipment, reflected an end-of-year surplus of \$4,672,386, which was \$872,386 more than the amount projected in the April 30, 2016, financial report. There was a position salary surplus of \$3,120,793 related to approximately 139 vacant FTE positions. The position salary surplus was partially offset by a deficit of \$1,113,898 in temporary part-time salaries. The deficit in part-time salaries was attributable to the use of building services substitutes to fill vacancies, overtime expenses that were incurred during the days that schools were closed due to weather emergencies, and the costs associated with the one additional day added to the school calendar to make up for school closures. There was a net surplus of \$292,611 in contractual services, supplies and materials, and equipment. The majority of the savings is related to building rental costs and custodial and recycling supplies. The actual expenditure surplus for utilities was \$1,830,000, which was \$380,000 more than the projected surplus in the April 30 financial report. The overall surplus was a result of lower rates and consumption amounts for electricity and natural gas. In addition there was a surplus of \$542,880 in other expenditures. The surplus in Category 10 was 3.5 percent of budgeted expenditures.

Category 11, Maintenance of Plant, reflected an end-of-year deficit of \$93,573, which was \$406,427 less than the \$500,000 projected deficit in the April 30, 2016, financial report. There was an actual position and temporary part-time salary balance of \$2,180,007. Actual end-of-year expenditures for contractual equipment repairs resulted in a deficit of \$2,093,149. The deficit in contractual services is largely related to snow removal costs and radon testing in all schools. The actual amount spent for maintenance and grounds care supplies and vehicle operation costs resulted in a deficit of \$399,377. The deficits in supplies and vehicle operation costs were primarily a result of snow removal activities that occurred during the winter months. There was a surplus of \$218,946 for equipment primarily due to delaying the purchase of tractors. The deficit in Category 11 was 0.3 percent of budgeted expenditures.

Category 12, Fixed Charges, reflected a year-end deficit of \$3,595,665 which is \$595,665 more than reflected in the April 30, 2016, financial report. Based on actual FY 2015 experience, the beginning fund balance in the MCPS Employees Group Insurance Fund for FY 2016 was \$8.8 million in deficit. FY 2016 actual expenditures and revenues for both active employees and retirees, reflected a surplus of \$1.1 million. This was primarily due to increased costs for claims and prescriptions experienced earlier in the fiscal year, offset by increased revenues for prescription drug rebates at the end of the fiscal year. The result is a total deficit of \$7.7 million in the fund by the end of the fiscal year. The deficit of \$3,595,665 in Category 12 assumes a \$4.0 million transfer from the category to the MCPS Employees Group Insurance Fund by the end of the year, which is partially offset by a surplus of \$404,335 in other areas of the category. As a result of the \$4.0 million category transfer, this allows for the projected MCPS Employees Group Insurance Fund end-of-year balance to decrease from a deficit of \$7.7 million to \$3.7 million. The deficit in Category 12 was 0.7 percent of budgeted expenditures.

Category 14, Community Services, ended the year with a surplus of \$47,775.

I recommend the Board approve the following resolution regarding categorical transfers:

WHEREAS, Category 11, Maintenance of Plant, reflected a deficit as of June 30, 2016, primarily related to snow removal costs and radon testing in all schools; and

WHEREAS, Category 12, Fixed Charges, reflected a deficit as of June 30, 2016, primarily related to the end-of-year deficit in the Montgomery County Public Schools Employees Group Insurance Fund; and

WHEREAS, The required funds are available for transfer from Category 3, Instructional Salaries; now therefore be it

Resolved, That the superintendent of schools be authorized, subject to the approval of the County Council, to effect the following categorical transfer:

| <u>Category</u> | <u>Description</u>     | <u>To</u>    | <u>From</u>  |
|-----------------|------------------------|--------------|--------------|
| 3               | Instructional Salaries |              | \$ 4,200,000 |
| 11              | Maintenance of Plant   | \$ 200,000   |              |
| 12              | Fixed Charges          | 4,000,000    |              |
| Total           |                        | \$ 4,200,000 | \$ 4,200,000 |

and be it further

Resolved, That a copy of this resolution be sent to the county executive and the County Council; and be it further

Resolved, That the county executive be requested to recommend approval of the categorical transfers to the County Council.

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