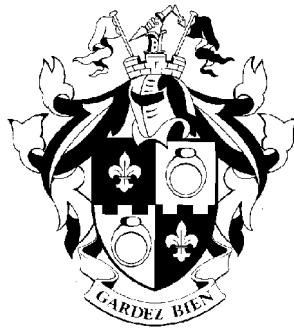


A REVIEW OF MONTGOMERY COUNTY PUBLIC SCHOOLS' BUDGET CATEGORY 12



**OFFICE OF LEGISLATIVE OVERSIGHT
REPORT NUMBER 2012-2**

November 29, 2011

Craig Howard
Kristen Latham
Aron Trombka

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

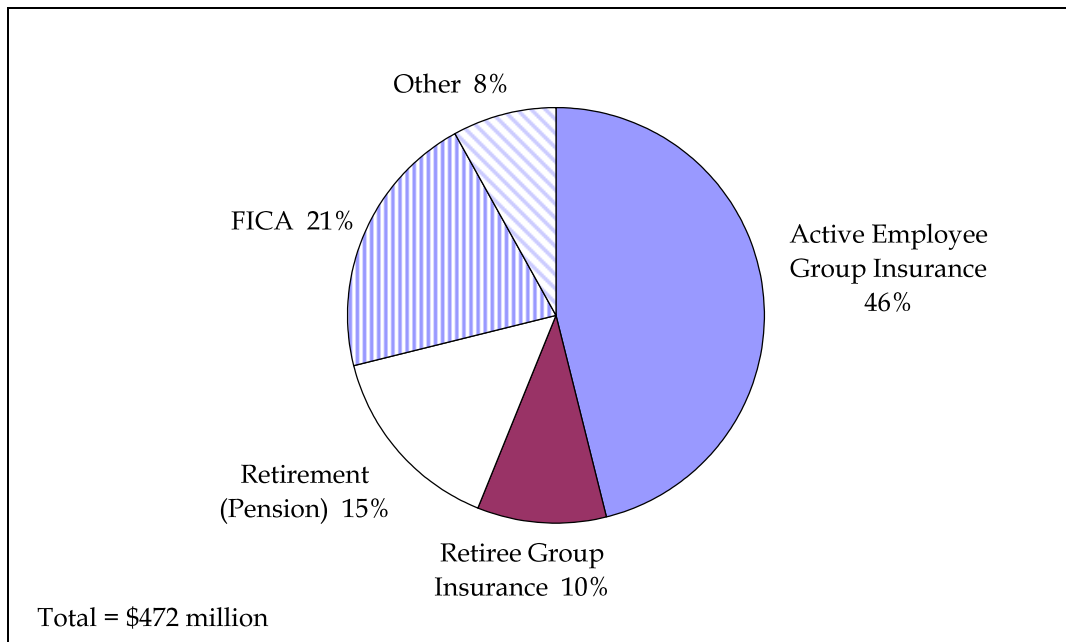
State law requires that the County Council appropriate funds to MCPS in standardized budget categories. One of the standardized categories is Budget Category 12; titled "Fixed Charges." Funds appropriated to Category 12 are primarily for employee benefits, i.e., retirement, health insurance, and social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

Active Employee Group Insurance Fund

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.

Office of Legislative Report 2012-2

TABLE OF CONTENTS

Executive Summary	i
I. Authority, Scope, and Organization of Report.....	1
II. Overview of Budget Category 12.....	3
III. Retirement Benefit Budget and Pension Fund	12
IV. MCPS Group Insurance Expenditures	23
V. Findings.....	40
VI. Recommendations and Discussion Issues	48
VII. Agency Comments	52

Appendix – A list of appendices is on page VIII.

Office of Legislative Report 2012-2**LIST OF TABLES**

Number	Tables	Page
2-1	Category 12 Budgeted vs. Actual Expenditures, FY03-FY12	8
2-2	FY03 and FY11 Category 12 Expenditures by Component	9
2-3	Comparison of FY11 Category 12 Budgeted and Actual Expenditures By Component	10
2-4	FY12 Category 12 Budgeted Expenditures	10
2-5	MCPS Enterprise Fund Employee Benefit Expenditures, FY03 to FY11 Actuals and FY12 Budgeted	11
3-1	MCPS Pension Fund: FY03-FY11 Actual Balances, Contributions, Expenses and Funded Ratios & FY12 Budgeted Employer Contribution	15
3-2	Percent of Total Payroll and Dollar Amount Contributed to MCPS Pension Fund for FY03 and FY12	17
3-3	Projected Rate of Growth for MCPS Pension Fund Contributions	21
4-1	2012 Group Insurance Plans Offered by MCPS	24
4-2	MCPS Group Insurance Fund Revenue Sources and Expenditure Types	26
4-3	MCPS Active Employee Group Insurance Fund Expenditures, FY03-FY12	29
4-4	MCPS Active Employee Group Insurance Fund Revenues, Expenditures, and Year-End Fund Balance Levels	30
4-5	Budgeted vs. Actual Revenue: MCPS Active Employee Group Insurance Fund	30
4-6	Budgeted vs. Actual Expenditures: MCPS Active Employee Group Insurance Fund	31
4-7	MCPS Retiree Group Insurance Fund Expenditures, FY03-FY12	33

LIST OF TABLES (CONTINUED)

Number	Tables	Page
4-8	MCPS Retiree Group Insurance Fund Revenues, Expenditures, and Year-End Fund Balance Levels	33
4-9	Budgeted vs. Actual Revenue: MCPS Retiree Group Insurance Fund	34
4-10	Budgeted vs. Actual Expenditures: MCPS Retiree Group Insurance Fund	34
4-11	FY11 Active Employee Group Insurance Fund: Budgeted vs. Actuals by Revenue Sources and Types of Expenditures	36
4-12	MCPS Active Employee Group Insurance Trust Fund FY11 Expenditures	39

LIST OF EXHIBITS

Number	Exhibit	Page
2-1	Category 12 Budgeted Expenditures, FY12	5
2-2	MCPS Category 12 Expenditures, FY03 to FY11 Actuals and FY12 Budgeted	7

Office of Legislative Report 2012-2

APPENDIX DOCUMENTS

Document	Begins on ©
Summary Tables: Category 12 Expenditures (Budgeted and Actual) FY03-FY12 by Component, Provided by MCPS	1
Details of MCPS Pension Plan Provisions, excerpted from <i>Understanding Your Retirement</i> , October 2011	12
MCPS Board of Education Policy GIG	19
Memorandum from Jerry Weast, Superintendent of Schools, to Members of the Board of Education. <i>FY 2008 Operating Budget Categorical Transfer</i> , July 28, 2008	22
Memorandum from Jerry Weast, Superintendent of Schools, to Members of the Board of Education. <i>FY 2009 Operating Budget Categorical Transfer</i> , July 27, 2009	27
Memorandum from Jerry Weast, Superintendent of Schools, to Members of the Board of Education. <i>Fiscal Year 2010 Operating Budget Categorical Transfer</i> , July 26, 2010	32
<i>Review of Group Insurance Programs for the Management and Fiscal Policy Committee</i> , Bolton Partners, Inc., April 16, 2003	37
Council Resolution 15-454 – Policy Guidance for Agency Group Insurance Programs	60
Memorandum from Valerie Ervin, Council President, to County Council. <i>Council's Package: An Alternative to the Executive's Proposal on Employee Benefits</i> , May 16, 2011	63
Memorandum from Jerry Weast, Superintendent of Schools, to Members of the Board of Education. <i>Final Adoption of the Fiscal Year 2012 Operating Budget</i> , June 16, 2011	66
Memorandum from Jerry Weast, Superintendent of Schools, to Members of the Board of Education. <i>Tentative Action on the Fiscal Year 2012 Operating Budget</i> , May 23, 2011	76
Memorandum from Valerie Ervin, Council President, to Christopher Barclay, Board of Education President. <i>FY12 MCPS Budget</i> , June 6, 2011	91
June 8, 2011 Letter from Christopher Barclay, Board of Education President, to Valerie Ervin, Council President	92
Memorandum from Valerie Ervin, Council President, to County Council. <i>Resolution to add Review of MCPS Category 12 to Office of Legislative Oversight's FY 2011 Work Program</i> , June 17, 2011	96
June 17, 2011 Letter from Christopher Barclay, Board of Education President, to Valerie Ervin, Council President	99

CHAPTER I. AUTHORITY, SCOPE, AND ORGANIZATION OF REPORT

A. Authority

Council Resolution 17-211, *FY 2012 Work Program of the Office of Legislative Oversight*, adopted July 19, 2011.

B. Purpose and Scope of Report

Maryland state law requires that all counties and Baltimore City appropriate school system funds into 18 budget categories, as defined in the Education Article of the Annotated Code of Maryland. One of those categories, Category 12 Fixed Charges, includes expenditures of “a generally recurring nature which are not readily allocable to other expenditure categories.” The primary expenditures in Category 12 are funding for employee benefits such as retirement, health insurance, and social security.

The purpose of this report is to provide information to assist the Council in its ongoing oversight of the MCPS Category 12 budget. Specifically, this report:

- Defines and examines the components of Category 12 and related funds, including those for employee pension and group insurance benefits;
- Tracks the multi-year budget and expenditure trends of these components;
- Summarizes FY11 budgeted and actual revenues and expenditures by Category 12 component; and
- Reviews the underlying assumptions behind MCPS' budget requests in Category 12 and related funds.

C. Organization of Report

Chapter II, Overview of Budget Category 12, provides an overview of MCPS Budget Category 12, including definitions, components, and funding trends.

Chapter III, Retirement Benefit Budget and Pension Fund, presents information on how MCPS budgets and funds annual retirement benefit costs, and provides data on MCPS' retirement benefit expenditure trends. This chapter also discusses the fiscal condition of the MCPS pension fund.

Chapter IV, MCPS Group Insurance Expenditures, details how MCPS budgets and accounts for employee group insurance costs, and provides data on MCPS' group insurance expenditure trends. This chapter also compares budgeted and actual FY11 group insurance fund revenues and expenses.

Chapters V-VI present OLO's **Findings, Recommendations to the Council, and Recommended Discussion Topics with MCPS**.

Chapter VII contains **Agency Comments** received from MCPS on the final draft of this report.

D. Methodology

Office of Legislative Oversight (OLO) staff members Craig Howard, Kristen Latham, and Aron Trombka conducted this study. OLO gathered information through document reviews, data analysis, and interviews with staff from the Montgomery County Public Schools. OLO also solicited actuarial advice from the Council's contract actuarial firm, Bolton Partners.

E. Acknowledgements

OLO received a high level of cooperation from MCPS staff involved in this study. OLO appreciates the significant time commitment, the information shared, and the insights provided by all staff who participated. In particular, OLO acknowledges the following MCPS staff for their assistance: Larry Bowers, Susanne DeGraba, Robert Doody, John Grabel, Carol Hurley, Richard Johnstone, Stephen Russ, Marshall Spatz, and Shafeena Yunus.

CHAPTER II. OVERVIEW OF BUDGET CATEGORY 12

State law requires that all counties and Baltimore City appropriate school system funds into 18 budget categories, as defined in the Education Article of the Annotated Code of Maryland.¹ This report focuses on Category 12, the State-defined budget category titled “Fixed Charges.” “Fixed Charges” are expenditures of a recurring nature that are not easily allocable to other budget categories. Employee benefits represent a majority of Category 12 expenditures.

This chapter summarizes MCPS’ budget Category 12, organized as follows:

- **Section A, Definition of Category 12** provides Maryland’s definition of Category 12;
- **Section B, MCPS Category 12 Budget Components** describes the nine spending components in Category 12;
- **Section C, Total Category 12 Expenditure Trends: FY03 – FY12** reviews total expenditures trends for MCPS’ Category 12;
- **Section D, Category 12 Expenditures by Component** reviews expenditure trends for the nine components in MCPS’ Category 12 budget; and
- **Section E, Employee Benefit Funding in Other MCPS Budget Categories** explains the small percent of MCPS’ benefit costs funded outside of Category 12.

A. Definition of Category 12

The Education Article of the Annotated Code of Maryland outlines financial accountability standards for Maryland public school systems, including the standardized reporting of expenditures. The following outlines the Maryland State budget categories that all school systems must use when budgeting expenditures.²

Maryland State Budget Categories³

1 Administration	8 Health Services
2 Mid-level Administration	9 Student Transportation
3 Instructional Salaries	10 Operation of Plant
4 Textbooks and Instructional Supplies	11 Maintenance of Plant
5 Other Instructional Costs	12 FIXED CHARGES
6 Special Education	14 Community Services
7 Student Personnel Services	15 Capital Outlay

¹ Maryland EDUCATION Code Annotated § 5-101 BUDGET AND REPORTING REQUIREMENTS (2011)

² MCPS also budgets in the following categories for enterprise funds: (37) MCPS Television Special Revenue Fund; (51) Real Estate Fund; (61) Food Services Fund; (71) Field Trip Fund; and (81) Entrepreneurial Activities Fund.

³ *Financial Reporting Manual for Maryland Public Schools* (Revised 2009) Resource available online at http://www.msde.maryland.gov/NR/rdonlyres/A0855BEB-5513-4758-8F15-1A0D64C50DBD/21354/FINANCIAL_REPORTING_MANUAL_REVISED_2009.pdf

The Maryland State Department of Education (MSDE) defines each of the budget categories in a document called the *Financial Reporting Manual for Maryland Public Schools*. In this document, MSDE defines Category 12, Fixed Charges, as:

“Charges of a generally recurring nature which are not readily allocable to other expenditure categories. Included are:

- Local school board contributions to employee retirement and social security;
- Employee insurance benefits (health, life, accident, disability, etc);
- Fidelity insurance, personal liability insurance, and judgments (distributed to General Support Services on the Fixed Charges supplemental report group);
- Interest on current loans; and
- Personnel tuition reimbursement for all staff (distributed to the proper category on the Fixed Charges supplemental report group).”⁴

B. MCPS Category 12 Budget Components

After the County Council appropriates funds to Category 12, the Board of Education makes final decisions on how to allocate the funds within Category 12. The Board of Education allocates Category 12 funds to nine expenditure components, listed below. A detailed description of each component begins on the next page.

- | | |
|--|---|
| • Group Insurance (Active and Retiree) | • Tuition Reimbursement |
| • FICA (Social Security and Medicare) | • Miscellaneous |
| • Retirement | • Partnership Tuition |
| • Non-Tax Supported Grants | • Other Post-Employment Benefits (OPEB) |
| • Risk Management/Self-Insurance | |

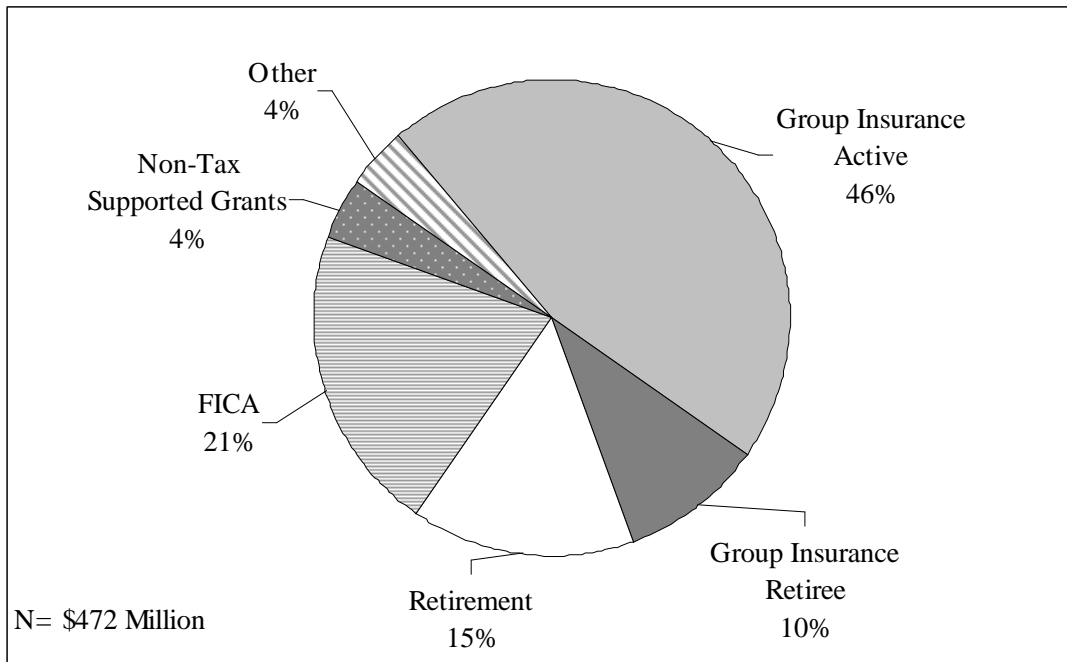
Excluding employee pension costs paid by the State, Category 12 contains funding for 97.5% of MCPS' total employee benefit costs.⁵ The remaining 2.5% is budgeted in MCPS enterprise funds (e.g., Food Services Fund, Real Estate Fund).

The chart below shows the distribution of FY12 Category 12 budgeted expenditures by category. Retirement and health benefits (for active and retirees) represent approximately 71% of all Category 12 expenditures.

⁴ *Financial Reporting Manual for Maryland Public Schools (Revised 2009)*, Page 61.

⁵ Approximately 77% of MCPS employees participate in a pension plan funded and administered by the State of Maryland; a more detailed summary of the MCPS pension system is available in Chapter III.

Exhibit 2-1. Category 12 Budgeted Expenditures, FY12



Source: MCPS

The following paragraphs describe each of the Category 12 components (listed in descending order of FY12 expenditures).

GROUP INSURANCE (FOR ACTIVE EMPLOYEES AND RETIREES). This component of Category 12 consists of MCPS' share of group insurance (medical, prescription, dental, vision, and life) coverage for active and retired employees. The amount of the annual MCPS contribution depends on plan premium costs and/or actuarial estimates of projected insurance claims. (Chapter IV discusses MCPS group insurance expenditures in further detail.)

FEDERAL INSURANCE CONTRIBUTIONS ACT (FICA). The FICA component consists of MCPS' federally-required contributions to Social Security and Medicare. The current employer contribution rate for Social Security is 6.2% of an employee's wages (up to a maximum salary of \$106,800) and for Medicare is 1.45% of an employee's taxable wages.

RETIREMENT. The retirement component consists of annual contributions to the MCPS pension fund. The MCPS pension plan provides a "Core Benefit" for almost one quarter of the agency's employees.⁶ In addition, MCPS provides a "Pension Supplement" to all agency employees. (Chapter III defines the different type of pension benefits and contains additional details about MCPS retirement expenditures.)

⁶ Approximately 77% of MCPS employees participate in a defined benefit plan funded and administered by the State of Maryland. The remaining 23% of MCPS employees participate in a locally-funded defined benefit plan that is identical to the State plan.

NON-TAX SUPPORTED GRANTS. This component consists of funding for the health, retirement, and other benefits of employees whose positions are funded through State or Federal grants. For these grant-funded (i.e., non-tax supported) positions, MCPS accounts for all benefit costs together under the component “Non-Tax Supported Grant” instead of allocating the costs among the other Category 12 components such as FICA, group insurance, and retirement.

RISK MANAGEMENT/SELF-INSURANCE. MCPS participates in the Montgomery County Liability and Property Coverage Self-Insurance Program. The Risk Management/Self-Insurance component consists of MCPS’ premium payments to the County Government’s Department of Finance for general liability, workers’ compensation, public official liability, property, and motor vehicle risks. MCPS’ premium payments to the fund are actuarially determined each year.

TUITION REIMBURSEMENT. This component consists of funding for MCPS’ tuition reimbursement program, a benefit provided to full-time and part-time employees who complete undergraduate or graduate courses to further their professional development.⁷ The program reimburses employees for expenses related to maintaining current certification and licensing, as well as tuition for advanced education.

MISCELLANEOUS. This component consists of funding for miscellaneous expenditures such as flexible spending account matches, unemployment compensation, cashed-in annual leave for Montgomery County Association of Administrators and Principals (MCAAP) employees, and automobile allowances.

PARTNERSHIP TUITION. This component consists of funding for MCPS’ “higher education partnership” programs that provide tuition assistance for candidates seeking employment in the school system. This program aims to recruit people changing careers to work with MCPS, with a focus on positions with critical staffing needs such as special education or math/science.

OTHER POST-EMPLOYMENT BENEFITS (OPEB). The OPEB component consists of MCPS’ contributions to a special trust fund established to finance future retiree health benefits. According to the 2011 MCPS Comprehensive Annual Financial Report, MCPS’ unfunded actuarial accrued liability (UAAL) for future retiree health costs was \$1.535 billion, as of July 1, 2010. In FY08 and FY09, MCPS made contributions into the agency’s OPEB trust fund. Similar to the other County agencies, MCPS did not make OPEB contributions in FY10 or FY11 due to budget constraints.⁸

Effective July 2011, Council Bill 17-11 amended the Retiree Health Benefits Trust to provide a funding mechanism to pay for other post employment benefits for employees of MCPS and Montgomery College. In FY12, the County Council appropriated \$20 million to the trust for MCPS OPEB; however these funds no longer appear as an MCPS Category 12 expenditure.

⁷ Board of Education Policy GMG-RA (August 10, 1987; revised March 11, 1997; revised September 29, 2009).

⁸ In FY10, County Council passed MCPS’ FY10 Budget Appropriation with the following clause: “This resolution appropriates \$12,000,000 for pre-funding retiree health insurance consistent with Resolution No. 16-555, which the Council adopted on May 14, 2008. These funds must not be placed in trust before June 30, 2010. Before June 30, 2010, these funds may be transferred, with Council approval, to address any unanticipated revenue shortfall.” In FY11, the Council did not appropriate funding for OPEB.

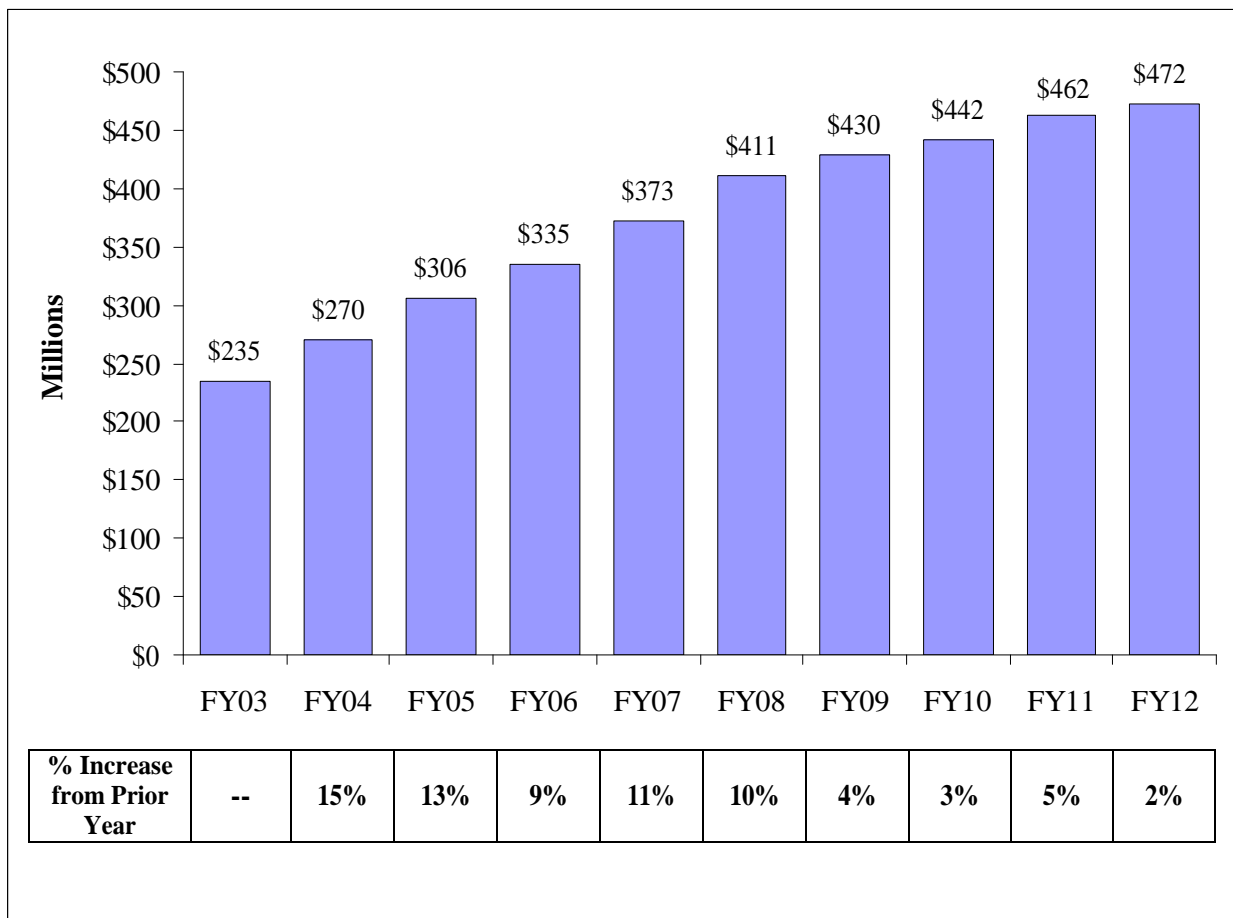
C. Total Category 12 Expenditure Trends: FY03 – FY12

This section reviews the spending trends for total Category 12 expenditures (budgeted and actual, tax supported and non-tax supported) from FY03 through FY12.

Chart 2-2 shows the actual Category 12 expenditures for FY03-FY11 and the approved budget for Category 12 in FY12. The data show:

- Actual Category 12 expenditures increased 97% from FY03 to FY11;
- Category 12 expenditure growth has slowed in recent years, increasing 3% per year on average from FY09 to FY11 compared to 13% per year on average from FY03 to FY08; and
- The \$472 million approved budget for Category 12 in FY12 represents a 2% increase over FY11 expenditures, the smallest annual increase over the last ten years.

Exhibit 2-2. MCPS Category 12 Expenditures, FY03 to FY11 Actuals and FY12 Budgeted



Source: MCPS

Category 12 Compared to MCPS Budget. Since FY03, Category 12 expenditures have increased as a proportion of total MCPS operating expenditures (excluding Enterprise and Special Revenue Fund expenditures). From FY03 to FY12, Category 12 expenditures increased by 101% while total MCPS operating expenditures increased by about 57% (from \$1.29 billion to \$2.03 billion) during the same period.

As a result, Category 12 expenditures as a percent of total MCPS operating expenditures have increased from 18% in FY03 to 23% in FY12.

Budgeted vs. Actual Category 12 Expenditures. Table 2-1 compares budgeted and actual Category 12 expenditures from FY03 through FY11. While MCPS' actual Category 12 expenditures exceeded the budget in seven of the past nine years, the variance between budget and actual was no more than 2% in each year, with an average variance of 1.2%.

Table 2-1. Category 12 Budgeted vs. Actual Expenditures, FY03-FY12
(\$'s in millions)

Fiscal Year	Category 12 Expenditures		\$ Variance	% Variance
	Budget	Actual		
FY03	\$233.3	\$235.1	(\$1.87)	(0.8%)
FY04	\$266.4	\$270.0	(\$3.61)	(1.4%)
FY05	\$302.2	\$305.9	(\$3.74)	(1.2%)
FY06	\$328.4	\$334.6	(\$6.13)	(1.9%)
FY07	\$371.5	\$372.8	(\$1.33)	(0.4%)
FY08	\$406.4	\$411.4	(\$5.06)	(1.2%)
FY09	\$420.7	\$429.6	(\$8.93)	(2.1%)
FY10	\$447.3	\$441.9	\$5.41	1.2%
FY11	\$463.3	\$462.2	\$1.11	0.2%
FY12	\$471.8	--	--	--

Source: MCPS

D. Category 12 Expenditures by Component

This section examines Category 12 expenditures by component. Table 2-2 compares FY03 and FY11 spending by component, breaking out the actual expenditures for the six largest components. In the table, "All Other" includes the remaining components: Tuition Reimbursement, Partnership Tuition, and Miscellaneous.⁹

⁹ OPEB was excluded from this table since that component did not exist in FY03 and there were no OPEB contributions made in FY11.

The data show that while the total expenditures in all the components increased between FY03 and FY11, the relative distribution of expenditures within Category 12 changed during the decade. Specifically, from FY03 to FY11, the percent of Category 12 dollars spent on:

- Active employee group insurance increased from 40% to 48%;
- Retirement contributions for active employees increased from 7% to 13%; and
- FICA contributions decreased from 30% to 21%.

The data also show that the four largest components – active employee group insurance, FICA, retirement, and retiree group insurance – accounted for 91% of MCPS' Category 12 expenditures in FY11. This represented a slight increase from the 86% of expenditures for those same components in FY03.

Table 2-2. FY03 and FY11 Category 12 Expenditures by Component
(\$'s in millions)

Category 12 Component	FY03 Expenditures		FY11 Expenditures	
	\$	% of Total	\$	% of Total
Active Employee Group Insurance	\$95.6	40%	\$216.5	48%
FICA (Social Security/Medicare)	\$69.5	30%	\$98.9	21%
Retirement	\$16.4	7%	\$62.0	13%
Retiree Group Insurance	\$20.7	9%	\$42.7	9%
Non-Tax Supported Grants	\$19.8	8%	\$21.9	5%
Risk Management/Self Insurance	\$9.0	4%	\$13.1	3%
All Other*	\$4.1	2%	\$6.9	1%
Total	\$235.1	100%	\$462.2	100%

*Include Tuition Reimbursement, Partnership Tuition, and Miscellaneous. OPEB was excluded from this table since that component did not exist in FY03 and there were no OPEB contributions made in FY11.

Source: MCPS

FY11 Budgeted vs. Actual Spending by Component. As shown earlier (page 8), MCPS' actual FY11 expenditures in Category 12 were about \$1.1 million lower than budgeted, a variance of 0.2%. Table 2-3 compares the budgeted and actual expenditures by component for FY11.

For the largest components of Category 12 spending – active employee group insurance, FICA, retirement, and retiree group insurance – actual expenditures in FY11 were within 1% of the budgeted amounts. Data on each Category 12 component's budgeted and actual expenditures for all years FY03-FY11 are available in the Appendix at ©1.

Table 2-3. Comparison of FY11 Category 12 Budgeted and Actual Expenditures By Component (\$'s in millions)

Category 12 Component	FY11		
	Budget	Actual	Difference
Active Employee Group Insurance	\$216.2	\$216.5	(\$0.3)
FICA (Social Security/Medicare)	\$99.2	\$98.9	\$0.3
Retirement	\$62.4	\$62.0	\$0.4
Retiree Group Insurance	\$42.7	\$42.7	--
Non-Tax Supported Grants	\$21.9	\$21.9	--
Risk Management/Self Insurance	\$13.1	\$13.1	--
Tuition Reimbursement	\$4.1	\$3.8	\$0.3
Miscellaneous Expenses	\$2.0	\$1.9	\$0.1
Partnership Tuition	\$1.6	\$1.2	\$0.4
OPEB	\$0	\$0	--
Total Category 12	\$463.3	\$462.2	\$1.1

Source: MCPS

FY12 Budgeted Expenditures by Component. Table 2-4 shows the FY12 budgeted expenditures for FY12 for each component of Category 12. Overall, the FY12 Category 12 budget increased by 2% over the FY11 budget.

Table 2-4. FY12 Category 12 Budgeted Expenditures (\$'s in millions)

Category 12 Component	FY12 Budget	Change from FY11 Budget
Active Employee Group Insurance	\$215.5	(0.3%)
FICA (Social Security/Medicare)	\$98.8	(0.3%)
Retirement	\$65.4	5%
Retiree Group Insurance	\$48.1	13%
Non-Tax Supported Grants	\$21.8	(0.6%)
Risk Management/Self Insurance	\$15.6	18%
Tuition Reimbursement	\$3.0	(26%)
Miscellaneous Expenses	\$2.0	0.7%
Partnership Tuition	\$1.4	(12%)
OPEB	\$0*	NA
Total Category 12	\$471.8	2%

*In FY12, the County Council appropriated \$20 million to the consolidated OPEB trust for MCPS OPEB; however these funds no longer appear as an MCPS Category 12 expenditure.

Source: MCPS

E. Employee Benefit Funding in Other MCPS Budget Categories

As noted on page 5, Category 12 does not include the employee benefit costs associated with positions funded through MCPS enterprise funds such as the Food Services Fund and Real Estate Fund.

Table 2-5 shows the total cost of employee benefits (unemployment, workers compensation, employee health benefits, FICA, and retirement) funded through MCPS' enterprise funds from FY03 through FY12. Total expenditures on benefits for enterprise funded positions increased 84% between FY03 and FY12.

**Table 2-5. MCPS Enterprise Fund Employee Benefit Expenditures,
FY03 to FY11 Actuals and FY12 Budgeted**

Enterprise Fund	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12 Budget
Non-Category 12 Benefit Expenditures	\$6.4 million	\$7.7 million	\$8.4 million	\$9.0 million	\$9.3 million	\$9.9 million	\$8.6 million	\$8.6 million	\$10.1 million	\$11.8 million

Source: MCPS

CHAPTER III. RETIREMENT BENEFIT BUDGET AND PENSION FUND

In FY12, 14% of MCPS' Category 12 budget funds the annual cost of employee retirement benefits. This chapter discusses how MCPS budgets and funds annual retirement benefit costs, and provides data on MCPS' retirement benefit expenditure trends. It is organized as follows:

- **Section A, Background** provides an overview of MCPS employee retirement benefits and explains the process of determining the annual required contribution to MCPS' locally-funded pension fund;
- **Section B, Pension Fund Contributions, Expenditures, Fund Balance and Funded Ratio** reviews annual contributions (FY03 through FY11) to the pension fund and identifies other factors that affect the fund balance and "funded ratio" of MCPS' pension fund. This section also includes data on the budgeted FY12 employer contribution to the pension fund;
- **Section C, Key Board of Education Decisions** identifies a set of important decisions made by the Board of Education regarding funding, plan design, and pension plan assumptions that affect the required annual contribution to MCPS' pension fund; and
- **Section D, Future Pension Costs** provides the most recent actuarial estimates of future MCPS pension fund contributions, and summarizes comments on MCPS' pension plan assumptions and policies, provided at OLO's request by the Chief Actuary at Bolton Partners, an independent employee benefits firm.

A. Background

Permanent MCPS employees participate in a defined benefit retirement plan, also referred to as a pension plan.¹ Defined benefit plans pay a retiree a set monthly amount from retirement until death. A retiree's annual pension is determined by a formula that takes into account the employee's final salary, years of service, and a pension "multiplier"² per year of credited service.

All current permanent MCPS employees participate in a "core" pension plan with a 1.8% multiplier:

- Approximately 77% of MCPS employees participate in a core plan funded and administered by the State of Maryland; and
- The other 23% of MCPS employees participate in a core plan that offers the same benefits as the State plan, but is County-funded and administered by MCPS.

¹ Temporary and substitute employees do not participate in the MCPS pension plan.

² A pension multiplier is the percent of wages used to calculate the amount of an annual pension benefit.

In addition to the core pension, all current permanent MCPS employees also receive a locally-funded “supplemental” pension with a 0.2% multiplier. The core pension multiplier of 1.8% combined with supplemental multiplier of 0.2% provide current MCPS employees with an overall 2.0% multiplier per year of credited service.³

Beginning in FY12, new permanent MCPS employees receive a core benefit with a 1.5% multiplier and a supplemental benefit with a 0.2% multiplier for an overall 1.7% multiplier per year of credited service.⁴

MCPS core and supplemental pension benefits paid do not change when a retiree reaches Social Security eligibility age.

MCPS' Pension Fund. Funding for MCPS' County-funded defined benefit pensions comes from annual contributions made by MCPS and active MCPS employees to the MCPS Employees' Retirement and Pension Systems Fiduciary Fund⁵ (hereafter, “MCPS' pension fund”). Annual contributions into MCPS' pension fund combined with the fund's investment earnings are used to pay for employees' pensions.

In 1995, the Board of Education created the MCPS Board of Investment Trustees to oversee the investment of assets⁶ in MCPS' pension fund. Responsibilities of the Board of Investment Trustees include establishing pension fund investment policies and guidelines, selecting investment managers, monitoring the investment performance of pension fund assets, and managing investment expenses.

Process for Determining Annual Contribution to the Pension Fund. Montgomery County Board of Education Policy GIG, *Funding Retirement/Pension System*, establishes MCPS' policy and guidelines for establishing an adequately funded pension plan. The Board of Education's adopted policy is to: “. . . have as a funding goal each year the improvement of the asset to accrued liability ratio toward the 100 percent funded level by the end of the amortization period.”⁷ In other words, MCPS policy is to make annual contributions to the pension fund in amounts necessary to accumulate assets that equal pension liabilities⁸ within 30 years (the current amortization period).

³ To be eligible for normal retirement, MCPS employees must have 30 years of credited service or must be age 62 (or older) with at least five years of credited service. The current multipliers are for years of service since 1998. The Core Pension multiplier is 1.4% and the Pension Supplement multiplier is 0.08% for years of service before 1998. Appendix beginning ©12 includes additional details about the MCPS pension plan.

⁴ To be eligible for normal retirement, employees hired in FY12 and after must have a combined age and years of credited service that are greater than 90 years or must be age 65 (or older) with at least ten years of credited service.

⁵ A fiduciary fund is a fund for which an entity (in this case, MCPS) serves as a trustee for assets that belong to others (in this case, retirees receiving the MCPS pension benefit).

⁶ The term *assets* refers to the value of cash and securities owned by a pension fund.

⁷ Board of Education Policy GIG (established by Resolution No. 534-83, June 1983 and amended by resolution No. 449-09, October 26, 2009). A copy of Board of Education Policy GIG appears in Appendix at ©19.

⁸ The term *liability* refers to the monetary value of pension payment obligations undertaken by the pension fund.

MCPS contracts with an actuary to calculate the annual required contribution (also known as, the “ARC”) to MCPS’ pension fund. Specifically, the Board of Education directs the actuary to calculate an annual required contribution that conforms to the MCPS pension funding policy and other specified assumptions (such as rate of investment return and future liabilities). The actuary calculates the annual required contribution in the fall of each year for MCPS to use in preparing its budget for the following fiscal year.

Every fall, MCPS staff meets with the Board of Education Fiscal Management Committee to review the latest actuarial plan assumptions and the recommended annual contribution to the pension fund for the upcoming fiscal year. The Board of Education approves the assumptions used in developing the calculation of the annual pension fund contribution and the amount is incorporated into MCPS’ Category 12 annual budget request.

MCPS’ contract actuary also prepares an annual pension fund “valuation report” that updates actuarial estimates of pension fund liabilities and expenses. In addition, as part of the annual valuation report, the actuary calculates the annual required contribution necessary to comply with the Board of Education’s approved policies and assumptions. Every three to five years, the actuary re-evaluates the plan’s experience and the assumptions used to calculate the fund’s accrued liability and future funding needs.

The next two sections of this chapter review ongoing MCPS practices and key decisions that affect the amount of the annual contribution to the pension fund.

**Table 3-1. MCPS Pension Fund
FY03-FY11 Actual Balances, Contributions, Expenses and Funded Ratios
FY12 Budgeted Employer Contribution**

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12 Budgeted*
Beginning Balance	\$613,019,791	\$599,870,936	\$673,459,160	\$727,894,344	\$785,112,495	\$929,722,902	\$877,327,308	\$702,465,603	\$805,616,685	\$994,130,100
Contributions										
Employer	\$16,639,493	\$19,866,733	\$28,871,207	\$36,817,620	\$58,000,751	\$58,761,275	\$61,405,163	\$63,080,846	\$64,814,364	\$77,788,472
Employee	\$4,493,106	\$4,520,946	\$4,811,344	\$4,908,325	\$8,932,215	\$12,791,123	\$16,752,846	\$16,312,774	\$16,897,603	
Investment Earnings (Loss)	\$4,711,194	\$88,981,263	\$63,827,661	\$62,207,300	\$128,374,337	(\$69,949,567)	(\$195,203,801)	\$83,972,809	\$169,716,298	
Benefits Paid	(\$35,897,885)	(\$37,956,887)	(\$41,090,497)	(\$44,689,076)	(\$48,426,240)	(\$51,675,769)	(\$54,859,755)	(\$58,041,590)	(\$61,029,941)	
Administrative Expenses	(\$3,094,763)	(\$1,823,831)	(\$1,984,531)	(\$2,026,018)	(\$2,270,656)	(\$2,322,656)	(\$2,956,158)	(\$2,173,757)	(\$1,884,899)	
Ending Balance	\$599,870,936	\$673,459,160	\$727,894,344	\$785,112,495	\$929,722,902	\$877,327,308	\$702,465,603	\$805,616,685	\$994,130,100	
Funded Ratio										
Start of FY	102.1%	93.4%	86.8%	80.5%	71.8%	73.5%	74.7%	71.9%	68.9%	
End of FY	93.4%	86.8%	80.5%	71.8%	73.5%	74.7%	71.9%	68.9%	70.1%	

* The FY12 MCPS budget includes funding for the employer contribution to the pension fund. The budget does not include estimates of employee contributions, investments earnings, benefits paid, and administrative expenses.

Sources: MCPS Comprehensive Annual Financial Reports, FY03 through FY11; Montgomery County Public Schools Annual Review and Actuarial Valuation of the Employees' Retirement and Pension Systems as of July 1, 2011, October 2011.

B. MCPS Pension Fund Contributions, Expenditures, and Fund Balance

This section provides information on the annual contributions into MCPS' pension fund as well as the other factors that add to or subtract from MCPS pension fund assets. MCPS' budget Category 12 includes almost all of the funding for MCPS' annual contribution to the MCPS pension fund.

Table 3-1 (page 15) shows actual fund balances, contributions, and expenses for MCPS' pension fund for FY03 through FY11. The last row contains data on the "funded ratio" at the start and end of each fiscal year. The table also shows budgeted pension fund contributions for FY12. Further explanations of the data contained in Table 3-1 are provided below.

Fund Balance. Table 3-1 shows start-of-year and end-of-year fund balances for MCPS' pension fund. The term "fund balance" refers to the amount of assets in a fund at a given point in time. Employer and employee contributions as well as investment gains add to a pension fund balance; pension benefit payments, investment losses, and administrative expenses draw down the fund balance. In most years over the past decade, the net effect of these changes resulted in the MCPS pension fund balance increasing during the course of the fiscal year. However, in FY08 and FY09, years of large investment losses, the pension fund balance declined.

Employer Contributions. As explained earlier (page 14), MCPS determines its annual required contribution to the pension fund based on the recommendations of an actuary. Category 12 of the operating budget includes nearly 90% of funding for MCPS' annual contribution to its pension fund.⁹

To integrate the annual required contribution into the agency budgeting process, the actuary calculates the required annual contribution as a percent of MCPS' total payroll. This calculation allows MCPS to adjust the annual contribution amount to reflect changes in payroll (e.g., changes in workforce size, pay adjustments) that occur between the completion of the valuation report (usually in November of each year) and the Board of Education's approval of the operating budget (the following June).

For example, in November 2010, the actuary calculated that annual required contribution equaled 5.57% of total MCPS payroll. In approving the FY12 budget, the Board of Education set aside an amount equivalent to 5.57% of total payroll as the recommended contribution to the pension fund.

Table 3-2 compares the FY03 and FY12 annual MCPS pension fund contribution as a percent of payroll. The increase in percent of payroll translated into an increase in MCPS' contribution from \$16.6 million in FY03 to \$77.8 million in FY12. This increase of \$51.2 million or 369% in the annual contribution to the fund is a product of multiple factors including higher pension costs per employee/retiree, salary increases, growth in workforce size, lower than assumed investment returns, and changes in actuarial assumptions.

⁹ MCPS makes contributions to the pension fund from sources other than Category 12, most notably from personnel costs budgeted in the Food Services Enterprise Fund.

Table 3-2. Percent of Total Payroll and Dollar Amount Contributed by MCPS to MCPS Pension Fund for FY03 and FY12

Fiscal Year	% of Payroll	Contribution Amount
FY03	2.74%	\$16,639,493
FY12	5.57%	\$77,788,472

Source: MCPS Annual Review and Actuarial Valuation of the Employees' Retirement and Pension Systems FY03 and FY11.

As mentioned above, more than three-quarters of MCPS permanent employees participate in a pension plan managed and funded by the State. For FY12, the portion of the State's contribution to its pension plan attributable to MCPS employees and retirees is estimated at \$168 million. In addition, MCPS must contribute \$2.8 million in FY12 to cover its share of administrative expenses for the State-run pension program.¹⁰

Employee Contributions. MCPS employees contribute to the pension fund through payroll deductions. In FY12, MCPS employees will contribute about \$20 million to the pension fund.

As of July 1, 2011, employees who participate in the locally-funded pension plan contribute 7% of salary for their core benefit into MCPS' pension fund. Consistent with changes made by the General Assembly for participants in the State-run pension plan, MCPS raised the employee contribution from 5% to 7% at the start of FY12.

All MCPS employees contribute an additional 0.5% of salary to the MCPS pension fund for their supplemental benefit. MCPS did not make any changes to the employee contribution for the supplemental benefit for FY12.

Pension Benefits Paid to Retirees. MCPS disburses (locally-funded) retiree pension benefits from its pension fund. In FY11, MCPS pension payments totaled \$61 million, a 37% increase over the FY06 amount.

Administrative Expenses. As with any pension system, MCPS incurs expenses to administer its plan. MCPS pays administrative costs from pension fund assets. Over the past decade, administrative expenses have cost MCPS between 0.23% and 0.50% of plan assets annually.

Investment Gains/Losses. Consistent with other pension funds across the country, MCPS has experienced great volatility in its pension trust investment returns in recent years. As shown in Table 3-1 (page 15), over the past decade, the MCPS pension fund has experienced annual investment gains as high as \$170 million (FY11) and investment losses as great as \$195 million (FY09). Volatility in investment performance affects the pension fund balance and the funded ratio (see below), and ultimately influences the employer's annual contribution.

¹⁰ Source: Maryland Department of Legislative Services.

As is common among public pension funds, MCPS averages investment gains and losses over a five-year period when calculating its annual required contribution. This practice, known as “smoothing,” moderates year-to-year swings in the annual contribution.

Funded Ratio. The “funded ratio” of a pension plan is a term that describes the percentage of the plan’s liabilities covered by the current actuarial value of the plan’s assets. In other words, the funded ratio measures the extent to which a plan has set aside funds to pay benefits accrued by its members.

At the end of FY11, the MCPS pension fund had assets of \$1,020 million and an accrued liability of \$1,454 million.¹¹ As the pension fund held assets equal to 70.1% of current liabilities, the funded ratio for the pension fund is 70.1%.

As shown in Table 3-1 (page 15), the funded ratio of the MCPS pension fund has experienced a downward trend over the past decade. Specifically, the funded ratio declined from 102.1% at the start of FY03 to 70.1% by the end of FY11.

Many other public sector pension funds also experienced significant reductions in their funded ratio over the past decade. In the case of MCPS, two primary factors contributed to the funded ratio decline: plan enhancements and investment performance.

Plan Enhancements. In 2006, the Board of Education approved two pension plan enhancements that significantly raised the plan’s unfunded liability with a resulting decrease in the funded ratio.

- MCPS changed the core pension multiplier (for participants in the locally-funded plan) from 1.4% to 1.8% of average final salary for each year of credited service, retroactive to July 1, 1998. This change in the multiplier was identical to the modification made in the same year for participants in the State-run pension plan.
- MCPS increased the multiplier for the locally-funded supplemental benefit for all employees (including participants in the State-run plan) from 0.08% to 0.20 % for each year of credited service, retroactive to July 1, 1998.

These plan enhancements increased MCPS’ liability to pay future pension benefits. As a result, the pension fund’s funded ratio declined since MCPS had not previously contributed assets to cover this additional liability.

Investment Performance. As mentioned above, the Board of Education has directed MCPS’ actuary to calculate annual pension contributions assuming a 7.5% annual rate of return on investments. In years that investments return less than 7.5%, the pension fund experiences an increase in its unfunded liability that negatively affects the funded ratio. As shown in Table 3-1 (page 15), the MCPS pension fund incurred a combined investment loss of more than \$265 million during FY08 and FY09. While investment gains in FY10 and FY11 offset most of the losses from the previous two years, nonetheless, the funded ratio has continued to decline, in part,

¹¹ Source: Montgomery County Public Schools Annual Review and Actuarial Valuation of the Employees’ Retirement and Pension Systems as of July 1, 2011, October 2011.

because the average annual investment return (over the past five years) has fallen below the assumed rate of 7.5%.

C. Key MCPS Pension Management Decisions

MCPS has made several pension fund management decisions that have altered the amount of the annual required contribution and/or affected the funded ratio. These decisions directly impacted the value of the fund's assets and adjusted the size of future pension liabilities.

Payment of Annual Required Contribution. As part of the annual budget process, the Board of Education decides how much to contribute to MPCPS' pension fund.

- MCPS annually contributes to its pension fund consistent with the recommendations of their actuarial advisors. While this practice may not seem remarkable, it is noteworthy that several states and municipalities have succumbed to budget pressures and failed to meet this basic financial obligation. In contrast, MCPS abided by its pension funding policy and made annual contributions as recommended by its actuaries.
- For FY12, MCPS used non-County funding to meet the actuary's recommendation. The Board of Education elected to use one-time federal grant dollars to cover \$4.4 million of its FY12 pension fund contribution. This decision did not change FY12 annual required contribution but reduced the amount of County funds needed to meet this obligation.

Pension Plan Design. In 2006 and 2011, the Board of Education made decisions that affected the design of the MCPS pension plans.

- In 2006, the Board of Education approved pension plan enhancements. As detailed above, the Board increased the core pension multiplier (for participants in the locally-funded plan) retroactive to July 1, 1998. The change in the core pension multiplier was identical to changes made for participants in the State-run plan. In addition, the Board increased the multiplier for the locally-funded supplement benefit for all employees (including participants in the State-run plan) retroactive to July 1, 1998. The 2006 pension enhancements created large unfunded liabilities, which in turn, required MCPS to make significant increases in its annual contribution. As shown in Table 3-1 on page 15, MCPS' annual contribution increased by more than \$21 million (or 58%) from FY06 to FY07, primarily as a result of plan enhancements.
- To offset some of the cost of the 2006 plan enhancements, the Board of Education approved a phased-in increase in employee contributions. For the core benefit, the employee contribution was 2% of salary in FY06. The employee contribution was raised to 3% in FY07; 4% in FY08; and 5% in FY09. For the supplemental benefit, the employee contribution increased by 0.1% per year, from 0.2% in FY06 to 0.5% in FY09.

- In 2011, the Board of Education raised the employee contribution for the locally-funded core pension from 5% to 7% of salary (similar to the change made by the General Assembly for the employees in the State-funded core pension). The Board retained the employee contribution rate for the supplemental benefit at 0.5% of salary. This increase in employees' contributions will increase pension fund assets and thereby mitigate the rate of growth for the employer's contribution.
- Also in 2011, the Board of Education amended the design of the locally-funded pension plan to correspond to changes made by the General Assembly to the State-run teachers' pension plan. Specifically, MCPS lowered the cap on annual cost-of-living adjustments for service after July 1, 2011 and modified the plan design for employees hired after July 1, 2011. Changes for new hires include a lower pension multiplier (for each year of credited service), a longer vesting period, a revised formula for calculating average final salary, and more stringent eligibility requirements for both normal and early retirement. These changes should have a positive effect on long-term pension liabilities.

Actuarial Assumptions. Some pension management decisions came from recognition of changing external conditions.

- In 2011, the Board of Education approved revised pension plan assumptions based on a new study prepared by MCPS' actuary. The revised assumptions reflected updated data on pension plan participants retirement ages, sick leave usage, mortality rates, and other factors that affect pension plan contributions and expenses. The new actuarial assumptions indicated that future pension liabilities were higher than previously estimated, and so, necessitated an increase in the employer's contribution.
- In 2006, the Board of Education reduced the assumed annual rate of return on pension plan investments from 8.0% to 7.5% to more closely reflect actual investment experience. This decision necessitated an increase in the annual required contribution.

D. Future Pension Costs

The final section of this chapter provides the most recent actuarial estimates of future MCPS pension fund contributions. It then summarizes comments on MCPS' pension plan assumptions and policies, provided at OLO's request by the Chief Actuary at Bolton Partners, an independent employee benefits firm.

Estimates of MCPS' Future Year Pension Costs. According to the most recent actuarial calculation, MCPS' FY13 contribution to the pension fund (5.42% of payroll) will be slightly lower than the FY12 rate (5.57% of payroll).¹² This decrease in the MCPS contribution as a percent of payroll is primarily a result of the higher employee contribution rate and plan revisions approved in 2011 by the Board of Education (see Section C of this chapter).

¹² Source: Montgomery County Public Schools Annual Review and Actuarial Valuation of the Employees' Retirement and Pension Systems as of July 1, 2011, October 2011.

Table 3-3 shows projected rates of growth for the MCPS pension fund contribution through FY16, as prepared by MCPS' actuary in May 2011. The actuarial estimates show that:

- In FY14 and FY15, pension costs will continue to grow as MCPS continues to absorb the investment losses from FY08 and FY09.
- By FY16, pension costs will stabilize (under the assumption that fund investments will meet their target).

Table 3-3. Projected Rate of Growth for MCPS Pension Fund Contributions¹³

Fiscal Year	Percent Growth over Previous Year
FY14	10.6%
FY15	6.6%
FY16	0.0%

Of course, these estimates will change if MCPS experiences demographic and investment changes that differ from assumptions. Moreover, workforce size and pay adjustments also will affect the actual dollar amount of future year MCPS pension fund contributions.

Assessment of MCPS Pension Policies and Assumptions. OLO asked Thomas B. Lowman, Chief Actuary at Bolton Partners, Inc.,¹⁴ to review past and current information about MCPS' pension plan and to provide his professional observations regarding MCPS' assumptions and policies.

With respect to MCPS' pension plan assumptions and policies, Mr. Lowman concluded that:

MCPS generally has adopted practices and assumptions that are common among public sector pension plans and on average reflect better choices than most. Not every method used by MCPS is a best practice and generally adopting more best practices would increase contributions. An example of one additional best practice would be to materially shorten the amortization period to pay for benefit improvements.

¹³ Source: Memorandum from Superintendent Jerry Weast for Board of Education Agenda Item 5.2, May 23, 2011.

¹⁴ Bolton Partners is an independent employee benefits firm headquartered in Baltimore, Maryland. Thomas Lowman has been a Fellow in the Society of Actuaries, an Enrolled Actuary and a member of the American Academy of Actuaries since 1982.

On the specific topic of the risk involved in MCPS' current investment return assumption of 7.5%, Mr. Lowman commented that:

It is lower than the rate used by most plans but still involves taking on investment risk to achieve the 7.5% target. Even at 7.5%, the policy shifts these investment risks to future year budgets and future taxpayers. The investment risk is probably the largest pension risk to MCPS other than the possibility of the State assigning the MCPS Teacher's pension cost to MCPS.

In addition, OLO asked Mr. Lowman for an overall assessment of the MCPS pension plan's funded ratio. Mr. Lowman observed that:

The ability of a pension fund to survive is related to (1) the ability of the employer to provide enough future funding and (2) the current funding level. An employer with unlimited resources has little to worry about even if a plan is poorly funded. As an employer's ability to fund in the future is brought more into question, the funded ratio increases in importance. At the end of Fiscal Year 2011, the MCPS funded ratio was 70% (using the actuarial value of assets) or 68% (using the market value of assets). Many other public pension plans have low funded ratios but MCPS' is below average. The most promising way to improve the ratio would be to increase annual contributions.

The low funded ratio means that MCPS must use current taxpayer funds to cover the cost of benefits earned in the past. The expected future trend in the funded ratio is a slow erratic increase until 100% funding is achieved.

CHAPTER IV. MCPS GROUP INSURANCE EXPENDITURES

In FY12, 56% of MCPS' Category 12 budget is for active employee and retiree group insurance benefits. Group insurance costs have consistently represented the largest single budget component in Category 12.

This chapter reviews how MCPS budgets and accounts for these annual group insurance costs, and provides data on MCPS' group insurance expenditure trends. It is organized as follows:

- **Section A, MCPS Group Insurance Overview** summarizes MCPS' group insurance offerings and group insurance benefit fund structure, and outlines the different revenue and expenditures associated with group insurance;
- **Section B, Group Insurance Funding and Expenditure Trends** reviews the FY03-FY12 MCPS group insurance funding and expenditure trends; and
- **Section C, Explanation of FY11 End-of-Year Surplus in the Active Employee Group Insurance Fund** provides more detailed information on the FY11 revenue and expenditures in MCPS' group insurance fund for active employees.

A. MCPS Group Insurance Overview

MCPS offers five types of group insurance benefits to their active employees and retirees: medical, prescription drug, dental, vision, and life insurance. For each type of benefit, employees/retirees have one or more plans to select from. As of July 1, 2011, MCPS has approximately 48,700 total members participating in its active employee insurance programs (19,100 employees and 29,600 related dependents) and 12,200 total members participating in its retiree group insurance programs (8,200 retirees and 4,000 related dependents).

Table 4-1 (on the next page) shows the Calendar Year 2012 plans offered by MCPS, indicates whether each plan is self-insured or fully-insured, and notes which plans are closed to open enrollment or available only for active employees. The distinction between self-insured and fully-insured plans is described in the box below.

A **self-insured plan** is one where an agency sets aside funding and pays all claims under the plan out of a self-insurance fund. Each year, the agency (with the assistance of actuaries) calculates the total premiums needed to cover the cost of anticipated claims. The agency contracts with a vendor to administer each self-insured plan and pays the vendor a negotiated administrative fee. The vendor provides access to its network of care providers and processes claims payments on behalf of the agency.

A **fully-insured plan** is one where a contracted insurance vendor establishes the total premiums each year and the vendor is responsible for paying all claims under the plan. There is no additional administrative fee apart from the premium paid to the vendor under a fully-insured plan.

Under both self-insured and fully-insured plans, MCPS (not the vendor) determines the agency's "cost share." The cost share refers to the amount, typically expressed as a percent, of an annual premium paid by the employer versus individual employees. For active employees, the Board of Education establishes the cost share based on the results of collective bargaining with MCPS' employee unions. For retirees, the Board of Education establishes the cost share after consultation with retiree representatives.

Table 4-1. 2012 Group Insurance Plans Offered by MCPS

Group Insurance Plans Offered by MCPS	Vendors/Plans Offered	Self-Insured	Fully-Insured
Medical	Carefirst POS (actives only)	✓	
	Carefirst HMO	✓	
	United Healthcare POS (open)	✓	
	United Healthcare POS (closed)	✓	
	United Healthcare HMO	✓	
	Kaiser Permanente HMO		✓
Prescription	Caremark	✓	
	Kaiser Permanente		✓
Dental	Aetna PPO	✓	
	Aetna DMO		✓
Vision	National Vision Administrators	✓	
Life Insurance	Prudential	✓	

Note: "Closed" means that the plan is no longer enrolling new members. "Actives only" means that the plan is not available to retirees.

Source: MCPS

Recent Changes to Retiree Health Benefits. In May 2011, the Board of Education adopted changes to retiree health benefit eligibility and cost share. The specific changes are:

- Future retiree health benefits will be granted only after 10 years of eligible service; and
- The cost share for health benefits will be determined on a service-based scale, meaning that employees with more years of service will pay relatively less.

These changes will affect all new employees hired after July 1, 2011, and all current MCPS employees hired after July 1, 2006 who are younger than 55 years old. MCPS anticipates that these changes will lead to significant long-term cost savings for the agency.¹

¹<http://www.montgomeryschoolsmd.org/boe/meetings/agenda/2010-11/2011-0523/5.1%20Retiree%20health%20benefits.pdf>

1. MCPS Group Insurance Fund Structure

MCPS develops and maintains budget and financial information for group insurance in two separate funds – one for active employees and a separate one for retirees.

- For active employees, MCPS accounts for group insurance costs in an internal service fund, the Employee Benefits Plan Trust Fund. This report will refer to this fund as the **Active Employee Group Insurance Fund**.
- For retirees, MCPS accounts for group insurance costs in a fiduciary fund, the Other Post-Employment Benefits (OPEB) Trust Fund.² This report will refer to this fund as the **Retiree Group Insurance Fund**.

In general, an internal service fund is used for operations serving other funds or departments within a governmental agency while a fiduciary fund is used to account for assets held in trust by the government for the benefit of others.

There are two types of funding associated with retiree group insurance costs, pay-as-you-go funding and OPEB pre-funding. Pay-as-you-go funding refers to annual group insurance benefit costs for MCPS' current retirees. OPEB pre-funding refers to contributions toward an OPEB trust fund to pay long-term retiree group insurance liability (i.e., future group insurance costs that will come due for current employees after they retire). **The MCPS retiree group insurance expenditures discussed in this chapter refer only to the annual pay-as-you-go funding.**³

Group Insurance Fund Revenues and Expenditures. Each year, MCPS' group insurance funds for active employees and retirees receive revenue and incur expenses. The table on the next page describes the primary revenue sources and expenditures types for each group insurance fund, and indicates the percent of total revenue or total expenditures each represented in FY11.

² Prior to FY08, MCPS accounted for both the active employee and retiree costs in the Employee Benefits Plan Trust Fund. In FY08, MCPS created an OPEB Plan Trust to comply with new Governmental Accounting Standards Board financial reporting requirements and began accounting for all retiree group insurance costs within that fund.

³ See Chapter II, page 6, for information related to MCPS OPEB funding.

Table 4-2: MCPS Group Insurance Fund Revenue Sources and Expenditure Types

Active Employee Group Insurance Fund		Retiree Group Insurance Fund	
Revenue Sources and % of FY11 Total Revenue			
Category 12 Agency Contribution. MCPS’ share of the annual group insurance premiums for all employees holding tax supported positions that are funded in the annual operating budget.	82%	Category 12 Agency Contribution. MCPS’ share of the annual group insurance premiums for all enrolled retirees.	57%
Employee Contributions. Employees’ share of annual group insurance premiums that is deducted from employees’ bi-weekly paychecks.	8%	Retirees Contributions. Retirees’ share of the annual group insurance premiums that is deducted from retiree’s pension payments or billed directly to retirees.	35%
Non-Category 12 Agency Contribution. MCPS’ share of the annual group insurance premiums for employees holding positions funded through: the capital budget; non-tax supported enterprise funds; and grants.	7%	Medicare Part D Reimbursements. Prescription drug cost reimbursement received from the federal Center for Medicare and Medicaid Services’ Medicare Part D program. ⁴	6%
Miscellaneous. Revenue from investment earnings, optional coverage purchased by employees, and rebates from vendors.	3%	Miscellaneous. Revenue from investment earnings and rebates from vendors.	2%
Types of Expenditures and % of Total FY11 Expenditures			
Claims. All expenditures paid out based on the actual insurance claims incurred under MCPS’ self-insured plans.	78%	Claims. All expenditures paid out based on the actual insurance claims incurred under MCPS’ self-insured plans.	84%
Premiums. Payments to vendors that provide and administer fully-insured plans to MCPS employees.	17%	Premiums. Payments to vendors that provide and administer fully-insured plans to MCPS retirees.	11%
Administrator Service Fees. Per month, per member fees paid to vendors that administer MCPS’ self-insured plans.	4%	Administrator Service Fees. Per month, per member fees paid to vendors that administer MCPS’ self-insured plans.	5%
MCPS Administrative Expenses. Expenditures for MCPS staff whose personnel costs are charged to the group insurance fund and trustee fees.	1%	MCPS Administrative Expenses. Expenditures for MCPS staff whose personnel costs are charged to the group insurance fund and trustee fees.	<1%

⁴ Medicare Part D reimbursements are available to employers who provide their Medicare-eligible retirees with prescription drug benefits that are at least actuarially equivalent to those that otherwise would be provided by Medicare.

2. Group Insurance Fund Balance (or Reserve)

Similar to other agencies, MCPS' practice is to maintain a balance (also known as a reserve) in both the active employee and retiree group insurance funds to protect against unanticipated expenditures in any given year. However, MCPS does not have a formal written policy that establishes a target reserve amount.

In practice, at the end of each fiscal year, any surplus or deficit between revenue and expenditures is added to or subtracted from the fund balance coming into the year; this action is reported by MCPS in its Comprehensive Annual Financial Report (CAFR). MCPS staff report that year-end fund balances remain in the respective funds and are not transferred for other uses.

Through FY07, the fund balance reported in MCPS' CAFR was for the active employee and retiree group insurance funds combined. In FY08, the CAFR began reporting fund balance information separately for the Active Employee Group Insurance Fund and the Retiree Group Insurance Fund. Fund balance data since FY08 are available in Section B of this chapter.

3. Budgeting for Group Insurance

MCPS' develops its annual budget for group insurance expenditures using estimates and projections from a health benefits actuarial consultant. Each year, the consultant provides MCPS with group insurance expenditure projections for each plan. The projections take into account numerous factors and assumptions, including:

- Actual expenditure trends for each of MCPS' plans;
- Overall health care cost trends based on an annual industry survey of medical, dental, pharmacy, and vision vendors;
- Current plan enrollment and any projected changes in enrollment; and
- Adjustments for expected changes in coverage requirements, e.g., mandates related to Federal Health Care Reform legislation.

MCPS utilizes group insurance expenditure projections to develop its annual budget request for the group insurance funds (on a fiscal year basis), and to develop its annual group insurance plan premiums (on a calendar years basis).

MCPS staff note that several factors complicate budgeting for group insurance expenditures, any and all of which can lead to variances between budgeted and actual group insurance expenditures. The primary factors, which are listed below, similarly apply to the other County-funded agencies.

- **MCPS is largely self-insured and group insurance expenditures each year result from actual health care use by plan participants.** In any given year, health care use can vary unexpectedly for multiple reasons. Self-insured plans bear the immediate financial "risk" for unanticipated expenditures and the immediate "benefit" from unanticipated savings.

- **Group insurance plans operate on a calendar year basis while budgets are approved on a fiscal year basis.** As a result, changes during the fiscal year (such as how many employees choose to switch health plans during open enrollment) may not have been fully anticipated at the time cost projections were prepared for the budget.
- **Many months elapse between budget development and the beginning of the fiscal year.** When MCPS develops its recommended budget for group insurance each fall, it uses cost projections based on the actual expenditures and experience over the most recent twelve months. By the time the fiscal year begins in July, expenditure trends may have varied from the projection prepared the previous fall.

B. Group Insurance Funding and Expenditure Trends

This section reviews funding and expenditure trends in the Active Employee Group Insurance Fund and the Retiree Group Insurance Fund. The information provided includes:

- Trend data on actual group insurance expenditures;
- A summary of group insurance fund revenue, expenditures, and fund balance; and
- A comparison of budgeted versus actual group insurance revenue and expenditures.

1. Active Employee Group Insurance Fund

Table 4-3 contains FY03 to FY11 data on annual expenditures and average expenditures per enrollee⁵ for MCPS' Active Employee Group Insurance Fund; for FY12, the data reflect budgeted expenditures.

In sum, during the past decade, active employee group insurance expenditures and expenditures per enrollee increased every year. The rate of expenditure growth, however, slowed during the past two fiscal years, FY10 and FY11. Specifically, between FY03 and FY11:

- Annual group insurance expenditures increased 90%, from \$131.4 to \$250.3 million;
- After averaging annual expenditure growth of 10% from FY03 to FY09, the rate of growth slowed to 5% in FY10 and 4% in FY11;
- Plan enrollment increased by 13%, from 17,078 to 19,226 employees; and
- Average expenditures per enrollee increased 69%, from \$7,695 to \$13,019.

MCPS' FY12 budget includes a 4% increase in Active Employee Group Insurance Fund expenditures. This budget amount translates into a 5% increase in average expenditures per enrollee.

⁵ Average expenditures per enrollee controls for changes in workforce size and plan enrollment. The enrollment data used for this calculation does not include covered dependents.

Table 4-3. MCPS Active Employee Group Insurance Fund Expenditures, FY03-FY12

Group Insurance	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12 Budget
Enrollment*	17,078	17,211	17,537	17,960	18,456	18,993	19,163	19,123	19,226	19,081
Expenditures	\$131.4 million	\$147.0 million	\$165.2 million	\$181.1 million	\$191.9 million	\$209.4 million	\$229.5 million	\$241.5 million	\$250.3 million	\$260.7 million
Change from Prior Year	--	12%	12%	10%	6%	9%	10%	5%	4%	4%
Average Expenditures per Enrollee	\$7,695	\$8,539	\$9,419	\$10,084	\$10,396	\$11,026	\$11,975	\$12,627	\$13,019	\$13,664
Change from Prior Year	--	11%	10%	7%	3%	6%	9%	5%	3%	5%

*Medical plan enrollment of MCPS active employees as of July 1st each year. Does not include dependents.
Source: MCPS and OLO

Revenue, Expenditures, and Fund Balance. Table 4-4 contains data on the annual Active Employee Group Insurance Fund revenues, expenditures, and resulting year-end fund balance from FY08 to FY11; for FY12, the table reflects budgeted data.

In FY11, the Fund's revenues exceeded expenditures by a sizable amount (\$13.1 million); this resulted in an unusually large year-end fund balance of \$21.6 million, or 8.6% of FY11 actual expenditures. Additionally, the data show:

- The actual year-end fund balance ranged from 1.2% to 8.6% of expenditures;
- Three years where revenue exceeded expenditures (FY08, FY10, and FY11) and increased the Fund's ending balance;
- Considerable fluctuation in the difference between revenue and expenditures from year to year. For example, a \$5 million surplus (i.e., revenue exceeded expenditures) in FY08 followed by a \$9 million deficit (i.e., expenditures exceeded revenue) in FY09; and
- MCPS' FY12 budget projects maintaining the \$21.6 million fund balance through the end of FY12, although the balance as a percent of expenditures would decline slightly to 8.3%.

Table 4-4. MCPS Active Employee Group Insurance Fund Revenue, Expenditures, and Year-End Fund Balance Levels

Active Employee Group Insurance Fund	FY08	FY09	FY10	FY11	FY12 Budgeted
Beginning Balance	\$6,757,570	\$11,818,442	\$2,797,995	\$8,541,533	\$21,598,686
Revenue	\$214,475,114	\$220,456,493	\$247,207,362	\$263,353,334	\$260,714,366
Expenditures	\$209,414,242	\$229,476,940	\$241,463,824	\$250,296,181	\$260,714,366
Difference	\$5,060,872	(\$9,020,447)	\$5,743,537	\$13,057,153	--
Ending Balance	\$11,818,442	\$2,797,995	\$8,541,533	\$21,598,686	\$21,598,686
Percent of Expenditures	5.6%	1.2%	3.5%	8.6%	8.3%

Source: MCPS

Comparison of Budgeted vs. Actual Revenue. Table 4-5 compares annual budgeted and actual revenue for the Active Employee Group Insurance Fund from FY08 to FY11. In this table, a variance that is “more than budget” represents extra revenue to the Fund. The data show that for these years:

- The actual revenue deposited each year into the Active Employee Group Insurance Fund was greater than budgeted. The amount of additional revenue ranged from \$2.8 million (or 1%) to \$6.3 million (or 3%) more than budgeted;
- MCPS’ Category 12 contribution to the Active Employee Group Insurance Fund exceeded the budgeted amount in FY08, FY09, and FY10, but not in FY11. The amount of additional contributions ranged from \$3 million (or 2%) to \$5.5 million (or 3%) more than budgeted.

Table 4-5. Budgeted vs. Actual Revenue: MCPS Active Employee Group Insurance Fund (\$’s in millions)

Group Insurance Fund Revenue	FY08		FY09		FY10		FY11	
	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual
Category 12 Contrib.	\$171.8	\$174.8	\$175.0	\$180.3	\$198.6	\$204.1	\$216.3	\$216.3
All Other	\$39.9	\$39.7	\$39.2	\$40.2	\$43.2	\$43.1	\$43.1	\$47.1
Total Revenue	\$211.7	\$214.5	\$214.2	\$220.5	\$241.8	\$247.2	\$259.4	\$263.4
Actual Revenue Variance from Budget	\$2.8 million <u>more</u> than budget		\$6.3 million <u>more</u> than budget		\$5.4 million <u>more</u> than budget		\$4.0 million <u>more</u> than budget	

Source: MCPS

Comparison of Budgeted vs. Actual Expenditures. Table 4-6 compares budgeted and actual group insurance expenditures for the Active Employee Group Insurance Fund from FY08 to FY11. In this table, a variance that is “less than budget” represents a savings to the Fund and a variance that is “more than budget” represents a shortfall to the Fund. The data show:

- Actual expenditures exceeded the budgeted amount in FY08 and FY09, were slightly lower than budgeted in FY10, and substantially lower than budgeted in FY11;
- The actual expenditures ranged from \$9.1 million (or 4%) less than budgeted to \$4.9 million (or 2%) more than budget; and
- Insurance claims were primarily responsible for expenditures exceeding the budget in FY08 and FY09, and for the expenditures savings compared to budget in FY11.

Table 4-6. Budgeted vs. Actual Expenditures: MCPS Active Employee Group Insurance Fund (\$'s in millions)

Group Insurance Fund Expenditures	FY08		FY09		FY10		FY11	
	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual
Claims	\$145.6	\$149.7	\$174.9	\$177.2	\$187.7	\$188.9	\$205.0	\$196.4
All Other	\$58.9	\$59.7	\$52.1	\$52.3	\$54.0	\$52.6	\$54.4	\$53.9
Total Expenditures	\$204.5	\$209.4	\$227.0	\$229.5	\$241.7	\$241.5	\$259.4	\$250.3
Actual Expenditures Variance from Budget	\$4.9 million <u>more</u> than budget		\$2.5 million <u>more</u> than budget		\$0.2 million <u>less</u> than budget		\$9.1 million <u>less</u> than budget	

Source: MCPS

Variation in Category 12 contributions. As noted in Table 4-5, the Category 12 contributions to the Active Employee Group Insurance Fund exceeded budgeted levels in FY08, FY09, and FY10. MCPS' year-end categorical transfer request memorandums (prepared for approval first by the Board of Education and the County Council, as required by law) report that the additional Category 12 contributions between FY08 and FY10 were made in order to increase the end-of-year fund balance.

In FY08 and FY09, the additional Category 12 contribution was funded through categorical transfers from other MCPS budget categories. In FY10, the additional contribution was funded through savings within other Category 12 components. Specifically:

- In FY08, MCPS contributed an additional \$3 million to the Active Employee Group Insurance Fund. MCPS' FY08 year-end categorical transfer request explained that: “Actual costs for the Employee Benefit Plan (EBP) were at budgeted levels. However, increased cost projections make it prudent to increase the contribution to the EBP reserve, as recommended by the County Council benefits consultant . . . These resources will be available in future years to offset unexpected cost increases.”⁶

⁶ FY 2008 Operating Budget Categorical Transfer memorandum, July 28, 2008. Attached at ©22.

- In FY09, MCPS contributed an additional \$3 million to the Active Employee Group Insurance Fund. MCPS' FY09 year-end categorical transfer request explained that: "Actual costs for the Employee Benefit Plan (EBP) were 2.5 percent higher than budgeted levels. In addition, increased costs projections make it prudent to increase the contribution to the EBP reserve by \$3,000,000, as recommended by the County Council benefits consultant. These resources will be available in future years to offset unexpected cost increases."⁷
- In FY10, MCPS contributed an additional \$5.5 million to the Active Employee Group Insurance Fund. MCPS' FY10 year-end categorical transfer request explained that: "Actual net costs for the Employee Benefit Plan (EBP) were 0.3 percent higher than budgeted levels. In addition, increased cost projections make it prudent to increase the contribution to the EBP reserve by \$5,500,000, as recommended by the County Council benefits consultant."⁸

Explanation of MCPS reference to County Council benefits consultant. In April 2003, Bolton Partners (an employee benefits consulting firm under contract to the County Council) issued a report for the Council's Management and Fiscal Policy Committee that reviewed group insurance programs offered by the County and bi-County agencies. The Bolton Partners' report made several recommendations, including a recommendation that each agency maintain a 5% fund balance in their respective group insurance funds.

In December 2003, the Council approved Resolution No. 15-454, *Policy Guidance for Agency Group Insurance Programs*, which endorsed four recommendations from the Bolton report; including that the agencies adhere to the proposed fund balance targets. The complete report by Bolton Partners and the approved resolution are in the Appendix (beginning at ©37).

2. Retiree Group Insurance Fund

Table 4-7 contains FY03 to FY11 data on annual expenditures and average expenditures per enrollee⁹ for MCPS' Retiree Group Insurance Fund; for FY12, the data reflect budgeted expenditures. In sum, during the past decade, retiree group insurance expenditures and expenditures per enrollee increased every year through FY10 before declining in FY11. Specifically, between FY03 and FY11:

- Annual group insurance expenditures increased 80%, from \$39.9 to \$72.0 million;
- Plan enrollment increased by 31%, from 5,657 to 7,424 retirees; and
- Average expenditures per enrollee grew by 38%, from \$7,054 to \$9,702.

MCPS' FY12 budget includes a 17% increase in Retiree Group Insurance Fund expenditures. Combined with an 11% increase in retiree plan enrollment, this budget amount translates into a 6% increase in average expenditures per enrollee.

⁷ FY 2009 Operating Budget Categorical Transfer memorandum, July 27, 2009. Attached at ©27.

⁸ Fiscal Year 2010 Operating Budget Categorical Transfer memorandum, July 26, 2010. Attached at ©32.

⁹ Average expenditures per enrollee controls for changes in number of retirees and plan enrollment. The enrollment data used for this calculation does not include covered dependents.

Table 4-7. MCPS Retiree Group Insurance Fund Expenditures, FY03-FY12

Group Insurance	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12 Budget
Enrollment*	5,657	5,942	6,161	6,382	6,583	6,858	7,011	7,131	7,424	8,266
Expenditures	\$39.9 million	\$43.3 million	\$47.7 million	\$54.7 million	\$59.8 million	\$63.0 million	\$66.5 million	\$73.9 million	\$72.0 million	\$84.6 million
Change from Prior Year	--	9%	10%	15%	9%	5%	5%	11%	(2%)	17%
Average Expenditures per Enrollee	\$7,054	\$7,285	\$7,745	\$8,412	\$9,077	\$9,190	\$9,481	\$10,358	\$9,702	\$10,235
Change from Prior Year	--	3%	6%	9%	8%	1%	3%	9%	(6%)	6%

*Medical plan enrollment as of July 1st each year. Does not include dependents.

Source: MCPS and OLO

Revenue, Expenditures, and Fund Balance. Table 4-8 contains data on the annual Retiree Group Insurance Fund revenue, expenditures, and resulting year-end fund balance from FY08 to FY11; for FY12 the table reflects budgeted data.

In FY11, the Fund's revenue exceeded expenditures by \$3.3 million; this resulted in a year-end fund balance of \$8.8 million, or 12.2% of FY11 actual expenditures. The data also show:

- The ending fund balance ranged from 7.5% to 14.8%; and
- MCPS' FY12 budget projects maintaining the \$8.8 million fund balance through the end of FY12, although the balance as a percent of expenditures would decline to 10.4%.

Table 4-8. MCPS Retiree Group Insurance Fund Revenue, Expenditures, and Year-End Fund Balance Levels

Retiree Group Insurance Fund	FY08	FY09	FY10	FY11	FY12 Budgeted
Beginning Balance	\$5,801,619	\$8,958,799	\$9,827,017	\$5,513,231	\$8,785,180
Revenue	\$66,181,591	\$67,339,627	\$69,547,481	\$75,297,003	\$84,603,576
Expenditures	\$63,024,411	\$66,471,409	\$73,861,267	\$72,025,056	\$84,603,576
Year-End Surplus/(Deficit)	\$3,157,180	\$868,218	(\$4,313,786)	\$3,271,947	--
Ending Balance	\$8,958,799	\$9,827,017	\$5,513,231	\$8,785,180	\$8,785,180
Percent of Expenditures	14.2%	14.8%	7.5%	12.2%	10.4%

Source: MCPS

Comparison of Budgeted vs. Actual Revenue. Table 4-9 compares annual budgeted and actual revenue for the Retiree Group Insurance Fund from FY08 to FY11. In this table, a variance that is “less than budget” represents a shortfall to the Fund. The data show that for these years:

- Revenue going into the Fund was lower than budgeted each year to varying degrees, however the Category 12 contribution was at the budgeted level each fiscal year; and
- Actual revenue ranged from \$0.2 million (or 0.3%) less than budgeted to \$2.7 million (or 3%) less than budgeted.

Table 4-9. Budgeted vs. Actual Revenue: MCPS Retiree Group Insurance Fund (\$'s in millions)

Group Insurance Fund Revenue	FY08		FY09		FY10		FY11	
	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual
Category 12 Contrib.	\$37.3	\$37.3	\$38.4	\$38.4	\$37.8	\$37.8	\$42.7	\$42.7
All Other	\$29.1	\$28.9	\$30.4	\$28.9	\$32.4	\$31.7	\$35.3	\$32.6
Total Revenue	\$66.4	\$66.2	\$68.8	\$67.3	\$70.2	\$69.5	\$78.0	\$75.3
Actual Revenue Variance from Budget	\$0.2 million less than budget		\$1.5 million less than budget		\$0.7 million less than budget		\$2.7 million less than budget	

Source: MCPS

Comparison of Budgeted vs. Actual Expenditures. Table 4-10 compares budgeted and actual group insurance expenditures for the Retiree Group Insurance Fund from FY08 to FY11. In this table, a variance that is “less than budget” represents a savings to the Fund and a variance that is “more than budget” represents a shortfall to the Fund. The data show that for these years:

- Actual expenditures ranged from \$3.3 million (or 5%) more than budgeted to \$7.3 million (or 9%) less than budgeted; and
- Insurance claims were primarily responsible for expenditures exceeding the budget in FY10 and for the expenditure savings compared to budget in FY08 and FY11.

Table 4-10. Budgeted vs. Actual Expenditures: MCPS Retiree Group Insurance Fund (\$'s in millions)

Group Insurance Fund Expenditures	FY08		FY09		FY10		FY11	
	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual
Claims	\$54.1	\$51.7	\$55.4	\$55.5	\$59.2	\$62.5	\$67.0	\$60.2
All Other	\$10.7	\$11.3	\$11.1	\$11.0	\$11.4	\$11.4	\$12.3	\$11.8
Total Expenditures	\$64.8	\$63.0	\$66.5	\$66.5	\$70.6	\$73.9	\$79.3	\$72.0
Actual Expenditures Variance from Budget	\$1.8 million less than budget		--		\$3.3 million more than budget		\$7.3 million less than budget	

Source: MCPS

C. Explanation of FY11 Surplus in the Active Employee Group Insurance Fund

As outlined earlier, MCPS' Active Employee Group Insurance Fund ended FY11 with a \$21.6 million fund balance. The final section of this chapter provides greater detail on the FY11 revenue and expenditure line-items, the variance between actual and budgeted amounts, and the reasons for those differences.

Chronology of Final FY12 Budget Actions. On May 26, 2011, the County Council approved the FY12 budget appropriation for MCPS that, among other changes, reduced the Category 12 appropriation from the Board of Education's request.¹⁰

The Council's reductions to the Category 12 budget assumed \$18.7 million in FY12 savings from potential MCPS changes to employee health and retirement benefits, with \$7 million of the savings from potential changes to health premium cost share. The Council President's May 16th memorandum to the Council recommending a package of budget actions related to employee benefits explained this action as follows:

The Council fully recognizes that decisions regarding the benefits offered to MCPS employees are the Montgomery County Board of Education's to make. The Council's package identifies the savings that would result if the Board of Education takes certain actions regarding the structure of employee retirement and health benefits. Specifically, the Council's package identifies savings associated with implementing changes to MCPS' locally-funded pension plans (Core and Supplement) that parallel those made by the State to the teachers' pension plan, and potential savings from adjusting the current 95/5 and 90/10 employer/employee health premium cost shares by five points.¹¹

On June 16th the Superintendent recommended and the Board of Education approved a series of reductions from the Board's initial budget request to align the final FY12 operating budget with the Council's appropriation.

In meeting the revised Category 12 budget, the Superintendent recommended a \$21.2 million reduction in employee benefit costs for FY12, with \$14.5 million of this amount coming from MCPS' budget for group insurance. Specifically, the Superintendent reported that the group insurance funds had achieved "significant savings" that allowed for a budget reduction in health benefit costs without changes to the premium cost share. A memorandum from the Superintendent to the Board of Education explained this action as follows:

Reductions in the cost of the Employee Benefit Plan, comprising employee health and life insurance plans for active and retired employees, total \$14.5 million. Savings result from a combination of participant usage patterns, health care prices, and participant plan selection. Employee health awareness, savings resulting from combined bidding of administrative services, and incentives designed to encourage employees to select more cost-effective health plan options have contributed to a significant savings. The dependent eligibility audit also had a positive effect

¹⁰ Montgomery County Council Resolution 17-150, Adopted May 26, 2011.

¹¹ Memo from Valerie Ervin, Council President, to County Council. *Council's Package: An Alternative to the Executive's Proposal on Employee Benefits*, May 16, 2011. Attached at ©63. Additional related FY12 budget correspondence between the County Council and the Board of Education is included in the Appendix (©67-101).

on plan experience. This enables MCPS to moderate health care costs without shifting increased costs to plan participants.¹²

The rest of this section details the savings that occurred in the Active Employee Group Insurance Fund during FY11.

FY11 Revenue and Expenditures Detail. For FY11, Table 4-11 breaks down the budgeted and actual revenue and expenditures in the Active Employee Group Insurance Fund by the different sources of revenue and types of expenditures.

As noted in the previous tables comparing budgeted vs. actual data, a revenue variance that is “more than budget” represents extra revenue to the Fund. Conversely, an expenditure variance that is “less than budget” represents a savings to the Fund.

Table 4-11. FY11 MCPS Active Employee Group Insurance Fund: Budgeted vs. Actuals by Revenue Sources and Types of Expenditures

Active Employee Group Insurance Fund	FY11 Budget	FY11 Actual	Actual Variance from Budget
Revenue			
Category 12 Contribution	\$216,252,358	\$216,252,358	--
Other Categories and Grants	\$17,611,140	\$18,359,305	\$748,165
Employee Contributions	\$20,841,998	\$21,365,140	\$523,142
Miscellaneous	\$4,651,762	\$7,376,532	\$2,724,770
Subtotal	\$259,357,258	\$263,353,334	\$3,996,077 more than budget
Expenditures			
Claims	\$205,015,842	\$196,411,062	\$8,604,780
Premiums	\$44,401,800	\$42,635,164	\$1,766,636
Administrative Services Fees	\$9,037,800	\$9,605,944	(\$568,144)
MCPS Admin. Expenses	\$901,816	\$1,644,011	(\$742,195)
Subtotal	\$259,357,258	\$250,296,181	\$9,061,077 less than budget
Total FY11 Fund Surplus (Actual Revenue minus Actual Expenditures)			\$13,057,154

Source: MCPS

¹² June 16, 2011 Memorandum from Jerry D. Weast, Superintendent of Schools, to Members of the Board of Education. *Final Adoption of the Fiscal Year 2012 Operating Budget*. Attached at ©66. Additional related FY12 budget correspondence between the County Council and the Board is included in the Appendix (©67-101).

End-of-Year Revenue Higher than Budgeted. Table 4-11 shows that the FY11 end-of-year revenue surplus was close to \$4 million, which equates to actual revenue that was 1.5% higher than budgeted.

Of this \$4 million, \$2.7 million (or 68%) occurred within “Miscellaneous” expenditures. More specifically, Fund data indicate that the line-item largely responsible for the revenue surplus was “Caremark rebates.” This line-item accounts for contractual rebates MCPS receives from its prescription drug vendor (currently Caremark) based on prescription drug usage by those enrolled in the Caremark prescription drug plan. In FY11, MCPS anticipated receiving approximately \$3.3 million in Caremark rebates but instead received \$6.0 million.

At OLO’s request, MCPS provided a written explanation (on 10/25/2011) for the additional rebate revenue in FY11 that is reproduced below in its entirety:

MCPS’ Explanation for Additional Rebate Revenue in FY11

The revenue surplus was a result of two items related to prescriptions. The first was a \$1,750,000 drug rebate from a prior period not previously recorded, and the second was \$1,000,000 from the Retiree Drug Subsidy (RDS) also from a prior period. RDS is the Medicare reimbursement subsidy established for retiree pharmacy programs.

Rebate revenues are budgeted based on the expectation that Caremark rebates and RDS funding will be distributed within the year they are earned. Caremark rebates are allocated between active and retiree plan budgets according to expected prescription utilization in each plan. Total rebates paid by Caremark of \$6,418,000 for the four quarters of Fiscal Year (FY) 2011 were \$400,000 greater than the projected amount for FY 2011; however, the payment from the prior period in FY 2010 of \$1,750,000 also was included in FY 2011.

RDS funds collected within a fiscal year can include prior year funds if prior year reconciliations were not available during that fiscal year. There was close to \$1 million collected during FY 2011 from a prior year. The RDS was created in 2005, and the ability to project the anticipated receipts during the first few years were limited by lack of data as well as prior experience with the systems and processes used by the federal government to generate the subsidy payments.

End-of-Year Expenditures Lower than Budgeted. Table 4-11 shows that the FY11 end-of-year expenditure savings was nearly \$9.1 million, which equates to actual expenditures that were 3.5% lower than budgeted.

Of this \$9.1 million, \$8.6 million (or 94%) resulted from lower than anticipated claims. More specifically, Fund data indicate that the line-items with the largest surplus in claims were MPCPS’ United Healthcare POS and HMO plans. Actual claims for each of the United Healthcare plans came in around \$4 million (or 8%) less than budgeted.

At OLO's request, MCPS provided a written explanation (on 10/25/2011) for the expenditure savings in FY11 that is reproduced below in its entirety:

MCPS' Explanation for Expenditures Savings in FY11

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. The pattern of positive claims experience by MCPS paralleled similar unexpected patterns in other governmental organizations including the county government and the federal government.

End-of-year expenditures were lower than budgeted for a combination of reasons. Expense surpluses were derived from \$4–6 million in reduced trend and utilization, \$500,000 from Caremark contract changes, and \$450,000 in fixed cost savings from plan marketings and ASO fee reductions.

The majority of the surplus is accounted for in the United Healthcare medical plans. Trend and utilization during FY 2011 in these United Healthcare plans were lower than expected. Trends used to set projections were 7.5 to 10 percent while the actual trend for active employees was less than 5 percent. This resulted in an estimated impact of \$3 to \$4 million.

Inpatient admissions were down 2.4 percent resulting in an 8.5 percent reduction in inpatient net paid per member per month (PMPM) expenses. CareFirst utilization also was less than expected and actual trend rates were below 5 percent compared to expected trends of 7 to 8 percent resulting in an estimated impact of \$1 million.

Caremark prescription drug contract terms were negotiated during this time, resulting in approximately \$500,000 savings in FY 2011 that would not have been accounted for when the FY 2011 budget was established. In addition, actual trend rates were lower than expected, resulting in further reduced claims.

Finally, medical, dental, vision, and life insurance plans were negotiated through the procurement process with new fixed fees effective January 1, 2011. The FY 2011 budget assumed no increases with maintaining the current fee structures. Actual negotiated fees resulted in over \$900,000 savings, half of which impacted the FY 2011 budget.

FY11 Expenditures by Quarter. At the beginning of each fiscal year, based on the budget for each line-item in the Active Employee Group Insurance Fund, MCPS develops a schedule of projected monthly revenue and expenditures. During the fiscal year, MCPS tracks the actual revenue into and expenditures from the Fund each month. As noted above, during FY11, actual expenditures totaled less than budgeted expenditures, a trend which resulted in an end-of-year variance of about \$9.1 million or 3.5%.

Table 4-12 contains quarterly data that tracks how actual expenditures were lower than projected expenditures throughout the fiscal year. The final line of the table tracks the cumulative savings at the end of each quarter. A review of the monthly Fund data indicates that:

- At the beginning of the fiscal year, Fund expenditures were projected to be \$2.2 million lower than originally budgeted;
- The rest of the expenditure savings accumulated over the first three quarters of FY11; and
- The largest dollar savings occurred in the 2nd Quarter (October-December) of FY11 when expenditures were \$4.5 million lower than projected.

As a result, the cumulative expenditures from the Active Employee Group Insurance Fund were running \$7.6 million lower than projected midway through the fiscal year (12/30/2010).

Table 4-12. MCPS Active Employee Group Insurance Fund FY11 Expenditures by Quarter (\$ in millions)

Expenditures	Initial Projected Savings	1st Quarter (July-Sep.)	2nd Quarter (Oct.-Dec.)	3rd Quarter (Jan.-March)	4th Quarter (April-June)
Projected	--	\$62.3	\$63.2	\$64.7	\$67.0
Actual	--	\$61.4	\$58.7	\$63.3	\$67.0
Difference	--	+\$0.9	+\$4.5	+\$1.4	--
Cumulative Savings	+\$2.2	+\$3.1	+\$7.6	+\$9.0	+\$9.0*

*Cumulative savings does not add up to \$9.1 million due to rounding.

Source: MCPS

CHAPTER V. FINDINGS

This chapter presents the Office of Legislative Oversight's (OLO) findings. The organization parallels the structure of OLO's review of MCPS' Budget Category 12 in previous chapters:

- Overview of Budget Category 12;
- Retirement Benefit Budget and Pension Fund; and
- Group Insurance Expenditures.

Chapter VI (begins on page 48) contains OLO's recommendations for Council action and issues for discussion with representatives of MCPS.

OVERVIEW OF BUDGET CATEGORY 12

Finding #1: MCPS' Budget Category 12 consists of nine expenditure components, primarily to fund employee benefits.

State law requires that the County Council appropriate funds to MCPS in standardized budget categories. This report focuses on one of these categories: Category 12, Fixed Charges. The box below contains the definition of Category 12 from the Maryland State Department of Education.

Category 12: Fixed Charges. Charges of a generally recurring nature which are not readily allocable to other expenditure categories. Included are:

- Local school board contributions to employee retirement and social security;
- Employee insurance benefits (health, life, accident, disability, etc);
- Fidelity insurance, personal liability insurance, and judgments;
- Interest on current loans; and
- Personnel tuition reimbursement for all staff

Source: Maryland State Department of Education, *Financial Reporting Manual for Maryland Public Schools (Revised 2009)*, pg. 61.

After the County Council appropriates funds to Category 12, the Board of Education makes final decisions on how to allocate the funds within Category 12. Under the State's definition, the Board of Education budgets the following nine expenditure components in Category 12:

- Group Insurance (Active and Retiree)
- FICA (Social Security and Medicare)
- Retirement
- Non-Tax Supported Grants
- Risk Management/Self-Insurance
- Tuition Reimbursement
- Miscellaneous
- Partnership Tuition
- Other Post-Employment Benefits (OPEB)

Category 12 contains funding for 97.5% of MCPS' locally-funded employee benefit costs.¹ The remaining 2.5% is budgeted in MCPS enterprise funds.

¹ Excluding employee pension costs paid by the State.

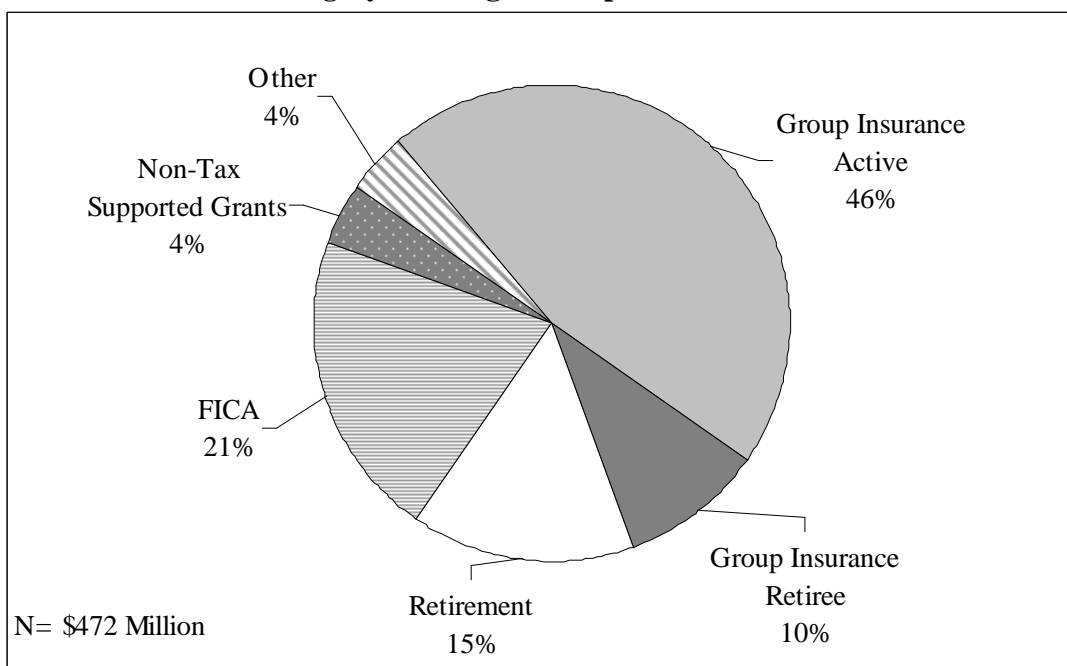
Finding #2: During the past decade, MCPS' Category 12 budget expenditures doubled and the relative portions of the various expenditure components changed.

MCPS' approved FY12 budget for Category 12 is \$472 million, more than double what it was ten years ago. In FY03, Category 12 expenditures represented 18% of MCPS total budget (excluding enterprise funds); in FY12, this percent has increased to 23%.

A review of Category 12 expenditures since FY03 shows that:

- Actual expenditures increased 101% between FY03 and FY12, with a reduced rate of annual growth in recent years. The Category 12 budget for FY12 is the smallest annual increase (2%) in the past decade.
- Costs for retirement benefits and group insurance benefits are expected to account for approximately 71% of all Category 12 spending in FY12.
- The relative distribution of expenditures within Category 12 shifted during the last decade. Today, the portions for group insurance and retirement are larger and the portion for FICA (social security and Medicare) is smaller.

Category 12 Budgeted Expenditures FY12



Comparison of Actuals to Budgeted Expenditures. Although MCPS' total actual Category 12 expenditures exceeded the budgeted levels in seven of the past nine years, the variance between budgeted and actual expenditures was no greater than 2% in any given year. When examined by component, the largest percent variations (between budgeted and actual expenditures) occurred in the smaller components of tuition reimbursement and partnership tuition. For the largest components of Category 12 spending, (active employee group insurance, FICA, retirement, and retiree group insurance) actual expenditures in FY11 were within 1% of the budgeted amounts.

RETIREMENT BENEFIT BUDGET AND PENSION FUND

Finding #3: 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.

Permanent MCPS employees participate in a defined benefit retirement plan, also known as a pension plan. Nearly one quarter of permanent employees (mostly non-teaching positions) receive a County-funded “core” pension benefit. In addition, all permanent employees (both teaching and non-teaching positions) receive a County-funded “supplemental” pension benefit.

Pension contributions from MCPS and its employees are deposited in the “pension fund,” a fiduciary account established to collect money needed to pay pension benefits and associated expenses. MCPS contracts with an actuary to calculate its annual required contribution to the pension fund. The actuary recommends the annual required contribution based on a series of assumptions (such as rate of investment return and future pension liabilities) approved by the Board of Education.

For FY12, the Board of Education approved the actuary’s recommendation that MCPS make a pension fund contribution of \$77.8 million. In addition, MCPS employees will contribute an estimated \$20 million in FY12 to the locally-funded pension fund.

The FY12 MCPS contribution of \$77.8 million represents a 369% increase over the \$16.6 million contribution made in FY03 (ten years ago). This sharp growth in pension costs is a function of multiple factors including benefit enhancements, salary increases, lower than assumed investment returns, and growth in workforce size.

Finding #4: The most recent valuation (October 2011) reports that MCPS’ pension fund assets are sufficient to cover 70% of its current liabilities.

The “funded ratio” is a common measure of the financial status of a pension fund. The funded ratio refers to the percentage of a pension plan’s liabilities covered by the current actuarial value of the plan’s assets. In other words, the funded ratio measures the extent to which a pension plan has funds set aside to pay the accrued pension benefits of its members.

MCPS’ most recent pension valuation (October 2011) includes a calculation of the funded ratio of the pension plan as of June 30, 2011. This valuation reports that the funded ratio for MCPS’ pension fund is 70.1%. This calculation is based upon assets of \$1.02 billion and an accrued liability of \$1.45 billion. A decade ago (FY03), the funded ratio of MCPS’ pension fund was 102.1%.

Two primary factors contributed to the decline in MCPS’ funded ratio: pension benefit enhancements and investment performance.

Plan Enhancements. In 2006, the Board of Education increased the “core” pension benefit (for participants in the locally-funded plan) and made the increase retroactive to 1998; this enhancement to the County-funded pension plan was identical to the one made that same year for participants in the State-funded pension plan. In addition, the Board increased the “supplemental” benefit (also retroactive to 1998) for all permanent employees, including participants in the State-run plan.

Concurrent with the 2006 plan enhancements, the Board increased the amount that employees must contribute for the “core” benefit” from 2% to 5% of salary (phased in over three years). The Board also raised the employee contribution for the “supplemental” benefit from 0.2% to 0.5% of salary (phased in over three years). Notwithstanding this increase in employee contributions, the 2006 plan enhancements greatly increased MCPS’ liability for future pension benefits. As a result, the pension fund’s funded ratio declined since MCPS had not previously contributed to cover this additional liability.

Investment Performance. As directed by the Board of Education, 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 investments return an amount less than 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. While investment gains in FY10 and FY11 offset most of the losses from the previous two years, the funded ratio has continued to decline, in part, because the average annual investment return (over the past five years) has fallen below the assumed rate of 7.5%.

Finding #5: 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.

In 2011, the Board of Education made two important changes to the MCPS pension plan. The Board raised the employee contribution for the locally-funded “core” benefit from 5% to 7% of salary. In addition, the Board lowered the cap on cost-of-living adjustments and reduced the pension benefit for new hires. This package of changes mirrored action taken by the General Assembly for the employees in the State-funded system. According to MCPS’ actuary, these modifications will result in a FY13 pension fund contribution that is similar to the FY12 amount.

While annual MCPS pension costs may change little from FY12 to FY13, the historic trend of large annual increases is projected to return. 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).

Any increases in MCPS’ payroll that result from workforce growth and/or pay increases will further increase required pension plan contributions. Moreover, as with any pension system, MCPS pension costs also are subject to change if other actuarial assumptions (such as retiree life expectancy or investment performance) differ from what actually occurs.

GROUP INSURANCE EXPENDITURES

Finding #6: At the end of FY11, MCPS had a \$21.6 million (or 8.6%) fund balance in its Active Employee Group Insurance Fund.

At the beginning of FY11 (July 1, 2010), the 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. The beginning year balance of \$8.5 million combined with the \$13.1 million “surplus” during the year resulted in an end of fiscal year (June 30, 2011) balance of \$21.6 million.

MCPS Active Employee Group Insurance Fund

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

FY11 Surplus. The \$13.1 million surplus in FY11 resulted from a combination of higher than budgeted revenue and lower than budgeted expenditures. Actual revenue into the Fund exceeded MCPS’ budget by about \$4 million (1.5% of total budgeted revenue). About 68% of this amount came from greater than anticipated prescription drug rebates or reimbursements. According to MCPS, the revenue surplus resulted from prescription drug rebate and Retiree Drug Subsidy revenue from FY10 that was recorded in FY11. (See page 37 for more details).

Actual expenditures from the Fund were lower than MCPS’ budget by about \$9.1 million (3.5% of total budgeted expenditures). About 94% of this amount resulted from lower than anticipated claims. According to MCPS, this trend of reduced utilization was unexpected and paralleled similar unexpected patterns in other governmental organizations. MCPS also noted reduced inpatient admissions as a cost savings factors. (See page 37 for more details).

Fund Balance Levels. Compared with recent years, the \$21.6 million balance in the Active Employee Group Insurance Fund at the end of FY11 is larger in terms of total dollars and as a percent of expenditures. As summarized in the table below, the balance in the Fund has fluctuated considerably from year-to-year, reflecting years where revenues exceeded expenditures and years where expenditures exceeded revenues.

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

Finding #7: 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.

At the beginning of each fiscal year, based on the budget for each line item in the Active Employee Group Insurance Fund, MCPS develops a schedule of projected monthly revenue and expenditures. During the fiscal year, MCPS tracks the actual revenue into and expenditures from the Fund each month.

While total Active Employee Group Insurance Fund expenditures increased by 4% in FY11, the actual increase was less than the budgeted increase. Specifically, as noted in Finding #6, actual expenditures from the Fund were lower than budgeted by about \$9.1 million in FY11. A review of the monthly Fund data indicates that:

- At the beginning of the fiscal year, Fund expenditures were projected to be \$2.2 million lower than originally budgeted;
- The rest of the expenditure savings accumulated over the first three quarters of FY11; and
- The largest dollar savings occurred in the 2nd Quarter (October-December) of FY11 when expenditures were \$4.5 million lower than projected.

As a result, the cumulative expenditures from the Active Employee Group Insurance Fund were running \$7.6 million lower than projected midway through the fiscal year (12/31/2010).

MCPS notes that while savings were accumulating in the first half of 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.” (See page 38 for more detail).

**MCPS Active Employee Group Insurance Fund FY11 Expenditure Savings by Quarter
(\$'s in millions)**

Expenditures	Initial Projected Savings	1st Quarter (July-Sep.)	2nd Quarter (Oct.-Dec.)	3rd Quarter (Jan.-March)	4th Quarter (April-June)
Budgeted	--	\$62.3	\$63.2	\$64.7	\$67.0
Actual	--	\$61.4	\$58.7	\$63.3	\$67.0
Difference	--	+\$0.9	+\$4.5	+\$1.4	--
Cumulative Savings	+\$2.2	+\$3.1	+\$7.6	+\$9.0	+\$9.0*

*Cumulative savings does not add up to \$9.1 million due to rounding.

Finding #8: 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 or Retiree Group Insurance Fund.

MCPS uses projections from a health benefits actuarial consultant to develop its annual budget request for group insurance (for each fiscal year) and its annual group insurance plan premiums (for each calendar year). The projections take into account numerous factors and assumptions, including plan enrollment, actual plan expenditures, and industry-wide health care cost 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. However, MCPS has not adopted a formal policy to establish a target fund balance amount in either group insurance fund.

MCPS staff note that several factors complicate budgeting for group insurance expenditures, any and all of which can lead to variances between budgeted and actual expenditures. The primary factors, listed below, similarly apply to the other County-funded agencies.

- **MCPS is largely self-insured and group insurance expenditures each year result from actual health care use by plan participants.** In any given year, health care use can vary unexpectedly for multiple reasons. Self-insured plans bear the immediate financial "risk" for unanticipated expenditures and the immediate "benefit" from unanticipated savings.
- **Group insurance plans operate on a calendar year basis while budgets are approved on a fiscal year basis.** As a result, changes during the fiscal year (such as how many employees choose to switch health plans during open enrollment season) may not have been fully anticipated at the time cost projections were prepared for the budget.
- **Many months elapse between budget development and the beginning of the fiscal year.** When MCPS develops its recommended budget for group insurance each fall, it uses cost projections based on the actual expenditures and experience over the most recent 12 months. By the time the fiscal year begins in July, expenditure trends may have varied from the projection prepared the previous fall.

Given the budgeting complications noted above, it is not unexpected that actual MCPS Active Employee and Retiree Group Insurance Fund expenditures vary to some degree from budget projections. Because the largest single cost driver in self-insured plans is health care claims, it is not surprising that a variance between budgeted and actual expenditures is attributable to claims being higher or lower than projected.

Finding #9: In FY08, FY09, and FY10, MCPS increased the ending balance in the Active Employee Group Insurance Fund through year-end transfers into the Fund.

In FY08, FY09, and FY10, MCPS' Category 12 contribution to the Active Employee Group Insurance Fund exceeded the total approved budgeted amounts for each year. MCPS' year-end categorical transfer request memorandums (prepared for approval first by the Board of Education and the County Council, as required by law) report that the additional Category 12 contributions in these years were made in order to increase the end-of-year fund balance.² Specifically:

- In FY08 and FY09, MCPS contributed an additional \$3 million (each year) to the Active Employees Group Insurance Fund. These additional contributions were funded through end-of-year categorical transfers from other MCPS budget categories. In FY09, the transfer was necessary to prevent the Fund from ending the year with a deficit due to higher than budgeted expenditures.
- In FY10, MCPS contributed an additional \$5.5 million to the Active Employee Group Insurance Fund. This additional contribution was funded through reallocating funds from other components within Category 12, and did not require a categorical transfer.

Explanation of MCPS' reference to County Council benefits consultant. In the categorical transfer memorandums, MCPS refers to the increased contribution to the group insurance fund balance as "recommended by the County Council benefits consultant." This reference is to an April 2003 report issued by Bolton Partners to the Council's Management and Fiscal Policy Committee. The Bolton Partners report made several recommendations related to County and bi-County agency group insurance programs, including a recommendation that each agency maintain a five percent fund balance in their respective group insurance funds.

In December 2003, the Council approved Resolution No. 15-454, *Policy Guidance for Agency Group Insurance Programs*, which endorsed four recommendations from the Bolton report; including that the agencies adhere to the proposed fund balance targets. The complete report by Bolton Partners and the approved resolution are in the Appendix (beginning at ©37).

² The year-end categorical transfer request memorandums for FY08, FY09, and FY10 are included in their entirety in the Appendix beginning at ©22.

CHAPTER VI. 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.

This chapter outlines OLO's recommendations for Council action and issues for Council discussion with MCPS representatives.

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% (see Appendix at ©60).

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?

In sum, OLO recommends that the Council designate at least two specific times each year to sit down with MCPS representatives to discuss supplemental information compiled by MCPS regarding budget Category 12. Remaining current with the changes that occur with Category 12's revenues and expenditures throughout the fiscal year will better position the Council to ask timely questions, exercise their fiscal oversight responsibilities, and make informed budget decisions.

CHAPTER VII. AGENCY COMMENTS

The Office of Legislative Oversight circulated a final draft of this report to the Chief Operating Officer of Montgomery County Public Schools. OLO appreciates the time taken by agency representatives to review the draft report and provide comments. OLO's final report incorporates technical corrections provided by MCPS staff.

The written comments received from MCPS are attached in their entirety, beginning on the following page.

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

Office of the Chief Operating Officer

850 Hungerford Drive, Room 149 ♦ Rockville, Maryland 20850 ♦ 301-279-3626

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

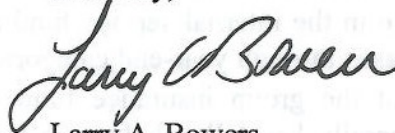
- MCPS agrees with Finding #2 that actual Category 12 expenditures have varied only slightly from budgeted expenditures. This is a challenging goal for group insurance expenditures, primarily because large claims in self-insured plans are unpredictable and can vary greatly from year to year. In seven 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

APPENDICES

Document	Begins on ©
Summary Tables: Category 12 Expenditures (Budgeted and Actual) FY03-FY12 by Component, Provided by MCPS	1
Details of MCPS Pension Plan Provisions, excerpted from <i>Understanding Your Retirement</i> , October 2011	12
MCPS Board of Education Policy GIG	19
Memorandum from Jerry Weast, Superintendent of Schools, to Members of the Board of Education. <i>FY 2008 Operating Budget Categorical Transfer</i> , July 28, 2008	22
Memorandum from Jerry Weast, Superintendent of Schools, to Members of the Board of Education. <i>FY 2009 Operating Budget Categorical Transfer</i> , July 27, 2009	27
Memorandum from Jerry Weast, Superintendent of Schools, to Members of the Board of Education. <i>Fiscal Year 2010 Operating Budget Categorical Transfer</i> , July 26, 2010	32
<i>Review of Group Insurance Programs for the Management and Fiscal Policy Committee</i> , Bolton Partners, Inc., April 16, 2003	37
Council Resolution 15-454 – Policy Guidance for Agency Group Insurance Programs	60
Memorandum from Valerie Ervin, Council President, to County Council. <i>Council's Package: An Alternative to the Executive's Proposal on Employee Benefits</i> , May 16, 2011	63
Memorandum from Jerry Weast, Superintendent of Schools, to Members of the Board of Education. <i>Final Adoption of the Fiscal Year 2012 Operating Budget</i> , June 16, 2011	66
Memorandum from Jerry Weast, Superintendent of Schools, to Members of the Board of Education. <i>Tentative Action on the Fiscal Year 2012 Operating Budget</i> , May 23, 2011	76
Memorandum from Valerie Ervin, Council President, to Christopher Barclay, Board of Education President. <i>FY12 MCPS Budget</i> , June 6, 2011	91
June 8, 2011 Letter from Christopher Barclay, Board of Education President, to Valerie Ervin, Council President	92
Memorandum from Valerie Ervin, Council President, to County Council. <i>Resolution to add Review of MCPS Category 12 to Office of Legislative Oversight's FY 2011 Work Program</i> , June 17, 2011	96
June 17, 2011 Letter from Christopher Barclay, Board of Education President, to Valerie Ervin, Council President	99

APPENDIX

Summary Tables: Category 12 Expenditures (Budgeted and Actual) FY03-FY12 by Component

Source: MCPS Staff, Original Document Provided July 25, 2011, Updated Document with FY11 Actuals and FY12 Budgeted Provided September 9, 2011; Variance Calculated by Office of Legislative Oversight

Category 12 Annual Expenditures / Fund Contributions

Social Security

Tax Supported

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	70,625,296	76,793,147	79,186,293	83,976,624	89,240,819	95,965,656	102,247,140	101,060,735	102,829,772	101,881,930
BOE Final (June)	70,915,228	75,393,844	79,004,188	83,572,931	89,157,299	95,540,360	100,786,986	101,060,735	99,157,055	98,871,839
Actual	69,503,135	74,811,645	78,395,415	83,123,949	88,927,327	94,656,558	99,519,617	100,610,094	98,946,892	--
Variance	(1,412,093)	(582,199)	(608,773)	(448,982)	(229,972)	(883,802)	(1,267,369)	(450,641)	(210,163)	
Variance %	-2%	-1%	-1%	-1%	0%	-1%	-1%	0%	0%	

Non-Tax Supported

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	5,874,359	6,021,354	4,996,065
BOE Final (June)	N/A	N/A	N/A	N/A	N/A	N/A	3,751,948	5,874,359	6,129,682	4,931,677
Actual	N/A	N/A	N/A	N/A	N/A	N/A	4,686,545	5,771,650	6,056,314	--
Variance	N/A	N/A	N/A	N/A	N/A	N/A	934,597	(102,709)	(73,368)	
Variance %	N/A	N/A	N/A	N/A	N/A	N/A	25%	-2%	-1%	

Total

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	106,935,094	108,851,126	106,877,995
BOE Final (June)	N/A	N/A	N/A	N/A	N/A	N/A	104,538,934	106,935,094	105,286,737	103,803,516
Actual	N/A	N/A	N/A	N/A	N/A	N/A	104,206,162	106,381,744	105,003,206	--
Variance	N/A	N/A	N/A	N/A	N/A	N/A	(332,772)	(553,350)	(283,531)	
Variance %	N/A	N/A	N/A	N/A	N/A	N/A	0%	-1%	0%	

NOTES:

Data Source: BMA and backup worksheets

Amounts for Non-Tax Supported not isolated in separate general ledger accounts prior to the FY 09 Final Budget.

Category 12 Annual Expenditures / Fund Contributions

Retirement Fund Contributions

Tax Supported

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	16,341,121	20,199,146	27,757,274	35,384,384	42,538,181	56,718,684	59,589,311	63,763,669	64,067,873	71,153,041
BOE Final (June)	16,411,614	19,905,122	27,742,617	35,189,710	55,702,204	56,513,644	58,981,200	59,419,658	62,422,441	65,442,044
Actual	16,428,670	19,821,944	27,917,203	35,189,710	55,705,804	56,651,146	59,719,558	59,580,157	62,019,905	--
Variance	17,056	(83,178)	174,586	0	3,600	137,502	738,358	160,499	(402,536)	
Variance %	0%	0%	1%	0%	0%	0%	1%	0%	-1%	

Non-Tax Supported

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	8,680,937	9,072,460	12,243,509
BOE Final (June)	N/A	N/A	N/A	N/A	N/A	N/A	6,548,053	8,705,513	8,653,645	12,346,428
Actual	N/A	N/A	N/A	N/A	N/A	N/A	6,629,233	8,935,983	9,270,437	--
Variance	N/A	N/A	N/A	N/A	N/A	N/A	81,180	230,470	616,792	
Variance %	N/A	N/A	N/A	N/A	N/A	N/A	1%	3%	7%	

Total

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	72,444,606	73,140,333	83,396,550
BOE Final (June)	N/A	N/A	N/A	N/A	N/A	N/A	65,529,253	68,125,171	71,076,086	77,788,472
Actual	N/A	N/A	N/A	N/A	N/A	N/A	66,348,791	68,516,140	71,290,342	--
Variance	N/A	N/A	N/A	N/A	N/A	N/A	819,538	390,969	214,256	
Variance %	N/A	N/A	N/A	N/A	N/A	N/A	1%	1%	0%	

NOTES:

Data Source: BMA and backup worksheets

Both FY 2012 Request and FY 2012 Final tax supported numbers include a \$4,377,655 budget shift from local funds to grant funds for the Jobs Education Fund

Both FY 2011 Tax supported budget and FY 2011 tax supported actuals contain the \$17,510,621 funds for the Jobs Education Fund

Amounts for Non-Tax Supported not isolated in separate general ledger accounts prior to the FY 09 Final Budget.

Category 12 Annual Expenditures / Fund Contributions

Active Employee Group Insurance

Tax Supported Appropriation

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	93,935,391	116,380,526	134,814,167	144,718,429	163,957,297	174,234,117	179,560,959	206,482,768	221,448,717	232,326,432
BOE Final (June)	94,568,107	116,295,929	134,472,850	144,355,575	163,640,219	171,806,039	174,970,684	198,437,624	216,235,797	215,479,233
Actual	95,568,107	119,450,237	134,808,793	143,996,295	163,097,978	175,402,265	183,053,381	205,809,932	216,495,691	--
Variance	1,000,000	3,154,308	335,943	(359,280)	(542,241)	3,596,226	8,082,697	7,372,308	259,894	
Variance %	1%	3%	0%	0%	0%	2%	5%	4%	0%	

Non-Tax Supported

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	NA	NA	NA	NA	NA	NA	N/A	15,896,717	16,357,146	16,675,470
BOE Final (June)	NA	NA	NA	NA	NA	NA	13,491,512	16,841,861	16,838,606	15,258,374
Actual	NA	NA	NA	NA	NA	NA	11,694,563	14,640,046	16,771,270	--
Variance							(1,796,949)	(2,201,815)	(67,336)	
Variance %							-13%	-13%	0%	

Total

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	NA	NA	NA	NA	NA	NA	N/A	222,379,485	237,805,863	249,001,902
BOE Final (June)	NA	NA	NA	NA	NA	NA	188,462,196	215,279,485	233,074,403	230,737,607
Actual	NA	NA	NA	NA	NA	NA	194,747,944	220,449,978	233,266,961	--
Variance							6,285,748	5,170,493	192,558	
Variance %							3%	2%	0%	

NOTES:

Data Source: BMA and backup worksheets

Amounts for Non-Tax Supported not isolated in separate general ledger accounts prior to the FY 09 Final Budget.

Total Tax Supported amounts reduced by the Employee Benefit Plan amounts for retirees which are all tax supported

Category 12 Annual Expenditures / Fund Contributions
Risk Management Fund Contributions
(Self Insurance)

Tax Supported

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	8,984,875	10,142,841	12,981,152	13,166,885	8,072,434	8,816,602	7,500,905	9,452,775	13,109,272	15,527,152
BOE Final (June)	8,984,875	10,142,841	12,981,152	13,166,885	8,072,434	7,904,802	7,500,905	9,452,775	13,109,272	15,527,152
Actual	8,984,875	10,142,841	12,981,152	13,166,885	8,072,434	7,904,802	7,500,905	9,452,775	13,121,576	--
Variance	0	0	0	0	0	0	0	0	12,304	
Variance %	0%	0%	0%	0%	0%	0%	0%	0%	0%	

Non-Tax Supported

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	338,425	378,479	607,978	616,975	342,896	370,718	299,495	299,495	496,348	496,348
BOE Final (June)	338,425	378,479	607,978	616,975	342,896	370,718	299,495	299,495	496,348	496,348
Actual	338,425	378,479	607,978	616,975	342,896	370,718	299,495	299,495	496,348	--
Variance	0	0	0	0	0	0	0	0	0	
Variance %	0%	0%	0%	0%	0%	0%	0%	0%	0%	

Total

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	9,323,300	10,521,320	13,589,130	13,783,860	8,415,330	9,187,320	7,800,400	9,752,270	13,605,620	16,023,500
BOE Final (June)	9,323,300	10,521,320	13,589,130	13,783,860	8,415,330	8,275,520	7,800,400	9,752,270	13,605,620	16,023,500
Actual	9,323,300	10,521,320	13,589,130	13,783,860	8,415,330	8,275,520	7,800,400	9,752,270	13,605,620	--
Variance	0	0	0	0	0	0	0	0	0	
Variance %	0%	0%	0%	0%	0%	0%	0%	0%	0%	

NOTES:

Data Source: BMA and backup worksheets

Risk Insurance is paid to the county. All are considered Tax Supported except for the allocation of Workers Compensation to Food Services

Category 12 Annual Expenditures / Fund Contributions

Tuition Reimbursement

Tax Supported

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	1,357,698	1,367,698	1,367,698	1,688,844	2,388,844	2,588,844	3,488,844	3,888,844	4,088,844	4,088,844
BOE Final (June)	1,357,698	1,367,698	1,367,698	1,688,844	2,388,844	2,588,844	3,488,844	3,888,844	4,088,844	3,039,746
Actual	1,602,163	1,984,213	2,221,923	2,517,393	3,347,804	3,597,350	3,883,005	3,602,212	3,826,537	--
Variance	244,465	616,515	854,225	828,549	958,960	1,008,506	394,161	(286,632)	(262,307)	
Variance %	18%	45%	62%	49%	40%	39%	11%	-7%	-6%	

Non-Tax Supported

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)										
BOE Final (June)										
Actual										--
Variance										
Variance %										

Total

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	1,357,698	1,367,698	1,367,698	1,688,844	2,388,844	2,588,844	3,488,844	3,888,844	4,088,844	4,088,844
BOE Final (June)	1,357,698	1,367,698	1,367,698	1,688,844	2,388,844	2,588,844	3,488,844	3,888,844	4,088,844	3,039,746
Actual	1,602,163	1,984,213	2,221,923	2,517,393	3,347,804	3,597,350	3,883,005	3,602,212	3,826,537	--
Variance	244,465	616,515	854,225	828,549	958,960	1,008,506	394,161	(286,632)	(262,307)	
Variance %	18%	45%	62%	49%	40%	39%	11%	-7%	-6%	

NOTES:

Data Source: BMA and backup worksheets

All tuition reimbursements are tax supported

Category 12 Annual Expenditures / Fund Contributions

Partnership Tuition

Tax Supported

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	2,044,774	1,703,052	1,852,338	1,986,238	1,993,786	2,699,901	2,316,818	1,816,239	1,638,239	1,493,776
BOE Final (June)	2,044,774	1,703,052	1,852,338	1,986,238	1,993,786	2,699,901	2,316,818	1,638,239	1,638,239	1,493,776
Actual	2,044,774	1,402,053	1,228,605	1,819,431	1,889,159	2,078,657	1,566,247	1,317,073	1,202,060	--
Variance	0	(300,999)	(623,733)	(166,807)	(104,627)	(621,244)	(750,571)	(321,166)	(436,179)	
Variance %	0%	-18%	-34%	-8%	-5%	-23%	-32%	-20%	-27%	

Non-Tax Supported

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)										
BOE Final (June)										
Actual										--
Variance										
Variance %										

Total

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	2,044,774	1,703,052	1,852,338	1,986,238	1,993,786	2,699,901	2,316,818	1,816,239	1,638,239	1,493,776
BOE Final (June)	2,044,774	1,703,052	1,852,338	1,986,238	1,993,786	2,699,901	2,316,818	1,638,239	1,638,239	1,493,776
Actual	2,044,774	1,402,053	1,228,605	1,819,431	1,889,159	2,078,657	1,566,247	1,317,073	1,202,060	--
Variance	0	(300,999)	(623,733)	(166,807)	(104,627)	(621,244)	(750,571)	(321,166)	(436,179)	
Variance %	0%	-18%	-34%	-8%	-5%	-23%	-32%	-20%	-27%	

NOTES:

Data Source: BMA and backup worksheets

All Partnership Tuition Expenses are tax supported

Category 12 Annual Expenditures / Fund Contributions

Grant Funded Employee Benefits

Non-Tax Supported

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)	17,757,247	11,023,933	11,570,944	12,094,148	13,106,205	13,751,414	14,490,815	20,955,720	21,628,840	23,163,753
BOE Final (June)	18,991,148	11,330,100	11,925,381	12,352,963	13,835,444	14,668,851	14,119,786	21,768,909	21,907,105	21,782,241
Actual	19,801,274	12,167,265	14,115,906	15,819,094	15,390,803	16,405,300	16,115,778	21,745,246	21,930,642	--
Variance	810,126	837,165	2,190,525	3,466,131	1,555,359	1,736,449	1,995,992	(23,663)	23,537	
Variance %	4%	7%	18%	28%	11%	12%	14%	0%	0%	

NOTES:

Data Source: BMA

Amounts include unemployment, workers compensation, employee health benefits, social security, and retirement

Category 12 Annual Expenditures / Fund Contributions

Enterprise Funded Employee Benefits

Non-Tax Supported

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BOE Request (Feb.)								10,899,437	10,962,256	11,823,578
BOE Final (June)	6,719,136	7,983,726	8,498,013	9,353,462	9,718,123	10,243,235	10,786,961	10,899,437	10,930,160	11,803,222
Actual	6,442,367	7,709,003	8,385,741	9,006,434	9,327,876	9,887,448	8,574,197	8,588,295	10,716,393	--
Variance	(276,769)	(274,723)	(112,272)	(347,028)	(390,247)	(355,787)	(2,212,764)	(2,311,142)	(213,767)	
Variance %	-4%	-3%	-1%	-4%	-4%	-3%	-21%	-21%	-2%	

NOTES:

Data Source: BMA

Amounts include unemployment, workers compensation, employee health benefits, social security, and retirement

Understanding Your Retirement Employees' Retirement Pension System

RETIREMENT BENEFITS,
PROCESS, AND FORMS

OCTOBER 2011



EMPLOYEE & RETIREE SERVICE CENTER

45 W. Gude Drive, Suite 1200, Rockville, MD 20850

301-517-8100

www.montgomeryschoolsmd.org/departments/ersc



ROCKVILLE, MD

Eligibility for Retirement

Eligibility for retirement is based on your system membership and the date you were hired with MCPS.

Retirement System

Employees hired prior to January 1, 1980, who are members of the Retirement System, qualify to retire as follows:

Retirement System Members (closed to new employees as of December 31, 1979)			
Type of retirement			
Normal Retirement	<ul style="list-style-type: none"> 30 years of credited service—at any age OR Age 60 with 5 years of credited service 		
Early Retirement	25 years of credited service—any age		
Penalty for Early Retirement		MCPS	State
	1 year	2%	6%
	2 years	5%	12%
	3 years	9%	18%
	4 years	14%	24%
	5 years	20%	30%

Pension System

Retirement eligibility for pension system members is as follows:

Pension System Members Hired on or before June 30, 2011	
Type of retirement	
Normal Retirement	<ul style="list-style-type: none"> 30 years of eligibility service—at any age OR Age 62 with 5 years of eligibility service
Early Retirement	15 years of eligibility service AND age 55
Penalty for Early Retirement	6% per year (.5% for each month prior to age 62)

Pension System Members Hired on or after July 1, 2011	
Type of retirement	
Normal Retirement	<ul style="list-style-type: none"> Age 65 with at least 10 years eligibility service OR Age + Years of Eligibility Service = 90
Early Retirement	15 years eligibility service AND age 60
Penalty for Early Retirement	6% per year (.5% for each month prior to age 65)

Disability Retirement

In the unfortunate event that an injury or illness permanently incapacitates you from performing your job duties, disability retirement is available to plan participants in addition to normal and early retirement.

Two types of disability retirement are available: ordinary disability and accidental disability.

Ordinary Disability: This benefit is available to employees who become permanently incapacitated due to illness. You are eligible for ordinary disability benefits if you—

- have a minimum of five years of eligibility service,
- are permanently incapacitated and unable to perform your job duties due to medical reasons,
- are not eligible for accidental disability, and
- there is no other available assignment for which you are qualified or capable of performing.

Accidental Disability: This benefit is available to employees who become permanently incapacitated due to a job-related accident. You are eligible for accidental disability if—

- your disability was the result of a job-related accident,
- you are permanently incapacitated and unable to perform your job duties due to medical reasons, and
- there is no other available assignment for which you are qualified or capable of performing.

Contact ERSC to speak with a retirement specialist about disability retirement options.

Vesting

What if I leave MCPS before I am eligible to retire?

Vesting is also dependent on the date you were hired with MCPS.

Employees who were hired on or before June 30, 2011, are considered vested after five years of eligibility service. If you have five or more years of eligibility service and you terminate employment with MCPS, you are vested and eligible to receive a future retirement benefit based on your service and earnings at the time of termination. Your benefit will be paid to you at your normal retirement date—age 60 or 62, depending on your plan membership. You may choose to receive this future benefit or you may choose to receive your contributions and interest in one lump sum upon your resignation. You may elect to receive a lump sum refund of your contributions and interest or to roll over funds into an Individual Retirement Account (IRA), Roth IRA, or a qualified plan such as a 403(b) or 457(b). If you choose to receive a refund of your contributions and interest, you will not be eligible for a future retirement benefit.

Employees who were hired on or after July 1, 2011, are considered vested after **ten** years of eligibility service. If you have **ten** or more years of eligibility service and you terminate employment with MCPS, you are vested and eligible to receive a future retirement benefit based on your service and earnings at time of termination. Your benefit will be paid to you at your normal retirement date. You may choose to receive this future benefit or you may choose to receive your contributions and interest in one lump sum upon your resignation. You may elect to receive a lump sum refund of your contributions and interest or to roll over funds into an Individual Retirement Account (IRA), Roth IRA, or a qualified plan such as a 403(b) or 457(b). If you choose to receive a refund of your contributions and interest, you will not be eligible for a future retirement benefit.

Benefit Amount

Benefit Formula Components

Both the Retirement and Pension Systems are defined benefit plans—your retirement benefit is based on a formula. These retirement benefit formulas use two key components.

1. **Average Final Salary (AFS)**—The AFS is an average of your earnings over a specified period of time. The period of time used is determined by your membership in the retirement or pension system and the year you were hired with MCPS.

Members of the Retirement System—The highest 3 years of salary during your career

Members of the Pension System who were hired on or before June 30, 2011—The highest 3 *consecutive* years of salary during your career

Example: Joe Smith joined MCPS in 2000 and is retiring July 1, 2011. His highest three years of salary were \$57,000, \$58,710, and \$60,471. His average final salary is \$58,727 $(\$57,000 + \$58,710 + \$60,471) \div 3$

Members of the Pension System who were hired on or after July 1, 2011—The highest 5 *consecutive* years of salary during your career

Example: Jane Smith joined MCPS on July 1, 2011, and will retire July 1, 2021. Her five highest years of salary were \$68,300, \$70,000, \$71,700, \$73,400, and \$75,160. Her average final salary is \$71,712 $(\$68,300 + \$70,000 + \$71,700 + \$73,400 + \$75,160) \div 5$

2. **Credited service**—Employees earn credited service based on membership in the retirement or pension system. One year of credited service is defined as 10 months from September to June. See “Service Toward Retirement” for more details.

Formulas Used to Calculate Your Benefit Amount

Using these components, each system calculates its own formula for benefits. In addition, your benefit formula is calculated differently based on the date you were hired with MCPS. The following charts define each system's benefit formula and specify which formula applies.

Retirement System

Employees who were hired with MCPS prior to July 1, 1976, and who are still members of the Retirement System receive a retirement benefit based on the following formula:

Core Benefit	$1.8181\% \times \text{Average Final Salary (AFS)} \times \text{Credited Service}$
Supplemental Benefit	$.18181\% \times \text{AFS} \times \text{Credited Service}$

Pension System

Pension System Members Hired on or before June 30, 2011

Core Benefit

Calculate *the greater of*

$.008 \times \text{Average Final Salary (AFS)}$ up to the SSIL *plus* $.015 \times \text{AFS}$ in excess of the SSIL multiplied by years of credited service prior to 7/1/98 **or**
 $.012 \times \text{AFS} \times \text{years of credited service prior to 7/1/98}$.

Plus $.018 \times \text{AFS} \times \text{years of credited service after 7/1/98}$

Supplemental Benefit

$.0008 \times \text{AFS}$ up to the SSIL *Plus* $.0015 \times \text{AFS}$ in excess of the SSIL multiplied by years of credited service to 7/1/98 *Plus* $.002 \times \text{AFS} \times \text{years of credited service after 7/1/98}$.

Note:

SSIL is the Social Security Integration Level. The SSIL for 2011 is \$59,300. The projected SSIL for 2012 is \$61,900.

Pension System Members Hired on or after July 1, 2011

Core Benefit

$1.5\% \times \text{Average Final Salary (AFS)} \times \text{credited service}$

Supplemental Benefit

$.2\% \times \text{AFS} \times \text{credited service}$

Cost-of-Living Adjustments

Your benefit is adjusted during your retirement years based on an annual cost-of-living adjustment (COLA). Typically, a COLA is applied to your retirement benefit each year.

When You Receive a COLA

The date you will receive your first COLA depends on the date you choose to retire. The COLA is added to MCPS Core and Supplement Plan benefits as of January 1 each year and to the State Teachers' Pension Plan (State core plan) benefits as of July 1 each year. MCPS Core and Supplemental Pension Plan members must be retired for at least one month to receive a COLA on January 1. Members of the state core plan must be retired for one full year before receiving a July 1 COLA. This means that in some instances, retiring one month later will result in a one-year delay in receipt of your first cost-of-living adjustment. If the calculated COLA is negative, it is allowed to accumulate from year-to-year and offset against future positive COLA adjustments.

How COLAs are Calculated

Both the state core plan and MCPS core plan use the Consumer Price Index (CPI) to calculate your cost-of-living adjustment. The U.S. Department of Labor publishes the annual CPI, and it is the most widely used measure of inflation. The CPI provides information about price changes in the nation's economy to government, business, labor, and private citizens, and is used as a guide to make economic decisions.

For benefits based on credited service earned **prior to July 1, 2011**, the annual COLA you receive as a retiree will be applied according to the yearly CPI with a three percent cap, with no additional conditions. The COLA for all service earned prior to July 1, 2011, is applied in the same way regardless of your core plan membership.

For benefits based on the credited service earned **after July 1, 2011**, the annual COLA you receive as a retiree will be calculated differently from benefits based on credited service earned prior to this time. The State core plan and MCPS core and supplemental plans will handle COLAs for this period of time differently.

State core plan members: You will receive a conditional COLA for benefits based on credited service earned after July 1, 2011. A conditional COLA is only applied if certain conditions are met for that year. If the State Teacher Pension Trust's investment returns meet their expectations for the year, then a COLA will be applied that is equal to the CPI with a two and a half percent cap. If the plan does not do as well as expected during the year, then the adjustment will be equal to the CPI but will be capped at one percent. For additional information about the conditional COLA, please visit the Maryland State Retirement Agency website at www.sra.state.md.us.

MCPS core plan members: The COLA for benefits based on credited service earned after July 1, 2011, will be based on the CPI and capped at two percent. No additional conditions will be applied to obtain the yearly COLA.

County supplement plan members (all employees, regardless of core plan membership): The COLA for benefits based on credited service earned after July 1, 2011, will be based on the CPI and capped at two percent. No additional conditions will be applied to obtain the yearly COLA.

Postretirement Benefit Plan

Medical, Dental, Prescription, Vision, and Life Insurance Coverage

Medical, dental, prescription, and life insurance benefits work differently when you are a retiree than when you are an active employee. The following pages offer an overview of retiree benefit options and rules. Complete information can be found in the *Retiree Benefit Summary*, available on the ERSC website.

You may elect to add, continue, or cancel coverage at the time of retirement. You must make an election for each component of the benefit plan. Submit MCPS Form 455-22: *Retiree Benefit Plan Enrollment* with your retirement forms to ERSC at least 30 days prior to the effective date of your retirement. If after retirement you move out of the service area for your health plan, you and your covered dependents must transfer to a different plan (see "Moving out of the Service Area" in this document).

Eligibility for Postretirement Benefits

Employees hired on or before June 30, 2006, are eligible for postretirement benefits if they have at least five years of eligibility service at retirement. Employees hired on or after July 1, 2006, are eligible for postretirement benefits if they have at least ten years of eligible service at retirement.

However, if you were hired between July 1, 2006, and June 30, 2011, and you retire with at least five years of eligible service, you will be eligible for postretirement benefits if—

- you were at least 55 years old as of July 1, 2011, or
- you will have at least 30 years eligible service in the State Teachers' Pension Plan upon retirement.

Note:

If you were **not** eligible for benefits coverage as an active employee, you will **not** be eligible for benefits coverage as a retiree.

POLICY

BOARD OF EDUCATION OF MONTGOMERY COUNTY

Related Entries:

Responsible Office: Chief Operating Officer

Funding Retirement/Pension System

A. PURPOSE

To set forth the priorities of the Montgomery County Public Schools (MCPS) Employees' Retirement and Pension System

B. ISSUE

The MCPS Employees' Retirement and Pension System will provide supplemental retirement/pension plan benefits for eligible employees who are members of the Maryland State Teachers' Retirement and Pension System or provide full retirement/pension plan benefit for eligible employees who are not eligible for membership in the Maryland system.

C. POSITION

1. In 1995 the Board of Education created a Board of Investment Trustees to oversee the investment of the pension assets based on an Investment Policy approved by the Board of Investment Trustees.
2. The Board of Investment Trustees shall review the Investment Policy annually and update as necessary to reflect prudent investment practice.
3. The results of the annual actuarial study will be made available at the conclusion of each fiscal year to establish funding percentages for the Board of Education's next annual operating budget request based on the actuarial unit credit cost method. Assumptions used in developing the actuarial valuation are determined by the Board of Education and will be kept current and adjusted as economic and demographic conditions change.
4. The study will include a funding percentage known as the "normal cost contribution" rate which when applied to annual compensation shall represent the cost of operating the plan during the current year.

5. The study also will include a funding percentage known as the “accrued liability” rate which when applied to annual compensation will produce an amount sufficient to liquidate the additional accrued liability over a period of no less than 15 years from the date of the actuarial valuation reducing such gain or loss.
6. The study also will include a funding percentage known as “expenses”, which when applied to the annual compensation will represent the cost to manage and administer the plan during the current year.
7. The amount of money calculated by applying the sum of the “normal contribution”, the “expenses”, and the “accrued liability” rate to the budgeted annual compensation less the employee contribution portion will be included in the fixed charges category of the superintendent of schools’ annual recommended operating budget.
8. MCPS will have as a funding goal each year the improvement of the asset to accrued liability ratio toward the 100 percent funded level by the end of the amortization period.
9. Any modifications to plan benefits will be announced in a timely manner prior to Board action allowing opportunities to receive input from active/retired employees and all employee organizations.

D. DESIRED OUTCOME

Montgomery County Public Schools will maintain a plan of retirement/pension benefits which is adequately funded and will provide employees income during their retirement years.

E. IMPLEMENTATION STRATEGIES

1. Every three to five years a credentialed actuarial firm will be contracted to evaluate the plan in terms of goals and objectives and this report will be made available to the Board of Education Fiscal Management Committee.
2. Staff will meet annually each fall with the Board of Education Fiscal Management Committee to review the annual report on the actuarial valuation of the retirement/pension plan from the actuary, actuarial plan assumptions, rate of return, and budget recommendations for the coming fiscal year.

F. REVIEW AND REPORTING

This policy will be reviewed in accordance with the Board of Education policy review process.

Policy History: Resolution No. 534-83, June 1983; amended by resolution No. 449-09, October 26, 2009.

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

July 28, 2008

MEMORANDUM

To: Members of the Board of Education

From: Jerry D. Weast, Superintendent of Schools

Subject: FY 2008 Operating Budget Categorical Transfer

At the end of each fiscal year, the Montgomery County Public Schools (MCPS) requests transfers among state categories to align budgeted appropriation with actual expenditures. These transfers are subject to approval by the County Council. For FY 2008, these transfers total \$12,000,000, approximately 0.6 percent of the total operating budget.

Overall, the MCPS Operating Budget ended FY 2008 with an expenditure surplus of \$14,500,000. Additionally, revenue was \$3,400,000 greater than budgeted, so that the total savings in local contribution was \$17,900,000. The County Council assumed \$17.9 million of savings from FY 2008 to fund the FY 2009 Operating Budget.

The FY 2008 expenditure surplus was due in part to comprehensive expenditure restrictions and a hiring freeze imposed on November 24, 2007. Offsetting the savings from expenditure restrictions were deficits in Special Education (Category 6), Pupil Personnel Services (Category 7), Student Transportation (Category 9), and Fixed Charges (Category 12) totaling \$11.4 million. In order to achieve the required expenditure savings of \$14.5 million, a total of \$25.9 million in savings was made in other state categories. Revenue surplus resulted from additional FY 2007 fund balance and higher than anticipated FY 2008 revenue for tuition due to more out-of-county students, federal impact aid, state reimbursement for students in nonpublic placements, and miscellaneous revenue.

During the past fiscal year, staff has closely monitored revenue and expenditures. Coordinated by the Office of the Chief Operating Officer, monitoring is led by the Department of Management, Budget, and Planning (DMBP) and the Department of Financial Services. With the assistance of the Office of the Chief Technology Officer and the Office of Human Resources, DMBP closely monitors expenditures. This financial monitoring process is extremely careful, comprehensive, and detailed. Primary and secondary account managers review each of their accounts on a monthly basis and report expenditure projections for the rest of the fiscal year. DMBP staff reviews and analyzes these projections using quantitative models, as well as knowledge of previous expenditure patterns and changing circumstances. Implementation of the Financial Management System (FMS), a comprehensive financial system integrated with the Human Resources Information System, improved the ability to monitor and control expenditures

and to successfully implement expenditure restrictions. Additional tools still being developed within the FMS system will further improve financial controls during the coming fiscal year.

The Board of Education received detailed financial status reports throughout the past year. Each month, beginning in November, the Board has discussed the financial status report at its public meetings. These reports have been transmitted to the county executive, the county's Office of Management and Budget, and the County Council. Final FY 2008 expenditures are in line with the trends indicated in the monthly reports. The following is a summary of the results in each of the categories in which actual expenditures through June 30, 2008, differed from the appropriation:

Category 1, Administration, reflected a surplus of \$2,678,000. The surplus is a result of greater than budgeted lapse and turnover savings (\$1,700,000) and other savings as a result of the comprehensive expenditure restrictions (\$900,000). These savings are 6.0 percent of budgeted expenditures.

Category 2, Mid-level Administration, reflected a surplus of \$3,280,000. The surplus is a result of greater than budgeted lapse and turnover savings (\$2,000,000), reductions in the acquisition of instructional materials (\$225,000) and other savings as a result of the comprehensive expenditure restrictions (\$1,000,000). Some of the savings resulted from using temporary part-time employees to fill some vacancies. These savings are 2.5 percent of budgeted expenditures.

Category 3, Instructional Salaries, reflected a surplus of \$10,754,000. The projected surplus is primarily a result of greater than anticipated lapse savings (\$5,200,000). As a result, approximately 80 teacher and supporting services positions were held in reserve rather than being allocated to schools. Teacher vacancies filled with long-term substitutes have resulted in savings in position accounts. There are savings due to lower than projected usage of extracurricular activities stipends (\$900,000), substitutes (\$1,100,000), and stipends for supervisors of student teachers (\$200,000). Additional savings are projected because of training activities limited by the comprehensive expenditure restrictions (\$2,000,000) and reduced usage of staff development substitutes (\$900,000). Lower than projected usage of long-term leave resulted in additional savings (\$700,000). These savings were partially offset by higher than projected payout of sick and annual leave for terminated employees in this category (\$300,000).

Category 4, Textbooks and Instructional Supplies, reflected a surplus of \$6,607,000. The surplus is a result of postponing acquisition of textbooks and instructional materials until FY 2009 (\$4,400,000); lower spending for textbooks, media center supplies, and instructional materials in accounts not allocated to schools (\$2,000,000); additional savings in instructional materials in the Office of the Chief Technology Officer (\$100,000); and lower than projected expenditures for training materials purchased by the Office of Organizational Development (\$100,000).

Category 5, Other Instructional Costs, reflected a surplus of \$1,578,000. The surplus is a result of savings as a result of the comprehensive expenditure restrictions. Savings included lower than anticipated school copier contractual services expenditures (\$200,000), staff development

expenditures (\$800,000), printing services (\$300,000), and school furniture and equipment (\$300,000).

Savings in regular instruction program costs in Categories 3, 4, and 5 are 2.2 percent of budgeted expenditures.

Category 6, Special Education, reflected a deficit of \$3,961,000. The deficit is due primarily to a higher than anticipated cost for special education students referred to private placements. This is the result of increases for tuition rates and supplementary services (\$3,500,000). There is also a deficit of \$1,000,000 due to lower than projected revenue for Medicaid that resulted from changes in reimbursement rates imposed by the federal government. The shortfall in Medicaid revenue increased local funding for special education expenditures. This deficit is partially offset by a net surplus in position costs (\$1,400,000) due to higher than anticipated lapse and turnover. There also were higher than budgeted costs for part-time salaries and contractual expenses, partially offset by a net surplus in other accounts resulting from the comprehensive expenditure restrictions (\$900,000).

Category 7, Student Personnel Services, reflected a deficit of \$108,000. The deficit is the result of lower than anticipated salary lapse and turnover.

Category 8, Health Services, reflected a surplus of \$14,000 due to lower than anticipated program needs.

Category 9, Student Transportation, reflected a deficit of \$4,430,000. The projected deficit is predominately the result of actual diesel fuel costs (\$3,400,000). Prices paid by MCPS for diesel fuel have been as high as \$4.40 per gallon. Higher fuel costs reflect the nationwide increase in the cost of gasoline and other petroleum products. Fuel costs have averaged approximately \$3.28 per gallon compared to the budgeted amount of \$2.50 per gallon. The deficit also resulted from higher than budgeted personnel costs, including lower than anticipated salary lapse (\$1,000,000).

Category 10, Operation of Plant and Equipment, reflected a surplus of \$547,000. The surplus resulted from higher than anticipated lapse and turnover savings (\$200,000) and savings in expenditures for electricity as a result of new bidding procedures (\$350,000). Savings in Category 10 are 0.5 percent of the budgeted expenditures.

Category 11, Maintenance of Plant, reflected a surplus of \$904,000. The surplus resulted from higher than budgeted lapse and turnover savings (\$700,000) and other savings resulting from the comprehensive expenditure restrictions (\$200,000). Savings in Category 11 are 2.7 percent of budgeted expenditures.

Category 12, Fixed Charges, reflected a deficit of \$2,918,000. Actual costs for the Employee Benefit Plan (EBP) were at budgeted levels. However, increased cost projections make it prudent to increase the contribution to the EBP reserve, as recommended by the County Council benefits

consultant, by \$2,000,000. These resources will be available in future years to offset unexpected cost increases. The projected deficit also is due to the increased cost of reimbursements for employee tuition expenses (\$1,000,000), which was partially offset by a surplus resulting from lower than anticipated social security payments and other items included in Category 12 (\$100,000).

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

WHEREAS, Category 6, Special Education, reflected a deficit as of June 30, 2008, as a result of higher than expected tuition costs for nonpublic placement of special education students and lower than projected revenue for Medicaid; and

WHEREAS, Category 7, Student Personnel Services, reflected a deficit as of June 30, 2008, as a result of lower than expected lapse and turnover savings; and

WHEREAS, Category 9, Student Transportation, reflected a deficit as of June 30, 2008, as a result of higher than expected costs for bus fuel and personnel costs; and

WHEREAS, Category 12, Fixed Charges, reflected a deficit as of June 30, 2008, as a result of higher than anticipated costs in tuition reimbursement for employees and an increased contribution to the Employee Benefit Plan; and

WHEREAS, The required funds are available for transfer from Category 1, Administration; Category 2, Mid-level Administration; Category 3, Instructional Salaries; and Category 4, Textbooks and Instructional Supplies; 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 transfers:

<u>Category</u>	<u>Description</u>	<u>To</u>	<u>From</u>
1	Administration		\$ 2,000,000
2	Mid-level Administration		3,000,000
3	Instructional Salaries		4,000,000
4	Textbooks and Instructional Supplies		<u>3,000,000</u>
6	Special Education	\$4,100,000	
7	Student Personnel Services	200,000	
9	Student Transportation	4,600,000	
12	Fixed Charges	<u>3,100,000</u>	
	Total	<u>\$12,000,000</u>	<u>\$12,000,000</u>

and be it further

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

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

JDW:LAB:MCS:jp

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

July 27, 2009

MEMORANDUM

To: Members of the Board of Education

From: Jerry D. Weast, Superintendent of Schools

Subject: FY 2009 Operating Budget Categorical Transfer

At the end of each fiscal year, Montgomery County Public Schools (MCPS) requests transfers among state categories to align budgeted appropriation with actual expenditures. These transfers are subject to approval by the County Council. For FY 2009, these transfers total \$7,700,000, approximately 0.4 percent of the total operating budget.

Overall, the FY 2009 MCPS Operating Budget ended with an expenditure surplus of \$19,500,000. Additionally, revenue was \$1,200,000 greater than budgeted so that the total savings in local contribution was \$20,700,000. The County Council assumed \$20.0 million of savings from FY 2009 to fund the FY 2010 Operating Budget.

The FY 2009 expenditure surplus was due in part to comprehensive expenditure restrictions and a hiring freeze imposed on September 16, 2009. Offsetting the savings from expenditure restrictions were deficits in Student Personnel Services (Category 7) and Fixed Charges (Category 12) totaling \$7.7 million. In order to achieve the required expenditure savings of \$18.7 million, a total of \$26.4 million in savings was made in other state categories. Revenue surplus resulted from higher than anticipated revenue for special education non-public placement tuition reimbursement and federal impact aid, partially offset by lower than anticipated summer school fees and other tuition revenue. As a result of legislation adopted by the state legislature at the 2009 session of the General Assembly, MCPS received \$24,171,000 in FY 2009 unrestricted Foundation state aid erroneously withheld. This additional revenue adds to the FY 2009 ending fund balance and was assumed by the County Council as resources available for the FY 2010 Operating Budget.

During the past fiscal year, staff has closely monitored revenue and expenditures. Coordinated by the Office of the Chief Operating Officer, monitoring is led by the Department of Management, Budget, and Planning (DMBP) and the Department of Financial Services. With the assistance of the Office of Human Resources, DMBP closely monitors expenditures. This financial monitoring process is extremely careful, comprehensive, and detailed. Primary and

secondary account managers review each of their accounts on a monthly basis and report expenditure projections for the rest of the fiscal year. DMBP staff review and analyze these projections using quantitative models, as well as knowledge of previous expenditure patterns and changing circumstances. Implementation of the Financial Management System (FMS), a comprehensive financial system integrated with the Human Resources Information System, improved the ability to monitor and control expenditures and to successfully implement expenditure restrictions. Additional tools being developed to integrate the FMS system with other information systems will further improve financial controls during the coming fiscal year.

The Board of Education received detailed financial status reports throughout the past year. Each month, beginning in November, the Board has discussed the financial status report at its public meetings. These reports have been transmitted to the county executive, the county's Office of Management and Budget, and the County Council. Final FY 2009 expenditures are in line with the trends indicated in the monthly reports. The following summary presents the results in each of the categories in which actual expenditures through June 30, 2009, differed from the appropriation.

Category 1, Administration, reflected a surplus of \$1,931,000. The surplus is a result of greater than budgeted salary lapse and turnover savings (\$500,000) and other savings as a result of the comprehensive expenditure restrictions (\$1,400,000). Savings in Category 1 are 4.4 percent of budgeted expenditures.

Category 2, Mid-level Administration, reflected a surplus of \$3,381,000. The surplus is a result of greater than budgeted lapse and turnover savings (\$1,300,000), reductions in the acquisition of instructional materials (\$250,000), and other savings as a result of the comprehensive expenditure restrictions (\$900,000). A portion of the savings resulted from using temporary part-time employees to fill some vacancies. In addition, \$900,000 in surplus resulted from taking a reduction for eight elementary intern positions from Category 3, Instructional Salaries, rather than Category 2, creating a surplus in this category. Savings in Category 2 are 2.5 percent of budgeted expenditures.

Category 3, Instructional Salaries, reflected a surplus of \$4,915,000. The projected surplus is a result of lower than projected expenditures for non-position salaries, primarily because of the comprehensive expenditure restrictions, including substitutes (\$1,100,000), sick and annual leave payout for terminated employees (\$300,000), clerical support (\$200,000), extracurricular activities stipends (\$300,000), and professional part-time salaries (\$1,500,000). Additional savings were realized because of staff development activities limited by the comprehensive expenditure restrictions (\$1,700,000) and reduced usage of staff development substitutes (\$650,000). These savings are partially offset by a deficit of \$900,000 resulting from taking a reduction for eight elementary intern positions from Category 3 rather than Category 2, Mid-level Administration.

Category 4, Textbooks and Instructional Supplies, reflected a surplus of \$4,651,000. The surplus is a result of reduced central acquisition of textbooks and instructional materials based on the comprehensive expenditure restrictions (\$3,600,000), savings in instructional materials in the Office of Curriculum and Instructional Programs (\$700,000), and lower than projected expenditures for training materials by the Office of Organizational Development (\$300,000).

Category 5, Other Instructional Costs, reflected a surplus of \$2,105,000. The surplus is a result of savings as a result of the comprehensive expenditure restrictions. Savings included lower than anticipated contractual services expenditures (\$700,000), staff development expenditures (\$500,000), printing services (\$100,000), school furniture and equipment (\$300,000), travel (\$200,000), and miscellaneous accounts (\$300,000).

Savings in regular instruction program costs in Categories 3, 4, and 5 are 1.4 percent of budgeted expenditures.

Category 6, Special Education, reflected a surplus of \$4,180,000. The surplus is due primarily to lower than budgeted actual average salaries for staff (\$1,000,000), greater than anticipated salary lapse and turnover savings (\$3,000,000), and a net surplus in non-position accounts resulting from the comprehensive expenditure restrictions (\$900,000). There also is a surplus of \$600,000 due to greater than projected revenue for Medicaid that resulted from a moratorium on proposed new regulations that would have limited federal reimbursement. The surplus in Medicaid revenue decreased local funding for special education expenditures. The surplus is partially offset by higher than anticipated costs of nonpublic placement tuition for special education students (\$1,300,000). Savings in Category 6 are 1.7 percent of budgeted expenditures.

Category 7, Student Personnel Services, reflected a deficit of \$134,000. The deficit is the result of lower than anticipated salary lapse and turnover.

Category 8, Health Services, reflected a surplus of \$26,000 due to lower than anticipated program needs.

Category 9, Student Transportation, reflected a surplus of \$3,958,000. The projected surplus is mainly the result of lower than budgeted diesel fuel costs (\$2,100,000). These lower fuel costs reflect the nationwide decrease in the cost of gasoline and other petroleum products. Fuel costs have averaged approximately \$2.15 per gallon compared to the budgeted amount of \$2.75 per gallon. The surplus also resulted from lower than budgeted personnel and materials costs resulting in part from the comprehensive expenditure restrictions, including higher than anticipated salary lapse and non-position savings (\$1,300,000) and savings in bus parts and supplies due to reduced prices (\$600,000). Savings in Category 9 are 4.3 percent of budgeted expenditures.

Category 10, Operation of Plant and Equipment, reflected a surplus of \$945,000. The surplus resulted from lower than anticipated expenditures for electricity (\$650,000) as a result of new

bidding procedures, and lower than budgeted prices for heating oil (\$300,000). Savings in Category 10 are 0.8 percent of budgeted expenditures.

Category 11, Maintenance of Plant, reflected a surplus of \$461,000. The surplus resulted from higher than budgeted lapse and turnover savings (\$800,000), partially offset by higher than budgeted expenditures for maintenance supplies and materials (\$300,000). Savings in Category 11 are 1.4 percent of budgeted expenditures.

Category 12, Fixed Charges, reflected a deficit of \$6,922,000. Actual costs for the Employee Benefit Plan (EBP) were 2.5 percent higher than budgeted levels (\$5,500,000). In addition, increased cost projections make it prudent to increase the contribution to the EBP reserve by \$3,000,000, as recommended by the County Council benefits consultant. These resources will be available in future years to offset unexpected cost increases. The projected deficit also is due to the increased cost of reimbursements for employee tuition expenses (\$350,000). The deficit was partially offset by a surplus resulting from lower than anticipated social security payments resulting from the comprehensive expenditure restrictions (\$1,200,000) and lower than budgeted costs for tuition in university partnership programs (\$750,000).

In addition to the deficit in tax-supported funds in Category 12, there was a Category 12 deficit of \$1,205,000 in grant funds because of higher than anticipated employee benefits costs in the *Individuals with Disabilities Education Act* (IDEA) Grant, requiring a transfer of grant funds from Category 6, Special Education.

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

WHEREAS, Category 7, Student Personnel Services, reflected a deficit as of June 30, 2009, as a result of lower than expected lapse and turnover savings; and

WHEREAS, Category 12, Fixed Charges, reflected a deficit as of June 30, 2009, as a result of higher than anticipated costs for health insurance for active and retired employees, increased costs of tuition reimbursement for employees, and an increased contribution to the Employee Benefit Plan; and

WHEREAS, The required funds are available for transfer from Category 1, Administration; Category 2, Mid-level Administration; and Category 9, Student Transportation; and

WHEREAS, Category 12, Fixed Charges, reflected a deficit in grant funds as of June 30, 2009, as a result of higher than anticipated costs for employee benefits in the *Individuals with Disabilities Education Act* Grant; and

WHEREAS, The required funds are available for transfer from grant funds in Category 6, Special Education; 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 transfers:

<u>Category</u>	<u>Description</u>	<u>To</u>	<u>From</u>
1	Administration		\$1,500,000
2	Mid-level Administration		3,000,000
7	Student Personnel Services	\$200,000	
9	Student Transportation		<u>3,200,000</u>
12	Fixed Charges	<u>7,500,000</u>	
	Total	<u>\$7,700,000</u>	<u>\$7,700,000</u>

and be it further

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

<u>Category</u>	<u>Description</u>	<u>To</u>	<u>From</u>
6	Special Education		\$1,205,000
12	Fixed Charges	<u>\$1,205,000</u>	
	Total	<u>\$1,205,000</u>	<u>\$1,205,000</u>

and be it further

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

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

JDW:LAB:MCS:jp

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

July 26, 2010

MEMORANDUM

To: Members of the Board of Education

From: Jerry D. Weast, Superintendent of Schools

Subject: Fiscal Year 2010 Operating Budget Categorical Transfer

At the end of each fiscal year, Montgomery County Public Schools (MCPS) requests transfers among state categories to align budgeted appropriation with actual expenditures. Categorical transfers are subject to approval by the County Council. For Fiscal Year (FY) 2010, categorical transfers total \$900,000, less than 0.1 percent of the total operating budget.

Overall, the FY 2010 MCPS Operating Budget ended with an expenditure surplus of \$32,800,000. Expenditure savings are partially offset by a revenue shortfall of \$1.6 million, including \$850,000 resulting from reduced state reimbursement for special education non-public tuition and \$750,000 in reduced investment income due to reduced interest rates, for a net savings of \$31,200,000. The County Council assumed \$30.0 million of savings from FY 2010, including \$10,300,000 to fund the FY 2011 Operating Budget. The remaining \$19.7 million of savings was not requested as local contribution in 2010, which allowed Montgomery County to realize an increased FY 2010 ending fund balance. In addition, the county contribution was \$2.0 million less than budgeted because of a shift in revenue source resulting from additional federal grants under the *American Recovery and Reinvestment Act of 2009*, resulting in \$2.0 million of additional savings for the county.

The FY 2010 expenditure surplus was due in part to comprehensive expenditure restrictions and a hiring freeze implemented on August 20, 2009. Offsetting the savings from expenditure restrictions were deficits in Student Personnel Services (Category 7) and Maintenance of Plant (Category 11) totaling \$0.7 million. In order to achieve the required expenditure savings, a total of \$33.5 million in expenditure savings was made in other state categories.

During the past fiscal year, staff closely monitored revenue and expenditures. Coordinated by the Office of the Chief Operating Officer, monitoring is led by the Department of Management, Budget, and Planning (DMBP) and the Department of Financial Services. With the assistance of the Office of Human Resources and Development, DMBP closely monitors expenditures. This

financial monitoring process is extremely careful, comprehensive, and detailed. Primary and secondary account managers review each of their accounts on a monthly basis and report expenditure projections for the rest of the fiscal year. DMBP staff reviews and analyzes these projections using quantitative models, as well as knowledge of previous expenditure patterns and changing circumstances. Implementation of the Financial Management System (FMS), a comprehensive financial system integrated with the Human Resources Information System, has improved the ability to monitor and control expenditures and to successfully implement expenditure restrictions.

The Board of Education received detailed financial status reports throughout the past year. Each month, beginning in November, the Board has discussed the financial status report at its public meetings. These reports have been transmitted to the county executive, the county's Office of Management and Budget, and the County Council. Final FY 2010 expenditures are in line with the trends indicated in the monthly reports. The following summary presents the results in each of the categories in which actual expenditures through June 30, 2010, differed from the appropriation.

Category 1, Administration, reflected a surplus of \$1,862,479. The surplus is a result of greater than budgeted salary lapse and turnover savings (\$900,000) and other savings as a result of the comprehensive expenditure restrictions (\$950,000). Savings in Category 1 are 4.4 percent of budgeted expenditures.

Category 2, Mid-level Administration, reflected a surplus of \$2,076,598. The surplus is a result of greater than budgeted lapse and turnover savings (\$1,600,000), reductions in the acquisition of instructional materials (\$200,000), and other savings as a result of the comprehensive expenditure restrictions (\$300,000). Savings in Category 2 are 1.6 percent of budgeted expenditures.

Category 3, Instructional Salaries, reflected a surplus of \$4,700,615. The projected surplus is primarily a result of lower than budgeted expenditures for non-position salaries because of the comprehensive expenditure restrictions, including substitutes (\$1,200,000), sick and annual leave payout for terminated employees (\$500,000), and part-time salaries (\$600,000). Savings in non-position salaries are partially offset by lower than budgeted salary lapse and turnover savings (\$500,000). Additional savings were realized because of staff development activities limited by the comprehensive expenditure restrictions (\$1,700,000) and reduced usage of staff development substitutes (\$1,200,000).

Category 4, Textbooks and Instructional Supplies, reflected a surplus of \$5,189,453. The surplus is a result of reduced central acquisition of textbooks and instructional materials based on the comprehensive expenditure restrictions (\$3,700,000), savings in instructional materials in the Office of Curriculum and Instructional Programs (\$900,000), savings in expenditures for staff development training materials (\$300,000), and savings in printing and computer supplies (\$300,000).

Category 5, Other Instructional Costs, reflected a surplus of \$2,467,136. The surplus is a result of savings from the comprehensive expenditure restrictions. Savings included lower than anticipated contractual services expenditures (\$600,000), staff development expenditures (\$400,000), printing services (\$100,000), copier maintenance (\$500,000), travel reimbursement (\$300,000), and miscellaneous accounts (\$500,000).

Savings in regular instruction program costs in Categories 3, 4, and 5 are 1.4 percent of budgeted expenditures.

Category 6, Special Education, reflected a surplus of \$9,500,474. The surplus is due primarily to lower than budgeted costs of nonpublic placement tuition for special education students (\$6,300,000) because fewer students than expected required non-public placement and because the state of Maryland did not approve rate increases for non-public providers. There also is a surplus as a result of greater than anticipated salary lapse and turnover savings (\$2,000,000), a net surplus in non-position accounts resulting from the comprehensive expenditure restrictions (\$550,000), greater than projected revenue for Medicaid (\$350,000), and savings in other accounts resulting from the comprehensive expenditure restrictions (\$600,000). The surplus is partially offset by higher than budgeted costs of legal services (\$300,000). Savings in Category 6 are 3.8 percent of budgeted expenditures.

Category 7, Student Personnel Services, reflected a deficit of \$182,110. The deficit is the result of lower than anticipated salary lapse and turnover savings.

Category 8, Health Services, reflected a surplus of \$1,671 due to lower than anticipated program needs.

Category 9, Student Transportation, reflected a surplus of \$2,881,179. The projected surplus is primarily a result of lower than anticipated personnel costs because of reductions in the need for regular rate overtime salaries for bus operators (\$1,100,000). There also is a surplus due to lower than budgeted diesel fuel and bus parts costs (\$900,000) and bus repair costs (\$300,000). Fuel costs averaged approximately \$2.40 per gallon compared to the budgeted amount of \$2.50 per gallon. The surplus also resulted from a reduction in the use of activity buses (\$300,000) and savings in other accounts resulting from the comprehensive expenditure restrictions (\$300,000). Savings in Category 9 are 3.1 percent of budgeted expenditures.

Category 10, Operation of Plant and Equipment, reflected a surplus of \$1,181,182. The surplus results primarily from lower than anticipated expenditures for electricity (\$3,300,000) as a result of competitive bidding procedures that lock in prices for electricity purchases and lower usage, and lower than budgeted prices for natural gas (\$200,000). Savings also resulted from higher than anticipated salary lapse and turnover savings resulting from the comprehensive expenditure restrictions (\$600,000), and a decrease in the use of postage because of reductions in printing (\$200,000). These savings are offset by overtime expenses related to the February 2010 snow storms (\$1,100,000), some of which may ultimately be reimbursed by federal aid, and

prepayment of energy costs resulting from County Council action to increase the Fuel Energy Tax (\$2,000,000). The County Council assumed that MCPS would pay the increased tax during FY 2010 from other projected savings. Savings in Category 10 are 1.3 percent of budgeted expenditures.

Category 11, Maintenance of Plant, reflected a deficit of \$514,370. The deficit resulted from costs associated with snow removal during the month of February. This includes higher costs for overtime for snow removal, including costs for contractual services paid to contractors for snow removal, and additional costs incurred for fuel and equipment repairs.

Category 12, Fixed Charges, reflected a surplus of \$3,663,961. The surplus is a result of \$12,000,000 that was budgeted for pre-funding retiree health insurance benefits but was held for the year-end fund balance. The surplus is partially offset by the need to transfer approximately \$1.8 million in expenses for health benefits from the Food and Nutrition Services Enterprise Fund to the General Fund. It is projected that the Food and Nutrition Services Enterprise Fund will have a deficit of about \$1.8 million for FY 2010 without this transfer. This transfer is necessary to maintain the solvency of the Fund. In addition, there is an increase in expenditures projected for benefits over the amount supported by grant funds (\$300,000). Actual net costs for the Employee Benefit Plan (EBP) were 0.3 percent higher than budgeted levels (\$900,000). In addition, increased cost projections make it prudent to increase the contribution to the EBP reserve by \$5,500,000, as recommended by the County Council benefits consultant. These resources will be available in future years to offset unexpected cost increases. The projected surplus also is due to lower than anticipated social security payments resulting from the comprehensive expenditure restrictions (\$400,000). There also is a deficit resulting from the increased cost of reimbursements for employee tuition expenses (\$300,000). Savings in Category 12 are 0.9 percent of budgeted expenditures.

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

WHEREAS, Category 7, Student Personnel Services, reflected a deficit as of June 30, 2010, as a result of lower than expected lapse and turnover savings; and

WHEREAS, Category 11, Maintenance of Plant, reflected a deficit as of June 30, 2010, as a result of costs associated with snow removal during the month of February; and

WHEREAS, The required funds are available for transfer from Category 1, Administration; 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 transfers:

<u>Category</u>	<u>Description</u>	<u>To</u>	<u>From</u>
1	Administration		\$900,000
7	Student Personnel Services	\$250,000	
11	Maintenance of Plant	<u>650,000</u>	<u> </u>
<u>Total</u>		<u>\$900,000</u>	<u>\$900,000</u>

and be it further

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

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

JDW:LAB:MCS:jp

ADDENDUM

Review of Group Insurance Programs
for the
Management and Fiscal Policy Committee

April 16, 2003

Prepared by:
Thomas Lowman, FSA
Mark Lynne
Bolton Partners, Inc.

Table of Contents

1.	Introduction.....	1
2.	Executive Summary.....	2
3.	Scope of Services/Terms Defined.....	3
4.	Summary of Findings.....	4
5.	Recommendations.....	9
6.	Separate Discussion of Each of the Five Agencies.....	11

1. Introduction

This report summarizes our review of the group insurance benefits offered by the County and bi-county agencies. The report is divided up into the following sections:

- Executive Summary
- Scope of Services
- Summary of Findings
- Recommendations
- Separate Discussion of Each of the Five Agencies

We would like to thank the agencies for providing the information we needed and for openly discussing the issues. We look forward to presenting this information to the Management and Fiscal Policy Committee on April 21, 2003.

Respectfully submitted,

BOLTON PARTNERS, INC.

Thomas Lowman, FSA

Mark Lynne

2. Executive Summary

We have reviewed the group insurance benefits offered by the County Government and the four other agencies. There are numerous differences among the agencies in the plans offered, cost sharing arrangements and funding. Some of these differences involve areas where there was no intention to create similarities due to the independence of each organization, differences in priorities and historical differences. However, differences can easily be compared to determine which group has the most expensive practices and which are the least expensive.

In a time of fiscal difficulties these differences have been the focus of our recommendations for budget savings. These recommendations are listed in section five. The key issues involve the use of several million dollars previously set aside to pre-fund retiree benefits and the use of excess reserve funds. Plan design changes are more difficult to deal with since the agencies have already been considering such changes and changes which involve bargaining take time to implement. The most obvious of the bargaining changes is to recommend a shift of more of the cost to employees of MCPS to bring them in line with the other agencies.

Some recommendations do not involve budget savings. We are concerned that some of the trend assumptions used might underestimate future cost. In addition, new accounting rules will add pressure to increase funding. Partly for these reasons, we recommend that all agencies consider preparation of detailed multiyear forecasts such as those prepared by County Government.

Our review focused on narrow issues often without dealing with the desire by each agency to establish separate priorities, including non-benefit uses of financial resources. Therefore, the Council should expect to hear about such trade-offs (e.g., higher benefits for lower salaries) from the agencies.

It should be noted that there are several initiatives under way to save health plan costs without affecting benefits. These consist primarily of RFP processes, the effects of which will be seen January 1, 2004. It is anticipated that competitive market pressures will result in savings on carrier rates/fees and provider discounts.

3. Scope of Services/Terms Defined

The Montgomery County Council hired Bolton Partners, Inc. to review the group insurance programs and budgets of the County and bi-county agencies. The initial phase of this review covers the FY04 budget process. The agencies involved are County Government, Montgomery County Public Schools (MCPS), Montgomery College, Maryland-National Capital Park and Planning Commission (M-NCPPC), and Washington Suburban Sanitary Commission (WSSC).

The two goals of the review are to (1) achieve a consistent approach by the agencies to IBNR¹ reserves, shock absorber reserves, and six-year fund projections and (2) clearly delineate the agencies' approaches to plan design and cost control and to help them strengthen their performance in these areas.

To attain these goals we have talked with each agency separately and met with the Interagency Working Group on Health Insurance and their consultants. Throughout the process we have shared several drafts of our work with the agencies.

Our initial work has been aimed toward a presentation to the Management and Fiscal Policy Committee during its April 21, 2003 meeting. For this meeting we have been asked to assess where the agencies now stand on these issues and what changes would help achieve the Council's goals. We have also been asked to (1) assess whether the agencies can achieve any FY04 cost savings compared to their budget requests and (2) address other relevant issues, such as the new GASB² accounting rules and how to deal with fund surpluses when they occur. This report addresses these points.

Future work will include preparing for the FY05 budget process during the summer and fall of 2003 by assisting working group members in developing a consistent approach to these issues and implementing any Council requests in this regard.

In this report we use the abbreviations IBNR and GASB.

IBNR refers to "incurred but not reported" claims. These arise from claims arising in one year but not reported or paid until the following year. IBNR only arises for self-insured plans and varies in amount by the type of benefits (i.e., Medical IBNR is more than Drug IBNR because of differences in claims reporting and payment processing).

GASB in this context refers to newly proposed "Governmental Accounting Standard Board" rules for accounting for post-retirement group insurance cost. Generally most employers have determined the accounting "expense" as equal to the cash "pay-as-you-go" cost. Starting in FY07 the proposed rules would require a higher expense, including an expense for active employees' projected future post-retirement cost. This "expense" could be three times the cash cost. One question that arises is whether employers will either begin to pre-fund this benefit or cut the benefit to reduce the accounting expense.

¹ Defined below.

² Defined below.

4. Summary of Findings

We have made comparisons among the five agencies and provided comments in the following areas:

1. Trend Rates
2. Budget Increases
3. Cost Sharing
4. IBNR
5. GASB post-retirement rules

Later in this report are individual discussions of each of the five agencies, covering items that we think the Council should be aware of prior to our meeting.

1. Trend Rates:

One of our concerns was trend rate assumptions. This has some apples-to-oranges issues partly because rates change on a calendar year basis and funding is on a July 1st fiscal year basis.

County Government:

The County Government has the most detailed projections and trend rates. They include:

1. Rate of change in active and retiree headcounts in six-month intervals
2. Rate of change in self-insured claims cost in six-month intervals
3. Rate of change in fully-insured rates in calendar year intervals
4. Separate rates for change in carrier fixed cost
5. Rate adjustments for use of surplus
6. Separate assumptions for each of the eight different plans
7. Separate assumptions for employees, non-Medicare retirees and Medicare retirees.

It is difficult to decide which rates to summarize. However, the following is the "Required Rate Increase Before Contribution From Surplus". This is on a calendar year basis and combines plans and groups:

Year	Medical	Dental	Drug
January 2003	16.4%	24.4%	31.0%
January 2004	6.8%	5.0%	15.5%
January 2005	4.9%	4.0%	11.3%
January 2006	3.9%	3.0%	8.6%
January 2007	3.8%	3.0%	6.1%
January 2008	3.8%	2.5%	6.1%
January 2009	3.8%	2.5%	4.5%

After 2004, there are no material differences in the trend rates between employees and retirees. The 2004 rates might be optimistic. Also, at this point the 2003 "trend" is now just an historic number.

MCPS:

MCPS does not do anything as elaborate as County Government. For the FY04 budget request MCPS applies a trend assumption of 6.97% for actives and 6.46% for retirees to the expected FY03 claims information. These trend assumptions are arrived at by weighting combined expected increases for different benefits. MCPS also adjusted for changes in expected numbers of retirees and employees.

A fiscal year trend factor is different than a calendar year factor. For example, the FY04 trend factor for fully insured plans is a function of the CY03 and CY04 increases in rates. The MCPS trend factor appears to be lower than either the County Government or M-NCPPC.

College:

We were told that the trend rate was 12% for FY04. (Note: retiree funding did not increase 12% since fewer retired in FY02 than had been expected and FY03 funding will probably be somewhat higher than claims experience.)

M-NCPPC:

M-NCPPC used a trend factor of 16% for FY04. This was the composite of the following components:

BCBS POS:	27.0%
Most HMO's:	16.0%
Dental:	15.0%
Vision:	0.5%
Drug:	40.0%

The above breakdown results in more than a 16% average trend rate. The difference is made up for by using set aside surpluses to gradually increase rates.

For years beyond FY04, insurance costs are trended forward at a 15% rate as part of the projection of operating funds. There is no explicit group insurance fund projection.

WSSC:

WSSC used a 15% trend rate for FY04.

2. Budget Increase:

The increase in the group insurance budget request between FY03 and FY04 can be thought of as partly a function of the CY03 rate increase and the CY04 rate increase. For example, the County's average projected rate increase for CY03 and CY04 is about 12%. Therefore, one component of the budget increase for FY04 would be to cover the 12%

rate increase. In addition, there may be (1) experience changes that are recognized between the time CY03 rates were set last fall and when the FY04 budget requests are made, (2) fund surpluses used in FY03 that are not available in FY04, (3) use of other funds for FY04, or (4) changes in head counts. An example of the third category is that we understand M-NCPPC will use \$1.5 million from their 115 Trust for FY04 retiree health insurance costs, as it did in FY03.

The Council gave us the following comparison of the requested retiree group insurance budget increase for FY04.

Retirees:

	FY03	FY04	Increase
County Government	\$14.0	\$17.8	27.2%
MCPS	\$19.7	\$29.9	51.4%
College (includes \$0.4 pre-funding)	\$1.4	\$1.5	5.2%
M-NCPPC (half of total expense)	\$1.4*	\$1.6*	16.0%
WSSC (not tax supported)	\$6.3	\$7.1	13.4%

The large MCPS increase is due to the FY03 request not being enough to cover FY03 expenses and the balance (possibly \$8.1 million) expected to be made up from fund surplus that may not exist after FY03. We are also concerned that the MCPS retiree trend rate of 6.46% from FY03 to FY04 might not be high enough.

The agencies provided the following similar information for employee group insurance cost.

Employees:

	FY03	FY04	Increase
County Government	\$43.8	\$56.8	29.7%
MCPS	\$104.3	\$125.0	19.8%
College	\$6.6	\$7.6	15.2%
M-NCPPC	\$6.1	\$7.0	14.8%
WSSC (not tax supported)	\$8.7	\$10.1	16.1%

* Part of budget request but paid from separate trust.

3. Cost Sharing (Employer %/Employee %)

Here is a rough summary of what we understand the cost sharing arrangements to be.

	Employees	Retirees
County Government	80/20 or 76/24 less for some part time employees	Ranges from 50/50 to 80/20 Long Service = 70/30 (several special rules)
MCPS	Ranges from 80/20 to 95/5	64/36
College	75/25 less for part time employees	Most are 60/40
M-NCPPC	85/15	85/15
WSSC	80/20	80/20 (Except Dental = 0/100)

If the Council focuses on the plans that provide the highest employer share of cost, it would focus on (1) MCPS employee cost sharing, (2) M-NCPPC retiree cost sharing, and (3) retiree cost sharing arrangements that do not vary by service.

4. IBNR:

County Government:

The County recently completed an IBNR study and the following are as of the end of CY2002. The IBNR varies by plan and is less for the Indemnity plan than the POS because the POS includes a Drug benefit.

Care First Indemnity:	19.8% of annual paid claims
Care POS:	13.6% of annual paid claims
NPA Drug:	3.1% of annual paid claims
NVA Vision:	13.1% of annual paid claims
Dental:	9.7% of annual paid claims

The aggregate IBNR is 14% of annual paid claims; both the level of the reserve and the calculation methodology look reasonable.

MCPS:

Dental	16.5% of annual paid claims
BCBS	25.0% of annual paid claims
Optimum Choice	25.4% of annual paid claims
Drug	0.4% of annual paid claims
Vision	24.3% of annual paid claims

College:

The IBNR was 20% of the premium equivalent.

M-NCPPC:

BCBS POS:	25% of annual paid claims
Caremark Drug:	1% of annual paid claims

WSSC:

IBNR equals about two months of claims.

5. GASB Post-retirement Rules:

MCPS had pre-funded post retirement medical benefits but no longer has a reserve. M-NCPPC has built up a reserve of \$8.8 million but is using \$1.5 million for each county in FY03 and again in FY04 to help cover current retiree cost. Montgomery College has built up a reserve of \$17.4 million (at 6/30/02) and is continuing to add to it a reduced rate. Neither the County Government nor WSSC has built up a fund to pre-fund retiree benefits.

New GASB rules will require the agencies to expense an amount higher than the current "pay-as-you-go" cost. The County has given a response (to the question about how it plans to address the proposed GASB rules) that goes all the way up to the point of deciding whether or not to start pre-funding retirees benefits. The County Government comment to the MFP Committee might not go any further at this time, but at least the Committee should ask for a formal statement.

5. Recommendations

GASB: The most immediate cost saving issue deals with continuing to pre-fund or draw down funds set aside for retiree health care benefits. Our recommendations at this time are:

- Place a hold on \$400,000 pre-funding contribution for Montgomery College in FY04.
- Continue to draw down "115 trust" funds to help fund retiree benefits for M-NCPPC for FY03 and FY04.
- Have all five budget/finance directors make a recommendation by October 1, 2003 regarding GASB compliance and pre-funding.
- Unless all agree to start pre-funding by FY07 with Council approval, discontinue funding for retiree benefits at the College starting in FY05 until pre-funding is eliminated.

M-NCPPC Reserve: M-NCPPC had \$3,239,837 in unreserved money in its group insurance fund at the end of FY02. Our recommendation is that this be used to reduce the FY04 funding level (half of the benefit going to each county). This will obviously result in an increase in FY05 funding needs compared to FY04.

MCPS Employee Cost Sharing: One seemingly obvious change is to lower the 95/5 cost sharing arrangements to 80/20. While this is our recommendation, we understand that this is not an easy thing to do. This would need to be negotiated with unions and would be tied into issues beyond those we have considered. We realize that the change could result in a decline in take home pay if negotiated during a time of low or no pay raises and rising health care costs. Therefore, we encourage the Council to discuss this directly with MCPS. The change may need to be spread out over several years. (Also see the comment in the MCPS section about becoming the provider of choice.)

Combining Active and Pre-Medicare Retiree Expense: As the groups get large enough to have credible experience for pre-Medicare retirees, we suggest that separate rates be established for employees vs. pre-Medicare retirees. For the County Government, this would likely raise retiree cost and lower employee and County Government cost.

IBNR: We recommend that medical IBNR rates be no more than 20% unless supported by actual claims experience. Rates of 25% that are simply recommendations by providers should not be used. However, if fund balances are not sufficient, simply lowering budget requests because of high IBNR reserves would not be appropriate.

Trend Assumptions: Our general feeling is that most of the trend assumptions used are too optimistic. We recommend that the agencies use trend rates similar to what the County Government proposed with the following two modifications: (1) ultimate medical rate be closer to 5% and Drug at 6% and (2) the decline from the high first year rate to an ultimate sixth year rate be somewhat more gradual. Even the 5% and 6% rates assume improvement and rates of 6% and 9% may be just as likely.

Fund Balance (shock absorber): We recommend that the target be 5% of prior year expenses.

Forecasting: We recommend that MCPS prepare detailed six-year forecasts of their group insurance funds similar to what is done by County Government. Given their size, we think an explicit group insurance fund projection would reassure everyone involved and help with planning. The other three agencies might also benefit, but given their smaller size they are not part of our recommendation.

Health/Prescription RFP Process: We understand that a joint RFP will be conducted by MCPS, the County Government and M-NCPPC for their health plans. We also understand that the County Government will include prescription drug coverage in the RFP process (the Schools and M-NCPPC did a prescription RFP for a January 2002 effective date). These should help, in a modest way, to temper health inflation for CY04. As part of this process, we encourage all entities to look at self-insuring their HMO plans.

Life Insurance RFP: The life insurance market continues to be very competitive. We recommend that any group which has not bid this coverage in the last two years do so for a January 2004 effective date. We believe such an RFP should be done by all groups combined for pricing leverage. Rate and benefit structure autonomy can still be maintained even with a joint bid.

Consumer-Driven Health Plans: These plans represent a unique new approach to address the problem of healthcare inflation. By giving consumers more control over the way dollars are spent, they aim to create a better-informed, more efficient consumer of healthcare. Though actual results with these plans are limited, early indications are that they can have a significant moderating affect on healthcare inflation. Contrary to the perception held by some employee groups, this can be accomplished without reductions to benefits. We recommend the introduction of such a plan (as an option) be considered, that it be discussed as part of the bargaining process, and that a potential vendor be chosen as part of the healthcare RFP process.

6. Separate Discussion of Each of the Five Agencies

Comments on Montgomery County Government Plans:

The plan covers about 7,746 employees and 3,366 retirees.

The County Government's plans seem to be well managed. Because of the history of tracking events and budgeting there seem to be relatively few areas for budget surprises other than large increases in rates.

However like almost every government, the existing design is a collection of past practices with its ability to adapt to best practices and current events limited by both collective bargaining constraints and a desire not to harm members. Eric Wallmark seems well aware of these issues and many of the options available for discussion. However, part of what we are trying to do is to make the Council aware of options, even those that the County Government has either rejected or has put on its own agenda for discussion internally or with the unions. The Council should also appreciate the reluctance of the County Government to disclose how it might present options in future labor negotiations.

Budget Comparison:

(\$ in millions)			
	FY03	FY04	Increase
Employees	\$43.8	\$56.8	29.7%
Retirees	\$14.0	\$17.8	27.2%

Retiree Cost:

We did note that the projection included an additional contribution of \$2,125,100 for retirees during the period 7/1/2003 through 12/31/2003. We were told that this was the result of an increase in projected retiree cost after the initial budget forecast was prepared.

The projection assumes that the number of retired participants does not change from year to year. However, the reality is that the number is likely to grow every year for many years due to overall growth in County Government employment over the last 25 years. The number of retirees increased 4.9% from 3,209 to 3,366 from February 2002 to February 2003. This is one reason why additional requests such as the one above are likely to continue to be needed.

Mixing of Active and Retiree experience when setting rates:

Actives and Pre-Medicare retirees who elect the same health care coverage are charged based on the same total cost of the plan. For example, the Care First point of service plan cost is \$337.15 per month for individual coverage. It is likely the retiree experience is higher due to their age. Therefore, the true cost could be \$320 for actives and \$380 for retirees. What would happen if the rates for retirees reflected just retiree experience? It is likely that the County cost would decline since the retirees tend to pay a larger share of

the premium than do active members. Said differently, retiree cost is currently being subsidized by the actives.

Bargaining constraints:

We understand that County Government will soon start the bargaining process with FOP and MCGEO, for contracts that will start 7/1/2004 (any change in cost sharing or benefits might be delayed until 1/1/2005).

Possible Cost-Saving alternatives:

A potential option to consider is self-insuring the Optimum Choice HMO. MCPS has done this, and County Government could probably "piggy-back" on the MCPS arrangement, while keeping the same benefits. This would give County Government lower fixed costs, while being transparent to members. In addition, the County Government will be providing retirees with a drug discount card. This will mean both the retiree and the Plan will be paying wholesale instead of retail. This should achieve savings without a benefit change.

76/24 Cost Sharing in Select Plan:

The original intent of the Select plan was to create a credit based system where the employer could better control its share of the cost. Going into this design, it was understood that there would be strong union resistance to anything that would make it easier for the employer to shift cost to employees. We understand that at this time (about 8 years after its inception, which was about the same time that the Defined Contribution plan was adopted) none of the unions have agreed to this plan. In addition, due to complications in administration, the plan has largely reverted to a 76/24 cost sharing arrangement. (Note: the employer pays less than 76% for part time employees.)

Other thoughts/observations:

GASB – The County gave a good current response to the GASB question. However, the big questions are whether they will begin to pre-fund and increase taxes (or find revenue from other sources). MCPS, Montgomery College and M-NCPPC have attempted pre-funding. However, MCPS and M-NCPPC ended up drawing down those funds and moving away from the pre-funding concept.

County Government has used a first year trend assumption for medical benefits of about 16.4% dropping to about 6.8% in the second year (both affecting FY04 budget projections).

Life and Accidental Death Disability (AD&D) rates are high because they include retirees (fully insured).

IBNR levels/setting of reserve: County rates are based on actual experience and seem appropriate. See the chart on page 7.

Comments on Montgomery County Public Schools:

The plan covers about 17,565 employees and 5,774 retirees.

Fund balance:

MCPS had an undesignated fund balance (in excess of IBNR) of \$34.9 million at 7/1/2001. The amount was roughly cut in half during FY02 and is expected to be close to zero by the end of FY03. A portion of this decline was due to the draw down of the funds set aside for post retirement benefits (mostly during FY02). Expenses are expected to materially exceed revenue for both the employee and retiree portions of the fund during FY03.

As a result, by the end of FY03 there is expected to be no material fund balance (shock reserve), and the FY04 budget request must include not only regular increases but make up for the lack of an available fund balance that was used to keep budget requests down during FY02 and FY03. The increase in the budget request is as follows:

(\$ in millions and excludes some funds such as grant money)

	FY03	FY04	Increase
Employees	\$104.3	\$125.0	19.81%
Retirees	\$19.7	\$29.9	51.36%

The trend rate used to determine the increase in the requested funds was determined on a composite basis. From FY03 to FY04 the trend assumption was 6.97% for actives and 6.46% for retirees. This is somewhat lower than the trend rate prepared by the MCPS consultant of about 8.8% and significantly lower than market trends (which are currently in the 12% to 18% range depending on product).

The difference between the trend rate and the large increases in requested money (i.e., 6.97% versus 19.81%) has to do with shortfalls in expenses over revenue during FY03 (i.e., the draw up of prior surplus).

What is MCPS planning to do about any deficit in the fund? Will MCPS try to build back a fund surplus after FY04? These are questions that MCPS needs to answer.

Forecast/Trend rates for CY2004/enrollment projections:

Like County Government, MCPS has a large self-insured component to its plan. While this is expected to save money, it does create a risk. MCPS should do a forecast, perhaps similar to the County's. For example, the large increase in the FY04 budget request can be predicted in advance since the FY03 request depended on using up fund surplus. In addition, we would like to be more confident that the FY04 trend rate fully factors in the impact of the large rate increases at 1/1/2003.

Cost sharing and becoming the provider of choice:

Most MCPS employees are covered by health plans where MCPS pays for 95% of the cost. This is higher than the other agencies. In addition, enrollment and the percentage

of members electing family coverage have risen. This may in part be due to the weak economy. The result is extra cost due to MCPS being the provider of choice. While this is a bargaining issue, we expect that the large increase in the FY04 budget request will result in the Council asking what plans MCPS has to change the cost sharing arrangement.

Mixing of Active and Retiree experience when setting rates:

MCPS sets rates separately for employees versus (pre-Medicare) retirees. Therefore, the higher claims cost for retirees results in higher rates for retirees. This keeps down the employer cost since the employer pays less of the retiree total rate than that of the active employee rate. This is not true of County Government's method.

Bargaining constraints:

MCPS starts bargaining in the fall (2003). New union contracts would likely be for benefits effective 1/1/2005 unless the council does not fund the budget request. What can MCPS tell the Council about the current bargaining process due to the large cost increases and potential fund deficits?

Drug Cards:

All medical coverages except Kaiser have a prescription plan administered by CareMark. The current co-pays are \$3 for generic and \$10 for brand. These co-pays are being increased for retirees to either a \$5/\$15/\$25 3-tier, or a \$10/\$25/\$35 3-tier. In addition, charging two co-pays for a three-month supply encourages mail order usage. Those employees who choose the Kaiser medical plan have their drug coverage through Kaiser, and the co-pays are the same as the CareMark plan.

IBNR:

MCPS has the health care providers set the IBNR levels. MCPS also has them checked by a consultant, for both reasonableness and to make sure every plan that needs and IBNR has one set. The IBNR levels look high as of 6/30/2002.

Comments on Montgomery College:

The Plan covers about 1,141 employees and 345 retirees.

Cost Sharing:

Actives have a 75/25 cost sharing arrangement for all plans and benefits. This is the lowest employer share of any of the five agencies. Part-time employees actually pay more; the College pays a pro-rata share based on the employee's % of time worked. For example, an employee who works 50% of the time receives a contribution of 50% of 75%, or 37.5%.

For retirees the employer share is 20%, 40% or 60%. For most retirees³, the College pays 60% of the cost.

Self Insured vs. Fully Insured Plans:

The College offers four different plans. Two of the plans are self-insured and are with CIGNA, covering about 54% of employees. Stop loss coverage on the CIGNA plans is \$125K specific and 125% aggregate. The CIGNA plans were just bid last year. The other two plans are HMOs (Kaiser and Optimum Choice) and are fully insured. Prescription plans are offered with all of the medical options and are administered by the various medical vendors. Plan design changes, like co-pay changes, etc., can be made without bargaining. Rate renewals are reviewed by Aon.

Retirees:

A retiree is a former employee who was eligible for retirement pursuant to the Maryland State Retirement Agency rules, terminates service with the College and immediately begins receipt of their College retirement annuity.

Mixing of Active and Retiree experience when setting rates:

Like MCPS, the actives and pre-Medicare retirees have different total rates for the same health care coverage, based on the separate experience of the two groups.

Bargaining constraints:

The bargaining on health benefits is very limited. The general agreement is to provide the same benefits as are provided to non-represented employees. Changes in plan design and co-pays are not bargained. The College added: "Through the budget and plan renewal process the projections are based on current plan design and realistic anticipated budget growth. If it appears that our cost increases cannot come within our projections, the plan design is reviewed and adjusted as appropriate and necessary."

³ The college pays 40% of the cost for future retirees who have less than ten years of service and 60% for those with at least ten years of service.

Drug Cards:

There is no stand-alone drug benefit.

Finance observations for Montgomery College:

The following is a comparison of the budget request amounts:

	(\$ in millions)		
	FY03	FY04	Increase
Employees	\$6.6	\$7.6	15.2%
Retirees	\$1.0	\$1.1	7.3%
Retiree pre-funding	\$0.4	\$0.4	0%

The trend rate used was 12% and a "few points were added for vacant positions."

The College uses an IBNR reserve of 25% of annual claims and holds about an additional 10% reserve fund. The 25% IBNR level seems too high.

The College is pre-funding retiree health benefits and has prepared Financial Accounting Standards 106-type valuations. We have seen the valuations. As of 6/30/2002, the College had accumulated \$17.4 million for this purpose. The annual expense amounts from the valuations (e.g., \$2.9 million for FY02) do not match up with the actual contributions (e.g., \$2.0 million for FY02). In addition, the contributions for FY03 and FY04 are expected to be even further below the FAS 106 expense values than in prior years. The amount used for pre-funding has dropped from \$1.2 million in FY02 to \$0.4 million in FY03 even though the "expense" has risen.

Partial College response to pre-funding questions: "We have an annual actuarial calculation done each year to determine our liability and such liability is stated as a footnote in our financial statement. We budget for some portion of this liability that includes the current retiree expenditures. It has never been the intent to discontinue budgeting current retiree benefit expenditures and drawing down on the funds to pay current costs, especially now in light of the draft exposure for such pre-funding under GASB on the horizon. Until the liability is fully funded and we are in an economic capacity to meet each year's current liability pursuant to FASB/GASB, we would be moving in the wrong direction.

Comments on Maryland National Capital Park and Planning Commission Plans:

The plan covers about 1,806 employees and 448 retirees.

M-NCPPC has started the process of bidding with the other agencies, but some of the plans it offers are different. It offers an AETNA HMO which neither the County nor MCPS offers. Some of the more material differences are in cost sharing, drug benefits and retiree life insurance.

Budget Comparison:

(\$ in millions)

	FY03	FY04	Increase
Employees	\$6.1	\$7.0	14.8%
Retirees	\$1.4	\$1.6	16.0%

Self Insured vs. Fully Insured Plans:

All of M-NCPPC's HMOs are fully insured. Only the Blue Cross/Blue Shield Point of Service plan (which is the largest plan and covers 42% of employees) and the Caremark drug plan (covering almost all employees) are self-insured. The number of employees electing the Blue Cross/Blue Shield Point of Service plan has grown materially in the last three years as other options were discontinued. The Point of Service plan has \$125K specific and 125% aggregate stop-loss coverage. As mentioned previously, M-NCPPC will look at self-insuring their HMO plans as part of the upcoming RFP process.

85/15 Cost Sharing:

Both actives and retirees have an 85/15 cost sharing arrangement for most plans and benefits. For active employees, this is generally a higher employer share than County Government and lower than MCPS. M-NCPPC says this is intended to help make up for direct compensation lagging that provided to County Government employees. For retirees the employer share is larger than both County Government and MCPS.

Retirees:

To be eligible for retiree medical, an active employee upon retiring must provide proof of insurance for 36 continuous months before retirement.

All retirees get a \$10,000 death benefit.

Mixing of Active and Retiree experience when setting rates:

Like County Government, the actives and pre-Medicare retirees that elect the same health care coverage are charged based on the combined experience of the two groups. Given the relatively small size of the retiree group, setting rates based on separate experience would be more difficult than for County Government or MCPS.

Bargaining constraints:

M-NCPPC bargains with MCGEO and FOP. All that is bargained is the 85/15 cost sharing. M-NCPPC retains the right to change the benefits (e.g., co-pays). Contracts last three years. M-NCPPC is now bargaining with MCGEO on a contract that would start July 1, 2003. The FOP contract (covers about 200 employees) began February 1, 2002.

Drug Cards:

The drug benefit is a stand-alone benefit. Employees and retirees can just elect drug coverage. There is a four-tiered drug benefit. While some co-pays are low, the four-tier structure is advanced.

Finance issues:

M-NCPPC had a fund balance of \$6,112,280 at June 30, 2002. Some of this was allocated as follows:

- \$1,175,901 to keep a 7% fund balance (shock reserve).
- \$1,600,000 to reduce the FY04 budget request or spend on certain activities in FY04 (including \$900,000 for employer share of retiree cost).
- \$96,542 for Flexible Spending Accounts.
- \$3,239,837 unreserved.

We assume that the \$3,239,837 could be used for FY04 (half allocated to each County). In addition, M-NCPPC had \$8,844,356 (as of June 30, 2002) in a trust to pre-fund retiree benefits. This fund is declining by about \$3 million per year, since it being used to help cover current retiree cost for both Counties combined. If used for this purpose, the \$8,844,356 plus the \$900,000 reserve in the group insurance fund will likely run out late in FY05.

GASB question:

Now that GASB has issued an exposure draft and M-NCPPC has made a request for FY04, what is to happen to the pre-funding concept? Why should the Council contribute to additional pre-funding if this fund is really being treated as a rainy day fund for health benefits?

Comments on WSSC:

The plan covers about 1,346 employees and 1,171 retirees. The number of active employees has fallen from more than 2,000 six years ago because of WSSC's Competitive Action Program.

Cost Sharing:

The cost sharing is 80/20 for both employees and retirees. The only plan that is not 80/20 is the dental plan for retirees where the retirees pay the full cost. While there may be an implicit subsidy for retirees if average claims tend to be higher for retirees, this tends to be less of an issue in dental coverage than in medical. For benefits other than dental, separating the rates between retirees and actives will do nothing for the employer's share of the cost since WSSC pays 80% for both active and retiree benefits.

The definition of a retiree is anyone who is eligible to retire under their retirement plan.

Self Insured vs. Fully Insured plans:

WSSC offers four different medical plans. Two are self-insured (AETNA POS and Optimum Choice) and two are fully insured. The self-insured plans have stop loss coverage.

Bargaining constraints:

The bargaining agreements simply provide for an 80/20 cost sharing. There is no requirement as to the level of benefits or plans offered. Bargaining agreements expire June 30, 2003.

Drug Cards:

There is no separate drug benefit. It is bundled with the medical coverage.

Bidding:

WSSC recently rebid the health plans in the summer of 2002. They did this on their own (i.e., without participation from the other agencies).

Budget Comparison:

(\$ in millions)

	FY03	FY04	Increase
Employees	\$8.7	\$10.1	16.0%
Retirees	\$6.3	\$7.1	13.4%

The FY04 budget projection was based on a 15% trend assumption.

Finance topics for WSSC:

WSSC's audited financial statements do not contain any separately identified health care information.

WSSC does have an IBNR reserve of about two months of claims.

WSSC does not explicitly forecast rates beyond FY04. There is a total WSSC multi-year budget forecast. Medical costs are covered in the assumed rates of growth for "All Other Expenses."

WSSC is not currently pre-funding any retiree benefits. WSSC is currently evaluating the proposed GASSB rules and has not made any decision on pre-funding at this time.

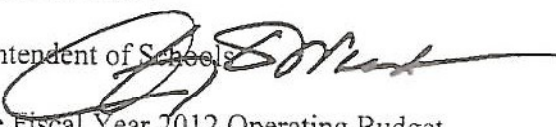
WSSC absorbs any gains and losses in its health insurance cost from other parts of its budget.

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

May 23, 2011

MEMORANDUM

To: Members of the Board of Education

From: Jerry D. Weast, Superintendent of Schools 

Subject: Tentative Action on the Fiscal Year 2012 Operating Budget

Executive Summary

On May 19, 2011, the County Council tentatively approved the Montgomery County Public Schools (MCPS) Operating Budget appropriation for Fiscal Year (FY) 2012. The Council approved a total of \$2,086,786,613. This is a decrease of \$17,401,427 (0.8 percent) from the current FY 2011 Operating Budget of \$2,104,188,040. The total tax-supported budget (excluding grants and enterprise funds) for FY 2012 is \$1,950,909,291, an increase of \$31,066,545 (1.6 percent) from the current FY 2011 Operating Budget of \$1,919,842,746 and the increase is solely the result of increased state aid. The amount to be approved by Council is \$127.1 million less than required by the state Maintenance of Effort (MOE) law. On May 26, 2011, the County Council plans to approve the appropriation by state categories.

Background

On February 14, 2011, the Board of Education adopted its FY 2012 Operating Budget totaling \$2,205,722,618. The Board's request assumed a local contribution of \$1,497,190,404, the minimum permitted by MOE state law. The County Council decreased the Board of Education's requested budget by \$118,936,005 (5.4 percent) to \$2,086,786,613. Attachment A shows the potential budget reductions issued by the superintendent of schools on March 2, 2011, to indicate the possible consequences of Council budget reductions.

On March 15, 2011, the county executive recommended to the County Council a total budget of \$2,123,491,884 for MCPS, including grants and enterprise funds, which was \$82.2 million (3.7 percent) less than the Board of Education's request. The county executive recommended a tax-supported budget for MCPS of \$1,987,614,562, excluding grants and enterprise funds, which was \$82.1 million (4.0 percent) less than the Board of Education's request. This included the same amount of local contribution (\$1,415,085,344) as MCPS received in FY 2011. As approved by the County Council, the FY 2011 Operating Budget includes a local contribution of \$1,370,101,480, a decrease of \$44,983,864 (3.2 percent) below the FY 2011 local contribution.

In addition, the approved appropriation includes an estimated FY 2011 ending fund balance of \$17 million as a result of the hiring freeze and comprehensive expenditure restrictions implemented on October 12, 2010. The FY 2011 savings also include \$4.4 million in federal grants through the Education Jobs Fund that can be expended in FY 2012.

Budget Development Process

On December 15, 2010, I recommended an operating budget for Montgomery County Public Schools at the minimum amount permitted by the state MOE law. That recommendation resulted from an extensive participatory process of budget development. This process continued a long tradition of extensive involvement of parents, staff, residents, and other stakeholders. From the beginning of the process, representatives of each of the employee associations (the Montgomery County Education Association, the Montgomery County Association of Administrators and Principals, and the Service Employees International Union [SEIU] Local 500) and leaders of the Montgomery County Council of Parent Teacher Associations (MCCPTA) participated in all of the budget development meetings. They spent hundreds of hours reviewing every proposal and alternative. I am profoundly grateful for their dedication and the unflagging cooperation they showed throughout such a difficult process. Executive leadership and many other staff members also played an essential role in providing information and developing new ideas to advance the budget process. The Board of Education received valuable input from parents and other county residents at two innovative community roundtables in October 2010. There, they heard first-hand about budget priorities and concerns. This and other input was fully reflected in the recommendations I made in December.

Following the presentation of my recommended operating budget, the Board of Education received extensive testimony from Parent Teacher Association representatives and many other stakeholders at two public hearings in January 2011. Based on this input, Board members asked many questions of staff during the hearings and at a budget work session. The questions and written answers were made available to the public and elicited more valuable input.

On February 14, 2011, the Board of Education adopted a budget at the minimum MOE level as required by state law. On March 2, 2011, because it was recognized that the fiscal situation might not permit county funding at the required level, I issued a list of potential budget reductions included here as Attachment A. These potential reductions totaled \$45,139,860 and included a reduction of 608.3 full-time equivalent positions. This was not a list of specific recommendations, but rather an indication of what alternatives might be needed if significant cuts became necessary. These potential reductions were reflected in preliminary staffing allocations distributed to schools in March 2011 in order for planning for the 2011–2012 school year to begin in a timely way. It is not possible to delay until after final Council funding is known and final decisions are made by the Board of Education in June to operationalize potential staffing changes. Individual staff members who might be affected were notified and have been able to explore alternative positions if necessary.

On May 19, 2011, the Council indicated its intent to decrease county contribution by a total of \$127,088,924 from the Board's request for a total reduction of \$118,936,005. The specific changes identified by the Council were as follows:

	<u>Reduction Amount</u>
Salary steps and longevities	\$28,000,000
Program reductions	27,900,000
Contribution to Retiree Health Benefit Trust Fund	47,000,000
Employee benefit costs	18,700,000
Retirement administration fee	(2,789,669)
Additional state aid	6,578,593
Additional Fund Balance	<u>1,700,000</u>
Total	<u>\$127,088,924</u>

Based on the reductions adopted by the County Council, I am recommending the following changes in the Board of Education's request:

	<u>Positions</u>	<u>Reduction Amount</u>
Salary steps and longevities		\$28,000,000
Central services reductions	32.1	4,893,719
Other program reductions	287.8	20,106,281
Contribution to Retiree Health Benefit Trust Fund		47,660,833
Employee benefit costs		20,939,167
Retirement administration fee		(2,789,669)
Instructional television special revenue fund		<u>125,674</u>
Total	<u>319.9</u>	<u>\$118,936,005</u>

The total number of positions in the FY 2012 Operating Budget will be reduced by 155.1 positions from the number of positions in the current FY 2011 budget. The number of positions added to reflect enrollment growth of 3,400 students and other changes (164.8) is offset by a decrease of 319.9 positions through reductions made by the County Council.

Attachment B is a summary of recommended reductions in central services and other program reductions, and Attachment C indicates the impact of each of these reductions. I also am recommending an increase in the reduction of contributions to the Retiree Health Benefit Trust Fund of \$660,833 to reflect the actual amount requested by the Board and an increase of \$2.3 million in the reduction of employee benefit costs. I also am recommending that funds for salary step and longevity increases be eliminated.

The elimination of the salary step and longevity increases and the reductions to employee benefit costs will require the Board of Education to complete negotiations with the three employee associations. It is my hope that at least tentative agreements can be reached by the time the Board takes final action on the budget on June 16, 2011. The employee associations will need to take any changes to their contracts out for ratification by their members.

The County Council is authorized by the State Education Article (Section 5-101) to approve the MCPS Operating Budget by category of expenditure as defined in the law. The Board of Education may reallocate the resources within each of the categories, but the Board cannot transfer any allocation between categories without approval by the County Council.

State Aid

Adoption of the FY 2012 state budget by the Maryland General Assembly included maintenance of current state aid formulas. The state budget replaces federal stimulus funding through the *American Recovery and Reinvestment Act of 2009* (ARRA) that terminates after FY 2011 with state funds to maintain current state aid formulas. Final legislative action increased the per-pupil amount for the Foundation program from \$6,599 to \$6,694, the current level. This provides MCPS with \$6.6 million more in state aid than expected when the Board's request was submitted to the County Executive and County Council.

State action also included a variety of changes in state health insurance and retirement plans, including the state retirement system for teachers in which Montgomery County participates. The Board of Education will consider similar changes in local retirement plans at tonight's meeting. The legislature also added an administrative fee imposed on plan participants, including MCPS, of \$162.77 per retirement system member. For FY 2012, this fee will total \$2,789,669. Council action adds this amount to the FY 2012 budget.

Maintenance of Effort

On March 31, 2011, Montgomery County applied for a waiver in the FY 2012 requirement for MOE to allow a local contribution of \$1,415,085,344. The Board of Education adopted a resolution on March 28, 2011, to support the county's application for a waiver. On April 15, 2011, the county withdrew its application. By making a local contribution of \$1,370,101,480, Montgomery County will be in violation of the state MOE requirement. The Maryland State Department of Education has notified counties of potential penalties for not meeting the MOE requirement, including \$26,235,817 for MCPS. As a result of Maryland General Assembly legislation passed during the 2011 session, the penalty will not take effect until FY 2013.

Summary of Recommendations

This has been one of the most difficult budget years in the history of MCPS. The fiscal effects of the "Great Recession" have increased each year to a point that may threaten the future quality of

the school system. I am confident that the Board of Education will maintain its focus on the core academic priorities that have guided the budget development process. This commitment and the support of the entire community will continue to guide the system. Fiscal challenges will continue, but the focus on strategic goals of student achievement will guide the direction of the operating budget.

Recommended Resolution

WHEREAS, The Board of Education adopted the FY 2012 Operating Budget of \$2,205,722,618 at the minimum maintenance of local effort requirement of Section 5-202 of the *Education Article, Annotated Code of Maryland* on February 16, 2011; and

WHEREAS, The county executive recommended \$2,123,491,884 for MCPS, \$82.2 million less than the Board of Education's Budget Request on March 15, 2011; and

WHEREAS, The County Council intends to approve a total of \$2,086,786,613 (including grants and enterprise funds), a decrease of \$118,936,005 from the Board of Education's request, on May 26, 2011; and

WHEREAS, The County Council intends to appropriate a total of \$1,950,909,291 (excluding grants and enterprise funds), a decrease of \$118,810,331 from the Board of Education's request; and

WHEREAS, The County Council plans to make reductions to the Board of Education's Fiscal Year 2012 Operating Budget Request of March 1, 2011, of \$118,936,005, from the various budget categories, as shown on the following schedule, consisting of a decrease of \$118,810,331, excluding grants and enterprise funds; and a reduction of \$125,674 in enterprise and special revenue funds, in appropriating \$2,086,786,613 for the Board of Education's FY 2012 Operating Budget:

I. Current Fund	BOE Request March 2011	Recommended (Reduction) Addition	Tentative Approved Budget
Category			
1 Administration	39,496,294	(1,197,519)	38,298,775
2 Mid-level Administration	139,404,916	(2,815,674)	136,589,242
3 Instructional Salaries	847,046,612	(27,287,479)	819,759,133
4 Textbooks and Instructional Supplies	25,284,894	(386,598)	24,898,296
5 Other Instructional Costs	14,120,980	(265,766)	13,855,214
6 Special Education	280,336,383	(8,562,722)	271,773,661
7 Student Personnel Services	11,351,034	(331,418)	11,019,616
8 Health Services	54,670		54,670
9 Student Transportation	93,644,620	(447,493)	93,197,127
10 Operation of Plant and Equipment	116,587,792	(930,702)	115,657,090
11 Maintenance of Plant	33,666,617	(1,270,220)	32,396,397
12 Fixed Charges	547,859,895	(75,314,740)	472,545,155
14 Community Services	208,495		208,495
Subtotal, including specific grants	2,149,063,202	(118,810,331)	2,030,252,871
Less specific grants	79,343,580		79,343,580
Subtotal, spending affordability	2,069,719,622	(118,810,331)	1,950,909,291
II. Enterprise Funds			
37 Instructional Television Fund	1,550,674	(125,674)	1,425,000
51 Real Estate Management Fund	3,266,430		3,266,430
61 Food and Nutrition Services Fund	47,025,335	(128,290)	46,897,045
71 Field Trip Fund	2,122,819		2,122,819
81 Entrepreneurial Fund	2,694,158	128,290	2,822,448
Subtotal, Enterprise Funds	56,659,416	(125,674)	56,533,742
Total Budget for MCPS	<u>2,205,722,618</u>	<u>(118,936,005)</u>	<u>2,086,786,613</u>

now therefore be it

Resolved, That based on an appropriation of \$2,086,786,613, that includes an appropriation of \$56,533,742 for enterprise and special revenue funds and \$79,343,580 for restricted grants, to be approved by the County Council on May 26, 2011, the Board of Education tentatively adopts its Fiscal Year 2012 Operating Budget.

JDW:LAB:MCS:jp


Attachments

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

March 2, 2011

MEMORANDUM

To: Members of the Board of Education

From: Jerry D. Weast, Superintendent of Schools 

Subject: Fiscal Year 2012 Staff Allocations to Schools

This memorandum is to inform you about the preliminary steps that are being taken to prepare for the possibility that the county executive and the County Council will substantially reduce the Board of Education's requested Fiscal Year 2012 Operating Budget. Although I am hopeful that the Council will approve our budget and provide us with the resources necessary to meet the educational needs of our students, I believe that we have to plan for the worst-case scenario of severe budget reductions.

Consistent with past practice, the timeline for staffing allocations to schools is made during the first week of March for the upcoming school year. In consideration of the difficult fiscal times we are facing, I believe it is prudent that we plan for significant reductions in allocations. It is extremely difficult, but it is the responsible thing to do. If we do not make this assumption and allocate positions to schools based on the Board's requested budget, and the County Council makes dramatic reductions in May 2011, we would have to eliminate hundreds of school-based positions in early June 2011 and restart the involuntary transfer process at a time when teachers and other 10-month employees would be leaving school for the summer. We know that making these reductions now will have a significant impact on schools, but the disruption will be far less severe than if we had to make these cuts during the summer.

If we wait to reduce school allocations until after the County Council takes final action on the budget, the allocation, transfer, and hiring processes would begin three months later than usual, and it would be impossible to complete the process before school begins in August 2011. The uncertainties and anxieties resulting from waiting to make reductions will have a tremendous impact on our schools next fall. The plan we have initiated is intended to make the process as smooth as possible given the difficult fiscal constraints. In the event that the County Council does not make reductions to the Montgomery County Public Schools (MCPS) FY 2012 Operating Budget, it will be much easier to allocate additional positions to the schools in June than it would be to begin reducing schools' allocations at that time.

Staffing Timeline

Schools are sent staff allocations for the upcoming year during the first week of March. After reviewing this information, between March 17 and March 22, principals identify and notify staff

members who will be involuntarily transferred. Position vacancies will be posted by principals at the end of March and the transfer process continues through May 31. After May 31, the offices of Human Resources and Development and School Performance begin to place all involuntarily transferred staff members who have not been offered positions during the transfer window. If vacancies exist at the time, the Office of Human Resources and Development will hire new teachers from outside MCPS. Prior to 2010, hiring began before June using the "open contract" process in which new hires were given a contract but were not assigned to schools until all involuntarily transferred staff members had been placed. This year, because of the uncertainty of the situation, open contracts will be offered in only a few selected areas of need, such as special education.

Reductions

On January 28, 2011, I sent an email message to MCPS staff about the FY 2012 Operating Budget and attached a list of reductions that might have to be considered if the County Council does not approve full funding of the budget request. Since January, based on input we received, we have made some adjustments to the list of reductions. The revised list, with notations where adjustments have been made, is attached. We have used the revised list of possible reductions as the basis for the allocations that will be made to schools this week. Some of the reductions have not been made at this time because they are not part of the March allocations, such as building service worker positions, high school athletics, high school activity buses, middle school extended day/year program, and Outdoor Education. Depending on the final actions of the County Council, my goal is to keep "Reductions in Force" (layoffs) and the number of staff who lose hours of employment to a minimum. Obviously, the final resolution of this issue will depend on the County Council's action.

The positions not allocated are being held in reserve to be used as part of the budget reduction if the final County Council action results in a decrease to our budget. If we ultimately have to eliminate the positions that are being held in reserve, there will be a significant impact on schools. As you know, we have identified several areas in central services for cuts as well. We will notify central services staff whose positions might be eliminated in the next few weeks so that they may have the opportunity to seek positions in schools during the scheduled voluntary transfer process.

If you have any questions, please contact Mr. Larry A. Bowers, chief operating officer, at 301-279-3626.

JDW:LAB:ndm

Attachment

Copy to:

Executive Staff
Ms. Cuttitta
Mr. Ikheola

Dr. Newman
Mr. Prouty
Ms. Tribble

MONTGOMERY COUNTY PUBLIC SCHOOLS

FISCAL YEAR 2012 OPERATING BUDGET

REVISED SUMMARY OF POTENTIAL BUDGET REDUCTIONS

In the event that Montgomery County Public Schools does not receive local funding for the Fiscal Year (FY) 2012 Operating Budget at the minimum Maintenance of Effort (MOE) level, it will be necessary to consider significant service reductions in the base budget. The amount of reductions will depend on how much local funding is actually received compared to the amount required by MOE. The following revised list contains potential major reductions in the budget and shows modifications since the list was originally issued. The list is not in any priority order, but will give stakeholders an overall idea of what reductions may be necessary to consider before the FY 2012 Operating Budget is approved in June 2011.

Item	Description	FTE	Savings
1	Class Size—An increase of an average of 1 student per class at the elementary and middle school levels and by .4 at the high school level would eliminate 193.4 168.4 teacher positions. This is in addition to the 240.0 positions cut to increase class size by an average of 1 for FY 2011.	193.4 168.4	\$12,608,419 \$10,978,582
2	Academic Intervention Teachers—Cutting 13.0 of the 46.4 elementary and 10.0 of the 38.5 middle school positions would significantly impact support for struggling students. This is over and above 33.8 positions cut in FY 2010 and FY 2011.	23.0	\$1,499,450
3	Staff Development Teachers—Reducing the 181.1 positions budgeted for elementary, secondary schools, special/alternative education by 79.4 51.2 (44 28 percent) would leave 101.7 129.9 positions.	79.4 51.2	\$5,761,618 \$3,715,300
4	Reading Recovery [®] Teachers—This would eliminate the support currently provided by Reading Recovery [®] teachers to elementary students who have reading delays. However, we will restore 7.0 teachers to support reading in 14 schools.	15.0 8.0	\$968,903 \$516,748
5	Instrumental Music Teachers—A reduction of 4.0 of the 37.2 instrumental music teacher positions would require that students receive instruction in larger groups and some students may receive less support.	4.0	\$260,774

Item	Description	FTE	Savings
6	School Counselors—A cut of 10.0 5.0 elementary and 10.0 middle school counselors would increase the ratio of students to professionals and severely impact services to at-risk students. In FY 2011, 9.0 school counselor positions were cut from the budget.	20.0 15.0	\$1,628,625 \$1,272,544
7	Elementary Paraeducators, Lunch Hour Aides, Parent Community Coordinators—A cut of 20.0 paraeducators, 6.0 lunch hour aides, and 2.2 parent community coordinators will reduce support at a time of significant student growth. There was a reduction of 27.0 paraeducator positions in FY 2011.	28.2	\$1,077,784
8	Instructional Data Assistants—A reduction of 16.4 elementary and 4.75 middle school positions will reduce support to administrators and teachers who use student data to drive educational decisions.	21.1	\$1,003,753
9	Media Assistants—A reduction of 23.0 elementary, 8.0 middle, and 7.5 high school positions will require a change in the current enrollment-based guidelines for allocating these positions to schools. Overall, support to students will be decreased. There were 10.5 media assistant positions cut over the last two years.	38.5	\$1,597,511
10	Middle School Extended Day/Year Program—The elimination of middle school after-school and summer school programs would cut services to middle school students who require significant support and are at risk of academic failure.		\$1,568,046
11	Assistant School Administrators—There would be a reduction of 8.0 2.0 of 15.0 middle school positions and 10.0 2.0 of 20.0 high school positions. These positions provide valuable support to the school administrative team, teachers, students, and the school community.	16.0 4.0	\$2,002,052 \$500,512
12	Security Assistants—School security staff will be reduced by cutting 10.0 2.0 positions at middle schools (from 69.0 to 59.0 67.0 positions), and 10.0 2.0 positions at high schools (from 112.0 to 102.0 110.0 positions). This reduction in staff would impact the ability of schools to maintain a secure learning environment.	20.0 4.0	\$858,655 \$171,731

Item	Description	FTE	Savings
13	Outdoor Education—Eliminating this program would deprive students of opportunities to participate in a variety of outdoor environmental field activities, including the overnight program for sixth grade students.	7.0	\$596,767
14	ESOL Counselors/Staffing Ratios—A reduction of 5.0 4.0 ESOL counselors would reduce the number of positions from 11.0 to 6.0 7.0. A reduction of 9.1 teacher positions would increase the student-to-staff ratio by .8 for elementary schools, .5 for middle schools, and .6 for high schools. There was a reduction of 6.0 ESOL teacher positions in the FY 2011 budget.	14.1 13.1	\$956,712 \$884,022
15	Vocational Support/Career Preparation Teachers—Vocational support teachers would be reduced by 50 25 percent – from 20.0 to 10.0 15.0 positions. Career preparation teachers also would be cut by 50 25 percent from 20.5 to 10.5 15.5 positions. Remaining staff will have to serve more students with less individual attention.	20.0 10.0	\$1,303,870 \$651,934
16	Reduce High School English Composition Assistants—Reduce 9.75 of 58.3 English composition assistants. Staff would have less time to assist individual students and teachers. This will reduce valuable support guiding students to postsecondary careers.	9.75	\$456,421
17	High School Career Information Coordinators—Change schedule of high school career information coordinators from 12- to 10-month positions (same number of days as media assistants). This will reduce valuable support to students during the summer.		\$264,141
18	Eliminate High School Activity Buses—Eliminate bus availability for students participating in after-school and extracurricular activities. Students will need to arrange their own transportation home to continue participation. Elementary school activity bus service was eliminated in FY 2011.		\$294,000
19	Reduce Funds for High School Athletics—Reduce stipends and other expenses that support high school athletics. This cut could reduce the number of coaches, games, practices, and/or teams in various sports. This will result in fewer athletic opportunities for students and could result in additional extracurricular fees to offset budget reductions.		\$1,080,000

Item	Description	FTE	Savings
20	Reduce Building Service Workers—Reduce 60.0 building service worker positions from a total of 1,262 school-based positions (5 percent). Remaining staff would clean more space and there would be less flexibility in assignments. Some preventive maintenance likely will be delayed.	60.0	\$2,422,981
21	Instructional Technology Systems Specialists (ITSS)—Reduce 8.0 out of 38.0 middle school ITSS positions and 1.0 out of 26.0 high school positions. The reduced level of support will result in longer waiting periods to resolve technology hardware and software problems that arise during the school day.	9.0	\$694,276
22	Middle School Lunch Hour Aides—Reduce 20.0 lunch-hour aide positions from the 34.6 budgeted for middle schools for FY 2012. Without these positions, school administrators and security staff will have responsibility to supervise students during lunch periods.	20.0	\$622,302
23	High School Secretaries I—Eliminate 13.25 of the 82.9 school secretary I positions (18 percent) at the high school level. Completion of general office responsibilities will be delayed. Students, parents, staff, and visitors will be required to wait longer for assistance. Also, cut a .5 registrar position.	13.75	\$572,063
24	High School Teacher Assistants—Reduce 3.575 teacher assistant positions at the high school level.	3.575	\$119,661
25	Reduce School Furniture and Equipment and Other K-12 Resources—Delay restoration of school furniture and equipment reductions made in FY 2011. Schools will have to continue using older furniture and equipment, except for emergency needs, until budget resources can be restored. Other reductions would reduce temporary part-time salaries for support of school improvement needs and reduce the cost of school contractual services.		\$864,000
26	Secondary Learning Centers—Continue phase-out of high school learning centers. Students already in secondary learning centers will remain through Grade 12. In addition, change staffing ratios in remaining center classes to match similar classes in other special education programs.	17.9	\$1,034,630

Item	Description	FTE	Savings
27	Infants and Toddlers and Preschool Programs—Reduce 26 17.55 teacher and paraeducator positions in Infants and Toddlers and Preschool programs. Staff will need to serve more students weekly in classroom and home settings. No required services will be reduced.	26.0 17.55	\$1,594,111 \$1,103,055
28	Special Education Staffing Ratios—Change staffing ratios in special education programs, including Learning and Academic Disabilities (LAD), Gifted and Talented/Learning Disabled (GT/LD), and Deaf and Hard of Hearing (DHOH) programs. LAD ratio would change from 14:1 to 15:1, GT/LD from 13:1 to 16:1, and DHOH from 15:1 to 17:1. Current services would continue based on individual student plans.	23.2	\$1,478,018
29	Special Education Nonpublic Tuition—Reduce projected rate increases for tuition for special education students in nonpublic placement based on lower inflation expectations. State sets tuition rates for nonpublic programs.		\$1,410,630 \$2,166,213
30	Central Office Administrative Expenditures—Reduce 13.1 38.1 central office administrative positions. Reduce non-position central office expenditures, including temporary part-time salaries, contractual services, supplies, and other expenditures. The FY 2012 budget already includes \$3.8 million in central office reductions. Over last three years, central office cuts have totaled 174.2 positions and a total of \$28 million—a 20 percent reduction in these expenditures.	13.1 38.1	\$2,715,713 \$5,015,713
31	Increases for Inflation—Eliminate projected 3 percent increase for inflation for textbooks and instructional materials.		\$656,928
	Total	649.9 608.369	\$47,976,216 \$45,139,860

FY 2012 Operating Budget Reductions

	Description	Potential Reductions		Proposed Reductions	
		FTE	Savings	FTE	Savings
1	Class Size by 1 Student	168.400	\$ 10,978,582		
2	Building Service Workers	60.000	2,422,981		
3	Middle School Extended Day/Year		1,568,046		
4	Outdoor Education	7.000	596,767		
5	Activity Buses		294,000		
6	Career Information Coordinators		264,141		
7	Assistant School Administrators	4.000	500,512	2.000	\$ 250,255
8	Academic Intervention Teachers	23.000	1,499,450	14.000	912,702
9	Special Education Staffing Ratios	23.206	1,478,018	11.025	800,238
10	Reading Recovery Teachers	8.000	516,748	8.000	516,748
11	Security Assistants	4.000	171,731	4.000	171,731
12	English Compositions Assistants	9.750	456,421	9.750	456,421
13	Special Education Preschool Programs	17.588	1,103,055	7.188	284,053
14	Athletics		1,080,000		750,000
15	Instructional Technology Systems Specialists	9.000	694,276	9.000	694,276
16	Secondary Learning Centers	17.875	1,034,630	17.875	1,034,630
17	Staff Development Teachers	51.200	3,715,300	51.200	3,715,300
18	Counselors	15.000	1,272,544	9.000	763,526
19	ESOL Counselors/Teachers	13.100	884,022	9.100	593,261
20	High School Secretaries	13.750	572,063	13.750	572,063
21	Paraeducators/Lunch Hr. Aides/Parent Comm. Coord.	28.200	1,077,784	28.200	1,077,784
22	Media Assistants	38.500	1,597,511	34.375	1,426,349
23	Instrumental Music Teachers	4.000	260,774	4.000	260,774
24	Vocational/Career Prep Teachers	10.000	651,934	10.000	651,934
25	Instructional Data Assistants	21.100	1,003,753	21.100	1,003,753
26	Middle School Lunch Hour Aides	20.000	622,302	18.625	579,519
27	School Furniture/Equipment/Other K-12 Resources		864,000		680,893
28	Inflation		656,928		656,928
29	High School Teacher Assistants	3.575	119,661	3.575	119,661
30	Special Education Nonpublic Tuition		2,166,213		2,133,482
31	Central Office Reductions	38.100	5,015,713	34.100	4,893,719
32	TOTAL	608.344	\$ 45,139,860	319.863	\$ 25,000,000



MONTGOMERY COUNTY COUNCIL
ROCKVILLE, MARYLAND

OFFICE OF THE COUNCIL PRESIDENT

MEMORANDUM

June 6, 2011

TO: Christopher Barclay, President
Montgomery County Board of Education

FROM: Valerie Ervin, Council President

SUBJECT: FY12 MCPS Budget

The Council understands that the Board of Education has suddenly discovered millions of dollars in additional resources and intends to meet the Council's approved FY12 budget level for MCPS without making changes to the employee cost-sharing required for health benefits. As you know, the Council's budget action explicitly assumed a multi-million dollar reduction associated with a minor increase in school employee cost-sharing. The current share – 5% for employees in HMOs and 10% for others – is remarkably low. For example, federal employees on average pay 28%.

If the Board now finds itself with these additional dollars, do you still intend to implement the program cuts you tentatively approved on May 23? These include cuts to media assistants, academic intervention teachers, reading recovery teachers, staff development teachers, counselors, para-educators, and lunch hour aides. Will the Board use the newly discovered savings to restore these positions, or will you inflict the cuts on schools to preserve the employee share of health benefits?

In your May 19 statement to the community on the Council's budget action, you said: "The Council has stated that they support the school system and that its cuts will not hurt the classroom. That simply isn't true. Every school will feel the effects of these cuts." On the contrary, the Council urged the Board to adjust employee health benefits explicitly to minimize cuts to the classroom and protect vital school services.

The Council urges the Board to reconsider its apparent budget approach and redirect any additional resources to the employees and programs that directly benefit our children. The Council would expeditiously consider any categorical transfer that might be required to achieve this important outcome for our schools. I look forward to hearing from you as soon as possible on this matter.



MONTGOMERY COUNTY BOARD OF EDUCATION

850 Hungerford Drive ♦ Rockville, Maryland 20850

June 8, 2011

The Honorable Valerie Ervin, President
Montgomery County Council
Stella B. Werner Council Office Building
100 Maryland Avenue
Rockville, Maryland 20850

Dear Ms. Ervin:

Yesterday, I learned, through an Internet press release, about a memorandum addressed to me regarding the Fiscal Year (FY) 2012 Operating Budget for Montgomery County Public Schools (MCPS), although I have not received a copy of this memorandum through regular channels. Your press release mentions press reports regarding the potential recommendation of the superintendent of schools to the Board of Education regarding how to reduce the Board of Education's Requested Budget as a result of the massive cuts made by the County Council, a reduction of \$118.9 million below the Board's request. The Council directed the Board of Education to cut \$66 million (52 percent) of this total from employee benefits and the Board of Education will comply with that direction. Let me remind you that the budget reductions blatantly violate state law regarding the minimum local contribution to schools and open MCPS to an undeserved penalty of \$26.2 million from the loss of increased state aid that we deserve because of increased enrollment and the educational needs of our students. This is \$26 million that can restore more than 400 teacher and other staff positions that we may have to cut in FY 2013.

According to these press reports, the superintendent of schools believes that the reductions imposed by the County Council in Category 12, Fixed Charges, can be met through efficiencies and cost reductions in the provision of health and life insurance to employees, rather than by increasing the share of these costs paid by employees. Let me note that the County Council appropriates funds to the Board of Education by category total and does not have the authority to determine how to make specific reductions. This is the responsibility of the members of the Board of Education, who must make those reductions with the interests of the school system and meaningful student outcomes in mind, not the wishes of the Council. The Council staff material on employee benefits issues repeatedly emphasizes the authority of the Board of Education to make these detailed determinations, and you and other Council members reinforced that view while I and other Board members were present at your meeting. At those meetings that I attended, you never called on the members of the Board to express their opinions or describe how the Council's proposed changes might impact MCPS.

At the Council's meetings, the staff of the Office of Legislative Oversight reported on the possible impact of benefit cost share changes on school employees. They repeatedly noted that

lower paid MCPS employees, as well as similarly paid county employees, would suffer disproportionately from significant increases in their cost share. For employees who typically earn \$30,000 or less annually, the proposed changes in health insurance costs might be 15 percent or higher of their gross pay and a greater share of their take home pay. At the meeting of the Council, you commented on this harsh possibility and on the difficulties that it might create for employees and for the county, and you said that further study was needed to evaluate all the possibilities for cost reduction instead of just cost shifting. The Council's staff director, Mr. Steve Farber, agreed with you and pointed several times to the improvements instituted by MCPS that have significantly reduced the growth of health care costs. He noted that MCPS has encouraged two-thirds of its employees to enroll in lower cost managed care programs, instead of the more expensive fee-for-service options that are selected by two-thirds of county government employees. This point was so convincing that you initiated the creation of a task force to study how to reduce health insurance costs. This is a very wise idea and MCPS completely supports your proposal. Why would you want to disrupt that process now that all agencies and their employee unions have agreed to participate in good faith?

MCPS employees already have agreed to significant reductions in compensation. Two years ago, they voluntarily gave back \$89 million of already negotiated wage increases. For the past two years they have had no general wage increases, nor have they received annual increments based on seniority for eligible employees, saving \$80 million. Already, this has saved an annual total of \$143 million, equal to seven percent of the MCPS budget. In addition to the lack of pay increases, employees must pay an extra two percent of their salary as a pension contribution, both for the state and local retirement plans. The Board of Education has already enacted far-reaching changes in the pension plans that will impact both existing and new employees and will save millions of dollars immediately and into the future. In FY 2012, employees also will resume paying an additional two percent of salary as a social security tax (FICA) contribution, related to the end of the federal economic stimulus. Yet, you ask employees to pay a higher share of health insurance, which is essentially just another pay cut, on top of the four percent reduction already mandated for next year.

In fact, MCPS is working with its employee unions to review all employee benefit plans. During the next year, we will reopen benefits issues and discuss a variety of options for reducing employer costs. The county decided to take immediate steps to cut employee benefits without any negotiations with its unions. The members of the Board of Education do not believe that this go-it-alone approach is effective. It is not part of the tradition of labor-management cooperation that has produced outstanding results in the classroom for our students. Would you needlessly put that at risk at a time when our employees are working with us to solve our long-term fiscal problems?

I also am surprised to hear from you about the health insurance issue at this time. As you know, when Board Vice President Shirley Brandman and I met with you on April 15, 2011, we indicated to you that we would likely be able to reduce healthcare expenditures this year by about \$15 million. In addition, the Council's Education Committee had plenty of opportunity to

review the Board of Education's Budget request during April and May 2011. It spent a total of less than one hour in its total public review. At our first meeting in April, you cut off your own staff's presentation of the MCPS budget. At your second meeting in May, that lasted only a few minutes, you never asked any specific budget questions. The Government Operations Committee reviewed benefits issues but never asked the Board of Education to participate in its review. As president of the County Council, you disposed of the MCPS budget in only a few minutes at your work session, with no opportunity for members of the Board to participate. Is it realistic to raise the important issue of health insurance now, when work on the operating budget is complete?

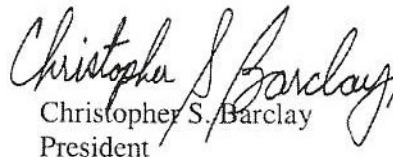
As a result of the Council's hasty action, the Board of Education must make \$119 million of reductions. Based on the tentative action taken by the Board of Education on May 23, 2011, approximately \$95 million (80 percent) of the \$119 million total will relate to employee compensation, including salary and benefits changes. The reductions in the cost of benefits will be \$22 million, even greater than the \$18.7 million recommended by the County Council. Fortunately, the costs of health insurance through the Employee Benefit Plan (EBP) have been lower than originally projected. The estimated expenditures for the EBP trust funds for FY 2011 were projected to be \$338.7 million. Because nearly all of the benefits plans are self-insured rather than paid through a fixed capitation fee, costs are notoriously difficult to predict. Not only do actual hospital and medical bills vary unpredictably based on usage and price, but employees have the opportunity to change plans in the middle of the fiscal year. Therefore, until after the completion of "open season" and the transition to new plans in January of each year, it is very difficult to predict total costs for the year. There also is a significant delay in receiving and analyzing invoices. It is only after we have analyzed the payments for February and March in late April that any trends from open season become apparent. Because the actual billings fluctuate significantly, it is not possible to make budget decisions from a single month's results; it is necessary to see a trend before making changes. Most consultants advise looking at trends lasting six months or longer and to use rolling averages of costs rather than individual billings to make any trend estimates. For example, the official federal health inflation rate for hospital services is 5.4 percent over the past 12 months, but the inflation rate for April (6 percent) was three times the rate for March (2 percent).

Your memorandum also states that had health insurance savings been identified sooner, it would have been possible to reduce reductions in school-based programs. That statement does not accord with actual Council action on the MCPS budget. The Council could have avoided reductions in school-based programs by accepting the county executive's budget recommendation of an \$82 million reduction, with which the Board of Education agreed. Instead, the Council made a further reduction of \$25 million, explicitly using \$8 million in increased state aid and MCPS savings to reduce the local contribution. The Council then took that \$25 million and used it all to fund county government projects. You ask me to believe that had you been able to reduce Fixed Charges by a greater amount you would have used the savings to restore cuts in school programs. When you had the chance to save school programs, you did not think that was such a high priority, but now that the budget is complete, you say it is.

The bottom line is that you want to reduce the salaries of MCPS employees and you believe that it will have no effect on educational quality. I remind you that that judgment is made by the Board of Education, not the County Council. The lack of effort that the Council made in studying these issues during its public review of the budget compromises your authority to give your opinion now. I urge you again to work with the members of the Board of Education in a respectful way to resolve the county's fiscal issues. Your continued disrespect of me and my colleagues on the Board of Education in statements to the media is unacceptable and unbecoming of someone in your position. We want to be your partner, but so far, we have not had sufficient communication to achieve our mutual goals.

I look forward to working closely with you and the County Council to resolve the fiscal issues impacting the quality of education in Montgomery County. Our staff will be available to answer any questions.

Sincerely,


Christopher S. Barclay
President

CSB:ms


Copy to:

Members of the County Council
Members of the Board of Education
Executive Staff

MEMORANDUM

June 17, 2011

TO: County Council

FROM: Valerie Ervin,  Council President

SUBJECT: **Resolution to add Review of MCPS Category 12 to Office of Legislative Oversight's FY 2011 Work Program**

For the Council and the public, full and transparent budget information from every County agency is essential to the integrity of our fiscal decision-making process. The Board of Education's handling of the FY12 Operating Budget for Montgomery County Public Schools raises serious questions about the adequacy of financial information provided by MCPS.

As one of the Council's initiatives to help ensure that the Council and the public receive full and transparent budget and related financial information from MCPS, I recommend that Council adopt the attached amendment to the Office of Legislative Oversight's FY 2011 Work Program (Council Resolution No. 16-1419). Specifically, the resolution assigns to OLO a project to review and analyze Category 12 of the MCPS budget, Fixed Charges. The resolution sets October 15, 2011 as the target deadline for OLO's initial report back to the Council.

As outlined in the attached Work Program amendment, the scope of the OLO project is to:

- Examine the components of Category 12 and all related funds, including those for employee pension and group insurance benefits;
- Track the budget, appropriation, and expenditure trends of these components; and
- Review the underlying assumptions behind MCPS' budget requests in Category 12 and related funds.

In addition, I recommend that the Council direct OLO to track MCPS' Category 12 expenditures throughout FY12.

I suggest that OLO be assigned this review with the understanding that they will be assisted, as needed, by central Council staff and the Council's actuarial adviser, Bolton Partners; and that OLO will coordinate its work with any related initiatives from the Office of the Inspector General. In addition to building upon OLO's outstanding work on the County's structural budget challenge and employee benefits, this project will provide critical information about a key part of the MCPS budget and lay a strong foundation for the Council's review of that budget in the coming year.

Attachment: Resolution to Amend OLO's FY 2011 Work Program

Resolution: _____
Introduced: _____
Adopted: _____

**COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND**

By: County Council

SUBJECT: Amendment to the FY 2011 Work Program of the Office of Legislative Oversight

Background

1. Chapter 29A, Montgomery County Code, establishes the Office of Legislative Oversight to serve as the principal means through which the Council exercises its legislative oversight functions. This includes providing the Council with information and recommendations concerning the operations of public and private agencies, programs, and functions for which funds are appropriated or approved by the Council.
2. The law establishing the Office of Legislative Oversight (Chapter 29A, Montgomery County Code) specifically authorizes the Office to conduct special program or budget analyses at the request of the Council.
3. The Council requires additional data and analysis to provide the basis for an informed dialog about the funds appropriated to Category 12, Fixed Charges of the Montgomery County Public Schools' budget, and other funds related to employee benefits.
4. On July 13, 2010, the Council adopted Resolution 16-1419, to establish the FY 2011 Work Program of the Office of Legislative Oversight (OLO). On February 15, 2011, the Council adopted Resolution 17-63 to amend the FY11 OLO Work Program.

Action

The County Council for Montgomery County, Maryland, amends Council Resolution 16-1419 to add the following project to the Office of Legislative Oversight's FY 2011 Work Program.

This is a correct copy of Council action.

Linda M. Lauer, Clerk of the Council

PROJECT #12
REVIEW OF CATEGORY 12 OF THE MCPS BUDGET

Principal agency: Montgomery County Public Schools

Origin of project: County Council

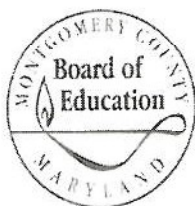
For the Council and the public, full and transparent budget information from every County agency is essential to the integrity of our fiscal decision-making process. The purpose of this OLO project is to provide critical information about a key part of the MCPS budget and lay a strong foundation for the Council's review of that budget in the coming year.

To improve the Council's fiscal oversight of the MCPS budget, the Office of Legislative Oversight must review and analyze Category 12 of the MCPS budget, Fixed Charges. Specifically, OLO must:

- Examine the components of Category 12 and all related funds, including those for employee pension and group insurance benefits;
- Track the budget, appropriation, and expenditure trends of these components; and
- Review the underlying assumptions behind MCPS' budget requests in Category 12 and related funds.

OLO should complete its initial report to the Council by October 15, 2011. In addition, OLO must continue to track MCPS' Category 12 expenditures and provide periodic reports to the Council throughout FY12.

OLO is assigned this review with the understanding that it will be assisted, as needed, by central Council staff and the Council's actuarial adviser, Bolton Partners. In addition, OLO's work will be coordinated with any related initiatives conducted by the Office of the Inspector General.



MONTGOMERY COUNTY BOARD OF EDUCATION

850 Hungerford Drive • Rockville, Maryland 20850

June 17, 2011

The Honorable Valerie Ervin, President
Montgomery County Council
Stella B. Werner Council Office Building
100 Maryland Avenue
Rockville, Maryland 20850

Dear Ms. Ervin:

I'm writing to acknowledge receipt of your June 16, 2011 memorandum about the County Council's intention to further review Category 12 of the Montgomery County Public Schools (MCPS) Operating Budget. As always, we stand ready to share financial information for the Council's review as has traditionally been the substance of Council Education Committee meetings. As I indicated in my previous letter, during our meeting with you on April 15, 2011, we notified you that we would likely be able to reduce healthcare expenditures this year by about \$15 million. In addition, there were numerous opportunities for the Council's Education Committee and Council staff, including the Office of Legislative Oversight staff that was focusing on the budget this year, to review Category 12, Fixed Charges, and ask questions about claims experience, assumptions used to project FY 2012 expenditures, fund balances, and other critical factors that are considered in developing the Employee Benefit Plan budget. In prior years, Montgomery County Public Schools (MCPS) staff would review the plan, actual experience, and projections with Council staff and the Council's committees. This type of analysis and review was not done this year. We look forward to resuming collaboration on this issue in the coming year so that you and all councilmembers understand MCPS' practices and procedures.

Before I discuss the employee benefit information, I am pleased to share with you that MCPS was recently notified that we have been awarded the Governmental Finance Officers Association Certificate of Achievement for Excellence in Financial Reporting for the seventh consecutive year for our 2010 Comprehensive Annual Financial Report (CAFR). In addition, the MCPS CAFR has been recognized with the Association of School Business Officers Certificate of Excellence in Financial Reporting for more than 20 consecutive years. Our financial reporting is well-respected, thorough, and complete.

Allow me now to provide you with more detailed information about the employee benefit plan fund that is used to manage health and life insurance benefits for MCPS employees. Employee health and life insurance benefits for MCPS employees are financed through an internal service fund, the Employee Benefit Plan (EBP) Trust Fund. The FY 2011 EBP budget totals \$338.7 million. The purpose of this fund is to dependably provide necessary resources to defray expenses for health and life insurance through a dedicated fund. This structure parallels the structure used for similar purposes by Montgomery County Government and by other county-funded agencies.

MCPS is largely self-insured for the purpose of meeting health and life insurance obligations. Because most EBP expenditures relate to direct claims payments, MCPS assumes the risk for unpredictable changes in billings. The EBP fund includes provisions to offset the claims risk. The fund maintains a reserve for Incurred But Not Reported (IBNR) claims that are known through

experience to have occurred but have not yet been received by MCPS. In addition, the fund includes a "shock reserve" that accounts for unpredictable changes in claims. During 2002–2004, the Council frequently reviewed the status of the funds of each county-funded agency because of the concern that rising costs might require the maintenance of greater reserves or that other plan design changes needed to be made to reduce costs. MCPS took an active part in that Council review. The Council consultant frequently urged county agencies, including MCPS, to maintain larger reserves and to make other administrative and plan design changes. On December 9, 2003, the County Council adopted a set of resolutions governing policy on health insurance plans, a copy of which is enclosed.

When the Superintendent's Recommended FY 2012 Operating Budget was developed in November 2010, health care costs were expected to increase by about \$18 million in FY 2012 based on estimates made by Aon, the MCPS health benefits consultant. Their projections were based on the trend of health care expenditure and actual experience for the previous 12 months. Beginning in January 2011, costs began to moderate and have been below the trend and the projections. By early spring, it became more likely that the fund would have a significant surplus for FY 2011. The county's health fund experienced similar positive results leading to a projected surplus of approximately \$12 million. Our consultants noticed the trends, warned us that it might be only a temporary blip, and could not provide a satisfactory explanation of the positive claims experience. At this time, we are still working with our consultant to estimate how much the actual savings might be.

Because health care costs factors are complex, because the EBP is self-insured, and because costs fluctuate sharply, it is difficult to project future costs or the status of the EBP fund. Health care costs can vary unpredictably. Changes occur in usage patterns, including both volume and intensity of service. Price changes have run at three times the general inflation rate or higher. Membership in the plan can change because of the changes in employment patterns or the number of spouses choosing to be on the MCPS plan and the number of dependents. Each year, cost patterns change as a result of "open season," as employees switch from plan to plan or join or abandon plan options in the middle of the fiscal year. The effects of open season make predictions for a fiscal year difficult until about three-quarters through the fiscal year as bills from January and February become available. In addition, during FY 2011, other factors have made projections even more difficult. For example, implementation of initial reforms in the federal *Affordable Care Act*, such as inclusion of adult dependents on family plans, has made it difficult to project costs. As additional health care reforms take effect, it will continue to be difficult to project expenses dependably using past models.

A review of the past decade of EBP results shows extensive fluctuation in costs and the resulting status of the fund. Since FY 2003, total health care costs for active and retired employees has increased in a range of \$16.8 million a year to \$23.5 million and in terms of percentage increase ranged from 6.6 percent to 11.9 percent annually. The year-end trust fund balance has fluctuated from a high of \$20.8 million (7.6 percent of expenses) to a low of \$93,000 (0.1 percent of expenses). The year-end fund balance has changed in a range from a gain of \$9.9 million in FY 2007 to a loss of \$8.2 million in FY 2009. The history of widespread fluctuations validates the importance of maintaining a sufficient reserve to weather unpredictable changes.

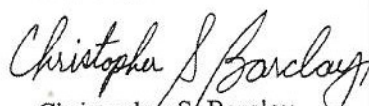
For the past decade, MCPS has worked diligently with the full involvement of its employee associations through the Labor Management Joint Benefits Committee and with its retiree association to reduce the long-term rate of growth of health care costs. MCPS and its employee associations

have undertaken a major wellness program to improve employee fitness and reduce chronic health care problems. We have worked with other county agencies to improve the competitiveness of bidding for health care services. We have made plan design changes to reduce costs, including limits on the use of prescription pharmaceuticals, changes in co-pay and deductible limits, and a limitation on high-cost plan options. Retirees have agreed to pay 36 percent of costs. Management has completed an audit of dependent coverage to make sure that ineligible dependents are not included as beneficiaries for health plans. We also work closely with our health consultant, Aon, the same firm used as a consultant by the county government, to explore other opportunities for cost savings. These measures have saved millions of dollars and slowed the growth of health care costs below regional and national averages. Our consultant has reported that MCPS stacks up well against other clients in the pursuit of cost-saving innovation.

Despite these positive changes, we can expect health care costs to continue to increase in future years. MCPS staff monitors health care costs monthly and reviews trends regularly with our consultant and with other county agencies. We are also continuing to negotiate with our employee associations to explore additional cost savings in health care costs. In addition, we are working closely with the Cross-Agency Resource Sharing Committee (CARS) to explore further improvements and encourage other agencies to adopt some of the cost-savings improvements already implemented by MCPS. It is gratifying that the Council staff director complimented MCPS on its efficiencies and said that we could be a model for other agencies.

As Council continues its work to reduce the county's structural budget deficit, it can ask its staff to explore whether long-term savings can be projected. Until we have clearer data, MCPS staff believes that it is premature to make changes in future trend projections. We stand ready to continue working with you and your staff on this important issue. Our staff will be available to answer any questions.

Sincerely,


Christopher S. Barclay
President

CSB:kmy

Enclosure

Copy to:

Members of the County Council
Members of the Board of Education
Dr. Weast
Mr. Bowers
Dr. Lacey
Mr. Ikheloa
Mr. Edwards