Howard County Public School System

January 7, 2020

MEMORANDUM

To: Members of the Board of Education

From: Michael J. Martirano, Ed.D.
Superintendent

Subject: Health Fund Deficit Elimination Plan

The purpose of this memorandum is to provide additional details on my proposed plan to eliminate the Health Fund deficit by fiscal year-end 2022. This plan builds on the outline provided to the Board on November 7, 2019, when the Board approved the FY 2020 General Fund Supplemental Budget Augmentation and Categorical Transfer Board Report authorizing the use of the $15.2 million of unassigned fund balance to pay down the deficit.

The adverse opinion from CohnReznick, HCPSS' external auditor, as well as our conversations with the Maryland State Department of Education (MSDE) underscore the need to address this deficit quickly.

Plan Background

As of June 30, 2019, the Health Fund has a deficit of $39.2 million. As was discussed during the December 9, 2019 meeting with the County Council, HCPSS does not have the ability to eliminate the deficit on its own. However, over a reasonable amount of time and with some level of County support, the deficit can be eliminated. This memo will be shared with staff from the County Budget Office and Auditor to begin discussions so that an agreement can be reached. It is my recommendation that once agreement is reached on a plan, that the Board of Education and County Government document this agreement.

The proposed plan is consistent with direction from the County Council that our plan demonstrate collaboration and considers how other districts have eliminated deficits within their Health Fund. The plan details provided in this memo also assume the use of one-time funds from Howard County government, similar to how the Anne Arundel County Public Schools utilized one-time support from Anne Arundel County Government.

Stabilizing the Fund vs. Eliminating the Deficit

It is important to emphasize again that over the last two years, HCPSS has fully funded our actuarial based health care cost projections, and my proposed FY 2021 Operating Budget will continue this commitment. We have stabilized the Health Fund and must now work to eliminate the accrued deficit. This deficit accumulated due to leadership decisions to use the

Health Fund balance to support other operating budget priorities, while underfunding the account for projected health care costs. As such, we must look to use one-time funds to eliminate the deficit and not look at permanent spending reductions that would impact our staff and students.

Proposed Deficit Elimination Timeline and Contributions
The proposed Plan eliminates the deficit through a combination of actions requiring one-time funds from the County and HCPSS. I have emphasized the importance that one-time funds not be used for recurring expenses. The deficit is a non-recurring expense. Therefore, utilizing one-time funds to cure the deficit fits squarely with this direction and is a prudent budget practice. That said, eliminating the deficit will not be done without difficult decisions and sacrifices.

The plan proposes to use one-time funds from HCPSS and to request one-time funds from Howard County to eliminate the deficit. The first of these one-time requests was approved by the Board in November by authorizing the use of the $15.2 million in unassigned General Fund balance. This action is pending approval by the County Council. If approved, the deficit would be lowered to $24 million. The deficit is proposed to be eliminated based on the following:

• FY 2020 use of unassigned fund balance (HCPSS)	$15.2 million
• FY 2020 year-end savings (HCPSS)	$ 2.5 million
• FY 2021 one-time request from (Howard County)	$ 9.0 million
• FY 2021 year-end savings (HCPSS)	$ 5.0 million
• FY 2022 year-end savings (HCPSS)	$ 4.0 million
• FY 2022 one-time request (Howard County)	$ 4.0 million
Total	$39.7 million

Frequently Asked Questions

There have been several misconceptions about the deficit and in order to clearly communicate this plan, I have provided some FAQ style information below that will also be posted to our website along with my proposed FY 2021 Operating Budget on January 9, 2020.

What is the goal of the Deficit Elimination Plan?
The goal is to eliminate the Health Fund deficit by fiscal year-end 2022.

Will the Plan require employees to pay more for their health insurance to eliminate the deficit?
No. The deficit was not caused by actions of employees. Therefore, my plan does not ask employees to pay more to eliminate the deficit.

Does the plan propose to change employee health benefits to eliminate the deficit?
Employee health benefits are subject to collective bargaining. Negotiated contracts are in place for fiscal year 2020 and 2021. The Deficit Elimination Plan does not propose to reopen contracts in order to extract plan design savings to eliminate deficit. Plan design changes to solve the deficit would have the same effect of asking employees to pay more or receive less

to eliminate the deficit. That would not be a fair resolution to a problem that is not of the employees' making.

How were these amounts determined?
Frequent questions have been asked by County staff about how the Anne Arundel County School System worked in partnership with Anne Arundel County to solve its health fund deficit. That partnership shared the burden with two-thirds coming from the school and one-third coming from the county. The Deficit Elimination Plan proposes that HCPSS contributes $26.7 million in one-time funds and Howard County contributes $13.0 million. This is a cost share of 67 percent and 33 percent.

Does Howard County have $13 million to contribute?
The intention is to work in collaboration with the County on this proposal. Rectifying this deficit is in everyone's interest and will require difficult decisions by the County and HCPSS. It would be premature to answer whether and how much the County will share in the burden. Staff did review the County's fiscal year-end 2019 CAFR. The County's General Fund has an unassigned fund balance of $18.4 million. In addition, the County has been able to fully fund its Rainy Day fund to the County Charter amount. The fund has $73.9 million. Making presumptions about the use of either source of these funds would be inappropriate. The County has a large budget to balance and faces many of the fiscal challenges faced by HCPSS. The intent is to work collaboratively to find a win-win path to eliminating this deficit as quickly as possible.

Why should the County contribute to solving the Health Fund deficit?
The County has direct interest in seeing this deficit eliminated. The first interest goes to sound fiscal stewardship. It is against Maryland Code for a school system to have a deficit in its General Fund (Maryland Annotated Code §5-114). The Health Fund is an internal service fund, which is not technically a General Fund. However, the law provides reasonable instruction that a deficit is not good fiscal management and should not exist even in the Health Fund. It should be further noted that the Health Fund provides health care coverage for all staff, which are almost entirely in the General Fund. In other words, the Health Fund deficit is a General Fund cost; and the deficit resulted from underfunding the cost of health care from FY 2015 to FY 2018. So long as the deficit remains, the total cost of providing educational services is not being funded and fiscal stewardship is at risk.

Second, HCPSS is not accurately stating its financial position. The adverse opinion by the independent auditors calls out the egregiousness of this situation and implores action to be taken to adopt a plan. Although, the County received a flawless opinion for its independent audit in FY 2019, it would be imprudent and fiscally parochial to view HCPSS adverse opinion as an isolated problem when HCPSS exists to serve the same public service ends as the County. The calling for sound fiscal management and stewardship is a shared calling.

The last point of shared interest with the County should be to maintain the excellent education system that is the foundation of Howard County's quality of life. The County provides approximately 70 percent of funding to the district. HCPSS does not have taxing authority to increase funds. The budget tools HCPSS controls to address the deficit are to propose a fiscally responsible budget that does not make the deficit worse, manage the budget to achieve savings to be applied to the deficit, and request additional funding to eliminate the deficit. This proposed plan utilizes all of these budget tools.

Would the County have to increase the MOE to eliminate the deficit?
No, the deficit should be resolved with one-time funds from the County and HCPSS. The Maryland State Department of Education (MSDE) has previously approved the one-time designation for funds used to reduce the deficit. It would be treated similar to the FY 2019 one-time contribution the County made, where HCPSS submitted the one-time funding as a non-recurring expense to be excluded from the base. Therefore, the MOE would not be impacted by the proposed Deficit Elimination Plan.

Why are future HCPSS contributions significantly lower than the $15.2 million HCPSS is requesting to use from the FY2019 General Fund balance?
The FY 2019 savings were achieved through hiring and spending freezes, underspending in certain programs, and salary lapse due to turnover. Moving forward, HCPSS, through the proposed FY 2021 has aligned salary lapse and spending in programs to be consistent with actual expenditures, both increasing and decreasing appropriation for certain programs. This alignment with actual spending right-sizes the budget and will reduce potential end of year savings as a result. Details will be included in the FY 2021 Superintendent's Proposed Operating Budget.

Where will HCPSS get the $26.7 million for its share?
The greatest portion of this amount would come from the use of the unassigned fund balance, $15.2 million. The remainder would have to be achieved through budgetary savings over the next three fiscal years: $2.5 million in FY 2020, $5.0 million in FY 2021, and $4.0 million in FY 2022.

How will HCPSS achieve these budgetary savings?
Nearly 85 percent of the total HCPSS General Fund budget is for the salaries and benefits of employees. The targeted area to generate funds are salary savings from turnover and strategic position freezes in central office and other non-teaching positions. In FY 2018 and FY 2019, HCPSS transferred nearly $7.0 million and $4.5 million respectively in year-end savings to help fully fund health benefits. It will take strategic budget management to achieve these types of savings going forward. However, the significance of the deficit requires the savings be generated.

Does the Deficit Elimination Plan address the cost growth pressure of health care?
Health care costs are volatile and grow at an irregular pace. In some years, cost growth is higher than projected, requiring mid-year budget actions to manage the fund. A major assumption of the Deficit Elimination Plan is that current year health care costs will be fully funded. This is a principled assumption to prevent the deficit from growing further. For the last two fiscal years, HCPSS has followed this principle and made budget cuts to achieve full funding of health care costs. In addition, the County contributed $11 million in one-time funding to cover health care costs in FY 2019.

Cost growth projections are based on the three-year average cumulative growth rate for claims paid. The amount is about six percent annually. This growth rate is applied to the cost of claims and the premiums going forward. A six percent annual growth rate strains long-term sustainability. State and County funding formulas generally do not grow at an annual rate of six percent making this type of growth unsustainable. Therefore, HCPSS must request additional funding above MOE and/or cut from other parts of the budget to pay for the increasing costs of health care, as mentioned above. The Deficit Elimination Plan does not tackle this issue. The cost pressure of health care would need to be addressed through plan design and collective bargaining.

If the Deficit Elimination Plan is approved and funded would it eliminate the deficit?
Yes, the Deficit Elimination Plan would eliminate the deficit by fiscal year-end 2022. The enclosed projections and chart provides the details.

Enclosure

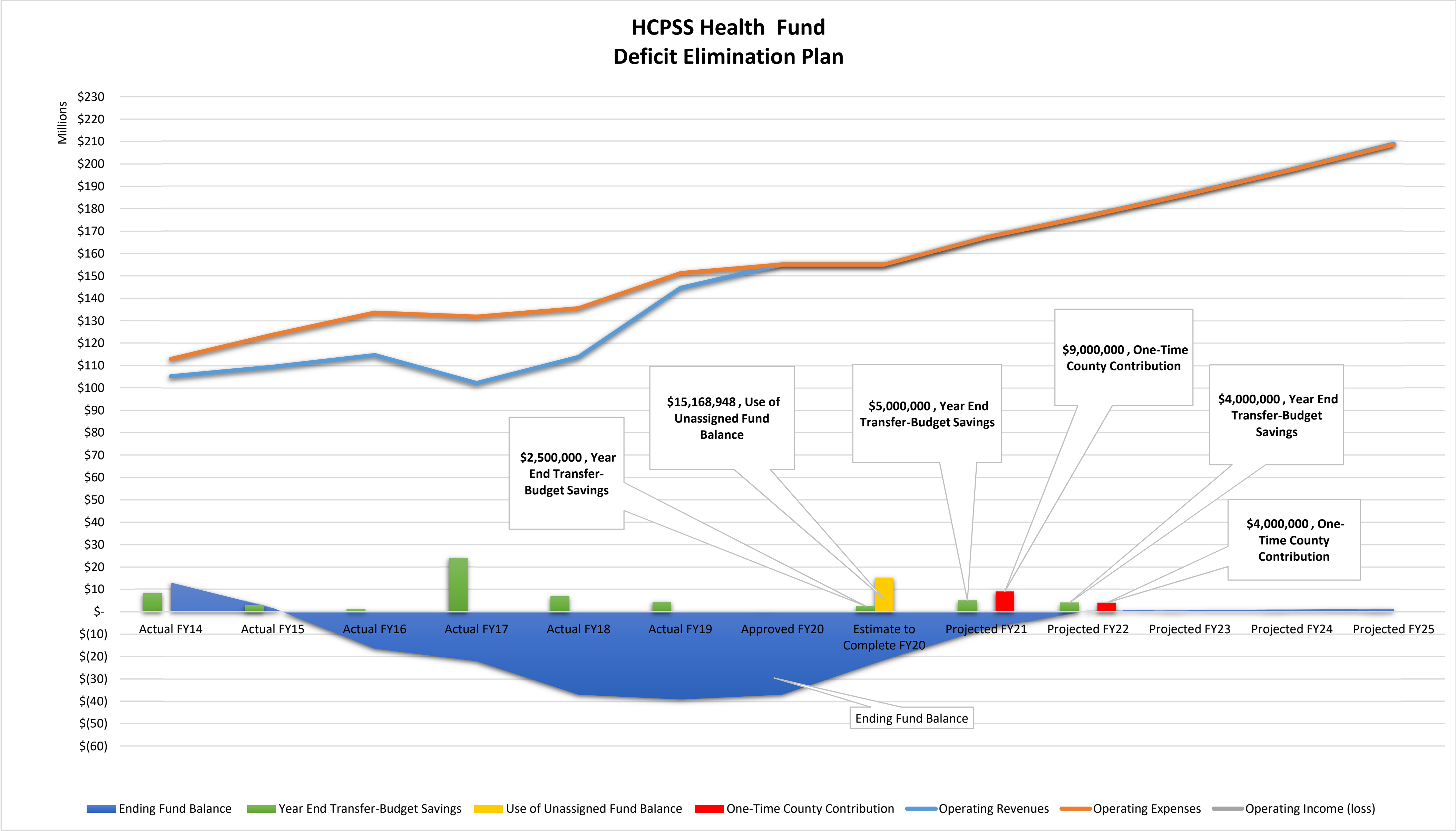
Copy to: Executive Staff
Board of Education Office

	Actual FY 2014*	Actual FY 2015*	Actual FY 2016*	Actual FY 2017*	Actual FY 2018*	Actual FY 2019*	Approved FY 2020	Estimate to Complete FY 2020	Proposed FY 2021	Projected FY 2022	Projected FY 2023	Projected FY 2024	Projected FY 2025
Sources of Funds													
Opening Fund Balance	$ -	$ -	$ -	$ -	$ -								
Employee withholdings	16,117,036	16,627,796	16,864,550	17,268,723	18,307,168	19,499,641	21,808,465	21,808,465	21,982,864	23,277,722	24,648,850	26,100,743	27,638,156
Retiree payments	4,826,278	5,008,063	6,169,210	6,113,344	6,575,763	7,449,146	7,291,363	7,291,363	8,873,969	9,396,673	9,950,165	10,536,261	11,156,878
COBRA, leave, refunds, etc.	332,808	429,154	269,996	510,280	381,812	482,262	350,000	350,000	400,000	428,954	460,004	493,301	529,009
Payment from Food Services	1,988,380	2,068,497	2,057,495	2,094,814	2,167,526	2,313,110	2,185,040	2,185,040	2,525,787	2,690,787	2,866,565	3,053,826	3,253,321
Payment from Transportation	689,303	693,216	153,592		-				-				
Payment from General Fund	75,877,910	78,000,000	82,500,000	68,321,679	74,007,346	101,875,203	112,975,623	112,975,623	117,863,558	124,806,081	132,157,539	139,942,021	148,185,033
Rebates	3,485,476	4,825,824	5,385,987	5,788,110	10,912,476	10,987,404	8,352,000	8,352,000	13,581,222	14,124,471	14,689,450	15,277,028	15,888,109
Miscellaneous Revenue	97,034	267,564	231,921	327,669	269,572	164,347	275,000	275,000	175,000	178,500	182,070	185,711	189,426
Payment from Grants	1,705,952	1,505,353	952,922	1,677,394	1,127,685	1,840,124	1,800,000	1,800,000	1,800,000	1,874,419	1,951,915	2,032,615	2,116,651
Operating Revenues	**$ 105,120,177**	**$ 109,425,467**	**$ 114,585,673**	**$ 102,102,013**	**$ 113,749,347**	**$ 144,611,237**	**$ 155,037,491**	**$ 155,037,491**	**$ 167,202,400**	**$ 176,777,606**	**$ 186,906,559**	**$ 197,621,506**	**$ 208,956,583**
Uses of Funds													
Employee Benefit Credits	$ 3,801,381	$ 3,826,893	$ 3,783,671	$ 3,788,480	$ 3,902,920	$ 3,344,743	2,916,060	2,916,060	2,968,140	2,968,140	2,968,140	2,968,140	2,968,140
Recovery of fund balance							-	-	-				
Administrative Fees	5,703,887	5,633,619	6,441,949	5,121,706	5,903,901	5,545,689	6,234,705	6,234,705	5,614,988	5,842,776	6,079,806	6,326,451	6,583,102
Incr/Decr to fund reserve	(641,860)	1,061,315	921,415	678,021	(243,287)	692,971	122,247	122,247					
Payment of claims	101,110,606	108,182,030	118,157,929	118,952,247	124,365,871	140,291,535	144,381,097	144,381,097	157,281,827	166,546,206	176,356,285	186,744,208	197,744,011
PPACA Fees	55,288	1,133,264	557,878	525,100	39,120	41,138	43,000	43,000					
Wellness Program	1,758,676	1,948,586	2,136,934	1,249,348	189,136		-	-	-				
Other Expenses	942,120	1,897,469	1,604,576	1,482,633	1,368,789	1,331,738	1,340,382	1,340,382	1,337,445	1,337,445	1,337,445	1,337,445	1,337,445
Payment to Tech Fund	182,890	-	-	-	-		-	-	-				
Payment to Printing Fund	840	-	-	-	-		-	-	-				
Operating Expenses	**$ 112,913,828**	**$ 123,683,176**	**$ 133,604,352**	**$ 131,797,534**	**$ 135,526,450**	**$ 151,247,814**	**$ 155,037,491**	**$ 155,037,491**	**$ 167,202,400**	**$ 176,694,568**	**$ 186,741,676**	**$ 197,376,244**	**$ 208,632,698**
Operating Income (loss)	**$ (7,793,651)**	**$ (14,257,709)**	**$ (19,018,679)**	**$ (29,695,521)**	**$ (21,777,104)**	**$ (6,636,577)**	**$ -**	**$ -**	**$ -**	**$ 83,038**	**$ 164,883**	**$ 245,262**	**$ 323,884**
Non Operating Revenues													
Year End Transfer-Budget Savings	***8,297,316***	***2,831,427***	***944,436***	***24,000,000***	***6,922,190***	***4,459,335***	***-***	***2,500,000***	***5,000,000***	***4,000,000***			
Use of Unassigned Fund Balance								***15,168,948***					
One-Time County Contribution	***-***	***-***	***-***	***-***	***-***	***-***	***-***	***-***	***9,000,000***	***4,000,000***			
Total Non-Operating Revenues	**$ 8,297,316**	**$ 2,831,427**	**$ 944,436**	**$ 24,000,000**	**$ 6,922,190**	**$ 4,459,335**	**$ -**	**$ 17,668,948**	**$ 14,000,000**	**$ 8,000,000**	**$ -**	**$ -**	**$ -**
Fund Balance													
Beginning Fund Balance	$ 12,527,992	$ 13,031,657	$ 1,605,375	$ (16,468,868)	$ (22,164,389)	$ (37,019,302)	$ (37,019,302)	$ (39,196,544)	$ (21,527,596)	$ (7,527,596)	$ 555,443	$ 720,325	$ 965,588
Change in Fund Balance	503,665	(11,426,282)	(18,074,243)	(5,695,521)	(14,854,914)	(2,177,242)	-	17,668,948	14,000,000	8,083,038	164,883	245,262	323,884
Ending Fund Balance	**$ 13,031,657**	**$ 1,605,375**	**$ (16,468,868)**	**$ (22,164,389)**	**$ (37,019,302)**	**$ (39,196,544)**	**$ (37,019,302)**	**$ (21,527,596)**	**$ (7,527,596)**	**$ 555,443**	**$ 720,325**	**$ 965,588**	**$ 1,289,472**

Summary of Deficit Solution	FY 2020	FY 2021	FY 2022	FY 2023	Total	% of Total
HCPSS Share	17,668,948	5,000,000	4,000,000	-	26,668,948	67.2%
County Share	-	9,000,000	4,000,000	-	13,000,000	32.8%
Total	17,668,948	14,000,000	8,000,000	-	39,668,948	

YEAR OVER YEAR PERCENT CHANGE

	Actual FY 2014*	Actual FY 2015*	Actual FY 2016*	Actual FY 2017*	Actual FY 2018*	Actual FY 2019*	Approved FY 2020	Estimate to Complete FY 2020	Proposed FY 2021	Projected FY 2022	Projected FY 2023	Projected FY 2024	Projected FY 2025
Sources of Funds													
Use of Fund Balance													
Employee withholdings	4.2%	3.2%	1.4%	2.4%	6.0%	6.5%	19.6%	11.8%	0.8%	5.9%	5.9%	5.9%	5.9%
Retiree payments	18.9%	3.8%	23.2%	-0.9%	7.6%	13.3%	6.1%	-2.1%	21.7%	5.9%	5.9%	5.9%	5.9%
COBRA, leave, refunds, etc.	20.3%	28.9%	-37.1%	89.0%	-25.2%	26.3%	16.4%	-27.4%	14.3%	7.2%	7.2%	7.2%	7.2%
Payment from Food Services	1.8%	4.0%	-0.5%	1.8%	3.5%	6.7%	4.0%	-5.5%	15.6%	6.5%	6.5%	6.5%	6.5%
Payment from Transportation	8.4%	0.6%	-77.8%	-100.0%									
Payment from General Fund	12.8%	2.8%	5.8%	-17.2%	8.3%	37.7%	10.9%	10.9%	4.3%	5.9%	5.9%	5.9%	5.9%
Rebates	60.1%	38.5%	11.6%	7.5%	88.5%	0.7%	17.8%	-24.0%	62.6%	4.0%	4.0%	4.0%	4.0%
Miscellaneous Revenue	-98.8%	175.7%	-13.3%	41.3%	-17.7%	-39.0%	6.4%	67.3%	-36.4%	2.0%	2.0%	2.0%	2.0%
Payment from Grants	17.1%	-11.8%	-36.7%	76.0%	-32.8%	63.2%	5.2%	-2.2%	0.0%	4.1%	4.1%	4.1%	4.1%
Total Sources of Funds	**4.0%**	**4.1%**	**4.7%**	**-10.9%**	**11.4%**	**27.1%**	**12.0%**	**7.2%**	**7.8%**	**5.7%**	**5.7%**	**5.7%**	**5.7%**
Uses of Funds													
Non-Election Benefits	1.8%	0.7%	-1.1%	0.1%	3.0%	-14.3%		-12.8%	1.8%	0.0%	0.0%	0.0%	0.0%
Recovery of fund balance							-100.0%						
Administrative Fees	-0.5%	-1.2%	14.3%	-20.5%	15.3%	-6.1%	6.1%	12.4%	-9.9%	4.1%	4.1%	4.1%	4.1%
Incr/Decr to fund reserve		-265.3%	-13.2%	-26.4%	-135.9%	-384.8%	-34.4%	-82.4%	-100.0%				
Payment of claims	6.1%	7.0%	9.2%	0.7%	4.6%	12.8%	10.6%	2.9%	8.9%	5.9%	5.9%	5.9%	5.9%
PPACA Fees		1949.7%	-50.8%	-5.9%	-92.5%	5.2%		4.5%	-100.0%				
Wellness Program	-0.2%	10.8%	9.7%	-41.5%	-84.9%	-100.0%							
Other Expenses	-2.8%	101.4%	-15.4%	-7.6%	-7.7%	-2.7%	3.3%	0.6%	-0.2%	0.0%	0.0%	0.0%	0.0%
Payment to Tech Fund	0.0%	-100.0%											
Payment to Printing Fund	-95.4%	-100.0%											
Total Uses of Funds	**4.8%**	**9.5%**	**8.0%**	**-1.4%**	**2.8%**	**11.6%**	**12.0%**	**2.5%**	**7.8%**	**5.7%**	**5.7%**	**5.7%**	**5.7%**


HCPSS Health Fund
Deficit Elimination Plan
Millions
$230
$220
$210
$200
$190
$180
$170
$160
$150
$140
$130
$120
$110
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$90
$80
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$(50)
$(60)
Actual FY14
Actual FY15
Actual FY16
Actual FY17
Actual FY18
Actual FY19
Approved FY20
Estimate to Complete FY20
Projected FY21
Projected FY22
Projected FY23
Projected FY24
Projected FY25
$2,500,000 , Year End Transfer-Budget Savings
$15,168,948 , Use of Unassigned Fund Balance
$5,000,000 , Year End Transfer-Budget Savings
$9,000,000 , One-Time County Contribution
$4,000,000 , Year End Transfer-Budget Savings
$4,000,000 , One-Time County Contribution
Ending Fund Balance
Ending Fund Balance
Year End Transfer-Budget Savings
Use of Unassigned Fund Balance
One-Time County Contribution
Operating Revenues
Operating Expenses
Operating Income (loss)