



## HOWARD COUNTY OFFICE OF COUNTY EXECUTIVE

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### MEMORANDUM

**To:** Members of the Board of Education

**From:** Calvin Ball   
County Executive

**Re:** Health Fund Deficit Elimination Plan

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The purpose of this memorandum is to provide a modified plan in response to the Howard County Public School System (HCPSS) proposal to eliminate the current \$39.2 million deficit in its Health and Dental Fund. After carrying an accrued deficit since FY2016 and a structural deficit with expenditures exceeding revenues in seven (7) of the past eight (8) years, it is encouraging that HCPSS has taken the initial step of proposing a multi-year plan to resolve its deficit issues.

We share an interest in cementing a multi-year approach to addressing the deficit, and remain committed to doing so in a way that ensures accountability and sound fiscal management. Our modified plan would satisfy this principle while achieving the following key goals:

- Elimination of the HCPSS Health and Dental Fund deficit (\$39.2 million) by the end of FY2024;
- Elimination of the HCPSS interfund borrowing loan (\$20.7 million) by the end of FY2021;
- Reduction of the deficit by \$6 to \$11 million annually until elimination in FY2024;
- Immediate action to reduce the deficit in FY2020;
- Contribution of \$13 million in total one-time County funding toward the elimination of the deficit, contingent upon HCPSS meeting established yearend savings targets and the Maryland State Department of Education (MSDE) excluding one-time County funding from the Maintenance-of-Effort (MOE) base calculation; and

- Preservation of \$8 million in unassigned fund balance in HCPSS General Fund throughout the duration of the modified plan period.

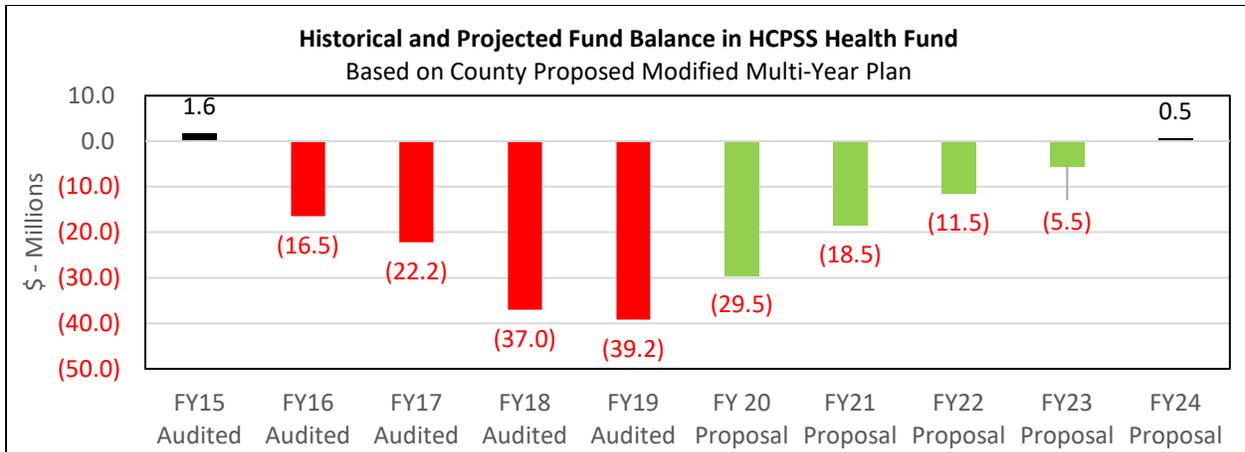
### Modified Plan

While we are aware of the adverse opinion HCPSS received on October 31, 2019 from its external auditor for its General Fund and Aggregate Remaining Fund Information, it should be noted that Howard County received an unmodified Comprehensive Annual Financial Report (CAFR) from its external auditor on November 22, 2019. Regardless, elimination of the deficit in the HCPSS Health and Dental Fund is a priority, and should be resolved in a fiscally responsible way that accounts for the needs of HCPSS and the County. The plan outlined below takes a balanced, incremental approach to address the HCPSS Health and Dental Fund deficit, and does so by the end of FY2024:

- FY2020 use of unassigned fund balance (HCPSS) \$7.2 million
  - FY2020 year-end savings (HCPSS) \$2.5 million
  - FY2021 one-time funding (Howard County) \$6 million\*
  - FY2021 year-end savings (HCPSS) \$5 million
  - FY2022 one-time funding (Howard County) \$3 million\*
  - FY2022 year-end savings (HCPSS) \$4 million
  - FY2023 one-time funding (Howard County) \$2 million\*
  - FY2023 year-end savings (HCPSS) \$4 million
  - FY2024 one-time funding (Howard County) \$2 million\*
  - FY2024 year-end savings (HCPSS) \$4 million
- Total \$39.7 million

\$ - Millions	FY19	FY20	FY21	FY22	FY23	FY24	Total
<b>HCPSS Contribution</b>	<b>0.0</b>	<b>9.7</b>	<b>5.0</b>	<b>4.0</b>	<b>4.0</b>	<b>4.0</b>	<b>26.7</b>
Yearend Savings	0.0	2.5	5.0	4.0	4.0	4.0	19.5
Use of Unassigned Fund Balance	0.0	7.2	0.0	0.0	0.0	0.0	7.2
<b>One-Time County Funding *</b>	<b>0.0</b>	<b>0.0</b>	<b>6.0</b>	<b>3.0</b>	<b>2.0</b>	<b>2.0</b>	<b>13.0</b>
<b>HCPSS Health and Dental Fund Surplus/(Deficit)</b>	<b>(39.2)</b>	<b>(29.5)</b>	<b>(18.5)</b>	<b>(11.5)</b>	<b>(5.5)</b>	<b>0.5</b>	<b>0.5</b>
<b>HCPSS Interfund Loan</b>	<b>(20.7)</b>	<b>(11.0)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

\* Indicates funding is contingent on HCPSS meeting prior fiscal year year-end savings targets and MSDE excluding one-time County funding from MOE base calculation.



The modified plan is consistent with the HCPSS Health and Dental Fund deficit elimination proposal in several ways. First, the modified plan acts in FY2020 to address the deficit, proposing to use a portion of the HCPSS unassigned fund balance and \$2.5 million in HCPSS year-end savings to pay down the deficit in the current fiscal year. Second, the modified plan proposes \$26.7 million in HCPSS and \$13 million in County contribution to eliminate the deficit, mirroring the cost breakdown provided in the HCPSS deficit elimination proposal. Last, the modified plan provides sufficient funding to eliminate the \$20.7 interfund loan by the end of FY2021. The ability of the Health and Dental Fund to pay the HCPSS General Fund interfund loan was cited in the adverse opinion issued by HCPSS’ external auditor.

However, there are noteworthy differences between the modified plan and the HCPSS proposal that should be highlighted. The plan outlined above makes County one-time funding payments contingent on HCPSS hitting its year-end savings targets. This mechanism provides a measure of accountability to ensure that HCPSS takes ownership and remains committed to the elimination of its deficit throughout the duration of the modified plan. For example, the \$6 million in one-time County funding to pay down the deficit in FY2021 would only be payable if HCPSS hits its \$2.5 million yearend savings target in FY2020.

Differing from the HCPSS proposal that eliminates the entirety of its \$15.2 million unassigned fund balance in FY2020, the modified plan outlined above maintains \$8 million of HCPSS unassigned fund balance throughout the duration of the plan to account for risk factors. Sound fiscal management principles dictate that some level of unassigned fund balance be preserved to account for the risk of unforeseen expenditures or declines in revenue.

Last, the modified plan eliminates the deficit by the end of FY2024, and not by the end of FY2022 as proposed by HCPSS. The Health and Dental Fund deficit took several years to accrue. While we share an interest in developing a multi-year plan to eliminate the deficit, we believe that any plan should be sustainable within existing resources and should avoid the unnecessary financial risk of operating without an unassigned fund balance. The modified plan provided above adequately balances available resources and risks.

## Potential Questions

- **Will the plan avoid an impact to the County's CAFR or AAA bond rating?**

Despite the adverse opinion HCPSS received from its external auditor, the County has continued to receive an unmodified opinion from its auditors for its own CAFR, confirming the County's full compliance with all financial rules and regulations. The County is confident that it will maintain its AAA bond rating, based on the unmodified opinion received from its external auditor and our strong record of fiscal discipline and financial management.

- **How can the County be sure that HCPSS will achieve proposed year-end savings to contribute to the elimination of the Health Fund deficit?**

To ensure that HCPSS takes the necessary budgetary actions to achieve year-end savings, the County will only make one-time payments to pay down the deficit if HCPSS year-end savings targets are hit. The County agrees with HCPSS that the significance of the deficit requires HCPSS to generate year-end savings. This measure will ensure that both the County and HCPSS remain committed to the elimination of the deficit.

- **Why is it important to have an unassigned fund balance?**

It is important for public entities to retain a fund balance to mitigate against current and future unforeseen risks. These risks could range from weather-related expenditures to dependence on potentially volatile revenue sources. Operating without a fund balance is against generally accepted financial best practices.

- **Why does the modified plan take longer to resolve the HCPSS Health and Dental Fund deficit?**

The modified plan outlined above strikes a balance between the County and HCPSS' shared interest in eliminating the Health and Dental Fund deficit, while minimizing potential impacts to programs and services. The HCPSS Health Fund deficit accrued over several years. While we appreciate the urgency with which HCPSS strives to eliminate the deficit, there is no audit or other mandate that dictates a two (2) year period to eliminate the deficit. The modified plan provides a sustainable approach to eliminating the deficit by the end of FY2024, with \$6 to \$11 million in contributions annually to achieve this goal. Once executed, it will result in sizable and consistent progresses every year towards eliminating the deficit until its fully resolved.

- **Has the County made one-time payments toward the HCPSS Health and Dental Fund deficit in the past?**

Yes. In FY2019 the County made an \$11.1 million one-time payment to assist the HCPSS in addressing its Health Fund issues. However, this payment was not accompanied by a multi-year plan with shared, sustainable contributions to achieve the elimination of the HCPSS

deficit. The modified plan provides a clear path toward eliminating the deficit through consistent annual payments.

- **Will the modified plan increase Maintenance of Effort (MOE) to eliminate the deficit?**

No. Similar to the HCPSS Health and Dental Fund deficit elimination proposal, the modified plan uses one-time County funds to help eliminate the deficit. MSDE previously approved the use of one-time County funds to reduce the deficit without the funds counting toward MOE. The County and HCPSS will work together with MSDE and request similar approval for excluding one-time County funding from the MOE base calculation.

Cc: HCPSS Staff  
Howard County Council