



CITY OF WORCESTER, MASSACHUSETTS

AUDITING DEPARTMENT

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City Auditor

October 3, 2017

TO: CITY COUNCIL

FROM: CITY AUDITOR

RE: Follow up questions to report on excess funds in the health care trust fund

Below are responses to the follow up questions from the City Council meeting of September 26, 2017 including (1) the legality of distributing excess funds from the trust and the recommendation the City Auditor contact the DOR to confirm, (2) the proportional share of employer premiums between City and the school department, and (3) data from other Massachusetts gateway cities' self-insured trusts for comparison.

The September 26th report was a compilation of the trust fund's activities and was prepared soon after the calculation of the incurred but not reported claims (IBNR) liability. Although the report did not discuss policy which is currently in progress and expected later in the year, I opined that a reserve of two months of expenses plus IBNR is adequate to cover contingencies and cash flow fluctuations. This results in an excess net fund balance of \$10M as of June 30, 2017. This was based on an analysis of the margin of expenses to revenue which averages 99.4% over the past five year which attests to the accuracy of rate setting and the back stop protection against catastrophic claims through the purchase of stop loss insurance. A review of monthly cash flow and balances over the 60 months shows cash never fell below \$22M and the largest drop in cash in any quarter was \$2M which recovered in the subsequent quarter. This is attributable to the steady inflow of premiums from employer and employees and the consistent trend of claims experience.

The reserve policy and the return of any excess are currently under consideration by the City Manager's office, which according to the City Solicitor has sole authority over the health insurance appropriation line item and rate setting, including premium holidays. As reported by the City Solicitor at the June 2, 2017 meeting, the City Council does not have the authority to reduce the appropriation but it vests with the City Manager. "In sum, the annual appropriation

for employee health insurance payments must be sufficient to pay healthcare providers for services rendered to city employees in accordance with the rates and plan design eligibility requirements established by the city manager.” “Therefore, in practical terms under the structure related by law for funding this obligation, the city council cannot reduce the amounts necessary to fund employee health insurance claims.”

The legality of distributing excess funds from the trust – request City Auditor contact the DOR.

I reached out to my contact at the Division of Local Services but due to the short turn-around was unable to connect. However, I have highlighted the applicable sections of the governing state law and a letter from DOR that relates to the matter of legally reducing an excess fund balance in a self-insured health insurance trust. Please note that the City reduced the trust fund balance in May 2010 by giving a one month premium holiday; city council archive dated May 4, 2010.

The law only allows expenditure from the trust fund to cover health service claims and associated administrative expenses. It does not allow funds to be transferred to the general fund. However the fund balance can be brought down by decreasing contribution revenue. Contribution adjustments are done by setting rates lower than anticipated claims at the start of the year *or* once the plan year begins by providing a “premium holiday” where contributions are not made for a certain period of time. This is done using the established proportional contribution rates for the employer and employees.

The Health Insurance Trust is governed under M.G.L. Ch. 32B section 3A that allows a city providing group health insurance to self-insure. Some key points to the law:

- The sole purpose of the trust is to cover health service claims as well as administrative and incidental expenses, including stop-loss coverage.
- The trust is set up to retain employee and employer contributions indefinitely until needed to pay claims.
- Interest earned on cash balances remains with the fund.
- The municipal employer’s contribution appropriation is deposited into the trust fund to match the agreed upon contribution ratio with the employee contributions.
- The treasurer is required to make an annual accounting to determine that the correct ratio of employee and employer contributions has been received. Deviations from established ratios are required to be made up in adjustments to future contributions until the ratio has been reestablished.
- The treasurer shall take measures that will assure a sufficient balance at all times in said fund to make prompt payment for incurred and unpaid claims and other related liabilities.
- A deficit in net fund balance would require the assessor to raise it on the next tax levy.

With regard to DOR's position on trust fund excess, below are excerpts from a 2010 letter the DOR wrote related to the return of excess funds upon converting from a self-insured plan to a premium based plan. Although this situation differs slightly, it does discuss relevant matters with regard to excess funds.

Quotes are from the DOR letter¹ :

"We do not believe the funds may be paid to the general fund"

Included in their rationale for application of the use of excess funds they stated, *"as an initial matter, to the extent any excess were to develop in the fund as it continues from year to year, the employee and town health insurance contribution amounts should be adjusted accordingly to use the surplus to the extent it is not needed to cover extraordinary claims"*.

"With respect to whether excess funds may be expended in a lump sum or may be paid over a period of time, we think the matter may very well be a term and condition of employment for, or at least a matter of impact on, the active employee members of the plan, and thus subject to negotiation."

"We note that the group of employees on the plan is continually changing, and the longer the surplus is kept the population gaining the benefit of premium reductions will be increasingly different from the population that contributed to the fund. However, depending on the size of the surplus and the amount necessary to provide coverage on an annual basis, it may not be possible to use the surplus within a particular year, since the payment of the surplus to reduce future covered employee premiums is based on practicality and does not require compete equity, we cannot say that extending the recouping period would necessarily be unlawful. We think the better answer is that any payment to reduce premiums should be subject to negotiation with respect to the period of time and amount of premium reductions."

¹ MA DOR letter to Assabet Valley Regional School District Feb. 4, 2010 including referenced DOR letter to Walpole dated Nov. 21, 2005.

What is the proportional share of employer contributions between City and School Department?

Based on the data for contributions to the trust in fiscal 2017, WPS represented 64% while City employees were 33% and enterprise fund employees 3%. An immediate reduction to the excess would be through a premium holiday by skipping monthly or weekly contributions for employers and employees in their proportional share. As an example, a premium holiday equal to one month would reduce inflows into the trust of approximately \$7.6M. The 25% proportionate share to employees/retirees total \$1.9M. The 75% proportionate share to the employer would create a savings to the WPS budget of \$3.6M; the City budget of \$1.9M, enterprise funds \$156K.

EMPLOYER CONTRIBUTIONS BY DEPT:		ratio
TOTAL	69,417,700	100.00%
EDUCATION	44,391,684	63.95%
CITY	23,130,515	33.32%
WATER	1,288,877	1.86%
SEWER	573,193	0.83%
GOLF	33,430	0.05%

One month contributions - estimated	<u>7,600,000.00</u>
Employees' / retirees' proportionate share @ 25%	1,900,000.00
Employer proportionate share @ 75%	<u>5,700,000.00</u>
	<u>7,600,000.00</u>
Employer proportionate share @ 75%	<u>5,700,000.00</u>

EDUCATION	63.95%	3,645,073
CITY	33.32%	1,899,284
WATER	1.86%	105,832
SEWER	0.83%	47,066
GOLF	0.05%	<u>2,745</u>
		<u>5,700,000</u>

A reduction to the health care appropriation, if recommended by the City Manager, prior to setting the tax rate could reduce the tax levy in the current year. A premium holiday given later in the year without reduction to the appropriation or the tax levy would create a budgetary surplus in the appropriation account for fy18, which could create additional free cash at year end. No premium holiday in the current year could allow flexibility in rate setting going into fy19 presumably allowing for lower rates than predicted claims.

Comparison to trust funds at other gateway cities

A review of internal service fund data from financial reports posted on-line for the 26 gateway cities, plus a review of Waltham, Cambridge and Boston is attached for your consideration.

Some internal service funds included workers compensation as part of the fund balance and did not separate the health insurance balance which likely accounts for a higher fund balance. Some cities did not self-insure healthcare. Some did not post their financial information or the data on the self-insurance trust was not included in their annual reports. None of the financial statements included a stated policy for reserve setting. Attached is the complete list and below is a list of those who reported self-insured healthcare separately.

Everett only had the 2016 report available. Haverhill went to a premium based plan in 2016 and I have included the 2014 data from the self-insured trust. Lynn has a low balance at year-end and noted they are considering moving to a premium based plan in 2018. Revere's latest available report is 2014. Boston's reserve has decreased over the past two years from a net fund balance equal to 2.98 of monthly expenses in 2014 to 1.70 in 2016.

INTERNAL SERVICE FUNDS (source CAFR's online)

			[A]	[B]	[A] / [B] No. of Months of Expenses of Ending Net Fund Balance	[C]	[A] + [C]	[[A] + [C]] / 12
MA Gateway Cities	Year ending:	Expenditures	Ending Net Fund Balance	Average monthly expense		IBNR	Total IBNR + Net Fund Balance	Avg. no of months of expenses
Everett	6/30/2016	21,626,703	8,606,991	1,802,225	4.78	2,100,000	10,706,991	5.94
Haverhill	6/30/2014	31,843,098	128,215	2,653,592	0.05	2,539,192	2,667,407	1.01
Lynn	6/30/2016	50,799,006	(1,897,909)	4,233,251	(0.45)	3,847,229	1,949,320	0.46
Revere	6/30/2014	20,472,769	6,530,472	1,706,064	3.83	1,224,137	7,754,609	4.55
Springfield	6/30/2016	84,563,863	6,982,738	7,046,989	0.99	158,928	7,141,666	1.01
Worcester	6/30/2017	87,826,743	25,931,187	7,318,895	3.54	5,832,940	31,764,127	4.34
Waltham	6/30/2016	46,769,467	650,912	3,897,456	0.17	2,734,957	3,385,869	0.87
Boston	6/30/2016	344,518,000	48,779,000	28,709,833	1.70	24,730,000	73,509,000	2.56

INTERNAL SERVICE FUNDS

						[A]	[B] Net Fund Balance as a Percentage of Annual Revenue	[B]	[A] / [B]	[C]	[A] + [C]	[[A] + [C]] / 12	
MA Gateway Cities	Year ending:	Revenues + interest income	Expenditures	Change in Fund Balance	Beginning Fund Balance	Ending Net Fund Balance		Average monthly expense	No. of Months of Expenses of Ending Net Fund Balance	IBNR	Total IBNR + Net Fund Balance	Avg. no of months of expenses	comment
Attleboro	6/30/2016	22,930,726	22,386,216	544,510	12,348,952	12,893,462	56%	1,865,518	6.91	1,608,125	14,501,587	7.77	internal service fund includes workers comp
Barnstable													not self-insured for health insurance
Brockton	6/30/2015	unavailable	46,043,131			3,650,000		3,836,928	0.95	2,781,134	6,431,134	1.68	not separately reported. partial data per footnotes of financial statements. Net fund balance net of long term liability
Chelsea	6/30/2015												not self-insured for health insurance
Chicopee													data not available
Everett	6/30/2016	22,966,941	21,626,703	1,340,238	7,266,753	8,606,991	37%	1,802,225	4.78	2,100,000	10,706,991	5.94	
Fall River													data not available
Fitchburg	6/30/2016	18,812,471	18,033,374	779,097	4,064,922	4,844,019	26%	1,502,781	3.22	808,117	5,652,136	3.76	internal service fund includes workers comp
Haverhill	6/30/2014	31,367,839	31,843,098	(475,259)	603,474	128,215	0%	2,653,592	0.05	2,539,192	2,667,407	1.01	not self-insured as of 2016.
Holyoke	6/30/2015												not self-insured for health insurance
Lawrence	6/30/2016												not self-insured for health insurance
Leominster	6/30/2015	20,613,415	19,317,090	1,296,325	3,944,316	5,240,641	25%	1,609,758	3.26	4,875,722	10,116,363	6.28	internal service fund includes workers comp
Lowell													not self-insured for health insurance
Lynn	6/30/2016	46,700,007	50,799,006	(4,098,999)	2,201,090	(1,897,909)	-4%	4,233,251	(0.45)	3,847,229	1,949,320	0.46	considering moving to premium based in fy18
Revere	6/30/2014	21,305,633	20,472,769	832,864	5,697,608	6,530,472	31%	1,706,064	3.83	1,224,137	7,754,609	4.55	
Methuen	6/30/2016	18,132,479	18,925,796	(793,317)	2,659,501	1,866,184	10%	1,577,150	1.18	600,000	2,466,184	1.56	
New Bedford	6/30/2016	50,174,043	49,494,563	679,480	3,692,719	4,372,199	9%	4,124,547	1.06	3,152,737	7,524,936	1.82	
Peabody													unavailable
Pittsfield	6/30/2016												Fund dormant. Appears not self-insured. No prior data available.
Quincy	6/30/2016												not self-insured for health insurance
Revere	6/30/2014	21,305,633	20,472,769	832,864	5,697,608	6,530,472	31%	1,706,064	3.83	1,224,137	7,754,609	4.55	
Salem	6/30/2016			-									not self-insured for health insurance
Springfield	6/30/2016	83,140,067	84,563,863	(1,423,796)	8,406,534	6,982,738	8%	7,046,989	0.99	158,928	7,141,666	1.01	
Westfield	6/30/2016												unavailable
Worcester	6/30/2017	91,637,377	87,826,743	3,810,634	22,120,553	25,931,187	28%	7,318,895	3.54	5,832,940	31,764,127	4.34	
Other Cities													
Waltham	6/30/2016	46,975,948	46,769,467	206,481	444,431	650,912	1%	3,897,456	0.17	2,734,957	3,385,869	0.87	
Cambridge	6/30/2016		48,739,585							17,064,000	17,064,000		90% self-insured but data not reported on trust fund balance
Boston	6/30/2016	330,405,000	344,518,000	(14,113,000)	62,892,000	48,779,000	15%	28,709,833	1.70	24,730,000	73,509,000	2.56	
Boston	6/30/2015	311,361,000	323,632,000	(12,271,000)	75,163,000	62,892,000	20%	26,969,333	2.33	22,553,000	85,445,000	3.17	
Boston	6/30/2014	311,054,000	302,876,000	8,178,000	66,985,000	75,163,000	24%	25,239,667	2.98	24,312,000	99,475,000	3.94	