

Report of the Town Manager

September 22, 2014

Financial Updates-

This will be a very, and necessarily, ugly discussion about our pending deficits in the Health Insurance Trust and the FY14 year end.

Health Insurance Related Deficit:

As I understand the case to be as I write, after a final unravelling by Town Accountant Donna Allard and a special outside auditor, at the close of FY14 (which is a two year compounded balance and also includes our now known final year end FY13) we have a deficit in the Health Insurance Trust fund that is far worse than had been estimated back in July when I informed each of you after the outside auditor was able to first identify a concern in FY13 numbers.

You will recall that Accountant Allard and I held off on rolling out any preliminary numbers prematurely until the FY14 health numbers could also be tracked and analyzed.

After that analysis, the final Health Insurance Trust Fund deficit, again to include FY13 and FY14 cumulative deficits, is \$1.8 million dollars. This is quite obviously a significant number.

Additionally, as a result of correcting an accounting convention that had been previously employed, the FY14 Health Insurance appropriation line item ended in a \$300k deficit as well.

This brings the health insurance related deficit to a total of \$2.1 million.¹

“How Did This Occur?”-

The answer first requires some background information:

Unlike your usual insurance structure, like your personal auto or home insurance, where you pay your insurance company an annual premium and the company assumes all risk and must pay all claims, for over a decade for employee health insurance in Winchendon we have functioned as a self-insured account.

You might be asking, “Why would we be self-insured?”

In 2003, after an analysis that showed that as a traditional premium paying account that we paid a million dollars more out to the insurance company than the actual cost of claims dollars incurred, we made the decision to change the plan structure to self-insurance in an effort to keep that tax money here in town.

¹ It is worth notation that 77%, or a full \$1.6 million of this \$2.1 million deficit would tie back to the school department pursuant to the indirect cost agreement between the parties. Given the fact that the school department could not have known of this issue either, any consideration that all of their share of this expense should run to them per the usage formula, is to my thinking at this time irrelevant. It is highly relevant and appropriate, however, for the school budget to absorb some portion of the problem. I will address my position on that later in this writing.

In making this move, the only change in the mechanics was in how the bills were to be paid. As a self-insured account we would be responsible to keep the premium money here in town and to pay the bills. We would pay a fee to Blue Cross/Blue Shield to be able to utilize Blue Cross/Blue Shield as our health insurance provider and still utilize their networks, their discounted relationships and administrative support.

Additionally, we had to place \$500k on deposit with them to cover any bills that would come in after we were to cancel our relationship with them at some future point in time. This deposit is our money and earns interest it is just held by them as a protection. It's not unlike your traditional last month's rent or security deposit arrangement.

After the decision to transition to a self-insured account we began with the then existing premiums and multiplied them by the subscribers and plan types to get the total required funding level for the group. From there we split that number into the 40% share to borne by the employees and the 60% to be borne by the town budget.

Then, with each payroll week both the 40% employee share which was deducted from the employee checks and the corresponding 60% town share which was deducted from the appropriation line item in the budget was transferred into a holding account known as the Health Insurance Trust Fund. When the monthly claims bill was received it was paid from that fund and the same transactions would occur each month thereafter.

Each year the rates would be adjusted and/or the plan benefits would be changed and the new projected funding level for the succeeding fiscal year would be arrived at for budgeting purposes.

Obviously, as a relatively small group there is always the unfortunate possibility that one of the group's insured souls could become very ill. Purely as a matter of financial protection, in a self-insurance structure, the group purchases an insurance product known as re-insurance. In simple terms, this product would cover any claim on any and all insured souls that go beyond a set dollar threshold. In Winchendon the analysis of the consultant that originally set up the system pegged that threshold at \$70k. Based upon the analysis of the town group's prior claims history the plan was structured to be able to absorb up to three such catastrophic claims in a plan year and still remain financially sound.

Eight years in and as recently as 2010, the program was functioning as expected and there was a \$929K positive balance in the fund.

The first sign of any concern was in October of 2012 or a full quarter of the way through FY13, when the then seated Town Accountant advised that we closed out FY12 with a \$200K+ deficit. While this was a concern, it was not deemed significant because the Massachusetts Department of Revenue (DOR) allows us to count our \$500k cash deposit that was on hand with Blue Cross/Blue Shield to offset any such deficit.

At our next annual rate setting in the winter/spring of 2013 we made plan changes in an effort to reduce costs. This was for a prospective rate change to take effect in July of 2013. It is important to remember that this was occurring while there was still at least a quarter of the FY13 claims year to go at the time when a review of the budget appropriation showed that we were trending to make budget.²

Several months later, at the end of FY13, but prior to the books being able to be closed, our long serving and now former Town Accountant (who was then set to retire) was stricken gravely ill while out of the country on vacation. For the better part of the next three months while she was ill and then thankfully recuperating, the

² This is an important issue to use to highlight the distinction between the appropriation balance and the health trust fund balance and I'd be pleased to spend whatever time on the issue as you deem appropriate.

books remained unclosed. Working as expeditiously as possible, the Board hired a replacement Town Accountant who dove straight into trying to get a handle on the now long since passed FY13 financial closing.

You will recall that the level of effort it took to get the books closed brought us to a December 30, 2013 special town meeting to reconcile the books in order for DOR to be able to set our tax rate prior to January 1, 2014.

During that hectic period of the new Accountant having to step into the prior Accountant's world (literally desks, paper and computer files and paperwork left untouched since the prior Accountant had left on vacation and unfortunately not returned) without the benefit of any transition, one matter that was not visible or apparent was that the Health Insurance Trust Fund was out of balance.³ It wasn't until the FY13 books were finally and officially closed in May of this year, 2014, that the issue of the FY13 Health Trust was identified as a problem showing a \$735k deficit. After analysis by the outside auditor nailed down this FY13 year-end deficit in the Trust our DOR representative was brought into a meeting between she, our current Accountant and me to address the issue in early July of this year, or one full year after the end of FY13, and in fact even more problematic a month after the end of the subsequent fiscal year FY14.

It is additionally worth noting that if not for the absence of an Accountant---due to vacation turned to serious illness then to the time it took to secure and bring in a replacement---that staff time on point would have allowed for a more regular level of attention and effort at the closing of FY13. I truly must believe that we would have had this matter identified long before it was allowed to continue to bleed unchecked through FY14 as well if not for that series of unplanned and unfortunate events.

In that July meeting with DOR, our Rep's position was that we needed to finalize the FY14 books to more completely tease out the exact and cumulative deficit and that we would need to cover it prior to being able to set the tax rate for FY15.

Now that the complete Health Insurance Trust Fund deficit number, at \$2.1 million as detailed above, is known we must begin to chart a course to address it.

Usual and Customary FY14 Deficits.

This Health Insurance Trust Fund deficit situation is further exacerbated by the **net** FY14 non-health insurance related deficit of \$218,000⁴. This deficit is driven in large part by the usual and customary over expenditure in the snow and ice and veterans service expense line items and offset by FY14 available revenues.

The Path Forward- Generally.

Back to the DOR. The Department has laid out a very tight and necessary timeline for us moving forward now that these deficits are finally in focus.

First things first, we must finalize our FY14 audit, we must complete the FY14 balance sheet and ultimately we must cover the deficit **prior to being able to set the tax rate.**

³ There are a number of reasons that this matter was difficult for our current Accountant to discern and I would be happy to address that in any level of detail that you may wish.

⁴ FY14 gross deficit of \$600,000 less enterprise revenue offset of \$214,000 less final increase in local receipts of \$168,000

While this may seem an unattainable task, most simply put, we do not have the luxury of not attaining it. Now that we are aware of the situation, we must use a combination of incredibly deep budget cutting measures, any available revenues and reserves and to close the gap.

With no health insurance pun intended, it is a very good analogy to compare our current fiscal situation to a very sick or injured patient. To be clear, contrary to some commentary that is afoot, we are not terminally ill or even on life support.

Now that the problem has been diagnosed we must proceed expeditiously to:

- **Stabilize-** employ measures to stop the bleeding. Toward that end we have:
 - imposed a spending freeze for all non-contractual FY15 expenditures;
 - frozen the filling of budgeted but currently vacant municipal positions;
 - have fully briefed each member of the Board of Selectmen on the FY14 and Health Insurance Trust Fund deficits, as we understand them to be today;
 - have prepared a budget/finance update further detailing this matter, to include preliminary plans for a path forward, for the public Board meeting tonight;

- **Correct-** employ measures to get back on track. Toward that end we have:
 - held a department head meeting earlier today to begin the earnest FY15 budget re-evaluation and reduction process, to include consideration of cuts that will remove expense without removing public service deliverables;
 - engaged, and as of last Friday have had a first meeting with, an outside health insurance consultant to analyze our past claims history, plan design and rate structure all toward the end of issuing an RFP to result in moving our group off of self-insured status and onto a full premium based plan with a mid FY15 plan change over. The IAC has been convened and advised of this plan of action.
 - Implementing tax and tax title receivable policies to strengthen our revenue receipts to potentially include- more aggressive tax title filing and court takings, auction of tax title possession properties, auction/sale of the existing tax receivable to an outside collection agent;
 - obviously, I cannot impose any action on the school department and any cooperation from that side of the budget would be left to the Superintendent and the School Committee.

- **Prevent-** measures to hedge against ever being here again. Toward that end we have:
 - implemented a mandatory Purchase Order system (I will seek and hope to receive a confirmatory vote of the Board of Selectmen on this policy tonight);
 - assigned the contracting of the firm to conduct our annual audit to be procured by the Board of Selectmen, perhaps with the input of the Finance Committee, instead of the Town Accountant.

- Introduce more formalized monthly budget to expense reporting with copies to all departments, the Board of Selectmen, the School Committee and the Finance Committee.
- Introduce quarterly revenue reports to illustrate revenue collection to date.

The Path Forward- Philosophically.

My assessment having spoken to each of you is that at least a majority of you philosophically support a plan that seeks to aggressively address this matter while simultaneously endeavoring to preserve public services all in an effort to impact the voting, tax paying citizens of the community the least in regard to what they see and receive. This does not mean that there would be no budget impacts and cuts but rather that such cuts would be geared toward reducing cost and not service deliverables.

The Path Forward- Override.

A cumulative deficit of \$2.318 million dollars is obviously a considerable sum. DOR is angling for us to put forth an override. It is their understandable and usual angle as it creates money.

I advised DOR that I would not expect an override to pass for several reasons. First, we just had one for the schools; second, we have debt exclusions still on the books that have yet to hit; and third and most obviously that no one wants to pay more for what they thought they had already paid for.

Lastly, an override would be permanent and we have a onetime need as of now.

It may be that such a discussion becomes relevant after we're cleaned up this current fiscal situation but to my thinking if there is ever to be a "right" time for that discussion right now is absolutely not that time.

The Path Forward- Health Insurance.

I have advised the employee union group representation on the health insurance advisory committee (IAC) that significant changes to health insurance for town employees must occur now. We will be transitioning away from self-insured pool, after an 11 year positive track record that was unfortunately blown up by brief period of terrible claims experience⁵ and an off record recording of its financial impacts, to a premium based plan where the risk runs to the insurer.

Please do not read anything callous in my description of the financial impacts of our insured employees. They have done nothing wrong and I am sure given the choice would have gladly chosen to not become ill.

I advised that the need to do this and to cut budget will necessarily require a significant restructuring of plan benefits. Each union represented understands this and while there is a lot of ground between here and their agreement we are at present beginning on the right track. Toward that end, I had a market health insurance consultant in house this Friday to synthesize our claims history, rate structure and plan design in an effort at charting the market course. This is a group that comes at the recommendation of Finance Committee Chair Tom Keane.

The Path Forward-Concrete Ideas.

A very preliminary effort at addressing the matter can be seen in the following **DRAFT** deficit reduction plan spreadsheet:

⁵ Over this roughly 18 month period the group incurred extraordinary claims on behalf of 13 insured souls who's claims either hit or got close to hitting the \$70k threshold (13*\$70k = \$910k)

\$ 2,100,000.00	health related deficit
<u>\$ 218,000.00</u>	FY14 net deficit
\$ 2,318,000.00	cumulative deficit
<u>\$ (250,000.00)</u>	targeted town budget cuts
\$ 2,068,000.00	
<u>\$ (250,000.00)</u>	targeted school budget cuts
\$ 1,818,000.00	
<u>\$ (550,000.00)</u>	prepayment residual balance of the infrastructure investment account
\$ 1,268,000.00	
<u>\$ (99,000.00)</u>	opex to capex- fire roof and generator, town hall computers
\$ 1,169,000.00	

We will continue to work the issue over the next several weeks in an effort at shrinking that bottomline that is not yet covered in the draft. If at the end of this preliminary analysis, however, it is the choice to seek town meeting approval to access stabilization funds, I offer the following to be considered in tandem.

The Path Forward-Stabilization.

As earlier articulated, the objective is to cover the deficit in a fashion that: avoids any tax increase, makes surgical and targeted budget cuts that excise cost and not service, uses other available revenues and/or conversions of cash capital purchases to short-termed borrowed purchases and only as a last resort to approach the stabilization fund.

Having said that, I do believe, at the end of our best efforts, that the use of **a portion** of our current \$1.6 million in stabilization may prove unavoidable **IF** the goal is truly to limit the impact to the citizens related to services as cited above.

I propose that any consideration of a use of stabilization funds be voted concurrently with a plan to replenish those funds, dollar for dollar, from revenue sources coming available starting in the spring of 2015. By way of example:

If we utilized \$750,000 in stabilization I would seek a vote of the town meeting⁶ as follows:

I move that the Town vote to transfer from stabilization fund the amount of \$750,000 to cover the residual balance of the FY14 budget and Health Insurance Trust Fund deficits, provided that it is understood to be the will of the assembly that said fund will be replenished, dollar for dollar, beginning at the Spring 2015 town meeting from funds made available from the residual balance from our health insurance deposit being returned to the town from Blue Cross Blue Shield (+/- \$300,000) and from the retirement of

⁶ Such a vote has the weight of providing a sense of the meeting but a subsequent vote would be required to actually effect the replenishment.

general obligation debt within the town budget beginning in FY16
(+/- \$250,000) until such time as the fund has been made whole.

Having offered all of the above, let me close by saying that I have penultimate faith in your department heads and town employees to tackle this matter head on now that it is known. I have faith that the task can and will be addressed in a professional and citizen friendly fashion. And lastly, while it is a problem that took two years to build we must and will defeat it right now. It is our charge. It is our job. It is our commitment. The next couple of months will not be easy but the work will be done as it is necessary.