

COUNTY OF MILWAUKEE
Interoffice Memorandum

DATE: March 15, 2007

TO: Supervisor Richard D. Nyklewicz Jr., Chairman, Committee on Finance and Audit
Supervisor James “Luigi” Schmitt, Chairman, Committee on Personnel

FROM: Employee Fringe Benefits Cost Allocation Work Group
Prepared by: Steve Cady, Fiscal and Budget Analyst, County Board

SUBJECT: 2007 Adopted Budget Amendment (1C004) – Allocation of Fringe Benefit Costs

REQUEST

The 2007 Adopted Budget included an amendment directing County Board and Department of Audit staff, working in consultation with the Controller and Director, Department of Administrative Services, to study alternative options to allocate fringe benefit costs to departmental budgets. The study is to include, but is not limited to, exploration of options to quantify and allocate actual fringe benefit costs of active employees from inactive or retired employees. A staff report is to be submitted to the Committees on Finance and Audit and Personnel for consideration at their March 2007 meetings, with the goal of implementing any subsequent new policy on the allocation and presentation of fringe benefit costs prior to the 2008 budget process.

BACKGROUND

Employee fringe benefit costs include health, dental and life insurance, pension contributions (including annuity, OBRA, and United Regional Medical Services pension contributions related to the John L. Doyne Hospital closure), Medicare reimbursement to eligible retirees, transit passes, and consultant fees related to the operation of these programs. All of these costs are itemized in Org. Unit 1950 – Employee Fringe Benefits.

Prior to the 2007 Budget, fringe benefits were allocated to departmental budgets based on a percentage of salary method. By dividing total fringe benefit costs, which include expenditures for active, inactive and retired employees, by the County payroll, a fringe benefit percentage was determined. This percentage was then applied to each fringe benefit eligible position based on its salary amount. This excluded seasonal and part-time employees. The fringe benefit percentage rose to approximately 78% of salaries in 2006 due to rising fringe benefit costs and fewer positions in which to allocate the costs.

For the preparation of the 2007 Recommended Budget, the Department of Administrative Services instead chose to allocate fringe benefit costs based on a fixed dollar amount per position, regardless of the salary. For the 2007 Budget, this amount is \$37,334 per position. This fixed dollar approach was adopted in part to recognize that much of the costs that are allocated to positions are not determined by the salary amount. For

example, health care expenses for a low wage employee can cost the county as much or more as those for a high wage employee. Indeed, direct health care expenditures, which include costs for retirees, are approximately 70% of the total anticipated 2007 fringe benefit budget. Pension related costs, on the other hand, are related to an individual's salary and may be more appropriately allocated based on a percentage of salary method. Still, the majority of the fringe benefit expenses are health care related, which influenced the decision by DAS-Fiscal Affairs to switch to a flat dollar fringe benefit allocation.

During its deliberations on the 2007 Recommended Budget, members of the Committee on Finance and Audit expressed concerns about the change from a percentage to a flat dollar amount to allocate anticipated fringe benefit costs. These concerns included the belief that the change adversely impacted departments that have average salaries that are less than the countywide average; thus they carried a greater share of the retiree cost burden. Moreover, the fringe benefit cost allocation, whether presented as a flat dollar or salary percentage method, did not allow policymakers to decipher the true fringe benefit cost for an active employee versus the amount that was allocated to each position for liabilities associated with retired employees. As such, this made it difficult to quantify actual costs associated with position restorations or the true value of several privatization initiatives included in the Recommended Budget. Policymakers noted the prohibitive cost of restoring positions and pointed out that, even if positions are privatized the retiree costs would remain a County liability and simply be spread over fewer employees, resulting in a higher fringe benefit allocation per employee in the future.

An analysis in the Fall of 2006 by the Department of Audit to calculate a fringe benefit rate for active employees resulted in a fringe benefit rate for post-1993 hires at approximately 39%, or about half of the 78% fringe percentage rate that was anticipated prior to the submission of the 2007 Recommended Budget. (Post-1993 hires are not eligible for lifetime health insurance and, in the event of staffing reductions, would most likely be laid off based on seniority provisions in union contracts)

DISCUSSION

The allocation of fringe benefit costs must be done in a way that is consistent with generally accepted accounting principles (GAAP) and maximizes the County's ability to recover outside revenues to offset these costs. With these guiding principles, the Employee Fringe Benefits Cost Allocation Work Group ("Work Group") explored various alternatives to allocate and present fringe benefit costs beginning with the 2008 Recommended Budget. It was determined that the Budget Reporting and Analysis Support System (BRASS) could allocate health and pension costs separately. Pension costs could be allocated using a percentage of salary method and health care (including dental, life insurance and other costs previously mentioned) could be allocated on the basis of a flat dollar amount. This hybrid allocation approach would include all retiree costs and be consistent with GAAP standards. In addition, it would ensure that all allowable outside revenues would be captured so as not to result in a revenue loss to the County.

To help address the presentation of fringe benefit costs, it was agreed that the Org. 1950 – Employee Fringe Benefits budget narrative could include a table that attempts to determine a fringe benefit rate (expressed as a flat dollar and percentage of salary amount) for active employees. Based on health care claims data, pension actuarial reports, etc., it is possible to calculate the approximate portion of the fringe benefit budget that is generated by active employees from the amount that is obligated by inactive and retired employees. The Department of Audit and the Controller will work together to develop a mutually agreeable template that can be presented beginning with the 2008 Recommended Budget. This should provide meaningful data to policymakers about actual fringe benefit costs for active employees and help provide context for future staffing decisions.

RECOMMENDATION

Based upon the foregoing, the Employee Fringe Benefits Cost Allocation Work Group recommends that, beginning with the 2008 Requested Budget, Milwaukee County allocate fringe benefit costs to departmental budgets based on a hybrid approach. Health care expenditures (actives and retirees), dental and life insurance, Medicare reimbursement, transit passes, and consultant fees will be allocated on a flat dollar amount to each benefit eligible position. Pension expenditures, including annuity, OBRA, and United Regional Medical Services contributions related to the John L. Doyne Hospital closure, will be allocated to each benefit eligible position based on a percentage of salary method.

The Department of Audit will work with the Controller to develop a mutually agreeable template that attempts to determine a fringe benefit rate (expressed as a flat dollar and percentage of salary amount) for active employees. This information will be included in the Org. 1950 – Employee Fringe Benefits budget narrative.

Respectfully submitted,

Employee Fringe Benefits Cost Allocation Work Group

Cynthia Archer, Fiscal and Budget Administrator, DAS
Steve Cady, Fiscal and Budget Analyst, County Board
Rick Ceschin, Senior Research Analyst, County Board
Jerome J. Heer, Director of Audits
Douglas Jenkins, Deputy Director of Audits
Alexandra Kotze, Budget Unit Manager, DAS
Scott Manske, Controller, DAS
James Martin, Fiscal and Management Analyst, DAS

cc: County Executive Scott Walker
Supervisor, Lee Holloway, Chairman, Milwaukee County Board of Supervisors
Dee Hervey, Chief Committee Clerk, County Board
Jodi Mapp, Committee Clerk, County Board