

COUNTY OF MILWAUKEE
Inter-Office Communication

Date: September 11, 2003
To: Supervisor Richard D. Nyklewicz, Jr., Chairman, Committee on Finance and Audit
From: Director of Audits
Subject: Report on Projected Surplus/Deficit in the Employee Health Benefits Account [File No. 02-503 (a)]

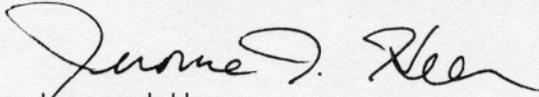
As part of the 2003 Adopted Budget, the Department of Audit was directed "...to provide monthly reports for the first quarter of 2003 and quarterly reports thereafter, unless otherwise determined, regarding the projected surplus/deficit in the employee Health Benefits account." At its meeting January 16, 2003 the Finance and Audit Committee directed the Department of Audit to provide subsequent reports in April, July, October and December. The budget directive was approved as an amendment to the County Executive's Proposed Budget in light of concerns expressed in a joint memo from the County Board Director of Research and the Director of Audits, dated October 17, 2002. That memo, which provided an analysis of the Health Care Cost Reduction Plan included in the proposed 2003 budget, cautioned that monitoring reports of actual health care costs throughout 2003 would be prudent, given the uncertain nature of various assumptions upon which budgeted health care costs are, by necessity, built. Due to sharp increases in expenditures in health care costs since our last report in July, the Chairman of the Finance and Audit Committee has requested an update at this time.

Expenditure information available from the County's financial system as of September 1, 2003 for the first eight months of the year is preliminary and almost certainly does not represent two-thirds of the actual health care costs that ultimately will be borne by the County for 2003. One method of reviewing current year costs is to measure the expenditures to date in relation to the percentage of total 2002 costs recorded at this same time last year. Using this method in our prior monitoring reports, we have noted that figures through June 2003 were tracking almost precisely on budget. As noted in our July report, preliminary year-to-date 2003 health care costs as of June 30, 2003 of \$38.2 million were approximately 47.4% of the total 2003 appropriation of \$80.6 million, or virtually identical to the percentage of total actual 2002 expenditures recorded at the same time last year.

This same methodology shows that expenditures for both July and August 2003 tracked sharply higher than for the same period in 2002. As a result, total year-to-date health care expenditures of \$54.6 million represents about 67.8% of the total appropriation of \$80.6 million. Records show the comparable figure for the same period last year reflected expenditures of about 63.4% of the total amount actually spent for 2002. Consequently, the 2003 expenditures of \$54.6 million are approximately \$3.5 million more than the amount that would replicate 2002 spending patterns.

It is important to note that several factors may affect the direct comparability of these figures. For instance, the 2003 expenditures include payment of approximately \$460,000 to the previous claims administrator in 'run-out' administrative charges for 2002 medical service claims. Since this one-time payment will not recur, this tends to provide a 'cushion' in the 2003 appropriation. On the other hand, health care costs are not entirely predictable, and one year's pattern or pacing of expenditures may not be replicated in the following year. For instance, to the extent certain high-cost episodes of health care needs arise among covered County employees or retirees in greater proportion than the previous year, County health care costs could experience an unexpected 'spike' such as those experienced in both July and August.

The controller has projected an estimated 2003 deficit of about \$4 million in health care accounts. This estimate was prepared using a separate methodology that breaks down the component parts of the 2003 health care costs and uses annualized figures based on year-to-date expenditures to project costs for the remainder of the year. That estimate is a valid approach, but is subject to the previously noted limitations concerning the difficulty in predicting future health care costs. The approach used by the controller is reasonable and his resulting projection is neither contradicted nor supported by the methodology used in our monitoring reports.



Jérôme J. Heer
Director of Audits

JJH/cah

cc: Finance and Audit Committee Members
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Terry Kocourek, Fiscal and Budget Administrator, Department of Administrative Services
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