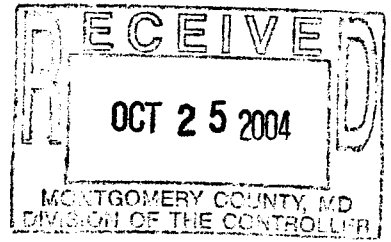


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OFFICE OF MANAGEMENT AND BUDGET

Douglas M. Duncan  
County Executive

MEMORANDUM

Beverley K. Swaim-Staley  
Director

October 7, 2004

TO: Budget and Finance Files

FROM: Beverley K. Swaim-Staley, Director  
Office of Management and Budget *BKS*

Timothy L. Firestine, Director  
Department of Finance *Timothy L. Firestine*

Joseph Adler, Director  
Office of Human Resources *Joseph Adler*

Marc Hansen, Chief  
General Counsel Division, Office of the County Attorney *Marc Hansen*

SUBJECT: Decision Memorandum – Budgetary treatment of year-end adjustments to IBNR claim reserves

**Purpose:** The purpose of this memorandum is to document and clarify for the file the budgetary treatment accorded to the year-end accounting adjustment for “IBNR” (incurred but not reported) claims within the Liability and Property Coverage Self-Insurance Fund in the Department of Finance, Division of Risk Management, and the Employee Health Benefits Self-Insurance Fund within the Office of Human Resources. This memorandum clarifies that any IBNR adjustment as of year-end does not require any budgetary action (*e.g.* supplemental or special appropriation or for that year. But any adjustment to IBNR claims reserve as of year-end will be incorporated in the budget preparation process of the following fiscal year.

**Background:**

Sections 20-37 (e) (4) and (e) (6) of the Montgomery County Code establish the budgetary requirements for the County’s Comprehensive Insurance and Self-Insurance program, which includes both funds referred to above.



Office of the Director

Section 20-37 (e) (4) of the Montgomery County Codes establishes that the County Council will annually appropriate to the self-insurance program sufficient funds to provide for the program's premium cost, claim expense and adequate claims reserves in addition to providing for the operating requirements of the program's risk management operation.

Section 20-37 (e) (6) the Montgomery County Code establishes that the interagency insurance panel prepare an annual budget for the Montgomery County self-insurance program, to include a list of charge-backs required to provide insurance coverage to those county departments and funds that currently are charged by the county's finance department for their insurance coverage. In addition, the budget shall also include an amount which is required to adequately fund the county self-insurance program's unencumbered claims reserve calculated with the assistance of an insurance consultant as necessary.

All of the above detailed requirements are part of the current annual budget process which results in an appropriation to the Liability and Property Coverage and Employee Health Benefits Self-Insurance Funds, and related chargebacks to the other county departments and funds. This includes, for the Liability and Property Coverage Self-Insurance Fund, the use of an actuarial consultant in preparing a projected calculation of amounts necessary to adequately fund the claims reserve, and to include in department's chargebacks for that year.

Any increase/decrease in claim reserves/IBNR, calculated after the fiscal year has ended, is based on an after-the-fact actuarial analysis of actual expenditures and projections of changes to known and unknown claims. The actuarial calculation is made for accounting purposes to reflect expenditures in the funds in accordance with generally accepted accounting principles (GAAP). However, since this calculation is made after the year is complete, it cannot impact the chargebacks planned for, and already made to, other departments and funds. It therefore appears appropriate and consistent with County Code that this accounting adjustment not be considered as requiring an after-the-fact budgetary appropriation. Rather, the year end IBNR analysis should be taken into account in the next budgetary cycle. Therefore, the treatment of any year-end adjustment to claims reserve/IBNR appears to be different for accounting/GAAP and for budgetary purposes.

There are a number of differences between GAAP accounting and the County's basis of budgeting. These are generally disclosed in the Fiscal Policy, Basis of Budgeting/Accounting Method section of the County Executive's Recommended Operating Budget and Public Services Program. From time to time, where it appears that differences exist but disclosure has been overlooked, the Office of Management and Budget and Department of Finance, along with any other impacted department(s), work together to correct such disclosures for the future. This difference between GAAP and budgetary treatment of year-end claims reserve/IBNR was not listed in the FY04 Fiscal Policy section referred to above.

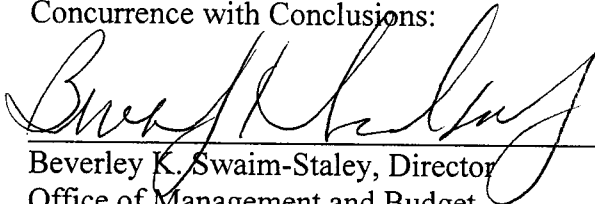
**Conclusions:**

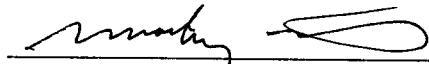
In summary, the current budgetary process of calculating the appropriations for the Liability and Property Coverage and Employee Health Benefits Self-Insurance Funds is consistent with the requirements of the County Code Section 20-37. The budgetary process of appropriating charge-backs to departments and agencies other than the General Fund which is funded in the Department of Finance is also in compliance with the process established in the County Code.

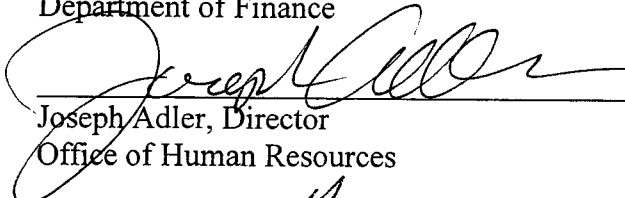
Any actuarial adjustment to claims reserves/IBNR, calculated after the fiscal year-end, is made for that year solely for accounting purposes to ensure that the financial statements are reported in accordance with GAAP, but is not required to be incorporated as part of that year's budget per the provisions of the County Code. Any increase/decrease in claims reserve/IBNR resulting from the year-end actuarial valuation is therefore not charged/credited against that year's appropriation.

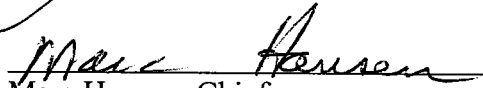
For FY06 and future years, the Fiscal Policy, Basis of Budgeting/Accounting Method section of the County Executive's Recommended Operating Budget and Public Services Program will be clarified to reflect this difference between GAAP and the County's basis for budgeting these funds.

Concurrence with Conclusions:

  
Beverley K. Swaim-Staley, Director  
Office of Management and Budget

  
Timothy L. Firestine, Director  
Department of Finance

  
Joseph Adler, Director  
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