STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

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EXPOSURE DRAFT
DEFICIT ELIMINATION PLANS
LOCAL AUDIT AND FINANCE DIVISION
MUNICIPAL FINANCE SECTION
JANUARY 13, 2012
COMMENTS REQUESTED BY FEBRUARY 13, 2012

Prepared by the Local Audit and Finance Division (LAFD) for comments from persons interested in the reduction and elimination of deficits in local government.

This exposure draft contains important proposals for review and comment by local units of government and other interested parties. The text and an explanation of the proposed pronouncement are included in this exposure draft.

Your comments are an important part of the standard setting process. Please take this opportunity to comment. Responses must be received by February 13, 2012. All written replies to this exposure draft may become part of the public record of the LAFD.

Please send comments to:

lafd_audits@michigan.gov or

Michigan Department of Treasury
Local Audit and Finance Division
PO Box 30728
Lansing, Michigan 48909-8228

If you have any question, feel free to call Harlan Goodrich at 517-373-3227

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NUMBERED LETTER 2012-1

DEFICIT ELIMINATION PLANS

Issued By: Local Audit and Finance Division, Bureau of Local Government Services

Issue Date: xxxx 2012

2012-1 This numbered letter clarifies when a deficit elimination plan is required and how to determine the amount of deficit to be eliminated.

The Glenn Steil State Revenue Sharing Act of 1971, Public Act 140 of 1971, Section 21(2), states that units of local government (local units) that end their fiscal year in a deficit condition shall formulate a deficit elimination plan (plan). The plan shall be filed with the Department of Treasury (Treasury) for evaluation and certification.

Determining a Deficit for Fund-Based Statements

For all funds that utilize fund-based statements (not proprietary funds or discretely presented component units), a plan is necessary to eliminate any "unrestricted fund balance" deficits. Unrestricted fund balance is the sum of the Committed, Assigned, and Unassigned balances. An unrestricted fund balance deficit exists when the local unit does not have sufficient resources available to cover the deficit. This occurs when the restricted fund balance is greater than the total fund balance. Resources available to cover the deficit includes assets that are not restricted by federal, state, or local laws, regulatory authorities, bond covenants, contractual agreements, or other legal constraints. Therefore, when funds have a total fund balance surplus and an unrestricted fund balance deficit, sufficient unrestricted resources do not exist to eliminate the deficit.

Determining a Deficit for Proprietary Funds and Discretely Presented Component Units

Various methods have been used to determine the amount of a deficit in a proprietary fund or a discretely presented component unit. For purposes of uniformity among all units of local government, effective immediately, Treasury will define a deficit as stated below. Local units will be expected to apply the same test to determine if a deficit elimination plan is necessary.

Proprietary Fund and Discretely Presented Component Unit Deficit Test

Step 1: Does the "unrestricted fund balance" or "total net assets" have a deficit? If both are no, no plan is necessary. If one is yes, proceed to Step 2.

Step 2: Is the current ratio (current assets/current liabilities) less than 1.0? If no, no plan is necessary. If yes, proceed to Step 3.
Step 3: Calculate current assets minus current liabilities.
Step 4: Compare A) the larger deficit between the "unrestricted fund balance" and the "total net assets", and B) current assets minus current liabilities.
Step 5: Submit a plan to eliminate the smaller deficit between A and B.
Note: When comparing the three numbers in Step 4 from smallest to largest, the middle number should be the deficit to be eliminated in Step 5.

Example 1
Unrestricted Fund Balance = (430,000), Total Net Assets = 1,800,000
Current Assets = 75,000, Current Liabilities = 60,000
Step 1: Unrestricted Fund Balance has a deficit. Yes.
Step 2: Current Ratio of 1.3 > 1.0. No. No plan is necessary.
Step 3: Not Applicable
Step 4: Not Applicable
Step 5: Not Applicable
Note: Not Applicable

Example 2
Unrestricted Fund Balance = (430,000), Total Net Assets = 1,800,000
Current Assets = 75,000, Current Liabilities = 510,000
Step 1: Unrestricted Fund Balance has a deficit. Yes.
Step 2: Current Ratio of 0.1 < 1.0. Yes.
Step 3: 75,000 – 510,000 = (435,000)
Step 4: A **(430,000)** or 1,800,000, B (435,000)
Step 5: A is a smaller deficit than B. Submit a plan to eliminate the (430,000) unrestricted fund balance deficit.
*Note: (435,000), **(430,000)**, 1,800,000*

Example 3
Unrestricted Fund Balance = (430,000), Total Net Assets = 1,800,000
Current Assets = 75,000, Current Liabilities = 200,000
Step 1: Unrestricted Fund Balance has a deficit. Yes.
Step 2: Current Ratio of 0.4 < 1.0. Yes.
Step 3: 75,000 – 200,000 = (125,000)
Step 4: A **(430,000)** or 1,800,000, B (125,000)
Step 5: B is a smaller deficit than A. Submit a plan to eliminate the (125,000) difference between current assets and current liabilities.
*Note: (430,000), **(125,000)**, 1,800,000*

Example 4
Unrestricted Fund Balance = (430,000), Total Net Assets = (1,500,000)
Current Assets = 75,000, Current Liabilities = 510,000
Step 1: Unrestricted Fund Balance and Total Net Assets have a deficit. Yes.
Step 2: Current Ratio of 0.1 < 1.0. Yes.

Step 3: 75,000 – 510,000 = (435,000)
Step 4: A (430,000) or **(1,500,000)**, B (435,000)
Step 5: B is a smaller deficit than A. Submit a plan to eliminate the (435,000) difference between current assets and current liabilities.
*Note: (1,500,000), **(435,000)**, (430,000)*

<u>Example 5</u>
Unrestricted Fund Balance = (430,000), Total Net Assets = (450,000)
Current Assets = 75,000, Current Liabilities = 610,000
Step 1: Unrestricted Fund Balance and Total Net Assets have a deficit. <u>Yes.</u>
Step 2: Current Ratio of 0.1 < 1.0. <u>Yes.</u>
Step 3: 75,000 – 610,000 = (535,000)
Step 4: A (430,000) or **(450,000)**, B (535,000)
Step 5: A is a smaller deficit than B. Submit a plan to eliminate the (450,000) total net assets deficit.
*Note: (535,000), **(450,000)**, (430,000)*

<u>Example 6</u>
Unrestricted Fund Balance = (470,000), Total Net Assets = (450,000)
Current Assets = 75,000, Current Liabilities = 610,000
Step 1: Unrestricted Fund Balance and Total Net Assets have a deficit. <u>Yes.</u>
Step 2: Current Ratio of 0.1 < 1.0. <u>Yes.</u>
Step 3: 75,000 – 610,000 = (535,000)
Step 4: A **(470,000)** or (450,000), B (535,000)
Step 5: A is a smaller deficit than B. Submit a plan to eliminate the (470,000) unrestricted fund balance deficit.
*Note: (535,000), **(470,000)**, (450,000)*

Local units whose only deficit is for a proprietary fund or discretely presented component unit where it has been determined a plan is not necessary should select "Yes" to question #2 on their Auditing Procedures Report (Form 496).

<u>Filing Requirements</u>

It is the position of Treasury that a reasonable plan to eliminate a deficit condition is vital to the fiscal well-being of a local unit as is early implementation of that plan. Therefore, local units should not wait until Treasury sends a request letter for a deficit elimination plan to develop one. By providing better guidance on what constitutes a deficit, it is the expectation of Treasury that a local unit will submit a plan as soon as possible after the close of its fiscal year end.

A plan generally should be for one year, but in no case longer than five years. Local units with multiple year plans that do not meet their subsequent year deficit projections must submit a revised plan that adheres to the time frame that was originally certified, not to exceed five years. Plans and acceptable evidence (defined below) can be emailed to Treas_MunicipalFinance@michigan.gov or to the address provided below. If a plan has been sent via email, it is not necessary to also send a copy via postal mail.

Acceptable Evidence to Support a Plan

1. Certified copies of board/council resolutions (describing funds and amounts) approving additional appropriations sufficient to eliminate the deficit and a copy of the journal entry that shows that the transfer has been made or a trial balance.

2. Projected budget approved by the legislative body as evidenced by a certified resolution itemizing yearly revenues by source, expenditures/expenses by activity, and changes in the fund balance/retained earnings through the year of the deficit's eventual elimination. There is a five-year limit for an approved plan; the plan must be amended if the deficit increases or the plan is not otherwise followed.

3. For tax increment finance or downtown development authorities, the ordinance or plan approving their existence is acceptable if it shows the flow of revenue and the priority of expenditures that would satisfy a deficit elimination plan for these funds as indicated in #2 above.

4. For drain or other special assessment-type funds that have deficits, which are not "covered" on the balance sheet by a long-term receivable and deferred revenue, a letter from the Drain Commissioner itemizing assessment levies which could not be recognized for the audited fiscal year due to generally accepted accounting principles, will suffice as a deficit elimination.

Revenue Sharing Withholding

Should a plan not voluntarily be submitted, Treasury will no longer "request" a plan. The local unit will be sent, via U.S. Postal Service, a Notice of Intent to Withhold Revenue Sharing. The local unit will have 30 days from the date of the letter to file a plan. Should a plan not be filed within 30 days, we will withhold 25% of the local unit's state-shared revenue payment. Once state-shared revenue has been withheld, it is released not when a plan has been filed, but when a plan has been evaluated and certified by Treasury.

If you have any questions, please contact our office.

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