STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

ANDY DILLON
STATE TREASURER

DATE: November 7, 2011

TO: Governor Snyder

FROM: Flint Financial Review Team:
Roger Fraser
Laura Argyle
Gene Dennis
Darnell Earley
Robert L. Emerson
Frederick Headen
Doug Ringler
Brom Stibitz

SUBJECT: Report of the Flint Financial Review Team

On October 5th, 13th, 17th, 21st and November 7th, 2011, Flint Financial Review Team members met and reviewed information relevant to the financial condition of the City. Based upon those reviews, the Review Team concludes, in accordance with Section 13(4)(d) of Public Act 4 of 2011, the Local Government and School District Fiscal Accountability Act, that a local government financial emergency exists within the City of Flint, and that no satisfactory plan exists to resolve that emergency. Therefore, the Review Team recommends the appointment of an emergency manager.

I. Background

A. Preliminary Review

On August 29th through September 12th, 2011, the Department of Treasury conducted a preliminary review of the finances of the City of Flint to determine whether or not probable financial stress existed. Section 12(1) of the Act provides that a preliminary review may be conducted if one, or more, of the conditions enumerated therein occurs. The preliminary review of the City of Flint resulted from the condition enumerated in subdivision (j), (m), (o) and (r) of Section 12(1) having occurred within the City.[1]

[1] Subdivision (j) provides that the "local government has violated a requirement of sections 17 to 20 of the uniform budgeting and accounting act, 1968 PA 2, MCL 141.437 to 141.440." Subsection (m) provides that a "local government is in breach of its obligations under a deficit elimination plan or an agreement entered into pursuant to a deficit elimination plan." Subsection (o) provides that a "municipal government has ended a fiscal year in a deficit condition as defined in section 21 of the Glenn Steil state revenue sharing act of 1971, 1971 PA 140, MCL 141.921, or has failed to comply with the requirements of that section for filing or instituting a financial plan to correct the deficit condition." Subsection (r) provides that "[t]he existence of other facts or circumstances that in the state treasurer's sole discretion for a municipal government are indicative of municipal financial stress."

The preliminary review found, or confirmed, the following:

- The City had incurred cumulative deficits in many of its funds over several years. The following are fund deficits from 2007 to 2011:

Fund	2007	2008	2009	2010	Unaudited 2011
General	--	$(7,046,820)	$(10,113,744)	$(14,621,546)	$(11,149,907)
Building Department	--	(1,550,369)	--	(576,276)	(1,251,459)
Central Maintenance	$(226,349)	(4,233,859)	(3,183,144)	(1,922,489)	*(2,029,230)
Data Processing	(778,458)	(245,488)	(72,773)	--	--
EDC	(26,772)	(10,721)	(58)	(7,404)	--
EDC Oak Business Ctr	(28,403)	(19,843)	(5,285)	(24,898)	--
Garbage Collection	--	--	--	(909,283)	(1,444,581)
Golf Course	(473,294)	(1,909,377)	--	(282,670)	*(576,861)
Self Insurance	--	--	--	--	(33,580)
Parks & Recreation	--	--	--	(163,096)	(185,255)
Senior Citizens	--	--	--	--	(26,709)
Water Supply	--	--	--	(5,795,973)	*(9,009,825)
Total	$(1,533,276)	$(15,016,477)	$(13,375,004)	$(24,303,635)	$(25,707,407)

*Estimated

- Deficit elimination plans submitted to the Department of Treasury by City officials had not been followed. City officials submitted a deficit elimination plan concerning a general fund deficit of $7,046,820 as of June 30, 2008. That five-year plan projected a general fund deficit of $9,124,747 as of June 30, 2010. However, the actual deficit as of that date was $14,621,546, or $5,496,800 higher than projected and the deficit as of June 30, 2011, is estimated to be approximately $11.0 million. The plan also anticipated that the deficit would be eliminated by 2014, but an updated deficit elimination plan submitted for 2010 did not purport to eliminate the deficit until the year 2030, relying heavily upon the issuance of an additional $12.0 million of debt in 2013.

- General fund expenditures exceeded revenues since 2007 and fund deficits have existed since 2008, as follows:

	6/30/2007	6/30/2008	6/30/2009	6/30/2010	Unaudited 6/30/2011
Revenues	$69,212,013	$66,823,137	$63,937,302	$57,189,454	$52,201,018
Expenditures	70,908,742	79,475,612	66,703,149	64,741,451	58,969,882
Excess/Deficiency	(1,696,729)	(12,652,475)	(2,765,847)	(7,551,997)	(6,768,864)
Other Sources (Uses	(866,831)	(568,589)	(478,527)	3,044,195	10,598,701
Net Change	(2,563,560)	(13,221,064)	(3,244,374)	(4,507,802)	3,829,837
Beginning Fund Balance	8,915,254	6,351,694	(6,869,370)	(10,113,744)	(14,621,546)
Ending Fund Balance	$6,351,694	$(6,869,370)	$(10,113,744)	$(14,621,546)	$(10,791,709)

- The City relied upon transfers from the water supply fund and the sewage disposal fund for general City operations. In 2009, City officials increased overhead charges from the water supply fund and the sewage disposal fund from $1 million to $2.4 million. Also in 2009, City officials began charging a return upon investments against the water supply fund and the sewage disposal fund of $2.9 million. Combined, City officials had been utilizing $5.3 million of water supply and the sewage disposal money for general fund operations annually. This amount of annual appropriation was not a loan and was not expected to be repaid to these funds.

  Although the water supply fund had an unrestricted deficit of $5,795,973in 2010, and an estimated deficit of $9,009,825 for 2011, City officials had continued to transfer money from the fund. In addition to the transfers out, both the water supply fund and the sewage disposal fund had lost money in their operations, the latter having lost over $61 million since 2001, and the former having lost almost $10 million since 2009. City officials recently had implemented a 35 percent increase in water and sewer rates.

- In addition to the foregoing activity, City officials had borrowed from other funds to compensate for cash shortages. For example, at June 30, 2010, the general fund owed other funds a total of $18,002,907, of which $11,698,376 was owed to the sewage disposal fund, $1,059,914 was owed to the local street fund, $1,683,733 was owed to the public improvement fund, and $2,139,590 was owed to the self insurance fund. Local street monies may only be expended for local streets in the City, since those monies derive from Federal and State grants. Similarly, monies placed in a public improvement fund may not be expended for any other purposes.

- The City continued to experience a cash shortage. The City recently borrowed $8.0 million in fiscal stabilization bonds, pursuant to Public Act 80 of 1981, the Fiscal Stabilization Act, to assist with cash flow shortfalls. However, there remained many negative cash balances in the City's records as of June 30, 2011. For example, the general fund had negative cash of more than $9.5 million, the rubbish collection fund had negative cash of almost $1.5 million, and the drinking water revolving loan fund had negative cash of more than $3 million.

  These, and other, negative cash balances represented inter-fund borrowing that was not booked as such in the City's records. As stated in the City's 2010 financial audit report, "[t]he majority of the City funds does [sic] not have their own cash accounts, but participate in a 'pooled cash account' where each fund's cash resources are pooled with the cash balances of other City funds. Pooling individual fund cash resources provides flexibility in investment options and allows for consolidated and more efficient accounting."

  The audit report continued, "[h]owever, pooling cash resources also allows individual funds to spend more money than they receive, creating a lending relationship between funds with a negative balance and those with a positive balance, making the funds financial [sic] dependent on each other."

- The City's ability to pay short-term obligations was uncertain. For 2010, the general fund had only $9 million in short-term assets to cover almost $22 million in short-term obligations. The City's unaudited financial records lacked sufficient information to reach a meaningful conclusion in the unaudited records of the City for 2011 since total current assets equated to a negative figure.

- The City's pension system was less than 60 percent funded. Benefits were based upon factors ranging from 1.7 to 2.6 of final average compensation. As of June 30, 2008, which was the last actuarial report for the 2010 audit period, there were 1,676 active members compared to 2,820 retirees. The unfunded accrued pension liability was over $39 million, with a one-year increase in the net pension obligation of $1,202,047.

- City officials had failed to make staff reductions in accordance with their deficit elimination plan. According to the 2010 audit report, between 2001 and 2010, City officials did reduce staffing from total full-time equivalent positions of 1,525.8 to 767. Many of these reductions came from Police (336 to 122) and Fire (216 to 110). The City continued to reduce staff. However, of the planned 40 layoffs by July 2011, only 18 were made. Of the planned 25 layoffs after July, only seven were made.

Based upon the preliminary review, the State Treasurer concluded, and reported to the Governor on September 12, 2011, that probable financial stress existed in the City of Flint and recommended the appointment of a financial review team.

B. Review Team Findings

On September 30, 2011, the Governor appointed an eight-member Financial Review Team. The Review Team convened on October 5th, 2011, October 13th, 2011, October 17th, 2011, October 21st, 2011, and November 7th, 2011.

1. Conditions Indicative of a Financial Emergency

The Review Team found, or confirmed, the existence of the following conditions based upon information provided by City officials, or the City's audit firm, or other relevant sources:

- According to the City's fiscal year 2010 financial audit, the City's cumulative general fund deficit increased by 44.6 percent from $10,113,744 as of June 30, 2009 to $14,621,546 as of June 30, 2010. The one-year increase in the City's cumulative general fund deficit resulted from general fund expenditures exceeding general fund revenues by $7,551,997. However, City officials largely offset this operating deficit by means of $3,044,195 in other funding sources which included a $2,990,000 transfer from the water and sewer fund to the general fund.

- The City's pooled cash position (exclusive of Hurley Medical Center) decreased significantly over the last five fiscal years as follows:

Fiscal Year Ending	Pooled Cash
2006	$69,025,428
2007	$63,894,691
2008	$45,580,145
2009	$24,688,481
2010	$4,378,207

The deterioration in pooled cash represents another measure of the extent to which City expenditures have outpaced available resources and, consistent with the findings of the preliminary review, of the extent to which City officials have borrowed the assets of other funds to supplement the general fund. Given the extent of inter-fund borrowing, normal operating functions of funds other than the general fund are being adversely impacted. For example, during the same five-year period, business (water and sewer) related cash decreased from $36,267,981 in 2006 to zero in 2010. Simply put, these other funds could lack sufficient cash to permit the performance of the statutory tasks assigned to them, to provide preventative maintenance, or to plan for future replacement of equipment.

- Financial audit reports for the City for its last three fiscal years reflect the following variances between general fund revenues and expenditures, as initially budgeted and as amended, versus general fund revenues and expenditures actually realized:

	2007-08	%	2008-09	%	2009-10	%
Revenues						
Budgeted	$70,441,919		$65,007,471		$65,866,661	
Amended	$71,059,795		$68,471,610		$62,441,644	
Actual	$66,823,137		$63,937,302		$57,189,454	
Variance	($4,236,658)	(5.96)	($4,534,308)	(6.62)	($5,252,190)	(8.41)
Expenditures						
Budgeted	$74,073,657		$64,880,786		$62,816,336	
Amended	$74,907,224		$68,053,422		$64,734,773	
Actual	$79,475,612		$66,703,149		$64,741,451	
Variance	($4,568,388)	(6.10)	$1,350,273	1.98	($6,678)	(0.01)

The foregoing variances reflect several considerations. First, there is the tradition, of which the Review Team was informed, of City administrations proposing, and City Councils then adopting without significant modification, budgets that knowingly overestimated revenues, knowingly underestimated expenditures, or both. Therefore, such budgets were facially unrealistic *ab initio.*

Second, City officials indicated to the Review Team that, while financial information is monitored and disseminated on a monthly basis, amendments to the budget to reflect actual revenues and expenditures are made only upon a quarterly, or semi-annual, basis. In other words, even after City officials are apprised of the fact that actual revenues are lower than budgeted, or that actual expenditures are higher than budgeted, or both, precious time may elapse before City officials amend the budget to address the situation.

Finally, the effect of adopting unrealistic budgets is exacerbated by the fact that City officials, as some expressed to the Review Team, "manage to the budget." Of course, the utilization of a budget as a financial management tool is eminently appropriate provided the budget accurately reflects the revenues and expenditures upon which it is predicated. However, when budgets are unrealistic when adopted and are not amended when needed to render them realistic, as has been demonstrated to be the case in the City of Flint, a budget is effectively meaningless as a financial management tool. [2]

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[2] It should be noted that many of the budgetary practices of the City are wholly inconsistent with the requirements of Public Act 2 of 1968, the Uniform Budgeting and Accounting Act. Various provisions of that Act govern the budget adoption and implementation process for units of local government in Michigan and require both the adoption of realistic budgets and their timely amendment as necessary to maintain them.

For example, Section 16 of the Act requires, unless another method is provided for by charter, that the local legislative body adopt a general appropriations act which shall set forth "the amounts appropriated by the legislative body to defray the expenditures and meet the liabilities of the local unit for the ensuing fiscal year, and shall set forth a statement of estimated revenues, by source, in each fund for the ensuing fiscal year." Similarly, Section 17 requires, among other things, as follows:

> If, during a fiscal year, it appears to the chief administrative officer or to the legislative body that the actual and probable revenues from taxes and other sources in a fund are less than the estimated revenues, including an available surplus upon which appropriations from the fund were based and the proceeds from bonds or other obligations issued under the fiscal stabilization act, 1981 PA 80, MCL 141.1001 to 141.1011, or the balance of the principal of these bonds or other obligations, *the chief administrative officer or fiscal officer shall present to the legislative body recommendations which, if adopted, would prevent expenditures from exceeding available revenues for that current fiscal year.* The recommendations shall include proposals for reducing appropriations from the fund for budgetary centers in a manner that would cause the total of appropriations to not be greater than the total of revised estimated revenues of the fund, or proposals for measures necessary to provide revenues sufficient to meet expenditures of the fund, or both. The recommendations shall recognize the requirements of state law and the provisions of collective bargaining agreements. Emphasis supplied.

Section 18 of the Act requires, among other things that, "[e]xcept as otherwise provided in section 19, *an administrative officer of the local unit shall not incur expenditures against an appropriation account in excess of the amount appropriated by the legislative body.* The chief administrative officer, an administrative officer, or an employee of the

- City officials consistently have failed to abide by various proposals submitted to the Department of Treasury which purported to address the City's financial deficiencies. For example, on February 28, 2011, the City administration submitted to the Department a written proposal in conjunction with a request to issue $20.0 million in fiscal stabilization bonds. The particulars of the proposal included: a reduction of 19.5 full-time equivalent positions in the Police Department unless concessions equal to a 15 percent reduction in compensation were achieved; a reduction of 13.1 full-time equivalent positions in the Fire Department unless concessions equal to a 15 percent reduction in compensation were achieved; a reduction of 25 full-time equivalent (non police and fire) positions; a reduction in City Council positions and other organizational adjustments which required amendments to the City charter.

  However, at its meeting on October 17th, 2011, the Review Team was informed that none of the proposed charter amendments had been submitted to City electors, that only a fraction of the reductions in non police and fire positions had been made, and that no additional reductions in police and fire positions had been made despite the fact that a 15 percent reduction in compensation costs had not been achieved. In respect to the latter, it is readily understandable why City officials would be reluctant to further reduce the number of police and firefighter positions. What is less readily apparent is why such reductions, or other particulars, would be included in a deficit reduction proposal in the first instance if their attainment was not realistic.

- City costs associated with actuarially determined other post employment benefits are increasing. In 2010 alone, the unfunded liability increased by nearly $37 million (i.e., the total cost for that year was $57,295,237, but the City funded only $20,325,123). In the aggregate, the unfunded liability for other post employment benefits stood at $860,623,370 as of 2010.

2. Review Team Meetings

On October 5, 2011, the Review Team met with Brian Ross, Pamela L. Hill, and Tadd Harburn of the certified public accounting firm Plante & Moran, PLLC.

On October 13, 2011, Review Team members Laura Argyle, Roger Fraser, Frederick Headen, Doug Ringler, and Brom Stibitz conducted a series of meetings in the City of Flint with Greg Eason, City Administrator; Michael Townsend, Finance Director; Alvern Lock, Police Chief; Archie L. Hayman, 68th District Court Chief Judge; William H. Crawford II, 68th District Court Judge; Paula J. McGlown, 68th District Court Administrator; Raymond Barton, Assistant Fire Chief; Donna

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local unit shall not apply or divert money of the local unit for purposes inconsistent with those specified in the appropriations of the legislative body." Emphasis supplied.

The sum of the foregoing statutory provisions is not an aspirational goal, but a legal requirement that officials in units of local government annually adopt a balanced budget, monitor throughout the course of the fiscal year the revenues and expenditures contained in that adopted budget, and adjust the budget to the extent necessary to maintain it in balance.

Poplar, Human Resources Director; Robert Erlenbeck, Risks and Benefits Administrator; Douglas Bingaman, City Treasurer; and Sekar Bawa, Deputy Finance Director.

On October, 17, 2011, the Review Team met with Dayne Walling, Mayor; Peter Bade, City Attorney; and with Jacqueline Poplar, City Council President; and Joshua Freeman and Scott Kincaid, City Councilmembers.

3. Other Considerations

The Review Team is cognizant of the economic and other challenges, many of them longstanding, which confront the City of Flint. However, no issue was taken by any official with the underlying conclusion of the preliminary review that probable financial stress existed within the City. Furthermore, it is noteworthy that while a number of City officials identified future initiatives and proposals, there was noticeably less emphasis upon what actually had been implemented to date to address the City's ongoing financial difficulties, to wit, the recurring instances of expenditures exceeding revenues, cumulative deficits, inter-fund borrowings, negative variances between budgeted revenues and expenditures and actual revenues and expenditures, and the deteriorating pooled cash. In short, it did not appear that City officials had moved with the degree of urgency and vigor commensurate with the seriousness of the existing financial emergency. [3]

Indeed, the failure of City officials to have addressed the City financial problems with greater urgency and vigor appears consistent with observations made to the Review Team regarding a lack of political will among a succession of City officials to confront reality and render difficult, but necessary, financial decisions. While some of this lack of political will has been asserted to be attributable to turnover in the office of Mayor, evidence concerning that assertion is inconclusive.[4]

C. Conclusion and Recommendation

Based upon the foregoing information, meetings and review, the Review Team confirms the findings of the preliminary review, concludes that a local government financial emergency exists within the City of Flint, and that no satisfactory plan exists to resolve the emergency. Therefore, the Review Team recommends the appointment of an emergency manager.

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[3] Given this, and other considerations, the Review Team declined to pursue the statutory option of a consent agreement because of the conclusion that a consent agreement would not afford an efficacious remedy to the financial emergency that exists within the City.

[4] Since its current charter was adopted in 1974, the City has had seven Mayors, excluding two temporary Mayors, who have served an average of 5.1 years as follows: James W. Rutherford, 1975-83; James A. Sharp, 1983-87; Matthew S. Collier, 1987-91; Woodrow Stanley, 1991-02; James W. Rutherford, 2002-03; Don Williamson, 2003-09, Dayne Walling, 2009-present.

II. Section 13(3) Requirements

Section 13(3) of Act 4 requires that this report include the existence or an indication of the likely occurrence of any of the conditions set forth in subdivisions (a) through (l).[5] The conditions in subdivisions (e), (g) (j) and (k) of Section 13(3) exist or are likely to occur, as follows:

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[5] Subdivisions (a) through (l) of Section 13(3) of the Act provide as follows:

> (a) A default in the payment of principal or interest upon bonded obligations, notes, or other municipal securities for which no funds or insufficient funds are on hand and, if required, segregated in a special trust fund.
>
> (b) Failure for a period of 30 days or more beyond the due date to transfer 1 or more of the following to the appropriate agency:
>
> (*i*) Taxes withheld on the income of employees.
>
> (*ii*) For a municipal government, taxes collected by the municipal government as agent for another governmental unit, school district, or other entity or taxing authority.
>
> (*iii*) Any contribution required by a pension, retirement, or benefit plan.
>
> (c) Failure for a period of 7 days or more after the scheduled date of payment to pay wages and salaries or other compensation owed to employees or benefits owed to retirees.
>
> (d) The total amount of accounts payable for the current fiscal year, as determined by the state financial authority's uniform chart of accounts, is in excess of 10% of the total expenditures of the local government in that fiscal year.
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> (e) Failure to eliminate an existing deficit in any fund of the local government within the 2-year period preceding the end of the local government's fiscal year during which the review team report is received.
>
> (f) Projection of a deficit in the general fund of the local government for the current fiscal year in excess of 5% of the budgeted revenues for the general fund.
>
> (g) Failure to comply in all material respects with the terms of an approved deficit elimination plan or an agreement entered into pursuant to a deficit elimination plan.
>
> (h) Existence of material loans to the general fund from other local government funds that are not regularly settled between the funds or that are increasing in scope.
>
> (i) Existence after the close of the fiscal year of material recurring unbudgeted subsidies from the general fund to other major funds as defined under government accounting standards board principles.
>
> (j) Existence of a structural operating deficit.
>
> (k) Use of restricted revenues for purposes not authorized by law.

- The City had a general fund deficit of $14,621,546 as of June 30, 2010, which was not eliminated within the two-year period preceding the end of the fiscal year of the City during which this Review Team report is received. (Section 13(3)(e)).

- As previously noted, City officials submitted to the Department of Treasury a deficit elimination plan regarding a cumulative general fund deficit of $7,046,820 as of June 30, 2008. That five-year plan projected a cumulative general fund deficit of $9,124,747 as of June 30, 2010. However, the actual cumulative deficit as of that date was $14,621,546 and the cumulative deficit as of June 30, 2011, is projected to have been approximately $11.0 million. The deficit elimination plan also anticipated the cumulative deficit would be eliminated by 2014, but an updated plan submitted for 2010 does not purport to eliminate the cumulative deficit until the year 2030, relying heavily upon the issuance of an additional $12.0 million of debt in 2013. (Section 13(3)(g)).

- As previously noted, the City general fund had structural operating deficits of $1,696,729 as of June 30, 2007; $12,652,475 as of June 30, 2008; $2,765,847 as of June 30, 2009; and $7,551,997 as of June 30, 2010. The general fund is projected to have had a structural operating deficit of $6,768,864 as of June 30, 2011. (Section 13(3)(j)).

III. Review Team Report Transmittal Requirements

Section 13(3) of Act 4 also requires that a copy of this report be transmitted to Mayor Dayne Walling, Flint City Councilmembers, the Speaker of the House of Representatives, and the Senate Majority Leader.

cc: Dayne Walling, Mayor
Flint City Councilmembers
James Bolger, Speaker of the House of Representatives
Randy Richardville, Senate Majority Leader

(l) Any other facts and circumstances indicative of local government financial stress or financial emergency.