STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

ANDY DILLON
STATE TREASURER

DATE: March 1, 2012

TO: Governor Snyder

FROM: Inkster Financial Review Team:
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David Fisher
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SUBJECT: Report of the Inkster Financial Review Team

On December 14th, 15th, 20th, 2011, January 4th, 12th, February 27th and 29th 2012, Inkster Financial Review Team members met and reviewed information relevant to the financial condition of the City of Inkster. Based upon those reviews, the Review Team concludes, in accordance with Section 13(4)(b) of Public Act 4 of 2011, the Local Government and School District Fiscal Accountability Act, that a condition of severe financial stress exists within the City of Inkster, but that a Consent Agreement containing a plan to resolve the problem has been adopted pursuant to Section 13(1)(c).

I. Background

A. Preliminary Review

On October 10th through November 9th, 2011, the Department of Treasury conducted a preliminary review of the finances of the City of Inkster 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 Inkster resulted from the condition enumerated in subdivision (a) and (r) of Section 12(1) having occurred within the City.[1]

The preliminary review found, or confirmed, the following:

- The City had not distributed property tax collections timely. Through the latter part of August

[1] Subdivision (a) provides that "[t]he governing body or the chief administrative officer of a local government requests a preliminary review under this act." In this case, the request was made by the then City Manager. 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."

2011, distribution of summer taxes were delayed. For example, from July 1 through August 31, $992,141 was collected on behalf of Inkster Schools, but only $337,392 was disbursed to the School District by September 15. During the same period, $15,389,798 in total was collected for all taxing jurisdictions, but only $7,140,530 was disbursed by September 15. In effect, the City borrowed property taxes collected on behalf of other taxing units of government and utilized them to fund its own operations. This borrowing resulted in an untimely disbursement of those taxes by the City to the other taxing units of government in violation of Public Act 206 of 1893, the General Property Tax Act. The City was able to make up some of the earlier shortfalls as of the date of the preliminary review. However, the property tax collection account was not reconciled and had a remaining balance of over $500,000.

- The City experienced significant cash management and cash deficit issues. The City utilized a pooled bank account for the majority of its funds, which offered the City flexibility and efficiencies. However, if not properly monitored, use of a single bank account for multiple funds can cause complications such as unrecorded inter-fund borrowing. Table 1 depicts, as of September 30, 2011, the most significant negative- and positive-cash balances, by fund, in the pooled bank account. Each of the funds that carried a positive cash balance had a restriction on the use of that cash.

Table 1
Pooled Cash Account

Fund	**Balance**
General	$(1,101,654)
Community Development Block Grant	(195,862)
Brownfield	(263,985)
Water and Sewer	(1,060,531)
Communication Services	(308,485)
Garage	(546,065)
Restricted Funds:	
Major Streets	1,726,856
Local Streets	176,593
Parks	340,429
Tax Increment Finance Authority	1,426,437
Downtown Development Authority	137,500
Library	390,767
Justice Center Debt	142,579
Agency	443,771

The deficit cash position of the foregoing funds represented inter-fund borrowing that is not permissible, due to restrictions upon usage of extra-voted millage or grants from State and Federal agencies. The preliminary review was unable to determine which fund owed another and it proved unlikely that City officials could do so either because checks were written from the pooled account without booking the corresponding liability to other funds. Since the cash was pooled, it could be presumed that each negative balance had drawn a proportional amount from each fund with a positive balance. It was only by the impermissible use of cash from restricted sources that the City had been able to operate. Were the City to have operated in compliance with those restrictions, the funds with negative balances would not have had the cash to carry out the activities associated with those funds. For example, the general fund had a negative $1.1 million in the pooled account. Therefore, City officials elected to use other restricted money or a different cash source in order to run the day to day operations of most of the City's departments.

- There was a projected operating deficit in the general fund for the remainder of the 2012 fiscal year. In addition to the pooled bank account illustrated in Table 1, there was a general fund set aside of $1.2 million in a separate account. City officials intended to use this separate account to offset the negative balance in the pooled bank account leaving $148,000 in available cash for the general fund ($1,250,000 less $1,102,000). Aside from the additional borrowing of cash, this amount was not likely to increase over the remaining months of the current fiscal year because the majority of the City's property taxes from its summer tax collection had already been used. A $1.8 million general fund deficit was projected for the 2011 fiscal year. There also was a projected $2.5 million general fund deficit in the 2012 fiscal year that would increase if additional debt proceeds were denied.

- Accounts receivable and accounts payable continued to increase. The City delayed payment of its bills, as could be seen by increased accounts payable from 2010 to 2011. For example, in the general fund, accounts payable increased from $684,288 to $1,045,977 and water and sewer fund accounts payable increased from $787,217 to $2,407,066. During the same period, the City's ability to collect outstanding water and sewer billings suffered as reflected in the increase in accounts receivable from $338,000 in 2010 to $2,004,731 in 2011, which only intensified the cash flow problem.

- City officials proposed unrealistic budgets and failed to make timely budget revisions. For example, for the 2012 fiscal year, the City originally budgeted $2.3 million in fines from police activities (an increase of over $1.6 million from the previous year), even while reducing budgeted expenditures for police patrols and other police expenditure activities. This amount was amended to $1.2 million, but still appeared to be too optimistic. Similarly, the chargeback of uncollectable tax collections reduced tax revenues by over $1 million in 2011; however, no chargebacks were originally budgeted for the current fiscal year, thereby artificially inflating projected property tax receipts.

- The general fund continued to charge the water and sewer fund over $700,000 for indirect costs related to costs incurred by general government employees, which exacerbated the cash flow shortage in the water and sewer fund. These cash shortages originated in fiscal years 2008 through 2010 when cash flows due to capital purchases and related financing reduced cash by almost $6 million. Simultaneously, the City's ability to collect from its customers lagged. Only recently had the City Council adopted a shut-off policy for delinquent customers. In addition, while the City had placed past due accounts on the tax rolls, many accounts remained unpaid because of foreclosures and other economic problems facing the City. While the water and sewer fund had not experienced significant losses, such factors had resulted in a cash shortage.

- The City experienced increased pension related expenses. In order to reduce costs of salaries and benefits, City officials offered general (non-police or fire) employees who were eligible to retire an incentive payment of $750 multiplied by their years of service to encourage early retirement. Ten employees agreed to the incentive and were to leave employment by the end of June 2011. The total amount of the incentive payments was $240,750. In addition, the City paid annual, sick, and longevity balances which amounted to $121,374. Combined, the total payments at the end of June 2011 were $362,124, which further reduced the City's cash.

  Early retirement incentives, along with relatively generous retirement benefits, resulted in a billing from the City's retirement administrator, Prudential Retirement Insurance and Annuity Company. In keeping with the City's stated commitment to fully fund the retirement system, Prudential indicated the need for an immediate payment of over $1.9 million to make the system whole.

- Liabilities for other postemployment benefits were increasing. In 2010, the annual required contribution for such benefits was $2,984,311. However, the City paid only $547,634, thus increasing the liability by $2,436,677. The aggregate unfunded liability was almost $30.0 million in 2010, and the City continued to utilize a "pay as you go" basis for funding these benefits.

- City debt levels were high in 2010, at $42,021,917. However, only $32,201,188 of that amount was subject to the statutory debt limitation of $39,900,995 (for 2010) imposed by Public Act 279 of 1909, the Home Rule City Act. Annual debt service payments exceeded $3.6 million. City voters approved extra-voted millages to service much of this debt, but this may diminish their willingness to approve additional property taxes in the future. In addition, City officials plan to borrow an additional $3 million in 2012 to assist with cash-flow difficulties.

Based upon the preliminary review, the State Treasurer concluded, and reported to the Governor on November 9, 2011, that probable financial stress existed in the City of Inkster and recommended the appointment of a financial review team.

B. Review Team Findings

On December 2, 2011, the Governor appointed a seven-member Financial Review Team. The Review

Team convened on December 14th, 2011, December 15th, 2011, December 20th, 2011, January 4th, 2012, January 12th, February 27th, and February 29th 2012.

1. Conditions Indicative of Severe Financial Stress

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 2011 financial audit, the balance in the general fund decreased from a surplus of $1,233,663 as of June 30, 2010 to a deficit of $2,964,062 as of June 30, 2011. The one-year swing (i.e., net change in fund balance) of $4,197,725 resulted from general fund expenditures exceeding general fund revenues by $3,691,773, together with an operating transfer out of the general fund of $505,952. Other City funds (i.e., major streets, local streets, and non-major governmental) also experienced operating deficits of $54,817, $781,263, and $678,999, respectively.

- 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:

	2008-09	%	2009-10	%	2010-11	%
Revenues						
Budgeted	$17,997,950		$18,882,828		$17,847,012	
Amended	$17,937,450		$19,387,544		$18,740,996	
Actual	$19,072,269		$17,665,127		$16,513,401	
Variance	$1,134,819	6.32	($1,722,417)	(8.89)	($2,227,595)	(11.89)
Expenditures						
Budgeted	$17,609,950		$18,526,501		$18,663,972	
Amended	$17,512,365		$19,454,230		$19,360,088	
Actual	$17,330,659		$17,787,693		$20,205,174	
Variance	$ 181,706	1.04	$1,666,537	8.57	($845,086)	(4.36)

- The City's pooled cash position, on an entity-wide basis, decreased significantly over the last five fiscal years as follows:

Fiscal Year Ending	Pooled Cash
2007	$6,964,349
2008	$6,685,243
2009	$1,957,769
2010	($647,528)
2011	$228,901

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.

- A cash-flow projection analysis prepared by the firm Pierce, Monroe & Associates indicated that cash management remains a critical challenge for City officials. The analysis, which included reductions in personnel implemented by City officials late last year, noted that the City experienced a net negative cash flow in its general fund beginning in November 2011, and that the trend was projected to continue for the remainder of the current fiscal year, which ends June 30, 2012. As a result, the analysis projected a negative ending cash balance in the general fund as follows:

Month	Projected Negative Cash Balance
February	($2,332,381)
March	($3,367,754)
April	($4,333,127)
May	($5,107,217)
June	($6,392,590)

A separate cash flow projection analysis prepared for City officials by the firm Plante & Moran on January 19, 2012, projected a net negative cash flow beginning in March 2012. While the analyses by Plante & Moran and Pierce, Monroe & Associates differed in respect to certain assumptions, even the Plante & Moran analysis projected that the City will have a cumulative negative ending cash balance of $2,928,269 by June 30, 2012.

- The analysis by Pierce, Monroe & Associates also noted a growing liability of the City in the form of accounts payable. In effect, City officials have attempted to manage the absence of cash by intentionally electing not to pay certain bills as they have come due. The analysis projected accumulated accounts payable of $11,817,414 as of June 30, 2012, as follows:

Accounts Payable	Amount
General Employees Retirement	$1,902,000
Compensated Absences Payout and Estimated Unemployment	$750,000
Estimated Lawsuit Settlements	$500,000
Other Post-Employment Benefits	$4,665,414
Water and Sewer Fund Liabilities	$4,000,000
Total	$11,817,414

2. Review Team Meetings

On December 14, 2011, the Review Team met with Alan C. Young, James D. Wilde II, and Anil Sakhuja of the certified public accounting firm Alan C. Young & Associates, PC.

On December 15, 2011, Review Team members David Fisher, Frederick Headen, Edward Koryzno, Deborah Owens, and Brom Stibitz conducted a series of meetings in the City of Inkster with Ron Wolkowicz, Interim City Manager; Mark Stuhldreher, Treasurer and Finance Director; Hilton Napoleon, Deputy Police Chief; Mark Lloyd, Building Department Director; Mark Hubanks, Fire Chief; William N. Lawrence, Jr., Human Resources Director; Valdemar L. Washington, Interim Chief Judge, 22nd District Court; Carl Brook, Transportation Director; Jerome Biven, Deputy Transportation Director; and with Inkster Police Union officials Tony Delgreco, Phillip Randazzo, John Kelly, and Al Lewis.

On December 20, 2011, Review Team members David Fisher, Frederick Headen, Edward Koryzno, Deborah Owens, and Doug Ringler met with City Council Mayor Pro Tem Marcus Hendricks; and Michael Canty and Timothy Williams, City Councilmembers; and with Hilliard L. Hampton II, Mayor; and Mark Stuhldreher, Treasurer and Finance Director.

3. Other Considerations

While the Review Team has executed a Consent Agreement in this matter, candor compels the admission that reservations remain concerning whether City officials will be able to achieve its successful implementation.

First, the Review Team was advised by a number of City officials, including the Mayor and several members of the City Council, that they were surprised concerning the seriousness of the City's financial plight. In this respect, there appears to have been a deficiency in the quality or timeliness of financial information, or a deficiency in the extent to which that information was made available to the Mayor and City Council, or both. To the extent that such information was made available, it is not clear that it was in a form that usefully apprised the Mayor and City Council of the deteriorating condition of the City's financial condition. As a result, the Review Team concluded that the inability of City officials to generate and utilize information needed to financially govern the City cast serious doubt upon the ability of City officials to fulfill the terms of a consent agreement.

Second, in addition to deficiencies in the quality or timeliness of financial information, several City Councilmembers attributed their lack of knowledge of the City financial plight to the city manager form of government in existence within the City. From their perspective, they delegated responsibility for managing the financial concerns of the City to the City Manager. However, the elected officials appear to have exercised little, if any, oversight in such matters. The fact that the Mayor and Council were disengaged from monitoring the financial affairs of the City also cast serious doubt upon their ability to abide by a consent agreement.

Third, the City has experienced considerable turnover in key positions. For example, the present City Treasurer-Finance Director assumed his position less than one year ago. The present City Manager holds that position on an interim basis until the City Council fills the position on a permanent basis. In addition, the Review Team was informed during its December 15, 2011, site visit that the Police Chief and Human Resources Director were scheduled to depart at the end of that month. The inconstancy in various positions within the City renders difficult day-to-day administration.

The foregoing reservations are serious. However, the Review Team is of the view that the Consent Agreement will afford City officials the opportunity, with appropriate State oversight, to resolve the severe financial stress within their City.

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 condition of severe financial stress exists within the City of Inkster, but that a Consent Agreement containing a plan to resolve the problem has been adopted pursuant to Section 13(1)(c).

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).[2] The conditions in subdivisions (d), (f), (h), (j), and (k) of Section 13(3) exist or are likely to occur, as follows:

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[2] 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:

- As previously noted, during the current fiscal year, City officials failed to timely distribute taxes collected "as agent for another governmental unit, school district, or other entity or taxing authority." For example, from July 1 through August 31, 2011, City officials collected $992,141 on behalf of Inkster Schools, but only $337,392 was disbursed timely to the School District. During the same period, $15,389,798 was collected for all taxing jurisdictions, but only $7,140,530 was disbursed timely. (Section 13(3)(b)).

- As previously noted, the City is projected to have $11,817,414 in accumulated accounts payable during the current fiscal year which will exceed 10 percent of the total expenditures of the local government in that fiscal year. (Section 13(3)(d)).

(*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.

(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.

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

- The City likely incurred material loans to the general fund from other funds. However, as previously noted, "the preliminary review was unable to determine which fund owed another and it proved unlikely that City officials could so either because checks were written from the pooled account without booking the corresponding liability to other funds." (Section 13(3)(h)).

- During the two preceding fiscal years (2010 and 2011), the general fund of the City incurred operating deficits of $122,566 and $3,691,773, respectively. Operating deficits also were incurred in other funds such as major streets and local streets. (Section 13(3)(j)).

- As previously noted, City officials impermissibly utilized for general operations restricted revenues, such as community development block grants and water and sewer which were restricted by millage, grant, or State and Federal agency requirements. (Section 13(3)(k)).

III. Review Team Report Transmittal Requirements

Section 13(3) of Act 4 also requires that a copy of this report be transmitted to Interim City Manager Ron Wolkowicz, Inkster City Councilmembers, the Speaker of the House of Representatives, and the Senate Majority Leader.

cc: Ron Wolkowicz, Interim City Manager
Inkster City Councilmembers
James Bolger, Speaker of the House of Representatives
Randy Richardville, Senate Majority Leader