



STATE OF MICHIGAN
OFFICE OF THE GOVERNOR
LANSING

JENNIFER M. GRANHOLM
GOVERNOR

JOHN D. CHERRY, JR.
LT. GOVERNOR

February 20, 2009

Clarence E. Phillips, Mayor
City of Pontiac
47450 Woodward Avenue
Pontiac, Michigan 48342-5009

Dear Mayor Phillips:

The purpose of this letter is to inform you that, pursuant to Section 16 of Public Act 72 of 1990, the Local Government Fiscal Responsibility Act, I have determined that a financial emergency now exists in the City of Pontiac.¹ This determination is based upon the fact that City of Pontiac

¹ Section 16 of the Act provides as follows:

If, at any time following determination by the governor that a serious financial problem exists under section 15(1)(b), the state treasurer or the review team informs the governor that the local government is not abiding by the provisions of a consent agreement, the governor shall determine that a financial emergency exists in the local government, and section 15(2) and section 18 shall then apply to that local government.

Section 15(2) of the Act provides as follows:

If the governor determines pursuant to subsection (1) that a financial emergency exists, the governor shall provide the governing body and chief administrative officer of the local unit with a written notification of the determination, findings of fact utilized as the basis upon which this determination was made, a concise and explicit statement of the underlying facts supporting the factual findings, and notice that the chief administrative officer or the governing body of the local government has 10 days after the date of this notification to request a hearing conducted by the governor or the governor's designate. Following the hearing, or if no hearing is requested following the expiration of the deadline by which a hearing may be requested, the governor shall either confirm or revoke, in writing, the determination of the existence of a local financial emergency. If confirmed, the governor shall provide a written report of the findings of fact of the continuing or newly developed conditions or events providing a basis for the confirmation of a local financial emergency, and a concise and explicit statement of the underlying facts supporting these factual findings.

However, it should be noted that City officials voluntarily and knowingly waived their right to a hearing under Section 15(2) of the Act and to an appeal under Section 17 of the Act by signing the Consent Agreement. Page 12, paragraph 8 of the Consent Agreement provides as follows:

In the absence of this Consent Agreement, the Review Team would have concluded in its report to the Governor required pursuant to Section 14(3) of the Act that a financial emergency existed within the City because no satisfactory plan to resolve a serious financial problem existed. Therefore, the failure of the City to comply in any respect with this Consent Agreement may be considered by the Review Team sufficient cause for the immediate appointment of an emergency

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officials have failed to abide by the terms of the Consent Agreement which was entered into by the City on June 23, 2008, and have not taken adequate steps to address what had been a serious financial problem. Therefore, Section 18 of the Act, which authorizes the appointment of an emergency financial manager, applies.²

Findings of Fact

Section 15(2) of the Act requires that, upon the determination by me of a financial emergency, I provide you with findings of fact utilized as the basis upon which this determination was made, and a concise and explicit statement of the underlying facts supporting the factual findings.

Preliminary Review Findings

On July 31, 2007, the Department of Treasury commenced a preliminary review of the finances of the City of Pontiac to determine whether or not a serious financial problem existed. Section 12(1) of the Act requires that a preliminary review be conducted if one or more of the conditions enumerated therein occurs. The preliminary review of the City of Pontiac resulted from the condition enumerated in subdivision (a) of Section 12(1) having occurred with respect to the City.

The preliminary review commenced on July 31, 2007, found, or confirmed, the following:

Annual general fund expenditures of the City had consistently exceeded annual general fund revenues, resulting in accumulated deficits. These accumulated deficits had been reduced to some

financial manager pursuant to Section 18(1) of the Act, the provisions of Sections 15 through 17 of the Act to the contrary notwithstanding.

² Section 18 of the Act provides as follows:

If the governor determines that a financial emergency exists under section 15, the governor shall assign the responsibility for managing the local government financial emergency to the local emergency financial assistance loan board created under the emergency municipal loan act, Act No. 243 of the Public Acts of 1980, being sections 141.931 to 141.942 of the Michigan Compiled Laws. The local emergency financial assistance loan board shall appoint an emergency financial manager. The emergency financial manager shall be chosen solely on the basis of his or her competence and shall not have been either an elected or appointed official or employee of the local government for which appointed for not less than 5 years before the appointment. The emergency financial manager need not be a resident of the local government for which he or she is appointed. The emergency financial manager shall serve at the pleasure of the local emergency financial assistance loan board. The emergency financial manager shall be entitled to compensation and reimbursement for actual and necessary expenses from the local government as approved by the local emergency financial assistance loan board. In addition to staff otherwise authorized by law, with the approval of the local emergency financial assistance loan board, the emergency financial manager may appoint additional staff and secure professional assistance considered necessary to implement this article.

extent through the use of various one-time adjustments. These one-time adjustments primarily included increasing long-term debt and appropriations from other funds.

- Deficit elimination plans required by Public Act 140 of 1971, the Glenn Steil State Revenue Sharing Act of 1971, had not eliminated the deficits. The City filed a deficit elimination plan on March 20, 2007. The Department did not certify the plan because it did not provide adequate assurances that the deficits would be eliminated. The actual 2006 fiscal year [operating] deficit was reduced to \$2,748,722 from the 2005 fiscal year [operating] deficit of \$6,898,326, but not eliminated.
- Cumulative deficits grew to \$31,697,547 at the end of the 2005 fiscal year, but were mostly eliminated by the issuance of \$27,640,000 in fiscal stabilization bonds. When added to the 2007 fiscal year deficit, the total [cumulative] deficit at the end of the 2008 fiscal year was projected to be approximately \$12 million. Other funds with deficits appeared to be manageable and the City was making significant progress in their reduction and eventual elimination.
- The City faced significant cash flow shortages reflected by negative cash balances in various funds. These negative cash balances represented unauthorized interfund borrowing.
- The Mayor's office and the City Council have exhibited an ongoing inability to resolve the City's budget issues.
- City officials have struggled to develop a meaningful budget. The budget lacked sufficient detail to compare the actual revenues and expenditures to budgeted revenues and expenditures. Consequently, it was difficult for City officials and other personnel to make the necessary comparisons. The adopted budget had a 90-day allocation which did not designate the entire fiscal year amounts to the budget. It was unclear what course of action was to be taken once the 90 days expired. The adopted budget did not reduce the estimated 2007 fiscal year deficit of over \$6 million, nor did it address the structural 2008 deficit of approximately \$6 million.
- There also was an ongoing dispute with the 50th District Court which had resulted in the Court withholding money that would normally be deposited with the City. While the Court did provide the City with periodic written reports regarding financial transactions of the Court for recordation in the City accounting system, the Court made but two disbursements of funds to the City each year. As a result of this practice, the majority of the written reports regarding financial transactions were unaccompanied by the related monies.
- The City had a personnel shortage that exacerbated the recording and reporting issues which had been cited in past financial audits. Internal and managerial control issues over the financial operations continued to be a serious issue and had been improved only by the outsourcing of the controller operations to the accounting firm of Plante & Moran.

- In prior financial audits of the City, its auditors had concerns about its future financial viability. While this was no longer anticipated to be the case, several difficult decisions having substantial impact on the City needed to be made quickly. These decisions would take cooperation and communication by both the members of the Mayor's office and the City Council.

Based upon the preliminary review, the State Treasurer concluded, and reported to me on August 31, 2007, that a serious financial problem existed and recommended the appointment of a financial review team.

Review Team Findings

On April 28, 2008, I appointed a nine-member Pontiac Financial Review Team. The Review Team convened on May 14, May 20, June 2, and June 18, 2008, to consider information relevant to the financial condition of the City of Pontiac. The Review Team found, or confirmed, the existence of the following based upon information provided by City officials, or the City's audit firm, or both:

- As of June 30, 2007, the City had a general fund deficit of \$6,078,240. The general fund deficit was projected to increase to approximately \$7.1 million as of June 30, 2008.
- The pooled cash position of the City had deteriorated significantly in recent years as City officials have borrowed the assets of other funds to supplement the general fund. Given the extent of interfund borrowing, normal operating functions of these other funds, such as the sanitation fund, sewer fund, and water fund, would be adversely impacted for quite some time. Simply put, these other funds might lack sufficient cash to permit the performance of statutory tasks assigned to them, to provide preventative maintenance, or to plan for future replacement of equipment. The pooled cash position of the City during the preceding five fiscal years was as follows:

Fiscal Year Ending	Pooled Cash
2003	\$60,021,049
2004	\$42,123,597
2005	\$13,853,802
2006	\$28,678,657
2007	\$18,377,708

- The City had a large number of unprocessed income tax returns from several years. As a result, the City likely had a liability in the form of an accounts payable for income tax refunds the amount of which could not be determined until the income tax returns are processed.
- The financial audit reports for the last three fiscal years reflected in several instances significant

variances between general fund budgeted revenues and expenditures versus revenues and expenditures actually realized. These variances, in concert with a demonstrated inability of City officials to accurately monitor revenues and expenditures throughout a given fiscal year and to amend City budgets in a meaningful manner, when at all, rendered the adopted budget ineffective as a financial management tool. The budgeted (or budgeted as amended) versus actual variances were as follows:

	2004-05	%	2005-06 ³	%	2006-07	%
Revenues						
Budgeted	\$58,629,992		\$57,007,582		\$56,293,037	
Amended	\$58,940,992		\$57,248,050		\$56,293,037	
Actual	\$54,973,109		\$86,517,440		\$53,904,646	
Variance	(\$3,967,883)	(6.7)	\$29,269,390	51.1	(\$2,388,391)	(4.2)
Expenditures						
Budgeted	\$58,688,207		\$57,808,107		\$55,293,037	
Amended	\$58,999,207		\$57,795,942		\$55,293,037	
Actual	\$65,824,687		\$58,933,096		\$55,869,683	
Variance	(\$6,825,480)	(11.6)	(\$1,137,154)	(2.0)	(\$576,646)	(1.0)

- The minimum manning provision of the City charter posed a significant limitation upon the ability of City officials to weigh competing budgetary needs from one year to the next and to allocate scarce financial resources accordingly.

Based upon the foregoing, in its June 23, 2008, report to me, the Review Team confirmed the findings of the preliminary review, concluded that a serious financial problem existed in the City, but that a Consent Agreement containing a plan to resolve the problem had been adopted.⁴

³ The 2005-06 actual revenue amount of \$86,517,440 includes \$27,640,000 in fiscal stabilization bonds.

⁴ In conducting its review, the Review Team met on May 14, 2008, with Anil Sakhuja and Ritesh Shah of the certified public accounting firm Alan C. Young & Associates, and Carl Johnson of the certified public accounting firm Plante & Moran, the latter of which acts as the City's controller.

On May 20, 2008, Review Team members Tom Clay, Robert Daddow, Frederick Headen, and Marcel Pultorak conducted a series of meetings in the City of Pontiac with Andrea Wright, Budget Director; Raymond Cochran, Finance Director; Valard Gross, Police Chief, who was accompanied by Captain Todd Courtney and Lieutenant Robert Ford; Jeffrey Hawkins, Fire Chief; Larry Marshall, Human Resources Director; Sandy McDonald, Downtown Development Authority Director; Allan Schneck, Public Works & Utilities Director; and Preston Thomas, Chief Judge, 50th District, and Judith Gracey, Court Administrator.

On June 2, 2008, the Review Team met with Clarence Phillips, Mayor; Wayne Belback, Assistant to the Mayor; and with Arthur McClellan, Council President; Joseph Hansen, Council President Pro Tem; and Marc Seay, Councilmember.

Consent Agreement Requirements and Violations

The Consent Agreement into which City officials entered on June 23, 2008, required City officials to take specific steps by specific dates to resolve the City's serious financial problem. The Consent Agreement also required City officials to file specific reports by specific dates in order to authenticate compliance with the Consent Agreement. For example, the Consent Agreement required City officials:

- To provide to the Review Team, within 30 days after the Consent Agreement was entered into, "a detailed plan containing specific and realistic expenditure reductions, or specific and realistic revenue enhancements, or both, in an amount sufficient to address any current or accumulated deficit in any fund maintained by the City."
- To fill, by August 15, 2008, "the position of income tax administrator on a permanent, full-time basis with an individual deemed qualified by the Michigan Department of Treasury."
- To "pursue negotiations with neighboring communities, and with Oakland County, concerning the consolidation of public services including, but not limited to, sanitation, garbage collection, street maintenance, police protection, fire protection, public works, and shall investigate other options including privatization of the foregoing services. The City shall file with the Review Team a report by September 15, 2008, and quarterly thereafter, indicating the progress of such negotiations."

The terms of the Consent Agreement made unmistakably clear that, "in the absence of the Consent Agreement, the Review Team would have concluded in its report to the Governor required pursuant to Section 14(3) of the Act that a financial emergency existed within the City because no satisfactory plan to resolve a serious financial problem existed." Likewise, the terms of the Consent Agreement made unmistakably clear that "the failure of the City to comply *in any respect* with this Consent Agreement may be considered by the Review Team sufficient cause for the immediate appointment of an emergency financial manager pursuant to Section 18(1) of the Act, the provisions of Sections 15 through 17 of the Act to the contrary notwithstanding." (Emphasis supplied.)

On October 31, 2008, you and members of your staff participated in a Department of Treasury initiated conference call to discuss concerns expressed by the Review Team regarding the lack of detailed information which City officials were providing. Subsequently, on November 6, 2008, you received a letter from Frederick Headen, of the Department of Treasury and a Review Team member, which advised, in part, as follows:

As you may be aware, the Pontiac Review Team met on October 16, 2008, to review and assess the financial information which you and your staff have submitted to date. It was the consensus of the Review Team, as my staff and I noted during the conference call, that much of the financial information provided thus far has been

lacking in detail. While we appreciate that you and your staff are busy, the Review Team must have information of sufficient adequacy and detail to permit it to properly monitor the financial condition of the City and compliance by the City with the Consent Agreement. Recent developments, such as the status of the North Oakland Medical Center and the imminent departure of your Finance Director, increase the necessity for such detailed information.

The letter requested more detailed information in regards to a number of specific areas, such as quarterly budget allotments, service consolidation efforts, and revenue projections. The letter concluded as follows:

In closing, the Review Team is somewhat concerned by what it perceives as a lack of urgency on the part of City officials in addressing in a meaningful manner the City's serious financial problem, particularly in light of the circumstances noted above that have the potential to exacerbate matters. That said, however, the Review Team continues to stand ready to offer appropriate assistance.

The Review Team did not receive a response regarding the foregoing letter and much of the information received by the Review Team after the letter was sent, lacked sufficient detail. For example:

- Rather than filling the position of income tax administrator on a permanent, full-time basis with an individual deemed qualified by the Michigan Department of Treasury, the City assigned income tax administrator duties to the City's Finance Director, who subsequently retired in December of 2008.
- The Consent Agreement explicitly prohibits the City from ending its fiscal year with an operating deficit in any fund absent a beginning balance in an amount sufficient to offset the operating deficit. However, City officials recently were advised that, as of December 31, 2008, the approximately \$2.1 million operating surplus which had been budgeted for the current fiscal year no longer existed, due principally to a decline in anticipated income tax revenues, and that an operating deficit was all but certain for the current fiscal year. Nevertheless, City officials have taken no meaningful action to amend the budget for the current fiscal year, as required by the Consent Agreement and by Public Act 2 of 1968, the Uniform Budgeting and Accounting Act, to bring revenues and expenditures into equilibrium.
- City officials were likewise advised that, again as of December 31, 2008, the City already had expended for Fire Department overtime the entire amount budgeted for that purpose for the current fiscal year. But again, City officials have taken no meaningful action to amend the budget for the current fiscal year.

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Conclusion

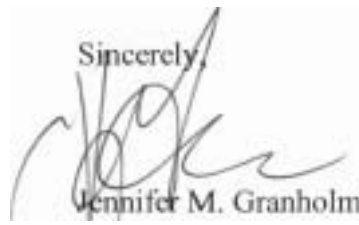
Due to all of the foregoing reasons, and pursuant to Section 16 of Public Act 72 of 1990, the Local Government Fiscal Responsibility Act, I have determined that a financial emergency now exists in the City of Pontiac.

As I noted at the outset, City officials voluntarily and knowingly waived their right to a hearing under Section 15(2) of the Act and to an appeal under Section 17 of the Act by signing the Consent Agreement. Noteworthy in this regard is the fact that, before the City Council adopted a resolution on June 19, 2008, to approve the Consent Agreement, the City Clerk read the Consent Agreement verbatim into the public record. The effect of this was to place the entire City Council, as well as you and members of your staff who were present, of the contents of the Consent Agreement. Thus, there can be no doubt that the City's waiver of its right to a hearing under Section 15(2) of the Act and to an appeal under Section 17 of the Act was voluntary and knowing.

However, out of courtesy to City officials, I have decided to provide the City with an opportunity to be heard regarding my determination that a financial emergency now exists in the City of Pontiac. The fact that I am granting this meeting as a courtesy in no manner waives any provision of the Consent Agreement and in no manner alters the fact that City officials voluntarily and knowingly waived their right to a hearing under Section 15(2) of the Act by signing the Consent Agreement.

The date and time of the meeting is a courtesy, regardless of the 10-day statutory window that the City waived in approving the Consent Agreement. The meeting will be for the purpose of deciding whether to confirm or revoke my determination that a financial emergency now exists in the City of Pontiac. The courtesy meeting will be convened on Wednesday March 4, 2009, at 2:00 P. M. at the Richard H. Austin Building, before members of the Pontiac Financial Review Team.

Sincerely,



Jennifer M. Granholm
Governor

c: Pontiac City Councilmembers