



STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

JENNIFER M. GRANHOLM
GOVERNOR

ROBERT J. KLEINE
STATE TREASURER

DATE: August 31, 2007
TO: Jennifer M. Granholm, Governor
FROM: Robert J. Kleine, State Treasurer *RJK*
SUBJECT: Preliminary Review of the City of Pontiac

I. Background

On July 31st, 2007, pursuant to a request by the Mayor of the City of Pontiac, the Department of Treasury commenced a preliminary review of the finances of the City to determine whether or not a serious financial problem existed. Section 12(1) of Public Act 72 of 1990, the Local Government Fiscal Responsibility 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 conditions enumerated in subdivisions (a) and (k) of Section 12(1) having occurred within the City of Pontiac.¹

In accordance with Section 12(2) of the Act, on August 7th, 2007, my designees Thomas F. Saxton, Deputy State Treasurer, and Frederick Headen, Director, Bureau of Local Government Services, met with Mayor Phillips, and members of his staff, to "receive, discuss, and consider information provided by the local government concerning the existence of and seriousness of financial conditions within the local government." On August 21st, 2007, my designees met with City Councilmember Marc Seay, and Janet Lazar, the City Council's budget advisor, at their request, for the same purpose. In addition, Treasury staff met with various City officials, including Raymond Cochran, the City's Finance Director, Carl Johnson, of Plante and Moran, which acts as the City's Controller, Arthur F. McClellan, City Council President, and Councilmember Kone Bowman.

As summarized below, based upon information received and considered as part of the preliminary review -- including accumulated deficit spending by the City, the inability of the City to adopt and maintain balanced budgets, and an ongoing inability of the Mayor and City Council to cooperate in regards to the financial management of the City -- **I conclude that a serious financial problem does exist in the City of Pontiac and recommend appointment of a financial review team.** Appointment of a financial review team is perquisite step in the Act 72 process to the appointment of an emergency financial manager. See the attached "Summary of Local Government Fiscal Responsibility Act Process."

¹ Subdivision (a) provides that "[t]he governing body or the chief administrative officer of a local government requests a preliminary review under this article. The request shall be in writing and shall identify the existing financial conditions that make the request necessary," while subdivision (k) provides that "[t]he local government has failed to comply with the requirements of section 21 of the Glenn Steil state revenue sharing act of 1971, 1971 PA 140, MCL 141.921, for filing or instituting a deficit recovery plan."

II. Preliminary Review Findings

The preliminary review found the following:

- Annual general fund expenditures of the City have consistently exceeded annual general fund revenues, resulting in accumulated deficits as depicted in Attachment 1. These accumulated deficits have been reduced to some extent through the use of various one-time adjustments. These one-time adjustments primarily include 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, have 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 deficit was reduced to \$2,748,722 from the 2005 fiscal year deficit of \$6,898,326, but not eliminated.

Based upon the unaudited statements for the fiscal year ending June 30, 2007, there is an indicated deficit in the City's General Fund of over \$6 million. The deficit would be larger if not for a one-time transfer from the Sanitization Fund of \$2.7 million. While the projected budget for 2008 appears to be balanced, it is anticipated that the actual amounts will create an additional deficit of \$6 million.

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 deficit at the end of the 2008 fiscal year is projected to be approximately \$12 million. Other funds with deficits appear to be manageable and the City is making significant progress in their reduction and eventual elimination.

- The City faces significant cash flow shortages reflected by negative cash balances in various funds. These negative cash balances represent 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 present budget lacks sufficient detail to compare the actual revenues and expenditures to budgeted revenues and expenditures. Consequently, it is difficult for City officials and other personnel to make the necessary comparisons. The adopted budget has a 90-day allocation which does not designate the entire fiscal year amounts to the budget. It is unclear what course of action is to be taken once the 90 days has expired. The adopted budget does not reduce the estimated 2007 fiscal year deficit of over \$6 million, nor does it address the structural 2008 deficit of approximately \$6 million.

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- There also is an ongoing dispute with the 50th District Court which has resulted in the Court withholding money that would normally be deposited with the City. While the Court does provide the City with periodic written reports regarding financial transactions of the Court for recordation in the City accounting system, the Court makes 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 are unaccompanied by the related monies.
- The City has a personnel shortage that exacerbates the recording and reporting issues which have been cited in past financial audits. Internal and managerial control issues over the financial operations continue to be a serious issue and have 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 is no longer anticipated to be the case, several difficult decisions having substantial impact on the City need to be made quickly. These decisions will take cooperation and communication by both the members of the Mayor's office and the City Council.

Attachments

cc: Thomas F. Saxton, Deputy State Treasurer
✓ Frederick Headen, Director, Bureau of Local Government Services