



STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

JENNIFER M. GRANHOLM
GOVERNOR

ROBERT J. KLEINE
STATE TREASURER

DATE: June 23, 2008

TO: Governor Granholm

FROM: Pontiac Financial Review Team:
Robert J. Kleine, Chairman
Tom Clay
Robert Daddow
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SUBJECT: Report of the Pontiac Financial Review Team

On May 14, May 20, June 2, and June 18, 2008, Pontiac 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 14 (3)(b) of Public Act 72 of 1990, the Local Government Fiscal Responsibility Act, that a serious financial problem exists in the City, but that a Consent Agreement containing a plan to resolve the problem has been adopted pursuant to Section 14(1)(c).

I. Background

A. Preliminary Review

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.¹

¹ The relevant subdivision of Section 12(1) reads as follows:

(1) The state treasurer shall conduct a preliminary review to determine the existence of a local government financial problem if 1 or more of the following occur:

- (a) The 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.

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 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 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 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 the Governor on August 31, 2007, that a serious financial problem existed and recommended the appointment of a financial review team.

B. Review Team Findings

On April 28, 2008, the Governor appointed a nine-member 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.

1. Conditions Indicative of a Serious Financial Problem

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 is projected to increase to approximately \$7.1 million as of June 30, 2008.
- The pooled cash position of the City has 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, will be adversely impacted for quite some time. Simply put, these other funds may 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 is 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 has a large number of unprocessed income tax returns from several years. As a result, the City likely has a liability in the form of an accounts payable for income tax refunds the amount of which cannot be determined until the income tax returns are processed.
- The financial audit reports for the last three fiscal years reflect 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 ²	%	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 poses 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.

2. Review Team Meetings

On May 14, 2008, the Review Team met 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

² The 2005-06 actual revenue amount of \$86,517,440 includes \$27,640,000 in fiscal stabilization bonds.

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.

C. Conclusion and Recommendation

Based upon the foregoing meetings and review, the Review Team confirms the findings of the preliminary review, concludes that a serious financial problem exists in the City, but that a Consent Agreement containing a plan to resolve the problem has been adopted.³

II. Section 14(2) Requirements

Section 14(2) of Act 72 requires that this report inform the Governor whether one or more of the conditions set forth in that section exist, have occurred, or are likely to exist or occur if remedial action is not taken.⁴ The conditions in subdivisions (b)(ii), (e), and (f) of Section 14(2) exist, have occurred, or are likely to exist or occur if remedial action is not taken, as follows:

³ At the November 7, 2006, general election City voters approved four millage proposals. Because two of those millage proposals -- up to one mill for ten years for all City police purposes authorized by law and up to 0.5 mills for ten years for juvenile programs -- lacked separate statutory authorization, the millages in question were required to be levied, if at all, within existing millage limitations imposed by the City charter and by Public Act 279 of 1909, the Home Rule City Act.

City officials collected, as part of the 2007 summer property tax levy, approximately \$1.5 million in connection with the two foregoing millages before it was determined that existing millage limitations imposed by the City charter did not permit the millages lawfully to be levied. A proposed amendment to the City charter to permit the two millages in question to be lawfully levied was submitted to City voters on January 15, 2008, and was rejected.

The Review Team takes cognizance of the fact that City officials, through the adoption of City Council Resolution 03-351 at its meeting on May 1, 2008, have committed to refund the \$1.5 million to City taxpayers by means of a credit on the 2008 summer property tax bills.

⁴ Section 14(2) of Act provides as follows:

- (a) A default in the payment of principal or interest upon bonded obligations or notes for which no funds or insufficient funds are on hand and 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.

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III. Review Team Report Transmittal Requirements

Section 14(3) of Act 72 requires that a copy of this report be transmitted to Mayor Phillips, Pontiac City Councilmembers, the Senate Majority Leader, and the Speaker of the House of Representatives.

cc: Clarence Phillips, Mayor
Pontiac City Councilmembers
Mike Bishop, Senate Majority Leader
Andy Dillon, Speaker of the House of Representatives