



STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

JENNIFER M. GRANHOLM
GOVERNOR

ROBERT J. KLEINE
STATE TREASURER

DATE: September 24, 2009
TO: Jennifer M. Granholm, Governor
FROM: Robert J. Kleine, State Treasurer *RJK*
SUBJECT: Preliminary Review of the City of Benton Harbor

I. Background

On August 24, 2009, pursuant to a request by the Benton Harbor City Manager, the Department of Treasury commenced a preliminary review of the finances of the City of Benton Harbor 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 Benton Harbor resulted from the condition enumerated in subdivision (a) of Section 12(1) having occurred within the City.¹

In accordance with Section 12(2) of the Act, on August 26, 2009, my designees Valdemar L. Washington, Deputy State Treasurer, and Frederick Headen, Director, Bureau of Local Government Services, met with Mayor Wilce Cooke, City Treasurer Jackie Bell, City Manager Richard Marsh, Interim City Manager Darwin Watson, and City Commissioners Ralph Crenshaw and Bryan Joseph "to receive, discuss, and consider information provided by the local government concerning the existence of and seriousness of financial conditions within the local government."

As summarized below, based upon information received and considered as part of the preliminary review -- including the inability of the City to operate within its budgets and to avoid fund deficits, recurrent accumulated deficit spending, severe cash flow shortages resulting in an improper reliance on interfund borrowing, unresolved material internal control deficiencies such as failing to keep financial records current and performing timely bank reconciliations, the City's inability to file financial audit reports timely, to distribute property taxes timely, and to submit payroll taxes timely -- I conclude that a serious financial problem does exist in the City of Benton Harbor and recommend appointment of a financial review team. Appointment of a financial review team is a prerequisite step in the Act 72 process to the appointment of an emergency financial manager.

II. Preliminary Review Findings

The preliminary review found the following:

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."

- During its fiscal year that ended June 30, 2008, the City failed to comply with provisions of Public Act 2 of 1968, the Uniform Budgeting and Accounting Act, by incurring significant general fund operating deficits in the following areas:

	Budget	Actual	Variance
Mayor and Commission	\$131,185	\$167,947	\$(36,762)
Finance	315,025	336,170	(21,145)
Building and Grounds	275,000	287,754	(12,754)
City Attorney	270,000	477,612	(207,612)
City Engineer	0	13,019	(13,019)
Police	3,102,513	3,146,137	(43,624)
Building Inspections	181,391	188,747	(7,356)
Rubbish Disposal	520,000	570,672	(50,672)
Department of Public Works	143,677	251,000	(107,323)
Community and Economic Development	98,000	117,008	(19,008)
Transfers Out	0	647,131	(647,131)

- The City incurred deficits in a number of its funds over several years. However, prior to March 2009, the City did not have a deficit elimination plan certified by the Department of Treasury since the City's 2004 fiscal year as required by Public Act 140 of 1971, the Glenn Steil State Revenue Sharing Act of 1971. A deficit elimination plan for the City's 2008 fiscal year was certified in March 2009. The following were fund deficits during the period 2004 to 2008²:

Fund	2004	2005	2006	2007	2008
Cemetery	\$(90,181)	\$(101,171)	\$(171,525)	\$(237,453)	\$(298,820)
Debt Service	0	0	0	0	(200)
Federal/State Grants	(210,062)	(377,499)	(384,272)	(410,258)	(503,423)
General	(2,163,478)	(3,027,256)	(3,265,368)	(2,427,411)	(2,921,194)
Local Streets	(203,403)	(314,111)	(551,044)	(526,051)	(479,551)
Major Streets	(73,824)	(57,841)	(143,157)	0	(130,627)
Public Improvements	0	0	0	(1,247)	(17,786)
State Grants	(66,021)	(66,021)	0	0	0
Total	\$(2,806,969)	\$(3,943,899)	\$(4,515,366)	\$(3,602,420)	\$(4,351,601)

- During its preceding eight fiscal years, the City has not filed timely annual financial audit reports with the Department of Treasury as required by Public Act 2 of 1968, the Uniform Budgeting and Accounting Act:

² Fund deficits could not be determined for the fiscal year ending June 30, 2009, due to potential adjustments to the City's financial records in preparation for its annual financial audit.

<u>Fiscal Year Ending</u>	<u>Due Date</u>	<u>Date Filed</u>
June 30, 2001	December 31, 2001	March 27, 2002
June 30, 2002	December 31, 2002	April 23, 2003
June 30, 2003	December 31, 2003	August 16, 2004
June 30, 2004	December 31, 2004	March 8, 2005
June 30, 2005	December 31, 2005	March 21, 2006
June 30, 2006	December 31, 2006	April 26, 2007
June 30, 2007	December 31, 2007	April 3, 2008
June 30, 2008	December 31, 2008	February 27, 2009

- The City's June 30, 2008, financial audit indicated that the City was delinquent in timely distributing property taxes collected for other units of government as required by Public Act 206 of 1893, the General Property Tax Act; the audit did not specify the amount of delinquent distributions or the taxing units of government to which those distributions were owed. However, the preliminary review found certain property tax distributions were delinquent during the City's fiscal year ending June 30, 2009, as follows:

Unit to Which Taxes Owed	Collection Period	Collection Period
	10-2-08 to 1-7-09	1-8-09 to 2-19-09
City	\$77,984.38	\$58,169.90
County	21,369.65	61,899.37
City Drains	41.50	228.67
Schools	47,956.42	27,741.12
State	22,898.77	14,458.22
Lake Michigan College	6,878.16	4,081.40
Intermediate School District	9,129.28	5,417.06
County Retirement	4,703.42	106,886.36
Debt Service	4,823.27	61,967.73
Library	7,178.37	
Retirement	2,074.17	--
Public Improvement	4,150.73	--
Dial-A-Ride	4,166.69	--
Total	\$213,354.81	\$412,793.13

- The City withheld federal income taxes from City employee wages, but did not timely remit those withholding taxes to the Internal Revenue Service. Pursuant to Internal Revenue Service regulations, the payment of withholding taxes is due by the last day of the month following the end of a quarter.

At one point, the City owed \$234,715 for the first quarter of 2009 and \$434,202 for the second quarter of 2009. Subsequently, the City used \$200,000 in loan proceeds from the Michigan Department of Transportation, State Infrastructure Bank, to partially repay the Internal Revenue Service. Given that the costs of the project for which the State Infrastructure Bank loan was received had already been covered by other City revenue sources, use of the loan proceeds apparently did not violate policies or guidelines of the State Infrastructure Bank. However, use of loan proceeds intended for infrastructure purposes to partially repay the Internal Revenue Service illustrates the City's practice of utilizing whatever funds are available to cover immediate obligations.

- The City has engaged in interfund borrowing to compensate for cash shortages. For example, at June 30, 2008, the general fund owed the general pension fund and the police and fire pension fund almost \$1.5 million, most of which remained outstanding during the 2009 fiscal year. Similarly, during 2009, the general fund, and other funds, borrowed almost \$1.0 million from the payroll fund. Other examples of interfund borrowing included the cemetery fund owing the general fund over \$300,000, the general fund owing the debt service fund over \$800,000, and the utility service fund owing the general fund over \$1.4 million.

These activities represent unauthorized interfund borrowing resulting in fewer resources in the funds from which the money was borrowed. Some of the amounts owed are to be forgiven, or adjusted, when the City's accounting firm completes year-end adjustments, provided there are sufficient fund balances in the funds to which money is owed.

- The City's financial records do not appear to accurately reflect underlying transactions. For example, bank reconciliations for the period July 2008 through December 2008 were not completed until at least January 2009, when the City hired an outside accounting firm to assist it. During this six-month period, the City could not accurately assess its cash position. Similarly, the preliminary review found that the total cash available in all City funds, including the current tax collection fund and the general fund, was a negative \$870,745. This was due partially to the City's practice of writing and recording checks, but not releasing them until funds are available to cover them. After taking into account adjustments for unreleased checks, the City's available cash amounted to slightly more than \$3,800.

cc: Valdemar L. Washington, Deputy State Treasurer
Frederick Headen, Director, Bureau of Local Government Services