DATE: January 27, 2010

TO: Governor Granholm

FROM: Benton Harbor Financial Review Team:
Robert J. Kleine, Chairman
Darnell Earley
Frederick Headen
Marcia Jones
Thomas H. McTavish
Linnie Taylor
Bret Witkowski

SUBJECT: Report of the Benton Harbor Financial Review Team

On December 8, December 16, December 22, 2009, and January 20, and January 27, 2010, Benton Harbor Financial Review Team members met and reviewed information relevant to the financial condition of the City of Benton Harbor. Based upon those reviews, the Review Team concludes, in accordance with Section 14 (3)(c) of Public Act 72 of 1990, the Local Government Fiscal Responsibility Act, that a local government financial emergency exists within the City because no satisfactory plan exists to resolve a serious financial problem, and recommends the appointment of an emergency financial manager.

I. Background

A. Preliminary Review

On August 24, 2009, 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 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 Benton Harbor resulted from the condition enumerated in subdivision (a) of Section 12(1) having occurred within the City.[1]

The preliminary review commenced on August 24, 2009, found, or confirmed, the following:

- During its fiscal year that ended June 30, 2008, the City failed to comply with provisions of Public

[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."

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 2008[2]:

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 had 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] As noted earlier, the preliminary review commenced on August 24, 2009; it concluded on September 24, 2009. During this time, 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 the annual financial audit for its 2009 fiscal year.

Fiscal Year Ending	Due Date	Date Filed
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 that 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 10-2-08 to 1-7-09	Collection Period 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	71,943.30
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 remit collected but unpaid payroll taxes to 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 remit collected but unpaid payroll taxes to the Internal Revenue Service illustrates the City's practice of utilizing funds intended for other purposes to cover immediate obligations.

- The City 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 did not appear accurately to 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.

Based upon the preliminary review, the State Treasurer concluded, and reported to the Governor on September 24, 2009, that a serious financial problem existed and recommended the appointment of a financial review team.

B. Review Team Findings

On November 30, 2009, the Governor appointed a seven-member Financial Review Team. The Review Team convened on December 8, 2009, December 16, 2009, December 22, 2009, January 20, 2010, and January 27, 2010.

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 other relevant sources:

- According to the City's fiscal year 2009 financial audit, the City's general fund deficit increased by 13.1 percent from $2,105,841 as of June 30, 2008 to $2,381,293 as of June 30, 2009. The one-year increase in the City's general fund deficit resulted primarily from general fund expenditures exceeding general fund revenues by $1,297,072. However, City officials largely offset the latter amount by means of various transfers, including a $1,061,083 transfer from a debt-service fund to the general fund.

- During its preceding eight fiscal years, the City did not file timely annual financial audit reports with the Department of Treasury as required by Public Act 2 of 1968, the Uniform Budgeting and Accounting Act. [3]

- The financial audit reports for the last three fiscal years reflect significant negative variances between general fund budgeted revenues and expenditures versus general fund revenues and expenditures actually realized. These significant variances, in concert with a demonstrated inability of City officials to accurately monitor revenues and expenditures throughout a given fiscal year and to properly amend City budgets accordingly, rendered the adopted budgets, and in many instances the amended budgets, effectively meaningless as a financial management tool.[4]

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[3] The City did file timely on December 28, 2009, its financial audit report for its fiscal year ending June 30, 2009. However, an initial review of the audit indicates that the financial statements do not conform with Governmental Accounting Standards Board requirements because the financial statements did not record City infrastructure assets or other post employment benefits. It also appears upon initial review that the audit failed to cite manifest deficiencies in the City's financial operations such as its repeated inability to timely reconcile financial records, at least without outside assistance, its inappropriate reliance upon interfund borrowings, and its inability to monitor revenues and expenditures. In accordance with Department of Treasury Numbered Letter 2008-2, which describes what constitutes an acceptable audit, the City's 2009 audit, upon final review, may be rejected as unacceptable and the City required to produce an audit that corrects or addresses the foregoing deficiencies.

[4] The significant negative variances between general fund budgeted revenues and general fund expenditures versus revenues and expenditures actually realized exhibited in City of Benton Harbor budgets are wholly inconsistent with the requirements of Public Act 2 of 1968, the Uniform Budgeting and Accounting Act. Various provisions of the Act govern the budget adoption and implementation process for units of local government in Michigan.

For example, Section 16 of the Act requires, unless another method is provided for by charter, that the local legislative body adopt a general appropriations act which shall set forth "the amounts appropriated by the legislative body to defray the expenditures and meet the liabilities of the local unit for the ensuing fiscal year, and shall set forth a statement of estimated revenues, by source, in each fund for the ensuing fiscal year." Similarly, Section 17 requires, among other things, as follows:

> If, during a fiscal year, it appears to the chief administrative officer or to the legislative body that the actual and probable revenues from taxes and other sources in a fund are less than the estimated

- The City's pooled cash position deteriorated markedly over the last four years, as follows:

Fiscal Year Ending	Pooled Cash
2006	$1,727,542
2007	$809,166
2008	$358,114
2009	$314,667

  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 interfund borrowing, normal operating functions of funds other than the general fund could be adversely impacted for quite some time. Simply put, these other funds could lack sufficient cash to permit the performance of the statutory tasks assigned to them, to provide preventive maintenance, or to plan for future replacement of equipment.

- In a majority of cases, cash balances reflected in the City's general ledger differed significantly from actual bank balances due to the failure of City officials to reconcile financial records. For example, the City might receive significant sums of revenue via electronic wire transfer. However, those sums were not recorded when received, but only when reconciliations were completed, which generally was not until year's end. The same is true for expenditures via electronic wire transfer. Similarly, handwritten checks issued on an emergency basis, voided checks, and bank service charges are

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> revenues, including an available surplus upon which appropriations from the fund were based and the proceeds from bonds or other obligations issued under the fiscal stabilization act, 1981 PA 80, MCL 141.1001 to 141.1011, or the balance of the principal of these bonds or other obligations, *the chief administrative officer or fiscal officer shall present to the legislative body recommendations which, if adopted, would prevent expenditures from exceeding available revenues for that current fiscal year*. The recommendations shall include proposals for reducing appropriations from the fund for budgetary centers in a manner that would cause the total of appropriations to not be greater than the total of revised estimated revenues of the fund, or proposals for measures necessary to provide revenues sufficient to meet expenditures of the fund, or both. The recommendations shall recognize the requirements of state law and the provisions of collective bargaining agreements. Emphasis supplied.

Section 18 requires, among other things that, "[e]xcept as otherwise provided in section 19, *an administrative officer of the local unit shall not incur expenditures against an appropriation account in excess of the amount appropriated by the legislative body.* The chief administrative officer, an administrative officer, or an employee of the local unit shall not apply or divert money of the local unit for purposes inconsistent with those specified in the appropriations of the legislative body." Emphasis supplied.

The sum of the foregoing statutory provisions is not an aspirational goal, but a legal requirement that officials in units of local government annually adopt a balanced budget, monitor throughout the course of the fiscal year the revenues and expenditures contained in that adopted budget, and adjust the budget to the extent necessary to maintain it in balance.

not recorded in a timely manner. Due to these lax financial practices, over the last several years the City has incurred bank service charges, mostly for overdraft charges, of $80,000 to $100,000 annually.

- The budgeted versus actual variances were as follows:

	2006-07	%	2007-08	%	2008-09	%
Revenues						
Budgeted	$6,670,783		$6,353,874		$6,661,235	
Amended	NA		$8,019,000		$7,443,100	
Actual	$6,422,310		$7,776,875		$7,549,625	
Variance	($248,473)	(3.7)	($242,125)	(3.0)	$106,525	1.4
Expenditures						
Budgeted	$7,582,751		$7,517,091		$6,573,650	
Amended	NA		$8,978,716		$7,437,939	
Actual	$8,223, 645		$9,300,637		$8,846,697	
Variance	($640,894)	(8.5)	($321,921)	(3.6)	($1,408,758)	(18.9)

- The City did not meet its minimum contribution requirement to either its General Employees' Retirement System or to the Police and Fire Pension System for the last several years. As of June 30, 2009, the City owed $3,066,971 to the General Employees' Retirement System and $840,424 to the Police and Fire Pension System. As a result, the General Employees' Retirement System had to liquidate $1,200,000 ($500,000 in 2008 and an additional $700,000 in 2009) in pension investments (7.5 percent and 12.3 percent of plan assets, respectively) to cover pension benefit payments. The Police and Fire Pension System had to liquidate $1,300,000 ($600,000 in 2008 and an additional $700,000 in 2009) in pension investments (5.4 percent and 7.2 percent of plan assets, respectively. [5]

- Over the last several years, the City engaged in several street projects funded with grants from the Michigan Department of Transportation. However, these grants required matching contributions from the City which the City failed to remit. As a result, the Department recovered the unpaid

[5] As of July 1, 2008, the General Employees' Retirement System was 70 percent funded (with assets of $7,428,057 and an actuarial accrued liability of $10,619,392), while the Police and Fire Pension System was 73.8 percent funded (with assets of $10,865,083 and an actuarial accrued liability of $14,720,295).

matching contributions by withholding those amounts from the City's monthly Act 51 distributions; for some months, the net amount of Act 51 distributions received by the City and recorded in its general ledger was only one dollar. Notwithstanding the fact that the Department was withholding from the City significant amounts of State transportation dollars, City officials continued to spend from the City's major and local street funds at the same level as in prior years by utilizing monies from other sources.

2. Review Team Meetings

On December 8, 2009, the Review Team met with Ritesh Shah and Anil Sakhuja of the certified public accounting firm Alan C. Young & Associates.

On December 16, 2009, Review Team members Darnell Earley, Frederick Headen, Marcia Jones, Linnie Taylor, and Bret Witkowski conducted a series of meetings in the City of Benton Harbor with Roger Lange, Police Chief; Jacqueline Bell, Finance Director and City Treasurer; Darwin Watson, City Manager; Richard Marsh, former City Manager; Carl Johnson and Sharon Vargo, of the certified public accounting firm Plante and Moran; Nicole Brown, Community Development Director; Charlotte Pugh Tall, City Attorney; and Joyce Taylor, City Clerk.

On December 22, 2009, the Review Team met with Wilce Cooke, Mayor; Jacqueline Bell, Finance Director and City Treasurer; and Ronald Carter, Consultant; and with Ralph Crenshaw, City Commission President; and James Hightower, Ricky Hill, and Bryan Joseph, City Commissioners.

C. Conclusion and Recommendation

Based upon the foregoing meetings and review, the Review Team confirms the findings of the preliminary review, concludes that a local government financial emergency exists within the City of Benton Harbor because no satisfactory plan exists to resolve a serious financial problem, and recommends the appointment of an emergency financial manager.[6]

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[6] City officials have characterized the December 21, 2009, report from the Carter Consulting Corporation as a plan "to improve operating efficiency, enhance revenue generation and ultimately balance the annual operating budget and reduce the city's long term debt." However, a review of that report suggests that it would not address, in any meaningful manner, the local government financial emergency which confronts the City. The report references various revenue enhancements ($5.1 million) and grants ($17.9 million) in an effort to increase available revenues. Yet, even were all of the revenue enhancements and grants to be realized (which would be no mean feat), it is worthy of remark that the report offered no solutions for the recurring deficiencies in the City's financial operations which were identified by the preliminary review and by the Review Team, to wit, the inability of City officials to reconcile City financial records in a timely manner, their inability to distribute property collections in a timely manner, their inability to file financial audits in a timely manner, and their inappropriate reliance upon interfund borrowing.

Furthermore, the City has had 15 different City Managers in the last 28 years as follows: Ellis Mitchell, 1982-86; Alex Little, 1987-88; Steve Manning 1988-92; John Elliot 1992-93; Beverly Brewer 1993-94; David Walker, (acting) 1994; Harold Reid, (interim) 1994-95; Dwight Mitchell, (interim) 1995-96; Kenneth Weaver, 1996; Charles Roberts, (interim) 1997-99; Ron Singleton, (interim) 2000; Alex Little, 2000-01; Joel Patterson, 2001-03; Dwight Mitchell, 2003-

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.[7] The conditions in subdivisions (b)(i), (b)(ii), (b)(iii), (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:

- As noted in the preliminary review, during 2009, 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. As of June 30, 2009, the amount owed to the Internal Revenue Service was $678,236. (Section 14(2)(b)(i)).

08, Richard Marsh, 2008-09; Darwin Watson, (interim) 2009; and Ronald Carter, 2009-present. City officials terminated five of the foregoing City Managers, one of them twice. Thus, even if the Review Team deemed the report issued by Carter Consulting Corporation to be a viable plan, which it does not, the Review Team would have no confidence that there would be sufficient stability, given the history of turnover in the office of City Manager, to implement the report.

[7] Section 14(2) of the 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.
>
> (ii) Taxes collected by the 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 30 days or more to pay wages and salaries or other compensation owed to employees or retirees.
>
> (d) The total amount of accounts payable for the current fiscal year, as determined by the state treasurer'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 10% of the budgeted revenues for the general fund.

- 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, did not specify the amount of delinquent distributions or the taxing units of government to which those distributions were owed. The preliminary review examined property tax collections for the period October 2, 2008, through January 7, 2009, and the period January 8, 2009, to February 19, 2009, and found the City to be delinquent in its property tax distributions by $213,354.81 and $412,793.13, respectively. (Section 14(2)(b)(ii)).

- The City did not meet its minimum contribution requirement to either its General Employees' Retirement System or to the Police and Fire Pension System for the last several years. As of June 30, 2009, the City owed $3,066,971 to the General Employees' Retirement System and $840,424 to the Police and Fire Pension System. (Section 14(2)(e)).

- The City had a general fund deficit of $2,381,293 as of June 30, 2009, which was not eliminated within the two-year period preceding the end of the fiscal year of the City during which this Review Team report is received. (Section 14(2)(e)).

- The general fund deficit of $2,381,293 as of June 30, 2009, exceeds 10 percent of the $6,912,200 in general fund revenues which the City has budgeted for the 2010 fiscal year. (Section 14(2)(f)).

III. Review Team Report Transmittal Requirements

Section 14(3) of Act 72 requires that a copy of this report be transmitted to Mayor Wilce Cooke, Benton Harbor City Commissioners, the Senate Majority Leader, and the Speaker of the House of Representatives.

cc: Wilce Cooke, Mayor
Benton Harbor City Commissioners
Mike Bishop, Senate Majority Leader
Andy Dillon, Speaker of the House of Representatives