Office of Legislative
Auditor General

WILLIE MAYO, CPA, CIA, CICA
AUDITOR GENERAL

500 GRISWOLD STREET
STE. 848; GUARDIAN BLDG.
DETROIT, MICHIGAN 48226
TELEPHONE: (313) 224-0924

November 29, 2011

FINAL REPORT TRANSMITTAL LETTER

Honorable Wayne County Commission:

Enclosed is our final copy of the Office of Legislative Auditor General's Consulting Report on Budget Sensitive Issues. Our report is dated June 27, 2011; DAP No. 2011-57-809. The draft report was accepted by the Audit Committee at its meeting held on Tuesday, November 8, 2011 and formally received by the Wayne County Commission on November 17, 2011.

We are pleased to inform you that officials from the county provided their full cooperation. If you have any questions, concerns, or desire to discuss the report in greater detail, we would be happy to do so at your convenience. This report is intended for your information and should not be used for any other purpose. Copies of all Office of Legislative Auditor General's final reports can be found on our website at: http//www.waynecounty.com/commission/lagreports.htm

Willie Mayo, CPA, CIA, CGAP, CICA
Auditor General

REPORT DISTRIBUTION

Wayne County Department of Management & Budget
Carla E. Sledge, Chief Financial Officer
Kevin Haney, Director, Budget and Planning
Terry L. Hasse, Director, Grants Compliance and Contracts Mangement

Wayne County Commission Fiscal Agency
Dwayne B. Seals, Chief Fiscal Advisor

Wayne County Executive

DAP No. 2011-57-809

BUDGET SENSITIVE ISSUES

Consulting Report

For the period: May 1, 2010 – April 30, 2011

(Revised)

June 27, 2011

Presented to: *Ways and Means and Audit Committees*
County of Wayne, MI

Prepared by: *Office of Legislative Auditor General*
County of Wayne, MI

TABLE OF CONTENTS

APPENDIX B

Office of Legislative
Auditor General

WILLIE MAYO, CPA, CIA, CICA
AUDITOR GENERAL

500 GRISWOLD STREET
STE. 848; GUARDIAN BLDG.
DETROIT, MICHIGAN 48226
TELEPHONE: (313) 224-0924

June 27, 2011 DAP No. 2011-57-809

Honorable Gary Woronchak, Chairman
Wayne County Commission
Honorable Bernard Parker, Chairman
Wayne County Ways and Means Committee
Honorable Ilona Varga, Chairwoman
Wayne County Audit Committee, and
Members of the Wayne County Commission
Honorable Robert A. Ficano, Wayne County Executive

Ladies and Gentlemen:

The Office of Legislative Auditor General (OAG) is proud to provide its annual Budget Sensitive Issues Report to the commission as it begins its fiscal year 2011-2012 budget deliberations. The report is based on matters of budgetary concerns, audits, consulting, and other engagement reports prepared by the OAG that contain issues which could have a budgetary impact on the county's financial activity and results.

In summary, this report identifies $256 million that have a potential budgetary (see Appendix A) impact on FY 2011 – 2012. The report is primarily prepared for the benefit and use of the county's Ways and Means Committee during its budget deliberation process.

This report is classified as a consulting engagement and is an extract of potential budgetary issues contained in reports issued by the OAG for the period May 1, 2010 – April 30, 2011. During this period, we completed 54 reports of which 7 contained potential budgetary issues.

You can be assured that the OAG will continue our efforts to strengthen the county's internal control environment by working to identify and mitigate risk, assess areas for potential cost saving and revenue enhancements, as well as assist the commission in its oversight responsibility of county operations.

Respectfully submitted,

Willie Mayo, CPA, CIA, CICA
Auditor General

PURPOSE AND OBJECTIVE

The purpose of this engagement is to comply with Enrolled Appropriations Ordinance 2010-516 that require the Office of Legislative Auditor General (OAG) to summarize issues which may be deemed to have budgetary impact on the budget hearings and deliberations for the fiscal year 2011-2012 and beyond.

The objective of this engagement is to specifically identify areas and issues that impact county operations, have budgetary implications, and to provide the report to the Ways and Means Committee, Wayne County Commission with an assessment overview, suggested topics of discussion and/or courses of action to consider in carrying out their oversight of the budget deliberation and approval responsibilities.

SCOPE

This report is not an audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

This is a consulting report and contains a summary of budgetary issues and observations that either came to the attention of the OAG or were presented in reports to the Wayne County Commission Committee on Audit for the period May 1, 2010 – April 30, 2011.

The consulting engagement and the procedures performed were in accordance with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors (IIA). The IIA standards define consulting engagements as advisory and related management services/activities, the nature and scope of which are agreed with and/or requested by management and is intended to add value and improve the county's governance, risk management, and control processes without the internal auditor assuming management responsibility.

The fieldwork for this engagement was completed on June 21, 2010.

METHODOLOGY

The procedures performed were limited to reviewing ordinances, laws, regulations, policies and procedures, external auditor reports, third-party reports, and when necessary, limited interviews with appropriate management officials. We also reviewed and evaluated financial issues and matters that came to our attention that could potentially have a budgetary impact on county operations.

FISCAL YEAR 2011-2012 BUDGETARY ISSUES

CFO Budget for FY 2012 and 2013 – lacks transparency and is not equitable

Condition

The CEO has presented a budget to the commission that is not transparent and equitable. This budget fails to break down expenditures by line item and has a $27 million mandatory credit which is suppose to represent a 10% reduction in expenditures. It is virtually impossible for the commission and its staff to properly analyze the budget without detail to support the expenditures and narratives that outlines significant assumptions.

In some instances the OAG was able to go the JD Edwards or the Gov Max systems to ascertain some detail, but even then there are not explanations as to the assumptions being made and sufficient detail to support line item expenditures.

Further, there is a 10% mandatory credit being presented as a single line item expenditure which is not reflected or allocated as line item expenditures for those departments that the CEO has direct control over, like M&B and DOT. Those two departments represent $4.5 million of the total mandatory credits.

Additionally based on our analysis of the10% mandatory credit, we noted that the OAG has a mandatory credit of $789,145, without explanation or assumptions, which is greater than the alleged 10% mandatory credit. The proposed reduction of 43 percent of the OAG budget will virtually decimate the OAG office and render us unable to provide mandated services to the commission body. We are disappointed the CEO did not submit a uniform and equitable budget for commission consideration.

In addition, there is no adjustment to properly reflect a reduction in charge backs for the OAG, M&B and DOT as a result of the 10% mandatory reduction in expenditures. Consequently, chargeback revenue, in some instances, is grossly overstated in the budget being submitted to the commission for approval.

Further, there is a contractual obligation to pay $1.7 million for the external audit for FY 2011, but the CEO has only budgeted $1.1 million, without a firm commitment from the external auditor to perform these services at the lower rate.

➢ **Impact/Action** – Commission leadership should require a detail balanced budget with explanations as to significant assumptions being made. Also, consider engaging the OAG in the budget process to independently prepare a report based on their assessment and analysis of the budget, similar to the services being performed by the City of Detroit OAG.

The Commission Fiscal Agency should be partnered with M&B and be involved with the entire budget process from beginning to end. This will allow the legislative branch to be better informed as to what comprises the budget and assumptions being made.

The above two action items can be accomplished by making it a part of the future Enrolled Ordinance Budget Appropriation language.

Increasing Fund Deficits

Condition

A review of the County's Comprehensive Annual Financial Report (CAFR) for fiscal years 2008, 2009, and 2010 disclosed the following undesignated/unrestricted fund balance deficits:

County of Wayne
Comprehensive Annual Financial Report
Undesignated/Unrestricted Fund Balance Deficits
Fiscal Years Ending September 30, 2010, 2009 and 2008

Description by Fund	Undesignated/ Unrestricted Fund Balance Deficit 9/30/2008	Undesignated/ Unrestricted Fund Balance Deficit 9/30/2009	2008/2009 Variance Increase (Decrease)	Undesignated/ Unrestricted Fund Balance Deficit 9/30/2010	2009/2010 Variance Increase (Decrease)	2008-2010 Total Variance Increase (Decrease)
General Fund	$ 10,606,000	$ 68,949,000	$ 58,343,000	$ 116,029,000	$ 47,080,000	$ 105,423,000
Mental Health	-	666,000	666,000	-	(666,000)	-
Juvenile Justice/Abuse & Neglect	24,672,000	20,575,000	(4,097,000)	16,886,000	(3,689,000)	(7,786,000)
Law Enforcement	4,078,000	3,980,000	(98,000)	3,401,000	(579,000)	(677,000)
Drug Enforcement	-	433,000	433,000	854,000	421,000	854,000
Nuisance Abatement	2,301,000	2,002,000	(299,000)	1,597,000	(405,000)	(704,000)
Central Services	3,273,000	-	(3,273,000)	907,000	907,000	(2,366,000)
Department of Environment	225,000	137,000	(88,000)	135,000	(2,000)	(90,000)
NE Sewage Disposal System	-	1,036,000	1,036,000	472,000	(564,000)	472,000
CSO Basins	-	-	-	213,000	213,000	213,000
Copy Center	-	470,000	470,000	818,000	348,000	818,000
Worker's Compensation	201,000	-	(201,000)	-	-	(201,000)
Community Development Block Grants	-	-	-	524,000	524,000	524,000
E&ND 21st Century	-	-	-	1,593,000	1,593,000	1,593,000
Pinnacle Aeropark	-	-	-	286,000	286,000	286,000
Equipment Lease Financing	6,525,000	39,560,000	33,035,000	36,749,000	(2,811,000)	30,224,000
Building and Ground Maintenance	7,658,000	7,249,000	(409,000)	5,847,000	(1,402,000)	(1,811,000)
Circuit Court	53,770,000	68,819,000	15,049,000	62,944,000	(5,875,000)	9,174,000
Probate Court	-	433,000	433,000	366,000	(67,000)	366,000
Reg. Jobs Econ. Growth Fnd.(RJEGF)	20,000	3,000	(17,000)	37,000	34,000	17,000
Brownfield Authority (BRA)	-	18,000	18,000	132,000	114,000	132,000
Land Bank	-	-	-	187,000	187,000	187,000
Rouge Valley Sewage Disp. Sys.	-	1,634,000	1,634,000	2,918,000	1,284,000	2,918,000
Totals	**$ 113,329,000**	**$ 215,964,000**	**$ 102,635,000**	**$ 252,895,000**	**$ 36,931,000**	**$ 139,566,000**

Condition

- Undesignated/unreserved fund deficits have increased from $113 million in FY 2008 to $253 million in FY 2010. This represents an increase of approximately $140 million, or 124%, over the three fiscal year period.

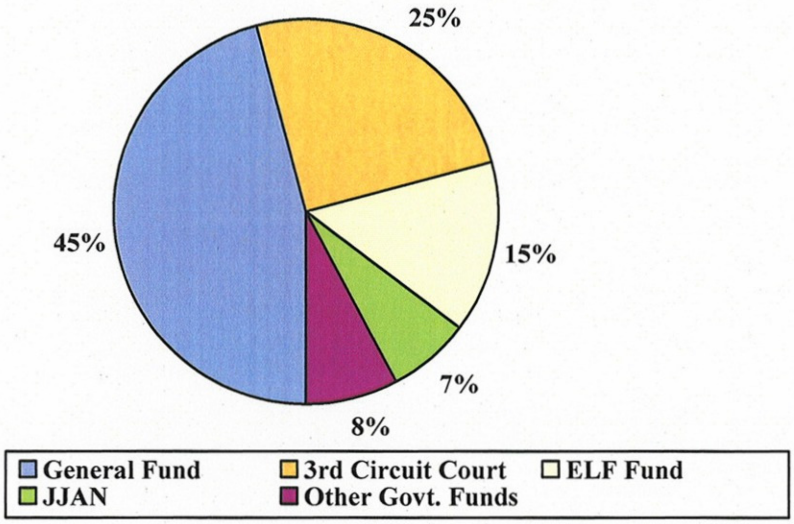
- **Impact/Action** – Commission leadership will need to intensify their efforts to review and monitor executive management's strategic plan to identify the causes and eliminate the increasing fund deficits. Also, ensure that designated funding appropriated to eliminate the fund deficits is actually being used for that purpose. The upward trend in the unrestricted/undesignated fund deficits could eventually have a major negative impact on the county's budget and could result in reduced services to county taxpayers and constituents, as well as necessitate the appointment of an emergency manager by the State of Michigan. (Also see discussion under **Deficit Elimination Plans (DEP)** and **Budgeted Revenue Projections** below.)
- The commission needs to reconsider enacting the ordinance to require a 20% reduction in all major vendors' contracts.

Deficit Elimination Plans

Section 5.171 of the Wayne County Charter states: "If expenditures exceed revenues in any fiscal year, the CEO shall submit a specific 5-year plan for short-term financial recovery and long-term financial stability to the Governor and the Legislature prior to the adoption of the next annual budget. The 5-year plan shall include those items required by law, the Governor, or the Legislature."

Condition

- From FY 2008 to FY 2010, Unreserved/Unrestricted fund deficits have increased nearly $140 million. Of this total, $105 million, or 76 percent, is attributable to the General Fund.
- As of FY 2010, total Unreserved/Unrestricted fund deficits amounted to nearly $253 million. Of this total, approximately 92 percent is attributed to four funds: General Fund, ($116 million) Third Circuit Court ($63 million), Equipment Lease Financing ($37 million) and Juvenile Justice/Abuse Neglect ($17 million) (see chart below).



- As of our report date, management has not issued the FY 2010 DEP. Our review of the county's DEPs for FYEs 2008 and 2009 revealed that the county has not complied with the DEP proposed actions to eliminate the deficits. Management stated a myriad of reasons as to why they have not been able to comply with the DEP submitted, such as, state and local depressing economic conditions, reduction in property tax revenues, and an inability to control expenditures in the Courts and Sheriff Office.

  - **Impact/Action** - The county General Fund deficits have increased by 76% from FY 2008 through FY 2010. Increased commission oversight, as that expressed in Enrolled Ordinance No. 2010-515 (the Deficit Elimination Plan Ordinance), needs to be intensified in order to ensure the DEP are adhered to and the county works toward reducing its deficits. By not adhering to the DEP submitted to the State Department of Treasury, could also result in a "trigger point" under House Bill 4214 - Emergency Financial Manager Act. **(See related topic below.)**
  - The CFO stated the FY 2012 budget has $24.5 million allocated to reducing the general fund deficit; however, this is only a little more than 10% of the amount required to eliminate the overall deficit of $253 million over a five year period as required by the State.

Structural Deficits

Condition

- A structural deficit is the difference between what is committed to spending in the next budget and what expected revenues are.
- For the past three fiscal years, the county's actual revenues have been less than budgeted amounts, yet expenditures are apparently not being decreased proportionately. Thus, there has been continuous deficit spending which means the

county is in violation of the state budgetary act as well as the appropriations ordinances being passed each year by the commission.

- The CEO has stated in his budget transmittal letter to the commissioners, that future structural budget changes will include:
    - Additional employee and retiree health care cost sharing as mandated by the State.
    - Elimination of payments to the State where the county is no longer obligated.
    - The continuation of the 10% salary concessions.
    - Enhanced revenues through modernization of fees to reflect current economic costs.
    - Finally, a ten percent reduction in general fund general purpose expenditures from elected officials and departments.

    - **Impact/Action** – Commission leadership will need to monitor and evaluate these proposed structural budget changes and assess the adequacy of the CEO action to correct the structural deficit deficiency. As a starting point, structural deficits can be eliminated through a concerted effort to align expenditures with realistic and realizable revenues. This must be a continuous process and involves deciding what mandated services must be provided and taking a hard look at the privatization of most county services if it is cost justified.
    - At present, it is difficult to determine if the submitted budget clearly defines and makes a distinction between core and mandated services. However, in order for the Commission to make informed decisions about the budget for FYs 2012 and 2013, we believe this is vital information and should be provided before the budget is approved and adopted by the Commission.

Decline in Bond Ratings

Condition

- Standard & Poor's (S&P) Ratings Services has lowered the county's bond rating from A- to BBB+. According to S&P, the decline was attributable to the following:
    - A negative unreserved general fund balance and a significantly reduced cash position;
    - The county and the courts being unable to reach an agreement on the budgetary support the county is to provide to the courts annually;
    - Negative unrestricted net assets in the county's juvenile justice and circuit court funds despite consistent general fund support for operations; and,
    - Significant economic pressures and unemployment rates hovering at about 15%.
    - It is also important to note that the rating agency stated some positive things about the county as well. They stated the county "has a good financial management profile that includes development and

implementation of policies designed to improve operational efficiencies across the organization. And a debt service we considered moderate."

➢ **Impact/Action** – The decline in the county's bond rating by one of the three (other two: Moody and Fitch) rating agencies could result in higher interest cost for the county on future borrowings. Commission and executive leadership will need to monitor the bond ratings in an effort to assess the potential increase in debt service payments.

Budgeted Revenue Projections

Condition

- In an effort to ascertain possible reasons for the increasing fund deficits, we performed a trend analysis of budgeted revenues to actual revenues for fiscal years 2008 through 2010 for both major and non-major governmental funds. See tables below.

Revenue Projections
Budget to Actual Analysis
Major Governmental Funds
Fiscal Years 2008 - 2010
(In Thousands)

FY	Original Budget	Amended Budget	From Original Budget Increase/ Decrease	% Increase/ Decrease	Actual	From Amended Budget Increase/ Decrease	% Increase/ Decrease
2008	1,341,060	1,353,807	12,747	0.95%	1,335,057	(18,750)	-1.38%
2009	1,344,923	1,359,511	14,588	1.08%	1,301,433	(58,078)	-4.27%
2010	1,341,488	1,425,531	84,043	6.26%	1,353,855	(71,676)	-5.03%
Totals	4,027,471	4,138,849	111,378	2.77%	3,990,345	(148,504)	-3.59%

FY	Original Budget	Amended Budget	From Original Budget Increase/ Decrease	% Increase/ Decrease	Actual	From Amended Budget Increase/ Decrease	% Increase/ Decrease
2008	174,652	174,941	289	0.17%	139,824	(35,117)	-20.07%
2009	159,440	169,354	9,914	6.22%	113,856	(55,498)	-32.77%
2010	178,710	184,207	5,497	3.08%	117,673	(66,534)	-36.12%
Totals	512,802	528,502	15,700	3.06%	371,353	(157,149)	-29.73%

Revenue Projections
Budget to Actual Analysis
Non-Major Governmental Funds
Fiscal Years 2008 - 2010
(In Thousands)

- Based on this analysis, excluding one exception, for both categories of governmental funds, projected county revenues are not being received as budgeted. Further, budgeted revenues are being amended upward and approved by commission, but falling short of actual revenue collections/charges. This could be one of the other attributing factors to the upward trend in county fund deficits.

    - **Impact/Action** – Over the three fiscal years, amended budgeted revenues fell short of actual revenue by over $300 million dollars. Commission leadership should request from the CEO, as part of the FY 2011-2012 budget process, to validate the revenue sources to support departmental expenditures. Also, they need to intensify their efforts to monitor material amendments to revenues, as well as consider analyzing budget to actual revenue trends on a periodic basis throughout the year.
    - As previously stated, there is an overall deficit of $253 million in unrestricted funds and we noted revenue has been overstated by more than $300 million over the last three years – this could very well be one of main contributing factors for budget deficits.

Tax Anticipation Notes (TANs)

Condition

- The county issues tax anticipation notes (TAN) in advance of property tax collections, depositing the proceeds in the general fund. Similar to a lot of municipalities, the TAN serves as a mechanism to manage periodic cash flow shortfalls that occur throughout the year. Over the past two fiscal years, management has issued $160 million in TAN and fully repaid them at a cost of approximately $3.2 million. In December 2010, management issued another $100 million. According to management, TAN will be necessary in the near term until there is a reduction of deficits and increase in cash collections.

We were able to determine TAN, with the exception of the first $60 million, were or are projected to be repaid from funds received in the same fiscal year they were borrowed. Therefore, we agree with management assertion that TAN borrowing is primarily due to the timing of cash collections between periods because, for the most part, the county is borrowing and repaying the bond debt within the same fiscal year.

The first $60 million in TAN was issued in August 2009. $35 million was repaid in FY 2008 – 2009. The remaining $25 million was repaid in October and November 2009; FY 2009 – 2010. In this instance, the borrowing took place in one fiscal year, but the debt repayment spanned two (2) fiscal years.

The interest rates for the TAN were as follows:

- 3.00% - August 2009 TAN of $60 million
- 3.75% - January 2010 TAN of $100 million
- 3.50% - December 2010 TAN of $100 million

  - **Impact/Action** – Commission leadership need to monitor the county's cash flow projections to make sure the debt is repaid in the same period borrowed and bond ratings for future periods do not continue to decline, therefore increasing interest cost to issue debt.

Pooled Cash "Loans"

Condition

- Certain funds and component units reported in the county's FYE 2010 CAFR statements have spent more resources out of the county's cash pool than they have provided. This condition results in 'negative equity' in the cash pool for those funds/component units. The county has been able to meet its on-going financial obligations through this management tool and the issuance of TAN. Negative equity in pooled cash totaled $236 million at September 30, 2010. Despite the borrowing from TAN, an additional $113 million in government funds was borrowed for Equity Pool Cash during the FYE September 30, 2010.
  - **Impact/Action** – The commission will need to monitor this financial condition and obtain the causes from management why the condition exists and their plans for corrective action. Management is borrowing in the current year to pay ongoing expenses and burdening future years for repayment of the debt. Also, the external auditors cited some inter-fund borrowings could be from restricted funds and a possible violation of grant agreements.

Revenue Enhancements – New User Fees

Condition

- According to executive management, it has been determined that the county subsidizes approximately $11 million annually to individuals and other governments when providing a service. Recent amendments to the Comprehensive User Fee Ordinance and new user fees for the Department of Assessment and Equalization (A&E) are projected to contribute an additional $2 million toward county revenues. In addition, increased user fees for the departments of Health and Human Services, Public Services, Corporation Counsel-Human Relation Division, and A&E can reduce general fund support.

  Some fees for certain business units have not been increased in over 10 years.

  - **Impact/Action –** Commission leadership need to assess and evaluate new fee increases proposed by the executive branch in an effort to recover cost of services and, minimize whenever possible, subsidies from the general fund. In addition, make it mandatory for management to periodically review the costs of delivering mandated services.

CEO Directives/Initiatives - Budget Policy Statement (BPS)

Condition

- Section 5.122 (Policy Statement) of the Wayne County Charter states: "At least 9 months before the next fiscal year, the CEO shall transmit the budget policy statement to all agencies to be included in the comprehensive budget. This statement shall estimate the revenues available for appropriation in the next fiscal year and include a budget policy statement." According to the charter, the BPS must be transmitted January 1 prior to the beginning of the next fiscal year.

- From fiscal year 2009 through fiscal year 2012, the issuance of the BPS has ranged from approximately 5 weeks to 5 months after the Charter mandated date of January 1.

  - **Impact/Action -** The Budget Policy Statement sets forth broad strategic parameters that are intended to provide guidance in preparing the budget. It initiates the county's budget process for the upcoming fiscal year (i.e., Oct. 1) and involves elected officials, department heads, and the County Commission in the budgetary process. For FY 2011-2012, the budgeting process will most likely require a detailed analysis of how reduction in personnel and monetary resources will be re-allocated to ensure the mandated delivery of services to the citizens of Wayne County are met.

Issuing a BPS five months after its due date and allotting the commission 90 days to adopt the budget, could hinder their ability to make fiscally sound budgetary decisions, especially in these times of the county's severe fiscal distress. Commission leadership should consider measures to ensure it receives adequate lead time to perform sufficient review, analysis, and inquiry prior to adopting and approving the county's annual $2 billion budget.

In addition, the commission and the CEO should validate and agree to the amount of revenue projected for the year and build mandated program expenditures around validated projected revenue.

<u>Mandatory Budget "Credits"</u>

<u>Condition</u>

- On July 5, 2011, the Wayne County CFO submitted a letter to the Chairman of the Wayne County Commission. In part, the letter stated: "the County Executive submitted a balanced 2011–2012 recommended budget to the Wayne County Commission (the Commission) for review and approval on June 30, 2011. The recommended budget submitted to the Commission includes a 10% reduction to all department heads and elected officials which was requested as part of the budget instructions....Not all departments submitted a budget which conformed to the 10% reduction....we have provided the Commission a balanced budget and a proposed appropriation ordinance which allocates funding to each department and includes the required 10% reduction."
- The letter further stated: "...Each department and elected official will be responsible for determining the specific expenditure reductions and/or position cuts that will bring their operations in line with the funding that is being recommended in the proposed appropriation ordinance. The reductions must be communicated to the Budget and Planning Division of Management and Budget by July 19, 2011, in order to incorporate the reductions into the budget. If the department does not respond or comply by July 19, 2011, Budget and Planning will make the necessary adjustments to the elected official's or department's budget to comply with proposed appropriation ordinance...."

  - ➢ **Impact/Action –** Total mandatory credits to elected officials and county departmental budgets amounted to approximately $27 million.
    - Imposing a two week time frame in which to comply with the CEO's required 10 percent reduction seemingly does not provide adequate time to thoughtfully produce a balanced budget.
    - If Management and Budget imposes the 10 percent cut, departments, such as the Sheriff Office and County Clerk, mandated services may be negatively impacted.
    - The Third Circuit Court's mandatory credit is approximately $5.4 million. Its implementation is problematic because the County Executive does not control the court and the county's continued

funding of the Court is currently in litigation.

- Commission leadership will need to ascertain from executive management the impact of the proposed mandatory credits on county operations and services to taxpayers and constituents.
- Some departments are allocated more than the 10% mandatory credit, such as, the OAG - 43%, Prosecuting Attorney – 21%, Sheriff Office – 13%, etc.

FUTURE BUDGETARY ISSUES

House Bill 4214 (Emergency Financial Manager Act)

Condition

- For a municipal government, the State Treasurer could conduct a preliminary review of financial problems if one or more of 18 events ("trigger points") occurred. Correspondence from the county's Chief Financial Officer stated that county management has reviewed all 18 trigger points and concluded that, at present, three of them are applicable to the county: (1) violating the budget act section regarding expenditures not exceeding budget; (2) ending the year in a deficit condition; and, (3) possibly breaching obligations under a deficit elimination plan.

  - **Impact/Action -** Under this act the county is, at a minimum, considered to be in severe financial stress that could lead to a state of financial emergency. If left unaddressed, the future capability to provide necessary government services essential to public health, safety and welfare could be threatened. The most undesirable outcome could be the county being placed in receivership and the governor appointing an Emergency Financial Manager.
  - Although, there has been very little negative publicity about the financial condition of the county, we are of the opinion that there are disturbing similarities between the City of Detroit and Wayne County: continuous increases in deficits, declining property tax revenue, population reduction, and high unemployment.

Contingent Liabilities

Condition

- Based on our review of the FY 2010 CAFR, there are three contingencies which could have a negative financial impact on county's operations in FY 2011 – 2012 and beyond, which will necessitate the Commission to monitor. Specifically:

  Third Circuit Court:

  - On October 28, 2010, the Third Circuit Court was granted an award that requires the county to forgive the prior overspending by the Circuit Court, as well as requiring the county to provide funding for 110 additional positions, and upgrade or replace Circuit Court facilities. Management estimates the cost of these positions to be approximately $10 million annually; the cost of the facilities improvements is not currently estimable. At September 30, 2010, the Circuit Court had accumulated approximately $55.1 million of spending in excess of appropriated amounts.

- In the county's A-133 report, the external auditors stated: …most likely the Circuit Court deficit will require appropriations from the General Fund for its eventual elimination.…the preferable treatment…would be to report the court as a department of the general fund of the county."

    - **Impact/Action** – Commission leadership will need to monitor and assess the financial impact of the court decision should the county lose its appeal; the immediate impact on the general fund will be to increase its deficit by $52.9 million. However, due to the uncertainty of the outcome, management has not recorded a liability in the audited financial statements at year end.

Wayne County Retirement Commission and Wayne County Employees Retirement System: On November 8, 2010, a lawsuit was filed claiming the county improperly deferred a portion of the County's obligation to make pension contributions to the Wayne County Employee Retirement System (WCERS).

- **Impact/Action** – Commission leadership will need to monitor and assess the financial impact of an adverse decision that would result in an additional cash contribution of up to $32 million, of which approximately $16 million is attributable to the county's general fund.

Collective Bargaining Agreements: The collective bargaining agreement between Wayne County and four of its AFSCME Locals expired September 30, 2008. A new agreement was not able to be negotiated. On December 1, 2010, Wayne County imposed the terms of its impasse position. AFSCME has proceeded with litigation against the county.

- **Impact/Action** – The commission should request periodic updates on the status of the negotiations to determine whether there could be an adverse outcome during FY 2011-2012; the result could have an immediate negative impact on the county's budget.

OPEB Liability

Condition

- As of September 30, 2010, the Other Post Employment Benefits (OPEB) unfunded actuarial accrued liability is $1.5 billion. The Annual Required Contribution (ARC) in

FY 2010 was approximately $88 million, an increase of $29 million over FY 2009. The increase can be attributed to the county required use of an investment rate of return of 4 percent opposed to the 8 percent used in FY 2009. GASB Statement No. 45 requires the use of the rate of return that is expected to be earned on the county's general assets. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal OPEB cost each year and amortize the unfunded actuarial accrued liability. Management has indicated an OPEB Trust has been set up and is awaiting IRS approval, and measures are being implemented to fund the trust.

> ➢ **Impact/Action** – The commission will need to monitor management's plans to fund the annual ARC and OPEB Trust. Funding the OPEB Trust could result in higher interest earning that can be used to reduce the obligation. Conversely, this will place an additional financial burden on the FY 2011/12 budget. Therefore, the funding of the OPEB Trust may not financially be possible at this time due to budget constraints.

<u>Defined Benefit Plan/Early Retirement Incentives</u>

<u>Condition</u>

- The actuary has recently computed the impact of allowing county employees to transfer to the Wayne County Defined Benefit Plan. The defined pension benefit plan has an unfunded actuarial liability as of September 30, 2009, for a funding ratio of 67.2 percent. Offering this plan as an incentive for early retirement has significantly increased the amount of under funding of the plan and has contributed toward the increase of annual required contribution.

- On April 1, 2011 an Early Retirement Incentive (ERI) was offered for certain members of the Wayne County Employees' Retirement System. One of the purposes of the ERI was to reduce the number of employees and associated personnel costs.

  ➢ **Impact**– As a result of the ERI:
    - An actuarial valuation measured the financial impact of the proposed benefit changes resulted in a removal of $13 million in payroll cost and an increase in the Present Value of Future Benefits (PVFB) of approximately $44.6 million.
    - A reduction in regular salaries and wages could be offset by an increase in temp salaries and wages as well as overtime.
    - The county's future pension costs will increase.
    - Experienced employees that have retired will take institutional knowledge with them that is not easily replaced and can have a negative impact on county operations.
    - The Government Finance Officers Association (GFOA) has stated: "Historically, ERI rarely have succeeded, since costs are often greater than initially anticipated by the government offering the

incentive, and savings are lower than projected." The GFOA has recommended that governments exercise extreme caution if considering ERI.

- **Action** – Commission leadership should consider requesting the executive branch to provide analysis on the financial impact when offering retirement incentives that include allowing employees to transfer to the county's defined benefit plan. Also, eliminating the option to participate in the Defined Benefit Plan in the future would be similar to what other counties and municipalities around the country have done and could result in controlling the escalation in pension costs.

<u>Guardian Building</u>

<u>Condition</u>

- For Fiscal Year 2010, the Guardian Building operations recorded a net operating loss of approximately $305,000. There is still vacant office space in the building. The Department of Public Services (DPS), which was one of the departments initially designated to move from 415 Clifford to the Guardian Building, is now leasing facilities at 400 Monroe. In addition, management recently requested commission approval of a lease agreement to move the Sheriff's Administration Division to 4747 Woodward until the new jail facility is constructed.

  - **Impact/Action** - The commission may want to request a cost/benefit analysis of these county departments' leasing arrangements to ascertain why the departments did not relocate to the Guardian Building. The analysis should include any financial impact on the general fund.

<u>Building Authority</u>

<u>Condition</u>

- Executive management has decided to construct a Criminal Justice Facility (facility), in an effort to realize long-term cost savings. The Building Authority (Authority), a component unit, will finance the facility through the issuance of bonds up to $300 million that are backed by the full faith and credit of the county. The county has agreed to pay the Authority cash rentals in the amount of the debt service requirements on the bonds. Within the Contract of Lease, under section 6, its states annually before finalizing its budget for the next fiscal year, the county has to prepare and submit to the Authority a statement of the moneys to be included in its budget for payment of all costs of the project. Also, under section 11, it states in the event of insufficient funds after the letting of contracts for the construction of the project, the Authority is authorized, on its own motion, to issue additional bonds necessary to raise sufficient funds. Cash rentals to be paid by the county shall automatically be increased by an amount sufficient to pay all principal and interest on the total amount of bond issuances.

> ➢ **Impact/Action** - The Authority is authorized to unilaterally issue additional bonds if there are insufficient funds to complete, repair, replace or alter the facility, without Commission consent, the county's cash rental payments will automatically increase. This could potentially amount to millions of dollars being expended without Commission approval.
>
> Commission leadership, which has no authority over the costs incurred to construct the facility, will need to implement a mechanism to monitor the debt service costs of the justice facility project which the county is responsible for paying to the Authority. In addition, a clause for an audit by the Wayne County Auditor General's Office and the requirement for the development of a procurement ordinance process or adoption of the county's procurement ordinance in order to competitively bid contracts.

<u>Economic Development Plans</u>

<u>Condition</u>

- For the past three fiscal years, executive management has stated[1]: "The County will look critically at all the services it provides on an annual basis. No longer will the County be able to finance services or programs that are not self-sustaining. Financing for these services will depend on the ongoing, sustainable revenue sources…."

  - ➢ **Impact/Action** – The commission should consider requesting the administration to provide a projected revenue stream for existing and proposed economic development projects in order to monitor the impact on the general fund or county core services.
    - For example, the Wayne County Land Bank has been funded at a cumulative level of $13.2 million in grants from the general fund since its inception; however, there are no performance measures in place in order for the commission to monitor the effectiveness of the program.

<u>Allocation of Indirect Cost</u>

<u>Condition</u>

- The Commission Office of Policy and Research Analysis (PRA) perform contract management and analysis work similar to those services performed by other executive departments. Based on discussion with the PRA director, it is estimated that approximately 50% of their time is spent performing these functions. We estimate that approximately $424,000 could be setup as charge backs and reduce the amount of support required by the general fund.

---

[1] The *Letter of Transmittal* for the County's Comprehensive Annual Financial Report (CAFR).

- **Impact/Action** – Charging back a portion of the costs in PRA will reduce the support being received from the general fund by at least $320,000.

Chargebacks

Condition

- There are several areas related to charge backs that are problematic and should be closely scrutinized by the Ways and Means Committee for the FY 2011 - 2012 budget: the Guardian Building, health insurance, and appointees being charged to internal service funds.

  - **Impact/Action** – The OAG has noted there are instances in which these cost are not being supported by actual costs being incurred. For example:
    - We could not reconcile the charge backs for the Guardian Building to actual cost being incurred.
    - Charges for retirees' health insurance appear to be excessively high.
    - Appointees are being placed in DPS and DOT without a clear description of what job functions they are performing.
    - Need to review the General Health fund for escalating costs of retirees' health care and its impact to the General Fund.
    - According to DOE management, audit fees for the Sewage Disposal Systems and Chapter 21 Drainage District, both of which are enterprise funds, is currently being paid for by the general fund and allocated to county business units. Since the OAG manages the external audit contract - we will request the auditors breakout that cost and bill these entities separately in the future.

GASB Statement No. 61

Condition

- There is a new GASB Statement No. 61, *The Financial Reporting Entity: Omnibus,* which will require municipalities to blend component units with the primary governmental units beginning, June 30, 2013. It states, in part: "a component unit will need to be blended if the total debt will be repaid entirely, or almost entirely, from resources of the primary government."

  - **Impact/Action** – Since the county is moving toward multi-year budgeting, commission leadership need to obtain management strategic plan(s) to address this new standard and its financial impact on the general fund for those discretely presented component units of the county, including the Third Circuit Court.

CURRENT BUDGET ISSUES CONTAINED IN REPORTS PRESENTED TO THE COMMITTEE ON AUDIT MAY 1, 2010 THROUGH APRIL 30, 2011

The audit, attestation, consulting, and other engagement reports that contain budget issues described in this section of the report are grouped according to the applicable county department, title and date of the engagement report, engagement period covered, and date presented to the Audit Committee.

WAYNE COUNTY REGISTER OF DEEDS

Recording and Indexing Services

Operational Assessment Review on the Wayne County Register of Deeds Recording and Indexing Services. Report Date February 28, 2011; (Presented to Audit Committee March 8, 2011) DAP No. 2010-57-859.

Condition

- We determined the monthly state transfer tax was not always being submitted by the filing due date, causing the Register of Deeds to be out of compliance with Public Act 330 of 1993.
    - **Impact –** Failure to remit the state transfer tax by the due date exposes the county to potential significant penalties and interest that could be imposed by the State of Michigan Treasury for non-compliance with Public Act 330 of 1993. An assessment of penalty and interest would reduce fee revenues to fund ROD operations and resultantly, could impact the general fund. Based on our report, the annualized potential penalty and interest is approximately $70,000.

DEPARTMENT OF CORPORATION COUNSEL HUMAN RELATIONS DIVISION

Operational Assessment on the Department of Corporation Counsel, Human Relations Division for the period October 1, 2009 –March 31, 2010; Report Date: July 21, 2010; (Presented to Audit Committee September 28, 2010) DAP No. 2010-57-855

Condition

- During the scope of our review, we found the Department of Corporation Counsel, Human Relations Division budgeted approximately $120,000 in FY 2010 revenues from a pending proposed new user fee ordinance.

  - **Impact** – The budgeted revenue by the Human Relations Division was based on passage of a new user fee ordinance during FY 2010. Because Human Relations is part of Central services, a chargeback unit, any incurred revenue shortages not fully reimbursed, would be charged to other county departments.

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Operational Assessment Review Report on the Patient Care Management System, Department of Health & Human Services, Report Date March 21, 2011; (Presented to Audit Committee March 8, 2011) DAP No. 2010-57-853.

Condition

- Patient Care Management System (PCMS) provides services to Health Choice of Michigan (Health Choice), a component unit of the county, based on an intergovernmental agreement, and receives reimbursement in an amount not to exceed three percent of Health Choice's funding. The reimbursement amount doesn't cover all costs incurred by PCMS to provide the services as outlined in the agreement.

  - **Impact** – Services are being provided to a component unit without full reimbursement or proper disclosure in the financial statements in accordance with generally accepted accounting principles. Moreover, the funding of the difference between the costs to provide the services and the current reimbursement by the general fund could be reduced if full reimbursement is received from Health Choice. We noted that the intergovernmental agreement between Health Choice and the county was recently increased from $125,000 to $725,000 per annum.

THE DEPARTMENT OF MANAGEMENT & BUDGET

Assessment & Equalization Division

Operational Assessment Review on the Assessment & Equalization Division, Department of Management & Budget. Report Date June 7, 2010; (Presented to Audit Committee July 13, 2010) DAP No. 2010-57-852

Condition

- The county currently provides property tax assessment and assistance to 19 communities in Wayne County. The estimated relevant costs for A&E to provide these services approximate $2 million and the revenue received is estimated at $1 million annually.

  - **Impact** – The cost to provide these services to the 19 communities at the current fee costs the county about $1 million. We understand management has taken the necessary action to increase the fees for the cost to provide these services.

THE DEPARTMENT OF MANAGEMENT & BUDGET COST ALLOCATION/CHARGEBACKS

Consulting Report on the Wayne County Department of Management & Budget, Cost Allocation/Chargebacks for Fiscal Years 2008 and 2009. Report Date: August 11, 2010 (Presented to Audit Committee October 26, 2010) DAP No. 2010-57-861.

Condition

- For fiscal years 2008 and 2009 combined, applicable indirect costs of $7.0 million were not allocated to county business units. According to Management & Budget officials, allocating the allowable costs would have caused hardship to the budgets of the other county business units for the respective fiscal years.

  - **Impact** – Sound OMB Circular A-87 cost accounting principles require costs to be uniformly allocated to business units based on the benefit derived from the providing departments. Thus, according to OMB Circular 87, all costs should be allocated on an equitable basis regardless of ability to pay.

- For fiscal years 2008 and 2009, the county received over $90 million and $85 million, respectively, in federal grants. A schedule provided by M&B listed $2,200 and $14,000 as recovered indirect costs for fiscal years 2008 and 2009, respectively. However, management subsequently stated they have no process in place to capture the amount of indirect cost being recovered by county departments.

  - **Impact** – Grant application and reporting requirements are decentralized throughout county departments. Therefore, it can not be readily determined whether county personnel, assigned responsibility for administering programs/services, are pursuing the maximum amount of indirect cost reimbursement from granting agencies.

- The administration implemented a change in its accounting method for its treatment of internal service fund costs for M&B, Personnel, and Corporation Counsel for FY 2010 – 2011. This proposed result is an annual long-term impact of approximately $1 million associated with the change from the full to the modified accrual basis of accounting.

  Impact - Although the departments in the county will receive lower chargeback amounts, county departments would also be using these lower chargeback rates or amounts when seeking reimbursement from federal and state grant funded programs. The accounting change impacted depreciation and accrued compensating absences of $2 million in FY 2010 – 2011. Since these costs will not be allocated to county departments, this means the departments and grants programs would not be charged full true costs for services they receive in any fiscal year.

DEPARTMENT OF PUBLIC SERVICES

Division of Parks

Consulting Report for the Department of Public Services, Division of Parks, Revenues Collected at County Parks. Report Date: January 14, 2011; (Presented to Audit Committee February 8, 2011) DAP No. 2009-57-819.

Condition

- Over fiscal years 2006, 2007, and 2008, prior to transfers in from the General Fund, total revenues recorded for park operations totaled $32.3 million, while expenditures totaled $35 million, resulting in an operating loss of nearly $2.7 million. For this three year period, transfers in or funding from the county's general fund totaled $10.4 million, resulting in revenues exceeding expenditures by $7.7 million.

- According to DPS officials, the general fund was to supplement the Parks millage to fund the Parks Division operations.

  - **Impact** - Given the county's present financial condition and impact on the general fund, management within the DPS – Parks Division may now need to reassess General Fund transfers for its park activities and events.

COMPONENT UNITS

Financial Assessment - Limited Review Report for the Wayne County Land Bank Corporation Financial Statements and Independent Auditor's Report for fiscal year ended September 30, 2009; Report Date: May 13, 2010; (Presented to Audit Committee May 25, 2010) DAP No. 2010-57-906.

The report provides an assessment on the financial statements of the Wayne County Land Bank Corporation for the fiscal year ended September 30, 2009.

Condition

- The Corporation is heavily dependent upon support from the county's general fund to support operations.
  - **Impact** – Without other sources of revenue, such reliance on the county's general fund could hamper Land Bank's ability to fulfill its mission and purpose if the county is unable to sustain its current level of support.

CONCLUSION

Over the period covered by this report, the Wayne County Office of Legislative Auditor General (OAG) completed 54 audits, attestation, consulting, and other engagements of which 7 contained potential budgetary issues. Some of the issues identified in these reports could result in additional revenue or cost savings opportunities to the county, or where additional resources may need to be directed to ensure goals and objectives are achieved.

We believe these items coupled with the following fiscal challenges faced by Wayne County could have an impact on the county's fiscal year 2011-2012 budget. This is particularly true given the current depressed state of the economy in the southeast Michigan region and the financial challenges the county faces in this and coming years. As such, we believe these issues may be useful to the commission as part of the budget deliberation process for fiscal year 2011-2012.

This report is intended solely to provide information to the Wayne County Commission and should not be used for any other purposes. This restriction is not intended to limit the distribution of the report, which is a matter of public record.

Willie Mayo, CPA, CIA, CICA
Auditor General

APPENDIX A

Summary of Budgetary Impact for Considerations for FY 2011-2012 and Beyond

Description	FY 2011-2012 Budgetary Impact	Page Number
Unreserved/Undesignated Fund Deficits	$ 252,895,000	2
Wayne County Register of Deed	70,000	16
Department of Health and Human Services	725,000	17
Management & Budget – Assessment & Equalization Division	1,000,000	17
Management & Budget – Cost Allocation/Chargebacks	1,000,000	18
Total Budgetary Impact	$ 255,690,000	

APPENDIX B

VIEWS FROM RESPONSIBLE OFFICIALS AND OAG'S RESPONSES

FISCAL YEAR 2011-2012
BUDGETARY ISSUES

CFO Budget for FY 2012 and 2013 – lacks transparency and is not equitable

Views from responsible officials:

The Charter provides that the CEO has sole discretion on how the budget will be presented to the Commission in the Comprehensive Recommended Budget. Line item detail was provided to the Commission as a courtesy as it is not required by Charter. The Commission, through the Committee on Ways and Means and the Commission fiscal staff, requests information regarding each department or elected official budget and that information is provided by either the elected official or the department. While not knowing the process, if the OAG had a question, they could have provided it to the fiscal staff for submission to the department. Additionally, as a result of recent litigation with the Courts, the County's legal representatives recommended that we provide less detail information as the CEO Recommended Budget document was used against the County in past litigations.

In regards to the mandatory credit, it is the position of Management and Budget and the Office of the CEO that the department/elected officials are responsible for their LUMP SUM appropriation and as such has discretion on how the mandatory credit is eliminated. The Commission at the end of the day approves the Appropriation Ordinance which highlights revenue sources but has only one expense line.

OAG Response:

The OAG contends that a line item budget is the best method to allow the legislative branch to be better informed regarding the composition of the budget and assumptions being made. We advocate this practice, while not required, should be the norm, not a courtesy to better inform the commission decision makers. More importantly, the providing of this essential detail will serve to enhance the department and elected officials understanding and willingness to work with county leadership.

Inserting a "mandatory credit" into a department's budgeted expenditures and allowing two weeks for the department to decide what expenditures to cut, (i.e., where to allocate the mandatory credit), is not a sound budgeting practice. Also, as the OAG stated in our report, some departments were allocated more/less than the 10% mandatory credit without providing guidance and\or rationale, which does not seem to be fair and equitable.

More specifically, while the budget director states department/elected officials had discretion as to how the mandatory credit could be eliminated, he failed to mention that departments and elected officials were instructed they could not reduce chargeback costs that are included in their respective budget.

Increasing Fund Deficits

Views from responsible officials:

We agree that increasing deficits are a problem and now with the passing of the DEP Ordinance and the Multi-year Budget Ordinance, we now have two new tools which reduces the deficit spending of the County.

The 2011 Budget includes approximately $22.5 million in deficit elimination funding. Both 2011-12 and 2012-13 include over $25 million in deficit elimination funding.

OAG Response:

We do not believe the allocation of $47.5 million over a two year period is sufficient enough to eliminate the accumulated deficit of $253 million over a five year period as required by the State Treasury. Therefore, executive management needs to take a more aggressive approach toward eliminating the deficit over the next five years. However, as a matter of record, management has failed to fulfill their pledge to apply revenue sharing funds toward the deficits in the past years.

Deficit Elimination Plans

Views from responsible officials:

The statement above declaring that the General Fund represents 76% of the Fund Deficits is misleading and does not provide the entire picture. While it is true that the General Fund had a $116 million unreserved deficit as of FY 2010, the report fails to provide any explanation or the accounting rule which explains the reasons causing the majority of the deficit in the General Fund. As the "Fund of Last Resort", the General Fund is required by Generally Accepted Accounting Principles (GAAP) to reserve for certain fund deficits that were created in other funds. For example, the deficit attributable to the Third Circuit Court in Fund 835 is recorded in Fund 835 but GAAP also requires that deficit is also reserved for in the General Fund. Essential, the deficit is recorded in both funds. In layman's terms, this represents a double count as the deficits are recorded in both funds. If the deficit in the Circuit Court Fund is reduced hypothetically by $5 million, the reservation in the General Fund is also reduced by an equal $5 million. However, in the statement above, there is no explanation of this cause and effect and may mislead the reader as to the nature of the unreserved deficit in the General fund.

OAG Response:

The OAG stated that the General Fund was responsible for ***76% of the increase*** in the

Unreserved/Unrestricted fund deficits for the period from FYs 2008 - 2011. For FY 2010, the General Fund represents ***45% of the total*** Unreserved/Unrestricted fund deficits as depicted in the pie chart above.

Management's response did not address the OAG's statement that not adhering to the DEP submitted to the State Department of Treasury could result in a "trigger point" under House Bill 4214 – Emergency Financial Manager Act.

We agree with the budget director that the deficit is being reflected twice in the county's financial statements, once in the courts and again in the general fund. This is true because the courts have no means to repay their $52.9 million overdrafts in pooled cash and governmental accounting principles requires the general fund to be designated as the payer of last resort.

However, effective June 30, 2013, this whole argument may become a moot point since GASB Statement No. 61 will require the Circuit Court be blended into the county's general fund.

Structural Deficits

Views from responsible officials:

We agree that the County is facing a structural problem. However, the 2011-12 and 2012-13 proposed Budgets include numerous structural corrections. As stated a number of times during the budget hearings, the emphasis on this year's multi-year budgets was to create structural change. The one time fixes as we have been required to use in the past do not work when the department/elected official is required to look at multiple years as part of their budget strategy.

OAG Response:

We concur that the county is facing a structural deficit problem. To address the structural problem, we are of the opinion executive management will need to use more sound budgetary principles to project revenue and differentiate between core and mandated services, and look to eliminate those services not required.

Decline in Bond Ratings

Views from responsible officials:

We agree that the lowering of the bond rating by S&P may increase our bond interest costs. S&P stated the primary reason of the downgrade was the problem with the failure of the Circuit Court to conform to its budget.

OAG Response:

We agree that lowered bond ratings may lead to an increase in bond interest cost. However, other than the Third Circuit Court, S&P also stated other reasons for the bond rating downgrade:

- "A negative unreserved general fund balance and a significantly reduced cash position,
- Negative unrestricted net assets in the county's juvenile justice and circuit court funds despite consistent general fund support for operations,
- Significant economic pressures and unemployment rates hovering at about 15%, and
- Economic indicators we consider just adequate."

Budgeted Revenue Projections

Views from responsible officials:

From a budgetary standpoint, consolidating governmental funds or non governmental fund together at a high level instead of providing information regarding specific funds or departments provides no real informational value. Additionally, there is no explanation of the variances or mention of offsetting expenditure variance. These revenue shortfalls are primarily the result of grant revenues that were budgeted but not spent. These revenue variances are largely offset by equal variances on the expenditure side.

OAG Response:

We disagree with management's position. Executive management is fiscally responsible for all governmental funds. In a recent meeting the budget director stated revenue decertification has not been performed on a timely basis. This could be a contributing factor for budgeted revenues exceeding actual revenue.

In other correspondence, management has stated the budget is based on federal awards and not on amounts expected to be received. If it is a reimbursable grant, as most federal grants are, the budget should be based on what is expected to be expended and not on the amount awarded. Budgetarily, this is not correct and can result in unrealizable revenue being adopted in the budget by the commission.

An analysis by the OAG did note, to a large extent, revenue shortfalls were offset by some reduction in expenditures, but not by similar amounts.

Tax Anticipation Notes (TANs)

Views from responsible officials:

It is true that the County will be required to borrow an amount uncertain for the near future. For FY 2011-12, that amount has not been decided but will probably be similar to the $100 million borrowed in FY 2011. The first $60 million was repaid over 2 fiscal years as required by the TAN repayment covenants. TANs are required to be repaid back within thirteen month of issuance. The County has repaid all TANs within 9 months of issuance.

OAG Response:

The OAG agrees with management's comments. The OAG point is that commission leadership needs to monitor the county's cash flow projections and the reasons behind the issuance of TAN which is cash flow shortages and make sure any borrowing is paid back in the same fiscal year it is borrowed.

Pooled Cash "Loans"

Views from responsible officials:

The purpose of the pooling of cash for intra-fund borrowings is to limit the need for external borrowings. The use of pooled cash borrowing actually saves the County money by not having to borrow externally. The borrowing of pooled cash can increase and/or decrease at any given time during the year. The CAFR statement of pooled cash is as of a point in time.

OAG Response:

We concur with management that borrowing internally is less expensive. However, if the management is borrowing from restricted funds it could place the management at great risk because it could be a violation of the grant provisions. As requested by the external auditors, management will need to obtain a separate legal opinion as to what funds, if any, can be borrowed from pooled cash.

Revenue Enhancements – New User Fees

Views from responsible officials:

The Commission passed phase I of the Fee Study increases during the budget process. Only reasonable increases in revenues were included in the budget related to these increases.

OAG Response:

We agree with management's assertions regarding this matter.

CEO Directives/Initiatives - Budget Policy Statement (BPS)

Views from responsible officials:

This year's budget presented challenges. With a $103 million gap projected in FY 2012 and $112 million projected in FY 2013, it was obvious that a business as usual approach would not work and as such took us longer to come up with viable and structural solutions and strategies which would correct both years' budget gaps. While we concede this budget was late, it was from my point of view, the hearings and deliberations was the smoothest process since FY 2004.

OAG Response:

We acknowledge there could be significant challenges given the county's financial condition. However, we are still of the opinion that, challenges not withstanding, the budget should be issued on a more timely basis in order to allow commission leadership sufficient time to review, analyze, and make inquiries prior to adopting the budget.

Mandatory Budget "Credits"

Views from responsible officials:

Mandatory credits were used in previous budgeting processes. At the end of the day, the commission approved a lump sum budget and requires departments/elected officials to manage their budget. The mandatory credit required the department to decide where the cuts are to be made. The mandatory credit was only applied to areas that did not meet the 10% reduction.

OAG Response:

Management stated in a recent meeting that the previous budgeting process to employ mandatory credits was used during the 1995/1996 budget cycle. As previously discussed, inserting a "credit" into a department's expenditures and allowing two weeks for the department to decide what expenditures to cut without guidance, i.e., where to allocate the mandatory credit, is not a sound and fair budgeting practice.

FUTURE BUDGETARY ISSUES

House Bill 4214 (Emergency Financial Manager Act)

Views from responsible officials:

As stated above, there are 18 criteria in which a financial manager could be brought it.(sic) The County is nowhere near any of the criteria needed to bring in a financial manager and to compare the financial condition of the County against the City is disingenuous. While the County faces a number of challenges, it is nowhere near the City as it relates to their problems or its financial condition.

OAG Response:

We disagree with management's assertions. As noted above, the county's Director of Financial Reporting stated that three of the eighteen trigger points are applicable to Wayne County.

Under parameters defined in the Act, the county is considered to be under financial stress. As such, comparison with the city of Detroit's financial position is valid.

At June 30, 2010, the City had an unreserved deficit in its general fund deficit of $156 million; the county's unreserved general fund deficit at September 30, 2010, was $116 million. In its CAFR, the city noted that the unreserved deficit in its general fund has contributed to their dependence on borrowing for cash flow purposes. Other similarities are related to: increases in deficit spending, declining property tax revenues, population reductions, and high unemployment.

Contingent Liabilities

Third Circuit Court

Views from responsible officials:

The decision regarding the Third Circuit was stayed by the Supreme Court as the case is on appeal. The County is also in negotiations with the Courts as well. The 2010 budget appropriated an additional $30 million to the Courts and the accumulated deficit actually came down in FY 2010. FYs 2011, 2012 and 2013 all have DEP funding included for the courts. **The County for a number of years HAS reserved for the accumulated deficit for the Courts and other funds in deficit in the General Fund. See my response to this report's section "Increase in Fund Deficits" above.**

OAG Response:

Effective June 30, 2013, this whole argument may become a moot since GASB Statement No. 61 will require the Circuit Court be blended into the County's General Fund.

It is true that at the insistence of the external auditors, the general fund has a reserve to offset the Circuit Court deficit over the last couple of years.

Wayne County Retirement Commission and Wayne County Employees Retirement System:

Collective Bargaining Agreements:

Views from responsible officials:

Both cases are being pursued vigorously with the intent of the County prevailing.

OAG Response:

On Thursday August 25, 2011, Wayne County Circuit Court ruled in favor of AFSCME regarding the Collective Bargaining Agreements litigation. It is our understanding that the county plans to appeal this adverse decision. However, the litigation with WCERS is still pending a decision.

OPEB Liability

Views from responsible officials:

We are currently looking at funding solutions for OPEB. However, we do not believe this is the correct time to bond for OPEB. We are currently prefunding OPEB for the new hires.

OAG Response:

We agree; however, we believe management missed numerous opportunities since GASB #45 became effective beginning after December 15, 2006, to fund the OPEB and recently the external auditor reported the unfunded actuarial liability for OPEB has increased from $838.9 million to $1.5 billion in the government –wide financial statements.

Defined Benefit Plan/Early Retirement Incentives

Views from responsible officials:

The County requires an actuarial study whenever there is a proposed change in retirement.

OAG Response:

The OAG has no knowledge of executive management requesting an actuarial study for the March 2011 Early Retirement Incentive. The 2011 Early Retirement Incentive was presented to eligible employees in February 2011 with a final termination date of March 2011. The Retirement Board requested an actuarial report on the impact of the incentive. The report was received in April 2011.

The OAG comments are not concerned with the actuarial valuation that was conducted but, center on commission leadership being provided an analysis of the financial impact of the proposed benefit changes.

Guardian Building

Views from responsible officials:

The County is currently performing a space consolidation study and will in all likelihood consolidate County occupied space. However, with the Renaissance Center being fully occupied with the new Blue Cross tenants and other surrounding buildings being occupied by Quicken loans and others, tenant ready office space is become (sic) more difficult to find an (sic) as such space in Guardian may bring premium rental revenue from organizations wishing to move downtown.

4747 Woodward is a necessary temporary housing for the Sheriff administrative personnel until the new facility is finished.

OAG Response:

The OAG encourages the space consolidation study and the likely consolidation of county occupied space. However, any potential premium rental revenue that may be obtained from organizations wishing to relocate downtown could be offset by lease costs of county departments, like the Sheriff Office and Department of Public Services that are not relocated to the Guardian Building.

Building Authority

Views from responsible officials:

This has no impact on the County Budget Appropriation Ordinance and should not be included in this report.

OAG Response:

The county has implemented a multi-year budget process. While the FY 2011-2012 Budget Appropriation Ordinance may not be impacted, the FY 2012-2013 and 2013-2014 could be, based on the conditions noted above. This is definitely a future budgetary consideration.

Because the county is responsible to pay to the Building Authority for "rental" based upon the amount of the Authority's debt service, funding will need to be budgeted for these payments for a number of future years.

Economic Development Plans

Views from responsible officials:

Land Bank is a separate component unit of the County with a separate oversight board. The Commission has representation on this board that is aware of the progress of the Land Bank and should be communicating that information to his/her colleagues.

OAG Response:

As noted, the Wayne County Land Bank is presented as an example. The our report states the general fund supports economic development plans without performance measures in place that do not allow the oversight body the ability to gauge the effectiveness of programs and proposed revenues from the project.

In addition, it should also be noted that the commission no longer has representation on the Land Bank board, as the commissioner representing the county lost reelection and has not yet been replaced.

Allocation of Indirect Cost

Views from responsible officials:

We are researching including the Commission Fiscal staff in the indirect cost model.

OAG Response:

The OAG concurs with the proposed action.

Chargebacks

Views from responsible officials:

The Chargeback models are available and have been reviewed by the OAG a number of times. Chargebacks are like taxes: a fact of life that no one likes the methodology, no one likes to pay but everyone has a right to complain about.

OAG Response:

Management's comments do not address the impact/action items listed above. These still remain valid points.

GASB Statement No. 61

Views from responsible officials:

This does not have a budgetary impact on the appropriation ordinance or the budget. This is a financial reporting issue and should not be in this report.

OAG Response:

GASB Statement No. 61 becomes effective June 30, 2013. Its implementation will result in more than just a financial reporting issue. Blending any component unit, specifically the Third Circuit Court, into the county's general fund will have a direct impact on the budget process because the **total deficit** in the general fund could increase from $26.5 million to $79.4 million.

CURRENT BUDGET ISSUES CONTAINED IN REPORTS PRESENTED TO THE COMMITTEE ON AUDIT MAY 1, 2010 THROUGH APRIL 30, 2011

WAYNE COUNTY REGISTER OF DEEDS

Recording and Indexing Services

Operational Assessment Review on the Wayne County Register of Deeds Recording and Indexing Services. Report Date February 28, 2011; (Presented to Audit Committee March 8, 2011) DAP No. 2010-57-859.

Views from responsible officials:

This is a ROD management issue, not an Appropriations Ordinance issue and should not be in this report.

OAG Response:

We concur the timely processing of the monthly state transfer tax is a ROD management issue. Because ROD is a general fund supported office, the late remittance does expose the county to potential significant penalties and interest that could be imposed by the State of Michigan Treasury. Should these be imposed, the ROD will incur immediate, **unbudgeted**, expenditures.

DEPARTMENT OF CORPORATION COUNSEL HUMAN RELATIONS DIVISION

Operational Assessment on the Department of Corporation Counsel, Human Relations Division for the period October 1, 2009 –March 31, 2010; Report Date: July 21, 2010; (Presented to Audit Committee September 28, 2010) DAP No. 2010-57-855

Views from responsible officials:

If these sets of fees are not passed by the Commission, the costs would be borne by the County end beneficiating department of Human Relations.

OAG Response:

The OAG concurs with management's comments.

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Operational Assessment Review Report on the Patient Care Management System, Department of Health & Human Services, Report Date March 21, 2011; (Presented to Audit Committee March 8, 2011) DAP No. 2010-57-853.

Views from responsible officials:

No response – revenue was increased in FY 2010

OAG Response:

Increase per annum reimbursement is contained in the 2011/2012 budget.

THE DEPARTMENT OF MANAGEMENT & BUDGET

Assessment & Equalization Division

Operational Assessment Review on the Assessment & Equalization Division, Department of Management & Budget. Report Date June 7, 2010; (Presented to Audit Committee July 13, 2010) DAP No. 2010-57-852

Views from responsible officials:

The increase in these fees are included in the fee study that was passed by the Commission.

OAG Response:

The OAG concurs with management's comments.

THE DEPARTMENT OF MANAGEMENT & BUDGET COST ALLOCATION/CHARGEBACKS

Consulting Report on the Wayne County Department of Management & Budget, Cost Allocation/Chargebacks for Fiscal Years 2008 and 2009. Report Date: August 11, 2010 (Presented to Audit Committee October 26, 2010) DAP No. 2010-57-861.

- **Impact –** Grant application and reporting requirements are decentralized throughout county departments. Therefore, it can not be readily determined whether county personnel, assigned responsibility for administering programs/services, are pursuing the maximum amount of indirect cost reimbursement from granting agencies.

Views from responsible officials:

No response – this occurred in 2008 and is not related to the current budget.

OAG Response:

The OAG impact statement is budgetarily relevant. There is a budget impact if the maximum amount of indirect cost reimbursement is not pursued from granting agencies annually.

> **Impact** - Although the departments in the county will receive lower chargeback amounts, county departments would also be using these lower chargeback rates or amounts when seeking reimbursement from federal and state grant funded programs. The accounting change impacted depreciation and accrued compensating absences of $2 million in FY 2010 – 2011. Since these costs will not be allocated to county departments, this means the departments and grants programs would not be charged full true costs for services they receive in any fiscal year.

Views from responsible officials:

This is incorrect. The impact of the accounting methodology change was a one-time budget initiative in FY 2011. Chargebacks expenses (less the 10% reductions) were fully restored in FY 2011-12 and 2012-13. Central Service depreciation was also taken into accounted for in the transaction included in FY 2010-11.

OAG Response:

Based on the accounting change implemented by M&B, there continues to be an annual long-term impact of approximately $1 million associated with the change from the full to the modified accrual basis of accounting since certain costs such as depreciation will not be allocated to other county business units.

DEPARTMENT OF PUBLIC SERVICES

Division of Parks

Consulting Report for the Department of Public Services, Division of Parks, Revenues Collected at County Parks. Report Date: January 14, 2011; (Presented to Audit Committee February 8, 2011) DAP No. 2009-57-819.

- **Impact** - Given the county's present financial condition and impact on the general fund, management within the DPS – Parks Division may now need to reassess General Fund transfers for its park activities and events.

Views from responsible officials:

This is incorrect. The primary source of revenue is the Parks millage that is based on taxable values which have been decreasing since 2007-08. I believe this is followed by Charges For Service revenue and the Transfer from the General Fund. For FY 2011-12 and 2012-13 the transfer from the General fund was reduced to $2.0 million in FY 2012 and $2.7 million in 2012-13. The Parks Fund will end in a surplus or deficit primarily depending on the completion of Parks CIP projects.

OAG Response:

The OAG did not state that the primary source of Parks funding came from the general fund. Rather, it was noted that transfers from the general fund were used to supplement the Parks millage. The OAG stated that transfers from the general fund should be reassessed. Management appears to agree since budgeted general fund transfers to the Parks Division are being budgetarily reduced.

COMPONENT UNITS

Financial Assessment - Limited Review Report for the Wayne County Land Bank Corporation Financial Statements and Independent Auditor's Report for fiscal year ended September 30, 2009; Report Date: May 13, 2010; (Presented to Audit Committee May 25, 2010) DAP No. 2010-57-906.

- **Impact –** Without other sources of revenue, such reliance on the county's general fund could hamper Land Bank's ability to fulfill its mission and purpose if the county is unable to sustain its current level of support.

Views from responsible officials:

As stated before, Land Bank is a separate component unit of the County with a separate oversight board. The Commission has representation on this board that is aware of the progress of the Land Bank and should be communicating that information to his/her colleagues.

OAG Response:

The OAG reiterates its previous comments regarding economic development plans. The budget impact pointed out by the OAG is the general fund support of economic development plans without performance measures in place to allow the commission to monitor effectiveness of programs.

It should also be noted that the commission no longer has representation on the Land Bank board, as the Commissioner representing the county lost reelection and has not yet been replaced.

CONCLUSION

Views from responsible officials:

This document provides limited and in many cases erroneous and misleading information. It should NEVER (sic) been allowed to become a public document before it was reviewed by Management and Budget. Unlike most, if not all, OAG reports, management usually has chance to view, and rebut items/findings in the report that we believe is (sic) not factual. This report was never provided to management prior to its public release.

OAG Response:

It was requested in the budget appropriation language by Ways and Means for the OAG to prepare and present this report at their first budget hearing meeting. Since the CEO was late in presenting the budget this year, due to time constraints we were not able to meet with management and share this report before it was issued. The OAG believes this to be a valuable step in the reporting process, and we have informed management that future Budgetary Sensitive reports will be shared with them prior to being issued.