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**Auditor General**

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August 30, 2012

**FINAL REPORT TRANSMITTAL LETTER**

Honorable Wayne County Commissioners:

Enclosed is our final copy of the Office of Legislative Auditor General's Analysis of Accumulated Deficits Report. Our report is dated May 7, 2012; DAP No. 2012-57-003. The report was accepted by the Audit Committee June 21, 2012, and formally received by the Wayne County Commission on July 12, 2012.

We are pleased to inform you officials from the Department of Management and Budget 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

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**Wayne County Executive**



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**Executive Summary**

May 7, 2012 (Revised)

DAP No. 2012-57-003

Honorable Ilona Varga  
Chairwoman, Audit Committee  
Wayne County Commission  
County of Wayne  
500 Griswold Street, 7<sup>th</sup> Floor  
Detroit, MI 48226

Re: Analysis of Accumulated Deficits

Chairwoman Varga:

**Engagement Objective, Scope, and Methodology**

This is an analytical review engagement performed under Generally Accepted Government Auditing Standards (GAGAS) - Attestation Standards. It is being prepared to adhere to the Wayne County Charter Section 3.119 and Ordinance Section 65 related to financial solvency and perceived risks.

The purpose of this engagement is to identify perceived risks and assess the financial condition of the county as of September 30, 2011.

Our objective is to evaluate how county leadership is identifying, analyzing, monitoring, and adopting measures to address Wayne County accumulated deficits in three funds which comprise 87% of the overall deficits as of September 30, 2011.

The scope of this engagement is classified as a special report and is limited to an analytical analysis of the county-wide accumulated deficits as of September 30, 2011. This report is classified as a review under GAGAS - Attestation engagements.

Due to additional factual information coming to our attention, this report is a revision to a previous report issued by the Wayne County Legislative Auditor General's Office (OAG) dated April 18, 2012, regarding this subject matter. The fieldwork related to this engagement was substantially completed on or about May 7, 2012.

The methodology used for this engagement included observations, analytical procedures, inquiries, and discussions with Management & Budget (M&B) officials, as well as analyses of



financial data and review of other supporting documents to validate certain statements and conclusions reached in this report.

### **Observation**

Based on the Comprehensive Annual Financial Report (CAFR) for 2011, there is a county-wide accumulated deficit of \$155 million as of September 30, 2011. (See Appendix A for County-wide Unrestricted Accumulated Deficits – FY 2011).

The county-wide accumulated deficits decreased by \$119 million as of September 30, 2011. This was primarily due to the following: the 3<sup>rd</sup> Circuit Court decreased by \$63 million; General Fund decreased by \$12 million; Juvenile Justice Abuse and Neglect decreased by \$6 million; and Equipment Lease Financing Fund decreased by \$6 million; Law Enforcement by \$1 million; and, the elimination of the reserve of \$31 million reported in the General Fund.

We believe the total accumulated deficits of \$155 million can be attributed to three factors: (1) accounting standards which require a reserve to be set up in the general fund for accumulated deficits in other funds; (2) structural deficit spending; and, (3) approval of expenditures in excess of the amount appropriated.

The current Deficit Elimination Plan (DEP) Wayne County is operating under was approved by the commission on July 1, 2010, and the plan covers FY 2010 – 2014. According to the State Treasury, the plan is required to be amended if the deficit increases or the plan is not followed. Communication from M&B stated the plan is being amended because it “incorporates corrective action for prior years as well as any new deficits which occurred during FY 2010 and 2011.”

The commission approved a revised DEP on May 3, 2012, to be submitted to the State Treasurer for their acceptance and approval.

The Chief Executive Officer (CEO) needs to budget general fund resources of \$52 million annually over the next three years to liquidate the accumulated deficits of \$155 million if the county is to remain compliant with the FY 2010 – 2014 DEP approved by the State Treasury. However, if the State approves the revised plan through 2016, the amount that is needed to be set aside each year could be less than the \$52 million stated above.

### **General Fund**

The general fund reported a deficit of \$94 million (\$125 million -\$31 million, see page 12) for FY 2011, a decrease of \$12 million as compared to the previous year. This was primarily due to the following: a decrease in the amount required for reserving long term assets of \$46 million; 3<sup>rd</sup> Circuit Court write-off of \$43 million; an operating surplus of \$9 million; and an entry of \$31 million for the reporting of accumulate deficits in the general fund.

It is important to note, if the county did not have one time fixes, such as the use of the retirement equity fund to make the FY 2011 annual retirement contribution of \$26 million, and

was required to actually pay the Other Post-Employment Benefits (OPEB) obligation of \$8 million in FY 2011 associated with the absorption of the 3<sup>rd</sup> Circuit Court accumulated deficits, the general fund deficit would have actually increased by a net of \$25 million.

The audited financial statements report a total general fund balance deficit of \$81.8 million as of September 30, 2011. However, after reducing the fund balance for restricted reserves of \$46 million, the general fund unassigned fund balance deficit is actually \$127 million.

According to discussions with M&B officials and the external auditors, accounting principles required the deficit in the 3<sup>rd</sup> Circuit Court to be recorded twice for FY 2010 financial presentation purposes; once in the general fund and again in the 3<sup>rd</sup> Circuit Court, a separate unit of government. Management stated that as a result of the FY 2012 settlement of the lawsuit with the courts, there is no longer a necessity for the \$63 million reserve to be reported in the general fund.

During FY 2011, the County CEO adopted a policy of preparing a budget for the current year and a projected budget for the succeeding year. As a result of this policy change, the commission adopted a budget for FY 2011-2012 and a projected budget for 2012 - 2013. Soon the commission will be deliberating on adopting a budget for FY 2012 - 2013. Since the general fund is the payer of last resort, it is imperative that a realistic budget be adopted that has valid and achievable revenues to support departmental expenditures in order to prevent the accumulated deficits from increasing. See Appendix C for the CFO's full response to this concern.

### **3<sup>rd</sup> Circuit Court Fund**

The 3<sup>rd</sup> Circuit Court sued the county in October 2010 on the premise that the county has failed to adequately appropriate sufficient funds for the courts to properly operate.

The county reached a settlement with the 3<sup>rd</sup> Circuit Court on December 1, 2011. Based on the settlement agreement, the courts accumulated deficit was \$63 million of which \$55 million was absorbed by the general fund. The additional \$8 million was reported as a long term liability (i.e. OPEB) in the government-wide financial statements. However, since this amount had already been previously reserved by the general fund in FY 2010, it did not have a significant impact on the general fund balance in FY 2011.

The settlement agreement now requires the 3<sup>rd</sup> Circuit Court to be responsible for any future accumulated deficits it may incur. The 3<sup>rd</sup> Circuit Court ended the FY 2011 with a surplus of \$10 million resulting from the reporting of capital assets net of related debt. See Appendix C for the CFO's full response to this concern.

### **Juvenile Justice/Abuse & Neglect Fund**

The State of Michigan Public Act 280 of 1939, Child Welfare Act, requires 50% local funds to be used to match the State of Michigan Child Care Fund. The county operates the juvenile detention facility, and provides juveniles with youth assistance programs, case management, counseling, foster care, tutoring, and other services ordered by the court system.

This fund generated an operating surplus of \$5 million during the FY 2011, which resulted in decreasing the fund balance deficit from \$16 million to \$11 million as of September 30, 2011. See Appendix C for the CFO's full response to this concern.

### **Equipment Lease Financing Fund**

The Equipment Lease Financing Fund (ELF) is an internal service fund designed to be used to acquire capital assets with internal resources and charge its cost to the various funds as the assets are used rather than when acquired. The external auditors stated, "Normally, acquisition of capital assets should be recognized in a modified accrual fund as expenditures at the time of purchase, rather than as the asset is used."

The county makes loans through the ELF Fund with "pooled cash resources" from other county funds for capital acquisitions. The ELF received both principal and interest charges and those proceeds are used to repay the loan from pooled cash.

The ELF generated an operating surplus of \$1 million and received a transfer in of \$5 million from the general fund during the FY 2011. This reduced the deficit fund balance from \$36 million to \$30 million.

### **Chief Financial Officer (CFO) Authority**

The CFO is granted authority under Section 5.143 of the Wayne County Charter to only allow expenditures that are appropriated in the budget. Any expenditure made in excess of the amount appropriated is a violation of the Charter.

The CFO stated one of the obstacles in carrying out this mandate has been the proliferation of lawsuits filed by county elected officials to restrict the administration's efforts to reduce deficit spending.

### **Monthly Cash Needs**

Based on our review of several cash flow projections, it appears that the general fund needs approximately \$54.8 million to meet its monthly cash requirements, which approximates \$658 million annually. Conversely, the cash inflows approximate \$49.6 million on a monthly basis and \$596 million annually.

Based on our review of monthly cash flow projections, we determined that in some instances, expenditures exceeded revenue by as much as \$62 million on an annual basis.

### **County Structural vs Cyclical Deficits**

Wayne County's FY 2012 First Quarter Financial Report is projecting to end the year with a \$46 million deficit. This is an indicator that a structural deficit condition exists and will require greater efforts by the CEO and commission to eliminate the deficit(s), such as,

additional reductions in personnel costs, health benefits, fee increases, etc., as well as zero tolerance for budgetary overruns.

Eventually, the county will need to engage in county-wide business process re-engineering in order to address its structural deficits.

### **County Bond Rating**

A continuous decline in the bond rating is due, in part, to the amount of the accumulated deficits. The current bond ratings from two of the three rating agencies are at BBB+ which is one level above junk bonds.

Needless to say, this will probably mean it will cost more to borrow in the future. See Appendix C for the CFO's full response to this concern.

### **County Debt Limitation**

The county appears to be doing quite well in this category and if all else is equal it could conceivably borrow up to \$3.5 billion in instances where the full faith and credit of the county is pledged.

### **County Legacy Cost**

The increase in health care benefits and pension costs are alarming and demands county leadership place a greater emphasis on: economic development; methods to reduce the number of property foreclosures in Wayne County; and, the creation of more jobs in Southeastern Michigan.

### **Emergency Financial Manager Act**

M&B identified three of the 18 elements that could trigger a preliminary financial review of the county books and records by the State Treasurer. They are: (1) violating the budget act regarding expenditures exceeding budget; (2) ending the year in deficit positions; (3) breaching obligations under a deficit elimination plan. The OAG identified a fourth, (4) existence of other facts or circumstances indicative of financial stress, as determined by the State Treasurer. (See Appendix B for a full explanation of the EFM Act).

However, it is important to note that any one the 18 triggers could prompt the State Treasury to conduct a preliminary review for financial problems. See Appendix C for the CFO's full response to this concern.

### **Suggested Action**

Since this is an attestation review engagement intended to assess the financial condition of the county, the OAG will not request a corrective action plan for this engagement. However, we would like to suggest the following actions be considered by management:



1. The CFO should immediately establish the Fiscal Stabilization Restoration Fund in FY 2012 and fund it for the \$11.5 million identified as general fund appropriations based on the recently amended DEP being submitted to the State Treasurer.
2. There are five months remaining in FY 2012 and based on the first quarter projections, there is an annual operating deficit of \$46 million in the general fund. Since the amended DEP was filed based on the deficits as of September 30, 2011, it is imperative that deficits in FY 2012 do not increase beyond the \$155 million requested for approval in the amended plan submitted to the State Treasurer for approval.
3. Revenues in the general fund must be realistically projected by the administration and analyzed and approved by the commission for the FY 2013 budget.
4. In order to address the structural deficit problem in FY 2013 budget priorities should be identified and established based on defined criteria for core services.
5. The county spends on average in excess of \$1.5 billion in contracts on an annual basis. Request concessions from vendors – place them into four tier groups – request 20% for vendors with contracts in excess of \$50 million; 15% concession for those with contracts in excess of \$25 million; 10% for those with contracts in excess of \$12 million, and 5% for those with contracts in excess of \$5 million.

### **Views from Responsible Officials**

The CFO provided a detailed response to the comments and observations being raised in this report and in some instances provided a plan of action going forward. For a detailed narrative of her responses see – Appendix C – Views from Responsible Officials.

### **Conclusion**

This report reviewed the fund balances in several of the Wayne County funds to gain a better understanding as to what are some of the main contributing factors that have led to mounting deficits in three of the county-wide funds: General Fund, Juvenile Justice/Abuse and Neglect Fund, and the Equipment Financing Leasing Fund. These funds comprise 87% of the accumulated deficits as of September 30, 2011.

As a result of the settlement of a lawsuit, the 3<sup>rd</sup> Circuit Court ended the year with a \$10 million positive fund balance due to investment in capital assets net of related debt.

Our report determined that the accumulated deficits county-wide decreased from \$274 million to \$155 million as of September 30, 2011. This is a \$119 million reduction in the county-wide deficits.

The county has a policy that recommends a surplus of \$20 - \$100 million for the general fund balance, which is crucial in order to provide a reserve for unexpected events. In addition, credit rating agencies monitor the levels of fund balances and unrestricted fund balances in a

government general fund when evaluating an organization's continued credit-worthiness.

Based on inquiries and discussions with M&B, it has been determined that Wayne County meets four of the 18 elements that could trigger a preliminary review by the State Treasury.

If county leadership fails to develop and execute a plan to eradicate the deficits, it will leave the State of Michigan no choice but to send a review team to assess if a financial emergency exists and recommend the Governor seek remedial action under Public Act 4 or impose some other sanctions on the county.

FY 2012 – 2013 holds many promising possibilities and it is important for the Commission to employ a couple of tools in their toolbox - the deficit elimination ordinance and the approval\adoption of the annual budget. In order to restore fiscal sustainability now is the time for those tools to be put to good use. Commission leadership must ensure that the budget expenditures for FY 2012 - 2013 are tied to realistic revenue projections submitted by the CEO.



## **Detail Report**

## **Purpose**

This special report is being prepared to adhere to the Wayne County Charter Section 3.119 and Ordinance Section 65 that require the Auditor General to perform engagements under Generally Accepted Government Auditing Standards (GAGAS) as it relates to the financial solvency and the perceived risks and challenges Wayne County could be facing.

The purpose of this engagement is to identify perceived risks and assess the financial condition of the county as of September 30, 2011.

## **Objective**

The objective of this engagement is to evaluate how county leadership is identifying, analyzing, monitoring, and addressing the accumulated deficits in three funds which comprise 87 percent of the total accumulated deficits.

## **Scope**

The scope of this engagement is classified as a special report and is limited to an in-depth analysis of information contained in the 2011 Comprehensive Audited Financial Report (CAFR) as it related to accumulated fund balance deficits. (See Appendix A - Schedule of Accumulated Deficits). This report is classified as a review under GAGAS - Attestation engagements.

Due to additional information coming to our attention, this report is a revision to a previous report issued by the Wayne County Legislative Auditor General's Office (OAG) dated April 18, 2012, regarding this subject matter. The fieldwork related to this engagement was substantially completed on or about May 7, 2012.

## **Methodology**

The methodology used for this engagement is based on observations, analytical procedures, inquiries, and discussions with M&B officials, as well as a review of audited financial data and other supporting documents to validate certain statements and conclusions reached in this report.

## **Observation**

The county-wide accumulated deficits decreased by \$119 million as of September 30, 2011. This was primarily due to the following: the 3<sup>rd</sup> Circuit Court decreased by \$63 million; General Fund decreased by \$12 million; Juvenile Justice Abuse and Neglect decreased by \$6 million; Equipment Lease Financing Fund decreased by \$6 million; a decrease of \$1 million for the Law Enforcement Fund; and, an adjustment of \$31 million for duplicate reporting of accumulated deficits in the general fund.

According to discussions with M&B officials and the external auditors, accounting principles required the deficit in the 3<sup>rd</sup> Circuit Court to be recorded twice for financial presentation purposes; once in the general fund and again in the 3<sup>rd</sup> Circuit Court which is a separate unit of government. However, now that there is a settlement of the lawsuit with the courts, there is no longer a need for the \$63 million reserve to be reported in the general fund.

In addition, as a result of new accounting standards, the county was required to implement GASB #54 for the FY 2011, which required the fund balances for reporting purposes to be reclassified.

The classification of the new fund balances are: non-spendable, unassigned, committed, assigned, and restricted. These GASB #54 reclassifications increased the fund balance in the general fund by \$2 million as of September 30, 2010. This was principally due to the reclassification of the Budget Stabilization and Nuisance Abatement Funds from special revenue funds to the general fund by retroactively restating the beginning fund balance which was consistent with GASB #54 standards.

Our report reviews the accumulated deficit balances in the following funds, which in aggregate are \$135 million or 87% of the total county-wide deficits of \$155 million at September 30, 2011: General Fund \$94 million (\$125 -31 million) ; Juvenile Justice\Abuse & Neglect Fund \$11 million; and, the Equipment Lease Financing Fund (ELF) Fund \$30 million. As a result of the lawsuit settlement, the 3<sup>rd</sup> Circuit Court ended the year with a \$10 million positive fund balance due to investment in capital assets net of related debt.

Based on our analysis of the accumulated deficits, we attribute the accumulated deficits over the last several years to three factors: (1) accounting standards which require a reserve to be setup in the general fund for accumulated deficits in other funds; (2) structural deficit spending; and, (3) approval of expenditures in excess of the amount appropriated.

As a result of GASB #54, the State of Michigan recently issued a new directive on how to determine deficits and it defines an unrestricted fund balance as the sum of committed, assigned and unassigned balances. It states an unrestricted fund balance deficit exists when the local unit does not have sufficient resources available to cover the deficit in these three categories.

It further states a Deficit Elimination Plan (DEP) should be for one year, but no more than five years. It emphasizes that a DEP is required to be filed as soon as possible after the close of its fiscal year end. It also allows the option for a plan to be filed prior to or concurrent with the submission of the local unit's audit report to Treasury. Failure to follow the DEP could result in sanctions being imposed by the State on the county.

The current DEP Wayne County is operating under was approved by the commission on July 1, 2010, and the plan covers FY 2010 – 2014. According to the State Treasury, the plan is required to be amended if the deficit increases or the plan is not followed. Communication from M&B stated the plan is being amended because it “incorporates corrective action for prior years as well as any new deficits which occurred during FY 2010 and 2011.”

The commission approved a revised DEP on May 3, 2012, to be submitted to the State Treasurer for their acceptance and approval.

In a recent communication from the CFO to the commission it states “that the county for FY 2010 and 2011 has established a Deficit Elimination Reserve Account and has redirected \$21.4 and \$24.5 million, respectively, have been set aside exclusively for deficit elimination.”

Based on a schedule provided by M&B – the administration is meeting the county’s obligation to fund the DEP plan based on the plan approved by the State of Michigan for the period – October 1, 2009 – September 30, 2014.

	(In Millions)		
	<u>2009</u>	<u>2010</u>	<u>2011</u>
Actual Funding of DEP	\$6.9	\$35.9	\$28.6
Required Funding of DEP	<u>2.9</u>	<u>8.6</u>	<u>24.0</u>
Excess Funding of DEP	<u>\$4.0</u>	<u>\$27.3</u>	<u>\$4.6</u>

We also were informed by M&B that a separate DEP reserve account is not set up in the general ledger; therefore, it is difficult to readily identify how appropriated funds are actually being applied to the DEP. However, M&B has stated to the commissioners that going forward, a separate account referred to as the Fiscal Stabilization Restoration Fund will be setup to provide transparency and accountability as to how funds are being applied toward the DEP in the future.

The CEO needs to budget general fund resources of \$52 million annually over the next three years to liquidate the accumulated deficits of \$155 million by FY 2014 based on the plan that was previously approved by the State Treasury. However, if the State approves the revised plan through 2016, the amount that is needed to be set aside each year could be less than the \$52 million stated above.

### **General Fund**

The general fund unrestricted fund balance for FY 2010 was restated and now reflects an accumulated deficit of \$137.4 million. Fiscal Year 2011 has an accumulated deficit of \$124.9 million as of September 30, 2011. The general fund ended fiscal year 2011 with an operating surplus of \$9 million.

It is important to note, if the county did not have one time fixes such as, the use of the retirement equity fund to make the FY 2011 annual retirement contribution of \$26 million, and was required to actually pay the OPEB obligation of \$8 million in FY 2011 associated with the absorption of the 3<sup>rd</sup> Circuit Court accumulated deficits, the general fund deficit would have actually increased by a net of \$25 million (\$26 + 8 million - \$9 million).

Below is an analysis of the changes in the general fund unrestricted deficit balance for FYs 2009 – 2011. The increase in the general fund from FY 2009 through 2011 was due to the following:

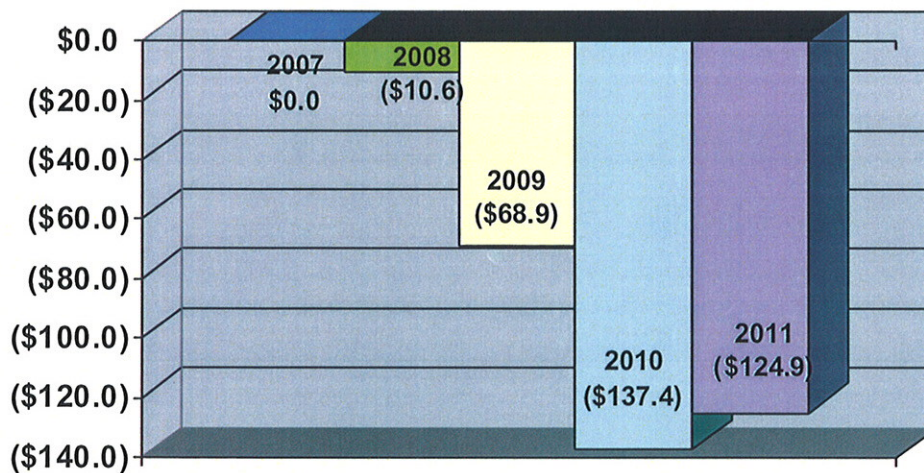
**Analysis of the General Fund Activity**  
**Fiscal Years 2009-2011**  
**(In Millions)**

Analysis	2009	2010	2011
Opening beginning balance – deficit	\$10.6	\$68.9	\$137.4
Increase (decrease) in long term assets reserve (1)	36.9	11.6	(46.5)
Operating losses (Income) (2)	18.6	33.3	( 9.1)
Prior Period adjustments (3)	-	23.6	43.0
GASB #54 Reclassifications	-	(2.2)	-
Changes in other reserve balances	2.8	2.2	.1
<b>Total</b>	<b>\$68.9</b>	<b>\$137.4</b>	<b>\$124.9</b>
Less Accumulated Deficits Reserves			( 31.0)
Total Reconciled Accumulated Deficit – General Fund			<b>\$ 93.9</b>

Footnotes

- (1) Deficits in other funds, such as the Courts, ELF, and Juvenile Justice are set up as reserves in the general fund because it is considered the payer of last resort. In accordance with GAAP, this treatment results in these obligations being reported twice.
- (2) Annual operating loss (income) based on the FY 2011 CAFR.
- (3) FY 2010 - prior period adjustment for estimated uncollectible property taxes. FY 2011 - \$43 million charge-off of debt related to the 3<sup>rd</sup> Circuit Court.

**General Fund**  
**Unrestricted Deficits – FY 2007 – 2011**  
**(In Millions)**



Source: The Wayne County CAFR and budget book

The CFO informed us that there is a projected annual operating deficit of \$46 million expected for the general fund for the FY 2012. The budget director stated that at the end of the first quarter of each year, departments with operating deficits are required, within 10 days after the end of the quarter, to submit a DEP to M&B.

According to the Wayne County Enrolled Ordinance 2010-515: “a department or office with a projected deficit shall develop and submit a DEP, in line-item form, to the commission and the CEO within seven (7) business days of receipt of written notice from M&B.”

M&B has a draft copy of a policy entitled “Fund Balance” which states the “County will maintain an unrestricted fund balance of at least 5% of annual expenditures but no more than 20%.” Mathematically, this policy targets the unrestricted general fund balance between \$20 and \$100 million at the end of any given year.

It may be more difficult for the general fund to remain compliant with the Fund Balance policy because they are the payer of last resort and are required to reserve for deficits in all of the other county-wide funds.

A review of the first quarter statement of revenues and expenditures report prepared by M&B for FY 2012 is estimating a \$46 million annual operating deficit in the general fund. This amount does not include deficits that may be required to be reserved in the general fund at year end.

According to recent newspaper articles, the city of Detroit has an accumulated deficit of \$265 million and has been declared a financially distressed municipality by the State of Michigan. The accumulated deficits in Wayne County are comparable to those at the city of Detroit and could very well impact the county’s ability to remain solvent in the future if immediate corrective action is not taken.

The audited financial statements report a total general fund balance deficit of \$81.8 million as of September 30, 2011. However, after reducing the fund balance for restricted reserves of \$46 million, the general fund unassigned fund balance deficit is actually \$127 million.

During FY 2011, the county CEO adopted a policy of preparing a budget for the upcoming fiscal year and a projected budget for the subsequent year. As a result of this policy change, the commission adopted a budget for FY 2011- 2012 and a projected budget for 2012 - 2013. Since the general fund is the payer of last resort, it is imperative that a realistic achievable budget be adopted for FY 2012- 2013.

### **3<sup>rd</sup> Circuit Court Funds**

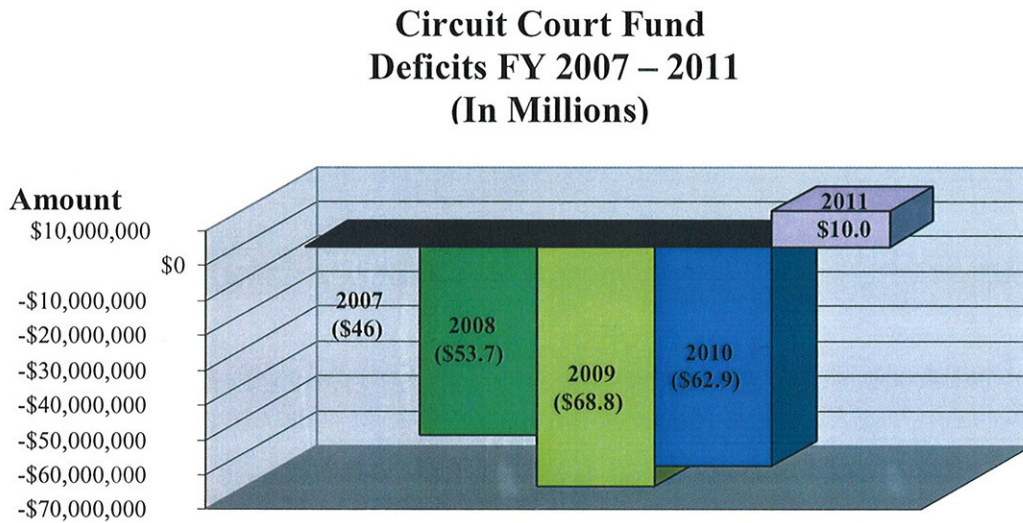
The 3<sup>rd</sup> Circuit Court sued the county in October 2010 on the premise that the county has failed to appropriate enough funds for the courts to properly operate.

The county reached a settlement with the 3<sup>rd</sup> Circuit Court on December 1, 2011.

As a result of the settlement, the court’s accumulated deficits of \$63 million, of which \$55



million was absorbed by the general fund, and \$8 million reported in long term liabilities (i.e. OPEB) in the government-wide financial statements. However, since this amount had already been previously reserved by the general fund in FY 2010, it did not increase the deficit in the general fund balances as of September 30, 2011.



**Source:** The Wayne County CAFR and budget book.

In keeping with past practices, the county has elected to continue reporting the courts as a discretely presented component unit, as opposed to being blended with the general fund as recommended by the external auditors.

Some of the more significant points regarding the court settlement agreement are: (1) the court is to receive a quarterly allotment deposited into its own bank account; (2) the court is to receive approximately \$65 million annually for the next five years; and, (3) the county is to provide a consolidated court facility which may include the refurbishing of Frank Murphy Hall of Justice.

As of September 30, 2011, the court has a \$10 million positive fund balance and under the settlement agreement, they are responsible for a DEP to eliminate any future deficits. The \$10 million of positive fund balance in the courts is due to investment in capital assets net of related debt.

### **Juvenile Justice/Abuse and Neglect Fund**

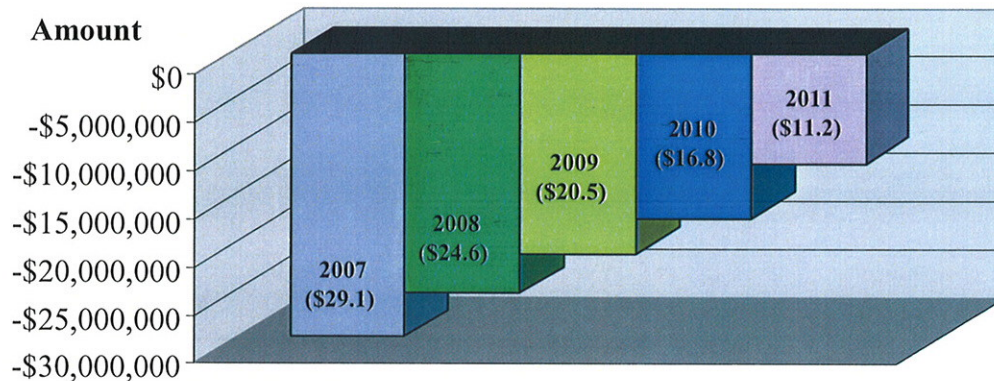
The purpose of the Juvenile Justice/Abuse and Neglect Fund is to account for the cost of providing required foster care and/or residential care to abused, neglected, and delinquent children in the county, including county residents who become wards of the State of Michigan.

The State of Michigan Public Act 280 of 1939, Child Welfare Act, requires 50 percent of local funds to be used to match the State of Michigan Child Care Fund. The county operates the



juvenile detention facility, and provides juveniles with youth assistance programs, case management, counseling, foster care, tutoring, and other services ordered by the court system. This fund balance is classified as restricted because a state public act restricts its use.

### Juvenile Justice / Abuse & Neglect Fund Deficits FYs 2007 – 2011 (In Millions)



Source: The Wayne County CAFR and budget book.

As illustrated by the graph above, this fund deficit is decreasing each year. The deficit is \$11.2 million as of September 30, 2011. The 2010 – 2014 DEP states the deficit in this fund will be eliminated by implementing operating efficiencies as well as an annual supplemental general fund appropriation to this fund through 2014. This fund generated a \$5 million dollar surplus for the FYE 2011.

It appears this fund is compliant with the DEP and the deficit will be eliminated in the near future.

### Equipment Lease Financing Fund

The Equipment Lease Financing Fund (ELF) is an internal service fund and designed to be used to acquire capital assets with internal resources, and charge its cost to the various funds as the assets are used rather than when acquired. The external auditors stated “normally, acquisition of capital assets should be recognized in a modified accrual fund as expenditures at the time of purchase, rather than as the asset is used.”

The county makes loans through the ELF Fund with “pooled cash resources” from other county funds for capital acquisitions. The ELF received both principal and interest charged and those proceeds are used to repay the loan from pooled cash.

According to the OAG audit report entitled “Wayne County Equipment Lease Financing Fund - Operational Audit – dated May 14, 2004”, the county used the ELF Fund to expend \$50 million for the land acquisition and development for the Pinnacle AeroPark Project. This loan is being repaid over a 15 year period at \$2.6 million annually.

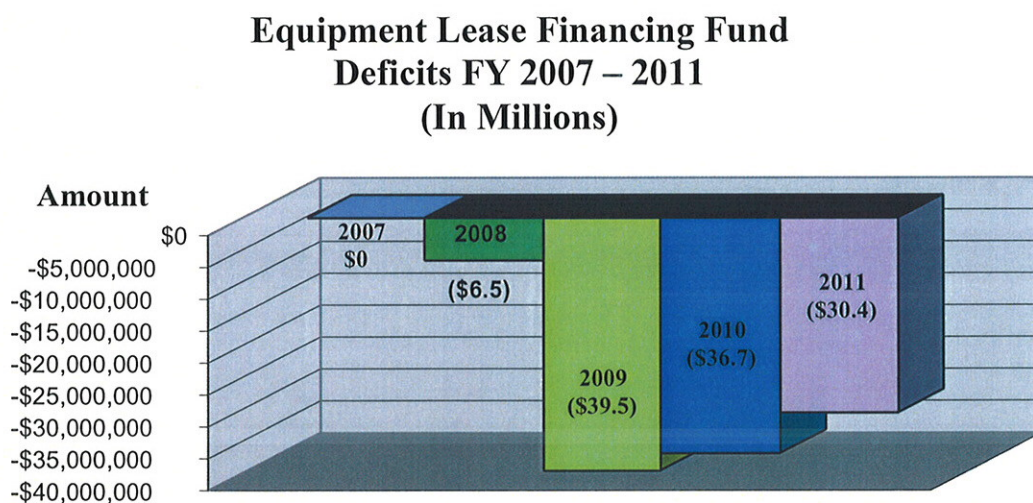
The ELF Fund was also used to acquire the two county golf courses in September 2002. This loan is being repaid over 30 years at an annual lease payment of \$728 thousand.

The accumulated deficit in the ELF fund is primarily due to certain acquisitions by the ELF fund: (1) Pinnacle AeroPark Project land acquisitions for \$50 million in May 1999; and two county golf courses acquired for \$14 million in September 2002.

The original source of these acquisitions that occurred in earlier years was loans from the Delinquent Tax Revolving and Worker's Compensation Funds. M&B reclassified the amounts as a reserve in FY 2009 audit report because the amounts would not repaid within one year.

In addition, the external auditors take exception to the accounting treatment of transactions related to general fund acquisitions. They suggest those assets should be fully expensed at the time of purchase rather than being charged as the asset is used.

The ELF has an accumulated deficit of \$30 million as of September 30, 2011. The chart below represents a five-year trend analysis for comparison purposes.



Source: The Wayne County CAFR and budget book.

According to the 2010-2014 DEP the administration states the deficit will be eliminated by adjusting internal debt service by \$500,000 annually.

The ELF generated an operating surplus of \$1 million and received a \$5 million transfer in from the general fund during FY 2011 that reduced the deficit fund balance from \$36 million to \$30 million.

### **CFO Authority**

The CFO is granted authority under Section 5.143 of the Wayne County Charter to only allow expenditures that are appropriated in the budget, and that expenditures made in excess of the



amount appropriated, is a violation of the Charter.

Based on a discussion with the CFO, it was stated that whenever attempts have been made to control department expenditures, such as the Sheriff and 3<sup>rd</sup> Circuit Court, they have filed litigation to stop such action, and often times they have won lawsuits to block the CEO's effort to control costs.

From a legal viewpoint, a closer review of the decisions made by the courts in the above referenced litigations now provides case law for the administration to revise its strategy in order to assist them in accomplishing the mandate as stated in Section 5.143 of the Charter.

In addition, Section 5.414 – Budget Execution of the Charter - compiler's comments states: "an administrative officer may be sued to recover costs of an unauthorized expenditure."

According to the CFO, she believes a unified effort by commission and administration, as well as the adoption of the long range strategic plan introduced by M&B a couple of years ago, would bring about some positive results in limiting expenditures made in excess of the budget.

### **Monthly Cash Needs**

Based on our review of December 2011 cash flow projections, the general fund need approximately \$54.8 million to meet its monthly cash requirements, which approximate \$658 million annually. Conversely, the cash inflows are approximately \$49.6 million on a monthly basis and \$596 million annually.

Consequently, cash outlays are exceeding expenditures by approximately \$5.2 million on a monthly basis and \$62.4 million annually. Needless to say, unless strategies are implemented to reduce the structural deficits, the general fund will continue to accumulate deficits of \$60 million or more on an annual basis.

On the other hand, exploring methods to minimize the cash requirement outlay by \$10 million per month, could minimize the necessity for short-term borrowing and generate an operating surplus of \$60 million annually.

### **County Structural vs. Cyclical Deficit**

Our research states a governmental agency's deficit can be thought of as consisting of two elements, structural and cyclical.

A structural deficit is the deficit that remains across the business cycle (year to year), because the general level of government spending is too high for the prevailing tax levels or general collections.

A cyclical deficit has more to do with a decline in economic conditions and the expectation is that an upswing in the economy will produce a surplus in the very near future that will eliminate the deficit(s).

Customarily, during the period of a cyclical deficit, the governmental unit borrows money (issues short-term bonds, etc.) and repays it during the upswing period. Conversely, a structural deficit exists even when the economy is healthy. Structural deficits are usually

addressed by explicit and direct government policies, such as improvement to technology or downsizing. It can be described as more “chronic” or long-term in nature, hence needing government action to remove it.

M&B is projecting a general fund operating deficit of \$46 million for the first quarter of FY 2012. This further validates the point that a structural deficit condition exists and will require greater efforts by the CEO and Commission to eliminate the deficit(s), such as additional reductions in personnel costs, health benefits, fee increases, etc., as well as zero tolerance for budgetary overruns.

In essence, county leadership need to reorganize county government business processes and concentrate on only providing mandated services going forward.

### **County Bond Rating**

According to a recent communication from the bond rating agencies, the 3rd Circuit Court and accumulated deficits are the biggest challenge facing the financial stability of Wayne County. Fitch downgraded the county’s bond rating in December 2010 and expressed the following concerns:

According to Senior Officials - a recent quote from Fitch’s rating agency stated:

“Wayne County’s financial stability has been severely reduced in recent years, and it continues to face ongoing challenges to fund accumulated deficits in funds outside the general fund, particularly those in the Juvenile Justice and Circuit Court funds”.

“While Wayne County has made progress in reducing the accumulated deficit in the Juvenile Justice Fund, the deficit in the Circuit Court has proven more difficult to contain. Management’s attempt to rein in the Circuit Court cost is further hindered by a recent adverse court decision mandating the hiring of 110 additional Circuit Court employees, estimated to cost an additional \$10 million per year, and obligating the county to fund capital improvements to court facilities.”

According to Senior Officials – a recent quote from the Standard & Poor’s rating agency stated:

“Debt service on the county’s outstanding general obligation debt is secured by the county’s limited tax pledge and payable from all operating funds, which are subject to levy limits. The downgrade to the Baa2 rating reflects the county’s ongoing financial stress evidenced by a sizeable deficit general fund balance following a significant operating shortfall in the fiscal 2010.”

“In addition, the county’s liquidity is severely strained, as evidenced by a substantial deficit position in the county’s unreserved general fund balance. The deficit is unlikely to be eliminated in a timely manner and has forced the county to rely on the issuance of tax anticipation notes to support operational cash flow. The rating also incorporates persistent economic challenges that have continued

to impact the State of Michigan (general obligation rated Aa2/stable outlook) and, most metropolitan regions of the city of Detroit (Ba3/under review for possible downgrade).”

### **The Current Bond Rating for the County:**

The EFM act identifies bond ratings as one of the conditions that could trigger an EFM. It states that another factor which could trigger an EFM is “long-term rating within or below BBB category or equivalent.” According to M&B below are the county bond ratings for the most recent five year period:

#### **Wayne County Bond Rating FY 2007 – FY 2011**

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
<b>S&amp;P</b>	A	A	A	A-	BBB+
<b>Moody's</b>	A3	A3	Baa2	A3	Baa2
<b>Fitch</b>	N/A	A	BBB+	A-	BBB+

Continuous declines in the bond ratings are due, in part, to the magnitude of accumulated deficits. The current bond ratings for two of the three rating agencies are at BBB+ which is one level above junk bonds. As a result of this, it may mean it could cost more to borrow in the future.

### **County Debt Limitation**

The State constitution limits the county’s borrowing to 10 percent of its state equalized valuation (SEV) when the pledging of the full faith and credit of the county is involved. Based on calculations in the budget book the county currently has borrowings of \$1.1 billion and can legally borrow up to an additional \$3.5 billion of indebtedness pledging the full faith and credit of the county.

### **County Legacy Cost**

Wayne County has been burdened with legacy costs for a number of years. Legacy costs are defined as those costs associated with an institution paying increased healthcare fees and other benefits-related costs for current and retired pensioners. Generally, escalating legacy costs are a contributing factor toward limiting an organization’s ability to survive. Such was the case most recently with the automobile industry.

Research studies have demonstrated it is the larger, older, more established organizations that have problems with spiraling legacy costs, because their work force are generally older, and pension and healthcare obligations are higher. As a result, the continued effort by county leadership to explore means to lower legacy costs is essential to our survival.

One example of this can be seen with the adoption of the State of Michigan's mandate requiring municipalities to compel their employees to pay a larger share of their healthcare benefits. Another is changes to retirement plans from defined-benefit plans to the defined-contribution plans.

The Defined Benefit plan requires funding by the county and the schedule below reports the annual required contributions made to the Wayne County Defined Benefit Contribution plan over the last five years and funding ratio.

Year	Contribution	Funded Ratio
<b>2007</b>	\$15,398,000	89%
<b>2008</b>	18,420,000	81%
<b>2009</b>	32,559,000	74%
<b>2010</b>	35,401,000	67%
<b>* 2011</b>	39,666,000	60%

\* \$26 million of the pension contribution in FY 2011 was made from the 13<sup>th</sup> check.

The CFO is projecting pension cost to escalate from \$67 million to \$77 million by 2016, and healthcare benefits to increase from \$80 million to \$122 million over the same period. Even though there are major concessions being imposed by the State of Michigan and county to reduce healthcare cost, one cannot help but believe the sharp increases in county healthcare cost is also attributed to Other Postemployment Benefit Cost (OPEB).

The increase in healthcare benefits and pension costs are alarming and demand(s) county leadership to place a greater emphasis on revenue enhancement to offset these costs through: (1) economic development; (2) methods to reduce the number of property foreclosures in Wayne County; and, (3) stimulus incentives to create more jobs in Southeastern Michigan.

### **Emergency Financial Manager Act**

The State of Michigan recently passed a new Emergency Financial Manager Act (EFM). This Act now grants additional powers to the State of Michigan over municipalities that have excessive accumulated deficits. See Appendix B - Schedule of Items that will trigger the Appointment of an Emergency Financial Manager.

In discussions with the CFO, we were informed that the county meets three of the 18 triggers that could prompt the appointment of an emergency financial manager by the State of Michigan, while the OAG identified a fourth. However, it is important to note that any one of the 18 triggers could prompt the State Treasury to conduct a preliminary review for financial problems.

The three trigger points identified by M&B are: (1) violating the budget act regarding expenditures exceeding budget; (2) ending the year in deficit positions; (3) breaching obligations under a deficit elimination plan; and the fourth identified by the OAG, (4) existence of other facts or circumstances indicative of financial stress as determined by the State Treasurer.

### **Suggested Action**

Since this is an attestation review engagement intended to assess the financial condition of the county, the OAG will not request a corrective action plan for this engagement. However, we would like to suggest the following actions be considered by management:

1. The CFO should immediately establish the Fiscal Stabilization Restoration Fund in FY 2012 and fund it for the \$11.5 million identified as general fund appropriations based on the recently amended DEP being submitted to the State Treasurer.
2. There are four months remaining in FY 2012 and based on the first quarter projections there is an annual operating deficit of \$46 in the general fund. Since the amended DEP was filed based on \$155 million accumulated deficits as of September 30, 2011, it is imperative that deficits in FY 2012 do not increase beyond the \$155 million requested for approval in the amended plan submitted to the State Treasurer for approval.
3. Revenues in the general fund must be realistically projected by the administration and analyzed and approved by the commission for the FY 2013 budget.
4. In order to address the structural deficit problem in FY 2013, budget priorities should be identified and established based on defined criteria for core or mandated services.
5. The county spends on average in excess of \$1.5 billion in contracts on an annual basis. Request concessions from vendors – place them into four tier groups – request 20% for vendors with contracts in excess of \$50 million; 15% concession for those with contracts in excess of \$25 million; 10% for those with contracts in excess of \$12 million, and 5% for those with contracts in excess of \$5 million.

### **Views from Responsible Officials**

The CFO provided her views and assessments of the report contents, and in some instances, also provided a plan of action going forward. For a detailed narrative of her responses, See – Appendix C – Views from Responsible Officials.

### **Conclusion**

This report reviewed the fund balances in several of the Wayne County funds to gain a better understanding as to what are some of the main contributing factors that have led to mounting deficits in three of the county-wide funds: General Fund, Juvenile Justice/Abuse and Neglect Fund, and the Equipment Lease Financing Fund. These funds make up 87% of accumulated deficits as of September 30, 2011.



As a result of the settlement of a lawsuit the 3<sup>rd</sup> Circuit Court ended the year with a \$10 million positive fund balance resulting from capital assets net of related debt.

Our report determined that the accumulated deficits county-wide decreased from \$274 million to \$187 million as of September 30, 2011. This is a \$119 million reduction in the county-wide deficits.

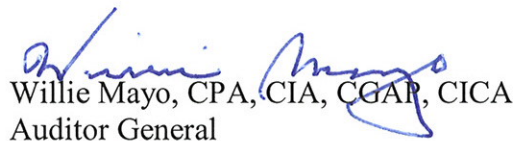
The county has a policy that recommends a surplus of \$20 - \$100 million for the general fund balance which is crucial in order to provide a reserve for unexpected events. In addition, credit rating agencies monitor the levels of fund balances and unrestricted fund balances in a government general fund when evaluating an organization's continued creditworthiness.

Based on inquiries and discussions with M&B, it has been determined that Wayne County meets four of the 18 elements that could trigger a preliminary review by the State Treasury.

If county leadership fails to develop and execute a plan to eradicate deficits, it will leave the State of Michigan no choice but to send a review team to assess if a financial emergency exists and recommend the governor seek remedial action under Public Act 4 or impose some other sanctions on the county.

FY 2012 – 2013 holds many promising possibilities and it is important for the commission to employ a couple of tools in their toolbox - the deficit elimination ordinance and the approval/adoption of the annual budget. In order to restore fiscal sustainability now is time for those tools to be put to good use. Commission leadership must ensure that the budget expenditures for FY 2012 - 2013 are tied to realistic revenue projections submitted by the CEO.

Respectfully submitted,

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

Appendix A  
Schedule of Fund Deficits

**County-wide Unrestricted Accumulated Deficits - FY 2011**

<b>Description by Fund</b>	<b>Fund Deficits 9/30/2011</b>	<b>Fund Deficits 9/30/2010</b>	<b>Increase/(Decrease)</b>
General Fund	\$124,953,000	\$137,447,000	\$ (12,494,000)
Health & Human Services	1,919,000	-	1,919,000
Juvenile Justice/Abuse & Neglect	11,255,000	16,886,000	(5,631,000)
Law Enforcement	1,886,000	3,401,000	(1,515,000)
Drug Enforcement	1,088,000	854,000	234,000
Nutrition	832,000	-	832,000
Community & Economic Development	1,742,000	-	1,742,000
Nuisance Abatement	-	1,597,000	(1,597,000)
Central Services	918,000	907,000	11,000
Department of Environment	14,000	135,000	(121,000)
General Liability	561,000	-	561,000
NE Sewage Disposal System	1,847,000	472,000	1,375,000
CSO Basins	-	213,000	(213,000)
Copy Center	586,000	818,000	(232,000)
Community Development Block Grants	-	524,000	(524,000)
E&ND 21st Century	-	1,593,000	(1,593,000)
Pinnacle Aeropark	-	286,000	(286,000)
Equipment Lease Financing	30,444,000	36,749,000	(6,305,000)
Building and Ground Maintenance	5,962,000	5,847,000	115,000
Circuit Court		62,944,000	(62,944,000)
Probate Court	1,711,000	366,000	1,345,000
Reg. Jobs Econ. Growth Fund	47,000	37,000	10,000
Brownfield Authority (BRA)	25,000	132,000	(107,000)
Land Bank	-	187,000	(187,000)
Rouge Valley Sewage Disp. Sys.	890,000	2,918,000	(2,028,000)
<b>General fund Reserves</b>	<b>(31,447,000)</b>	<b>-</b>	<b>(31,447,000)</b>
<b>Totals</b>	<b>\$155,233,000</b>	<b>\$274,313,000</b>	<b>\$ (119,080,000)</b>

## Appendix B

### Schedule of Items that will Trigger the Appointment of an Emergency Financial Manager

# THE NEW EFM ACT – MAKING SENSE OF THE PROCESS

Prepared by Plante & Moran, PLLC  
March 18, 2011

**OUR CLIENTS** are understandably anxious about the provisions of the new Local Government and School District Fiscal Accountability Act (commonly referred to as the EFM Act) and the related potential impact on their organizations. The best first step is always education. Bits and pieces of the legislation have been reported on in the media. Having a full understanding of the triggers that may lead to a review and understanding the resulting review process is key to determining what impact, if any, this Act will have on your entity. To that end, we have summarized the provisions of the EFM Act that was passed on March 16, 2011.

If you have any concerns at all about being impacted by the new provisions, we encourage you to answer the following questions:

1. Do we have our financial house in order? Do we know where we stand?
2. Do any of the 18 triggers listed below apply to us?
3. Can we develop a practical plan to deal with these items?
4. Have we fully documented how these new plans will pay off in the long-run?
5. Have we prepared a long-range forecast to determine if new triggers will be set off in the near future?

Knowing where you stand in terms of your structural deficit, implementing plans to address the issues and fully documenting your

game plan will help you now and will go a long way later if a review is ever initiated.

**Background** — House Bill 4214 repeals Public Act 72 of 1990 — the existing Local Government Fiscal Responsibility Act. Legislators felt this amendment was necessary in order to protect the health, safety and welfare of the citizens that may be adversely affected by insolvency of local governments and school districts. Fiscal solvency is necessary to protect the credit of the state and its political subdivisions.

To date, seven Michigan communities have had emergency financial managers appointed under Public Act 72 of 1990:

- Hamtramck — 2000
- Highland Park — 2001
- Flint — 2002
- Village of Three Oaks — 2008
- Ecorse — 2009
- Pontiac — 2009
- Benton Harbor — 2010

Additionally, a financial manager was appointed for the Detroit Public School District in 2009.

## Preliminary Review to Determine Financial Problem

For a municipal government, the State Treasurer could conduct a preliminary review for financial problems, if one or more of the following 18 events occurred:

1. Review requested by governing body/chief administrative officer
2. Review requested by a creditor under certain conditions
3. Petition received, signed by at least 5 percent of the total votes cast in that jurisdiction for last gubernatorial election
4. Failure to timely contribute required contributions to the pension plan
5. Payless paydays or not paying retirees (seven-day window)
6. Bond or note default or violation of covenants
7. Senate or House resolution requesting a review
8. Revenue Bond or Revised Municipal Finance Act violations
9. Local Emergency Financial Assistance Loan Board order violations

10. Violating the budget act section regarding expenditures not exceeding budget
11. Failing to file a timely, conforming annual audit
12. Delinquencies in distribution of taxes collected for other jurisdictions
13. Breaching obligations under a deficit elimination plan
14. A court ordered a tax levy without the prior approval of the governing body
15. Ending the year in a deficit condition or not filing a deficit elimination plan
16. School specific — ending its most recently completed fiscal year with a deficit without submitting a deficit elimination plan within the required timeframe
17. Long-term debt rating within or below BBB category or equivalent
18. Existence of other facts or circumstances indicative of financial stress, as determined by the State Treasurer

Before commencing the review, the Treasurer will give specific written notification of the review.

If a finding of probable financial stress is made, the Governor shall appoint a review team consisting of the Treasurer or his designee, director of technology, management and budget or his designee, a nominee of the Senate Majority Leader and a nominee of the Speaker of the House. Others could be appointed as well.

## Appendix C

### Views from Responsible Officials





Robert A. Ficano  
County Executive

May 29, 2012

Mr. Willie Mayo  
Office of the Auditor General  
500 Griswold, 8<sup>th</sup> floor  
Detroit, Michigan 48226

Re: Responses to Analysis of the Accumulated Deficit Report

Dear Mr. Mayo:

Attached are the responses to DAP No. 2012-57-003 dated May 7, 2012 (revised) Analysis of Accumulated Deficits Report. On May 3, 2012, the Wayne County Commission approved the County's FY2011 five year deficit elimination plan (the Plan). The Plan was subsequently submitted to the State of Michigan Department of Treasury in accordance with state statute.

If you have any further questions, please contact me or Stacie Durant at (313) 224-0420 or (313) 833-4199 respectively.

Sincerely,

Carla E. Sledge  
Chief Financial Officer

Cc: Stacie Durant, Deputy Chief Financial Officer  
Kevin Haney, Deputy Chief Financial Officer/Director of Budgeting and Planning  
Lyn Roberts, Director of Financial Reporting  
Marcella Cora, Deputy Auditor General  
Wil Hamner, Senior Manager

Attachment

DEPARTMENT OF MANAGEMENT AND BUDGET  
500 GRISWOLD • DETROIT, MICHIGAN 48226 • (313) 224-7766 • [www.waynecounty.com](http://www.waynecounty.com)





## Responses to Auditor General's Analysis of Accumulated Deficit Report

### General Fund

The County is projected to end fiscal year 2011-12 with a \$46 million deficit if no management action is taken. As previously discussed the, projected deficit is a result two factors: a property tax shortfall of approximately \$15 million and expenditures over budget by \$31 million. A budget adjustment has been prepared and submitted to the Commission to decertify revenues for the revenue shortfall. This adjustment will have a negative impact County wide. On the expenditure side, departments have prepared a deficit elimination plan and submitted it to Management and Budget. Those plans have been forwarded to the Commission with our analysis. According to Wayne County Ordinance 2010 – 515, the Commission has broad authority if a department, including those of a constitutional officer fails to submit a realistic plan. The Ordinance does not exempt any programs or departments nor does it require the Commission to make cross the board cuts.

The Fund Balance Policy to which the report refers is in the process of revision. The purpose of a fund balance policy is threefold: to enable realistic long-term planning, to assist with effective development of annual budgets and to promote clear communications with the general public, staff and administration. Credit rating agencies monitor levels of fund balance and unrestricted fund balance to evaluate a government's credit worthiness. The revised policy will incorporate elements from Government Finance Officers Association Best Practice, *Appropriate Level of Unrestricted Fund Balance in the General Fund (2002-2009)*. The adequacy of the General fund balance will be based on the County's specific circumstances. It is not longer appropriate (although it may be desired) to expect that the County will have a \$20 to \$100 million unrestricted reserve balance given the environment. Therefore, at a minimum we recommend that the County maintain an unrestricted fund balance of no less than two months of regular operating revenues or regular general fund expenditures. This requirement will not come into fruition until at least five years or fiscal year 2016, when all of our accumulated deficits have been eliminated. The revised policy will be finalized by June 30, 2012.

The Chief Financial Officer uniformly warns that a state takeover of the County should be the last resort, a trap to be avoided, as getting out of state receivership is costly (it can eliminate all union and other contracts, sell off public property and includes a salary of a state-appointed administrator and advisers) and lengthy. The emergency manager replaces the Commission and makes all financial decisions. The County Executive likewise loses all authority. The State of Michigan has already taken over nine governments, including the Detroit Public Schools System. Like other governments, the County has been slammed with revenue shortfalls, including revenue sharing and property taxes. But the difference between the County and most other local governments is that we have been making painful adjustments to our annual budget since 2004. Although there are a few more cuts that could be done, in reality, the County cannot cut its way out of a structural deficit. More revenues are needed and the solution needs to be addressed at the State level. There is no silver bullet therefore, the Budget Task Force has been established to come up with short and long term solutions.

The report suggests that the General Fund was the sole beneficiary of the \$26 million in the retirement equity fund. The General Fund did not receive the entire benefit rather the savings was allocated county wide including to the Office of the Auditor General and all elected

officials. In addition, to suggest that the County record the \$8 million of OPEB would be in violation of Generally Accepted Accounting Principles (GAAP) as long term liabilities are not reported in governmental funds. Accordingly, the liabilities were properly reported in the government-wide financial statements in accordance with GAAP.

Finally, the report indicated that the OAG was unable to verify all the funding applied toward deficits. As discussed in the report, the County had to absorb the Court accumulated deficit. In accordance with the DEP, approximately \$12 million was used to offset the transferred deficit in the courts; thus \$12 million remained in the general fund. The remaining was used as follows:

Pinnacle	Nuisance Abatement	Law Enforcement	Copy Center	ELF	Bldg & Grounds	General fund
\$57	\$500	\$831	\$199	\$5,164	\$1,290	\$8,553
<i>(in thousands)</i>						

### **Third Circuit Court**

The settlement allowed all parties to bring the case to a conclusion with the agreement that all could live with. In contrast, all parties would have taken the risk of losing if the case did not settle and the parties ultimately proceeded to the appellate court or back to the trial court. It protected the settling parties from incurring more cost for attorney fees or damages related to the case, not to mention the cost if the County were to ultimately lose the case. That said, the County did absorb the \$55 million accumulated deficit and an additional \$8 million in long term liabilities related to the Third Circuit Court. This action eliminated a double count in the County's accumulated deficits, thereby reducing its total deficit by \$55 million thus significantly impacting the general fund's accumulated deficit.

### **Juvenile Justice & Neglect Fund/Equipment Lease Financing Fund**

The reductions in these funds are consistent with the Commission's last approved Deficit Elimination Plan (DEP). We anticipate the deficits will be eliminated in its entirety by the end of 2013. We also anticipate the ELF deficit to be eliminated shortly thereafter.

### **County Bond Rating**

More recently on May 7, 2012, S&P affirmed the County's bond rating and indicated a stable outlook. They cited many positive credit factors including: the declining deficits, moderate debt margin, the Third Circuit Court settlement agreement, economic diversification beyond the city of Detroit, a relatively diverse tax base, and a good financial management profile that includes development and implementation of policies designed to improve operational efficiencies across the organization. This outlook was further supported by the reduction of over \$1.7 million in interest expense related to the County's TANS issue in April 2012 as compared to the prior issuance.

#### Emergency Financial Manager – Public Act 4

As mentioned, the Act allows:

- The suspension home rule, by giving emergency managers sole power to adopt and repeal local laws, ordinances, charters and contracts
- Effectively eliminates citizens' rights to vote for and petition local government on matters of local concern
- Violating the separation of powers, by allowing the executive branch and its agencies to exercise legislative duties
- Allowing the Legislature to enact unfunded mandates, by using local taxpayer dollars for such purposes as managers' salaries and staff

Currently, there is a petition to overturn the State's emergency manager law. There are approximately 226,000 signatures that have been gathered in an order to put the law up for voter referendum. The state had until mid-May to make a final decision. If the petitions are certified, the state's emergency manager law will be suspended until a vote in November. Whatever the ultimate result may be, the County does not need the threat of a State or Federal law in order to balance its budget. It does need the cooperation of all elected officials and departments. As mentioned in the Auditor General's report, the County currently meets three (not four) of the 18 conditions that could trigger a financial report: the violation of budget act regarding expenditures exceeding budget, ending the year in a deficit position and change in bond ratings. We are not familiar with number three to which the report is referring. To date, the County has not received a letter from the State requesting a review of the County.