4425 (8-06)

STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

ANDY DILLON
STATE TREASURER

Date: August 8, 2011

To: Cary Vaughn
Audit Manager

From: Bob Reamer
Auditor

Subject: **CITY OF FLINT** **MuniCode 25-2-040**
TIER III REVIEW **FYE 6/30/10**

EXECUTIVE SUMMARY

Key Financial Data

Overall Financial Condition	Critical
General Fund Cash and Investments	$15,064
Unrestricted GF Fund Balance	($14,621,546)
General Fund Quick Ratio	0.3:1
Total Government LT Debt / Net Assets	0.5:1

Background

A Tier III Review was completed following a Tier II recommendation in addition to other concerns noted from review of the City's 2010 audit report:

- Reporting an unrestricted general fund deficit of $14.6 million,
- Reporting interfund payables of $18 million for negative equity in pooled cash,
- Reporting a net pension obligation of $8.9 million,
- Court ordered judgment levy of 8.3 million was entered subsequent to year end,
- Not filing its Single Audit report with the Department of Treasury on a timely basis, and
- Not complying with a Water Fund bond covenant.

The City submitted a deficit elimination plan to the Department of Treasury in May 2011 which is presently under review. The proposed plan includes issuance of $20 million in Fiscal Stabilization Bonds in order to eliminate the General Fund deficit in FYE 2013.

Background (continued)
In January 2011, the Flint Journal reported that the City Council approved a resolution to request the State Administrative Board approve issuance of $20 million of Fiscal Stabilization Bonds. The Department of Treasury approved issuance of $8 million in bonds in March 2011 and agreed to reconsider an additional $12 million in 2013.
In July 2011, the Flint Journal reported that the federal government suspended the City's two energy grants as a result of an investigation into its stimulus-funded energy grant programs dating back to April 2009. The Mayor cited possible problems with compliance and allowable costs as the reason for the federal government's action.

The City's 2010 Single Audit has not been filed with the Department of Treasury. The City's 2009 Single Audit was qualified by Plante Moran due to non-compliance with the suspension and disbarment compliance provisions applicable to its CDBG. Management responded by indicating that it had implemented corrective actions to eliminate this deficiency.

Operating Results

The City's General Fund has incurred cumulative operating deficits of $21 million since 2007 which has resulted in its unrestricted fund balance decreasing from a surplus of $6.4 million at FYE 2007 to a deficit of $14.6 million at FYE 2010. The losses have been reduced by the City's decision in 2009 to begin transferring $3 million of equity from its Water and Sewer funds each year. The primary reason for the decrease in fund balance is attribuatable to the loss of revenues due to the economy and City officials inability to adjust its cost structure appropriately.

The City's website reports preliminary results for its 2011 fiscal year end. The preliminary results indicate the City's General Fund will report an operating surplus of $4 million which does not appear to include $1.4 million of transfers to other funds, as proposed in its DEP and which was a part of the approval to issue Fiscal Stabiliazation Bonds. The operating surplus includes $8 million of revenue related to the Fiscal Stabilization Bonds and $3 million of transfers from the Water and Sewer funds.

The City's website reports that a $49.9 million budget was approved for the General Fund for fiscal year 2012. Budgeted revenues include $3 million in transfers from the Water and Sewer funds. Expenditures were budgeted to decrease approximately $9 million from FYE 2011. The decrease in expenditures appears to be primaily related to cuts in public safety costs, specifically the police department. Police department expenditures are budgeted to be $15.1 million in FYE 2012 which is 50% of the cost incurred in FYE 2008. Total police department expenditures were $31.5 million in FYE 2008 and $24.7 million in FYE 2010.

In 2009, the City appears to have made the decision to make annual transfers totaling $3 million from its Water and Sewer funds to assist the General Fund, and has facrtored continuing transfers from these fund into its Gneral Fund's DEP. The Water Fund had an unrestricted deficit of $5.8 million and the Sewer Fund had unrestricted Net Assets of $9.3 million at FYE 2010.

The City's sewer fund has incurred a significant decrease in net assets since 2006. The fund has incurred a cumlative net decrease in net assets of $47.9 million over this period ($28.6 million net of depreciation). The decrease in net assets includes $4 million transferred to the General Fund and a net amount of $13 million charged for the settlement of a sewer back claim with residents.

Serious Deficiencies Noted in Audit Report

- Material year end adjustments to the OPEB liability and to transfer delinquent water and sewer receivables to the tax rolls, and
- Non-compliance with the suspension and disbarment provisions of the CDBG.

Other Significant Issues

- Federal investigation and suspension energies grants.
- City has not filed its Single Audit report with the Department of Treasury.
- The City failed to comply with a water bond covenant which requires water rates to equal at least

125% of the principal and interest on the bonds, plus any other legal requirements.

- Moody's rated a 2010 revenue bond issue by Hurley Medical Facility Ba1.

Conclusion

The City's overall financial condition is very good. The primary issue identified as part of this review are the deficiencies noted in the City's Single Audit and its controls over federal grant programs.

The City's controls over administration of its federal grant programs deteriorated in FYE 2010 as compared to 2009. Plante Moran qualified its opinion on the 2010 Single Audit due to the City's non-compliance with OMB Circular A-133 and cited a total of 15 significant and material deficiencies in its internal control over grant programs.

Based on the number and seriousness of the deficiencies noted by its CPA firm, it appears as though the City has little, if any, procedures and controls in place to properly administer and comply with the requirements of OMB Circular A-133.

Recommendations

- Insist that the City file its FYE 2010 Single Audit with the department of treasury,

- Consider requiring the City to provide a detailed corrective action plan that requires installation of procedures insuring compliance with OMB Circular A-133.

- Consider performing an Internal Control Review of the City's procedures over federal award programs.

STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

ANDY DILLON
STATE TREASURER

August 26, 2011

BY ELECTRONIC AND UNITED STATES MAIL

Dayne Walling, Mayor
City of Flint
1101 South Saginaw Street
Flint, Michigan 48502

Jacqueline Poplar, President
Flint City Council
1101 South Saginaw Street
Flint, Michigan 48502

The purpose of this letter is to notify you that the Department of Treasury will commence a preliminary review of the financial condition of the City of Flint pursuant to Public Act 4 of 2011, the Local Government and School District Fiscal Accountability Act.[1] The Department intends to commence the preliminary review on Monday August 29, 2011.

Section 12(1) of the Act authorizes this Department to commence a preliminary review if one, or more, of the enumerated conditions occur. To date, the conditions contained in subdivisions (j), (m), (o) and (r) have occurred within the City.[2]

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[1] Section 12(2) of the Act provides as follows:

> If the state financial authority [State Treasurer] determines that a preliminary review is appropriate under this section, before commencing the preliminary review the state financial authority shall give the local government specific written notification of the review. The preliminary review shall be completed within 30 days following its commencement. Elected and appointed officials of a local government shall promptly and fully provide the assistance and information requested by the state financial authority for that local government in conducting the preliminary review.

[2] Subdivision (j) provides that "[t]he local government has violated a requirement of sections 17 to 20 of the uniform budgeting and accounting act, 1968 PA 2, MCL 141.437 to 141.440." Subdivision (m) provides that "[a] local government is in breach of its obligations under a deficit elimination plan or an agreement entered into pursuant to a deficit elimination plan." Subdivision (o) provides that "[a] municipal government has ended a fiscal year in a deficit condition as defined in section 21 of the Glenn Steil state revenue sharing act of 1971, 1971 PA 140, MCL 141.921, or has failed to comply with the requirements of that section for filing or instituting a financial plan to correct the deficit condition." Subdivision (r) provides that a preliminary review may be commenced due to "[t]he existence of other facts or circumstances that in the state treasurer's sole discretion for a municipal government are indicative of municipal financial stress, or, that in the superintendent of public instruction's sole discretion for a school district are indicative of school district financial stress."

In respect to subdivision (r), I note the confluence of several interrelated factors. Notably, City officials were authorized to issue $8.0 million in fiscal stabilization bonds in February. At that time, City officials indicated that the foregoing amount would be sufficient to keep the City in a positive cash position for approximately 24 months. However, a recently prepared cash flow analysis indicates the City may have insufficient cash to pay current obligations in a much shorter period.

Additionally, several steps City officials committed to take to reduce the City's financial stress and to address recurring structural operating deficits, such as securing labor concessions, have not been implemented. Accordingly, you are receiving this notice of our planned preliminary review.

I trust that this information will be of assistance. If I may be of further assistance, let me know.

Sincerely,

Andy Dillon
State Treasurer

cc: Governor Rick Snyder

Lamphier, Wendy (Treasury)

Subject:	Meeting with Rep Hammel and Genesee Co Drain CommissionerJeff Wright regarding the new water pipeline for Genesse, Lapeer and Sanilac Counties.
Location:	Capitol Building, H-167
Start:	Wed 11/9/2011 12:15 PM
End:	Wed 11/9/2011 12:45 PM
Recurrence:	(none)
Meeting Status:	Accepted
Organizer:	Hichez, Amy (Treasury)
Required Attendees:	Dillon, Andy (Treasury); Stibitz, Brom (Treasury)
Optional Attendees:	Cousineau, Sara (Treasury); Hichez, Amy (Treasury)

When: Wednesday, November 09, 2011 12 15 PM-12 45 PM (GMT-05:00) Eastern Time (US & Canada)
Where: Capitol Building, H-167

Note The GMT offset above does not reflect daylight saving time adjustments

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Confirmed with Lauryn in Rep Hammel's office on 10/19/11--517-373-7557.
TOPIC: Construction of the new water pipeline for Genesee, Lapeer, and Sanilac Counties. Commissioner Jeff Wright will be discussing the cost of the pipeline, the savings and benefit it will provide to the constituents of that region.