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AUDITOR GENERAL

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To Honorable City Council:

The Office of the Auditor General performed an analysis of the Mayor's 2013-2014 Proposed Budget, primarily to attest to the reasonableness of the proposed revenues and expenditures contained therein and to provide this Honorable Body with relevant and reliable data and information to assist you in your decision making process. The focus of our analysis was to determine whether the proposed expenditures could be supported by the resources that are reasonably expected to be realized in Fiscal Year 2013-2014.

This report includes a roll-forward analysis of all major revenues we reviewed during the Revenue Estimation Conference in February. We used the latest information available to update our estimates on all major revenues of the City. Also included is an analysis of the City's major appropriations; risk management related expenses; general fund subsidy payments; the current year's deficit and other budget related information.

In our opinion the Mayor's Proposed Budget for fiscal year 2013-2014 is reasonable. However, I must qualify our conclusion. In no way do we mean that we believe that the Proposed Budget for 2013-2014 is accurate. In fact, most financial statements of multimillion dollar entities have some inaccuracies, mainly because of estimates. The City's Comprehensive Annual Financial Report, which we consider the official financial position of the City includes estimates. Estimates by themselves are not the problem. The problem is when the estimates do not approximate the actual results.

The very reason for the preparation of an annual budget is to enhance the City's ability to control its costs and mitigate the propensity for deficit spending. An ideal internal financial reporting system would yield monthly results only days after the end of each month. It would include financial analysis with financial ratios and other indicators of how well we are managing our costs. It would tell us if we have sufficient revenues to cover our current liabilities. It would let us know whether or not it is time to issue bonds.



It is one thing to not have control over declining revenues or rising costs of providing services. It is another thing to not have basic and detailed internal financial reporting. The City will never be able to control the costs of purchased goods and services if it does not begin to maintain better records of its various inventories and monitoring the contracts for those goods and services. Without significant improvement in our financial reporting systems, the risks of deficit spending will be high even after our capital structure is corrected, and we begin to feel some relief from our fixed obligations. The City needs to continuously invest in its financial and reporting systems to keep up with the change in technology, and to provide our leaders and decision makers with the most accurate information upon which to act upon in a timely manner.

The City also needs to invest in its human resources and to limit as much as possible the unnecessary loss of its highly productive individuals. Particularly, over the past few years, the City has lost some of its best employees because of the fear of the continuous loss of salaries and benefits. As the City begins to correct its capital structure, it should also be committed to investing in one of its most valuable assets, its employees. In addition, we must put our citizens first because we exist to provide services to them, and in return, they provide our funding. We applaud the Mayor for maintaining to the best of his ability the services our citizens need and deserve. In order to retain and even attract more citizens to come and live in our neighborhoods, the City must continually make improvements on providing the most basic of services more efficiently and effectively.

In financial terms, and as you are aware, the City's current capital structure is not sustainable. Too much of our revenue is being spent on servicing the City's debt. Far too long, we have relied on the issuance of bonds to fill the gaps. The Office of the Auditor General is encouraged at the prospects of the City freeing itself from millions upon millions of dollars spent on servicing the City's debt. We are hopeful that our new emergency manager and his team will be successful in renegotiating the bests financial terms with our creditors and debtors. In the future we should beware of the issuance of bonds if they are being used to cover our current operations.

Considering the proposed deficit, which according to the Executive Budget is a total of \$348.8 million, the Mayor indicated in his budget address that he chose not to include the accumulated and current year's deficit estimate into his 2013-2014 Proposed Budget. Our response is that without the inclusion of the accumulated and current year deficits, the Mayor's Proposed Budget is not balanced. However, we were informed that the Budget Department had in fact been in discussions with the State who impressed upon them that the primary intent of the statue requiring the inclusion of the deficit is to address temporary rather than systemic operating deficits. Furthermore, the Financial Stability Agreement directs the City to eliminate its deficit by 2018, and the Budget Department has understood this timeline as the practical window for full deficit elimination.



The Mayor also mentioned in his budget address that the City had requested and obtained a waiver from the State that allows the City to forgo for one year the preparation of a triennial budget as required by the Financial Stability Agreement. We recommend that the Administration request and obtain an official waiver from the State that authorizes the City to forgo the inclusion of the accumulated deficit estimate in the 2013-2014 Budget.

The Office of the Auditor General's estimate of the deficit for the current fiscal year 2012-2013 is \$378.0 million and includes a net operating deficit for the current year of \$51.4 million. The Mayor's Executive Budget reflects an estimated increase in the deficit for 2012-2013 of \$22.2 million, but the component details of how this figure was calculated were not provided. In our opinion the Administration's estimate of the current year's deficit is overly optimistic. We recommend that the Administration consider a more conservative estimate of the current year deficit and request an official waiver from the State to allow that the new estimate be deferred into a deficit elimination plan. The Office of the Auditor General believes that it would be better to submit a more conservative estimate now especially since we are encouraged that the City really will begin to repair its financial structure and other major financial issues in the near future.

Given that assumption we analyzed the City's Major Revenues including: Property Tax; Income Tax; State Revenue Sharing; Wagering Tax; Utility Users Tax and Other Revenues. With the exception of Property Tax Revenue and Other Revenues, our analysis of revenues went smoothly. Income tax collections appear to be increasing. State Revenue Sharing is fairly consistent over the past couple of years, and Utility Users tax appears to have slowed its rate of decline.

One issue with attempting to estimate Property Tax collections is that approximately half of the revenue that has already been received by the City has yet to be posted in the City's general ledger. This is the second year this has happened, and we were forced to rely on the information contained in the property tax subsidiary ledger. Property tax continues to decline, and may decline even more as taxable values begin to better reflect the market value of residential and commercial properties. In the long run tax collection should be enhanced because more people will probably be able to pay smaller tax bills.

Other Revenues comprise over 68 percent of total revenues, and it is an area where timely reporting, cost accounting, and communication are so greatly needed. Historically, too many of our estimates are based on systematic and optimistic projections. Other Revenues collections should be closely monitored throughout the year.

In addition, we focused our analysis on the City's major expenditures including: Salaries and Wages; Employee Benefits; Pension and Other Expenses. These areas were particularly challenging to analyze for several reasons, including not receiving all of the supporting assumptions of the projections in a timely manner,



along with the detailed components that make-up the proposed estimate of the accumulated deficit.

Salaries and Wages require closer attention. The City must reduce overtime for Uniform Police and Fire, and stop underestimating civilian salaries and wages. For example, in Fiscal year 2011-2012, Non-Departmental salaries and wages exceeded the Budget by \$5.7 million; DPW exceeded its budget by \$10.5 million, Police exceeded its budget by \$4.1 million, the Health Department exceeded its budget for salaries and wages by \$7.0 million and Transportation exceeded its budget by \$20.6 million. When reviewing our report, you will notice that actual salaries and wages for Civilian employees have exceeded the budget by an average of more than \$150.0 million for the past five years, of which more than \$100 million of the overage is attributable to Water and Sewerage.

Pension and Fringe Benefits are beyond the City's immediate control. As long as we maintain a defined benefit plan, we will always have significant fluctuations with these costs. The smoothing of contribution payments and the deferral of services years are only temporary fixes. The City should implement a defined contribution plan. A defined contribution plan greatly reduces the financial risk to the employer and all but eliminates the uncertainty of contributions. Health care cost is another area where timely information on costs is greatly needed. Moreover, the City needs to renegotiate our health care costs while maintaining sensible plans that are reasonably affordable and competitive.

Other Expenses is an area that needs consistent accounting and transparency. It includes many types of expenses that fluctuate from year-to-year. For example, fiscal years 2008-2009 through 2011-2012, actual Miscellaneous Expense was significantly less than budgeted. Budget amounts exceeded actual amounts from \$47.7 million to \$1.1 billion. Also, actual amounts in Redevelopment Projects Costs exceeded budget amounts substantially from fiscal year 2008-2009 through fiscal year 2011-2012 from \$16.5 million to \$42.3 million

In closing the Office of the Auditor General believes that the Administration has prepared and presented a good faith representation at providing the most accurate Proposed Budget at this time. Could it be more accurate? Perhaps it could. Will it differ from actual results...it always differs; however, more emphasis must be placed on directing and controlling our expenses throughout the year. When it comes to financial instability, the timing of the City's cash flow is still the most important and volatile of all assets. During these difficult times, the City must continue to find ways to conserve the use of cash by spending wisely and conservatively.

I would like to thank this Honorable Body for allowing us to present this budget analysis report to you today. We encourage you to review it thoroughly, and as always, we stand ready to assist you with your due diligence of the Proposed Budget. I want to thank the Mayor and his Administration for the preparation of the Proposed Budget, and everyone who assisted the Office of the Auditor General on

behalf of me and my staff, particularly all members of the Fiscal Analysis Division, the Finance Department, and Budget Department. Last but not least, I thank all of my staff for their hard work and for taking on more this budget season than in recent years.

Respectfully submitted,

A handwritten signature in blue ink that reads "Mark W. Lockridge". The signature is written in a cursive style with a large initial "M".

Mark W. Lockridge, CPA  
Auditor General