RISK MANAGEMENT

Conclusion

The Mayor's 2010-2011 Proposed Budget for the Risk Management Fund is reasonable. The budget is based on an average of five years of payouts for claims, workers' compensation, and lawsuits. A major challenge to the City's risk management approach, is the lack of a citywide risk management policy.

Analysis of the Risk Management Fund

The Risk Management Fund is a self-insurance fund established by Section 18-8 of the City Code in 1995 to cover liability to third parties for any loss or damage arising out of negligence, tort, contract or otherwise accruing, payable by the City from and after July 1, 1994. The City may be liable under Workers' Compensation or Disability Benefits Law, or under any similar laws, or for damage to property or personal injury.

The Risk Management Fund premium included in the Mayor's 2010-2011 Proposed Budget is compared to the fiscal year 2009-2010 Budget in the following schedule:

	In Millions		
	Mayor's 2010-2011 Proposed Budget	2009-2010 Budget	Increase (Decrease)
General Fund Premium	$ 63.9	$ 72.7	$ (8.8)
DDOT Premium	$ 18.9	$ 18.3	0.6
Annual Premium	$ 82.8	$ 91.0	$ (8.2)

Current Year Premium

Risk Management Fund revenues are premiums paid by the General Fund and Detroit Department of Transportation (DDOT), earnings from the investment of fund assets, and reimbursements from the State.

The calculation of the Risk Management Fund premium in the Mayor's 2010-2011 Proposed Budget is based on a five-year running average of actual payouts for damage claims, lawsuits, and other general and administrative expenditures from fiscal year 2004-2005 through fiscal year 2008-2009. The five-year historical average for the General Fund decreased $5.10 million from $48.4 million to $43.3 million from fiscal year 2007-2008 to fiscal year 2008-2009. The five-year historical average for DDOT increased $.6 million during the same time period.

The overall premium requirement decrease is due in large part to a $1.0 million decrease in the debt service requirement over the prior year.

Fund Balance

In 1995, pursuant to the Ordinance and Bond Resolution, the City issued $100.0 million in self-insurance bonds. The proceeds were deposited in the Risk Management Fund to cover claim and lawsuit payments.

The following table shows the actual expenditures, revenues, excess or deficiency of revenues to cover current expenditures, and the fund balance of the Risk Management Fund from fiscal years 1995-1996 through 2005-2006 broken down into six and five year periods, respectively. The table also shows fiscal years ending June 30, 2007, 2008, and 2009, the contributions and expenditures to date for the current fiscal year, and the contribution from the City included in the Mayor's 2010-2011 Proposed Budget.

		In Millions			
Fiscal Year Ended June 30		City Contributions	Expenditures	Excess/(Deficiency) of Revenues	Fund Balance
Beginning Balance					$100.0
1996-2001		$ 336.0	$ 353.7	$ (17.7)	44.8
2002-2006		268.5	312.5	(44.0)	51.7
2007		62.6	44.3	18.3	19.1
2008		63.0	67.6	(4.6)	14.5
2009		61.6	50.4	11.2	25.7
2010	(A)	60.7	26.4	34.3	60.0
2011	(B)	82.8	N/A	N/A	

(A) As of April 12, 2010.

(B) The proposed budget amount is the only figure available for fiscal year 2010-2011.

As reflected in the preceding table, claim revenues exceeded fund expenditures by $11.2 million in fiscal year 2008-2009. The Risk Management Fund ended 2008-2009 above the legally required minimum of $20 million.

Debt Service

In fiscal year 2003-2004, the City issued an additional $98.9 million in self-insurance bonds primarily to fund the fiscal year 2003-2004 Risk Management Fund premium, and to refinance the remaining balance of the original $100.0 million self-insurance bond issue. Financing the claims premium, a current operating expenditure, with long-term debt was to be a one-time occurrence. However, in fiscal year 2004-2005 the City again issued $62.3 million in self-insurance bonds to cover the annual premium amount for claims and litigation.

The table on the next page shows the annual premiums paid for each of the previous five fiscal years, from fiscal years 2004-2005 through 2008-2009, the budgeted premium and debt service for 2009-2010 and the Mayor's 2010-2011 Proposed Budget, for claims and lawsuits against the City related to General Fund agencies and DDOT, and debt service (bond principal and interest) on the self-insurance bonds.

Fiscal Year		General Fund and DDOT Contributions	Debt Service	Budgeted or Actual Amounts
2004-2005		$ 61.1	$ 4.0	$ 65.1
2005-2006		25.2	21.4	46.6
2006-2007		62.0	21.4	83.4
2007-2008		62.5	9.6	72.1
2008-2009		61.3	12.2	73.5
2009-2010	(A)	60.5	30.5	91.0
2010-2011	(B)	82.8	0	82.8
Total		$ 415.4	$ 99.1	$ 514.5

(A) These are the actual contribution and debt service for fiscal year 2009-2010 as of April 12, 2010.

(B) The proposed budget amounts for fiscal year 2010-2011.

As shown in the preceding table, the total Risk Management Fund appropriations for both premiums and debt service have ranged from a low of $46.6 million in fiscal year 2005-2006, when only a portion of the budgeted premium was paid, to a high of $91.0 million for fiscal year 2009-2010.

As of June 30, 2009, the current balance of the 2003 and the 2004 self-insurance bond issues totaled $121.8 million. Each bond issue matures over a ten-year period and should be paid off in fiscal years 2012-2013 and 2013-2014, respectively. The debt service requirements increase substantially in the coming years. The principal payment nearly quadruples from fiscal year 2008-2009 to 2009-2010 indicating that the principal payments were backloaded to the end of the bond repayment period, which cost the City more in interest. For fiscal years 2010-2011 through 2013-2014 the average annual debt service requirement will be $26.9 million.

Future Liabilities

The estimated total future liabilities of the Risk Management Fund included in the Notes to Basic Financial Statements of the June 30, 2008 Comprehensive Annual Financial Report (CAFR) were $146.1 million. The current portion of this liability, payable within one year, was estimated at $2.6 million, while the long-term portion of the liability was estimated at $143.5 million. The total liability reflects a decrease of $13.0 million from the prior year estimate of $159.1 million. The Office of the Auditor General is unable to report on the estimated total future liabilities of the Risk Management Fund for fiscal year ending June 30, 2009 because the CAFR has not been completed.

Risk Management Council Establishment and Initiatives

City Charter Section 9-701 establishes the Risk Management Council (RMC). The RMC is comprised of the corporation counsel, the chief of police, the finance director, the human resources director and the auditor general. Members may serve by deputy or a person designated from the department. The RMC makes recommendations to the Mayor concerning implementation of policies, programs and activities to minimize exposure or liability of the City to claims and damages.

In furtherance of their purpose, the RMC has taken initiatives to implement a City-wide risk management strategy that will reduce costs the City pays in claims, settlements, and workers' compensation. The RMC is currently working in conjunction with the Mayor's Office to raise awareness and accountability for mitigating risks within the City. They are planning sessions whereby City departments will be educated on how to reduce risks that lead to claims and litigations. The RMC has developed a self-assessment survey that was distributed to all Executive agencies and will be distributed to the Legislative branch shortly. The survey is designed to help departmental management identify, evaluate, and monitor risks. The RMC will use those surveys during small-group sessions with departments in discussing departments' exposure to risks and in performing root cause analyses with the ultimate goal to create a city-wide risk plan that will reduce costs to the City.

Best practices of risk management indicate that a successful risk management program involves an organization's top decision makers and their strong support for a risk management program. Officials representing City Council and the Mayor have participated in risk management meetings and provided support for a City-wide risk management approach.

The Risk Management Division (RMD) of Finance is responsible for managing medical and workers' compensation claims. They also manage the central safety programs (MIOSHA and OSHA) as well as long-term disability benefits. The RMD has implemented the RiskMaster software, which will assist the City in efficiently managing their claims. As part of the implementation of the software, RMD is consolidating claims information from the Fire and Police Departments into RiskMaster. The RiskMaster software will capture more comprehensive data and will allow the use of trend analysis reporting to assist departments in mitigating future claims.

Departments are now charged for the costs of repairing their City-owned vehicles damaged in accidents in cases where the employees involved are found to have contributed to the accident or damage by the City's Motor Vehicle Accident Review Board. From July 2009 through April 12, 2010, $92,856 has been charged back to departments causing them to adjust their budgets to account for these costs.

Challenges in the City's Current Risk Management Approach

Fundamental to a successful risk management program is a policy. The City has not developed one. In addition, costs associated with workers' compensation claims, settlements and lawsuits are charged to the risk fund rather than to the budgets of the departments causing the losses. Therefore, departments are not held accountable for their actions or lack of actions resulting in workers' compensations payments, legal costs, and settlements. Currently, the budget for workers' compensation, claims, and lawsuits is included in the non-departmental budget. The budget is based on an average of five years of payouts for claims, lawsuits, and workers compensation. The ordinance that established the risk management fund requires City departments to contribute to the fund.

Ordinance No. 16-95 states:

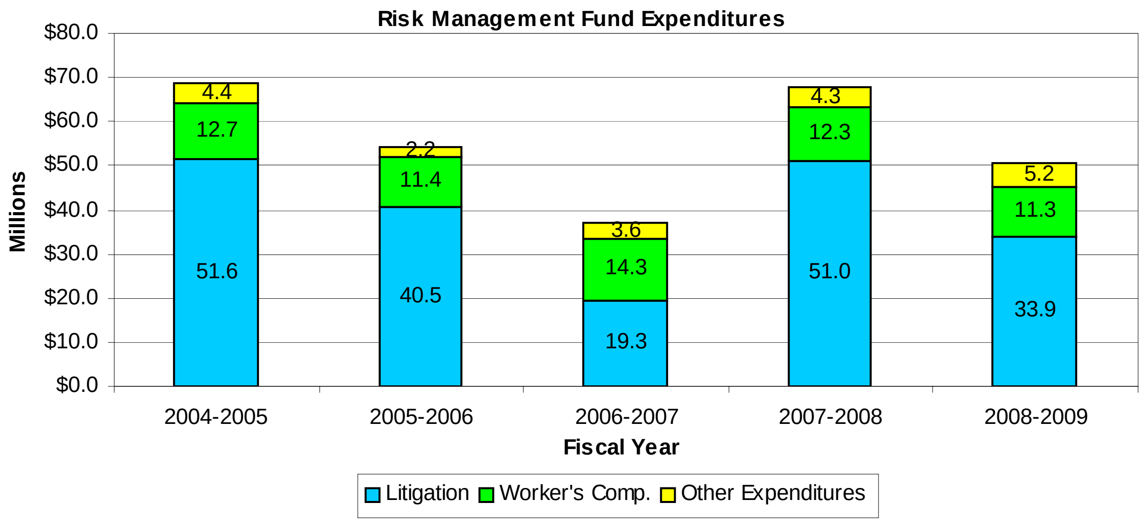
> The Finance Director shall annually make a recommendation for inclusion in the budget…of the amounts to be contributed to the risk management fund by the departments, respectively, to the end that such contributions will be sufficient to carry out the purposes of the risk management fund. Subject to applicable laws, the finance director is authorized to develop and administer guidelines, policies and procedures for risk management by the departments, which guidelines, policies and procedures shall be applied in a nondiscriminatory manner to, and shall be adhered to by, the departments…in as cost effective a manner as possible and to preserve the risk management fund for the purposes for which it has been established.

The budget should reflect the ordinance requiring each department to make a contribution to the Risk Management Fund based on the historical five-year average for actual payouts for which the department is responsible. Budgeting in this manner would allow the City Council and the Administration to hold each department director more accountable for losses experienced by the City based on the actions, or inactions of the department.

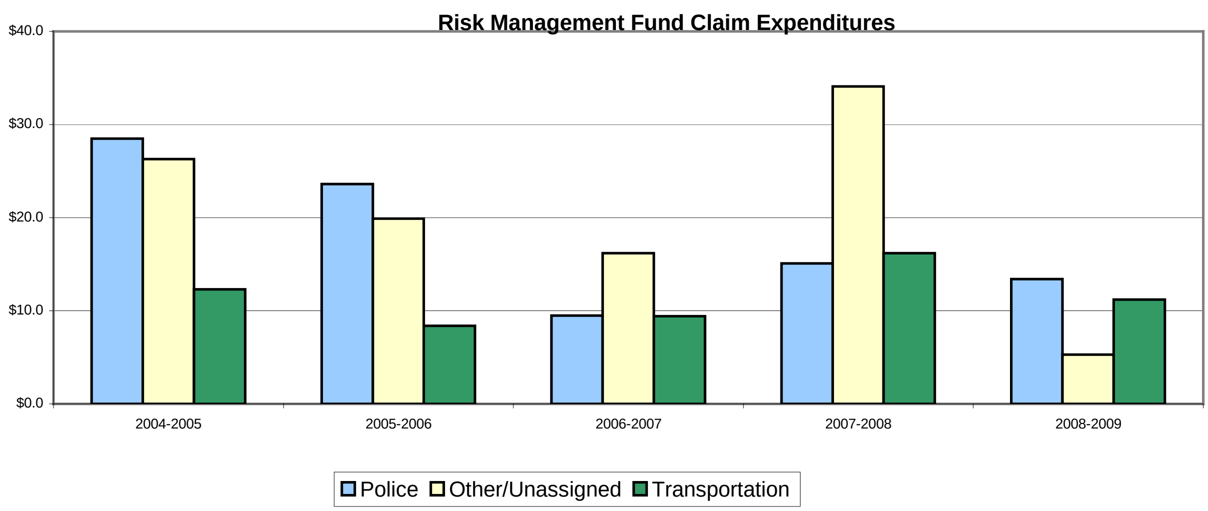
Litigation payouts make up the largest portion of risk management expenditures. In the past five years, the highest overall litigation payout was in 2003-2004 when the litigation payout was $56.5 million. The lowest was in fiscal year 2006-2007 when the litigation payout was $19.3 million. However, the litigation payouts for 2008-2009 decreased to $34.3 million, a decrease of $16.7 million from 2007-2008. Litigation payouts from departments other than those usually associated with large payouts (Police, Department of Public Works, Fire, and Department of Transportation) decreased from $23.6 million in 2007-2008 to $5.3 million in 2008-2009.

Expenditures

The following chart shows the trend in total Risk Management Fund expenditures over the past five years. Total expenditures were $50.4 million in fiscal year 2008-2009.



The following chart illustrates the trend in Risk Management Fund claim expenditures only, which excludes any general or administrative expenditures, and shows the expenditures broken into three groups, Police, DDOT and all other agencies.



GENERAL FUND SUBSIDY PAYMENTS

Conclusion

Trends in general fund subsidy payments to DDOT, People Mover, Charles H. Wright Museum of African American History, and Airport show that the entities depend significantly on the general fund to support their operational activities. However, revising bus service and reducing DDOT staff through lay-offs in fiscal year 2009-2010, and the elimination of vacant positions will reduce the general fund subsidy to DDOT by $18.0 million in the Mayor's 2010-2011 Proposed Budget. Subsidy payments to the Airport will be eliminated once the planned transfer of Airport operations occurs.

General Fund Subsidy Payments

The Mayor's 2010-2011 Proposed Budget includes $65.0 million in general fund subsidy payments to the following City departments or entities:

	In Millions		
	Mayor's 2010-2011 Proposed Budget	2009-2010 Budget	Increase (Decrease)
Department of Transportation	$ 55.8	$ 73.8	$ (18.0)
Detroit Transportation Corporation	4.9	6.2	(1.3)
Charles H. Wright Museum of African American History	2.0	2.5	(0.5)
Detroit Zoological Society	0.8	0.8	0.0
Detroit Institute of Arts	0.5	0.5	0.0
Detroit Historical Society	0.5	0.5	0.0
Detroit/Wayne County Port Authority	0.3	0.3	0.0
Airport	0.2	0.8	(0.6)
Total	$ 65.0	$ 85.4	$ (20.4)

We analyzed trends of the general fund subsidy payments for fiscal years 2005-2006 through 2008-2009, to determine what percentage of the organizations' operational revenue are supported by general fund subsidies, and which entities rely on the subsidy payments to support operating activities.

The tables included in this analysis show the general fund subsidy, the entities' total operating (unrestrictive) revenue, and percentage of subsidy to revenue, for fiscal years 2005-2006 through 2008-2009, and the budgeted subsidy for fiscal year 2009-2010. Actual revenue is not available for fiscal year 2009-2010. N/A indicates information was not available.

Detroit Department Of Transportation (DDOT)
One of DDOT's initiatives is to continue reorganization, emphasizing cost savings and increased revenue. From fiscal years 2005-2006 through 2008-2009, DDOT's general fund subsidies have averaged $75.1 million annually. On average, 48.3% of DDOT's operating revenue is supported by subsidy. The Mayor's 2010-2011 Proposed Budget includes a $55.8 million subsidy for DDOT, which is a decrease of $18.0 million from fiscal year 2009-2010 subsidy of $73.8 million. In fiscal year 2009-2010, DDOT reduced scheduled bus service and laid-off 113 bus drivers. The Mayor's 2010-2011 Proposed Budget also eliminates 207 vacant positions in DDOT. The following table shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2004-2005 through 2008-2009.

	Dollars In Millions				
	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
DDOT:					
Subsidy	$ 77.3	$ 70.6	$ 73.5	$ 78.9	$ 73.8
Operating (Unrestricted) Revenue	$ 154.6	$ 150.9	$ 157.5	$ 158.5	N/A
Percentage of Subsidy to Revenue	50.0%	46.8%	46.7%	49.8%	N/A

Detroit Transportation Corporation (The People Mover)
The People Mover is the City's only local rail system and is operated by the Detroit Transportation Corporation. Currently, the People Mover's operation is dependent upon receiving the general fund subsidy. For fiscal years 2005-2006 through 2008-2009, the general fund subsidy averaged approximately 53.4% of the People Mover's operating revenue. From fiscal years 2005-2006 through 2008-2009 the People Mover's annual subsidy was $6.2 million. The Mayor's 2010-2011 Proposed Budget recommends a reduction of $1.3 million in the subsidy to $4.9 million. The table below shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2005-2006 through 2009-2010.

	Dollars In Millions				
	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
The People Mover:					
Subsidy	$ 6.2	$ 6.2	$ 6.2	$ 6.2	$ 6.2
Operating (Unrestricted) Revenue	$ 12.7	$ 11.5	$ 11.4	$ 11.0	N/A
Percentage of Subsidy to Revenue	48.8%	53.9%	54.4%	56.4%	N/A

Charles H. Wright Museum of African-American History (MAAH)
The City has a long-term operating agreement with the MAAH to manage and operate the facility, which also includes management and maintenance of the artifacts collection and presentation of exhibitions and other events. Under the terms of the agreement, the MAAH petitions the City for operating funds each year. For fiscal years 2005-2006 through 2008-2009, the general fund subsidy comprised an average of 33.0% of the MAAH's operating revenue. In fiscal year 2008-2009, the MAAH received $2.5 million

from the City for general operations, which accounted for 45.5% of the MAAH's operating revenue. The fiscal year 2009-2010 budget maintained the subsidy at $2.5 million. The Mayor's 2010-2011 Proposed Budget recommends reducing the subsidy by $0.5 million to $2.0 million. The following table shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2005-2006 through 2009-2010.

	Dollars In Millions				
	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
MAAH:					
Subsidy	$ 1.0	$ 1.8	$ 2.0	$ 2.5	$ 2.5
Operating (Unrestricted) Revenue	$ 6.6	$ 4.7	$ 6.1	$ 5.5	N/A
Percentage of Subsidy to Revenue	15.2%	38.3%	32.8%	45.5%	N/A

Detroit Zoological Society (Zoo)

The Zoo receives an operating subsidy for insurance and security costs totaling $0.8 million. The subsidy comprises an average of 3.8% of the Zoo’s operating revenue. The table below shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2005-2006 through 2009-2010.

	Dollars In Millions				
	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
Zoo:					
Subsidy	N/A	$ 0.9	$ 0.9	$ 0.9	$ 0.8
Operating (Unrestricted) Revenue	N/A	$ 26.3	$ 19.3	$ 28.3	N/A
Percentage of Subsidy to Revenue	N/A	3.4%	4.7%	3.2%	N/A

Detroit Historical Society (Society)

The Society is an independent, Michigan non-profit Corporation. Under an agreement with the City, the Society manages the daily operation of the Detroit Historical Museum, the Dossin Great Lakes Museum, and the Collections Resources Center. The City contributes $0.5 million to subsidize operational expenses. An average of 16.9% of the Society’s operating revenue is from the general fund subsidy. The table below shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2005-2006 through 2009-2010.

	Dollars In Millions				
	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
Society:					
Subsidy	N/A	$ 0.5	$ 0.5	$ 0.5	$ 0.5
Operating (Unrestricted) Revenue	N/A	$ 3.0	$ 3.1	$ 2.8	N/A
Percentage of Subsidy to Revenue	N/A	16.7%	16.1%	17.9%	N/A

Detroit/Wayne County Port Authority (Authority)

The Authority was created to enter into contracts for the acquisition, improvement, enlargement, or extension of port facilities. The Authority has a contract with the City that is renewed annually unless a notice to terminate is requested by either party. The amount of funding is also negotiated annually. From fiscal year 2005-2006 through 2008-2009, the annual general fund subsidy has been $0.3 million, which averages to approximately 10.2% of the Authority's operating revenue. The table below shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2005-2006 through 2009-2010.

	Dollars In Millions				
	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
Authority:					
Subsidy	$ 0.3	$ 0.3	$ 0.3	$ 0.3	$ 0.3
Operating (Unrestricted) Revenue	$ 2.6	$ 2.1	$ 2.6	$ 8.6	N/A
Percentage of Subsidy to Revenue	11.5%	14.3%	11.5%	3.5%	N/A

Airport

The Mayor's 2010-2011 Proposed Budget includes a $0.2 million subsidy for the Airport, which is a decrease of $0.6 million from the fiscal year 2009-2010 subsidy of $0.8 million. The $0.2 million subsidy is for operating expenses at the Airport for the first quarter of fiscal year 2010-2011. The Mayor's 2010-2011 Proposed Budget assumes management and operation of the Airport will be transferred to a private contractor by June 30, 2010. The prospective contractor will be responsible for all operational costs; however, the City will retain ownership of the Airport. If the transfer does not occur, the Airport will require additional subsidy from the general fund in fiscal year 2010-2011. The table below shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2004-2005 through 2008-2009.

	Dollars In Millions				
	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
Airport:					
Subsidy (A)	$ 0.0	$ 0.9	$ 0.6	$ 0.9	$ 0.8
Operating (Unrestricted) Revenue	$ 1.0	$ 2.0	$ 2.2	$ 2.0	N/A
Percentage of Subsidy to Revenue	0.0%	45.0%	27.3%	45.0%	N/A

(A) The Airport did not receive a subsidy payment in fiscal year 2005-2006.

ESTIMATED SURPLUS/(DEFICIT)

Conclusion
The Mayor's 2010-2011 Proposed Budget projection of an accumulated deficit of $85.6 million is questionable. Based on our analysis, we estimate the deficit for fiscal year 2009-2010 at approximately $133.5 million.

Estimated Deficit - Fiscal Year 2009-2010
The estimated deficit includes the unaudited accumulated deficit of $330.2 million from fiscal year 2008-2009, an anticipated operating deficit of $55.4 million from fiscal year 2009-2010, and revenue items listed as accounting changes that total $51.0 million. The following table provides a high-level view of the funding plan for addressing the accumulated deficit:

Fiscal Year 2008-2009 Accumulated Deficit		$(330.2)
Sale of Fiscal Stabilization Bonds		249.0
		$ (81.2)
Estimated Fiscal Year 2009-2010 Revenue Deficit	$(80.1)	
Estimated Fiscal Year 2009-2010 Appropriation Surplus	24.8	
Fiscal Year 2009-2010 Operating Deficit		(55.3)
Accounting Changes:		
State Revenue Sharing Posting for Fiscal Year 2008-09	$ 23.0	
DDOT Grant Funding	13.0	
DPS Bad Debt Expense	15.0	
Total Accounting Changes		51.0
Fiscal Year 2009-2010 Accumulated Deficit		$ (85.5)

We have determined that the projected accumulated deficit for fiscal year 2009-2010 is questionable, due to the following issues:

Greater Detroit Resource Recovery Authority (GDRRA)/(DTE Escrow)
The Mayor's 2010-2011 Proposed Budget includes anticipated revenue of $20.0 million from GDRRA/DTE Escrow fund. The Escrow account, which is held by GDRRA, was created to hedge against fluctuations in energy sales from GDRRA to DTE Energy. As of April 23, 2010, we were not provided any documentation regarding this transaction.

Detroit Public School (DPS) Bad Debt
The Mayor's 2010-2011 Proposed Budget includes $15.0 million for collection of a bad debt from the DPS. The bad debt is related to electricity sold by the Public Lighting Department and student bus card sales belonging to the Department of Transportation. The Administration stated that DPS is developing a plan to obtain an infusion of cash

sometime this spring to pay some of their outstanding debts, which includes the aforementioned funds to the City of Detroit.

Detroit Department of Transportation (DDOT) Grant Funding
According to the Budget Department, DDOT borrowed $13.0 million from the general fund, which will be repaid in fiscal year 2009-2010. We were not provided any documentation related to this transaction.

The following table shows our estimate of the deficit, based on our review:

Fiscal Year 2009-2010 Accumulated Deficit	$ (85.5)
DDOT Grant Funding	(13.0)
DPS Bad Debt	(15.0)
GDRRA (DTE Escrow)	(20.0)
OAG Estimated Deficit	$(133.5)