



City of Detroit
OFFICE OF THE AUDITOR GENERAL
COLEMAN A. YOUNG MUNICIPAL CENTER
2 WOODWARD AVENUE, SUITE 208
DETROIT, MICHIGAN 48226
PHONE: (313) 224-3101
FAX: (313) 224-4091
WWW.CI.DETROIT.MI.US

LOREN E. MONROE, CPA
AUDITOR GENERAL

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To Honorable City Council:

The information and data contained in this report represents the Office of the Auditor General's analysis of the Mayor's 2012-2013 Proposed Budget. The purpose of this analysis is to provide relevant and reliable information to this Honorable Body to assist in its due diligent review of the Mayor's Proposed Budget. Primarily, our analysis focus is whether the proposed expenditures can be supported by the resources that are reasonably expected to be realized in the coming year.

The Mayor's 2012-2013 Proposed Budget of \$2.54 billion is approximately \$570 million less than the 2011-2012 Budget of \$3.11 billion. The primary reason for the decrease pertains to the sale of \$300 million in revenue bonds for the Water Department budgeted in fiscal year 2011-2012. In addition, revenues from Federal Sources decreased by approximately \$143 million related to reductions in Head Start, Health, and Workforce Investment Act grants.

The Proposed Budget projects a \$203 million accumulated deficit at the end of fiscal year 2011-2012, but also recommends a \$128 million deficit deferral and the appropriation of the remaining estimated \$75 million deficit. Based on our analysis of the Proposed Budget, our estimates of current year revenues and expenditures, and the probability of an additional shortfall in the current fiscal year 2011-2012, we project that the accumulated deficit will be approximately \$218 million by the end of the fiscal year 2011-2012. Therefore, to achieve a prior year deficit of \$75 million, requires the deferral of an additional \$15 million.

In compliance with the City Charter and the Financial Stability Agreement, representatives of the Administration, Finance Department, Budget Department, Office of the Auditor General (OAG), and City Council's Fiscal Analysis Division discussed and reached a consensus with an estimate of revenues for fiscal year 2012-2013. The Budget Consensus Working Group concluded that the proposed budget for revenues is overestimated by \$6.4 million.



We are encouraged that the key budget assumptions included on the revenue side of the Proposed Budget are reasonable and realistic. The plans should be clear on how key budget assumptions on the appropriation side will be realized. Our level of concern is high for the following:

- Processing the layoffs of nearly 800 employees by July 1, 2012 as is expected as a part of the reduction in headcount of 2,566 FTEs from the 2011-2012 budget.
- The transition or consolidation of several departments without budgetary provision for transitional costs being included in the proposed budget.
- Plans for operational reforms to systems and processes to achieve reliable and timely financial reporting on a monthly, and more accurate quarterly basis.
- The rationalization and improvement of Detroit Department of Transportation (DDOT) services that will result in adequate services without realizing the significant overage in the subsidy that DDOT receives on a yearly basis.
- The impact of the difference between contribution rate assumptions included in the Mayor's Proposed Budget for the General Retirement System and Police and Fire Retirement System, versus the actuarially determined contribution rates that will be published in the near future.
- Details of the plan for savings in union work rules and the methodology for tracking results to ensure that savings are being achieved.
- Details of a \$30 million variance in proposed medical benefits versus our calculation.

The reductions to the key appropriation assumptions represent structural changes that when realized will represent significant savings. During this budget review process we will continue to gather information pertaining to our concerns regarding the key appropriation assumptions, or any other relevant information. We will inform this Honorable Body of any additional information we deem significant that could affect how you might view and ultimately accept or reject any part of the key appropriation assumptions.

The Proposed Budget includes an estimated prior year 2011-2012 deficit that does not account for all expenditure estimations that will likely be borne by the general fund. For example, the overage in the general fund subsidy to the DDOT is not considered as a component of the administration's general fund deficit. In addition, the prior year deficit does not include estimates for expected expenditures for the Human Services and Buildings and Safety Engineering and Environmental Department.

We applaud the Administration for the significant effort that went into the preparation of the Mayor's 2012-2013 Proposed Budget. The proposed revenue is significantly more realistic than the previous year's budget and is not contingent upon initiatives that are not likely to materialize in the coming year.



The Proposed Budget contains a reasonable projection of the City's major revenues as well as other revenues, and also reduces appropriations in many ways that can reasonably be considered realistic if we are committed to following the plan. We are encouraged that the Administration continue to pursue revenue initiatives from the prior year, but did not include any of these additional revenues in the Proposed Budget. These initiatives could result in a revenue surplus in the near future.

A major concern is our ability to measure the City's performance in a timely manner in the coming year. Historically, the City has not generated monthly or even quarterly financial reporting. The City must begin to produce timely financial information to allow for decision makers to react to its financial performance in a timely manner, and make sound decisions based on reliable and relevant information. The City's major information and accounting systems are not integrated and require significant manual intervention to input the information into the general ledger. Significant investment is required and needed to update and integrate our accounting information systems. In the meantime, we need to ensure timely accounting, reporting, and analysis with the systems we currently have until we can upgrade our systems.

We applaud the Budget Department for its performance under significant pressure in incorporating the Mayor's additional savings in the Proposed Budget. The budget analysis was challenging this year due to a number of issues. However, we are encouraged with the implementation of the budget consensus in the coming year, thereby making it possible for all stakeholders to have the same relevant information at the same time

In closing, I reiterate that this is the time to improve our accounting information systems like we have not done in recent years. There must be an emphasis and high priority on reporting reliable financial information on a timely basis. An accounting subsystem is not the reporting system of the City. Accounting information not entered into the City's general ledger in a timely manner is not available and hinders the ability of the analyst to perform an accurate and reliable analysis.

I want to thank my staff for its due diligence in the preparation of this analysis, the Fiscal Analysis Division for the pertinent information they shared, representatives of the Finance Department, Budget Department and all other agency representatives that assisted the OAG in the preparation of our analysis.

Respectfully submitted,

A handwritten signature in cursive script that reads "Loren E. Monroe".

Loren E. Monroe, CPA
Auditor General