

RISK MANAGEMENT

Conclusion

The Mayor's 2011-2012 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.

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 2011-2012 Proposed Budget is compared to the fiscal year 2010-2011 Budget in the following schedule:

	<u>In Millions</u>		
	<u>Mayor's 2011-2012 Proposed Budget</u>	<u>2010-2011 Budget</u>	<u>Increase (Decrease)</u>
General Fund Premium	\$ 65.1	\$ 63.2	\$ 1.9
DDOT Premium	<u>\$ 19.6</u>	<u>\$ 18.9</u>	<u>0.7</u>
Annual Premium	<u>\$ 84.7</u>	<u>\$ 82.1</u>	<u>\$ 2.6</u>

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 2011-2012 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 2005-2006 through fiscal year 2009-2010. The five-year historical average for the General Fund decreased \$3.0 million from \$43.3 million to \$40.3 million from fiscal year 2008-2009 to fiscal year 2009-2010. The five-year historical average for DDOT decreased \$0.7 million during the same time period.

The overall premium requirement increase is due in large part to a \$2.8 million increase in the debt service requirement over the prior year.

Fund Balance

This fund was established to cover the cost of claims and lawsuit payouts and workers compensation costs.

The following table shows the Risk Management Fund balance as of June 30, 2007. The table also includes the actual expenditures, revenues, and fund balance for the fiscal years ending June 30, 2008, 2009 and 2010, the balance of the Risk Management Fund as of April 11, 2011, the contributions to the fund (excluding debt service costs) included in the Mayor's 2011-2012 Proposed Budget.

In Millions			
Fiscal Year Ended June 30	City Contributions	Expenditures	Fund Balance ¹
2007			(A) 19.2
2008	63.0	59.8	22.4
2009	62.1	50.1	34.4
2010	58.5	53.7	39.2
2011	(B) 52.6	29.8	62.0
2012	(C) 52.4		

(A) The fiscal year ended 2007 Fund Balance was taken from the 2007 Comprehensive Annual Financial Report.

(B) Contributions, expenditures and fund balance as of April 11, 2011.

(C) The proposed budget amount (less debt service requirement) is the only figure available for fiscal year 2011-2012.

Per City of Detroit Ordinance the City's Risk Management Fund is required to maintain a balance of \$20 million. The balance fell below that level at fiscal year ended June 30, 2007, but has been increasing in recent years.

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 following table shows the annual budgeted premiums for each of the previous five fiscal years, from fiscal years 2005-2006 through 2009-2010, the budgeted premium

¹ In previous Office of the Auditor General Analyses of the Mayor's Proposed Budget this chart showed the entire history of the Risk Management Fund beginning with the initial \$100 million in bonds, the excess or deficit for each year, and the balance of the funds remaining. It was determined that a more accurate picture of the Risk Management Fund position would be achieved by showing a five-year snapshot of the Risk Management Fund including the City contributions (less debt service requirements) and the expenditures. The Risk Management Fund Balances shown are in agreement with those stated in the City's Comprehensive Annual Financial Statements for the shown fiscal year.

and debt service for 2010-2011 and the Mayor's Proposed 2011-2012 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.

<u>General Fund and DDOT</u>			
Fiscal Year	Premium	Debt Service	Budgeted or Actual Appropriations
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	60.5	30.5	91.0
2010-2011	(A) 52.6	29.5	82.1
2011-2012	(B) 52.4	32.3	84.7
Total	\$ 376.5	\$ 156.9	\$ 533.4

(A) Budgeted premium and debt service for fiscal year 2010-2011.

(B) The proposed budget amounts for fiscal year 2011-2012.

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 the proposed budget of \$91.0 million for fiscal year 2009-2010.

As of June 30, 2010, the current balance of the 2003 and the 2004 self-insurance bond issues totaled \$96.9 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 have increased substantially since fiscal year 2008-2009. The principal payment nearly quadrupled 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 2011-2012 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, 2009 Comprehensive Annual Financial Report (CAFR) were \$192.5 million. The estimated total future liabilities of the Risk Management Fund included in the Notes to Basic Financial Statements of the June 30, 2010 CAFR were \$187.5 million. This is a decrease of \$5.0 million from the previous year.

The City's Current Risk Management Budgeting Approach

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 financially accountable for their actions or lack of actions resulting in workers' compensation 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. ...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.

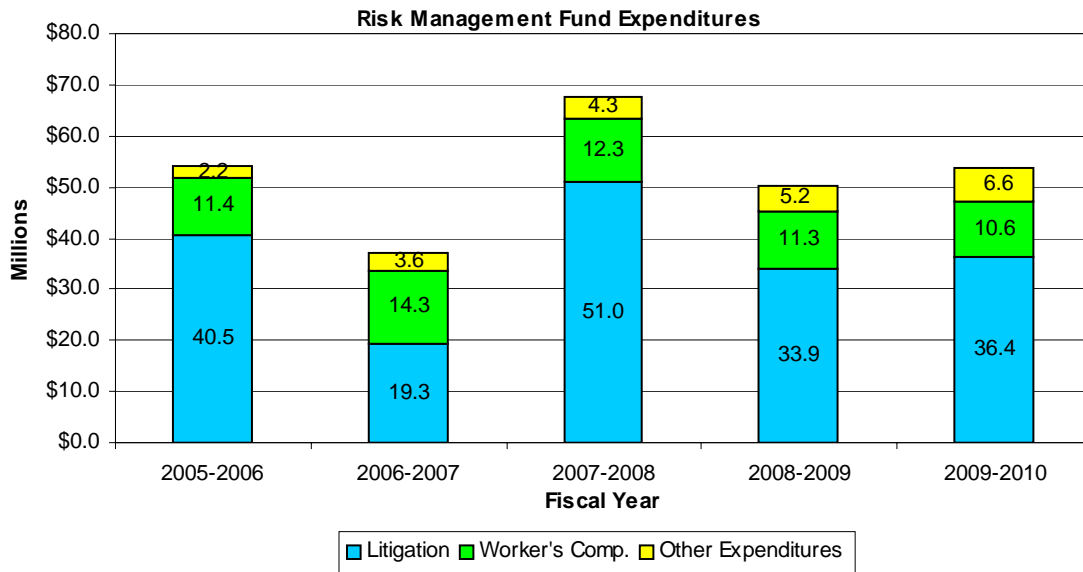
The budget should reflect the ordinance requiring each department to make a contribution to the Risk Management Fund based on the historical five-year average for actual payouts for which the department is responsible. Budgeting in this manner would allow the City Council and the Administration to hold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

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. For fiscal year 2009-2010, \$0.92 million has been charged back to departments causing them to adjust their budgets to account for these costs.

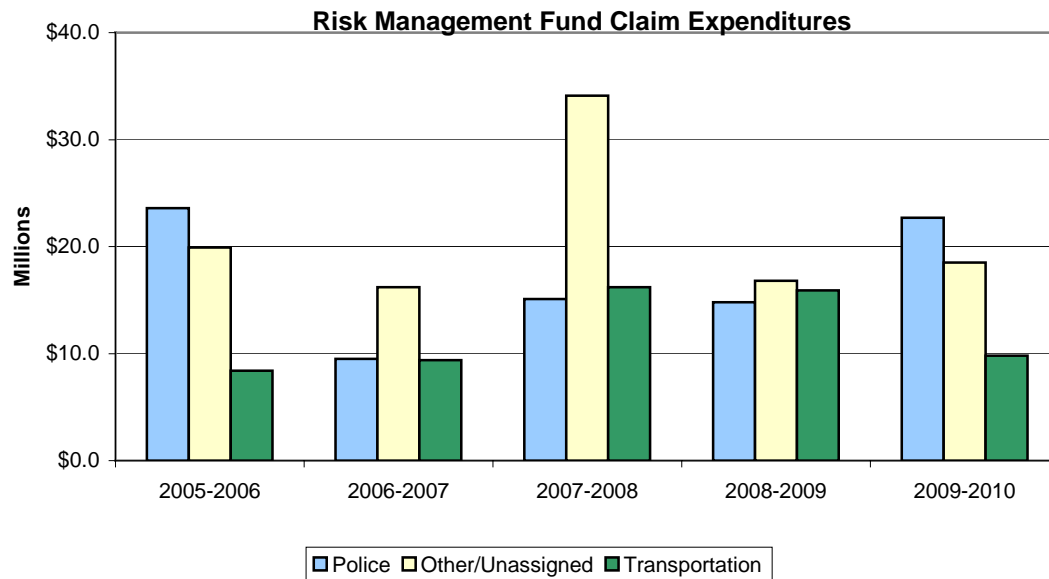
Litigation payouts make up the largest portion of risk management expenditures. In the past five years, the highest overall litigation payout was in 2007-2008 when the litigation payout was \$51.0 million. The lowest was in fiscal year 2006-2007 when the litigation payout was \$19.3 million. However, the litigation payouts for 2008-2009 decreased to \$34.3 million, a decrease of \$16.7 million from 2007-2008. Litigation payouts for fiscal year 2009-2010 were \$36.4 million, a \$2.1 million increase from the prior year. 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 and decreased again to \$2.8 million in 2009-2010. Litigation payouts for the Detroit Police Department increased from \$13.0 million in 2008-2009 to \$19.2 million in 2009-2010.

Expenditures

The following chart shows the trend in total Risk Management Fund expenditures over the past five years. Total expenditures were \$53.6 million in fiscal year 2009-2010.



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. The Detroit Historical Society (DHS), Detroit/Wayne County Port Authority (DWCPA), and the Detroit Zoological Society (DZS) are not as dependent on the subsidy from the City based on the amount of revenues received.

General Fund Subsidy Payments

The Mayor's 2011-2012 Proposed Budget includes \$60.5 million in general fund subsidy payments to the following City departments or entities:

	In Millions		
	Mayor's 2011-2012 Proposed Budget	2010-2011 Budget	Increase (Decrease)
Department of Transportation	\$ 51.2	\$ 50.9	\$ 0.3
Detroit Transportation Corporation	4.4	4.4	0.0
Charles H. Wright Museum of African American History	2.0	2.0	0.0
Detroit Zoological Society	0.8	0.8	0.0
Airport	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
Total	<u>\$ 60.5</u>	<u>\$ 60.2</u>	<u>\$ 0.3</u>

We analyzed trends of the general fund subsidy payments for fiscal years 2006-2007 through 2009-2010, 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 2006-2007 through 2009-2010, and the budgeted subsidy for fiscal year 2010-2011. Actual revenue is not available (N/A) for fiscal year 2010-2011.

Detroit Department Of Transportation (DDOT)

One of DDOT’s initiatives is to continue reorganization, emphasizing cost savings and increased revenue. From fiscal years 2006-2007 through 2009-2010, DDOT’s general fund subsidies have averaged \$74.2 million annually. On average, 47.9% of DDOT’s operating revenue is supported by subsidy. The Mayor’s 2011-2012 Proposed Budget includes a \$51.2 million subsidy for DDOT, which is an increase of \$0.3 million from fiscal year 2010-2011 subsidy of \$50.9 million. The following table shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2006-2007 through 2010-2011.

	Dollars In Millions				
	<u>2006-2007</u>	<u>2007-2008</u>	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
DDOT:					
Subsidy	\$ 70.6	\$ 73.5	\$ 78.9	\$ 73.8	\$ 50.9
Operating (Unrestricted) Revenue	\$ 150.9	\$ 157.5	\$ 158.5	\$ 152.6	N/A
Percentage of Subsidy to Revenue	46.8%	46.7%	49.8%	48.4%	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. From fiscal years 2006-2007 through 2009-2010 the People Mover’s annual subsidy was \$6.2 million. The general fund subsidy averaged approximately 55.5% of the People Mover’s operating revenue. The Mayor’s 2011-2012 Proposed Budget does not reflect any change from fiscal year 2010 - 2011. The table below shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2006-2007 through 2010-2011.

	Dollars In Millions				
	<u>2006-2007</u>	<u>2007-2008</u>	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
The People Mover:					
Subsidy	\$ 6.2	\$ 6.2	\$ 6.2	\$ 6.2	\$ 4.4
Operating (Unrestricted) Revenue	\$ 11.5	\$ 11.4	\$ 11.0	\$ 10.8	N/A
Percentage of Subsidy to Revenue	53.9%	54.4%	56.4%	57.4%	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 2006-2007 through 2009-2010, the general fund subsidy comprised an average of 41.7% of the MAAH’s operating revenue. In fiscal year 2009-2010, the MAAH received \$2.5 million from the City for general operations, which accounted for 50.0% of the MAAH’s operating revenue. The fiscal year 2010-2011 subsidy was reduced to \$2.0 million. The Mayor’s 2011-2012 Proposed Budget maintained the subsidy at \$2.0 million. The

following table shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2006-2007 through 2010-2011.

	Dollars In Millions				
	<u>2006-2007</u>	<u>2007-2008</u>	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
MAAH:					
Subsidy	\$ 1.8	\$ 2.0	\$ 2.5	\$ 2.5	\$ 2.0
Operating (Unrestricted) Revenue	\$ 4.7	\$ 6.1	\$ 5.5	\$ 5.0	N/A
Percentage of Subsidy to Revenue	38.3%	32.8%	45.5%	50.0%	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 3.4% 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 2006-2007 through 2010-2011.

	Dollars In Millions				
	<u>2006-2007</u>	<u>2007-2008</u>	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
Zoo:					
Subsidy	\$ 0.9	\$ 0.9	\$ 0.9	\$ 0.8	\$ 0.8
Operating (Unrestricted) Revenue	\$ 26.3	\$ 19.3	\$ 28.3	\$ 37.8	N/A
Percentage of Subsidy to Revenue	3.4%	4.7%	3.2%	2.1%	N/A

Airport

The Mayor's 2011-2012 Proposed Budget includes a \$0.8 million subsidy for the Airport, which does not reflect a change in the dollar amount from the fiscal year 2010-2011.

The table below shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2006-2007 through 2010-2011.

	Dollars In Millions				
	<u>2006-2007</u>	<u>2007-2008</u>	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
Airport:					
Subsidy	\$ 0.9	\$ 0.6	\$ 0.9	\$ 0.8	\$ 0.8
Operating (Unrestricted) Revenue	\$ 2.0	\$ 2.2	\$ 2.0	\$ 1.7	N/A
Percentage of Subsidy to Revenue	45.0%	27.3%	45.0%	47.1%	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 16.6% of the Society's operating revenue is from the general fund subsidy. The table on the following page shows the general fund subsidy, operating revenue and percentage of subsidy to revenue for fiscal years 2006-2007 through 2010-2011.

	Dollars In Millions				
	<u>2006-2007</u>	<u>2007-2008</u>	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
Society:					
Subsidy	\$ 0.5	\$ 0.5	\$ 0.5	\$ 0.5	\$ 0.5
Operating (Unrestricted) Revenue	\$ 3.0	\$ 3.1	\$ 2.8	\$ 3.2	N/A
Percentage of Subsidy to Revenue	16.7%	16.1%	17.9%	15.6%	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 2006-2007 through 2009-2010, the annual general fund subsidy has been \$0.3 million, which averages to approximately 8.3% 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 2006-2007 through 2010-2011.

	Dollars In Millions				
	<u>2006-2007</u>	<u>2007-2008</u>	<u>2008-2009</u>	<u>2009-2010</u>	<u>2010-2011</u>
Authority:					
Subsidy	\$ 0.3	\$ 0.3	\$ 0.3	\$ 0.3	\$ 0.3
Operating (Unrestricted) Revenue	\$ 2.1	\$ 2.6	\$ 8.6	\$ 8.0	N/A
Percentage of Subsidy to Revenue	14.3%	11.5%	3.5%	3.8%	N/A

ESTIMATED SURPLUS/ (DEFICIT)

Conclusion

In our opinion, the Mayor's 2011-2012 Proposed Budget estimate of \$5.2 million for the 2010-2011 prior year deficit lacks representational faithfulness. The \$5.2 million prior year's deficit was calculated based on the difference between an expected prior year's deficit of \$208.9 million, and the deferment of \$203.7 million of the deficit over a five year period. The deferment is also included in the Mayor's 2011-2012 Proposed Budget. Based on our analysis of major revenues, we determined that the expected prior year's deficit of \$208.9 million is understated by approximately \$13.6 million based on our analysis of major revenues. We also estimate the accumulated deficit for fiscal year 2011-2012 at approximately \$323.8 million.

Estimated Deficit - Fiscal Year 2010-2011

The Mayor's estimated deficit for fiscal year 2010-2011 includes the accumulated deficit of \$155.7 million from fiscal year 2009-2010, an anticipated operating deficit of \$97.2 million from fiscal year 2010-2011, and revenue items listed as accounting changes that total \$44.0 million. The following table provides a high-level view of how the proposed deficit of \$5.2 million is derived including the prior year's deficit, the current year's estimated operating deficit, the current years funding plan for addressing the accumulated deficit, and the proposed deferment of the prior year's deficit:

	<u>In Millions</u>
Fiscal Year 2009-2010 Accumulated Deficit	\$ (155.7)
Estimated Fiscal Year 2010-2011	
Revenue Deficit	\$ (124.5)
Estimated Fiscal Year 2010-2011	
Appropriation Surplus	<u>27.3</u>
Fiscal Year 2010-2011 Operating Deficit	(97.2)
<u>Funding Plan:</u>	
DPS Overpayment	\$ 15.0
Hamtramck/State of MI	15.0
Additional Recovery of Medicare	5.0
Recovery DWDD Central Services	3.0
Wayne County PLD Charges	2.0
HR IPO Billing FY 2010	2.0
Recovery Health Grant	<u>2.0</u>
Total Funding Plan	<u>44.0</u>
Total Proposed Accumulated Deficit	\$ (208.9)
Proposed Deferment of Prior Year's Deficit	<u>203.7</u>
Fiscal Year 2010-2011 Prior Year's Deficit	<u><u>\$ (5.2)</u></u>

We have determined that the projected prior year's deficit for fiscal year 2010-2011 is understated by approximately \$13.6 million based on our analysis of major revenues.

Estimated Accumulated Deficit – Fiscal Year 2011-2012

Based on our analysis of the Mayor's 2011-2012 Proposed Budget, we project the fiscal year 2011-2012 accumulated deficit at \$323.8 million. We have determined that the Mayor's projected accumulated deficit for fiscal year 2011-2012 is highly questionable, due to the following issues:

Deferment of Prior Year's Deficit

The Mayor's 2011-2012 Proposed Budget includes a deferment of prior year's deficit of \$203.7 million. Our office questions the budgetary soundness of deferring the prior year's accumulated deficit. Section 8-204 of the City's Municipal Code states that "the total proposed expenditures shall not exceed the total of estimated revenues." Section 15 of the Michigan Department of Treasury's Uniform Budget Manual for Local Units of Government states that "**the total estimated expenditures, including an accrued deficit, in the budget shall not exceed the total estimated revenues**, including an available unappropriated surplus and the proceeds from bonds or other obligations issued under the fiscal stabilization act or the balance of the principal of these bonds or other obligations."

The City budget operates on an annual basis. In our opinion the deferment of the prior year's accumulated deficit is inconsistent with the letter and spirit of both the City's Municipal Code and the State's Uniform Budget Manual as they are currently written.

Suspension of the Annual Loss Recovery Pension Payment

The Mayor's 2011-2012 Proposed Budget includes \$65.0 million for the suspension of the annual loss recovery payment to the City's pension funds. Approval of the suspension of the pension fund loss recovery payment is contingent upon the approval of the Board of Trustees for the General Retirement System and the Police and Fire Retirement System.

Gaming Tax

The Mayor's 2011-2012 Proposed Budget includes \$20 million in additional revenue through a one-year 3% increase of the City's portion of the gaming tax. This additional source of revenue in the Mayor's 2011-2012 Proposed Budget is contingent upon State legislation. Strong opposition from gaming lobbyists and special interest groups may obstruct the realization of this additional gaming revenue. Based on our analysis, we have determined that the additional \$20 million revenue in gaming taxes is questionable.

House Bill 4308 – License Renewal Revenue

The Mayor's 2011-2012 Proposed Budget includes \$10 million in additional revenue based on the approval of House Bill 4308, which lowers the threshold for any person renewing their license from six unpaid parking tickets to three. In addition to State approval, the initiative will also require amending the City ordinance. Based on our analysis, we determined that revenue to be realized is questionable.

State Revenue Sharing Shortfall

The Mayor's 2011-2012 Proposed Budget for State Revenue is \$6.3 million greater than the amount included in the Governor's 2011-2012 Executive Budget.

The following table provides a high-level overview of our estimated accumulated deficit for fiscal year ending 2011-2012:

FY 2010-2011 Estimated Accumulated (Administration)	\$ (208.9)	
Proposed Deferment of Prior Year's Deficit	<u>203.7</u>	
Mayor's 2011-2012 Proposed Prior Year's Deficit		\$ (5.2)
<u>OAG Revisions to Accumulated Deficit:</u>		
Deferment of Prior Year's Deficit	\$ (203.7)	
Suspension of Pension Payment	(65.0)	
Gaming Tax Revenue	(20.0)	
FY 2010-2011 Accumulated Deficit Shortfall	(13.6)	
License Renewal Revenue	(10.0)	
State Revenue Sharing Shortfall	<u>(6.3)</u>	
Total Accounting Changes		<u>(318.6)</u>
Fiscal Year 2011-2012 Accumulated Deficit		<u><u>\$ (323.8)</u></u>