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DATE: August 21, 2014

TO: Honorable Village Council Mary Kalbach
Village of Elberta Village Clerk

Neil Hammerbacher, CPA Sheila Applebee
Gabridge & Company Village Treasurer

COPY TO: Eric Cline, Office of Fiscal Responsibility, MI Department of Treasury
Roxanne Nicholas, Local Audit and Finance Division, MI Department of Treasury

FROM: Chris Olson, Consultant

RE: Summary and Detail Budget Amendments with Updated
End-of-Year Financial Information for FY 2013-14

Background

On February 26, 2014, the Village Council approved a series of budget amendments for FY 2013-14 for all of its funds. This met the statutory obligations of the Village to re-authorize spending limits as well as to address provisions in the State Treasury's notice of material weaknesses in internal controls to address these matters within the fiscal year (rather than after-the-fact).

The Village has traditionally approved its budgets and amendments at the fund level. At the time, I provided the Council with projections of the Village's financial picture utilizing the various activity areas within each fund, relying upon the accuracy and completeness of the February 25, 2014 revenue-expense statements and representations provided to me by Village staff at the time. As you are aware, the clerk and treasurer at that time both resigned their positions at the start of FY 2014-15 and did not provide transitional assistance to the Village, nor was there any information that large invoices were pending.

Present Issues and Work Products for your Review and Consideration

In early August, I received a call from acting Village President Robin Rommell, and we discussed the auditor's need for the sewer debt service schedules (which I previously FAXed to him) and for detailed, line-item budget amendments for the purpose of completing the Village's FY 2013-14 audit. Typically, Village staff would have made the line-item changes within a few weeks of the "big picture" fund and activities spending limits as approved by Council. However, with the turnover in the clerk and treasurer positions since March 2014, along with the reduced work hours for those positions, this task was not able to be performed. Obviously, it has not been a typical year for the Village.

Task Work: As to process, I would normally write in the line-item amendments on a monthly revenue-expense statement and provide that to the staff for the data entry changes. However, to assure accuracy and legibility, I instead hand-entered the attached series of Excel spreadsheets comprising the entire line-item financial statement for each Village fund. It was necessary to format this on legal-size paper in a landscape configuration to incorporate all of the financial information, as well as commentary. All of this work has taken longer than expected due to the extent of the task details and to consider further actions that could assist the Village to mitigate the new extent of the deficit(s). Those suggestions are included below.

Attached is the detail work for the FY 2013-14 that I have been doing since my conversations with Robin and Neil, based upon the most recent revenue-expense information from Clerk Mary Kalbach and Treasurer Sheila Applebee. For the large spreadsheet file, "sheet 1" on the bottom tab is the summary of the budget amendments by fund and activity area. This is an update showing what was done with the information available on February 25, and then with the August updates. "Sheet 2" shows all of the Village's operating funds in full line-item detail. I have shown the actual expenses as currently reported in comparison with the original budget adopted in February 2013, as well as the budget that was amended in February 2014. Included are percentages over/under for the original as well as the amended budgets, when compared to actual revenues and expenses.

While outside the scope of my contract, I also recognize the limitations of Village staff's time and what they need to do at present to maintain the Village's daily operations. Subsequently, I am not charging the Village for this additional work. It will also be helpful for the next version of the Deficit Elimination Plan, although it is my hope that certain costs can be re-examined, as you will read below.

Findings

Besides the budget amendments, there are some aspects of the financial statements that the Council should be aware of as well as the impacts upon the latest revision of Deficit Elimination Plan. Summarized, it appears that the overall General Fund deficit increased by \$113,817. This effectively increases the overall General Fund deficit from \$558,496 to \$672,313. The major causes for this are as follows:

- First, General Fund revenues came in about \$5,000 less than anticipated. While revenues came in at over 97% of the amended budget, this revenue shortfall is still significant in light of the deficit.
- Second, there are some significant expense over-runs in a number of General Fund activity areas that were not known at the time that the budget amendments were approved on February 26, 2014. You will see this on the attached summary and detail spreadsheets. These expenses were some of the largest causes for the deficit increase, and are discussed below.
 - a. **Attorney expenses of \$45,118 were apparently paid after February 28, and these were not known nor discussed at the Council meeting on February 26. This has had a significant negative impact on the general fund deficit for the year.** Presumably, these expenses were attributable to the zoning litigation matter with the Putneys and should be a one-time, non-recurring expense. However, the Village may still want to explore different liability carriers, as there are insurers which will provide zoning litigation coverage even if there are not plaintiff requests for monetary damages.
 - b. **The Fire Department activity area was \$2,202 over the amended budget (and \$2,000 over the original budget), as shown on the revenue-expense statement. This is primarily due to an added payment of \$3,369.70 that was not present on the February 25, 2014 revenue-expense statement.** Is the \$19,191.47 in contractual services to the Fire Authority totally attributable to FY 2013-14? If the quarterly payment to the authority is \$3,369.70, then that total should be \$13,479 for the total year, not \$19,191.47, unless other expenses were charged here. Also, these expenses have risen considerably over the past 3 years, and a fixed rate within the contract should be strongly considered.
- Third, there appear to be adjusting entries that were not accomplished which would have helped with the general fund deficit., as follows:

- a. **The labor expense in 101-441-70200 (General Fund Garage) was \$14,494 over budget, and should be examined to see if there are labor hours/expenses that actually occurred in the snow and ice maintenance activity in the street funds (202-478-70200 and 203-478-70200, respectively). It appears that the labor expenses for the ice and snow activity areas have not changed since the November 30, 2013 quarterly DPW wage distributions, and what is currently reported does not match up with the fuel and equipment rental expenses as shown in the snow and ice expenses.** Given the extent of this winter's snowfall and storms, it is not realistic that labor expenses for plowing/salting were less than \$1,000 in each street fund, and it appears that there is only about 134 hours of work for the two employees from December through February. The labor-to-equipment payback ratios in street fund routine maintenance averaged 1:1.5 for the two funds. In ice and snow, that ratio averaged 1:3.74, or over 2.5 times lower. Also, it is likely that a considerable amount of plowing/salting was done at an overtime labor rate, which should further decrease the ratio. **I would expect that there is approximately \$5,000 to \$6,000 in added labor for those two funds which could provide some relief to the General Fund.** My concern is that the general fund is still subsidizing the other operating funds, which unnecessarily increases the general fund deficit. The street funds already have large fund balances, both of which increased sizably at the end of the fiscal year. Salt expenses also seems to be very low for the severity of the winter as well. Lastly, if there are 4th quarter charges from 101-441-70200 to the water or sewer funds, then these should also be explored.
- b. Internally, 101-100-95500 was undercharged by \$3,920, and 101-253-95500 was overcharged by that same amount. Making this adjusting entry will put the Treasurer activity area back within budget, and the Council activity area will stay within its planned expenses. This is a much smaller concern than items "a" through "c."

Other funds were impacted as follows:

- Both Street funds finished much better than expected, due to apparent undercharging of labor expenses. Also, the Local Street Fund benefited from the new 1-mill road levy approved by County voters in November 2013.
- The Parks Fund went into deficit condition as anticipated, but the amount is not as large as projected in February. This is a good sign, although mitigated by information in FY 2014-15.
- The Sewer Fund operated at a small loss, including depreciation expense. However, the debt payments as shown in the line-item details, including a negative entry for the Rural Bond payment, appear to be inconsistent with the debt schedules from the USDA and BLUA.
- While slightly less than anticipated, the Water Fund still suffered a sizable loss in FY 2013-14 and has an overall deficit of about \$32,000. It appears that this loss is continuing into FY 2014-15, and a rate study should be performed to determine how large of a rate increase is necessary for this operation to eliminate the current deficit and to operate in the future without incurring losses.

It should be noted that the losses in the sewer and water funds include depreciation costs, which are "paper" expenses. However, the water fund's operational losses are greater than depreciation expense, so this fund is in a true deficit. The sewer fund is not operating at an operational loss. However, the failure to include depreciation in both funds' budgets (to determine needed revenues), will adversely impact financial resources necessary for emergency system repairs.

Additional Findings from FY 2014-15

Sheila FAXed me the FY 2014-15 YTD revenue-expense statement (dated 8-18-2014) and then today sent an updated report dated 8-19-2014. There are additional concerns that I would like to share with you. I have performed an initial review at this point, but there are some items which will affect the DEP for the General, Park and Water Funds, respectively.

- First, wages in Garage, 101-441-70200, have already exceeded the fiscal year budget. Secondly, Waste Removal, 101-528-80150, has also exceeded its fiscal year budget (was there sufficient offsetting revenue for Spring Clean-Up?).
- Administrative fees to the various operating funds have not been charged to those respective funds, which should be done for those that did not incur deficits at the end of FY 2013-14.
- Sale of Fixed Asset: At six months into the fiscal year, the anticipated sale of the Library has not yet occurred. This is a critical component of the Deficit Elimination Plan. I encourage the Village to consummate a sale with the Township as soon as possible, or to advertise the property while there are still some “warm months” for showings.
- Street Funds: Both Street funds have large equipment payback charges in their ice and snow activity areas that have exceeded their annual budgets. That these amounts could be incurred from March to August, with virtually no labor charges, does not seem probable. It appears that the equipment hours should be attributed to routine maintenance for summer seasonal work, or were simply not cleared on the statements from the prior fiscal year (but those amounts did not match the FY 2013-14 figures).
- Parks Fund: It appears that all Solstice Festival expenses are in at \$22,897. While this slightly exceeds the amended budget, these costs are close to traditional levels. However, revenues are only reported at \$8,116, and Festival revenues are typically within \$1,000 of expenses. I am assuming that the Festival did not incur such a large loss. If all funds have not been provided for deposit or reported to the Village, then those monies need to be deposited and/or the necessary accounting entries made. A \$15,000 loss at this time would be virtually impossible for the Park Fund to overcome within the five year DEP at current operational levels.
- Sewer Fund: This appears to be in good shape, although budget amendments for FY 2014-15 that were discussed with the BFA committee earlier this summer need to be entered into the system. Revenues are at 65%, and expenses are at 26%, which is a bright spot for the Village’s finances. **I will assemble these amendments for your future consideration, based upon my notes from that meeting.**
- Water Fund: At six months into the current fiscal year, revenues are less than 43% rather than reaching at least 50% for the “warm” half of the year. While overall expenses are currently at 38%, I am concerned that the labor, fuel and utility expenses for that fund are already at 65% and that repairs/maintenance is at 70%. These expenses are continual and ongoing, and if the trend continues, then the fund will have a more significant loss than prior years. As stated above, the Council needs to address water rates to eliminate the existing deficit as well as to stop the annual operational losses. Water usage increases due to customer base additions should be part of the considerations. Water losses should also be examined (the difference between the volume of what is pumped at the wells versus what is billed to customers).

STATUS OF DEFICIT ELIMINATION PLAN

The suggested corrections stated above would assist the Village’s current deficits, and in my “what-if” scenario work thus far, I have not been able to eliminate the general fund deficit within the required 5 years without the Council considering and authorizing some fairly drastic steps.

The history of the General Fund Deficit Elimination Plan is as follows:

	<u>Annual Losses</u>	<u>Overall Deficits</u>	<u>Growth Rate</u>
Actual Deficit as of 2-28-2011:		\$539,726	
Actual Deficit as of 2-28-2012:	(\$12,350)	\$552,076	2.3%
Actual Deficit as of 2-28-2013:	(\$ 6,421)	\$558,497	1.2%
Original Plan, January 14, 2014:	(\$18,790)	\$577,287	3.4%
1 st Revision, February 25, 2014:	(\$53,000)	\$611,497	9.5%
Pending Revision, August 21, 2014:	(\$113,817)	\$672,314	20.4%

Options that were considered:

- a. **Sale of the Village’s remaining assets:** This will not be viable. The value of the Village’s remaining park properties (that could possibly be sold) do not come up to \$61,000, and are further complicated by isolation restrictions necessary for the Village’s well system. This reduces the usability of these properties for development, and likely reduces their value below the appraised values (and 100’ public well isolation was not addressed by the appraiser as a property restriction). In the case of selling the community center, it is my experience that CDBG funds would have to be repaid upon sale of the property, although this should be researched due to the length of time since those funds were granted and the age of the structure. However, if repayment is required, this would make the proceeds of such a sale less than what is needed for deficit elimination.
- b. While previously discussed and rejected, **contracting out the Village’s public works functions** should be reconsidered, provided that desired service levels can be strictly enforced along with the containment of costs to eliminate the deficits in the General, Parks and Water funds. While this would reduce the Village’s flexibility to respond to the needs and wants of current operations, this would save funds as well as to relieve the Village of significant liabilities as well as future equipment, facility and vehicle replacement expenses.
- c. **Increasing the property tax rate** may be necessary, particularly if suggestion “b” is rejected by the Council. The Village has incurred operational losses in its General Fund, Parks Fund and Water Fund in each and all of the past 3 years. The rate of deficit growth has also increased, despite the awareness and steps taken to reduce it at the conclusion of FY 2013-14. In January, I was instructed to formulate a plan that did not include tax increases, which I agreed with and accomplished. **However, conditions have now significantly changed.** Water rates need to be addressed as well, and have been previously discussed.

RECOMMENDED ACTIONS:

First, Village staff need to incorporate the line-item budget changes as noted within the Village's Fund Balance system for the FY 2013-14 amended budget so that the detail that supports the Council's previously-approved budget amendments is completed. The budget amendments are highlighted in yellow on the attached detail sheets.

Secondly, research into the actual spending and the representative accounting entries should be done by Village staff and the auditor. These are highlighted in pink on the attached spreadsheet. This is critical, particularly if reductions to the general fund deficit can be accomplished prior to the next update of the DEP.

Third, the Council needs to discuss certain policy and departmental directions for the Village for incorporation into the next revision of the DEP in light of the new deficit information. **I suggest that a special meeting of the Village Council and staff be scheduled to concentrate solely on this matter. This meeting should also include Eric Cline and Roxanne Nicholas, and the candidates for Council, Clerk and Treasurer positions. The annual audit should also be presented at this meeting, as updated with the information as recommended herein. Per statute, this will need to occur prior to August 31, 2014.**

Motion by: _____

Seconded by: _____

Vote: Gattrell _____
Holmes _____
Jenks _____

Manville, R _____
Rommell _____
Wilkins _____