

Municipal Bankruptcy in America – Lessons Learned



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Today's Agenda

- Status of Municipal Bankruptcies in the US
- Accounting, Financial Reporting and Auditing
- Lessons Learned - Managing to avoid bankruptcy

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»»» Status of Municipal Bankruptcies in the US





Status of Municipal Bankruptcies in the US

- Still a rare occurrence – out of 89,000 governments+ in the US:
 - 38 municipal governments have filed (no states)
 - 9 Cities, Counties and Towns
 - Detroit
 - San Bernardino, California
 - Mammoth Lakes, California (dismissed)
 - Stockton, California
 - Jefferson, County Alabama
 - Westfall, Pennsylvania
 - Harrisburg, Pennsylvania (dismissed)
 - Central Falls, Rhode Island
 - Boise, County, Idaho (dismissed)
 - 2 cases in 1990's – Orange County California (1994) and Pritchard Alabama (1999 and 2009 *again*)



Status of Municipal Bankruptcies in the US

- Still a rare occurrence – out of 89,000 governments+ in the US:
 - 30 municipal and similar districts including
 - 8 District / Community Hospitals
 - Community Improvement Districts or similar
 - Water and other Utility Districts
 - Property owners associations
 - South Carolina Toll Road (Southern Connector)
 - Off Track Betting – Suffolk County New York



Status of Municipal Bankruptcies in US

- Not more prevalent because
 - 23 states do not have law allowing it
 - Most have some form of trustee / oversight commission
 - 19 states have intervention programs for distressed government
 - 3 states (Oregon, Colorado, Illinois) only have limited authorization
 - Oregon – only for irrigation districts
 - Colorado – very limited
 - Illinois – only Illinois Power Authority
 - 12 states only allow after approval by the state or other entity
 - Remaining 12 adopted federal statute (Chapter 9) or similar



Typical Situation – City of San Bernardino

	2011			2010		
	Govt activities	Bus-type activities	Total	Govt activities	Bus-type activities	Total
Current and other assets	\$ 258.8	\$ 133.7	\$ 392.5	\$ 251.6	\$ 134.2	\$ 385.8
Capital assets	460.8	255.5	716.3	464.2	258.0	722.2
Total assets	<u>719.6</u>	<u>389.2</u>	<u>1,108.8</u>	<u>715.8</u>	<u>392.2</u>	<u>1,108.0</u>
Long-term debt	284.8	64.2	349.0	285.2	68.7	353.9
Other liabilities	72.3	71.0	143.3	44.9	70.8	115.7
Total liabilities	<u>357.1</u>	<u>135.2</u>	<u>492.3</u>	<u>330.1</u>	<u>139.5</u>	<u>469.6</u>
Net assets:						
Invested in capital assets, net of debt	425.7	204.4	630.1	417.6	201.0	618.6
Restricted	197.7	8.3	206.0	188.9	12.0	200.9
Unrestricted	(260.9)	41.3	(219.6)	(220.8)	39.7	(181.1)
Total net assets	<u>\$ 362.5</u>	<u>\$ 254.0</u>	<u>\$ 616.5</u>	<u>\$ 385.7</u>	<u>\$ 252.7</u>	<u>\$ 638.4</u>

Amounts in Millions



Typical Situation – City of San Bernardino

- Negative unassigned fund balance in General Fund - \$1.3 million
- Governmental Fund balance negative unassigned fund balance - \$40 million
- General fund borrowed funds from other funds - \$10.2 million to cover shortfalls in cash
- Unfunded OPEB liability was \$87 million
- Taxable real estate value dropped by \$1.3 billion between 2009 and 2011



Not typical situation – Mammoth Lakes CA, Boise County, Idaho

- Both governments –
 - Court cases against Town / County
 - Town of Mammoth Lakes - \$43 million property dispute
 - Boise County – violation of fair housing act \$5.4 million
 - In both cases – governments were found not insolvent by bankruptcy judges
 - In both cases – avoidance of settlement claims



Accounting and Financial Reporting Provisions

- *GASB-58 (Accounting and Financial Reporting for Chapter 9 Bankruptcies)*
 - Not applicable where Chapter 9 is not available
 - Must be granted relief by a court
 - Government *not* expected to emerge as a going concern
 - Plan of adjustment filed with the court may call for payments contingent on future events
 - Taxes collected exceed thresholds
 - New debt allowed to be issued by court
 - If contingent payments exist – liability recognized



Accounting and Financial Reporting Provisions

- *GASB-58 (Accounting and Financial Reporting for Chapter 9 Bankruptcies)*
 - Plan of adjustment may result in
 - Reduced debt service – gains recorded for the difference between old and new debt
 - Issuance costs should be expensed per GASB-65
 - Lease terminations / modification may also result in a gain
 - Largest change usually in post-employment benefits
 - Termination of plan may result
 - Assets and liabilities eliminated and net is gain / loss
 - If no termination but modification – accounted for as a change in the plan(s)
 - GASB-68 would have the change deferred and amortized over remaining service life of employees or revenue / expense for retirees



Accounting and Financial Reporting Provisions

- *GASB-58 (Accounting and Financial Reporting for Chapter 9 Bankruptcies)*
 - Other liabilities remeasured to basis of payment expectations (e.g. environmental liabilities)
 - For governments dis-incorporating – assets adjusted to fair value expected to be received as of the date of confirmation of plan adjustment – usually \$0
 - All gains & losses reported as extraordinary items
 - All costs of bankruptcy are expensed
 - Reporting includes
 - Conditions that caused bankruptcy
 - Plan of adjustment
 - Termination / combination of the government



Accounting and Financial Reporting Provisions

- *GASB-62 (Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements)* applies to non-Chapter 9 situations
 - Troubled debt restructuring may occur
 - If assets transfer in settlement
 - Assets marked to fair value or market value
 - Difference between fair value and carrying value is gain or loss
 - Liability restructuring
 - Gain or loss may occur based on cash flow differential
 - Disclosure similar to GASB-58



Accounting and Financial Reporting Provisions – Other

- GASB-69 (*Government Combinations*) may apply
 - Government would dis-incorporate
 - Assets, deferrals and liabilities transfer at carrying value
 - Presumption of GAAP
- Adjustments
 - Accounting principles, policies, and estimates
 - Capital asset impairment
 - Transaction eliminations
- Transferor reports a gain or loss as a special item—should consider all costs directly associated with disposals of operations



Accounting and Financial Reporting Provisions – Other

- GASB-70 (*Nonexchange Financial Guarantees*) may also apply
 - Guarantor government may have a liability to pay debts of troubled government
 - Troubled government would have revenue upon release of a liability paid by another government with no obligation to repay



Lessons Learned - Managing to Avoid Bankruptcy

- Common themes of governments that have declared bankruptcy or are fiscally unstable
 - Excessive debt issuance
 - Not realizing that post-employment benefits that cannot be changed easily are really debts
 - Concentrations of revenue (or declining revenue) from
 - Particular industry or taxpayer base
 - Different level of government (federal / state) (fiscal dependency)
 - Inflexible collective bargaining
 - Short-sighted decision-making (managing only to an election cycle)



Lessons Learned - Managing to Avoid Bankruptcy

- Key Lessons include Management in place with
 - Full understanding of debt position and post-employment plan(s) obligation(s) present and future
 - Full understanding of laws regarding both
 - Both should be limited to a percentage of personal income or tax base
 - Include overlapping debt from other jurisdictions charged to government
 - Understand if debts are guaranteed by a higher level of government
 - Update at least monthly (maybe weekly) if under fiscal stress
 - Understanding of schedule of regulatory filings



Lessons Learned - Managing to Avoid Bankruptcy

- Key lessons include Management in place with
 - Administrative abilities
 - Consolidation of functions / programs in government
 - Shared services with other governments, especially in
 - Purchasing
 - Banking (investment pools)
 - Payroll and benefits
 - Information technology
 - Tax collection
 - Considered the cost of carrying capital assets
 - Do we sell City Hall?
 - Can public works be contracted for?
 - Can a higher level of government perform program / service?



Lessons Learned - Managing to Avoid Bankruptcy

- Key lessons include Management in place with
 - Administrative abilities (continued)
 - Is there an ability to merge / transfer program (or entire government) with another government?
 - Thinking outside norm
 - Mandate budget constraints to revenue base
 - Create a stabilization fund (rainy day) based on a percentage of revenues
 - Draws from the fund must be restricted
 - Working with other governments to create
 - Fiscal monitoring system at higher level of government (e.g. California Municipal Fiscal Health Diagnostic system)
 - Independent committee to approve debts of all types and post-employment benefits
 - Seeking new, reliable sources of revenue
 - Types depend on tax structure of jurisdiction (residential / commercial / agricultural)
 - Transit oriented development and congestion pricing are success stories
 - Balance quality of life (casinos are not always the answer)



California Municipal Fiscal Health Diagnostic System

- **Measures based on audited financial reports**
 - **Cash solvency** – ability to meet obligations over the next 30-60 days – accounts payable / payroll
 - **Budgetary solvency** – ability to meet all financial obligations next year based on prior receipts
 - **Long run solvency** – ability to meet all financial obligations in the future based on economics
 - **Service level solvency** – ability to provide the desired level of services for general health and welfare of the community
- **Based largely on ICMA's fiscal trends monitoring system (FTMS)**

Example of FTMS

City of Fort Lauderdale Financial Trend Monitoring System (FTMS) Results			
Revenue Indicators			
Indicator	Formula	Warning Trend	Rating
Revenue Per Capita	General government revenue/ Population	Decreasing net operating revenues per capita (constant dollars)	Favorable 
Percentage of Restricted Revenue	Restricted operating revenue/ General government revenue	Increasing amount of intergovernmental operating revenues as a percentage of gross operating revenues	Favorable 
Intergovernmental Revenue	Intergovernmental revenue/ General government revenue	Increasing amount of intergovernmental operating revenues as a percentage of general government revenue	Favorable 
Tax Revenue	Tax revenues	Decline in tax revenue	Unfavorable 

Tax Revenue decline is an issue in the City – declining tax base



Example of FTMS

Expenditure Indicators			
Indicator	Formula	Warning Trend	Rating
User Charge Coverage	Revenue from fees and user charges/ Expenditures for related services	Decreasing revenues from user charges as a percentage of total expenditures for related services.	Favorable 
Expenditures Per Capita	Net operating expenditures (constant dollars)/ Population	Increasing net operating expenditures per capita	Caution 
Expenditures by Function	Operating expenditures for one function/ Total net operating expenditures	Increasing operating expenditures for one function as a percentage of total net operating expenditures	Caution 
Employees Per Capita	Number of Full Time Equivalent (FTE)/ Population	Increasing number of municipal employees per capita	Favorable 
Fringe Benefits	Fringe Benefit Expenditures/ Salaries and Wages	Increasing fringe benefit expenditures as a percentage of salaries and wages	Unfavorable 

Issues with cost of services related to population growth – Fringe benefits are a Key concern (like most cities)



Example of FTMS

Operating Position Indicators			
Indicator	Formula	Warning Trend	Rating
Operating Deficit or Surplus	Operating deficit or surplus/Operating revenues	Increase in general fund operating deficit or surplus as a percentage of net operating revenues	Unfavorable 
Enterprise Operating Position	Operating income (constant dollars)	Recurring operating income losses	Caution 

Capital Plan Indicator			
Indicator	Formula	Warning Trend	Rating
Capital Outlay	Capital outlay/ Total operating expenditures	A three or more year decline in capital outlay from operating funds as a percentage of net operating expenditures	Unfavorable 

Summary position is unfavorable, but also trends are not favorable – see capital outlay



Study Recommendations

- Dependent upon appropriate financial controls
 - The City should formalize Financial Integrity Policies and Principles to ensure the long - term fiscal health of the City.
 - The City should continue to participate in long-range budgetary planning and financial forecasting.
 - The City should develop and track additional key performance measures to monitor key financial trends from the Financial Trend Monitoring System (FTMS)
 - Programs aimed at increasing valuation of residential and commercial properties within the City of Fort Lauderdale should be researched and developed.
 - Fort Lauderdale should develop and adopt a formalized policy related to standardizing user fees to ensure an appropriate level of cost recovery for City programs.



Study Recommendations

- City staff should actively search for and pursue intergovernmental and other grants as well as other grant related opportunities to capitalize on funds available from sources outside of the City.
- The City should increase its efforts to lobby for tourism revenues that are currently being generated in Fort Lauderdale.
- The City should create a committee to focus on developing ways to capitalize on the City's growing tourism base and further leverage associated tourism tax revenues from the County.

Recommendations focused on **cost cutting strategies**:

- The City should continue to engage in a comprehensive budget analysis instead of simply utilizing incremental budgeting strategies.
- The City should explore the possibility of privatization with the aim of lowering costs to the City while retaining quality of service level.
- The City should engage in additional pension reform.

Questions!



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