Municipal Bankruptcy in America – Lessons Learned

International Consortium on Governmental Financial Management
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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

#### Amounts in Millions

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Govt activities</td>
<td>Bus-type activities</td>
</tr>
<tr>
<td>Current and other assets</td>
<td>$ 258.8</td>
<td>$ 133.7</td>
</tr>
<tr>
<td>Capital assets</td>
<td>460.8</td>
<td>255.5</td>
</tr>
<tr>
<td>Total assets</td>
<td>719.6</td>
<td>389.2</td>
</tr>
<tr>
<td>Long-term debt</td>
<td>284.8</td>
<td>64.2</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>72.3</td>
<td>71.0</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>357.1</td>
<td>135.2</td>
</tr>
</tbody>
</table>

#### Net assets:

- **Invested in capital assets, net of debt**
  - 2011: $425.7, $204.4, $630.1
  - 2010: $417.6, $201.0, $618.6

- **Restricted**
  - 2011: $197.7, $8.3, $206.0
  - 2010: $188.9, $12.0, $200.9

- **Unrestricted**
  - 2011: $(260.9), $41.3, $(219.6)
  - 2010: $(220.8), $39.7, $(181.1)

#### Total net assets

- 2011: $362.5, $254.0, $616.5
- 2010: $385.7, $252.7, $638.4
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

- 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

- 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

- 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

• 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

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Formula</th>
<th>Warning Trend</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Per Capita</td>
<td>General government revenue/Population</td>
<td>Decreasing net operating revenues per capita</td>
<td>Favorable</td>
</tr>
<tr>
<td>Percentage of Restricted Revenue</td>
<td>Restricted operating revenue/General government revenue</td>
<td>Increasing amount of intergovernmental operating revenues as a percentage of gross operating revenues</td>
<td>Favorable</td>
</tr>
<tr>
<td>Intergovernmental Revenue</td>
<td>Intergovernmental revenue/General government revenue</td>
<td>Increasing amount of intergovernmental operating revenues as a percentage of general government revenue</td>
<td>Favorable</td>
</tr>
<tr>
<td>Tax Revenue</td>
<td>Tax revenues</td>
<td>Decline in tax revenue</td>
<td>Unfavorable</td>
</tr>
</tbody>
</table>

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

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

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

<table>
<thead>
<tr>
<th>Operating Position Indicators</th>
<th>Formula</th>
<th>Warning Trend</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Deficit or Surplus</td>
<td>Operating deficit or surplus/Operating revenue</td>
<td>Increase in general fund operating deficit or surplus as a percentage of net operating revenues</td>
<td>Unfavorable</td>
</tr>
<tr>
<td>Enterprise Operating Position</td>
<td>Operating income (constant dollars)</td>
<td>Recurring operating income losses</td>
<td>Caution</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Capital Plan Indicator</th>
<th>Formula</th>
<th>Warning Trend</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Outlay</td>
<td>Capital outlay/Total operating expenditures</td>
<td>A three or more year decline in capital outlay from operating funds as a percentage of net operating expenditures</td>
<td>Unfavorable</td>
</tr>
</tbody>
</table>
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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