

Update on the Financial Condition of the City of Battle Creek

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Executive Summary

- The City of Battle Creek continued its strong results in 2010, with increases in reserves, declines in debt, and increases in fund balances.
- The main revenue sources all increased from 2009 to 2010.
- Looking forward, the decline in the State shared revenue that is being proposed will not have a significant effect at all for 2012 revenues and beyond.

Statement of Net Assets: Big Picture

Total Primary Government	2008	2009	2010
Total Assets	433,226,754	427,428,145	417,370,891
Total Liabilities	69,712,471	68,343,861	62,756,476
Net Assets	363,514,283	359,084,284	354,614,415
	2008	2009	2010
Total Assets	100%	100%	100%
Total Liabilities	16%	16%	15%
Net Assets	84%	84%	85%

- The percentage of liabilities is very low, indicating that the City has very little debt. We will confirm this conclusion later.
- Note the liability percentage got lower in 2010; this is because no new debt was issued, and some principle of debt was paid off.

Statement of Net Assets: Government Activities Only

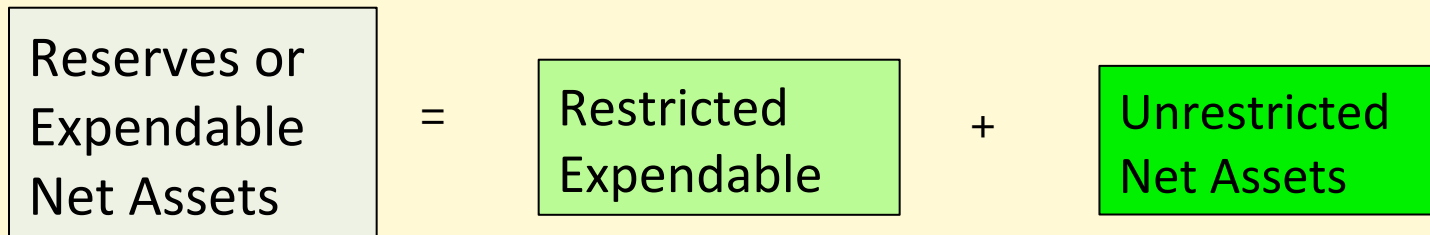
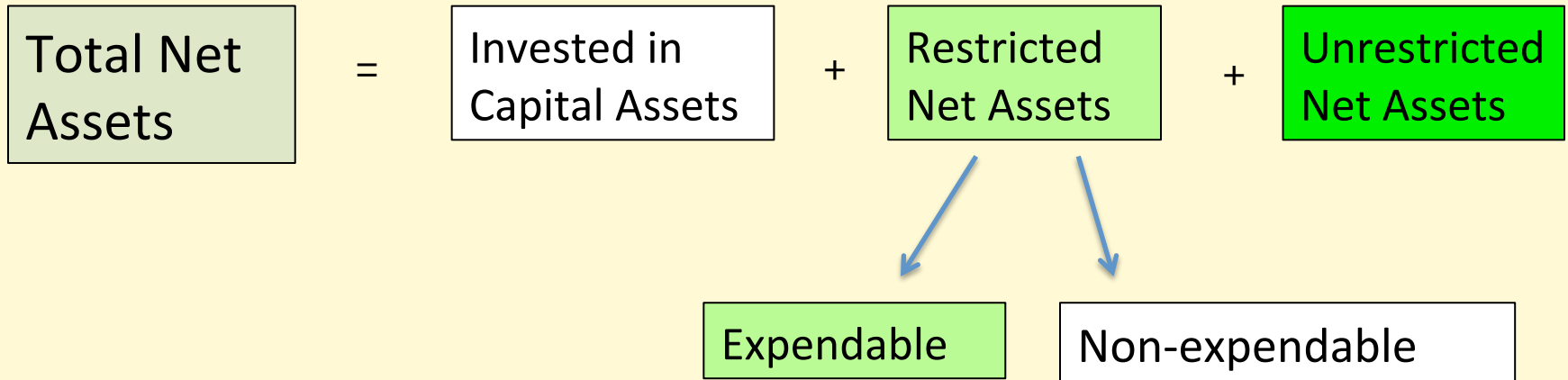
Government Activities Only	2008	2009	2010
Total Assets	291,922,027	287,112,610	278,357,798
Total Liabilities	44,544,532	42,470,759	39,608,533
Net Assets	247,377,495	244,641,851	238,749,265
	2008	2009	2010
Total Assets	100%	100%	100%
Total Liabilities	15%	15%	14%
Net Assets	85%	85%	86%

- This table takes out the wastewater and water activities
- However, it still reveals that the City has very little debt, and that the amount of debt decreased in 2010.

Components of Net Assets or Reserves

- Net assets in the NPO sector are the equivalent of owner's equity in the for-profit sector. They are often referred to as reserves. There are several components of net assets:
 - Net Assets invested in capital assets, which do not reveal any significant inference about an NPO's financial condition
 - Restricted net assets, which are those that are earmarked for specific purposes, but which may be utilized at the City's discretion. Some of these are expendable, and some are not expendable.
 - Unrestricted net assets, which can be seen as a pure reserve fund for the City, to be used without restrictions.
- Expendable net assets are the numerical sum of restricted-expendable net assets and unrestricted net assets. These expendable net assets are the equivalent of retained earnings in the for-profit sector.
- The expendable net assets are those net assets that can be used for operations or to pay off debt of the city. Therefore, they are an indication of financial flexibility. These expendable net assets do not represent a pot of cash; however, they indicate that the City either has cash of this amount, or has access to cash in this amount.
- Expendable net assets are seen by the financial community as an important measure of financial strength, which is why we will see these metric used in several ratios used by bond rating agencies.

Reserves



Analysis of 2010 Reserves

	Total Primary Government	Government Activities Only
Restricted - Expendable	1,157,171	1,157,171
Unrestricted	48,473,958	29,256,852
Total Expendable	49,631,129	30,414,023
Total Expenses	94,867,246	62,840,710
Primary Reserve Ratio	52%	48%

- The primary reserve ratio = Total expendable net assets / Total Expenses
- The level of reserves is very high, as we will see later when we compute the Moody's scores.
- A primary reserve ratio of close to 50% means that the City has almost 6 months worth of expenses in reserve. This is much larger than other cities.

Do These Reserves Represent Liquidity? YES!

	Total Primary Government	Government Activities Only
Cash and Investments	40,351,136	27,224,505
Receivables	21,028,134	15,370,270
Inventories	3,021,022	1,439,966
Total Current Assets	64,400,292	44,034,741
Accounts Payable	13,239,455	7,976,443
Interest Payable	251,470	251,470
Unearned Revenue	1,194,628	1,081,772
Total Current Liabilities	14,685,553	9,309,685
Excess of Current Assets Over Current Liabilities	49,714,739	34,725,056
Total Reserves	49,631,129	30,414,023
Current Ratio 2010	4.39	4.73
Current Ratio 2009	3.50	3.65

- A current ratio of between 4 and 5 is extremely high, and demonstrates solid liquidity
- The current ratio increased significantly from 2009 to 2010

History of Reserves

Total Primary Government	2006	2007	2008	2009	2010
Unrestricted Net Assets	58,855,585	55,362,938	52,704,905	46,629,950	48,473,958
Total Expenses	89,261,668	93,137,802	99,533,824	96,474,947	94,867,246
Primary Reserve Ratio	66%	59%	53%	48%	51%
Government Activities Only	2006	2007	2008	2009	2010
Unrestricted Net Assets	38,237,634	33,944,289	33,063,496	28,294,180	29,256,852
Total Expenses	56,771,517	60,611,202	64,441,719	63,443,180	62,840,710
Primary Reserve Ratio	67%	56%	51%	45%	47%

- The primary reserve ratio is increased for 2010, after declining for the last few years.
- Still, the level at 51% is very high;
- The increase demonstrates that 2010 was a strong year for the City

Reserves and Debt

Total Primary Government	2006	2007	2008	2009	2010
Unrestricted Net Assets	58,855,585	55,362,938	52,704,905	46,629,950	48,473,958
Debt	53,179,948	52,320,899	49,401,276	46,028,207	45,039,688
Viability Ratio	111%	106%	107%	101%	108%

- The viability ratio is defined as reserves (here, unrestricted net assets) divided by debt
- A viability ratio over 100% is considered extremely strong
- Conclusions:
 - High level of reserves
 - Low level of debt

Reserves from a Fund Perspective: Fund Balance

- Cities are typically constitutionally required to balance the budget, and the budget is in the General Fund and all funds.
- For this reason, we need to examine reserves and its relation to total expenses in both the General Fund and all funds (there is no debt in the fund balance sheet)
- In the fund statements, we call reserves the fund balance, and the “free” reserves are unreserved fund balances.

Fund Balance Sheet for 2009 and 2010: All Funds

	2009		2010	
All Funds	Dollars	% of Total Assets	Dollars	% of Total Assets
Total Assets	28,213,793	100%	26,093,431	100%
Total Liabilities	16,933,010	60%	14,632,323	56%
Reserved Fund Balance	2,801,961	10%	1,272,407	5%
Unreserved Fund Balance	8,478,822	30%	10,188,701	39%
Total Fund Balance	11,280,783	40%	11,461,108	44%

- From a fund perspective, reserves are very strong.
- There was a significant increase of \$1.7 million in the unreserved fund balance from 2009 to 2010.
- The City will try and claim that some of the unreserved fund balance is “designated.” However, the City can reverse those decisions at its discretion. If the reserves were truly irreversible, the outside auditors would put them in the reserved category.

Fund Balance Sheet for 2009 and 2010: General Fund Only

	2009		2010	
General Fund Only	Dollars	% of Total Assets	Dollars	% of Total Assets
Total Assets	16,750,347	100%	15,328,704	100%
Total Liabilities	9,332,421	56%	8,069,004	53%
Reserved Fund Balance	531,030	3%	185,776	1%
Unreserved Fund Balance	6,886,896	41%	7,073,924	46%
Total Fund Balance	7,417,926	44%	7,259,700	47%

- As with all the funds, the unreserved fund balance, which is the measure of reserves that the City believes is most relevant, increased from 2009 to 2010
- The ratio of unreserved fund balance to total assets (47%) is extremely high, and is far above the recommended level of 5 to 15%

Fund Reserves Compared to Total Fund Expenditures

All Funds:	2006	2007	2008	2009	2010
Unreserved Fund Balance	19,721,817	17,418,117	14,147,903	8,478,822	10,188,701
Total Expenditures	62,171,424	64,673,803	64,892,342	65,978,301	57,995,539
Viability Ratio	32%	27%	22%	13%	18%
General Fund Only:	2006	2007	2008	2009	2010
Unreserved Fund Balance	9,574,180	7,500,072	7,875,800	6,886,896	7,073,924
Total Expenditures	38,761,312	40,283,842	41,594,473	41,322,532	39,821,886
Viability Ratio	25%	19%	19%	17%	18%

- A ratio of between 5% and 15% is considered solid, as the next slide demonstrates
- For the General Fund, Battle Creek is at 18% and increased from 2009 to 2010

Decline in Fund Expenditures from 2009 to 2010

- Total Fund Expenditures declined from approximately \$66 million in 2009 to \$58 million in 2010. This main reasons for the \$8.0 million decline was due to:
 - \$5.3 million decline in highway and road
 - \$2.4 million decline in general government
 - \$0.8 million decline in parks and recreation
 - \$0.2 million decline in public safety
 - \$0.9 million increase in community development

Unreserved Fund Balances Are Available

- From page 3 of the 2010 Management Discussion and Analysis of the Audited Financial Statements, the City said the following (emphasis as reported)
- “As of the close of the current fiscal year, the City’s governmental funds reported combined ending fund balances of \$11,461,108, an increase of \$170,699 in comparison with the prior year. Approximately 89 percent of this total amount, or \$10,153,635, is *available for spending* at the government’s discretion (*unreserved fund balance*).”

Revenues and Expenses: Total Primary Government

	2006	2007	2008	2009	2010
Total Revenues	87,785,441	89,794,815	93,615,208	92,044,948	90,771,473
Total Expenses	89,261,668	93,137,802	99,533,824	96,474,947	94,867,246
Change in Net Assets	(1,476,227)	(3,342,987)	(5,918,616)	(4,429,999)	(4,095,773)
Percent of Total Revenues	-1.7%	-3.7%	-6.3%	-4.8%	-4.5%

Revenues and Expenses: Government Activities Only

	2006	2007	2008	2009	2010
Total Revenues	58,718,983	57,421,369	61,714,838	60,717,536	57,322,220
Total Expenses	56,771,517	60,611,202	64,441,719	63,443,180	62,840,710
Change in Net Assets	1,947,466	(3,189,833)	(2,726,881)	(2,725,644)	(5,518,490)
Percent of Total Revenues	3.3%	-5.6%	-4.4%	-4.5%	-9.6%

Revenues and Expenses Closer to Cash Flows: Effect of Non-Cash Depreciation

Total Primary Government	2009	2010
Total Revenues	89,348,756	90,771,473
Total Expenses	94,867,246	94,867,246
Depreciation Expense	16,468,923	16,627,124
Total Expenses Without Depreciation	78,398,323	78,240,122
Change in Net Assets	10,950,433	12,531,351
Percent of Total Revenues	12.3%	13.8%

- The change in net assets here is closer to cash flows, as non-cash depreciation expense is added back
- The results are better in 2010 than in 2009

Revenues and Expenses Net of Depreciation: Government Activities Only

Government Activities Only	2009	2010
Total Revenues	59,347,407	57,322,220
Total Expenses	63,443,180	62,840,710
Depreciation Expense	8,272,872	8,415,201
Total Expenses Without Depreciation	55,170,308	54,425,509
Change in Net Assets	4,177,099	2,896,711
Percent of Total Revenues	7.0%	5.1%

Analysis of Revenues and Expenses

- It appears as if the City of Battle Creek is running a deficit each year
- However, the City has a total of over \$16 million of depreciation expense each year, which does not use any cash.
- Therefore, if we add back the non-cash depreciation expense (which is very common), we get a different picture of how well the City is doing. That is why they have so much cash on hand; they are generating solid amounts of cash each year.

Revenues and Expenditures: Fund Basis

All Funds	2005	2006	2007	2008	2009
Total Revenues	57,173,984	58,201,679	58,751,244	60,393,638	59,339,473
Total Expenditures	60,632,567	62,171,424	64,673,803	64,892,342	65,978,301
Difference	(3,458,583)	(3,969,745)	(5,922,559)	(4,498,704)	(6,638,828)
Percent of Total Revenues	-6.0%	-6.8%	-10.1%	-7.4%	-11.2%
General Fund Only	2005	2006	2007	2008	2009
Total Revenues	42,451,043	43,437,129	44,100,292	47,116,396	45,853,051
Total Expenditures	38,951,181	38,761,312	40,283,842	41,594,473	41,322,532
Difference	3,499,862	4,675,817	3,816,450	5,521,923	4,530,519
Percent of Total Revenues	8.2%	10.8%	8.7%	11.7%	9.9%

- On an all funds basis, it appears as if there is an annual deficit
- However, the General Fund is running a large surplus each year
- This analysis omits transfers and debt issuances, as these are not revenues nor expenditures based on standard accounting principles – and the numbers are exactly as reported in pages 109 to 112 of the 2009 CAFR
- The firefighters are part of the General Fund

Moody's Ratio Analysis

- **Moody's uses three ratios to judge the financial condition of public entities. Then a composite score is compiled based on these 3 ratios:**
- **Primary Reserve Ratio**
 - Are there sufficient reserves?
- **Viability Ratio**
 - Is there too much debt?
- **Net Income Ratio**
 - Are revenues and expenses in line with each other?

Moody's Ratio Definitions

- *Primary reserve ratio*: Expendable net assets divided by total operating expenses.
- *Viability ratio*: Expendable net assets divided by debt.
- *Net Income Ratio*: Change in total net assets divided by total revenues.
- Final Score =
50% * Primary Reserve Ratio +
30% * Viability Ratio +
20% * Net Income Ratio

Moody's Ratings

- There has not been an update since April 23, 2010.
- The ratings are now the ratings are now Aa2 and Aa3, as of April 23, 2010
- The ratings as of February, 22, 2010 were A1.
- <http://v3.moodys.com/page/ataglance.aspx?orgid=600024873>,
- This is outside confirmation that the City is doing very well financially

City of Battle Creek Moody's Scores

	2006	2007	2008	2009	2010
Primary Reserve Ratio	65.9%	59.4%	53.0%	48.3%	51.1%
Viability Ratio	110.7%	105.8%	106.7%	101.3%	107.6%
Net Income Ratio	-1.7%	-3.7%	-6.3%	-4.8%	-4.5%
Primary Reserve Score	5	5	5	4	5
Viability Score	4	4	4	4	4
Net Income Score	1	1	0	1	1
Moody's Composite Score	3.9	3.9	3.7	3.4	3.9

- A score of 3.9 is considered very solid
- The net income ratio is low, but it includes depreciation expense; if this was taken out, the composite scores would be above 4.

Revenue Dollar Analysis

	2006	2007	2008	2009	2010
Property Taxes	14,580,358	15,322,115	16,485,528	17,033,749	17,414,875
Income Taxes	14,450,183	14,226,870	15,505,430	14,240,808	14,328,097
Charges and Grants - Gov	22,920,663	20,654,529	21,878,876	22,224,246	19,061,941
Charges and Grants - Biz	28,081,498	30,718,022	30,625,684	30,580,969	32,795,594
Grants - General	6,221,293	6,038,495	6,090,487	5,882,127	5,235,168
Investment Earnings	1,531,446	2,834,784	3,029,203	2,083,049	1,935,798
Total Revenues	87,785,441	89,794,815	93,615,208	92,044,948	90,771,473

- Property tax revenues have increased every year.
- Income tax revenue increased from 2009 to 2010
- The charges and grants for Gov are from the State, as well as from parks and recreation
- The charges for biz are mostly related to wastewater and water

Revenue Percentage Analysis

	2006	2007	2008	2009	2010
Property Taxes	17%	17%	18%	19%	19%
Income Taxes	16%	16%	17%	15%	16%
Charges and Grants -	26%	23%	23%	24%	21%
Charges and Grants -	32%	34%	33%	33%	36%
Grants - General	7%	7%	7%	6%	6%
Investment Earnings	2%	3%	3%	2%	2%
Total Revenues	100%	100%	100%	100%	100%

- This table is very important, as it indicates that the financial health of the City is not overly reliant on property taxes
- With this diversity of revenue sources, any decline in one source will not have a significant detrimental effect on the City's financial condition

Revenue Dollar Analysis: General Fund Only

	2006	2007	2008	2009	2010
Property Taxes	14,580,358	15,322,115	16,485,528	17,033,749	17,414,875
Income Taxes	14,450,183	14,226,870	15,505,430	14,240,808	14,328,097
Licenses and Permits	1,084,527	1,075,341	1,026,490	1,012,079	1,038,089
Intergovernmental	7,804,482	7,814,021	7,932,595	7,688,340	7,121,712
Charges for services	2,518,560	2,436,074	2,377,713	2,297,536	2,305,552
Fines and forfeitures	250,683	210,795	249,809	207,251	217,119
Investment income	1,047,649	1,408,071	1,455,000	1,330,682	793,498
Loan collection and other	1,700,687	1,607,005	2,083,831	2,042,606	1,545,510
Total General Fund Revenues	43,437,129	44,100,292	47,116,396	45,853,051	44,764,452

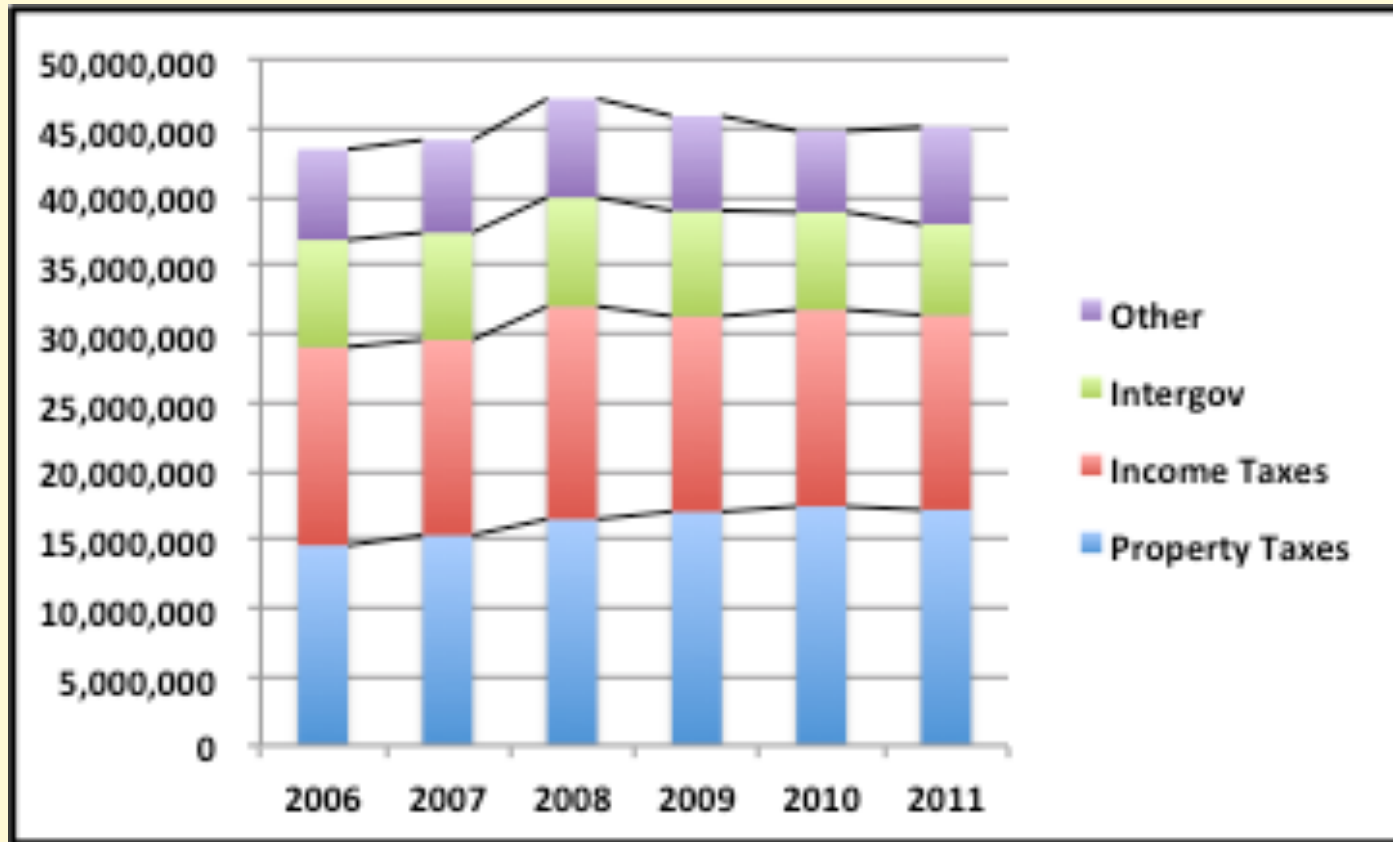
- Property taxes increased every year
- Income taxes declined from 2008 to 2009, but increased from 2009 to 2010

Revenue Percentage Analysis: General Fund Only

	2006	2007	2008	2009	2010
Property Taxes	34%	35%	35%	37%	39%
Income Taxes	33%	32%	33%	31%	32%
Licenses and Permits	2%	2%	2%	2%	2%
Intergovernmental	18%	18%	17%	17%	16%
Charges for services	6%	6%	5%	5%	5%
Fines and forfeitures	1%	0%	1%	0%	0%
Investment income	2%	3%	3%	3%	2%
Loan collection and other	4%	4%	4%	4%	3%
Total General Fund Revenue	100%	100%	100%	100%	100%

- Though property taxes are a larger percentage of total revenues than with the total primary government, they are still not the majority revenue source
- The intergovernmental revenue contains the revenues from Lansing, and we will see that this decline has not been detrimental to the City

General Fund Revenues for 2006 to 2011



- The 20-11 data is budget data
- Note that 2011 total revenues are budgeted to be above 2010 levels
- Property taxes and ncome taxes decline very slightly for 2011, but are steady

Intergovernmental Revenues

	Original Budget 2010	Actual 2010	Budget 2011
State Shared - Statutory	2,454,751	1,829,548	1.8M
State Shared - Constiitutional	3,447,991	3,367,924	3.4M
Other	1,926,190	1,924,240	1.4M
Total	7,828,932	7,121,712	6.6M
33% cut in statutory for 2012		600,000	

- In 2010, the state shared revenue was well below budget, and wound up at 1.8 million. In 2012, even if the full 33% cut in the state shared statutory revenue is met, the most the City will be hit is 600,000
- In fact, the hit will likely be less than this, because if certain performance measures are met, the cut will be smaller.
- Conclusion: The Governor's reduction will not affect the City significantly

General Fund Revenues vs. Expenditures

General Fund Only	2006	2007	2008	2009	2010
Total Revenues	43,437,129	44,100,292	47,116,396	45,853,051	44,764,452
Total Expenditures	38,761,312	40,283,842	41,594,473	41,322,532	39,821,886
Difference	4,675,817	3,816,450	5,521,923	4,530,519	4,942,566
Percent of Total Revenues	10.8%	8.7%	11.7%	9.9%	11.0%

- General Fund revenues exceed general fund expenditures by around \$5 every year.
- This matches the government-wide results when we take out depreciation expense, which is not a GF expenditure
- This demonstrates the strength of the City's operating performance

Fire Department Costs

	2009	2010
Fire Department Expenditures	7,872,124	8,100,453
Total Expenses	94,867,246	94,867,246
Total Gov Expenses	62,840,710	62,840,710
Total General Fund Expenditures	39,821,886	39,821,886
Fire Department as Percent of:		
Total GW Expenses	8%	9%
Total Gov Only Expenses	13%	13%
Total GF Expenditures	20%	20%

- Fire department expenses are less than 10% of all expenses, and 20% of general fund expenditures.
- Fire department expenses increased 2.9% from 2009 to 2010
- These costs are clearly not driving the City's financial situation

What Will a 1% Increase in Fire Department Costs Mean?

	2009	2010
1% Increase in Fire Department Costs	78,721	81,005
As % of Total Expenses	0.1%	0.1%
As % of Total Gov Expenses	0.1%	0.1%
As % of Total GF Expenditures	0.2%	0.2%

- A 1% increase in total fire department costs will cost very little;
- A 1% increase would lead to less than a 1/10th of 1% increase in total expenses, and only 2/10th of 1% increase in General Fund expenditures

Fire Department Costs are Less than Budgeted

	2009	2010
Fire Department Budget	8,305,428	8,465,397
Actual Fire Department Expenditures	7,872,124	8,100,453
Amount Under Budget	433,304	364,944
Percent Under Budget	5.2%	4.3%

- Each year, the City seems to budget expenses higher than actual. This contingency is just a cushion or profit built into the budget.
- In 2010, total expenditures were \$1 million below budget
- The actual fire department costs were significantly below budget in both 2009 and 2010
- If this over-budgeting is common, then the ability to pay fire department costs is more than is being portrayed by the City

Conclusions

- The City of Battle Creek is in strong financial condition. This is demonstrated by:
 - Strong level of reserves
 - Low level of debt
 - Revenues greater than expenses when depreciation is added back
 - Diversity of revenue sources
 - Strong ratings by outside credit-rating agencies
 - Fire department costs that are a small component of total expenses
 - Fire department costs that were much less than budgeted in 2009 and 2010
- The City will claim that the future is bleak, due to declining property tax and income tax revenues. However, we have yet to see a significant decline through the 2011 budget.
- As to our predictions of the future, what we do know is that as of June 30, 2010, the City of Battle Creek is in strong financial condition
- The decline in State statutory revenue sharing will not have a significant effect on the City in 2012.