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AUDITOR

AUDITOR OF THE COMMONWEALTH
STATE HOUSE, BOSTON 02133

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2007-2104-170

August 23, 2007

Honorable Stephen J. Buoniconti, State Senator
Honorable Thomas M. Petrolati, Speaker Pro Tempore of the House of Representatives
State House
Boston, MA 02108

Dear Senator Buoniconti and Representative Petrolati:

At your request and as authorized by Chapter 11, Section 12, of the Massachusetts General Laws, we performed a special-scope review of the current fiscal conditions and the budgetary forecasts for the next five fiscal years in the City of Springfield (City) as they relate to the activities of the Springfield Fiscal Recovery Trust Fund (SFRTF) authorized by Chapter 169 of the Acts of 2004. Our review was initiated for the purpose of reviewing City financial activity and budget projections in conjunction with the required repayment of \$52 million in interest-free loan funds provided to the City by the Commonwealth of Massachusetts in accordance with Chapter 169.

Due to the nature of this engagement, the procedures we performed do not constitute an audit made in accordance with either generally accepted auditing standards or generally accepted government auditing standards. Our review of the City's current fiscal conditions; budgetary forecasts; and drawdown, use, and anticipated repayment of the loan funds from the SFRTF consisted of, but was not limited to, the following:

- Reviewing applicable laws, regulations, and policies relating to the enactment of provisions of Chapter 169 of the Acts of 2004, including the establishment of the SFRTF and the Springfield Finance Control Board (FCB).
- Reviewing the financial activity related to the disbursement of the loan funds to the City.
- Meeting with various officials, including the Executive Director and staff members of the FCB, City officials, certain state legislators, and others, as we deemed necessary.

- Examining City budget proposals and projections, and other pertinent municipal documents and data provided to us by the FCB regarding the activities of the \$52 million in loan funds, City operations, and current financial status of the City to determine how the loan funds were used and assess plans of action concerning repayment.
- Evaluating both the assumptions used by the FCB staff and the preparation and presentation of the City's five-year budget forecasts for the periods ending June 30, 2012.
- Examining pertinent independent audit reports and management letters of the City of Springfield.

During our review we met with FCB and City representatives to discuss key focus areas of concern necessary for both fiscal turnaround and future success, including:

- Economic development within the City
- Collection of back taxes and diligence in future collection procedures
- Prudent uses of overlay/surplus/other reserves in budgetary process
- Practical utilization of "Free Cash" upon certification
- Ensuring accuracy of school census
- School Building Assistance expenditure controls and future projects
- "MUNIS" accounting system implementation within the City, both expansion and final integration throughout all City departments
- Pension funding and future funding plans
- Capital planning and debt management
- Timeliness of completing the City's Annual A-133 Single Audit and filing with the Federal Audit Clearinghouse

At the close of fiscal year 2004, the City was experiencing significant financial difficulties, and there was a high probability that the City would be unable to pay its current obligations. For fiscal year 2005, a projected structural deficit resulted in the City's inability to enact a balanced budget, and the resultant fiscal crisis posed an imminent danger to the City and its ability to provide core services to its citizens. In response to the City's fiscal crisis, Chapter 169 of the Acts of 2004 was passed by the Massachusetts Legislature and signed by the Governor to assist the City. This statute provided up to \$52 million in no-interest loan funds that could be used to help confront budget deficits and restore the City to financial

stability. Access to the loan funds expired on June 30, 2007. In addition to this funding, Chapter 169 established the five-member FCB to oversee City operations.

Since the inception of this financial relief legislation, the FCB has made progress in helping to resolve the City's fiscal crisis. The City has seen an annual operating deficit reduced from \$20,757,027 in fiscal year 2005 to budget surpluses in 2006 and 2007 of \$4,777,812 and \$2,414,206 (projected), respectively. To assist in this turnaround, the FCB drew down \$29.7 million in funds from the SFRTF prior to May 2007. Further, prior to the loan authorization's expiration date of June 30, 2007, the FCB voted to draw down and set aside the balance of \$22.3 million from the State Treasurer in a special reserve fund presently intended to be utilized for future economic development. As of the completion of our field work, this drawdown was awaiting the required approval of its release by the Secretary of the Executive Office for Administration and Finance.

In addition to the use of state funds in helping to resolve the City's deficit, several major steps have been taken by the FCB to enhance revenues, stabilize expenditures, and institute structural changes to improve the overall management of resources. These measures have included aggressively collecting past-due property taxes, negotiating long-term collective bargaining agreements, joining the Commonwealth's Group Insurance Commission health plan, and investing the City's pension assets in the Commonwealth's Pension Reserves Investment Trust Fund.

Our review also indicated that the FCB was diligent in monitoring its cash-flow activity during fiscal years 2005, 2006, and 2007, and in doing so was not over-requesting loan funds, which has resulted in the remaining \$22.3 million balance. Chapter 169 requires the City to begin repaying the no-interest loan to the Commonwealth beginning in fiscal year 2008 and ending in fiscal year 2012.

Critical to the long-term fiscal health of the City is the implementation of a structurally balanced operating budget that does not rely on one-time revenues. To assess the impact of the actions taken to date by the FCB and determine the budget outlook for the City over the next five years, we reviewed the FCB's five-year Budget Projection and its forecast of revenues and expenditures through fiscal year 2012.

Our review disclosed that the underlying assumptions and estimates used in formulating the five year budget projection provide a reasonable basis for the forecast of revenues and expenditures, which shows a balanced budget in fiscal year 2008 and estimates modest surpluses in the ensuing four fiscal years. However, although we believe the budget projections to be reasonable, we would like to emphasize that there will usually be differences between forecasted and actual results because events and circumstances frequently do not occur as expected, and such differences may be material.

Because the budget situation is fragile, we do want to point out two assumptions that are relied upon in balancing these budgets. First, built into the fiscal years 2009 through 2012 budgets is an efficiency factor, which is a projection of assumed savings through management actions. The savings estimates represent only approximately one half of one percent of each year's budget; however, such savings are factored in and must be realized to assist in balancing these budgets.

Further, and much more significant, is the FCB's loan payment plan as presented. As you are well aware, Chapter 169 requires that all funds loaned to the City be paid back in total by June 30, 2012. The current financing plan provided to us amortizes a \$30 million loan payback over a 20-year period, which does not comply with the existing statutory timeline requirements. In addition, because the FCB has authorized the drawdown of the remaining loan balance of \$22.3 million, any additional use of these funds will only compound the payback problem and create an additional strain on the City's budgets.

Although the FCB has reserved the remaining \$22.3 million balance to help provide for the financial stability of the City with the intention of utilizing such funds for future economic development, we recommend that the FCB proceed with caution, assessing both the economic benefit/budgetary impact of any such spending, as well as the City's ability to repay the Commonwealth. As stated previously, the financial stability of the City, which has required significant efforts and is heading in a positive direction, is still fragile. Anticipated revenues may not meet budget projections if, for example, a recent rise in housing foreclosures in the City has been identified both as a City, regional, and state problem that could negatively impact and limit property tax revenues. Likewise, anticipated expenditure savings projected in the current City budget estimates may not generate the full reduction of expenditures expected. The FCB

has documented and we agree that one of the key components to a successful and stable City lies in future economic development to expand the tax base, and reserving the remaining loan funds could certainly be helpful in accomplishing that goal. However, if these funds were utilized for this purpose and circumstances change that negatively impact the financial situation, such funds would not be available to cover operating budget shortfalls.

After meeting with FCB officials and reviewing existing City records, including financial statements, the current year's budget, and budget projections for the next five years, we have concluded that it will be extremely difficult for the City to repay the current \$30 million loan obligation in the 5 year timeframe as stipulated in Chapter 169, unless operating results generate significant surpluses or without utilizing reserve funds and /or making reductions to core municipal services. Based on this analysis, it is clear that any further expenditures of the remaining \$22 million loan balance without realizable revenue growth will further exacerbate a tenuous short-term budget situation by compounding the loan payback problem.

In summary, significant operational improvements have been made in the way the City conducts its business. Departments have been reorganized, uncollected sources of revenue have been pursued, new revenue sources have been identified, and expenditures have been brought under control. As a result, the significant deficits of a few years ago no longer exist. Increased recurring revenue and continued expenditure control are necessary to further stabilize budgetary operations. Also, surpluses and reserve accounts have not been adequately funded to a level necessary to address normal cyclical and unforeseen circumstances.

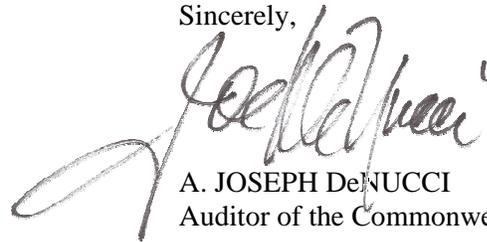
As a result of our assessment of the City's financial status and progress to date, we have made several recommendations that should be considered by the FCB and the City in order for the fiscal stability and welfare of the Commonwealth's third-largest city be maintained, as follows:

- Maintain diligent oversight and continue to make improvements within the key focus areas of concern identified as necessary for both turnaround and future fiscal success.
- Vigorously monitor budget/actual revenues and expenditures on an ongoing basis, and if necessary, develop an action plan to help ensure that operating results are positive.
- Avoid, if possible, the use of one-time revenues to support recurring expenditures.

- Continue to review and make changes as appropriate in operational functions in an effort to provide efficiencies and cost savings.
- Improve upon the timeliness of initiating, completing, and filing the City's Annual A-133 Single Audit with the Federal Clearinghouse and develop appropriate corrective action plans to immediately address cited findings, questioned costs, internal control weaknesses, or any disclosures requiring remedial response by the City.
- Pursue economic development projects to help enhance the property tax base. In this regard, a thorough cost/benefit analysis should be completed before making any Chapter 169 funding commitment for this purpose.
- Work closely and communicate with the State Legislature's delegation, keeping them informed of progress and matters of significance.
- Request legislative support to extend the payback period of the loan beyond the five-year term.

I hope this information will be helpful in your continued efforts to secure the financial stability and economic future of the City of Springfield. Should you have any questions or need further assistance concerning this or any other matters, please feel free to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "A. Joseph DeNucci". The signature is written in a cursive, flowing style with a large initial "A" and "J".

A. JOSEPH DeNUCCI
Auditor of the Commonwealth