COUNTY OF MILWAUKEE
Inter-Office Communication

Date: May 1, 2007

To: Supervisor Richard D. Nyklewicz, Jr., Chairman, Committee on Finance and Audit
Finance and Audit Committee Members

From: Steve Cady, Fiscal & Budget Analyst, County Board Staff
Jerome J. Heer, Director of Audits

Subject: Department of Administrative Services – Economic and Community Development Division 2006 Deficit (File No. 53-A-562)

On March 15, 2007, the Director of the Department of Administrative Services (DAS) and the Director of the Division of Economic and Community Development Services (ECD) notified the County Board and County Executive that the Division was projecting a 2006 deficit of $2.5 million. On March 29, 2007, the Committee on Finance and Audit laid the report over and referred it to the Department of Audit and County Board staff for a report on the factors that contributed to the deficit and recommendations on avoiding deficits in the future.

Background

Total budgeted revenue for the Division in 2006 was $20.4 million. Total budgeted expense was $18.6 million. The result, after adding carryovers, was a budgeted surplus of $1.4 million. Preliminary, unaudited results for 2006 show that the net deficit for the year is $2.5 million. Given a surplus of $547,000 projected for the Economic Development section of the Division, the actual deficit in housing programs is approximately $3 million. This is not the first time in recent years that the Division has reported problems with fiscal management. A deficit of approximately $775,000 was also reported at year-end 2004. This amount was later revised to $531,000.

According to the March 15 report, key components of the 2006 deficit include:

- Administration Reimbursement Revenue - $960,806 in reimbursement revenue for administrative costs in excess of the allowable chargeback to U.S. Housing and Urban Development funding sources. The issue of the administrative budget vs. actual allowable charges was also identified by DAS and the Department of Audit as an issue in 2005.

- Grant Revenue - $960,733 of unachieved grant revenue in five programs as follows: $183,000 in Community Development Block Grant funds, $48,000 in the Home Repair Program, $430,000 in the HOME Program, $124,000 in the Shelter Plus Care / Safe Haven Program and $175,000 in the Rent Assistance Voucher Program.

- Carryovers from 2005 to 2006 - $1,161,000 was included in funding carried over from 2005 that was either not achievable as revenue or included expenditures that were to occur in 2006 that could not be incurred.

Analysis

There are several factors that contributed to the recurrence of deficits within the Division. These include limitations in both budgeting and fiscal monitoring procedures, specific problems related to the recording of carryovers, as well as decisions about the number and nature of fiscal staff assigned to the Division.

Budgeting and Fiscal Monitoring Procedures
ECD is responsible for a number of complex programs with funding streams that are diverse and challenging.

Real Estate / Economic Development

Manages the sale and acquisition of real estate. Coordinates economic development functions.

Community Development Block Grant

Administers the distribution of Federal block grant funding throughout 16 municipalities participating in the program.

Home Repair

Provides low or no interest loans to low- income homeowners for home repairs.

Special Needs (Shelter Plus / Safe Haven)

Manages Federally funded programs to provide a home-like environment for homeless individuals with serious mental illness. This program was transferred to the Department of Health and Human Services in the 2007 Budget.

Home Investment Partnership (HOME)

Administers Federal grant funds for developing or rehabilitating affordable housing as well as financial assistance for eligible first-time home buyers.

Housing Choice Voucher

Manages the Federal program that subsidizes rent for nearly 2,000 eligible low-income households.

Administration

While not a separate program, administrative costs are identified as a component of each program and are to be charged out as appropriate.

The total budget breakout by each program for 2006 as well as the projected deficit is shown in **Table 1**.

Table 1
Economic and Community Development Division
2006 Budget and Projected Deficit by Program

	Revenue Budget	Expenditure Budget	Net Budget	Projected Actual	Projected 2006 Surplus (Deficit)
Economic Development	$1,643,000	$1,459,964	$183,036	$730,238	$547,202
Administration	300,000	(1,059,190)	1,359,190	398,384	(960,806)
Comm. Dev. Block Grant	4,178,688	3,655,154	523,534	(67,233)	(590,767)
Home Repair Program	26,822	1,576,088	(1,549,266)	(1,597,988)	(48,722)
HOME Program	4,167,209	3,688,436	478,773	(466,202)	(944,975)
Shelter Plus/Safe Haven	3,521,527	3,171,184	350,343	172,810	(177,533)
Voucher Program	11,911,183	11,781,123	130,060	(43,993)	(174,053)
Total	**$25,748,429**	**$24,272,759**	**$1,475,670**	**($873,984)**	**$(2,349,654)**

Source: Department of Administrative Services

For several of these programs, in particular the Voucher (rent assistance) program, there is significant Federal pressure to spend the full amount of funding committed to the County. In fact, the County is penalized for underspending. On the other hand, any overspending creates deficits that are also not acceptable. In the face of this dynamic, effective fiscal monitoring is essential.

There is no one, integrated system used by the Division to perform fiscal monitoring. Instead, program administrators use several manual and automated systems. Each of the systems has different cutoffs and processing cycles so the ability to rely on any one system is limited. While each program manager should be accountable for managing within their budget regardless of how they track it, managing in a fiscal "silo" does not work given the extent to which County programs are affected by administrative cross charges. For 2006, this situation was compounded by a "glitch" that resulted in an allocation of fringe benefits to the Division at year-end instead of throughout the year. Further compounding the challenge of managing within an appropriation was a practice of not charging services and commodities within the Division until year-end. According to the Division, these charges will now be processed on a quarterly basis.

In managing the budgets for these programs, Division administrators also expressed concerns about the impact of both the amount and the timing of administrative cross charges budgeted into their operations. The U.S. Department of Housing and Urban Development (HUD) is a primary funding source for the Division. HUD has placed limits on the amount of "overhead" and administration that can be charged. As noted in **Table 1**, budgeted net revenue of approximately $1.3 million was anticipated for 2006 yet less than $400,000 was achieved. This situation was further exaggerated by the manner in which the Division budgets administration charges for all programs. Because all of the programs are budgeted together, each program proceeds through the year with an understanding that other programs will cover administrative charges. This situation is further compounded because the adopted budget does not clearly identify and align actual charges and anticipated revenues that are identifiable, manageable and achievable. While the Division has attempted to use activity and function codes to track its budget, these efforts have not been successful. Budgeting at a program level would isolate the administrative charges that are expected to be generated by each funding stream within the Division.

The administrative charge in each program should be driven by program requirements and managed to an acceptable fiscal outcome. Administrators also expressed dissatisfaction with the high level of the administrative cross-charges and with the timing of charges that arise too late in budget year to be effectively managed. These concerns are not unique to the Division. However, regardless of the level of administrative charges to County programs, it is incumbent upon managers to properly budget for those charges at the beginning of the year and monitor progress in achieving a balanced budget.

On a more minor note, administrators expressed concern that the full cost of an employee on union release time is charged to their program. As an expense that is related to Countywide labor activity, an argument could be made that the cost should be included in Countywide central services charges.

Carryovers

A significant portion of the reported 2006 deficit is actually attributable to errors in the carryover of ECD funds from 2005 to 2006. **Table 2** shows the breakout between the 2006 deficit and issues related to 2005 carryover problems.

Table 2
Economic and Community Development Division
Breakout of 2005 and 2006 Deficit Components

	2005 Carryover Variance	Projected 2006 Budget Variance	Total Projected 2006 Surplus (Deficit)
Economic Development	$ -	$ 547,202	$ 547,202
Administration	-	(960,806)	(960,806)
Comm. Dev. Block Grant	(407,604)	(183,163)	(590,767)
Home Repair Program	-	(48,722)	(48,722)
HOME Program	(514,352)	(430,623)	(944,975)
Shelter Plus/Safe Haven	(239,280)	61,748	(177,533)
Voucher Program	-	(174,053)	(174,053)
Net Surplus/(Deficit)	$(1,161,236)	$(1,188,417)	$(2,349,654)

Source: Department of Administrative Services

According to the Division, multi-year projects create a particular problem with managing carryovers. In the CDBG program for example, the Division noted that there are approximately 80 open project files. Administrative charges for these projects are incurred in the initial project year. Thus, a charge-out mechanism for the cost of administering the open projects is not available. Further, because the projects are tracked manually, multi-year carryovers generate significant challenges. These challenges were some of the reasons behind the 2005 carryover variance of $407,604. The new agreements with municipalities receiving CDBG funds will limit the time frame for open projects to two years.

In the HOME program, revenues, expenditures, encumbrances and carryovers from 2005 to 2006 did not reconcile. In terms of the carryover, an error of $514,000 was found in the prior year carryover figure for Federal funds received in 2006 for 2005 services. The remaining deficit variance of $430,623 for the HOME program includes a HUD Federal grant recoupment from the 2000 grant year of $350,000. This recoupment reduced the HUD Federal funds available in that year, but had not previously reduced the carryover of HOME funds available, until 2006.

The final carryover adjustment of $239,280 was related to a reconciliation of the Safe Haven grant program. The Safe Haven grant is a three-year rolling grant, whose most recent grant end date was September 2005. A reconciliation of the Federal funds and the County match for that 3-year grant program was made on this program in 2006. It was determined that County match funds from BHD were not available for carryover, and should have reduced the 2005—2006 carryover. This grant program has now been reconciled.

In another instance, the carryover situation was compounded by a change in the Voucher program's federal treatment of underspent funds. Prior to 2005, unspent Federal funds had to be repaid to the Federal government. A change allowed those Federal funds to be rolled forward and be used by the Voucher program for specific voucher rent assistance needs. The Housing unit is still holding discussions with HUD as to the dollars that are available and the purpose that the funds can be used for.

As of April 20, 2007, the breakout of the various elements of the 2006 deficits are:

2005 Carryover Errors	($1.20 million)
Unachieved Administrative Revenue	($1.00 million)
Prior Year Recoupment Cleanup	($ .35 million)
Various Budget Errors	($ .35 million)
Deficit	($2.90 million)
Real Estate Surplus	($ .55 million)
Net 2006 Deficit	($2.35 million)

<u>Fiscal Staff</u>
In the face of these budget and fiscal monitoring challenges, it is essential that adequate fiscal staff resources be committed to the Division. This has not been the case. Since the Department of Audit's report on the 2004 deficit, the situation with fiscal staff has deteriorated because of turnover, hiring gaps and vacancies in key positions. A timeline on fiscal staffing and deficits is attached to this report. It is clear that even after the concern that arose from the 2004 deficit, the path that was chosen was to replace accounting staff with budget staff and then to hold the budget staff vacant. The first decision disregards the distinction and value of accounting resources in contrast to budget resources. The second shows a disregard for the value of budget staff support for these programs. Indeed, the elimination of fiscal staff resources in the 2007 budget was "due to fiscal restraints". Fiscal duties were assigned to an Assistant Housing and Community Development Coordinator who was hired in August 2006.

One of the reasons identified by program administrators for a lack of accounting resources is an ongoing problem with recruitment of accounting staff into County positions. Given the significant impact of failure to properly account for program revenues and expenses, it may be appropriate to reexamine Milwaukee County's ability to compete for qualified accounting support in the labor market.

When accounting resources are not properly deployed to program operations, the burden shifts to after-the-fact analysis by central accounting staff. Historically, it has not been the responsibility of central accounting to do day-to-day program accounting for operations. Indeed, the accounting staff of several County departments is larger than the DAS accounting group. The experience of Milwaukee County with deficits in recent years indicates that it may be time to re-examine both the level of accounting resources and the manner in which they are deployed.

Timeliness of Deficit Reporting

According to ECD, original concerns were raised by DAS regarding potential 2006 budget problems in November 2006. DAS budget staff began assessing the status of the budget in December 2006. Eventually, when it appeared that carryovers would be a key factor in determining the level of the deficit, if any, central accounting staff became involved in reviewing the situation as part of the 2006 closing of the books. A review of the carryover impact identified a 2006 deficit and indicated that a review of 2005 carryovers would also be warranted. The analysis of 2005 resulted in the identification of $1.1 million of additional deficit related to the carryover. By March 9, 2007, it appeared that the results of the year-end close would initially be a $2.9 million deficit. Later that day, the figure was adjusted to $2.5 million.

Section 56.02 (1) of Milwaukee County Code of General Ordinances requires departmental administrators to notify the Committee on Finance and Audit as well as the County Executive and DAS when the administrator has reason to "know or believe" that a revenue deficit of $75,000 or more is anticipated. The Ordinance also calls for a corrective action plan. The timing of the reporting on the 2006 deficit for ECD is such that it does appear that the Division had reason to "believe" that it may have a deficit in excess of $75,000 well in advance of the time it was reported, perhaps as far back as November 2006. However, given the concerns we have identified with the fiscal staffing of the Division, it is also clear that there was a lack of understanding about the nature and extent of the deficit until early in March 2007. In order for administrators to make a reasonable assessment of a potential deficit that must be reported, they must have the resources to make that conclusion. With regard to a 2006 corrective plan for a deficit reported in March of 2007, the only action available is the offset or the housing program's $3 million deficits with the surplus of $.5 million in real estate revenue within the Division. Beyond that, the deficit falls to the County's "bottom line" for 2006.

2007 Budget Status

While several components of the 2006 deficit should not be a problem in 2007, others, like charges for administrative expenses, could present challenges in 2007. DAS will be preparing a corrective action plan to address issues raised in this report. In addition to any update provided at the May 15, 2007 meeting of the Committee on Finance and Audit, the corrective action plan should include an update on the 2007 budget status of the Division.

Conclusions and Recommendations

A second sizable deficit in the Division in the last three years indicates a serious lack of appropriate fiscal staff as well as budget and financial monitoring procedures by management. The size and complexity of the programs administered by the Division should have warranted attention even without the added warning of the 2004 deficit. And certainly, given the deficit that occurred in 2004, consideration should have been given to enhancing financial management resources. In response to the 2004 deficit, the County Board approved a request by the Economic Development Division in May 2005 to abolish one position of Accountant 3 and create one position of Fiscal and Management Analyst 2 to better provide fiscal and programmatic needs. The division's fiscal positions were since allowed to gradually diminish without adequate systems in place to monitor fiscal and budget activities.

To resolve this situation, we recommend the DAS:

1. Establish a high level accounting position within the Division.

2. Budget the Division at the "low org level (by program or by revenue source)" to isolate each program's revenues, expenses and levy support.

3. Develop procedures to link accounting, budgeting and ongoing fiscal monitoring including the identification of appropriate "red flags" to provide early warnings of potential deficits

4. Proceed with plans to conduct internal administrative allocations on a quarterly basis rather than at year-end.

5. Attempt to limit the number of years that revenues and expenses are carried over to subsequent years. The two-year limit on CDBG is a step in the right direction.

6. Reassess the 2007 Adopted Budget, in particular the administrative expense charges, and provide a status report.

In addition to improvements needed with the Economic and Community Development Division, the ongoing pattern of deficits in this Division as well as other County departments, is indicative of a need to reassess the resources within the County's Central Accounting unit. The efforts of central accounting staff are often necessary to assist with damage control after a deficit has been identified within a department. The unit is routinely part of the solution even when it is not part of the problem. Given the fiscal challenges that this government faces, the continued pattern of deficits cannot be allowed to persist. One solution would be to create a Deputy Controller to do training, coordination, support and project management within the accounting group. The effectiveness of this effort would be further enhanced if the top accountant in each department were a direct report to this Deputy. Creation of such a position would free the Controller to perform other duties associated with the extreme time demands and complexities of his duties.

Jerome J. Heer / Dcf

Jerome J. Heer
Director of Audits

Steve Cady

Steve Cady
Fiscal & Budget Analyst

JJH/SC/cah

cc: Chairman Lee Holloway, Milwaukee County Board of Supervisors
Supervisor Michael Mayo, Sr., Milwaukee County Board of Supervisors
Scott Walker, Milwaukee County Executive
Robert Dennik, Director, DAS-Economic & Community Development
Rob Henken, Director, Department of Administrative Services
Cynthia Archer, Fiscal & Budget Administrator, Department of Administrative Services
Scott Manske, Controller, Department of Administrative Services
Terrence Cooley, Chief of Staff, County Board Staff
Delores Hervey, Chief Committee Clerk, County Board Staff
Linda Durham, Committee Clerk, County Board Staff
Glenn Bultman, Research Analyst, County Board Staff

Key Dates Related to Economic and Community Development Deficits

January 1, 2004. Adopted Budget per County Executive's recommendation merges two divisions (Division of Economic Development and Division of Housing and Community Development) into one division and abolishes 6.7 Housing positions, including Director, after first quarter.

April 9, 2004. Last day of work for retired Housing and Development Program Coordinator.

April 22, 2004 – September 30, 2004. HUD issues notice of Federal 2004 appropriations for Housing Choice Voucher Program, informs Milwaukee County Housing officials of impact on program funding, informs County of revisions to 2004 administrative rates.

April 30, 2004. Director of Housing and Community Development laid off as part of budget reductions. Had worked part time from January 1, 2004 until departure.

September 1, 2004. Last day of work for retired Director of Economic Development, effective date October 8, 2004.

November 9, 2004. Acting Director of Economic and Community Development appointed.

December 17, 2004. Last day of work for retired Assistant Housing and Development Coordinator.

February 11, 2005. The Division informs County officials of a potential **2005** deficit in excess of $75,000.

March 8, 2005. The Division informs County officials of a **2004** deficit of approximately $775,000.

April 26, 2005. Acting Director of Economic and Community Development resigns after County Board denies confirmation.

May 9, 2005. Accountant 3 for Economic and Community Development Division takes transfer promotion to Department of Public Works. Position held vacant.

May 9, 2005. Department of Audit memo notes impact of deficit for **2004** at $531,000 and identifies impact of staffing changes as a primary factor in deficits.

May 9, 2005. Current Director of Economic and Community Development appointed.

June 6, 2005. Fiscal and Management Analyst 2 hired.

January 1, 2006. Accountant 3 position abolished and two Fiscal and Management Analyst 2 positions created in 2006 Budget per County Executive's recommendation.

March 17, 2006. Fiscal and Management Analyst 2 transfers to Fiscal Services Division. Economic and Community Development positions held vacant.

August 21, 2006. Assistant Housing and Development Coordinator hired and assigned some budget duties of vacant Fiscal and Management Analyst 2.

January 1, 2007. Fiscal and Management Analyst 2 position unfunded in budget "due to fiscal constraints" per County Executive's recommendation.

March 15, 2007. Directors of the Department of Administrative Services and Division of Economic and Community Development issue notification of a **2006** deficit estimated at $2.5 million.