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# MUNICIPAL RESTRUCTURING

FINDING OPERATIONAL IMPROVEMENTS

November 28, 2011

NORTH AMERICA EUROPE MIDDLE EAST LATIN AMERICA ASIA



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## I. OVERVIEW

- **Founded in 1983, Alvarez & Marsal (“A&M”) is a global professional services firm, specializing in providing turnaround management, restructuring and corporate advisory services.**
- **With professionals based in locations across the globe, A&M excels in problem solving and value creation. Drawing on our strong operational heritage and hands-on approach, A&M professionals work closely with organizations and stakeholders to help tackle complex issues and maximize value.**
- **In 2003, A&M launched its Public Sector Group. Led by William Roberti, the Public Sector Group provides specialized services to Federal, State, and Municipal organizations.**
- **A&M turnaround expertise is a natural fit in the public sector.**
- **A&M has successfully applied its approach over the last eight years from The U.S. Virgin Islands to Guam and has worked both in distressed municipal entities and large urban school systems.**



## I. OVERVIEW

- **Our presentation today is focused on outlining A&M's approach to solving operational issues and restructuring a municipal entity**
- **The following three primary components of a restructuring will be the basis for discussion:**
  1. Understanding Cash Flows / Liquidity Assessment
  2. Budget Review and Development
  3. Balance Sheet Assessment



## II. UNDERSTANDING CASH FLOWS

### General

- **A treasury Cash Flow forecast is the first point of entry in assessing a situation at a municipal government**
  - It is a summary of the organization's sources & uses of cash; it is not the same as a GAAP statement of cash flows
- **The primary benefits of this approach are that a cash flow forecast provides a clear picture of the fundamental structure and allows for analysis that enables a true current assessment to be made**
- **This analysis helps A&M understand the following:**
  - Major cash sources & uses
  - Operational structure
  - Primary assets
  - Variable & fixed expenses
  - Core vs. Non-core activities
  - Major cost drivers

*Why is Cash Flow forecasting even relevant to a municipality?*



## II. UNDERSTANDING CASH FLOWS

### General (continued)

➤ **This analysis is crucial to help answer the following questions:**

- Is there an immediate or imminent cash crisis?
- Will cut-backs be needed in the foreseeable future?
- What areas of the system use the most capital?
- Are working capital decisions undermining operations?
- Is spending in particular areas too high?
- Is there a need for interim financing and if so, what future revenue stream may be available as collateral?



## II. UNDERSTANDING CASH FLOWS

### Structure

- **It is best to take a hands-on and bottoms-up approach to any cash flow analysis**
- **The cash flow forecast should be set up as a 13 week rolling forecast that is divided into:**
  - Sources & Uses Summary
    - All major cash sources
    - All major cash uses
    - Net cash flow
    - Cash balance summary
  - Assumptions – a list of every major assumption the forecast is based on by type
  - Detailed Footnotes – stand alone summaries for every major line item
- **The forecast should be continuously updated based upon new facts and actual results should be monitored against forecast on a weekly basis**



## II. UNDERSTANDING CASH FLOWS

### A&M Approach

- **A&M's path to building a cash flow forecast has the following major steps:**
  1. Talk with key management
  2. Review historical financials
  3. Analyze Cash Flow Forecast & Annual Budgets
  4. Initiate Departmental Reviews



## II. UNDERSTANDING CASH FLOWS

### 1. Talk With Key Management

- Ask general questions and let them talk about their operations
- Explain the goal of generating a bottoms-up forecast in a short time frame
- Try and connect with management
- The following individuals should have an encyclopedia of knowledge:
  - Finance
    - Accounts Payable Manager
    - Treasurer
    - Controller
    - CFO
    - Purchasing Manger
  - Human Resources Director
  - Department Heads



## II. UNDERSTANDING CASH FLOWS

### 2. Review Historical Financials

- **Historical financials will be the anchor and ultimate “Vet” of your cash flow**
- **Try to obtain access to the following electronic files for at least 6 months and up to 2 years if possible:**
  - Monthly Financial Statements (Income Statement, Balance Sheet and Cash Flow)
  - Revenues by appropriate division
  - Accounts payable check runs
  - Payroll
  - Key vendor payments
- **Analyze these financials to understand where the cash went**
- **Try and get the data into an understandable format**



## II. UNDERSTANDING CASH FLOWS

### 3. Analyze Cash Flow Forecast & Annual Budgets

- Find out if and how the entity currently forecasts cash flow and develops budgets. Obtain old forecasts and compare these to actual results. This will help:
  - Focus on where they view the priorities
  - Identify the Entities' view of major sources and uses of cash
  - Identify busts / areas of inaccurate forecasting
- If they do not have a treasury forecast, review Comprehensive Annual Financial Reports (CAFR) if available
- Look for trends within both revenue and expense categories

**Key challenges:**

- *Municipal Entities will not think in terms of cash flow but in terms of budget dollars (i.e., if you have the budget line item, you can spend it, regardless of actual cash flow).*
- *They may budget and forecast its costs to match anticipated revenues but may not have an operational plan that allows them to meet these goals.*
- *What are the major sources of cash inflows / outflows for a city? Describe their timing.*



## II. UNDERSTANDING CASH FLOWS

### 4. Departmental Reviews

- **After you have had a chance to digest the municipality's managerial plans, historical financials and cash flow forecast, you can proceed with key departmental reviews**
  - Start with the largest line items and talk to the manager in charge of that department
  - Let them tell you where to start and get your hands on materials relevant to the forecast
  - Have a list of detailed questions about historical results and what to expect in the future

- *Under the current annual budgeting process found in most public entities, how is management incentives to spend their budgets? Early and often vs. later and cautiously?*
- *What incentives could be structured to align spending patterns with greater efficiency/effectiveness?*



## II. UNDERSTANDING CASH FLOWS

### ROLLING CASH FLOW FORECAST

	1	2	3	4	5	6	7
	week ending	week ending	week ending	week ending	week ending	week ending	week ending
	8/26/2005	9/2/2005	9/9/2005	9/16/2005	9/23/2005	9/30/2005	10/7/2005
General	32,164,296	42,966,743	23,411,282	17,046,368	(376,864)	(5,354,550)	(2,112,993)
Debt Service	3,512,540	3,512,540	1,698,610	1,698,610	1,698,610	1,698,610	1,698,610
<b>Beginning Cash Balance - General &amp; Debt Service</b>	<b>35,676,836</b>	<b>46,479,283</b>	<b>25,109,892</b>	<b>18,744,979</b>	<b>1,321,746</b>	<b>(3,655,940)</b>	<b>(414,382)</b>
<b>CASH RECEIPTS</b>							
Local							
Ad valorem	126,746	146,829	146,829	146,829	146,829	146,829	188,894
Sales taxes	-	3,841,505	-	3,841,505	-	-	3,922,940
Other local	340,000	-	-	-	-	340,000	-
<b>Total Local</b>	<b>466,746</b>	<b>3,988,335</b>	<b>146,829</b>	<b>3,988,335</b>	<b>146,829</b>	<b>486,829</b>	<b>4,111,835</b>
Grants							
MFP	16,645,032	-	-	-	-	16,645,032	-
Non-public funds	-	-	-	-	-	-	-
Revenue sharing	-	-	-	-	-	-	-
PIP program	37,500	30,000	30,000	30,000	30,000	30,000	37,500
Other state	-	-	-	-	-	-	-
<b>Total Grants</b>	<b>16,682,532</b>	<b>30,000</b>	<b>30,000</b>	<b>30,000</b>	<b>30,000</b>	<b>16,675,032</b>	<b>37,500</b>
Federal							
Impact aid	2,083	1,667	1,667	1,667	1,667	1,667	2,083
ROTC	14,583	11,667	11,667	11,667	11,667	11,667	14,583
<b>Total Federal</b>	<b>16,667</b>	<b>13,333</b>	<b>13,333</b>	<b>13,333</b>	<b>13,333</b>	<b>13,333</b>	<b>16,667</b>
Child Nutrition							
Special Revenue	93,750	75,000	75,000	75,000	75,000	75,000	645,221
Other Sources	144,170	144,170	144,170	1,531,397	1,531,397	1,531,397	1,531,397
<b>TOTAL, CASH RECEIPTS</b>	<b>17,403,864</b>	<b>4,250,838</b>	<b>409,333</b>	<b>5,638,065</b>	<b>1,796,560</b>	<b>18,781,592</b>	<b>6,342,620</b>
<b>DISBURSEMENTS</b>							
Payroll-Related							
Total, Payroll-Related	2,969,454	8,776,845	3,090,427	15,864,168	3,090,427	8,342,905	5,331,819
Accounts Payable (Non-Payroll Disbursements)							
Debt Service	1,818,479	1,584,783	1,584,783	1,584,783	1,584,783	1,584,783	1,975,658
LDE grant disbursement	-	9,646,255	-	-	-	-	-
Child nutrition	201,486	487,039	487,039	487,039	487,039	487,039	608,799
Special revenue	1,611,997	5,125,307	1,611,997	5,125,307	1,611,997	5,125,307	151,758
<b>TOTAL, CASH DISBURSEMENTS</b>	<b>6,601,417</b>	<b>25,620,230</b>	<b>6,774,246</b>	<b>23,061,298</b>	<b>6,774,246</b>	<b>15,540,034</b>	<b>8,068,035</b>
<b>Net Cash Flow</b>	<b>10,802,447</b>	<b>(21,369,391)</b>	<b>(6,364,913)</b>	<b>(17,423,232)</b>	<b>(4,977,686)</b>	<b>3,241,557</b>	<b>(1,725,415)</b>
General	42,966,743	23,411,282	17,046,368	(376,864)	(5,354,550)	(2,112,993)	(3,838,407)
Debt Service	3,512,540	1,698,610	1,698,610	1,698,610	1,698,610	1,698,610	1,698,610
<b>Ending Cash Balance - General &amp; Debt Service</b>	<b>46,479,283</b>	<b>25,109,892</b>	<b>18,744,979</b>	<b>1,321,746</b>	<b>(3,655,940)</b>	<b>(414,382)</b>	<b>(2,139,797)</b>



## II. UNDERSTANDING CASH FLOWS

### Cash Receipts

- **Identify the key sources of cash and separate the receipts into major categories:**
  - Local
  - State
  - Federal
  - Other
  
- **Use the following approaches to identify how much cash the organization can expect to receive:**
  - Historical receipt / collection patterns – look at the last two years of revenue and collections; identify a typical collection cycle
  - Expected annual receipts based upon key drivers
  - Identify non-core receipts – identify non-recurring receipts, expected “windfalls” and adjust forecast accordingly



## II. UNDERSTANDING CASH FLOWS

Payroll (along with benefits, typically 80% of costs)

- Talk to the Human Resources Director or Payroll Clerk and understand key drivers -- payroll is the single largest expense item on the financials
- Separate historical payroll into the following components:
  - Recurring payroll
  - Stipends
  - Severance
  - Taxes
  - Healthcare
  - Retirement / Pension
- Identify what is expected to happen in the future and forecast off this basis
- Does the payable register tie out to what was historically paid

- *What key challenges do "position control" in HR/Payroll bring to the situation?*
- *How can this control be strengthened?*



## II. UNDERSTANDING CASH FLOWS

### Accounts Payable (Non Payroll Disbursements)

- **Obtain a detailed Accounts Payable Run and look at how much the organization typically pays out on a historical basis**
- **Perform an A/P aging analysis**
  - Does every invoice come through accounts payable?
  - Who approves payments?
  - Focus on the top 10 to 20 key vendors?
  - Are there any emergency payments scheduled or due?
  - Who is screaming the loudest?
- **Remove any line item that is being forecasted as a separate analysis**
- **As a percentage of total accounts payable, analyze how much the organization typically pays out each month**
- **Build the analysis so that a “stretch factor” can be built in later – illustrate with an example of the one-time cash flow benefit of stretching payables**



## II. UNDERSTANDING CASH FLOWS

### Debt Service

- All expected debt payments should be accounted for, including principal and interest payments on bonds
- Separate permanent reduction in principal from temporary
- Be sure to include all fees
- If interest is variable, forecast very conservatively

- *Has a sinking fund been established?*
- *Are there opportunities for arbitrage through refinancing?*
- *Is interest income useable for GOB purposes?*



## II. UNDERSTANDING CASH FLOWS

### Potential Challenges

- **How do you get your hands around cash flow if you are pushed into a position in which there is limited openness to reviewing cash flows?**
  - Review public documents – historical financials are generally available for all to see
  - Determine if there are major new initiatives underway that will impact historical run-rates
  - Assess whether there are expected events in the future that will have a financial impact on departmental or system-wide operations
  - Move to a departmental P&L or Budget assessment



### III. BUDGET REVIEW AND DEVELOPMENT

#### General

- **Another key process that should be relied upon in finding operational improvements is budget review and development**
- **The budget review and development process can be used as the basis for:**
  - Identifying performance improvement opportunities
  - Making decisions on implementation of restructuring and cost reduction initiatives
  - Perform annual budgeting
  - Defining performance metrics for individual departments



### III. BUDGET REVIEW AND DEVELOPMENT

#### General (continued)

- **The budget development process should be based upon a bottoms-up build; a bottoms-up budget is a great tool that uses actual departmental needs as the foundation for planning**
- **A bottoms-up build uses the key drivers of costs and revenues as the basis for budgeting and assessing needs**
  - It helps keep the organization on track with its objectives
  - It helps monitor progress
  - It delegates responsibility
  - It helps manage expectations



### III. BUDGET REVIEW AND DEVELOPMENT

#### General (continued)

- **Many of the same principles and approaches that were discussed during the cash flow section are also central to budget review and development**
- **Key management**
  - The first step is to talk with key management - Ask general questions and let them talk about their departments
- **Historical financials**
  - Historical financials will be the basis for the forecast
  - Try to obtain electronic files for at least 6 months and up to 2 years if possible
- **Departmental interviews**
  - After you have had a chance to digest the management overviews, historical financials and cash flow forecast, you can proceed with key departmental reviews
  - Ask detailed questions, listen carefully and be modest



### III. BUDGET REVIEW AND DEVELOPMENT

#### Approach

- **The approach to building a bottoms-up departmental budget includes:**
  - Identify key financial drivers for each major department
  - Review historical trends on financial drivers and develop assumptions for future activity
    - Forecast revenue associated with individual department
    - Then move down the income statement to operating expense line items
      - Payroll
      - Benefits (often, medical provider's invoices have significant cost and employee participation detail)
      - Other Operating Expense
  - Understand roles and responsibilities for all individuals in department – evaluate value-add of processes. Identify opportunities to streamline and use budgeting process as opportunity to drive change.
  - Assess opportunities for cost reductions throughout process. Develop fact base and present to management.
    - Challenge historical assumptions and present clear alternatives



### III. BUDGET REVIEW AND DEVELOPMENT

#### Challenges to Bottoms-Up Budget Development when there is Not a Crisis

- **Position Control**
- **Lack of sufficiently-detailed and reliable historical data**
- **No monthly closings of the books – no regular accounting practices**
- **Absence of monitoring functions in finance**
- **Difficulty forecasting mandated services**
- **Management reluctance to buy-off on true bottoms-up build or change in assumptions – “this is the way it has always been done”**
  - Sensitivity around review of roles and responsibilities
  - Culture adverse to change



## III. BUDGET REVIEW AND DEVELOPMENT

### HR / Finance:

#### **Hypothetical**

There are rumblings throughout the organization that there are people receiving pay checks that should not be on payroll. What do you do about this?

#### **Management Interviews**

Who do you talk to? Where do you start?

What do you ask?

Challenges / likely areas of blame?

#### **Key Financial Drivers**

What are the key areas to look in order to find opportunities to contain costs?

How can these drivers be managed?

#### **Other Considerations**

Budget impact



## III. BUDGET REVIEW AND DEVELOPMENT

### Facilities:

#### **Hypothetical**

You are placed into the facilities department and tasked with making more of available budget dollars. What do you do about this?

#### **Management Interviews**

Who do you talk to? Where do you start?

What do you ask?

Challenges / likely areas of blame?

#### **Key Financial Drivers**

What are the key areas to look in order to find opportunities to contain costs?

How can these drivers be managed?

Outsourcing: Costs / Benefits, RFP considerations

#### **Other Considerations**

Aging, under-maintained public buildings in urban America



## III. BUDGET REVIEW AND DEVELOPMENT

### Finance:

#### **Hypothetical**

Historically, your municipality has not had the best budgeting and monitoring practices. How do you implement new procedures for management accountability and control within the city?

#### **Management Interviews**

Who do you talk to? Where do you start?

What do you ask?

Challenges / likely areas of blame?

#### **Key Financial Drivers**

What are the key areas to look in order to find opportunities to contain costs?

How can these drivers be managed?

Outsourcing: Costs / Benefits, RFP considerations

#### **Other Considerations**

Site Based Budgeting



## IV. BALANCE SHEET ASSESSMENT

### Overview

1. **Core Competence vs. Non-core**
2. **Sell Redundant & Surplus Assets**
  - Capacity Utilization
  - Factors to consider
  - Community engagement
3. **Sale & leaseback**
4. **Inventory Liquidation/Warehouse Audit**
5. **Vehicle/Fleet Review**



## IV. BALANCE SHEET ASSESSMENT

### 1. Core Competence vs. Non-core

- Focus on our core competencies
  - Build a plan around leveraging this competence to world class levels
- Protect the Municipality
  - Eliminate and reduce waste and inefficiencies

### 2. Sell Redundant and Surplus Assets

- Improve liquidity by cleaning up the balance sheet
  - Sale of unused property and buildings
  - Other underutilized prime real estate
  - Consult with the City's Planning Department to better understand the City's future zoning and redevelopment plans
- Capacity Utilization – how many buildings do we need?
- What factors should we consider in determining which assets to part with?
  - Review what we did on prior projects
  - How should the community be engaged?
  - Lessons learned from prior projects on how not to do it



## IV. BALANCE SHEET ASSESSMENT

### 3. Sale & Leaseback of Office Buildings

- Get out of the real estate/property management business
- Ability to transfer tax exempt status
- Attractiveness of a long term lease to a stable client from a buyer perspective

### 4. Inventory/Warehouse Audit & Liquidation

- PC hardware & software, machinery & equipment
- Figure out what is truly out there – often a fixed asset appraisal has not been done in years

### 5. Fleet Review

- Analyze capacity utilization
- Insured dead or missing vehicles
- Municipality/Department cars



## V. KEY TAKEAWAYS

1. A&M Approach - A&M's approach to restructuring uses (a) Liquidity Assessments, (b) Budget Review and Development, and (c) Balance Sheet Assessments as the basis for finding and implementing operational improvements and rescuing a municipality from financial crisis.
2. Treasury Cash Flow Forecast - A 13 week cash flow forecast is a great tool for monitoring and understanding activity in a county, city or town, and identifying opportunities for improvement.
3. Budget Development – Detailed review and build of budgets, and the related monitoring of actual expenditures, is a discipline that all municipalities should employ.
4. Balance Sheet Assessment – There is often hidden value that sits on the balance sheets of most state and local governments. Careful review is likely to unearth opportunities to enhance liquidity.
5. Change Management – Private sector techniques do work in driving change and movements to efficiency in municipalities.

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