CITIZEN BUDGET REVIEW

City of Harbor Springs, Michigan

Fiscal Year 2026 Proposed Budget

December 2025

Purpose and Limitations

This memo is offered in the spirit of a citizen management letter—highlighting areas where closer alignment with Generally Accepted Accounting Principles (GAAP) and government finance best practices could strengthen the City's budget presentation and fiscal planning.

Important Disclaimer: This review was conducted with limited time and access to underlying documentation. I may have missed context, corrections, or explanations that would address the observations below. Staff and Council are far more familiar with the details than I am, and I welcome correction on any point where I have misunderstood the situation.

The intent is not to criticize staff effort—preparing a budget for a city with this level of complexity (municipal electric utility, DDA, waterfront, capital plan) is substantial work. Rather, this memo suggests ways to strengthen governance and transparency that would benefit any municipality of our size.

Context: Harbor Springs has a year-round population of approximately 1,200 residents, with significant seasonal fluctuation. The City operates its own electric utility, maintains waterfront facilities, and supports a tourism-oriented downtown through a Downtown Development Authority (DDA).

Summary

Based on my review of the proposed FY2026 budget and the December 8, 2025 Council discussion, I identified several areas where GAAP best practices suggest modifications. These relate primarily to revenue recognition, capital project authorization, liability accrual, and enterprise fund oversight.

The budget as presented shows a General Fund deficit of $762,000. However, this figure includes a $500,000 boardwalk project that staff recommends removing, and $400,000 in FEMA revenue whose timing and amount remain uncertain. Adjusting for these items would significantly change the reported position.

The recommendations below are offered as suggestions for Council's consideration, grounded in GAAP principles and best practices from the Government Finance Officers Association (GFOA).

Illustrative Budget Position (If Adjusted)

Item	Amount	Section
Reported General Fund Deficit	($762,000)	—
Remove Unfunded Boardwalk (per staff recommendation)	+$500,000	2.1
Remove Uncertain FEMA Revenue	($400,000)	1.2
Illustrative Adjusted Position	**($262,000)**	—

Note: This is illustrative only. Additional items (PTO liability, utility impacts) are discussed but not quantified here. Staff may have already addressed some of these points.

Section 1: GAAP Best Practices - Revenue and Liability Recognition

GAAP and GFOA best practices provide a framework for consistent, conservative financial reporting. The following observations highlight areas where closer alignment with these standards could strengthen the budget presentation.

1.1 Accrual of Compensated Absences (PTO)

GAAP Standard: GASB Statement No. 16 requires governments to accrue a liability for compensated absences (vacation, sick leave, PTO) that are attributable to services already rendered and are not contingent on a specific event.

Best Practice Rationale: Accruing these liabilities annually ensures that current taxpayers fund the benefits earned by current employees, rather than creating budget surprises when long-tenured employees retire.

Observation from December 8 Meeting:

- Discussion indicated that a retiring officer's PTO payout plus healthcare buyout totaled approximately $160,500
- Staff noted that PTO can accumulate up to six months and payout percentages vary by tenure
- This suggests the City may be using cash-basis recognition for these obligations

Suggestions for Consideration:

1. Calculate and disclose total accumulated PTO liability across all funds
2. Consider establishing an Employee Benefit Reserve Fund with annual contributions
3. Publish an annual schedule showing total liability and year-over-year changes

1.2 Recognition of Contingent Grant Revenue (FEMA)

GAAP Standard: GASB Statement No. 33 requires that grant revenue be recognized only when eligibility requirements are met and resources are measurable and available. Until a grant is formally awarded and funds obligated, the revenue is considered a contingent asset.

Best Practice Rationale: Conservative revenue recognition protects against budget shortfalls if expected grants are delayed or denied. This is particularly important for FEMA reimbursements, which can take months or years to process.

Observation:

- The budget includes $400,000 in anticipated FEMA reimbursement (approximately 9% of General Fund revenue)
- Staff indicated uncertainty about timing: "That could be 10 days, it could be two years"
- Some permanent work claims have already been denied
- Grant is currently in "final signature in review" with State Emergency Management

Suggestions for Consideration:

1. Consider presenting a base budget that balances without FEMA revenue
2. Identify specific projects or reserve replenishment that would be funded if FEMA is received
3. Consider adopting a policy that FEMA funds first replenish reserves drawn down for storm response
4. Present scenario analysis (full/partial/no FEMA) to help Council and citizens understand the range of outcomes

Example FEMA Scenario Analysis:

Scenario	Amount	Potential Use
Full Reimbursement	$400,000	Replenish reserves; fund contingent CIP items
Partial	$200,000	Replenish reserves only
None	$0	No impact (base budget balanced without FEMA)

Section 2: Capital Improvement Plan Structure and Transparency

GFOA best practices recommend that capital budgets clearly distinguish between funded and unfunded projects, and that aspirational projects not be included in appropriations until funding is secured.

2.1 Contingent Projects in the Operating Budget

Best Practice: Capital projects that depend on external funding (grants, donations) should not appear as appropriations in the annual operating budget until funding is contractually committed. Including them creates a misleading deficit narrative.

Observation:

- The budget includes a $500,000 boardwalk project without corresponding revenue
- Staff recommended removing this item: "We're not showing any revenue coming in donations in 2026"
- City Manager stated: "My recommendation there is to remove the boardwalk from this budget"

Suggestion: Follow staff's recommendation to remove the $500,000 boardwalk expenditure from the operating budget. Keep it in the CIP as a contingent project to be initiated when sufficient donations and/or grants are secured. Post the CIP on City website along with budget. If there are important unfunded elements, include the logic/concern/outreach for funds via city newsletter/facebook/website.

2.2 Restricted Fund Reconciliation

Best Practice: Restricted funds should be fully reconciled before authorizing new spending, with clear documentation of receipts, expenditures, and current balance.

Observation:

- There appears to be some uncertainty about the current boardwalk fund balance (Not sure I have this right, it was hard to distinguish in the transcript)
- Historical audit records and current reported balances may warrant reconciliation

Suggestion: Before any future boardwalk spending is authorized, consider presenting a complete reconciliation showing: total donations received by year, expenditures to date, current restricted balance, and any transfers or reclassifications.

2.3 Tiered CIP Approach

Best Practice: GFOA recommends that capital plans clearly distinguish between projects that are funded and ready for execution versus those that are contingent on future resources.

Suggested Structure:

Tier 1 (Base): Approved	Tier 2 (Contingent): If Revenue Received
Projects funded from existing city resources	Projects dependent on FEMA, grants, or donations
Authorized for immediate execution	Pre-approved; execution upon revenue confirmation
Budget must balance at this tier	No budget amendment required when triggered

Benefit: This approach maintains fiscal discipline while allowing rapid execution of deferred projects when revenue materializes, without requiring a budget amendment. Post a memo explaining the tiered approach on city website

2.4 CIP Publication and Strategic Guidance

Best Practice: GFOA recommends publishing the full CIP alongside the annual budget, with clear status indicators for each project.

Suggestions:

1. Publish the CIP on the City website with projects clearly labeled as Funded, Contingent, or Unfunded
2. For unfunded items, include estimated cost and anticipated funding sources
3. Consider providing Council guidance on strategic priorities (e.g., relative emphasis on resident infrastructure vs. tourism amenities) to help staff rank and sequence projects consistently

Benefit: Transparency allows citizens to see not just what the City can afford this year, but what it aspires to do over time. Residents can provide informed input on priorities.

Section 3: Electric Utility Fund Oversight and Reporting

The proposed $8 million utility bond authorization represents a significant commitment for a city of 1,200 year-round residents. GFOA best practices suggest that enterprise fund borrowing of this magnitude warrants detailed analysis and enhanced oversight.

3.1 Bond Sizing and Debt Service Planning

Observation:

- $8 million authorized, though final engineering is not complete
- Staff indicated a preference to bond for $6 million if possible
- The method for funding debt service (rate increases vs. General Fund support) appears undetermined
- Council discussed eliminating the $245,000 annual Electric Fund transfer to General Fund

Suggestion: 10-Year Pro Forma

Before finalizing bond size and rate decisions, consider presenting a 10-year Electric Fund pro forma including:

1. Forecasted operating revenues and expenses
2. Planned capital expenditures beyond current projects
3. Proposed bond structure and debt service schedule
4. Planned transfers to General Fund (if any)
5. Projected debt service coverage ratios

6. Target minimum fund balance and reserve requirements

3.2 Transfer Policy

Best Practice: Transfers from enterprise funds to the General Fund should be based on a clear, documented policy rather than ad hoc decisions. The policy should include safeguards to protect utility financial health. Policy should be posted on city website.

Suggestion:

- Consider formalizing the transfer policy with a defined formula (e.g., percentage of revenues or net plant)
- Include automatic safeguards: if debt service coverage or fund reserves fall below target thresholds, transfers are reduced or suspended
- Document the General Fund impact under different transfer scenarios

3.3 Emerging Risks and Oversight

Observation:

- The City recently sold a Power Purchase Agreement, suggesting active capacity management
- Seasonal population fluctuation (1,200 to potentially 5,000+) creates variable peak demand
- Regional trends toward electrification (heat pumps, EVs) may increase future load and increased supply of renewables may make supply intermittent.
- There does not appear to be regular, formal utility reporting to Council beyond budget documents. Council is running a utility, and needs to oversee it properly.

Suggestions:

1. **Quarterly Reporting:** Consider establishing quarterly or semi-annual Electric Fund reports to Council covering demand trends, capacity utilization, project status, and fund balance
2. **Advisory Input:** Given the complexity of utility operations, consider engaging an informal advisor, perhaps a retired utility executive residing in the community, to review the bond business case, load assumptions, and rate impact before debt is incurred
3. **Load Analysis:** Survey community on the rate at which it is moving more electric. And/Or discuss with HVAC contractors. The shift to more electric was a reason for the multi-day winter blackout in Texas.

Section 4: DDA Accountability Framework

The Downtown Development Authority spends approximately $270,000 annually, funded largely by TIF capture (~$181,000) and special assessments. GFOA best practices suggest that entities receiving dedicated tax revenue should demonstrate measurable outcomes.

4.1 Performance Measurement

Best Practice: Organizations funded by dedicated revenue streams should establish Key Performance Indicators (KPIs) that connect spending to outcomes, allowing stakeholders to evaluate return on investment.

Observation:

- The DDA budget presentation focused on activities (events, beautification, marketing) rather than outcomes

- No KPIs were presented to measure effectiveness
- Fund balance is approximately $430,000 (growing) with no stated deployment plan

Suggestion:

Before approving the FY2026 DDA budget, Council might ask the DDA to propose a small set of KPIs and provide a good-faith estimate of current performance against those metrics. This need not be onerous—even simple measures like commercial vacancy rate, year-round vs. seasonal business count, or taxable value growth would provide baseline accountability.

4.2 Example KPIs (Illustrative)

The following are **examples only**—final metrics should be developed collaboratively between Council and DDA:

Category	Example KPI
Economic Impact	Taxable value growth (DDA district vs. city overall)
Economic Impact	Commercial vacancy rate
Business Health	Year-round vs. seasonal business count
Event ROI	Event attendance and merchant-reported impact

Section 5: Citizen Communications

Effective communication is essential for democratic governance. The population varies greatly, and the part time residents do represent a substantial aspect of revenue. Given Harbor Springs' small full time population, and engaged part time population, achieving high coverage is feasible at relatively low cost.

5.1 Current Challenges

- Audio/visual reliability issues noted during Council meetings
- No comprehensive email/text notification system for budget hearings or major decisions
- Seasonal residents may miss important information

5.2 Suggestions

The budget includes $60,000 for A/V upgrades. Consider whether a portion of this could fund active engagement systems:

1. **Notification Platform:** A mass notification system (email/SMS) capable of reaching residents and property owners for major announcements
2. **Contact Collection:** Make email/phone collection a standard part of utility account management and permitting
3. **Coverage Target:** Consider setting a goal to have 90% of utility accounts with valid contact information within 2-3 years. Current technology may be sufficient, so a coverage taget may be the missing element to an effective communications strategy.
4. **Major Initiative Commitment:** For significant decisions (budget, rate changes, zoning), commit to direct mailing plus electronic notification plus clear website postings
5. **Measure:** Use Net Promoter scoring to validate outcomes of communications engagement. All KPIs for communications should be based on results not effort

Section 6: Summary of Suggestions

The following suggestions are offered for Council's consideration, grounded in GAAP and GFOA best practices. Staff may have already addressed some of these points, and I welcome correction where I have misunderstood.

Budget Adoption Considerations

1. Remove $500,000 boardwalk expenditure per staff recommendation; keep in CIP as contingent
2. Consider presenting a base budget that balances without $400,000 FEMA revenue
3. Adopt tiered CIP: Tier 1 (funded) and Tier 2 (contingent on external revenue)
4. If FEMA is received, consider prioritizing reserve replenishment before new projects
5. Request DDA propose KPIs and baseline performance estimate before budget approval

Near-Term Process Improvements

6. Calculate and disclose total PTO liability; consider establishing benefit reserve fund
7. Complete 10-year Electric Fund pro forma before finalizing bond decisions
8. Consider quarterly utility reporting to Council
9. Formalize Electric Fund transfer policy with coverage safeguards
10. Publish CIP on website with funding status clearly labeled
11. Launch citizen notification enrollment campaign

Strategic Guidance

- Consider providing explicit Council guidance on CIP priorities (resident infrastructure vs. tourism amenities)
- Clarify DDA mission expectations: business development vs. placemaking vs. capital improvements
- Consider engaging informal utility advisory input before major bond decisions

Harbor Springs is a small city with sophisticated responsibilities: a municipal electric utility, an active DDA, waterfront facilities, and a capital plan that would not be out of place in a larger community. These suggestions are intended to help align the budget more closely with GAAP best practices and strengthen transparency for the 1,200 year-round residents who depend on these decisions.

Again, I had limited time to review these materials and may have missed important context. I welcome correction on any point and appreciate the substantial work that staff and Council invest in the City's governance.

Thank you for considering these observations.

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