

November 9, 2011

To the Honorable Mayor and  
Members of the City Council  
City of Farmington, Michigan

We have audited the financial statements of the City of Farmington, Michigan (the "City") as of and for the year ended June 30, 2011 and have issued our report thereon dated November 9, 2011. Professional standards require that we provide you with the following information related to our audit which is divided into the following sections:

Section I - Communications Required Under SAS 114

Section II - Legislative and Informational Items

Section I includes information that current auditing standards require independent auditors to communicate to those individuals charged with governance. We will report this information annually to the mayor and members of the City Council.

Section II contains updated legislative and informational items that we believe will be of interest to you.

We would like to take this opportunity to thank the City's staff for the cooperation and courtesy extended to us during our audit. Their assistance and professionalism are invaluable.

This report is intended solely for the use of the mayor, members of the City Council, and management of the City and is not intended to be and should not be used by anyone other than these specified parties.

We welcome any questions you may have regarding the following communications and we would be willing to discuss any of these or other questions that you might have at your convenience.

Very truly yours,

**Plante & Moran, PLLC**



David Helisek

## **Section I - Communications Required Under SAS 114**

### **Our Responsibility Under U.S. Generally Accepted Auditing Standards**

As stated in our engagement letter dated June 1, 2011, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities. Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement.

As part of our audit, we considered the internal control of the City. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

### **Planned Scope and Timing of the Audit**

We performed the audit according to the planned scope and timing previously communicated to you in our meeting about planning matters on August 31, 2011.

### **Significant Audit Findings**

#### ***Qualitative Aspects of Accounting Practices***

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City are described in Note 1 to the financial statements. As described in Note 1, the City implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund-type Definitions*, in 2011. Fund balance classifications in the governmental fund financial statements have been changed to reflect the five new classifications required under GASB No. 54. Accordingly, the accounting change has been retrospectively applied to prior periods presented as if the policy had always been used.

We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus.

There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

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City of Farmington, Michigan

November 9, 2011

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

The most sensitive estimates affecting the financial statements were the estimate of accounts receivable related to unbilled water and sewer fees and the estimates related to pension and other postemployment benefits (OPEB) funding. Management's estimate of the unbilled water and sewer fees was based on historical information and the pension and OPEB contributions were calculated on an actuarial basis. We evaluated the key factors and assumptions used to develop the estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were Note 5 - Capital Assets, Note 7 - Long-term Debt, Note 9 - Defined Benefit Pension Plan, and Note 10 - Postemployment Benefits.

#### ***Difficulties Encountered in Performing the Audit***

We encountered no significant difficulties in dealing with management in performing and completing our audit.

#### ***Corrected and Uncorrected Misstatements***

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. No such misstatements were identified.

#### ***Disagreements with Management***

For the purpose of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

#### ***Management Representations***

We have requested certain representations from management that are included in the management representation letter dated November 9, 2011.

To the Honorable Mayor and  
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City of Farmington, Michigan

November 9, 2011

***Management Consultations with Other Independent Accountants***

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to the City’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

## **Section II - Legislative and Informational Items**

### **Impact of Census Results on State-shared Revenue**

The 2010 census data was released on March 22, 2011. Census results indicated an overall decline in population for the state of Michigan of 0.6 percent. The impact of the census on local units of government will vary widely; based mostly upon whether or not a local unit is receiving statutory revenue-sharing payments.

In the prior year, it was reported that approximately 1,200 local units (out of approximately 1,775) did not receive any statutory revenue payments. For those communities who are only receiving constitutional payments, their percentage increase (or decrease) in population should result in a corresponding percentage increase (decrease) in constitutional revenue-sharing payments, retroactive to October 1, 2010. The retroactive payments are scheduled to be made (or deducted) in the June and August distributions.

The State's budget appropriation for 2010-2011 specifies that each local unit that experiences an increase in constitutional distributions (for instance, as a result of a population increase) will receive a corresponding reduction in statutory revenue sharing. What is less clear is whether those communities that receive a decline in constitutional distributions (due to a population decline) would receive an increase in statutory revenue sharing.

This is because of the provision that if the total statutory state-shared revenue to be paid throughout the state is higher than the State's budgeted amount, the State is under no obligation to pay more than was budgeted. At this point, we believe communities should plan on receiving the decreased amount.

### **State Initiatives Impacting Local Units of Government**

Governor Snyder has begun his tenure with several significant initiatives, and he is moving his agenda forward at a quick pace. One of these initiatives is to improve the transparency and efficiency of local units - cities, townships, villages, and counties. More specifically, his current local government initiatives include:

- Replace "statutory revenue sharing" with a newly named "Economic Vitality Incentive Program" (EVIP) that will be reduced by approximately 1/3 and require local units to compete for the remaining \$200 million by demonstrating best practices in the following areas:
  - Transparency - Provide more accessible financial information to citizens
  - Service-sharing - Consolidation or collaboration with other units of government
  - Employee benefits - Slimmed-down pension and healthcare benefits
- Significantly strengthening the powers of emergency managers
- Changes to Act 312, police and fire arbitration
- Changes to the Urban Cooperation Act
- Potential elimination of personal property taxes

Each of these initiatives could have an impact on the City of Farmington, Michigan and will be discussed in more detail below.

### **Accountability and Transparency**

Governor Snyder's proposals call for each local unit to produce a citizen's guide to its finances (a "transparency tool") and a performance "dashboard" (already prepared and submitted by the City prior to the October 1, 2011 deadline). These two tools should be readily available to the public, which likely means available via the Internet. The citizen's guide can be thought of as a simplified view of financial data, much like a Popular Annual Financial Report (PAFR). The performance dashboard would be comparisons of key metrics both to your community (over time) and to other communities (comparables).

At this point, there is no single set of criteria for these two tools; the result is to allow local units to design tools that are tailored and relevant to them.

### **Service-sharing and Consolidation**

The second requirement to compete for statutory revenue sharing has an implementation date of January 1, 2012. The State is requiring local units to submit a plan that identifies the increased sharing of services with other governments, or consolidation of services. While it appears that past endeavors will be considered this first year, the State is also looking for communities to develop plans to enter into new sharing arrangements. At this time, communities are required to certify that they have plans that they intend to implement. Actual sharing agreements do not need to be in place by January 1, 2012.

The State requires the service-sharing plans to include estimates of potential savings and costs associated with sharing services. In addition, the State has set aside a small amount (\$5 million out of the \$200 million) to assist communities with one-time implementation costs related to launching new service-sharing initiatives.

### **Employee Compensation Best Practices**

The new EVIP program requires changes only to new, modified, or extended employee contracts. Communities must certify their intention to implement the following by May 1, 2012. Such contracts would be subject to the following criteria:

- a) Placing all new hires in a defined contribution plan or a hybrid retirement plan that caps annual employer contributions at 10 percent of base salary
- b) Where applicable, a 1.5 percent multiplier should be used to determine employee pensions. A 2 percent multiplier should be used for employees who are not eligible for Social Security benefits.
- c) Implementing controls to avoid pension spiking such as using a three-year salary average that does not include more than a total of 240 hours of paid leave and overtime to determine benefit levels
- d) If health care is offered, all new hires must be on an 80/20 employer to employee healthcare premium split.

## **Other Legislative Developments**

### **Healthcare Initiatives**

Senate Bill 7 (now PA 152 of 2011), the "Publicly Funded Health Insurance Contribution Act", was signed into law by the governor in late September 2011. This new law requires all public employers to place hard caps on the amounts they contribute toward health care with an option to elect an 80 percent contribution cap rather than a hard cap. There is also an option for the local unit to opt out entirely.

PA 152 would limit annual costs for medical benefit plans to the following:

- \$5,500 for single coverage
- \$11,000 for individual and spousal coverage
- \$15,000 for family coverage

These limits would apply once contracts expire or by January 1, 2012 if there is no contract.

Alternatively, given a majority vote of its governing bodies, a public employer can opt out of the hard cap and into an 80 percent contribution cap. Under this option, public employers would pay no more than 80 percent of the total annual costs for all of the medical benefit plans it offers or contributed to for its employees and elected public officials. This option would require that publically elected officials would have to pay 20 percent or more of the total annual costs of that plan, but the employee's share of the costs could be allocated as the government sees fit.

This act does contain a complete opt-out provision. It would allow communities to opt out of these provisions entirely with a 2/3 vote of the governing body.

Failure to comply with the provisions in this act will result in a 10 percent reduction in each EVIP payment for the period of noncompliance. Opting out by a 2/3 vote of the governing body under the provisions of this act is not considered failure to comply.

The law, which applies to all public employers, will take effect on January 1, 2012. However, any collective bargaining agreement or other contract executed on or after September 15, 2011 would also have to comply.

### **Senate Bill 34 - Elimination of the Personal Property Tax**

On January 19, 2011, SB 34 was introduced. Very simply, this bill, if it becomes law, will amend PA 206 of 1893 and exempt all personal property from the collection of taxes. Altogether, this would reduce revenue for communities across the state by approximately \$770 million. Including the school districts, the lost revenue would be over \$1 billion. This bill does not provide any source of revenue to replace that which is lost.

To the Honorable Mayor and  
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November 9, 2011

Obviously, this would be devastating to many communities as personal property taxes are a significant component of a local unit's tax structure. During the governor's announcement of his budget, he did state that the elimination of the personal property tax was not part of his 2012 budget. The City of Farmington, Michigan's personal property tax currently brings in approximately \$248,000.

### **Emergency Managers - Public Act 4 of 2011**

On March 16, 2011, PA 4, *Local Government and School District Fiscal Accountability Act*, was signed into law. This act repeals Public Act 72 of 1990, the previous *Local Government Fiscal Responsibility Act*. Under the new act, the state treasurer can conduct a preliminary review to determine the existence of a local government financial problem if one or more of 18 different "triggering events" occur. Some of these events are truly a sign of financial stress, such as incurring payless paydays or defaulting on a bond or note payment. Others are more subjective, including a blanket statement that the existence of "other facts or circumstances...as determined by the state treasurer" is sufficient to start the process.

If a finding of probable financial stress is made, the governor shall appoint a review team. The team would conduct its review and report back to the governor and state treasurer within 60 days of its appointment. Depending on the severity of the findings during the review, the actions then taken could range from none to a declaration of a financial emergency, the local unit would be placed in receivership, and an Emergency Manager (EM) appointed in place of the existing governing body and chief administrative officer.

For communities that have some of the triggers but seem to have a plan to address them, there is an in-between step whereby a consent agreement is entered into and monitored.

Clearly, this legislation is causing great anxiety in terms of both the uncertainty as to how aggressive the State will be in implementing the legislation as well the broadness of the powers granted to an EM. Any new EMs would have the authority to reject, modify, or terminate the terms of an existing contract or collective bargaining agreement.

This legislation may ultimately change the tenor of future union negotiations, in that it gives the collective bargaining representatives a strong incentive to work with the City to avoid receivership by an EM.

### **Proposed Changes to Act 312, Police and Fire Arbitration**

Public Act 312 prohibited public police and fire department employees from the right to strike. Whenever contracts are not resolved, the employees or employer may initiate binding arbitration in lieu of striking. The arbitrator's decision is final and binding upon the parties involved.

To the Honorable Mayor and  
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November 9, 2011

The governor's March 21, 2011 special message called for reforming Act 312 of 1969, the Police and Fire Arbitration Act. In July 2011, Public Act 116 of 2011 was signed into law and contains the following provisions:

- A stronger consideration of a community's ability to pay
- Internal salary and benefit comparisons
- Reducing the timeframe of the process to no more than 180 days

### **Proposed Amendments to the Urban Cooperation Act and Related Statutes**

Various house and senate bills intend to amend the numerous statutes that govern local unit service sharing. These bills eliminate certain guarantees and provisions of collectively bargained agreements. The problem in trying to form new collaborative ventures is that the existing act includes a clause that prevents the immediate negotiation of new contracts. This stands in the way of even the consideration of mergers by many local units because the new entity is hampered by a multi-layer set of work rules, wages, and benefits which effectively eliminate the economic efficiencies that are the very reason to consolidate. Under the amended act, management and employees should be allowed to immediately begin the collective bargaining process for the new entity and complete this within an appropriate timeframe.

The bills are still a work in progress; however, passage in the fall is expected.

### **Retro Pay Prohibition**

Public Act 54 of 2011, which was signed by the governor on June 7, prohibits retroactive pay on an expired contract and calls for employees working under an expired agreement to bear the cost of any increased healthcare costs until a new contract is in effect. During that period, the public employer is authorized to make payroll deductions necessary to pay the increased cost of maintaining those benefits. This act was ordered to take effect immediately.