

November 8, 2016

To the Mayor and City Council  
City of Davison, Michigan

We have audited the financial statements of the City of Davison, Michigan (the "City") as of and for the year ended June 30, 2016 and have issued our report thereon dated November 8, 2016. Professional standards require that we provide you with the following information related to our audit which is divided into the following sections:

Section I - Internal Control Related Matters Identified in an Audit

Section II - Required Communications with Those Charged with Governance

Section III - Legislative and Informational Items

Section I includes any deficiencies we observed in the City's accounting principles or internal control that we believe are significant. Current auditing standards require us to formally communicate annually matters we note about the City's accounting policies and internal control.

Section II 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 City Council of the City of Davison, Michigan.

Section III 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, especially Julie and Michael, 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 management, the Mayor, the City Council, and others within 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**



Pam Hill, CPA  
Partner



Amanda Cronk, CPA  
Manager

## **Section I - Internal Control Related Matters Identified in an Audit**

In planning and performing our audit of the financial statements of the City as of and for the year ended June 30, 2016, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

We consider the following deficiency in the City's internal control to be a material weakness:

During the fiscal year, management performed a detailed analysis of the estimates within the City's financial statements. During this review, the City's staff identified that there were several formula errors within the spreadsheet the City used to estimate the other postemployment benefit obligation. These formula errors, as identified by the City, resulted in an understatement of the obligation as of June 30, 2015, which required the City to calculate an adjustment to correct the liability. This adjustment does not affect the budget of the governmental funds but is an entry on the full-accrual basis statements only. While this adjustment was identified by management through their improved, current, strong system of internal controls, a prior period adjustment was required to adjust the beginning of year net position for governmental activities, business-type activities, the Sewer Fund, and the Water Fund. Therefore, as this adjustment was for a material dollar amount, even though identified by the City's management, it is required to be communicated to the City Council within this letter. The impact of not correcting this calculation would be that the net position in the above mentioned opinion units would be understated.

## **Section II - Required Communications with Those Charged with Governance**

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

As stated in our engagement letter dated July 20, 2016, 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 of Davison. 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 1, 2016.

### **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 of Davison are described in Note I to the financial statements.

The City changed accounting policies related to the adoption of GASB Statement No. 72, *Fair Value Measurement and Application*. As a result, the notes to the financial statements now include enhanced disclosures about fair value measurement, the level of fair value hierarchy, and valuation techniques.

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.

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 estimated liability related to open Michigan tax tribunal cases, the net pension liability, and other postemployment benefit obligations. Management's estimates of the estimated Michigan tax tribunal cases, net pension liability, and other postemployment benefit obligations are based on probability of the settlement, the pension actuarial valuations, and the other postemployment benefit actuarial valuation, respectively. 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.

## **Section II - Required Communications with Those Charged with Governance (Continued)**

The disclosures in the financial statements are neutral, consistent, and clear.

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

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

### ***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.

### ***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. Management has corrected all such misstatements. Material adjustments were required to the beginning net position related to the other postemployment benefit obligation as noted in Section I above.

### ***Significant Findings or Issues***

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, business conditions affecting the City, and business plans and strategies that may affect the risks of material misstatement with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition of our retention.

### ***Management Representations***

We have requested certain representations from management that are included in the management representation letter dated November 8, 2016.

### ***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 III - Legislative and Informational Items**

### **Legacy Costs**

Legacy costs and the challenge of funding them continues to be a topic of discussion. GASB pronouncements of late have placed even more focus on the net long-term liability arising from these benefit promises. The pension system is 52 percent and 82 percent funded for union and nonunion plans, respectively, as of June 30, 2016. To the extent that you have been able to make some gains in terms of your funded status, some changes to assumptions may result in the funding level decreasing which may result in higher contributions going forward. We recommend that the City continue to monitor these long-term obligations and the related funding requirements of the systems.

### **New Other Postemployment Benefits Standards (Retiree Healthcare Obligations)**

In June 2015, the GASB issued two new standards addressing accounting and financial reporting by state and local governments for postemployment benefits other than pensions (OPEB, which refers to retiree healthcare). GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans other than Pension Plans*, addresses reporting by OPEB plans, whereas GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, addresses accounting and reporting by employer governments that provide OPEB benefits to their employees.

Since the City does not currently administer the OPEB plan, GASB Statement No. 74 will not impact the City. The City will, after adoption of GASB 75, recognize on the face of the financial statements its net OPEB liability. The City is currently evaluating the impact these standards will have on the financial statements when adopted. GASB 75 is effective for fiscal year ending June 30, 2018.

### **PA 298 of 2012 - Act 51 Performance Audits**

Public Act 298 of 2012 allows the Michigan Department of Transportation (MDOT) to conduct performance audits and make investigations of the disposition of all Act 51 state funds received by county road commissions, cities, and villages. The act states that these audits will be conducted by either an independent CPA or an employee of MDOT; however, recent communications sent to all cities, villages, and road commissions from MDOT indicate that you will need to have your CPA conduct the performance audit.

Based on this communication, the City will need a performance audit for its fiscal year ended June 30, 2017. These procedures will be focused on evaluating the procedures the City puts in place to ensure it complies with the requirements of Public Act 51, and we will issue a separate report for this engagement. We are currently in the process of writing programs to address the key compliance areas. It is not clear to us whether this will be an annual requirement, but we will keep you apprised as additional information is provided by the State.

A key aspect of the compliance testing will focus on support for allocated costs. Recent communication from MDOT stated that MDOT auditors have determined that because time cards support, as a fundamental accounting record, the amounts billed for labor, equipment, and materials that cost allocations plans are not acceptable and therefore labor costs must be based on actual time, which can be verified by signed and approved time cards. Given the October 1, 2015 commencement of the audit time period, we encourage you to review your documentation methods to ensure compliance with this critical aspect.