

September 28, 2011

To the Mayor and Members
of the City Council
City of Northville, Michigan

We have audited the financial statements of the City of Northville, Michigan (the "City") for the year ended June 30, 2011 and have issued our report thereon dated September 28, 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 - Other Recommendations

Section III - 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 City Council of the City.

Section II presents recommendations related to internal control and procedures noted during our current year audit. These comments are offered in the interest of helping the government in its efforts toward continuous improvement, not just in the areas of internal control and accounting procedures, but also in operational or administrative efficiency and effectiveness.

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 Sandi Wiktorowski, her finance team, and the entire City 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 City Council and management of the City of Northville and is not intended to be and should not be used by anyone other than these specified parties.

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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

A handwritten signature in cursive script, appearing to read "Christopher Jones".

Christopher S. Jones

A handwritten signature in cursive script, appearing to read "Kristin L. Hunt".

Kristin L. Hunt

Section I - Communications Required Under SAS 114

Our Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter, 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 Northville, Michigan. 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.

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 I to the financial statements.

As described in Note I4, the City changed accounting policies related to fund balance reporting and governmental fund-type definitions. 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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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 estimate affecting the financial statements is the net other postemployment benefit obligation.

Management's estimate of the net other postemployment benefit obligation recorded in the financial statements is based on their calculation of annual required contribution. The calculation is based on significant estimates, including anticipated rate of return on investments, estimated future healthcare costs, and employee eligibility rates. We reviewed assumptions and believe them to be reasonable.

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

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. Management elected not to record an expense and liability for \$3,339 in the Downtown Development Authority. Management has determined that the effect is immaterial to the financial statements taken as a whole.

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 September 28, 2011.

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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 government’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 - Other Items and Recommendations

Implementation of GASB No. 54

We would like to commend Sandi and the rest of the finance department staff for the great work they did familiarizing themselves with this new accounting standard and determining how it would impact the City. The upfront time and effort they put in was evident when it came time for the audit and the City was clearly well-prepared and demonstrated a thorough understanding of the new standard.

OPEB Valuation Reminder

Two years ago, the City took advantage of the alternative valuation method for calculating required retiree healthcare contributions permitted under GASB No. 45. Plante & Moran is pleased to have developed an Excel model that allows communities to take advantage of this alternative valuation method. This model which is provided at no-charge to our clients will generally save communities \$8,000 - \$10,000 in actuary fees each time it is used. The “cost” of this method is the considerable time invested by the finance team to prepare and update the model appropriately. We commend the City’s finance team on being willing to put the time and effort into this method and take advantage of the cost savings. We would like to remind the City that these valuations must be updated every three years, which means that the City must update their calculation prior to the next audit.

Funding Levels

We continue to highlight the funding levels of the City’s pension and postemployment benefits plans. The funding level of the pension system is now at 63 percent and the postemployment system annual costs are being funded at 50 percent. We recommend that actuary assumptions and amounts funded continue to be re-evaluated regularly to provide full funding over the long term of these systems. The larger the unfunded obligation, the higher the future required contributions will be.

New Retirement Reporting

We want to remind the City that new accounting rules are being proposed for pension system accounting which, among other changes, would require the pension assets and pension obligations to be reported on the City’s financial statements. What this means is that, as the rules are currently drafted, an underfunded pension system would be shown on the City’s financial statements even if actuarially determined contributions were being made. We will continue to assist management on following these potential changes and to understand the possible impact to the City.

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Community Building Programs

Many communities are finding ways to help residents be more active and more supportive of their local resources and businesses. Northville is a progressive city with an active population. Therefore, we recommend the City investigate programs being used and the possibility of adapting one for yourselves. For example, the City of Grand Rapids recently won an innovation award for their program called myGRcitypoints. As its website states, “myGRcitypoints is an innovative community engagement program that links individuals, organizations, local businesses, and city government to encourage recycling, volunteering, and community building.” It allows participants to earn points for a variety of activities and then redeem the points at local businesses for discounts on products or services.

Section III - Legislative and Informational Items

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” 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 Northville, 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 their finances (a “transparency tool”) and a performance “dashboard” by October 1, 2011. 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.

There are a couple of Excel-based citizen’s guide tools that have been created, including one by Plante & Moran that have been made available. We were happy to share this tool with the City and assist you with its preparation in order to comply with the October 1 deadline.

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. 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 Limitations

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.

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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 prior to January 1, 2012 would also have to comply once the bill is signed.

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.

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 Northville personal property tax currently brings in approximately \$155,000.

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.

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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.

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.

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.

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

New Contractor Withholding Requirements

IRC 3402(t) provides that all federal, state, and some local governments and instrumentalities must withhold 3 percent of payments for property or services, unless the payment is less than \$10,000 or another exception applies. The withholding is remitted by the government agency to the federal government and the payee will have the amount of withholding applied to federal taxes owed or refunded when a tax return is filed.

Even though IRC 3402(t) was originally effective on January 1, 2011, the effective date has been extended several times. The final regulations were issued May 9, 2011 and extended the effective date to January 1, 2013. This requirement applies to local government entities if the total payments are more than \$100 million. Local government entities are generally any city, county, township, water or fire district. The rules for determining which payments are included in the determination of the \$100 million threshold are cumbersome and the guidance for the actual process for withholding has not yet been issued. For the time being, we wanted to make you aware of this upcoming change.