

April 15, 2004

Honorable Mayor and Members
of the City Council
City of Rochester Hills
1000 Rochester Hills Drive
Rochester Hills, MI 48309-3033

Dear Mayor and Council Members:

We have recently completed our audit of the financial statements of the City of Rochester Hills for the year ended December 31, 2003. As a result of our audit, and in addition to our financial report, we offer the following comments for the Council's review:

NEW FINANCIAL STATEMENT FORMAT

During the current year, the City, along with many other communities in Michigan, was required to implement a new accounting pronouncement that has changed the format and content of your financial statements. The information that was previously provided in your financial statements has been retained in the new financial statement format. In addition, the following major items have been added:

- *Management Discussion and Analysis:* Management is now required to give an overview of the City's overall financial position and results of operations. This section provides an overview of the City's finances, as well as major projects worked on throughout the year.
- *Government-wide Financial Statements:* These additional statements adjust the normal fund-based statements into a combined, full-accrual format. This allows a financial statement reader to see the City from a longer term perspective (i.e. are today's taxpayers paying the full cost of today's services?). These statements show capital and infrastructure assets, as well as long term debt as part of the City's financial picture.
- *Budget Comparison:* A financial statement reader will now be able to view not only the actual revenue and expenditures of the City as compared to the amended budget, but also as compared to the original budget.

While getting used to the new format may take a while, the GASB hopes that the new model will improve comparability of financial statements among communities and will provide a better matching of the current year's revenue sources to the full cost of services provided during that year.

Accumulating the information necessary for the new financial statement format has meant a significant amount of work for the City's accounting department. The City's staff has worked hard, preparing the necessary schedules, as well as assisting and cooperating with the audit work being done on those schedules.

We would be happy to discuss any questions you may have about the new statements and how to best interpret the information provided.

STATE SHARED REVENUE

Municipalities in Michigan have and will continue to feel the effects of the slow down in the State's economy. State shared revenue accounted for approximately 27% of the City's total General Fund revenue for the calendar year ended December 31, 2003. Because of slower than anticipated growth in the State's sales tax collections (the sole source of revenue sharing payments to local units of government) and the State's budget problems which have resulted in additional appropriation reductions to the revenue sharing line item in the State's budget, revenue sharing payments for the last several years have been lower than anticipated.

The following depicts the City's actual and estimated revenue sharing payments over a five year period – from the State's fiscal year ending September 30, 2001 through the fiscal year ending September 30, 2005.

	<u>Actual FY 2001</u>	<u>Actual FY 2002</u>	<u>Actual FY 2003</u>	<u>Estimated FY 2004</u>	<u>Estimated FY 2005</u>
Constitutional	\$ 4,466,205	\$ 4,511,699	\$ 4,588,082	\$ 4,608,460	\$ 4,807,372
Statutory	<u>2,028,562</u>	<u>1,873,564</u>	<u>1,607,879</u>	<u>1,004,647</u>	<u>768,470</u>
Total payments	<u>\$ 6,494,767</u>	<u>\$ 6,385,263</u>	<u>\$ 6,195,961</u>	<u>\$ 5,613,107</u>	<u>\$ 5,575,842</u>
Dollar change		\$ (109,504)	\$ (189,302)	\$ (582,854)	\$ (37,265)
Percentage change		-1.69%	-2.96%	-9.41%	-0.66%

While the City's constitutional revenue sharing payments have been increasing slightly each year, the statutory piece of revenue sharing has dropped approximately \$1,300,000 since 2001. For the State's fiscal year 04/05, the Governor has proposed to hold the line on revenue sharing – meaning that FY 04/05 levels will equal FY 03/04 levels – but only for cities, villages and townships. As you can see, the proposed revenue sharing for Rochester Hills for the State's fiscal year ending September 30, 2005 is \$5,575,842 which represents a reduction of approximately \$37,000 from the estimated amount for the State's fiscal year ending September 30, 2004.

Although sales tax revenue would support an increase to state shared revenue payments, the State's budget situation remains troublesome at best. It is generally acknowledged that the State's budget woes will continue for several more years. As a result, we continue to urge the City to be conservative in its estimation of state shared revenue as this line item in the State's budget remains vulnerable.

FINANCIAL PLANNING

The situation in Michigan related to the reduction in state shared revenue is made even more tenuous given other economic factors affecting municipal finance currently and in the near future. With the exception of local governments with a growing tax base and room for more development, there are structural problems with the municipal finance model in the State. Municipalities in Michigan face numerous challenges to their ability to raise revenue and are subject to increasing costs not necessarily under their control. These factors would include the restricted growth of property tax revenue under Proposal A and the Headlee Amendment, decreased investment returns, and increasing healthcare and employee benefit costs. These items have already impacted several municipalities in Michigan where the municipality's growth in expenditures is outpacing the growth in revenues for an extended period of time. While the City of Rochester Hills is currently in very good financial condition, we would encourage the City to continually review its long range financial plans through the use of a five year plan model in order to ensure continued financial viability over the long-run.

RETIREE HEALTH CARE FUNDING

The Governmental Accounting Standards Board recently issued an exposure draft addressing the accounting for retiree health care. As you know, the promise to provide health care to retirees is very similar to the promise to provide an annual pension check. As a result, GASB is proposing changes that would result in the City having to have an actuarial valuation (or compute the liability internally using a prescribed formula) to define the liability for its Supplemental Benefit Plan. That liability would need to be disclosed in the financial statements. In addition, the City's funding status, or the progress it has made in accumulating assets to pay for this liability, would also be disclosed. Lastly, the City would be required to make an annual contribution equal to the amount that the actuary deems necessary to fund the liability over a 30 year period. As you know, to date, the City has been funding its Supplemental Benefit Plan on a pay-as-you-go basis. The City may find that the annual expenditure will significantly increase as a result of the actuarial valuation. While this change is still in the draft phase, it is expected that it will be adopted in which case you will need to keep this in mind for long-range planning. These changes are anticipated to be effective starting in 2008.

CHANGES IN THE SINGLE AUDIT ACT

The Single Audit Act specifies the requirement for compliance auditing of federal funding received by not-for-profits and state and local governments. In 2003, legislation to amend the Single Audit Act was signed into law. These revised audit requirements are effective for audits of not-for-profit organizations and state and local governments receiving federal awards for years ending **after** December 31, 2003. The law raises the audit threshold from \$300,000 to \$500,000. This means that if a covered entity recognizes less than \$500,000 in federal expenditures in its fiscal year, then a single audit is not required. Prior to this year, the City of Rochester Hills' federal funding, including that received by OPC, has been close to \$500,000. This new legislation may have an impact on the need for future audits under this Act.

MUNICIPAL FINANCE ACT – REMINDER

The Municipal Finance Act was amended during 2001. Communities are now required to submit a filing once a year with the Michigan Department of Treasury. The old ten-day "exemption from prior approval" process has been eliminated and is replaced with this qualification process. This filing will serve as a pre-approval for debt issuances. The current filing is due within six months of the City's year-end (June 30, 2004) and is good for one year thereafter.

INTERNAL CONTROL CONSIDERATIONS

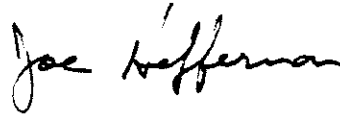
During the audit, we noted the following regarding the internal control structure:

- The monthly bank reconciliations are not reviewed by anyone other than the preparer.
- The ability to add vendors into the system is not limited to a specific department (i.e. purchasing). A formal policy should be used for the approval of new vendors within the accounts payable system.

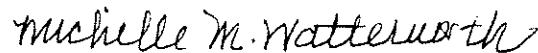
We would like to thank the City for the continued opportunity to serve as your auditors and for the assistance and cooperation that we received from the accounting staff, and the rest of the City personnel during the audit. We would be happy to answer any questions or concerns you have regarding the annual financial report and the above comments and recommendations at your convenience.

Very truly yours,

PLANTE & MORAN, PLLC



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Michelle M. Watterworth