

October 24, 2016

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

We have audited the financial statements of the City of Novi, Michigan (the "City") as of and for the year ended June 30, 2016 and have issued our report thereon dated October 24, 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 - Required Communications with Those Charged with Governance

Section II - Other Recommendations and Related Information

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 members of the City Council.

Section II includes observations and related recommendations as a result of our testing.

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 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 by 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



Martin J. Olejnik



Amanda Cronk

Section I - Required Communications with Those Charged with Governance

Our Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated August 29, 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. 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 letter about planning matters dated August 29, 2016.

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.

No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2016.

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 include the liability and expense associated with pension and other postemployment benefits (OPEB), as well as the Oakland County chargeback liability for uncollectible property taxes.

Section I - Required Communications with Those Charged with Governance (Continued)

Management's estimates of the pension liability and related expense and long-term cost of retiree healthcare benefits are based on discount rates, rate of return, and other assumptions, which are used by an actuary to calculate the total pension and retiree healthcare liabilities. While the actuary uses the assumptions to calculate the total pension and other postemployment benefit liabilities, it is management's responsibility to assess whether the assumptions made are reasonable. We evaluated the key assumptions used to calculate the liabilities in determining that they are reasonable in relation to the financial statements taken as a whole.

The City estimates that 50 percent of the real taxes turned over to Oakland County for the years ended June 30, 2015 and 2016 will be collected by the County and the other 50 percent will be charged back to the City. We obtained support from the Oakland County Treasurer's Office and evaluated the amount of delinquent taxes still outstanding in determining that the estimate is reasonable in relation to the financial statements taken as a whole.

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.

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. We did not detect any misstatements as a result of audit procedures with the exception of the transfer noted in Section II of this letter.

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 our 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 October 24, 2016.

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

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.

Other Information in Documents Containing Audited Financial Statements

Our responsibility for other information in documents containing the entity’s financial statements and report does not extend beyond the financial statements. We do not have an obligation to determine whether or not such other information is properly stated. However, we read the introductory and statistical sections of the comprehensive annual financial report and nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information or manner of its presentation appearing in the financial statements.

Section II - Other Recommendations and Related Information

As noted in the prior year, the City utilizes an Agency Fund to account for escrow deposits received from developers that are required as part of construction projects. The City has been working on reconciling these balances to the subledger and as a result of the efforts, has made significant improvements over the last year. We recommend that the City continue to work in this area in order to reconcile these accounts.

As discussed in the prior year, the City does not currently require a dual approval process for wire transfers of cash. While there are mitigating controls in place to detect misappropriation of cash such as the controls surrounding the bank reconciliation process and journal entry posting process, we recommend the City evaluate the controls around wire transfers and consider implementing a preventive control in which the same individual cannot initiate and approve a wire transfer.

During the current year, the Police and Fire Fund transferred \$5,300,000 to the General Fund as a reimbursement of costs which the General Fund originally paid, but are expenditures that can be funded by the police and fire millage. This transfer was recorded as an operating transfer whereas generally accepted accounting principles would require that the financial statements present this as a reimbursing transfer by reducing the original expenditure in the General Fund and instead showing the expenditure as if it originally occurred in the Police and Fire Fund. At the end of the day, fund balance in both funds is properly stated, so there is no net impact to this presentation. We encourage the City to review its reporting procedures during the upcoming year and adjust to align with generally accepted accounting principles.

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 nearly 60 percent funded 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.

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.

Along with the currently required statement of fiduciary net position and statement of changes in fiduciary net position, OPEB plans will now be required to include in the financial statements more extensive footnote disclosures and required supplementary information related to the measurement of the OPEB liabilities for which assets have been accumulated. In addition, 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 74 is effective for fiscal years beginning after June 15, 2016 (the City's year end of June 30, 2017) whereas GASB 75 is effective one year later.

Revenue Sharing

The FY 2017 governor's budget recommendation includes \$1.3 billion for revenue sharing broken down as follows:

Description	FY 2016 Budget	FY 2016 forecasted actual	Final 2017 budget
Constitutionally required payments	\$783.8 M	\$745.9 M	\$757.9 M
CVTRS	243.0 M	243.0 M	243.0 M
CVTRS - One-time payments	5.8 M	5.8 M	5.8 M
County revenue sharing	171.8 M	171.8 M	174.2 M
County incentive program	42.9 M	42.9 M	43.0 M
Fiscally distressed community grants	5.0 M	5.0 M	5.0 M
Total	\$1,252.3 M	\$1,214.4 M	\$1,228.9M

Section III - Legislative and Informational Items (Continued)

As noted above, actual sales tax revenue, which serves as the base for the constitutionally required payments, came in lower than expected. As a result, constitutional revenue sharing is \$38 million lower than budgeted. The new budget for 2017 anticipates a slight increase of 1.6 percent. The FY 2017 budget also includes the “City, Village, and Township Revenue Sharing” (CVTRS) appropriation which was established in FY 2015 and that number remains flat at \$243 million. Each community’s overall increase will vary as each has a different mix of constitutional and CVTRS.

In order to receive the CVTRS payments in FY 2017, qualified local units will once again need to comply with the same best practices as they did last year:

- A citizen’s guide to local finances with disclosure of unfunded liabilities
- Performance dashboard
- Debt service report
- Two-year budget projection

The “one-time” additional CVTRS payments that existed in the 2015 and 2016 budgets were not in the governor’s 2017 budget. However, the payments were reinstated in the final 2017 budget.

Personal Property Tax

In August 2014, Michigan voters put the last piece of personal property tax reform in place. As a result, personal property taxes will be reduced in two respects:

1. Small Taxpayer Exemption Loss (STEL) - Small taxpayers with total personal property within a taxing unit valued at less than \$80,000 are able to sign an affidavit exempting this personal property from taxation. This exemption began with the 2014 tax billings.
2. Beginning with 2016 tax filings, an affidavit can be filed to exempt eligible property used in a manufacturing process that is purchased either prior to 2006 or after December 31, 2012.

For 2014 and 2015, all communities were qualified to be reimbursed for losses related to debt millages and lost TIF capture arising from the STEL. Only cities were reimbursed for the balance of the Small Taxpayer Exemption Loss. However, for 2016, the legislation is generally intended to fully reimburse all local units of government for revenue losses that result from all exempt personal property.

The changes include creation of a new Local Community Stabilization Authority (LCSA) that will receive money from two sources:

- Use Tax: The legislation includes specific amounts of the use tax that will be diverted from the State’s General Fund to the new LCSA; and
- Essential Services Assessment: Manufacturers will pay a “local community essential services assessment” to the LCSA based on the value of their exempt manufacturing property. The rate is set at 2.4 mills for a property’s first five years; then 1.25 mills for the next five; then 0.9 mills thereafter.

Please keep in mind that if these two sources do not generate sufficient revenue for 100 percent of the losses, there could be a potential for something less than full reimbursement.

Section III - Legislative and Informational Items (Continued)

Local Community Stabilization Authority Revenue - As noted above, eligible communities began receiving reimbursements for certain lost personal property taxes. The State agency making those reimbursements is the Local Community Stabilization Authority (LCSA). These reimbursements should NOT be reported on the financial statements with property taxes; instead, they should be included with other intergovernmental revenue from the State (state shared revenue, grants, and other). The State has created a new account number for the revenue, 573, and titled it "Local Community Stabilization Share Appropriation". As always, communities should follow the State's guidance related to the Uniform Chart of Accounts.

The State Department of Treasury will compute the reimbursements and are scheduled to make the payments by October 20 of each year. The State will compare the total current year taxable value of commercial and industrial personal property to the value as of 2013 (the year before PPT reform).

New Rules Governing Management of Federal Programs

As discussed in the prior years, the Office of Management and Budget (OMB) has issued significant reforms to the compliance requirements that must be followed by non-federal entities receiving federal funding. All entities receiving federal dollars will need to understand the changes made as a result of these reforms and may be required to make changes to internal procedures, processes, and controls.

These reforms impact three key areas of federal grants management:

1. **Audit Requirements** - For fiscal years beginning on or after January 1, 2015, the threshold for obtaining a federal awards audit will increase from the current threshold of \$500,000 of annual federal spending to \$750,000. There will also be significant changes to the criteria for qualifying as a low-risk auditee and a reduction in the number of major programs required to be tested for some clients.

The City has historically been below the current \$500,000 threshold. However, from time to time, depending upon the level of federal spending, the City may still be subject to an audit requirement even at the new higher \$750,000 threshold.

2. **Cost Principles** - Effective for all federal awards received on or after December 26, 2014, the grant reforms related to cost principles go into effect. Not only were certain changes made to allowable costs under this new guidance, but there were significant changes in the area of time and effort reporting and indirect costs.
3. **Administrative Requirements** - Also effective for all federal awards received on or after December 26, 2014, non-federal entities receiving federal funding must adhere to new rules related to administering federal awards. Most notably, these requirements may impact the City's procurement systems, including maintaining written conflict of interest policies and disclosures.

These revisions are clearly the most significant changes to occur to federal grants management in recent history. Entities receiving federal funding will need to carefully digest these changes. Plante & Moran, PLLC has been on the cutting edge of these reforms, offering our clients free webinars, implementation checklists, and other tools to aid in implementation. The implementation date has passed and the City will need to ensure that the implementation of the new regulations has occurred and if not, they need to work quickly to put the new requirements into practice. Plante & Moran, PLLC has many experts in this area and we welcome any questions or needs you may have in this area.

Section III - Legislative and Informational Items (Continued)

EVIP-like Requirements Tied to Act 51 Monies (Public Act 301 of 2014)

PA 301 of 2014 became effective October 9, 2014. This act creates EVIP-like requirements for those who pay employees with Act 51 monies. For the purposes of this act, “transportation employee” means an employee paid in whole or in part through Act 51 revenue or who is engaged in work funded through Act 51 revenue.

The act requires local units receiving Act 51 money for the construction or maintenance of roads to comply with one of the following conditions by September 30, 2015:

1. Develop and publicize a transportation employee compensation plan that the local agency intends to implement with any new, modified, or extended employment contracts or agreements. This compensation plan must include certain limitations on employer contribution toward retirement plans and health insurance as well as limitations on factors that determine pension benefits.
2. Comply with Public Act 152 of 2011, which requires public employers to place hard caps on the amounts they contribute toward healthcare costs with an option to elect an 80 percent contribution cap rather than a hard cap. These hard caps are adjusted annually for inflation.
3. Certify that the local road agency does not offer medical benefits to its transportation employees or elected public officials.

If a local unit receiving Act 51 money does not certify that it complies with one of the above criteria by September 30 of each year, the Department of Transportation may withhold Act 51 distributions until compliance is established. Act 301 also requires local road agencies to maintain a searchable website (accessible to the public) that includes the current budget, the number of active transportation employees by job classification and wage rate, a financial performance dashboard, the names and contact information of the governing body, and a copy of the annual certification provided to MDOT.

For communities that are already complying with the requirements of Public Act 152 of 2011, we do not expect this new legislation to have a significant impact on operations since it essentially just creates a new reporting requirement; however, please contact your audit team if you would like to talk through the details of the act and the City’s compliance.

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 ending 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.

**Section III - Legislative and Informational Items
(Continued)**

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, 2105 commencement of the audit time period, we encourage you to review your documentation methods to ensure compliance with this critical aspect.