

## **Note I - Summary of Significant Accounting Policies**

The accounting policies of the City of Midland, Michigan (the "City") conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies used by the City of Midland, Michigan:

### **Reporting Entity**

The City is a municipal corporation governed by an elected five-member City Council (the "Council"), which biannually selects one of its members to serve as mayor. The City operates under a Council-Manager form of government. The accompanying financial statements present the City and its component units, entities for which the City is considered to be financially accountable. Blended component units, although legally separate entities, are in substance part of the City's operations, and data from these units are therefore combined with data from the primary government.

### **Blended Component Unit**

**Midland Downtown Development Authority** - The Midland Downtown Development Authority (MDDA) was established in 1987 for the purpose of maintaining and renovating the downtown Midland area. The MDDA is administered by a 13-person board, which is appointed by the City Council. Funding for the MDDA is provided by a two-mill levy on property within the district and by tax increment financing. All projects initiated by the MDDA are considered public improvements to the City's infrastructure, parks, or parking facilities. Since the MDDA is used exclusively as a financing source for City facilities, it has been blended into the financial statements of the City as a Special Revenue Fund. The MDDA has a June 30 year end.

### **Joint Ventures**

**Saginaw-Midland Municipal Water Supply Corporation** - The Saginaw-Midland Municipal Water Supply Corporation (SMMWSC), located approximately eight miles east of the city of Midland, is an authority incorporated by the cities of Midland and Saginaw, Michigan, under Act 233, Public Acts of Michigan, 1955, as amended. The SMMWSC is administered by a six-member Board of Trustees, each community appointing three members, and is empowered to prepare, adopt, and submit to the legislative bodies of each municipality an annual budget covering estimated revenues, proposed expenditures, and the necessary funds required from each municipality for the next fiscal year.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 1 - Summary of Significant Accounting Policies (Continued)

Funding for the acquisition of property and for the development and improvement of the water supply system is provided by sale of SMMWSC negotiable bonds secured by the full faith and credit of each municipality in a ratio based upon predetermined capacity reserves; 20/43rds for the City of Midland and 23/43rds for the City of Saginaw. Funding for operations is provided by sale of water to the two communities on a consumption basis. The City's equity in the SMMWSC is accounted for in the Water Fund, which is included in the business-type activities column of the statement of net assets.

A summary of the financial information for the year ended June 30, 2004 follows:

Total assets	\$ 36,678,710
Total liabilities	23,522,077
Equity - City of Midland	7,049,597
Equity - City of Saginaw	8,107,036
Total revenues	4,710,411
Total expenses	4,448,176
Net income	262,235

At June 30, 2004, total outstanding bonded debt of the SMMWSC was \$23,365,000. The City was obligated for \$10,867,442 of this total.

**Midland City/County Joint Building Authority** - The City's ownership interest in the Midland City/County Joint Building Authority is accounted for in the governmental activities column of the statement of net assets. The Authority was created as a financing vehicle for the Midland Law Enforcement Center. The Law Enforcement Center is leased from the Joint Building Authority (JBA) by the City of Midland Police Department, the Midland County Sheriff Department, and the Midland County Central Dispatch Authority. The JBA is governed by a three-person board with the City and County each appointing one member and with the third member being mutually appointed. Additional information concerning the Joint Building Authority and its lease with the City is detailed in Note 8 - Leases.

**General** - Complete financial statements, which are audited for the Saginaw-Midland Municipal Water Supply Corporation and the Midland City/County Joint Building Authority, are available from the City Clerk's Office.

The City is unaware of any circumstances that would cause an additional benefit or burden to the participating parties in the near future for any of the above organizations.

## **Note I - Summary of Significant Accounting Policies (Continued)**

### **Government-wide and Fund Financial Statements**

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include: (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment; and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual Enterprise Funds are reported as separate columns in the fund financial statements.

### **Measurement Focus, Basis of Accounting, and Financial Statement Presentation**

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay current period liabilities.

## **Note I - Summary of Significant Accounting Policies (Continued)**

For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, expenditures relating to compensated absences, and claims and judgments are recorded only when payment is due.

Property taxes, franchise fees, licenses, interest, and special assessments are susceptible to accrual. Sales and motor fuel taxes collected and held by the State at fiscal year end on behalf of the City are also recognized as revenue of the current fiscal period. Other receipts become measurable and available when cash is received by the City and are recognized as revenue at that time.

The City reports the following major governmental funds:

- The General Fund is the City's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.
- The Major Street Fund accounts for state-shared revenues relating to construction activities, repairs, and maintenance of all major streets and trunklines.

The City reports the following major proprietary funds:

- The Water Fund accounts for the operation and maintenance of the City's water supply system, capital additions, and retirement of bonds.
- The Wastewater Fund accounts for the operation and maintenance of the City's sewage disposal system, capital additions and improvements, and retirement of bonds.
- The Landfill Fund accounts for the operation and maintenance of the City's trash and garbage disposal system.
- The Real Estate Rental Fund accounts for the operation and maintenance of the City's various senior housing rental properties.

## **Note I - Summary of Significant Accounting Policies (Continued)**

Additionally, the City reports the following Internal Service Funds:

- The Data Processing Fund accounts for the operations of the City's Information Services Department.
- The Equipment Revolving Fund accounts for the rental charges of City-owned equipment to other City departments.
- The Service Center Rental Fund accounts for the operations of the City's Service Center building.
- The Insurance Claims Fund accounts for insurance expenses resulting from property and liability claims.
- The Special Assessment Revolving Fund accounts for the funding of the City's special assessment projects.

Fiduciary Funds are used to account for resources held for the benefit of parties outside the government. Because these funds represent trust responsibilities of the City, these assets are restricted in purpose and do not represent discretionary assets of the City. The Police and Fire Retirement Fund and the Post-Employment Health Care Plan Fund are fiduciary funds of the City. The City's fiduciary activities are reported in separate statements of fiduciary net assets and changes in fiduciary net assets.

Agency Funds are used to account for those held by the City as a custodian for other governments or organizations. Agency Funds have only assets and liabilities representing the parties that are entitled to the assets. The Tax Collection Fund and the Shopping Area Redevelopment Authority Fund are accounted for as Agency Funds.

Private-sector standards of accounting issued prior to December 1, 1989 are generally followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with the standards of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and Enterprise Funds, subject to this same limitation. The City has elected not to follow subsequent private-sector guidance.

## **Note I - Summary of Significant Accounting Policies (Continued)**

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between the City's water and sewer function and various other functions of the City. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as program revenue include: (1) charges to customers or applicants for goods, services, or privileges provided; (2) operating grants and contributions; and (3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenue rather than as program revenue. Likewise, general revenue includes all taxes.

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's proprietary funds are charges to customers for sales and services. The City also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. The portion intended to recover the cost of infrastructure is recognized as nonoperating revenue. Operating expenses for the proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenue and expenses not meeting this definition are reported as nonoperating revenues and expenses.

### **Assets, Liabilities, and Net Assets or Equity**

**Bank Deposits and Investments** - The City's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition. Investments for the City, as well as for its component unit, are reported at fair value.

**Receivables and Payables** - Transactions between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "interfund receivable/payables" or "advances to/from other funds". All other outstanding balances between funds are reported as "due to/from other funds". Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

### **Note 1 - Summary of Significant Accounting Policies (Continued)**

All trade and property tax receivables are shown net of an allowance for uncollectible amounts. Trade accounts receivable in excess of 180 days comprise the trade accounts receivable allowance for uncollectibles. The property tax receivable allowance at June 30, 2003 is equal to 100 percent of outstanding property taxes over four years old plus 4 percent of outstanding property taxes less than five years old.

Properties are assessed annually as of December 31, and property taxes are billed and become a lien on July 1 of the following year. These taxes are due on September 15 with a final collection date of February 28 before they are added to the county tax roll. The City also bills and collects an amount each December, primarily for schools, county, and college. Also included in the December billing is a tax administration fee, which is revenue to the City. The December billing is due on February 14 with a final collection date of February 28. Penalties and interest are assessed on payments received after the due date.

**Inventories and Prepaid Items** - Inventories are valued at cost on an average cost method. The costs of governmental fund-type inventories are recorded as expenditures when consumed rather than when purchased.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both the government-wide and fund financial statements.

**Restricted Assets** - Certain resources set aside for debt service on the City's Enterprise Fund revenue bonds are classified as restricted assets on the balance sheet because their use is limited by applicable bond covenants. Additionally, certain resources set aside for closure and postclosure costs for the enterprise landfill operation are classified as restricted assets because their use is limited by applicable State regulations.

**Capital Assets** - Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items) are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are defined by the City as assets with an initial individual cost of more than \$1,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

### Note I - Summary of Significant Accounting Policies (Continued)

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Projects with total costs of less than \$10,000 are considered repair and are expensed in the year incurred. Interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed.

Property, plant, and equipment are depreciated using the straight-line method over the following estimated useful lives:

Buildings	50 years
Land improvements	20 years
Infrastructure	10-50 years
Vehicles	3-10 years
Office equipment	10 years
Computer equipment	4 years

**Compensated Absences** - It is the City's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. Vacation pay is fully vested when earned, and sick pay is conditionally vested upon completion of 10 years of service. Upon retirement, employees are paid accumulated vacation and one-half of unused sick days at their hourly rate as of their retirement date.

All sick and vacation pay is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for the entire amount, current and long-term, is accrued in the government-wide and proprietary financial statements. A liability for these amounts is reported in governmental funds only for employee terminations as of year end.

**Long-term Obligations** - In the government-wide financial statements and the proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund-type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

### **Note I - Summary of Significant Accounting Policies (Continued)**

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts are reported as other financing uses. Issuance costs are reported as debt service expenditures.

**Fund Equity** - In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

**Use of Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from these estimates.

**Reclassification** - Balances and activities of the Special Assessment Revolving Fund have been reclassified in the 2004 statements to more properly reflect their activity as an Internal Service Fund.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 2 - Stewardship, Compliance, and Accountability

**State Construction Code Act** - The City oversees building construction, in accordance with the State's Construction Code Act, including inspection on building construction renovation to ensure compliance with the building codes. The City charges fees for these services. Beginning January 1, 2000, the law requires that collection of these fees be used only for construction code costs, including an allocation of estimated overhead costs. A summary of the current year activity and the cumulative shortfall generated since January 1, 2000 follows:

Shortfall at July 1, 2003		\$	(204,324)
Current year building permit revenue			393,381
Related expenses:			
Direct costs	\$	397,760	
Estimated indirect costs		<u>23,866</u>	
Total construction code expenses			<u>421,626</u>
Cumulative shortfall at June 30, 2004		\$	<u>(232,569)</u>

### Note 3 - Deposits and Investments

Michigan Compiled Laws, Section 129.91, authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; United States government or federal agency obligations; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The City Council has designated nine financial institutions for the deposit of Local Unit funds.

### Note 3 - Deposits and Investments (Continued)

The investment policy adopted by the City in accordance with Public Act 20 of 1943 (as amended) authorizes investments in U.S. Treasuries, U.S. agencies and instrumentalities, certificates of deposit, commercial paper (meeting certain rating and maturity requirements), repurchase agreements, investment pools, bankers' acceptances of U.S. banks, and mutual funds. Repurchase agreements must be signed with the bank or dealer and must contain provisions comparable to those outlined in the Public Security Association's model Master Repurchase Agreement. The Treasurer may invest in investment pools organized under the Surplus Funds Investment Pool Act of 1982 and under the Urban Cooperation Act of 1967.

For mutual funds, the Treasurer may invest in funds registered under the Investment Company Act of 1940. This authorization is limited to securities whose intention is to maintain a net asset value of \$1.00 per share and investment vehicles that are legal for direct investment by a public corporation.

The above-mentioned City investment policy applies to all financial assets of the City except for its Employee Pension Fund and the Police and Fire Retirement System Fund, which are organized and administered separately. Investments are made pursuant to provisions of the Public Employee Retirement System Investment Act of 1965.

At year end, the City's deposits and investments were reported in the basic financial statements in the following categories:

	Governmental Activities	Business-type Activities	Fiduciary Funds	Total
Cash and cash equivalents	\$ 71,391,917	\$ 15,027,922	\$ 11,191,555	\$ 97,611,394
Investments	-	316,239	43,529,409	43,845,648
Restricted assets	-	2,379,276	-	2,379,276
Total	<u>\$ 71,391,917</u>	<u>\$ 17,723,437</u>	<u>\$ 54,720,964</u>	<u>\$ 143,836,318</u>

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 3 - Deposits and Investments (Continued)

The breakdown between deposits and investments follows:

Bank deposits (checking accounts, money market accounts, and certificates of deposit)	\$ 97,754,630
Investments in securities, investment pools, and similar vehicles	<u>46,081,688</u>
Total	<u>\$ 143,836,318</u>

**Deposits** - The above deposits were reflected in the accounts of the bank (without recognition of checks written but not yet cleared or of deposits in transit) at \$97,758,294. Of that amount, \$344,880 was covered by federal depository insurance and \$2,776,187 was covered by collateral held by the City's agent in the City's name. The remainder of the bank balance was uninsured and uncollateralized.

**Investments** - The City's investments are categorized as either (1) insured or registered or for which the securities are held by the City or its agent in the City's name, (2) uninsured and unregistered for which the securities are held by the counterparty or its trust department or agent in the City's name, or (3) uninsured and unregistered for which the securities are held by the counterparty or its trust department or agent but not in the City's name.

As of June 30, 2003, the City's balances were categorized as follows:

	Category 1	Category 2	Reported Amount (Fair Value)
Categorized:			
Common stock	\$ 316,239	\$ 25,405,052	\$ 25,721,291
Preferred stock	-	2,051,476	2,051,476
Corporate bonds	-	8,443,075	8,443,075
U.S. government securities	-	1,041,717	1,041,717
Mortgage and asset-backed securities	-	2,212,609	2,212,609
International equities	-	<u>4,375,479</u>	<u>4,375,479</u>
Subtotal	316,239	43,529,408	43,845,647
Investments not subject to categorization:			
Bank investment pool funds	-	-	2,015,906
Interlocal agreement investment pool funds	-	-	<u>220,134</u>
Total	<u>\$ 316,239</u>	<u>\$ 43,529,408</u>	<u>\$ 46,081,687</u>

## **Note 3 - Deposits and Investments (Continued)**

The Category I investment represents 7,770 shares of Dow Chemical Company common stock that the Golf Course Fund acquired as a gift, the income from which is to be used to operate the golf course. Use of the principal represented by the shares of stock is subject to certain restrictions specified by the donor. There were no Category type 3 investments at June 30, 2004.

The bank investment pool funds consist of bank trust funds, which are held by the trust department of the bank and are regulated by the Michigan Banking Act. The investments under the interlocal agreement investment pool are regulated by the Urban Cooperation Act. The fair value of the position in the bank investment pools and interlocal agreement investment pools (MBIA-CLASS) is the same as the value of the pool shares. The bank investment pools, money market mutual funds, and interlocal agreement investment pools are not categorized because they are not evidenced by securities that exist in physical or book entry form. Management believes that the investments in these funds comply with the investment authority noted above.

Included in the City's pension fund investments at June 30, 2004 are the following:

- Approximately \$321,000 of securities issued by the Government National Mortgage Association (GNMA). These investments are backed by the full faith and credit of the U.S. government. The yields provided by these mortgage-related securities historically have exceeded the yields on other types of U.S. government securities with comparable maturities, in large measure due to the potential for prepayment. Prepayment could result in difficulty in reinvesting the prepaid amounts in investments with comparable yields.
- Approximately \$1,546,000 of obligations of the Federal National Mortgage Association. These investments are usually not backed by the full faith and credit of the U.S. government, but are generally considered to offer modest credit risks. The yields provided by these mortgage-related securities historically have exceeded the yields on other types of U.S. government securities with comparable maturities, in large measure due to the potential for prepayment. Prepayment could result in difficulty in reinvesting the prepaid amounts in investments with comparable yields.
- Variable rate instruments (floaters) of approximately \$211,000. These securities are based on cash flows from interest and principal payments in underlying securities. These variable rate debt instruments are tied to prevailing short-term interest rates and are relatively insensitive to interest rate changes. There is no prepayment risk associated with these instruments.

## **Note 3 - Deposits and Investments (Continued)**

- Approximately \$7,650,000 of corporate bonds and preferred stocks, which are convertible into common stock of their respective companies. These securities are considered to be derivative investments because their value is significantly influenced by the value of securities into which they are convertible.
- Approximately \$1,042,000 of United States Governmental Securities. Similar to a zero coupon bond, it is purchased at a discount (which represents the future interest earnings of the investment). The discount is amortized over the remaining maturity of the instrument.
- Asset-backed securities of approximately \$135,000. These securities are backed by credit card receivables. These obligations typically include credit enhancements in the form of over-collateralization, third-party letters of credit, seller recourse, insurance company guarantees and/or senior subordinated structures. These securities are generally considered to offer modest credit risk, but such risk varies depending on the type of asset being securitized and the extent and nature of the credit enhancement. Prepayments for these “pay through” securities could result in difficulty reinvesting the prepaid amounts in investments with comparable yields.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 4 - Interfund Transfers, Receivables, and Payables

Interfund transfers reported in the fund statements for the year ended June 30, 2004 were as follows:

Transfers in:	Transfers Out				
	General Fund	Major Street Fund	Local Street Fund	Storm Water Mgmt. Fund	Downtown Develop Auth. Fund
General Fund	\$ -	\$ -	\$ -	\$ -	\$ -
Major Street Fund	-	-	-	-	-
Local Street Fund	-	600,000	-	-	-
Storm Water Mgmt. Fund	2,074,100	124,809	127,419	-	-
Transportation Fund	520,718	-	-	-	-
Grace A. Dow Library Fund	2,567,206	-	-	-	-
CDBG Fund	2,848	-	-	-	-
Downtown Dev. Auth. Fund	-	-	-	-	-
Debt Fund	199,610	-	-	-	163,916
Capital Projects Fund	621,417	-	3,865	306,098	-
Water Fund	-	-	-	-	-
Wastewater Fund	-	-	-	-	-
Parking Fund	-	-	-	-	30,000
Special Assessment Rev.	740,686	-	-	-	-
<b>Total</b>	<b>\$ 6,726,585</b>	<b>\$ 724,809</b>	<b>\$ 131,284</b>	<b>\$ 306,098</b>	<b>\$ 193,916</b>

The transfer from the General Fund to the Grace A. Dow Memorial Library Fund represents the use of unrestricted resources to finance that program, in accordance with budgetary authorizations. The transfer from the General Fund to the Capital Projects Fund represents funding of construction projects from unrestricted resources, in accordance with budgetary authorizations. The transfer from the Major Street Fund to the Local Street Fund represents the sharing of gas and weight tax revenues, in accordance with Act 51. The transfer from the Debt Fund to the Wastewater Fund is necessary to transfer an additional millage for debt retirement to the Wastewater Fund, which is the fund that accounts for the related debt.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 4 - Interfund Transfers, Receivables, and Payables (Continued)

Transfers Out					
CDBG Fund	Debt Fund	Capital Projects Fund	ERF Fund	Special Assessment Revolving	Total
\$ -	\$ -	\$ 173,871	\$ 90,000	\$ 1,000,000	\$ 1,263,871
-	-	2,328	-	-	2,328
212,630	-	15,000	-	-	827,630
-	-	-	-	-	2,326,328
-	-	-	-	-	520,718
-	-	-	-	-	2,567,206
-	-	-	-	-	2,848
-	-	-	-	-	-
-	-	-	-	-	363,526
40,036	-	-	-	-	971,416
-	-	38,825	-	-	38,825
-	1,779,425	269,665	-	-	2,049,090
-	-	-	-	-	30,000
-	-	184,888	-	-	925,574
<u>\$ 252,666</u>	<u>\$ 1,779,425</u>	<u>\$ 684,577</u>	<u>\$ 90,000</u>	<u>\$ 1,000,000</u>	<u>\$ 11,889,360</u>

The composition of interfund balances as of June 30, 2004 was as follows:

Receivable Fund	Payable Fund	Amount
General	Special Assessment Revolving	\$ 1,000,000
Special Assessment Revolving	Midland Housing	150,000
Community Development Block Grant	Midland Housing	209,186
Landfill	Real Estate Rental	9,000
Total		<u>\$ 1,368,186</u>

The balance owing from the Special Assessment Revolving Fund to the General Fund represents a return of General Fund monies that were used to initiate the Special Assessment Revolving Fund.

The balance owing from the Midland Housing Fund to the Community Development Block Grant (CDBG) Fund represents remaining balances on mortgages subsidized by the CDBG Fund. The remaining two resulted from loans made for working capital purposes.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 5 - Capital Assets

Capital asset activity for the year ended June 30, 2004 was as follows:

<b>Governmental Activities</b>	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not depreciated:				
Land	\$ 3,159,011	\$ -	\$ -	\$ 3,159,011
Construction in progress	<u>6,438,691</u>	<u>2,047,964</u>	<u>1,602,098</u>	<u>6,884,557</u>
Total capital assets not depreciated	9,597,702	2,047,964	1,602,098	10,043,568
Capital assets being depreciated:				
Major and local roads	1,807,606	1,582,597	259,068	3,131,135
Sidewalks	-	75,936	-	75,936
Buildings	21,032,894	93,925	21,511	21,105,308
Land improvements	574,975	682,322	25,969	1,231,328
Library circulation materials	6,565,463	628,057	792,515	6,401,005
Equipment	9,404,567	402,561	1,608,986	8,198,142
Vehicles	<u>12,395,555</u>	<u>984,390</u>	<u>792,061</u>	<u>12,587,884</u>
Total capital assets being depreciated	<u>51,781,060</u>	<u>4,449,788</u>	<u>3,500,110</u>	<u>52,730,738</u>
Total capital assets before depreciation	61,378,762	6,497,752	5,102,208	62,774,306
Less accumulated depreciation for:				
Major and local roads	46,497	25,535	-	72,032
Sidewalks	-	1,266	-	1,266
Buildings	7,945,967	428,700	21,511	8,353,156
Land improvements	172,957	22,040	25,969	169,028
Library circulation materials	4,241,870	778,345	634,012	4,386,203
Furniture, fixtures, and equipment	7,701,453	482,891	1,586,105	6,598,239
Vehicles	<u>6,117,049</u>	<u>1,183,538</u>	<u>625,147</u>	<u>6,675,440</u>
Subtotal	26,225,793	2,922,315	2,892,744	26,255,364
Net capital assets being depreciated	<u>25,555,267</u>	<u>1,527,473</u>	<u>607,366</u>	<u>26,475,374</u>
Net governmental capital assets	<u>\$ 35,152,969</u>	<u>\$ 3,575,437</u>	<u>\$ 2,209,464</u>	<u>\$ 36,518,942</u>

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 5 - Capital Assets (Continued)

Business-type Activities	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated:				
Land	\$ 2,316,600	\$ 80	\$ -	\$ 2,316,680
Construction in progress	<u>9,529,865</u>	<u>4,020,676</u>	<u>9,990,985</u>	<u>3,559,556</u>
Total capital assets not being depreciated	11,846,465	4,020,756	9,990,985	5,876,236
Capital assets being depreciated:				
Water and sewer lines	56,532,936	9,984,518	44,617	66,472,837
Buildings and building improvements	70,370,555	46,115	-	70,416,670
Land improvements	5,540,226	5,708	80	5,545,854
Landfill improvements	6,753,516	3,040,577	-	9,794,093
Equipment	4,801,745	191,422	14,571	4,978,596
Vehicles	<u>545,317</u>	<u>52,131</u>	<u>-</u>	<u>597,448</u>
Total capital assets being depreciated	144,544,295	13,320,471	59,268	157,805,498
Less accumulated depreciation:				
Water and sewer lines	20,900,783	1,180,493	-	22,081,276
Buildings and building improvements	24,846,115	1,415,216	3,989	26,257,342
Land improvements	811,899	111,747	9,718	913,928
Landfill improvements	5,709,559	374,484	-	6,084,043
Equipment	3,193,314	281,431	22,830	3,451,915
Vehicles	<u>266,323</u>	<u>79,354</u>	<u>-</u>	<u>345,677</u>
Total accumulated depreciation	<u>55,727,993</u>	<u>3,442,725</u>	<u>36,537</u>	<u>59,134,181</u>
Net capital assets being depreciated	<u>88,816,302</u>	<u>9,877,746</u>	<u>22,731</u>	<u>98,671,317</u>
Net business-type capital assets	<u>\$ 100,662,767</u>	<u>\$ 13,898,502</u>	<u>\$ 10,013,716</u>	<u>\$ 104,547,553</u>

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 5 - Capital Assets (Continued)

Depreciation expense charged to programs of the government follows:

Governmental activities:

General government	\$ 420,399
Public safety	334,883
Public works	518,982
Sanitation	98,804
Parks and recreation	322,317
Library	1,033,175
Airport	30,973
Transportation	155,250
Other functions	<u>7,532</u>

Total governmental activities \$ 2,922,315

Business-type activities:

Water	\$ 1,099,888
Wastewater	1,245,882
Landfill	477,629
Golf course	136,152
Parking system	39,467
Real estate rental	<u>443,707</u>

Total business-type activities \$ 3,442,725

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 5 - Capital Assets (Continued)

**Construction Commitments** - The City has active construction projects as of June 30, 2004. The projects include streets, water and wastewater system improvements, landfill improvements, and park improvements. At year end, the City's commitments with contractors are as follows:

	<u>Spent to Date</u>	<u>Remaining Commitment</u>
Street projects	\$ 375,861	\$ 938,878
Water system improvements	1,257,588	134,269
Wastewater system improvements	61,425	5,486
Landfill improvements	46,331	2,137,493
Park improvements	256,762	91,837
Total	<u>\$ 1,997,967</u>	<u>\$ 3,307,963</u>

Infrastructure assets have not been retroactively recorded, and will be within four years, as allowed under GASB 34.

### Note 6 - Restricted Assets

**Enterprise Funds** - Cash and cash equivalents are restricted within the Water and Wastewater Funds for future debt service obligations and guaranteed deposits, in the amounts of \$1,476,194 and \$1,920,256, respectively. Within each of these funds, an offsetting liability "payable from restricted assets" designates the separation of these assets from unreserved assets. In addition, the Landfill Fund has \$903,082 of restricted assets that are for closure and postclosure costs.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 7 - Deferred Revenue

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received but not yet earned. As of June 30, 2004, the various components of deferred revenue are as follows:

	<u>Unavailable</u>	<u>Unearned</u>
Special assessments not yet due - Internal Service	\$ 555,842	\$ -
FEMA grant money for fire equipment received in excess of expenses - General Fund	-	21,029
Grant money drawn down in excess of expenses - CDBG Fund	-	11,916
Grand money awaiting final program audit and redistribution - Transportation Fund	-	5,050
Grant money received in excess of earned - Transportation Fund	-	<u>52,624</u>
Total deferred/unearned for governmental funds	<u>\$ 555,842</u>	<u>\$ 90,619</u>

### Note 8 - Leases

#### Operating Leases

The City leases its police administration facility and landfill equipment under non-cancelable operating leases. Total costs for such leases were \$368,857 for the year ended June 30, 2004. According to the terms of its lease with the Midland City/County Joint Building Authority, the City's obligation for operating leases amounts to 64.8 percent of total operating expenses of the police administration facility.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 8 - Leases (Continued)

The future minimum lease payments for these leases, including estimates of obligations under the police administration facility lease areas, follows:

Years Ending June 30	Amount
2005	\$ 390,125
2006	396,031
2007	244,114
2008	215,111
2009	221,564
2010-2014	<u>1,211,602</u>
Total	<u>\$ 2,678,547</u>

### Capital Leases

The City has entered into a lease agreement with the Midland City/County Joint Building Authority as lessee for financing the construction of police administration facilities. This lease qualifies as a capital lease for accounting purposes and, therefore, has been recorded at the present value of the future minimum lease payments as of the inception date. The total cost of this lease was \$210,274 for the year ended June 30, 2004. Payments under this lease agreement for the year ended June 30, 2004 totaled \$210,274, including \$56,197 of interest charges.

The future minimum lease obligation and net present value as of June 30, 2004 are as follows:

Years Ending June 30	Amount
2005	\$ 202,583
2006	212,899
2007	206,200
2008	215,495
2009	207,530
2010-2013	<u>866,786</u>
Total minimum lease payments	1,911,493
Less amount representing interest	<u>260,005</u>
Present value of minimum lease payments	<u>\$ 1,651,488</u>

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 9 - Long-term Debt

The City issues bonds to provide for the acquisition and construction of major capital facilities. General obligation bonds, which are direct obligations and pledge the full faith and credit of the City, have been issued for both governmental and business-type activities. Revenue bonds involve a pledge of specific income derived from the acquired or constructed asset to pay debt service and have been issued for business-type activities.

Long-term obligation activity can be summarized as follows:

	Interest Rate Ranges	Principal Maturity Ranges	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<b>Governmental Activities</b>							
<u>General obligation bonds</u>							
1990 Downtown Development Amount of issue: \$660,000 Maturing through: December 2004	6.65%	\$85,000	\$ 170,000	\$ -	\$ (85,000)	\$ 85,000	\$ 85,000
1992 Downtown Development Amount of issue: \$600,000 Maturing through: September 2007	5.65% - 6.05%	\$50,000 - \$100,000	350,000	-	(50,000)	300,000	50,000
Capital leases (Note 8)			1,807,537	-	(156,049)	1,651,488	202,583
Total bond and capital lease			2,327,537	-	(291,049)	2,036,488	337,583
<u>Other long-term obligations</u>							
Compensated absences *			3,501,581	1,574,949	(1,640,841)	3,435,689	1,443,980
Property tax appeals contingency reserve refunds (Note 17)			34,864,900	5,235,862	-	40,100,762	-
Total other long-term			38,366,481	6,810,811	(1,640,841)	43,536,451	1,443,980
Total governmental activities			\$ 40,694,018	\$ 6,810,811	\$ (1,931,890)	\$ 45,572,939	\$ 1,781,563
<b>Business-type Activities</b>							
<u>General obligation bonds</u>							
1989 Sewer Construction: Amount of issue: \$900,000 Maturing through: October 2005	6.00%	\$400,000	\$ 800,000	\$ -	\$ -	\$ 800,000	\$ 400,000
1990 Sewer Construction: Amount of issue - \$3,400,000 Maturing through: October 2005	4.75%	\$725,000	1,450,000	-	-	1,450,000	725,000
1993 Sewer Refunding: Amount of issue: \$8,230,000 Maturing through: October 2003	4.75%	\$1,075,000	1,075,000	-	(1,075,000)	-	-
2001 Sewer Construction: Amount of issue: \$13,600,000 Maturing through: May 2021	4.50% - 5.25%	\$375,000 - \$1,100,000	13,025,000	-	(375,000)	12,650,000	425,000
2001 Sewer Construction - State Revolving Fund: Amount of issue: \$5,130,000 Borrowed as of 6/30/03: \$4,688,961 Maturing through: April 2022	2.50%	\$205,000 - \$320,000	4,488,961	76,925	-	4,565,886	210,000
<u>Revenue bonds</u>							
2000 Water Rev Refunding: Amount of issue: \$12,190,000 Maturing through: April 2010	4.80%- 5.30%	\$1,155,000- \$1,390,000	8,500,000	-	(1,390,000)	7,110,000	1,335,000
Total bonds obligations			29,338,961	76,925	(2,840,000)	26,575,886	3,095,000

\* Liability will be liquidated by the General Fund, Library Fund, Cable TV Fund, DART Fund, and the DDA Fund based on the allocable portion of the liability.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 9 - Long-term Debt (Continued)

Business-type Activities	Interest	Principal	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
	Rate Ranges	Maturity Ranges					
<u>Other long-term obligations</u>							
Compensated absences			\$ 755,748	\$ 373,852	\$ (456,486)	\$ 673,114	\$ 322,072
Landfill closure and postclosure (Note 10)			2,431,000	99,000	-	2,530,000	-
Total other long-term obligations			3,186,748	472,852	(456,486)	3,203,114	322,072
Less current portion payable from restricted assets (Note 6)			3,045,000	50,000	-	3,095,000	3,095,000
Total business-type activities			29,480,709	499,777	(3,296,486)	26,684,000	322,072
Total governmental and business-type activities			\$ 70,174,727	\$ 7,310,588	\$ (5,228,376)	\$ 72,256,939	\$ 2,103,635

The 1990 and 1992 Downtown Development Bonds were issued pursuant to a tax increment financing plan and development plan for the Midland Downtown Development Area under authority of Act 197, Public Act of Michigan, 1975, as amended. Proceeds of the 1990 bonds were used to finance a portion of the construction cost of a downtown parking structure, as described in the plan and located in the Development Area. The 1992 bonds were used to finance a portion of the Downtown Streetscape Project. The bonds are payable from tax increment revenues pursuant to the plan.

The 1989 and 1990 general obligation sewer construction bonds were approved by the voters of the City in a general election held on November 3, 1987. The City Council has passed a resolution to levy a millage to pay approximately 80 percent of the principal and interest cost of these bonds. The remaining 20 percent of the obligation is to be repaid by fees from the users of the municipal sanitary sewage collection and treatment system. The proceeds have been used for the construction of sewer facilities capitalized in the Wastewater Fund or for the construction of the City's storm sewer separation project.

The full faith and credit and the unlimited taxing power of the City are also pledged for payment of principal and interest on the 1993 Sewer Refunding Bonds, the proceeds of which were used to redeem certain portions of the 1989 and 1990 Sewer Construction Bonds to take advantage of lower interest rates.

The 2001 Sewer Construction Bonds were approved by the voters in a general election held on February 22, 2000. The City Council has approved a resolution to levy a millage to pay approximately 60 percent of the principal and interest cost of these bonds. The 40 percent balance of the obligation is to be repaid by fees from the users of the municipal sanitary sewage collection and treatment system. The proceeds are being used for construction of sewer facilities recorded as construction in progress in the Wastewater Fund.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 9 - Long-term Debt (Continued)

On December 3, 2001, the City Council authorized issuance of general obligation limited tax bonds, series 2001, in the principal sum not to exceed \$5,130,000. The purpose of this issuance is to fund the construction of a storm water retention basin at the wastewater treatment plant. User fees will fund 40 percent of the principal and interest on these bonds, and the remaining 60 percent will be funded by a millage that the City will levy. The full faith and credit and the limited taxing power of the City are pledged for payment of the principal and interest thereon.

The City has pledged its full faith and credit on the bonded indebtedness of the Saginaw-Midland Municipal Water Supply Corporation, a jointly owned raw water system described in Note 1 - Summary of Significant Accounting Policies.

By statute, the City's general obligation debt is restricted to 10 percent of the equalized value of all property in the City. Certain obligations, such as water revenue refunding bonds, are not subject to this limitation. At June 30, 2004, the City's general obligation debt statutory and legal debt limit amounted to \$239,384,160 and the indebtedness subject to the limitation aggregated \$12,514,532.

Annual requirements to pay principal and interest on the long-term bonds and capital leases outstanding at June 30, 2004 are as follows:

Fiscal Year	Governmental Activities			Business-type Activities		
	Principal	Interest	Total	Principal	Interest	Total
2005	\$ 331,688	\$ 25,134	\$ 356,822	\$ 3,095,000	\$ 1,179,505	\$ 4,274,505
2006	275,679	24,982	300,661	2,945,000	1,031,606	3,976,606
2007	263,694	25,806	289,500	1,850,000	919,012	2,769,012
2008	291,467	27,053	318,520	1,910,000	834,388	2,744,388
2009	179,015	28,515	207,530	1,940,000	746,107	2,686,107
2010-2014	694,945	171,841	866,786	5,785,000	2,686,950	8,471,950
2015-2019	-	-	-	6,095,000	1,524,612	7,619,612
2020-2022	-	-	-	2,955,886	206,922	3,162,808
Total	<u>\$ 2,036,488</u>	<u>\$ 303,331</u>	<u>\$ 2,339,819</u>	<u>\$ 26,575,886</u>	<u>\$ 9,129,102</u>	<u>\$ 35,704,988</u>

## **Note 10 - Landfill Closure and Postclosure Care Cost**

State and federal laws and regulations require the City to place a final cover on its sanitary landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for 30 years after closure. Although closure and postclosure care costs will be paid only near or after the date that the landfill stops accepting waste, the City reports a portion of these closure and postclosure care costs as an operating expense in each period based on landfill capacity used as of each balance sheet date. The \$2,530,000 reported as landfill closure and postclosure care liability at June 30, 2004 represents the cumulative amount reported to date based on the use of 100 percent of the capacity of Area A (32 acres closed in 1991) and cells 1 through 14 (53 acres closed in 2004), and 4 percent of the estimated capacity of cell 14. The City will recognize the remaining estimated cost of closure and postclosure care of approximately \$764,000 as the remaining capacity of cell 15 is filled.

These amounts are based on what it would cost to perform all closure and postclosure care in current dollars. The City expects to close cell 15 during the fiscal year ending June 2010. Actual cost may be higher due to inflation, changes in technology, or changes in regulations.

The City is required by state and federal laws and regulations to make contributions to a trust to finance closure and postclosure care. The City is in compliance with these requirements, and at June 30, 2004, cash and cash equivalents in the amount of \$903,082 were held for these purposes, reported as restricted assets on the balance sheet. The City expects that future inflation costs will be paid from interest earnings on these contributions. However, if interest earnings are inadequate or additional postclosure care requirements are determined (due to changes in technology or applicable laws or regulations, for example), these costs may need to be covered by charges to future landfill users or from future tax revenue.

The City has also entered into an agreement to provide a letter of credit in favor of the State of Michigan to fulfill certain bonding requirements imposed upon the City, by Michigan law.

## **Note 11 - Pension Funds**

### **Police and Fire Pension System**

**Plan Description** - The Police and Fire Pension System is a single-employer defined benefit pension plan that is administered by the City of Midland Police and Fire Employees Retirement System. This plan covers all police and fire employees of the City. The system provides retirement, disability, and death benefits to plan members and their beneficiaries. At December 31, 2003, the date of the most recent actuarial valuation, membership consisted of 98 retirees and beneficiaries currently receiving benefits, terminated employees entitled to benefits but not yet receiving them, and 94 current active employees. The plan does not issue a separate financial report.

**Funding Policy** - The obligation to contribute to and maintain the system for those employees was established by negotiation with the City's collective bargaining units and requires a contribution from the employees of 7 percent of gross wages for firefighters and 8 percent of gross wages for all other employees. The City's funding policy provides for biweekly employee contributions and monthly employer contributions at actuarially determined rates. Administrative costs of the plan are financed through investment earnings.

**Contributions** - Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Please refer to Note 1 for further significant accounting policies.

**Annual Pension Cost** - For the year ended June 30, 2004, the City's annual pension cost was \$194,061, which was equal to the City's required and actual contribution. The required employer contributions were determined as part of an actuarial valuation at December 31, 2003, using the entry age actuarial funding method. Significant actuarial assumptions used include (a) a 7 percent investment rate of return, (b) projected salary increases of 4.5 percent per year, compounded annually, (c) additional projected salary increases of up to 5.2 percent per year, attributable to seniority/merit and (d) no postretirement benefit increases other than 5 percent increases for Police Command members with 26 or more years at 5, 10, 15, and 20 years after retirement. Both (a) and (b) include an inflation component of 4.5 percent. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a four-year period. The overfunded actuarial liability is being amortized as a level percentage of payroll on a closed basis. The remaining amortization period is 10 years.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 11 - Pension Funds (Continued)

**Reserves** - As of June 30, 2004, the plan's legally required reserves have been fully funded as follows:

Reserve for employees' contributions	\$ 4,790,805
Reserve for employer contributions	14,991,827
Reserve for retired benefit payment	25,815,215

### Three-year Trend Information

Year Ended June 30	Annual Pension Cost (APC)	Percentage of APC Contribution	Net Pension Obligation
2002	None	100	None
2003	None	100	None
2004	\$ 194,061	100	None

### Schedule of Funding Progress

Actuarial Valuation Date	Fiscal Year Ended	Actuarial Value of Assets	Actuarial Accrued Liabilities (AAL)	Unfunded (Overfunded) ALL (UALL)	Funded Ratio (Percent)	Covered Payroll	UAAL as a Percent of Covered Payroll
12/31/01	06/30/03	\$ 58,752,348	\$ 44,458,293	\$ (14,294,055)	132	\$ 4,939,281	(289.4)
12/31/02	06/30/04	55,073,738	47,343,528	(7,730,210)	116	5,534,596	(139.7)
12/31/03	06/30/05	51,008,034	49,478,634	1,529,400	103	5,582,280	27.4

### Municipal Employees' Retirement System of Michigan

**Plan Description** - The City of Midland participates in the Municipal Employees Retirement System of Michigan (MERS), an agent multiple-employer, defined-benefit pension plan that covers substantially all employees of the City other than police and fire employees. The system provides retirement, disability, and death benefits to plan members and their beneficiaries. The MERS issues a publicly available financial report that includes financial statements and required supplementary information for the system. That report may be obtained by writing to MERS at Municipal Way, Lansing, MI 48917.

### Note 11 - Pension Funds (Continued)

**Funding Policy** - The obligation to contribute to and maintain the system for these employees was established primarily by negotiation with the City's collective bargaining units and requires a contribution from the employees ranging from 0 percent to 5 percent of gross wages. The City's funding policy provides for quarterly employee and employer contributions at actuarially determined rates.

**Annual Pension Cost** - For the year ended June 30, 2004, the City's annual pension cost of \$2,347,812 for the plan was equal to the required and actual contribution. The annual required contribution was determined as part of an actuarial valuation at December 31, 2002 using the entry age actuarial funding method. Significant actuarial assumptions used include (a) an 8 percent investment rate of return, (b) projected salary increases of 4.5 percent per year, compounded annually, (c) additional projected salary increases of 0 percent to 4.16 percent per year, attributable to seniority/merit and (d) the assumption that benefits will increase after retirement by 2.5 percent annually, non-compounded. Both (a) and (b) include an inflation component of 4.5 percent. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a five-year period. The unfunded actuarial liability is being amortized as a level percentage of payroll on a closed basis. The remaining amortization period is 30 years.

#### Three-year Trend Information

<u>Year Ended</u> <u>June 30</u>	<u>Annual</u> <u>Pension</u> <u>Cost</u> <u>(APC)</u>	<u>Percentage</u> <u>of APC</u> <u>Contribution</u>	<u>Net</u> <u>Pension</u> <u>Obligation</u>
2002	\$ 1,464,582	100	None
2003	1,727,255	100	None
2004	2,347,812	100	None

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 11 - Pension Funds (Continued)

#### Schedule of Funding Progress

Actuarial Valuation Date	Fiscal Year Ended	Actuarial Value of Assets	Actuarial Accrued Liabilities (AAL)	Unfunded (Overfunded) ALL (UALL)	Funded Ratio (Percent)	Covered Payroll	UAAL as a Percent of Covered Payroll
12/31/01	06/30/04	\$ 64,797,133	\$ 75,384,039	\$ 10,586,906	86	\$ 11,432,757	92.6
12/31/02	06/30/05	64,917,238	79,443,565	14,526,327	82	11,979,594	121.3
12/31/03	06/30/06	68,149,881	86,011,816	17,861,935	79	12,342,359	144.7

### Note 12 - Postemployment Benefits

The City of Midland provides postemployment health care coverage under a traditionally insured plan to all retired employees and their qualified spouses and other dependents, as mandated by collective bargaining agreements. Currently, these costs are funded on a “pay as you go” basis.

In general, retirees are required to contribute up to 40 percent of the cost of coverage until attaining a specified age (ages 46 to 50 for police and fire retirees, depending on bargaining group, and 65 for all other retirees), at which time the full cost of coverage becomes the obligation of the City.

The net cost to the City of providing postemployment health care coverage follows:

Year	Number of Retirees	Amount
2004	284	\$ 3,544,232
2003	270	3,131,547
2002	270	2,866,760

### Note 13 - Claims, Litigation, and Other Contingencies

In the normal course of its activities, the City becomes a party in various legal actions. Although some actions have been brought for large amounts, the City has not generally experienced significant losses or cost. City management is of the opinion that the outcome of such actions will not have a material effect on the financial position of the City.

### Note 13 - Claims, Litigation, and Other Contingencies (Continued)

The City has received several federal and state grants for specific purposes that are subject to review and audit by the grantor agencies. Such audits could lead to requests for reimbursement to the grantor agency for expenditures disallowed under the terms of the grant. City management believes such disallowances, if any, will be immaterial.

### Note 14 - Enterprise Fund Contractual Revenue

The City supplies large quantities of water to Dow Chemical Company and Dow Corning Corporation under contractual arrangements with each company. Under the Dow Chemical Supplemental Agreement dated March 1, 1979, and Dow Corning Agreement dated July 15, 1985, the companies agree to pay for the variable cost of industrial grade water. In addition, the companies agree to pay a percentage of certain fixed costs, including the principal and interest costs on debt incurred by the City related to plant expansions necessary to meeting the companies' special requirements. These fixed cost payments are due in monthly installments until the year 2010, or until the bonds are paid in full.

The payment percentage is based upon the cost of the facilities required to meet the companies' exact capacity requirements relative to the total cost of the City's initial capacity requirements.

The percentage of the bond principal and interest payments reimbursed by each company follows:

	Dow Chemical Company	Dow Corning Corporation
1992 Saginaw-Midland - Water Revenue Refinancing Bonds	34.00	4.20
1992 Saginaw-Midland - Water Revenue Bonds	34.00	4.20
1993 Saginaw-Midland - Water Revenue Bonds	34.00	4.20
1998 Saginaw-Midland - Water Revenue Refinancing Bonds	34.00	4.20
2000 Water Revenue Refinancing Bonds	37.976	4.667

## **Note 14 - Enterprise Fund Contractual Revenue (Continued)**

Total payments received under these agreements during the fiscal year were \$1,196,491, consisting of principal and interest of \$827,919 and \$368,572, respectively. These payments have been recorded as nonoperating revenue in the City's Enterprise Funds. Under the terms of these agreements, no equity accrues to either company.

Under the terms of the agreement with Dow Chemical Company, the Water Fund shall retain in a Dow Chemical Emergency Repair and Maintenance Fund, \$25,000 to fund Dow's share of non-budgeted repair, replacement, or improvements.

## **Note 15 - Urban Cooperation Act Agreement**

Effective December 30, 1992, the City entered into a 30-year interlocal public agency agreement with the Township of Midland, as authorized by the provisions of Public Act 7 of the Public Acts of the State of Michigan of 1967 (Ex Sess) [MSA 5.4088(1) et seq; MCLA 124.501 et seq].

The agreement provides for (1) the orderly and uncontested annexation to the City of certain property then located in the Township; (2) future sharing, through the year 2022, of revenues derived from the City's levy of property taxes on certain property to be annexed under the agreement; (3) beginning in September 1993, and continuing through the year 2012, the sharing of revenues derived from the City's levy of property taxes on certain commercial and industrial property already located within the City; and (4) extension, at City cost, of water and sewer services by the City to the Township boundary.

The City's obligation under provision 3, above, shall cease if and when total cumulative payments thereunder reach \$15,000,000. The amount of revenue sharing due to the Township by the City under this agreement during the year ended June 30, 2004 was \$344,620.

Due to the tax appeals by the City's three largest taxpayers (see Note 17), the City and the Township have agreed to have the City hold back the portion of the Township's payments in relation to the additional millage levied for the tax appeal reserve. The amount recorded as a liability to the Township in the General Fund is \$1,785,536 as of June 30, 2004.

## **Note 16 - Risk Management**

The City is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation). The City has purchased commercial insurance for liability and property claims, airport liability and pension fiduciary liability claims, and participates in the Michigan Municipal Workers Compensation Pool for employee injury claims.

The Michigan Municipal League risk pool programs operate as common risk-sharing/management programs for local units of government in Michigan. Member premiums are used to purchase commercial excess insurance coverage and to pay member claims in excess of deductible amounts.

Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

## **Note 17 - Property Tax Appeals Contingency**

The City's three largest taxpayers have filed appeals with the Michigan Tax Tribunal (MTT), seeking to reduce their taxable values from 1997 through the current year. For the year ended June 30, 2004, the aggregate reduction of these three taxpayers for 1997 through 2003 was approximately \$577 million, \$577 million, \$630 million, \$570 million, \$587 million, \$644 million, and \$630 million, respectively. If granted in their entirety, the requested adjustments would result in property tax and administrative fee refunds of approximately \$52.2 million.

During the year ended June 30, 2004, a decision was reached by the MTT on the years 1997 through 2000, on the largest of the three appeals. If agreed to by both parties, this decision would substantially reduce the amount under dispute; however, the MTT's decision has been appealed by both parties. Accordingly, no reduction to the reserve was made as of June 30, 2004, as a result of the MTT's decision.

In October 2004, a settlement was reached between the City and the second largest of the three tax appeals. See Note 20 - Subsequent Events for additional information.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2004

### Note 17 - Property Tax Appeals Contingency (Continued)

In each of the last seven fiscal years, the City levied additional property tax millage, the proceeds of which have been set aside to provide partial funding for the potential liability in the event of an unfavorable resolution of these appeals.

<u>Year Ended</u> <u>June 30</u>	<u>Additional</u> <u>Millage Rate</u>
1998	2.30
1999	2.49
2000	3.24
2001	3.64
2002	1.94
2003	1.44
2004	2.13

The fund balance reserve for the year ended June 30, 2004 is as follows:

General Fund	\$ 40,100,762
Special Revenue Funds	<u>1,738,209</u>
Total	<u>\$ 41,838,971</u>

Each of the three taxpayers has also filed petitions necessary to appeal their 2004 assessments. While one appeal was settled subsequent to fiscal year end, it is anticipated that adjudication and/or settlement of the remaining two appeals will take several years. A similar additional millage has been levied for the 2004-2005 fiscal year.

The City Council has adopted a policy that any unused funds remaining in the General Fund reserve after final resolution of these appeals will be returned to City taxpayers through a future millage reduction. Because the amount of the reserve will eventually be paid out in satisfaction of these appeals and/or returned to City taxpayers through a future millage reduction, the full amount of the General Fund reserve has been recorded as a liability in the government-wide financial statements. The Special Revenue Funds reserve is not deemed to be refundable, so it will only be paid out in the event of an unfavorable outcome to the tax appeals.

## **Note 18 - Special Items**

In July 2003, the Downtown Development Authority (DDA) sold its 49.5 percent equity in the Downtown Office Center Limited Partnership. The DDA received proceeds of approximately \$724,000. In addition, during August 2003 the City sold its 19.4 percent equity interest in the Larkin Building Limited Partnership for proceeds of approximately \$30,000. The total gain on the sale of these equity interests of approximately \$454,000 is reported as a special item on the government-wide statement of activities.

## **Note 19 - Upcoming Reporting Change**

The Governmental Accounting Standards Board has recently released Statement Number 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any "other" postemployment benefits (other than pensions). The new rules will cause the government-wide financial statements to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid. The new pronouncement is effective for the year ending June 30, 2008.

## **Note 20 - Subsequent Events**

On August 9, 2004, the City Council approved the sale of \$6.5 million in limited tax general obligation bonds for the construction of a new civic arena. The terms of the issue provide for annual principal and interest payments beginning on May 1, 2005. Annual principal payments range from \$135,000 and \$490,000, while annual interest payments range from 2.5 percent to 4.7 percent. The final payment will be made in the year 2027. The total estimated cost of the civic arena project is approximately \$10.2 million, with the balance of the funding coming primarily from area foundations. The project is expected to be completed in the fall of 2005.

In October 2004, the City and Dow Corning Corporation settled a multi-year tax appeal. See Note 17 for related information. The settlement provided for an approximate 11 percent reduction of the petitioned taxable values for the years under dispute, 1997 through 2004. As of the settlement date, including 2004-2005 tax collections, the City had reserved approximately \$7.2 million dollars in the General Fund, and \$557,000 in Special Revenue Funds to pay potential liabilities as a result of an unfavorable settlement from the Dow Corning Corporation tax appeal. The actual settlement resulted in a \$1,914,996 distribution from the General Fund and a \$117,470 distribution from the Special Revenue Funds. The balance of the amount that the General Fund had reserved for the Dow Corning Corporation settlement will be returned to City taxpayers through a millage reduction in July 2005. The balance in Special Revenue Fund reserves will become immediately available to fund future projects.