

## **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, 2006

### 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, 2006 follows:

Total assets	\$ 40,238,160
Total liabilities	23,533,523
Equity - City of Midland	7,769,599
Equity - City of Saginaw	8,935,038
Total revenues	4,998,655
Total expenses	4,062,940
Net income	935,715

At June 30, 2006, total outstanding bonded debt of the SMMWSC was \$22,245,000. The City was obligated for \$10,811,628 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. As a general rule, the effect of interfund activity has been removed from these 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. 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.

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

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.

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 Civic Arena Fund accounts for the operations and maintenance of the City's ice arena facility, capital additions, and retirement of debt.

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

- The Real Estate Rental Fund accounts for the operation and maintenance of the City's various senior housing rental properties.

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 Geographical Information Systems Fund accounts for operations of the City's geographic information systems.
- 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.

The Agency Funds account for assets held by the City in a trustee capacity. Agency funds are custodial in nature (assets equal liabilities) and do not involve the measurement of results of operations.

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

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.

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 I - 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, 2006 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.

The 2005 taxable valuation of the City totaled \$2,432,040,700, on which ad valorem taxes levied consisted of 9.17 mills for the City's operating purposes and debt levies equaling .62 mills. This resulted in \$22,305,088 for operating and \$1,507,865 for debt service. The ad valorem taxes levied are recognized in the respective General, Special Revenue, and Water and Sewer Fund financial statements as taxes receivable - current or as tax revenue.

**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.

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

**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.

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
Building improvements	20 years
Land improvements	50 years
Roads and sidewalks	20-30 years
Water and sewer distribution systems	50 years
Vehicles	3-10 years
Equipment	10 years
Library circulation material	5 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.

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

**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.

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.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2006

### 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, 2005		\$	(278,617)
Current year building permit revenue			386,037
Related expenses:			
Direct costs	\$	393,692	
Estimated indirect costs		<u>23,622</u>	
Total construction code expenses			<u>417,314</u>
Cumulative shortfall at June 30, 2006		\$	<u>(309,894)</u>

### Note 3 - Deposits and Investments

Michigan Compiled Laws, Section 129.91 (Public Act 20 of 1943, as amended) 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.

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

The City Council has designated nine financial institutions for the deposit of Local Unit funds. 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 Post Retirement Health Care 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. Michigan Public Act 314 of 1965 and Michigan Public Act 149 of 1999, as amended, authorize investments in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, real estate (if the trust fund's assets exceed \$250 million), debt or entity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

The City's cash and investments are subject to several types of risk, which are examined in more detail below:

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

#### Custodial Credit Risk of Bank Deposits

Custodial credit risk is the risk that in the event of a bank failure, the City's deposits may not be returned to it. The City does not have a deposit policy for custodial credit risk. At year end, the City had \$59,821,329 of bank deposits (certificates of deposit, checking and savings accounts) that were uninsured and uncollateralized. The City believes that due to the dollar amounts of cash deposits and the limits of the FDIC insurance, it is impractical to insure all deposits. As a result, the City evaluates each financial institution with which it deposits its funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

#### Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The City's investment policy does not restrict investment maturities, other than commercial paper which can only be purchased with a 270-day maturity. At year end, the average maturities of investments are as follows:

Investment	Fair Value	Weighted Average Maturity (Years)
Commercial paper	\$ 9,528,870	0.181
Government bonds	1,575,823	9.699
Asset and mortgage-backed securities	4,318,718	23.532
Corporate bonds	7,839,546	15.589
International bonds	1,162,900	16.890

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

#### Credit Risk

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The City's investment policy does not further limit its investment choices. As of year end, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Organization
Interlocal Agreement Fund	\$ 233,621	Not Rated	N/A
Bank Investment Pooled Funds	2,136,042	Not Rated	N/A
Commercial paper	9,528,870	A1	S & P
Government bonds	53,745	AA-	S & P
Money market funds	1,278,897	AAA	S & P
Money market funds	1,046,038	Not Rated	N/A
Mutual funds	2,175,600	Not Rated	N/A
Asset and mortgage-backed securities	4,318,718	AAA	S & P
Corporate bonds	185,013	AA	S & P
Corporate bonds	575,113	AA-	S & P
Corporate bonds	797,975	A+	S & P
Corporate bonds	772,523	A	S & P
Corporate bonds	933,903	A-	S & P
Corporate bonds	1,047,163	BBB+	S & P
Corporate bonds	1,141,348	BBB	S & P
Corporate bonds	1,027,572	BBB-	S & P
Corporate bonds	607,588	BB+	S & P
Corporate bonds	380,275	Not Rated	N/A
Corporate bonds	250,700	Aa3	Moody's
Corporate bonds	120,375	Baa2	Moody's
International bonds	253,813	A+	S & P
International bonds	182,000	BBB+	S & P
International bonds	209,588	BBB	S & P
International bonds	517,500	BBB-	S & P

# City of Midland, Michigan

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

Interfund transfers reported in the fund statements for the year ended June 30, 2006 were as follows:

	Transfers Out						
	General Fund	Major Street Fund	Local Street Fund	Storm Water Mgmt. Fund	Community Develop Block Grant	Downtown Develop. Auth. Fund	Special Activities Fund
Transfers in:							
General Fund	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Major Street Fund	-	-	90,000	-	-	-	-
Local Street Fund	-	1,356,250	-	-	-	-	-
Storm Water Mgmt. Fund	290,000	137,035	120,870	-	-	-	-
Downtown Develop Auth.	-	98,903	-	-	-	-	-
Transportation Fund	613,312	-	-	-	-	-	-
Grace A. Dow Library Fund	2,774,892	-	-	-	4,000	-	-
Debt Fund	194,386	-	-	-	-	88,438	-
Capital Projects Fund	1,268,387	-	18,000	176,255	-	-	1,750
Civic Arena Fund	200,000	-	-	-	-	-	-
Real Estate Rental Fund	-	-	-	-	60,000	-	-
Wastewater Fund	-	-	-	-	-	-	-
Parking Fund	-	-	-	-	-	35,000	-
Geographic Info Sys Fund	237,500	31,250	31,250	-	-	-	-
Special Assessment Rev.	-	-	-	-	-	-	-
<b>Total</b>	<b>\$ 5,578,477</b>	<b>\$ 1,623,438</b>	<b>\$ 260,120</b>	<b>\$ 176,255</b>	<b>\$ 64,000</b>	<b>\$ 123,438</b>	<b>\$ 1,750</b>

In fiscal year 2005, the Civic Arena project was included in construction in progress on the governmental-type funds. Beginning with the 2006 fiscal year, the City has transferred this capital asset to the Civic Arena activity in an Enterprise Fund. Therefore, the government-wide activities include an additional interfund transfer of \$994,991.

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.

**Notes to Financial Statements**  
**June 30, 2006**

Transfers Out					
Debt Fund	Capital Projects Fund	Civic Arena Fund	Wastewater Fund	Water Fund	Total
\$ -	\$ 214,364	\$ -	\$ -	\$ -	\$ 214,364
-	-	-	-	-	90,000
-	-	-	-	-	1,356,250
-	50,927	-	-	-	598,832
-	-	-	-	-	98,903
-	-	-	-	-	613,312
-	-	-	-	-	2,778,892
-	-	-	-	-	282,824
-	-	1,967,809	-	-	3,432,201
-	2,533,828	-	-	-	2,733,828
-	-	-	-	-	60,000
1,731,917	-	-	-	-	1,731,917
-	-	-	-	-	35,000
-	-	-	100,000	90,000	490,000
-	120,164	-	-	-	120,164
<u>\$ 1,731,917</u>	<u>\$ 2,919,283</u>	<u>\$ 1,967,809</u>	<u>\$ 100,000</u>	<u>\$ 90,000</u>	<u>\$ 14,636,487</u>

The composition of interfund balances as of June 30, 2006 was as follows:

Receivable Fund	Payable Fund	Amount
Special Assessment Revolving	Midland Housing	\$ 150,000
Community Development Block Grant	Midland Housing	145,898
Landfill	Real Estate Rental	9,000
Landfill	Civic Arena	1,707,709
Total		<u>\$ 2,012,607</u>

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 three resulted from loans made for working capital purposes.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2006

### Note 5 - Capital Assets

Capital asset activity for the year ended June 30, 2006 was as follows:

Governmental Activities	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not depreciated:				
Land	\$ 3,368,554	\$ 48,806	\$ 562	\$ 3,416,798
Construction in progress	13,939,761	7,955,742	17,330,877	4,564,626
Total capital assets not depreciated	17,308,315	8,004,548	17,331,439	7,981,424
Capital assets being depreciated:				
Major and local roads	8,524,714	4,537,681	-	13,062,395
Sidewalks	259,206	299,021	-	558,227
Buildings	22,943,000	100,028	-	23,043,028
Land improvements	1,885,269	2,875,570	-	4,760,839
Library circulation materials	6,575,821	429,819	323,171	6,682,469
Equipment	8,522,120	828,464	78,378	9,272,206
Vehicles	13,219,026	1,172,917	569,531	13,822,412
Total capital assets being depreciated	61,929,156	10,243,500	971,080	71,201,576
Total capital assets before depreciation	79,237,471	18,248,048	18,302,519	79,183,000
Less accumulated depreciation:				
Major and local roads	342,396	507,031	-	849,427
Sidewalks	9,063	19,834	-	28,897
Buildings	8,795,659	436,546	-	9,232,205
Land improvements	204,530	70,797	-	275,327
Library circulation materials	5,270,971	445,414	323,171	5,393,214
Equipment	6,830,018	441,950	58,851	7,213,117
Vehicles	6,965,164	1,220,505	546,397	7,639,272
Subtotal	28,417,801	3,142,077	928,419	30,631,459
Net capital assets being depreciated	33,511,355	7,101,423	42,661	40,570,117
Net governmental activities capital assets	<u>\$ 50,819,670</u>	<u>\$ 15,105,971</u>	<u>\$ 17,374,100</u>	<u>\$ 48,551,541</u>

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2006

### Note 5 - Capital Assets (Continued)

Business-type Activities	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated:				
Land	\$ 2,316,680	\$ -	\$ -	\$ 2,316,680
Construction in progress	976,463	1,971,283	1,657,828	1,289,918
Total capital assets not being depreciated	3,293,143	1,971,283	1,657,828	3,606,598
Capital assets being depreciated:				
Water and sewer lines	71,969,281	2,481,612	-	74,450,893
Buildings and building improvements	70,440,819	8,529,082	-	78,969,901
Land improvements	5,542,796	488,342	-	6,031,138
Landfill improvements	9,798,091	50,031	-	9,848,122
Equipment	4,715,470	1,128,536	25,542	5,818,464
Vehicles	580,164	189,105	33,800	735,469
Total capital assets being depreciated	163,046,621	12,866,708	59,342	\$ 175,853,987
Less accumulated depreciation:				
Water and sewer lines	23,502,533	1,494,978	-	24,997,511
Buildings and building improvements	27,667,001	1,520,815	-	29,187,816
Land improvements	1,021,275	116,444	-	1,137,719
Landfill improvements	6,667,843	183,560	-	6,851,403
Equipment	3,354,706	307,093	18,378	3,643,421
Vehicles	375,886	37,153	33,800	379,239
Total accumulated depreciation	62,589,244	3,660,043	52,178	66,197,109
Net capital assets being depreciated	100,457,377	9,206,665	7,164	109,656,878
Net business-type activities capital assets	\$ 103,750,520	\$ 11,177,948	\$ 1,664,992	\$ 113,263,476

### Note 5 - Capital Assets (Continued)

During the current year, the City established a separate Enterprise Fund to account for civic arena activities. In prior years, this activity was included in the General Fund and any activity relating to the construction of the new civic arena was reported as governmental activity. The current year financial statements reflect the transfer of these activities from governmental to business-type activities.

The civic arena project was not completed until the current year. As such, the prior year governmental activities included approximately \$7.5 million of construction in progress (CIP) relating to the construction of the new civic arena. These costs are included in the beginning CIP balance for governmental activities as reported in this footnote. Further, current year project costs of approximately \$2.5 million are included in CIP additions, and the total completed project costs of approximately \$10 million are included in CIP disposals within the governmental activities. The completed project assets were then transferred from governmental to business-type activities and capitalized as completed assets within the business-type activities.

Depreciation expense charged to programs of the government follows:

Governmental activities:

General government	\$ 483,594
Public safety	293,278
Public works	1,128,025
Sanitation	78,391
Parks and recreation	318,054
Library	672,086
Airport	22,344
Transportation	137,018
Other functions	9,287

Total governmental activities \$ 3,142,077

Business-type activities:

Civic Arena	\$ 159,077
Landfill	270,134
Real estate rental	438,220
Golf course	131,309
Parking system	38,383
Wastewater	1,437,258
Water	1,185,662

Total business-type activities \$ 3,660,043

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2006

### Note 5 - Capital Assets (Continued)

**Construction Commitments** - The City has active construction projects as of June 30, 2006. The projects include landfill, sewer, sidewalk, storm sewer, streets, water, and wastewater improvements. At year end, the City's commitments with contractors are as follows:

	<u>Spent to Date</u>	<u>Remaining Commitment</u>
Landfill projects	\$ 56,504	\$ 651
Sidewalk projects	472	60,214
Storm sewer projects	-	23,391
Street projects	1,707,112	1,398,837
Water system projects	<u>77,421</u>	<u>240,766</u>
Total	<u>\$ 1,841,509</u>	<u>\$ 1,723,859</u>

Infrastructure assets have not been retroactively recorded, and will be within one year, 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 in the amounts of \$1,265,693 and \$862,997, 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 \$1,262,995 of restricted assets that are for closure and postclosure costs.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2006

### 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, 2006, the various components of deferred revenue are as follows:

	<u>Unavailable</u>	<u>Unearned</u>
Grant money received in excess of expenses - Transportation Fund	\$ -	\$ 10,004
Grant money earned but not received - Transportation Fund	<u>56,742</u>	<u>-</u>
Total deferred/unearned for governmental funds	<u>\$ 56,742</u>	<u>\$ 10,004</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 \$453,652 for the year ended June 30, 2006. 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.

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

<u>Years Ending</u> <u>June 30</u>	<u>Amount</u>
2007	\$ 328,027
2008	299,365
2009	233,615
2010	240,623
2011	247,842
2012-2016	<u>1,355,299</u>
Total	<u>\$ 2,704,771</u>

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2006

### Note 8 - Leases (Continued)

#### 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 \$212,899 for the year ended June 30, 2006. Payments under this lease agreement for the year ended June 30, 2006 totaled \$212,899, including \$44,955 of interest charges.

The future minimum lease obligation and net present value as of June 30, 2006 are as follows:

<u>Years Ending</u> <u>June 30</u>	<u>Amount</u>
2007	\$ 206,200
2008	215,495
2009	207,530
2010	215,703
2011	223,005
2012-2013	<u>428,078</u>
Total minimum lease payments	1,496,011
Less amount representing interest	<u>165,501</u>
Present value of minimum lease payments	<u>\$ 1,330,510</u>

### 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.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2006

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

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>							
2004 Civic Arena							
Amount of issue: \$6,500,000	2.50% -	\$135,000 -					
Maturing through: May 2030	4.75%	\$490,000	\$ 6,500,000	\$ -	\$ (6,500,000)	\$ -	\$ -
1992 Downtown Development							
Amount of issue: \$600,000	5.65% -	\$50,000 -					
Maturing through: September 2007	6.05%	\$100,000	250,000	-	(75,000)	175,000	75,000
Capital lease (Note 8)			1,498,454	-	(167,944)	1,330,510	166,287
Total bond and capital lease			8,248,454	-	(6,742,944)	1,505,510	241,287
<u>Other long-term obligations</u>							
Compensated absences			3,579,931	256,688	(252)	3,836,367	1,612,981
Property tax appeals contingency reserve refunds (Note 17)			31,171,066	490,104	-	31,661,170	19,736,654
Total other long-term obligations			34,750,997	746,792	(252)	35,497,537	21,349,635
Total governmental activities			42,999,451	746,792	(6,743,196)	37,003,047	21,590,922
<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	400,000	-	(400,000)	-	-
1990 Sewer Construction:							
Amount of issue - \$3,400,000							
Maturing through: October 2005	4.75%	\$725,000	725,000	-	(725,000)	-	-
2001 Sewer Construction:							
Amount of issue: \$13,600,000	4.50% -	\$375,000 -					
Maturing through: May 2021	5.25%	\$1,100,000	12,225,000	-	(9,475,000)	2,750,000	475,000
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	4,359,063	-	(215,000)	4,144,063	220,000
2004 Civic Arena							
Amount of issue: \$6,500,000	2.50% -	\$135,000 -					
Maturing through: May 2030	4.75%	490,000	-	6,500,000	(445,000)	6,055,000	470,000
2005 Sewer Refunding Bonds							
Amount of issue: \$9,480,000	2.95% -	\$135,000 -					
Maturing through: May 2021	4.15%	490,000	-	9,480,000	-	9,480,000	60,000
<u>Revenue bonds</u>							
2000 Water Rev Refunding:							
Amount of issue: \$12,190,000	4.80% -	\$1,155,000 -					
Maturing through: April 2010	5.30%	1,390,000	5,775,000	-	(1,155,000)	4,620,000	1,155,000
Total bonds obligations			23,484,063	15,980,000	(12,415,000)	27,049,063	2,380,000
<u>Other long-term obligations</u>							
Compensated absences			662,767	98,837	-	761,604	343,900
Landfill closure and postclosure (Note 10)			2,889,000	133,000	-	3,022,000	-
Total other long-term obligations			3,551,767	231,837	-	3,783,604	343,900
Less current portion payable from restricted assets (Note 6)			2,945,000	-	(1,035,000)	1,910,000	1,910,000
Total business-type activities			24,090,830	16,211,837	(11,380,000)	28,922,667	813,900
Total governmental and business-type activities			\$ 67,090,281	\$ 16,958,629	\$ (18,123,196)	\$ 65,925,714	\$ 22,404,822

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

As reported in Note 5, during the current year the City established a separate Enterprise Fund to account for civic arena activities. In prior years, this activity was included in the General Fund and any activity relating to the construction of the new civic arena was reported as governmental activity. The current year financial statements reflect the transfer of these activities from governmental to business-type activities.

The prior year governmental activities included \$6.5 million in bonds payable that related to funding construction costs of the new civic arena. Those bonds are shown in the beginning balance of the governmental activities debt schedule within this note, and include a \$6.5 million reduction to reflect the transfer of that debt from governmental to business-type. Similarly, the business-type activities report these bonds with a zero beginning balance and a \$6.5 million addition. Future financial statements will report this debt issue as business-type activity.

**Advance and Current Refundings** - On September 13, 2005, the City issued \$9,480,000 of General Obligation Unlimited Tax Refund Bonds. The bonds were issued pursuant resolutions adopted by City Council on July 11, 2005 and August 22, 2005, and provide for an average interest rate of 3.95 percent. The proceeds of these bonds were used to advance refund \$9,025,000 of outstanding 2001 General Obligation Unlimited Tax Bonds with an average interest rate of 5.07 percent. The bond proceeds plus an additional \$191,000 from the Wastewater Fund were used to pay issuance costs of \$67,828, and purchase of \$9,603,172 of state and local government securities that will remain in an irrevocable trust with an escrow agent to provide for all future debt service payments on the original bonds. As a result, the bonds are considered to be defeased and the liability for the bonds has been removed from the Wastewater Fund. The advanced refunding reduced total debt service payments over the next 16 years by approximately \$644,500, which represents an economic gain of approximately \$450,900.

The 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. The bonds were used to finance a portion of the Downtown Streetscape Project. The bonds are payable from tax increment revenues pursuant to the plan.

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

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. On September 12, 2005, General Obligation Unlimited Tax Bonds were issued to refund \$9,025,000 of the outstanding bond. See details above regarding advance and current refunding for more details.

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, 2006, the City's general obligation debt statutory and legal debt limit amounted to \$281,171,210 and the indebtedness subject to the limitation aggregated \$22,604,063.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2006

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

Annual requirements to pay principal and interest on the long-term bonds and capital leases outstanding at June 30, 2006 are as follows:

Fiscal Year	Governmental Activities			Business-type Activities		
	Principal	Interest	Total	Principal	Interest	Total
2007	\$ 241,287	\$ 48,213	\$ 289,500	\$ 2,380,000	\$ 1,077,920	\$ 3,457,920
2008	280,572	37,948	318,520	2,460,000	979,775	3,439,775
2009	178,018	29,512	207,530	2,145,000	876,189	3,021,189
2010	191,537	24,166	215,703	2,200,000	778,202	2,978,202
2011	204,573	18,432	223,005	1,095,000	676,828	1,771,828
2012-2016	409,523	18,555	428,078	6,295,000	2,758,151	9,053,151
2017-2021	-	-	-	7,600,000	1,530,673	9,130,673
2022-2026	-	-	-	1,534,063	514,128	2,048,191
2027-2031	-	-	-	1,340,000	162,530	1,502,530
Total	<u>\$ 1,505,510</u>	<u>\$ 176,826</u>	<u>\$ 1,682,336</u>	<u>\$ 27,049,063</u>	<u>\$ 9,354,396</u>	<u>\$ 36,403,459</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 \$3,022,000 reported as landfill closure and postclosure care liability at June 30, 2006 represents the cumulative amount reported to date based on the use of 100 percent of the capacity of Area A (32 acres closed in 1993) and cells 1 through 14 (53 acres closed in 2004), and 31 percent of the estimated capacity of cell 15. The City will recognize the remaining estimated cost of closure and postclosure care of approximately \$661,704 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 2012. The actual cost may be higher due to inflation, changes in technology, or changes in regulations.

## **Note 10 - Landfill Closure and Postclosure Care Cost (Continued)**

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, 2006, cash and cash equivalents in the amount of \$1,262,995 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, 2005, the date of the most recent actuarial valuation, membership consisted of 103 retirees and beneficiaries currently receiving benefits, terminated employees entitled to benefits but not yet receiving them, and 91 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.

### Note 11 - Pension Funds (Continued)

**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, 2006, the City's annual pension cost was \$1,290,917, 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, 2005, 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 25 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 unfunded actuarial accrued liability is being amortized as a level percentage of payroll contributions over 10 years.

**Reserves** - As of June 30, 2006, the plan's legally required reserves have been fully funded as follows:

Reserve for employees' contributions	\$ 4,766,178
Reserve for employer contributions	12,230,219
Reserve for retired benefit payment	32,241,314

### Three-year Trend Information

Year Ended June 30	Annual Pension Cost (APC)	Percentage of APC Contribution	Net Pension Obligation
2004	\$ 194,061	100	None
2005	929,589	100	None
2006	1,290,917	100	None

### Note 11 - Pension Funds (Continued)

#### Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liabilities (AAL)	Unfunded (Overfunded) AAL (UAAL)	Funded Ratio (Percent)	Covered Payroll	UAAL as a Percent of Covered Payroll
12/31/03	\$ 51,008,034	\$ 49,478,634	\$ (1,529,400)	103	\$ 5,582,280	(27.4)
12/31/04	48,603,366	50,436,943	1,833,577	96	5,419,813	33.8
12/31/05	50,186,088	54,310,758	4,124,670	92	5,665,317	72.8

#### Municipal Employees' Retirement System of Michigan - Defined Benefit Retirement Plan

**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 and employees hired on or after July 1, 2005. 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 1134 Municipal Way, Lansing, MI 48917.

**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, 2006, the City's annual pension cost of \$2,332,776 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, 2003 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.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2006

### Note 11 - Pension Funds (Continued)

#### Three-year Trend Information

Year Ended June 30	Annual Pension Cost (APC)	Percentage of APC Contribution	Net Pension Obligation
2004	\$ 2,347,812	100	None
2005	2,495,316	100	None
2006	2,332,776	100	None

#### Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liabilities (AAL)	Unfunded (Overfunded) AAL (UAAL)	Funded Ratio (Percent)	Covered Payroll	UAAL as a Percent of Covered Payroll
12/31/03	\$ 68,149,881	\$ 86,011,816	\$ 17,861,935	79	\$ 12,342,359	144.7
12/31/04	70,567,636	91,177,957	20,610,321	77	12,373,482	166.6
12/31/05	72,701,562	95,809,652	23,108,090	76	12,935,257	178.6

#### Municipal Employees' Retirement System of Michigan - Defined Contribution Retirement Plan

The City of Midland participates in a Municipal Employees' Retirement System of Michigan (MERS) defined contribution plan which is administered by ICMA for all employees hired on or after July 1, 2005, with the exception of police and fire employees. In the defined contribution plan, benefits depend solely on the amounts contributed to the plan plus investment earnings. Employees are eligible to participate from the date of employment. As established by City Council resolution, the City contributes 5 percent of the employees' gross earnings in the plan. The employee is fully vested after five (5) years of service or at age 65.

The City's total payroll during the current year was \$22,171,884. The current year contribution was calculated based on covered payroll of \$294,268, resulting in an employer contribution of \$14,713.

### Note 11 - Pension Funds (Continued)

#### International City/County Management Association (ICMA) - RC 457 - Deferred Compensation Plan

The City also participates in an ICMA-RC 457 deferred compensation plan for all employees hired on or after July 1, 2005, with the exception of police and fire employees. In the deferred compensation plan, benefits depend solely on the amounts contributed to the plan plus investment earnings. Employees are eligible to participate from the date of employment. As established by City Council resolution, the City will contribute up to 7 percent of the employee's wages with 100 percent matching of the employee wage contributions, in 1 percent increments.

The City's total payroll during the current year was \$22,171,884. The current year contribution was calculated based on covered payroll of \$294,268, resulting in an employer contribution of \$5,856 and employee contributions of \$5,856.

Condensed financial statements for the individual pension plans are as follows:

#### Statement of Plan Net Assets

	Police and Fire Pensions	Post- employment Health Care
Investments	\$ 48,007,886	\$ -
Other assets	1,229,826	260,318
Total assets	<u>\$ 49,237,712</u>	<u>\$ 260,318</u>

#### Statement of Changes in Plan Net Assets

	Police and Fire Pensions	Post- employment Health Care
Contributions	\$ 1,784,401	\$ 1,116,241
Investment income (net of expenses)	3,998,389	389,415
Deduction for benefit payments	(3,261,210)	-
Transfer of RHC assets to MERS	-	(11,610,236)
Change in net assets	<u>\$ 2,521,580</u>	<u>\$ (10,104,580)</u>

### Note 12 - Postemployment Benefits

The City of Midland provides postemployment health care coverage under a traditional insured plan to retired employees and their qualified spouses and other dependents, as mandated by collective bargaining agreements. Each agreement contains variations of the following general guidelines. Most employees fall into one of the following general groups:

The first group of employees will be enrolled in the comprehensive master medical plan available at the time of retirement. The City will pay 100 percent of the premium for retiree, spouse, and family.

The second group of employee will be eligible for continued medical coverage when they retire from the City, providing they pay 50 percent of the premium. The City will pay the other 50 percent.

The third group, employees hired on or after July 1, 2005, excluding police and fire employees, will not be eligible to be included in the City's group health insurance plan. For those employees, the City will contribute 2 percent of the employee's wages into a health care savings program.

The City funds the retiree health insurance on a "pay as you go" basis. The net cost to the City of providing postemployment health care coverage follows:

<u>Year</u>	<u>Number of Retirees</u>	<u>Amount</u>
2006	300	\$ 4,636,377
2005	301	3,993,508
2004	284	3,544,232

During the fiscal year, the City of Midland transferred \$11,610,236 previously held in a trust fund to Municipal Employees' Retirement System of Michigan (MERS) to establish a Retiree Health Funding Vehicle. MERS will act as a fiduciary investing and managing funds for the future payment of postemployment health care coverage for the City of Midland.

## **Note 12 - Postemployment Benefits (Continued)**

### **Municipal Employees' Retirement System of Michigan - Health Care Savings Program**

The City of Midland participates in the Municipal Employees' Retirement System of Michigan (MERS) health care savings program for all employees hired on or after July 1, 2005, with the exception of police and fire employees. In the health care savings program, benefits depend solely on the amounts contributed to the plan plus investment earnings. Employees are eligible to participate from the date of employment. As established by City Council resolution, the City contributes 2 percent of the employee's gross earnings in the program. The employee is fully vested after three (3) years of service.

The City's total payroll during the current year was \$22,171,884. The current year contribution was calculated based on covered payroll of \$294,268, resulting in an employer contribution of \$5,885.

**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, 2009.

## **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.

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 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:

	<u>Dow Chemical Company</u>	<u>Dow Corning Corporation</u>
1998 Saginaw-Midland - Water Revenue Refinancing Bonds	34.00	4.20
2000 Water Revenue Refinancing Bonds	37.976	4.667
2002 Saginaw-Midland - Water Revenue Refinancing Bond	34.00	4.20
2006 Saginaw-Midland - Water Revenue Bonds	34.00	4.20

Total payments received under these agreements during the fiscal year were \$1,041,853, consisting of principal and interest of \$752,968 and \$288,885, 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, 2006 was \$356,825. The total cumulative payments from the City through June 30, 2006 were \$2,027,986.

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 \$2,257,371 as of June 30, 2006.

## **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), as well as medical benefits provided to employees. The City has purchased commercial insurance for medical benefit claims, 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**

In 1997, the City was presented with tax appeals from its three largest taxpayers: Midland Cogeneration Venture (MCV), the Dow Chemical Company (Dow), and the Dow Corning Corporation (Corning). The next year the City began levying a special millage to accumulate a reserve to provide partial funding for the potential liability in the event of unfavorable resolutions to these appeals. In each year from 1998 through 2004, the City assessed its risk on each of the three appeals and increased its reserve accordingly through the special millage. In addition, the City established a reserve for Special Revenue Funds for potential refunds of county road millage passed through to the City from Midland County.

By the year ended June 30, 2004, both MCV and Corning had, at least in part, been to trial before the Michigan Tax Tribunal (MTT), and as part of the trial proceedings and preparations, the exchange of information between the concerned parties enabled the City's legal counsel to recommend a reduction in its funding levels on both cases. As a result of this action, in July 2004, the City refunded approximately \$1.7 million from the reserve back to the taxpayers in the form of a millage reduction of negative .68 mills.

In October 2004, the City and Corning reached a settlement which provided for a refund to Corning of approximately \$2 million, and an 11 percent reduction of the petitioned taxable values for the tax years under dispute. The City had reserved approximately \$7.2 million in the General Fund, and \$557,000 in Special Revenue Funds for this appeal. In July 2005, the City refunded approximately \$5.3 million from the General Fund reserve to the taxpayers as part of a millage reduction of negative 2.63 mills. The balance in Special Revenue Fund reserves were allocated to future projects.

# City of Midland, Michigan

## Notes to Financial Statements June 30, 2006

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

A summary of the City's General Fund tax appeal reserve and millage are illustrated below.

Year	Tax Year	Contribution to Tax Appeal Reserve	Special Millage
1996-97	1996	\$ -	0.00
1997-98	1997	5,029,000	2.30
1998-99	1998	5,834,300	2.49
1999-00	1999	8,063,200	3.24
2000-01	2000	9,226,000	3.64
2001-02	2001	5,457,400	1.94
2002-03	2002	1,255,000	1.44
2003-04	2003	5,235,900	2.13
2004-05	2004	(1,682,300)	(0.68)
2005-06	2005	<u>(6,520,666)</u>	<u>(2.63)</u>
Subtotal		31,897,834	
Refunded to Dow Corning		<u>(1,914,996)</u>	
Reserve balance		<u>\$ 29,982,838</u>	

A summary of all fund balances reserved for tax appeal contingency, as of June 30, 2006, follows:

General Fund	\$ 29,982,838
Major Street Fund	1,488,111
Local Street Fund	<u>409,504</u>
Total	<u>\$ 31,880,453</u>

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

In November 2006, the City and Dow Chemical Company reached a settlement on a property tax appeal involving both real and personal property that will provide a refund to Dow Chemical Company of approximately \$9.8 million and a 19 percent reduction of the petitioned taxable values for the tax years under dispute, 1997 through 2006, including July 2006 taxes. With respect to activity up through fiscal year June 30, 2006 (tax year 2005), the City had reserved approximately \$8.2 million in the General Fund and \$650,000 in Special Revenue Funds for this appeal. The actual payout from the General Fund and Special Revenue Funds is approximately \$8 million and \$650,000, respectively. Any remaining reserves in the General Fund will be available for future tax refunds. The balance of the settlement refund, approximately \$1.7 million, was adequately funded by July 2006 additions to the General Fund and special revenue tax appeal reserves for Dow.

Tax appeal proceedings for MCV remain ongoing. However, it is anticipated that prior to July 1, 2007, the City will be issuing a refund of approximately \$11.1 million to MCV for the tax years 1997 through 2000, based upon a decision made by the MTT. The City has been reserving funds for potential settlement of this appeal based upon this MTT decision. The second appeal for years 2001-2005 has not yet gone to trial. As such, no tax refunds relating to those years are anticipated to be made during the next fiscal year.

As a result of these events in the Dow and MCV tax appeals, the reserves are reported on the government-wide financial statements, as of June 30, 2006, as follows:

	Noncurrent Liabilities		
	Due Within One Year	Due Beyond One Year	Total
MCV	\$11,124,089	\$11,924,516	\$23,048,605
Dow *	8,612,565	-	8,612,565
Total	<u>\$ 19,736,654</u>	<u>\$ 11,924,516</u>	<u>\$ 31,661,170</u>

\* \$219,283 in excess reserves become available for future tax refunds.