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December 08, 2008

Honorable Mayor and City Councilmen:

State law requires that every general-purpose local government publish, within six months of the close of each fiscal year, a complete set of financial statements presented in conformity with generally accepted accounting principles (GAAP) and audited in accordance with generally accepted auditing standards (GAAS) by a firm of licensed certified public accountants. This report is to fulfill the City of Midland's requirement for the fiscal year ended June 30, 2008.

This report consists of management's representations concerning the finances of the City of Midland. Therefore, management assumes full responsibility for the completeness and reliability of the information contained in this report. To provide a reasonable basis for making these representations, City management has established a comprehensive internal control framework that is designed both to protect the government's assets from loss, theft, or misuse and to compile sufficient reliable information for the preparation of the City's financial statements in conformity with GAAP. Because the cost of internal controls should not outweigh their benefits, the City of Midland's comprehensive framework of internal controls has been designed to provide reasonable assurance rather than absolute assurance that the financial statements will be free from material misstatement. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material aspects.

Plante & Moran, PLLC, certified public accountants, have issued an unqualified opinion on the City of Midland's financial statements for the year ended June 30, 2008. The independent auditor's report is located at the front of the financial sections of this report.

The independent audit of the financial statements of the City was part of a broader, federally-mandated "Single Audit" in conformity with the provisions of the Single Audit Act Amendments of 1996 and U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the audited government's internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal awards. These reports are available in the separately issued City's Single Audit Report.

GAAP require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of the Management, Discussion, and Analysis letter (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The City of Midland's MD&A can be found immediately following the independent auditor's report.

PROFILE OF THE CITY

The City of Midland was incorporated in 1887. Located near the center of the eastern portion of Michigan's Lower Peninsula, approximately 120 miles northwest of Detroit, the City currently occupies a land area of 35.7 square miles and, according to the 2000 Census, serves a population of 41,685. The City is empowered to levy a property tax on both real and personal properties located within its boundaries. It is also empowered to extend its corporate limits by annexation, which occurs periodically in accordance with state statute and the terms of urban cooperation agreements between the City and its surrounding townships.

The City Charter calls for a council-manager form of government. The governing body consists of five council members who are elected on a non-partisan basis, one from each of the City's five wards who in turn choose one of their number to serve as mayor. The City Manager and City Attorney are appointed independently by the City Council. The City Manager is responsible for carrying out the policies and ordinances of the City Council, for overseeing the day-to-day operations of the City and for appointing heads of the various departments and all other City employees. The City Attorney oversees all legal matters of the City, including review of contracts and legal documents. An organization chart is included to better illustrate the City's governmental structure.

The City provides a full range of services including police and fire protection, community planning and zoning, building inspections, code enforcement, library, sanitation, water and wastewater treatment, construction and maintenance of highways, streets and infrastructure, recreation programs, parks, public transportation and senior housing facilities.

BUDGET CONTROLS

The annual budget serves as the foundation for the City's financial planning and control. In April of each year, the City Manager presents a proposed budget to the City Council for review. The Council holds public hearings and a final budget must be prepared and adopted no later than the fourth Monday in May. The Council approves appropriations on the functional basis, which is the legal level of control.

Expenditures in excess of departmental appropriations are a violation of state law. Amounts not spent by the end of the fiscal year lapse, and require City Council approval to re-appropriate into the next year.

CASH MANAGEMENT POLICIES AND PRACTICES

The City's investments are managed by the City Treasurer, as authorized by the City's formal investment policy and Michigan Public Act 20 of 1943, as amended. The City's Police and Fire Pension Trust Fund investments are managed by the Police and Fire Pension Board.

RISK MANAGEMENT

The City participates in a public entity risk pool with other Michigan units of government, the Michigan Municipal League Liability and Property Pool for its general liability and property coverage. For employee injury claims, the City also participates in a public entity risk pool with other Michigan units of government, the Michigan Municipal Workers Compensation Pool.

PENSION AND OTHER POST-EMPLOYMENT BENEFITS

The City sponsors a single-employer, defined-benefit pension plan for its police and fire employees. Each year the City fully funds the annual required contribution to the pension plan as determined by an independent actuary. The most recent actuarial valuation, as of December 31, 2007, reports this plan to be 92.8% funded. The remaining unfunded amount is being systematically amortized over 18 years as part of the annual required contribution calculation by the actuary.

The City also provides pension benefits that cover substantially all employees hired by June 30, 2005, other than police and fire employees. These benefits are provided through a state-wide plan managed by the Municipal Employees' Retirement System of Michigan (MERS). Except for contributions from unclassified employees, who contribute 5% of their wages annually, the City fully funds each year's annual required contribution to the pension plan as determined by an independent actuary. The most recent actuarial valuation, as of December 31, 2007, reports this plan to be 74% funded. For employees hired on or after June 30, 2005 (except police and fire employees), the City contributes 5% of each participant's gross earnings to a defined contribution plan also managed by MERS. In addition, for employees hired after June 30, 2005 (except police and fire employees) the City participates in a deferred compensation plan administered by International City/County Management Association (ICMA) and will match 100% of a participant's contribution, up to a maximum of 7% of the participant's gross earnings.

The City provides post-employment health care benefits for police and fire employees, and other employees (and their dependents) that are hired by June 30, 2005. As of the end of the current fiscal year, there were 341 retired employees or beneficiaries receiving these benefits, which are financed on both a "pay-as-you-go" and "prefunding" basis. GAAP do not yet require the City to report a liability in the financial statements in connection with an employer's obligation to provide these benefits. In addition, for substantially all employees hired after June 30, 2005, except police and fire employees,

the City contributes an amount equal to 2% of the participant's wages into a Health Savings Account administered by MERS.

Additional information on the City's pension arrangements and post-employment benefits can be found in Notes 11 and 12 in the notes to the financial statements.

ECONOMIC CONDITION AND OUTLOOK

The economic environment of the City has traditionally remained steady, despite the many financial challenges that the State of Michigan and neighboring communities face. The City is recognized as a community that offers its residents many economic, cultural, recreational, and educational benefits. While these favorable attributes remain true today, the City is feeling the continued effects of the sustained economic slump of the State.

Over the past few years, the City has experienced declines in its population size, the number of building permits issued, the number of homes sold, and the number of single family residential dwelling permits. While the City continues to have a strong commercial and industrial sector which serves to partially mitigate other negative economic indicators, recent large tax appeal settlements have reduced the taxable value of this sector from \$1.54 billion for 2008 to \$1.12 billion for 2009. This reduction of \$419 million is a 27% reduction. In addition, due to the depressed housing market, residential taxable values will decline by 1.5%. In total, City taxable values will decline by 17% for 2009.

The City's tax base is approximately 46% residential and 54% commercial, industrial and utility as compared to 39% and 61% in 2007. The three largest industrial/utility taxpayers, The Dow Chemical Company, Dow Corning Corporation, and Midland Cogeneration Venture (MCV) make up nearly 35% of the City's total taxable value, as compared to 45% for 2007. Other significant contributors to the City's tax base or employment include small-to-medium sized manufacturing companies, retail and service establishments, a regional health care facility, state and local educational institutions, financial institutions, and local government. The City's June 2008 unemployment rate of 5.1% compares favorably to the state's average rate of 8.7%, as well as with the national average of 5.7%.

The City's largest revenue source is property taxes. From 1999 through 2007 the City's taxable value increased at an average rate of 2%. Recent unfavorable settlements to tax appeals with MCV, the City's then largest taxpayer, resulted in the 17% reduction to the City's 2008 taxable value, as previously noted. Note 17 of the Notes to Financial Statements provides more historical and current information on the City's tax appeals. Because property taxes account for 77% of General Fund revenue, the City will engage its staff, City residents, and business officials to re-assess the level of City services provided, and achieve an acceptable mix of services provided versus taxes levied.

The City Charter allows a property tax rate of up to 18 mills, which is then reduced by the Headlee Amendment to 17.87 mills. During the 2007-08 fiscal year, the City levied only 11.00 of its authorized mills, plus one mill authorized for libraries. Under applicable state statutes, the City is also authorized to levy up to three additional mills for solid waste management.

It is the City's practice to plan capital projects on a multi-year basis, in accordance with the City's Master Plan. Typically this allows the City to look ahead and budget for the financing of these projects through existing sources of revenue, including contributions from the community and area foundations. No capital projects are currently planned during the next few years that will cause the City to deviate from this practice and consider outside financing.

SIGNIFICANT INITIATIVES, EVENTS, AND ACCOMPLISHMENTS

In May of 2008, City Council adopted the 2008-2009 annual budget, which featured a dramatically new appearance. To help Midland residents understand not only how municipal resources are allocated but also the effectiveness of functional work areas, this budget incorporates basic performance and efficiency measurements listed on a department by department basis. This format also provides a functional organizational chart, service statement, comparative **spending** data and comparative data on staffing levels. In this new budget format Midland citizens now have an excellent resource in understanding where and how effectively public dollars are spent.

Midland has a long history of proactively identifying both opportunities to enhance and paths to avoid deterioration of the quality of life enjoyed by our residents. A key component in that effort is a practical and effective comprehensive plan for community growth and sustainability. In October of 2007 the City Council adopted *Changes and Choices*, the first comprehensive plan update since 1997. The Planning Commission took great care to solicit community input through a very successful "meetings in a box" program. That input served as a solid foundation for the numerous public policy recommendations included in the plan.

In April 2008 the Michigan Tax Tribunal ratified an agreement between City and MCV, which brought closure to the second of two lengthy tax appeals between the parties, stemming back to 1997. While settling this matter put years of acrimony between the City and MCV behind the parties, the City faces a 17% reduction in its taxable value as well as repaying \$18 million in judgment bonds issued in July 2008 to fully retire the City's refund liability. Future financial pressures will be significant but because of the settlements they are significantly more predictable. The City undertook an organization-wide effort to reduce costs in the face of declining revenues. Through the hard work and dedication of our employees approximately \$1.4 million worth of expenses were trimmed from the 2008-09 General Fund Budget, approved by City Council on May 19, 2008.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association (GFOA) of the United States and Canada awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Midland for its comprehensive annual financial report for the fiscal year ended June 30, 2007. This was the 19th consecutive year that the City has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report, which satisfies both GAAP and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

ACKNOWLEDGEMENTS

The preparation of this report was made possible by the dedicated service of the entire staff of the Finance Department. Each member of the Department has our sincere appreciation for the contributions made in the preparation of this report.

In closing, the preparation of this document and the accomplishments reported therein would not have been possible without the leadership and support of the Midland City Council.

Respectfully submitted,



Jon J. Lynch
City Manager



David A. Keenan
Director of Fiscal Services