

**HOUGHTON COUNTY ROAD COMMISSION
HOUGHTON COUNTY, MICHIGAN**

**REPORT ON COMPONENT UNIT FINANCIAL STATEMENTS
(with required supplementary and additional information)**

September 30, 2011

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INDEPENDENT AUDITOR'S REPORT

Board of County Road Commissioners
Houghton County Road Commission
Hancock, Michigan

We have audited the accompanying financial statements of the governmental activities of the Houghton County Road Commission as of and for the year then ended September 30, 2011, which collectively comprise the Road Commission's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Road Commission's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities of the Houghton County Road Commission as of September 30, 2011, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 28, 2012 on our consideration of the Houghton County Road Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, budgetary comparison, Non-union MERS Pension Schedule of Funding Progress, and Post-Retirement Benefits Other than Pension Schedule of Funding Progress information on pages 5 through 9 and 25 through 27 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Houghton County Road Commission's financial statements as a whole. The additional information on page 29 is presented for purposes of additional analysis and is not a required part of the basic financial statements. The additional information on page 29 is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

**Rukkila, Negro & Associates,
Certified Public Accountants, PC**

March 28, 2012

**HOUGHTON COUNTY ROAD COMMISSION
MANAGEMENT'S DISCUSSION AND ANALYSIS
SEPTEMBER 30, 2011**

Our discussion and analysis of Houghton County Road Commission's (Road Commission's) financial performance provides an overview of the Road Commission's financial activities for the fiscal year ended September 30, 2011. The analysis focuses on the Road Commission's financial performance as a whole. It is intended to be read as part of the Road Commission's financial statements, which immediately follow this section.

The Houghton County Road Commission is one of the most unique county road commissions in the State of Michigan due to their yearly budget being so dependent upon the severity of the winter season.

The Houghton County Road Commission routinely spends between 30% and 50% or more of their Michigan Transportation income on snow removal costs each year, the highest in the State of Michigan.

The highest cost of snow removal is due to five month long winters with up to 350 inches of snow and the extremely high cost of operating and maintaining a 10 million dollar fleet of specialized equipment needed to operate on, not only the open county roads, but in the narrow 25 or 30 foot right-of-ways in the old mining era residential locations.

In addition to the operating costs associated with sophisticated snow removal equipment, the Houghton County Road Commission must annually place and clean up some 15,000 tons of abrasives and salt on their 844 mile county road system.

The winter maintenance activity typically may last up to six months or more, and is the top priority item in the development of an operating budget each year, with contract federal aid construction, routine maintenance and road commission financed construction following in order of priority.

Overview of The Financial Statements

This annual report consists of four parts: 1) management's discussion and analysis (this section), 2) the basic financial statements, 3) required supplementary information, and 4) an additional section that presents the fund broken down between primary, local and county funds. The basic financial statements include two kinds of statements that present different views of the Road Commission:

- ▶ The government-wide financial statements provide both long-term and short-term information about the Road Commission's overall financial status. These statements report information about the Road Commission as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes all of the government's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid. The government-wide statements report the Road Commission's net assets (the difference between the assets and liabilities) and the changes to those net assets-- this is one way to ensure the Road Commission's financial health or position.
- ▶ The remaining statements are fund financial statements that focus on individual funds; reporting the operations in more detail than the government-wide statements.

Statement of Net Assets and the Statement of Activities

The statement of net assets and the statement of activities report information about the Road Commission, as a whole, and about its activities in a way that helps answer the question of whether the Road Commission, as a whole, is better off or worse off as a result of the year's activities. The statement of net assets includes all of the Road Commission's assets and liabilities using the accrual basis of accounting, which is similar to the accounting method used by most private-sector companies. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

**HOUGHTON COUNTY ROAD COMMISSION
MANAGEMENT'S DISCUSSION AND ANALYSIS
SEPTEMBER 30, 2011**

Overview of The Financial Statements (Continued)

The two statements, mentioned above, report the Road Commission's net assets and how they have changed. The reader can think of the Road Commission's net assets (the difference between assets and liabilities) as one way to measure the Road Commission's financial health or financial position. Over time, increases or decreases in the Road Commission's net assets are one indicator of whether its financial health is improving or deteriorating, respectively. To assess the overall health of the Road Commission, additional nonfinancial factors such as changes in the county's property tax base, the conditions of the Road Commission's roads, and changes in the law related to the gas taxes and the distribution of them need to be considered.

Fund Financial Statements

All of the Road Commission's activities are accounted for in the general operations fund, a governmental fund type.

Governmental Funds focus on how money flows into and out of this fund and the balances left at year end that are available for spending. This fund is reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the Road Commission's general operations and the basic service it provides. Governmental fund information helps the reader to determine whether there are more or fewer financial resources that can be spent in the near future to finance the Road Commission's services. We describe the relationship (or differences) between governmental activities (reported in the statement of net assets and the statement of activities) and the governmental fund in a reconciliation following the fund financial statements.

Summary of Net Assets

The Road Commission's net assets increased approximately 4.90%, or \$878,046, from \$18,017,058 to \$18,895,104 for the year ended September 30, 2011. The net assets and change in net assets are summarized on the following page.

Net Assets

Restricted net assets are those net assets that have constraints placed on them by either: a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or b) imposed by law through constitutional provisions or enabling legislation. Enabling legislation authorized the government to assess, levy, and charge or otherwise mandate payment of resources and include a legally enforceable requirement that those resources be used only for the specific purpose stipulated in the legislation; as such, all assets (except for assets invested in capital assets, net of related debt) are considered restricted.

GASB No.(54) required a reclassification of net assets which split the prior year's net assets into restricted or unrestricted. The total restricted and unrestricted net assets increased by \$254,263 during 2011. The increase in restricted and unrestricted net assets occurred mainly from the increase in contributions from local units.

The investment in capital assets, net of related debt increased by \$623,208. This change was due to the increase of infrastructure of \$1,479,199 and buildings of \$37,221, decreases in road, office, and shop equipment of \$44,266, and depreciation expense of \$1,263,777.

**HOUGHTON COUNTY ROAD COMMISSION
MANAGEMENT'S DISCUSSION AND ANALYSIS
SEPTEMBER 30, 2011**

Summary of Net Assets (Continued)

| | 2011 | 2010 |
|---|----------------------|----------------------|
| Current and other assets | \$ 3,041,692 | \$ 2,910,712 |
| Capital assets, net | 16,531,801 | 15,908,593 |
| Total Assets | \$ 19,573,493 | \$ 18,819,305 |
| Current liabilities | \$ 67,994 | \$ 190,375 |
| Non-current liabilities | 610,395 | 611,297 |
| Total Liabilities | 678,389 | 801,672 |
| Net Assets: | | |
| Invested in capital assets, net of related debt | 16,531,801 | 15,908,593 |
| Restricted - nonspendable | 758,978 | - |
| Unrestricted | 1,604,325 | 2,109,040 |
| Total Net Assets | 18,895,104 | 18,017,633 |
| Total Liabilities and Net Assets | \$19,573,493 | \$18,819,305 |

Results of Operations

| | 2011 | 2010 |
|--|----------------------|----------------------|
| Program revenue: | | |
| Federal sources | \$ 812,727 | \$ 845,229 |
| State sources | 4,120,425 | 4,116,866 |
| Contributions from local units | 624,310 | 228,246 |
| Reimbursements | - | - |
| Charges for services | 12,483 | 27,667 |
| General revenue: | | |
| Taxes | 689,023 | 678,088 |
| Other | 88,777 | 47,532 |
| Total Revenues | 6,347,745 | 5,943,628 |
| Expenses: | | |
| Public works | 5,469,699 | 5,266,963 |
| Increase (decrease) in net assets | 878,046 | 676,665 |
| Net assets, Beginning | 18,017,058 | 17,340,393 |
| Net assets, Ending | \$ 18,895,104 | \$ 18,017,058 |

Road Commission Fund

The Road Commission is used to control the expenditures of Michigan Transportation Fund monies distributed to the county which are earmarked by law for road and highway purposes.

Total operating revenues were \$6,347,745, an increase of \$404,117 as compared to last year due mainly to a large increase in local unit activities contributions.

Total expenditures were \$5,469,699, an increase of \$202,736 as compared to last year, with higher primary and local road maintenance and net expenses increase for equipment and capital outlay.

**HOUGHTON COUNTY ROAD COMMISSION
MANAGEMENT'S DISCUSSION AND ANALYSIS
SEPTEMBER 30, 2011**

Significant Transactions and Changes

A summary of changes in the fund is as follows:

| | 2011 | 2010 | Favorable (Unfavorable) Variance | % Variance |
|-------------------------------------|---------------------|---------------------|--|----------------|
| Revenues | | | | |
| Taxes | \$ 689,023 | \$ 678,088 | \$ 10,935 | 1.61% |
| Federal grants | 812,727 | 845,229 | (32,502) | -3.85% |
| State grants | 4,120,425 | 4,116,866 | 3,559 | 0.09% |
| Contributions from local units | 624,310 | 228,246 | 396,064 | 173.53% |
| Charges for services | 12,483 | 27,667 | (15,184) | -54.88% |
| Other revenue | 88,777 | 47,532 | 41,245 | 86.77% |
| Total Revenues | <u>6,347,745</u> | <u>5,943,628</u> | <u>404,117</u> | <u>203.27%</u> |
| Expenditures - Public works | <u>6,093,809</u> | <u>5,505,162</u> | <u>(588,647)</u> | <u>-10.69%</u> |
| Excess of Revenue over expenditures | <u>253,936</u> | <u>438,466</u> | <u>992,764</u> | |
| Fund Balance - Beginning | 1,815,048 | 2,136,135 | (1,581,411) | -74.03% |
| Fund Balance - Ending | <u>\$ 2,068,984</u> | <u>\$ 2,574,601</u> | <u>\$ (588,647)</u> | <u>-22.86%</u> |

Budgetary Highlights

Prior to the beginning of any year, the Road Commission's budget is compiled based upon certain assumptions and facts available at that time. During the year, the Road Commission board acts to amend its budget to reflect changes in these original assumptions, facts and/or economic conditions that were unknown at the time the original budget were compiled. In addition, by policy, the board reviews and authorizes large expenditures when requested throughout the year.

The final amended revenue budget was \$190,000 lower than the original budget. The actual revenue recognized during 2011 was more than the final amended budget by \$140,745.

The final amended revenue budget was less than the original budget mainly due to a decrease in federal funds by \$313,000, and an increase in Michigan Transportation Program revenue by \$85,000. The actual revenues recognized during the current year were more than the final amended budget mainly due to an increase in Michigan Transportation funds of \$89,567.

The final amended expenditure budget was \$375,000 higher than the original budget mainly due to the increase in maintenance by \$200,000, an increase in heavy maintenance by \$250,000, a decrease in equipment expense by \$150,000, and a increase in capital outlay by \$100,000. The actual total expenditures recognized during the year were less than the final amended budget by \$891,191. Actual expenditures were less due to a decrease in preservation of heavy maintenance by \$220,802, an increase in maintenance by \$731,608, a decrease in equipment expense by \$1,563,520, and an increase in administration expense of \$129,808.

**HOUGHTON COUNTY ROAD COMMISSION
MANAGEMENT'S DISCUSSION AND ANALYSIS
SEPTEMBER 30, 2011**

Capital Asset and Debt Administration

Capital Assets

As of September 30, 2011, the Road Commission had invested \$16,531,801 in capital assets. This amount represents a net increase (including additions and deductions) of \$623,208 or 4% over the prior year investment amount.

The Road Commission reported a significant increase in infrastructure during the current year in the amount of \$1,479,199. The infrastructure was financed through federal, state and local contributions.

During fiscal year 2011 the Road Commission had significant purchases of \$359,109 in new road equipment. There were significant disposals of \$385,610 in road equipment also.

Additional information on the Road Commission's capital assets can be found at Note D of this report.

Debt

Other obligations include accrued vacation pay and sick leave. More detailed information about the Road Commission's long-term liabilities is presented in Note I to the financial statements.

Economic Factors and Next Year's Budget

The Board considers many factors when setting the fiscal year budget. One of the factors is economy. The Road Commission derives approximately 55% of its revenues from the fuel tax collected. Using Michigan Department of Transportation projections, it is estimated the Road Commission will receive a decrease in Michigan Transportation Fund revenues of roughly \$100,000 in 2012. Fuel tax projected collections are provided by the State of Michigan.

Property taxes are very stable with slight increases due to new construction in the county.

The most difficult revenue to project are federal and state economic development monies which in many cases can be awarded by grant application during the year, and also can be very difficult to time revenues and expenditures because of outside contractor scheduling and performance work. These projects usually overlap in at least two fiscal years.

The Road Commission is participating in the federal ARRA program that will advance several construction projects for an estimate amount of \$460,000.

Contacting the Commission's Financial Management

This financial report is designed to provide the motoring public, citizens and other interested parties a general overview of the Road Commission's finances and to show the Road Commission's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Houghton County Road Commission's administrative offices at P.O. Box 269, Hancock, Michigan, 49930.

HOUGHTON COUNTY ROAD COMMISSION
STATEMENT OF NET ASSETS
September 30, 2011

| | 2011 |
|--|----------------------|
| ASSETS: | |
| CURRENT ASSETS: | |
| Cash | \$ 1,522,073 |
| Account receivables: | |
| Sundry accounts | 19,172 |
| Michigan transportation fund | 596,178 |
| Due on county road agreements | 145,291 |
| Inventories: | |
| Road materials | 309,730 |
| Equipment, parts and materials | 408,076 |
| Prepaid expense | 41,172 |
| TOTAL CURRENT ASSETS | 3,041,692 |
| NONCURRENT ASSETS: | |
| Capital assets - net of accumulated depreciation | 16,531,801 |
| TOTAL NONCURRENT ASSETS | 16,531,801 |
| TOTAL ASSETS | \$ 19,573,493 |
| LIABILITIES: | |
| CURRENT LIABILITIES: | |
| Accounts payable | \$ 8,056 |
| Accrued liabilities | 59,938 |
| TOTAL CURRENT LIABILITIES | 67,994 |
| NONCURRENT LIABILITIES: | |
| Advances from state | 145,736 |
| Compensated absences | 351,402 |
| Other post-employment benefits | 113,257 |
| TOTAL NONCURRENT LIABILITIES | 610,395 |
| TOTAL LIABILITIES | 678,389 |
| NET ASSETS: | |
| Invested in capital assets net of related debt | 16,531,801 |
| Restricted | 758,978 |
| Unrestricted | 1,604,325 |
| TOTAL NET ASSETS | 18,895,104 |
| TOTAL LIABILITIES AND NET ASSETS | \$ 19,573,493 |

The accompanying notes to financial statements are an integral part of this statement.

HOUGHTON COUNTY ROAD COMMISSION
STATEMENT OF ACTIVITIES
For the Year Ended September 30, 2011

| | 2011 |
|---|----------------------|
| REVENUES: | |
| Property taxes | \$ 689,023 |
| Licenses and permits | 12,101 |
| Federal sources | 812,727 |
| State sources | 4,120,425 |
| Contributions from local units | 624,310 |
| Charges for services | 12,483 |
| Interest and rents | 16,691 |
| Other revenues | 59,985 |
| TOTAL REVENUES | 6,347,745 |
| EXPENDITURES: | |
| Primary road routine and preventive maintenance | 3,420,211 |
| Local road routine and preventive maintenance | 2,990,596 |
| Equipment expense - Net | (753,520) |
| Administrative expense - Net | 404,808 |
| Capital outlay - Net | (1,855,271) |
| Compensated absences | (516) |
| Other post-employment benefits | 1,418 |
| Depreciation | 1,263,777 |
| TOTAL EXPENDITURES | 5,469,699 |
| CHANGE IN NET ASSETS | 878,046 |
| NET ASSETS - BEGINNING | 18,017,058 |
| NET ASSETS - ENDING | \$ 18,895,104 |

The accompanying notes to financial statements are an integral part of this statement.

HOUGHTON COUNTY ROAD COMMISSION

BALANCE SHEET

September 30, 2011

| | <u>2011</u> |
|---|-----------------------------|
| CURRENT ASSETS: | |
| Cash and cash equivalents | \$ 1,522,073 |
| Account receivables: | |
| Sundry accounts | 19,172 |
| Michigan transportation fund | 596,178 |
| Due on county road agreements | 145,291 |
| Inventories: | |
| Road materials | 309,730 |
| Equipment, parts and materials | 408,076 |
| Prepaid expense | 41,172 |
| TOTAL ASSETS | <u>\$ 3,041,692</u> |
| LIABILITIES: | |
| CURRENT LIABILITIES: | |
| Accounts payable | \$ 8,056 |
| Accrued liabilities | 59,938 |
| TOTAL CURRENT LIABILITIES | <u>67,994</u> |
| NONCURRENT LIABILITIES: | |
| Advances from state | 145,736 |
| TOTAL LIABILITIES | <u>213,730</u> |
| FUND BALANCE: | |
| Nonspendable: | |
| Inventory | 717,806 |
| Prepaid expense | 41,172 |
| Unrestricted | 2,068,984 |
| TOTAL FUND BALANCE | <u>2,827,962</u> |
| Amounts reported for governmental activities in the statement of net assets are different because: | |
| Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. | 16,531,801 |
| Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds. Long-term liabilities consist of: | |
| Compensated absences | (466,077) |
| Other post-employment benefits (OPEB) | (1,418) |
| In the statement of activities, only the gain on the sale of equipment is reported, whereas in the governmental funds, the proceeds from the sale increase financial resources. Thus, the change in net assets differs from the change in fund balance by the cost of equipment sold. | 3,009 |
| Net assets of governmental activities | <u>\$ 18,898,113</u> |

The accompanying notes to financial statements are an integral part of this statement.

HOUGHTON COUNTY ROAD COMMISSION
STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN NET ASSETS
For the Year Ended September 30, 2011

| | 2011 |
|---|----------------|
| REVENUES: | |
| Property taxes | \$ 689,023 |
| Licenses and permits | 12,101 |
| Federal sources | 812,727 |
| State sources | 4,120,425 |
| Contributions from local units | 624,310 |
| Charges for services | 12,483 |
| Interest and rents | 16,691 |
| Other revenues | 59,985 |
| TOTAL REVENUES | 6,347,745 |
| EXPENDITURES: | |
| Public works | 6,093,809 |
| NET CHANGE IN FUND BALANCE | 253,936 |
| Amounts reported for governmental activities in the statement of activities are different because: | |
| Governmental funds do not record depreciation and report capital outlays as expenditures. | |
| Depreciation expense - building & equipment | (378,047) |
| Depreciation expense - infrastructure | (885,730) |
| Capital outlays - building & equipment | 407,786 |
| Capital outlays - infrastructure (local) | 1,479,199 |
| Some expenses reported in the statement of activities, such as compensated absences, do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. | 516 |
| Some expenses reported in the statement of activities, such as other post-employment benefits (OPEB), do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. | (1,418) |
| Change in net assets of governmental activities | \$ 878,046 |

The accompanying notes to financial statements are an integral part of this statement.

HOUGHTON COUNTY ROAD COMMISSION
NOTES TO FINANCIAL STATEMENTS
September 30, 2011

The accounting policies of Houghton County Road Commission 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 Houghton County Road Commission.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REPORTING ENTITY

The Houghton County Road Commission (Road Commission), a component unit of the County of Houghton, Michigan was established pursuant to the County Road Law (MCL 224.1), and is governed by a three member Board of County Road Commissioners appointed by the County Board of Commissioners. The Road Commission may not issue debt without the County's approval and property tax levies are subject to County Board of Commissioners' approval.

The criteria established by the Governmental Accounting Standards Board (GASB) Statement No. 14, The Financial Reporting Entity, for determining the reporting entity includes oversight responsibility, fiscal dependency and whether the financial statements would be misleading if the component unit data were not included. Based on the above criteria, these financial statements present the Road Commission, a discretely presented component unit of Houghton County.

The Road Commission Operating Fund is used to control the expenditures of Michigan Transportation Fund monies distributed to the County, which are earmarked by law for street and highway purposes. The Board of County Road Commissioners is responsible for the administration of the Road Commission operating fund.

GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

The government-wide financial statements (reporting the Houghton County Road Commission as a whole) report all of the activities of the Road Commission. There is only one fund reported in the government-wide financial statements.

The Statement of Net Assets presents the Road Commission's assets and liabilities with the difference being reported as either invested in capital assets, net of related debt, or restricted net assets.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment is 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. Revenues which are not classified as program revenues are presented as general revenues.

Governmental Funds - Separate financial statements are provided for the Operating Fund (governmental fund). The Operating Fund is an independent fiscal and accounting entity with self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions.

MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND BASIS OF PRESENTATION

Basis of accounting refers to the point at which revenues or expenditures/expenses are recognized in the accounts and reported in the financial statements. It relates to the timing of the measurements made regardless of the measurement focus applied.

HOUGHTON COUNTY ROAD COMMISSION
NOTES TO FINANCIAL STATEMENTS
September 30, 2011

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Full Accrual - The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. 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.

Modified Accrual Method - 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 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, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Michigan transportation funds, grants, permits, township contributions and interest associated with the current fiscal period are all considered to be susceptible to accrual and have been recognized as revenue of the current fiscal period. All other revenue items are considered to be available only when cash is received by the government.

Other Accounting Policies

Cash, Cash Equivalents and Investments - Cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

Property Taxes Receivable - The property tax is levied on each December 1st on the taxable valuation of property located in the county as of the preceding December 31st. The 2010 taxable valuation of the Road Commission amounted to \$734,032,911 less \$277,361 for cities and villages, on which ad valorem taxes of 1.3149 mills were levied for the Road Commission for road construction purposes for a total of \$689,023.

In the government-wide financial statements, the property taxes receivable is recorded as revenue when the tax is levied in the current year.

Although Houghton County's 2010 ad valorem tax is levied and collectible on December 1, 2010, it is the Road Commission's policy to recognize revenues from the current tax levy in the governmental fund financial statements in the current year, when the proceeds of this levy are budgeted and made available for the financing of the Road Commission's operations.

Inventories - Inventories are priced at cost as determined on the average unit cost method. Inventory items, which consist of expendable supplies, are recorded as an asset when purchased and charged to road construction and maintenance, equipment repairs and operations when used.

Prepaid Expenses - Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid expense in both the government-wide and fund financial statements.

Capital Assets - Capital assets, which include land, buildings, equipment, infrastructure assets (e.g., roads, bridges and similar items), are reported on the statement of net assets in the government-wide financial statements. Capital assets are defined by the Road Commission as assets with an initial individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost of purchase or construction. Donated capital assets are recorded at estimated fair market value at the date of donation.

HOUGHTON COUNTY ROAD COMMISSION
NOTES TO FINANCIAL STATEMENTS
September 30, 2011

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

GASB 34 requires major networks and major subsystems of infrastructure assets acquired, donated, constructed, or substantially rehabilitated since fiscal years ending after June 30, 1980 be inventoried and capitalized by the fourth anniversary of the mandated date of adoption of the other provisions of GASB 34, and be reported as infrastructure in the statement of net assets.

Depreciation - Depreciation is computed on the sum-of-the-years'-digits method for road equipment and straight line method for all other assets. The depreciation rates are designed to amortize the cost of the assets over their estimated useful lives as follows:

| | |
|--------------------------|-------------|
| Building | 30-50 years |
| Road equipment | 5-8 years |
| Shop equipment | 10 years |
| Engineering department | 4-10 years |
| Office equipment | 4-10 years |
| Infrastructure - Roads | 8-30 years |
| Infrastructure - Bridges | 12-50 years |

Long-Term Obligations - In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the statement of net assets.

Estimates - The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and affect the disclosure of contingent assets and liabilities at the date of financial statements. These estimates and assumptions also affect the reported amounts of revenue and expenditures during the reporting period. Actual results could differ from those estimates.

Fund Balance - The Road Commission adopted the provisions of GASB Statement Number 54 (GASB 54), *Fund Balance Reporting and Governmental Fund Type Definitions*, in the current year. GASB 54 establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. Detailed information on fund balances of governmental funds is presented on the face of the balance sheet.

Governmental funds report *nonspendable fund balance* for amounts that cannot be spent because they are either a.) Not in spendable form, or b.) Legally or contractually required to be maintained intact. *Restricted fund balance* is reported when externally imposed constraints are placed on the use of the resources by grantors, contributors, laws or regulations of other governments. *Committed fund balance*, if any, is reported from amounts that can be used for specific purposes pursuant to constraints imposed by formal action by the government's highest level of decision making authority, the Board. A formal resolution of the Board is required to establish, modify or rescind a fund balance commitment. The Road Commission reports *assigned fund balance* for amounts that are constrained by the government's intent to be used for specific purposes, but are neither restricted nor committed. *Unassigned fund balance* is the residual classification for the general fund.

When the Road Commission incurs an expenditure for purposes for which various fund balance classifications can be used, it is the Road Commission's policy to use restricted fund balance first, then committed fund balance, assigned fund balance, and finally unassigned balance.

Reclassification - Certain items in the prior year financial statements have been reclassified to conform with the current year presentation.

**HOUGHTON COUNTY ROAD COMMISSION
NOTES TO FINANCIAL STATEMENTS
September 30, 2011**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Compensated Absences - It is the Road Commission’s policy to permit employees to accumulate earned but unused sick and vacation pay benefits. All sick and vacation pay is accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in governmental funds.

NOTE B – STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgetary procedures are established pursuant to PA 621 of 1978, as amended, (MCL 141.421) which requires the county board of commissioners to approve a budget for the County Road Fund. Pursuant to the Act, the Road Commission’s chief financial officer prepares and submits a proposed operating budget to the board of road commissioners for its review and consideration. The Road Commission does not conduct a public budget hearing, the budget is submitted to the county and included in its public hearing. The budget is approved by the board and amended as necessary during the year. The budget is prepared on the modified accrual basis of accounting, which is the same basis as the financial statements.

NOTE C – CASH DEPOSITS AND INVESTMENTS

The cash and investments are classified in the following categories:

| | |
|---|---------------------|
| Cash - Bank Deposits | \$ 40,748 |
| Cash - Held with County Treasurer - Bank Deposits | <u>1,481,325</u> |
| | <u>\$ 1,522,073</u> |

Michigan Compiled Laws, Section 129.91, authorizes the Road Commission to deposit and invest in the accounts of federally insured banks, credit unions, and savings and loan associations; bonds, securities and other direct obligations of the United States, or any agency or instrumentality of the United States, United States governmental or federal agency obligation repurchase agreements; banker’s acceptance of United States banks; commercial paper rated within the two highest classifications, which mature not more than 270 days after the date purchase; obligations of the State of Michigan or its political subdivision which are treated as investment grade; and mutual funds composed of investment vehicles which are legal for direct investment by local units of government in Michigan. Financial institutions eligible for deposit of public funds must maintain an office in Michigan.

The Road Commission has adopted the County’s investment policy, which is in accordance with the provisions of Public Act 20 of 1943.

Interest Rate Risk - The Road Commission does not have a formal investment policy that limits investment maturities as a means of managing its exposure to Fair Value losses arising from increasing interest rates. *Credit Risk* State law limits investments in commercial paper, corporate bonds, and mutual bond funds to the top two ratings issued by nationally recognized statistical rating organizations. The Road Commission has no investment policy that would further limit its investment choices.

Custodial Investment Credit Risk - Investment custodial credit risk is the risk that in the event of the failure of the counter party, the Road Commission will not be able to recover the value of its investments or securities that are in the possession of an outside party. The Road Commission invests with the County of Houghton and would receive its proportional share of holdings.

Custodial Deposit Credit Risk - Custodial deposit credit risk is the risk that in the event of a bank failure, the Road Commission deposits may not be returned. State law does not require and the Road Commission does not have a policy for deposit custodial credit risk. The carrying amounts of the Road Commission’s bank balance was \$600. The \$1,522,073 other cash balance is pooled with the County of Houghton funds and would receive a proportionate share of insurance.

HOUGHTON COUNTY ROAD COMMISSION
NOTES TO FINANCIAL STATEMENTS
September 30, 2011

NOTE D – CAPITAL ASSETS

Capital asset activity of the Road Commission for the current year was as follows:

| | Balance 9/30/10 | Additions | Disposals | Balance 9/30/11 |
|---------------------------------------|----------------------|---------------------|-------------------|----------------------|
| Capital assets not being depreciated: | | | | |
| Land and improvements | \$ 93,137 | \$ - | \$ - | \$ 93,137 |
| Subtotal | <u>93,137</u> | <u>-</u> | <u>-</u> | <u>93,137</u> |
| Capital assets being depreciated: | | | | |
| Depletable assets | 102,093 | - | - | 102,093 |
| Buildings | 1,474,234 | 37,221 | - | 1,511,455 |
| Road equipment | 7,988,381 | 359,109 | 385,610 | 7,961,880 |
| Shop equipment | 153,225 | - | 12,380 | 140,845 |
| Office equipment | 97,468 | 11,456 | 16,841 | 92,083 |
| Infrastructure - bridges | 2,393,953 | - | - | 2,393,953 |
| Infrastructure - roads | 16,003,335 | 1,479,199 | - | 17,482,534 |
| Subtotal | <u>28,212,689</u> | <u>\$ 1,886,985</u> | <u>\$ 414,831</u> | <u>29,684,843</u> |
| Accumulated depreciation | | | | |
| Depletable assets | 49,241 | \$ 1,208 | \$ - | 50,449 |
| Buildings | 900,130 | 46,214 | - | 946,344 |
| Road equipment | 7,245,475 | 314,696 | 385,610 | 7,174,561 |
| Shop equipment | 139,450 | 9,858 | 12,380 | 136,928 |
| Office equipment | 91,575 | 6,070 | 16,841 | 80,804 |
| Infrastructure - bridges | 218,288 | 47,879 | - | 266,167 |
| Infrastructure - roads | 3,753,074 | 837,852 | - | 4,590,926 |
| Subtotal | <u>12,397,233</u> | <u>\$ 1,263,777</u> | <u>\$ 414,831</u> | <u>13,246,179</u> |
| Net capital assets being depreciated | <u>15,815,456</u> | | | <u>16,438,664</u> |
| Total Net capital assets | <u>\$ 15,908,593</u> | | | <u>\$ 16,531,801</u> |

Depreciation expense was charged to programs of the Road Commission as follows:

| | |
|----------------------------|---------------------|
| Infrastructure: | |
| Primary | \$ 720,083 |
| Local | 165,648 |
| Equipment expense: | |
| Road equipment | 314,696 |
| Shop equipment | 9,858 |
| Administrative expense: | |
| Buildings | 46,214 |
| Office equipment | 6,070 |
| Depletable assets | 1,208 |
| Total depreciation expense | <u>\$ 1,263,777</u> |

HOUGHTON COUNTY ROAD COMMISSION
NOTES TO FINANCIAL STATEMENTS
September 30, 2011

NOTE E - DUE TO MICHIGAN DEPARTMENT OF TREASURY

On December 17, 2009 the Road Commission and Michigan Department of Transportation settled a dispute regarding the final settlement relating to fiscal year 2002 and 2003 in the amount of \$175,578. This matter was concluded with the Road Commission paying five annual installments of \$35,116 without interest commencing on May 1, 2011 and the final installment due May 1, 2014.

Remaining payments at September 30, 2011 are as follows:

| <u>Fiscal Year</u> | <u>Advance Repayment</u> | | <u>Total</u> |
|--------------------|--------------------------|--------------------------|-------------------|
| | <u>Capital Equipment</u> | <u>Operating Advance</u> | |
| 2011-12 | \$ 40,389 | \$ 35,116 | \$ 75,505 |
| 2012-13 | - | 35,116 | 35,116 |
| 2013-14 | - | 35,115 | 35,115 |
| TOTAL | <u>\$ 40,389</u> | <u>\$ 105,347</u> | <u>\$ 145,736</u> |

NOTE F – EMPLOYEE BENEFITS AND POLICIES

Vested Employee Vacation Benefits - The Road Commission employment policies provide for vacation benefits to be earned in varying amounts depending on the number of years of service of the employee. Benefits earned in the current year but not used are paid out in full in the subsequent year up to a maximum of one week. Employees who anticipate the need for an extended vacation shall be allowed (on receiving approval from the County Engineer) to use up to two (2) weeks of the next year’s vacation for such purpose, but not in the months of November, December, January, or February. Holidays occurring during the employee’s scheduled vacation period shall not be charged against the vacation time.

Sick Leave Benefit Policies - The Road Commission employment policies provide that each regular employee shall earn sick leave with pay at the rate of 3/4 day, or 6 hours, for each completed month of employment. Sick leave may be accumulated to a maximum of 90 days. On an annual basis sick leave accruals over the 90 days are paid off at 50 percent for the first 5 days and charged in full against the employee’s accumulated sick leave. Three personal days are allowed each employee per calendar year. If the personal days are not used during the year they are added to the sick leave accruals for the year. Upon retirement, death or discontinuance of employment for any reason, except for dismissal for disciplinary reasons, the employee shall be paid for all accumulated sick leave at the employee’s prevailing rate of pay at the time of the termination of employment.

As of September 30, 2011, the accrued vacation and sick leave had a balance of \$351,402.

| | |
|----------------------------|-------------------|
| Beginning Balance, 9/30/10 | \$ 350,886 |
| Current Year Change | 516 |
| Ending Balance, 9/30/11 | <u>\$ 351,402</u> |

HOUGHTON COUNTY ROAD COMMISSION
NOTES TO FINANCIAL STATEMENTS
September 30, 2011

NOTE G – FEDERAL GRANTS

The Michigan Department of Transportation (MDOT) requires that road commissions report all Federal and State grants pertaining to their county. During the year ended September 30, 2011, the total Federal aid received and expended by the Road Commission was \$812,727 for contracted projects. There were no negotiated projects.

Contracted projects are defined as projects performed by private contractors paid for and administered by MDOT (they are included in MDOT’s single audit). Negotiated projects are projects where the road commission administers the grant and either performs the work or contracts it out.

The Road Commission is subject to single audit requirements with the expending of more than \$500,000 in federal funds. The schedule of federal awards for the Road Commission is included in the Schedule of Federal Awards of County of Houghton, Michigan.

NOTE H – PENSION PLAN

Defined Benefit Pension Plan (Michigan Municipal Employees’ Retirement System)

Plan Description - The Road Commission participates in the Michigan Municipal Employees’ Retirement System (MERS), an agent multiple-employer defined benefit pension plan that covers all nonunion employees of the Road Commission. The system provides retirement, disability and death benefits to plan members and their beneficiaries. 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 the System at: Gabriel, Roeder, Smith & Company, One Town Square, Suite 800, Southfield, Michigan, 48076.

Funding Policy – The obligation to contribute to and maintain the system for these employees was established by negotiation with the Road Commission’s competitive bargaining units and requires a contribution from the employer of 27.98% of gross wages for the Road Commission.

Annual Pension Costs – For the year ended 2011, Road Commission’s annual pension cost of \$110,132 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, 2010, using the entry age normal funding method. Significant actuarial assumptions used include: (1) an 8% investment rate of return; (2) projected salary increases of 4.5% per year; and (3) 4.5% per year cost of living adjustments. Both are determined using techniques that smooth the effects of short-term volatility over a four-year period. The unfunded actuarial liability is being amortized as a level percent of payroll on a closed basis. The remaining amortization period is 30 years.

Analysis of Funding Progress Three-Year Trend Information

| | Valuation as of December 31 | | |
|---|-----------------------------|--------------|--------------|
| | 2008 | 2009 | 2010 |
| Actuarial value of assets | \$ 2,709,097 | \$ 2,858,049 | \$ 2,824,797 |
| Actuarial accrued liability (entry age) | \$ 3,801,932 | \$ 3,839,178 | \$ 3,875,815 |
| Unfunded actuarial liability (UAAL) | \$ 1,092,835 | \$ 981,129 | \$ 1,051,018 |
| Funded ratio | 71% | 74% | 73% |
| Covered payroll | \$ 335,643 | \$ 388,373 | \$ 395,764 |
| UAAL as a percentage of covered payroll | 326% | 253% | 266% |

HOUGHTON COUNTY ROAD COMMISSION
NOTES TO FINANCIAL STATEMENTS
September 30, 2011

NOTE H – PENSION PLAN (Continued)

Schedule of Employer Contributions Three-Year Trend Information

| | Fiscal Year Beginning January 1 | | |
|-------------------------------|---------------------------------|------------|------------|
| | 2008 | 2009 | 2010 |
| Annual pension cost (APC) | \$ 106,553 | \$ 297,848 | \$ 121,698 |
| Percentage of APC contributed | 100% | 100% | 100% |
| Net pension obligation | \$ - | \$ - | \$ - |

Defined Contribution Pension Plan

The County Road Commission provides pension benefits to all of its full-time union employees through a defined contribution plan. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate from the date of employment. As established by union contract, the County Road Commission contributes a fixed amount per the union agreement, plus interest allocated to the employee’s account, and employees are fully vested after 10 years of service.

The current year contribution was calculated based on \$81.90 (October to December 2010), and \$88.50 (January to September 2011) per employee, for 31 employees, resulting in an employer contribution of \$139,360 and employee contributions of \$0.

NOTE I – DEFERRED COMPENSATION PLAN

The Road Commission offers all its employees a deferred compensation plan created in accordance with the Internal Revenue Code (IRC), Section 457. The assets of the plans are held in trust, (custodial account or annuity contract) as described in IRC Section 457(g) for the exclusive benefit of the participants (employees) and their beneficiaries. The custodian thereof for the exclusive benefit of the participants holds the custodial account for the beneficiaries of this Section 457 plan, and the assets may not be diverted to any other use. The administrators are agents of the employer (Road Commission) for the purposes of providing direction to the custodian of the custodial account from time to time for the investment of the funds held in the account, transfer of assets to or from the account, and all other matters. In accordance with the provisions of GASB Statement No. 32, plan balances and activities are not reflected in the Road Commission’s financial statements.

NOTE J – POST-EMPLOYMENT BENEFITS OTHER THAN PENSION

The Houghton County Road Commission provides post-employment health care insurance benefits to certain retired union employees and/or their spouse in accordance with the following provisions:

The hospital and medical coverage benefits are provided in accordance with the Houghton County Road Commission Retiree Medical Plan, which can be amended at the Commission’s discretion. Currently, there are 45 employees and retirees covered under this plan. The current union contract states: After 30 years of service with the Houghton County Road Commission, the employee may elect to receive up to \$600 towards the premium cost for the employee and spouse health and prescription drug coverage only, paid for a period of the next 3 years by the Board, if it is before the employee’s sixty second birthday when he retires. If the employee is at least age sixty two on the date he retires, and has at least 10 years of service with the Houghton County Road Commission, the employee shall receive up to \$600 of the premium paid until such time as the employee is eligible for Medicare benefits. The employee will be reimbursed up to \$600 for the above premium for any health insurance plan purchased and paid for upon presentation of proof of payment to the Houghton County Road Commission.

HOUGHTON COUNTY ROAD COMMISSION
NOTES TO FINANCIAL STATEMENTS
September 30, 2011

NOTE J – POST-EMPLOYMENT BENEFITS OTHER THAN PENSION (Continued)

The Road Commission has no obligation to make contributions in advance of when insurance premiums are due for payment (in other words, this may be financed on a pay-as-you-go basis).

GASB 45 provides an alternative measurement method for a single employer that operates a Plan with less than 100 total members (including active employees, inactive employees who are not yet receiving benefits, retirees, and beneficiaries) may apply a simplified measurement method in lieu of obtaining an actuarial valuation. This alternative calculation requires the same broad measurement steps as would be necessary in the actuarial process, but allows an organization to utilize a set of predetermined assumptions that simplify the calculations necessary to determine the OPEB liability.

For the year ended September 30, 2011 the Road Commission has prospectively estimated the cost of providing retiree health care benefits, utilizing the alternative measurement method, as provided by GASB 45, for the actuarial valuation as of September 31, 2011. The OPEB Accounting Report and Valuation can be obtained by contacting the Houghton County Road Commission, Hancock MI 49930. The valuation computes an annual required contribution, which represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years. These valuations computed contribution and actual funding are summarized as follows:

| | <u>2010</u> | <u>2011</u> |
|--|-------------------|-------------------|
| Annual required contribution (ARC) | \$ 147,423 | \$ 42,913 |
| Interest on Net OPEB Obligation | - | - |
| Adjustments to ARC | - | - |
| Annual OPEB cost | <u>147,423</u> | <u>42,913</u> |
| Contributions made | <u>(32,748)</u> | <u>(44,331)</u> |
| Increase (Decrease) in net OPEB obligation | 114,675 | (1,418) |
| OPEB obligation - beginning of year | - | 114,675 |
| OPEB obligation - end of year | <u>\$ 114,675</u> | <u>\$ 113,257</u> |

The annual OPEB costs, the percentage contributed to the plan, and the net OPEB obligation for the fiscal year ended September 30, 2011 were as follows:

| | <u>2010</u> | <u>2011</u> |
|------------------------|-------------|-------------|
| Annual OPEB costs | \$ 147,423 | \$ 42,913 |
| Percentage contributed | 77.79% | 103.00% |
| Net OPEB obligation | \$ 114,675 | \$ 113,257 |

As of the date of this reporting, the organization has not yet made contributions to the Trust that are in excess of the benefit payments due in the current year. Thus, there are no assets to report in the Trust as of September 30, 2011.

Actuarial valuations of an ongoing plan involve estimates of the value for reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision, as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

HOUGHTON COUNTY ROAD COMMISSION
NOTES TO FINANCIAL STATEMENTS
September 30, 2011

NOTE J – POST-EMPLOYMENT BENEFITS OTHER THAN PENSION (Continued)

In the September 30, 2011 actuarial valuation, the actuarial assumptions used to calculate the annual required contribution included an annual increase in salary of 2.5 percent, a discount rate of 4.8 percent, no mortalities prior to retirement, and a post retirement interest rate of 7.0 percent. The assumptions also include expected increases in healthcare costs of 6.2 percent, utilizing the NIH National Health Expenditure Projections for 2008-2018. Tables provided by GASB 45 were used for employee turnover prior to retirement, expected employee future working life, and post retirement mortality projections. To determine the current liability, an assumed interest rate of 7.0 percent was utilized.

NOTE K – COMMITMENTS AND CONTINGENCIES

Grants – The Road Commission has received significant financial assistance from state and federal agencies in the form of various grants. The disbursements of funds received under these programs generally require compliance with terms and conditions specified in the grant agreement and are subject to audit by the grantor agency. Any disallowed claims resulting from such audits could become a liability of the applicable fund of the Road Commission. In the opinion of management, any such disallowed claims may have a material effect on any of the financial statements included herein or on the overall financial position of the Road Commission at September 30, 2011.

Risk Management – The Road Commission is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Road Commission was unable to obtain general liability insurance at a cost it considered to be economically justifiable. The Road Commission joined together with other Michigan Road Commissions and created a public entity risk pool currently operating as a common risk management and insurance program. The Road Commission pays an annual premium to the pool for its general insurance coverage. The agreement provides that the pool will be self-sustaining through member premiums and will reinsure through commercial companies for claims in excess of \$1,000 (\$2,000 for errors and omissions) for each insured event. The maximum limit of liability for each occurrence is \$10,500,000. The pooling agreement allows for the pool to make additional assessments to make the pool self-sustaining. The Road Commission is unable to provide an estimate of the amounts of additional assessments.

NOTE L – PRIOR PERIOD ADJUSTMENT

The ending fund balance has been adjusted for fiscal year 2010 and a accounts payable liability reduced in the amount \$575.

REQUIRED SUPPLEMENTARY INFORMATION

HOUGHTON COUNTY ROAD COMMISSION
BUDGETARY COMPARISON SCHEDULE
Year Ended September 30, 2011

| | <u>Budgeted Amounts</u> | | <u>Actual (GAAP Basis)</u> | <u>Variance Final to Actual</u> |
|---|-------------------------|---------------------|--------------------------------|-------------------------------------|
| | <u>Original</u> | <u>Final</u> | | |
| REVENUES: | | | | |
| Federal sources | | | | |
| Federal "D" funds | \$ 998,000 | \$ 685,000 | \$ 670,727 | \$ (14,273) |
| Federal ARRA funds | 142,000 | 142,000 | 142,000 | 0 |
| Total Federal Sources | <u>1,140,000</u> | <u>827,000</u> | <u>812,727</u> | <u>(14,273)</u> |
| State sources | | | | |
| Michigan transportation fund | 3,755,000 | 3,840,000 | 3,929,567 | 89,567 |
| Economic development "D" funds | 167,000 | 167,000 | 167,648 | 648 |
| Other funds | - | - | 23,210 | 23,210 |
| Total State Sources | <u>3,922,000</u> | <u>4,007,000</u> | <u>4,120,425</u> | <u>113,425</u> |
| Local sources | | | | |
| Property taxes | 650,000 | 670,000 | 689,023 | 19,023 |
| Contributions | 610,000 | 605,000 | 624,310 | 19,310 |
| Other sources | 75,000 | 98,000 | 101,260 | 3,260 |
| Total Local Sources | <u>1,335,000</u> | <u>1,373,000</u> | <u>1,414,593</u> | <u>41,593</u> |
| TOTAL REVENUE | <u>6,397,000</u> | <u>6,207,000</u> | <u>6,347,745</u> | <u>140,745</u> |
| EXPENDITURES: | | | | |
| Preservation - heavy maintenance | 1,450,000 | 1,700,000 | 1,479,199 | 220,801 |
| Maintenance | 4,000,000 | 4,200,000 | 4,931,608 | (731,608) |
| Equipment expense (net) | 960,000 | 810,000 | (753,520) | 1,563,520 |
| Administrative expense (net) | 300,000 | 275,000 | 404,808 | (129,808) |
| Capital outlay (net) | (100,000) | - | 31,714 | (31,714) |
| TOTAL EXPENDITURES | <u>6,610,000</u> | <u>6,985,000</u> | <u>6,093,809</u> | <u>891,191</u> |
| NET CHANGE IN FUND BALANCE | <u>\$ (213,000)</u> | <u>\$ (778,000)</u> | 253,936 | <u>\$ (750,446)</u> |
| FUND BALANCE - BEGINNING OF YEAR | | | <u>2,574,026</u> | |
| FUND BALANCE - END OF YEAR | | | <u>\$ 2,827,962</u> | |

HOUGHTON COUNTY ROAD COMMISSION
NON-UNION MERS PENSION PLAN
SCHEDULE OF FUNDING PROGRESS
Year Ended September 30, 2011

| Valuation Date December 30 | Actuarial Value of Assets (a) | Actuarial Accrued Liability ("AAL") (b) | Unfunded Actuarial Accrued Liability (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll | Ratio of UAAL to Covered Payroll |
|-------------------------------------|--|---|--|--------------------------|--------------------|---|
| 2010 | \$ 2,824,797 | \$ 3,875,815 | \$ 1,051,018 | 73% | \$ 395,764 | 266% |
| 2009 | \$ 2,858,049 | \$ 3,839,178 | \$ 981,129 | 74% | \$ 388,373 | 253% |
| 2008 | \$ 2,709,097 | \$ 3,801,932 | \$ 1,092,835 | 71% | \$ 335,643 | 326% |
| 2007 | \$ 2,729,412 | \$ 3,775,827 | \$ 1,046,415 | 72% | \$ 389,272 | 269% |
| 2006 | \$ 2,651,173 | \$ 3,619,213 | \$ 968,040 | 73% | \$ 362,174 | 267% |

| | <u>Employee Retirement</u> |
|-------------------------------|----------------------------|
| Actuarial Cost Method: | Entry age normal |
| Amortization Method | Level percent of payroll |
| Remaining amortization period | 30 years (closed) |
| Asset valuation method | 4-year smoothed market |
| Actuarial Assumption: | |
| Investment rate of return | 8% |
| Wage inflation | 4.5% |
| Projected salary increases | 4.5% |

HOUGHTON COUNTY ROAD COMMISSION
POST-RETIREMENT BENEFITS OTHER THAN PENSION
SCHEDULE OF FUNDING PROGRESS
Year Ended September 30, 2011

| Valuation Date September 30 | Annual Required Contribution (ARC) | Interest on Net OPEB Obligation | Adjustments to ARC | Annual OPEB Cost | Contributions Made | Increase (Decrease) in Net OPEB Obligation | OPEB Obligation - Beginning of Year | OPEB Obligation - End of Year |
|--------------------------------|------------------------------------|---------------------------------|--------------------|------------------|--------------------|--|-------------------------------------|-------------------------------|
| 2011 | \$ 42,913 | \$ - | \$ - | \$ 42,913 | \$ 44,331 | \$ (1,418) | \$ 114,675 | \$ 113,257 |
| 2010 | \$ 147,423 | \$ - | \$ - | \$ 147,243 | \$ 32,748 | \$ 114,675 | \$ - | \$ 114,675 |

| Valuation Year Ended September 30 | Annual OPEB Costs | Percentage Contributed | Net Pension Obligation |
|--------------------------------------|-------------------|------------------------|------------------------|
| 2011 | \$ 42,913 | 103.00% | \$ 113,257 |
| 2010 | \$ 147,423 | 77.79% | \$ 114,675 |

| Descriptions | Sources |
|---|--|
| Method for valuation - Actuarial Cost Method | GASB 45 - Alternate Method |
| Discount Rate - 4.8% | GASB 45 - Alternate Method |
| Mortality prior to retirement - None | GASB 45 - Table 3 |
| Turnover prior to retirement | GASB 45 - Table 1 |
| Expected Future Working Life | GASB 45 - Table 2 |
| Salary scale - 2.5% | Historical based on CPI index |
| Post retirement interest rate - 7% | GASB 45 - Alternate Method |
| Post retirement mortality | GASB 45 - Table 3 |
| Health Care Inflation rate - 6.2% | NIH National Health Expenditure Projections, 2008-2018 |
| Interest on Net Pension Obligation (NPO) - 7% | GASB 45 - Alternate Method |

SUPPLEMENTARY INFORMATION

HOUGHTON COUNTY ROAD COMMISSION
ANALYSIS OF CHANGES IN ROAD FUND BALANCE
Year Ended September 30, 2011

| | Primary Road Fund | Local Road Fund | County Road Commission Fund | Total |
|---|-------------------------|-----------------------|--------------------------------------|---------------------|
| Revenue | | | | |
| Federal sources | \$ 404,642 | \$ 408,085 | \$ - | \$ 812,727 |
| State sources | 2,241,865 | 1,687,702 | - | 3,929,567 |
| Taxes | 621,496 | 67,527 | - | 689,023 |
| Contributions from local units | 101,330 | 510,976 | 12,004 | 624,310 |
| Licenses and permits | - | - | 12,101 | 12,101 |
| Charges for services | 10,520 | - | 1,963 | 12,483 |
| Economic Development Fund | 143,714 | 23,934 | - | 167,648 |
| Other | - | 82,091 | - | 82,091 |
| Interest and rents | - | - | 17,795 | 17,795 |
| Total revenue | <u>3,523,567</u> | <u>2,780,315</u> | <u>43,863</u> | <u>6,347,745</u> |
| Expenditures | | | | |
| Preservation | 1,104,505 | 374,694 | - | 1,479,199 |
| Maintenance | 2,315,706 | 2,615,902 | - | 4,931,608 |
| Equipment expense - Net | (346,303) | (399,121) | (8,096) | (753,520) |
| Administrative - Net | 215,968 | 188,840 | - | 404,808 |
| Capital outlay - Net | - | - | 31,714 | 31,714 |
| Total expenditures | <u>3,289,876</u> | <u>2,780,315</u> | <u>23,618</u> | <u>6,093,809</u> |
| Excess of Revenue (Under) Over Expenditures | 233,691 | - | 20,245 | 253,936 |
| Other Financing Sources (Uses) | | | | |
| Interfund Transfers In (Out) | (233,691) | - | 233,691 | - |
| Excess of Revenue and Other Sources Over (Under) Expenditures and Other Uses | <u>-</u> | <u>-</u> | <u>253,936</u> | <u>253,936</u> |
| Fund Balance - Beginning of Year | <u>-</u> | <u>-</u> | <u>2,574,026</u> | <u>2,574,026</u> |
| Fund Balance - End of Year | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 2,827,962</u> | <u>\$ 2,827,962</u> |

COMPLIANCE SECTION

RUKKILA | NEGRO AND ASSOCIATES

Certified Public Accountants, P C

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of County Road Commissioners
Houghton County Road Commission
Hancock, Michigan

We have audited the financial statements of the governmental activities of the Houghton County Road Commission as of and for the year then ended September 30, 2011, which collectively comprise the Road Commission's basic financial statements and have issued our report thereon dated March 28, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Road Commission's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Road Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Road Commission's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will be not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs that we consider to be significant deficiencies in internal control over financial reporting as items 2011-1 and 2011-2. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charge with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Road Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Houghton County Road Commission in a separate letter dated March 28, 2012.

The Houghton County Road Commission's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the Houghton County Road Commission's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board, and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.

**Rukkila, Negro & Associates,
Certified Public Accountants, PC**

March 28, 2012

COMMUNICATIONS SECTION

RUKKILA | NEGRO AND ASSOCIATES

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COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

Board of County Road Commissioners
Houghton County Road Commission
Hancock, Michigan

We have audited the financial statements of the governmental activities of the Houghton County Road Commission for the year ended September 30, 2011. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated January 17, 2012 . Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Houghton County Road Commission are described in Note A to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended September 30, 2011. We noted no transactions entered into by the Houghton County Road Commission during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements is current judgements.

Management's estimate of the useful lives of fixed assets, used to calculate depreciation, is based on the estimated useful lives of certain classes of assets. We evaluated the key factors and assumptions used to develop the useful lives to determine that they are reasonable in relation to the financial statements taken as a whole.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated March 28, 2012.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the County's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Houghton County Road Commission's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Information in Documents Containing Audited Financial Statements

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

This information is intended solely for the use of the Houghton County Road Commission board and management and is not intended to be and should not be used for anyone other than these specified parties.

We appreciate your business, thank you.

**Rukkila, Negro & Associates,
Certified Public Accountants, PC**

March 28, 2012

**HOUGHTON COUNTY ROAD COMMISSION
FINANCIAL STATEMENT FINDINGS
SEPTEMBER 30, 2011**

In planning and performing our audit of the financial statements of the Houghton County Road Commission, as of and for the year ended September 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered the Commission's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.

FINANCIAL STATEMENT FINDINGS

2011-1 – Preparation of Financial Statements in Accordance with GAAP

Criteria: All entities are required to prepare financial statements in accordance with generally accepted accounting principles (GAAP). This is a responsibility of management. The preparation of financial statements in accordance with GAAP requires internal controls over both recording, processing, and summarizing accounting data (i.e., maintaining internal books and records), and reporting government-wide financial statements, including related footnotes.

Condition, Cause and Effect: As is the case with many small entities, the Commission has historically relied on its independent external auditors to assist in the preparation of the financial statements and footnotes as part of its external financial reporting process. Accordingly, the Commission's ability to prepare financial statements in accordance with GAAP is based, in part, on its external auditors, who cannot by definition be considered a part of the internal controls. As a result of this condition, the Commission lacks internal controls over the preparation of financial statements in accordance with GAAP, and instead relies, in part, on its external auditors for assistance with this task.

View of Responsible Officials: The Houghton County Road Commission has evaluated the benefits of establishing internal controls over the preparation of financial statements in accordance with GAAP, and determined that it is in the best interest of the Commission to outsource this task to its external auditors, and to carefully review the draft financial statements and notes prior to approving them and accepting responsibility for their content and presentation.

ADDITIONAL COMMENTS AND RECOMMENDATIONS

During our audit we became aware of opportunities for strengthening internal controls and operating efficiencies. The following items summarize our comments and suggestions regarding those matters.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and suggestions with various personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

Budget

Michigan law prohibits spending amounts in excess of appropriations (budgeted amounts). As noted in our audit report, there were several instances of spending amounts greater than budgeted.

We recommend that the Board carefully review its actual revenues and expenditures to budgeted amounts at least quarterly. Amendments to the budget should be made after reviewing all financial information, if required or necessary.