

September 19, 2003

Honorable Mayor and Members of the City Council  
City of Sterling Heights  
40555 Utica Road  
P.O. Box 8009  
Sterling Heights, MI 48311-8009

Dear Mayor and Council Members:

We have recently completed our audit of the governmental activities, business type activities, the aggregate discretely presented component unit information, each major fund, and the aggregate remaining fund information of the City of Sterling Heights for the year ended June 30, 2003. We offer the following items of an informational nature for your consideration as the policy making body of the City:

#### **OVERVIEW OF THE CITY'S FINANCIAL CONDITION**

Despite a reduction of approximately \$1.1 million in State Shared Revenue payments from the State of Michigan, the City's financial condition continued to improve as the total of the City's General Fund revenues exceeded expenditures by approximately \$386,000. We compliment the City Council, as well as the City's department heads and staff, for their continued success with budgeting and financial management during these times of economic uncertainty and reduction in state funding for local units. The fund balance in the General Fund totaled \$18,222,086 with \$580,930 being reserved for encumbrances, inventory, and prepaid costs, \$4,750,000 being designated for use in technology and capital improvements, and \$2,750,000 being designated for future funding to the City's Retiree Medical Benefits Fund. As a result, the City's undesignated General Fund fund balance remains at approximately \$10.6 million. By maintaining an adequate fund balance, the City is able to adjust to financial changes without the need for drastic reactions to adverse circumstances. The City's undesignated portion of fund balance represents approximately 15% of budgeted expenditures, which continues to be within the range typically expected by bond rating services.

#### **CONDITION OF ACCOUNTING RECORDS AND AUDIT PREPARATION**

We would like to compliment the City Council and the staff of the Office of Financial Services for the continued efforts to improve and enhance the City's financial management and reporting procedures and controls. This was the City's second year of preparing a financial report in compliance with the Governmental Accounting Standards Board (GASB) new comprehensive reporting model. As you may recall, last year the City was only one of a hand full of communities to apply this new and complex reporting model. Application of GASB's new model requires significantly more work on the part of the Financial Services staff in preparation for the annual audit. Even with these additional requirements, the City's preparation of the financial records and required audit schedules was the best we have seen in years. It is also worth noting that our detailed audit procedures did not result in any necessary adjustments to the City's financial records.

## **REMOTE LOCATION RECEIPTS**

Despite the fact that most municipalities have formal internal control policies governing cash receipt procedures, it is common for these procedures to not be fully implemented at cash receipt locations outside of the main municipal offices. While our annual audit of procedures in these locations indicated no significant internal control weaknesses, we recommend that the Treasurer's Department continue to conduct periodic spot checks of cash receipt procedures in remote locations such as the Parks and Recreation, Library and Police Departments to ensure adherence to City-wide internal control policies. These spot checks should be documented and the results should be discussed with the department head.

## **POSITIVE PAY SYSTEMS**

All organizations are facing a growing risk of check fraud due to the continued sophistication of devices such as scanners and color copiers. Annual losses due to check fraud in the U.S. are estimated to be beyond \$12 billion. It is not very difficult for someone to take a valid check, a canceled check, or a voided check and either duplicate or modify the check and thereby relieve the check writer of an amount much greater than what had been intended. Making matters worse, where banks once protected their customers for this type of check fraud, sentiment is beginning to change, where ultimately it may be the customer's responsibility to cover fraudulent checks.

To combat this problem, many banks have introduced a tool called "positive pay", which verifies each check presented to the bank against a file of written checks that is electronically downloaded from the customer to the bank. Funds are not relieved from the customer's account unless the check matches the information downloaded or until the customer approves the check. The cost of this tool is very low. A side benefit is that it allows the bank to prepare an outstanding checklist as a by-product of this service. Prior to the audit, the City Treasurer had begun a cost/benefit analysis of this service. We believe that the "positive pay" program offers a heightened level of internal control and we encourage the City to consider the benefits of this service.

## **FUNDING OF POST-EMPLOYMENT BENEFIT OBLIGATIONS**

In the prior year, the City established a Retiree Health Care Fund which is used to accumulate monies to fund future post-employment benefits. This represented an important first step in beginning to set aside resources to fund these obligations.

We understand that the City is evaluating funding post-employment benefit obligations on an actuarial basis, similar to pension obligations. Current accounting pronouncements do not require accounting for post-employment on an actuarial basis, however, a proposed standard by the Governmental Accounting Standards Board includes provisions for measuring post-employment benefit liabilities and expenses on an actuarial basis. Furthermore, actuarial funding generally provides the best mechanism for funding obligations over long time periods and multiple budget cycles.

## LEGISLATIVE UPDATES

### Revenue Sharing

As you are aware, the slow down in the State's economy is now directly affecting the General Fund. State shared revenue accounts for approximately 17% of the City's total General Fund revenue.

The State has set a revenue estimating conference for October 14, 2003. The State announced on September 24, 2003, that all areas (except for the school aid foundation allowance) will be open for possible cuts following the conference. This again puts revenue sharing at risk! The next regularly scheduled revenue estimating conference was not to occur until January 2004. The State's decision to call a revenue estimating conference in October 2003 signifies the significance of the expected revenue shortfall. While the exact amount of the shortfalls for FY 2002/2003 and FY 2003/2004 was not released by the State, a September 2003 House Fiscal Agency memo estimated that revenue for FY 2002/2003 would be down by \$200 million if revenue growth continues for the next two months at the rate it did in July and August. This is consistent with earlier estimates of the Senate Fiscal Agency.

We recommend that the City continue to evaluate the impact of the revenue sharing reductions on the 2003-2004 budget. Updated information can be obtained from the Department of Treasury's web site at <http://treas-secure.state.mi.us/apps/findrevshareinfo.asp> or by calling the Office of Revenue and Tax Analysis at (517) 373-2697. We will continue to update the City as developments occur.

We would like to thank Mr. Baker, Ms. Reinhart, Mr. Sanborn and the Financial Services department staff for the courtesy and assistance extended to us during the audit. We would be happy to answer any questions or concerns you have regarding the annual financial report and the above comments and recommendations at your convenience.

Very truly yours,

**PLANTE & MORAN, PLLC**



Mark R. Hurst



Lisa M. Vargo