

City of Benton
Harbor,
Michigan



Year Ended
June 30, 2012

Financial
Statements

CITY OF BENTON HARBOR, MICHIGAN

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INDEPENDENT AUDITORS' REPORT

December 18, 2012

Emergency Financial Manager of the
City of Benton Harbor
Benton Harbor, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the *City of Benton Harbor, Michigan* (the "City"), as of and for the year ended June 30, 2012, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Twin Cities Area Transportation Authority, which represents 16.2 percent, 16.7 percent and 38.7 percent, respectively of the assets, net assets and revenues of aggregate discretely presented component units. We also did not audit the financial statements of the Benton Harbor Housing Commission component unit, which represents 82 percent, 81.4 percent and 57.2 percent, respectively of the assets, net assets and revenues of aggregate discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for aggregate discretely presented component units, is based on the reports of other auditors.

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 opinions.

As discussed in note 1 to the financial statements, the City has recorded general infrastructure assets only for projects that occurred subsequent to June 30, 2002. Accounting principles generally accepted in the United States of America require the reporting of general infrastructure assets for projects dating back to January 1, 1980. The amount by which this departure would affect the assets, net assets and expenses of governmental activities is not reasonably determinable.

The financial statements do not include financial data for the City's legally separate component unit, the Benton Harbor Cemetery Board. Accounting principles generally accepted in the United States of America require the financial data for all component units to be reported with the financial data of the City's primary government unless the City also issues financial statements for the financial reporting entity that include the financial data for all of its component units. The amount by which this departure would affect the assets, net assets and expenses of aggregate discretely presented component units is not reasonably determinable.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary with respect to the items referred to in the preceding paragraphs had the related account balances been susceptible to satisfactory audit tests, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Benton Harbor, Michigan as of June 30, 2012, and the respective changes in financial position and cash flows, where applicable, thereof and the budgetary comparison for the general fund and each major special revenue fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The City has suffered recurring operating deficits in the General Fund. Management's plans with regard to these matters are described in Note 17.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 18, 2012, on our consideration of the City's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and 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 the 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 and the schedules of funding progress and employer contributions, as listed in the table of contents, 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 opinions on the financial statements that collectively comprise the City's basic financial statements. The combining and individual fund financial statements are presented for purposes of additional analysis and are not a required part of the City's basic financial statements. Such information is the responsibility of management and was derived from and relates 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.

A handwritten signature in black ink, reading "Lehmann Lobson". The signature is written in a cursive, flowing style with a large initial 'L'.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

CITY OF BENTON HARBOR, MICHIGAN

Management's Discussion and Analysis

As management of the City of Benton Harbor, Michigan (the "City"), we offer readers of the City's financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2012. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the financial statements and notes to the financial statements.

Financial Highlights

Fiscal 2012 was a year of significant activity at the City including:

- The General Fund decreased its cumulative fund deficit by \$106,549 from \$2,339,429 in 2011 to \$2,232,880 in 2012. The reduction in the deficit exceeded the amount of the State approved deficit elimination plan.
- The Emergency Financial Manager (EFM) made substantial reductions to personnel and other costs during the current year. The expenditure reductions were partially offset by one time costs for compensated balance payouts and unemployment.
- The General Fund had an increase in total revenue of approximately \$106,000 from 2011 including approximately \$500,000 from charges for services.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to City's financial statements. The City's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide financial statements. The *government-wide financial statements* are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the City's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

Both of the government wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) or from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business type activities). The governmental activities of the City include public safety, public works, community and economic development, culture and recreation, and general administrative services. The business-type activities of the City include utility services.

Fund financial statements. A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Benton Harbor, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary and fiduciary funds.

Governmental funds. Governmental funds are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenue, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The City adopts an annual appropriated budget for its general fund. Budgetary comparison statements or schedules have been provided herein to demonstrate compliance with those budgets.

Proprietary funds. The City maintains one type of proprietary fund. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses enterprise funds to account for its utility services.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are *not* reflected in the government-wide financial statements because the resources of those funds are *not* available to support the City's own programs. The City uses fiduciary funds to account for taxes collected on behalf of other local units and to account for funds set aside in trust for pension benefits.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information. This is limited to this management discussion and analysis and required pension benefits information.

The combining statements referred to earlier in connection with nonmajor governmental funds are presented immediately following the notes to the financial statements.

Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City of Benton Harbor, assets exceeded liabilities by \$32,751,290 at the close of the most recent fiscal year.

A portion of the City's net assets reflects unrestricted net assets which are available for future operation while a significant portion of net assets is invested in capital assets (e.g., land, buildings, vehicles, equipment and infrastructure), less any related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are *not* available for future spending.

City of Benton Harbor's Net Assets

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Assets						
Current and other assets	\$ 1,107,188	\$ 507,774	\$ 14,410,149	\$ 14,675,807	\$ 15,517,337	\$ 15,183,581
Capital assets, net	15,352,968	16,376,956	25,779,292	23,580,789	41,132,260	39,957,745
Total assets	16,460,156	16,884,730	40,189,441	38,256,596	56,649,597	55,141,326
Liabilities						
Other liabilities	8,460,715	6,264,729	1,592,109	2,119,622	10,052,824	8,384,351
Long-term liabilities	1,355,941	1,612,260	12,489,542	11,013,689	13,845,483	12,625,949
Total liabilities	9,816,656	7,876,989	14,081,651	13,133,311	23,898,307	21,010,300
Net assets						
Invested in capital assets, net of related debt	14,279,860	15,052,938	13,333,803	12,700,461	27,613,663	27,753,399
Restricted	75,964	394,903	-	675,434	75,964	1,070,337
Unrestricted (deficit)	(7,712,324)	(6,440,100)	12,773,987	11,747,390	5,061,663	5,307,290
Total net assets	\$ 6,643,500	\$ 9,007,741	\$ 26,107,790	\$ 25,123,285	\$ 32,751,290	\$ 34,131,026

Net assets of the City decreased by \$1,379,736 for the year ended June 30, 2012. This is primarily due to the \$2.4 million loss in governmental activities due to the City's increasing pension obligation and depreciation expense in excess of current year capital asset acquisitions.

City of Benton Harbor's Changes in Net Assets

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Revenues						
Program revenues:						
Charges for services	\$ 1,840,394	\$ 1,517,657	\$ 3,734,744	\$ 4,633,646	\$ 5,575,138	\$ 6,151,303
Operating grants and contributions	5,596,680	2,215,695	384	2,288	5,597,064	2,217,983
Capital grants and contributions	1,330,584	712,519	-	2,518,878	1,330,584	3,231,397
General revenues:						
Property taxes, levied for:						
General purposes	2,112,549	2,184,125	-	-	2,112,549	2,184,125
Specific purposes	176,759	295,556	-	-	176,759	295,556
State revenue sharing	1,464,078	1,912,387	-	-	1,464,078	1,912,387
Unrestricted interest earnings	1,107	1,842	-	-	1,107	1,842
Other	4,078	6,206	-	-	4,078	6,206
Gain on sale of capital assets	-	313,635	-	660,594	-	974,229
Transfers - internal activities	-	(23,508)	-	23,508	-	-
Total revenue	12,526,229	9,136,114	3,735,128	7,838,914	16,261,357	16,975,028
Expenses						
General government	4,173,397	3,334,709	-	-	4,173,397	3,334,709
Public safety	3,871,172	4,843,612	-	-	3,871,172	4,843,612
Public works	2,965,453	1,843,415	-	-	2,965,453	1,843,415
Community and economic development	4,541,008	1,443,901	-	-	4,541,008	1,443,901
Recreation and culture	141,113	118,666	-	-	141,113	118,666
Interest on long-term debt	57,406	132,074	-	-	57,406	132,074
Utility Services	-	-	2,750,623	3,458,883	2,750,623	3,458,883
Total expenses	15,749,549	11,716,377	2,750,623	3,458,883	18,500,172	15,175,260
Change in net assets before special items	(3,223,320)	(2,580,263)	984,505	4,380,031	(2,238,815)	1,799,768
Special items	859,079	1,511,455	-	21,406	859,079	1,532,861
Change in net assets	(2,364,241)	(1,068,808)	984,505	4,401,437	(1,379,736)	3,332,629
Net assets, beginning of year, as restated	9,007,741	10,076,549	25,123,285	20,721,848	34,131,026	30,798,397
Net assets, end of year	\$ 6,643,500	\$ 9,007,741	\$ 26,107,790	\$ 25,123,285	\$ 32,751,290	\$ 34,131,026

Governmental activities. Governmental activities decreased the City's net assets by \$2,364,241. Key elements of this decrease are as follows:

- Governmental revenues increased by approximately \$3,390,000 primarily as a result of increase in grant revenue from the NSP II program increasing grant revenue by approximately \$3,380,000.
- Governmental expenditures increased by approximately \$643,000. The increase is primarily as a result of an increase in grant related disbursements of approximately \$3,097,000 offset by overall reductions in public safety and other expenditures.
- The overall decrease in net assets was primarily due to the recording of the significant annual pension of approximately \$1,700,000.

Business-type activities. Business-type activities increased the City's net assets by \$984,505. Key elements of this increase are as follows:

- Charges for services revenue decreased by approximately \$898,000 due to a decrease in utility consumption.
- Capital grant revenue decreased by approximately \$2,519,000 from final draw down of state revolving funds.
- Utility services expenditures decreased by approximately \$713,000, consistent with the drop in utility revenue.

Financial Analysis of the Government's Funds

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the City's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the City's financing requirements. In particular, *unassigned fund balance* may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the City's governmental funds reported a combined ending fund deficit of \$(2,164,521), a decrease in the deficit by \$153,104 in comparison with the prior year. Of the total fund balance (deficit), \$52,603 is considered to be nonspendable as it represents balances recorded for prepaid services. \$75,964 represents amounts restricted for major and local streets. The remaining deficit of \$2,293,088 is reported as *unassigned fund deficit*.

The general fund is the chief operating fund of the City. At the end of the current fiscal year, the unassigned fund deficit in the general fund was \$2,232,880. The deficit of the City's general fund decreased by \$106,549 during the current fiscal year. This is primary the result of one-time special items recorded in the current year.

General Fund Budgetary Highlights

The City is required by State law to adopt an operating budget for its general fund and special revenue funds prior to the commencement of the fiscal year. During the year, as more information on funding sources and uses of funds becomes available, the EFM amends to the budget to reflect the changing circumstances.

Actual results varied from the original/final budget as follows:

- The original budget was adopted by the EM and amended during the year. The primary reason the revenue variance of approximately \$472,000 is the items the auditors have classified as special items were budgeted as revenue and they did not move the budget amounts from revenue. The overall budget variance for expenditures of approximately \$623,000 was primarily a result of a significant increase in legal fees to defend lawsuits and unexpected self insurance costs.

Capital Asset and Debt Administration

Capital assets. The City’s investment in capital assets for its governmental and business-type activities as of June 30, 2012, amounted to \$41,132,260 (net of accumulated depreciation).

	Capital Assets (net of accumulated depreciation)					
	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Land	\$ 3,860,238	\$ 3,860,238	\$ 6,626	\$ 6,736	\$ 3,866,864	\$ 3,866,974
Construction in progress	-	-	19,823,384	19,747,606	19,823,384	19,747,606
Capital assets being depreciated, net	11,492,730	12,516,718	5,949,282	3,826,447	17,442,012	16,343,165
	<u>\$ 15,352,968</u>	<u>\$ 16,376,956</u>	<u>\$ 25,779,292</u>	<u>\$ 23,580,789</u>	<u>\$ 41,132,260</u>	<u>\$ 39,957,745</u>

Additional information on the City of Benton Harbor’s capital assets can be found in Note 6 of this report.

Long-term debt. At the end of the current fiscal year, the City had total debt outstanding of \$13,845,483, which was accounted for in governmental and business-type activities.

	Long-term Debt					
	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Loans payable	\$ 935,300	\$ 1,065,300	\$ 12,441,446	\$ 10,936,609	\$ 13,376,746	\$ 12,001,909
Other obligations	420,641	546,960	48,096	77,080	468,737	624,040
	<u>\$ 1,355,941</u>	<u>\$ 1,612,260</u>	<u>\$ 12,489,542</u>	<u>\$ 11,013,689</u>	<u>\$ 13,845,483</u>	<u>\$ 12,625,949</u>

The City’s total debt increased by \$1,219,534 from fiscal year 2011.

Additional information on the City’s long-term debt can be found in Note 8 of this report.

Economic Factors and Next Year’s Budgets and Rates

The following factors were considered in preparing the City’s budget for the 2012-13 fiscal year:

- Expiration of extra voted operating mills in the General Fund
- Increase in required pension contributions for both pension systems from the General Fund

Requests for Information

This financial report is designed to provide a general overview of the City’s finances for all those with an interest in the government’s finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Emergency Financial Manager, 200 E. Wall Street, Benton Harbor, MI 49022.

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BASIC FINANCIAL STATEMENTS

CITY OF BENTON HARBOR, MICHIGAN

Statement of Net Assets

June 30, 2012

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
Assets				
Pooled cash and investments	\$ 556,288	\$ 78,429	\$ 634,717	\$ 1,784,962
Receivables, net	1,198,301	1,012,381	2,210,682	329,384
Internal balances	(830,385)	830,385	-	-
Other assets	52,603	52,603	105,206	80,524
Investment in joint ventures	130,381	12,436,351	12,566,732	-
Capital assets:				
Not being depreciated	3,860,238	19,830,010	23,690,248	350,770
Being depreciated, net	11,492,730	5,949,282	17,442,012	8,187,057
Total assets	16,460,156	40,189,441	56,649,597	10,732,697
Liabilities				
Payables and accrued liabilities	3,168,224	997,673	4,165,897	244,972
Unearned revenue	-	-	-	564,882
Long-term liabilities:				
Due within one year	469,892	697,946	1,167,838	-
Due in more than one year	886,049	11,791,596	12,677,645	-
Net pension obligation	5,292,491	594,436	5,886,927	-
Total liabilities	9,816,656	14,081,651	23,898,307	809,854
Net assets (deficit)				
Invested in capital assets, net of related debt	14,279,860	13,333,803	27,613,663	8,537,827
Restricted for:				
Street construction and maintenance	75,964	-	75,964	231,521
Unrestricted (deficit)	(7,712,324)	12,773,987	5,061,663	921,974
Total net assets	\$ 6,643,500	\$ 26,107,790	\$ 32,751,290	\$ 9,922,843

The accompanying notes are an integral part of these financial statements.

CITY OF BENTON HARBOR, MICHIGAN

Statement of Activities For the Year Ended June 30, 2012

Functions / Programs	Expenses	Program Revenues			Net (Expense) Revenue
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Primary government					
Governmental activities:					
General government	\$ 4,173,397	\$ 581,496	\$ 517,179	\$ -	\$ (3,074,722)
Public safety	3,871,172	73,326	310,448	-	(3,487,398)
Public works	2,965,453	950,078	200,000	1,330,584	(484,791)
Community and economic development	4,541,008	91,594	4,463,349	-	13,935
Recreation and culture	141,113	143,900	105,704	-	108,491
Interest on long-term debt	57,406	-	-	-	(57,406)
Total governmental activities	15,749,549	1,840,394	5,596,680	1,330,584	(6,981,891)
Business-type activities:					
Utility services	2,750,623	3,734,744	384	-	984,505
Total primary government	\$ 18,500,172	\$ 5,575,138	\$ 5,597,064	\$ 1,330,584	\$ (5,997,386)
Component units					
Brownfield Redevelopment Authority	\$ 213,776	\$ 1,500	\$ -	\$ -	\$ (212,276)
Twin Cities Area Transportation Authority	2,530,071	351,041	1,820,003	38,770	(320,257)
Benton Harbor Housing Commission	3,350,714	2,787,663	-	365,470	(197,581)
	\$ 6,094,561	\$ 3,140,204	\$ 1,820,003	\$ 404,240	\$ (730,114)

continued...

CITY OF BENTON HARBOR, MICHIGAN

Statement of Activities

For the Year Ended June 30, 2012

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
Changes in net assets				
Net (expense) revenue	\$ (6,981,891)	\$ 984,505	\$ (5,997,386)	\$ (730,114)
General revenues:				
Property taxes, levied for:				
General purposes	2,112,549	-	2,112,549	250,099
Specific purposes	176,759	-	176,759	-
State revenue sharing	1,464,078	-	1,464,078	-
Unrestricted interest earnings	1,107	-	1,107	1,438
Other	4,078	-	4,078	364,663
Gain on sale of capital assets	-	-	-	119,802
Total general revenues	3,758,571	-	3,758,571	736,002
Change in net assets before special items	(3,223,320)	984,505	(2,238,815)	5,888
Special items (Note 15)	859,079	-	859,079	-
Change in net assets	(2,364,241)	984,505	(1,379,736)	5,888
Net assets, beginning of year, as restated	9,007,741	25,123,285	34,131,026	9,916,955
Net assets, end of year	<u>\$ 6,643,500</u>	<u>\$ 26,107,790</u>	<u>\$ 32,751,290</u>	<u>\$ 9,922,843</u>

concluded

The accompanying notes are an integral part of these financial statements.

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CITY OF BENTON HARBOR, MICHIGAN

Balance Sheet

Governmental Funds

June 30, 2012

	General Fund	Neighborhood Stabilization Program Grant II	Nonmajor Governmental Funds	Total Governmental Funds
Assets				
Pooled cash and investments	\$ 218,719	\$ 25,763	\$ 311,806	\$ 556,288
Receivables:				
Accounts	341,684	1,535	99,180	442,399
Due from other governmental units	305,288	289,764	137,178	732,230
Taxes	20,051	-	3,621	23,672
Due from other funds	113,114	134,067	8,078	255,259
Prepaid items	52,603	-	-	52,603
Total assets	\$ 1,051,459	\$ 451,129	\$ 559,863	\$ 2,062,451
Liabilities				
Accounts payable	\$ 940,165	\$ 450,526	\$ 167,631	\$ 1,558,322
Accrued liabilities	115,644	-	7,675	123,319
Due to other governmental units	1,244,027	-	183,781	1,427,808
Due to other funds	964,452	-	121,192	1,085,644
Deferred revenue	20,051	603	11,225	31,879
Total liabilities	3,284,339	451,129	491,504	4,226,972
Fund balances (deficit) (Note 9)				
Nonspendable	52,603	-	-	52,603
Restricted	-	-	75,964	75,964
Unassigned (deficit)	(2,285,483)	-	(7,605)	(2,293,088)
Total fund balances (deficit)	(2,232,880)	-	68,359	(2,164,521)
Total liabilities and fund balances (deficit)	\$ 1,051,459	\$ 451,129	\$ 559,863	\$ 2,062,451

The accompanying notes are an integral part of these financial statements.

CITY OF BENTON HARBOR, MICHIGAN

Reconciliation

Fund Balances of Governmental Funds
to Net Assets of Governmental Activities
June 30, 2012

Fund balances (deficit) - total governmental funds \$ (2,164,521)

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 fund statements.

Capital assets not being depreciated	3,860,238
Capital assets being depreciated, net	11,492,730

The government investment in its joint venture is not a financial resource, and therefore is not reported in the funds.

Investment in joint venture	130,381
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Certain assets, such as deferred property taxes and grants receivable are not due and receivable in the current period and therefore are offset with deferred revenue in the fund statements.

Deferred property taxes receivable	23,672
Deferred grants receivable	8,207

Some items are recorded as revenues and expenditures in the fund statements when paid or when received. These items are recorded on the government-wide statements when incurred in the case of expenditures and when revenues are earned.

Net pension obligation	(5,292,491)
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Certain liabilities, such as bonds payable, are not due and payable in the current period, and therefore are not reported in the fund statements.

Loans, notes and capital leases payable	(1,073,108)
Termination benefits	(25,597)
Compensated absences	(257,236)
Accrued interest on loans, notes and capital leases payable	(58,775)

Net assets of governmental activities \$ 6,643,500

The accompanying notes are an integral part of these financial statements.

CITY OF BENTON HARBOR, MICHIGAN

Statement of Revenues, Expenditures, and Changes in Fund Balances

Governmental Funds

For the Year Ended June 30, 2012

	General Fund	Neighborhood Stabilization Program Grant II	Nonmajor Governmental Funds	Total Governmental Funds
Revenues				
Property taxes	\$ 2,116,748	\$ -	\$ 176,759	\$ 2,293,507
Licenses and permits	217,560	-	-	217,560
Intergovernmental revenues:				
Federal	298,398	3,486,266	917,785	4,702,449
State	1,535,192	-	735,813	2,271,005
Local	450,056	-	620,674	1,070,730
Franchise fees	90,114	-	-	90,114
Charges for services	1,093,927	-	-	1,093,927
Fees	62,169	-	-	62,169
Interest and rentals	174,241	-	28	174,269
Other	517,248	25,160	-	542,408
Total revenues	6,555,653	3,511,426	2,451,059	12,518,138
Expenditures				
Current:				
General government	3,462,392	-	-	3,462,392
Public safety	2,953,711	-	-	2,953,711
Public works	877,367	-	1,276,424	2,153,791
Community and economic development	-	3,511,426	-	3,511,426
Culture and recreation	255,165	-	790,230	1,045,395
Debt service:				
Principal	120,910	-	130,000	250,910
Interest	11,906	-	31,091	42,997
Capital outlay	-	-	176,759	176,759
Total expenditures	7,681,451	3,511,426	2,404,504	13,597,381
Revenues over (under) expenditures	(1,125,798)	-	46,555	(1,079,243)
Other financing sources (uses)				
Transfers in	-	-	78,649	78,649
Transfers out	-	-	(78,649)	(78,649)
Proceeds from sales of assets	373,268	-	-	373,268
Total other financing sources (uses)	373,268	-	-	373,268
Net changes in fund balances before special items	(752,530)	-	46,555	(705,975)
Special items (Note 15)	859,079	-	-	859,079
Net changes in fund balances	106,549	-	46,555	153,104
Fund balances (deficit), beginning of year, as restated	(2,339,429)	-	21,804	(2,317,625)
Fund balances (deficit), end of year	\$ (2,232,880)	\$ -	\$ 68,359	\$ (2,164,521)

The accompanying notes are an integral part of these financial statements.

CITY OF BENTON HARBOR, MICHIGAN

Reconciliation

Net Changes in Fund Balances of Governmental Funds
to Change in Net Assets of Governmental Activities
For the Year Ended June 30, 2012

Net changes in fund balances - total governmental funds \$ 153,104

Amounts reported for *governmental activities* in the statement of activities are different

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

Purchase of capital assets	814,079
Depreciation expense	(1,194,642)
Net book value of disposed capital assets	(643,425)

The change in the value of the investment in its joint venture is not a financial resource, and therefore is not reported in the funds.

Change in investment in joint venture	4,083
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Deferred taxes and grants receivable are long-term in nature and are collectable over several years. However, the current receipts are reflected as revenues on the fund statements.

Change in deferred taxes receivable	(4,199)
Change in deferred grants receivable	8,207

Bond proceeds provide current financial resources to governmental funds in the period issued, but issuing bonds increases long-term liabilities in the statement of net assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.

Principal payments on loans and notes	130,000
Principal payments on capital leases payable	120,910

Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.

Change in accrued interest on loans, notes and capital leases payable	(14,409)
Change in the accrual for compensated absences	726
Change in termination benefit liability	4,683
Change in net pension obligation	(1,743,358)

Change in net assets of governmental activities \$ (2,364,241)

The accompanying notes are an integral part of these financial statements.

CITY OF BENTON HARBOR, MICHIGAN

Statement of Revenues, Expenditures, and Changes in Fund Balance

Budget and Actual - General Fund
For the Year Ended June 30, 2012

	Original Budget	Amended Budget	Actual	Variance from Amended Budget Over (Under)
Revenues				
Property taxes	\$ 2,295,000	\$ 2,867,300	\$ 2,116,748	\$ (750,552)
Licenses and permits	350,000	228,000	217,560	(10,440)
Intergovernmental revenues:				
Federal	270,000	310,000	298,398	(11,602)
State	1,425,120	1,520,063	1,535,192	15,129
Local	520,000	500,000	450,056	(49,944)
Franchise fees	82,400	90,000	90,114	114
Charges for services	275,000	885,300	1,093,927	208,627
Fees	50,000	28,200	62,169	33,969
Interest and rentals	236,030	136,000	174,241	38,241
Other	310,883	463,503	517,248	53,745
Total revenues	5,814,433	7,028,366	6,555,653	(472,713)
Expenditures				
Current:				
General government:				
City Commission	-	400	322	(78)
General administration	1,191,000	1,526,580	2,067,404	540,824
Elections	35,030	-	-	-
Assessor	187,958	151,405	152,694	1,289
Emergency financial manager	300,704	134,875	134,932	57
City manager	80,775	243,630	246,574	2,944
Finance	254,600	291,437	229,809	(61,628)
Clerk	191,734	213,208	211,278	(1,930)
Buildings and grounds	50,200	262,910	283,156	20,246
Personnel	-	90,193	88,541	(1,652)
Aid to others	-	47,682	47,682	-
Total general government	2,292,001	2,962,320	3,462,392	500,072
Public safety:				
Police	1,989,438	2,175,842	2,195,297	19,455
Fire	328,334	482,478	474,222	(8,256)
Inspections	372,948	285,061	284,192	(869)
Total public safety	2,690,720	2,943,381	2,953,711	10,330

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CITY OF BENTON HARBOR, MICHIGAN

Statement of Revenues, Expenditures, and Changes in Fund Balance Budget and Actual - General Fund For the Year Ended June 30, 2012

	Original Budget	Amended Budget	Actual	Variance from Amended Budget Over (Under)
Expenditures (concluded)				
Current (continued):				
Public works:				
Department of public works	\$ 431,262	\$ 805,820	\$ 877,367	\$ 71,547
Culture and recreation	-	245,695	255,165	9,470
Debt service:				
Principal	-	-	120,910	120,910
Interest and fees	-	100,700	11,906	(88,794)
Total debt service	-	100,700	132,816	32,116
Total expenditures	5,413,983	7,057,916	7,681,451	623,535
Revenues over (under) expenditures	400,450	(29,550)	(1,125,798)	(1,096,248)
Other financing uses				
Proceeds from sales of assets	-	430,000	373,268	(56,732)
Net changes in fund balances before special items	400,450	400,450	(752,530)	(1,152,980)
Special items (Note 15)	-	-	859,079	859,079
Net changes in fund balances	400,450	400,450	106,549	(293,901)
Fund balances, beginning of year, as restated	(2,339,429)	(2,339,429)	(2,339,429)	-
Fund balances, end of year	\$ (1,938,979)	\$ (1,938,979)	\$ (2,232,880)	\$ (293,901)

concluded

The accompanying notes are an integral part of these financial statements.

CITY OF BENTON HARBOR, MICHIGAN

Statement of Revenues, Expenditures, and Changes in Fund Balance Budget and Actual - Neighborhood Stabilization Program Grant II For the Year Ended June 30, 2012

	Original Budget	Amended Budget	Actual	Variance from Amended Budget Over (Under)
Revenues				
Intergovernmental revenues:				
Federal	\$ 3,808,264	\$ 3,200,000	\$ 3,486,266	\$ 286,266
Other	-	-	25,160	25,160
Total revenues	<u>3,808,264</u>	<u>3,200,000</u>	<u>3,511,426</u>	<u>311,426</u>
Expenditures				
Current:				
Community and economic development	<u>3,808,264</u>	<u>3,200,000</u>	<u>3,511,426</u>	<u>311,426</u>
Net changes in fund balances	-	-	-	-
Fund balances, beginning of year	-	-	-	-
Fund balances, end of year	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>

The accompanying notes are an integral part of these financial statements.

CITY OF BENTON HARBOR, MICHIGAN

Statement of Net Assets

Enterprise Fund - Utility Services

June 30, 2012

Assets

Current assets:

Pooled cash and investments	\$ 78,429
Accounts receivable	1,012,381
Due from other funds	830,385
Prepaid items	52,603
Total current assets	<u>1,973,798</u>

Noncurrent assets:

Investment in joint venture	12,436,351
Capital assets, net:	
Not being depreciated	19,830,010
Being depreciated, net	5,949,282
Total noncurrent assets	<u>38,215,643</u>

Total assets

40,189,441

Liabilities

Current liabilities:

Accounts payable	630,335
Accrued liabilities	90,027
Customer deposits	277,311
Accrued compensated absences, current portion	33,040
Loans, notes and capital leases payable, current portion	664,906
Total current liabilities	<u>1,695,619</u>

Noncurrent liabilities:

Net pension obligation	594,436
Accrued compensated absences, net of current portion	11,013
Loans, notes and capital leases payable, net of current portion	11,780,583
Total noncurrent liabilities	<u>12,386,032</u>

Total liabilities

14,081,651

Net assets

Invested in capital assets, net of related debt	13,333,803
Unrestricted	12,773,987

Total net assets

\$ 26,107,790

The accompanying notes are an integral part of these financial statements.

CITY OF BENTON HARBOR, MICHIGAN

Statement of Revenues, Expenses and Changes in Fund Net Assets

Enterprise Fund - Utility Services

For the Year Ended June 30, 2012

Operating revenues	
Water sales	\$ 2,426,229
Sewer sales	<u>1,308,515</u>
Total operating revenues	<u>3,734,744</u>
Operating expenses	
Utility administration	838,863
Customer service	259,169
Water treatment	574,028
Water distribution	542,793
Sewer lift stations	490,343
Storm drains	25,375
Other operations	10,722
Depreciation	<u>217,452</u>
Total operating expenses	<u>2,958,745</u>
Operating income	<u>775,999</u>
Nonoperating revenues	
Income from joint venture	208,122
Interest income	<u>384</u>
Total nonoperating revenues	<u>208,506</u>
Change in net assets	984,505
Net assets, beginning of year	<u>25,123,285</u>
Net assets, end of year	<u>\$ 26,107,790</u>

The accompanying notes are an integral part of these financial statements.

CITY OF BENTON HARBOR, MICHIGAN

Statement of Cash Flows

Enterprise Fund - Utility Services
For the Year Ended June 30, 2012

Cash flows from operating activities	
Receipts from customers and users	\$ 3,733,799
Payments to suppliers	(2,563,507)
Payments to employees	<u>(957,416)</u>
Net cash provided by operating activities	<u>212,876</u>
Cash flows from capital and related financing activities	
Acquisition of capital assets	(2,148,768)
Proceeds from issuance of long-term debt	2,747,840
Principal paid on long-term debt	(1,248,668)
Interest paid on long-term debt	<u>(255,263)</u>
Net cash used in capital and related financing activities	<u>(904,859)</u>
Cash flows from investing activities	
Interest on investments	<u>384</u>
Net decrease in pooled cash and investments	(691,599)
Pooled cash and investments, beginning of year	<u>770,028</u>
Pooled cash and investments, end of year	<u>\$ 78,429</u>
Cash flows from operating activities	
Operating income	\$ 775,999
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	217,452
Changes in operating assets and liabilities which provided (used) cash:	
Accounts receivable	30,805
Due from other funds	(238,244)
Prepaid items	(10,270)
Accounts payable	(416,492)
Accrued liabilities	2,069
Due to other governments	(48,657)
Accrued compensated absences	(23,319)
Customer deposits	206,494
Net pension obligation	<u>(282,961)</u>
Net cash provided by operating activities	<u>\$ 212,876</u>

The accompanying notes are an integral part of these financial statements.

CITY OF BENTON HARBOR, MICHIGAN

Statement of Fiduciary Net Assets

Fiduciary Funds

June 30, 2012

	Pension Trust Funds	Agency Funds
Assets		
Pooled cash and investments	\$ 450,717	\$ 896
Investments, at fair value:		
Money market funds	1,161,830	-
Mutual funds - bonds	2,746,223	-
Mutual funds - equities	3,280,595	-
Common stock	3,695,899	-
Other	6,829	-
Total investments, at fair value	<u>10,891,376</u>	<u>-</u>
Property taxes receivable	2,048	-
Accounts receivable	<u>-</u>	<u>4,012</u>
Total assets	11,344,141	<u><u>\$ 4,908</u></u>
Liabilities		
Accounts payable	<u>2,048</u>	<u><u>\$ 4,908</u></u>
Net assets		
Held in trust for benefits	<u><u>\$ 11,342,093</u></u>	

The accompanying notes are an integral part of these financial statements.

CITY OF BENTON HARBOR, MICHIGAN

Statement of Changes in Fiduciary Net Assets

Pension Trust Funds

For the Year Ended June 30, 2012

Additions

Contributions:

Employer	\$ 246,406
Employee	226,059
Investment loss	(132,094)
Property taxes	88,135
Other revenue	126

Total additions

428,632

Deductions

Distributions and benefit payments	2,233,176
Administrative	<u>25,960</u>

Total deductions

2,259,136

Change in net assets

(1,830,504)

Net assets, beginning of year

13,172,597

Net assets, end of year

\$ 11,342,093

The accompanying notes are an integral part of these financial statements.

CITY OF BENTON HARBOR, MICHIGAN

Combining Statement of Net Assets Discretely Presented Component Units June 30, 2012

	Brownfield Redevelopment Authority	Twin Cities Area Transportation Authority	Benton Harbor Housing Commission	Total
Assets				
Cash and pooled investments	\$ 194,567	\$ 355,702	\$ 1,234,693	\$ 1,784,962
Receivables:				
Accounts	5,333	19,412	38,789	63,534
Due from other governmental units	-	265,850	-	265,850
Other assets	-	69,878	10,646	80,524
Capital assets:				
Not being depreciated	-	62,700	288,070	350,770
Being depreciated, net	-	961,316	7,225,741	8,187,057
Total assets	199,900	1,734,858	8,797,939	10,732,697
Liabilities				
Accounts payable	13,568	31,909	83,076	128,553
Accrued liabilities	-	44,560	71,859	116,419
Unearned revenue	-	-	564,882	564,882
Total liabilities	13,568	76,469	719,817	809,854
Net assets				
Invested in capital assets, net of related debt	-	1,024,016	7,513,811	8,537,827
Restricted for:				
Housing Choice Voucher program	-	-	231,521	231,521
Unrestricted	186,332	634,373	332,790	1,153,495
Total net assets	\$ 186,332	\$ 1,658,389	\$ 8,078,122	\$ 9,922,843

The accompanying notes are an integral part of these financial statements.

CITY OF BENTON HARBOR, MICHIGAN

Combining Statement of Activities Discretely Presented Component Units For the Year Ended June 30, 2012

	Brownfield Redevelopment Authority	Twin Cities Area Transportation Authority	Benton Harbor Housing Commission	Total
Expenses				
Public works	\$ 213,776	\$ 2,530,071	\$ -	\$ 2,743,847
Economic Development	-	-	3,350,714	3,350,714
Total expenses	<u>213,776</u>	<u>2,530,071</u>	<u>3,350,714</u>	<u>6,094,561</u>
Program revenues				
Charges for services	1,500	351,041	2,787,663	3,140,204
Intergovernmental revenues:				
Federal	-	38,770	365,470	404,240
State	-	1,820,003	-	1,820,003
Total program revenues	<u>1,500</u>	<u>2,209,814</u>	<u>3,153,133</u>	<u>5,364,447</u>
Net program expenses	<u>(212,276)</u>	<u>(320,257)</u>	<u>(197,581)</u>	<u>(730,114)</u>
General revenues				
Property taxes	113,889	136,210	-	250,099
Interest and rentals	-	486	952	1,438
Other	135,058	14,277	215,328	364,663
Gain on sale of capital assets	-	977	118,825	119,802
Total general revenues	<u>248,947</u>	<u>151,950</u>	<u>335,105</u>	<u>736,002</u>
Change in net assets	<u>36,671</u>	<u>(168,307)</u>	<u>137,524</u>	<u>5,888</u>
Net assets, beginning of year	<u>149,661</u>	<u>1,826,696</u>	<u>7,940,598</u>	<u>9,916,955</u>
Net assets, end of year	<u>\$ 186,332</u>	<u>\$ 1,658,389</u>	<u>\$ 8,078,122</u>	<u>\$ 9,922,843</u>

The accompanying notes are an integral part of these financial statements.

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NOTES TO THE FINANCIAL STATEMENTS

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the City of Benton Harbor, Michigan (the “City”) conform to generally accepted accounting principles as applicable to governments. The following is a summary of the more significant policies.

The Reporting Entity

The City was incorporated in 1891. The City normally operates under a Council-Manager form of government. Since April of 2010, the City has been run by an Emergency Financial Manager appointed by the State of Michigan.

Under Public Act 72 of 1990 and pursuant to a report issued by a State appointed financial review team dated January 27, 2010, the governor appointed Joe Harris as the Emergency Financial Manager (EFM) effective April 1, 2010.

Under Act 72, the EFM shall develop and may amend a written financial and operating plan for the local government. The plan shall have the objectives of assuring that the local government is able to provide necessary or cause to be provided governmental services essential to the public health, safety, and welfare and assuring the fiscal accountability of the local government.

In addition, the EFM powers include, but are not limited to, the authority to:

Amend, revise approve, or disapprove the budget of the local government, and limit the total amount appropriated or expended; receive and disburse on behalf of the local government all federal, state, and local funds earmarked for the local government. These funds may include, but are not limited to, funds for specific programs and the retirement of debt; require and approve or disapprove, or amend or revise a plan for paying all outstanding obligations of the local government; make, approve, or disapprove any appropriation, contract, expenditure, or loan, the creation of any new position, or the filling of any vacancy in a position by any appointing authority; act as sole agent of the local government in collective bargaining with employees or representatives and approve any contract or agreement; employ or contract for, at the expense of the local government and with the approval of the state financial authority, auditors and other technical personnel considered necessary to implement this act; remove, replace, appoint, or confirm the appointments to any office, board, commission, authority, or other entity which is within or is a component unit of the local government.

As required by generally accepted accounting principles, these financial statements present the City and its component units, entities for which the City is considered to be financially accountable. Blended component units, although legally separate entities, are, in substance, part of the City's operations, so data from these units are combined with data of the primary government. Discretely presented component units, on the other hand, are reported in a separate column in the government-wide financial statements to emphasize they are legally separate from the City.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Blended Component Unit - Economic Development Corporation

The Corporation was established to encourage the location and expansion of industrial/commercial enterprises within the City limits on the City's behalf. The City provides all administrative functions of the Corporation and appoints two commission members to the Corporation's nine-member board. The Economic Development Corporation had no assets and no activity during current fiscal year.

Discretely Presented Component Units

In addition, financial information for the following component units are included separately in the government-wide financial statements. They are reported separately to emphasize that they are legally separate from the City.

Brownfield Redevelopment Authority - The Brownfield Redevelopment Authority (the "Authority") was established pursuant to Act 381 of the Public Acts of 1996, as amended. The purpose of the Authority is to treat and revitalize environmentally distressed brownfield zones. The Authority's budget is subject to approval by the Emergency Manager. Separate financial statements are not prepared for the Authority.

Twin Cities Area Transportation Authority - The Transportation Authority was incorporated in the state of Michigan on July 1 1974 under Public Act 55 of 1963. The purpose of the Transportation Authority is to acquire, own, operate, and manage a public transportation system within the boundaries of the City. Given that the City has significant influence over the Transportation Authority and is the only participating municipality, the Transportation Authority is considered to be a component unit of the City. A complete financial report can be obtained from the Transportation Authority at 275 East Wall Street, Benton Harbor, MI 49023-083. The Transportation Authority is presented on a September 30 fiscal year end.

Benton Harbor Housing Commission - The Benton Harbor Housing Commission is a public housing agency created by the City and consisting of a five member board appointed by the Emergency Manager. The Commission is charged with the responsibility of providing low-rent housing, under the low-rent program annual contributions contract for qualified individuals in accordance with the rules and regulations prescribed by the Department of Housing and Urban Development. A complete financial report can be obtained from the Housing Commission at 721 Nate Wells Drive, Benton Harbor, Michigan 49022. The Housing Commission is presented on a September 30 fiscal year end.

Benton Harbor Cemetery Board - The Benton Harbor Cemetery Board is a legally separate entity from the City of Benton Harbor. The governing board is appointed by the Emergency Financial Manager. The Board is responsible for operating and maintaining the Crystal Springs Cemetery. A complete financial report for the Cemetery Board is not available at this time.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Jointly Governed Organizations

Southwest Michigan Regional Airport Authority - In fiscal year 1998, four municipalities approved the establishment of an Airport Authority to oversee airport operations. Operations are partially funded by property taxes. In late July 1998, control of airport operations was transferred to the Airport Authority. The Airport Authority is governed by a board of four members, including one from each participating municipality. Upon dissolution, net assets will be shared on a pro rata basis based on amounts contributed to the Airport Authority. The City's equity share was 4.9 percent at June 30, 2012. Based on audited financial statements of the Authority, an equity interest has been recorded in the City's basic financial statements as a governmental activity.

Benton Harbor-St. Joseph Joint Sewage Disposal Plant - The City is a participant with the City of St. Joseph in a joint venture to provide sanitary sewage treatment and collection facilities for the residents of these communities. The Benton Harbor St. Joseph joint wastewater treatment plant was created for that purpose. Upon dissolution of the plant, the net assets will be shared on an equal basis with the City of St. Joseph. The plant is governed by a board of eight members consisting of three members each from Benton Harbor and St. Joseph and two members chosen from neighboring communities. The City's equity share was 50 percent at June 30, 2012. Based on audited financial statements, an equity interest has been recorded in the City's Utility Services enterprise fund.

Government-wide and Fund Financial Statements

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

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. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

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

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the proprietary fund and fiduciary fund financial statements, except for agency funds, which do not have a measurement focus. Revenues are 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 revenues in the year for which they are levied. After March 1 of each year, the County is responsible for collecting any outstanding real property taxes as of that date. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service and accrued employee benefit expenditures are recorded only when payment is due.

Property taxes, intergovernmental revenue, charges for services and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the City.

The City reports the following major governmental funds:

The *general fund* is the City's primary operating fund. It accounts for all financial resources of the general government, except those accounted for and reported in another fund.

The *Neighborhood Stabilization Program Grant II Fund* accounts for all financial resources of the Neighborhood Stabilization Grant program administered by the City.

The City reports the following major proprietary fund:

The *utility services fund* is used to account for the activities of the City's water distribution and wastewater treatment systems. Revenues are primarily from charges to customers for usage and service charges to customers. These revenues are used to pay operating costs and principal and interest on capital leases and funds borrowed from the federal and state governments which were used to finance improvements to the systems.

Additionally, the City reports the following fund types:

Special revenue funds are used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

The *debt service fund* is used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest.

The *capital projects fund* used to account for and report financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets.

The *enterprise funds* are used to report operations that provide services to citizens, financed primarily by a user charge or activities where the periodic measurement of net income is deemed appropriate for capital maintenance, public policy, management control, accountability or other purposes.

The *pension trust funds* are used to account for resources held in trust for employee pensions.

The *agency funds* are used to account for assets held by the City in a trustee capacity or as an agent for individuals, private organizations, and other governments.

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

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the enterprise funds are charges for services. Operating expenses for the enterprise funds include depreciation on capital assets, labor, supplies and contracted services. All revenues and expenses are not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

Budgets and Budgetary Accounting

Budgets are adopted for general and special revenue funds on a basis consistent with generally accepted accounting principles (GAAP). The budget is adopted and may be amended by the Emergency Manager.

Assets, Liabilities and Equity

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired. For purposes of the statement of cash flows, the City considers all highly liquid investments with an original maturity of three months or less to be cash and temporary investments.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Investments

State statutes authorize the City to invest in the following:

- a. Bonds, securities, other obligations and repurchase agreements of the United States, or an agency or instrumentality of the United States.
- b. Certificates of deposit, savings accounts, deposit accounts or depository receipts of a qualified financial institution.
- c. Commercial paper rated at the time of purchase within the two highest classifications established by not less than two standard rating services and that matures not more than 270 days after the date of purchase.
- d. Bankers acceptances of United States banks.
- e. Obligations of the State of Michigan and its political subdivisions that, at the time of purchase are rated as investment grade by at least one standard rating service.
- f. Mutual funds registered under the Investment Company Act of 1940 with the authority to purchase only investment vehicles that are legal for direct investment by a public corporation.
- g. External investment pools as authorized by Public Act 20 as amended through 12/31/97.

Receivables

All receivables are reported at their gross value and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible.

Prepaid Items

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

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$1,000 and an estimated useful life in excess of one year. Such assets are valued at cost where historical records are available and at an estimated historical cost where no historical records exist. Donated capital assets are valued at their estimated fair market value on the date received.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related capital assets, as applicable.

Interest expense has been incurred and capitalized on certain capital assets reported in proprietary funds. Depreciation on capital assets (including infrastructure) of the primary government is computed using the straight-line method over the following estimated useful lives:

	Years
Land improvements	5-75
Buildings and improvements	10-30
Vehicles and equipment	5-7
Utility systems	12-75
System infrastructure	10-15

The City has recorded infrastructure assets only for projects that occurred subsequent to June 30, 2002. Generally accepted accounting principles require recording infrastructure assets constructed or acquired since 1980.

Deferred Revenue

Governmental funds report *deferred revenue* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Long-term Obligations

In the government-wide financial statements and proprietary fund types in the fund financial statements, the long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. For new bond issuances of governmental funds after the implementation of GASB Statement No. 34 and all proprietary fund bond issues, bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method which approximates the effective interest method. Bonds payable are reported net of the applicable bond premium or discount.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums and discounts on debt issuances are reported as other financing sources and uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Compensated Absences

It is the City's policy to permit employees to accumulate earned but unused sick and vacation pay benefits.

Vacation and sick leave earned as of year end, is recorded in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

Fund Equity

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 resources by grantors, contributors, or laws or regulations of other governments. Committed fund balance is reported for amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the government's highest level of decision-making authority, the Emergency Manager. A formal order or resolution of the Emergency Manager is required to establish, modify, or rescind a fund balance commitment. The City 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 City incurs an expenditure for purposes for which various fund balance classifications can be used, it is the City's policy to use restricted fund balance first, then committed fund balance, assigned fund balance, and finally unassigned fund balance.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Property Taxes

City property taxes are attached as an enforceable lien on property as of July 1. Taxes are levied July 1 and are due without penalty on or before September 15. These summer tax bills include the City's own property taxes and taxes billed on behalf of other districts within the City limits. Real property taxes not collected are returned to the County for collection, which advances the City 100% for the delinquent real property taxes. Collection of delinquent personal property taxes remains the responsibility of the City Treasurer.

Interfund Transactions

During the course of normal operations, the City has numerous transactions between funds, including expenditures and transfers of resources to provide services, construct assets, and service debt. The accompanying financial statements generally reflect such transactions as transfers. Operating subsidies are also recorded as transfers. The amounts recorded as subsidies, advances, or equity contributions are determined by the City.

Use of Estimates

The preparation of financial statements requires the use of estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

2. EXCESS OF EXPENDITURES OVER APPROPRIATIONS

During the year ended June 30, 2012, general and special revenue fund expenditures were incurred in excess of the amounts appropriated as follows:

	Amended Budget	Actual	Variance
General fund			
General government:			
General administration	\$ 1,526,580	\$ 2,067,404	\$ 540,824
Assessor	151,405	152,694	1,289
Emergency financial manager	134,875	134,932	57
City manager	243,630	246,574	2,944
Buildings and grounds	262,910	283,156	20,246
Public safety:			
Police	2,175,842	2,195,297	19,455
Public works:			
Department of public works	805,820	877,367	71,547
Culture and recreation	245,695	255,165	9,470
Debt service:			
Principal	-	120,910	120,910
Neighborhood Stabilization Program Grant II			
Community and economic development	3,200,000	3,511,426	311,426

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

3. FUND DEFICITS

As of June 30, 2012, the City had fund deficits as follows:

	Deficit
General fund	\$ (2,232,880)
Neighborhood Stabilization Program Grant	(1,556)
MSHDA planning grant	(6,049)

4. DEPOSITS AND INVESTMENTS

The captions on the government-wide and fund statements relating to cash and investments are as follows:

	Governmental Activities	Business-type Activities	Fiduciary Funds	Component Units	Total
Pooled cash and investments	\$ 556,288	\$ 78,429	\$ 451,613	\$ 1,784,962	\$ 2,871,292
Investments	-	-	10,891,376	-	10,891,376
Total deposits and investments	\$ 556,288	\$ 78,429	\$ 11,342,989	\$ 1,784,962	\$ 13,762,668

These deposits are in various financial institutions located in Michigan in varying amounts. State policy limits the Treasurer's investing options to financial institutions located in Michigan. All accounts are in the name of the City and a specific fund or common account. Deposits and investments are recorded in City records at fair value. Interest is recorded when earned.

Cash and investments are composed of the following at June 30, 2012:

Checking/savings accounts	\$ 2,870,441
Investments	10,891,376
Petty cash	851
Total cash and investments	\$ 13,762,668

Credit Risk. State law limits investments to specific government securities, certificates of deposits and bank accounts with qualified financial institutions, commercial paper with specific maximum maturities and ratings when purchased, bankers acceptances of the City's specific financial institutions, qualified mutual funds, and qualified external investment pools as identified in "statutory authority" in the significant accounting policies. The City's investment policy does not have specific limits in excess of state law on investment credit risk. The City had no general government investments with credit ratings at year end.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Custodial Credit Risk - Deposits. Custodial credit risk is the risk that in the event of a bank failure, the City’s deposits may not be returned. As of year-end, \$2,612,798 of the City’s bank balance of \$2,890,347 was exposed to custodial credit risk because it was not fully insured and/or collateralized.

Custodial Credit Risk-Investments. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. State law does not require and the City does not have a policy for the investment custodial risk. At year-end, the City had no investments subject to custodial credit risk.

Concentration of Credit Risk. State law limits allowable investments but does not limit concentration of credit risk. The City’s investment policy does not have specific limits in excess of state law on concentration of credit risk. All investments held at year-end are reported above.

Deposits and Investments - Pension Trust Funds

Investment and Deposit Risk

Interest Rate Risk. State law limits the allowable investments and the maturities of some of the allowable investments as identified under “statutory authority” in the significant accounting policies. The City’s investment policy does not have specific limits in excess of state law on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The maturity dates for each investment held at year-end are summarized as follows:

	General Employee Pension	Police and Fire Pension	Total
No maturity	\$ 2,766,407	\$ 5,981,656	\$ 8,748,063
1 to 5 years	499,985	1,050,496	1,550,481
6 to 10 years	190,914	401,918	592,832
	<u>\$ 3,457,306</u>	<u>\$ 7,434,070</u>	<u>\$ 10,891,376</u>

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Credit Risk. State law limits investments to specific government securities, certificates of deposits and bank accounts with qualified financial institutions, commercial paper with specific maximum maturities and ratings when purchased, bankers acceptances of the City’s specific financial institutions, qualified mutual funds, and qualified external investment pools as identified in “statutory authority” in the significant accounting policies. The City’s investment policy does not have specific limits in excess of state law on investment credit risk. The ratings for investments held at year-end are summarized as follows:

	General Employee Pension	Police and Fire Pension	Total
Not rated	\$ 2,568,566	\$ 5,576,587	\$ 8,145,153
Morningstar 4 stars	616,488	1,298,627	1,915,115
Morningstar 3 stars	272,252	558,856	831,108
	<u>\$ 3,457,306</u>	<u>\$ 7,434,070</u>	<u>\$ 10,891,376</u>

Custodial Credit Risk - Deposits. Custodial credit risk is the risk that in the event of a bank failure, the City’s deposits may not be returned. As of year-end, there were no Pension Trust Fund deposits on hand at the City.

Custodial Credit Risk - Investments. Following is a summary of the general employee pension and police and fire pension investments as of June 30, 2012:

	General Employee Pension	Police and Fire Pension	Total
Money market funds	\$ 300,134	\$ 861,696	\$ 1,161,830
Mutual funds - bonds	888,740	1,857,483	2,746,223
Mutual funds - equities	1,071,056	2,209,539	3,280,595
Common stock	1,195,166	2,500,733	3,695,899
Other	2,210	4,619	6,829
	<u>\$ 3,457,306</u>	<u>\$ 7,434,070</u>	<u>\$ 10,891,376</u>

Concentration of Credit Risk. State law limits allowable investments but does not limit concentration of credit risk. The City’s investment policy does not have specific limits in excess of state law on concentration of credit risk. All investments held at year-end are reported above.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

5. RECEIVABLES AND PAYABLES

At the end of the current fiscal year, the various components of receivables, net were as follows:

	Governmental Activities	Business-type Activities	Component Units
Accounts	\$ 442,399	\$ 1,012,381	\$ 63,534
Due from other governmental units	732,230	-	265,850
Taxes	23,672	-	-
	<u>\$ 1,198,301</u>	<u>\$ 1,012,381</u>	<u>\$ 329,384</u>

The various components of payables were as follows:

	Governmental Activities	Business-type Activities	Component Units
Accounts	\$ 1,558,322	\$ 630,335	\$ 128,553
Accrued payroll and related liabilities	123,319	14,817	57,492
Accrued interest payable	58,775	75,210	-
Deposits payable	-	277,311	58,927
Due to other governmental units	1,427,808	-	-
	<u>\$ 3,168,224</u>	<u>\$ 997,673</u>	<u>\$ 244,972</u>

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

6. CAPITAL ASSETS

Primary government

Changes in capital assets for the year ending June 30, 2012, are as follows:

	Balance June 30, 2011 (As Restated)	Additions	Deletions	Transfers	Balance June 30, 2012
Governmental activities					
Capital assets, not being depreciated					
Land	\$ 3,860,238	\$ -	\$ -	\$ -	\$ 3,860,238
Capital assets, being depreciated:					
Infrastructure	7,921,767	-	733,329	-	7,188,438
Airport depreciable property	9,112,065	-	-	-	9,112,065
Land improvements	716,750	172,683	-	-	889,433
Buildings and improvements	6,445,800	153,662	-	-	6,599,462
Vehicles	2,954,872	158,063	76,380	-	3,036,555
Equipment	3,660,246	329,671	17,280	-	3,972,637
Office furniture	127,080	-	-	-	127,080
	<u>30,938,580</u>	<u>814,079</u>	<u>826,989</u>	<u>-</u>	<u>30,925,670</u>
Less accumulated depreciation for:					
Infrastructure	1,984,111	327,441	90,139	-	2,221,413
Airport depreciable property	7,171,437	148,630	-	-	7,320,067
Land improvements	425,081	25,172	-	-	450,253
Buildings and improvements	3,654,723	208,387	-	-	3,863,110
Vehicles	2,414,620	210,108	76,380	-	2,548,348
Equipment	2,660,230	269,358	17,045	-	2,912,543
Office furniture	111,660	5,546	-	-	117,206
	<u>18,421,862</u>	<u>1,194,642</u>	<u>183,564</u>	<u>-</u>	<u>19,432,940</u>
Capital assets being depreciated, net	<u>12,516,718</u>	<u>(380,563)</u>	<u>643,425</u>	<u>-</u>	<u>11,492,730</u>
Governmental activities capital assets, net	<u>\$ 16,376,956</u>	<u>\$ (380,563)</u>	<u>\$ 643,425</u>	<u>\$ -</u>	<u>\$ 15,352,968</u>

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

	Balance June 30, 2011	Additions	Deletions	Transfers	Balance June 30, 2012
Business-type activities					
Capital assets, not being depreciated					
Land	\$ 6,736	\$ -	\$ 110	\$ -	\$ 6,626
Construction in progress	19,747,606	75,778	-	-	19,823,384
	<u>19,754,342</u>	<u>75,778</u>	<u>110</u>	<u>-</u>	<u>19,830,010</u>
Capital assets, being depreciated:					
Land improvements	40,138	-	-	-	40,138
Buildings and improvements	2,363,632	-	-	-	2,363,632
Utility systems	9,776,250	2,340,287	-	-	12,116,537
Vehicles and equipment	2,378,528	-	-	-	2,378,528
	<u>14,558,548</u>	<u>2,340,287</u>	<u>-</u>	<u>-</u>	<u>16,898,835</u>
Less accumulated depreciation for:					
Land improvements	13,921	573	-	-	14,494
Buildings and improvements	1,670,354	53,693	-	-	1,724,047
Utility systems	6,746,867	149,000	-	-	6,895,867
Vehicles and equipment	2,300,959	14,186	-	-	2,315,145
	<u>10,732,101</u>	<u>217,452</u>	<u>-</u>	<u>-</u>	<u>10,949,553</u>
Capital assets being depreciated, net	<u>3,826,447</u>	<u>2,122,835</u>	<u>-</u>	<u>-</u>	<u>5,949,282</u>
Business-type activities capital assets, net	<u>\$ 23,580,789</u>	<u>\$ 2,198,613</u>	<u>\$ 110</u>	<u>\$ -</u>	<u>\$ 25,779,292</u>

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental activities:

General government	\$ 245,817
Public safety	220,642
Public works	477,782
Community and economic development	191,770
Recreation and culture	58,631
	<u>58,631</u>

Total depreciation expense - governmental activities \$ 1,194,642

Business-type activities:

Utility services	<u>\$ 217,452</u>
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CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Component Units

	Balance October 1, 2010	Additions	Deletions	Transfers	Balance September 30, 2011
Twin Cities Area Transportation Authority					
Capital assets, not being depreciated					
Land	\$ 62,700	\$ -	\$ -	\$ -	\$ 62,700
Capital assets, being depreciated:					
Buildings and improvements	1,693,426	18,889	80,974	-	1,631,341
Vehicles	1,498,618	-	-	-	1,498,618
Equipment	555,478	1,131	138,948	-	417,661
	<u>3,747,522</u>	<u>20,020</u>	<u>219,922</u>	<u>-</u>	<u>3,547,620</u>
Less accumulated depreciation for:					
Buildings and improvements	1,541,405	14,841	80,974	-	1,475,272
Vehicles	652,559	223,411	-	-	875,970
Equipment	348,907	25,103	138,948	-	235,062
	<u>2,542,871</u>	<u>263,355</u>	<u>219,922</u>	<u>-</u>	<u>2,586,304</u>
Capital assets being depreciated, net	<u>1,204,651</u>	<u>(243,335)</u>	<u>-</u>	<u>-</u>	<u>961,316</u>
Twin Cities Area Transportation Authority capital assets, net					
	<u>\$ 1,267,351</u>	<u>\$ (243,335)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,024,016</u>

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

	Balance October 1, 2010	Additions	Deletions	Transfers	Balance September 30, 2011
City of Benton Harbor Housing Commission					
Capital assets, not being depreciated					
Land	\$ 121,806	\$ -	\$ 36,732	\$ -	\$ 85,074
Construction in progress	465,784	-	-	(262,788)	202,996
	<u>587,590</u>	<u>-</u>	<u>36,732</u>	<u>(262,788)</u>	<u>288,070</u>
Capital assets, being depreciated:					
Buildings and improvements	16,630,992	340,647	-	262,788	17,234,427
Furniture and equipment - admin	232,469	-	-	-	232,469
Furniture and equipment - dwellings	108,018	24,822	-	-	132,840
	<u>16,971,479</u>	<u>365,469</u>	<u>-</u>	<u>262,788</u>	<u>17,599,736</u>
Less accumulated depreciation for:					
All depreciable assets	<u>9,781,997</u>	<u>591,998</u>	<u>-</u>	<u>-</u>	<u>10,373,995</u>
Capital assets being depreciated, net	<u>7,189,482</u>	<u>(226,529)</u>	<u>-</u>	<u>262,788</u>	<u>7,225,741</u>
City of Benton Harbor Housing Commission capital assets, net					
	<u>\$ 7,777,072</u>	<u>\$ (226,529)</u>	<u>\$ 36,732</u>	<u>\$ -</u>	<u>\$ 7,513,811</u>

7. INTERFUND PAYABLES, RECEIVABLES, AND TRANSFERS

Interfund receivables/payables consist of the following at year-end:

	Due to other funds		
	General Fund	Nonmajor Governmental Funds	Total
Due from other funds			
General fund	\$ -	\$ 113,114	\$ 113,114
Neighborhood stabilization program grant	134,067	-	134,067
Nonmajor governmental funds	-	8,078	8,078
Utility services fund	830,385	-	830,385
Fiduciary funds	4,012	-	4,012
Total	<u>\$ 968,464</u>	<u>\$ 121,192</u>	<u>\$ 1,089,656</u>

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Interfund balances represent borrowing to cover short-term cash flow needs as well as balances payable and receivable for goods and services received from and provided to other funds.

The composition of transfers for the year ended June 30, 2012, is as follows:

	Operating transfers out Nonmajor governmental funds
Operating transfers in	
Nonmajor governmental funds	<u>\$ 78,649</u>

Transfer were used to cover costs that were incurred in one fund for the benefit of another.

8. LONG-TERM DEBT

The following is a summary of debt transactions of the City for the year ended June 30, 2012:

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Governmental Activities					
Loans and notes payable					
*\$200,000 Core Communities Loan due in quarterly installments of \$4,958 including interest at 6% through September of 2015; all remaining principal and accrued interest is due on December 31, 2015.	\$ 195,300	\$ -	\$ -	\$ 195,300	\$ 44,417
*\$200,000 State Infrastructure Loan due in annual installments of \$20,554 including interest at 0.5% through December 2018; all remaining principal and accrued interest is due on December 31, 2019.	200,000	-	-	200,000	38,199
\$1,050,000 HUD Section 108 Loan due in annual installments of \$20,000 to \$100,000 through August 2022; interest at 5%.	670,000	-	130,000	540,000	100,000
Total loans and notes payable	<u>1,065,300</u>	<u>-</u>	<u>130,000</u>	<u>935,300</u>	<u>182,616</u>

* Currently maturities include amounts from prior years which were unpaid.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Capital leases payable					
Lawn equipment	\$ 27,027	\$ -	\$ 14,457	\$ 12,570	\$ 12,570
Computers	8,382	-	5,783	2,599	2,599
Copiers	6,784	-	2,909	3,875	3,132
Wheel loader	35,621	-	23,070	12,551	12,551
Street sweeper	118,704	-	34,839	83,865	36,349
Four trucks	62,200	-	39,852	22,348	22,348
Total capital leases payable	258,718	-	120,910	137,808	89,549
Compensated absences	257,962	192,746	193,472	257,236	192,927
Termination benefit liability	30,280	-	4,683	25,597	4,800
Total governmental activities	\$ 1,612,260	\$ 192,746	\$ 449,065	\$ 1,355,941	\$ 469,892
Business-type activities					
Loans and notes payable					
Note payable to Benton Township; due in monthly installments of \$22,857 through December 2013; including interest at 3.00%.	\$ 659,828	\$ -	\$ 257,511	\$ 402,317	\$ 265,863
\$978,000 Drinking Water Revolving Fund Loan; due in annual installments of \$5,000 to \$10,000 beginning October 2011 through October 2040; interest at 2.50%.	978,000	-	657,492	320,508	5,000
Less: amounts not drawn	(320,508)	29,483	-	(291,025)	-
	657,492	29,483	657,492	29,483	5,000
\$8,622,000 Drinking Water Revolving Fund Loan; due in annual installments of \$200,000 to \$400,000 beginning April 2012 through April 2041; interest at 2.50%.	8,622,000	-	207,000	8,415,000	200,000
Less: amounts not drawn	(1,509,253)	1,509,253	-	-	-
	7,112,747	1,509,253	207,000	8,415,000	200,000

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
\$3,096,000 Drinking Water Revolving Fund Loan; due in annual installments of \$121,000 to \$195,000 beginning October 2011 through October 2030; interest at 2.50%.					
	\$ 3,096,000	\$ -	\$ 121,000	\$ 2,975,000	\$ 125,000
Less: amounts not drawn	(589,458)	203,358	-	(386,100)	-
	<u>2,506,542</u>	<u>203,358</u>	<u>121,000</u>	<u>2,588,900</u>	<u>125,000</u>
\$1,705,000 Drinking Water Revolving Fund Loan; due in annual installments of \$65,000 to \$105,000 beginning April 2013 through April 2032; interest at 2.50%.					
	-	1,705,000	-	1,705,000	65,000
Less: amounts not drawn	-	(699,254)	-	(699,254)	-
	<u>-</u>	<u>1,005,746</u>	<u>-</u>	<u>1,005,746</u>	<u>65,000</u>
Total loans and notes payable	10,936,609	2,747,840	1,243,003	12,441,446	660,863
Capital leases					
Computers	9,708	-	5,665	4,043	4,043
Compensated absences	67,372	27,210	50,529	44,053	33,040
Total business-type activities	\$ 11,013,689	\$ 2,775,050	\$ 1,299,197	\$ 12,489,542	\$ 697,946

Annual debt service requirements to maturity for loans and notes payable are as follows:

Year Ended June 30,	Governmental Activities		Business-type Activities	
	Principal	Interest	Principal	Interest
2013	\$ 182,616	\$ 25,367	\$ 660,863	\$ 302,618
2014	126,929	22,328	546,452	285,524
2015	127,468	19,254	420,000	274,009
2016	256,017	10,335	430,000	263,657
2017	40,043	3,794	440,000	252,707
2018-2022	182,227	9,250	2,390,000	1,092,723
2023-2027	20,000	-	2,690,000	776,153
2028-2032	-	-	2,835,000	446,683
2033-2037	-	-	1,800,000	300,999
2038-2041	-	-	1,605,508	75,206
Less: amounts not drawn	-	-	(1,376,377)	-
	<u>\$ 935,300</u>	<u>\$ 90,328</u>	<u>\$ 12,441,446</u>	<u>\$ 4,070,279</u>

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

The estimated annual requirements to maturity on the total capital leases outstanding at June 30, 2012 are as follows:

	Governmental Activities		Business-type Activities	
	Principal	Interest	Principal	Interest
2013	\$ 89,549	\$ 5,817	\$ 4,043	\$ 126
2014	48,259	1,649	-	-
	<u>\$ 137,808</u>	<u>\$ 7,466</u>	<u>\$ 4,043</u>	<u>\$ 126</u>

For the governmental activities, compensated absences are generally liquidated by the general fund.

Termination benefits in the amount of a \$200 per month stipend to defray health insurance costs paid directly to the individual's insurance provider. These payments are scheduled to continue until the former employee becomes Medicare eligible. Three individuals are currently participating in the plan. Two other former fire fighters are eligible to participate in the benefit, but do not qualify at this time because they do not currently have personal health insurance. The liability recognized is the net present value of the expected future cash flows related to this benefit using a discount rate of 2.5%.

9. FUND BALANCES - GOVERNMENTAL FUNDS

In accordance with GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, the City classifies fund balances of governmental funds based on the extent to which a government is bound to observe constraints imposed upon the use of the resources. Detailed information on fund balances of governmental funds is as follows:

	General Fund	Neighborhood Stabilization Program II	Nonmajor Governmental Funds	Total
Nonspendable:				
Prepaid items	\$ 52,603	\$ -	\$ -	\$ 52,603
Restricted for:				
Major and local streets	-	-	75,964	75,964
Unassigned (deficit)	<u>(2,285,483)</u>	<u>-</u>	<u>(7,605)</u>	<u>(2,293,088)</u>
	<u>\$ (2,232,880)</u>	<u>\$ -</u>	<u>\$ 68,359</u>	<u>\$ (2,164,521)</u>

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

10. NET ASSETS INVESTED IN CAPITAL ASSETS, NET OF RELATED DEBT

	Governmental Activities	Business-type Activities	Total
Capital assets:			
Not being depreciated	\$ 3,860,238	\$ 19,830,010	\$ 23,690,248
Being depreciated, net	11,492,730	5,949,282	17,442,012
	<u>15,352,968</u>	<u>25,779,292</u>	<u>41,132,260</u>
Related debt:			
Loans and notes payable	935,300	12,441,446	13,376,746
Capital leases payable	137,808	4,043	141,851
	<u>1,073,108</u>	<u>12,445,489</u>	<u>13,518,597</u>
Invested in capital assets, net of capital-related debt	<u>\$ 14,279,860</u>	<u>\$ 13,333,803</u>	<u>\$ 27,613,663</u>

11. DEFINED BENEFIT PENSION PLANS

General Employees Retirement System

Plan description. The City of Benton Harbor administers a single-employer defined benefit pension plan (the "General Employee Plan"), that covers all appointed officers and employees of the City (except for employees of the fire and police departments) and appointed officers and employees of the Southwest Michigan Regional Airport Authority.

Funding policy. The contribution requirements of General Employee Plan members and the City are established and may be amended by the City Council. The required contribution is based on actuarially determined requirements. For the year ended June 30, 2012, the City contributed \$196,940 to the General Employee Plan. The General Employee Plan participants are required to contribute 3% of their salary to the Plan. A total of \$108,087 was withheld from employee's salary during the year.

For the year ended June 30, 2012, the General Employee Plan's required contribution was \$707,289. The required contribution was determined as part of the July 1, 2011 actuarial valuation using the aggregate actuarial cost method. The actuarial assumptions included: (a) a rate of return on the investment of present and future assets of 7.75%; (b) projected salary increases of 4.0% per year compounded annually, attributable to inflation; and (c) post-retirement Benefits will increase based on City Council resolution. The actuarial value of assets was determined using a technique that smooth the effects of short-term volatility over a five-year period.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Annual Pension Cost and Net Pension Obligation. The City's annual net pension cost (expense) is calculated based on the *annual required contribution of the employer (ARC)*. The ARC 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 (or funding excess) over a period not to exceed thirty years. The following table shows the components of the General Employee Plan's annual net pension cost for the year, the amount actually contributed to the Plan, and changes in the net pension obligation:

Annual required contribution	\$ 707,289
Interest on net pension obligation	237,994
Adjustment to annual required contribution	<u>(153,544)</u>
Net pension cost (expense)	791,739
Contributions made	<u>(196,940)</u>
Increase in net pension obligation	594,799
Net pension obligation, beginning of year	<u>3,070,888</u>
Net pension obligation, end of year	<u><u>\$ 3,665,687</u></u>

The City allocates this liability ratably to its various functions and activities on the basis of covered payroll.

The Plan's annual pension cost, the percentage of annual pension cost contributed to the Plan, and the net pension obligation for 2012 and the two preceding years were as follows:

Three-Year Trend Information			
Year Ended	Annual Pension Cost	Percentage of Annual Pension Cost Contributed	Net Pension Obligation
2010	\$ 604,326	0%	\$ 2,295,979
2011	774,909	0%	3,070,888
2012	791,739	25%	3,665,687

Funded status and funding progress. As of July 1, 2011, the date of the most recent actuarial valuation, the Plan was 47% funded. The actuarial accrued liability for benefits (AAL) was \$9,799,009, and the actuarial value of plan assets was \$4,592,264, leaving an unfunded AAL (UAAL) of \$5,206,745. The covered payroll (annual payroll of the active employees covered by the Plan) was \$1,938,742 and the ratio of the UAAL to the covered payroll was 269 percent.

The schedules of funding progress and employer contributions, presented as required supplementary information (RSI) following the notes to the financial statements, presents multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AAL for benefits.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Police and Fire Retirement System

Plan description. The City of Benton Harbor administers a single-employer defined benefit pension plan (the “Police and Fire Plan”), that covers all employees of the fire and police departments.

Funding policy. The contribution requirements of Police and Fire Plan members and the City are established and may be amended by the City Council. The required contribution is based on actuarially determined requirements. For the year ended June 30, 2012, the City contributed \$49,466 to the Police and Fire Plan. The Police and Fire Plan participants are required to contribute 10% and 11% of their salaries, respectively, to the Plan. A total of \$117,972 was withheld from employee’s salary during the year.

For the year ended June 30, 2012, the Police and Fire Plan’s required contribution was \$785,007. The required contribution was determined as part of the July 1, 2010 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included: (a) a rate of return on the investment of present and future assets of 7.75%; (b) projected salary increases of 4.0% per year compounded annually, attributable to inflation; (c) projected cost-of-living adjustments of 3% per year for retirees eligible for COLA; and (c) post-retirement Benefits will increase based on City Council resolution. The actuarial value of assets was determined using the market value of the underlying assets. The Police and Fire Plan’s unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at July 1, 2010, the date of the latest actuarial valuation, was 21 years.

Annual Pension Cost and Net Pension Obligation. The City’s annual net pension cost (expense) is calculated based on the *annual required contribution of the employer (ARC)*. The ARC 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 (or funding excess) over a period not to exceed thirty years. The following table shows the components of the Police and Fire Plan’s annual net pension for the year, the amount actually contributed to the Plan, and changes in the net pension obligation:

Annual required contribution	\$ 785,007
Interest on net pension obligation	112,348
Adjustment to annual required contribution	<u>(76,297)</u>
Net pension cost (expense)	821,058
Contributions made	<u>(49,466)</u>
Increase in net pension obligation	771,592
Net pension obligation, beginning of year	<u>1,449,648</u>
Net pension obligation, end of year	<u><u>\$ 2,221,240</u></u>

The City allocates this liability ratably to the applicable functions and activities on the basis of covered payroll.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

The Plan's annual pension cost, the percentage of annual pension cost contributed to the Plan, and the net pension obligation for 2012 and the two preceding years were as follows:

Three-Year Trend Information			
Year Ended	Annual Pension Cost	Percentage of Annual Pension Cost Contributed	Net Pension Obligation
2010	\$ 436,282	0%	\$ 2,295,979
2011	802,796	0%	1,449,648
2012	821,058	6%	2,221,240

Funded status and funding progress. As of July 1, 2010, the date of the most recent actuarial valuation, the Plan was 52% funded. The actuarial accrued liability for benefits (AAL) was \$16,066,362, and the actuarial value of plan assets was \$8,413,034, leaving an unfunded AAL (UAAL) of \$7,653,328. The covered payroll (annual payroll of the active employees covered by the Plan) was \$1,650,025 and the ratio of the UAAL to the covered payroll was 464 percent.

The schedules of funding progress and employer contributions, presented as required supplementary information (RSI) following the notes to the financial statements, presents multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AAL for benefits.

12. JEAN KLOCK PARK LEASE

On January 22, 2007, the City entered into an operating lease with Harbor Shores Community Redevelopment, Inc. (HSCRI), a not-for-profit organization, for approximately 22 acres of Jean Klock Park for the purpose of constructing three holes of a Jack Nicklaus signature golf course that is being built as part of the Harbor Shore development project. The lease was amended and restated on July 25, 2008 and will run for 35 years with renewal options for two additional 35- year terms.

In addition, the HSCRI agrees to make an annual payment to the City of Benton Harbor Community Benefits Program (various community benefit programs, including transportation, small business development, adult education, reduced golf course rates, and golf course access for various youth events). The annual amount will be the greater of \$5,000 or 20 percent of annual net operating income of the golf course, as defined in the lease agreement.

The initial annual lease payment of \$30,000 was payable no later than June 30, 2007. Subsequent annual payments will increase by 1 percent per year. Rent income of \$31,530 was received in 2012 and is recorded in the General Fund.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

Future minimum lease commitments are as follows:

Year Ended June 30,	Amount
2013	\$ 31,845
2014	32,163
2015	32,485
2016	32,810
2017	33,138
2018-2022	170,726
2023-2027	179,433
2028-2032	188,584
2033-2037	198,204
2038-2041	165,813
	\$ 1,065,201
	\$ 1,065,201

Additional lease terms are as follows:

The HSCRI will construct and pay for certain road improvements related to the project totaling approximately \$2,800,000, contingent upon approval and receipt of approximately \$1,035,000 of MDOT grant funding assistance.

The HSCRI will construct and improve Graham Avenue at a cost of approximately \$3,100,500, contingent upon approval and receipt of approximately \$1,990,800 of MDOT grant funding assistance.

The HSCRI will construct and pay for improvements to the expansion properties at an estimated cost of \$500,000, as well as construct and pay for improvements to existing Jean Klock Park estimated at a cost of \$1,000,000.

The HSCRI will convey certain property to the City as “expansion properties” to be added to Jean Klock Park. The estimated value of these expansion properties is approximately \$999,500.

The HSCRI agrees to provide customary park maintenance at an approximate annual cost of \$115,000.

The HSCRI agrees to provide specified percentages of construction and ongoing maintenance jobs to the City of Benton Harbor residents.

The HSCRI agrees to provide various community benefit programs to residents of the cities of Benton Harbor and St. Joseph and Berrien City. Two lawsuits have been filed, one in Berrien City courts and one in federal court, to prevent the construction of these three holes in Jean Klock Park. The Berrien City lawsuit, which names the City of Benton Harbor and HSCRI as defendants, was dismissed on August 22, 2008 but an appeal has been filed. The City of Benton Harbor was not named as a defendant in the federal lawsuit. Both cases are still pending.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

13. CONTINGENCIES

Federal Grants

The City has received several federal grants for specific purposes that are subject to review and audit by the grantor agencies. Although no amounts have been claimed, such audits could lead to requests for reimbursement to the grantor agency for expenditures disallowed under the terms of the grant. The City believes such disallowances, if any, will be immaterial.

Litigation and Other Matters

In the normal course of its activities, the City has become a party in various legal actions, including property tax assessment appeals, as well as other claims against the City. Management of the City is of the opinion that the outcome of such actions will not have a material effect on the financial position of the City and, therefore, has not reflected loss reserves in the financial statements.

14. RISK MANAGEMENT

The City 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. During the year ended June 30, 2012, the City carried commercial insurance to cover all risks of losses. The City has had no settled claims resulting from these risks that exceeded their commercial coverage in any of the past three fiscal years. There was no significant change in coverage during the year.

15. SPECIAL ITEMS

Special items are reported in the basic financial statements at June 30, 2012 for the following items:

Write-off of property tax liability due to other governments- During the current year, the City recognized \$668,555 of revenue from a write-off of property tax collections that were reported as due to other governmental units at June 30, 2011. The City performed various steps to ensure that these amounts are not due to the units, including but not limited to confirming with the units that there are no outstanding balances from prior years. Management believes that any claims that may arise against these tax collections would be immaterial.

Write-off of outstanding checks - The City has written off \$190,524 of outstanding checks dated prior to 2007. The reasoning behind this was the City believes that internal control related issues in regards to voiding and cutting checks contributed to the large balance of outstanding checks and that such amounts are not actually owed to any third parties. Management believes that any claims that may arise against these outstanding checks would be immaterial.

16. RESTATEMENTS

The fund balance of the general fund was decreased by \$152,963 to account for accounts payable amounts that were not properly accrued in fiscal year 2011.

The net assets of governmental activities were increased by \$816,316 to adjust for capital assets that were over-depreciated as of June 30, 2011 due to a software malfunction.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Financial Statements

17. FUNDING UNCERTAINTIES

Under Public Act 72 of 1990 and pursuant to a report issued by a State appointed financial review team dated January 27, 2010, the governor appointed Joseph L. Harris as the Emergency Financial Manager (EFM) effective April 1, 2010. The (EFM) submitted a financial and operating plan to eliminate the operating deficit for the 2012 fiscal year. The key initiatives that will be undertaken to eliminate the operating deficit are as follows:

- Secure a three million dollar emergency loan from the State of Michigan to extinguish the General Fund deficit, pay all delinquent obligations to vendors, and provide the City with much needed working capital.
- Thirty-three percent reduction in City employees combined with a 20 percent payment of health care premiums by employees.
- Increase in the employee contribution to the pension funds.



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REQUIRED SUPPLEMENTARY INFORMATION

CITY OF BENTON HARBOR, MICHIGAN

Required Supplemental Information

For the Year Ended June 30, 2012

General Employee's Retirement System

Schedule of Funding Progress - Defined Benefit Pension Plan

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
07/01/2006	\$ 6,910,619	\$ 9,412,291	\$ 2,501,672	73%	\$ 2,883,603	87%
07/01/2007	7,261,183	9,763,237	2,502,054	74%	2,783,905	90%
07/01/2008	7,428,057	10,619,392	3,191,335	70%	2,607,898	122%
07/01/2009	6,558,179	10,694,725	4,136,546	61%	2,239,425	185%
07/01/2010	6,526,996	11,292,842	4,765,846	58%	2,113,602	225%
07/01/2011	4,592,264	9,799,009	5,206,745	47%	1,938,742	269%

Schedule of Employer Contributions - Defined Benefit Pension Plan

Year Ended June 30,	Annual Required Contribution (ARC)	Percentage of ARC Contributed
2007	\$ 488,323	4%
2008	492,067	1%
2009	596,948	12%
2010	649,894	0%
2011	711,770	0%
2012	707,289	28%

CITY OF BENTON HARBOR, MICHIGAN

Required Supplemental Information

For the Year Ended June 30, 2012

Police and Fire Employee's Retirement System

Schedule of Funding Progress - Defined Benefit Pension Plan

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
06/30/2002	\$ 10,210,869	\$ 12,109,175	1,898,306	84%	\$ 1,231,468	154%
06/30/2003	10,235,411	11,884,761	1,649,350	86%	1,349,989	122%
06/30/2004	10,184,702	14,548,269	4,363,567	70%	1,439,856	303%
06/30/2005	10,337,642	14,618,145	4,280,503	71%	1,610,145	266%
06/30/2007	10,865,083	14,720,295	3,855,212	74%	1,744,669	221%
07/01/2010	8,413,034	16,066,362	7,653,328	52%	1,650,025	464%

Schedule of Employer Contributions - Defined Benefit Pension Plan

Year Ended June 30,	Annual Required Contribution (ARC)	Percentage of ARC Contributed
2007	\$ 472,707	67%
2008	413,871	86%
2009	445,170	1%
2010	436,282	0%
2011	785,007	0%
2012	785,007	6%

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**COMBINING AND INDIVIDUAL FUND
STATEMENTS AND SCHEDULES**

CITY OF BENTON HARBOR, MICHIGAN

Combining Balance Sheet Nonmajor Governmental Funds June 30, 2012

	Special Revenue Funds			
	Major Streets	Local Streets	Community Development Block Grant	MSHDA Community Development
Assets				
Cash and pooled investments	\$ 232,616	\$ -	\$ 79,190	\$ -
Receivables:				
Accounts	99,001	-	179	-
Due from other governmental units	-	-	64,310	65,264
Taxes	-	-	-	-
Due from other funds	-	8,078	-	-
Total assets	<u>\$ 331,617</u>	<u>\$ 8,078</u>	<u>\$ 143,679</u>	<u>\$ 65,264</u>
Liabilities				
Accounts payable	\$ 54,529	\$ 4,915	\$ 42,305	\$ 59,224
Accrued liabilities	2,864	3,128	1,199	484
Due to other governmental units	157,375	-	26,406	-
Due to other funds	40,920	-	73,769	5,556
Deferred revenue	-	-	-	-
Total liabilities	<u>255,688</u>	<u>8,043</u>	<u>143,679</u>	<u>65,264</u>
Fund balances				
Restricted	75,929	35	-	-
Unassigned (deficit)	-	-	-	-
Total fund balances	<u>75,929</u>	<u>35</u>	<u>-</u>	<u>-</u>
Total liabilities and fund balances	<u>\$ 331,617</u>	<u>\$ 8,078</u>	<u>\$ 143,679</u>	<u>\$ 65,264</u>

Special Revenue Funds		Debt Service Fund	Capital Project Fund	Total Nonmajor Governmental Funds
Neighborhood Stabilization Program Grant	MSHDA Planning Grant	Debt Service	Public Improvement	
\$ -	\$ -	\$ -	\$ -	\$ 311,806
-	-	-	-	99,180
1,555	6,049	-	-	137,178
-	-	1,822	1,799	3,621
-	-	-	-	8,078
<u>\$ 1,555</u>	<u>\$ 6,049</u>	<u>\$ 1,822</u>	<u>\$ 1,799</u>	<u>\$ 559,863</u>
\$ 757	\$ 5,901	\$ -	\$ -	\$ 167,631
-	-	-	-	7,675
-	-	-	-	183,781
799	148	-	-	121,192
1,555	6,049	1,822	1,799	11,225
<u>3,111</u>	<u>12,098</u>	<u>1,822</u>	<u>1,799</u>	<u>491,504</u>
-	-	-	-	75,964
(1,556)	(6,049)	-	-	(7,605)
<u>(1,556)</u>	<u>(6,049)</u>	<u>-</u>	<u>-</u>	<u>68,359</u>
<u>\$ 1,555</u>	<u>\$ 6,049</u>	<u>\$ 1,822</u>	<u>\$ 1,799</u>	<u>\$ 559,863</u>

CITY OF BENTON HARBOR, MICHIGAN

Combining Statement of Revenues, Expenditures and Changes in Fund Balances Nonmajor Governmental Funds For the Year Ended June 30, 2012

	Special Revenue Funds			
	Major Streets	Local Streets	Community Development Block Grant	MSHDA Community Development
Revenues				
Property taxes	\$ -	\$ -	\$ -	\$ -
Intergovernmental revenues:				
Federal	-	-	665,083	252,702
State	529,129	180,753	-	-
Local	620,674	-	-	-
Interest and rentals	23	5	-	-
Total revenues	1,149,826	180,758	665,083	252,702
Expenditures				
Current:				
Public works	1,007,027	269,397	-	-
Culture and recreation	-	-	503,992	252,702
Debt service:				
Principal	-	-	130,000	-
Interest	-	-	31,091	-
Capital outlay	-	-	-	-
Total expenditures	1,007,027	269,397	665,083	252,702
Revenues over (under) expenditures	142,799	(88,639)	-	-
Other financing sources (uses)				
Transfers in	-	78,649	-	-
Transfers out	(78,649)	-	-	-
Total other financing sources (uses)	(78,649)	78,649	-	-
Net change in fund balances	64,150	(9,990)	-	-
Fund balances (deficits), beginning of year	11,779	10,025	-	-
Fund balances (deficit), end of year	\$ 75,929	\$ 35	\$ -	\$ -

Special Revenue Funds		Debt Service Fund	Capital Project Fund	Total Nonmajor Governmental Funds
Neighborhood Stabilization Program Grant	MSHDA Planning Grant	Debt Service	Public Improvement	
\$ -	\$ -	\$ -	\$ 176,759	\$ 176,759
-	-	-	-	917,785
-	25,931	-	-	735,813
-	-	-	-	620,674
-	-	-	-	28
-	25,931	-	176,759	2,451,059
-	-	-	-	1,276,424
1,556	31,980	-	-	790,230
-	-	-	-	130,000
-	-	-	-	31,091
-	-	-	176,759	176,759
1,556	31,980	-	176,759	2,404,504
(1,556)	(6,049)	-	-	46,555
-	-	-	-	78,649
-	-	-	-	(78,649)
-	-	-	-	-
(1,556)	(6,049)	-	-	46,555
-	-	-	-	21,804
<u>\$ (1,556)</u>	<u>\$ (6,049)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 68,359</u>

CITY OF BENTON HARBOR, MICHIGAN

Combining Statement of Fiduciary Net Assets

Pension Trust Funds

June 30, 2012

	General Employee Pension	Police and Fire Pension	Total
Assets			
Pooled cash and investments	\$ 225,717	\$ 225,000	\$ 450,717
Investments, at fair value:			
Money market funds	300,134	861,696	1,161,830
Mutual funds - bonds	888,740	1,857,483	2,746,223
Mutual funds - equities	1,071,056	2,209,539	3,280,595
Common stock	1,195,166	2,500,733	3,695,899
Other	2,210	4,619	6,829
Total investments, at fair value	<u>3,457,306</u>	<u>7,434,070</u>	<u>10,891,376</u>
Property taxes receivable	<u>-</u>	<u>2,048</u>	<u>2,048</u>
Total assets	3,683,023	7,661,118	11,344,141
Liabilities			
Accounts payable	<u>-</u>	<u>2,048</u>	<u>2,048</u>
Net assets			
Held in trust for benefits	<u>\$ 3,683,023</u>	<u>\$ 7,659,070</u>	<u>\$ 11,342,093</u>

CITY OF BENTON HARBOR, MICHIGAN

Combining Statement of Changes in Fiduciary Net Assets

Pension Trust Funds

For the Year Ended June 30, 2012

	General Employee Pension	Police and Fire Pension	Total
Additions			
Contributions:			
Employer	\$ 196,940	\$ 49,466	\$ 246,406
Employee	108,087	117,972	226,059
Investment loss	(38,825)	(93,269)	(132,094)
Property taxes	-	88,135	88,135
Other revenue	114	12	126
Total additions	<u>266,316</u>	<u>162,316</u>	<u>428,632</u>
Deductions			
Distributions and benefit payments	846,382	1,386,794	2,233,176
Administrative	23,406	2,554	25,960
Total deductions	<u>869,788</u>	<u>1,389,348</u>	<u>2,259,136</u>
Change in net assets	(603,472)	(1,227,032)	(1,830,504)
Net assets, beginning of year	<u>4,286,495</u>	<u>8,886,102</u>	<u>13,172,597</u>
Net assets, end of year	<u>\$ 3,683,023</u>	<u>\$ 7,659,070</u>	<u>\$ 11,342,093</u>

CITY OF BENTON HARBOR, MICHIGAN

Combining Statement of Fiduciary Assets and Liabilities

Agency Funds
June 30, 2012

	Tax Collection Fund	Imprest Payroll Fund	Total
Assets			
Pooled cash and investments	\$ 896	\$ -	\$ 896
Due from other funds	4,012	-	4,012
Total assets	<u>\$ 4,908</u>	<u>\$ -</u>	<u>\$ 4,908</u>
Liabilities			
Accounts payable	<u>\$ 4,908</u>	<u>\$ -</u>	<u>\$ 4,908</u>

CITY OF BENTON HARBOR, MICHIGAN

Balance Sheet

Brownfield Redevelopment Authority

June 30, 2012

Assets

Cash and pooled investments	\$ 194,567
Accounts receivable	5,333
	<hr/>

Total assets	\$ 199,900
	<hr/> <hr/>

Liabilities

Accounts payable	\$ 13,568
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Fund balance

Restricted	184,832
	<hr/>

Total liabilities and fund balance	\$ 198,400
	<hr/> <hr/>

CITY OF BENTON HARBOR, MICHIGAN

Statement of Revenues, Expenditures and Changes in Fund Balance

Brownfield Redevelopment Authority

For the Year Ended June 30, 2012

Revenues

Property taxes	\$ 113,889
Application Fees	-
Other	<u>135,058</u>

Total revenues 248,947

Expenditures

Current:

Public works	<u>213,776</u>
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Net change in fund balance 35,171

Fund balance, beginning of year 149,661

Fund balance, end of year \$ 184,832

City of Benton
Harbor, Michigan



Year Ended
June 30, 2012

Single Audit Act
Compliance

CITY OF BENTON HARBOR, MICHIGAN

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**INDEPENDENT AUDITORS' REPORT ON THE
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

December 18, 2012

Emergency Financial Manager of
the City of Benton Harbor
Benton Harbor, Michigan

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the *City of Benton Harbor, Michigan* ("the City") as of and for the year ended June 30, 2012, which collectively comprise the basic financial statements, and have issued our report thereon dated December 18, 2012. Our report includes a reference to other auditors, and was qualified for certain departures from accounting principles generally accepted in the United States of America. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates 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.

A handwritten signature in black ink that reads "Rehmann Lobson". The signature is written in a cursive, flowing style.

CITY OF BENTON HARBOR, MICHIGAN

Schedule of Expenditures of Federal Awards

For the Year Ended June 30, 2012

Federal Agency / Cluster / Program Title	CFDA Number	Passed Through	Pass-through / Grantor Number	Federal Expenditures
U.S. Department of Housing and Urban Development				
Community Development Block Grant	14.218	Direct	B-11-MC-26-0035	\$ 665,083
ARRA - Neighborhood Stabilization Program	14.256	MSHDA	NSP-2009-0610	3,486,266
Home Investment Partnership (HOME)	14.239	MSHDA	M-2008-0610	<u>252,702</u>
Total U.S. Department of Housing and Urban Development				<u>4,404,051</u>
U.S. Department of Justice				
JAG Program Cluster:				
Edward Byrne Memorial Justice Assistance Grant	16.738	Direct	2011-DJ-BX-2772	9,695
Edward Byrne Memorial Justice Assistance Grant	16.738	Direct	2010-DJ-BX-1486	9,645
ARRA - Edward Byrne Memorial Justice Assistance Grant	16.803	Direct	2009-SU-B9-0017	<u>279,058</u>
Total U.S. Department of Justice				<u>298,398</u>
U.S. Environmental Protection Agency				
Drinking Water State Revolving Fund	66.468	MDEQ	5330-01	1,005,746
ARRA - Drinking Water State Revolving Fund	66.468	MDEQ	5329-01	203,358
ARRA - Drinking Water State Revolving Fund	66.468	MDEQ	7262-01	29,483
ARRA - Drinking Water State Revolving Fund	66.468	MDEQ	7273-01	<u>1,509,253</u>
Total U.S. Environmental Protection Agency				<u>2,747,840</u>
Total Expenditures of Federal Awards				<u><u>\$ 7,450,289</u></u>

See notes to schedule of expenditures of federal awards.

CITY OF BENTON HARBOR, MICHIGAN

Notes to Schedule of Expenditures of Federal Awards

1. BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards (the "Schedule") includes the federal grant activity of the City of Benton Harbor, Michigan (the "City") under programs of the federal government for the year ended June 30, 2012. The information in this schedule is presented in accordance with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the Schedule presents only a selected portion of the operations of the City, it is not intended to and does not present the financial position, changes in net assets or cash flows of the City.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the modified accrual basis of accounting, which is described in Note 1 to the City's financial statements. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Negative amounts shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years. Pass-through entity identifying numbers are presented where available.

3. OTHER FEDERAL REVENUE

The basic financial statements of the City of Benton Harbor include two discretely presented component units that have engaged other auditors to perform the audits of their financial statements. The Twin Cities Area Transportation Authority reported federal revenue of \$994,135, and the Benton Harbor Housing Commission reported federal revenue of \$365,470. These amounts are not included on the Schedule, as those organizations were separately audited.

4. PASS-THROUGH AGENCIES

The City receives certain federal grant as subawards from non-federal entities. Pass-through entities, where applicable, have been identified in the Schedule with an abbreviation, defined as follows:

Pass-through Agency Abbreviation	Pass-through Agency Name
MSHDA	Michigan State Housing Development Authority
MDEQ	Michigan Department of Environmental Quality

CITY OF BENTON HARBOR, MICHIGAN

Notes to Schedule of Expenditures of Federal Awards

5. RECONCILIATION TO FINANCIAL STATEMENTS

A reconciliation of the amount reported as federal revenue in the City's financial statements to the amount reported in the Schedule is as follows:

Federal revenue reported in the financial statements	\$ 4,702,449
Add: Current year federal loan activity	<u>2,747,840</u>
Total expenditures of federal awards	<u>\$ 7,450,289</u>



**INDEPENDENT AUDITORS' 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***

December 18, 2012

Emergency Financial Manager of
the City of Benton Harbor
Benton Harbor, Michigan

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the *City of Benton Harbor, Michigan* (the "City") as of and for the year ended June 30, 2012, which collectively comprise the basic financial statements of the City, and have issued our report thereon dated December 18, 2012. Our report includes a reference to other auditors, and was qualified for certain departures from accounting principles generally accepted in the United States of America. 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

Management of the City is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the City'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 City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statement will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as items 2012-FS-1 through -7 to be material weaknesses in internal control over financial reporting.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City'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 statements 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 instances of noncompliance that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items FS-2012-3, -4, -6 and -7.

In addition, we noted certain other matters that we reported to management of the City in a separate letter dated December 18, 2012.

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Emergency Financial Manager, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Lehmann Johnson".

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH
REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT
ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

December 18, 2012

Emergency Financial Manager of
the City of Benton Harbor
Benton Harbor, Michigan

Compliance

We have audited the *City of Benton Harbor, Michigan's* ("the City") compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the City's major federal programs for the year ended June 30, 2012. The City's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the City's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the City's compliance with those requirements.

As described in item 2012-SA-1 in the accompanying schedule of findings and questioned costs, the City did not comply with a requirement regarding Allowable Costs/Cost Principles that is applicable to its Neighborhood Stabilization II and CDBG programs. Compliance with this requirement is necessary, in our opinion, for the City to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the City complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal programs for the year ended June 30, 2012. The results of our auditing procedures disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2012-SA-2 and -3.

Internal Control Over Compliance

Management of the City is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the City's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified a certain deficiency in internal control over compliance that we consider to be a material weakness, and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over compliance 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, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 2012-SA-1 to be a material weakness.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, as items 2012-SA-2 and -3 to be significant deficiencies.

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the City's responses, and accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Emergency Financial Manager, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, reading "Lehmann Lohman". The signature is written in a cursive style with a large, prominent initial 'L'.

CITY OF BENTON HARBOR, MICHIGAN

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2012

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: Qualified

Internal control over financial reporting:

Material weakness(es) identified? X yes no

Significant deficiency(ies) identified? yes X none reported

Noncompliance material to financial statements noted? X yes no

Federal Awards

Internal control over major programs:

Material weakness(es) identified? X yes no

Significant deficiency(ies) identified? X yes none reported

Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section 510(a)? X yes no

Identification of major programs/
Type of auditor's report issued on compliance for major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>	<u>Opinion</u>
14.218	Community Development Block Grant	Qualified
14.256	Neighborhood Stabilization II	Qualified
66.468	State Drinking Water Revolving Fund	Unqualified

Dollar threshold used to distinguish between Type A and Type B programs: \$ 300,000

Auditee qualified as low-risk auditee? yes X no

CITY OF BENTON HARBOR, MICHIGAN

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2012

SECTION II - FINANCIAL STATEMENT FINDINGS

2012-FS-1 - Material Audit Adjustments / Restatements

Finding Type. Material Weakness in Internal Control over Financial Reporting

Criteria. Management is responsible for maintaining its accounting records in accordance with generally accepted accounting principles (GAAP).

Condition. During our audit, we identified and proposed certain material adjustments (which were approved and posted by management) to adjust the City's general ledger to the appropriate balances. These adjustments related to record additional account payable, and to record depreciation expense. In addition, two material prior period adjustments were prepared and posted by management to properly record accounts payable that were not accrued in the prior year, and correct accumulated depreciation on capital assets.

Cause. This condition appears to be the result of various oversights in the process of closing the City's books.

Effect. As a result of this condition, the City's accounting records were initially misstated by amounts that were material to the financial statements. In addition, the City is exposed to an increased risk that misstatements (whether caused by error or fraud) may occur and not be detected and corrected by management in a timely manner.

Recommendation. We recommend that financial procedures be modified to ensure that all necessary adjustments are identified and posted to the City's financial statements.

View of Responsible Officials. This finding relates to three material adjustments relating to various miscellaneous liabilities. The material adjustments were discovered subsequent to books being closed and turned over to the auditors. The financial statements included two prior period adjustments. These adjustments were a result of final reconciliation of balance sheet items from prior years. The City will review its internal control procedures to ensure all necessary adjustments are completed prior to audit start.

CITY OF BENTON HARBOR, MICHIGAN

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2012

SECTION II - FINANCIAL STATEMENT FINDINGS

2012-FS-2 - Segregation of Incompatible Duties / Control Activities

Finding Type. Material Weakness in Internal Control over Financial Reporting

Criteria. Management is responsible for maintaining internal controls in order to safeguard the assets of the City. A key element of internal controls is the segregation of incompatible duties within the accounting function. Additionally, journal entries, while an essential part of any accounting system, represent an opportunity to enter information into the City's records in a way that bypasses normal internal controls. Accordingly, the City should have a system in place to ensure that all journal entries and similar adjustments made to the City's accounting records are reviewed and approved by an appropriate member of management independent of the preparer.

Condition. The City has several accounting functions that are performed by the same individual and are not subject to a documented independent review and approval, as follows:

- Preparing journal entries, credit memos, and other non-routine transactions and posting such activity to the general ledger
- Handling cash receipts and preparing bank reconciliations
- Generating customer utility bills, recording and approval of credit adjustments, review of cutoff procedures, reconciling subsidiary detail to the general ledger and recording corresponding entries in the general ledger
- Employees with cash receipting and disbursement functions are not required to take vacations, and other employees are not cross-trained to perform those duties in their absence
- No evidence of independent review and approval of bank reconciliations

We also selected a sample of journal entries posted during the year, and noted that several lacked supporting documentation, and that none of them showed evidence of independent review or approval.

Cause. This condition is primarily the result of staffing constraints at the City. While some level of independent review and approval may be taking place, there is no documentation to evidence this review.

Effect: As a result of this condition, the City is exposed to an increased risk that misstatements (whether caused by error or fraud) may occur and not be prevented or detected by management on a timely basis.

Recommendation. While there are, of course, no easy answers to the challenge of balancing the costs and benefits of internal controls and the segregation of duties, we would nevertheless encourage management to actively seek ways to further strengthen its internal control structure by requiring as much independent review, reconciliation, and approval of accounting functions by qualified members of management if possible. Such review and approval should be clearly documented. Further, all journal entries should be supported by appropriate documentation, and initialed by both the preparer and reviewer.

View of Responsible Officials. This is a repeat finding from last year as the City continues to have limited personnel in the finance department. Further, during the past year the City continued its efforts to cross-train personnel. The City believes it has segregated the duties as much as possible.

CITY OF BENTON HARBOR, MICHIGAN

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2012

SECTION II - FINANCIAL STATEMENT FINDINGS

2012-FS-3 - Remittance of Employer and Employee Pension Contributions

Finding Type. Material Weakness in Internal Control over Financial Reporting / Noncompliance with Laws and Regulations

Criteria. The City is obligated to remit required employer and employee contributions into each of its pension trust funds in accordance with State law.

Condition. While the City has made progress in remitting required employer contributions to each pension fund, the City still has not been able to fully comply with required pension contributions.

Cause. Due to the City's difficult financial position, the City has been unable to remit the required employer contributions to each of its pension funds.

Effect. As a result of this condition, the City's pension funds are not being properly funded in accordance with State law.

Recommendation. We recommend that the City remit the required employer contributions going forward into both of its pension funds. We further recommend that the City draft a plan to fund pension contributions that have not been made in prior years.

View of Responsible Officials: Due to cash flow and the City's financial condition, the City did not remit the entire pension contribution to each pension fund. For the first time in several years, the City did contribute a substantial amount to each system. The City had not made any pension contributions for the past several years.

CITY OF BENTON HARBOR, MICHIGAN

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2012

SECTION II - FINANCIAL STATEMENT FINDINGS

2012-FS-4 - Distribution of Payments in Lieu of Taxes (PILOT) to Local Entities

Finding Type. Material Weakness in Internal Control over Financial Reporting / Noncompliance with Laws and Regulations

Criteria. Michigan Law states that tax collections are required to be distributed to the intended taxing authorities by the collecting entity within 10 days following the 1st and 15th of each month.

Condition. While it appears that the City made a good faith effort to be timely with distributing current tax collections, we noted that as of June 30, 2012, the City still owed approximately \$1,200,000 in back PILOT to local entities. These balances appear to primarily relate to collections from prior years.

Cause. This condition was caused by the City not having sufficient funding available to liquidate these liabilities.

Effect. The City is in violation of State law pertaining to the transmittal of payments in lieu of taxes collected on behalf of other governmental units.

Recommendation. We recommend that the City carefully implement policies and procedures to ensure that amounts are properly remitted to the correct local entities on a timely basis.

View of Responsible Officials. Due to the cash flow and the City's financial condition, the City was not able to make payment on any of the outstanding PILOT liability balances. The balances are from collections from the 2003-2011 tax years. The City's deficit elimination plan called for these balances to be liquidated over the next three years, as the deficit is eliminated.

CITY OF BENTON HARBOR, MICHIGAN

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2012

SECTION II - FINANCIAL STATEMENT FINDINGS

2012-FS-5 - Capital Asset Records

Finding Type. Material Weakness in Internal Control over Financial Reporting

Criteria. Management is responsible to maintain detailed records on capital assets in accordance with generally accepted accounting principles (GAAP).

Condition. Our audit identified several issues related to the City's accounting for its capital assets, as follows:

- Capital lease payments were initially added to the capital asset schedules as additions during fiscal year 2012
- Depreciation expense was not initially booked for business-type activities
- Capital assets from prior year schedules were initially not included on the current year schedule
- No physical inventory of capital assets has been taken for numerous years

Further, the City never implemented the retroactive infrastructure reporting requirements of GASB Statement No. 34, which became effective for the City in fiscal year 2007. The City is required to record the historical cost of all public infrastructure projects (especially streets and sidewalks) incurred from fiscal years 1980 through 2001.

Cause. This condition was caused by various management oversights in the accurate recording of capital assets and updating the asset schedule timely. Further, due to resource restraints, the City has never attempted to implement the retroactive infrastructure reporting requirements of GASB 34.

Effect. As a result of this condition, the City's capital assets are not fully presented in accordance with GAAP. Our opinion on the City's financial statements was qualified for this condition.

Recommendation. We recommend that the City either hire an outside firm to value its capital assets or use one of the acceptable methods prescribed by GAAP to estimate the historical cost of its infrastructure capital assets. Further, we recommend that the City carefully monitor its additions and disposals, and annually update its capital assets records, accordingly.

View of Responsible Officials. Capital asset recording is a cumbersome, manual process at the City. Due to financial and staffing constraints, the City has not undertaken the project of valuing its infrastructure. The City will undertake this project as soon as resources become available. The City will also ensure that all capital assets and related depreciation are properly recorded prior to audit start.

CITY OF BENTON HARBOR, MICHIGAN

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2012

SECTION II - FINANCIAL STATEMENT FINDINGS

2012-FS-6 - Inclusion of All Required Entities in the Audit Report

Finding Type. Material Weakness in Internal Control over Financial Reporting / Noncompliance with Laws and Regulations

Criteria. State law requires that all component units/funds/agencies of the local unit be included in the financial statements. Furthermore, state law requires all municipal agencies to have an annual audit.

Condition. The Benton Harbor Cemetery Board, a discretely presented component unit, and the related cemetery perpetual care fund have not been included in the audited financial statements of the City.

Cause. This condition is due to the fact that there is not audited financial data available for inclusion in the City's financial statements.

Effect. The City has not reported all component units as required by state law. Our opinion on the City's financial statements was qualified for this condition.

Recommendation. We recommend that the City require all component units/funds of the City to have an annual audit and report audited information to the State of Michigan as required.

View of Responsible Officials. The cemetery and perpetual care funds are the responsibility of the Cemetery Board. The City requested a copy of the Board's annual audit for inclusion in the City's annual financial statement and was informed that the audit has not taken place.

CITY OF BENTON HARBOR, MICHIGAN

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2012

SECTION II - FINANCIAL STATEMENT FINDINGS

2012-FS-7 - Remitting Payments to MDOT

Finding Type. Material Weakness in Internal Control over Financial Reporting / Noncompliance with Laws and Regulations

Criteria. Municipalities are required to honor contractual agreements that are entered into with State Agencies.

Condition. The City failed to remit payments to the Michigan Department of Transportation for a specific road project that the City administered.

Cause. This was caused by a lack of financial resources at the City along with a management oversight in remitting the required payments to the Department of Transportation.

Effect. The City has had its Act 51 payments withheld by the Michigan Department of Transportation until the balance of the project is paid in full.

Recommendation. We recommend that the City review all contractual agreements and payment terms and ensure that required agencies are paid in a timely manner.

View of Responsible Officials. The City intended to use the monthly MDOT act 51 remittances to pay for the specific road project and therefore allowed MDOT to withhold the monthly remittances and apply them to the outstanding contract balance until it was paid in full.

CITY OF BENTON HARBOR, MICHIGAN

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2012

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

2012-SA-1 - Documentation of Payroll Costs and Disbursements

Finding Type. Material Noncompliance / Material Weakness in Internal Controls over Compliance (Allowable Costs/Cost Principles)

Program. ARRA - Neighborhood Stabilization Program II; U.S. Department of Housing and Urban Development; CFDA Number 14.256; Passed through the Michigan State Housing Development Authority; Award Number NSP-2009-0610.

Community Development Block Grant; U.S. Department of Housing and Urban Development; CFDA Number 14.218; Award Number B-11-MC-26-0035.

Criteria. Office of Management and Budget Circular No. A-87, *Cost Principles for State, Local, and Indian Tribal Governments*, requires that when employees work on multiple activities, the distribution of their salaries or wages must be supported by personnel activity reports. The Circular requires that these reports be prepared at least monthly, that they coincide with one or more pay periods, and that they include all of the hours worked by that employee during the pay period being documented. For employees charged entirely to one program or cost objective, the use of semi-annual certifications is also permissible.

Condition. Personal activity reports that were completed by City personnel lacked documentation for actual hours worked on each grant. Also, we observed one journal entry to reclassify certain expenditures between the two grant programs lacked supporting documentation.

Cause. This condition was caused by management and program employees not having a full understanding of the documentation of personnel services requirements set forth in OMB Circular A-87.

Effect. As a result of this condition, the City failed to fully comply with the documentation requirements of OMB Circular A-87 and OMB A-133 requirements for allowable costs.

Questioned Costs. The total amount of costs charged to the programs that were not properly documented were \$34,750 and \$95,616 for the Community Development Block Grant Program and Neighborhood Stabilization Program II respectively.

Recommendation. We recommend that management review the guidance on allowable documentation for personnel costs provided during the audit and determine the most effective method for documenting time of co-funded staff.

View of Responsible Officials. The City did in fact maintain documentation of personnel activity. The auditors recommended that the format be changed such that the hours were broken out by grant. The City will adjust the format to accommodate this change.

CITY OF BENTON HARBOR, MICHIGAN

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2012

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

2012-SA-2 - Separate Accountability for American Recovery and Reinvestment Act (ARRA) Grants

Finding Type. Immaterial Noncompliance / Significant Deficiency in Internal Controls over Compliance (Special Tests and Provisions)

Program. ARRA - State Drinking Water Revolving Fund; U.S. Environmental Protection Agency; CFDA Number 66.468; Passed through Michigan Department of Environmental Quality; Award Numbers 5330-01, 5329-01, 7262-01, 7273-01.

Criteria. Management is responsible for identifying compliance requirements applicable to each of its federal programs. The OMB Circular A-133 Compliance Supplement requires that expenditures of ARRA loan proceeds be accounted for separately, such that expenditures of ARRA funds can be clearly distinguished from expenditures of other programs.

Condition. The City did not maintain separate accountability for expenditures of ARRA funds in its general ledger, but rather used a single account to account for expenditures from four different loan proceeds throughout the year.

Cause. This condition was caused by an oversight in identifying appropriate ARRA funding, and not fully understanding the compliance requirements associated with separate accountability for ARRA program funds.

Effect. As a result of this condition, the City did not fully comply with certain compliance requirements of this program.

Questioned Costs. No costs were required to be questioned as a result of this finding.

Recommendation. We recommend that the City review all correspondence with federal award and pass-through agencies (as well as the OMB Circular A-133 Compliance Supplement) to identify and follow all applicable compliance requirements.

View of Responsible Officials. The City was fully aware of the ARRA funding compliance requirements relating to separate accountability. The City opted to include all grants in a single revenue line item and expenditure department and prepare detail schedules separating each grant.

CITY OF BENTON HARBOR, MICHIGAN

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2012

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

2012-SA-3 - Identifying and Accounting for Equipment and Real Property Purchases

Finding Type. Immaterial Noncompliance / Significant Deficiency in Internal Controls over Compliance (Equipment and Real Property Management).

Program. ARRA - State Drinking Water Revolving Fund; U.S. Environmental Protection Agency; CFDA Number 66.468; Passed through Michigan Department of Environmental Quality; Award Numbers 5330-01, 5329-01, 7262-01, 7273-01.

Criteria. Equipment and real property purchased with federal awards are subject to certain compliance requirements in accordance with the OMB Circular A-133 Compliance Supplement. These requirements include, but are not limited to: (a) tracking such purchases in the entity's capital asset records along with the item's cost, serial or other identification number, location, federal awarding agency involved, and percentage of item cost provided by the federal grant; (b) ensuring that these records are available to the appropriate individuals such that, upon sale or disposal of the item, the proceeds (if any) are handled properly, and (c) conducting a physical inventory of federally-funded equipment no less than every two years and making appropriate adjustments to the accounting records.

Condition. The City has not conducted a physical inventory of federally funded capital asset purchases in numerous years and has not identified which assets were purchased with federal funding on their capital asset schedules.

Cause. This condition appears to be the result of management oversight of compliance requirements of the grant.

Effect. As a result of this condition, the City did not fully comply with certain compliance requirements of this program.

Questioned Costs. No costs were required to be questioned as a result of this finding.

Recommendation. We recommend that the City review all correspondence with grantor agencies (as well as the OMB Circular A-133 Compliance Supplement) to identify and follow all applicable compliance requirements.

View of Responsible Officials. This is a repeat finding from prior years, consistent with finding 2012-FS-5. Due to financial and staffing constraints, the City has not undertaken the project of updating the capital asset listing, which would include the identification of assets purchased with federal dollars. The City will undertake this project as soon as resources become available.

CITY OF BENTON HARBOR, MICHIGAN

Summary Schedule of Prior Audit Findings

For the Year Ended June 30, 2012

2011-FS-01 - Material Audit Adjustments/Restatements

Management is responsible for maintaining its accounting records in accordance with generally accepted accounting principles (GAAP). During the audit, we identified and proposed several audit adjustments (each of which was reviewed and approved by management) to correct various account balances in both the current and prior years. This finding has been repeated as 2012-FS-1.

2011-FS-02 - Segregation of Incompatible Duties/Control Activities

Management is responsible for maintaining internal controls in order to safeguard the assets of the City. A key element of internal controls is the segregation of incompatible duties within the accounting function. The City has several accounting functions that are performed by the same individual and are not subject to a documented independent review and approval. This finding has been repeated as 2012-FS-2.

2011-FS-03 - Remittance of Employer and Employee Pension Contributions

The City has failed to remit the required employer contributions to its individual pension trust funds for several years, including 2011. The City has still not fully remitted the required employer contributions to the City's pension plans. This finding has been repeated as 2012-FS-3.

2011-FS-04 - Internal Controls over Cash and Investments

At various times throughout the year, the City was several months behind in the process of reconciling its bank accounts. Completed bank reconciliations do not bear written evidence of any independent review or approval. This finding has been corrected, except for the evidence of independent review or approval of bank reconciliations, which has been repeated within 2012-FS-2.

2011-FS-05 - Distribution of Taxes and PILOT to Local Entities

While it appears that the City made a good faith effort to be timely with distributing current tax collections, we noted that as of June 30, 2011, the City still owed approximately \$1,700,000 in back taxes to local entities. These balances appear to primarily relate to collections from prior years. This findings has been repeated as 2012-FS-4.

2011-FS-06 - Billing for Fire Protection Services Fees

The utility services department failed to bill any local entities for fire sprinkler fees during the year. The total amount that was neither billed nor collected amounted to approximately \$200,000. Since a majority of the billings have been taken over by another township, no further corrective action is necessary.

2011-FS-07- Payment of FICA Taxes

The City did not make timely payments to the IRS for FICA taxes (both the employer portion, and the employee withholdings) throughout the year. As of June 30, 2011, the outstanding liability to the IRS amounted to \$402,305. The amount was paid subsequent to year end. This finding has been corrected.

CITY OF BENTON HARBOR, MICHIGAN

Summary Schedule of Prior Audit Findings

For the Year Ended June 30, 2012

2011-FS-08 - Governmental Capital Asset Detail

The City was not initially able to produce detailed records for capital assets used in governmental operations. Further, the City never implemented the retroactive infrastructure reporting requirements of GASB Statement No. 34, which became effective for the City in fiscal year 2007. The City is required to record the historical cost of all public infrastructure projects (especially streets and sidewalks) incurred from fiscal years 1980 through 2001. This finding has been repeated as 2012-FS-5.

2011-FS-09 - General Employee Pension Data

GAAP require disclosure of certain pension information in the City's financial statements, which is derived from the actuarial valuations of the City's pension plans. These valuations are in turn derived from the census data provided by the City to the actuaries. The General Employee census data submitted to the actuary was incomplete and missing employees from certain departments. Furthermore, our testing of the census data revealed numerous errors in the information reported due to manual recordkeeping processes. We also observed multiple instances of inadequate support for employee hire dates and one instance in which an employee's contribution records could not be located. This finding has been corrected.

2011-FS-10 - Internal Controls over Financial Reporting/Supporting Documentation - Cemetery Enterprise

The City reported amounts for land held for resale and compensated absences payable in its Cemetery enterprise fund that could not adequately be supported. For 2012, the City's audit did not include the operations of the Benton Harbor Cemetery Board. Accordingly, corrective action cannot be determined, and a new finding has been reported as 2012-FS-6.

2011-SA-01 - Filing of A-133 Single Audit Reporting Package

The City's single audit reporting package for 2010 was not submitted to the Federal Audit Clearinghouse until approximately ten months after the fiscal year end. This finding has been corrected.

2011-SA-02 - Separate Accountability for American Recovery and Reinvestment Act Grants - CFDA#14.256 Neighborhood Stabilization Program II (ARRA)

The City did not maintain separate accountability for expenditures of ARRA funds in its general ledger, but rather used a single fund to account for expenditures from three different grants throughout the year. After year end, management recorded adjusting journal entries to agree the expenditures reported in each grant fund to the amounts previously reported on the quarterly financial status reports. However, such adjustments were made in the aggregate, and did not identify which specific expenditures were being moved. This finding has been repeated as 2012-SA-2.

CITY OF BENTON HARBOR, MICHIGAN

Summary Schedule of Prior Audit Findings

For the Year Ended June 30, 2012

2011-SA-03 - Filing of required Community Development Block Grant reports- CFDA#14.218 - Community Development Block Grant.

The City filed its CAPER after the stated deadline of 90 days after the program year end. Further, we noted that the City did not file a Section 3 Summary report or a third quarter SF-425 Cash Transaction Report. This finding has been corrected.



December 18, 2012

To the Emergency Financial Manager
City of Benton Harbor
Benton Harbor, Michigan

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the *City of Benton Harbor, Michigan* (the "City") for the year ended June 30, 2012, and have issued our report thereon dated December 18, 2012. Our report includes a reference to other auditors, and was qualified for certain departures from accounting principles generally accepted in the United States of America. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under Auditing Standards Generally Accepted in the United States of America and OMB Circular A-133

As stated in our engagement letter dated June 13, 2012, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities.

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the City's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* applicable to each of its major federal programs for the purpose of expressing an opinion on the City's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the City's compliance with those requirements.

Other Information in Documents Containing Audited Financial Statements

Our responsibility for the supplementary information accompanying the financial statements, as described by professional standards, is to evaluate the presentation of the supplementary information in relation to the financial statements as a whole and to report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

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.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter and our meeting about planning matters on September 18, 2012 except that our procedures were delayed due to supporting information not being made available on the schedule initially agreed to during the planning stages of the audit.

Significant Results of the Audit

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred, other than the restatement described in Note 16 to the financial statements.

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 were:

- Management's estimate of the useful lives of depreciable capital assets is based on the length of time it is believed that those assets will provide some economic benefit in the future.
- Management's estimate of the accrued compensated absences is based on current hourly rates and policies regarding payment of sick and vacation banks.
- Management's estimate of the allowance for uncollectible receivable balances is based on past experience and future expectation for collection of various account balances.
- The assumptions used in the actuarial valuation of the pension plans are based on historical trends and industry standards.
- Future maturities of capital leases payable were based on an assumed 5% interest rate and 5 year term, inasmuch as actual lease terms could not be determined.

We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

The financial statements may be affected by unusual transactions, including nonrecurring transactions. The following significant unusual accounting transactions occurred during the year:

- During 2012, the City recognized \$668,555 of revenue from a write-off of property tax collections that were reported as due to other governmental units at June 30, 2011. The City performed various steps to ensure that these amounts are not due to the units, including but not limited to confirming with the units that there are no outstanding balances from prior years. Management believes that any claims that may arise against these tax collections would be immaterial.
- During 2012, the City wrote off \$190,524 of outstanding checks dated prior to 2007. The reasoning behind this was the City believes that internal control related issues in regards to voiding and cutting checks contributed to the large balance of outstanding checks and that such amounts are not actually owed to any third parties. Management believes that any claims that may arise against these outstanding checks would be immaterial.

Difficulties Encountered in Performing the Audit

The timing of our audit procedures was delayed from the schedule agreed to during the planning stages of our engagement due to appropriate supporting information not being made available to us in a timely fashion.

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. Attachment B to this letter summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to each opinion unit's financial statements taken as a whole. The material misstatements detected as a result of audit procedures and corrected by management are described in detail in our report on Single Audit Act compliance.

Upcoming Changes in Accounting Standards

Generally accepted accounting principles (GAAP) are continually changing in order to promote the usability and enhance the applicability of information included in external financial reporting. While it would not be practical to include an in-depth discussion of every upcoming change in professional standards, Attachment C to this letter contains a brief overview of recent pronouncements of the Governmental Accounting Standards Board (GASB) and their related effective dates. Management is responsible for reviewing these standards, determining their applicability, and implementing them in future accounting periods.

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 attached management representation letter dated December 18, 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 entity’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 governmental unit’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the Emergency Financial Manager and management of the City of Benton Harbor and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in cursive script that reads "Lehmann Johnson". The signature is written in black ink and is positioned centrally below the closing text.

CITY OF BENTON HARBOR, MICHIGAN

Attachment A - Consideration of Internal Control Over Financial Reporting For the June 30, 2012 Audit

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the *City of Benton Harbor, Michigan* (the “City”) for the year ended June 30, 2012, and have issued our report thereon dated December 18, 2012. Our report includes a reference to other auditors, and was qualified for certain departures from accounting principles generally accepted in the United States of America.

In planning and performing our audit in accordance with auditing standards generally accepted in the United States of America, we considered the City’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 City’s internal control. Accordingly, we do not express an opinion on the effectiveness of the City’s internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

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 not be prevented, or detected and corrected on a timely basis. The deficiencies we noted that we consider to be material weaknesses are described in the Summary of Findings and Questioned Costs issued as part of our report on Single Audit Act compliance.

Other Matters

Fire Escrow Accounts (repeat comment)

The City has a liability account set up for Fire Escrow (amounts collected from insurance companies and retained by the City until required repairs or demolition are completed) but does not have a corresponding Fire Escrow Bank account in place. We recommend that the City establish a separate Fire Escrow bank account to maintain accountability over restricted cash.

Debt Obligations (repeat comment)

The City has various outstanding debt obligations, including capital leases. However, the City did not make required payments on several of these agreements, and was unable to locate payment schedules for others. We recommend that the City carefully forecast its future cash flow needs to ensure that payments are made in a timely manner.



CITY OF BENTON HARBOR

Attachment B - Schedule of Adjustments Passed (SOAP) For the June 30, 2012 Audit

In accordance with the provisions of SAS 107, *Audit Risk and Materiality*, we have prepared the following schedule of proposed audit adjustments, which we believe are immaterial both individually and in the aggregate. Also in accordance with SAS 107, we are providing this schedule to both management and those charged with governance to receive their assurance that they agree that the amounts listed below are not material to the financial statements, either individually or in the aggregate, and do not need to be recorded.

	Effect of Passed Adjustment - Over(Under)Statement				
	Assets	Liabilities	Beginning Equity	Revenue	Expenses/ Expenditures
Utility Services fund					
Unposted prior year deposits (corrected in 2012)	\$ -	\$ -	\$ 120,284	\$ (120,284)	\$ -
Misstatement as a percentage of total assets utility services fund	0.00%	0.00%	0.30%	-0.30%	0.00%

CITY OF BENTON HARBOR, MICHIGAN

Attachment C - Upcoming Changes in Accounting Standards

For the June 30, 2012 Audit

The following pronouncements of the Governmental Accounting Standards Board (GASB) have been released recently and may be applicable to the City in the near future. We encourage management to review the following information and determine which standard(s) may be applicable to the City. For the complete text of these and other GASB standards, visit www.gasb.org and click on the “pronouncements” tab. If you have questions regarding the applicability, timing, or implementation approach for any of these standards, please contact your audit team.

GASB 63 ■ Deferred Inflows, Outflows, and Net Position

Effective 12/15/2012 (your FY 2013)

This standard will introduce new terminology to the balance sheet by creating a category of quasi-assets called “deferred outflows”, and a category of quasi-liabilities called “deferred inflows”. As a result, the term “net assets” will no longer be used, and is replaced by the more generic term “net position”. Essentially, deferred inflows and outflows will be used to report transactions that occurred prior to year end that relate to revenues and expenses (inflows and outflows) of future periods. The format of the new “statement of net position” will be presented as *assets + deferred outflows - liabilities - deferred inflows = net position*. Net position will be further categorized into *net investment in capital assets, restricted, and unrestricted* amounts. Fund balance of governmental funds will be unaffected, and governmental funds will continue to report a traditional balance sheet (*assets = liabilities + fund balance*).

GASB 64 ■ Derivative Instruments (an Amendment of GASB 53)

Effective 06/15/2011 (your FY 2011)

Under certain circumstances, a government is permitted to enter into swap agreements to “hedge” or protect against the risk of loss. The government is required to recognize the income statement impact of a hedge upon its termination. This standard addresses whether amending an existing swap agreement or entering into a new swap agreement qualifies as a termination for accounting purposes.

Statement No. 64 is already in effect. However, since the City does not hold any derivative instruments, this standard had no impact on its financial reporting.

GASB 65 ■ Items Previously Reported as Assets and Liabilities

Effective 12/15/2013 (your FY 2014)

This standard builds on the new terminology introduced in GASB 63. Certain items previously reported as assets and liabilities will now be classified as deferred inflows and outflows, while other items will no longer be carried on the balance sheet. As such, a restatement of beginning equity may be required to write off balances from previous years that no longer meet the definition for presentation on the balance sheet. The term “deferred revenue” will no longer be used by governments for any purpose. While GASB 65 is not required to be implemented until one year after GASB 63, we recommend that they be adopted together, as the standards complement one another.

CITY OF BENTON HARBOR, MICHIGAN

Attachment C - Upcoming Changes in Accounting Standards

For the June 30, 2012 Audit

The following table provides examples of balances affected by this standard:

Item	Pre-GASB 65	Post-GASB 65
Loss/gain on refunding of bonds payable	Liability/asset ("deferred loss/gain on refunding")	Deferred outflow/inflow
Property taxes levied prior to the year they are intended to finance	Liability ("deferred revenue")	Deferred inflow
Grant funds received but all grant requirements not met	Provider: asset ("advance to...") Recipient: liability ("advance from...")	No change
Grant funds received and all grant requirements met, but advance is for the following program year	Provider: asset ("advance to...") Recipient: liability ("advance from...")	Provider: deferred outflow Recipient: deferred inflow
Bond issuance costs	Asset ("deferred bond issuance costs" or "deferred bond charges")	Expense in year incurred
Initial direct costs of operating leases	Asset ("prepaid")	Expense in year incurred
Unexpended proceeds of expenditure-driven grants; charges for services collected in advance	Liability ("deferred revenue")	Liability ("unearned revenue")
Revenues not "available" in governmental funds because they are not collected soon enough after year-end	Liability ("deferred revenue")	Deferred inflow

GASB 66 ■ 2012 Technical Corrections (an Amendment to GASB 10 and GASB 62)

Effective 12/15/2013 (your FY 2014)

This standard was issued to eliminate conflicting guidance that resulted from the issuance of GASB 54 and GASB 62, which are both already effective. GASB 10 was amended to allow for risk financing activities to be accounted for in whichever fund type is most applicable (no longer limited to the general fund or an internal service fund). GASB 62 was amended to modify specific guidance related to (1) operating leases with scheduled rent increases, (2) purchase of loans at an amount other than the principal amount, and (3) service fees related to mortgages that are sold when the service rate varies significantly from the current (normal) service fees.

We do not expect GASB 66 to have any significant impact on the City at this time.

GASB 67 ■ Financial Reporting for Pension Plans

Effective 06/15/2014 (your FY 2014)

This standard establishes the requirements for pension plans administered by trusts to report on their operations, including setting new uniform requirements for actuarial valuations of the total pension liability, and reporting various 10-year trend data as required supplementary information. The financial statements of pension plans will not change substantially as a result of GASB 67, though the additional note disclosures and required supplementary information will be significant. Additionally, actuarial valuations conducted in accordance with GASB 67 will have to match the government's fiscal year, or be rolled forward to that date by the actuary.

CITY OF BENTON HARBOR, MICHIGAN

■ Attachment C - Upcoming Changes in Accounting Standards

For the June 30, 2012 Audit

GASB 68 ■ Accounting and Financial Reporting for Pensions

Effective 06/15/2015 (your FY 2015)

This standard establishes new requirements for governments to report a “net pension liability” for the unfunded portion of its pension plan. Governments that maintain their own pension plans (either single employer or agent multiple-employer) will report a liability for the difference between the total pension liability calculated in accordance with GASB 67 and the amount held in the pension trust fund. Governments that participate in a cost sharing plan will report a liability for their “proportionate share” of the net pension liability of the entire system.

Historically, governments have only been required to report a net pension obligation to the extent that they have not met the annual required contribution (ARC) in any given year. Upon implementation of this standard, governments will be required to report a net pension liability based on the current funded status of their pension plans. This liability would be limited to the government-wide financial statements and proprietary funds. Changes in this liability from year to year will largely be reflected on the income statement, though certain amounts will be deferred and amortized over varying periods.

GASB 68 also requires more extensive note disclosures and required supplementary information, including 10 years of historical information. The methods used to determine the discount rate (the assumed rate of return on plan assets held in trust) are mandated and must be disclosed, along with what the impact would be on the net pension liability if that rate changed by 1% in either direction. Other new disclosure requirements include details of the changes in the components of the net pension liability, comparisons of actual employer contributions to actuarially determined contributions, and ratios to put the net pension liability in context. For single-employer and agent multiple-employer plans, the information for these statements will come from the annual actuarial valuation. For cost sharing plans, this information will be derived from the financial reports of the plan itself, multiplied by the government’s proportionate share of plan.

GASB 67 and 68 are only applicable to pension plans. However, the GASB has announced its intent to issue similar standards for other postemployment benefits (e.g., retiree healthcare) on a two year delay from these standards.





December 18, 2012

Rehmann Robson
2330 East Paris Avenue SE.
Grand Rapids, MI 49546

We are providing this letter in connection with your audit of the financial statements of the *City of Benton Harbor, Michigan* (the "City") as of June 30, 2012 and for the year then ended for the purpose of expressing opinions as to whether the financial statements present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Benton Harbor, Michigan and the respective changes in financial position and, where applicable, cash flows thereof in conformity with accounting principles generally accepted in the United States of America. We confirm that we are responsible for the fair presentation of the previously mentioned financial statements in conformity with accounting principles generally accepted in the United States of America. We are also responsible for adopting sound accounting policies, establishing and maintaining effective internal control over financial reporting, and preventing and detecting fraud.

We confirm, to the best of our knowledge and belief, as of December 18, 2012, the following representations made to you during your audit.

1. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America and include all properly classified funds and other financial information of the primary government and all component units required by generally accepted accounting principles to be included in the financial reporting entity.
2. We have made available to you all—
 - a. Financial records and related data and all audit or relevant monitoring reports, if any, received from funding sources.
 - b. Minutes of the meetings of the City or summaries of actions of recent meetings for which minutes have not yet been prepared.
3. There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.
4. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements or the schedule of expenditures of federal awards.
5. We are in agreement with the adjusting journal entries you have proposed, and they have been posted.
6. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.

7. We have no knowledge of any fraud or suspected fraud affecting the entity involving:
 - a. Management,
 - b. Employees who have significant roles in internal control, or
 - c. Others where the fraud could have a material effect on the financial statements.
8. We have no knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, analysts, regulators, or others.
9. We have a process to track the status of audit findings and recommendations.
10. We have identified to you any previous audits, attestation engagements, and other studies related to the audit objectives and whether related recommendations have been implemented.
11. We have provided our views on reported findings, conclusions, and recommendations, as well as our planned corrective actions, for the report.
12. The City has no plans or intentions that may materially affect the carrying value or classification of assets, liabilities, or equity.
13. The following, if any, have been properly recorded or disclosed in the financial statements:
 - a. Related party transactions, including revenues, expenditures/expenses, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.

For the purposes of this letter, related parties mean members of the governing body; board members; administrative officials; immediate families of administrative officials, board members, and members of the governing body; and any companies affiliated with or owned by such individuals.
 - b. Guarantees, whether written or oral, under which the City is contingently liable.
 - c. All accounting estimates that could be material to the financial statements, including the key factors and significant assumptions underlying those estimates and measurements. We believe the estimates and measurements are reasonable in the circumstances.
14. We are responsible for compliance with the laws, regulations, and provisions of contracts and grant agreements applicable to us, including tax or debt limits and debt contracts; and we have identified and disclosed to you all laws, regulations and provisions of contracts and grant agreements that we believe have a direct and material effect on the determination of financial statement amounts, or other financial data significant to the audit objectives, including legal and contractual provisions for reporting specific activities in separate funds.

15. There are no—
 - a. Violations or possible violations of budget ordinances, laws and regulations (including those pertaining to adopting, approving, and amending budgets), provisions of contracts and grant agreements, tax or debt limits, and any related debt covenants whose effects should be considered for disclosure in the financial statements, or as a basis for recording a loss contingency, or for reporting on noncompliance.
 - b. Unasserted claims or assessments that our lawyer has advised us are probable of assertion and must be disclosed in accordance with generally accepted accounting principles.
 - c. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by generally accepted accounting principles.
16. As part of your audit, you assisted with preparation of the financial statements and related notes and schedule of expenditures of federal awards. We have designated an individual with suitable skill, knowledge, or experience to oversee your services and have made all management decisions and performed all management functions. We have reviewed, approved, and accepted responsibility for those financial statements and related notes and schedule of expenditures of federal awards.
17. The City has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral.
18. The City has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance other than those matters disclosed in the notes to the financial statements.
19. We have followed all applicable laws and regulations in adopting, approving, and amending budgets.
20. The financial statements include all component units as well as joint ventures with an equity interest, and properly disclose all other joint ventures and other related organizations, except as made known to you and disclosed in the financial statements.
21. The financial statements properly classify all funds and activities.
22. All funds that meet the quantitative criteria in GASB Statement Nos. 34 and 37 for presentation as major are identified and presented as such and all other funds that are presented as major are particularly important to financial statement users.
23. Components of net assets (invested in capital assets, net of related debt; restricted; and unrestricted) and equity amounts are properly classified and, if applicable, approved.
24. Investments, derivative transactions, and land and other real estate held by endowments are properly valued.
25. Provisions for uncollectible receivables have been properly identified and recorded.
26. Expenses have been appropriately classified in or allocated to functions and programs in the statement of activities, and allocations have been made on a reasonable basis.

27. Revenues are appropriately classified in the statement of activities within program revenues, general revenues, contributions to term or permanent endowments, or contributions to permanent fund principal.
28. Interfund, internal, and intra-entity activity and balances have been appropriately classified and reported.
29. Special and extraordinary items are appropriately classified and reported.
30. Deposits and investment securities and derivative transactions are properly classified as to risk and are properly disclosed.
31. Capital assets, including infrastructure and intangible assets, are properly capitalized, reported, and, if applicable, depreciated.
32. We have appropriately disclosed the City's policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available and have determined that net assets were properly recognized under the policy.
33. We believe that the actuarial assumptions and methods used to measure pension liabilities and costs for financial accounting purposes are appropriate in the circumstances.
34. We acknowledge our responsibility for the required supplementary information (RSI). The required supplementary information is measured and presented within prescribed guidelines and the methods of measurement and presentation have not changed from those used in the prior period. We have disclosed to you any significant assumptions and interpretations underlying the measurement and presentation of the RSI.
35. With respect to the combining and individual fund financial statements and schedules, we acknowledge our responsibility for presenting the combining and individual fund financial statements and schedules in accordance with accounting principles generally accepted in the United States of America, and we believe the combining and individual fund financial statements and schedules, including their form and content, are fairly presented in accordance with accounting principles generally accepted in the United States of America. The methods of measurement and presentation of the combining and individual fund financial statements and schedules have not changed from those used in the prior period, and we have disclosed to you any significant assumptions or interpretations underlying the measurement and presentation of the supplementary information.
36. We have evaluated the City's ability to continue as a going concern and have included appropriate disclosures, as necessary, in the financial statements.
37. With respect to federal award programs:
 - a. We are responsible for understanding and complying with and have complied with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, including requirements relating to preparation of the schedule of expenditures of federal awards.

- b. We have prepared the schedule of expenditures of federal awards in accordance with OMB Circular A-133, and have identified and disclosed in the schedule expenditures made during the audit period for all awards provided by federal agencies in the form of grants, federal cost-reimbursement contracts, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance.
- c. We acknowledge our responsibility for presenting the schedule of expenditures of federal awards (SEFA) in accordance with the requirements of OMB Circular A-133 §310.b and we believe the SEFA, including its form and content, is fairly presented in accordance with the Circular. The methods of measurement and presentation of the SEFA have not changed from those used in the prior period and we have disclosed to you any significant assumptions and interpretations underlying the measurement and presentation of the SEFA.
- d. If the SEFA is not presented with the audited financial statements, we will make the audited financial statements readily available to the intended users of the supplementary information no later than the date we issue the supplementary information and the auditor's report thereon.
- e. We have identified and disclosed to you all of our government programs and related activities subject to OMB Circular A-133.
- f. We are responsible for understanding and complying with, and except as noted in your report have complied with, the requirements of laws, regulations, and the provisions of contracts and grant agreements related to each of our federal programs and have identified and disclosed to you the requirements of laws, regulations, and the provisions of contracts and grant agreements that are considered to have a direct and material effect on each major program.
- g. We are responsible for establishing and maintaining, and except as noted in your report have established and maintained, effective internal control over compliance requirements applicable to federal programs that provides reasonable assurance that we are managing our federal awards in compliance with laws, regulations, and the provisions of contracts and grant agreements that could have a material effect on our federal programs. Except as noted in your report, we believe the internal control system is adequate and is functioning as intended.
- h. We have made available to you all contracts and grant agreements (including amendments, if any) and any other correspondence with federal agencies or pass-through entities relevant to federal programs and related activities.
- i. We have received no requests from a federal agency to audit one or more specific programs as a major program.
- j. We have complied with the direct and material compliance requirements (except for noncompliance disclosed to you), including when applicable, those set forth in the *OMB Circular A-133 Compliance Supplement*, relating to federal awards and have identified and disclosed to you all amounts questioned and any known noncompliance with the requirements of federal awards.
- k. We have disclosed any communications from grantors and pass-through entities concerning possible noncompliance with the direct and material compliance requirements, including communications received from the end of the period covered by the compliance audit to the date of the auditor's report.

- l. We have disclosed to you the findings received and related corrective actions taken for previous audits, attestation engagements, and internal or external monitoring that directly relate to the objectives of the compliance audit, including findings received and corrective actions taken from the end of the period covered by the compliance audit to the date of the auditor's report.
- m. Amounts claimed or used for matching were determined in accordance with relevant guidelines in OMB Circular A-87, *Cost Principles for State, Local, and Tribal Governments*, and OMB's *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*.
- n. We have disclosed to you our interpretation of compliance requirements that may have varying interpretations.
- o. We have made available to you all documentation related to compliance with the direct and material requirements, including information related to federal program financial reports and claims for advances and reimbursements.
- p. We have disclosed to you the nature of any subsequent events that provide additional evidence about conditions that existed at the end of the reporting period affecting noncompliance during the reporting period.
- q. There are no such known instances of noncompliance with direct and material compliance requirements that occurred subsequent to the period covered by the auditor's report.
- r. No changes have been made in internal control over compliance or other factors that might significantly affect internal control, including any corrective action we have taken regarding significant deficiencies in internal control over compliance (including material weaknesses in internal control over compliance), have occurred subsequent to the date as of which compliance was audited.
- s. Federal program financial reports and claims for advances and reimbursements are supported by the books and records from which the financial statements have been prepared.
- t. The copies of federal program financial reports provided you are true copies of the reports submitted, or electronically transmitted, to the respective federal agency or pass-through entity, as applicable.
- u. We have charged costs to federal awards in accordance with applicable cost principles except as noted in your report.
- v. We are responsible for and have accurately prepared the summary schedule of prior audit findings to include all findings required to be included by OMB Circular A-133 and we have provided you with all information on the status of the follow-up on prior audit findings by federal awarding agencies and pass-through entities, including all management decisions.
- w. We are responsible for and have accurately prepared the auditee section of the Data Collection Form as required by OMB Circular A-133.
- x. We are responsible for preparing and implementing a corrective action plan for each audit finding.

38. We have evaluated and classified any subsequent events as recognized or nonrecognized through the date of this letter. No events, including instances of noncompliance, have occurred subsequent to the balance sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.

Signature

A handwritten signature in black ink, appearing to be "David A. ...", written over a horizontal line.

Title

EMERGENCY FINANCIAL MANAGER