

Kalamazoo County Road Commission

**Financial Report
with Supplemental Information
December 31, 2012**

Kalamazoo County Road Commission

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Independent Auditor's Report

To the Board of County Road Commissioners
Kalamazoo County Road Commission

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and the Road Fund of the Kalamazoo County Road Commission, a component unit of Kalamazoo County, as of and for the year ended December 31, 2012 and the related notes to the financial statements, which collectively comprise the Kalamazoo County Road Commission's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities and the Road Fund of the Kalamazoo County Road Commission as of December 31, 2012 and the changes in its financial position for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

To the Board of County Road Commissioners
Kalamazoo County Road Commission

Other Matters

Required Supplemental Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the Road Fund budgetary comparison schedule on pages 3-7 and 24, respectively, 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, which 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 supplemental 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.

Other Information

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

Plante & Moran, PLLC

March 25, 2013

Kalamazoo County Road Commission

Management's Discussion and Analysis

The Kalamazoo County Road Commission (the "Road Commission") is a special purpose government engaged in a single government program of road and bridge maintenance, preservation, and construction for the County of Kalamazoo, Michigan. The Kalamazoo County Road Commission was established by a vote of the citizens of Kalamazoo County in 1909.

The following financial statements are presented in accordance with prescribed methods of accounting. The financial statements related to the governmental fund are prepared in modified accrual format, commonly referred to as governmental fund level accounting. The full accrual method of accounting focuses on the entity as a whole (the Road Commission's net position) and is referred to as government-wide level accounting. The significant differences between the governmental fund statements and the government-wide statements relate to capital assets (buildings and equipment) and the infrastructure (roads, bridges, and signals). Capital assets and infrastructure are not recognized as assets and are capitalized at the governmental fund level.

With respect to the statements of net position and activities, the fund-level financial statements and the government-wide financial statements have been combined and are presented on the same page.

Management's Discussion and Analysis

This section of Kalamazoo County Road Commission's annual financial report presents our discussion and analysis of the Road Commission's financial performance during the fiscal year that ended on December 31, 2012. Please read it in conjunction with the Road Commission's basic financial statements, which follow this section.

Using this Annual Report

This annual report consists of four parts: management's discussion and analysis (this section), the basic financial statements, required supplemental information, and other supplemental information.

The basic financial statements are the governmental fund balance sheet/statement of net position, statement of governmental fund revenue, expenditures, and changes in fund balance/statement of activities, and notes to the financial statements. The notes to the financial statements are an integral part of the document that explain some of the information in the financial statements and provide more detailed data.

Additional data and schedules that further explain and support the information in the financial statements are provided in both the required supplemental information and the other supplemental information.

Kalamazoo County Road Commission

Management's Discussion and Analysis (Continued)

Financial Analysis of the Road Commission as a Whole

The following tables provide condensed information about the Road Commission as of December 31, 2012 and 2011 and for the years then ended. Over time, increases or decreases in the Road Commission's net position may serve as an indicator of the overall financial position. To assess the overall health of the Road Commission, additional nonfinancial factors need to be considered, such as the condition of the roads in our jurisdiction and changes in the laws related to gas taxes and their distribution.

Condensed Statement of Net Position

	December 31	
	2012	2011
Assets		
Other assets	\$ 6,765,922	\$ 9,567,817
Capital assets	<u>116,879,946</u>	<u>112,694,808</u>
Total assets	123,645,868	122,262,625
Liabilities - Current liabilities	<u>1,322,054</u>	<u>961,642</u>
Net Position		
Unrestricted net position	5,443,868	8,606,175
Net investment in capital assets	<u>116,879,946</u>	<u>112,694,808</u>
Total net position	<u>\$ 122,323,814</u>	<u>\$ 121,300,983</u>

Kalamazoo County Road Commission

Management's Discussion and Analysis (Continued)

Condensed Statement of Activities

	Year Ended December 31	
	2012	2011
Revenue		
Intergovernmental	\$ 18,356,841	\$ 16,830,854
Other contributions and service charges	156,912	497,120
Other	<u>31,922</u>	<u>168,374</u>
Total revenue	18,545,675	17,496,348
Expenses		
Primary maintenance	4,288,174	4,620,264
Local maintenance	4,722,369	4,377,159
Depreciation	7,898,547	7,727,357
Administrative	907,690	949,135
Equipment rental and other charges	(417,853)	(640,146)
Nonroad-related projects	<u>123,917</u>	<u>78,036</u>
Total expenses	<u>17,522,844</u>	<u>17,111,805</u>
Change in Net Position	<u>\$ 1,022,831</u>	<u>\$ 384,543</u>

The Road Commission's revenue for the year ended December 31, 2012 increased approximately 6 percent from the prior year. This increase was due principally to an increase in federal, state, and local government participation in road improvement projects. Total expenses for the year increased by approximately 2 percent due to an increase in road project expenditures. Overall, the Road Commission added \$1,022,831 to net position.

Budgetary Highlights

Prior to beginning each year, the Road Commission's budget is prepared based upon certain assumptions and facts available at that time. During the year, the Road Commission board amends its budget to reflect changes in the original assumptions, facts, and/or economic conditions that were unknown at the time the original budget was adopted.

Kalamazoo County Road Commission

Management's Discussion and Analysis (Continued)

The Road Commission amended its 2012 budget during the year. The final budget for revenue was approximately \$642,000 more than the original budget, primarily due to more than expected federal and state revenue. Our actual revenue ended the year higher than expected, primarily due to the additional revenue received from the Michigan Transportation Fund and townships. The final budget for expenditures was approximately \$3,779,000 more than the original budget due to the addition of the Kalamazoo River Trailway project and higher than anticipated road improvement and maintenance expenditures. Actual expenditures at the end of the year were approximately \$54,000 more than the final amended budget, primarily due to the Road Commission spending more on routine and preventative maintenance-related expenses.

Capital Assets

The Road Commission ended the year with an increase in net capital assets amounting to \$4,185,138. Infrastructure continues to be the largest asset class and is funded by federal, state, and local contributions, as well as by Road Commission revenue. Depreciation of capital assets is provided for annually over estimated future lives.

	December 31	
	2012	2011
Land and improvements	\$ 20,857,806	\$ 20,675,386
Buildings and improvements	4,083,767	4,070,148
Road equipment	8,345,020	7,464,189
Other equipment	551,446	587,659
Infrastructure and improvements	<u>171,429,256</u>	<u>163,031,707</u>
Total capital assets	205,267,295	195,829,089
Accumulated depreciation	<u>(88,387,349)</u>	<u>(83,134,281)</u>
Net capital assets	<u>\$ 116,879,946</u>	<u>\$ 112,694,808</u>

Additional information regarding capital assets is located in Note 5 to the financial statements.

Economic Factors and Next Year's Budget

Michigan continues its longest sustained economic downturn since the Great Depression. With high unemployment levels and per-gallon gas prices increasing, gasoline usage will most certainly continue to decline. As a result, the Road Commission's largest source of operating revenue, the gas tax, has decreased to levels received almost 10 years ago.

Kalamazoo County Road Commission

Management's Discussion and Analysis (Continued)

The Michigan Transportation Fund (MTF) formula that was derived in 1951, while having been modified, continues to work against the Road Commission. The formula does not account for vehicles that are highly fuel efficient, alternative-powered vehicles, or the change in consumer driving and buying habits. Without any changes to the formula or other sources of funding roads, local agencies that depend on MTF dollars will continue to suffer.

The board, management, and staff of the Road Commission continue to work diligently to be efficient and keep our expenses low, look for opportunities to partner with other agencies in our area and region, and access all available dollars to maintain the roads and infrastructure within Kalamazoo County.

Contacting the Road Commission's Management

This financial report is designed to provide a general overview of the Road Commission's finances and accountability of the public trust. Questions regarding any of the information provided in this report or requests for additional information should be addressed to Kalamazoo County Road Commission, 3801 East Kilgore Road, Kalamazoo, MI 49001, or visit our website at www.kalamazoocountyroads.com.

Kalamazoo County Road Commission

Statement of Net Position/Governmental Funds Balance Sheet December 31, 2012

	Modified Accrual Basis		Statement of Net Position
	Road Fund	Adjustments	
Assets			
Cash (Note 4)	\$ 2,512,011	\$ -	\$ 2,512,011
Receivables:			
Special assessments receivable	75,979	-	75,979
Due from state transportation department	2,079,216	-	2,079,216
Due on county road agreements	237,139	-	237,139
Sundry accounts receivable	92,429	-	92,429
Inventory	1,137,861	-	1,137,861
Prepaid expenses	157,238	-	157,238
Advances	170,131	-	170,131
Deferred expenses	294,358	-	294,358
Restricted assets - Kalamazoo Area Transportation Study (Note 4)	9,560	-	9,560
Capital assets (Note 5):			
Assets not subject to depreciation	-	20,857,806	20,857,806
Assets subject to depreciation	-	96,022,140	96,022,140
Total assets	\$ 6,765,922	116,879,946	123,645,868
Liabilities			
Accounts payable	\$ 1,018,258	-	1,018,258
Accrued liabilities	92,210	-	92,210
Deferred revenue	75,979	(75,979)	-
Escrow agreements	31,895	-	31,895
Kalamazoo Area Transportation Study	9,560	-	9,560
Advances	170,131	-	170,131
Total liabilities	1,398,033	(75,979)	1,322,054
Equity			
Fund balance:			
Nonspendable:			
Inventory	1,137,861	(1,137,861)	-
Prepays and deferred expenses	451,596	(451,596)	-
Unassigned	3,778,432	(3,778,432)	-
Total fund balance	5,367,889	(5,367,889)	-
Total liabilities and fund balance	\$ 6,765,922		
Net position:			
Net investment in capital assets		116,879,946	116,879,946
Unrestricted		5,443,868	5,443,868
Total net position		\$ 122,323,814	\$ 122,323,814

Kalamazoo County Road Commission

Statement of Activities/Governmental Fund Revenues, Expenditures, and Changes in Fund Balance Year Ended December 31, 2012

	Modified Accrual Basis		Statement of Activities
	Road Fund	Adjustments	
Revenues			
Michigan Transportation Fund	\$ 12,911,394	\$ -	\$ 12,911,394
Federal grants	2,984,335	-	2,984,335
State funding	354,824	-	354,824
Township and city contributions	2,106,288	-	2,106,288
Other contributions and service charges	156,912	-	156,912
Other revenue	85,158	(53,236)	31,922
Total revenues	18,598,911	(53,236)	18,545,675
Expenditures/Expenses			
Primary preservation	9,348,142	(9,348,142)	-
Primary maintenance	4,288,174	-	4,288,174
Local preservation	1,604,374	(1,604,374)	-
Local maintenance	4,722,369	-	4,722,369
Administrative	907,690	-	907,690
Capital outlay	1,132,927	(1,132,927)	-
Less equipment rental and other charged to other expenditures	(417,853)	-	(417,853)
Depreciation expense	-	7,898,547	7,898,547
Nonroad-related projects	123,917	-	123,917
Total expenditures/expenses	21,709,740	(4,186,896)	17,522,844
Net Change in Fund Balances/Net Position	(3,110,829)	4,133,660	1,022,831
Fund Balances/Net Position - Beginning of year	8,478,718	112,822,265	121,300,983
Fund Balances/Net Position - End of year	\$ 5,367,889	\$ 116,955,925	\$ 122,323,814

Kalamazoo County Road Commission

Notes to Financial Statements December 31, 2012

Note I - Summary of Significant Accounting Policies

The Kalamazoo County Road Commission (the "Road Commission") is a governmental agency responsible for the maintenance and construction of the road system in Kalamazoo County, Michigan. The Road Commission is governed by a five-member Board of County Road Commissioners appointed by the Kalamazoo County Board of Commissioners. The Road Commission's financial statements will be included in the basic financial statements of Kalamazoo County, Michigan, as well as a discretely presented component unit.

The accounting policies of the Road Commission conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies used by the Road Commission:

Basic Financial Statements - Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net position and the statement of activities) report information on all of the activities of the Road Commission. For the most part, the effect of interfund activity has been removed from these statements. The Road Commission consists solely of governmental-type activities; no business-type activities exist.

The fund financial statements are provided to report the governmental fund and have been separately stated in conjunction with the government-wide financial statements.

The major individual governmental fund has been reported as a separate column in the fund financial statements. The Road Fund is used to account for all the revenue of the Road Commission.

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. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. 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. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Road Commission considers revenue to be available if it is collected within 60 days of the end of the current fiscal period. Revenue related to construction projects is recognized when the related costs are incurred, subject to the availability criterion. Other revenue is recorded when received.

Kalamazoo County Road Commission

Notes to Financial Statements December 31, 2012

Note 1 - Summary of Significant Accounting Policies (Continued)

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, expenditures relating to compensated absences, and claims and judgments are recorded only when payment is due.

Noncurrent receivables, such as special assessments, are recorded at full value and deferred revenue is recorded for the portion not available for use for finance operations at year end.

Interest earned on investments is recorded on the accrual basis. Interest revenue on special assessment receivables is not accrued until due date.

The Road Fund is the Road Commission's only fund. All activities are reported in this fund on a modified accrual basis of accounting.

Cash and Investments - Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value, based on quoted market prices. Restricted cash consists of cash held by the Road Commission for use by the Kalamazoo Area Transportation Study (KATS).

Due from Other Governments - Due from other governments consists of amounts due from the Michigan Transportation Fund for state-shared revenue as well as receivables from townships for their share of construction projects.

Inventories and Prepaid Items - Inventories consist principally of road material, salt, signs, and equipment maintenance materials and is valued at average cost. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased. Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid items in both the government-wide and fund financial statements.

Deferred Expenses - Deferred expenses result when progress payments made to the Michigan Department of Transportation are in excess of the total expenses incurred for projects on a percentage-of-completion basis. The payments will be applied to projects in future years as expenses are incurred.

Capital Assets - Capital assets, which include property, buildings, equipment, intangible assets, 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 Road Commission as assets with an initial individual cost of more than \$2,500 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. The related revenue is recorded as other contributions.

Kalamazoo County Road Commission

Notes to Financial Statements December 31, 2012

Note 1 - Summary of Significant Accounting Policies (Continued)

Kalamazoo County Road Commission

Capital assets are depreciated using the sum-of-the-years'-digits method for road equipment and the straight-line method for all other capital assets over the following useful lives:

Buildings	25 to 50 years
Road equipment	5 to 8 years
Other equipment	4 to 20 years
Infrastructure	5 to 50 years

Deferred Revenue - The Road Fund reports deferred revenue in connection with receivables for revenue that is not considered to be available to liquidate liabilities of the current period. The Road Fund also defers revenue recognition in connection with resources that have been received but not yet earned. At the end of the current fiscal year, deferred revenue consisted of \$75,979, which is considered to be unavailable.

Kalamazoo Area Transportation Study (KATS) - The Road Commission leases office space and provides certain accounting services for KATS, including physical custody of cash belonging to KATS. As of December 31, 2012, the Road Commission recorded restricted cash and a liability to KATS for \$9,560, which represents the amount held in the Road Commission's bank accounts at year end. On May 8, 2012, a resolution was approved to terminate the KATS and KCRC memorandum of understanding effective January 1, 2013.

Fund Balance - In the fund financial statements, governmental funds are to report the following components of fund balance:

- **Nonspendable** - Amounts that are not in spendable form or are legally or contractually required to be maintained intact
- **Restricted** - Amounts that are legally restricted by outside parties, constitutional provisions, or enabling legislation for use for a specific purpose
- **Committed** - Amounts that have been formally set aside by the Road Commission for use for specific purposes. Commitments are made and can be rescinded only via resolution of the Board of County Road Commissioners.
- **Assigned** - Intent to spend resources on specific purposes expressed by the Board of County Road Commissioners or by the managing director, who is authorized by resolution of the Board of County Road Commissioners to make assignments
- **Unassigned** - Amounts not otherwise categorized above and available to be spent for any purpose

Kalamazoo County Road Commission

Notes to Financial Statements December 31, 2012

Note 1 - Summary of Significant Accounting Policies (Continued)

When multiple components of fund balance are available for the same expenditures (for example, a project has both restricted and unrestricted funds available for it), spending will occur in this order - restricted, committed, assigned, and unassigned.

In January 2012, the Board of County Road Commissioners adopted an organizational goal to maintain fund balance in the Road Fund of 25 percent of annual expenditures.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Other accounting policies are disclosed in the following notes to the financial statements.

Note 2 - Reconciliation of Individual Fund Columns of the Statement of Net Position/Statement of Activities

Net position reported in the statement of net position column is different than the fund balance reported in the individual fund columns because of the different measurement focus and basis of accounting, as discussed in Note 1. Below is a reconciliation of the differences:

Fund Balance Reported in Governmental Funds	\$ 5,367,889
Amounts reported for governmental activities in the statement of net position are different because:	
Capital assets used in governmental activities are not financial resources and are not reported in the funds	116,879,946
Special assessment receivables that are collected after year end, such that they are not available to pay bills outstanding as of year end, are not recognized in the funds	75,979
Net Position of Governmental Activities	<u>\$122,323,814</u>

Kalamazoo County Road Commission

Notes to Financial Statements December 31, 2012

Note 2 - Reconciliation of Individual Fund Columns of the Statement of Net Position/Statement of Activities (Continued)

The change in net position reported in the statement of activities column is different than the change in fund balance reported in the individual fund columns because of the different measurement focus and basis of accounting, as discussed in Note 1. Below is a reconciliation of the differences:

Net Change in Fund Balances - Total Governmental Funds	\$ (3,110,829)
Amounts reported for governmental activities in the statement of activities are different because:	
Governmental funds report capital outlays as expenditures; however, in the statement of activities, these costs are allocated over their estimated useful lives as depreciation:	
Capital outlay	12,085,472
Depreciation expense	(7,898,547)
Net book value of assets disposed of	(1,787)
Revenues are recorded in the statement of activities when earned; they are not reported in the funds until collected or collectible within 60 days of year end	<u>(51,478)</u>
Change in Net Position of Governmental Activities	<u>\$ 1,022,831</u>

Note 3 - Stewardship, Compliance, and Accountability

The Road Commission is legally subject to the budgetary control requirements of State of Michigan P.A. 621 of 1978 (the Uniform Budgeting Act). The following is a summary of the requirements of this Act according to the State Treasurer's *Bulletin for Audits of Local Units of Government in Michigan*, dated April 1982, as amended by P.A. 493 of 2000:

- Budgeted expenditures cannot exceed budgeted revenue and fund balance.
- The budgets must be amended when necessary.
- Public hearings must be held before budget adoptions.
- Expenditures cannot exceed budget appropriations.
- Expenditures must be authorized by a budget before being incurred.

Kalamazoo County Road Commission

Notes to Financial Statements December 31, 2012

Note 3 - Stewardship, Compliance, and Accountability (Continued)

Pursuant to this requirement, the Road Commission follows these procedures:

- The director submits a proposed operating budget for the fiscal year to the Board of County Road Commissioners before the beginning of the fiscal year. The budget includes proposed expenditures and the means of providing them.
- A public hearing is held to obtain comments.
- Prior to the beginning of the year, the budget and appropriations are legally adopted by the Board of County Road Commissioners.
- Comparison of budget to actual activity is used as a management control device throughout the year.
- Budgets are prepared using the modified accrual basis of accounting.
- The budgetary information presented may be amended throughout the year by an official action of the board.

Excess of Expenditures Over Appropriations - The law requires budget amendments as needed to prevent actual expenditures from exceeding those provided in the budget. During the year ended December 31, 2012, the Road Commission incurred the following expenditures that were in excess of amounts budgeted:

	Amended Budget	Actual	Variance
Routine and preventative	\$ 8,860,000	\$ 9,010,543	\$ (150,543)
Capital outlay	1,072,600	1,132,927	(60,327)
Work performed for others	1,100,000	1,119,356	(19,356)

Routine and preventative expenditures were greater than the amended budget because 2012 project costs were greater than expected.

Capital outlay was greater than the amended budget due to three factors:

- (1) The Road Commission purchased radios during 2012 that were partially funded through a grant and rebates. The amended budget did not reflect the portion of the cost that was not funded by the Road Commission.
- (2) In late 2012, the Road Commission purchased a hydraulic system for \$8,000 associated with a sign maintenance truck that was not included in the amended budget.
- (3) Approximately \$15,000 of expenditures related to improvements to the administrative parking area was not included in the amended budget.

Kalamazoo County Road Commission

Notes to Financial Statements December 31, 2012

Note 3 - Stewardship, Compliance, and Accountability (Continued)

Work performed for others was over budget due to expenses incurred on the Kalamazoo River Valley Trailway project. These expenditures were offset by matching revenue.

Note 4 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended), authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The law also allows investments outside the state of Michigan when fully insured. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The Road Commission has designated three banks for the deposit of its funds. The Road Commission's deposits and investment policies are in accordance with statutory authority.

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the Road Commission's deposits may not be returned to it. The Road Commission does not have a deposit policy for custodial credit risk. At year end, the Road Commission had \$2,020,466 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured. Included in these bank deposits is \$9,560 that the Road Commission held at year end on behalf of the Kalamazoo Area Transportation Study.

Kalamazoo County Road Commission

Notes to Financial Statements December 31, 2012

Note 5 - Capital Assets

Capital asset activity for the current year was as follows:

Governmental Activities	Balance January 1, 2012	Additions	Retirements/ Transfers	Balance December 31, 2012
Capital assets not being depreciated:				
Land and improvements	\$ 475,599	\$ 132,394	\$ -	\$ 607,993
Infrastructure and improvements	20,199,787	50,026	-	20,249,813
Subtotal	20,675,386	182,420	-	20,857,806
Capital assets being depreciated:				
Buildings and improvements	4,070,148	13,619	-	4,083,767
Road equipment	7,464,189	975,766	(94,935)	8,345,020
Other equipment	587,659	11,151	(47,364)	551,446
Infrastructure and improvements	163,031,707	10,902,516	(2,504,967)	171,429,256
Subtotal	175,153,703	11,903,052	(2,647,266)	184,409,489
Accumulated depreciation:				
Buildings and improvements	2,219,736	78,073	-	2,297,809
Road equipment	6,474,886	462,771	(93,148)	6,844,509
Other equipment	504,755	24,224	(47,364)	481,615
Infrastructure and improvements	73,934,904	7,333,479	(2,504,967)	78,763,416
Subtotal	83,134,281	7,898,547	(2,645,479)	88,387,349
Net capital assets being depreciated	92,019,422	4,004,505	(1,787)	96,022,140
Net capital assets	<u>\$ 112,694,808</u>	<u>\$ 4,186,925</u>	<u>\$ (1,787)</u>	<u>\$ 116,879,946</u>

Note 6 - Defined Benefit Pension Plan

Plan Description - The Road Commission participates in the Kalamazoo County Employees' Retirement Plan (the "Plan"), a public employee retirement system which is an agent multiple-employer defined benefit pension plan administered by the Kalamazoo County Employees' Retirement System (the "System"). The Road Commission's Plan provides retirement, disability, and death benefits to plan members and their beneficiaries. The Kalamazoo County Board of Commissioners establishes and amends the benefit provisions of the participants in the Plan. The System issues a publicly available financial report that includes financial statements and required supplemental information for the Plan. That report may be obtained by writing to the System at 201 W. Kalamazoo Avenue, Kalamazoo, Michigan 49007 or by calling (269) 384-8111.

Kalamazoo County Road Commission

Notes to Financial Statements December 31, 2012

Note 6 - Defined Benefit Pension Plan (Continued)

Funding Policy - The Road Commission is required to contribute at an actuarially determined rate; however, no contribution was required in the current year. The contribution requirements are established the System based on an actuarial valuation. The contribution requirements of plan members, if any, are established and may be amended by the Road Commission depending on the Plan's contribution program. Plan members are currently not required to contribute to the System.

Annual Pension Cost - For the year ended December 31, 2012, the Road Commission had no annual pension cost or required contribution to the plan. The annual required contribution was determined as part of an actuarial valuation at December 31, 2011, using the entry age actuarial cost method. Significant actuarial assumptions used include (a) a 7.75 percent investment rate of return and (b) projected salary increases of between 4.5 percent and 9.2 percent per year compounded annually, of which 4.5 percent is attributable to inflation. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a five-year period.

The unfunded actuarial liability is being amortized as a level percentage of payroll on a closed basis. The remaining amortization period is 10 years.

Three-year Trend Information

	Fiscal Year Ended December 31		
	2012	2011	2010
Annual pension cost (APC)	\$ -	\$ -	\$ -
Percentage of APC contributed	100.0 %	100.0 %	100.0 %
Net pension obligation	-	-	-

	Fiscal Year Ended December 31		
	2011	2010	2009
Actuarial value of assets	\$ 17,852,065	\$ 18,347,379	\$ 18,277,106
Actuarial accrued liability (AAL) (entry age)	13,574,391	13,253,098	13,398,414
Overfunded AAL	4,277,674	5,094,281	4,878,692
Funded ratio	131.5 %	138.4 %	136.4 %
Covered payroll	2,699,115	2,747,330	2,758,960
Overfunded AAL as a percentage of covered payroll	158.5 %	185.4 %	176.8 %

Kalamazoo County Road Commission

Notes to Financial Statements December 31, 2012

Note 7 - Other Postemployment Benefits

Plan Description - The Road Commission provides medical benefits to eligible retired Road Commission employees through the Kalamazoo County Retiree Medical Benefits Plan (the "Plan"), an agent multiple employer plan. The plan is affiliated with the Kalamazoo County Retiree Health Trust (the "Trust"), which is exempt from tax under Section 115 of the Internal Revenue Code of 1986.

Benefit provisions of the Plan are established and amended by the Kalamazoo County Board of Commissioners. The Plan issues a publicly available financial report that includes financial statements and required supplemental information. That report may be obtained by writing to the Kalamazoo County Employees' Retirement System, 201 W. Kalamazoo Avenue, Kalamazoo, Michigan 49007 or by calling (269) 384-8111.

Funding Policy - The Road Commission is required to contribute at a percentage of covered payroll as determined by the Plan; the required contribution for the year ended December 31, 2012 was \$177,972 or 7.79 percent. The actual contribution made by the Road Commission during the year ended December 31, 2012 was \$196,250. The contribution requirements are established by the Plan based on an actuarial valuation. Road Commission retirees pay 16 percent of the cost of their health insurance premiums. This percentage is established and may be amended by the Road Commission. Beginning in 2013, retirees will be required to pay 20 percent of the cost of their healthcare premiums. Retiree healthcare benefits will not be available to nonunion employees hired on or after January 1, 2013.

Funding Progress - The required and actual contributions for the last three years are as follows:

	Fiscal Year Ended December 31		
	2012	2011	2010
Annual covered payroll	\$ 2,284,616	\$ 2,483,917	\$ 2,705,045
Required contribution rate	7.8 %	9.9 %	9.9 %
Required contribution	\$ 177,972	\$ 245,411	\$ 267,258
Actual contribution made	\$ 196,250	\$ 245,411	\$ 247,696

The resulting net OPEB asset is not considered to be significant related to the financial statements taken as a whole and has not been recorded as an asset in the statement of net position.

Kalamazoo County Road Commission

Notes to Financial Statements December 31, 2012

Note 7 - Other Postemployment Benefits (Continued)

The funding progress of the plan as of the most recent valuation date is as follows:

	December 31, 2011	December 31, 2009
Valuation as of December 31, 2011:		
Actuarial value of assets	\$ 1,435,680	\$ 1,233,280
Actuarial accrued liability	3,956,241	4,936,576
Unfunded AAL	(2,520,561)	(3,703,296)
Funded ratio	36.30 %	24.98 %
Annual covered payroll	2,284,616	2,970,142
Ratio of UAAL to covered payroll	(110.33)%	(124.68)%

Actuarial Methods and Assumptions - Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented above, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

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

In the December 31, 2011 actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included are (a) a rate of return on investments of present and future assets of 7.75 percent, (b) projected salary increases of 3.5 percent to 8.22 percent per year, compounded annually, with 3.5 percent attributable to inflation, and (c) a healthcare cost trend rate of 9 percent. The UAAL is being amortized as a level percent of payroll on an open basis. The remaining amortization period at December 31, 2012 was 30 years.

Kalamazoo County Road Commission

Notes to Financial Statements December 31, 2012

Note 8 - Risk Management

The Road Commission is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The Road Commission participates in the Michigan County Road Commission Self-Insurance Pool (MCRCSIP) for claims relating to property loss, torts, errors, and omissions. Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

MCRCSIP operates as a common risk-sharing management program for road commissions in Michigan; member premiums are used to purchase commercial excess insurance coverage and to pay member claims in excess of deductible amounts.

The Road Commission is a member of the County Road Association Self-insurance Fund (CRASIF) for workers' compensation claims. Member premiums are used to purchase workers' compensation insurance. As a member of the fund, the Road Commission is fully insured for workers' compensation claims incurred.

The Road Commission continues to carry commercial insurance for other risks of loss, including employee health and accident insurance.

Note 9 - Upcoming Accounting Pronouncements

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which is required to be implemented for financial statements for periods beginning after December 15, 2012. Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows and inflows of resources, certain items that were previously reported as assets and liabilities. This statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources. Statement No. 65 will be implemented for the Road Commission as of December 31, 2013. As a result of adopting this statement, the Road Commission's revenue that is deferred because it is not collected within the period of availability (defined by the Road Commission as 60 days after year end) will be presented as a "deferred inflow of resources" in the Road Commission's 2013 financial statements. This deferred revenue is presented as a liability in the Road Commission's 2012 financial statements.

Kalamazoo County Road Commission

Notes to Financial Statements December 31, 2012

Note 9 - Upcoming Accounting Pronouncements (Continued)

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. Statement No. 68 requires governments providing defined benefit pensions to recognize their unfunded pension benefit obligation as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. This net pension liability that will be recorded on the government-wide, proprietary, and discretely presented component units statements will be computed differently than the current unfunded actuarial accrued liability, using specific parameters set forth by the GASB. The statement also enhances accountability and transparency through revised note disclosures and required supplemental information (RSI). The Road Commission is currently evaluating the impact this standard will have on the financial statements when adopted. As of December 31, 2012, the Road Commission's pension system is overfunded. The provisions of this statement are effective for financial statements for the year ending December 31, 2015.

Required Supplemental Information

Kalamazoo County Road Commission

Required Supplemental Information Budgetary Comparison Schedule - Road Fund Year Ended December 31, 2012

	Original Budget	Amended Budget	Actual	Variance with Amended Budget
Revenues				
Michigan Transportation Fund	\$ 12,500,000	\$ 12,700,000	\$ 12,911,394	\$ 211,394
Federal, state, and enhancements	3,658,436	4,300,000	4,334,598	34,598
Townships	1,290,000	1,203,000	2,058,222	855,222
Township special assessments	50,000	51,000	65,005	14,005
Cities and other governmental	25,000	44,000	50,067	6,067
Interest	50,000	9,500	10,077	577
New platted roads donated	-	50,000	50,026	26
Other	250,000	108,000	114,961	6,961
Total revenues	17,823,436	18,465,500	19,594,350	1,128,850
Expenditures				
Construction and capacity	-	50,000	50,026	(26)
Preservation and structural	9,263,600	10,903,000	10,902,490	510
Routine and preventative	7,283,250	8,860,000	9,010,543	(150,543)
Equipment rental and other charged to other expenditures	(970,252)	(285,800)	(417,853)	132,053
Capital outlay	1,204,484	1,072,600	1,132,927	(60,327)
Administration	969,820	951,000	907,690	43,310
Work performed for others	190,000	1,100,000	1,119,356	(19,356)
Distributive	930,974	-	-	-
Total expenditures	18,871,876	22,650,800	22,705,179	(54,379)
Excess of Expenditures Over Revenue	(1,048,440)	(4,185,300)	(3,110,829)	1,074,471
Fund Balance - Beginning of year	8,478,718	8,478,718	8,478,718	-
Fund Balance - End of year	\$ 7,430,278	\$ 4,293,418	\$ 5,367,889	\$ 1,074,471

Kalamazoo County Road Commission

Note to Required Supplemental Information Year Ended December 31, 2012

The budgetary comparison schedule for the Road Fund is presented on the same basis of accounting used in preparing the adopted budget. The following is a reconciliation of the budgetary comparison schedule to the governmental fund (statement of governmental fund revenue, expenditures, and changes in fund balance):

	<u>Total Revenue</u>	<u>Total Expenditures</u>	<u>Fund Balance</u>
Kalamazoo County Road Commission:			
Amount per governmental fund revenue, expenditures, and changes in fund balance	\$ 18,598,911	\$ 21,709,740	\$ (3,110,829)
Project performed on behalf of another governmental unit	<u>995,439</u>	<u>995,439</u>	<u>-</u>
Amounts per budget statement	<u>\$ 19,594,350</u>	<u>\$ 22,705,179</u>	<u>\$ (3,110,829)</u>

Other Supplemental Information

Kalamazoo County Road Commission

Analysis of Revenue, Expenditures, and Changes in Fund Balance - Road Fund Year Ended December 31, 2012

	Primary Roads	Local Roads	County Road Funds	Total
Revenue				
Michigan Transportation Fund:				
Engineering	\$ 7,569	\$ 2,431	\$ -	\$ 10,000
Snow removal	1,065	1,934	-	2,999
Urban road	1,794,691	532,403	-	2,327,094
Allocation	8,001,009	2,570,292	-	10,571,301
Total Michigan Transportation Fund	9,804,334	3,107,060	-	12,911,394
Economic Development Fund:				
Target industries	13,791	-	-	13,791
Rural primary	(28,253)	-	-	(28,253)
Total Economic Development Fund	(14,462)	-	-	(14,462)
Governmental funding:				
Federal	2,984,335	-	995,439	3,979,774
Local bridge	357,456	-	-	357,456
Township and city contributions	27,852	2,034,557	45,881	2,108,290
Other contributions and changes for services	23,764	72,044	18,563	114,371
Total governmental funding	13,183,279	5,213,661	1,059,883	19,456,823
Other:				
Gain on equipment disposals	-	-	8,673	8,673
Special assessments	-	65,005	-	65,005
Private contributions	-	50,026	-	50,026
Interest earned	4,698	3,551	5,574	13,823
Total other	4,698	118,582	14,247	137,527
Total revenue	13,187,977	5,332,243	1,074,130	19,594,350
Expenditures				
Preservation and maintenance:				
Construction - Capacity improvements	-	50,026	-	50,026
Preservation - Structural improvements	9,348,143	1,554,347	-	10,902,490
Maintenance	4,288,174	4,723,693	-	9,011,867
Total preservation and maintenance	13,636,317	6,328,066	-	19,964,383
Other:				
Administrative expenses	619,982	287,708	-	907,690
Net equipment expenses	64,674	79,870	2,672	147,216
Net capital outlay	-	-	566,534	566,534
Other - Services for other units	-	-	1,119,356	1,119,356
Total other	684,656	367,578	1,688,562	2,740,796
Total expenditures	14,320,973	6,695,644	1,688,562	22,705,179
Excess of Expenditures Over Revenue	(1,132,996)	(1,363,401)	(614,432)	(3,110,829)
Other Financing (Uses) Sources - Optional transfers	(1,363,401)	1,363,401	-	-
Net Change in Fund Balance	(2,496,397)	-	(614,432)	(3,110,829)
Fund Balance - Beginning of year	6,104,282	-	2,374,436	8,478,718
Fund Balance - End of year	<u>\$ 3,607,885</u>	<u>\$ -</u>	<u>\$ 1,760,004</u>	<u>\$ 5,367,889</u>

Kalamazoo County Road Commission

Note to Other Supplemental Information Year Ended December 31, 2012

Note - Reconciliation of Analysis of Revenue, Expenditures, and Changes in Fund Balance - Road Fund to Basic Financial Statements

The following is a reconciliation of the analysis of changes in fund balance - Road Fund schedule to the governmental fund (statement of governmental fund revenue, expenditures, and changes in fund balance):

	Road Fund	
	Total Revenue	Total Expenditures
Amounts per governmental fund revenue, expenditures, and changes in fund balance	\$ 18,598,911	\$ 21,709,740
Project performed on behalf of another governmental unit	<u>995,439</u>	<u>995,439</u>
Amount per analysis of changes in Road Fund balance	<u>\$ 19,594,350</u>	<u>\$ 22,705,179</u>



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March 25, 2013

To the Board of County Road Commissioners
Kalamazoo County Road Commission

We have audited the financial statements of the Kalamazoo County Road Commission (the "Road Commission") as of and for the year ended December 31, 2012 and have issued our report thereon dated March 25, 2013. Professional standards require that we provide you with the following information related to our audit which is divided into the following sections:

Section I - Required Communications with Those Charged with Governance

Section II - Other Recommendations and Related Information

Section I includes information that current auditing standards require independent auditors to communicate to those individuals charged with governance. We will report this information annually to the Board of County Road Commissioners.

Section II presents recommendations related to internal control, procedures, and other matters noted during our current year audit. These comments are offered in the interest of helping the Road Commission in its efforts toward continuous improvement, not just in the areas of internal control and accounting procedures, but also in operational or administrative efficiency and effectiveness.

We would like to take this opportunity to thank the Road Commission's staff for the cooperation and courtesy extended to us during our audit. Their assistance and professionalism are invaluable.

This report is intended solely for the use of the Board of County Road Commissioners and management of the Kalamazoo County Road Commission and is not intended to be and should not be used by anyone other than these specified parties.

To the Board of County Road Commissioners
Kalamazoo County Road Commission

March 25, 2013

We welcome any questions you may have regarding the following communications and we would be willing to discuss any of these or other questions that you might have at your convenience.

Very truly yours,

Plante & Moran, PLLC

A handwritten signature in cursive script that reads "Beth Bialy".

Beth A. Bialy

A handwritten signature in cursive script that reads "Kristine M Ray".

Kristine M. Ray

Section I - Required Communications with Those Charged with Governance

We have audited the financial statements of Kalamazoo County Road Commission (the "Road Commission") as of and for the year ended December 31, 2012 and have issued our report thereon dated March 25, 2013. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated February 9, 2013, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities. Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement.

As part of our audit, we considered the internal control of the Road Commission. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our letter about planning matters dated February 9, 2013.

Significant Audit Findings

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 Road Commission are described in Note 1 to the financial statements. There were no new accounting policies adopted in 2012.

We noted no transactions entered into by the Road Commission 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.

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 are the annual pension and retiree health care costs. Management's estimates of the annual pension and retiree healthcare costs are based on significant assumptions, including anticipated rate of return on investments, employee eligibility rates, projected salary increases, and estimated healthcare cost trends. We evaluated the key factors and assumptions used to develop the annual pension and retiree healthcare costs in determining that they are reasonable in relation to the financial statements taken as a whole.

The disclosures in the financial statements are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

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

Disagreements with Management

For the purpose 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.

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.

The attached schedules summarize uncorrected misstatements of the financial statements which were requested to be recorded. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

Significant Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, business conditions affecting the Road Commission, and business plans and strategies that may affect the risks of material misstatement with management each year prior to retention as the Road Commission's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition of our retention.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated March 25, 2013.

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 Road Commission'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.

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

Client: **Kalamazoo County Road Commission**
 Opinion Unit: **Governmental Activities**
 Y/E: **12/31/2012**

SUMMARY OF UNRECORDED POSSIBLE ADJUSTMENTS

The effect of misstatements and classification errors identified would be to increase (decrease) the reported amounts in the financial statement categories identified below:

Ref. #	Description of Misstatement	Current Assets	Long-term Assets	Current Liabilities	Long-term Liabilities	Equity	Revenue	Expenses	Net Income Statement Impact
FACTUAL MISSTATEMENTS:									
A1	To record net OPEB asset as of December 31,		\$ 169,989					\$ (169,989)	\$ 169,989
A2	To reclassify amount from revenue to expense due to final billing of U Ave. - 2nd Street to 12th Street						\$ 57,241	57,241	
A3	To reclassify amount from assets to liabilities due to the Road Commission owing additional funds to MDOT at year end for CMAQ project	\$ 34,838		\$ 34,838					
A4	To remove revenue that was incorrectly charged to the federal and state government for road projects - River St. Bridge over Kalamazoo River						(35,788)		(35,788)
JUDGMENTAL ADJUSTMENTS:									
B1	None								
B2									
PROJECTED ADJUSTMENTS:									
C1	None								
C2									
	Total	\$ (950)	\$ 169,989	\$ 34,838	\$ -	\$ -	\$ 21,453	\$ (112,748)	\$ 134,201

Client: **Kalamazoo County Road Commission**
 Opinion Unit: **General Fund**
 Y/E: **12/31/2012**

SUMMARY OF UNRECORDED POSSIBLE ADJUSTMENTS

The effect of misstatements and classification errors identified would be to increase (decrease) the reported amounts in the financial statement categories identified below:

Ref. #	Description of Misstatement	Current Assets	Long-term Assets	Current Liabilities	Long-term Liabilities	Equity	Revenue	Expenses	Net Income Statement Impact
FACTUAL MISSTATEMENTS:									
A1	Client had compensated absence liability recorded in the General Fund. Improper - Should only be recorded at government-wide level			\$ (44,378)				\$ (44,378)	\$ 44,378
A2	To remove revenue and expense related to donated roads*						\$ (50,026)	(50,026)	
A3	To recognize special assessment collections received within 60 days of year end			(14,143)			14,143		14,143
A4	To reclassify amount from revenue to expense due to final billing of U Ave. - 2nd Street to 12th						57,241	57,241	
A5	To reclassify amount from assets to liabilities due to the Road Commission owing additional funds to MDOT at year end for CMAQ project	\$ 34,838		34,838					
A6	To remove revenue that was incorrectly charged to the federal and state government for road project - River St. Bridge over Kalamazoo River	(35,788)					(35,788)		(35,788)
JUDGMENTAL ADJUSTMENTS:									
B1	None								
B2									
PROJECTED ADJUSTMENTS:									
C1	None								
C2									
		-	\$ -	-	\$ -	\$ -	-	-	-
	Total	\$ (950)	\$ -	\$ (23,683)	\$ -	\$ -	\$ (14,430)	\$ (37,163)	\$ 22,733
PASSED DISCLOSURES:									
D1	None								
D2									

* The Road Commission has recorded donated roads as a revenue and offsetting expense in the Road Fund. While this treatment is consistent with the State Accounting Manual for Road Commissions, it is an area of which the manual is in conflict with generally accepted accounting principles. In the future, we recommend donated roads be recorded as a revenue and infrastructure asset in the government-wide statements only.

Section II - Other Recommendations and Related Information

Status of Prior Year Recommendations

During our audit this year, we noted management implemented the following recommendations from 2011:

- **Backup Procedures** - Management implemented a procedure for moving backup tapes off-site on a daily basis. The tapes are now moved to a site that is more than five miles away from the Road Commission's office to protect the tapes from any disaster at the primary location.
- **Environmental Controls** - In order to help protect the servers from environmental damage, the servers were raised off the floor during 2012. This will help minimize loss in the event of a flood.
- **Access to Financial Application** - The financial application module does not allow the use of unique user access log on information or passwords. While the software is only installed on computers of employees who are authorized to access the software, it is possible that an unauthorized user could gain access to the software by using another employee's computer. To mitigate this risk, the Road Commission implemented a procedure in 2012 whereby employees are required to lock their computers whenever they leave their workstation. While it would be ideal to have this be an automatic process whereby the computer would lock itself after a period of inactivity, we understand that the integration of the phone system with the desktop computers makes an automatic process less desirable because it would lead to unintentional forwarding of phone calls.
- **Access to Blank Check Stock** - During the 2011 audit, we recommended the Road Commission enhance the security of the key that provides access to the bin where blank check stock is stored. During 2012, we noted this key has been moved to a more secure location.

Information Technology Controls and Process Recommendations

As a normal part of our audit process, we gain an understanding of the processes and controls related to your information technology (IT) system. We then compare the Road Commission's system to industry best practices and make recommendations for improvement, as appropriate. As a result of this review, we make the following recommendations:

- **Data Access** - During our audit procedures, we noted that the former finance director still had access to the Road Commission's data via the VPN system. While this was corrected in 2013, we recommend the Road Commission implement a formal process for periodically reviewing user access to the system. Reports detailing user access rights should be provided to supervisors on a regular basis and access reviewed and documented at least annually. Reviews are best performed by someone other than the IT administrator, as they administer access to the system.

- **Administrative Access** - The finance director has administrative access to the IT network and also has the ability to post transactions in the financial application. The finance director has two login names in the system, one with administrator access rights, which includes access to all core financial modules within the application, and the other login with the access rights required for daily work. While segregation of duties between the administrator and the financial department can be challenging given the Road Commission's limited staff, we suggest that management consider not allowing administrative access for the finance director, as she performs many of the transactions in the financial application, and grant administrative rights to someone else within the Road Commission.

The administrator of the system will have the ability to create user accounts and grant access to the financial system, but should be restricted from posting transactions in the application. This allows for proper segregation of duties and ensures that user access and accountability controls are not compromised. If it is necessary to allow the administrator to have the ability to post transactions (this may be a system limitation), the activities of the administrator should be logged and independently reviewed. This review can be completed by someone without administrative rights.

Other Controls and Process Recommendations

We commend management's commitment to improving internal controls and note the following observation based on our audit:

Authorized Check Signers - The Road Commission went through significant changes in the finance director position during 2012. Because the finance director plays an integral role in accounting processes and internal controls, turnover in the position requires the Road Commission to go through a series of steps to ensure the outgoing finance director's access and authority is properly removed. One such step is removing the finance director as an authorized signer on the bank accounts. We noted that the Road Commission sent forms to the bank requesting two former finance directors be removed as authorized check signers. These requests were made in June and September 2012; however, there appears to have been a failure in the bank's system in responding to the Road Commission's initial requests. When we confirmed authorized signers with the bank in February 2013, we noted the two former finance directors were still listed as authorized signers. We discussed this item with management during the audit and noted it was immediately corrected with the bank.

Legislative Update

The Michigan Legislature passed several new bills effecting road commissions that were signed into law by Governor Snyder in 2012. Three of the bills, Public Acts 466, 506, and 507 of 2012, place limitations on the amount road commissions can pay for pension and healthcare benefits. The new acts require road commissions to comply with one of the following conditions by September 30, 2014:

- Develop and publicize a transportation employee compensation plan that the Road Commission intends to implement with any new, modified, or extended employment contracts or agreements. This compensation plan must include all of the following:
 - For new employee hires, the employer contribution toward retirement plans must be capped at 10 percent of base salary.
 - Defined benefit pension plans may use a maximum multiplier of 1.5 percent if postemployment healthcare is provided and 2.25 percent if postemployment healthcare is not provided.
 - For defined benefit pension plans, the final average compensation must be calculated using a minimum of three years of compensation and must not include more than 240 hours of paid leave. Overtime hours cannot be used in calculating final average compensation.
 - The employer contribution for health care coverage for new employee hires is capped at 80 percent of the employee's premium or must be competitive with the new state preferred provider organization health plan on a per-employee basis.
- Comply with Public Act 152 of 2011, which requires public employers to place hard caps on the amounts they contribute toward healthcare costs with an option to elect an 80 percent contribution cap rather than a hard cap. These hard caps are adjusted annually for inflation. The caps in 2012 were \$5,000 for single coverage, \$11,000 for individual and spousal coverage, and \$15,000 for family coverage.

While the Road Commission is not required to comply with this new law until September 30, 2014, the Road Commission's pension and healthcare benefits compared to the new requirements are as follows:

- The defined contribution pension plan provided through the Kalamazoo County Pension Retirement System is currently overfunded; therefore, no employer contributions are required at this time. If contributions were required, there are no limitations on the percentage the Road Commission must contribute.
- The defined contribution pension plan currently uses a multiplier of 2.1 percent for non-union employees and American Federation of State, County, and Municipal Employees (AFSCME) members and 2.2 percent for Teamsters employees.
- Final average compensation is calculated using the highest five consecutive years out of the last 10. There is no provision for limiting the inclusion of overtime pay or paid leave.
- Teamsters employees currently contribute 8 percent of their healthcare premium costs. The current contract was adopted before P.A. 152 of 2012 went into effect. The Road Commission is currently addressing this issue in current negotiations with the Teamsters. Management expects future benefits to be in compliance with P.A. 152 of 2012.

- The Road Commission’s responsibility for healthcare costs is currently in compliance with P.A. 152 of 2011 for all nonunion and AFSME employees.

Retirement System Assets

Last year, we reported to you about a difference between the actuarial value and market value of the assets in the Kalamazoo County Employees’ Retirement System (the “System”). We offer the following update:

The System’s most recent actuarial valuation indicates that the system-wide (all County) actuarial value of assets was approximately \$9.6 million higher than the actual market value as of December 31, 2011. This gap in value is significantly larger than the prior year when it was only \$3 million. Differences between the actuarial value and market value are common and are caused by the practice of smoothing market gains and losses over a period of time in order to provide relatively consistent required contributions from year to year. The large difference at December 31, 2011 is the residual impact of the losses in the stock market that occurred in 2008 and 2011. Since the actuary uses a five-year period to smooth gains and losses, there are still significant losses from 2008 and 2011 remaining to be recognized in the actuarial value of the System’s assets. The following table shows the historical gains and losses not yet recognized in the actuarial valuation:

	(Losses) Gains to be Recognized in Actuarial Valuation Dated December 31 (in millions)				
(Losses) Gains Incurred in	2012	2013	2014	2015	Total
2011	(\$3.3)	(\$3.3)	(\$3.3)	(\$3.3)	(\$13.2)
2010	\$2.4	\$2.4	\$2.4	---	\$7.2
2009	\$3.7	\$3.7	---	---	\$7.4
2008	(\$11.0)	---	---	---	(\$11.0)
Total	(\$8.2)	\$2.8	(\$0.9)	(\$3.3)	(\$9.6)

As this table shows, losses of \$11 million from 2008 will be recognized in the 2012 valuation and losses of \$13.2 million from 2011 will be recognized in the 2012 through 2015 valuations. While these losses will be partially offset by gains from 2010 and 2009, the System will need to experience a rate of return higher than the actuarial assumed rate of 7.75 percent in order for the market value of assets to move closer to the actuarial value. The System’s actual rate of return was a loss of 2.32 percent in 2011 and a gain of 17.11 percent in 2010. The large gain in 2010 was partially due to a market correction after the downturn in late 2008 and early 2009; investment returns should not be expected to continue at this level into the future.

To the Board of County Road Commissioners
Kalamazoo County Road Commission

March 25, 2013

If assets do not continue rebounding, or if the market experiences another significant downturn, a contribution to the System may be required. We encourage the Road Commission to continue monitoring this situation and consider the potential future impact on the Road Commission's budget.

Proposed Pension Redesign

In February 2012, the System received a supplemental valuation to determine the impact of a proposed pension redesign. The proposed changes include decreasing the assumed market rate of return from 7.75 percent to 7.50 percent and decreasing the wage inflation assumption from 4.50 percent to 3.5 percent. Because the Road Commission's pension liability is currently overfunded on an actuarial basis, the Road Commission's required contribution for 2012 would have been \$0 under both the existing assumptions and the proposed changes. It is important to note that the proposed pension redesign does not impact the difference between the actuarial value and market value of the assets, as discussed above.

Kalamazoo County Road Commission

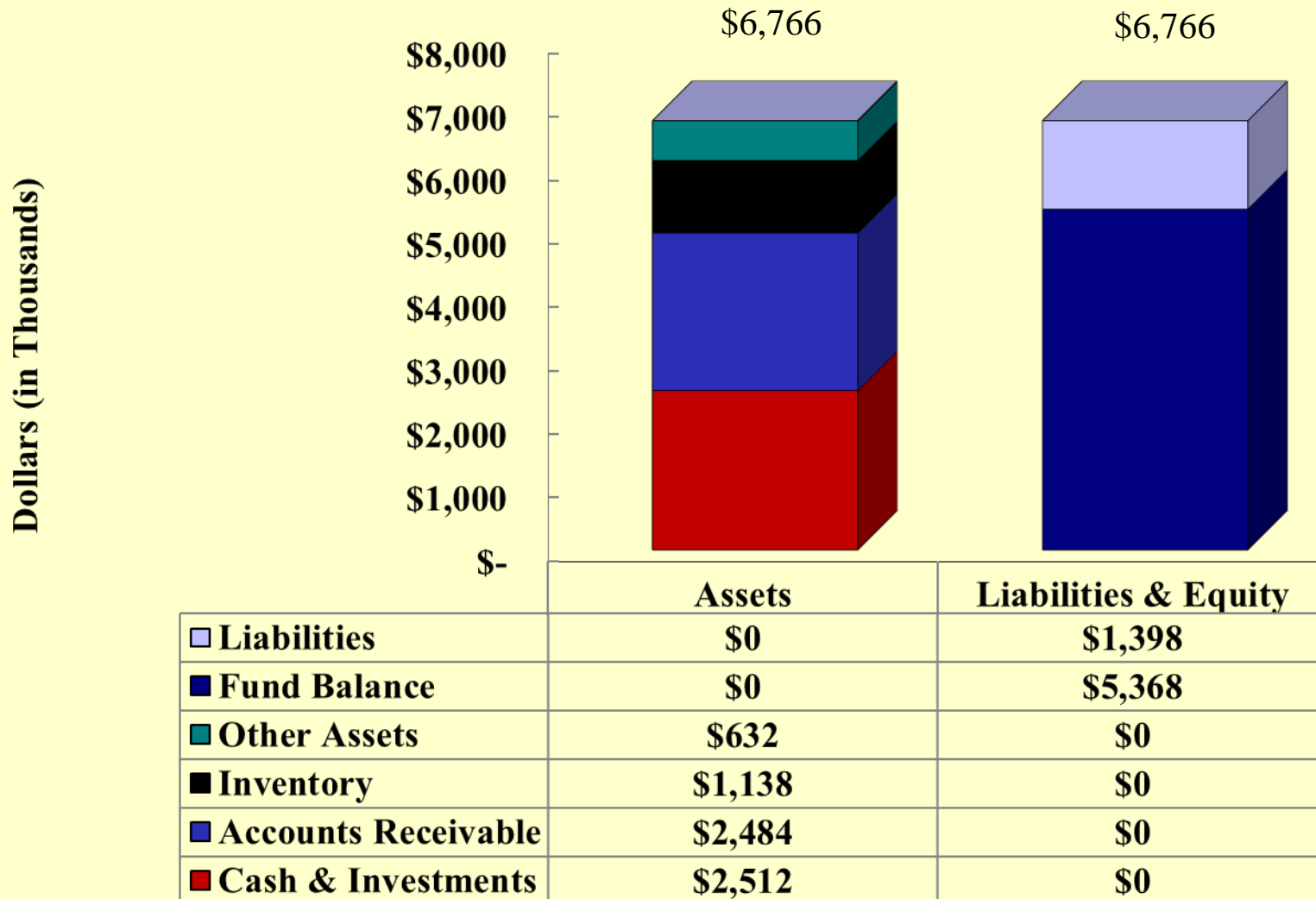
**Financial Statement Presentation
December 31, 2012**

**Presented By:
Beth Bialy
Kris Ray**

Kalamazoo County Road Commission

Road Fund Balance Sheet (in thousands)

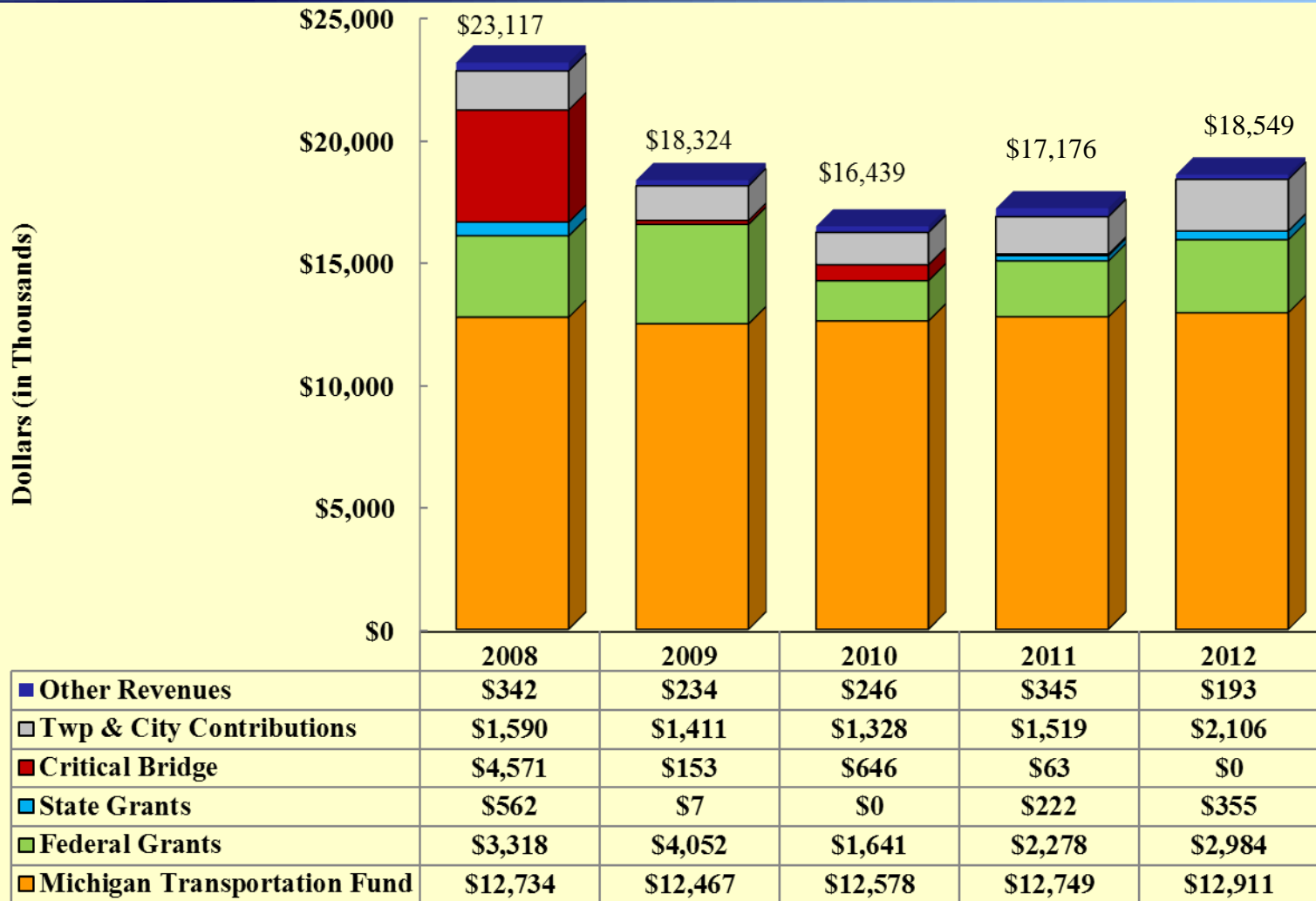
December 31, 2012



Kalamazoo County Road Commission

Road Fund Revenue

Years Ended December 31, 2008 through 2012*

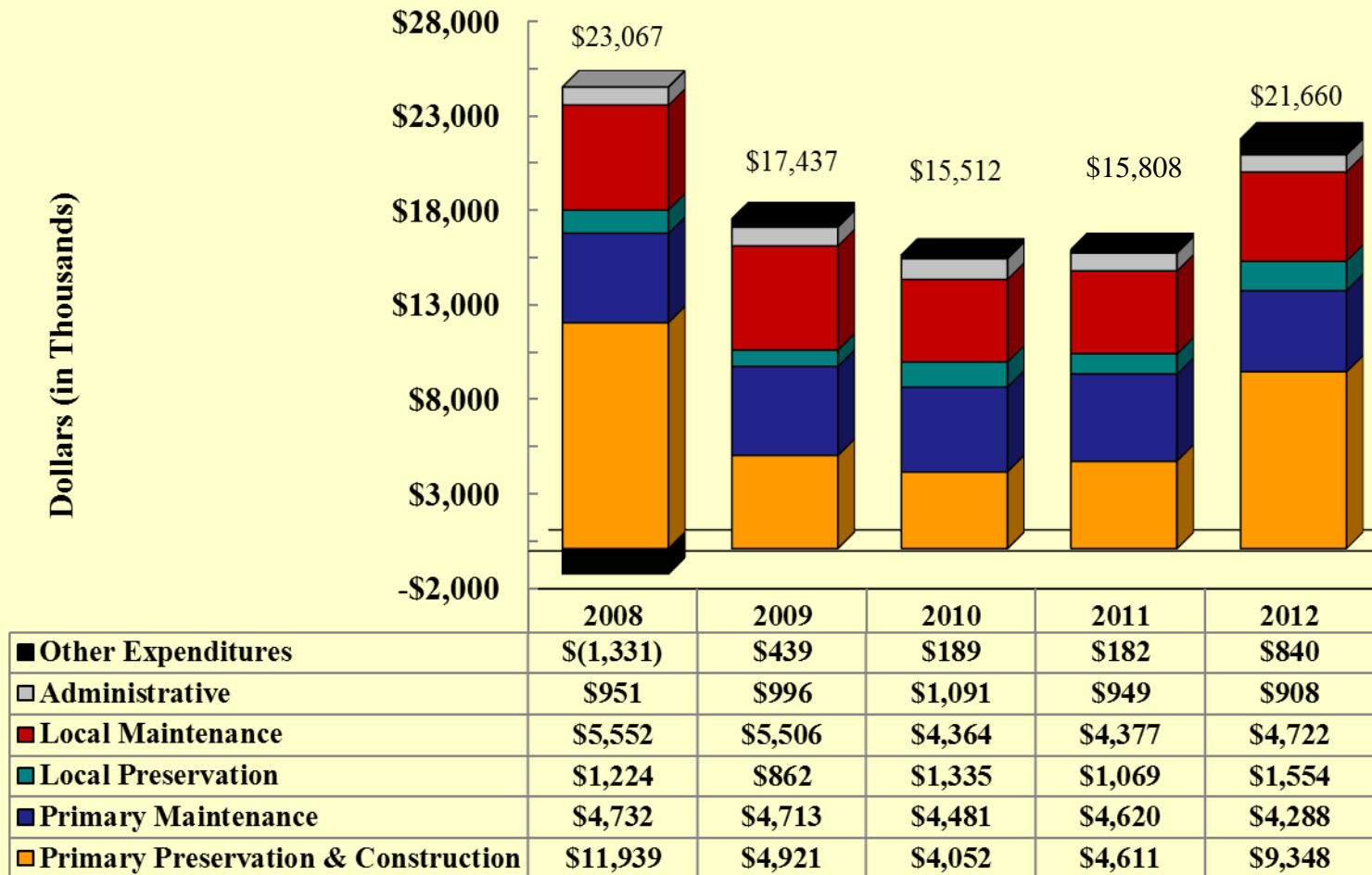


* All years exclude construction in-kind revenue

Kalamazoo County Road Commission

Road Fund Expenditures

Years Ended December 31, 2008 through 2012 *



* All years exclude construction in-kind expenditures

Kalamazoo County Road Commission

Road Fund - Budget to Actual

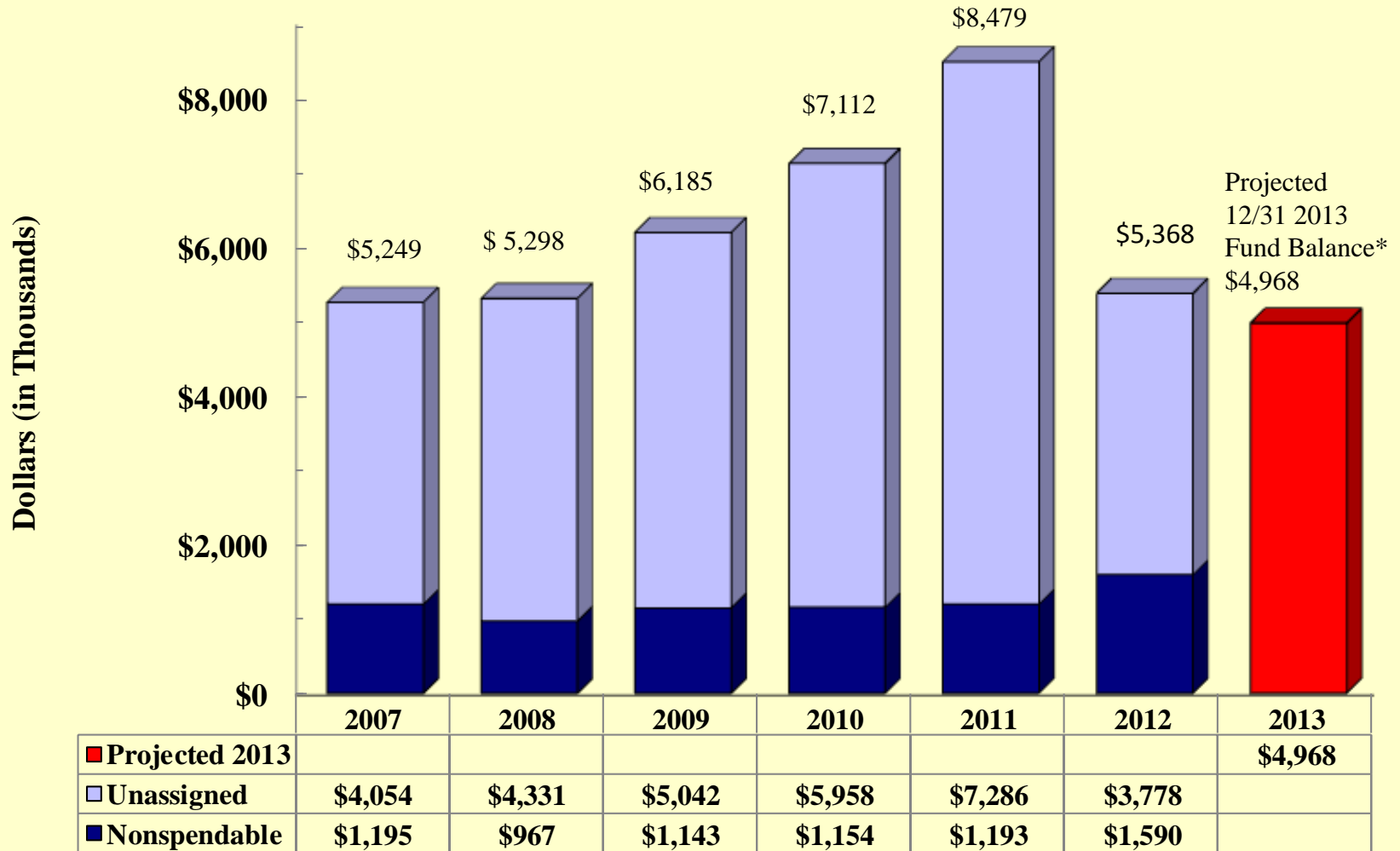
Year Ended December 31, 2012

	Original Budget	Amended Budget	Actual	Variance
Total Revenues	\$17,823,436	\$18,465,500	\$19,594,350	\$1,128,850
Total Expenditures	18,871,876	22,650,800	22,705,179	(54,379)
Revenue under Expenditures	(1,048,440)	(4,185,300)	(3,110,829)	1,074,471
Fund Balance	\$7,430,278	\$4,293,418	\$5,367,889	\$1,074,471

Kalamazoo County Road Commission

Road Fund – Fund Balance

For the Years Ended December 31, 2007 through 2012 **

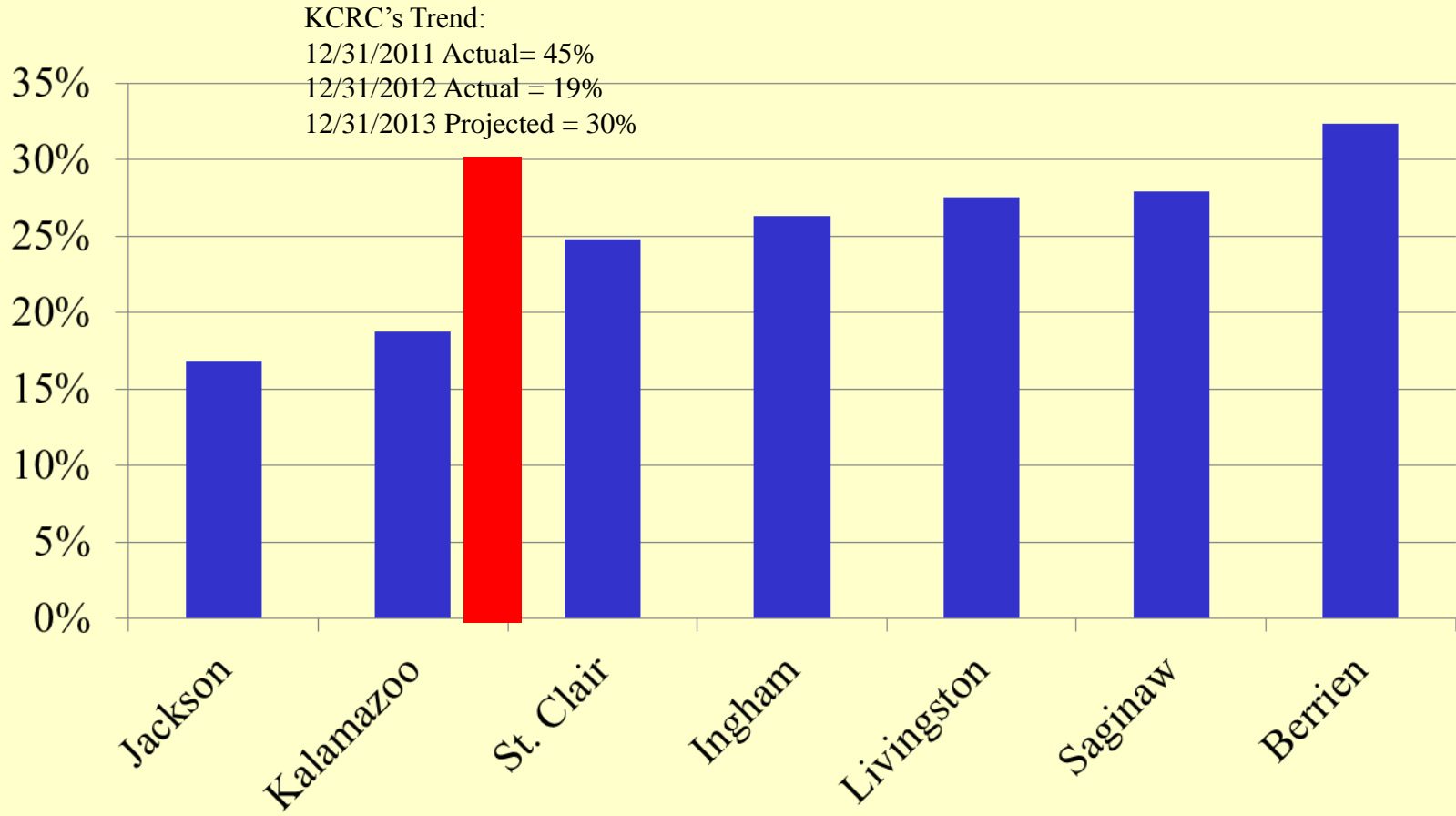


*12/31/2013 fund balance projected based on KCRC's 2013 budget.

** Prior year fund balance classifications have been restated to reflect GASB 54 definitions of fund balance classifications.

Kalamazoo County Road Commission

Unrestricted Fund Balance as a Percentage of Annual Expenditures Comparison to Other Road Commissions *



*Road Commissions selected for comparison based on annual MTF funding similar to KCRC.

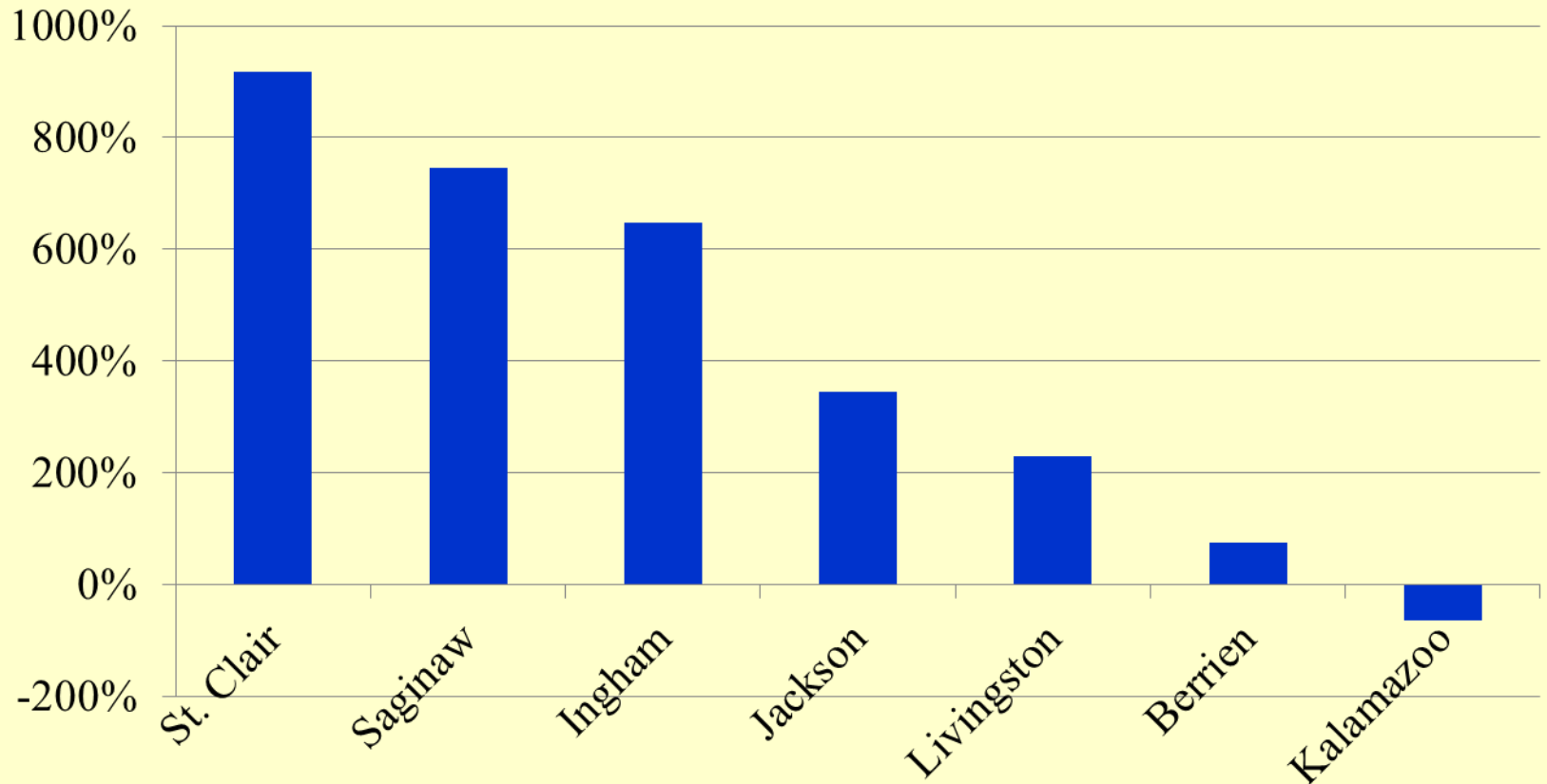
Information based on the most recently available financial statements, as follows:

Kalamazoo – 2012 Financial Statements

All others – 2011 Financial Statements

Kalamazoo County Road Commission

Unfunded Pension and OPEB Obligations as a Percentage of Annual Payroll Expenditures Comparison to Other Road Commissions *



*Road Commissions selected for comparison based on annual MTF funding similar to KCRC.

Information based on the most recently available financial statements, as follows:

Kalamazoo – 2012 Financial Statements

All others – 2011 Financial Statements

*Thank you for the opportunity to serve the
Kalamazoo County Road Commission*



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