

BAY COUNTY ROAD COMMISSION

(A Component Unit of Bay County, Michigan)

Financial Statements

For the Year Ended December 31, 2017



SMITH & KLACZKIEWICZ, PC
CERTIFIED PUBLIC ACCOUNTANTS

Bay County Road Commission
(A Component Unit of Bay County)

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SMITH & KLACZKIEWICZ, PC
CERTIFIED PUBLIC ACCOUNTANTS

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A VETERAN OWNED BUSINESS

Independent Auditor's Report

To the Board of County Road Commissioners
County of Bay
Kawkawlin, Michigan

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and the major fund of the *Bay County Road Commission*, a component unit of Bay County, Michigan, as of and for the year ended December 31, 2017, and the related notes to the financial statements, which collectively comprise the 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 opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the major fund of the *Bay County Road Commission*, as of December 31, 2017, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis (pages 3-7), budgetary comparison information (pages 28-29), schedule of funding progress (page 30), schedule of changes in net pension liability and related ratios (page 31) and the schedule of employer contributions (page 32) 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.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Bay County Road Commission's** basic financial statements. The other supplementary information schedules are the responsibility of management and were derived from and relate 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 supplementary information schedules are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 9, 2018, on our consideration of the **Bay County Road Commission's** internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the **Bay County Road Commission's** internal control over financial reporting and compliance.

Smith + Klayhewicz PC

Saginaw, Michigan

May 9, 2018

MANAGEMENT'S DISCUSSION AND ANALYSIS

Bay County Road Commission

Management's Discussion and Analysis

As management of the Bay County Road Commission, we offer readers of these financial statements this narrative, overview and analysis of the financial activities of the Road Commission for the year ended December 31, 2017. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues and activities and to identify any significant changes in financial position.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to provide a basis of understanding of the Bay County Road Commission's basic statements. These basic financial statements comprise three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. Supplementary financial information is also provided for additional information purposes.

Government-Wide Financial Statements

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

The *Statement of Net Position* presents information on all of the Bay County Road Commission's assets, deferred outflows, liabilities and deferred inflows, with the difference between them reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Road Commission is improving or deteriorating.

The *Statement of Activities* presents information showing how the government's net position changed during the most recent fiscal year. All changes in net position 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 (e.g., vested sick and vacation).

Governmental Fund Financial Statements

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 the Road Commission's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statement, it is useful to compare the information presented for governmental funds financial statements with similar information presented for government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions.

The Bay County Road Commission adopts an annual appropriated budget for the General Operating / Road Fund. A budgetary comparison statement has been provided to demonstrate compliance with this budget.

Bay County Road Commission

Management's Discussion and Analysis

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 governmental fund financial statements. The notes to financial statements can be found on pages 12-27 of this report.

FINANCIAL HIGHLIGHTS

Government-Wide Financial Analysis

As noted above net position may serve over time as a useful indicator of the Road Commission's financial position. As shown on the table below, the Road Commission's assets and deferred outflows exceeded liabilities and deferred inflows by \$90,899,508 at the end of the year.

Net position is separated into three major components, net investment in capital assets of \$88,237,713, restricted net position of \$7,228,632 and unrestricted net position / (deficit) of \$(4,566,837). The investment in capital assets reflects the Road Commission's investment in capital assets (i.e., land, infrastructure, buildings, vehicles and equipment), less any related debt issued to acquire those assets that are still outstanding. The Road Commission uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the Road Commission's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The restricted net position reflects the Road Commission's proportionate share of the net pension asset in the Bay County Employee's Retirement System. These assets and deferred outflows, net of liabilities and deferred inflows are held in a trust and are not considered available to the Road Commission, except to satisfy pension obligations to retirees. The remaining balance of unrestricted net position / (deficit) represents the remaining amount may be used to meet the Road Commission's ongoing obligations to citizens and creditors.

At the end of the year, the Road Commission reported a positive balance in net position invested in capital assets and restricted net position and a negative balance in unrestricted net position. The deficit situation mainly results from implementing GASB statement number 45 in a prior year, which required the recording of a net OPEB obligation in excess of \$10 million on the Statement of Net Position in the current year.

The following compares the net position at December 31, 2017 and 2016 in a condensed format:

	<u>2017</u>	<u>2016</u>
Assets –		
Current and other unrestricted assets	\$ 6,960,758	\$ 6,375,791
Capital and other long-term assets	<u>90,935,488</u>	<u>89,910,780</u>
Total assets	<u>97,896,246</u>	<u>96,283,571</u>
Deferred outflows of resources	<u>5,192,090</u>	<u>5,512,382</u>
Liabilities –		
Current liabilities	584,112	768,293
Long-term liabilities	<u>11,200,505</u>	<u>9,592,617</u>
Total liabilities	<u>11,784,617</u>	<u>10,360,910</u>

Bay County Road Commission

Management's Discussion and Analysis

	<u>2017</u>	<u>2016</u>
Deferred inflows of resources	\$ 404,211	\$ -
Net position –		
Net investment in capital assets	88,237,713	88,182,280
Restricted for pension benefits	7,228,632	7,237,882
Unrestricted (deficit)	<u>(4,566,837)</u>	<u>(3,985,119)</u>
Total net position	<u>\$ 90,899,508</u>	<u>\$ 91,435,043</u>

The following presents a comparison of revenues, expenses and changes in net position for the year ended December 31, 2017 and 2016 in a condensed format:

	<u>2017</u>	<u>2016</u>
Revenues –		
Charges for services	\$ 3,435,564	\$ 1,882,479
Operating grants and contributions	10,600,567	10,429,217
Capital grants and contributions	1,044,079	983,854
General revenue	<u>206,519</u>	<u>242,168</u>
Total	<u>15,286,729</u>	<u>13,537,718</u>
Expenses –		
Public works	15,822,264	15,675,191
Debt service	<u>-</u>	<u>1,638</u>
Total	<u>15,822,264</u>	<u>15,676,829</u>
Change in net position	<u>\$ (535,535)</u>	<u>\$ (2,139,111)</u>

Financial Analysis of Governmental Fund Financial Statements

As noted earlier, the focus of the governmental fund financial statements is to provide information on the near-term inflows, outflows, and balances of spendable resources. Such information can be useful in assessing the Road Commission's financing requirements. In particular, unrestricted fund balance may serve as a useful measure of the Road Commission's net resources available to finance routine and emergency spending in succeeding years.

For the year ended December 31, 2017, the fund balance of the Road Commission increased by \$851,916 to \$6,376,646. Of this amount, \$718,483 is not spendable (prepaid items and inventory) and \$5,658,163 is restricted because it may only be used to finance future maintenance projects on the County's road and bridge system.

Total revenues were \$15,286,729, an increase of \$1,058,231 as compared to the prior year. This was primarily the result of decreases in spending of proceeds received from the State for priority road improvement projects. Total expenditures of \$14,434,813 increased \$127,586 over the prior year, mainly as a result of decreased activity for priority road improvement projects.

Bay County Road Commission

Management's Discussion and Analysis

BUDGETARY HIGHLIGHTS

The Road Commission amended its annual budget to reflect status changes in planned expenditures for preservation-structural improvements, State trunkline maintenance projects, administration, equipment and capital outlay. The final revenue budget was \$1,646,600 less than the original budget due to changes in projections of several sources, including Federal and State pass-through, contributions from local units and State trunkline maintenance. The final expenditure budget was \$2,615,415 less than the original budget due mainly to changes in projections for preservation and maintenance expenditures. The actual revenues were \$101,637 less than the amended budget and the actual expenditures were \$116,210 more than the amended budget.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets – The Road Commission had \$88,237,713 in net capital assets at the end of the year, a net increase of \$55,433. The reason for the increase from the previous year is the result of capital outlay and the capitalization of road and bridge projects funded by Federal, State and local sources. A summary of capital assets net of accumulated depreciation at year-end in comparison to the previous year is as follows:

	<u>2017</u>	<u>2016</u>
Nondepreciable capital assets	\$ 35,922,151	\$ 35,921,220
Buildings and improvements, net	707,079	707,722
Equipment, net	1,438,040	1,189,942
Infrastructure, net	<u>50,170,443</u>	<u>50,363,396</u>
Total, net	<u>\$ 88,237,713</u>	<u>\$ 88,182,280</u>

Additional information about the Road Commission's capital assets activity may be found in Note C on page 19 of the financial statements.

Long-term Liabilities – The Road Commission recorded liabilities of \$940,311 for accrued compensated absences. Additional information on the Road Commission's long-term liabilities may be found in Note C on page 18 of the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Board of County Road Commissioners considered many factors when setting the fiscal year 2018 budget. A key factor that was used in the development of the budget was the number of projects to be completed and Township contributions to be received toward the projects under the cost-share program with Townships and others. Another key factor is the economy. During 2017, the Road Commission derived nearly 70% of its revenue from gas and fuel taxes collected. Michigan Transportation Funds are expected to increase significantly over the five (5) years due to State legislation that increased the gas and fuel tax in 2016. The Road Commission adopted a balanced budget for 2018 that reflected this new legislation. The Board realizes, and the reader should understand, that there are not sufficient funds available to repair and/or rebuild every road and bridge in Bay County's transportation system. Therefore, the Board attempts to spend the

Bay County Road Commission

Management's Discussion and Analysis

public's money wisely and equitably, and in the best interest of the motoring public and the citizens of Bay County.

CONTACTING THE ROAD COMMISSION'S MANAGEMENT

This financial report is designed to provide the motoring public, citizens and other interested parties a general overview of the Road Commission's finances and to show accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Road Commission for Bay County administrative office at 2600 E. Beaver Road, Kawkawlin, MI 48631.



BASIC FINANCIAL STATEMENTS

Bay County Road Commission

General Operating / Road Fund Balance Sheet and Statement of Net Position

December 31, 2017

	General Operating / Road Fund	Adjustments	Statement of Net Position
Assets			
Cash and cash equivalents	\$ 50,234	\$ -	\$ 50,234
Investments	3,695,348	-	3,695,348
Receivables			
Due from other governmental units	2,419,356	-	2,419,356
Due from other sources	60,544	-	60,544
Interest receivable	16,793	-	16,793
Inventories			
Equipment material and parts	206,246	-	206,246
Road materials	423,780	-	423,780
Prepaid items	88,457	257,022	345,479
Net pension asset	-	2,440,753	2,440,753
Capital assets, net			
Assets not being depreciated	-	35,922,151	35,922,151
Assets being depreciated	-	52,315,562	52,315,562
Total assets	6,960,758	90,935,488	97,896,246
Deferred outflows of resources	-	5,192,090	5,192,090
Total assets and deferred inflows	\$ 6,960,758	96,127,578	103,088,336
Liabilities			
Accounts payable	\$ 156,740	72,748	229,488
Due to State of Michigan	6,732	-	6,732
Accrued liabilities	122,455	-	122,455
Advances			
State trunkline capital equipment	175,432	-	175,432
State trunkline maintenance	122,753	-	122,753
Long-term liabilities			
Net OPEB obligation	-	10,187,446	10,187,446
Accrued compensated absences	-	940,311	940,311
Total liabilities	584,112	11,200,505	11,784,617
Deferred inflows of resources	-	404,211	404,211
Fund Balance / Net Position			
Fund balance			
Nonspendable			
Inventory	630,026	(630,026)	-
Prepaid items	88,457	(88,457)	-
Restricted for road system	5,658,163	(5,658,163)	-
Total fund balance	6,376,646	(6,376,646)	-
Total liabilities, deferred inflows and fund balance	\$ 6,960,758		
Net Position:			
Net investment in capital assets		88,237,713	88,237,713
Restricted for pension benefits		7,228,632	7,228,632
Unrestricted (deficit)		(4,566,837)	(4,566,837)
Total net position		\$ 90,899,508	\$ 90,899,508

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

Bay County Road Commission

Reconciliation of Fund Balances of the General Operating / Road Fund to Net Position of Governmental Activities

December 31, 2017

Fund balance - General Operating / Road Fund	\$	6,376,646
The amount reported as net position in the <i>governmental activities</i> in the Statement of Net Position are different because:		
Prepaid expenses for the self-insured plan are not a current financial resource and therefore are not reported in the fund financial statements		257,022
The net pension asset is not a current financial resource and therefore is not reported in the fund financial statements		2,440,753
Capital assets used in governmental activities are not current financial resources and therefore are not reported in the General Operating / Road Fund.		
Add - capital assets not being depreciated		35,922,151
Add - capital assets being depreciated		117,477,804
Deduct - accumulated depreciation		(65,162,242)
Certain pension-related amounts such as the net pension liability and deferred amounts are not due an payable in the current period or do not represent current financial resources and therefore are not reported in the fund financial statements		
Deferred outflows related to the net pension liability		5,192,090
Deferred inflows related to the net pension liability		(404,211)
Long-term liabilities are not due and payable in the current period and therefore are not reported in the General Operating / Road Fund.		
Deduct - incurred but not reported (IBNR) claims of self-insured plan		(72,748)
Deduct - net OPEB obligation		(10,187,446)
Deduct - accrued compensated absences		(940,311)
Net position of governmental activities	\$	<u>90,899,508</u>

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

Bay County Road Commission

General Operating / Road Fund Statement of Revenues, Expenditures and Changes in Fund Balance and Statement of Activities

For the Year Ended December 31, 2017

	General Operating / Road Fund	Adjustments	Statement of Activities
Expenditures/expenses			
Public works	\$ 9,239,866	\$ 6,582,398	\$ 15,822,264
Capital outlay	5,194,947	(5,194,947)	-
Total expenditures/expenses	14,434,813	1,387,451	15,822,264
Program revenue			
Charges for services	3,435,564	-	3,435,564
Operating grants and contributions			
State transportation and other funds	10,600,567	-	10,600,567
Capital grants and contributions			
Federal sources	628,603	-	628,603
State sources	415,476	-	415,476
Total program revenue	15,080,210	-	15,080,210
Net program revenue			(742,054)
General revenue			
Sales of capital assets and yard materials	139,150	-	139,150
Interest and rents	67,369	-	67,369
Total general revenue	206,519	-	206,519
Total revenue	15,286,729		
Revenue over (under) expenditures	851,916	(851,916)	-
Change in net position	-	(1,387,451)	(535,535)
Fund balance / net position:			
Beginning of the year	5,524,730	85,910,313	91,435,043
End of the year	\$ 6,376,646	\$ 84,522,862	\$ 90,899,508

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

Bay County Road Commission

Reconciliation of Net Change in Fund Balance of the General Operating / Road Fund to Change in Net Position of Governmental Activities

For the Year Ended December 31, 2017

Change in fund balance - General Operating / Road Fund	\$	851,916
Amounts reported for <i>governmental activities</i> in the Statement of Activities are different because:		
The change in the prepaid expense for the self-insured plan does not impact current financial resources and therefore is not reported in the fund financial statements		
		95,936
The change in the net pension asset and the related deferred inflows / outflows of resources does not impact current financial resources and therefore is not reported in the fund financial statements		
Net pension asset		715,253
Deferred outflows related to the net pension liability		(320,292)
Deferred inflows related to the net pension liability		(404,211)
Fund financial statements 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.		
Add - capital outlay		811,105
Add - infrastructure purchases		4,383,842
Deduct - depreciation expense		(5,139,514)
Long-term liabilities are not due and payable in the current period and therefore are not reported in the General Operating / Road Fund.		
Change in insured but not reported (IBNR) claims of self-insured plan		5,570
Change in net OPEB obligation		(1,475,934)
Change in accrued compensated absences		(59,206)
		<hr/>
Change in net position of governmental activities	\$	<u>(535,535)</u>

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

Bay County Road Commission

Notes to Financial Statements

NOTE 1 – Summary of Significant Accounting Policies

The accounting policies adopted by the *Bay County Road Commission* (the “Road Commission”) conform to accounting principles generally accepted in the United States of America (U.S. GAAP) as applied to governmental entities, including the following accounting policies specific to road commissions: allocation of depreciation / depletion and equipment rental; the recording of handling and overhead credits; and the recording of equipment retirements with the related gain or loss on disposal of equipment. The following is a summary of the significant policies.

Reporting Entity

The *Bay County Road Commission* is a discrete component unit of the County of Bay, Michigan. The Road Commission is considered to be a component unit of the County because it is an entity for which the County is considered to be financially accountable. The Road Commission, as a component unit of the County, is required by Public Act 51 of the State of Michigan to have a separate audit performed of its operations. These audited financial statements have been prepared to meet this State requirement.

The Road Commission is used to control the expenditure of revenues from the State distribution of gas and weight taxes, reimbursements from the Michigan Department of Transportation for work done by the County on State trunklines, Federal Transportation funds and contributions from other local units of government for work performed by the Road Commission.

The Road Commission is established pursuant to the County Road Law (MCL224.1) and operates under a 3-member elected Board of County Road Commissioners. The Board of County Road Commissioners establishes policies and reviews operations of the Road Commission. The Road Commission provides services to 14 Townships in Bay County and maintains 77 bridges and over 1,600 miles of State, primary and local roads.

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. *Governmental activities* are supported by charges for services and intergovernmental grants and contributions.

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. Interest and other items not properly included among program revenues are reported as general revenues.

A combined financial statement is provided for the General Operating / Road Fund Balance Sheet, Statement of Net Position, Statement of Revenues, Expenditures and Changes in Fund Balances and the Statement of Activities. The General Operating / Road Fund is considered to be a major fund for financial reporting purposes.

Bay County Road Commission

Notes to Financial Statements

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements (Statement of Net Position and the Statement of Activities) are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are 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 (General Operating / Road Fund) financial statements (Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balance) 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 Road Commission 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 expenditures, as well as expenditures related to compensated absences not expected to be paid in the current year, pension and retiree healthcare contributions and claims and judgments are recorded only when payment is due.

State and Federal revenue, licenses and interest associated with the current fiscal period are all considered susceptible to accrual and therefore 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 Road Commission.

The Road Commission reports the following major *governmental* fund:

The *General Operating / Road Fund* is the Road Commission's primary operating fund. It accounts for all financial resources of the Road Commission, except those required to be accounted for in another fund.

Assets, Deferred Outflows, Liabilities, Deferred Inflows and Net Position or Equity

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand and deposits in demand and time deposit accounts.

Investments

The Road Commission's investments are comprised of a pooling of investments that is maintained by the County Treasurer.

Receivables and Payables

All receivables and payables 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 expenditures in both the government-wide and fund financial statements. The governmental activities also deposits / prepayments made relative to the self-insured healthcare benefits program and prepaids.

Inventory

Inventory consists of various operating parts, supplies and road material and is stated at cost, using the average unit cost method. Inventory items are charged to road construction and maintenance, equipment repairs and operations as they are used.

Bay County Road Commission

Notes to Financial Statements

Capital Assets

Land, buildings, equipment and infrastructure assets (roads, bridges and other similar items) are reported as capital assets in the government-wide financial statements (Statement of Net Position). Capital assets are defined by the Road Commission as land, buildings, improvements and equipment (except road equipment), with an initial individual cost of \$2,000 or more and an estimated useful life in excess of one (1) year. No minimum cost is used to record road equipment capital assets that appear in the State Equipment List (Schedule C). 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 donated. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Capital assets are recorded as capital outlay expenditures at the time of purchase in the fund financial statements and are subsequently capitalized on the government-wide statements through an adjustment to the governmental fund (General Operating / Road Fund) column. Infrastructure is reported prospectively from 1980, except for right-of-ways, bridges and traffic signals, which are required to be reported regardless of the date of purchase. The Uniform Accounting Procedures Manual for Michigan County Road Commissions (the "Manual") provides for removing roads from capital assets at the time the group of individually recorded roads becomes fully depreciated.

The Manual also provide for recording depreciation in the General Operating / Road Fund as a charge to various expense accounts and a credit to the depreciation contra expense account. Accordingly, the annual depreciation expense does not affect the available operating fund balance of the General Operating / Road Fund.

The Manual also provides for the net book value of road equipment that is retired to be reported as an equipment retirement in the equipment retirement credit account that is offset against capital outlay. The net of any proceeds received for the retirement (sale, abandonment, trade-in, etc.) is reported as a gain or loss on disposal of equipment. Accordingly, the annual depreciation expense does not affect the available operating fund balance of the General Operating / Road Fund.

Depreciation is recorded over the following estimated useful lives using the sum-of-years digits method for road equipment and the straight-line method for all other capital assets and infrastructure:

Buildings and improvements	8 to 50 years
Road equipment	5 to 8 years
Shop equipment	5 to 10 years
Office equipment	5 to 10 years
Engineering equipment	5 to 10 years
Infrastructure – bridges	12 to 50 years
Infrastructure – roads	5 to 30 years

Deferred Outflows of Resources

In addition to assets, the Statement of Net Position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense / expenditure) until then. The Road Commission has one item that qualifies for reporting in this category, which is the deferred outflow of resources related to the defined benefit pension plan. The deferred outflows of resources related to the defined benefit pension plan are reported in the government-wide financial statements. The deferred outflows of resources result from the variance between the plan's actual investment earnings compared to the plan's assumed investment earnings,

Bay County Road Commission

Notes to Financial Statements

changes in assumptions, differences between expected and actual experience, differences between employer contributions and proportionate share contributions and contributions to the defined benefit pension plan subsequent to the measurement date.

Advances from the State of Michigan

The State of Michigan advances funds on a State maintenance agreement that it has with the Road Commission for specific maintenance performed by the Road Commission during the year. The advance is considered a current liability because it is subject to repayment annually, based upon results of audit procedures performed by the State of Michigan.

State Trunkline Adjustments

Adjustments to available operating funds resulting from audits of State Trunkline maintenance expenditures are recorded at the time cash settlement is made. The amount of the adjustments, if any, as a result of current year operations cannot be reasonably determined and is therefore not recorded.

Compensated Absences

In accordance with the union contract and policies adopted by the Board of County Road Commissioners, employees have a vested right upon termination of employment to receive compensation for accumulated unused sick leave and vacation time under formulas and conditions specified in the contract / policies.

Vacation and sick leave payable is reported in the General Operating / Road Fund only for matured amounts, for example, as a result of employee resignations and retirements. The remaining portion is recorded as an adjustment to the fund financial statements which results in the government-wide statements including both short and long-term portions of this liability. The Road Commission allows employees to accumulate vacation and sick leave in varying amounts, depending on time of service and other factors.

Net OPEB Obligation

The Road Commission offers healthcare benefits to its employees and retirees. The Road Commission's annual required contribution (ARC) to fund these benefits over the remaining amortization period is provided through an actuarial valuation. The General Operating / Road Fund accounts for contributions as expenditures when they are made. The governmental activities record expenses for the full-accrual cost which is equal to the current year required contribution, adjusted for interest and an adjustment to the ARC.

Fund Equity

In the financial statements, the General Operating / Road Fund reports the following components of fund balance:

Nonspendable

Amounts that are not in spendable form or are legally or contractually required to be maintained intact are reported as nonspendable fund balance.

Restricted

Amounts that are legally restricted by externally imposed constraints that are placed on the use of resources by grantors, contributors, or laws or regulations of other governments are reported as restricted fund balance.

Bay County Road Commission

Notes to Financial Statements

Committed

Amounts that have been formally set aside by the Board of County Road Commissioners for use for specific purposes are reported as committed fund balance. Commitments are made and can only be rescinded by resolution of the Board of County Road Commissioners.

Assigned

Amounts that are constrained by the Road Commission's *intent* to be used for specific purposes but are neither restricted nor committed are reported as assigned fund balance. The Board of County Road Commissioners has authorized the Managing Director or her designee the authority to assign fund balance on behalf of the Road Commission.

Unassigned

Amounts that have not been restricted, committed or assigned to specific purposes are reported as unassigned fund balance.

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

Deferred Inflows of Resources

In addition to liabilities, the Statement of Net Position will sometimes report deferred inflows of resources in a separate section. This separate financial statement element represents an acquisition of net position that applies to a future period(s) and therefore will not be recognized as an inflow of resources (revenue) until that time. At year-end, the Road Commission had two types of items that qualified for reporting in this category; differences between expected and actual experience related to its defined benefit pension plan and differences between employer contributions and proportionate share contributions. Additional information regarding the differences between expected and actual experience related to its defined benefit pension plan can be found in note D of these financial statements.

Equipment Rental

The Manual requires that the cost of operating equipment, including depreciation, be allocated (charged) to the various activities. The effect of this allocation is offset to equipment expenditures / expenses. As a result, fund balance is not affected.

Handling and Overhead Credits

The Manual requires that the charging of handling and overhead based upon a calculation related to a specific project's cost (particularly projects on the State Trunkline) be reported as an expenditure to the project, with a credit to administrative expenditures. As a result, fund balance is not affected.

Estimates

In preparing financial statements in conformity with U.S. GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Bay County Road Commission

Notes to Financial Statements

NOTE B - Stewardship, Compliance and Accountability

Auditing and Reporting

The audit was performed 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 as described in the Independent Auditors' Report and with the types of compliance requirements described in Public Act 51 of 1951, as amended. The financial statements were prepared in accordance with U.S. GAAP, as described in the Independent Auditor's Report and also with applicable rules of the Michigan State Department of Transportation.

NOTE C - Detailed Notes on Select Financial Statement Captions / Transaction Classes

Deposits and Investments

At year-end, the carrying amounts of the Road Commission's deposits and investments were as follows:

	<u>General Operating / Road Fund</u>
Cash on hand	\$ 300
Deposits with financial institutions - demand	<u>49,934</u>
Sub-total	50,234
Investments maintained by County Treasurer	<u>3,695,348</u>
Total	<u>\$ 3,745,582</u>

Deposit and Investment Risk

State law limits the allowable investments and the maturities of some of the allowable investments as identified in the following list of authorized investments.

- Bonds, securities, other obligations and repurchase agreements of the United States, or an agency or instrumentality of the United States.
- Certificates of deposit, savings accounts, deposit accounts or depository receipts of a qualified financial institution.
- Commercial paper rated at the time of purchase within the 2 highest classifications established by not less than 2 standard rating services and that matures not more than 270 days after the date of purchase
- Bankers acceptances of United States banks.
- 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.
- 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.
- External investment pools as authorized by Public Act 20 as amended through December 31, 1997.

Interest Rate Risk

The Road Commission'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.

Bay County Road Commission

Notes to Financial Statements

Credit Risk

The Road Commission's investment policy does not have specific limits in excess of State law on investment credit risk.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Road Commission's deposits may not be returned. State law does not require, and the Road Commission does not have a policy for deposit custodial credit risk. At year-end, \$132,795 of the Road Commission's bank balance of \$385,795 was exposed to custodial credit risk because it was uninsured under FDIC coverage and was uncollateralized.

The Road Commission has determined that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits. As a result, the Road Commission evaluates each financial institution and assesses the level of risk associated with each financial institution. The Road Commission's policy is to conduct business only with financial institutions that have an acceptable estimated level of risk as a depository.

Investments

The Road Commission participates in an investment pool administered by the County Treasurer. The Treasurer invests surplus funds of the County and its component units in certificates of deposit, governmental obligations, commercial paper and money market funds. Information regarding these investments, including fair value measurement, categorization, risks and other disclosures cannot be separately determined for the Road Commission. Information about the County's investment pool as a whole may be obtained from the Bay County Comprehensive Annual Financial Report for the year ended December 31, 2017.

Receivables

The year-end balance in receivables was comprised of the following:

Michigan Transportation Fund	\$ 1,647,082
State trunkline maintenance	250,610
State trunkline non-maintenance	592
State grants	263,061
Due on road agreements – Townships	258,012
Sundry and other accounts receivable	<u>77,336</u>
Total	<u>\$ 2,496,693</u>

Long-term Debt

Long-term debt activity for the year was as follows:

	<u>Beginning Balance</u>	<u>Net Increase</u>	<u>Net (Decrease)</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Accrued compensated absences	<u>\$ 881,105</u>	<u>\$ 59,206</u>	<u>\$ -</u>	<u>\$ 940,311</u>	<u>\$ 325,000</u>

Bay County Road Commission

Notes to Financial Statements

Accrued Compensated Absences

In accordance with Board policy and labor agreements, employees have a vested right upon termination of employment to receive compensation for accumulated sick leave and vacation under formulas and conditions specified in the policy and agreements. The estimated dollar amounts of these vested rights, which have been accrued on the government-wide financial statements, amounted to approximately \$728,000 for sick leave and \$212,000 for vacation at year-end.

Capital Assets

Capital asset activity for the year was as follows:

	Beginning Balance	Additions	Disposals	Ending Balance
Capital assets not being depreciated				
Land	\$ 392,502	\$ -	\$ -	\$ 392,502
Land improvements	35,179,057	931	-	35,179,988
Right-of-ways	349,661	-	-	349,661
Total capital assets not being depreciated	35,921,220	931	-	35,922,151
Capital assets being depreciated				
Buildings and improvements	2,786,976	67,639	(171,806)	2,682,809
Road equipment	10,828,347	728,028	-	11,556,375
Shop equipment	129,671	-	-	129,671
Office equipment	201,596	-	(20,559)	181,037
Engineer equipment	154,404	-	(16,386)	138,018
Yard and storage equipment	1,396,103	15,438	(15,490)	1,396,051
Infrastructure - roads	78,171,777	4,351,214	(2,584,253)	79,938,738
Infrastructure – bridges	20,722,858	31,697	-	20,754,555
Infrastructure – traffic signals	700,550	-	-	700,550
Total capital assets being depreciated	115,092,282	5,194,016	(2,808,494)	117,477,804
Less accumulated depreciation				
Buildings and improvements	(2,079,254)	(68,282)	171,806	(1,975,730)
Road equipment	(9,917,391)	(419,293)	-	(10,336,684)
Shop equipment	(108,021)	(8,751)	-	(116,772)
Office equipment	(115,182)	(25,292)	20,559	(119,915)
Engineer equipment	(121,619)	(10,105)	16,386	(115,338)
Yard and storage equipment	(1,257,966)	(31,927)	15,490	(1,274,403)
Infrastructure – roads	(38,256,545)	(4,114,769)	2,584,253	(39,787,061)
Infrastructure – bridges	(10,519,590)	(429,157)	-	(10,948,747)
Infrastructure – traffic signals	(455,654)	(31,938)	-	(487,592)
Total accumulated depreciation	(62,831,222)	(5,139,514)	2,808,494	(65,162,242)
Net capital assets being depreciated	52,261,060	54,502	-	52,315,562
Total net capital assets	\$ 88,182,280	\$ 55,433	\$ -	\$ 88,237,713

Bay County Road Commission

Notes to Financial Statements

NOTE D – Defined Benefit Pension Plan (BCERS)

Plan Description

The Road Commission participates in the Bay County Employees' Retirement System (BCERS); an agent multiple-employer defined benefit contributory pension plan (the "Plan") that covers all eligible employees. BCERS was adopted by Bay County (the "County") pursuant to Michigan Compiled Laws, Section 46.12a. The Road Commission shares its experience risks and benefits with the County and as such, it is reported as a cost-sharing, multiple-employer plan. Benefit provisions are established and may be amended by the Board of Trustees of BCERS as permitted by County Ordinances. BCERS issues a publicly available financial report that includes financial statements and required supplementary information and may be obtained by writing Bay County at 515 Center Avenue, Third Floor, Bay City, Michigan, 48708.

For the purpose of measuring the net pension asset, deferred outflows of resources related to the Plan and pension expense have been determined on the same basis as they are reported by the Plan. The Plan uses the economic resources measurement focus and the full accrual basis of accounting. Investments are stated at fair value or estimated fair value. Short-term investments are reported at cost, which approximates fair value. Employee contributions are recognized in the period in which the contributions are due. Road Commission contributions to the Plan are recognized when due pursuant to legal requirements. Benefit payments and refunds are recognized as expense when due and payable in accordance with the terms of the Plan.

Benefits Provided

Retirement benefits are calculated as 2.50% of the employee's highest five-year salary for all employee groups hired before January 1, 2011 and 2.25% for all employee groups hired after January 1, 2011, except supervisory and administration. Supervisory and administration employees use a 2.50% multiplier if hired before March 31, 2011 and a 2.25% multiplier if hired after March 31, 2011 and the employee's highest five-year salary to calculate the retirement benefit. The maximum benefit is 75% of final average earnings. Normal retirement age is 60 with 8 years of service for employees hired before January 1, 2007, 60 with 10 years of service for employees hired after January 1, 2007, or any age with 30 years of service. Employees are eligible for non-duty disability benefits after 10 years of service and for duty-related disability benefits upon hire. An employee who leaves service may withdraw his or her contributions, plus accumulated interest.

Benefit terms, within the parameters established by BCERS are established and amended by authority of Board of Commissioners of the Road Commission and ratification by the collective bargaining units.

Employees Covered by the Benefit Terms

At the December 31, 2016 measurement date, the following participants were covered by the benefit terms:

Inactive plan members or beneficiaries currently receiving benefits	99
Inactive plan members entitled to but not yet receiving benefits	1
Active employees	<u>56</u>
Total participants	<u>156</u>

Contribution Requirements

Article 9, Section 24 of the State of Michigan constitution requires that financial benefits arising on account of employee service rendered in each year be funded during that year. Accordingly, BCERS retains an independent actuary to determine the annual contribution. The employer is required to contribute amounts at least equal to the actuarially determined rate. The actuarially determined rate is the

Bay County Road Commission

Notes to Financial Statements

estimated amount necessary to finance the costs of benefits earned by plan members during the year, with an additional amount to finance any unfunded accrued liability. Participants of the Plan contribute between 4.0% to 5.0% of annual covered payroll. The Road Commission contributes the actuarially determined amount, which was 19.19% of annual covered payroll for the year ended.

Actuarial Assumptions

The total pension liability in the December 31, 2016 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Actuarial cost method	Entry-age normal
Amortization method	Level percentage of payroll; open
Remaining amortization period	10 years
Asset valuation method	5-year smoothed market
Wage inflation	3.50%
Price inflation	3.00%
Salary increases	4.25% to 9.50%, including inflation
Investment rate of return	7.50%, net of investment expense and including inflation

Mortality rates were based on the RP-2000 Mortality Combined Healthy Tables, projected 20 years with U.S. Population Scale BB (multiplied by 75% for pre-retirement mortality and 110% for post-retirement mortality for both males and females). The actuarial assumptions used in the December 31, 2016 valuation were based on the results of the most recent actuarial experience study that covers the period from January 1, 2007 through December 31, 2011.

A single discount rate of 7.50% was used to measure the total pension liability. This single discount rate was based on the expected rate of return on pension plan investments of 7.50%. The projection of cash flows used to determine this single discount rate assumed that plan member contributions will be made at the current contribution rate and that employer contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate. Based on these assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

The long-term expected rate of return on the Plan's investments was determined using a building-block method, in which best-estimate ranges of expected future real rates of return (expected returns, net of investment expenses and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the Plan's target asset allocation as disclosed above are summarized as follows:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-term Expected Real Rate of Return</u>
Domestic equity	50.00%	5.02%
International equity	20.00	8.50
U.S. fixed income	23.00	2.50
Real estate	7.00	4.50
	<u>100.00%</u>	

Bay County Road Commission

Notes to Financial Statements

Net Pension Liability

The net pension liability reported at year-end was determined using a measure of the total pension liability and the pension net position as of December 31, 2016. The December 31, 2016 total pension liability was determined by an actuarial valuation performed as of that date.

Changes in the Road Commission's proportionate share of the net pension liability during the year were as follows:

	Increase (Decrease)		
Changes in Net Pension Liability	Total Pension Liability	Plan Net Position	Net Pension Liability (Asset)
Beginning balance	\$ 31,834,223	\$ 33,559,723	\$ (1,725,500)
Service cost	553,423	-	553,423
Interest	2,335,000	-	2,335,000
Changes of benefit terms	41,177	-	41,177
Expected and actual experience	(471,179)	-	(471,179)
Changes in assumptions	1,097,683	-	1,097,683
Employer contributions	-	268,666	(268,666)
Employee contributions	-	241,448	(241,448)
Net investment income	-	2,610,679	(2,610,679)
Benefit payments	(1,955,208)	(1,955,208)	-
Administrative expenses	-	(39,430)	39,430
Other changes	-	1,189,994	(1,189,994)
Net changes	1,600,896	2,316,149	(715,253)
Ending balance	\$ 33,435,119	\$ 35,875,872	\$ (2,440,753)

Sensitivity of the Net Pension Liability to Changes in the Discount Rate - The following presents the Road Commission's net pension liability (asset), calculated using the discount rate of 7.25%, as well as what the net pension liability (asset) would be if it were calculated using a discount rate that is 1% lower (6.25%) or 1% higher (8.25%) than the current rate:

	1% Decrease in Rate to 6.25%	Assumed Discount Rate 7.25%	1% Increase in Rate to 8.25%
Net pension liability (asset)	\$ 1,429,216	\$ (2,440,753)	\$ (5,698,095)

Pension Plan Fiduciary Net Position - Detailed information about the Plan's fiduciary net position is available in the separately issued financial report. For the purpose of measuring the net pension liability, deferred outflows of resources and deferred inflows or resources related to pension and pension expense, information about the Plan's fiduciary net position and addition to / deduction from fiduciary net position have been determined on the same basis as they are reported by the Plan. The Plan uses the economic resources measurement focus and the full accrual basis of accounting. Investments are stated at fair value. Contribution revenue is recorded as contributions are due pursuant to legal requirements. Benefit payments and refunds of employee contributions are recognized as expense when due and payable in accordance with the benefit terms.

Bay County Road Commission

Notes to Financial Statements

Pension Expense and Deferred Outflows and Inflows of Resources Related to Pensions

During the year the Road Commission recognized pension expense of \$316,443. At year-end, the Road Commission reported deferred outflows and deferred inflows of resources related to pensions from the following sources:

Description	Deferred Outflows of Resources	Deferred Inflows of Resources
Employer contributions to the plan subsequent to the measurement date	\$ 587,549	\$ -
Net difference between projected and actual earnings on pension plan investments	1,229,142	-
Changes in assumptions	890,850	-
Changes in proportionate share	2,362,671	21,814
Differences between expected and actual experience	121,878	382,397
Total	\$ 5,192,090	\$ 404,211

The amount reported as deferred outflows and deferred inflows of resources related to the net difference between projected and actual earnings on pension plan investments, changes in assumptions and differences between expected and actual experience will be recognized as pension expense as follows:

Year Ending December 31,	Net Amount
2018	\$ 1,272,471
2019	1,272,471
2020	1,267,407
2021	353,115
2022	34,866
Total	\$ 4,200,330

The amount reported as deferred outflows of resources related to employer contributions to the plan made subsequent to the measurement date of \$587,549 will impact the net pension liability in 2018, as opposed to being amortized to pension expense over a period of years.

NOTE E – Postemployment Benefits Other than Pensions (OPEB)

Plan Description

The Road Commission participates in the Bay County Retiree Health Care Plan (the “Plan”). The Plan is a single employer defined benefit public retiree healthcare plan. The Plan provides postemployment benefits consisting of health, dental, vision, life, and prescription drug coverage, to eligible employees and spouses who retire from the Road Commission on or after attaining retirement age with at least ten years of service, age 60 with 10 years of service (after 2007 for new hires), or with 30 years of service regardless of age. Effective January 1, 2016, employees hired after this date are not eligible for health insurance benefits at retirement.

The benefits are provided under the collective bargaining agreement for union employees and by resolution of the Board of County Road Commissioners for nonunion employees. At year-end there were 88 retirees eligible for benefits under the plan. The Road Commission has no obligation to make

Bay County Road Commission

Notes to Financial Statements

contributions in advance of when the insurance premiums or claims are due for payment (in other words, this may be financed on a “pay-as-you-go” basis).

The County issues a publicly available Annual Financial Report that includes financial statements for the Plan. That report may be obtained from Bay County by writing to the Bay County Employees’ Retirement System, Bay County Building, 515 Center Avenue – Third Floor, Bay City, MI 48708-6128.

Funding Policy

The contribution requirements of plan members and the Road Commission are established by labor contracts and may be amended by the Board of County Road Commissioners through labor negotiations. The Plan does not require member contributions from Road Commission employees. The required contribution is based on projected pay-as-you-go financing requirements, with optional additional amounts to prefund benefits as determined by the Board of County Road Commissioners.

Expenditures for postemployment healthcare benefits are recognized as the insurance premiums become due. During the year, the Road Commission paid current retiree premiums of \$1,124,546. The premiums for postemployment healthcare benefits were paid and recorded as expenditures in the General Operating / Road Fund.

Annual OPEB Cost and Net OPEB Obligation

The Road Commission’s annual other postemployment benefit (OPEB) cost (expense) is calculated based the *annual required contribution of the employer (ARC)*, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents the level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period of 16 (sixteen) years.

The following table shows the components of the Road Commission’s annual OPEB cost for the year, the amount actually contributed to the plan and changes in the Road Commission’s OPEB obligation to the Retiree Health Plan:

Annual required contribution (recommended)	\$	2,821,742
Interest on the prior year’s net OPEB obligation		435,576
Less adjustment to the annual required contributions		<u>(656,838)</u>
Annual OPEB cost		2,600,480
Amounts contributed:		
Payments of current premiums		(1,124,546)
Advance funding		<u>-</u>
Increase (decrease) in net OPEB obligation		1,475,934
OPEB obligation – beginning of year		<u>8,711,512</u>
OPEB obligation – end of year	\$	<u><u>10,187,446</u></u>

Three-Year Trend Information

Fiscal Year Ended	Annual OPEB Cost (AOC)	Percentage of AOC Contributed	Net OPEB Obligation
12/31/2015	\$ 1,989,401	94.52%	\$ 8,412,380
12/31/2016	2,370,730	87.38%	8,711,512
12/31/2017	2,600,480	43.24%	10,187,446

Bay County Road Commission

Notes to Financial Statements

The funded status of the plan as of December 31, 2015 (the most recent valuation date) was as follows:

Actuarial value of assets	\$	904,055
Actuarial accrued liability (AAL)	\$	30,689,652
Unfunded actuarial accrued liability (UAAL)	\$	29,785,597
Funded ratio		2.90%
Annual covered payroll	\$	3,048,019
Ratio of UAAL to covered payroll		977.21%

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 expectation and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, 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.

Actuarial Methods and Assumptions

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.

The required contribution rate was determined as part of the December 31, 2015 actuarial valuation using the individual entry age actuarial cost method. The actuarial assumptions included (a) 5.00% net investment rate of return for active employees, (b) projected salary increases of 3.50% plus merit and longevity increases ranging from 0.75% to 6.00% per year, and (c) projected health care premium increases of 3.50% to 9.00% per year. The actuarial value was determined using techniques that smooth the effect of short-term volatility in the market of investments over a five-year period. The Plan unfunded actuarial accrued liability is being amortized by level percent of active member payroll contributions on a closed period over 16 years.

Net Equipment Expenditures Balance

The Road Commission, in compliance with the Uniform Accounting Procedures Manual for Michigan County Road Commissions charges rental on Road Commission equipment used for various construction and maintenance projects performed by the Road Commission. The cost for this rental, which is based on a rental rate per hour established by the Michigan Department of Transportation multiplied by rental hours, is reported as an expenditure in the various maintenance activities. An expenditure credit is reported as an offset against the equipment expenditure activities. Accordingly, the equipment rental does not affect total expenditures or the available operating equity of the Road Commission's General Operating Fund. The net balance in equipment expenditures for the year is comprised of the following:

Equipment –		
Direct	\$	1,074,058
Indirect		790,172
Operating		330,264
Less equipment rental credits		<u>(2,233,399)</u>
Total, net	\$	<u>(38,905)</u>

Bay County Road Commission

Notes to Financial Statements

Capital Outlay Expenditure Balance

On the governmental financial statements, the Road Commission reports a depreciation credit to offset capital outlay as a result of charging depreciation to various expenditure accounts. The net book value of capital asset retirements is also reported as a credit against capital outlay. The balance in capital outlay expenditures for the year is comprised of the following:

Capital outlay	\$	811,105
Less equipment retirements		-
Less depreciation / depletion		<u>(563,650)</u>
Total, net	\$	<u>247,455</u>

Risk Management

The Road Commission is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (worker's compensation), as well as medical benefits provided to employees. The Road Commission has purchased commercial insurance for healthcare claims. The Road Commission is a member of the Michigan County Road Commission Self-Insurance Pool (Pool). The Michigan County Road Commission Self-insurance Pool program operates as a common risk-sharing management program for local units of government in Michigan; member premiums are used to purchase excess commercial insurance coverage and to pay member claims in excess of deductible amounts. The pool provides loss coverage includes, but is not limited to, general liability, auto, property insurance, stop loss protection, errors and omissions, trunkline liability and an umbrella policy. The amount the Road Commission pays annually is determined by the Administrator of the Pool and is based on miles of roads, population and prior claim history of the Road Commission. The Road Commission's exposure is limited to \$1,000 per claim; all other risk is transferred to the Pool. Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three (3) fiscal years.

The Road Commission is a member of the County Road Association Self-Insurance Fund for workers' compensation claims. As a member of the fund, the Road Commission is fully insured for workers' compensation claims incurred.

The Road Commission is self-insured for health care benefits with the administrative services of the program being performed by a health insurance company. The Road Commission makes monthly payments based on estimated claims and a stop-loss provision, which are adjusted quarterly. The Road Commission pays claims up to \$75,000 per contract year. Based on claims incurred, the Road Commission has estimated the accrued health care claims, including an estimate for claims incurred but not reported (IBNR) of \$72,748 and \$78,318 at December 31, 2017 and 2016, respectively.

Changes in the balance of the self-funded health claims provision for the years ended December 31 are as follows:

	<u>2017</u>	<u>2016</u>
Unpaid claims, beginning of year	\$ 78,318	\$ -
Incurred claims (including IBNR)	1,879,302	2,290,204
Claims paid	<u>(1,884,872)</u>	<u>(2,211,886)</u>
Unpaid (prepaid) claims, end of year	72,748	78,318
Less: current portion	<u>(72,748)</u>	<u>(78,318)</u>
Long-term portion	\$ -	\$ -

Bay County Road Commission

Notes to Financial Statements

Contingencies

At times, the Road Commission is named as a defendant in various litigation involving lawsuits pending and notices of intent to file suit. Management and legal counsel of the Road Commission expect no material losses in excess of insurances should an unfavorable outcome prevail. No provision for any loss has been made in the accompanying financial statements.

Under the terms of various Federal and State grants periodic audits are required, and certain costs may be questioned as not being appropriate expenditures under the terms of the grants. Such grants could lead to reimbursement to the grantor agencies. However, Road Commission management does not believe such disallowances, if any, will be material to the financial position of the Road Commission.

Excess of Expenditures over Appropriations

During the year, the General Operating / Road Fund had expenditures at the activity level (legal level of budgetary control) that were in excess of the amounts appropriated, as follows:

	<u>Total</u> <u>Appropriations</u>	<u>Amount of</u> <u>Expenditures</u>	<u>Budget</u> <u>Variance</u>
Public works	\$ 14,318,603	\$ 14,434,813	\$ 116,210

Revenues and existing equity were sufficient to fund all expenditures.

Federal Award Expenditures / Single Audit

The Michigan Department of Transportation (MDOT) requires that Road Commissions report all Federal and State grants pertaining to their County. During the year, the Federal aid received and expended by the Road Commission was \$562,055 for contracted projects and \$66,548 for negotiated projects. Contracted projects are defined as projects performed by private contractors paid for and administrated by MDOT (they are included in MDOT's single audit). Negotiated projects are projects where the Road Commission administers the grant and either performs the work or contracts it out. Because the Road Commission expended less than \$750,000 in negotiated projects, no single audit was required.



REQUIRED SUPPLEMENTARY INFORMATION

Bay County Road Commission

General Operating / Road Func

Schedule of Revenues, Expenditures and Change in Fund Balance - Budget and Actual

For the Year Ended December 31, 2017

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Over (Under) Budget</u>
Licenses and permits	\$ 61,000	\$ 65,262	\$ 67,434	\$ 2,172
Federal sources				
Surface transportation program (STP)	2,008,093	610,231	628,603	18,372
State sources				
Michigan transportation funds				
Engineering	10,000	10,000	10,000	-
Urban road	1,418,114	1,526,069	1,507,235	(18,834)
Allocation	8,679,103	9,206,112	9,083,332	(122,780)
Other				
Other	1,022,067	376,596	415,476	38,880
Contributions from local units				
City and Village	2,075,000	1,570,361	1,295,089	(275,272)
Townships	-	-	122,386	122,386
Charges for services				
State trunkline maintenance	1,661,138	1,502,664	1,536,382	33,718
State trunkline non-maintenance	2,075	411,044	411,136	92
Salvage sales	1,888	2,495	3,137	642
Interest and rentals	59,638	73,301	67,369	(5,932)
Other				
Sundry refunds	16,850	11,153	557	(10,596)
Proceeds from sale of capital assets	20,000	1,000	1,000	-
Other	-	22,078	137,593	115,515
Total revenue	<u>\$ 17,034,966</u>	<u>\$ 15,388,366</u>	<u>\$ 15,286,729</u>	<u>\$ (101,637)</u>

Bay County Road Commission

General Operating / Road Fund

Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual (continued)

For the Year Ended December 31, 2017

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Over (Under) Budget</u>
Primary Road				
Construction / capacity improvements	\$ -	\$ -	\$ 931	\$ 931
Preservation / structural improvements	7,092,081	3,201,573	3,285,676	84,103
Maintenance	2,808,300	3,750,268	3,705,926	(44,342)
Local Road				
Preservation / structural improvements	942,042	1,123,126	1,097,235	(25,891)
Maintenance	2,675,523	2,587,243	2,528,047	(59,196)
Total preservation and maintenance	13,517,946	10,662,210	10,617,815	(44,395)
State trunkline maintenance	1,661,138	1,502,664	1,534,103	31,439
State trunkline non-maintenance	2,075	411,044	411,115	71
Administrative (net)	1,219,832	1,146,766	1,060,425	(86,341)
Equipment (net)	(231,298)	65,677	(38,905)	(104,582)
Capital outlay (net)	467,325	162,785	247,455	84,670
Other	297,000	367,457	602,805	235,348
Total expenditures	<u>16,934,018</u>	<u>14,318,603</u>	<u>14,434,813</u>	<u>116,210</u>
Net change in fund balance	100,948	1,069,763	851,916	(217,847)
Fund balance, beginning of year	<u>5,296,767</u>	<u>5,524,730</u>	<u>5,524,730</u>	<u>-</u>
Fund balance, end of year	<u><u>\$ 5,397,715</u></u>	<u><u>\$ 6,594,493</u></u>	<u><u>\$ 6,376,646</u></u>	<u><u>\$ (217,847)</u></u>

Bay County Road Commission
Required Supplementary Information
Schedule of Funding Progress

Postemployment Healthcare (OPEB)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Simplified Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
12/31/2011	\$ 638,763	\$ 27,399,478	\$ 26,760,715	2.33%	\$ 2,902,123	922%
12/31/2013	839,502	26,711,098	25,871,596	3.14%	2,878,870	899%
12/31/2015	904,055	30,689,652	29,785,597	2.95%	3,048,019	977%

Bay County Road Commission
Required Supplementary Information
Schedule of Changes in Net Pension Liability and Related Ratios
Last 10 Fiscal Years Ended December 31,

	2017	2016	2015	2008* to 2014*
Total pension liability				
Service cost	\$ 553,423	\$ 544,163	\$ 1,016,721	---
Interest on total pension liability	2,335,000	2,249,952	4,094,622	---
Changes of benefit terms	41,177	-	-	---
Differences between expected and actual experience	(471,179)	-	528,402	---
Changes in assumptions	1,097,683	-	-	---
Benefit payments	(1,955,208)	(1,847,223)	(3,336,651)	---
Other changes	-	13,618	-	---
Net change in total pension liability	<u>1,600,896</u>	<u>960,510</u>	<u>2,303,094</u>	---
Total pension liability - beginning	31,834,223	30,650,896	55,754,922	---
Total pension liability - ending	<u><u>\$ 33,435,119</u></u>	<u><u>\$ 31,611,406</u></u>	<u><u>\$ 58,058,016</u></u>	---
Plan fiduciary net position				
Contributions - employer	\$ 268,666	\$ 294,881	\$ 663,990	---
Contributions - member	241,448	216,673	430,756	---
Net investment income (loss), net	2,610,679	253,542	4,912,826	---
Benefit payments, including refunds of member contributions	(1,955,208)	(1,847,223)	(3,336,651)	---
Administrative expenses	(39,430)	(20,213)	(49,872)	---
Other	1,189,994	-	-	---
Net change in fiduciary net position	<u>2,316,149</u>	<u>(1,102,340)</u>	<u>2,621,049</u>	---
Fiduciary net position - beginning	33,559,723	34,439,246	62,612,748	---
Fiduciary net position - ending	<u><u>\$ 35,875,872</u></u>	<u><u>\$ 33,336,906</u></u>	<u><u>\$ 65,233,797</u></u>	---
Net pension liability (asset) - ending	<u><u>\$ (2,440,753)</u></u>	<u><u>\$ (1,725,500)</u></u>	<u><u>\$ (7,175,781)</u></u>	---
Fiduciary net position as a percentage of the total pension liability	107.30%	105.46%	112.36%	---
Covered-employee payroll	\$ 5,193,678	\$ 5,101,865	\$ 9,357,020	---
Net pension liability (asset) as percentage of covered-employee payroll	-46.99%	-33.82%	-76.69%	---

* GASB Statement No. 68 was implemented as of December 31, 2015. Information from 2008 through 2014 is not available. Additional years will be presented on this schedule on a prospective basis.

See Notes to Required Supplementary Information

Bay County Road Commission
Required Supplementary Information
Schedule of Employer Contributions
Last 10 Fiscal Years Ended December 31,

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2008* to 2014*</u>
Actuarially determined contribution	\$ 587,549	\$ 549,002	\$ 562,787	---
Contributions in relation to the actuarially determined contribution	<u>587,549</u>	<u>549,002</u>	<u>562,787</u>	---
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	---
Covered-employee payroll	\$ 3,061,746	\$ 3,018,201	\$ 3,048,019	---
Contributions as percentage of covered- employee payroll	19.19%	18.19%	18.46%	---

* GASB Statement No. 68 was implemented as of December 31, 2015. Information from 2008 through 2014 is not available. Additional years will be presented on this schedule on a prospective basis.

Bay County Road Commission
Notes to Required Supplementary Information

Budgetary Data

The Road Commission’s procedures for establishing budgetary data are as follows:

- * The Road Commission Finance Director prepares a proposed operating budget for the fiscal year commencing January 1st. The proposed operating budget includes identification of expenditures and resources to finance them.
- * Prior to December 31st, the proposed budget is presented to the Board of County Road Commissioners. The budget is reviewed and may be amended by the Board and a public hearing is held regarding the proposed budget. The budget is then legally enacted through passage of a resolution adopted by the Board of County Road Commissioners and is placed in the Board minutes.
- * The Road Commission’s approved budget was adopted at the activity level. This is the legally enacted level under the State of Michigan Uniform Budgeting and Accounting Act, since the Board of County Road Commissioners must approve amendments to the budget at the activity level.
- * The budget for the General Operating / Road Fund is adopted on a basis consistent with U.S. GAAP. Budget amounts reported in the financial statements consist of those amounts contained in the formal budget approved and amended by the Board.
- * The Road Commission adopts a budget for the General Operating / Road Fund by means of an appropriations act, on a departmental activity basis in summary form. Periodic internal reporting is on a detail basis in accordance with the State-prescribed uniform chart of accounts consistent with the way the books are maintained. The budget is prepared on the modified accrued basis of accounting.
- * Michigan Public Act 621 of 1978, Section 18(1), as amended, provides that a governmental unit shall not incur expenditures in excess of the amount appropriated at the legally adopted level. Variances at the legal level of control are as disclosed on the Schedule of Revenues, Expenditures and Changes in Fund Balance – Budget and Actual.

Defined Benefit Pension Plan

Valuation date	December 31, 2016
Notes	Actuarially determined contribution rates are calculated as of the December 31 that is 12 months prior to the beginning of the fiscal year in which contributions are reported.
Methods and assumptions used to determine contribution rates:	
Actuarial cost method	Entry-age normal
Amortization method	Level percentage of payroll, open
Remaining amortization period	27 years
Asset valuation method	5-year smoothed market
Wage inflation	3.50%
Price inflation	3.00%
Salary increases	4.25% to 9.50%, including inflation
Investment rate of return	7.50% (net of administrative and investment expenses)
Retirement age	Age-based table of rates that are specific to the type of eligibility condition
Mortality	RP-2000 Mortality Combined Healthy Tables, projected 20 years with U.S. Population Scale BB (multiplied by 75% for pre-retirement mortality and 110% for post-retirement mortality for both males and females.

Beginning balance amounts presented on the Schedule of Changes in Net Pension Liability and Related Ratios do not roll-forward each year because they represent the Road Commission's *proportionate share* of all components of the balances. The proportionate share is based upon the present value of future benefits for each employer in the Plan, which fluctuates annually based upon the results of each actuarial valuation.

OTHER SUPPLEMENTARY INFORMATION

Bay County Road Commission

General Operating / Road Fund

Schedule of Revenues by Component

For the Year Ended December 31, 2017

	<u>Primary Road Funds</u>	<u>Local Road Funds</u>	<u>County Road Commission Funds</u>	<u>Total</u>
Revenues				
Licenses and permits	\$ 45,218	\$ 10,640	\$ 11,576	\$ 67,434
Federal sources				
Surface transportation program (STP)	628,603	-	-	628,603
State sources				
Michigan transportation funds				
Engineering	7,156	2,844	-	10,000
Urban road	1,223,200	284,035	-	1,507,235
Allocation	6,500,067	2,583,265	-	9,083,332
Other				
Other	415,476	-	-	415,476
Contributions from local units				
City and Village	-	1,295,089	-	1,295,089
Township	-	122,386	-	122,386
Charges for services				
State trunkline maintenance	-	-	1,536,382	1,536,382
State trunkline non-maintenance	-	-	411,136	411,136
Salvage sales	-	-	3,137	3,137
Interest and rentals	31,412	-	35,957	67,369
Other				
Sundry refunds	-	-	557	557
Proceeds from sale of capital assets	-	-	1,000	1,000
Other	-	10,785	126,808	137,593
Total revenues	<u>\$ 8,851,132</u>	<u>\$ 4,309,044</u>	<u>\$ 2,126,553</u>	<u>\$ 15,286,729</u>

Bay County Road Commission
General Operating / Road Fund
Schedule of Expenditures by Component
For the Year Ended December 31, 2017

	Primary Road Funds	Local Road Funds	County Road Commission Funds	Total
Expenditures				
Construction / Capacity Improvements	\$ 931	\$ -	\$ -	\$ 931
Preservation / Structural Improvements				
Roads	3,272,673	1,078,541	-	4,351,214
Structures	13,003	18,694	-	31,697
Maintenance				
Roads	2,676,967	2,129,222	-	4,806,189
Winter maintenance	556,384	246,334	-	802,718
Traffic control	472,575	152,491	-	625,066
Total construction and maintenance	6,992,533	3,625,282	-	10,617,815
State trunkline maintenance	-	-	1,534,103	1,534,103
State trunkline non-maintenance	-	-	411,115	411,115
Administrative expense (net)	698,360	362,065	-	1,060,425
Equipment expense (net)	(15,971)	(14,161)	(8,773)	(38,905)
Capital outlay (net)	-	-	247,455	247,455
Other	221,760	-	381,045	602,805
Total expenditures	\$ 7,896,682	\$ 3,973,186	\$ 2,564,945	\$ 14,434,813

Bay County Road Commission
General Operating / Road Fund
Schedule of Changes in Fund Balance by Component
For the Year Ended December 31, 2017

	Primary Road Funds	Local Road Funds	County Road Commission Funds	Total
Total revenues	\$ 8,851,132	\$ 4,309,044	\$ 2,126,553	\$ 15,286,729
Total expenditures	7,896,682	3,973,186	2,564,945	14,434,813
Revenues over (under) expenditures	954,450	335,858	(438,392)	851,916
Fund balance, beginning of year	2,576,006	-	2,948,724	5,524,730
Fund balance, end of year	<u>\$ 3,530,456</u>	<u>\$ 335,858</u>	<u>\$ 2,510,332</u>	<u>\$ 6,376,646</u>

INTERNAL CONTROL AND COMPLIANCE



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A VETERAN OWNED BUSINESS

**Independent Auditor's 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***

To the Board of County Road Commissioners
County of Bay, Michigan
Kawkawlin, Michigan

We have audited, in accordance with the 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, the financial statements of the governmental activities and the major fund of the **Bay County Road Commission**, a component unit of Bay County, as of and for the year ended December 31, 2017, and the related notes to the financial statements, which collectively comprise the **Bay County Road Commission's** basic financial statements and have issued our report thereon dated May 9, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered **Bay County Road Commission's** internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 **Bay County Road Commission's** internal control. Accordingly, we do not express an opinion on the effectiveness of the **Bay County Road Commission's** internal control.

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 statements will not be prevented or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a certain deficiency in internal control, as described as finding 2017-1 in the accompanying Schedule of Findings and Responses that we consider to be a material weakness.

Compliance and Other Matters

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

Road Commission's Responses to Findings

The *Bay County Road Commission's* written response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The Road Commission's response was not subject to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Road Commission's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Road Commission's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Smith + Klaehowitz PC

Saginaw, Michigan

May 9, 2018

Bay County Road Commission

Schedule of Findings and Responses

For the Year Ended December 31, 2017

Finding 2017-1 – Preparation of Financial Statements in Accordance with U.S. GAAP (*repeated*)

Criteria: The Road Commission is required to prepare financial statements in accordance with accounting principles generally accepted in the United States (U.S. GAAP). This is a responsibility of the Road Commission's management. The preparation of financial statements in accordance with U.S. GAAP requires internal controls over both (1) recording, processing, and summarizing accounting data (i.e., maintaining internal books and records), and (2) reporting government-wide and fund financial statements, including the related footnotes (i.e., external financial reporting).

Condition: As is the case with many smaller and medium-sized entities, the Road Commission has historically relied on its independent external auditors to assist in the preparation of the government-wide financial statements and footnotes as part of its external financial reporting process. Accordingly, the Road Commission's ability to prepare financial statements in accordance with U.S. GAAP is based, in part, on its reliance on its *external* auditors, who cannot by definition be considered a part of the government's *internal* controls.

Cause: This condition was caused by the Road Commission's decision that it is more cost effective to outsource the preparation of its annual financial statements to the auditors than to incur the time and expense of obtaining the necessary training and expertise required for the government to perform this task internally.

Effect: As a result of this condition, the Road Commission lacks internal controls over the preparation of financial statements in accordance with U.S. GAAP, and instead relies, in part, on its external auditors for assistance with this task.

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