

City of Gaylord,
Michigan



Year Ended
June 30,
2012

Financial
Statements and
Single Audit Act
Compliance

CITY OF GAYLORD

Table of Contents

	<u>Page</u>
Independent Auditors' Report	1-2
Management's Discussion and Analysis	4-11
Basic Financial Statements:	
Government-wide Financial Statements:	
Statement of Net Assets	13
Statement of Activities	14-15
Fund Financial Statements:	
Balance Sheet - Governmental Funds	16
Reconciliation of Fund Balances for Governmental Funds to Net Assets of Governmental Activities	17
Statement of Revenue, Expenditures and Changes in Fund Balances - Governmental Funds	18
Reconciliation of Net Changes in Fund Balances of Governmental Funds to Change in Net Assets of Governmental Activities	19
Statement of Revenue, Expenditures and Changes in Fund Balances - Budget and Actual:	
General Fund	20
Municipal Street Special Revenue Fund	21
Statement of Net Assets - Proprietary Funds	22
Statement of Revenue, Expenses and Changes in Fund Net Assets - Proprietary Funds	23
Statement of Cash Flows - Proprietary Funds	24-25
Statement of Fiduciary Assets and Liabilities - Current Tax Collection Agency Fund	26
Notes to Financial Statements	28-47
Required Supplementary Information:	
Schedule of Funding Progress - MERS Defined Benefit Pension Plan	49
Schedule of Employer Contributions - MERS Defined Benefit Pension Plan	49
Schedule of Funding Progress - Other Postemployment Benefits Plan	50
Schedule of Employer Contributions - Other Postemployment Benefits Plan	50
Combining and Individual Fund Financial Statements and Schedules	
Detailed Schedule of Revenue, Expenditures and Changes in Fund Balances - Budget and Actual - General Fund	52-54
Nonmajor Governmental Funds:	
Combining Balance Sheet - Nonmajor Governmental Funds	55-56
Combining Statement of Revenue, Expenditures and Changes in Fund Balances - Nonmajor Governmental Funds	57-58

CITY OF GAYLORD

Table of Contents

	<u>Page</u>
Component Unit:	
Downtown Development Authority	
Combining Balance Sheet	59
Reconciliation of Fund Balances of Governmental Funds to Net Assets of Governmental Activities	60
Combining Statement of Revenue, Expenditures and Changes in Fund Balances Reconciliation of Net Changes in Fund Balances of Governmental Funds to Change in Net Assets of Governmental Activities	61
	62
Single Audit Act Compliance	
Independent Auditors' Report on the Schedule of Expenditures of Federal Awards	64
Schedule of Expenditures of Federal Awards	65
Notes to Schedule of Expenditures of Federal Awards	66
Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	67-68
Independent Auditors' Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133	69-70
Schedule of Findings and Questioned Costs	71-75
Summary Schedule of Prior Audit Findings	76

INDEPENDENT AUDITORS' REPORT

December 7, 2012

City Council
City of Gaylord
Gaylord, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the *City of Gaylord, Michigan* (the "City"), as of and for the year ended June 30, 2012, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City, as of June 30, 2012, and the respective changes in financial position and, where applicable, cash flows thereof and the budgetary comparison for the General Fund and Municipal Streets special revenue fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 7, 2012, on our consideration of the City's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4-11 and the Schedules of Funding Progress and Employer Contributions for the pension and other postemployment benefit plans on pages 49-50 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 statement, 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 assurance.

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

CITY OF GAYLORD

Management's Discussion and Analysis

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

Financial Highlights

- The assets of the City exceeded its liabilities at the close of the most recent fiscal year by approximately \$26,585,000 (net assets). Of this amount, approximately \$1,583,000 (unrestricted net assets) may be used to meet the City's ongoing obligations to citizens and creditors.
- Major asset acquisition items include the annual Street Improvement Project and a new police car.

Overview of the Financial Statements

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

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

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

The statement of activities presents information showing how the City's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., earned but unused vacation leave and accrued interest expense).

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

The government-wide financial statements include not only the City itself (known as the primary government), but also a legally separate component unit, the Downtown Development Authority, (the "DDA"), for which the City is financially accountable and as such, the DDA is accountable to the City for its activities.

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

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

CITY OF GAYLORD

Management's Discussion and Analysis

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

Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund, Municipal Streets Fund, and Edelweiss Special Assessment Fund, each of which are considered to be major funds. The remaining governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the form of combining statements elsewhere in this report.

The City adopts an annual appropriated budget for its General and special revenue funds. Budgetary comparison statements have been provided herein to demonstrate compliance with the General Fund and Municipal Street Special Revenue Fund. The budget, as adopted, delineates each of the individual funds and specifies a certain amount for each funds budget.

Proprietary Funds. The City maintains two different types of proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses enterprise funds to account for its water and sewer operations. Internal service funds are an accounting device used to accumulate and allocate costs related to the City's equipment internally among the various City functions.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the sewer and water operations which are considered major enterprise funds of the City.

Fiduciary Funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the City. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City's programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

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

Other Information. In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the City's pension and other postemployment benefit plans. This information is presented immediately following the notes to the financial statements. The combining fund financial statements referred to earlier in connection with nonmajor governmental funds can be found as supplementary information, as listed in the table of contents.

CITY OF GAYLORD

Management's Discussion and Analysis

Government-Wide Financial Analysis

Net assets may serve over time as a useful indicator of the City's financial position. In the case of the City, assets exceeded liabilities by approximately \$26,585,000 at the close of fiscal year 2012.

	Net Assets					
	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Current and other assets	\$ 2,144,150	\$ 2,502,261	\$ 1,167,074	\$ 1,312,906	\$ 3,311,224	\$ 3,815,167
Capital assets, net	14,761,038	15,278,173	20,269,566	20,821,389	35,030,604	36,099,562
Total assets	16,905,188	17,780,434	21,436,640	22,134,295	38,341,828	39,914,729
Current and other liabilities	470,500	390,148	250,853	411,892	721,353	802,040
Long-term liabilities	5,210,154	5,595,979	5,825,608	6,305,587	11,035,762	11,901,566
Total liabilities	5,680,654	5,986,127	6,076,461	6,717,479	11,757,115	12,703,606
Net assets:						
Invested in capital assets, net of related debt	9,796,038	9,913,173	14,519,566	14,591,389	24,315,604	24,504,562
Restricted	315,485	490,594	317,184	173,709	632,669	664,303
Unrestricted	1,113,011	1,390,540	523,429	651,718	1,636,440	2,042,258
Total net assets	\$ 11,224,534	\$ 11,794,307	\$ 15,360,179	\$ 15,416,816	\$ 26,584,713	\$ 27,211,123

Approximately 91% of the City's net assets reflect its investment in capital assets (e.g., land, buildings, water and sewer systems, equipment and vehicles); less any related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its 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. Net assets restricted for debt service, perpetual care and capital improvements represent approximately 3% of total net assets. The remaining balance of unrestricted net assets may be used to meet the City's ongoing obligation to citizens and creditors.

The City's net assets decreased approximately \$626,000 during the current fiscal year.

CITY OF GAYLORD

Management's Discussion and Analysis

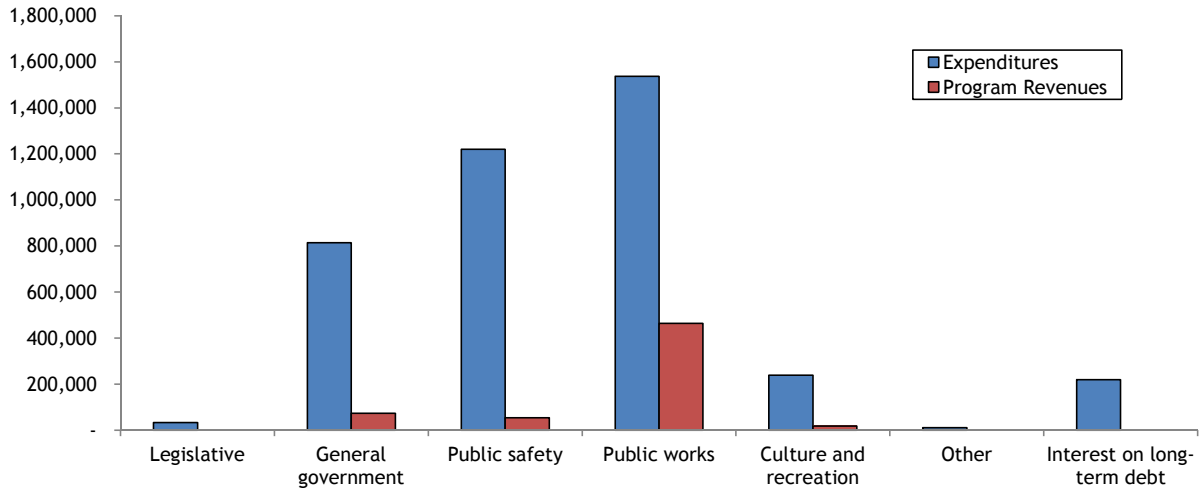
	Change in Net Assets					
	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Program revenues:						
Charges for services	\$ 49,318	\$ 68,226	\$ 1,757,119	\$ 1,840,898	\$ 1,806,437	\$ 1,909,124
Operating grants	545,621	457,949	-	-	545,621	457,949
Capital grants	12,000	-	-	725,967	12,000	725,967
General revenues:						
Property taxes	2,706,724	2,962,979	392,304	430,278	3,099,028	3,393,257
State shared revenues	286,910	271,464	-	-	286,910	271,464
Miscellaneous revenue	-	-	845	-	845	-
Interest earnings	22,087	30,132	-	1,190	22,087	31,322
Total revenues	<u>3,622,660</u>	<u>3,790,750</u>	<u>2,150,268</u>	<u>2,998,333</u>	<u>5,772,928</u>	<u>6,789,083</u>
Expenses:						
Legislative	32,659	43,667	-	-	32,659	43,667
General government	814,484	771,150	-	-	814,484	771,150
Public safety	1,220,405	1,295,323	-	-	1,220,405	1,295,323
Public works	1,537,636	1,707,016	-	-	1,537,636	1,707,016
Culture and recreation	238,137	241,454	-	-	238,137	241,454
Other	9,980	31,158	-	-	9,980	31,158
Water	-	-	596,858	728,808	596,858	728,808
Sewer	-	-	1,730,868	1,747,010	1,730,868	1,747,010
Interest on long-term debt	218,311	233,575	-	-	218,311	233,575
Total expenses	<u>4,071,612</u>	<u>4,323,343</u>	<u>2,327,726</u>	<u>2,475,818</u>	<u>6,399,338</u>	<u>6,799,161</u>
Change in net assets, before transfers	(448,952)	(532,593)	(177,458)	522,515	(626,410)	(10,078)
Transfers	(120,821)	663,291	120,821	(663,291)	-	-
Change in net assets	(569,773)	130,698	(56,637)	(140,776)	(626,410)	(10,078)
Net assets:						
Beginning of year	11,794,307	11,663,609	15,416,816	15,557,592	27,211,123	27,221,201
End of year	<u>\$ 11,224,534</u>	<u>\$ 11,794,307</u>	<u>\$ 15,360,179</u>	<u>\$ 15,416,816</u>	<u>\$ 26,584,713</u>	<u>\$ 27,211,123</u>

CITY OF GAYLORD

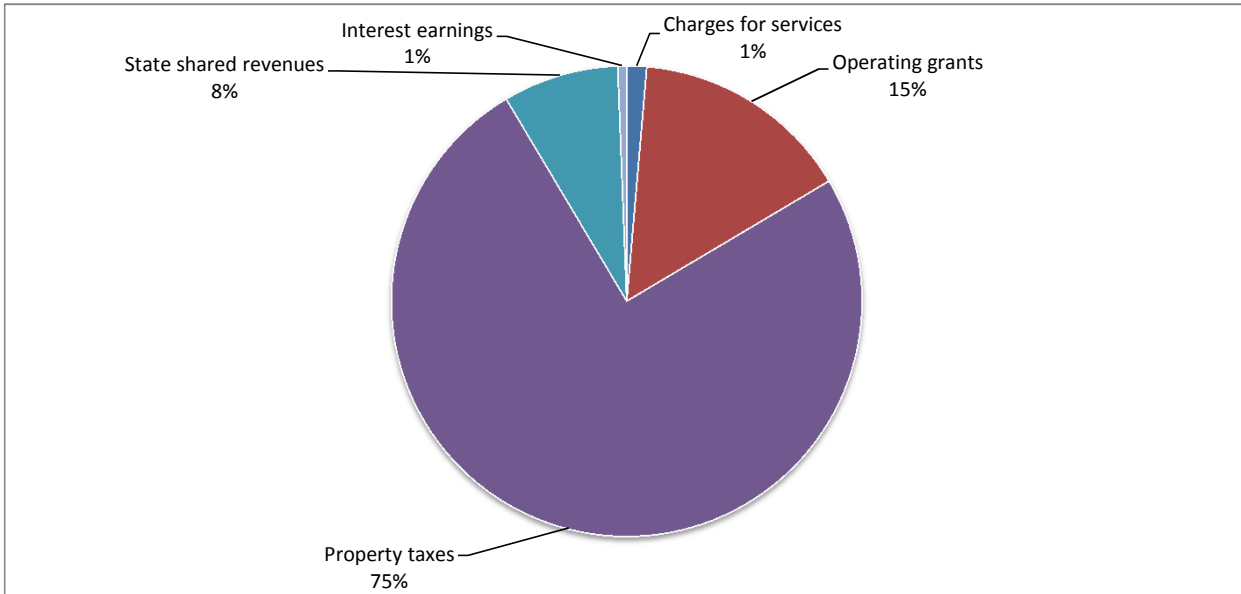
Management's Discussion and Analysis

Governmental Activities. Governmental activities decreased the City's net assets by approximately \$570,000, which was a result of a combination of decrease in property tax revenue, tax tribunal settlements and an increase in transfers. The value of certain property which the City purchased in 2008 and holds as real estate held for sale also decreased during the current year. It should be noted that overall expenses decreased approximately \$252,000 from the previous year. Public works expense decreased approximately \$169,000 which is related to reduced salaries and fringe benefits which is the result of a reduction in staffing and overtime.

Expenditures and Program Revenues - Governmental Activities



Revenues by Source - Governmental Activities

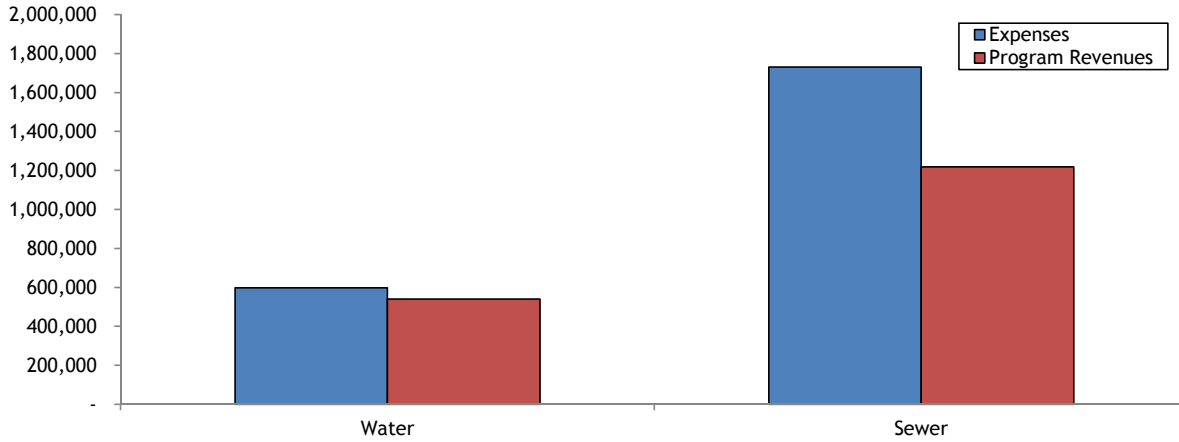


CITY OF GAYLORD

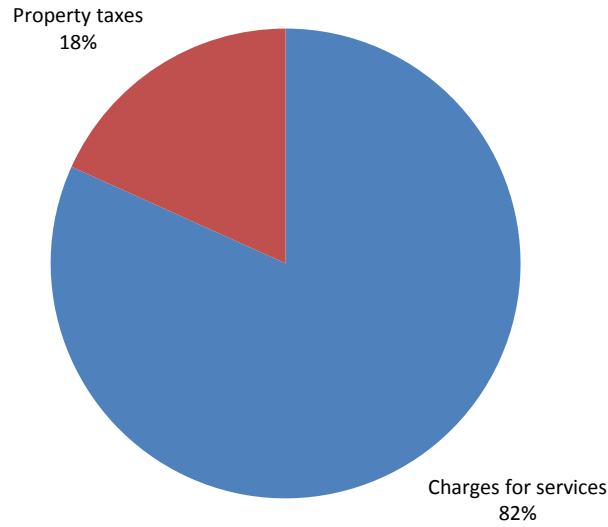
Management's Discussion and Analysis

Business-type Activities. Business-type activities decreased the City's net assets by approximately \$57,000 which was the result reduced usage and tax tribunal settlements.

Expenses and Program Revenues - Business-type Activities



Revenues by Source - Business-type Activities



CITY OF GAYLORD

Management's Discussion and Analysis

Financial Analysis of the Government's Funds

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

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

The General Fund is the main operating fund of the City. The General Fund's fund balance decreased by approximately \$164,000 from approximately \$287,000 to approximately \$123,000 during 2012. This decrease was substantially due to a reduction in property tax revenue which is directly related to an increase in tax tribunal settlements and a reduction in the taxable value of properties. This decrease was also the result of the City writing down some real estate held for sale during 2012 to its estimated realizable value.

Proprietary Funds. The City's proprietary fund statements provide the same type of information found in the government-wide financial statements, but in more detail.

The Water Fund had an increase in net assets of approximately \$109,000 and the Sewer Fund had a decrease in net assets of approximately \$165,000. The increase in the Water Fund is mainly attributable to transfers from the Municipal Streets Special Revenue Fund and Sewer Fund. The decrease in the Sewer Fund can be attributable to depreciation expense and transfers out related to capital improvement projects.

General Fund Budgetary Highlights

The actual revenues were approximately \$100,000 under budget which was mainly due to a reduction in property tax revenues and estimated tax tribunal settlements. Expenditures fluctuated from budget between functions mainly related to a reduction in the City's workforce; however, total expenditures were under budget by approximately \$225,000.

Capital Asset and Debt Administration

Capital Assets. The City defines a capital asset as an asset with an original cost that exceeds \$5,000 and an estimated useful life greater than one year. Included in the cost of a capital asset are items such as labor and freight and any other costs associated with bringing the asset into full operation. Assets are depreciated using the straight-line method over the course of their estimated useful lives.

	Capital Assets (Net of Depreciation, where applicable)					
	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Land	\$ 1,231,573	\$ 1,182,540	\$ 414,080	\$ 414,080	\$ 1,645,653	\$ 1,596,620
Construction in progress	34,546	9,596	-	-	34,546	9,596
Buildings and improvements	4,657,783	4,794,534	1,106,064	1,149,765	5,763,847	5,944,299
Office furnishings	9,656	10,944	-	-	9,656	10,944
Tools and equipment	84,568	112,211	-	-	84,568	112,211
Vehicles	134,735	171,439	-	-	134,735	171,439
Roads and sidewalks	8,608,177	8,996,909	-	-	8,608,177	8,996,909
Water and sewer system	-	-	18,749,422	19,257,544	18,749,422	19,257,544
Total capital assets, net	\$ 14,761,038	\$ 15,278,173	\$ 20,269,566	\$ 20,821,389	\$ 35,030,604	\$ 36,099,562

Additional information on the City's capital assets can be found in the notes to the financial statements.

CITY OF GAYLORD

Management's Discussion and Analysis

Long-Term Debt. Debt incurred in the course of constructing or acquiring a capital asset is recorded and paid for through a debt service fund or proprietary fund. Debt is classified as long-term if the debt matures in a period greater than one year. At the end of the current fiscal year, the City had total debt outstanding (not including accrued compensated absences) of \$10,715,000. Of this amount \$9,325,000 is comprised of debt backed by the full faith and credit of the City. The remainder of the City's debt represents bonds secured solely by a specified revenue source.

Additional information on the City's long-term debt can be found in the notes to the financial statements.

Economic Factors and Next Year's Budget and Rates

The 2013 budget projects the fourth straight year of decreases in taxable property values and increases in tax tribunal settlements. The overall economy of the area factors into the City's revenue projections. Property assessment values continue to be challenged by local property owners. The City will continue to monitor closely its capital needs, debt service requirements, and upcoming projects as they relate to budget and projected revenue streams. The 2013 budget reflects a reduction in staff in the police department of two officers, a freeze in salaries and wages for DPW and nonunion employees, reduction in fringe benefits, and policy changes to restrict all overtime. The City has established road maintenance policies in both the Major and Local Street Funds as projected revenues from the State of Michigan to assist in the funding of roadway maintenance and snow removal expenses are inadequate to maintain the street system of each fund. The City continues to retire long-term debt issues, with debt related to the 1997 Mankowski Road project scheduled to retire in 2013. No new debt issues are planned or being considered.

In fiscal 2013, the City will commence construction on its annual street improvement project, including related infrastructure improvements, funded by voter approved millage revenue and grant proceeds. Street projects will continue to be funded through millage revenue and grants wherever possible. However, these projects, along with normal maintenance and other infrastructure improvements continue to present budgetary challenges within the City.

Requests for Information

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the City's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Mr. Joe Duff, City Manager, 305 E. Main Street, Gaylord, Michigan 49735.

BASIC FINANCIAL STATEMENTS

CITY OF GAYLORD

Statement of Net Assets June 30, 2012

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Totals	
Assets				
Cash and cash equivalents	\$ 511,008	\$ 580,778	\$ 1,091,786	\$ 35,184
Receivables	565,447	192,280	757,727	-
Internal balances	(248)	248	-	-
Due from component unit	79,388	76,584	155,972	-
Due from primary government	-	-	-	359
Other assets	554,281	-	554,281	3,300
Restricted cash	279,666	317,184	596,850	-
Restricted investments	154,608	-	154,608	-
Capital assets not being depreciated	1,266,119	414,080	1,680,199	-
Capital assets being depreciated, net	13,494,919	19,855,486	33,350,405	617,797
Total assets	16,905,188	21,436,640	38,341,828	656,640
Liabilities				
Accounts payable and accrued liabilities	361,588	250,853	612,441	17,359
Due to component unit	359	-	359	-
Due to primary government	-	-	-	155,972
Long-term liabilities:				
Due within one year	318,801	505,000	823,801	-
Due in more than one year	4,891,353	5,320,608	10,211,961	-
Net other postemployment benefit obligation	108,553	-	108,553	-
Total liabilities	5,680,654	6,076,461	11,757,115	173,331
Net assets				
Invested in capital assets, net of related debt	9,796,038	14,519,566	24,315,604	617,797
Restricted:				
Highways and streets	225,130	-	225,130	-
Debt service	90,355	-	90,355	-
Capital improvements	-	317,184	317,184	-
Unrestricted (deficit)	1,113,011	523,429	1,636,440	(134,488)
Total net assets	\$ 11,224,534	\$15,360,179	\$26,584,713	\$ 483,309

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

CITY OF GAYLORD

Statement of Activities

For the Year Ended June 30, 2012

Functions / Programs	Expenses	Program Revenues			Net (Expense) Revenue
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Primary government					
Governmental activities:					
Legislative	\$ 32,659	\$ -	\$ -	\$ -	\$ (32,659)
General government	814,484	27,801	45,748	-	(740,935)
Public safety	1,220,405	21,517	19,719	12,000	(1,167,169)
Public works	1,537,636	-	463,185	-	(1,074,451)
Culture and recreation	238,137	-	16,969	-	(221,168)
Other	9,980	-	-	-	(9,980)
Interest on long-term debt	218,311	-	-	-	(218,311)
Total governmental activities	4,071,612	49,318	545,621	12,000	(3,464,673)
Business-type activities:					
Water	596,858	539,251	-	-	(57,607)
Sewer	1,730,868	1,217,868	-	-	(513,000)
Total business-type activities	2,327,726	1,757,119	-	-	(570,607)
Total primary government	\$ 6,399,338	\$ 1,806,437	\$ 545,621	\$ 12,000	\$ (4,035,280)
Component unit	\$ 747,450	\$ -	\$ 52,266	\$ 570,000	\$ (125,184)

Continued...

CITY OF GAYLORD

Statement of Activities (Continued) For the Year Ended June 30, 2012

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	
Changes in net assets				
Net expense	\$ (3,464,673)	\$ (570,607)	\$ (4,035,280)	\$ (125,184)
General revenues:				
Property taxes:				
General operating	2,706,724	-	2,706,724	-
Debt	-	392,304	392,304	208,924
State shared revenues	286,910	-	286,910	-
Interest earnings	22,087	-	22,087	571
Miscellaneous revenue	-	845	845	124,543
Transfers - internal activities	(120,821)	120,821	-	-
Total general revenues and transfers	2,894,900	513,970	3,408,870	334,038
Change in net assets	(569,773)	(56,637)	(626,410)	208,854
Net assets, beginning of year	11,794,307	15,416,816	27,211,123	274,455
Net assets, end of year	\$ 11,224,534	\$ 15,360,179	\$ 26,584,713	\$ 483,309

Concluded

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

CITY OF GAYLORD

Balance Sheet

Governmental Funds

June 30, 2012

	General	Municipal Streets	Edelweiss Special Assessment	Nonmajor Funds	Total
Assets					
Cash and cash equivalents	\$ 161,194	\$ 30,639	\$ 50,418	\$ 223,129	\$ 465,380
Due from other governmental units	115,909	-	-	63,818	179,727
Special assessment receivable	-	-	371,801	2,877	374,678
Due from other funds	-	-	-	45,736	45,736
Due from component unit	42,762	-	-	-	42,762
Inventory	65,775	-	-	-	65,775
Real estate held for sale	250,000	-	-	238,506	488,506
Restricted cash	-	-	-	279,666	279,666
Restricted investments	154,508	-	-	-	154,508
Total assets	\$ 790,148	\$ 30,639	\$ 422,219	\$ 853,732	\$ 2,096,738
Liabilities					
Accounts payable	\$ 233,731	\$ 32,211	\$ -	\$ 10,221	\$ 276,163
Accrued expenditures	19,539	-	-	1,402	20,941
Due to other funds	413,741	-	-	-	413,741
Due to component unit	-	359	-	-	359
Deferred revenue	-	-	371,801	2,877	374,678
Total liabilities	667,011	32,570	371,801	14,500	1,085,882
Fund balances					
Nonspendable					
Inventory	65,775	-	-	-	65,775
Perpetual care	-	-	-	280,766	280,766
Restricted					
Highways and streets	-	-	-	225,130	225,130
Debt service	-	-	50,418	94,830	145,248
Committed					
Culture and recreation	42,481	-	-	-	42,481
Act 495 fire loss	22	-	-	-	22
Assigned - real estate held for sale	14,859	-	-	238,506	253,365
Unassigned	-	(1,931)	-	-	(1,931)
Total fund balances (deficit)	123,137	(1,931)	50,418	839,232	1,010,856
Total liabilities and fund balances	\$ 790,148	\$ 30,639	\$ 422,219	\$ 853,732	\$ 2,096,738

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

CITY OF GAYLORD

Reconciliation

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

Fund balances - total governmental funds \$ 1,010,856

Amounts reported for governmental activities in the statement of
net assets are different because:

Capital assets used in governmental activities are not financial resources,
and therefore are not reported in the fund statement.

Capital assets not being depreciated	1,266,119
Capital assets being depreciated, net	13,283,911

The focus of governmental funds is on short-term financing. Accordingly, some
assets will not be available to pay for current-period expenditures. Those
assets (such as certain receivables) are offset by deferred revenue in the
governmental funds, and thus are not included in fund balance.

Deferred special assessment revenue	374,678
Personal property tax receivables, net	11,042

Internal service funds are used by management to charge the costs of
equipment to individual funds. The assets and liabilities of certain
internal service funds are included in governmental activities.

Net assets of governmental activities accounted for in internal service funds	646,002
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Certain liabilities, such as bonds payable, are not due and payable
in the current period, and therefore are not reported in the funds.

Compensated absences	(239,628)
Installment debt and bonds payable	(4,965,000)
Net other postemployment benefit obligation	(108,553)
Accrued interest on bonds payable	(54,893)

Net assets of governmental activities \$ 11,224,534

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

CITY OF GAYLORD

Statement of Revenue, Expenditures and Changes in Fund Balances

Governmental Funds

For the Year Ended June 30, 2012

	General	Municipal Streets	Edelweiss Special Assessment	Nonmajor Funds	Total
Revenues					
Taxes and penalties	\$ 1,980,544	\$ 517,842	\$ -	\$ 217,025	\$ 2,715,411
Special assessments	-	-	75,900	87,807	163,707
Charges for services	49,318	-	-	-	49,318
State revenue	302,211	-	-	398,611	700,822
Local revenue	16,969	-	-	-	16,969
Interest	2,707	-	13,180	6,200	22,087
Miscellaneous	61,086	10,000	-	6,432	77,518
Total revenues	2,412,835	527,842	89,080	716,075	3,745,832
Expenditures					
Current:					
Legislative	32,659	-	-	-	32,659
General government	538,833	-	-	-	538,833
Public safety	1,192,154	-	-	-	1,192,154
Public works	363,400	401,838	-	365,870	1,131,108
Culture and recreation	96,042	-	-	-	96,042
Other	229,026	-	142	880	230,048
Debt service:					
Principal	15,000	-	70,000	315,000	400,000
Interest and fiscal charges	10,920	-	13,180	208,285	232,385
Total expenditures	2,478,034	401,838	83,322	890,035	3,853,229
Revenues over (under) expenditures	(65,199)	126,004	5,758	(173,960)	(107,397)
Other financing sources (uses)					
Transfers in	100,402	-	-	186,495	286,897
Transfers out	(199,064)	(210,958)	-	(30,000)	(440,022)
Total other financing sources (uses)	(98,662)	(210,958)	-	156,495	(153,125)
Net change in fund balances	(163,861)	(84,954)	5,758	(17,465)	(260,522)
Fund balances, beginning of year	286,998	83,023	44,660	856,697	1,271,378
Fund balances (deficit), end of year	\$ 123,137	\$ (1,931)	\$ 50,418	\$ 839,232	\$ 1,010,856

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

CITY OF GAYLORD

Reconciliation

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

Net change in fund balances - total governmental funds \$ (260,522)

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, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

Capital outlay	433,498
Depreciation expense	(920,767)
Transfer of capital assets from business-type activities	32,304

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds, but rather are deferred to the following fiscal year.

Current year collections on special assessments	(163,707)
Increase in delinquent personal property taxes	(8,687)

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

Principal payments on long-term liabilities	400,000
Increase in net other postemployment benefit obligation	(34,759)

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

Change in accrued interest on bonds	3,154
Change in the accrual of compensated absences	(14,217)

An internal service fund is used by management to charge the costs of certain services to individual governmental funds. The net revenue (expense) attributable to those funds is reported with governmental activities.

Change in net assets from internal service funds accounted for in governmental activities	<u>(36,070)</u>
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Change in net assets of governmental activities	<u><u>\$ (569,773)</u></u>
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The accompanying notes are an integral part of these financial statements.

CITY OF GAYLORD

Statement of Revenue, Expenditures and Changes in Fund Balances

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

	Original Budget	Final Budget	Actual	Actual Over (Under) Final Budget
Revenues				
Taxes and penalties	\$ 2,098,094	\$ 2,098,094	\$ 1,980,544	\$ (117,550)
Charges for services	67,000	67,000	49,318	(17,682)
State revenue	259,695	259,695	302,211	42,516
Local revenue	25,100	25,100	16,969	(8,131)
Interest	500	500	2,707	2,207
Miscellaneous	62,850	62,850	61,086	(1,764)
Total revenues	2,513,239	2,513,239	2,412,835	(100,404)
Expenditures				
Current:				
Legislative	41,300	41,300	32,659	(8,641)
General government	473,015	524,275	538,833	14,558
Public safety	1,245,095	1,250,595	1,192,154	(58,441)
Public works	338,086	441,986	363,400	(78,586)
Culture and recreation	31,500	105,700	96,042	(9,658)
Other	239,800	312,850	229,026	(83,824)
Debt service:				
Principal	15,000	15,000	15,000	-
Interest	11,280	11,280	10,920	(360)
Total expenditures	2,395,076	2,702,986	2,478,034	(224,952)
Revenues over (under) expenditures	118,163	(189,747)	(65,199)	(124,548)
Other financing sources (uses)				
Transfers in	37,833	37,833	100,402	62,569
Transfers out	(119,450)	(160,000)	(199,064)	39,064
Total other financing sources (uses)	(81,617)	(122,167)	(98,662)	(23,505)
Net change in fund balance	36,546	(311,914)	(163,861)	(148,053)
Fund balance, beginning of year	286,998	286,998	286,998	-
Fund balance (deficit), end of year	\$ 323,544	\$ (24,916)	\$ 123,137	\$ (148,053)

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

CITY OF GAYLORD

Statement of Revenue, Expenditures and Changes in Fund Balances

Budget and Actual - Municipal Streets Fund

Year Ended June 30, 2012

	Original Budget	Amended Budget	Actual	Actual Over (Under) Final Budget
Revenues				
Taxes and penalties	\$ 550,333	\$ 550,333	\$ 517,842	\$ (32,491)
Miscellaneous	-	-	10,000	10,000
Total revenues	550,333	550,333	527,842	(22,491)
Expenditures				
Current:				
Public works	530,000	625,000	401,838	223,162
Revenues over (under) expenditures	20,333	(74,667)	126,004	(200,671)
Other financing uses				
Transfers out	(20,000)	(20,000)	(210,958)	(190,958)
Net change in fund balances	333	(94,667)	(84,954)	(9,713)
Fund balances, beginning of year	83,023	83,023	83,023	-
Fund balances (deficit), end of year	\$ 83,356	\$ (11,644)	\$ (1,931)	\$ (9,713)

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

CITY OF GAYLORD

Statement of Net Assets

Proprietary Funds

June 30, 2012

	Business-type Activities - Enterprise Funds			Governmental Activities
	Water	Sewer	Total	Internal Service Fund
Assets				
Current assets:				
Cash and cash equivalents	\$ 4,804	\$ 575,974	\$ 580,778	\$ 45,628
Accounts receivable	56,157	136,123	192,280	-
Due from other funds	-	248	248	367,757
Due from component unit	-	76,584	76,584	36,626
Total current assets	<u>60,961</u>	<u>788,929</u>	<u>849,890</u>	<u>450,011</u>
Noncurrent assets:				
Restricted cash	112,118	205,066	317,184	-
Restricted investment	-	-	-	100
Capital assets not being depreciated	33,100	380,980	414,080	11,590
Capital assets being depreciated, net	<u>4,574,005</u>	<u>15,281,481</u>	<u>19,855,486</u>	<u>199,418</u>
Total noncurrent assets	<u>4,719,223</u>	<u>15,867,527</u>	<u>20,586,750</u>	<u>211,108</u>
Total assets	<u>4,780,184</u>	<u>16,656,456</u>	<u>21,436,640</u>	<u>661,119</u>
Liabilities				
Current liabilities:				
Accounts payable	64,971	124,101	189,072	9,591
Accrued liabilities	3,058	58,723	61,781	-
Current portion of bonds payable	-	505,000	505,000	-
Total current liabilities	<u>68,029</u>	<u>687,824</u>	<u>755,853</u>	<u>9,591</u>
Long-term debt				
Bonds payable, net of current portion	-	5,245,000	5,245,000	-
Compensated absences	26,547	49,061	75,608	5,526
Total long-term debt	<u>26,547</u>	<u>5,294,061</u>	<u>5,320,608</u>	<u>5,526</u>
Total liabilities	<u>94,576</u>	<u>5,981,885</u>	<u>6,076,461</u>	<u>15,117</u>
Net assets				
Invested in capital assets, net of related debt	4,607,105	9,912,461	14,519,566	211,008
Restricted for capital improvements	112,118	205,066	317,184	-
Unrestricted (deficit)	<u>(33,615)</u>	<u>557,044</u>	<u>523,429</u>	<u>434,994</u>
Total net assets	<u>\$ 4,685,608</u>	<u>\$ 10,674,571</u>	<u>\$ 15,360,179</u>	<u>\$ 646,002</u>

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

CITY OF GAYLORD

Statement of Revenue, Expenses and Changes in Fund Net Assets

Proprietary Funds

For the Year Ended June 30, 2012

	Business-type Activities - Enterprise Funds			Governmental Activities
	Water	Sewer	Total	Internal Service Fund
Operating revenue				
Sales and charges for services	\$ 539,251	\$ 1,217,868	\$ 1,757,119	\$ -
Equipment rental	-	-	-	333,806
Total operating revenue	539,251	1,217,868	1,757,119	333,806
Operating expenses				
Personnel services	261,754	508,627	770,381	144,643
Contracted services	115,020	106,874	221,894	-
Supplies and repairs	25,041	41,789	66,830	170,579
Equipment rental	24,847	37,271	62,118	268
Utilities	59,710	145,862	205,572	-
Depreciation	101,579	620,217	721,796	85,431
Miscellaneous	8,907	14,200	23,107	29,097
Total operating expenses	596,858	1,474,840	2,071,698	430,018
Operating loss	(57,607)	(256,972)	(314,579)	(96,212)
Nonoperating revenue (expenses)				
Federal grants	-	-	-	12,000
Taxes and penalties	-	392,304	392,304	-
Miscellaneous revenue	845	-	845	48,142
Interest expense	-	(256,028)	(256,028)	-
Total nonoperating revenue (expenses)	845	136,276	137,121	60,142
Loss before transfers	(56,762)	(120,696)	(177,458)	(36,070)
Other financing sources (uses)				
Transfers in	186,227	66,818	253,045	-
Transfers out	(20,673)	(111,551)	(132,224)	-
Total other financing sources (uses)	165,554	(44,733)	120,821	-
Change in net assets	108,792	(165,429)	(56,637)	(36,070)
Net assets, beginning of year	4,576,816	10,840,000	15,416,816	682,072
Net assets, end of year	\$ 4,685,608	\$ 10,674,571	\$ 15,360,179	\$ 646,002

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

CITY OF GAYLORD

Statement of Cash Flows

Proprietary Funds

For the Year Ended June 30, 2012

	Business-type Activities - Enterprise Funds			Governmental Activities
	Water	Sewer	Total	Internal Service Fund
Cash flows from operating activities				
Cash collected from customers	\$ 544,022	\$ 1,256,712	\$ 1,800,734	\$ -
Cash collected from other funds	-	-	-	333,806
Cash paid for employee wages and benefits	(261,894)	(508,466)	(770,360)	(144,685)
Cash paid for other operating and administrative expenses	(329,183)	(406,654)	(735,837)	(195,090)
Net cash (used in) provided by operating activities	(47,055)	341,592	294,537	(5,969)
Cash flows from noncapital financing activities				
Taxes and penalties	-	392,304	392,304	-
Transfers in	186,227	66,818	253,045	-
Transfers out	(20,673)	(79,247)	(99,920)	-
Other income	845	-	845	48,142
Net cash provided by noncapital financing activities	166,399	379,875	546,274	48,142
Cash flows from capital and related financing activities				
Interest paid on long-term debt	-	(256,028)	(256,028)	-
Principal paid on long-term debt	-	(480,000)	(480,000)	-
Federal grants	-	-	-	12,000
Purchase of capital assets	(135,459)	(66,818)	(202,277)	(23,261)
Net cash used in capital and related financing activities	(135,459)	(802,846)	(938,305)	(11,261)
Net (decrease) increase in cash and cash equivalents	(16,115)	(81,379)	(97,494)	30,912
Cash and cash equivalents, beginning of year	133,037	862,419	995,456	14,716
Cash and cash equivalents, including restricted cash, end of year	116,922	781,040	897,962	45,628
Less restricted cash, end of year	112,118	205,066	317,184	-
Cash and cash equivalents, end of year	\$ 4,804	\$ 575,974	\$ 580,778	\$ 45,628

Continued...

CITY OF GAYLORD

Statement of Cash Flows

Proprietary Funds

For the Year Ended June 30, 2012

	Business-type Activities - Enterprise Funds			Governmental Activities
	Water	Sewer	Total	Internal Service Fund
Cash flows from operating activities				
Operating loss	\$ (57,607)	\$ (256,972)	\$ (314,579)	\$ (96,212)
Adjustments to reconcile operating loss to net cash (used in) provided by operating activities				
Depreciation	101,579	620,217	721,796	85,431
Changes in operating assets and liabilities which provided (used) cash				
Accounts receivable	4,771	38,844	43,615	-
Due from other funds	-	17,730	17,730	-
Due from component unit	-	5,000	5,000	15,000
Accounts payable	(78,553)	(80,413)	(158,966)	(10,146)
Accrued expenses	873	(2,946)	(2,073)	-
Due to other funds	(17,978)	(29)	(18,007)	-
Compensated absences	(140)	161	21	(42)
Net cash (used in) provided by operating activities	<u>\$ (47,055)</u>	<u>\$ 341,592</u>	<u>\$ 294,537</u>	<u>\$ (5,969)</u>
Noncash capital and related financing activity				
Transfer of capital assets to governmental activities	<u>\$ -</u>	<u>\$ 32,304</u>	<u>\$ 32,304</u>	<u>\$ -</u>

Concluded

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

CITY OF GAYLORD

Statement of Fiduciary Assets and Liabilities

Current Tax Collection - Agency Fund

June 30, 2012

Assets

Cash and cash equivalents	<u>\$ 11,988</u>
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Liabilities

Due to the City of Gaylord	<u>\$ 11,988</u>
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The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

CITY OF GAYLORD

Notes to Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

As required by accounting principles generally accepted in the United States of America, the financial statements of the reporting entity include those of the City of Gaylord (the “City”) and its component unit. The component unit discussed below is included in the City’s reporting entity because of the significance of its operational or financial relationship with the City.

Gaylord Downtown Development Authority - The Downtown Development Authority (the “DDA”) is a discretely presented component unit of the City. The component unit column in the government-wide financial statements include the financial data of the DDA. This component unit is reported in a separate column to emphasize that it is legally separate from the City. The members of the governing Board of the DDA are appointed by the City Council. The budgets and expenditures of the DDA must be approved by the City Council. The City also has the ability to significantly influence operations of the DDA.

Government-Wide and Fund Financial Statements

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

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Fund Financial Statements. The fund financial statements provide information about the City’s funds, including its fiduciary funds, even though the latter are excluded from the government-wide financial statements. Separate statements for each fund category - governmental, proprietary and fiduciary - are presented. The emphasis of fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are aggregated and reported as nonmajor funds.

The City reports the following major governmental funds:

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

The *Municipal Streets Special Revenue Fund* accounts for the resources from a property tax levy restricted for the improvements of streets and related infrastructure.

CITY OF GAYLORD

Notes to Financial Statements

The *Edelweiss Special Assessment Debt Service Fund* accounts for the resources of special assessment proceeds that are used for the annual payment of principal, interest, and expenses in connection with certain long-term debt.

Additionally, the City reports the following major enterprise funds:

The *Water Fund* accounts for the operation, maintenance and development of water facilities.

The *Sewer Fund* accounts for the operation, maintenance and development of sewer facilities.

The City reports the following fund types:

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

Debt Service Funds are used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest.

Capital Project Funds are used to account for and report financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets.

The *Permanent Fund* accounts for the assets of the Cemetery Perpetual Care Fund. The principal portion of these funds must stay intact, but the interest earnings are used to provide for maintenance of the City's cemetery.

Enterprise Funds. These funds account for operations (a) that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Internal Service Fund account for the operations that provide machinery and equipment to other departments of the City on a cost-reimbursement basis.

The *Agency Fund* is custodial in nature and does not present results of operations or have a measurement focus. This fund is used to account for assets that the City holds for others in an agency capacity (such as taxes collected for other governments).

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Government-wide and Proprietary Fund Financial Statements. The government-wide and proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. The agency fund also uses the accrual basis of accounting but does not have a measurement focus.

CITY OF GAYLORD

Notes to Financial Statements

Proprietary fund operating revenues such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities.

Nonexchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes and grants and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

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

Governmental Fund Financial Statements. Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal period, or within one year for reimbursement-based grants. Property taxes, state revenue and interest are considered to be susceptible to accrual.

Expenditures are recorded when the related fund liability is incurred, except for principal and interest on long-term debt, compensated absences, and claims and judgments, which are recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of long-term debt and acquisitions under capital leases, if any, are reported as other financing sources.

Amounts reported as *program revenues* include (1) charges to customers or applicants for goods, services, or privileges provided, (2) operating grants and contributions, and (3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise, general revenues include all taxes.

Restricted net assets are assets that are subject to restrictions beyond the City's control. The restrictions may be externally imposed or imposed by law. When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

Assets, liabilities and equity

Deposits and investments

The City's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

CITY OF GAYLORD

Notes to Financial Statements

State statutes authorize the City to deposit in the accounts of federally insured banks, credit unions, and savings and loan associations, and to invest in obligations of the U.S. Treasury, certain commercial paper, repurchase agreements, bankers acceptances, and mutual funds composed of otherwise legal investments.

Investments consist of the City's share in an external investment pool and are reported at fair value. This investment pool operates in a manner consistent with the Securities and Exchange Commission's Rule 2a7 of the Investment Company Act of 1940.

Receivables and payables

All receivables are reported at their gross value, and where appropriate, are reduced by the estimated portion that is expected to be uncollectible. The governmental activities have an allowance recorded for delinquent personal property taxes in the amount of \$58,167 at June 30, 2012.

Transactions between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

Property taxes

The City's property taxes are levied each July 1 on the taxable valuation of property located in the City as of the preceding December 31, the lien date. Property taxes are payable without penalty and interest through September 14; as of March 1 of the succeeding year, unpaid real property taxes are sold to and collected by Otsego County. Assessed values, as established annually by the City and subject to acceptance by the County, are equalized by the State at an estimated 50% of current market value.

Property taxes for the Downtown Development Authority are derived by capturing the taxes on the increase in taxable value of the property located within the District.

Property taxes are recognized in the fiscal year for which they are levied.

Inventories

Inventory maintained by the General Fund is valued at cost using the first-in, first-out method.

Restricted assets

Certain resources are set aside for future improvements to the City's water and sewer system and cemetery perpetual care, which are classified as restricted assets on the statement of net assets because their use is restricted by an external party or law.

CITY OF GAYLORD

Notes to Financial Statements

Capital assets

Capital assets, which include property, equipment, and infrastructure assets are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. The City defines capital assets as assets with an initial, individual cost of more than \$5,000 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 value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the assets or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities, if any, is included as part of the capitalized value of the assets constructed. No such interest expense was incurred during the current fiscal year.

Capital assets of the primary government and component unit are depreciated using the straight-line method over the following estimated useful lives:

	Years
Buildings and improvements	5-50
Office furnishings and tools and equipment	3-20
Vehicles	3-10
Water and sewer system	40-75
Roads and sidewalks	15-25

Compensated absences

It is the City's policy to permit employees to accumulate earned but unused sick and vacation time benefits, subject to certain limitations. All sick and vacation time pay is accrued when incurred in the government-wide statements and proprietary fund financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations or retirements.

Long-term obligations

In the government-wide financial statements and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets.

In the fund financial statements, governmental funds report the face amount of debt issued as other financing sources.

CITY OF GAYLORD

Notes to Financial Statements

Fund equity

Governmental funds report nonspendable fund balance for amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact. Restricted fund balance is reported when externally imposed constraints are placed on the use of resources by grantors, contributors, or laws or regulations of other governments. Committed fund balance is reported for amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the City Council (the City's highest level of decision-making authority). A formal resolution of the City Council is required to establish, modify, or rescind a fund balance commitment. The City reports assigned fund balance for amounts that are constrained by the City's intent to be used for specific purposes, but are neither restricted nor committed. The City Council has delegated the authority to assign fund balance to the City Manager or his designee. Unassigned fund balance is the residual classification for the General Fund.

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

Restricted net assets represent assets which are legally restricted by outside parties or enabling legislation.

Interfund transactions

During the course of normal operations, the City has numerous transactions between funds, including expenditures and transfers of resources to provide services, construct assets, and service debt. The accompanying financial statements generally reflect such transactions as transfers. Transfers between governmental or proprietary funds are netted as part of the reconciliation to the government-wide financial statements. Internal service funds are used to record charges for services to all City departments and funds as transfers or operating revenue. All City funds record these payments to the internal service funds as transfers or operating expenditures/expenses.

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 amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

2. BUDGETARY INFORMATION

Budgets presented in the financial statements were prepared on the same basis as the accounting basis used to reflect actual results. The General Fund and special revenue funds are subject to legal budgetary accounting controls and all are budgeted annually. Debt service and capital project funds are also included in the budgetary process; however, State statutes do not require legally adopted budgets for such funds. The City follows these procedures in establishing the budgetary data reflected in the financial statements:

1. Each June, after receiving input from the individual departments, the City Manager prepares a proposed operating budget for the fiscal period commencing July 1 and lapsing on June 30. The operating budget includes proposed expenditures and the means of financing them.
2. Public hearings are conducted to obtain taxpayer comments.

CITY OF GAYLORD

Notes to Financial Statements

3. Prior to July 1, the budget is legally enacted through a resolution passed by the City Council.
4. Formal budgetary integration is employed for the governmental fund types as a management control device.
5. Budgets are adopted at the functional level. Any revisions that alter the total expenditures of any department or fund (i.e. budget amendments) require approval by the City Council. All appropriations lapse at the end of the fiscal year.
6. Adoption and amendments of all budgets used by the City are governed by Public Act 621, which was followed during the year. The appropriations resolution is based on the projected expenditures budget of the department heads of the City. Any amendment to the original budget must meet the requirements of Public Act 621. Any revisions that alter the total expenditures of any fund must be approved by the City Council. The City Manager is authorized to transfer budgeted amounts within an activity, subject to the condition that the total expenditures do not exceed the approved appropriations by activity.

3. DEFICIT FUND EQUITY

The DDA's General Downtown and TIF Funds reported deficit fund balances of \$1,148 and \$133,340, respectively, as of June 30, 2012. The Municipal Streets Fund reported deficit fund balance of \$1,931 as of June 30, 2012. The Water Fund has a deficit in unrestricted net assets; however, total net assets are not in a deficit. The City is in the process of submitting a deficit elimination plan to the Department of Treasury, in accordance with Public Act 275 of 1980.

4. EXCESS OF EXPENDITURES OVER BUDGET

P.A. 621 of 1978, as amended, provides that a local unit shall not incur expenditures in excess of the amount budgeted. The approved budgets of the City were adopted on the functional level basis for all governmental funds, which is the legal level of control. During the year ended June 30, 2012 the City had expenditures in excess of the amounts budgeted of \$14,558 in the general government function and transfers out in excess of the amounts budgeted of \$39,064 in the General Fund.

5. DEPOSITS AND INVESTMENTS

Following is a reconciliation of deposit and investment balances as of June 30, 2012:

	Primary Government	Component Unit	Totals
Statement of Net Assets			
Cash and cash equivalents	\$ 1,091,786	\$ 35,184	\$ 1,126,970
Restricted cash	596,850	-	596,850
Restricted investments	154,608	-	154,608
Statement of Fiduciary Net Assets			
Cash and cash equivalents	-	-	11,988
Total	\$ 1,843,244	\$ 35,184	\$ 1,890,416

CITY OF GAYLORD

Notes to Financial Statements

Deposits and investments

Bank deposits:

Checking and savings accounts \$ 1,735,408

Investments:

External investment pool 154,608

Cash on hand 400

Total \$ 1,890,416

Investment and deposit risk

Interest Rate 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. The City's investment policy does not have specific limits in excess of state law on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit risk. The City's investment policy does not have specific limits in excess of state law on investment credit risk. The City has no investments for which ratings are required.

Custodial credit risk - deposits. Custodial credit risk is the risk that in the event of a bank failure, the City's deposits may not be returned. State law does not require and the City does not have a policy for deposit custodial credit risk. As of year-end, \$272,781 of the City's total bank deposits of \$1,658,396 is uninsured and uncollateralized.

Custodial credit risk - investments. Custodial credit risk is the risk that, in the event of the failure of the counterpart the City will not be able to recover the value of its investments that are in the possession of an outside party. State law does not require and the City does not have a policy for investment custodial credit risk. The City's investments are not exposed to custodial credit risk because external investment pools are not evidenced by securities in physical or book entry form.

The City is authorized by statute to invest surplus funds in the following:

- a. Bonds, securities, other obligations and repurchase agreements of the United States, or an agency or instrumentality of the United States.
- b. Certificates of deposit, savings accounts, deposit accounts or depository receipts of a qualified financial institution.
- c. Investment pools organized under surplus funds investment pool act, 1982 PA 367, 129.111 to 129.118.
- d. Obligations described in subdivision (a) through (g), of PA 20, as revised, if purchased through an interlocal agreement under the Urban Cooperation Act of 1967, (Ex Sess) PA 7, MCL 124.501 to 124.512.
- e. Certificate of Deposit Account Registry Service ("CDARS"), (Approved December 18, 2008, Senate Bill No 1517).

CITY OF GAYLORD

Notes to Financial Statements

The City Council is authorized to designate depositories for City funds, and to determine that the funds are invested in accordance with State of Michigan statutory authority.

The City's deposits are in accordance with statutory authority.

6. RECEIVABLES

The composition of receivables is as follows as of June 30, 2012:

	Governmental Activities	Business-type Activities
Accounts receivable	\$ -	\$ 192,280
Property taxes receivable, net	11,042	-
Due from other governmental units	179,727	-
Special assessment receivable		
Due within one year	78,777	-
Due after one year	295,901	-
	<u>\$ 565,447</u>	<u>\$ 192,280</u>

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not earned. At the end of the current fiscal year, \$371,801 and \$2,877 was recorded as deferred revenue in the Edelweiss Special Assessment Fund and Mankowski Road Fund, respectively, and is unavailable to liquidate liabilities of the current period.

7. CAPITAL ASSETS

Primary government

Capital asset activity was as follows for the year ended June 30, 2012:

	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Governmental Activities					
Capital assets, not being depreciated:					
Land	\$ 1,182,540	\$ 49,033	\$ -	\$ -	\$ 1,231,573
Construction-in-progress	9,596	34,546	-	(9,596)	34,546
	<u>1,192,136</u>	<u>83,579</u>	<u>-</u>	<u>(9,596)</u>	<u>1,266,119</u>
Capital assets, being depreciated:					
Buildings and improvements	5,672,054	-	-	-	5,672,054
Office furnishings	262,875	-	-	-	262,875
Tools and equipment	818,755	-	-	-	818,755
Vehicles	1,410,352	23,261	-	-	1,433,613
Roads and sidewalks	17,038,392	349,919	-	42,730	17,431,041
	<u>25,202,428</u>	<u>373,180</u>	<u>-</u>	<u>42,730</u>	<u>25,618,338</u>

CITY OF GAYLORD

Notes to Financial Statements

	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Less accumulated depreciation for:					
Buildings and improvements	\$ (877,520)	\$ (136,751)	\$ -	\$ -	\$ (1,014,271)
Office furnishings	(251,931)	(1,288)	-	-	(253,219)
Tools and equipment	(706,544)	(27,643)	-	-	(734,187)
Vehicles	(1,238,913)	(59,965)	-	-	(1,298,878)
Roads and sidewalks	(8,041,482)	(780,552)	-	(830)	(8,822,864)
	<u>(11,116,390)</u>	<u>(1,006,199)</u>	<u>-</u>	<u>(830)</u>	<u>(12,123,419)</u>
Total capital assets being depreciated, net	<u>14,086,038</u>	<u>(633,019)</u>	<u>-</u>	<u>41,900</u>	<u>13,494,919</u>
Governmental activities capital assets, net	<u>\$ 15,278,174</u>	<u>\$ (549,440)</u>	<u>\$ -</u>	<u>\$ 32,304</u>	<u>\$ 14,761,038</u>
Business-type Activities					
Capital assets, not being depreciated:					
Land	\$ 414,080	\$ -	\$ -	\$ -	\$ 414,080
Capital assets, being depreciated:					
Buildings & equipment	1,824,680	-	-	-	1,824,680
Water and sewer system	28,831,973	202,277	-	(33,134)	29,001,116
	<u>30,656,653</u>	<u>202,277</u>	<u>-</u>	<u>(33,134)</u>	<u>30,825,796</u>
Less accumulated depreciation for:					
Buildings & equipment	(674,915)	(43,701)	-	-	(718,616)
Water and sewer system	(9,574,429)	(678,095)	-	830	(10,251,694)
	<u>(10,249,344)</u>	<u>(721,796)</u>	<u>-</u>	<u>830</u>	<u>(10,970,310)</u>
Total capital assets being depreciated, net	<u>20,407,309</u>	<u>(519,519)</u>	<u>-</u>	<u>(32,304)</u>	<u>19,855,486</u>
Business-type activities capital assets, net	<u>\$ 20,821,389</u>	<u>\$ (519,519)</u>	<u>\$ -</u>	<u>\$ (32,304)</u>	<u>\$ 20,269,566</u>

Component Unit

The DDA maintains the rights for the use of the pavilion. Title of the pavilion is held by the City of Gaylord; however, the DDA maintains control and upkeep of the asset.

CITY OF GAYLORD

Notes to Financial Statements

Capital asset activity for the DDA component unit was as follow for the year ended June 30, 2012:

	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Capital assets, not being depreciated:					
Construction-in-progress	\$ 15,150	\$ -	\$ -	\$ (15,150)	\$ -
Capital assets, being depreciated:					
Investment in pavilion	550,000	189,373	-	15,150	754,523
Less accumulated depreciation for:					
Investment in pavilion	(115,500)	(21,226)	-	-	(136,726)
Total capital assets being depreciated, net	434,500	168,147	-	15,150	617,797
Capital assets, net	\$ 449,650	\$ 168,147	\$ -	\$ -	\$ 617,797

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

Governmental activities		
General government		\$ 143,753
Public works		736,821
Culture and recreation		40,194
Capital assets held by the City's internal service funds are charged to the various functions based on their usage of the assets		85,431
		<u>\$ 1,006,199</u>
Business-type activities		
Water		\$ 101,579
Sewer		620,217
		<u>\$ 721,796</u>

8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The composition of accounts payable and accrued liabilities is as follows at June 30, 2012:

	Governmental Activities	Business-type Activities	Component Unit
Accounts payable	\$ 285,754	\$ 189,072	\$ 16,919
Accrued liabilities	75,834	61,781	440
Total accounts payable and accrued liabilities	<u>\$ 361,588</u>	<u>\$ 250,853</u>	<u>\$ 17,359</u>

CITY OF GAYLORD

Notes to Financial Statements

9. INTERFUND RECEIVABLES AND PAYABLES AND TRANSFERS

The composition of interfund balances as of June 30, 2012, was as follows:

	Due from Other Funds	Due to Other Funds
General Fund	\$ -	\$ 413,741
Nonmajor governmental funds	45,736	-
Sewer Fund	248	-
Internal Service Fund	367,757	-
	<u>\$ 413,741</u>	<u>\$ 413,741</u>

At June 30, 2012, the following transactions are recorded between the primary government and the discretely presented component unit. The DDA owes \$42,762, \$76,584 and \$36,626 to the General Fund, Sewer Fund and Internal Service Fund, respectively. The Municipal Streets Fund owes the DDA \$359.

These balances resulted from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

Interfund transfers consisted of the following for the year ended June 30, 2012:

	Transfers In	Transfers Out
General Fund	\$ 100,402	\$ 199,064
Municipal Streets Fund	-	210,958
Nonmajor governmental funds	186,495	30,000
Water Fund	186,227	20,673
Sewer Fund	66,818	111,551
Governmental Activities	32,304	-
	<u>\$ 572,246</u>	<u>\$ 572,246</u>

Transfers are used to (1) move revenues from the fund that is required to collect them to the fund that is required or allowed to expend them, (2) move receipts restricted to or allowed for debt service from the funds collecting the receipts to the debt service fund as debt service payments become due, and (3) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

CITY OF GAYLORD

Notes to Financial Statements

10. LONG-TERM DEBT

Long-term debt activity for the year ended June 30, 2012, was as follows:

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Governmental Activities					
Installment debt					
Act 99 Installment Purchase Agreement due in annual principal installments ranging from \$10,000 to \$25,000; interest is charged annually at a rate of 4.80%; final payment due October 2022.	\$ 235,000	\$ -	\$ (15,000)	\$ 220,000	\$ 15,000
Bonded debt					
2006 General Obligation Unlimited Tax Bonds, payable in annual installments ranging from \$50,000 to \$250,000, interest is charged semi-annually ranging from 4.25% to 5.50%; final payment due April 2036.	3,650,000	-	(50,000)	3,600,000	75,000
2003 General Obligation Limited Tax Bonds, payable in annual installments ranging from \$50,000 to \$75,000, interest is charged semi-annually ranging from 4.10% to 5.00%; final payment due October 2022.	750,000	-	(50,000)	700,000	50,000
2003 Special Assessment Limited Tax Bonds, payable in annual installments ranging from \$50,000 to \$70,000, interest is charged semi-annually ranging from 3.00% to 3.70%; final payment due October 2017.	430,000	-	(70,000)	360,000	70,000
2003 General Obligation Limited Tax Bonds, payable in annual installments of \$75,000, interest is charged semi-annually ranging from 3.00% to 3.10%; final payment due October 2012.	150,000	-	(75,000)	75,000	75,000

CITY OF GAYLORD

Notes to Financial Statements

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Governmental Activities (concluded)					
1997 Special Assessment Limited Tax Bonds, payable in annual installments ranging from \$10,000 to \$15,000, interest is charged semi-annually at a rate of 5.05%; final payment due October 2012.	\$ 25,000	\$ -	\$ (15,000)	\$ 10,000	\$ 10,000
1996 Special Assessment Limited Tax Bonds, repaid during 2012.	125,000	-	(125,000)	-	-
Total bonded debt	5,130,000	-	(385,000)	4,745,000	280,000
Total installment and bonded debt	5,365,000	-	(400,000)	4,965,000	295,000
Accrued compensated absences	230,979	200,193	(186,018)	245,154	23,801
Total governmental activities	\$ 5,595,979	\$ 200,193	\$ (586,018)	\$ 5,210,154	\$ 318,801
Business-type Activities					
General Obligation Unlimited Tax Refunding Bonds, Series 2005, payable in annual installments ranging from \$365,000 to \$570,000, interest is charged semi-annually ranging from 3.43% to 4.24%; final payment due October 2019.	\$ 4,125,000	\$ -	\$ (365,000)	\$ 3,760,000	\$ 385,000
1999 Revenue Bonds, payable in annual installments ranging from \$115,000 to \$195,000, interest is charged semi-annually ranging from 5.40% to 6.00%; final payment due November 2021.	1,505,000	-	(115,000)	1,390,000	120,000

CITY OF GAYLORD

Notes to Financial Statements

	Beginning Balance	Additions	Deductions	Ending Balance	Due Within One Year
Business-type Activities (concluded)					
1999 General Obligation Unlimited Tax Bonds (non-refunded portion), payable in one final installment of \$600,000; due October 2020, interest is charged semi-annually at 4.00%.	\$ 600,000	\$ -	\$ -	\$ 600,000	\$ -
Total bonded debt	6,230,000	-	(480,000)	5,750,000	505,000
Accrued compensated absences	75,587	161	(140)	75,608	-
Total business-type activities	\$ 6,305,587	\$ 161	\$ (480,140)	\$ 5,825,608	\$ 505,000

Accrued compensated absences are generally liquidated by the General Fund for all governmental activities and the Water and Sewer Funds for business-type activities.

Annual debt service requirements to maturity for the above obligations of the governmental activities and business-type activities except for accrued compensated absences are as follows:

Year Ended June 30,	Governmental Activities		Business-type Activities	
	Principal	Interest	Principal	Interest
2013	\$ 295,000	\$ 218,160	\$ 505,000	\$ 239,581
2014	210,000	207,620	535,000	218,816
2015	210,000	198,383	560,000	196,539
2016	190,000	189,340	590,000	172,294
2017	195,000	179,555	620,000	145,650
2018-2022	965,000	765,801	2,940,000	272,550
2023-2027	800,000	582,450	-	-
2028-2032	1,100,000	382,750	-	-
2033-2036	1,000,000	113,750	-	-
	\$ 4,965,000	\$ 2,837,809	\$ 5,750,000	\$ 1,245,430

Total interest expense for the primary government for the year ending June 30, 2012, was \$474,339.

CITY OF GAYLORD

Notes to Financial Statements

11. BENEFIT PLANS

Defined Benefit Pension Plan

Plan Description. The City's defined benefit pension plan provides retirement, death and disability benefits to plan members and beneficiaries. The City participates in the Municipal Employees Retirement System of Michigan ("MERS"), an agent multiple-employer plan administered by the MERS Retirement Board. Act No. 427 of the Public Acts of 1984, as amended, establishes and amends the benefit provisions of the participants in MERS. The Municipal Employees Retirement System of Michigan issues a publicly available financial report that includes financial statements and required supplementary information for MERS. That report may be obtained by writing to the Municipal Employees Retirement System of Michigan, 1134 Municipal Way, Lansing, Michigan 48917 or by calling (800) 767-6377.

Funding Policy. The City is required to contribute at an actuarially determined rate; the current rate for the police is 23.68% of annual covered payroll, the general non-union rate is 16.82% and the general public works rate is 18.16% of covered payroll. Employees covered by the police union are required to contribute 3% of their annual covered payroll. The contribution requirements of the City are established and may be amended by the Retirement Board of MERS. The contribution requirements of plan members are established and may be amended by the City, depending on the MERS contribution program adopted by the City.

Annual Pension Cost. For the year ended June 30, 2012, the City's annual MERS pension cost of \$343,296 was equal to the City's required and actual contributions. The required contribution was determined as part of the December 31, 2009, actuarial valuation using the entry age actuarial cost method. The significant actuarial assumptions included (a) a rate of return on the investment of present and future assets of 8.0%, (b) additional projected annual salary increases of 4.5% (1% for calendar years 2012-2014) plus a percentage based on an age-related scale to reflect merit, longevity and promotional pay increases, and (c) an inflationary rate of 3-4%. The actuarial value of MERS assets was determined on the basis of a valuation method that assumes the fund earns the expected rate of return, and includes an adjustment to reflect fair value. The City's unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at December 31, 2011, the date of the last actuarial valuation, was 27 years.

Three-Year Trend Information			
Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
6/30/2010	\$ 313,418	100%	\$ -
6/30/2011	349,607	100%	-
6/30/2012	343,296	100%	-

CITY OF GAYLORD

Notes to Financial Statements

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Under-funded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-
12/31/11	\$ 7,502,288	\$ 10,399,939	\$ 2,897,651	72%	\$ 1,540,752	188%

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

12. OTHER POSTEMPLOYMENT BENEFITS

Plan Description. The City of Gaylord administers a single employer defined benefit healthcare plan established by the City Council. In addition to the retirement benefits described in Note 11, the City provides health insurance benefits to certain retirees, which are advance funded on a discretionary basis. In accordance with City policy, eligible retirees receive healthcare benefits until death. At June 30, 2011, the date of the last plan valuation, the City's healthcare plan covered thirty-nine members (thirty-one active plan members and eight retirees receiving benefits).

Funding Policy. The contribution requirements of Plan members and the City are established and may be amended by the City Council. The required contribution is based on projected pay-as-you go financing requirements, with an additional amount to prefund benefits as determined annually by City Council. For the year ended June 30, 2012, the City contributed \$19,848 to the Plan, all of which was to fund current year benefits. Retirees receiving benefits made no contributions to the Plan, as none were required.

Annual OPEB Cost and Net OPEB Obligation. The City's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC). The City has elected to calculate the ARC and related information using the alternative measurement method permitted by GASB Statement No. 45 for employers in plans with fewer than one hundred total plan members. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The following table shows the components of the City's annual OPEB cost for the year, the amount actually contributed to the Plan, and changes in the City's net OPEB obligation:

Annual required contribution	\$ 54,811
Interest on net OPEB obligation	3,246
Adjustment to annual required contribution	<u>(3,450)</u>
Net OPEB cost (expense)	54,607
Contributions made	<u>(19,848)</u>
Increase in net OPEB obligation	34,759
Net OPEB obligation, beginning of year	<u>73,794</u>
Net OPEB obligation, end of year	<u>\$ 108,553</u>

CITY OF GAYLORD

Notes to Financial Statements

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

Three-Year Trend Information			
Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
2010	\$ 57,895	36%	\$ 37,059
2011	54,607	33%	73,794
2012	54,607	36%	108,553

Funded Status and Funding Progress. As of June 30, 2011, the actuarial accrued liability for benefits was \$739,026, all of which was unfunded. The covered payroll (annual payroll of the active employees covered by the Plan) was \$1,946,562 and the ratio of the UAAL to the covered payroll was 38%.

The projection of future benefit payments for an ongoing plan involves 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 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 benefit obligations.

Methods and Assumptions. Projections of benefits for financial reporting purposes are based on the substantive plan (the Plan as understood by the employer and 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 following simplifying assumptions were made:

Retirement age for active employees—Based on the historical average retirement age for the covered group, active plan members were assumed to retire at age 58.

Mortality—Life expectancies were based on mortality tables from the National Center for Health Statistics. The 2006 United States Life Tables for Males and Females were used.

Turnover—Non-group-specific age-based turnover data from GASB Statement No. 45 were used as the basis for assigning active members a probability of remaining employed until the assumed retirement age and for developing an expected future working lifetime assumption for purposes of allocating to periods the present value of total benefits to be paid.

Healthcare cost trend rate—The expected rate of increase in healthcare insurance premiums of 10% was based on projections by City management.

CITY OF GAYLORD

Notes to Financial Statements

Inflation rate—The expected long-term inflation assumption of 2% was based on projected changes in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) in the 2010 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds for an intermediate growth scenario.

Payroll growth rate—The expected long-term payroll growth rate was assumed to equal the rate of inflation.

Based on the historical and expected returns of the City's short-term investment portfolio, a discount rate of 4% was used. In addition, a simplified version of the entry age actuarial cost method was used. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at June 30, 2012, was twenty-nine years.

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

13. RISK MANAGEMENT

The City is exposed to various risks of losses related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters, for which the City carries commercial insurance with minimal deductibles. Settled claims relating to commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

14. RELATED PARTY TRANSACTIONS

During the year ended June 30, 2012 the City paid approximately \$24,000 related to cleanup and restoration as a result of a sewer backup at a Council member's residence. The Council member is also an employee of the company which was contracted to perform the cleanup and restoration services.

15. CONTINGENCIES

The City currently is a party in several outstanding Michigan Tax Tribunal cases for which a settlement has not been reached as of June 30, 2012. The City has recorded an estimated liability related to these cases based on their expected outcome; however, the final outcome of these cases is not yet determinable.

CITY OF GAYLORD

Notes to Financial Statements

16. INVESTED IN CAPITAL ASSETS, NET OF RELATED DEBT

The composition of net assets invested in capital assets, net of related debt as of June 30, 2012 was as follows:

	Governmental Activities	Business-type Activities	Component Units
Capital assets:			
Capital assets not being depreciated	\$ 1,266,119	\$ 414,080	\$ -
Capital assets being depreciated, net	13,494,919	19,855,486	617,797
	<u>14,761,038</u>	<u>20,269,566</u>	<u>617,797</u>
Noncurrent liabilities:			
Due within one year	(318,801)	(505,000)	-
Due in more than one year	(4,891,353)	(5,320,608)	-
Add back: accrued compensated absences	245,154	75,608	-
	<u>(4,965,000)</u>	<u>(5,750,000)</u>	<u>-</u>
Invested in capital assets, net of capital - related debt	<u>\$ 9,796,038</u>	<u>\$ 14,519,566</u>	<u>\$ 617,797</u>



REQUIRED SUPPLEMENTARY INFORMATION

CITY OF GAYLORD

Required Supplementary Information

The following schedules of funding progress and schedules of employer contributions, present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

1. MERS Defined Benefit Pension Plan

Schedule of Funding Progress MERS Defined Benefit Pension Plan						
Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a) / c)
12/31/2006	\$ 5,306,787	\$ 7,498,035	\$ 2,191,248	71%	\$ 1,625,901	135%
12/31/2007	5,768,458	7,936,952	2,168,494	73%	1,603,002	135%
12/31/2008	6,133,220	9,119,001	2,985,781	67%	1,827,768	163%
12/31/2009	6,542,666	9,083,409	2,540,743	72%	1,687,885	151%
12/31/2010	6,971,310	9,467,921	2,496,611	74%	1,581,382	158%
12/31/2011	7,502,288	10,399,939	2,897,651	72%	1,540,752	188%

Schedule of Employer Contributions MERS Defined Benefit Pension Plan		
Year Ended June 30,	Annual Required Contributions	Percentage Contributed
2007	\$ 266,446	100%
2008	304,249	100%
2009	319,391	100%
2010	313,418	100%
2011	349,607	100%
2012	343,296	100%

2. Other Postemployment Benefits

Schedule of Funding Progress Other Postemployment Benefits Plan						
* Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a) / c)
6/30/2010	\$ -	\$ 793,851	\$ 793,851	0%	\$ 1,886,371	42%
6/30/2011	-	739,026	739,026	0%	1,946,562	38%

Schedule of Employer Contributions Other Postemployment Benefits Plan		
Year Ended June 30,	Annual Required Contributions	Percentage Contributed
2010	\$ 57,895	36%
2011	54,811	33%
2012	54,811	36%

* A plan of this size is not required to be valued each year. Additional years of data will be included in future years as revised valuations are necessary.

**COMBINING AND INDIVIDUAL FUND
STATEMENTS AND SCHEDULES**

CITY OF GAYLORD

Detailed Schedule of Revenue, Expenditures and Changes in Fund Balance

Budget and Actual - General Fund

For the Year Ended June 30, 2012

	Original Budget	Final Budget	Actual	Actual Over (Under) Final Budget
Revenues				
Taxes and penalties	\$ 2,098,094	\$ 2,098,094	\$ 1,980,544	\$ (117,550)
Charge for services	67,000	67,000	49,318	(17,682)
State revenue	259,695	259,695	302,211	42,516
Local revenue	25,100	25,100	16,969	(8,131)
Interest	500	500	2,707	2,207
Miscellaneous	62,850	62,850	61,086	(1,764)
Total revenues	\$ 2,513,239	\$ 2,513,239	\$ 2,412,835	\$ (100,404)

Continued...

CITY OF GAYLORD

Detailed Schedule of Revenue, Expenditures and Changes in Fund Balance

Budget and Actual - General Fund

For the Year Ended June 30, 2012

	Original Budget	Final Budget	Actual	Actual Over (Under) Final Budget
Expenditures				
Legislative:				
City council	\$ 41,300	\$ 41,300	\$ 32,659	\$ (8,641)
General government:				
City manager	53,730	55,650	53,036	(2,614)
Elections	17,340	18,540	13,102	(5,438)
Professional services	16,000	16,000	15,000	(1,000)
Assessor	85,565	88,750	85,737	(3,013)
City attorney	35,000	38,000	39,069	1,069
Clerk	43,290	49,250	48,630	(620)
Board of review	2,680	2,680	2,412	(268)
Treasurer	22,095	30,150	28,536	(1,614)
Building and grounds	71,175	73,925	107,154	33,229
Other city property	56,510	79,700	81,624	1,924
Cemetery	64,200	66,200	62,358	(3,842)
Planning	4,890	4,890	2,121	(2,769)
Zoning	540	540	54	(486)
Total general government	473,015	524,275	538,833	14,558
Public safety:				
Police department	1,179,507	1,185,007	1,126,566	(58,441)
Fire department	65,588	65,588	65,588	-
Total public safety	1,245,095	1,250,595	1,192,154	(58,441)
Public works:				
Public works	158,650	234,350	214,594	(19,756)
Sidewalk	16,636	20,136	4,952	(15,184)
Street lighting	86,200	106,000	97,268	(8,732)
Parking	76,600	81,500	46,586	(34,914)
Total public works	338,086	441,986	363,400	(78,586)

Continued...

CITY OF GAYLORD

Detailed Schedule of Revenue, Expenditures and Changes in Fund Balance

Budget and Actual - General Fund

For the Year Ended June 30, 2012

	Original Budget	Final Budget	Actual	Actual Over (Under) Final Budget
Expenditures (concluded)				
Culture and recreation:				
Park maintenance and construction	\$ 31,500	\$ 105,700	\$ 96,042	\$ (9,658)
Other expenditures:				
General administration	21,350	65,400	57,957	(7,443)
Administrative supplies	20,000	20,000	18,028	(1,972)
Community promotion	147,700	176,700	143,061	(33,639)
Insurance and bonds	15,750	15,750	8,851	(6,899)
Other	35,000	35,000	1,129	(33,871)
Total other expenditures	239,800	312,850	229,026	(83,824)
Debt service:				
Principal	15,000	15,000	15,000	-
Interest	11,280	11,280	10,920	(360)
Total debt service	26,280	26,280	25,920	(360)
Total expenditures	2,395,076	2,702,986	2,478,034	(224,952)
Revenues over (under) expenditures	118,163	(189,747)	(65,199)	(124,548)
Other financing sources (uses)				
Transfers in	37,833	37,833	100,402	62,569
Transfers out	(119,450)	(160,000)	(199,064)	39,064
Total other financing sources (uses)	(81,617)	(122,167)	(98,662)	(23,505)
Net change in fund balances	36,546	(311,914)	(163,861)	(148,053)
Fund balance, beginning of year	286,998	286,998	286,998	-
Fund balance (deficit), end of year	\$ 323,544	\$ (24,916)	\$ 123,137	\$ (148,053)

Concluded

CITY OF GAYLORD

Combining Balance Sheet Nonmajor Governmental Funds June 30, 2012

	Special Revenue Funds		Debt Service Funds	
	Major Streets (202)	Local Streets (203)	Edelweiss (395)	Mankowski Road (330)
Assets				
Cash and cash equivalents	\$ 96,808	\$ 21,946	\$ -	\$ 3,227
Due from other governmental units	49,331	13,387	-	-
Special assessment receivable	-	-	-	2,877
Due from other funds	45,602	-	-	-
Real estate held for sale	-	-	-	-
Restricted cash	-	-	-	-
Total assets	\$ 191,741	\$ 35,333	\$ -	\$ 6,104
Liabilities				
Accounts payable	\$ 292	\$ 250	\$ -	\$ -
Accrued expenditures	504	898	-	-
Deferred revenue	-	-	-	2,877
Total liabilities	796	1,148	-	2,877
Fund balances				
Nonspendable - perpetual care	-	-	-	-
Restricted				
Highways and streets	190,945	34,185	-	-
Debt service	-	-	-	3,227
Assigned - real estate held for sale	-	-	-	-
Total fund balances	190,945	34,185	-	3,227
Total liabilities and fund balances	\$ 191,741	\$ 35,333	\$ -	\$ 6,104



Debt Service Funds			Capital Project Fund		
Old 27 (318)	Industrial Park (302)	City Hall (315)	IDC (415)	Permanent Fund (711)	Total
\$ 58,964	\$ 4,171	\$ 38,013	\$ -	\$ -	\$ 223,129
-	-	-	-	1,100	63,818
-	-	-	-	-	2,877
-	-	134	-	-	45,736
-	-	-	238,506	-	238,506
-	-	-	-	279,666	279,666
<u>\$ 58,964</u>	<u>\$ 4,171</u>	<u>\$ 38,147</u>	<u>\$ 238,506</u>	<u>\$ 280,766</u>	<u>\$ 853,732</u>
\$ -	\$ -	\$ 9,679	\$ -	\$ -	\$ 10,221
-	-	-	-	-	1,402
-	-	-	-	-	2,877
-	-	9,679	-	-	14,500
-	-	-	-	280,766	280,766
-	-	-	-	-	225,130
58,964	4,171	28,468	-	-	94,830
-	-	-	238,506	-	238,506
<u>58,964</u>	<u>4,171</u>	<u>28,468</u>	<u>238,506</u>	<u>280,766</u>	<u>839,232</u>
<u>\$ 58,964</u>	<u>\$ 4,171</u>	<u>\$ 38,147</u>	<u>\$ 238,506</u>	<u>\$ 280,766</u>	<u>\$ 853,732</u>

CITY OF GAYLORD

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

	Special Revenue Funds		Debt Service Funds	
	Major Streets (202)	Local Streets (203)	Edelweiss (395)	Mankowski Road (330)
Revenues				
Taxes and penalties	\$ -	\$ -	\$ -	\$ -
Special assessments	-	-	-	2,879
State revenues	301,391	97,220	-	-
Interest	-	-	-	346
Miscellaneous	132	-	-	-
Total revenues	301,523	97,220	-	3,225
Expenditures				
Current:				
Public works	228,737	137,133	-	-
Other	-	-	142	200
Debt service:				
Principal	-	-	75,000	15,000
Interest and fiscal charges	-	-	3,450	1,084
Total expenditures	228,737	137,133	78,592	16,284
Revenues over (under) expenditures	72,786	(39,913)	(78,592)	(13,059)
Other financing sources (uses)				
Transfers in	-	50,000	78,592	16,284
Transfers out	(30,000)	-	-	-
Total other financing sources (uses)	(30,000)	50,000	78,592	16,284
Change in fund balances	42,786	10,087	-	3,225
Fund balances, beginning of year	148,159	24,098	-	2
Fund balances, end of year	\$ 190,945	\$ 34,185	\$ -	\$ 3,227



Debt Service Funds			Capital Project Fund		
Old 27 (318)	Industrial Park (302)	City Hall (315)	IDC (415)	Permanent Fund (711)	Total
\$ -	\$ -	\$ 217,025	\$ -	\$ -	\$ 217,025
84,928	-	-	-	-	87,807
-	-	-	-	-	398,611
5,854	-	-	-	-	6,200
-	-	-	-	6,300	6,432
<u>90,782</u>	<u>-</u>	<u>217,025</u>	<u>-</u>	<u>6,300</u>	<u>716,075</u>
-	-	-	-	-	365,870
133	250	155	-	-	880
125,000	50,000	50,000	-	-	315,000
3,438	33,463	166,850	-	-	208,285
<u>128,571</u>	<u>83,713</u>	<u>217,005</u>	<u>-</u>	<u>-</u>	<u>890,035</u>
<u>(37,789)</u>	<u>(83,713)</u>	<u>20</u>	<u>-</u>	<u>6,300</u>	<u>(173,960)</u>
-	41,619	-	-	-	186,495
-	-	-	-	-	(30,000)
-	41,619	-	-	-	156,495
<u>(37,789)</u>	<u>(42,094)</u>	<u>20</u>	<u>-</u>	<u>6,300</u>	<u>(17,465)</u>
<u>96,753</u>	<u>46,265</u>	<u>28,448</u>	<u>238,506</u>	<u>274,466</u>	<u>856,697</u>
<u>\$ 58,964</u>	<u>\$ 4,171</u>	<u>\$ 28,468</u>	<u>\$ 238,506</u>	<u>\$ 280,766</u>	<u>\$ 839,232</u>

CITY OF GAYLORD

Combining Balance Sheet

Downtown Development Authority Component Unit
June 30, 2012

	General Downtown	Pavilion Debt Retirement	TIF	Total
Assets				
Cash and cash equivalents	\$ 785	\$ -	\$ 34,399	\$ 35,184
Due from other funds	-	-	3,143	3,143
Due from primary government	-	-	359	359
Prepaid expenses	3,300	-	-	3,300
Total assets	\$ 4,085	\$ -	\$ 37,901	\$ 41,986
Liabilities				
Accounts payable	\$ -	\$ -	\$ 16,919	\$ 16,919
Accrued expenditures	440	-	-	440
Due to other funds	3,143	-	-	3,143
Due to primary government	1,650	-	154,322	155,972
Total liabilities	5,233	-	171,241	176,474
Fund balances (deficits)				
Unassigned	(1,148)	-	(133,340)	(134,488)
Total liabilities and fund balances	\$ 4,085	\$ -	\$ 37,901	\$ 41,986

CITY OF GAYLORD

Reconciliation

Fund Balances for Governmental Funds
to Net Assets of Governmental Activities
Downtown Development Authority Component Unit
June 30, 2012

Fund balances - total governmental funds \$ (134,488)

Amounts reported for the *component unit* in the statement of net assets
are different because:

Capital assets used in the component unit are not financial resources
and therefore are not reported in the fund statement.

Capital assets, net 617,797

Net assets of the component unit \$ 483,309

CITY OF GAYLORD

Combining Statement of Revenue, Expenditures and Changes in Fund Balances Downtown Development Authority Component Unit For the Year Ended June 30, 2012

	General Downtown	Pavilion Debt Retirement	TIF	Total
Revenues				
Taxes and penalties	\$ 31,291	\$ -	\$ 177,633	\$ 208,924
Federal revenue	-	-	570,000	570,000
Contributions	-	51,626	-	51,626
Interest	12	1	558	571
Miscellaneous	640	-	124,543	125,183
Total revenues	31,943	51,627	872,734	956,304
Expenditures				
Current:				
Culture and recreation	31,281	-	884,316	915,597
Revenues over (under) expenditures	662	51,627	(11,582)	40,707
Other financing sources (uses)				
Transfers in	-	-	24,304	24,304
Transfers out	-	(24,304)	-	(24,304)
Total other financing sources (uses)	-	(24,304)	24,304	-
Change in fund balances	662	27,323	12,722	40,707
Fund balances (deficit), beginning of year	(1,810)	(27,323)	(146,062)	(175,195)
Fund balances (deficits), end of year	\$ (1,148)	\$ -	\$ (133,340)	\$ (134,488)

CITY OF GAYLORD

Reconciliation

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

Net change in fund balances - component unit \$ 40,707

Amounts reported for the *component unit* in the statement of activities
are different because:

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

Capital outlay	189,373
Depreciation expense	<u>(21,226)</u>

Change in net assets of component unit \$ 208,854

SINGLE AUDIT ACT COMPLIANCE

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

December 7, 2012

Members of the City Council
City of Gaylord
Gaylord, Michigan

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component unit, each major fund, and the aggregate remaining fund information of the *City of Gaylord, Michigan*, (the "City") as of and for the year ended June 30, 2012, which collectively comprise the basic financial statements, and have issued our report thereon dated December 7, 2012. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.



CITY OF GAYLORD

Schedule of Expenditures of Federal Awards For the Year Ended June 30, 2012

Federal Agency / Cluster / Program Title	CFDA Number	Passed Through	Pass-through / Grantor Number	Federal Expenditures
U.S. Department of Agriculture - Rural Development Community Facilities Loan and Grant Program	10.766	Direct	N/A	<u>\$ 12,000</u>
U.S. Department of Housing and Urban Development Community Development Block Grant/Entitlement Grant Cluster:				
Community Development Block Grant	14.228	MSF	MSC 210056-CDF	400,000
Community Development Block Grant	14.228	MSF	MSC 210014-FMK	<u>170,000</u>
Total U.S. Department of Housing and Urban Development				<u>570,000</u>
Total Expenditures of Federal Awards				<u><u>\$ 582,000</u></u>

See notes to schedule of expenditures of federal awards.

CITY OF GAYLORD

Notes to Schedule of Expenditures of Federal Awards

1. BASIS OF PRESENTATION

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

3. PASS-THROUGH AGENCIES

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

Pass-through Agency Abbreviation	Pass-through Agency Name
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MSF	Michigan Strategic Fund
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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

December 7, 2012

City Council
City of Gaylord
Gaylord, Michigan

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the *City of Gaylord* (the "City"), as of and for the year ended June 30, 2012, which collectively comprise the basic financial statements of the City, and have issued our report thereon dated December 7, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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 City's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as 2012-FS-1 and 2012-FS-2 to be material weaknesses.

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. We consider the deficiency described in the accompanying schedule of findings and questions costs as 2012-FS-3 to be a significant deficiency.

Compliance and Other Matters

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

We noted certain other matters that we reported to management of the City in a separate letter dated December 7, 2012.

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

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



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

December 7, 2012

City Council
City of Gaylord
Gaylord, Michigan

Compliance

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

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

In our opinion, the City complied, in all material respects, with the requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2012.

Internal Control Over Compliance

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

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

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

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

CITY OF GAYLORD

Schedule of Findings and Questioned Costs For the Year Ended June 30, 2012

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

Material weakness(es) identified? X yes no

Significant deficiency(ies) identified? X yes none reported

Noncompliance material to financial statements noted? yes X no

Federal Awards

Internal control over major programs:

Material weakness(es) identified? yes X no

Significant deficiency(ies) identified? yes X none reported

Type of auditors' report issued on compliance for major programs: Unqualified

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

Identification of major programs:

CFDA Number

Name of Federal Program or Cluster

14.228

Community Development Block Grants

Dollar threshold used to distinguish between Type A and Type B programs:

\$ 300,000

Auditee qualified as low-risk auditee?

yes X no

CITY OF GAYLORD

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2012

SECTION II - FINANCIAL STATEMENT FINDINGS

2012-FS-1 - Management is unable to produce financial statements, including budgets, in accordance with accounting principles generally accepted in the United States of America.

Finding Type. Material Weakness in Internal Control over Financial Reporting.

Criteria. All governmental units are required to prepare financial statements in accordance with generally accepted accounting principles ("GAAP") and adopt budgets in accordance with State law. This is a responsibility of the City's management. The preparation of financial statements and budgets in accordance with GAAP and State law 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 City 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 City's ability to prepare financial statements in accordance with GAAP is based, in part, on its reliance on its external auditors, who cannot by definition be considered a part of the City's internal controls.

Cause. This condition was caused by the City'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 City to perform this task internally.

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

Recommendation. The City's decision to rely, in part, on its auditors, for the preparation of external financial statements is allowable provided that it is disclosed as part of the report on internal control and compliance in accordance with *Government Auditing Standards*. However, management should actively seek ways to further strengthen its internal controls by requiring as much as possible independent review, reconciliation, and approval of accounting transactions by members of management or the City Council to ensure accounting records are accurate throughout the year to assist the City with improved financial management.

View of Responsible Officials. The City has evaluated the cost vs. benefit of establishing internal controls over the preparation of financial statements in accordance with GAAP, and determined that it is in the best interests of the City 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.

CITY OF GAYLORD

Schedule of Findings and Questioned Costs For the Year Ended June 30, 2012

SECTION II - FINANCIAL STATEMENT FINDINGS

2012-FS-2 - Recording, processing and summarizing accounting data

Finding Type. Material Weakness in Internal Control over Financial Reporting.

Criteria. All governmental units are required to have in place internal controls over recording, processing, and summarizing accounting data (i.e., maintaining internal books and records).

Condition. As is the case with many smaller and medium-sized entities, the City has historically relied on its independent external auditors to assist in the recording, processing and summarizing of certain accounting data as part of its external financial reporting process. Accordingly, the City has placed reliance on its external auditors, who cannot by definition be considered a part of the City's internal controls.

Cause. This condition was caused by the City's decision that it is more cost effective to have the external auditors recommend the necessary adjusting journal entries to its general ledger than to incur the time and expense of obtaining the necessary training and expertise required for the City to perform this task internally.

Effect: As a result of this condition, the City lacks internal controls over the recording, processing, and summarizing of accounting data, and instead relies, in part, on its external auditors for assistance with this task.

Recommendation. The City should record all journal entries necessary to arrive at a reasonably adjusted trial balance prior to generating trial balances to be used for preparation of year-end financial statements.

View of Responsible Officials. The City will continue its efforts to record all known adjustments in order to provide a reasonably adjusted trial balance for the purposes of audit.

CITY OF GAYLORD

Schedule of Findings and Questioned Costs For the Year Ended June 30, 2012

SECTION II - FINANCIAL STATEMENT FINDINGS

2012-FS-3 - Lack of segregation of duties in the accounting function

Finding Type. Significant Deficiency in Internal Control over Financial Reporting.

Criteria. All governments are required to establish an internal control structure with segregation of responsibilities necessary to prevent a misappropriation of assets or fraudulent financial reporting. This is a responsibility of the City's management. Adequate segregation of duties as it relates to the cash cycle of a municipality requires separation of the management function, the custody of assets function and the accounting function.

Condition. The small size of the City's accounting staff does not allow for adequate separation of duties. Certain members of the accounting department are responsible for the custody of assets as well as for the accounting for those assets in the area of cash receipts and cash disbursements. Further, certain employees holding management positions also collect or disburse cash or account for the transactions of the City.

Cause. As is the case with many organizations of similar size, the City lacks a sufficient number of accounting personnel in order to ensure a complete segregation of duties within the accounting function.

Effect. As a result of this condition, the City's current system of internal control has no safeguards in place to ensure that fraud or abuse is being prevented, specifically in the transactions of the cash cycle. Ideally, no single individual should ever be able to authorize a transaction, record the transaction in the accounting records, and maintain custody of the assets resulting from the transaction. Effectively, proper segregation of duties is intended to prevent an individual from committing an act of fraud or abuse and being able to conceal it.

Recommendation. While there are, of course, no easy answers to the challenge of balancing the costs and benefits of internal controls and segregation of duties, we would nevertheless encourage management to actively seek ways to further strengthen its internal controls as much as possible by requiring as much independent review, reconciliation, and approval of accounting transactions by qualified members of management or the City Council.

View of Responsible Officials: To the extent possible, duties are allocated between accounting personnel to mitigate risk of material misappropriation of assets. In addition, the City Council assumes a higher level of oversight responsibilities to mitigate risks related to this lack of segregation of duties.

CITY OF GAYLORD

Schedule of Findings and Questioned Costs For the Year Ended June 30, 2012

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

No findings or questioned costs.

CITY OF GAYLORD

Summary Schedule of Prior Audit Findings

For the Year Ended June 30, 2012

Finding 2011-1 - Management is unable to produce financial statements in accordance with accounting principles generally accepted in the United States of America.

Finding was repeated during fiscal year 2012. Refer to Finding 2012-FS-1.

Finding 2011-2 - Recording, processing, and summarizing accounting data

Finding was repeated for unrelated audit adjustments. Refer to Finding 2012-FS-2.

Finding 2011-3 - Lack of segregation of duties exists in the accounting function due to the limited number of accounting personnel.

Finding was repeated during fiscal year 2012. Refer to Finding 2012-FS-3.

