Public Schools of the City of Ann Arbor, Michigan

Report to the Board of Education

Year Ended June 30, 2013

plante moran

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November 7, 2013

To the Board of Education
Public Schools of the City of Ann Arbor, Michigan
2555 S. State Street
Ann Arbor, MI 48104

We have recently completed our audit of the basic financial statements of the Public Schools of the City of Ann Arbor, Michigan (the "School District") as of and for the year ended June 30, 2013. In addition to our audit report, we are providing the following results of the audit, other recommendations, and informational items which impact the School District:

We are grateful for the opportunity to be of service to the Public Schools of the City of Ann Arbor, Michigan. We would also like to extend our thanks to Nancy Hoover and the entire business office for their assistance and preparedness during the audit. Should you have any questions regarding the comments in this report, please do not hesitate to call.

Plante & Moran, PLLC

cc: Jeanice Kerr Swift, Superintendent
Nancy Hoover, Director of Finance

Results of the Audit

plante moran

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Results of the Audit

November 7, 2013

To the Board of Education
Public Schools of the City of Ann Arbor, Michigan
454 South Harvey Street
Plymouth, MI 48107

We have audited the financial statements of the Public Schools of the City of Ann Arbor, Michigan (the "School District") as of and for the year ended June 30, 2013 and have issued our report thereon dated November 7, 2013. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated March 26, 2013, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities. Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement.

As part of our audit, we considered the internal control of the Public Schools of the City of Ann Arbor, Michigan. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

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

Our audit of the School District's financial statements has also been conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Under *Government Auditing Standards*, we are obligated to communicate certain matters that come to our attention related to our audit to those responsible for the governance of the School District, including compliance with certain provisions of laws, regulations, contracts, grant agreements, certain instances of error or fraud, illegal acts applicable to government agencies, and significant deficiencies in internal control that we identify during our audit. Toward this end, we issued a separate letter dated November 7, 2013 regarding our consideration of the School District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements.

To the Board of Education
Public Schools of the City of Ann Arbor, Michigan

November 7, 2013

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated in our discussion with the finance committee and in our letter to the Board of Education about audit scope and timing plans.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the School District are described in Note 1 to the financial statements. As discussed in Note 1 to the basic financial statements, effective July 1, 2012, the School District adopted the provisions of Governmental Accounting Standards Board Statement Nos. 62, 63, and 65. Our opinion is not modified with respect to this matter.

There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. We evaluated the key factors and assumptions used to develop management's estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

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

Difficulties Encountered in Performing the Audit

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

Disagreements with Management

For the purpose of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

To the Board of Education
Public Schools of the City of Ann Arbor, Michigan

November 7, 2013

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The attached schedules summarize uncorrected misstatements of the financial statements which were requested to be recorded. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated November 7, 2013.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the School District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

In the normal course of our professional association with the School District, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, business conditions affecting the School District, and business plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition of our retention as the School District's auditors.

As required by OMB Circular A-133, we have also completed an audit of the federal programs administered by the School District. The results of that audit are provided to the Board of Education in our report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133 dated November 7, 2013.

To the Board of Education
Public Schools of the City of Ann Arbor, Michigan

November 7, 2013

This information is intended solely for the use of the Board of Education and management of the Public Schools of the City of Ann Arbor, Michigan and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Plante & Moran, PLLC

Laura Claeys

Jennifer Chambers

To the Board of Education
Public Schools of the City of Ann Arbor, Michigan

November 7, 2013

Client: **Public Schools of the City of Ann Arbor, Michigan**
Opinion Unit: **Governmental Activities**
Y/E: **6/30/2013**

SUMMARY OF UNRECORDED POSSIBLE ADJUSTMENTS

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

Ref. #	Description of Misstatement	Current Assets	Long-term Assets	Current Liabilities	Long-term Liabilities	Equity	Revenue	Expenses	Net Income Statement Impact
FACTUAL MISSTATEMENTS:									
A1	To record invoice for services performed before June 30, 2013 not included in AP in the 2010 Sinking Fund			$ 409,648				$ 409,648	$ (409,648)
A2	To record prepaid expenses related to overpayment for self-insurance	$ 139,975						(139,975)	139,975
JUDGMENTAL ADJUSTMENTS:									
B1	Estimated July and August claims for 26 pay employees			1,522,574		$ (1,462,446)		60,128	(60,128)
PROJECTED ADJUSTMENTS:									
C1	None	-	$ -	-	$ -	-	$ -	-	-
	Total	$ 139,975	$ -	$ 1,932,222	$ -	$ (1,462,446)	$ -	$ 329,801	$ (329,801)
PASSED DISCLOSURES:									
D1	None								

To the Board of Education
Public Schools of the City of Ann Arbor, Michigan

November 7, 2013

Client: **Public Schools of the City of Ann Arbor, Michigan**
Opinion Unit: **General Fund**
Y/E: **6/30/2013**

SUMMARY OF UNRECORDED POSSIBLE ADJUSTMENTS

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

Ref. #	Description of Misstatement	Current Assets	Long-term Assets	Current Liabilities	Long-term Liabilities	Equity	Revenue	Expenses	Net Income Statement Impact
FACTUAL MISSTATEMENTS:									
A1	To record prepaid expenses related to overpayment for self-insurance	$ 139,975						$ (139,975)	$ 139,975
JUDGMENTAL ADJUSTMENTS:									
B1	Estimated July and August claims for 26 pay employees			$ 1,522,574		$ (1,462,446)		60,128	(60,128)
PROJECTED ADJUSTMENTS:									
C1	None								
		-	$ -	-	$ -	-	$ -	-	-
	Total	$ 139,975	$ -	$ 1,522,574	$ -	$ (1,462,446)	$ -	$ (79,847)	$ 79,847
PASSED DISCLOSURES:									
D1	None								

To the Board of Education
Public Schools of the City of Ann Arbor, Michigan

November 7, 2013

Client: **Public Schools of the City of Ann Arbor, Michigan**
Opinion Unit: **Aggregate Remaining Fund Information**
Y/E: **6/30/2013**

SUMMARY OF UNRECORDED POSSIBLE ADJUSTMENTS

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

Ref. #	Description of Misstatement	Current Assets	Long-term Assets	Current Liabilities	Long-term Liabilities	Equity	Revenue	Expenses	Net Income Statement Impact
FACTUAL MISSTATEMENTS:									
A1	To record invoice for services performed before June 30, 2013 not included in AP in the 2010 Sinking Fund			$ 409,648				$ 409,648	$ (409,648)
JUDGMENTAL ADJUSTMENTS:									
B1	None								
PROJECTED ADJUSTMENTS:									
C1	None								
		$ -	$ -	-	$ -	$ -	$ -	-	-
	Total	$ -	$ -	$ 409,648	$ -	$ -	$ -	$ 409,648	$ (409,648)
PASSED DISCLOSURES:									
D1	None								

Other Recommendations

Financial Statement and Internal Control Items

Fund Balance Deficits - Currently, there are fund balance deficits in the Food Service Fund, 2004 Bond Refunded Debt Payment Fund, and 2012 Bond Debt Payment Fund. The School District has made significant efforts over the past few years to reduce the Food Service Fund deficit and we commend them for these efforts. The deficit in the debt service funds should be reviewed to ensure that the proper mills are being levied. If deficits continue to arise, the School District should look to increase their debt mills.

Change Orders - It was noting during testing that change orders relating to capital projects are not approved by the Board of Education. The School District should implement a policy to ensure that all change orders for current capital projects are being approved by the Board of Education prior to being implemented.

Capital Assets - It was noted that the School District removes assets from their fixed asset schedules when those assets become fully depreciated, regardless if they are still in use or not. It was also noted that they do not utilize a construction in progress tracking system for projects that are completed over time; instead, invoices are capitalized when payments are made. We recommend that the School District review its capital asset policies so that fixed asset schedules in the financial statements properly reflect assets that are still on hand at the end of the period and that depreciation is not recorded on assets that have not yet been placed into service.

Student Activities Fund - It was noted that Athletics and the Student Activities Funds share a single bank account which results in interfund borrowings and transfers. We recommend that the School District consider opening a bank account for the Student Activities Fund to ensure that cash activity is recorded in the proper fund and to eliminate interfund borrowings and transfers.

Arbitrage - Arbitrage is not calculated by the School District. The School District should discuss with bond counsel as to whether an arbitrage calculation should be performed on an annual basis.

Investments - During the audit, it was noted that the School District's cash is currently invested in low-interest earning accounts. We recommend that the School District review its investment portfolio and consider investing some of this cash in higher-yield investments that are still in compliance with the State and Board of Education guidelines as long as longer-term investments do not impair cash flow needs.

Federal Program Related Items

Retention of Documentation - As described in 34 CFR Part 80, records of federal grantees must be retained and available for timely access for a minimum of three years. We encourage the School District to review its process for records retention to ensure that federal grant records are retained and easily accessible.

Fiscal Monitoring - The Michigan Department of Education (MDE) continues to focus on the grants fiscal monitoring process. This process focuses on the financial aspects of grants management with an emphasis on control procedures assessments in the key compliance areas of the grant. These actions continue as part of the increased federal emphasis for pass-through entities (the State of Michigan) to improve their monitoring efforts. To assist districts in their compliance efforts, the State has issued a self-evaluation checklist which will allow districts to identify areas which may require additional attention. In addition, the MDE has developed sample written compliance procedures for districts to consider when improving the quality of documentation maintained by the district. We highly recommend the School District obtain the checklist and the sample procedures (located on the MDE website) and self-assess their processes and documentation against the types of items the MDE is focused upon.

Written Procedures for Grants - The MDE continues to emphasize the importance of maintaining adequate written procedures for grants. Additionally, the MDE has added example procedures to the Office of Audits website for reference. These requirements are described in 34 CFR Part 80, 2 CFR Part 215, and OMB Circular A-133 Compliance Supplement Part 6. We encourage the School District to review its written procedures for grants to ensure that they adhere to the guidance provided by the Department of Education.

Special Education Excess Cost Determination - "Excess costs" are those costs incurred for the education of an elementary school or secondary school student with a disability that are in excess of the average annual per student expenditure in a school district during the preceding school year. School districts are required to compute the minimum average amount of per-pupil expenditure separately for children with disabilities in its elementary schools and for children with disabilities in its secondary schools, and not on a combination of the enrollments in both. The Michigan Department of Education continues to work on a tool which would assist districts in computing the minimum average amount. Once this tool is finalized, the MDE will provide additional guidance and the district will be required to show compliance. It is important the School District be aware of this requirement and be prepared to demonstrate compliance for fiscal year 2013-2014.

Informational Items

Redefining State Aid and the Foundation Allowance

The fiscal year ended June 30, 2013 was the second year under a redefined funding approach for Michigan schools. While the foundation allowance concept continues, changes in the funding strategy significantly impacted your School District's 2012-2013 funding level and, with some modifications, those changes carry forward into 2013-2014. The three changes are a permanent reduction of the School District's foundation allowance, use of an incentive payment concept (best practice and student performance), and an additional categorical to aid in paying for the significantly increased cost of the retirement system (MPSERS).

- **Foundation** - After receiving a per-pupil foundation reduction of $470 in 2011-2012, for the 2012-2013 fiscal year, the School District's foundation allowance continued at $9,020. The net impact of the foundation allowance reduction was that the School District's 2012-2013 foundation allowance was 5 percent lower than the foundation allowance in place for the fiscal year ended June 30, 2011. For the 2013-2014 fiscal year, the base foundation increases by $30, from $9,020 to $9,050.

- **Best Practice** - The governor identified many educational initiatives shortly after taking office. One key initiative was the concept of encouraging best practices. This concept was built into the State Aid Act for the first time in 2011-2012. This concept continued into 2012-2013 and 2013-2014. For 2012-2013, the concept of funding best practices included new initiative criteria listed in the State Aid Act. The amount provided $52 per pupil in 2012-2013 and 2013-2014. To qualify for this incentive, the School District is required to meet seven of eight identified best practice initiatives. These incentives are not guaranteed past the 2013-2014 year. A new best practice item has been added to include the addition of new items to a district's dashboard requesting revenue and expenditure projections for 2014-2015, a list of all debt service obligations by project, anticipated payments for fiscal year 2013-2014, and total outstanding debt. Your School District qualified for the $52 per pupil in 2012-2013, and this amounted to $867,446.

- **MPSERS Cost Support** - The contribution rate the School District is required to pay has continued to rise. The School District has no ability to influence the rate and no choice regarding its participation in the program. Recognizing the costs are increasing under the current system, the 2012-2013 State Aid Act continued to include funding to help pay for some of the increased cost. The categorical aid is formula driven using the School District's MPSERS payroll participation data. The School District received $2,357,734 in categorical aid to help offset the impact of the increase in the retirement costs under what is termed Section 147a categorical funding. The 2013-2014 State Aid Act continues this MPSERS cost support categorical, but at a lower level. In addition, near the end of the 2012-2013 fiscal year, the State determined that additional support the State was paying into the retirement system would now be distributed to the School District via their state aid status report, and then remitted by the School District, in the exact same amount, to the Office of Retirement Services. This is termed the Section 147c categorical funding and represented $2,233,194 in funding. This payment represents approximately 4 percent of covered payroll and does not increase School District resources. Instead, the funding is recognized as revenue and then returned directly to the retirement system. In general terms, this means that the total cost of the retirement system contributions, representing approximately 29 percent of covered payroll, is recognized as an expenditure in the School District's financial statements along with related revenue that was previously considered State support to the system. The net effect is that the School District is responsible for an approximate 25 percent contribution to the retirement system. This retirement funding approach continues into 2013-2014. The School District budgeted for additional State revenue and additional retirement expenditures in order to accommodate this funding mechanism.

Other State Aid Act Changes Impacting 2013-2014

The amendments to the State Aid Act made several other changes impacting school districts. Several changes we identified that could impact the School District include:

Pupil Count Weighting - District membership blend will be based on a 90/10 split. The funding will be based on 90 percent of the October pupil count and 10 percent of the following February pupil count. This means when the initial fiscal year budget is prepared, 100 percent of student counts and, therefore, foundation revenue is not known, since the February count will not yet have occurred. In addition, for the first time, if a student moves to another school district after the count date, the receiving district can claim a pro-rata share of the count with the "sending" district having a like reduction. The tracking of students has become exponentially more complex and now involves reporting and coordination through the Intermediate School District and the State of Michigan.

Great Start Readiness Program - Funding has increased substantially to allow for program expansion. The funding per half-day slot increased from $3,400 to $3,625. A minimum of 90 percent of the participation must come from families with incomes under 250 percent of the poverty level. The funds are provided to the district through the Intermediate School District.

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, which will be effective for the School District's June 30, 2015 financial statements. Statement No. 68 requires governments providing defined benefit pensions to recognize their unfunded pension benefit obligation as a liability for the first time and to more comprehensively and comparably measure the annual costs of pension benefits. Due to the School District's participation in the Michigan Public School Employees' Retirement System (MPSERS), the School District will be required to report the difference between the School District's share of the MPSERS pension plan net assets and the pension obligation liability as an asset or liability in the basic financial statements (at the government-wide level and in proprietary funds - but not in governmental funds). This will be called the "net pension liability" or "net pension asset." The data required to record this liability will come from the retirement system. Changes in the net pension liability will generally be reported as pension expense at the government-wide level and in proprietary funds. Currently, the unfunded liability associated with retiree health care is not included in the computation, but may be added in the future. The statement also enhances accountability and transparency through revised note disclosures and required supplemental information (RSI).

Fund Balance

During the 2012-2013 fiscal year, the School District faced continued financial challenges due to declining enrollment, no federal stimulus dollars, and inflationary cost pressures. The outlook for 2013-2014 and beyond suggests future funding increases are unlikely. This continues to put substantial pressure on the School District's operating budgets and fund equity.

During the 2012-2013 school year, the School District's General Fund expenditures exceeded revenue by approximately $7,000,000. This resulted in reducing the General Fund equity to approximately $9,500,000 at June 30, 2013, or 4.8 percent of annual expenditures. We feel that it is important for the School District to maintain its fund equity at an appropriate level. The benefit to the School District of maintaining appropriate fund equity is the ability to meet unforeseen circumstances, like the implementation of State Aid proration, without significantly affecting the level of programs for the year. This gives the School District time to work out financial changes without the need for sudden or drastic reactions to adverse circumstances. The need for fund equity will continue to be important due to the funding caps imposed by school finance reform, rising pension costs, continuing concerns over the financial health of the School Aid Fund, and continued cash flow concerns due to the receipt of over 18 percent of the School District's state aid after the school year has ended.

Fund balance goals are often stated in terms of a percentage of total expenditures. As a point of reference, the statewide average for school districts at June 30, 2012 (excluding Detroit) is approximately 11 percent of expenditures. Fund equity of 4.8 percent of expenditures would approximately equal the School District's average expenses for a three-week period.