

Arenac County Road Commission

(A Component Unit of Arenac County, Michigan)

Standish, Michigan

Financial Statements

For the Year Ended December 31, 2020



SMITH & KLACZKIEWICZ, PC
CERTIFIED PUBLIC ACCOUNTANTS

Arenac County Road Commission

(A Component Unit of Arenac County)

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SMITH & KLACZKIEWICZ, PC
CERTIFIED PUBLIC ACCOUNTANTS

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A VETERAN OWNED BUSINESS

Independent Auditor's Report

To the Board of County Road Commissioners
Arenac County
Standish, Michigan

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and the major fund of the *Arenac County Road Commission*, a component unit of Arenac County, Michigan, as of and for the year ended December 31, 2020, and the related notes to the financial statements, which collectively comprise the Road Commission's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the major fund of the *Arenac County Road Commission*, as of December 31, 2020, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis (pages 3 through 9), budgetary comparison information (pages 27 and 28), schedule of changes in net pension liability and related ratios (page 29), schedule of employer's net pension liability (page 30) and the schedule of employer contributions (page 31) be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the ***Arenac County Road Commission's*** basic financial statements. The other supplementary information schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the other supplementary information schedules are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 27, 2021, on our consideration of the ***Arenac County Road Commission's*** control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ***Arenac County Road Commission's*** internal control over financial reporting and compliance.

Smith + Klaushewitz PC

Saginaw, Michigan

April 27, 2021

MANAGEMENT'S DISCUSSION AND ANALYSIS

Arenac County Road Commission

Management's Discussion and Analysis

Our discussion and analysis of *Arenac County Road Commission's* financial performance provides an overview of the Road Commission's financial activities for the year ended December 31, 2020. The annual report consists of a series of financial statements. The Statement of Net Position and the Statement of Activities provide information about the activities of the Road Commission and present a long-term view of the Road Commission's finances. Fund financial statements tell how these services were financed in the short-term, as well as what remains for future spending. Fund financial statements also report the Road Commission's operations in more detail than the government-wide financial statements.

Overview of the Financial Statements

This annual report consists of three parts – management's discussion and analysis (this section), the basic financial statements and an additional section that presents the operating fund broken down between primary, local and county road funds. The basic financial statements include two kinds of statements that present different views of the Road Commission:

- The first two statements are government-wide financial statements that provide both long-term and short-term information about the Road Commission's overall financial status. These statements report information about the Road Commission as a whole using accounting methods similar to those used by private-sector companies. The Statement of Net Position includes all of the Road Commission's assets and liabilities. All of the current year's revenues and expenses are accounted for in the Statement of Activities regardless of when cash is received or paid. The two government-wide statements report the Road Commission's net position and how they have changed. "Net Position" is the difference between the assets and liabilities – this is one way to measure the Road Commission's financial health or position.
- The remaining statements are fund financial statements that focus on the General Operating / Road Fund, reporting the operations in more detail than the government-wide statements.

It should be noted that the Arenac County government-wide financial statements are not herein presented because the Road Commission is a component unit of the County. The County presents its financial statements elsewhere and, in a manner, partially resembling private-sector business in its government-wide financial statements, in compliance with GASB Statement No. 34.

Government-wide Financial Statements

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

The *Statement of Activities* presents information showing how the Road Commission's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related* cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in past or future fiscal periods (for instance, depreciation expense associated with capital assets).

Arenac County Road Commission

Management's Discussion and Analysis

The component unit financial statements are principally supported by gas and weight taxes (operating grants) and State and Federal pass-through funding (capital grants). The governmental activities of the Road Commission include providing construction, repair, maintenance and snow removal on roads within Arenac County.

The government-wide financial statements include only the Road Commission itself. The Road Commission has no legally separate component units for which the Road Commission is financially accountable. In this report, financial information for the Road Commission is reported separately from the financial information presented for Arenac County, which reports the Road Commission as a component unit.

The government-wide financial statements can be found on pages 10 and 12 of this report.

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 Road Commission, like other units of State and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The activity of the Road Commission is accounted for in a governmental fund (General Operating / Road Fund).

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

Because the focus of the General Operating / Road Fund is narrower than that of the government-wide financial statements, it is useful to compare the information presented for the General Operating / Road Fund with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the General Operating / Road Fund Balance Sheet and the General Operating / Road Fund Statement of Revenues, Expenditures and Changes in Fund Balances provide a reconciliation to facilitate this comparison between the General Operating / Road Fund and the government-wide statements.

The Road Commission maintains one governmental fund (the General Operating / Road Fund). Information is presented in the General Operating / Road Fund Balance Sheet and in the General Operating / Road Fund Statement of Revenues, Expenditures and Changes in Fund Balances for the Road Commission. The General Operating / Road Fund is a major fund for financial reporting purposes as defined by GASB Statement No. 34.

The Road Commission adopts an annual appropriated budget for its General Operating / Road Fund. A budgetary comparison statement has been provided herein to demonstrate compliance with that budget.

Arenac County Road Commission

Management's Discussion and Analysis

The Schedules of Revenues, Expenditures and Changes in Fund Balance – Budget and Actual for the General Operating / Road Fund can be found on pages 27 and 28 of this report.

The Road Commission does not maintain proprietary nor fiduciary funds.

Notes to the financial statements: The notes provide additional information that is essential to a full understanding of the data provided in the Road Commission's financial statements. The notes to the financial statements can be found on pages 14 through 26 of this report.

Other information: In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information*. This is limited to this management discussion and analysis, budgetary comparison schedules and schedule of changes in net pension liability and related ratios and schedule of employer contributions related to the defined benefit pension plan. The schedule of funding progress follows after the notes to the financial statements and presents multiyear trend information about whether the actuarial value of plan assets are increasing over time relative to the actuarial accrued liability for benefits.

Government-wide Financial Analysis

The Road Commission's net position increased approximately 13% or \$3,054,658, from \$23,846,501 to \$26,901,159 during the year. The net position and change in net position are summarized as follows:

	<u>2020</u>	<u>2019</u>
Current and other assets	\$ 4,326,573	\$ 3,273,481
Capital assets, net	<u>27,024,385</u>	<u>24,931,387</u>
Total assets	<u>31,350,958</u>	<u>28,204,868</u>
Deferred outflows of resources	<u>739,293</u>	<u>741,241</u>
Current liabilities	550,471	388,537
Long-term liabilities	<u>4,132,662</u>	<u>4,219,244</u>
Total liabilities	<u>4,683,133</u>	<u>4,607,781</u>
Deferred inflows	<u>505,959</u>	<u>491,827</u>
Net position:		
Net investment in capital assets	27,024,385	24,931,387
Unrestricted (deficit)	<u>(123,226)</u>	<u>(1,084,886)</u>
Total net position	<u>\$ 26,901,159</u>	<u>\$ 23,846,501</u>

As noted earlier, net position may serve over time as a useful indicator of the Road Commission's financial position. In the case of the Road Commission, assets and deferred outflows of resources exceeded liabilities and deferred inflows by \$26,901,159 at the close of the year.

Arenac County Road Commission
Management's Discussion and Analysis

Governmental Activities

Following is a summary of changes in net position for the current and prior year:

	2020	2019
Program revenue		
Charges for services	\$ 2,235,622	\$ 1,797,266
Operating grants and contributions	4,338,798	4,352,470
Capital grants and contributions	1,132,765	531,384
General revenue	521,734	690,662
Total revenue	8,228,919	7,371,782
 Expenses		
Public works	5,174,261	4,774,348
 Increase (decrease) in net position	 \$ 3,054,658	 \$ 2,597,434

Governmental activities increased the Road Commission's net position by \$3,054,658. The key elements of this increase are as follows:

- There was a modest increase in revenue from charges for services from the prior year, due mainly to increased charges for non-recurring revenue for road maintenance projects.
- Revenue from State transportation funds remained relatively consistent with the prior year and is derived from gas taxes distributed through MDOT.
- Revenue from capital grants and contributions experienced an increase from the prior year, due to increased activity from non-recurring road and bridge projects funded with grants and contributions, as compared to the prior year.
- Non-recurring revenue from the sale of property and equipment owned by the Road Commission in the prior year resulted in decreased general revenue.
- There was an increase in public works expenses in the current year, due mainly to changes in activity for non-recurring maintenance projects as compared to the prior year.
- Purchases / construction of capital assets were greater than disposals of capital assets and depreciation expense, resulting in an increase in net position invested in capital assets.

Arenac County Road Commission
Management's Discussion and Analysis

A summary of changes in the General Operating / Road Fund is as follows:

	Final Budget	Actual	Over (Under) Budget	Actual for the Year Ended December 31, 2019
Revenues				
Property taxes	\$ 505,959	\$ 505,939	\$ (20)	\$ 491,827
Licenses and permits	10,300	10,300	-	10,850
Federal sources	1,040,278	383,476	(656,802)	287,867
State sources	4,065,000	4,057,487	(7,513)	4,048,019
Contributions	996,793	988,647	(8,146)	1,224,251
Charges for services	1,316,656	1,333,034	16,378	807,429
Interest and rentals	10,000	11,264	1,264	23,777
Sale of federal aid	281,311	281,311	-	304,451
Proceeds from sale of capital assets	-	-	-	172,746
Other	-	-	-	565
Total revenue	<u>8,226,297</u>	<u>7,571,458</u>	<u>(654,839)</u>	<u>7,371,782</u>
Expenditures				
Primary road maintenance	2,731,181	2,682,664	(48,517)	3,504,810
Local road maintenance	2,532,753	2,489,281	(43,472)	2,711,117
State trunkline maintenance	1,250,741	1,268,774	18,033	684,164
Equipment (net)	46,976	92,949	45,973	134,034
Administrative (net)	391,000	374,245	(16,755)	387,029
Capital outlay (net)	570,664	434,567	(136,097)	(2,081)
Other	10,000	9,413	(587)	14,972
Total expenditures	<u>7,533,315</u>	<u>7,351,893</u>	<u>(181,422)</u>	<u>7,434,045</u>
Net change in fund balance	692,982	219,565	(473,417)	(62,263)
Fund balance, beginning of year	<u>2,393,117</u>	<u>2,393,117</u>	<u>-</u>	<u>2,455,380</u>
Fund balance, end of year	<u>\$3,086,099</u>	<u>\$2,612,682</u>	<u>\$ (473,417)</u>	<u>\$ 2,393,117</u>

General Operating / Road Fund Budgetary Highlights

Prior to the beginning of the year, the Road Commission's budget is compiled based upon certain assumptions and facts available at that time. During the year, the Road Commission Board acts to amend its budget to reflect changes in these original assumptions, facts and / or economic conditions that were unknown at the time the original budget was compiled. In addition, by policy, the Board reviews and authorizes large expenditures when requested throughout the year.

The final amended revenue budget was \$1,501,123 more than the original budget primarily due to changes in projections for revenue from Federal sources, State sources, local contributions and trunkline maintenance. The actual revenue recognized was \$654,839 less than the final amended budget, due mainly to Federal reimbursement of costs from flood damage being delayed to 2021.

Arenac County Road Commission

Management's Discussion and Analysis

The final amended expenditure budget was \$667,812 more than the original budget primarily due to changes in projections for preservation and maintenance expenditures, State trunkline maintenance, net equipment expenditures, administrative and capital outlay. The actual expenditures were \$181,422 less than the final amended budget. There were variances in several expenditure line items, as presented on page 28, due mainly to the final allocation of distributive expenditures and lower than anticipated expenditures for net capital outlay costs.

Capital Assets and Debt Administration

Capital Assets

At year-end, the Road Commission had a net investment in capital assets of \$27,024,385. This amount represents a net increase (including additions and disposals) of \$2,092,998 or 8% from the prior year, as follows:

	<u>2020</u>	<u>2019</u>
Capital assets not being depreciated	\$ 937,975	\$ 588,166
Capital assets being depreciated		
Buildings and improvements	1,462,768	1,260,427
Equipment	5,000,737	4,428,827
Infrastructure	<u>35,903,180</u>	<u>33,557,595</u>
Subtotal	<u>42,366,685</u>	<u>39,246,849</u>
Total capital assets	43,304,660	39,835,015
Total accumulated depreciation	<u>(16,280,275)</u>	<u>(14,903,628)</u>
Total net capital assets	<u>\$ 27,024,385</u>	<u>\$ 24,931,387</u>

Capital asset activity during the year included the following:

Various resurfacing of roads and bridges	\$ 2,910,544
Land improvements	513,874
Purchases of capital assets	729,914
Disposals, net	2,146
Depreciation expense	<u>(2,063,480)</u>
Net change	<u>\$ 2,092,998</u>

Additional information about the Road Commission's capital assets can be found in Note C on page 20.

Long-term Debt

At year-end, the Arenac County Road Commission's long-term obligations consisted of accrued compensated absences and a net pension liability. Major long-term debt activity for the year included normal changes in the liability for accrued compensated absences and the presentation of a net pension liability in accordance with GASB No. 68. More detailed information about the Road Commission's long-term liabilities is presented in the notes to the financial statements.

Arenac County Road Commission

Management's Discussion and Analysis

Economic Factors and Next Year's Budgets and Rates

The Board of County Road Commissioners considered many factors when setting the fiscal year 2021 budget. A key factor that was used in the development of the 2021 budget was the number of projects to be completed and Township contributions to be received toward the projects under the Arenac County Road Commission cost-share program with Townships and others. Another key factor is the economy. During 2020, the Road Commission derived 57% of its revenue from gas and fuel taxes collected. Michigan Transportation Funds were expected to increase next year due to 2016 State legislation that phased-in increases to the gas and fuel tax. The Road Commission adopted a balanced budget for 2021 that reflected this new legislation.

The adopted budget for 2021 was balanced by budgeting the use of available fund balance in the amount of \$319,941 (3.8% of total budget). The Covid-19 pandemic put significant strain on the Arenac County Road Commission's 2020 and 2021 budget. A five-hundred-year flood in May of 2020 also drastically changed the intended budget priorities of the Road Commission for 2020 and 2021. One-time flood damage reimbursements from FEMA, FHWA and the State of Michigan should materially increase Arenac County Road Commission's revenue in 2021.

The Board realizes, and the reader should understand, that there are not sufficient funds available to repair and/or rebuild every road and bridge in Arenac County's transportation system. Therefore, the Board attempts to spend the public's money wisely and equitably, and in the best interest of the motoring public and the citizens of Arenac County.

Requests for Information

This financial report is designed to provide a general overview of the Road Commission's finances for all those with an interest in the component unit's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Clerk, Arenac County Road Commission; 4271 Airpark Drive, Standish, Michigan 48658.



BASIC FINANCIAL STATEMENTS

Arenac County Road Commission

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

December 31, 2020

	General Operating / Road Fund	Adjustments	Statement of Net Position
Assets			
Cash and cash equivalents	\$ 1,902,304	\$ -	\$ 1,902,304
Receivables			
Property taxes receivable	505,959	-	505,959
Due from other governmental units	1,616,630	-	1,616,630
Inventories			
Equipment material and parts	118,901	-	118,901
Road materials	161,658	-	161,658
Prepaid items	21,121	-	21,121
Capital assets, net			
Assets not being depreciated	-	937,975	937,975
Assets being depreciated	-	26,086,410	26,086,410
Total assets	4,326,573	27,024,385	31,350,958
Deferred outflows of resources - related to the net pension liability	-	739,293	739,293
Total assets and deferred inflows	\$ 4,326,573	27,763,678	32,090,251
Liabilities			
Accounts payable	\$ 67,664	-	67,664
Accrued liabilities	40,540	-	40,540
Advances			
State trunkline equipment	121,934	-	121,934
State trunkline maintenance	53,634	-	53,634
Unearned revenue	266,699	-	266,699
Noncurrent liabilities			
Net pension liability	-	4,064,628	4,064,628
Accrued compensated absences	-	68,034	68,034
Total liabilities	550,471	4,132,662	4,683,133
Deferred inflows of resources			
Property taxes receivable	505,959	-	505,959
Flood disaster relief receivable - unavailable	657,461	(657,461)	-
Total deferred inflows of resources	1,163,420	(657,461)	505,959
Fund Balance / Net Position			
Fund balance			
Nonspendable			
Inventory	280,559	(280,559)	-
Prepaid items	21,121	(21,121)	-
Assigned for subsequent year's budget	319,941	(319,941)	-
Restricted for road system	1,991,061	(1,991,061)	-
Total fund balance	2,612,682	(2,612,682)	-
Total liabilities, deferred inflows and fund balance	\$ 4,326,573		
Net Position:			
Net investment in capital assets		27,024,385	27,024,385
Unrestricted (deficit)		(123,226)	(123,226)
Total net position		\$ 26,901,159	\$ 26,901,159

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

Arenac County Road Commission

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

December 31, 2020

Fund balances - General Operating / Road Fund	\$	2,612,682
Amounts reported for <i>governmental activities</i> in the Statement of Net Position are different because:		
Deferred inflows related to revenue that is earned but unavailable are not reported in the fund General Operating / Road Fund because they are not a current economic resource. However, they are recognized as revenue in the governmental activities		657,461
Capital assets used in governmental activities are not financial resources and therefore are not reported in the General Operating / Road Fund		
Add - land and improvements		936,302
Add - construction in progress		1,673
Add - buildings, property and equipment		6,463,505
Add - infrastructure		35,903,180
Deduct - accumulated depreciation		(16,280,275)
Certain pension-related amounts such as the net pension liability and deferred amounts are not due and payable in the current period or do not represent current financial resources and therefore are not reported in the fund financial statements		
Deferred outflows related to the net pension liability		739,293
Net pension liability		(4,064,628)
Long-term accrued compensated absences are not due and payable in the current period and therefore are not reported in the General Operating / Road Fund		(68,034)
Net position of governmental activities	\$	<u>26,901,159</u>

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

Arenac County Road Commission

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

For the Year Ended December 31, 2020

	General Operating / Road Fund	Adjustments	Statement of Activities
Expenditures/expenses			
Public works	\$ 3,195,415	\$ 1,978,846	\$ 5,174,261
Capital outlay	4,156,478	(4,156,478)	-
Total expenditures/expenses	7,351,893	(2,177,632)	5,174,261
Program revenue			
Charges for services	2,235,622	-	2,235,622
Operating grants and contributions			
State transportation and other funds	4,338,798	-	4,338,798
Capital grants and contributions			
Federal sources	383,476	563,549	947,025
Local sources	91,828	93,912	185,740
Total program revenue	7,049,724	-	7,707,185
Net program revenue			2,532,924
General revenue			
Property taxes	505,939	-	505,939
Salvage sales	4,531	-	4,531
Interest and rents	11,264	-	11,264
Total general revenue	521,734	-	521,734
Total revenue	7,571,458		
Revenue over (under) expenditures	219,565	(219,565)	-
Changes in net position	-	2,397,197	3,054,658
Fund balance / net position:			
Beginning of the year	2,393,117	21,453,384	23,846,501
End of the year	\$ 2,612,682	\$ 23,631,016	\$ 26,901,159

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

Arenac County Road Commission

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

For the Year Ended December 31, 2020

Change in fund balance - General Operating / Road Fund	\$ 219,565
Amounts reported for <i>governmental activities</i> in the Statement of Activities are different because:	
Deferred inflows related to revenue that is earned but unavailable are not reported in the General Operating / Road Fund because they are not a current economic resource. However, they are recognized as revenue in the governmental activities	657,461
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	
Add - capital outlay	729,914
Add - infrastructure purchases	3,424,418
Deduct - depreciation expense	(2,063,480)
Add - gain on disposal of capital assets	2,146
The change in the net pension liability and related deferred outflows and inflows of resources does not impact current financial resources and therefore is not reported in the fund financial statements	86,260
The change in the accrued compensated absences is reported as an expense in the Statement of Activities but does not require the use of current financial resources and therefore is not reported as an expenditure in the General Operating / Road Fund	<u>(1,626)</u>
Change in net position of governmental activities	<u>\$ 3,054,658</u>

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

Arenac County Road Commission

Notes to Financial Statements

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Reporting Entity

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

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

The Road Commission was established pursuant to the County Road Law (MCL224.1) and operates under a three-member Board of County Road Commissioners that is elected by the citizens of Arenac County. The Board of County Road Commissioners establishes policies and reviews operations of the Road Commission.

Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the Statement of Net Position and the Statement of Activities) report information on all of the activities of the Road Commission. *Governmental activities* are primarily supported by intergovernmental revenues and charges for services.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges to customers 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. Property taxes, interest and other items are properly excluded from program revenues and are reported as general revenues.

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

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements (Statement of Net Position and the Statement of Activities) are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Arenac County Road Commission

Notes to Financial Statements

Governmental fund (General Operating / Road Fund) financial statements (Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balance) are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Road Commission considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures and expenditures related to compensated absences and claims and judgments that are not expected to be paid in the current year are recorded only when payment is due.

Local, State and Federal revenue, permits and interest associated with the current fiscal period are all considered susceptible to accrual and have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received.

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

The *General Operating / Road Fund* is the Road Commission's primary operating fund. It accounts for all financial resources of the Road Commission.

Assets, Liabilities, Deferred Outflows & Inflows of Resources and Net Position / Equity

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, deposits in demand accounts and balances held by the County Treasurer.

Receivables and Payables

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

Inventory

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

Prepaid Items

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

Capital Assets

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

Arenac County Road Commission

Notes to Financial Statements

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

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

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

Buildings	30 to 50 years
Road equipment	5 to 8 years
Shop equipment	10 years
Office equipment	4 to 10 years
Engineering equipment	4 to 10 years
Infrastructure – bridges	12 to 50 years
Infrastructure – roads	5 to 30 years
Infrastructure – traffic signals	15 years

Deferred Outflows of Resources

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

Advances from the State of Michigan

The State of Michigan advances funds on a State maintenance agreement it has with the Road Commission for specific maintenance performed by the Road Commission during the year and for equipment purchases. These advances are considered current liabilities because they are subject to repayment annually, upon results of audit procedures performed by the State of Michigan.

State Trunkline Adjustments

Adjustments to available operating funds resulting from audits of State Trunkline maintenance expenditures are recorded at the time cash settlement is made. The amount of the adjustments, if any, for the current year cannot be reasonably determined therefore, no provisions have been made in these financial statements for any adjustments related to the maintenance contract.

Arenac County Road Commission

Notes to Financial Statements

Unearned Revenue

Governmental funds report unearned revenue for revenue that is not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition for resources that have been received but not earned. The balance of unearned revenue at year-end consists of amounts that were received from State and local sources for road improvements that have not been expended / earned.

Compensated Absences

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

Deferred Inflows of Resources

In addition to liabilities, the Statement of Net Position will sometimes report deferred inflows of resources in a separate section. This separate financial statement element represents an acquisition of net position that applies to a future period(s) and therefore will not be recognized as an inflow of resources (revenue) until that time. At year-end, the Road Commission had one type of item that qualified for reporting in this category; unavailable revenue for property taxes that were levied for the subsequent year (voluntary non-exchange transactions). At year-end, the entire balance of property taxes is deferred and will be recognized as an inflow of resources in the period that the amount become available.

Fund Equity

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

Nonspendable

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

Restricted

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

Committed

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

Assigned

Amounts that are constrained by the Road Commission's *intent* to be used for specific purposes but are neither restricted nor committed are reported as assigned fund balance. The Board of County Road Commissioners has not adopted a policy to authorize anyone the authority to assign fund balance on behalf of the Road Commission.

Unassigned

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

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

Arenac County Road Commission
Notes to Financial Statements

Equipment Rental

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

Handling and Overhead Credits

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

Estimates

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

NOTE B - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Auditing and Reporting

The audit was performed in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States as described in the Independent Auditors' Report and with the types of compliance requirements described in Public Act 51 of 1951, as amended. The financial statements were prepared in accordance with U.S. GAAP, as described in the Independent Auditor's Report and also with applicable rules of the Michigan State Department of Transportation.

NOTE C - DETAILED NOTES ON SELECT ACCOUNTS / TRANSACTION CLASSES

Deposits

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

	<u>General Operating / Road Fund</u>
Deposits with financial institutions:	
Cash on hand	\$ 300
Interest bearing deposits – demand	95,429
Cash on deposit with Arenac County Treasurer	<u>1,806,575</u>
Total	<u>\$ 1,902,304</u>

The Uniform Accounting Procedures Manual for Michigan County Road Commissions provides that the County Treasurer maintain cash balances of the Road Commission. All Road Commission receipts are deposited with the Arenac County Treasurer's Office and in order to make disbursements, the Road Commission requests the County Treasurer to transfer funds to an imprest vendor or payroll checking account. Investment activities of the Road Commission's cash are performed by the County Treasurer.

Arenac County Road Commission

Notes to Financial Statements

Deposit and Investment Risk

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

- Bonds, securities, other obligations and repurchase agreements of the United States, or an agency or instrumentality of the United States
- Certificates of deposit, savings accounts, deposit accounts or depository receipts of a qualified financial institution
- Commercial paper rated at the time of purchase within the 2 highest classifications established by not less than 2 standard rating services and that matures not more than 270 days after the date of purchase
- Bankers acceptances of United States banks
- Obligations of the State of Michigan and its political subdivisions that, at the time of purchase are rated as investment grade by at least one standard rating service
- Mutual funds registered under the investment company act of 1940 with the authority to purchase only investment vehicles that are legal for direct investment by a public corporation
- External investment pools as authorized by Public Act 20 as amended through December 31, 1997

Interest Rate Risk

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

Credit Risk

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

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Road Commission's deposits may not be returned. State law does not require, and the Road Commission does not have a policy for deposit custodial credit risk. At year-end, none of the Road Commission's bank balance of \$512,708 was exposed to custodial credit risk because it was insured by the Federal Deposit Insurance Corporation (FDIC). Deposits in the amount of \$1,806,575 were held by the Arenac County Treasurer and may have been partially covered by the FDIC. The amount of federal depository insurance is determined for the County as a whole and cannot be identified separately for the Road Commission.

Custodial Credit Risk – Investments

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Road Commission will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. State law does not require a policy for investment custodial credit risk. The Road Commission's investment policy does not address custodial credit risk for investments. At year-end, the Road Commission had no investments and therefore, did not have any custodial credit risk.

Concentration of Credit Risk

State law limits allowable investments but does not limit concentration of credit risk. The Road Commission's investment policy does not have specific limits in excess of State law on concentration of credit risk. At year-end, the Road Commission had no investments and therefore, did not have any concentrations of credit risk.

Arenac County Road Commission
Notes to Financial Statements

Capital Assets

Capital asset activity for the year was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Disposals</u>	<u>Ending Balance</u>
Capital assets not being depreciated				
Land and improvements	\$ 422,428	\$ 513,874	\$ -	\$ 936,302
Construction in progress	<u>165,738</u>	<u>-</u>	<u>(164,065)</u>	<u>1,673</u>
Total capital assets being depreciated	<u>588,166</u>	<u>513,874</u>	<u>(164,065)</u>	<u>937,975</u>
Capital assets being depreciated				
Buildings and improvements	1,260,427	202,341	-	1,462,768
Road equipment	4,189,633	676,227	(104,317)	4,761,543
Shop equipment	118,386	-	-	118,386
Office equipment	120,808	-	-	120,808
Infrastructure - bridges	5,862,670	62,813	-	5,925,483
Infrastructure – roads	<u>27,694,925</u>	<u>2,863,142</u>	<u>(580,370)</u>	<u>29,977,697</u>
Total capital assets being depreciated	<u>39,246,849</u>	<u>3,804,523</u>	<u>(684,687)</u>	<u>42,366,685</u>
Less accumulated depreciation				
Buildings and improvements	(152,199)	(28,249)	-	(180,448)
Road equipment	(3,510,771)	(265,563)	106,463	(3,669,871)
Shop equipment	(110,542)	(695)	-	(111,237)
Office equipment	(110,325)	(840)	-	(111,165)
Infrastructure – bridges	(1,184,639)	(129,347)	-	(1,313,986)
Infrastructure – roads	<u>(9,835,152)</u>	<u>(1,638,786)</u>	<u>580,370</u>	<u>(10,893,568)</u>
Total accumulated depreciation	<u>(14,903,628)</u>	<u>(2,063,480)</u>	<u>686,833</u>	<u>(16,280,275)</u>
Net capital assets being depreciated	<u>24,343,221</u>	<u>1,741,043</u>	<u>2,146</u>	<u>26,086,410</u>
Total net capital assets	<u>\$ 24,931,387</u>	<u>\$ 2,254,917</u>	<u>\$ (161,919)</u>	<u>\$ 27,024,385</u>

Long-term Debt

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

	<u>Beginning Balance</u>	<u>Increases</u>	<u>(Decreases)</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Compensated absences	<u>\$ 66,408</u>	<u>\$ 83,751</u>	<u>\$ (82,125)</u>	<u>\$ 68,034</u>	<u>\$ 68,034</u>

Arenac County Road Commission

Notes to Financial Statements

Accrued Compensated Absences

In accordance with Board policy and the labor agreement with the Road Commission, individual employees have a vested right upon termination of employment to receive compensation for accumulated personal, vacation and sick days at 100% of their hourly rate at the time of termination under formulas and conditions specified in the contracts. The dollar amounts of these vested rights, which have been accrued on the government-wide statements amounted to approximately \$2,800 for personal days, \$24,000 for sick leave and \$41,234 for vacation days at year-end.

NOTE D - OTHER INFORMATION

Defined Benefit Pension Plan

Plan Description

The Road Commission participates in an agent multiple-employer defined benefit pension plan administered by the Municipal Employees' Retirement System of Michigan (MERS) that covers all full-time employees of the Road Commission. MERS was established as a State-wide public employee pension plan by the Michigan Legislature under PA 135 of 1945 and is administered by a nine-member retirement Board. MERS issues a publicly available financial report which includes the financial statements and required supplemental information of this defined benefit plan. This report can be obtained at www.mersofmichigan.com or in writing to MERS at 1134 Municipal Way, Lansing, Michigan 48917.

Benefits Provided

The Plan provides certain retirement, disability, and death benefits to plan members and beneficiaries. PA 427 of 1984, as amended, established and amends the benefit provisions of the participants in MERS.

General Division

Retirement benefits are calculated as 2.50% of the employee's final 5-year average salary times the employee's years of service (80% maximum); frozen final average compensation to 1.50% (no maximum). Normal retirement age is 60 years, with early retirement at age 55 with 25 years of service (unreduced) or age 50 with 25 years of service or age 55 with 15 years of service (reduced). The vesting period is 10 years.

Administrative Division

Retirement benefits are calculated as 2.25% of the employee's final 5-year average salary times the employee's years of service. Normal retirement age is 60 years, with early retirement at age 50 with 25 years of service or age 55 with 15 years of service (reduced). The vesting period is 10 years.

Office Manager Division

Retirement benefits are calculated as 2.50% of the employee's final 5-year average salary times the employee's years of service. Normal retirement age is 60 years, with early retirement at age 50 with 25 years of service or age 55 with 15 years of service (reduced). The vesting period is 10 years.

Employees are eligible for non-duty disability benefits after 10 years of service and for duty-related disability benefits upon hire. Disability retirement benefits are determined in the same manner as retirement benefits but are payable immediately without an actuarial reduction. Death benefits are always the larger of the benefit computed as a contingent survivor beneficiary or 85% of accrued retirement allowance benefit. An employee who leaves service may withdraw his or her contributions, plus any accumulated interest.

Benefit terms, within the parameters established by MERS, are generally established and amended by authority of the Board of County Road Commissioners, generally after negotiations of these terms with the labor union.

Arenac County Road Commission
Notes to Financial Statements

Employees Covered by the Benefit Term

At the December 31, 2019 measurement date, the following participants were covered by the benefit terms:

Inactive plan members or beneficiaries currently receiving benefits	34
Inactive plan members entitled to but not yet receiving benefits	3
Active employees	<u>17</u>
Total participants	<u><u>54</u></u>

Contribution Requirements

Article 9, Section 24 of the State of Michigan constitution requires that financial benefits arising on account of employee service rendered in each year be funded during that year. Accordingly, MERS retains an independent actuary to determine the annual contribution. The employer is required to contribute amounts at least equal to the actuarially determined rate, as established by the MERS retirement Board. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by plan members during the year, with an additional amount to finance any unfunded accrued liability. The employer may establish contribution rates to be paid by its covered employees.

For the year ended December 31, 2020, the Road Commission's actuarially determined contribution rate was 36.61% of annual covered payroll for the General division, 53.58% for the administrative division and 15.28% for the office manager division. Employees in the General and Administrative divisions are required to contribute 8.00% and 2.00% of their annual covered payroll to the plan, respectively.

Net Pension Liability

The net pension liability reported at year-end was determined using a measure of the total pension liability and the pension net position as of December 31, 2019. The December 31, 2019 total pension liability was determined by an actuarial valuation performed as of that date.

Changes in the net pension liability during the year were as follows:

<u>Changes in Net Pension Liability</u>	<u>Increase (Decrease)</u>		
	<u>Total Pension Liability</u>	<u>Plan Net Position</u>	<u>Net Pension Liability</u>
Beginning balance	\$ 6,624,496	\$ 2,471,660	\$ 4,152,836
Service cost	72,998	-	72,998
Interest on total pension liability	511,357	-	511,357
Changes of benefit terms	-	-	-
Expected / actual experience differences	49,208	-	49,208
Changes in assumptions	198,595	-	198,595
Employer contributions	-	541,177	(541,177)
Employee contributions	-	55,350	(55,350)
Net investment income (loss)	-	329,509	(329,509)
Benefit payments	(538,059)	(538,059)	-
Administrative expenses	-	(5,670)	5,670
Other changes	-	-	-
Net changes	<u>294,099</u>	<u>382,307</u>	<u>(88,208)</u>
Ending balance	<u>\$ 6,918,595</u>	<u>\$ 2,853,967</u>	<u>\$ 4,064,628</u>

Arenac County Road Commission
Notes to Financial Statements

Pension Expense and Deferred Outflows of Resources Related to Pensions

During the year the Road Commission recognized a negative pension expense of (\$86,260). At year-end, the Road Commission reported deferred outflows of resources related to pensions from the following sources:

Description	Deferred Outflows of Resources
Employer contributions to the plan subsequent to the measurement date	\$ 555,169
Net difference between projected and actual earnings on pension plan investments	18,922
Changes in assumptions	32,805
Differences between expected and actual experience	132,397
Total	\$ 739,293

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

Year Ending December 31,	Net Amount
2021	\$ 82,119
2022	95,148
2023	32,789
2024	(25,932)
Total	\$ 184,124

The amount reported as deferred outflows of resources related to employer contributions to the plan made subsequent to the measurement date of \$555,169 will impact the net pension liability in 2021, as opposed to being amortized to pension expense over a period of years.

Actuarial Assumptions

The total pension liability in the December 31, 2019 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.50%
Salary increases	3.00% (plus 0.00% to 11.00% for merit and longevity)
Investment rate of return	7.35%, net of investment expense and including inflation

Mortality rates were based on the RP-2014 Group Annuity Mortality Table of a 50% Male and 50% Female blend for non-disabled plan members and 50% Male and 50% Female blend of the RP-2014 Disabled Retiree Mortality Tables for disabled plan members.

The actuarial assumptions used in the December 31, 2019 valuation were based on the results of the most recent actuarial experience study dated in 2015 that covers the period from January 1, 2009 through December 31, 2013.

Arenac County Road Commission
Notes to Financial Statements

The long-term expected rate of return on pension plan investments was determined using a model in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-term Expected Real Rate of Return	Expected Money-Weighted Rate of Return
Global equity	57.50%	5.02%	2.87%
Global fixed income	20.00	2.18	0.44
Real assets	12.50	4.23	0.53
Diversifying strategies	10.00	6.56	0.66
	<u>100.00%</u>		
Inflation			2.50
Administrative expenses netted above			0.75
Investment rate of return			<u>7.75%</u>

Discount Rate - The discount rate used to measure the total pension liability was 7.60%. The projection of cash flows used to determine the discount rate assumes that employer and employee contributions will be made at the rates agreed upon for employees and the actuarially determined rates for employers.

Projected Cash Flows - Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate - The following presents the Road Commission's net pension liability, calculated using the discount rate of 7.60%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1% lower (6.60%) or 1% higher (8.60%) than the current rate:

	1% Decrease in Rate to 6.60%	Assumed Discount Rate 7.60%	1% Increase in Rate to 8.60%
Net Pension Liability	\$ 4,711,533	\$ 4,064,628	\$ 3,505,524

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

Arenac County Road Commission
Notes to Financial Statements

Equipment Expenditure Net Balance

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

Equipment –	
Direct	\$ 921,095
Indirect	262,567
Operating	119,145
Less equipment rental credits	<u>(1,209,858)</u>
Total	<u>\$ 92,949</u>

Administrative Expenditure Balance

In compliance with the Uniform Accounting Procedures Manual for Michigan County Road Commissions, administrative expenditures are reported net of certain credits. The amount reported as net administrative expenditures is comprised of the following:

Administrative expenditures	\$ 516,907
Less overhead – State trunkline maintenance	<u>(142,662)</u>
Total	<u>\$ 374,245</u>

Capital Outlay Expenditure Balance

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

Capital outlay	\$ 729,914
Less depreciation / depletion	<u>(295,347)</u>
Total	<u>\$ 434,567</u>

Risk Management

The Road Commission is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (worker's compensation), as well as medical benefits provided to employees. The Road Commission has purchased commercial insurance for healthcare claims.

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

Arenac County Road Commission

Notes to Financial Statements

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

Contingencies

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

The Road Commission incurred expenditures for flood-related damages during the year. Management anticipates that a portion of those expenditures will be reimbursed from Federal and State agencies subsequent to year-end but is unable to reasonably estimate the total amount to be reimbursed. There are no provisions for these reimbursements reflected in the financial statements.

Federal Award Expenditures / Single Audit

The Michigan Department of Transportation (MDOT) requires that Road Commissions report all Federal and State grants pertaining to their County. During the year, the Federal aid expended in the County was \$383,476 for contracted projects and \$0 for negotiated projects. Contracted projects are defined as projects performed by private contractors paid for and administered by MDOT (they are included in MDOT's single audit). Negotiated projects are projects where the Road Commission administers the grant and either performs the work directly or contracts it out. The amount of federal award expenditures administered by the Road Commission was less than \$750,000; therefore, a single audit was not required.



REQUIRED SUPPLEMENTARY INFORMATION

Arenac County Road Commission

General Operating / Road Fund Schedule of Revenues, Expenditures and Change in Fund Balance - Budget and Actual

For the Year Ended December 31, 2020

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Over (Under) Budget</u>
Property taxes	\$ 491,871	\$ 505,959	\$ 505,939	\$ (20)
Licenses and permits	10,000	10,300	10,300	-
Federal sources				
High priority	270,000	382,817	382,806	(11)
FEMA / FHWA flood reimbursement	-	657,461	-	(657,461)
Other - economic development funds	-	-	670	670
State sources				
Michigan transportation funds				
Engineering	10,000	10,000	10,000	-
Allocation	4,339,674	4,055,000	4,047,487	(7,513)
Contributions from local units				
City and Village	10,000	-	5,932	5,932
Townships	300,000	903,965	890,887	(13,078)
Chippewa tribe	91,828	92,828	91,828	(1,000)
Charges for services				
State trunkline maintenance	900,490	900,490	973,690	73,200
State trunkline non-maintenance	-	406,166	350,251	(55,915)
Salvage sales	5,000	5,000	4,531	(469)
Other - 2017 trunkline audit adjustment	5,000	5,000	4,562	(438)
Interest and rentals	10,000	10,000	11,264	1,264
Other				
Sale of federal aid	281,311	281,311	281,311	-
Total revenues	<u>\$ 6,725,174</u>	<u>\$ 8,226,297</u>	<u>\$ 7,571,458</u>	<u>\$ (654,839)</u>

Arenac County Road Commission

General Operating / Road Fund

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

For the Year Ended December 31, 2020

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Over (Under) Budget</u>
Primary Road				
Preservation / structural improvements	\$ 2,157,314	\$ 1,930,760	\$ 1,885,762	\$ (44,998)
Maintenance	904,191	800,421	796,902	(3,519)
Local Road				
Preservation / structural improvements	691,828	1,555,829	1,538,656	(17,173)
Maintenance	1,369,198	976,924	950,625	(26,299)
Total preservation and maintenance	5,122,531	5,263,934	5,171,945	(91,989)
State trunkline maintenance	900,490	900,490	918,523	18,033
State trunkline non-maintenance	-	350,251	350,251	-
Equipment (net)	-	46,976	92,949	45,973
Administrative (net)	431,510	391,000	374,245	(16,755)
Capital outlay (net)	395,972	570,664	434,567	(136,097)
Other - billable services	15,000	10,000	9,413	(587)
Total expenditures	<u>6,865,503</u>	<u>7,533,315</u>	<u>7,351,893</u>	<u>(181,422)</u>
Net change in fund balance	(140,329)	692,982	219,565	(473,417)
Fund balance, beginning of year	1,954,452	2,393,117	2,393,117	-
Fund balance, end of year	<u>\$ 1,814,123</u>	<u>\$ 3,086,099</u>	<u>\$ 2,612,682</u>	<u>\$ (473,417)</u>

Arenac County Road Commission

Required Supplementary Information

Schedule of Changes in Net Pension Liability and Related Ratios

Last 10 Fiscal Years Ended December 31,

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015*</u>
Total pension liability						
Service cost	\$ 72,998	\$ 66,568	\$ 67,770	\$ 70,464	\$ 72,157	\$ 70,741
Interest	511,357	505,812	499,181	483,066	479,742	492,056
Changes of benefit terms	-	15,186	-	-	-	-
Differences between expected and actual experience	49,208	4,437	27,703	(166,416)	-	-
Changes in assumptions	198,595	-	-	-	-	-
Benefit payments	(538,059)	(513,736)	(508,616)	(490,124)	(526,856)	(535,236)
Other changes	-	-	-	-	(1,010)	(1)
Net change in total pension liability	<u>294,099</u>	<u>78,267</u>	<u>86,038</u>	<u>(103,010)</u>	<u>24,033</u>	<u>27,560</u>
Total pension liability - beginning	6,624,496	6,546,229	6,460,191	6,563,201	6,539,168	6,511,608
Total pension liability - ending	<u>\$ 6,918,595</u>	<u>\$ 6,624,496</u>	<u>\$ 6,546,229</u>	<u>\$ 6,460,191</u>	<u>\$ 6,563,201</u>	<u>\$ 6,539,168</u>
Plan fiduciary net position						
Contributions - employer	\$ 541,177	\$ 548,587	\$ 550,402	\$ 296,328	\$ 325,757	\$ 285,998
Contributions - member	55,350	46,458	51,669	59,329	54,693	53,628
Net investment income (loss), net	329,509	(91,617)	274,614	222,725	(30,907)	138,752
Benefit payments, including refunds of member contributions	(538,059)	(513,736)	(508,616)	(490,124)	(526,856)	(535,236)
Administrative expenses	(5,670)	(4,682)	(4,354)	(4,403)	(4,663)	(5,033)
Other	-	-	-	-	-	-
Net change in fiduciary net position	<u>382,307</u>	<u>(14,990)</u>	<u>363,715</u>	<u>83,855</u>	<u>(181,976)</u>	<u>(61,891)</u>
Fiduciary net position - beginning	2,471,660	2,486,650	2,122,935	2,039,080	2,221,056	2,282,947
Fiduciary net position - ending	<u>\$ 2,853,967</u>	<u>\$ 2,471,660</u>	<u>\$ 2,486,650</u>	<u>\$ 2,122,935</u>	<u>\$ 2,039,080</u>	<u>\$ 2,221,056</u>
Net pension liability - ending	<u>\$ 4,064,628</u>	<u>\$ 4,152,836</u>	<u>\$ 4,059,579</u>	<u>\$ 4,337,256</u>	<u>\$ 4,524,121</u>	<u>\$ 4,318,112</u>
Fiduciary net position as a percentage of the total pension liability	41.25%	37.31%	37.99%	32.86%	31.07%	33.97%
Covered-employee payroll	\$ 905,130	\$ 755,394	\$ 760,865	\$ 776,658	\$ 790,134	\$ 778,702
Net pension liability as percentage of covered-employee payroll	449.07%	549.76%	533.55%	558.45%	572.58%	554.53%

* GASB Statement No. 68 was implemented as of December 31, 2015. Information from 2011 through 2014 is not available. Additional years will be presented on this schedule on a prospective basis.

See Notes to Required Supplementary Information

Arenac County Road Commission
Required Supplementary Information
Schedule of Employer's Net Pension Liability
Last 10 Fiscal Years Ended December 31,

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015*</u>
Total pension liability	\$ 6,918,595	\$ 6,624,496	\$ 6,546,229	\$ 6,460,191	\$ 6,563,201	\$ 6,539,168
Plan net position	2,853,967	2,471,660	2,486,650	2,122,935	2,039,080	2,221,056
Net pension liability	4,064,628	4,152,836	4,059,579	4,337,256	4,524,121	4,318,112
Plan net position as a percent of total pension liability	41.25%	37.31%	37.99%	32.86%	31.07%	33.97%
Covered payroll	\$ 905,130	\$ 755,394	\$ 760,865	\$ 776,658	\$ 790,134	\$ 778,702
Net pension liability as a percent of covered payroll	449.07%	549.76%	533.55%	558.45%	572.58%	554.53%

* GASB Statement No. 68 was implemented as of December 31, 2015. Information from 2011 through 2014 is not available. Additional years will be presented on this schedule on a prospective basis.

See Notes to Required Supplementary Information

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

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015*</u>
Actuarially determined contribution	\$ 372,289	\$ 372,154	\$ 298,587	\$ 370,077	\$ 270,883	\$ 329,432
Contributions in relation to the actuarially determined contribution	<u>554,169</u>	<u>541,177</u>	<u>548,587</u>	<u>550,402</u>	<u>270,883</u>	<u>329,432</u>
Contribution deficiency (excess)	<u>\$ (181,880)</u>	<u>\$ (169,023)</u>	<u>\$ (250,000)</u>	<u>\$ (180,325)</u>	<u>\$ -</u>	<u>\$ -</u>
Covered-employee payroll	\$ 905,130	\$ 755,394	\$ 760,865	\$ 776,658	\$ 790,134	\$ 778,702
Contributions as percentage of covered-employee payroll	61.23%	71.64%	72.10%	70.87%	34.28%	42.31%

* GASB Statement No. 68 was implemented as of December 31, 2015. Information from 2011 through 2014 is not available. Additional years will be presented on this schedule on a prospective basis.

See Notes to Required Supplementary Information

Arenac County Road Commission

Notes to Required Supplementary Information

Budgetary Data

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

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

Defined Benefit Pension Plan

Valuation date	December 31, 2019
Notes	Actuarially determined contribution rates are calculated as of the December 31 that is 12 months prior to the beginning of the fiscal year in which contributions are reported.

Methods and assumptions used to determine contribution rates:

Actuarial cost method	Entry-age normal
Amortization method	Level percentage of payroll, closed
Remaining amortization period	19 years
Asset valuation method	Open; 10-year smoothed market
Inflation	2.50%
Salary increases	3.00% (plus 0.00% to 11.00% for merit and longevity)
Investment rate of return	7.35% (net of administrative and investment expenses)
Discount rate	7.60%
Retirement age	Age-based table of rates that are specific to the type of eligibility condition.
Mortality	RP-2014 Group Annuity Mortality Table of a 50% Male and 50% Female blend for non-disabled plan members and 50% Male and 50% Female blend of the RP-2014 Disabled Retiree Mortality Tables for disabled plan members.
Assumption changes	In the 2019 valuation, the investment rate of return was changed from 7.75% to 7.35% and the wage inflation rate was changed from 3.75% to 3.00%.

OTHER SUPPLEMENTARY INFORMATION

Arenac County Road Commission

General Operating / Road Fund

Schedule of Revenues by Component

For the Year Ended December 31, 2020

	<u>Primary Road Funds</u>	<u>Local Road Funds</u>	<u>County Road Commission Funds</u>	<u>Total</u>
Revenues				
Property taxes	\$ -	\$ -	\$ 505,939	\$ 505,939
Licenses and permits	-	-	10,300	10,300
Federal sources				
High priority	382,806	-	-	382,806
Other - economic development fund	-	-	670	670
State sources				
Michigan transportation funds				
Engineering	6,378	3,622	-	10,000
Allocation	2,581,636	1,465,851	-	4,047,487
Contributions from local units				
City and Village	-	-	5,932	5,932
Townships	-	890,887	-	890,887
Other - tribal contributions	-	91,828	-	91,828
Charges for services				
State trunkline maintenance	-	-	973,690	973,690
State trunkline non-maintenance	-	-	350,251	350,251
Salvage sales	-	-	4,531	4,531
Other	4,562	-	-	4,562
Interest and rentals	-	-	11,264	11,264
Other				
Sale of federal aid	281,311	-	-	281,311
Total revenues	<u>\$ 3,256,693</u>	<u>\$ 2,452,188</u>	<u>\$ 1,862,577</u>	<u>\$ 7,571,458</u>

Arenac County Road Commission

General Operating / Road Fund

Schedule of Expenditures by Component

For the Year Ended December 31, 2020

	Primary Road Funds	Local Road Funds	County Road Commission Funds	Total
Expenditures				
Preservation / Structural Improvements				
Roads	\$ 1,822,949	\$ 1,538,656	\$ -	\$ 3,361,605
Structures	62,813	-	-	62,813
Maintenance				
Roads	512,317	767,110	-	1,279,427
Structures	12,779	14,467	-	27,246
Winter maintenance	233,721	147,801	-	381,522
Traffic control	38,085	21,247	-	59,332
Total maintenance	2,682,664	2,489,281	-	5,171,945
State trunkline maintenance	-	-	918,523	918,523
State trunkline non-maintenance	-	-	350,251	350,251
Administrative expense (net)	194,119	180,126	-	374,245
Equipment expense (net)	26,234	47,569	19,146	92,949
Capital outlay (net)	-	-	434,567	434,567
Other - billable services	-	-	9,413	9,413
Total expenditures	\$ 2,903,017	\$ 2,716,976	\$ 1,731,900	\$ 7,351,893

Arenac County Road Commission
General Operating / Road Fund
Schedule of Changes in Fund Balance by Component
For the Year Ended December 31, 2020

	Primary Road Funds	Local Road Funds	County Road Commission Funds	Total
Total revenues	\$ 3,256,693	\$ 2,452,188	\$ 1,862,577	\$ 7,571,458
Total expenditures	2,903,017	2,716,976	1,731,900	7,351,893
Revenues over (under) expenditures	353,676	(264,788)	130,677	219,565
Other financing sources (uses)				
Interfund transfers	(264,788)	264,788	-	-
Revenues and other sources over (under) expenditures and other sources (uses)	88,888	-	130,677	219,565
Fund balance, beginning of year	-	-	2,393,117	2,393,117
Fund balance, end of year	<u>\$ 88,888</u>	<u>\$ -</u>	<u>\$ 2,523,794</u>	<u>\$ 2,612,682</u>

INTERNAL CONTROL AND COMPLIANCE



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A VETERAN OWNED BUSINESS

**Independent Auditor's Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

To the Board of County Road Commissioners
Arenac County
Standish, Michigan

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities and the major fund of the ***Arenac County Road Commission***, a component unit of Arenac County, as of and for the year ended December 31, 2020, and the related notes to the financial statements, which collectively comprise the ***Arenac County Road Commission's*** basic financial statements and have issued our report thereon dated April 27, 2021.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered ***Arenac County Road Commission's*** internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the ***Arenac County Road Commission's*** internal control. Accordingly, we do not express an opinion on the effectiveness of the ***Arenac County Road Commission's*** internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, as described as findings 2020-1 and 2020-2 in the accompanying Schedule of Findings and Responses that we consider to be significant deficiencies.

Compliance and Other Matters

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

Road Commission's Responses to Findings

The *Arenac County Road Commission's* written responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The Road Commission's responses were not subject to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

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

Smith + Klaehring PC

Saginaw, Michigan

April 27, 2021

Arenac County Road Commission

Schedule of Findings and Responses (*continued*)

For the Year Ended December 31, 2020

Finding 2020-1 – Preparation of Financial Statements in Accordance with U.S. GAAP (*repeated*)

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

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

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

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

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

Arenac County Road Commission

Schedule of Findings and Responses (*concluded*)

For the Year Ended December 31, 2020

Finding 2020-2 – Lack of Segregation of Duties (*repeated*)

- Criteria:** An important component of any internal control system is appropriate segregation of duties over key accounting functions. To provide a system of checks and balances, these functions are generally assigned to different employees to minimize the potential for unauthorized transactions. Ideally, no single individual should be able to authorize a transaction, record the transaction in the accounting records and maintain custody of the assets resulting from the transaction. These include an individual authorized to setup vendors and process accounts payable, setup new employees and process payroll information and initiate manual journal entries and post them. Proper segregation of duties is intended to prevent an individual from committing an act of fraud or abuse and have the ability to conceal it.
- Condition:** As is the case with many organizations of similar size, the Road Commission lacks a sufficient number of accounting personnel in order to completely segregate incompatible duties within its accounting function.
- Cause:** Sufficient resources and staff are not available to adequately segregate these functions. Additionally, the benefit of separating these duties does not appear to exceed the costs associated with the additional personnel that would be required to segregate all incompatible duties.
- Effect:** This condition creates opportunities for inaccurate or unauthorized disbursements or transfers of Road Commission assets and increases the potential for inaccurate reporting of financial activity.
- View of Responsible Officials:** The Road Commission is aware of the weakness in this area and has determined that the strong oversight and involvement of the Board of County Road Commissioners reduces the risk of unauthorized disbursements and inaccurate financial reporting to an acceptably low level.