City of Pontiac
General Employees' Retiree Health and Insurance Benefits Trust

Financial Report

December 31, 2011

City of Pontiac
General Employees' Retiree Health and Insurance Benefits Trust

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Independent Auditor's Report

To the Board of Trustees
City of Pontiac General Employees' Retiree
Health and Insurance Benefits Trust

We have audited the accompanying statement of trust net assets of the City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust (a component unit of the City of Pontiac, Michigan) as of December 31, 2011 and the related statement of changes in trust net assets for the year then ended. These financial statements are the responsibility of the board of trustees of the City of Pontiac General Employees' Retiree Health and Insurance Benefits Plan and Trust. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust as of December 31, 2011 and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Matter of Emphasis - In May 2012, the City's Emergency Manager issued an Executive Order repealing the General Employees' Retiree Health and Insurance Benefits Trust. The remaining assets of the Trust are expected to be used to reimburse the City for eligible costs.

Accounting principles generally accepted in the United States of America require that management's discussion and analysis, retirement system schedule of funding progress, and the schedule of employer contributions, as identified in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplemental information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Plante & Moran, PLLC

September 20, 2012

Using this Annual Report

This annual report consists of two parts: (1) management's discussion and analysis (this section) and (2) the basic financial statements. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

	Fiscal Year Ended December 31	
	2011	2010
Total assets	$ 340,810	$ 456,405
Total liabilities	34,797	136,206
Trust net assets	**$ 306,013**	**$ 320,199**
Net investment gain	$ 17,066	$ 548,273
Contributions - Employer	8,439,824	3,141,083
Retirees' health benefits paid	(8,438,139)	(9,551,730)
General and administrative expenses	(32,937)	(25,411)
Net decrease in trust net assets	**$ (14,186)**	**$ (5,887,785)**

<u>Overall Fund Structure and Objectives</u>

The City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust (the "Trust") exists to pay healthcare benefits to retired members. Through the year ended December 31, 2009, the Trust was in the preliminary phases of accumulating assets to build a corpus; however, given the financial condition of the plan sponsor, in 2010 the System begin using the assets held in Trust to pay or otherwise make reimbursements to the City related to City payments for retiree healthcare benefits. Any excess contributions over benefits paid will allow for additional funding to increase investment income to a level where the Trust will generate adequate earnings to pay future benefits. The public capital markets represent the primary source of investments.

Asset Allocation

The Trust has invested in a balanced mutual fund that provides exposure to both the equity and fixed-income markets. Once an adequate funding level is established, the Trust is expected to deliver sufficient investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the Trust.

Investment Results

The sovereign debt crisis in Europe and disappointing economic growth globally dominated the capital markets during 2011. Central banks maintained very accommodative policies and interest rates tended to decline around the world. Core inflation in the U.S. was near long-term targets at 3.0 percent while commodity prices tended to fall. The decline in interest rates drove the fixed income markets higher; the Barclays U.S. Aggregate returned 7.8 percent for the year. The equities markets were volatile. After posting nice gains in the first quarter, stocks suffered a significant sell off over the summer; a recovery late in the year helped offset those losses. The Standard & Poor's 500 rose 2.1 percent, the Russell 2000 Index (a proxy for U.S. small-cap stocks) declined 4.2 percent, and the MCSI EAFE Index (a proxy for international stocks) dropped 12.1 percent. For the year ended December 31, 2011, the total Trust had investment income of $17,066, with no plan contributions made into the Trust, and $300,000 paid out of the Trust to the City of Pontiac to reimburse healthcare expenses, along with paying other administrative expenses of $32,937. In addition, the City paid $8,138,139 for premiums for retirees, which under GASB 45 are shown as both contributions and benefit payments of the plan.

The Total Fund's return must always be considered in a longer-term context. The Fund's investment horizon is long-term, corresponding to the long-term nature of the System's liabilities. Therefore, the Board of Trustees establishes an asset allocation policy to control risks and generate expected returns that will enable the Fund to pay the benefits promised to members and retirees. Accordingly, the board of trustees must make investment decisions that it believes will be the most beneficial to the System over many years, not just one or two years.

Abolishment of Plan

On May 30, 2012, the City's Emergency Manager signed an Executive Order to abolish the plan with immediate effect. As such, the plan will cease to exist. It is management's intent that any remaining assets held in Trust will be remitted to the plan sponsor for reimbursements of benefit payments made for covered members. The future of the Trust has not been determined.

City of Pontiac
General Employees' Retiree Health and Insurance Benefits Trust

Statement of Trust Net Assets
December 31, 2011

Assets	
Investments at fair value - Mutual funds (Note 2)	$ 39,125
Due from City of Pontiac	301,685
Total assets	340,810
Liabilities	
Due to General Employees' Retirement System	21,420
Accounts payable	13,377
Total liabilities	34,797
Net Assets Held in Trust for Retiree Health and Insurance Benefits	**$ 306,013**

The Notes to Financial Statements are
an Integral Part of this Statement.

City of Pontiac
General Employees' Retiree Health and Insurance Benefits Trust

Statement of Changes in Trust Net Assets
Year Ended December 31, 2011

Additions	
Contributions	$ 8,439,824
Investment income:	
Interest and dividend income	3,229
Net increase in fair value of investments	13,837
Net investment income	17,066
Total additions	8,456,890
Deductions	
Professional services	(32,937)
Retirees' health benefits	(8,438,139)
Total deductions	(8,471,076)
Net Decrease in Trust Net Assets	(14,186)
Net Assets Held in Trust for Retiree Health and Insurance Benefits - January 1, 2011	320,199
Net Assets Held in Trust for Retiree Health and Insurance Benefits - December 31, 2011	**$ 306,013**

Note 1 - Summary of Significant Accounting Policies

The City of Pontiac (the "City") has established an irrevocable prefunded group health and insurance trust fund, the City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust (the "Trust"), for health, optical, dental, and life insurance benefits for retirees who are members of the General Employees' Retirement System of the City of Pontiac (the "System"). Through the year ended December 31, 2009, the Trust was in the preliminary phases of accumulating assets to build a corpus; however, given the financial condition of the plan sponsor, in 2010 the System begin using the assets held in trust to pay or otherwise make reimbursements to the City related to City payments for retiree healthcare benefits. The Trust was created as an Internal Revenue Code 501(c)(9) Trust (VEBA). The System performs the Trust's accounting function.

Reporting Entity - The Trust is a component unit of the City of Pontiac, Michigan (the "City"). The Trust does not hold securities of or formal loans to the City or the General Employees' Retirement System.

Plan Sponsor Financial Condition - The City of Pontiac (the plan sponsor) is experiencing significant financial difficulty. The City is currently operating under Michigan Public Act 4 of 2011. The result is that the State has appointed an Emergency Manager to control the finances of the City. Uncertainty exists regarding the City's ability to continue to make contributions to the Pension and Healthcare Trust Plans. Contributions that were scheduled to be made to the plan for the City's fiscal year ended June 30, 2010 in the amount of approximately $167,000 (based on a percent of payroll) were not remitted to the plan by the City.

In 2011, the Trust filed a lawsuit against the plan sponsor to demand payment. As a result, a judgment levy was placed on the tax roll in order to satisfy these outstanding contributions. Subsequently, an injunction was filed to cease the tax collection process; the taxes collected under this judgment levy, which were previously held in escrow by the City, have now been refunded to the tax payers. As the legal proceedings are still pending, with significant uncertainty existing as to the anticipated outcome (and thus ultimate collectibility of these contribution amounts), these amounts have not been reflected in the Trust's 2010 or 2011 financial statements.

Contributions that were scheduled to be made during 2012 for the year ended December 31, 2011 were remitted to the Trust in August 2012, and thus have been reflected in the Trust's 2011 financial statements.

Note 1 - Summary of Significant Accounting Policies (Continued)

Due to the abolishment of the General Employees' Retiree Health and Insurance Benefits Trust plan as of May 30, 2012 (see details below), pending contributions as noted above, will not be remitted.

Abolishment of Plan - On May 30, 2012, the City's Emergency Manager signed an Executive Order to abolish the plan with immediate effect. As such, the plan will cease to exist. It is management's intent that any remaining assets held in Trust will be remitted to the plan sponsor for reimbursements of benefit payments made for covered members. The future of the Trust has not been determined.

Basis of Accounting - The City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust's statements are prepared using the accrual basis of accounting. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Insurance costs are recognized when due and payable in accordance with the terms of the Trust.

Investments - Investments are reported at fair value. Mutual fund investments are valued at net asset value. Dividend income is recorded on the ex-dividend date. Income from other investments is recorded as earned on an accrual basis. In accordance with the policy of stating investments at fair value, net unrealized appreciation or depreciation for the year is reflected in the statement of changes in trust net assets.

Federal Income Taxes - The Trust is exempt from income tax under Section 501(a).

Note 2 - Investments

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

Note 2 - Investments (Continued)

The trust fund is also authorized by Michigan Public Act 314 of 1965, as amended, to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

The System has designated one bank for the deposit of its funds. The System's deposits and investments are in accordance with statutory authority.

The System's cash and investments are subject to two types of risk, which are examined in more detail below:

Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The System does not have an investment policy that restricts investment maturities. At year end, the average maturities of investments are as follows:

Investment	Fair Value	Weighted Average Maturity
Mutual fund - Bond	$ 15,102	7.3 Years

Credit Risk

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Trust has no investment policy that would further limit its investment choices. As of year end, the credit quality ratings of debt securities are as follows:

Investment	Fair Value	Rating	Rating Organization
Mutual fund - Bond	544	AAA	Moody's
Mutual fund - Bond	800	Aa	Moody's
Mutual fund - Bond	1,691	A	Moody's
Mutual fund - Bond	1,510	Baa	Moody's
Mutual fund - Bond	10,556	N/A*	N/A*

* Explicitly guaranteed by the U.S. government therefore credit risk is N/A

Note 3 - Trust Contribution Information

The Trust is funded by employer contributions. The City is required by ordinance to make minimum contributions in the amount of 3 percent of valuation payroll unless a lesser amount is actuarially determined to be necessary to actuarially fund the Trust. The ordinance that established the Trust requires annual funding of the actuarial rate or 3 percent of valuation payroll. Under GASB 45, premiums paid directly by the City for retiree health benefit costs covered by the VEBA are included as employer contributions to the Trust along with an offsetting benefit expense. See Note 1 for the status of outstanding contributions due to the Trust in light of the City's financial condition.

Subsequent to year end, an Executive Order modifying the terms of health care insurance for all retirees that are eligible and currently receiving these benefits was issued by the City's Emergency Manager pursuant to the provisions of Public Act 152 of 2011 (PA 152). The Executive Order includes various plan changes, the most significant being that pre-age 65 retirees pay by deduction from their pension checks the amount above the "hard-cap" (as defined by PA 152), or twenty percent (20 percent) of the annual rates, whichever is higher, to be effective July 1, 2012.

Note 4 - Trustees

The City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust as of December 31, 2011 has two trustees who sit by virtue of their position, one who is appointed by the City of Pontiac General Employees' Retirement System, one appointed by the City Council of the City of Pontiac, and one who is elected by the retirees.

Note 5 - Membership Data

At December 31, 2010, the date of the most recent actuarial valuation, membership consisted of the following:

Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving them	696
Current employees:	
Fully vested	111
Nonvested	96
Total	207

During 2011, a partial termination of the pension plan for general employees was deemed to have occurred. This resulted from the termination of various active employee positions at the City under Executive Orders issued by the Emergency Manager. The impact of membership composition and the funded status of the healthcare trust are unknown at this time; however, as disclosed in Note 1, the Trust was abolished as of May 30, 2012. As the plan will cease to exist, the unfunded actuarial accrued liability will be reported at the plan sponsor level only going forward. The future of the Trust has not been determined.

Note 6 - Postemployment Benefits

Plan Description - The City provides retiree healthcare benefits to eligible employees and their spouses through the City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust. This is a single employer benefit plan administered by the City of Pontiac General Employees' Retirement System.

The Trust's financial statements are included in the City of Pontiac's financial report and can be obtained by writing to 47450 Woodward Ave., Pontiac, MI 48342.

Note 6 - Postemployment Benefits (Continued)

Funding Policy - The City is required by ordinance to contribute 3 percent of eligible payroll toward pre-funding unless an actuarial valuation requires a lesser amount. The City has not made the minimum contribution to the Trust of $207,763 for the plan period ending December 31, 2011, and the City has stated the payments are not forthcoming and thus the Trust has not reflected these contributions in the current year financial statements. During the year ended December 31, 2011, the Trust reimbursed the City for healthcare costs paid by the City in the amount of $300,000, which represented a portion of payments made by the City for the period from July 1, 2010 through December 31, 2010. Additionally, for the period from January 1, 2011 through December 31, 2011, the City has estimated the portion of healthcare costs paid by the City to be $8,138,139 which is reflected as additional contributions to the plan and benefit payments made from the plan during the current year, pursuant to governmental accounting standards which require gross-up of qualified retiree healthcare payments made by the City even though they were not remitted to and paid through the plan.

The funding progress of the Trust as of December 31, 2010 (the most recent valuation date) is as follows:

Actuarial value of assets	$ 488,148
Actuarial accrued liability (AAL)	$ 191,388,835
Unfunded AAL (UAAL)	$ 190,900,687
Funded ratio	0.26%
Annual covered payroll	$ 9,493,229
Ratio of UAAL to covered payroll	2,010.91%

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

Note 6 - Postemployment Benefits (Continued)

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

In the December 31, 2010 actuarial valuation (the most recent available actuary report), the entry age actuarial cost method was used. The actuarial assumptions included a 5.0 percent investment rate of return compounded annually (net of administrative expenses), which consists of a real rate of return of .5 percent per year plus a long-term rate of inflation of 4.5 percent per year. It also included healthcare cost increases ranging from 4.5 to 10.0 percent for the years included in the valuation. The actuarial value of assets is set to equal fair market value. The UAAL is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at December 31, 2010 was an open 30-year period.

During 2011, a partial termination of the pension plan for general employees was deemed to have occurred. This resulted from the termination of various active employee positions at the City under Executive Orders issued by the Emergency Manager. The impact of membership composition and the funded status of the healthcare trust are unknown at this time; however, as disclosed in Note 1, the Trust was abolished as of May 30, 2012. As the plan will cease to exist, the unfunded actuarial accrued liability will be reported at the plan sponsor level only going forward.

Required Supplemental Information

City of Pontiac
General Employees' Retiree Health and Insurance Benefits Trust

Required Supplemental Information
Schedule of Analysis of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (Percent) (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll
12/31/04	$ 3,202,351	$ 139,925,086	$ 136,722,735	2.3	$ 21,210,461	644.60
12/31/05	3,973,887	157,048,845	153,074,958	2.5	16,751,815	913.78
12/31/06	4,928,700	154,823,626	149,894,926	3.2	14,996,753	999.52
12/31/07	5,682,510	159,345,212	153,662,702	3.6	13,559,473	1,133.25
12/31/08	4,796,224	226,279,072	221,482,848	2.1	14,414,481	1,536.53
12/31/09	6,207,984	129,889,840	123,681,856	4.8	12,553,146	985.27
12/31/10	488,148	191,388,835	190,900,687	0.3	9,493,229	2,010.91

Required Supplemental Information
Schedule of Employer Contributions

Year Ended June 30	Annual Required Contribution*	Amount Contributed**
2009	$ 10,674,833	$ 7,450,360
2010	9,759,248	6,957,549
2011	10,000,245	540,429

* GASB Statement No. 45 was adopted by the City for the City's fiscal year ended June 30, 2009. As such, the amount contributed corresponds to the City's fiscal year end (pursuant to GASB Statement No. 45) as opposed to the Trust's calendar year end.

** In accordance with GASB Statement No. 45, the amount contributed for 2011 excludes premiums of $6,841,607, which were reimbursed to the City from the Trust.

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September 20, 2012

To City of Pontiac Boards
City of Pontiac Retirement Systems and
Retiree Health and Insurance Trusts

We have audited the financial statements of the General Employees' Retirement System, the Police and Fire Retirement System, the General Employees' Prefunded Group Health Insurance Plan and Trust, and the Police and Fire Retiree Prefunded Group Health and Insurance Plan and Trust (the "Systems and Trusts") as of and for the year ended December 31, 2011 and have issued our report thereon dated September 20, 2012. Professional standards require that we provide you with the following information related to our audit which is divided into the following sections:

Section I - Communications Required Under SAS 114

Section II - Other Observations and Legislative Updates

Section I includes information that current auditing standards require independent auditors to communicate to those individuals charged with governance. We will report this information annually to the boards of the City of Pontiac Retirement Systems and Retiree Health and Insurance Trusts.

Section II presents recommendations and other observations related to internal controls and procedures noted during our current year audit as well as legislative and informational items that we believe will be of interest to you. These comments are offered in the interest of helping the Systems and Trusts in their efforts toward continuous improvement, not just in the areas of internal control and accounting procedures, but also in operational or administrative efficiency and effectiveness.

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

This information is intended solely for the use of the boards and management of the City of Pontiac Retirement Systems and Retiree Health and Insurance Trusts and is not intended to be and should not be used by anyone other than these specified parties.

To City of Pontiac Boards
City of Pontiac Retirement Systems and
Retiree Health and Insurance Trusts

September 20, 2012

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

Very truly yours,

Plante & Moran, PLLC

Beth Bialy

Beth Bialy

Alisha Davis

Alisha Davis

To City of Pontiac Boards
City of Pontiac Retirement Systems and
Retiree Health and Insurance Trusts

September 20, 2012

Section I - Communications Required Under SAS 114

Our Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated April 23, 2012, 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 audits of the financial statements does not relieve you or management of your responsibilities. Our responsibility is to plan and perform the audits to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement.

As part of our audits, we considered the internal control of the City of Pontiac Retirement Systems and Retiree Health and Insurance Trusts. 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 audits that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

Planned Scope and Timing of the Audits

We performed the audits according to the planned scope and timing previously communicated to you in our letter dated April 23, 2012 and in our correspondence with the board chairs.

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 City of Pontiac Retirement Systems and Retiree Health and Insurance Trusts are described in Note 1 to the financial statements.

No new accounting policies were adopted and the application of existing policies was not changed during 2011.

We noted no transactions entered into by the systems or trusts during the year for which there is a lack of authoritative guidance or consensus.

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

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements relate to the valuation of alternative investments and the valuation of the actuarial accrued liability. The valuation for certain alternative investments is based on unaudited financial statements or other valuation methods in use by the boards. The valuation of the actuarial accrued liability is based on third-party actuarial assumptions and methods. We evaluated the key factors and assumptions used to develop these 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. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive estimates affecting the financial statements relate to the plan sponsor financial condition, partial termination and closing of the pension plans, and the abolishment of the general employees' retiree health and insurance benefits trust, as described in Note 1 of the respective system and trust financial statements.

Difficulties Encountered in Performing the Audits

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

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audits, other than those that are trivial, and communicate them to the appropriate level of management.

The attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

No other misstatements were identified during the course of our audit procedures.

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 audits.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated September 20, 2012.

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 City of Pontiac's (the "City") 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.

Section II - Other Observations and Legislative Updates

During our audits, we noted areas where we believe there are opportunities for the Systems and Trusts to further strengthen internal controls or to increase operating efficiencies. Our observations on those areas are presented for your consideration below.

Pension Systems' Benefit Payments

During our review of benefit payments, we noted several retirees receiving benefits based on initial estimates rather than final benefit calculations. Pending calculations go back as far as 2007 in some instances but primarily relate to 2009, 2010, and 2011 for both pension systems. In conjunction with our auditing procedures, we selected a sample of retirees from this group of members and compared the estimated benefit payment to their recent final calculation. We then extrapolated that error rate to the rest of the affected population to estimate the difference on the Systems overall. Based on our testing, we proposed an adjustment for the Police & Fire Retirement System for the estimated misstatement of benefit payments (see Attachment 1); however for the General Employees Retirement System, the estimated misstatement was less than our threshold for required reporting and thus is omitted from Attachment 1. The Systems' personnel do have a system in place to track "'open" calculations and have been working to clear the back log. We recommend that they continue to work on determining final benefit calculations to minimize the ultimate impact on retirees when estimates become finalized.

Plan Sponsor Financial Condition: Impact on the Systems

As you are aware, the City of Pontiac (the plans' sponsor) is experiencing significant financial difficulty. The result is that the State has appointed an Emergency Manager to control the finances of the City. There is uncertainty regarding the City's ability to remit current (and prior year) contributions to the Systems, including whether these amounts will be placed on the tax roll in order to satisfy the outstanding contributions as those legal proceedings are still pending (also with uncertainty as to the outcome). The following contributions were originally expected to be paid by the City to the various Trusts, but ultimately were not paid and it is our understanding that the payments will not be forthcoming. As a result, these contributions were removed from the financial statements:

	2011	2010
Police and Fire Retirement System	$ 931,311	$ 448,541
Police and Fire Retiree Prefunded Group Heath and Insurance Trust	2,635,156	2,104,382

Regardless of the City's financial condition, the Systems and the Police and Fire VEBA have accumulated significant assets that will be paid out to retirees for decades to come. As fiduciaries, the boards have the responsibility to ensure efficient and effective administration of the plan assets and benefit payments for many years to come. This involves ensuring that resources (staffing, training, monitoring, etc.) continue to be available. We commend the boards for the steps that were taken to transition the Systems' and Trusts' personnel from being employees of the City to employees of the Systems.

State Initiatives Impacting Local Units of Government

PA 314 Proposed Changes

Senate Bill 797 and House Bill 5416 make some significant changes to Public Act 314, as follows:

- The legislation utilizes existing asset classes but expands some categories such as foreign equities (from 20 to 70 percent), real estate (5-10 percentage points higher) and the "basket clause" (10 percentage points higher than existing limits for all plan sizes)
- Requires fee disclosures by investment service providers
- Establishes uniform transparency standards to allow for benchmarking
- Expands prohibition against payments to providers that make contributions to plan sponsor officials
- Permits local pension boards to self-police, which means they can remove a member who is legally incapacitated, convicted of certain violations or has committed material breaches of policies
- Imposes limits on dollars spent on training to the lesser of $12,000 per board trustee or $150,000. No one trustee can spend more than $30,000.
- Requires the retention of records for six years

Pension and OPEB Bonding Proposal

Introduced in the House in April 2012, Bill 5530 amends the Municipal Finance Act to allow for bonding for the unfunded accrued liability related to both pension and retiree healthcare under two scenarios:

- Limited tax general obligations - By ordinance or resolution, without a vote

- Unlimited tax general obligations - By resolution and with a vote

Municipal securities issued under the Act, along with debt currently outstanding, shall not exceed 5 percent of state equalized value. In addition, the government unit must have a credit rating of at least "A". Lastly, securities shall not be issued unless the projected difference between the assumed rate of return on the healthcare trust fund or the pension fund investments and the projected actual interest rate paid on the securities is at least 100 basis points.

State Initiatives Impacting Local Units Of Government

Revenue Sharing

The State budget is awaiting the governor's signature, which we anticipate will come any day now. With this new budget, come some tweaks to revenue sharing. One major change is moving 20 percent of the County revenue sharing to an incentive program. In order to receive funds for EVIP and the County incentive program, three requirements must be met. Categories 1 and 2 relate to Accountability & Transparency and Consolidation of Services, respectively. These first two requirements have minimal to no direct impact on the pension and VEBA plans; however the third requirement includes major provisions impacting the pension and VEBA plans and thus is outlined in detail below:

Category 3 - Employee Compensation - Due date June 1, 2013

Key point – this section has three options.

Option 1 - Modified Compensation Plan

- New hires who are eligible for retirement plans must be put in plans that cap employer contributions at 10 percent of base salary if eligible for Social Security, or 16.2 percent if not.

- For defined benefit plans, maximum multipliers are as follows:

Eligible for Social Security?	Provided with retiree healthcare?	Maximum multiplier
Yes	Yes	1.5%
Yes	No	2.25%
No	Yes	2.25%
No	No	3.00%

- For defined benefit plans, final average compensation shall use a minimum of three years and shall not include more than 240 hours of paid leave. Overtime hours shall not be included.

- Healthcare premium costs for new hires shall include a minimum 20 percent employee share or employer's share shall be cost competitive with the new State preferred provider organization health plan on a per-employee basis.

Option 2 **- Compliance With PA 152 of 2011** - Publicly Funded Health Insurance Contribution Act - Certify compliance with the new Act that requires hard caps, or alternately 80 percent/20 percent cost sharing. This includes the opt-out provision.

Option 3 - Certify that no medical benefits are offered

Assistance - Detailed guidance is scheduled to be provided by the Department of Treasury by October 1, 2012.

Prohibition Against Hiring Current Retirees

House Bill 5637, the Jobs Initiative Reform Act, is a bill that has been introduced in the House that prohibits public employers in Michigan from employing an individual who is receiving benefits from the public employer's defined benefit retirement plan; and to provide sanctions.

A public employer shall not directly, or indirectly through a contract with a third party, employ an individual who is receiving retirement benefits from a public employee defined benefit retirement plan of that public employer. This prohibition does not apply if the individual waives his or her right to receive previously accrued retirement benefits from that public employer's defined benefit retirement plan while reemployed by the public employer.

Sanctions would consist of reimbursing the defined benefit retirement plan for retirement benefits that the defined benefit retirement plan paid to the individual during the prohibited employment.

This appears to be an issue only if a retiree is being rehired by the existing employer and would not apply if that retiree seeks employment with a different employer.

To City of Pontiac Boards
City of Pontiac Retirement Systems and
Retiree Health and Insurance Trusts

September 20, 2012

Attachment 1

Client: **City of Pontiac Retirement Systems and Retiree Health and Insurance Trusts**

Y/E: **12/31/2011**

SUMMARY OF UNRECORDED POSSIBLE ADJUSTMENTS

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

Ref. #	Description of Misstatement	Current Assets	Long-term Assets	Current Liabilities	Long-term Liabilities	Net Assets	Revenue	Expenses
KNOWN MISSTATEMENTS:								
A1	None							
ESTIMATE ADJUSTMENTS:								
B1	None							
IMPLIED ADJUSTMENTS:								
C1	Misstatement of benefit payments (Police and Fire Retirement System)	$ 292,000						$ (292,000)
		-	$ -	$ -	$ -	$ -	$ -	-
	Total	**$ 292,000**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ (292,000)**
PASSED DISCLOSURES:								
D1	None							