

# Bay County Employees' Retirement System

## Defined Benefit Plan

Year Ended  
December 31,  
2016

Financial  
Statements

# BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

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## INDEPENDENT AUDITORS' REPORT

June 30, 2017

To the Bay County Board of Commissioners  
and the Bay County Retirement Board of Trustees  
Bay County, Michigan

We have audited the accompanying statement of fiduciary net position of the *Bay County Employees' Retirement System Defined Benefit Plan* (the "Plan"), a pension trust fund of Bay County, Michigan, as of December 31, 2016, and the related statement of changes in fiduciary net position for the year then ended and the related notes to the financial statements, which collectively comprise the Plan'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.

### *Independent Auditors' Responsibility*

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 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 auditors' 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 Plan'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 Plan'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 opinion.

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Plan, as of December 31, 2016 and the respective changes in its fiduciary net position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### *Reporting Entity*

As discussed in Note 1, the financial statements present only the Bay County Employees' Retirement System Defined Benefit Plan pension trust fund and do not purport to, and do not, present fairly the financial position of Bay County, Michigan as of December 31, 2016 and the changes in its financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the schedule of investment returns, as listed in the table of contents, be presented to supplement the 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 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 financial statements, and other knowledge we obtained during our audit of the 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 an opinion on the financial statements that collectively comprise the Bay County Employees' Retirement System Defined Benefit Plan basic financial statements. The Management's Discussion and Analysis is not a required part of the basic financial statements.

The Management's Discussion and Analysis has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on the information.

*Rehmann Lohman LLC*

## MANAGEMENT'S DISCUSSION AND ANALYSIS

# BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

## Management's Discussion and Analysis

This section of the annual report of the Bay County Employees' Retirement System Defined Benefit Plan (the "Plan") presents management's discussion and analysis of the Plan's financial performance during the plan year that ended on December 31, 2016. Please read it in conjunction with the Plan's financial statements, which follow this section.

### Financial Highlights

- The Plan's total net position increased during fiscal 2016 by approximately \$10.6 million. Assets are held in trust and restricted to meet future benefit payments.
- The Plan's benefits are funded by contributions from Bay County and its component units (the "County"), Bay Arenac Behavioral Health ("BABH") and active members, as well as by the investment income earned on the Plan's assets.
- The change in the fair value of investments was favorable for the current year. The fair value of investments had a net appreciation of approximately \$19.0 million for the year ended December 31, 2016 compared with net depreciation of approximately \$1.3 million for the year ended December 31, 2015.

### Overview of the Financial Statements

This annual report contains the Plan's financial statements, which consist of the statement of fiduciary net position and statement of changes in fiduciary net position. These financial statements report information about the Plan as a whole using accounting methods similar to those used by private-sector pension plans. The statement of fiduciary net position include all of the Plan's assets and liabilities. All of the current year increases and decreases in the Plan's net position are accounted for in the statement of changes in fiduciary net position, regardless of when cash is received or paid.

These financial statements report the Plan's net position and how it has changed. Net position represents the difference between the Plan's assets and deferred outflows of resources and liabilities and deferred inflows of resources, and it represents one way to measure the Plan's financial health, or position. Over time, increases or decreases in the Plan's net position are an indicator of whether its financial health is improving or deteriorating.

The notes to the financial statements explain some of the information in the financial statements and provide more detailed data.

## BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

### Management's Discussion and Analysis

#### Financial Analysis of the Plan as a Whole

Below are the condensed statements of fiduciary net position as of December 31, 2016 and 2015:

	Net Position	
	2016	2015
Assets		
Investments	\$ 311,580,626	\$ 302,011,064
Other assets	<u>1,322,506</u>	<u>1,450,082</u>
Total assets	<u>312,903,132</u>	<u>303,461,146</u>
Deferred outflows of resources	24,472	3,830
Liabilities	1,409,933	2,515,898
Deferred inflows of resources	<u>16,695</u>	<u>849</u>
Net position restricted for pension benefits	<u>\$ 311,500,976</u>	<u>\$ 300,948,229</u>

The Plan's total assets as of December 31, 2016 were \$312.9 million and were mostly comprised of investments. Total assets increased by \$9.4 million, or 3.1%, from the prior year. The increase is primarily attributable to favorable market conditions at December 31, 2016, resulting in a favorable fair value in investments.

Total net position restricted for benefits at December 31, 2016 increased by \$10.6 million from 2015. The increase is primarily attributable to the increase in the Plan's assets as discussed above.

# BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

## Management's Discussion and Analysis

Below are the condensed statements of changes in fiduciary net position for the years ended December 31, 2016 and 2015:

	Change in Net Position	
	2016	2015
<b>Additions</b>		
Investment income:		
Net appreciation (depreciation) in fair value of investments	\$ 18,995,041	\$ (1,296,077)
Other investment income (net of investment expenses)	3,937,871	3,622,465
Contributions	5,477,623	7,186,980
<b>Total additions</b>	<u>28,410,535</u>	<u>9,513,368</u>
<b>Deductions</b>		
Benefit payments and refunds of contributions	17,222,061	16,425,644
Administrative expenses	635,727	280,388
<b>Total deductions</b>	<u>17,857,788</u>	<u>16,706,032</u>
<b>Change in net position</b>	10,552,747	(7,192,664)
<b>Net position</b>		
Beginning of year	<u>300,948,229</u>	<u>308,140,893</u>
End of year	<u>\$ 311,500,976</u>	<u>\$ 300,948,229</u>

### Change in Fiduciary Net Position

The reserves needed to finance pension benefits are accumulated through the collection of employee and employer contributions and through earnings on investments. The increase in net position of \$10.6 million is the result of a net appreciation in fair value of \$20,291,118 of the investments, over the net depreciated value from 2015. Also, an increase of \$346,425 in investment income in comparison to the 2015 recorded investment income.

### Economic Factors

The financial market started to come back over the current year. The Plan saw increasing financial market values and investment returns throughout the year. Management believes that the Plan is in a financial position to meet its pension benefit obligations. Management continues to strive for a consistent investment strategy and believes the market conditions will become more stable in the next few years.

### Financial Contact

This financial report is designed to present its users with a general overview of the Plan's finances and to demonstrate the Plan's accountability for the funds it holds. If you have any questions about this report or need additional financial information, contact Bay County Finance Department, Bay County Building - 7th Floor, 515 Center Avenue, Bay City, Michigan 48708.



**BASIC FINANCIAL STATEMENTS**

# BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

## Statement of Fiduciary Net Position December 31, 2016

Assets	
Investments at fair value:	
Equities	\$ 229,588,148
Fixed income	72,860,195
Money market	9,132,283
Total investments	<u>311,580,626</u>
Receivables:	
Interest and dividends	679,025
Contributions	348,668
Total receivables	<u>1,027,693</u>
Other assets:	
Prepaid items and other assets	274,744
Net pension asset	20,069
Total other assets	<u>294,813</u>
Total assets	<u>312,903,132</u>
Deferred outflows of resources	<u>24,472</u>
Liabilities	
Accounts payable	698,833
Accrued liabilities	709,725
Accrued vacation and sick pay	1,375
Total liabilities	<u>1,409,933</u>
Deferred inflows of resources	<u>16,695</u>
Net position	
Restricted for pension benefits	<u>\$ 311,500,976</u>

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

# BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

## Statement of Changes in Fiduciary Net Position For the Year Ended December 31, 2016

Additions	
Investment income:	
Net appreciation in fair value of investments	18,995,041
Interest and dividends	5,471,879
Other revenue	9,949
Total investment income	<u>24,476,869</u>
Investment expenses	<u>(1,543,957)</u>
Net investment income	<u>22,932,912</u>
Contributions:	
Employer	3,201,873
Plan members	2,275,750
Total contributions	<u>5,477,623</u>
Total additions	<u>28,410,535</u>
Deductions	
Participant benefits (including refunds of contributions)	17,222,061
Administrative expenses	635,727
Total deductions	<u>17,857,788</u>
Change in net position	10,552,747
Net position, beginning of year	<u>300,948,229</u>
Net position, end of year	<u>\$ 311,500,976</u>

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

# BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

## Notes to Financial Statements

### 1. PLAN DESCRIPTION

*General* - The Bay County Employees' Retirement System Defined Benefit Plan (the "Plan") is an agent multiple employer defined benefit plan covering two employers, Bay County, Michigan (the "County"), which includes six divisions (General County, Sheriff's Department, Library, Department of Water and Sewer, Medical Care Facility, and Road Commission), and Bay Arenac Behavioral Health ("BABH"). The Plan provides retirement, disability, and death benefits to plan members and their beneficiaries.

The accompanying financial statements present only the financial position and changes in net position of the Bay County Employees' Retirement System pension trust fund. They do not purport to, and do not, present fairly the net position or changes in net position of Bay County in conformity with accounting principles generally accepted in the United States of America.

The Retirement Commission consists of nine individual trustees whether elected or appointed in accordance with the County Retirement Ordinance. Four members (active employees) are elected by active members of the retirement system. Each elected position is voted on by the following four groups 1) Bay County Road Commission and Department of Water and Sewer 2) Bay County Medical Care Facility 3) Sheriff's Department and Library 4) General County and Bay Arenac Behavioral Health. The remaining trustees are the chairperson of the Bay County Board of Commissioners ex-officio or his/her designee, the chairperson of the Ways and Means Committee of the Bay County Board of Commissioners or his/her designee, the Treasurer of the Bay County, the chairperson of the Bay County Board of Human Services ex officio or his/her designee, and the chairperson of the Bay Arenac Behavioral Health Board of Directors or his/her designee. All elected terms are for three years.

*Plan Membership* - The Plan's membership consists of the following at December 31, 2016:

Active participants:

Retirees and beneficiaries	937
Inactive, nonretired members	80
Active members	<u>1,169</u>
	<u><u>2,186</u></u>

*Contributions* - The provisions of the Plan require the participating employers/divisions to contribute at an actuarially determined rate. Rates for the year ended December 31, 2016, determined through an actuarial valuation performed at December 31, 2014, were as follows for each employer/division:

General County	0.00%
Sheriff's Department	0.00%
Department of Water and Sewer	14.16%
Medical Care Facility	2.87%
Road Commission	18.09%
Bay Arenac Behavioral Health	11.36%

The Library portion of the plan is closed to new hires as of January 1, 2012 and therefore, the annual employer/division contribution is fixed at \$34,265 for the year ended December 31, 2016.

In addition, the general county division made discretionary monthly contributions into the Plan of 4.00% of payroll for the year ended December 31, 2016. The Library and Bay Arenac Behavioral Health exceed their annual required contributions by \$43,529 and \$61,717, respectively.

# BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

## Notes to Financial Statements

Contribution requirements for Plan members are established and may be amended through the collective bargaining process after approval by the benefit granting Board for each group. Currently, certain divisions have elected to pay all or some of the Plan member contributions. Plan member average contribution rates for the year ended December 31, 2016, were as follows by employer/division:

General County	4.18%
Sheriff's Department	5.60%
Department of Water and Sewer	4.00%
Medical Care Facility	4.00%
Road Commission	4.76%
Bay Arenac Behavioral Health	4.00%

The Library portion of the plan is closed to new hires as of January 1, 2012 and therefore, the annual plan member contribution is fixed at \$61,408 for the year ended December 31, 2016.

*Retirement Benefits* - The Plan benefit provisions and contribution requirements of plan members and the participating employers are established and may be amended by the Retirement Board, who also administers the plan, in accordance with County policies, union contracts, and plan provisions. Benefits are paid monthly over the member or survivor's lifetime calculated as total service times final average compensation (highest 5 years) times a percent ranging from 1.60% to 2.80%, with a maximum of 75% of final average compensation.

*Death and Disability Benefits* - The Plan also provides non-duty death and disability benefits to members after 10 years of credited service. The 10 year service provision is waived for duty disability and death benefits.

Retirement eligibility varies depending on employer, division, and date of hire. Requirements for normal retirement range from age 55 to 62 with 8 years of service to 30 years of service, regardless of age. Early retirement options are also available at age 55 with 8 to 10 years of service or 25 years of service, regardless of age. The detailed summary annual report (SAR) is distributed annually to all Bay County Retirement System members.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Accounting.** The Plan's financial statements are prepared on the accrual basis of accounting using the economic resources measurement focus. Member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the Pension Ordinance. Administrative expenses are financed through investment earnings.

**Valuation of Investments and Income Recognition.** Investments are stated at fair value. Short-term investments are reported at amortized cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Fixed debt quotations are provided by a national brokerage pricing service. Real estate values are determined on the basis of comparable yields available in the marketplace. Investments for which market quotations are not readily available are valued at their fair values as determined by the custodian under the direction of the Retirement Board, with the assistance of a valuation service.

Dividend income is recognized based on the ex-dividend date, and interest income is recognized on the accrual basis as earned. All realized gains and losses on investments are recognized at the point of sale and are included in investment income. Purchases and sales of investments are recorded as of the trade date, which is the date when the transaction is initiated.

## BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

### Notes to Financial Statements

#### *Investment Allocation Policy*

The Plan's policy in regard to the allocation of invested assets is established and may be amended by the Retirement Board. The investment policy has been formulated based on consideration of a wide range of policies and describes the prudent investment process that the Board deems appropriate. The Board established the following allocation range for each asset class in recognition of the need to vary exposure within and among different asset classes, based on investment opportunities and changing capital market conditions:

Asset Class	Target Allocation	Allocation Range
U.S. large cap equity	31%	15%-45%
U.S. mid cap equity	12%	6%-18%
U.S. small cap equity	5%	2%-10%
International equity	20%	10%-20%
REIT	2%	0%-8%
Real estate	5%	0%-8%
U.S. core fixed income	21%	10%-40%
Convertible securities	4%	1%-8%
Total investments	100%	

#### *Investments and Securities Lending*

A contract approved by the Bay County Board of Commissioners permits the Plan to lend its securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Plan's custodial bank manages the securities lending program and receives securities or cash as collateral. The collateral securities cannot be pledged or sold by the Plan unless the borrower defaults. Collateral securities and cash are initially pledged at 102 percent of the fair value of United States securities lent and 105 percent of the fair value of non-United States securities, and may not fall below 100 percent during the term of the loan. The Plan had the following investments, at fair value, in the securities lending program at year end:

	Market Value of Loaned Securities	Cash Collateral Received
Domestic equities	\$ 41,566,925	\$ 42,735,089
Corporate bonds	8,042,933	8,249,917
Municipal bonds	3,428,198	3,504,820
U.S. Agencies	52,120	53,308

There are no restrictions on the amount of the securities that can be loaned. Securities on loan at year-end are classified in the following schedule of investments according to the category for the collateral received on the securities lent. At year-end the Plan has no credit risk exposure to borrowers because the amounts the System owes the borrowers exceed the amounts the borrowers owe the Plan. The contract with the Plan's custodian requires it to indemnify the Plan if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the Plan for income distributions by the securities' issuers while the securities are on loan.

# BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

## Notes to Financial Statements

### 3. INVESTMENTS

The authority for the purchase and sale of investments rests with the Retirement Board. The Michigan Public Employees Retirement Systems' Investment Act, Public Act 314 of 1965, as amended, authorizes the Plan to invest in domestic and foreign stocks, government securities, corporate securities, mortgages, real estate and various other investment instruments, subject to certain limitations and investment policy established by the Retirement Board. The Investment Act incorporates the prudent person rule and requires investment fiduciaries to act solely in the interest of the Plan's participants and beneficiaries.

The Plan's investments are primarily held in a bank-administered trust fund. Following is a summary of the Plan's investments as of December 31, 2016:

Investments at fair value

Equities:

Convertible equities	\$ 1,273,456
Domestic equities	183,470,424
International equities	28,944,086
Preferred stock	366,506
Private equities	15,533,676
Total equities	<u>229,588,148</u>

Fixed income:

Asset backed securities	57,431
Corporate bonds **	27,839,286
Corporate convertible bonds **	8,649,220
Government agencies	449,131
Government bonds	10,916,641
Government issued commercial mortgage-backed	4,427,140
Government mortgage-backed securities	11,437,150
International bonds **	9,084,196
Total fixed income	<u>72,860,195</u>

Money market	<u>9,132,283</u>
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Total investments	<u>\$ 311,580,626</u>
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\*\* The Plan's investments in corporate bonds and corporate convertible bonds include call options with a market value of \$15,372,892 and \$1,087,445, respectively.

*Credit Risk.* Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Plan's investment policy emphasizes appropriate risk/return parameters and compliance with Public Act 314, and gives discretionary authority to its investment managers as opposed to establishing specific credit rating benchmarks.

## BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

### Notes to Financial Statements

As of December 31, 2016, Moody's ratings for the Plan's investments were as follows:

	Investment Type			
	Equities	Fixed Income	Money Market	Total
Aaa	\$ -	\$ 13,235,963	\$ -	\$ 13,235,963
Aa	-	2,236,082	-	2,236,082
A	-	13,473,402	-	13,473,402
Baa	-	16,694,589	-	16,694,589
Ba	-	3,381,186	-	3,381,186
B	-	558,033	-	558,033
Not rated	229,588,148	23,280,940	9,132,283	262,001,371
<b>Total</b>	<b>\$ 229,588,148</b>	<b>\$ 72,860,195</b>	<b>\$ 9,132,283</b>	<b>\$ 311,580,626</b>

*Custodial Credit Risk.* For investments, custodial credit risk is the risk that, in the event of the failure of the counterparty to a transaction, the Plan will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Plan's investment policy requires that securities be held in trust by a third-party institution in the Plan's name or its nominee custodian's name or in bearer form. Although uninsured and unregistered, the Plan's investments are not exposed to custodial credit risk since the securities are held by the counterparty's trust department or agent in the Plan's name. Short-term investments in money market funds and open-end mutual funds are not exposed to custodial credit risk because their existence is not evidenced by securities that exist in physical or book form.

*Concentration of Credit Risk.* Concentration of credit risk is the risk of loss attributed to the magnitude of the Plan's investment in a single issuer. The Plan's investment policy requires that no manager will hold more than 5% of its portion of the total fund in any single company and no more than 5% may be held in any single common stock. At December 31, 2016 the Plan did not hold any investments that exceeded this threshold.

*Interest Rate Risk.* Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Plan's investment policy does not discuss the maximum maturity for any single fixed income security or the weighted average portfolio maturity.

As of December 31, 2016, investment maturities for the Plan's investments were as follows:

	Investment Type			
	Equities	Fixed Income	Money Market	Total
Less than 1 year	\$ -	\$ 2,253,497	\$ -	\$ 2,253,497
1 - 5 years	-	24,759,302	-	24,759,302
6 - 10 years	-	19,529,603	-	19,529,603
More than 10 years	-	26,317,793	-	26,317,793
No maturity	229,588,148	-	9,132,283	238,720,431
<b>Total</b>	<b>\$ 229,588,148</b>	<b>\$ 72,860,195</b>	<b>\$ 9,132,283</b>	<b>\$ 311,580,626</b>



## BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

### Notes to Financial Statements

*Foreign Currency Risk.* Foreign currency risk is the risk that significant fluctuations in exchange rates may adversely affect the fair value of an investment. The Plan has no policies relating to foreign currency risk. The Plan's exposure to foreign currency risk is summarized as follows:

Investment/ Country	Currency	Fair Value (in U.S. Dollars)	
		International Equities	International Fixed Income
Australia	Australian Dollar	\$ -	\$ 685,851
Belgium	European Euro	-	589,860
Brazil	Brazilian Real	38,500	207,795
Canada	Canadian dollar	517,554	1,161,998
Cayman Islands	Cayman Dollar	230,827	85,398
Chile	Chilean Peso	-	127,216
Denmark	Danish Krone	-	247,945
France	European Euro	218,997	1,068,709
Germany	European Euro	-	333,491
Hong Kong	Hong Kong Dollar	-	200,098
International Region	Special Drawing Right	27,638,354	-
Israel	Israeli New Sheqel	258,000	350,239
Japan	Japanese Yen	-	325,765
Netherlands	European Euro	41,854	1,070,905
New Zealand	New Zealand Dollar	-	-
Norway	Norwegian Krone	-	157,383
Peru	Peruvian Nuevo Sol	-	168,955
Republic of Korea	South Korean Won	-	200,744
Switzerland	Swiss Franc	-	100,634
United Kingdom	British Pound	-	2,001,210
Total international investments		<u>\$ 28,944,086</u>	<u>\$ 9,084,196</u>

*Rate of Return.* For the year ended December 31, 2016, the annual money-weighted rate of return on Plan's investments, net of Plan investment expenses, was 7.70%. The money-weighted rate of return expresses investment performance, net of investment expenses, adjusted for the changing amounts that are actually invested.

## BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

### Notes to Financial Statements

#### *Fair Value Measurement*

The Plan categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the assets. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. The County had the following recurring fair value measurements as of year end:

Investment Type	Level 1	Level 2	Level 3	Total Fair Value
Convertible equities	\$ 1,273,456	\$ -	\$ -	\$ 1,273,456
Domestic equities	183,470,424	-	-	183,470,424
International equities	28,625,186	318,900	-	28,944,086
Preferred stock	366,506	-	-	366,506
Private equities	-	15,533,676	-	15,533,676
Asset-backed securities	-	57,431	-	57,431
Corporate bonds	27,420,626	418,660	-	27,839,286
Corporate convertible bonds	-	8,649,220	-	8,649,220
Government agencies	51,471	397,660	-	449,131
Government bonds	1,132,794	9,783,847	-	10,916,641
Government issued commercial mortgage-backed securities	-	4,427,140	-	4,427,140
Government mortgage-backed securities	-	11,437,150	-	11,437,150
International bonds	8,767,916	316,280	-	9,084,196
	<u>\$ 251,108,379</u>	<u>\$ 51,339,964</u>	<u>\$ -</u>	<u>\$ 302,448,343</u>
Investments carried at amortized cost - Money market funds				<u>9,132,283</u>
<b>Total</b>				<u><b>\$ 311,580,626</b></u>

The following is a description of the valuation methodology used for assets recorded at fair value. There have been no changes from the prior year in the methodologies used.

Convertible, domestic and foreign equities, preferred stock, corporate bonds, government agencies, government bonds, international bonds and other fixed income classified as Level 1 of the fair value hierarchy are valued based on quoted market prices in active markets.

Private equities, asset backed securities, commercial mortgage-backed securities, corporate bonds, corporate convertible bonds, government agencies, government bonds, government mortgage-backed, government issued commercial mortgage-backed, international bonds and municipal bonds are classified as Level 2 of the fair value hierarchy and are valued using a matrix pricing technique. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices.

## REQUIRED SUPPLEMENTARY INFORMATION

# BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

## Required Supplementary Information

### Schedule of Investment Returns

Fiscal Year Ending December 31,	Annual Return *
2014	7.89%
2015	0.77%
2016	7.70%

\* Annual money-weighted rate of return, net of investment expenses

Note: GASB 67 was implemented in fiscal year 2014. This schedule is being built prospectively. Ultimately, 10 years of data will be presented.

## INDEPENDENT AUDITORS' COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

June 30, 2017

Bay County Board of Commissioners  
and the Bay County Retirement Board of Trustees  
Bay County, Michigan

We have audited the financial statements of the *Bay County Employees' Retirement System Defined Benefit Plan* (the "Plan") as of and for the year ended December 31, 2016, and have issued our report thereon dated June 30, 2017. Professional standards require that we advise you of the following matters relating to our audit.

### Our Responsibility in Relation to the Financial Statement Audit

As communicated in our engagement letter dated January 4, 2017 and our change order dated February 1, 2017, our responsibility, as described by professional standards, is to form and an express opinions about whether the financial statements that have been prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, as part of our audit, we considered the internal control of the Plan solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

### Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter and in our meeting about planning matters on May 1, 2017.

### Compliance with All Ethics Requirements Regarding Independence

The engagement team, others in our firm, as appropriate, and our firm has complied with all relevant ethical requirements regarding independence.

## Qualitative Aspects of the Plan's Significant Accounting Practices

### *Significant Accounting Policies*

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the Plan is included in Note 2 to the financial statements.

There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during the year.

No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

### *Significant Accounting Estimates*

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on 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 markedly from management's current judgments.

The most sensitive accounting estimates affecting the financial statements were:

- The assumptions used in the actuarial valuations of the pension and other postemployment benefits plans are based on historical trends and industry standards.
- Management's estimate of the fair value of certain investments (primarily those that are not traded on a national or international exchange) is based on a variety of factors including the purchase price, changes in the financial condition and prospects of the issuer, calculations of the total enterprise value using discounted cash flow projections, trading comparables of securities of comparable companies engaged in similar businesses, estimates of liquidation value, the existence of restrictions on transferability, prices received in recent significant placements of securities of the same issuer, and other analytical data relating to the investment.

We evaluated the key factors and assumptions used to develop these estimates and determined that they are reasonable in relation to the basic financial statements taken as a whole and in relation to the applicable opinion units.

### *Financial Statement Disclosures*

Certain financial statement disclosures involve significant judgment and are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements relate to management's estimate of the valuation of investment securities recorded at fair value.

To the Bay County Board of Commissioners  
and the Bay County Retirement Board of Trustees  
June 30, 2017  
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### **Significant Difficulties Encountered During the Audit**

We encountered no significant difficulties in dealing with management relating to the performance of the audit.

### **Uncorrected and Corrected Misstatements**

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole and each applicable opinion unit. In addition, professional standards require us to communicate to you all material, corrected misstatements that were brought to the attention of management as a result of our audit procedures. We did not identify any misstatements during our audit.

### **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to the Plan's financial statements or the auditors' report. No such disagreements arose during the course of the audit.

### **Representations Requested from Management**

We have requested certain written representations from management, which are included in Attachment A to this letter.

### **Management's Consultations with Other Accountants**

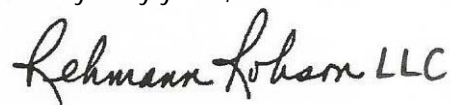
In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

### **Other Significant Matters, Findings, or Issues**

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

This information is intended solely for the use of the governing body and management of the Plan and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in black ink that reads "Lehmann Johnson LLC". The signature is written in a cursive, flowing style.

# BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM DEFINED BENEFIT PLAN

## Attachment A - Management Representations

For the December 31, 2016 Audit

The following pages contain the written representations that we requested from management.





**BAY COUNTY EMPLOYEES' RETIREMENT SYSTEM  
BAY COUNTY VOLUNTARY EMPLOYEES' BENEFICIARY ASSOCIATION**

BAY COUNTY BUILDING  
515 CENTER AVENUE  
BAY CITY, MICHIGAN 48708-5128

Jan Histed  
Secretary

BOARD OF TRUSTEES  
Steven Gray, Chairperson  
Richard Brzezinski  
Kristal Gonzales  
Richard Gromaski  
Thomas M. Herek  
Jon Morse  
Matthew Pett  
Thomas Ryder  
Thomas Starkweather

June 30, 2017

Rehmann Robson  
5800 Gratiot Road, Suite 201  
Saginaw, MI 48638

ADMINISTRATIVE STAFF  
Katie Meeth  
Tracy Cederquist  
(989) 895-4043  
TDD (989) 895-4049  
FAX (989) 895-2076

This representation letter is provided in connection with your audit of the financial statements of *Bay County Employees' Retirement System Defined Benefit Plan*, as of and for the year ended December 31, 2016, and the related notes to the financial statements, for the purpose of expressing opinions on whether the basic financial statements present fairly, in all material respects, the financial position and results of operations the *Bay County Employees' Retirement System Defined Benefit Plan* in conformity with accounting principles generally accepted for governments in the United States of America (U.S. GAAP).

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm that, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves as of June 30, 2017:

**Financial Statements**

1. We have fulfilled our responsibilities, as set out in the terms of the audit engagement letter dated January 4, 2017 and our change order dated February 1, 2017, for the preparation and fair presentation of the financial statements of the various opinion units referred to above in accordance with U.S. GAAP. We have reviewed, approved, and taken responsibility for the financial statements and related notes.
2. We acknowledge our responsibility for 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.
3. We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.
4. Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
5. Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of U.S. GAAP. For the purposes of this letter, related parties mean members of the governing body; board members; administrative officials; immediate families

- of administrative officials, board members, and members of the governing body; and any companies affiliated with or owned by such individuals.
6. All events subsequent to the date of the financial statements and for which U.S. GAAP requires adjustment or disclosure have been adjusted or disclosed.
  7. The effects of all known actual or possible litigation and claims have been accounted for and disclosed in accordance with U.S. GAAP.
  8. With regard to items reported at fair value:
    - a. The underlying assumptions are reasonable and they appropriately reflect management's intent and ability to carry out its stated courses of action.
    - b. The measurement methods and related assumptions used in determining fair value are appropriate in the circumstances and have been consistently applied.
    - c. The disclosures related to fair values are complete, adequate, and in conformity with U.S. GAAP.
    - d. There are no subsequent events that require adjustments to the fair value measurements and disclosures included in the financial statements.
  9. All funds and activities are properly classified.
  10. All funds that meet the quantitative criteria in GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, for presentation as major are identified and presented as such and all other funds that are presented as major are considered important to financial statement users.
  11. All components of net position have been properly reported.
  12. Deposit and investment risks have been properly and fully disclosed.
  13. All required supplementary information is measured and presented within the prescribed guidelines.
  14. We believe that the actuarial assumptions and methods used to measure pension liabilities and costs for financial accounting purposes are appropriate in the circumstances.

#### **Information Provided**

15. We have provided you with:
  - a. Access to all information, of which we are aware that is relevant to the preparation and fair presentation of the financial statements of the various opinion units referred to above, such as records, documentation, meeting minutes, and other matters;
  - b. Additional information that you have requested from us for the purpose of the audit; and
  - c. Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
16. All transactions have been recorded in the accounting records and are reflected in the financial statements.
17. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
18. We have no knowledge of any fraud or suspected fraud that affects the entity and involves:
  - a. Management;
  - b. Employees who have significant roles in internal control; or
  - c. Others where the fraud could have a material effect on the financial statements.
19. We have no knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, vendors, regulators, or others.

20. We are not aware of any pending or threatened litigation and claims whose effects should be considered when preparing the financial statements and we have not consulted legal counsel concerning litigation or claims.
21. We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.
22. There have been no communications from regulatory agencies concerning noncompliance with or deficiencies in accounting, internal control, or financial reporting practices.
23. The government has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
24. We have disclosed to you all guarantees, whether written or oral, under which the government is contingently liable.
25. We have identified and disclosed to you the laws, regulations, and provisions of contracts and grant agreements that could have a direct and material effect on financial statement amounts, including legal and contractual provisions for reporting specific activities in separate funds.
26. There are no:
  - a. Violations or possible violations of laws or regulations, or provisions of contracts or grant agreements whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency, including applicable budget laws and regulations.
  - b. Unasserted claims or assessments that our lawyer has advised are probable of assertion and must be disclosed in accordance with GASB-62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.
  - c. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by GASB-62.
27. The government has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset or future revenue been pledged as collateral, except as disclosed to you.
28. We have complied with all aspects of grant agreements and other contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
29. We have disclosed to you all significant estimates and material concentrations known to management that are required to be disclosed in accordance with GASB-62. Significant estimates are estimates at the balance sheet date that could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year.

#### **Required Supplementary Information**

30. With respect to the required supplementary information accompanying the financial statements:
  - a. We acknowledge our responsibility for the presentation of the required supplementary information in accordance with accounting principles generally accepted in the United States of America.
  - b. We believe the required supplementary information, including its form and content, is measured and fairly presented in accordance with accounting principles generally accepted in the United States of America.
  - c. The methods of measurement or presentation have not changed from those used in the prior period.
  - d. We believe the significant assumptions or interpretations underlying the measurement or presentation of the required supplementary information, and the basis for our assumptions and interpretations, are reasonable and appropriate in the circumstances.

*Stam G. Gray*

Chairman of the Board

*Jan M. Husted*

Finance Officer