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September 27, 2016

Management and the Board of Education
Southgate Community School District
14600 Dix Toledo Road
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We have completed our audit of the financial statements of the governmental activities, each major fund, and aggregate remaining fund information of Southgate Community School District as of and for the year ended June 30, 2016, and have issued our report dated September 27, 2016. We are required to communicate certain matters to you in accordance with auditing standards generally accepted in the United States of America that are related to internal control and the audit. The first appendix to this letter sets forth those communications as follows:

I. Auditors' Communication of Significant Matters with Those Charged with Governance

In addition, we have identified additional matters that are not required to be communicated but we believe are valuable for management:

II. Matters for Management's Consideration

We discussed these matters with various personnel in the School District during the audit and we would also be pleased to meet with you to discuss these matters at your convenience.

These communications are intended solely for the information and use of management, the Board of Education, and others within the School District, and are not intended to be and should not be used by anyone other than those specified parties.

Yeo & Yeo, P.C.

Ann Arbor, Michigan

Appendix I

Auditors' Communication of Significant Matters with Those Charged with Governance

Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America, *Government Auditing Standards* and Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our engagement letter dated June 27, 2016. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the School District are described in Note 1 of the financial statements. The School District has adopted Governmental Accounting Standards Board Statements (GASB) No. 72, 76, 79, and 82, *Fair Value Measurement and Application, Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statement 67 and 68, The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments, Certain External Investment Pools and Pool Participants, and Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73, respectively*. GASB No. 72, 76, and 79 are effective July 1, 2015, and GASB 82 is effective for years beginning July 1, 2016, however, early implementation is encouraged. Statement No. 72 addresses accounting and financial reporting issues related to fair value measurements. Statement 76 identifies the hierarchy of generally accepted accounting principles. Statement 79 addresses accounting and financial reporting for certain external investment pools and pool participants. Statement 82 amends Statements 67 and 68 to instead require the presentation of covered payroll, defined as the payroll on which contributions to a pension plan are based, and ratios that use that measure. We noted no transactions entered into by the School District during the year where there is lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

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 School District's financial statements were:

- The useful lives of its capital assets. Useful lives are estimated based on the expected length of time during which the asset is able to deliver a given level of service.
- Net pension liability, and related deferred outflows of resources and deferred inflows of resources. The estimate is based on an actuarial report.
- Management's estimate of the accrued compensated absences is based on current hourly rates and policies regarding payment of sick and vacation banks.

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 and free from bias.

Disclosures in the financial statements are neutral, consistent and clear.

Accounting Standards and Regulatory Updates

Accounting Standards

The Governmental Accounting Standards Board has released the following Statements:

GASB Statement No. 74 *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* addresses the other postemployment benefits plans (OPEB) – defined benefit and defined contribution – administered through trusts. This Statement will improve the financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that will be presented by OPEB plans that are administered through trusts. This information will enhance the transparency by providing information about measures of net OPEB liabilities and explanations of how and why those liabilities changed from year to year. Statement No. 74 is effective for the fiscal year ending June 30, 2017.

GASB Statement No. 75 *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined OPEB plans, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee services. It also requires additional note disclosures and required supplementary information. Statement No. 75 is effective for the fiscal year ending June 30, 2018.

GASB Statement No. 77, *Tax Abatement Disclosures* requires disclosure of tax abatement information about (1) a reporting government's own tax abatement agreements and (2) those that are entered into by other governments and that reduce the reporting government's tax revenues. The requirements of this Statement are effective for the fiscal year ending June 30, 2017.

GASB Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14* amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The requirements of this Statement are effective for the fiscal year ending June 30, 2017.

GASB Statement No. 81, *Irrevocable Split-Interest Agreements*. The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. Statement No. 81 is effective for the fiscal year ending June 30, 2018.

The School District is evaluating the impact the above GASBs will have on its financial reporting.

Regulatory and Other Updates

Cybersecurity and data backup best practices

The School District's data is critically important. There are millions of ways data can be compromised. It is vitally important that all employees have proper knowledge on what is safe to click on and what is not. It is equally important that a proper data backup solution is in place in the event a School District's information is targeted by malware or a phishing attack. A School District's vital information is always a moment away from being compromised. Encouraging and educating employees to pay attention to what they click on and what they do is the first step in keeping information safe.

Having a proper data backup solution in place can mean the difference between a School District surviving a cyber-attack or losing valuable data and time. Every School District should know the answer to two questions when looking at data backup solutions.

1. How long can my District survive a network outage?
Many School Districts assume that they are properly backing up their network but how often are those backups tested? Internally managed backups are more susceptible to lack of testing. Management often believes they have successful backups but in the moment of a disaster, they find out that their last successful backup was months ago. Test backups often to make sure files can be recovered when needed.
2. Does our District understand the difference between a backup and disaster recovery?
Management often assumes that simply backing up files is “good enough”. Backing up files is something all School Districts should do. However, it’s important to remember that restoring files and emails is one thing, but recovering and restoring all District data in the event of a disaster is another.

Audit and FID Submission Deadline

Beginning last year, the deadline to submit the Financial Information Database (FID) and the school district financial audits was November 1st. This will continue to be the deadline for current and future fiscal years.

Uniform Grant Guidance (Super Circular)

In December 2013, the Federal Office of Management and Budget (OMB) issued final guidance on administrative requirements. The Guidance supersedes and streamlines requirements from OMB Circulars A-21, A-87, A-110, A-122, A-89, A-102 and A-133 and the guidance in Circular A-50 on Single Audit Act follow-up. Districts implemented the new administrative requirements and Cost Principles for all new federal grants awarded after December 26, 2014, and to additional funding to existing awards (referred to as funding increments) made after that date. EDGAR is the source for guidance that school districts will follow. Additional information and resources are available at the following websites:

- OMB http://www.whitehouse.gov/omb/grants_docs
- Council on Federal Assistance Reform (COFAR) <https://cfo.gov/cofar/>
- US Department of Education <http://1.usa.gov/1rzFswz>
- EDGAR <http://1.usa.gov/1pOUq2p>
- MDE http://www.michigan.gov/mde/0,4615,7-140-5236_76204---,00.html

Fiscal Year (FY) 2017 School Aid

- The Omnibus Education Bill (Senate Bill 801) for FY 2017 has been passed by the legislature. It has been presented to the Governor for signature. There is always the possibility of vetoes. Following are some highlights of the bill:
- The per pupil Foundation Grants for FY 2017 will increase by a range of \$60 to \$120 using the “2X formula.” The increase will be added to the FY 2016 foundation grant resulting in the lowest foundation for FY 2017 being \$7,511 and the maximum state guaranteed foundation being \$8,229.
- A new Section 20m would provide hold harmless districts with the difference in per pupil funding between \$60 and the increase in their foundation which is limited to the rate of inflation (.1% in this case).
- The Pupil Membership Blend will remain at 90% of the current school year October count and 10% of the prior school year February count.
- The Section 31a At-Risk funding is maintained at \$389,685,500.
- The per pupil funding under Sections 20f(2) and 20f(4) will be equal to the per pupil funding under those Sections in 2015-16.
- ISD General Operation funding under Section 81 will remain at \$67.1 million.
- An additional \$90 million is appropriated in Section 147c to reflect the actuarially estimated costs of the required state share of the MPSERS Unfunded Accrued Liability (UAL) and maintain the UAL cap at 20.96%.

Other School Aid “Boilerplate” Changes

- Section 18 has been amended to require that the FID data and audited financial statements must be consistent or school aid must be withheld.
- Sections 6(4) and 25e have been amended to restrict districts from counting a prorated FTE for pupils who transfer from a district/academy that counted the pupil on the October pupil count day to another district/academy prior to the February count day. Beginning in 2016-17 only strict discipline academies will be allowed to count a prorated FTE in these cases.
- Section 51a(15) has been amended to state that there will be a 10% state school aid penalty for a district or ISD that does not comply with the language in Section 51a(14) that requires the pupil’s resident district and/or ISD to provide special education services and cover special education added costs for pupils educated in a Public School Academy who reside outside of the ISD in which the academy is located.
- The Section 101 Instructional Day requirement will go from a minimum of 175 days to a minimum of 180 days beginning with the 2016-17 school year.

Early Warning

Pursuant to Public Act 109 of 2015, each school district and public school academy that has a general fund balance less than 5% of total unrestricted general revenue for either of the 2013-2014 or 2014-2015 school fiscal years is required to submit budget assumptions to the Center for Educational Performance and Information (CEPI).

Uniform Budgeting and Accounting Act (UBAA)

The UB&AA establishes budget and accounting requirements for local governments and school districts, including public school academies. It also establishes oversight requirements for MDE as well as the Michigan Attorney General. Material violations of the UBAA, including but not limited to general fund deficits, should be reported as financial statement findings in the audit report. UBAA states that if it becomes apparent during the year that the probable revenues will be less than the budgeted revenues, the fiscal officer shall present recommendations to the legislative body which, if adopted, would prevent expenditures from exceeding available revenues for the fiscal year. UBAA states that an officer of the district shall not incur expenditures against an appropriation account in excess of the amount appropriated by the board. Noncompliance includes, but is not limited to, over-expending the budget authorized by the board. MDE is analyzing the general fund only, and at the total revenues, expenditures and financing sources (uses) levels, rather than at the line item level. MDE has stated a 0% tolerance for UBAA noncompliance.

Difficulties Encountered in Performing the Audit

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

Corrected and Uncorrected Misstatements

Professional standards require that the auditor accumulate all known and likely misstatements identified during the audit, other than those the auditor believes to be trivial, and communicate them to the appropriate level of management. There were no misstatements detected as a result of audit procedures that were more than trivial.

Management has determined that the effects of the uncorrected misstatements below are immaterial both individually and in the aggregate, qualitatively and quantitatively, to the financial statements taken as a whole.

In 2015, management passed on recording an entry to defer tax receivable not collected within 60 days. The impact on the 2016 financial statements is that revenues were understated by \$24,848 and beginning fund balance was overstated by \$24,848.

Disagreements with Management

For purposes 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 auditors' report. We are pleased to report we had no disagreements with management during the audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated as of the date of the audit report.

Management's Consultations with Other Accountants

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

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the School District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Emphasis of Matters in Independent Auditors' Report

The School District posted a prior period adjustment, and our report will include the following emphasis of matter paragraph:

Prior Period Adjustment

As described in Note 14 to the financial statements, the 2015 financial statements have been restated to correct a misstatement. Our opinions are not modified with respect to this matter.

The School District adopted a new accounting standard, and our report will include the following emphasis of matter paragraph:

Adoption of New Accounting Standard

As described in Note 1 to the financial statements, during the year ended June 30, 2016, the School District adopted GASB Statements No. 72, 76, 79, and 82, *Fair Value Measurement and Application, The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments, Certain External Investment Pools and Pool Participants, and Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73, respectively*. Our opinions are not modified with respect to this matter.

Other Reports

Other information that is required to be reported to you is included in the: Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*; Report on Compliance For Each Major Federal Program; Report on Internal Control over Compliance; Report on Schedule of Expenditures of Federal Awards Required

by the Uniform Grant Guidance; and the Schedule of Findings and Questioned Costs Responses. Please read all information included in those reports to ensure you are aware of relevant information.

Report on Required Supplementary Information

With respect to the required supplementary information accompanying the financial statements, which includes management's discussion and analysis, schedule of school district's proportionate share of net pension liability, schedule of school district's contributions, and budgetary comparison information, we 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 regarding 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.

Report on Other Supplementary Information

With respect to the other supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

Appendix II
Matters for Management's Consideration

In planning and performing our audit of the financial statements of Southgate Community School District as of and for the year ended June 30, 2016, we considered Southgate Community School District's internal control over financial reporting (internal control) as a basis for designing our audit procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School District's internal control. Accordingly, we do not express an opinion on the effectiveness of the School District's internal control.

However, during our audit we became aware of a matter for management's consideration that is an opportunity for strengthening internal controls. This letter does not affect our report dated September 27, 2016, on the financial statements of Southgate Community School District . Our comment and recommendation regarding this matter is:

Fund Balance Policy

Now that the School District has come out of a deficit, and is working towards having available fund balance, it is important to develop a fund balance policy in accordance with GASB No. 54. The policy should include the prioritization of fund balance use when an expenditure is incurred for purposes for which both restricted and unrestricted amounts are available. The School District can include a minimum fund balance goal in the policy as well and strategies to be utilized when the fund balance falls below the minimum.