

Auditing Procedures Report

Issued under Public Act 2 of 1968, as amended.

Unit Name	Bay Area Narcotics Enforcement	County	BAY	Type	OTHER	MuniCode	09-7-515
Opinion Date	June 23, 2008	Audit Submitted		Fiscal Year		12/31/2007	

If a local unit of government (authorities & commissions included) is operating within the boundaries of the audited entity and is NOT included in this or any other audit report, nor do they obtain a stand-alone audit, enclose the name(s), address(es), and a description(s) of the authority and/or commission.

Place a check next to each "Yes" or non-applicable question below. Questions left unmarked should be those you wish to answer "No".

<input checked="" type="checkbox"/>	1. Are all required component units/funds/agencies of the local unit included in the financial statements and/or disclosed in the reporting entity notes to the financial statements?
<input checked="" type="checkbox"/>	2. Does the local unit have a positive fund balance in all of its unreserved fund balances/unrestricted net assets?
<input checked="" type="checkbox"/>	3. Were the local unit's actual expenditures within the amounts authorized in the budget?
<input checked="" type="checkbox"/>	4. Is this unit in compliance with the Uniform Chart of Accounts issued by the Department of Treasury?
<input checked="" type="checkbox"/>	5. Did the local unit adopt a budget for all required funds?
<input checked="" type="checkbox"/>	6. Was a public hearing on the budget held in accordance with State statute?
<input checked="" type="checkbox"/>	7. Is the local unit in compliance with the Revised Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, and other guidance as issued by the Local Audit and Finance Division?
<input checked="" type="checkbox"/>	8. Has the local unit distributed tax revenues, that were collected for another taxing unit, timely as required by the general property tax act?
<input checked="" type="checkbox"/>	9. Do all deposits/investments comply with statutory requirements including the adoption of an investment policy?
<input checked="" type="checkbox"/>	10. Is the local unit free of illegal or unauthorized expenditures that came to your attention as defined in the Bulletin for Audits of Local Units of Government in Michigan, as revised (see Appendix H of Bulletin.)
<input checked="" type="checkbox"/>	11. Is the unit free of any indications of fraud or illegal acts that came to your attention during the course of audit that have not been previously communicated to the Local Audit and Finance Division? (If there is such activity, please submit a separate report under separate cover.)
<input type="checkbox"/>	12. Is the local unit free of repeated reported deficiencies from previous years?
<input checked="" type="checkbox"/>	13. Is the audit opinion unqualified?
	14. If not, what type of opinion is it? <input type="text" value="NA"/>
<input checked="" type="checkbox"/>	15. Has the local unit complied with GASB 34 and other generally accepted accounting principles (GAAP)?
<input checked="" type="checkbox"/>	16. Has the board or council approved all disbursements prior to payment as required by charter or statute?
<input checked="" type="checkbox"/>	17. To your knowledge, were the bank reconciliations that were reviewed performed timely?
<input checked="" type="checkbox"/>	18. Are there reported deficiencies?
<input checked="" type="checkbox"/>	19. If so, was it attached to the audit report?

General Fund Revenue:	<input type="text" value="993304"/>
General Fund Expenditure:	<input type="text" value="895945"/>
Major Fund Deficit Amount:	<input type="text" value="N/A"/>

General Fund Balance:	<input type="text" value="251120"/>
Governmental Activities Long-Term Debt (see instructions):	<input type="text" value="N/A"/>

We affirm that we are certified public accountants (CPA) licensed to practice in Michigan. We further affirm the above responses have been disclosed in the financial statements, including the notes, or in the Management Letter (Reported deviations).

CPA (First Name)	Gerald	Last Name	Desloover	Ten Digit License Number	1101007126		
CPA Street Address	5800 Gratiot, PO Box 2025	City	Saginaw	State	MI	Zip Code	48605
CPA Firm Name	Rehmann Robson	Unit's Street Address	P.O. Box 676	City	Freeland	Zip Code	48623
Telephone	(989) 799-9580						

**BAY AREA NARCOTICS
ENFORCEMENT TEAM (BAYANET)**

Bay City, Michigan

FINANCIAL STATEMENTS

**For the Year Ended
December 31, 2007**

**BAY AREA NARCOTICS
ENFORCEMENT TEAM (BAYANET)**

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REHMANN ROBSON

Certified Public Accountants

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INDEPENDENT AUDITORS' REPORT

June 23, 2008

To the Board of Directors
Bay Area Narcotics Enforcement
Team (BAYANET)
Saginaw, Bay, Midland, Gladwin,
Isabella and Clare, Michigan

We have audited the accompanying financial statements of the governmental activities, the major fund and the remaining fund information of the **Bay Area Narcotics Enforcement Team** ("BAYANET"), a component unit of Bay County, Michigan, as of and for the year ended December 31, 2007, which collectively comprise BAYANET's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of BAYANET's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 respective financial position of the governmental activities, the major fund and the remaining fund information of the **Bay Area Narcotics Enforcement Team** as of December 31, 2007, and the respective changes in its financial position thereof and the budgetary comparison for the General Fund for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The **Bay Area Narcotics Enforcement Team** has not presented a Management's Discussion and Analysis ("MD&A") as required supplementary information that the *Governmental Accounting Standards Board* has determined is necessary to supplement, although not required to be, a part of the basic financial statements.

BAY AREA NARCOTICS ENFORCEMENT TEAM (BAYANET)

STATEMENT OF NET ASSETS AND GENERAL FUND BALANCE SHEET

DECEMBER 31, 2007

	<u>General Fund</u>	<u>Adjustments</u>	<u>Statement of Net Assets</u>
Assets			
Cash and cash equivalents	\$ 260,866	\$ -	\$ 260,866
Accounts receivable	71,071	-	71,071
Capital assets, net of accumulated depreciation	-	28,771	28,771
Total assets	<u>\$ 331,937</u>	<u>28,771</u>	<u>360,708</u>
Liabilities			
Accounts payable	\$ 67,112	-	67,112
Accrued liabilities	13,705	-	13,705
Total liabilities	<u>80,817</u>	<u>-</u>	<u>80,817</u>
Fund Balance / Net Assets			
Fund Balance:			
Unreserved	<u>251,120</u>	<u>(251,120)</u>	<u>-</u>
Total liabilities and fund balance	<u>\$ 331,937</u>		
Net Assets:			
Invested in capital assets		28,771	28,771
Unrestricted		<u>251,120</u>	<u>251,120</u>
Total net assets		<u>\$ 279,891</u>	<u>\$ 279,891</u>

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

BAY AREA NARCOTICS ENFORCEMENT TEAM (BAYANET)

STATEMENT OF ACTIVITIES AND GENERAL FUND REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

FOR THE YEAR ENDED DECEMBER 31, 2007

	<u>General Fund</u>	<u>Adjustments</u>	<u>Statement of Activities</u>
Expenditures / expenses			
Public safety	<u>\$ 895,945</u>	<u>\$ (139)</u>	<u>\$ 895,806</u>
Program revenues			
Charges for services	519,562	-	519,562
Operating grants and contributions	<u>468,711</u>	<u>-</u>	<u>468,711</u>
Total program revenues	<u>988,273</u>	<u>-</u>	<u>988,273</u>
Net program revenues			92,467
General revenues			
Interest earnings	<u>5,031</u>	<u>-</u>	<u>5,031</u>
Revenues over (under) expenditures	97,359	(97,359)	-
Change in net assets	-	97,498	97,498
Fund balance / net assets			
Beginning of the year	<u>153,761</u>	<u>28,632</u>	<u>182,393</u>
End of the year	<u>\$ 251,120</u>	<u>\$ 28,771</u>	<u>\$ 279,891</u>

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

BAY AREA NARCOTICS ENFORCEMENT TEAM (BAYANET)

**STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE - BUDGET AND ACTUAL -
GENERAL FUND**

FOR THE YEAR ENDED DECEMBER 31, 2007

	Original Budget	Final Budget	Actual	Actual Over (Under) Final Budget
Revenues				
Forfeitures	\$ 741,916	\$ 741,916	\$ 445,666	\$ (296,250)
Grants - Saginaw Chippewa Tribe	-	-	389,200	389,200
Interest income	-	-	5,031	5,031
Reimbursements	-	-	73,896	73,896
Other	-	-	79,511	79,511
Total revenues	741,916	741,916	993,304	251,388
Expenditures				
Wages and payroll taxes	265,000	265,000	289,079	24,079
Office supplies	10,000	10,000	7,881	(2,119)
Narcotics / operational purchases	55,000	55,000	68,291	13,291
Informants	-	-	24,995	24,995
Investigative	5,000	5,000	5,118	118
Office lease and utilities	44,400	44,400	51,625	7,225
Communications	26,300	26,300	27,127	827
Federal grant shares	-	-	38,371	38,371
Vehicle leases	145,000	145,000	166,104	21,104
Forfeiture costs	113,000	113,000	193,278	80,278
Contracted services	10,000	10,000	15,988	5,988
Equipment repairs	3,000	3,000	-	(3,000)
Vehicle repairs and towing	1,000	1,000	184	(816)
Education and training	7,500	7,500	(38)	(7,538)
Capital outlay	10,000	10,000	7,942	(2,058)
Other	46,716	46,716	-	(46,716)
Total expenditures	741,916	741,916	895,945	154,029
Net change in fund balance	-	-	97,359	97,359
Fund balance, beginning of year	153,761	153,761	153,761	-
Fund balance, end of year	<u>\$ 153,761</u>	<u>\$ 153,761</u>	<u>\$ 251,120</u>	<u>\$ 97,359</u>

The accompanying notes are an integral part of these financial statement

BAY AREA NARCOTICS ENFORCEMENT TEAM (BAYANET)

STATEMENT OF FIDUCIARY NET ASSETS

DECEMBER 31, 2007

	<u>Agency Fund</u>
Assets	
Cash and cash equivalents	<u>\$ 311,210</u>
Liabilities	
Unadjudicated seizures	<u>\$ 311,210</u>

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

BAY AREA NARCOTICS ENFORCEMENT TEAM (BAYANET)

Notes To Financial Statements

1. DESCRIPTION OF THE ENTITY

BAYANET was formed in 1981 as a cooperative, multi-jurisdictional unit of narcotic investigators comprised of personnel from municipal, county, and state law enforcement agencies within the Counties of Saginaw, Bay, Midland, Gladwin, Isabella and Clare.

BAYANET is a discretely presented component unit of the County of Bay, Michigan. Accordingly, the accounting policies of BAYANET conform to generally accepted accounting principles as applicable to governments.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Government-wide and fund financial statements

As permitted by GASB Statement No. 34, BAYANET uses an alternative approach reserved for single program governments to present combined government-wide fund financial statements by using a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column. Accordingly, this is presented in the Statement of Net Assets and General Fund Balance Sheet and the Statement of Activities and General Fund Revenues, Expenditures and Changes in Fund Balances.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Other items not properly included among program revenues are reported instead as *general revenues*.

BAYANET maintains only one governmental fund – the general fund, which is also considered a major fund for reporting purposes. BAYANET maintains a separate fiduciary fund for the purpose of holding non-adjudicated forfeitures. Separate financial statements are provided for the general fund and the fiduciary fund, even though the latter is excluded from the government-wide financial statements.

BAY AREA NARCOTICS ENFORCEMENT TEAM (BAYANET)

Notes To Financial Statements

Measurement focus, basis of accounting, and financial statement presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. The agency fund uses the accrual basis of accounting also, but does not have a measurement focus.

Governmental fund statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Modifications from the accrual basis are: (a) revenue is recognized when it becomes measurable and is available as a net current asset and (b) expenditures are recorded when the liability is incurred, except for principal and interest on long-term obligations which are recorded when due. Revenues are considered available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the government-wide financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

Amounts presented as *program revenues* include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Interest earned on deposits are reported as *general revenues* rather than as program revenues.

Deposits

Cash and cash equivalents consist of cash on hand and deposits in demand and time deposit accounts.

Accounts Receivable

Accounts receivable represent amounts due from Isabella County (payable from a grant awarded by the Saginaw Chippewa Indian Tribe of Michigan to BAYANET) and reimbursements for wages of personnel funded by member counties totaling \$31,654 which are expected to be collected within one year.

BAY AREA NARCOTICS ENFORCEMENT TEAM (BAYANET)

Notes To Financial Statements

Capital Assets

Capital assets are comprised of office equipment and are reported as governmental activities in the government-wide financial statements. Capital assets are defined by the Board as assets with an initial, individual cost of more than \$1,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Office equipment is depreciated using the straight-line method over estimated useful lives of 4 to 7 years.

Budgets and Budgetary Accounting

Formal budgetary integration is employed as a management control device during the year. BAYANET approves total budget amounts by function; BAYANET currently has one function, which is Public Safety. Unused appropriations for all items lapse at the end of the year.

Donated Services

Substantial services related to the utilization of personnel and personal property are contributed by cooperating law enforcement agencies. The value of these services has not been recognized in the financial statements. Any legal proceedings resulting from the actions of such personnel or the use of donated personal property are the responsibility of the donor agency.

**BAY AREA NARCOTICS
ENFORCEMENT TEAM (BAYANET)**

Notes To Financial Statements

3. DEPOSITS

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

	<u>Cash and Cash Equivalents</u>
Cash on hand	\$ 25,000
Other demand accounts	<u>547,076</u>
	<u>\$ 572,076</u>

This entire balance is considered to be deposits for disclosure purposes.

Deposit and investment risk

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

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

BAY AREA NARCOTICS ENFORCEMENT TEAM (BAYANET)

Notes To Financial Statements

- External investment pools as authorized by Public Act 20 as amended through December 31, 1997

Interest Rate Risk. BAYANET's investment policy does not have specific limits in excess of state law on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk. BAYANET's investment policy does not have specific limits in excess of state law on investment credit risk. At year-end, BAYANET had no investments and was therefore, not exposed to credit risk.

Custodial Credit Risk – Deposits. Custodial credit risk is the risk that in the event of a bank failure, BAYANET's deposits may not be returned. State law does not require and BAYANET does not have a policy for deposit custodial credit risk. At year-end, \$283,075 of BAYANET's bank balance of \$483,075 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Concentration of Credit Risk. State law limits allowable investments but does not limit concentration of credit risk. BAYANET's investment policy does not have specific limits in excess of state law on concentration of credit risk. At year-end, BAYANET had no investments and was therefore, not exposed to concentration of credit risk.

4. LEASE

BAYANET leases office space from SAHASA Realty Company on a month-to-month basis. Total rent expenditures for the year ended December 31, 2007, were \$21,960. BAYANET leases vehicles through the State of Michigan's procurement program. Total vehicle lease expenditures for the year ended December 31, 2007, were \$166,104.

**BAY AREA NARCOTICS
ENFORCEMENT TEAM (BAYANET)**

Notes To Financial Statements

5. CAPITAL ASSETS

Capital assets activity for the year ended December 31, 2007, was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Governmental activities				
Capital assets being depreciated:				
Office equipment	\$ 68,764	\$ 9,920	\$ -	\$78,684
Less accumulated depreciation for:				
Furniture and equipment	<u>(40,132)</u>	<u>(9,781)</u>	<u>-</u>	<u>(49,913)</u>
Governmental activities capital assets, net	<u>\$ 28,632</u>	<u>\$ 139</u>	<u>\$ -</u>	<u>\$28,771</u>

6. RISK MANAGEMENT

BAYANET is exposed to various risks of loss related to torts; theft of, damage to, and distribution of assets; errors and omissions; injuries to employees and natural disasters. BAYANET carries commercial insurance to cover any potential claims associated with these risks and has had no claims that exceeded the insurance coverage during the past three years.

BAY AREA NARCOTICS ENFORCEMENT TEAM (BAYANET)

Notes To Financial Statements

7. ADJUSTMENTS

Following is an explanation of the adjustments between the general fund balance sheet and the government-wide statement of net assets, which reconciles fund balance to net assets:

Fund balance	\$ 251,120
Adjustments:	
Capital assets that are purchased to be used in governmental activities are reported as expenditures in general fund. However, the statement of net assets includes those capital assets (net of accumulated depreciation) among BAYANET's assets as a whole	<u>28,771</u>
Net assets	\$ <u>279,891</u>

Following is an explanation of the adjustments between the general fund statement of revenues, expenditures and changes in fund balance and the government-wide statement of activities, which reconciles the net change in fund balances to the change in net assets:

Net change in fund balance	\$ 97,359
Adjustments:	
Governmental funds report capital outlay as expenditures. However in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.	9,920
Depreciation expense is reported in the statement of activities, but because depreciation does not require the use of current financial resources, it is not reported as an expenditure in the general fund.	<u>(9,781)</u>
Change in net assets	\$ <u>97,498</u>

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REHMANN ROBSON

Certified Public Accountants

A member of **THE REHMANN GROUP**

An Independent Member of Baker Tilly International

**COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE
UNDER SAS NO. 114**

June 23, 2008

To the Board of Directors
Bay Area Narcotics Enforcement
Team (BAYANET)
Saginaw, Bay, Midland, Gladwin
Isabella and Clare, Michigan

We have audited the financial statements of the governmental activities, the major fund, and the aggregate remaining fund information of the Bay Area Narcotics Enforcement Team (“BAYANET”) for the year ended December 31, 2007, and have issued our report thereon dated June 23, 2008. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under Auditing Standards Generally Accepted in the United States of America

As stated in our engagement letter dated December 28, 2007, our responsibility, as described by professional standards, is to express opinions about whether the financial statements 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 responsibilities.

Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control of BAYANET. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

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 *BAYANET* 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 the year. We noted no transactions entered into by the governmental unit 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 were:

- Management's estimate of the useful lives of depreciable capital assets is based on the length of time it is believed that those assets will provide some economic benefit in the future.

We evaluated the key factors assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

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 us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. The following material misstatements detected as a result of audit procedures were corrected by management: all audit entries that were posted to convert financial statements from cash basis to modified accrual basis and from modified accrual basis to full accrual basis. In other words, audit entries are required to properly account for receivables, payables, capital assets, etc.

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 auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated June 23, 2008.

Management Consultations with Other Independent Accountants

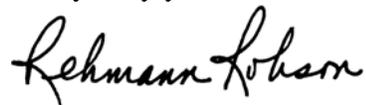
In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to the Entity’s financial statements or a determination of the 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 governmental unit’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the governing body and management of *BAYANET* 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, appearing to read "Lehmann Johnson", written in a cursive style.

BAYANET

Communication of Significant Deficiencies and Material Weaknesses

For the Year Ended December 31, 2007

In planning and performing our audit of the financial statements of the BAYANET as of and for the year ended December 31, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered BAYANET's internal control over financial reporting (internal control) as a basis for designing our auditing 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 *BAYANET*'s internal control. Accordingly, we do not express an opinion on the effectiveness of *BAYANET*'s internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. The deficiencies we noted that we consider to be significant deficiencies are described in items 1 and 2 attached.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

We believe that deficiencies 1 and 2 attached constitute material weaknesses.

BAYANET's written response to the material weaknesses identified in our audit have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

BAYANET

Communication of Significant Deficiencies and Material Weaknesses

For the Year Ended December 31, 2007

Lack of Adequate Controls to Produce Full-Disclosure GAAP Basis Financial Statements

- Criteria: All Michigan governments are required to prepare financial statements in accordance with generally accepted accounting principles (“GAAP”). This is a responsibility of the government’s management. The preparation of financial statements in accordance with GAAP requires internal controls over both (1) recording, processing, and summarizing accounting data (i.e., maintaining internal books and records), and (2) reporting government-wide and fund financial statements, including the related footnotes (i.e., external financial reporting.)
- Condition: As is the case with many smaller and medium-sized entities, the government has historically relied on its independent external auditors to assist in the preparation of the government-wide financial statements and footnotes as part of its external financial reporting process. Accordingly, BAYANET’s ability to prepare financial statements in accordance with GAAP is based, in part, on its reliance on its *external* auditors, who cannot by definition be considered a part of the government’s *internal* controls.
- Cause: This condition was caused by BAYANET’s decision that it is more cost effective to outsource the preparation of its annual financial statements to the auditors than to incur the time and expense of obtaining the necessary training and expertise required for the government to perform this task internally.
- Effect: As a result of this condition, BAYANET lacks internal controls over the preparation of financial statements in accordance with GAAP, and instead relies, in part, on its external auditors for assistance with this task.

BAYANET

Communication of Significant Deficiencies and Material Weaknesses

For the Year Ended December 31, 2007

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

1) Segregation of Duties

Criteria: Management is responsible for establishing and maintaining effective internal control over financial reporting and safeguarding BAYANET's assets.

Condition: During the course of our audit, we noted several instances where multiple key financial duties were being performed by the same individual and there were no mitigating controls in place to ensure effective internal controls. Specifically, we found that the following incompatible functions are being performed by the same individual:

- (1) The physical receipting of cash and checks is done by the individual who also prepares and make bank deposits
- (2) The individual who prepares bank reconciliations also handles cash receipts and disbursements
- (3) The individual who initiates transfers between bank accounts also prepares the bank reconciliations and has access to the general ledger

Cause: As is the case with many organizations of similar size, BAYANET lacks a sufficient number of personnel in order to ensure a complete segregation of duties within its accounting function.

BAYANET

Communication of Significant Deficiencies and Material Weaknesses

For the Year Ended December 31, 2007

Effect: BAYANET's current system of internal control does not appear to have sufficient safeguards in place to ensure that fraud or abuse is prevented or can be detected in a timely manner. Ideally, no single individual should ever be able to authorize a transaction, record the transaction in the accounting records and maintain custody of the assets resulting from the transaction. Effectively, proper segregation of duties is intended to prevent an individual from committing an act of fraud or abuse and be able to conceal it.

Recommendation: While there are no easy answers to the challenge of balancing the costs and benefits of internal controls and the segregation of duties, we would nevertheless encourage management to actively seek ways to further strengthen its internal control structure by requiring as much independent review, reconciliation, and approval of accounting functions by qualified members of management as possible.

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