

**BOARD OF COUNTY ROAD COMMISSIONERS
COUNTY OF BAY
DEPARTMENT OF WATER AND SEWER**

ANNUAL FINANCIAL STATEMENTS

DECEMBER 31, 2007

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April 17, 2008

Independent Auditors' Report

Board of County Road Commissioners
Bay County Department of Water and Sewer
Bay County, Michigan

We have audited the accompanying financial statements of the business-type activities, each major fund, and the aggregate remaining fund information of the Bay County Department of Water and Sewer, a component unit of the Bay County Road Commission, as of and for the year ended December 31, 2007, which collectively comprise the Bay County Department of Water and Sewer's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Bay County Department of Water and Sewer's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 business-type activities, each major fund, and the aggregate remaining fund information of the Bay County Department of Water and Sewer, as of December 31, 2007, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

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Board of County Road Commissioners
Bay County Department of Water and Sewer
April 17, 2008
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In accordance with *Government Auditing Standards*, we have also issued our report dated April 17, 2008, on our consideration of Bay County Department of Water and Sewer's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Required Supplemental Information

The management's discussion and analysis on pages 3a through 3g are not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles and the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Weinlander Fitzhugh

Board of County Road Commissioners
County of Bay
Department of Water and Sewer
Management's Discussion & Analysis
For the Year Ended December 31, 2007

The Bay County Department of Water and Sewer is presenting the following discussion and analysis in order to provide an overall review of the Department's financial activities for the fiscal year ending December 31, 2007. We encourage readers to consider the information presented here in conjunction with the Department's financial statements, and notes to the basic financial statements to enhance their understanding of the Department's financial performance.

FINANCIAL HIGHLIGHTS

- The Department of Water & Sewer's net assets decreased \$37,000.
- For 2007 "operating revenues" increased \$309,000 while "operating expenses" increased \$155,000.

OVERVIEW OF THE FINANCIAL STATEMENTS

The annual report includes management's discussion and analysis report, the independent auditor's report and the basic financial statements of the DWS. The financial statements also include notes that explain in more detail some of the information in the financial statements.

Government-wide financial statements. The government-wide financial statements are designed to provide readers with a broad overview of the DWS' finances, in a manner similar to a private-sector business.

The Statement of Net Assets presents information on all of the Department's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Department is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, population growth, and new or changed government legislation.

The Statement of Activities presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

Both of the government-wide financial statements report functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The business-type activities of the Department are the Water and Sewer systems.

Fund financial statements. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the Department can be divided into two categories: proprietary funds and fiduciary funds.

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Proprietary funds. Enterprise funds are used to report the same functions presented as business type-activities in the government-wide financial statements. The Department uses enterprise funds to account for its water and sewer systems.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Water and Sewer funds since both are considered to be major funds of the Department.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the Department's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

FINANCIAL ANALYSIS OF THE DEPARTMENT

The most common financial question posed to the DWS is "How did we do financially during 2007?" The Statement of Net Assets and the Statement of Activities report information about the Department's activities in a way that will help answer this question. These two statements report the net assets of the DWS and the changes in them.

Net Assets

The statement of net assets provides the perspective of the DWS as a whole. Exhibit A provides a summary of the DWS' net assets as of December 31, 2007 and 2006.

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Department of Water and Sewer
Management's Discussion & Analysis
For the Year Ended December 31, 2007

Exhibit A

	<u>2007</u>	<u>2006</u>
	(in thousands)	(in thousands)
Assets		
Current and other assets	\$ 13,579	\$ 15,433
Capital assets - net of accumulated depreciation	<u>17,941</u>	<u>18,510</u>
Total assets	<u>31,520</u>	<u>33,943</u>
Liabilities		
Current liabilities	758	458
Long-term liabilities	<u>9,517</u>	<u>12,203</u>
Total liabilities	<u>10,275</u>	<u>12,661</u>
Net Assets		
Invested in capital assets	17,941	18,510
Restricted	404	354
Unrestricted	<u>2,900</u>	<u>2,418</u>
Total net assets	<u>\$ 21,245</u>	<u>\$ 21,282</u>

Exhibit A focuses on net assets of the DWS. The DWS' net assets were approximately \$21.2 million at December 31, 2007. Capital assets, net of related debt, totaling \$17.9 million compares the original costs, less depreciation of the DWS' capital assets to long-term debt used to finance the acquisition of those assets, if any.

The \$404,000 in restricted net assets represents reserves for sewer system replacement in accordance with bond ordinances.

The \$2.9 million in unrestricted net assets of business type activities represents the *accumulated* results of all past and current years' operations.

The results of this year's operations for the DWS as a whole are reported in the statement of activities, which shows the changes in net assets for the year ended December 31, 2007.

Exhibit B provides a comparative summary of 2007 and 2006 operations.

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Exhibit B

Revenue	<u>2007</u> (in thousands)	<u>2006</u> (in thousands)
Program revenue:		
Charges for service	\$ 4,166	\$ 3,988
General revenue:		
Investment earnings	133	113
Other	<u>185</u>	<u>-</u>
Total revenue	<u>4,484</u>	<u>4,101</u>
 Function/Program Expenses		
Water	1,377	1,296
Sewer	<u>3,144</u>	<u>3,205</u>
Total expenses	<u>4,521</u>	<u>4,501</u>
 Decrease in Net Assets	 <u>\$ (37)</u>	 <u>\$ (400)</u>

While the Statement of Activities (page 5) shows the change in financial position of net assets, the Statement of Revenues, Expenses, and Changes in Fund Net Assets (page 7) provides answers as to the nature and source of these changes. As can be seen in Exhibit B above, the increase in charges for service and general revenues are the major factors in the improvement of the net asset decrease in 2007.

The Department's charges for service increased by \$178,000 to \$4,166,000 in 2007 due to an increase in gross service charges. General revenues increased because of an increase in investment earnings and an increase in other revenue.

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FINANCIAL ANALYSIS OF THE DEPARTMENT'S FUNDS

Proprietary funds. The Department's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

(In Thousands)	2007	
	Water	Sewer
Gross service charges	\$ 1,104	\$ 2,341
Cost of water	624	-
Gross profit	480	2,341
Operating revenue	207	94
Operating expenses	(526)	(2,951)
Nonoperating revenue	273	46
Change in net assets	<u>\$ 434</u>	<u>\$ (470)</u>
 Total net assets - end of year	 <u>\$ 5,376</u>	 <u>\$ 15,869</u>

(In Thousands)	2006	
	Water	Sewer
Gross service charges	\$ 904	\$ 2,240
Cost of water	500	-
Gross profit	404	2,240
Operating revenue	214	79
Operating expenses	(533)	(2,914)
Nonoperating revenue	73	37
Change in net assets	<u>\$ 158</u>	<u>\$ (558)</u>
 Total net assets - end of year	 <u>\$ 4,942</u>	 <u>\$ 16,340</u>

Budgetary Highlights

The preparation of budgets is not required for proprietary funds or fiduciary funds.

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Capital Assets

The Department of Water and Sewer had \$17,941,000 (net of accumulated depreciation) invested in capital assets as of December 31, 2007. The investment in capital assets includes land, buildings, improvements other than buildings, machinery and equipment, a water system and a sewer system.

	<u>2007</u> <u>(in thousands)</u>	<u>2006</u> <u>(in thousands)</u>
Land	\$ 63	\$ 63
Construction in Progress	-	5
Buildings	13,290	13,268
Improvements other than buildings	76	76
Machinery and Equipment	8,767	8,759
Water System	4,146	3,844
Sewer System	<u>17,170</u>	<u>17,170</u>
 Total capital assets	 43,512	 43,185
 Less accumulated depreciation	 <u>25,571</u>	 <u>24,675</u>
 Total capital assets	 <u>\$ 17,941</u>	 <u>\$ 18,510</u>

Long-Term Debt

As of December 31, 2007, the Department of Water and Sewer had \$9,170,000 in outstanding debt. This is a reduction of \$2,645,000 from December 31, 2006. The reduction represents principal payments made during the 2007 fiscal year.

The County obligated long-term debt is paid from contractual obligations with various local units. Additional information on the Bay County Department of Water and Sewer's long-term debt is provided in Note 4 of the financial statements.

Board of County Road Commissioners
County of Bay
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Management's Discussion & Analysis
For the Year Ended December 31, 2007

Contacting the Department's Management

This financial report is designed to provide our citizens, taxpayers, customers, and creditors with a general overview of the Department's finances and to show the Department's accountability for the money it receives. If you have questions about this report or need additional information, contact our Accounting Manager at 3933 Patterson Road, Bay City, Michigan 48706.

**Board of County Road Commissioners
County of Bay
Department of Water and Sewer
Statement of Net Assets
December 31, 2007**

	<u>Business- Type Activities</u>
<u>Assets</u>	
Cash and investments	\$ 3,649,422
Accounts receivable - net of allowance for uncollectible of \$7,000	174,213
Interest receivable	88,200
Due from other governments	0
Inventory - at cost	400,155
Prepaid expenses	97,418
Lease receivable	9,170,000
Capital assets less accumulated depreciation of \$25,571,298	<u>17,940,833</u>
Total assets	<u>31,520,241</u>
 <u>Liabilities</u>	
Accounts payable	604,484
Accrued payroll	76,490
Accrued interest payable	66,089
Deferred revenue and advances	10,340
Long-term liabilities:	
Due within one year	2,622,118
Due in more than one year	<u>6,895,333</u>
Total liabilities	<u>10,274,854</u>
 <u>Net Assets</u>	
Investment in capital assets - net of related debt	17,940,833
Restricted	403,995
Unrestricted	<u>2,900,559</u>
Total net assets	<u><u>\$ 21,245,387</u></u>

See accompanying notes to financial statements

Board of County Road Commissioners
County of Bay
Department of Water and Sewer
Statement of Activities
For The Year Ended December 31, 2007

<u>Function/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>			<u>Business- Type Activities Net (Expense) Revenue and Changes in Net Assets</u>
		Charges for Service	Operating Grants and Contributions	Capital Grants and Contributions	
Business-type Activities					
Water	\$ 1,377,400	\$ 1,538,692	\$ 0	\$ 0	\$ 161,292
Sewer	<u>3,144,238</u>	<u>2,627,216</u>	<u>0</u>	<u>0</u>	<u>(517,022)</u>
Total business-type activities	<u>\$ 4,521,638</u>	<u>\$ 4,165,908</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>(355,730)</u>
General revenues:					
					133,336
					<u>185,839</u>
					319,175
					<u>(36,555)</u>
					<u>21,281,942</u>
					<u>\$ 21,245,387</u>

See accompanying notes to financial statements

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County of Bay
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Statement of Net Assets
Proprietary Funds
December 31, 2007

		Business-type Activities - Enterprise Funds		
<u>Assets</u>		Water	Sewer	Total
Current assets:				
Cash and investments		\$ 2,265,048	\$ 1,384,374	\$ 3,649,422
Accounts receivable		155,456	25,757	181,213
Less allowance for uncollectible accounts		(7,000)	0	(7,000)
Interest receivable		48,588	39,612	88,200
Due from other governments		0	0	0
Inventory - at cost		385,866	14,289	400,155
Prepaid expenses		7,699	89,719	97,418
Total current assets		2,855,657	1,553,751	4,409,408
Lease receivable		4,330,000	4,840,000	9,170,000
Capital assets - at cost		5,780,267	37,731,864	43,512,131
Less allowance for depreciation		(2,647,132)	(22,924,166)	(25,571,298)
Net capital assets		3,133,135	14,807,698	17,940,833
Total assets		10,318,792	21,201,449	31,520,241
<u>Liabilities</u>				
Current liabilities:				
Bonds and leases payable		460,000	2,110,000	2,570,000
Accounts payable		495,303	109,181	604,484
Accrued payroll		40,492	35,998	76,490
Accrued interest payable		34,777	31,312	66,089
Advances		10,340	0	10,340
Compensated absences		4,735	47,383	52,118
Total current liabilities		1,045,647	2,333,874	3,379,521
Long-term liabilities:				
Compensated absences		26,831	268,502	295,333
Bonds and leases payable		3,870,000	2,730,000	6,600,000
Total long-term liabilities		3,896,831	2,998,502	6,895,333
Total liabilities		4,942,478	5,332,376	10,274,854
<u>Net Assets</u>				
Investment in capital assets - net of related debt		3,133,135	14,807,698	17,940,833
Restricted		0	403,995	403,995
Unrestricted		2,243,179	657,380	2,900,559
Total net assets		\$ 5,376,314	\$ 15,869,073	\$ 21,245,387

See accompanying notes to financial statements

Board of County Road Commissioners
County of Bay
Department of Water and Sewer
Statement of Revenues, Expenses and Changes in Fund Net Assets
Proprietary Funds
For The Year Ended December 31, 2007

	<u>Business-type Activities - Enterprise Funds</u>		
	<u>Water</u>	<u>Sewer</u>	<u>Total</u>
Gross service charges	\$ 1,104,504	\$ 2,340,760	\$ 3,445,264
Water costs	<u>624,488</u>	<u>0</u>	<u>624,488</u>
Gross profit	<u>480,016</u>	<u>2,340,760</u>	<u>2,820,776</u>
Operating revenues:			
Service connections	30,330	0	30,330
Charges, fees, etc.	<u>176,760</u>	<u>93,588</u>	<u>270,348</u>
Total operating revenues	<u>207,090</u>	<u>93,588</u>	<u>300,678</u>
Operating expenses:			
Personal services	191,409	1,483,891	1,675,300
Utilities	4,204	258,143	262,347
Chemicals	0	64,489	64,489
Operation and maintenance	44,967	248,236	293,203
Administration	61,193	177,062	238,255
Fiscal and other charges	19,575	6,077	25,652
Depreciation	<u>204,466</u>	<u>713,472</u>	<u>917,938</u>
Total operating expenses	<u>525,814</u>	<u>2,951,370</u>	<u>3,477,184</u>
Operating income (loss)	161,292	(517,022)	(355,730)
Nonoperating revenues (expenses):			
Other net revenue	5,139	0	5,139
Interest income	87,071	46,265	133,336
Interest expense	(227,098)	(192,868)	(419,966)
Payment by local unit	180,700	0	180,700
Interest income on leases	<u>227,098</u>	<u>192,868</u>	<u>419,966</u>
Change in net assets	434,202	(470,757)	(36,555)
Net assets - beginning of year	<u>4,942,112</u>	<u>16,339,830</u>	<u>21,281,942</u>
Net assets - end of year	<u>\$ 5,376,314</u>	<u>\$ 15,869,073</u>	<u>\$ 21,245,387</u>

See accompanying notes to financial statements

Board of County Road Commissioners
County of Bay
Department of Water and Sewer
Statement of Cash Flows
Proprietary Funds
For The Year Ended December 31, 2007

	<u>Business-type Activities - Enterprise Funds</u>		
	<u>Water</u>	<u>Sewer</u>	<u>Total</u>
Cash flows from operating activities:			
Cash received from customers	\$ 1,115,015	\$ 2,321,534	\$ 3,436,549
Cash payments to suppliers for goods and services	(449,324)	(735,563)	(1,184,887)
Cash payments to employees for services	(208,260)	(1,509,081)	(1,717,341)
Other operating income	466,380	93,588	559,968
Net cash provided by operating activities	<u>923,811</u>	<u>170,478</u>	<u>1,094,289</u>
Cash flows from capital and related financing activities:			
Advances (payments) from (to) other funds	95,681	0	95,681
Payments from (to) local units	93,800	0	93,800
Acquisition and construction of capital assets	(329,287)	(19,596)	(348,883)
Net cash used by capital and related financing activities	<u>(139,806)</u>	<u>(19,596)</u>	<u>(159,402)</u>
Cash flows from investing activities:			
Interest and investment earnings	89,403	45,960	135,363
Net increase (decrease) in cash and cash equivalents	873,408	196,842	1,070,250
Cash and cash equivalents, beginning of year	<u>1,391,640</u>	<u>1,187,532</u>	<u>2,579,172</u>
Cash and cash equivalents, end of year	<u>\$ 2,265,048</u>	<u>\$ 1,384,374</u>	<u>\$ 3,649,422</u>

See accompanying notes to financial statements

Board of County Road Commissioners
County of Bay
Department of Water and Sewer
Statement of Net Assets
Fiduciary Funds
December 31, 2007

		Private Purpose Trust Funds		
		Water	Sewer	Total
<u>Assets</u>				
Current assets:				
	Cash and investments	\$ 6,305,506	\$ 2,793,175	\$ 9,098,681
	Accounts receivable	383,647	506,812	890,459
	Less allowance for uncollectible accounts	(1,000)	0	(1,000)
	Interest receivable	43,687	26,440	70,127
	Due from other governments	0	0	0
	Special assessments	0	251,876	251,876
	Prepaid expenses	36,888	22,086	58,974
	Total current assets	6,768,728	3,600,389	10,369,117
	Restricted assets - cash and investments	8,309	0	8,309
	Total assets	6,777,037	3,600,389	10,377,426
<u>Liabilities</u>				
Current liabilities:				
	Accounts payable	1,460,973	67,311	1,528,284
	Accrued payroll	4,080	2,248	6,328
	Deferred revenue and advances	21,789	251,876	273,665
	Compensated absences	21,648	454	22,102
	Total current liabilities	1,508,490	321,889	1,830,379
Long-term liabilities:				
	Compensated absences	122,673	2,570	125,243
	Total long-term liabilities	122,673	2,570	125,243
	Total liabilities	1,631,163	324,459	1,955,622
<u>Net Assets</u>				
	Restricted	22,000	0	22,000
	Unrestricted	5,123,874	3,275,930	8,399,804
	Total net assets	\$ 5,145,874	\$ 3,275,930	\$ 8,421,804

See accompanying notes to financial statements

Board of County Road Commissioners
County of Bay
Department of Water and Sewer
Statement of Changes in Fiduciary Net Assets
Fiduciary Funds
For The Year Ended December 31, 2007

	Private Purpose Trust Funds		
	Water	Sewer	Total
Gross service charges	\$ 4,730,212	\$ 4,419,903	\$ 9,150,115
Water and sewer costs	2,439,024	169,540	2,608,564
Gross profit	2,291,188	4,250,363	6,541,551
Operating revenues:			
Service connections	224,996	146,191	371,187
Charges, fees, etc.	17,536	192,762	210,298
Total operating revenues	242,532	338,953	581,485
Operating expenses:			
Personal services	920,466	375,534	1,296,000
Utilities	26,623	32,818	59,441
Regional charges	0	2,340,760	2,340,760
Operation and maintenance	546,321	109,279	655,600
Administration	186,065	100,231	286,296
Fiscal and other charges	84,088	7,939	92,027
Total operating expenses	1,763,563	2,966,561	4,730,124
Operating income	770,157	1,622,755	2,392,912
Nonoperating revenues (expenses):			
Interest income	291,522	158,362	449,884
Lease expense	(772,638)	(2,314,913)	(3,087,551)
Payment by local unit	804,860	1,094,331	1,899,191
Payment to local unit	(976,737)	(511,405)	(1,488,142)
Change in net assets	117,164	49,130	166,294
Net assets - beginning of year	5,028,710	3,226,800	8,255,510
Net assets - end of year	\$ 5,145,874	\$ 3,275,930	\$ 8,421,804

See accompanying notes to financial statements

Board of County Road Commissioners
County of Bay
Department of Water and Sewer
Notes to Financial Statements
December 31, 2007

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Department of Water and Sewer (DWS) conform to U.S. generally accepted accounting principles (GAAP) as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The following is a summary of the significant accounting policies used by the Department of Water and Sewer.

Reporting Entity

The Department of Water and Sewer was organized in 1975 and is located in Bay County, Michigan. The Department provides water and sewer services to approximately 19,000 customers as authorized by Monitor, Bangor, Frankenlust, Portsmouth, Williams, Beaver, Merritt, Pinconning, Kawkawlin and Fraser Townships, the City of Auburn, Beaver Road Water Association and Bay County.

The County of Bay is governed by Public Act 139 of the State of Michigan, known as the "Unified County Government Act." While Public Act 139 allows a department of public works to remain within a unified county government, it does not provide the department with bonding powers. In order to secure these bonding powers, the County of Bay Department of Water and Sewer was reorganized in 1980 under Act 342 which transferred control of the Department to the Bay County Board of County Road Commissioners. Accordingly, the County of Bay Department of Water and Sewer is treated as a component unit of the Bay County Road Commission.

The Department is governed by an elected Board of the Bay County Road Commission. The accompanying financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board for determining the various governmental organizations to be included in the reporting entity. These criteria include significant operational financial relationships that determine which of the governmental organizations are a part of the Department's reporting entity, and which organizations are legally separate component units of the Department. The Department has no component units.

A primary focus of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* (GASB No. 34) is on the ownership of capital assets and the legal obligation to repay any related debt.

The DWS operations include water and sewer lines that were constructed and financed under varying scenarios. While certain debt issues may be the general obligation of Bay County, in most cases a local unit is primarily responsible for the repayment of the debt. The local units have the sole authority to set rates and are financially responsible for the integrity of their systems. Under certain circumstances, the local units have the right to operate their system.

Management has determined that the DWS is acting in a fiduciary capacity for the local units and ownership of the capital assets and related debt resides with them. Accordingly, these financial statements include only the activities for which the DWS owns the capital assets. A separate reporting of local unit activities is made to them.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities which rely to a significant extent on fees and charges for support. All of the Department's government-wide activities are considered business-type activities.

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 operations or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenue.

Separate financial statements are provided for proprietary funds and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual enterprise funds are reported as separate columns in the fund 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, as are the proprietary fund and fiduciary fund financial statements. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The government reports the following major proprietary funds.

The Water Fund accounts for the activities of the water distribution system.

The Sewer Fund accounts for the activities of the sewer collection system.

Additionally, the government reports the following fund types:

The Private Purpose Trust Funds account for the activities of the water and sewer operations of other local government units.

Private-sector standards of accounting issued prior to December 1, 1989, are generally followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with the standards of the Governmental Accounting Standards Board. The government has elected to also follow private-sector standards issued after November 30, 1989 for its business-type activities.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between the government's water and sewer function and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as program revenue include: (1) charges to customers or applicants for goods, services or privileges provided; (2) operating grants and contributions; and (3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenue rather than as program revenue.

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of the proprietary funds relate to charges to customers for water and sewer services. The water and sewer funds also recognize the portion of tap fees intended to recover current costs (e.g., labor and materials to hook up new customers) as operating revenue. The portion intended to recover the cost of the infrastructure is recognized as nonoperating revenue. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

Assets, Liabilities, and Net Assets or Equity

Bank Deposits and Investments - Cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value. The DWS maintains a cash and investment pool account that is available for use by all funds. Each fund's portion of this pool account is accounted for separately and included in "cash and investments" on the statement of net assets. Interest income is allocated to each local unit.

Receivables and Payables - In general, outstanding balances between funds are reported as "due to/from other funds." Activity between funds that is representative of lending/borrowing arrangements outstanding at the end of the fiscal year is referred to as "advances to/from other funds." Any residual balances outstanding between fiduciary activities and the business-type activities are reported in the government-wide financial statements as "internal balances."

All trade receivables are shown as net of allowance for uncollectible amounts.

Inventories and Prepaid Items - Inventories are valued at cost, on a first-in, first-out basis. Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid items in both government-wide and fund financial statements.

Restricted Assets - The revenue bonds of the enterprise funds require amounts to be set aside for construction, debt service principal and interest, operations and maintenance, and a bond reserve. These amounts have been classified as restricted assets.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Capital Assets - Capital assets, which include property, plant, and equipment are reported in the applicable business-type activities column in the government-wide financial statements. Capital assets are defined by the government as assets with an initial individual cost of more than \$2,500 and any assets susceptible to theft. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

Interest incurred during the construction of capital assets of business-type activities is included as part of the capitalized value of the assets constructed. During the current year, \$0 of interest expense was capitalized as part of the cost of assets under construction.

Property, plant and equipment is depreciated using the straight-line method over the following useful lives:

Buildings	40 to 50 years
Building Improvements	7 to 30 years
Water and Sewer Lines	40 to 50 years
Vehicles	5 to 7 years
Other Equipment	5 to 10 years
Computer Equipment	5 to 7 years

Compensated Absences - The liability for compensated absences reported in the district-wide proprietary and fiduciary fund financial statements consists of unpaid, accumulated sick, vacation pay, and longevity pay benefits. The liability has been calculated using the vesting method, in which the obligation for employees who are currently eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included.

Long-Term Obligations - In the government-wide financial statements and the proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount.

General Obligation Bonds - The Sewage Disposal and Water System General Obligation Bonds are backed by the limited tax, full faith and credit of the County. Debt service requirements are funded by various local government contributions, investment earnings and user and maintenance charges.

Deferred Revenue - Deferred revenue represents amounts which are measurable but not available. Deferred revenue consists mainly of special assessments receivable for connection fees collected in advance.

Contributed Capital - The DWS has received federal and state grants to pay a portion of the construction costs of the wastewater treatment facility and transmission and distribution system assets. The DWS also receives contributions from local districts to finance construction of transmission and distribution system assets and future repairs by the DWS.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Use of Estimates - The process of preparing the basic financial statements in conformity with U.S. generally accepted accounting principles requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

NOTE 2 - DEPOSITS AND INVESTMENTS

The Department of Water and Sewer has not adopted an official investment policy of its own and, therefore, utilizes the County of Bay's policy. State statutes and the County of Bay's policy authorize the DWS to make deposits in the accounts of banks, savings and loan associations, and credit unions in the State of Michigan. The DWS is also allowed to invest in U.S. government obligations, certificates of deposit of banks, savings and loans, and credit unions; commercial paper; repurchase agreements; bankers' acceptances; and, with some restrictions, mutual funds. The DWS' deposits are in accordance with statutory authority.

The DWS' deposits and investments were reported in the basic financial statements as follows:

Business-type activities	\$ 3,649,422
Fiduciary funds	<u>9,106,990</u>
Total	<u><u>\$ 12,756,412</u></u>

The breakdown between deposits and investments for the DWS is as follows:

Deposits (checking and savings accounts)	\$ 290,721
Investments	<u>12,465,691</u>
Total	<u><u>\$ 12,756,412</u></u>

The DWS participates in an investment pool with the County of Bay, of which it is a component unit. Considering the nature of the pooled investments and the fact that the DWS's investments aren't necessarily exactly proportional to the assets of the pool as a whole, it would be exceedingly difficult to report on the investments of the DWS as they pertain to the pooled investments with the County of Bay. Therefore, disclosures pertaining to the nature and maturity of investments in the pool are not included in these financial statements.

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NOTE 2 - DEPOSITS AND INVESTMENTS (CONTINUED)

Interest Rate Risk

State law limits the allowable investments and the maturities of some of the allowable investments. The County of Bay'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. The maximum maturity dates for each DWS investment type held at year end are as follows.

<u>Instrument</u>	<u>Maturity Maximum</u>
Certificates of deposit	365 days
U.S. government obligations	191 days
Commercial paper	183 days
Municipal investment fund	Liquid

Credit Risk

State law limits investments to specific government securities, certificates of deposits and bank accounts with qualified financial institutions, commercial paper with specific maximum maturities and ratings when purchased, bankers acceptances of specific financial institutions, qualified mutual funds and qualified external investment pools. The County of Bay's investment policy does not have specific limits in excess of state law on investment credit risk.

Custodial Credit Risk - Deposits

In the case of deposits, this is the risk that in the event of a bank failure, the DWS' deposits may not be returned to it. State law does not require and the County of Bay does not have a policy for deposit custodial credit risk. The amount of DWS' deposits covered by federal depository insurance cannot be determined since other County deposits would need to be considered.

Custodial Credit Risk - Investments

For an investment, this is the risk that, in the event of the failure of the counterparty, the DWS will not be able to recover the value of its investments or collateral securities that are in possession of an outside party. State law does not require a policy for investment custodial credit risk. However, the County of Bay's investment policy states that no more than sixty percent of the County investment portfolio will be invested with a single financial institution. However, while uninsured and unregistered, the County's funds are not exposed to custodial credit risk since the securities are held in the counterparty's trust department in the County's name.

Concentration of Credit Risk

State law limits allowable investments but does not limit concentration of credit risk. The County of Bay's investment policy states that with the exception of U.S. Treasury securities and authorized pools, no more than sixty percent of the County investment portfolio should be invested in a single security type.

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NOTE 3 - CAPITAL ASSETS

Capital asset activity of the DWS for the current year was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital Assets Not Being Depreciated:				
Land	\$ 62,791	\$ 0	\$ 0	\$ 62,791
Construction in Progress	<u>5,300</u>	<u>0</u>	<u>(5,300)</u>	<u>0</u>
Subtotal	<u>68,091</u>	<u>0</u>	<u>(5,300)</u>	<u>62,791</u>
Capital Assets Being Depreciated:				
Buildings	13,267,513	22,206	0	13,289,719
Improvements other than buildings	76,474	0	0	76,474
Machinery and Equipment	8,759,600	29,341	(21,724)	8,767,217
Water System	3,843,526	302,636	0	4,146,162
Sewer System	<u>17,169,768</u>	<u>0</u>	<u>0</u>	<u>17,169,768</u>
Subtotal	43,116,881	354,183	(21,724)	43,449,340
Less Accumulated Depreciation for:				
Buildings	6,658,045	278,890	0	6,936,935
Improvements other than buildings	72,347	589	0	72,936
Machinery and Equipment	7,874,681	204,547	(21,724)	8,057,504
Water System	1,489,563	90,517	0	1,580,080
Sewer System	<u>8,580,448</u>	<u>343,395</u>	<u>0</u>	<u>8,923,843</u>
Subtotal	<u>24,675,084</u>	<u>917,938</u>	<u>(21,724)</u>	<u>25,571,298</u>
Net Capital Assets Being Depreciated	<u>18,441,797</u>	<u>(563,755)</u>	<u>0</u>	<u>17,878,042</u>
Net Capital Assets	<u>\$ 18,509,888</u>	<u>\$ (563,755)</u>	<u>\$ (5,300)</u>	<u>\$ 17,940,833</u>

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NOTE 4 - LONG-TERM DEBT

Bay County Water Supply System (Beaver Extension) General Obligation Bonds, dated November 1, 1999, due in annual installments through November 1, 2011, bearing interest rates of 5.2% to 5.4%.	\$ 400,000
1998 Merritt-Portsmouth Townships Water Extension General Obligation Bonds, dated July 1, 1998, due in annual installments through May 1, 2018, bearing interest rates of 4.7% to 4.75%.	1,530,000
2000 Merritt Township Water Extension General Obligation Bonds, dated September 1, 2000, due in annual installments through November 1, 2020, bearing interest rates of 4.85% to 5.25%.	1,450,000
Kawkawlin-Fraser Water Extension General Obligation Bonds, dated July 1, 1998, due in annual installments through July 1, 2018, bearing interest rates of 4.85% to 5%.	850,000
Bay County Water Supply System (County Service Area) 1990 Series General Obligation Bonds, dated February 1, 1990, due in annual installments through May 1, 2009, bearing interest rate of 7.3%.	100,000
Bay County Sewage Disposal (Essexville Sewage Disposal System Improvements) General Obligation Bonds, dated March 27, 1997, due in annual installments through October 1, 2017, bearing interest rate of 2.25%.	1,105,000
Portsmouth Sewer General Obligation Bonds, dated September 26, 1991 and December 20, 1991, due in annual installments through October 1, 2012, bearing interest rate of 2%.	2,135,000
Bay County West Side Regional Sewage Disposal System General Obligation Bonds, dated July 1, 1978, due in annual installments through May 1, 2008, bearing interest rate of 5.5%.	<u>1,600,000</u>
Total Bonds Payable	<u><u>\$ 9,170,000</u></u>

**Board of County Road Commissioners
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NOTE 4 - LONG-TERM DEBT (CONTINUED)

Compensated Absences

The Department of Water and Sewer has an employee benefit plan that allows employees to accumulate unused sick days. Union employees may accumulate up to a maximum of 120 days. They may either use these sick days when ill or receive payment for 70% of the unused portion at time of retirement. All other employees may accumulate a maximum of 108 days, and receive 85% of the unused portion at time employment is terminated. Employees are also allowed to accumulate unused vacation days. Employees can accumulate a maximum of 30 days to carry over at the end of the year. The DWS provided a longevity payment to all supervisory and administrative employees at time of retirement. The benefit was based on years of employment times one-third of monthly salary, with a maximum payment of six months of salary. Effective June 1, 2007, the years of employment for longevity payment purposes was frozen. Payments will be made to employees' at their discretion, at their current rate of pay. The cost of this benefit has been recognized when earned. The total liability for all compensated absences was \$347,451 for Proprietary Funds and \$147,345 for Fiduciary Funds.

The following is a summary of long-term debt transactions for the Department of Water and Sewer for the year ended December 31, 2007:

	Balance January 1, 2007	Increase	Decrease	Balance December 31, 2007	Amount Due Within One Year
General Obligation Bonds	\$11,815,000	\$ 0	\$ 2,645,000	\$ 9,170,000	\$2,570,000
Compensated Absences	388,616	0	41,165	347,451	52,118
	<u>\$12,203,616</u>	<u>\$ 0</u>	<u>\$ 2,686,165</u>	<u>\$ 9,517,451</u>	<u>\$2,622,118</u>

The annual requirements to amortize bonds outstanding as of December 31, 2007, including interest payments, are as follows:

General Obligation Bonds

Year Ending December 31,	Principal	Interest	Total
2008	\$ 2,570,000	\$ 318,530	\$ 2,888,530
2009	970,000	240,515	1,210,515
2010	935,000	208,350	1,143,350
2011	950,000	177,476	1,127,476
2012	870,000	146,065	1,016,065
2013-2017	2,285,000	404,334	2,689,334
2018-2022	590,000	33,113	623,113
	<u>\$ 9,170,000</u>	<u>\$ 1,528,383</u>	<u>\$10,698,383</u>

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NOTE 5 - RESTRICTED NET ASSETS

Details of restricted net assets at December 31, 2007 are as follows:

The Bay County West Side Regional Sewage Disposal System has a contractual obligation that requires \$50,000 of net assets of the Sewer Fund be reserved yearly for system replacement. During 2007, the reserve was reduced for system replacement costs of \$0.

\$ 403,995

NOTE 6 - RETIREMENT SYSTEM

Pension Plan

Plan Description - Bay County Department of Water and Sewer participates in the Bay County Employees' Retirement System through the County of Bay, a single-employer defined benefit pension plan. The System operates under the authority of County ordinances. The County issues a publicly available financial report that includes financial statements and required supplementary information for the System. That report may be obtained by writing to the County of Bay, 515 Center Avenue, Bay City, MI 48708.

Benefits - The plan provides retirement, disability, and death benefits to plan members and beneficiaries. Plan members may retire after reaching the age of 60 with 8 or more years of service, or at any age with 30 years of service. Eligible employees are provided benefits based on 2.25% of their final average compensation times the number of years of credited service. Maximum retirement is 75% of final average compensation, defined as the average of the highest five years.

Funding Policy - The DWS' policy is to fund normal costs which are based on actuarially determined rates, expressed as percentage of annual covered payroll, and which are sufficient to accumulate assets to pay benefits when due. The current rate for the DWS is 0% of annual covered payroll. Plan members are required to contribute at the rate of 4% of their annual salary. The DWS paid the plan members' contributions for 2007, in the amount of \$80,193.

Annual Pension Cost - For 2007, the DWS' annual pension cost of \$0 was equal to its required contribution. The required contribution was determined as part of the December 31, 2006 actuarial evaluation, using the entry age normal cost method. The actuarial assumptions included (a) 7.5% rate of return and (b) projected salary increases of 5.0% to 9.0%. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five year period. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis.

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NOTE 6 - RETIREMENT SYSTEM (CONTINUED)

Three-year trend information:

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
2005	\$ 0	100%	\$ 0
2006	0	100%	0
2007	0	100%	0

Schedule of funding progress:

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
12/31/04	\$8,694,308	\$ 6,728,857	\$ (1,965,451)	129%	\$1,823,683	none
12/31/05	\$8,911,854	\$ 7,087,183	\$ (1,824,671)	126%	\$1,811,136	none
12/31/06	\$9,422,561	\$ 7,664,807	\$ (1,757,754)	123%	\$1,868,868	none

NOTE 7 - POST-EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

Retiree Health Care Plan

Bay County Department of Water and Sewer participates in a Voluntary Employees Beneficiary Association (VEBA) trust through the County of Bay. The plan is a single employer defined benefit public retiree health care plan established effective October 1, 2001. The purpose of the plan is to provide medical and health care benefits for the welfare of certain retirees of the DWS and the spouses and dependents of such retirees who are participants in the Bay County Employees' Retirement System. Benefits under the plan are provided pursuant to a group contract issued by Blue Cross Blue Shield of Michigan. The County Board of Commissioners has the authority to establish and amend benefit provisions.

The Plan is a contributory defined benefit plan which covers substantially all employees of the DWS as defined above. The December 31, 2006 actuarial valuation identified the required employer contribution rate as 21.22% of covered payroll. The DWS contributions to the plan were \$180,193 for 2007, representing 4% of covered payroll, plus an additional \$100,000. Contributions were \$174,847 for 2006 and \$172,296 for 2005, representing 4% of covered payroll, plus additional contributions of \$99,980 and \$99,996 respectively.

The Plan's unfunded accrued liability was determined as part of the December 31, 2006 actuarial valuation. The actuarial assumptions included (a) a rate of return on investments of 7.5% per year for active employees and 4% for retirees, (b) projected salary increases of 5% to 9%, and (c) health care cost increases of 9% for 2007 and declining by .5% per year until 2016, where the projected annual increase will thereafter remain at 4% per year.

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NOTE 7 - POST-EMPLOYMENT BENEFITS OTHER THAN PENSION (CONTINUED)

The Plan's unfunded accrued liability as determined by the December 31, 2006 actuarial valuation is as follows:

Retirees and beneficiaries	\$3,455,466
Current employees:	
Value of expected future benefit payments	6,348,656
Less: Value of future normal costs	<u>(1,622,040)</u>
Total accrued liability	8,182,082
Valuation assets	<u>(852,799)</u>
Unfunded accrued liability	<u><u>\$7,329,283</u></u>

Current retiree health care benefits are financed on a pay-as-you-go basis. The benefits are provided through an insurance company whose premiums are based on the benefits paid during the year. The cost of these benefits is recognized as expense when paid and was \$121,833 for 2007. Eleven participants were eligible to receive benefits as of December 31, 2007.

NOTE 8 - SELF INSURANCE

Workers' compensation - The DWS is self-insured for workers' compensation claims. This program is administered by an independent company which furnishes safety inspections, claims review, and claims processing services. The employers' liability maximum limit of indemnity per occurrence is \$1,000,000 and the self insured retention per occurrence is \$400,000. Net cost for the year was \$5,254.

General, automobile and errors or omissions liability - The DWS is a member of the Michigan County Road Commission Self-Insurance Pool. As a member of this pool, the DWS is insured for general, automobile and errors or omissions liability up to a limit of \$10,500,000 per occurrence, subject to a \$1,000 deductible. The DWS would be responsible for losses in excess of the limit. Payments made for the year ended December 31, 2007 were \$56,767.

Building, contents, off-road equipment and licensed vehicles coverage - The DWS is a member of the Michigan County Road Commission Self-Insurance Pool. As a member of this pool, the DWS is insured for the lesser of the scheduled value of property or the cost of repairs or replacement. Coverage is subject to a \$500 deductible and the DWS would be responsible for losses in excess of the limit. Payments made for the year ended December 31, 2007 were \$62,743.

Healthcare - The DWS became self-insured for healthcare claims effective February 1, 2006. Blue Cross Blue Shield of Michigan administers the claims and provides \$75,000 specific stop loss coverage in a combined contract with the DWS and Bay County Road Commission. Net cost for the DWS for the year ended December 31, 2007 was \$583,757.

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NOTE 9 - RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	<u>Water Fund</u>	<u>Sewer Fund</u>	<u>Total</u>
Operating income (loss)	\$ 161,292	\$ (517,022)	\$ (355,730)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:			
Depreciation	204,466	713,472	917,938
Change in assets and liabilities:			
Accounts receivable	10,511	(19,226)	(8,715)
Due from other governments	259,290	0	259,290
Inventories	(5,395)	1,640	(3,755)
Prepaid and other current assets	1,342	11,766	13,108
Accounts payable	309,156	5,038	314,194
Due to other governments	0	0	0
Accrued payroll	(11,461)	10,585	(876)
Compensated absences	(5,390)	(35,775)	(41,165)
Net cash provided (used) by operating activities	<u>\$ 923,811</u>	<u>\$ 170,478</u>	<u>\$1,094,289</u>

The DWS had noncash capital and related financing transactions relating to lease receivable and general obligation debt of Bay County as described in Note 11. The DWS had noncash investing transactions relating to interest income on lease receivable.

The noncash transactions for 2007 are as follows:

	<u>Water Fund</u>	<u>Sewer Fund</u>	<u>Total</u>
Lease receivable	\$ 540,000	\$ 2,105,000	\$2,645,000
Bonds payable	540,000	2,105,000	2,645,000
Interest paid on long-term debt	227,098	192,868	419,966
Interest income on leases	227,098	192,868	419,966

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NOTE 10 - COMMITMENTS AND CONTINGENT LIABILITIES

The DWS purchases wholesale water from the City of Bay City at a predetermined rate. At the end of the fiscal year a "True Up" between projected and actual costs is performed and a recalculated wholesale water rate is determined. The City of Bay City has billed the DWS \$260,676 for the shortage calculated by the True Up. The DWS is disputing the shortage because management feels that inappropriate capital expenditures not yet in service have been included in the calculation of the True Up. Management is considering arbitration as the means of resolving the dispute. The possible range on liability resulting from the arbitration is \$0 to \$260,676. No amount for this potential liability has been recorded in these financial statements.

The DWS is engaged in routine litigation incidental to the conduct of its municipal and utilities affairs. In the opinion of legal counsel, no legal proceedings are pending against the DWS, not covered by insurance, which would inhibit the DWS' ability to perform its operations or materially affect its financial condition.

NOTE 11 - LEASE RECEIVABLE

The DWS operations include the construction of water and sewer lines on behalf of local units, which are financed with bonds that are the general obligation of Bay County. Contractual agreements provide for the payment of this debt by the local units through user charges, connection fees and assessments. These capital assets are owned by the local units and the responsibility to pay the related debt resides with them.

U.S. generally accepted accounting principles require governments to report this transaction as a direct financing lease/sale. Accordingly, the total obligation for bonds has been recorded as long-term debt and a like amount as a lease receivable.

Following is the component of the DWS' net investment in direct financing leases:

Total minimum lease payments to be received	\$10,698,383
Less unearned income	<u>(1,528,383)</u>
Net investment in direct financing leases	<u><u>\$ 9,170,000</u></u>

Future minimum lease payments for subsequent years are as follows:

<u>Year Ending December 31,</u>	
2008	\$ 2,888,530
2009	1,210,515
2010	1,143,350
2011	1,127,476
2012	1,016,065
Thereafter	<u>3,312,447</u>
	<u><u>\$10,698,383</u></u>



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April 17, 2008

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

Board of County Road Commissioners
Bay County Department of Water and Sewer
Bay City, Michigan 48706

We have audited the financial statements of the Bay County Department of Water and Sewer as of and for the year ended December 31, 2007, and have issued our report thereon dated April 17, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Bay County Department of Water and Sewer's internal control over financial reporting 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 the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

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 Department'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 Department's financial statements that is more than inconsequential will not be prevented or detected by the Department's internal control.

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 presented or detected by the Department's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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Board of County Road Commissioners
Bay County Department of Water and Sewer
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Compliance and Other Matters

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

This report is intended solely for the information and use of management, Board of County Road Commissioners, others within the entity, and is not intended to be and should not be used by anyone other than these specified parties.

Weinlander Fitzhugh