South Macomb Disposal Authority

Financial Report

June 30, 2004

Michigan Dept. of Treasury. Local Audit & Finance Division
496 (3-98). Formerly L-3147

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type:	Local Government Name:	County
☐ City ☐ Township ☐ Village ☒ Other	South Macomb Disposal Authority	Macomb

Audit Date	Opinion Date	Date Accountant Report Submitted To State:
June 30, 2004	June 20, 2005	September 13, 2005

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

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LOCAL AUDIT & FINANCE DIV

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations.

You must check the applicable box for each item below:

☐ yes ☒ no 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
☐ yes ☒ no 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
☐ yes ☒ no 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
☐ yes ☒ no 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
☐ yes ☒ no 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91] or P.A. 55 of 1982, as amended [MCL 38.1132])
☐ yes ☒ no 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
☐ yes ☒ no 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
☐ yes ☒ no 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
☐ yes ☒ no 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	☒	☐	☐
Reports on individual federal assistance programs (program audits).	☐	☐	☒
Single Audit Reports (ASLGU).	☐	☐	☒

Certified Public Accountant (Firm Name): **PLANTE & MORAN, PLLC**			
Street Address 2601 Cambridge Court, Suite 500	City Auburn Hills	State MI	ZIP 48326

Accountant Signature

Plante & Moran, PLLC

South Macomb Disposal Authority

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Independent Auditor's Report

To the Board of Directors
South Macomb Disposal Authority

We have audited the accompanying basic financial statements of South Macomb Disposal Authority as of June 30, 2004 and for the year then ended, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Macomb Disposal Authority at June 30, 2004 and the results of its operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis (identified in the table of contents) is not a required part of the basic financial statements but is supplemental information required by 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 required supplemental information. However, we did not audit the information and express no opinion on it.

Plante & Moran, PLLC

June 20, 2005

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Using this Annual Report

South Macomb Disposal Authority (the "Authority") is a joint venture of five cities located in southern Macomb County: Centerline, Eastpointe, Roseville, St. Clair Shores, and Warren. The primary roles of the Authority are to manage the transfer of solid waste currently collected by all of the member cities (except Warren) and to provide for the postclosure care of landfill sites previously operated by the Authority. The Authority does not currently operate any landfill sites. This annual report consists of a series of financial statements. The statement of net assets and the statement of revenue, expenses, and changes in net assets provide information about the financial activities of the Authority. This is followed by the statement of cash flows, which presents detailed information about the changes in the Authority's cash position during the year.

Financial Overview

In analyzing the Authority's financial position, it is important to recognize the dual missions of the Authority. From a financial perspective, the Authority's core objective (and ongoing operation) is to manage the costs of solid waste transfer for Centerline, Eastpointe, Roseville, and St. Clair Shores. With respect to this core objective, the Authority acts as a conduit for the four participating members. The amounts to be charged to the participating members for these services will, by definition, be equal to the Authority's costs of providing solid waste transfer services. The key financial statistics for the Authority, therefore, relate to measurements of the ability to reduce total costs to its members (as opposed to the ability to accumulate financial resources). To this end, the net assets of the Authority related to ongoing operations is approximately $1,715,000, of which approximately $940,000 is invested in capital assets.

The other objective of the Authority is to provide for the postclosure care of landfill sites previously operated by the Authority, including all five of its member cities. During the prior year, the Authority successfully sued its insurers and received a settlement for remediation of two of its sites. Under the terms of the settlement, the Authority's continuing insurance coverage is limited to costs of defense, past response costs, and the cost of remedial investigation, on four sites for which the Authority has continuing maintenance and monitoring responsibilities. In addition, the Authority had previously received grant monies from the State of Michigan related to the remediation of sites 9 and 9A, the two sites for which the Authority successfully sued its insurers and received a settlement during the prior year. Because the Authority was able to recover the remediation costs from its insurers, the State requested the Authority pay back these grant monies. On May 4, 2005, the Macomb County Circuit Court deemed the settlement with the Authority's insurers for sites 9 and 9A to be a recovery of costs paid with grant monies and, therefore, the Authority is required to reimburse the State of Michigan for these grant monies. The liability to the State for the grant monies at June 30, 2004 is approximately $5,700,000, of which $400,000 will be reimbursed to the Authority by its attorneys. The liability and receivable have been recorded by the Authority at June 30, 2004.

During the year ended June 30, 2004, two of the four remaining sites were required by the State of Michigan Department of Environmental Quality to undergo remediation. The Authority has entered into a contract with a company for approximately $7,500,000 to perform the required remediation of the two landfill sites and to indemnify the Authority against any future claims. As of June 30, 2004, the Authority is still responsible for the cost of the remediation investigation not included in the contract to remediate the two sites and for paying the State's previous response costs. These costs, estimated at $3,400,000, will be reimbursed by the Authority's insurer. As of June 30, 2004, the Authority has net assets of approximately $2,644,000, including approximately $1,026,000 invested in capital assets, accumulated to pay for future postclosure care or remediation costs for the two remaining landfill sites.

Condensed Financial Information

The following table presents condensed information about the Authority's financial position compared to the prior year.

	Year Ended June 30		Change	
	2004	2003	Amount	Percent
Assets				
Current assets	$ 13,276,223	$ 14,547,106	$ (1,270,883)	(9)
Capital assets	824,674	2,005,745	(1,181,071)	(59)
Total assets	14,100,897	16,552,851	(2,451,954)	(15)
Liabilities				
Current liabilities	392,716	908,360	(515,644)	(57)
Long-term liabilities	9,350,000	3,269,253	6,080,747	186
Total liabilities	9,742,716	4,177,613	5,565,103	133
Net Assets				
Invested in capital assets	1,964,322	2,005,745	(41,423)	(2)
Unrestricted	2,393,859	10,369,493	(7,975,634)	(77)
Total net assets	**$ 4,358,181**	**$ 12,375,238**	**$ (8,017,057)**	**(65)**

The following table presents condensed information about the Authority's revenues and expenses compared to the prior year.

	Year Ended June 30		Change	
	2004	2003	Amount	Percent
Disposal fees	$ 1,487,526	$ 1,997,118	$ (509,592)	(26)
Administrative fees	60,024	63,764	(3,740)	(6)
Total operating revenue	1,547,550	2,060,882	(513,332)	(25)
Operations and maintenance	88,790	87,636	1,154	1
General and administrative	46,889	18,184	28,705	158
Contracted disposal costs	1,173,457	1,787,517	(614,060)	(34)
Total operating expenses	1,309,136	1,893,337	(584,201)	(31)
Postclosure and remediation costs	(7,976,482)	(3,032,505)	(4,943,977)	163
Reimbursements related to remediation - Insurance and other	4,873,000	23,152,108	(18,279,108)	(79)
Repayment of municipal landfill cost-share grant	(5,088,611)	-	(5,088,611)	100
Municipal landfill cost-share grant	-	3,455,728	(3,455,728)	(100)
Other income	201,943	871,038	(669,095)	(77)
Other legal expenses related to closed sites	(265,321)	(154,943)	(110,378)	71
Interest expense	-	(522,947)	522,947	(100)
Forgiveness of assessment receivable	-	(20,000,000)	20,000,000	(100)
Cost of defeasement of bond	-	(2,158,214)	2,158,214	(100)
Total nonoperating revenue (expense)	(8,255,471)	1,610,265	(9,865,736)	(613)
Net income (loss)	**$ (8,017,057)**	**$ 1,777,810**	**$ (9,794,867)**	**(551)**

Significant Variances from Prior Year

The decrease in the Authority's total net assets from the prior year is due to the Authority using a large portion of its net asset reserves to pay for a remediation contract that indemnifies the Authority of any further future claims on two landfill sites. In addition, the year ended June 30, 2004 captures any additional liabilities that may result due to the remediation of these two landfills. Therefore, the Authority now has only two landfill sites for which it is responsible for future postclosure care. An estimated liability has been recorded to capture the potential liability related to any postclosure care costs related to the two remaining sites at the Authority. Consequently, the significant variances from prior year revenue and expenditures is due to the landfill remediation and lawsuit costs described above and in Note 7 of the report. In addition, the prior year income statement reflected a $23,000,000 settlement received from the Authority's insurers (separate from contingent fees collected by legal counsel from the insurers), the subsequent use of proceeds to defease $20,000,000 in bonds, and the forgiveness by the Authority of special assessments to the member cities for payment of the defeased debt.

The significant decrease from the prior year in operating revenue is consistent with the significant decrease in operating expenses due to the Authority passing on its costs of refuse disposal services.

Net Asset Designations and Risk Management

The Authority has potentially significant economic issues to resolve over the next several years related to the two remaining landfill sites. The accumulated net assets for postclosure care costs have been set aside by the Authority's governing body to serve as a reserve fund for potential remediation costs for which the Authority is now uninsured.

Economic Factors and Next Year's Budget

For ongoing solid waste transfer operations, costs will be dependent on the volume of solid waste hauled. The Authority's budget for the year ending June 30, 2005 forecasts a moderate increase in solid waste and, therefore, costs.

The Authority has estimated and recorded known postclosure care liabilities as of June 30, 2004. The Authority will amend its budget as necessary for additional costs assessed by the State of Michigan or other regulatory authorities.

Contacting the Authority's Management

This financial report is intended to provide our member cities with a general overview of the Authority's finances and to show the Authority's accountability for the money it receives from the member cities and other sources. If you have questions about this report or need additional information, we welcome you to contact the Authority offices.

South Macomb Disposal Authority

Statement of Net Assets
June 30, 2004

Assets	
Cash and investments (Note 2)	$ 7,127,759
Accounts receivable	328,569
Accrued interest receivable	13,965
Prepaid insurance	8,282
Receivables related to site remediation - Insurance and other (Note 7)	4,658,000
Land	1,139,648
Capital assets (Note 3)	824,674
Total assets	14,100,897
Liabilities	
Accounts payable	362,716
Accrued postclosure care and remediation liabilities (Note 7):	
Due within one year	30,000
Due in more than one year	9,350,000
Total liabilities	9,742,716
Net Assets	
Invested in capital assets	1,964,322
Unrestricted (Note 4)	2,393,859
Total net assets	**$ 4,358,181**

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

South Macomb Disposal Authority

Statement of Revenue, Expenses, and Changes in Net Assets
Year Ended June 30, 2004

Operating Revenue	
Disposal fees	$ 1,475,024
Closure cost billings	12,502
Administrative fees	60,024
Total operating revenue	1,547,550
Operating Expenses	
Operations and maintenance	88,790
General and administrative	46,889
Contracted disposal costs	1,173,457
Total operating expenses	1,309,136
Operating Income	238,414
Nonoperating Revenue (Expenses)	
Postclosure and remediation costs (Note 7)	(7,976,482)
Reimbursements related to remediation - Insurance and other (Note 7)	4,873,000
Repayment of municipal landfill cost share grant (Note 7)	(5,088,611)
Investment interest income	201,943
Other legal expenses related to closed sites	(265,321)
Total nonoperating expenses	(8,255,471)
Net Loss	(8,017,057)
Net Assets - Beginning of year	12,375,238
Net Assets - End of year	**$ 4,358,181**

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

South Macomb Disposal Authority

Statement of Cash Flows
Year Ended June 30, 2004

Cash Flows from Operating Activities	
Cash received from customers	$ 1,553,738
Cash payments to suppliers for goods and services	(1,171,968)
Net cash provided by operating activities	381,770
Cash Flows from Noncapital Financing Activities	
Cash received from insurance reimbursements	215,000
Payment of postclosure care and remediation costs	(7,861,056)
Net cash used in noncapital financing activities	(7,646,056)
Cash Flows from Investing Activities	
Sale of investments	4,011,754
Interest received on investments	217,994
Net cash provided by investing activities	4,229,748
Net Decrease in Cash and Cash Equivalents	(3,034,538)
Cash and Cash Equivalents - July 1, 2003	9,753,786
Cash and Cash Equivalents - June 30, 2004	**$ 6,719,248**
Statement of Net Assets Classification of Cash and Cash Equivalents	
Cash and investments	$ 7,127,759
Investments greater than 90 days	(408,511)
Total cash and cash equivalents	**$ 6,719,248**
Cash Flows from Operating Activities	
Operating income	$ 238,414
Adjustments to reconcile operating income to net cash from operating activities:	
Depreciation and amortization	41,423
Changes in assets and liabilities:	
Decrease in accounts receivable	6,188
Increase in accounts payable	95,745
Net cash provided by operating activities	**$ 381,770**

Noncash Activities - There were no significant noncash operating, financing, or investing activities during the year ended June 30, 2004.

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

Note 1 - Nature of Business and Significant Accounting Policies

The South Macomb Disposal Authority (the "Authority") consists of five member municipalities in Macomb County, Michigan. The Authority currently provides refuse disposal services primarily for the benefit of four of the five member municipalities. The governing body of the Authority consists of five members - one appointed by each of the five member communities.

The accounting policies of the Authority conform to accounting principles generally accepted in the United States of America as applicable to an enterprise fund of a governmental unit. Accordingly, the accrual basis of accounting is followed by the Authority. In accordance with accounting principles generally accepted in the United States of America, there are no component units to be included in these financial statements.

Fixed Assets - Fixed assets are recorded at cost and are shown net of accumulated depreciation. Depreciation is computed using the straight-line method.

Cash Equivalents - For the purpose of the statement of cash flows, the Authority considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Investments - Investments are valued at fair value.

Other accounting policies are disclosed in other notes to the financial statements.

Note 2 - Deposits and Investments

The Authority's deposits and investments, which are categorized on the balance sheet as cash and investments, are composed of the following:

Bank deposits (checking accounts, savings accounts, money market accounts, and certificates of deposit)	$ 7,127,709
Petty cash	50
Total	$ 7,127,759

Deposits

Deposits were reflected in the accounts of the bank (without recognition of checks written but not yet cleared or of deposits in transit) at approximately $14,700,000 at June 30, 2004. Of that amount, $300,000 was covered by federal depository insurance and the remainder was uninsured and uncollateralized.

Note 2 - Deposits and Investments (Continued)

The Authority believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits. As a result, the Authority evaluates each financial institution with which it deposits Authority funds and assesses the level of risk of each institution. Only those institutions with an acceptable estimated risk level are used as depositories.

Note 3 - Capital Assets

Capital asset activity for the year ended June 30, 2004 was as follows:

	2003	Deductions	2004	Depreciable Life - Years
Capital assets being depreciated:				
Site improvements	$ 585,144	$ -	$ 585,144	40
Equipment	346,848	-	346,848	7-15
Waste transfer station	1,201,645	-	1,201,645	40
Transfer station equipment	36,807	-	36,807	10-15
Subtotal	2,170,444	-	2,170,444	
Less accumulated depreciation for:				
Site improvements	(212,379)	(14,801)	(227,180)	
Equipment	(343,249)	(2,137)	(345,386)	
Waste transfer station	(711,912)	(24,485)	(736,397)	
Transfer station equipment	(36,807)	-	(36,807)	
Subtotal	(1,304,347)	(41,423)	(1,345,770)	
Net capital assets being depreciated	$ 866,097	$ (41,423)	$ 824,674	

Note 4 - Net Assets

The Authority has designated certain net assets related to postclosure care and potential remediation activities. The designated net assets include proceeds from several litigation settlements with the Authority's insurers for remediation of the Authority's landfill sites. As part of these settlements, the insurers may be held to pay future defense costs but not remediation costs for the remaining two sites operated by the Authority. The amount of net assets designated totals $2,643,457, which includes approximately $1,026,000 of the capital assets of the Authority. The Authority has designated these funds in a postclosure care/insurance reserve fund to pay for the potential remediation of the remaining two landfill sites (see Note 7).

Note 5 - Risk Management

The Authority is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The Authority has purchased commercial insurance for medical and life insurance claims, and participates in the Michigan Municipal League risk pool for claims relating to property loss, torts, errors and omissions, and employee injuries (workers' compensation). Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

The Michigan Municipal League risk pool program operates as a common risk-sharing management program for local units of government in Michigan; member premiums are used to purchase commercial excess insurance coverage and to pay member claims in excess of deductible amounts.

Note 6 - Postclosure Care Liabilities

Current State and federal laws and regulations require final covers on active landfill sites and the performance of certain maintenance and monitoring functions at the site for 30 years after closure. Although closure and postclosure care costs are paid only near or after the date that the landfill stopped accepting waste, the Authority reports a portion of these closure and postclosure care costs as an operating expense in each period based on landfill capacity used as of each balance sheet date. As of June 30, 2004, the Authority has two landfill sites for which it has continuing postclosure maintenance and monitoring responsibilities.

The Authority has also recorded a liability for landfill postclosure care for all sites at June 30, 2004. This amount is an estimate of the cost to perform all known post-closure care in current dollars for all other Authority landfill sites with continuing maintenance requirements. Actual cost may be higher due to inflation, changes in technology, or changes in regulations.

Note 7 - Remediation Costs, Commitments, and Contingent Liabilities

The Authority reached an agreement with the State of Michigan Department of Environmental Quality (MDEQ) of its liability for the remediation of the Red Run Drain landfill sites previously operated by the Authority. To complete the remediation, the Authority has entered into a contract with and paid Environmental Risk Solutions (ERS) approximately $7,500,000. Under this contract, ERS is obligated to perform the remediation of the Red Run Drain landfills to whatever standards the MDEQ imposes and to indemnify the Authority against essentially any future claim, backed up by $16 million of insurance. Although the contract with ERS limits the Authority's liability related to the remediation, the Authority is still responsible for paying the costs of the remediation investigation to determine the nature and extent of the contamination at the Red Run Drain landfills. ERS has provided a written quote to the Authority to perform the remediation investigation for approximately $1.7 million. The Authority is also responsible to pay the State for past response costs of approximately $1.7 million. The agreement with the State also provides for the Authority to receive approximately $858,000 that the State has collected from other third parties.

The Authority has also been engaging in extended settlement discussions with its insurer regarding coverage for the Red Run Drain landfill sites. Under a previous consent judgment that was entered on September 3, 2003, the insurer is liable for the Authority's cost of defense, past response costs that the Authority is required to pay the State, and the cost of performing the remedial investigation. Based on this consent judgment, the insurer would owe the Authority approximately $3.4 million to cover the estimated remediation investigation and the past response costs to the State of Michigan. On June 17, 2005, the Authority and its insurer tentatively agreed to a settlement of $4,200,000, plus accrued defense costs, in return for which the Authority will relinquish all future rights of claim. This tentative agreement is currently oral and has not received final approval by the Authority board. To date, accrued defense costs are not determinable and costs to date determined to be fully reimbursable are the $3.4 million. As of June 30, 2004, the Authority has recorded a receivable from the insurer for $3.4 million.

In addition, the Authority has received a total of approximately $5.7 million in landfill grant funds from the State of Michigan to assist with the remediation of sites 9 and 9a. The State demanded that these funds be returned since the Authority received reimbursement from its insurers and, on May 4, 2005, the Macomb County Circuit Court upheld the State's demand, which the Authority is appealing. If the Authority is ultimately required to pay the grant monies back to the State, the attorneys that represented the Authority in its claim against the insurers will reimburse approximately $400,000 of legal fees to the Authority. The payable and receivable are reflected in the Authority's balance sheet as of June 30, 2004.

Note 8 - Postemployment Benefits

The Authority provides health care benefits to all full-time employees upon retirement. Currently, three retirees are receiving benefits. The Authority includes retirees and their dependents in its insured health care plan, with no contribution required by the participants. Expenditures for postemployment health care benefits are recognized as insurance premiums become due; during the year, this amount was approximately $6,000.

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September 13, 2005

To the Board Members
South Macomb Disposal Authority
20001 Pleasant Avenue
St. Clair Shores, MI 48080

RECEIVED
DEPT OF TREASURY
SEP 29 2005
LOCAL AUDIT & FINANCE DIV.

Dear Board Members:

We have recently completed our audit of the financial statements of the South Macomb Disposal Authority for the year ended June 30, 2004. The purpose of this communication is to provide you with additional information regarding the scope and results of our audit that may assist you with your oversight responsibilities of the financial reporting process for which management is responsible. This report is intended solely for the use of the board members and others within the organization.

Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America

We conducted our audit of the financial statements of the South Macomb Disposal Authority in accordance with auditing standards generally accepted in the United States of America. The following paragraphs explain our responsibilities under those standards.

Management has the responsibility for adopting sound accounting policies, for maintaining an adequate and effective system of accounts, for the safeguarding of assets, and for devising internal controls that will, among other things, help assure the proper recording of transactions. The transactions that should be reflected in the accounts and in the financial statements are matters within the direct knowledge and control of management. Our knowledge of such transactions is limited to that acquired through our audit. Accordingly, the fairness of representations made through the financial statements is an implicit and integral part of management's responsibility. We may make suggestions as to the form or content of the financial statements or even draft them, in whole or in part, based on management's accounts and records. However, our responsibility for the financial statements is confined to the expression of an opinion on them. The financial statements remain the representations of management.

The concept of materiality is inherent in the work of an independent auditor. An auditor places greater emphasis on those items that have, on a relative basis, more importance to the financial statements and greater possibilities of material error than with those items of lesser importance or those in which the possibility of material error is remote. For this purpose, materiality has been defined as "the magnitude of an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement."

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An independent auditor's objective in an audit is to obtain sufficient competent evidential matter to provide a reasonable basis for forming an opinion on the financial statements. In doing so, the auditor must work within economic limits; the opinion, to be economically useful, must be formed within a reasonable length of time and at reasonable cost. That is why an auditor's work is based on selected tests rather than an attempt to verify all transactions. Since evidence is examined on a test basis only, an audit provides only reasonable assurance, rather than absolute assurance, that financial statements are free of material misstatement. Thus, there is a risk that audited financial statements may contain undiscovered material errors or fraud. The existence of that risk is implicit in the phrase in the audit report, "in our opinion."

Internal Controls

In planning and performing our audit of the financial statements of South Macomb Disposal Authority for the year ended June 30, 2004, we considered the Authority's internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. However, we noted a matter involving the internal control and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Authority's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Segregation of accounting duties is a fundamental control activity that separates the duties of authorization, recordkeeping, and custody of assets. Incompatible functions place a person in the position to both perpetrate and conceal errors or fraud in the normal course of his or her duties. Due to its limited staff size, the Authority does not have an adequate segregation of accounting duties. We consider this item to be a reportable condition.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control structure would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we do not believe that the reportable condition noted above is a material weakness.

As always, we thank the board for the opportunity to serve. We would be happy to answer any questions you may have regarding the annual financial report, and would be pleased to discuss the above comments and recommendations with you at your convenience.

Very truly yours,

Plante & Moran, PLLC

Kevin J. Conte

Kevin J. Conte