

**HOUGHTON LAKE COMMUNITY SCHOOLS**  
**REPORT ON FINANCIAL STATEMENTS**  
**(with required supplementary and additional information)**  
**YEAR ENDED JUNE 30, 2006**

# CONTENTS

	<u>Page</u>
<b>Independent auditors' report</b> .....	iv - v
<b>Management's Discussion and Analysis</b> .....	vi - xi
<b>Basic financial statements</b>	
Government-wide financial statements	
Statement of net assets .....	1
Statement of activities .....	2
Fund financial statements	
Balance sheet - governmental funds .....	3
Statement of revenues, expenditures and changes in fund balances - governmental funds.....	4
Reconciliation of the statement of revenues, expenditures and changes in fund balances of governmental funds to the statement of activities.....	5
Agency funds	
Statement of fiduciary assets and liabilities .....	6
Notes to financial statements.....	7 - 23
<b>Required supplementary information</b> .....	24
Budgetary comparison schedule - general fund .....	25
<b>Additional information</b> .....	26
Nonmajor governmental fund types	
Combining balance sheet .....	27
Combining statement of revenues, expenditures, and changes in fund balances .....	28

## CONTENTS

	<u>Page</u>
Special revenue funds	
Combining balance sheet .....	29
Combining statement of revenues, expenditures and changes in fund balances .....	30
Fiduciary funds	
Schedule of cash receipts and disbursements.....	31
General fund	
Schedule of revenues .....	32
Schedule of expenditures.....	33
Long-term debt	
Bonded debt - Qualified Zone Academy Bond .....	34
Schedule of installment note payable .....	35 - 36



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## INDEPENDENT AUDITORS' REPORT

To the Board of Education  
Houghton Lake Community Schools  
Houghton Lake, Michigan

August 29, 2006

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Houghton Lake Community Schools, as of and for the year ended June 30, 2006, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Houghton Lake Community Schools' 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 and the standards applicable to financial audits contained in *Governmental Auditing Standards* issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Houghton Lake Community Schools, as of June 30, 2006, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

To the Board of Education  
Houghton Lake Community Schools

August 29, 2006

In accordance with *Government Auditing Standards*, we have also issued our report dated August 29, 2006, on our consideration of Houghton Lake Community Schools' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and 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 considered in assessing the results of our audit.

The management's discussion and analysis and budgetary comparison information on pages vi - xi and 25, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Houghton Lake Community Schools' basic financial statements. The additional information on pages 27 to 36 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This additional information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in cursive script that reads "Mamer, Costeniser & Ellis, P.C.".

Certified Public Accountants

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of Houghton Lake Community Schools (HCS) annual financial report presents our discussion and analysis of the District's financial performance during the fiscal year that ended on June 30, 2006. Please read it in conjunction with the District's financial statements, which immediately follow this section.

### FINANCIAL OVERVIEW

The District's general fund financial situation did not improve from the 2005 fiscal year to 2006. This is the second straight year in which the general fund did not show improvement. For the 2005/2006 school year general fund, fund equity was decreased by \$467,681. The Board of Education initially approved a budget with a deficit of \$1,502,740.

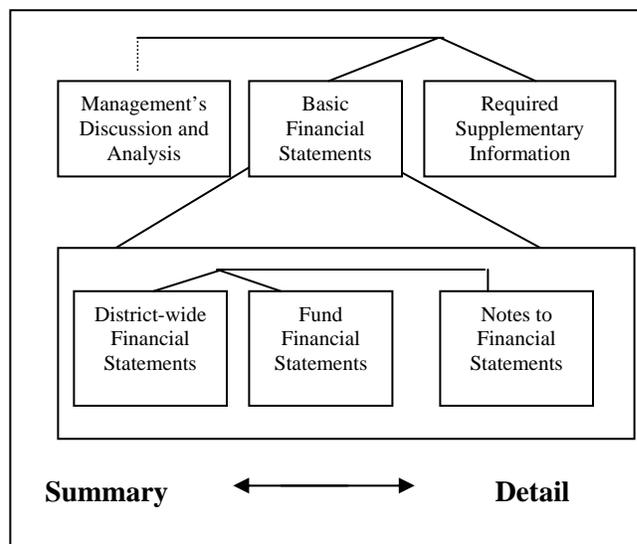
For the 2005/06 school year, the capital projects fund paid for the newly installed roof and other repairs from the proceeds of the QZAB bond.

### OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of three parts - management's discussion and analysis (this section), the basic financial statements and required supplementary information. The basic financial statements include two kinds of statements that present different views of the District:

- The first two statements are district-wide financial statements that provide both short-term and long-term information about the District's overall financial status.
- The remaining statements are fund financial statements that focus on individual parts of the District, reporting the District's operations in more detail than the district-wide notes to financial statements.
- The governmental funds statements tell how basic services like instruction and support services were financed in the short-term as well as what remains for future spending.
- Fiduciary funds statements provide information about the financial relationships in which the District acts solely as a trustee or agent for the benefit of others.

**Figure A-1  
Organization of Houghton Lake  
Community Schools' Annual Financial**



The financial statements also include notes that explain some of the information in the statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the financial statements with a comparison of the District's budget for the year. Figure A-1 shows how the various parts of this annual report are arranged and related to one another.

<b>Figure A-2 Major Features of District-Wide and Fund Financial Statements</b>			
	District-wide Statements	Fund Financial Statements	
		Governmental Funds	Fiduciary Funds
Scope	Entire district (except fiduciary funds)	The activities of the district that are not proprietary or fiduciary, such as special education and building maintenance.	Instances in which the district administers resources on behalf of someone else, such as scholarship programs and student activities monies
Required financial statements	* Statement of net assets * Statement of activities	* Balance sheet * Statement of revenues, expenditures and changes in fund balances	* Statement of fiduciary net assets * Statement of changes in fiduciary net assets
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus
Type of asset/liability information	All assets and liabilities, both financial and capital, short-term and long-term	Generally assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets or long-term liabilities included	All assets and liabilities, both short-term and long-term, Houghton Lake's funds do not currently contain capital assets, although they can
Type of inflow/outflow information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year, expenditures when goods or services have been received and the related liability is due and payable	All additions and deductions during the year, regardless of when cash is received or paid

Figure A-2 summarized the major features of the District’s financial statements, including the portion of the District’s activities they cover and the types of information they contain. The remainder of this overview section of management’s discussion and analysis highlights the structure and contents of each of the statements.

## **DISTRICT-WIDE STATEMENTS**

The district-wide statements report information about the District as a whole using accounting methods similar to those used by private-sector companies. The statements of net assets include all of the District's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two district-wide statements report the District's net assets and how they have changed. Net assets - the difference between the District's assets and liabilities - are one way to measure the District's financial health or position.

- Over time, increases or decreases in the District's net assets are an indicator of whether its financial position is improving or deteriorating, respectively.
- To assess the overall health of the District, you need to consider additional non-financial factors such as changes in the District's property tax base and the condition of school buildings and other facilities.

In the district-wide financial statements, the District's activities:

- Governmental activities - Most of the District's basic services are included here, such as regular and special education, transportation and administration. Property taxes and state formula aid finance most of these activities.

## **FUND FINANCIAL STATEMENTS**

The fund financial statements provide more detailed information about the District's funds, focusing on its most significant or "major" funds - not the District as a whole. Funds are accounting devices the District uses to keep track of specific sources of funding and spending on particular programs:

- Some funds are required by State law and by bond covenants.
- The District establishes other funds to control and manage money for particular purposes (like repaying debt, and its capital projects fund) or to show that it is properly using certain revenues (like school lunch and athletics).

The District has two kinds of funds:

- Governmental funds - Most of the District's basic services are included in governmental funds, which generally focus on (1) how cash and other financial assets that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the District's programs. Because this information does not encompass the additional long-term focus of the district-wide statements, we provide additional information with the governmental funds statements that explain the relationship (or differences) between them.
- Fiduciary funds - The District is the trustee, or fiduciary, for assets that belong to others, such as the scholarship fund and the student activities funds. The District is responsible for ensuring that the assets reported in these funds are used only for their intended purposes and by those to whom the assets belong. We exclude these activities from the district-wide financial statements because the District cannot use these assets to finance its operations.

**FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE**

Net assets - The District's combined net assets were less on June 30, 2006 than the year before, decreasing by \$796,141 to \$2,154,016.

	2006	2005
Current assets	\$ 5,276,109	\$ 4,309,436
Capital assets and other	4,109,932	3,658,457
<b>Total assets</b>	<b>9,386,041</b>	<b>7,967,893</b>
Long-term debt outstanding	2,052,466	2,895,402
Other liabilities	5,179,559	2,122,334
<b>Total liabilities</b>	<b>7,232,025</b>	<b>5,017,736</b>
Net assets		
Invested in capital assets, net of related debt	3,006,519	3,439,832
Restricted for debt service	10,327	49,077
Unrestricted	(862,830)	(538,752)
<b>Total net assets</b>	<b>\$ 2,154,016</b>	<b>\$ 2,950,157</b>

	2006	2005
Revenues:		
Program revenues:		
Charges for services	\$ 435,680	\$ 396,380
Federal and state categorical grants	2,641,338	3,404,146
General revenues:		
Property taxes	6,994,342	6,526,248
Investment	140,707	41,540
State aid - unrestricted	6,719,604	7,054,546
Other	248,418	132,028
<b>Total revenues</b>	<b>17,180,089</b>	<b>17,554,888</b>
Expenses:		
Instruction	10,386,556	11,377,025
Support services	6,379,035	6,258,457
Food services	781,776	728,628
Athletics	237,838	173,696
Interest on long-term debt	21,421	14,978
Unallocated depreciation	169,604	381,394
<b>Total expenses</b>	<b>17,976,230</b>	<b>18,934,178</b>
<b>Change in net assets</b>	<b>\$ (796,141)</b>	<b>\$ (1,379,290)</b>

## District Governmental Activities

The District's financial condition has come about through a number of areas.

- Proposal A which established the student foundation grant concept, and has increased that amount from \$4,352 per student in 1995 to \$6,875 per student in 2006.
- The District continues to evaluate its operations to balance its general fund activities.
- During the year the District incurred significant turnover in the areas of the Superintendent and the Business Office.

### FINANCIAL ANALYSIS OF THE DISTRICT'S FUNDS

For the District as a whole its combined fund balance is \$509,543 compared to \$1,609,868 million in 2005. The fund balance decreased by \$1,100,325 for the year primarily due to the completion of the renovations in the capital projects fund and \$467,681 of activity in the general fund.

#### General Fund and Budget Highlights

During the 2006 fiscal year the original District budget was amended several times to reflect changes which affected the District.

The District incurred significant turnover during the year. An interim Superintendent and interim Business Manager were retained. The final budget was amended to show a current year deficit of (\$625,196) while the actual deficit for the year was (\$467,681).

### CAPITAL ASSET AND DEBT ADMINISTRATION

#### Capital Assets

The District's capital assets are as follows:

<b>Table A-5</b>				
<b>Houghton Lake Community Schools' Capital Assets</b>				
	<b>2006</b>			<b>2005</b>
	<b>Cost</b>	<b>Accumulated depreciation</b>	<b>Net book value</b>	<b>Net book value</b>
Land	\$ -	\$ -	\$ -	\$ -
Construction in progress	93,974		93,974	-
Buildings and improvements	11,403,238	8,031,321	3,371,917	3,262,276
Machinery and equipment	1,081,012	998,258	82,754	69,300
Transportation equipment	1,770,883	1,298,817	472,066	326,881
Total	<u>\$ 14,349,107</u>	<u>\$ 10,328,396</u>	<u>\$ 4,020,711</u>	<u>\$ 3,658,457</u>

Capital asset purchases throughout fiscal 2006 include improvements and repairs financed with the proceeds from the QZAB Bond. It also includes transportation equipment financed with additional debt. Original cost of land is not determinable and is recorded at zero.

## LONG-TERM DEBT

At year end the District had \$2,367,344 long-term debt outstanding as shown in Table A-6. More detailed information is available in Note 6 to the financial statements.

	2006	2005
QZAB bonds	\$ 1,000,000	\$ 1,000,000
Notes payable	302,152	91,420
Compensated absences and termination benefits	1,065,192	1,215,500
	\$ 2,367,344	\$ 2,306,920

## FACTORS BEARING ON THE DISTRICT'S FUTURE

At the time these financial statements were prepared and audited, the District was aware of four existing circumstances that could significantly affect its financial health in the future:

- The 2006-2007 foundation allowance has been projected to increase to \$7,085.
- Several collective bargaining unit contracts have expired and need to be settled.
- Health care costs and retirement contributions continue to increase.
- Impact of declining enrollment.

## CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers and investors and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have questions about this report or need additional information, contact the Business Office, Houghton Lake Community Schools, 6001 W. Houghton Lake Drive, Houghton Lake, Michigan 48629.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
STATEMENT OF NET ASSETS  
JUNE 30, 2006**

	<u>Governmental activities</u>
<b>ASSETS</b>	
<b>CURRENT ASSETS:</b>	
Cash	\$ 2,761,845
Investments	889,517
Receivables:	
Other governmental units	1,568,833
Interest income	46,431
Inventories	2,261
Prepaid expenditures	7,222
	<hr/>
<b>TOTAL CURRENT ASSETS</b>	<b>5,276,109</b>
	<hr/>
<b>NONCURRENT ASSETS:</b>	
Cash - restricted for debt service set- aside	744
Investments - restricted for debt service set-aside	53,477
Capital assets	14,349,107
Less accumulated depreciation	(10,328,396)
Deferred charges net of amortization	35,000
	<hr/>
<b>TOTAL NONCURRENT ASSETS</b>	<b>4,109,932</b>
	<hr/>
<b>TOTAL ASSETS</b>	<b>\$ 9,386,041</b>
	<hr/> <hr/>
<b>LIABILITIES AND NET ASSETS</b>	
<b>CURRENT LIABILITIES:</b>	
Accounts payable	\$ 151,052
Accrued interest payable	43,894
Accrued salaries and related items	487,023
Contracts payable	93,973
Deferred revenue	50,411
Due to other governmental units	38,328
Notes payable	4,000,000
Current portion of long-term obligations	97,878
Current portion of severance and termination benefits	165,000
Current portion of compensated absences	52,000
	<hr/>
<b>TOTAL CURRENT LIABILITIES</b>	<b>5,179,559</b>
	<hr/>
<b>NONCURRENT LIABILITIES:</b>	
Noncurrent portion of long-term obligations	1,204,274
Noncurrent severance and termination benefits	378,440
Noncurrent compensated absences	469,752
	<hr/>
<b>TOTAL NONCURRENT LIABILITIES</b>	<b>2,052,466</b>
	<hr/>
<b>TOTAL LIABILITIES</b>	<b>7,232,025</b>
	<hr/>
<b>NET ASSETS:</b>	
Invested in capital assets, net of related debt	3,006,519
Restricted - debt service	10,327
Unrestricted	(862,830)
	<hr/>
<b>TOTAL NET ASSETS</b>	<b>2,154,016</b>
	<hr/>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 9,386,041</b>
	<hr/> <hr/>

See notes to financial statements.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
STATEMENT OF ACTIVITIES  
YEAR ENDED JUNE 30, 2006**

<u>Functions/programs</u>	<u>Expenses</u>	<u>Program revenues</u>		<u>Governmental</u>
		<u>Charges for</u>	<u>Operating</u>	<u>activities</u>
		<u>services</u>	<u>grants</u>	<u>Net (expense)</u>
				<u>revenue and</u>
				<u>changes in</u>
				<u>net assets</u>
Governmental activities:				
Instruction	\$ 10,386,556	\$	\$1,775,432	\$ (8,611,124)
Support services	6,379,035	29,451	346,847	(6,002,737)
Food services	781,776	203,015	519,059	(59,702)
Athletics	237,838	203,214		(34,624)
Interest on long-term debt	21,969			(21,969)
Unallocated depreciation	169,604			(169,604)
Total governmental activities	<u>\$ 17,976,778</u>	<u>\$ 435,680</u>	<u>\$2,641,338</u>	<u>(14,899,760)</u>
General revenues:				
Property taxes, levied for general purposes				6,994,342
Investment earnings				141,255
State sources				6,719,604
Other				248,418
Total general revenues				<u>14,103,619</u>
<b>CHANGE IN NET ASSETS</b>				(796,141)
<b>NET ASSETS, beginning of year</b>				<u>2,950,157</u>
<b>NET ASSETS, end of year</b>				<u>\$ 2,154,016</u>

**HOUGHTON LAKE COMMUNITY SCHOOLS  
BALANCE SHEET  
GOVERNMENTAL FUNDS  
JUNE 30, 2006**

	<b>General fund</b>	<b>Other nonmajor governmental funds</b>	<b>Total governmental funds</b>
<b>ASSETS</b>			
<b>ASSETS:</b>			
Cash	\$ 2,296,293	\$ 465,552	\$ 2,761,845
Investments	889,517		889,517
Receivables:			
Other governmental units	1,568,833		1,568,833
Accounts receivable		46,431	46,431
Due from other funds	155,965		155,965
Inventories		2,261	2,261
Prepaid expenditures	7,222		7,222
Cash - restricted for debt service set- aside		744	
Investments - restricted for debt service set-aside		53,477	
	<b>\$ 4,917,830</b>	<b>\$ 568,465</b>	<b>\$ 5,486,295</b>
<b>LIABILITIES AND FUND BALANCES</b>			
<b>LIABILITIES:</b>			
Accounts payable	\$ 142,186	\$ 8,866	\$ 151,052
Accrued salaries and related items	487,023		487,023
Contracts payable		93,973	93,973
Deferred revenue	50,411		50,411
Due to other governmental units	38,328		38,328
Due to other funds		155,965	155,965
Notes payable	4,000,000		4,000,000
	<b>4,717,948</b>	<b>258,804</b>	<b>4,976,752</b>
<b>FUND BALANCES:</b>			
Reserved for debt service	\$	\$ 54,221	\$ 54,221
Reserved for prepaid expenditures	7,222		7,222
Reserved for inventories		2,261	2,261
Reserved for capital projects		252,960	252,960
Designated for maintenance and repairs and termination benefits	192,660		192,660
Undesignated		219	219
	<b>199,882</b>	<b>309,661</b>	<b>509,543</b>
	<b>\$ 4,917,830</b>	<b>\$ 568,465</b>	<b>\$ 5,486,295</b>
<b>Total governmental fund balance</b>			<b>\$ 509,543</b>
Amounts reported for governmental activities in the statement of net assets are different because:			
Capital assets used in governmental activities are not financial resources and are not reported in the funds:			
The cost of the capital assets is		\$ 14,349,107	
Accumulated depreciation is		(10,328,396)	
			4,020,711
The value of unamortized bond issuance costs		37,500	
Accumulated amortization		(2,500)	
			35,000
Long-term liabilities are not due and payable in the current period and are not reported in the funds:			
Accrued severance and termination benefits			(543,440)
Bonds payable and unamortized premium			(1,302,152)
Compensated absences			(521,752)
Accrued interest is not included as a liability in government funds, it is recorded when paid			(43,894)
<b>Net assets of governmental activities</b>			<b>\$ 2,154,016</b>

**HOUGHTON LAKE COMMUNITY SCHOOLS**  
**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES**  
**GOVERNMENTAL FUNDS**  
**YEAR ENDED JUNE 30, 2006**

	<b>General fund</b>	<b>Other nonmajor governmental funds</b>	<b>Total governmental funds</b>
<b>REVENUES:</b>			
Local sources:			
Property taxes	\$ 6,994,342	\$	\$ 6,994,342
Community services and tuition	29,451		29,451
Investment income	123,710	17,545	141,255
Other	196,048	406,229	602,277
Total local sources	7,343,551	423,774	7,767,325
State sources	7,570,635	84,093	7,654,728
Federal sources	1,271,248	434,966	1,706,214
Incoming transfers and other transactions	52,370		52,370
Total revenues	16,237,804	942,833	17,180,637
<b>EXPENDITURES:</b>			
Current:			
Instruction	10,451,132		10,451,132
Support services	6,376,437		6,376,437
Athletics		231,432	231,432
Food service		781,776	781,776
<b>EXPENDITURES (Concluded):</b>			
Current (Concluded):			
Capital outlay		637,295	637,295
Debt service:			
Payments on debt	44,894		44,894
Interest and fiscal charges	2,790	10,548	13,338
Total expenditures	16,875,253	1,661,051	18,536,304
<b>EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES</b>	(637,449)	(718,218)	(1,355,667)
<b>OTHER FINANCING SOURCES (USES):</b>			
Proceeds from bank loan	255,342		255,342
Operating transfers in		85,659	85,659
Operating transfers out	(85,574)	(85)	(85,659)
Total other financing sources	169,768	85,574	255,342
<b>NET CHANGE IN FUND BALANCES</b>	(467,681)	(632,644)	(1,100,325)
<b>FUND BALANCES:</b>			
Beginning of year	667,563	942,305	1,609,868
End of year	\$ 199,882	\$ 309,661	\$ 509,543

**HOUGHTON LAKE COMMUNITY SCHOOLS  
RECONCILIATION OF THE STATEMENT OF REVENUES,  
EXPENDITURES AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS  
TO THE STATEMENT OF ACTIVITIES  
YEAR ENDED JUNE 30, 2006**

**Net change in fund balances total governmental funds** \$ (1,100,325)

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlays as expenditures. In the statement of activities these costs are allocated over their estimated useful lives as depreciation.

Depreciation expense	(419,427)
Capital outlay	781,681

Accrued interest on bonds is recorded in the statement of activities when incurred; it is not recorded in governmental funds until it is paid:

Accrued interest payable, beginning of the year	547
Accrued interest payable, end of the year	(43,894)

Proceeds and repayments of principal on long-term debt are other financing sources and expenditures in the governmental funds, but not in the statement of activities (where they are additions and reductions of liabilities)

Repayments of principal on long-term debt	44,610
Proceeds from bus loan	(255,342)
Bond issuance costs	37,500
Amortization expense	(2,500)

Compensated absences are reported on the accrual method in the statement of activities, and recorded as an expenditure when financial resources are used in the governmental funds:

Accrued compensated absences, beginning of the year	724,700
Accrued compensated absences, end of the year	(521,752)
Accrued severance and termination benefits, beginning of the year	490,800
Accrued severance and termination benefits, end of the year	(543,440)
Accrued unemployment expense, beginning of the year	10,701

**Change in net assets of governmental activities** \$ (796,141)

**HOUGHTON LAKE COMMUNITY SCHOOLS  
STATEMENT OF FIDUCIARY ASSETS AND LIABILITIES  
JUNE 30, 2006**

	<u>Agency funds</u>
<b>ASSETS</b>	
Cash	\$ 284,551
<b>LIABILITIES</b>	
Due to student groups	\$ 284,551

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The basic financial statements of the Houghton Lake Community Schools have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the District's accounting policies are described below.

**A. Reporting Entity**

The Houghton Lake Community Schools (the "District") is governed by the Houghton Lake Community Schools Board of Education (the "Board"), which has responsibility and control over all activities related to public school education within the District. The District receives funding from local, state, and federal government sources and must comply with all of the requirements of these funding source entities. However, the District is not included in any other governmental reporting entity as defined by accounting principles generally accepted in the United States of America. Board members are elected by the public and have decision-making authority, the power to designate management, the ability to significantly influence operations, and the primary accountability for fiscal matters. The District's reporting entity contains no significant component units as defined in GASB Statements No. 14 and 39.

**B. 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 non-fiduciary activities of the District. For the most part, the effect of interfund activity has been removed from these statements. The government-wide financial statements categorize primary activities as either governmental or business type. All of the District's activities are classified as governmental 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 paid by recipients who purchase, use or directly benefit from goods or services by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. State Foundation Aid, certain revenue from the intermediate school district and other unrestricted items are not included as program revenues but instead as *general revenues*.

In the government-wide statement of net assets, the governmental activities column (a) is presented on a consolidated basis, (b) and is reported on a full accrual, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations. The District's net assets are reported in three parts - invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets.

The District first utilizes restricted resources to finance qualifying activities.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**B. Government-wide and Fund Financial Statements (Continued)**

The government-wide statement of activities reports both the gross and net cost of each of the District's functions. The functions are also supported by general government revenues (property taxes, certain intergovernmental revenues, investment income and other revenue) The statement of activities reduces gross expenses by related program revenues and operating grants. Program revenues must be directly associated with the function. Operating grants include operating-specific and discretionary (either operating or capital) grants.

The net costs (by function) are normally covered by general revenue (property taxes, state sources, intermediate district sources, interest income and other revenues.)

The District does not allocate indirect costs.

This government-wide focus is more on the sustainability of the District as an entity and the change in the District's net assets resulting from the current year's activities.

Separate financial statements are provided for governmental funds and fiduciary funds, even though the latter are excluded from government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

**Governmental Funds** - Governmental funds are those funds through which most school district functions typically are financed. The acquisition, use and balances of the school district's expendable financial resources and the related current liabilities are accounted for through governmental funds.

The District reports the following major governmental fund:

The *general fund* is the District's primary operating fund. It accounts for all financial resources of the District, except those required to be accounted for in another fund.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**B. Government-wide and Fund Financial Statements (Concluded)**

**Other Non-major Funds**

The *special revenue funds* account for revenue sources that are legally restricted to expenditures for specific purposes (not including expendable trusts or major capital projects). The District accounts for its food service and athletic activities in the special revenue funds.

The *debt service fund* accounts for the resources accumulated and payments for principal and interest on long-term general obligation debt of governmental funds.

The *capital projects fund* accounts for the receipt of the QZAB bond proceeds and the acquisition of fixed assets or construction of capital projects.

The *fiduciary funds* account for assets held by the District in a trustee capacity or as an agent on behalf of others. Trust funds account for assets held by the District under the terms of a formal trust agreement. Fiduciary funds are not included in the government-wide statements.

The *agency fund* is custodial in nature and does not present results of operations or have a measurement focus. Agency funds are accounted for using the accrual basis of accounting. This fund is used to account for assets that the District holds for others in an agency capacity (primarily student activities).

**Accrual Method**

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

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

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**C. Measurement Focus, Basis of Accounting and Basis of Presentation**

**Modified Accrual Method**

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the District considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, state and federal aid and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the District.

**State Revenue**

The State of Michigan utilizes a foundation grant approach which provides for a specific annual amount of revenue per pupil based on a statewide formula. The Foundation is funded from state and local sources. Revenues from state sources are primarily governed by the School Aid Act and the School Code of Michigan. The Michigan Department of Education administers the allocation of state funds to school districts based on information supplied by the districts. For the year ended June 30, 2006, the foundation allowance was based on pupil membership counts taken in February and September of 2005.

The state portion of the foundation is provided primarily by a state education property tax millage of 6 mills and an allocated portion of state sales and other taxes. The local portion of the foundation is funded primarily by non-homestead property taxes which may be levied at a rate of up to 18 mills. The State revenue is recognized during the foundation period and is funded through payments from October 2005 to August 2006. Thus, the unpaid portion at June 30th is reported as due from other governmental units.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**C. Measurement Focus, Basis of Accounting and Basis of Presentation (Concluded)**

**State Revenue (Concluded)**

The District also receives revenue from the state to administer certain categorical education programs. State rules require that revenue earmarked for these programs be used for its specific purpose. Categorical funds received, which are not expended by the close of the fiscal year are recorded as deferred revenue. Other categorical funding is recognized when appropriation is received.

**D. Other Accounting Policies**

1. Cash and equivalents include amounts in demand deposits and certificates of deposit.

The District reports its investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* and No. 40, *Deposits and Investment Risk Disclosures*. Under these standards, certain investments are valued at fair value as determined by quoted market prices, or by estimated fair values when quoted market prices are not available. The standards also provide that certain investments are valued at cost (or amortized cost) when they are of a short-term duration, the rate of return is fixed, and the district intends to hold the investment until maturity. Accordingly, investments in banker acceptances and commercial paper are recorded at amortized cost.

State statutes authorize the District to invest in bonds and other direct and certain indirect obligations of the U.S. Treasury; certificates of deposit, savings accounts, deposit accounts, or depository receipts of a bank, savings and loan association, or credit union, which is a member of the Federal Deposit Insurance Corporation, Federal Savings and Loan Insurance Corporation, or National Credit Union Administration, respectively; in commercial paper rated at the time of purchase within the three highest classifications established by not less than two standard rating services and which matures not more than 270 days after the date of purchase. The District is also authorized to invest in U.S. Government or federal agency obligation repurchase agreements, bankers' acceptances of U.S. banks, and mutual funds composed of investments as outlined above.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**D. Other Accounting Policies (Continued)**

2. Property Taxes

Property taxes levied by the District are collected by various municipalities and periodically remitted to the District. The taxes are levied and become a lien as of July 1 and December 1 and are due upon receipt of the billing by the taxpayer and become a lien on the first day of the levy year. The actual due dates are September 14 and February 14, after which time the bills become delinquent and penalties and interest may be assessed by the collecting entity.

For the year ended June 30, 2006, the District levied the following amounts per \$1,000 of assessed valuation:

Fund	Mills
General Fund - Non-homestead	18.0000

3. Inventories and Prepaid Expenditures

Inventories are valued at the lower of cost (first-in, first-out) or market. Inventories consisting of expendable supplies held for consumption, are recorded as expenditures when consumed rather than when purchased. Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid expenditures.

4. Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the noncurrent portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds."

All receivables, including property taxes receivable, are shown net of an allowance for uncollectibles.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**D. Other Accounting Policies (Continued)**

5. Capital Assets

Capital assets purchased or acquired are capitalized at historical cost or estimated historical cost. Donated fixed assets are valued at their estimated fair market value on the date received.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related capital assets.

Depreciation on all assets is provided on the straight-line basis over the estimated useful lives as follows:

Buildings and additions	50 years
Furniture and other equipment	5 - 20 years

The District's capitalization policy is to capitalize individual amounts exceeding \$5,000.

6. Compensated Absences

The District's contracts generally provide for granting vacation, sick leave with pay and contain termination incentives. The current and long-term liability for compensated absences is reported on the government-wide financial statements. A liability for these amounts, including related benefits, is reported in governmental funds only if they have matured, for example, as a result of employee leave, resignations or retirements upon the legally enforceable due date.

7. Long-term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities on the statement of net assets. Bond premiums and discounts, as well as issuance costs and the difference between the reacquisition price and the net carrying amount of the old debt, are deferred and amortized over the life of the bonds using the straight-line method over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Concluded)**

**D. Other Accounting Policies (Concluded)**

8. Use of Estimates

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenditures. 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 - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY**

Budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America. Annual appropriated budgets are adopted for the general and special revenue funds.

The District follows these procedures in establishing the budgetary data reflected in the financial statements:

1. The Superintendent submits to the School Board a proposed operating budget for the fiscal year commencing on July 1. The operating budget includes proposed expenditures and the means of financing them. The level of control for the budgets is at the functional level as set forth and presented as required supplementary information.
2. Public hearings are conducted to obtain taxpayer comments.
3. Prior to July 1, the budget is legally adopted by School Board resolution pursuant to the Uniform Budgeting and Accounting Act (1968 PA 2). The Act requires that the budget be amended prior to the end of the fiscal year when necessary to adjust appropriations if it appears that revenues and other financing sources will be less than anticipated or so that expenditures will not be in excess of original estimates. Expenditures shall not be made or incurred, unless authorized in the budget, in excess of the amount appropriated. Violations, if any, in the general fund are noted in the required supplementary information section.
4. The Superintendent is authorized to transfer budgeted amounts between major expenditure functions within any fund; however, these transfers and any revisions that alter the total expenditures of any fund must be approved by the School Board.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 2 - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY (Concluded)**

5. Formal budgetary integration is employed as a management control device during the year for the general, special revenue, debt service and capital projects funds.
6. The budget was amended during the year with supplemental appropriations, the last one approved prior to June 30, 2006. The District does not consider these amendments to be significant.

**NOTE 3 - DEPOSITS AND INVESTMENTS - CREDIT RISK**

As of June 30, 2006, the District had the following investments.

<u>Investment type</u>	<u>Fair value</u>	<u>Weighted average maturity (years)</u>	<u>Standard &amp; Poor's rating</u>	<u>%</u>
MILAF External Investment pool - MIMAX	\$ 889,517	0.0238	AAAm	94.33%
JP Morgan US Treasury Plus Money Market	53,477	0.0027	AAAm	5.67%
Total fair value	<u>\$ 942,994</u>			<u>100.00%</u>
Portfolio weighted average maturity		<u>0.0226</u>		

1 day maturity equals 0.0027, one year equals 1.00

The District voluntarily invests certain excess funds in external pooled investment funds which included money market funds. One of the pooled investment funds utilized by the District is the Michigan Investment Liquid Asset Fund (MILAF). MILAF is an external pooled investment fund of “qualified” investments for Michigan school districts. MILAF is not regulated nor is it registered with the SEC. MILAF reports as of June 30, 2006, the fair value of the District’s investments is the same as the value of the pool shares.

**Interest rate risk.** In accordance with its investment policy, the District will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates, by; structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities in the open market; and, investing operating funds primarily in shorter-term securities, liquid asset funds, money market mutual funds, or similar investment pools and limiting the average maturity in accordance with the District’s cash requirements.

**Credit risk.** State law limits investments in commercial paper and corporate bonds to a prime or better rating issued by nationally recognized statistical rating organizations (NRSROs).

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 3 - DEPOSITS AND INVESTMENTS - CREDIT RISK (Concluded)**

**Concentration of credit risk.** The District will minimize concentration of credit risk, which is the risk of loss attributed to the magnitude of the District's investment in a single issuer, by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized.

**Custodial credit risk - deposits.** In the case of deposits, this is the risk that in the event of a bank failure, the District's deposits may not be returned to it. As of June 30, 2006, \$2,842,614 of the District's bank balance of \$3,047,140 was exposed to custodial credit risk because it was uninsured and uncollateralized.

**Custodial credit risk - investments.** For an investment, this is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

The District will minimize custodial credit risk, which is the risk of loss due to the failure of the security issuer or backer, by; limiting investments to the types of securities allowed by law; and pre-qualifying the financial institutions, broker/dealers, intermediaries and advisors with which the District will do business.

**Foreign currency risk.** The District is not authorized to invest in investments which have this type of risk.

The above amounts are previously reported in Note 3:

Deposits	\$ 3,047,140
Investments	<u>942,994</u>
	<u>\$ 3,990,134</u>

The above amounts are reported in the financial statements as follows:

Cash -District wide restricted	\$ 744
Cash - District wide	2,761,845
Cash - Agency fund	284,551
Investments - Unrestricted	889,517
Investments - Restricted	<u>53,477</u>
	<u>\$ 3,990,134</u>

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 4 - CAPITAL ASSETS**

A summary of changes in the District's capital assets follows:

	Balance July 1, 2005	Additions	Deletions	Balance June 30, 2006
Governmental activities:				
Capital assets, not being depreciated	\$	\$	\$	\$
Land				
Construction in progress		93,974		93,974
Total capital assets, not being depreciated		93,974		93,974
Capital assets, being depreciated				
Site improvements	245,168			245,168
Buildings and improvements	10,783,861	374,209		11,158,070
Machinery and equipment	1,041,856	39,156		1,081,012
Transportation equipment	1,711,863	274,342	215,322	1,770,883
Total capital assets, being depreciated	13,782,748	687,707	215,322	14,255,133
Accumulated depreciation:				
Land improvements	175,315	4,234		179,549
Buildings and additions	7,591,438	260,334		7,851,772
Machinery and equipment	972,556	25,702		998,258
Transportation equipment	1,384,982	129,157	215,322	1,298,817
Total accumulated depreciation	10,124,291	419,427	215,322	10,328,396
Net capital assets being depreciated	3,658,457	268,280		3,926,737
Net governmental capital assets	\$ 3,658,457	\$ 362,254	\$	\$ 4,020,711

Depreciation for the fiscal year ended June 30, 2006 amounted to \$419,427. The District allocated depreciation expense to the various activities as follows:

Instruction	\$ 240,819
Support services	2,598
Athletics	6,406
Unallocated	169,604
	<u>\$ 419,427</u>

Depreciation of capital assets that serve multiple functions is recorded as unallocated. Original cost of land is not determinable and is recorded at zero.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 5 - NOTES PAYABLE**

At June 30, 2006, the District has notes payable outstanding of \$4,000,000. The tax anticipation note of \$3,000,000 has an interest rate of 4.016% and matures March 30, 2007. The note is secured by the full faith and credit of the District as well as pledged property taxes. The state aid note of \$1,000,000 has an interest rate of 3.60% and matures August 18, 2006. The note is secured by the full faith and credit of the District as well as pledged state aid.

Balance June 30, 2005	Additions	Payments	Balance June 30, 2006
\$ 1,500,000	\$ 4,000,000	\$ 1,500,000	\$ 4,000,000

**NOTE 6 - LONG-TERM DEBT**

The District issues general obligation bonds to provide funds for the acquisition, construction and improvement of major capital facilities. General obligation bonds are direct obligations and pledge the full faith and credit of the District. Long-term obligations currently outstanding are as follows:

The following is a summary of the long-term debt transactions of the District for the year end June 30, 2006:

	Notes payable	QZAB bonds	Sub-total bonded & notes	Voluntary termination benefits	Compensated absences	Severance benefits	Total
Balance, July 1, 2005	\$ 91,420	\$ 1,000,000	\$ 1,091,420	\$ 185,000	\$ 724,700	\$ 305,800	\$ 2,306,920
Additions	255,342		255,342	60,000			315,342
Deletions	44,610		44,610		202,948	7,360	254,918
Balance, June 30, 2006	302,152	1,000,000	1,302,152	245,000	521,752	298,440	2,367,344
Less current portion	97,878		97,878	140,000	52,000	25,000	314,878
Total due after one year	\$ 204,274	\$ 1,000,000	\$ 1,204,274	\$ 105,000	\$ 469,752	\$ 273,440	\$ 2,052,466

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 6 - LONG-TERM DEBT (Continued)**

Long-term obligation debt at June 30, 2006 is comprised of the following:

2005 School Building Bond is due in one installment on June 21, 2021. The bond was issued under the Qualified Zone Academy Bond program. Interest is reduced to 1.00% through a tax credit. A set-aside amount of \$64,684 is required each year. Interest of 2.75% will be earned on the set-aside account.	<u>\$ 1,000,000</u>
Total bonded debt	1,000,000
Chase Bank note for purchase of a bus with final payment due June 7, 2007, at 3.99% interest rate.	46,810
Chase Bank note for purchase of a bus with annual payments of \$51,068 to \$51,070 through October 21, 2011, at 4.02% interest rate.	255,342
Obligation under contract from compensated absences	521,752
Voluntary termination benefits	245,000
Obligation under contract from retirement incentives	<u>298,440</u>
Total long-term debt	<u><u>\$ 2,367,344</u></u>

Interest expense (all funds) for the year ended June 30, 2006 was \$75,423.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 6 - LONG-TERM DEBT (Concluded)**

The annual requirements to amortize long-term debt outstanding as of June 30, 2006, including interest of \$161,698 are as follows:

Year ending June 30,	Principal	Interest	Total
2007	\$ 97,878	\$ 21,168	\$ 119,046
2008	51,068	18,212	69,280
2009	51,068	16,159	67,227
2010	51,068	14,106	65,174
2011	51,070	12,053	63,123
2012 - 2017		50,000	50,000
2018 - 2022	1,000,000	30,000	1,030,000
Total	1,302,152	161,698	1,463,850
Voluntary termination benefits	245,000		245,000
Accumulated compensated absences	521,752		521,752
Accumulated severance benefits	298,440		298,440
	<u>\$ 2,367,344</u>	<u>\$ 161,698</u>	<u>\$ 2,529,042</u>

Voluntary Termination Benefits

The District had entered into voluntary termination benefit arrangements with certain employees. The original agreement provides for a total payment to each individual of \$40,000 for an employee retiring in 2002-03. This amount is paid over four equal payments of \$10,000 annually. The agreement also provides that any teacher retiring in 2003-04 and 2004-05 shall receive \$35,000. This amount is to be paid in three payments of \$10,000, \$10,000, and \$15,000 annually. There are currently fourteen employees entitled to future payments. The liability has been recorded at the face amount, plus accrued FICA, as the discounted present value approximates face amount of the liability. The legally enforceable due date for payment is July 1. Amounts due July 1 (\$140,000) are not accrued as a liability in the general fund.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 7 - OPERATING LEASES**

The District leases copiers under non-cancelable operating leases, which expire over the next five years. Lease payments for the year ended June 30, 2006 amounted to \$10,139.

Minimum future lease payments for the years ended June 30, are as follows:

Year ending June 30,	Total
2007	\$ 10,139
2008	8,192
2009	196
	\$ 18,527

**NOTE 8 - INTERFUND RECEIVABLES AND PAYABLES**

Interfund payable and receivable balances at June 30, 2006 are as follows:

Receivable fund		Payable fund	
General	\$ 155,965	Athletic fund	\$ 147,012
	\$ 155,965	School lunch fund	8,953
	\$ 155,965		\$ 155,965

The outstanding balances between funds result mainly from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in accounting systems, and (3) payments between funds are made.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 9 - EMPLOYEE RETIREMENT SYSTEM - DEFINED BENEFIT PLAN**

Plan Description - The District contributes to the statewide Michigan Public School Employees' Retirement System (MPERS), a cost sharing multiple-employer state-wide defined benefit public employee retirement plan governed by the State of Michigan. The MPERS provides retirement survivor and disability benefits and postretirement benefits for health, dental and vision for substantially all employees of the District. The MPERS was established by Public Act 136 of 1945 and operated under the provisions of Public Act 300 of 1980, as amended. The MPERS issues a publicly available financial report that includes financial statements and required supplementary information for MPERS. That report may be obtained by writing to Michigan Public School Employees Retirement System, P.O. Box 30171, Lansing, Michigan 48909-7671 or by calling (800) 381-5111.

Funding Policy - Member Investment Plan (MIP) members enrolled in MIP prior to January 1, 1990 contribute a permanently fixed rate of 3.9% of gross wages. The MIP contribution rate was 4.0% from January 1, 1987, the effective date of the MIP, until January 1, 1990 when it was reduced to 3.9%. Members first hired January 1, 1990 or later and returning members who did not work between January 1, 1987 through December 31, 1989 contribute at the following graduated permanently fixed contribution rate: 3% of the first \$5,000; 3.6% of \$5,001 through \$15,000; 4.3% of all wages over \$15,000.

Basic Plan members make no contributions. For a limited period ending December 31, 1992, an active Basic Plan member could enroll in the MIP by paying the contributions that would have been made had enrollment occurred initially on January 1, 1987 or on the date of hire, plus interest. MIP contributions at the rate of 3.9% of gross wages begin at enrollment. Actuarial rate interest is posted to member accounts on July 1st on all MIP monies on deposit for 12 months. If a member leaves MPERS service and no pension is payable, the member's accumulated contribution plus interest, if any, are refundable.

The District is required to contribute the full actuarial funding contribution amount to fund pension benefits, plus an additional amount to fund retiree health care benefit amounts on a cash disbursement basis. The rates for the year ended June 30, 2006 were 14.87% of payroll through September 30, 2005 and 16.34% effective October 1, 2005 through June 30, 2006. The contribution requirements of plan members and the District are established and may be amended by the MPERS Board of Trustees. The District contributions to MPERS for the year ended June 30, 2006, 2005 and 2004 were approximately \$1,578,000, \$1,530,000 and \$1,415,000, respectively, and were equal to the required contribution for those years.

The District is not responsible for the payment of retirement benefits or other post-employment benefits which is the responsibility of the State of Michigan.

Other Post-employment Benefits - Retirees have the option of health coverage, which is funded on a cash disbursement basis by the employers. The System has contracted to provide the comprehensive group medical, hearing, dental and vision coverages for retirees and beneficiaries. A significant portion of the premiums is paid by the System with the balance deducted from the monthly pension.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO FINANCIAL STATEMENTS**

**NOTE 10 - RISK MANAGEMENT**

The District is exposed to various risk of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees' and natural disasters. The District participates in a distinct pool of educational institutions within the State of Michigan for self-insuring workers' disability compensation. The pool is considered a public entity risk pool. The District pays annual premiums to the pool for the respective insurance coverage. In the event the pool's total claims and expenses for a policy year exceed the total normal annual premiums for said years, all members of the specific pool's policy year may be subject to special assessment to make up the deficiency. The pool maintains reinsurance for claims in excess of \$500,000 for each occurrence with the overall maximum coverage being unlimited. The District has not been informed of any special assessments being required.

The District continues to carry commercial insurance for other risks of loss, including property and casualty errors and omissions, fleet and employee health and accident insurance.

**NOTE 11 - CONTINGENCIES**

The District is a defendant in a lawsuit. Although the outcome of these lawsuits is not presently determinable, in the opinion of the District's legal counsel, the resolution of these matters will not have a material adverse effect on the financial condition of the District.

**NOTE 12 - TRANSFERS**

The general fund transferred \$20,890 to the school lunch fund to subsidize operation and \$64,684 to the QZAB debt service fund to fund the required set aside funding requirement. The capital projects fund transferred \$85 to the QZAB debt service fund to cover expenditures.

**NOTE 13 - SCHOOL LUNCH FUND**

At June 30, 2006, the school lunch fund had a deficit of \$3,507.

**REQUIRED SUPPLEMENTARY INFORMATION**

**HOUGHTON LAKE COMMUNITY SCHOOLS  
REQUIRED SUPPLEMENTARY INFORMATION  
BUDGETARY COMPARISON SCHEDULE  
GENERAL FUND  
YEAR ENDED JUNE 30, 2006**

	<u>Original budget</u>	<u>Final budget</u>	<u>Actual</u>	<u>Variance with final budget positive (negative)</u>
<b>REVENUES:</b>				
Local	\$ 6,720,405	\$ 7,287,300	\$ 7,343,551	\$ 56,251
State sources	7,734,816	7,511,475	7,570,635	59,160
Federal sources	1,327,422	1,330,600	1,271,248	(59,352)
Incoming transfers and other transactions	28,000	53,000	52,370	(630)
Total revenues	<u>15,810,643</u>	<u>16,182,375</u>	<u>16,237,804</u>	<u>55,429</u>
<b>EXPENDITURES:</b>				
Current:				
Instruction:				
Basic programs	8,644,742	7,696,643	7,564,390	132,253
Added needs	2,675,747	2,825,860	2,886,742	(60,882)
Total instruction	<u>11,320,489</u>	<u>10,522,503</u>	<u>10,451,132</u>	<u>71,371</u>
Support services:				
Pupil	1,058,386	982,156	984,272	(2,116)
Instructional staff	368,466	416,678	389,764	26,914
General administration	308,671	367,143	394,708	(27,565)
School administration	1,237,283	1,231,510	1,271,448	(39,938)
Technology services	152,161	139,322	163,197	(23,875)
Business	371,287	591,262	460,705	130,557
Operations/maintenance	1,406,139	1,463,502	1,512,184	(48,682)
Transportation	970,501	1,165,837	1,200,159	(34,322)
Total support services	<u>5,872,894</u>	<u>6,357,410</u>	<u>6,376,437</u>	<u>(19,027)</u>
Debt Service	120,000	183,000	47,684	135,316
Total expenditures	<u>17,313,383</u>	<u>17,062,913</u>	<u>16,875,253</u>	<u>187,660</u>
<b>EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES</b>	<u>(1,502,740)</u>	<u>(880,538)</u>	<u>(637,449)</u>	<u>243,089</u>
<b>OTHER FINANCING SOURCES (USES):</b>				
Proceeds from bank loan		255,342	255,342	
Operating transfers out			(85,574)	(85,574)
Total other financing sources (uses)		<u>255,342</u>	<u>169,768</u>	<u>(85,574)</u>
<b>NET CHANGE IN FUND BALANCE</b>	<u>\$ (1,502,740)</u>	<u>\$ (625,196)</u>	<u>\$ (467,681)</u>	<u>\$ 157,515</u>
<b>FUND BALANCE:</b>				
Beginning of year			<u>667,563</u>	
End of year			<u>\$ 199,882</u>	

**ADDITIONAL INFORMATION**

**HOUGHTON LAKE COMMUNITY SCHOOLS  
 COMBINING BALANCE SHEET  
 NONMAJOR GOVERNMENTAL FUND TYPES  
 JUNE 30, 2006**

	<u>Special revenue</u>	<u>QZAB debt service</u>	<u>Capital projects</u>	<u>Total nonmajor governmental funds</u>
<b>ASSETS</b>				
<b>ASSETS:</b>				
Cash	\$ 118,619	\$ 744	\$ 346,933	\$ 466,296
Investments		53,477		53,477
Receivables:				
Accounts receivable	46,431			46,431
Inventories	2,261			2,261
<b>TOTAL ASSETS</b>	<u>\$ 167,311</u>	<u>\$ 54,221</u>	<u>\$ 346,933</u>	<u>\$ 568,465</u>
<b>LIABILITIES AND FUND BALANCES</b>				
<b>LIABILITIES:</b>				
Accounts payable	\$ 8,866	\$	\$	\$ 8,866
Contracts payable			93,973	93,973
Due to other funds	155,965			155,965
<b>TOTAL LIABILITIES</b>	<u>164,831</u>		<u>93,973</u>	<u>258,804</u>
<b>FUND BALANCES:</b>				
Reserved for debt service		54,221		54,221
Reserved for inventories	2,261			2,261
Reserved for capital projects			252,960	252,960
Undesignated	219			219
<b>TOTAL FUND BALANCES</b>	<u>2,480</u>	<u>54,221</u>	<u>252,960</u>	<u>309,661</u>
<b>TOTAL LIABILITIES AND FUND BALANCES</b>	<u>\$ 167,311</u>	<u>\$ 54,221</u>	<u>\$ 346,933</u>	<u>\$ 568,465</u>

**HOUGHTON LAKE COMMUNITY SCHOOLS  
COMBINING STATEMENT OF REVENUES, EXPENDITURES  
AND CHANGES IN FUND BALANCES  
NONMAJOR GOVERNMENTAL FUND TYPES  
YEAR ENDED JUNE 30, 2006**

	<u>Special revenue</u>	<u>QZAB debt service</u>	<u>Capital projects</u>	<u>Total nonmajor governmental funds</u>
<b>REVENUES:</b>				
Local sources:				
Investment income	\$	\$	\$ 17,545	\$ 17,545
Other	406,229			406,229
Total local sources	406,229		17,545	423,774
State sources	84,093			84,093
Federal sources	434,966			434,966
Total revenues	925,288		17,545	942,833
<b>EXPENDITURES:</b>				
Current :				
Athletics	231,432			231,432
Food service	781,776			781,776
Capital outlay			637,295	637,295
Debt service:				
Interest and fiscal charges		10,548		10,548
Total expenditures	1,013,208	10,548	637,295	1,661,051
<b>EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES</b>	(87,920)	(10,548)	(619,750)	(718,218)
<b>OTHER FINANCING SOURCES (USES):</b>				
Operating transfers out			(85)	(85)
Operating transfers in	20,890	64,769		85,659
Total other financing sources	20,890	64,769		85,574
<b>NET CHANGE IN FUND BALANCES</b>	(67,030)	54,221	(619,835)	(632,644)
<b>FUND BALANCES:</b>				
Beginning of year	69,510		872,795	942,305
End of year	\$ 2,480	\$ 54,221	\$ 252,960	\$ 309,661

**HOUGHTON LAKE COMMUNITY SCHOOLS  
SPECIAL REVENUE FUNDS  
COMBINING BALANCE SHEET  
JUNE 30, 2006  
(with comparative totals for June 30, 2005)**

	<u>School lunch fund</u>	<u>Athletics fund</u>	<u>Totals</u>	
			<u>2006</u>	<u>2005</u>
<b>ASSETS</b>				
Cash and investments	\$ 445	\$ 118,174	\$ 118,619	\$ 39,407
Accounts receivable	5,606	40,825	46,431	38,953
Inventory and prepaid expenditures	2,261		2,261	3,006
Total assets	<u>\$ 8,312</u>	<u>\$ 158,999</u>	<u>\$ 167,311</u>	<u>\$ 81,366</u>
 <b>LIABILITIES AND FUND BALANCES</b>				
Liabilities:				
Accounts payable	\$ 2,866	\$ 6,000	\$ 8,866	\$ 2,864
Due to other funds	8,953	147,012	155,965	(8,992)
Total liabilities	<u>11,819</u>	<u>153,012</u>	<u>164,831</u>	<u>(6,128)</u>
 Fund balances:				
Reserved for inventories and prepaid expenditures	2,261		2,261	2,261
Undesignated	(5,768)	5,987	219	67,249
Total fund balances	<u>(3,507)</u>	<u>5,987</u>	<u>2,480</u>	<u>69,510</u>
Total liabilities and fund balances	<u>\$ 8,312</u>	<u>\$ 158,999</u>	<u>\$ 167,311</u>	<u>\$ 63,382</u>

**HOUGHTON LAKE COMMUNITY SCHOOLS  
SPECIAL REVENUE FUNDS  
COMBINING STATEMENT OF REVENUES, EXPENDITURES  
AND CHANGES IN FUND BALANCES  
YEAR ENDED JUNE 30, 2006  
(with comparative totals for June 30, 2005)**

	<b>School lunch fund</b>	<b>Athletics fund</b>	<b>Totals</b>	
			<b>2006</b>	<b>2005</b>
<b>REVENUES:</b>				
Food service	\$ 203,015	\$	\$ 203,015	\$ 205,624
Athletics		203,214	203,214	211,853
State sources	84,093		84,093	78,758
Federal sources	434,966		434,966	403,479
	<u>722,074</u>	<u>203,214</u>	<u>925,288</u>	<u>899,714</u>
<b>EXPENDITURES:</b>				
Salaries and wages	158,161	130,347	288,508	263,928
Employee benefits	228,865	35,804	264,669	227,039
Supplies and other expenses	394,750	65,281	460,031	416,545
	<u>781,776</u>	<u>231,432</u>	<u>1,013,208</u>	<u>907,512</u>
<b>EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES</b>	<u>(59,702)</u>	<u>(28,218)</u>	<u>(87,920)</u>	<u>(7,798)</u>
<b>OTHER FINANCING SOURCES (USES):</b>				
Operating transfer to general fund				(122,264)
Operating transfer in from general fund	20,890		20,890	
	<u>20,890</u>		<u>20,890</u>	<u>(122,264)</u>
<b>NET CHANGE IN FUND BALANCES</b>	<u>(38,812)</u>	<u>(28,218)</u>	<u>(67,030)</u>	<u>(130,062)</u>
<b>FUND BALANCES:</b>				
Beginning of year	<u>35,305</u>	<u>34,205</u>	<u>69,510</u>	<u>199,572</u>
End of year	<u>\$ (3,507)</u>	<u>\$ 5,987</u>	<u>\$ 2,480</u>	<u>\$ 69,510</u>

**HOUGHTON LAKE COMMUNITY SCHOOLS  
 AGENCY FUNDS  
 STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS  
 YEAR ENDED JUNE 30, 2006**

	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2006</u>
High School	\$ 152,115	\$ 221,973	\$ 194,425	\$ 179,663
Middle School	44,132	91,986	92,816	43,302
Prudenville Elementary	56,001	150,436	154,530	51,907
Merritt Internal	4,694		993	3,701
Merritt Playground	1,451			1,451
Collins Playground	3,288	3,002	1,763	4,527
	<u>\$ 261,681</u>	<u>\$ 467,397</u>	<u>\$ 444,527</u>	<u>\$ 284,551</u>

**HOUGHTON LAKE COMMUNITY SCHOOLS  
GENERAL FUND  
SCHEDULE OF REVENUES  
YEARS ENDED JUNE 30, 2006 AND 2005**

	<u>2006</u>	<u>2005</u>
<b>REVENUES:</b>		
Local sources:		
Property taxes	\$ 6,937,004	\$ 6,507,654
Delinquent property taxes	13,291	18,594
Penalties on summer tax collection	44,047	35,633
Community education	24,242	21,862
Interest	123,710	40,959
Summer school tuition	5,209	3,375
Other	196,048	140,949
	<u>7,343,551</u>	<u>6,769,026</u>
Total local sources		
State sources:		
Foundation	6,175,596	7,054,546
At risk	544,008	575,223
Special education	611,597	532,320
Durant settlement	12,212	12,212
Early childhood education	105,600	105,600
Drivers' education		2,792
Other	121,622	85,451
	<u>7,570,635</u>	<u>8,368,144</u>
Total state sources		
Federal sources:		
Title I - regular	637,579	604,426
Title II	195,416	196,957
Title V	20,219	45,841
Special Education IDEA	350,876	367,232
Special Education Transition Grant	3,450	1,887
Adult Basic Education	48,000	60,000
Michigan Rural System Initiative	2,432	375
Drug Free Schools	3,683	4,904
Homeland security grant	6,670	1,295
Vocational Education Basic Grant		22,776
Health Day grant	2,923	1,000
	<u>1,271,248</u>	<u>1,306,693</u>
Total federal sources		
Interdistrict		
Transportation		16,891
Other reimbursements	15,144	15,094
	<u>15,144</u>	<u>31,985</u>
Total interdistrict sources		
Other revenues:		
Prior year refund	37,226	175,481
	<u>37,226</u>	<u>175,481</u>
Total revenues	<u>\$ 16,237,804</u>	<u>\$ 16,651,329</u>

**HOUGHTON LAKE COMMUNITY SCHOOLS**  
**GENERAL FUND**  
**SCHEDULE OF EXPENDITURES**  
**YEAR ENDED JUNE 30, 2006**  
(with comparative totals for the year ended June 30, 2005)

	Salaries	Employee benefits	Purchased services	Supplies and materials	Other expenses	Capital outlay	Totals	
							2006	2005
Instruction:								
Elementary	\$ 1,991,497	\$ 1,073,682	\$ 1,638	\$ 39,882	\$ 726	\$ 155	\$ 3,107,580	\$ 3,499,075
Middle school	1,062,971	511,848	3,097	30,736	2,049	1,222	1,611,923	1,928,879
High school	1,746,699	833,750	45,505	51,906	6,602	4,833	2,689,295	2,762,736
Preschool	89,102	65,841	194		455		155,592	213,662
Total basic	4,890,269	2,485,121	50,434	122,524	9,832	6,210	7,564,390	8,404,352
Special education	982,091	578,641		3,253	36,809	100	1,600,894	1,649,024
Compensatory education	614,319	323,792	69,052	70,923			1,078,086	1,139,676
Vocational education	12,388	2,955		10,710	57,861		83,914	63,133
Enrichment program	2,496	602	6,685	891	200		10,874	12,066
Adult basic education	4,195	2,136	4,836	975	4,166	529	16,837	84,930
Adult secondary education	65,992	21,222	4,491	4,432			96,137	120,172
Total added needs	1,681,481	929,348	85,064	91,184	99,036	629	2,886,742	3,069,001
Total instruction	6,571,750	3,414,469	135,498	213,708	108,868	6,839	10,451,132	11,473,353
Support services:								
Guidance	231,007	94,596		236			325,839	432,282
Health service	64,956	30,212	1,130	30			96,328	98,806
Psychological services	69,336	31,160					100,496	105,970
Speech and language therapy	130,838	60,616					191,454	183,058
Social worker services	189,411	80,744					270,155	268,378
Total pupil	685,548	297,328	1,130	266			984,272	1,088,494
Improvement of instruction	39,106	29,452	789	6,212			75,559	65,787
Educational media services	111,076	91,082	8,144	5,848		52	216,202	189,319
Other school administration	56,534	39,209	1,337	878	45		98,003	90,298
Total instructional staff	206,716	159,743	10,270	12,938	45	52	389,764	345,404
Board of education	12,390		130,779		26,137		169,306	46,459
Executive administration	111,273	44,804	37,886	5,760	3,811		203,534	221,026
Pupil Accounting	15,650	5,601	617				21,868	16,563
Total general administration	139,313	50,405	169,282	5,760	29,948		394,708	284,048
School Administration	784,702	476,388	414	4,316	5,628		1,271,448	1,284,154
Technology services	81,308	53,383	1,919	3,707		22,880	163,197	126,112
Fiscal services	121,506	36,077	125,469		850		283,902	238,553
Internal services	7,081	1,683					8,764	16,417
Other business services		43	108,016		59,980		168,039	320,945
Total business	128,587	37,803	233,485		60,830		460,705	575,915
Operation and maintenance	477,912	356,467	203,491	455,894	17,456	964	1,512,184	1,480,776
Pupil transportation services	366,028	373,622	20,606	180,752	3,809	255,342	1,200,159	912,400
Total support services	2,870,114	1,805,139	640,597	663,633	117,716	279,238	6,376,437	6,097,303
Debt Service					47,684		47,684	118,136
Total expenditures	\$ 9,441,864	\$ 5,219,608	\$ 776,095	\$ 877,341	\$ 274,268	\$ 286,077	\$ 16,875,253	\$ 17,688,792

**HOUGHTON LAKECOMMUNITY SCHOOLS  
BONDED DEBT  
YEAR ENDED JUNE 30, 2006**

2005 Qualified Zone Academy Bonds

<u>Calendar Year</u>	<u>Interest rate</u>	<u>Principal due June 21</u>
2021	1.00%	<u>\$ 1,000,000</u>

The above bonds dated June 21, 2005 were issued for the purpose of financing renovations and improvements to school properties. The amount of the original bond issue was \$1,000,000.

Bonds of this issue are not subject to redemption prior to maturity.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
SCHEDULE OF INSTALLMENT NOTE PAYABLE  
YEAR ENDED JUNE 30, 2006**

\$216,284 installment notes payable dated May 20, 2002 for bus purchase.

Principal due June 7,	Interest due June 6,	Debt service requirement	
		June 30,	Amount
\$ 46,810	\$ 891	2007	\$ 47,701

The above notes have an interest rate of 3.99%.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
SCHEDULE OF INSTALLMENT NOTE PAYABLE  
YEAR ENDED JUNE 30, 2006**

\$255,342 installment notes payable dated October 21, 2005 for bus purchase.

Principal due October 21,	Interest due October 21,	Debt service requirement	
		June 30,	Amount
\$ 51,068	\$ 10,151	2007	\$ 61,219
51,068	8,212	2008	59,280
51,068	6,159	2009	57,227
51,068	4,106	2010	55,174
51,070	2,053	2011	53,123
<u>\$ 255,342</u>	<u>\$ 30,681</u>		<u>\$ 286,023</u>

The above notes have an interest rate of 4.02%.

**HOUGHTON LAKE COMMUNITY SCHOOLS**

**ADDITIONAL REPORTS REQUIRED BY  
OMB CIRCULAR A-133**

**YEAR ENDED JUNE 30, 2006**

## CONTENTS

	<u>Page</u>
Report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with <i>Government Auditing Standards</i> .....	1 - 2
Report on compliance with requirements applicable to each major program and internal control over compliance in accordance with OMB Circular A-133 .....	3 - 4
Schedule of expenditures of federal awards .....	5 - 7
Notes to schedule of expenditures of federal awards.....	8 - 9
Schedule of findings and questioned costs .....	10 - 12
Schedule of prior audit findings.....	13
Corrective action plan .....	14



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Timothy H. Adams  
David B. Caldwell  
Edward L. Williams, III  
Timothy J. Orians  
Dennis D. Theis

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Walter P. Maner, Jr. (1921-2004)  
Floyd L. Costerisan  
Leon A. Ellis (1933-1988)

**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***

To the Board of Education  
Houghton Lake Community Schools  
Houghton Lake, Michigan

August 29, 2006

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Houghton Lake Community Schools as of and for the year ended June 30, 2006, which collectively comprise Houghton Lake Community Schools' basic financial statements and have issued our report thereon dated August 29, 2006. 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 Houghton Lake Community Schools' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Houghton Lake Community Schools' ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying schedule of findings and questioned costs as item 2006-01.

August 29, 2006

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud 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 over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Houghton Lake Community Schools' 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*.

However, we noted other matters involving the internal control over financial reporting, which we have reported to management of Houghton Lake Community Schools in a separate letter dated August 29, 2006.

This report is intended solely for the information and use of the board of education, management, U.S. Department of Education and Michigan Department of Education and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Mamer, Costeniser & Ellis, P.C." The signature is written in a cursive style.

Certified Public Accountants



Lamonte T. Lator  
Bruce J. Dunn  
Jeffrey C. Stevens  
Linda I. Schirmer  
Steven W. Scott  
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**REPORT ON COMPLIANCE WITH REQUIREMENTS  
APPLICABLE TO EACH MAJOR PROGRAM  
AND INTERNAL CONTROL OVER COMPLIANCE  
IN ACCORDANCE WITH OMB CIRCULAR A-133**

To the Board of Education  
Houghton Lake Community Schools  
Houghton Lake, Michigan

August 29, 2006

Compliance

We have audited the compliance of Houghton Lake Community Schools with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2006. Houghton Lake Community Schools' major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Houghton Lake Community Schools' management. Our responsibility is to express an opinion on Houghton Lake Community Schools' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Houghton Lake Community Schools' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Houghton Lake Community Schools' compliance with those requirements.

In our opinion, Houghton Lake Community Schools complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 2006-02.

Internal Control Over Compliance

The management of Houghton Lake Community Schools is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Houghton Lake Community Schools' internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of Houghton Lake Community Schools as of and for the year ended June 30, 2006, and have issued our report thereon dated August 29, 2006. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise Houghton Lake Community Schools' basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the board of education, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Mayer, Costeniser & Ellis, P.C.*

Certified Public Accountants

**HOUGHTON LAKE COMMUNITY SCHOOLS  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2006**

Federal grantor/pass-through grantor program title	Federal CFDA number	Pass- through grantor's number	Award amount	Accrued (deferred) revenue 6/30/2005	Prior year expenditures (memorandum only)	Current year receipts (cash basis)	Current year expenditures	Accrued (deferred) revenue 6/30/2006
<u>U.S. Department of Agriculture:</u>								
Passed through Michigan Department of Education:								
Child nutrition cluster:								
National School Lunch Program - Section 4	10.555	051950	\$ 6,005	\$ -	\$ 34,993	\$ 6,005	\$ 6,005	\$ -
National School Lunch Program - Section 4		061950	35,456	-	-	35,457	35,457	-
National School Lunch Program - Section 11		051960	38,034	-	221,451	38,034	38,034	-
National School Lunch Program - Section 11		061960	224,037	-	-	224,037	224,037	-
			<u>303,532</u>	<u>-</u>	<u>256,444</u>	<u>303,533</u>	<u>303,533</u>	<u>-</u>
National School Lunch Program - Breakfast	10.553	051970	12,458	-	89,783	12,458	12,458	-
National School Lunch Program - Breakfast		061970	86,926	-	-	86,926	86,926	-
			<u>99,384</u>	<u>-</u>	<u>89,783</u>	<u>99,384</u>	<u>99,384</u>	<u>-</u>
Total child nutrition cluster			<u>402,916</u>	<u>-</u>	<u>346,227</u>	<u>402,917</u>	<u>402,917</u>	<u>-</u>
National School Lunch Program - Commodities:				-				
Entitlement	10.550		30,347	-	19,264	30,347	30,347	-
Bonus			1,702	-	1,820	1,702	1,702	-
Total National School Commodities Program			<u>32,049</u>	<u>-</u>	<u>21,084</u>	<u>32,049</u>	<u>32,049</u>	<u>-</u>
Total U.S. Department of Agriculture			<u>434,965</u>	<u>-</u>	<u>367,311</u>	<u>434,966</u>	<u>434,966</u>	<u>-</u>
<u>National Science Foundation:</u>								
Passed through Western Michigan University:								
05-06 Michigan Rural Systemic Initiative	47.076		2,432	-	375	2,432	2,432	-

The accompanying notes are an integral part of this schedule.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2006**

Federal grantor/pass-through grantor program title	Federal CFDA number	Pass- through grantor's number	Award amount	Accrued (deferred) revenue 6/30/2005	Prior year expenditures (memorandum only)	Current year receipts (cash basis)	Current year expenditures	Accrued (deferred) revenue 6/30/2006
<b>U.S. Department of Education:</b>								
Passed through C.O.O.R.I.S.D.:								
Special Education Cluster:								
Special Education Flow Through Grant	84.027	050450-0405	\$ 367,232	\$ 367,232	\$ 367,232	\$ 367,232	\$ -	\$ -
Special Education Flow Through Grant		060450-0405	350,876	-		174,716	350,876	176,160
Transition Services Grant		050490/TS	1,887	1,887	1,887	1,887	-	-
Transition Services Grant		060490/TS	3,450	-	-	3,450	3,450	-
Total Special Education Cluster			723,445	369,119	369,119	547,285	354,326	176,160
Vocational Education - Basic Grant	84.048	033350/401506	23,000	22,776	22,776	22,776	-	-
Total C.O.O.R.I.S.D.			746,445	391,895	391,895	570,061	354,326	176,160
Passed through Michigan Department of Education:								
Adult Basic Education	84.002	061130-610776	48,000	-	-	42,333	48,000	5,667
Title I	84.010	051530-0405	582,020	237,021	582,020	237,021	-	-
Title I		051530-0506	35,354	-	-	35,354	35,354	-
Title I		061530-0506	635,499	-	-	635,499	602,225	(33,274)
Total Title I			1,252,873	237,021	582,020	907,874	637,579	(33,274)
Title II - Improving Teacher Quality	84.367	050520-0405	165,526	10,526	165,526	10,526	-	-
Title II - Improving Teacher Quality		050520-0506	10,498	-	-	10,498	10,498	-
Title II - Improving Teacher Quality		060520-0506	177,248	-	-	177,248	177,248	-
Total Title II			353,272	10,526	165,526	198,272	187,746	-

The accompanying notes are an integral part of this schedule.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2006**

Federal grantor/pass-through grantor program title	Federal CFDA number	Pass- through grantor's number	Award amount	Accrued (deferred) revenue 6/30/2005	Prior year expenditures (memorandum only)	Current year receipts (cash basis)	Current year expenditures	Accrued (deferred) revenue 6/30/2006
<u>U.S. Department of Education (Concluded):</u>								
Passed through Michigan Department of Education (Concluded):								
Title V	84.298	040250-0405	\$ 22,816	\$ 1,413	\$ 22,816	\$ 1,413	\$ -	\$ -
Title V		050250-0405	23,025	21,025	23,025	21,025	-	-
Title V		050250-0506	2,768	-	-	2,768	2,768	-
Title V		060250-0506	17,547	-	-	9,181	17,451	8,270
Total Title V			<u>66,156</u>	<u>22,438</u>	<u>45,841</u>	<u>34,387</u>	<u>20,219</u>	<u>8,270</u>
Tech Literacy Challenge Grant	84.318	054290-0405	8,020	3,874	8,020	3,874	-	-
Tech Literacy Challenge Grant		054290-0506	7,670	-	-	7,670	7,670	-
Total Tech Literacy Challenge Grant			<u>15,690</u>	<u>3,874</u>	<u>8,020</u>	<u>11,544</u>	<u>7,670</u>	<u>-</u>
Passed through Cheboygan-Otsego-Presque Isle Educational Service District:								
Drug Free Schools	84.186	052860	11,703	-	4,904	11,703	3,683	(8,020)
Total Michigan Department of Education			<u>1,747,694</u>	<u>273,859</u>	<u>806,311</u>	<u>1,206,113</u>	<u>904,897</u>	<u>(27,357)</u>
Total U.S. Department of Education			<u>2,494,139</u>	<u>665,754</u>	<u>1,198,206</u>	<u>1,776,174</u>	<u>1,259,223</u>	<u>148,803</u>
<u>U.S. Department of Health and Human Services:</u>								
Passed through Michigan Department of Education:								
CDC Grant - CSHP Tech Assistant Grant	93.938	052770-ACS0305	2,923	-	-	3,000	2,923	(77)
<u>U.S. Department of Homeland Security:</u>								
2003 State Homeland Grant Program Part II	97.004		6,670	-	-	6,670	6,670	-
<b>TOTAL EXPENDITURES OF FEDERAL AWARDS</b>			<u>\$ 2,941,129</u>	<u>\$ 665,754</u>	<u>\$ 1,565,892</u>	<u>\$ 2,223,242</u>	<u>\$ 1,706,214</u>	<u>\$ 148,726</u>

The accompanying notes are an integral part of this schedule.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2006**

1. Basis of presentation - The accompanying schedule of expenditures of federal awards includes the grant activity of Houghton Lake Community Schools and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with OMB Circular A-133 and reconciles with the amounts presented in the preparation of the financial statements.
2. CFDA (#10.553, #10.555, and #84.002) were audited as the major programs, representing 26% of expenditures. The District qualifies for low risk auditee status.
3. The threshold for distinguishing Type A and Type B programs was \$300,000.
4. Management has utilized the Grant Section Auditors' Report (Form R7120) in preparing the Schedule of Expenditures of Federal Awards.
5. Federal expenditures are reported as revenue in the following funds in the financial statements:

General fund	\$ 1,271,248
Other nonmajor governmental fund	<u>434,966</u>
Subtotal	<u><u>\$ 1,706,214</u></u>

**HOUGHTON LAKE COMMUNITY SCHOOLS  
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2006**

6. The federal amounts reported on Form R7120 "Grants Section Auditors' Report", are in agreement with the Schedule of Expenditures of Federal Awards, except for the following amounts

CFDA #	Name of Grant	Grant ID #	Schedule of	Grants	Difference
			Federal	Section	
			Awards	Auditors'	
			Current year	Current	
			receipts	year	
				receipts	
84.010	Title I	051530 0405	\$ 237,021	\$ 26,851	\$ 210,170
84.298	Title V	040250 0405	1,413	-	1,413
84.298	Title V	050250 0405	21,025	420	20,605
84.318	Tech Literacy Challenge Grant	054290 0405	3,874	2,216	1,658
84.367	Title II - Improving Teacher Quality	050520 0405	10,526	2,911	7,615
			<u>\$ 273,859</u>	<u>\$ 32,398</u>	<u>\$ 241,461</u>

The difference is due to a grant request submitted on June 28, 2005 that was received July 1, 2005 but was not included in the 2005-06 Grant Section Auditors' Report as current year revenue.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006**

**Section I - Summary of Auditors' Results**

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***Financial Statements***

Type of auditors' report issued: *Unqualified*

➤ Material weakness(es) identified:   X   Yes        No

➤ Reportable condition(s) identified that are not considered to be material weaknesses?        Yes   X   None reported

Noncompliance material to financial statements noted?        Yes   X   No

***Federal Awards***

Internal control over major programs:

➤ Material weakness(es) identified:        Yes   X   No

➤ Reportable condition(s) identified that are not considered to be material weakness(es)?        Yes   X   None reported

Type of auditors' report issued on compliance for major programs: *Unqualified*

Any audit findings disclosed that are required to be reported with Section 510(a) of Circular A-133?   X   Yes        No

Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster
10.555 and 10.553 84.002	Child Nutrition Cluster Adult Basic Education

Dollar threshold used to distinguish between type A and Type B programs: \$300,000

Auditee qualified as low-risk auditee?   X   Yes        No

**HOUGHTON LAKE COMMUNITY SCHOOLS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006**

**Section II - Financial Statement Findings**

---

Reportable Condition 2006-01 - Considered a material weakness

**Criteria:** During the year, month-end reconciliations of primary asset and liability accounts were not completed in a timely manner. This resulted in year end adjustments to several accounts.

**Condition:** During the year, the District experienced employee turnover with its Superintendent and Business Manager.

**Effect:** Material weakness in internal control

**Cause:** Completion of reconciliations primarily in the area of cash, accounts payable, accrued liabilities and revenue on a monthly basis was not completed.

**Recommendation:** Monthly bank reconciliations should be reviewed by an appropriate individual every month. In addition, the reconciled balance should be compared to the general ledger to ensure all necessary adjustments to the general ledger are made in a timely manner. This will improve the accuracy of interim reporting.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2006**

**Section III - Federal Award Findings and Questioned Costs**

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Finding 2006-02

**Federal Programs:** Title I CFDA # 84.010, Drug Free Schools CFDA # 84.186

**Specific Requirement:** Cash management

**Criteria:** The grants in question allow for cash advances for up to 3 days of cash needs.

**Condition:** The District incorrectly forecasted its cash needs in March 2006, and consequently received cash advances in excess of immediate cash needs.

**Questioned Costs:** The District may owe interest income earned back to the Michigan Department of Education. At June 30, 2006, \$41,294 had been received and not expended.

CFDA #84.186	\$	8,020
CFDA # 84.010		<u>33,274</u>
	\$	<u><u>41,294</u></u>

**Context:** During the year, the District incurred significant turnover in the business office, resulting in this error.

**Effect:** The District has excess cash and deferred revenue at June 30, 2006. The District received the benefit of interest earnings on the unspent federal funds.

**Cause:** Premature request of funds which could not be spent within the subsequent 3 days.

**Recommendation:** The District should base its cash advance requests on accruable expenditures which meet the 3 day cash needs criteria.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
SCHEDULE OF PRIOR AUDIT FINDINGS  
YEAR ENDED JUNE 30, 2006**

There were no audit findings.

**HOUGHTON LAKE COMMUNITY SCHOOLS  
CORRECTIVE ACTION PLAN  
JUNE 30, 2006  
CONTACT PERSON: LYLE SPALDING  
OVERSIGHT AGENCY: U.S. DEPARTMENT OF EDUCATION**

Houghton Lake Community Schools respectfully submits the following corrective action plan for the year ended June 30, 2006.

**Auditor:** Maner, Costerisan & Ellis, P.C.  
544 Cherbourg Drive, Suite 200  
Lansing, Michigan 48917-5010

**Audit Period:** Year ended June 30, 2006

The finding from the June 30, 2006 schedule of findings and questioned costs are discussed below. The finding is numbered consistently with the number assigned in the schedule.

**Finding - Financial statement audit**

Reportable condition considered a material weakness 2006-01.

**Recommendation:** Monthly bank reconciliations should be reviewed by an appropriate individual every month. In addition, the reconciled balance should be compared to the general ledger to ensure all necessary adjustments to the general ledger are made in a timely manner. This will improve the accuracy of interim reporting.

**Action to be taken:** We concur with the recommendation. We have worked diligently to resolve all issues. We are currently in the process of hiring a Business Manager as this position is currently vacant.

**Finding - Federal award audit**

Reportable condition 2006-02

**Recommendation:** The District should base its cash advance requests on accruable expenditures which meet the 3 day cash needs criteria.

**Action to be taken:** We concur with the recommendation. We have worked diligently to improve the federal grant request process.



Lamonte T. Lator  
Bruce J. Dunn  
Jeffrey C. Stevens  
Linda I. Schirmer  
Steven W. Scott  
David M. Raeck  
Robert E. Miller, Jr.  
Steven B. Robbins  
James E. Nyquist  
James R. Dedyne

Timothy H. Adams  
David B. Caldwell  
Edward L. Williams, III  
Timothy J. Orians  
Dennis D. Theis

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Walter P. Maner, Jr. (1921-2004)  
Floyd L. Costerisan  
Leon A. Ellis (1933-1988)

August 29, 2006

To the Board of Education  
Houghton Lake Community Schools  
Houghton Lake, Michigan

In planning and performing our audit of the financial statements of Houghton Lake Community Schools for the year ended June 30, 2006, we considered the District's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control.

However, during our audit we became aware of certain matters that are opportunities for strengthening internal controls and operating efficiency. The comments and suggestions regarding those matters follow. This letter does not affect our report dated August 29, 2006, on the financial statements of Houghton Lake Community Schools.

**Prior Year Comments - Status**

**Athletic Funds**

In the prior year, it was recommended the athletic department improve deposit procedures. Deposits were not being made in a timely manner. We are pleased to report the athletic department implemented such a system.

Parent/Staff Involvement

The Michigan Department of Education requires that a school district provide opportunities for consultation with parents and teachers of pupils eligible for Title I, including those from private schools, in the design, implementation, and evaluation of the Title I project. Districts with allocations of more than \$500,000 must reserve at least 1% for parental involvement activities. We are pleased to report the district set aside and spent 1% for parental involvement.

**Repeat Comments**

Student Activity Funds

In the prior year, it was recommended the person maintaining the financial records of the internal funds at each location provide a monthly activity report to the corresponding teacher or organizational leader. This procedure was not in place at all locations throughout the 2005-06 fiscal year. We recommend this procedure be fully implemented.

**Current Year Comments**

The following are our current year comments. This is our first year as the District's auditor's. We are also aware of the turnover in the business office and the necessity for a interim Superintendent. We have separately reported a material weakness in internal control as part of our reporting requirements under the single audit act and OMB-Circular-A-133.

We commend the District for retaining outside assistance in the accounting department. Our current year comments follow:

Improve and Standardize Monthly Closing Procedures

During the audit, we proposed more than 50 adjusting journal entries. Substantially all of the entries were to adjust the general ledger or to make accruals and other adjustments. We believe that a review and evaluation of transactions and formalized monthly closing procedures will expedite the month-end closing and improve interim reporting. A formalized month end procedures checklist should be implemented and reviewed monthly.

Accounting Department Needs a Business Manager

The business manager position, a key position, is currently vacant. Since that time, Houghton Lake Community School's has experienced many problems in the accounting and finance area. The vacancy left by the Business Manager requires that other employees in the accounting department perform the business manager's duties while still completing their own work. After an extended period of time, working under these conditions, the likelihood for errors increases and the likelihood of employee turnover will also increase. In addition, segregation of duties is diminished. We recommend an experienced individual be selected to fill this position as soon as possible.

Accounting Staff Needs to Perform Year-End Accounting

This year external individuals assisted the accounting staff with the year-end bookkeeping and accounting procedures that are necessary to prepare the books for audit purposes. With adequate training, the accounting staff will become familiar with the necessary procedures to complete the year-end accounting. In time, the condition of the accounting records should improve, and less help by external individuals will be required in this area. We suggest Houghton Lake Community School's provide its accounting staff with the necessary training to ensure they are able to efficiently prepare the year-end accounting for the audit.

Cash: Reconcile Bank Statements Timely

During the audit, we noted that bank statements for Houghton Lake Community School's various accounts were not reconciled to the general ledger. Many of the problems encountered within the area of cash can be avoided if a proper system of checks and balances is incorporated into the district's procedures. We recommend that all of the bank accounts be reconciled monthly to the general ledger and that all suspicious reconciling items be promptly investigated and adjusted with adequate explanations.

In addition, all reconciliations should be reviewed and bank statements should be received and opened by an appropriate individual not involved in the check writing process.

Cash Receipts: Segregation of Duties

We noted there was a lack of segregation of duties within the cash receipts area. The objective of internal control over cash receipts is to obtain control over amounts received at the time of receipt. We feel that separating these closely related functions in the cash receipts system of Houghton Lake Community School's will result in much greater internal control in this particular area. To achieve this control, certain duties involving receipts should be handled by more than one member of Houghton Lake Community School's personnel. The following procedures should be enacted to ensure efficient internal control:

- One employee, preferably the receptionist, should open the mail, make a control list of all receipts, and restrictively endorse all items received as “for deposit only.” This would prevent any unauthorized endorsement should the checks be misplaced or lost before being deposited.
- The receipts should then go to another employee for further processing and deposit to the bank on a timely basis.
- Finally, someone who does not otherwise handle receipts should compare the deposit slips to the list of receipts to ensure that all funds reflected on the control list were deposited in a timely manner.

#### Dating of Checks

During our audit procedures, it was noted that checks issued in July and August 2006 were dated using a June 2006 date. These checks were then included in the list of June 30, 2006, outstanding checks as if they had been issued in June. Proper cutoff is extremely critical in all aspects of accounting. Any process or procedure that holds the books open or closes them in advance will yield inaccurate financial results. We strongly recommend that all check disbursements be dated using the date the check is actually produced.

Retirement Incentive Accounting

Currently the District has commitments to former employers who have retired. The legally enforceable due date for payments is July 1<sup>st</sup> of each year. The Michigan Department of Education Accounting Manual interprets (GASB) Interpretation #6 *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements* as requiring a liability and corresponding expenditure to be recorded in the general fund on the legally enforceable due date.

In prior years payments due on July 1<sup>st</sup> were paid prior to June 30<sup>th</sup> and recorded as an expenditure in the year paid. For the year ended June 30, 2006, the July 1, 2006 payment was made after year-end. This results in \$140,000 of payments to be recorded as expenditures in the 2006 - 2007 fiscal year. Should the July 1, 2007 payment be made prior to July 1, 2007, then this amount will also be recorded as an expenditure in 2006 - 2007.

For the year ended June 30, 2006 early retirement incentive expenditures for teachers were zero because the payment was not made by June 30, 2006. This results in allowable inconsistency. We bring this to your attention to consider when amending your 2006 - 2007 budget.

Physical Inventory of Fixed Assets Needs to Be Taken Periodically

During the last fiscal year, physical inventories of fixed assets were taken for the first time in many years and significant amounts of fixed assets were written off because numerous assets had been disposed of or otherwise taken out of operation in prior years. These transactions have been adjusted on the accounting records. We suggest that physical inventories of fixed assets be taken periodically and related records be timely and appropriately updated, to prevent an unaccepted differences in the future. Also, a complete and accurate inventory of fixed assets will provide for much stronger control to detect any future fixed asset removal or disposition without proper authorization.

#### Fixed Asset Disposals Policy Needs to Be Implemented

At present, Houghton Lake Community School's does not have a formal procedure to ensure that disposals of fixed assets, whether by destruction, sale, scrapping, or trade-in, are reported to the accounting department. Without such a procedure, the likelihood of a disposal going unrecorded increases substantially. A formal policy to ensure the reporting of fixed asset dispositions should be adopted and should require the necessary level of approvals based on the value of the asset. We suggest that a simple yet standardized form be developed to provide adequate approvals for disposal, details, and other pertinent information as evidence of adherence to the District's policy. This form would also provide the necessary accounting documentation for recording the disposal into the books of account.

#### Establish System of Management Approval of Purchases

We noted that there is no system of effective review for purchases. This is a serious weakness of the system of internal controls and this opens the way for the possibility of not only unapproved but also fraudulent purchases. We suggest that purchases in excess of a certain dollar limit, established by management, be approved and that this approval be documented by a signature and date on the purchase order and invoice.

#### Control over District Credit Cards

During our audit procedures, it was determined that as many as twenty employees, possess and use District credit cards. Furthermore, the cards are used for a variety of purchases, including for charges other than travel expenses. We recommend that District credit cards be limited or eliminated in order to strengthen the internal controls over disbursements and help prevent misappropriation of assets.

#### Payroll Review

Our audit testing of payroll procedures disclosed that only one employee in the accounting department performs the complete payroll process. This is contrary to the establishment of strong internal controls regarding segregation of duties and makes Houghton Lake Community School's vulnerable in this area. While we clearly understand the limitations on obtaining an adequate segregation of duties with such a small staff, we feel that the Business manager (when hired) should review the payroll on a regular basis. This review should include which employees are listed on payroll, amounts at which they are paid, reasonableness of withholdings, correct account distribution and the assurance that all related payroll taxes are being paid.

#### Distribution of Paychecks

Presently paychecks for staff located throughout the District are distributed by the maintenance supervisor who is also the payroll clerk's husband. In order to improve controls over payroll, we recommend that someone other than payroll clerk's husband, distribute the paychecks to the staff.

#### Adequacy of Bonding Insurance Coverage

As a part of our regular audit procedures, we reviewed Houghton Lake Community School's insurance coverage and as a result, noted that the level of bonding insurance seemed low in relation to the dollar value of assets and revenues. Bonding coverage insures an organization in the event of theft or embezzlement by an employee and is an inherent element in any system of internal controls. Currently, Houghton Lake Community School's has \$25,000 in bonding insurance coverage. We strongly recommend that the limits of Houghton Lake Community School's bonding coverage be reviewed by both the Board and an insurance professional and adjusted accordingly.

Federal Grants Reporting: Timely and Accurate Reporting

Our audit procedures revealed that there were instances where reports required to be filed under the grant agreement were either not filed at all or filed after the due date. We strongly recommend that Houghton Lake Community School's institute policies and procedures that stipulate that the required reports must be filed by their respective due dates. It is critically important that timely and accurate reports be produced to ensure that the goals and purposes of the grant have been achieved and accounted for properly. We commend Houghton Lake Community School's on maintaining separate cost centers for each federal funding source to more clearly reflect activity on a grant-by-grant basis. Houghton Lake Community School's should use these expenditure reports to assist in filing the federal grant requests.

Employment Contracts

During the audit, we read certain employment contracts the District has entered into with various union groups. We noted these contracts do not include the dates when an employee will receive fringe benefits. Currently for teachers the first month of insurance in a fiscal year is the month of September. This requires a two month accrual at year-end to include the subsequent months of July and August as expenditures in the previous year. The Districts' practice for all other employees is the first month of insurance in a fiscal year is July. We recommend the District clarify in the contracts the first date an employee will receive compensation and fringe benefits.

Financial Condition and Possible Future Effect on Audit Opinion

It was noted during our audit that Houghton Lake Community School's has had a negative change in general fund, fund balance for the past three years and now has a fund balance of approximately \$199,000 as of June 30, 2006. This indicates that Houghton Lake Community School's is approaching becoming theoretically insolvent in that its liabilities exceed its assets. We strongly recommend that management and the Board of Education evaluate the reasons why this condition has occurred. Future plans and budgets should then be developed to produce a plan to avoid continuing deficits. Please be aware that continuation of these negative financial results can impact the type of audit opinion that can be issued in the future. This situation is critical and may very well impact the future ability of Houghton Lake Community School's to conduct its affairs in the manner it is accustomed to.

Budget Enforcement by the Michigan Department of Education

The Michigan Department of Education is changing their enforcement and monitoring of budget violations. They are currently focusing on total expenditures violations that exceed 1% of the total expenditures budget and total other financing uses that exceed 1% of the total other financing uses budget. The Department of Education will be issuing letters to school board presidents, the superintendent and the chief business official when they identify these types of violations.

Currently identified violations of the Act include, but are not limited to:

- Incurring expenditures in excess of the appropriation approved by the school board.
- Ending the fiscal year with a negative general fund balance.
- Adopting a budget that, when implemented, would put the district in a deficit.

The Department is also currently reviewing their interpretation of Section 17(2). This would be a situation where a District's actual revenues were less than budgeted revenues and, at the same time, depleted the district fund balance, beyond what was approved in total by the school board.

We recommend you continue to review your current budget amendments during the year. There will be situations where there continues to be budget violations as disclosed in footnote 2 subsection 3 of the financial statements. While there may be technical violations of the act we believe the District's current budget procedures should be monitored during the year to avoid budget violation letters from the Michigan Department of Education.

The District should review its budget in the areas of state revenue, instruction, support services pupil and support services pupil transportation. These were areas which had negative variances this year.

#### Cash Management - Federal Awards

The Michigan Department of Education has recently been notified that it, along with all other states, has misinterpreted the advance provision of the Cash Management Improvement Act (CMIA). The United States Department of Education started monitoring and auditing CMIA compliance and is notifying sub-recipients that advances are limited to three days cash needs. In other words, funds must be spent by the district within 72 hours of being drawn down from the USDE GAPS system. Because of this new awareness, the department will no longer allow 30-day cash advances for ongoing programs during fiscal year 2006/2007. Thirty-day cash advances may be permitted for new one-time federal grant programs at the discretion of program management.

We recommend the District request funds on a reimbursement basis in order to ensure compliance with the revised cash management interpretation. In March 2006, the District requested the remaining balance of certain federal awards. Federal award money was not spent by June 30, 2006; this was a direct violation of the Cash Management Improvement Act.

#### Computer Passwords

We understand that computer passwords are not changed on a regular basis. In order to reduce the risk of access to computer files by unauthorized personnel, we recommend the District institute a policy that requires passwords to be changed on a regular basis. The District may also wish to investigate building into its software automatic expiration of passwords to ensure that they are changed periodically.

In addition, the District should consider a standard setting whereby computers are logged off of the network after a predetermined amount of inactivity.

#### Disaster Recovery Plan

The District utilizes a third party service provider to host its primary student and financial applications. Despite this the District has a number of applications and corresponding data that is maintained by the District. While the District performs daily backups of these systems we recommend a formal disaster recovery plan be developed and documented for its in-house applications. We understand the third party service provider has updated and documented its disaster recovery procedures during the current year.

New Auditing Standards

Recently, 10 new auditing standards have been released and will become effective over the District's next two fiscal years. In reviewing the new standards, we do not believe, for the most part, they will have a significant impact on our overall audit approach. However, two of the new standards may directly impact the District beginning with the June 30, 2007 year-end.

One of the new standards revises the dating of the auditors' report. Under the old standards, the auditors' report was dated the last day of fieldwork. The new standards define the date as the date adequate audit evidence is obtained. Adequate audit evidence is now being interpreted as including the client's approval of draft financial statements. Although the dating of the report may seem trivial to non-auditors, it does have an impact on auditors' subsequent events work (June 30 through date of the auditors' report). The impact to the District could be if there was a long period of time needed to resolve certain open issues. This would extend the dating of the auditors' report and increase the amount of work we need to complete our subsequent events work.

Another standard effective for the June 30, 2007 year-end is related to our communications with the client. The new standard retained the definition of a "material weakness" and added two new categories of deficiencies "significant deficiency" and "control deficiency". Certain situations were included as examples of strong indicators of significant deficiencies and possibly material weaknesses. One of the situations is the client is unable to write financial statements, including the footnotes, in accordance with generally accepted accounting principles. Historically, we have prepared the financial statements and footnotes for the District. We will have to evaluate the District's ability to produce appropriate financial statements and footnotes and, accordingly, if any control deficiencies exists.

To the Board of Education  
Houghton Lake Community Schools  
Houghton Lake, Michigan

14

August 29, 2006

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with various District personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

This report is intended solely for the information and use of Houghton Lake Community Schools, management, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

We appreciate the cooperation we received from your staff during our engagement and the opportunity to be of service.

Very truly yours

A handwritten signature in black ink that reads "Mamer, Costenisaar & Ellis, P.C." The signature is written in a cursive style with a large initial 'M' and a distinct ampersand.



Lamonte T. Lator  
Bruce J. Dunn  
Jeffrey C. Stevens  
Linda I. Schirmer  
Steven W. Scott  
David M. Raack  
Robert E. Miller, Jr.  
Steven B. Robbins  
James E. Nyquist  
James R. Dedyne

Timothy H. Adams  
David B. Caldwell  
Edward L. Williams, III  
Timothy J. Orians  
Dennis D. Theis

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Walter P. Maner, Jr. (1921-2004)  
Floyd L. Costerisan  
Leon A. Ellis (1933-1988)

August 29, 2006

To the Board of Education  
Houghton Lake Community Schools  
Houghton Lake, Michigan

We have audited the financial statements of Houghton Lake Community Schools for the year ended June 30, 2006, and have issued our report thereon dated August 29, 2006. Professional standards require that we provide you with the following information related to our audit.

1. Our Responsibility under Auditing Standards Generally Accepted in the United States of America and OMB Circular A-133

As stated in our engagement letter, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

In planning and performing our audit, we considered Houghton Lake Community School's internal control over financial reporting 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 over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether Houghton Lake Community School's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of law, regulations, contracts and grants, 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. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about Houghton Lake Community Schools' compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* applicable to each of its major programs for the purpose of expressing an opinion on Houghton Lake Community Schools' compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on Houghton Lake Community Schools' compliance with those requirements.

2. Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by Houghton Lake Community Schools are described in Note 1 to the financial statements. We noted no transactions entered into by Houghton Lake Community Schools during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

3. Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Management's estimate of the liability of the payout for the employee compensated absences upon their retirement is based on expected payout; the balance reported for compensated absences was approximately \$521,752 and accumulated severance benefits were approximately \$543,440. We evaluated the key factors and assumptions used to develop the balance of compensated absences in determining that it is reasonable in relation to the financial statements as a whole.

Certain amounts included in capital assets have estimated based on an outside appraisal company. Certain allocations on the statement of activities allocating revenue between instruction and support services have been used in preparing the statements.

4. Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Houghton Lake Community Schools' financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the Houghton Lake Community Schools, either individually or in the aggregate, indicate matters that could have a significant effect on the Houghton Lake Community Schools' financial reporting process.

5. Disagreements with Management

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

6. Consultations with Other Independent Accountants

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

7. Issues Discussed Prior to Retention of Independent Auditors

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

8. Difficulties Encountered in Performing the Audit

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

This information is intended solely for the use of the Board of Education, management, and federal awarding agencies and pass-through entities of Houghton Lake Community Schools and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

*Mama, Costeusan & Ellis, P.C.*