

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input checked="" type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name City of Grayling	County Crawford
Fiscal Year End 06/30/07	Opinion Date October 26, 2007	Date Audit Report Submitted to State October 31, 2007	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

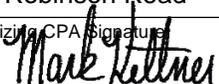
We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

YES NO Check each applicable box below. (See instructions for further detail.)

1. All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. The local unit has adopted a budget for all required funds.
5. A public hearing on the budget was held in accordance with State statute.
6. The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. The local unit only holds deposits/investments that comply with statutory requirements.
9. The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. The local unit is free of repeated comments from previous years.
12. The audit opinion is UNQUALIFIED.
13. The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. The board or council approves all invoices prior to payment as required by charter or statute.
15. To our knowledge, bank reconciliations that were reviewed were performed timely.

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

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)		
Financial Statements	<input checked="" type="checkbox"/>			
The letter of Comments and Recommendations	<input checked="" type="checkbox"/>			
Other (Describe)	<input type="checkbox"/>			
Certified Public Accountant (Firm Name) REHMANN ROBSON		Telephone Number 517-787-6503		
Street Address 675 Robinson Road		City Jackson	State MI	Zip 49204
Authorized CPA Signature 		Printed Name Mark T. Kettner, CPA, CGFM		License Number 11673

City of Grayling

FINANCIAL STATEMENTS

**For the Fiscal Year Ended
June 30, 2007**



REHMANN ROBSON

Certified Public Accountants

CITY OF GRAYLING, MICHIGAN

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REHMANN ROBSON

Certified Public Accountants

A member of **THE REHMANN GROUP**



INDEPENDENT AUDITORS' REPORT

October 26, 2007

The Honorable Mayor, Members of
the City Council and City Manager
City of Grayling
Grayling, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the *City of Grayling, Michigan* (the "City"), as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City, as of June 30, 2007, and the respective changes in financial position and cash flows, where applicable, thereof, and the respective budgetary comparison for the general and each major special revenue fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The City has not presented Management's Discussion and Analysis as required supplementary information. The GASB has determined that such information is necessary to supplement, although not required to be part of, the basic financial statements.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The combining and individual fund financial statements listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial statements have 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 black ink that reads "Lehmann Johnson". The signature is written in a cursive, flowing style.

BASIC FINANCIAL STATEMENTS

GOVERNMENT-WIDE FINANCIAL STATEMENTS

CITY OF GRAYLING
STATEMENT OF NET ASSETS
June 30, 2007

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Assets			
Cash and cash equivalents	\$ 2,603,448	\$ 581,603	\$ 3,185,051
Investments	714,146	250,000	964,146
Receivables	289,239	344,310	633,549
Inventory	-	18,900	18,900
Capital assets not being depreciated	215,764	850,376	1,066,140
Capital assets being depreciated, net	<u>5,921,251</u>	<u>5,407,503</u>	<u>11,328,754</u>
Total assets	<u>9,743,848</u>	<u>7,452,692</u>	<u>17,196,540</u>
Liabilities			
Accounts payable	162,141	98,937	261,078
Unearned revenue	153,691	-	153,691
Long-term liabilities:			
Due within one year	72,971	34,000	106,971
Due in more than one year	<u>935,367</u>	<u>1,528,000</u>	<u>2,463,367</u>
Total liabilities	<u>1,324,170</u>	<u>1,660,937</u>	<u>2,985,107</u>
Net Assets			
Invested in capital assets, net of related debt	5,189,193	4,695,879	9,885,072
Restricted for:			
Debt service	-	48,817	48,817
Capital projects	-	47,996	47,996
Unrestricted	<u>3,230,485</u>	<u>999,063</u>	<u>4,229,548</u>
Total net assets	<u>\$ 8,419,678</u>	<u>\$ 5,791,755</u>	<u>\$ 14,211,433</u>

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

CITY OF GRAYLING
STATEMENT OF ACTIVITIES
For the year ended June 30, 2007

<u>Functions / Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>		<u>Net (Expense) Revenue</u>	
		<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>		<u>Capital Grants and Contributions</u>
Primary government					
Governmental activities:					
Legislative	\$ 26,431	\$ -	\$ -	\$ -	\$ (26,431)
General government	773,155	278,554	334,562	-	(160,039)
Public safety	890,809	181,918	-	-	(708,891)
Public works	605,631	-	163,176	-	(442,455)
Community and economic development	56,798	-	-	-	(56,798)
Recreation and culture	25,752	-	349,000	-	323,248
Interest and fiscal charges on debt	34,307	-	-	-	(34,307)
Total governmental activities	<u>2,412,883</u>	<u>460,472</u>	<u>846,738</u>	<u>-</u>	<u>(1,105,673)</u>
Business-type activities:					
Sewer	445,587	386,899	232,272	-	173,584
Water	259,548	220,280	-	-	(39,268)
Total business-type activities	<u>705,135</u>	<u>607,179</u>	<u>232,272</u>	<u>-</u>	<u>134,316</u>
Total primary government	<u>\$ 3,118,018</u>	<u>\$ 1,067,651</u>	<u>\$ 1,079,010</u>	<u>\$ -</u>	<u>\$ (971,357)</u>

continued...

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

CITY OF GRAYLING
STATEMENT OF ACTIVITIES "(Concluded)"
For the year ended June 30, 2007

Functions/Programs	Governmental Activities	Business-type Activities	Total
Changes in net assets			
Net (expense) revenue	\$ (1,105,673)	\$ 134,316	\$ (971,357)
General revenues:			
Property taxes	918,048	-	918,048
Income taxes	451,108	-	451,108
Unrestricted investment earnings	114,631	38,530	153,161
Interest and rent	49,636	-	49,636
Miscellaneous	33,741	12,238	45,979
Gain from sale of capital assets	18,620	-	18,620
Transfers - internal activities	(40,747)	40,747	-
Total general revenues and transfers	<u>1,545,037</u>	<u>91,515</u>	<u>1,636,552</u>
Change in net assets	439,364	225,831	665,195
Net assets, beginning of year	<u>7,980,314</u>	<u>5,565,924</u>	<u>13,546,238</u>
Net assets, end of year	<u><u>\$ 8,419,678</u></u>	<u><u>\$ 5,791,755</u></u>	<u><u>\$ 14,211,433</u></u>

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

**CITY OF GRAYLING
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2007**

	<u>General</u>	<u>Income Tax Fund</u>	<u>Nonmajor Governmental Funds</u>	<u>Total</u>
Assets				
Cash and cash equivalents	\$ 1,133,517	1,183,900	\$ 51,460	\$ 2,368,877
Investments	714,146	-	-	714,146
Accounts receivable, net of allowance for doubtful accounts	91,957	34,900	23,184	150,041
Taxes receivable, net of allowance for doubtful accounts	2,168	-	-	2,168
Due from other governmental units	137,030	-	-	137,030
Total assets	<u>\$ 2,078,818</u>	<u>\$ 1,218,800</u>	<u>\$ 74,644</u>	<u>\$ 3,372,262</u>
Liabilities and fund balances				
Liabilities				
Accounts payable	\$ 111,451	\$ -	\$ 3,469	\$ 114,920
Accrued liabilities	28,900	762	1,792	31,454
Deferred revenue	-	153,691	-	153,691
Total liabilities	<u>140,351</u>	<u>154,453</u>	<u>5,261</u>	<u>300,065</u>
Fund balances				
Unreserved, designated for:				
Cemetery expenditures	445,509	-	-	445,509
Fire protection expenditures	84,675	-	-	84,675
Unfunded pension liability	406,700	-	-	406,700
Transfer to DDA Michigan Ave	-	250,000	-	250,000
Perpetual Fund (City Council)	-	215,000	-	215,000
Unreserved				
Undesignated, reported in:				
General Fund	1,001,583	-	-	1,001,583
Special Revenue Funds	-	599,347	69,383	668,730
Total fund balances	<u>1,938,467</u>	<u>1,064,347</u>	<u>69,383</u>	<u>3,072,197</u>
Total liabilities and fund balances	<u>\$ 2,078,818</u>	<u>\$ 1,218,800</u>	<u>\$ 74,644</u>	<u>\$ 3,372,262</u>

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

CITY OF GRAYLING
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
June 30, 2007

Fund balances - total governmental funds	\$ 3,072,197
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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 therefore not reported in the funds.

Add: capital assets	12,896,933
Subtract: accumulated depreciation	(7,346,049)

Internal service funds are used by management to charge the costs of certain activities, such as insurance and other centralized costs, to individual funds. The assets and liabilities of certain internal service funds are included in governmental activities in the statement of net assets.

Add: net assets of governmental activities accounted for in internal service funds	813,989
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Certain liabilities, such as bonds payable, are not due and payable in the current period, and therefore are not reported in the funds.

Subtract: bonds payable	(790,000)
Subtract: installment contracts and capital lease payable	(157,822)
Subtract: accrued interest payable	(9,054)
Subtract: compensated absences	(60,516)
	(1,017,402)

Net assets of governmental activities	\$ 8,419,678
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The accompanying notes are an integral part of these financial statements.

CITY OF GRAYLING
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
For the year ended June 30, 2007

	<u>General</u>	<u>Income Tax Fund</u>	<u>Nonmajor Governmental Funds</u>
Revenues			
Property taxes	\$ 918,048	\$ -	\$ -
Income tax	-	451,108	-
Licenses and permits	2,946	-	-
Intergovernmental	515,405	349,000	155,700
Charges for services	276,683	-	7,476
Interest and rent	99,527	49,636	4,961
Other revenue	33,624	-	117
Total revenues	<u>1,846,233</u>	<u>849,744</u>	<u>168,254</u>
Expenditures			
Current:			
Legislative	26,431	-	-
General government	677,693	77,948	-
Public safety	790,444	-	-
Public works	148,862	-	294,718
Community and economic developmen	56,798	-	-
Recreation and culture	530,524	-	-
Debt service	-	-	113,462
Total expenditures	<u>2,230,752</u>	<u>77,948</u>	<u>408,180</u>
Revenues over (under) expenditures	<u>(384,519)</u>	<u>771,796</u>	<u>(239,926)</u>
Other financing sources (uses)			
Sale of fixed assets	18,620	-	-
Transfers in	506,653	-	180,594
Transfers (out)	(164,094)	(639,358)	(16,500)
Total other financing sources (uses)	<u>361,179</u>	<u>(639,358)</u>	<u>164,094</u>
Net change in fund balances	<u>(23,340)</u>	<u>132,438</u>	<u>(75,832)</u>
Fund balances, beginning of year	<u>1,961,807</u>	<u>931,909</u>	<u>145,215</u>
Fund balances, end of year	<u>\$ 1,938,467</u>	<u>\$ 1,064,347</u>	<u>\$ 69,383</u>

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

<u>Total</u>	
\$	918,048
	451,108
	2,946
	1,020,105
	284,159
	154,124
	33,741
	<u>2,864,231</u>
	26,431
	755,641
	790,444
	443,580
	56,798
	530,524
	113,462
	<u>2,716,880</u>
	<u>147,351</u>
	18,620
	687,247
	<u>(819,952)</u>
	<u>(114,085)</u>
	33,266
	<u>3,038,931</u>
\$	<u><u>3,072,197</u></u>

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

CITY OF GRAYLING
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
For the year ended June 30, 2007

Net change in fund balances - total governmental funds	\$	33,266
<p>Amounts reported for <i>governmental activities</i> in the statement of activities are different because:</p>		
<p>Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.</p>		
Add: capital outlay		538,336
Subtract: depreciation expense		(255,505)
<p>Repayment of long-term liabilities is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.</p>		
Add: principal payments on long-term liabilities		71,387
<p>Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.</p>		
Add: decrease in the accrued interest payable		7,766
Subtract: increase in the accrual of compensated absences		(6,829)
<p>Internal service funds are used by management to charge the costs of certain activities, such as insurance and other centralized costs, to individual funds. The net revenue (expense) of certain internal service funds is reported with governmental activities.</p>		
Add: interest revenue		10,143
Add: transfers in		91,958
Subtract: net operating loss from governmental activities accounted for in internal service funds		(51,158)
		(51,158)
Change in net assets of governmental activities	\$	439,364

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

CITY OF GRAYLING
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL
GENERAL FUND
For the year ended June 30, 2007

	<u>Original Budget</u>	<u>Amended Budget</u>	<u>Actual</u>	<u>Over (Under) Budget</u>
Revenues				
Property taxes	\$ 904,237	\$ 904,237	\$ 918,048	\$ 13,811
Licenses and permits	3,000	3,000	2,946	(54)
Intergovernmental	553,421	591,520	515,405	(76,115)
Charges for services	232,852	232,852	276,683	43,831
Interest and rent	46,100	46,100	99,527	53,427
Other revenue	5,000	5,000	33,624	28,624
Total revenues	<u>1,744,610</u>	<u>1,782,709</u>	<u>1,846,233</u>	<u>63,524</u>
Expenditures				
Current				
Legislative	21,150	23,650	26,431	2,781
General government	740,869	755,869	677,693	(78,176)
Public safety	772,740	886,126	790,444	(95,682)
Public works	145,000	149,000	148,862	(138)
Community and economic development	3,000	116,000	56,798	(59,202)
Recreation and culture	566,339	566,339	530,524	(35,815)
Total expenditures	<u>2,249,098</u>	<u>2,496,984</u>	<u>2,230,752</u>	<u>(266,232)</u>
Revenues over (under) expenditures	<u>(504,488)</u>	<u>(714,275)</u>	<u>(384,519)</u>	<u>329,756</u>
Other financing sources (uses)				
Sale of capital assets	9,000	9,000	18,620	9,620
Transfers in	541,988	541,988	506,653	(35,335)
Transfers (out)	(146,463)	(146,463)	(164,094)	(17,631)
Total other financing sources (uses)	<u>404,525</u>	<u>404,525</u>	<u>361,179</u>	<u>(43,346)</u>
Net change in fund balance	(99,963)	(309,750)	(23,340)	286,410
Fund balance, beginning of year	1,961,807	1,961,807	1,961,807	-
Fund balance, end of year	<u>\$ 1,861,844</u>	<u>\$ 1,652,057</u>	<u>\$ 1,938,467</u>	<u>\$ 286,410</u>

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

CITY OF GRAYLING
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE -
BUDGET AND ACTUAL
INCOME TAX FUND
For the year ended June 30, 2007

	<u>Original Budget</u>	<u>Amended Budget</u>	<u>Actual</u>	<u>Over (Under) Budget</u>
Revenues				
Income tax	\$ 440,000	\$ 440,000	\$ 451,108	\$ 11,108
Intergovernmental	348,000	348,000	349,000	1,000
Interest and rent	25,000	25,000	49,636	24,636
Total revenues	813,000	813,000	849,744	36,744
Expenditures				
General government	157,229	157,229	77,948	(79,281)
Revenues over (under) expenditures	655,771	655,771	771,796	116,025
Other financing sources (uses)				
Transfers (out)	(730,488)	(730,488)	(639,358)	91,130
Net change in fund balance	(74,717)	(74,717)	132,438	116,025
Fund balance, beginning of year	931,909	931,909	931,909	-
Fund balance, end of year	<u>\$ 857,192</u>	<u>\$ 857,192</u>	<u>\$ 1,064,347</u>	<u>\$ 116,025</u>

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

CITY OF GRAYLING
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
June 30, 2007

	<u>Business-type Activities</u>			<u>Governmental Activities</u>
	<u>Enterprise Funds</u>			<u>Internal Service Fund</u>
	<u>Sewer</u>	<u>Water</u>	<u>Total</u>	
Assets				
Current assets:				
Cash and cash equivalents	\$ 439,463	\$ 142,140	\$ 581,603	\$ 234,571
Investments	162,500	87,500	250,000	-
Accounts receivable, net	267,826	76,484	344,310	-
Inventory	12,285	6,615	18,900	-
Total current assets	<u>882,074</u>	<u>312,739</u>	<u>1,194,813</u>	<u>234,571</u>
Non-current assets				
Capital assets, net	<u>5,440,383</u>	<u>817,496</u>	<u>6,257,879</u>	<u>586,131</u>
Total assets	<u>6,322,457</u>	<u>1,130,235</u>	<u>7,452,692</u>	<u>820,702</u>
Liabilities				
Current liabilities:				
Accounts payable	40,162	17,828	57,990	6,002
Accrued expenses	24,210	16,737	40,947	711
Bonds and contracts payable - current	<u>20,000</u>	<u>14,000</u>	<u>34,000</u>	<u>-</u>
Total current liabilities	84,372	48,565	132,937	6,713
Long-term liabilities -				
Bonds and contracts payable	<u>909,000</u>	<u>619,000</u>	<u>1,528,000</u>	<u>-</u>
Total liabilities	<u>993,372</u>	<u>667,565</u>	<u>1,660,937</u>	<u>6,713</u>
Net assets				
Investment in capital assets, net of related debt	4,511,383	184,496	4,695,879	586,131
Restricted for:				
Debt service	29,290	19,527	48,817	-
Capital projects	26,534	21,462	47,996	-
Unrestricted	<u>761,878</u>	<u>237,185</u>	<u>999,063</u>	<u>227,858</u>
Total net assets	<u>\$ 5,329,085</u>	<u>\$ 462,670</u>	<u>\$ 5,791,755</u>	<u>\$ 813,989</u>

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

CITY OF GRAYLING
STATEMENT OF REVENUE, EXPENSES AND
CHANGES IN FUND NET ASSETS
PROPRIETARY FUNDS
For the year ended June 30, 2007

	<u>Business-type Activities</u>			<u>Governmental Activities</u>
	<u>Enterprise Funds</u>			<u>Internal Service Fund</u>
	<u>Sewer</u>	<u>Water</u>	<u>Total</u>	
Operating revenues				
Charges for services	\$ 386,899	\$ 220,280	\$ 607,179	\$ 167,391
Other revenue	1,800	10,438	12,238	7,037
Total operating revenues	<u>388,699</u>	<u>230,718</u>	<u>619,417</u>	<u>174,428</u>
Operating expenses				
Salaries and fringes	102,374	87,277	189,651	69,909
Supplies	4,821	10,616	15,437	41,907
Contracted services	85,780	66,348	152,128	17,792
Utilities	45,824	16,953	62,777	9,286
Repair and maintenance	24,281	13,171	37,452	19,850
Depreciation	135,852	33,738	169,590	66,842
Total operating expenses	<u>398,932</u>	<u>228,103</u>	<u>627,035</u>	<u>225,586</u>
Operating income (loss)	<u>(10,233)</u>	<u>2,615</u>	<u>(7,618)</u>	<u>(51,158)</u>
Nonoperating revenues (expenses)				
Investment earnings	27,085	11,445	38,530	10,143
Interest expense	(46,655)	(31,445)	(78,100)	-
Intergovernmental	232,272	-	232,272	-
Total nonoperating revenues (expenses)	<u>212,702</u>	<u>(20,000)</u>	<u>192,702</u>	<u>10,143</u>
Income (loss) before transfers	<u>202,469</u>	<u>(17,385)</u>	<u>185,084</u>	<u>(41,015)</u>
Transfers				
Transfers in	48,947	-	48,947	91,958
Transfers (out)	-	(8,200)	(8,200)	-
Changes in net assets	<u>251,416</u>	<u>(25,585)</u>	<u>225,831</u>	<u>50,943</u>
Net assets, beginning of year	<u>5,077,669</u>	<u>488,255</u>	<u>5,565,924</u>	<u>763,046</u>
Net assets, end of year	<u>\$ 5,329,085</u>	<u>\$ 462,670</u>	<u>\$ 5,791,755</u>	<u>\$ 813,989</u>

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

CITY OF GRAYLING
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
For the year ended June 30, 2007

	<u>Business-type Activities</u>			<u>Governmental Activities</u>
	<u>Enterprise Funds</u>			<u>Internal Service Fund</u>
	<u>Sewer</u>	<u>Water</u>	<u>Total</u>	
Cash flows from operating activities				
Cash received from customers and users	\$ 280,769	\$ 216,803	\$ 497,572	\$ -
Cash received from interfund services provided	-	-	-	174,428
Cash payments to suppliers for goods and services	(157,205)	(90,779)	(247,984)	(85,633)
Cash payments to employees for services	(103,303)	(87,342)	(190,645)	(69,889)
Net cash provided by operating activities	<u>20,261</u>	<u>38,682</u>	<u>58,943</u>	<u>18,906</u>
Cash flows from noncapital financing activities				
Interest income	27,085	11,445	38,530	10,143
Intergovernmental	232,272	-	232,272	-
Transfers in (out)	48,947	(8,200)	40,747	91,958
Net cash provided by noncapital financing activities	<u>308,304</u>	<u>3,245</u>	<u>311,549</u>	<u>102,101</u>
Cash flows from capital and related financing activities				
Purchase and construction of capital assets	(274,947)	-	(274,947)	(91,808)
Principal paid on capital debt	(27,400)	(4,600)	(32,000)	-
Interest paid on capital debt	(46,655)	(31,445)	(78,100)	-
Net cash used by capital and related financing activities	<u>(349,002)</u>	<u>(36,045)</u>	<u>(385,047)</u>	<u>(91,808)</u>
Net (decrease) increase in cash and cash equivalents	<u>(20,437)</u>	<u>5,882</u>	<u>(14,555)</u>	<u>29,199</u>
Cash and cash equivalents, beginning of year	<u>459,900</u>	<u>136,258</u>	<u>596,158</u>	<u>205,372</u>
Cash and cash equivalents, end of year	<u>\$ 439,463</u>	<u>\$ 142,140</u>	<u>\$ 581,603</u>	<u>\$ 234,571</u>
Reconciliation of operating income to net cash provided (used) by operating activities				
Operating income (loss)	\$ (10,233)	\$ 2,615	\$ (7,618)	\$ (51,158)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:				
Depreciation	135,852	33,738	169,590	66,842
Changes in assets and liabilities:				
Accounts receivable	(107,930)	(13,915)	(121,845)	-
Inventory	-	(2)	(2)	-
Accounts payable	3,501	16,311	19,812	3,202
Accrued liabilities	(929)	(65)	(994)	20
Net cash provided by operating activities	<u>\$ 20,261</u>	<u>\$ 38,682</u>	<u>\$ 58,943</u>	<u>\$ 18,906</u>

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

CITY OF GRAYLING
STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUNDS
June 30, 2007

	<u>Agency Fund</u>
Assets	
Cash and cash equivalents	\$ <u>271</u>
Liabilities	
Accounts payable	\$ <u>271</u>

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

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting entity

The *City of Grayling* (the "City") is directed by a City Council elected by the community at large. This legislative body appoints a City Manager to administer the affairs of the City. The City provides the following services as authorized by its charter: public safety (police and fire), highways and streets, cemetery, sanitation, health and social services, culture and recreation, public improvements, planning and zoning and general administrative services. The City has adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 14 and Statement No. 39, regarding the definition of the reporting entity.

GASB 14 states that the primary basis for determining whether outside agencies and organizations should be considered component units of the City and included in the City's financial statements is financial accountability. Financial accountability has been defined as follows: a primary government has substantive authority to appoint a voting majority of the component unit's board; the primary government is either able to impose its will on a component unit or there is a potential for the component unit to provide specific financial burdens on the primary government; and the component unit is fiscally dependent on the primary government. The City has no component units.

B. Related organization

The Grayling Housing Commission ("the Commission") is governed by a five-member board appointed by the Grayling City Council. The Commission is legally separate and not financially accountable to the City of Grayling, thus it is not shown as part of the City's financial statements. Complete financial statements for the Commission can be obtained from its administrative office.

C. Government-wide and fund financial statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component units, of which the City has none. For the most part, the effect of interfund activity has been removed from these statements. *Governmental activities*, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support.

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

Separate financial statements are provided for governmental funds, proprietary funds, and

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

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

The City reports the following major governmental funds:

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

The *Income Tax Fund* accounts for the proceeds from the City income tax collections. These collections are reserved for capital improvements.

The *Water and Sewer Funds* are the City's major enterprise funds. They account for the activities of the City's water distribution and sewage disposal and treatment systems.

Additionally, the City reports the following non-major fund types:

The *Major and Local Street Funds* account for the use of money received from the State of Michigan under the revenue sharing guidelines of Public Act 51.

The *Debt Service Fund* accounts for the payment of interest and principal on long-term obligations.

The *Internal Service Fund* accounts for fleet and equipment management to other departments or agencies of the City, or to other governments, on a cost reimbursement basis.

The *Agency Fund* accounts for the collection and payments of assets held for other governments in an agency capacity, primarily property tax levies.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

D. Measurement focus, basis of accounting, and financial statement presentation

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the proprietary fund and fiduciary fund financial statements, except for agency funds, which do not have a measurement focus. Revenues are recorded when earned and expenses are recorded when liabilities are 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.

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 government 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-shared revenue, 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 City.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The government has elected not to follow subsequent private-sector guidance.

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

Amounts reported as *program revenues* include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise, general revenues include all taxes.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Water and Sewer Enterprise Funds and of the government's Motor Pool Internal Service Fund are charges to customers for sales and services. The enterprise funds also recognize as operating revenues the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses for enterprise funds and the internal service fund include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the government's policy to use restricted resources first, and then use unrestricted resources as they are needed.

E. Assets, liabilities and equity

1. Deposits and investments

The City's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

Investments are stated at fair market value.

2. Receivables and payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year and all other outstanding balances between funds are referred to as "due to/from other funds" (i.e., the current portion of interfund loans). Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

3. Inventory

Inventory (if held) by the enterprise funds is valued at cost on the first-in, first-out basis. Inventory of expendable supplies in other funds have not been recorded and the amount of any such inventories is not considered material. The cost value of such inventories has been treated as an expenditure at the time of purchase.

4. Capital assets

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

Capital assets, which include property, plant, equipment and infrastructure assets (i.e., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the City as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities, if any, is included as part of the capitalized value of the assets constructed. No such interest expense was incurred during the current fiscal year.

Capital assets of the primary government and component units are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings	40-60
Building improvements	15-30
Water and sewer lines	50-75
Streets, curbs and gutters	10-30
Vehicles	3-5
Equipment	5-7

5. *Compensated absences*

Vacation and sick days for the City's salaried and some hourly employees are determined by the City's personnel policies; the remaining hourly employees are determined by the union agreement between the City and the employees' union. The liability for these amounts are included in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations or retirements.

6. *Long-term obligations*

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

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

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.

7. *Fund equity*

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

II. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. Budgetary information

Annual budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America for all operating funds of the City except for the agency fund. State law requires that budgets be adopted for the general and special revenue funds.

The City follows the following procedures in establishing the budgetary data reflected in the financial statements:

1. Prior to the first Council meeting in May, the City Manager submits to the City Council a proposed operating budget for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures/expenses and the means of financing them.
2. A public hearing is conducted at City Hall to obtain taxpayer comments.
3. Prior to July 1, the fund budgets are legally adopted at the activity level and enacted through passage of resolutions.
4. The City Manager is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total expenditures/expenses of any fund must be approved by the City Council.
5. Formal budgetary integration is employed as a management control device during the year for the general and special revenue funds.
6. Budgeted amounts are as originally adopted, or as amended by the City Council.
7. Encumbrances, which are commitments related to unperformed contracts for goods or services, lapse at year-end and are re-appropriated as part of the subsequent year's budget.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

B. Excess of expenditures over appropriations

For the year ended June 30, 2007, the General Fund had activities in which expenditures exceeded appropriations. Legislative expenditures within the General Fund were over budget by \$2,781 and transfers out were over budget by \$17,631. These over expenditure were funded by greater than anticipated revenues in that fund and the use of prior year fund balance.

III. DETAILED NOTES ON ALL FUNDS

A. Deposits and investments

Michigan Compiled Laws, Section 129.91 authorizes the local government unit to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations, which have an office in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; United States government or federal agency obligations; repurchase agreements; bankers' acceptance of United States banks; commercial paper rated within the two highest classifications which mature not more than 270 days after the date of purchase; obligations of the state of Michigan or its political subdivisions which are rated as investment grade; and mutual funds composed of investment vehicles which are legal for direct investment by local units of government in Michigan.

The City Council has designated six banks for the deposit of City funds. The investment policy adopted by the Council has authorized all allowable investments in accordance with Public Act 20 of 1943.

The City's deposit and investment policy are in accordance with statutory authority.

A reconciliation of cash and investments as shown on the Statement of Net Assets and Statement of Fiduciary Net Assets to deposits and investments as classified for note disclosure purposes is as follows:

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

	Primary Government
Cash and cash equivalents	
Statement of Net Assets	\$ 3,185,051
Statement of Fiduciary Net Assets	271
Total cash and cash equivalents	3,185,322
Investments	
Statement of Net Assets	964,146
	\$ 4,149,468
	Primary Government
Bank deposits (checking accounts)	\$ 4,049,393
Government agencies -	
Federal Home Loan Bank	99,875
Cash on hand	200
	\$ 4,149,468

As of June 30, 2007, the City had the following investments.

Investment	Weighted Average Maturity (Years)	Fair Value
Government agencies –		
Federal Home Loan Bank	1.0	\$ 99,875

Investment and deposit risk

Interest Rate Risk. State law limits the allowable investments and the maturities of some of those investments as identified above. The City’s investment policy does not have specific limits that differ from state law on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The weighted average maturity dates for investments are identified above for investments held at year-end.

Credit Risk. The City’s investment policy does not have specific limits that differ from state law on investment credit risk.

Custodial Credit Risk – Deposits. Custodial credit risk is the risk that in the event of a bank failure, the City’s deposits may not be returned. State law does not require and the City does not have a policy for deposit custodial credit risk. As of year end, \$3,187,352 of the City’s bank balance of \$4,121,983 was exposed to custodial credit risk because it was uninsured and uncollateralized.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

Custodial Credit Risk – Investments. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. State law does not require and the City does not have a policy for investment custodial credit risk. Of the above \$99,875 of investments, the City has a custodial credit risk exposure of \$99,875 because the related securities are uninsured, unregistered and held by the government's brokerage firm which is also the counterparty for these particular securities.

Concentration of Credit Risk. State law limits allowable investments but does not limit concentration of credit risk as identified on the previous page. The City's investment policy also does not have specific limits in concentration of credit risk. The City holds only one investment which therefore represents 100 percent of the City's total investments.

B. Receivables

Receivables in the City's governmental activities consist of 1% taxes receivable, 3% interest receivable, and 96% due from other governments. Receivables in the business-type activities consist of 99% due from customers and 1% interest receivable.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

C. Capital assets

Primary Government

Capital asset activity of the City's governmental and business-type activities was as follows:

	July 1, 2006	Increases	Decreases	June 30, 2007
Governmental activities				
Capital assets not being depreciated:				
Land	\$ 215,764	\$ -	\$ -	\$ 215,764
Construction in progress	81,710	506,653	(588,363)	-
Total capital assets not being depreciated	297,474	506,653	(588,363)	215,764
Capital assets being depreciated:				
Infrastructure	8,095,746	-	-	8,095,746
Equipment	2,842,529	123,491	-	2,966,020
Buildings	2,136,681	588,363	-	2,725,044
Total capital assets being depreciated	13,074,956	711,854	-	13,786,810
Less accumulated depreciation:				
Infrastructure	(5,737,483)	(109,995)	-	(5,847,478)
Equipment	(1,299,816)	(168,518)	-	(1,468,334)
Buildings	(505,913)	(43,834)	-	(549,747)
Total accumulated depreciation	(7,543,212)	(322,347)	-	(7,865,559)
Total capital assets being depreciated, net	5,531,744	389,507	-	5,921,251
Governmental activities capital assets, net	\$ 5,829,218	\$ 896,160	\$ (588,363)	\$ 6,137,015

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

	July 1, 2006	Increases	Decreases	June 30, 2007
Business-type activities				
Capital assets not being depreciated:				
Construction in progress	\$ 575,429	\$ 274,947	\$ -	\$ 850,376
Capital assets being depreciated:				
Infrastructure	8,504,578	-	-	8,504,578
Equipment	100,687	-	-	100,687
Total capital assets being depreciated	8,605,265	-	-	8,605,265
Less accumulated depreciation:				
Infrastructure	(2,951,507)	(168,839)	-	(3,120,346)
Equipment	(76,665)	(751)	-	(77,416)
Total accumulated depreciation	(3,028,172)	(169,590)	-	(3,197,762)
Total capital assets being depreciated, net	5,577,093	(169,590)	-	5,407,503
Business-type activities capital assets, net	\$ 6,152,522	\$ 105,357	\$ -	\$ 6,257,879

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental activities	
General government	\$ 9,087
Public safety	128,838
Public works	115,699
Culture and recreation	1,881
Capital assets held by the City's internal service fund charged to the various functions based on their usage of the assets	66,842
Total depreciation expense – governmental activities	\$ 322,347
Business-type activities	
Water	135,852
Sewer	33,738
Total depreciation expense – business-type activities	\$ 169,590

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

D. Interfund transfers

The composition of interfund transfers is as follows:

	<u>Transfer in</u>	<u>Transfer out</u>
General Fund	\$ 506,653	\$ 164,094
Non-major Governmental Funds	180,594	16,500
Income Tax Fund	-	639,358
Water Funds	-	8,200
Sewer Funds	48,947	-
Internal Service Fund	91,958	-
Total	\$ 828,152	\$ 828,152

The operating transfers are mainly for street improvements, general city operations, debt service and capital improvements.

E. Long-term debt

Following is a summary of bonds and notes payable of the City for the year ending June 30, 2007:

<u>Purpose</u>	<u>Maturity Date</u>	<u>Interest Rates</u>	<u>Amount</u>
Governmental activities			
2003 General Obligation Bond	2022	2.0-5.0%	\$ 790,000
Installment Note Payable	2010	3.75%	157,822
			\$ 947,822
Business-type activities			
1991A Water and Sewer Bond	2030	5.0%	\$ 929,000
1991B Water and Sewer Bond	2030	5.0%	633,000
			\$ 1,562,000

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

Annual debt service requirements to maturity for governmental activities and business-type activities are as follows:

<u>Year Ending June 30,</u>	<u>Governmental Activities</u>		<u>Business-type Activities</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2008	\$ 72,971	\$ 39,771	\$ 34,000	\$ 77,250
2009	79,641	37,177	37,000	75,475
2010	81,362	34,327	38,000	73,600
2011	58,848	31,400	40,000	71,650
2012	40,000	29,600	42,000	69,600
2013-2017	230,000	120,508	246,000	313,250
2018-2022	310,000	58,221	315,000	243,375
2023-2027	75,000	1,875	404,000	153,950
2028-2031	-	-	406,000	41,850
Total	<u>\$ 947,822</u>	<u>\$ 352,879</u>	<u>\$ 1,562,000</u>	<u>\$ 1,120,000</u>

Changes in long-term liabilities. Long-term liability activity was as follows:

	<u>July 1, 2006</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2007</u>	<u>Due Within One Year</u>
<u>Primary Government</u>					
Governmental activities					
General obligation					
Bonds	\$ 820,000	\$ -	\$ (30,000)	\$ 790,000	\$ 30,000
Notes payable	199,209	-	(41,387)	157,822	42,971
Compensated absences	53,687	6,829	-	60,516	-
	<u>\$ 1,072,896</u>	<u>\$ 6,829</u>	<u>\$ (71,387)</u>	<u>\$ 1,008,338</u>	<u>\$ 72,971</u>
Business-type activities					
Revenue obligation					
Bonds	<u>\$ 1,594,000</u>	<u>\$ -</u>	<u>\$ (32,000)</u>	<u>\$ 1,562,000</u>	<u>\$ 34,000</u>

For the governmental activities, compensated absences are generally liquidated by the general fund.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

IV. OTHER INFORMATION

A. Risk management

The City is exposed to various risks of loss related to property loss, torts, errors and omissions and employee injuries (workers' compensation), as well as medical benefits provided to employees. The City belongs to the Michigan Municipal League Liability and Property Pool, a public entity risk pool currently operating as a common risk management and insurance program for various municipalities throughout the state. The City pays an annual premium for its general insurance coverage. The pool is self-sustaining through member premiums and reinsures through commercial companies for claims in excess of \$500,000 for each insured event. Although the City could be assessed charges beyond the annual premium, the likelihood of receiving such an assessment is minimal. Settled claims have not exceeded coverage in any of the past three years.

B. Property taxes

Property taxes are levied and become a lien on property as of July 1 on the State taxable valuation of property in the City as of the preceding December 31. The City bills and collects its own property taxes and also collects taxes for other governmental units. Collections of other governmental unit's taxes and remittance of them to the units are accounted for in the Agency Fund. Property taxes are recognized as revenue in the year for which they are levied.

The City is permitted by charter to levy taxes, subject to State Headlee and Truth in Taxation provisions, up to \$20 per \$1,000 of taxable valuation for general governmental services and for the payment of principal and interest on general obligation long-term debt. The 2006 State taxable valuation of the City of Grayling totaled \$56,827,418.

The government's general operating tax rate for fiscal year 2007 was 14.80 mills.

C. Defined contribution plan

The City provides pension benefits for employees as designated by City Council through a defined contribution plan. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. As of July 1, 2004, employees are eligible to participate from the date of employment. The City's contributions for each employee (and interest allocated to each employee's account) are fully vested after four years.

In 2003, all existing employees were given the choice of converting from the defined benefit plan to the defined contribution plan. Those employees who elected to convert, along with all new hires after July 1, 2004, are participants only in the defined contribution plan.

As established by City Council and governed by Federal Regulations, the City made the required 11% contribution. Contributions for the year totaled \$20,594 for the six employees that participate in this plan. There are no contribution requirements for employees of the City of Grayling.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

D. Defined benefit pension plan

Plan Description

The City's defined benefit pension plan provides retirement and disability benefits, annual cost-of-living adjustments and death benefits to plan members and beneficiaries. The City participates in the Municipal Employees Retirement System of Michigan (MERS), an agent multiple-employer plan administered by the MERS Retirement Board. Act No. 427 of the Public Acts of 1984, as amended, establishes and amends the benefit provisions of the participants in MERS. The Municipal Employees Retirement System of Michigan issues a publicly available financial report that includes financial statements and required supplementary information for MERS. That report may be obtained by writing to the Municipal Employees Retirement System of Michigan, 447 N. Canal Road, Lansing, MI 48917 or by calling (800) 767-6377.

Funding Policy

The City is required to contribute at an actuarially determined rate; the current rate is 10.78% of annual covered payroll. Employees are currently not required to contribute to the Plan. The contribution requirements of the City are established and may be amended by the MERS Retirement Board. The contribution requirements of plan members, if any, are established and may be amended by the City depending on the MERS contribution program adopted by the City.

Annual Pension Cost

For the year ended June 30, 2007, the City's annual pension cost of \$92,329 for MERS was equal to the City's required and actual contributions. The required contribution was determined as part of the initial actuarial valuation using the entry age actuarial cost method. The actuarial assumption included (a) a rate of return on the investment of present and future assets of 8.0%, (b) additional projected salary increases of 0.0% to 4.5% per year, depending on age, attributable to seniority/merit and (c) projected salary increases of 4.5% per year, compounded annually, attributable to inflation. The actuarial value of MERS assets was determined on the basis of a valuation method that assumes the fund earns the expected rate of return and includes an adjustment to reflect fair value. The City's unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The amortization period at initial valuation was 30 years.

Trend Information

<u>Fiscal Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
6/30/05	\$ 73,160	100%	\$ -
6/30/06	76,517	100%	-
6/30/07	92,329	100%	-

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

Schedule of Funding Progress

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Liability (AAL) -Entry Age (b)</u>	<u>Accrued AAL (UAAL) (b-a)</u>	<u>Unfunded AAL (UAAL) (b-a)</u>	<u>Funded Ratio (a/b)</u>	<u>Covered Payroll (c)</u>	<u>UAAL as a Percentage of Covered Payroll ((b-a)/c)</u>
12/31/2004	\$2,140,549	\$2,558,191	\$ 417,642		84%	\$803,158	52%
12/31/2005	2,275,804	2,699,947	424,143		84	815,659	52%
12/31/2006	2,456,343	2,863,043	406,700		86	847,292	48%

E. Designated Fund Balances / Restricted Net Assets

Major Governmental Funds

The General Fund has \$445,509 designated for the cemetery, \$84,675 designated for fire protection and \$406,700 designated for unfunded pension liabilities.

The Income Tax Fund has \$465,000 designated for future capital improvement projects.

Major Proprietary Funds

The Water Fund has \$19,527 of its net assets restricted due to revenue bond indentures and \$21,462 for capital improvements. The sewer fund has \$29,290 of its net assets restricted due to bond indentures and \$26,534 for capital improvements.

F. Other postemployment benefits

The City provides postemployment benefits of health insurance to eligible employees. For the year ended June 30, 2007, there was one participant. The City's actual expense was \$10,430.

G. Contingencies and commitments

In the normal course of its activities, the City is a party to various legal actions. After taking into consideration legal counsel's evaluation of pending actions, the City is of the opinion that the potential claims not covered by insurance will not have a material effect on the financial statements.

The General Fund is contingently liable for the Water and Sewer System revenue bonds. The General Fund is obligated only if revenues of the Water and Sewer System Funds would be insufficient to meet its debt service requirements.

CITY OF GRAYLING, MICHIGAN

Notes to the Financial Statements

In addition, the City has received federal and state grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under terms of the grants, management believes that any required reimbursements would not be material.

* * * * *

FUND FINANCIAL STATEMENTS

CITY OF GRAYLING
NONMAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET
June 30, 2007

<u>ASSETS</u>	<u>Special Revenue Funds</u>			<u>Debt Service Fund</u>	Total Nonmajor Governmental Funds
	Major Street	Local Street	Total	Debt Service	
Assets					
Cash and cash equivalents	\$ 51,459	\$ 1	\$ 51,460	\$ -	\$ 51,460
Accounts receivable	15,892	7,292	23,184	-	23,184
<u>TOTAL ASSETS</u>	\$ 67,351	\$ 7,293	\$ 74,644	\$ -	\$ 74,644
 <u>LIABILITIES AND FUND BALANCES</u>					
Liabilities					
Accounts payable	\$ 2,782	\$ 687	\$ 3,469	\$ -	\$ 3,469
Accrued liabilities	1,010	782	1,792	-	1,792
Total Liabilities	3,792	1,469	5,261	-	5,261
Fund Balances					
Unreserved - undesignated	63,559	5,824	69,383	-	69,383
<u>TOTAL LIABILITIES AND FUND BALANCES</u>	\$ 67,351	\$ 7,293	\$ 74,644	\$ -	\$ 74,644

**CITY OF GRAYLING
NONMAJOR GOVERNMENTAL FUNDS
COMBINING STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
For the year ended June 30, 2007**

	Special Revenue Funds			Debt Service Funds	Total Nonmajor Governmental Funds
	Major Street	Local Street	Total	Debt Service	
Revenues					
Intergovernmental	\$ 101,567	\$ 54,133	\$ 155,700	\$ -	\$ 155,700
Charges for services	-	7,476	7,476	-	7,476
Interest and rent	4,458	503	4,961	-	4,961
Other	191	(74)	117	-	117
Total revenues	<u>106,216</u>	<u>62,038</u>	<u>168,254</u>	<u>-</u>	<u>168,254</u>
Expenditures					
Current:					
Public works	156,535	138,183	294,718	-	294,718
Public safety	-	-	-	-	-
Recreation and culture	-	-	-	-	-
Capital outlay	-	-	-	-	-
Debt Service:					
Principal	-	-	-	71,387	71,387
Interest and fiscal charges	-	-	-	42,075	42,075
Total expenditures	<u>156,535</u>	<u>138,183</u>	<u>294,718</u>	<u>113,462</u>	<u>408,180</u>
Revenues over (under) expenditures	<u>(50,319)</u>	<u>(76,145)</u>	<u>(126,464)</u>	<u>(113,462)</u>	<u>(239,926)</u>
Other financing sources (uses)					
Transfers in	-	67,132	67,132	113,462	180,594
Transfers (out)	(16,500)	-	(16,500)	-	(16,500)
Total other financing sources (uses)	<u>(16,500)</u>	<u>67,132</u>	<u>50,632</u>	<u>113,462</u>	<u>164,094</u>
Net change in fund balances	(66,819)	(9,013)	(75,832)	-	(75,832)
Fund balances, beginning of period	<u>130,378</u>	<u>14,837</u>	<u>145,215</u>	<u>-</u>	<u>145,215</u>
Fund balances, end of period	<u>\$ 63,559</u>	<u>\$ 5,824</u>	<u>\$ 69,383</u>	<u>\$ -</u>	<u>\$ 69,383</u>

CITY OF GRAYLING
STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - BUDGET AND ACTUAL
MAJOR STREET FUND
For the year ended June 30, 2007

	Original Budget	Amended Budget	Actual	Over (Under) Budget
Revenues				
Intergovernmental	\$ 103,000	\$ 103,000	\$ 101,567	\$ (1,433)
Charges for services	-	-	-	-
Interest and rent	3,000	3,000	4,458	1,458
Other	-	-	191	191
Total revenues	106,000	106,000	106,216	216
Expenditures				
Public works:				
Wages and Fringes - Routine	80,717	80,717	82,399	1,682
Inmate Labor - Routine	5,600	5,600	2,384	(3,216)
Payroll Taxes - Routine	4,652	4,652	4,237	(415)
Supplies - Routine	2,000	2,000	1,228	(772)
Repairs and maintenance - Routine	8,500	8,500	2,671	(5,829)
Equipment Rental - Routine	17,000	17,000	20,009	3,009
Salt Contracts - Snow	7,500	7,500	4,645	(2,855)
Equipment Rental - Snow	23,000	23,000	26,067	3,067
Repairs and maintenance - Snow	3,000	3,000	3,228	228
Administration - Snow	9,667	9,667	9,667	-
Total public works expenditures	161,636	161,636	156,535	(5,101)
Revenues over (under) expenditures	(55,636)	(55,636)	(50,319)	5,317
Other financing uses				
Transfers out	(33,000)	(33,000)	(16,500)	16,500
Net change in fund balance	(88,636)	(88,636)	(66,819)	21,817
Fund balance, beginning of year	130,378	130,378	130,378	-
Fund balance, end of year	\$ 41,742	\$ 41,742	\$ 63,559	\$ 21,817

CITY OF GRAYLING
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL
LOCAL STREET FUND
For the year ended June 30, 2007

	Original Budget	Amended Budget	Actual	Over (Under) Budget
Revenues				
Intergovernmental	\$ 57,500	\$ 57,500	\$ 54,133	\$ (3,367)
Charges for services	8,000	8,000	7,476	(524)
Interest and rent	1,000	1,000	503	(497)
Other	-	-	(74)	(74)
Total revenues	66,500	66,500	62,038	(4,462)
Expenditures				
Public works:				
Wages and Fringes - Routine	64,713	64,713	67,661	2,948
Payroll Taxes - Routine	3,972	3,972	3,846	(126)
Supplies - Routine	2,500	2,500	761	(1,739)
Professional services - Routine	10,000	10,000	-	(10,000)
Repairs and maintenance - Routine	1,200	1,200	813	(387)
Equipment Rental - Routine	20,000	20,000	25,553	5,553
Salt Contracts - Snow	7,500	7,500	4,065	(3,435)
Equipment Rental - Snow	27,000	27,000	26,595	(405)
Administration - Snow	8,889	8,889	8,889	-
Total public works expenditures	145,774	145,774	138,183	(7,591)
Revenues over (under) expenditures	(79,274)	(79,274)	(76,145)	3,129
Other financing sources				
Transfers in	76,000	76,000	67,132	(8,868)
Net change in fund balance	(3,274)	(3,274)	(9,013)	(5,739)
Fund balance, beginning of year	14,837	14,837	14,837	-
Fund balance, end of year	\$ 11,563	\$ 11,563	\$ 5,824	\$ (5,739)



REHMANN ROBSON

Certified Public Accountants

A member of THE REHMANN GROUP



October 26, 2007

To the City Council of the
City of Grayling
Grayling, Michigan

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the *City of Grayling, Michigan* for the year ended June 30, 2007, and have issued our report thereon dated October 26, 2007. Professional standards require that we provide you with the following information related to our audit.

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

As stated in our engagement letter dated May 16, 2007, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that 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.

As part of our audit, we considered the internal control of the *City of Grayling, Michigan*. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the *City of Grayling, Michigan* are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the *City of Grayling, Michigan* 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.

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. The most sensitive estimates affecting the financial statements were:

- Management's estimate of the useful lives of depreciable capital assets is based on the length of time it is believed that those assets will provide some economic benefit in the future. We evaluated the key factors and assumptions used to develop the useful lives of those assets in determining that they are reasonable in relation to the financial statements taken as a whole.

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 *City of Grayling, Michigan's* 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 *City of Grayling, Michigan*, either individually or in the aggregate, indicate matters that could have a significant effect on the *City of Grayling, Michigan's* financial reporting process.

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.

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.

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 *City of Grayling, Michigan's* auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

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

This information is intended for the use of the City Council and management of the *City of Grayling, Michigan* and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in black ink that reads "Lehmann Johnson". The signature is written in a cursive style with a large, prominent initial 'L'.