

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 Petoskey	County Emmet
Fiscal Year End December 31, 2007	Opinion Date May 6, 2008	Date Audit Report Submitted to State May 13, 2008		

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 type="checkbox"/>			
Other (Describe)	<input checked="" type="checkbox"/>	Audit-Related Communications		
Certified Public Accountant (Firm Name) Dennis, Gartland & Niergarth		Telephone Number 231-946-1722		
Street Address 415 Munson Avenue		City Traverse City	State MI	Zip 49686
Authorizing CPA Signature 		Printed Name Robert C. Thompson		License Number 1101011523

City of Petoskey

FINANCIAL STATEMENTS
AND REPORT OF INDEPENDENT
CERTIFIED PUBLIC ACCOUNTANTS

December 31, 2007

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CITY OF PETOSKEY BUILDING AUTHORITY

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Management Discussion and Analysis

December 31, 2007

The City of Petoskey's financial statements consists of a series of financial reports. The Statement of Net Assets and the Statement of Activities provide information about the activities of the City as a whole and presents a longer-term view of the City's finances. Fund financial statements tell how the services were financed in the short-term, as well as what remains for future spending. Fund financial statements also report the City's operations in more detail than the government-wide financial statements.

Financial Highlights

The City's net assets increased by \$2.7 million or 3.9% in 2007 with the increase made up of the following:

- Governmental net assets increased by \$0.5 million.
- Business-type net assets increased by \$1.9 million.
- Component units net assets increased by \$0.3 million.

Total revenues and transfers for the year are \$25.0 million and are made up of the following:

- Governmental activities \$9.8 million.
- Business-type activities \$13.5 million.
- Component units activities \$1.7 million.

Total expenses for the year are \$22.4 million and are made up of the following:

- Governmental activities \$9.4 million.
- Business-type activities \$11.5 million.
- Component units activities \$1.5 million.

The General Fund on a current financial resources basis experienced a decrease of \$182,069 in fund balance resulting in a total fund balance at year-end of \$3.1 million.

Project Highlights

The downtown alley running between Mitchell Street and Lake Street, commonly referred to as Ried's alley was improved last year by converting electric lines from overhead to underground along with repaving the alley at a cost of just over \$600,000. The City has improved other downtown alleys in this same manner in previous years.

A section of Charlevoix Avenue including Branch Street and Maple Street received improvements to the water, sewer and electric utilities along with new sidewalks, street pavement and trees. Improvements also included a new parking layout that includes bumpouts at intersections. Cost of the project, which was accounting for in four different funds, totaled nearly \$380,000.

Riverbend Park on Standish Avenue which extends along the Bear River received a paved roadway that includes curb and gutter along with sidewalks, landscaping and necessary water, sewer and electric improvements that totaled \$280,000. Additional work is to be performed on the skateboarding area of the park in 2008.

Financial Statement Presentation

Overview of Statements

The financial statements provide two views of the City's financial position. Government-wide statements are the top level which summarizes all City funds into two statements using the full accrual method of accounting. This method of accounting is similar to private sector for profit accounting.

Government-wide statements include the Statement of Net Assets and the Statement of Activities. The Statement of Net Assets includes; assets, liabilities and the resulting difference between the two called net assets. Changes in net assets can be reviewed to determine financial strength with increases to net assets perceived as a sign of improving condition.

The Statement of Activities presents revenues and expenses (including depreciation) that are the underlying cause of changes in net assets. Capital projects are excluded from this statement since they are included in the Statement of Net Assets as additions to capital assets.

Fund financial statements under GASB Statement 34 separate funds into major and nonmajor categories. Major funds focus on funds with a large amount of financial activities which results in the inclusion of more detailed information. Governmental Funds for the City of Petoskey include the following major funds:

- General Fund
- Right of Way Improvement Fund
- Major Street Fund
- Local Street Fund

Non major funds are smaller funds with less activity and are consolidated into one column in the fund financial statements. Additional and more detailed information on nonmajor funds is presented after the notes to the financial statements.

Fund Type Statements

The City's funds are organized on the basis of individual funds with each fund having a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures, or expenses as appropriate. Funds are classified as either governmental, proprietary or fiduciary in nature.

Governmental funds make up the funds included within the governmental activities column of the government-wide statements discussed above except for internal service funds (Motor Pool and Fringe Benefits) that are included in government-wide statements and are not governmental funds. Governmental funds utilize a modified accrual basis of accounting that focuses on more available and spendable resources and expenses like debt payments and capital purchases. Long-term debt and depreciation are not recorded under the modified accrual basis of accounting.

This varies from the full accrual basis of accounting used in the government-wide statements that records the purchase of capital items as assets and depreciates them over time and records long-term debt as a liability reducing the principal portion from the liability when paid and only expensing interest. There are also other less significant differences between the two accounting methods.

Financial Statement Presentation – continued

Proprietary funds use the full accrual method of accounting for both government-wide and fund level financial statements. There are two types of proprietary funds: enterprise and internal service funds.

Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises where costs for goods and services provided to the general public are recovered primarily through user charges. The City’s enterprise funds include the Electric, Water and Sewer, and Downtown Management Parking Funds, although the Downtown Management Parking Fund is included as a component unit.

Internal service funds are like enterprise funds except they only provide goods or services to City departments and agencies. The City’s internal service funds include the Fringe Benefit and Motor Pool Funds. Internal service funds are consolidated into the governmental activities in the government-wide statements and are presented separately in the fund level statements.

Component units are separate legal entities for which the City has some level of financial accountability and oversight control. Component units are shown in a separate column of the government-wide financial statements. The City’s component units include the Tax Increment Finance Authority, Library and Downtown Management Parking Funds. Separate financial statements for the component units are not required and none are issued.

Financial Analysis

Summary of Net Assets December 31, 2007 and 2006

	Governmental	Activities	Business-type	Activities	Total Primary	Government
	2007	2006	2007	2006	2007	2006
Current and other assets	\$ 6,577,027	\$6,966,924	\$16,524,787	\$14,975,830	\$23,101,814	\$21,942,754
Capital assets	18,222,569	17,465,143	34,875,044	34,581,252	53,097,613	52,046,395
Total assets	\$24,799,596	\$24,432,067	\$51,399,831	\$49,557,082	\$76,199,427	\$73,989,149
Current and other liabilities	\$679,530	\$632,182	\$1,956,424	\$1,477,735	\$2,635,954	\$2,109,917
Long-term debt outstanding	485,000	630,000	10,573,173	11,115,040	11,058,173	11,745,040
Total liabilities	\$1,164,530	\$1,262,182	\$12,529,597	\$12,592,775	\$13,694,127	\$13,854,957
Net assets:						
Invested in capital assets, net of related debt	\$17,587,569	\$16,680,143	\$23,796,916	\$23,001,212	\$41,384,485	\$39,681,355
Restricted	365,389	950,428	4,188,779	4,666,827	4,554,168	4,730,183
Unrestricted	5,682,108	5,539,314	10,884,539	9,296,268	16,566,647	15,722,654
Total net assets	\$23,635,066	\$23,169,885	\$38,870,234	\$36,964,307	\$62,505,300	\$60,134,192

Financial Analysis – continued

Total net assets of the City are \$62,505,300 which includes \$41,384,485 in capital assets net of debt. Capital assets are largely made up of electric, water, sewer and street systems assets.

The City used fund balance reserves during 2007 in the following governmental funds and amounts to cover anticipated expenditures that were included in the City's 2007 budget:

General Fund	\$182,069
Right of Way Improvement Fund	599,495
General Street Fund	89,079

Common Effects to Net Assets

There are a number of transactions in the normal course of business that will affect the comparability of the Summary of Net Assets presentation.

The net result of business activities for the year will impact (increase/decrease) current assets and/or net assets.

Borrowing capital will increase current assets and long-term debt.

Spending of borrowed proceeds on capital projects will reduce current assets and increase capital assets while having no impact on invested in capital assets, net of debt.

Spending non-borrowed current assets on capital projects will reduce current assets and increase capital assets while reducing unrestricted net assets and increasing invested in capital assets net of debt.

Principal payment on debt will reduce current assets, long-term debt and unrestricted net assets while increasing invested in capital assets, net of related debt.

The reduction of capital assets due to annual depreciation will reduce capital assets and invested in capital assets, net of debt.

Financial Analysis – continued

**Changes in Net Assets
December 31, 2007 and 2006**

	Governmental	Activities	Business-type	Activities	Total Primary	Government
	2007	2006	2007	2006	2007	2006
Revenues						
Program revenues:						
Charges for services	\$1,259,520	\$1,698,834	13,872,497	13,859,350	15,132,017	15,558,184
Operating grants and contributions	747,883	725,308	98,153	85,525	846,036	810,833
Capital grants and contributions	-	-	167,864	95,121	167,864	95,121
	2,007,403	2,424,142	14,138,514	14,039,996	16,145,917	16,464,138
General revenues:						
Property taxes	5,380,706	5,260,796	-	-	5,380,706	5,260,796
State shared revenue	549,690	559,707	-	-	549,690	559,707
Investment earnings	495,231	415,322	623,652	470,048	1,118,883	885,370
	6,425,627	6,235,825	623,652	470,048	7,049,279	6,705,873
Total revenues	8,433,030	8,659,967	14,762,166	14,510,044	23,195,196	23,170,011
Expenses						
Program expenses:						
Legislative	8,327	6,438	-	-	8,327	6,438
General government	1,430,776	1,364,644	-	-	1,430,776	1,364,644
Public safety	2,621,293	2,636,298	-	-	2,621,293	2,636,298
Public works	3,453,140	2,627,852	-	-	3,453,140	2,627,852
Health and welfare	19,904	21,066	-	-	19,904	21,066
Recreation and cultural	1,643,091	1,687,547	-	-	1,643,091	1,687,547
Other	1,442	1,595	-	-	1,442	1,595
Interest on long-term debt	36,456	43,488	-	-	36,456	43,488
Unallocated depreciation	153,218	845,180	-	-	153,218	845,180
Water and Sewer	-	-	3,520,296	3,564,601	3,520,296	3,564,601
Electric	-	-	8,025,843	7,778,748	8,025,843	7,778,748
Total expenses	9,367,647	9,234,108	11,546,139	11,343,349	20,913,786	20,577,457
Changes in net assets before transfers	(934,617)	(574,141)	3,216,027	3,166,695	2,281,410	2,592,554
Transfers	1,399,800	1,736,900	(1,310,100)	(1,647,700)	89,700	89,200
Changes in net assets	465,183	1,162,759	1,905,927	1,518,995	2,371,110	2,681,754
Net assets-beginning of year	23,169,883	22,007,126	36,964,307	35,445,312	60,134,190	57,452,436
Net assets-end of year	23,635,066	23,169,885	38,870,234	36,964,307	62,505,300	60,134,190

Financial Analysis – continued

Although total revenues for governmental activities for 2007 of \$8,433,030 were only \$226,437 less than the \$8,659,467 for 2006, the charges for services in Governmental Activities totaled \$1,259,520 for 2007, a decrease of \$439,314 from 2006's \$1,698,834. The decrease is due to a reduction in General Government, Public Safety and Public Works revenues.

Charges for services in Business-type Activities increased \$13,147 to a total of \$13,872,497 in 2007, up from \$13,859,350 in 2006. Electric Fund charges declined by \$175,248 while Water and Sewer charges increased by \$188,395, for a net increase of \$13,147. Electric customer monthly billing charges increased by \$120,391 primarily due to continued rising costs for purchased wholesale electric power that is passed on to customers through a monthly fuel cost adjustment while nonoperating revenues declined by \$295,639. Water and sewer charges increased due to an increase in number of customers and overall usage.

Revenues from all sources total \$23,284,896, of which \$9,832,830 is from governmental activities and \$13,452,066 from business-type activities. Total revenues from governmental activities include \$5,380,706 in property taxes accounting for 55% of the funds and \$1,259,520 or 13% from charges for services. Total revenues for business-type activities receive the vast majority of revenues through charges for services totaling \$13,872,497 last year.

Expenses under the full accrual basis of accounting for governmental activities totaled \$9,367,647 which includes depreciation on such items as buildings and infrastructure amounting to \$153,218. Total expense does not include capital asset items such as street and sidewalk improvements. Public safety accounts for \$2,621,293 or 28.0% of expenses while public works totals \$3,453,140 or 36.9%. Expenses for general government were \$1,430,776 and recreation and cultural were \$1,643,091 or 15.3% and 17.5%, respectively.

Expenses for business-type activities total \$11,546,139 which consists of \$8,025,843 or 69.5% from the electric system and \$3,520,296 or 30.5% from the water and sewer systems. Within the electric system \$6,103,735 or 76.1% of the expense is for purchased power. The water and sewer system costs are broken down between the two at \$1,590,431 or 45.2% water and \$1,929,865 or 54.8% sewer.

General Fund Budgetary Highlights

Total General Fund revenues of \$5,574,418 were less than total budgeted revenues as amended of \$5,611,600 by \$37,182 or 0.6%. Actual revenues increased slightly from \$5,473,176 received in 2006 or 1.9%, due to increases in taxes, charges for services and interest and investment earnings. Taxes increased \$81,047 while charges for services and interest and investment earnings both increased slightly more than \$70,000 each.

Total General Fund expenditures of \$6,771,887 were \$318,113 less than total budgeted expenditures of \$7,090,000 or 4.5%. Total expenditures for 2007 were more than the 2006 total of \$6,236,208 by \$535,679 or 8.6%. The difference is due primarily to increases in Public Safety of \$305,405, Recreation and Cultural of \$146,490 and General Government of \$129,169.

Capital Assets and Debt Administration

Capital Assets

As of year-end the City of Petoskey had \$53,097,613 invested in capital assets as reflected in the following schedule:

Capital Assets
December 31, 2007 and 2006
(Net of Depreciation)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2007	2006	2007	2006	2007	2006
Land and land rights	\$1,887,069	\$1,887,069	\$837,856	\$837,856	\$2,724,925	\$2,724,925
Land improvements	358,687	398,044	-	-	358,687	398,044
Buildings	2,117,746	2,215,420	-	-	2,117,746	2,215,420
Equipment	2,620,640	2,056,454	-	-	2,620,640	2,056,454
Streets and sidewalks	11,238,427	10,908,156	-	-	11,238,427	10,908,156
Electric system	-	-	13,871,466	13,344,376	13,871,466	13,344,376
Water system	-	-	9,096,849	9,101,635	9,096,849	9,101,635
Sewer system	-	-	11,068,873	11,297,385	11,068,873	11,297,385
	\$18,222,569	\$17,465,143	\$34,875,044	\$34,581,252	\$53,097,613	\$52,046,395

Major capital asset additions for 2007 include:

Governmental Activities

Street reconstruction projects	\$ 1,064,859
Fire trucks (2)	635,839
Motor pool replacement	256,691

Business-Type Activities

Water system improvements	\$ 326,815
Sewer system improvements	157,635
Electric system improvements	1,285,513

Bond Debt

The City had \$11,990,000 of face value in outstanding bond debt at year-end which is distributed in the following debt schedule:

Debt Schedule		
December 31, 2007 and 2006		
	2007	2006
Governmental Activities		
General Obligation Bonds:		
Municipal facilities	\$ 190,000	\$ 290,000
Parking improvements	445,000	495,000
	<u>635,000</u>	<u>785,000</u>
Business-Type Activities		
Revenue Bonds:		
Sewer system improvements	7,200,000	7,300,000
Water system improvements	4,155,000	4,520,000
	<u>11,355,000</u>	<u>11,820,000</u>
Total bond debt	<u><u>\$11,990,000</u></u>	<u><u>\$12,605,000</u></u>

Principal payments on bonds in the amount of \$150,000 for governmental activities and \$465,000 for business-type activities were made in 2007.

Economic Factors

The City of Petoskey's three largest sources of revenue include property taxes, revenues received from the State and utility charges. The economic forecast for the community is dependent on these three revenue sources.

Property tax revenue experienced substantial growth due to the development of Bay Harbor during its first several years. Bay Harbor now makes up over half of the City's total taxable value but the significant annual increases have leveled off and more normal additions to the taxable value of the city are expected from now on. Based on current economic conditions, there has been some decline in the property that the City will not regain when economic conditions improve and values increase based on State valuation laws. The City will continue to see taxable value increases at 5% or the rate of inflation, whichever is less. The inflation rate has always been less than the 5% limit with the rate in 2007 at 3.7% although the City's actual increase was less than 1%.

Revenues received from the State, which include revenue sharing and transportation funds, are affected as well by current economic conditions along with allocation to local units established by the legislature. Revenue sharing amounts are dependent on the collection of sales tax, which tend to go down when the economy is slow with the reverse being true when the economy is good. Transportation funds are derived through gas taxes and while they are affected by the economy they are more affected by the price of oil and resulting gas prices that do not always follow certain economic conditions. State revenue sharing declined again in 2007, by about the same amount of 1.9%, while transportation funds in the Major and Local Street Funds declined by 5.4% from the previous year.

Utility charges for electric, water, and sewer service tend to fluctuate based on weather conditions more so than any other factor. During hot summer months electrical usage will be up while dry spells will increase water usage. Utility rates have not been increased in several years but due to rising costs and concerns over water quality issues. Increases in water and sewer rates may be required in the near future. Electric revenues have increased as the City's purchased power costs have increased, which is passed on to customers through the monthly fuel cost adjustment.

Contacting the City's Financial Management

This financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional information, contact the Director of Finance at 101 E. Lake Street, Petoskey, MI 49770.



Business and Financial Advisors
Our clients' success – our business

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Honorable Mayor, Members of City Council and City Manager
City of Petoskey

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented components units, each major fund and the aggregate remaining fund information of the *City of Petoskey* (the "City") as of and for the year ended December 31, 2007, which collectively compose 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, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of the City of Petoskey as of December 31, 2007 and the respective changes in financial position, where applicable, and cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages i through ix and budgetary comparison and defined benefit pension plan trend information on pages 42 through 46 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.

Member of



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Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the City's basic financial statements. The combining financial statements listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Michigan Department of Treasury for the purpose of additional analysis. 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.

Dennis, Gartland & Niergarth

May 6, 2008

Member of



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City of Petoskey

STATEMENT OF NET ASSETS

December 31, 2007

	Primary Government			Component Units	
	Governmental Activities	Business-type Activities	Total	Library	Other Nonmajor Component Units
ASSETS					
Current assets					
Cash	\$ 3,011,641	\$ 6,549,560	\$ 9,561,201	\$ 399,090	\$ 880,781
Investments	1,952,559	2,000,770	3,953,329	65,991	100,000
Receivables					
Special assessments	29,329	-	29,329	-	-
Accounts	17,150	2,247,208	2,264,358	3,518	-
Due from Fiduciary Fund	562,295	-	562,295	79,810	-
Due from other governmental units	179,313	-	179,313	-	-
Inventory	<u>121,767</u>	<u>943,533</u>	<u>1,065,300</u>	<u>-</u>	<u>-</u>
Total current assets	<u>5,874,054</u>	<u>11,741,071</u>	<u>17,615,125</u>	<u>548,409</u>	<u>980,781</u>
Non-current assets					
Restricted cash and investments					
Customer deposits	-	175,503	175,503	-	-
Sewage service covenants	-	381,423	381,423	-	-
Revenue bond covenants	-	2,641,276	2,641,276	-	-
MPPA energy restrictions	-	1,166,080	1,166,080	-	-
Deferred charges	-	92,498	92,498	33,315	-
Prepaid pension	702,973	-	702,973	-	-
MPPA working capital advance	-	326,936	326,936	-	-
Capital assets	31,391,919	52,926,190	84,318,109	7,183,239	461,017
Less accumulated depreciation	<u>(13,169,350)</u>	<u>(18,051,146)</u>	<u>(31,220,496)</u>	<u>(1,557,109)</u>	<u>(77,171)</u>
Total non-current assets	<u>18,925,542</u>	<u>39,658,760</u>	<u>58,584,302</u>	<u>5,659,445</u>	<u>383,846</u>
Total assets	<u>\$ 24,799,596</u>	<u>\$ 51,399,831</u>	<u>\$ 76,199,427</u>	<u>\$ 6,207,854</u>	<u>\$ 1,364,627</u>

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

City of Petoskey

STATEMENT OF NET ASSETS - Continued

December 31, 2007

	Primary Government			Component Units	
	Governmental Activities	Business-type Activities	Total	Library	Other Nonmajor Component Units
LIABILITIES AND NET ASSETS					
LIABILITIES					
Current liabilities					
Accounts payable	\$ 253,464	\$ 973,163	\$ 1,226,627	\$ 4,762	\$ 8,667
Accrued expenses	183,335	25,081	208,416	10,881	-
Accrued interest	7,731	-	7,731	39,656	-
Payable from restricted assets					
Current portion of revenue bonds	-	560,000	560,000	-	-
Accrued interest	-	222,677	222,677	-	-
Bonds payable, due within one year	<u>150,000</u>	<u>-</u>	<u>150,000</u>	<u>100,000</u>	<u>-</u>
Total current liabilities	<u>594,530</u>	<u>1,780,921</u>	<u>2,375,451</u>	<u>155,299</u>	<u>8,667</u>
Noncurrent liabilities					
Payable from restricted assets					
Customer deposits	-	175,503	175,503	-	-
Estimated liability for landfill closure and post closure care costs	85,000	-	85,000	-	-
Bonds payable, net	<u>485,000</u>	<u>10,573,173</u>	<u>11,058,173</u>	<u>3,920,774</u>	<u>-</u>
Total noncurrent liabilities	<u>570,000</u>	<u>10,748,676</u>	<u>11,318,676</u>	<u>3,920,774</u>	<u>-</u>
Total liabilities	<u>1,164,530</u>	<u>12,529,597</u>	<u>13,694,127</u>	<u>4,076,073</u>	<u>8,667</u>
NET ASSETS					
Invested in capital assets, net of debt	17,587,569	23,796,916	41,384,485	1,605,356	383,846
Restricted					
Debt service	77,812	-	77,812	-	-
Right-of-way improvements	287,577	-	287,577	-	-
Sewage service covenants	-	381,423	381,423	-	-
Revenue bond indentures	-	2,641,276	2,641,276	-	-
MPPA energy expenses	-	1,166,080	1,166,080	-	-
TIFA expenses	-	-	-	-	584,827
Unrestricted	<u>5,682,108</u>	<u>10,884,539</u>	<u>16,566,647</u>	<u>526,425</u>	<u>387,287</u>
Total net assets	<u>23,635,066</u>	<u>38,870,234</u>	<u>62,505,300</u>	<u>2,131,781</u>	<u>1,355,960</u>
Total liabilities and net assets	<u>\$ 24,799,596</u>	<u>\$ 51,399,831</u>	<u>\$ 76,199,427</u>	<u>\$ 6,207,854</u>	<u>\$ 1,364,627</u>

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

City of Petoskey

STATEMENT OF ACTIVITIES

Year ended December 31, 2007

Functions/Program	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets				
		Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government			Component Units	
					Governmental Activities	Business-type Activities	Total	Library	Nonmajor
Primary Government									
Governmental activities									
Legislative	\$ 8,327	\$ -	\$ -	\$ -	\$ (8,327)	\$ -	\$ (8,327)	\$ -	\$ -
General government	1,430,776	86,853	3,320	-	(1,340,603)	-	(1,340,603)	-	-
Public safety	2,621,293	40,306	7,461	-	(2,573,526)	-	(2,573,526)	-	-
Public works	3,453,140	261,476	686,980	-	(2,504,684)	-	(2,504,684)	-	-
Health and welfare	19,904	-	-	-	(19,904)	-	(19,904)	-	-
Recreation and cultural	1,643,091	870,885	50,122	-	(722,084)	-	(722,084)	-	-
Other	1,442	-	-	-	(1,442)	-	(1,442)	-	-
Interest on long-term debt	36,456	-	-	-	(36,456)	-	(36,456)	-	-
Unallocated depreciation	153,218	-	-	-	(153,218)	-	(153,218)	-	-
Total governmental activities	<u>9,367,647</u>	<u>1,259,520</u>	<u>747,883</u>	<u>-</u>	<u>(7,360,244)</u>	<u>-</u>	<u>(7,360,244)</u>	<u>-</u>	<u>-</u>
Business-type activities									
Water and sewer	3,520,296	4,270,725	98,153	122,330	-	970,912	970,912	-	-
Electric	8,025,843	9,601,772	-	45,534	-	1,621,463	1,621,463	-	-
Total business-type activities	<u>11,546,139</u>	<u>13,872,497</u>	<u>98,153</u>	<u>167,864</u>	<u>-</u>	<u>2,592,375</u>	<u>2,592,375</u>	<u>-</u>	<u>-</u>
Total primary government	<u>\$ 20,913,786</u>	<u>\$ 15,132,017</u>	<u>\$ 846,036</u>	<u>\$ 167,864</u>	<u>(7,360,244)</u>	<u>2,592,375</u>	<u>(4,767,869)</u>	<u>-</u>	<u>-</u>
Component Units									
Library	\$ 1,102,879	\$ 189,816	\$ 69,470	\$ -	-	-	-	(843,593)	-
Other nonmajor component units	357,197	413,032	-	-	-	-	-	-	55,835
Total component units	<u>\$ 1,460,076</u>	<u>\$ 602,848</u>	<u>\$ 69,470</u>	<u>\$ -</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(843,593)</u>	<u>55,835</u>
General revenues									
Property taxes					5,380,706	-	5,380,706	813,011	262,717
State shared revenue					549,690	-	549,690	-	-
Unrestricted interest and investment earnings					495,231	513,205	1,008,436	24,084	45,585
Restricted interest and investment earnings					-	110,447	110,447	-	-
Transfers					1,399,800	(1,310,100)	89,700	-	(89,700)
Total general revenues and transfers					<u>7,825,427</u>	<u>(686,448)</u>	<u>7,138,979</u>	<u>837,095</u>	<u>218,602</u>
Change in net assets					465,183	1,905,927	2,371,110	(6,498)	274,437
Net assets, beginning of year					<u>23,169,883</u>	<u>36,964,307</u>	<u>60,134,190</u>	<u>2,138,279</u>	<u>1,081,523</u>
Net assets, end of year					<u>\$ 23,635,066</u>	<u>\$ 38,870,234</u>	<u>\$ 62,505,300</u>	<u>\$ 2,131,781</u>	<u>\$ 1,355,960</u>

City of Petoskey

BALANCE SHEET - GOVERNMENTAL FUNDS

December 31, 2007

		Right-of-Way			Other	
	General	Improvement	Major	Local	Nonmajor	Total
	Fund	Fund	Street	Street	Governmental	Governmental
	<u>Fund</u>	<u>Fund</u>	<u>Fund</u>	<u>Fund</u>	<u>Funds</u>	<u>Funds</u>
ASSETS						
Cash	\$ 931,223	\$ 113,220	\$ 455,209	\$ 667,836	\$ 368,814	\$ 2,536,302
Investments	1,952,559	-	-	-	-	1,952,559
Receivables						
Special assessments	-	-	-	-	29,329	29,329
Accounts	3,639	-	-	282	13,229	17,150
Due from other funds	383,744	174,357	-	-	4,194	562,295
Due from governmental units	93,971	-	68,380	16,962	-	179,313
Inventory	-	-	-	-	89,727	89,727
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total assets	<u>\$ 3,365,136</u>	<u>\$ 287,577</u>	<u>\$ 523,589</u>	<u>\$ 685,080</u>	<u>\$ 505,293</u>	<u>\$ 5,366,675</u>
LIABILITIES AND FUND BALANCES						
LIABILITIES						
Accounts payable	\$ 54,813	\$ -	\$ 5,602	\$ 85,784	\$ 87,509	\$ 233,708
Accrued expenditures	<u>164,420</u>	<u>-</u>	<u>11,249</u>	<u>6,240</u>	<u>268</u>	<u>182,177</u>
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total liabilities	<u>219,233</u>	<u>-</u>	<u>16,851</u>	<u>92,024</u>	<u>87,777</u>	<u>415,885</u>
FUND BALANCES						
Reserved						
Debt service	-	-	-	-	85,544	85,544
Inventory	-	-	-	-	89,727	89,727
Refuse collection	16,041	-	-	-	-	16,041
Marina	657,226	-	-	-	-	657,226
Right-of-way improvement	-	287,577	-	-	-	287,577
Unreserved/Undesignated						
General Fund	2,472,636	-	-	-	-	2,472,636
Special Revenue Funds	<u>-</u>	<u>-</u>	<u>506,738</u>	<u>593,056</u>	<u>242,245</u>	<u>1,342,039</u>
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total fund balances	<u>3,145,903</u>	<u>287,577</u>	<u>506,738</u>	<u>593,056</u>	<u>417,516</u>	<u>4,950,790</u>
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total liabilities and fund balances	<u>\$ 3,365,136</u>	<u>\$ 287,577</u>	<u>\$ 523,589</u>	<u>\$ 685,080</u>	<u>\$ 505,293</u>	<u>\$ 5,366,675</u>

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

City of Petoskey

RECONCILIATION OF GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET ASSETS

December 31, 2007

Total Fund Balance - Governmental Funds \$ 4,950,790

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

Governmental funds report capital outlays as expenditures. However, in the statement of net assets, these assets are capitalized and depreciated over their useful lives.

Governmental capital assets	26,084,552
Accumulated depreciation	(10,166,868)

Governmental funds report interest when due, whereas in the statement of net assets, interest is accrued on outstanding bonds. (7,731)

Governmental funds report all pension contributions as an expenditure, whereas, in the statement of net assets, a prepaid has been reported for the cumulative amount by which contributions exceed the Annual Pension Cost 702,973

Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the governmental funds.

Governmental bonds payable	(635,000)
Landfill post closure costs	(85,000)

Internal service funds are used to charge costs of certain activities, such as insurance and motor vehicle usage, to various departments within the City. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets. 2,791,350

Net Assets of Governmental Activities \$ 23,635,066

City of Petoskey

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE - GOVERNMENTAL FUNDS

Year ended December 31, 2007

	General Fund	Right-of-Way Improvement Fund	Major Street Fund	Local Street Fund	Other Nonmajor Governmental Funds	Total Governmental Funds
REVENUES						
Taxes	\$ 3,627,715	\$ 1,752,991	\$ -	\$ -	\$ -	\$ 5,380,706
Special assessments	-	-	-	-	57,204	57,204
Licenses and permits	8,019	-	-	-	-	8,019
State grants	560,471	-	534,726	152,254	-	1,247,451
Contributions from local units	50,122	-	-	-	-	50,122
Charges for services	870,882	-	-	-	-	870,882
Fines and forfeits	39,813	-	-	-	-	39,813
Interest and investment earnings	338,069	23,956	16,612	38,374	25,030	442,041
Other	79,327	-	-	483	12,671	92,481
	<u>5,574,418</u>	<u>1,776,947</u>	<u>551,338</u>	<u>191,111</u>	<u>94,905</u>	<u>8,188,719</u>
Total revenues						
EXPENDITURES						
Current						
Legislative	8,327	-	-	-	-	8,327
General government	1,393,808	-	-	-	-	1,393,808
Public safety	2,821,121	-	-	-	-	2,821,121
Public works	655,848	-	778,892	424,420	448,940	2,308,100
Health and welfare	19,904	-	-	-	-	19,904
Recreational and cultural	1,584,296	-	-	-	-	1,584,296
Other	-	1,442	-	-	-	1,442
Capital outlay	288,583	-	157,122	642,639	265,098	1,353,442
Debt service						
Principal	-	-	-	-	150,000	150,000
Interest and fiscal charges	-	-	-	-	38,199	38,199
	<u>6,771,887</u>	<u>1,442</u>	<u>936,014</u>	<u>1,067,059</u>	<u>902,237</u>	<u>9,678,639</u>
Total expenditures						
REVENUES (UNDER) OVER EXPENDITURES	<u>(1,197,469)</u>	<u>1,775,505</u>	<u>(384,676)</u>	<u>(875,948)</u>	<u>(807,332)</u>	<u>(1,489,920)</u>
OTHER FINANCING SOURCES (USES)						
Operating transfers in	1,744,400	-	665,000	1,160,000	663,700	4,233,100
Operating transfer out	(738,700)	(2,375,000)	(164,800)	(164,300)	-	(3,442,800)
Transfers from component units	9,700	-	-	-	80,000	89,700
	<u>1,015,400</u>	<u>(2,375,000)</u>	<u>500,200</u>	<u>995,700</u>	<u>743,700</u>	<u>880,000</u>
Total other financing sources (uses)						
NET CHANGE IN FUND BALANCES	<u>(182,069)</u>	<u>(599,495)</u>	<u>115,524</u>	<u>119,752</u>	<u>(63,632)</u>	<u>(609,920)</u>
Fund balance, beginning of year	<u>3,327,972</u>	<u>887,072</u>	<u>391,214</u>	<u>473,304</u>	<u>481,148</u>	<u>5,560,710</u>
Fund balance, end of year	<u>\$ 3,145,903</u>	<u>\$ 287,577</u>	<u>\$ 506,738</u>	<u>\$ 593,056</u>	<u>\$ 417,516</u>	<u>\$ 4,950,790</u>

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

City of Petoskey

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

Year ended December 31, 2007

Net Change in Fund Balances - Total Governmental Funds \$ (609,920)

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

Governmental funds report capital outlays as expenditures.

However, in the statement of activities, the cost of these assets is allocated over their useful lives as depreciation.

Expenditures for capital assets	1,064,859
Current year depreciation	(914,488)

Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. This is the amount of principal paid on long-term debt. 150,000

Interest on long-term debt is recognized as an expenditure when it is due in the governmental funds. However, in the statement of activities, interest expense is recognized as the interest accrues, regardless of when it is due. 1,743

Governmental funds report pension expenditures when paid or payable, whereas the statement of activities reports the Annual Pension Cost 702,973

Internal service funds are used to charge costs of certain activities, such as insurance and motor vehicle usage, to various departments within the City. The net revenue (expense) of the internal service funds is included in governmental activities in the statement of activities. 70,016

Change in Net Assets of Governmental Activities \$ 465,183

City of Petoskey

STATEMENT OF NET ASSETS - PROPRIETARY FUNDS

December 31, 2007

	Business-Type Activities - Enterprise Funds			Governmental Activities - Internal Service Funds
	Electric System	Water and Sewer System	Totals	
ASSETS				
Current assets				
Cash	\$ 4,235,635	\$ 2,313,925	\$ 6,549,560	\$ 475,339
Investments	-	2,000,770	2,000,770	-
Receivables				
Accounts	1,686,325	560,883	2,247,208	-
Inventory	822,552	120,981	943,533	32,040
Total current assets	6,744,512	4,996,559	11,741,071	507,379
Noncurrent assets				
Restricted cash and investments				
Customer deposits	167,003	8,500	175,503	-
Sewage service covenants	-	381,423	381,423	-
Revenue bond covenants	-	2,641,276	2,641,276	-
MPPA energy charges	1,166,080	-	1,166,080	-
Deferred charges	-	92,498	92,498	-
MPPA working capital advance	326,936	-	326,936	-
Capital assets	22,631,845	30,294,345	52,926,190	5,307,367
Less accumulated depreciation	(8,456,271)	(9,594,875)	(18,051,146)	(3,002,482)
Total noncurrent assets	15,835,593	23,823,167	39,658,760	2,304,885
Total assets	\$ 22,580,105	\$ 28,819,726	\$ 51,399,831	\$ 2,812,264

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

City of Petoskey

STATEMENT OF NET ASSETS - PROPRIETARY FUNDS - Continued

December 31, 2007

	Business-Type Activities - Enterprise Funds			Governmental Activities - Internal Service Funds
	Electric System	Water and Sewer System	Totals	
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES				
Accounts payable	\$ 778,646	\$ 194,517	\$ 973,163	\$ 19,756
Accrued expenses	<u>10,463</u>	<u>14,618</u>	<u>25,081</u>	<u>1,158</u>
Total current liabilities	<u>789,109</u>	<u>209,135</u>	<u>998,244</u>	<u>20,914</u>
CURRENT LIABILITIES (payable from restricted assets)				
Current portion of revenue bonds	-	560,000	560,000	-
Accrued interest	<u>-</u>	<u>222,677</u>	<u>222,677</u>	<u>-</u>
Total current liabilities (payable from restricted assets)	<u>-</u>	<u>782,677</u>	<u>782,677</u>	<u>-</u>
NONCURRENT LIABILITIES				
Payable from restricted assets				
Customer deposits	167,003	8,500	175,503	-
Revenue bonds (net current portion, unamortized premiums and discounts, and deferred amount on refunding)	<u>-</u>	<u>10,573,173</u>	<u>10,573,173</u>	<u>-</u>
Total noncurrent liabilities	<u>167,003</u>	<u>10,581,673</u>	<u>10,748,676</u>	<u>-</u>
Total liabilities	<u>956,112</u>	<u>11,573,485</u>	<u>12,529,597</u>	<u>20,914</u>
NET ASSETS				
Invested in capital assets, net of debt	14,230,619	9,566,297	23,796,916	2,304,885
Restricted for sewage service covenants	-	381,423	381,423	-
Restricted for revenue bond indentures	-	2,641,276	2,641,276	-
Restricted for MPPA energy expenses	1,166,080	-	1,166,080	-
Unrestricted	<u>6,227,294</u>	<u>4,657,245</u>	<u>10,884,539</u>	<u>486,465</u>
Total net assets	<u>21,623,993</u>	<u>17,246,241</u>	<u>38,870,234</u>	<u>2,791,350</u>
Total liabilities and net assets	<u>\$ 22,580,105</u>	<u>\$ 28,819,726</u>	<u>\$ 51,399,831</u>	<u>\$ 2,812,264</u>

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

City of Petoskey

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS - PROPRIETARY FUNDS

Year ended December 31, 2007

	Business-Type Activities - Enterprise Funds			Governmental Activities - Internal Service Funds
	Electric System	Water and Sewer System	Totals Current Year	
Operating revenue				
Charges for services	\$ 9,450,538	\$ 4,267,026	\$ 13,717,564	\$ 959,767
Operating expenses				
Purchased power	6,125,259	-	6,125,259	-
Personal services	388,683	614,531	1,003,214	47,954
Contractual services	328,776	868,975	1,197,751	981,381
Supplies	4,145	32,159	36,304	175,465
Materials	155,003	301,998	457,001	-
Heat, light and power	235	359,362	359,597	-
Depreciation	747,249	738,450	1,485,699	285,476
Rent	21,000	32,300	53,300	-
Total operating expenses	<u>7,770,350</u>	<u>2,947,775</u>	<u>10,718,125</u>	<u>1,490,276</u>
OPERATING INCOME (LOSS)	<u>1,680,188</u>	<u>1,319,251</u>	<u>2,999,439</u>	<u>(530,509)</u>
Nonoperating revenues				
Unrestricted interest and investment earnings	186,921	326,284	513,205	53,190
Restricted interest and investment earnings	110,447	-	110,447	-
Rent	117,600	-	117,600	-
Sewage service covenant	-	98,153	98,153	-
Construction	2,250	3,699	5,949	-
Miscellaneous	61,630	-	61,630	27,535
Total nonoperating revenues	<u>478,848</u>	<u>428,136</u>	<u>906,984</u>	<u>80,725</u>
Nonoperating expenses				
Personal services	23,702	118	23,820	-
Contractual services	156,806	-	156,806	-
Supplies	23,778	-	23,778	-
Materials	3,587	-	3,587	-
Heat, light and power	35,015	-	35,015	-
Interest	-	562,653	562,653	-
Depreciation	42,851	-	42,851	-
Amortization	-	9,250	9,250	-
Other expenses	-	500	500	-
Total nonoperating expenses	<u>285,739</u>	<u>572,521</u>	<u>858,260</u>	<u>-</u>
Net nonoperating revenues (expenses)	<u>193,109</u>	<u>(144,385)</u>	<u>48,724</u>	<u>80,725</u>
INCOME (LOSS) BEFORE OPERATING TRANSFERS	1,873,297	1,174,866	3,048,163	(449,784)
Other financing sources (uses)				
Operating transfers in	-	-	-	625,000
Operating transfers out	(527,100)	(783,000)	(1,310,100)	(105,200)
Capital contributions	<u>45,534</u>	<u>122,330</u>	<u>167,864</u>	<u>-</u>
CHANGE IN NET ASSETS	1,391,731	514,196	1,905,927	70,016
Net assets, beginning of year	<u>20,232,262</u>	<u>16,732,045</u>	<u>36,964,307</u>	<u>2,721,334</u>
Net assets, end of year	<u>\$ 21,623,993</u>	<u>\$ 17,246,241</u>	<u>\$ 38,870,234</u>	<u>\$ 2,791,350</u>

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

City of Petoskey

STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS

Year ended December 31, 2007

	Business-Type Activities - Enterprise Funds			Governmental Activities - Internal Service Funds
	Electric System	Water and Sewer System	Totals Current Year	
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash received from customers	\$ 9,202,459	\$ 4,256,753	\$ 13,459,212	\$ -
Cash received for interfund services provided	-	-	-	1,021,386
Cash payments to suppliers for goods and services	(6,269,691)	(1,539,381)	(7,809,072)	(1,157,585)
Cash payments to employees for services	(383,609)	(607,433)	(991,042)	(146,670)
Cash payments to other funds for services	(178,543)	(326,968)	(505,511)	(434)
	<u>2,370,616</u>	<u>1,782,971</u>	<u>4,153,587</u>	<u>(283,303)</u>
Net cash provided (used) by operating activities				
CASH FLOWS FROM NON-CAPITAL AND RELATED FINANCING ACTIVITIES				
Operating transfers-out to other funds	(383,100)	(491,900)	(875,000)	(105,200)
Operating transfers-in from other funds	-	-	-	625,000
Increase (decrease) in customer deposits	(1,328)	-	(1,328)	-
	<u>(384,428)</u>	<u>(491,900)</u>	<u>(876,328)</u>	<u>519,800</u>
Net cash (used) provided by non-capital and related financing activities				
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Acquisition and construction of capital assets	(1,295,043)	(484,450)	(1,779,493)	(892,531)
Principal paid on revenue bonds and contracts payable	-	(465,000)	(465,000)	-
Interest paid on revenue bonds and contracts payable	-	(569,110)	(569,110)	-
Capital contributed by customers	45,534	122,330	167,864	-
Net cash provided by rental, construction and miscellaneous non-operating activities	524,772	119,367	644,139	27,535
	<u>524,772</u>	<u>119,367</u>	<u>644,139</u>	<u>27,535</u>
Net cash used by capital and related financing activities				
CASH FLOWS FROM INVESTING ACTIVITIES				
Sale (purchase) of investments (net)	489,250	270,950	760,200	-
Interest received	297,368	326,284	623,652	53,190
	<u>786,618</u>	<u>597,234</u>	<u>1,383,852</u>	<u>53,190</u>
Net cash provided by investing activities				
NET INCREASE (DECREASE) IN CASH				
	2,048,069	611,442	2,659,511	(575,309)
Cash, beginning of year	<u>2,354,569</u>	<u>4,725,182</u>	<u>7,079,751</u>	<u>1,050,648</u>
Cash, end of year	<u>\$ 4,402,638</u>	<u>\$ 5,336,624</u>	<u>\$ 9,739,262</u>	<u>\$ 475,339</u>
Current assets	\$ 4,235,635	\$ 2,313,925	\$ 6,549,560	\$ 475,339
Restricted assets	167,003	3,022,699	3,189,702	-
	<u>\$ 4,402,638</u>	<u>\$ 5,336,624</u>	<u>\$ 9,739,262</u>	<u>\$ 475,339</u>
Totals				

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

City of Petoskey

STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS - Continued

Year ended December 31, 2007

	Business-Type Activities - Enterprise Funds			Governmental Activities - Internal Service Funds
	Electric System	Water and Sewer System	Totals Current Year	
Reconciliation of operating income to net cash provided (used) by operating activities				
Operating income (loss)	\$ 1,680,188	\$ 1,319,251	\$ 2,999,439	\$ (530,509)
Adjustments to reconcile operating income to net cash provided (used) by operating activities				
Depreciation	747,249	738,450	1,485,699	285,476
Operating transfer for payment in lieu of taxes	(144,000)	(291,100)	(435,100)	-
(Increase) decrease in accounts receivable	(248,079)	(10,273)	(258,352)	61,556
(Increase) decrease in inventory	9,041	(22,775)	(13,734)	1,607
(Increase) decrease in prepaid expenses	(28,976)	465	(28,511)	-
Decrease in due from other component units	-	-	-	63
Increase (decrease) in accounts payable	363,662	45,887	409,549	(101,769)
Increase in accrued expenses	5,074	7,098	12,172	707
Decrease in due to other funds	(13,543)	(4,032)	(17,575)	(434)
Total adjustments	690,428	463,720	1,154,148	247,206
Net cash provided (used) by operating activities	\$ 2,370,616	\$ 1,782,971	\$ 4,153,587	\$ (283,303)

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

City of Petoskey

STATEMENT OF FIDUCIARY NET ASSETS

December 31, 2007

	<u>Pension Trust Fund</u>	<u>Private Purpose Trust Fund</u>	<u>Agency Funds</u>
ASSETS			
Cash	\$ -	\$ 18,612	\$ 1,024,308
Investments	232,438	-	-
Receivables			
Taxes	<u>-</u>	<u>-</u>	<u>3,908,614</u>
 Total assets	 <u>\$ 232,438</u>	 <u>\$ 18,612</u>	 <u>\$ 4,932,922</u>
 LIABILITIES AND NET ASSETS			
LIABILITIES			
Accounts payable	\$ -	\$ 500	\$ 38,727
Due to other funds	-	-	562,295
Due to component unit	-	-	79,810
Due to other governmental units	<u>-</u>	<u>-</u>	<u>4,252,090</u>
 Total liabilities	 -	 500	 4,932,922
 NET ASSETS			
Held in trust for pension benefits and other purposes	<u>232,438</u>	<u>18,112</u>	<u>-</u>
 Total liabilities and net assets	 <u>\$ 232,438</u>	 <u>\$ 18,612</u>	 <u>\$ 4,932,922</u>

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

City of Petoskey

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS

Year ended December 31, 2007

	Pension Trust Fund	Private Purpose Trust Fund
ADDITIONS TO NET ASSETS		
Contributions		
Employer	\$ 18,450	\$ -
Private donations	-	26,816
Total contributions	18,450	26,816
Net investment earnings		
Interest and unrealized gains/losses	8,267	670
Total additions	26,717	27,486
DEDUCTIONS FROM NET ASSETS		
Miscellaneous expenses	-	14,068
Administrative expenses	26	-
Distributions/transfers out	29,544	2,872
Total deductions	29,570	16,940
NET CHANGE IN NET ASSETS	(2,853)	10,546
Net assets, beginning of year	235,291	7,566
Net assets, end of year	\$ 232,438	\$ 18,112

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

City of Petoskey

NOTES TO FINANCIAL STATEMENTS

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Introduction

The City of Petoskey (the "City") was incorporated November 4, 1924, under the provisions of Act 279, P.A. 1909, as amended (Home Rule City Act). The City operates under a Council-Manager form of government and provides the following services as authorized by its charter: public safety (police and fire), highways and streets, sanitation, health and social services, culture-recreation, public improvements, planning and zoning, and general administrative services.

The Financial Reporting Entity

The City's financial statements include the accounts of all City operations. In evaluating the City as a reporting entity, management has addressed all potential component units (traditionally separate reporting units) for which the City may or may not be financially accountable and, as such, be includable within the City's financial statements. In accordance with generally accepted accounting principles and Governmental Accounting Standards Board ("GASB") Statement No. 14, *The Financial Reporting Entity*, the City is financially accountable if it appoints a voting majority of an organization's governing board and (1) it is able to impose its will on the organization or (2) there is a potential for the organization to provide specific financial benefit to or impose specific financial burden on the City. Additionally, the City is required to consider other organizations for which the nature and significance of their relationship with the City are such that exclusion would cause the City's financial statements to be misleading or incomplete.

Based on this criteria, the City has identified the following blended and discretely presented component units requiring inclusion in the City's financial statements and other jointly governed organizations evaluated:

Blended Component Unit

City of Petoskey Building Authority - The City of Petoskey Building Authority is governed by a three member board appointed by the City of Petoskey. Although it is legally separate from the City, the Building Authority is reported as if it were part of the primary government because its sole purpose is to provide financing for the construction of buildings, parking lots, recreational facilities and to acquire the necessary sites for such facilities. Separate financial statements for the City of Petoskey Building Authority may be obtained by contacting the City's Director of Finance, 101 East Lake Street, Petoskey, Michigan 49770.

Discretely Presented Component Units

Tax Increment Finance Authority - The Tax Increment Finance Authority, which was established pursuant to the provisions of Public Act 450 of 1980, as amended, is governed by an eight-person board appointed by the City Council. The Authority may issue debt subject to limitations set forth in the Act and is funded by a specified annual property tax capture of a portion of all units' levies which may only be used for activities within the tax increment finance district. Separate financial statements for the Tax Increment Finance Authority are not issued.

NOTES TO FINANCIAL STATEMENTS - Continued

Library - The City Library, which was established pursuant to the provisions of Public Act 164 of 1877, as amended, and City charter as adopted on August 7, 1984, is governed by a five-person commission appointed by the mayor. The commission may not issue debt and the tax levy is subject to approval by the City Council. Separate financial statements for the City Library are not issued.

Downtown Management Board (Downtown Management/Parking) - The Downtown Management Board was established in February of 1994 pursuant to the provisions of Public Act 120 of 1961. By a resolution dated February 1, 2000, responsibilities for operating and maintaining the City's downtown area parking system and facilities were transferred to the Downtown Management Board. Separate financial statements for the Downtown Management Board are not issued.

Government-Wide and Fund Financial Statements

The City of Petoskey's basic financial statements include both government-wide (reporting the City as a whole) and the fund financial statements (reporting the City's major funds). Both the government-wide and the fund financial statements categorize primary government activities as either governmental or business-type. 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 primary government is reported separately from legally separate component units for which the primary government is financially accountable.

Government-Wide Financial Statements

The government-wide financial statements report information on all of the nonfiduciary activities of the primary government and its component units. As a general rule the effect of interfund activity, such as overhead costs, has been eliminated from these statements. The government-wide focus is more on operational efficiency, the sustainability of the City as an entity and the change in the City's net assets resulting from the current year's activities.

Internal service funds are consolidated into the governmental column when presented at the government-wide level. This is because the principal users of the internal service are the City's governmental activities. The net profit/loss in the internal service funds is allocated to the functional activity (public safety, public works, etc.) based upon usage.

In the government-wide statement of net assets, both the governmental and business-type activities are presented on a consolidated basis. Due to the full accrual, economic resource basis, all long-term assets and receivables, as well as long-term debt and obligations are recognized. The City's net assets are reported in three parts - invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets.

The government-wide statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. This statement reduces gross expenses (including depreciation) by related program revenues, which include charges for services, operating grants and capital grants.

NOTES TO FINANCIAL STATEMENTS - Continued

The program revenues must be directly associated with the 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 as general revenue.

Fund Financial Statements

The financial transactions of the City are reported in individual funds in the fund financial statements. Each fund is accounted for by providing a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues and expenditures/expenses. The focus of the fund financial statements is upon the determination of financial position and changes in financial position (sources, uses and balances of financial resources).

Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. The balance sheets; statements of revenues, expenditures/expenses and changes in fund balances/net assets; and statements of cash flows (i.e., fund financial statements) for the City's governmental, proprietary and fiduciary funds display information about the major and aggregated non-major funds for the various fund types. Major funds are generally those that represent 10% or more of the respective fund assets, liabilities, revenues or expenditures.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The financial statements of the City are prepared in accordance with *Generally Accepted Accounting Principles* ("GAAP"). The City applies all relevant Governmental Accounting Standards Board ("GASB") pronouncements and applicable Financial Accounting Standards Board ("FASB") pronouncements and Accounting Principles Board ("APB") opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements. The City does not apply FASB pronouncements or APB opinions issued after November 30, 1989.

Basis of accounting refers to the point at which revenues and expenditures/expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The government-wide statements are reported using the economic resources measurement focus and the full accrual basis of accounting, which incorporates long-term assets and receivables as well as long-term debt and obligations. Revenue is 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 revenue 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. Expenditures generally are recorded when a liability is incurred.

NOTES TO FINANCIAL STATEMENTS - Continued

The governmental funds use a financial resources measurement focus and are accounted for using the modified accrual basis of accounting. Under the financial resources measurement focus, only current assets and current liabilities are generally included on governmental fund balance sheets. An exception to this general rule is long-term interfund advances which are recorded on governmental fund balance sheets. The governmental fund operating statements present a summary of sources and uses of available spendable resources. Under modified accrual basis of accounting, revenues are recorded when susceptible to accrual, i.e., both measurable and available. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period (generally 60 days). Grants are recognized when grantor eligibility requirements are met. Current expenditures are generally recorded when the fund liability is incurred, if measurable. Exceptions to this general rule include principal and interest on long-term debt, which is recognized when due and accrued vacation and sick leave, which is recorded when payable from current available financial resources.

The proprietary funds use the accrual basis of accounting and are accounted for on a cost-of-service or "capital maintenance" measurement focus. Under the capital maintenance measurement focus, all assets and liabilities associated with the fund's activities are included on its balance sheet. Under the accrual basis, revenues are recognized when earned and expenses are recognized when they are incurred.

The fiduciary funds are generally maintained on the accrual basis which is consistent with the accounting measurement objectives of the funds.

Fund Types and Major Funds

Activities in Major Funds

Governmental Funds

General Fund - The General Fund is the government's primary operating fund. It accounts for all financial resources of the City, except those required to be accounted for in another fund. Revenues are primarily derived from property taxes and State shared revenue.

Right-of-Way Improvement Fund - The Right-of-Way Improvement Fund is used to account for the disposition of tax revenues restricted for right-of-way improvements. Transfers are made to other funds, primarily street funds, to reimburse their costs.

Major Street Fund - The Major Street Fund accounts for State gas and weight tax revenues and transfers from the Right-of-Way Improvement Fund that are restricted for expenditures related to maintaining and improving the City's major streets.

Local Street Fund - The Local Street Fund accounts for State gas and weight tax revenues and transfers from the Right-of-Way Improvement Fund that are restricted for expenditures related to maintaining and improving the City's local streets.

Proprietary Funds

Electric Fund - This fund is an enterprise fund. The fund is financed and operated in a manner similar to a private enterprise. The intent is that costs (expenses, including depreciation) of providing electricity to the general public are recovered through user charges.

NOTES TO FINANCIAL STATEMENTS - Continued

Water and Sewer Fund - This fund is an enterprise fund. The fund is financed and operated in a manner similar to a private enterprise. The intent is that costs (expenses, including depreciation) of providing water and sewer services to the general public are recovered through user charges.

Activities in Non-Major Funds

Governmental Funds

Special Revenue Funds - These funds are used to account for specific revenue (other than special assessments, expendable trusts or major capital projects) derived from State and Federal grants, General Fund appropriations and charges for services which are to be expended for specific purposes as dictated by legal, regulatory or administrative requirements. The City maintains the General Street Fund and the Downtown Management Fund.

Debt Service Funds - These funds are used to record revenues which are restricted or otherwise provided for the payment of principal and interest on general long-term debt.

Proprietary Funds

Internal Service Funds - These funds account for the cost of acquiring, maintaining and providing equipment and services for the benefit of other funds, generally on a cost-reimbursement basis.

Fiduciary Funds

Trust and Agency Funds - These funds account for assets held by the City in a trustee capacity or as an agent for individuals, private organizations, other governmental units and/or other funds.

Budgets and Budgetary Accounting

Budgets are adopted by the City Council for the primary government's General and Special Revenue Funds. The budget basis of accounting does not differ significantly from the modified accrual basis used to reflect actual revenues and expenditures for these funds. The budget is adopted at the functional level and control is exercised at the fund level.

The City does not employ encumbrance accounting as an extension of formal budgetary integration. All annual appropriations lapse at year-end.

Cash and Investments

The City pools financial resources of its various funds to facilitate the management of cash and investments. Cash applicable to a particular fund is readily identifiable. The balance in the pooled cash accounts is available to meet current operating requirements. Cash in excess of current requirements is invested in bank certificates of deposit and in various interest-bearing securities.

For the purpose of the statement of cash flows, the City considers all highly liquid investments, including all certificates of deposit and all restricted investments, with a maturity of 90 days or less, to be cash equivalents.

NOTES TO FINANCIAL STATEMENTS - Continued

Cash deposits are reported at carrying amount which reasonably estimates fair value. Short-term investments are reported at cost, which approximates fair value. Other investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates, and investments that do not have an established market are reported at estimated fair value.

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. Collection of other governmental units' 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.

Taxes receivable are considered to be available to fund current operations, even if collection occurs beyond 60 days, if they are purchased by the Emmet County delinquent tax collection program.

Interfund Transactions and Balances

Interfund receivables and payables arise from interfund transactions and are recorded by all funds affected in the period in which transactions are executed. Due to/from other funds are short-term interfund balances that occur in the normal course of operations. Advances to/from other funds are long-term interfund financing arrangements. Outstanding balances on the government-wide statement of net assets are captioned "internal balances."

Operating transfers in and out arise in the normal course of operations from interfund transactions and are recorded by all funds affected in the period in which transactions are executed.

Inventories

Inventory is valued at cost, which approximates market, using the first-in, first-out method. Inventory in the Special Revenue Funds consist of expendable supplies held for consumption, which are recorded as expenditures when consumed rather than when purchased. Fund balance has been reserved for inventory in governmental funds.

Capital Assets

Property, plant and equipment used in proprietary funds are stated in a manner consistent with the presentation in the entity-wide financial statements. Capital assets, which include property, buildings, equipment and infrastructure assets (e.g., roads, bridges, sidewalks and similar items) are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are recorded by the City when the initial individual costs are equal to or greater than the following amounts:

<u>Asset Type</u>	<u>Amount</u>
Land	\$ 1
Equipment	5,000
Buildings	50,000
Infrastructure	100,000

NOTES TO FINANCIAL STATEMENTS - Continued

Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

Interest incurred during the construction of capital assets of business-type activities is included as part of the capitalized value of the assets constructed.

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

Buildings	20 - 60 years
Building improvements	15 - 30 years
Land improvements	10 - 20 years
Water and sewer lines	50 - 75 years
Streets, curbs and gutters	10 - 30 years
Sidewalks	20 years
Vehicles	3 - 5 years
Furniture and equipment	10 - 20 years
Office equipment	5 - 7 years

Long-term Obligations

In the government-wide financial statements and the proprietary fund financial statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs during the period in which the bonds were issued. 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 are reported as other financing uses. Issuance costs are reported as debt service expenditures.

Restricted Assets

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

Compensated Absences (Personal, Vacation and Sick Time)

All employees are entitled to 56 hours of personal time starting on December 1. The City reimburses all employees for any unused portion, on an annual basis. Vacation days not used during the year may not be accumulated. Unpaid sick time accrued represents sick time accumulated before December 1, 1990 and payable to eligible employees on termination. Due to contract years differing from the City's fiscal year, unpaid vacation time represents earned but unused vacation time.

Accumulated unpaid vacation, sick pay and other employee benefit amounts are provided for on a timely basis by accrual in the governmental funds when payable from available spendable resources. All vacation, sick pay and other employee benefit amounts accrue when earned in the government-wide and proprietary fund financial statements.

NOTES TO FINANCIAL STATEMENTS - Continued

Fund Equity

The unreserved fund balances for governmental funds represent the amount available for budgeting future operations. Reserves of fund equity represent portions of fund equity not appropriable for expenditure or legally segregated for a specific future use. Designated fund balances represent tentative plans for future use of financial resources. Unrestricted net assets of Proprietary Funds represent the net assets that have not been legally identified for specific purposes.

Use of Estimates

The preparation of financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from those estimates.

NOTE B - BUDGETARY COMPLIANCE

P.A. 621 of 1978, as amended, provides that a local unit shall not incur expenditures in excess of the amounts appropriated. During the year ended December 31, 2007, the City incurred expenditures in the General Fund which were in excess of the amounts appropriated for public safety, health and welfare, and operating transfers by \$336,621, \$4,704 and \$113,700, respectively; in the Major Street Fund which were in excess of the amounts appropriated by \$76,814; and in the General Street Fund which were in excess of the amounts appropriated by \$31,918.

NOTE C - DEPOSITS AND INVESTMENTS

The funds of the City are deposited and invested as permitted under Act 20 P.A. 1943, as amended by Act 196 P.A. 1997. Pension trust funds are invested as permitted under Act 314 P.A. 1965, as amended.

At December 31, 2007, the City's cash and investments include the following:

	<u>Primary Government</u>		<u>Component Unit</u>		<u>Fiduciary Funds</u>	
	<u>Deposits</u>	<u>Investments</u>	<u>Deposits</u>	<u>Investments</u>	<u>Deposits</u>	<u>Investments</u>
Carrying amounts						
Cash and equivalents	\$ 9,560,251	\$ -	\$ 1,279,746	\$ -	\$ 1,042,920	\$ -
Restricted assets	1,543,714	2,820,568	-	-	-	-
Investments	-	3,953,329	65,991	100,000	-	232,438
	<u>\$11,103,965</u>	<u>\$6,773,897</u>	<u>\$ 1,345,737</u>	<u>\$ 100,000</u>	<u>\$1,042,920</u>	<u>\$ 232,438</u>

Deposits

Michigan law permits the City to deposit in the accounts of Federally insured banks, credit unions and savings and loans associations located in Michigan.

NOTES TO FINANCIAL STATEMENTS - Continued

Custodial Credit Risk

In the event of bank failure, the City's uninsured deposits may not be returned to it. As of December 31, 2007, \$14,200,000 of the City's deposits (including certificates of deposit) were exposed to custodial credit risk because they were uninsured and uncollateralized.

Investments

Michigan law permits the City to invest in the following vehicles (except pension trust funds, which have much greater flexibility):

1. Bonds and other obligations of the United States Government.
2. Certificates of deposit, savings, deposit and money market accounts.
3. Certain commercial paper.
4. United States Government repurchase agreements.
5. Banker's acceptance of United States banks.
6. Certain obligations of the State of Michigan or its political subdivisions.
7. Certain mutual funds.
8. Certain investment pools.

At December 31, 2007, the City's investments consisted of the following:

<u>Investment Type</u>	<u>Fair Market Value</u>	<u>Weighted Average Maturity (Years)</u>
Certificates of Deposit	\$ 165,904	\$ 1.85
Federal Home Loan Bank	4,105,097	8.26
Federal National Mortgage Associations	1,100,310	13.06
Federal Home Loan Mortgage Company	502,410	14.98
MPPA Investment Pools	1,166,080	8.50
Money Market Mutual Fund	<u>232,438</u>	<u>-</u>
Total portfolio	<u>\$ 7,272,239</u>	<u>7.57</u>

Credit Risk

The City will minimize credit risk, which is the risk of loss due to the failure of the security issuer or backer, by: Limiting investments to the type of securities allowed by law and pre-qualifying the financial institution, broker/dealers, intermediaries and advisors with which the City will do business.

The City's policy does not further limit its investment choices. The certificates of deposit are insured by the FDIC for up to \$165,904. Moody's Investor Service rated the City's investments in the Federal Home Loan Bank and the Federal National Mortgage Association AAA. Moody's rated the City's mutual fund investments Aal. There is no regulatory oversight of the MPPA Investment Pool and no overall credit quality rating of the pool.

NOTES TO FINANCIAL STATEMENTS - Continued

Concentration of Credit Risk

The City places no limit on the amount it may invest in any one issuer. There are no investments not guaranteed by the U.S. Government that represent more than 5% of the City's investments.

Interest Rate Risk

The City does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

NOTE D - PROPERTY TAXES

The City is permitted by charter to levy taxes, subject to State Headlee and Truth in Taxation provisions, up to \$10 per \$1,000 of taxable valuation for general governmental services other than the payment of principal and interest of long-term debt and in unlimited amounts for the payment of principal and interest on general obligation long-term debt. The City is also permitted by charter to levy taxes up to \$5 per \$1,000 of taxable valuation for right-of-way improvements. The City is permitted by State law to levy up to \$1 per \$1,000 of taxable valuation for the public library and \$2 per \$1,000 of taxable valuation for refuse collection. If approved by a majority of the voters, the City may increase the tax levied by an additional \$1 per \$1,000 of taxable valuation for the public library. The 2007 State taxable valuation of the City of Petoskey totaled \$520,302,891.

The tax rates for the year-ended December 31, 2007 were as follows:

<u>Purpose</u>	<u>Rate/Taxable Valuation</u>
General governmental services	7.4940 per \$1,000
Right-of-way improvements	3.8580 per \$1,000
Library	0.8600 per \$1,000
Library (additional, approved by voters)	0.9050 per \$1,000
Refuse collection	0.4890 per \$1,000

NOTE E - INTERFUND RECEIVABLES AND PAYABLES

The amounts of interfund receivables and payables within the primary government are as follows:

	<u>Interfund Receivables</u>	<u>Interfund Payables</u>
General Fund	\$ 383,744	\$ -
Right-of-Way Improvement Fund	174,357	-
Other Nonmajor Governmental Funds	4,194	-
Fiduciary Funds	<u>-</u>	<u>562,295</u>
Total	<u>\$ 562,295</u>	<u>\$ 562,295</u>

NOTES TO FINANCIAL STATEMENTS - Continued

The amounts of interfund receivables and payables between the primary government and the component units are as follows:

	<u>Interfund Receivables</u>	<u>Interfund Payables</u>
Library Fund	\$ 79,810	\$ -
Fiduciary Funds	<u>-</u>	<u>79,810</u>
Total	<u>\$ 79,810</u>	<u>\$ 79,810</u>

The interfund balances are mainly for property taxes, material and inventory usage, building rent and equipment.

NOTE F - INTERFUND TRANSFERS

Operating transfers within the primary government are as follows:

	<u>Transfers In</u>	<u>Transfers Out</u>
General Fund	\$ 1,744,400	\$ 738,700
Right-of-Way Improvement Fund	-	2,375,000
Major Street Fund	665,000	164,800
Local Street Fund	1,160,000	164,300
Electric Fund	-	527,100
Water and Sewer Fund	-	783,000
Other Nonmajor Governmental Funds	663,700	-
Internal Service Funds	<u>625,000</u>	<u>105,200</u>
Total	<u>\$ 4,858,100</u>	<u>\$ 4,858,100</u>

Operating transfers between the primary government and the component units are as follows:

	<u>Transfers In</u>	<u>Transfers Out</u>
Other Nonmajor Component Units	\$ -	\$ 89,700
General Fund	9,700	-
Other Nonmajor Governmental Funds	<u>80,000</u>	<u>-</u>
Total	<u>\$ 89,700</u>	<u>\$ 89,700</u>

NOTES TO FINANCIAL STATEMENTS - Continued

The operating transfers are mainly for right-of-way improvements, debt service and general City operations.

Enterprise fund payments in lieu of taxes, classified as transfers to the General Fund above, were as follows:

Electric Fund	<u>\$ 144,000</u>
Water and Sewer Fund	<u>\$ 291,100</u>

NOTE G - CAPITAL ASSETS

Investment in capital assets changed as follows during the year ended December 31, 2007:

Governmental Activities

	<u>Beginning</u>	<u>Capital Acquisitions</u>	<u>Sales and Other Dispositions</u>	<u>Ending</u>
Capital assets not being depreciated				
Land	\$ 1,887,069	\$ -	\$ -	\$ 1,887,069
Capital assets being depreciated				
Land improvements	628,636	-	-	628,636
Buildings	3,942,846	-	-	3,942,846
Equipment	5,241,666	892,530	(40,035)	6,094,161
Infrastructure	<u>17,774,347</u>	<u>1,064,859</u>	<u>-</u>	<u>18,839,206</u>
Subtotal	<u>27,587,495</u>	<u>1,957,389</u>	<u>(40,035)</u>	<u>29,504,849</u>
Less accumulated depreciation				
Land improvements	(230,592)	(39,357)	-	(269,949)
Buildings	(1,727,426)	(97,674)	-	(1,825,100)
Equipment	(3,185,212)	(328,344)	40,035	(3,473,521)
Infrastructure	<u>(6,866,191)</u>	<u>(734,588)</u>	<u>-</u>	<u>(7,600,779)</u>
Subtotal	<u>(12,009,421)</u>	<u>(1,199,963)</u>	<u>40,035</u>	<u>(13,169,349)</u>
Net capital assets being depreciated	<u>15,578,074</u>	<u>757,426</u>	<u>-</u>	<u>16,335,500</u>
Governmental activities net capital assets	<u>\$ 17,465,143</u>	<u>\$ 757,426</u>	<u>\$ -</u>	<u>\$ 18,222,569</u>

NOTES TO FINANCIAL STATEMENTS - Continued

Business-Type Activities

	<u>Beginning</u>	<u>Capital Acquisitions</u>	<u>Sales and Other Dispositions</u>	<u>Ending</u>
Capital assets not being depreciated				
Land	\$ 837,856	\$ -	\$ -	\$ 837,856
Capital assets being depreciated				
Buildings	\$ 17,447,136	\$ 94,175	\$ -	\$ 17,541,311
Utility system improvements	32,115,132	1,728,169	-	33,843,301
Equipment	<u>703,723</u>	<u>-</u>	<u>-</u>	<u>703,723</u>
Subtotal	<u>50,265,991</u>	<u>1,822,344</u>	<u>-</u>	<u>52,088,335</u>
Less accumulated depreciation				
Buildings	(6,050,820)	(474,761)	-	(6,525,581)
Utility system improvements	(9,768,052)	(1,053,791)	-	(10,821,843)
Equipment	<u>(703,723)</u>	<u>-</u>	<u>-</u>	<u>(703,723)</u>
Subtotal	<u>(16,522,595)</u>	<u>(1,528,552)</u>	<u>-</u>	<u>(18,051,147)</u>
Net capital assets being depreciated	<u>33,743,396</u>	<u>293,792</u>	<u>-</u>	<u>34,037,188</u>
Business-type activities net capital assets	<u>\$ 34,581,252</u>	<u>\$ 293,792</u>	<u>\$ -</u>	<u>\$ 34,875,044</u>

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

Governmental activities

General government	\$ 5,175
Public safety	92,023
Public works	898,153
Recreation and cultural	51,394
Unallocated	<u>153,218</u>
Total governmental activities	<u>\$ 1,199,963</u>

Business-type activities

Water and sewer	\$ 738,450
Electric	<u>790,100</u>
Total business-type activities	<u>\$ 1,528,550</u>

NOTES TO FINANCIAL STATEMENTS - Continued

Component Units

	<u>Beginning</u>	<u>Capital Acquisitions</u>	<u>Sales and Other Dispositions</u>	<u>Ending</u>
Capital assets being depreciated				
Land improvements	\$ 102,360	\$ -	\$ -	\$ 102,360
Buildings	5,878,591	-	-	5,878,591
Equipment	<u>1,617,718</u>	<u>45,586</u>	<u>-</u>	<u>1,663,304</u>
Subtotal	<u>7,598,669</u>	<u>45,586</u>	<u>-</u>	<u>7,644,255</u>
Less accumulated depreciation				
Land improvements	(7,698)	(5,118)	-	(12,816)
Buildings	(630,784)	(155,493)	-	(786,277)
Equipment	<u>(773,013)</u>	<u>(62,174)</u>	<u>-</u>	<u>(835,187)</u>
Subtotal	<u>(1,411,495)</u>	<u>(222,785)</u>	<u>-</u>	<u>(1,634,280)</u>
Component units' net capital assets	<u>\$ 6,187,174</u>	<u>\$ (177,199)</u>	<u>\$ -</u>	<u>\$ 6,009,975</u>

Proprietary Fund Type Property, Plant and Equipment

Proprietary fund type property, plant and equipment at December 31, 2007 are summarized as follows:

	<u>Enterprise</u>	<u>Internal Service</u>
Land	\$ 837,856	\$ -
Buildings	17,541,311	11,011
Utility system improvements	33,843,301	-
Equipment	<u>703,723</u>	<u>5,296,355</u>
Total	52,926,191	5,307,366
Less accumulated depreciation	<u>(18,051,147)</u>	<u>(3,002,481)</u>
Net	<u>\$ 34,875,044</u>	<u>\$ 2,304,885</u>

NOTES TO FINANCIAL STATEMENTS - Continued

NOTE H - BONDS PAYABLE

The following is a summary of the City's bond transactions for the year ended December 31, 2007:

	<u>Beginning Balance</u>	<u>New Debt</u>	<u>Payments</u>	<u>Ending Balance</u>	<u>Current Portion</u>
PRIMARY GOVERNMENT					
Governmental activities					
General obligation debt	\$ 785,000	\$ -	\$ 150,000	\$ 635,000	\$ 150,000
Business-type activities					
Revenue obligation debt	\$ 11,820,000	\$ -	\$ 465,000	\$ 11,355,000	\$ 560,000
COMPONENT UNIT					
General obligation debt	\$ 4,150,000	\$ -	\$ 100,000	\$ 4,050,000	\$ 100,000

Bonds payable at December 31, 2007 is composed of the following individual issues:

General Obligation (Governmental Activities)

\$965,000, 1999 City of Petoskey Building Authority Refunding serial bonds due; remaining annual installments of \$95,000 through October 2009; interest rate of 4.70% to 4.75%. Funds for repayment have been provided by the General Fund.	\$ 190,000
\$800,000, 1999 Building Authority Downtown Improvement bonds; due in remaining annual installments of \$55,000 to \$75,000 through October 2014; interest rate of 4.5% to 4.75%. Funds for repayment have been provided by the Downtown Management/ Parking Fund.	<u>445,000</u>
Total governmental activities general obligation bonds	<u>\$ 635,000</u>

Revenue Obligation (Business-type Activities)

\$7,500,000, 2001 Water and Sewer bonds; remaining annual installments of \$200,000 to \$600,000 through February 2026; interest rate of 4.00% to 5.00%.	\$ 7,200,000
Unaccreted discount	(85,500)
\$5,505,000, 2002 Water and Sewer Refunding bonds; remaining annual installments of \$355,000 to \$475,000 through February 2017; interest rate of 3.00% to 5.25%.	4,155,000
Unamortized premium	88,041
Loss on refunding	<u>(224,368)</u>
Total business-type activities revenue obligation debt	<u>\$ 11,133,173</u>

NOTES TO FINANCIAL STATEMENTS - Continued

General Obligation (Component Unit)

\$4,300,000, 2003 Building Authority Library Improvement bonds; remaining annual installments of \$100,000 to \$300,000 through October 2028; interest rate of 2.50% to 4.40%.	\$ 4,050,000
Unaccreted discount	<u>(29,226)</u>
Total component unit general obligation bonds	<u>\$ 4,020,774</u>

The annual requirements to amortize all general and revenue obligation bonds outstanding, as of December 31, 2007, are as follows:

Annual Requirements to Amortize Outstanding Bonds
December 31, 2007

Years Ending	Governmental Activities		Business-type Activities		Component Unit	
	Principal	Interest	Principal	Interest	Principal	Interest
2008	\$ 150,000	\$ 30,925	\$ 560,000	\$ 524,124	\$ 100,000	\$ 158,625
2009	150,000	23,875	555,000	503,257	125,000	156,125
2010	60,000	16,750	595,000	480,987	125,000	152,813
2011	65,000	13,750	590,000	457,384	125,000	149,187
2012	65,000	10,500	585,000	433,217	150,000	145,313
2013 - 2017	145,000	11,000	3,870,000	1,633,762	825,000	645,925
2018 - 2022	-	-	2,200,000	881,125	1,000,000	471,375
2023 - 2027	-	-	2,400,000	240,000	1,300,000	241,250
2028	-	-	-	-	300,000	13,200
	<u>\$ 635,000</u>	<u>\$ 106,800</u>	<u>\$ 11,355,000</u>	<u>\$ 5,153,856</u>	<u>\$ 4,050,000</u>	<u>\$ 2,133,813</u>

NOTE I - RESERVED FUND BALANCES/RESTRICTED NET ASSETS

Major Governmental Funds

Reserved for marina - The General Fund has \$657,226 reserved for marina operations and improvements.

Reserved for refuse - The General Fund has \$16,041 reserved for refuse collection expenditures.

Reserved/restricted for right-of-way improvements - The entire fund balance of the Right-of-Way Improvement Fund is reserved and restricted by enabling legislation for right-of-way improvements.

Nonmajor Governmental Funds

Reserved for inventory - The Special Revenue Funds have \$89,727 reserved for inventory.

NOTES TO FINANCIAL STATEMENTS - Continued

Reserved/restricted for debt service - The Debt Service Funds have \$85,544 reserved for debt service and related costs, which is also restricted in the Governmental Activities.

Major Proprietary Funds

Restricted for MPPA energy expenses - The Electric Fund has \$1,166,080 restricted for MPPA energy expenses.

Restricted for revenue bond indentures - In accordance with revenue bond indentures, the Water and Sewer System Fund has \$2,641,276 of its net assets restricted for this specific purpose.

Restricted for sewage agreement covenants - The City has \$381,423 restricted for repair and replacement of sewage treatment facilities.

Fiduciary Funds

Restricted for pension benefits and other purposes - The Employees Retirement Trust Fund and the Library Endowment Trust Fund have \$232,438 and \$18,112, respectively, restricted for employee pension benefits and library costs.

Component Units

Restricted for Tax Increment Finance Authority - The Tax Increment Finance Authority has \$584,827 restricted for use within the TIFA district.

When both restricted and unrestricted resources are available to cover an expense incurred for restricted purposes, restricted resources are utilized first.

NOTE J - CITY OF PETOSKEY RETIREMENT PLAN

Plan Description

The City of Petoskey participates in the Michigan Municipal Employees' Retirement System ("MERS"), and agent multiple-employer defined benefit pension plan that covers all employees of the City of Petoskey. MERS was established by the State of Michigan for the purpose of providing retirement, survivor and disability benefits on a voluntary basis to the State's local government employees. MERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Municipal Employees Retirement System of Michigan, 447 North Canal, Lansing, Michigan 48917.

Funding Policy

There are no contribution requirements for plan members. The City is required to contribute all amounts necessary to fund the system using the actuarial basis specified by statute. The contribution requirements of plan members and the City are established and may be amended by the MERS board.

NOTES TO FINANCIAL STATEMENTS - Continued

Annual Pension Cost

For the year-ended 2007, the City's required contributions were \$584,906, while their actual contributions were \$1,264,795. The annual required contribution was determined as part of an actuarial valuation at December 31, 2006, using the entry age normal cost method. Significant actuarial assumptions included (a) 8% investment rate of return (net of administrative expenses); and (b) projected salary increases of 4.5% per year (plus a percentage based on an age-related scale to reflect merit, longevity and promotional pay increases). Both (a) and (b) included an inflation component of 3% to 4%. The actuarial value of the City's assets was determined on the basis of a valuation method that assumes the fund earns the expected rate of return (8%) and includes an adjustment to reflect market value. The City's unfunded actuarial accrued liabilities are amortized by a level percent of payroll contributions over a 30-year period.

Three-Year Trend Information for the City of Petoskey

<u>Fiscal Year-Ending</u>	<u>Annual Pension Cost ("APC")</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Prepayment</u>
December 31, 2005	521,868	103%	(13,885)
December 31, 2006	524,086	102%	(9,200)
December 31, 2007	584,906	216%	(679,889)

Additional trend information may be found within the Required Supplemental Information section of the financial statements.

NOTE K - DEFINED CONTRIBUTION RETIREMENT PLAN

The City provides pension benefits for management employees as designed 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. Designated 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 immediately.

The City's contributions were calculated using the eligible base salary amount of \$122,024, as established by City Council and governed by Federal regulations. The City made the required 15.12% contribution for the year, which totaled \$18,450.

At December 31, 2007, the City had \$232,438 within the Employees Retirement Trust Fund.

NOTE L - DEFERRED COMPENSATION PLAN

The City offers its employees a deferred compensation plan created in accordance with Internal Revenue Code 457. The plan, available to all City employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

In complying with the amended Section 457 requirements, these assets are for the exclusive benefit of participants and not subject to the claims of the City's general creditors. As such, they are not included in an agency fund of the City.

NOTE M - OTHER POST-EMPLOYMENT BENEFITS

The City allows all retirees and their spouses to continue to participate in the City's health insurance plan. The City pays \$1,200 per year for each electing retiree. The remaining cost is the individual retiree's responsibility. As of December 31, 2007, there were 20 participants. The City's actual expense was \$24,000.

NOTE N - COMMITMENTS AND CONTINGENCIES

Landfill Closure and Post-Closure Care Costs

An agreement with the State of Michigan requires that the City of Petoskey perform monitoring functions at a former landfill site for 30 years after closure. A liability is being recognized based on the estimated future post closure costs that will be incurred over the remaining term of the agreement, which runs through August 2022. The estimated total current cost of the landfill post closure care of \$85,000 is based on the amount that would be paid if the services to monitor the landfill were acquired as of December 31, 2007. However, the actual cost of post closure care may be higher due to inflation, changes in technology or changes in landfill laws and regulations.

Entitlement Commitments

Between 1979 and 2001, the Michigan Public Power Agency ("MPPA"), of which the City is a member, acquired ownership interests in the Consumers Power Campbell No. 3 plant, the Detroit Edison Belle River Unit and other related assets, and the CT Project No. 1. The City's entitlement share of the Campbell No. 3, Belle River Unit and CT Project No. 1 generating capacities are 1,470 (KW), 4,137 (KW) and 4,392 (KW), respectively.

NOTES TO FINANCIAL STATEMENTS - Continued

The entitlements specify minimum annual payments on a "take-or-pay" basis for the generation and transmission capabilities of the units as follows:

<u>Years ending December 31,</u>	<u>Campbell No. 3</u>	<u>Belle River Unit</u>	<u>CT Project No. 1</u>	<u>Total</u>
2008	\$ 164,221	\$ 508,608	\$ 241,091	\$ 913,920
2009	137,177	508,617	241,155	886,949
2010	137,856	508,693	241,499	888,048
2011	138,239	508,691	241,159	888,089
2012	138,429	508,627	241,248	888,304
2013 - 2017	391,050	2,543,270	1,206,152	4,140,472
2018 - 2022	-	-	1,206,234	1,206,234
2023 - 2026	-	-	964,981	964,981
Total	<u>\$ 1,106,972</u>	<u>\$ 5,086,506</u>	<u>\$ 4,583,519</u>	<u>\$ 10,776,997</u>

There is a possibility of refunds or subsidy payments to the City due to past fuel overcharges. However, since the amounts are unknown at this time, there are no provisions made in the financial statements.

Capital Purchase Commitments

On December 28, 2004, the City signed an agreement with Lake Street Petoskey Associates, LLC (the "Developer") for the purchase of a lower-level parking deck (the "Project") for \$6,252,042. The City will receive a \$970,000 credit against the purchase price for the transfer of City property on the Project site to the Developer. The purchase price is due within 45 days of the Project's completion, which is required to be prior to July 30, 2008. Financing for the Project is to be provided via a Downtown Development Authority Tax-Increment Financing Plan that the City Council approved on December 27, 2004. The plan permits financing of up to \$10.6 million of bonded indebtedness through 2036.

The probability of the developer meeting the completion deadline in the agreement is remote. The City Council is deliberating whether or not to provide an extension of the completion date.

Revenue Bond Contingencies

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 Fund would be insufficient to meet its debt service requirements.

Grant Programs

The City participates in State and Federally assisted grant programs. The programs are subject to economy and efficiency and program result audits by the grantors or their representatives. The audits of the programs for, or including, the year ended December 31, 2007 have not yet been conducted. Accordingly, the City's compliance with applicable grant requirements will be established at some future date.

Legal Matters

There are lawsuits pending in which the City is involved. The City estimates that the potential claims against the City not covered by insurance resulting from such litigation would not materially affect the financial position of the City.

NOTE O - RISK MANAGEMENT

The City is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets; errors and omissions; injuries to employees and natural disasters. For most property and liability risks, the City belongs to the Michigan Municipal League Liability and Property Pool. For employee injury, the City belongs to the Michigan Municipal League Workers' Compensation Fund. The City purchases commercial health care insurance from Blue Cross/Blue Shield of Michigan for all eligible and participating employees and retirees, and has no risk in excess of policy coverage.

The Michigan Municipal League operates its public entity risk pool and group self insurance program as common risk management and insurance programs for various municipalities throughout the State. The City pays an annual premium for its general insurance and workers' compensation coverage. The liability and property 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.

REQUIRED SUPPLEMENTARY INFORMATION

City of Petoskey

BUDGETARY COMPARISON SCHEDULE FOR THE GENERAL FUND

Year ended December 31, 2007

	Budgeted Amounts		Actual (GAAP Basis)	Variances - Positive (Negative)	
	Original	Final		Original to Final	Final to Actual Total
REVENUES					
Taxes	\$ 3,976,000	\$ 3,896,000	\$ 3,627,715	\$ (80,000)	\$ (268,285)
Licenses and permits	7,000	7,000	8,019	-	1,019
State grants	667,700	667,700	560,471	-	(107,229)
Contributions from local units	91,700	91,700	50,122	-	(41,578)
Charges for services	747,500	747,500	870,882	-	123,382
Fines and forfeitures	86,200	86,200	39,813	-	(46,387)
Interest and investment earnings	115,000	115,000	338,069	-	223,069
Other	500	500	79,327	-	78,827
	<u>5,691,600</u>	<u>5,611,600</u>	<u>5,574,418</u>	<u>(80,000)</u>	<u>(37,182)</u>
Total revenues					
EXPENDITURES					
Current					
Legislative	25,700	25,700	8,327	-	17,373
General government	1,450,600	1,450,600	1,393,808	-	56,792
Public safety	2,484,500	2,484,500	2,821,121	-	(336,621)
Public works	673,000	673,000	655,848	-	17,152
Health and welfare	15,200	15,200	19,904	-	(4,704)
Recreation and cultural	1,840,500	1,840,500	1,584,296	-	256,204
Capital outlay	755,700	755,700	288,583	-	467,117
	<u>7,245,200</u>	<u>7,245,200</u>	<u>6,771,887</u>	<u>-</u>	<u>473,313</u>
Total expenditures					
REVENUES (UNDER) OVER EXPENDITURES	<u>(1,553,600)</u>	<u>(1,633,600)</u>	<u>(1,197,469)</u>	<u>(80,000)</u>	<u>436,131</u>
OTHER FINANCING SOURCES (USES)					
Operating transfers in	1,791,400	1,791,400	1,744,400	-	(47,000)
Operating transfers out	(625,000)	(625,000)	(738,700)	-	(113,700)
Transfers from component units	-	-	9,700	-	9,700
	<u>1,166,400</u>	<u>1,166,400</u>	<u>1,015,400</u>	<u>-</u>	<u>(151,000)</u>
Total other financing sources (uses)					
NET CHANGE IN FUND BALANCES	(387,200)	(467,200)	(182,069)	(80,000)	285,131
Fund balance, beginning of year	<u>3,107,300</u>	<u>3,107,300</u>	<u>3,327,972</u>	<u>-</u>	<u>220,672</u>
Fund balance, end of year	<u>\$ 2,720,100</u>	<u>\$ 2,640,100</u>	<u>\$ 3,145,903</u>	<u>\$ (80,000)</u>	<u>\$ 505,803</u>

City of Petoskey

BUDGETARY COMPARISON SCHEDULE FOR THE MAJOR STREET FUND

Year ended December 31, 2007

	Budgeted Amounts		Actual (GAAP Basis)	Variances - Positive (Negative)	
	Original	Final		Original to Final	Final to Actual Total
REVENUES					
State grants	\$ 429,300	\$ 429,300	\$ 534,726	\$ -	\$ 105,426
Interest and other	27,000	27,000	16,612	-	(10,388)
Total revenues	<u>456,300</u>	<u>456,300</u>	<u>551,338</u>	<u>-</u>	<u>95,038</u>
EXPENDITURES					
Current					
Routine maintenance	121,500	121,500	158,938	-	(37,438)
Winter maintenance	264,900	264,900	346,112	-	(81,212)
Traffic services	37,200	37,200	28,046	-	9,154
Administration	335,400	420,400	410,596	(85,000)	9,804
Capital outlay	<u>140,000</u>	<u>180,000</u>	<u>157,122</u>	<u>(40,000)</u>	<u>22,878</u>
Total expenditures	<u>899,000</u>	<u>1,024,000</u>	<u>1,100,814</u>	<u>(125,000)</u>	<u>(76,814)</u>
REVENUES (UNDER) OVER EXPENDITURES	(442,700)	(567,700)	(549,476)	(125,000)	18,224
OTHER FINANCING SOURCES					
Operating transfers in	<u>665,000</u>	<u>665,000</u>	<u>665,000</u>	<u>-</u>	<u>-</u>
NET CHANGE IN FUND BALANCES	222,300	97,300	115,524	(125,000)	18,224
Fund balance, beginning of year	<u>285,600</u>	<u>285,600</u>	<u>391,214</u>	<u>-</u>	<u>105,614</u>
Fund balance, end of year	<u><u>\$ 507,900</u></u>	<u><u>\$ 382,900</u></u>	<u><u>\$ 506,738</u></u>	<u><u>\$ (125,000)</u></u>	<u><u>\$ 123,838</u></u>

City of Petoskey

BUDGETARY COMPARISON SCHEDULE FOR THE LOCAL STREET FUND

Year ended December 31, 2007

	Budgeted Amounts		Actual (GAAP Basis)	Variances - Positive (Negative)	
	Original	Final		Original to Final	Final to Actual Total
REVENUES					
State grants	\$ 145,000	\$ 145,000	\$ 152,254	\$ -	\$ 7,254
Interest	15,000	15,000	38,374	-	23,374
Other	-	-	483	-	483
	<u>160,000</u>	<u>160,000</u>	<u>191,111</u>	<u>-</u>	<u>31,111</u>
EXPENDITURES					
Routine maintenance	83,000	83,000	75,606	-	7,394
Winter maintenance	136,100	136,100	149,647	-	(13,547)
Traffic services	13,900	13,900	8,471	-	5,429
Administration	313,600	313,600	354,996	-	(41,396)
Capital outlay	1,060,000	1,060,000	642,639	-	417,361
	<u>1,606,600</u>	<u>1,606,600</u>	<u>1,231,359</u>	<u>-</u>	<u>375,241</u>
REVENUES OVER EXPENDITURES	(1,446,600)	(1,446,600)	(1,040,248)	-	406,352
OTHER FINANCING SOURCES					
Operating transfers in	<u>1,360,000</u>	<u>1,360,000</u>	<u>1,160,000</u>	<u>-</u>	<u>(200,000)</u>
NET CHANGE IN FUND BALANCES	(86,600)	(86,600)	119,752	-	206,352
Fund balance, beginning of year	<u>430,200</u>	<u>430,200</u>	<u>473,304</u>	<u>-</u>	<u>43,104</u>
Fund balance, end of year	<u>\$ 343,600</u>	<u>\$ 343,600</u>	<u>\$ 593,056</u>	<u>\$ -</u>	<u>\$ 249,456</u>

City of Petoskey

BUDGETARY COMPARISON SCHEDULE FOR THE RIGHT-OF-WAY IMPROVEMENT FUND

Year ended December 31, 2007

	Budgeted Amounts		Actual (GAAP Basis)	Variances - Positive (Negative)	
	Original	Final		Original to Final	Final to Actual Total
	REVENUES				
Property taxes	\$ 1,924,000	\$ 1,883,209	\$ 1,752,991	\$ (40,791)	\$ (130,218)
Interest	<u>19,000</u>	<u>10,000</u>	<u>23,956</u>	<u>(9,000)</u>	<u>13,956</u>
Total revenue	1,943,000	1,893,209	1,776,947	(49,791)	(116,262)
EXPENDITURES					
Contracted services	<u>2,000</u>	<u>2,000</u>	<u>1,442</u>	<u>-</u>	<u>558</u>
REVENUES OVER EXPENDITURES	1,941,000	1,891,209	1,775,505	(49,791)	(115,704)
OTHER FINANCING SOURCES					
Operating transfers out	<u>(2,575,000)</u>	<u>(2,575,000)</u>	<u>(2,375,000)</u>	<u>-</u>	<u>200,000</u>
NET CHANGE IN FUND BALANCES	(634,000)	(683,791)	(599,495)	(49,791)	84,296
Fund balance, beginning of year	<u>917,100</u>	<u>917,100</u>	<u>887,072</u>	<u>-</u>	<u>(30,028)</u>
Fund balance, end of year	<u>\$ 283,100</u>	<u>\$ 233,309</u>	<u>\$ 287,577</u>	<u>\$ (49,791)</u>	<u>\$ 54,268</u>

City of Petoskey

DEFINED BENEFIT PENSION PLAN TREND INFORMATION

For the year ended December 31, 2007

Schedule of Funding Progress (\$000)

DEFINED BENEFIT PENSION PLAN TREND INFORMATION	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
12/31/2003	12,032	15,316	3,284	79 %	3,219	102 %
12/31/2004	12,659	15,717	3,058	81 %	3,069	100 %
12/31/2005	13,219	16,754	3,535	79 %	3,536	100 %
12/31/2006	13,877	17,043	3,166	81 %	3,012	105 %
12/31/2007	*	*	*	*	*	*

* Information not currently available.

Schedule of Employer Contributions

Fiscal Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed
12/31/03	\$ 401,128	100 %
12/31/04	454,518	100 %
12/31/05	521,868	103 %
12/31/06	524,086	102 %
12/31/07	584,906	216 %

COMBINING FINANCIAL STATEMENTS

City of Petoskey

COMBINING STATEMENT OF NET ASSETS - NONMAJOR COMPONENT UNITS

December 31, 2007

	TIFA	Downtown Management/ Parking	Total
ASSETS			
Current assets			
Cash	\$ 490,926	\$ 389,855	\$ 880,781
Investments	100,000	-	100,000
Total current assets	590,926	389,855	980,781
Noncurrent assets			
Capital assets	461,017	-	461,017
Less accumulated depreciation	(77,171)	-	(77,171)
Total noncurrent assets	383,846	-	383,846
Total assets	\$ 974,772	\$ 389,855	\$ 1,364,627
LIABILITIES AND FUND BALANCES			
LIABILITIES			
Accounts payable	\$ 6,099	\$ 2,568	\$ 8,667
NET ASSETS			
Invested in capital assets, net of related debt	383,846	-	383,846
Restricted			
TIFA expenses	584,827	-	584,827
Unrestricted	-	387,287	387,287
Total net assets	968,673	387,287	1,355,960
Total liabilities and net assets	\$ 974,772	\$ 389,855	\$ 1,364,627

City of Petoskey

COMBINING STATEMENT OF ACTIVITIES - NONMAJOR COMPONENT UNITS

Year ended December 31, 2007

Functions/Program	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
		Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	TIFA	Downtown Management/ Parking	Total
Component units							
TIFA	\$ 156,504	\$ -	\$ -	\$ -	\$ (156,504)	\$ -	\$ (156,504)
Downtown Management/Parking	<u>200,693</u>	<u>413,032</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>212,339</u>	<u>212,339</u>
Total component units	<u>\$ 357,197</u>	<u>\$ 413,032</u>	<u>\$ -</u>	<u>\$ -</u>	<u>(156,504)</u>	<u>212,339</u>	<u>55,835</u>
General revenues							
Property taxes					262,717	-	262,717
Interest and investment earnings					30,750	14,835	45,585
Transfers					<u>-</u>	<u>(89,700)</u>	<u>(89,700)</u>
Total general revenues and transfers					<u>293,467</u>	<u>(74,865)</u>	<u>218,602</u>
Change in net assets					136,963	137,474	274,437
Net assets, beginning of year					<u>831,710</u>	<u>249,813</u>	<u>1,081,523</u>
Net assets, end of year					<u>\$ 968,673</u>	<u>\$ 387,287</u>	<u>\$1,355,960</u>

City of Petoskey

COMBINING BALANCE SHEET - NONMAJOR GOVERNMENTAL FUNDS

December 31, 2007

	Special Revenue Funds			Debt Service Funds			
	General Street	Downtown Management	Total Special Revenue	Building Authority Downtown Improvement Bonds Debt	Building Authority Refunding Bonds Debt	Total Debt Service	
ASSETS							
Current assets							
Cash	\$ 185,873	\$ 97,397	\$ 283,270	\$ 24,834	\$ 60,710	\$ 85,544	\$ 368,814
Receivables							
Special assessments	-	29,329	29,329	-	-	-	29,329
Accounts	13,229	-	13,229	-	-	-	13,229
Due from other funds	-	4,194	4,194	-	-	-	4,194
Inventory, at cost	89,727	-	89,727	-	-	-	89,727
Total assets	<u>\$ 288,829</u>	<u>\$ 130,920</u>	<u>\$ 419,749</u>	<u>\$ 24,834</u>	<u>\$ 60,710</u>	<u>\$ 85,544</u>	<u>\$ 505,293</u>
LIABILITIES AND FUND BALANCES							
LIABILITIES							
Accounts payable	\$ 84,544	\$ 2,965	\$ 87,509	\$ -	\$ -	\$ -	\$ 87,509
Accrued expenditures	268	-	268	-	-	-	268
Total liabilities	<u>84,812</u>	<u>2,965</u>	<u>87,777</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>87,777</u>
FUND BALANCES							
Reserved							
Inventory	89,727	-	89,727	-	-	-	89,727
Debt service	-	-	-	24,834	60,710	85,544	85,544
Unreserved	<u>114,290</u>	<u>127,955</u>	<u>242,245</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>242,245</u>
Total fund balances	<u>204,017</u>	<u>127,955</u>	<u>331,972</u>	<u>24,834</u>	<u>60,710</u>	<u>85,544</u>	<u>417,516</u>
Total liabilities and fund balances	<u>\$ 288,829</u>	<u>\$ 130,920</u>	<u>\$ 419,749</u>	<u>\$ 24,834</u>	<u>\$ 60,710</u>	<u>\$ 85,544</u>	<u>\$ 505,293</u>

City of Petoskey

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE - NONMAJOR GOVERNMENTAL FUNDS

Year ended December 31, 2007

	Special Revenue Funds			Debt Service Funds			Total Other Non-Major Funds
	General Street	Downtown Management	Total	Building Authority Downtown Improvement Bonds Debt	Building Authority Refunding Bonds Debt	Total	
REVENUES							
Special assessments	\$ -	\$ 57,204	\$ 57,204	\$ -	\$ -	\$ -	\$ 57,204
Interest	13,219	4,599	17,818	1,179	6,033	7,212	25,030
Other	<u>8,520</u>	<u>4,151</u>	<u>12,671</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>12,671</u>
Total revenues	<u>21,739</u>	<u>65,954</u>	<u>87,693</u>	<u>1,179</u>	<u>6,033</u>	<u>7,212</u>	<u>94,905</u>
EXPENDITURES							
Current							
Public works	395,720	53,220	448,940	-	-	-	448,940
Capital outlay	265,098	-	265,098	-	-	-	265,098
Principal	-	-	-	50,000	100,000	150,000	150,000
Interest	<u>-</u>	<u>-</u>	<u>-</u>	<u>24,422</u>	<u>13,777</u>	<u>38,199</u>	<u>38,199</u>
Total expenditures	<u>660,818</u>	<u>53,220</u>	<u>714,038</u>	<u>74,422</u>	<u>113,777</u>	<u>188,199</u>	<u>902,237</u>
REVENUES (UNDER) OVER EXPENDITURES	<u>(639,079)</u>	<u>12,734</u>	<u>(626,345)</u>	<u>(73,243)</u>	<u>(107,744)</u>	<u>(180,987)</u>	<u>(807,332)</u>
OTHER FINANCING SOURCES							
Operating transfers in	550,000	-	550,000	-	113,700	113,700	663,700
Transfers from component units	<u>-</u>	<u>-</u>	<u>-</u>	<u>80,000</u>	<u>-</u>	<u>80,000</u>	<u>80,000</u>
Total other financing sources	<u>550,000</u>	<u>-</u>	<u>550,000</u>	<u>80,000</u>	<u>113,700</u>	<u>193,700</u>	<u>743,700</u>
NET CHANGE IN FUND BALANCE	(89,079)	12,734	(76,345)	6,757	5,956	12,713	(63,632)
Fund balance, beginning of year	<u>293,096</u>	<u>115,221</u>	<u>408,317</u>	<u>18,077</u>	<u>54,754</u>	<u>72,831</u>	<u>481,148</u>
Fund balance, end of year	<u><u>\$ 204,017</u></u>	<u><u>\$ 127,955</u></u>	<u><u>\$ 331,972</u></u>	<u><u>\$ 24,834</u></u>	<u><u>\$ 60,710</u></u>	<u><u>\$ 85,544</u></u>	<u><u>\$ 417,516</u></u>

City of Petoskey

COMBINING BALANCE SHEET - INTERNAL SERVICE FUNDS

December 31, 2007

	<u>Motor Vehicle and Equipment</u>	<u>Employee Fringe Benefit</u>	<u>Totals</u>
ASSETS			
Current assets			
Cash	\$ 474,949	\$ 390	\$ 475,339
Inventory	<u>32,040</u>	<u>-</u>	<u>32,040</u>
Total current assets	<u>506,989</u>	<u>390</u>	<u>507,379</u>
Noncurrent assets			
Capital assets	5,307,367	-	5,307,367
Less accumulated depreciation	<u>(3,002,482)</u>	<u>-</u>	<u>(3,002,482)</u>
Total noncurrent assets	<u>2,304,885</u>	<u>-</u>	<u>2,304,885</u>
Total assets	<u><u>\$ 2,811,874</u></u>	<u><u>\$ 390</u></u>	<u><u>\$ 2,812,264</u></u>
LIABILITIES AND NET ASSETS			
CURRENT LIABILITIES			
Accounts payable	\$ 19,366	\$ 390	\$ 19,756
Accrued wages	<u>1,158</u>	<u>-</u>	<u>1,158</u>
Total liabilities	<u>20,524</u>	<u>390</u>	<u>20,914</u>
NET ASSETS			
Invested in capital assets, net of related debt	2,304,885	-	2,304,885
Unrestricted	<u>486,465</u>	<u>-</u>	<u>486,465</u>
Total net assets	<u>2,791,350</u>	<u>-</u>	<u>2,791,350</u>
Total liabilities and net assets	<u><u>\$ 2,811,874</u></u>	<u><u>\$ 390</u></u>	<u><u>\$ 2,812,264</u></u>

City of Petoskey

COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS - INTERNAL SERVICE FUNDS

Year ended December 31, 2007

	Motor Vehicle and Equipment	Employee Fringe Benefit	Totals
Operating revenues			
Charges for services	\$ 959,767	\$ -	\$ 959,767
Operating expenses			
Personal services	47,954	-	47,954
Contractual services	354,882	626,499	981,381
Supplies	175,465	-	175,465
Depreciation	285,476	-	285,476
Total operating expenses	863,777	626,499	1,490,276
OPERATING INCOME	95,990	(626,499)	(530,509)
Nonoperating revenues (expenses)			
Interest	28,747	24,443	53,190
Miscellaneous	27,535	-	27,535
Total nonoperating revenues (expenses)	56,282	24,443	80,725
INCOME (LOSS) BEFORE TRANSFERS	152,272	(602,056)	(449,784)
Transfers in	625,000	-	625,000
Transfers out	(105,200)	-	(105,200)
CHANGE IN NET ASSETS	672,072	(602,056)	70,016
Net assets, beginning of year			
As previously reported	2,119,278	602,056	2,721,334
Net assets, end of year	\$ 2,791,350	\$ -	\$ 2,791,350

**City of Petoskey
Building Authority**

COMBINING COMPONENT UNIT BALANCE SHEET/STATEMENT OF NET ASSETS

December 31, 2007

	Debt Service Funds			Reconciliation of Fund Balance Sheets to the Statement of Net Assets			
	Downtown Improvement Bonds	Refunding Bonds	Library Improvement Bonds	Governmental Financing Leases	Governmental Bonds Payable	Accrued Interest	Statement of Net Assets
ASSETS							
Current assets							
Cash	\$ 24,834	\$ 60,710	\$ -	\$ -	\$ -	\$ -	\$ 85,544
Interest receivable	-	-	-	47,387	-	-	47,387
Lease contract receivable within one year	-	-	-	250,000	-	-	250,000
Total current assets	<u>24,834</u>	<u>60,710</u>	<u>-</u>	<u>297,387</u>	<u>-</u>	<u>-</u>	<u>382,931</u>
Non-current assets							
Deferred charges - bond issue costs	-	-	-	-	33,315	-	33,315
Lease contract receivable	-	-	-	4,405,774	-	-	4,405,774
Total assets	<u>\$ 24,834</u>	<u>\$ 60,710</u>	<u>\$ -</u>	<u>\$ 4,703,161</u>	<u>\$ 33,315</u>	<u>\$ -</u>	<u>\$ 4,822,020</u>
LIABILITIES AND FUND BALANCES/NET ASSETS							
LIABILITIES							
Current liabilities							
Accrued interest	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 47,387	\$ 47,387
Bonds payable due within one year	-	-	-	-	250,000	-	250,000
Total current liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>250,000</u>	<u>47,387</u>	<u>297,387</u>
Non-current liabilities							
Bonds payable, net	-	-	-	-	4,405,774	-	4,405,774
Total liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,655,774</u>	<u>47,387</u>	<u>4,703,161</u>
FUND BALANCE/NET ASSETS							
Reserved/restricted for debt service	<u>24,834</u>	<u>60,710</u>	<u>-</u>	<u>4,703,161</u>	<u>(4,622,459)</u>	<u>(47,387)</u>	<u>118,859</u>
Total liabilities and fund balance/net assets	<u>\$ 24,834</u>	<u>\$ 60,710</u>	<u>\$ -</u>	<u>\$ 4,703,161</u>	<u>\$ 33,315</u>	<u>\$ -</u>	<u>\$ 4,822,020</u>

**City of Petoskey
Building Authority**

COMBINING COMPONENT UNIT STATEMENT OF REVENUES AND EXPENDITURES/STATEMENT OF ACTIVITIES

December 31, 2007

	Debt Service Funds			Reconciliation of Fund Statements of Revenues and Expenditures to the Statement of Activities			Statement of Activities
	Downtown Improvement Bonds	Refunding Bonds	Library Improvement Bonds	Governmental Financing Lease	Debt Service	Interest Expense	
Program revenues							
Lease income	\$ 80,000	\$ 113,700	\$ 261,375	\$ (258,182)	\$ -	\$ -	\$ 196,893
Expenditures/expenses							
Debt service	50,000	100,000	100,000	-	(250,000)	-	-
Interest and fees	24,422	13,777	161,375	-	-	(2,681)	196,893
Total expenditures/expenses	74,422	113,777	261,375	-	(250,000)	(2,681)	196,893
Net revenue	5,578	(77)	-	(258,182)	250,000	2,681	-
General revenues							
Interest and investment earnings	1,179	6,033	-	-	-	-	7,212
Revenues over (under) expenditures/ change in net assets	6,757	5,956	-	(258,182)	250,000	2,681	7,212
Fund balance/net assets - beginning of year	18,077	54,754	-	4,961,343	(4,872,459)	(50,068)	111,647
Fund balance/net assets - end of year	\$ 24,834	\$ 60,710	\$ -	\$ 4,703,161	\$ (4,622,459)	\$ (47,387)	\$ 118,859

AUDIT-RELATED COMMUNICATION

Honorable Mayor, Members of City
Council and City Manager
City of Petoskey

We have audited the financial statements of the *City of Petoskey* (the "City") for the year ended December 31, 2007 and have issued our report thereon dated May 6, 2008. Professional standards require that we provide you with the following information related to our audit. In addition, we are offering our comments and recommendations on ways in which you may improve internal control, efficiency or financial management.

Our Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated December 10, 2007, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles ("GAAP"). Our audit of the financial statements does not relieve you or management of your responsibilities.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter dated December 10, 2007.

Internal Control

In planning and performing our audit, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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

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

We consider the following deficiencies to be significant deficiencies in internal control.

Reporting Financial Data

The above definition of a significant deficiency includes any condition that adversely affects the City's ability to report financial data in accordance with GAAP. As a matter of convenience, the City has always relied upon its auditors to prepare financial statements and related notes and supplemental schedules for external reporting in accordance with GAAP. Further, the audit process is used as a means of accumulating data, performing reconciliations and making numerous year-end adjustments. As a consequence, the City has not developed the tools and resources necessary to enable its employees to prepare reports in conformity with GAAP in the normal course of performing their assigned functions. The City has committed the resources necessary to meet its internal reporting needs. In this regard, the City is not unlike many other governments of its size and nature.

Segregation of Duties

The internal controls of the City should segregate accounting responsibilities related to authorization, execution, review/approval and reconciliation and also from physical access to assets. The limited size of the City's staff creates some inherent challenges to providing a thorough segregation of duties. To help improve controls through additional segregation of duties, we make the following recommendations:

1. Receipts should be first received by an individual not otherwise involved in the billing and collection of receivables. This individual should prepare a control list of receipts to later be reconciled to accounts receivable records.
2. Once checks have been signed, they should not be returned to the person responsible for accounts payable for mailing.
3. Evidence of approval of each payroll should be documented on the payroll register.

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 the City are described in Note A to the financial statements. Except as described below, no new significant 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 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, except as discussed below.

Capital Outlays

The City's general policy is to capitalize in the statement of financial position all assets with a value of \$5,000 or more. However, the capital outlay expenditure accounts in the governmental funds use a lower threshold. There is nothing technically incorrect with this inconsistency, but it has caused some difficulty in identifying items to be capitalized. We recommend that you segregate capital outlays that will be capitalized in the statement of financial position from other expenditures that will not be capitalized. You may also wish to consider increasing the extent to which fixed asset records are computerize, as a means of increasing efficiency in accumulating and maintaining data.

Internal Service Fund Closure

During 2007, the Employee Fringe Benefit Fund was closed by expending substantially all of its residual equity from 2006 with a supplemental contribution to the City's pension plan. This supplemental contribution was made for the purpose of improving the funded position of the plan relative to police and fire employee groups. In the governmental activities statement of net assets, the amount by which the total pension contribution exceeded the Required Annual Contribution has been reported as an asset.

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 estimate affecting the financial statements was depreciation of capital assets. This item is sensitive because of its significance to the financial statements and not because there is significant potential that future events may differ.

Management's estimate of depreciation is based on the estimated useful lives of capital assets. We evaluated the key factors and assumptions used to develop the estimated useful lives and the resulting depreciation amounts in determining that they are reasonable in relation to the financial statements taken as a whole.

Disclosures

The disclosures in the financial statements are neutral, consistent and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

Investment risk disclosures in Note C describe the various risks inherent in the City's investment portfolio. These risks include those associated with the make/custodian of the securities, the term of the security and other factors.

Pension disclosures in Note J describe the assumptions that are made to evaluate the plan's funded status and Annual Pension Cost. Because of the significance of pension disclosures to financial statement users, GAAP requires that certain supplemental information accompany the financial statements.

Commitment and contingency disclosures in Note N are particularly sensitive because they describe matters that are "off balance sheet" but which could have a significant effect on future activities.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The City has consistently not recorded an accrual of investment income, preferring to record interest as it is received. Also, a liability has been recorded in the General Fund for long-term leave liabilities. Management has determined that the effects of these misstatements are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Last year we noted an immaterial misstatement resulting from not adjusting investments to reflect their market value change during 2006. This was corrected in 2007 and we recommend that the City consistently report market value changes in the investment portfolio.

We processed numerous journal entries during the course of the audit, most of which were developed by City staff as part of the year-end adjusting process. We encourage you to develop and record these journal entries prior to audit fieldwork in the future. The following material misstatement detected as a result of audit procedures was corrected by management:

Unrecorded liability for purchased power to be paid for with 2008 withdrawals from the MPPA trust.

No 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.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated May 6, 2008.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City'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 discussed a variety of matters, including the application of accounting principles and auditing standards, with management prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

No Difficulties Encountered in Performing the Audit

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

Other Comments and Recommendations

Electric Fund Accounts Receivable

Included in accounts receivable owed to the Electric Fund are significant amounts of old penalties. You may wish to evaluate the collectibility of these penalties and establish an allowance for amounts that may not be collected.

Personnel Policies

As we noted last year, personnel policies for non-union employees appear to be out-of-date. We recommend that the City Manager review these policies and consider whether updating is necessary.

Prior Comments

Last year we recommended that the General Fund budget be adopted at the functional level. This recommendation was adopted with the budget amendment in 2007.

Last year we recommended that the Right of Way Fund be changed to a special revenue fund and that a more transparent method be used to track the disposition of transfers made out of the fund. Management considered our recommendation and concluded that the fund's classification as a capital project fund and methods used to track expenditures are adequate in the circumstances.

Last year we recommended that City officials execute conflict of interest statements as a means of communicating areas in which they may have a conflict and commit to disclose conflicts that arise in the future. We have been asked by City management to assist in developing such a document.

This communication is intended solely for the information and use of management, City Council, others within the City and the Michigan Department of Treasury and is not intended to be and should not be used by anyone other than these specified parties.

Dennis, Gartland & Niergarth

May 6, 2008