Michigan Department of Treasury
496 (02/06)

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	Local Unit Name	County
☐County ☐City ☐Twp ☐Village ☒Other	Ionia Area Sewage Disposal System	Ionia

Fiscal Year End	Opinion Date	Date Audit Report Submitted to State
June 30, 2006	September 21, 2006	November 10, 2006

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	☒	
The letter of Comments and Recommendations	☒	
Other (Describe)	☒	N/A

Certified Public Accountant (Firm Name)	Telephone Number		
Abraham & Gaffney, P.C.	(517)351-6836		
Street Address	**City**	**State**	**Zip**
3511 Coolidge Road, Suite 100	East Lansing	MI	48820

Authorizing CPA Signature	Printed Name	License Number
Aaron M. Stevens	Aaron M. Stevens, CPA	1101024055

Ionia Area Sewage Disposal System
Ionia, Michigan

FINANCIAL STATEMENTS

June 30, 2006

Ionia Area Sewage Disposal System

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INDEPENDENT AUDITOR'S REPORT

Ionia Area Sewage Disposal System
Ionia, Michigan

We have audited the accompanying basic financial statements of the Ionia Area Sewage Disposal System as of and for the year ended June 30, 2006 and 2005, as listed in the table of contents. These basic financial statements are the responsibility of the Ionia Area Sewage Disposal System's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

We conducted our audits 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 audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Ionia Area Sewage Disposal System as of June 30, 2006 and 2005, and the results of its operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, as identified in the table of contents, is not a required part of the basic financial statements but is supplementary information required by the accounting principals generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Ionia Area Sewage Disposal System's basic financial statements. The other supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

Abraham & Gaffney, P.C.

ABRAHAM & GAFFNEY, P.C.
Certified Public Accountants

September 21, 2006

IONIA AREA SEWAGE DISPOSAL SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS

The intent of the management discussion and analysis is to provide highlights of the Agency's financial activities for the Fiscal Year ended June 30, 2006. Readers are encouraged to read this section in conjunction with the transmittal letter and the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

- Net Assets: The assets of the Sewage Disposal System (SDS) exceeded its liabilities by $8.1 million. Of this amount, $740,466 (unrestricted net assets) may be used to meet the SDS's ongoing obligations to citizens and creditors. The total net assets increased by $134,261. Total assets were slightly less than one year ago. Capital projects were started and recorded as Construction in Progress which used up some cash. However, unfunded depreciation reduced the Capital Assets, which resulted in a decrease of total assets by $166,276. Principal was paid on existing debt so the decrease in liabilities was a net of $300,537.

- Operating Revenues and Expenses: Revenues were higher for the fiscal year ending June 30, 2006. Expenses for Administrative costs include bond issue costs from the June 7, 2005 bond issue. Fringes and Salaries were higher than last year as a result of staffing levels primarily due to one employee previously being on military leave and returning to full employment and another employee receiving a step increase for length of service.

- Non-Operating Revenues and Expenses: Investment income was $3,357 more than a year ago from the long term investment earnings. The SDS paid for half of the debt payment on the special assessment bond in the Skyview subdivision that had reverted back to the City. When the improved lots were taken back by the City, the subsequent sale to a developer was made with the knowledge that the City and SDS would be responsible for the future bond payments on the improvements which included a lift station to handle future projected flows. In addition, the SDS received land from the transfer on which the lift station and other future improvements can be located. The restriction of these properties and control of the improvements allows for potential future growth without the need to acquire such assets. This bond will be retired October 2010.

- Deferred Revenue: In November 2001, Easton Township decided to have the City bill their sewer customers for actual usage instead of the township billing them a flat fee. At this point, the township also chose to pay off their portion of existing debt based on their previous percentage of ownership. The township paid $203,270, which was determined to be their percentage of total debt on Oct 22, 2002. This amount was set up as restricted cash and deferred revenue. It is shown as earned revenue as each semi-annual payment is made on existing debt. Interest earned on this restricted cash is kept separate and will be recognized as the payments are recorded.

OVERVIEW OF THE FINANCIAL STATEMENTS

The annual report includes this management's discussion and analysis report, the independent auditor's report and the basic financial statement of the Sewage Disposal System, which include notes that explain in more detail some of the information in the financial statements.

As a municipal wastewater treatment plant, the Ionia Area Sewage Disposal System engages in primarily enterprise operations in various separate and distinct activities. These activities include but are not limited to: 1) acquisition and construction of collection and plant facilities and treatment of domestic and industrial wastewater; 2) maintenance of sanitary sewers and storm sewers; 3) lift station operation and maintenance. The SDS was created by the City of Ionia, and Ionia, Berlin and Easton Townships to provide for the collection, treatment and disposal of sewage for the benefit of their constituents. The service area includes all of the City of Ionia and the more intensely developed areas of the townships adjacent to the City.

REQUIRED FINANCIAL STATEMENTS

The financial statements report information of the Sewage Disposal System (SDS) using accounting methods similar to those used by private sector companies. These statements offer short and long-term financial information about its activities. The Statement of Net Assets includes all of the SDS's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to SDS creditors (liabilities). It also provides the basis for evaluating the capital structure of the SDS and assessing the liquidity and financial flexibility of the SDS.

All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement measures the success of the SDS's operations over the past year and can be used to determine whether the SDS has successfully recovered all of its costs through its user fees and other charges, profitability and credit worthiness.

The final required financial statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments and net changes in cash resulting from operations, investing, and financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

FINANCIAL ANALYSIS OF THE SDS

The Statement of Net Assets and the Statement of Activities provide information to determine how the SDS did financially during FY 05-06. The net assets, or the difference between assets and liabilities, and the changes in them can indicate whether financial health is improving or deteriorating overtime. However, other non-financial factors such as changes in economic conditions, population growth, and new or changed government legislation also need to be considered in determining the SDS financial health.

NET ASSETS

The SDS's Condensed Statement of Net Assets and Statement of Revenue, Expenses and Changes in Fund Net Assets are presented in the following Tables. A comparative analysis of data is presented from the fiscal year of 2004-2005.

TABLE 1
CONDENSED STATEMENT OF NET ASSETS

	As of 6/30/2005	As of 6/30/2006
Current and Other Assets	$ 1,714,821	$ 1,464,758
Capital Assets	10,580,632	10,664,419
Total Assets	12,295,453	12,129,177
Current Liabilities	693,599	638,031
Noncurrent Liabilities	3,613,591	3,368,622
Total Liabilities	4,307,190	4,006,653
Invested in Capital Assets Net of Related debt	7,020,526	6,952,919
Restricted	638,489	429,139
Unrestricted	329,248	740,466
Total Net Assets	$ 7,988,263	$ 8,122,524

TABLE 2
CONDENSED STATEMENT OF REVENUE, EXPENSES,
AND CHANGES IN NET ASSETS

	FY 04-05	FY 05-06
Operating Revenues	$ 1,005,956	$ 1,088,560
Non-operating Revenues	574,201	575,651
Total Revenues	1,580,157	1,664,211
Depreciation Expense	331,062	340,906
Other Operating Expense	938,710	1,012,289
Non-operating Expense	210,163	176,755
Total Expenses	1,479,935	1,529,950
Changes in Net Assets	100,222	134,261
Beginning Net Assets	7,888,041	7,988,263
Ending Net Assets	$ 7,988,263	$ 8,122,524

While the Statement of Net Assets shows the change in financial position of net assets, the Statement of Revenues, Expenses and Changes in Net Assets shows how total revenues and expenses increased the net assets. Operating revenues of $1,088,560, less operating expenses of $1,012,289 show that the day to day operations of the treatment plant are being met by user fees. The Depreciation expense of $340,906 is a non-cash expense, which represents the reduction in the value of the facility and system.

The rate charged to municipal users is computed by taking actual operating costs and adding an $85,000 annual replacement reserve to get a total cost that is divided by the actual usage billed to each municipality. The Annual Replacement reserve is used to pay for capital improvements such as computer upgrades, plant improvements and equipment. Participating municipalities are also billed separately for the actual debt payment due during the fiscal year. This is again computed based on usage by the municipalities.

BUDGETARY HIGHLIGHTS

The Sewage Disposal System is an enterprise fund. The City of Ionia is not required to adopt an annual budget. However, the City Council does adopt an annual Operating Budget and a five-year Capital Plan following a public hearing. This budget is also presented to the Ionia County Board of Public Works, after the Council's approval. The Operating Budget includes proposed expenses and the means of financing them. The SDS's operating budget remains in effect but can be revised with City Council approval prior to the fiscal year end.

The capital plan and annual capital expenditures are also included in the budget. The depreciation expense is recorded in the budget but is not covered by revenues. Therefore the budget is allowed to show a net loss for the year. A replacement reserve line item is budgeted to allow for capital improvements. This amount is added to the operating costs as explained in the previous section.

A FY 05-06 budget comparison and analysis is presented in TABLE 3.

TABLE 3
BUDGET vs. ACTUAL
FY 05-06

	BUDGETED ORIGINAL	BUDGETED FINAL	ACTUAL	Variance Favorable (Unfavorable)
OPERATING REVENUES				
Sales and charges for services	$ 1,177,507	$1,056,326	$1,060,959	$ 4,633
Other	10,393	27,616	27,601	(15)
TOTAL OPERATING REVENUES	1,187,900	1,083,942	1,088,560	4,618
OPERATING EXPENSES				
Salaries	288,035	297,888	297,882	6
Payroll taxes and fringe benefits	160,707	166,606	173,378	(6,772)
Central garage allocation	50	37	0	37
Insurance	61,619	62,303	62,302	1
Contractual and professional	103,703	73,633	87,631	(13,998)
Operating supplies	146,729	159,409	159,401	8
Administration	96,659	99,133	99,131	2
Telephone	6,896	5,224	5,213	11
Transportation and training	1,167	2,911	2,907	4
Public utilities	106,242	106,588	106,577	11
Depreciation	337,653	340,993	340,906	87
Gas and oil	4,692	6,827	6,818	9
Equipment rental	412	2,013	2,011	2
Miscellaneous	306	25	8	17
Repair & maintenance supplies	1,030	4,506	4,504	2
TOTAL OPERATING EXPENSES	1,315,900	1,332,626	1,353,195	(20,569)
OPERATING (LOSS)	(128,000)	(248,684)	(264,635)	(15,951)
NONOPERATING REVENUES (EXPENSES)				
Interest revenue	40,228	49,507	49,964	457
Contributions from local units	535,810	527,350	525,687	(1,663)
Capital outlay	(5,000)	(5,000)	0	5,000
Replacement reserve	(85,000)	(85,000)	0	85,000
Interest expense	(654,518)	(654,518)	(176,755)	477,763
Contributions to local unit	(708,400)	(367,742)	0	367,742
TOTAL NONOPERATING REVENUE (EXPENSE)	(876,880)	(385,403)	398,896	784,299
NET INCOME (LOSS)	$(1,004,880)	$(634,087)	$ 134,261	$ 809,486

The cost of the Treatment Plant is allocated to the participating municipalities. Operating costs were similar to last year and billable flow was slightly less than last year. Rates to the municipalities went from $1.44/1000 to $1.59/1000 gallons. The actual increase in revenues from the municipalities was not as much as budgeted, based on actual costs and billable flow. The Operating Supplies variances from amended budget are based on purchasing only when needed. The non-operating revenues and expenses variances are due to budget processes which are set up to show Balance Sheet activity, such as Bond indebtedness, payment of principal on debt, purchases of capital items and improvements to the system that are tracked through the Capital Projects fund. For example, the interest expense variance of $477,763 ties to the principal on the debt that was paid during the year. The budget shows both interest and principal. In order to reduce the balance of the long term debt the principal must be reclassified to the balance sheet.

CAPITAL ASSETS

At the end of FY 05-06, the SDS had invested $12,726 in equipment for the wastewater treatment plant operations. The amount added to the system during this fiscal year as construction in progress was $411,967. The SDS has a five year Asset Management Plan that includes continued improvements for controls, radios, lift station, and exterior work on the plant. Future projects that need to be bonded for and will be evaluated further include air conditioning installation and additional storage at the facility. The increase in structures, machinery & equipment, and furniture & fixtures is from additions to the system less recognizing plant asset disposals for obsolete equipment or depreciation.

TABLE 4
CAPITAL ASSETS

	FY 04-05	FY 05-06
Sewer Plant and Improvements	$ 15,835,162	$ 16,250,688
Machinery and Equipment	189,311	198,478
Sub-total	15,527,991	16,449,166
Less: Accumulated Depreciation	(5,443,841)	(5,784,747)
Net Property and Equipment	$ 10,580,632	$ 10,664,419

DEBT ADMINISTRATION

Since the SDS does not levy a millage it does not generate property tax revenue. The system charges each of the municipalities for the purpose of funding the debt service on bond issues from 1976 - 2002 based on billable flow within the participating municipalities. Revenue bond indebtedness outstanding at June 30, 2006 amounted to $3,711,500. More detailed information about the SDS's long-term liabilities is presented in note F to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The amount charged to the participating municipalities is adjusted each fiscal year based on actual costs and billable flows. When the billable flow volume is higher the cost per thousand gallons of sewage can be lower. Conversely, when the actual expenses for the year are higher the cost per thousand gallons can be higher.

When the bond for the 1990 addition to the treatment plant was issued, Orange Township was identified as a partner if they chose to utilize capacity. At that point they did not buy into the system and currently are not served by the SDS. However, recent discussions with Orange Township and the other municipalities have begun. Concerns regarding buying into the current system as well as identifying capacity, future loads, and use of existing lines are issues that need to be addressed before service can be extended to Orange Township. An engineering consultant has been retained by the County Board of Public Works on behalf of the municipal users and Orange Township to develop answers to these questions.

The City's biggest customer within the SDS is the State of Michigan. The State has committed to paying for 69.44% of the 1976 and 1990 bonds which allowed for improving the system to meet the demands of the prisons served by the SDS. This commitment has helped to keep the debt costs, which are passed on to the individual customers, at a minimum.

TABLE 5
RATES HISTORY

07/01/1999-06/30/2000	$ 1.088	per 1,000 gallons
07/01/2000-06/30/2001	1.134	"
07/01/2001-06/30/2002	1.262	"
07/01/2002-06/30/2003	1.333	"
07/01/2003-06/30/2004	1.406	"
07/01/2004-06/30/2005	1.440	"
07/01/2005-06/30/2006	1.590	"

CONTACT INFORMATION

This financial report is designed to provide citizens and creditors with a general overview of the SDS's finances and to demonstrate the SDS's accountability for the funds it receives. Questions regarding this report may be addressed to Robin Marhofer, Finance Director/Treasurer, City Hall, P.O. Box 496, Ionia, Michigan 48846 or by phone at (616) 527-4170 ext. 120 or by email at dirfinance@city.ionia.mi.us.

BASIC FINANCIAL STATEMENTS

Ionia Area Sewage Disposal System

STATEMENTS OF NET ASSETS

June 30, 2006 and 2005

	2006	2005
ASSETS		
Current assets		
Cash and cash equivalents	$ 276,561	$ 279,161
Accounts receivable	6,129	3,197
Due from other governmental units - local	747,304	788,699
Inventory	5,625	5,275
Total current assets	1,035,619	1,076,332
Noncurrent assets		
Cash - restricted	139,600	151,595
Deposit with county	289,539	486,894
Capital assets not being depreciated	566,960	496,482
Capital assets, net of accumulated depreciated	10,097,459	10,084,150
Total noncurrent assets	11,093,558	11,219,121
TOTAL ASSETS	12,129,177	12,295,453
LIABILITIES		
Current liabilities		
Accounts payable	35,223	31,777
Accrued liabilities	12,300	7,364
Due to other governmental units - local	37,867	-
Deferred revenue	139,600	151,595
Current portion of accrued sick and vacation pay	17,541	17,363
Current portion of long-term debt	395,500	485,500
Total current liabilities	638,031	693,599
Noncurrent liabilities		
Accrued sick and vacation pay	52,622	52,091
Noncurrent portion of long-term debt	3,316,000	3,561,500
Total noncurrent liabilities	3,368,622	3,613,591
TOTAL LIABILITIES	4,006,653	4,307,190
NET ASSETS		
Invested in capital, net of related debt	6,952,919	7,020,526
Restricted for debt service	139,600	151,595
Restricted for capital projects	289,539	486,894
Unrestricted	740,466	329,248
TOTAL NET ASSETS	$ 8,122,524	$ 7,988,263

See accompanying notes to financial statements.

Ionia Area Sewage Disposal System

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS

Years Ended June 30, 2006 and 2005

	2006	2005
OPERATING REVENUES		
Sales and charges for services	$ 1,060,959	$ 981,990
Other	27,601	23,966
TOTAL OPERATING REVENUES	1,088,560	1,005,956
OPERATING EXPENSES		
Administrative	388,594	371,072
Treatment plant	605,188	544,234
Lift station	18,507	23,404
Depreciation	340,906	331,062
TOTAL OPERATING EXPENSES	1,353,195	1,269,772
OPERATING LOSS	(264,635)	(263,816)
NONOPERATING REVENUES (EXPENSES)		
Interest revenue	49,964	46,607
Contributions from local units	525,687	527,594
Interest expense	(176,755)	(174,690)
Contributions to local unit	-	(35,473)
TOTAL NONOPERATING REVENUES	398,896	364,038
CHANGE IN NET ASSETS	134,261	100,222
Net assets, beginning of year	7,988,263	7,888,041
Net assets, end of year	$ 8,122,524	$ 7,988,263

See accompanying notes to financial statements.

Ionia Area Sewage Disposal System

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2006 and 2005

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	1,312,383	$1,038,582
Cash paid to supplies	(500,066)	(552,247)
Cash paid to employees	(292,946)	(278,993)
Cash paid for employee benefits	(172,669)	(164,247)
NET CASH PROVIDED BY OPERATING ACTIVITIES	346,702	43,095
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Contributions from local units	525,687	527,594
Contributions to local unit	-	(35,473)
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	525,687	492,121
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Bond proceeds received	150,000	370,000
Capital purchases	(424,693)	(565,001)
Payment of borrowing	(485,500)	(475,500)
Interest expense	(176,755)	(174,690)
NET CASH (USED) BY FINANCING ACTIVITIES	(936,948)	(845,191)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest revenue	49,964	46,607
NET (DECREASE) IN CASH AND CASH EQUIVALENTS DURING YEAR	(14,595)	(263,368)
Cash and cash equivalents, beginning of year	430,756	694,124
Cash and cash equivalents, end of year	$ 416,161	$ 430,756

Ionia Area Sewage Disposal System

STATEMENTS OF CASH FLOWS - CONTINUED

Years Ended June 30, 2006 and 2005

	2006	2005
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating loss	$ (264,635)	$ (263,816)
Adjustments to reconcile operating loss to net cash provided by operating activities		
Depreciation	340,906	331,062
(Increase) decrease in accounts receivable	(2,932)	686
(Increase) decrease in due from other governmental units	41,395	(100,771)
(Increase) in inventory	(350)	(1,524)
Decrease in deposits with county	197,355	145,031
Increase in accounts payable	3,446	8,572
Increase in accrued liabilities	4,936	1,759
Increase (decrease) in due to other governmental units	37,867	(61,679)
(Decrease) in deferred revenue	(11,995)	(12,320)
Increase (decrease) in accrued sick and vacation pay	709	(3,905)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 346,702	$ 43,095

See accompanying notes to financial statements.

NOTE A: DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Ionia Area Sewage Disposal System (System) was created by contractual agreement between the City of Ionia and Ionia, Berlin, Easton, and Orange Townships. The purpose of the System is to construct, improve, enlarge, operate, and maintain all sanitary sewers, storm sewers, combined sanitary and storm sewers, plants, and works used in connection with the collection treatment or disposal of sewage for the benefit of the constituent municipalities.

The allocation of costs of the SDS to the constituent municipalities is based on usage of the system as measured by billable flow. During 1996, the City of Ionia began to directly bill Ionia Township SDS customers. As a result, the City's allocation of costs includes the portion of costs that had been charged to Ionia Township in the past. On December 1, 2001, the City began to directly bill Easton Township SDS customers for operating costs and fixed asset reserves. As a result, the City's allocation of costs includes a portion of costs that would have been charged to Easton Township in the past. The Township continues to make contributions to SDS to fund their portion of the debt service requirements.

Funding of operating costs and the capital asset reserve as based on annual participant usage is currently as follows:

City of Ionia	91.67%
Ionia Township	4.88%
Berlin Township	3.45%

Funding of debt service as based on annual participant usage is currently as follows:

City of Ionia	88.66%
Ionia Township	4.49%
Berlin Township	3.46%
Easton Township	3.39%

1. Reporting Entity

The accompanying financial statements are exclusive presentations of the financial condition and results of operations of the Ionia Area Sewage Disposal System. The System is considered a "joint venture" of the constituent municipalities.

2. Basis of Presentation

The operations of the System are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, net assets, revenues, and expenses. The System's resources are allocated to and accounted for in the individual fund based upon the purpose for which they are to be spent and the means by which spending activities are controlled. The fund in the financial statements in this report is described as follows:

PROPRIETARY FUND

Enterprise Fund - This fund is used to account for operations that are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

The SDS applies all GASB pronouncements as well as Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements. The SDS has elected not to follow FASB pronouncements issued after November 30, 1989 to its business-type activities and enterprise fund.

NOTE A: DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

3. Measurement Focus

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The proprietary fund is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the Statement of Net Assets. Fund equity (i.e., total net assets) is segregated into invested in capital (net of related debt) and unrestricted components. Proprietary fund type operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

4. Basis of Accounting

Basis of accounting refers to when revenues and 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 proprietary fund is accounted for using the accrual basis of accounting. The revenues are recognized when they are earned, and the expenses are recognized when they are incurred.

5. Budgets and Budgetary Accounting

The City of Ionia operates, administers, and maintains the SDS on behalf of the City and Townships. The annual budget of the SDS is prepared by the City and adopted by City Council. The proposed budget and allocation of costs are submitted to the City and Townships at least sixty (60) days prior to the beginning of each fiscal year. The Townships have thirty (30) days to advise the City of any objections to the proposed budget and allocation. Objections that cannot be resolved are brought before a review board consisting of one (1) appointed member from each constituent municipality and the City Board of Public Works. All actions of the review board are made by a majority vote.

6. Cash and Cash Equivalents

Cash equivalents consist of the System's portion of the City of Ionia's pooled cash accounts. These pooled accounts consist of various checking, savings, certificates of deposit and investment trust funds.

7. Due From Other Governmental Units

Due from other governmental units consists of amounts due from constituent municipalities for debt service and operating costs and amounts due from a component unit of the City of Ionia.

8. Inventories

Inventories in the Enterprise Fund consist of operating materials and supplies, which are stated at cost on a first-in/first-out basis.

9. Capital Assets and Long-Term Liabilities

Capital assets, which include facilities and equipment, are capitalized at total acquisition cost, provided such cost exceeds $5,000 and the expected useful life of the asset is more than one year. Depreciation is recorded on all depreciable capital assets on a straight-line basis over the estimated useful lives of the assets.

NOTE A: DESCRIPTION OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

9. Capital Assets and Long-Term Liabilities - continued

The estimated useful lives are:

Sewer plant and improvements	50 years
Machinery and equipment	3 years

Long-term liabilities are recognized in the basic financial statements when incurred. The portion of those liabilities expected to be paid within the next year is a current liability with the remaining amounts shown as long-term.

10. Accrued Vacation and Sick Leave

The System's employees are granted vacation and sick leave in varying amounts. In the event of termination, an employee is paid for certain portions of unused accumulated vacation and sick time. This amount has been recorded as a long-term liability in the Proprietary Fund.

11. Comparative Data

Comparative data for the prior year has been presented in the accompanying financial statements in order to provide an understanding of changes in the financial position, operations, and cash flows.

NOTE B: CASH AND CASH EQUIVALENTS

In accordance with Michigan Compiled Laws, the System is authorized to invest in the following investment vehicles:

1. Bonds, securities, and other obligations of the United States or an agency or instrumentality of the United States.

2. Certificates of deposit, savings accounts, deposit accounts, or depository receipts of a State or nationally chartered bank or a State or Federally chartered savings and loan association, savings bank, or credit union whose deposits are insured by an agency of the United States government, and which maintains a principal office or branch office located in this State under the laws of the State or the United States, but only if the bank, savings and loan association, savings bank or credit union is eligible to be a depository of surplus funds belong to the State under Section 5 or 6 of Act No. 105 of the Public Acts of 1855, as amended, being Section 21.145 and 21.146 of Michigan Compiled Laws.

3. Commercial paper rated at the time of purchase within the three (3) highest classifications established by not less than two (2) standard rating services and which matures not more than 270 days after the date of purchase.

4. The United States government or Federal agency obligations repurchase agreements.

5. Bankers acceptances of United States Banks.

6. Mutual funds composed of investment vehicles, which are legal for direct investment by local units of government in Michigan.

NOTE B: CASH AND CASH EQUIVALENTS - CONTINUED

Federal Deposit Insurance Corporation (FDIC) regulations provide that deposits of governmental units are to be separately insured for the amount of $100,000 for deposits in an insured bank for savings deposits and $100,000 for demand deposits. Furthermore, if specific deposits are regulated by statute or bond indenture, these specific deposits are to be separately insured for the amount of $100,000. Michigan Compiled Laws allow for collateralization of government deposits, if the assets for pledging are acceptable to the State Treasurer under Section 3 of 1855 PA 105, MCL 21.143, to secure deposits of State surplus funds, securities issued by the Federal Loan Mortgage Corporation, Federal National Mortgage Association, or Government National Mortgage Association.

Deposits

There is a custodial credit risk as it relates to deposits. In the case of deposits, this is the risk that in the event of a bank failure, the System's deposits may not be returned to it. A portion of the cash and cash equivalents of the System are covered by Federal deposit insurance along with other deposits of the City of Ionia, limited to $100,000 in total deposits for each bank customer. Since the City maintains these funds in pooled accounts it is not practical to determine what portion of the System's funds are insured.

As of June 30, 2006, the City had funds on deposit with Ionia County of $289,539 for construction projects and payment of debt service. This amount is considered to be uninsured and uncollateralized.

Credit Risk

State law limits investments in certain types of investments to a prime or better rating issued by nationally recognized statistical rating organizations (NRSRO's).

Interest Rate Risk

The System has not adopted a policy to minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates.

Concentration of Credit Risk

The System has not adopted a policy to minimize concentration of credit risk, which is the risk of loss attributed to the magnitude of the System's investment in a single issuer.

Custodial Credit Risk

The System has not adopted a policy to minimize custodial credit risk, which is the risk of loss due to failure of the security issuer or backer.

NOTE C: CASH - RESTRICTED

The restricted cash as of June 30, 2006, of $139,600 is to be used for future debt payments by the System.

NOTE D: DUE FROM OTHER GOVERNMENTAL UNITS - LOCAL

A summary of amounts due from other governmental units - local at June 30, 2006 follows:

Due from the City of Ionia LDFA	$ 721,505
Due from Berlin Township	25,799
	$ 747,304

NOTE E: CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2006, was as follows:

	Balance July 1, 2005	Additions/ Reclassifications	Deletions/ Reclassifications	Balance June 30, 2006
Business-type activities:				
Capital assets not being depreciated				
Construction in progress	$ 496,482	$ 411,967	$(341,489)	$ 566,960
Capital assets being depreciated				
Sewer plant and improvements	15,338,680	345,048	-	15,683,728
Machinery and equipment	189,311	9,167	-	198,478
Totals at historical cost	15,527,991	354,215	-0-	15,882,206
Less accumulated depreciation for:				
Sewer plant and improvements	5,360,554	304,759	-	5,665,313
Machinery and equipment	83,287	36,147	-	119,434
Total accumulated depreciation	5,443,841	340,906	-0-	5,784,747
Net capital assets being depreciated	10,084,150	13,309	-0-	10,097,459
Capital assets, net	$10,580,632	$ 425,276	$(341,489)	$10,664,419

Depreciation expense in the amount of $340,906 was reported for the year ended June 30, 2006.

NOTE F: LONG-TERM DEBT

The following is a summary of changes in long-term debt (including current portion) of the System for the year ended June 30, 2006:

	Balance July 1, 2005	Additions	Deletions	Balance June 30, 2006	Amounts Due Within One Year
1976 General Obligation Bonds	$ 100,000	$ -	$ 100,000	$ -0-	$ -
1990 General Obligation Bonds	2,380,000	-	375,000	2,005,000	385,000
2001 Water & Sewer Improvement Bonds	357,000	-	10,500	346,500	10,500
2004 General Obligation Bonds	840,000	-	-	840,000	-
2005 General Obligation Bonds	370,000	-	-	370,000	-
2006 Water & Sewer Improvement Bonds	-	150,000	-	150,000	-
Compensated Absences	69,454	709	-	70,163	17,541
	$ 4,116,454	$ 150,709	$ 485,500	$ 3,781,663	$ 413,041

Significant details regarding outstanding long-term debt (including current portion) are presented below:

$6,382,251 1990 Limited Tax General Obligation Bonds dated August 1, 1990, due in annual installments ranging from $375,000 to $415,000 through October 1, 2010, with interest at 2.00 percent, payable semi-annually.	$ 2,005,000

NOTE F: LONG-TERM DEBT - CONTINUED

$3,600,000 2001 Water and Sewer Improvement Bonds dated August 1, 2003, due in annual installments ranging from $10,500 to $31,500 through October 1, 2020, with interest ranging from 4.00 percent to 5.00 percent, payable semi-annually. The Bonds were issued with the full faith and credit of the City of Ionia. The City is responsible for paying 89.5 percent of the debt and the system is responsible for paying 10.5 percent of the debt.	$ 346,500
$4,200,000 2004 Limited Tax General Obligation Bonds dated April 28, 2004, due in annual installments ranging from $0 to $300,000 through August 1, 2029, with interest ranging from 3.00 percent to 4.60 percent, payable semi-annually. The City is responsible for paying 80 percent of the debt and the system is responsible for paying 20 percent of the debt.	840,000
$3,700,000 2005 Limited Tax General Obligation Bonds dated May 27, 2005, due in annual installments ranging from $0 to $27,500 through August 1, 2029, with interest ranging from 3.50 percent to 4.50 percent, payable semi-annually. The City is responsible for paying 90 percent, which leaves the system responsible for paying 10 percent of the debt.	370,000
$1,500,000 2006 Water and Sewer Improvement Bonds dated May 1, 2005, due in annual installments ranging from $0 to $100,000 through August 1, 2030, with interest ranging from 4.60 percent to 6.00 percent, payable semi-annually. The Bonds were issued with the full faith and credit of the City of Ionia. The City is responsible for paying 90 percent of the debt and the system is responsible for paying 10 percent of the debt.	150,000
	$ 3,711,500

Compensated Absences

Individual employees have vested rights upon termination of employment to receive payments for unused vacation. The dollar amounts of these vested rights have been recorded in the statement of net assets. They amount to approximately $70,163 at June 30, 2006.

The annual requirements to pay the debt principal and interest outstanding for the bonds payable are as follows:

Year Ending June 30,	Principal	Interest
2007	$ 395,500	$ 157,761
2008	430,750	166,842
2009	438,250	156,144
2010	450,750	145,245
2011	463,500	133,967
2012-2016	305,750	583,369
2017-2021	427,000	436,052
2022-2026	415,000	265,428
2027-2030	385,000	68,431
	$ 3,711,500	$ 2,113,239

NOTE G: RISK MANAGEMENT

The System is incorporated into the City of Ionia's insurance coverage and as a result is protected from losses. The City participates in a pool, the Michigan Municipal Workers' Compensation Fund, with other municipalities for workers' compensation losses. The pool is organized under Public Act 317 of 1969, as amended. The City has no liability for additional assessments based on the claims filed against the pool nor do they have any right to dividends.

The City also participates in a State pool, the Michigan Municipal Liability and Property Pool, with other municipalities for property, liability, bonding, and casualty losses. The pool is organized under Public Act 138 of 1982, as amended. The City has no liability for additional assessments based on the claims filed against the pool nor do they have any right to dividends.

OTHER SUPPLEMENTARY INFORMATION

Ionia Area Sewage Disposal System

SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN
FUND NET ASSETS - AMENDED BUDGET AND ACTUAL

Year Ended June 30, 2006
With Actual Amounts for the Year Ended June 30, 2005

	Amended Budget	2006 Actual	Variance Favorable (Unfavorable)	2005 Actual
OPERATING REVENUES				
Sales and charges for services				
City of Ionia	$ 1,024,918	$ 1,023,955	$ (963)	$ 954,240
Berlin Township	31,408	37,004	5,596	27,750
Other	27,616	27,601	(15)	23,966
TOTAL OPERATING REVENUES	1,083,942	1,088,560	4,618	1,005,956
OPERATING EXPENSES				
Administrative				
Salaries	47,339	47,338	1	45,946
Payroll taxes and fringe benefits	32,422	32,356	66	41,186
Insurance	62,303	62,302	1	58,683
Contractual and professional	18,471	32,477	(14,006)	11,952
Administrative	99,133	99,131	2	91,718
Telephone	4,910	4,900	10	5,592
Transportation and training	2,911	2,907	4	1,729
Public utilities	102,651	102,649	2	99,433
Depreciation	340,993	340,906	87	331,062
Bond issuance costs	4,530	4,526	4	14,809
Miscellaneous	25	8	17	24
Total administrative	715,688	729,500	(13,812)	702,134
Treatment plant				
Salaries	245,708	245,707	1	230,295
Payroll taxes and fringe benefits	131,918	138,758	(6,840)	117,093
Central garage allocation	37	-	37	36
Contractual and professional	54,506	54,504	2	59,166
Operating supplies	86,318	86,315	3	64,178
Gas and oil	6,827	6,818	9	5,609
Chemicals	73,091	73,086	5	67,457
Equipment rental	2	-	2	400
Total treatment plant	598,407	605,188	(6,781)	544,234

Ionia Area Sewage Disposal System

SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN
FUND NET ASSETS - AMENDED BUDGET AND ACTUAL - CONTINUED

Year Ended June 30, 2006
With Actual Amounts for the Year Ended June 30, 2005

	Amended Budget	2006 Actual	Variance Favorable (Unfavorable)	2005 Actual
OPERATING EXPENSES - CONTINUED				
Lift Station				
Salaries	$ 4,841	$ 4,837	$ 4	$ 4,511
Payroll taxes and fringe benefits	2,266	2,264	2	2,063
Contractual and professional	656	650	6	7,711
Repair and maintenance supplies	4,506	4,504	2	2,380
Telephone	314	313	1	285
Public utilities	3,937	3,928	9	4,502
Equipment rental	2,011	2,011	-0-	1,952
Total lift station	18,531	18,507	24	23,404
TOTAL OPERATING EXPENSES	1,332,626	1,353,195	(20,569)	1,269,772
OPERATING LOSS	(248,684)	(264,635)	25,187	(263,816)
NONOPERATING REVENUES (EXPENSES)				
Bond Proceeds	150,000	-	(150,000)	-
Replacement reserve	(85,000)	-	85,000	-
Capital outlay	(5,000)	-	5,000	-
Interest revenue	49,507	49,964	457	46,607
Contributions from local units	527,350	525,687	(1,663)	527,594
Interest expense	(654,518)	(176,755)	477,763	(174,690)
Contributions to local unit	(367,742)	-	367,742	(35,473)
TOTAL NONOPERATING REVENUES (EXPENSES)	(385,403)	398,896	784,299	364,038
CHANGE IN NET ASSETS	(634,087)	134,261	809,486	100,222
Net assets, beginning of year	7,988,263	7,988,263	-0-	7,888,041
Net assets, end of year	$ 7,354,176	$ 8,122,524	$ 809,486	$ 7,988,263

Note: Budget data is presented for informational purposes only.

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MANAGEMENT LETTER

Ionia Area Sewage Disposal System
Ionia, Michigan

As you know, we have recently completed our audit of the records of Ionia Area Sewage Disposal System as of and for the year ended June 30, 2006. In connection with the audit, we feel that a certain change in your accounting and administrative procedures would be helpful in improving management's control and the operational efficiency of the accounting and administrative functions. This suggestion is a result of our evaluation of the internal control structure and our discussions with management.

The investment policy of the System should be amended to address the disclosure requirements of GASB Statement No. 40.

During the course of our audit and through discussions with administration, it was noted that the System has not amended their investment policy to address the reporting requirements of GASB Statement No. 40. This issue was noted and reported in our audit comments last year.

Deposit resources often represent significant assets of the System's governmental funds. These resources are necessary for the delivery of the System's services and programs. Effective for the year ended June 30, 2005, GASB Statement No. 40 is designed to inform financial statement users about deposit and risks that could affect the System's ability to provide services and meet its obligations as they become due.

We suggest the System review their current investment policy and make the necessary amendments to address custodial credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. Such policies are required to be disclosed in the notes to the System's financial statements by GASB Statement No. 40.

This condition was considered in determining the nature, timing, and extent of the audit tests to be applied in our audit of the basic financial statements, and this report does not affect our report on the basic financial statements dated September 21, 2006.

This report is intended solely for the information and use of the administration of Ionia Area Sewage Disposal System, and should not be used for any other purpose.

We wish to express our appreciation for the courtesy and cooperation extended to us during our audit. We are available to discuss any or all of these suggestions with you and to provide assistance in the implementation of improvements.

Abraham & Gaffney, P.C.

ABRAHAM & GAFFNEY, P.C.
Certified Public Accountants

September 21, 2006