Mason County Eastern School District

REPORT ON FINANCIAL STATEMENTS
(with required supplementary information)

Year ended June 30, 2007

Mason County Eastern School District

TABLE OF CONTENTS

Management's Discussion and Analysis ..... i - vii

Independent Auditors' Report 1

Basic Financial Statements
- District-wide Financial Statements
  - Statement of Net Assets 3
  - Statement of Activities 4
- Fund Financial Statements
  - Governmental Funds
    - Balance Sheet 5
    - Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets 6
    - Statement of Revenues, Expenditures and Changes in Fund Balances 7
    - Reconciliation of the Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balances to the Statement of Activities 8
  - Statement of Fiduciary Assets and Liabilities 9
- Notes to Financial Statements 10

Required Supplementary Information
- Budgetary Comparison Schedule—General Fund 25

Mason County Eastern School District

Management's Discussion and Analysis

This section of Mason County Eastern School District's annual financial report presents our discussion and analysis of the School District's financial performance during the year ended June 30, 2007. Please read it in conjunction with the School District's financial statements, which immediately follow this section.

Using this Annual Report

This annual report consists of a series of financial statements and notes to those statements. These statements are organized so the reader can understand Mason County Eastern Schools financially as a whole. The district-wide Financial Statements provide information about the activities of the whole School District, presenting both an aggregate view of the School District's finances and a longer-term view of those finances. The fund financial statements provide the next level of detail. For governmental funds, these statements tell how services were financed in the short-term, as well as what remains for future spending. The fund financial statements look at the School District's operations in more detail than the district-wide financial statements by providing information about the School District's most significant fund, the General Fund, with all other funds presented in one column as nonmajor funds. The remaining statement, the Statement of Fiduciary Net Assets, presents financial information about activities for which the School District acts solely as an agent for the benefit of students and parents.

Overview of the Financial Statements

This annual report consists of four parts: (1) management's discussion and analysis (this section), (2) the auditors' opinion, (3) the basic financial statements and (4) the required supplementary information. The financial statements include notes that explain some of the information in the statements by providing detailed data. These statements are followed by a section of required supplementary information that further explains and supports the financial statements, utilizing a comparison to the District's budget for the year. Additionally, the basic financial statements also include two kinds of statements that present different views of the district.

Reporting the School District as a Whole – District-Wide Financial Statements

One of the most important questions asked about the School District is, "As a whole, what is the School District's financial condition as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities, which appear first in the School District's financial statements, report information about the School District as a whole and its activities in a way that helps you answer this question. We prepare these statements to include all assets and liabilities, using the accrual basis of accounting,

which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the School District's net assets – the difference between assets and liabilities, as reported in the Statement of Net Assets – as one way to measure the School District's financial health or financial position. Over time, increases or decreases in the School District's net assets – as reported in the Statement of Activities – are indicators of whether its financial health is improving or deteriorating. The relationship between revenues and expenses is the School District's operating results. However, the School District's goal is to provide services to our students, not to generate profits as commercial entities do. One must consider many other non-financial factors, such as the quality of the education provided and the safety of the schools, to assess the overall health of the School District.

The Statement of Net Assets and Statement of Activities report the governmental activities for the School District, which encompass all of the School District's services, including instruction, support services, community services, athletics, and food services. Property taxes, unrestricted State Aid (foundation allowance revenue), and State and federal grants finance most of these activities.

Reporting the School District's Most Significant Funds – Fund Financial Statements

The School District's fund financial statements provide detailed information about the most significant funds – not the School District as a whole. Some funds are required to be established by State law and by bond covenants. However, the School District establishes many other funds to help it control and manage money for particular purposes (the Food Service and Athletics funds are examples) or to show that it's meeting legal responsibilities for using certain taxes, grants, and other money (such as bond-funded construction funds used for voter-approved capital projects).

Governmental Funds

All of the School District's services are reported in governmental funds. Governmental fund reporting focuses on showing how money flows into and out of funds and the balances left at year end that are available for spending. They are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the operations of the School District and the services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the School District's programs. We describe the relationship (or differences)

between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in a reconciliation.

The School District as Trustee – Reporting the School District's Fiduciary Responsibilities

The School District is the trustee, or fiduciary, for its student activity funds. All of the School District's fiduciary activities are reported in a separate Statement of Fiduciary Assets and Liabilities. We exclude these activities from the School District's other financial statements because the School District cannot use these assets to finance its operations. The School District is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

The School District as a Whole

Recall that the statement of net assets provides the perspective of the School District as a whole. Table 1 provides a summary of the School District's net assets as of June 30, 2006 and 2007.

TABLE 1	Governmental Activities June 30, 2006	Governmental Activities June 30, 2007
Assets		
Current assets	$2,226,798	$2,523,649
Capital assets	4,908,061	4,812,418
Total assets	7,134,859	7,336,067
Liabilities		
Current liabilities	1,615,096	1,850,384
Long-term liabilities	4,236,239	3,988,815
Total liabilities	5,851,335	5,839,199
Net Assets		
Invested in capital assets – Net of related debt	471,950	608,210
Restricted	190,183	135,522
Unrestricted	621,391	753,136
Total net assets	**$1,283,524**	**$1,496,868**

The School District's net assets were $1,496,868 as of June 30, 2007 (see Table 1). Capital assets, net of related debt, totaling $608,210 compares the original cost (less depreciation) of the School District's capital assets to long-term debt used to finance the acquisition of those assets. Most of the debt will be repaid from voter-approved property taxes collected as the debt service comes due. Restricted net assets of $135,522, are reported separately to show legal constraints from debt covenants and enabling legislation that limit the School District's ability to use those net assets for day-to-day operations. The remaining amount of net assets, $753,136, is unrestricted.

The $753,136 of unrestricted net assets of governmental activities represents the accumulated results of all past years' operations. The unrestricted net asset balance is used to provide working capital and cash flow requirements as well as providing for future uncertainties. The operating results of the General Fund will have significant impact on the change in unrestricted net assets from year to year.

The results of this year's operations for the School District as a whole are reported in the Statement of Activities (see Table 2), which shows the changes in net assets for fiscal years 2006 and 2007.

TABLE 2	Governmental Activities June 30, 2006	Governmental Activities June 30, 2007
Revenue		
Program revenue:		
Charges for services	$ 86,229	$ 88,815
Operating grants/contributions	684,799	730,760
General revenue:		
Property taxes	1,294,004	1,337,858
State foundation allowance	3,322,398	3,300,552
Other	98,788	169,831
Total revenue	5,486,218	5,627,816
Function/Program Expenditures		
Instruction	3,028,378	3,101,668
Support services	1,741,813	1,557,403
Food services	241,173	241,928
Athletics	115,241	123,635

Interest on long-term debt	$ 210,329	$ 201,934
Unallocated depreciation	183,955	187,904
Total expenses	5,520,889	5,414,472
Increase (Decrease) in Net Assets	**$ (34,671)**	**$ 213,344**

As reported in the statement of activities, the cost of all of our governmental activities this year was $5,414,472. Certain activities were partially funded from those who benefited from the programs ($88,815) or by other governments and organizations that subsidized certain programs with grants and contributions ($730,760). We paid for the remaining "public benefit" portion of our governmental activities with $1,337,858 in taxes, $3,300,552 in State Foundation Grant, and with our other revenues, such as interest and general entitlements.

The School District experienced an increase in net assets of $213,344. With the uncertainty of state funding and county-wide enrollment trends, an increase of 16.6% in net assets is very positive and points to the continued financial stability of the School District.

As discussed above, the net cost shows the financial burden that was placed on the State and the School District's taxpayers by each of these functions. Since property taxes for operations and unrestricted State Aid constitute the vast majority of district operating revenue sources, the Board of Education and Administration must annually evaluate the needs of the School District and balance those needs with State-prescribed available unrestricted resources.

As we noted earlier, the School District uses funds to help it control and manage money for particular purposes. Looking at funds helps the reader consider whether the School District is being accountable for the resources taxpayers and others provide to it and may provide more insight into the School District's overall financial health.

As the School District completed this year, the governmental funds reported a combined fund balance of $960,597, which is an increase of $78,974 from last year. The main reason for the increase is the decrease in General Fund Support Services of $159,747, partially due to a reduction and redistribution of personnel.

The General Fund fund balance is available to fund costs related to allowable school operating purposes.

The Debt Service Fund showed a fund balance of $167,657. Millage rates are determined annually to ensure that the School District accumulates sufficient resources to pay annual bond issue-related debt service. Debt Service Fund fund balances are reserved since they can only be used to pay debt service obligations.

General Fund Budgetary Highlights

Over the course of the year, the School District revises its budget as it attempts to deal with unexpected changes in revenues and expenditures. State law requires that the budget be amended to ensure that expenditures to not exceed appropriations. The final amendment to the budget was actually adopted just before year end. (A schedule showing the School District's original and final budget amounts compared with amounts actually paid and received is provided in the required supplementary information section of these financial statements).

The final budget for Pupil Support Services is down from the original budget as a counselor was replaced and also subcontracted out for part of the time to another local area school district which reduced the cost to the School District. The operations and maintenance budget was up due to the District receiving donations for athletic improvements which were spent through this area.

Capital Assets

At June 30, 2007, the School District had $4,782,895 (after accumulated depreciation) invested in a broad range of capital assets, including land, buildings, vehicles, and furniture and equipment. This amount represents a net decrease (including additions, deductions, and depreciation) of $95,643, or 2 percent, from last year.

	2006	2007
Land	$ 86,079	$ 86,079
Building and building improvements	5,878,075	5,953,481
Buses and other vehicles, furniture and equipment	786,197	803,052
Total capital assets, before depreciation	**$6,750,351**	**$6,842,612**

Debt

At the end of this year, the School District had $4,094,523 in bonds outstanding versus $4,304,523 in the previous year – a decrease of 4.9 percent.

Other obligations include compensated absences. We present more detailed information about our long-term liabilities in the notes to the financial statements.

Economic Factors and Next Year's Budget

Our school board and administration considered many factors when setting the School District's 2008 fiscal year budget. One of the most important factors affecting the budget is our student count. The State foundation allowance is determined by multiplying the foundation allowance per pupil by the average blended count from the last three years. The 2008 budget was adopted in June 2007, based on an estimated number of students that will be enrolled in September 2007. Approximately 72 percent of total General Fund revenue is from the foundation allowance. Under State law, the School District cannot assess additional property tax revenue for general operations. As a result, School District funding is heavily dependent on the State's ability to fund local school operations. We anticipate that the fall student count will be close to the estimates used in creating the 2008 budget. Once the final student count and related per pupil funding is validated, State law requires the School District to amend the budget if actual School District resources are not sufficient to fund original appropriations.

The anticipated State School Aid Budget estimates funds are sufficient to fund $7,085 per pupil.

A teacher contract was ratified June 6, 2006. The cost of the settlement is reflected in the 2008 budget.

Contacting the School District's Financial Management

This financial report is designed to provide the School District's citizens, taxpayers, customers, investors, and creditors with a general overview of the School District's finances and to demonstrate the School District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact our Business Department at 18 South Main, MCE Administration Office, Custer, Michigan 49405

BRICKLEY DELONG
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

August 30, 2007

Board of Education
Mason County Eastern School District
Custer, Michigan

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Mason County Eastern School District (the School District), as of and for the year ended June 30, 2007, which collectively comprise the Schools District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Mason County Eastern School District'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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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, each major fund, and the aggregate remaining fund information of Mason County Eastern School District as of June 30, 2007, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards,* we have also issued our report dated August 30, 2007, on our consideration of Mason County Eastern School District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

Brickley DeLong, PLC

Mason County Eastern School District

STATEMENT OF NET ASSETS

June 30, 2007

ASSETS

	Governmental activities
CURRENT ASSETS	
Cash and cash equivalents	$ 102,322
Investments	1,627,480
Receivables	36,339
Due from other governmental units	694,024
Inventories	11,244
Prepaid items	52,239
Total current assets	2,523,648
NONCURRENT ASSETS	
Capital assets, net	
Nondepreciable	86,079
Depreciable	4,696,816
Note receivable	29,523
Total noncurrent assets	4,812,418
Total assets	7,336,066

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES	
State aid loan	1,000,000
Accounts payable and accrued liabilities	578,800
Deferred revenue	17,882
Bonds and other obligations, due within one year	253,701
Total current liabilities	1,850,383
NONCURRENT LIABILITIES	
Bonds and other obligations, less amounts due within one year	3,988,815
Total liabilities	5,839,198
NET ASSETS	
Invested in capital assets, net of related debt	608,210
Restricted for debt service	135,522
Unrestricted	753,136
Total net assets	$ 1,496,868

The accompanying notes are an integral part of this statement.

Mason County Eastern School District

STATEMENT OF ACTIVITIES

For the year ended June 30, 2007

Functions/Programs	Expenses	Program Revenue: Charges for services	Program Revenue: Operating grants and contributions	Net (Expense) Revenue and Changes in Net Assets: Governmental activities
Governmental activities				
Instruction	$ 3,101,668	$ 8,831	$ 554,013	$ (2,538,824)
Support services	1,557,403	-	3,384	(1,554,019)
Food services	241,928	58,869	173,363	(9,696)
Athletics	123,635	21,115	-	(102,520)
Interest on long-term debt	201,934	-	-	(201,934)
Unallocated depreciation	187,904	-	-	(187,904)
Total governmental activities	$ 5,414,472	$ 88,815	$ 730,760	(4,594,897)
General revenues				
Property taxes levied for				
General purposes				971,232
Debt service				366,626
Grants and contributions not restricted to specific programs				3,300,552
Investment earnings				64,210
Miscellaneous				105,621
Total general revenues				4,808,241
Change in net assets				213,344
Net assets at July 1, 2006				1,283,524
Net assets at June 30, 2007				$ 1,496,868

The accompanying notes are an integral part of this statement.

Mason County Eastern School District

BALANCE SHEET

Governmental Funds

June 30, 2007

	General Fund	Other governmental funds	Total governmental funds
ASSETS			
Cash and cash equivalents	$ 55,730	$ 46,592	$ 102,322
Investments	1,507,480	120,000	1,627,480
Receivables	30,271	6,068	36,339
Due from other governmental units	692,030	1,994	694,024
Due from other funds	5,138	-	5,138
Inventories	-	11,244	11,244
Prepaid items	52,239	-	52,239
Total assets	$ 2,342,888	$ 185,898	$ 2,528,786
LIABILITIES AND FUND BALANCES			
Liabilities			
State aid loan	$ 1,000,000	$ -	$ 1,000,000
Accounts payable	109,262	908	110,170
Accrued liabilities	430,762	4,237	434,999
Due to other funds	-	5,138	5,138
Deferred revenue	16,787	1,095	17,882
Total liabilities	1,556,811	11,378	1,568,189
Fund balances			
Reserved			
Inventories and prepaid items	52,239	11,244	63,483
Debt service	-	167,657	167,657
Unreserved			
Undesignated			
General Fund	733,838	-	733,838
School service	-	(4,381)	(4,381)
Total fund balances	786,077	174,520	960,597
Total liabilities and fund balances	$ 2,342,888	$ 185,898	$ 2,528,786

The accompanying notes are an integral part of this statement.

Mason County Eastern School District

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

June 30, 2007

Total fund balance—governmental funds		$ 960,597
Amounts reported for governmental activities in the Statement of Net Assets are different because:		
Capital assets used in governmental activities are not current financial resources and are not reported in the governmental funds.		
Cost of capital assets	$ 6,842,612	
Accumulated depreciation	(2,059,717)	4,782,895
Other long-term note receivable in governmental activities is not reported in the governmental funds.		29,523
Accrued interest in governmental activities is not reported in the governmental funds.		(33,631)
Long-term liabilities in governmental activities are not due and payable in the current period and are not reported in the governmental funds.		
Bonds and notes payable	(4,174,685)	
Compensated absences	(67,831)	(4,242,516)
Net assets of governmental activities in the Statement of Net Assets		$ 1,496,868

The accompanying notes are an integral part of this statement.

Mason County Eastern School District

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

Governmental Funds

For the year ended June 30, 2007

	General Fund	Other governmental funds	Total governmental funds
REVENUES			
Local sources			
Property taxes	$ 971,232	$ 366,626	$ 1,337,858
Investment earnings	54,855	9,355	64,210
Fees and charges	-	74,482	74,482
Other	103,489	6,553	110,042
Total local sources	1,129,576	457,016	1,586,592
State sources	3,587,147	11,827	3,598,974
Federal sources	205,184	161,535	366,719
Total revenues	4,921,907	630,378	5,552,285
EXPENDITURES			
Instruction	3,102,763	-	3,102,763
Support services	1,658,531	-	1,658,531
Food services	-	241,928	241,928
Athletics	-	125,732	125,732
Debt service			
Principal	-	200,000	200,000
Interest and other charges	-	198,507	198,507
Total expenditures	4,761,294	766,167	5,527,461
Excess (deficiency) of revenues over (under) expenditures	160,613	(135,789)	24,824
OTHER FINANCING SOURCES (USES)			
Transfers from other governmental units and other transactions	75,530	-	75,530
Transfers in	-	104,617	104,617
Transfers out	(104,617)	-	(104,617)
Other transactions	(21,380)	-	(21,380)
Total other financing sources (uses)	(50,467)	104,617	54,150
Net change in fund balances	110,146	(31,172)	78,974
Fund balances at July 1, 2006	675,931	205,692	881,623
Fund balances at June 30, 2007	$ 786,077	$ 174,520	$ 960,597

The accompanying notes are an integral part of this statement.

Mason County Eastern School District

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

For the year ended June 30, 2007

Net change in fund balances—total governmental funds		$ 78,974
Amounts reported for governmental activities in the Statement of Activities are different because:		
Governmental funds report outlays for capital assets as expenditures; in the Statement of Activities these costs are depreciated over their estimated useful lives.		
Depreciation expense	$ (187,904)	
Capital outlay	92,261	(95,643)
Repayment of principal on long-term obligations is an expenditure in the governmental funds, but the repayment reduces long-term obligations in the Statement of Net Assets.		231,903
Interest expense on long-term obligations is recorded in the Statement of Activities when incurred, but is not reported in governmental funds until paid.		1,853
Compensated absences are reported on the accrual method in the Statement of Activities and reported as expenditures when financial resources are used in the governmental funds.		(3,743)
Change in net assets of governmental activities		$ 213,344

The accompanying notes are an integral part of this statement.

Mason County Eastern School District

STATEMENT OF FIDUCIARY ASSETS AND LIABILITIES

Fiduciary Funds

June 30, 2007

	Agency funds
ASSETS	
Cash and cash equivalents	$ 17,928
LIABILITIES	
Deposits held for others	$ 17,928

The accompanying notes are an integral part of this statement.

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Reporting Entity
The School District is governed by an elected seven-member Board of Education (Board), which has responsibility and control over all activities related to public school education within the School District. The School District receives funding from local, state, and federal government sources and must comply with all of the requirements of these funding source entities. However, the School District is not included in any other governmental reporting entity as defined by generally accepted accounting principles. In addition, the School District's reporting entity does not contain any component units as defined in Governmental Accounting Standards Board Statement No. 14. Board members have decision-making authority, the power to designate management, the ability to significantly influence operations, and the primary accountability for fiscal matters.

District-wide and Fund Financial Statements

District-wide Financial Statements – The primary focus of district-wide financial statements is on the sustainability of the School District as an entity and the change in the School District's net assets resulting from the current year's activities. The district-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all of the non-fiduciary activities of the School District. For the most part, the effect of interfund activity has been removed from these statements. The district-wide financial statements categorize primary activities as either governmental or business type. All of the School District's activities are classified as governmental activities.

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

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. The School District first utilizes restricted resources to finance qualifying activities. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges paid by recipients who purchase, use or directly benefit from goods or services by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. State Foundation Aid, certain revenue from the intermediate school district, and other unrestricted items are not included as program revenues but instead as *general revenues*.

The district-wide Statement of Activities reports both the gross and net cost of each of the School District's functions. The functions are also supported by general revenues (property taxes, certain intergovernmental revenues and charges, etc.). The Statement of Activities reduces gross expenses by related program revenues and operating grants. Program revenues must be directly associated with the function. Operating grants include operating-specific and discretionary (either operating or capital) grants. The School District does not allocate indirect costs.

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

District-wide and Fund Financial Statements—Continued

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

Governmental funds – Governmental funds are those funds through which most School District functions typically are financed. The acquisition, use and balances of the School District's expendable financial resources and the related current liabilities are accounted for through governmental funds.

The School District reports the following major governmental fund:

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

The other nonmajor governmental funds are reported within the following types:

- The *special revenue funds* account for revenue sources that are legally restricted to expenditures for specific purposes (not including expendable trusts or major capital projects). The School District accounts for its food service and athletic activities in the school service special revenue funds.
- The *debt service funds* account for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

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

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

Measurement Focus, Basis of Accounting and Basis of Presentation

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

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

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

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Measurement Focus, Basis of Accounting and Basis of Presentation—Continued

State Revenue
The State of Michigan utilizes a foundation grant approach which provides for a specific annual amount of revenue per pupil based on a statewide formula. The Foundation is funded from state and local sources. Revenues from state sources are primarily governed by the School Aid Act and the School Code of Michigan. The Michigan Department of Education administers the allocation of state funds to school districts based on information supplied by the school districts. For the year ended June 30, 2007, the foundation allowance was based on pupil membership counts taken in February and September of 2006.

The state portion of the foundation is provided primarily by a state education property tax millage of 6 mills and an allocated portion of state sales and other taxes. The local portion of the foundation is funded primarily by non-homestead property taxes which may be levied at a rate of up to 18 mills. The state revenue is recognized during the foundation period and is funded through payments from October 2006 to August 2007. Thus, the unpaid portion at June 30, 2007 is reported as due from other governmental units.

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

Other Accounting Policies

Deposit and Investments
Cash and cash equivalents include cash on hand, demand deposits and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

The School District reports its investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools.* Under this standard, certain investments are valued at fair value as determined by quoted market prices or by estimated fair values when quoted market prices are not available. The standard also provides that certain investments are valued at cost (or amortized cost) when they are of a short-term duration, the rate of return is fixed, and the School District intends to hold the investment until maturity.

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

Interfund Receivables and Payables
Activities between funds that are representative of lending or borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds". The School District had no advances between funds.

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Other Accounting Policies—Continued

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

For the year ended June 30, 2007, the School District levied the following amounts per $1,000 of taxable valuation:

Fund	Mills
General Fund—Non-homestead	18
Debt service fund—Homestead and non-homestead	3.2

Inventories
Food service inventory is valued at the lower of cost (first-in, first-out) or market. The inventory is expendable supplies held for consumption and is recorded as expenditures when consumed rather than when purchased. Inventories for commodities are recorded as revenue when utilized.

Prepaid Items
Payments made to vendors for services that will benefit periods beyond the fiscal year end are recorded as prepaid items using the consumption method. A current asset for the prepaid amount is recorded at the time of the purchase and an expenditure/expense is reported in the year in which services are consumed.

Restricted Assets
Assets are reported as restricted when limitations on their use change the normal understanding of the availability of the asset. Such constraints are either imposed by creditors, contributors, grantors, or laws of other governments or imposed by enabling legislation. Restricted assets include bond proceeds to be used for capital construction.

Capital Assets
Capital assets purchased or acquired are capitalized at historical cost or estimated historical cost. Donated fixed assets are valued at their estimated fair market value on the date received. Capital assets are defined by the School District as assets with an initial cost of more than $5,000 and an estimated useful life in excess of one year. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related fixed assets. The School District does not have infrastructure-type assets.

Depreciation is provided on the straight-line basis over the following useful lives:

Building and improvements	10-50 years
Buses and other vehicles	10-15 years
Furniture and other equipment	5-15 years

Land and certain land improvements are deemed to be inexhaustible capital assets, as the economic benefit or service potential is used up so slowly that the estimated useful life is extraordinarily long. These inexhaustible assets are not depreciated.

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Other Accounting Policies—Continued

Compensated Absences
The liability for compensated absences reported in the district-wide statement consists of unpaid, accumulated sick leave and vacation balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who are currently eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included.

For fund financial statements, no compensated absence liability is reported for current employees and a compensated absence liability is reported for terminated employees only when the termination date is on or before year end.

Deferred Revenue
Deferred revenue arises when assets are recorded before revenue recognition criteria have been satisfied. Grants and entitlements received before the eligibility requirements are met are also recorded as deferred revenue. On fund financial statements, receivables that will be collected after the available period are reported as deferred revenue.

Long-term Obligations
In the district-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the Statement of Net Assets. Bond premiums and discounts, as well as issuance cost, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs, if any, are reported as deferred charges and amortized over the term of the related debt.

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

Net Assets In District-wide Financial Statements
Net assets represent the difference between assets and liabilities and are segregated into the following components:

- **Invested in capital assets, net of related debt** consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- **Restricted net assets** result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributions, and the like, or imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted net assets** consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources which are imposed by management, but can be removed or modified.

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Other Accounting Policies—Continued

Fund Equity In Fund Financial Statements
The School District reserves those portions of governmental fund balances that are legally segregated for specific future use or which do not represent available expendable resources and therefore are not available for appropriations for expenditures. Unreserved fund balance indicates that portion of fund equity which is available for appropriation in future periods. Fund balance reserves are established for encumbrances, inventory of materials and supplies, prepaid items, deferred charges and advances to other funds, when applicable. Designations of fund balance represent tentative management plans that are subject to change.

Estimates
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statement and accompanying notes. Actual results may differ from those estimates.

NOTE B—STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgets and Budgetary Accounting
Budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America. Annual appropriated budgets are adopted for the General Fund and special revenue funds. All annual appropriations lapse at year end.

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

1. The Superintendent submits to the School Board a proposed operating budget for the fiscal year commencing on July 1. The operating budget includes proposed expenditures and the means of financing them. The level of control for the budgets is at the functional level as set forth and presented as required supplementary information.
2. Public hearings are conducted to obtain taxpayer comments.
3. Prior to July 1, the budget is legally adopted by Board of Education resolution pursuant to the Uniform Budgeting and Accounting Act (P.A. 621 of 1978). The Act requires that the budget be amended prior to the end of the fiscal year when necessary to adjust appropriations if it appears that revenues and other financing sources will be less than anticipated or so that expenditures will not be in excess of original estimates. Expenditures shall not be made or incurred, unless authorized in the budget, in excess of the amount appropriated. Violations, if any, are noted in the required supplementary information section.
4. The Business Manager is authorized to transfer budgeted amounts within major expenditure functions within any fund; however, these transfers and any revisions that alter the total expenditures of any fund must be approved by the Board of Education.
5. Formal budgetary integration is employed as a management control device during the year.
6. The budget is amended during the year with supplemental appropriations, the last one approved prior to June 30, 2007. The School District does not consider these amendments to be significant.

Excess of Expenditures Over Appropriations
For the year ended June 30, 2007, expenditures exceeded appropriations in business services and operations and maintenance by $13,543 and $14,022, respectively.

NOTE C—DEPOSITS AND INVESTMENTS

As of June 30, 2007, the School District had the following investments:

Investment Type	Fair value	Weighted average maturity (Days)	Standard & Poor's rating	Percent
External investment pool	$ 618,622	1	AAAm	38 %
Guaranteed Investment Contract (GIC)	888,858	367	SP-1+	55
Certificate of Deposit	120,000	180	Not rated	7
Total fair value	$ 1,627,480			100 %
Portfolio weighted average maturity		40		

The School District voluntarily invests certain excess funds in external pooled investment funds which included money market funds. One of the pooled investment funds utilized by the School District is the Michigan Investment Liquid Asset Fund (MILAF). MILAF is an external pooled investment fund of "qualified" investments for Michigan school districts. MILAF is not regulated nor is it registered with the SEC. MILAF reports as of June 30, 2007, the fair value of the School District's investments is the same as the value of the pool shares.

Interest rate risk. The School District 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.

Credit risk. State law limits investments in commercial paper and corporate bonds to the three highest classifications issued by nationally recognized statistical rating organizations. The School District has no investment policy that would further limit its investment choices.

Concentration of credit risk. The School District does not have a concentration of credit risk policy. Concentration of credit risk is the risk of loss attributed to the magnitude of the School District investment in a single issuer, by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized.

Custodial credit risk - deposits. In the case of deposits, this is the risk that in the event of a bank failure, the School District's deposits may not be returned to it. As of June 30, 2007, $17,202 of the School District's bank balance of $123,016 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Custodial credit risk - investments. The School District does not have a custodial credit risk policy for investments. This is the risk that, in the event of the failure of the counterparty, the School District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

NOTE C—DEPOSITS AND INVESTMENTS—Continued

Custodial credit risk - investments—Continued
The School District's Guaranteed Investment Contract is collateralized and invested for the purpose of paying off the state aid anticipation note disclosed in Note F. The Investment Agreement, dated as of August 18, 2006, by and among Wells Fargo Bank, N.A, as the Depository on behalf of both the participating Michigan School Districts and the Michigan Municipal Bond Authority, and Citigroup Global Markets, Inc., as Provider. The net proceeds from the sale of the Series B-1 Notes were loaned by the Authority to Michigan School Districts. Such loans were repaid with monthly set-a-side installments deposited with the Depository for investment under the Investment Agreement. Set-a-side installments are deposited under the Investment Agreement versus Permitted Investments (collateral securities) equaling at least 102 percent of the deposited amount and such Permitted Investments are held by the Depository in a fiduciary capacity. The Guaranteed Rate under this Investment Agreement (commonly referred to as guaranteed investment contract-GIC or collateralized investment agreement-CIA) is 5.01 percent (simple interest actual days elapsed over a 365-day year). The Guarantor is Citigroup Global Markets Holdings, Inc., as guarantor of the Provider's obligations under this Investment Agreement.

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

NOTE D—CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2007 was as follows:

	Balance July 1, 2006	Additions	Deductions	Balance June 30, 2007
Capital assets, not being depreciated:				
Land	$ 86,079	$ -	$ -	$ 86,079
Capital assets, being depreciated:				
Land improvements	229,948	49,506	-	279,454
Buildings and improvements	5,648,127	25,900	-	5,674,027
Office furniture and equipment	261,241	16,855	-	278,096
Vehicles and equipment	524,956	-	-	524,956
Total capital assets, being depreciated	6,664,272	92,261	-	6,756,533

NOTE D—CAPITAL ASSETS—Continued

	Balance July 1, 2006	Additions	Deductions	Balance June 30, 2007
Less accumulated depreciation:				
Land improvements	$ 84,770	$ 11,632	$ -	$ 96,402
Buildings and improvements	1,341,365	122,684	-	1,464,049
Office furniture and equipment	92,994	22,423	-	115,417
Vehicles and equipment	352,684	31,165	-	383,849
Total accumulated depreciation	1,871,813	187,904	-	2,059,717
Total capital assets, being depreciated, net	4,792,459	(95,643)	-	4,696,816
Capital assets, net	$ 4,878,538	$ (95,643)	$ -	$ 4,782,895

Depreciation
Depreciation expense has been charged as unallocated depreciation.

NOTE E—INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS

The composition of interfund balances as of June 30, 2007 is as follows:

Due to/from other funds:

Receivable fund	Payable Fund	Amount
General Fund	Other governmental funds	$ 5,138

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

Interfund Transfers
The General Fund transferred $104,617 to the Athletics Fund to finance operations.

NOTE F—SHORT-TERM DEBT

The School District issues State of Michigan school aid anticipation notes to provide short-term operating funds. The notes are obligations of the General Fund, which received the note proceeds, and are backed by the full faith, credit and resources of the School District. The short-term debt activity for the year ended June 30, 2007 follows:

	Balance July 1, 2006	Additions	Reductions	Balance June 30, 2007
State aid anticipation note				
2005/2006 2.87% due August 2006	$ 950,000	$ -	$ 950,000	$ -
2006/2007 3.68% due August 2007	-	1,000,000	-	1,000,000
	$ 950,000	$ 1,000,000	$ 950,000	$ 1,000,000

NOTE G—LONG-TERM OBLIGATIONS

The School District issues bonds, notes and other contractual commitments to provide for the acquisition, construction and improvement of major capital facilities and for the acquisition of certain equipment. General obligation bonds are direct obligations and pledge the full faith and credit of the School District. Other long-term obligations include capital leases for office equipment and school bus loans.

Summary of Long-term Obligations

The following is a summary of long-term obligations activity for the School District for the year ended June 30, 2007:

	Balance July 1, 2006	Additions	Reductions	Balance June 30, 2007	Due within one year
Governmental activities:					
Bonds	$ 4,304,523	$ -	$ 210,000	$ 4,094,523	$ 230,000
Other obligations	102,065	-	21,903	80,162	23,701
Compensated absences	64,088	24,903	21,160	67,831	-
	$ 4,470,676	$ 24,903	$ 253,063	$ 4,242,516	$ 253,701

NOTE G—LONG-TERM OBLIGATIONS—Continued

Summary of Long-term Obligations—Continued
General obligation bonds consist of the following:

1999 School Building and Site and Refunding General Obligation Bond payable in annual installments ranging from $220,000 to $435,000 due May 2008 to 2019; plus interest ranging from 4.35% to 4.95% payable semi-annually	$ 4,000,000
2002 School Building and Site General Obligation Bond payable in annual installments ranging from $10,000 to $15,000 due May 2008 to 2012; plus interest ranging from 4.8% to 4.85% payable semi-annually	65,000
Durant obligations payable in annual installments ranging from $3,511 to $23,591 including interest at 4.76% due May 2009 to 2013. The School District is only obligated to make the annual payments to the extent of annual State of Michigan state school aid appropriations.	29,523
Total bonded debt	4,094,523
Other obligations	
School bus installment loan payable in annual installments of $11,380, plus interest at 3.34%; final payment due August 2010	45,520
Capital lease obligations, secured by equipment, payable in monthly installments of $1,323, including interest ranging from 11.67% to 12.5%; final payment due July 2011	34,642
Total other obligations	80,162
Compensated absences	67,831
	$ 4,242,516

The Durant bonds, including interest, were issued in anticipation of payment to the School District as appropriated and to be appropriated by the State of Michigan under Section 11g(3) of Act 94 (State Aid payments). The School District has pledged and assigned to the bondholder all rights to these State Aid payments as security for the Bond. The note receivable on the Statement of Net Assets is for the future appropriations from the State of Michigan to pay the Durant obligations.

NOTE G—LONG-TERM OBLIGATIONS—Continued

Summary of Long-term Obligations—Continued

The annual requirements of principal and interest to amortize bonded debt, capital leases and school bus loans outstanding as of June 30, 2007 follows:

June 30,	Principal	Interest	Total
2008	$ 253,701	$ 197,880	$ 451,581
2009	278,095	186,568	464,663
2010	299,191	173,568	472,759
2011	336,864	165,873	502,737
2012	333,484	145,184	478,668
2013-2017	1,818,350	484,648	2,302,998
2018-2019	855,000	63,856	918,856
	$ 4,174,685	$ 1,417,577	$ 5,592,262

NOTE H—EMPLOYEE BENEFITS

Employee Retirement System – Defined Benefit Plan

Plan description – The School District contributes to the statewide Michigan Public School Employees' Retirement System (MPSERS), a cost sharing multiple-employer defined benefit pension plan administered by the nine member board of the MPSERS. The MPSERS provides retirement benefits and post-retirement benefits for health, dental and vision. The MPSERS was established by Public Act 136 of 1945 and operated under the provisions of Public Act 300 of 1980, as amended. The MPSERS issues a publicly available financial report that includes financial statements and required supplementary information for MPSERS. That report may be obtained by writing to or calling:

Office of Retirement Systems
Michigan Public School Employees Retirement System
P.O. Box 30171
Lansing Michigan 48909
1-800-381-5111

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

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

NOTE H—EMPLOYEE BENEFITS—Continued

Employee Retirement System – Defined Benefit Plan—Continued

Funding policy—Continued
The School District is required to contribute the full actuarial funding contribution amount to fund pension benefits, plus an additional amount to fund retiree health care benefit amounts on a cash disbursement basis. The rate for the year ended June 30, 2007 was 17.74 percent of payroll. The contribution requirements of plan members and the School District are established and may be amended by the MPSERS Board of Trustees. The School District contributions to MPSERS for the year ended June 30, 2007, 2006 and 2005 were approximately $470,000, $449,000 and $398,000, respectively, and were equal to the required contribution for those years.

The School District is not responsible for the payment of retirement benefits which is the responsibility of the State of Michigan.

Other post-employment benefits – Under the MPSERS Act, all retirees have the option of continuing health, dental and vision coverage.

NOTE I—COMMITMENTS AND CONTINGENCIES

Commitments

- The School District leases a school building and adjacent playground facilities from St. Mary's Church of Custer. The lease, which expires June 2009, provides for annual rents of approximately $7,000 through June 2007 with annual adjustments thereafter based upon changes in the Consumer Price index. The School District has the option to renew for three additional terms of five years each at a mutually-agreeable rate.

- The School District leases the Fountain School building to FiveCAP, Inc. a non-profit corporation. The School District has negotiated a twenty-year lease expiring August 2018. Under terms of the lease, the building will be leased for one dollar per year with FiveCAP, Inc. responsible for maintenance, repairs, and operational costs of the building.

Contingencies

- The School District participates in grant programs, which are subject to program compliance audits by the grantor or its representatives. Such audits of these programs may be performed at some future date. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time although the School District expects such amounts, if any, to be immaterial.

NOTE J—OTHER INFORMATION

Economic dependence - Prior years revision of the State of Michigan (State) school aid formula for local public schools significantly increased State school aid, and the change in property tax laws significantly decreased local property tax revenues. As a result, State school aid represents approximately 71.8 percent of General Fund revenues.

Risk management – The School District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; error and omissions; injuries to employees; and natural disasters. The School District participates in two distinct pools of educational institutions within the State of Michigan for self-insuring property and casualty and workers' disability compensation. The pools are considered public entity risk pools. The School District pays annual premiums under a retrospectively rated policy to the pools for the respective insurance coverage. In the event a pool's total claims and expenses for a policy year exceed the total normal annual premiums for said years, all members of the specific pool's policy year may be subject to special assessment to make up the deficiency. The workers' compensation pool and the property casualty pool maintain reinsurance for claims generally in excess of $500,000 for each occurrence with the overall maximum coverage varying depending on the specific type coverage of reinsurance.

The School District continues to carry commercial insurance for other risks of loss, including employee health and accident insurance. No settlements have occurred in excess of coverage for June 30, 2007 or any of the prior three years.

NOTE K—SUBSEQUENT EVENT

In August 2007, the School District received the proceeds of a $930,000 State of Michigan (State) school aid anticipation note payable. The note payable is not subject to redemption prior to its maturity in August 2008 and bears interest at the rate of 3.68 percent per annum. The School District pledged for payment of the note payable, the amount of state school aid to be received plus the full faith, credit, and resources of the School District.

REQUIRED SUPPLEMENTARY INFORMATION

Mason County Eastern School District
REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE
General Fund
For the year ended June 30, 2007

	Budgeted amounts			Variance with final budget - positive
	Original	Final	Actual	(negative)
REVENUES				
Local sources	$ 1,027,481	$ 1,123,411	$ 1,129,576	$ 6,165
State sources	3,595,900	3,574,379	3,587,147	12,768
Federal sources	256,751	207,431	205,184	(2,247)
Incoming transfers				
and other transactions	-	60,045	75,530	15,485
Total revenues	4,880,132	4,965,266	4,997,437	32,171
EXPENDITURES				
Instruction				
Basic programs	2,610,405	2,579,866	2,562,996	16,870
Added needs	563,862	538,886	539,767	(881)
Support services				
Pupil	137,675	90,187	88,465	1,722
General administration	242,419	242,499	242,873	(374)
School administration	323,411	328,463	322,007	6,456
Business	100,116	117,673	131,216	(13,543)
Operations and maintenance	468,496	505,686	519,708	(14,022)
Pupil transportation services	265,468	270,264	272,266	(2,002)
Central	94,400	81,634	81,996	(362)
Outgoing transfers and other transactions	140,880	127,480	125,997	1,483
Total expenditures	4,947,132	4,882,638	4,887,291	(4,653)
Excess (deficiency) of revenues over (under) expenditures	$ (67,000)	$ 82,628	110,146	$ 27,518
Fund balance at July 1, 2006			675,931	
Fund balance at June 30, 2007			$ 786,077	

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

August 30, 2007

Board of Education
Ellen Bonter, Superintendent
Mason County Eastern School District
Custer, Michigan

In planning and performing our audit of the financial statements of Mason County Eastern School District as of and for the year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered Mason County Eastern School District's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control.

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 a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above. However, we identified the attached deficiencies in internal control that we consider to be significant deficiencies.

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

Brickley DeLong, PLC

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PHONE (231) 726-5800 • FAX (231) 722-0260

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SIGNIFICANT DEFICIENCY

Recommendation 1: Segregation of duties should be strengthened.

Although the small size of the School District's staff limits the segregation of duties, we believe certain steps could be taken to separate incompatible duties. The basic premise is that no one employee should have access to both physical assets and the related accounting records or to all phases of a transaction. Often, one of the most effective approaches is the expansion of documented approval of transactions and reconciliations by someone outside of the office staff.

The following are some suggested areas where improvements could be made:

- Cash—The monthly bank reconciliations should be reviewed and approved by someone independent of cash receipt and cash disbursement functions.
- Payroll—The payroll registers should be reviewed and approved after payroll is prepared, by someone independent of those who prepare payroll.
- Journal entries—The journal entries prepared and entered into the accounting system should be reviewed and approved by appropriate personnel.
- Cross-training—An individual or individuals should be trained to perform day-to-day activities in the absence of the bookkeeper.

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

August 30, 2007

Board of Education
Ellen Bonter, Superintendent
Mason County Eastern School District
Custer, Michigan

We have audited the financial statements of Mason County Eastern School District as of and for the year ended June 30, 2007 and have issued our report thereon dated August 30, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Mason County Eastern School District's internal control over financial reporting 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 Mason County Eastern School District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Mason County Eastern School District's internal control over financial reporting.

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

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 entity's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying Schedule of Findings and Responses, as Finding 1, to be a significant deficiency in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Internal Control Over Financial Reporting—Continued
Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance
As part of obtaining reasonable assurance about whether Mason County Eastern School District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

Mason County Eastern School District's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Responses. We did not audit Mason County Eastern School District's response and, accordingly, we express no opinion on it.

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

Brickley DeLong, PLC

MASON COUNTY EASTERN SCHOOL DISTRICT
SCHEDULE OF FINDINGS AND RESPONSES
Year ended June 30, 2007

COMPLIANCE

NONE

SIGNIFICANT DEFICIENCIES

Fiscal 2007 Finding No. 1: Segregation of Duties

Criteria: Duties should be adequately segregated so as to separate incompatible duties.

Condition: Certain employees have access to both physical assets and the related accounting records or all phases of a transaction.

Cause: The School District is a small organization with limited opportunities for the segregation of duties.

Effect: Errors in processing transactions and financial reporting and the misappropriation of assets could go undetected.

Recommendation: Segregation of duties should be strengthened, including but not limited to:

- Cash—The monthly bank reconciliations should be reviewed and approved by someone independent of cash receipt and cash disbursement functions.
- Cash—The monthly bank statements should be received unopened by and reviewed for unusual items by someone independent of the bank reconciliation process.
- Payroll—The payroll registers should be reviewed and approved after payroll is prepared by someone independent of those who prepare payroll.
- Journal entries—The journal entries prepared and entered into the accounting system should be reviewed and approved by appropriate personnel.
- Cross-training—An individual or individuals should be trained to perform day-to-day activities in the absence of the bookkeeper.

School District Response:

- Monthly bank reconciliations will be reviewed and approved by Superintendent beginning September 2007.
- The payroll registers will be reviewed by the Administrative Assistant beginning September 2007.
- Journal entries are reviewed and approved by the Superintendent and have been since early August 2007.
- It is highly likely that a Secretary will be replaced within the next year due to retirement. An effort will be made to hire an individual who can be cross-trained to handle many of the above items and perform day-to-day activities in the absence of the bookkeeper.