

CITY OF STEPHENSON
AUDITED FINANCIAL STATEMENTS
REQUIRED SUPPLEMENTAL INFORMATION
AND SUPPLEMENTAL REPORT
YEAR ENDED JUNE 30, 2007

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type <input checked="" type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Government Name CITY OF STEPHENSON	County MENOMINEE
Audit Date JUNE 30, 2007	Opinion Date JULY 23, 2007	Date Accountant Report Submitted to State: JULY 23, 2007	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- yes no 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- yes no 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- yes no 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- yes no 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- yes no 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- yes no 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- yes no 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- yes no 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- yes no 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.			X
Reports on individual federal financial assistance programs (program audits).			X
Single Audit Reports (ASLGU).			X

Certified Public Accountant (Firm Name) RAY PAYMENT, CPA			
Street Address 617 LUDINGTON STREET	City ESCANABA	State MI	ZIP 49829
Accountant Signature 			

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July 23, 2007

INDEPENDENT AUDITOR'S REPORT

Honorable City Council
City of Stephenson
Stephenson, Michigan

I have audited the combined financial statements of the City of Stephenson as of June 30, 2007, and the related statements of revenues and expenditures and fund balances for the year then ended. These financial statements are the responsibility of the City's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America, Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that I 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. I believe that my audit provides a reasonable basis for my opinion.

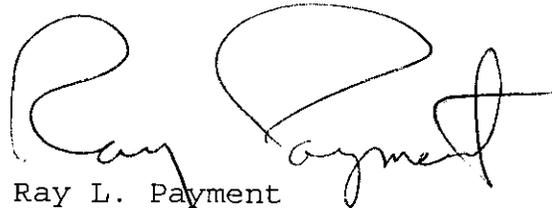
In my opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the various funds of the City of Stephenson at June 30, 2007, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note A, The City has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34 Basic Financial Statements and Management's Discussion and Analysis - for State and Local Governments, as amended and interpreted, as of July 1, 2006.

July 23, 2007

In accordance with Government Auditing Standards, I have also issued my report dated July 23, 2007 on my consideration of the City of Stephenson's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of my audit.

The financial statements referred to in the foregoing opinion are identified in the contents of this report. My examination was made primarily for the purpose of rendering an opinion on these basic financial statements, taken as a whole. The supplementary financial data identified in the contents, although not considered necessary for a fair presentation of the assets and liabilities of the various funds of the City of Stephenson at June 30, 2007 is presented primarily for supplement analysis purposes. This additional information has been subjected to the audit procedures applied in the examination of the basic financial statements and, in my opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink, appearing to read "Ray L. Payment". The signature is stylized with large, sweeping loops and a long horizontal stroke at the end.

Ray L. Payment
Certified Public Accountant

CITY OF STEPHENSON
MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended June 30, 2007

Management's Discussion and Analysis

This section of the City of Stephenson annual financial report presents our discussion and analysis of the City's performance during the year ended June 30, 2007. It is to be read in conjunction with the City's financial statements, which immediately follow. This is a requirement of the Governmental Accounting Standards Board Statement No. 34 (GASB 34) Basic Financial Statements - and Managements Discussion and Analysis - for State and Local Governments, as amended and interpreted, and is intended to provide the financial results for the fiscal year ending June 30, 2007. This is the first year of GASB 34 implementation. As a result the financial report is presented differently than previous years. Because this is the first year of implementation of GASB Statement No. 34, prior-year data is not available but will be provided in subsequent years for comparative purposes.

Government-wide Financial Statements

The Government-wide financial statements appear first in the financial report. These financial statements include the statement of net assets and the statement of activities. They report information about the City as a whole. The statements are prepared using the accrual method of accounting which is the accounting used by most private sector businesses. The statement of net assets includes all of the City's assets and liabilities except the fiduciary funds and proprietary funds. All current year revenues and expenses are reported in the statement of activities. The two statements report the governmental activities of the City that include all services performed by the City. These activities are funded primarily by property taxes and by state grants.

The statement of net assets reports the City's assets and liabilities. The corresponding balance between the assets and liabilities equals the net assets of the City. This statement measures the financial strength of the City; the greater the net asset figure, the healthier the financial position of the City generally is. It helps management determine if the City will be able to fund current obligations and whether they have resources available for future use.

The statement of activities shows the current year change in net assets on a revenue less expense basis. It shows the operating results for a given year of the City. Any excess of revenues over expenditures results in a surplus for the year that in turn increases the net assets (or reduces a deficit) available to fund future needs of the City.

CITY OF STEPHENSON
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Fund Financial Statements

The City's fund financial statements show a detail of funds that are determined to be significant, called major funds. The funds that are separately stated as the major fund are the General Fund and Special Revenue Funds.

Governmental funds are accounted for by the modified accrual method of accounting (flow of current financial resources measurement focus). This method records revenues when all applicable eligibility requirements are met and resources are available to finance expenditures of the fiscal period. Expenditures are recorded when the related liability is incurred. The governmental fund financial statements show the detail of operations for a given year according to this method of accounting. This is similar to how the City reported their finances in the past. The individual fund statements help management determine what financial resources are available on a short-term basis to fund operations.

Although the government-wide financial statements and the fund financial statements use different methods of accounting to report the City's financial condition, there are no current year differences between the two types of statements except depreciation expense and fixed assets.

Fiduciary funds, such as the Trust and Agency and Tax Collection Funds, are reported in the fiduciary fund financial statement, but are excluded from the government-wide reporting. The fiduciary fund financial statement reports resources that are not available to fund City programs. The fiduciary fund financial statement reports similarly to governmental funds.

Proprietary funds, such as the Water, Sewer and Electric Funds are also reported separately as the Utility Funds. These funds are available to operate the utility activities of the City.

CITY OF STEPHENSON
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Government-wide Financial Statements - Condensed Financial Information

Statement of Net Assets

The following is a June 30, 2007 condensed statement of net assets with a detailed analysis of the statement below.

	<u>Governmental Activities</u>
ASSETS	
Current Assets:	
Cash and CD's	\$ 513,586
Receivables	<u>198</u>
Total Current Assets	\$ 513,784
Noncurrent Assets -	
Capital assets, net of accumulated depreciation	<u>481,164</u>
Total Assets	<u>\$ 994,948</u>
LIABILITIES	
Accounts payable	<u>\$ 9,773</u>
NET ASSETS	<u>\$ 985,175</u>
Invested in capital assets, net of related debt	\$ 481,164
Unrestricted	449,087
Restricted	<u>54,924</u>
Total Net Assets	<u>\$ 985,175</u>

The City's governmental net assets are \$985,175 at June 30, 2007. Capital assets are \$481,164. This figure is derived by taking the original cost of the City's assets and subtracting accumulated depreciation to date.

CITY OF STEPHENSON
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Government-wide Financial Statements - Condensed Financial Information

Statement of Net Assets (Continued)

The total restricted and unrestricted net assets are \$504,011 as of June 30, 2007. This is the net accumulated result of the current and past years' operations. The balance in the unrestricted net assets shows that the City has an ample amount of assets to fund liabilities at June 30, 2007.

Statement of Activities

The results of operations for the City as a whole are reported in the statement of activities. This statement reports the changes in net assets for the fiscal year ended June 30, 2007. Since this is the first year the City has prepared financial statements following GASB Statement No. 34, revenue and expense comparisons to the previous year are not made.

	<u>Governmental Activities</u>
Revenue:	
Program Revenues:	
Charges for services	\$ 23,831
Operating grants and contributions	88,073
General Revenues:	
Taxes and collection fees	68,581
State and federal grants	77,213
Interest	24,030
Other revenue	<u>22,399</u>
Total Revenue	\$ 304,127
Program expenses -	
Governmental activities	<u>247,295</u>
Increase in Net Assets	\$ 56,832

The City had an overall increase in net assets of \$56,832 for the year ended June 30, 2007. The City's revenues totaled \$304,127.

CITY OF STEPHENSON
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Statement of Activities (Continued)

The City's total cost to fund governmental activities was \$247,295. A majority of these costs were funded by property taxes and state and federal grants. This shows the City has reliance on property taxes and grants to provide future funding for its programs and administrative costs.

Governmental Fund Budgetary Items

A schedule showing the City's final budget and the actual results are included as required supplementary information in the financial section of the audit report.

Capital Assets

At June 30, 2007 the City had \$481,164 invested in capital assets net of accumulated depreciation. The changes in capital assets during the year ended June 30, 2007 were equipment purchases of \$13,398.

Debt

The City had no outstanding debt at June 30, 2007 in the Governmental Funds.

Future Considerations

The change in state aid payments along with State budget cuts will impact the financial condition of the City. The City has adopted a budget for the upcoming fiscal year that should not over expend it's funding and leave the City with a positive Fund Balance.

Contacting the City

If you have any questions about this report or need additional information, contact the City offices.

BASIC
FINANCIAL
STATEMENTS

CITY OF STEPHENSON
STATEMENT OF NET ASSETS

June 30, 2007

ASSETS	
CURRENT ASSETS:	
Cash and CD's	\$ 513 586
Receivables	<u>198</u>
TOTAL CURRENT ASSETS	<u>\$ 513 784</u>
NONCURRENT ASSETS	
Capital assets	789 943
Less accumulated depreciation	<u>(308 779)</u>
TOTAL NONCURRENT ASSETS	<u>481 164</u>
TOTAL ASSETS	<u>\$ 994 948</u>
LIABILITIES	
Accounts payable	\$ 9 773
NET ASSETS	<u>\$ 985 175</u>
Invested in capital assets, net of related debt	\$ 481 164
Unrestricted	449 087
Restricted	<u>54 924</u>
TOTAL NET ASSETS	<u>\$ 985 175</u>

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

CITY OF STEPHENSON
STATEMENT OF ACTIVITIES

June 30, 2007

		Program Revenues			Governmental Activities
	Expenses	Charges for Services	Operating Grants and Contributions		Net (Expense) Revenue and Changes in Net Assets
Governmental activities:					
Legislative and General					
Government	\$ 32 338	\$ -	\$ -		\$ (32 338)
Public Safety	34 523	-	589		(33 934)
Public Works	66 753	-	87 484		20 731
Other functions	78 249	23 831	-		(54 418)
Unallocated - depreciation	35 432	-	-		(35 432)
Total Governmental Activities	\$ 247 295	\$ 23 831	\$ 88 073		\$ (135 391)
General revenues:					
Taxes and collection fees				\$ 68 581	
State and federal grants				77 213	
Interest				24 030	
Other revenue				22 399	
Total General Revenues				192 223	
Changes in Net Assets				\$ 56 832	
Net assets at July 1, 2006				928 343	
Net assets at June 30, 2007				985 175	

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

CITY OF STEPHENSON
BALANCE SHEET - GOVERNMENTAL FUNDS

June 30, 2007

ASSETS			
	General Fund	Special Revenue Funds	Total
Cash and CD's	\$ 391 167	\$ 122 419	\$ 513 586
Receivables	198	-	198
TOTAL ASSETS	\$ 391 365	\$ 122 419	\$ 513 784

LIABILITIES AND FUND EQUITY			
Liabilities - Accounts payable	\$ 9 256	\$ 517	\$ 9 773
Fund Equity - unreserved	327 185	121 902	449 087
reserved	54 924	-	54 924
TOTAL LIABILITIES AND FUND BALANCE	\$ 391 365	\$ 122 419	\$ 513 784

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

CITY OF STEPHENSON
 RECONCILIATION OF THE BALANCE SHEET OF THE GOVERNMENTAL FUND
 WITH THE STATEMENT OF NET ASSETS

June 30, 2007

Total fund equity of governmental activities		\$513 784
Amounts reported for governmental activities in the statement of net assets are different because:		
Additions:		
Capital assets used in government activities are not financial resources and therefore are not reported as assets in governmental funds.		
Cost of capital assets	\$789 943	
Accumulated depreciation	<u>(308 779)</u>	<u>481 164</u>
Total net assets of governmental activities		<u>\$994 948</u>

RECONCILIATION OF STATEMENT OF REVENUES AND
 EXPENDITURES OF THE GOVERNMENTAL FUND
 WITH THE STATEMENT OF ACTIVITIES
 June 30, 2007

Excess revenues over expenditures of governmental activities		\$ 78 866
Additions:		
Cost of capital assets acquired this year		13 398
Subtractions:		
Depreciation expense		<u>(35 432)</u>
Changes in net assets		<u>\$ 56 832</u>

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

CITY OF STEPHENSON
 COMBINED STATEMENT OF REVENUES AND EXPENDITURES
 AND CHANGES IN FUND BALANCES
 ALL GOVERNMENTAL FUND TYPES
 YEAR ENDED JUNE 30, 2007

	General Fund	Special Revenue Funds	Proprietary Fund Type
REVENUES:			
Property taxes - Current	\$ 57 593	\$ -	\$ 57 593
- Collection Fees	5 336	-	5 336
- Delinquent	5 652	-	5 652
State shared taxes	73 247	-	73 247
State grants - Motor Vehicle Highway Fund	-	87 484	87 484
Liquor law enforcement	-	589	589
Interest	17 712	6 318	24 030
Parking and City fines	796	-	796
Other reimbursements & misc.	280	21 323	21 603
Services rendered and rents	23 831	-	23 831
Metro act	3 966	-	3 966
TOTAL REVENUES	188 413	115 714	304 127
EXPENDITURES:			
City council	17 706	-	17 706
Mayor	3 736	-	3 736
Elections	2 285	-	2 285
General services	36 187	-	36 187
Fire department	15 426	-	15 426
Sanitation	5 670	-	5 670
Parks	24 935	-	24 935
Highways and streets	-	66 753	66 753
Law enforcement	22 612	589	23 201
Zoning and Downtown Development	12 382	-	12 382
Vehicle expenses	6 841	-	6 841
Administrative	10 139	-	10 139
TOTAL EXPENDITURES	157 919	67 342	225 261
EXCESS REVENUES AND OTHER SOURCES (EXPENDITURES & OTHER USES)	30 494	48 372	78 866
FUND BALANCES, beginning of year	351 615	73 530	425 145
FUND BALANCES, end of year	\$ 382 109	\$ 121 902	\$ 504 011

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

CITY OF STEPHENSON
COMBINED STATEMENT OF FIDUCIARY NET ASSETS - FIDUCIARY FUNDS

June 30, 2007

	ASSETS	
		Trust and Agency Fund
		<u> </u>
Cash in bank		\$ 7 840
		<u> </u>
	TOTAL ASSETS	\$ 7 840
		<u> </u>
	LIABILITIES	
Customer Deposits		\$ 7 500
Payroll taxes withheld		<u> 340</u>
	TOTAL LIABILITIES	\$ 7 840
		<u> </u>

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

CITY OF STEPHENSON
 COMBINED BALANCE SHEET - UTILITY FUNDS
 JUNE 30, 2007

	Electric Fund	Sewer Fund	Water Fund
<u>ASSETS</u>			
CURRENT ASSETS:			
Cash	\$ 728 339	\$ 28 116	\$ 229 419
Accounts receivable	52 865	15 645	12 936
TOTAL CURRENT ASSETS	781 204	43 761	242 355
PROPERTY, PLANT & EQUIPMENT:			
Land	11 800	800	-
Plant and equipment	576 653	1 631 653	673 033
Total	588 453	1 632 453	673 033
Less accumulated depreciation	(203 385)	(565 133)	(116 891)
Net Property, Plant & Equipment	385 068	1 067 320	556 142
RESTRICTED ASSETS:			
Funded equipment	173 507	12 367	14 462
Bond and interest reserve accounts	-	26 260	27 320
TOTAL RESTRICTED ASSETS	173 507	38 627	41 782
TOTAL ASSETS	\$1 339 779	\$1 149 708	\$ 840 279
<u>LIABILITIES</u>			
Accounts payable	\$ 49 991	\$ 12 549	\$ 12 432
Bonds payable	-	360 000	479 000
TOTAL LIABILITIES	49 991	372 549	491 432
<u>RETAINED EARNINGS</u>			
RETAINED EARNINGS - UNRESTRICTED	\$1 116 281	\$ 738 532	\$ 307 065
RETAINED EARNINGS - RESTRICTED	173 507	38 627	41 782
TOTAL RETAINED EARNINGS	1 289 788	777 159	348 847
TOTAL LIABILITIES AND RETAINED EARNINGS	\$1 339 779	\$1 149 708	\$ 840 279

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

CITY OF STEPHENSON
 STATEMENTS OF REVENUES AND EXPENDITURES,
 AND CHANGES IN FUND BALANCE
 UTILITY FUND
 YEAR ENDED JUNE 30, 2007

	Electric Fund	Sewer Fund	Water Fund
OPERATING REVENUES:			
Charges for services:			
Electric and sales tax	\$ 631 299	\$ -	\$ -
Sewer	-	169 864	-
Water	-	-	116 024
Service charges and rents	5 796	3 391	2 581
Reimbursements and refunds	12 515	5 062	4 878
TOTAL OPERATING REVENUES	649 610	178 317	123 483
OPERATING EXPENDITURES:			
Electric	582 423	-	-
Sewer - collection	-	9 299	-
Sewer - operating	-	200 983	-
Water	-	-	83 568
TOTAL OPERATING EXPENDITURES	582 423	210 282	83 568
OPERATING INCOME (LOSS)	67 187	(31 965)	39 915
NONOPERATING REVENUES (EXPENDITURES):			
Interest income	43 469	3 927	12 909
Interest on bonds	-	(16 313)	(21 713)
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	\$ 110 656	\$ (44 351)	\$ 31 111
RETAINED EARNINGS, at beginning of period	1 179 132	821 510	317 736
RETAINED EARNINGS, at end of period	\$ 1 289 788	\$ 777 159	\$ 348 847

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

CITY OF STEPHENSON
 STATEMENTS OF CASH FLOWS
 YEAR ENDED JUNE 30, 2007

	<u>Electric</u>	<u>Sewer</u>	<u>Water</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	\$ 110 656	\$(44 351)	\$ 31 111
Non-cash expenses included in net income:			
Depreciation	26 297	40 179	13 094
Increase in accounts payable- (receivable)	11 051	(4 125)	3 944
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	148 004	(8 297)	48 149
CASH FLOWS FROM FINANCING ACTIVITIES:			
Increase in property, plant and equipment - (net)	(39 363)	(20 575)	(17 674)
Increase (decrease) in bonds issued	-	(5 000)	(7 000)
NET CASH (USED) BY FINANCING ACTIVITIES	(39 363)	(25 575)	(24 674)
NET INCREASE (DECREASE) IN CASH	108 641	(33 872)	23 475
CASH, BEGINNING OF YEAR	793 205	100 615	247 726
CASH, END OF YEAR	\$ 901 846	\$ 66 743	\$ 271 201

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

NOTES
TO
FINANCIAL
STATEMENTS

CITY OF STEPHENSON
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Stephenson operates under an elected City Council. The financial statements of the City have been prepared in conformity with generally accepted accounting principles as applicable to governmental units. The Governmental Accounting Standards Board is the accepted standard-setting body for establishing governmental accounting and financial-reporting principles. The more significant of the City's accounting policies are described below.

Financial Reporting Entity

In conformity with generally accepted accounting principles, other autonomously operated governmental organizations are not considered to be part of the City entity for financial-reporting purposes. The criteria established for determining the various governmental organizations to be included in the City's financial statements include oversight responsibility, scope of public service and special financing relationships.

On this basis, the financial statements of the local school district are not included in the financial statements of the City. Educational services are provided to citizens through the local school district, which is a separate governmental entity.

Basis of Presentation

Governmental-wide Financial Statements

The City government-wide financial statements (Statement of Net Assets and Statement of Activities) report information on all of the activities of the City except for the fiduciary activities and proprietary funds. All of the City activities are considered to be governmental activities except for the fiduciary and proprietary fund activities. There was no interfund activity to be eliminated in the Governmental-wide financial statements.

Fund-based Financial Statements

Separate financial statements are provided on the basis of funds, each of which is considered a separate fiscal and accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures. Resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. Governmental and fiduciary funds are provided. The City reports the General and Special Revenue Funds as the Major Fund.

CITY OF STEPHENSON
NOTES TO FINANCIAL STATEMENTS (CONTINUED)

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fund-based Financial Statements (Continued)

Governmental Fund Type

General Fund and Special Revenue Funds - The General Fund is the general operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund. This fund includes the general operating expenditures of the City. Revenues are derived primarily from property taxes, state and federal grants and various local sources. The Special Revenue Funds account for revenues and expenditures to be used as per legal or regulatory provisions.

Fiduciary Fund Type

The Trust and Agency Fund is used to account for assets held by the City in a trustee capacity. This fund is custodial in nature and does not involve measurement of results of operations.

Proprietary Funds

Proprietary Funds report activities that are financed primarily by user charges. The City's Utility Fund is a Proprietary Fund.

Basis of Accounting

Government-wide Financial Statements

The Governmental-wide financial statements report all financial and capital assets, short and long-term liabilities, revenues, expenses, gains and losses using the economic resources measurement focus and the accrual basis of accounting. All revenue is recorded when earned and expenses are recorded when a liability is incurred.

The Statement of Activities reports net cost information based on the City's functions. Direct expenses are listed by function with program revenues for each function offset against those expenses. Program revenues include charges for services that are fees and other charges to the users or recipients of the services the City provides. Program revenues also include operating grants and contributions that are restricted for a particular purpose. Property taxes, nonrestricted state and federal aid and other revenues that are not program revenues are reported as general revenues.

CITY OF STEPHENSON
NOTES TO FINANCIAL STATEMENTS (CONTINUED)

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Accounting (Continued)

Fund-based Financial Statements

Governmental fund types and Agency Funds use the modified accrual basis of accounting and the flow of expendable financial resources (measurement focus). Under the modified accrual basis of accounting, revenues are recorded when all applicable eligibility requirements are met and resources are available (often referred to as "susceptible to accrual"). Revenues are available when revenues are collectible during the period and the actual collection will occur either (a) during the current period or (b) after the end of the period but in time to pay fund liabilities. The City considers revenues to be available if they are expected to be collected within 60 days of the end of the year, except that tax revenues, fees and nontax revenues are recognized when received. Grants, entitlements and shared revenues are recorded when they are susceptible to accrual. Expenditure-based grants are recorded as revenue when all applicable eligibility requirements of the grants are met and resources are available. Expenditures, if measurable, are recorded when they have been used or are expected to use current expendable financial resources, except unmatured interest on general long-term debt is recorded when due. The City has no long-term debt in the Governmental Funds.

Budgets and the Budgetary Process

The City Council adopts an annual operating budget, which can be amended by the Council throughout the year. Formal budgetary accounting is employed as a management control for the City. For budgetary purposes, the same basis of accounting is used to reflect actual revenues and expenditures recognized on the basis of generally accepted accounting principles. For this reason, there is no common basis for preparing a reconciliation between budgeted and actual amounts. The budgeted financial statements presented in this report reflect the final budget authorization, including all amendments. Budgets are adopted on the functional level and lapse at the end of the year.

CITY OF STEPHENSON
NOTES TO FINANCIAL STATEMENTS (CONTINUED)

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property Tax Revenues

Properties are assessed as of December 31 and the related property taxes become a lien on December 1 of the following year. These taxes are due on February 14 of the ensuing year with the final collection date of February 28 before they are added to the delinquent rolls. The City records property taxes as a revenue as collections are made, when monies are available for use to finance City operations. Delinquent real property taxes of the City and all other local units are purchased annually by the County. The City bills and collects its own property taxes and also collects current rolls for the County, Intermediate School District and Local School District.

Capital Assets and Depreciation

Capital assets include land, buildings and improvements and equipment and are reported in the Government-wide financial statements. Capital assets are defined by the City as assets with an acquisition cost of generally more than \$100 or betterments totaling \$1,000 with an estimated useful life in excess of five years. Assets meeting this criteria are recorded at historical cost or estimated historical costs if the amount is not known. Any donated capital assets are recorded at estimated fair market value at the date of donation. The costs of capital assets are charged to expense using an annual allocation of depreciation expense. Taking the depreciable cost of an asset and dividing that cost by its estimated useful life calculates the annual expense. The expense is recorded on the Government-wide Statement of Activities and included as a direct expense of an identifiable function if the assets sole purpose can be identified as being for that function. Depreciation expense (unallocated) is the amount of depreciation expense that cannot be charged to any particular function.

The Capital assets are depreciated using the straight-line method over the following useful lives:

Land	Not depreciated
Buildings and improvements	25-50 years
Equipment	5-10 years

Investment in Capital Assets

This is a portion of net assets of the City that consists of capital assets, net accumulated depreciation. The City had net investment in capital assets at June 30, 2007 of \$481,164.

Restricted Assets

Net assets are restricted when there are constraints placed on their use by external parties or by statute.

CITY OF STEPHENSON
NOTES TO FINANCIAL STATEMENTS (CONTINUED)

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Unrestricted Net Assets

Net assets not meeting either criteria above are considered unrestricted.

Fund Equity

The unreserved fund equity for governmental funds represent the amount available for budgeting future operations.

Use of Estimates

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

Accounting Change

Effective April 1, 2006, the City implemented the provisions of Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments (GASB No. 34). Significant changes to the Township's financial statements as a result of GASB No. 34 are as follows:

Management Discussion and Analysis - provides analysis of the City's overall financial position and results of operations as reported by the City's management.

Government-wide financial statements - Statement of Net Assets and Statement of Activities are prepared using the full accrual basis of accounting that includes all of the City's governmental activities.

Capital assets - recorded in the governmental activities statement of net assets at June 30, 2007 are \$789,943 along with \$308,779 of accumulated depreciation of those capital assets. The June 30, 2006 financial statements reported fixed assets in the General Fixed Assets Account Group (GFAAG) that has been eliminated for reporting purposes. No change was reported in the historical cost of the assets from the GFAAG to the current July 1, 2006 beginning capital assets balance.

Major funds - fund-based financial statements focus on major funds rather than fund-types. Major funds are determined based on the comparison of activity of individual governmental funds to total governmental fund activity.

CITY OF STEPHENSON
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)

NOTE B - CASH INFORMATION

All deposits were made either in banks insured by federal depository insurance or with an investment broker who purchased certificates of deposit insured by federal depository insurance. Deposits were made in accordance with State of Michigan statutes and under authorization of the City Council.

At June 30, 2007 total cash and certificates of deposit as reported by banks and investment broker amounted to \$1,761,216, of which \$700,000 was covered by depository insurance and \$1,061,216 was not covered.

NOTE C - PROPERTY TAXES

A summary of the 2006 tax roll follows:

<u>Taxing Unit</u>	<u>Mills</u>	<u>Spread</u>	<u>Delinquent</u>	<u>Collected</u>
County	8.8205	\$ 109 299	\$ 6 281	\$ 103 018
State education tax	6.0000	74 354	3 445	70 909
Local school	20.3576	118 999	7 865	111 134
Intermediate school	2.2619	28 029	1 977	26 052
City - General	<u>5.0000</u>	<u>61 962</u>	<u>4 369</u>	<u>57 593</u>
TOTALS	42.4400	\$ 392 643	\$ 23 937	\$ 368 706
		<u> </u>	<u> </u>	<u> </u>
Taxable Valuation				<u>\$12 392 607</u>

CITY OF STEPHENSON
NOTES TO FINANCIAL STATEMENTS (CONTINUED)

NOTE D - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Public Act 275 of 1980 Disclosure

The City had no funds with a deficit as of June 30, 2007.

Public Act 621 of 1978 Disclosure

Public Act 621 of 1978, as amended, provides that a local unit of government shall not incur expenditures in excess of the amount appropriated. The City was in substantial compliance with the Act.

NOTE E - PROPERTY TAX ADMINISTRATION FEE

The City has not established a subsidiary ledger to account for costs incurred in collection, assessing and reviewing of property tax levies as required by Public Act 503 of 1982. A summary of the transactions that would affect the balance sheet equity account for the ended June 30, 2007, follows:

Receipts from charging administrative fee	\$ 5 741
Cost incurred	<u>6 296</u>
Excess of costs	<u><u>\$ (555)</u></u>

NOTE F - CAPITAL ASSETS

Following is a summary of changes in capital assets during the year ended June 30, 2007:

	Balance at July 1, <u>2006</u>	<u>Additions</u>	<u>Disposals</u>	Balance at June 30, <u>2007</u>
<u>Governmental Activities</u>				
Assets:				
Buildings and improvements	\$ 553 545	\$ -	\$ -	\$ 553 545
Equipment	<u>223 000</u>	<u>12 398</u>	<u>-</u>	<u>236 398</u>
	\$ 776 545	\$ 13 398	\$ -	\$ 789 943
Less accumulated depreciation	<u>(273 347)</u>	<u>(35 432)</u>	<u>-</u>	<u>(308 779)</u>
Net Capital Assets	<u>\$ 503 198</u>	<u>\$ (22 034)</u>	<u>\$ -</u>	<u>\$ 481 164</u>

CITY OF STEHPENSON
NOTES TO FINANCIAL STATEMENTS (CONTINUED)

NOTE G - RISK MANAGEMENT

The City is exposed to various risks of losses related to torts; theft of, damage to and destruction of assets; errors or omissions; injuries to employees; and natural disasters. The City has obtained coverage from commercial insurance companies.

All risk management activities are accounted for in the General Fund of the City. Expenditures and claims are recognized when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. In determining claims, events that might create claims, but for which none have been reported, are considered.

Management estimates that the amount of actual or potential claims against the City as of June 30, 2007, will not materially affect the financial condition of the City. Therefore, the financial statements contain no provisions for estimated claims. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three years.

CITY OF STEPHENSON
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)

NOTE H - SEWER REVENUE BONDS PAYABLE

The sewer revenue bond ordinance requires at least one-fourth of the interest and bond redemption requirements for the year be deposited in the bond and interest redemption fund and bond reserve fund each quarter. At June 30, 2007 the required amount in this fund was \$26,260 and \$26,260 was on deposit. The original issue amount was \$400,000 for Sewer Fund construction.

BOND ISSUE NO. 1

4 1/2% SEWER REVENUE BONDS

<u>Due Date</u>	<u>Amount of Annual Maturity</u>	<u>Outstanding June 30, 2007</u>
9/1/2007 thru 9/1/2010	\$ 6 000	\$ 24 000
9/1/2011 thru 9/1/2013	7 000	21 000
9/1/2014 thru 9/1/2016	8 000	24 000
9/1/2017 thru 9/1/2019	9 000	27 000
9/1/2020 thru 9/1/2021	10 000	20 000
9/1/2022 thru 9/1/2023	11 000	22 000
9/1/2024 thru 9/1/2025	12 000	24 000
9/1/2026 thru 9/1/2027	13 000	26 000
9/1/2028	14 000	14 000
9/1/2029 thru 9/1/2030	15 000	30 000
9/1/2031	16 000	16 000
9/1/2032 thru 9/1/2033	17 000	34 000
9/1/2034	18 000	18 000
9/1/2035	19 000	19 000
9/1/2036	20 000	20 000
9/1/2037	21 000	<u>21 000</u>
Total Bond Issue No. 1		<u>\$ 360 000</u>

CITY OF STEPHENSON
 NOTES TO FINANCIAL STATEMENTS (CONTINUED)

NOTE I - WATER BONDS PAYABLE

The water bond ordinance requires at least one-fourth of the interest and bond redemption requirements for the year be deposited in the bond and interest redemption fund and bond reserve fund each quarter. At June 30, 2007 the required amount in this fund was \$27,320 and \$27,320 was on deposit. The original issue amount was \$572,000 for Water Fund construction.

WATER BOND ISSUE NO. 1

4 1/2% WATER REVENUE BONDS

<u>Due Date</u>	<u>Amount of Annual Maturity</u>	<u>Outstanding June 30, 2007</u>
9/1/2006 thru 9/1/2007	\$ 7 000	\$ 7 000
9/1/2008 thru 9/1/2010	8 000	24 000
9/1/2011 thru 9/1/2012	9 000	18 000
9/1/2013 thru 9/1/2015	10 000	30 000
9/1/2016 thru 9/1/2017	11 000	22 000
9/1/2018 thru 9/1/2019	12 000	24 000
9/1/2020 thru 9/1/2021	13 000	26 000
9/1/2022	14 000	14 000
9/1/2023 thru 9/1/2024	15 000	30 000
9/1/2025	16 000	16 000
9/1/2026 thru 9/1/2027	17 000	34 000
9/1/2028 thru 9/1/2029	19 000	38 000
9/1/2030	20 000	20 000
9/1/2031	21 000	21 000
9/1/2032	22 000	22 000
9/1/2033	23 000	23 000
9/1/2034	24 000	24 000
9/1/2035	25 000	25 000
9/1/2036	26 000	26 000
9/1/2037	27 000	27 000
9/1/2038 thru 9/1/2039	29 000	<u>8 000</u>
Total		<u>\$ 479 000</u>

REQUIRED
SUPPLEMENTAL
INFORMATION

CITY OF STEPHENSON
 COMBINED STATEMENT OF REVENUES, EXPENDITURES,
 AND CHANGES IN FUND BALANCES - BUDGET AND ACTUAL
 GENERAL AND SPECIAL REVENUE FUNDS
 YEAR ENDED JUNE 30, 2007

	<u>General Fund</u>		
	<u>Actual Amount</u>	<u>Budget Amount</u>	<u>Variance Favorable (Unfavorable)</u>
CASH REVENUES:			
Property taxes			
- Current and in-lieu	\$ 57 593	\$ 59 000	\$ (1 407)
- Collection fees	5 336	5 200	136
- Delinquent	5 652	400	5 252
State shared taxes	73 247	75 000	(1 753)
State grants - Motor Vehicle Highway Fund	-	-	-
Liquor law enforcement	-	-	-
Interest	17 712	5 000	12 712
Fines	796	420	376
Services rendered and rents	23 831	16 050	7 781
Other reimbursements & misc.	280	1 400	(1 120)
Metro act	3 966	-	3 966
TOTAL REVENUES	<u>188 413</u>	<u>162 470</u>	<u>25 943</u>
EXPENDITURES:			
City council	17 706	21 443	3 737
Mayor	3 736	3 200	(536)
Elections	2 285	2 361	76
General services	36 187	36 809	622
Fire department	15 426	15 371	(55)
Sanitation	5 670	5 753	83
Parks	24 935	29 607	4 672
Highways and streets	-	-	-
Law enforcement	22 612	23 831	1 219
Zoning and Downtown Development	12 382	12 703	321
Administrative	10 139	25 115	14 976
Vehicle expenses	6 841	11 885	5 044
TOTAL EXPENDITURES	<u>157 919</u>	<u>188 078</u>	<u>30 159</u>
EXCESS REVENUE AND OTHER SOURCES (EXPENDITURES & OTHER USES)	30 494	(25 608)	56 102
FUND BALANCES, beginning of year	<u>351 615</u>	<u>351 615</u>	<u>-</u>
FUND BALANCES, end of year	<u>\$ 382 109</u>	<u>\$ 326 007</u>	<u>\$ 56 102</u>

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

Special Revenue Funds

<u>Actual Amount</u>	<u>Budget Amount</u>	<u>Variance Favorable (Unfavorable)</u>
\$ -	\$ -	\$ -
-	-	-
-	-	-
-	-	-
87 484	88 000	(516)
589	600	(11)
6 318	-	6 318
-	-	-
-	-	-
21 323	-	21 323
-	-	-
<u>115 714</u>	<u>88 600</u>	<u>27 114</u>
-	-	-
-	-	-
-	-	-
-	-	-
-	-	-
-	-	-
66 753	77 000	10 247
589	600	11
-	-	-
-	-	-
-	-	-
<u>67 342</u>	<u>77 600</u>	<u>10 258</u>
48 372	11 000	37 372
<u>73 530</u>	<u>73 530</u>	<u>-</u>
\$ 121 902	\$ 84 530	\$ 37 372

OTHER
FINANCIAL
INFORMATION

CITY OF STEPHENSON
STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
ALL FIDUCIARY FUND TYPES
JUNE 30, 2007

	<u>Balance</u> July 1, 2006	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> June 30, 2007
<u>ASSETS</u>				
Cash	\$ 9 739	\$ 388 813	\$ 390 712	\$ 7 840
TOTAL ASSETS	<u>\$ 9 739</u>	<u>\$ 388 813</u>	<u>\$ 390 712</u>	<u>\$ 7 840</u>
 <u>LIABILITIES</u>				
Due to other taxing units:				
State of Michigan withholding	\$ 339	\$ 4 871	\$ 4 870	\$ 340
Customer deposits	9 400	3 300	5 200	7 500
City of Stephenson	-	65 664	65 664	-
Menominee County	-	104 658	104 658	-
Intermediate School District	-	26 273	26 273	-
Stephenson Area Schools	-	113 138	113 138	-
State of Michigan-S.E.T.	-	70 909	70 909	-
TOTAL LIABILITIES	<u>\$ 9 739</u>	<u>\$ 388 813</u>	<u>\$ 390 712</u>	<u>\$ 7 840</u>

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

CITY OF STEPHENSON
 COMBINED BALANCE SHEET - SPECIAL REVENUE FUNDS
 JUNE 30, 2007

	Major Street Fund	Local Street Fund	Liquor Fund
<u>ASSETS:</u>			
CASH	\$ 110 841	\$ 11 578	\$ -
ACCOUNTS RECEIVABLE	-	-	-
 TOTAL ASSETS	 \$ 110 841	 \$ 11 578	 \$ -
 LIABILITIES - ACCOUNTS PAYABLE	 349	 168	 -
FUND BALANCES	110 492	11 410	-
 TOTAL LIABILITIES AND FUND BALANCES	 \$ 110 841	 \$ 11 578	 -

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

CITY OF STEPHENSON
 COMPARATIVE BALANCE SHEETS - UTILITY FUNDS
 JUNE 30, 2007 AND 2006

<u>ASSETS</u>	<u>Year Ended 2007</u>	<u>June 30, 2006</u>
PROPERTY, PLANT AND EQUIPMENT		
Property, plant and equipment	\$ 2 893 939	\$ 2 816 327
Less accumulated depreciation	<u>(885 409)</u>	<u>(805 839)</u>
Net property and equipment	<u>2 008 530</u>	<u>2 010 488</u>
RESTRICTED ASSETS:		
Bond and Interest Redemption Fund - Cash	53 580	48 180
Funded Equipment - Cash	<u>200 336</u>	<u>252 324</u>
Total restricted assets	<u>253 916</u>	<u>300 504</u>
CURRENT ASSETS:		
Cash on deposit	985 874	841 042
Accounts Receivable	<u>81 446</u>	<u>70 106</u>
TOTAL ASSETS	<u>\$ 3 329 766</u>	<u>\$ 3 222 140</u>
 <u>LIABILITIES, DEFERRED CREDITS AND RETAINED EARNINGS</u>		
RETAINED EARNINGS	\$ 2 415 794	\$ 2 318 378
LONG-TERM DEBT		
Revenue bonds payable - noncurrent portion	826 000	839 000
CURRENT LIABILITIES:		
Maturing bonds payable (Due January 1, 2006)	13 000	12 000
Accounts payable	<u>74 972</u>	<u>52 762</u>
TOTAL LIABILITIES AND RETAINED EARNINGS	<u>\$ 3 329 766</u>	<u>\$ 3 222 140</u>

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

CITY OF STEPHENSON
 COMPARATIVE STATEMENT OF REVENUES AND EXPENDITURES - UTILITY FUNDS
 YEAR ENDED JUNE 30, 2007 AND 2006

	<u>Year Ended</u> 2007	<u>June 30,</u> 2006
OPERATING REVENUES:		
Charges for services:		
Electric and sales tax	\$ 631 299	\$ 469 746
Sewer	169 864	157 702
Water	116 024	107 327
Service charges and rents	11 768	8 475
Reimbursements and refunds	<u>22 455</u>	<u>17 579</u>
TOTAL OPERATING REVENUES	<u>951 410</u>	<u>760 829</u>
OPERATING EXPENDITURES:		
Electric	582 423	524 222
Sewer - collection	9 299	9 809
Sewer - operating	200 983	173 537
Water	<u>83 568</u>	<u>75 068</u>
TOTAL OPERATING EXPENDITURES	<u>876 273</u>	<u>782 636</u>
OPERATING INCOME (LOSS)	75 137	(21 807)
NONOPERATING INCOME (EXPENDITURES):		
Interest income	60 305	29 642
Interest on bonds	<u>(38 026)</u>	<u>(38 565)</u>
EXCESS OF REVENUES OVER EXPENDITURES	\$ 97 416	\$ (30 730)
RETAINED EARNINGS, at beginning of period	<u>2 318 378</u>	<u>2 349 108</u>
RETAINED EARNINGS, at end of period	<u>\$ 2 415 794</u>	<u>\$ 2 318 378</u>

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

CITY OF STEPHENSON
 COMBINED STATEMENT OF REVENUES,
 EXPENDITURES AND CHANGES IN FUND BALANCES
 ALL SPECIAL REVENUE FUNDS
 YEAR ENDED JUNE 30, 2007

	Major Street Fund	Local Street Fund	Liquor Fund
REVENUES:			
State grants	\$ 66 987	\$ 20 497	\$ -
Liquor law fees	-	-	589
Reimbursements & misc.	21 044	279	-
Interest income	5 636	682	-
TOTAL REVENUES	93 667	21 458	589
EXPENDITURES:			
Routine maintenance:			
Salaries	4 492	2 401	-
Traffic services & nonmotorized	262	163	-
Maintenance	6 242	3 192	-
Equipment rent to General Fund	4 789	3 139	-
Insurance	889	444	-
Payroll taxes & fringe benefits	2 598	1 416	-
Professional & contract services	121	60	-
Equipment rental	375	-	-
Winter maintenance:			
Salaries	4 283	2 222	-
Repairs and maintenance	770	384	-
Insurance	857	428	-
Equipment rent to General Fund	8 207	5 604	-
Professional and contract	50	33	-
Payroll taxes & fringe benefits	2 174	1 120	-
Construction:			
Professional services	10 005	33	-
Law enforcement	-	-	589
TOTAL EXPENDITURES	46 114	20 639	589
EXCESS REVENUES (EXPENDITURES) AND OTHER SOURCES	47 553	819	-
FUND BALANCE, at beginning of period	62 939	10 591	-
FUND BALANCE, at end of period	\$ 110 492	\$ 11 410	\$ -

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

RAYMOND L. PAYMENT
CERTIFIED PUBLIC ACCOUNTANT

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July 23, 2007

PROFESSIONAL BUILDING
STEPHENSON, MICHIGAN 49887
PHONE: 906-753-4700

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
"GOVERNMENT AUDITING STANDARDS"

Honorable City Council
City of Stephenson
Stephenson, Michigan

I have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the City of Stephenson, Menominee County, Michigan as of and for the year ended June 30, 2007, which collectively comprises the City's basic financial statements and have issued my report thereon dated July 23, 2007. The City has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis - for State and Local Governments, as of June 30, 2007. I conducted my 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.

Compliance

As part of obtaining reasonable assurance about whether the City of Stephenson's general purpose financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

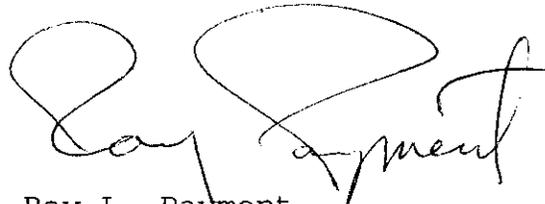
Internal Control Over Financial Reporting

In planning and performing my audit I considered the City of Stephenson's internal control over financial reporting in order to determine my audit procedures for the purpose of expressing my

July 23, 2007

opinion on the general purpose financial statements and not to provide assurance on the internal control over financial reporting. My consideration of the internal control over financial reporting would not necessarily disclose all matter in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. I noted no matters involving the internal control over financial reporting and its operation that I consider to be material weaknesses.

This report is intended solely for the information and use of the audit committee, management, others within the organization, City Council, 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.

A handwritten signature in black ink, appearing to read "Ray L. Payment". The signature is stylized with large loops and a long horizontal stroke at the end.

Ray L. Payment
Certified Public Accountant