Michigan Department of Treasury
496 (02/06)

Auditing Procedures Report

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

Local Unit of Government Type	Local Unit Name	County
☐County ☒City ☐Twp ☐Village ☐Other	City of Muskegon Heights	Muskegon

Fiscal Year End	Opinion Date	Date Audit Report Submitted to State
12/31/2006	6/15/07	6/28/07

We affirm that:

We are certified public accountants licensed to practice in Michigan.

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

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

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

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

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)
Financial Statements	☒	
The letter of Comments and Recommendations	☒	
Other (Describe)	☒	Single audit report

Certified Public Accountant (Firm Name)	Telephone Number		
Vredeveld Haefner LLC	616 460-9388		
Street Address	**City**	**State**	**Zip**
4001 Granada Ct	Grand Rapids	MI	49534

Authorizing CPA Signature	Printed Name	License Number
	Peter Haefner	1102003198

CITY OF MUSKEGON HEIGHTS, MICHIGAN

FINANCIAL STATEMENT
and
SINGLE AUDIT REPORTS

FOR THE YEAR ENDED DECEMBER 31, 2006

Vredeveld Haefner LLC

CITY OF MUSKEGON HEIGHTS

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CITY OF MUSKEGON HEIGHTS

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INDEPENDENT AUDITORS' REPORT

June 15, 2007

Honorable Mayor and Members of the City Council
City of Muskegon Heights, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Muskegon Heights, Michigan, as of and for the year ended December 31, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the management of the City of Muskegon Heights, Michigan. 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, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information for the City of Muskegon Heights, Michigan as of December 31, 2006, and the respective changes in financial position and, where applicable, cash flows, thereof and the respective budgetary comparison for the general fund 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 a report dated June 15, 2007, on our consideration of the City of Muskegon Heights' internal control over financial reporting and 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 on pages 3-8 is not a required part of the basic financial statements but is supplementary information required by accounting principals generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Specializing in services to governmental and nonprofit entities

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Muskegon Heights' basic financial statements. The combining and individual financial statements and schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the United States Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non Profit Organizations*, and is also not a required part of the basic financial statements of the City of Muskegon Heights. The combining and individual financial statements and schedules and the schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Vredeveld Haefner LLC

Management's Discussion and Analysis

As management of the City of Muskegon Heights (the City), we offer readers of the City's financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended December 31, 2006.

Financial Highlights

The financial statements, which follow this Management's Discussion and Analysis, provide these significant key financial highlights for the 2006 fiscal year as follows:

- $9.615 million dollars in refunding bonds were issued in the water supply fund to refund $8.935 of water supply revenue bonds. The refunding reduced future debt service cost by approximately $850,000 and resulted in an economic gain of approximately $484,000.
- Water supply system improvements including upgrades to the plant SCADA system of approximately $440,000 were completed.
- The City received a combination $2,000,000 grant and loan to remove and restore the property referred to as the "old sewage treatment plant" to a residential buildable condition. The City has entered into an agreement with a developer to build homes on the site as soon as it is available.
- A consultant was hired to begin the job of conducting a survey and analysis of Downtown Muskegon Heights known as a "Blueprint for Downtown". This document, when completed, will be used as a plan for a five-year project to revitalize the downtown area. It is hoped that this will help the City to attract businesses, which will increase our tax base and provide jobs for local residents.
- Also in 2006, work on the sale of fifty-two vacant lots for the development of residential housing was very close to completion. It is expected that the sale will be finalized and that development of the lots will begin in 2007

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components: 1) Government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide financial statements The Government-wide financial statements are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The statement of net assets presents information on all of the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The statement of activities presents information showing how the City's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected revenues and earned but unused compensated absences).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City include general government, public safety, public works and streets, community development, and culture and recreation. The business-type activities of the City include sewer, water, and water supply operations.

The government-wide financial statements include not only the City itself (known as the primary government), but also a legally separate Downtown Development Authority (DDA) and the Brownfield Redevelopment Authority for which the City is financially accountable. The Brownfield Redevelopment Authority was formed in prior years and no financial activity or balances are reported for 2006. Information for these component units is reported separately from the financial information presented for the primary government itself.

Fund financial statements A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a City's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the City's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general fund which is considered a major fund. Data is combined into a single aggregated presentation for the other governmental funds. Individual fund data for each of the non-major governmental funds is provided in the form of combining statements and schedules.

The City adopts an annual appropriated budget for its General Fund and all special revenue funds as required by state law. A budgetary comparison statement has been provided for the major funds to demonstrate legal compliance.

Proprietary funds The City maintains one type of proprietary fund (Enterprise funds). Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses enterprise funds to account for its sewer, water, and water supply operations. The City does not use internal service funds.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the sewer, water, and water supply operations, all of which are considered to be major funds of the City. Conversely, all internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements.

Fiduciary funds Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statement because the resource of those funds are not available to support the City's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

Notes to the financial statements The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain supplementary information. This is limited to this discussion and analysis and combining statements and schedules.

Government-wide Financial Analysis

Statement of Net Assets As noted earlier, net assets may serve over time as a useful indicator of a City's financial position. In the case of the City, assets exceeded liabilities by $16,836,119 at the close of the most recent fiscal year. The following chart illustrates the composition of net assets.

City of Muskegon Heights Net Assets

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Assets						
Current and other assets	$3,007,313	$2,987,086	$6,140,205	$6,560,478	$9,147,518	$ 9,547,564
Capital assets	8,996,392	9,856,921	21,684,847	21,886,373	30,681,239	31,743,294
Total assets	12,003,705	12,844,007	27,825,052	28,446,851	39,828,757	41,290,858
Liabilities						
Current liabilities	2,223,228	2,030,510	1,003,839	1,450,415	3,227,067	3,480,925
Long-term liabilities	2,191,574	2,328,845	17,573,997	16,961,452	19,765,571	19,290,297
Total liabilities	4,414,802	4,359,355	18,577,836	18,411,867	22,992,638	22,771,222
Net assets						
Invested in capital assets, net of related debt	8,243,703	8,762,653	5,357,846	5,843,582	13,601,549	14,606,235
Restricted	823,233	731,407	1,641,558	2,484,352	2,464,791	3,215,759
Unrestricted	(1,478,033)	(1,009,408)	2,247,812	1,707,050	769,779	697,642
Total net assets	$7,588,903	$8,484,652	$9,247,216	$10,034,984	$16,836,119	$18,519,636

By far the largest portion of the City's net assets in the amount of 80% reflects its investment in capital assets (e.g., land, buildings, machinery and equipment and infrastructure), less any related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the City's net assets in the amount of 15% represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets in the amount of $769,779, or 5%, may be used to meet the City's ongoing obligations to citizens and creditors.

At the end of the current fiscal year, the City is able to report positive balances in all three categories of net assets, for the government as a whole and the business-type activities. Governmental activities reported negative unrestricted net assets at year end.

Statement of Activities The City's total revenue for the fiscal year ended December 31, 2006, was $12,342,717. The total cost of all programs and services was $14,026,234 of which $1,959,781 represent depreciation expense. This results in a net asset decrease at the end of the fiscal year of $1,683,517. The following table presents a summary of the changes in net assets for the year ended December 31. Certain revenues, expenses, and transfers have been classified differently in 2006 than in 2005.

City of Muskegon Heights Changes in Net Assets

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Revenues						
Program revenues						
Charges for services	$1,110,488	$831,714	$4,221,604	$4,598,909	$5,332,092	$5,430,623
Operating grants and contributions	1,706,368	1,407,144	-	-	1,706,368	1,407,144
Capital grants and contributions	-	375,087	-	-	-	375,087
General revenues						
Property taxes	2,280,569	2,139,942	-	-	2,280,569	2,139,942
Income taxes	1,045,324	1,016,829	-	-	1,045,324	1,016,829
State shared revenues	1,782,345	1,836,180	-	-	1,782,345	1,839,180
Investment earnings	24,663	28,354	171,356	173,453	196,019	28,354
Other	-	431,502	-	-	-	431,502
Total revenues	7,949,757	8,066,752	4,392,960	4,772,362	12,342,717	12,839,114
Expenses						
General government	1,564,457	2,019,164	-	-	1,564,457	2,019,164
Public safety	3,885,033	3,348,447	-	-	3,885,033	3,348,447
Public works and streets	2,605,040	2,339,557	-	-	2,605,040	2,339,557
Culture and recreation	337,703	350,395	-	-	337,703	350,395
Community development	631,549	369,123	-	-	631,549	369,123
Interest on long-term debt	98,028	103,447	-	-	98,028	103,447
Sewer	-	-	873,269	942,016	873,269	942,016
Water	-	-	1,049,003	1,443,764	1,049,003	1,443,764
Water supply	-	-	2,982,152	3,275,621	2,982,152	3,275,621
Total expenses	9,121,810	8,530,133	4,904,424	5,661,401	14,026,234	14,191,534
Increase (decrease) before transfers	(1,172,053)	(463,381)	(511,464)	(889,039)	(1,683,517)	(1,352,420)
Transfers in (out)	276,304	32,541	(276,304)	(32,541)	-	-
Increase (decrease) in net assets	(895,749)	(430,840)	(787,768)	(921,580)	(1,683,517)	(1,352,420)
Net assets – beginning	8,484,652	8,915,492	10,034,984	10,956,564	18,519,636	19,872,056
Net assets – ending	$7,588,903	$8,484,652	$9,247,216	$10,034,984	$16,836,119	$18,519,636

Governmental Activities The preceding table shows that the governmental activities decreased the City's net assets by $895,749 during this fiscal year, accounting for approximately 53% of the total decrease in net assets. This decrease is primarily the result of depreciation on capital asses.

Business-type Activities Business-type activities decreased the City's net assets by $787,768, or approximately 47% of the total decline in the City's net assets.

Financial Analysis of the Government's Funds

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a City's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of $851,889 a decrease of $58,422 in comparison with the prior year.

The general fund is the chief operating fund of the City. At the end of the current fiscal year, the entire fund balance of the general fund of $88,238 was unreserved and undesignated. As a measure of the general fund's liquidity, it may be useful to compare unreserved fund balance to total fund expenditures. Unreserved fund balance represents 1% of total general fund expenditures.

The fund balance of the general fund decreased by $148,214, or 67%, during the current fiscal year. The change in fund balance is highly dependent on the level of transfers made to and received from other funds.

Proprietary funds The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

The City of Muskegon Heights's enterprise operations consist of three separate and distinct activities. The sewer, water and water supply funds provide service to most residents and businesses of the City. The sewer and water supply funds experienced declines in net assets of $177,232 and $814,673 respectively while the water fund increased net assets by $204,137.

General Fund Budgetary Highlights

Differences between the general fund original and final amended budgets were primarily the result of increased income tax expectations, receipt of additional federal grants, and increases in multiple charges for service.

Capital Asset and Debt Administration

Capital Assets The City's investment in capital assets for its governmental and business-type activities as of December 31, 2006, amounted to $30,681,239 (net of accumulated depreciation). Of this amount, $8,996,392 was for its governmental type activities and $21,684,847 was for its business-type activities. This investment in capital assets includes land, buildings and equipment, vehicles and infrastructure.

Major capital asset events during the current fiscal year included the following:

- Purchase of three additional police vehicles for $67,850.
- Construction of the boardwalk for $80,000.
- Water supply system and plant improvement of approximately $440,000.
- Purchase of a vactor truck in the sewer fund for $216,337.

Additional information on the City's capital assets can be found in note 6 of these financial statements.

Long-term debt. At the end of the current fiscal year, the City had total long-term debt including compensated absences outstanding of $20,733,374. Of this amount, $2,572,705 was for governmental activities while $18,160,669 was for business type activities.

The City's total long-term debt decreased by $41,005, during the current fiscal year.

The City debt limit, as defined by statute, is ten percent (10%) of state equalized property values, which currently equals $15,345,660. Total City's long-term debt subject to this limit is $2,350,578.

Additional information on the City's long-term debt can be found in note 8 of these financial statements.

Economic Factors and Next Year's Budgets and Rates

The following economic factors were considered in preparing the City's budget for the 2007 fiscal year:

- Flat performance of the State of Michigan's economy will likely result in stagnant or additional decreases in state funding.
- Wage increases as identified in employment agreements.
- The City's unemployment rate is higher than the state's average unemployment rate due in part to the struggling manufacturing base in the State of Michigan.

Requests for Information

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the City's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Finance Director, City of Muskegon Heights, 2724 Peck Street, Muskegon Heights, MI 49444.

CITY OF MUSKEGON HEIGHTS

STATEMENT OF NET ASSETS

DECEMBER 31, 2006

	Primary Government			Component Unit
	Governmental Activities	Business-Type Activities	Total	Downtown Development Authority
Assets				
Cash and pooled investments	$ 758,990	$ 3,870,857	$ 4,629,847	$ 257,808
Receivables				
Accounts	285,683	623,128	908,811	89
Property taxes	585,503	-	585,503	134,413
Income taxes	249,133	-	249,133	-
Special assessment receivable	104,318	-	104,318	-
Due from other governments	569,817	-	569,817	-
Inventory	93,406	31,212	124,618	-
Prepaid items	149,583	-	149,583	-
Internal balances	171,219	(171,219)	-	-
Loans receivable	-	-	-	24,136
Capital assets				
Land	254,408	40,012	294,420	294,635
Depreciable capital assets, net	8,741,984	21,644,835	30,386,819	582,346
Bond issuance costs	39,661	1,786,227	1,825,888	-
Total assets	12,003,705	27,825,052	39,828,757	1,293,427
Liabilities				
Accounts payable	550,843	257,620	808,463	63,965
Accrued liabilities	85,365	159,547	244,912	8,636
Due to other governments	3,323	-	3,323	20,914
Unearned revenue	1,202,566	-	1,202,566	164,270
Noncurrent liabilities				
Due within one year	381,131	586,672	967,803	99,374
Due in more than one year	2,191,574	17,573,997	19,765,571	626,510
Total liabilities	4,414,802	18,577,836	22,992,638	983,669
Net assets				
Invested in capital assets, net of related debt	8,243,703	5,357,846	13,601,549	151,097
Restricted for				
Capital improvements	22,072	-	22,072	-
Debt service	4,339	1,641,558	1,645,897	-
Major streets	139,177	-	139,177	-
Local streets	140,305	-	140,305	-
Cemetery perpetual care	517,340	-	517,340	-
Unrestricted (deficit)	(1,478,033)	2,247,812	769,779	158,661
Total net assets	$ 7,588,903	$ 9,247,216	$ 16,836,119	$ 309,758

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

CITY OF MUSKEGON HEIGHTS

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED DECEMBER 31, 2006

Functions/Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net (Expense) Revenue
Primary government					
Governmental activities					
General government	$ 1,564,457	$ 681,007	$ 56,834	$ -	$ (826,616)
Public safety	3,885,033	321,097	201,683	-	(3,362,253)
Public works and streets	2,605,040	12,038	835,792	-	(1,757,210)
Culture and recreation	337,703	37,442	-	-	(300,261)
Community development	631,549	58,904	612,059	-	39,414
Interest on long-term debt	98,028	-	-	-	(98,028)
Total governmental activities	9,121,810	1,110,488	1,706,368	-	(6,304,954)
Business-type activities					
Sewer	873,269	747,451	-	-	(125,818)
Water	1,049,003	1,325,768	-	-	276,765
Water supply	2,982,152	2,148,385	-	-	(833,767)
Total business-type activities	4,904,424	4,221,604	-	-	(682,820)
Total primary government	$ 14,026,234	$ 5,332,092	$ 1,706,368	$ -	$ (6,987,774)
Component units					
Downtown Development Authority	$ 385,835	$ 51,046	$ -	$ -	$ (334,789)
Total component units	$ 385,835	$ 51,046	$ -	$ -	$ (334,789)

(Continued)

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

CITY OF MUSKEGON HEIGHTS

STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED DECEMBER 31, 2006

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	Downtown Development Authority
Changes in net assets				
Net (expense) revenue	$ (6,304,954)	$ (682,820)	$ (6,987,774)	$ (334,789)
General revenues				
Property taxes	2,280,569	-	2,280,569	330,492
Income taxes	1,045,324	-	1,045,324	-
State shared revenues - unrestricted	1,782,345	-	1,782,345	-
Interest earnings	24,663	171,356	196,019	9,311
Transfers - internal activities	276,304	(276,304)	-	-
Total general revenues and transfers	5,409,205	(104,948)	5,304,257	339,803
Change in net assets	(895,749)	(787,768)	(1,683,517)	5,014
Net assets, beginning of year, as restated	8,484,652	10,034,984	18,519,636	304,744
Net assets, end of year	$ 7,588,903	$ 9,247,216	$ 16,836,119	$ 309,758

(Concluded)

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

CITY OF MUSKEGON HEIGHTS

GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET

DECEMBER 31, 2006

	General	Nonmajor Governmental Funds	Total
Assets			
Cash and pooled investments	$ 60,978	$ 698,012	$ 758,990
Receivables			
Accounts	255,119	30,564	285,683
Property taxes	585,503	-	585,503
Income taxes	249,133	-	249,133
Special assessment	-	104,318	104,318
Due from other funds	404,858	397,448	802,306
Due from other governments	352,303	217,514	569,817
Inventory	28,406	-	28,406
Prepaid items	149,583	-	149,583
Total assets	$ 2,085,883	$ 1,447,856	$ 3,533,739
Liabilities and fund balances			
Liabilities			
Accounts payable	$ 412,791	$ 138,052	$ 550,843
Accrued liabilities	60,346	12,019	72,365
Due to other funds	244,043	387,044	631,087
Due to other governments	3,323	-	3,323
Deferred revenue	1,277,142	147,090	1,424,232
Total liabilities	1,997,645	684,205	2,681,850
Fund balances			
Unreserved			
Undesignated	88,238	-	88,238
Undesignated reported in nonmajor			
Special revenue funds	-	737,240	737,240
Capital projects funds	-	22,072	22,072
Debt service fund	-	4,339	4,339
Total fund balances	88,238	763,651	851,889
Total liabilities and fund balances	$ 2,085,883	$ 1,447,856	$ 3,533,739

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

CITY OF MUSKEGON HEIGHTS

RECONCILIATION OF FUND BALANCE ON THE BALANCE SHEET FOR GOVERNMENTAL FUNDS TO NET ASSETS OF GOVERNMENTAL ACTIVITIES ON THE STATEMENT OF NET ASSETS

DECEMBER 31, 2006

Fund balances - total governmental funds	$ 851,889
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 therefore are not reported in the funds.	
Add - land	254,408
Add - capital assets (net of accumulated depreciation)	8,741,984
Certain assets do not represent current expendable financial resources and therefore are not recognized in the funds.	
Add - Houses held in inventory	65,000
Add - Bond issuance costs	39,661
Certain assets are not due and receivable in the current period and therefore are offset with deferred revenue in the funds.	
Add - deferred revenue	221,666
Certain liabilities are not due and payable in the current period and therefore are not reported in the funds.	
Deduct - compensated absences payable	(450,355)
Deduct - bonds payable	(2,122,350)
Deduct - accrued interest on bonds payable	(13,000)
Net assets of governmental activities	$ 7,588,903

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

CITY OF MUSKEGON HEIGHTS

GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

FOR THE YEAR ENDED DECEMBER 31, 2006

	General	Nonmajor Governmental Funds	Total
Revenues			
Taxes			
Property	$ 2,279,983	$ -	$ 2,279,983
Income	1,045,324	-	1,045,324
Intergovernmental revenues			
Federal	116,047	601,088	717,135
State	1,886,481	885,097	2,771,578
Licenses and permits	96,550	-	96,550
Charges for services	556,901	149,509	706,410
Fines	92,411	63	92,474
Interest earnings	23,799	24,759	48,558
Miscellaneous	189,998	74,073	264,071
Total revenues	6,287,494	1,734,589	8,022,083
Expenditures			
Current			
General government	2,043,472	194,187	2,237,659
Public safety	3,486,832	-	3,486,832
Public works and streets	774,736	653,535	1,428,271
Community development	12,461	557,907	570,368
Culture and recreation	278,994	121,697	400,691
Debt service			
Principal	33,347	208,553	241,900
Interest	3,339	93,154	96,493
Total expenditures	6,633,181	1,829,033	8,462,214
Revenues over (under) expenditures	(345,687)	(94,444)	(440,131)
Other financing sources (uses)			
Proceeds from issuance of debt	105,405	-	105,405
Transfers in	350,034	382,922	732,956
Transfers out	(257,966)	(198,686)	(456,652)
Total other financing sources (uses)	197,473	184,236	381,709
Net changes in fund balances	(148,214)	89,792	(58,422)
Fund balances, beginning of year, as restated	236,452	673,859	910,311
Fund balances, end of year	$ 88,238	$ 763,651	$ 851,889

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

CITY OF MUSKEGON HEIGHTS

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

FOR THE YEAR ENDED DECEMBER 31, 2006

Net changes in fund balances - total governmental funds	$ (58,422)
Amounts reported for *governmental activities* in the statement of activities are different because	
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets are allocated over their estimated useful lives and reported as depreciation expense.	
Add - capital outlay	270,566
Deduct - depreciation expense	(1,113,338)
Deduct - loss on disposal of capital assets	(17,757)
Certain accounts receivable are long-term in nature and are collectable over several years. However the current portions are reflected as revenues on the fund statements.	
Deduct - current portion of long-term receivables	(72,326)
Long-term debt proceeds provide current financial resources to governmental funds in the period issued, but issuing debt increases long-term liabilities in the statement of net assets. Repayment of long-term debt is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.	
Deduct - proceeds from issuance of long-term debt	(105,405)
Add - payments on long-term debt	241,900
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the funds.	
Deduct - increase in compensated absences	(39,433)
Deduct - amortization of bond issuance costs	(6,034)
Add - changes in accrued interest	4,500
Change in net assets of governmental activities	$ (895,749)

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

CITY OF MUSKEGON HEIGHTS

GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE BUDGET AND ACTUAL

FOR THE YEAR ENDED DECEMBER 31, 2006

	Budget Amounts		Actual	Variance Positive
	Original	Final	Amount	(Negative)
Revenues				
Taxes				
Property	$ 2,135,800	$ 2,185,800	$ 2,279,983	$ 94,183
Income	950,000	1,040,000	1,045,324	5,324
Intergovernmental revenues				
Federal	30,000	104,894	116,047	11,153
State	1,911,636	1,930,136	1,886,481	(43,655)
Licenses and permits	110,000	118,500	96,550	(21,950)
Charges for services	497,500	601,407	556,901	(44,506)
Fines	40,000	97,687	92,411	(5,276)
Interest earnings	8,800	12,300	23,799	11,499
Miscellaneous	174,000	241,000	189,998	(51,002)
Total revenues	5,857,736	6,331,724	6,287,494	(44,230)
Expenditures				
Current				
General government	1,946,841	2,056,267	2,043,472	12,795
Public safety	3,068,749	3,315,659	3,486,832	(171,173)
Public works	713,254	756,040	774,736	(18,696)
Community development	6,100	11,000	12,461	(1,461)
Culture and recreation	189,216	259,720	278,994	(19,274)
Debt service				
Principal	55,300	71,301	33,347	37,954
Interest	97,880	97,880	3,339	94,541
Total expenditures	6,077,340	6,567,867	6,633,181	(65,314)
Revenues over (under) expenditures	(219,604)	(236,143)	(345,687)	21,084
Other financing sources (uses)				
Proceeds from issuance of debt	-	-	105,405	105,405
Transfers in	305,200	366,700	350,034	(16,666)
Transfers out	(83,000)	(83,000)	(257,966)	(174,966)
Total other financing sources (uses)	222,200	283,700	197,473	(86,227)
Net changes in fund balance	2,596	47,557	(148,214)	(195,771)
Fund balance, beginning of year, as restated	236,452	236,452	236,452	-
Fund balance, end of year	$ 239,048	$ 284,009	$ 88,238	$ (195,771)

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

CITY OF MUSKEGON HEIGHTS

PROPRIETARY FUNDS
STATEMENT OF NET ASSETS

DECEMBER 31, 2006

	Enterprise Funds			
Assets	Sewer	Water	Water Supply	Total
Current assets				
Cash and pooled investments	$ 578,232	$ 206,317	$ 1,444,750	$ 2,229,299
Accounts receivable	220,411	311,876	90,841	623,128
Due from other funds	162,358	-	-	162,358
Inventory	-	20,030	11,182	31,212
Total current assets	961,001	538,223	1,546,773	3,045,997
Noncurrent assets				
Capital assets				
Land	2,246	-	37,766	40,012
Buildings and equipment	416,463	203,922	141,551	761,936
Infrastructure and plant	3,181,347	1,962,706	25,758,843	30,902,896
Less accumulated depreciation	(2,024,337)	(1,708,500)	(6,287,160)	(10,019,997)
Net capital assets	1,575,719	458,128	19,651,000	21,684,847
Restricted cash and pooled investments	-	-	1,641,558	1,641,558
Bond issuance costs and discount	-	-	1,786,227	1,786,227
Total noncurrent assets	1,575,719	458,128	23,078,785	25,112,632
Total assets	2,536,720	996,351	24,625,558	28,158,629
Liabilities				
Current liabilities				
Accounts payable	130,381	37,032	90,207	257,620
Accrued liabilities	4,686	19,791	135,070	159,547
Due to other funds	-	278,166	55,411	333,577
Current portion of long-term debt	118,453	7,332	460,887	586,672
Total current liabilities	253,520	342,321	741,575	1,337,416
Long-term liabilities				
Long-term debt, net of current portion	115,688	1,548	17,456,761	17,573,997
Total long-term liabilities	115,688	1,548	17,456,761	17,573,997
Total liabilities	369,208	343,869	18,198,336	18,911,413
Net assets				
Investment in capital assets net of related debt	1,347,744	458,128	3,551,974	5,357,846
Restricted for debt service	-	-	1,641,558	1,641,558
Unrestricted	819,768	194,354	1,233,690	2,247,812
Total net assets	$ 2,167,512	$ 652,482	$ 6,427,222	$ 9,247,216

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

CITY OF MUSKEGON HEIGHTS

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

FOR THE YEAR ENDED DECEMBER 31, 2006

	Enterprise Funds			
	Sewer	Water	Water Supply	Total
Operating revenue				
Charges for services	$ 709,991	$ 1,285,195	$ 1,035,561	$ 3,030,747
Fines	37,460	45,490	-	82,950
Charges for debt service	-	-	1,112,824	1,112,824
Total operating revenue	747,451	1,330,685	2,148,385	4,226,521
Operating expense				
Personnel services	100,369	188,023	353,550	641,942
Benefits	57,135	90,869	193,228	341,232
Contractual/professional services	574,376	629,782	347,240	1,551,398
Materials and supplies	12,559	39,523	188,679	240,761
Utilities	506	38,521	327,425	366,452
Repair and maintenance	8,436	1,825	40,541	50,802
Depreciation	74,578	33,307	760,192	868,077
Miscellaneous	31,005	32,070	14,664	77,739
Total operating expense	858,964	1,053,920	2,225,519	4,138,403
Operating income (loss)	(111,513)	276,765	(77,134)	88,118
Non-operating revenue (expense)				
Interest income	28,586	7,372	135,398	171,356
Interest expense	(14,305)	-	(756,633)	(770,938)
Total non-operating revenue (expense)	14,281	7,372	(621,235)	(599,582)
Income (loss) before transfers	(97,232)	284,137	(698,369)	(511,464)
Transfers				
Transfers out	(80,000)	(80,000)	(116,304)	(276,304)
Changes in net assets	(177,232)	204,137	(814,673)	(787,768)
Net assets, beginning of year	2,344,744	448,345	7,241,895	10,034,984
Net assets, end of year	$ 2,167,512	$ 652,482	$ 6,427,222	$ 9,247,216

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

CITY OF MUSKEGON HEIGHTS

PROPRIETARY FUNDS
STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2006

	Enterprise Funds			
	Sewer	Water	Water Supply	Total
Cash flows from operating activities				
Receipts from customers and users	$ 759,088	$ 1,338,495	$ 2,452,210	$ 4,549,793
Payments to employees	(159,285)	(258,881)	(551,481)	(969,647)
Payments to suppliers	(790,390)	(960,294)	(1,334,283)	(3,084,967)
Net cash provided by (used in) operating activities	(190,587)	119,320	566,446	495,179
Cash flows from non-capital financing activities				
Transfers in	-	-	-	-
Transfers out	(80,000)	(80,000)	(116,304)	(276,304)
Net cash provided by (used in) non-capital financing activities	(80,000)	(80,000)	(116,304)	(276,304)
Cash flows from capital and related financing activities				
Proceeds from issuance of refunding bonds	-	-	9,615,000	9,615,000
Interest paid	(14,305)	-	(681,955)	(696,260)
Bond issuance costs	-	-	(815,481)	(815,481)
Principal paid on long-term debt	(115,744)	-	(9,375,000)	(9,490,744)
Acquisitions of capital assets	(225,106)	-	(441,444)	(666,550)
Net cash provided by (used in) capital and related financing activities	(355,155)	-	(1,698,880)	(2,054,035)
Cash flows from investing activities				
Interest income	28,586	7,372	135,398	171,356
Net cash provided by (used in) investing activities	28,586	7,372	135,398	171,356
Net increase (decrease) in cash and pooled investments	(597,156)	46,692	(1,113,340)	(1,663,804)
Cash and pooled investments, beginning of year	1,175,388	159,625	4,199,648	5,534,661
Cash and pooled investments, end of year	$ 578,232	$ 206,317	$ 3,086,308	$ 3,870,857
Cash flows from operating activities				
Operating income (loss)	$ (111,513)	$ 276,765	$ (77,134)	$ 88,118
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities				
Depreciation	74,578	33,307	760,192	868,077
Allowance for delinquent accounts	62,488	53,100	-	115,588
Change in operating assets and liabilities which provided (used) cash				
Accounts receivable	(50,851)	(45,290)	(90,841)	(186,982)
Due from other funds	(128,731)	-	394,666	265,935
Inventory	-	(2,980)	(2,793)	(5,773)
Accounts payable	29,403	10,385	(456,671)	(416,883)
Accrued liabilities	(7,947)	11,131	(4,703)	(1,519)
Accrued compensated absences	6,166	8,880	32,395	47,441
Due to other funds	(64,180)	(208,969)	11,335	(261,814)
Unearned revenue	-	(17,009)	-	(17,009)
Net cash provided by (used in) operating activities	$ (190,587)	$ 119,320	$ 566,446	$ 495,179

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

CITY OF MUSKEGON HEIGHTS

FIDUCIARY FUNDS
STATEMENT OF NET ASSETS

DECEMBER 31, 2006

	Private Purpose Trust Fund - John Hendrick Flower Fund	Agency Fund
Assets		
Cash and pooled investments	$ 3,125	$ 577,123
Due from other governments	-	4,731
Total assets	$ 3,125	$ 581,854
Liabilities		
Accounts payable	$ -	$ 111,592
Due to other governments	-	430,240
Deposits held for others	-	40,022
Total liabilities	-	$ 581,854
Net assets	$ 3,125	

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

CITY OF MUSKEGON HEIGHTS

PRIVATE PURPOSE TRUST FUND
STATEMENT OF CHANGES IN NET ASSETS

FOR THE YEAR ENDED DECEMBER 31, 2006

	Private Purpose Trust Fund - John Hendrick Flower Fund
Additions	
Interest earnings	$ -
Deductions	
Fees	44
Changes in net assets	(44)
Net assets, beginning of year	3,169
Net assets, end of year	$ 3,125

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the City of Muskegon Heights, Michigan (the "City") conform to generally accepted accounting principles as applicable to governments. The following is a summary of the significant policies.

Reporting Entity

These financial statements present the City and its component units, entities for which the City is considered to be financially accountable. Discretely presented component units are reported in a separate column in the financial statements to emphasize they are legally separate from the City. A separate section of the Basic Financial Statements provides detailed financial information on the discretely presented component units. The City has no blended component units.

Discretely Presented Component Units

The component unit column in the basic financial statements includes the financial data of the Downtown Development Authority (DDA). This entity is reported in a separate column and rows to emphasize that it is legally separate from the City. The City also has one additional component unit which had no financial assets or financial activity during the year (the Brownfield Redevelopment Authority). The DDA was formed to complete various projects in the downtown district. Funding for these projects will be provided through captured property taxes from various units of government. The members of the governing board of the DDA are appointed by the City Council. The budgets of the Authority must be approved by the City Council, and the City has the ability to significantly influence its operations. Financial statements are not separately issued for the DDA.

Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Exceptions to this general rule are changes between enterprise functions and other various functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned. *Governmental activities,* which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities,* which rely to a significant extent on fees and charges for support.

Likewise, the *primary government* is reported separately from certain legally separate *component units* for which the primary government is financially accountable.

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

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

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the proprietary fund and fiduciary fund financial statements, except for agency funds which do not have a measurement focus. Revenues are recorded when earned and expenses are recorded when 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. Income taxes are recognized in the year for which the tax is due. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers property tax revenues to be available if they are collected within 60 days of the end of the current fiscal period. Reimbursement-based grants, income taxes, and interest revenues use a one year collection period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, income tax, state revenue, licenses, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the City.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's ongoing operations. The primary operating revenues of the enterprise fund are charges for services. Operating expenses for the enterprise funds include depreciation on capital assets, labor, supplies and contracted services. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The City reports the following major governmental fund:

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.

The City reports the following major proprietary funds:

The *Sewer Enterprise Fund* is used to account for the operations of the City's sewer department that provides sewer services to most residents of the City on a user charge basis.

The *Water Enterprise Fund* is used to account for the operations of the City's water department that provides water services to most residents of the City on a user charge basis.

The *Water Supply Enterprise Fund* is used to account for operations of the City water treatment plant and related assets utilized to treat and distribute water to the City and surrounding communities on a user charge basis.

Additionally, the City reports the following fund types:.

The *Special Revenue Funds* are used to account for the proceeds of specific revenue sources (other than major capital projects) that are legally restricted to expenditures for specified purposes.

The *Debt Service Fund* is used to account for the accumulation of resources for, and payment of, long-term debt principal, interest, and related costs of governmental funds.

The *Capital Projects Fund* accounts for the accumulation and disbursement of resources for the construction of City capital projects.

The *Private Purpose Trust Fund* is used to account for resources that are restricted for the benefit of other governments, organizations or individuals.

The *Agency Funds* are used to account for the collection and disbursement of funds that are collected on behalf of outside governments, organizations or individuals.

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

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

Budgets and Budgetary Accounting

Comparisons to budget are presented for the General Fund. Special Revenue Funds adopt a legal budget with remaining funds maintaining budgets as a management control device. The City follows these procedures in establishing the budgetary data reflected in the financial statements:

1. Prior to November 1, the City Manager submits to the City Council a proposed operating budget for the fiscal year commencing the following January 1. The operating budget is adopted by activity.

2. Public hearings are conducted to obtain taxpayer comments.

3. Prior to January 1, the budget is legally enacted through passage of a resolution.

4. Formal budgetary integration is employed for the governmental fund types as a management control device.

5. Budgets for the General and Special Revenue Funds are adopted on a basis consistent with generally accepted accounting principles (GAAP). Annual budgets lapse at fiscal year end.

6. Adoption and amendments of all budgets used by the City are governed by Michigan state law. The appropriations resolution is based on the projected expenditures budget of the department heads of the City. Any amendment to the original budget must meet the requirements of Michigan law. Any revisions that alter the total expenditures of any department must be approved by the City Council. The City Manager is authorized to transfer budgeted amounts within a department subject to the condition that the total expenditures do not exceed the approved appropriations by department. Thus the legal level of budgetary control is at the department level. Supplemental appropriations were necessary during the year.

Cash and Pooled Investments

For the purpose of the statement of cash flows, the City considers cash and pooled investments to be cash and cash equivalents because the pooling of these balances allows for withdrawal of these balances at any time similar to a demand deposit account.

Investments

Investments are stated at fair value at the balance sheet date.

State statutes authorize the City to invest in:

a. Bond, securities, other obligations and repurchase agreements of the United States, or an agency or instrumentality of the United States.

b. Certificates of deposit, savings accounts, deposit accounts or depository receipts of a qualified financial institution.

c. Commercial paper rated at the time of purchase within the two highest classifications established by not less than two standard rating services and that matures not more than 270 days after the date of purchase.

d. Bankers acceptances of United States banks.

e. Obligations of the State of Michigan and its political subdivisions that, at the time of purchase are rated as investment grade by at lease one standard rating service.

f. Mutual funds registered under the Investment Company Act of 1940 with the authority to purchase only investment vehicles that are legal for direct investment by a public corporation.

g. External investment pools as authorized by Public Act 20 as amended.

Receivables

All receivables are recorded at their gross value and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible. Uncollectible balances are estimated to be $62,488 and $53,100 at December 31, 2006, based on outstanding billings for services in the sewer and water enterprise funds, respectively.

Due to and Due from Other Funds

Interfund receivables and payables are short term borrowings that arise from interfund transactions which are recorded by all funds affected in the period in which transactions are executed.

Capital Assets

Capital assets, which include land, buildings and improvements, equipment, motor vehicles, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the governmental and business-type activities columns in the government-wide financial statements.

Capital assets are defined by the government as assets with an initial, individual cost of more than $5,000 and an estimated useful life in excess of one year. Such assets are valued at cost where historical records are available and at estimated historical cost where no historical records exist. Donated capital assets are valued at their estimated fair market value on the date received.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related capital assets, as applicable.

No interest expense has been incurred or capitalized on capital assets reported in proprietary funds.

Depreciation on capital assets (including infrastructure) is computed using the straight-line method over the following estimated useful lives:

	Years
Buildings and improvements	7-50
Equipment	5-40
Motor vehicles	5-25
Infrastructure	5-100

Deferred Revenue

Funds report *deferred revenue* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period or for resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of *deferred revenue* reported in the fund statements were as follows:

General Fund	
Property taxes (Levied for 2007)	$1,159,793
Unavailable receivables	117,349
Nonmajor Funds	
Special assessments	104,318
Unexpended program revenue	26,817
Unearned grant revenue	15,955
Total governmental funds	1,424,232
Component Unit	
Downtown Development Authority	
Property taxes (Captured for 2007)	164,270
	$1,588,502

Long-Term Obligations

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

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. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.

Compensated Absences

Under contracts negotiated with employee groups and employment policy, individual employees have a vested right to receive payments for unused vacation and sick leave benefits under formulas and conditions specified in the contracts. Accumulated vacation and sick leave time of governmental funds is recorded on the statement of net assets and not on the governmental fund balance sheets because it is not expected to be liquidated with expendable available financial resources. Amounts accumulated for proprietary funds are reported on the statements of net assets of the individual enterprise funds.

Property Taxes

City property taxes are levied and attached as an enforceable lien on property as of July 1 on the taxable value of property as of the preceding December 31. Taxes are levied July 1 and are due without penalty on or before August 15. These summer tax bills include the City's own property taxes and taxes billed on behalf of other taxing units within the City limits. Real property taxes not collected as of March 1 are turned over to the County for collection, which advances the City 100% for the delinquent real property taxes. Collection of delinquent personal property taxes remains the responsibility of the City Treasurer.

Property taxes levied in July of each year are recognized 50% in the City's current year and 50% in the City's subsequent year (the years the property taxes are intended to finance).

Grants and Other Intergovernmental Revenues

Grants and assistance awards made on the basis of entitlement periods are recorded as intergovernmental receivables and revenue when entitlement occurs. Reimbursement-type grants are recorded as intergovernmental receivables and revenues when the related expenditure/expenses are incurred.

Interfund Transactions

During the course of normal operations, the City has numerous transactions between funds, including expenditures and transfers of resources to provide services and to service debt. The accompanying financial statements generally reflect such transactions as transfers. Operating subsidies are also recorded as transfers.

2. DEFICIT FUND BALANCE/NET ASSETS

At December 31, 2006 the City had deficit fund balances in the Cemetery special revenue fund of $55,974, and the Recreation special revenue fund of $3,608 and deficit unrestricted net assets for governmental activities of $1,478,033.

3. EXCESS OF EXPENDITURES OVER APPROPRIATIONS IN BUDGETARY FUNDS

Michigan law, provides that a local unit shall not incur expenditures in excess of the amount appropriated.

In the body of the financial statements, the City's actual and budgeted expenditures for the major fund (general fund) has been shown on a functional basis. The approved budget of the City for this fund was adopted at the department level. Budgets for special revenue funds were adopted at the function level.

During the year ended December 31, 2006, the City incurred expenditures in certain budgetary funds which were in excess of the amounts appropriated as follows:

	Final Budget	Actual	Variance (Unfavorable)
General Fund			
General government			
Assessor	$ 137,932	$ 140,903	$ 2,971
Buildings and grounds	162,000	171,470	9,470
Motor pool	75,000	85,860	10,860
Public safety			
Police	1,933,922	2,058,904	124,982
Auto theft grant	114,200	118,020	3,820
Fire	1,061,000	1,092,581	31,581
Inspections	200,000	205,790	5,790
Special investigations	6,537	11,537	5,000
Public works and streets			
Public works	63,000	73,653	10,653
Street lighting	170,000	170,822	822
Refuse collection	515,000	523,018	8,018
Community development			
Farmer's market	2,600	4,580	1,980
Culture and recreation			
Parks	141,500	161,391	19,891
Transfers out	83,000	257,966	174,966
Local Streets			
Public works and streets	231,050	253,899	22,849
Cemetery			
General government	178,950	187,702	8,752
Debt service	-	3,744	3,744
Community Development Block Grant			
Community development	519,656	546,937	27,181
Transfers out	45,000	106,500	61,500
Brownfield Project			
Community development	1,000	10,971	9,971

4. CASH AND INVESTMENTS

The captions on the financial statements relating to cash and pooled investments and investments are as follows:

	Primary Government	Component Units	Fiduciary Funds	Total
Cash and pooled investments	$4,629,847	$257,808	$580,248	$5,467,903

Cash and pooled investments and investments captions consist of the following at December 31, 2006:

Deposits and certificates of deposit	$1,273,721
Mutual funds and securities	4,194,182
Total	$5,467,903

The deposits are in seven financial institutions located in Michigan in varying amounts. State policy limits the Treasurer's depository investing options to financial institutions located in Michigan. All accounts are in the name of the City and a specific fund or common account. They are recorded in City records at fair value. Interest is recorded when earned.

Custodial Credit Risk - Deposits. Custodial credit risk is the risk that in the event of a bank failure, the City's deposits may not be returned. State law does not require, and the City does not have, a policy for deposit custodial credit risk. As of year-end, $829,263 of the City's bank balance of $1,296,534 was exposed to custodial credit risk because the balances were uninsured and uncollateralized.

Investments

The City chooses to disclose its investments by specifically identifying each. As of year-end, the City had the following investments:

	Maturity	Fair Value	Rating	Source
FNMA	12/18/17	116,132	AAA	S&P
FNMA	3/4/19	44,124	AAA	S&P
FNMA	3/1/25	7,129	AAA	S&P
GNMA	9/15/08	10,321	AAA	S&P
FHLMC	6/30/09	127,857	AAA	S&P
FHLB	5/22/13	394,000	AAA	S&P
FHLB	12/30/15	234,610	AAA	S&P
FHLB	3/4/19	19,185	AAA	S&P
Treasury Note	4/30/07	44,796	N/A	
Treasury Note	5/15/09	25,055	N/A	
Treasury Note	6/30/08	50,157	N/A	
Treasury Bills	1/4/07	59,993	N/A	
Mutual fund account				
Allegiant Government Money Market	N/A	98,248	AAAm	S&P
Institutional Trust	N/A	310,287	None	
Government Cash Investment Fund J	N/A	2,464,407	None	
General Treasury Prime Class B	N/A	187,881	None	
		$4,194,182		

The above investments do not include certificates of deposit which are classified as deposits for risk identification purposes.

Investment and deposit risk

Interest Rate Risk. State law limits the allowable investments and the maturities of some of the allowable investments as identified in Note 1, the summary of significant accounting policies. The City's investment policy does not have specific limits in excess of state law on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The maturity date for each investment is identified above for investments held at year-end.

Credit Risk. State law limits investments to specific government securities, certificates of deposits and bank accounts with qualified financial institutions, commercial paper with specific maximum maturities and ratings when purchased, bankers acceptances of specific financial institutions, qualified mutual funds and qualified external investment pools as identified in Note 1, the summary of significant accounting policies. The investment policy does not have specific limits in excess of state law on investment credit risk. The rating for each investment is identified above for investments held at year end.

Custodial Credit Risk - Investments. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. State law does not require and the City does not have a policy for investment custodial credit risk. Of the above $1,133,359 of investments, the City has a custodial credit risk of $1,133,359 because the related securities are uninsured, unregistered and held by the government's brokerage firm which is also the counterparty for these particular securities. Of the above mutual fund investments the City's custodial credit risk exposure cannot be determined because the mutual funds do not consist of specifically identifiable securities.

Concentration of Credit Risk. State law limits allowable investments but does not limit concentration of credit risk as identified in Note 1, the summary of significant accounting policies. The City's investment policy does not have specific limits in excess of state law on concentration of credit risk. All investments held at year-end are reported above.

5. INTERFUND TRANSACTIONS

Interfund receivables and payables of individual funds at December 31, 2006 were as follows:

	Payable Fund				
Receivable fund	General fund	Water	Water supply	Nonmajor governmental funds	Total
General fund	$ -	$188,497	$55,411	$160,950	$404,858
Sewer	104,297	58,061			162,358
Nonmajor governmental funds	139,746	31,608		226,094	397,448
Total	**$244,043**	**$278,166**	**$55,411**	**$387,044**	**$964,664**

Interfund balances reflect loans made from funds with cash and pooled investments to those funds requiring temporary cash flow and transactions payable in the normal course of operation.

Transfers in and out for the year ended December 31, 2006 are as follows:

	Transfer in		
Transfer out	**General Fund**	**Nonmajor governmental funds**	**Total**
General Fund	$ -	$257,966	$257,966
Enterprise			
Sewer	80,000	-	80,000
Water	80,000	-	80,000
Water Supply	80,000	36,304	116,304
Nonmajor governmental funds	110,034	88,652	198,686
Total	**$350,034**	**$382,922**	**$732,956**

Transfers to the general fund represent payments to fund administrative costs from benefiting funds. Transfers out of the general fund are used to fund debt service on outstanding bonds.

A transfer of $96,311 was made from the Downtown Development Authority (DDA) general fund to the DDA debt service fund to assist with payment of long-term debt.

6. CAPITAL ASSETS

Capital asset activity for the year was as follows:

	Balance January 1, 2006	Additions	Deletions	Balance December 31, 2006
Governmental Activities				
Capital assets, not being depreciated				
Land	$ 254,408	$ -	$ -	$ 254,408
Construction in Progress	-	-	-	-
Total capital assets, not being depreciated	254,408	-	-	254,408
Capital assets, being depreciated				
Buildings and improvements	1,235,756	-	-	1,235,756
Equipment	1,364,901	49,400	61,483	1,352,818
Motor vehicles	2,134,569	67,850	-	2,202,419
Infrastructure	18,403,662	153,316	-	18,556,978
Total capital assets, being depreciated	23,138,888	270,566	61,483	23,347,971
Less accumulated depreciation for				
Buildings and improvements	568,796	25,705	-	594,501
Equipment	478,403	83,293	-	561,696
Motor vehicles	1,189,961	95,548	43,726	1,241,783
Infrastructure	11,299,215	908,792	-	12,208,007
Total accumulated depreciation	13,536,375	1,113,338	43,726	14,605,987
Net capital assets, being depreciated	9,602,513	(842,772)	17,757	8,741,984
Governmental Activities capital assets, net	**$9,856,921**	**$(842,772)**	**$17,757**	**$8,996,392**

	Balance January 1, 2006	Additions	Deletions	Balance December 31, 2006
Business-type Activities				
Capital assets, not being depreciated				
Land	$ 40,012	$ -	$ -	$ 40,012
Construction in Progress	-	-	-	-
Total capital assets, not being depreciated	40,012	-	-	40,012
Capital assets being depreciated				
Buildings and improvements	137,713	25,758	-	163,471
Equipment	813,922	632,025	-	1,445,947
Plant	20,932,530	-	-	20,932,530
Infrastructure	9,114,117	8,767	-	9,122,884
Total capital assets, being depreciated	30,998,282	666,550	-	31,664,832
Less accumulated depreciation for				
Buildings and improvements	29,336	6,145	-	35,481
Equipment	742,224	64,926	-	807,150
Plant	2,138,786	674,456	-	2,813,242
Infrastructure	6,241,574	122,550	-	6,364,124
Total accumulated depreciation	9,151,920	868,077	-	10,019,997
Net capital assets, being depreciated	21,846,362	(201,527)	-	21,644,835
Business-type Activities capital assets, net	**$21,886,374**	**$(201,527)**	**$ -**	**$21,684,847**
Downtown Development Authority				
Capital assets, not being depreciated				
Land	$294,635	$ -	$ -	$294,635
Construction in Progress	-	-	-	-
Total capital assets, not being depreciated	294,635	-	-	294,635
Capital assets being depreciated				
Buildings and improvements	753,835	-	-	753,835
Accumulated depreciation	154,363	17,126	-	171,489
Net capital assets, being depreciated	599,472	(17,126)	-	582,346
Downtown Development Authority capital assets, net	**$894,107**	**$(17,126)**	**$ -**	**$876,981**

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

Governmental Activities	
General government	$ 27,826
Public safety	77,913
Public works and streets	985,338
Culture and recreation	22,261
Total depreciation expense - governmental activities	$1,113,338
Business-type Activities	
Sewer	$ 74,578
Water	33,307
Water Treatment	760,192
Total depreciation expense - business-type activities	$868,077

7. PENSION PLAN

Plan Description

The various bargaining and non-bargaining unit employees of the City participate in the Municipal Employees' Retirement System of Michigan (MERS), an agent multi-employer defined benefit pension plan providing retirement, death and disability benefits. The System is administered by the MERS retirement board. Act No. 427 of the Public Acts of 1984, as amended, establishes and amends the benefit provisions of the participants in MERS. A publicly available financial report that includes financial statements and required supplementary information for MERS may be obtained by writing to the Municipal Employees Retirement System of Michigan, 1134 Municipal Way, Lansing, Michigan 48917.

The City is required to contribute at an actuarially determined rate, which for the current year was 0% to 14.41% of annual covered payroll. Participating employees are required to contribute from 3 to 6% percent of gross wages to the Plan. The contribution requirements of the City are established and may be amended by the MERS Retirement Board. The contribution requirements of employees are established and may be amended by labor agreements.

For the year ended December 31, 2006, the City's annual pension cost of $326,831 for MERS was equal to the City's required and actual contributions. The required contribution was determined as part of the December 31, 2004 actuarial valuation using the entry age actuarial cost method. The actuarial assumptions included: (a) a rate of return on the investment of present and future assets of eight (8.0) percent; and (b) projected salary increases of four and one-half (4.5) percent per year compounded annually based on inflation, plus from 0 to 8.4% percent based on an age-related scale to reflect merit, longevity and promotional salary increases. The actuarial value of MERS assets was determined on the basis of a valuation method that assumes the fund earns the expected rate of return and includes an adjustment to reflect fair value. The City's unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at December 31, 2006, the date of the latest actuarial valuation, was from 26 to 29 years.

Three-Year Trend Information

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
12/31/04	$44,000	100%	$ -
12/31/05	160,000	100%	-
12/31/06	326,831	100%	-

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio Total	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/04	$28,636,859	$26,923,112	$1,713,747	94%	$3,708,494	46%
12/31/05	29,060,165	26,354,905	2,705,260	91%	3,315,952	82%
12/31/06	26,973,198	29,892,734	2,919,536	90%	3,547,340	82%

8. LONG-TERM DEBT

The following is a summary of the debt transactions of the City for the year ended December 31, 2006:

	Balance January 1, 2006	Additions	Deletions	Balance December 31, 2006	Due Within One Year
Governmental Activities					
2004 Michigan Municipal Bond Authority, Fiscal Stabilization Bonds, due in varying installments of $170,000 to $210,000 through November 2013; plus interest at 2.5% to 4%	$1,500,000	$ -	$170,000	$1,330,000	$175,000
1997C Michigan Municipal Bond Authority, Advanced Refunding of Series 1991C, Group B of 1991 bonds, due in varying installments of $20,000 to $75,000 through November 2020; plus interest at 7.2%	645,000	-	20,000	625,000	25,000
Computer equipment installment purchase due in semi-annual installments of $4,982 including interest at 3.75% through March 2008	23,535	-	9,164	14,371	9,509
Telephone equipment installment purchase due in monthly installments of $1,014 including interest at 4.25% through April 2008	26,967	-	11,233	15,734	11,630

	Balance January 1, 2006	Additions	Deletions	Balance December 31, 2006	Due Within One Year
Governmental Activities					
Equipment installment purchase due in quarterly installments of $936 including interest at 6.25% through September 2008	9,386	-	3,213	6,173	3,438
Street sweeper installment purchase due in quarterly installments of $4,673 including interest at 6.94% through March 2009	53,957	-	15,340	38,617	16,433
Police Vehicle purchase due in quarterly installments of $6,112 including interest at 5.8% through March 2008	-	67,850	11,330	56,520	6,743
Equipment installment purchase due in monthly installments of $723 including interest at 5.8% through September 2011	-	37,555	1,620	35,935	21,637
Total bonds and notes	2,258,845	105,405	241,900	2,122,350	269,390
Accrued employee benefits	410,922	100,000	139,433	450,355	111,741
Total Governmental Activities	**2,669,767**	**205,405**	**381,333**	**2,572,705**	**381,131**
Business-type Activities					
2000 Water Supply System revenue bonds due in annual installments of $310,000 to $720,000 through November 2030, plus interest from 5.2% to 6%	10,795,000	-	9,270,000	1,525,000	355,000
2005 Water Supply System revenue refunding bonds due in annual installments of $40,000 to $465,000 through November 2030, plus interest from 3.3% to 4.5%	6,850,000	-	75,000	6,775,000	40,000
2006 Water Supply System revenue refunding bonds due in annual installments of $40,000 to $465,000 through November 2030, plus interest from 3.3% to 4.5%	-	9,615,000	30,000	9,585,000	45,000

CITY OF MUSKEGON HEIGHTS

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2006

	Balance January 1, 2006	Additions	Deletions	Balance December 31, 2006	Due Within One Year
Business-type Activities					
1996 Muskegon County Wastewater Management System Bond Refunding Contractual Agreement due annually, plus interest at 5.7% through 2008.	343,972	-	115,744	228,228	114,114
Total bonds and contractual agreement	17,988,972	9,615,000	9,490,744	18,113,228	554,114
Accrued employee benefits	33,630	37,695	23,884	47,441	32,558
Total Business-type Activities	**18,022,602**	**9,652,695**	**9,514,628**	**18,160,669**	**586,672**
Component Unit					
Downtown Development Authority					
1994 Downtown Development limited tax obligation bonds due in annual installments of $50,000 to $125,000, plus interest at 7% to 7.25% through May 2112;	660,000	-	50,000	610,000	75,000
Mortgage note due in monthly installments of $2,736 including interest at 7.95% through February 2011	138,169	-	22,285	115,884	24,374
Total Component Unit	**798,169**	**-**	**72,285**	**725,884**	**99,374**
Total Long-term Debt - Reporting Entity	**$21,490,538**	**$9,858,100**	**$9,968,246**	**$21,459,258**	**$1,067,177**

The annual requirements to amortize all debt outstanding (excluding accrued employee benefits) as of December 31, 2006 are as follows:

	Governmental Activities		Business-type Activities		Component Units	
Year Ending December 31	**Principal**	**Interest**	**Principal**	**Interest**	**Principal**	**Interest**
2007	$ 269,390	$ 91,229	$ 554,114	$ 762,111	$ 99,374	$ 49,677
2008	259,374	81,582	569,114	740,583	111,413	41,959
2009	239,128	72,404	485,000	718,226	128,622	33,132
2010	228,041	64,310	505,000	694,427	131,016	23,538
2011	236,417	55,909	530,000	669,406	130,459	13,650
2012-2016	630,000	146,740	3,005,000	2,889,242	125,000	4,532
2017-2021	260,000	30,785	3,685,000	2,327,920	-	-
2022-2026	-	-	4,470,000	1,521,487	-	-
2027-2030	-	-	4,310,000	491,101	-	-
Total	**$2,122,350**	**$542,959**	**$18,113,228**	**$10,814,503**	**$725,884**	**$166,488**

The City pays the County of Muskegon a fixed portion of debt service on the 1996 Muskegon County Wastewater Management System Refunding Bonds under a contractual agreement for which the City has pledged its full faith and credit. The City's portion of the required debt service is reported above in the business type activities outstanding long-term debt. In addition, the City pays the County of Muskegon for operating and debt service costs related to wastewater treatment activities based on the City's flow into the County wastewater treatment system.

In January 2006 the City issued $9,615,000 of 2006 Water Supply System Revenue Refunding Bonds to advance refund $8,935,000 of the 2000 Water Supply System Revenue Bonds. The net proceeds of the refunding bonds were used to purchase U.S. Government securities which were place in an irrevocable trust with an escrow agent to provide for principal and interest payments on the refunded bonds. As a result of the refunding the refunded portion of the 2000 Water Supply System Revenue Bonds are considered to be defeased and the liability for these bonds has been removed for the City's long-term debt. The current year refunding reduced total debt service payments by approximately $850,000 and resulted in an economic gain of approximately $484,000.

During the current and prior years, advance refunding resulted in a defeasance of bonds. As a result, the irrevocable trust escrow account assets and the related liability for the defeased bonds are not included in the City's financial statements. At year end, $15,190,000 of bonds outstanding are considered defeased.

9. OPERATING LEASES

The City leases equipment under noncancelable operating lease agreements. Current year cost for these leases was approximately $16,000. Future minimum payments under these agreements is as follows:

December 31,	
2007	$13,956
2008	13,956
2009	3,292
Total	$31,204

10. RISK MANAGEMENT

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters for which the government carries commercial insurance. The City also purchases health and other insurance for employees. Settled claims have not exceeded commercial insurance coverage in any of the past three fiscal years.

11. OTHER POST EMPLOYMENT BENEFITS

The City provides health care insurance benefits to retired full-time employees in accordance with various labor agreements. Currently there are 84 retirees eligible. The city recognized the cost of the post employment health care benefits when the payments are made. During 2006, the amount expended for post employment benefits was $568,386.

12. DEFERRED COMPENSATION PLAN

The City offers its employees a deferred compensation plan in accordance with Internal Revenue Code Section 457. The plan, available to all full-time employees at their option, permits participants to defer a portion of their salary until future years. The assets of this plan are held in trust for the employees and are therefore not included in these financial statements

13. ECONOMIC DEPENDENCY

The water supply fund has a significant economic dependency on two other municipalities that are major users of water services. During the year ended December 31, 2006, billing for these services was approximately 61% of total charges.

During the year ended December 31, 2006, State of Michigan shared revenue was approximately 30% of total general fund revenue.

14. CONTINGENCIES

Under the terms of various Federal and State grants and regulatory requirements, periodic audits are required and certain costs maybe questioned as not being appropriate expenditures under the terms of the grants and requirements. Such audits could lead to reimbursement to the grantor or regulatory agencies. However, management believes such disallowances, if any, will not be material to the financial position of the City.

The City is named as a defendant in various lawsuits. Although the outcome of these lawsuits is not known, City management believes the final outcome of these matters will not have a material effect on the financial condition of the City.

15. PRIOR PERIOD ADJUSTMENTS

Beginning net assets at January 1, 2006 has been increased in the governmental activities by $130,248 to reflect a reduction of debt which was recorded twice of $24,501, an increase in receivable of $27,107, and an increase in accounts receivable due to a change in accounting policy for income tax recognition of $78,640. Fund balance as of January 1, 2006, in the general fund has been increased by $106,879 to reflect a reclassification of property taxes receivable from the recreation fund of $28,239 and an increase in accounts receivable due to a change in accounting policy for income tax recognition of $78,640. Fund balance as of January 1, 2006, in the recreation special revenue fund was decreased by $28,239 to reflect a reclassification of property taxes receivable to the general fund. The cemetery perpetual care fund was reclassified from a permanent fund to a special revenue fund based on the legal restrictions on this fund.

CITY OF MUSKEGON HEIGHTS

GENERAL FUND
SCHEDULE OF EXPENDITURES
BUDGET AND ACTUAL

FOR THE YEAR ENDED DECEMBER 31, 2006

	Budget Amounts Original	Budget Amounts Final	Actual Amount	Variance Positive (Negative)
Expenditures				
Current				
General government				
City Council	$ 42,508	$ 40,000	$ 37,348	$ 2,652
Mayor	16,792	15,750	15,591	159
City Manager	165,050	145,000	133,340	11,660
Personnel	8,500	39,500	38,944	556
Elections	9,500	12,000	11,554	446
Income Tax	61,241	60,000	58,009	1,991
Assessor	136,067	137,932	140,903	(2,971)
City Attorney	125,000	240,000	239,605	395
City Clerk	65,643	66,579	66,273	306
Finance	130,278	125,000	121,875	3,125
Treasurer	55,062	53,500	52,078	1,422
Data Processing	12,000	4,000	3,050	950
Buildings and Grounds	170,694	162,000	171,470	(9,470)
Motor Pool	65,000	75,000	85,860	(10,860)
Other general government	883,506	880,006	867,572	12,434
	1,946,841	2,056,267	2,043,472	12,795
Public safety				
Police	1,933,240	1,933,922	2,058,904	(124,982)
Auto theft grant	65,975	114,200	118,020	(3,820)
Fire	877,787	1,061,000	1,092,581	(31,581)
Inspections	191,747	200,000	205,790	(5,790)
Special investigations	-	6,537	11,537	(5,000)
	3,068,749	3,315,659	3,486,832	(171,173)
Public works				
Public works	50,214	63,000	73,653	(10,653)
Street lighting	175,000	170,000	170,822	(822)
Traffic	8,040	8,040	7,243	797
Refuse collection	480,000	515,000	523,018	(8,018)
	713,254	756,040	774,736	(18,696)
Community development				
Farmer's market	3,000	2,600	4,580	(1,980)
Planning	3,100	8,400	7,881	519
	6,100	11,000	12,461	(1,461)
Culture and recreation				
Parks	161,416	141,500	161,391	(19,891)
Library	27,800	26,000	25,600	400
Boardwalk	-	80,000	80,000	-
Festival in the park	-	11,720	11,720	-
Mona Lake boat launch	-	500	283	217
	189,216	259,720	278,994	(19,274)
Debt service				
Principal	55,300	71,301	33,347	37,954
Interest and fiscal charges	97,880	97,880	3,339	94,541
	153,180	169,181	36,686	132,495
Total expenditures	$ 6,077,340	$ 6,567,867	$ 6,633,181	$ (65,314)

NON-MAJOR FUNDS

Special Revenue Funds are used to account for specific revenues that are legally restricted to expenditures for particular purposes.

Major Streets - This fund is used to account for the revenues received from the State of Michigan under Act 51 (fuel taxes) which are specifically earmarked for construction and maintenance of roads designated as major streets in the City.

Local Streets - This fund is used to account for the revenues received from the State of Michigan under Act 51 (fuel taxes) which are specifically earmarked for construction and maintenance of roads designated as local streets in the City.

Community Development Block Grant - This fund accounts for the grant funding, program income and participant contributions which are restricted for specific expenditures to meet program objectives established annually.

Cemetery - This fund accounts for specific fees for the operation and maintenance of the City cemetery as well as transfers of interest income from the Cemetery Perpetual Care Permanent Fund.

Recreation - This fund accounts for fees and subsidies from other funds which are utilized to fund the City recreation programs.

Cemetery Perpetual Care - This fund accounts for various cemetery service fees which are restricted for cemetery use.

Brownfield Project - This fund accounts for grant funding utilized to rehabilitate the former wastewater treatment plant site for future development.

Debt Service Funds are used to account for the accumulation and disbursement of resources to pay principal and interest payments on long-term debt.

Capital Project Funds are used to account for the acquisition and construction of major capital facilities other than those financed by proprietary funds and trust funds.

CITY OF MUSKEGON HEIGHTS

NONMAJOR GOVERNMENTAL FUNDS
COMBINING BALANCE SHEET

DECEMBER 31, 2006

	Special Revenue			
	Major Streets	Local Streets	Community Development Block Grant	Cemetery
Assets				
Cash and pooled investments	$ 183,477	$ 39,877	$ -	$ -
Receivables				
Accounts	-	275	-	26,492
Special assessments	103,393	925	-	-
Due from other funds	27,865	95,984	108,504	22,081
Due from other governments	91,706	33,585	81,252	-
Total assets	$ 406,441	$ 170,646	$ 189,756	$ 48,573
Liabilities and fund balances				
Liabilities				
Accounts payable	$ 64,279	$ 5,545	$ 41,805	$ 8,569
Accrued liabilities	983	3,476	3,204	2,087
Due to other funds	98,609	20,395	101,975	93,891
Deferred revenue	103,393	925	42,772	-
Total liabilities	267,264	30,341	189,756	104,547
Fund balances				
Unreserved				
Undesignated	139,177	140,305	-	(55,974)
Total fund balances (deficit)	139,177	140,305	-	(55,974)
Total liabilities and fund balances	$ 406,441	$ 170,646	$ 189,756	$ 48,573

Recreation	Cemetery Perpetual Care	Brownfield Project	Capital Projects	Debt Service	Total
$ -	$ 449,864	$ -	$ 23,512	$ 1,282	$ 698,012
-	3,797	-	-	-	30,564
-	-	-	-	-	104,318
54,108	85,849	-	-	3,057	397,448
-	-	10,971	-	-	217,514
$ 54,108	$ 539,510	$ 10,971	$ 23,512	$ 4,339	$ 1,447,856
$ 6,236	$ 89	$ 10,089	$ 1,440	$ -	$ 138,052
2,269	-	-	-	-	12,019
49,211	22,081	882	-	-	387,044
-	-	-	-	-	147,090
57,716	22,170	10,971	1,440	-	684,205
(3,608)	517,340	-	22,072	4,339	763,651
(3,608)	517,340	-	22,072	4,339	763,651
$ 54,108	$ 539,510	$ 10,971	$ 23,512	$ 4,339	$ 1,447,856

CITY OF MUSKEGON HEIGHTS

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

FOR THE YEAR ENDED DECEMBER 31, 2006

	Special Revenue			
	Major Streets	Local Streets	Community Development Block Grant	Cemetery
Revenues				
Intergovernmental revenues				
Federal	$ -	$ -	$ 601,088	$ -
State	611,690	224,102	-	-
Charges for services	-	-	-	123,675
Fines	-	-	-	-
Interest earnings	1,243	241	1	864
Miscellaneous	16,550	3,916	52,347	-
Total revenues	629,483	228,259	653,436	124,539
Expenditures				
Current				
General government	-	-	-	188,907
Public works and streets	397,351	256,184	-	-
Community development	-	-	546,936	-
Culture and recreation	-	-	-	-
Debt Service				
Principal	15,340	-	-	3,213
Interest	3,351	-	-	531
Total expenditures	416,042	256,184	546,936	192,651
Revenues over (under) expenditures	213,441	(27,925)	106,500	(68,112)
Other financing sources (uses)				
Transfers in	-	-	-	22,346
Transfers out	-	(21,306)	(106,500)	(5,200)
Total other financing sources (uses)	-	(21,306)	(106,500)	17,146
Net changes in fund balances	213,441	(49,231)	-	(50,966)
Fund balances (deficit), beginning of year, as restated	(74,264)	189,536	-	(5,008)
Fund balances (deficit), end of year	$ 139,177	$ 140,305	$ -	$ (55,974)

Recreation	Cemetery Perpetual Care	Brownfield Project	Capital Projects	Debt Service	Total
$ -	$ -	$ -	$ -	$ -	$ 601,088
-	-	10,971	38,334	-	885,097
19,801	6,033	-	-	-	149,509
-	63	-	-	-	63
-	22,347	-	56	7	24,759
260	-	-	1,000	-	74,073
20,061	28,443	10,971	39,390	7	1,734,589
-	135	-	5,145	-	194,187
-	-	-	-	-	653,535
-	-	10,971	-	-	557,907
121,697	-	-	-	-	121,697
-	-	-	-	190,000	208,553
-	-	-	-	89,272	93,154
121,697	135	10,971	5,145	279,272	1,829,033
(101,636)	28,308	-	34,245	(279,265)	(94,444)
81,304	-	-	-	279,272	382,922
(5,000)	(22,346)	-	(38,334)	-	(198,686)
76,304	(22,346)	-	(38,334)	279,272	184,236
(25,332)	5,962	-	(4,089)	7	89,792
21,724	511,378	-	26,161	4,332	673,859
$ (3,608)	$ 517,340	$ -	$ 22,072	$ 4,339	$ 763,651

CITY OF MUSKEGON HEIGHTS

AGENCY FUNDS
COMBINING STATEMENT OF ASSETS AND LIABILITIES

DECEMBER 31, 2006

	Tax Collection	Imprest Payroll	Woodcliffe Village	Total
Assets				
Cash and pooled investments	$ 410,738	$ 126,363	$ 40,022	$ 577,123
Due from other governments	-	4,731	-	4,731
Total assets	$ 410,738	$ 131,094	$ 40,022	$ 581,854
Liabilities				
Accounts payable	$ 26,840	$ 84,752	$ -	$ 111,592
Due to other governments	383,898	46,342	-	430,240
Deposits held for others	-	-	40,022	40,022
Total liabilities	$ 410,738	$ 131,094	$ 40,022	$ 581,854

CITY OF MUSKEGON HEIGHTS

DOWNTOWN DEVELOPMENT AUTHORITY
COMBINING BALANCE SHEET/STATEMENT OF NET ASSETS

DECEMBER 31, 2006

	Governmental Fund Types				
	General Fund	Debt Service Fund	Totals	Adjustments	Statement of Net Assets
Assets					
Cash and pooled investments	$ 257,808	$ -	$ 257,808	$ -	$ 257,808
Accounts receivable	89	-	89	-	89
Property taxes receivable	134,413	-	134,413	-	134,413
Due from other funds	-	339	339	(339)	-
Loans receivable	24,136	-	24,136	-	24,136
Capital assets					
Land	-	-	-	294,635	294,635
Buildings	-	-	-	753,835	753,835
Accumulated depreciation	-	-	-	(171,489)	(171,489)
Total assets	$ 416,446	$ 339	$ 416,785	876,642	1,293,427
Liabilities and fund balances					
Liabilities					
Accounts payable	$ 63,627	$ 338	$ 63,965	$ -	63,965
Accrued liabilities	1,322	-	1,322	7,314	8,636
Deferred revenue	164,270	-	164,270	-	164,270
Due to other funds	339	-	339	(339)	-
Due to other governments	20,914	-	20,914	-	20,914
Noncurrent liabilities					
Due within one year	-	-	-	99,374	99,374
Due in more than one year	-	-	-	626,510	626,510
Total liabilities	250,472	338	250,810	732,859	983,669
Fund balances					
Reserved for loans	24,136	-	24,136		
Unreserved					
Undesignated	141,838	1	141,839		
Total fund balances	165,974	1	165,975		
Total liabilities and fund balances	$ 416,446	$ 339	$ 416,785		
Net assets					
Unrestricted					$ 309,758

CITY OF MUSKEGON HEIGHTS

DOWNTOWN DEVELOPMENT AUTHORITY
COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES/STATEMENT OF ACTIVITIES

FOR THE YEAR ENDED DECEMBER 31, 2006

	Governmental Fund Types				
	General Fund	Debt Service Fund	Totals	Adjustments	Statement of Net Assets
Revenues					
Property taxes	$ 330,492	$ -	$ 330,492	$ -	$ 330,492
Charges	50,350	-	50,350	-	50,350
Interest earnings	9,311	-	9,311	-	9,311
Miscellaneous	696	-	696	-	696
	390,849	-	390,849	-	390,849
Expenditures					
Current					
General government	315,275	-	315,275	17,126	332,401
Debt Service					
Principal	22,285	50,000	72,285	(72,285)	-
Interest	8,611	46,310	54,921	(1,487)	53,434
Total expenditures	346,171	96,310	442,481	(56,646)	385,835
Revenues over (under) expenditures	44,678	(96,310)	(51,632)	56,646	5,014
Other financing sources (uses)					
Transfers in	-	96,311	96,311	-	96,311
Transfers out	(96,311)	-	(96,311)	-	(96,311)
Total other financing sources (uses)	(96,311)	96,311	-	-	-
Net changes in fund balances	(51,633)	1	(51,632)	51,632	
Change in net assets				5,014	5,014
Fund balances/net assets, beginning of year	217,607	-	217,607	87,137	304,744
Fund balances/net assets, end of year	$ 165,974	$ 1	$ 165,975	$ 143,783	$ 309,758

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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*

June 15, 2007

Honorable Mayor and Members of the City Council
City of Muskegon Heights, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Muskegon Heights, Michigan, as of and for the year ended December 31, 2006, which collectively comprise the City of Muskegon Heights' basic financial statements and have issued our report thereon dated June 15, 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 the City of Muskegon Heights' internal control over financial reporting 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 City of Muskegon Heights' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of Muskegon Heights' 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 certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City of Muskegon Heights' 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 City of Muskegon Heights' financial statements that is more than inconsequential will not be prevented or detected by the City of Muskegon Heights' internal control. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item 2006-5 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 City of Muskegon Heights' internal control.

Specializing in services to governmental and nonprofit entities

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 consider the significant deficiency described above to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Muskegon Heights' 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.*

We noted certain matters that we reported to management of the City of Muskegon Heights, in a separate letter dated June 15, 2007.

The City of Muskegon Heights' response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the City of Muskegon Heights' response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, 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.

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

June 15, 2007

Honorable Mayor and Members of the City Council
City of Muskegon Heights, Michigan

Compliance
We have audited the compliance of the City of Muskegon Heights, Michigan, with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended December 31, 2006. The City of Muskegon Heights' major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the City of Muskegon Heights' management. Our responsibility is to express an opinion on the City of Muskegon Heights' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City of Muskegon Heights' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the City of Muskegon Heights' compliance with those requirements.

In our opinion, the City of Muskegon Heights, complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2006. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2006-1 through 2006-4.

Internal Control Over Compliance
The management of the City of Muskegon Heights is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the City of Muskegon Heights' internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Entity's internal control over compliance.

Specializing in services to governmental and nonprofit entities

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

A control deficiency in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2006-1 and 2006-4 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, we consider both items above to be material weaknesses.

The City of Muskegon Heights' response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the City of Muskegon Heights' response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, 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.

Vredeveld Haefner LLC

CITY OF MUSKEGON HEIGHTS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

FOR THE YEAR ENDED DECEMBER 31, 2006

Federal Grantor/Pass-through Grantor/Program Title	Federal CFDA Number	Pass-through Grantor's Number	Approved Grant Award Amount	Accrued (deferred) Revenue January 1, 2006	Cash Received	Year Ended Expenditures	Accrued (deferred) Revenue December 31, 2006
U.S. Department of Housing and Urban Development							
Community Development Block Grant	14.218	B-00-MC-26-0027	$ -	$ -	$ 7,185	$ 7,185	$ -
Community Development Block Grant	14.218	B-01-MC-26-0027	586,000	-	-	-	-
Community Development Block Grant	14.218	B-02-MC-26-0027	593,000	-	87,046	87,046	-
Community Development Block Grant	14.218	B-03-MC-26-0027	579,000	-	31,203	31,203	-
Community Development Block Grant	14.218	B-04-MC-26-0027	569,000	-	34,371	34,371	-
Community Development Block Grant	14.218	B-05-MC-26-0027	536,550	152,032	234,881	82,849	-
Community Development Block Grant	14.218	B-06-MC-26-0027	480,152	-	277,182	358,434	81,252
Program income	14.218		-	(33,784)	17,200	24,167	(26,817)
Total U.S. Department of Housing and Urban Development			3,343,702	118,248	689,068	625,255	54,435
U.S. Federal Emergency Management Administration							
Assistance to Firefighters Grant Training Program	83.554	EMW-2004-FG-00243	-	(42,266)	-	42,266	-
Total U.S. Federal Emergency Management Administration			-	(42,266)	-	42,266	-
U.S. Department of Justice							
Passed through Muskegon County United Way							
Weed and Seed	16.595	2005-WS-Q5-0145	54,750	-	54,750	54,750	-
Weed and Seed	16.595	2006-WS-Q5-0145	48,500	-	7,878	19,031	11,153
Total Passed through Muskegon County United Way			103,250	-	62,628	73,781	11,153
Total U.S. Department of Justice			103,250	-	62,628	73,781	11,153
U.S. Department of Interior							
Urban Park and Recreation Recovery Program	15.919	26-CTY-3460-01-01	15,956	-	15,956	-	(15,956)
Less program income non federal CDBG program income			-	33,784	(17,200)	(24,167)	26,817
Total Federal Awards			$ 3,462,908	$ 109,766	$ 750,452	$ 717,135	$ 76,449

Notes to Schedule of Expenditures of Federal Awards

1. This schedule is presented on the accrual basis of accounting.
2. Expenditures in this schedule are in agreement with amounts reported in the financial statements

CITY OF MUSKEGON HEIGHTS

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED DECEMBER 31, 2006

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued	Unqualified on basic financial statements	
Internal controls over financial reporting		
Material weaknesses identified?	X yes	___ no
Reportable conditions identified not considered to be material weaknesses?	___ yes	X none reported
Noncompliance material to financial statements noted?	___ yes	X no

Federal Awards

Internal control over major programs		
Material weaknesses identified?	X yes	___ no
Reportable conditions identified not considered to be material weaknesses?	X yes	___ none reported
Type of auditors' report issued on compliance for major programs	Unqualified	
Any audit findings disclosed that are required to be reported in accordance with Circular A-133, section 510(a)?	X yes	___ no

Identification of Major Programs

CFDA Number(s)	Name of Federal Program or Cluster
14.218	Community Development Block Grant

Dollar threshold used to distinguish between Type A and B programs?	$300,000	
Auditee qualified as low-risk auditee?	___ yes	X no

SECTION II - FINANCIAL STATEMENT FINDINGS

2006-5

Conditions: The City staff has not recorded all entries necessary to prepare fund basis financial statements or the government-wide financial statements in accordance with generally accepted accounting principles.

Effect: Auditing standards require that the inability to prepare financial statements in accordance with generally accepted accounting principles be reported as a material weakness.

Recommendation: The City's system of control should be modified so that general ledger balances are reviewed and adjusted periodically to reflect balances in accordance with generally accepted accounting principles.

Management corrective action: Additional staff has been added to the Finance Department so that the Finance Director has sufficient time to account for the City's finances in accordance with generally accepted accounting principles.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

2006-1

Conditions: Actual expenditures for personnel costs are not always supported by documentation required by current federal cost principals. Federal cost principals require periodic certification of time by employees working on a single grant and time sheets or time studies for employees working on multiple grants/cost centers.

Effect: City documentation of personnel cost is not meeting the requirements of federal cost principal.

Recommendation: Require and document periodic certification of time by employees working on a single grant and time sheets or time studies for employees working on multiple grants/cost centers.

Management corrective action: Beginning January 1, 2007 this issue was address through implementation of a process that meets federal cost principals.

2006-2

Conditions: The City's Operational Directive (policy) to require specific co-payments by participants in the Home Ownership Rehabilitation Program was not consistently followed.

Effect: City leveraging of program funding with co-payments is not consistent with the Operational Directive (policy).

Recommendation: The City should follow the Operational Directive (policy) or modify the policy to allow for consistent application of the program co-payment requirements.

Management corrective action: Management has determined that this finding is the result of initial underestimation of project cost that resulted in co-payments being less than the percentage required by City policy. The City will implement changes in the estimation and approval process to assure that co-payments are in accordance with City policy.

2006-3

Conditions: The City's policy to place liens on the property of program participants was not always being followed.

Effect: The City may not receive repayment on loans when property transfers from program participants to other parties due to the lack of liens on related property.

Recommendation: Complete and file the necessary documentation to lien property when applicable.

Management corrective action: The City will be filing liens on all property on a monthly basis.

2006-4

Conditions: The City's policy to document program compliance and internal controls over programs is not always functioning as designed. Specifically all program checklist items are not always being documented or approved.

Effect: Documentation of compliance with program and City policy requirements in not always occurring.

Recommendation: Complete and review all necessary documentation before issuing any payments to program participants.

Management corrective action: The City has established a policy to require signed contracts and completed files before payments are made. The City will also be meeting with staff to reemphasis the need for accurate and complete file management.

SECTION IV - SUMMARY OF PRIOR AUDIT FINDINGS

None noted

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June 15, 2007

Honorable Mayor and City Council
City of Muskegon Heights
Muskegon Heights, MI

In planning and performing our audit of the financial statements of the City of Muskegon Heights, for the year ended December 31, 2006, we noted certain matters which we would like to bring to your attention. These matters were reviewed with management and we will review these matters during future audits.

WATER FUND COMMODITY LOSS

During our audit we noted that there was a 25% difference between gallons of water purchased from the water supply fund and the gallons of water sold to the retail customers. We suggest that the city review this discrepancy and take appropriate action.

POOLED CASH

During our audit we noted numerous bank accounts were being utilized to account for the resources of the various funds and activities of the City. This process results in multiple internal balances between funds which complicates accounting for, and reconciliation of, internal balances between funds and necessitates performance of multiple monthly bank reconciliations. We suggest that the City consider pooling cash and investment balances between funds to the extent allowable under state requirements to minimize the number of bank and investment accounts, number of monthly reconciliations, and the amount of time expended on accounting for these balances.

FINANCIAL ANALYSIS AND GRANTS MANAGEMENT

During our audit we noted several aspects of grant management and reporting were not occurring which have been noted in the schedule of findings and questioned costs of the single audit. In addition, we noted that numerous significant adjustments to the City general ledger balances were necessary to compile accurate year-end financial statements. We believe that modification of the City's current internal control process to require a monthly review and reporting of City budget and actual information by appropriate level staff would result in the identification of errors and process bottlenecks in a more timely manner.

NEW ACCOUNTING STANDARDS

The Governmental Accounting Standards Board recently issued Statement No. 43 *Financial Reporting for Post Employment Benefit Plans other Than Pension Plans*. Statement No. 43 will become effective for the City for the 2007 fiscal year and will requires additional disclosure, an actuarial evaluation of those employee benefits granted to retirees, and additional expenditure recognition in the government-wide financial statements. We would be happy to work with your staff to implement this significant new accounting standard.

We would like to thank the City staff for their assistance during the annual audit.

This report is intended solely for the information and use of the City of Muskegon Heights, and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

Vredeveld Haefner LLC