

October 10, 2005

Board of Education
School District of the City of Bay City
910 N. Walnut Street
Bay City, MI 48706

Dear Board Members:

The Comprehensive Annual Financial Report of the School District of the City of Bay City for the year ended June 30, 2005, is completed and available for review. This report was prepared by the District's Finance and Accounting Department in conjunction with the District auditors of Andrews Hooper & Pavlik P.L.C. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with the District. We believe the data, as presented, is accurate in all material respects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of the District as measured by the financial activity of its various funds; and that all disclosures necessary to enable the reader to gain the maximum understanding of the District's financial affairs have been included.

The Comprehensive Annual Financial Report is presented in three sections: introduction, financial, and statistical. The introductory section includes this transmittal letter, the District organizational chart, and a listing of the elected board members. The financial section includes the Administration's discussion and analysis, the basic financial statements, and the required and other supplemental information, as well as the auditors' report on the financial statements and schedules. The statistical section includes selected financial and demographic information, generally presented on a multiple-year basis.

The accompanying financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board for determining the various governmental organizations to be included in the reporting entity. The School District of the City of Bay City Board of Education (Board) is the basic level of government that has oversight responsibility and control over all activities related to public school education in the School District of the City of Bay City. The Board receives funding from local, state, and federal government sources and must comply with the requirements of these funding source entities. However, the Board is not included in any other governmental "reporting entity" as defined by the Governmental Accounting Standards Board, since the Board members are elected by the public and have decision-making authority, the authority to levy taxes, the power to designate management, the ability to significantly influence operations and primary responsibility for fiscal matters.

The report has been prepared following accounting principles generally accepted in the United States of America. We believe the data presented are accurate in all material respects and clearly reflect the financial position and the results of operations of the District. All disclosures necessary to enable the reader to gain full understanding of the District's financial activity have been made.

GENERAL OVERVIEW OF THE SCHOOL DISTRICT

The School District of the City of Bay City is a fiscally independent school district established under the laws of the State of Michigan and governed by a seven (7) member elected Board of Education. The District has ten (10) K-5 elementary schools, three (3) 6-8 middle schools, two (2) 9-12 high schools and one (1) alternative school. Other facilities are used for administration, transportation, technology, maintenance, warehouse, community education, special education, and various other programs of the District. It is a 270 square mile district located in Bay and Saginaw Counties, Michigan. There are three (3) cities and twelve (12) townships within the boundaries of this urban-suburban school district.

A comprehensive general education program for kindergarten through grade 12 students is provided and extensive additional programs are incorporated into the general education structure. Examples of the wide range of offerings include young fives, full-day kindergarten, before and after school programs, community education, special education, compensatory education, alternative education, vocational education, gifted and talented education, and programs for at-risk students. A full selection of courses is available to high school students and both high schools in the District are fully accredited by the North Central Association. Cooperative education, advanced placement, fine arts, and athletic programs provide students with many choices for academic and individual growth.

The Board and administration continuously strive to improve its curriculum and academic programs and the results of these efforts are reflected in increasing student standardized test results that have Bay City in the top five in several curriculum categories among demographically similar Michigan "Middle Cities" districts. The District has implemented a Middle School Concept in grades 6 through 8 that allows students a more age appropriate educational experience as a transition from the elementary grades to high school. At the secondary level, a High School of the 21st Century curriculum is utilized to assist students as they prepare for future educational and career objectives. Other examples of the broad range of curriculum offerings include art, music, physical education, and foreign language offered to K-5 students in our elementary schools, educational assistance for non-English speaking students, cooperative education programs that allow high school students to explore career opportunities while gaining actual work experiences, vocational education such as automobile repair and maintenance offered in our high schools and many other offerings through the regional Bay Area Skill Center. The District also provides many educational opportunities and student services to parochial schools within its boundaries including Title I, transportation and food service.

The Bay-Arenac Intermediate School District (BAISD) levies a special education tax to support the special education center programs for all local school districts within the BAISD. These special education programs are for the more severely handicapped students within the BAISD. The School District of the City of Bay City also operates its own special education program for the less severely handicapped.

Operating results for 2004-05 reflect a general fund fiscal surplus of \$1,341,392, which is a decrease of \$1,429,041 from the \$2,770,433 fund balance for the 2003-2004 school year. However, as compared to our fund balance of \$230,418 in 2000-2001 when the fund balance policy was enacted, the District has made strides toward improving its financial position despite reductions in State funding. This commitment toward improving the financial position is evidenced by the adoption in July 2001 of a formal fund balance board policy designed to increase, establish and maintain a healthy fund balance in relation to the size of the overall budget. This policy has also been included as a annual District goal. Budget, fund balance, and cost effective operations will continue to be a major issue as we struggle to maintain core student programs and services in the face of difficult economic times.

Initiatives are constantly taken to attract new students and maintain the opportunities for current students. For example, in 2000-2001, two elementary schools were completely renovated with additional space being added in the form of classrooms, gymnasiums, and cafeterias. Programs such as day care, pre-school, full-day kindergarten, and young-fives have either been added or expanded to meet demand. During 2003-2004, a program was developed that provides programs such as art, music, physical education, and foreign languages to parochial students. The District does not charge the parochial schools because State Aid can be received for this instructional time. This program has been an instructional and financial success for both the parochial schools and our School District.

MARKETING AND COMMUNICATION

Marketing through the use of printed information, internet web sites, and television are being stepped up to increase awareness of the many programs and services the District offers and also many other positive features including schools, curriculum, technology, and dedicated employees and volunteers. As a result of these initiatives, the District's student population has stabilized after several years of decline.

In the area of television, the District is one of three partners along with the City of Bay City and Bay County governments in the operation of a local cable television station called Bay3-TV. The School District broadcasts board meetings, school events such as concerts and plays, community events, educational programs such as a mathline where students can call and get assistance with math problems as well as programs on child safety. Other programming includes monthly updates on issues such as curriculum, technology, and finance.

In the area of communication, the District has a web site for parents and community members to stay informed about District issues and information and for employees to use for accessing operations and training. Individual schools also have web pages that provide information ranging from event schedules to school lunch menus. The district's budget and audit also are part of the website.

Printed information is also an important communication component. The District distributes a brochure to local banks, realtors, and other businesses that includes information about programs and services offered in the District. A District newsletter entitled "The Light" is distributed as an insert in the local newspaper and provides

information of interest to community and students. An internal newsletter entitled "The Beacon" is used to communicate information on a variety of issues to the 1,200 employees in the District including important reminders.

This spring a new initiative was begun called "Key Communicators." Each principal and central office administrator is part of a network involving a cross section of community members such as business leaders and parents. Each month, an email communication of current school district initiatives, events, and information is shared through the network and any questions can be answered.

ECONOMIC ENVIRONMENT

At the State level, funding for K-12 education has decreased or been frozen during the last three years but is expected to increase for 2005-06 based on current State economic data. As a historical perspective, in 1994-1995, Michigan began a new funding structure for K-12 education. This new structure reduced property taxes to 6 mills on homes, 24 mills on businesses, and increased the State sales tax from 4% to 6%. A foundation grant base amount of \$5,000 per student was established for districts funded below that level. Districts, such as Bay City, that were below the initial \$5,000 foundation grant level were increased at twice the official rate in order to catch those districts up at a faster rate.

Because economic conditions had been good during the 1990's, school funding was predicable and stable with regular increases each year. Stable foundation grant levels and annual increases are critical for all school systems in their efforts to deal with important issues such as contract negotiations, facility improvements, technology improvements, curriculum improvements, increased testing, competition from charter schools, expansion of schools of choice, and the escalation of school violence. The foundation grant for the Bay City School District was \$6,621 per student in 2002-2003, which was an increase of \$121 from the \$6,500 amount received in 2001-2002. Originally, the 2002-2003-student foundation grant was \$6,700 but was reduced in March 2003 due to severe economic problems with the State's budget to \$6,621. This reduction resulted in an unexpected loss of revenue by Bay City Schools of approximately \$800,000 three-fourths through the fiscal year. The foundation grant for 2003-2004 was originally set at \$6,700 but was reduced midway through the fiscal year to \$6,616 due to State budget problems. In 2004-2005 the State maintained the foundation grant at \$6,700. School funding for future years is primarily dependent on the State's economy which is struggling and creating budgetary difficulties at all levels of government. In addition, the State's Michigan Public School Employee Retirement System (MPERS) is projecting that school districts will experience a 50% increase in contribution premiums over the next 5 years. Because these contributions are State mandated to fund the pension system, real school funding is declining even with modest increases in the per student foundation grant.

The City of Bay City itself has continued to strive towards greater economic development through a combination of public and private investment. The Bay City Mall constructed several years ago continues to flourish with more than 100 outlets. Anchor stores in the Mall include Sears, Younkers, Target, J.C. Penney, and Radio Shack. Many restaurants and retail businesses have located near the Bay City Mall including two new hotels as well as several strip malls. This has increased the traffic in the Bay City area and has drawn residents from the northern part of the State as well as tourists either attending Bay City events or passing through on their way northward to destinations such as Mackinaw Island, Traverse City, or one of the many lakes located in Michigan.

Continued construction and renovation projects are marking significant changes within the City of Bay City boundaries. Public investment in new streets, sidewalks, parking areas and parks are greatly improving the investment atmosphere for commercial, residential areas and major thoroughfares. Another bright spot for the Bay City area is the increase in new home construction in various townships located within the District.

The explosion of home construction is due to a combination of current residents who are relocating and new families moving into the area. All of these developments are not only increasing the economic activity of the community but are also enhancing overall property values.

The downtown Bay City area has also seen a re-vitalization such as the Delta College Planetarium/Learning Center and Jennison Place, a 33-unit condominium that is located on the shore of the Saginaw River. In addition, many buildings in the downtown area have been re-developed into specialty shops and restaurants. A new hotel convention center and hotel complex is now located on the riverfront with the expectation that this facility will enhance the economic revitalization of the city.

Bay City is home to many summer events that utilize the Saginaw River and Bay as well as surrounding parks and recreation areas. As a result, tourism has become an integral part of the local economy. A "Friendship

Shell" located in Wenona Park on the banks of the Saginaw River in downtown Bay City, is used each Fourth of July weekend to celebrate our Nation's birth. A River Walk rests along the Saginaw River for walking, fishing, or jogging in a scenic setting. The River Walk is complimented by a Rail Trail for bikers, walkers, rollerbladers, and joggers that winds throughout the City and surrounding townships providing a peaceful, and scenic experience. The annual fireworks festival draws hundreds of thousands of tourists to the Bay City area. Other activities at the Shell take place continually during the summer months. A few examples are the River Roar boat race and the Pig Gig featuring national rib cooking competition and family activities. In addition, nationally sponsored boat races are held on both the Saginaw River and Saginaw Bay. Various concerts, festivals, bazaars and other family events are also a big part of the Bay City experience during the summer months.

The School District is also located very near two institutions for higher learning. Delta College is a junior college that offers many two-year degree programs such as Dental Hygiene as well as basic course offerings for individuals in pursuit of a four-year degree. Saginaw Valley State University located in Saginaw County offers both undergraduate and graduate degrees in many areas such as Business Administration, Engineering, Nursing, and Teaching. In addition, Central Michigan University is located approximately 60 miles from the District and also offers a full range of undergraduate and graduate degree programs. These colleges and universities also work with the surrounding K-12 school districts, including Bay City, to promote educational opportunities, provide student teaching, cooperative education opportunities, professional development, and grant initiatives.

MAJOR INITIATIVES

The mission and vision of the District puts the student as the focal point for every decision that is made. District initiatives and goals in areas such as finance, curriculum, technology, and support services are designed with this same philosophy.

During 2004-05 the District implemented a School Improvement Bond of \$5.9 million for energy system improvements in all facilities. The bonds will be paid using savings from the improvements and is intended to be the starting point for a comprehensive facility plan to upgrade and maintain all facilities through a combination of a voted bond issue and general fund operational dollars.

A technology plan implemented in 1999-2000 continues throughout the District focusing on standardizing equipment, software, email, and networking. At the beginning of the 2000-2001 school year the District entered into a capital lease arrangement with Dell Computers for a three-year lease with an option for upgrading computers every three years. In 2003-2004 this leasing arrangement was re-authorized with Dell under a four-year arrangement. Under this plan, District staff is replacing computer equipment from the original Dell lease with new computer equipment. Computer technicians, computer lab aides, and building level computer liaisons were added to insure that the technology was properly installed, properly used, and will be properly maintained in the future. The technology plan also included distributing employee handbooks regarding District policies on technology hardware, software, and Internet access.

Curriculum has been and continues to be a major focus. The District has implemented a Middle School Concept and High Schools of the 21st Century, has been working to improve reading at the early elementary level, instituted a regular replacement schedule for textbooks throughout the District, has continued alignment of curriculum for all schools and in all core subject areas, and has initiated a balanced calendar program at one elementary school and one middle school. Because of its tremendous popularity with parents, the full-day kindergarten offerings continue to increase as well. These initiatives are being accomplished in conjunction with the technology department to ensure that technology equipment and software purchases are effectively used by staff to achieve curriculum goals.

Academic progress for our students in the Bay City Public Schools is improving due to the hard work of staff and students. This progress is measured through numerous district, state, and national assessments and supported by the prioritization of our budget on student needs. The long-term effects of the changes that have been made in curriculum during the past several years are beginning to be realized. For example, the State of Michigan's MEAP assessment test results from May 2005 and May 2004 indicate significant improvements in student achievement in various subject areas. Annual improvements in student assessment is and will continue to be critical for all school districts in view of the national emphasis on student achievement and accountability as reflected in the "No Child Left Behind" legislation.

FINANCIAL INFORMATION

GASB 34 requires management to prepare a report referred to as "Management Discussion and Analysis or MD&A. Discussion of specific financial information and financial trends of the District are contained in the MD&A included in this Comprehensive Annual Financial Statement.

Management of the District is also responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the District are protected from loss, theft or misuse, and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

Single Audit - As a recipient of federal, state, and county financial assistance, the District is also responsible for ensuring that an adequate internal and administrative control structure is in place to ensure compliance with applicable laws and regulations related to those programs.

This internal control structure is subject to periodic evaluation by management and the District's independent public accountants in conjunction with their audits of the District. As a part of the District's single audit, described above, an evaluation of the internal control structure is performed and tests are conducted to determine whether the District complied with provisions of certain laws, regulations, and contracts. The auditors then issue reports related to these matters. The results of the District's single audit for the fiscal year ended June 30, 2005 provided no instances of material weaknesses in the internal control structure or significant violations of applicable laws and regulations.

Budgetary Controls - In addition, the District also maintains budgetary controls. The objective of budgetary controls is to ensure that budgets are in compliance with legal provisions in the annual appropriation budget adopted by the Board of Education.

Formal budgetary integration is employed as a management control device during the year for the General Fund, Special Revenue Funds, and Debt Service Funds. Under the guidelines of Bulletin 1022 (revised), the State of Michigan's School Accounting Manual, detailed line item budget information is provided and appropriate administrators are delegated the responsibility for monitoring and controlling their respective budget allocations. An encumbrance system is utilized to measure the uncommitted budget amount available at any given point in time during the year.

The administration believes that the existing system of budgetary and accounting controls provides a reasonable level of assurance that errors or irregularities that could be material to the financial statements are prevented or that they would be detected within a timely manner.

Debt Administration - The district currently holds an "A -" rating for bonded debt from Standard and Poor's Financial Rating Service. We see this as a statement that the District is a well-supported financial entity worthy of the prudent investor's investment dollar. The District has maintained a low debt position in proportion to the overall budget that includes \$16,015,523 long-term bonds and loans that will mature over the next five years and \$7,300,000 short term State Aid Anticipation Notes set to mature in August 2005. The District also has \$9,890,601 in long-term obligations for retirement incentives and vested severance pay obligations to current and past employees. Because of the concern on the size of these long-term obligations and the related impact of cash payments on the annual budget, the District, in collaboration with its 9 employee bargaining groups have changed both the qualifying criteria and the payment calculations for severance pay,

Cash Management - In accordance with Michigan statutes, the District's cash management guidelines are established to maximize its interest earnings while attempting to minimize the risk of loss of invested money. Interest bearing checking accounts, cash management accounts, certificates of deposit in state or national banks, approved savings and loan association, and high grade commercial paper are all instruments used to achieve this goal.

In 2004-2005 the District earned \$93,934 in interest from investments in the general fund. The average yield on investments for all funds held at June 30, 2005, was 0.82% and is lower than the average yield on June 30, 2004 of 0.82%. The average monthly cash balance including borrowed funds for 2004-2005 was \$5,828,084.

OTHER INFORMATION

Independent Audit - State of Michigan statutes require an annual audit by independent certified public accountants. The accounting firm of Andrews Hooper & Pavlik P.L.C. was appointed by the Bay City Board of Education to perform this service for the 2004-2005 fiscal year. In addition, the Single Audit Act requires governmental recipients of Federal assistance to have organizational-wide financial and compliance audits on an annual basis. Both of these requirements have been met and the auditors' report on the financial statements is included herein.

Acknowledgments - The preparation of this report was accomplished through the commitment and dedication of the Finance and Accounting Department. We thank the personnel of the Finance and Accounting Department and the administrative staff for their dedication and efforts in preparation of the financial statements and the preparation of this Comprehensive Annual Financial Report. We also thank the independent audit firm of Andrews Hooper & Pavlik, P.L.C. for their assistance in the preparation of this report.

Continued diligence in fiscal management and timely communication between the Administration and Board of Education will facilitate efforts to exceed the present high level of excellence expected by its constituents.

In order that the community may know the content of this report, copies will be made available at various public libraries within the boundaries of the District. Copies of this report are also available for public distribution upon request to the Finance and Accounting Department and can be found on the District website at www.bcschools.net.

Sincerely,

Ms. Carolyn C. Wierda,
Superintendent of Schools

Mr. Douglas L. Newcombe, MBA, CPA
Director of Finance & Accounting