

**CITY OF SHELBY
RICHLAND COUNTY, OHIO**

**BASIC FINANCIAL STATEMENTS
*FOR THE YEAR ENDED
DECEMBER 31, 2006***

ROBERT LAFFERTY, DIRECTOR OF FINANCE



Mary Taylor, CPA

Auditor of State

Members of Council
City of Shelby
23 West Main Street
Shelby, Ohio 44875

We have reviewed the *Independent Auditors' Report* of the City of Shelby, Richland County, prepared by Julian & Grube, Inc., for the audit period January 1, 2006 through December 31, 2006. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

Our review was made in reference to the applicable sections of legislative criteria, as reflected by the Ohio Constitution, and the Revised Code, policies, procedures and guidelines of the Auditor of State, regulations and grant requirements. The City of Shelby is responsible for compliance with these laws and regulations.

Mary Taylor

Mary Taylor, CPA
Auditor of State

July 9, 2007

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**CITY OF SHELBY
RICHLAND COUNTY, OHIO**

**BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006**

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Julian & Grube, Inc.
Serving Ohio Local Governments

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Independent Auditors' Report

Mayor and Members of Council
City of Shelby
23 W. Main Street
Shelby, Ohio 44875

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Shelby, Richland County, Ohio, (the "City"), 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 City's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the Comptroller General of the United States' *Government Auditing Standards*. 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 the 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, each major fund and the aggregate remaining fund information of the City of Shelby, Richland County, as of December 31, 2006, and the respective changes in financial position and cash flows, where applicable, 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 our report dated May 10, 2007 on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Mayor and Members of Council
City of Shelby
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The management's discussion and analysis is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied limited procedures, consisting principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. We did not audit the information and express no opinion on it.

A handwritten signature in cursive script that reads "Julian & Grube, Inc.".

Julian & Grube, Inc.
May 10, 2007

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

The discussion and analysis of the City of Shelby's (the "City") financial performance provides an overall review of the City's financial activities for the fiscal year ended December 31, 2006. The intent of this discussion and analysis is to look at the City's financial performance as a whole; readers should also review the basic financial statements and the notes to the basic financial statements to enhance their understanding of the City's financial performance.

Financial Highlights

Key financial highlights for 2006 are as follows:

- The total net assets of the City increased \$1,735,872. Net assets of governmental activities decreased \$316,283 or 1.62% from fiscal year 2005. Net assets of business-type activities increased \$2,052,155 or 8.88% from fiscal year 2005.
- General revenues accounted for \$4,637,457 or 68.05% of total governmental activities revenue. Program specific revenues accounted for \$2,177,616 or 31.95% of total governmental activities revenue.
- Governmental activities capital assets, net of related debt decreased \$394,103.
- The City had \$6,392,857 in expenses related to governmental activities; \$2,177,616 of these expenses was offset by program specific charges for services, grants or contributions. General revenues (primarily property taxes, income taxes and unrestricted grants and entitlements) of \$4,637,457 were not adequate to provide for these programs.
- The general fund, the City's only major governmental fund, had revenues of \$3,585,498 in 2006. This represents a decrease of \$472,090 or 11.64% from 2005 revenues. The expenditures and other financing uses of the general fund, which totaled \$3,765,128 in 2006, increased \$203,329 from 2005. The fund balance in the general fund decreased \$179,630 to \$854,719 in 2006.
- Net assets for the business-type activities, which are made up of the Water, Sewer and Electric enterprise funds, increased in 2006 by \$2,052,155 or 8.88%. This increase in net assets was due primarily to the increase in capital assets in the Water, Sewer and Electric funds.
- In the general fund, actual revenues came in \$173,242 greater than they were in the original budget and actual expenditures and other financing uses were \$240,501 less than the amount in the original budget. The general fund maintained a positive variance of \$53,448 in revenues and a positive variance of \$320,501 in expenditures versus the final budgeted amounts.

Using this Annual Financial Report

This annual report consists of a series of financial statements and notes to those statements. These statements are organized so the reader can understand the City as a financial whole, an entire operating entity. The statements then proceed to provide an increasingly detailed look at specific financial activities.

The Statement of Net Assets and Statement of Activities provide information about the activities of the whole City, presenting both an aggregate view of the City's finances and a longer-term view of those finances. Fund financial statements provide the next level of detail. For governmental funds, these statements tell how services were financed in the short-term as well as what remains for future spending. The fund financial statements also look at the City's most significant funds with all other nonmajor funds presented in total in one column. The general fund is the City's only major governmental fund.

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

Reporting the City as a Whole

Statement of Net Assets and the Statement of Activities

While this document contains a large number of funds used by the City to provide programs and activities, the view of the City as a whole looks at all financial transactions and asks the question, "How did we do financially during 2006?" The Statement of Net Assets and the Statement of Activities answer this question. These statements include all assets, liabilities, revenues and expenses using the accrual basis of accounting similar to the accounting used by most private-sector companies. This basis of accounting will take into account all of the current year's revenues and expenses regardless of when cash is received or paid.

These two statements report the City's net assets and changes in those assets. This change in net assets is important because it tells the reader that, for the City as a whole, the financial position of the City has improved or diminished. The causes of this change may be the result of many factors, some financial, some not. Non-financial factors include the City's property tax base, current property tax laws in Ohio restricting revenue growth, facility conditions, required community programs and other factors.

In the Statement of Net Assets and the Statement of Activities, the City is divided into two distinct kinds of activities:

Governmental Activities - Most of the City's programs and services are reported here including general government, security of persons and property, public health and welfare, transportation, community environment, and leisure time activity. These services are funded primarily by property and income taxes and intergovernmental revenues including federal and state grants and other shared revenues.

Business-Type Activities - These services are provided on a charge for goods or services basis to recover all or a significant portion of the expenses of the goods or services provided.

Reporting the City's Most Significant Funds

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.

Fund financial reports provide detailed information about the City's major funds. The City uses many funds to account for a multitude of financial transactions. However, these fund financial statements focuses on the City's most significant funds. The City's only major governmental fund is the general fund. The analysis of the City's major governmental and proprietary funds begins on page 9.

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 government's near-term financing requirements.

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

Because the focus of the 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, the readers may better understand the long-term impact of the government'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.

The City maintains a multitude of individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental statement of revenues, expenditures, and changes in fund balances for the major fund, which was identified earlier. Data from the other governmental funds are combined into a single, aggregated presentation. The basic governmental fund financial statements can be found on pages 17 - 21 of this report.

Proprietary Funds

The City maintains two different types of proprietary 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 electric operations. Internal service funds are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses an internal service fund to account for its self-insurance program. Because this service predominantly benefits governmental rather than business-type functions, it has been included within governmental activities in the government-wide financial statements. The basic proprietary fund financial statements can be found on pages 22 – 25 of this report.

Fiduciary Funds

Fiduciary funds are used to account for resources held for the benefit of parties outside the City. Fiduciary funds are not reflected in the government-wide financial statement because the resources 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. Agency funds are the City's only fiduciary fund type. The basic fiduciary fund financial statement can be found on page 26 of this report.

Notes to the Basic 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. These notes to the basic financial statements can be found on pages 27 – 57 of this report.

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

Government-Wide Financial Analysis

The Statement of Net Assets provides the perspective of the City as a whole. The table below provides a summary of the City's net assets for 2006 compared to 2005.

	Net Assets					
	<u>Governmental Activities</u>		<u>Business-Type Activities</u>		<u>Total</u>	
	2006	Restated 2005	2006	Restated 2005	2006	Restated 2005
<u>Assets</u>						
Current and other assets	\$ 6,550,684	\$ 6,419,613	\$13,364,063	\$ 12,580,758	\$19,914,747	\$19,000,371
Capital assets, net	<u>14,684,100</u>	<u>15,142,910</u>	<u>24,676,977</u>	<u>18,812,773</u>	<u>39,361,077</u>	<u>33,955,683</u>
Total assets	<u>21,234,784</u>	<u>21,562,523</u>	<u>38,041,040</u>	<u>31,393,531</u>	<u>59,275,824</u>	<u>52,956,054</u>
<u>Liabilities</u>						
Long-term liabilities						
outstanding	612,079	671,526	4,894,566	658,673	5,506,645	1,330,199
Other liabilities	<u>1,425,807</u>	<u>1,377,816</u>	<u>7,984,741</u>	<u>7,625,280</u>	<u>9,410,548</u>	<u>9,003,096</u>
Total liabilities	<u>2,037,886</u>	<u>2,049,342</u>	<u>12,879,307</u>	<u>8,283,953</u>	<u>14,917,193</u>	<u>10,333,295</u>
<u>Net Assets</u>						
Invested in capital assets, net of related debt	14,416,950	14,811,053	17,924,056	15,969,916	32,341,006	30,780,969
Restricted	3,561,415	3,552,405	-	-	3,561,415	3,552,405
Unrestricted	<u>1,218,533</u>	<u>1,149,723</u>	<u>7,237,677</u>	<u>7,139,662</u>	<u>8,456,210</u>	<u>8,289,385</u>
Total net assets	<u>\$19,196,898</u>	<u>\$19,513,181</u>	<u>\$25,161,733</u>	<u>\$23,109,578</u>	<u>\$44,358,631</u>	<u>\$42,622,759</u>

Over time, net assets can serve as a useful indicator of a government's financial position. At December 31, 2006, the City's assets exceeded liabilities by \$44,358,631. At year-end, net assets were \$19,196,898 and \$25,161,733 for the governmental activities and the business-type activities, respectively.

Capital assets reported on the government-wide statements represent the largest portion of the City's net assets. At year-end, capital assets represented 66.41% of total assets. Capital assets include land, construction in progress, land improvements, buildings and improvements, furniture, fixtures and equipment, vehicles and infrastructure. Capital assets, net of related debt to acquire the assets, at December 31, 2006, were \$14,416,950 and \$17,924,056 in the governmental activities and business-type activities, respectively. These capital assets are used to provide services to citizens and are not available for future spending. Although the City's investment in capital assets is reported net of related debt, it should be noted that the resources to repay the debt must be provided from other sources, since capital assets may not be used to liquidate these liabilities.

As of December 31, 2006, the City is able to report positive balances in all three categories of net assets, both for the government as a whole, as well as for its separate governmental and business-type activities.

A portion of the City's net assets, \$3,561,415 or 8.03%, represents resources that are subject to external restriction on how they may be used. In the governmental activities, the remaining balance of unrestricted net assets of \$1,218,533 may be used to meet the government's ongoing obligations to citizens and creditors.

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

The table below shows the comparative analysis of changes in net assets for fiscal year 2006 compared to 2005.

Change in Net Assets

	<u>Governmental Activities</u>		<u>Business-Type Activities</u>		<u>Total</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
<u>Revenues:</u>						
Program revenues:						
Charges for services and sales	\$ 831,782	\$ 778,943	\$ 14,610,184	\$ 14,665,113	\$ 15,441,966	\$ 15,444,056
Operating grants and contributions	1,186,137	873,445	-	-	1,186,137	873,445
Capital grants and contributions	159,697	4,909	38,700	116,297	198,397	121,206
General revenues:						
Property taxes	1,246,039	1,264,975	-	-	1,246,039	1,264,975
Income taxes	2,167,682	2,239,110	-	-	2,167,682	2,239,110
Excise taxes	-	-	427,822	444,389	427,822	444,389
Unrestricted grants	730,340	706,056	-	-	730,340	706,056
Interest	421,239	122,958	179,323	11,945	600,562	134,903
Other	72,157	247,434	108,172	179,643	180,329	427,077
Total revenues	<u>6,815,073</u>	<u>6,237,830</u>	<u>15,364,201</u>	<u>15,417,387</u>	<u>22,179,274</u>	<u>21,655,217</u>
<u>Expenses:</u>						
General government	1,427,932	1,221,217	-	-	1,427,932	1,221,217
Security of persons and property	2,826,085	2,670,160	-	-	2,826,085	2,670,160
Public health and welfare	260,566	484,522	-	-	260,566	484,522
Transportation	1,170,135	931,650	-	-	1,170,135	931,650
Community environment	606,006	471,414	-	-	606,006	471,414
Leisure time activity	68,650	67,966	-	-	68,650	67,966
Other	27,650	-	-	-	27,650	-
Interest and fiscal charges	5,833	7,874	-	-	5,833	7,874
Sewer	-	-	1,298,369	1,089,446	1,298,369	1,089,446
Water	-	-	1,757,098	1,906,661	1,757,098	1,906,661
Electric	-	-	10,995,078	10,880,866	10,995,078	10,880,866
Total expenses	<u>6,392,857</u>	<u>5,854,803</u>	<u>14,050,545</u>	<u>13,876,973</u>	<u>20,443,402</u>	<u>19,731,776</u>
Increase (decrease) in net assets						
before transfers	422,216	383,027	1,313,656	1,540,414	1,735,872	1,923,441
Transfers	<u>(738,499)</u>	<u>(770,381)</u>	<u>738,499</u>	<u>770,381</u>	<u>-</u>	<u>-</u>
Change in net assets	(316,283)	(387,354)	2,052,155	2,310,795	1,735,872	1,923,441
Net assets at beginning of year (restated)	<u>19,513,181</u>	<u>19,900,535</u>	<u>23,109,578</u>	<u>20,798,783</u>	<u>42,622,759</u>	<u>40,699,318</u>
Net assets at end of year	<u>\$ 19,196,898</u>	<u>\$ 19,513,181</u>	<u>\$ 25,161,733</u>	<u>\$ 23,109,578</u>	<u>\$ 44,358,631</u>	<u>\$ 42,622,759</u>

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

Governmental Activities

Governmental activities net assets decreased \$316,283 in 2006. This decrease is due to the contribution of capital from a capital projects fund to the Business-Type Activities.

Security of persons and property, which supports the operations of the police and fire departments, accounted for \$2,826,085 or 44.21% of total expenses of the City. These expenses were partially funded by \$328,599 in direct charges to users of the services. General government expenses, which includes city council, the mayor's office, the finance department, civil service and building and zoning programs, totaled \$1,427,932 or 22.34% of total expenses. General government expenses were partially funded by \$415,053 in direct charges to users of the services.

The state and federal government contributed to the City a total of \$1,186,137 in operating grants and contributions and \$159,697 in capital grants and contributions. These revenues are restricted to a particular program or purpose. Of the total operating grants and contributions \$628,593, or 53.00%, subsidized transportation programs.

General revenues totaled \$4,637,457, and amounted to 68.05% of total revenues. These revenues primarily consist of property and income tax revenue of \$3,413,721, or 73.61% of total general revenues. The other primary source of general revenues is grants and entitlements not restricted to specific programs, with local government and local government revenue assistance making up \$730,340 or 15.75% of the total.

The Statement of Activities shows the cost of program services and the charges for services and grants offsetting those services. The following table shows, for governmental activities, the total cost of services and the net cost of services for 2006 compared to 2005. That is, it identifies the cost of these services supported by tax revenue and unrestricted state grants and entitlements.

Governmental Activities

	<u>2006</u>		<u>2005</u>	
	<u>Total Cost of</u>	<u>Net Cost of</u>	<u>Total Cost of</u>	<u>Net Cost of</u>
	<u>Services</u>	<u>Services</u>	<u>Services</u>	<u>Services</u>
Expenses:				
General government	\$ 1,427,932	\$ 1,012,879	\$ 1,221,217	\$ 806,283
Security of persons and property	2,826,085	2,460,709	2,670,160	2,366,654
Public health and welfare	260,566	198,828	484,522	413,192
Transportation	1,170,135	408,764	931,650	349,363
Community environment	606,006	46,573	471,414	205,316
Leisure time activity	68,650	54,005	67,966	48,824
Other	27,650	27,650	-	-
Interest and fiscal charges	<u>5,833</u>	<u>5,833</u>	<u>7,874</u>	<u>7,874</u>
Total expenses	<u>\$ 6,392,857</u>	<u>\$ 4,215,241</u>	<u>\$ 5,854,803</u>	<u>\$ 4,197,506</u>

The dependence upon general revenues for governmental activities is apparent, with 65.94% and 71.69% of expenses supported through taxes and other general revenues during 2006 and 2005, respectively.

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

Business-Type Activities

Business-type activities include the Sewer, Water and Electric enterprise funds. These programs had program revenues of \$14,648,884, general revenues of \$715,317, transfers in of \$738,499 and expenses of \$14,050,545 for fiscal year 2006.

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 the City's net resources available for spending at year-end.

The City's governmental funds (as presented on the balance sheet on page 17) reported a combined fund balance of \$4,018,377 which is \$333,119 less than last year's total of \$4,351,496. The schedule below indicates the fund balances and the total change in fund balances as of December 31, 2006 for all major and nonmajor governmental funds.

	<u>Fund Balance</u> <u>December 31, 2006</u>	<u>Fund Balance</u> <u>December 31, 2005</u>	<u>(Decrease)</u>
Major Funds:			
General	\$ 854,719	\$ 1,034,349	\$ (179,630)
Other Nonmajor Governmental Funds	<u>3,163,658</u>	<u>3,317,147</u>	<u>(153,489)</u>
 Total	 <u>\$ 4,018,377</u>	 <u>\$ 4,351,496</u>	 <u>\$ (333,119)</u>

General Fund

The City's general fund balance decreased \$179,630, due to a decrease in income tax revenues. Intergovernmental revenue also decreased, due to a decrease in the amount of local government assistance received by the City. Investment income increased due to rising interest rates during 2006. The table that follows assists in illustrating the financial activities and fund balances of the general fund.

	<u>2006</u>	<u>2005</u>	<u>Percent</u> <u>Change</u>
Revenues			
Taxes	\$ 2,001,605	\$ 2,556,117	(21.69) %
Charges for services	354,706	359,000	(1.20) %
Licenses and permits	15,108	39,316	(61.57) %
Fines and forfeitures	214,261	209,530	2.26 %
Investment income	328,295	100,849	225.53 %
Intergovernmental	649,921	761,055	(14.60) %
Other revenues	<u>21,602</u>	<u>31,721</u>	(31.90) %
 Total	 <u>\$ 3,585,498</u>	 <u>\$ 4,057,588</u>	 (11.63) %

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

	<u>2006</u>	<u>2005</u>	<u>Percentage Change</u>
Expenditures			
General government	\$ 991,613	\$ 1,018,277	(2.62) %
Security of persons and property	2,383,456	2,301,478	3.56 %
Transportation	<u>32,694</u>	<u>25,860</u>	26.43 %
Total	<u>\$ 3,407,763</u>	<u>\$ 3,345,615</u>	1.86 %

General fund expenditures remained consistent with the prior year.

Budgeting Highlights - General Fund

The City's budgeting process is prescribed by the Ohio Revised Code (ORC). Essentially the budget is the City's appropriations which are restricted by the amounts of anticipated revenues certified by the Budget Commission in accordance with the ORC. Therefore, the City's plans or desires cannot be totally reflected in the original budget. If budgeted revenues are adjusted due to actual activity then the appropriations can be adjusted accordingly.

Budgetary information is presented for the general fund, the City's only major governmental fund. Total actual revenues of \$3,743,494 were more than final budgeted revenues by \$53,448. The other significant change was between the final budgeted expenditures and other financing uses and actual expenditures and other financing uses. Actual expenditures and other financing uses came in \$320,501 lower than the final budgeted amounts.

Proprietary Funds

The City's proprietary funds provide the same type of information found in the government-wide financial statements for business-type activities, except in more detail. The only difference between the amounts reported as business-type activities and the amounts reported in the proprietary fund statements are interfund eliminations between proprietary funds. The only interfund activity reported in the government wide statements are those between business-type activities and governmental activities (reported as internal balances and transfers) whereas interfund amounts between the various enterprise funds are reported in the proprietary fund statements.

Water Fund

The water fund had operating revenues of \$1,558,752 in 2006. This represents a decrease of \$66,984 from 2005 operating revenues. The operating expenses of the water fund, which totaled \$1,531,348 in 2006, decreased \$414,355 from 2005. The increase in net assets for the water fund was \$510,580 or 7.09%.

Sewer Fund

The sewer fund had operating revenues of \$1,289,016 in 2006. This represents a decrease of \$1,104 from 2005 operating revenues. The operating expenses of the sewer fund, which totaled \$1,271,725 in 2006, increased \$154,840 from 2005. The increase in net assets for the sewer fund was \$130,422 or 2.22%.

Electric Fund

The electric fund had operating revenues of \$11,870,588 in 2006. This represents a decrease of \$58,312 from 2005 operating revenues. The operating expenses of the electric fund, which totaled \$10,149,468 in 2006, decreased \$200,906 from 2005. The increase in net assets for the electric fund was \$1,549,909 or 15.68%.

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

Capital Assets and Debt Administration

Capital Assets

At the end of fiscal 2006, the City had \$39,361,077 (net of accumulated depreciation) invested in land, land improvements, buildings and improvements, furniture, fixtures and equipment, vehicles, infrastructure and construction in progress. Of this total, \$14,684,100 was reported in governmental activities and \$24,676,977 was reported in business-type activities. The 2005 capital asset balances have been restated. See Note 3.B. for detail. The following table shows fiscal 2006 balances compared to 2005:

**Capital Assets at December 31
(Net of Depreciation)**

	Governmental Activities		Business-Type Activities		Total	
		Restated		Restated		Restated
	2006	2005	2006	2005	2006	2005
Land	\$ 206,050	\$ 206,050	\$ 233,440	\$ 233,440	\$ 439,490	\$ 439,490
Land improvements	287,580	312,617	1,225,252	64,790	1,512,832	377,407
Buildings and improvements	644,904	662,042	7,230,636	3,557,070	7,875,540	4,219,112
Furniture, fixtures and equipment	666,800	682,617	5,382,475	5,738,630	6,049,275	6,421,247
Vehicles	273,956	340,870	249,107	270,257	523,063	611,127
Infrastructure	12,604,810	12,762,321	6,444,776	6,710,092	19,049,586	19,472,413
Construction in progress	-	176,393	3,911,291	2,238,494	3,911,291	2,414,887
Increase in net assets	<u>\$ 14,684,100</u>	<u>\$ 15,142,910</u>	<u>\$ 24,676,977</u>	<u>\$ 18,812,773</u>	<u>\$ 39,361,077</u>	<u>\$ 33,955,683</u>

See Note 9 to the basic financial statements for additional information concerning the City's capital assets.

Debt Administration

At December 31, 2006 the City had \$104,700 in special assessment bonds, \$448,164 in OPWC loans and \$4,277,207 in OWDA loans outstanding. Of this total, \$241,923 is due within one year and \$4,588,148 is due in more than one year. The following table is a comparison of the bonds and loans outstanding.

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

Outstanding Debt, at Year End

	Governmental Activities <u>2006</u>	Governmental Activities <u>2005</u>
<u>Special Assessment Bonds:</u>		
Street Improvement - Route 39	\$ 50,712	\$ 76,069
Street Improvement - Fox Run 6	<u>53,988</u>	<u>67,485</u>
Total Special Assessment Bonds	<u>104,700</u>	<u>143,554</u>
<u>OPWC Loans:</u>		
Wareham Road	162,450	178,695
Auburn Street	<u>-</u>	<u>9,608</u>
Total OPWC Loans	<u>162,450</u>	<u>188,303</u>
Total	<u>\$ 267,150</u>	<u>\$ 331,857</u>
	Business-Type Activities <u>2006</u>	Business-Type Activities <u>2005</u>
<u>OPWC Loan:</u>		
Wastewater Treatment Plant	\$ <u>285,714</u>	\$ <u>342,857</u>
<u>OWDA Loans:</u>		
EQ Basin	1,277,679	-
WTP Upgrade	<u>2,999,528</u>	<u>-</u>
Total OWDA Loans	<u>4,277,207</u>	<u>-</u>
Total	<u>\$ 4,562,921</u>	<u>\$ 342,857</u>

The City has two special assessment bonds outstanding at December 31, 2006 in the amount of \$104,700. The city issued \$126,783 in special assessment bonds on September 5, 2003, for water and sewer improvements along State Route 39. These bonds bear an interest rate of 3.10% and mature on December 1, 2008. The City also issued \$67,485 in special assessment bonds on August 17, 2005 for water and sewer improvements in the Fox Run 6 area. These bonds bear an interest rate of 2.36% and mature on December 1, 2010. In the event that property owners fail to make their special assessment payments, the City is responsible for providing the resources to meet the annual principal and interest payments.

The City has two Ohio Public Works Commission (OPWC) loans outstanding at December 31, 2006 in the amount of \$162,450 in governmental activities and \$285,714 in business-type activities. On July 1, 1997, the City issued \$96,073 in OPWC loans to finance the Auburn Street Storm Sewer Replacement Project. This loan was retired during 2006. The City issued \$394,200 in OPWC loans on July 7, 1997 to finance the Wareham Road Area Storm Sewer Replacement Project. This loan is scheduled to mature on July 1, 2016. During 2003, the City received \$20,435, in OPWC loans and in 2004 the City received \$66,565 from available borrowings of \$400,000, to finance the wastewater plant expansion. The remaining \$313,000 was received in 2005. The OPWC loans are interest free.

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

The City has two Ohio Water Development Authority (OWDA) loans outstanding at December 31, 2006. The WTP Upgrade loan has a balance of \$2,999,528 at December 31, 2006. This loan bears an interest rate of 2.75%. The EQ Basin loan has a balance of \$1,277,679 at December 31, 2006. This loan bears an interest rate of 1.00%. These two loans have not been completely drawn at December 31, 2006.

Economic Outlook

Since the 1800's the Community of Shelby has been known for its talented work force, which continues to be innovative, productive and stable. The city's industrial base continues to be strong and competitive, producing and shipping goods and materials around the world. While national trends reflect mergers and consolidations the City has been aggressive and successful in adapting to these changing times by creating new opportunities. In 2006, the City of Shelby was chosen as the site for a major warehouse construction project by MTD Corporation. They are constructing a 467,000 square foot warehouse to maintain jobs and increase their presence. Also, the MedCentral Hospital has announced and started a 19,000 square foot surgical area expansion. Currently MedCentral does 1,400 surgical procedures per year but this addition has and will draw talented surgeons and more procedures to advance our hospital.

The City relies heavily upon grants, entitlements, property and income taxes to fund the general services of the City. The City also has experienced revenue stagnation as other community's in Ohio but has taken steps in an effort contain its operating expenses.

In the spring of 2006, the City placed an additional ¼% income tax issue on the May Primary Election in an effort to make permanent improvements to the City's assets; which the voters approved. A major repaving project will occur in 2007 using these additional funds.

In 2006, the City primarily completed modernization of its wastewater treatment plant and its water treatment plant. The City incurred substantial debt in its enterprise funds but these upgrades will serve the citizens for years to come. The new 138 KV electric line will be completed in 2007 to secure connections to AEP power and loop the Cities electric source.

For the future the City will continue to meet the needs of its citizens, employees and vendors through cooperation, hard work and determination.

Contacting the City's Financial Management

This financial report is designed to provide our citizen's, taxpayers, and investors and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Robert Lafferty, Finance Director, 23 W. Main Street, Shelby, Ohio, 44875.

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**BASIC
FINANCIAL STATEMENTS**

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CITY OF SHELBY, OHIO

STATEMENT OF NET ASSETS
DECEMBER 31, 2006

	Governmental Activities	Business-type Activities	Total
Assets:			
Equity in pooled cash and cash equivalents.	\$ 3,927,723	\$ 5,541,451	\$ 9,469,174
Cash with fiscal agent	-	4,000,000	4,000,000
Cash in segregated accounts.	-	291,930	291,930
Receivables (net of allowances for uncollectibles):			
Income taxes	664,774	-	664,774
Real and other taxes	966,365	-	966,365
Accounts	-	1,637,791	1,637,791
Special assessments	2,410	-	2,410
Accrued interest	42,772	36,494	79,266
Internal balances	16,532	(16,532)	-
Due from other governments	736,963	-	736,963
Prepayments.	67,863	227,350	295,213
Materials and supplies inventory.	125,282	857,245	982,527
Investment in joint venture.	-	788,334	788,334
Capital assets:			
Land and construction in progress.	206,050	4,144,731	4,350,781
Depreciable capital assets, net	14,478,050	20,532,246	35,010,296
Total capital assets.	<u>14,684,100</u>	<u>24,676,977</u>	<u>39,361,077</u>
Total assets.	<u>21,234,784</u>	<u>38,041,040</u>	<u>59,275,824</u>
Liabilities:			
Accounts payable.	43,241	817,492	860,733
Contracts payable.	38,359	402,538	440,897
Retainage payable	-	291,930	291,930
Accrued wages and benefits	48,073	44,099	92,172
Due to other governments	212,287	154,365	366,652
Deferred revenue.	877,000	-	877,000
Accrued interest payable.	309	84,317	84,626
Claims payable.	206,538	-	206,538
Notes payable.	-	6,190,000	6,190,000
Long-term liabilities:			
Due within one year.	131,045	270,995	402,040
Due in more than one year	481,034	4,623,571	5,104,605
Total liabilities	<u>2,037,886</u>	<u>12,879,307</u>	<u>14,917,193</u>
Net assets:			
Invested in capital assets, net of related debt	14,416,950	17,924,056	32,341,006
Restricted for:			
Capital projects.	1,075,657	-	1,075,657
Debt service	885,245	-	885,245
Human services programs	258,770	-	258,770
Community development projects	545,621	-	545,621
Security of persons and property	210,752	-	210,752
Street maintenance, construction and repair	447,444	-	447,444
Other purposes	137,926	-	137,926
Unrestricted.	1,218,533	7,237,677	8,456,210
Total net assets	<u>\$ 19,196,898</u>	<u>\$ 25,161,733</u>	<u>\$ 44,358,631</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF SHELBY, OHIO

STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

	<u>Expenses</u>	<u>Program Revenues</u>		
		<u>Charges for Services</u>	<u>Operating and Contributions</u>	<u>Capital Grants and Contributions</u>
Governmental Activities:				
General government	\$ 1,427,932	\$ 415,053	\$ -	\$ -
Security of persons and property.	2,826,085	328,599	2,080	34,697
Public health and welfare	260,566	38,777	22,961	-
Transportation	1,170,135	7,778	628,593	125,000
Community environment.	606,006	26,930	532,503	-
Leisure time activity.	68,650	14,645	-	-
Other	27,650	-	-	-
Interest and fiscal charges.	5,833	-	-	-
Total governmental activities	<u>6,392,857</u>	<u>831,782</u>	<u>1,186,137</u>	<u>159,697</u>
Business-Type Activities:				
Sewer	1,298,369	1,288,836	-	-
Water	1,757,098	1,556,742	-	38,700
Electric	10,995,078	11,764,606	-	-
Total business-type activities	<u>14,050,545</u>	<u>14,610,184</u>	<u>-</u>	<u>38,700</u>
Total primary government.	<u>\$ 20,443,402</u>	<u>\$ 15,441,966</u>	<u>\$ 1,186,137</u>	<u>\$ 198,397</u>

General Revenues:

Property taxes levied for:	
General purposes.	
Special revenue	
Income taxes levied for:	
General purposes.	
Special revenue	
Capital projects	
Other local taxes	
Grants and entitlements not restricted to specific programs	
Investment earnings	
Miscellaneous	
Total general revenues	
Transfers.	
Change in net assets.	
Net assets at beginning of year (restated)	
Net assets at end of year	

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

Net (Expense) Revenue and Changes in Net Assets

Governmental Activities	Business-type Activities	Total
\$ (1,012,879)	\$ -	\$ (1,012,879)
(2,460,709)	-	(2,460,709)
(198,828)	-	(198,828)
(408,764)	-	(408,764)
(46,573)	-	(46,573)
(54,005)	-	(54,005)
(27,650)	-	(27,650)
(5,833)	-	(5,833)
<u>(4,215,241)</u>	<u>-</u>	<u>(4,215,241)</u>
-	(9,533)	(9,533)
-	(161,656)	(161,656)
-	769,528	769,528
<u>-</u>	<u>598,339</u>	<u>598,339</u>
<u>(4,215,241)</u>	<u>598,339</u>	<u>(3,616,902)</u>
704,574	-	704,574
541,465	-	541,465
1,363,936	-	1,363,936
513,534	-	513,534
290,212	-	290,212
-	427,822	427,822
730,340	-	730,340
421,239	179,323	600,562
72,157	108,172	180,329
<u>4,637,457</u>	<u>715,317</u>	<u>5,352,774</u>
<u>(738,499)</u>	<u>738,499</u>	<u>-</u>
(316,283)	2,052,155	1,735,872
<u>19,513,181</u>	<u>23,109,578</u>	<u>42,622,759</u>
<u>\$ 19,196,898</u>	<u>\$ 25,161,733</u>	<u>\$ 44,358,631</u>

CITY OF SHELBY, OHIO

BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2006

	<u>General</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Assets:			
Equity in pooled cash and cash equivalents	\$ 505,176	\$ 2,934,100	\$ 3,439,276
Receivables (net of allowance for uncollectibles):			
Income taxes.	332,387	332,387	664,774
Real and other taxes.	358,117	608,248	966,365
Accrued interest	34,895	7,877	42,772
Special assessments.	-	2,410	2,410
Due from other governments	395,520	341,443	736,963
Prepayments.	45,795	22,068	67,863
Materials and supplies inventory	26,682	98,600	125,282
Total assets	<u>\$ 1,698,572</u>	<u>\$ 4,347,133</u>	<u>\$ 6,045,705</u>
Liabilities:			
Accounts payable	\$ 25,749	\$ 17,492	\$ 43,241
Contracts payable.	-	38,359	38,359
Accrued wages and benefits payable	40,671	7,402	48,073
Compensated absences payable	-	10,065	10,065
Due to other governments.	106,941	105,346	212,287
Deferred revenue	670,492	1,004,811	1,675,303
Total liabilities	<u>843,853</u>	<u>1,183,475</u>	<u>2,027,328</u>
Fund Balances:			
Reserved for encumbrances.	74,334	132,056	206,390
Reserved for prepayments	45,795	22,068	67,863
Reserved for materials and supplies inventory	26,682	98,600	125,282
Reserved for debt service.	-	875,903	875,903
Unreserved, undesignated, reported in:			
General fund.	707,908	-	707,908
Special revenue funds.	-	1,222,654	1,222,654
Capital projects funds.	-	812,377	812,377
Total fund balances	<u>854,719</u>	<u>3,163,658</u>	<u>4,018,377</u>
Total liabilities and fund balances.	<u>\$ 1,698,572</u>	<u>\$ 4,347,133</u>	<u>\$ 6,045,705</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF SHELBY, OHIO

RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCES TO
NET ASSETS OF GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2006

Total governmental fund balances		\$ 4,018,377
<i>Amounts reported for governmental activities in the statement of net assets are different because:</i>		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.		14,684,100
Other long-term assets are not available to pay for current period expenditures and therefore are deferred in the funds.		
Property taxes	\$ 89,365	
Income tax	316,534	
Special assessments	2,410	
Intergovernmental revenues	347,222	
Interest	<u>42,772</u>	
Total		798,303
An internal service fund is used by management to charge the costs of health insurance to individual funds. The assets and liabilities of the internal service fund are included in governmental activities in the statement of assets. The net assets of the internal service fund, including internal balances of \$16,532, are:		298,441
In the statement of activities interest is accrued on outstanding bonds, whereas in governmental funds, interest expenditures are reported when due.		(309)
Long-term liabilities, including bonds and loans payable, are not due and payable in the current period and therefore are not reported in the funds.		
Street improvement bonds	104,700	
OPWC loans	162,450	
Compensated absences	<u>334,864</u>	
Total		<u>(602,014)</u>
Net assets of governmental activities		<u><u>\$ 19,196,898</u></u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF SHELBY, OHIO

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

	<u>General</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Revenues:			
Municipal income taxes	\$ 1,307,060	\$ 746,870	\$ 2,053,930
Property and other taxes	694,545	524,683	1,219,228
Charges for services	354,706	113,860	468,566
Licenses and permits	15,108	38,777	53,885
Fines and forfeitures	214,261	49,940	264,201
Intergovernmental	649,921	1,297,001	1,946,922
Special assessments	-	43,187	43,187
Investment income	328,295	34,625	362,920
Rental income	-	3,615	3,615
Other	21,602	62,190	83,792
Total revenues	<u>3,585,498</u>	<u>2,914,748</u>	<u>6,500,246</u>
Expenditures:			
Current:			
General government	991,613	438,705	1,430,318
Security of persons and property	2,383,456	323,478	2,706,934
Public health and welfare	-	259,707	259,707
Transportation	32,694	634,458	667,152
Community environment	-	547,004	547,004
Leisure time activity	-	56,393	56,393
Capital outlay	-	1,067,558	1,067,558
Other	-	27,650	27,650
Debt service:			
Principal retirement	-	64,707	64,707
Interest and fiscal charges	-	5,942	5,942
Total expenditures	<u>3,407,763</u>	<u>3,425,602</u>	<u>6,833,365</u>
Excess (deficiency) of revenues over (under) expenditures	<u>177,735</u>	<u>(510,854)</u>	<u>(333,119)</u>
Other financing sources (uses):			
Transfers in	-	357,365	357,365
Transfers out	<u>(357,365)</u>	<u>-</u>	<u>(357,365)</u>
Total other financing sources (uses)	<u>(357,365)</u>	<u>357,365</u>	<u>-</u>
Net change in fund balances	(179,630)	(153,489)	(333,119)
Fund balances at beginning of year	<u>1,034,349</u>	<u>3,317,147</u>	<u>4,351,496</u>
Fund balances at end of year	<u>\$ 854,719</u>	<u>\$ 3,163,658</u>	<u>\$ 4,018,377</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF SHELBY, OHIO

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

Net change in fund balances - total governmental funds \$ (333,119)

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 is allocated over their estimated useful lives as depreciation expense. Depreciation expense exceeds capital outlays in the current period accordingly.

Capital asset additions	\$ 266,893	
Current year depreciation	<u>(725,703)</u>	(458,810)

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.

Income taxes	113,752	
Property and other taxes	26,811	
Intergovernmental	129,201	
Special assessments	(13,256)	
Accrued interest	<u>40,817</u>	297,325

Repayment of bond and loan principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities on the statement of net assets. 64,707

In the statement of activities, interest is accrued on outstanding bonds, whereas in governmental funds, an interest expenditure is reported when due. 109

Some expenses reported in the statement of activities, such as compensated absences, do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. (9,192)

An internal service fund is used by management to charge the costs of health insurance to individual funds is not reported in the government-wide statement of activities. Governmental fund expenditures and the related internal service fund revenues are eliminated. The net revenue (expense) of (\$16,059) of the internal service fund, netted with internal balance activity of \$138,756, is allocated among the governmental activities. 122,697

Change in net assets of governmental activities. \$ (316,283)

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF SHELBY, OHIO

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN
 FUND BALANCE - BUDGET AND ACTUAL (NON-GAAP BUDGETARY BASIS)
 GENERAL FUND
 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

	Budgeted Amounts		Actual	Variance with Final Budget Positive (Negative)
	Original	Final		
Revenues:				
Income taxes	\$ 1,480,042	\$ 1,439,042	\$ 1,435,641	\$ (3,401)
Property and other taxes	598,103	644,120	660,388	16,268
Charges for services	321,262	345,969	354,706	8,737
Licenses and permits.	13,683	14,738	15,108	370
Fines and forfeitures.	194,063	208,983	214,261	5,278
Intergovernmental	646,202	695,917	713,493	17,576
Investment income	297,332	320,208	328,295	8,087
Other	19,565	21,069	21,602	533
Total revenues.	<u>3,570,252</u>	<u>3,690,046</u>	<u>3,743,494</u>	<u>53,448</u>
Expenditures:				
Current:				
General government	1,147,347	1,145,247	1,020,963	124,284
Security of persons and property	2,519,165	2,599,165	2,406,585	192,580
Transportation	34,950	37,050	33,413	3,637
Total expenditures	<u>3,701,462</u>	<u>3,781,462</u>	<u>3,460,961</u>	<u>320,501</u>
Excess of revenues over (under) expenditures	<u>(131,210)</u>	<u>(91,416)</u>	<u>282,533</u>	<u>373,949</u>
Other financing uses:				
Transfers out	<u>(357,365)</u>	<u>(357,365)</u>	<u>(357,365)</u>	<u>-</u>
Total other financing uses.	<u>(357,365)</u>	<u>(357,365)</u>	<u>(357,365)</u>	<u>-</u>
Net change in fund balance	(488,575)	(448,781)	(74,832)	373,949
Fund balance at beginning of year	405,301	405,301	405,301	-
Prior year encumbrances appropriated	83,274	83,274	83,274	-
Fund balance (deficit) at end of year.	<u>\$ -</u>	<u>\$ 39,794</u>	<u>\$ 413,743</u>	<u>\$ 373,949</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF SHELBY, OHIO

STATEMENT OF NET ASSETS
 PROPRIETARY FUNDS
 DECEMBER 31, 2006

	Business Type Activities - Enterprise Funds				Governmental
	Sewer	Water	Electric	Total	Activities - Internal Service Fund
Assets:					
Current Assets:					
Equity in pooled cash and cash equivalents	\$ 954,987	\$ 563,416	\$ 4,023,048	\$ 5,541,451	\$ 488,447
Cash with fiscal agent	-	-	4,000,000	4,000,000	-
Cash in segregated accounts	-	291,930	-	291,930	-
Receivables (net of allowance for uncollectibles):					
Accounts	114,645	245,669	1,277,477	1,637,791	-
Accrued interest	-	3,778	32,716	36,494	-
Prepayments	25,548	25,603	176,199	227,350	-
Materials and supplies inventory	22,751	107,260	727,234	857,245	-
Total current assets	1,117,931	1,237,656	10,236,674	12,592,261	488,447
Noncurrent Assets:					
Investment in joint venture	-	-	788,334	788,334	-
Capital assets:					
Land and construction in progress	761,397	2,375,424	1,007,910	4,144,731	-
Depreciable capital assets, net	5,810,410	8,023,073	6,698,763	20,532,246	-
Total capital assets	6,571,807	10,398,497	7,706,673	24,676,977	-
Total noncurrent assets	6,571,807	10,398,497	8,495,007	25,465,311	-
Total assets	7,689,738	11,636,153	18,731,681	38,057,572	488,447
Liabilities:					
Current Liabilities:					
Accounts payable	4,232	60,829	752,431	817,492	-
Contracts payable	-	402,538	-	402,538	-
Retainage payable	-	291,930	-	291,930	-
Accrued wages and benefits	7,617	10,468	26,014	44,099	-
Due to other governments	20,232	28,660	105,473	154,365	-
Claims payable	-	-	-	-	206,538
Accrued interest payable	-	47,855	36,462	84,317	-
Notes payable	-	-	6,190,000	6,190,000	-
Current portion of OWDA loans	-	129,682	-	129,682	-
Current portion of OPWC loans	57,143	-	-	57,143	-
Current portion of compensated absences	14,328	27,815	42,027	84,170	-
Total current liabilities	103,552	999,777	7,152,407	8,255,736	206,538
Long-term liabilities:					
OWDA loans payable	1,277,679	2,869,846	-	4,147,525	-
OPWC loans payable	228,571	-	-	228,571	-
Compensated absences	51,303	54,941	141,231	247,475	-
Total long-term liabilities	1,557,553	2,924,787	141,231	4,623,571	-
Total liabilities	1,661,105	3,924,564	7,293,638	12,879,307	206,538
Net assets:					
Invested in capital assets, net of related debt	5,008,414	7,398,969	5,516,673	17,924,056	-
Unrestricted	1,020,219	312,620	5,921,370	7,254,209	281,909
Total net assets	\$ 6,028,633	\$ 7,711,589	\$ 11,438,043	25,178,265	\$ 281,909
Adjustment to reflect the consolidation of the internal service funds activities related to enterprise funds.				(16,532)	
Net assets of business-type activities				\$ 25,161,733	

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF SHELBY, OHIO

STATEMENT OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS
PROPRIETARY FUNDS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

	<u>Business-Type Activities - Enterprise Funds</u>				<u>Governmental Activities - Internal Service Fund</u>
	<u>Sewer</u>	<u>Water</u>	<u>Electric</u>	<u>Total</u>	
Operating revenues:					
Charges for services	\$ 1,288,836	\$ 1,556,742	\$ 11,764,606	\$ 14,610,184	\$ 987,567
Other	180	2,010	105,982	108,172	461
Total operating revenues	<u>1,289,016</u>	<u>1,558,752</u>	<u>11,870,588</u>	<u>14,718,356</u>	<u>988,028</u>
Operating expenses:					
Personal services	573,378	805,780	1,936,148	3,315,306	-
Contract services	205,811	188,055	522,477	916,343	-
Materials and supplies	69,158	144,763	6,722,486	6,936,407	-
Utilities	108,312	119,847	187,950	416,109	-
Depreciation	305,709	262,503	535,245	1,103,457	-
Claims.	-	-	-	-	1,021,589
Other	9,357	10,400	245,162	264,919	-
Total operating expenses.	<u>1,271,725</u>	<u>1,531,348</u>	<u>10,149,468</u>	<u>12,952,541</u>	<u>1,021,589</u>
Operating income (loss)	<u>17,291</u>	<u>27,404</u>	<u>1,721,120</u>	<u>1,765,815</u>	<u>(33,561)</u>
Nonoperating revenues (expenses):					
Interest expense and fiscal charges	-	(97,469)	(248,162)	(345,631)	-
Intergovernmental revenue	-	38,700	-	38,700	-
Interest revenue.	-	9,331	169,992	179,323	17,502
Investment in joint venture	-	-	(48,388)	(48,388)	-
Other local tax revenue.	-	-	427,822	427,822	-
Loss on disposal of capital assets	-	(92,754)	-	(92,754)	-
Excise tax expense	-	-	(472,475)	(472,475)	-
Total nonoperating revenues (expenses)	<u>-</u>	<u>(142,192)</u>	<u>(171,211)</u>	<u>(313,403)</u>	<u>17,502</u>
Net income (loss) before capital contributions	17,291	(114,788)	1,549,909	1,452,412	(16,059)
Capital contributions.	<u>113,131</u>	<u>625,368</u>	<u>-</u>	<u>738,499</u>	<u>-</u>
Changes in net assets	130,422	510,580	1,549,909	2,190,911	(16,059)
Net assets at beginning of year (restated).	<u>5,898,211</u>	<u>7,201,009</u>	<u>9,888,134</u>		<u>297,968</u>
Net assets at end of year.	<u>\$ 6,028,633</u>	<u>\$ 7,711,589</u>	<u>\$ 11,438,043</u>		<u>\$ 281,909</u>
Adjustment to reflect the consolidation of the internal service funds activities related to enterprise funds.				<u>(138,756)</u>	
Changes in net assets of business-type activities				<u>\$ 2,052,155</u>	

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF SHELBY, OHIO

STATEMENT OF CASH FLOWS
 PROPRIETARY FUNDS
 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

	Business-Type Activities - Enterprise Funds				Governmental
	Sewer	Water	Electric	Total	Activities - Internal Service Fund
Cash flows from operating activities:					
Cash received from customers	\$ 1,289,384	\$ 1,557,915	\$ 11,770,707	\$ 14,618,006	\$ 987,567
Cash received from other operations.	180	2,010	105,982	108,172	461
Cash payments for personal services	(554,526)	(794,109)	(1,876,701)	(3,225,336)	-
Cash payments for contract services	(220,058)	(157,961)	(456,399)	(834,418)	-
Cash payments for materials and supplies	(70,464)	(171,533)	(7,149,841)	(7,391,838)	-
Cash payments for utilities.	(108,312)	(103,701)	(173,778)	(385,791)	-
Cash payments for claims	-	-	-	-	(994,055)
Cash payments for other expenses.	(9,357)	(10,400)	(245,162)	(264,919)	-
Net cash provided by (used in) operating activities	326,847	322,221	1,974,808	2,623,876	(6,027)
Cash flows from noncapital financing activities:					
Cash received from other local taxes	-	-	427,822	427,822	-
Cash payments for excise taxes	-	-	(393,155)	(393,155)	-
Net cash provided by noncapital financing activities	-	-	34,667	34,667	-
Cash flows from capital and related financing activities:					
Acquisition of capital assets	(1,323,880)	(3,626,597)	(1,288,368)	(6,238,845)	-
Intergovernmental revenue	-	38,700	-	38,700	-
OWDA loans.	1,277,679	3,127,451	-	4,405,130	-
Sale of notes.	-	-	2,190,000	2,190,000	-
Principal retirement.	(57,143)	(127,923)	(2,500,000)	(2,685,066)	-
Interest and fiscal charges.	-	(49,614)	(249,988)	(299,602)	-
Net cash (used in) capital and related financing activities	(103,344)	(637,983)	(1,848,356)	(2,589,683)	-
Cash flows from investing activities:					
Interest received.	-	5,553	147,080	152,633	17,502
Net cash provided by investing activities	-	5,553	147,080	152,633	17,502
Net increase (decrease) in cash and cash equivalents	223,503	(310,209)	308,199	221,493	11,475
Cash and cash equivalents at beginning of year (restated)	<u>731,484</u>	<u>873,625</u>	<u>7,714,849</u>	<u>9,319,958</u>	<u>476,972</u>
Cash and cash equivalents at end of year.	<u>\$ 954,987</u>	<u>\$ 563,416</u>	<u>\$ 8,023,048</u>	<u>\$ 9,541,451</u>	<u>\$ 488,447</u>

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CITY OF SHELBY, OHIO

STATEMENT OF CASH FLOWS
 PROPRIETARY FUNDS (CONTINUED)
 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

	<u>Business-Type Activities - Enterprise Funds</u>				<u>Governmental Activities - Internal Service Fund</u>
	<u>Sewer</u>	<u>Water</u>	<u>Electric</u>	<u>Total</u>	
Reconciliation of operating income (loss) to net cash provided by operating activities:					
Operating income (loss)	\$ 17,291	\$ 27,404	\$ 1,721,120	\$ 1,765,815	\$ (33,561)
Adjustments:					
Depreciation	305,709	262,503	535,245	1,103,457	-
Changes in assets and liabilities:					
(Increase)/decrease in materials and supplies inventory	2,167	(18,156)	(547,362)	(563,351)	-
Decrease in accounts receivable	548	1,173	6,101	7,822	-
(Increase)/decrease in prepayments	(14,247)	(4,977)	99,764	80,540	-
Increase/(decrease) in accounts payable	(3,473)	42,603	101,206	140,336	-
Increase in accrued wages and benefits	864	1,046	2,897	4,807	-
Increase in due to other governments.	12,376	16,629	39,616	68,621	-
Increase/(decrease) in compensated absences payable.	5,612	(6,004)	16,221	15,829	-
Increase in claims payable	-	-	-	-	27,534
Net cash provided by (used in) operating activities . . .	<u>\$ 326,847</u>	<u>\$ 322,221</u>	<u>\$ 1,974,808</u>	<u>\$ 2,623,876</u>	<u>\$ (6,027)</u>

At December 31, 2006 and 2005, the Sewer fund purchased \$2,000 and \$0 of capital assets on account, respectively.
 At December 31, 2006 and 2005, the Water fund purchased \$402,538 and \$0 of capital assets on account, respectively.
 At December 31, 2006 and 2005, the Water fund purchased \$0 and \$321,467 of capital assets on account, respectively.
 The Sewer and Water funds received \$113,131 and \$625,368, respectively, in capital contributions during 2006.

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF SHELBY, OHIO

STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUND
DECEMBER 31, 2006

	<u>Agency</u>
Assets:	
Equity in pooled cash and cash equivalents	\$ 178,732
Cash in segregated accounts	5,684
Receivables:	
Accrued interest.	<u>1,899</u>
Total assets	<u>\$ 186,315</u>
Liabilities:	
Due to other governments	\$ 180,631
Restricted/refundable deposits.	<u>5,684</u>
Total liabilities	<u>\$ 186,315</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

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CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 1 - DESCRIPTION OF THE CITY

The City of Shelby (the "City") is a home rule municipal corporation incorporated as a City in 1921 under the laws of the State of Ohio. The City operates under its own charter and is governed by a mayor-council form of government, which was adopted on August 9, 1921.

The Mayor, elected by the voters for a four-year term, is the head of the municipal government for ceremonial, administrative, and executive purposes. As chief conservator of the peace, the mayor oversees the enforcement of all laws and ordinances. The mayor also executes all contracts, conveyances, and evidences of indebtedness of the City.

Legislative authority is vested in a five member council with four members elected from wards and the vice-president of Council elected at large. Members of Council are elected to two year terms. Council enacts ordinances and resolutions relating to tax levies, appropriates and borrows money, and authorizes bids for materials and services and other municipal purposes.

The Finance Director, elected by the voters for a four-year term is the chief accountant of the municipal government and is responsible for all accounting functions and responsibilities per the charter of the City. The Finance Director is also the keeper of all public funds collected by the City as well as investing and disbursing of those funds. All contracts and agreements or obligations receiving or disbursing City moneys are all certified by the Director of Finance before entered into.

The Law Director, a practicing attorney-at-law is elected by the voters for a four-year term and is the chief legal representative and adviser for the City. The Law Director prepares all contracts bonds and other legal instruments as well as endorses each with his approval. The Law Director also acts as the prosecuting attorney for the City's municipal court system.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements (BFS) of the City have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to local governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial principles. The City also applies Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, to its governmental and business-type activities and its proprietary funds provided they do not conflict with or contradict GASB pronouncements. The City has the option to also apply FASB Statements and Interpretations issued after November 30, 1989 to its business-type activities and enterprise funds, subject to this same limitation. The City has elected not to apply these FASB Statements and Interpretations. The City's significant accounting policies are described below.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)

A. Reporting Entity

For financial reporting purposes, the City's basic financial statements include all funds, agencies, boards, commissions, and departments for which the City is financially accountable. Financial accountability, as defined by the GASB, exists if the City appoints a voting majority of an organization's governing board and is either able to impose its will on that organization or there is a potential for the organization to provide specific financial benefits to, or impose specific burdens on, the City. The City may also be financially accountable for governmental organizations with a separately elected governing board, a governing board appointed by another government, or a jointly appointed board that is fiscally dependent on the City. The City also took into consideration other organizations for which the nature and significance of their relationship with the City are such that exclusion would cause the City's basic financial statements to be misleading or incomplete. Based upon the foregoing criteria, the City has no component units, but is a member of one insurance purchasing pool which is described in Note 13.

The primary government of the City consists of all funds, agencies, departments and offices that are not legally separate from the City. The primary government includes the City departments and agencies that provide the following services: police protection, fire fighting and prevention, street maintenance and repairs, building inspection, parks and recreation, wastewater, water and electric.

The following organization is described due to its relationship with the City:

JOINT VENTURE WITH EQUITY INTEREST

The City of Shelby is a Non-Financing Participant and an Owner Participant with an ownership percentage of 1.89% and shares participation with thirty-five other subdivisions within the State of Ohio in the Ohio Municipal Electric Generation Agency (OMEGA JV2). Owner Participants own undivided interests, as tenants in common, in the OMEGA JV2 Project in the amount of their respective Project Shares. Purchaser Participants agree to purchase the output associated with their respective Project shares, ownership of which is held in trust for such Purchaser Participants.

Pursuant to the OMEGA JV2 Agreement, the participants jointly undertook as either Financing Participants or Non-Financing Participants and as either Owner Participants or Purchaser Participants, the acquisition, construction, and equipping of OMEGA JV2, including such portions of OMEGA JV2 as have been acquired, constructed or equipped by AMP-Ohio and to pay or incur the costs of the same in accordance with the JV2 Agreement.

OMEGA JV2 was created to provide additional sources of reliable, reasonably priced electric power and energy when prices are high or during times of generation shortages or transmission constraints, and to improve the reliability and economic status of the participants' respective municipal electric utility systems. The Project consists of 138.65 MW of distributed generation of which 134.081MW is the participants' entitlement and 4.569MW are held in reserve. On dissolution of OMEGA JV2, the net assets will be shared by the participants on a percentage of ownership basis. OMEGA JV2 is managed by AMP-Ohio, which acts as the joint venture's agent. During 2001, AMP-Ohio issued \$50,260,000 of 20 year fixed rate bonds on behalf of the Financing Participants of OMEGA JV2. The net proceeds of the bond issue of \$45,904,712 were contributed to OMEGA JV2. The City's net investment and its share of operating results of OMEGA JV2 are reported in the City's electric fund (an enterprise fund). The City's net investment in OMEGA JV2 was \$788,334 at December 31, 2006. Complete financial statements for OMEGA JV2 may be obtained from AMP-Ohio or from the State Auditor's website at www.auditor.state.oh.us.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)

The thirty-six participating subdivisions and their respective ownership shares at December 31, 2006 are:

Municipality	Percent Ownership	Kw Entitlement	Municipality	Percent Ownership	Kw Entitlement
Hamilton	23.87%	32,000	Grafton	0.79%	1,056
Bowling Green	14.32%	19,198	Brewster	0.75%	1,000
Niles	11.49%	15,400	Monroeville	0.57%	764
Cuyahoga Falls	7.46%	10,000	Milan	0.55%	737
Wadsworth	5.81%	7,784	Oak Harbor	0.55%	737
Painesville	5.22%	7,000	Elmore	0.27%	364
Dover	5.22%	7,000	Jackson Center	0.22%	300
Galion	4.29%	5,753	Napoleon	0.20%	264
Amherst	3.73%	5,000	Lodi	0.16%	218
St. Mary's	2.98%	4,000	Genoa	0.15%	199
Montpelier	2.98%	4,000	Pemberville	0.15%	197
Shelby	1.89%	2,536	Lucas	0.12%	161
Versailles	1.24%	1,660	South Vienna	0.09%	123
Edgerton	1.09%	1,460	Bradner	0.09%	119
Yellow Springs	1.05%	1,408	Woodville	0.06%	81
Oberlin	0.91%	1,217	Haskins	0.05%	73
Pioneer	0.86%	1,158	Arcanum	0.03%	44
Seville	0.79%	1,066	Custar	0.00%	4
	<u>95.20%</u>	<u>127,640</u>		<u>4.80%</u>	<u>6,441</u>
			Grand Total	<u>100.00%</u>	<u>134,081</u>

B. Basis of Presentation - Fund Accounting

The City's basic financial statements consist of government-wide statements, including a statement of net assets and a statement of activities, and fund financial statements which provide a more detailed level of financial information.

Government-wide Financial Statements - The statement of net assets and the statement of activities display information about the City as a whole. These statements include the financial activities of the primary government, except for fiduciary funds. The activity of the internal service fund is eliminated to avoid "doubling up" revenues and expenses. The statements distinguish between those activities of the City that are governmental and those that are considered business-type activities.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)

The statement of net assets presents the financial condition of the governmental and business-type activities of the City at year-end. The statement of activities presents a comparison between direct expenses and program revenues for each program or function of the City's governmental activities and for the business-type activities of the City. Direct expenses are those that are specifically associated with a service, program or department and therefore clearly identifiable to a particular function. Program revenues include charges paid by the recipient of the goods or services offered by the program, grants and contributions that are restricted to meeting the operational or capital requirements of a particular program and interest earned on grants that is required to be used to support a particular program. Revenues which are not classified as program revenues are presented as general revenues of the City, with certain limited exceptions. The comparison of direct expenses with program revenues identifies the extent to which each business segment or governmental function is self-financing or draws from the general revenues of the City.

Fund Financial Statements - During the year, the City segregates transactions related to certain City functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. Fund financial statements are designed to present financial information of the City at this more detailed level. The focus of governmental and enterprise fund financial statements is on major funds. Each major fund is presented in a separate column. Nonmajor funds are aggregated and presented in a single column. The internal service fund is presented in a single column on the face of the proprietary fund statements. Fiduciary funds are reported by type.

C. Fund Accounting

The City uses funds to maintain its financial records during the year. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts. There are three categories of funds: governmental, proprietary and fiduciary.

Governmental Funds - Governmental funds are those through which most governmental functions typically are financed. Governmental fund reporting focuses on the sources, uses and balances of current financial resources. Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used. Current liabilities are assigned to the fund from which they will be paid. The difference between governmental fund assets and liabilities is reported as fund balance. The following is the City's major governmental fund:

General Fund - The general fund accounts for all financial resources except those required to be accounted for in another fund.

Other governmental funds of the City are used to account for (a) the accumulation of resources for, and payment of, general long-term debt principal, interest and related costs; (b) financial resources to be used for the acquisition, construction, or improvement of capital facilities other than those financed by proprietary funds; and (c) for grants and other resources whose use is restricted to a particular purpose.

Proprietary Funds - Proprietary fund reporting focuses on changes in net assets, financial position and cash flows. Proprietary funds are classified as either enterprise or internal service.

Enterprise Funds - Enterprise funds may be used to account for any activity for which a fee is charged to external users for goods or services. The following are the City's major enterprise funds:

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)

Sewer Fund - This fund accounts for the provision of sanitary sewer service to the residents and commercial users located within the City.

Water Fund - This fund accounts for the provision of water treatment and distribution to its residential and commercial users located within the City.

Electric Fund - This fund accounts for the operations providing electric services to the residents and commercial users located within the City.

Internal Service Fund - Internal service funds account for the financing of services provided by one department or agency to other departments or agencies of the City on a cost-reimbursement basis. The City's internal service fund reports on a self-insurance program for employee medical benefits.

Fiduciary Funds - Fiduciary fund reporting focuses on net assets and changes in net assets. The fiduciary fund category is split into four classifications: pension trust funds, investment trust funds, private-purpose trust funds and agency funds. Trust funds are used to account for assets held by the City under a trust agreement for individuals, private organizations, or other governments and are therefore not available to support the City's own programs. Agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations. The City's only fiduciary funds are agency funds. The City's agency funds account for customer deposits and Municipal Court. The customer deposit fund is deposits made by utility customers which are refunded if the customer has fulfilled their obligations when they cancel their account. The Municipal Court fund represents cash that is collected by the City's Municipal Court and disbursed to government agencies, including the City.

D. Measurement Focus and Basis of Accounting

Government-wide Financial Statements - The government-wide financial statements are prepared using the economic resources measurement focus. All assets and all liabilities associated with the operation of the City are included on the Statement of Net Assets.

Fund Financial Statements - All governmental funds are accounted for using a flow of current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. The statement of revenues, expenditures and changes in fund balances reports on the sources (i.e., revenues and other financing sources) and uses (i.e., expenditures and other financing uses) of current financial resources. This approach differs from the manner in which the governmental activities of the government-wide financial statements are prepared. Governmental fund financial statements therefore include a reconciliation with brief explanations to better identify the relationship between the government-wide statements and the statements for governmental funds.

Like the government-wide statements, all proprietary funds are accounted for on a flow of economic resources measurement focus. All assets and all liabilities associated with the operation of these funds are included on the statement of net assets. The statement of changes in fund net assets presents increases (i.e., revenues) and decreases (i.e., expenses) in total net assets. The statement of cash flows provides information about how the City finances and meets the cash flow needs of its proprietary activities.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)

E. Basis of Accounting

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. Government-wide financial statements are prepared using the accrual basis of accounting. Governmental funds use the modified accrual basis of accounting. Proprietary and fiduciary funds also use the accrual basis of accounting. Differences in the accrual and modified accrual basis of accounting arise in the recognition of revenue, the recording of deferred revenue and in the presentation of expenses versus expenditures.

Revenues - Exchange and Non-exchange Transactions - Revenue resulting from exchange transactions, in which each party gives and receives essentially equal value, is recorded on the accrual basis when the exchange takes place. On a modified accrual basis, revenue is recorded in the fiscal year in which the resources are measurable and become available. Available means that the resources will be collected within the current fiscal year or are expected to be collected soon enough thereafter to be used to pay liabilities of the current fiscal year. For the City, available means expected to be received within sixty days of year-end.

Nonexchange transactions, in which the City receives value without directly giving equal value in return, include income taxes, property taxes, grants, entitlements and donations. On an accrual basis, revenue from income taxes is recognized in the period in which the income is earned (See Note 7). Revenue from property taxes is recognized in the year for which the taxes are levied (See Note 6). Revenue from grants, entitlements and donations is recognized in the year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the year when use is first permitted, matching requirements, in which the City must provide local resources to be used for a specified purpose, and expenditure requirements, in which the resources are provided to the City on a reimbursement basis. On a modified accrual basis, revenue from nonexchange transactions must also be available before it can be recognized.

Under the modified accrual basis, the following revenue sources are considered to be both measurable and available at year-end: income tax, state-levied locally shared taxes (including gasoline tax, local government funds and permissive tax), fines and forfeitures, interest, grants, fees and rentals.

Deferred Revenue - Deferred revenue arises when assets are recognized before revenue recognition criteria have been satisfied.

Property taxes for which there is an enforceable legal claim as of December 31, 2006, but which were levied to finance year 2007 operations, have been recorded as deferred revenue. Special assessments not received within the available period and grants and entitlements received before the eligibility requirements are met are also recorded as deferred revenue.

On governmental fund financial statements, receivables that will not be collected within the available period have also been reported as deferred revenue.

Expenses/Expenditures - On the accrual basis of accounting, expenses are recognized at the time they are incurred.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)

The measurement focus of governmental fund accounting is on decreases in net financial resources (expenditures) rather than expenses. Expenditures are generally recognized in the accounting period in which the related fund liability is incurred, if measurable. Allocations of cost, such as depreciation and amortization, are not recognized in governmental funds.

F. Budgetary Data

The budgetary process is prescribed by provisions of the Ohio Revised Code and entails the preparation of budgetary documents within an established timetable. The major documents prepared are the tax budget, the certificate of estimated resources and the appropriations resolution, all of which are prepared on the budgetary basis of accounting. The certificate of estimated resources and the appropriations ordinance are subject to amendment throughout the year with the legal restriction that appropriations cannot exceed estimated resources, as certified. The legal level of budgetary control is at the item level within each fund. Budgetary modifications may only be made by resolution of the City Council at the legal level of control.

Tax Budget - During the first Council meeting in July, the Mayor presents the following fiscal year's annual operating budget to City Council for consideration and passage. The adopted budget is submitted to the County Auditor, as Secretary of the County Budget Commission, by July 20 of each year, for the period January 1 to December 31 of the following year.

Estimated Resources - The County Budget Commission determines if the budget substantiates a need to levy all or part of previously authorized taxes and reviews estimated revenue. The Commission certifies its actions to the City by September 1. As part of this certification, the City receives the official certificate of estimated resources, which states the projected revenue of each fund. Prior to December 31, the City must revise its budget so that the total contemplated expenditures from any fund during the ensuing fiscal year will not exceed the amount available as stated in the certificate of estimated resources. The revised budget then serves as the basis for the annual appropriations measure. On or about January 1, the certificate of estimated resources is amended to include encumbered cash balances at December 31 of the preceding year. The certificate may be further amended during the year if the Finance Director determines, and the Budget Commission agrees, that estimates need to be either increased or decreased. The amounts reported on the budgetary statement reflect the amounts in the original and final amended official certificate of estimated resources issued during 2006.

Appropriations - A temporary appropriation ordinance to control expenditures may be passed on or about January 1 of each year for the period January 1 to March 31. An annual appropriation ordinance must be passed by April 1 of each year for the period January 1 to December 31. The appropriation ordinance fixes spending authority at the item level. The appropriation ordinance may be amended during the year as new information becomes available, provided that total fund appropriations do not exceed current estimated resources, as certified. The appropriations at the legal level of control may only be modified during the year by an ordinance of Council. The amounts on the budgetary statement reflect the original and final appropriation amounts, including all amendments and modifications legally enacted by Council.

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006**

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)

Lapsing of Appropriations - At the close of each year, the unencumbered balance of each appropriation reverts to the respective fund from which it was appropriated and becomes subject to future appropriations. Encumbrances are carried forward and are not reappropriated as part of the subsequent year appropriations.

G. Health Care

The Comprehensive Omnibus Budget Reconciliation Act (COBRA) of 1986 required the City to offer and provide terminated or retired employees continued participation in the City's employee health care benefits program, provided that the employees pay the rate established by the plan administrator. The City incurred no expenditures or revenues in providing these services. The participating former employees make premium payments directly to the City's Insurance Provider and the Provider is responsible for all claims.

H. Cash and Cash Equivalents

To improve cash management, cash received by the City is pooled. Monies for all funds are maintained in this pool. Individual fund integrity is maintained through the City's records. Each fund's interest in the pool is presented as "Equity in Pooled Cash and Cash Equivalents" on the basic financial statements.

During fiscal year 2006, investments were limited to nonnegotiable certificates of deposit. Nonparticipating investment contracts, such as nonnegotiable certificates of deposit, are reported at cost.

Following Ohio statutes, the Council has, by resolution, specified the funds to receive an allocation of interest earnings. During fiscal 2006, interest revenue credited to the general fund amounted to \$328,295 which includes \$300,173 assigned from other City funds.

The City has segregated bank accounts for monies held separate from the City's central bank account. These interest bearing depository accounts are presented on the basic financial statements as "Cash in Segregated Accounts" since it is not required to be deposited into the City treasury. The City maintains segregated depository account for municipal court deposits and retainage escrow accounts.

The City has monies being held by AMP-Ohio which are presented on the basic financial statements as "Cash with Fiscal Agent".

For purposes of the statement of cash flows and for presentation on the statement of net assets/balance sheet, investments with an original maturity of three months or less and investments of the cash management pool are considered to be cash equivalents.

An analysis of the City's investment account at year-end is provided in Note 4.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)

I. Inventories of Materials and Supplies

On government-wide and fund financial statements, inventories are presented at the lower of cost or market on a first-in, first-out basis and are expensed when used. Inventories are accounted for using the consumption method.

On the fund financial statements, reported material and supplies inventory is equally offset by a fund balance reserve in the governmental funds which indicates that it does not constitute available spendable resources even though it is a component of net current assets.

Inventory consists of expendable supplies held for consumption.

J. Capital Assets

General capital assets are those assets not specifically related to activities reported in the proprietary funds. These assets generally result from expenditures in the governmental funds. These assets are reported in the governmental activities column of the government-wide statement of net assets but are not reported in the fund financial statements. Capital assets utilized by the proprietary funds are reported both in the business-type activities column of the government-wide statement of net assets and in the respective funds.

All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the year. Donated capital assets are recorded at their fair market values as of the date received. The City maintains a capitalization threshold of \$1,000. The City's infrastructure consists of bridges, culverts, curbs, sidewalks, storm sewers, streets, irrigation systems, electric distribution systems, and water and sewer lines. Improvements are capitalized; the costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not. Interest incurred during the construction of capital assets is also capitalized.

All reported capital assets are depreciated except for land and construction in progress. Improvements are depreciated over the remaining useful lives of the related capital assets. Useful lives for infrastructure were estimated based on the City's historical records of necessary improvements and replacement. Depreciation is computed using the straight-line method over the following useful lives:

<u>Description</u>	<u>Governmental Activities Estimated Lives</u>	<u>Business-Type Activities Estimated Lives</u>
Land improvements	20 years	20 years
Buildings and improvements	30 - 50 years	30 - 50 years
Furniture, fixtures and equipment	5 - 30 years	5 - 30 years
Vehicles	6 - 8 years	6 - 8 years
Infrastructure	10 - 65 years	10 - 65 years

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)

K. Compensated Absences

Compensated absences of the City consist of vacation leave and sick leave to the extent that payment to the employee for these absences are attributable to services already rendered and are not contingent on a specific event that is outside the control of the City and the employee.

In conformity with GASB Statement No. 16, "Accounting for Compensated Absences", vacation benefits are accrued as a liability as the benefits are earned if the employees' rights to receive compensation are attributable to services already rendered and it is probable that the City will compensate the employees for the benefits through paid time off or some other means. Sick leave benefits are accrued as a liability using the vesting method. The liability is based on the sick leave accumulated at December 31 by those employees who are currently eligible to receive termination payments and by those employees for whom it is probable they will become eligible to receive termination benefits in the future.

The total liability for vacation and sick leave payments has been calculated using pay rates in effect at the balance sheet date, and reduced to the maximum payment allowed by labor contract and/or statute, plus applicable additional salary related payments. City employees are granted vacation and sick leave in varying amounts. In the event of termination, an employee is reimbursed for accumulated vacation and sick leave at various rates.

The entire compensated absence liability is reported on the government-wide financial statements.

For governmental funds, the current portion of unpaid compensated absences is the amount that is normally expected to be paid using expendable available financial resources. These amounts are recorded in the account "compensated absences payable" in the fund from which the employees who have accumulated leave are paid. The noncurrent portion of the liability is not reported in the governmental funds; however, they are reported in the government-wide financial statements. In proprietary funds, the entire amount of compensated absences is reported as a fund liability.

L. Prepayments

Payments made to vendors for services that will benefit beyond December 31, 2006, are recorded as prepaid items using the consumption method by recording a current asset for the prepaid amount and reflecting the expenditures/expense in the year in which it was consumed.

M. Accrued Liabilities and Long-Term Obligations

All payables, accrued liabilities and long-term obligations are reported in the government-wide financial statements, and all payables, accrued liabilities and long-term obligations payable from proprietary funds are reported on the proprietary fund financial statements.

In general, governmental fund payables and accrued liabilities that, once incurred, are paid in a timely manner and in full from current financial resources, are reported as obligations of the funds. However, claims and judgments, compensated absences, and contractually required pension contributions that will be paid from governmental funds are reported as a liability in the fund financial statements only to the extent that they are due for payment during the current year. Bonds, capital leases and long-term loans are recognized as a liability on the fund financial statements when due.

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006**

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)

N. Interfund Balances

On fund financial statements, receivables and payables resulting from short-term interfund loans are classified as “interfund receivables/payables.” On fund financial statements, long-term interfund loans are classified as “advances to/from other funds” on the financial statements and are equally offset by a fund balance reserve account which indicates that they do not constitute available expendable resources. These amounts are eliminated in the governmental and business-type activities columns of the statement of net assets, except for any net residual amounts due between governmental and business-type activities, which are presented as internal balances. The City had no short-term or long-term interfund balances at year-end. The internal balances between the governmental activities and the business-type activities reported on the statement of net assets results from the consolidation of the internal service fund with governmental activities for reporting on the government-wide financial statements.

O. Interfund Activity

Transfers between governmental and business-type activities on the government-wide statements are reported in the same manner as general revenues.

Exchange transactions between funds are reported as revenues in the seller funds and as expenditures/expenses in the purchaser funds. Flows of cash or goods from one fund to another without a requirement for repayment are reported as interfund transfers. Interfund transfers are reported as other financing sources/uses in governmental funds and after nonoperating revenues/expenses in proprietary funds. Repayments from funds responsible for particular expenditures/expenses to the funds that initially paid for them are not presented on the basic financial statements.

P. Fund Balance Reserves

Reserved fund balances indicate that portion of fund equity which is not available for current appropriation or use. The unreserved portions of fund equity reflected in the governmental funds are available for use within the specific purposes of the funds.

The City reports amounts representing encumbrances outstanding, prepayments, materials and supplies inventory, and debt service as reservations of fund balance in the governmental fund financial statements.

Q. Estimates

The preparation of the basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the basic financial statements and accompanying notes. Actual results may differ from those estimates.

R. Contributed Capital

Contributions of capital in proprietary fund financial statements arise from outside contributions of capital assets, tap-in fees to the extent they exceed the cost of the connection to the system, or from grants or outside contributions of resources restricted to capital acquisition and construction. Capital contributions are reported as revenue in the proprietary fund financial statements.

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006**

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (Continued)

S. Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowing used for the acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation or through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

The City applies restricted resources first when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

T. Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary funds. For the City, these revenues are charges for services for water, sewer and electric programs. Operating expenses are necessary costs incurred to provide the good or service that is the primary activity of the fund.

U. Extraordinary and Special Items

Extraordinary items are transactions or events that are both unusual in nature and infrequent in occurrence. Special items are transactions or events that are within the control of the City Administration and that are either unusual in nature or infrequent in occurrence. Neither type of transaction occurred during 2006.

NOTE 3 - ACCOUNTABILITY AND COMPLIANCE

A. Changes in Accounting Principles

For fiscal year 2006, the City has implemented GASB Statement No. 46, "Net Assets Restricted by Enabling Legislation" and GASB Statement No. 47, "Accounting for Termination Benefits".

GASB Statement No. 46 defines enabling legislation and specifies how net assets should be reported in the financial statements when there are changes in such legislation. The Statement also requires governments to disclose in the notes to the financial statements the amount of net assets restricted by enabling legislation.

GASB Statement No. 47 establishes accounting standards for termination benefits.

The implementation of GASB Statement No. 46 and GASB Statement No. 47 did not have an effect on the fund balances/net assets of the City as previously reported at December 31, 2005.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 3 - ACCOUNTABILITY AND COMPLIANCE – (Continued)

B. Prior Period Adjustment

The beginning net assets of the governmental and business-type activities as well as the enterprise funds have been restated for errors and omissions in the amounts reported in the prior year. These adjustments did not have an effect on the fund balances of the City as previously reported at December 31, 2005. The capital asset adjustment had the following effect on net assets at December 31, 2005:

	<u>Governmental Activities</u>	<u>Sewer Fund</u>	<u>Water Fund</u>	<u>Electric Fund</u>	<u>Business-Type Activities</u>
Net assets December 31, 2005	\$ 19,905,127	\$ 5,924,116	\$ 7,351,288	\$ 9,653,059	\$ 23,050,687
Adjustment for capital assets	<u>(391,946)</u>	<u>(25,905)</u>	<u>(150,279)</u>	<u>235,075</u>	<u>58,891</u>
Net assets January 1, 2006, restated	<u>\$ 19,513,181</u>	<u>\$ 5,898,211</u>	<u>\$ 7,201,009</u>	<u>\$ 9,888,134</u>	<u>\$ 23,109,578</u>

NOTE 4 - DEPOSITS AND INVESTMENTS

State statutes classify monies held by the City into three categories.

Active deposits are public deposits necessary to meet current demands on the treasury. Such monies must be maintained either as cash in the City treasury, in commercial accounts payable or withdrawable on demand, including negotiable order of withdrawal (NOW) accounts, or in money market deposit accounts.

Inactive deposits are public deposits that the City Council has identified as not required for use within the current five year period of designation of depositories. Inactive deposits must either be evidenced by certificates of deposit maturing not later than the end of the current period of designation of depositories, or by savings or deposit accounts including, but not limited to, passbook accounts.

Interim deposits are deposits of interim monies. Interim moneys are those monies which are not needed for immediate use but which will be needed before the end of the current period of designation of depositories. Interim deposits must be evidenced by time certificates of deposit maturing not more than one year from the date of deposit or by savings or deposit accounts including passbook accounts.

Interim monies to be deposited or invested in the following securities:

1. United States Treasury Notes, Bills, Bonds, or any other obligation or security issued by the United States Treasury or any other obligation guaranteed as to principal and interest by the United States;
2. Bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality, including but not limited to, the Federal National Mortgage Association, Federal Home Loan Bank, Federal Farm Credit Bank, Federal Home Loan Mortgage Corporation, Government National Mortgage Association, and Student Loan Marketing Association. All federal agency securities shall be direct issuances of federal government agencies or instrumentalities;
3. Written repurchase agreements in the securities listed above provided that the market value of the securities subject to the repurchase agreement must exceed the principal value of the agreement by at least two percent and be marked to market daily, and that the term of the agreement must not exceed thirty days;

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006**

NOTE 4 - DEPOSITS AND INVESTMENTS - (Continued)

4. Bonds and other obligations of the State of Ohio;
5. No-load money market mutual funds consisting exclusively of obligations described in section (1) or (2) of Note 4 and repurchase agreements secured by such obligations, provided that investments in securities described in this division are made only through eligible institutions;
6. The State Treasurer's investment pool State Treasury Asset Reserve of Ohio (STAR Ohio);
7. Certain banker's acceptance and commercial paper notes for a period not to exceed one hundred eighty days from the purchase date in an amount not to exceed twenty-five percent of the interim monies available for investment at any one time: and,
8. Under limited circumstances, corporate debt interests rated in either of the two highest classifications by at least two nationally recognized rating agencies.

Protection of City's deposits is provided by the Federal Deposit Insurance Corporation (FDIC), by eligible securities pledged by the financial institution as security for repayment, by surety company bonds deposited with the Finance Director by the financial institution or by a single collateral pool established by the financial institution to secure the repayment of all public monies deposited with the institution.

Investments in stripped principal or interest obligations, reverse repurchase agreements and derivatives are prohibited. The issuance of taxable notes for the purpose of arbitrage, the use of leverage and short selling are also prohibited. An investment must mature within five years from the date of purchase unless matched to a specific obligation or debt of the City, and must be purchased with the expectation that it will be held to maturity. Investments may only be made through specified dealers and institutions. Payment for investments may be made only upon delivery of the securities representing the investments to the Finance Director or, if the securities are not represented by a certificate, upon receipt of confirmation of transfer from the custodian.

A. Cash with Fiscal Agent

At December 31, 2006, the City had \$4,000,000 on deposit with AMP-Ohio. The data regarding insurance and collateralization can be obtained from the AMP-Ohio Annual Financial Report for the year ended December 31, 2006. This amount is not included in the City's depository balance below.

B. Cash in Segregated Accounts

At December 31, 2006, the City had \$297,614 in segregated accounts for municipal court deposits and retainage escrow accounts. These accounts were covered by Federal Deposit Insurance Corporation or pooled collateral held by the depository institution. This amount is not included in the City's depository balance below

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 4 - DEPOSITS AND INVESTMENTS - (Continued)

C. Deposits with Financial Institutions

At December 31, 2006, the carrying amount of all City deposits was \$9,647,906. Based on the criteria described in GASB Statement No. 40, "Deposits and Investment Risk Disclosures", as of December 31, 2006, \$9,763,885 of the City's bank balance of \$10,273,885 was exposed to custodial risk as discussed below, while \$510,000 was covered by Federal Deposit Insurance Corporation.

Custodial credit risk is the risk that, in the event of bank failure, the City's deposits may not be returned. All deposits are collateralized with eligible securities in amounts equal to at least 105% of the carrying value of the deposits. Such collateral, as permitted by the Ohio revised Code, is held in single financial institution collateral pools at Federal Reserve Banks, or at member banks of the federal reserve system, in the name of the respective depository bank and pledged as a pool of collateral against all of the public deposits it holds or as specific collateral held at the Federal Reserve Bank in the name of the City.

D. Investments

The City had no investments at December 31, 2006.

E. Reconciliation of Cash and Investment to the Statement of Net Assets

The following is a reconciliation of cash and investments as reported in the footnote above to cash and investments as reported on the statement of net assets as of December 31, 2006:

<u>Cash and Investments per footnote</u>	
Carrying amount of deposits	\$ 9,647,906
Cash with fiscal agent	4,000,000
Cash in segregated accounts	<u>297,614</u>
Total	<u>\$ 13,945,520</u>
 <u>Cash and investments per Statement of Net Assets</u>	
Governmental activities	\$ 3,927,723
Business-type activities	9,833,381
Agency funds	<u>184,416</u>
Total	<u>\$ 13,945,520</u>

NOTE 5 - INTERFUND TRANSACTIONS

Interfund transfers for the year ended December 31, 2006, consisted of the following, as reported on the fund statements:

Transfers to nonmajor governmental funds from:	
General fund	<u>\$ 357,365</u>
Total	<u>\$ 357,365</u>

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 5 - INTERFUND TRANSACTIONS – (Continued)

Transfers are used to (1) move revenues from the fund that statute or budget required to collect them to the fund that statute or budget requires to expend them, (2) move receipts restricted to debt service from the funds collecting the receipts to the debt service fund as debt service payments become due, and (3) use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations. Transfers between governmental activities have been eliminated for reporting in the statement of activities.

NOTE 6 - PROPERTY TAXES

Property taxes include amounts levied against all real, public utility, and tangible personal property located in the City. Taxes collected on real property (other than public utility) in one calendar year are levied in the preceding calendar year on assessed values as of January 1 of that preceding year, the lien date. Assessed values are established by the state statute at 35 percent of appraised market value. All property is required to be revalued every six years. The last revaluation was completed in 2003. Real property taxes are payable annually or semiannually. The first payment is due January 20, with the remainder payable by June 20.

Tangible personal property tax revenues received in 2006 (other than public utility property) represent the collection of 2006 taxes. Tangible personal property taxes received in 2006 were levied after October 1, 2005, on the true value as of December 31, 2005. In prior years, tangible personal property assessments were twenty-five percent of true value for capital assets and twenty-three percent of true value for inventory. Tangible personal property tax is being phased out - the assessment percentage for property, including inventory, is 18.75% for 2006. This percentage will be reduced to 12.5% for 2007, 6.25% for 2008, and zero for 2009. Amounts paid by multi-county taxpayers are due September 20. Single county taxpayers may pay annually or semiannually. If paid annually, the first payment is due April 30; if paid semiannually, the first payment is due April 30, with the remainder payable by September 20.

House Bill No. 66 was signed into law on June 30, 2005. House Bill No. 66 phases out the tax on tangible personal property of general businesses, telephone and telecommunications companies, and railroads. The tax on general business and railroad property will be eliminated by calendar year 2009, and the tax on telephone and telecommunications property will be eliminated by calendar year 2011. The tax is phased out by reducing the assessment rate on the property each year. The bill replaces the revenue lost by the City due to the phasing out of the tax. In calendar years 2006-2010, the City will be fully reimbursed for the lost revenue. In calendar years 2011-2017, the reimbursements will be phased out.

Public utility real and tangible personal property taxes collected in one calendar year are levied in the preceding calendar year on assessed values determined as of December 31 of the second year preceding the tax collection year, the lien date. Certain public utility tangible personal property currently is assessed at 100 percent of its true value. Public utility property taxes are payable on the same dates as real property taxes described previously.

The County Treasurer collects property taxes on behalf of all taxing districts in the County, including the City of Shelby. The County Auditor periodically remits to the City its portion of the taxes collected with final settlement in June and December for taxes payable in the first and second halves of the year, respectively.

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006**

NOTE 6 - PROPERTY TAXES – (Continued)

The full tax rate for all City operations for the year ended December 31, 2006, was \$5.60 per \$1,000.00 of assessed value. The assessed values of real and tangible personal property for tax year 2006 are as follows:

Real property	\$ 136,096,650
Public utility property	1,680,530
Tangible personal property	<u>29,390,355</u>
Total assessed valuation	<u>\$ 167,167,535</u>

Accrued taxes receivable represent delinquent taxes outstanding and real, tangible personal, and public utility taxes which were measurable and unpaid as of December 31, 2006. Although total property tax collections for the next fiscal year are measurable, amounts to be received during the available period are not subject to reasonable estimation at December 31 and are not intended to finance 2006 operations. Accordingly, the receivable is offset by a credit to “Deferred Revenue.”

NOTE 7 - LOCAL INCOME TAX

The City levies a municipal income tax of one and three-quarters percent on all salaries, wages, commissions and other compensation, and net profits earned within the City as well as incomes of residents earned outside of the City. In the latter case, the City allows a credit of 100% of the tax paid to another municipality to a maximum of the total amount assessed. Employers within the City are required to withhold income tax on employee compensation and remit the tax to the City either monthly or quarterly. Corporations and other individual taxpayers are required to pay their estimated tax quarterly and file a declaration annually. Income tax proceeds are received by the City Income Tax special revenue fund and are transferred to other funds as determined by the City.

NOTE 8 - RECEIVABLES

Receivables at December 31, 2006, consisted of taxes, accounts (billings for user charged services), special assessments, accrued interest and intergovernmental receivables arising from grants, entitlements, and shared revenue. All intergovernmental receivables have been classified as “Due from other governments” on the basic financial statements. Receivables have been recorded to the extent that they are both measurable and available at December 31, 2006, as well as intended to finance fiscal 2006 operations. A summary of the items of receivables reported on the statement of net assets follows:

Governmental Activities:	
Income taxes	\$ 664,774
Real and other taxes	966,365
Special assessments	2,410
Accrued interest	42,772
Due from other governments	736,963
Business-Type Activities:	
Accounts	1,637,791
Accrued interest	36,494

Receivables have been disaggregated on the face of the basic financial statements. All receivables are expected to be collected within the subsequent year.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 9 - CAPITAL ASSETS

- A. Governmental and business-type capital assets have been restated due to reclassifications in asset categories and errors and omissions in the amounts reported in the prior year (see Note 3. B for detail). The amounts reported at December 31, 2005 are restated as follows:

	<u>Balance</u> <u>12/31/05</u>	<u>Adjustments</u>	<u>Restated</u> <u>Balance</u> <u>12/31/05</u>
Governmental Activities:			
<i>Capital assets, not being depreciated:</i>			
Land	\$ 206,050	\$ -	\$ 206,050
Construction in progress	<u>176,393</u>	<u>-</u>	<u>176,393</u>
Total capital assets, not being depreciated	<u>382,443</u>	<u>-</u>	<u>382,443</u>
<i>Capital assets, being depreciated:</i>			
Land improvements	479,714	268,154	747,868
Buildings and improvements	1,776,139	(346,490)	1,429,649
Furniture, fixtures and equipment	1,422,387	(28,395)	1,393,992
Vehicles	2,027,239	(638,381)	1,388,858
Infrastructure	<u>17,262,452</u>	<u>(193,668)</u>	<u>17,068,784</u>
Total capital assets, being depreciated	<u>22,967,931</u>	<u>(938,780)</u>	<u>22,029,151</u>
<i>Less: accumulated depreciation:</i>			
Land improvements	(307,035)	(128,216)	(435,251)
Buildings and improvements	(962,274)	194,667	(767,607)
Furniture, fixtures and equipment	(734,633)	23,258	(711,375)
Vehicles	(1,524,464)	476,476	(1,047,988)
Infrastructure	<u>(4,287,112)</u>	<u>(19,351)</u>	<u>(4,306,463)</u>
Total accumulated depreciation	<u>(7,815,518)</u>	<u>546,834</u>	<u>(7,268,684)</u>
Total capital assets, being depreciated, net	<u>15,152,413</u>	<u>(391,946)</u>	<u>14,760,467</u>
Governmental activities capital assets, net	<u>\$ 15,534,856</u>	<u>\$ (391,946)</u>	<u>\$ 15,142,910</u>

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 9 - CAPITAL ASSETS – (Continued)

	Balance <u>12/31/05</u>	<u>Adjustments</u>	Restated Balance <u>12/31/05</u>
Business-Type Activities:			
<i>Capital assets, not being depreciated:</i>			
Land	\$ 233,440	\$ -	\$ 233,440
Construction in progress	<u>2,238,494</u>	<u>-</u>	<u>2,238,494</u>
Total capital assets, not being depreciated	<u>2,471,934</u>	<u>-</u>	<u>2,471,934</u>
<i>Capital assets, being depreciated:</i>			
Land improvements	559,423	(249,851)	309,572
Buildings and improvements	7,569,284	266,946	7,836,230
Furniture, fixtures and equipment	23,201,806	3,489,110	26,690,916
Vehicles	643,737	638,381	1,282,118
Infrastructure	<u>15,138,825</u>	<u>(3,561,725)</u>	<u>11,577,100</u>
Total capital assets, being depreciated	<u>47,113,075</u>	<u>582,861</u>	<u>47,695,936</u>
<i>Less: accumulated depreciation:</i>			
Land improvements	(375,337)	130,555	(244,782)
Buildings and improvements	(4,106,566)	(172,594)	(4,279,160)
Furniture, fixtures and equipment	(17,900,217)	(3,052,069)	(20,952,286)
Vehicles	(560,002)	(451,859)	(1,011,861)
Infrastructure	<u>(7,889,005)</u>	<u>3,021,997</u>	<u>(4,867,008)</u>
Total accumulated depreciation	<u>(30,831,127)</u>	<u>(523,970)</u>	<u>(31,355,097)</u>
Total capital assets, being depreciated, net	<u>16,281,948</u>	<u>58,891</u>	<u>16,340,839</u>
Business-type activities capital assets, net	<u>\$ 18,753,882</u>	<u>\$ 58,891</u>	<u>\$ 18,812,773</u>

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 9 - CAPITAL ASSETS – (Continued)

B. Capital asset activity for the year ended December 31, 2006 is as follows:

	Restated Balance <u>12/31/05</u>	<u>Additions</u>	<u>Disposals</u>	Balance <u>12/31/06</u>
Governmental Activities:				
<i>Capital assets, not being depreciated:</i>				
Land	\$ 206,050	\$ -	\$ -	\$ 206,050
Construction in progress	<u>176,393</u>	<u>-</u>	<u>(176,393)</u>	<u>-</u>
Total capital assets, not being depreciated	<u>382,443</u>	<u>-</u>	<u>(176,393)</u>	<u>206,050</u>
<i>Capital assets, being depreciated:</i>				
Land improvements	747,868	13,490	-	761,358
Buildings and improvements	1,429,649	25,104	-	1,454,753
Furniture, fixtures and equipment	1,393,992	99,822	-	1,493,814
Vehicles	1,388,858	19,194	-	1,408,052
Infrastructure	<u>17,068,784</u>	<u>285,676</u>	<u>-</u>	<u>17,354,460</u>
Total capital assets, being depreciated	<u>22,029,151</u>	<u>443,286</u>	<u>-</u>	<u>22,472,437</u>
<i>Less: accumulated depreciation:</i>				
Land improvements	(435,251)	(38,527)	-	(473,778)
Buildings and improvements	(767,607)	(42,242)	-	(809,849)
Furniture, fixtures and equipment	(711,375)	(115,639)	-	(827,014)
Vehicles	(1,047,988)	(86,108)	-	(1,134,096)
Infrastructure	<u>(4,306,463)</u>	<u>(443,187)</u>	<u>-</u>	<u>(4,749,650)</u>
Total accumulated depreciation	<u>(7,268,684)</u>	<u>(725,703)</u>	<u>-</u>	<u>(7,994,387)</u>
Total capital assets, being depreciated, net	<u>14,760,467</u>	<u>(282,417)</u>	<u>-</u>	<u>14,478,050</u>
Governmental activities capital assets, net	<u>\$ 15,142,910</u>	<u>\$ (282,417)</u>	<u>\$ (176,393)</u>	<u>\$ 14,684,100</u>

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 9 - CAPITAL ASSETS - (Continued)

	<u>Restated Balance 12/31/05</u>	<u>Additions</u>	<u>Disposals</u>	<u>Balance 12/31/06</u>
Business-Type Activities:				
<i>Capital assets, not being depreciated:</i>				
Land	\$ 233,440	\$ -	\$ -	\$ 233,440
Construction in progress	<u>2,238,494</u>	<u>3,768,751</u>	<u>(2,095,954)</u>	<u>3,911,291</u>
Total capital assets, not being depreciated	<u>2,471,934</u>	<u>3,768,751</u>	<u>(2,095,954)</u>	<u>4,144,731</u>
<i>Capital assets, being depreciated:</i>				
Land improvements	309,572	1,200,022	-	1,509,594
Buildings and improvements	7,836,230	3,881,357	(202,200)	11,515,387
Furniture, fixtures and equipment	26,690,916	266,192	(532,117)	26,424,991
Vehicles	1,282,118	24,274	-	1,306,392
Infrastructure	<u>11,577,100</u>	<u>15,773</u>	<u>-</u>	<u>11,592,873</u>
Total capital assets, being depreciated	<u>47,695,936</u>	<u>5,387,618</u>	<u>(734,317)</u>	<u>52,349,237</u>
<i>Less: accumulated depreciation:</i>				
Land improvements	(244,782)	(39,560)	-	(284,342)
Buildings and improvements	(4,279,160)	(207,791)	202,200	(4,284,751)
Furniture, fixtures and equipment	(20,952,286)	(529,593)	439,363	(21,042,516)
Vehicles	(1,011,861)	(45,424)	-	(1,057,285)
Infrastructure	<u>(4,867,008)</u>	<u>(281,089)</u>	<u>-</u>	<u>(5,148,097)</u>
Total accumulated depreciation	<u>(31,355,097)</u>	<u>(1,103,457)</u>	<u>641,563</u>	<u>(31,816,991)</u>
Total capital assets, being depreciated, net	<u>16,340,839</u>	<u>4,284,161</u>	<u>(92,754)</u>	<u>20,532,246</u>
Business-type activities capital assets, net	<u>\$ 18,812,773</u>	<u>\$ 8,052,912</u>	<u>\$ (2,188,708)</u>	<u>\$ 24,676,977</u>

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 9 - CAPITAL ASSETS - (Continued)

Depreciation expense was charged to functions/programs of the governmental activities and funds of the business-type activities as follows:

Governmental activities:

General government	\$ 34,525
Security of persons and property	106,390
Public health and welfare	859
Transportation	512,670
Community environment	59,002
Leisure time activity	<u>12,257</u>
Total depreciation expense - governmental activities	<u>\$ 725,703</u>

Business-type activities:

Sewer	\$ 305,709
Water	262,503
Electric	<u>535,245</u>
Total depreciation expense - business-type activities	<u>\$1,103,457</u>

NOTE 10 - COMPENSATED ABSENCES

Employees earn vacation and sick leave at different rates which are affected by length of service. Vacation can be carried over at different rates depending on the department. Service and office employees may carry over 80 hours while the police may carry over 40 hours for use in the following year. Sick leave accrual is continuous, without limit.

Upon retirement, an employee can be paid for his/her accumulated hours of sick leave up to 720 hours, except for eligible fire department employees, who can be paid for his/her accumulated hours up to 2,160 hours. Upon retirement, termination, or death of the employee, vacation is paid for the total time accumulated for the employee.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 11 - LONG-TERM OBLIGATIONS

A. The following activity occurred in the City's long-term obligations during 2006:

		Balance			Balance	Amounts
	Interest	Outstanding			Outstanding	Due in
	Rate	12/31/05	Additions	Reductions	12/31/06	One Year
Governmental Activities:						
<u>Special Assessment Bonds Payable:</u>						
Street Improvement - Route 39	3.10%	\$ 76,069	\$ -	\$ (25,357)	\$ 50,712	\$ 25,356
Street Improvement - Fox Run 6	2.36%	67,485	-	(13,497)	53,988	13,497
Total Bonds Payable		<u>143,554</u>	-	<u>(38,854)</u>	<u>104,700</u>	<u>38,853</u>
<u>OPWC Loans Payable:</u>						
Wareham Road	0.00%	178,695	-	(16,245)	162,450	16,245
Auburn Street	0.00%	9,608	-	(9,608)	-	-
Total OPWC Loans Payable		<u>188,303</u>	-	<u>(25,853)</u>	<u>162,450</u>	<u>16,245</u>
<u>Other Long-Term Obligations:</u>						
Compensated Absences		339,669	57,026	(51,766)	344,929	75,947
Total Governmental Activities		<u>\$ 671,526</u>	<u>\$ 57,026</u>	<u>\$ (116,473)</u>	<u>\$ 612,079</u>	<u>\$131,045</u>
Business-Type Activities:						
<u>OPWC Loan Payable:</u>						
Wastewater Treatment Plant Expansion	0.00%	\$ 342,857	\$ -	\$ (57,143)	\$ 285,714	\$ 57,143
<u>OWDA Loans Payable:</u>						
EQ Basin	1.00%	-	1,277,679	-	1,277,679	-
WTP Upgrade	2.75%	-	3,127,451	(127,923)	2,999,528	129,682
Total OWDA Loans Payable		-	4,405,130	(127,923)	4,277,207	129,682
<u>Other Long-Term Liabilities:</u>						
Compensated Absences		315,816	95,608	(79,779)	331,645	84,170
Total Business-Type Activities		<u>\$ 658,673</u>	<u>\$ 4,500,738</u>	<u>\$ (264,845)</u>	<u>\$ 4,894,566</u>	<u>\$270,995</u>

Special Assessment Bonds: Special assessment bonds are payable from the proceeds of assessments levied against the specific property owners who primarily benefited from the project. Special assessment monies will be received in the debt service fund and the debt will also be retired from this fund. In the event that property owners fail to make their special assessment payments, the City is responsible for providing the resources to meet the annual principal and interest payments.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 11 - LONG-TERM OBLIGATIONS - (Continued)

Street Improvement Bond – Route 39: The Street improvements bonds were issued on September 5, 2003, for the purpose of financing the cost of water and sewer improvements along State Route 39 under authority of the Ohio Revised Code. The bond proceeds and capital outlay expenditures have been recorded in the Special Assessment capital projects fund. Additions to water and sewer infrastructure will be recorded in the Water and Sewer Enterprise funds as capital contributions.

Street Improvement Bond – Fox Run 6: The Street improvements bonds were issued on August 17, 2005, for the purpose of financing the cost of water and sewer improvements in the Fox Run 6 area under authority of the Ohio Revised Code. The bond proceeds and capital outlay expenditures have been recorded in the Special Assessment capital projects fund. Additions to water and sewer infrastructure will be recorded in the Water and Sewer Enterprise funds as capital contributions.

OPWC Loans Payable: The City has entered into debt financing arrangements through the Ohio Public Works Commission (OPWC) to fund construction projects. These loans are retired through the General Bond Retirement debt service fund and the sewer fund. The OPWC notes are interest free.

OWDA Loans Payable: The City has entered into debt financing arrangements through the OWDA to fund construction projects. The amounts due to the OWDA are payable solely from water and sewer revenues. The loan agreements function similar to a line-of-credit agreement. The loan agreements require semi-annual payments based on the permissible borrowings rather than the actual amount loaned. These payments are reflected in the future maturities of principal and interest table and are subject to revision if the total amount is not drawn down. The EQ Basin and Water Treatment Plant Upgrade projects financed through OWDA loans are not closed out as of December 31, 2006. Future annual debt service principal and interest requirements for these loans, which have balances at December 31, 2006 of \$1,277,679 and \$2,999,528, are not available.

Compensated Absences: Compensated absences will be paid from the fund from which the employee is paid. The City will pay compensated absences from the general fund, street maintenance and repair fund, income tax fund, health fund, park/pool fund, sewer fund, water fund and electric funds.

- B.** Principal and interest requirements to retire the long-term obligations outstanding at December 31, 2006, are as follows:

<u>Year Ended</u>	<u>Street Improvement Bond</u>			<u>OPWC Loans</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 38,853	\$ 3,759	\$ 42,612	\$ 73,388	\$ -	\$ 73,388
2008	38,853	2,426	41,279	73,388	-	73,388
2009	13,497	1,093	14,590	73,388	-	73,388
2010	13,497	546	14,043	73,388	-	73,388
2011	-	-	-	73,387	-	73,387
2012 - 2016	-	-	-	81,225	-	81,225
Total	<u>\$104,700</u>	<u>\$ 7,824</u>	<u>\$112,524</u>	<u>\$448,164</u>	<u>\$ -</u>	<u>\$448,164</u>

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 11 - LONG-TERM OBLIGATIONS - (Continued)

C. Legal Debt Margin

The City's voted and unvoted legal debt margins were \$18,428,494 and \$5,240,046, respectively, at December 31, 2006.

NOTE 12 - GENERAL OBLIGATION NOTES PAYABLE

The City had the following general obligation note activity during fiscal year 2006 for Electric enterprise fund. These notes are reported as a liability in the Electric enterprise fund, the fund that received the proceeds.

	<u>Issue Date</u>	<u>Maturity Date</u>	<u>Balance Outstanding 12/31/05</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance Outstanding 12/31/06</u>
Electric System						
Improvements - 5.00%	11/17/05	11/16/06	\$ 2,500,000	\$ -	\$ (2,500,000)	\$ -
Electric System						
Improvements - 5.00%	11/17/05	11/16/07	4,000,000	-	-	4,000,000
Electric System						
Improvements - 5.00%	11/17/06	11/16/07	<u>-</u>	<u>2,190,000</u>	<u>-</u>	<u>2,190,000</u>
Total			<u>\$ 6,500,000</u>	<u>\$ 2,190,000</u>	<u>\$ (2,500,000)</u>	<u>\$ 6,190,000</u>

NOTE 13 - 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. During 2006, the City was part of the Ohio Municipal League (OML) Joint Self-Insurance Pool, an insurance purchasing pool. In addition, the City contracted with other insurance carriers for various types of coverage. The City has transferred the risk of loss to the insurance carriers to the extent of the coverage limits. A summary of the City's insurance coverage at December 31, 2006, follows:

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 13 - RISK MANAGEMENT - (Continued)

<u>Company</u>	<u>Type of Coverage</u>	<u>Deductible</u>	
EMC Insurance Co.	Property	\$1,000	
	General Liability	1,000	
	Inland Marine	1,000	
	Errors and Omission	1,000	
	Law Enforcement	5,000	
	Excess Liability	1,000	
	Shelby Mutual Insurance Company	Public Employee Dishonest Bond Finance	1,000 5,000
EMC Insurance Co.	Automobile	1,000	Comprehensive
		1,000	Collision
EMC Insurance Co.	Steam Boiler	5,000	Water Plant
		1,000	All Other

The City has elected to provide a comprehensive medical benefits package through a self-insured program providing either Fee for Service (FFS) or Preferred Provider Organizations (PPO) programs to the employees through a self-insured package. The City maintains a self-insured internal service fund to account for the finances of its uninsured risks of loss in this program. A third party administrator, Benefit Services, Inc., located in Akron, Ohio, reviews all claims for the plan which are then paid by the City. The total monthly premium paid into the internal service fund for the FFS plan is \$581.00 for single coverage and \$1,400.00 for family coverage and for the PPO plan is \$440.00 for single coverage and \$1,050.00 for family coverage. The employee's share for the FFS plan is \$15.50 for single coverage and \$40.00 per month for family coverage.

The claims liability of \$206,538 reported in the Hospitalization internal service fund at December 31, 2006, is based on the requirements of GASB Statement No. 10, "Accounting and Financial Reporting for Risk Financing and Related Insurance Issues", as amended by GASB Statement No. 30 "Risk Financing Omnibus", which requires that a liability for claims be reported at the estimated ultimate cost of settling the claims if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Changes in the fund's claims liability amounts for the years ended December 31, 2006 and 2005 were as follows:

<u>Fiscal Year</u>	<u>Beginning of Fiscal Year</u>	<u>Claims</u>	<u>Payments</u>	<u>End of Fiscal Year</u>
2006	\$ 179,004	\$ 1,021,589	\$ (994,055)	\$ 206,538
2005	141,242	884,742	(846,980)	179,004

Settled claims have not exceeded this commercial coverage in any of the past three years. There has been no significant reduction in the amount of insurance coverage from fiscal year 2005.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 14 - PENSION PLANS

A. Ohio Public Employees Retirement System

The City participates in the Ohio Public Employees Retirement System (OPERS). OPERS administers three separate pension plans. The traditional plan is a cost-sharing, multiple-employer defined benefit pension plan. The member-directed plan is a defined contribution plan in which the member invests both member and employer contributions (employer contributions vest over five years at 20% per year). Under the member directed plan, members accumulate retirement assets equal to the value of the member and vested employer contributions plus any investment earnings. The combined plan is a cost-sharing, multiple-employer defined benefit pension plan that has elements of both a defined benefit and a defined contribution plan. Under the combined plan, employer contributions are invested by the retirement system to provide a formula retirement benefit similar to the traditional plan benefit. Member contributions, whose investment is self-directed by the member, accumulate retirement assets in a manner similar to the member-directed plan.

OPERS provides retirement, disability, survivor and death benefits and annual cost of living adjustments to members of the traditional and combined plans. Members of the member-directed plan do not qualify for ancillary benefits. Authority to establish and amend benefits is provided by Chapter 145 of the Ohio Revised Code. OPERS issues a stand-alone financial report that may be obtained by writing to OPERS, 277 E. Town St., Columbus, OH 43215-4642 or by calling (614) 222-5601 or (800) 222-7377.

For the year ended December 31, 2006, the members of all three plans, except those in law enforcement under the traditional plan, were required to contribute 9.0% of their annual covered salaries. Members participating in the traditional plan that were in law enforcement contributed 10.1% of their annual covered salary. The City's contribution rate for pension benefits for 2006 was 9.20%, except for those plan members in law enforcement and public safety. For those classifications, the City's pension contributions were 12.43% of covered payroll. The Ohio Revised Code provides statutory authority for member and employer contributions.

The City's required contributions for pension obligations to the traditional and combined plans for the years ended December 31, 2006, 2005, and 2004 were \$432,584, \$420,313, and \$436,372, respectively; 100% has been contributed for 2005 and 2004. The City and plan members did not make any contributions to the member-directed plan for 2006. 92.38% has been contributed for 2006 with the remainder being reported as a liability.

B. Ohio Police and Fire Pension Fund

The City contributes to the Ohio Police and Fire Pension Fund (OP&F), a cost-sharing multiple-employer defined benefit pension plan. OP&F provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefit provisions are established by the Ohio State Legislature and are codified in Chapter 742 of the Ohio Revised Code. OP&F issues a publicly available financial report that includes financial statements and required supplementary information for the plan. That report may be obtained by writing to the Ohio Police and Fire Pension Fund, 140 East Town Street, Columbus, Ohio 43215-5164.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 14 - PENSION PLANS – (Continued)

Plan members are required to contribute 10.0% of their annual covered salary, while the City is required to contribute 19.50% and 24.0% for police officers and firefighters, respectively. The portion of the City's contributions to fund pension obligations was 11.75% for police officers and 16.25% for firefighters. The City's contributions to the fund for police and firefighters were \$159,209 and \$154,137 for the year ended December 31, 2006, \$152,593 and \$147,291 for the year ended December 31, 2005 and \$141,843 and \$141,713 for the year ended December 31, 2004. 72.60% and 72.64%, respectively, have been contributed for 2006 with the remainder being reported as a liability.

NOTE 15 – POSTEMPLOYMENT BENEFITS

A. Ohio Public Employees Retirement System

The Ohio Public Employees Retirement System (OPERS) provides postretirement health care coverage to age and service retirees with ten or more years of qualifying Ohio service credit with either the traditional or combined plans. Health care coverage for disability recipients and primary survivor recipients is available. Members of the member-directed plan do not qualify for postretirement health care coverage. The health care coverage provided by the retirement system is considered an Other Postemployment Benefit as described in GASB Statement No. 12, "Disclosure of Information on Postemployment Benefits other than Pension Benefits by State and Local Government Employers". A portion of each employer's contribution to the traditional or combined plans is set aside for the funding of postretirement health care based on authority granted by State statute. The 2006 local government employer contribution rate was 13.70% of covered payroll (16.93% for public safety and law enforcement); 4.50% of covered payroll was the portion that was used to fund health care.

Benefits are advance-funded using the entry age actuarial cost method. Significant actuarial assumptions, based on OPERS's latest actuarial review performed as of December 31, 2005, include a rate of return on investments of 6.50%, an annual increase in active employee total payroll of 4.00% compounded annually (assuming no change in the number of active employees) and an additional increase in total payroll of between .50% and 6.30% based on additional annual pay increases. Health care premiums were assumed to increase at the projected wage inflation rate (4.00%) plus an additional factor ranging from .50% to 6.00% for the next nine years. In subsequent years, (10 and beyond) health care costs were assumed to increase at 4.00%.

All investments are carried at market value. For actuarial valuation purposes, a smoothed market approach is used. Under this approach, assets are adjusted to reflect 25% of unrealized market appreciation or depreciation on investment assets annually, not to exceed a 12% corridor.

The number of active contributing participants in the traditional and combined plans was 369,214 as of December 31, 2006. The City's actual employer contributions for 2006 which were used to fund postemployment benefits were \$127,700. The actual contribution and the actuarially required contribution amounts are the same. OPERS's net assets available for payment of benefits at December 31, 2005 (the latest information available) were \$11.1 billion. At December 31, 2005 (the latest information available), the actuarially accrued liability and the unfunded actuarial accrued liability were \$31.3 billion and \$20.2 billion, respectively.

The Health Care Preservation Plan (HCPP) adopted by the OPERS Retirement Board on September 9, 2004, is effective on January 1, 2007. OPERS took additional actions to improve the solvency of the Health care Fund in 2005 by creating a separate investment pool for health care assets. Member and employer contribution rates increased as of January 1, 2006, and January 1, 2007, which will allow additional fund to be allocated to the health care plan.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006

NOTE 15 – POSTEMPLOYMENT BENEFITS – (Continued)

B. Ohio Police and Fire Pension Fund

The Ohio Police and Fire Pension Fund (OP&F) provides postretirement health care coverage to any person who receives or is eligible to receive a monthly service, disability or survivor benefit check or is a spouse or eligible dependent child of such person. An eligible dependent child is any child under the age of 18 whether or not the child is attending school, or under the age of 22 if attending school full-time or on a 2/3 basis.

The health care coverage provided by the retirement system is considered an Other Postemployment Benefit (OPEB) as described in GASB Statement No. 12, "Disclosure of Information on Postemployment Benefits other than Pension Benefits by State and Local Government Employers". The Ohio Revised Code provides the authority allowing the Ohio Police and Fire Pension Fund's board of trustees to provide health care coverage and states that health care costs paid from the funds of OP&F shall be included in the employer's contribution rate. Health care funding and accounting is on a pay-as-you-go basis. The total police employer contribution rate is 19.5% of covered payroll and the total firefighter employer contribution rate is 24% of covered payroll, of which 7.75% of covered payroll was applied to the postemployment health care program during 2005 and 2006. In addition, since July 1, 1992, most retirees have been required to contribute a portion of the cost of their health care coverage through a deduction from their monthly benefit payment. Beginning in 2001, all retirees and survivors have monthly health care contributions.

The City's actual contributions for 2006 that were used to fund postemployment benefits were \$63,275 for police and \$49,773 for firefighters. The OP&F's total health care expense for the year ended December 31, 2005 (the latest information available) was \$108.039 million, which was net of member contributions of \$55.272 million. The number of OP&F participants eligible to receive health care benefits as of December 31, 2005 (the latest information available), was 13,922 for police and 10,537 for firefighters.

NOTE 16 - BUDGETARY BASIS OF ACCOUNTING

While the City is reporting financial position, results of operations and changes in fund balance on the basis of generally accepted accounting principles (GAAP), the budgetary basis as provided by law is based upon accounting for certain transactions on a basis of cash receipts, disbursements and encumbrances. The Statement of Revenues, Expenditures and Changes in Fund Balances - Budget and Actual (Non-GAAP Budgetary Basis) presented for the general fund is presented on the budgetary basis to provide a meaningful comparison of actual results with the budget. The major differences between the budget basis and GAAP basis are as follows:

1. Revenues and other financing sources are recorded when received in cash (budget) as opposed to when susceptible to accrual (GAAP).
2. Expenditures/expenses and other financing uses are recorded when paid in cash (budget) as opposed to when the liability is incurred (GAAP).
3. Encumbrances are treated as expenditures (budget) rather than as a reservation of fund balance (GAAP).
4. Unreported cash represents amounts received but not included as revenue on the budget basis operating statements. These amounts are included as revenue on the GAAP basis operating statement.

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006**

NOTE 16 - BUDGETARY BASIS OF ACCOUNTING – (Continued)

5. Advances-in and advances-out are operating transactions (budget) as opposed to balance sheet transactions (GAAP).

The following table summarizes the adjustments necessary to reconcile the GAAP basis statements (as reported in the fund financial statements) to the budgetary basis statements for the general fund.

Net Change in Fund Balance

	<u>General</u>
Budget basis	\$ (74,832)
Net adjustment for revenue accruals	(157,996)
Net adjustment for expenditure accruals	(38,235)
Adjustment for encumbrances	<u>91,433</u>
GAAP basis	<u>\$ (179,630)</u>

NOTE 17 - CONTINGENCIES

A. Grants

The City receives significant financial assistance from numerous federal and state agencies in the form of grants. The disbursement of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and is subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of the general fund or other applicable funds. However, in the opinion of management, any such disallowed claims will not have a material effect on any of the financial statements of the individual fund types included herein or on the overall financial position of the City at December 31, 2006.

B. Contracts

In the year 2001, the City entered into contracts with AMP-Ohio and is committed to provide and sell power (electricity) at a marginal profit through 2010. If the City would not be able to generate the required power, it may be forced to actually buy power at a higher cost and forced to sell it at a lesser amount.

C. Litigation

The City is currently not involved in litigation that the City's legal counsel anticipates a loss.

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2006**

NOTE 18 - CONTRACTUAL COMMITMENTS

During 2006, the City entered several construction contracts for various projects.

The following is a list of the contracts outstanding at December 31, 2006:

<u>Vendor</u>	<u>Contract Amount</u>	<u>Completed Amount</u>	<u>Outstanding 12/31/06</u>
Village Engineering	\$ 70,700	\$ (46,340)	\$ 24,360
Simonsen Construction	1,603,091	(1,277,679)	325,412
Universal	253,971	(222,376)	31,595
Stanley Miller Construction	3,704,450	(3,127,451)	576,999
GRW	483,000	(450,000)	33,000
Lake Erie Construction	433,370	(423,159)	10,211
R.A. Bores Excavating	<u>118,044</u>	<u>(88,096)</u>	<u>29,948</u>
Total	<u>\$ 6,666,626</u>	<u>\$ (5,635,101)</u>	<u>\$ 1,031,525</u>



Julian & Grube, Inc.
Serving Ohio Local Governments

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**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***

Mayor and Members of Council
City of Shelby
23 W. Main Street
Shelby, Ohio 44875

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Shelby, as of and for the year ended December 31, 2006, which collectively comprise the City of Shelby's basic financial statements and have issued our report thereon dated May 10, 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 Shelby's 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 Shelby's internal control over financial reporting. Accordingly we do not express an opinion on the effectiveness of the City of Shelby's internal control over financial reporting.

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

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 Shelby's internal control.

Our consideration of 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 internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Members of Council and Mayor
City of Shelby

Compliance and Other Matters

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

We noted a certain matter that we reported to the management of the City of Shelby in a separate letter dated May 10, 2007.

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

A handwritten signature in cursive script that reads "Julian & Grube, Inc.".

Julian & Grube, Inc.
May 10, 2007



Mary Taylor, CPA
Auditor of State

CITY OF SHELBY

RICHLAND COUNTY

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

CERTIFIED
JULY 19, 2007