VILLAGE OF KELLEYS ISLAND
ERIE COUNTY

REGULAR AUDIT

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2006

Mary Taylor, CPA
Auditor of State

VILLAGE OF KELLEYS ISLAND
ERIE COUNTY

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Mary Taylor, CPA
Auditor of State

Village of Kelleys Island
Erie County
121 Addison Street, P.O. Box 469
Kelleys Island, Ohio 43438-0469

To the Village Council:

As you are aware, the Auditor of State's Office (AOS) must modify the *Independent Accountants' Report* we provide on your financial statements due to an interpretation from the American Institute of Certified Public Accountants (AICPA). While AOS does not legally require your government to prepare financial statements pursuant to Generally Accepted Accounting Principles (GAAP), the AICPA interpretation requires auditors to formally acknowledge that you did not prepare your financial statements in accordance with GAAP. Our Report includes an adverse opinion relating to GAAP presentation and measurement requirements, but does not imply the amounts the statements present are misstated under the non-GAAP basis you follow. The AOS report also includes an opinion on the financial statements you prepared using the cash basis and financial statement format the AOS permits.

Mary Taylor

Mary Taylor, CPA
Auditor of State

April 8, 2008

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INDEPENDENT ACCOUNTANTS' REPORT

Village of Kelleys Island
Erie County
121 Addison Street, P.O. Box 469
Kelleys Island, Ohio 43438-0469

To the Village Council:

We have audited the accompanying financial statements of the Village of Kelleys Island, Erie County, (the Village) as of and for the years ended December 31, 2006 and 2005. These financial statements are the responsibility of the Village's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 audits to reasonably assure whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

As described more fully in Note 1, the Village has prepared these financial statements using accounting practices the Auditor of State prescribes or permits. These practices differ from accounting principles generally accepted in the United States of America (GAAP). Although we cannot reasonably determine the effects on the financial statements of the variances between these regulatory accounting practices and GAAP, we presume they are material.

Instead of the combined funds the accompanying financial statements present, GAAP require presenting entity wide statements and also presenting the Village's larger (i.e. major) funds separately. While the Village does not follow GAAP, generally accepted auditing standards requires us to include the following paragraph if the statements do not substantially conform to GAAP presentation requirements. The Auditor of State permits, but does not require villages to reformat their statements. The Village has elected not to follow GAAP statement formatting requirements. The following paragraph does not imply the amounts reported are materially misstated under the accounting basis the Auditor of State permits. Our opinion on the fair presentation of the amounts reported pursuant to its non-GAAP basis is in the second following paragraph.

In our opinion, because of the effects of the matter discussed in the preceding two paragraphs, the financial statements referred to above for the years ended December 31, 2006 and 2005, do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Village as of December 31, 2006 and 2005, or its changes in financial position or cash flows, where applicable for the years then ended.

Also, in our opinion, the financial statements referred to above present fairly, in all material respects, the combined fund cash balances and reserves for encumbrances of the Village of Kelleys, Erie County, as of December 31, 2006 and 2005, and its combined cash receipts and disbursements for the years then ended on the accounting basis Note 1 describes.

As described in Note 2, the Village changed the classification of a fund previously classified as a nonexpendable trust fund.

The Village has not presented Management's Discussion and Analysis, which accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the financial statements.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 8, 2008, on our consideration of the Village's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. While we did not opine on the internal control over financial reporting or on compliance, that report describes the scope of our testing of internal control over financial reporting and compliance, and the results of that testing. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*. You should read it in conjunction with this report in assessing the results of our audits.

Mary Taylor

Mary Taylor, CPA
Auditor of State

April 8, 2008

VILLAGE OF KELLEYS ISLAND
ERIE COUNTY

COMBINED STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND CHANGES IN FUND CASH BALANCES ALL GOVERNMENTAL FUND TYPES FOR THE YEAR ENDED DECEMBER 31, 2006

	Governmental Fund Types			
	General	Special Revenue	Capital Projects	Totals (Memorandum Only)
Cash Receipts:				
Property and Local Taxes	$317,599	$155,388		$472,987
Intergovernmental	95,135	90,758	$466,587	652,480
Special Assessments		3,109		3,109
Charges for Services	1,750	15,000		16,750
Fines, Licenses and Permits	64,821	7,490		72,311
Earnings on Investments	61,052	8,714		69,766
Miscellaneous	25,620	1,150	29	26,799
Total Cash Receipts	565,977	281,609	466,616	1,314,202
Cash Disbursements:				
Current:				
Security of Persons and Property	179,942	13,411		193,353
Public Health Services		33,326		33,326
Leisure Time Activities	198			198
Community Environment	13,871			13,871
Transportation	63,784	81,512		145,296
General Government	257,456	2,386		259,842
Debt Service:				
Redemption of Principal		46,238		46,238
Capital Outlay	2,773	195,201	502,288	700,262
Total Cash Disbursements	518,024	372,074	502,288	1,392,386
Total Cash Receipts Over/(Under) Cash Disbursements	47,953	(90,465)	(35,672)	(78,184)
Other Financing Receipts / (Disbursements):				
Transfers-In		1,132		1,132
Transfers-Out	(1,132)			(1,132)
Advances-In			25,500	25,500
Advances-Out	(25,500)			(25,500)
Other Financing Uses	(6)			(6)
Total Other Financing Receipts / (Disbursements)	(26,638)	1,132	25,500	(6)
Excess of Cash Receipts and Other Financing Receipts Over/(Under) Cash Disbursements and Other Financing Disbursements	21,315	(89,333)	(10,172)	(78,190)
Fund Cash Balances, January 1	738,692	683,814	38,088	1,460,594
Fund Cash Balances, December 31	**$760,007**	**$594,481**	**$27,916**	**$1,382,404**
Reserve for Encumbrances, December 31	$37,262	$250,080	$25,000	$312,342

The notes to the financial statements are an integral part of this statement.

VILLAGE OF KELLEYS ISLAND
ERIE COUNTY

COMBINED STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND CHANGES IN FUND CASH BALANCES - ALL PROPRIETARY AND FIDUCIARY FUND TYPES FOR THE YEAR ENDED DECEMBER 31, 2006

	Proprietary Fund Type	Fiduciary Fund Type	
	Enterprise	**Agency**	**Totals (Memorandum Only)**
Operating Cash Receipts:			
Charges for Services	$347,814		$347,814
Miscellaneous	458		458
Total Operating Cash Receipts	348,272		348,272
Operating Cash Disbursements:			
Personal Services	142,906		142,906
Travel Transportation	1,204		1,204
Contractual Services	68,539		68,539
Supplies and Materials	14,007		14,007
Capital Outlay	10,411		10,411
Total Operating Cash Disbursements	237,067		237,067
Operating Income	111,205		111,205
Non-Operating Cash Receipts:			
Intergovernmental	500		500
Special Assessments	35,860		35,860
Earnings on Investments	10,782		10,782
Miscellaneous Receipts	290		290
Other Non-Operating Cash Receipts		$49,176	49,176
Total Non-Operating Cash Receipts	47,432	49,176	96,608
Non-Operating Cash Disbursements:			
Redemption of Principal	97,402		97,402
Other Non-Operating Cash Disbursements		50,582	50,582
Total Non-Operating Cash Disbursements	97,402	50,582	147,984
Excess of Cash Receipts Over/(Under) Cash Disbursements Before Interfund Transfers	61,235	(1,406)	59,829
Transfers-In	19,731		19,731
Transfers-Out	(19,731)		(19,731)
Net Cash Receipts Over/(Under) Cash Disbursements	61,235	(1,406)	59,829
Fund Cash Balances, January 1	189,245	4,860	194,105
Fund Cash Balances, December 31	**$250,480**	**$3,454**	**$253,934**
Reserve for Encumbrances, December 31	$2,973		$2,973

The notes to the financial statements are an integral part of this statement.

VILLAGE OF KELLEYS ISLAND
ERIE COUNTY

COMBINED STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND CHANGES IN FUND CASH BALANCES
ALL GOVERNMENTAL FUND TYPES
FOR THE YEAR ENDED DECEMBER 31, 2005

	Governmental Fund Types			
	General	**Special Revenue**	**Capital Projects**	**Totals (Memorandum Only)**
Cash Receipts:				
Property and Local Taxes	$350,880	$151,708		$502,588
Intergovernmental	126,655	81,794	$40,314	248,763
Special Assessments		2,935		2,935
Charges for Services	250	2,600		2,850
Fines, Licenses and Permits	62,419	8,867		71,286
Earnings on Investments	37,213	5,780		42,993
Miscellaneous	7,188	1,476		8,664
Total Cash Receipts	584,605	255,160	40,314	880,079
Cash Disbursements:				
Current:				
Security of Persons and Property	155,921	8,819		164,740
Public Health Services		36,653		36,653
Leisure Time Activities	911	2,500		3,411
Community Environment	12,867			12,867
Transportation	68,796	60,277		129,073
General Government	262,794	2,624		265,418
Debt Service:				
Redemption of Principal		41,559		41,559
Capital Outlay	6,972	59,995	3,746	70,713
Total Cash Disbursements	508,261	212,427	3,746	724,434
Total Cash Receipts Over Cash Disbursements	76,344	42,733	36,568	155,645
Other Financing Receipts / (Disbursements):				
Transfers-In		393		393
Transfers-Out	(393)			(393)
Advances-In		20,000		20,000
Advances-Out			(20,000)	(20,000)
Other Financing Uses	(80)	(600)		(680)
Total Other Financing Receipts / (Disbursements)	(473)	19,793	(20,000)	(680)
Excess of Cash Receipts and Other Financing Receipts Over Cash Disbursements and Other Financing Disbursements	75,871	62,526	16,568	154,965
Fund Cash Balances, January 1	662,821	621,288	21,520	1,305,629
Fund Cash Balances, December 31	**$738,692**	**$683,814**	**$38,088**	**$1,460,594**
Reserve for Encumbrances, December 31	$2,000	$2,450	$25,000	$29,450

The notes to the financial statements are an integral part of this statement.

VILLAGE OF KELLEYS ISLAND
ERIE COUNTY

COMBINED STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND CHANGES IN FUND CASH BALANCES - ALL PROPRIETARY AND FIDUCIARY FUND TYPES FOR THE YEAR ENDED DECEMBER 31, 2005

	Proprietary Fund Type	Fiduciary Fund Type	
	Enterprise	**Agency**	**Totals (Memorandum Only)**
Operating Cash Receipts:			
Charges for Services	$332,951		$332,951
Total Operating Cash Receipts	332,951		332,951
Operating Cash Disbursements:			
Personal Services	129,537		129,537
Travel Transportation	2,638		2,638
Contractual Services	69,917		69,917
Supplies and Materials	27,328		27,328
Capital Outlay	17,397		17,397
Total Operating Cash Disbursements	246,817		246,817
Operating Income	86,134		86,134
Non-Operating Cash Receipts:			
Intergovernmental	500		500
Special Assessments	35,274		35,274
Earnings on Investments	5,234		5,234
Miscellaneous Receipts		$7,061	7,061
Other Non-Operating Cash Receipts		52,859	52,859
Total Non-Operating Cash Receipts	41,008	59,920	100,928
Non-Operating Cash Disbursements:			
Debt Service	97,461		97,461
Other Non-Operating Cash Disbursements		62,469	62,469
Total Non-Operating Cash Disbursements	97,461	62,469	159,930
Excess of Cash Receipts Over/(Under) Cash Disbursements Before Interfund Transfers	29,681	(2,549)	27,132
Transfers-In	19,731		19,731
Transfers-Out	(19,731)		(19,731)
Net Cash Receipts Over/(Under) Cash Disbursements	29,681	(2,549)	27,132
Fund Cash Balances, January 1	159,564	7,409	166,973
Fund Cash Balances, December 31	**$189,245**	**$4,860**	**$194,105**

The notes to the financial statements are an integral part of this statement.

NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2006 AND 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of the Entity

The constitution and laws of the State of Ohio establish the rights and privileges of the Village of Kelleys, Erie County, (the Village) as a body corporate and politic. A publicly-elected six-member Council directs the Village. The Village provides water and sewer utilities, park operations, and police services. The Village appropriates general fund money to support a volunteer fire department.

The Village participates in Public Entities Pool of Ohio public entity risk pool. Note 9 to the financial statements provides additional information for this entity. These organization provides property and casualty coverage for its members.

The Village's management believes these financial statements present all activities for which the Village is financially accountable.

B. Accounting Basis

These financial statements follow the accounting basis the Auditor of State prescribes or permits. This basis is similar to the cash receipts and disbursements accounting basis. The Village recognizes receipts when received in cash rather than when earned, and recognizes disbursements when paid rather than when a liability is incurred. Budgetary presentations report budgetary expenditures when a commitment is made (i.e., when an encumbrance is approved).

These statements include adequate disclosure of material matters, as the Auditor of State prescribes or permits.

C. Cash and Investments

The Village's accounting basis includes investments as assets. This basis does not record disbursements for investment purchases or receipts for investment sales. This basis records gains or losses at the time of sale as receipts or disbursements, respectively. As of December 31, 2007, the Village had no investments.

D. Fund Accounting

The Village uses fund accounting to segregate cash and investments that are restricted as to use. The Village classifies its funds into the following types:

1. General Fund

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

2. Special Revenue Funds

These funds account for proceeds from specific sources (other than from capital projects, enterprise, or agency funds) that are restricted to expenditure for specific purposes. The Village had the following significant Special Revenue Funds:

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (CONTINUED)

Street Construction, Maintenance and Repair Fund - This fund receives gasoline tax and motor vehicle tax money for constructing, maintaining, and repairing Village streets.

Road Construction Fund – This fund receives tax and special assessment funds for construction and repair of roads within the Village.

Fireman's Levy Fund – This fund receives tax revenue to provide fire protection services for the Village.

3. Capital Project Fund

This fund accounts for receipts restricted to acquiring or constructing major capital projects (except those financed through enterprise funds). The Village had the following significant capital project fund:

Airport Resurfacing Fund – This fund receives grant revenues used for airport improvements.

4. Enterprise Funds

These funds account for operations that are similar to private business enterprises, where management intends to recover the significant costs of providing certain goods or services through user charges. The Village had the following significant Enterprise Fund:

Water Fund - This fund receives charges for services from residents to cover water service costs.

5. Fiduciary Funds

Fiduciary funds include private purpose trust funds and agency funds. Trust funds account for assets held under a trust agreement for individuals, private organizations, or other governments which are not available to support the Village's own programs. The Village has no trust funds.

Agency funds are purely custodial in nature and are used to hold resources for individuals, organizations or other governments. The Village disburses these funds as directed by the individual, organization or other government. The Village's agency fund accounts for the activity of the Mayor's Court.

E. Budgetary Process

The Ohio Revised Code requires that each fund (except certain agency funds) be budgeted annually.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (CONTINUED)

1. Appropriations

Budgetary expenditures (that is, disbursements and encumbrances) may not exceed appropriations at the fund level, except the department level for the General Fund, and appropriations may not exceed estimated resources. The Village Council must annually approve appropriation measures and subsequent amendments. The County Budget Commission must also approve the annual appropriation measure. Unencumbered appropriations lapse at year end.

2. Estimated Resources

Estimated resources include estimates of cash to be received (budgeted receipts) plus unencumbered cash as of January 1. The County Budget Commission must also approve estimated resources.

3. Encumbrances

The Ohio Revised Code requires the Village to reserve (encumber) appropriations when individual commitments are made. Encumbrances outstanding at year end are carried over, and need not be reappropriated.

A summary of 2006 and 2005 budgetary activity appears in Note 4.

F. Property, Plant, and Equipment

The Village records disbursements for acquisitions of property, plant, and equipment when paid. The accompanying financial statements do not report these items as assets.

G. Accumulated Leave

In certain circumstances, such as upon leaving employment, employees are entitled to cash payments for unused leave. The financial statements do not include a liability for unpaid leave.

2. FUND RECLASSIFICATION AND RESTATEMENT OF FUND BALANCES

Changes to fund classifications introduced as part of the changes to the financial reporting model established by GASB Statement No. 34 eliminated expendable trust and nonexpendable trust fund classifications. Beginning in fiscal year 2005, the Village fund previously classified as a nonexpendable trust fund was reclassified to special revenue funds as the Village deemed this classification more appropriate based on the permitted use of these funds. This change in classification had the following effect on fund balances previously reported for the year ended December 31, 2004:

2. FUND RECLASSIFICATION AND RESTATEMENT OF FUND BALANCES – (CONTINUED)

	Special Revenue	Fiduciary Fund
Fund balance December 31, 2004	$564,697	$56,591
Fund reclassification	56,591	(56,591)
Restated fund balance December 31, 2004	$621,288	

3. EQUITY IN POOLED CASH

The Village maintains a cash pool all funds use. The Ohio Revised Code prescribes allowable deposits and investments. The carrying amount of cash at December 31 was as follows:

	2006	2005
Demand deposits	$1,636,338	$1,654,699

Deposits are insured by the Federal Depository Insurance Corporation or collateralized by the financial institution's public entity deposit pool.

4. BUDGETARY ACTIVITY

Budgetary activity for the years ending December 31, 2006 and 2005 follows:

2006 Budgeted vs. Actual Receipts

Fund Type	Budgeted Receipts	Actual Receipts	Variance
General	$540,580	$565,977	$25,397
Special Revenue	404,117	282,741	(121,376)
Capital Projects	804,995	492,116	(312,879)
Enterprise	805,334	415,435	(389,899)
Total	$2,555,026	$1,756,269	($798,757)

2006 Budgeted vs. Actual Budgetary Basis Expenditures

Fund Type	Appropriation Authority	Budgetary Expenditures	Variance
General	$608,600	$581,924	$26,676
Special Revenue	728,467	622,154	106,313
Capital Projects	753,063	527,288	225,775
Enterprise	775,822	357,173	418,649
Total	$2,865,952	$2,088,539	$777,413

4. BUDGETARY ACTIVITY – (CONTINUED)

2005 Budgeted vs. Actual Receipts

Fund Type	Budgeted Receipts	Actual Receipts	Variance
General	$423,084	$584,605	$161,521
Special Revenue	289,033	275,553	(13,480)
Capital Projects	80,000	40,314	(39,686)
Enterprise	294,166	393,690	99,524
Total	$1,086,283	$1,294,162	$207,879

2005 Budgeted vs. Actual Budgetary Basis Expenditures

Fund Type	Appropriation Authority	Budgetary Expenditures	Variance
General	$775,704	$510,734	$264,970
Special Revenue	342,439	215,477	126,962
Capital Projects	140,804	48,746	92,058
Enterprise	389,265	364,009	25,256
Total	$1,648,212	$1,138,966	$509,246

5. RESORT TAXES

The Village levies a resort tax of 1.5 percent on income arising from business activities conducted within the Village. Businesses submit the tax to the Ohio Department of Taxation. The Ohio Department of Taxation remits the tax to the Village monthly.

6. PROPERTY TAX

Real property taxes become a lien on January 1 preceding the October 1 date for which the Council adopted tax rates. The State Board of Tax Equalization adjusts these rates for inflation. Property taxes are also reduced for applicable homestead and rollback deductions. The financial statements include homestead and rollback amounts the State pays as Intergovernmental Receipts. Payments are due to the County by December 31. If the property owner elects to pay semiannually, the first half is due December 31. The second half payment is due the following June 20.

Public utilities are also taxed on personal and real property located within the Village.

Tangible personal property tax is assessed by the property owners, who must file a list of such property to the County by each April 30.

The County is responsible for assessing property, and for billing, collecting, and distributing all property taxes on behalf of the Village.

7. DEBT

Debt outstanding at December 31, 2006 was as follows:

	Principal	Interest Rate
OWDA Water Line Project Loan	$205,342	5.90%
OWDA Water Treatment Plant Loan	931,309	1.50%
USDA Water System Loan	237,300	6.13%
OPWC Road Project Loan	38,471	0.00%
Total	$1,412,422	

The Ohio Water Development Authority (OWDA) loans relate to water system improvements. The Water Line Project Loan was obtained in 1990 and will be repaid in semiannual installments, including interest, over a period of 20 years. The Water Treatment Plant Loan was obtained in 2001 and will be repaid in semiannual installments, including interest, over a period of 30 years. These loans are collateralized by water receipts. The USDA Water System Loan relates to water system improvements for rural development. The loan was obtained in 1990 and will repaid in annual installments of over 40 years. The OPWC Road Project Loan was obtained in 2001 for a road improvement project and will be repaid in semiannual installments over 12 years.

Amortization of the above debt, excluding interest, is scheduled as follows:

Year ending December 31:	OWDA Water Line Project Loan	OWDA Water Treatment Plant Loan	USDA Water System Loan	OPWC Road Project Loan
2007	$10,411	$15,419	$5,200	$4,809
2008	21,436	31,186	5,500	4,809
2009	22,700	31,656	5,800	4,809
2010	24,040	32,133	6,200	4,809
2011	25,459	32,616	6,600	4,809
2012 - 2016	101,296	170,597	39,300	14,426
2017 - 2021		183,834	53,000	
2022 - 2026		198,094	71,300	
2027 - 2031		213,465	44,400	
2032		22,309		
Total	$205,342	$931,309	$237,300	$38,471

8. RETIREMENT SYSTEMS

The Village's full-time Police Officers belong to the Police and Fire Pension Fund (OP&F). Other employees belong to the Ohio Public Employees Retirement System (OPERS). OP&F and OPERS are cost-sharing, multiple-employer plans. The Ohio Revised Code prescribes these plans' benefits, which include postretirement healthcare and survivor and disability benefits.

8. RETIREMENT SYSTEMS – (CONTINUED)

The Ohio Revised Code also prescribes contribution rates. For 2006 and 2005, OP&F participants contributed 10% of their wages. For 2006 and 2005, the Village contributed to OP&F an amount equal to 19.5% of full-time police members' wages. For 2006 and 2005, OPERS members contributed 9 and 8.5%, respectively, of their gross salaries and the Village contributed an amount equaling 13.7 and 13.55%, respectively, of participants' gross salaries. The Village has paid all contributions required through December 31, 2006.

9. RISK MANAGEMENT

Risk Pool Membership

The Village is exposed to various risks of property and casualty losses, and injuries to employees.

The Village insures against injuries to employees through the Ohio Bureau of Worker's Compensation.

The Village belongs to the Public Entities Pool of Ohio (PEP), a risk-sharing pool available to Ohio local governments. PEP provides property and casualty coverage for its members. PEP is a member of the American Public Entity Excess Pool (APEEP). Member governments pay annual contributions to fund PEP. PEP pays judgments, settlements and other expenses resulting from covered claims that exceed the members' deductibles.

<u>Casualty Coverage</u>
For an occurrence prior to January 1, 2006, PEP retains casualty risks up to $250,000 per occurrence, including claim adjustment expenses. PEP pays a percentage of its contributions to APEEP. APEEP reinsures claims exceeding $250,000, up to $1,750,000 per claim and $10,000,000 in the aggregate per year. For an occurrence on or subsequent to January 1, 2006, the Pool retains casualty risk up to $350,000 per occurrence, including loss adjustment expenses. Claims exceeding $350,000 are reinsured with APEEP in an amount not to exceed $2,650,000 for each claim and $10,000,000 in the aggregate per year. Governments can elect up to $10,000,000 in additional coverage with the General Reinsurance Corporation, through contracts with PEP.

If losses exhaust PEP's retained earnings, APEEP provides *excess of funds available* coverage up to $5,000,000 per year, subject to a per-claim limit of $2,000,000 (for claims prior to January 1, 2006) or $3,000,000 (for claims on or after January 1, 2006) as noted above.

<u>Property Coverage</u>
Through 2004, PEP retained property risks, including automobile physical damage, up to $100,000 on any specific loss in any one occurrence. The Travelers Indemnity Company reinsured losses exceeding $100,000 up to $500 million per occurrence.

9. RISK MANAGEMENT – (CONTINUED)

Beginning in 2005, Travelers reinsures specific losses exceeding $250,000 up to $600 million per occurrence. APEEP reinsures members for specific losses exceeding $100,000 up to $250,000 per occurrence, subject to an annual aggregate loss payment. Travelers provides aggregate stop-loss coverage based upon the combined members' total insurable values. If the stop loss is reached by payment of losses between $100,000 and $250,000, Travelers will reinsure specific losses exceeding $100,000 up to their $600 million per occurrence limit. The aggregate stop-loss limit for 2006 was $1,901,127.

The aforementioned casualty and property reinsurance agreements do not discharge PEP's primary liability for claims payments on covered losses. Claims exceeding coverage limits are the obligation of the respective government.

Property and casualty settlements did not exceed insurance coverage for the past three fiscal years.

Financial Position
PEP's financial statements (audited by other accountants) conform with generally accepted accounting principles, and reported the following assets, liabilities and retained earnings at December 31, 2006 and 2005:

Casualty Coverage	2006	2005
Assets	$30,997,868	$29,719,675
Liabilities	(15,875,741)	(15,994,168)
Retained earnings	$15,122,127	$13,725,507

Property Coverage	2006	2005
Assets	$5,125,326	$4,443,332
Liabilities	(863,163)	(1,068,245)
Retained earnings	$4,262,163	$3,375,087

At December 31, 2006 and 2005, respectively, casualty coverage liabilities noted above include approximately $14.4 million and $14.3 million of estimated incurred claims payable. The Casualty Coverage assets and retained earnings above also include approximately $14.4 million and $14.3 million of unpaid claims to be billed to approximately 447 member governments in the future, as of December 31, 2006 and 2005, respectively. These amounts will be included in future contributions from members when the related claims are due for payment. The Village's share of these unpaid claims collectible in future years is approximately $67,296. This payable includes the subsequent year's contribution due if the Village terminates participation, as described in the last paragraph below.

9. RISK MANAGEMENT – (CONTINUED)

Based on discussions with PEP, the expected rates PEP charges to compute member contributions, which are used to pay claims as they become due, are not expected to change significantly from those used to determine the historical contributions detailed below. By contract, the annual liability of each member is limited to the amount of financial contributions required to be made to PEP for each year of membership.

Contributions to PEP	
2004	$34,163
2005	$34,262
2006	$33,648

After completing one year of membership, members may withdraw on each anniversary of the date they joined PEP provided they give written notice to PEP 60 days in advance of the anniversary date. Upon withdrawal, members are eligible for a full or partial refund of their capital contributions, minus the subsequent year's budgetary contribution. Withdrawing members have no other future obligation to the pool. Also upon withdrawal, payments for all casualty claims and claim expenses become the sole responsibility of the withdrawing member, regardless of whether a claim occurred or was reported prior to the withdrawal.

10. CONTINGENT LIABILITIES

Amounts grantor agencies pay to the Village are subject to audit and adjustment by the grantor, principally the federal government. The grantor may require refunding any disallowed costs. Management cannot presently determine amounts grantors may disallow. However, based on prior experience, management believes any refunds would be immaterial.

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INDEPENDENT ACCOUNTANTS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS REQUIRED BY *GOVERNMENT AUDITING STANDARDS*

Village of Kelleys Island
Erie County
121 Addison Street, P.O. Box 469
Kelleys Island, Ohio 43438-0469

To the Village Council:

We have audited the financial statements of the Village of Kelleys Island, Erie County, (the Village) as of and for the years ended December 31, 2006 and 2005, and have issued our report thereon dated April 8, 2008, wherein we noted the Village followed accounting practices the Auditor of State prescribes rather than accounting principles generally accepted in the United States of America and that the Village reclassified its nonexpendable trust fund. We conducted our audits 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*.

Internal Control over Financial Reporting

In planning and performing our audits, we considered the Village's internal control over financial reporting as a basis for designing our audit procedures for expressing our opinion on the financial statements, but not to opine on the effectiveness of the Village's internal control over financial reporting. Accordingly, we have not opined on the effectiveness of the Village's internal control over financial reporting.

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in 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 Village's ability to initiate, authorize, record, process, or report financial data reliably in accordance with its applicable accounting basis, such that there is more than a remote likelihood that the Village's internal control will not prevent or detect a more-than-inconsequential financial statement misstatement.

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We consider the following deficiency described in the accompanying schedule of findings to be a significant deficiency in internal control over financial reporting: 2006-001.

A material weakness is a significant deficiency, or combination of significant deficiencies resulting in more than a remote likelihood that the Village's internal control will not prevent or detect a material financial statement misstatement.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and accordingly, would not necessarily disclose all significant deficiencies that are also material weaknesses. We believe the significant deficiency described above is not a material weakness.

We also noted a certain internal control matter that we reported to the Village's management in a separate letter dated April 8, 2008.

Compliance and Other Matters

As part of reasonably assuring whether the Village's financial statements are free of material misstatement, we tested its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could directly and materially affect the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audits and accordingly, we do not express an opinion. The results of our tests disclosed no instances of noncompliance or other matters we must report under *Government Auditing Standards*.

We did note certain noncompliance that we reported to the Village's management in a separate letter dated April 8, 2008.

We intend this report solely for the information and use of the audit committee, management, and Village Council. We intend it for no one other than these specified parties.

Mary Taylor

Mary Taylor, CPA
Auditor of State

April 8, 2008

**SCHEDULE OF FINDINGS
DECEMBER 31, 2006 AND 2005**

**FINDINGS RELATED TO THE FINANCIAL STATEMENTS
REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS**

FINDING NUMBER 2006-001

Significant Deficiency

Federal Grants Management

A review of the records maintained for federal grants received from the Federal Aviation Administration identified the following deficiencies:

- Copies of approved grant agreements were not retained on file;
- Documentation included in voucher packs did not contain documentation that would identify the federal program to which the expenditure applies;
- Various federal grants were commingled within the same fund without a method for differentiating activity for the various grants from one another.

Grant agreements provide the specific authorized use of grant funds. The failure to maintain these agreements on file results in a lack of documentation that can be reviewed to ascertain whether or not the expenditure is permissible under the grant requirements. The lack of documentation regarding which federal program an expenditure pertains to along with commingling grant funds results in the inability to ascertain if a specific transaction is permissible under the applicable grant and the inability to determine expenditures to be reported on financial reports submitted to the grantor.

The Village should maintain copies of all grant agreements on file. Vouchers should specifically identify the grant to which the disbursement applies. The Village should also consider creating separate funds to account for each grant or establishing separate program codes within individual funds to segregate grant activity.

Officials Response:

Officials chose not to respond.

Mary Taylor, CPA
Auditor of State

VILLAGE OF KELLEYS ISLAND

ERIE 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
MAY 1, 2008

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