

CITY OF SHELBY
BASIC
FINANCIAL STATEMENTS
FOR THE YEAR ENDED
DECEMBER 31, 2005

LARRY PAXTON, FINANCE DIRECTOR



**Auditor of State
Betty Montgomery**

Mayor and 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 and Grube, Inc., for the audit period January 1, 2005 through December 31, 2005. 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.

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BETTY MONTGOMERY
Auditor of State

August 21, 2006

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CITY OF SHELBY, OHIO
BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

TABLE OF CONTENTS

Independent Auditors' Report	1 - 2
Management's Discussion and Analysis	3 - 13
Basic Financial Statements:	
Government-Wide Financial Statements:	
Statement of Net Assets	14
Statement of Activities.....	15 - 16
Fund Financial Statements:	
Balance Sheet - Governmental Funds	17
Reconciliation of Total Governmental Fund Balances to Net Assets of Governmental Activities.....	18
Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds	19
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities.....	20
Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual (Non GAAP Budgetary Basis) - General Fund.....	21
Statement of Net Assets - Proprietary Funds	22
Statement of Revenues, Expenses and Changes in Net Assets - Proprietary Funds	23
Statement of Cash Flows - Proprietary Funds.....	24 - 25
Statement of Fiduciary Net Assets - Fiduciary Fund	26
Notes to the Basic Financial Statements	27 - 54
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	55 - 56



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, 2005, 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, 2005, 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 April 28, 2006 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
Page 2

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.
April 28, 2006

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005 UNAUDITED

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, 2005. 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 2005 are as follows:

- The total net assets of the City increased \$1,923,441. Net assets of governmental activities decreased \$387,354 or 1.91% from fiscal year 2004. Net assets of business-type activities increased \$2,310,795 or 11.14% from fiscal year 2004.
- General revenues accounted for \$4,580,533 or 73.43% of total governmental activities revenue. Program specific revenues accounted for \$1,657,297 or 26.57% of total governmental activities revenue.
- Governmental activities capital assets, net decreased \$149,481.
- The City had \$5,854,803 in expenses related to governmental activities; \$1,657,297 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 \$4,580,533 were not adequate to provide for these programs.
- The general fund, the City's only major governmental fund, had revenues \$4,057,588 in 2005. This represents an increase of \$590,176 or 17.02% from 2004 revenues. The expenditures and other financing uses of the general fund, which totaled \$3,561,799 in 2005, increased \$173,981 from 2004. Also, the general fund's operating transfers out decreased by \$67,744 in 2005. The fund balance in the general fund increased \$495,789 to \$1,034,349 in 2005.
- Net assets for the business-type activities, which are made up of the Water, Sewer and Electric enterprise funds, increased in 2005 by \$2,310,795 or 11.14%. This increase in net assets was due primarily to increased revenues in the water, sewer and electric funds.
- In the general fund, the actual revenues and other financing sources came in \$316,980 higher than they were in the original budget and actual expenditures and other financing uses were \$88,321 less than the amount in the original budget. The general fund maintained a positive variance of \$313,080 in revenues and a positive variance of \$92,221 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, 2005 UNAUDITED

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 2005?" 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, 2005 UNAUDITED

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 funds, which were 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 – 54 of this report.

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005
UNAUDITED

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 2005 compared to 2004.

	Governmental Activities		Business-Type Activities		Total	
	2005	2004	2005	2004	2005	2004
<u>Assets</u>						
Current and other assets	\$ 6,419,613	\$ 6,692,162	\$12,580,758	\$ 8,636,442	\$19,000,371	\$ 15,328,604
Capital assets	15,534,856	15,687,337	18,753,882	16,619,051	34,288,738	32,306,388
Total assets	21,954,469	22,379,499	31,334,640	25,255,493	53,289,109	47,634,992
<u>Liabilities</u>						
Long-term liabilities						
outstanding	671,526	619,912	658,673	447,679	1,330,199	1,067,591
Other liabilities	1,377,816	1,467,106	7,625,280	4,067,922	9,003,096	5,535,028
Total liabilities	2,049,342	2,087,018	8,283,953	4,515,601	10,333,295	6,602,619
<u>Net Assets</u>						
Invested in capital assets, net of related debt	15,202,999	15,458,711	15,911,025	13,282,051	31,114,024	28,740,762
Restricted	3,552,405	4,420,121	-	-	3,552,405	4,420,121
Unrestricted	1,149,723	413,649	7,139,662	7,457,841	8,289,385	7,871,490
Total net assets	\$ 19,905,127	\$20,292,481	\$23,050,687	\$ 20,739,892	\$42,955,814	\$ 41,032,373

Over time, net assets can serve as a useful indicator of a government's financial position. At December 31, 2005, the City's assets exceeded liabilities by \$42,955,814. At year-end, net assets were \$19,905,127 and \$23,050,687 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 64.34% 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, 2005, were \$15,202,999 and \$15,911,025 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, 2005, 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, \$3,552,405 or 8.27%, 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 \$1,149,723 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, 2005
UNAUDITED

The table below shows the comparative analysis of changes in net assets for fiscal year 2005 compared to 2004.

Change in Net Assets

	Governmental Activities		Business-Type Activities		Total	
	2005	2004	2005	2004	2005	2004
Revenues						
Program revenues:						
Charges for services and sales	\$ 778,943	\$ 652,196	\$ 14,665,113	\$ 13,241,300	\$ 15,444,056	\$ 13,893,496
Operating grants and contributions	873,445	1,080,602	-	-	873,445	1,080,602
Capital grants and contributions	4,909	41,981	116,297	-	121,206	41,981
General revenues:						
Property taxes	1,264,975	1,211,426	-	-	1,264,975	1,211,426
Income taxes	2,239,110	1,953,819	-	-	2,239,110	1,953,819
Excise taxes	-	-	444,389	431,462	444,389	431,462
Unrestricted grants	706,056	632,748	-	-	706,056	632,748
Interest	122,958	52,186	11,945	3,117	134,903	55,303
Other	247,434	73,965	179,643	-	427,077	73,965
Total revenues	<u>6,237,830</u>	<u>5,698,923</u>	<u>15,417,387</u>	<u>13,675,879</u>	<u>21,655,217</u>	<u>19,374,802</u>
Expenses:						
General government	1,221,217	1,168,902	-	-	1,221,217	1,168,902
Security of persons and property	2,670,160	2,728,909	-	-	2,670,160	2,728,909
Public health and welfare	484,522	346,791	-	-	484,522	346,791
Transportation	931,650	1,014,300	-	-	931,650	1,014,300
Community environment	471,414	666,562	-	-	471,414	666,562
Leisure time activity	67,966	64,556	-	-	67,966	64,556
Other	-	327	-	-	-	327
Interest and fiscal charges	7,874	4,863	-	-	7,874	4,863
Sewer	-	-	1,089,446	971,822	1,089,446	971,822
Water	-	-	1,906,661	1,347,692	1,906,661	1,347,692
Electric	-	-	10,880,866	10,447,184	10,880,866	10,447,184
Total expenses	<u>5,854,803</u>	<u>5,995,210</u>	<u>13,876,973</u>	<u>12,766,698</u>	<u>19,731,776</u>	<u>18,761,908</u>
Increase (decrease) in net assets before transfers	383,027	(296,287)	1,540,414	909,181	1,923,441	612,894
Transfers	<u>(770,381)</u>	<u>-</u>	<u>770,381</u>	<u>-</u>	<u>-</u>	<u>-</u>
Change in net assets	(387,354)	(296,287)	2,310,795	909,181	1,923,441	612,894
Net assets at beginning of year	<u>20,292,481</u>	<u>20,588,768</u>	<u>20,739,892</u>	<u>19,830,711</u>	<u>41,032,373</u>	<u>40,419,479</u>
Net assets at end of year	<u>\$ 19,905,127</u>	<u>\$20,292,481</u>	<u>\$ 23,050,687</u>	<u>\$ 20,739,892</u>	<u>\$ 42,955,814</u>	<u>\$ 41,032,373</u>

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005
UNAUDITED

Governmental Activities

Governmental activities net assets decreased \$387,354 in 2005. 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 \$2,670,160 or 45.61% of total expenses of the City. These expenses were partially funded by \$285,469 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 \$1,221,217 or 20.86% of total expenses. General government expenses were partially funded by \$413,650 in direct charges to users of the services.

The state and federal government contributed to the City a total of \$873,445 in operating grants and contributions and \$4,909 in capital grants and contributions. These revenues are restricted to a particular program or purpose. Of the total operating grants and contributions \$582,287, or 66.67%, subsidized transportation programs.

General revenues totaled \$4,580,533, and amounted to 73.43% of total revenues. These revenues primarily consist of property and income tax revenue of \$3,504,085, or 76.50% 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 \$706,056 or 15.41% 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 2005 compared to 2004. That is, it identifies the cost of these services supported by tax revenue and unrestricted state grants and entitlements.

Governmental Activities

	2005		2004	
	Total Cost of Services	Net Cost of Services	Total Cost of Services	Net Cost of Services
Expenses:				
General government	\$ 1,221,217	\$ 806,283	\$ 1,168,902	\$ 844,269
Security of persons and property	2,670,160	2,366,654	2,728,909	2,411,149
Public health and welfare	484,522	413,192	346,791	276,472
Transportation	931,650	349,363	1,014,300	463,152
Community environment	471,414	205,316	666,562	176,943
Leisure time activity	67,966	48,824	64,556	43,256
Other	-	-	327	327
Interest and fiscal charges	7,874	7,874	4,863	4,863
Total expenses	\$ 5,854,803	\$ 4,197,506	\$ 5,995,210	\$ 4,220,431

The dependence upon general revenues for governmental activities is apparent, with 71.69% and 70.40% of expenses supported through taxes and other general revenues during 2005 and 2004, respectively.

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005
UNAUDITED

Business-Type Activities

Business-type activities include the Sewer, Water and Electric enterprise funds. These programs had program revenues of \$14,781,410, general revenues of \$635,977 and expenses of \$13,876,973 for fiscal year 2005.

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 \$4,351,496 which is \$273,533 below last year's total of \$4,625,029. The schedule below indicates the fund balances and the total change in fund balances as of December 31, 2005 for all major and nonmajor governmental funds.

	<u>Fund Balance</u> <u>December 31, 2005</u>	<u>Fund Balance</u> <u>December 31, 2004</u>	<u>Increase</u> <u>(Decrease)</u>
Major Funds:			
General	\$ 1,034,349	\$ 538,560	\$ 495,789
Other Nonmajor Governmental Funds	<u>3,317,147</u>	<u>4,086,469</u>	<u>(769,322)</u>
Total	<u>\$ 4,351,496</u>	<u>\$ 4,625,029</u>	<u>\$ (273,533)</u>

General Fund

The City's general fund balance increased \$495,789, due to a slight increase in revenues. The table that follows assists in illustrating the financial activities and fund balances of the general fund.

	<u>2005</u>	<u>2004</u>	<u>Percent</u> <u>Change</u>
Revenues			
Taxes	\$ 2,556,117	\$ 2,237,805	14.22 %
Charges for services	359,000	312,000	15.06 %
Licenses and permits	39,316	11,733	235.09 %
Fines and forfeitures	209,530	185,268	13.10 %
Investment income	100,849	42,424	137.72 %
Intergovernmental	761,055	651,979	16.73 %
Other revenues	<u>31,721</u>	<u>26,203</u>	21.06 %
Total	<u>\$ 4,057,588</u>	<u>\$ 3,467,412</u>	17.02 %

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005
UNAUDITED

	<u>2005</u>	<u>2004</u>	<u>Percentage Change</u>
Expenditures			
General government	\$ 1,018,277	\$ 945,694	7.68 %
Security of persons and property	2,301,478	2,158,096	6.64 %
Transportation	<u>25,860</u>	<u>-</u>	100.00 %
Total	<u>\$ 3,345,615</u>	<u>\$ 3,103,790</u>	7.79 %

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 and other financing sources of \$3,815,428 were higher than final budgeted revenues and other financing sources by \$313,080. The other significant change was between the final budgeted expenditures and actual expenditures. Actual expenditures came in \$92,221 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 \$1,625,736 in 2005. This represents an increase of \$72,527 from 2004 operating revenues. The operating expenses of the water fund, which totaled \$1,945,703 in 2005, increased \$607,611 from 2004. The increase in net assets for the water fund was \$568,335 or 8.38%.

Sewer Fund

The sewer fund had operating revenues of \$1,290,120 in 2005. This represents an increase of \$314,557 from 2004 operating revenues. The operating expenses of the sewer fund, which totaled \$1,116,885 in 2005, increased \$151,866 from 2004. The increase in net assets for the sewer fund was \$172,093 or 2.99%.

Electric Fund

The electric fund had operating revenues of \$11,928,900 in 2005. This represents an increase of \$1,216,372 from 2004 operating revenues. The operating expenses of the electric fund, which totaled \$10,350,374 in 2005, increased \$482,850 from 2004. The increase in net assets for the electric fund was \$1,416,762 or 17.20%.

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005
UNAUDITED

Capital Assets and Debt Administration

Capital Assets

At the end of fiscal 2005, the City had \$34,288,738 (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, \$15,534,856 was reported in governmental activities and \$18,753,882 was reported in business-type activities. The following table shows fiscal 2005 balances compared to 2004:

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

	Governmental Activities		Business-Type Activities		Total	
	2005	2004	2005	2004	2005	2004
Land	\$ 206,050	\$ 206,050	\$ 233,440	\$ 233,440	\$ 439,490	\$ 439,490
Land improvements	172,679	180,372	184,086	209,333	356,765	389,705
Buildings and improvements	813,865	820,852	3,462,718	3,493,195	4,276,583	4,314,047
Furniture, fixtures and equipment	687,754	644,028	5,301,589	5,438,113	5,989,343	6,082,141
Vehicles	502,775	628,299	83,735	112,171	586,510	740,470
Infrastructure	12,975,340	12,887,514	7,249,820	7,045,799	20,225,160	19,933,313
Construction in progress	176,393	317,222	2,238,494	87,000	2,414,887	404,222
Increase in net assets	<u>\$ 15,534,856</u>	<u>\$ 15,684,337</u>	<u>\$ 18,753,882</u>	<u>\$ 16,619,051</u>	<u>\$ 34,288,738</u>	<u>\$ 32,303,388</u>

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

Debt Administration

At December 31, 2005 the City had \$143,554 in special assessment bonds and OPWC notes of \$188,303 outstanding. Of this total, \$64,707 is due within one year and \$267,150 is due within greater than one year. The following table is a comparison of the bonds and notes outstanding.

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005
UNAUDITED

Outstanding Debt, at Year End

	Governmental Activities <u>2005</u>	Governmental Activities <u>2004</u>
Long-Term Obligations:		
<u>Special Assessment Bonds:</u>		
Street Improvement	\$ 143,554	\$ 101,426
Total Special Assessment Bonds	<u>143,554</u>	<u>101,426</u>
<u>OPWC Notes:</u>		
Wareham Road	178,695	194,940
Auburn Street	<u>9,608</u>	<u>19,215</u>
Total OPWC Notes	<u>188,303</u>	<u>214,155</u>
Total	<u>\$ 331,857</u>	<u>\$ 315,581</u>
	Business-Type Activities <u>2005</u>	Business-Type Activities <u>2004</u>
OPWC Note:		
Wastewater Treatment Plant	<u>\$ 342,857</u>	<u>\$ 87,000</u>

The City has one special assessment bond outstanding at December 31, 2005 in the amount of \$143,554. 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 annual interest rate of 3.10% and mature on December 1, 2008. 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 three Ohio Public Works Commission (OPWC) notes outstanding at December 31, 2005 in the amount of \$188,303 in governmental activities and \$342,857 in business-type activities. On July 1, 1997, the City issued \$96,073 in OPWC notes to finance the Auburn Street Storm Sewer Replacement Project. These notes are scheduled to retire on January 1, 2007. The City issued \$394,200 in OPWC notes on July 7, 1997 to finance the Wareham Road Area Storm Sewer Replacement Project. These notes are scheduled to mature on July 1, 2016. During 2003, the City received \$20,435, in OPWC notes 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 notes are interest free.

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 2005 the City of Shelby saw the enhancement of North Central State College with Integrated Systems and Engineering & Industrial Technologies Programs.

CITY OF SHELBY, OHIO

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005 UNAUDITED

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; hopefully the voters accept this proposal.

In 2005 the City continued the process of compiling with environmental requirements by planning for the modernization of its water and waste water treatment facilities as well as an additional electric transmission line for the City's electricity customers. The City looks forward to the completion of these projects in 2006. Unfortunately also as a part of these projects the City enterprise funds have incur substantial debt that will not be paid of for several years.

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 Larry Paxton, Finance Director, 23 W. Main Street, Shelby, Ohio, 44875.

**BASIC
FINANCIAL STATEMENTS**

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CITY OF SHELBY, OHIO

STATEMENT OF NET ASSETS
DECEMBER 31, 2005

	<u>Governmental</u> <u>Activities</u>	<u>Business-type</u> <u>Activities</u>	<u>Total</u>
Assets:			
Equity in pooled cash and cash equivalents.	\$ 3,997,540	\$ 5,319,958	\$ 9,317,498
Cash with fiscal agent	-	4,000,000	4,000,000
Receivables (net of allowances for uncollectibles):			
Income taxes	808,186	-	808,186
Real and other taxes	929,554	-	929,554
Accounts	-	1,645,613	1,645,613
Special assessments	15,666	-	15,666
Accrued interest	1,955	9,804	11,759
Internal balances	(122,224)	122,224	-
Due from other governments	600,056	44,653	644,709
Prepayments.	51,043	307,890	358,933
Materials and supplies inventory.	137,837	293,894	431,731
Investment in joint venture.	-	836,722	836,722
Capital assets:			
Land and construction in progress.	382,443	2,471,934	2,854,377
Depreciable capital assets, net	<u>15,152,413</u>	<u>16,281,948</u>	<u>31,434,361</u>
Total capital assets.	<u>15,534,856</u>	<u>18,753,882</u>	<u>34,288,738</u>
Total assets.	<u>21,954,469</u>	<u>31,334,640</u>	<u>53,289,109</u>
Liabilities:			
Accounts payable.	53,389	675,677	729,066
Contracts payable.	59,710	320,946	380,656
Accrued wages and benefits	59,868	39,292	99,160
Due to other governments	158,427	51,077	209,504
Deferred revenue.	867,000	-	867,000
Accrued interest payable.	418	38,288	38,706
Claims payable.	179,004	-	179,004
Note payable.	-	6,500,000	6,500,000
Long-term liabilities:			
Due within one year.	132,940	136,922	269,862
Due in more than one year	<u>538,586</u>	<u>521,751</u>	<u>1,060,337</u>
Total liabilities	<u>2,049,342</u>	<u>8,283,953</u>	<u>10,333,295</u>
Net assets:			
Invested in capital assets, net of related debt	15,202,999	15,911,025	31,114,024
Restricted for:			
Capital projects.	1,557,108	-	1,557,108
Debt service	897,228	-	897,228
Human services programs	170,031	-	170,031
Community development projects	375,069	-	375,069
Security of persons and property	98,914	-	98,914
Street maintenance, construction and repair	440,760	-	440,760
Other purposes	13,295	-	13,295
Unrestricted.	<u>1,149,723</u>	<u>7,139,662</u>	<u>8,289,385</u>
Total net assets	<u>\$ 19,905,127</u>	<u>\$ 23,050,687</u>	<u>\$ 42,955,814</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF SHELBY, OHIO

STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005

	Program Revenues			
	Expenses	Charges for Services	Operating and Contributions	Capital Grants and Contributions
Governmental Activities:				
General government	\$ 1,221,217	\$ 413,650	\$ 1,284	\$ -
Security of persons and property.	2,670,160	285,469	13,128	4,909
Public health and welfare	484,522	37,197	34,133	-
Transportation	931,650	-	582,287	-
Community environment.	471,414	29,040	237,058	-
Leisure time activity.	67,966	13,587	5,555	-
Interest and fiscal charges.	7,874	-	-	-
Total governmental activities	<u>5,854,803</u>	<u>778,943</u>	<u>873,445</u>	<u>4,909</u>
Business-Type Activities:				
Sewer	1,089,446	1,283,515	-	-
Water	1,906,661	1,601,411	-	116,297
Electric	10,880,866	11,780,187	-	-
Total business-type activities	<u>13,876,973</u>	<u>14,665,113</u>	<u>-</u>	<u>116,297</u>
Total primary government.	<u>\$ 19,731,776</u>	<u>\$ 15,444,056</u>	<u>\$ 873,445</u>	<u>\$ 121,206</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
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
\$ (806,283)	\$ -	\$ (806,283)
(2,366,654)	-	(2,366,654)
(413,192)	-	(413,192)
(349,363)	-	(349,363)
(205,316)	-	(205,316)
(48,824)	-	(48,824)
(7,874)	-	(7,874)
<u>(4,197,506)</u>	<u>-</u>	<u>(4,197,506)</u>
-	194,069	194,069
-	(188,953)	(188,953)
-	899,321	899,321
<u>-</u>	<u>904,437</u>	<u>904,437</u>
<u>(4,197,506)</u>	<u>904,437</u>	<u>(3,293,069)</u>
732,225	-	732,225
532,750	-	532,750
1,830,528	-	1,830,528
170,595	-	170,595
237,987	-	237,987
-	444,389	444,389
706,056	-	706,056
122,958	11,945	134,903
247,434	179,643	427,077
<u>4,580,533</u>	<u>635,977</u>	<u>5,216,510</u>
<u>(770,381)</u>	<u>770,381</u>	<u>-</u>
(387,354)	2,310,795	1,923,441
<u>20,292,481</u>	<u>20,739,892</u>	<u>41,032,373</u>
<u>\$ 19,905,127</u>	<u>\$ 23,050,687</u>	<u>\$ 42,955,814</u>

CITY OF SHELBY, OHIO

BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2005

	<u>General</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Assets:			
Equity in pooled cash and cash equivalents	\$ 488,575	\$ 3,031,993	\$ 3,520,568
Receivables (net of allowance for uncollectibles):			
Income taxes.	404,093	404,093	808,186
Real and other taxes.	343,088	586,466	929,554
Accrued interest	1,533	422	1,955
Special assessments.	15,666	-	15,666
Due from other governments	390,476	209,580	600,056
Prepayments.	36,420	14,623	51,043
Materials and supplies inventory	26,934	110,903	137,837
Total assets	<u>\$ 1,706,785</u>	<u>\$ 4,358,080</u>	<u>\$ 6,064,865</u>
Liabilities:			
Accounts payable	\$ 21,001	\$ 32,388	\$ 53,389
Contracts payable.	-	59,710	59,710
Accrued wages and benefits payable	38,960	20,908	59,868
Compensated absences	13,997	-	13,997
Due to other governments.	52,045	106,382	158,427
Deferred revenue	546,433	821,545	1,367,978
Total liabilities	<u>672,436</u>	<u>1,040,933</u>	<u>1,713,369</u>
Fund Balances:			
Reserved for encumbrances.	67,148	819,969	887,117
Reserved for prepayments	36,420	14,623	51,043
Reserved for materials and supplies inventory	26,934	110,903	137,837
Reserved for debt service.	-	881,980	881,980
Unreserved, undesignated, reported in:			
General fund.	903,847	-	903,847
Special revenue funds.	-	710,866	710,866
Capital projects funds.	-	778,806	778,806
Total fund balances	<u>1,034,349</u>	<u>3,317,147</u>	<u>4,351,496</u>
Total liabilities and fund balances.	<u>\$ 1,706,785</u>	<u>\$ 4,358,080</u>	<u>\$ 6,064,865</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, 2005

Total governmental fund balances		\$ 4,351,496
<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.		15,534,856
Other long-term assets are not available to pay for current period expenditures and therefore are deferred in the funds.		
Property taxes	\$ 62,554	
Income tax	202,782	
Special assessments	15,666	
Intergovernmental revenues	218,021	
Interest	<u>1,955</u>	
Total		500,978
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 \$122,224, are:		175,744
In the statement of activities interest is accrued on outstanding bonds, whereas in governmental funds, interest expenditures are reported when due.		(418)
Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds.		
Street improvement bonds	(143,554)	
OPWC notes	(188,303)	
Compensated absences	<u>(325,672)</u>	
Total		<u>(657,529)</u>
Net assets of governmental activities		<u><u>\$ 19,905,127</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, 2005

	<u>General</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Revenues:			
Municipal income taxes	\$ 1,830,230	\$ 408,282	\$ 2,238,512
Property and other taxes	725,887	523,946	1,249,833
Charges for services	359,000	114,627	473,627
Licenses and permits	39,316	37,197	76,513
Fines and forfeitures	209,530	18,373	227,903
Intergovernmental	761,055	880,898	1,641,953
Special assessments	-	96,907	96,907
Investment income	100,849	14,840	115,689
Rental income	-	900	900
Other	31,721	103,314	135,035
Total revenues	<u>4,057,588</u>	<u>2,199,284</u>	<u>6,256,872</u>
Expenditures:			
Current:			
General government	1,018,277	193,345	1,211,622
Security of persons and property	2,301,478	307,023	2,608,501
Public health and welfare	-	339,848	339,848
Transportation	25,860	652,016	677,876
Community environment	-	427,107	427,107
Leisure time activity	-	63,284	63,284
Capital outlay	-	1,210,664	1,210,664
Debt service:			
Principal retirement	-	51,209	51,209
Interest and fiscal charges	-	7,779	7,779
Total expenditures	<u>3,345,615</u>	<u>3,252,275</u>	<u>6,597,890</u>
Excess (deficiency) of revenues over (under) expenditures	<u>711,973</u>	<u>(1,052,991)</u>	<u>(341,018)</u>
Other financing sources (uses):			
Bond issuance	-	67,485	67,485
Transfers in	-	216,184	216,184
Transfers out	(216,184)	-	(216,184)
Total other financing sources (uses)	<u>(216,184)</u>	<u>283,669</u>	<u>67,485</u>
Net change in fund balances	495,789	(769,322)	(273,533)
Fund balances at beginning of year	<u>538,560</u>	<u>4,086,469</u>	<u>4,625,029</u>
Fund balances at end of year	<u>\$ 1,034,349</u>	<u>\$ 3,317,147</u>	<u>\$ 4,351,496</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, 2005

Net change in fund balances - total governmental funds \$ (273,533)

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	\$	590,457	
Current year depreciation		<u>(739,938)</u>	(149,481)

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

Income taxes		598	
Property and other taxes		15,142	
Intergovernmental		(57,543)	
Special assessments		15,492	
Accrued interest		<u>1,955</u>	(24,356)

The bond issuance is recorded as revenue in the funds, however on the statement of activities, it is not reported as revenue as it increases the liabilities on the statement of net assets. (67,485)

Repayment of bond and note principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. 51,209

In the statement of activities, interest is accrued on outstanding bonds, whereas in governmental funds, an interest expenditure is reported when due. (95)

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. (25,504)

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 the internal service fund, including internal balances is allocated among the governmental activities. 101,891

Change in net assets of governmental activities. \$ (387,354)

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, 2005

	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variance with Final Budget Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
Revenues:				
Income taxes	\$ 1,559,283	\$ 1,563,183	\$ 1,681,018	\$ 117,835
Property and other taxes	708,775	708,775	714,452	5,677
Charges for services	359,000	359,000	359,000	-
Licenses and permits.	11,940	11,940	39,316	27,376
Fines and forfeitures.	184,900	184,900	209,530	24,630
Intergovernmental	606,050	606,050	667,986	61,936
Investment income	42,000	42,000	100,970	58,970
Other	26,500	26,500	43,156	16,656
Total revenues.	<u>3,498,448</u>	<u>3,502,348</u>	<u>3,815,428</u>	<u>313,080</u>
Expenditures:				
Current:				
General government	1,062,154	1,064,453	1,034,735	29,718
Security of persons and property	2,438,046	2,438,159	2,375,980	62,179
Transportation	27,500	29,088	28,764	324
Total expenditures	<u>3,527,700</u>	<u>3,531,700</u>	<u>3,439,479</u>	<u>92,221</u>
Excess of revenues over (under) expenditures	<u>(29,252)</u>	<u>(29,352)</u>	<u>375,949</u>	<u>405,301</u>
Other financing uses:				
Transfers out	<u>(216,284)</u>	<u>(216,184)</u>	<u>(216,184)</u>	<u>-</u>
Total other financing uses.	<u>(216,284)</u>	<u>(216,184)</u>	<u>(216,184)</u>	<u>-</u>
Net change in fund balance	(245,536)	(245,536)	159,765	405,301
Fund balance at beginning of year	174,286	174,286	174,286	-
Prior year encumbrances appropriated	<u>71,250</u>	<u>71,250</u>	<u>71,250</u>	<u>-</u>
Fund balance at end of year.	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 405,301</u>	<u>\$ 405,301</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF SHELBY, OHIO

STATEMENT OF NET ASSETS
 PROPRIETARY FUNDS
 DECEMBER 31,2005

	Business Type Activities - Enterprise Funds				Governmental
	Sewer	Water	Electric	Total	Activities - Internal Service Fund
Assets:					
Current Assets:					
Equity in pooled cash and cash equivalents	\$ 731,484	\$ 873,625	\$ 3,714,849	\$ 5,319,958	\$ 476,972
Cash with fiscal agent	-	-	4,000,000	4,000,000	-
Receivables (net of allowance for uncollectibles)					
Accounts	115,193	246,842	1,283,578	1,645,613	-
Accrued interest.	-	-	9,804	9,804	-
Due from other governments	-	-	44,653	44,653	-
Prepayments.	11,301	20,626	275,963	307,890	-
Materials and supplies inventory	24,918	89,104	179,872	293,894	-
Total current assets	<u>882,896</u>	<u>1,230,197</u>	<u>9,508,719</u>	<u>11,621,812</u>	<u>476,972</u>
Noncurrent Assets:					
Investment in joint venture	-	-	836,722	836,722	-
Capital assets:					
Land and construction in progress	317,250	1,959,145	195,539	2,471,934	-
Depreciable capital assets, net	5,147,160	4,611,852	6,522,936	16,281,948	-
Total capital assets	<u>5,464,410</u>	<u>6,570,997</u>	<u>6,718,475</u>	<u>18,753,882</u>	<u>-</u>
Total noncurrent assets	<u>5,464,410</u>	<u>6,570,997</u>	<u>7,555,197</u>	<u>19,590,604</u>	<u>-</u>
Total assets	<u>6,347,306</u>	<u>7,801,194</u>	<u>17,063,916</u>	<u>31,212,416</u>	<u>476,972</u>
Liabilities:					
Current Liabilities:					
Accounts payable.	5,705	18,747	651,225	675,677	-
Contracts payable.	-	320,946	-	320,946	-
Accrued wages and benefits	6,753	9,422	23,117	39,292	-
Due to other governments	7,856	12,031	31,190	51,077	-
Claims payable.	-	-	-	-	179,004
Accrued interest payable.	-	-	38,288	38,288	-
Note payable.	-	-	6,500,000	6,500,000	-
Current portion of OPWC loans.	57,143	-	-	57,143	-
Current portion of compensated absences	12,473	25,030	42,276	79,779	-
Total current liabilities.	<u>89,930</u>	<u>386,176</u>	<u>7,286,096</u>	<u>7,762,202</u>	<u>179,004</u>
Long-term liabilities:					
OPWC loans payable	285,714	-	-	285,714	-
Compensated absences	47,546	63,730	124,761	236,037	-
Total long-term liabilities	<u>333,260</u>	<u>63,730</u>	<u>124,761</u>	<u>521,751</u>	<u>-</u>
Total long-term liabilities	<u>333,260</u>	<u>63,730</u>	<u>124,761</u>	<u>521,751</u>	<u>-</u>
Total liabilities	<u>423,190</u>	<u>449,906</u>	<u>7,410,857</u>	<u>8,283,953</u>	<u>179,004</u>
Net assets:					
Invested in capital assets, net of related debt	5,121,553	6,570,997	4,218,475	15,911,025	-
Unrestricted	802,563	780,291	5,434,584	7,017,438	297,968
Total net assets	<u>\$ 5,924,116</u>	<u>\$ 7,351,288</u>	<u>\$ 9,653,059</u>	22,928,463	<u>\$ 297,968</u>
Adjustment to reflect the consolidation of the internal service funds activities related to enterprise funds.				122,224	
Net assets of business-type activities				<u>\$ 23,050,687</u>	

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, 2005

	<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	\$ 1,283,515	\$ 1,601,411	\$ 11,780,187	\$ 14,665,113	\$ 1,134,924
Other	6,605	24,325	148,713	179,643	-
Total operating revenues	<u>1,290,120</u>	<u>1,625,736</u>	<u>11,928,900</u>	<u>14,844,756</u>	<u>1,134,924</u>
Operating expenses:					
Personal services	388,914	756,396	1,538,285	2,683,595	-
Contract services	141,707	603,357	570,798	1,315,862	-
Materials and supplies	52,858	143,452	7,121,933	7,318,243	-
Utilities	119,563	95,221	200,159	414,943	-
Depreciation	281,297	247,231	451,499	980,027	-
Claims.	-	-	-	-	884,742
Other	132,546	100,046	467,700	700,292	-
Total operating expenses.	<u>1,116,885</u>	<u>1,945,703</u>	<u>10,350,374</u>	<u>13,412,962</u>	<u>884,742</u>
Operating income (loss)	<u>173,235</u>	<u>(319,967)</u>	<u>1,578,526</u>	<u>1,431,794</u>	<u>250,182</u>
Nonoperating revenues (expenses):					
Interest expense and fiscal charges	-	-	(153,991)	(153,991)	-
Intergovernmental revenue	-	116,297	-	116,297	-
Interest revenue.	-	1,624	10,321	11,945	5,314
Investment in joint venture	-	-	(49,428)	(49,428)	-
Other local tax revenue.	-	-	444,389	444,389	-
Loss on disposal of capital assets	(1,142)	-	-	(1,142)	-
Excise tax expense	-	-	(413,055)	(413,055)	-
Total nonoperating revenues (expenses)	<u>(1,142)</u>	<u>117,921</u>	<u>(161,764)</u>	<u>(44,985)</u>	<u>5,314</u>
Net income (loss) before capital contributions	172,093	(202,046)	1,416,762	1,386,809	255,496
Capital contributions.	-	770,381	-	770,381	-
Changes in net assets	172,093	568,335	1,416,762	2,157,190	255,496
Net assets at beginning of year	<u>5,752,023</u>	<u>6,782,953</u>	<u>8,236,297</u>		<u>42,472</u>
Net assets at end of year.	<u>\$ 5,924,116</u>	<u>\$ 7,351,288</u>	<u>\$ 9,653,059</u>		<u>\$ 297,968</u>
Adjustment to reflect the consolidation of the internal service funds activities related to enterprise funds.				153,605	
Changes in net assets of business-type activities				<u>\$ 2,310,795</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, 2005

	<u>Business-Type Activities - Enterprise Funds</u>				Governmental
	Sewer	Water	Electric	Total	Activities - Internal Service Fund
Cash flows from operating activities:					
Cash received from customers	\$ 1,266,767	\$ 1,565,522	\$ 11,593,567	\$ 14,425,856	\$ 1,134,924
Cash received from other operations.	6,605	24,325	593,102	624,032	-
Cash payments for personal services	(389,663)	(758,595)	(1,622,850)	(2,771,108)	-
Cash payments for contract services	(141,598)	(280,451)	(713,366)	(1,135,415)	-
Cash payments for materials and supplies	(61,059)	(135,464)	(6,650,974)	(6,847,497)	-
Cash payments for utilities.	(119,563)	(95,221)	(200,159)	(414,943)	-
Cash payments for claims	-	-	-	-	(846,980)
Cash payments for other expenses.	(132,546)	(100,046)	(956,742)	(1,189,334)	-
Net cash provided by operating activities	428,943	220,070	2,042,578	2,691,591	287,944
Cash flows from noncapital financing activities:					
Cash received from other local taxes	-	-	444,389	444,389	-
Cash payments for excise taxes	-	-	(444,389)	(444,389)	-
Net provided by noncapital financing activities	-	-	-	-	-
Cash flows from capital and related financing activities:					
Acquisition of capital assets	(380,663)	(1,862,569)	(872,768)	(3,116,000)	-
Capital contributions	-	770,381	-	770,381	-
Intergovernmental revenue	-	116,297	-	116,297	-
Sale of notes.	313,000	-	2,500,000	2,813,000	-
Principal retirement.	(57,143)	-	(3,250,000)	(3,307,143)	-
Interest and fiscal charges.	-	-	(123,974)	(123,974)	-
Net cash used in capital and related financing activities	(124,806)	(975,891)	(1,746,742)	(2,847,439)	-
Cash flows from investing activities:					
Interest received.	-	1,641	1,569	3,210	5,314
Net cash provided by investing activities	-	1,641	1,569	3,210	5,314
Net increase (decrease) in cash and cash equivalents	304,137	(754,180)	297,405	(152,638)	293,258
Cash and cash equivalents at beginning of year	<u>427,347</u>	<u>1,627,805</u>	<u>3,417,444</u>	<u>5,472,596</u>	<u>183,714</u>
Cash and cash equivalents at end of year.	<u>\$ 731,484</u>	<u>\$ 873,625</u>	<u>\$ 3,714,849</u>	<u>\$ 5,319,958</u>	<u>\$ 476,972</u>

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CITY OF SHELBY, OHIO

STATEMENT OF CASH FLOWS
 PROPRIETARY FUNDS (CONTINUED)
 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005

	<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)	\$ 173,235	\$ (319,967)	\$ 1,578,526	\$ 1,431,794	\$ 250,182
Adjustments:					
Depreciation	281,297	247,231	451,499	980,027	-
Changes in assets and liabilities:					
(Increase)/decrease in materials and supplies inventory.	(5,705)	833	519,732	514,860	-
Increase in accounts receivable.	(16,748)	(35,889)	(186,620)	(239,257)	-
(Increase)/decrease in prepayments	761	1,439	(217,192)	(214,992)	-
Increase/(decrease) in due from					
other governments	-	-	(44,653)	(44,653)	-
Increase/(decrease) in accounts payable	(3,148)	7,676	25,851	30,379	-
Increase in contracts payable	-	320,946	-	320,946	-
Increase/(decrease) in accrued wages and benefits	2,957	2,823	(8,412)	(2,632)	-
Decrease in due to other governments.	(5,563)	(7,488)	(26,967)	(40,018)	-
Increase (decrease) in compensated absences payable.	1,857	2,466	(49,186)	(44,863)	-
Increase in claims payable	-	-	-	-	37,762
Net cash provided by operating activities	<u>\$ 428,943</u>	<u>\$ 220,070</u>	<u>\$ 2,042,578</u>	<u>\$ 2,691,591</u>	<u>\$ 287,944</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF SHELBY, OHIO

STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUND
DECEMBER 31, 2005

	<u>Agency</u>
Assets:	
Equity in pooled cash and cash equivalents	\$ 178,433
Cash in segregated accounts	<u>10,784</u>
Total assets	<u>\$ 189,217</u>
Liabilities:	
Due to other governments	\$ 178,433
Restricted/refundable deposits.	<u>10,784</u>
Total liabilities	<u>\$ 189,217</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, 2005

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, 2005

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 system. 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 \$838,638 at December 31, 2005. 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, 2005

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

The thirty-six participating subdivisions and their respective ownership shares at December 31, 2005 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, 2005

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, 2005

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 are 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, 2005

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, 2005, but which were levied to finance year 2006 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, 2005

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 fund level within each fund. Although the legal level of budgetary control was established at the fund level of expenditures, the City has elected to present budgetary statement comparisons at the fund and function level of expenditures. 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 2005.

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 line item level within each fund. 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 for a fund 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.

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.

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005**

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

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, including proprietary 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 2005, investments were limited to repurchase agreements and nonnegotiable certificates of deposit. Nonparticipating investment contracts, such as repurchase agreements and 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 2005, interest revenue credited to the general fund amounted to \$100,849 which includes \$96,055 assigned from other City funds.

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

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.

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.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

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

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	N/A
Infrastructure	10 - 65 years	10 - 65 years

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.

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005**

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

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, 2005, 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.

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 balance sheet 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.

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005**

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

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 fixed 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.

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 adopted by the City or through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

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

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005**

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

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 2005.

NOTE 3 - ACCOUNTABILITY AND COMPLIANCE

Change in Accounting Principles

For fiscal year 2005, the City has implemented GASB Statement No. 40, "Deposit and Investment Risk Disclosures."

GASB Statement No. 40 establishes and modified disclosure requirements related to investment risks: credit risk (including custodial credit risk and concentrations of credit risk) and interest rate risk. This statement also establishes and modified disclosure requirements for custodial credit risk on deposits.

The implementation of GASB Statement No. 40 did not have an effect on the financial statements of the City, however additional note disclosure can be found in Note 4.

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.

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005**

NOTE 4 - DEPOSITS AND INVESTMENTS - (Continued)

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.

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;
4. Bonds and other obligations of the State of Ohio;
5. No-load money market mutual funds consisting exclusively of obligations described in division (1) or (2) of this section 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.

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.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

NOTE 4 - DEPOSITS AND INVESTMENTS - (Continued)

A. Cash with Fiscal Agent

At December 31, 2005, 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, 2005. This amount is not included in the City's depository balance below.

B. Cash in Segregated Accounts

At December 31, 2005, the City had \$10,784 in a segregated account for municipal court deposits. This amount is not included in the City's depository balance below

C. Deposits with Financial Institutions

At December 31, 2005, the carrying amount of all City deposits was \$3,995,916. Based on the criteria described in GASB Statement No. 40, "Deposits and Investment Risk Disclosures", as of December 31, 2005, \$3,483,293 of the City's bank balance of \$3,993,923 was exposed to custodial risk as discussed below, while \$510,630 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

As of December 31, 2005, the City had the following investments and maturities:

<u>Investment type</u>	<u>Fair Value</u>	<u>Maturities</u> <u>6 months or less</u>
Repurchase Agreements	\$ 5,500,015	\$ 5,500,015
Total	<u>\$ 5,500,015</u>	<u>\$ 5,500,015</u>

Interest Rate Risk: As a means of limiting its exposure to fair value losses arising from rising interest rates and according to state law, the City's investment policy limits investment portfolio maturities to five years or less.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the City will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The City has no investment policy dealing with investment custodial risk beyond the requirement in Ohio law that prohibits payments for investments prior to the delivery of the securities representing such investments to the treasurer or qualified trustee. The City's investment in repurchase agreements is collateralized by underlying securities pledged by the investment's counterparty, not in the name of the City. Ohio law requires the market value of the securities subject to a repurchase agreement must exceed the principal value of securities subject to a repurchase agreement by 2%.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

NOTE 4 - DEPOSITS AND INVESTMENTS - (Continued)

Concentration of Credit Risk: The City places no limit on the amount that may be invested in any one issuer. The following table includes the percentage of each investment type held by the City at December 31, 2005:

<u>Investment type</u>	<u>Fair Value</u>	<u>% to Total</u>
Repurchase Agreements	\$ 5,500,015	100.00%
Total	<u>\$ 5,500,015</u>	<u>100.00%</u>

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, 2005:

<u>Cash and Investments per footnote</u>	
Carrying amount of deposits	\$ 3,995,916
Investments	5,500,015
Cash with fiscal agent	4,000,000
Cash in segregated accounts	<u>10,784</u>
Total	<u>\$ 13,506,715</u>
 <u>Cash and investments per Statement of Net Assets</u>	
Governmental activities	\$ 3,997,540
Business type activities	9,319,958
Agency funds	<u>189,217</u>
Total	<u>\$ 13,506,715</u>

NOTE 5 - INTERFUND TRANSACTIONS

Interfund transfers for the year ended December 31, 2005, consisted of the following, as reported on the fund statements:

Transfers to nonmajor governmental funds from:	
General fund	\$ 216,184
Total	<u>\$ 216,184</u>

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.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

NOTE 6 - PROPERTY TAXES

Property taxes include amounts levied against all real, public utility, and tangible personal property located in the City. Taxes collected from real property (other than public utility) in one calendar year are levied on January 1 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 City Auditor at 35% of appraised market value. All property is required to be revalued every six years with a triennial update. The last revaluation was completed in 2000. Real property taxes are payable annually or semi-annually. If paid annually, payment is due January 20; if paid semi-annually, the first payment is due January 20, with the remainder payable June 20. In certain instances, state statute permits earlier or later payment dates to be established.

Taxpayers (other than public utilities) become liable for tangible personal property taxes on January 1st of the current calendar year based on tax rates determined in the preceding year and assessed values determined at the close of the most recent fiscal year of the taxpayer that ended on or before March 31 of the current calendar year. Tangible personal property used in business (except for public utilities) is currently assessed for ad valorem taxation purposes at 25% of its true value. Amounts paid by multi-City taxpayers are due September 20. Single City taxpayers may pay annually or semi-annually. If paid annually, payment is due April 30; if paid semi-annually, the first payment is due April 30 with the remainder payable by September 20. Under Ohio law personal property taxes do not attach as a lien on the personal property. Public utility real and tangible personal property taxes collected in one calendar year are levied on January 1 in the preceding calendar year on assessed values determined as of January 1 of the preceding year, the lien date.

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.

The full tax rate for all City operations for the year ended December 31, 2005, was \$5.60 per \$1,000.00 of assessed value. The assessed values of real and tangible personal property for tax year 2003 are as follows:

Real property	\$ 132,641,200
Public utility property	27,890
Tangible personal property	<u>30,495,213</u>
Total assessed valuation	<u>\$ 163,164,303</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, 2005. 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 2005 operations. Accordingly, the receivable is offset by a credit to "Deferred Revenue."

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005**

NOTE 7 - LOCAL INCOME TAX

The City levies a municipal income tax of one and a half 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, 2005, 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, 2005, as well as intended to finance fiscal 2005 operations.

A summary of the items of receivables reported on the Statement of Net Assets follows:

Governmental Activities:

Income taxes	\$ 808,186
Real and other taxes	929,554
Special assessments	15,666
Accrued interest	1,955
Due from other governments	600,056

Business-Type Activities:

Accounts	1,645,613
Accrued interest	9,804
Due from other governments	44,653

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, 2005

NOTE 9 - CAPITAL ASSETS

A. Capital asset activity for the fiscal year ended December 31, 2005, was as follows:

	<u>Balance</u> <u>12/31/04</u>	<u>Additions</u>	<u>Disposals</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>317,222</u>	<u>176,393</u>	<u>(317,222)</u>	<u>176,393</u>
Total capital assets, not being depreciated	<u>523,272</u>	<u>176,393</u>	<u>(317,222)</u>	<u>382,443</u>
<i>Capital assets, being depreciated:</i>				
Land improvements	464,886	14,828	-	479,714
Buildings and improvements	1,733,842	42,297	-	1,776,139
Furniture, fixtures and equipment	1,281,569	140,818	-	1,422,387
Vehicles	2,001,464	25,775	-	2,027,239
Infrastructure	<u>16,754,884</u>	<u>507,568</u>	<u>-</u>	<u>17,262,452</u>
Total capital assets, being depreciated	<u>22,236,645</u>	<u>731,286</u>	<u>-</u>	<u>22,967,931</u>
<i>Less: accumulated depreciation:</i>				
Land improvements	(284,514)	(22,521)	-	(307,035)
Buildings and improvements	(912,990)	(49,284)	-	(962,274)
Furniture, fixtures and equipment	(637,541)	(97,092)	-	(734,633)
Vehicles	(1,373,165)	(151,299)	-	(1,524,464)
Infrastructure	<u>(3,867,370)</u>	<u>(419,742)</u>	<u>-</u>	<u>(4,287,112)</u>
Total accumulated depreciation	<u>(7,075,580)</u>	<u>(739,938)</u>	<u>-</u>	<u>(7,815,518)</u>
Total capital assets, being depreciated, net	<u>15,161,065</u>	<u>(8,652)</u>	<u>-</u>	<u>15,152,413</u>
Governmental activities capital assets, net	<u>\$ 15,684,337</u>	<u>\$ 167,741</u>	<u>\$ (317,222)</u>	<u>\$ 15,534,856</u>

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

NOTE 9 - CAPITAL ASSETS - (Continued)

	<u>Balance</u> <u>12/31/04</u>	<u>Additions</u>	<u>Disposals</u>	<u>Balance</u> <u>12/31/05</u>
Business-Type Activities:				
<i>Capital assets, not being depreciated:</i>				
Land	\$ 233,440	\$ -	\$ -	\$ 233,440
Construction in progress	<u>87,000</u>	<u>2,238,494</u>	<u>(87,000)</u>	<u>2,238,494</u>
Total capital assets, not being depreciated	<u>320,440</u>	<u>2,238,494</u>	<u>(87,000)</u>	<u>2,471,934</u>
 <i>Capital assets, being depreciated:</i>				
Land improvements	559,423	-	-	559,423
Buildings and improvements	7,445,293	123,991	-	7,569,284
Furniture, fixtures and equipment	22,899,925	304,633	(2,752)	23,201,806
Vehicles	643,737	-	-	643,737
Infrastructure	<u>14,602,943</u>	<u>535,882</u>	<u>-</u>	<u>15,138,825</u>
Total capital assets, being depreciated	<u>46,151,321</u>	<u>964,506</u>	<u>(2,752)</u>	<u>47,113,075</u>
 <i>Less: accumulated depreciation:</i>				
Land improvements	(350,090)	(25,247)	-	(375,337)
Buildings and improvements	(3,952,098)	(154,468)	-	(4,106,566)
Furniture, fixtures and equipment	(17,461,812)	(440,015)	1,610	(17,900,217)
Vehicles	(531,566)	(28,436)	-	(560,002)
Infrastructure	<u>(7,557,144)</u>	<u>(331,861)</u>	<u>-</u>	<u>(7,889,005)</u>
Total accumulated depreciation	<u>(29,852,710)</u>	<u>(980,027)</u>	<u>1,610</u>	<u>(30,831,127)</u>
Total capital assets, being depreciated, net	<u>16,298,611</u>	<u>(15,521)</u>	<u>(1,142)</u>	<u>16,281,948</u>
Business-type activities capital assets, net	<u>\$ 16,619,051</u>	<u>\$ 2,222,973</u>	<u>\$ (88,142)</u>	<u>\$ 18,753,882</u>

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005**

NOTE 9 - CAPITAL ASSETS - (Continued)

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

Governmental activities	
General government	\$ 47,727
Security of persons and property	126,615
Public health and welfare	1,566
Transportation	504,667
Community environment	54,681
Leisure time activity	<u>4,682</u>
Total depreciation expense - governmental activities	<u>\$ 739,938</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, 2005

NOTE 11 - LONG-TERM OBLIGATIONS

A. The City's long-term obligations at year-end and a schedule of current year activity is as follows:

	Interest	Balance			Balance	Amounts
	Rate	Outstanding	Additions	Reductions	Outstanding	Due in
		12/31/04			12/31/05	One Year
Governmental Activities:						
<u>Bonds Payable:</u>						
Street Improvement	3.10%	\$ 101,426	\$ -	\$ (25,357)	\$ 76,069	\$ 25,357
Special Assessment - Street Improvement	2.36%	\$ -	\$ 67,485	\$ -	\$ 67,485	\$ 13,497
Total Bonds Payable		<u>101,426</u>	<u>67,485</u>	<u>(25,357)</u>	<u>143,554</u>	<u>38,854</u>
<u>OPWC Notes Payable:</u>						
Wareham Road	0.00%	194,940	-	(16,245)	178,695	16,245
Auburn Street	0.00%	<u>19,215</u>	<u>-</u>	<u>(9,607)</u>	<u>9,608</u>	<u>9,608</u>
Total OPWC Notes Payable		<u>214,155</u>	<u>-</u>	<u>(25,852)</u>	<u>188,303</u>	<u>25,853</u>
<u>Other Long-Term Obligations:</u>						
Compensated Absences		<u>304,151</u>	<u>53,517</u>	<u>(17,999)</u>	<u>339,669</u>	<u>68,233</u>
Total Other Long-Term Obligations		<u>304,151</u>	<u>53,517</u>	<u>(17,999)</u>	<u>339,669</u>	<u>68,233</u>
Total Governmental Activities		<u>\$ 619,732</u>	<u>\$ 121,002</u>	<u>\$ (69,208)</u>	<u>\$ 671,526</u>	<u>\$ 132,940</u>
Business-Type Activities:						
<u>OPWC Note Payable:</u>						
Wastewater Treatment Plant Expansion	0.00%	\$ 87,000	\$ 313,000	\$ (57,143)	\$ 342,857	\$ 57,143
<u>Other Long-Term Liabilities:</u>						
Compensated Absences		<u>360,679</u>	<u>36,928</u>	<u>(81,791)</u>	<u>315,816</u>	<u>79,779</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.

Street Improvements Bond: 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 and on August 17, 2005 for the purpose of financing the cost of water and sewer improvements along Samantha Drive, 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.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

NOTE 11 - LONG-TERM OBLIGATIONS - (Continued)

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

Compensated Absences: Sick leave and vacation benefits are presented net of actual increases and decreases because of the practicality of determining these values. Compensated absences reported in the "compensated absences payable" account will be paid from the fund from which the employee's salaries are paid.

- B.** Principal and interest requirements to retire the long-term obligations outstanding at December 31, 2005, are as follows:

<u>Year Ended</u>	<u>Street Improvement Bond</u>			<u>OPWC Notes</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 38,854	\$ 5,881	\$ 44,735	\$ 25,853	\$ -	\$ 25,853
2007	38,853	3,759	42,612	16,245	-	16,245
2008	38,853	2,426	41,279	16,245	-	16,245
2009	13,497	1,093	14,590	16,245	-	16,245
2010	13,497	546	14,043	16,245	-	16,245
2011 - 2015	-	-	-	81,225	-	81,225
2016	-	-	-	16,245	-	16,245
Total	<u>\$143,554</u>	<u>\$ 13,705</u>	<u>\$157,259</u>	<u>\$188,303</u>	<u>\$ -</u>	<u>\$188,303</u>

NOTE 12 - GENERAL OBLIGATION NOTES PAYABLE

The City had the following general obligation note activity during fiscal year 2005 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 12/31/04</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance Outstanding 12/31/05</u>
Electric System						
Improvements - 2.30%	11/18/04	11/17/05	\$3,250,000	\$ -	\$(3,250,000)	\$ -
Electric System						
Improvements - 5.00%	11/17/05	11/16/06	-	6,500,000	-	6,500,000
Total			<u>\$3,250,000</u>	<u>\$ 6,500,000</u>	<u>\$(3,250,000)</u>	<u>\$6,500,000</u>

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

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 2004, 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, 2005, follows:

<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	1,000	
	Finance	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 \$179,004 reported in the Hospitalization internal service fund at December 31, 2005, 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, 2005 and 2004 were as follows:

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

NOTE 13 - RISK MANAGEMENT – (Continued)

<u>Fiscal Year</u>	<u>Beginning of Fiscal Year</u>	<u>Claims</u>	<u>Payments</u>	<u>End of Fiscal Year</u>
2005	\$ 141,242	\$ 884,742	\$ (846,980)	\$ 179,004
2004	\$ 165,659	\$ 935,257	\$ (959,674)	\$ 141,242

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 2004.

NOTE 14 - DEFINED BENEFIT 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) 222-6705.

For the year ended December 31, 2005, the members of all three plans, except those in law enforcement or public safety participating in the traditional plan, were required to contribute 8.5% of their annual covered salaries. Members participating in the traditional plan who were in law enforcement contributed 10.1% of their annual covered salary; members in public safety contributed 9%. The City's contribution rate for pension benefits for 2005 was 9.55%, except for those plan members in law enforcement or public safety. For those classifications, the City's pension contributions were 13.31% 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, 2005, 2004, and 2003 were \$420,313, \$436,372, and \$459,666, respectively; 100% has been contributed for 2005, 2004 and 2003. The City and plan members did not make any contributions to the member-directed plan for 2005.

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005**

NOTE 14 - DEFINED BENEFIT PENSION PLANS – (Continued)

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.

Plan members are required to contribute 10% of their annual covered salary to fund pension obligations while the City is required to contribute 11.75% for police officers and 16.25% for firefighters. Contributions are authorized by State statute. The City's contributions to the fund for police and firefighters were \$299,884, \$283,556, \$282,859, respectively. The full amount has been contributed for 2005, 2004 and 2003.

NOTE 15 - POSTRETIREMENT BENEFIT PLANS

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 2005 local government employer contribution rate was 13.55% of covered payroll (16.70% for public safety and law enforcement); 4.00% of covered payroll was the portion that was used to fund health care.

Benefits are advance-funded using the entry age normal actuarial cost method. Significant actuarial assumptions, based on OPERS latest actuarial review performed as of December 31, 2005, include a rate of return on investments of 8.00%, 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 6.3% based on additional annual pay increases. Health care premiums were assumed to increase 1.00% and 6.00% annually for the next eight years and 4.00% annually after nine years.

All investments are carried at market. For actuarial valuation purposes, a smoothed market approach is used. Assets are adjusted to reflect 25% of unrealized market appreciation or depreciation on investment assets annually.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

NOTE 15 - POSTRETIREMENT BENEFIT PLANS - (Continued)

The number of active contributing participants in the traditional and combined plans was 376,109 as of December 31, 2005. The number of active participants for both plans used in the December 31, 2004 actuarial valuation was 355,287. Actual employer contributions for 2005 which were used to fund postemployment benefits were \$124,078. The actual contribution and the actuarially required contribution amounts are the same. OPERS net assets available for payment of benefits at December 31, 2004 (the latest information available) were \$10.8 billion. The actuarially accrued liability and the unfunded actuarial accrued liability were \$29.5 billion and \$18.7 billion, respectively.

On September 9, 2004 the OPERS Retirement Board adopted a Health Care Preservation Plan (HCPP) with an effective date of January 1, 2007. The HCPP restructures OPERS' health care coverage to improve the financial solvency of the fund in response to skyrocketing health care costs.

Under the HCPP, retirees eligible for health care coverage will receive a graded monthly allocation based on their years of service at retirement. The Plan incorporates a cafeteria approach, offering a broad range of health care options that allow benefit recipients to use their monthly allocation to purchase health care coverage customized to meet their individual needs. If the monthly allocation exceeds the cost of the options selected, the excess is deposited into a Retiree Medical Account that can be used to fund future health care expenses.

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. 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 2005 that were used to fund postemployment benefits was \$60,646 for police and \$47,563 for firefighters. The OP&F's total health care expense for the year ended December 31, 2004 (the latest information available) was \$102,173,796, which was net of member contributions of \$55,665,341. The number of OP&F participants eligible to receive health care benefits as of December 31, 2004 (the latest information available), was 13,812 for police and 10,528 for firefighters.

CITY OF SHELBY, OHIO

NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

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 are recorded when received in cash (budget) as opposed to when susceptible to accrual (GAAP).
2. Expenditures/expenses 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.
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 and health fund.

Net Change in Fund Balance

	<u>General</u>
Budget basis	\$ 159,765
Net adjustment for revenue accruals	242,160
Net adjustment for expenditure accruals	10,590
Adjustment for encumbrances	<u>83,274</u>
GAAP basis	<u>\$ 495,789</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, 2005.

CITY OF SHELBY, OHIO

**NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005**

NOTE 17 - CONTINGENCIES - (Continued)

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.

NOTE 18 - CONTRACTUAL COMMITMENTS

During 2005, the City entered several construction contracts for various projects.

The following is a list of the contracts outstanding at December 31, 2005:

<u>Project</u>	<u>Contract Amount</u>	<u>Completed Amount</u>	<u>Outstanding 12/31/05</u>
Water Treatment Plant	\$ 5,896,565	\$ (1,444,684)	\$ 4,451,881
2005 Paving Program	<u>125,910</u>	<u>(120,874)</u>	<u>5,036</u>
Total	<u>\$ 6,022,475</u>	<u>\$ (1,565,558)</u>	<u>\$ 4,456,917</u>

NOTE 19 - SUBSEQUENT EVENT

Effective April 28, 2006, Mr. Larry Paxton resigned as the Finance Director of the City.



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, 2005, which collectively comprise the City of Shelby's basic financial statements and have issued our report thereon dated April 28, 2006. 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*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Shelby's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted a certain matter involving the internal control over financial reporting that do not require inclusion in this report that we have reported to the City of Shelby in a separate letter dated April 28, 2006.

Mayor and Members of Council
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*. However, we noted certain immaterial instances of noncompliance that we have reported to the management of the City of Shelby in a separate letter dated April 28, 2006.

This report is intended solely for the information and use of management and the City 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." with a period at the end.

Julian & Grube, Inc.
April 28, 2006



**Auditor of State
Betty Montgomery**

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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
AUGUST 31, 2006**