



CITY OF SALEM, VIRGINIA
Comprehensive Annual Financial Report
Year Ended June 30, 2006

CITY OF SALEM, VIRGINIA

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CITY OF SALEM, VIRGINIA

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INTRODUCTORY SECTION



CITY OF SALEM, VIRGINIA

December 11, 2006

The Honorable Mayor and Members of City Council and the Citizens of Salem, Virginia

In accordance with Section 8.9 of the Salem City Charter, we are pleased to present the City of Salem (the City) Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2006. The charter requires the City to issue an annual report on its financial position and activities and that the report be audited by an independent firm of certified public accountants. This report was prepared by the Department of Finance in conjunction with generally accepted accounting principles (GAAP) as promulgated by the Government Accounting Standards Board (GASB).

Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the City. The data as presented is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the City as measured by the financial activity of various funds and component units. All disclosures necessary to enable the reader to gain the maximum understanding of the City's financial activity have been included.

The CAFR is presented in the following four sections:

- (1) **Introductory Section** - This section is unaudited and includes this letter of transmittal, a list of the City's principal officials and an organization chart;
- (2) **Financial Section** - This section includes the independent auditors' report on the basic financial statements, management's discussion and analysis (MD&A), basic financial statements, notes to the basic financial statements, required supplementary information and combining fund financial statements;
- (3) **Statistical Section** - This section is unaudited and includes selected financial and demographic information, generally presented on a multi-year comparative basis; and
- (4) **Compliance Section** - This section includes the Schedule of Expenditures of Federal Awards, the independent auditors' reports on internal controls and on compliance with applicable laws and regulations as required by the U.S. Office of Management and Budget's Circular A-133, ***Audits of States, Local Governments and Non-Profit Organizations*** and the Schedule of Findings and Questioned Costs.

GAAP requires that management provide a narrative introduction, overview and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it.

Profile of the Government

Salem is located at the southern end of the Shenandoah Valley, approximately 170 miles west of Richmond and 235 miles southwest of Washington, DC. Its position in the southeastern United States gives the City ready access, within a 500-mile radius, to nearly two-thirds of the total population of the United States. In addition, the City lies at the region's crossroads of major rail and highway systems, making it a part of the principal trade, industrial, transportation, medical, and cultural center of western Virginia.

Chartered by the Commonwealth of Virginia as a town in 1806 and as a city in 1968, Salem encompasses a land area of 14.3 square miles and operates under a council-manager form of government. The City's 2006 estimated population, 25,100, accounts for almost eight percent of the population in its metropolitan statistical area (MSA), which includes the neighboring City of Roanoke and the Counties of Botetourt, Craig, Franklin and Roanoke.

The primary government provides a full range of services including general government administration, judicial administration, public safety, public works, health and welfare, parks and recreation, and community development activities. The City also owns and operates an electric distribution system, water and sewage facilities, and a civic center.

The financial reporting entity reflected in the CAFR, which is more fully described in Note 1 to the basic financial statements, conforms to the requirements of the Governmental Accounting Standards Board (GASB) Statement No. 14, as amended by (GASB) Statement No. 39. The accounting and reporting principles of the GASB are based on the fundamental concept that publicly elected officials are accountable to their constituents, and the financial statements should emphasize the primary government and permit financial statement users to distinguish between the primary government and its component units. There are several commissions and authorities where the City's accountability is limited to appointments to, or seats on, the respective boards. The City does not exercise financial or administrative control over these entities, so they are excluded from this report.

The City's reporting entity includes one discretely presented component unit. A component unit is a legally separate entity, which meets one of three conditions; the governing board is appointed by the primary government, the entity is fiscally dependent on the primary government, or excluding the entity could

potentially result in misleading financial reporting. The discretely presented component unit is the School Board of the City of Salem. A five member appointed School Board supervises the operation of the City's school system. The school system receives significant financial support from the City. The School Board is presented in a separate column in the government-wide financial statements to emphasize that it is legally separate from the primary government and to differentiate its financial position and results of operations from that of the primary government.

The annual budget is based upon the financial policies of the City and reflects the balance between anticipated revenues and proposed expenditures. As required by City Code, the City Manager submits a recommended budget to City Council thirty days prior to the last Council meeting in May each year for the fiscal year beginning July 1st. After an extensive study process and a public hearing to receive citizen input, the City Council adopts the budget on or before June 15th.

Local Economic Condition and Outlook

Although small in area, Salem is large when looking at its economic base and that of the surrounding communities. This base consists of industrial manufacturing, medical facilities, wholesale/retail trade, agriculture, hotel and motel services, higher education, rail transportation, banking services and regional utility services.

Salem strives to provide an atmosphere and quality of life conducive to families and businesses. Over the years, Salem has been able to maintain a low unemployment rate, currently 2.9 percent, and stable property tax rates, while enjoying moderate growth. A strong educational system providing a well-educated and skilled workforce along with generally lower operating costs is a key reason why employers have chosen to relocate in Salem and the rest of the Valley. The City's effort to retain existing business and industry is an integral part of its economic development efforts. The use of public funds when appropriate to attract or expand existing businesses has paid off for Salem in terms of expanded investments and employment.

Included in the manufacturing process are hi-tech electronics, medical equipment, tires, furniture, meat processing, steel and motor manufacturing, tool and die, and railroad equipment just to name a few. The largest employers include such companies as General Electric, Hospital Corporation of America, Veterans Administration Medical Center, Carter Machinery, and Yokohama Industries. The top employers in Salem provide over 10,000 jobs to Salem's citizens and those of the surrounding valley.

The past year has seen the completion of a number of residential subdivisions along with business expansions and relocations and the announcement of several others. In the residential area, The Homeplace and The Lawn, both high-end subdivisions are now complete. Also included is The Hill which is close to completion consisting of 120 new homes which have added an assessed value in excess of \$41,000,000. Four new subdivisions including Phillip Brook, Emory Creek and North Oaks subdivisions are under construction and will add an additional 110 lots with building costs expected to exceed \$300,000 per unit.

The Salem Commerce Park, announced in 2005, saw the completion of the One Beacon, a regional insurance office in 2006. In addition, both the Atlantic Mutual Insurance Building and the Waldrop Medical Office Building were completed and occupied by September 2006. Other medical facilities are expected over the next two years. Another lot has been sold for development while four others owned by the City are available. When built out the City anticipates approximately 1,500 jobs to be added and \$100 million in investment; producing up to \$1.2 million in new revenue.

In its effort to encourage economic development in Salem, the City assisted Lewis Gale Medical Center with a new addition, provided assistance to both Federal Express for its expansion at the Cook Commerce Park and Pitzer Transfer for a rail siding to their facility. Qualchem Corporation was provided assistance and as a result decided to remain in Salem.

Seventeen new retail establishments opened their doors in Salem providing various services such as restaurants, shopping and other office services.

Revenue performance for 2006 was improved as real estate taxes increased by 11 percent and personal property taxes were up 5.2 percent. Other Local Taxes were up slightly and Intergovernmental Revenues or Grants remained level in the General Fund, but were up by 5.3 percent in the School Division representing increases State and Federal Grants.

As part of its fiscal year 2006 budget process, the City was again able to meet the goals of maintaining service levels to citizens, providing additional funding for employee compensation and benefits, and capital replacement and maintenance.

Accounting System and Budgetary Controls

The City has established a comprehensive internal control framework designed to both safeguard the government's assets against loss from unauthorized use or theft and to properly record and adequately document transactions in order to compile information for the presentation of the City's financial statements in conformity with GAAP. Because the cost of internal controls should not outweigh their benefits, the City's comprehensive framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatement.

Currently the City utilizes a financial management system that was developed internally in conjunction with the Department of Management Information Services. The City has established an Information Technology Planning Board (ITPB) charged with reviewing both current business practices and best practices in order to develop a Request for Proposal for a new Financial Management System. The goal of this project is to obtain enterprise functionality that fully utilizes technology to maximize the users ability to retrieve data. Systems to be included are financial, payroll / human resources, budget and treasury management. This project is to be implemented over a three-year period beginning in 2006-07.

Budgeting Controls - The budget function is used as a management tool, including performance objectives, goals and long-range planning, as well as maintaining budgetary controls. The objective of these budgetary controls is to ensure compliance with legal provision embodied in the annual appropriated budget approved by City Council. Activities of the general fund are included in the annual budgetary control (that is, the level at which expenditures cannot legally exceed the appropriated amount) is established at the fund level. The government also maintains an encumbrance accounting system as one technique of accomplishing budgetary control. Encumbered amounts lapse at year-end. However, encumbrances generally are re-appropriated as part of the following year's budget.

Risk Management

The City utilizes a variety of techniques to identify and monitor risks and exposures for the City activities. Risk Management is a function of several departments under the General Government heading. The City is insured for most General Liability and Property coverage. In addition, Workmen's Compensation is covered by insurance through the Virginia Municipal Self Insurance Association. The City is self-insured for health coverage for City and School employees. Note 13 of this report provides an outline of Salem's Risk Management Coverage.

Cash Management

The City uses a pooled cash concept to allow greater investment flexibility and consequently a better return on investments. Cash from all funds except those restricted for specific purposes is pooled for investment purposes with maturities planned to coincide with cash needs. Funds not immediately needed (30 days or greater) are invested in certificates of deposit or other approved investments, while funds available for periods of less than 30 days are invested with the City's lead bank as a part of its cash management program. All City funds are fully secured either through the City's cash management program with its lead bank or through the Virginia Security for Publics Deposits Act.

Major Initiatives and Accomplishments

Salem City Council and Management are committed to making Salem a great place to live, work, and raise a family. To that end the City and School Board work diligently to provide one of the finest school systems not only in the region but throughout the Commonwealth. Student scores both on National Testing and the Standards of Learning either meet or exceed state and national averages. Salem provides continued funding to the School Division in order to be able to offer a highly competitive pay and benefit package to attract the best teachers available.

Salem works hard in the areas of economic development and is committed to creating jobs for its citizens and in generating new sources of tax revenue by strengthening and diversifying its economy. Salem Commerce Park is now under construction with three businesses successfully located there and space for several more. Salem continues to be active in tourism development as a means of economic development.

Located at the Salem Civic Center, the Visitor's Center provides an abundance of information about local sites and events. The City continues to participate with the Roanoke Valley Convention and Visitors Bureau to promote conventions and events in the region. Events such as Salem Avalanche Baseball, Olde Salem Days, the Salem Fair, Stagg Bowl, Commonwealth Games, the Roanoke Valley Horse Show, NCAA Championship events, and many other events bring hundreds of thousands participants, spectators, and tourists to Salem and the surrounding area.

As fiscal year 2006 closed, a number of initiatives that will benefit the City for years to come were completed. Salem entered into a new 20-year contract with American Electric Power to provide electric power to the City's electric distribution system. An expiring contract with Waste Management, Inc. was renegotiated providing for an additional ten years of solid waste disposal at very favorable terms. Simultaneously, the new Solid Waster Transfer Station was dedicated. In the spring of 2006, the City sold

\$25 million in bonds to upgrade and add to two substations and build two additional ones to meet the City's needs. Included also is a new warehouse and administration building that will get under way soon. The East Main Street Widening Project was completed along with upgrades or replacements to bridges and storm drains. The Police Department was reaccredited while the Sheriff's Department was accredited for the first time.

In the area of Parks and Recreation, final design was completed for the Roanoke River Greenway along with improvements to the Skate Park and the 419 River Park. Construction began on the new Spartan Stadium which will be utilized by soccer and lacrosse teams on the high school and college level along with a variety of youth sports.

Like many businesses and other local governments Salem will soon face the retirement of the "Baby Boomer Generation". In order to effectively plan for this event the City has created a "Leadership Program" to identify and instill in the younger management staff the ethics, knowledge, education, and technical training to pass on the "Salem Way" to future leaders of the City. Currently, over 50 individuals are enrolled in this program.

Prospects for the Future

The budget for 2006-07 includes the continuation of a new pay plan along with both cost-of-living and merit increase. It maintains all real and personal property tax rates. Since this is not a reassessment year, tax revenue is expected to be consistent with overall CPI increases. Rates for electricity increased by 8 percent while Water and Sewer rates increased by 15 percent each as a result of contractual obligations. Overall the General Fund, which includes the School Division, increased by 4.0 percent over the amended 2005-06 Budget and meets all of the City's current requirements.

The new Public Safety addition with a newly enhanced E-911 Communications center, classrooms, and office space is now under construction and will be completed in fall 2006. Salem's first major upgrade to its electric distribution system since the early 80's is underway. This upgrade will include two new substations, improvements to existing stations and an upgrade to distribution lines. This project is expected to be complete in spring 2007. A new Electric Department Administration Building / Warehouse Facility is nearing final design with construction expected to begin in the winter 2007.

The City is looking at the effects of the new GASB 45 regulations and its impact on the City. An actuarial study will begin soon. Implementation is expected during fiscal year 2008-09 as required.

The City of Salem was authorized by the State Corporation Commission to provide local exchange telecommunication services. The City has undertaken a feasibility study to evaluate the provision of a broad range of services, which may include broadband, cable, wireless, phone and other telecommunication services.

Lastly, Salem City Council accepted Management's recommendation to move to an annual reassessment process for real estate. This process will allow for a more even and predictable growth in real estate rather than the current bi-annual process; this transition will take place in the 2007-08 fiscal year.

Independent Audit

Virginia law and the Charter of the City of Salem require that the financial statements of the City be audited by a Certified Public Accountant selected by City Council. Brown, Edwards & Company, L.L.P., has performed an annual audit of the Comprehensive Annual Financial Report. Their audit was conducted in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Auditor of Public Accounts of the Commonwealth of Virginia. The auditor's report, which includes their opinion on the financial statements of the City, is contained in the Financial Section of this report. Other auditor's reports are included in the Compliance Section.

Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) has awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Salem, Virginia, for its Comprehensive Annual Financial Report for 2005. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized Comprehensive Annual Financial Report, whose contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements. We believe this report conforms to the Certificate of Achievement Program requirements and standards and are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgments

We would like to express our appreciation to the staff of the Finance department for the dedication and professionalism-demonstrated daily assuring the financial integrity of the City and the preparation of this report. We would also like to express our appreciation to you, City Council, for the continued insight to bring to this City and the strong commitment you have made to its fiscal integrity and financial leadership. Lastly, we would like to express our appreciation to our independent auditing firm. Brown, Edwards & Company, L.L.P., for their cooperation and input in our efforts.

Respectfully submitted,



Forest G. Jones
City Manager



Frank P. Turk
Director of Finance

CITY OF SALEM, VIRGINIA

**DIRECTORY OF PRINCIPAL OFFICIALS
June 30, 2006**

MEMBERS OF CITY COUNCIL

Carl E. Tarpley, Jr..... Mayor
Howard C. Packett..... Vice-Mayor
John C. Givens
John C. Clemens
Jane W. Johnson

GENERAL CITY GOVERNMENT

Forest G. Jones..... City Manager
Jay Taliaferro..... Assistant City Manager and Clerk of Council
Frank P. Turk..... Director of Finance
Stephen M. Yost..... City Attorney
Bonnie C. McCormack..... City Treasurer
Linda M. Carroll..... Commissioner of Revenue
Thomas E. Bowers..... Commonwealth's Attorney
Gary Chance Crawford..... Clerk of Circuit Court
Roger L. Surber..... City Sheriff
Carolyn H. Barrett..... Director of Human Resources
Mark R. Waldron..... Director of Management Information Services
James R. Bryant..... Chief of Police Department
Chester G. Counts..... Fire Chief
Chuck Van Allman..... City Engineer
Norman M. Tyler, Jr..... Director of Streets and General Maintenance
John Shaner..... Director of Parks and Recreation Department
Janis Augustine..... Library Director
Dana Oliver..... Registrar
A. K. Briele, III..... Director of Electric Department
Melvin Doughty..... Director of Water and Sewer Department
Wendel I. Ingram..... Real Estate Assessor
Charles B. Aldridge, Sr..... Building Official and Zoning Administrator
James M. Fender, Jr..... Director of Solid Waste Disposal
Melinda M. Payne..... Director of Planning and Community Development
R. Carey Harveycutter, Jr..... Director of Civic Facilities

CITY OF SALEM SCHOOL DIVISION

MEMBERS OF SCHOOL BOARD

Sally W. Southard..... Chairman
C. Wayne Adkins..... Vice-Chairman
James L. Chisom
Cindy W. Neathawk
William Sinkler

SCHOOL ADMINISTRATION

Dr. N. Wayne Tripp..... Superintendent of Schools
Michael A. Bryant..... Assistant Superintendent
Frank P. Turk..... Director of Finance
Joseph T. Coleman..... Director of Assessment and Technology
Michael R. Crew..... Director of Business Services
Russell L. Holladay..... Director of Personnel Services
Joe G. Kirby, III..... Director of Instruction
Dr. Lewis D. Romano..... Director of Student Services
Diane Washenberger..... Director of Elementary Education

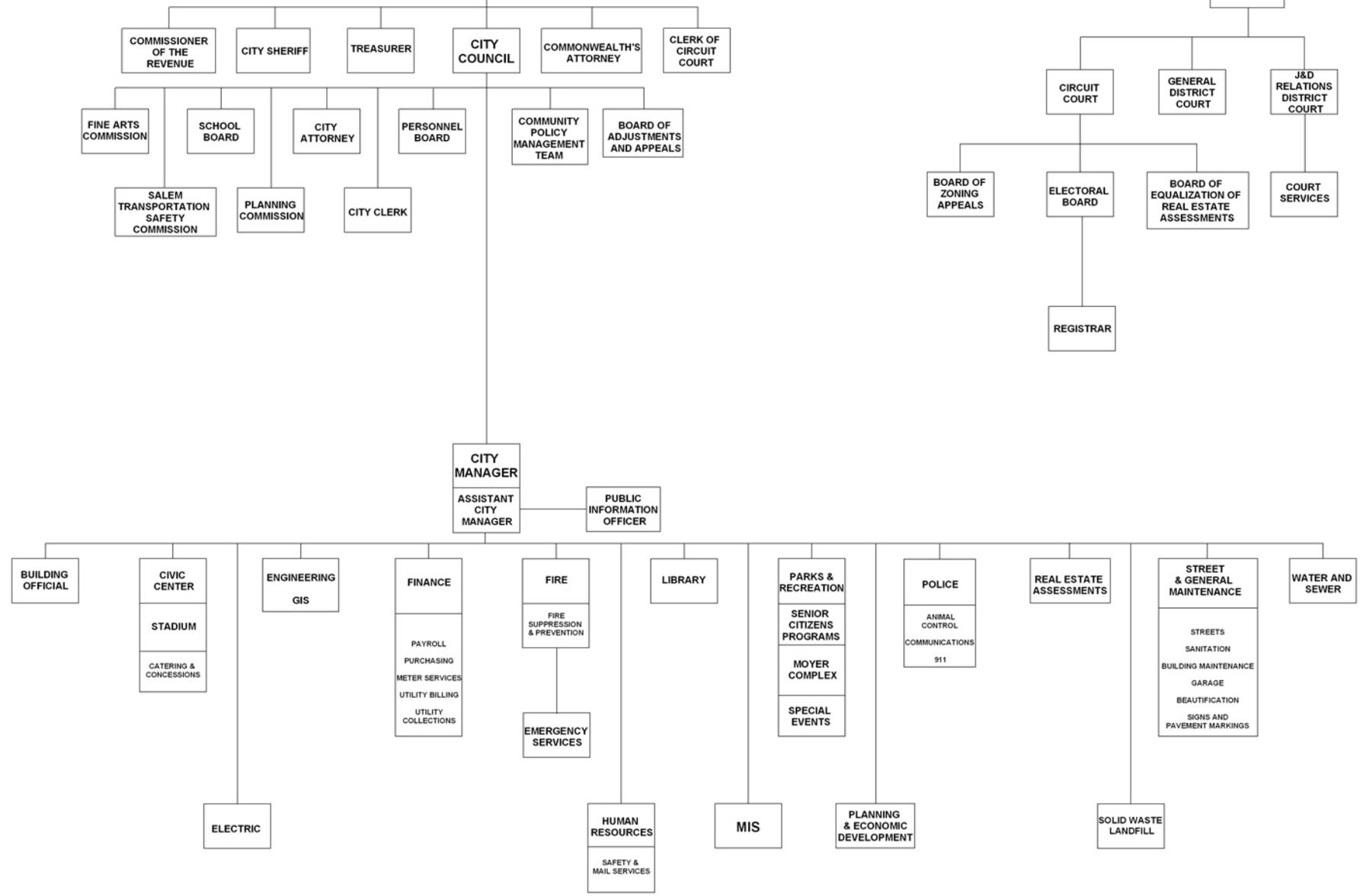


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 P.O. Box 869
 Salem, Virginia 24153-0869
 Phone: (540) 375-3032

CITY OF SALEM ORGANIZATIONAL CHART

VOTERS

LEGISLATURE



Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Salem
Virginia

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2005

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



A handwritten signature in black ink, appearing to read "Ronald J. Hawn".

President

A handwritten signature in black ink, appearing to read "Jeffrey R. Emer".

Executive Director



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FINANCIAL SECTION

INDEPENDENT AUDITOR'S REPORT

To the Honorable Members of the City Council
City of Salem, Virginia
Salem, Virginia

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Salem, Virginia as of and for the year ended June 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion 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; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Specifications for Audits of Counties, Cities, and Towns*, issued by the Auditor of Public Accounts of the Commonwealth of Virginia. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Salem, Virginia, as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof and the 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 November 17, 2006, on our consideration of the City's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis and supplementary information on pages 3a and 41, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The introductory section, combining and individual nonmajor fund statements, and statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of the City. The combining and individual nonmajor fund financial statements and the schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Brown, Edwards & Company, S. L. P.

CERTIFIED PUBLIC ACCOUNTANTS

Roanoke, Virginia
November 17, 2006

**CITY OF SALEM, VIRGINIA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

The following discussion and analysis of the City of Salem's financial performance provides an overview of the City's financial activities for the fiscal year ended June 30, 2006. It should be read in conjunction with the transmittal letter and the City's basic financial statements.

FINANCIAL HIGHLIGHTS

- The total assets of the City of Salem Primary Government exceeded its liabilities as of June 30, 2006 by \$134.4 million (*net assets*). Of this amount, \$30 million (*unrestricted net assets*) may be used to meet the City's future obligations to citizens and creditors.
- During the year, the City's governmental activities reflect an increase in net assets of \$6.4 million. Net assets totaling \$8.2 million are unrestricted.
- The business-type activities net assets at June 30, 2006 totaled \$58.8 million, a decrease of \$0.6 million from the June 30, 2005 balance. Of this amount, approximately \$21.8 million is unrestricted.
- Component unit net assets decreased by \$1.8 million to \$42.7 million. Of this amount, \$1 million is unrestricted while \$41.8 million is invested in capital assets (Exhibit I).
- At the end of the current fiscal year, undesignated fund balance for the general fund was approximately \$6.4 million or 11.12% of fiscal year 2006 general fund revenues. The City Council has stated its intent to keep the undesignated general fund balance at a minimum of 10.0% of general fund revenues.

OVERVIEW OF THE FINANCIAL STATEMENTS

Our discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's financial statements present two types of statements, each with a different snapshot of the City's finances. The focus is on both the City as a whole (government-wide) and the fund financial statements. The government-wide financial statements provide both short-term and long-term information about the City's overall financial status. The fund financials focus on the individual parts of City government, reporting the City's operations in more detail than the government-wide statements, which present a longer-term view. Presentation of both perspectives provides the user a broader overview, enhances the basis for comparisons, and better reflects the City's accountability.

Government-Wide Financial Statements

The government-wide financial statements include the Statement of Net Assets and the Statement of Activities. These statements provide information about the City as a whole using the accrual basis of accounting, which is the method used by most private-sector enterprises. All current year revenues and expenses are reported in the Statement of Activities regardless of when cash is received or paid.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)**

These statements allow readers to answer the question, "Is the City's financial position, as a whole, better or worse as a result of the year's activities?"

One of the main goals of these two statements is to report the City's net assets and changes that affected net assets during the fiscal year. The change in the City's net assets, the difference between assets and liabilities, is one way to measure the City's financial health, or financial position. Increases or decreases in net assets are indicators of whether the City's financial health is improving or deteriorating. Other non-financial factors, such as changes in the City's property tax base and the condition of the City's infrastructure should also be considered in assessing the overall financial health of the City.

In the Statement of Net Assets and the Statement of Activities, the City's fund-based activity is classified as follows:

Governmental activities – Most of the City's basic services are reported here, including general government, judicial administration, public safety, public works, health and welfare, education, parks and recreation, and community development departments. Property taxes, other local taxes, and federal and state grants finance most of these activities.

Business-type activities – The City's Electric Distribution System, Water and Sewer, Civic Center, and Catering and Concessions are reported here as the City charges a fee to customers designed to cover all or most of the cost of services it provides.

Component unit – The City includes a discretely presented component unit in this report, the School Division. Although legally separate, the component unit is important because the City of Salem is financially accountable for it.

Fund Financial Statements

The fund financial statements begin on page 7 and provide detailed information about the most significant funds, not the City as a whole. The City has three types of funds.

Governmental funds – Most of the City's basic services are included in governmental funds. Fund-based statements for these funds focus on how resources flow into and out of those funds and the balances left at year-end that are available for future spending. These funds are reported on the modified accrual basis of accounting, which measures cash and other liquid assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term overview that helps the reader determine the financial resources that can be spent in the near future to finance the City's programs. The differences between governmental activities as reported in the government-wide and fund financial statements are reconciled in Exhibits 3 and 4 on pages 7 and 8.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Proprietary funds – When the City charges customers for the services it provides, whether to outside customers or to other units of the City, these services are generally reported in proprietary funds. Proprietary funds, like the government-wide statements, utilize the accrual basis of accounting, and their statements provide both short and long-term financial information.

The City's enterprise funds, one type of proprietary fund, are the same as the government-wide business-type activities; however, the fund financial statements provide more detail and additional information, such as cash flows. The City's enterprise funds include the Electric Distribution System, Water and Sewer Fund, Civic Center and Catering and Concessions.

Fiduciary funds – Resources held for other governments or agencies not part of the City are reported as fiduciary funds. These activities are excluded from the government-wide financial statements because the City cannot use these assets to finance its operations. The accounting used for fiduciary funds is much like that used for proprietary funds. The City accounts for assets held on behalf of the Blue Ridge Mental Health, the Cardinal Criminal Justice Academy, and the Court Community Corrections Program as an agency fund. Agency funds are custodial in nature and do not involve measurement of results of operations.

Notes to the basic financial statements. The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the basic financial statements can be found beginning on page 14 of this report.

Required supplementary information. In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information* concerning the City's and progress in funding its obligation to provide pension benefits to its employees. Required supplementary information can be found beginning on page 4p of this report.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)**

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

A comparative analysis of government-wide information is as follows:

Summary of Net Assets:

The following table presents a condensed summary of net assets:

**Summary of Net Assets (as restated)
For the Years Ended June 30, 2006 and 2005
(In Thousands)**

	Governmental Activities		Business-type Activities		Total Primary Government		Component Unit	
	2006	2005	2006	2005	2006	2005	2006	2005
Current and other assets	\$ 13,131	\$ 17,973	\$ 43,099	\$ 28,958	\$ 56,230	\$ 46,931	\$ 5,033	\$ 6,445
Capital assets, net	99,536	90,743	88,666	76,559	188,202	167,302	41,809	42,288
Total Assets	\$ 112,667	\$ 108,716	\$ 131,765	\$ 105,517	\$ 244,432	\$ 214,233	\$ 46,842	\$ 48,733
Other Liabilities	\$ 4,147	\$ 3,853	\$ 6,098	\$ 5,608	\$ 10,245	\$ 9,461	\$ 3,539	\$ 3,623
Long-term liabilities	32,917	35,648	66,908	40,529	99,825	76,177	577	576
Total liabilities	\$ 37,064	\$ 39,501	\$ 73,006	\$ 46,137	\$ 110,070	\$ 85,638	\$ 4,116	\$ 4,199
Net assets:								
Invested in capital assets, net of related debt	\$ 67,413	\$ 59,318	\$ 36,955	\$ 36,502	\$ 104,368	\$ 95,820	\$ 41,809	\$ 42,289
Unrestricted	8,190	9,897	21,804	22,878	29,994	32,775	917	2,245
Total net assets	\$ 75,603	\$ 69,215	\$ 58,759	\$ 59,380	\$ 134,362	\$ 128,595	\$ 42,726	\$ 44,534

The City's combined net assets increased from \$128.6 million to \$134.4 million as a result of an increase in net assets of governmental activities of \$6.4 million and a decrease in net assets of business type activities of \$0.6 million.

Certain amounts for the year 2005 have been changed, see Note 15 on page 37.

Unrestricted net assets, the portion of net assets that can be used to finance the day-to-day operations of the City, totaled \$30 million. Net assets invested in capital assets, net of related debt, represents the amount of capital assets owned by the City, including infrastructure, net of any outstanding debt issued to fund the asset purchase or construction. Net assets are reported as restricted when constraints on asset use are externally imposed by creditors, grantors, contributors, regulators, or are imposed by law through constitutional provisions or enabling legislation.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)**

Component unit net assets decreased \$1.8 million due to the utilization of various funds within the Division. The Division spent \$1,180,419 on several capital projects and one-time equipment purchases. In addition, depreciation on capital assets exceeded new capital assets by \$479,325 further accentuating this year's decrease. The School Division has completed new major capital asset projects until a facilities study is completed and a new plan is formulated.

Summary of Changes in Net Assets:

The following table shows the revenues and expenses of the government:

Summary of Changes in Net Assets									
For the Years Ended June 30, 2006 and 2005									
(In Thousands)									
	Governmental		Business-type		Total		Component		
	Activities		Activities		Primary		Unit		
	2006	2005	2006	2005	2006	2005	2006	2005	
Revenues									
Program Revenues:									
Charges for services	\$ 3,586	\$ 3,320	\$ 39,014	30,558	42,600	33,878	1,477	1,307	
Operating grants and contributions	6,038	5,980	-	-	6,038	5,980	5,595	4,862	
Capital grants and contributions	6,393	315	-	-	6,393	315	-	710	
General Revenues:									
Property taxes	27,162	25,062	-	-	27,162	25,062	-	-	
Local portion of state sales tax	5,635	5,602	-	-	5,635	5,602	-	-	
Business and professional occupational license taxes	3,867	4,033	-	-	3,867	4,033	-	-	
Utility taxes	1,372	1,339	-	-	1,372	1,339	-	-	
Meals tax	2,351	2,190	-	-	2,351	2,190	-	-	
Other taxes	2,625	2,487	-	-	2,625	2,487	-	-	
State aid not restricted to a specific program	3,524	3,597	-	-	3,524	3,597	12,618	11,880	
Interest and investment income	556	502	271	311	827	813	-	-	
Other	619	837	-	-	619	837	413	130	
Payments from Salem City	-	-	-	-	-	-	16,266	15,618	
Total Revenues	\$ 63,728	\$ 55,264	\$ 39,285	\$ 30,869	\$ 103,013	\$ 86,133	\$ 36,369	\$ 34,507	

**MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)**

**Summary of Changes in Net Assets
For the Years Ended June 30, 2006 and 2005
(In Thousands)**

	Governmental		Business-type		Total		Component	
	Activities		Activities		Primary		Unit	
	2006	2005	2006	2005	2006	2005	2006	2005
Expenses								
General Government	\$ 5,107	\$ 4,284	\$ -	\$ -	\$ 5,107	\$ 4,284	\$ -	\$ -
Judicial Administration	1,458	1,293	-	-	1,458	1,293	-	-
Public Safety	13,547	11,535	-	-	13,547	11,535	-	-
Public Works	12,443	10,789	-	-	12,443	10,789	-	-
Health and Welfare	2,055	1,823	-	-	2,055	1,823	-	-
Parks, Recreation and Cultural	5,240	3,852	-	-	5,240	3,852	-	-
Community Development	933	513	-	-	933	513	-	-
Education	16,266	15,618	-	-	16,266	15,618	38,177	35,591
Non-Departmental	-	2,424	-	-	-	2,424	-	-
Interest and Fiscal Charges	1,267	1,478	-	-	1,267	1,478	-	-
Electric Distribution	-	-	24,692	15,272	24,692	15,272	-	-
Water and Sewer	-	-	10,836	9,503	10,836	9,503	-	-
Civic Center	-	-	2,365	2,200	2,365	2,200	-	-
Catering and Concessions	-	-	1,037	960	1,037	960	-	-
Total Expenses	\$ 58,316	\$ 53,609	\$ 38,930	\$ 27,935	\$ 97,246	\$ 81,544	\$ 38,177	\$ 35,591
Excess/(Deficiency) before								
Transfers	5,412	1,655	355	2,934	5,767	4,589	(1,808)	(1,084)
Transfers	976	(71)	(976)	71	-	-	-	-
Increase (Decrease) in Net Assets	6,388	1,584	(621)	3,005	5,767	4,589	(1,808)	(1,084)
Net Assets, Beginning, as reported								
of Restatement of Prior Period	69,215	67,631	59,380	56,375	128,595	124,006	44,534	45,618
Net Assets, Ending	\$ 75,603	\$ 69,215	\$ 58,759	\$ 59,380	\$ 134,362	\$ 128,595	\$ 42,726	\$ 44,534

The property tax classification, which comprises approximately 42.6% of total revenue generated by governmental activities, includes real estate tax, the local portion of personal property tax, and public service corporation taxes. Real estate tax revenue, the largest source of revenue for the City, totaled \$18.8 million. Fiscal year 2006 was a reassessment year, and the assessed value of real property in the City increased approximately 10%.

In 1998, the Commonwealth enacted the Personal Property Tax Relief Act for personal vehicles and modified the Act again during FY2006. The Commonwealth share of personal property under this act totaled \$2.5 million and is included in the other taxes category. Personal property tax revenue, including the Commonwealth share, totaled \$8.2 million. The net assessed value of personal property increased approximately 4% from 2005.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)**

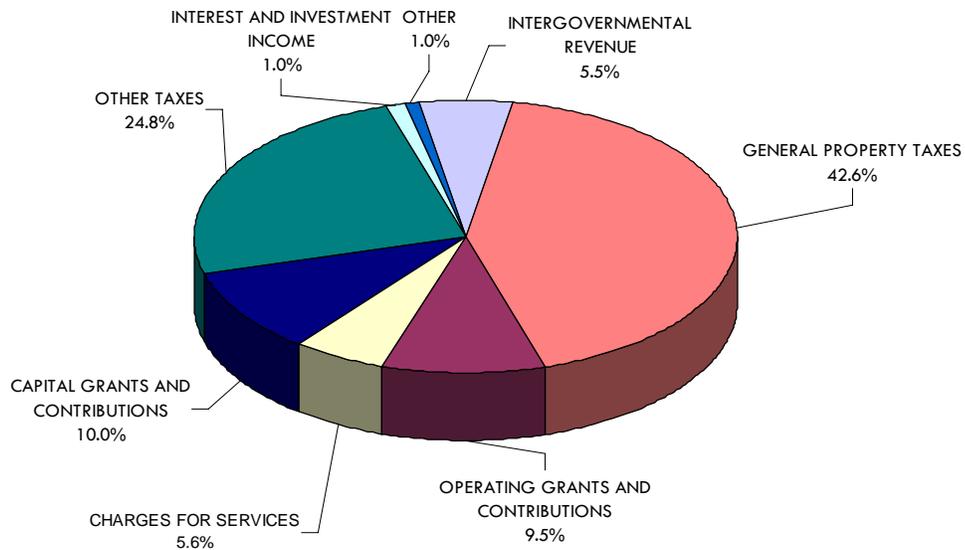
Sales taxes, utility taxes, business and professional occupational license taxes, prepared food and beverage taxes, transient room taxes; cigarette taxes and utility taxes comprise the majority of other local taxes collected by the City. Other taxes comprise approximately 24.8% of total revenues generated for government activities.

Operating grants and contributions comprise approximately 9.5% of governmental activities revenue with revenue remaining comparable with the prior year. Street maintenance funds, reimbursement for social service programs, funding received under House Bill 599 for law enforcement, and reimbursement for shared expenses of the constitutional officers are some of the major sources of revenue included in this category. The primary source of these revenues, state and federal funds, were mostly level funded in 2006.

Charges for services include items such as fines, court fees, inspection fees, garbage collection fees and recreation and other program-based fees and increased slightly from the prior year.

Revenues generated for governmental activities are presented below by category:

REVENUES



MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Local support of education expenses comprises 27.9% of governmental activities. Funding of \$16.3 million was provided to the Salem City School Board to support School operations, an increase of 4% from fiscal year 2005.

Public Safety expenses comprised approximately 23.2% of expenses of the governmental activities. Operations of the Police and Fire Departments are included in this category, along with expenses of Emergency Medical Services, Communications (E911 Call Center), and the cost of juvenile justice programs. Expenses for both the Police and Fire departments increased from the prior year largely due to increased personnel costs.

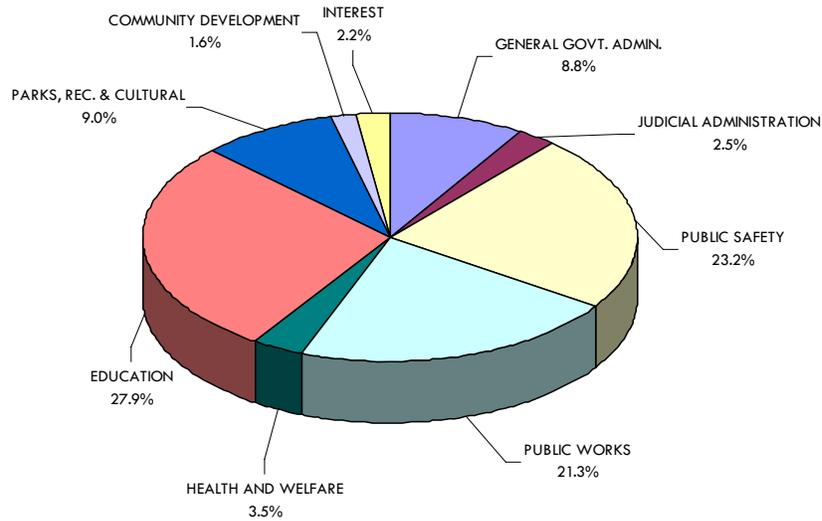
Public Works and Parks, Recreation and Cultural expenses comprised approximately 21.3% and 9.0% respectively, of governmental activities expenses. Expenses for Engineering, Solid Waste Management, Building Maintenance, Street Paving, Traffic Engineering and Street Maintenance are included in the Public Works category. Maintenance of City parks, library expenses and expenses for City-wide recreational and athletic events are included in the Parks, Recreation and Cultural expense category. The Comprehensive Services Act and social services programs incurred the majority of expenses reported in the Health and Welfare category, which comprised 3.5% of governmental activities expenses.

Net transfers of \$975,685 between the business-type activities and governmental activities represent a payment in lieu of taxes of \$1,265,000 received by the General Fund and \$850,000 received by the Capital Projects fund less operational support of the Civic Center in the amount of \$1,129,284 and \$10,031 in capital assets transferred by the General Fund.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)**

Expenses of the governmental activities are shown below by functional area:

EXPENDITURES



The net assets of governmental activities increased \$6.4 million during 2006. Significant current year activities affecting net assets include:

- Property taxes increased approximately 8% from the prior year largely due to real estate reassessments. In addition, machinery and tools tax increased approximately 5% due to business investment. Other local taxes including sales, meals and lodging also increased from the prior year.
- Governmental activities expense increased \$4.7 million from the prior year due to increased operational costs of all functions.
- Capital grants and contributions were up over \$6 million from the previous fiscal year because of a contribution of assets from the Virginia Department of Transportation related to the East Main Street transportation project.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)**

The net assets of business-type activities decreased approximately \$0.6 million during 2006. Significant current year activities affecting net assets include:

- The wholesale rate paid by the City for electricity increased approximately 70% under the new contract, which was effective July 1, 2005.
- This increase necessitated an increase of approximately 38% in the rates charged to customers for electricity. Water and sewer rates increased approximately 15% each to cover increasing operation costs.
- A transfer from the General Fund of \$1,129,284 to the Civic Center for support of its operations and capital improvements.
- The Electric Fund transferred \$1,265,000 as payment in lieu of taxes to the General Fund, \$850,000 to the Capital Projects Fund to cover project costs and \$390,000 to the Civic Center Fund to fund renovation expenses.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

For the fiscal year ended June 30, 2006, the governmental funds reflect a total fund balance of \$8,640,117. Approximately \$5.9 million of this amount constitutes unreserved fund balance, which is available for spending for services and capital projects. Unreserved fund balance is designated to purchase capital equipment, pay self-insured claims, pay for future years' capital projects expenditures and provide for unforeseen circumstances. The remainder of fund balance is reserved for encumbrances, which indicates that it has already been committed to liquidate contracts and purchase orders outstanding at year-end.

The General Fund is the chief operating fund of the City. At the end of the current fiscal year, the general fund unreserved fund balance was \$6,388,650, while the total fund balance was \$7,851,760. As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents approximately 11.5% of the total General Fund expenditures, while total fund balance represents 14.2% of that same amount.

During the year, a portion of the previous years fund balance may be appropriated and expended. In addition, encumbrances unpaid at the end of the prior year are liquidated, increasing expenditures. The fund balance of the General Fund decreased by \$3,861,948 due to City Council's appropriation of approximately \$3.2 million of prior year fund balance to fund general government capital projects and Civic Center improvements. The decision to utilize existing resources to provide needed funding for capital projects was made in order to balance the City's need for borrowing in the Enterprise Funds and bring to a conclusion other projects that City Council was committed to.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Property and local taxes generated the majority of General Fund revenue, totaling approximately \$44 million in fiscal year 2006. Real estate taxes showed substantial growth of 10.7% because FY06 was a reassessment year. Machinery and tools tax increased approximately 5% due to increased business investment. Personal property tax increased approximately 4%. There were no increases in the rates assigned to any of the City's real, personal property or other taxes.

Intergovernmental revenue is the next largest source of General Fund revenues, generating approximately \$8.6 million in fiscal year 2006. Most of this revenue is received from the Commonwealth and includes reimbursement for social services programs, library grants, law enforcement funding received under House Bill 599 and street maintenance funds. Reimbursements received for street maintenance funding and the Comprehensive Services Act increased from the prior year.

The Capital Projects Fund balance decreased approximately \$1.3 million due to expenditures for on-going projects, including the public safety building addition and construction of the new transfer station.

GENERAL FUND BUDGETARY HIGHLIGHTS

The City's budget is prepared in accordance with the *Code of Virginia*. During the year, the City amended the original budget primarily for the following purposes:

- To re-appropriate monies to pay for commitments in the form of encumbrances established prior to June 30, 2005, but not paid by that date.
- To re-appropriate grants, donations and other revenues authorized in fiscal year 2005 or earlier, but not expended or encumbered as of June 30, 2005.
- To appropriate grants, donations, and other revenues accepted or adjusted in fiscal year 2006 when official notice of approval was received.
- To appropriate the designated general fund balance to capital projects.
- To appropriate funds as authorized by City Council during the mid-year review process.

Below is a condensed version of the budgetary comparison of the General Fund original budget, amended budget and actual amounts for the fiscal year 2006.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)**

Budgetary Highlights for 2006

	Original Budget	Budget As Amended	Actual
Revenues/Transfers In	\$ 56,832,006	\$ 58,985,366	\$ 58,739,491
Expenditures	52,796,688	56,293,511	55,351,795
Transfers Out	(6,960,320)	(6,956,379)	(7,249,644)
Use of Fund Balance	<u>\$ (2,925,002)</u>	<u>\$ (4,264,524)</u>	<u>\$ (3,861,948)</u>

CAPITAL ASSETS

As of June 30, 2006, the City's capital assets for its governmental and business-type activities amounted to \$188.2 million net of accumulated depreciation. This investment includes land, historical treasures, construction in progress, land improvements, buildings and structures, equipment and infrastructure. The total net increase (additions less retirements and depreciation) in the City's investment in capital assets for the current fiscal year was \$20.9 million or 12.5%.

**Capital Assets
Net of Depreciation
(In Millions)**

	Governmental Activities		Business-type Activities		Total	
	Balance 2006	Balance 2005	Balance 2006	Balance 2005	Balance 2006	Balance 2005
Land and Improvements	\$ 4.5	\$ 4.5	\$ 1.3	\$ 1.3	\$ 5.8	\$ 5.8
Buildings and Improvements	19.4	19.3	3.9	4.0	23.3	23.3
Equipment	4.5	4.3	2.3	1.8	6.8	6.1
Infrastructure	54.6	56.5	-	-	54.6	56.5
Construction in Progress	16.5	6.1	18.2	4.5	34.7	10.6
Distribution and Transmission	-	-	7.0	7.2	7.0	7.2
Utility Plant	-	-	39.5	40.9	39.5	40.9
Sewage Treatment Contract	-	-	16.5	16.9	16.5	16.9
Total	<u>\$ 99.5</u>	<u>\$ 90.7</u>	<u>\$ 88.7</u>	<u>\$ 76.6</u>	<u>\$ 188.2</u>	<u>\$ 167.3</u>

The changes in each category of Capital Assets are presented in detail in note 6 to the Basic Financial Statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

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

- Expenditures of \$2,772,000 were incurred during the current year for construction of the new transfer station. The new transfer station was put in service during the fall of 2006.
- Construction continued on the addition to the Public Safety Building, which will house a communication center, administrative offices, classrooms and locker rooms for the Police Department and is expected to cost \$5 million dollars. Expenditures of \$1,405,000 were incurred during 2006. The project is expected to be completed before the end of FY07.
- Installation of a new elevator at the Salem Football Stadium was completed during FY06 at a cost of \$362,000.
- Business-type asset activity included the construction of two new electric substations and the upgrade of existing electric substations, which will increase the reliability of the City's electric distribution system. Expenses of \$9.6 million were incurred. The project is expected to be completed in the spring of 2007.
- Renovation was completed on the Salem High School cafeteria and serving line at a cost of approximately \$600,000.

LONG-TERM DEBT

At June 30, 2006, the City's long-term liabilities, excluding compensated absences, landfill liability and claims payable totaled \$98,978,942 comprised of \$32,123,210 related to governmental activities, and \$66,855,732 related to business-type activities. Total debt increased by \$23,497,356 during the fiscal year due to the issuance of \$25,000,000 general obligation bonds to fund the electric system expansion project. Also, an additional \$3,567,356 was borrowed from the Virginia Resource Authority to fund upgrades to the regional water pollution control plant. Principal payments made during FY06 totaled \$5,070,000. Detailed information regarding these changes in long-term debt is disclosed in Note 7 to the financial statements.

With its most recent rating, the City maintained a rating of Aa3 from Moody's Investor Service.

The Charter of the City of Salem and the Code of Virginia limits the City's net debt to 18% of the assessed valuation of real estate within the City limits. This limit applies to governmental fund tax supported debt and some long-term liabilities of business-type funds. The City considers long-term debt of its Electric, Water and Sewer Funds to be self-supporting. The City's tax-supported debt of \$32,123,210 is below the legal debt limit of \$160,772,446. Table 9 on page 6d provides additional information.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)**

The School Board Component Unit relies upon the City to provide full faith and credit for any debt obligations incurred. Therefore, the City reports School Board Component Unit long-term liabilities, other than claims payable and compensated absences, as its own. In addition to bonded debt the City's long-term obligations include compensated absences and estimated landfill liability. Additional information concerning the City's long-term liabilities is presented in note 7 and Table 9 of this report.

Interest and fiscal charges for 2006 were \$1,263,219 or 2.17% of total governmental activities expenses.

FACTORS INFLUENCING FUTURE BUDGETS

Key factors that are expected to impact future budgets include:

- Uncertainty regarding the economy and state funding.
- Projected increases in health insurance premiums and retirement contribution rates assessed by the Virginia Retirement System.
- Funding for the Capital Improvement Program.
- Implementation of the requirements of GASB 45 effective with fiscal year 2008-09.

Effective July 1, 2006, water and sewer rates increased an average of 15% to cover increasing operational costs and fund on-going capital improvements. The City negotiated a new, twenty year contract to purchase electricity, which became effective July 1, 2006. The rate the City will pay for wholesale electricity will vary based on the supplier's costs. Effective July 1, 2006, electric rates increased an average of 8%.

REQUESTS FOR INFORMATION

This financial report is designed to provide our citizens, tax payers, customers, and investors and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the resources it receives. If you have any questions about this report or need additional information, contact the Director of Finance, City of Salem, 114 North Broad Street, Salem, Virginia 24153, telephone number (540) 375-3061, or visit the City's website at www.ci.salem.va.us

Additional information on the Component Unit can be obtained from the Director of Business Service, Salem Public Schools, 510 South College Avenue, Salem, Virginia 24153.



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BASIC FINANCIAL STATEMENTS

CITY OF SALEM, VIRGINIA

STATEMENT OF NET ASSETS

June 30, 2006

	Primary Government			Component
	Governmental Activities	Business-type Activities	Total	Unit School Division
ASSETS				
Cash and cash equivalents (Note 2)	\$ 4,839,993	\$ 17,017,710	\$ 21,857,703	\$ 4,279,006
Investments (Note 2)	-	3,961,576	3,961,576	-
Receivables, net (Note 3)	2,341,316	4,806,198	7,147,514	2,499
Due from component unit	1,278	-	1,278	-
Due from other governmental units (Note 5)	4,236,231	-	4,236,231	711,367
Internal balances (Note 4)	(4,685)	4,685	-	-
Inventories	474,946	2,094,647	2,569,593	40,378
Prepaid items	-	69,873	69,873	-
Restricted assets:				
Cash and cash equivalents (Note 2)	1,242,356	15,144,419	16,386,775	-
Capital assets: (Note 6)				
Depreciable, net	78,545,060	69,169,635	147,714,695	40,454,342
Nondepreciable	20,990,943	19,496,362	40,487,305	1,354,660
Total Assets	112,667,438	131,765,105	244,432,543	46,842,252
LIABILITIES				
Accounts payable and accrued liabilities	2,398,261	4,215,795	6,614,056	239,793
Accrued interest	265,315	1,001,078	1,266,393	-
Accrued payroll and related liabilities	798,728	261,900	1,060,628	3,286,861
Self insurance claims liability (Note 13)	575,119	75,082	650,201	-
Due to primary government	-	-	-	1,278
Unearned revenue (Note 3)	109,698	140,395	250,093	11,808
Customer security deposits	-	403,885	403,885	-
Long-term liabilities:				
Due within one year (Note 7)	3,608,979	2,801,281	6,410,260	314,306
Due in more than one year (Note 7)	29,308,439	64,106,438	93,414,877	262,529
Total Liabilities	37,064,539	73,005,854	110,070,393	4,116,575
NET ASSETS				
Invested in capital assets, net of related debt	67,412,793	36,954,684	104,367,477	41,809,002
Unrestricted	8,190,106	21,804,567	29,994,673	916,675
Total Net Assets	\$ 75,602,899	\$ 58,759,251	\$ 134,362,150	\$ 42,725,677

CITY OF SALEM, VIRGINIA

STATEMENT OF ACTIVITIES

Year Ended June 30, 2006

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets			Component Unit School Division
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government		Total	
					Governmental Activities	Business-type Activities		
Primary government:								
Governmental activities:								
General government administration	\$ 5,107,268	\$ 104,840	\$ 253,143	\$ -	\$ (4,749,285)		\$ (4,749,285)	
Judicial administration	1,457,720	166,975	404,405	-	(886,340)		(886,340)	
Public safety	13,547,191	1,315,417	2,146,892	-	(10,084,882)		(10,084,882)	
Public works	12,443,334	1,799,284	2,972,787	6,392,874	(1,278,389)		(1,278,389)	
Health and welfare	2,055,166	-	-	-	(2,055,166)		(2,055,166)	
Education	16,266,005	-	-	-	(16,266,005)		(16,266,005)	
Parks, recreation, and cultural	5,239,517	199,233	260,941	-	(4,779,343)		(4,779,343)	
Community development	933,002	89	-	-	(932,913)		(932,913)	
Interest on long-term debt	1,267,296	-	-	-	(1,267,296)		(1,267,296)	
Total governmental activities	<u>58,316,499</u>	<u>3,585,838</u>	<u>6,038,168</u>	<u>6,392,874</u>	<u>(42,299,619)</u>		<u>(42,299,619)</u>	
Business-type activities:								
Electric	24,692,031	27,699,386	-	-		\$ 3,007,355	3,007,355	
Water and sewage	10,836,280	9,529,125	-	-		(1,307,155)	(1,307,155)	
Civic Center	2,364,891	793,716	-	-		(1,571,175)	(1,571,175)	
Catering and concessions	1,036,737	991,208	-	-		(45,529)	(45,529)	
Total business-type activities	<u>38,929,939</u>	<u>39,013,435</u>	<u>-</u>	<u>-</u>		<u>83,496</u>	<u>83,496</u>	
Total primary government	<u>\$ 97,246,438</u>	<u>\$ 42,599,273</u>	<u>\$ 6,038,168</u>	<u>\$ 6,392,874</u>	<u>(42,299,619)</u>	<u>83,496</u>	<u>(42,216,123)</u>	
Component unit:								
School division	<u>\$ 38,176,635</u>	<u>\$ 1,476,768</u>	<u>\$ 5,594,779</u>	<u>\$ -</u>				<u>\$ (31,105,088)</u>
General revenues:								
Property taxes					27,161,942	-	27,161,942	-
Meals tax					2,351,010	-	2,351,010	-
Local sales and use taxes					5,634,585	-	5,634,585	-
Utility taxes					1,372,250	-	1,372,250	-
Business license tax					3,866,585	-	3,866,585	-
Other taxes					2,625,066	-	2,625,066	-
Intergovernmental revenue not restricted					3,523,634	-	3,523,634	-
Payments from City of Salem					-	-	-	16,266,005
State aid – unrestricted					-	-	-	12,618,480
Unrestricted investment earnings					556,039	271,303	827,342	-
Gain on sale of property					402,089	-	402,089	-
Other					218,274	-	218,274	412,632
Transfers (Note 4)					975,685	(975,685)	-	-
Total general revenues and transfers					<u>48,687,159</u>	<u>(704,382)</u>	<u>47,982,777</u>	<u>29,297,117</u>
Change in net assets					6,387,540	(620,886)	5,766,654	(1,807,971)
Net assets at July 1, as restated (Note 15)					<u>69,215,359</u>	<u>59,380,137</u>	<u>128,595,496</u>	<u>44,533,648</u>
Net assets at June 30					<u>\$ 75,602,899</u>	<u>\$ 58,759,251</u>	<u>\$ 134,362,150</u>	<u>\$ 42,725,677</u>

The Notes to Financial Statements are an integral part of this statement.

CITY OF SALEM, VIRGINIA

BALANCE SHEET
GOVERNMENTAL FUNDS

June 30, 2006

	General	Debt Service	Capital Projects	Total Governmental Funds
ASSETS				
Cash and cash equivalents	\$ 4,839,993	\$ -	\$ -	\$ 4,839,993
Cash and cash equivalents, restricted	-	-	1,242,356	1,242,356
Receivables, net	2,341,316	-	-	2,341,316
Due from component unit	1,278	-	-	1,278
Due from other governmental units	4,186,857	-	49,374	4,236,231
Inventories	474,946	-	-	474,946
Total Assets	<u>\$ 11,844,390</u>	<u>\$ -</u>	<u>\$ 1,291,730</u>	<u>\$ 13,136,120</u>
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable and accrued liabilities	\$ 1,952,077	\$ -	\$ 503,373	\$ 2,455,450
Accrued payroll and related liabilities	798,728	-	-	798,728
Self insurance claims liability	575,119	-	-	575,119
Due to other funds	4,685	-	-	4,685
Deferred revenue	662,021	-	-	662,021
Total Liabilities	<u>3,992,630</u>	<u>-</u>	<u>503,373</u>	<u>4,496,003</u>
Fund Balances:				
Reserved for:				
Inventories	474,946	-	-	474,946
Encumbrances	956,980	-	1,251,705	2,208,685
Unreserved, reported in:				
General fund, designated for				
Uninsured claims	31,184	-	-	31,184
Capital projects, undesignated	-	-	(463,348)	(463,348)
General fund, undesignated	6,388,650	-	-	6,388,650
Total Fund Balances	<u>7,851,760</u>	<u>-</u>	<u>788,357</u>	<u>8,640,117</u>
Total Liabilities and Fund Balances	<u>\$ 11,844,390</u>	<u>\$ -</u>	<u>\$ 1,291,730</u>	

**Amounts reported for governmental activities in the statement of
net assets are different because:**

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.	99,536,003
Other long-term assets are not available to pay for current-period expenditures and therefore are deferred in the funds.	552,323
Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds:	
Bonds payable	(32,123,210)
Deferred costs	670,904
Accrued interest	(265,315)
Compensated absences	(1,407,923)
Net Assets of Governmental Activities	<u>\$ 75,602,899</u>

CITY OF SALEM, VIRGINIA

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
Year Ended June 30, 2006

	General	Debt Service	Capital Projects	Total Governmental Funds
REVENUES				
General property taxes	\$ 27,349,919	\$ -	\$ -	\$ 27,349,919
Other local taxes	16,687,438	-	-	16,687,438
Permits, privilege fees, and regulatory licenses	294,314	-	-	294,314
Fines and forfeitures	150,860	-	-	150,860
Revenue from use of money and property	1,384,562	-	560	1,385,122
Charges for services	2,959,842	-	-	2,959,842
Other	32,544	-	-	32,544
Intergovernmental	8,615,012	-	105,117	8,720,129
Total revenues	<u>57,474,491</u>	<u>-</u>	<u>105,677</u>	<u>57,580,168</u>
EXPENDITURES				
Current:				
General government administration	4,994,542	-	-	4,994,542
Judicial administration	1,321,052	-	-	1,321,052
Public safety	12,707,985	-	-	12,707,985
Public works	9,400,116	-	-	9,400,116
Health and welfare	1,918,490	-	-	1,918,490
Education	16,266,005	-	-	16,266,005
Parks, recreation, and cultural	4,316,920	-	-	4,316,920
Community development	815,991	-	-	815,991
Non-departmental	3,610,694	-	-	3,610,694
Capital projects	-	-	4,325,562	4,325,562
Debt service:				
Principal retirement	-	2,863,024	-	2,863,024
Interest and fiscal charges	-	1,185,708	-	1,185,708
Total expenditures	<u>55,351,795</u>	<u>4,048,732</u>	<u>4,325,562</u>	<u>63,726,089</u>
Excess (deficiency) of revenues over expenditures	<u>2,122,696</u>	<u>(4,048,732)</u>	<u>(4,219,885)</u>	<u>(6,145,921)</u>
OTHER FINANCING SOURCES (USES)				
Transfers in	1,265,000	4,048,732	2,921,628	8,235,360
Transfers out	(7,249,644)	-	-	(7,249,644)
Total other financing sources (uses)	<u>(5,984,644)</u>	<u>4,048,732</u>	<u>2,921,628</u>	<u>985,716</u>
Net change in fund balances	<u>(3,861,948)</u>	<u>-</u>	<u>(1,298,257)</u>	<u>(5,160,205)</u>
FUND BALANCES AT JULY 1	<u>11,713,708</u>	<u>-</u>	<u>2,086,614</u>	
FUND BALANCES AT JUNE 30	<u>\$ 7,851,760</u>	<u>\$ -</u>	<u>\$ 788,357</u>	

Adjustments for the Statement of Activities:

Governmental funds report capital outlays as expenditures while governmental activities report depreciation expense to allocate those expenditures over the life of the assets. Also, capital contributions are not reported as revenues in the fund statements. This is the amount by which capital outlays and capital contributions exceeded depreciation in the current period.	9,034,466
In the Statement of Activities, only the <i>gain</i> on the sale of capital assets is reported, whereas in the governmental funds, the proceeds from the sale increase financial resources. Thus, the change in net assets differs from the change in fund balance by the cost of the capital assets sold.	(242,441)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as fund revenues.	(2,247)
The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the Statement of Activities. This amount is the net effect of these differences in the treatments of long-term debt and related items.	2,785,513
Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.	(27,546)
Change in Net Assets of Governmental Activities	<u>\$ 6,387,540</u>

CITY OF SALEM, VIRGINIA

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN
FUND BALANCES – BUDGET AND ACTUAL – GENERAL FUND
Year Ended June 30, 2006**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with Final Budget Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES				
General property taxes	\$ 29,787,940	\$ 27,298,465	\$ 27,349,919	\$ 51,454
Other local taxes	16,741,831	16,691,831	16,687,438	(4,393)
Permits, privilege fees, and regulatory licenses	294,500	294,500	294,314	(186)
Fines and forfeitures	175,000	175,000	150,860	(24,140)
Revenue from use of money and property	569,500	1,188,250	1,384,562	196,312
Charges for services	2,975,300	3,061,300	2,959,842	(101,458)
Other	24,000	24,000	32,544	8,544
Intergovernmental	4,998,935	8,987,020	8,615,012	(372,008)
Total revenues	<u>55,567,006</u>	<u>57,720,366</u>	<u>57,474,491</u>	<u>(245,875)</u>
EXPENDITURES				
Current:				
General government administration	5,236,192	5,090,240	4,994,542	95,698
Judicial administration	1,459,338	1,359,167	1,321,052	38,115
Public safety	12,066,817	12,889,039	12,707,985	181,054
Public works	9,759,990	10,173,583	9,400,116	773,467
Health and welfare	995,493	2,350,953	1,918,490	432,463
Education	16,547,500	16,553,742	16,266,005	287,737
Parks, recreation, and cultural	3,940,006	4,366,043	4,316,920	49,123
Community development	306,738	830,363	815,991	14,372
Non-departmental	2,484,614	2,680,381	3,610,694	(930,313)
Total expenditures	<u>52,796,688</u>	<u>56,293,511</u>	<u>55,351,795</u>	<u>941,716</u>
Excess of revenues over expenditures	<u>2,770,318</u>	<u>1,426,855</u>	<u>2,122,696</u>	<u>695,841</u>
OTHER FINANCING SOURCES (USES)				
Transfers in	1,265,000	1,265,000	1,265,000	-
Transfers out	(6,960,320)	(6,956,379)	(7,249,644)	(293,265)
Total other financing sources (uses)	<u>(5,695,320)</u>	<u>(5,691,379)</u>	<u>(5,984,644)</u>	<u>(293,265)</u>
Net change in fund balances	<u>\$ (2,925,002)</u>	<u>\$ (4,264,524)</u>	<u>\$ (3,861,948)</u>	<u>\$ 402,576</u>

CITY OF SALEM, VIRGINIA

STATEMENT OF NET ASSETS
PROPRIETARY FUNDS

June 30, 2006

	Business-type Activities – Enterprise Funds			Total
	Electric	Water and Sewage	Nonmajor Enterprise Funds	
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 12,396,694	\$ 3,719,856	\$ 901,160	\$ 17,017,710
Investments	3,961,576	-	-	3,961,576
Receivables, net	3,478,717	1,153,905	173,576	4,806,198
Due from other funds	4,810,170	-	26,212	4,836,382
Inventories	1,854,605	212,788	27,254	2,094,647
Prepaid items	-	-	69,873	69,873
Total current assets	<u>26,501,762</u>	<u>5,086,549</u>	<u>1,198,075</u>	<u>32,786,386</u>
Noncurrent assets:				
Restricted cash	15,144,419	-	-	15,144,419
Capital assets, net	18,886,477	66,653,532	3,125,988	88,665,997
Total noncurrent assets	<u>34,030,896</u>	<u>66,653,532</u>	<u>3,125,988</u>	<u>103,810,416</u>
Total assets	<u>60,532,658</u>	<u>71,740,081</u>	<u>4,324,063</u>	<u>136,596,802</u>
LIABILITIES				
Current liabilities:				
Accounts payable and accrued liabilities	2,638,930	1,335,660	241,205	4,215,795
Accrued interest	158,879	842,199	-	1,001,078
Accrued payroll and related liabilities	71,517	94,245	96,138	261,900
Self insurance claims liability (Note 13)	19,099	39,583	16,400	75,082
Due to other funds	-	4,810,170	21,527	4,831,697
Unearned revenue	2,500	-	137,895	140,395
Customer security deposits	403,885	-	-	403,885
Bonds payable	660,000	1,792,635	-	2,452,635
Compensated absences	130,671	158,995	58,980	348,646
Total current liabilities	<u>4,085,481</u>	<u>9,073,487</u>	<u>572,145</u>	<u>13,731,113</u>
Noncurrent liabilities:				
Bonds payable	24,271,912	39,663,420	-	63,935,332
Compensated absences	86,161	56,389	28,556	171,106
Total noncurrent liabilities	<u>24,358,073</u>	<u>39,719,809</u>	<u>28,556</u>	<u>64,106,438</u>
Total liabilities	<u>28,443,554</u>	<u>48,793,296</u>	<u>600,701</u>	<u>77,837,551</u>
NET ASSETS				
Invested in capital assets, net of related debt	9,030,896	24,797,800	3,125,988	36,954,684
Unrestricted	23,058,208	(1,851,015)	597,374	21,804,567
Total net assets	<u>\$ 32,089,104</u>	<u>\$ 22,946,785</u>	<u>\$ 3,723,362</u>	<u>\$ 58,759,251</u>

CITY OF SALEM, VIRGINIA
STATEMENT OF REVENUES, EXPENSES,
AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUNDS
Year Ended June 30, 2006

	Business-type Activities – Enterprise Funds			Total
	Electric	Water and Sewage	Nonmajor Enterprise Funds	
OPERATING REVENUES				
Charges for services	\$ 26,874,487	\$ 9,019,222	\$ 1,719,520	\$ 37,613,229
Connections and transfers	15,050	141,196	-	156,246
Penalties	79,213	161,023	-	240,236
Pole rentals	118,779	-	-	118,779
Commissions	-	-	23,490	23,490
Equipment rental credits	322,067	121,663	-	443,730
Other	289,790	86,021	51,945	427,756
Total operating revenues	<u>27,699,386</u>	<u>9,529,125</u>	<u>1,794,955</u>	<u>39,023,466</u>
OPERATING EXPENSES				
Salaries	-	1,857,508	1,379,226	3,236,734
Fringe benefits	-	706,299	416,025	1,122,324
Labor charged to capital improvements	-	(354,918)	-	(354,918)
Show expenses	-	-	125,839	125,839
Maintenance	-	887,448	273,092	1,160,540
Billing and collection	323,024	483,732	-	806,756
Professional services	57,402	113,783	24,709	195,894
Insurance	59,249	73,216	16,634	149,099
Purchased power	20,005,964	-	-	20,005,964
Distribution – operations	1,083,598	-	-	1,083,598
Distribution – maintenance	1,371,212	-	-	1,371,212
Administration	676,557	192,403	36,130	905,090
Travel and training	-	16,134	19,674	35,808
Materials and supplies	-	263,502	366,597	630,099
Utilities	-	213,473	236,514	449,987
Miscellaneous	180,445	22,904	12,796	216,145
Depreciation	782,924	2,519,980	280,415	3,583,319
Amortization	1,211	39,769	-	40,980
Treatment of sewage	-	2,046,278	-	2,046,278
Commissions	-	-	213,977	213,977
Total operating expenses	<u>24,541,586</u>	<u>9,081,511</u>	<u>3,401,628</u>	<u>37,024,725</u>
Operating income (loss)	<u>3,157,800</u>	<u>447,614</u>	<u>(1,606,673)</u>	<u>1,998,741</u>
NONOPERATING REVENUES (EXPENSES)				
Interest income	338,723	1,199	605	340,527
Interest expense	(150,445)	(1,754,769)	-	(1,905,214)
Decrease in fair value of investments	(61,728)	(7,496)	-	(69,224)
Net nonoperating revenues (expenses)	<u>126,550</u>	<u>(1,761,066)</u>	<u>605</u>	<u>(1,633,911)</u>
Income (loss) before transfers	3,284,350	(1,313,452)	(1,606,068)	364,830
TRANSFERS IN	-	-	1,519,284	1,519,284
TRANSFERS OUT	<u>(2,505,000)</u>	<u>-</u>	<u>-</u>	<u>(2,505,000)</u>
Change in net assets	779,350	(1,313,452)	(86,784)	(620,886)
NET ASSETS AT JULY 1, AS RESTATED (Note 15)	<u>31,309,754</u>	<u>24,260,237</u>	<u>3,810,146</u>	<u>59,380,137</u>
NET ASSETS AT JUNE 30	<u>\$ 32,089,104</u>	<u>\$ 22,946,785</u>	<u>\$ 3,723,362</u>	<u>\$ 58,759,251</u>

CITY OF SALEM, VIRGINIA
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
Year Ended June 30, 2006

	Business-type Activities – Enterprise Funds			Total
	Electric	Water and Sewage	Nonmajor Enterprise Funds	
OPERATING ACTIVITIES				
Receipts from customers	\$ 21,691,894	\$ 10,834,860	\$ 1,520,652	\$ 34,047,406
Payments to suppliers	(20,787,235)	(2,098,783)	(1,272,780)	(24,158,798)
Payments to employees	(1,979,484)	(2,193,769)	(1,768,402)	(5,941,655)
Other receipts	289,790	86,021	75,435	451,246
Net cash provided by (used in) operating activities	<u>(785,035)</u>	<u>6,628,329</u>	<u>(1,445,095)</u>	<u>4,398,199</u>
NONCAPITAL FINANCING ACTIVITIES				
Interfund transfers	(2,505,000)	-	1,519,284	(985,716)
Net cash provided by (used in) noncapital financing activities	<u>(2,505,000)</u>	<u>-</u>	<u>1,519,284</u>	<u>(985,716)</u>
CAPITAL AND RELATED FINANCING ACTIVITIES				
Proceeds from capital debt	25,000,000	3,567,356	-	28,567,356
Purchases of capital assets	(10,172,059)	(3,852,380)	(253,208)	(14,277,647)
Principal paid on capital debt	(412,769)	(1,794,208)	-	(2,206,977)
Interest paid on capital debt	2,446	(1,663,244)	-	(1,660,798)
Net cash provided by (used in) capital and related financing activities	<u>14,417,618</u>	<u>(3,742,476)</u>	<u>(253,208)</u>	<u>10,421,934</u>
INVESTING ACTIVITIES				
Proceeds from the sale of investments	5,498,151	-	-	5,498,151
Interest received	338,723	1,199	605	340,527
Net cash provided by investing activities	<u>5,836,874</u>	<u>1,199</u>	<u>605</u>	<u>5,838,678</u>
Net increase (decrease) in cash and cash equivalents	16,964,457	2,887,052	(178,414)	19,673,095
CASH AND CASH EQUIVALENTS				
Beginning at July 1	10,576,656	832,804	1,079,574	12,489,034
Ending at June 30 (including \$15,144,419 for the electric fund reported as restricted cash)	<u>\$ 27,541,113</u>	<u>\$ 3,719,856</u>	<u>\$ 901,160</u>	<u>\$ 32,162,129</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) BY OPERATING ACTIVITIES				
Operating income (loss)	\$ 3,157,800	\$ 447,614	\$ (1,606,673)	\$ 1,998,741
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:				
Depreciation and amortization	784,135	2,559,749	280,415	3,624,299
Change in assets and liabilities:				
(Increase) decrease in:				
Receivables, net	(1,094,679)	19,458	13,271	(1,061,950)
Due from other funds	(4,810,170)	2,833	(18,124)	(4,825,461)
Due from component unit	-	1,246,271	-	1,246,271
Inventories	(135,000)	(28,348)	(2,742)	(166,090)
Prepaid items	-	-	23,046	23,046
(Decrease) increase in:				
Accounts payable and accrued liabilities	1,212,934	(2,484,121)	70,725	(1,200,462)
Accrued payroll and related liabilities	46,481	15,120	26,849	88,450
Self insurance claim liability	19,099	39,583	16,400	75,082
Due to other funds	(8,505)	4,810,170	(44,868)	4,756,797
Customer security deposits payable	40,370	-	-	40,370
Deferred revenue	2,500	-	(203,394)	(200,894)
Net cash provided by (used in) operating activities	<u>\$ (785,035)</u>	<u>\$ 6,628,329</u>	<u>\$ (1,445,095)</u>	<u>\$ 4,398,199</u>
NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES				
Capital assets financed with accounts payable	<u>\$ 176,738</u>	<u>\$ 1,249,756</u>	<u>\$ 55,986</u>	<u>\$ 1,482,480</u>
NONCASH INVESTING ACTIVITIES				
Unrealized loss on investments	<u>\$ (61,728)</u>	<u>\$ (7,496)</u>	<u>\$ -</u>	<u>\$ (69,224)</u>

The Notes to Financial Statements are an integral part of this statement.

CITY OF SALEM, VIRGINIA

STATEMENT OF FIDUCIARY NET ASSETS

June 30, 2006

	<u>Agency Funds</u>
ASSETS	
Cash and cash equivalents	\$ 448,305
Accounts receivable, net	1,770
Grant receivable	20,461
Due from Commonwealth of Virginia	<u>66,677</u>
Total assets	<u><u>\$ 537,213</u></u>
LIABILITIES	
Accounts payable	174,713
Accrued expenses	50,929
Liability to agency	<u>311,571</u>
Total liabilities	<u>537,213</u>
NET ASSETS	
Net assets	<u><u>\$ -</u></u>

CITY OF SALEM, VIRGINIA
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 1. Summary of Significant Accounting Policies

A. The Financial Reporting Entity

The Town of Salem was established by act of the Virginia General Assembly in 1806. The City of Salem, Virginia (the "City") was established by act of the Virginia General Assembly in 1968. It is a political subdivision of the Commonwealth of Virginia, operating under the Council-manager form of government. The City Council consists of a mayor and four other council members. The City is not part of a county and has taxing powers subject to state-wide restrictions and tax limits. The City of Salem is the primary government of the reporting entity.

The City provides a full range of municipal services including police and fire, sanitation, health and social services, public improvements, planning and zoning, general administrative services, education, electric, water, and sewer services.

The following entities are excluded from the accompanying financial statements:

Joint Ventures

Roanoke Valley Regional Board

The City of Salem School Division, along with the City of Roanoke and Counties of Botetourt, Franklin, and Craig, jointly participate in a regional education program for severely handicapped students operated by the Roanoke Valley Regional Board (the "Regional Board"). The Regional Board is composed of five members, one from each participating locality. The City has control over budget and financing of the venture only to the extent of representation by the Regional Board member appointed. Each locality's financial obligation is based on their proportionate share of students attending the regional program. For the year ended June 30, 2006, the City's proportionate share was \$328,807, which was paid by the City of Salem School Division. Complete financial statements of the Roanoke Valley Regional Board can be obtained from the Executive Director of The Roanoke Valley Regional Board at 12 Barron Drive, Suite 1, Troutville, Virginia, 24175.

Roanoke Valley Regional Fire – EMS Training Center

The City, along with the County of Roanoke, Virginia, City of Roanoke, Virginia, and the Town of Vinton, Virginia, jointly operate a fire/EMS training center (the "Center"). The Center is governed by a committee designated by the participating jurisdictions. New fire/EMS recruits are required to take a five-month training course at the facility before being assigned to a station. After completion of the training, the new recruits are state certified. Each jurisdiction is responsible for a percentage of the annual operating costs of the facility. The City of Salem is responsible for 8% of the annual operating costs. For the fiscal year ended June 30, 2006, the City paid \$6,000 of the total annual operating costs of the facility. Financial statements may be obtained from the Roanoke Valley Regional Fire/EMS Training Center, 1220 Kessler Mill Road, Salem, Virginia 24153.

CITY OF SALEM, VIRGINIA

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 1. Summary of Significant Accounting Policies (Continued)

A. The Financial Reporting Entity (Continued)

Joint Ventures (Continued)

Western Virginia Regional Jail Authority

The Counties of Roanoke, Franklin, and Montgomery, Virginia, and the City formed the Western Virginia Regional Jail Authority (the "WVRJA") on May 25, 2005 for the purpose of developing and operating a regional jail for the benefit of Member Jurisdictions. The Board consists of three representatives from each of the Member Jurisdictions. The Member Jurisdictions will each be responsible for a per diem cost based on prisoner days used.

Jointly Governed Organizations

Roanoke Valley Detention Commission

The Counties of Botetourt, Craig, and Roanoke, Virginia and the Cities of Roanoke and Salem, Virginia formed the Roanoke Valley Detention Commission (the "Commission") to renovate, expand and operate a detention facility for juveniles. The Commission is governed by a six-member board. Each locality's financial obligation is to be based on the number of juveniles housed at the facility. The Commission has the authority to issue debt and such debt is the responsibility of the Commission.

Blue Ridge Community Services

The Counties of Botetourt, Craig and Roanoke, Virginia and the Cities of Roanoke and Salem, Virginia formed Blue Ridge Community Services ("Blue Ridge") to provide a system of comprehensive community mental health, mental retardation and substance abuse services. Blue Ridge is governed by a sixteen-member board. Each locality's financial obligation is based on the type and amount of services performed for individuals in the locality.

Fifth District Employment and Training Consortium

The Counties of Alleghany, Botetourt, Craig, and Roanoke, Virginia, the Cities of Covington and Salem, and the Town of Clifton Forge, Virginia jointly participate in the Fifth District Employment and Training Consortium (the "Consortium"). The Consortium is governed by an eight-member board.

Fifth Planning District Disability Services Board

The Counties of Alleghany, Botetourt, Craig, and Roanoke, Virginia, the Towns of Vinton and Clifton Forge, Virginia, and the Cities of Roanoke, Salem, and Covington, Virginia jointly participate in the Fifth Planning District Disability Services Board (the "Services Board"). The Services Board provides input to state and local agencies on service needs and priorities of persons with physical and sensory disabilities.

CITY OF SALEM, VIRGINIA
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 1. Summary of Significant Accounting Policies (Continued)

B. Individual Component Unit Disclosure

Discretely Presented Component Unit

The City of Salem School Division (the “School Division”) is a legally separate entity which operates four elementary schools, one middle school, and one high school. School Board members are appointed by City Council. City Council also provides fiscal guidance because it levies taxes for the School Division’s operations and issues debt for its capital projects. Based on these facts, the City reports the School Division as a discretely presented component unit. Separately issued financial statements may be obtained by contacting the City of Salem Schools, Director of Business Services, 510 South College Avenue, Salem, Virginia 24153.

C. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of the primary government. *Governmental activities*, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support.

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

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

D. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

CITY OF SALEM, VIRGINIA
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 1. Summary of Significant Accounting Policies (Continued)

D. Measurement Focus, Basis of Accounting, and Financial Statement Presentation (Continued)

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

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

Agency funds are unlike all other types of funds, reporting only assets and liabilities; therefore, agency funds do not have a measurement focus.

The City reports the following major governmental funds:

The *general fund* is the government's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The *debt service fund* accounts for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

The *capital projects fund* accounts for financial resources to be used for the acquisition or construction of major capital facilities.

The City reports the following major proprietary funds:

The *electric fund* accounts for the activities of the electric distribution operations.

The *water and sewage fund* accounts for the activities of the water and sewer operations.

Additionally, the City reports the following fund type:

The *agency funds* are used to account for monies held on behalf of the Cardinal Criminal Justice Academy, Court-Community Criminal Justice Board and Blue Ridge Community Services Board in purely a custodial capacity.

CITY OF SALEM, VIRGINIA
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 1. Summary of Significant Accounting Policies (Continued)

D. Measurement Focus, Basis of Accounting, and Financial Statement Presentation (Continued)

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

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between the government's proprietary funds and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as *program revenues* include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as *general revenues* rather than as program revenues. Likewise, general revenues include all taxes.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Electric and the Water and Sewage enterprise funds are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

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

E. Budgets and Budgetary Accounting

The City's budget is presented in accordance with accounting principles generally accepted in the United States of America. The following procedures are used by the City in establishing the budgetary data reflected in the financial statements:

- 1) Thirty days prior to the last council meeting in May, the City Manager submits to City Council a proposed operating and capital budget for the fiscal year commencing the following July 1. This budget includes proposed expenditures and the means of financing them for the general funds. The Capital Projects Fund utilizes a project length budget in lieu of an annual budget; therefore, no annual budgets for capital projects are presented.
- 2) Public hearings are conducted to obtain citizen comments.

CITY OF SALEM, VIRGINIA
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 1. Summary of Significant Accounting Policies (Continued)

E. Budgets and Budgetary Accounting (Continued)

- 3) Prior to June 30, the budgets are legally enacted through passage of an Appropriations Ordinance. City Council may, from time to time, amend the budget providing for additional expenditures and the means for financing them. City Council approved additional appropriations of \$3,492,882 during the current year primarily for new capital projects and additional operating expenditures.
- 4) The Appropriations Ordinance places legal restrictions on expenditures at the department or function level. The City Manager is authorized to transfer budget amounts within and between the general government departments and categories.
- 5) Formal budgetary integration is employed as a management control device for the general funds.
- 6) All budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America.
- 7) All appropriations lapse on June 30 except for the capital projects fund, which carry unexpended balances into the following year.

F. Encumbrances

Encumbrance accounting, under which purchase orders, contracts, and other commitments for the expenditure of monies are recorded in order to reserve that portion of the appropriation, is employed as an extension of formal budgetary integration in the general fund. Encumbrances outstanding at year end are reported as reservations of fund balances since they do not constitute expenditures or liabilities.

G. Cash and Cash Equivalents and Investments

The City considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

Investments are stated at fair value.

H. Allowance for Uncollectible Accounts

The City calculates its allowance for uncollectible accounts using historical collection data and specific account analysis.

CITY OF SALEM, VIRGINIA

NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 1. Summary of Significant Accounting Policies (Continued)

I. Inventory

Governmental fund inventories consist of street and building materials and general supplies held for consumption. Inventories are valued at cost using the first-in, first-out (“FIFO”) method. Disbursements for inventory type items are considered to be expenditures at the time of use (“consumption method” of accounting). Supplies transferred to and consumed by the individual departments are considered a reduction of inventory and an expenditure of the user department.

Enterprise fund inventories consist principally of spare parts held for consumption. Electric fund inventories are valued at cost using the average cost method. All other enterprise fund inventories are valued at cost using the FIFO method. The cost of these spare parts is recorded as an expense at the time individual inventory items are withdrawn for use.

J. Prepaid Items

Prepaid items include, among other items, costs incurred as of June 30 which are directly related to Civic Center shows and events scheduled for the subsequent fiscal year. Such costs are expensed in the subsequent fiscal year to obtain a proper matching of revenues and expenses. Governmental fund type prepaid items are offset by fund balance reserves because they do not constitute available expendable resources.

K. Capital Assets

Capital assets, which include property, plant and equipment, and infrastructure assets, are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$2,500 and an estimated useful life in excess of three years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets’ lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

Property, plant, and equipment are depreciated using the straight-line method over the following estimated useful lives:

Buildings and improvements	20-50 years
Machinery and equipment	5-10 years
Distribution and transmission systems	35-50 years
Public domain infrastructure	50 years
Utility plant	35-50 years
Sewage treatment contract	40 years
Furniture and equipment	5-10 years

CITY OF SALEM, VIRGINIA

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 1. Summary of Significant Accounting Policies (Continued)

L. Capitalization of Interest

The City follows the policy of capitalizing net interest costs on funds borrowed to finance the construction of proprietary fixed assets. Interest is not capitalized on the construction of assets used in governmental activities. Interest of \$2,768 was capitalized for the year ended June 30.

M. School Division Capital Assets and Related Debt Reporting

Local governments in Virginia have a “tenancy in common” with the School Board whenever the locality incurs a financial obligation, excluding capital leases, for school property which is payable over more than one fiscal year. The primary government reports this debt in its financial statements while the component-unit School Division reports the capital asset.

N. Deferred Revenues

Deferred revenue in the general fund consists primarily of property taxes not collected within 60 days of year end and property taxes collected that are not yet due.

Deferred revenue in the nonmajor enterprise funds represents amounts received by the Civic Center as deposits for events or rentals associated with the subsequent year.

O. Compensated Absences

The City and the School Division have policies which allow for the accumulation and vesting of limited amounts of vacation and sick leave until termination or retirement. Amounts of such absences are accrued when incurred in the government-wide, proprietary, and fiduciary fund financial statements. A liability for these amounts is reported in governmental funds when the amounts are due for payment.

P. Long-Term Obligations

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources, while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

CITY OF SALEM, VIRGINIA
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 1. Summary of Significant Accounting Policies (Continued)

Q. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

R. Estimates

Management uses estimates and assumptions in preparing its financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities, and reported revenues, expenditures, and expenses. Actual results could differ from those estimates.

Note 2. Deposits and Investments

Deposits

All cash of the City and component unit School Division is maintained in accounts collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 *et. seq.* of the *Code of Virginia* or covered by federal depository insurance.

Investments

Statutes authorize local governments and other public bodies to invest in obligations of the United States or agencies thereof, obligations of the Commonwealth of Virginia or political subdivisions thereof, obligations of the International Bank for Reconstruction and Development (“World Bank”), the Asian Development Bank, the African Development Bank, “prime quality” commercial paper and certain corporate notes; banker’s acceptances, repurchase agreements, the State Treasurer’s Local Government Investment Pool (“LGIP”), and the State Treasurer’s Non-Arbitrage Program (“SNAP”).

Credit Risk

State statute requires that obligations of the Commonwealth of Virginia and its political subdivisions have a debt rating of at least AA by Standard & Poor’s (“S&P”) or equivalent by Moody’s Investors Service (“Moody’s”). Repurchase agreements are collateralized by Treasury or Agency obligations of which the market value is at least 102% of the purchase price of the agreement. Commercial paper must be issued by an entity incorporated in the U.S. and rated at least A-1 by S&P and P-1 by Moody’s. Corporate notes and bonds have a rating of at least AA by S&P and Aa by Moody’s. Money market mutual funds must trade on a constant net asset value and invest solely in securities otherwise eligible for investment under these guidelines.

CITY OF SALEM, VIRGINIA

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 2. Deposits and Investments (Continued)

Credit Risk (Continued)

As of June 30, 2006, 45% of the portfolio was invested in “AAA” rated securities, 21% was invested in “AA2” rated securities, 3% was invested in “AA1” rated securities, 4% was invested in “Aa3” rated securities, 6% was invested in “A2” rated securities, and 9% was invested in “P-1” rated commercial paper. The remaining 12% of the portfolio was invested in money market accounts guaranteed by the U.S. Government. All credit ratings presented in this paragraph are either S&P or Moody’s ratings.

Concentration of Credit Risk

Although the intent of the City is to diversify its investment portfolio to avoid incurring unreasonable risks regarding (i) security type, (ii) individual financial institution or issuing entity, and (iii) maturity, the City places no limit on the amount it may invest in any one issuer.

As of June 30, the portions of the portfolio that exceed 5% of the total portfolio are as follows:

Issuer	Percentage of Portfolio
Corporate Obligations	36%
Other Federal Obligations	17%
Federal National Mortgage Association	16%
Money Market	12%
Federal Home Loan Bank	10%
Commercial Paper	9%

Interest Rate Risk

As of June 30, the fair values and weighted average maturity of the investments were as follows:

Investment Type	Fair Value	Average Maturity*
Corporate Obligations	\$ 1,801,116	269
Other Federal Obligations	859,172	64
Federal National Mortgage Association	792,595	269
Money Market	588,597	-
Federal Home Loan Bank	508,693	181
Commercial Paper	449,039	6
Total investments	\$ 4,999,212	
Portfolio weighted average maturity		170

* Average maturity in days.

CITY OF SALEM, VIRGINIA

NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 2. Deposits and Investments (Continued)

Custodial Credit Risk

As required by the *Code of Virginia*, all security holdings with maturities over 30 days may not be held in safekeeping with the “counterparty” to the investment transaction. As of June 30, all of the City’s investments are held in a bank’s trust department in the City’s name by the City’s designated custodian.

All investment activity during the year was in securities of the type held at year end. The previous items are reflected in the statements as follows:

	Primary Government	Component Unit-School Division
Deposits and investments		
Cash and cash equivalents	\$ 21,857,703	\$ 4,279,006
Investments	3,961,576	-
Cash and cash equivalents, restricted	16,386,775	-
	\$ 42,206,054	\$ 4,279,006

Restricted cash and cash equivalents consist primarily of unused bond proceeds.

Note 3. Receivables

Receivables are as follows:

	General	Electric	Water and Sewage	Nonmajor Enterprise Funds	Component Unit-School Division
Receivables					
Taxes	\$ 1,283,833	\$ -	\$ -	\$ -	\$ -
Accounts	-	3,553,124	1,174,870	178,515	-
Other	1,530,963	-	-	-	2,499
Gross receivables	2,814,796	3,553,124	1,174,870	178,515	2,499
Less allowance for: uncollectibles	473,480	74,407	20,965	4,939	-
Net total receivables	\$ 2,341,316	\$ 3,478,717	\$ 1,153,905	\$ 173,576	\$ 2,499

CITY OF SALEM, VIRGINIA

NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 3. Receivables (Continued)

Governmental funds report *deferred revenue* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At June 30, the components of *deferred revenue* reported in the governmental funds were as follows:

	Deferred Revenue		
	Unavailable	Unearned	Total
Delinquent property taxes receivable	\$ 552,323	\$ -	\$ 552,323
Fees paid in advance	-	85,596	85,596
Taxes paid for subsequent year	-	24,102	24,102
	\$ 552,323	\$ 109,69885,596	\$ 662,021

Note 4. Interfund Receivables, Payables, and Transfers

The composition of the interfund receivables and payables is as follows:

Receivable Fund	Payable Fund	Amount
Electric Fund	Water and Sewage Fund	\$ 4,810,710
Nonmajor Enterprise Fund	General Fund	4,685
Nonmajor Enterprise Fund	Nonmajor Enterprise Fund	21,527
		\$ 4,836,922

The amount due from the water and sewage fund to the electric fund represents a short-term loan of cash for operations. The amounts due to the nonmajor enterprise fund from both the general fund and the other nonmajor enterprise fund represent fees for services.

Interfund transfers are as follows:

	Transfers In:				Total
	General	Debt Service	Capital Projects	Nonmajor Enterprise	
Transfers out:					
General	\$ -	\$ 4,048,732	\$ 2,071,628	\$ 1,129,284	\$ 7,249,644
Electric	1,265,000	-	850,000	390,000	2,505,000
	\$ 1,265,000	\$ 4,048,732	\$ 2,921,628	\$ 1,519,284	\$ 9,754,644

Transfers between major funds and other nonmajor enterprise funds were primarily for debt payments, operation of funds, and reimbursement of capital items paid out of the general fund. The general fund transferred capital assets with the enterprise funds resulting in a \$10,031 reconciling item for interfund transfers for the enterprise funds between Exhibit 2 and Exhibit 7.

CITY OF SALEM, VIRGINIA

NOTES TO FINANCIAL STATEMENTS

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Note 5. Due from Other Governmental Units

Amounts due from other governmental units are as follows:

	Governmental Activities	Component Unit-School Division
Commonwealth of Virginia		
Personal property tax	\$ 2,489,475	\$ -
State sales tax	-	271,556
Local sales tax	1,038,420	-
Recordation tax	15,313	-
Constitutional officers	31,068	-
Comprehensive services act	466,865	-
Other	195,090	-
Federal government		
School funds	-	439,811
	\$ 4,236,231	\$ 711,367

Note 6. Capital Assets

Capital asset activity for the year was as follows:

Governmental Activities	Beginning Balance*	Increases	Decreases	Ending Balance
Capital assets, not depreciated				
Land	\$ 4,469,325	\$ 163,245	\$ 129,959	\$ 4,502,611
Construction in progress	6,145,893	11,013,069	670,630	16,488,332
Total capital assets, not depreciated	10,615,218	11,176,314	800,589	20,990,943
Capital assets, depreciated				
Buildings and improvements	27,563,579	640,551	-	28,204,130
Machinery and equipment	13,715,119	1,390,339	965,543	14,139,915
Public domain infrastructure	77,614,535	152,813	-	77,767,348
Total capital assets, depreciated	118,893,233	2,183,703	965,543	120,111,393
Less accumulated depreciation for:				
Buildings and improvements	8,255,754	550,392	-	8,806,146
Machinery and equipment	9,377,295	1,050,943	843,030	9,585,208
Public domain infrastructure	21,131,424	2,043,555	-	23,174,979
Total accumulated depreciation	38,764,473	3,644,890	843,030	41,566,333
Total capital assets, depreciated, net	80,128,760	(1,461,187)	122,513	78,545,060
Governmental activities capital assets, net	\$ 90,743,978	\$ 9,715,127	\$ 923,102	\$ 99,536,003

*Amounts have been restated, see Note 15.

CITY OF SALEM, VIRGINIA

NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 6. Capital Assets (Continued)

Business-Type Activities	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not depreciated				
Land	\$ 1,252,171	\$ -	\$ -	\$ 1,252,171
Construction in progress	4,480,466	13,763,725	-	18,244,191
Total capital assets, not depreciated	<u>5,732,637</u>	<u>13,763,725</u>	<u>-</u>	<u>19,496,362</u>
Capital assets, depreciated				
Buildings and improvements	7,446,254	188,644	47,349	7,587,549
Distribution and transmission	20,191,146	400,829	1,457	20,590,518
Utility plant	70,722,430	541,390	345,702	70,918,118
Sewage treatment contract	18,297,088	-	-	18,297,088
Machinery and equipment	5,348,917	864,139	346,503	5,866,553
Total capital assets, depreciated	<u>122,005,835</u>	<u>1,995,002</u>	<u>741,011</u>	<u>123,259,826</u>
Less accumulated depreciation for:				
Buildings and improvements	3,416,563	261,179	35,727	3,642,015
Distribution and transmission	13,022,722	563,955	704	13,585,973
Utility plant	29,799,512	1,919,648	323,393	31,395,767
Sewage treatment contract	1,372,231	457,427	-	1,829,658
Machinery and equipment	3,568,540	410,895	342,657	3,636,778
Total accumulated depreciation	<u>51,179,568</u>	<u>3,613,104</u>	<u>702,481</u>	<u>54,090,191</u>
Total capital assets, depreciated, net	<u>70,826,267</u>	<u>(1,618,102)</u>	<u>38,530</u>	<u>69,169,635</u>
Business-type activities capital assets, net	<u>\$ 76,558,904</u>	<u>\$ 12,145,623</u>	<u>\$ 38,530</u>	<u>\$ 88,665,997</u>

(Continued)

CITY OF SALEM, VIRGINIA

**NOTES TO FINANCIAL STATEMENTS
June 30, 2006**

Note 6. Capital Assets (Continued)

Discretely Presented Component Unit – School Division	Beginning Balance*	Increases	Decreases	Ending Balance
Capital assets, not depreciated				
Land	\$ 1,123,637	\$ -	\$ -	\$ 1,123,637
Construction in progress	184,919	231,023	184,919	231,023
Total capital assets, not depreciated	1,308,556	231,023	184,919	1,354,660
Capital assets, depreciated				
Buildings and improvements	50,754,134	690,118	253,096	51,191,156
Furniture and equipment	4,603,909	452,946	4,035	5,052,820
Total capital assets, depreciated	55,358,043	1,143,064	257,131	56,243,976
Less accumulated depreciation for:				
Buildings and improvements	12,192,964	1,249,753	153,573	13,289,144
Furniture and equipment	2,185,308	317,781	2,599	2,500,490
Total accumulated depreciation	14,378,272	1,567,534	156,172	15,789,634
Total capital assets, depreciated, net	40,979,771	(424,470)	100,959	40,454,342
Capital assets, net	<u>\$ 42,288,327</u>	<u>\$ (193,447)</u>	<u>\$ 285,878</u>	<u>\$ 41,809,002</u>

*Amounts have been restated, see Note 15

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

Governmental activities	
General government administration	\$ 165,207
Judicial administration	39,725
Public safety	469,997
Public works	2,329,553
Parks, recreation, and cultural	528,360
Community development	10,332
Total depreciation expense**	<u>\$ 3,543,174</u>
Business-type activities	
Electric	\$ 782,924
Water and sewage	2,519,980
Civic Center	270,862
Catering and concessions	9,553
Total depreciation expense**	<u>\$ 3,583,319</u>

**Amounts vary from depreciation in the previous tables due to transfer of depreciated items between funds.

CITY OF SALEM, VIRGINIA
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 6. Capital Assets (Continued)

Construction Commitments

The City has an active construction project at June 30 as follows:

Project	Spent to Date	Remaining Commitment
Salem High School renovations	\$ 101,588	\$ 263,412

Sewage Treatment Contract

The sewage treatment contract represents a 1994 agreement between the Cities of Salem and Roanoke, Virginia along with the Counties of Roanoke and Botetourt, Virginia and the Town of Vinton, Virginia to provide for the transportation and treatment of waste for a 40-year period. On July 1, 2004, the Western Virginia Water Authority (“WVWA”) was created by the City of Roanoke and the County of Roanoke. The WVWA is a full service authority that provides water and wastewater treatment to the Roanoke Valley region. This authority assumed the contractual obligation to provide wastewater treatment to the City of Salem. Rates are adjusted annually.

Note 7. Long-Term Liabilities

Prior Year Defeasances of Debt

In prior years, the City defeased certain general obligation bonds by placing the proceeds in irrevocable trusts to provide for all future debt service on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the City’s financial statements. On June 30, \$13,504,515 of bonds are considered defeased. The deferred costs are being amortized over the life of the new bonds as a component of interest expense.

CITY OF SALEM, VIRGINIA

**NOTES TO FINANCIAL STATEMENTS
June 30, 2006**

Note 7. Long-Term Liabilities (Continued)

The following is a summary of changes in long-term liabilities:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Governmental Activities:					
General obligation bonds	\$ 34,236,234	\$ -	\$ 2,738,024	\$ 31,498,210	\$ 2,482,365
Literary fund loans	750,000	-	125,000	625,000	125,000
Landfill closure liability	67,300	-	10,111	57,189	57,189
Compensated absences	1,355,377	1,200,791	1,148,245	1,407,923	944,425
Adjust for deferred amounts:					
Issuance discounts	(21,353)	-	(1,779)	(19,574)	-
Issuance costs	(741,450)	-	(90,120)	(651,330)	-
Governmental activities, long-term liabilities	<u>\$ 35,646,108</u>	<u>\$ 1,200,791</u>	<u>\$ 3,929,481</u>	<u>\$ 32,917,418</u>	<u>\$ 3,608,979</u>
Business-type Activities:					
General obligation bonds	\$ 36,033,766	\$ 25,000,000	\$ 2,206,976	\$ 58,826,790	\$ 2,452,635
Revenue bonds	4,461,586	3,567,356	-	8,028,942	-
Compensated absences	472,264	396,134	348,646	519,752	348,646
Adjust for deferred amounts:					
Issuance premiums	26,373	112,486	1,951	136,908	-
Issuance costs	(464,621)	(181,033)	(40,981)	(604,673)	-
Business-type activities, long-term liabilities	<u>\$ 40,529,368</u>	<u>\$ 28,894,943</u>	<u>\$ 2,516,592</u>	<u>\$ 66,907,719</u>	<u>\$ 2,801,281</u>
Discretely Presented Component Unit:					
Compensated absences	<u>\$ 576,143</u>	<u>\$ 33,452</u>	<u>\$ 32,760</u>	<u>\$ 576,835</u>	<u>\$ 314,306</u>

The general fund has been used to liquidate the liability for compensated absences in prior years.

The annual requirements to amortize long-term debt and related interest are as follows:

Year Ended June 30	Governmental Activities				Business-type Activities			
	General Obligation Bonds		Literacy Fund Loans		General Obligation Bonds		Revenue Bonds	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2007	\$ 2,482,365	\$ 1,094,793	\$ 125,000	\$ 25,000	\$ 2,452,635	\$ 2,560,108	\$ -	\$ -
2008	2,426,290	1,040,933	125,000	20,000	2,398,710	2,563,830	191,818	363,276
2009	2,430,215	982,398	125,000	15,000	2,439,785	5,475,566	322,380	232,714
2010	2,401,355	914,369	125,000	10,000	2,488,645	2,383,531	332,124	222,970
2011	2,373,085	838,614	125,000	5,000	2,526,915	2,288,336	342,162	212,932
2012-2016	9,834,900	3,010,470	-	-	13,380,100	9,795,311	1,872,333	903,135
2017-2021	6,250,000	1,388,325	-	-	11,775,000	6,802,500	2,172,919	602,549
2022-2026	3,300,000	222,063	-	-	12,505,000	3,936,746	2,521,761	253,707
2027-2031	-	-	-	-	8,860,000	410,083	273,445	4,102
	<u>\$31,498,210</u>	<u>\$ 9,491,965</u>	<u>\$ 625,000</u>	<u>\$ 75,000</u>	<u>\$58,826,790</u>	<u>\$36,216,011</u>	<u>\$ 8,028,942</u>	<u>\$ 2,795,385</u>

(Continued)

CITY OF SALEM, VIRGINIA
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 7. Long-Term Liabilities (Continued)

Details of long-term indebtedness are as follows:

	Interest Rates	Date Issued	Final Maturity Date	Amount of Original Issue	Governmental Activities	Business-type Activities
<u>General Obligation Bonds:</u>						
Public Improvement Bonds	4.00-4.90 %	04-99	04-19	17,000,000	\$ 3,250,000	\$ 7,800,000
Public Improvement Bonds	4.50-5.00 %	01-02	01-27	23,000,000	19,800,000	-
Public Improvement Bonds	2.00-3.50 %	10-03	12-12	5,700,000	4,315,000	-
Public Improvement Bonds	2.00-4.50 %	10-03	10-23	22,000,000	-	20,830,000
Refunding Bonds	1.50-3.50 %	03-04	04-16	9,640,000	4,133,210	5,196,790
Public Improvement Bonds	4.00-5.00 %	05-06	04-22	25,000,000	-	25,000,000
					31,498,210	58,826,790
			Less deferred costs		(651,330)	(604,673)
			Less bond discounts		(19,574)	-
			Add bond premium		-	136,908
					\$ 30,827,306	\$ 58,359,025
<u>Revenue Bonds:</u>						
Virginia Resource Authority	3.00%	04-04	Varies *	8,028,942	\$ -	\$ 8,028,942
<u>Other Long-term Debt:</u>						
Literary Fund Loan	4.00%	01-91	02-11	2,500,000	\$ 625,000	\$ -

*Amount represents drawdowns at June 30 on total approved loan of \$11,052,222.

CITY OF SALEM, VIRGINIA

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 8. Landfill Closure and Post-closure Care Costs

The City stopped accepting waste at its municipal landfill prior to October 9, 1993. State and federal regulations required the City to place a final cover on the landfill site and to perform certain maintenance and monitoring functions at the site for ten years after closure. Post-closure maintenance and monitoring costs are currently estimated at \$25,000 annually and commenced during 1998. Actual cost may be higher due to inflation, changes in technology, or changes in regulations. These costs are being recognized as expenditures under the modified accrual basis of accounting. The cumulative accrual is reported with the governmental activities long-term debt. The City uses the financial test method of demonstrating assurance for closure and post-closure care cost.

Note 9. Pension Plan

Plan Description

The City contributes to the Virginia Retirement System (“VRS”), an agent and cost sharing multiple-employer defined benefit pension plan administered by the Virginia Retirement System (the “System”). In addition, professional and non-professional employees of the City of Salem School Division are covered by the VRS. Professional employees participate in a VRS statewide teacher cost sharing pool, and non-professional employees participate as a separate group in the agent multiple-employer retirement system.

All full-time, salaried permanent employees of participating employers must participate in the VRS. Benefits vest after five years of service. Employees are eligible for an unreduced benefit at age 65 with five years of service (age 60 for participating local law enforcement officers and firefighters) or at age 50 with 30 years of service for participating employers, (age 50 with 25 years for participating local law enforcement officers and firefighters), payable monthly, for life in an amount equal to 1.7% of their average final compensation (AFC) for each year of credited service. Benefits are actuarially reduced for retirees who retire prior to becoming eligible for full retirement benefits. In addition, retirees qualify for annual cost-of-living (COLA) beginning in their second year of retirement. The COLA is limited to 5% per year. AFC is defined as the highest consecutive 36 months of reported compensation. Participating local law enforcement officers and firefighters may receive a monthly benefit supplement if they retire prior to age 65. The VRS also provides death and disability benefits. Title 51.1 of the *Code of Virginia* (1950), as amended, assigns the authority to establish and amend benefit provisions to the General Assembly of Virginia.

The System issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information for VRS. A copy of that report may be downloaded from <http://www.varetire.org/Pdf/2005AnnuRept.pdf> or obtained by writing to the System at P.O. Box 2500, Richmond, Virginia 23218-2500.

Funding Policy

Plan members are required by Title 51.1 of the *Code of Virginia* (1950), as amended, to contribute 5% of their annual reported compensation to the VRS. The 5% member contribution has been assumed by both the City and School Division. In addition, the City and School Division are required to contribute the remaining amount necessary to fund its participation in the VRS using the actuarial basis specified by the statute and approved by the VRS Board of Trustees. The City’s and the School Division’s contribution rates for the fiscal year ended 2006 were 15.25% and 8% of annual covered payroll, respectively (including the employee share of 5% paid by the employer).

CITY OF SALEM, VIRGINIA

**NOTES TO FINANCIAL STATEMENTS
June 30, 2006**

Note 9. Pension Plan (Continued)

Funding Policy (Continued)

For the three years ended June 30, 2006, 2005, and 2004, total employer and employee contributions made to the VRS statewide teacher pool for professional employees by the School Division were \$2,314,322, \$2,061,238, and \$1,564,076, representing 11.62%, 11.03%, and 8.77%, of annual covered payroll, respectively.

Annual Pension Cost

For fiscal year 2006, the City's and the School Division's annual pension cost of \$4,949,519 and \$109,561, respectively, were equal to their required and actual contributions. The required contribution was determined as part of the June 30, 2005 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 8% investment rate of return, (b) projected salary increases ranging from 4.25% to 6.10% per year, and (c) 3% per year cost-of-living adjustments. Both (a) and (b) included an inflation component of 3%. The actuarial value of the City's and the School Division's assets is equal to the modified market value of assets. This method was determined using techniques that smooth the effects of short-term volatility in the market value of assets over a five-year period. The City's and School Division's actuarial accrued liabilities are being amortized as a level percentage of payroll on an open basis within a period of 30 years or less.

Three-Year Trend Information for the City

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 2006	\$ 4,949,519	100.0%	\$ -
June 30, 2005	\$ 4,704,758	100.0%	\$ -
June 30, 2004	\$ 3,296,950	100.0%	\$ -

Three-Year Trend Information for the School Division

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 2006	\$ 109,561	100.0%	\$ -
June 30, 2005	\$ 103,329	100.0%	\$ -
June 30, 2004	\$ 96,299	100.0%	\$ -

CITY OF SALEM, VIRGINIA

NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 10. Other Post-Employment Benefits

The City provides healthcare benefits under current personnel policy to retired employees under one of two programs. In the first, retirees 65 and under who are ineligible for the Nationwide Medicare Program are allowed to continue in the City's health insurance program described in Note 13. The City continues to pay the retiree's share of the single rate premium. The City's contribution for these retired individuals was \$333,418 for the year ended June 30. At June 30, there were 73 participants eligible to receive benefits under this program.

Second, for those eligible retirees age 65 and over participating in the Nationwide Medicare Program, the City provides supplemental healthcare coverage under the Medicare Extended Plus Program and Medicare D, drug plan administered by Anthem. The City's contribution to this program for the year ended June 30 was \$279,595. This amount represents the full single premium for retirees. The City's liability under this program is limited to paying the monthly premium. At June 30, there were 120 participants eligible to receive benefits under this program.

The City's contributions under these two programs are funded on a current disbursement basis.

Note 11. Service Contracts

The following is a summary of significant service contracts:

A. Electrical Service

Agreement with American Electric Power Service Corporation to purchase electricity for consumption and resale to City residents effective July 1, 2006 through May 31, 2026 with two possible renewals of five year periods each. An early termination date may become effective under certain circumstances. The rates increased significantly over the prior year.

Agreement with the United States Department of Energy to purchase electricity during American Electric Power's peak usage periods. The agreement requires a 37-month notification prior to cancellation.

Agreement with Blue Ridge Power Agency for billing and power supply related services and partial assignment of contract effective July 1, 2005 through June 30, 2010. The agreement requires a 90-day notification prior to termination.

B. Water Contract

Agreement dated July 1, 1981, to sell surplus water to Roanoke County, Virginia at a bulk rate determined by a mutually agreed upon formula. The contract is for a term of 30 years and automatically renews for terms of ten years unless 24 months notice of termination is given. The WVWA has assumed this contract from Roanoke County.

CITY OF SALEM, VIRGINIA
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 11. Service Contracts (Continued)

C. Solid Waste Disposal

On July 1, 2006 the City entered an amendment to the July 1, 1998 agreement with Waste Management, Inc. to begin its first five year renewal period. The 1998 agreement for the disposal of nonhazardous solid waste provided an eight year term with two renewable five year terms.

D. Special Services

The following special services are provided by the County of Roanoke, Virginia under an agreement effective July 1, 1973 which can be renewed or terminated at the end of any two-year period with proper notice:

Social Services – Salem shares in the local costs of providing services to Salem citizens in need qualifying under Federal Regulations. Salem share is the total cost of services less any applicable Federal or State Grants.

Agricultural and Home Demonstration Services – Cost is shared based on population.

Jail Services and Facilities – Cost is shared per prisoner, per day based on total net cost.

Note 12. Property Taxes

The two major sources of property taxes are described below:

Real Estate

The City levies real estate taxes on all real estate within its boundaries, except that exempted by statute, each year as of July 1 on 100% of estimated fair market value of the property. Real estate taxes become a lien on real property the first day of the levy year. The City follows the practice of reassessing all property biannually. Real estate taxes are due in equal semiannual payments on December 5 and June 5 and are considered delinquent after each due date. The tax rate for 2006 was \$1.18 per \$100 of assessed value.

Personal Property

The City levies personal property taxes on motor vehicles and business and other tangible personal property. Personal property taxes do not create a lien on property; however, City vehicle tags, which are required by law for all vehicles garaged in the City, may not be issued to any individual having outstanding personal property taxes. These levies are made each year as of January 1 with payment due the following May 31. In addition, personal property transactions during the year are taxed on a prorated basis. Personal property taxes are considered delinquent after the May 31 due date. The tax rate for 2006 was \$3.20 per \$100 of assessed value.

CITY OF SALEM, VIRGINIA
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 13. Risk Management

The Risk Management Programs of the City are as follows:

Workers' Compensation

Workers' Compensation Insurance is provided through the Virginia Municipal Self Insurance Association for the City and through School Systems of Virginia for the School Division. Benefits are those afforded through the State of Virginia as outlined in the *Code of Virginia* Section 65.2-100; premiums are based upon covered payroll, job rates, and claims experience. During 2005-2006, total premiums paid were \$435,864 and \$70,094 for the City and School Division, respectively.

General Liability and Other

The City provides General Liability and other insurance through policies with the St. Paul Insurance Company. General Liability and Business Automobile have a \$2,000,000 limit. Boiler and Machinery coverage and Property Insurance are covered as per statement of values. The City maintains an additional \$5,000,000 umbrella policy over all forms of liability through the St. Paul Insurance Company. Lastly, both Police Professional Liability and Public Officials Liability Insurance with a \$1,000,000 limit are covered through a policy with the Commonwealth of Virginia. Total premiums were \$669,684 in the current year.

Healthcare

The City's professionally administered self-insurance program provides health coverage for employees of the City and the School Division on a cost-reimbursement basis. Retired employees and dependents of employees of the City are also covered by the program provided they pay a premium to the City. Under the program, the City is obligated for claims payments. A stop loss insurance contract executed with an insurance carrier covers claims in excess of \$125,000 per covered individual and approximately \$7,925,259 in the aggregate. During the year ended June 30, total claims expense of \$6,521,345, which did not exceed the stop loss provisions, was incurred. This represents claims processed and an estimate, based on plan experience prior and subsequent to June 30 for claims incurred but not reported ("IBNR") as of June 30. The designated portion of fund balance for self-insurance equaled \$31,184 at June 30. The estimated liability at June 30, including reported and IBNR claims, was \$650,201. Changes in the reported liability during the last three fiscal years are as follows:

Year Ended June 30	Liability July 1	Claims and Changes in Estimates	Claim Payments	Liability June 30
2006	\$ 541,469	\$ 6,521,345	\$ 6,412,613	\$ 650,201
2005	\$ 698,955	\$ 5,593,438	\$ 5,750,924	\$ 541,469
2004	\$ 664,451	\$ 5,888,567	\$ 5,854,063	\$ 698,955

CITY OF SALEM, VIRGINIA
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

Note 13. Risk Management (Continued)

Other

There were no significant changes in insurance coverage's from the prior year and no settlements that exceeded the amount of insurance coverage during the last three fiscal years.

Note 14. Commitments and Contingencies

Special Purpose Grants

Special Purpose Grants are subject to audit to determine compliance with their requirements. City officials believe that if any refunds are required, they will be immaterial.

Litigation

Various claims and lawsuits are pending against the City. In the opinion of management, after consulting with legal counsel, the potential loss on all claims and lawsuits will not materially affect the City's financial position.

Note 15. Restatement of Fund Balances and Net Assets

The following is a summary of the restatement of fund balance/net assets as of June 30, 2005:

	Governmental Activities	Business Type Activities (Electric Fund)	Discretely Presented Component Units <u>School Governmental Activities</u>
Net assets, June 30, 2005, as previously stated	\$ 76,804,523	\$ 30,270,722	\$ 44,217,745
Restatement to:			
Record equipment received in prior year	108,421	-	-
Record GASB 34 conversion error in infrastructure	(7,697,585)	-	-
Record change in inventory valuation method	-	1,039,032	-
Record land and building received in prior year, not previously recorded	-	-	315,903
Net change in net assets	<u>(7,589,164)</u>	<u>1,039,032</u>	<u>315,903</u>
Net assets, June 30, 2005, as restated	<u>\$ 69,215,359</u>	<u>\$ 31,309,754</u>	<u>\$ 44,533,648</u>

CITY OF SALEM, VIRGINIA

NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 16. New Accounting Standards

The Governmental Accounting Standards Board (GASB) has issued its Statement No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefit Plans Other Than Pensions*. The Statement establishes standards for the measurement, recognition and display of OPEB expense and related liabilities in the financial statements. Management has not completed the process of evaluating the impact that will result from adoption of the standard, and is therefore unable to disclose the impact of adoption. The requirements of the Statement are effective in three phases based on the government's annual revenues, with the earliest effective date being for the year ended June 30, 2008. The City is required to implement this Statement for fiscal year end June 30, 2009.



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**REQUIRED SUPPLEMENTARY
INFORMATION**

CITY OF SALEM, VIRGINIA
REQUIRED SUPPLEMENTARY INFORMATION
ANALYSIS OF FUNDING PROGRESS FOR DEFINED BENEFIT PENSION PLAN
June 30, 2006

City Employees:

	(a)	(b)	(b-a)	(a/b)	(c)	((b-a)/c)
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL as of Percentage of Covered Payroll
June 30, 2005	\$ 98,906,486	\$ 123,869,651	\$ 24,963,165	79.8%	\$ 31,283,159	79.8%
June 30, 2004	\$ 95,206,763	\$ 109,456,032	\$ 14,249,269	87.0%	\$ 30,358,747	46.9%
June 30, 2003	\$ 93,474,787	\$ 102,357,661	\$ 8,882,874	91.3%	\$ 29,197,584	30.4%

Component Unit – School Division Non-Professional Employees:

	(a)	(b)	(b-a)	(a/b)	(c)	((b-a)/c)
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded Actuarial Accrued Liability (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL as of Percentage of Covered Payroll
June 30, 2005	\$ 3,073,833	\$ 3,248,857	\$ 175,024	94.6%	\$ 1,287,079	13.6%
June 30, 2004	\$ 2,980,504	\$ 2,840,773	\$ (139,731)	104.9%	\$ 1,188,646	-11.8%
June 30, 2003	\$ 2,909,817	\$ 2,641,266	\$ (268,551)	110.2%	\$ 1,089,087	-24.7%

OTHER SUPPLEMENTARY INFORMATION

CITY OF SALEM, VIRGINIA

COMBINING STATEMENT OF NET ASSETS
NONMAJOR PROPRIETARY FUNDS

June 30, 2006

	Business-type Activities - Enterprise Funds		
	Civic Center	Catering and Concessions	Total
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 665,453	\$ 235,707	\$ 901,160
Receivables, net	114,995	58,581	173,576
Due from other funds	-	26,212	26,212
Inventories	-	27,254	27,254
Prepaid items	69,873	-	69,873
Total current assets	<u>850,321</u>	<u>347,754</u>	<u>1,198,075</u>
Noncurrent assets:			
Capital assets, net	3,092,469	33,519	3,125,988
Total noncurrent assets	<u>3,092,469</u>	<u>33,519</u>	<u>3,125,988</u>
Total assets	<u>3,942,790</u>	<u>381,273</u>	<u>4,324,063</u>
LIABILITIES			
Current liabilities:			
Accounts payable and accrued liabilities	198,135	43,070	241,205
Accrued payroll and related liabilities	66,568	29,570	96,138
Self insurance claims liability (Note 13)	12,975	3,425	16,400
Due to other funds	21,527	-	21,527
Unearned revenue	137,895	-	137,895
Compensated absences	47,910	11,070	58,980
Total current liabilities	<u>485,010</u>	<u>87,135</u>	<u>572,145</u>
Noncurrent liabilities:			
Compensated absences	12,283	16,273	28,556
Total noncurrent liabilities	<u>12,283</u>	<u>16,273</u>	<u>28,556</u>
Total liabilities	<u>497,293</u>	<u>103,408</u>	<u>600,701</u>
NET ASSETS			
Invested in capital assets, net of related debt	3,092,469	33,519	3,125,988
Unrestricted	353,028	244,346	597,374
Total net assets	<u>\$ 3,445,497</u>	<u>\$ 277,865</u>	<u>\$ 3,723,362</u>

CITY OF SALEM, VIRGINIA
COMBINING STATEMENT OF REVENUES, EXPENSES,
AND CHANGES IN FUND NET ASSETS –
NONMAJOR PROPRIETARY FUNDS
Year Ended June 30, 2006

	Business-type Activities – Enterprise Funds		
	Civic Center	Catering and Concessions	Total
OPERATING REVENUES			
Charges for services	\$ 758,575	\$ 960,945	\$ 1,719,520
Commissions	23,490	-	23,490
Other	21,682	30,263	51,945
Total operating revenues	<u>803,747</u>	<u>991,208</u>	<u>1,794,955</u>
OPERATING EXPENSES			
Salaries	998,793	380,433	1,379,226
Fringe benefits	314,353	101,672	416,025
Show expenses	125,839	-	125,839
Maintenance	270,844	2,248	273,092
Professional services	5,130	19,579	24,709
Insurance	16,634	-	16,634
Administration	17,139	18,991	36,130
Travel and training	14,953	4,721	19,674
Materials and supplies	82,081	284,516	366,597
Utilities	236,318	196	236,514
Miscellaneous	11,945	851	12,796
Depreciation	270,862	9,553	280,415
Commissions	-	213,977	213,977
Total operating expenses	<u>2,364,891</u>	<u>1,036,737</u>	<u>3,401,628</u>
Operating loss	<u>(1,561,144)</u>	<u>(45,529)</u>	<u>(1,606,673)</u>
NONOPERATING REVENUES			
Interest income	605	-	605
Net nonoperating revenue	<u>605</u>	<u>-</u>	<u>605</u>
Loss before transfers	<u>(1,560,539)</u>	<u>(45,529)</u>	<u>(1,606,068)</u>
TRANSFERS IN	<u>1,519,284</u>	<u>-</u>	<u>1,519,284</u>
Change in net assets	<u>(41,255)</u>	<u>(45,529)</u>	<u>(86,784)</u>
NET ASSETS AT JULY 1	<u>3,486,752</u>	<u>323,394</u>	<u>3,810,146</u>
NET ASSETS AT JUNE 30	<u>\$ 3,445,497</u>	<u>\$ 277,865</u>	<u>\$ 3,723,362</u>

CITY OF SALEM, VIRGINIA
COMBINING STATEMENT OF CASH FLOWS –
NONMAJOR PROPRIETARY FUNDS
Year Ended June 30, 2006

	Business-type Activities – Enterprise Funds		
	Civic Center	Catering and Concessions	Total
OPERATING ACTIVITIES			
Receipts from customers	\$ 589,237	\$ 931,415	\$ 1,520,652
Payments to suppliers	(752,721)	(520,059)	(1,272,780)
Payments to employees	(1,297,274)	(471,128)	(1,768,402)
Other receipts	45,172	30,263	75,435
Net cash used in operating activities	<u>(1,415,586)</u>	<u>(29,509)</u>	<u>(1,445,095)</u>
NONCAPITAL FINANCING ACTIVITIES			
Interfund transfers	1,519,284	-	1,519,284
Net cash provided by noncapital financing activities	<u>1,519,284</u>	<u>-</u>	<u>1,519,284</u>
CAPITAL AND RELATED FINANCING ACTIVITIES			
Purchases of capital assets	(253,208)	-	(253,208)
Net cash used in capital and related financing activities	<u>(253,208)</u>	<u>-</u>	<u>(253,208)</u>
INVESTING ACTIVITIES			
Interest received	605	-	605
Net cash provided by investing activities	<u>605</u>	<u>-</u>	<u>605</u>
Net decrease in cash and cash equivalents	(148,905)	(29,509)	(178,414)
CASH AND CASH EQUIVALENTS			
Beginning at July 1	814,358	265,216	1,079,574
Ending at June 30	<u>\$ 665,453</u>	<u>\$ 235,707</u>	<u>\$ 901,160</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES			
Operating loss	\$ (1,561,144)	\$ (45,529)	\$ (1,606,673)
Adjustments to reconcile operating loss to net cash used in operating activities:			
Depreciation and amortization	270,862	9,553	280,415
Change in assets and liabilities:			
(Increase) decrease in:			
Receivables, net	24,677	(11,406)	13,271
Due from other funds	-	(18,124)	(18,124)
Inventories	-	(2,742)	(2,742)
Prepaid items	23,046	-	23,046
(Decrease) increase in:			
Accounts payable and accrued liabilities	43,555	27,170	70,725
Accrued payroll and related liabilities	15,872	10,977	26,849
Self insurance claim liability	12,975	3,425	16,400
Due to other funds	(42,035)	(2,833)	(44,868)
Deferred revenue	(203,394)	-	(203,394)
Net cash used in operating activities	<u>\$ (1,415,586)</u>	<u>\$ (29,509)</u>	<u>\$ (1,445,095)</u>
NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES			
Capital assets financed with accounts payable	<u>\$ 55,986</u>	<u>\$ -</u>	<u>\$ 55,986</u>

CITY OF SALEM, VIRGINIA

COMBINING STATEMENT OF FIDUCIARY NET ASSETS

June 30, 2006

	Blue Ridge Mental Health	Cardinal Criminal Justice Academy	Court- Community Corrections Program	Total Agency Funds
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
ASSETS				
Cash and cash equivalents	\$ -	\$ 290,191	\$ 158,114	\$ 448,305
Accounts receivable, net	-	1,770	-	1,770
Grant receivable	-	20,461	-	20,461
Due from Commonwealth of Virginia	-	-	66,677	66,677
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total assets	<u>\$ -</u>	<u>\$ 312,422</u>	<u>\$ 224,791</u>	<u>\$ 537,213</u>
LIABILITIES				
Accounts payable	\$ -	\$ 98,126	\$ 76,587	\$ 174,713
Accrued expenses	-	11,732	39,197	50,929
Liability to agency	-	202,564	109,007	311,571
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total liabilities	<u>-</u>	<u>312,422</u>	<u>224,791</u>	<u>537,213</u>
NET ASSETS				
Net assets	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

CITY OF SALEM, VIRGINIA

COMBINING STATEMENT OF CHANGES IN FIDUCIARY ASSETS AND LIABILITIES

June 30, 2006

	Blue Ridge Mental Health	Cardinal Criminal Justice Academy	Court- Community Corrections Program	Total Agency Funds
ASSETS				
Balance, Beginning of Year	\$ -	\$ 317,175	\$ 306,373	\$ 623,548
Additions	11,040,669	618,404	1,894,888	13,553,961
Deletions	11,040,669	623,157	1,976,470	13,640,296
	<u>\$ -</u>	<u>\$ 312,422</u>	<u>\$ 224,791</u>	<u>\$ 537,213</u>
	<u>\$ -</u>	<u>\$ 312,422</u>	<u>\$ 224,791</u>	<u>\$ 537,213</u>
LIABILITIES				
Balance, Beginning of Year	\$ -	\$ 317,175	\$ 306,373	\$ 623,548
Additions	11,040,669	618,404	1,894,888	13,553,961
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	<u>\$ -</u>	<u>\$ 312,422</u>	<u>\$ 224,791</u>	<u>\$ 537,213</u>
	<u>\$ -</u>	<u>\$ 312,422</u>	<u>\$ 224,791</u>	<u>\$ 537,213</u>

SUPPORTING SCHEDULE

CITY OF SALEM, VIRGINIA

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2006

Federal Grantor/Pass-through Grantor (Commonwealth of Virginia)/Program Title	Federal CFDA Number	Federal Expenditures
<u>Department of Agriculture</u>		
<u>Department of Agriculture and Consumer Services</u>		
Food Distribution – Commodities – Pass-through Payments	10.555	\$ 103,450
<u>Department of Education</u>		
National School Breakfast Program	10.553	65,842
National School Lunch Program	10.555	343,950
<u>U.S. Department of Justice, Office of Justice Programs</u>		
<u>Department of Criminal Justice Services</u>		
Crime Victim Assistance	16.588	41,618
<u>Department of Justice</u>		
<u>Direct Payments</u>		
Drug Enforcement Task Force	16.500	50,123
Bureau of Justice Assistance	16.607	9,622
Homeland Security	97.067	93,074
<u>Department of Transportation</u>		
<u>Division of Motor Vehicles</u>		
State and Highway Safety Program	20.600	13,187
<u>Department of Education</u>		
<u>Department of Education</u>		
Education Consolidation Improvement Act of 1981:		
Title I: Grants to Local Educational Agencies	84.010	443,662
Title I: State Grants for Innovation Programs	84.298	8,091
Title II: Part A, Improving Teacher Quality	84.367	138,837
Title II: Education for Economic Security	84.048	65,023
Elementary and Secondary Education Act (ESEA):		
Title IV-A: Assistance to States for Assessments and Activities	84.369	10,736
Special Education – Grants to States	84.027	927,164
Special Education – Preschool Grants	84.173	19,712
Vocational Education:		
Tech Prep Education	84.318	14,372
Special Projects:		
Class Size Reduction	84.365	5,743
Safe and Drug Free Schools and Communities	84.367	13,249
<u>Federal Emergency Management Agency</u>		
<u>Department of Emergency Services</u>		
Emergency Management Assistance	83.503	6,741
Disaster Assistance	83.516	6,071
State and Local Emergency Operation Planning	97.004	52,740
<u>Election Assistance Commission</u>		
<u>Virginia State Board of Elections</u>		
Help America Vote Act	90.401	8,323
Total Expenditures of Federal Awards		\$ 2,441,330

Note 1: Basis of Accounting

This schedule was prepared on the modified accrual basis of accounting.

Note 2: Nonmonetary Assistance

Nonmonetary assistance is reported in the Schedule of Expenditures of Federal Awards at the fair market value of the food commodities disbursed. At June 30, 2006, the component unit – school division had food commodities in inventory of \$26,761.

STATISTICAL SECTION

TABLE 1

**CITY OF SALEM, VIRGINIA
NET ASSETS BY COMPONENT
LAST FOUR FISCAL YEARS**

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Governmental Activities				
Invested in capital assets, net of related debt	\$ 67,412,793	\$ 66,907,332	\$ 61,403,039	\$ 63,298,534
Restricted	-	-	2,313,457	2,473,586
Unrestricted	<u>8,190,106</u>	<u>9,897,191</u>	<u>11,504,311</u>	<u>10,421,502</u>
Total governmental net assets	<u>\$ 75,602,899</u>	<u>\$ 76,804,523</u>	<u>\$ 75,220,807</u>	<u>\$ 76,193,622</u>
Business-type activities				
Invested in capital assets, net of related debt	\$ 36,954,684	\$ 36,501,799	\$ 31,689,583	\$ 23,078,380
Unrestricted	<u>21,804,567</u>	<u>21,839,306</u>	<u>24,685,946</u>	<u>31,038,458</u>
Total business-type activities net assets	<u>\$ 58,759,251</u>	<u>\$ 58,341,105</u>	<u>\$ 56,375,529</u>	<u>\$ 54,116,838</u>
Primary government				
Invested in capital assets, net of related debt	\$ 104,367,477	\$ 103,409,131	\$ 93,092,622	\$ 86,376,914
Restricted	-	-	2,313,457	2,473,586
Unrestricted	<u>29,994,673</u>	<u>31,736,497</u>	<u>36,190,257</u>	<u>41,459,960</u>
Total primary government net assets	<u>\$ 134,362,150</u>	<u>\$ 135,145,628</u>	<u>\$ 131,596,336</u>	<u>\$ 130,310,460</u>

Source: City of Salem Finance Department

TABLE 2

**CITY OF SALEM, VIRGINIA
CHANGES IN NET ASSETS
LAST FOUR FISCAL YEARS
(accrual basis of accounting)**

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Expenses				
Governmental activities				
General government	\$ 5,107,268	\$ 4,283,754	\$ 4,402,755	\$ 4,156,677
Judicial administration	1,457,720	1,292,722	1,224,425	1,190,643
Public safety	13,547,191	11,535,321	10,574,969	10,409,689
Public works	12,443,334	10,789,008	9,603,482	9,471,217
Parks, recreation and cultural	5,239,517	3,851,575	4,257,005	3,697,241
Health and welfare	2,055,166	1,823,783	1,419,802	1,217,958
Community development	933,002	513,272	842,963	1,290,922
Education	16,266,005	15,618,081	29,340,564 (1)	14,747,635
Nondepartmental	-	2,424,022	1,788,744	2,253,821
Interest on long-term debt	1,267,296	1,478,103	1,339,037	1,045,306
Total governmental activities	<u>58,316,499</u>	<u>53,609,641</u>	<u>64,793,746</u>	<u>49,481,109</u>
Business-type activities				
Electric	24,692,031	16,311,434	15,116,855	16,810,659
Water and Sewage	10,836,280	9,502,885	7,305,334	7,427,270
Civic Center	2,364,891	2,199,589	2,096,344	1,856,562
Catering and Concessions	1,036,737	960,320	953,609	932,823
Total business-type activities expense	<u>38,929,939</u>	<u>28,974,228</u>	<u>25,472,142</u>	<u>27,027,314</u>
Total primary government expenses	<u>\$ 97,246,438</u>	<u>\$ 82,583,869</u>	<u>\$ 90,265,888</u>	<u>\$ 76,508,423</u>
Program Revenues				
Governmental activities				
Charges for services				
Public Safety	1,315,417	1,083,694	532,717	553,437
Public Works	1,799,284	1,821,717	1,805,400	1,781,202
Other Activities	471,137	415,225	508,282	426,281
Operating grants and contributions	6,038,168	5,979,520	5,359,113	5,557,143
Capital grants and contributions	6,392,874	314,789	3,260,581	300,000
Total governmental activities program revenues	<u>16,016,880</u>	<u>9,614,945</u>	<u>11,466,093</u>	<u>8,618,063</u>
Business-type activities				
Charges for services				
Electric	27,699,386	20,192,965	20,092,111	19,640,717
Water and Sewage	9,529,125	8,510,106	8,368,156	7,663,093
Civic Center	793,716	887,312	862,129	716,643
Catering and Concessions	991,208	967,446	975,666	995,280
Total business-type activities program revenues	<u>39,013,435</u>	<u>30,557,829</u>	<u>30,298,062</u>	<u>29,015,733</u>
Total primary government program revenues	<u>\$ 55,030,315</u>	<u>\$ 40,172,774</u>	<u>\$ 41,764,155</u>	<u>\$ 37,633,796</u>
Net (expense) revenue				
Governmental activities	\$ (42,299,619)	\$ (43,994,696)	\$ (53,327,653)	\$ (40,863,046)
Business-type activities	83,496	1,583,601	4,825,920	1,988,419
Total primary government net expense	<u>\$ (42,216,123)</u>	<u>\$ (42,411,095)</u>	<u>\$ (48,501,733)</u>	<u>\$ (38,874,627)</u>

(Continued)

**TABLE 2
(Continued)**

**CITY OF SALEM, VIRGINIA
CHANGES IN NET ASSETS
LAST FOUR FISCAL YEARS
(accrual basis of accounting)**

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
General Revenues and Other Changes in Net Assets				
Governmental activities:				
Taxes				
Property taxes	27,161,942	25,062,245	24,868,585	23,353,997
Sales tax	5,634,585	5,601,846	5,397,710	4,996,579
Business license tax	3,866,585	4,032,843	3,647,786	3,496,933
Meals tax	2,351,010	2,190,099	2,091,998	2,055,706
Other taxes	2,625,066	2,486,633	2,484,614	2,233,301
Utility taxes	1,372,250	1,339,238	1,122,167	1,141,696
Intergovernmental revenue not restricted	3,523,634	3,597,191	3,213,462	3,243,932
Investment earnings	556,039	501,808	394,977	319,062
Gain on sale of property	402,089	571,311	-	-
Other	218,274	266,019	285,750	302,877
Transfers	975,685	(70,821)	236,756	226,527
Total governmental activities	<u>48,687,159</u>	<u>45,578,412</u>	<u>43,743,805</u>	<u>41,370,610</u>
Business-type activities:				
Investment earnings	271,303	311,154	110,832	369,743
Transfers	(975,685)	70,821	(236,756)	(226,527)
Total business-type activities	<u>(704,382)</u>	<u>381,975</u>	<u>(125,924)</u>	<u>143,216</u>
Total primary government	<u>\$ 47,982,777</u>	<u>\$ 45,960,387</u>	<u>\$ 43,617,881</u>	<u>\$ 41,513,826</u>
Changes in Net Assets				
Governmental activities	\$ 6,387,540	\$ 1,965,576	\$ 4,699,996	\$ 2,131,635
Business-type activities	(620,886)	1,583,716	(9,583,848)	507,564
Total primary government	<u>\$ 5,766,654</u>	<u>\$ 3,549,292</u>	<u>\$ (4,883,852)</u>	<u>\$ 2,639,199</u>

Note:

(1) This amount includes \$14,000,000 of bond funds transferred to the School Division to fund capital projects.

Source: City of Salem Finance Department

TABLE 3

**CITY OF SALEM, VIRGINIA
FUND BALANCES, GOVERNMENTAL FUNDS
LAST TEN FISCAL YEARS**

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
General Fund										
Reserved	\$ 1,431,926	\$ 1,179,343	\$ 1,009,767	\$ 745,321	\$ 811,145	\$ 967,680	\$ 857,533	\$ 839,548	\$ 1,006,052	\$ 725,351
Unreserved	<u>6,419,834</u>	<u>10,534,365</u>	<u>11,124,617</u>	<u>10,319,757</u>	<u>7,785,113</u>	<u>8,494,384</u>	<u>8,290,010</u>	<u>5,540,300</u>	<u>4,715,564</u>	<u>3,993,161</u>
Total General Fund	<u>\$ 7,851,760</u>	<u>\$ 11,713,708</u>	<u>\$ 12,134,384</u>	<u>\$ 11,065,078</u>	<u>\$ 8,596,258</u>	<u>\$ 9,462,064</u>	<u>\$ 9,147,543</u>	<u>\$ 6,379,848</u>	<u>\$ 5,721,616</u>	<u>\$ 4,718,512</u>
All Other Governmental Funds										
Reserved	\$ 1,251,705	\$ 3,777,959	\$ 7,434,079	\$ 2,920,546	\$ 2,639,011	\$ 702,166	\$ 980,723	\$ 1,569,842	\$ -	\$ 495,851
Unreserved, reported in:										
Capital projects fund	(463,348)	(1,691,345)	2,914,998	(305,531)	-	-	-	-	29,933	(92,393)
Debt service fund	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total all other governmental funds	<u>\$ 788,357</u>	<u>\$ 2,086,614</u>	<u>\$ 10,349,077</u>	<u>\$ 2,615,015</u>	<u>\$ 2,639,011</u>	<u>\$ 702,166</u>	<u>\$ 980,723</u>	<u>\$ 1,569,842</u>	<u>\$ 29,933</u>	<u>\$ 403,458</u>

Source: City of Salem Finance Department

TABLE 4

**CITY OF SALEM, VIRGINIA
CHANGES IN FUND BALANCE, GOVERNMENTAL FUNDS
LAST TEN FISCAL YEARS**

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
Revenue										
Taxes	\$ 44,037,357	\$ 41,593,054	\$ 40,747,374	\$ 38,137,448	\$ 36,436,995	\$ 35,323,279	\$ 35,547,144	\$ 34,505,383	\$ 33,727,514	\$ 32,125,989
Permits, privilege fees, and regulatory licenses	294,314	286,150	308,511	257,796	269,237	237,722	268,517	244,810	245,138	235,578
Fines and forfeitures	150,860	162,207	197,297	170,922	156,128	159,404	162,188	117,048	108,977	114,235
Revenue from use of money and property	1,385,122	1,861,432	579,303	482,878	928,857	1,197,369	1,103,489	712,303	439,550	600,467
Charges for services	2,959,842	2,749,670	2,186,113	2,168,506	1,967,128	1,950,211	2,146,002	1,955,586	2,149,051	2,038,078
Other	32,544	43,796	53,590	385,733	1,385,165	1,142,483	1,099,482	917,618	900,645	1,010,554
Intergovernmental	8,720,129	8,765,664	7,764,376	8,562,593	8,400,270	7,663,260	7,146,529	4,612,946	4,611,127	4,027,001
Total revenues	57,580,168	55,461,973	51,836,564	50,165,876	49,543,780	47,673,728	47,473,351	43,065,694	42,182,002	40,151,902
Expenditures										
General government	4,994,542	4,386,061	4,005,851	3,555,873	3,330,674	3,511,823	3,145,638	2,876,123	2,600,765	2,737,015
Judicial administration	1,321,052	1,256,107	1,207,990	1,172,370	1,185,883	1,152,094	1,090,282	1,036,931	1,039,647	859,080
Public safety	12,707,985	11,670,171	10,740,352	10,103,738	9,706,080	9,058,667	8,610,382	8,215,706	7,515,791	7,292,406
Public works	9,400,116	9,777,021	8,879,090	8,514,725	9,491,691	8,036,110	7,791,651	7,957,248	8,471,332	8,733,594
Parks, recreation and cultural	4,316,920	4,037,410	3,696,621	3,336,510	3,549,487	3,238,115	3,136,048	2,831,101	2,599,727	2,986,056
Health and welfare	1,918,490	1,823,783	1,419,802	1,217,958	1,858,199	1,541,957	1,455,984	1,324,350	1,234,790	935,543
Education	16,266,005	15,618,081	15,340,564	14,747,635	14,851,000	15,552,599	15,005,469	14,274,284	13,777,388	15,279,333
Community development	815,991	513,272	842,963	1,290,922	843,615	662,157	508,435	337,914	223,287	289,229
Nondepartmental	3,610,694	2,424,022	1,788,744	2,253,821	1,669,551	1,163,257	2,002,046	1,343,146	1,507,441	1,217,764
Capital projects	4,325,562	5,519,655	14,604,233	76,230	819,507	1,379,692	589,119	459,386	-	387,847
Debt service										
Principal	2,863,024	5,616,505 (1)	1,055,518	1,628,985	1,969,433	903,164	944,572	900,553	859,716	531,389
Interest	1,185,708	1,432,203	1,150,476	1,063,168	1,160,076	430,350	481,247	447,130	510,306	458,587
Total expenditures	63,726,089	64,074,291	64,732,204	48,961,935	50,435,196	46,629,985	44,760,873	42,003,872	40,340,190	41,707,843
Excess of revenues over (under) expenditures	(6,145,921)	(8,612,318)	(12,895,640)	1,203,941	(891,416)	1,043,743	2,712,478	1,061,822	1,841,812	(1,555,941)
Other Financing Sources (Uses)										
Proceeds from borrowing	-	-	31,970,540	-	-	-	-	2,000,000	428,145	-
Payments to bond escrow agents	-	-	(10,508,287)	-	-	-	-	-	-	-
Transfers in	8,235,360	5,417,206	4,252,823	3,993,355	2,862,517	2,189,014	1,825,819	1,443,662	1,390,258	1,619,772
Transfers out	(7,249,644)	(5,488,027)	(4,016,067)	(3,766,828)	(3,875,163)	(3,196,793)	(2,359,721)	(2,307,343)	(2,607,419)	(2,756,977)
Total other financing sources (uses)	985,716	(70,821)	21,699,009	226,527	(1,012,646)	(1,007,779)	(533,902)	1,136,319	(789,016)	(1,137,205)
Net change in fund balances	\$ (5,160,205)	\$ (8,683,139)	\$ 8,803,369	\$ 1,430,468	\$ (1,904,062)	\$ 35,964	\$ 2,178,576	\$ 2,198,141	\$ 1,052,796	\$ (2,693,146)
Debt service as a percentage of noncapital expenditures	7.06%	12.35% (2)	4.60%	5.68%	6.51%	3.09%	3.36%	3.36%	3.50%	2.48%

Note:

(1) Includes one-time balloon payment of \$2,715,000.

(2) Net of balloon payment, percentage equals 7.59%.

Source: City of Salem Finance Department

TABLE 5

**CITY OF SALEM
ASSESSED VALUE AND ACTUAL VALUE OF TAXABLE PROPERTY
LAST TEN FISCAL YEARS**

Fiscal Year Ended June 30,	Real Estate	Personal Property	Machinery and Tools	Public Service Corporation	Mobile Homes	Total Taxable Assessed Value	Total Direct Tax Rate
2006	\$ 1,572,732,200	\$ 262,141,563	\$ 86,409,864	\$ 34,992,259	\$ 1,855,348	\$ 1,958,131,234	\$ 1.54
2005	1,414,891,600	253,619,878	82,714,938	33,586,047	2,186,076	1,786,998,539	1.55
2004	1,386,790,100	250,218,290	88,317,031	35,032,203	2,092,797	1,762,450,421	1.56
2003	1,276,162,600	262,415,563	75,075,156	35,658,160	2,257,457	1,651,568,936	1.60
2002	1,260,133,200	257,336,535	81,289,685	36,825,471	2,573,480	1,638,158,371	1.60
2001	1,159,955,100	291,662,164	79,003,832	35,119,042	2,782,250	1,568,522,388	1.66
2000	1,132,465,500	252,607,101	87,609,659	33,842,393	3,311,164	1,509,835,817	1.65
1999	1,035,946,400	234,113,024	83,530,905	30,630,006	3,508,695	1,387,729,030	1.64
1998	1,014,195,800	218,922,343	83,591,859	31,223,785	3,799,229	1,351,733,016	1.64
1997	946,774,735	206,601,133	89,727,446	29,633,460	3,713,699	1,276,450,473	1.65

Source: City of Salem Finance Department

TABLE 6

CITY OF SALEM, VIRGINIA
 PRINCIPAL PROPERTY TAXPAYERS
 CURRENT YEAR AND NINE YEARS AGO

	Fiscal Year 2006			Fiscal Year 1997		
	Taxable Assessed Value	Rank	Percentage of Total City Taxable Assessed Value	Taxable Assessed Value	Rank	Percentage of Total City Taxable Assessed Value
<u>Taxpayer</u>						
Lewis-Gale Hospital HCA	\$ 63,346,200	1	3.99%	\$ 17,835,500	2	(1) 1.85%
Yokohama Industries	16,126,100	2	1.02%	15,630,100	3	1.62%
U.S. Food Service, Inc.	12,222,400	3	0.77%	5,504,100	7	0.57%
General Electric	11,147,000	4	0.70%	10,086,100	4	1.05%
C.S.W. Associates	8,167,800	5	0.51%	6,743,700	6	0.70%
Rowe Furniture/Salem Frame	7,511,800	6	0.47%			
Spartan Square, Inc.	7,003,300	7	0.44%	4,872,500	10	0.51%
Wal-Mart, Inc.	6,309,500	8	0.40%			
Carthy Corporation/Carter Machinery	6,223,300	9	0.39%	4,910,600	9	0.51%
Salem Ridge	5,383,200	10	0.34%	5,112,000	8	0.53%
Lewis-Gale Building Corporation				18,240,200	1	(1) 1.89%
Home Shopping/Stuart McGuire				9,430,300	5	0.98%

Note:

(1) In 2005, Lewis-Gale Hospital HCA acquired the assets of Lewis-Gale Building Corporation.

Source: City of Salem Real Estate Valuation Department.

TABLE 7

**CITY OF SALEM, VIRGINIA
PROPERTY TAX LEVIES AND COLLECTIONS
LAST TEN FISCAL YEARS**

Fiscal Year	Taxes Levied for the Fiscal Year	Collected within the Fiscal Year of the Levy		Collections in Subsequent Years	Total Collections to Date	
		Amount (1)	Percentage of Levy		Amount	Percentage of Levy
2006	\$ 30,146,687	\$ 29,379,690	97.46%	\$ 273,850	\$ 29,653,540	98.36%
2005	27,797,041	27,074,619	97.40%	294,662	27,369,281	98.46%
2004	27,635,328	26,861,320	97.20%	364,687	27,226,007	98.52%
2003	26,305,825	25,829,614	98.19%	253,199	26,082,813	99.15%
2002	25,816,066	25,015,942	96.90%	259,718	25,275,660	97.91%
2001	24,642,171	24,300,445	98.61%	255,210	24,555,655	99.65%
2000	24,340,279	24,089,227	98.97%	239,461	24,328,688	99.95%
1999	22,512,879	22,294,549	99.03%	236,974	22,531,523	100.08%
1998	21,754,573	21,513,420	98.89%	644,141	22,157,561	101.85%
1997	20,412,369	20,293,839	99.42%	368,472	20,662,311	101.22%

TABLE 8

**CITY OF SALEM, VIRGINIA
RATIOS OF GENERAL BONDED DEBT OUTSTANDING
LAST TEN FISCAL YEARS**

Fiscal Year	Governmental Activities (1)					Percentage of Estimated Actual Value of Taxable Property	Net Bonded Debt Per Capita
	General Obligation Bonds	Loans/Notes	Capital Leases	Less: Amounts Restricted to Repaying Principal	Total		
2006	\$ 31,498,210	\$ 625,000	\$ -	\$ -	\$ 32,123,210	1.64%	\$ 1,279.81
2005	34,236,234	750,000	-	-	34,986,234	1.96%	1,393.87
2004	39,727,739	875,000	-	2,988,308	37,614,431	2.13%	1,520.39
2003	18,362,717	1,000,000	-	2,673,586	16,689,131	1.01%	675.67
2002	19,866,702	1,125,000	-	2,621,352	18,370,350	1.12%	740.05
2001	21,368,934	1,592,200	-	2,737,447	20,223,687	1.29%	817.22
2000	22,829,000	2,059,400	-	2,769,188	22,119,212	1.47%	897.08
1999	24,369,864	2,538,200	-	2,759,842	24,148,222	1.74%	980.68
1998	20,711,349	3,057,000	20,361	2,823,012	20,965,698	1.55%	852.89
1997	21,986,460	3,615,324	39,524	2,777,035	22,864,273	1.79%	932.21

Fiscal Year	Business-Type Activities			Total Primary Government
	General Obligation Bonds	Revenue Bonds (2)	Total	
2006	\$ 58,826,790	\$ 8,028,942	\$ 66,855,732	\$ 98,978,942
2005	36,033,766	4,461,586	40,495,352	75,481,586
2004	39,347,261	432,388	39,779,649	77,394,080
2003	42,047,283	-	42,047,283	58,736,414
2002	45,158,298	-	45,158,298	63,528,648
2001	24,726,065	-	24,726,065	44,949,752
2000	27,190,998	-	27,190,998	49,310,210
1999	29,540,134	-	29,540,134	53,688,356
1998	19,193,650	-	19,193,650	40,159,348
1997	19,503,540	-	19,503,540	42,367,813

Note:

Details regarding the City's outstanding debt can be found in the notes to the financial statements.

See Table 10 for personal income and population data.

(1) Outstanding debt for Schools is included with Governmental Activities.

TABLE 9

**CITY OF SALEM, VIRGINIA
LEGAL DEBT MARGIN INFORMATION
LAST FOUR FISCAL YEARS**

	Fiscal Year			
	2006 (1)	2005 (2)	2004 (3)	2003 (4)
Assessed Value of Real Property	\$ 1,607,724,459	\$ 1,448,477,647	\$ 1,421,822,303	\$ 1,419,380,260
Debt Limit, 10% of Assessed Value	160,772,446	144,847,765	142,182,230	141,938,026
Amount of Debt Applicable to Limit				
General Obligation Bonds	90,325,000	70,270,000	79,075,000	60,410,000
Other Long Term Debt	8,653,942	5,211,586	1,307,388	1,000,000
Less: Enterprise Fund Bonds (5)	(66,855,732)	(40,495,352)	(39,347,261)	(42,047,283)
Less: Resources Restricted to Paying Principal	-	-	(2,313,457)	(2,673,586)
Total net debt applicable to limit	32,123,210	34,986,234	38,721,670	16,689,131
Legal Debt Margin	128,649,236	109,861,531	103,460,560	125,248,895
Total net debt applicable to the limit as a percentage of debt limit	19.98%	24.15%	27.23%	11.76%

Note:

(1) Includes \$1,572,732,200 in General Real Estate and \$34,992,259 in Public Service Corporation Real Estate.

(2) Includes \$1,414,891,600 in General Real Estate and \$33,586,047 in Public Service Corporation Real Estate.

(3) Includes \$1,386,790,100 in General Real Estate and \$35,032,203 in Public Service Corporation Real Estate.

(4) Includes \$1,384,722,100 in General Real Estate and \$35,658,160 in Public Service Corporation Real Estate.

(5) The Enterprise Fund bonds are backed by the full faith and credit of the City, but are expected to be paid from the revenue and receipts of the Enterprise Funds.

(6) School debt is included in the amount of debt applicable to limit

Source: City of Salem Finance Department

TABLE 10

**CITY OF SALEM, VIRGINIA
DEMOGRAPHIC AND ECONOMIC INFORMATION
LAST TEN FISCAL YEARS**

<u>Fiscal Year Ended (1)</u>	<u>Population (2)</u>	<u>Total Personal Income (3)</u>	<u>Per Capita Personal Income (4)</u>	<u>Public School Enrollment</u>	<u>Unemployment Rate (5)</u>
2006	25,100	\$ 9,200,878 (est.)	\$ 34,878 (est.)	3,918	2.90%
2005	25,100	9,200,878 (est.)	32,951	3,916	2.50%
2004	24,740	9,200,878	33,208	3,885	2.70%
2003	24,700	8,639,183	33,208	3,927	3.80%
2002	24,823	8,496,306	33,208	4,007	3.10%
2001	24,747	8,226,312	32,053	3,932	2.20%
2000	24,657	7,807,564	31,978	3,957	1.60%
1999	24,624	7,439,501	31,675	3,912	1.70%
1998	24,582	7,175,994	28,214	3,920	2.50%
1997	24,527	6,773,692	27,570	3,900	3.00%

Note:

(1) Population, school enrollment and unemployment figures are based on fiscal years ending June 30. Per Capita Income is as of December 31.

(2) Population is based on figures available from the Weldon Cooper Center, University of Virginia and the City Planning Department.

(3) Total personal income reported is for the Roanoke Metropolitan Statistical Area. No data is available for the City of Salem only.

(4) Source: Bureau of Economic Analysis, City Planning Department

(5) Virginia Employment Commission

TABLE 11

**CITY OF SALEM, VIRGINIA
PRINCIPAL EMPLOYERS
CURRENT YEAR AND NINE YEARS AGO**

<u>Employer</u>	<u>2006</u>			<u>1997</u>		
	<u>Employees</u>	<u>Rank</u>	<u>Percentage of Total City Employment (1)</u>	<u>Employees</u>	<u>Rank</u>	<u>Percentage of Total City Employment (1)</u>
Lewis-Gale Clinic	1,456	1	6.38%	1,200	4	4.71%
Veterans Administration Medical Center	1,393	2	6.10%	1,353	2	5.32%
General Electric	1,100	3	4.82%	1,710	1	6.72%
Lewis-Gale Hospital	1,100	4	4.82%	1,413	3	5.55%
Virginia Department of Transportation	895	5	3.92%			
Yokohama Industries	885	6	3.88%	925	5	3.63%
City of Salem Schools	583	7	2.55%	486	8	1.91%
City of Salem	527	8	2.31%	485	9	1.91%
US Foodservice	465	9	2.04%			
Roanoke College	420	10	1.84%	430	10	1.69%
Rowe Furniture				725	6	2.85%
Home Shopping Network Virginia Division				625	7	2.46%

Note:

(1) Calculated using data provided by Virginia Employment Commission

Source: City of Salem Department of Planning and Economic Development, Virginia Employment Commission

TABLE 12

CITY OF SALEM, VIRGINIA
**FULL-TIME EQUIVALENT CITY GOVERNMENT EMPLOYEES BY FUNCTION/PROGRAM
 LAST FOUR FISCAL YEARS**

<u>Function/Program</u>	Full-Time Equivalent Employees as of June 30			
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
General government	72	72	71	70
Judicial administration	19	19	19	19
Public safety	162	159	154	154
Public works	115	115	114	115
Parks, recreation and cultural	25	20	22	22
Community development	4	2	2	2
Electric	28	29	29	28
Water and sewer	58	60	63	63
Civic Center	19	20	20	19
Catering and concessions	5	5	5	5
Total	<u>507</u>	<u>501</u>	<u>499</u>	<u>497</u>

TABLE 13

**CITY OF SALEM, VIRGINIA
OPERATING INDICATORS BY FUNCTION/PROGRAM
LAST FOUR FISCAL YEARS**

<u>Program/Function</u>	<u>Fiscal Year</u>			
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
General Government				
Finance				
Accounts payable checks issued	15,638	16,307	16,836	16,183
Human Resources				
Positions filled (full-time and temporary)	246	233	219	246
Registrar				
Number of registered voters	14,995	15,652	15,146	14,442
Fleet				
Pieces of equipment maintained	527	517	510	498
Judicial Administration				
Sheriff				
Inmates housed	1,125	1,067	1,497	1,708
Inmate transports	1,391	1,315	1,471	1,292
Courts worked	611	593	588	580
Public safety				
Police				
Calls for service	30,163	30,442	31,566	30,396
Accidents	1,221	1,263	1,258	1,221
DUI Arrests	159	124	196	254
Fire				
Emergency responses - fire	3,006	2,537	2,182	2,106
Emergency responses - medic units	3,289	2,934	2,281	2,007
Hazardous materials responses	82	101	72	79
Building Inspections				
Residential construction permits issued	309	319	272	599
Commercial construction permits issued	92	139	163	53
Public works				
Refuse collection				
Refuse collected (tons per year)	81,379	84,270	92,665	90,762
Tons recycled	2,154	3,594	3,550	3,559
Other public works				
Tons of asphalt used in resurfacing	9,111	11,966	8,005	7,088
Square yards of milling completed	58,605	25,480	17,973	15,990
Tons of salt used	901	705	1,350	1,574
Leaves collected (loads)	422	604	375	400
Parks, recreation and cultural				
Parks and recreation				
Tournaments hosted	59	54	51	54
Special events held	21	18	18	18
Youth sports teams	184	219	219	214
Adult sports teams	40	40	40	42
Library				
Circulation	233,852	232,892	224,712	230,848
Children's program attendance	3,580	4,164	2,622	3,324
Patron visits to the library	228,560	217,477	220,571	214,911
New patrons	1,510	1,537	1,492	1,553
Internet sessions	32,650	25,834	27,973	25,845
Electric				
Number of customer accounts	12,968	12,856	12,883	12,678
Water				
Number of customer accounts	9,107	9,055	9,035	8,916
Volume pumped (million gallons per day average)	3.8	4.4	4.4	5.4
Sewer				
Number of customer accounts	8,513	8,461	8,446	8,339
Waste/water treated (million gallons per day)	6.8	9.2	7.3	7.8
Civic Facilities				
Concerts	6	8	12	16
Meetings	1,209	1,282	1,259	1,282
Tickets sold	163,972	129,248	150,801	162,263
Arena utilization days	175	203	180	175

Source: Various City Departments

TABLE 14

**CITY OF SALEM, VIRGINIA
CAPITAL ASSET STATISTICS BY FUNCTION/PROGRAM
LAST THREE FISCAL YEARS**

<u>Function/Program</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Public safety			
Police stations	1	1	1
Law enforcement vehicles	45	42	56
Fire stations	3	3	3
Fire trucks	5	5	5
Ambulance	4	3	3
Public works			
Primary streets (lane miles)	64.8	64.8	64.3
Secondary streets (lane miles)	224.8	224.8	222.8
Alley (lane miles)	10.8	10.8	10.8
Number of garbage trucks	10	11	12
Parks, recreation and cultural			
Community centers	3	3	3
Parks/athletic fields	15	15	15
Acres of parks maintained	495	495	495
Libraries	1	1	1
Golf courses	1	1	1
Electric			
Substations	7	7	7
Miles of distribution lines			
Overhead	159	161	161
Underground	33	31	31
Miles of Transmission Lines	23	23	23
Water and sewage			
Water treatment plants	1	2	2
Miles of distribution lines	181	180	155
Miles of sanitary sewers	174	174	144

Source: City of Salem Finance Department

COMPLIANCE SECTION

**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**

Honorable Members of City Council
City of Salem
Salem, Virginia

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Salem, Virginia, as of and for the year ended June 30, 2006, which collectively comprise the City's basic financial statements and have issued our report thereon dated November 17, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Specifications for Audits of Counties, Cities and Towns*, issued by the Auditor of Public Accounts of the Commonwealth of Virginia.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the City's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. **This reportable condition is described in the accompanying schedule of findings and questioned costs as Item 06-1.**

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. **However, we believe that the reportable condition described above is not a material weakness. Other matters involving internal control over financial reporting and its operation were communicated to management in a separate letter dated November 17, 2006.**

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements, including certain provisions of the compliance matters described in the Summary of Compliance Matters, 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 an instance of noncompliance that is required to be reported under *Government Auditing Standards*, which is described in the accompanying schedule of findings and questioned costs as Item 06-2.**

This report is intended solely for the information of the audit committee, management, state and federal awarding agencies, and pass-through entities and the Salem City Council and is not intended to be, and should not be, used by anyone other than these specified parties.

Brown, Edwards & Company, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

Roanoke, Virginia
November 17, 2006

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

Honorable Members of the City Council
City of Salem
Salem, Virginia

Compliance

We have audited the compliance of the City of Salem, Virginia with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2006. The City's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

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

In our opinion, the City of Salem, Virginia, complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006.

Internal Control over Compliance

The management of the City is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the City's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with *OMB Circular A-133*.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a 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 noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program 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 compliance and its operation that we consider to be material weaknesses.**

This report is intended for the information of the audit committee, management, federal awarding agencies and pass-through entities, and the Salem City Council and is not intended to be, and should not be, used by anyone other than these specified parties.

Brown, Edwards & Company, S. L. P.

CERTIFIED PUBLIC ACCOUNTANTS

Roanoke, Virginia
November 17, 2006

CITY OF SALEM, VIRGINIA
SUMMARY OF COMPLIANCE MATTERS
June 30, 2006

As more fully described in the 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*, we performed tests of the City's compliance with certain provisions of the laws, regulations, contracts, and grants shown below.

STATE COMPLIANCE MATTERS

<u><i>Code of Virginia</i></u>	<u>State Agency Requirements</u>
Budget and Appropriation Laws	Education
Cash and Investment Laws	Comprehensive Services Act
Conflicts of Interest Act	
Local Retirement Systems	
Debt Provisions	
Procurement Laws	
Uniform Disposition of Unclaimed Property Act	
Personal Property Tax Relief Act	
Enhanced E-911 Service Taxes	

FEDERAL COMPLIANCE MATTERS

Compliance Supplement for Single Audits of State and Local Governments

Provisions and conditions of agreements related to federal programs selected for testing.

LOCAL COMPLIANCE MATTERS

City Charter

CITY OF SALEM, VIRGINIA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended June 30, 2006

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an **unqualified opinion** on the financial statements.
2. **One reportable condition** related to the audit of the financial statements is reported in the 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*. These reportable conditions were not deemed to be material weaknesses.
3. **No instances of noncompliance** material to the basic financial statements were disclosed during the audit.
4. **No reportable conditions** are disclosed in the Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with *OMB Circular A-133*.
5. The auditor's report on compliance for the major federal award programs expresses an **unqualified opinion**.
6. The audit disclosed **no audit findings** relating to major programs.
7. The programs tested as major programs include:

National School Lunch Program	10.555
National School Breakfast Program	10.553
Special Education – Grants to States	84.027
Special Education – Preschool Grants	84.173
8. The threshold for distinguishing Type A and B programs was **\$300,000**.
9. The City was **not determined to be a low-risk auditee**.

B. FINDINGS – FINANCIAL STATEMENT AUDIT

06-1: Electric Inventory Quantities (Reportable Condition)

Condition:

The electric department performed a year end physical count of assets to ensure the quantities were accurate. During our inventory test counting, 21% of items tested were miscounted. This indicates ineffective controls over the physical inventory process.

Recommendation:

Procedures should be put in place to ensure an effective physical count of inventory at year end.

Management's Response:

The auditee concurs. The City feels this came about as a result of too much reliance on a new inventory software system that was not thoroughly understood before implementation. The Finance Department is working with the Electric Department to rectify the situation for 2006-07.

CITY OF SALEM, VIRGINIA

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended June 30, 2006**

C. FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARD PROGRAMS AUDIT

None.

D. FINDINGS AND QUESTIONED COSTS – COMMONWEALTH OF VIRGINIA

06-2: Unclaimed Property

Condition:

As of June 30, 2006 there were checks totaling \$54,296 outstanding for more than five years. Checks outstanding more than five years are required to be filed annually on the unclaimed property report to the State Treasurer.

Recommendation:

Bank reconciliations should be reviewed periodically for checks outstanding more than five years and if in existence, include the checks on the unclaimed property report.

Management's Response:

The auditee concurs with this recommendation.

CITY OF SALEM, VIRGINIA
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
Year Ended June 30, 2006

Auditor
Reference No.

05-1: Submission of the Single Audit Reporting Package

Condition:

The Single Audit Reporting Package was not submitted timely.

Current Status:

Management has taken efforts to improve their filing process and expect to file the Single Audit Reporting Package for fiscal year ended June 30, 2006 in a timely manner.