

CITY OF SALEM, VIRGINIA



COMPREHENSIVE ANNUAL FINANCIAL REPORT YEAR ENDED JUNE 30, 2005

Prepared by the Department of Finance

CITY OF SALEM, VIRGINIA

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INTRODUCTORY SECTION

February 27, 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, 2005. 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 lays 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 2005 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 2.5 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 along with the announcement of several others. In the residential area, The Homeplace, The Hill and The Lawn all high-end subdivisions are now virtually complete with over 120 new homes and assessed value in excess of \$41,000,000. Four new subdivisions have been announced with a total of 110 lots and building costs expected to exceed \$300,000 per unit. Roanoke College completed two new residential dorms as part of its plan to grow student enrollment.

In the business and commercial market, the Salem YMCA completed the final phase of a \$7.1 million expansion. The City officially opened the Salem Commerce Park located adjacent to the YMCA. This Park with over 30 acres is already occupied by One Beacon Insurance Company. Both the Atlantic Mutual Insurance Company Building along with the Waldrop Medical Office Park are currently under construction. When completed, the Park will provide as many as 700 jobs and \$80.0 million dollars in assessed value becoming a jewel in the City's efforts to provide for the future. Additionally three restaurants, Five Guys, Awful Arthur's Seafood, and Surf and Turf opened for business while Hanover Direct Fulfillment took over the space vacated by Home Shopping. Other business relocations or expansions include Goody's, the Dialysis Center, Virginia Varsity Transfer and Robertson Marketing. Lewis-Gale Medical Center completed its new Oncology wing at a cost of \$8.0 million dollars. The completion of most of these projects in the last half of 2004-05 help set the stage for a positive 2005-06 fiscal year.

Fiscal year 2005 revenue performance was a mixed assortment of outcomes as taxes such as Sales Tax 4.3 percent, Food and Beverage Tax 4.7 percent, Transient Lodging Tax 21.3 percent and Business License Tax 5.6 percent increased from the prior year, while Personal Property and Real Estate were relatively level. Not being a reassessment year, Real Estate grew as anticipated. Fiscal year 2005 solidified the savings the City derived from the Refunding of the City's 1994, 1995 and 1996 Bonds.

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 and debt service 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 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.

The Andrew Lewis Renovation/Construction project has been completed and houses 1,000 middle school students. With the completion of this project all of the School Division's major upgrades have been accomplished. Construction on Salem's new 10 MGD Water Treatment Plant is complete and fully operational as of May 2005. This will allow the City to permanently close both the 4th Street and Glenvar Plants, thus providing increased efficiencies. The final phase of the City's Comprehensive Plan dealing with zoning and land use was completed in Winter 2005.

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 2005-06 includes the implementation of a new pay plan along with both cost-of-living and merit increase. It maintains all real and personal property tax rates while real estate assessments increased by 9.1 percent. Rates for electricity increased by 38 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 5.1 percent over the amended 2004-05 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 Spring 2006. The new Solid Waste Transfer Station is under construction and is expected to become operational in June 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 Summer 2006.

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 in previous years. 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.

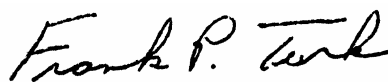
Acknowledgments

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, 2005**

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
Charlene Day 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
Melvin Doughty City Engineer
Norman M. Tyler, Jr. Director of Streets and General Maintenance
Charles M. Hammersley Director of Parks and Recreation Department
Janis Augustine Library Director
Dana Oliver Registrar
A. K. Briele, III Director of Electric Department
J. Wesley Graham 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
Joseph E. Yates, Jr. Director of Planning and Community Development
R. Carey Harveycutter, Jr. Director of Civic Facilities

CITY OF SALEM SCHOOL DIVISION

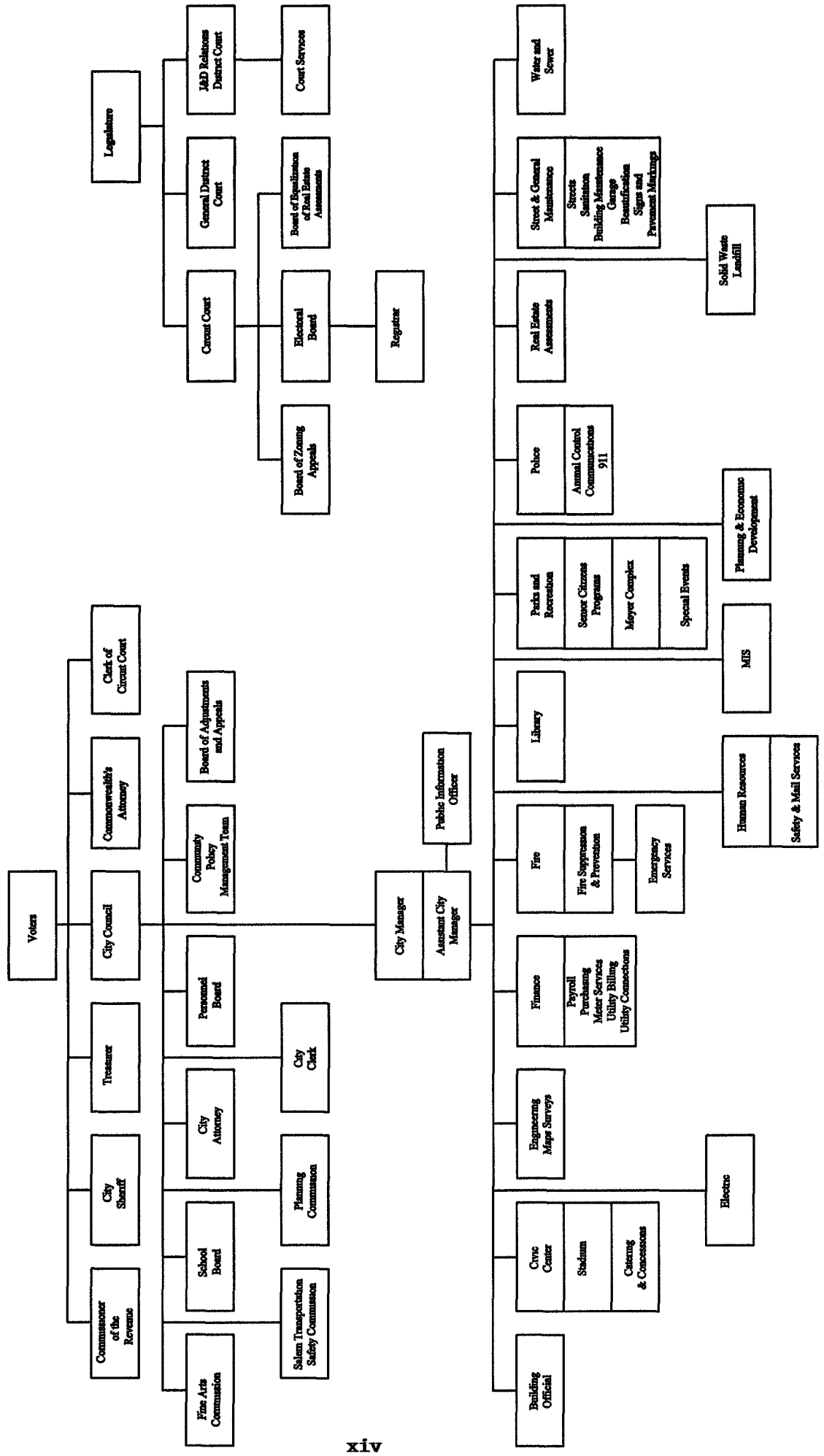
MEMBERS OF SCHOOL BOARD

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

SCHOOL ADMINISTRATION

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

City of Salem, Virginia Organizational Chart



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FINANCIAL SECTION

INDEPENDENT AUDITOR'S REPORT

To the Honorable Members of the City Council
City of Salem
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, 2005, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these basic 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, 2005, 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 December 29, 2005, 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, 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 discussion and analysis on page 3a is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board (GASB). Also, the required supplementary information on page 41 is not a required part of the basic financial statements but is supplementary information required by the GASB. 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 of the City. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basis 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
December 29, 2005

**CITY OF SALEM, VIRGINIA
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2005**

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, 2005. 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, 2005 by \$135.1 million (*net assets*). Of this amount, \$31.7 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 \$1.6 million.
- The business-type activities net assets at June 30, 2005 totaled \$58.3 million, an increase of \$2 million from the June 30, 2004 balance. Of this amount, approximately \$21.8 million is unrestricted.
- Component unit net assets decreased by \$1.1 million to \$44.2 million. Of this amount, \$2.2 million is unrestricted while \$42 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 \$9.6 million or 17.5% of fiscal year 2005 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. These

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

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, 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 Board of the City of Salem. 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

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

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.

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 Court Community Corrections Program and the Cardinal Criminal Justice Academy 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 41 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									
For the Years Ended June 30, 2005 and 2004									
(In Thousands)									
	Governmental Activities		Business-type Activities		Total Primary Government		Component Unit		
	2005	2004	2005	2004	2005	2004	2005	2004	
Current and other assets	\$ 17,973	\$ 25,579	\$ 27,919	\$ 29,386	\$ 45,892	\$ 54,965	\$ 6,445	\$ 11,916	
Capital assets, net	98,333	93,772	76,559	70,853	174,892	164,625	41,972	39,465	
Total Assets	\$ 116,306	\$ 119,351	\$ 104,478	\$ 100,239	\$ 220,784	\$ 219,590	\$ 48,417	\$ 51,381	
Other Liabilities	\$ 3,853	\$ 2,949	\$ 5,608	\$ 4,237	\$ 9,461	\$ 7,186	\$ 3,623	\$ 5,612	
Long-term liabilities	35,648	41,181	40,529	39,627	76,177	80,808	576	467	
Total liabilities	\$ 39,501	\$ 44,130	\$ 46,137	\$ 43,864	\$ 85,638	\$ 87,994	\$ 4,199	\$ 6,079	
Net assets:									
Invested in capital assets, net of related debt	\$ 66,908	\$ 61,403	\$ 36,502	\$ 31,689	\$ 103,410	\$ 93,092	\$ 41,973	\$ 39,465	
Restricted	-	2,313	-	-	-	2,313	-	-	
Unrestricted	9,897	11,505	21,839	24,686	31,736	36,191	2,245	5,837	
Total net assets	\$ 76,805	\$ 75,221	\$ 58,341	\$ 56,375	\$ 135,146	\$ 131,596	\$ 44,218	\$ 45,302	

The City's combined net assets increased from \$131.6 million to \$135.1 million as a result of an increase in net assets of governmental activities of \$1.6 million and of business type activities of \$1.9 million.

Unrestricted net assets, the portion of net assets that can be used to finance the day-to-day operations of the City, totaled \$31.7 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.

Summary of Changes in Net Assets:

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

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

**Summary of Changes in Net Assets
For the Years Ended June 30, 2005 and 2004
(In Millions)**

	Governmental		Business-type		Total		Component	
	Activities		Activities		Primary		Unit	
	2005	2004	2005	2004	2005	2004	2005	2004
Revenues								
Program Revenues:								
Charges for services	\$ 3,320	\$ 2,846	\$ 30,558	\$ 30,298	33,878	33,144	1,307	1,195
Operating grants and contributions	5,980	5,359	-	-	5,980	5,359	4,862	4,556
Capital grants and contributions	315	3,261	-	-	315	3,261	710	14,510
General Revenues:								
Property taxes	25,062	24,867	-	-	25,062	24,867	-	-
Local portion of state sales tax	5,602	5,398	-	-	5,602	5,398	-	-
Business and professional								
occupational license taxes	4,033	3,648	-	-	4,033	3,648	-	-
Utility taxes	1,339	1,122	-	-	1,339	1,122	-	-
Prepared food and beverage taxes	2,190	2,092	-	-	2,190	2,092	-	-
Other taxes	2,487	2,485	-	-	2,487	2,485	-	-
State aid not restricted to a								
specific program	3,597	3,213	-	-	3,597	3,213	11,880	10,036
Interest and investment income	502	395	311	111	813	395	-	-
Other	837	286	-	-	837	397	130	182
Payments from Salem City	-	-	-	-	-	-	15,618	15,341
Total Revenues	\$ 55,264	\$ 54,972	\$ 30,869	\$ 30,409	\$ 86,133	\$ 85,381	\$ 34,507	\$ 45,820

