



**Auditor of State
Betty Montgomery**

CITY OF HILLSBORO
HIGHLAND COUNTY

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Auditor of State Betty Montgomery

INDEPENDENT ACCOUNTANTS' REPORT

City of Hillsboro
Highland County
130 North High Street
Hillsboro, Ohio 45133

To the Members of Council:

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Hillsboro, Highland County, Ohio (the City), as of and for the year ended December 31, 2005, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the Comptroller General of the United States' *Government Auditing Standards*. Those standards require that we plan and perform the audit to reasonably assure whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Hillsboro, Highland County, Ohio, as of December 31, 2005, and the respective changes in financial position and where applicable, cash flows, 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 12, 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. While we did not opine on the internal control over financial reporting or on compliance, that report describes the scope of our testing of internal control over financial reporting and compliance and the results of that testing. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*. You should read it in conjunction with this report in assessing the results of our audit.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information accounting principles generally accepted in the United States of America requires. We have applied certain limited procedures, consisting principally of inquiries of management regarding the methods of measuring and presenting the required supplementary information. However, we did not audit the information and express no opinion on it.

We conducted our audit to opine on the financial statements that collectively comprise the City's basic financial statements. The federal awards expenditure schedule is 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. We subjected the federal awards expenditure schedule to the auditing procedures applied in the audit of the basic financial statements. In our opinion, this information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink that reads "Betty Montgomery". The signature is written in a cursive, flowing style.

Betty Montgomery
Auditor of State

December 12, 2006

City of Hillsboro, Ohio
Management's Discussion and Analysis
For the Year Ended December 31, 2005
(Unaudited)

The discussion and analysis of the City of Hillsboro's financial performance provides an overall review of the City's financial activities for the year ended December 31, 2005. The intent of this discussion and analysis is to look at the City's financial performance as a whole; readers should also review the basic financial statements and the notes to the basic financial statements to enhance their understanding of the City's financial performance.

Financial Highlights

Key financial highlights for 2005 are as follows:

- In total, net assets increased \$1,494,751. Net assets of governmental activities increased \$543,101. Net assets of business-type activities increased \$951,650.
- Governmental Activities general revenues accounted for \$4,679,524 in revenue or 75 percent of all revenues. Program specific revenues in the form of charges for services and sales, grants and contributions accounted for \$1,596,738 or 25 percent of total revenues of \$6,276,262. Business-type activities general revenues accounted for \$149,425 in revenue or 5 percent of all revenues. Program specific revenues accounted for \$3,131,548 or 95 percent of total revenues of \$3,280,973.
- The City had \$5,733,161 in expenses related to governmental activities; \$1,596,738 of these expenses was offset by program specific charges for services and sales, grants and contributions. The City had \$2,329,323 in expenses related to business-type activities; the entire amount was offset by program specific charges for services, grants and contributions.

Using the Annual Financial Report

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

The statement of net assets and statement of activities provide information about the activities of the whole City, presenting both an aggregate view of the City's finances and a longer-term view of those assets. Fund financial statements provide the next level of detail. For governmental funds, these statements tell how services were financed in the short-term as well as what monies remain for future spending. The fund financial statements also look at the City's most significant funds with all other non-major funds presented in total in a single column.

Reporting the City as a Whole

Statement of Net Assets and Statement of Activities

While this report contains information about the funds used by the City to provide services to our citizens, the view of the City as a whole looks at all financial transactions and asks the question, "How did we do financially during 2005?" The statement of net assets and the statement of activities answer this question. These statements include all assets and liabilities using the accrual basis of accounting similar to the accounting system used by private sector companies. This basis of accounting takes into account all of the current year's revenues and expenses regardless of when the cash is received or paid.

These two statements report the City's net assets and the changes in those assets. The change in assets is important because it identifies whether the financial position of the City has improved or diminished for the City as a whole. However, in evaluating the overall position of the City, non financial information such as changes in the City's tax base and the condition of the City's capital assets will also need to be evaluated.

City of Hillsboro, Ohio
Management's Discussion and Analysis
For the Year Ended December 31, 2005
(Unaudited)

In the statement of net assets and the statement of activities, the City is divided into two types of activities:

- **Governmental Activities** - Most of the City's services are reported as governmental activities including police, fire, administration, and all departments with the exception of business-type activities (sanitation, wastewater treatment, storm water utility and water services).
- **Business-Type Activities** - These services have a charge based upon usage. The City charges fees to recoup the cost of the entire operation of the Water Plant and Wastewater Treatment Plant as well as all capital expenses associated with these facilities. The City also charges fees to recoup the cost of disposal of solid waste, leaf and brush removal and also a fee to provide for improvements to the City's storm water removal system.

Reporting the City's Most Significant Funds

Fund Financial Statements

Fund financial statements provide detailed information about the City's major funds. Based on restrictions on the use of monies, the City has established many funds which account for the multitude of services provided to our residents; however, fund financial statements focus on the City's most significant funds. The City of Hillsboro's major funds are the General Fund and the Water and Sewer enterprise funds.

Governmental Funds - Most of the City's activities are reported in governmental funds, which focus on how monies flow into and out of those funds and the year-end balances available for spending in the future periods. These funds are reported using the modified accrual basis of accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the City's general governmental operations and the basic services provided. Governmental fund information helps determine whether there are more or less financial resources that can be spent in the near future on services provided to residents. The relationships between governmental activities reported in the statement of net assets and the statement of activities and the governmental fund statements are reconciled in the financial statements.

Enterprise Funds - When the City charges customers for the services it provides, these services are generally reported in enterprise funds. Enterprise funds use the same basis of accounting as business-type activities; therefore, these statements are essentially the same.

City of Hillsboro, Ohio
Management's Discussion and Analysis
For the Year Ended December 31, 2005
(Unaudited)

The City as a Whole

The statement of net assets reviews the City as a whole. Table 1 provides a summary of the City's net assets for 2005 compared to the prior year:

Table 1
Net Assets

	Governmental Activities		Business-Type Activities		Total	
	2005	2004	2005	2004	2005	2004
Assets						
Current and Other Assets	\$ 5,580,919	\$ 5,057,275	\$ 2,082,791	\$ 2,512,525	\$ 7,663,710	\$ 7,569,800
Capital Assets, Net	9,830,356	9,810,324	13,618,699	12,732,063	23,449,055	22,542,387
Total Assets	15,411,275	14,867,599	15,701,490	15,244,588	31,112,765	30,112,187
Liabilities						
Other Liabilities	767,794	694,085	625,934	4,241,210	1,393,728	4,935,295
Long-Term Liabilities	435,505	470,742	7,908,094	4,655,108	8,343,599	5,125,850
Total Liabilities	1,203,299	1,164,827	8,534,028	8,896,318	9,737,327	10,061,145
Net Assets						
Invested in Capital Assets						
Net of Debt	9,663,473	9,624,164	5,759,942	5,170,930	15,423,415	14,795,094
Restricted	1,883,160	2,220,087	-	-	1,883,160	2,220,087
Unrestricted (Deficit)	2,661,343	1,858,521	1,407,520	1,177,340	4,068,863	3,035,861
Total Net Assets	\$ 14,207,976	\$ 13,702,772	\$ 7,167,462	\$ 6,348,270	\$ 21,375,438	\$ 20,051,042

The beginning net asset balances for 2005 were restated as more fully described in note 3 to the basic financial statements. The 2004 balances do not reflect this restatement. Total governmental activities assets increased \$543,101 while business-type activities increased \$951,650.

Capital assets reported on the government-wide statements represent the largest portion of the City's net assets. At year-end, capital assets represented 74.16% of total assets. Capital assets include land, land improvements, buildings and improvements, furniture and equipment, vehicles, construction in progress and infrastructure. Capital assets, net of related debt to acquire the assets at December 31, 2005, were \$15,423,415. These capital assets are used to provide services to citizens and are not available for future spending. Although the City's investment in capital assets is reported net of related debt, it should be noted that the resources to repay the debt must be provided from other sources, since capital assets may not be used to liquidate these liabilities. Invested in capital assets, net of related debt for the City as a whole remained stable during 2005.

A portion of the City's net assets, \$1,883,160 or 8.81%, represents resources that are subject to external restrictions on how they may be used. There was a decrease of \$336,927 or 15.17% in restricted net assets as the result of a reduction in restrictions on assets associated with capital projects. The remaining balance of the government-wide unrestricted net assets is \$4,068,863. Unrestricted net assets increased \$1,033,002 or 34.03% during 2005 due to an increase in cash and cash equivalents in the general fund, and water and sewer funds.

City of Hillsboro, Ohio
Management's Discussion and Analysis
For the Year Ended December 31, 2005
(Unaudited)

Table 2 shows the changes in net assets for the year 2005 compared to the prior year.

Table 2
Changes in Net Assets

	Governmental Activities		Business Type Activities		Total	
	2005	2004	2005	2004	2005	2004
Revenue						
Program Revenues:						
Charges for Services and Sales	\$ 989,482	\$ 979,673	\$ 2,786,990	\$ 2,616,741	\$ 3,776,472	\$ 3,596,414
Operating Grants and Contributions	1,160,911	723,667	-	-	1,160,911	723,667
Capital Grants and Contributions	-	-	344,558	1,035,164	344,558	1,035,164
Total Program Revenues	2,150,393	1,703,340	3,131,548	3,651,905	5,281,941	5,355,245
General Revenue:						
Property & Income Taxes	3,767,201	4,241,361	-	-	3,767,201	4,241,361
Unrestricted Investment Earnings	59,209	56,039	13,166	9,715	72,375	65,754
Gain on Sale of Capital Assets	14,800	-	-	-	14,800	-
Other	284,659	200,327	136,259	246,370	420,918	446,697
Total General Revenues	4,125,869	4,497,727	149,425	256,085	4,275,294	4,753,812
Total Revenues	6,276,262	6,201,067	3,280,973	3,907,990	9,557,235	10,109,057
Program Expenses						
General Government -						
Legislative and Executive	1,316,413	1,282,510	-	-	1,316,413	1,282,510
Judicial	242,754	247,434	-	-	242,754	247,434
Security of Persons and Property	2,826,116	3,209,061	-	-	2,826,116	3,209,061
Public Health	134,053	45,070	-	-	134,053	45,070
Leisure Time Activities	118,738	125,813	-	-	118,738	125,813
Community Environment	440,298	444,741	-	-	440,298	444,741
Transportation	643,567	531,169	-	-	643,567	531,169
Interest and Fiscal Charges	11,222	13,605	-	-	11,222	13,605
Water Fund	-	-	1,178,408	1,090,363	1,178,408	1,090,363
Sewer Fund	-	-	1,150,915	1,252,499	1,150,915	1,252,499
Total Expenses	5,733,161	5,899,403	2,329,323	2,342,862	8,062,484	8,242,265
Increase in Net Assets	543,101	301,664	951,650	1,565,128	1,494,751	1,866,792
Beginning Net Assets	13,664,875	13,401,108	6,215,812	4,783,142	19,880,687	18,184,250
Ending Net Assets	\$ 14,207,976	\$ 13,702,772	\$ 7,167,462	\$ 6,348,270	\$ 21,375,438	\$ 20,051,042

The 2005 beginning net asset balances were restated as more fully described in note 3 to the basic financial statements. The 2004 columns do not reflect these restatements.

City of Hillsboro, Ohio
Management's Discussion and Analysis
For the Year Ended December 31, 2005
(Unaudited)

Governmental Activities

Governmental activities increased \$505,204 or 3.69% during 2005.

The state and federal government contributed to the County revenues of \$1,160,911 in operating grants and contributions. These revenues are restricted to a particular program or purpose. Operating grants and contributions decreased 437,244 or 60.42% in 2005 due to a decrease in funding related to the economic development and transportation programs.

General revenues totaled \$4,125,869, and amounted to 65.74% of total revenues. These revenues primarily consist of property and income tax revenue of \$3,767,201, or 91.31% of total general revenues in 2005. Property tax revenue decreased by \$716,719 or 61.46%. This is a result of less real estate tax revenue collected but undistributed at December 31, 2005 compared to December 31, 2004, and due to misclassified revenues in 2004 which are not reflected in the reported amounts. An increase in taxable revenue within the City resulted in an income tax revenue increase of \$224,559 or 7.89%. Other revenues increased \$84,332 from miscellaneous refunds and reimbursements.

General government expenses include legislative and executive and judicial programs, totaled \$1,559,167 or 27.19% of total governmental expenses. Legislative and executive expenses increased \$33,903 due to increases in salaries and payments for retirement earnings.

Security of persons and property is one of the major activities of the City, generating 49.29% of total expenses. During 2005, an adjustment to the estimated life of fire department vehicles contributed to a reduction in reported expenses from 2004 of \$382,945

Public Health expense increased \$139,882 from 2004 due to the payment of cost in 2005 related to the ice storm in which occurred in December of 2004.

Transportation expenses increased \$112,398 from 2004 due to increases in fuel cost, and increases in repair and maintenance of aging equipment.

Business-Type Activities

The City's business-type activities are its water and sewer departments. The water and wastewater treatment plants provide services to the City's residents. The water plant generated operating revenues of \$1,239,234 and had operating expenses of \$930,489. The wastewater treatment plant generated operating revenues of \$1,547,756 and had operating expenses of \$1,125,017. The City's goal is to cover the costs of operations as well as to build a cash balance in these funds. The City is also generating funds for additional capital expansion to ensure continued capacity and capacity improvements for future growth and development. During 2005, a reduction of Capital Grants and Contributions of \$690,606 or 66.71 was to the completion of the new waste water plant which was partly funded by federal grant funds, the final payment of which was received during 2005.

The City's Funds

Information about the City's major fund starts on page 12. Governmental funds are accounted for using the modified accrual basis of accounting. All governmental funds had total revenues and other financing sources of \$7,150,526 and expenditures and other financing uses of \$6,546,565. The net change in fund balance for the year was most significant in the General Fund, an increase of \$441,141. The majority of the increase in fund balance is due to a \$305,741 increase in the City's tax revenue from 2004 to 2005.

City of Hillsboro, Ohio
Management's Discussion and Analysis
For the Year Ended December 31, 2005
(Unaudited)

General Fund Budgeting Highlights

The City's budget is prepared according to Ohio law and is based on accounting for certain transactions on a basis of cash receipts, disbursements, and encumbrances. The most significant budgeted fund is the General Fund.

During the course of 2005, the City amended its General Fund budget numerous times. With the General Fund supporting many of the major activities such as the City's police and fire departments, as well as most general government activities, the General Fund is monitored closely to prevent possible revenue shortfalls or over spending by individual departments.

For the General Fund, original budgeted revenues were \$4,367,760 and final budgeted revenues were \$4,667,760. Original budgeted expenditures were \$4,782,700 and final budgeted expenditures were \$5,348,486. Actual ending fund balance was \$1,085,856 greater than the final budgeted fund balance.

Capital Assets and Debt Administration

Capital Assets

At the end of the 2005 the City had \$23,449,055 invested in land, construction in progress, buildings, equipment, vehicles, and infrastructure. Table 3 shows 2005 and 2004 balances.

Table 3

	Governmental Activities		Business-Type Activities		Total	
	2005	2004	2005	2004*	2005	2004
Land	\$ 384,072	\$ 373,192	\$ -	\$ -	\$ 384,072	\$ 373,192
Land Improvements	1,113,155	1,149,605	109,467	118,519	1,222,622	1,268,124
Buildings and Improvements	1,229,076	1,278,157	8,748,397	3,395,114	9,977,473	4,673,271
Furniture and Equipment	521,205	529,785	289,669	253,611	810,874	783,396
Vehicles	564,527	359,112	38,851	47,556	603,378	406,668
Infrastructure	5,916,026	6,082,576	3,051,808	3,105,630	8,967,834	9,188,206
Construction in Progress	102,295	-	1,380,507	5,811,633	1,482,802	5,811,633
Totals	<u>\$ 9,830,356</u>	<u>\$ 9,772,427</u>	<u>\$ 13,618,699</u>	<u>\$ 12,732,063</u>	<u>\$ 23,449,055</u>	<u>\$ 22,504,490</u>

* As more fully described in note 3 to the basic financial statements, the City restated beginning net assets from 2005. This change is not reflected in the above table.

The increase to the business-type activities is due to completion of construction projects that were in process at the end of 2004.

See Note 14 for additional information on the City's capital assets.

City of Hillsboro, Ohio
Management's Discussion and Analysis
For the Year Ended December 31, 2005
(Unaudited)

Debt

At December 31, 2005, the City of Hillsboro had \$7,752,940 in bonds, loans, and leases outstanding, \$555,919 due within one year.

Table 5
Outstanding Debt, at Year End

	Governmental Activities		Business-Type Activities		Total	
	2005	2004	2005	2004	2005	2004
O.W.D.A. Loan	\$ -	\$ -	\$ 544,890	\$ 161,133	\$ 544,890	\$ 161,133
Capital Lease	66,883	41,160	-	-	66,883	41,160
Mortgage Revenue Bonds	-	-	7,041,167	4,440,000	7,041,167	4,440,000
Bonds	100,000	145,000	-	-	100,000	145,000
Total	\$ 166,883	\$ 186,160	\$ 7,586,057	\$ 4,601,133	\$ 7,752,940	\$ 4,787,293

The City's overall legal debt margin was \$3,877,042 at December 31, 2005.

See Note 15 for additional information about the City's debt.

The Future

The City of Hillsboro continues to work diligently to increase revenues and decrease costs to put the City on more stable footing. The City has continued to grow with new homes constructed annually, and several new commercial facilities opened with more planned for the future.

The City of Hillsboro has committed itself to financial excellence in the coming years. Our commitment to the residents of the City of Hillsboro should always be full disclosure of the financial position of the City.

Contacting the City's Finance Department

This financial report is designed to provide our citizens, taxpayers, creditors, and investors with a general overview of the City's finances and to reflect the City's accountability for the monies it receives. Questions about this report or additional financial information needs should be directed to Gary Lewis, City Auditor, 130 North High Street, Hillsboro, Ohio 45133, (937) 393-5791.

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City of Hillsboro, Ohio

Statement of Net Assets

December 31, 2005

	Governmental Activities	Business-Type Activities	Totals
<u>ASSETS</u>			
Equity in Pooled Cash and Cash Equivalents	\$2,565,793	\$1,258,652	\$3,824,445
Investments	5,093	0	5,093
Cash and Cash Equivalents in Segregated Accounts	0	419,529	419,529
Receivables:			
Taxes	1,709,970	0	1,709,970
Accounts	190,126	357,205	547,331
Due From Other Governments	225,348	0	225,348
Loans Receivable	884,589	0	884,589
Deferred Expense on Refunding	0	47,405	47,405
Restricted Assets:			
Non-Depreciable Capital Assets	486,367	1,380,507	1,866,874
Depreciable Capital Assets	9,343,989	12,238,192	21,582,181
 Total Assets	 <u>\$15,411,275</u>	 <u>\$15,701,490</u>	 <u>\$31,112,765</u>
 <u>Liabilities</u>			
Accounts Payable	\$103,306	\$57,180	\$160,486
Contracts Payable	102,295	495,000	597,295
Accrued Wages and Benefits	69,855	19,744	89,599
Due to Other Governments	149,193	16,554	165,747
Deferred Revenue	343,145	0	343,145
Accrued Interest Payable	0	37,456	37,456
Long-Term Liabilities			
Due Within One Year	121,629	473,301	594,930
Due in More than One Year	313,876	7,434,793	7,748,669
 Total Liabilities	 <u>1,203,299</u>	 <u>8,534,028</u>	 <u>9,737,327</u>
 <u>Net Assets</u>			
Invested in Capital Assets, Net of Related Debt	9,663,473	5,759,942	15,423,415
Restricted for:			
Debt Service	289,073	0	289,073
Other Purposes	1,594,087	0	1,594,087
Unrestricted	2,661,343	1,407,520	4,068,863
 Total Net Assets	 <u>\$14,207,976</u>	 <u>\$7,167,462</u>	 <u>\$21,375,438</u>

See accompanying notes to the basic financial statements

City of Hillsboro, Ohio
Statement of Activities
For the Year Ended December 31, 2005

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
		Charges for Services and Sales	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-Type Activities	Totals
Governmental Activities:							
General Government:							
Legislative and Executive	\$1,316,413	\$168,390	\$236,477	\$0	(\$911,546)		(\$911,546)
Judicial	242,754	32,453	41,780	0	(168,521)		(168,521)
Security of Persons and Property	2,826,116	629,614	565,883	0	(1,630,619)		(1,630,619)
Public Health	134,053	23,520	45,112	0	(65,421)		(65,421)
Leisure Time Activities	118,738	12,907	25,991	0	(79,840)		(79,840)
Community Environment	440,298	63,187	124,164	0	(252,947)		(252,947)
Transportation	643,567	59,156	119,125	0	(465,286)		(465,286)
Interest and Fiscal Charges	11,222	255	2,379	0	(8,588)		(8,588)
Total Governmental Activities	5,733,161	989,482	1,160,911	0	(3,582,768)		(3,582,768)
Business-Type activities:							
Sewer	1,150,915	1,547,756	0	0		\$396,841	396,841
Water	1,178,408	1,239,234	0	344,558		405,384	405,384
Total Business-Type Activities	2,329,323	2,786,990	0	344,558	0	802,225	802,225
Total Government	\$ 8,062,484	\$ 3,776,472	\$ 1,160,911	\$ 344,558	(3,582,768)	802,225	(2,780,543)
General revenues:							
Taxes:							
Property taxes levied for:							
General Purposes					328,501	0	328,501
Special Purposes					51,242	0	51,242
Debt Service					69,724	0	69,724
Income taxes					3,317,734	0	3,317,734
Gain on Sale of Capital Assets					14,800	0	14,800
Unrestricted Investment Earnings					59,209	13,166	72,375
Rent					19,875	0	19,875
Miscellaneous					264,784	136,259	401,043
Total general revenues					4,125,869	149,425	4,275,294
Change in net assets					543,101	951,650	1,494,751
Net assets - January 1, 2005 (Restated - See Note 3)					13,664,875	6,215,812	19,880,687
Net assets - December 31, 2005					\$14,207,976	\$7,167,462	\$21,375,438

See accompanying notes to the basic financial statements

City of Hillsboro, Ohio
 Balance Sheet
 Governmental Funds
 December 31, 2005

	<u>General</u>	<u>All Other Governmental Funds</u>	<u>Total Governmental Funds</u>
ASSETS:			
Equity in Pooled Cash and Cash Equivalents	\$1,117,300	\$1,448,493	\$2,565,793
Investments	5,093	0	5,093
Accounts Receivable	190,126	0	190,126
Interfund Receivable	410,000	0	410,000
Taxes Receivable	1,482,993	226,977	1,709,970
Due from Other Governments	160,524	64,824	225,348
Loans Receivable	0	884,589	884,589
<i>Total Assets</i>	<u>\$3,366,036</u>	<u>\$2,624,883</u>	<u>\$5,990,919</u>
LIABILITIES:			
Accounts Payable	94,157	9,149	103,306
Accrued Wages and Benefits	66,256	3,599	69,855
Contracts Payable	0	102,295	102,295
Intergovernmental Payable	53,603	95,590	149,193
Interfund Payable	0	410,000	410,000
Deferred Revenue	907,256	271,322	1,178,578
<i>Total Liabilities</i>	<u>1,121,272</u>	<u>891,955</u>	<u>2,013,227</u>
FUND BALANCES:			
Reserved:			
Reserved for Encumbrances	131,778	187,258	319,036
Reserved for Loans Receivable	0	884,589	884,589
Unreserved, Undesignated, Reported in:			
General Fund	2,112,986	0	2,112,986
Special Revenue Funds	0	820,371	820,371
Debt Service Funds	0	250,179	250,179
Capital Projects Funds	0	(409,469)	(409,469)
<i>Total Fund Balances</i>	<u>2,244,764</u>	<u>1,732,928</u>	<u>3,977,692</u>
<i>Total Liabilities and Fund Balances</i>	<u>\$3,366,036</u>	<u>\$2,624,883</u>	<u>\$5,990,919</u>

See accompanying notes to the basic financial statements

City of Hillsboro, Ohio
 Reconciliation of Total Governmental Fund Balances to
 Net Assets of Governmental Activities
 December 31, 2005

Total Governmental Fund Balances		\$ 3,977,692
<p>Amounts reported for governmental activities in the statement of net assets are different because:</p>		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.		9,830,356
Other long-term assets are not available to pay for current period expenditures and therefore are deferred in the funds.		
Taxes	692,726	
Intergovernmental	<u>142,707</u>	
Total		835,433
<p>Long-Term Liabilities, including bonds, capital lease obligations, and the long-term portion of compensated absences are not due and payable in the current period and therefore are not reported in the funds.</p>		
Capital Lease Payable	(66,883)	
Compensated Absences	(268,622)	
General Obligation Bonds	<u>(100,000)</u>	
Total		<u>(435,505)</u>
Net Assets of Governmental Activities		<u>\$ 14,207,976</u>

See accompanying notes to the basic financial statements

City of Hillsboro, Ohio
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended December 31, 2005

	<u>General</u>	All Other Governmental <u>Funds</u>	<u>Total</u> Governmental <u>Funds</u>
REVENUES:			
Taxes	\$3,473,574	\$244,158	\$4,271,387
Charges for Services	509,042	0	509,042
Licenses and Permits	32,758	63,217	95,975
Fines and Forfeitures	214,827	169,638	384,465
Intergovernmental	694,430	669,976	810,751
Interest	50,276	8,933	59,209
Rent	8,000	11,875	19,875
Other	165,930	98,854	264,784
<i>Total Revenues</i>	<u>5,148,837</u>	<u>1,266,651</u>	<u>6,415,488</u>
EXPENDITURES:			
Current:			
General Government:			
Legislative and Executive	1,028,077	205,605	1,233,682
Judicial System	238,166	4,369	242,535
Security of Persons and Property	2,695,408	351,480	3,046,888
Public Health	22,748	141,982	164,730
Lesiure Time Services	0	89,466	89,466
Community and Economic Development	30,964	409,334	440,298
Transportation	0	409,319	409,319
Capital Outlay	59,953	113,792	173,745
Debt Service:			
Principal Retirements	21,083	58,147	79,230
Interest and Fiscal Charges	0	11,222	11,222
<i>Total Expenditures</i>	<u>4,096,399</u>	<u>1,794,716</u>	<u>5,891,115</u>
<i>Excess of Revenues Over(Under) Expenditures</i>	<u>1,052,438</u>	<u>(528,065)</u>	<u>524,373</u>
OTHER FINANCING SOURCES AND USES:			
Transfers In	0	680,000	680,000
Proceeds from Sale of Capital Assets	8,750	10,885	19,635
Inception of Capital Lease	59,953	0	59,953
Transfers Out	(680,000)	0	(680,000)
<i>Total Other Financing Sources and Uses</i>	<u>(611,297)</u>	<u>690,885</u>	<u>79,588</u>
<i>Net Change in Fund Balance</i>	441,141	162,820	603,961
<i>Fund Balance at Beginning of Year</i>	<u>1,803,623</u>	<u>1,570,108</u>	<u>3,373,731</u>
<i>Fund Balance at End of Year</i>	<u>\$2,244,764</u>	<u>\$1,732,928</u>	<u>\$3,977,692</u>

See accompanying notes to the basic financial statements

City of Hillsboro, Ohio
 Reconciliation of the Statement of Revenues, Expenditures and Changes
 in Fund Balances of Governmental Funds to the Statement of Activities
 For the Year Ended December 31, 2005

Net Change in Fund Balances - Total Governmental Funds		\$ 603,961
 Amounts reported for governmental activities in the statement of activities are different because:		
 Governmental funds report capital outlays as expenditures. However in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the difference between depreciation and capital outlays in the current period.		
Capital Asset Additions	302,922	
Current Year Depreciation	<u>(240,157)</u>	
Total		62,765
 Governmental funds only report the disposal of assets to the extent proceeds are received from the sale. In the statement of activities a gain or loss is reported for each disposal. This is the amount of the proceeds and gain on the disposal of fixed assets.		
Proceeds from Sale of Capital Assets	(19,635)	
Gain on Disposal of Capital Assets	<u>14,800</u>	
Total		(4,835)
 Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.		
Taxes	49,469	
Intergovernmental	<u>(203,496)</u>	
Total		(154,027)
 Repayments of bond principal are expenditures in the governmental funds, but the repayment reduces liabilities in the statement of net assets and does not result in an expense in the statement of activities.		
		45,000
 Repayment of capital leases obligations are expenditures in the governmental funds, but the repayment reduces liabilities in the statement of net assets and does not result in an expense in the statement of activities.		
		34,230
 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.		
Increase in Compensated Absences	<u>15,960</u>	
Total		<u>15,960</u>
 Inception of capital leases is recorded as other financing sources in the governmental funds, but is recorded as a capital lease obligation and therefore is not recorded in the statement of activities		
	<u>(59,953)</u>	(59,953)
		<hr/> <hr/>
Net Change in Net Assets of Governmental Activities		\$ 543,101

See accompanying notes to the basic financial statements

City of Hillsboro, Ohio
Statement of Fund Net Assets
Proprietary Funds

as of December 31, 2005

	Water	Sewer	Total
ASSETS:			
<i>Current Assets</i>			
Equity in Pooled Cash and Cash Equivalents	\$552,970	\$705,682	\$1,258,652
Cash and Cash Equivalents in Segregated Accounts	0	419,529	419,529
Accounts Receivable	154,720	202,485	357,205
Deferred Expense on Refunding	0	47,405	47,405
Total Current Assets	<u>707,690</u>	<u>1,375,101</u>	<u>2,082,791</u>
<i>Noncurrent Assets</i>			
Non-Depreciable Capital Assets	92,036	1,288,471	1,380,507
Depreciable Capital Assets, net	<u>8,021,937</u>	<u>4,216,255</u>	<u>12,238,192</u>
Total Noncurrent Assets	<u>8,113,973</u>	<u>5,504,726</u>	<u>13,618,699</u>
Total Assets	<u><u>\$8,821,663</u></u>	<u><u>\$6,879,827</u></u>	<u><u>\$15,701,490</u></u>
LIABILITIES:			
<i>Current Liabilities</i>			
Accounts Payable	\$15,277	\$41,903	\$57,180
Accrued Wages and Benefits	11,978	7,766	19,744
Contracts Payable	0	495,000	495,000
Due to Other Governments	4,559	11,995	16,554
Accrued Interest Payable	<u>34,184</u>	<u>3,272</u>	<u>37,456</u>
Total Current Liabilities	65,998	559,936	625,934
<i>Noncurrent Liabilities</i>			
Long Term Liabilities:			
OWDA Loans Payable	0	817,590	817,590
Compensated Absences Payable	24,337	25,000	49,337
Revenue Bonds Payable	6,135,333	810,000	6,945,333
Unamortized Charge - Refunding Bonds	<u>95,834</u>	<u>0</u>	<u>95,834</u>
Total Noncurrent Liabilities	<u>6,255,504</u>	<u>1,652,590</u>	<u>7,908,094</u>
Total Liabilities	<u>6,321,502</u>	<u>2,212,526</u>	<u>8,534,028</u>
NET ASSETS:			
Invested in capital assets, net of related debt	1,882,806	3,877,136	5,759,942
Unrestricted	<u>617,355</u>	<u>790,165</u>	<u>1,407,520</u>
Total Net Assets	<u><u>\$2,500,161</u></u>	<u><u>\$4,667,301</u></u>	<u><u>\$7,167,462</u></u>

See accompanying notes to the basic financial statements

City of Hillsboro, Ohio
Statement of Revenues, Expenses and
Changes in Net Assets
Proprietary Funds

For the Year Ended December 31, 2005

	Water	Sewer	Total
Operating Revenues			
Charges for Services	\$1,157,234	\$1,445,427	\$2,602,661
Tap-In Fees	82,000	102,329	184,329
Total Operating Revenues	1,239,234	1,547,756	2,786,990
Operating Expenses			
Salaries and Wages	296,458	379,118	675,576
Fringe Benefits	187,745	163,529	351,274
Contractual Services	47,913	244,020	291,933
Materials & Supplies	86,809	74,689	161,498
Utilities	75,760	76,033	151,793
Other	7,727	1,970	9,697
Amortized Expense	0	24,336	24,336
Depreciation Expense	228,077	161,322	389,399
Total Operating Expenses	930,489	1,125,017	2,055,506
Operating Income	308,745	422,739	731,484
Nonoperating Revenues (Expenses)			
Interest	0	13,166	13,166
Other Revenues	80,194	56,065	136,259
Other Expenses	(14,256)	(626)	(14,882)
Interest & Fiscal Charges	(233,663)	(25,272)	(258,935)
Total Nonoperating Revenues (Expenses)	(167,725)	43,333	(124,392)
Changes in Net Assets Before Capital Contributions	141,020	466,072	607,092
Capital Contributions - Intergovernmental	344,558	0	344,558
Changes in Net Assets	485,578	466,072	951,650
Net Assets at Beginning of Year (Restated - See Note 3)	2,014,583	4,201,229	6,215,812
Net Assets at End of Year	\$2,500,161	\$4,667,301	\$7,167,462

See accompanying notes to the basic financial statements

City of Hillsboro, Ohio
Statement of Cash Flows
Proprietary Funds
For the Year Ended December 31, 2005

	Water	Sewer	Total
Increase (Decrease) in Cash and Cash Equivalents:			
Cash Flows from Operating Activities:			
Cash Received from Customers	\$1,246,426	\$1,537,029	\$2,783,455
Cash Payments to Suppliers for Goods and Services	(270,629)	(98,444)	(369,073)
Cash Payments to Employees for Services and Benefits	(498,895)	(549,004)	(1,047,899)
Cash Payments for Refunds	(7,727)	(1,970)	(9,697)
<i>Net Cash Provided by (Used for) Operating Activities</i>	<u>469,175</u>	<u>887,611</u>	<u>1,356,786</u>
Cash Flows from Noncapital Financing Activities:			
Other non-operating expenses	(14,256)	(626)	(14,882)
Other non-operating revenues	80,194	56,065	136,259
<i>Net Cash Provided by (Used for) Noncapital Financing Activities</i>	<u>65,938</u>	<u>55,439</u>	<u>121,377</u>
Cash Flows from Capital and Related Financing Activities:			
Proceeds from Sale of Bonds	2,960,000	0	2,960,000
Receipts from Capital Grants	344,558	0	344,558
Proceeds from OWDA Loan	0	405,731	405,731
Payments for Capital Acquisitions	(538,421)	(784,458)	(1,322,879)
Principal Payments	(3,070,000)	(266,974)	(3,336,974)
Interest Payments	(320,583)	(45,868)	(366,451)
<i>Net Cash Used for Capital and Related Financing Activities</i>	<u>(624,446)</u>	<u>(691,569)</u>	<u>(1,316,015)</u>
Cash Flows from Investing Activities:			
Interest on Investments	0	14,574	14,574
<i>Net Cash Provided by (Used for) Investing Activities</i>	<u>0</u>	<u>14,574</u>	<u>14,574</u>
Net Increase/(Decrease) in Cash and Cash Equivalents	(89,333)	266,055	176,722
Cash and Cash Equivalents at Beginning of Year	642,303	859,156	1,501,459
Cash and Cash Equivalents at End of Year	<u>\$552,970</u>	<u>\$1,125,211</u>	<u>\$1,678,181</u>
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used for) Operating Activities:			
Operating Income	308,745	422,739	731,484
<i>Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided by (Used for) Operating Activities:</i>			
Depreciation	228,077	161,322	389,399
Amortization	0	24,336	24,336
Changes in Assets and Liabilities:			
(Increase)/Decrease in Accounts Receivable	7,192	(10,727)	(3,535)
(Increase)/Decrease in Prepaid Items	0	0	0
(Increase)/Decrease in Materials and Supplies Inventory	0	0	0
Increase/(Decrease) in Accounts Payable	(60,147)	22,429	(37,718)
Increase/(Decrease) in Contracts Payable	0	273,869	273,869
Increase/(Decrease) in Accrued Wages and Benefits	5,142	352	5,494
Increase/(Decrease) in Compensated Absences Payable	(5,708)	1,070	(4,638)
Increase/(Decrease) in Due to Other Governments	(14,126)	(7,779)	(21,905)
Total Adjustments	<u>160,430</u>	<u>464,872</u>	<u>625,302</u>
Net Cash Provided by (Used for) Operating Activities	<u>\$469,175</u>	<u>\$887,611</u>	<u>\$1,356,786</u>

See accompanying notes to the basic financial statements

City of Hillsboro, Ohio
Statement of Fiduciary Assets and Liabilities
Agency Funds
As of December 31, 2005

	<u>Agency</u>
ASSETS	
Equity in Pooled Cash and Cash Equivalents	\$ 22,069
Cash and Cash Equivalents in Segregated Accounts	77,802
Receivables:	
Accounts	<u>116,971</u>
Total Assets	<u>\$ 216,842</u>
 LIABILITIES	
Due to Other Governments	68,661
Undistributed Monies	48,310
Deposits Held and Due to Others	<u>99,871</u>
Total Liabilities	<u>\$ 216,842</u>

See accompanying notes to the basic financial statements

City of Hillsboro, Ohio
Statement of Revenues, Expenditures and Changes
In Fund Balance - Budget (Non-GAAP Budgetary Basis) and Actual

General Fund
For the Year Ended December 31, 2005

	Budgeted Amounts		Actual	Variance With Final Budget Positive (Negative)
	Original	Final		
REVENUES:				
Property Taxes	\$852,479	\$935,115	\$1,009,886	\$74,771
Income Taxes	2,557,440	2,805,345	3,029,659	224,314
Charges for Services	431,131	401,800	510,738	108,938
Licenses and Permits	27,652	24,500	32,758	8,258
Fines and Forfeitures	181,343	222,000	214,827	(7,173)
Intergovernmental	129,128	20,000	152,971	132,971
Interest	42,440	45,000	50,276	5,276
Rent	6,753	8,000	8,000	0
Other	139,394	106,000	165,133	59,133
Total Revenues	4,367,760	4,567,760	5,174,248	606,488
EXPENDITURES:				
Current:				
General Government:				
Legislative and Executive	1,782,132	1,296,253	1,039,290	256,963
Judicial System	243,018	313,833	238,166	75,667
Security of Persons and Property	2,689,850	2,922,603	2,706,700	215,903
Public Health	25,000	25,000	22,748	2,252
Community Environment	42,700	50,797	30,964	19,833
Total Expenditures	4,782,700	4,608,486	4,037,868	570,618
Excess of Revenues Over(Under) Expenditures	(414,940)	(40,726)	1,136,380	1,177,106
OTHER FINANCING SOURCES AND USES:				
Proceeds from Sale of Capital Assets	0	0	8,750	8,750
Advances In	0	100,000	0	(100,000)
Advances Out	0	(60,000)	(60,000)	0
Transfers Out	0	(680,000)	(680,000)	0
Total Other Financing Sources and Uses	0	(640,000)	(731,250)	(91,250)
Net Change in Fund Balance	(414,940)	(680,726)	405,130	1,085,856
Fund Balance at Beginning of Year	444,513	444,513	444,513	0
Fund Balance (Deficit) at End of Year	\$29,573	(\$236,213)	\$849,643	\$1,085,856

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

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CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

1. FINANCIAL REPORTING ENTITY

The financial statements of the City of Hillsboro have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board is the accepted standard - setting body for establishing governmental accounting and financial reporting principles. The City also applies Financial Accounting Standards Board (FASB) Statements and Interpretations issued before November 30, 1989, to its proprietary activities provided they do not conflict with or contradict GASB pronouncements. The more significant of the City's accounting policies are described below.

CITY GOVERNMENT AND REPORTING ENTITY

The City of Hillsboro (the "City"), is a body politic and corporate established for the purpose of exercising the rights and privileges conveyed to it by the constitution and laws of the State of Ohio. The City was named in honor of Lord Hillsborough, was founded in 1807 by David Hayes and was named the county seat of Highland County. On January 1, 1952, Hillsboro was first organized as a city under the laws of the State of Ohio.

The City of Hillsboro is a home rule municipal corporation established under the laws of the State of Ohio. The legislative authority is vested in a seven member council three of whom are elected at-large and four by ward for four year terms. The presiding officer is the president, who is elected by the Council for a two year term. Council enacts ordinances and resolutions relating to tax levies, city services, and licensing, appropriates and borrows money, and accepts bids for materials and services and other municipal purposes. The mayor is elected at-large and is the Chief Executive Officer of the City. The Mayor supervises the administration of all departments and appoints their directors and all other employees in accordance with civil service requirements.

The reporting entity is comprised of the primary government, component units and other organizations that are included to ensure that the financial statements of the City are fairly presented and completed. The primary government consists of all funds, departments, boards and commissions that are not legally separate from the City. The City departments include a public safety department, a public service department, a parks and recreation department, a planning and zoning department, income tax department, utility departments including sewer and water, and staff to provide support to service providers.

Component units are legally separate organizations for which the City is financially accountable. The City is financially accountable for an organization if the City appoints a voting majority of the organization's governing board and (1) the City is able to significantly influence the programs or services performed or provided by the organization; or (2) the City is legally entitled to or can otherwise access the organization's resources; the City is legally obligated or has otherwise assumed the responsibility to finance the deficits of, or provide financial support to, the organization; or the City is obligated for the debt of the organization. Component units may also include organizations for which the City approves the budget, the issuance of debt or levying of taxes. The City has no blended or discretely presented component units.

The Hillsboro Municipal Court which provides judiciary services is included as an agency fund in the City's financial statements. The Municipal Court Judge is an elected City Official who has a fiduciary responsibility for the collection and distribution of the court fees and fines.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

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

Government-wide Financial Statements

The statement of net assets and the statement of activities display information about the City as a whole. These statements include the financial activities of the primary government, except for fiduciary funds. The statements distinguish between those activities of the City that are governmental in nature and those that are considered business-type.

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

Fund Financial Statements

During the year, the City segregates transactions related to certain functions or activities in separate funds in order to assist financial management and to demonstrate legal compliance. Fund financial statements are designed to present financial information of the City at this more detailed level. The focus of governmental financial statements is on major funds. Each major fund is presented in a separate column. Nonmajor funds are aggregated and presented in a single column.

FUND ACCOUNTING

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

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Governmental Funds - Governmental funds are those through which most governmental functions typically are financed. The acquisition, use and balances of the City's expendable financial resources and the related current liabilities are accounted for through governmental funds. The City maintains records showing revenues, actual and accrued expenditures and encumbrances to assure legal and accounting compliance and to assure that budgetary authority is not exceeded. The difference between governmental fund assets and liabilities is reported as fund balance. The following is the City's major governmental fund:

General Fund - This fund is established to account for resources devoted to financing the general services that the City performs for its residents. Municipal income tax, general tax revenues, as well as other sources of revenue used to finance the fundamental operations of the City are included in this fund. The fund is charged with all costs of operating the government for which a separate fund has not been established.

The other governmental funds of the City account for grants and other resources that are generally restricted to use for a particular purpose.

Proprietary Funds - Proprietary fund reporting focuses on the determination of operating income, changes in net assets, financial position, and cash flows.

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

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

Sewer Fund - This fund accounts for the provision of wastewater treatment services to residential and commercial users within the City.

Fiduciary Funds - Fiduciary funds are used to account for assets held by the City as a trustee or as an agent for individuals, private organizations, or other units of government. The fiduciary fund category is split into four classifications: agency funds, pension trust funds, investment trust funds, and private purpose trust funds. Agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations. Trust funds are used to account for assets held under a trust agreement for individuals, private organizations, or other governments and are therefore not available to support the City's own programs. The City's fiduciary fund consists only of an agency fund which is used to account for the activities of the Hillsboro Municipal Court.

MEASUREMENT FOCUS

Government-wide Financial Statements

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

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fund Financial Statements

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

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

BASIS OF ACCOUNTING

Accounting basis determines when transactions and economic events are reflected in its financial statements. Government-wide financial statements are prepared using the accrual basis of accounting. Government funds use the modified accrual basis of accounting; proprietary and fiduciary funds use the accrual basis of accounting. Differences in the accrual and modified accrual basis of accounting arise in the recognition of revenue, the recording of deferred revenue and in the presentation of expenses versus expenditures.

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

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

Under the modified accrual basis, the following revenue sources are considered to be both measurable and available at fiscal year end: property taxes available as an advance, interest, and grants.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

Property taxes for which there is an enforceable legal claim as of December 31, 2005, but which were levied to finance fiscal year 2006 operations, have been recorded as deferred revenue. Grants and entitlements received before the eligibility requirements were met have also been recorded as deferred revenue.

On governmental fund financial statements, receivables that were not collected with the available period are also reflected as deferred revenue.

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

BUDGETS AND BUDGETARY ACCOUNTING

The budgetary process is prescribed by provisions of the Ohio Revised Code and entails the preparation of budgetary documents within an established timetable. The major documents prepared are the tax budget, the certificate of estimated resources, and the appropriation resolution, all of which are prepared on the budgetary basis of accounting. The certificate of estimated resources and the appropriations resolution are subject to amendment throughout the year with the legal restriction that appropriations cannot exceed estimated resources, as certified. All funds, other than agency funds are legally required to be budgeted and appropriated. For the General fund, Council appropriations are budgeted for fund and function level. For all other funds, Council appropriations are budgeted to the fund level. Any budgetary modifications at this level may only be made by resolution of the members of Council. The City follows these procedures in establishing the budgetary data reported in the financial statements.

Tax Budget: By July 15, the Auditor submits an annual tax budget for the following fiscal year to City Council for consideration and passage. The adopted budget is submitted to the County Auditor, as secretary of the County Budget Commission, by July 20 of each year, for the period January 1 to December 31 of the following year.

Estimated Resources: The County Budget Commission certifies its actions to the City by September 1. As part of this certification, the City receives the official certificate of estimated resources which states the projected receipts of each fund. On or about January 1, this certificate is amended to include any unencumbered balances from the preceding year. Prior to December 31, the City must revise its budget so that the total contemplated expenditures from a fund during the ensuing fiscal year will not exceed the amount stated in the certificate of estimated resources.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The revised budget then serves as the basis for the annual appropriation measure. Further amendments may be made during the year if the Council determines that revenue to be collected will be greater than or less than prior estimates and the budget commission finds the revised estimate to be reasonable. The amounts set forth in the financial statements represent estimates from the final amended certificate issued in 2005.

Appropriations: A temporary appropriation measure to control cash disbursements may be passed on or about January 1 of each year for the period January 1 to March 31. An annual appropriation measure must be passed by April 1 of each year for the period January 1 to December 31. The appropriation measure may be amended or supplemented during the year as new information becomes available. Appropriations may not exceed estimated resources. Supplemental appropriations may be adopted by Council. Amounts shown in the financial statements represent the appropriated budgeted amounts and all supplemental appropriations. One supplemental appropriation was adopted during 2005 by Council.

Budgeted Level of Expenditure: Administrative control is maintained through the establishment of budgets. Appropriated funds may not be expended for purposes other than those designated in the appropriation ordinance without authority from Council. Expenditures plus encumbrances may not legally exceed appropriations at the level of appropriation adopted by Council. The appropriations allocations may be made by the City Auditor as long as the allocations are within Council's appropriated amount.

Encumbrances: As part of formal budgetary control, purchase orders, contracts and other commitments for the expenditure of funds are recorded as the equivalent of expenditures on the non-GAAP budgetary basis in order to reserve the portion of the applicable appropriation and determine and maintain legal compliance. On the GAAP basis, encumbrances outstanding at year end are reported as a reservation of fund balance and subsequent year expenditures for governmental funds.

Lapsing of Appropriations: At the close of each fiscal year, the unencumbered balance of each appropriation reverts to the respective fund from which it was appropriated and becomes subject to future appropriation. Encumbered appropriations are carried forward to the succeeding fiscal year and are not reappropriated.

CASH AND INVESTMENTS

Cash balances of the City's funds, except cash held by a trustee or fiscal agent and in segregated accounts, are pooled and invested in short-term investments in order to provide improved cash management. Individual fund integrity is maintained through the City's records. Interest is distributed to various funds based upon the Ohio Revised Code requirements. Each fund's interest in the pool and is presented as "Equity in Pooled Cash and Cash Equivalents" on the balance sheet.

During the year 2005, investments were limited to repurchase agreements, money market accounts, and donated common stock.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Except for nonparticipating investment contracts, investments are reported at fair value which is based on quoted market prices. Nonparticipating investment contracts such as repurchase agreements and nonnegotiable certificates of deposit are reported at cost.

For purposes of the statement of cash flows and for presentation on the statement of net assets and the balance sheet, funds included within the City's cash management pool and investments with original maturities of three months or less are considered to be cash and cash equivalents. Investments with an initial maturity of more than three months are reported as investments.

CAPITAL ASSETS

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

All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and reductions during the year. Donated fixed assets are recorded at their fair market value on the date donated. The City maintains a capitulation threshold of five hundred dollars. The City's infrastructure consists of streets, bridges, storm and sanitary sewer lines and water lines. Improvements are capitalized. Interest incurred during the construction of fund capital assets is also capitalized.

All capital assets are depreciated, except for land and construction in progress. Improvements are depreciated over the remaining useful lives of the related capital assets. Depreciation has been provided on a straight-line basis over the following estimated useful lives for both governmental and business-type activities:

<u>Description</u>	<u>Estimated Lives</u>
Buildings	30 years
Land Improvements	20 years
Furniture	10 years
Machinery and Equipment	10-20 years
Vehicles	8 years
Water/Sewer Lines	65 years
Infrastructure	10-40 years

INTERFUND ASSETS AND LIABILITIES

On fund financial statements, receivables and payables resulting from short-term inter-fund loans are classified as "Interfund Receivables/Payables". Inter-fund balances within governmental activities and within business-type activities are eliminated on the government-wide statement of net assets. The only inter-fund balances which remain on the government-wide statement of net assets are those between governmental and business-type activities. These amounts are reflected as "Internal Balances"; however, there were no internal balances at December 31, 2005.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

COMPENSATED ABSENCES

In 1996, the City implemented the provisions of GASB Statement No. 16, *Accounting for Compensated Absences*. Vacation benefits are accrued as a liability as the benefits are earned if the employees' rights to receive compensation are attributable to services already rendered and it is probable that the employer will compensate the employees for the benefits through paid time off or some other means. Sick leave benefits are accrued as a liability using the termination method. The liability includes the employees who are currently eligible to receive termination benefits and by those employees for whom it is probable will become eligible to receive payment in the future. The amount is based on accumulated sick leave and employee's wage rates at year end. This item is discussed in Note 13 to the Basic Financial Statements.

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

On fund financial statements for governmental funds, the current portion of unpaid compensated absences is the amount expected to be paid as a result of employee resignations and retirements. These amounts are recorded in the account "matured compensated absences payable" in the fund from which the employees who have accumulated unpaid leave are paid. The non-current portion of the liability is not reported. For enterprise funds, the entire amount of compensated absences is reported as a fund liability.

ACCRUED LIABILITIES AND LONG-TERM OBLIGATIONS

All payables, accrued liabilities, and long-term obligations are reported on the government-wide financial statements. All payables, accrued liabilities, and long-term obligations payable from the enterprise funds are reported on the enterprise fund financial statements. In general, governmental fund payables and accrued liabilities that, once incurred, are paid in a timely manner and in full from current financial resources are reported as obligations of the funds. However, contractually required pension contributions and compensated absences that are paid from governmental funds are reported as liabilities on the fund financial statements only to the extent that they are due for payment during the current year. Notes, capital leases, and bonds are recognized as liabilities on the fund financial statements when due.

RESERVES OF FUND BALANCES

The City records reservations for those portions of fund balance which are legally segregated for specific future use or which do not represent available, spendable resources and, therefore, are not available for expenditure. Undesignated fund balance indicates that portion of fund balance which is available for appropriation in future periods. Fund balance reserves have been established for encumbrances and for loans, which represent community development monies loaned to local businesses and homeowners.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

NET ASSETS

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

Restricted for other purposes represents balances of state and federal grants and other restricted purposes in Special Revenue funds. The City's policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

OPERATING REVENUES AND EXPENSES

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

CAPITAL CONTRIBUTIONS

Capital contributions in the enterprise fund financial statements arise from outside contributions of fixed assets or from grants or outside contributions of resources restricted to capital acquisition and construction.

INTERFUND TRANSACTIONS

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

Exchange transactions between funds are reported as revenues in the seller funds and as expenditures/expenses in the purchaser funds. Flows of cash or goods from one fund to another without a requirement for repayment are reported as inter-fund transfers. Inter-fund transfers are reported as other financing sources/uses in governmental funds and after non-operating revenues/expenses in enterprise funds. Repayments from funds responsible for particular expenditures/expenses to the funds that initially paid for them are not presented on the financial statements. Transfers between governmental funds are eliminated on the statement of activities.

ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

3. CHANGE IN ACCOUNTING PRINCIPLES AND RESTATEMENT OF FUND BALANCES/NET ASSETS

For fiscal year 2005, the City has implemented Governmental Accounting Standards Board (GASB) Statement No. 40, "Deposit and Investment Risk Disclosures" and GASB Technical Bulletin No. 2004-2, "Recognition of Pension and Other Post-employment Benefit Expenditures/Expenses and Liability by Cost-Sharing Employers." GASB 40 establishes and modifies disclosure requirements related to investment risks: credit risk (including custodial credit risk and concentrations of credit risk) and interest rate risk. This statement also establishes and modifies disclosure requirements for custodial credit risk on deposits. This statement applies to all state and local governments. GASB Technical Bulletin No. 2004-2 addresses the amount that should be recognized as an expenditure/expense and as a liability each period by employers participating in a cost-sharing multiple-employer pension and other post-employment benefit (OPEB) plans. The implementation of this bulletin and of GASB Statement No. 40 had no effect on the City's financial statements.

Restatement of Net Assets: During the previous fiscal year accounting errors were noted. There were some corrections to governmental capital assets. Specifically in the enterprise funds, some accrued interest belonging in the water fund was erroneously recorded in the sewer fund. Also, there were minor changes to the capital assets balance in the sewer fund. These changes had the following affect on beginning net asset balances:

	Governmental Activities		
Fund Balances, December 31, 2004	\$ 13,702,772		
Restatement	(37,897)		
Restated Fund Balances, December 31, 2004	\$ 13,664,875		
	Water	Sewer	Business-Type Activities
Net Assets, December 31, 2004	\$ 2,086,733	\$4,261,537	\$ 6,348,270
Restatement	(72,150)	(60,308)	(132,458)
Restated Net Assets, December 31, 2004	\$ 2,014,583	\$4,201,229	\$ 6,215,812

4. EQUITY IN POOLED CASH AND INVESTMENTS

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

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

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

4. EQUITY IN POOLED CASH AND INVESTMENTS (Continued)

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

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

State statute permits interim monies to be deposited or invested in the following securities:

1. United States treasury notes, bills, bonds, or other obligations of or security issued by the United States treasury or any other obligation guaranteed as to the payment of principal and interest by the United States;
2. Bonds, notes, debentures, or other obligations or securities issued by any federal government agency or instrumentality, including but not limited to, the federal national mortgage association, federal home loan bank, federal farm credit bank, federal home loan mortgage corporation, government national mortgage association, and student loan marketing association. All federal agency securities shall be direct issuances of federal government agencies or instrumentalities;
3. Written repurchase agreements in the securities listed above, provided that the market value of the securities subject to the repurchase agreement must exceed the principal value of the agreement by at least two percent and be marked to market daily, and that the term of the agreement must not exceed thirty days;
4. Bond and other obligations of the State of Ohio, its political subdivision, or other units or agencies of this State or its political subdivisions;
5. Time certificates of deposit or savings or deposit accounts, including, but not limited to, passbook accounts;
6. No-load money market mutual funds consisting exclusively of obligations described in division (1) or (2) and repurchase agreements secured by such obligations, provided that investments in securities described in this division are made only through eligible institutions;
7. The State Treasurer's investment pool (STAR Ohio);
8. Securities lending agreements in which the County lends securities and the eligible institution agrees to exchange either securities described in division (1) or (2), or cash, or both securities and cash, equal value for equal value;

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

4. EQUITY IN POOLED CASH AND INVESTMENTS (Continued)

- 9. High grade commercial paper in an amount not to exceed 5 percent of the County's total average portfolio; and
- 10. Bankers acceptances for a period not to exceed two hundred seventy days and in an amount not to exceed 10 percent of the County's total average portfolio.

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

Investments in stripped principal or interest obligations, reverse repurchase agreements and derivatives are prohibited. The issuance of taxable notes for the purpose of arbitrage, the use of leverage and short selling are also prohibited. An investment must mature within five years from the date of purchase unless matched to a specific obligation or debt of the City, and must be purchased with the expectation that it will be held to maturity.

Investments may only be made through specified dealers and institutions. Payment for investments may be made only upon delivery of the securities representing the investments to the treasurer or qualified trustee or, if the securities are not represented by a certificate, upon receipt of confirmation of transfer from the custodian.

Deposits:

Custodial credit risk is the risk that, in the event of a bank failure, the City's deposits may not be returned. According to state law, public depositories must give security for all public funds on deposit in excess of those funds that are insured by the federal deposit insurance corporation (FDIC) or by any other agency or instrumentality of the federal government. These institutions may either specifically collateralize individual accounts in lieu of amounts insured by the FDIC, or may pledge a pool of government securities valued at least 105% of the total value of public monies on deposit at the institution. The City's policy is to deposit money with financial institutions that are able to abide by the laws governing insurance and collateral of public funds.

As of December 31, the carrying amount of the City's deposits was \$2,668,511. The County's bank balance of \$2,168,511 was exposed to custodial credit risk as follows:

Uninsured and collateral held by pledging bank's trust department and not in the City's name	\$ 2,168,511
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CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

4. EQUITY IN POOLED CASH AND INVESTMENTS (Continued)

Investments:

<u>Investment type</u>	<u>Fair Value</u>	<u>Maturities</u> 6 months or less
Common Stock	\$ 5,093	\$ 5,093
Repurchase Agreement	1,492,388	1,492,388
U.S. Government Money Market Mutual Funds	<u>419,529</u>	<u>419,529</u>
	<u>\$ 1,917,010</u>	<u>\$ 1,917,010</u>

Interest rate risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with investment policy, the City manages its exposure to declines in fair values by limiting the weighted average maturity of its investment portfolio.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The City limits their investments to money market accounts, repurchase agreements, and stocks.

Concentration of credit risk – Concentration of credit risk is the risk of loss attributed to the magnitude of a government’s investment in a single issuer. The City does have an investment policy. More than 5 percent of the City’s investments are in money market funds and repurchase agreements. These investments were 21% and 78%, respectively of the City’s total investments as of December 31, 2005.

Custodial Credit Risk – Custodial credit risk is the risk that in the event of the failure of the counterparty, the City will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The City’s repurchase agreements are exposed to custodial credit risk in that they are uninsured, unregistered, and held by the counterparty’s trust department or agent, but not in the City’s name.

5. BUDGETARY BASIS OF ACCOUNTING

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

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

5. BUDGETARY BASIS OF ACCOUNTING (Continued)

1. Revenues are recorded when received in cash (budget basis) as opposed to when susceptible to accrual (GAAP basis).
2. Expenditures are recorded when paid in cash (budget basis) as opposed to when the liability is incurred (GAAP basis).
3. Encumbrances are treated as expenditures for all funds (budget basis) rather than as a reservation of fund balance for governmental fund types (GAAP basis).

The following table summarizes the adjustments necessary to reconcile the GAAP and budgetary basis for the General Fund.

Net Change in Fund Balance	
	General
GAAP Basis	\$ 441,141
Adjustments:	
Revenue Accrual	(34,542)
Expenditure Accrual	83,368
Encumbrances	(84,837)
Budget Basis	\$ 405,130

6. PROPERTY TAX

Property taxes include amounts levied against all real, public utility, and tangible personal property located in the County. Taxes collected on real property (other than public utility) in one calendar year are levied in the preceding calendar year on assessed values as of January 1 of that preceding year, the lien date. Assessed values are established by the County Auditor at 35 percent of appraised market value. All property is required to be revalued every six years. The last revaluation was completed in 2000. Real property taxes are payable annually or semiannually. The first payment is due January 20, with the remainder payable by June 20.

Taxes collected from tangible personal property (other than public utility) in one calendar year are levied in the prior calendar year on assessed values during and at the close of the most recent fiscal year of the taxpayer that ended on or before March 31 of that calendar year, and at the tax rates determined in the preceding year. Tangible personal property used in business (except for public utilities) is currently assessed for ad valorem taxation purposes at 25 percent of its true value. Amounts paid by multi-county taxpayers are due September 20. Single county taxpayers may pay annually or semiannually. If paid annually, payment is due April 30; if paid semiannually, the first payment is due April 30, with the remainder payable by September 20.

Public utility real and tangible personal property taxes collected in one calendar year are levied in the preceding calendar year on assessed values determined as of December 31 of the second year preceding the tax collection year, the lien date. Certain public utility tangible personal property currently is assessed at 88 percent of its true value. Public utility property taxes are payable on the

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

6. PROPERTY TAX (Continued)

same dates as real property taxes described previously.

The County Treasurer collects property tax on behalf of all taxing districts within the County. The County Auditor periodically remits to the City its share of the taxes collected. The City records receipt of these taxes in various funds.

Accrued property taxes receivable represent delinquent taxes outstanding and real, tangible personal, and public utility taxes which were measurable and unpaid as of December 31, 2005. Although total property tax collections for the next fiscal year are measurable, amounts to be received during the available period are not subject to reasonable estimation at December 31 and are not intended to finance 2005 operations. The receivable and the portion of the tax levies prepaid by year end into the undivided general tax agency fund are therefore offset by a credit to deferred revenue.

The full tax rate for all City operations for the year ended December 31, 2005, was \$3.00 per \$1,000 of assessed value. The assessed values of real and tangible personal property upon which 2005 property tax receipts were based are as follows:

<u>Category</u>	<u>Assessed Value</u>
Real Estate	\$102,337,280
Public Utility Personal Property	3,783,460
Tangible Personal Property	<u>26,884,388</u>
Total Property Taxes	<u>\$133,005,128</u>

7. LOCAL INCOME TAX

This locally levied tax of one and one-half percent applies to gross salaries, wages and other personal service compensation earned by residents both in and out of the City of Hillsboro and to earnings of nonresidents earned in the City. It also applies to net income of business organizations conducted within the City. Proceeds of the tax are credited entirely to the General Fund.

8. RECEIVABLES

Receivables at December 31, 2005 consisted of taxes, accounts (billings for user charged services including unbilled utility services), and intergovernmental receivables arising from grants, entitlements and shared revenues. All receivables are considered fully collectible except accounts receivable related to utility services.

Loans receivable represents low interest loans for development projects and home improvements granted to eligible City residents and business under the Community Development Program.

Municipal Court receivables reported in the agency funds amount to \$1,231,012. Due to the age of many of these accounts, the amount of \$1,114,041 is considered uncollectable.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

8. RECEIVABLES (Continued)

A summary of the amounts due from other governments are as follows:

<u>General</u>	
Local Government	\$152,623
Homestead & Rollback	7,901
 <u>Special Revenue</u>	
Street Constr., Maint. & Repair Fund	
Gasoline Tax	50,634
State Highway Fund	
Gasoline Tax	4,105
Police Pension Fund	
Homestead & Rollback	1,129
Fire Pension Fund	
Homestead & Rollback	1,129
Municipal Motor Vehicle Fund	
Permissive Tax	6,698
 <u>Debt Service</u>	
Bond Retirement Fund	
Homestead & Rollback	<u>1,129</u>
 Total Governmental Activities	 <u>\$225,348</u>

9. INTERFUND TRANSACTIONS

Interfund balances at December 31, 2005, consist of the following individual fund receivables and payables:

	Interfund Receivable	Interfund Payable
General Fund	\$410,000	\$ 0
<i>Non-major Funds:</i>		
Tax Increment Capital Project Fund	0	410,000
Total All Funds	\$410,000	\$410,000

These balances primarily resulted from the time lag between the dates that interfund goods and services are provided or reimbursable expenditures occur and payment is made.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

9. INTERFUND TRANSACTIONS (Continued)

Transfers are used to move revenues from the fund that statute or budget requires to collect them to the fund that statute or budget requires to expend them; to move receipts restricted to debt service from the funds collecting the receipts to the debt service fund as debt service payment become due, and use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

Transfers made during the year ended December 31, 2005, were as follows:

FUND	Transfer In	Transfer Out
General	\$ -	\$ 680,000
	-	680,000
<i>Non-Major Special Revenue Funds</i>		
Street C.M. & Repair	150,000	-
Police Pension	160,000	-
Fire Pension	185,000	-
Recreation	85,000	-
Life Squad Improvement	100,000	-
Total Non-Major Special Revenue	680,000	-

10. DEFINED BENEFIT RETIREMENT PLANS

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

OPERS provides retirement, disability, survivor and death benefits and annual cost of living adjustments to members of the traditional and combined plans. Members of the member directed plan do not qualify for ancillary benefits. Authority to establish and amend benefits is provided by Chapter 145 of the Ohio Revised Code. OPERS issues a stand-alone financial report that may be obtained by writing to OPERS, 277 East Town Street, Columbus, OH 43215-4642 or by calling (614) 222-6701 or (800) 222-7377.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

10. DEFINED BENEFIT RETIREMENT PLANS (Continued)

For the year ended December 31, 2005, the members of all three plans, except those in law enforcement or public safety participating in the traditional plan, were required to contribute 8.5 percent of their annual covered salaries. Members participating in the traditional plan who were in law enforcement contributed 10.1 percent of their annual covered salary; members in public safety contributed 9 percent. The employer contribution rate for pension benefits for 2005 was 9.55 percent, except for those plan members in law enforcement or public safety. For those classifications, the employer's pension contributions were 12.7 percent of covered payroll. The Ohio Revised Code provides statutory authority for member and employer contributions.

The City's contributions to the PERS of Ohio for the years ending December 31, 2003, 2004, and 2005 were \$296,149, \$228,234, and \$228,461 respectively. These contributions were equal to the required contributions for each of the years.

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

Plan members are required to contribute 10 percent of their annual covered salary to fund pension benefits while the employer is required to contribute 11.75 percent for police officers and 16.25 percent for firefighters. Contributions are authorized by State statute.

The City's contributions to OP&F for the years ended December 31, 2003, 2004, and 2005 were \$154,710, \$203,315, and \$157,541 for policemen and \$190,155, \$160,814, and \$197,546 for firefighters, respectively, equal to required contributions for each year.

11. POSTEMPLOYMENT BENEFITS

Ohio Public Employees Retirement System: The Ohio Public Employees Retirement System (OPERS) provides postretirement health care coverage to age and service retirees with ten or more years of qualifying Ohio service credit with either the traditional or combined plans. Health care coverage for disability benefit recipients and qualified survivor benefit recipients is available. Members of the member-directed plan do not qualify for postretirement health care coverage. The health care coverage provided by the retirement system is considered an Other Postemployment Benefit as described in *GASB Statement No. 12*. A portion of each employer's contribution to the traditional or combined plans is set aside for the funding of postretirement health care based on authority granted by State statute. The 2005 local government employer contribution rate was 13.55 percent of covered payroll (16.7 percent for public safety and law enforcement); 4 percent of covered payroll was the portion that was used to fund health care.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

11. POSTEMPLOYMENT BENEFITS (Continued)

Benefits are advance-funded using the entry age normal actuarial cost method. Significant actuarial assumptions, based on OPERS's latest actuarial review performed as of December 31, 2004, include a rate of return on investments of 8 percent, an annual increase in active employee total payroll of 4 percent compounded annually (assuming no change in the number of active employees) and an additional increase in total payroll of between 0.50 percent and 6.3 percent based on additional annual pay increases. Health care premiums were assumed to increase at the projected wage inflation rate plus an additional factor ranging from 1 to 6 percent annually for the next eight years and 4 percent annually after eight years.

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

The number of active contributing participants in the traditional and combined plans was 376,109. Actual City contributions for 2005 which were used to fund postemployment benefits were \$67,442. The actual contribution and the actuarially required contribution amounts are the same. The actuarial value of OPERS's net assets available for payment of benefits at December 31, 2004, (the latest information available) was \$10.8 billion. The actuarially accrued liability and the unfunded actuarial accrued liability were \$29.5 billion and \$18.7 billion, respectively.

On September 9, 2004, the OPERS Retirement Board adopted a Health Care Preservation Plan (HCPP) with an effective date of January 1, 2007. The HCPP restructures OPERS' health care coverage to improve the financial solvency of the fund in response to increasing health care costs. Member and employer contribution rates increased as of January 1, 2006, which will allow additional funds to be allocated to the health care plan.

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

The health care coverage provided by the retirement system is considered an Other Postemployment Benefit (OPEB) as described in *GASB Statement No. 12*. The Ohio Revised Code provides the authority allowing the Ohio Police and Fire Pension Fund's board of trustees to provide health care coverage and states that health care costs paid from the funds of OP&F shall be included in the employer's contribution rate. Health care funding and accounting is on a pay-as-you-go basis. The total police employer contribution rate is 19.5 percent of covered payroll and the total firefighter employer contribution rate is 24 percent of covered payroll, of which 7.75 percent of covered payroll was applied to the postemployment health care program during 2005 and 2004. In addition, since July 1, 1992, most retirees and survivors have been required to contribute a portion of the cost of their health care coverage through a deduction from their monthly benefit payment. Beginning in 2001, all retirees and survivors have monthly health care contributions.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

11. POSTEMPLOYMENT BENEFITS (Continued)

The City's actual contributions for 2005 that were used to fund postemployment health care benefits were \$63,807 for police and \$62,544 for firefighters. The OP&F's total health care expense for the year ended December 31, 2004, (the latest information available) was \$102,173,796, which was net of member contributions of \$55,665,341. The number of OP&F participants eligible to receive health care benefits as of December 31, 2004, was 13,812 for police and 10,528 for firefighters.

12. RISK MANAGEMENT

The City maintains a comprehensive risk management program through the purchase of various types of liability, property and crime insurance from the Ohio Government Risk Management Plan.

General liability insurance is maintained in the amount of \$10,000,000 for each occurrence. Other liability insurances include \$10,000,000 employers liability coverage (which provides additional coverage to the State's Workers Compensation Program), \$10,000,000 for law enforcement professional liability, \$10,000,000 for public official errors and omissions liability and \$10,000,000 for automobile liability. In addition the City maintains replacement cost insurance on building and contents in the blanket amount of \$22,724,872. Other property insurance includes contractor's equipment, automobile physical damage and earthquake damage to the blanket limit. The City carries comprehensive boiler and machinery coverage in the amount of \$13,000,000.

The City also maintains a blanket crime bond in the amount of \$2,500. In addition the City carries employee dishonesty coverage in the amount of \$242,000. The City pays all elected officials' bonds by statute. The City insures an employee health benefits program through Humana Insurance Company.

Settlement claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three years.

The City has not incurred significant reductions in insurance coverage from coverage in prior year by major category risk.

13. OTHER EMPLOYEE BENEFITS

Deferred Compensation: Employees of the City may elect to participate in the ING Deferred Compensation Program created in accordance with Internal Revenue Code Section 457. Participation is on a voluntary payroll deduction basis. The plan permits deferral of compensation until future years. According to the plan, the deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. Assets of the plan are held in trust for the exclusive benefit of the participants and their beneficiaries.

Compensated Absences: Vacation leave is earned at rates that vary depending upon length of service and standard work week. Current policy credits vacation on the employee's anniversary date and is to be taken by the next anniversary date. Vacation time is not cumulative and must be taken during the year unless otherwise specified. City employees are paid for earned, unused vacation leave at the time of termination of employment if the employee has at least one year of service.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

13. OTHER EMPLOYEE BENEFITS (Continued)

The Police Department earns sick leave at a rate of 4.6 hours per completed eighty hours of active pay status. Those employees with not less than 10 years of service at retirement shall be paid the value of his/her sick leave credit for up to one-third of the leave up to a maximum of 400 hours upon termination. The Fire Department earns sick leave at a rate of 6.44 hours for each completed pay period. Those employees with not less than 10 years of service at retirement shall be paid the value of his/her sick leave credit for up to one-fourth of their leave balance. All other City employees earn sick leave at a rate of 4.6 hours per completed eighty hours of active pay status. Those employees with at least ten years of service at the time of separation shall be paid the value of his/her sick credit for up to one-fourth of the leave up to 300 hours. Such payment shall be based on the employee's rate of pay at the time of separation, or the full balance may be transferred to another governmental agency.

14. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2005:

	Beginning Balance 12/31/2004*	Additions	Deletions	Ending Balance 12/31/2005
<u>Governmental Activities</u>				
Capital Assets, Not Being Depreciated				
Land	\$ 373,192	\$ 10,880	\$ -	\$ 384,072
Construction in Progress	-	102,295	-	102,295
Total Capital Assets, Not Being Depreciated	<u>373,192</u>	<u>113,175</u>	<u>-</u>	<u>486,367</u>
Capital Assets Being Depreciated				
Land Improvements	2,024,132	-	-	2,024,132
Buildings and Improvements	1,640,401	-	-	1,640,401
Furniture and Equipment	1,217,262	101,588	(51,000)	1,267,850
Vehicles	1,599,210	82,265	(68,880)	1,612,595
Infrastructure	8,970,413	5,894	-	8,976,307
Total Capital Assets Being Depreciated	<u>15,451,418</u>	<u>189,747</u>	<u>(119,880)</u>	<u>15,521,285</u>
Less Accumulated Depreciation				
Land Improvements	(874,527)	(36,450)	-	(910,977)
Buildings and Improvements	(362,244)	(49,081)	-	(411,325)
Furniture and Equipment	(687,477)	(110,168)	51,000	(746,645)
Vehicles	(1,025,381)	(86,732)	64,045	(1,048,068)
Infrastructure	(2,887,837)	(172,444)	-	(3,060,281)
Total Accumulated Depreciation	<u>(5,837,466)</u>	<u>(454,875)</u>	<u>115,045</u>	<u>(6,177,296)</u>
Total Capital Assets Being Depreciated, Net	<u>9,613,952</u>	<u>(265,128)</u>	<u>(4,835)</u>	<u>9,343,989</u>
Governmental Activities Capital Assets, Net	<u>\$ 9,987,144</u>	<u>\$ (151,953)</u>	<u>\$ (4,835)</u>	<u>\$ 9,830,356</u>

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

14. CAPITAL ASSETS (Continued)

* As restated see note 3.

Depreciation expense was charged to governmental functions as follows:

General Government:

Legislative and Executive	\$ 71,595
Security of Persons & Property	100,263
Public Health	20,222
Leisure Time Activities	29,272
Transportation	<u>233,523</u>
Total Depreciation Expense	<u>\$ 454,875</u>

	Ending Balance <u>12/31/2004</u>	Additions	Deletions	Ending Balance <u>12/31/2005</u>
<u>Business Type Activities</u>				
Capital Assets, Not Being Depreciated				
Construction in Progress	<u>5,811,633</u>	<u>1,197,476</u>	<u>(5,628,602)</u>	<u>1,380,507</u>
Total Capital Assets, Not Being Depreciated	<u>5,811,633</u>	<u>1,197,476</u>	<u>(5,628,602)</u>	<u>1,380,507</u>
Capital Assets Being Depreciated				
Land Improvements	273,604	-	-	273,604
Buildings and Equipment	7,315,674	5,430,798	-	12,746,472
Mechanical Equipment	779,870	97,309	-	877,179
Vehicles	156,601	-	-	156,601
Water/Sewer Lines	<u>5,156,724</u>	<u>126,445</u>	-	<u>5,283,169</u>
Total Capital Assets Being Depreciated	13,682,473	5,654,552	-	19,337,025
Less Accumulated Depreciation				
Land Improvements	(155,085)	(9,052)	-	(164,137)
Buildings and Equipment	(3,867,951)	(130,124)	-	(3,998,075)
Mechanical Equipment	(526,259)	(61,251)	-	(587,510)
Vehicles	(109,045)	(8,705)	-	(117,750)
Water/Sewer Lines	<u>(2,051,094)</u>	<u>(180,267)</u>	-	<u>(2,231,361)</u>
Total Accumulated Depreciation	(6,709,434)	(389,399)	-	(7,098,833)
Total Capital Assets Being Depreciated, Net	<u>6,973,039</u>	<u>5,265,153</u>	-	<u>12,238,192</u>
Business Type Activities Capital Assets, Net	<u>12,784,672</u>	<u>6,462,629</u>	<u>(5,628,602)</u>	<u>13,618,699</u>

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

15. LONG-TERM DEBT OBLIGATIONS

The City's long-term obligations at year end consisted of the following:

	Outstanding 12/31/2004	Issued	Retired	Outstanding 12/31/2005	Due In One Year
<i>Governmental Activities</i>					
Compensated Absences	\$ 284,582	\$ 268,622	\$ 284,582	\$ 268,622	\$ 39,011
1997 - 6.5%					
Street Improvement Bonds	145,000	-	45,000	100,000	50,000
Capital Lease	41,160	59,953	34,230	66,883	32,618
Total Governmental Activities	\$ 470,742	\$ 328,575	\$ 363,812	\$ 435,505	\$ 121,629
	Outstanding 12/31/2004	Issued	Retired	Outstanding 12/31/2005	Due In One Year
<i>Business Activities</i>					
Compensated Absences	\$ 53,975	\$ 49,337	\$ 53,975	\$ 49,337	\$ -
Water					
2004 - 2% Mortgage Revenue Bond	3,285,333	-	110,000	3,175,333	75,000
Water System Improvement Revenue Bonds - 4.25%	-	560,000	-	560,000	18,000
Water System Improvement Revenue Bonds - 4.25%	-	2,400,000	-	2,400,000	79,000
Unamortized Charge	99,667	-	3,833	95,834	3,833
Total Water Fund	3,385,000	2,960,000	113,833	6,231,167	175,833
Sewer					
2004 - OWDA Loan - 1%	161,133	250,541	21,974	389,700	11,069
2005 - OWDA Loan - 1%	-	427,890	-	427,890	31,399
1997 - 4.65% Mortgage Revenue Bond	1,055,000	-	245,000	810,000	255,000
Total Sewer Fund	1,216,133	678,431	266,974	1,627,590	297,468
Total Business-Type Activities	\$ 4,655,108	\$ 3,687,768	\$ 434,782	\$ 7,908,094	\$ 473,301

Mortgage revenue bonds were issued for payment of water system improvements, construction of a 150,000,000 gallon reservoir, and a water storage tank. Properties and revenues of the utility facilities have been pledged to repay these debts. Mortgage revenue bonds in the amount of \$3,385,000 were issued in 2004 to refund water mortgage revenue bonds of \$3,281,500 issued in 1991. Property and revenue of the utility facilities have been pledged to repay these debts.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

15. LONG-TERM DEBT OBLIGATIONS (Continued)

Mortgage revenue bonds in the amount of \$560,000 and \$2,400,000 were issued in 2005 to improve the water system of the City. Property and revenue of the utility facilities have been pledged to repay these debts.

Compensated Absences (sick leave and vacation benefits) will be paid from the fund from which the person is paid. Capital lease obligations will be paid from the fund that maintains custody of the related asset.

The Street Improvement Bonds in the amount of \$400,000 were issued for the improvement of city streets. General obligation bonds are direct obligations of the City for which its full faith, credit and resources are pledged and are payable from taxes levied on all taxable property in the City. Property tax monies will be received in and the debt will be repaid from a General Obligation Bond Retirement Fund.

The 2004 OWDA loan was issued at an interest rate of 1% during 2004 and 2005 to pay for the costs of sanitary sewer lining. The 2005 OWDA loan is to pay for the costs of lift station, equalization basin, and relief sewers. The sewer fund will be used to repay these loans.

Principal and interest requirements to retire Mortgage Revenue Bonds at December 31, 2005 were as follows:

	<u>Mortgage Revenue Bonds</u>	
	<u>Principal</u>	<u>Interest</u>
2006	\$427,000	\$293,262
2007	445,000	285,357
2008	471,000	265,679
2009	190,000	251,242
2010	199,000	243,626
2011-2015	1,120,000	1,088,441
2016-2020	1,374,000	829,889
2021-2025	1,699,000	499,133
2026-2030	910,000	170,500
2031-2035	<u>206,167</u>	<u>5,250</u>
Total	<u>\$7,041,167</u>	<u>\$3,932,379</u>

The amortization schedule does not match the outstanding debt amounts listed on page 44 in the amount of \$95,834 which is the unamortized charge.

The OWDA loans were still open as of December 31, 2005 and no amortization schedules had been established for these loans.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

15. LONG-TERM DEBT OBLIGATIONS (Continued)

Principal and interest requirements to retire General Obligation Bonds at December 31, 2005 were as follows:

	<u>General Obligation Bonds</u>	
	<u>Principal</u>	<u>Interest</u>
2006	50,000	6,500
2007	50,000	3,250
Total	<u>\$100,000</u>	<u>\$9,750</u>

The City's overall legal debt margin was \$3,877,042 at December 31, 2005.

16. CONTINGENCIES

Grants

The City received financial assistance from federal and state agencies in the form of grants. The expenditure of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and is subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become liability of the General Fund or other applicable funds. However, in the opinion of management, any such disallowed claims will not have a material adverse effect on the overall financial position of the City at December 31, 2005.

Litigation

The City is currently party to legal proceedings. The City's management is of the opinion that ultimate disposition of claims will not have a material effect, if any, on the financial condition of the City.

17. ACCOUNTABILITY AND COMPLIANCE

A. Accountability

The following fund had a fund balance deficit as of December 31, 2005:

<u>Capital Project Fund</u>	
Tax Increment Fund	290,421

This deficit is a result of the application of accounting principles generally accepted in the United States of America to the financial reporting of these funds. The General Fund is liable for any deficit in this fund and provides operating transfers when cash is required, not when accruals occur.

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

17. ACCOUNTABILITY AND COMPLIANCE (Continued)

B. Compliance

The General Fund's final budgeted appropriations exceeded estimated revenues by \$213,213.

18. CAPITALIZED LEASES - LESSEE DISCLOSURE

During fiscal year 2005, the City entered into a capital lease for the purchase of a Ford Explorer and two police cruisers. In a previous fiscal year, the City entered into a capitalized lease for the acquisition of a backhoe. The terms of the agreements provide options to purchase the equipment. The leases meet the criteria of a capital lease as defined by Statement of Financial Accounting Standards No. 13 *Accounting for Leases*, which defines a capital lease generally as one which transfers benefits and risks of ownership to the lessee. Capital lease payments have been reclassified and are reflected as debt service in the Basic Financial Statements for the street fund. These expenditures are reflected as program/object expenditures on a budgetary basis.

The capital assets acquired by the leases have been capitalized in the statement of net assets for governmental activities in the amount of \$113,718 which is equal to the present value of the minimum lease payments at the time of acquisition. A corresponding liability was recorded on the statement of net assets for governmental activities. Principal payments in fiscal year 2005 totaled \$34,230 in the governmental funds.

The following is a schedule of the future minimum lease payments required under the capital leases and the present value of the minimum lease payments as of December 31, 2005.

<u>Year Ending December 31,</u>	<u>Capitalized Lease Obligation</u>
2006	\$35,999
2007	35,999
Total Minimum Lease Payments	71,998
Less: Amount Representing Interest	(5,115)
Present Value of Minimum Lease Payments	\$66,883

19. CONTRACT COMMITMENTS

As of December 31, 2005, the City had contractual commitments for the completion of the expansion of the water plant and South High Street water to school.

Contractor	Contract Amount	Amount Expended	Balance as of 12/31/05
Foill Excavating	\$187,510	\$103,110	\$84,400
Sunesis Construction Company	918,193	0	918,193

CITY OF HILLSBORO, OHIO
NOTES TO THE BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2005

20. SHORT TERM OBLIGATIONS

During fiscal year 2005, the City paid off Bond Anticipation Notes for the purpose of water system improvements by issuing water system improvement revenue bonds in the total amount of \$2,960,000.

	Principal Outstanding 12/31/04	Additions	Deductions	Principal Outstanding 12/31/05
Water System Bond Anticipation Note - 3.90%	\$2,960,000	\$0	\$2,960,000	\$0

21. DONATED STOCK

On October 23, 2003, the City received a donation of Proctor and Gamble Stock to be used for Life Squad improvements and related equipment. The market value of this stock at the time of donation was \$3,235. An investment firm holds the City's stock in book entry form in the City's name.

22. RELATED PARTY TRANSACTION

The City currently has an existing revolving loan with the Southern Ohio Economic Development Corporation (SOEDC), of which Dan Cowdrey is the current President. Dan Cowdrey is also under contract as the City's Loan Administrator for the City of Hillsboro, Revolving Loan Fund Committee (RLFC). However, at the time the loan was originated in 2001, Dan Cowdrey was not the President of the SOEDC.

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CITY OF HILLSBORO, OHIO
HIGHLAND COUNTY

SCHEDULE OF FEDERAL AWARDS EXPENDITURES
FOR THE YEAR ENDED December 31, 2005

Federal Grantor/Pass Through Grantor Program Title	Pass Through Entity Number	Federal CFDA Number	Disbursements
<u>U.S. DEPARTMENT OF AGRICULTURE</u>			
<i>Direct from the Federal Government</i>			
Water & Waste Disposal Systems for Rural Communities	N/A	10.760	\$ 344,558
Total U.S. Department of Agriculture			<u>344,558</u>
<u>U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT</u>			
<i>Passed Through Ohio Department of Development</i>			
Community Development Block Grant	AC-02-131-1	14.228	121,834
Home Investment Partnership Program	AC-02-131-2	14.239	166,749
Total U.S. Department of Housing and Urban Development			<u>288,583</u>
<u>U.S. Department of Homeland Security</u>			
<i>Passed through Ohio Emergency Management Agency</i>			
Disaster Assistance Grant	DR-1580-OH	97.036	137,940
Total U. S. Department of Homeland Security			<u>137,940</u>
Total Federal Expenditures			<u>\$ 771,081</u>

The accompanying notes to this schedule are an integral part of this schedule.

**CITY OF HILLSBORO, OHIO
HIGHLAND COUNTY**

**NOTES TO THE FEDERAL AWARDS EXPENDITURES SCHEDULE
FISCAL YEAR ENDED DECEMBER 31, 2005**

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

The accompanying Federal Awards Expenditures Schedule (the Schedule) summarizes activity of the City's federal award programs. The schedule has been prepared on the cash basis of accounting.



Auditor of State Betty Montgomery

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

City of Hillsboro
Highland County
130 North High Street
Hillsboro, Ohio 45133

To the Member of Council:

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Hillsboro, Highland County, Ohio (the City), as of and for the year ended December 31, 2005, which collectively comprise the City's basic financial statements and have issued our report thereon dated December 12, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the Comptroller General of the United States' *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting to determine our auditing procedures in order to express our opinion on the financial statements and not to opine 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 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 record, process, summarize, and report financial data consistent with management's assertions in the financial statements. Reportable conditions are described in the accompanying schedule of findings as items 2005-001 and 2005-002.

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 material to the financial statements we audited may occur and not be timely detected by employees when 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 material weaknesses. However, we do not believe the reportable condition described above to be a material weakness. In a separate letter to the City's management dated December 12, 2006, we reported other matters involving internal control over financial reporting which we did not deem reportable conditions.

Compliance and Other Matters

As part of reasonably assuring whether the City's financial statements are free of material misstatement, we tested its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could directly and materially affect the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express an opinion. The results of our tests disclosed an instance of noncompliance that we must report under *Government Auditing Standards* that is described in the accompanying schedule of findings as item 2005-002. Also, in a separate letter to the City's management dated December 12, 2006, we reported other matters related to noncompliance we deemed immaterial.

We intend this report solely for the information and use of the management, and City Council, and is not intended for anyone other than these specified parties.



Betty Montgomery
Auditor of State

December 12, 2006



Auditor of State Betty Montgomery

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

City of Hillsboro
Highland County
130 North High Street
Hillsboro, Ohio 45133

To the Members of Council:

Compliance

We have audited the compliance of City of Hillsboro, Highland County, Ohio (the City), with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133, Compliance Supplement that apply to its major federal program for the year ended December 31, 2005. The summary of auditor's results section of the accompanying schedule of findings identifies the City's major federal program. The City's management is responsible for complying with the requirements of laws, regulations, contracts, and grants applicable to each major federal program. 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 reasonably assure whether noncompliance occurred with the types of compliance requirements referred to above that could directly and materially affect a major federal program. An audit includes examining, on a test basis, evidence about the City's compliance with those requirements and performing other procedures we considered necessary in the circumstances. We believe 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 complied, in all material respects, with the requirements referred to above that apply to its major federal program for the year ended December 31, 2005.

Internal Control Over Compliance

The City's management 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 directly and materially affect a major federal program 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 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 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 timely detected by employees when performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

However, we noted a matter involving the internal control over federal compliance not requiring inclusion in this report, that we reported to the City's management in a separate letter dated December 12, 2006.

We intend this report solely for the information and use of the audit committee, management, city council, federal awarding agencies, and pass-through entities. It is not intended for anyone other than these specified parties.

A handwritten signature in black ink that reads "Betty Montgomery". The signature is written in a cursive, flowing style.

Betty Montgomery
Auditor of State

December 12, 2006

CITY OF HILLSBORO
HIGHLAND COUNTY

SCHEDULE OF FINDINGS
OMB CIRCULAR A -133 § .505
DECEMBER 31, 2005

1. SUMMARY OF AUDITOR'S RESULTS

<i>(d)(1)(i)</i>	Type of Financial Statement Opinion	Unqualified
<i>(d)(1)(ii)</i>	Were there any material control weakness conditions reported at the financial statement level (GAGAS)?	No
<i>(d)(1)(ii)</i>	Were there any other reportable control weakness conditions reported at the financial statement level (GAGAS)?	Yes
<i>(d)(1)(iii)</i>	Was there any reported material noncompliance at the financial statement level (GAGAS)?	Yes
<i>(d)(1)(iv)</i>	Were there any material internal control weakness conditions reported for major federal programs?	No
<i>(d)(1)(iv)</i>	Were there any other reportable internal control weakness conditions reported for major federal programs?	No
<i>(d)(1)(v)</i>	Type of Major Programs' Compliance Opinion	Unqualified
<i>(d)(1)(vi)</i>	Are there any reportable findings under § .510?	No
<i>(d)(1)(vii)</i>	Major Programs (list):	Waste & Waste Disposal Systems for Rural Communities, CFDA # 10.760
<i>(d)(1)(viii)</i>	Dollar Threshold: Type A\B Programs	Type A: > \$ 300,000 Type B: all others
<i>(d)(1)(ix)</i>	Low Risk Auditee?	Yes

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

FINDING NUMBER 2005-001

Reportable Condition

Organizations that use service organizations to process certain transactions should gain assurance that the service organization has controls in place and operating effectively to reduce the risk that transactions are not processed correctly.

**FINDING NUMBER 2005-001
(Continued)**

During the 2005 fiscal year, the City of Hillsboro Fire and Rescue (HFD) entered into an agreement with HealthServe, LLC to receive, use, obtain, access or create Protected Health Information from or on behalf of HFD in the course of providing services. HealthServe, LLC service includes claims processing and payment posting for emergency medical service customers served by the HFD which is a significant accounting function for the City. The City of Hillsboro (City) has not established procedures to determine whether the service organization, HealthServe, LLC, has sufficient controls in place and operating effectively to ensure that emergency medical service claims processed on behalf of the HFD have been completely and accurately processed in accordance with their service contract.

HealthServe, LLC obtained a Tier I SAS 70 report "Independent Service Auditor's Report Provided by Service Auditor" dated June 30, 2005. However, a Tier I SAS 70 report is of limited benefit to the City because it only provides assurance that: 1) the description of the controls are fairly described; 2) that the controls are suitably designed to meet control objectives specified in the description; and 3) that the controls are in place and operating as of the opinion date. A Tier I SAS 70 report provides no opinion on the operating effectiveness of the controls.

A failure by the City to ensure, on an on-going basis, that emergency medical service claims processed on behalf of the HFD are completely and accurately processed in accordance with their specific service contract could result in the City incurring emergency medical service charges that are not billed or collected, thus resulting in lost revenues.

The City should implement procedures to assure the completeness, and accuracy of emergency medical service claims processed by its third party administrator. Statement on Auditing Standards (SAS) No. 70, as amended, prescribes standards for reporting on the processing (i.e. control design and operation) of transactions by service organizations. An unqualified Tier II "Report on Policies and Procedures Placed in Operation and Tests of Operating Effectiveness" in accordance with SAS No. 70 should provide the City with an appropriate level of assurance that emergency medical service claims are being processed in conformance with the contract.

We recommend that the City work with HealthServe, LLC to specify in their contract that an annual Tier II SAS 70 audit report be performed. The City should be provided a copy of the Tier II SAS 70 report in a timely manner and should review the report's content. A SAS 70 audit report should be conducted in accordance with American Institute of Certified Public Accountants' (AICPA) standards by a firm registered and considered in "good standing" with the Accountancy Board of the respective State. If the third-party administrator refuses to provide the City with a Tier II SAS 70 report, we recommend that the City only contract with a third-party administrator that will provide such a report. If HealthServe, LLC provides a Tier II SAS 70 report, we recommend that the City establish procedures to review on a monthly basis a Run Activity Report and the Fee and Receipt Analysis Report to ensure all runs have completely and accurately processed for billing, and that all collected receipts have been deposited to the City's bank account.

In the absence of a Tier II SAS 70 audit report, the District should establish procedures to strictly monitor claims processed by HealthServe, LLC to ensure that all emergency medical run claims were processed and collected in accordance with the contract. The claims information received, used, obtained, access or created by HealthServe, LLC on behalf of the HFD should be considered confidential and should be used by the City in compliance with the Health Insurance Portability and Accountability Act.

Officials' Response:

We did not receive a response from Officials to this finding.

FINDING NUMBER 2005-002

Noncompliance/Reportable Condition

Ohio Revised Code, § 5705.39, states that the total appropriation from each fund should not exceed the total estimated revenue. No appropriation measure is to become effective until the county auditor files a certificate that the total appropriations from each fund do not exceed the total official estimate or amended official estimate. In 2005, the appropriation exceeded the estimate revenue by \$236,213 in the General Fund and by \$149,428, in the Water Improvement Fund. Failure to properly monitor appropriations and estimated resources could cause the City to expend more funds than they actually have available resulting in negative fund balances. We recommend the City take steps to ensure appropriations and estimated resources are being properly monitored and that appropriations do not exceed estimated resources.

Officials' Response:

We did not receive a response from Officials to this finding.

3. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARDS
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None.



**Auditor of State
Betty Montgomery**

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CITY OF HILLSBORO

HIGHLAND COUNTY

CLERK'S CERTIFICATION

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

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
JANUARY 4, 2007**