

**CITY OF DEFIANCE
DEFIANCE COUNTY, OHIO**

*Basic
Financial Statements*
(Audited)

FOR THE YEAR ENDED
DECEMBER 31, 2005

JOHN SEELE, FINANCE DIRECTOR



**Auditor of State
Betty Montgomery**

Members of Council and Mayor
City of Defiance
631 Perry Street
Defiance, Ohio 43512

We have reviewed the *Independent Auditor's Report* of the City of Defiance, Defiance County, prepared by Julian and Grube, Inc., for the audit period January 1, 2005 through December 31, 2005. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

Our review was made in reference to the applicable sections of legislative criteria, as reflected by the Ohio Constitution, and the Revised Code, policies, procedures and guidelines of the Auditor of State, regulations and grant requirements. The City of Defiance is responsible for compliance with these laws and regulations.

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BETTY MONTGOMERY
Auditor of State

August 31, 2006

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

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Julian & Grube, Inc.
Serving Ohio Local Governments

333 County Line Rd. West, Westerville, OH 43082 Phone: 614.846.1899 Fax: 614.846.2799

Independent Auditors' Report

Members of Council and Mayor
City of Defiance
631 Perry Street
Defiance, OH 43082

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 Defiance, Defiance County, Ohio, (the "City"), as of and for the year ended December 31, 2005, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Defiance, Defiance County, as of December 31, 2005, and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the General fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As disclosed in Note 3B, the City restated its net assets due to errors and omissions in capital assets.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 16, 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 grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Members of Council and Mayor
City of Defiance
Page Two

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

A handwritten signature in cursive script that reads "Julian & Grube, Inc.".

Julian & Grube, Inc.
June 16, 2006

CITY OF DEFIANCE, OHIO

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

The management's discussion and analysis of the City of Defiance's (the "City") 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:

- The total net assets of the City increased \$750,566. Net assets of governmental activities increased \$353,002 or 1.70% over 2004 and net assets of business-type activities increased \$397,564 or 3.33% over 2004.
- General revenues accounted for \$8,746,740, or 72.39%, of total governmental activities revenue. Program specific revenues accounted for \$3,336,444, or 27.61%, of total governmental activities revenue.
- The City had \$11,730,182 in expenses related to governmental activities; \$3,336,444 of these expenses was offset by program specific charges for services, grants or contributions. The remaining expenses of the governmental activities of \$8,393,738 were offset by general revenues (primarily property taxes, income taxes and unrestricted grants and entitlements) of \$8,746,740.
- The City has two major funds, the general fund and capital improvements fund. The general fund had revenues and other financing sources of \$9,444,365 in 2005. This represents an increase of \$760,619 from 2004. The expenditures and other financing uses of the general fund which totaled \$8,546,136 in 2005, increased \$420,197 from 2004. The net increase in fund balance for the general fund was \$898,229 or 46.63%.
- The capital improvements fund had revenues of \$1,697,848 in 2005 this is an increase of \$159,303 from 2004 revenues. The capital improvements fund had expenditures of \$1,771,702 in 2005 this is a decrease of \$52,908 from 2004. The net decrease in fund balance for the capital improvements fund was \$73,854 or 12.76%.
- Net assets for the business-type activities, which are made up of the Water, Sewer, Refuse and Utility Deposit enterprise funds, increased in 2005 by \$397,564. This increase in net assets was due primarily to adequate charges for services revenue to cover operating expenses.
- In the general fund, the actual revenues and other financing sources came in \$394,540 higher than they were in the final budget and actual expenditures and other financing uses were \$456,560 lower than the amount in the final budget. These positive variances are the result of the City's conservative budgeting. Budgeted revenues and other financing sources increased \$1,276,466 from the original to the final budget. Budgeted expenditures and other financing uses increased \$1,069,607 from the original to the final budget due primarily to an increase in the cost of general government expenditures.

Using this Annual Financial Report

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

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

CITY OF DEFIANCE, OHIO

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

Reporting the City as a Whole

Statement of Net Assets and the Statement of Activities

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

These two statements report the City's net *assets* and changes in those assets. This change in net assets is important because it tells the reader that, for the City as a whole, the financial position of the City has improved or diminished. The causes of this change may be the result of many factors, some financial, some not. Non-financial factors include the City's property tax base, current property tax laws in Ohio restricting revenue growth, facility conditions, required community programs and other factors.

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

Governmental activities - Most of the City's programs and services are reported here including police, fire and rescue, street maintenance, capital improvements and general administration. These services are funded primarily by property and income taxes and intergovernmental revenues including federal and state grants and other shared revenues.

Business-type activities - These services are provided on a charge for goods or services basis to recover all or a significant portion of the expenses of the goods or services provided. The City's water, sewer, refuse and utility deposits operations are reported here.

Reporting the City's Most Significant Funds

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Fund financial reports provide detailed information about the City's major funds. The City uses many funds to account for a multitude of financial transactions. However, these fund financial statements focuses on the City's most significant funds. The analysis of the City's major governmental and proprietary funds begins on page 10.

Governmental Funds

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

CITY OF DEFIANCE, OHIO

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2005
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Because the focus of the governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, the readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains a multitude of individual governmental funds. The City has segregated these funds into major funds and nonmajor funds. The City's major governmental funds are the general fund and Capital Improvements fund. Information for major funds is presented separately in the governmental fund balance sheet and in the governmental statement of revenues, expenditures, and changes in fund balances. Data from the other governmental funds are combined into a single, aggregated presentation. The basic governmental fund financial statements can be found on pages 20-24 of this report.

Proprietary Funds

The City maintains two different types of proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses enterprise funds to account for its water, sewer, refuse and utility deposits management functions. The City's major enterprise funds are the water and sewer funds. Internal service funds are an accounting device used to accumulate and allocate costs internally among the City's various functions. The basic proprietary fund financial statements can be found on pages 25-28 of this report.

Fiduciary Funds

Fiduciary funds are used to account for resources held for the benefit of parties outside the City. Fiduciary funds are not reflected in the government-wide financial statement because the resources of those funds are not available to support the City's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. Agency funds are the City's only fiduciary fund type. The basic fiduciary fund financial statement can be found on page 29 of this report.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. These notes to the basic financial statements can be found on pages 30-61 of this report.

CITY OF DEFIANCE, OHIO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2005
UNAUDITED

Government-Wide Financial Analysis

The net assets of the governmental and business-type activities have been restated as described in Note 3 to the financial statements. The table below provides a summary of the City's net assets for 2005 and 2004:

	Net Assets					
	Governmental	Business-type	Restated	Restated		Restated
	Activities	Activities	Governmental	Business-type	2005	2004
	<u>2005</u>	<u>2005</u>	<u>2004</u>	<u>2004</u>	<u>Total</u>	<u>Total</u>
<u>Assets</u>						
Current and other assets	\$ 11,338,620	\$ 5,892,281	\$ 10,703,990	\$ 3,797,391	\$ 17,230,901	\$ 14,501,381
Capital assets	<u>14,408,720</u>	<u>35,148,376</u>	<u>14,567,837</u>	<u>35,206,539</u>	<u>49,557,096</u>	<u>49,774,376</u>
Total assets	<u>25,747,340</u>	<u>41,040,657</u>	<u>25,271,827</u>	<u>39,003,930</u>	<u>66,787,997</u>	<u>64,275,757</u>
<u>Liabilities</u>						
Long-term liabilities outstanding	2,020,127	23,936,112	2,128,366	25,104,107	25,956,239	27,232,473
Other liabilities	<u>2,591,220</u>	<u>4,758,371</u>	<u>2,360,470</u>	<u>1,951,213</u>	<u>7,349,591</u>	<u>4,311,683</u>
Total liabilities	<u>4,611,347</u>	<u>28,694,483</u>	<u>4,488,836</u>	<u>27,055,320</u>	<u>33,305,830</u>	<u>31,544,156</u>
<u>Net Assets</u>						
Invested in capital assets, net of related debt	12,348,500	7,214,254	12,166,650	8,637,432	19,562,754	20,804,082
Restricted	4,527,719	-	4,356,637	-	4,527,719	4,356,637
Unrestricted	<u>4,259,774</u>	<u>5,131,920</u>	<u>4,259,704</u>	<u>3,311,178</u>	<u>9,391,694</u>	<u>7,570,882</u>
Total net assets	<u>\$ 21,135,993</u>	<u>\$ 12,346,174</u>	<u>\$ 20,782,991</u>	<u>\$ 11,948,610</u>	<u>\$ 33,482,167</u>	<u>\$ 32,731,601</u>

Over time, net assets can serve as a useful indicator of a government's financial position. At December 31, 2005, the City's assets exceeded liabilities by \$33,482,167. At year-end, net assets were \$21,135,993 and \$12,346,174 for the governmental activities and the business-type activities, respectively.

Capital assets reported on the government-wide statements represent the largest portion of the City's net assets. At year-end, capital assets represented 74.20% of total assets. Capital assets include land, buildings and improvements, improvements other than buildings, equipment, vehicles and infrastructure. Capital assets, net of related debt to acquire the assets at December 31, 2005, were \$12,348,500 and \$7,214,254 in the governmental activities and business-type activities, respectively. These capital assets are used to provide services to citizens and are not available for future spending. Although the City's investment in capital assets is reported net of related debt, it should be noted that the resources to repay the debt must be provided from other sources, since capital assets may not be used to liquidate these liabilities.

As of December 31, 2005, the City is able to report positive balances in all three categories of net assets, both for the government as a whole, as well as for its separate governmental and business-type activities.

A portion of the City's net assets, \$4,527,719, represents resources that are subject to external restriction on how they may be used. In the governmental activities, the remaining balance of unrestricted net assets of \$4,259,774 may be used to meet the government's ongoing obligations to citizens and creditors.

CITY OF DEFIANCE, OHIO

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

The net assets of the governmental and business-type activities have been restated as described in Note 3 to the financial statements. The table below shows the changes in net assets for fiscal year 2005 and 2004.

	Change in Net Assets					
	Governmental	Business-type	Governmental	Business-type	2005	2004
	Activities	Activities	Activities	Activities	Total	Total
	<u>2005</u>	<u>2005</u>	<u>2004</u>	<u>2004</u>		
Revenues						
Program revenues:						
Charges for services	\$ 2,060,207	\$ 7,514,875	\$ 1,689,230	\$ 7,592,953	\$ 9,575,082	\$ 9,282,183
Operating grants and contributions	<u>1,276,237</u>	<u>454,589</u>	<u>1,193,356</u>	<u>255,064</u>	<u>1,730,826</u>	<u>1,448,420</u>
Total program revenues	<u>3,336,444</u>	<u>7,969,464</u>	<u>2,882,586</u>	<u>7,848,017</u>	<u>11,305,908</u>	<u>10,730,603</u>
General revenues:						
Property taxes	855,142	-	877,410	-	855,142	877,410
Income taxes	6,323,614	-	6,052,905	-	6,323,614	6,052,905
Unrestricted grants and entitlements	761,789	-	846,451	-	761,789	846,451
Investment earnings	190,327	107,930	85,767	34,491	298,257	120,258
Miscellaneous	<u>615,868</u>	<u>46,875</u>	<u>353,772</u>	<u>65,821</u>	<u>662,743</u>	<u>419,593</u>
Total general revenues	<u>8,746,740</u>	<u>154,805</u>	<u>8,216,305</u>	<u>100,312</u>	<u>8,901,545</u>	<u>8,316,617</u>
Total revenues	<u>12,083,184</u>	<u>8,124,269</u>	<u>11,098,891</u>	<u>7,948,329</u>	<u>20,207,453</u>	<u>19,047,220</u>
Expenses:						
General government	3,000,979	-	2,490,843	-	3,000,979	2,490,843
Security of persons and property	4,576,342	-	4,993,929	-	4,576,342	4,993,929
Public health and welfare	243,875	-	316,518	-	243,875	316,518
Transportation	2,122,467	-	1,087,018	-	2,122,467	1,087,018
Community environment	403,071	-	440,540	-	403,071	440,540
Leisure time activity	825,764	-	1,020,436	-	825,764	1,020,436
Economic development	423,379	-	112,177	-	423,379	112,177
Intergovernmental	-	-	6,129	-	-	6,129
Other	6,460	-	55,125	-	6,460	55,125
Interest and fiscal charges	127,845	-	75,737	-	127,845	75,737
Water	-	3,700,775	-	3,486,248	3,700,775	3,486,248
Sewer	-	3,482,750	-	4,112,246	3,482,750	4,112,246
Refuse	-	<u>543,180</u>	-	<u>543,170</u>	<u>543,180</u>	<u>543,170</u>
Total expenses	<u>11,730,182</u>	<u>7,726,705</u>	<u>10,598,452</u>	<u>8,141,664</u>	<u>19,456,887</u>	<u>18,740,116</u>
Special item	-	-	1,983,137	-	-	1,983,137
Extraordinary item	-	-	260,683	-	-	260,683
Transfers	-	-	<u>(1,026,313)</u>	<u>1,026,313</u>	-	-
Change in net assets	353,002	397,564	1,717,946	832,978	750,566	2,550,924
Net assets, beg. of year (restated)	<u>20,782,991</u>	<u>11,948,610</u>	<u>19,065,045</u>	<u>11,115,632</u>	<u>32,731,601</u>	<u>30,180,677</u>
Net assets, end of year	<u>\$ 21,135,993</u>	<u>\$ 12,346,174</u>	<u>\$ 20,782,991</u>	<u>\$ 11,948,610</u>	<u>\$ 33,482,167</u>	<u>\$ 32,731,601</u>

CITY OF DEFIANCE, OHIO

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

Governmental Activities

Governmental activities net assets increased \$353,002 in 2005. This increase is a result of slightly decreasing expenses and an increase in municipal income tax revenue.

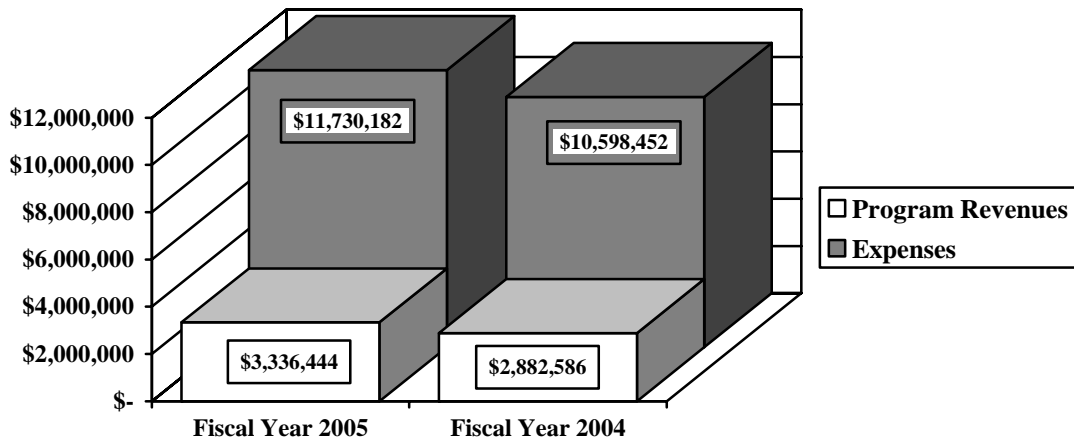
Security of persons and property, which primarily supports the operations of the police and fire departments accounted for \$4,576,342 of the total expenses of the City. These expenses were partially funded by \$1,082,726 in direct charges to users of the services. Transportation expenses totaled \$2,122,467. Transportation expenses were partially funded by \$792,776 in operating grants and contributions.

The state and federal government contributed to the City a total of \$1,276,237 in operating grants and contributions. These revenues are restricted to a particular program or purpose. Of the total operating grants and contributions, \$483,461 subsidized general government programs.

General revenues totaled \$8,746,740, and amounted to 72.39% of total governmental revenues. These revenues primarily consist of property and income tax revenue of \$7,178,756. The other primary source of general revenues is grants and entitlements not restricted to specific programs, including local government and local government revenue assistance, making up \$761,789.

The statement of activities shows the cost of program services and the charges for services and grants offsetting those services. The following table shows, for governmental activities, the total cost of services and the net cost of services. That is, it identifies the cost of these services supported by tax revenue and unrestricted State grants and entitlements. As can be seen in the graph below, the City is highly dependent upon property and income taxes as well as unrestricted grants and entitlements to support its governmental activities.

Governmental Activities – Program Revenues vs. Total Expenses



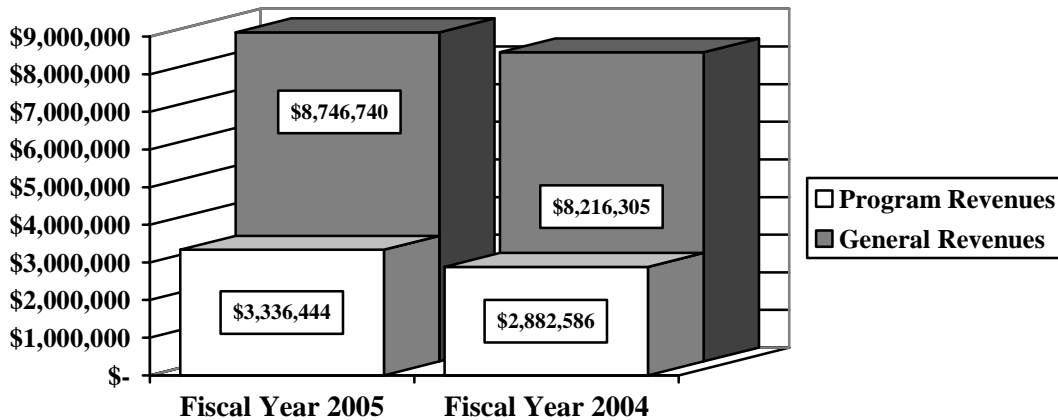
CITY OF DEFIANCE, OHIO

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

	Governmental Activities			
	Total Cost of Services <u>2005</u>	Net Cost of Services <u>2005</u>	Total Cost of Services <u>2004</u>	Net Cost of Services <u>2004</u>
Program Expenses:				
General government	\$ 3,000,979	\$ 1,955,758	\$ 2,490,843	\$ 1,370,894
Security of persons and property	4,576,342	3,493,616	4,993,929	3,985,675
Public health and welfare	243,875	178,334	316,518	247,527
Transportation	2,122,467	1,329,691	1,087,018	577,580
Community environment	403,071	84,187	440,540	311,160
Leisure time activity	825,764	799,151	1,020,436	1,003,791
Economic development	423,379	418,696	112,177	82,248
Intergovernmental	-	-	6,129	6,129
Other	6,460	6,460	55,125	55,125
Interest and fiscal charges	<u>127,845</u>	<u>127,845</u>	<u>75,737</u>	<u>75,737</u>
Total	<u>\$ 11,730,182</u>	<u>\$ 8,393,738</u>	<u>\$ 10,598,452</u>	<u>\$ 7,715,866</u>

The dependence upon general revenues for governmental activities is apparent, with 71.56% of expenses supported through taxes and other general revenues.

Governmental Activities – General and Program Revenues

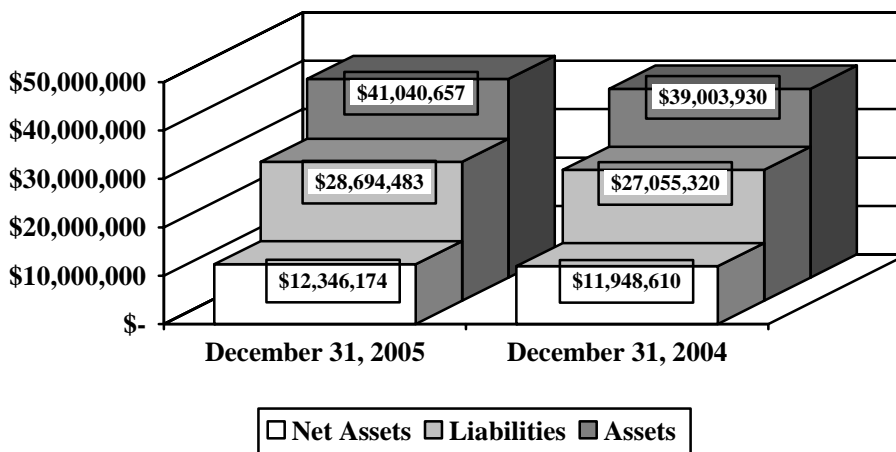


CITY OF DEFIANCE, OHIO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2005
UNAUDITED

Business-type Activities

Business-type activities include the water, sewer, refuse and utility deposit enterprise funds. These programs had program revenues of \$7,969,464, general revenues of \$154,805 and expenses of \$7,726,705 for 2005. Net assets of the business-type activities at December 31, 2004 have been restated as described in Note 3 to the financial statements. The graph below shows the business-type activities assets, liabilities and net assets at year-end.

Net Assets in Business – Type Activities



Financial Analysis of the Government's Funds

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds

The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unreserved fund balance may serve as a useful measure of the City's net resources available for spending at year-end.

The schedule below indicates the fund balances and the total change in fund balances as of December 31, 2005 for all major and nonmajor governmental funds.

	Fund Balances 12/31/05	Fund Balances 12/31/04	Increase (Decrease)
Major funds:			
General	\$ 2,824,697	\$ 1,926,468	\$ 898,229
Capital improvements	504,929	578,783	(73,854)
Other nonmajor governmental funds	3,408,673	3,019,463	389,210
Total	\$ 6,738,299	\$ 5,524,714	\$ 1,213,585

CITY OF DEFIANCE, OHIO

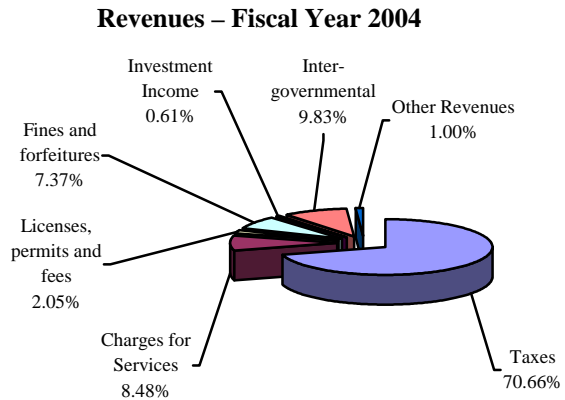
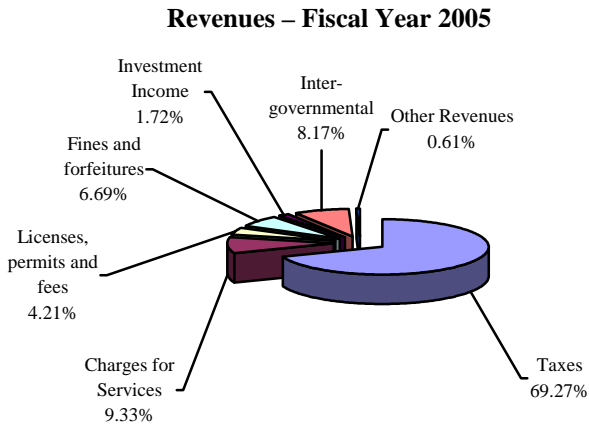
**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2005
UNAUDITED**

General Fund

The City's general fund balance increased \$898,229. The table that follows assists in illustrating the revenues of the general fund.

	<u>2005</u> <u>Amount</u>	<u>2004</u> <u>Amount</u>	<u>Percentage</u> <u>Change</u>
<u>Revenues</u>			
Taxes	\$ 5,522,780	\$ 5,110,717	8.06 %
Charges for services	743,495	613,550	21.18 %
Licenses, permits and fees	335,899	148,319	126.47 %
Fines and forfeitures	533,087	533,387	(0.06) %
Investment income	137,439	44,196	210.98 %
Intergovernmental	651,561	711,398	(8.41) %
Other	48,104	72,165	(33.34) %
Total	<u>\$ 7,972,365</u>	<u>\$ 7,233,732</u>	10.21 %

Tax revenue represents 69.27% of all general fund revenue. Tax revenue increased slightly by 8.06% from the prior year. The increase in investment income is due to additional investments held by the City during the year. The increase in licenses, permits and fees is a result of a higher number of permits and licenses issued. All other revenue remained comparable to 2004.



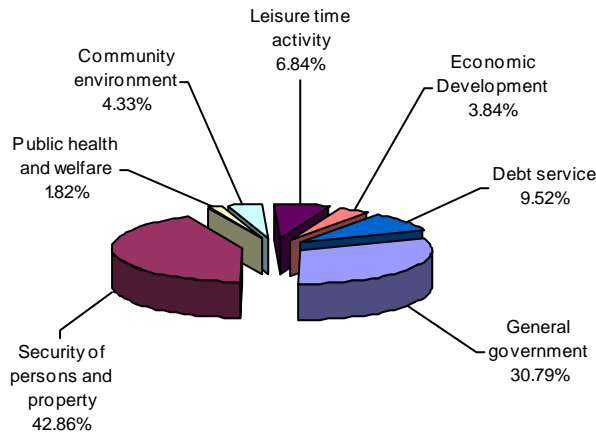
CITY OF DEFIANCE, OHIO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2005
UNAUDITED

The table that follows assists in illustrating the expenditures of the general fund.

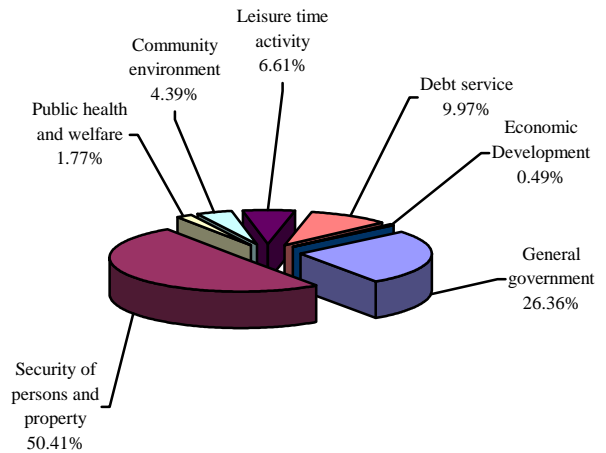
	<u>2005</u> <u>Amount</u>	<u>2004</u> <u>Amount</u>	<u>Percentage</u> <u>Change</u>
<u>Expenditures</u>			
General government	\$ 2,505,249	\$ 2,031,496	23.32 %
Security of persons and property	3,486,696	3,885,688	(10.27) %
Public health and welfare	148,132	136,487	8.53 %
Community environment	352,314	338,152	4.19 %
Leisure time activity	556,414	509,370	9.24 %
Economic development	312,722	37,392	736.33 %
Debt service	774,844	768,660	0.80 %
Total	<u>\$ 8,136,371</u>	<u>\$ 7,707,245</u>	5.57 %

The most significant increase was in the area of economic development. This increase is due to a larger number of development expenses incurred by the City. All other expenditures remained comparable to 2004.

Expenditures - Fiscal Year 2005



Expenditures - Fiscal Year 2004



Capital Improvements Fund

The capital improvements fund had revenues of \$1,697,848 in 2005. This represents an increase of \$159,303 from 2004 revenues. The expenditures of the capital improvements fund, which totaled \$1,771,702 in 2005, decreased \$52,908 from 2004. The net decrease in fund balance for the capital improvements fund was \$73,854 or 12.76%.

CITY OF DEFIANCE, OHIO

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

Budgeting Highlights

The City's budgeting process is prescribed by the Ohio Revised Code (ORC). Essentially the budget is the City's appropriations which are restricted by the amounts of anticipated revenues certified by the Budget Commission in accordance with the ORC. Therefore, the City's plans or desires cannot be totally reflected in the original budget. If budgeted revenues are adjusted due to actual activity then the appropriations can be adjusted accordingly.

Budgetary information is presented for the general fund. In the general fund, the actual revenues and other financing sources came in \$394,540 higher than they were in the final budget and actual expenditures and other financing uses were \$456,560 lower than the amount in the final budget. These positive variances are the result of the City's conservative budgeting. Budgeted revenues and other financing sources increased \$1,276,466 from the original to the final budget. Budgeted expenditures and other financing uses increased \$1,069,607 from the original to the final budget due primarily to an increase in the cost of general government expenditures.

Proprietary Funds

The City's proprietary funds provide the same type of information found in the government-wide financial statements for business-type activities, except in more detail. The only difference between the amounts reported as business-type activities and the amounts reported in the proprietary fund statements are interfund eliminations between proprietary funds and internal balances due to governmental activities for internal service activities. The only interfund activity reported in the government wide statements are those between business-type activities and governmental activities (reported as internal balances and transfers) whereas interfund amounts between various enterprise funds, are reported in the proprietary fund statements.

Capital Assets and Debt Administration

Capital Assets

At the end of fiscal 2005, the City had \$49,557,096 (net of accumulated depreciation) invested in land, buildings and improvements, improvements other than buildings (IOTB), equipment, vehicles, infrastructure and construction in progress. Of this total, \$14,408,720 was reported in governmental activities and \$35,148,376 was reported in business-type activities. The balance of the City's capital assets have been restated as described in Note 3 to the financial statements. The following table shows fiscal 2005 balances compared to 2004:

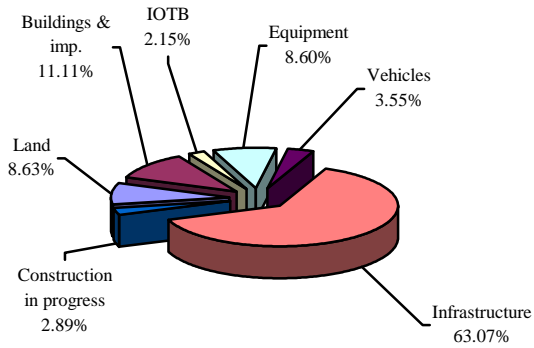
**Capital Assets at December 31
(Net of Depreciation)**

	<u>Governmental Activities</u>		<u>Business-Type Activities</u>		<u>Total</u>	
	<u>2005</u>	<u>Restated 2004</u>	<u>2005</u>	<u>Restated 2004</u>	<u>2005</u>	<u>Restated 2004</u>
Land	\$ 1,243,358	\$ 1,243,358	\$ 267,100	\$ 267,100	\$ 1,510,458	\$ 1,510,458
IOTB	309,131	345,666	400,680	432,132	709,811	777,798
Buildings and improvements	1,602,920	1,730,220	21,783,575	22,415,867	23,386,495	24,146,087
Equipment	1,239,054	1,231,552	218,725	241,252	1,457,779	1,472,804
Vehicles	511,053	527,493	130,282	187,706	641,335	715,199
Infrastructure	9,087,287	9,489,548	10,568,147	9,793,628	19,655,434	19,283,176
Construction in progress	<u>415,917</u>	<u>-</u>	<u>1,779,867</u>	<u>1,868,854</u>	<u>2,195,784</u>	<u>1,868,854</u>
Totals	<u>\$ 14,408,720</u>	<u>\$ 14,567,837</u>	<u>\$ 35,148,376</u>	<u>\$ 35,206,539</u>	<u>\$ 49,557,096</u>	<u>\$ 49,774,376</u>

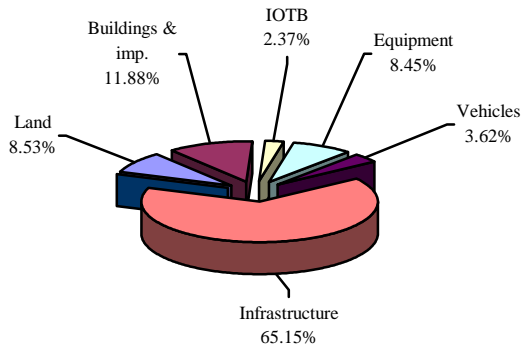
CITY OF DEFIANCE, OHIO
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005
UNAUDITED

The following graphs show the breakdown of governmental capital assets by category for 2005 and 2004.

Capital Assets - Governmental Activities 2005



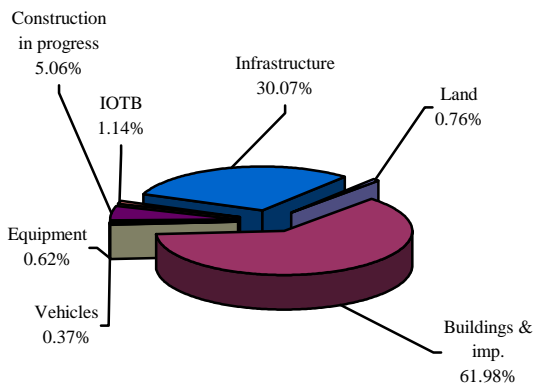
Capital Assets - Governmental Activities 2004



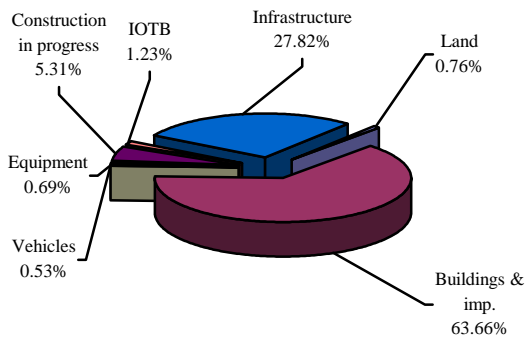
In 2005, the City retroactively reported its infrastructure assets. The capital asset category infrastructure includes roads, bridges, culverts, sidewalks and curbs. These items are immovable and of value only to the City, however, the annual cost of purchasing these items is quite significant. The net book value of the City's infrastructure (cost less accumulated depreciation), represents approximately 63.07% of the City's total governmental capital assets.

The following graphs show the breakdown of business-type capital assets by category for 2005 and 2004.

Capital Assets - Business-Type Activities 2005



Capital Assets - Business-Type Activities 2004



The City's second largest business-type capital asset category is infrastructure that primarily includes water and sewer lines. These items play a vital role in the income producing ability of the business-type activities. The net book value of the City's infrastructure (cost less accumulated depreciation) represents approximately 30.07% of the City's total business-type capital assets.

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

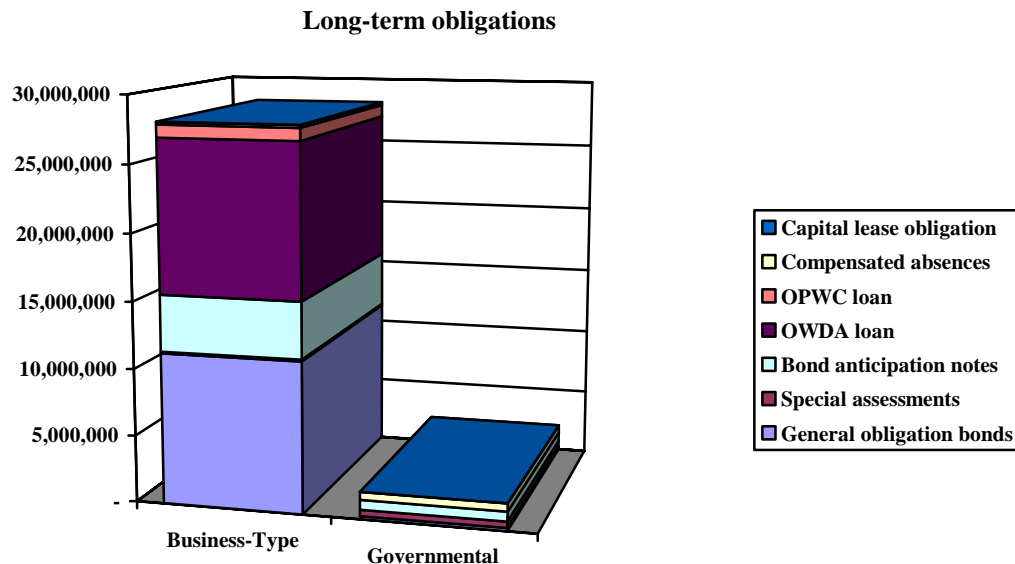
Debt Administration

The City had the following long-term obligations outstanding at December 31, 2005 and 2004:

	Governmental Activities	
	<u>2005</u>	<u>2004</u>
Compensated absences	\$ 594,907	\$ 562,179
General obligation bonds	230,000	260,000
Special assessment bonds	473,220	546,187
Bond anticipation notes	<u>722,000</u>	<u>760,000</u>
Total long-term obligations	<u>\$ 2,020,127</u>	<u>\$ 2,128,366</u>

	Business-type Activities	
	<u>2005</u>	<u>2004</u>
General obligation bonds	\$ 11,307,568	\$ 11,625,000
Special assessment bonds	124,844	130,013
OWDA loan	11,372,326	12,145,142
OPWC loan	918,595	988,105
Bond anticipation notes	4,185,600	1,465,000
Capital lease obligation	25,189	-
Compensated absences	<u>187,590</u>	<u>215,847</u>
Total long-term obligations	<u>\$ 28,121,712</u>	<u>\$ 26,569,107</u>

A comparison of the long-term obligations by category is depicted in the chart below.



CITY OF DEFIANCE, OHIO

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

Economic Conditions and Outlook

Defiance is the commercial and industrial hub of the six-county Northwest Ohio area. It is conveniently located within a one-hour drive of Toledo and Fort Wayne. Cleveland, Cincinnati, Detroit and Chicago are all within an easy drive of Defiance. An excellent system of state and U.S. highways serves the transportation needs of the community. Intersecting in Defiance are state routes 18, 15, 66, 281, 424 and 111, and U.S. 24, a major route between Fort Wayne and Toledo.

Ranked in the Top 100 U.S. Small Towns according to "Site Selection" magazine, the City of Defiance has taken a proactive approach to developing new industry. In particular, R & L Enterprise Park on the west side of Defiance offers an excellent site for manufacturing, warehousing, service business or office needs. It consists of 750 acres of flat to gently rolling land which has access to two gas service providers as well as feasibility of two railroads servicing the site. Additionally, the north corridor of the City and the Elliott Road area has been primed for development. The City and Defiance County have worked together for funding for roadway improvements and installation of a waterline. The City continues to attract interest by introducing new incentives through tax increment financing, enterprise zone agreements, and revolving loans in cooperation with the Defiance County Economic Development Office.

Recently, the Ohio Department of Transportation (ODOT) has engineered plans to provide a connector road from West High Street to Ralston Avenue as part of the U.S. 24 improvements that they anticipate will take place over the next 3 to 5 years. Also, ODOT is making the necessary provisions for an interchange at St. Rt. 281 and U.S. 24. Once this interchange is complete, ODOT will be working with City officials on the expansion of the overpass at St. Rt. 66 and U.S. 24. The City and ODOT have already agreed to engineering, Right of Way and construction issues for this overpass expansion as part of the 2009-2010 ODOT plan. In preparation for the U.S. 24 project which will widen the current two-lane roadway to a four-lane expressway from Toledo, Ohio to Ft. Wayne, Indiana, the City of Defiance and ODOT have been planning for upgrades to the downtown signalization system. These upgrades are necessary in order to handle the detoured traffic during the construction of the U.S. 24 project.

In addition to the above roadway improvements, planning for the construction of an above ground 120 day reservoir continues.

Public and private cooperation and support is widespread as demonstrated by the City making an application to become part of the Main Street USA program.

The City of Defiance is poised for significant positive economic changes. The City voters passed a two-tenths percent income tax in May 2005 which became effective June 2005. Additionally, the City Council is considering rate increases for its water and sewer customers to become effective in 2006.

The difficult economic conditions that surround local governments in the State of Ohio are well known, but City government believes it is taking the steps necessary to ensure a future of continued economic growth.

Contacting the City's Financial Management

This financial report is designed to provide our citizen's, taxpayers, and investors and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional financial information contact: Mr. John Seele, Finance Director, City of Defiance, 631 Perry Street, Defiance, Ohio 43512.

**BASIC
FINANCIAL STATEMENTS**

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CITY OF DEFIANCE, OHIO

STATEMENT OF NET ASSETS
DECEMBER 31, 2005

	Governmental Activities	Business-type Activities	Total
Assets:			
Equity in pooled cash and cash equivalents.	\$ 5,414,970	\$ 5,022,336	\$ 10,437,306
Investments	267,911	-	267,911
Receivables (net of allowances for uncollectibles):			
Income taxes	1,657,587	-	1,657,587
Property and other local taxes	930,450	-	930,450
Accounts	265,139	299,275	564,414
Loans.	785,219	-	785,219
Special assessments	486,636	203,581	690,217
Accrued interest	4,894	-	4,894
Due from other governments	1,408,366	-	1,408,366
Materials and supplies inventory	45,080	35,315	80,395
Prepayments	90,531	-	90,531
Internal balance.	(18,163)	18,163	-
Unamortized bond issuance costs	-	102,568	102,568
Restricted assets:			
Equity in pooled cash and cash equivalents	-	211,043	211,043
Capital assets:			
Land and construction-in-progress	1,659,275	2,046,967	3,706,242
Depreciable capital assets, net	12,749,445	33,101,409	45,850,854
Total capital assets.	<u>14,408,720</u>	<u>35,148,376</u>	<u>49,557,096</u>
Total assets.	<u>25,747,340</u>	<u>41,040,657</u>	<u>66,787,997</u>
Liabilities:			
Accounts payable	237,498	121,744	359,242
Accrued wages and benefits	82,681	33,288	115,969
Due to other governments.	627,800	99,602	727,402
Due to claimants.	28,553	-	28,553
Accrued interest payable.	17,656	107,094	124,750
Payable from restricted assets:			
Refunded deposits	-	211,043	211,043
Deferred revenue.	825,926	-	825,926
Claims payable.	136,106	-	136,106
Bond anticipation notes payable.	635,000	4,185,600	4,820,600
Long-term liabilities:			
Due within one year.	1,081,432	1,436,901	2,518,333
Due in more than one year	938,695	22,499,211	23,437,906
Total liabilities.	<u>4,611,347</u>	<u>28,694,483</u>	<u>33,305,830</u>
Net assets:			
Invested in capital assets, net of related debt	12,348,500	7,214,254	19,562,754
Restricted for:			
Capital projects	535,747	-	535,747
Debt service.	1,188,950	-	1,188,950
Other purposes	2,803,022	-	2,803,022
Unrestricted	<u>4,259,774</u>	<u>5,131,920</u>	<u>9,391,694</u>
Total net assets	<u>\$ 21,135,993</u>	<u>\$ 12,346,174</u>	<u>\$ 33,482,167</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF DEFIANCE, OHIO

STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2005

		<u>Program Revenues</u>	
	<u>Expenses</u>	<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>
Governmental Activities:			
General government	\$ 3,000,979	\$ 561,760	\$ 483,461
Security of persons and property	4,576,342	1,082,726	-
Public health and welfare	243,875	65,541	-
Transportation	2,122,467	-	792,776
Community environment	403,071	318,884	-
Leisure time activity	825,764	26,613	-
Economic development	423,379	4,683	-
Other	6,460	-	-
Interest and fiscal charges	127,845	-	-
Total governmental activities	<u>11,730,182</u>	<u>2,060,207</u>	<u>1,276,237</u>
Business-type Activities:			
Water	3,700,775	3,523,194	11,307
Sewer	3,482,750	3,381,425	443,282
Other enterprise fund:			
Refuse	543,180	610,256	-
Total business-type activities	<u>7,726,705</u>	<u>7,514,875</u>	<u>454,589</u>
Total primary government	<u>\$ 19,456,887</u>	<u>\$ 9,575,082</u>	<u>\$ 1,730,826</u>

General Revenues:

Income taxes levied for:	
General purposes	
Special purposes	
Capital purposes	
Property taxes levied for:	
General purposes	
Special purposes	
Grants and entitlements not restricted	
to specific programs	
Investment earnings	
Miscellaneous	
Total general revenues	
Change in net assets	
Net assets at beginning of year (restated)	
Net assets at end of year	

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

Net Revenue (Expense) and Changes in Net Assets

Governmental Activities	Business-type Activities	Total
\$ (1,955,758)	\$ -	\$ (1,955,758)
(3,493,616)	-	(3,493,616)
(178,334)	-	(178,334)
(1,329,691)	-	(1,329,691)
(84,187)	-	(84,187)
(799,151)	-	(799,151)
(418,696)	-	(418,696)
(6,460)	-	(6,460)
(127,845)	-	(127,845)
<u>(8,393,738)</u>	<u>-</u>	<u>(8,393,738)</u>
-	(166,274)	(166,274)
-	341,957	341,957
-	67,076	67,076
<u>-</u>	<u>242,759</u>	<u>242,759</u>
<u>(8,393,738)</u>	<u>242,759</u>	<u>(8,150,979)</u>
4,890,763	-	4,890,763
23,490	-	23,490
1,409,361	-	1,409,361
580,184	-	580,184
274,958	-	274,958
761,789	-	761,789
190,327	107,930	298,257
615,868	46,875	662,743
<u>8,746,740</u>	<u>154,805</u>	<u>8,901,545</u>
353,002	397,564	750,566
<u>20,782,991</u>	<u>11,948,610</u>	<u>32,731,601</u>
<u>\$ 21,135,993</u>	<u>\$ 12,346,174</u>	<u>\$ 33,482,167</u>

CITY OF DEFIANCE, OHIO

BALANCE SHEET
GOVERNMENTAL FUNDS
DECEMBER 31, 2005

	<u>General</u>	<u>Capital Improvements</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Assets:				
Equity in pooled cash and cash equivalents.	\$ 1,431,487	\$ 1,146,702	\$ 2,445,242	\$ 5,023,431
Investments	267,911	-	-	267,911
Receivables (net of allowance for uncollectibles):				
Income taxes.	1,268,692	382,519	6,376	1,657,587
Property and other local taxes.	721,050	-	209,400	930,450
Accounts.	216,623	-	48,516	265,139
Loans	-	-	785,219	785,219
Special assessments	-	-	486,636	486,636
Accrued interest.	4,894	-	-	4,894
Prepayments	90,531	-	-	90,531
Due from other governments.	1,081,059	-	327,307	1,408,366
Materials and supplies inventory.	-	-	45,080	45,080
Total assets	<u>\$ 5,082,247</u>	<u>\$ 1,529,221</u>	<u>\$ 4,353,776</u>	<u>\$ 10,965,244</u>
Liabilities:				
Accounts payable.	\$ 156,851	\$ 38,600	\$ 42,047	\$ 237,498
Accrued wages and benefits	75,066	-	7,615	82,681
Due to other governments	263,741	317,863	46,196	627,800
Accrued interest payable	-	2,011	-	2,011
Bond anticipation note payable.	-	635,000	-	635,000
Due to claimants	28,553	-	-	28,553
Deferred revenue.	1,733,339	30,818	849,245	2,613,402
Total liabilities	<u>2,257,550</u>	<u>1,024,292</u>	<u>945,103</u>	<u>4,226,945</u>
Fund balances:				
Reserved for encumbrances	110,565	461,704	55,874	628,143
Reserved for materials and supplies inventory.	-	-	45,080	45,080
Reserved for prepayments	90,531	-	-	90,531
Reserved for loans	-	-	785,219	785,219
Reserved for debt service	-	-	728,885	728,885
Reserved for noncurrent investments	267,911	-	-	267,911
Unreserved undesignated, reported in:				
General fund	2,355,690	-	-	2,355,690
Special revenue funds.	-	-	1,793,615	1,793,615
Capital projects funds.	-	43,225	-	43,225
Total fund balances.	<u>2,824,697</u>	<u>504,929</u>	<u>3,408,673</u>	<u>6,738,299</u>
Total liabilities and fund balances	<u>\$ 5,082,247</u>	<u>\$ 1,529,221</u>	<u>\$ 4,353,776</u>	<u>\$ 10,965,244</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF DEFIANCE, OHIO

RECONCILIATION OF TOTAL GOVERNMENTAL FUND BALANCES
TO NET ASSETS OF GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2005

Total governmental fund balances		\$ 6,738,299
<i>Amounts reported for governmental activities on the statement of net assets are different because:</i>		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.		14,408,720
Other long-term assets are not available to pay for current period expenditures and therefore are deferred in the funds.		
Income tax	\$ 133,546	
Property and other local taxes	76,050	
Special assessments	475,710	
Intergovernmental	1,097,276	
Interest	4,894	
Total		1,787,476
An internal service fund is used by management to charge the costs of health care to individual funds. The assets and liabilities of the internal service fund is included in governmental activities on the statement of net assets. The net assets of the internal service fund, including an internal balance of \$(18,163), are:		237,270
Accrued interest payable is not due and payable in the current period and therefore is not reported in the funds.		(15,645)
Long-term liabilities, including bonds payable, are not due and payable long-term liabilities are as follows: funds) are as follows:		
General obligation bonds	\$ 230,000	
Special assessment bonds	473,220	
Bond anticipation notes	722,000	
Compensated absences	594,907	
Total		<u>(2,020,127)</u>
Net assets of governmental activities		<u>\$ 21,135,993</u>

CITY OF DEFIANCE, OHIO

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2005

	<u>General</u>	<u>Capital Improvements</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
Revenues:				
Income taxes	\$ 4,971,240	\$ 1,433,626	\$ 23,894	\$ 6,428,760
Property and other local taxes	551,540	-	274,958	826,498
Charges for services	743,495	-	96,162	839,657
Licenses, permits and fees	335,899	-	127,454	463,353
Fines and forfeitures	533,087	-	224,110	757,197
Intergovernmental	651,561	-	1,291,270	1,942,831
Special assessments	-	-	146,712	146,712
Investment income	137,439	-	41,441	178,880
Other	48,104	264,222	303,542	615,868
Total revenues.	<u>7,972,365</u>	<u>1,697,848</u>	<u>2,529,543</u>	<u>12,199,756</u>
Expenditures:				
Current:				
General government	2,505,249	-	393,985	2,899,234
Security of persons and property.	3,486,696	-	705,398	4,192,094
Public health and welfare	148,132	-	-	148,132
Transportation	-	-	766,292	766,292
Community environment.	352,314	-	-	352,314
Leisure time activity	556,414	-	-	556,414
Economic development and assistance	312,722	-	110,657	423,379
Other	-	-	6,460	6,460
Capital outlay.	-	1,714,938	413,795	2,128,733
Debt service:				
Principal retirement	760,000	-	102,967	862,967
Interest and fiscal charges	14,844	56,764	50,544	122,152
Total expenditures	<u>8,136,371</u>	<u>1,771,702</u>	<u>2,550,098</u>	<u>12,458,171</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(164,006)</u>	<u>(73,854)</u>	<u>(20,555)</u>	<u>(258,415)</u>
Other financing sources (uses):				
Issuance of notes	722,000	-	-	722,000
Transfers in	-	-	409,765	409,765
Transfers out	(409,765)	-	-	(409,765)
Sale of capital assets.	750,000	-	-	750,000
Total other financing sources (uses)	<u>1,062,235</u>	<u>-</u>	<u>409,765</u>	<u>1,472,000</u>
Net change in fund balances	898,229	(73,854)	389,210	1,213,585
Fund balances at beginning of year	<u>1,926,468</u>	<u>578,783</u>	<u>3,019,463</u>	<u>5,524,714</u>
Fund balances at end of year	<u>\$ 2,824,697</u>	<u>\$ 504,929</u>	<u>\$ 3,408,673</u>	<u>\$ 6,738,299</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF DEFIANCE, 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 \$ 1,213,585

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

Government funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets are allocated over their estimated useful lives as depreciation expense. This is the amount by which depreciation expense exceeded capital outlays in the current period.

Capital asset additions	788,101	
Current year depreciation	(927,857)	
Total		(139,756)

Governmental funds only report the disposal of capital assets to the extent proceeds are received from the sale. In the statement of activities, a gain or loss is reported for each disposal. (19,361)

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

Income taxes	(105,146)	
Property and other local taxes	28,644	
Special assessments	(116,478)	
Intergovernmental	(685,039)	
Interest	4,894	
Total		(873,125)

Proceeds of notes are reported as an other financing source in the governmental funds, but as an increase in liabilities on the statement of net assets. (722,000)

Repayment of bonds and notes principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities on the statement of net assets. 862,967

In the statement of activities, interest is accrued on outstanding bonds, whereas in governmental funds, an interest expenditure is reported when due. (5,693)

Some expenses reported in the statement of activities, such as compensated absences, do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. (32,728)

The internal service fund used by management to charge the costs of health care to individual funds is not reported in the statement of activities. Governmental fund expenditures and the related internal service fund revenues are eliminated. The net revenue (expense) of the internal service fund, including the consolidation of internal service fund activity of \$2,612, is allocated among the governmental activities. 69,113

Change in net assets of governmental activities \$ 353,002

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF DEFIANCE, OHIO

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
 BUDGET AND ACTUAL (NON-GAAP BUDGETARY BASIS)
 GENERAL FUND
 FOR THE YEAR ENDED DECEMBER 31, 2005

	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variance with Final Budget Positive (Negative)</u>
	<u>Original</u>	<u>Final</u>		
Revenues:				
Income taxes	\$ 4,088,273	\$ 4,748,666	\$ 4,874,184	\$ 125,518
Property and other local taxes	454,726	528,180	551,540	23,360
Charges for services	489,009	568,000	646,354	78,354
Licenses, permits and fees	179,934	209,000	335,899	126,899
Fines and forfeitures	485,220	563,600	530,565	(33,035)
Intergovernmental	575,339	668,276	723,405	55,129
Investment income	67,755	78,700	137,438	58,738
Other	46,664	54,202	15,322	(38,880)
Total revenues.	<u>6,386,920</u>	<u>7,418,624</u>	<u>7,814,707</u>	<u>396,083</u>
Expenditures:				
Current:				
General government	3,333,322	3,794,180	3,605,340	188,840
Security of persons and property.	3,528,024	3,757,379	3,640,420	116,959
Public health and welfare	156,185	171,247	148,966	22,281
Community environment.	340,828	376,732	363,787	12,945
Leisure time activity	556,539	596,167	559,688	36,479
Economic development and assistance	63,243	322,043	312,722	9,321
Total expenditures	<u>7,978,141</u>	<u>9,017,748</u>	<u>8,630,923</u>	<u>386,825</u>
Deficiency of revenues under expenditures.	<u>(1,591,221)</u>	<u>(1,599,124)</u>	<u>(816,216)</u>	<u>782,908</u>
Other financing sources (uses):				
Sale of capital assets	645,698	750,000	750,000	-
Issuance of notes	621,592	722,000	722,000	-
Transfers in.	247,948	288,000	286,457	(1,543)
Transfers out	(382,000)	(412,000)	(342,265)	69,735
Total other financing sources (uses)	<u>1,133,238</u>	<u>1,348,000</u>	<u>1,416,192</u>	<u>68,192</u>
Net change in fund balance.	(457,983)	(251,124)	599,976	851,100
Fund balance at beginning of year	663,845	663,845	663,845	-
Prior year encumbrances appropriated	<u>244,607</u>	<u>244,607</u>	<u>244,607</u>	<u>-</u>
Fund balance at end of year.	<u>\$ 450,469</u>	<u>\$ 657,328</u>	<u>\$ 1,508,428</u>	<u>\$ 851,100</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF DEFIANCE, OHIO

STATEMENT OF NET ASSETS
 PROPRIETARY FUNDS
 DECEMBER 31, 2005

	Business-type Activities - Enterprise Funds				Governmental Activities - Internal Service Fund
	Water	Sewer	Nonmajor	Total	
Assets:					
Current assets:					
Equity in pooled cash and cash equivalents	\$ 1,107,835	\$ 3,559,237	\$ 355,264	\$ 5,022,336	\$ 391,539
Receivables (net of allowance for uncollectibles):					
Accounts	123,790	146,033	29,452	299,275	-
Special assessments	95,539	108,042	-	203,581	-
Materials and supplies inventory	24,576	10,739	-	35,315	-
Total current assets	<u>1,351,740</u>	<u>3,824,051</u>	<u>384,716</u>	<u>5,560,507</u>	<u>391,539</u>
Noncurrent assets:					
Restricted equity in pooled cash and cash equivalents.	-	-	211,043	211,043	-
Unamortized bond issuance costs	102,568	-	-	102,568	-
Capital assets:					
Land and construction-in-progress	449,922	1,597,045	-	2,046,967	-
Depreciable capital assets, net	<u>17,345,993</u>	<u>15,755,416</u>	<u>-</u>	<u>33,101,409</u>	<u>-</u>
Total capital assets	<u>17,795,915</u>	<u>17,352,461</u>	<u>-</u>	<u>35,148,376</u>	<u>-</u>
Total noncurrent assets	<u>17,898,483</u>	<u>17,352,461</u>	<u>211,043</u>	<u>35,461,987</u>	<u>-</u>
Total assets	<u>19,250,223</u>	<u>21,176,512</u>	<u>595,759</u>	<u>41,022,494</u>	<u>391,539</u>
Liabilities:					
Current liabilities:					
Accounts payable	75,094	46,650	-	121,744	-
Accrued wages and benefits	18,775	14,513	-	33,288	-
Claims payable	-	-	-	-	136,106
Due to other governments	56,409	43,193	-	99,602	-
Bond anticipation notes payable	84,500	4,101,100	-	4,185,600	-
General obligation bonds payable - current	455,000	-	-	455,000	-
OPWC loans payable - current	60,147	10,710	-	70,857	-
Special assessment bonds payable - current	-	5,467	-	5,467	-
Accrued interest payable	39,481	67,613	-	107,094	-
OWDA loans payable - current	-	819,944	-	819,944	-
Compensated absences -current	44,182	36,558	-	80,740	-
Capital lease obligation - current	3,064	1,829	-	4,893	-
Total current liabilities	<u>836,652</u>	<u>5,147,577</u>	<u>-</u>	<u>5,984,229</u>	<u>136,106</u>
Current liabilities payable from restricted assets:					
Refundable deposit	-	-	211,043	211,043	-
Noncurrent liabilities:					
Compensated absences	69,039	37,811	-	106,850	-
General obligation bonds payable (net of unamortized premium and deferred amount on refunding)	10,852,568	-	-	10,852,568	-
Special assessment bonds payable	-	119,377	-	119,377	-
OPWC loans payable	703,159	144,579	-	847,738	-
OWDA loans payable	-	10,552,382	-	10,552,382	-
Capital lease obligation	13,032	7,264	-	20,296	-
Total noncurrent liabilities	<u>11,637,798</u>	<u>10,861,413</u>	<u>-</u>	<u>22,499,211</u>	<u>-</u>
Total liabilities	<u>12,474,450</u>	<u>16,008,990</u>	<u>211,043</u>	<u>28,694,483</u>	<u>136,106</u>
Net assets:					
Invested in capital assets, net of related debt	5,624,445	1,589,809	-	7,214,254	-
Unrestricted	<u>1,151,328</u>	<u>3,577,713</u>	<u>384,716</u>	<u>5,113,757</u>	<u>255,433</u>
Total net assets	<u>\$ 6,775,773</u>	<u>\$ 5,167,522</u>	<u>\$ 384,716</u>	<u>12,328,011</u>	<u>\$ 255,433</u>
Adjustment to reflect the consolidation of the internal service fund activity related to enterprise funds				<u>18,163</u>	
Net assets of business-type activities				<u>\$ 12,346,174</u>	

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF DEFIANCE, OHIO

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
 PROPRIETARY FUNDS
 FOR THE YEAR ENDED DECEMBER 31, 2005

	Business-type Activities - Enterprise Funds				Governmental Activities - Internal Service Fund
	Water	Sewer	Nonmajor	Total	
Operating revenues:					
Charges for services	\$ 3,444,322	\$ 3,381,425	\$ 610,256	\$ 7,436,003	\$ 1,521,520
Tap-in fees	78,872	-	-	78,872	-
Other	500	-	-	500	-
Total operating revenues	3,523,694	3,381,425	610,256	7,515,375	1,521,520
Operating expenses:					
Personal services	1,390,232	981,231	-	2,371,463	-
Contractual services	277,820	173,395	-	451,215	-
Materials and supplies	410,080	445,365	-	855,445	-
Administrative costs	146,476	174,624	-	321,100	-
Utilities expense	259,466	274,529	543,180	1,077,175	-
Claims expense	-	-	-	-	1,456,348
Depreciation	507,312	621,571	-	1,128,883	-
Other	126,531	-	-	126,531	-
Total operating expenses	3,117,917	2,670,715	543,180	6,331,812	1,456,348
Operating income	405,777	710,710	67,076	1,183,563	65,172
Nonoperating revenues (expenses):					
Interest revenue	37,151	70,779	-	107,930	6,553
Interest and fiscal charges	(581,395)	(816,110)	-	(1,397,505)	-
Intergovernmental	11,307	443,282	-	454,589	-
Other nonoperating revenue	27,144	19,231	-	46,375	-
Total nonoperating revenues (expenses)	(505,793)	(282,818)	-	(788,611)	6,553
Changes in net assets	(100,016)	427,892	67,076	394,952	71,725
Net assets at beginning of year (restated)	6,875,789	4,739,630	317,640		183,708
Net assets at end of year	\$ 6,775,773	\$ 5,167,522	\$ 384,716		\$ 255,433
Adjustment to reflect the consolidation of the internal service fund activity related to enterprise funds				2,612	
Change in net assets of business-type activities				\$ 397,564	

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF DEFIANCE, OHIO
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2005

	Business-type Activities - Enterprise Funds				Governmental Activities - Internal Service Fund
	Water	Sewer	Nonmajor	Total	
Cash flows from operating activities:					
Cash received from charges for services	\$ 3,451,323	\$ 3,414,810	\$ 620,595	\$ 7,486,728	\$ 1,540,909
Cash received from tap-in fees	78,872	-	-	78,872	-
Cash payments for personal services	(1,415,783)	(995,358)	-	(2,411,141)	-
Cash payments for contractual services	(277,256)	(174,808)	-	(452,064)	-
Cash payments for administrative costs	(144,961)	(174,634)	-	(319,595)	(1,442,899)
Cash payments for materials and supplies.	(343,875)	(443,935)	-	(787,810)	-
Cash payments for utilities expense.	(255,833)	(247,089)	(543,180)	(1,046,102)	-
Cash payments for other expenses	(127,595)	-	-	(127,595)	-
Net cash provided by operating activities	<u>964,892</u>	<u>1,378,986</u>	<u>77,415</u>	<u>2,421,293</u>	<u>98,010</u>
Cash flows from noncapital financing activities:					
Cash received from nonoperating revenues	27,144	19,231	-	46,375	-
Cash payments for nonoperating expenses	-	-	-	-	-
Cash received from operating grants.	11,902	443,877	-	455,779	-
Net cash provided by noncapital financing activities.	<u>39,046</u>	<u>463,108</u>	<u>-</u>	<u>502,154</u>	<u>-</u>
Cash flows from capital and related financing activities:					
Cash payments for the acquisition of capital assets	(306,140)	(749,185)	-	(1,055,325)	-
Cash received from premium on bonds	249,112	-	-	249,112	-
Cash payments to refunding bond escrow agent	(4,948,105)	-	-	(4,948,105)	-
Cash received from issuance of refunding bonds	4,805,000	-	-	4,805,000	-
Cash received from issuance of notes	84,500	4,101,100	-	4,185,600	-
Cash payments for refunding bond issuance costs	(106,007)	-	-	(106,007)	-
Cash payments for principal retirement.	(480,542)	(2,255,241)	-	(2,735,783)	-
Cash payments for interest and fiscal charges	(586,413)	(755,508)	-	(1,341,921)	-
Net cash provided by (used in) capital and related financing activities	<u>(1,288,595)</u>	<u>341,166</u>	<u>-</u>	<u>(947,429)</u>	<u>-</u>
Cash flows from investing activities:					
Cash received from interest earned.	37,151	70,779	-	107,930	6,553
Net cash provided by investing activities.	<u>37,151</u>	<u>70,779</u>	<u>-</u>	<u>107,930</u>	<u>6,553</u>
Net increase (decrease) in cash and cash equivalents.	(247,506)	2,254,039	77,415	2,083,948	104,563
Cash and cash equivalents at beginning of year	<u>1,355,341</u>	<u>1,305,198</u>	<u>488,892</u>	<u>3,149,431</u>	<u>286,976</u>
Cash and cash equivalents at end of year.	<u>\$ 1,107,835</u>	<u>\$ 3,559,237</u>	<u>\$ 566,307</u>	<u>\$ 5,233,379</u>	<u>\$ 391,539</u>

--Continued

CITY OF DEFIANCE, OHIO

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

	<u>Business-type Activities - Enterprise Funds</u>				Governmental
	<u>Water</u>	<u>Sewer</u>	<u>Nonmajor</u>	<u>Total</u>	Activities - Internal Service Fund
Reconciliation of operating income to net cash provided by operating activities:					
Operating income.	\$ 405,777	\$ 710,710	\$ 67,076	\$ 1,183,563	\$ 65,172
Adjustments to reconcile operating income to net cash provided by operating activities:					
Depreciation.	507,312	621,571	-	1,128,883	-
Changes in assets and liabilities:					
(Increase) decrease in accounts receivable	1,194	2,866	(3,102)	958	19,389
Decrease in special assessments receivable	5,307	30,519	-	35,826	-
(Increase) decrease in materials and supplies inventory	62,277	(6,013)	-	56,264	-
Increase in accounts payable	8,601	33,843	-	42,444	-
Decrease in contracts payable	(770)	(671)	-	(1,441)	-
Increase in accrued wages and benefits	783	1,703	-	2,486	-
Decrease in compensated absences payable	(18,441)	(9,816)	-	(28,257)	-
Decrease in due to other governments	(7,148)	(5,726)	-	(12,874)	-
Increase in utility deposits payable	-	-	13,441	13,441	-
Increase in claims payable.	-	-	-	-	13,449
Net cash provided by operating activities.	<u>\$ 964,892</u>	<u>\$ 1,378,986</u>	<u>\$ 77,415</u>	<u>\$ 2,421,293</u>	<u>\$ 98,010</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

CITY OF DEFIANCE, OHIO

**STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUND
DECEMBER 31, 2005**

	<u>Agency</u>
Assets:	
Cash in segregated accounts	\$ 19,847
Total assets	<u>\$ 19,847</u>
Liabilities:	
Due to other governments.	\$ 19,847
Total liabilities	<u>\$ 19,847</u>

SEE ACCOMPANYING NOTES TO THE BASIC FINANCIAL STATEMENTS

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CITY OF DEFIANCE, OHIO

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

NOTE 1 - DESCRIPTION OF THE CITY

The City of Defiance, Ohio (the “City”), located in Defiance County, is a politic and corporate body established for the purpose of exercising the rights and privileges conveyed to it by the constitution and laws of the State of Ohio and its charter. The City operates under a Council/Mayor form of government and provides the following services to its residents: public safety, highways and streets, water sanitation, health and social services, culture-recreation, public improvements, planning and zoning, and general administrative services.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements (BFS) of the City have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to local governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial principles. The City also applies Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, to its governmental and business-type activities and to its proprietary funds provided they do not conflict with or contradict GASB pronouncements. The City has the option to also apply FASB Statements and Interpretations issued after November 30, 1989 to its business-type activities and enterprise funds, subject to this same limitation. The City has elected not to apply these FASB Statements and Interpretations. The most significant of the City’s accounting policies are described below.

A. Reporting Entity

For financial reporting purposes, the City’s BFS include all funds, agencies, boards, commissions, and departments for which the City is financially accountable. Financial accountability, as defined by the GASB, exists if the City appoints a voting majority of an organization’s governing board and is either able to impose its will on that organization or there is a potential for the organization to provide specific financial benefits to, or impose specific burdens on, the City. The City may also be financially accountable for governmental organizations with a separately elected governing board, a governing board appointed by another government, or a jointly appointed board that is fiscally dependent on the City. The City also took into consideration other organizations for which the nature and significance of their relationship with the City are such that exclusion would cause the City’s basic financial statements to be misleading or incomplete. Based upon the foregoing criteria, the City has no component units.

The primary government consists of all funds, agencies, departments and offices that are not legally separate from the City. The primary government includes the City departments and agencies that provide the following services: police protection, fire fighting and prevention, emergency medical services, street maintenance and repair, parks and recreation, wastewater, water, public service and planning and zoning.

The following organizations are described due to its relationship with the City.

JOINTLY GOVERNED ORGANIZATIONS

Maumee Valley Planning Organization (MVPO) - The City is a member of MVPO, which is a jointly governed organization between Defiance, Fulton, Henry, Paulding, and Williams Counties and the respective townships and municipalities in each of those counties. The purpose of MVPO is to act as a joint regional planning commission to write and administer Community Development Block Grants (CDBG) and help with housing rehabilitation in the area. In 2005, the City paid \$108,646 to MVPO.

CITY OF DEFIANCE, OHIO

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

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

MVPO is governed by a Board consisting of fifteen members. The Board is made up of one County Commissioner from each member County as well as one township representative and one municipal representative for each of the five member counties. The main sources of revenue are fees charged by MVPO to administer CDBG grants and a per capita amount from each City.

Noble Township - City of Defiance Joint Economic Development District - The City and Noble Township agreed to create a joint economic development district, (the "District"). The District is wholly situated within Noble Township, Defiance County. The purpose of the District is to facilitate economic development to create and preserve employment opportunities within the District.

The District is governed by a board of directors consisting of five members. The board is made up of one representative appointed by the City, Noble Township, the District business owners' association, the District employee's association and one "at-large member". The main source of revenue is a tax levied upon the income earned by persons working in the District and the net profits of businesses located in the District. The tax is at rates equal to those levied upon earned income and profits by the City.

JOINT VENTURES WITHOUT EQUITY INTEREST

Multi-Area Narcotics Task Force (MANTF) - The City is a member of the MANTF, which is a joint venture between Defiance, Paulding and Putnam Counties and the Cities of Defiance and Bryan. The purpose of the drug task force is to act as a joint task force in the fight against narcotics. The MANTF is jointly controlled by the chief law enforcement officer of each respective entity.

The main source of revenue for the MANTF is from federal grants and local matching shares by the entities. The City has no ongoing financial responsibility to the MANTF. The City has indirect access to the net resources of the MANTF since the City is able to influence the MANTF to use its surplus resources to undertake projects of interest to the City's residents. This access to the net resources of the Board has not been explicitly defined, nor is it currently measurable. The City contributed \$7,500 to the MANTF in 2005. Complete financial statements for the MANTF can be obtained through the Defiance City Sheriff's Office located at 113 Biede Street, Defiance, Ohio.

Community Improvement Corporation of Defiance County (Corporation) - The Corporation shall be exercised, conducted, and controlled by the Board of Trustees, which Board shall number a minimum of nine (9) and a maximum of fifteen (15) trustees with forty percent (40%) of the Trustees to be elected officials. Further each shall be a Member of the Corporation and all of whom shall be citizens of the United States. Defiance County, City of Defiance, Village of Hicksville, and Defiance County Townships participate in the operation of the Corporation. The Corporation duties are to advance, encourage and promote the industrial, economic, commercial and civic development.

The Defiance County Economic Development Employment Agreement between the Board of Trustees of the Corporation and the Defiance County Director of Economic Development states that the county's Director of Economic Development may serve as executive director of the Corporation, such corporation having agreed to furnish the county with the funds needed to pay his salary. The City of Defiance partially funds the Corporation to pay the salary of the Director of the Defiance County Economic Development. The City made \$50,000 in payments to the Corporation in 2005. The City's degree of control over the Board is limited to its representation on the Board.

CITY OF DEFIANCE, OHIO

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

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

RELATED ORGANIZATION

Defiance Public Library - The Defiance Public Library is a distinct political subdivision of the State of Ohio created under Chapter 3375 of the Ohio Revised Code. The Library is governed by a Board of Trustees appointed by City Council. The Board of Trustees possesses its own contracting and budgeting authority, hires and fires personnel, and does not depend on the District for operational subsidies. Although the City does serve as the taxing authority and may issue tax related debt on behalf of the Library, its role is limited to a ministerial function. The determination to request approval of a tax, the rate and the purpose are discretionary decisions made solely by the Board of Trustees. Financial information can be obtained from the Defiance Public Library, Mary Kay Reineke, Clerk/Treasurer, at 320 Fort Street, Defiance, Ohio 43512

B. Basis of Presentation - Fund Accounting

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

Government-wide Financial Statements - The statement of net assets and the statement of activities display information about the City as a whole. These statements include the financial activities of the primary government, except for fiduciary funds. The activities of the internal service fund are eliminated to avoid "doubling up" revenues and expenses. The statements distinguish between those activities of the City that are governmental and those that are considered business-type activities.

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

Fund Financial Statements - During the year, the City segregates transactions related to certain City functions or activities in separate funds in order to aid financial management and to demonstrate legal compliance. Fund financial statements are designed to present financial information of the City at this more detailed level. The focus of governmental and enterprise fund financial statements is on major funds. Each major fund is presented in a separate column. Nonmajor funds are aggregated and presented in a single column. The internal service fund is presented in a single column on the face of the proprietary fund financial statements. Fiduciary funds are reported by type.

CITY OF DEFIANCE, OHIO

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

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

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operation. The principal operating revenues of the City's proprietary funds are charges for services. Operating expenses from the enterprise funds include personnel and other expenses related to sewer, water, refuse, and utility deposits and operating expenses for the internal service fund include claims and administrative expenses. All revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses.

The agency funds do not report a measurement focus as they do not report operations.

C. Fund Accounting

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

Governmental Funds - Governmental funds are those through which most governmental functions typically are financed. Governmental fund reporting focuses on the sources, uses and balances of current financial resources. Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used. Current liabilities are assigned to the fund from which they will be paid. The difference between governmental fund assets and liabilities is reported as fund balance. The following are the City's major governmental funds:

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

Capital Improvements Fund - The capital improvements fund accounts for resources used to purchase equipment and construct capital assets.

Other governmental funds of the City are used to account for (a) the accumulation of resources for, and payment of, general long-term debt principal, interest and related costs; (b) financial resources to be used for the acquisition, construction, or improvement of capital facilities other than those financed by proprietary funds; and (c) for grants and other resources whose use is restricted to a particular purpose.

Proprietary Funds - Proprietary fund reporting focuses on changes in net assets, financial position and cash flows. Proprietary funds are classified as either enterprise or internal service.

Enterprise Funds - The 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 its residential and commercial users located within the City.

Sewer Fund - This fund accounts for the provision of sanitary sewer service to the residents and commercial users located within the City.

Other enterprise funds of the City are used to account for refuse collection and utility deposits. These funds are nonmajor funds whose activity has been aggregated and presented in a single column in the BFS.

CITY OF DEFIANCE, OHIO

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

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

Internal Service Fund - The internal service fund accounts for the financing of services provided by one department or agency to other departments or agencies of the City on a cost-reimbursement basis. The City's internal service fund is used to account for employee health insurance.

Fiduciary Funds - Fiduciary fund reporting focuses on net assets and changes in net assets. The fiduciary fund category is split into four classifications: pension trust funds, investment trust funds, private-purpose trust funds and agency funds. Trust funds are used to account for assets held by the City under a trust agreement for individuals, private organizations, or other governments and are therefore not available to support the City's own programs. Agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations. The City's only fiduciary funds are agency funds.

D. Measurement Focus and Basis of Accounting

Government-wide Financial Statements - The government-wide financial statements are prepared using the economic resources measurement focus. All assets and all liabilities associated with the operation of the City are included on the statement of net assets.

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

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

E. Basis of Accounting

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. Government-wide financial statements are prepared using the accrual basis of accounting. Governmental funds use the modified accrual basis of accounting. Proprietary and agency funds also use the accrual basis of accounting. Differences in the accrual and modified accrual basis of accounting arise in the recognition of revenue, the recording of deferred revenue and in the presentation of expenses versus expenditures.

CITY OF DEFIANCE, OHIO

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

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

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

Nonexchange transactions, in which the City receives value without directly giving equal value in return, include income taxes, property taxes, grants, entitlements and donations. On an accrual basis, revenue from income taxes is recognized in the period in which the income is earned (See Note 7). Revenue from property taxes is recognized in the year for which the taxes are levied (See Note 6). Revenue from grants, entitlements and donations is recognized in the year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the year when use is first permitted, matching requirements, in which the City must provide local resources to be used for a specified purpose, and expenditure requirements, in which the resources are provided to the City on a reimbursement basis. On a modified accrual basis, revenue from nonexchange transactions must also be available before it can be recognized.

Under the modified accrual basis, the following revenue sources are considered to be both measurable and available at year-end: income tax, state-levied locally shared taxes (including gasoline tax, local government funds and permissive tax), fines and forfeitures, fees and special assessments.

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

Property taxes for which there is an enforceable legal claim as of December 31, 2005, but which were levied to finance year 2006 operations, have been recorded as deferred revenue. Special assessments not received within the available period and grants and entitlements received before the eligibility requirements are met are also recorded as deferred revenue.

On governmental fund financial statements, receivables that will not be collected within the available period have also been reported as deferred revenue.

Expenses/Expenditures - On the accrual basis of accounting, expenses are recognized at the time they are incurred.

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.

CITY OF DEFIANCE, OHIO

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

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

F. Budgetary Data

The budgetary process is prescribed by provisions of the Ohio Revised Code and entails the preparation of budgetary documents within an established timetable. The major documents prepared are the tax budget, the certificate of estimated resources and the appropriations resolution, all of which are prepared on the budgetary basis of accounting. The certificate of estimated resources and the appropriations ordinance are subject to amendment throughout the year with the legal restriction that appropriations cannot exceed estimated resources, as certified. The legal level of budgetary control is at the fund, department and object level. Budgetary modifications may only be made by resolution of the City Council at the legal level of control.

Tax Budget - During the first Council meeting in July, the Mayor presents the following fiscal year's annual operating budget to City Council for consideration and passage. The adopted budget is submitted to the County Auditor, as Secretary of the County Budget Commission, by July 20 of each year, for the period January 1 to December 31 of the following year.

Estimated Resources - The County Budget Commission determines if the budget substantiates a need to levy all or part of previously authorized taxes and reviews estimated revenue. The Commission certifies its actions to the City by September 1. As part of this certification, the City receives the official certificate of estimated resources, which states the projected revenue of each fund. Prior to December 31, the City must revise its budget so that the total contemplated expenditures from any fund during the ensuing fiscal year will not exceed the amount available as stated in the certificate of estimated resources. The revised budget then serves as the basis for the annual appropriations measure. On or about January 1, the certificate of estimated resources is amended to include encumbered cash balances at December 31 of the preceding year. The certificate may be further amended during the year if the Finance Director determines, and the Budget Commission agrees, that an estimates need to be either increased or decreased. The amounts reported on the budgetary statement reflect the amounts in the original and final amended official certificate of estimated resources issued during 2005.

Appropriations - A temporary appropriation ordinance to control expenditures may be passed on or about January 1 of each year for the period January 1 to March 31. An annual appropriation ordinance must be passed by April 1 of each year for the period January 1 to December 31. The appropriation ordinance fixes spending authority at the fund, department and object level. The appropriation ordinance may be amended during the year as new information becomes available, provided that total fund appropriations do not exceed current estimated resources, as certified. The appropriations for a fund may only be modified during the year by an ordinance of Council. The amounts on the budgetary statement reflect the original and final appropriation amounts, including all amendments and modifications legally enacted by Council.

Lapsing of Appropriations - At the close of each year, the unencumbered balance of each appropriation reverts to the respective fund from which it was appropriated and becomes subject to future appropriations. Encumbrances are carried forward and are not reappropriated as part of the subsequent year appropriations.

CITY OF DEFIANCE, OHIO

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

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

G. Health Care

The Comprehensive Omnibus Budget Reconciliation Act (COBRA) of 1986 required the City to offer and provide terminated or retired employees continued participation in the City's employee health care benefits program, provided that the employees pay the rate established by the plan administrator. The City incurred no expenditures or revenues in providing these services. The participating former employees make premium payments directly to the City's Insurance Provider and the Provider is responsible for all claims.

H. Cash and Investments

To improve cash management, cash received by the City other than cash in segregated accounts, is pooled. Monies for all funds, including proprietary funds, are maintained in this pool. Individual fund integrity is maintained through the City's records. Each fund's interest in the pool is presented as "Equity in Pooled Cash and Cash Equivalents" and "Investment" on the financial statements.

During fiscal year 2005, investments were limited to the State Treasury Asset Reserve of Ohio (STAR Ohio) mutual funds and the City's own bonds. These investments are reported at fair value which is based on quoted market prices.

The City has invested funds in STAR Ohio during fiscal year 2005. STAR Ohio is an investment pool managed by the State Treasurer's Office which allows governments within the state to pool their funds for investment purposes. STAR Ohio is not registered with the SEC as an investment company, but does operate in a manner consistent with Rule 2a7 of the Investment Company Act of 1940. Investments in STAR Ohio are valued at STAR Ohio's share price which is the price the investment could be sold for on December 31, 2005.

Following Ohio statutes, the Council has, by resolution, specified the funds to receive an allocation of interest earnings. Interest revenue earned and credited to the general fund during 2005 amounted to \$137,439, which included \$100,523 assigned from other funds of the City.

The City has segregated bank accounts for monies held separate from the City's central bank account. These monies are held for the municipal court operations. These interest bearing depository accounts are presented on the financial statements as "Cash with Segregated Accounts" since they are not required to be deposited into the City treasury.

For purposes of the combined statement of cash flows and for presentation on the combined balance sheet, investments of the cash management pool and investments with original maturities of three months or less at the time they are purchased by the City are considered to be cash equivalents. Investments with an initial maturity of more than three months are reported as investments.

An analysis of the City's investment account at year-end is provided in Note 4.

CITY OF DEFIANCE, OHIO

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

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

I. Restricted Assets

Customer deposits are classified as restricted assets because these funds are being held for specified purposes.

J. Inventories of Materials and Supplies

On government-wide and fund financial statements, inventories are presented at the lower of cost or market on a first-in, first-out basis and are expensed when used. Inventories are accounted for using the consumption method.

On the fund financial statements, reported material and supplies inventory is equally offset by a fund balance reserve in the governmental funds which indicates that it does not constitute available spendable resources even though it is a component of net current assets.

Inventory consists of expendable supplies held for consumption.

K. Capital Assets

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

All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the year. Donated capital assets are recorded at their fair market values as of the date received. The City maintains a capitalization threshold at \$2,500. The City's infrastructure consists of roads, bridges, culverts, and sanitary sewers. Improvements are capitalized; the costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not capitalized. Interest incurred during the construction of capital assets is also capitalized.

All reported capital assets are depreciated except for land and construction in progress. Improvements are depreciated over the remaining useful lives of the related capital assets. Useful lives for infrastructure were estimated based on the City's historical records of necessary improvements and replacements. Depreciation is computed using the straight-line method over the following useful lives:

<u>Description</u>	<u>Governmental Activities Estimated Lives</u>	<u>Business-type Activities Estimated Lives</u>
Improvements other than buildings	15 - 30 years	N/A
Land improvements	N/A	15 - 30 years
Buildings and improvements	15 - 45 years	30 - 50 years
Furniture and equipment	10 - 30 years	10 - 30 years
Infrastructure	30 years	50 years
Vehicles	6 - 15 years	6 - 15 years

CITY OF DEFIANCE, OHIO

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

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

Interest is capitalized on proprietary fund assets acquired with tax-exempt debt. The City's policy is to capitalize net interest on construction projects until substantial completion of the project. The amount of capitalized interest equals the difference between the interest cost associated with the tax-exempt borrowing used to finance the project from the date of borrowing until completion of the project and the interest earned from temporary investment of the debt proceeds over the same period.

Capitalized interest is amortized on the straight-line method over the estimated useful life of the asset. For 2005, the net interest expense incurred on proprietary fund construction projects was not material.

L. Compensated Absences

Compensated absences of the City consist of vacation leave and sick leave to the extent that payment to the employee for these absences are attributable to services already rendered and are not contingent on a specific event that is outside the control of the City and the employee.

In conformity with GASB Statement No. 16, "Accounting for Compensated Absences", vacation benefits are accrued as a liability as the benefits are earned if the employees' rights to receive compensation are attributable to services already rendered and it is probable that the City will compensate the employees for the benefits through paid time off or some other means. Sick leave benefits are accrued as a liability using the vesting method. The liability is based on the sick leave accumulated at December 31 by those employees who are currently eligible to receive termination payments and by those employees for whom it is probable they will become eligible to receive termination benefits in the future.

American Federation of State, County and Municipal Employees (AFSCME) and non-bargaining employees with a minimum of ten years of service are paid one day for every two days sick leave for the first 120 days of accumulated sick time and one day for every seven days for accumulated sick time in excess of 120 days upon retirement. International Union of Police Associations (IUPA) bargaining unit individuals employed for ten years or more as of December 31, 1991, shall be eligible for sick leave conversion upon retirement at one day for each two days accumulation without limit. Beginning January 1, 1992, an IUPA bargaining unit individual with twenty-two or more years of service, who resigns shall be eligible for payment for one day's pay for every two days of accumulated but unused sick leave, not to exceed 120 days. International Association of Firefighters (IAFF) bargaining unit individuals with ten or more years of service, shall upon retirement under provision of the Police & Firefighters Pension Fund be eligible for payment of one-half of the employee's accrued, but unused sick leave earned up to a maximum payment for 50 twenty-four hour days. An IAFF bargaining unit individual with twenty-two or more years of service, who retires or resigned from the City shall be eligible for payment for one-half of accrued, but unused sick leave up to a maximum payment for 50 twenty-four hour days.

The total liability for vacation and sick leave payments has been calculated using pay rates in effect at the balance sheet date, and reduced to the maximum payment allowed by labor contract and/or statute, plus applicable additional salary related payments. City employees are granted vacation and sick leave in varying amounts. In the event of termination, an employee is reimbursed for accumulated vacation and sick leave at various rates.

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

CITY OF DEFIANCE, OHIO

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

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

On governmental fund financial statements, compensated absences are recognized as liabilities and expenditures to the extent payments come due each period upon the occurrence of employee resignations and retirements. These amounts are recorded in the account "compensated absences payable" in the fund from which the employees who have accumulated leave are paid. The noncurrent portion of the liability is not reported. For proprietary funds, the entire amount of compensated absences is reported as a fund liability.

M. Accrued Liabilities and Long-Term Obligations

All payables, accrued liabilities and long-term obligations are reported in the government-wide financial statements, and all payables, accrued liabilities and long-term obligations payable from proprietary funds are reported on the proprietary fund financial statements.

In general, governmental fund payables and accrued liabilities that, once incurred, are paid in a timely manner and in full from current financial resources are reported as obligations of the funds. However, claims and judgments, compensated absences, and contractually required pension contributions that will be paid from governmental funds are reported as a liability in the fund financial statements only to the extent that they are due for payment during the current year.

N. Prepayments

Payments made to vendors for services that will benefit periods beyond December 31, 2005, are recorded as prepaid items using the consumption method by recording a current asset for the prepaid amount and reflecting the expenditure/expense in the year in which services are consumed.

O. Interfund Balances

On fund financial statements, receivables and payables resulting from short-term interfund loans are classified as "interfund receivables/payables." These amounts are eliminated in the governmental and business-type activities columns of the statement of net assets, except for any net residual amounts due between governmental and business-type activities, which are presented as internal balances.

P. Interfund Activity

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

Exchange transactions between funds are reported as revenues in the seller funds and as expenditures/expenses in the purchaser funds. Flows of cash or goods from one fund to another without a requirement for repayment are reported as interfund transfers. Interfund transfers are reported as other financing sources/uses in governmental funds and after nonoperating revenues/expenses in proprietary funds. Repayments from funds responsible for particular expenditures/expenses to the funds that initially paid for them are not presented on the BFS.

Q. Sale of Capital Assets

During 2004, the City sold land to Defiance County. In 2004, the City reported a \$1,983,137 gain on the sale of land which was reflected as a special item in the 2004 financial statements. In accordance with the sales agreement, the City received \$750,000 in 2005 and will receive another \$750,000 in 2006 from the County related to this sale.

CITY OF DEFIANCE, OHIO

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

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

R. Fund Balance Reserves

Reserved fund balances indicate that portion of fund equity which is not available for current appropriation or use. The unreserved portions of fund equity reflected in the governmental funds are available for use within the specific purposes of the funds.

The City reports a reservation of fund balance for amounts representing encumbrances outstanding, materials and supplies inventory, prepayments, loans, debt service, and noncurrent investments in the governmental fund financial statements.

S. Estimates

The preparation of the BFS in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the BFS and accompanying notes. Actual results may differ from those estimates.

T. Contributions of Capital

Contributions of capital in proprietary fund financial statements arise from outside contributions of capital assets, tap-in fees to the extent they exceed the cost of the connection to the system, or from grants or outside contributions of resources restricted to capital acquisition and construction. Capital contributions are reported as revenue in the proprietary fund financial statements.

U. Net Assets

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

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

V. Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary funds. For the City, these revenues are charges for services for sewer, water, refuse and utility deposits programs. Operating expenses are necessary costs incurred to provide the good or service that are the primary activity of the fund.

W. Extraordinary and Special Items

Extraordinary items are transactions or events that are both unusual in nature and infrequent in occurrence. Special items are transactions or events that are within the control of City Administration and that are either unusual in nature or infrequent in occurrence. During fiscal year 2005, the City did not have any transactions that would be classified as either a special item or an extraordinary item.

CITY OF DEFIANCE, OHIO

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

NOTE 3 - ACCOUNTABILITY AND COMPLIANCE

A. Change in Accounting Principles

For fiscal year 2005, the City has implemented GASB Statement No. 40 "Deposit and Investment Risk Disclosures", and GASB Statement No. 42, "Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries".

GASB Statement No. 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.

GASB Statement No. 42 amends GASB Statement No. 34 and establishes accounting and financial reporting standards for impairment of capital assets and accounting requirements for insurance recoveries.

The implementation of GASB Statement No. 40 and GASB Statement No. 42 did not have an effect on the financial statements of the City, however additional note disclosure can be found in Note 4.

B. Restatement of Net Assets

Net assets have been restated due to retroactively reporting infrastructure in the governmental activities capital assets and to correct for governmental activities infrastructure assets that were previously included in business-type activities infrastructure assets. These prior period adjustments had the following effect on net assets as previously reported in the enterprise fund statements and in the government-wide statements.

	Enterprise Funds		Government - Wide	
	Water	Sewer	Governmental Activities	Business-Type Activities
Net assets, December 31, 2004	\$ 8,916,844	\$ 8,014,144	\$ 11,584,997	\$ 17,264,179
Retroactive reporting of infrastructure	-	-	9,197,994	-
Correction of infrastructure assets	(2,041,055)	(3,274,514)	-	(5,315,569)
Restated net assets, January 1, 2005	\$ 6,875,789	\$ 4,739,630	\$ 20,782,991	\$ 11,948,610

NOTE 4 - DEPOSITS AND INVESTMENTS

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

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

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

CITY OF DEFIANCE, OHIO

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

NOTE 4 - DEPOSITS AND INVESTMENTS - (Continued)

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

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

Interim monies to be deposited or invested in the following securities:

1. United States Treasury Notes, Bills, Bonds, or any other obligation or security issued by the United States Treasury or any other obligation guaranteed as to principal and interest by the United States;
2. Bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality, including but not limited to, the Federal National Mortgage Association, Federal Home Loan Bank, Federal Farm Credit Bank, Federal Home Loan Mortgage Corporation, Government National Mortgage Association, and Student Loan Marketing Association. All federal agency securities shall be direct issuances of federal government agencies or instrumentalities;
3. Written repurchase agreements in the securities listed above provided that the market value of the securities subject to the repurchase agreement must exceed the principal value of the agreement by at least two percent and be marked to market daily, and that the term of the agreement must not exceed thirty days;
4. Bonds and other obligations of the State of Ohio;
5. No-load money market mutual funds consisting exclusively of obligations described in division (1) or (2) of this section and repurchase agreements secured by such obligations, provided that investments in securities described in this division are made only through eligible institutions;
6. The State Treasurer's investment pool State Treasury Asset Reserve of Ohio (STAR Ohio);
7. Certain banker's acceptance and commercial paper notes for a period not to exceed one hundred eighty days from the purchase date in an amount not to exceed twenty-five percent of the interim monies available for investment at any one time: and,
8. Under limited circumstances, corporate debt interests rated in either of the two highest classifications by at least two nationally recognized rating agencies.

The City may also invest any monies not required to be used for a period of six months or more in the following:

1. Bonds of the State of Ohio;
2. Bonds of any municipal corporation, village, county, township, or other political subdivision of this state, as to which there is no default of principal, interest or coupons; and
3. Obligations of the City.

CITY OF DEFIANCE, OHIO

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

NOTE 4 - DEPOSITS AND INVESTMENTS - (Continued)

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 City, if the securities are not represented by a certificate, upon receipt of confirmation of transfer from the custodian.

A. Cash on Hand

At year-end, the City had \$2,250 in undeposited cash on hand which is included on the financial statements of the City as part of "Equity in Pooled Cash and Cash Equivalents."

B. Cash in Segregated Accounts

At year-end, the City had \$19,847 in cash in segregated accounts held for the Municipal Court which is included on the financial statements of the City as an agency fund. This amount is included in the "Deposits with Financial Institutions" below.

C. Deposits with Financial Institutions

At December 31, 2005, the carrying amount of all City deposits was \$1,226,664. Based on the criteria described in GASB Statement No. 40, "Deposits and Investment Risk Disclosures", as of December 31, 2005, \$890,796 of the City's bank balance of \$1,396,391 was exposed to custodial risk as discussed below, while \$505,595 was covered by Federal Deposit Insurance Corporation.

Custodial credit risk is the risk that, in the event of bank failure, the City's deposits may not be returned. All deposits are collateralized with eligible securities in amounts equal to at least 105% of the carrying value of the deposits. Such collateral, as permitted by the Ohio revised Code, is held in single financial institution collateral pools at Federal Reserve Banks, or at member banks of the federal reserve system, in the name of the respective depository bank and pledged as a pool of collateral against all of the public deposits it holds or as specific collateral held at the Federal Reserve Bank in the name of the City.

D. Investments

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

<u>Investment type</u>	<u>Balance at Fair Value</u>	<u>6 months or less</u>	<u>7 to 12 months</u>	<u>Investment Maturities</u>			<u>Greater than 24 months</u>
				<u>13 to 18 months</u>	<u>19 to 24 months</u>		
STAR Ohio	\$ 3,202,798	\$ 3,202,798	\$ -	\$ -	\$ -	\$ -	
City Owned Bonds	267,911	-	23,432	-	23,746	220,733	
Money Market Mutual Fund	<u>6,236,484</u>	<u>6,236,484</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	
	<u>\$ 9,707,193</u>	<u>\$ 9,439,282</u>	<u>\$ 23,432</u>	<u>\$ -</u>	<u>\$ 23,746</u>	<u>\$ 220,733</u>	

The weighted average maturity of investments is .27 years.

CITY OF DEFIANCE, OHIO

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

NOTE 4 - DEPOSITS AND INVESTMENTS - (Continued)

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

Credit Risk: The City's investments in U.S. government money market mutual funds are invested in securities which are rated AAA and Aaa by Standard & Poor's and Moody's Investor Services., respectively. Standard & Poor's has assigned STAR Ohio an AAA money market rating.

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

<u>Investment type</u>	<u>Fair Value</u>	<u>% of Total</u>
STAR Ohio	\$ 3,202,798	32.99%
City Owned Bonds	267,911	2.76%
Money Market Mutual Fund	<u>6,236,484</u>	<u>64.25%</u>
	<u>\$ 9,707,193</u>	<u>100.00%</u>

E. Reconciliation of Cash and Investment to the Statement of Net Assets

The following is a reconciliation of cash and investments as reported in the footnote above to cash and investments as reported on the statement of net assets as of December 31, 2005:

<u>Cash and Investments per footnote</u>	
Carrying amount of deposits	\$ 1,226,664
Investments	9,707,193
Cash on hand	<u>2,250</u>
Total	<u>\$ 10,936,107</u>
 <u>Cash and investments per Statement of Net Assets</u>	
Governmental activities	\$ 5,682,881
Business type activities	5,233,379
Agency funds	<u>19,847</u>
Total	<u>\$ 10,936,107</u>

NOTE 5 - INTERFUND TRANSFERS

For 2005, interfund transfers consisted of the following, as reported in the fund statements:

Transfers to nonmajor governmental funds from:	
General fund	\$ 409,765

Transfers are used to (1) move revenues from the fund that statute or budget required to collect them to the fund that statute or budget requires to expend them, (2) move receipts restricted to debt service from the funds collecting the receipts to the debt service fund as debt service payments become due, and (3) use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations.

CITY OF DEFIANCE, OHIO

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

NOTE 6 - PROPERTY TAXES

Property taxes include amounts levied against all real, public utility and tangible personal property located in the City. Taxes collected from real property taxes (other than public utility) in one calendar year are levied in the preceding calendar year on the assessed value 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 revaluated every six years. The last revaluation was completed in 1999. Real property taxes are payable annually or semi-annually. The first payment is due January 20, with the remainder payable by July 20.

Taxes collected on tangible personal property (other than public utility) in one calendar year are levied in the prior calendar year on assessed values listed on December 31 of the prior year, and at 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 semi-annually. If paid annually, payment is due April 30; if paid semi-annually, the first payment is due April 30 with the remainder payable by September 20.

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 real property is assessed at 35 percent of true value. Public utility property taxes are payable on the same dates as real property taxes described previously.

The County Treasurer collects property taxes on behalf of all taxing districts in the County, including the City of Defiance. The County Auditor periodically remits to the City its portion of the taxes collected. The full tax rate for all City operations for the year ended December 31, 2005 was \$10.59 per \$1,000 of assessed value. The assessed values of real and tangible personal property upon which 2004 property tax receipts were based are as follows:

Real property tax	\$ 246,337,300
Public utility tangible personal property	7,646,390
Tangible personal property	<u>45,231,763</u>
Total assessed valuation	<u>\$ 299,215,453</u>

Property taxes receivables represent real and tangible personal property taxes, public utility taxes and outstanding delinquencies which are measurable as of December 31, 2005. Although total property tax collections for the next year are measurable, they are generally not collected during the available period. The exception to this is any advances received by the City in the first thirty-one days of the year are credited as property tax revenues with the remainder being credited to deferred revenue.

NOTE 7 - LOCAL INCOME TAX

This locally levied tax of 1.3 percent is applied to gross salaries, wages and other personal service compensation earned by residents both in and out of the City, and to earnings of nonresidents (except certain transients) earned in the City. It also applies to net income of for-profit organizations conducting business within the City. Income tax revenues are reported to the extent that it was measurable and available to finance current operations at December 31. Income tax revenue for 2005 was \$6,428,760.

CITY OF DEFIANCE, OHIO

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

NOTE 8 - RECEIVABLES

Receivables at December 31, 2005, consisted of income and property taxes, accounts (billings for user charged services), special assessments, and intergovernmental receivables arising from grants, entitlements, and shared revenue. All intergovernmental receivables have been classified as "Due From Other Governments" on the financial statements. Receivables have been recorded to the extent that they are measurable at December 31, 2005, as well as intended to finance fiscal 2005 operations.

A summary of the principal items of receivables reported on the statement of net assets follows:

Governmental Activities:

Income taxes	\$1,657,587
Property and other local taxes	930,450
Accounts	265,139
Special assessments	486,636
Accrued interest	4,894
Due from other governments	1,408,366

Business-type Activities:

Accounts	299,275
Special assessments	203,581

Receivables have been disaggregated on the face of the BFS. The only receivable not expected to be collected within the subsequent year are the special assessments which are collected over the life of the assessment.

NOTE 9 - CAPITAL ASSETS

A. The capital asset balances of the governmental activities have been restated due to the retroactive reporting of infrastructure assets for the governmental activities and to correct for certain governmental activities infrastructure assets that were previously reported as a component of business-type activities infrastructure assets.

	Balance		Restated
	<u>12/31/04</u>	<u>Adjustments</u>	<u>Balance</u>
<u>Governmental Activities:</u>			<u>01/01/05</u>
Land	\$ 1,243,358	\$ -	\$ 1,243,358
Buildings	4,523,425	-	4,523,425
Equipment	2,038,187	-	2,038,187
Improvements other than buildings	979,424	-	979,424
Vehicles	2,318,249		2,318,249
Infrastructure	301,608	13,899,128	14,200,736
Less: accumulated depreciation	<u>(6,034,408)</u>	<u>(4,701,134)</u>	<u>(10,735,542)</u>
Total	<u>\$ 5,369,843</u>	<u>\$ 9,197,994</u>	<u>\$ 14,567,837</u>

CITY OF DEFIANCE, OHIO

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

NOTE 9 - CAPITAL ASSETS - (Continued)

<u>Governmental Activities:</u>	Restated Balance 01/01/05	<u>Additions</u>	<u>Disposals</u>	Balance 12/31/05
<i>Capital assets, not being depreciated:</i>				
Land	\$ 1,243,358	\$ -	\$ -	\$ 1,243,358
Construction in progress	<u>-</u>	<u>415,917</u>	<u>-</u>	<u>415,917</u>
Total capital assets, not being depreciated	<u>1,243,358</u>	<u>415,917</u>	<u>-</u>	<u>1,659,275</u>
<i>Capital assets, being depreciated:</i>				
Buildings	4,523,425	-	-	4,523,425
Improvements other than buildings	979,424	-	-	979,424
Equipment	2,038,187	168,631	(55,328)	2,151,490
Vehicles	2,318,249	130,000	(5,500)	2,442,749
Infrastructure	<u>14,200,736</u>	<u>73,553</u>	<u>-</u>	<u>14,274,289</u>
Total capital assets, being depreciated	<u>24,060,021</u>	<u>372,184</u>	<u>(60,828)</u>	<u>24,371,377</u>
<i>Less: accumulated depreciation:</i>				
Buildings	(2,793,205)	(127,300)	-	(2,920,505)
Improvements other than buildings	(633,758)	(36,535)	-	(670,293)
Equipment	(806,635)	(144,060)	38,259	(912,436)
Vehicles	(1,790,756)	(144,148)	3,208	(1,931,696)
Infrastructure	<u>(4,711,188)</u>	<u>(475,814)</u>	<u>-</u>	<u>(5,187,002)</u>
Total accumulated depreciation	<u>(10,735,542)</u>	<u>(927,857)</u>	<u>41,467</u>	<u>(11,621,932)</u>
Total capital assets, being depreciated, net	<u>13,324,479</u>	<u>(555,673)</u>	<u>(19,361)</u>	<u>12,749,445</u>
Governmental activities capital assets, net	<u>\$ 14,567,837</u>	<u>\$ (139,756)</u>	<u>\$ (19,361)</u>	<u>\$ 14,408,720</u>

CITY OF DEFIANCE, OHIO

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

NOTE 9 - CAPITAL ASSETS - (Continued)

- B.** The capital asset balances of the business-type activities have been restated to correct for certain governmental activities infrastructure assets that were previously reported as a component of business-type activities infrastructure assets.

<u>Business-Type Activities:</u>	Balance <u>12/31/04</u>	Adjustments	Restated Balance <u>01/01/05</u>
Land	\$ 267,100	\$ -	\$ 267,100
Construction in progress	1,868,854	-	1,868,854
Land improvements	789,494	-	789,494
Buildings and improvements	29,474,793	-	29,474,793
Furniture and equipment	2,321,770	-	2,321,770
Vehicles	810,847	-	810,847
Infrastructure	24,980,870	(6,390,042)	18,590,828
Less accumulated depreciation	<u>(19,991,620)</u>	<u>1,074,473</u>	<u>(18,917,147)</u>
Total	<u>\$ 40,522,108</u>	<u>\$ (5,315,569)</u>	<u>\$ 35,206,539</u>

CITY OF DEFIANCE, OHIO

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

NOTE 9 - CAPITAL ASSETS - (Continued)

	Restated Balance 01/01/05	Additions	Disposals	Balance 12/31/05
<u>Business-type Activities:</u>				
<i>Capital assets, not being depreciated:</i>				
Land	\$ 267,100	\$ -	\$ -	\$ 267,100
Construction in progress	<u>1,868,854</u>	<u>1,139,488</u>	<u>(1,228,475)</u>	<u>1,779,867</u>
Total capital assets, not being depreciated	<u>2,135,954</u>	<u>1,139,488</u>	<u>(1,228,475)</u>	<u>2,046,967</u>
<i>Capital assets, being depreciated:</i>				
Land improvements	789,494	-	-	789,494
Buildings and improvements	29,474,793	-	-	29,474,793
Equipment	2,321,770	20,688	-	2,342,458
Vehicles	810,847	-	-	810,847
Infrastructure	<u>18,590,828</u>	<u>1,139,019</u>	<u>-</u>	<u>19,729,847</u>
Total capital assets, being depreciated	<u>51,987,732</u>	<u>1,159,707</u>	<u>-</u>	<u>53,147,439</u>
<i>Less: accumulated depreciation:</i>				
Land improvements	(357,362)	(31,452)	-	(388,814)
Buildings and improvements	(7,058,926)	(632,291)	-	(7,691,217)
Equipment	(2,080,518)	(43,215)	-	(2,123,733)
Vehicles	(623,141)	(57,424)	-	(680,565)
Infrastructure	<u>(8,797,200)</u>	<u>(364,501)</u>	<u>-</u>	<u>(9,161,701)</u>
Total accumulated depreciation	<u>(18,917,147)</u>	<u>(1,128,883)</u>	<u>-</u>	<u>(20,046,030)</u>
Total capital assets being depreciated, net	<u>33,070,585</u>	<u>30,824</u>	<u>-</u>	<u>33,101,409</u>
Business-type activities capital assets, net	<u>\$ 35,206,539</u>	<u>\$ 1,170,312</u>	<u>\$ (1,228,475)</u>	<u>\$ 35,148,376</u>

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

Governmental activities:

General government	\$ 47,435
Security of persons and property	150,415
Public health and welfare	39,924
Transportation	557,557
Community environment	19,390
Leisure time activity	<u>113,136</u>
Total depreciation expense - governmental activities	<u>\$ 927,857</u>

CITY OF DEFIANCE, OHIO

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

NOTE 9 - CAPITAL ASSETS - (Continued)

Business-type activities:

Water	\$ 507,312
Sewer	<u>621,571</u>
Total depreciation expense - business-type activities	<u><u>\$ 1,128,883</u></u>

NOTE 10 - OTHER EMPLOYEE BENEFITS

Compensated Absences

Accumulated Unpaid Vacation

City employees earn vacation leave at varying rates based upon length of service. In the case of death or retirement, an employee (or his estate) is paid for his unused vacation leave. The total obligation for vacation leave for the City as a whole amounted to \$327,204 at December 31, 2005. Amounts are recorded as a fund liability and/or on the government-wide financial statements, as applicable.

Accumulated Unpaid Sick Leave

City employees earn sick leave at varying rates based upon length of service. Upon retirement an employee is paid a percentage of his accumulated sick leave within various limits. The total obligation for sick leave accrual for the City as a whole amounted to \$455,293 at December 31, 2005. Amounts are recorded as a fund liability and/or on the government-wide financial statements, as applicable.

NOTE 11 - CAPITAL LEASES

During 2005, capital assets consisting of copier equipment were capitalized in the Water and Sewer enterprise funds. These lease agreements meet the criteria of a capital lease as defined by FASB Statement No. 13 "Accounting for Leases", which defines a capital lease as one which transfers benefits and risks of ownership to the lessee. The amount of the \$28,477 represents the present value of the minimum lease payments at the time of acquisition. A corresponding liability was recorded in the Water and Sewer enterprise funds. Principal payments in fiscal year 2005 totaled \$3,288.

The following is a schedule of the future long-term minimum lease payments required under the capital lease and the present value of the minimum lease payments as of December 31, 2005:

<u>Year Ended December 31</u>	<u>Amount</u>
2006	\$ 6,732
2007	6,732
2008	6,732
2009	6,732
2010	<u>3,121</u>
Total	30,049
Less: amount representing interest	<u>(4,860)</u>
Present value of net minimum lease payments	<u><u>\$ 25,189</u></u>

CITY OF DEFIANCE, OHIO

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

NOTE 12 - NOTES PAYABLE

The City had the following governmental bond anticipation notes outstanding at December 31, 2005:

	Issue	Balance			Balance
Governmental Activities:	<u>Date</u>	<u>12/31/04</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/05</u>
<u>General Obligation Bond</u>					
<u>Anticipation Notes:</u>					
Capital Improvements Fund - 2004	12/24/04	\$ 835,000	\$ -	\$(835,000)	\$ -
Capital Improvements Fund - 2005	12/20/05	<u>-</u>	<u>635,000</u>	<u>-</u>	<u>635,000</u>
Total Capital Improvements Fund		<u>\$ 835,000</u>	<u>\$ 635,000</u>	<u>\$(835,000)</u>	<u>\$ 635,000</u>

On December 24, 2004, the City issued \$835,000 of general obligation bonds anticipation notes for the purpose of improving the streets within the Powell View subdivision. These notes matured December 24, 2005 and were “rolled over” into a new general obligation bond anticipation notes in the amount of \$635,000. The new \$635,000 general obligation bond anticipation notes bear an interest rate of 3.80% and have a maturity date of December 20, 2006.

The City had the following bond anticipation note activity during fiscal year 2005 in the Water and Sewer enterprise funds:

	Interest	Issue	Maturity	Balance			Balance
Business-Type Activities	<u>Rate</u>	<u>Date</u>	<u>Date</u>	<u>12/31/04</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/05</u>
<u>Water Fund</u>							
Water Improvements - 2005	3.45%	05/05/05	05/05/06	\$ -	\$ 84,500	\$ -	\$ 84,500
Total Water				<u>\$ -</u>	<u>\$ 84,500</u>	<u>\$ -</u>	<u>\$ 84,500</u>
<u>Sewer Fund</u>							
Sewer improvements - 2004	1.25%	07/11/04	07/11/05	\$ 1,465,000	\$ -	\$(1,465,000)	\$ -
Sewer Improvements - 2005	3.05%	07/06/05	05/05/06	-	4,000,000	-	4,000,000
Sewer improvements - 2005	3.45%	05/05/05	05/05/06	<u>-</u>	<u>101,100</u>	<u>-</u>	<u>101,100</u>
Total Sewer				<u>\$ 1,465,000</u>	<u>\$ 4,101,100</u>	<u>\$(1,465,000)</u>	<u>\$ 4,101,100</u>

During 2005, the City issued two sewer improvement notes in the amounts of \$4,000,000 and \$101,100. Of the \$4,000,000 note issue, \$1,400,000 was used to repay the Series 2004 note outstanding at December 31, 2004 and \$2,600,000 was used to finance various sewer improvement construction projects. The \$101,100 note issue was used to repay the Series 2004 note outstanding at December 31, 2004.

CITY OF DEFIANCE, OHIO

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

NOTE 13 - LONG-TERM OBLIGATIONS

A. Governmental Activities Long-Term Obligations

The City's long term obligations for the governmental activities at year-end consist of the following:

	Balance			Balance	Amount
<u>Governmental Activities:</u>	<u>12/31/04</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/05</u>	<u>Due in</u>
					<u>One Year</u>
Compensated absences payable	\$ 562,179	\$ 253,229	\$ (220,501)	\$ 594,907	\$ 246,464
General obligation bonds payable	260,000	-	(30,000)	230,000	35,000
Special assessment bonds payable	546,187	-	(72,967)	473,220	77,968
Bond anticipation notes payable	<u>760,000</u>	<u>722,000</u>	<u>(760,000)</u>	<u>722,000</u>	<u>722,000</u>
Total	<u>\$2,128,366</u>	<u>\$ 975,229</u>	<u>\$ (1,083,468)</u>	<u>\$ 2,020,127</u>	<u>\$1,081,432</u>

Special assessment debt with governmental commitment and debt issued for governmental purposes of the City is retired from the debt service fund. General obligation bonds are secured by the City's ability to levy a voted or unvoted property tax within limitations of Ohio law.

Special assessment bonds are secured by an unvoted property tax levy (special assessment), however, each appropriate bond indenture provides for principal and interest to be paid from use charges.

On July 13, 2000, the City issued \$760,000 in bond anticipation notes to pay costs of acquiring, remodeling, and renovating a building and site to house municipal functions. During fiscal years 2001-2004, these notes were retired and reissued with the principal balance of \$722,000 remaining due at December 31, 2005. The proceeds of the 2005 issue and the retirement of the 2004 issue are reported in the general fund.

The following is a summary of the City's future annual debt service requirements for the governmental activities long-term obligations:

<u>Year Ending</u>	<u>General Obligation Bonds</u>			<u>Special Assessment Bonds</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 35,000	\$ 15,985	\$ 50,985	\$ 77,968	\$ 32,136	\$ 110,104
2007	35,000	13,553	48,553	77,968	26,491	104,459
2008	40,000	11,120	51,120	87,968	21,131	109,099
2009	40,000	8,348	48,348	62,958	15,007	77,965
2010	40,000	5,560	45,560	59,543	10,843	70,386
2011 - 2014	<u>40,000</u>	<u>2,388</u>	<u>42,388</u>	<u>106,815</u>	<u>11,771</u>	<u>118,586</u>
Total	<u>\$ 230,000</u>	<u>\$ 56,954</u>	<u>\$ 286,954</u>	<u>\$ 473,220</u>	<u>\$ 117,379</u>	<u>\$ 590,599</u>

CITY OF DEFIANCE, OHIO

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

NOTE 13 - LONG-TERM OBLIGATIONS - (Continued)

B. Business-Type Activities Long-Term Obligations

The City had the following general obligation bonds and long-term loans payable outstanding at year-end related to business-type activities:

<u>Business-Type Activities</u>	<u>Interest Rate</u>	<u>Balance 12/31/04</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance 12/31/05</u>	<u>Amount Due in One Year</u>
<u>General Obligation Bonds:</u>						
Waterline improvements	6.10%	\$ 4,805,000	\$ -	\$ (4,805,000)	\$ -	\$ -
Waterline refunding	4.00-5.00%	-	4,805,000	(195,000)	4,610,000	220,000
Waterworks - Series 1997	Various	<u>6,820,000</u>	-	<u>(225,000)</u>	<u>6,595,000</u>	<u>235,000</u>
Total general obligation bonds		<u>11,625,000</u>	<u>4,805,000</u>	<u>(5,225,000)</u>	<u>11,205,000</u>	<u>455,000</u>
<u>Special Assessment Bonds</u>						
Sewer street improvements - Series 2000	5.75%	<u>130,013</u>	-	<u>(5,169)</u>	<u>124,844</u>	<u>5,467</u>
<u>Other Long-Term Obligations</u>						
OWDA loans	3.91-7.65%	12,145,142	-	(772,816)	11,372,326	819,944
OPWC loans	0-4.00%	988,105	-	(69,510)	918,595	70,857
Capital leases		-	28,477	(3,288)	25,189	4,893
Compensated absence payable		<u>215,847</u>	<u>65,487</u>	<u>(93,744)</u>	<u>187,590</u>	<u>80,740</u>
Total other long-term obligations		<u>13,349,094</u>	<u>93,964</u>	<u>(939,358)</u>	<u>12,503,700</u>	<u>976,434</u>
Total business-type activities long-term liabilities		<u>\$ 25,104,107</u>	<u>\$ 4,898,964</u>	<u>\$ (6,169,527)</u>	23,833,544	<u>\$ 1,436,901</u>
Less: Unamortized deferred charge on refunding					(138,465)	
Add: Unamortized bond premium					<u>241,033</u>	
Total on statement of net assets					<u>\$ 23,936,112</u>	

General obligation bonds are expected to be retired with revenues of the enterprise funds. General obligation bonds are secured by the City's ability to levy a voted or unvoted property tax within limitations of Ohio law.

On July 6, 2005, the City issued \$4,805,000 in Waterworks System Improvement Refunding Bonds to currently refund all the outstanding 1994 Waterworks System Improvement Bonds (principal \$4,805,000; interest rate 6.10%). The refunded debt is considered defeased (in-substance) and accordingly, has been removed from the statement of net assets. The principal balance of the Waterworks System Improvement Refunding Bonds at December 31, 2005 was \$4,610,000.

The 2005 Waterworks System Improvement Refunding Bonds issue is comprised of current interest bonds, par value \$4,805,000, with an annual interest rate ranging from 4.00%-5.00%. The re-acquisition price exceeded the net carrying amount of the old debt by \$143,106. This amount is being netted against the new debt and amortized over the remaining life of the refunded debt, which is equal to the life of new debt issued.

CITY OF DEFIANCE, OHIO

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

NOTE 13 - LONG-TERM OBLIGATIONS - (Continued)

On February 3, 1998, the City issued \$8,000,000 in Waterworks System Improvements bonds. The Bonds were issued for the purpose of improving and expanding the municipal waterworks system by acquiring, construction, reconstructing and otherwise improving structures and facilities for raw water intake, treatment and storage, finished water storage and distribution and waterworks administration and service, including all necessary equipment, site improvements and furnishings, together with all necessary and related improvements and the acquisition of any real estate or interest therein required. During 2005, the City retired \$225,000 of these bonds, leaving an outstanding balance of \$6,595,000 at December 31, 2005.

On May 11, 2001, the City issued \$145,434 in special assessment bonds to finance the costs of sewer improvements to South Jefferson Street. These bonds bear an interest rate of 5.75 percent and mature December 1, 2020. During 2005, the City retired \$5,169 of these bonds, leaving an outstanding balance of \$124,844 at December 31, 2005.

The City constructed a waste water treatment facility in 1990. The Project was financed through expenditure by the Ohio Water Development Authority (OWDA). In 1999, the City began making major improvements to its wastewater treatment facility, which was also partially financed by OWDA. At December 31, 2005, the City had the following OWDA loans outstanding:

	<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Balance Outstanding 12/31/05</u>
OWDA loan	7.65%	1/1/2013	\$ 4,655,507
OWDA loan	3.91%	7/1/2020	<u>6,716,819</u>
Total			<u>\$11,372,326</u>

Improvements to the City's water treatment facilities were financed through expenditures by the Ohio Public Works Commission (OPWC). At December 31, 2005, the City has the following four loans outstanding to the OPWC:

	<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Balance Outstanding 12/31/05</u>
OPWC loan	4.00%	1/1/2014	\$ 175,637
OPWC loan	3.00%	7/1/2017	323,087
OPWC loan	3.91%	7/1/2019	264,582
OPWC loan	3.91%	7/1/2020	<u>155,289</u>
Total			<u>\$ 918,595</u>

The loans are payable in semi-annual installments of principal and interest (if applicable).

CITY OF DEFIANCE, OHIO

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

NOTE 13 - LONG-TERM OBLIGATIONS - (Continued)

The following is a summary of the City's future annual debt service principal and interest requirements for the business-type activities:

Year Ending	General Obligation Bonds			Sewer Special Assessment Bonds		
	Principal	Interest	Total	Principal	Interest	Total
2006	\$ 455,000	\$ 532,425	\$ 987,425	\$ 5,467	\$ 7,178	\$ 12,645
2007	475,000	513,168	988,168	5,781	6,864	12,645
2008	495,000	492,942	987,942	6,113	6,532	12,645
2009	520,000	471,868	991,868	6,465	6,180	12,645
2010	540,000	464,962	1,004,962	6,836	5,809	12,645
2011 - 2015	3,155,000	1,952,465	5,107,465	40,551	22,674	63,225
2016 - 2020	4,010,000	1,001,729	5,011,729	53,631	9,594	63,225
2021 - 2023	1,555,000	158,250	1,713,250	-	-	-
Total	<u>\$ 11,205,000</u>	<u>\$ 5,587,809</u>	<u>\$ 16,792,809</u>	<u>\$ 124,844</u>	<u>\$ 64,831</u>	<u>\$ 189,675</u>

Year Ending	OWDA Loans Payable			OPWC Loans Payable		
	Principal	Interest	Total	Principal	Interest	Total
2006	\$ 819,944	\$ 615,514	\$ 1,435,458	\$ 70,857	\$ 16,404	\$ 87,261
2007	870,205	565,253	1,435,458	72,252	15,009	87,261
2008	923,818	511,640	1,435,458	73,696	13,565	87,261
2009	981,020	454,437	1,435,457	75,191	12,070	87,261
2010	1,042,068	393,390	1,435,458	76,738	10,524	87,262
2011 - 2015	4,051,710	969,677	5,021,387	384,396	27,667	412,063
2016 - 2020	2,683,561	296,984	2,980,545	165,465	1,467	166,932
Total	<u>\$ 11,372,326</u>	<u>\$ 3,806,895</u>	<u>\$ 15,179,221</u>	<u>\$ 918,595</u>	<u>\$ 96,706</u>	<u>\$ 1,015,301</u>

NOTE 14 - RISK MANAGEMENT

The City is exposed to various risks of loss related to torts, theft of, and destruction of assets, errors and omissions, injuries to employees and natural disasters. The City participates with other cities in the Buckeye Ohio Risk Management Agency, Inc. (BORMA, Inc.), in jointly funded risk financing programs administered by Arthur J. Gallagher & Co. BORMA, Inc. includes two separate pools which provide separate and distinct coverages.

The first pool provides comprehensive automobile liability, automobile physical damage, comprehensive general liability, crime and property liability, and public officials' liability coverage up to specific limits. The pool includes the following municipalities: Archbold, Bowling Green, Defiance, Huron, Napoleon, Sandusky and Willard. Member contributions are calculated annually to produce a sufficient sum of money within the pool to fund administrative expenses and to create reserves for claims. As of December 31, 2004 (the latest information available), the pool had cash reserves of \$601,551, which in the opinion of management is adequate for any claims against the pool. The amount of risk retained with the pool is \$300,000 per claim.

CITY OF DEFIANCE, OHIO

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

NOTE 14 - RISK MANAGEMENT - (Continued)

Claims in excess of the \$300,000 up to \$10,000,000 are covered by various insurance carriers.

The second pool is for employee benefits and includes life insurance, accidental death and dismemberment insurance, health insurance and prescription drug insurance. Each member has an option on the coverage it has elected to provide for its employees. Defiance provides to its employees all available options offered by the pool. The employee benefits pool includes the following municipalities: Archbold, Bowling Green, Carey, Clyde, Defiance, Fayette, Hicksville, Napoleon, Oberlin, Sandusky, Upper Sandusky and Willard. As of December 31, 2004 the pool had cash reserves of \$2,397,520 which, in the opinion of management, is adequate for any claims against the pool (latest information available).

Premiums are paid to the employee benefits pool at a cost of \$966.97 for family coverage, \$726.18 for two party coverage, and \$335.84 for single party coverage. Life insurance monthly premiums are \$4.72 for family and two party coverage and \$2.60 for single party coverage. During 2004, the City paid \$1,249,325 into the pool for coverage (latest information available). The cost of coverage is paid by the fund that pays the salary of the individual employees. The amount of the risk retained within the employee is \$75,000 per individual with excess claims coverage provided by the Lloyds Company.

BORMA, Inc. has the ability to require the member cities to make supplemental payments in the event reserves are not adequate to cover claims. The probability of this occurring is considered remote due to the adequacy of the pool reserves and premium levels, therefore, no amount have been reserved in the financial statements. Audited financial statements are maintained separately by BORMA, Inc.

Workers' Compensation claims are covered through the City's participation in the State of Ohio's program. The City pays the State Workers' Compensation System a premium based upon a rate per \$100 of payroll plus administrative costs. The rate is determined based on accident history of the North Central Ohio Municipal Finance Officers Association, of which the City is a member. The City also pays unemployment claims to the State of Ohio as incurred.

There has been no significant reduction in insurance coverages from coverages in the prior year. In addition, settled claims resulting from these risks have not exceeded commercial insurance converge in any of the past three fiscal years.

NOTE 15 - PENSION PLANS

A. Ohio Public Employees Retirement System

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

CITY OF DEFIANCE, OHIO

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

NOTE 15 - PENSION PLANS - (Continued)

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 established and amend benefits is provided by Chapter 145 of the Ohio Revised Code. OPERS issues a stand-alone financial report that may be obtained by writing to OPERS, 277 E. Town St., Columbus, OH 43215-4642 or by calling (614) 222-6705.

For the year ended December 31, 2004, the members of all three plans, except those in law enforcement or public safety participating in the traditional plan, were required to contribute 8.5% of their annual covered salaries. Members participating in the traditional plan who were in law enforcement contributed 10.1% of their annual covered salary; members in public safety contributed 9%. The City's contribution rate for pension benefits for 2004 was 9.55%, except for those plan members in law enforcement or public safety. For those classifications, the City's pension contributions were 12.7% of covered payroll. The Ohio Revised Code provides statutory authority for member and employer contributions.

The City's required contributions for pension obligations to the traditional and combined plans for the years ended December 31, 2005, 2004, and 2003 were \$295,981, \$334,381, and \$336,553, respectively; 91.58% has been contributed for 2005 and 100% for 2004 and 2003. \$24,926, representing the unpaid pension contribution for 2005, is recorded as a liability within the respective funds. The City and plan members did not make any contributions to the member-directed plan for 2005.

B. Ohio Police and Fire Pension Fund

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

Plan members are required to contribute 10.0% of their annual covered salary to fund pension obligations while the City is required to contribute 11.75% for police officers and 16.25% for firefighters. Contributions are authorized by State statute. The City's contributions to the Fund for police and firefighters for the years ended December 31, 2005, 2004, and 2003 were \$321,643, \$330,188, and \$330,386, respectively. 91.98% has been contributed for 2005 and 100% for the years 2004 and 2003. \$25,805, representing the unpaid pension contributions for 2005, is recorded as a liability within the respective funds.

CITY OF DEFIANCE, OHIO

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

NOTE 16 - POSTRETIREMENT BENEFIT PLANS

A. Ohio Public Employees Retirement System

The Ohio Public Employees Retirement System (OPERS) provides postretirement health care coverage to age and service retirees with ten or more years of qualifying Ohio service credit with either the traditional or combined plans. Health care coverage for disability recipients and primary survivor recipients is available. Members of the member-directed plan do not qualify for postretirement health care coverage. The health care coverage provided by the retirement system is considered an Other Postemployment Benefit as described in GASB Statement No. 12, "Disclosure of Information on Postemployment Benefits other than Pension Benefits by State and Local Government Employers". A portion of each employer's contribution to the traditional or combined plans is set aside for the funding of postretirement health care based on authority granted by State statute. The 2005 local government employer contribution rate was 13.55% of covered payroll (16.70% for public safety and law enforcement); 4.00% of covered payroll was the portion that was used to fund health care.

Benefits are advance-funded using the entry age normal actuarial cost method. Significant actuarial assumptions, based on OPER's latest actuarial review performed as of December 31, 2003, include a rate of return on investments of 8.00%, an annual increase in active employee total payroll of 4.00% compounded annually (assuming no change in the number of active employees) and an additional increase in total payroll of between .50% and 6.3% based on additional annual pay increases. Health care premiums were assumed to increase 4.00% annually. All investments are carried at market. For actuarial valuation purposes, a smoothed market approach is used. Assets are adjusted to reflect 25% of unrealized market appreciation or depreciation on investment assets annually.

The number of active contributing participants in the traditional and combined plans was 376,109. Actual employer contributions for 2005 which were used to fund postemployment benefits were \$173,089. The actual contribution and the actuarially required contribution amounts are the same. OPERS's net assets available for payment of benefits at December 31, 2003 (the latest information available) were \$10.8 billion. The actuarially accrued liability and the unfunded actuarial accrued liability were \$29.5 billion and \$18.1 billion, respectively.

In December 2001, the Board adopted the Health Care "Choices" Plan. The Choices Plan will be offered to all persons newly hired in an OPERS covered position after January 1, 2003, with no prior service credit accumulated toward health care coverage. Choices will incorporate a cafeteria approach, offering a broader range of health care options. The Plan uses a graded scale from ten to thirty years to calculate a monthly health care benefit. This is in contrast to the ten-year "cliff" eligibility standard for the present Plan. The benefit recipient will be free to select the option that best meets their needs. Recipients will fund health care costs in excess of their monthly health care benefit. The Plan will also offer a spending account feature, enabling the benefit recipient to apply their allowance toward specific medical expenses, much like a Medical Spending Account.

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

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

CITY OF DEFIANCE, OHIO

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

NOTE 16 - POSTRETIREMENT BENEFIT PLANS – (Continued)

B. Ohio Police and Fire Pension Fund

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

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

The City's actual contributions for 2005 that were used to fund postemployment benefits was \$99,902 for police and \$81,062 for firefighters. The OP&F's total health care expense for the year ended December 31, 2003 (the latest information available) was \$102,173,796, which was net of member contributions of \$55,665,341. The number of OP&F participants eligible to receive health care benefits as of December 31, 2004 (the latest information available), was 13,872 for police and 10,474 for firefighters.

NOTE 17 - BUDGETARY BASIS OF ACCOUNTING

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

1. Revenues and other financing sources are recorded when received in cash (budget) as opposed to when susceptible to accrual (GAAP).
2. Expenditures/expenses and other financing uses are recorded when paid in cash (budget) as opposed to when the liability is incurred (GAAP).
3. Encumbrances are treated as expenditures (budget) rather than as a reservation of fund balance (GAAP).
4. Unreported cash represents amounts received but not included as revenue on the budget basis operating statements. These amounts are included as revenue on the GAAP basis operating statement.

CITY OF DEFIANCE, OHIO

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

NOTE 17 - BUDGETARY BASIS OF ACCOUNTING – (Continued)

The following table summarizes the adjustments necessary to reconcile the GAAP basis statements (as reported in the fund financial statements) to the budgetary basis statements for all governmental funds for which a budgetary basis statement is presented.

Net Change in Fund Balances	<u>General</u>
Budget basis	\$ 599,976
Net adjustment for revenue accruals	157,658
Net adjustment for expenditure accruals	303,582
Net adjustment for other sources/uses	(353,957)
Adjustment for encumbrances	<u>190,970</u>
GAAP basis	<u>\$ 898,229</u>

NOTE 18 - LOANS RECEIVABLE

Loans receivable represent low interest loans made by the City for development projects and businesses under the Community Development Block Grant (CDBG) Program. A summary of the loan activity is as follows:

	Balance Outstanding <u>12/31/04</u>	Loans Disbursed	Principal Received	Balance Outstanding <u>12/31/05</u>
CDBG loans	<u>\$ 914,776</u>	<u>\$ 74,000</u>	<u>\$ (203,557)</u>	<u>\$ 785,219</u>

The CDBG loans are reported in the nonmajor governmental funds. Fund balance has been reserved for the outstanding balance due at year-end.

NOTE 19 - CONTINGENCIES

A. Grants

The City receives significant financial assistance from numerous federal and state agencies in the form of grants. The disbursement of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and are subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of the general fund or other applicable funds. However, in the opinion of management, any such disallowed claims will not have a material effect on any of the financial statements of the individual fund types included herein or on the overall financial position of the City at December 31, 2005.

B. Litigation

Several claims and lawsuits are pending against the City. In the opinion of the City Law Director, any potential liability would not have a material effect on the Basic Financial Statements.

NOTE 20 – SIGNIFICANT SUBSEQUENT EVENT

On May 1, 2006, the City issued \$3,850,000 in bond anticipation notes to refinance water and sewer improvement notes outstanding at December 31, 2005 (see Note 12). The bond anticipation notes have an interest rate of 4.50% and mature on May 1, 2007.



Julian & Grube, Inc.
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**Report on Internal Control Over Financial Reporting and on Compliance
and Other Matters Based on an Audit of Financial Statements Performed
in Accordance With *Government Auditing Standards***

Members of Council and Mayor
City of Defiance
631 Perry Street
Defiance, OH 43082

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 Defiance, Defiance 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 June 16, 2006. As disclosed in Note 3, the City restated its net assets due to errors and omissions in capital assets. 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 *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that do not require inclusion in this report that we have reported to the management of the City in a separate letter dated June 16, 2006.

Members of Council and Mayor
City of Defiance

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted a certain matter that we have communicated to management in a separate letter dated June 16, 2006.

This report is intended solely for the information and use of Council and the management of the City of Defiance, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Julian & Grube, Inc.".

Julian & Grube, Inc.
June 16, 2006

**CITY OF DEFIANCE
DEFIANCE COUNTY, OHIO**

**STATUS OF PRIOR AUDIT FINDINGS
DECEMBER 31, 2005**

<u>Finding Number</u>	<u>Finding Summary</u>	<u>Fully Corrected?</u>	Not Corrected, Partially Corrected; Significantly Different Corrective Action Taken; or Finding No Longer Valid; Explain:
2004-COD-001	Ohio Revised Code Section 5705.39 states in part that the total appropriation from each fund shall not exceed total estimated resources.	Yes	Finding no longer valid.
2004-COD-002	Ohio Revised Code Section 5705.41(B) requires that no subdivision is to expend money unless it has been appropriated.	Yes	Finding no longer valid.
2004-COD-003	Ohio Revised Code Section 5705.10 in part requires that money paid into any fund shall be expended only after such fund receives monies to cover expenditures.	Yes	Finding no longer valid.



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Betty Montgomery**

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CITY OF DEFIANCE

DEFIANCE 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
SEPTEMBER 12, 2006**