



**Auditor of State
Betty Montgomery**

VILLAGE OF GRATIS
PREBLE COUNTY

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**Auditor of State
Betty Montgomery**

Village of Gratis
Preble County
404 Harrison Street
Gratis, Ohio 45330

To the Village Council:

As you are aware, the Auditor of State's Office (AOS) must modify the *Independent Accountants' Report* we provide on your financial statements due to a February 2, 2005 interpretation from the American Institute of Certified Public Accountants (AICPA). While AOS does not legally require your government to prepare financial statements pursuant to Generally Accepted Accounting Principles (GAAP), the AICPA interpretation requires auditors to formally acknowledge that you did not prepare your financial statements in accordance with GAAP. Our Report includes an opinion relating to GAAP presentation and measurement requirements, but does not imply the amounts the statements present are misstated under the non-GAAP basis you follow. The AOS report also includes an opinion on the financial statements you prepared using the cash basis and financial statement format the AOS permits.

A handwritten signature in cursive script that reads "Betty Montgomery".

Betty Montgomery
Auditor of State

November 2, 2006

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Auditor of State Betty Montgomery

INDEPENDENT ACCOUNTANTS' REPORT

Village of Gratis
Preble County
404 Harrison Street
Gratis, Ohio 45330

To the Village Council:

We have audited the accompanying financial statements of the Village of Gratis, Preble County, Ohio (the Village), as of and for the years ended December 31, 2005 and 2004. These financial statements are the responsibility of the Village's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the Comptroller General of the United States' *Government Auditing Standards*. Those standards require that we plan and perform the audit to reasonably assure whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. The Village processes its financial transactions with the Auditor of State's Uniform Accounting Network (UAN). *Government Auditing Standards* considers this service to impair the independence of the Auditor of State to audit the Village because the Auditor of State designed, developed, implemented, and as requested, operates UAN. However, *Government Auditing Standards* permits the Auditor of State to audit and opine on this entity, because Ohio Revised Code § 117.101 requires the Auditor of State to provide UAN services, and Ohio Revised Code §§ 117.11(B) and 115.56 mandate the Auditor of State to audit Ohio governments. We believe our audit provides a reasonable basis for our opinion.

As described more fully in Note 1, the Village has prepared these financial statements using accounting practices the Auditor of State prescribes or permits. These practices differ from accounting principles generally accepted in the United States of America (GAAP). Although we cannot reasonably determine the effects on the financial statements of the variances between these regulatory accounting practices and GAAP, we presume they are material.

Revisions to GAAP would require the Village to reformat its financial statement presentation and make other changes effective for the years ended December 31, 2005 and 2004. Instead of the combined funds the accompanying financial statements present for 2005 and 2004, the revisions require presenting entity wide statements and also to present its larger (i.e. major) funds separately for 2005 and 2004. While the Village does not follow GAAP, generally accepted auditing standards requires us to include the following paragraph if the statements do not substantially conform to the new GAAP presentation requirements. The Auditor of State permits, but does not require governments to reformat their statements. The Village has elected not to reformat its statements. Since this Village does not use GAAP to measure financial statement amounts, the following paragraph does not imply the amounts reported are materially misstated under the accounting basis the Auditor of State permits. Our opinion on the fair presentation of the amounts reported pursuant to its non-GAAP basis is in the second following paragraph.

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In our opinion, because of the effects of the matter discussed in the preceding two paragraphs, the financial statements referred to above for the years ended December 31, 2005 and 2004 do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Village as of December 31, 2005 and 2004, or its changes in financial position or cash flows of its proprietary funds for the years then ended.

Also, in our opinion, the financial statements referred to above present fairly, in all material respects, the combined fund cash balances and reserves for encumbrances of the Village of Gratis, Preble County, Ohio, as of December 31, 2005 and 2004, and its combined cash receipts and disbursements for the years then ended on the accounting basis Note 1 describes.

The aforementioned revision to generally accepted accounting principles also requires the Village to include Management's Discussion and Analysis for the years ended December 31, 2005 and 2004. The Village has not presented Management's Discussion and Analysis, which accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the financial statements.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 2, 2006, on our consideration of the Village's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. While we did not opine on the internal control over financial reporting or on compliance, that report describes the scope of our testing of internal control over financial reporting and compliance, and the results of that testing. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*. You should read it in conjunction with this report in assessing the results of our audit.



Betty Montgomery
Auditor of State

November 2, 2006

**VILLAGE OF GRATIS
PREBLE COUNTY**

**COMBINED STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND
CHANGES IN FUND CASH BALANCES - GOVERNMENTAL FUND TYPES
FOR THE YEAR ENDED DECEMBER 31, 2005**

	<u>General</u>	<u>Special Revenue</u>	<u>Capital Projects</u>	<u>Totals (Memorandum Only)</u>
Cash Receipts:				
Property Tax and Other Local Taxes	\$19,681	\$37,155	\$0	\$56,836
Intergovernmental Receipts	43,152	63,285	0	106,437
Charges for Services	0	203,024	0	203,024
Fines, Licenses, and Permits	160	0	0	160
Earnings on Investments	1,733	258	0	1,991
Miscellaneous	6,480	18,188	0	24,668
	<u>71,206</u>	<u>321,910</u>	<u>0</u>	<u>393,116</u>
Cash Disbursements:				
Current:				
Security of Persons and Property	35,648	31,070	0	66,718
Public Health Services	0	109,966	0	109,966
Leisure Time Activities	536	1,481	0	2,017
Transportation	1,725	35,753	0	37,478
General Government	48,232	12,074	0	60,306
Debt Service:				
Principal Payments	0	15,070	0	15,070
Interest Payments	0	2,581	0	2,581
Capital Outlay	1,265	51,478	0	52,743
	<u>87,406</u>	<u>259,473</u>	<u>0</u>	<u>346,879</u>
Total Receipts Over/(Under) Disbursements	<u>(16,200)</u>	<u>62,437</u>	<u>0</u>	<u>46,237</u>
Other Financing Receipts and (Disbursements):				
Advances-In	1,000	0	0	1,000
Advances-Out	(1,000)	0	0	(1,000)
Other Financing Uses	0	(3,795)	0	(3,795)
	<u>0</u>	<u>(3,795)</u>	<u>0</u>	<u>(3,795)</u>
Excess of Cash Receipts and Other Financing Receipts Over/(Under) Cash Disbursements and Other Financing Disbursements	(16,200)	58,642	0	42,442
Fund Cash Balances, January 1	<u>26,238</u>	<u>147,116</u>	<u>58</u>	<u>173,412</u>
Fund Cash Balances, December 31	<u>\$10,038</u>	<u>\$205,758</u>	<u>\$58</u>	<u>\$215,854</u>
Reserves for Encumbrances, December 31	<u>\$421</u>	<u>\$921</u>	<u>\$0</u>	<u>\$1,342</u>

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

**VILLAGE OF GRATIS
PREBLE COUNTY**

**COMBINED STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND
CHANGES IN FUND CASH BALANCES - PROPRIETARY FUND TYPE
FOR THE YEAR ENDED DECEMBER 31, 2005**

Operating Cash Receipts:	
Charges for Services	\$236,307
Total Operating Cash Receipts	236,307
Operating Cash Disbursements:	
Personal Services	62,225
Fringe Benefits	19,786
Contractual Services	104,207
Supplies and Materials	16,519
Other	591
Capital Outlay	28,630
Total Operating Cash Disbursements	231,958
Operating Income	4,349
Non-Operating Cash Receipts:	
Property Tax and Other Local Taxes	
Intergovernmental Receipts	57,528
OWDA Loan Proceeds	10,406
Other Non-Operating Receipts	4,768
Total Non-Operating Cash Receipts	72,702
Non-Operating Cash Disbursements:	
Debt Service	68,628
Total Non-Operating Cash Disbursements	68,628
Excess of Receipts Over Disbursements Before Interfund Advances	8,423
Advances-In	1,000
Advances-Out	(1,000)
Net Receipts Over Disbursements	8,423
Fund Cash Balances, January 1	184,124
Fund Cash Balances, December 31	\$192,547
Reserve for Encumbrances, December 31	\$842

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

**VILLAGE OF GRATIS
PREBLE COUNTY**

**COMBINED STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND
CHANGES IN FUND CASH BALANCES - GOVERNMENTAL FUND TYPES
FOR THE YEAR ENDED DECEMBER 31, 2004**

	<u>General</u>	<u>Special Revenue</u>	<u>Capital Projects</u>	<u>Totals (Memorandum Only)</u>
Cash Receipts:				
Property Tax and Other Local Taxes	\$20,537	\$37,249	\$0	\$57,786
Intergovernmental Receipts	43,144	58,956	0	102,100
Charges for Services	0	182,073	0	182,073
Fines, Licenses, and Permits	3,879	0	0	3,879
Earnings on Investments	1,237	167	0	1,404
Miscellaneous	7,587	29,952	0	37,539
	<u>76,384</u>	<u>308,397</u>	<u>0</u>	<u>384,781</u>
Total Cash Receipts				
Cash Disbursements:				
Current:				
Security of Persons and Property	14,360	28,433	0	42,793
Public Health Services	0	104,160	0	104,160
Leisure Time Activities	344	1,350	0	1,694
Transportation	0	34,723	0	34,723
General Government	36,275	13,460	0	49,735
Debt Service:				
Principal Payments	0	24,515	0	24,515
Interest Payments	0	3,254	0	3,254
Capital Outlay	4,423	17,599	0	22,022
	<u>55,402</u>	<u>227,494</u>	<u>0</u>	<u>282,896</u>
Total Cash Disbursements				
Total Receipts Over Disbursements	<u>20,982</u>	<u>80,903</u>	<u>0</u>	<u>101,885</u>
Other Financing Receipts and (Disbursements):				
EMS Payroll Loan Proceeds	10,000	0	0	10,000
Sale of Fixed Assets		15,000		15,000
Advances-In		10,000	0	10,000
Advances-Out	(10,000)	0	0	(10,000)
Othe Financing Uses		(5,039)	0	(5,039)
	<u>0</u>	<u>19,961</u>	<u>0</u>	<u>19,961</u>
Total Other Financing Receipts/(Disbursements)				
Excess of Cash Receipts and Other Financing Receipts Over Cash Disbursements and Other Financing Disbursements	20,982	100,864	0	121,846
Fund Cash Balances, January 1	<u>5,256</u>	<u>46,252</u>	<u>58</u>	<u>51,566</u>
Fund Cash Balances, December 31	<u>\$26,238</u>	<u>\$147,116</u>	<u>\$58</u>	<u>\$173,412</u>

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

VILLAGE OF GRATIS
PREBLE COUNTY

COMBINED STATEMENT OF CASH RECEIPTS, CASH DISBURSEMENTS, AND
CHANGES IN FUND CASH BALANCES - PROPRIETARY FUND TYPE
FOR THE YEAR ENDED DECEMBER 31, 2004

Operating Cash Receipts:	
Charges for Services	\$222,447
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Total Operating Cash Receipts	222,447
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Operating Cash Disbursements:	
Personal Services	53,948
Fringe Benefits	13,067
Contractual Services	130,552
Supplies and Materials	38,215
Other	6,590
Capital Outlay	71,803
	<hr/>
Total Operating Cash Disbursements	314,175
	<hr/>
Operating (Loss)	(91,728)
	<hr/>
Non-Operating Cash Receipts:	
Intergovernmental Receipts	36,706
Water & Sewer Meters Loan Proceeds	50,433
OWDA Loan Proceeds	58,281
Other Non-Operating Receipts	68
	<hr/>
Total Non-Operating Cash Receipts	145,488
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Non-Operating Cash Disbursements:	
Debt Service	52,532
	<hr/>
Total Non-Operating Cash Disbursements	52,532
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Net Receipts Over Disbursements	1,228
	<hr/>
Fund Cash Balances, January 1	182,896
	<hr/>
Fund Cash Balances, December 31	\$184,124
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The notes to the financial statements are an integral part of this statement.

**VILLAGE OF GRATIS
PREBLE COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of the Entity

The constitution and laws of the State of Ohio establish the rights and privileges of the Village of Gratis, Preble County, Ohio (the Village), as a body corporate and politic. A publicly-elected six-member Council governs the Village. The Village provides water and sewer utilities, EMS, fire and police.

The Village's management believes these financial statements present all activities for which the Village is financially accountable, except the financial statements do not include debt service funds external custodians maintain. Note 6 to the financial statements describes these assets.

B. Basis of Accounting

These financial statements follow the accounting basis the Auditor of State prescribes or permits. This basis is similar to the cash receipts and disbursements accounting basis. This basis recognizes receipts when received in cash rather than when earned, and recognizes disbursements when paid rather than when a liability is incurred. Budgetary presentations report budgetary expenditures when a commitment is made (i.e., when an encumbrance is approved).

These statements adequately disclose material matters the Auditor of State prescribes.

C. Cash and Deposits

Village funds are pooled in checking accounts with local commercial banks.

D. Fund Accounting

The Village uses fund accounting to segregate cash and deposits that are restricted as to use. The Village classifies its funds into the following types:

1. General Fund

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

2. Special Revenue Funds

These funds account for proceeds from specific sources (other than from trusts or for capital projects) that are restricted to expenditure for specific purposes. The Village had the following significant Special Revenue Funds:

Street Construction, Maintenance, and Repair Fund - This fund receives gasoline tax and motor vehicle tax money for constructing, maintaining, and repairing Village streets.

**VILLAGE OF GRATIS
PREBLE COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(Continued)**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fire Fund – This fund receives real estate and personal property taxes and contracts with Gratis Township to provide for the protection of area citizens.

EMS Fund – This fund receives real estate and personal property taxes and contracts with Gratis Township and the Village of West Elkton to provide for the protection of area citizens.

3. Capital Project Fund

This fund accounts for receipts restricted to acquiring or constructing major capital projects (except those financed through enterprise or trust funds). The Village had the following significant capital project fund:

Capital Improvement Fund - This fund was used to construct a capital improvement.

4. Enterprise Funds

These funds account for operations that are similar to private business enterprises, where management intends to recover the significant costs of providing certain goods or services through user charges. The Village had the following significant Enterprise Funds

Water Fund - This fund receives charges for services from residents to cover water service costs.

Sewer Fund - This fund receives charges for services from residents to cover sewer service costs.

E. Budgetary Process

The Ohio Revised Code requires that each fund be budgeted annually.

1. Appropriations

Budgetary expenditures (that is, disbursements and encumbrances) may not exceed appropriations at the object level of control, and appropriations may not exceed estimated resources. Village Council must annually approve appropriation measures and subsequent amendments. The County Budget Commission must also approve the annual appropriation measure. Unencumbered appropriations lapse at year end.

2. Estimated Resources

Estimated resources include estimates of cash to be received (budgeted receipts) plus unencumbered cash as of January 1. The County Budget Commission must also approve estimated resources.

**VILLAGE OF GRATIS
PREBLE COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(Continued)**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3. Encumbrances

The Ohio Revised Code requires the Village to reserve (encumber) appropriations when commitments are made. Encumbrances outstanding at year end are carried over, and need not be reappropriated.

A summary of 2005 and 2004 budgetary activity appears in Note 3.

F. Property, Plant, and Equipment

The Village records disbursements for acquisitions of property, plant, and equipment when paid. The accompanying financial statements do not report these items as assets.

G. Accumulated Leave

In certain circumstances, such as upon leaving employment, employees are entitled to cash payments for unused leave. The financial statements do not include a liability for unpaid leave.

2. EQUITY IN POOLED CASH AND DEPOSITS

The Village maintains a cash and deposits pool all funds use. The Ohio Revised Code prescribes allowable deposits and investments. The carrying amount of cash and deposits at December 31 was as follows:

	2005	2004
Demand deposits	408,401	357,536
Total deposits	408,401	357,536

Deposits: Deposits are insured by the Federal Depository Insurance Corporation; or collateralized by the financial institution's public entity deposit pool.

3. BUDGETARY ACTIVITY

Budgetary activity for the years ending December 31, 2005 and 2004 follows:

2005 Budgeted vs. Actual Receipts			
Fund Type	Budgeted Receipts	Actual Receipts	Variance
General	\$79,000	\$71,206	(\$7,794)
Special Revenue	378,153	321,910	(56,243)
Enterprise	334,998	309,009	(25,989)
Total	\$792,151	\$702,125	(\$90,026)

**VILLAGE OF GRATIS
PREBLE COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(Continued)**

3. BUDGETARY ACTIVITY (Continued)

2005 Budgeted vs. Actual Budgetary Basis Expenditures			
Fund Type	Appropriation Authority	Budgetary Expenditures	Variance
General	\$105,212	\$87,827	\$17,385
Special Revenue	399,857	264,189	135,668
Capital Projects	58	0	58
Enterprise	458,615	301,428	157,187
Total	<u>\$963,742</u>	<u>\$653,444</u>	<u>\$310,298</u>

2004 Budgeted vs. Actual Receipts			
Fund Type	Budgeted Receipts	Actual Receipts	Variance
General	\$79,000	\$86,384	\$7,384
Special Revenue	327,803	323,397	(4,406)
Enterprise	281,980	367,935	85,955
Total	<u>\$688,783</u>	<u>\$777,716</u>	<u>\$88,933</u>

2004 Budgeted vs. Actual Budgetary Basis Expenditures			
Fund Type	Appropriation Authority	Budgetary Expenditures	Variance
General	\$74,256	\$55,402	\$18,854
Special Revenue	376,555	232,533	144,022
Capital Projects	58	0	58
Enterprise	404,184	366,707	37,477
Total	<u>\$855,053</u>	<u>\$654,642</u>	<u>\$200,411</u>

4. PROPERTY TAX

Real property taxes become a lien on January 1 preceding the October 1 date for which the Village Council adopts tax rates. The State Board of Tax Equalization adjusts these rates for inflation. Property taxes are also reduced for applicable homestead and rollback deductions. The State pays the Village amounts equaling these deductions. The Village includes these with Intergovernmental Receipts. Payments are due to the County by December 31. If the property owner elects to pay semiannually, the first half payment is due December 31. The second half payment is due the following June 20.

Public utilities are also taxed on personal and real property located within the Village.

Property owners assess tangible personal property tax. They must file a list of tangible property to the County by each April 30. The County is responsible for assessing property, and for billing, collecting, and distributing all property taxes on the Village's behalf.

**VILLAGE OF GRATIS
PREBLE COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(Continued)**

5. DEBT

Debt outstanding at December 31, 2005 was as follows:

	Principal	Interest Rate
Sewer Revenue Bonds	\$339,000	5.00%
Water Revenue Bonds	80,000	Varies
Vehicle Acquisition and Renovation Bonds	68,389	3.75%
Water Tower Land Loan	15,000	4.53%
Ohio Water Development Authority Loan	81,916	5.65%
Water and Sewer Meters Loan	41,205	4.00%
Total	\$625,510	

The Sewer Revenue Bonds relate to mortgage revenue bonds issued in 1980. The bonds will be repaid in annual installments over 40 years. The bonds are collateralized by water and sewer receipts. The Village has agreed to set utility rates sufficient to cover debt service requirements.

The Water Revenue Bonds relate to mortgage revenue bonds issued in 1998 to fund improvements to the Village's water system. The bonds will be repaid in semi-annual installments over 15 years. The bonds are collateralized by water and sewer receipts. The Village has agreed to set utility rates sufficient to cover debt service requirements.

The Vehicle Acquisition and Renovation Bonds relate to bonds issued in 2003 for the purpose of acquiring a new truck and related equipment, acquiring an ambulance and renovating an existing ambulance. The bonds will be repaid in semi-annual installments over 7 years. The bonds are collateralized solely by the Village's taxing authority.

The Water Tower Land Loan was obtained in 2003 to purchase land for the water tower. The loan is to be repaid in ten semi-annual installments of \$2,500, excluding interest. The loan is collateralized by a mortgage on the water tower land.

The Ohio Water Development Authority (OWDA) loan relates to the Village's water system improvements planned in the water system. The OWDA has approved up to \$110,895 in loans to the Village for this project. The one lump sum loan payoff is due in July 2007. The scheduled payment amount below assumes that \$110,895 will be borrowed. The scheduled payment will be adjusted to reflect any revisions in amounts actually borrowed. The loan is collateralized by water and sewer receipts.

The Water and Sewer Meter Loan was obtained in 2004 to purchase touch read water and sewer meters. The loan is to be repaid in annual installments payments of \$931.42 over 5 years. The loan is collateralized by water and sewer receipts.

The EMS Payroll Loan was obtained in January 2004 in the amount of \$10,000 to pay EMS employees' payroll. The loan was receipted into the General Fund and then advanced to the EMS Fund. The loan was then repaid from the EMS Fund in April 2004.

**VILLAGE OF GRATIS
PREBLE COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(Continued)**

5. DEBT (Continued)

Amortization of the above debt, including interest, follows:

Year ending December 31:	Sewer Revenue Bonds	Water Revenue Bonds	Vehicle Acquisition Bonds	Water Tower Land Loan
2006	\$32,950	\$14,350	\$21,053	\$5,619
2007	32,150	13,830	21,053	5,394
2008	32,350	13,305	21,060	5,169
2009	32,500	12,775	10,520	
2010	32,600	12,235		
2011 - 2015	163,750	33,373		
2016 - 2020	163,950			
Total	<u>\$490,250</u>	<u>\$99,868</u>	<u>\$73,686</u>	<u>\$16,182</u>

Year ending December 31:	OWDA Loan	Water and Sewer Meter Loan
2006		\$10,246
2007	\$110,895	11,177
2008		11,177
2009		11,177
2010		
2011 - 2015		
2016 - 2020		
Total	<u>\$110,895</u>	<u>\$43,777</u>

6. DEBT SERVICE TRUSTEED FUNDS

The 1998 Water Revenue bond agreement required the Village to establish a debt service fund to be maintained by a custodian bank. The Village has established this fund. At December 31, 2005, the custodian held \$1,605 in Village assets. The accompanying financial statements do not include these assets or the related receipts and disbursements.

7. RETIREMENT SYSTEMS

A. Ohio Personal Employee Retirement System

The Village's full-time employees belong to the Ohio Public Employees Retirement System (OPERS). OPERS is a cost-sharing, multiple-employer plan. The Ohio Revised Code prescribes the plan's retirement benefits, including postretirement healthcare and survivor and disability benefits.

**VILLAGE OF GRATIS
PREBLE COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(Continued)**

7. RETIREMENT SYSTEMS (Continued)

The Ohio Revised Code also prescribes contribution rates. For 2005 and 2004, OPERS members contributed 8.5 percent of their wages. The Village contributed an amount equal to 13.55 percent of participants' gross salaries. The Village has paid all contributions required through December 31, 2005.

B. Social Security System

Effective July 1, 1991, all employees not otherwise covered by the OPERS have an option to choose Social Security. As of December 31, 2005, fourteen employees of the Village have elected Social Security. The employees' liability is 6.2 percent of wages paid.

8. RISK MANAGEMENT

The Village is exposed to various risks of property and casualty losses, and injuries to employees.

The Village insures against injuries to employees through the Ohio Bureau of Worker's Compensation.

The Village belongs to the Public Entities Pool of Ohio (PEP), a risk-sharing pool available to Ohio local governments. PEP provides property and casualty coverage for its members. PEP is a member of the American Public Entity Excess Pool (APEEP). Member governments pay annual contributions to fund PEP. PEP pays judgments, settlements and other expenses resulting from covered claims that exceed the members' deductibles.

Casualty Coverage

PEP retains casualty risks up to \$250,000 per occurrence, including claim adjustment expenses. PEP pays a percentage of its contributions to APEEP. APEEP reinsures claims exceeding \$250,000, up to \$1,750,000 per claim and \$10,000,000 in the aggregate per year. Governments can elect additional coverage, from \$2,000,000 to \$12,000,000 with the General Reinsurance Corporation, through contracts with PEP.

If losses exhaust PEP's retained earnings, APEEP provides *excess of funds available* coverage up to \$5,000,000 per year, subject to a per-claim limit of \$2,000,000.

Property Coverage

Through 2004, PEP retained property risks, including automobile physical damage, up to \$100,000 on any specific loss in any one occurrence. The Travelers Indemnity Company reinsured losses exceeding \$100,000 up to \$500 million per occurrence. APEEP's Guarantee Fund was responsible for losses and loss adjustment expenses exceeding operating contributions.

**VILLAGE OF GRATIS
PREBLE COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(Continued)**

8. RISK MANAGEMENT (Continued)

Beginning in 2005, Travelers reinsures specific losses exceeding \$250,000 up to \$600 million per occurrence. APEEP reinsures members for specific losses exceeding \$100,000 up to \$250,000 per occurrence, subject to an annual aggregate loss payment. Travelers provides aggregate stop-loss coverage based upon the combined members' total insurable value. If the stop loss is reached by payment of losses between \$100,000 and \$250,000, Travelers will reinsure specific losses exceeding \$100,000 up to their \$600 million per occurrence limit. The aggregate stop-loss limit for 2005 was \$1,682,589.

The aforementioned casualty and property reinsurance agreements do not discharge PEP's primary liability for claims payments on covered losses. Claims exceeding coverage limits are the obligation of the respective township.

Property and casualty settlements did not exceed insurance coverage for the past three fiscal years.

Members may withdraw on each anniversary of the date they joined PEP. They must provide written notice to PEP 60 days in advance of the anniversary date. Upon withdrawal, members are eligible for a full or partial refund of their capital contribution, minus the subsequent year's premium. Also upon withdrawal, payments for all property and casualty claims and claim expenses become the sole responsibility of the withdrawing member, regardless of whether a claim was incurred or reported prior to the withdrawal.

Financial Position

PEP's financial statements (audited by other accountants) conform with generally accepted accounting principles, and reported the following assets, liabilities and retained earnings at December 31, 2005 and 2004.

<u>Casualty Coverage</u>	<u>2005</u>	<u>2004</u>
Assets	\$29,719,675	\$27,437,169
Liabilities	<u>(15,994,168)</u>	<u>(13,880,038)</u>
Retained earnings	<u>\$13,725,507</u>	<u>\$13,557,131</u>

<u>Property Coverage</u>	<u>2005</u>	<u>2004</u>
Assets	\$4,443,332	\$3,648,272
Liabilities	<u>(1,068,245)</u>	<u>(540,073)</u>
Retained earnings	<u>\$3,375,087</u>	<u>\$3,108,199</u>

**VILLAGE OF GRATIS
PREBLE COUNTY**

**NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004
(Continued)**

8. RISK MANAGEMENT (Continued)

The Casualty Coverage assets and retained earnings above include approximately \$14.3 million and \$12 million of unpaid claims to be billed to approximately 430 member governments in the future, as of December 31, 2005 and 2004, respectively. PEP will collect these amounts in future annual premium billings when PEP's related liabilities are due for payment. The Village's share of these unpaid claims is approximately \$33,072.

9. SUBSEQUENT EVENT

In 2006, the Village obtained a \$763,289 loan from OWDA for the construction of an elevated water tower.

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Auditor of State Betty Montgomery

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

Village of Gratis
Preble County
404 Harrison Street
Gratis, Ohio 45330

To the Village Council:

We have audited the financial statements of the Village of Gratis, Preble County, Ohio (the Village), as of and for the years ended December 31, 2005 and 2004, and have issued our report thereon dated November 2, 2006, wherein we noted the Village followed accounting practices the Auditor of State prescribes rather than accounting principles generally accepted in the United States of America. We also noted that the Village uses the Auditor of State's Uniform Accounting Network (UAN) to process its financial transactions. *Government Auditing Standards* considers this service to impair the Auditor of State's independence to audit the Village because the Auditor of State designed, developed, implemented, and, as requested, operates UAN. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the Comptroller General of the United States' *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Village's internal control over financial reporting to determine our auditing procedures to express our opinion on the financial statements and not to opine 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 material to the financial statements we audited may occur and not be timely detected by employees when performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider material weaknesses. In a separate letter to the Village's management dated November 2, 2006, we reported other matters involving internal control over financial reporting we did not deem reportable conditions.

Compliance and Other Matters

As part of reasonably assuring whether the Village's financial statements are free of material misstatement, we tested its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could directly and materially affect the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express an opinion. The results of our tests disclosed no instances of noncompliance or other matters we must report under *Government Auditing Standards*. In a separate letter to the Village's management dated November 2, 2006, we reported other matters related to noncompliance we deemed immaterial.

Village of Gratis
Preble County
Independent Accountants' Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters
Required by *Government Auditing Standards*
Page 2

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

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

Betty Montgomery
Auditor of State

November 2, 2006

VILLAGE OF GRATIS
PREBLE COUNTY

SCHEDULE OF PRIOR AUDIT FINDINGS
DECEMBER 31, 2005 AND 2004

Finding Number	Finding Summary	Fully Corrected?	Not Corrected, Partially Corrected; Significantly Different Corrective Action Taken; or Finding No Longer Valid; <i>Explain</i>
2003-001	Activity from separate Fire Department bank account not recorded on Village's books.	Yes	N/A



**Auditor of State
Betty Montgomery**

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VILLAGE OF GRATIS

PREBLE 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
NOVEMBER 28, 2006**