

OFFICE OF FINANCIAL INCENTIVES

FINANCIAL STATEMENTS

Franklin County

June 30, 2005



**Auditor of State
Betty Montgomery**

Office of Financial Incentives
77 South High Street
28th Floor
Columbus, Ohio 43215

We have reviewed the Independent Auditor's Report of the Office of Financial Incentives, Franklin County, prepared by Crowe Chizek and Company LLC for the audit period July 1, 2004 through June 30, 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 Office of Financial Incentives is responsible for compliance with these laws and regulations.

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BETTY MONTGOMERY
Auditor of State

November 17, 2005

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OFFICE OF FINANCIAL INCENTIVES

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Crowe Chizek and Company LLC
Member Horwath International

REPORT OF INDEPENDENT AUDITORS

To the Office of Financial Incentives
State of Ohio

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Office of Financial Incentives (Office), State of Ohio, as of and for the year ended June 30, 2005, which collectively comprise the Office's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Office'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 *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

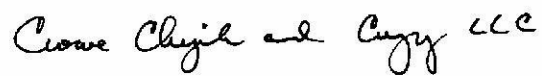
As discussed in Note 1, the financial statements of the Office of Financial Incentives are intended to present the financial position and the changes in net assets, or fund balances thereof of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information that is attributable to the transactions of the Office. They do not purport to, and do not, present fairly the financial position of the State of Ohio as of June 30, 2005, and the changes in its financial position for the year ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Office of Financial Incentives, as of June 30 2005, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 23, 2005 on our consideration of the Office's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis on pages 3 through 7 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Office of Financial Incentives' basic financial statements. The combining nonmajor fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining nonmajor fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in cursive script that reads "Crowe Chizek and Company LLC".

Crowe Chizek and Company LLC

Columbus, Ohio
September 23, 2005

**OFFICE OF FINANCIAL INCENTIVES
MANAGEMENT'S DISCUSSION & ANALYSIS**
For the Year Ended June 30, 2005

As management of the Office of Financial Incentives (OFI) we are providing this overview of OFI's financial activities for the fiscal year ended June 30, 2005. Please read this overview in conjunction with the OFI's basic financial statements, which follow.

OFI was created as part of the Ohio Department of Development (ODOD) on July 14, 1983, by action of the State of Ohio Legislature. OFI administers the 166 Direct Loan, Loan Guarantee, and Ohio Enterprise Bond Fund programs of the ODOD under Chapter 122 and 166 of the Ohio Revised Code.

The 166 Direct Loan program provides direct loans for businesses locating or expanding in Ohio that demonstrate they will create or retain new jobs for Ohio citizens. The Ohio Enterprise Bond Fund program (OEBF) provides one-stop project financing for qualifying commercial, industrial, and manufacturing businesses in the State of Ohio. OEBF project amounts may range from \$2 million to \$10 million for up to 90% of the eligible project cost. The OEBF has achieved an investment grade rating of "AA-" by Standard & Poors (S&P). As a result, ODOD can issue, on behalf of all borrowers, investment grade economic development revenue bonds. The OEBF allows large and small creditworthy, but unrated, businesses access to national capital markets which they otherwise may not be able to independently enter.

OFI is included within the State of Ohio's Comprehensive Annual Financial Report as part of the primary government. OFI uses a special revenue fund to report its financial position and results of operations. We believe these financial statements present all activities for which OFI is financially responsible.

FINANCIAL HIGHLIGHTS

Key financial highlights for fiscal year 2005 are as follows:

- The assets of the OFI exceeded its liabilities at the close of the most recent fiscal year by \$589 million (net assets).
- The OFI's total net assets increased by \$60.6 million.
- As of the close of the current fiscal year, the OFI's government funds reported combined ending fund balances of \$592 million, an increase of \$60.8 million in comparison with the prior year.
- At the end of the current fiscal year, unreserved fund balance was \$174 million.
- OFI closed 27 166 Direct Loans totaling \$41.4 million, one Pioneer Rural Loan totaling \$750,000, one OEBF totaling \$7.9 million, two Rural Industrial Park Loans totaling \$1 million, one Research and Development Loan totaling \$4.5 million, three Innovation Ohio Loans totaling \$2 million, and two Rural Development grants totaling \$1 million.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to OFI's basic financial statements. These basic financial statements are comprised of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements.

Government-wide financial statements.

The government-wide financial statements are designed to provide readers with a broad overview of the OFI's finances, in a manner similar to a private-sector business.

The statement of net assets presents information on all of the OFI's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of OFI is improving or deteriorating.

**OFFICE OF FINANCIAL INCENTIVES
MANAGEMENT'S DISCUSSION & ANALYSIS**
For the Year Ended June 30, 2005

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED)

The statement of activities presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash inflows or outflows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

The government-wide financial statements can be found on pages 9-10 of this report.

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 OFI, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All funds can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds. All of the OFI's funds are 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.

Because the focus of 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, 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 OFI maintains eleven individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the Operating Fund, Facilities Establishment Fund, Regional Agency Fund, Rural Development Initiative Fund, Ohio Innovation Fund and Research and Development Fund, all of which are considered to be major funds. Data from the other six governmental funds are combined into a single, aggregated presentation. Individual data for each of these nonmajor governmental funds is provided in the form of combining statements elsewhere in this report.

The fund financial statements can be found on pages 11-17 of this report.

Notes to the 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. The notes to the financial statements can be found on pages 18-30 of this report.

Other information

The combining statements referred to earlier in connection with nonmajor governmental funds are presented immediately following the notes to the financial statements. These combining statements can be found on pages 32-35 of this report.

**OFFICE OF FINANCIAL INCENTIVES
MANAGEMENT'S DISCUSSION & ANALYSIS
For the Year Ended June 30, 2005**

FINANCIAL ANALYSIS OF THE OFFICE OF CREDIT AND FINANCE

Government-wide Financial Analysis

The following is a summary of OFI's net assets as of June 30, 2005 compared to June 30, 2004.

Net Assets at June 30

	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Assets			
Current and Other Non Current Assets	\$ 745,203,097	\$ 616,209,491	20.9%
Capital Assets, Non-Infrastructure	<u>231,524</u>	<u>231,524</u>	0.0%
Total Assets	<u>745,434,621</u>	<u>616,441,015</u>	20.9%
Liabilities			
Current Liabilities	153,300,494	84,984,170	80.4%
Due in More Than One Year	<u>3,095,811</u>	<u>3,067,869</u>	0.9%
Total Liabilities	<u>156,396,305</u>	<u>88,052,039</u>	77.6%
Net Assets			
Invested in Capital Assets	231,524	231,524	0.0%
Restricted for the Enterprise Bond Program	10,000,000	10,000,000	0.0%
Unrestricted	<u>578,806,792</u>	<u>518,157,452</u>	11.7%
Total Net Assets	<u>\$ 589,038,316</u>	<u>\$ 528,388,976</u>	11.5%

Total Assets

Total Assets of OFI increased by \$129 million, or 20.9%, during fiscal year 2005. This increase is primarily the result of a combination of OFI receiving \$ 50 million in bond proceeds in the Facilities Establishment Fund and a \$68.2 million increase in allocated collateral on lent securities, as reported by the Treasurer of State.

Total Liabilities

Total Liabilities of OFI increased by \$68.3 million during fiscal year 2005. This increase is the result of the \$68.2 million increase in allocated obligations under securities lending, as reported by the Treasurer of State.

Total Net Assets

During fiscal year 2005, OFI's Net Assets increased \$ 60.6 million, or 11.5%. Net Assets invested in Capital Assets and Restricted Net Assets remained unchanged. The increase in Unrestricted Net Assets is primarily attributed to the \$50 million in bond proceeds received. The remaining \$10.6 million is the amount by which program and general revenues, \$10.3 million and \$6.9 million, respectively, outstripped program expenses of \$6.5 million.

**OFFICE OF FINANCIAL INCENTIVES
MANAGEMENT'S DISCUSSION & ANALYSIS**
For the Year Ended June 30, 2005

FINANCIAL ANALYSIS OF THE OFFICE OF CREDIT AND FINANCE (CONTINUED)

The following is a summary of OFI's Statement of Activities for the year ending June 30, 2005 compared to the year ending June 30, 2004.

Statement of Activity for the year ending June 30

	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Revenues			
Program Revenues:			
Community and Economic Development	<u>\$ 10,332,506</u>	<u>\$ 10,413,074</u>	-0.8%
General Revenues			
Bond Proceeds from the State of Ohio	50,000,000	100,000,000	100.0%
Investment Income	6,737,706	2,824,185	138.6%
Net Decrease in Fair Value of Investments	-	(382,157)	-100.0%
Miscellaneous Revenues	<u>193,488</u>	<u>152,606</u>	26.8%
Total General Revenues	<u>56,931,194</u>	<u>102,594,634</u>	
Program Expenses			
Community and Economic Development	<u>(6,485,940)</u>	<u>(11,934,987)</u>	-45.7%
Distributions to Other Offices	<u>(128,420)</u>	<u>(214,197)</u>	-40.0%
Change in Net Assets	\$ 60,649,340	\$ 100,858,524	

Program revenues consist of loan fee and interest income. In fiscal year 2005, program revenues were consistent with the prior year.

In general revenues, investment income increased \$3.9 million, or 138.6%. Towards the end of fiscal year 2004, OFI received \$100 million in bond proceeds from the State of Ohio and an additional \$50 million was received during fiscal year 2005. These additional proceeds, in conjunction with improved interest rates and a change in policy in regards to Ohio Enterprise Bond Fund reserve account interest resulted in this significant increase.

Program expenses consist primarily of personnel and operating expenditures and bad debt expense. The total program expenses decreased \$5.4 million or 45.7%. This decrease was the result of a decrease in bad debt expense.

Distributions to Other Offices decreased \$85,777, or 40%. This decrease is due to the phasing-out of the 122 Direct Loan Program.

**OFFICE OF FINANCIAL INCENTIVES
MANAGEMENT'S DISCUSSION & ANALYSIS**
For the Year Ended June 30, 2005

FINANCIAL ANALYSIS OF THE OFFICE OF CREDIT AND FINANCE (CONTINUED)

Financial Analysis of the Government's Funds

The following is a summary of OFI's fund balances as of June 30, 2005 compared to June 30, 2004.

	Fund Balance at June 30		
	2005	2004	% Change
Operating Fund	\$ 1,379,001	\$ 2,033,310	-32.2%
Facilities Establishment Fund	396,662,636	342,188,328	15.9%
Regional Agency Fund	63,797,839	61,699,644	3.4%
Rural Development Initiative Fund	1,500,000	500,000	200.0%
Ohio Innovation Fund	51,700,337	50,696,486	2.0%
Research and Development Fund	51,596,203	50,506,476	2.2%
Nonmajor Governmental Funds	<u>25,341,145</u>	<u>23,535,252</u>	7.7%
Total Fund Balance	<u>\$ 591,977,161</u>	<u>\$ 531,159,496</u>	11.4%

The Operating Fund fund balance decreased \$ 654,309, or 32.2%. This is the amount by which personnel and operating expenditures outstripped fee revenues during fiscal year 2005.

The Facilities Establishment Fund fund balance increased \$54.5 million, or 15.9%, as a result of the \$50 million of bond proceeds received from the State of Ohio.

The Rural Development Initiative Fund fund balance increased \$1 million, or 200%. This was the amount by which operating transfers in exceeded grant expenditures during fiscal year 2005.

BUDGET VARIANCES IN THE GENERAL FUND

Since OFI operates using only special revenue funds, an analysis of variations between original and final budget amounts for the General Fund has not been presented.

CAPITAL ASSETS

OFI has \$231,524 invested in net capital assets as of June 30, 2005. There were no acquisitions or dispositions during the fiscal year.

CONDITION EXPECTED TO AFFECT FUTURE OPERATIONS

OFI is aware of no conditions projected to have a significant impact on future operations.

CONTACTING THE OFFICE OF FINANCIAL INCENTIVES MANAGEMENT

This financial report is designed to provide an overview of OFI's finances and its accountability for the money it receives. If you have questions about this report or need additional financial information, contact Cindy Cleveland, Manager, Ohio Department of Development, Office of Financial Incentives, 77 South High Street, 28th Floor, Columbus, Ohio 43216-1001.

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BASIC FINANCIAL STATEMENTS

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OFFICE OF FINANCIAL INCENTIVES
STATEMENT OF NET ASSETS
June 30, 2005

	Governmental Activities
Assets	
Cash Equity with Treasurer	\$ 256,923,287
Cash and Cash Equivalents	52,044,935
Allocated Collateral on Lent Securities	152,960,353
Loans Receivable, Net	281,757,978
Leases Receivable	1,423,946
Other Assets	92,598
Capital Assets, Non-Infrastructure	<u>231,524</u>
Total Assets	<u>745,434,621</u>
Liabilities	
Accounts Payable	123,303
Accrued Liabilities	53,828
Allocated Obligations Under Securities Lending	152,960,353
Long Term Liabilities:	
Due in One Year	163,010
Due in More Than One Year	<u>3,095,811</u>
Total Liabilities	<u>156,396,305</u>
Net Assets	
Invested in Capital Assets, Net of Related Debt	231,524
Restricted for:	
Enterprise Bond Program	10,000,000
Unrestricted	<u>578,806,792</u>
Total Net Assets	<u>\$ 589,038,316</u>

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

OFFICE OF FINANCIAL INCENTIVES
 STATEMENT OF ACTIVITIES
 For the Fiscal Year Ended June 30, 2005

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Charges for Services</u>	<u>Net (Expense) Revenue and Changes in Net Assets Primary Government Governmental Activities</u>
Primary Government			
Governmental Activities			
Community and Economic Development	\$ 6,485,940	\$ 10,332,506	\$ 3,846,566
Total Governmental Activities	<u>6,485,940</u>	<u>10,332,506</u>	<u>3,846,566</u>
Total Primary Government	<u>\$ 6,485,940</u>	<u>\$ 10,332,506</u>	<u>\$ 3,846,566</u>

General Revenues:

Bond Proceeds received from the State of Ohio	50,000,000
Investment Income	6,737,706
Miscellaneous Revenue	193,488
Total General Revenues	<u>56,931,194</u>
Distributions to Other Offices	<u>(128,420)</u>
Change in Net Assets	60,649,340
Net Assets, Beginning of Year	<u>528,388,976</u>
Net Assets, End of Year	<u>\$ 589,038,316</u>

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

**OFFICE OF FINANCIAL INCENTIVES
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2005**

	Operating Fund	Facilities Establishment Fund	Regional Agency Fund
ASSETS:			
Cash Equity with Treasurer	\$ 1,532,928	\$ 149,870,270	\$ -
Cash and Cash Equivalents	-	30,894,578	20,396,152
Allocated Collateral on Lent Securities	909,578	89,419,758	-
Loans Receivable, Net	-	214,496,606	43,401,687
Leases Receivable	-	1,423,946	-
Other Assets	4,146	88,452	-
Due From Other Funds	-	-	-
TOTAL ASSETS	<u>\$ 2,446,652</u>	<u>\$ 486,193,610</u>	<u>\$ 63,797,839</u>
LIABILITIES:			
Accounts Payable	\$ 104,245	\$ -	\$ -
Accrued Liabilities	53,828	-	-
Allocated Obligations Under Securities Lending	909,578	89,419,758	-
Deferred Revenue	-	88,452	-
Due To Other Funds	-	22,764	-
TOTAL LIABILITIES	<u>1,067,651</u>	<u>89,530,974</u>	<u>-</u>
FUND BALANCES:			
Reserved for:			
Encumbrances	757,131	64,284,240	5,310,780
Noncurrent Portion of Loans Receivable	-	208,542,165	42,025,046
Noncurrent Portion of Leases Receivable	-	1,403,402	-
Ohio Enterprise Bond Program	-	10,000,000	-
Unreserved/Undesignated (Deficits)	621,870	112,432,829	16,462,013
TOTAL FUND BALANCES	<u>1,379,001</u>	<u>396,662,636</u>	<u>63,797,839</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 2,446,652</u>	<u>\$ 486,193,610</u>	<u>\$ 63,797,839</u>

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

Rural Development Initiative Fund	Innovation Ohio Fund	Research and Development Fund	Nonmajor Governmental Funds	Total Governmental Funds
\$ 1,500,000	\$ 49,719,395	\$ 47,096,203	\$ 7,204,491	\$ 256,923,287
-	-	-	754,205	52,044,935
890,040	29,501,491	27,944,995	4,294,491	152,960,353
-	2,000,000	4,500,000	17,359,685	281,757,978
-	-	-	-	1,423,946
-	-	-	-	92,598
-	-	-	22,764	22,764
<u>\$ 2,390,040</u>	<u>\$ 81,220,886</u>	<u>\$ 79,541,198</u>	<u>\$ 29,635,636</u>	<u>\$ 745,225,861</u>
\$ -	\$ 19,058	\$ -	\$ -	\$ 123,303
-	-	-	-	53,828
890,040	29,501,491	27,944,995	4,294,491	152,960,353
-	-	-	-	88,452
-	-	-	-	22,764
<u>890,040</u>	<u>29,520,549</u>	<u>27,944,995</u>	<u>4,294,491</u>	<u>153,248,700</u>
1,500,000	5,965,708	37,275,000	17,369,792	132,462,651
-	2,000,000	4,500,000	17,012,748	274,079,959
-	-	-	-	1,403,402
-	-	-	-	10,000,000
-	<u>43,734,629</u>	<u>9,821,203</u>	<u>(9,041,395)</u>	<u>174,031,149</u>
<u>1,500,000</u>	<u>51,700,337</u>	<u>51,596,203</u>	<u>25,341,145</u>	<u>591,977,161</u>
<u>\$ 2,390,040</u>	<u>\$ 81,220,886</u>	<u>\$ 79,541,198</u>	<u>\$ 29,635,636</u>	<u>\$ 745,225,861</u>

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OFFICE OF FINANCIAL INCENTIVES
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
June 30, 2005

Total Fund Balances for Governmental Funds **\$ 591,977,161**

Total net assets reported for governmental activities in the Statement of Net Assets is different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported as assets in the governmental funds. 231,524

Some of the Office's revenues are collected after year-end but are not available soon enough to pay for the current period's (within 60 days of year-end) expenditures, and therefore, are deferred in the funds. 88,452

Long term liabilities are not due and payable in the current period and therefore are not reported in the governmental funds.

Compensated Absences	(97,458)
Ohio Enterprise Bond Fund Liability	<u>(3,161,363)</u>

Total Net Assets of Governmental Activities **\$ 589,038,316**

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

OFFICE OF FINANCIAL INCENTIVES
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
GOVERNMENTAL FUNDS
For the Fiscal Year Ended June 30, 2005

	Operating Fund	Facilities Establishment Fund	Regional Agency Fund
REVENUES:			
Fee Revenue	\$ 1,134,844	\$ 530,004	\$ -
Loan Interest Income	-	6,792,675	1,764,140
Investment Income	-	4,306,257	254,599
Miscellaneous	-	134,074	42,669
TOTAL REVENUES	<u>1,134,844</u>	<u>11,763,010</u>	<u>2,061,408</u>
EXPENDITURES:			
Personnel Expenditures	902,546	-	-
Operating Expenditures	886,607	-	1,327,971
Grant Expenditures	-	-	-
OEBF Loan Payment Expenditures	-	149,760	-
Bad Debt Expense	-	1,669,020	(15,642)
Miscellaneous	-	266,476	-
TOTAL EXPENDITURES	<u>1,789,153</u>	<u>2,085,256</u>	<u>1,312,329</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	<u>(654,309)</u>	<u>9,677,754</u>	<u>749,079</u>
OTHER FINANCING SOURCES (USES):			
Interfund Transfers	-	(5,203,446)	1,349,116
Bond Proceeds received from the State of Ohio	-	50,000,000	-
Distributions to Other Offices	-	-	-
TOTAL OTHER FINANCING SOURCES (USES)	<u>-</u>	<u>44,796,554</u>	<u>1,349,116</u>
NET CHANGE IN FUND BALANCES	<u>(654,309)</u>	<u>54,474,308</u>	<u>2,098,195</u>
FUND BALANCES - JULY 1, RESTATED (SEE NOTE 9)	<u>2,033,310</u>	<u>342,188,328</u>	<u>61,699,644</u>
FUND BALANCES, JUNE 30	<u>\$ 1,379,001</u>	<u>\$ 396,662,636</u>	<u>\$ 63,797,839</u>

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

Rural Development Initiative Fund	Innovation Ohio Fund	Research and Development Fund	Nonmajor Governmental Funds	Total
\$ -	\$ 6,000	\$ 4,500	\$ 12,610	\$ 1,687,958
-	20,833	-	66,900	8,644,548
-	1,076,414	1,085,227	15,209	6,737,706
-	-	-	12	176,755
-	<u>1,103,247</u>	<u>1,089,727</u>	<u>94,731</u>	<u>17,246,967</u>
-	-	-	-	902,546
-	80,338	-	-	2,294,916
1,000,000	-	-	-	1,000,000
-	-	-	-	149,760
-	-	-	14,748	1,668,126
-	19,058	-	-	285,534
1,000,000	<u>99,396</u>	-	<u>14,748</u>	<u>6,300,882</u>
<u>(1,000,000)</u>	<u>1,003,851</u>	<u>1,089,727</u>	<u>79,983</u>	<u>10,946,085</u>
2,000,000	-	-	1,854,330	-
-	-	-	-	50,000,000
-	-	-	(128,420)	(128,420)
2,000,000	-	-	<u>1,725,910</u>	<u>49,871,580</u>
1,000,000	<u>1,003,851</u>	<u>1,089,727</u>	<u>1,805,893</u>	<u>60,817,665</u>
500,000	50,696,486	50,506,476	23,535,252	531,159,496
<u>\$ 1,500,000</u>	<u>\$ 51,700,337</u>	<u>\$ 51,596,203</u>	<u>\$ 25,341,145</u>	<u>\$ 591,977,161</u>

OFFICE OF FINANCIAL INCENTIVES
RECONCILIATION OF THE CHANGE IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
For the Fiscal Year Ended June 30, 2005

Net Change in Fund Balances - Total Governmental Funds **\$ 60,817,665**

The change in net assets reported for governmental activities in the Statement of Activities is different because:

Some of the Office's revenues are collected after year-end but are not available soon enough to pay for the current period's (within 60 days of year-end) expenditures, and therefore, are deferred in the funds. This amount represents the change in beginning and end of year deferred revenues.

16,733

Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds

Change in Compensated Absences	(23,695)
Change in Ohio Enterprise Bond Fund Liability	<u>(161,363)</u>

Change in Net Assets of Governmental Activities **\$ 60,649,340**

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

**OFFICE OF FINANCIAL INCENTIVES
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Office of Financial Incentives (OFI), as of June 30, 2005, and for the year then ended, conform with accounting principles generally accepted in the United States of America as applied to governments. The OFI is considered a single purpose governmental entity reported as Community and Economic Development. The Governmental Accounting Standards Board (GASB) is the standard-setting body for establishing governmental accounting and financial reporting principles. The GASB's *Codification of Governmental Accounting and Financial Reporting Standards* documents these principles. OFI's significant accounting policies are as follows:

A. Reporting Entity

The Office of Financial Incentives, formerly the Office of Credit and Finance, was created as part of the Department of Development of the State of Ohio on July 14, 1983, by action of the State of Ohio Legislature. OFI administers the Direct Loan, Loan Guarantee, and Ohio Enterprise Bond Fund programs of the Department of Development under Chapters 122 and 166 of the Ohio Revised Code. These programs loan money to qualified businesses throughout the state for the purpose of stimulating jobs and business within the state. The financial statements present only the financial position and results of operations of the transactions attributable to OFI, which is a part of the primary reporting entity of the State of Ohio, and they are not intended to present the financial position or the results of operations of the Department of Development taken as a whole. The Comprehensive Annual Financial Report of the State of Ohio provides more extensive disclosure of the significant accounting policies of the State as a whole. Budgetary statements are not required since the budgetary level of control lies with the Department of Development and not with the OFI.

B. Basis of Presentation

The Statement of Net Assets and the Statement of Activities display information about OFI. These statements include the financial activities of the overall government and eliminations have been made for interfund transfers.

The Statement of Net Assets reports all financial and capital resources using the economic resources measurement focus and the accrual basis of accounting. OFI presents the statement in a format that displays assets less liabilities equal net assets. Net assets is displayed in three components:

- The *Invested in Capital Assets* component consists of land that OFI acquired.
- The *Restricted Net Assets* component represents net assets with constraints placed on their use that are either 1.) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or 2.) imposed by law through constitutional provisions or enabling legislation.
- The *Unrestricted Net Assets* component consists of net assets that do not meet the definition of the preceding two components.

The Statement of Activities presents a comparison between direct expenses and program revenues for each function of OFI's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular program or function. Centralized expenses have been included in direct expenses. Indirect expenses have not been allocated to the programs or functions reported in the Statement of Activities. Generally, OFI does not incur expenses for which it has the option of first applying restricted or unrestricted resources for their payment.

OFFICE OF FINANCIAL INCENTIVES
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

B. Basis of Presentation (continued)

Program revenues include loan interest income and fee revenue. Revenues that are not classified as program revenues include all unrestricted investment income and miscellaneous revenue.

The fund financial statements provide information about OFI's funds. The emphasis of fund financial statements is on major governmental funds, each displayed in a separate column. All remaining governmental funds are aggregated and reported as non-major funds. The funds maintained by OFI are all governmental special revenue fund types. Each accounts for specific revenues that are legally restricted to expenditure for designated purposes.

1. Major Governmental Funds

Operating Fund (CAS Fund 451) – records operating expenditures related to the administration of the loans and loan guarantees made pursuant to Revised Code Sections 122.39 to 122.62 and Chapter 166. Operations are primarily funded through transfers from the Facilities Establishment Fund.

Facilities Establishment Fund (CAS Fund 037) - accounts for proceeds deposited by the Treasurer of the State of Ohio with OFI from bond sales, fee income, interest income, loan receipts and disbursements for loans made pursuant to Chapter 166 of the Code. Also, this Fund provides a reserve for the Ohio Enterprise Bond Fund in the event of bondholder default.

Development Enterprise Bond Reserve Account - This account is used to account for the accumulation of payments made on type 166 loans from January to June and July to December. Funds are held in the account for a six month period to provide a secondary reserve in the event the OEBF Program Reserve Account exceeds the \$10,000,000 available balance.

OEBF Program Reserve Account - This reserve account was initially created from net proceeds of the 1988-1 State of Ohio bond issuance. The account is used to ensure adequate funds are available to repay Ohio Enterprise Bond Fund (OEBF) bondholders when due. The \$10,000,000 OEBF fund balance reserve will remain for OEBF bondholders within the Facilities Establishment Fund.

Regional Agency Fund - reports funds deposited with the regional agencies from fee income, interest income, loan receipts, and loans disbursements made pursuant to Chapter 166 of the Code and transfers of funds from the Facilities Establishment Fund.

Rural Development Initiative Fund – provides grants to eligible applicants who also qualify and receive funding under the Rural Industrial Park Loan program.

Innovation Ohio Loan Fund (Fund 009) – created to assist existing Ohio companies develop next generation products within certain Targeted Industry Sectors by financing the acquisition, construction and related costs of technology, facilities and equipment.

Research and Development Investment Loan Fund (Fund 010) – created to position Ohio to compete aggressively for private-sector research and development investments that will create high wage jobs.

OFFICE OF FINANCIAL INCENTIVES
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

B. Basis of Presentation (continued)

2. Non-major Governmental Funds

Loan Guarantee Fund - records funds deposited with the Treasurer of the State of Ohio and accounts for payments made by OFI due to the default on contractual loan terms by borrowers on loans guaranteed pursuant to Chapter 166 of the Code.

122 Direct Loan Program Fund (ODOD GRF) - accounted for the administration of development loans made pursuant to Sections 122.38 to 122.62 of the ORC. The 122 Direct Loan Program, no longer an active program, was replaced by the 166 Direct Loan Program. The two remaining loans were paid off in fiscal year 2005.

Rural Industrial Park Fund (Fund 4Z6) - accounts for designated priority investment areas within Ohio.

Urban Redevelopment Loan Fund (Fund 5D2) - accounts for activity which aides in the development of eligible communities within the State of Ohio, which are designated as "Central Cities" as defined by the U.S. Office of Management and Budget.

Family Farm Loan Guarantee Fund (Fund 5H1) - reports OFI's share of family farm loan financing deposited with various financial institutions as a loan guarantee for eligible borrowers. OFI guarantees up to 40% of the loan project, which should not exceed \$200,000 per project.

C. Measurement Focus and Basis of Accounting

The government-wide financial statements (i.e. the statement of net assets and the statement of activities) are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred, regardless of the timing of related cash flows. For revenues arising from exchange transactions (i.e., charges for goods or services), OFI defers revenue recognition when resources are received in advance of the exchange.

As permitted by GAAP, OFI has elected not to apply Financial Accounting Standards Board Statements and Interpretations issued after November 30, 1989.

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

Significant revenue sources subject to accrual under the modified accrual basis of accounting include investment income (including net increase or decrease in the fair value of investments), loan interest income (including net increase or decrease in allowance for doubtful loans), and fee revenue.

**OFFICE OF FINANCIAL INCENTIVES
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- D. Estimates** - The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.
- E. Deposits and Investments** - In fiscal year 2005, OBM implemented GASB Statement No. 40, "Deposit and Investment Risk Disclosures". In addition, the OBM has adopted provisions of GASB Statement No. 31, "Accounting and Financial Reporting for Certain Investments and External Investment Pools" ("GASB 31") of the Governmental Accounting Standards Board ("GASB"). Accordingly, OFI's investments are stated at fair value (based on quoted market prices) in the accompanying statement of net assets and the change in the fair value of the investments is recorded as Net Increase (Decrease) in Fair Value of Investments in the Statement of Activities.

OFI has invested funds in the State Treasury Asset Reserve of Ohio (STAROhio). STAROhio is an investment pool managed by the State Treasurer's office, which allows governments within the state to pool their funds for investment purposes. STAROhio 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 STAROhio are valued at STAROhio's share price, which is the price at which the investment could be sold.

- F. Securities Lending** - In accordance with GASB Statement No. 28, "Accounting and Financial Reporting for Securities Lending Transactions" ("GASB 28"), OFI reports cash received as collateral on securities lending transactions and any investments made with that cash as assets in the accompanying balance sheet. Liabilities to return the collateral to the borrower are also recognized. Securities received as collateral in connection with securities lending activities are not recorded as assets and liabilities of OFI, because OFI does not have the ability to pledge or sell the securities without borrower default.
- G. Loans Receivable, Net and Allowance for Uncollectible Loans** - Loans receivable includes amounts due OFI for loans and loan guarantees entered into as part of its loan programs. Loans receivable is reported net of the allowance for uncollectible loans, which applies the following allowance methodology:
- 75% of loans certified to the Office of the Attorney General,
 - 1% of loans outstanding within the Facilities Establishment Fund, and
 - 0.5% of the loans outstanding within the Regional Agency Fund and the Family Fam Loan Fund.

The OFI management has determined that an Allowance for Uncollectible Loans is not necessary for the Innovation Ohio Fund, Research and Development Fund, Rural Industrial Park Loan Fund and Urban Development Loan Fund based on collection history.

Direct loan write-offs are reported upon notification from the Attorney General that an account is uncollectible. Direct loan write-offs are charged against the allowance.

The loan receivables are divided into current (60 days) and non-current portions. The following table summarizes the various funds and the breakdown of the receivables.

OFFICE OF FINANCIAL INCENTIVES
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

<u>Fund</u>	<u>Current</u>	<u>Non-current</u>
Facilities Establishment	\$ 5,954,441	\$ 208,542,165
Regional Agency	1,376,641	42,025,046
Innovation Ohio	-	2,000,000
Research and Development	-	4,500,000
Rural Industrial Park	238,749	6,137,947
Urban Redevelopment	6,666	8,041,460
Family Farm Loan Guarantee	<u>101,522</u>	<u>2,833,341</u>
Total	<u>\$ 7,678,019</u>	<u>\$ 274,079,959</u>

- H. **Leases Receivable** - Lease Receivable includes a 166 Direct Loan to Union County CIC/Scotts. The State holds title to the asset and leases it back. Total lease receivable as of June 30, 2005 was \$1,423,946 which is comprised of a current portion (\$20,544) and a non-current portion (\$1,403,402).
- I. **Other Assets** - Other assets includes receivables for Port Authority Bond Reserve service fees and prepaid expenses. Total other assets as of June 30, 2005, were \$92,598.
- J. **Accounts Payable and Accrued Liabilities** - Accounts payable includes accruals for operating expenditures/expenses, which are attributable to purchases prior to June 30, 2005. Total accounts payable as of June 30, 2005 was \$123,303. Accrued liabilities include wages payable of \$53,828 as of June 30, 2005.
- K. **Deferred Revenue** - In the fund financial statements, deferred revenue includes accruals for revenue due to OFI by June 30, 2005 but collected after August 31, 2005. Total deferred revenue as of June 30, 2005 was \$88,452.
- L. **Compensated Absences** - The State of Ohio, which governs employee leave benefits and policies, pays compensation to separated employees for leave balances accumulated during the employee's term of service. In accordance with Governmental Accounting Standards Board Statement No. 16, *Accounting for Compensated Absences*, OFI calculated the compensated absences liability on employees' fiscal year-end balances for vacation, sick, and compensatory leaves. The total compensated absences balance for the period ending June 30, 2005 was \$97,458.
- M. **Fund Balance/Net Assets**

Reservations of equity represent amounts that are not appropriable or are legally restricted for a specific purpose. The total fund balance for the period ended June 30, 2005 was \$591,977,161.

The fund balance includes \$132,462,651 for encumbrances, \$274,079,959 for non-current loan receivables, \$1,403,402 for non-current lease receivable, \$10,000,000 for the Ohio Enterprise Bond Fund Program Reserve and \$174,031,149 that is unreserved/undesignated.

The total net assets as of June 30, 2005 were \$589,038,316 which includes \$231,524 for capital assets, \$10,000,000 that is restricted for the OEBF Program Reserve, and \$578,806,792 of unrestricted net assets.

**OFFICE OF FINANCIAL INCENTIVES
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- N. Investment and Loan Interest Income** - Investment income includes investment earnings from STAR Ohio investments and the quarterly allocation of investment earnings from cash equity with treasurer and corresponding interest receivables. Loan interest income includes interest earned from the repayment of loans.
- O. Fee Revenue and Miscellaneous Revenue** - Fees include service fees for the administration of the loan processing and commitment and application fees paid by the borrower.
- P. Personnel and Operating Expenditures/Expenses** - Personnel expenditures/expenses include all payroll and fringe benefit costs paid by the OFI. Operating expenditures/expenses include various supplies and maintenance expenditures, equipment purchases, and regional agency trustee and administrative fees.
- Q. Grant Expenditures/Expenses** - The Rural Development Initiative Fund provides grants to eligible applicants who also qualify and receive funding under the Rural Industrial Park Loan program.
- R. OEBF Loan Payment Expenditures/Expenses** - The OFI guarantees Ohio Enterprise Bonds and makes loan payments for Bonds that are in default of monthly payments. As of June 30, 2005, there were three OEBF bonds in default totaling \$3,161,363.
- S. Interfund Transfers and Distributions to Other Offices** - The OFI interfund transfers primarily consisted of transfers from the Facilities Establishment Fund to other loan programs and the regional agencies. These and other transfers are provided for in HB No. 95 and require Controlling Board approval unless otherwise specified. Transfers out to state agencies resulted from repayment of 122 Direct Loans into the State of Ohio's General Revenue Fund. Since the financial statements present only the financial information of OFI and do not present the consolidated financial information of the State of Ohio, taken as a whole, the total distributions to other offices will not reflect offsetting receipts from state agencies.
- T. Bond Proceeds received from the State of Ohio** - The OFI received an additional \$50 million in cash to finance a number of large projects as well as to replenish the Facilities Establishment Fund.
- U. Self-Insurance** - The State of Ohio serves as the OFI's primary government and is self-insured for claims covered under its traditional healthcare plan, vehicle liability, public fidelity blanket bonds, property losses, and tort liability. Additionally, the State of Ohio participates in a public entity risk pool which covers liabilities associated with claims submitted to the Bureau of Workers' Compensation.

**OFFICE OF FINANCIAL INCENTIVES
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005**

NOTE 2 – DEPOSITS AND INVESTMENTS

The deposit and investment policies of the Treasurer of State and the State Board of Deposit are governed by the Uniform Depository Act, Chapter 135, Ohio Revised Code, which requires state moneys to be maintained in one of the following three classifications:

Active Deposits — Moneys required to be kept in a cash or near-cash status to meet current demands. Such moneys must be maintained either as cash in the State's treasury or in one of the following: a commercial account that is payable or withdrawable, in whole or in part, on demand, a negotiable order of withdrawal account, a money market deposit account, or a designated warrant clearance account.

Inactive Deposits — Those moneys not required for use within the current two-year period of designation of depositories. Inactive moneys may be deposited or invested only in certificates of deposit maturing not later than the end of the current period of designation of depositories.

Interim Deposits — Those moneys not required for immediate use, but needed before the end of the current period of designation of depositories. Interim deposits may be deposited or invested in the following instruments:

- Bonds, notes, or other obligations of or guaranteed by the United States, or those for which the faith of the United States is pledged for the payment of principal and interest;
- Bonds, notes, debentures, or other obligations or securities issued by any federal government agency, or the Export-Import Bank of Washington;
- Repurchase agreements in the securities enumerated above;
- Interim deposits in the eligible institutions applying for interim moneys;
- Bonds and other obligations of the State of Ohio;
- The Treasurer of State's investment pool;
- Linked deposits, reduced-rate deposits at financial institutions that provide reduced-rate loans to small businesses, as authorized under Section 135.63, Ohio Revised Code;
- Agricultural linked deposits, reduced-rate deposits at financial institutions that provide reduced-rate loans to agricultural businesses, as authorized under Section 135.74, Ohio Revised Code;
- Reverse repurchase agreements with any eligible financial institution that is a member of the Federal Reserve System or federal home loan bank, or any recognized U.S. government securities dealer;
- Securities lending agreements with any eligible financial institution that is a member of the federal reserve system or federal home loan bank, or any recognized U.S. government securities dealer;
- Commercial paper, rated in one of the two highest rating categories by two nationally recognized rating agencies and not exceeding five percent of the investment portfolio;
- Bankers' acceptances maturing in 270 days or less and not exceeding 10 percent of the investment portfolio;
- Debt of domestic corporations and foreign nations diplomatically recognized by the United States, rated investment grade by nationally recognized rating agencies and, in the aggregate, not exceeding five percent of the investment portfolio; and
- No-load money market funds consisting of U.S. government and agency obligations and repurchase agreements secured by such obligations.

The primary government's deposits must be held in insured depositories approved by the State Board of Deposit and must be fully collateralized.

**OFFICE OF FINANCIAL INCENTIVES
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005**

NOTE 2 – DEPOSITS AND INVESTMENTS (continued)

As of June 30, 2005, OFI's investments totaled \$52,012,313, consisting of money market funds (\$32,345,096) and STAR Ohio (\$19,667,217).

Credit Risk – Credit risk is the risk that an issuer or counterparty to an investment will be unable to fulfill its obligations. At year end, OFI indirectly held debt securities through STAR Ohio and multiple money market funds. STAR Ohio was rated AAA and OFI's money market funds were not rated.

Concentration of Credit Risk – Concentration of credit risk is the risk of inability to recover the value of deposits, investments, or collateral securities in the possession of an outside party caused by a lack of diversification. At year end, OFI was not exposed to concentration of credit risk because OFI had no positions of 5 percent or more in any single issuer.

Interest Rate Risk – Interest rate risk is the risk that an interest rate change could adversely affect an investment's fair value. At year end, all of OFI's investments had an average maturity of less than one year.

Custodial Credit Risk – Deposits – In the case of deposits, this is the risk that in the event of a bank failure, OFI's deposits may not be returned to it. OFI maintains cash on deposit at a commercial bank and in two custodial accounts with the State Treasurer. Public depositories are required to give security for all public funds on deposit. These institutions may either specifically collateralize individual accounts in lieu of amounts insured by the Federal Deposit Insurance Corporation (FDIC) or may pledge a pool of government securities, the face value of which is at least 110% of the total value of public moneys on deposit at the institution. At year end, OFI's deposits were not exposed to custodial credit risk.

Custodial Credit Risk - Investments – For an investment, this is the risk that, in the event of the failure of the counterparty, OFI will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. OFI's investments were not exposed to custodial credit risk at year end because all investments were registered in the OFI's name.

Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates between the U.S. Dollar and foreign currencies could adversely affect an investment's fair value. OFI had no exposure to foreign currency risk at fiscal year end.

NOTE 3 – SECURITIES LENDING TRANSACTIONS

OFI through the Treasurer of State's Investment Department participates in a securities lending program for securities included in the "Equity in State of Ohio common cash and investments" and STAR Ohio accounts. The State's lending programs, authorized under Sections 135.143, 135.45 and 135.47, Ohio Revised Code, are administered by custodial agent banks, whereby certain securities are transferred to independent broker-dealers (borrowers) in exchange for collateral. OFI has minimized its exposure to credit risk due to borrower default by requiring the custodial agent to ensure that the lent securities are collateralized at no less than 102 percent of the market value at the time of the loan. At no point in time can the value of the collateral be less than 100 percent of the value of the underlying securities on loan.

For loaned contracts the Treasurer executes, not more than 15 percent of the State's cash and investment portfolio can be lent to a single broker-dealer. For State funds on deposit with the Treasurer, the lending agent may not lend more than 75 percent of the total average portfolio. For the STAR Ohio program, not more than 25 percent of the STAR Ohio investment pool may be lent at any one time, and not more than 10 percent of the investment pool may be subject to term loans in excess of one business day.

**OFFICE OF FINANCIAL INCENTIVES
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005**

NOTE 3 – SECURITIES LENDING TRANSACTIONS (continued)

During the fiscal year, the State Treasurer and the STAR Ohio program lent U.S. government and agency obligations in exchange for collateral consisting of cash and/or U.S. government obligations. OFI cannot sell securities received as collateral unless the borrower defaults. At June 30, 2005 the collateral OFI had received for securities lent consisted entirely of cash, some of which had been temporarily invested by OFI in various securities. For State funds, the State Treasurer invests cash collateral in short-term obligations, which have a weighted average maturity of all loans was 4.9 days while the weighted maturity of collateral was 19.5 days. For STAR Ohio, the weighted average of all loans and collateral was 1 day.

For State funds, the securities lending agent shall indemnify the Treasurer of State for any losses resulting from either the default of the borrower or any violations of the securities lending policy. For the STAR Ohio program, the agent agrees to indemnify the Treasurer for losses resulting from the failure of the borrower to return the loaned securities in accordance with the terms of the loan agreement, provided, however, that the agent's obligation to indemnify the Treasurer shall be limited to an indemnification amount equal to the difference between the market value of the loaned securities on the date that such loaned securities should have been returned to the agent and the greater of (1) the cash collateral received from the borrower or (2) the value of investments of collateral. There were no recoveries during fiscal year 2005 due to prior-period losses.

For both the State funds and STAR Ohio lending programs, since the lender owes the borrower more than the borrower owes the lender, there is no credit risk to the lender as of June 30, 2005. The State's Office of Budget and Management allocates the State's pooled cash collateral to various funds within the State's Central Accounting System (CAS) based on cash balances at June 30, 2005. As a result, OFI's Allocated Collateral on Lent Securities and related Allocated Obligations Under Securities Lending as of June 30, 2005, was \$152,960,353.

NOTE 4 – LOAN PROGRAM ACTIVITY

The following table summarizes loan repayments and new loan activity of the various funds during the fiscal year:

Fund	Beginning Balance	Loan Additions	Loan Reductions	Ending Balance
Facilities Establishment	\$ 230,591,276	\$ 36,305,804	\$(39,784,266)	\$ 227,112,814
Regional Agency	46,748,116	6,111,164	(9,239,494)	43,619,786
Innovation Ohio	-	2,000,000	-	2,000,000
Research and Development	-	4,600,000	-	4,500,000
122 Direct	127,188	-	(127,188)	-
Rural Industrial Park	6,831,218	1,000,000	(1,454,522)	6,376,696
Urban Redevelopment	8,221,459	-	(173,333)	8,048,126
Family Farm Loan Guarantee	3,507,778	50,000	(608,167)	2,949,611
Grand Total	\$ 296,027,035	\$ 49,966,968	\$(51,386,970)	\$ 294,607,033

The allowance for loan losses is the result of management's review of loans, with consideration given to collateral values, borrower's financial condition and current economic environment. The allowance is maintained at the level management estimates adequately provide for potential loan losses. The total allowance for loan losses as of June 30, 2005 was \$11,425,109 (Facilities Establishment Fund was \$11,192,262; Regional Agency Fund was \$218,099; and Family Farm Loan Guarantee Fund was \$14,748).

**OFFICE OF FINANCIAL INCENTIVES
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005**

NOTE 4 – LOAN PROGRAM ACTIVITY (continued)

Under the Family Farm Loan Guarantee Program, OFI's share of loan financing is in the form of Certificates of Deposit with various financial institutions as a loan guarantee for eligible borrowers. OFI guarantees up to 40% of the loan project, which should not exceed \$200,000 per project. As the borrowers pay down the bank loan, the bank refunds a portion of the Certificate of Deposit to OFI.

NOTE 5 – COMMITMENTS AND CONTINGENCIES

A. Ohio Enterprise Bond Funds

Ohio Enterprise Bond Fund (OEBF) bonds are issued through the Treasurer of State for the purpose of financing "eligible projects" of private industry organizations, such as a company's purchase of manufacturing equipment. The actual bonds are sold through private placement. At June 30, 2005 outstanding loan balances under this program aggregated \$163,560,000 with original terms up to 20 years at interest ranging from 2.0% to 10.0%. According to the Ohio Enterprise Bond Fund's official bond statement, the bonds are not general obligations of the State of Ohio or of any political subdivision and are not payable from any tax source, therefore, the rights of holders of the bonds to payments of amounts due there under are limited solely to the Ohio Enterprise Bond Fund Accounts. The scheduled payment of the bonds is, however, guaranteed through OFI. OFI only monitors OEBF activities and does not include the financial transactions within its financial statements.

Of the 36 Ohio Enterprise Bond Fund bonds with outstanding principal balances, 33 were current in their repayment as of June 30, 2005. The following schedule identifies the three bonds in default and shows payments to be made each year from FY2006 through FY2010 and then in 5-year increments.

	<u>Euclid & Wickliffe</u>	<u>CIC of Hamilton</u>	<u>Erie Terminal</u>	<u>Total</u>
FY 2006	\$ 196,667	\$ 71,668	\$ 120,000	\$ 388,335
FY 2007	200,000	80,000	120,000	400,000
FY 2008	216,667	80,000	136,667	433,334
FY 2009	231,667	80,000	146,667	458,334
FY 2010	251,667	91,667	161,666	505,000
FY 2011-2015	1,621,666	558,332	75,000	2,254,998
FY 2016-2020	<u>1,951,666</u>	<u>433,333</u>	-	<u>2,384,999</u>
Total	<u>\$ 4,670,000</u>	<u>\$ 1,395,000</u>	<u>\$ 760,000</u>	<u>\$ 6,825,000</u>

At June 30, 2005, OFI's debt service obligation in regards to these three defaulted bonds was \$3,161,363, which is recorded as a long term liability on the Statement of Net Assets. The difference between the total bond amount outstanding and OFI's long term liability amount is a combination of net collateral proceeds and debt service reserve funds totaling \$3,566,730 and \$96,907, respectively.

B. Ohio Enterprise Bond Fund Leases

Within the OEBF, there are seven projects where the State of Ohio holds title to the assets and leases them back to the companies. These lease transactions are OEBF activities and are not part of the OFI financial statements. Total leases receivable as of June 30, 2005 were \$24,072,000. The projects that include leases are as follows:

**OFFICE OF FINANCIAL INCENTIVES
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005**

NOTE 5 – COMMITMENTS AND CONTINGENCIES (continued)

<u>Issue #</u>	<u>Borrower</u>	<u>Original Amount</u>	<u>Current Balance</u>
1993-5	Foremost Management	8,100,000	4,885,000
1989-4	House of LaRosa	8,255,000	3,120,000
1995-1	JJ & W Partnership	3,425,000	2,260,000
1991-1	Kinetics Noise Control	2,270,000	1,230,000
1994-4	Orlando Baking Company	3,575,000	1,485,000
2000-1	Scotts/Union County	6,025,000	5,335,000
2000-2	Western Reserve P.A. Timken	6,185,000	5,757,000
	Grand Total	<u>\$ 37,835,000</u>	<u>\$ 24,072,000</u>

In case of a lease default, OFI would first draw on the 10% letter of credit to satisfy the bondholders. If the letter of credit is insufficient, the State would then liquidate the assets to which it holds title. Finally, if the bondholders are still not paid in full, OFI is obligated to make the bond payments using the Facilities Establishment Fund.

C. Loan Commitments

These commitments primarily represent Chapter 166 loan commitments, which have been approved by OFI's Development Financing Advisory Council and the State's Controlling Board; however, the loans were not closed as of June 30, 2005. Below is a summary of outstanding commitments of OFI related to the Chapter 166 program:

<u>Fund</u>	<u>Commitment</u>
Facilities Establishment	\$ 64,284,240
Innovation Ohio	6,715,104
Research and Development	37,275,000
Rural Industrial Park	2,000,000
Urban Redevelopment	<u>15,369,792</u>
Grand Total	<u>\$ 124,644,136</u>

The Facilities Establishment encumbrance includes \$ 5,923,955 to local agencies. These funds are transferred to the escrow funds of these agencies for eligible project loans based on program requirements. The encumbrances do not include each individual agency's pollution prevention program. These programs are administered by the local agencies on behalf of OFI.

D. Loan Guarantees

Under the Chapter 166 Loan Guarantee Program, OFI guarantees up to 75% of certain qualifying loans made by various financial institutions. The bonds issued by the State of Ohio to fund the loan and loan guarantee programs under 166 of the Code are to be repaid initially from revenue of the State from the sale of liquor. Repayment would come from the Facilities Establishment Fund only if such revenues were inadequate to service the debt. At June 30, 2005, OFI had two guarantees outstanding.

**OFFICE OF FINANCIAL INCENTIVES
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005**

NOTE 6 – PENSION PLAN

All full-time employees participate in the Ohio Public Employees Retirement System (OPERS). OPERS administers three separate pension plans as described below:

1. The Traditional Plan – a cost-sharing multiple-employer defined benefit pension plan.
2. The Member-Directed Plan – 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 member and (vested) employer contributions plus any investment earnings.
3. The Combined Plan – a cost-sharing multiple-employer defined benefit pension plan. Under the Combined Plan employer contributions are invested by the retirement system to provide a formula retirement benefit similar in nature to the Traditional Plan benefit. Member contributions, the investment of which is self-directed by the members, accumulate retirement assets in a manner similar to the Member-Directed Plan.

OPERS provides retirement, disability, survivor and death benefits and annual cost of living adjustments to members of the Traditional Plan and Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits.

Authority to establish and amend benefits is provided by state statute per Chapter 145 of the Ohio Revised Code. OPERS issues a stand-alone financial report. Interested parties may obtain a copy by making a written request to 277 East Town Street, Columbus, Ohio 43215-4642 or by calling (614) 222-6701 or 1-800-222-PERS (7377).

The Ohio Revised Code provides statutory authority for employee and employer contributions. For 2004, member and employer contribution rates were consistent across all three plans.

The 2004 member contribution rate was 8.5% for OFI employees. The 2004 employer contribution rate was 13.31% of covered payroll. OFI's required contributions to OPERS for the years ended June 30, 2005, 2004, and 2003 were \$89,298, \$67,998, and \$93,589, respectively, equal to the required contributions for each year.

NOTE 7 – OTHER POST-EMPLOYMENT BENEFITS

The Ohio Public Employees Retirement System (OPERS) administers three separate pension plans: The Traditional Plan (TP) – a cost-sharing multiple-employer defined benefit plan; the Member-Directed Plan (MD) – a defined contribution plan; and the Combined Plan (CO) – a cost-sharing multiple-employer defined benefit pension plan that has elements of both a defined benefit and defined contribution plan.

OPERS provides retirement, disability, and survivor benefits, as well as postretirement health care coverage to qualifying members of both the Traditional and the Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits, including postemployment health care coverage.

In order to qualify for post-retirement health care coverage, age and service retirees under the Traditional Pension and Combined Plans must have 10 or more years of qualifying Ohio service credit. Health care coverage for disability recipients and qualified survivor benefit recipients is available. The health care coverage provided by the OPERS is considered an Other Postemployment Benefit (OPEB) as described in GASB Statement No. 12.

OFFICE OF FINANCIAL INCENTIVES
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2005

7. OTHER POST-EMPLOYMENT BENEFITS (continued)

A portion of each employer's contribution to OPERS is set aside for the funding of postretirement health care. The Ohio Revised Code provides statutory authority for employer contributions. The 2004 employer contribution rate was 13.31% of covered payroll, of which 4% was used to fund health care for the year. The Ohio Revised Code provides the statutory authority requiring public employers to fund postretirement health care through their contributions to OPERS.

The assumptions and calculations below were based on OPERS' latest actuarial review performed as of December 31, 2003.

Funding Method - An entry age normal actuarial cost method of valuation is used in determining the present value of OPEB. The difference between assumed and actual experience (actuarial gains and losses) becomes part of unfunded actuarial accrued liability.

Asset Valuation Method - All investments are carried at market value. For actuarial valuation purposes, a smoothed market approach is used. Under this approach assets are adjusted to reflect 25% of unrealized market appreciation or depreciation on investment assets annually.

Investment Return - The investment assumption rate for 2003 was 8%.

Active Employee Total Payroll - An annual increase of 4%, compounded annually, is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees. Additionally, annual pay increases, over and above the 4% base increase, were assumed to range from .5% to 6.3%.

Health Care - Health care costs were assumed to increase at the projected wage inflation rate plus an additional factor ranging from 1% to 6% for the next 8 years. In subsequent years (9 and beyond) health care costs were assumed to increase at 4% (the projected wage inflation rate).

OPEB's are advance-funded on an actuarially determined basis. At year-end 2004, the number of active contributing participants in the Traditional Pension and Combined Plans totaled 369,885. The contribution rates stated above are the actuarially determined contribution requirements for OPERS. The portion of OFI's 2005 contributions that was used to fund post-employment benefits was \$26,834.

The amount of \$10.5 billion represents the actuarial value of OPERS' net assets available for OPEBs at December 31, 2003. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$26.9 billion and \$16.4 billion, respectively.

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

OFFICE OF FINANCIAL INCENTIVES
 NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2005

8. LONG TERM LIABILITIES

Long term liability activity for the year ended June 30, 2005 is as follows:

Type	Beginning Balance	Increase	Decrease	Ending Balance	Amount Due in One Year
Compensated Absences	\$ 73,763	\$ 23,695	\$ -	\$ 97,458	\$ 6,625
Ohio Enterprise Bond Fund	<u>3,000,000</u>	<u>161,363</u>	<u>-</u>	<u>3,161,363</u>	<u>156,385</u>
Total Long Term Liabilities	<u>\$ 3,073,763</u>	<u>\$ 185,058</u>	<u>\$ -</u>	<u>\$ 3,258,821</u>	<u>\$ 163,010</u>

The compensated absences will be paid from the operating fund.

A summary of OFI's future Ohio Enterprise Bond Fund debt service obligations as of June 30, 2005 are as follows:

Fiscal Year	Principal Due
2006	156,385
2007	-
2008	-
2009	3,334
2010	161,667
2011-2015	454,981
2016-2020	<u>2,384,996</u>
Total	<u>3,161,363</u>

9. RESTATEMENT OF FUND BALANCE

During 2005, it was determined that the liability established for the Ohio Enterprise Bond Fund was not a liability under the governmental modified accrual basis of accounting because it was not expected to be liquidated with available financial resources in the current period. Therefore, OFI increased the July 1, 2004 beginning Facilities Establishment Fund fund balance \$3,000,000, the amount of the previously accrued liability. This adjustment had no effect on the government-wide financial statements as those statements are reported on the full accrual basis of accounting.

**SUPPLEMENTARY COMBINING
FINANCIAL STATEMENTS**

**OFFICE OF FINANCIAL INCENTIVES
BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS
June 30, 2005**

	Loan Guarantee Fund	122 Direct Loan Fund	Rural Industrial Park Loan Fund
ASSETS:			
Cash Equity with Treasurer	\$ -	\$ -	\$ 3,413,759
Cash and Cash Equivalents	754,205	-	-
Allocated Collateral on Lent Securities	19,636	-	2,025,587
Loans Receivable, Net	-	-	6,376,696
Leases Receivable	-	-	-
Other Assets	-	-	-
Due From Other Funds	-	-	22,764
TOTAL ASSETS	<u>773,841</u>	<u>-</u>	<u>11,838,806</u>
LIABILITIES:			
Accounts Payable	-	-	-
Accrued Liabilities	-	-	-
Allocated Obligations Under Securities Lending	19,636	-	2,025,587
Deferred Revenue	-	-	-
TOTAL LIABILITIES	<u>19,636</u>	<u>-</u>	<u>2,025,587</u>
FUND BALANCES:			
Reserved for:			
Encumbrances	-	-	2,000,000
Noncurrent Portion of Loans Receivable	-	-	6,137,947
Noncurrent Portion of Leases Receivable	-	-	-
Ohio Enterprise Bond Program	-	-	-
Unreserved/Undesignated (Deficits)	754,205	-	1,675,272
TOTAL FUND BALANCES	<u>754,205</u>	<u>-</u>	<u>9,813,219</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 773,841</u>	<u>\$ -</u>	<u>\$ 11,838,806</u>

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

I.	Urban Redevelopment Loan Fund	Family Farm Loan Gaurantee Fund	Total Nonmajor Governmental Funds
	\$ 2,216,667	\$ 1,574,065	\$ 7,204,491
	-	-	754,205
	1,315,281	933,987	4,294,491
	8,048,126	2,934,863	17,359,685
	-	-	-
	-	-	-
	-	-	22,764
	<u>11,580,074</u>	<u>5,442,915</u>	<u>29,635,636</u>
	-	-	-
	-	-	-
	1,315,281	933,987	4,294,491
	-	-	-
	<u>1,315,281</u>	<u>933,987</u>	<u>4,294,491</u>
	-	-	-
	15,369,792	-	17,369,792
	8,041,460	2,833,341	17,012,748
	-	-	-
	-	-	-
	(13,146,459)	1,675,587	(9,041,395)
	<u>10,264,793</u>	<u>4,508,928</u>	<u>25,341,145</u>
	<u>\$ 11,580,074</u>	<u>\$ 5,442,915</u>	<u>\$ 29,635,636</u>

OFFICE OF FINANCIAL INCENTIVES
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
NONMAJOR GOVERNMENTAL FUNDS
For the Fiscal Year Ended June 30, 2005

	Loan Guarantee Fund	122 Direct Loan Fund	Rural Industrial Park Loan Fund
REVENUES:			
Fee Revenue	\$ -	\$ -	\$ 5,156
Loan Interest Income	-	1,868	10,665
Investment Income	15,209	-	-
Miscellaneous	-	-	-
TOTAL REVENUES	<u>15,209</u>	<u>1,868</u>	<u>15,821</u>
EXPENDITURES:			
Bad Debt Expense	-	-	-
TOTAL EXPENDITURES	<u>-</u>	<u>-</u>	<u>-</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	<u>15,209</u>	<u>1,868</u>	<u>15,821</u>
OTHER FINANCING SOURCES (USES):			
Interfund Transfers	-	-	1,854,330
Distributions to Other Offices	-	(128,420)	-
TOTAL OTHER FINANCING SOURCES (USES)	<u>-</u>	<u>(128,420)</u>	<u>1,854,330</u>
NET CHANGE IN FUND BALANCES	15,209	(126,552)	1,870,151
FUND BALANCES, JULY 1	738,996	126,552	7,943,068
FUND BALANCES, JUNE 30	<u>\$ 754,205</u>	<u>\$ -</u>	<u>\$ 9,813,219</u>

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

Urban Redevelopment Loan Fund	Family Farm Loan Gaurantee Fund	Total Nonmajor Governmental Funds
\$ 7,454	\$ -	\$ 12,610
-	54,367	66,900
-	-	15,209
<u>12</u>	<u>-</u>	<u>12</u>
<u>7,466</u>	<u>54,367</u>	<u>94,731</u>
-	14,748	14,748
-	14,748	14,748
<u>7,466</u>	<u>39,619</u>	<u>79,983</u>
-	-	1,854,330
-	-	(128,420)
-	-	<u>1,725,910</u>
7,466	39,619	1,805,893
<u>10,257,327</u>	<u>4,469,309</u>	<u>23,535,252</u>
<u>\$ 10,264,793</u>	<u>\$ 4,508,928</u>	<u>\$ 25,341,145</u>



Crowe Chizek and Company LLC
Member Horwath International

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*

To the Office of Financial Incentives
State of Ohio

We have audited the financial statements of the Office of Financial Incentives (Office), State of Ohio, as of and for the year ended June 30, 2005, and have issued our report thereon dated September 23, 2005. 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 Office's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. 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 Office in a separate letter dated September 23, 2005.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Office'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*.

This report is intended for the information and use of audit committee, management, the Office's Development Financing Advisory Council, management of the State of Ohio and the Ohio Legislature and is not intended to be and should not be used by anyone other than these specified parties.

Crowe Chizek and Company LLC

Crowe Chizek and Company LLC

Columbus, Ohio
September 23, 2005

Prior Year Finding 2004-01 – Reportable Condition

General ledger

In the past, the Office of Financial Incentives (Office) did not utilize a general ledger system to record its financial activities. The Office began installation and implementation of a general ledger system in fiscal year 2004. While the implementation is not complete, the Office does have a general ledger process in place now that provides a framework for accurate recording of transactions, appropriate reconciliations of account balances and proper reporting of the financial information.



**Auditor of State
Betty Montgomery**

88 East Broad Street
P.O. Box 1140
Columbus, Ohio 43216-1140

Telephone 614-466-4514
800-282-0370

Facsimile 614-466-4490

OFFICE OF FINANCIAL INCENTIVES

FRANKLIN 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
DECEMBER 1, 2005**