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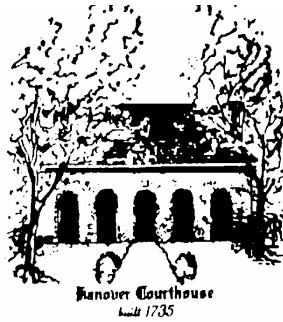
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November 4, 2005

To The Honorable Members of the Board of Supervisors and the Citizens of the County of Hanover:

The Commonwealth of Virginia requires that local governments publish within six months of the close of each fiscal year a complete set of financial statements presented in conformity with accounting principles generally accepted in the United States of America (GAAP) and audited in accordance with auditing standards generally accepted in the United States of America by a firm of licensed certified public accountants. Pursuant to the requirement, we hereby issue the Comprehensive Annual Financial Report of the County of Hanover ("the County") for the fiscal year ended June 30, 2005.

This report consists of management's representations concerning the finances of the County. Consequently, management assumes full responsibility for the completeness and reliability of all of the information presented in this report. To provide a reasonable basis for making these representations, management of the County has established a comprehensive internal control framework that is designed both to protect the County's assets from loss, theft, or misuse and to compile sufficient reliable information for the preparation of the County financial statements in conformity with GAAP. Because the cost of internal controls should not outweigh their benefits, the County's comprehensive framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatement. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.

The County's financial statements have been audited by Cherry, Bekaert and Holland, LLP, a firm of licensed certified public accountants. The goal of the independent audit was to provide reasonable assurance that the financial statements of the County for the fiscal year ended June 30, 2005, are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation.

The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the County financial statements for the fiscal year ended June 30, 2005, are fairly presented in conformity with GAAP. The independent auditor's report is presented as the first component of the financial section of this report.

The independent audit of the financial statements of the County was part of a broader, federally mandated "Single Audit" designed to meet the special needs of federal grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the audited County's internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal awards. These reports are available in the Compliance Section of this report.

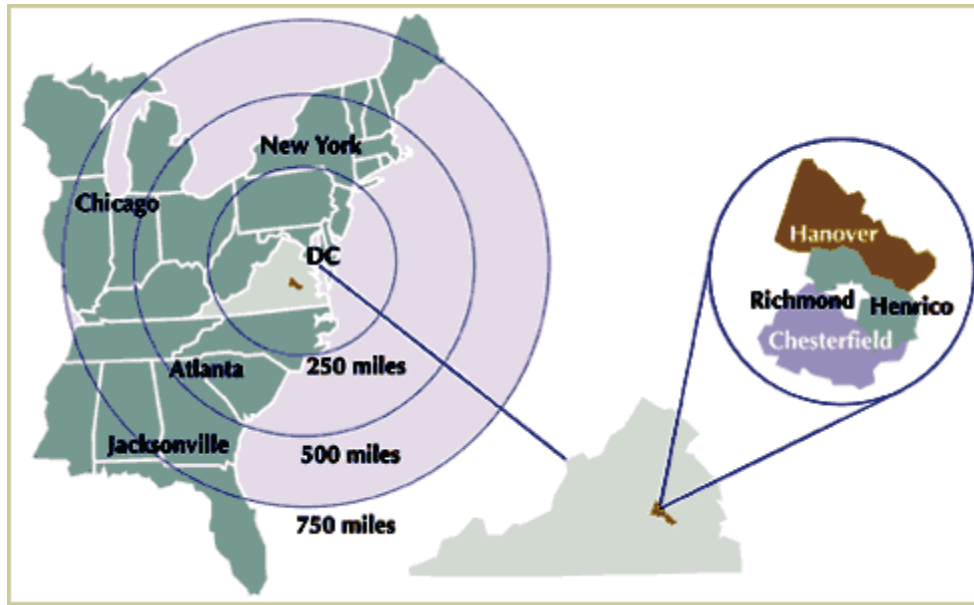
GAAP requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The County MD&A can be found immediately following the report of the independent auditors.

Profile of the County

The County was formed on November 26, 1720, by the Virginia General Assembly in "An Act for dividing New Kent County." It is named for King George I of England, who, at the time he came to the throne, was Elector of Hanover in Germany. Two of the County's native sons, Patrick Henry and Henry Clay, distinguished themselves as orators, patriots and statesmen in the early history of this Country. Prior to English colonization in the seventeenth century, the Pamunkey Indians populated this area. The northern boundary, the Pamunkey River, carries their name and they maintain a reservation on the lower part of the river in neighboring King William County. The Town of Ashland is located within Hanover County and was incorporated in 1858.

The County currently employs the traditional board form of County government with a county administrator. Policies governing the administration of the County are set by a seven-member Board of Supervisors elected from seven magisterial districts. This body also has responsibility for appointing the county administrator. The County has taxing powers subject to statewide restrictions and tax limits.

Located in central Virginia 15 miles north of the City of Richmond, the County's 471 square miles lies in the Commonwealth's Piedmont and Coastal regions. Hanover is bordered by the Counties of Caroline, King William, New Kent, Henrico, Goochland, Spotsylvania and Louisa and by the Pamunkey, North Anna and Chickahominy Rivers. The South Anna River is also located in the County. Home of the internationally renowned Hanover tomato, the County also offers both historic houses and the latest new home developments with a balance between residential, commercial, industrial and agricultural tax bases.



The County provides education through its own school system administered by the Hanover County School Board (the “School Board”) and promotes industry through the Economic Development Authority (the “EDA”). These agencies have been classified as discretely presented component units in the financial reporting entity because the School Board administers their own appropriations within the categories defined by the Commonwealth of Virginia. The Board of Supervisors’ (the “Board”) financial accountability over the School Board is also limited to approving transfers between education funds, authorizing school debt issuances and appointing School Board members. The EDA has the power to issue tax-exempt industrial development revenue bonds to qualifying enterprises wishing to utilize that form of financing. Those bonds representing limited obligations of the EDA are to be repaid solely from the revenue and receipts derived from the projects funded with the proceeds. The debt outstanding does not constitute a debt or pledge of the faith and credits of the County or the EDA.

The annual budget serves as the foundation of the County’s financial planning and control. All agencies of the County are required to submit requests for appropriation to the County Administrator on or before December 1 each year. The County Administrator uses these requests as the starting point for developing a proposed budget. The County Administrator then presents the proposed budget to the Board for review no later than the fourth Wednesday in February. The Board is required to hold a public hearing on the proposed budget and to adopt a final budget by no later than June 30, the close of the County fiscal year. The appropriated budget is prepared by fund, function (e.g., public safety), and department (e.g., Sheriff’s Office) with the Appropriations Resolution adopted by the Board of Supervisors placing legal restrictions on expenditures at the fund level.

Board of Supervisors approval is needed for transfers of \$25,000 or more between department budget categories of personnel, operating, and capital, and any transfers increasing the County’s total appropriated budget. The County Administrator can authorize transfers within department budget categories of personnel, operating, and capital, and for amounts up to \$25,000, between departmental budget categories. The School Board is authorized to transfer budgeted amounts within the school funds, with any transfer that increases total revenues requiring subsequent Board of Supervisors approval. Budget-to-actual comparisons are provided in this report for which an appropriated annual budget has been adopted. For the General Fund, this comparison is presented on page 33 as part of the basic financial statements for the government funds. For governmental funds, other than the General Fund, with

appropriated annual budgets, this comparison is presented in the County fund subsection of this report, which starts on page 70.

Factors Affecting Financial Condition

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which the County operates.

Local economy: While general property tax collections were in line with budgetary estimates, sales tax collections were over budget by \$1.7 million for 2005. The overall positive economic environment has enabled the County to continue to have the lowest unemployment rate in the Richmond region at 2.9% calendar year 2004. Further indicators of continued economic strength and strong financial condition are as follows:

- The tax base grew by 2.5% last year. Tax collections remained strong in 2004-05; the County has collected over 98% of taxes every year since 1997.
- Total outstanding delinquent taxes represent only 1.5% of the total tax levy. This ratio has been below 2.0% since 2000 and 3.0% since 1997.
- The County has continued to realize high median new home sales prices over many years with new home median sales price at \$280,000 in January 2005, a 5.7% increase over the prior year value of \$265,000. The average value of a house in the County is now \$195,000, a 7.7% increase over the prior year.
- The County has also maintained its strong bond rating of AA1/AA/AA+ (with a positive outlook) with only six counties in Virginia and ~45 counties nationwide having higher bond ratings than Hanover.
- Debt policy compliance is strong in all indicators, highlighted by debt service to expenditures at 6.9% (policy is <10%) as this ratio is the lowest since 1990.
- The undesignated fund balance as of June 2005 was \$16.2 million, which represented 10.5% of General Fund revenues in fiscal year 2005 and exceeds the policy of 10%.
- Population growth rate was 1.9%, with a total population of 97,600 estimated for July 2005.

To internally assess our financial health, the County has traditionally tracked State-published indicators of fiscal stress and median adjusted gross income. The most recent State report shows Hanover with the 11th lowest level of fiscal stress, which is the same as the previous year. Hanover's \$39,784 median adjusted gross income is the 8th highest, which is also the same rank as the prior year. These ratings are higher than all but four of the State's AAA rated localities. Hanover has maintained and strengthened its own ratings of Aa1, AA+ and AA. A component of the fiscal stress index is a locality's tax rate compared to State-wide averages, with low tax rate jurisdictions assigned a lower stress as they would appear to have the greater capacity to raise their taxes. The County's commitment to remain a low tax locality does impact our budgetary process as the services sought by many residents in the County are similar to services offered by higher taxing localities. The preceding economic highlights are not only very strong indicators of fiscal health, but also indicative of the traditionally strong indicators that the County has maintained or improved over many years.

Economic Development Update: As Hanover continues to mature and grow, the Board of Supervisors maintains focus on long-range strategic planning. The Board of Supervisors' adopted Economic Development Strategic Plan encourages and supports growth of existing and future businesses. This plan outlines the County's four major Economic Development goals: expansion of the tax base, economic stability, job retention, and job creation. The plan identifies target industries, utilization of incentives, the establishment of economic development zones for infrastructure enhancement, and revisions to County development regulations. This year the Board undertook a competitiveness analysis of the County's economic development program. This analysis included a SWOT analysis and a tour of three other jurisdictions in the Richmond Region: Henrico County, Chesterfield County, and Goochland County. The Board has identified the provision of infrastructure for economic development as a top priority and has requested that the revision of the Comprehensive Plan be advanced to study the options available.

A major objective of the Economic Development Strategic Plan was the establishment of five Economic Development Zones (EDZ). The purpose of these zones is to give priority consideration for development of infrastructure and fast track permitting to support new and expanding industrial and office projects in the County. Selection of the EDZs was based on several factors: Comprehensive Plan designation, site location, cost to serve the site with infrastructure, the amount of product currently available for sale, and the level of private sector activity occurring in the area. The County's commercial tax base continues to grow through a combination of existing business expansions and new business attraction.

In the past four years, Hanover County has added over 600 acres of zoned property in three business parks - Lewistown Commerce Center, Northlake Business Park, and Bell Creek Business Park. Now, the proverbial ships are starting to come in, generating revenue for the County and creating high-quality employment opportunities for residents. Owens & Minor, a Fortune 500 company, will re-locate its home office from Henrico County to the Atlee Station office park in March 2006. About 450 people will be employed at the Hanover office. Nearly 1 million square feet of office and commercial space has been added to Lewistown Commerce Center, Northlake Business Park, Bell Creek Business Park, and the Crescent Business Center in Lakeridge Business Park during the past five years. As North Lakeridge Parkway is extended to U.S. Rt. 1, additional development will follow. Construction of the North Lakeridge Parkway is underway and should be completed this fall. According to Advantis Real Estate, 24.5 percent of all industrial leases over 50,000 square feet in the Richmond Region were signed in Hanover County between 2003 and 2005, although Hanover only contains 7.5% of all industrial space available in the region.

Last year commercial and industrial development represented 43% of the total value of building permits issued in Hanover. This is one of the highest percentages in the past ten years. Through August 2005 of this year, that percentage is 30%, still above the County's historic percentage. Several major retail developments have opened or plan to open in 2005, including a Target in Hanover Square South in Mechanicsville and a Home Depot near the newly reconstructed Atlee-Elmont interchange in "NorthCross Center". The "NorthCross Center" is the first major new retail project within the 167 acres planned for commercial development, which takes advantage of opportunities created by Virginia Center Commons, the revitalization of U.S. Rt. 1, and the improved road network around the new interchange. The Atlee-Elmont interchange also includes about 357 acres planned for industrial zoning.

The County continues to position itself well for economic development in the region. The County has the lowest property tax rate; no business, professional and occupational tax (BPOL); high residential wealth and education (i.e., customers and employees); available commercial and industrial sites; and water and wastewater capacity. In addition, the County utilizes comprehensive planning that targets business development for appropriate areas while maintaining a high quality of residential, forestal, and agricultural uses in other parts of the County.

Long-term financial planning: The County has long been recognized as formulating detailed public plans for its long-term financial planning. Planning enables the County to appropriately analyze issues and initiatives, provide public comment during public hearings and formulate desired service level plans and phase-in funding in attaining desired goals in the long-term. Primarily, these long-term financial plans involve the Five-Year Capital Improvements Program and Five Year Financial Plan:

- **Capital Improvements Program (CIP):** The Capital Improvements Program (CIP) is the County's plan for investing in facilities, equipment, and vehicles over the next five years and includes those items with a unit cost greater than \$50,000. The fiscal year 2006 capital budget for County and School projects is \$23.5 million, which is \$5.0 million lower than fiscal year 2005. The decrease is primarily attributable to the 2005 budget including \$14.2 million for Kersey Creek Elementary School that will open in 2006. The County budget policies recommend the use of "pay-as-you-go" funding for 10% of more to recognize the need to balance the use of debt with the use of other resources for funding. The fiscal year 2006 County and School Five-Year CIP includes 35.5% in "pay-as-you-go" funding (non-debt sources). The CIP recognizes the continued accumulation and utilization of the School and County Savings Plan.
- **Bond Referendum:** In order to meet our capital needs over the next five years, a referendum is included on the November 2005 ballot. The County has successfully implemented all projects approved by the citizens in the 1994 and 1997 referendums. By using a similar model, the County and schools can fund the necessary capital infrastructure for our public safety, schools, parks and libraries for the upcoming five years. The 2005 bond referendum includes three questions totaling \$95.1 million as follows: Schools \$51.9 million, Public Safety \$33.4 million, Parks and Libraries \$9.7 million.
- **Five-Year Financial Plan:** The County's Five-Year Financial Plan represents the County's attempt to quantify the impacts of future needs matched with a projection of available resources. Each year this plan is adopted by the Board of Supervisors, thereby indicating to the public the County's expected tax rates, operating costs, capital improvements, debt service requirements, school allocations and service level plans. The plan is illustrated with detailed assumptions in a separate section of the budget document. Generally, the plan seeks to maintain or enhance all current budgetary objectives and Board adopted goal statements. The County's conservative revenue forecasting has enabled it to meet future targets.

Cash management policies and practices: The County Treasurer is responsible for investing County funds. Investments and deposits during the year consisted of a variety of securities, durations and increments as allowable by the Code of Virginia and further restricted by the County's investment policy. These allowable investments include savings accounts, certificates of deposit, U. S. County agency securities, corporate notes, banker's acceptances, commercial paper, money market accounts, mutual funds, state bonds, local bonds, mortgage-backed securities and repurchase agreements. The County Treasurer and Board of Supervisors have a jointly adopted investment policy that seeks to safeguard principal, meet liquidity objectives and seek fair value rates of return.

Risk management: The County, through periodic formal request for proposals, solicits insurance companies/agencies/pools to provide worker's compensation, property, auto, liability, inland marine, boiler and crime insurance. The County has experienced favorable loss ratios. In addition, the County provides various surety bond coverage as required under regulations and at industry-recommended desired levels.

The County is a participating member in the Virginia Municipal Group Self Insurance Association (“VMGSIA”) and the School Board is a participating member in the School Systems of Virginia Self Insurance Program, with both of these entities providing workers’ compensation coverage in compliance with the Virginia Workers’ Compensation Statute. The County insures most of its other exposures through the Virginia Municipal Liability Pool (VMLP). These entities are non-profit insurance pools created to provide local governmental entities with a stable insurance market for workers’ compensation, property, and liability coverages, to reduce the cost of insurance for local governments and public school systems, and to improve risk management and loss prevention programs. As a member of the insurance pools, the County receives annual dividends, which represent a return of premiums, based upon the County’s individual loss experience, the overall performance of the pools, and the relative premium size of the pool members.

The risks of loss to which the County and School Board are exposed include, but are not limited to, property loss - both fixed and mobile, boiler and machinery equipment breakdown, general liability, personal injury, vehicle liability, theft, embezzlement, sexual harassment, age and sex discrimination, zoning, false arrest, illegal searches, slander, and building code enforcement. The ways in which these risks of loss are managed and mitigated include, but are not limited to, insurance, insurance consulting services, and safety policies. The various pools have loss prevention departments to help the County administer its loss prevention program. The County had no reduction in insurance coverage from the previous fiscal year in any categories of risk that would increase liability and there were no settlements greater than insurance coverage. The County has a Risk Manager who, with the County's insurance coordinator and insurance consultant, oversees the areas of risk identified and manages this risk in order for the County to further strengthen its risk management program.

Pension and other post-employment benefits: The County is a participant in the Virginia Retirement System (“VRS”) a defined benefits plan pension system, for which the County contributes a percentage of a qualifying County employee’s salary towards the VRS. The VRS is responsible for administering the setting of the contribution rate and making retirement payments in accordance with the established plan. In addition, the County provides access to section 457 and/or section 403b, as applicable, retirement investment programs that are funded through employee deductions.

Awards and Acknowledgements

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the County for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2004. The County has received this prestigious award each fiscal year since 1985. In order to be awarded a Certificate of Achievement, the County published an easily readable and efficiently organized CAFR. This report satisfied both GAAP and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the Certificate of Achievement Program’s requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

In addition, the County received the GFOA’s Distinguished Budget Presentation Award for its annual budget document for fiscal year 2005-2006. The County has received this prestigious award each fiscal year since 1990. In order to qualify for the Distinguished Budget Presentation Award, the County’s budget document was judged to be proficient in several categories, including as a policy document, a financial plan, an operations guide, and a communications device.

The County utilizes its website www.co.hanover.va.us for a variety of purposes, which include presentation of the audit report and budget document. The budget document serves as the best source for

the variety of accomplishments of County functions, new initiatives and changes in service levels. In addition, the website also provides many other topics of interest, recognizes outstanding employees and various awards and commendations received. While many of those accomplishments could also be made in this report, it is the County's current intention to focus this report on the results of operations and analysis of the financial statements.

The preparation of this report would not have been possible without the efficient and dedicated services of the entire staff of the Department of Finance. We would like to express our appreciation to all members of the department who assisted and contributed to the preparation of this report. Credit also must be given to the Board of Supervisors for their unfailing support for maintaining the highest standards of professionalism in the management of the County finances.

Respectfully submitted,

Cecil R. Harris, Jr., County Administrator

Terry S. Adams, Director of Finance