

**CITY OF HAMILTON! OHIO  
GAS SYSTEM**

**Financial Statements  
Years Ended December 31, 2003 and 2002  
With Independent Auditors' Report**





**Auditor of State  
Betty Montgomery**

City Council  
City of Hamilton!-Gas System

We have reviewed the Independent Auditor's Report of the City of Hamilton!-Gas System, Butler County, prepared by Clark, Schaefer, Hackett & Co., for the audit period January 1, 2003 through December 31, 2003. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

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

A handwritten signature in black ink that reads "Betty Montgomery".

BETTY MONTGOMERY  
Auditor of State

August 17, 2004

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# CITY OF HAMILTON! OHIO – GAS SYSTEM

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Clark, Schaefer, Hackett & Co.  
CERTIFIED PUBLIC ACCOUNTANTS  
BUSINESS CONSULTANTS

**INDEPENDENT AUDITORS' REPORT**

Honorable City Council  
City of Hamilton! Ohio

We have audited the accompanying financial statements of the City of Hamilton! Ohio - Gas System, an enterprise fund of the City of Hamilton! Ohio as of and for the years ended December 31, 2003 and 2002, as listed in the table of contents. These financial statements are the responsibility of the City of Hamilton!'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Gas System and do not purport to, and do not, present fairly the financial position of the City of Hamilton! Ohio as of December 31, 2003 and 2002, and the changes in its financial position and cash flows, where applicable, for the years then 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 financial position of the City of Hamilton! Ohio - Gas System as of December 31, 2003 and 2002 and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Clark, Schaefer, Hackett & Co.*

Cincinnati, Ohio  
June 14, 2004

**CITY OF HAMILTON! OHIO – GAS SYSTEM  
STATEMENTS OF NET ASSETS  
DECEMBER 31, 2003 AND 2002**

	<u>2003</u>	<u>2002</u>
<b>ASSETS</b>		
Current assets:		
Cash and investments	\$ 2,502,108	3,938,905
Accounts receivable (less allowance for uncollectible accounts of \$3,103,552 and \$2,578,234, respectively)	5,013,341	4,684,485
Interest receivable	37,023	43,927
Due from other funds	5,000	5,000
Inventory of supplies at cost	103,751	113,950
Prepaid expenses	<u>95,499</u>	<u>96,356</u>
Total current assets	<u>7,756,722</u>	<u>8,882,623</u>
Restricted assets:		
Cash and investments	<u>3,754,544</u>	<u>3,579,545</u>
Bond issuance costs	<u>401,752</u>	<u>236,884</u>
Capital assets:		
Property, plant and equipment	58,452,097	57,368,740
Construction in progress	573,472	878,938
Accumulated depreciation	<u>(21,543,002)</u>	<u>(19,800,042)</u>
Total capital assets	<u>37,482,567</u>	<u>38,447,636</u>
Total assets	\$ <u>49,395,585</u>	<u>51,146,688</u>
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable	\$ 3,228,292	2,503,877
Accrued wages and benefits	52,746	51,738
Intergovernmental payable	19,856	15,070
Accrued interest payable	115,118	159,469
Revenue bonds payable - current portion	<u>955,000</u>	<u>695,000</u>
Total current liabilities	<u>4,371,012</u>	<u>3,425,154</u>
Non-current liabilities:		
Customer deposits payable	424,190	399,770
Compensated absences payable	400,861	371,056
Revenue bonds payable	<u>12,133,268</u>	<u>15,076,292</u>
Total noncurrent liabilities	<u>12,958,319</u>	<u>15,847,118</u>
Total liabilities	<u>17,329,331</u>	<u>19,272,272</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	23,094,281	22,676,344
Unrestricted	<u>8,971,973</u>	<u>9,198,072</u>
Total net assets	\$ <u>32,066,254</u>	<u>31,874,416</u>

See notes to financial statements.



**CITY OF HAMILTON! OHIO - GAS SYSTEM**  
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**  
**YEARS ENDED DECEMBER 31, 2003 AND 2002**

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	<u>2003</u>	<u>2002</u>
<b>Operating revenues:</b>		
Charges for services	\$ 26,059,532	21,917,517
Other operating revenues	<u>55,970</u>	<u>3,956</u>
Total operating revenues	<u>26,115,502</u>	<u>21,921,473</u>
 <b>Operating expenses:</b>		
Purchased gas	18,300,993	15,058,714
Personal services	1,398,765	1,153,226
Contractual services	846,380	758,890
Depreciation	1,808,207	1,771,187
Materials and supplies	54,311	89,192
Other operating expenses	<u>2,880,887</u>	<u>1,918,960</u>
Total operating expenses	<u>25,289,543</u>	<u>20,750,169</u>
 Operating income	825,959	1,171,304
 <b>Non-operating revenues (expenses):</b>		
Investment earnings	124,610	218,252
Gain (loss) on disposal of capital assets	(5,224)	(47,357)
Interest and fiscal charges	<u>(753,507)</u>	<u>(876,809)</u>
Total non-operating revenues (expenses)	<u>(634,121)</u>	<u>(705,914)</u>
 Change in net assets	191,838	465,390
 Net assets - beginning of year	<u>31,874,416</u>	<u>31,409,026</u>
 Net assets - end of year	\$ <u>32,066,254</u>	<u>31,874,416</u>

See notes to financial statements.

**CITY OF HAMILTON! OHIO - GAS SYSTEM  
STATEMENTS OF CASH FLOWS  
YEARS ENDED DECEMBER 31, 2003 AND 2002**

	<u>2003</u>	<u>2002</u>
<b>Cash flows from operating activities:</b>		
Cash received from customers	\$ 25,798,832	21,217,641
Cash paid for employee services and benefits	(1,363,166)	(1,195,935)
Cash paid to suppliers for goods and services	(21,347,100)	(18,068,864)
Other operating revenues	<u>12,234</u>	<u>4,578</u>
Net cash provided by operating activities	<u>3,100,800</u>	<u>1,957,420</u>
<b>Cash flows from capital and related financing activities:</b>		
Acquisition and construction of capital assets	(848,362)	(1,112,723)
Proceeds from sale of refunding debt	15,448,723	-
Payment to escrow agent for refunding of debt	(16,917,357)	-
Principal payment on debt	(860,000)	(670,000)
Interest and fiscal charges	<u>(1,328,264)</u>	<u>(824,313)</u>
Net cash used in capital and related financing activities	<u>(4,505,260)</u>	<u>(2,607,036)</u>
<b>Cash flows from investing activities:</b>		
Interest from investments	<u>142,662</u>	<u>284,738</u>
Net cash provided by investing activities	<u>142,662</u>	<u>284,738</u>
Net change in cash and investments	(1,261,798)	(364,878)
Cash and investments at beginning of year	<u>7,518,450</u>	<u>7,883,328</u>
Cash and investments at end of year	\$ <u>6,256,652</u>	<u>7,518,450</u>
<b>Reconciliation of operating income to net cash provided by operating activities:</b>		
Operating income	\$ 825,959	1,171,304
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,808,207	1,771,187
Changes in assets and liabilities:		
Accounts receivable	(328,856)	(699,254)
Inventories	10,199	7,160
Prepaid expenses	857	(16,664)
Accrued wages and benefits	1,008	11,888
Intergovernmental payables	4,786	8,856
Accounts payable	724,415	9,514
Compensated absences payable	29,805	15,351
Customer deposits	24,420	8,088
Due to other funds	<u>-</u>	<u>(330,010)</u>
Net cash provided by operating activities	\$ <u>3,100,800</u>	<u>1,957,420</u>

See notes to financial statements.

# CITY OF HAMILTON! OHIO – GAS SYSTEM

## Notes to Financial Statements Years Ended December 31, 2003 and 2002

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### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Financial Reporting Entity** – The City of Hamilton! Ohio – Gas System (Gas System) is a utility operating as a separate enterprise fund of the City of Hamilton! Ohio (City). The Gas System is controlled by and is dependent on the City's executive and legislative branches. Control by or dependence on the City is determined on the basis of outstanding debt secured by revenues or general obligations of the City, obligation of the City to finance any deficits that may occur, or receipt of subsidies from the City.

**Measurement Focus, Basis of Accounting and Basis of Presentation** – The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. The Gas System has elected only to apply Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989 that do not conflict with or contradict GASB pronouncements.

Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Gas System's principal ongoing operations. The principal operating revenues are charges to customers for sales and services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting these definitions are reported as non-operating revenues and expenses.

**Income Taxes** – The Gas System, which is owned and operated by the City, is exempt from income taxes since it is a division of a municipality.

**Cash and Investments** – Certain Gas System cash and investments are held in the City Treasury and pooled for investment management purposes. The portion of these pooled funds owned by the Gas System is reported as cash and investments. The Gas System's investments are stated at fair value. Interest earned on funds invested is distributed on the basis of the relationship of the average monthly balance of all funds, including the Gas System.

**Inventories** – Inventories are stated at the lower of cost or market based on a moving-average cost method.

**Capital Assets** – Expenditures that increase values or extend the useful life of the respective assets are capitalized while the costs of maintenance and repairs are charged to operating expenses. Interest costs related to the construction of property, plant and equipment are capitalized. Depreciation is calculated on a straight-line basis over the estimated useful life of the various classes of assets. The range of useful lives for computing depreciation is 3 to 75 years.

***Bond Premiums and Discounts and Issuance Costs*** – Unamortized bond premiums and discounts as well as issuance costs are amortized on the interest method over the term of the related bonds. Amortization of bond premiums was \$51,643 in 2003. Amortization of bond discounts was \$8,965 and \$44,302 in 2003 and 2002, respectively. Amortization of issuance costs in 2003 and 2002 amounted to \$16,156 and \$20,835, respectively.

***Compensated Absences*** - The Gas System follows the provisions of GASB Statement No. 16, “Accounting for Compensated Absences”. Vacation and compensatory time benefits are accrued as a liability as the benefits are earned if the employees' rights to receive compensation are attributable to services already rendered and it is probable that the Gas System will compensate the employees for the benefits through paid time off or some other means. Sick leave termination benefits are accrued using the vesting method. The liability includes the employees who are currently eligible to receive termination benefits and those employees for whom it is probable that they will become eligible to receive payment in the future. The amount is based on accumulated sick leave and employees' wage rates at year-end.

***Use of Estimates*** – The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Reclassifications*** – Certain items from the prior year financial statements have been reclassified to conform to the current year presentation.

## 2. CASH AND INVESTMENTS

The Gas System follows the practice of pooling cash and investments with the City Treasurer except for the cash and investments of certain accounts maintained by trustees. Pooled cash and investments of the Gas System totaled \$2,502,108 and \$3,938,905 at December 31, 2003 and 2002, respectively and consisted of demand deposits, money market funds, U.S. government securities and STAR Ohio.

Star Ohio is an investment pool managed by the State Treasurer’s Office, which allows governments within the State to pool their funds for investment purposes. STAR Ohio is not registered with the SEC as an investment company, but does operate in a manner consistent with Rule 2a7 of the Investment Company Act of 1940. Investments in STAR Ohio are valued at STAR Ohio’s share price, which is the price the investment could be sold for on December 31, 2003.

***Deposits*** – Custodial credit risk is the risk that in the event of a bank failure, the City’s deposits may not be returned to it. The City does not have a custodial risk policy. As of December 31, 2003, nearly 97% of the City’s deposits with financial institutions, including the amount of pooled deposits related to the Gas System, were exposed to custodial credit risk because they are considered uninsured and uncollateralized. However, the State of Ohio has established by statute a collateral pooling system for financial institutions acting as public depositories. Public depositories must pledge qualified securities with fair values greater than the total amount of all public deposits to be secured by the collateral pool. This pooled collateral covers the Gas System’s uninsured and uncollateralized deposits.

**Investments** – The State of Ohio statutes, Gas Revenue Bond indentures, and the City Charter authorize the City to invest in obligations of the U.S. Treasury, agencies, instrumentalities, and repurchase agreements. Custodial credit risk in regards to investments is the risk that, in the event of a failure of a counter party, the City will not be able to recover the value of its investments or collateral securities that are in possession of an outside party. The City employs the use of “safekeeping” accounts to hold and maintain custody of its investments as identified within this policy and as means of mitigating this risk.

Interest rate risk is the risk that the City will incur fair value losses arising from rising interest rates. Such risk is mitigated by the investment policy by limiting investments to certain maximum maturities. As a rule, unless specified otherwise within the policy, investments are to have a maximum maturity of five years unless the investment is matched to a specific expenditure. The context of a specific investment purchase must be weighed in proportion to the remainder of the existing investment portfolio and the “prudent investor” rule to attempt to limit such risk.

The City’s pooled investments, as well as the investments held by trustees specifically for the Gas System, are invested primarily in U.S. governmental agency securities with an average maximum maturity of 3.07 years and STAR Ohio which has a credit rating of AAAM.

**3. ACCOUNTS RECEIVABLE**

Receivables at December 31, 2003 and 2002 consist of the following:

		<u>2003</u>	<u>2002</u>
Earned and unbilled consumer accounts	\$	2,698,418	2,506,492
Earned and billed consumer accounts		5,418,475	4,756,227
Less allowance for uncollectible accounts		<u>(3,103,552)</u>	<u>(2,578,234)</u>
 Total	 \$	 <u>5,013,341</u>	 <u>4,684,485</u>

**4. RESTRICTED ASSETS**

Restricted assets consist of assets whose use has been restricted by bond indenture, City Charter or City Council ordinance for debt service or gas rate stabilization. Restrictions and related assets are as follows:

		<u>2003</u>	<u>2002</u>
Debt service	\$	270,219	251,372
Reserve for debt service		-	1,528,201
Gas rate stabilization		<u>3,484,325</u>	<u>1,799,972</u>
 Total	 \$	 <u>3,754,544</u>	 <u>3,579,545</u>

## 5. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2003 and 2002 was as follows:

	Balance			Balance
	<u>1/1/03</u>	<u>Increases</u>	<u>Decreases</u>	<u>12/31/03</u>
<i>Capital assets not being depreciated:</i>				
Land	\$ 92,101	-	-	92,101
Construction in progress	<u>878,938</u>	<u>27,955</u>	<u>(333,421)</u>	<u>573,472</u>
Subtotal	<u>971,039</u>	<u>27,955</u>	<u>(333,421)</u>	<u>665,573</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	443,288	73,132	-	516,420
Machinery and equipment	<u>56,833,351</u>	<u>1,080,696</u>	<u>(70,471)</u>	<u>57,843,576</u>
Subtotal	<u>57,276,639</u>	<u>1,153,828</u>	<u>(70,471)</u>	<u>58,359,996</u>
Totals at historical cost	<u>58,247,678</u>	<u>1,181,783</u>	<u>(403,892)</u>	<u>59,025,569</u>
Less accumulated depreciation:				
Buildings and improvements	163,030	16,401	-	179,431
Machinery and equipment	<u>19,637,012</u>	<u>1,791,806</u>	<u>(65,247)</u>	<u>21,363,571</u>
Total accumulated depreciation	<u>19,800,042</u>	<u>1,808,207</u>	<u>(65,247)</u>	<u>21,543,002</u>
Capital assets, net	\$ <u>38,447,636</u>	<u>(626,424)</u>	<u>(338,645)</u>	<u>37,482,567</u>
	Balance			Balance
	<u>1/1/02</u>	<u>Increases</u>	<u>Decreases</u>	<u>12/31/02</u>
<i>Capital assets not being depreciated:</i>				
Land	\$ 92,101	-	-	92,101
Construction in progress	<u>443,346</u>	<u>435,592</u>	<u>-</u>	<u>878,938</u>
Subtotal	<u>535,447</u>	<u>435,592</u>	<u>-</u>	<u>971,039</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	418,587	24,701	-	443,288
Machinery and equipment	<u>56,316,247</u>	<u>619,201</u>	<u>(102,097)</u>	<u>56,833,351</u>
Subtotal	<u>56,734,834</u>	<u>643,902</u>	<u>(102,097)</u>	<u>57,276,639</u>
Totals at historical cost	<u>57,270,281</u>	<u>1,079,494</u>	<u>(102,097)</u>	<u>58,247,678</u>
Less accumulated depreciation:				
Buildings and improvements	147,958	15,072	-	163,030
Machinery and equipment	<u>17,935,637</u>	<u>1,756,115</u>	<u>(54,740)</u>	<u>19,637,012</u>
Total accumulated depreciation	<u>18,083,595</u>	<u>1,771,187</u>	<u>(54,740)</u>	<u>19,800,042</u>
Capital assets, net	\$ <u>39,186,686</u>	<u>(691,693)</u>	<u>(47,357)</u>	<u>38,447,636</u>

## 6. LONG TERM DEBT

Dated May 1, 2003, the City of Hamilton issued Gas System Revenue Refunding Bonds intended to provide, in conjunction with an irrevocable escrow trust agreement with Huntington National Bank, for the advanced refunding and in-substance defeasance of the existing 1993 Gas System Revenue Bonds. The bonds were issued with a face value of \$14,540,000 and included the purchase of U.S. Government securities that when combined, with interest earned thereon, is considered sufficient to provide for an in-substance defeasance of the existing 1993 Gas System Revenue Bonds. The City also liquidated available bond funds and the debt service reserve fund of the 1993 Gas System bonds to provide for the advanced refunding. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the financial statements. The reacquisition price exceeded the net carrying amount of the old debt by \$1,378,349. This amount will be amortized over the remaining life of the new debt, which was issued with a final maturity in October 2015, three years prior to the maturity of the refunded debt. This advance refunding was undertaken to reduce total debt service payments over the next fifteen years by \$3,765,901 and resulted in an economic gain of \$1,077,784. The Gas System Revenue Refunding are due serially through 2015 with interest from 2.0% to 5.0% per annum. Activity for the year ended December 31, 2003 was as follows:

	Balance January 1, <u>2003</u>	<u>Additions</u>	<u>Reductions</u>	Balance December 31, 2003	Due Within <u>One Year</u>
1993 Series A Bonds	\$ 16,275,000	-	(16,275,000)	-	-
Less deferred amount for issuance discounts	(503,708)	-	(503,708)	-	-
2003 Refunding Bonds	-	14,540,000	(860,000)	13,680,000	955,000
Less deferred amount on refunding	-	(1,378,349)	78,331	(1,300,018)	-
for issuance premium	-	<u>750,963</u>	<u>(42,677)</u>	<u>708,286</u>	-
	\$ <u>15,771,292</u>	<u>13,912,614</u>	<u>(17,603,054)</u>	<u>13,088,268</u>	<u>955,000</u>

Activity for the year ended December 31, 2002 was as follows:

	Balance January 1, <u>2002</u>	<u>Additions</u>	<u>Reductions</u>	Balance December 31, 2002	Due Within <u>One Year</u>
1993 Series A Bonds	\$ 16,945,000	-	(670,000)	16,275,000	695,000
Less deferred amount for issuance discounts	<u>(548,010)</u>	-	<u>(44,302)</u>	<u>(503,708)</u>	-
	\$ <u>16,396,990</u>	-	<u>(714,302)</u>	<u>15,771,292</u>	<u>695,000</u>

Under the terms of the revenue bond indenture, the City has agreed to certain covenants including, among other things, maintaining revenue levels and providing for operating expenses and debt service. The revenue bonds are insured under municipal bond insurance policies. Under the terms of the policies, the payments of principal and interest are guaranteed by the insurer.

Annual debt service requirements to maturity for the refunding bonds are as follows:

		<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$	955,000	538,212	1,493,212
2005		970,000	519,112	1,489,112
2006		1,000,000	490,012	1,490,012
2007		1,025,000	467,512	1,492,512
2008		1,055,000	436,762	1,491,762
2009-2013		5,900,000	1,548,360	7,448,360
2014-2015		2,775,000	199,262	2,974,262
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Total	\$	13,680,000	4,199,232	17,879,232
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#### 7. **DEFINED BENEFIT PENSION PLANS AND OTHER POSTEMPLOYMENT BENEFITS**

The Gas System contributes to the Ohio Public Employees Retirement System (OPERS) which administers three separate pension plans as described below:

- The Traditional Pension Plan – a cost-sharing multiple-employer defined benefit pension plan.
- 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 thereon.
- 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 and of the Traditional Plan and Combined Plan. Members of the Member-Directed Plan do not qualify for ancillary benefits. The 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 that may be obtained by writing to the Ohio Public Employees Retirement System, 277 East Town Street, Columbus, Ohio 43215-4642.

Plan members are required to contribute 8.5% of their annual covered salary. The City was required to contribute 13.55% of covered payroll for employees. The Gas System's required contributions to PERS for the years ended December 31, 2003, 2002, and 2001 were approximately \$133,000, \$125,000 and \$96,000 respectively, equal to the required contributions for each year.



PERS provides postretirement health care coverage to age and service retirees with ten or more years of qualifying Ohio service credit and to primary survivor recipients of such retirees. Health care coverage for disability recipients is available. The health care coverage provided by the retirement system is considered an Other Postemployment Benefit (OPEB) as described in GASB Statement No. 12. A portion of each employer's contribution to PERS is set aside for the funding of postretirement health care based on authority granted by State statute. The 2003 employer contribution rate was 13.55% of covered payroll for employees and 5.0% was the portion that was used to fund health care for the year.

The assumptions and calculations below were based on the System's latest Actuarial Review performed as of December 31, 2002. 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. All investments are carried at market value. For actuarial valuation purposes, a smoothed market approach is used. Under this approach, assets are adjusted annually to reflect 25% of unrealized market appreciation or depreciation on investment assets. The investment assumption rate for 2002 was 8.00%. An annual increase of 4.00% 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 4.00% base increase, were assumed to range from 0.50% to 6.30%. Health care costs were assumed to increase 4.00% annually.

The OPEB's are advance-funded on an actuarially determined basis. The number of active contributing participants in the Traditional and Combined Plans totaled 364,881. The portion of the Gas System's contributions that were used to fund postemployment benefits was approximately \$49,000 and \$46,000 in 2003 and 2002, respectively. At December 31, 2002, the actuarial value of the Retirement System's net assets available for OPEB was \$10 billion. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$18.7 billion and \$8.7 billion, respectively.

## **8. CONTINGENT LIABILITIES**

Various claims and lawsuits are pending against the City involving the Gas System. The City believes that the ultimate disposition of such claims and lawsuits will not have a material adverse effect on the financial position of the Gas System.

## **9. RELATED PARTY TRANSACTIONS**

The Gas System sells gas to the City's Electric System for use in the generation of electricity. Revenues of approximately \$503,000 and \$461,000 from the Electric System to the Gas System are included in operating revenues in 2003 and 2002, respectively.

The City allocates the cost of certain administrative services. In addition, the City established internal service funds that provide services to various City departments. Charges to the Gas System for these services were approximately \$2,158,000 and \$2,189,000 in 2003 and 2002, respectively, and are included in other operating expenses.

**10. RISK MANAGEMENT**

The City is exposed to various risks of loss related to torts and liability, damage to and theft of or destruction of assets; errors and omissions; injuries to employees; and natural disasters. The City maintains comprehensive insurance coverage, for all City departments including the Gas System, with private carriers for real property, building contents, vehicle, property and general liability insurance, police professional liability, and public officials errors and omissions insurance. Vehicle policies include liability coverage for bodily injury and property damage. Claim payments have not exceeded coverage in the past three years. There was no decline in the level of coverage from the prior year.

**11. CONTRACTUAL COMMITMENTS**

At December 31, 2003 and 2002, the Gas System had contractual commitments to purchase gas from in the amount of \$2,730,196 and \$3,244,430, respectively.



**Auditor of State  
Betty Montgomery**

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**CITY OF HAMILTON GAS SYSTEM**

**BUTLER COUNTY**

**CLERK'S CERTIFICATION**

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

*Susan Babbitt*

**CLERK OF THE BUREAU**

**CERTIFIED  
SEPTEMBER 2, 2004**