

**CITY OF HAMILTON! OHIO
ELECTRIC SYSTEM**

**Financial Statements
Years Ended December 31, 2004 and 2003
With Independent Auditors' Report**



**Auditor of State
Betty Montgomery**

Honorable Mayor and Members of City Council
City of Hamilton Electric System
345 High Street
Hamilton, Ohio 45011

We have reviewed the *Independent Auditors' Report* of the City of Hamilton Electric System, Butler County, prepared by Clark, Schaefer, Hackett & Co., for the audit period January 1, 2004 through December 31, 2004. 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 Electric System is responsible for compliance with these laws and regulations.

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

BETTY MONTGOMERY
Auditor of State

August 3, 2005

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CITY OF HAMILTON! OHIO – ELECTRIC 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 - Electric System, an enterprise fund of the City of Hamilton! Ohio as of and for the years ended December 31, 2004 and 2003, 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 Electric System and do not purport to, and do not, present fairly the financial position of the City of Hamilton! Ohio as of December 31, 2004 and 2003, 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 - Electric System as of December 31, 2004 and 2003 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.

The Management's Discussion and Analysis on pages 2-7 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.

Clark, Schaefer, Hackett & Co.

Cincinnati, Ohio
June 10, 2005

City of Hamilton, Ohio

Electric System

Management's Discussion and Analysis
For the Year Ended December 31, 2004 and 2003
Unaudited

The discussion and analysis of the City of Hamilton, Ohio's Electric System's financial performance provide an overall review of that system's financial activities for the year ended December 31, 2004 and 2003. While the intent of this discussion and analysis is to look at the system's financial performance, readers should also review the Statements of Net Assets; Revenues, Expenses and Changes in Net Assets; and Cash Flows to enhance their understanding of the system's fiscal performance.

Financial Highlights

Key highlights for 2004 and 2003 are as follows:

- The liabilities of the Hamilton Electric System exceeded its assets at the close of 2004 and 2003 respectively by \$1,370,215 and \$332,667 (net assets). At December 31, 2004 and 2003, \$18,813,088 and \$29,189,651, respectively (unrestricted net assets) may be used to meet the system's ongoing obligations to customers and creditors.
- The system's total net assets decreased between 2004 and 2003 by \$1,037,548.
- The system's investment in capital assets, net of related debt increased by \$9,151,116 in 2004.
- In November 2004, the City issued a \$2,000,000 general obligation bond anticipation note to finance the engineering, construction, acquisition and related costs of a new ash removal system at the Power Plant.
- The City completed its installation of new coal blending equipment at a cost of \$247,466 during 2004, enabling the system to operate at its highest efficiency.
- The City completed installation of pollution monitoring equipment in 2003 (nitrous oxide or NoX) which yielded additional revenue in 2004 due to the system's ability to sell unused credits to other utilities.

Electric System Summary and Using this Annual Report

The City of Hamilton, Ohio has owned and operated an electric utility system since 1893. Currently, the system is the second largest municipally owned electric system in Ohio. The electric system is a fully integrated electric generation, transmission and distribution system. The system owns both thermal and hydroelectric generation facilities and maintains a diverse 27,500 customers. Customer rates are established by the City and are not subject to the regulatory jurisdiction of the Public Utilities Commission of Ohio (PUCO) or any other regulatory body.

This annual report consists only of the Statement of Net Assets, the Statement of Revenues, Expenses and Changes in Net Assets, and the Statement of Cash Flows as well as Notes to the Financial Statements for the City of Hamilton, Ohio's Electric System for the year ended December 31, 2004 and 2003.

City of Hamilton, Ohio

Electric System

Management's Discussion and Analysis
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Reporting Hamilton's Electric System (Whole and Significant Fund)

The financial statements contained within this report include the City of Hamilton, Ohio's Electric System *only*. Readers desiring to view city-wide financial statements, as well as the impact that the Electric System has on the City's overall financial position and operating results, should refer to the City's Basic Financial Statements appearing in the Comprehensive Annual Financial Report for 2004 and 2003. The City of Hamilton's Electric System is reported as a business-type, proprietary, enterprise fund and is considered a major fund for purposes of individual fund reporting. Payments made from the Electric Fund are restricted to Electric System purposes by municipal ordinance, Ohio Revised Code and indentures issued pursuant to long-term financing.

In the Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets, the view of the System looks at all financial transactions of the Electric Fund and asks the question, "How did we do financially during 2004 and 2003?" These statements provide answers to that question. The statements include all assets and liabilities of the System using the accrual basis of accounting similar to the accounting used by private sector companies. This basis of accounting considers all of the current year's revenues and expenses regardless of when the cash is received or paid. These two statements report the System's net assets and the changes in those net assets. The change in net assets is important because it tells the reader whether, for the system, the financial position of the City has improved or diminished. However, in evaluating this position, non-financial information including the condition of capital assets will also need to be evaluated. The Notes to the Electric System's Financial Statements provide additional information that is essential to a full understanding of the data provided.

The System provides services that have a charge based upon the amount of usage. The City's Electric System charges fees to recoup the cost of the entire operation of the Electric System as well as all capital expenses associated with these facilities.

Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of financial position. In the case of the Electric Fund, liabilities exceeded assets by \$1,370,215 as of December 31, 2004. Unrestricted Net Assets of \$18,813,088 and \$29,189,651 for 2004 and 2003, respectively encompass the largest portion of the net assets of the System. A vast majority of the System's assets lie within the physical property, plant and equipment of the system having a historical cost of \$344,925,210 and \$341,561,548 at December 31, 2004 and 2003, respectively. The System has a historical cost less accumulated depreciation of \$139,955,114 and \$146,334,180, respectively at December 31, 2004 and

City of Hamilton, Ohio

Electric System

Management's Discussion and Analysis
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2003. The System employs these assets in the generation, transmission, and distribution of electricity to customers; consequently, these assets are not readily available for future spending. The System's investment in its capital assets is reported net of related debt in the Net Assets section of the Statement of Net Assets and it should be noted that the resources needed to repay these debts must be provided from other sources, primarily the revenues of the system, since the capital assets themselves cannot be used to liquidate the liabilities. Table 1 provides a summary of the Electric System's Statement of Net Assets for the Years Ended December 31, 2004 and 2003.

	2004	2003
Current and Other Assets	\$30,373,758	\$28,008,727
Capital Assets	139,955,114	146,334,180
Total Assets	<u>170,328,872</u>	<u>174,342,907</u>
Long-term Liabilities	160,626,130	165,484,841
Other Liabilities	<u>11,072,957</u>	<u>9,190,733</u>
Total Liabilities	<u>171,699,087</u>	<u>174,675,574</u>
Invested in capital assets,		
net of related debt	(22,735,080)	(31,886,196)
Restricted - Debt Service	2,551,777	2,363,878
Unrestricted	<u>18,813,088</u>	<u>29,189,651</u>
Total Net Assets	<u>(1,370,215)</u>	<u>(332,667)</u>

As of December 31, 2004 and 2003, the City is not able to report positive balances in net assets as well as reducing balances in the overall change in net assets of (\$1,037,548) and (\$661,904) respectively. Operating income of \$5,683,252 for 2004 and \$5,493,304 for 2003 were positive, in light of depreciation expense exceeding \$9,700,000 in both years, a great deal of which ratably allocates the cost of generation assets. Maintenance of positive operating income is primarily due to controlling the growth of expenses and maintaining rates commensurate with the costs of providing electricity as well as the sale of pollution control credits in 2004. Interest expense on the City's outstanding long-term revenue bonds was reduced by more than \$2.5 Million annually as a function of the refinancing that occurred in 2002.

City of Hamilton, Ohio

Electric System

Management's Discussion and Analysis
For the Year Ended December 31, 2004 and 2003
Unaudited

Statement of Revenues, Expenses and Changes in Net Assets

	2004	2003
Operating Revenues	\$50,994,645	\$49,237,431
Operating Expenses:		
Purchased electric	19,421,957	15,980,616
Depreciation	9,805,932	9,753,838
Other Operating Expenses	16,083,504	18,009,673
Total Operating Expenses	45,311,393	43,744,127
Operating income	5,683,252	5,493,304
Non-Operating revenues (expenses)		
Interest and fiscal charges	(6,974,056)	(6,892,909)
Other non-operating revenues (expenses)	253,256	737,701
Total non-operating revenues (expenses)	(6,720,800)	(6,155,208)
Change in Net Assets	(1,037,548)	(661,904)
Beginning Net Assets	(\$332,667)	329,237
Ending Net Assets	(\$1,370,215)	(\$332,667)

Capital Assets and Debt Administration

Capital Assets: The City's investment in capital assets of the Electric System as of December 31, 2004 and 2003 amounted to (\$22.74 Million) and (\$31.89 Million), respectively, (net of accumulated depreciation and related debt). The negative balances are a direct result of continued depreciation expense coupled with long-term debt balances. This investment in capital assets includes land, buildings, improvements, construction in progress, and machinery and equipment including the City's hydro-electric and thermal generation facilities, the historical cost of which was \$344,925,210 and \$341,561,548, respectively. The plant and equipment of the Electric System are rigorously tested and maintenance schedules are adhered to in a strenuous fashion to insure safe, long-term, efficient operation.

City of Hamilton, Ohio

Electric System

Management's Discussion and Analysis
For the Year Ended December 31, 2004 and 2003
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Note 5 (Capital Assets) provides Electric System asset activity during 2004 and 2003. The System placed Emission Testing equipment in place in 2003 and installed coal blending equipment in 2004.

Debt Administration: At the end of 2004, the City had outstanding long-term revenue bond issues, the 2002 Electric System Variable Rate Revenue Refunding Bonds totaling \$173,330,000. The variable rate nature of the bonds was mitigated by the City by purchasing an interest rate swap (or hedge) allowing the City to hedge the complete outstanding debt for a fixed rate of 2.95%. The City remarketed these bonds to a term fixed rate in 2005 (see subsequent event note).

In November 2004, the City issued General Obligation bond anticipation notes totaling \$2,000,000 to finance an ash removal system at the Power Plant.

The City has major plans to finance and continue construction of an ash removal system, the rebuild of the #9 turbine and various other projects. See Notes 6 and 7 for a discussion of outstanding Electric System bonds, notes and related activity. See Note 15 for a discussion of Subsequent Events specifically related to the Electric System.

Economic Factors and the Future of the System

The City's Electric System is continually monitoring the cost of purchased power, coal and natural gas. However, the cost of coal over the past five years has increased tremendously and the City is required by both ordinance and indentures to pass these cost increases to its customers. The number of customers has remained steady. Debt service coverage has been maintained above indenture required minimums.

The annual budget of the City Electric System is adopted in accordance with ten-year projections developed by a rate consultant, and these projections are updated and reviewed in the spring and fall of each year, or more often as deemed necessary by City Management.

In spite of increasing costs and a focus on replacement, improvement and renewal of system assets, the City's Electric System has prospered. All bond anticipation notes of the City have received a MIG-1 rating, the highest possible rating. The City's Electric System maintains an A3 underlying rating for the system and the 2002 Electric System Variable Rate Revenue Refunding Bonds maintained a VMIG-1 rating.

City of Hamilton, Ohio

Electric System

Management's Discussion and Analysis
For the Year Ended December 31, 2004 and 2003
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Requests for Information

This financial report is designed to provide our citizens, customers, taxpayers, creditors, investors and elected officials with an overview of the City of Hamilton, Ohio's Electric System's finances and to show accountability for the money the system receives. If you have any questions about this report or need additional information, contact George M. Gordon IV, CPA, City of Hamilton Finance Director, 345 High Street, Hamilton, Ohio 45011, (513) 785-7170, (email at gordong@ci.hamilton.oh.us) or visit the City website at www.hamilton-city.org.

CITY OF HAMILTON! OHIO – ELECTRIC SYSTEM
STATEMENTS OF NET ASSETS
DECEMBER 31, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
ASSETS		
Current assets:		
Cash and investments	\$ 17,110,006	14,858,782
Accounts receivable (less allowance for uncollectible accounts of \$4,747,240 and \$4,067,837, respectively)	4,943,645	6,051,281
Interest receivable	23,413	63,697
Due from other funds	-	5,000
Inventory of supplies at cost	2,143,275	799,105
Prepaid expenses	<u>450,221</u>	<u>450,171</u>
Total current assets	<u>24,670,560</u>	<u>22,228,036</u>
Restricted assets:		
Cash and investments	<u>2,551,777</u>	<u>2,363,878</u>
Bond issuance costs	<u>3,151,421</u>	<u>3,416,813</u>
Capital assets:		
Property, plant and equipment	341,071,200	337,946,167
Construction in progress	3,854,010	3,615,381
Accumulated depreciation	<u>(204,970,096)</u>	<u>(195,227,368)</u>
Total capital assets	<u>139,955,114</u>	<u>146,334,180</u>
Total assets	\$ <u>170,328,872</u>	<u>174,342,907</u>
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 2,248,096	2,339,767
Accrued wages and benefits	155,963	379,448
Intergovernmental payable	165,226	133,382
Accrued interest payable	718,672	733,136
General obligation notes payable	2,000,000	-
Revenue bonds payable - current portion	<u>5,785,000</u>	<u>5,605,000</u>
Total current liabilities	<u>11,072,957</u>	<u>9,190,733</u>
Non-current liabilities:		
Customer deposits payable	539,765	456,979
Compensated absences payable	2,029,750	1,985,296
Revenue bonds payable (net of unamortized discounts)	<u>158,056,615</u>	<u>163,042,566</u>
Total noncurrent liabilities	<u>160,626,130</u>	<u>165,484,841</u>
Total liabilities	<u>171,699,087</u>	<u>174,675,574</u>
NET ASSETS		
Invested in capital assets, net of related debt	(22,735,080)	(31,886,196)
Restricted for debt service	2,551,777	2,363,878
Unrestricted	<u>18,813,088</u>	<u>29,189,651</u>
Total net assets	\$ <u>(1,370,215)</u>	<u>(332,667)</u>

See notes to financial statements.

CITY OF HAMILTON! OHIO - ELECTRIC SYSTEM
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
Operating revenues:		
Charges for services	\$ 49,479,128	49,046,899
Other operating revenues	<u>1,515,517</u>	<u>190,532</u>
Total operating revenues	<u>50,994,645</u>	<u>49,237,431</u>
Operating expenses:		
Purchased electric	19,421,957	15,980,616
Personal services	8,827,347	8,945,629
Contractual services	3,422,673	3,495,527
Depreciation	9,805,932	9,753,838
Materials and supplies	55,472	1,450,524
Other operating expenses	<u>3,778,012</u>	<u>4,117,993</u>
Total operating expenses	<u>45,311,393</u>	<u>43,744,127</u>
Operating income	5,683,252	5,493,304
Non-operating revenues (expenses):		
Investment earnings	250,634	288,762
Loss on disposal of capital assets	2,622	(8,038)
Grants	-	456,977
Interest and fiscal charges	<u>(6,974,056)</u>	<u>(6,892,909)</u>
Total non-operating revenues (expenses)	<u>(6,720,800)</u>	<u>(6,155,208)</u>
Change in net assets	(1,037,548)	(661,904)
Net assets - beginning of year	<u>(332,667)</u>	<u>329,237</u>
Net assets - end of year	\$ <u><u>(1,370,215)</u></u>	<u><u>(332,667)</u></u>

See notes to financial statements.

CITY OF HAMILTON! OHIO - ELECTRIC SYSTEM
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Cash received from customers	\$ 50,892,329	49,573,347
Cash paid for employee services and benefits	(8,965,690)	(8,942,878)
Cash paid to suppliers for goods and services	(24,313,931)	(25,906,401)
Other operating revenues	1,214,952	199,758
Other operating expenses	<u>(3,726,132)</u>	<u>-</u>
Net cash provided by operating activities	<u>15,101,528</u>	<u>14,923,826</u>
Cash flows from capital and related financing activities:		
Proceeds from sale of notes	2,000,000	-
Capital grant	-	456,977
Acquisition and construction of capital assets	(3,431,521)	(2,719,496)
Proceeds from sale of assets	7,277	2,629
Principal payment on debt	(5,605,000)	(5,425,000)
Interest paid on debt	<u>(5,924,079)</u>	<u>(5,947,272)</u>
Net cash used in capital and related financing activities	<u>(12,953,323)</u>	<u>(13,632,162)</u>
Cash flows from investing activities:		
Interest from investments	<u>290,918</u>	<u>333,647</u>
Net cash provided by investing activities	<u>290,918</u>	<u>333,647</u>
Net change in cash and investments	2,439,123	1,625,311
Cash and investments at beginning of year	<u>17,222,660</u>	<u>15,597,349</u>
Cash and investments at end of year	<u>\$ 19,661,783</u>	<u>17,222,660</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 5,683,252	5,493,304
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	9,805,932	9,753,838
Changes in assets and liabilities:		
Accounts receivable	1,112,636	468,741
Inventories	(1,344,170)	132,859
Prepaid expenses	(50)	209,128
Accrued wages and benefits	(223,485)	26,738
Intergovernmental payables	31,844	34,457
Accounts payable	(91,671)	(1,203,728)
Compensated absences payable	44,454	(58,444)
Customer deposits	<u>82,786</u>	<u>66,933</u>
Net cash provided by operating activities	<u>\$ 15,101,528</u>	<u>14,923,826</u>

See notes to financial statements.

CITY OF HAMILTON! OHIO – ELECTRIC SYSTEM

Notes to Financial Statements Years Ended December 31, 2004 and 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Reporting Entity – The City of Hamilton! Ohio – Electric System (Electric System) is a utility operating as a separate enterprise fund of the City of Hamilton! Ohio (City). The Electric 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 Electric 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 Electric 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 Electric 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 Electric 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 Electric System is reported as cash and investments. The Electric 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 Electric 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 Discounts and Issuance Costs – Unamortized bond discounts and issuance costs are amortized on the interest method over the term of the related bonds. Amortization of bond discounts was \$55,506 and \$50,470 in 2004 and 2003, respectively. Amortization of issuance costs in 2004 and 2003 amounted to \$265,392 and \$241,313, respectively.

Compensated Absences - The Electric 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 Electric 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 Electric 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 Electric System totaled \$17,110,006 and \$14,858,782 at December 31, 2004 and 2003, 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, 2004.

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, 2004, nearly 96% of the City’s deposits with financial institutions, including the amount of pooled deposits related to the Electric 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 Electric System’s uninsured and uncollateralized deposits.

Investments – The State of Ohio statutes, Electric 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 Electric System, are invested primarily in U.S. governmental agency securities with an average maximum maturity of 2.07 years and STAR Ohio which has a credit rating of AAAM.

3. ACCOUNTS RECEIVABLE

Receivables at December 31, 2004 and 2003 consist of the following:

	<u>2004</u>	<u>2003</u>
Earned and unbilled consumer accounts	\$ 2,034,847	2,980,715
Earned and billed consumer accounts	7,323,066	7,117,919
Other	332,972	20,484
Less allowance for uncollectible accounts	<u>(4,747,240)</u>	<u>(4,067,837)</u>
Total	\$ <u><u>4,943,645</u></u>	<u><u>6,051,281</u></u>

4. RESTRICTED ASSETS

Restricted assets consist of assets whose use has been restricted by bond indenture for debt service. Restricted assets were \$2,551,777 and \$2,363,878 at December 31, 2004 and 2003, respectively.

5. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2004 and 2003 was as follows:

	Balance <u>1/1/04</u>	<u>Increases</u>	<u>Decreases</u>	Balance <u>12/31/04</u>
<i>Capital assets not being depreciated:</i>				
Land	\$ 1,688,866	25,759	-	1,714,625
Construction in progress	<u>3,615,381</u>	<u>599,837</u>	<u>(361,208)</u>	<u>3,854,010</u>
Subtotal	<u>5,304,247</u>	<u>625,596</u>	<u>(361,208)</u>	<u>5,568,635</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	14,420,775	116,143	-	14,536,918
Machinery and equipment	<u>321,836,525</u>	<u>3,088,545</u>	<u>(105,413)</u>	<u>324,819,657</u>
Subtotal	<u>336,257,300</u>	<u>3,204,688</u>	<u>(105,413)</u>	<u>339,356,575</u>
Totals at historical cost	<u>341,561,547</u>	<u>3,830,284</u>	<u>(466,621)</u>	<u>344,925,210</u>
Less accumulated depreciation:				
Buildings and improvements	5,383,684	209,733	-	5,593,417
Machinery and equipment	<u>189,843,683</u>	<u>9,596,199</u>	<u>(63,203)</u>	<u>199,376,679</u>
Total accumulated depreciation	<u>195,227,367</u>	<u>9,805,932</u>	<u>(63,203)</u>	<u>204,970,096</u>
Capital assets, net	\$ <u>146,334,180</u>	<u>(5,975,648)</u>	<u>(403,418)</u>	<u>139,955,114</u>
	Balance <u>1/1/03</u>	<u>Increases</u>	<u>Decreases</u>	Balance <u>12/31/03</u>
<i>Capital assets not being depreciated:</i>				
Land	\$ 1,688,866	-	-	1,688,866
Construction in progress	<u>3,618,851</u>	<u>914,966</u>	<u>(918,436)</u>	<u>3,615,381</u>
Subtotal	<u>5,307,717</u>	<u>914,966</u>	<u>(918,436)</u>	<u>5,304,247</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	14,390,707	30,068	-	14,420,775
Machinery and equipment	<u>319,325,043</u>	<u>2,692,897</u>	<u>(181,415)</u>	<u>321,836,525</u>
Subtotal	<u>333,715,750</u>	<u>2,722,965</u>	<u>(181,415)</u>	<u>336,257,300</u>
Totals at historical cost	<u>339,023,467</u>	<u>3,637,931</u>	<u>(1,099,851)</u>	<u>341,561,547</u>
Less accumulated depreciation:				
Buildings and improvements	5,175,556	208,128	-	5,383,684
Machinery and equipment	<u>180,468,722</u>	<u>9,545,710</u>	<u>(170,749)</u>	<u>189,843,683</u>
Total accumulated depreciation	<u>185,644,278</u>	<u>9,753,838</u>	<u>(170,749)</u>	<u>195,227,367</u>
Capital assets, net	\$ <u>153,379,189</u>	<u>(6,115,907)</u>	<u>(929,102)</u>	<u>146,334,180</u>

6. LONG-TERM DEBT

Debt activity for the year ended December 31, 2004 was as follows:

	Balance January 1, <u>2004</u>	<u>Additions</u>	<u>Reductions</u>	Balance December 31, 2004	Due Within <u>One Year</u>
2002 Electric Variable Refunding A/B Bonds	\$ 178,935,000	-	(5,605,000)	173,330,000	5,785,000
Less deferred amount:					
on refunding	(9,572,810)	-	743,543	(8,829,267)	-
for issuance discounts	<u>(714,624)</u>	<u>-</u>	<u>55,506</u>	<u>(659,118)</u>	<u>-</u>
	\$ <u>168,647,566</u>	<u>-</u>	<u>(4,805,951)</u>	<u>163,841,615</u>	<u>5,785,000</u>

In 2002, the Electric System issued \$184,360,000 of variable rate revenue refunding bonds to advance refund outstanding revenue bonds of the Electric System. The proceeds from these bonds were placed in an irrevocable trust for the purpose of generating resources for all future debt service payments of the refunded revenue bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the financial statements. At the time of issuance, the Electric System purchased an interest rate swap (or hedge) allowing the City to hedge the complete outstanding debt of the electric system to a fixed rate of 2.95% for four years. The revenue bonds fully mature in 2025.

Debt 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>
2002 Electric Variable Refunding A/B Bonds	\$ 184,360,000	-	(5,425,000)	178,935,000	5,605,000
Less deferred amount:					
On refunding	(10,248,892)	-	676,082	(9,572,810)	-
for issuance discounts	<u>(765,094)</u>	<u>-</u>	<u>50,470</u>	<u>(714,624)</u>	<u>-</u>
	\$ <u>173,346,014</u>	<u>-</u>	<u>(4,698,448)</u>	<u>168,647,566</u>	<u>5,605,000</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.

A summary of the System's annual debt service requirements as of December 31, 2004 follows:

		<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$	5,785,000	5,113,235	10,898,235
2006		5,975,000	4,942,577	10,917,577
2007		6,175,000	4,766,315	10,941,315
2008		6,375,000	4,596,712	10,971,712
2009		6,585,000	4,396,061	10,981,061
2010-2014		36,305,000	18,946,447	55,251,447
2015-2019		42,655,000	13,226,588	55,881,588
2020-2024		51,350,000	6,507,103	57,857,103
2025		12,125,000	357,688	12,482,688
		<hr/>	<hr/>	<hr/>
Total	\$	173,330,000	62,852,726	236,182,726
		<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Interest on the variable rate electric system revenue refunding bonds is paid at the current swap rate of 2.95%. The bonds re-price every seven days but the City has only a requirement to fund the 2.95% interest rate on all outstanding electric system bonds. The 2.95% rate is employed throughout the future long-term financing requirements until maturity. The swap rate is guaranteed for a period of four years until November 2006. The rate may vary only if the actual re-pricing rate of the variable rate bonds exceeds the BMHA rate. The City's interest rate in effect since the variable rate bonds were issued has not exceeded 2.28% through the end of 2004.

7. NOTES PAYABLE

In 2004, City issued \$2,000,000 of bond anticipation notes for Gas System improvements which remained outstanding at December 31, 2004. The notes bear interest at 3% and mature in June 2005.

8. DEFINED BENEFIT PENSION PLANS AND OTHER POSTEMPLOYMENT BENEFITS

The Electric 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 Electric System's required contributions to PERS for the years ended December 31, 2004, 2003, and 2002 were approximately \$925,000, \$889,000 and \$835,000 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 2004 employer contribution rate was 13.55% of covered payroll for employees and 4.0% 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, 2003. 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 2003 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 at the projected wage inflation rate plus an additional factor ranging from 1.00% to 6.00% for the next 8 years. In subsequent years (9 and beyond) 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 369,885. The portion of the Gas System's contributions that were used to fund postemployment benefits was approximately \$273,000 and \$328,000 in 2004 and 2003, respectively. At December 31, 2003, the actuarial value of the Retirement System's net assets available for OPEB was \$10.5 billion. 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.

9. RELATED PARTY TRANSACTIONS

Under an arrangement with the City, the Electric System provides street lighting and traffic light services to the City, without charge. Street and traffic light facilities used approximately 10,132,000 kilowatt-hours of electrical energy in both 2004 and 2003 and the estimated operating cost of supplying these free services was \$1,130,040 in each year.

The City's Gas System provides gas to the Electric System for use in the generation of electricity. Gas costs of \$547,000 and \$503,380 in 2004 and 2003, respectively, paid to the Gas System are included in operating expenses.

The Electric System sells electricity to the City's Water and Wastewater Systems. Included in revenues are sales to the Water System and Wastewater System in 2004 and 2003 of approximately \$863,000 and \$525,000, respectively.

The Electric System is allocated from the City a portion of the City's administrative cost. In addition, it was charged expenses by the City's internal service funds, which provide services to various City departments. Total expenses for these items were approximately \$2,617,000 and \$2,497,000 in 2004 and 2003, respectively, and are included in other operating expenses.

10. CONTINGENT LIABILITIES

Various claims and lawsuits are pending against the City involving the Electric 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 Electric System.

11. 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 Electric 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.

12. JOINT VENTURES/JOINTLY GOVERNED ORGANIZATIONS

The City of Hamilton is a member of a number of Governmental Joint Ventures and Jointly Governed Organizations as described in GASB Statement No. 14, The Financial Reporting Entity. The following is a list of organizations and a brief description of the Joint Venture and the Jointly Governed Organizations pertaining specifically to the Electric System of the City.

(a) Amp Ohio, Inc. – The City of Hamilton is a member of American Municipal Power Ohio, Inc. (AMP-OHIO). AMP-OHIO is a non-profit corporation organized under Ohio law and Internal Revenue Code Section 501 and is a jointly governed organization. The organization operates on a non-profit basis for the mutual benefit of its member municipalities, all of whom own or operate a municipal electric system. The non-profit corporation is dedicated to providing member assistance and low-cost power supplies.

The controlling board of AMP-OHIO, Inc. is based upon a representative from several of the member communities. The degree of control exercised by any participating government is limited to its representation on the board. The continued existence of the corporation is not dependent upon the City. Complete financial statements may be obtained from AMP-OHIO, Inc., 2600 Airport Drive, Columbus, Ohio 43219.

(b) Amp Ohio, Inc. – OMEGA JV2 Project – In December 2000, the City became a part of the OMEGA (Ohio Municipal Energy Generation Association) JV2 Project. The OMEGA JV2 project is a joint venture among the City of Hamilton and 35 other participating municipalities created under the auspices of the Ohio Constitution section XVIII, Sections 3 and 4 and Ohio Revised Code Section 715.02. All of the participating communities are members of AMP-OHIO, Inc. and the joint venture has appointed that non-profit corporation to perform certain management functions. The purpose of the joint venture is to create distributive generation among the participating members allowing for increased electric production capacity during peak demand. The degree of control exercised by any participating member is weighted in proportion to each participant's project share, which is 23.87% for the City (a non-majority voting position). Project share is equal to the amount of the distributive generation capacity for each of the members. Membership in the joint venture is defined as financing or non-financing Participant, as well as owner or purchasing participant, for which the City qualified as a financing, purchasing participant. As a financing participant, the City makes payments to OMEGA JV2.

Dated January 1, 2001, AMP-Ohio on behalf of OMEGA JV2 participants issued \$50,260,000 of Distributive Generation Bonds, supported by financing participant payments. The issuance of the bonds retired \$50,000,000 of AMP-OHIO, Inc.'s Distributive Generation Notes, financing the remaining un-funded portion of the project and pay issuance costs. The Bonds do not represent an obligation on behalf of the financing participants to levy or pledge any form of taxation nor any mortgage on or interest in the project or the City's electric system or fund. The following amounts were expended by the Electric Fund and recorded within the Purchase of Electric expense account to the OMEGA JV2 in 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Annual capacity	\$ 1,204,587	1,154,239
Power purchases	<u>965,000</u>	<u>477,400</u>
Total payments	\$ <u>2,169,587</u>	<u>1,631,639</u>

The continued existence of OMEGA JV2 is dependent upon the City's continued participation but the City, as a purchaser participant, does not have an equity interest in OMEGA JV2. Complete financial statements may be obtained from AMP-OHIO, Inc., 2600 Airport Drive, Columbus, Ohio 43219.

13. CONTRACTUAL COMMITMENTS

As of December 31, 2004 and 2003, the Electric System had contractual commitments of approximately \$13,200,000 and \$3,137,000, respectively to purchase coal and electricity.

14. CLOSURE OF THE ELECTRIC SYSTEM TO COMPETITION

In March 2002, the Hamilton City Council adopted an ordinance effectively closing the municipal borders of the City to electric deregulation. With the adoption of the ordinance, electric customers within these corporate boundaries must purchase their electricity from the Hamilton Electric System.

15. SUBSEQUENT EVENTS

In May 2005, the City converted its 2002 Series A and B Variable Rate Revenue Refunding Bonds from a seven-day floating variable interest rate to a term fixed rate for the remaining term of the bonds.

In June 2005, the City issued bond anticipation notes in the amount of \$3,000,000 for Electric System improvements.



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**CITY OF HAMILTON
ELECTRIC 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
AUGUST 16, 2005**