

**CITY OF HAMILTON! OHIO
GAS 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 Gas System
345 High Street
Hamilton, Ohio 45011

We have reviewed the *Independent Auditors' Report* of the City of Hamilton Gas 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 Gas 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 – GAS SYSTEM

Table of Contents

	<u>Page</u>
Independent Auditors' Report	1
Management's Discussion and Analysis	2 - 6
Financial Statements:	
Statements of Net Assets	7
Statements of Revenues, Expenses and Changes in Net Assets	8
Statements of Cash Flows	9
Notes to Financial Statements	10 - 17



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, 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 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, 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 - Gas 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 2-6 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

Gas System

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

The discussion and analysis of the City of Hamilton, Ohio's Gas System's financial performance provide an overall review of that system's financial activities for the years 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 assets of the Hamilton Gas System exceeded its liabilities at the close of 2004 and 2003 respectively by \$32,310,140 and \$32,066,254 (net assets). Of this amount, \$7,788,286 and \$8,701,755 (unrestricted net assets) may be used to meet the system's ongoing obligations to customers and creditors.
- The system's total net assets increased by \$243,886 in 2004, representing a .76% increase.
- In June 2004, the City issued an \$800,000 general obligation bond anticipation note for the system to finance the engineering, acquisition and installation of Phase One construction for the Headgates Road Subdivision Main Replacement.
- In May 2003, the City issued \$14,540,000 Gas System Revenue Refunding Bonds that provided for an advanced refunding and in-substance defeasance of the \$16,275,000 remaining outstanding 1993 Gas System Revenue Bonds. The 2003 bonds were issued with a final maturity in October 2015, three years prior to the refunded debt.

Gas System Summary and Using this Annual Report

The City of Hamilton, Ohio has owned and operated a natural gas utility system since 1890. Currently, the system is the largest municipally owned natural gas distribution operation in Ohio. The system has 220 miles of looped steel, cast iron and plastic mains that distribute natural gas to 23,529 customers. The City has a full requirements contract with Proliance for the supply and transportation of natural gas to the City's gate. Hamilton derives its authority to own and operate a gas utility from the provisions in Article XVII of the Constitution of the State of Ohio. 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 Gas System for the year ended December 31, 2004 and 2003.

City of Hamilton, Ohio

Gas System

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

Reporting Hamilton's Gas System (Whole and Significant Fund)

The financial statements contained within this report include the City of Hamilton, Ohio's Gas System *only*. Readers desiring to view city-wide financial statements, as well as the impact that the Gas 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 Gas 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 Gas Fund are restricted to Gas 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 Gas 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 Gas 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 Gas System charges fees to recoup the cost of the entire operation of the Gas 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 Gas Fund, assets exceeded liabilities by \$32,310,140 as of December 31, 2004. By far, the largest portion of the net assets of the Gas System reflect its investment in capital assets (e.g. land, buildings, improvements, construction in progress, machinery and equipment) less any related debt used to acquire those assets that are still outstanding (74.73% for 2004 and 72.02% for 2003). The System employs these assets in the delivery of natural gas 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 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.

City of Hamilton, Ohio

Gas System

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

Table 1 provides a summary of the Gas System's Statement of Net Assets for the Years Ended December 31, 2004 and 2003.

	2004	2003
Current and Other Assets	\$13,913,589	\$11,913,018
Capital Assets	36,806,717	37,482,567
Total Assets	<u>50,720,306</u>	<u>49,395,585</u>
Long-term Liabilities	12,119,016	12,958,319
Other Liabilities	6,291,150	4,371,012
Total Liabilities	<u>18,410,166</u>	<u>17,329,331</u>
Invested in capital assets, net of related debt	24,147,869	23,094,281
Restricted-Debt Service	373,985	270,218
Unrestricted	7,788,286	8,701,755
Total Net Assets	<u>\$32,310,140</u>	<u>\$32,066,254</u>

As of December 31, 2004 and 2003, the City is able to report positive balances in net assets as well as positive balances in the overall change in net assets of \$243,886 and \$191,838, respectively. Operating income of \$795,968 for 2004 and \$825,959 for 2003 were both positive. Maintenance of positive operating income and increases to the total net assets are primarily due to controlling the growth of expenses and maintaining rates commensurate with the costs of acquiring natural gas.

City of Hamilton, Ohio

Gas System

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

Statements of Revenues, Expenses and Changes in Net Assets

	2004	2003
Operating Revenues	\$24,848,869	\$26,115,502
Operating Expenses:		
Purchased Gas	17,326,703	18,300,993
Depreciation	1,829,937	1,808,207
Other Operating Expenses	4,896,261	5,180,343
Total Operating Expenses	24,052,901	25,289,543
Operating income	795,968	825,959
Non-Operating revenues (expenses)		
Interest and fiscal charges	(670,836)	(753,507)
Other non-operating revenues	118,754	119,386
Total non-operating revenues (expenses)	(552,082)	(634,121)
Change in Net Assets	243,886	191,838
Beginning Net Assets	\$32,066,254	31,874,416
Ending Net Assets	\$32,310,140	\$32,066,254

Capital Assets and Debt Administration

Capital Assets: The City's investment in capital assets of the Gas System as of December 31, 2004 and 2003 amounted to \$24.15 Million and \$23.09 Million, respectively, (net of accumulated depreciation and related debt). This investment in capital assets includes land, buildings, improvements, construction in progress, and machinery and equipment.

Note 5 (Capital Assets) provides Gas System capital asset activity during 2004 and 2003. Of the most notable achievements, the Gas System began engineering and construction on Phase 1 of the Headgates Road Main Replacement Program in 2004. In years 2004 and 2003, the Gas System invested \$909,399 and \$892,600 in replacing gas mains, respectively.

Debt Administration: At the end of 2004, the City had one outstanding long-term revenue bond issue, the 2003 Gas System Revenue Refunding Bonds totaling \$12,725,000. In June 2004, the City issued General Obligation bond anticipation notes totaling \$800,000 to finance Phase 1 of the Headgates Road Main Replacement Program. The bond anticipation notes are issued in anticipation of long-term financing.

City of Hamilton, Ohio

Gas System

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

During 2003, the City issued \$14,540,000 Gas System Revenue Refunding Bonds that provided for an advanced refunding and in-substance defeasance of the \$16,275,000 remaining outstanding 1993 Gas System Revenue Bonds. The 2003 bonds were issued with a final maturity in October 2015, three years prior to the refunded debt.

The City has plans to finance and begin construction on Phase 2 of the Headgates Road Main Replacement and Phase 1 of the Highland Park Main Replacement. See Notes 6 and 7 for a discussion of outstanding Gas System bonds, notes and related activity. See Note 13 for a discussion of Subsequent Events specifically related to the Gas System.

Economic Factors and Next Year's Budgets and Rates

The City's Gas System is continually monitoring the cost of natural gas and employs several methods to attempt to mitigate cost increases to its customers. However, the cost of natural gas 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. The City has no plans to change its rates other than those required by these natural gas acquisition cost increases.

The annual budget of the City Gas 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.

The City has plans to finance and begin construction on Phase 2 of the Headgates Road Main Replacement and Phase 1 of the Highland Park Main Replacement. These projects are expected to cost \$3.6 Million in the next two years.

In spite of increasing costs and a renewed focus on main replacements, the City's Gas System has prospered. All bond anticipation notes of the City have received a MIG-1 rating, the highest possible rating. The City's Gas System maintains an A3 underlying rating for both its system and the 2003 Gas System Revenue Refunding Bonds.

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 Gas 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 – GAS SYSTEM
STATEMENTS OF NET ASSETS
DECEMBER 31, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
ASSETS		
Current assets:		
Cash and investments	\$ 8,321,037	5,986,434
Accounts receivable (less allowance for uncollectible accounts of \$3,553,743 and \$3,103,552, respectively)	4,614,369	5,013,341
Interest receivable	14,585	37,023
Due from other funds	-	5,000
Inventory of supplies at cost	141,376	103,751
Prepaid expenses	<u>97,976</u>	<u>95,499</u>
Total current assets	<u>13,189,343</u>	<u>11,241,048</u>
Restricted assets:		
Cash and investments	<u>373,985</u>	<u>270,218</u>
Bond issuance costs	<u>350,261</u>	<u>401,752</u>
Capital assets:		
Property, plant and equipment	59,516,269	58,452,097
Construction in progress	591,134	573,472
Accumulated depreciation	<u>(23,300,686)</u>	<u>(21,543,002)</u>
Total capital assets	<u>36,806,717</u>	<u>37,482,567</u>
Total assets	\$ <u>50,720,306</u>	<u>49,395,585</u>
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 4,356,470	3,228,292
Accrued wages and benefits	19,472	52,746
Accrued liabilities	100	-
Intergovernmental payable	24,698	19,856
Accrued interest payable	120,410	115,118
General obligation notes payable	800,000	-
Revenue bonds payable - current portion	<u>970,000</u>	<u>955,000</u>
Total current liabilities	<u>6,291,150</u>	<u>4,371,012</u>
Non-current liabilities:		
Customer deposits payable	458,079	424,190
Compensated absences payable	421,828	400,861
Revenue bonds payable	<u>11,239,109</u>	<u>12,133,268</u>
Total noncurrent liabilities	<u>12,119,016</u>	<u>12,958,319</u>
Total liabilities	<u>18,410,166</u>	<u>17,329,331</u>
NET ASSETS		
Invested in capital assets, net of related debt	24,147,869	23,094,281
Restricted for debt service	373,985	270,218
Unrestricted	<u>7,788,286</u>	<u>8,701,755</u>
Total net assets	\$ <u>32,310,140</u>	<u>32,066,254</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, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
Operating revenues:		
Charges for services	\$ 24,813,882	26,059,532
Other operating revenues	<u>34,987</u>	<u>55,970</u>
Total operating revenues	<u>24,848,869</u>	<u>26,115,502</u>
Operating expenses:		
Purchased gas	17,326,703	18,300,993
Personal services	1,355,603	1,398,765
Contractual services	548,767	846,380
Depreciation	1,829,937	1,808,207
Materials and supplies	59,902	54,311
Other operating expenses	<u>2,931,989</u>	<u>2,880,887</u>
Total operating expenses	<u>24,052,901</u>	<u>25,289,543</u>
Operating income	795,968	825,959
Non-operating revenues (expenses):		
Investment earnings	151,759	124,610
Loss on disposal of capital assets	(33,005)	(5,224)
Interest and fiscal charges	<u>(670,836)</u>	<u>(753,507)</u>
Total non-operating revenues (expenses)	<u>(552,082)</u>	<u>(634,121)</u>
Change in net assets	243,886	191,838
Net assets - beginning of year	<u>32,066,254</u>	<u>31,874,416</u>
Net assets - end of year	\$ <u>32,310,140</u>	<u>32,066,254</u>

See notes to financial statements.

CITY OF HAMILTON! OHIO - GAS 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	\$ 25,242,837	25,798,832
Cash paid for employee services and benefits	(1,361,552)	(1,363,166)
Cash paid to suppliers for goods and services	(16,856,208)	(21,347,100)
Other operating revenues	10,104	12,234
Other operating expenses	<u>(2,890,704)</u>	<u>-</u>
Net cash provided by operating activities	<u>4,144,477</u>	<u>3,100,800</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(1,187,092)	(848,362)
Proceeds from sale of refunding debt	800,000	15,448,723
Payment to escrow agent for refunding of debt	-	(16,917,357)
Principal payment on debt	-	(860,000)
Principal payment on mortgage revenue bonds	(955,000)	-
Interest and fiscal charges	<u>(538,212)</u>	<u>(1,328,264)</u>
Net cash used in capital and related financing activities	<u>(1,880,304)</u>	<u>(4,505,260)</u>
Cash flows from investing activities:		
Interest from investments	<u>174,197</u>	<u>142,662</u>
Net cash provided by investing activities	<u>174,197</u>	<u>142,662</u>
Net change in cash and investments	2,438,370	(1,261,798)
Cash and investments at beginning of year	<u>6,256,652</u>	<u>7,518,450</u>
Cash and investments at end of year	\$ <u>8,695,022</u>	<u>6,256,652</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 795,968	825,959
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,829,937	1,808,207
Changes in assets and liabilities:		
Accounts receivable	403,972	(328,856)
Inventories	(37,625)	10,199
Prepaid expenses	(2,477)	857
Accrued wages and benefits	(33,274)	1,008
Intergovernmental payables	4,842	4,786
Accounts payable	1,128,178	724,415
Compensated absences payable	20,967	29,805
Customer deposits	33,889	24,420
Accrued liabilities	<u>100</u>	<u>-</u>
Net cash provided by operating activities	\$ <u>4,144,477</u>	<u>3,100,800</u>

See notes to financial statements.

CITY OF HAMILTON! OHIO – GAS 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 – 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 \$90,781 and \$42,677 in 2004 and 2003, respectively. Amortization of issuance costs in 2004 and 2003 amounted to \$51,491 and \$16,156, 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 \$8,321,037 and \$5,986,434 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 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 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	\$ 2,660,625	2,698,418
Earned and billed consumer accounts	5,500,725	5,418,475
Other	6,762	-
Less allowance for uncollectible accounts	<u>(3,553,743)</u>	<u>(3,103,552)</u>
Total	\$ <u><u>4,614,369</u></u>	<u><u>5,013,341</u></u>

4. RESTRICTED ASSETS

Restricted assets consist of assets whose use has been restricted by bond indenture for debt service. Restricted assets were \$373,985 and \$270,218 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	\$ 92,101	-	-	92,101
Construction in progress	<u>573,472</u>	<u>17,662</u>	<u>-</u>	<u>591,134</u>
Subtotal	<u>665,573</u>	<u>17,662</u>	<u>-</u>	<u>683,235</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	516,420	-	-	516,420
Machinery and equipment	<u>57,843,576</u>	<u>1,169,430</u>	<u>(105,258)</u>	<u>58,907,748</u>
Subtotal	<u>58,359,996</u>	<u>1,169,430</u>	<u>(105,258)</u>	<u>59,424,168</u>
Totals at historical cost	<u>59,025,569</u>	<u>1,187,092</u>	<u>(105,258)</u>	<u>60,107,403</u>
Less accumulated depreciation:				
Buildings and improvements	179,431	19,450		198,881
Machinery and equipment	<u>21,363,571</u>	<u>1,810,487</u>	<u>(72,253)</u>	<u>23,101,805</u>
Total accumulated depreciation	<u>21,543,002</u>	<u>1,829,937</u>	<u>(72,253)</u>	<u>23,300,686</u>
Capital assets, net	\$ <u>37,482,567</u>	<u>(642,845)</u>	<u>(33,005)</u>	<u>36,806,717</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	\$ 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>

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 Bonds are due serially through 2015 with interest from 2.0% to 5.0% per annum.

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, <u>2004</u>	Due Within <u>One Year</u>
2003 Refunding Bonds	\$ 13,680,000	-	(955,000)	12,725,000	970,000
Less deferred amount on refunding for issuance premium	(1,300,018) <u>708,286</u>	- -	166,622 <u>(90,781)</u>	(1,133,396) <u>617,505</u>	- -
	\$ <u>13,088,268</u>	<u>-</u>	<u>(879,159)</u>	<u>12,209,109</u>	<u>970,000</u>

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, <u>2003</u>	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 for issuance premium	- -	(1,378,349) <u>750,963</u>	78,331 <u>(42,677)</u>	(1,300,018) <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>

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>
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		1,085,000	405,112	1,490,112
2010-2014		6,170,000	1,275,060	7,445,060
2015		1,420,000	67,450	1,487,450
		<u>12,725,000</u>	<u>3,661,020</u>	<u>16,386,020</u>
Total	\$	12,725,000	3,661,020	16,386,020

7. NOTES PAYABLE

In 2004, City issued \$800,000 of bond anticipation notes for Gas System improvements which remained outstanding at December 31, 2004. The notes bear interest at 2% and mature in June 2005.

8. 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, 2004, 2003, and 2002 were approximately \$138,000, \$133,000, and \$125,000 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 \$41,000 and \$49,000 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. 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.

10. RELATED PARTY TRANSACTIONS

The Gas System sells gas to the City's Electric System for use in the generation of electricity. Revenues of approximately \$547,000 and \$503,000 from the Electric System to the Gas System are included in operating revenues in 2004 and 2003, 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 \$2,343,000 and \$2,158,000 in 2004 and 2003, respectively, and are included in other operating expenses.

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 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.

12. CONTRACTUAL COMMITMENTS

At December 31, 2004 and 2003, the Gas System had contractual commitments to purchase gas in the amount of \$3,983,000 and \$2,730,000, respectively.

13. SUBSEQUENT EVENT

In June 2005, the City issued bond anticipation notes in the amount of \$2,100,000 to renew the \$800,000 outstanding bond anticipation notes and provide \$1,300,000 for Gas System improvements.



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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
AUGUST 16, 2005**