

**CITY OF HAMILTON! OHIO  
WATER SYSTEM**

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





**Auditor of State  
Betty Montgomery**

City Council  
City of Hamilton!-Water System

We have reviewed the Independent Auditor's Report of the City of Hamilton!-Water 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!-Water 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 – WATER SYSTEM

## Table of Contents

	<u>Page</u>
Independent Auditors' Report	1
Financial Statements:	
Statements of Net Assets	2
Statements of Revenues, Expenses and Changes in Net Assets	3
Statements of Cash Flows	4
Notes to Financial Statements	5 - 12

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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 - Water 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 Water 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 - Water 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 – WATER SYSTEM**  
**STATEMENTS OF NET ASSETS**  
**DECEMBER 31, 2003 AND 2002**

	<u>2003</u>	<u>2002</u>
<b>ASSETS</b>		
Current assets:		
Cash and investments	\$ 13,046,900	12,088,193
Accounts receivable (less allowance for uncollectible accounts of \$678,191 and \$590,852, respectively)	1,161,431	1,156,035
Interest receivable	69,271	97,089
Due from other funds	5,000	5,000
Due from other governments	57,739	-
Inventory of supplies at cost	95,836	104,866
Prepaid expenses	<u>92,533</u>	<u>93,393</u>
Total current assets	<u>14,528,710</u>	<u>13,544,576</u>
Restricted assets:		
Cash and investments	<u>3,322,292</u>	<u>2,994,665</u>
Bond issuance costs	<u>315,704</u>	<u>343,610</u>
Capital assets:		
Property, plant and equipment	98,010,439	95,755,272
Construction in progress	5,476,823	3,426,301
Accumulated depreciation	<u>(29,682,139)</u>	<u>(27,978,712)</u>
Total capital assets	<u>73,805,123</u>	<u>71,202,861</u>
Total assets	\$ <u>91,971,829</u>	<u>88,085,712</u>
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable	\$ 932,801	763,851
Accrued wages and benefits	113,506	105,813
Intergovernmental payable	41,731	31,148
Accrued interest payable	116,808	121,503
Revenue bonds payable - current portion	<u>510,000</u>	<u>500,000</u>
Total current liabilities	<u>1,714,846</u>	<u>1,522,315</u>
Non-current liabilities:		
Customer deposits payable	89,411	81,881
Compensated absences payable	780,218	743,629
Revenue bonds payable (net of unamortized discounts)	<u>9,406,834</u>	<u>9,693,805</u>
Total noncurrent liabilities	<u>10,276,463</u>	<u>10,519,315</u>
Total liabilities	<u>11,991,309</u>	<u>12,041,630</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	61,432,960	58,336,694
Unrestricted	<u>18,547,560</u>	<u>17,707,388</u>
Total net assets	\$ <u>79,980,520</u>	<u>76,044,082</u>

See notes to financial statements.

**CITY OF HAMILTON! OHIO - WATER 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	\$ 14,094,741	17,200,708
Other operating revenues	<u>95,063</u>	<u>108,506</u>
Total operating revenues	<u>14,189,804</u>	<u>17,309,214</u>
<b>Operating expenses:</b>		
Personal services	2,864,732	2,586,839
Contractual services	2,735,901	3,328,538
Depreciation	1,877,545	1,850,489
Materials and supplies	687,180	665,105
Other operating expenses	<u>1,651,896</u>	<u>1,886,011</u>
Total operating expenses	<u>9,817,254</u>	<u>10,316,982</u>
Operating income	4,372,550	6,992,232
<b>Non-operating revenues (expenses):</b>		
Investment earnings	265,818	590,139
Grants	102,851	17,149
Loss on disposal of capital assets	(51,427)	(27,069)
Interest and fiscal charges	<u>(753,354)</u>	<u>(1,583,159)</u>
Total non-operating revenues (expenses)	<u>(436,112)</u>	<u>(1,002,940)</u>
Change in net assets before special item	3,936,438	5,989,292
Revenue bonds payable debt assumed by Butler County as part of lawsuit settlement	<u>-</u>	<u>34,437,550</u>
Change in net assets	3,936,438	40,426,842
Net assets - beginning of year	<u>76,044,082</u>	<u>35,617,240</u>
Net assets - end of year	\$ <u>79,980,520</u>	<u>76,044,082</u>

See notes to financial statements.

**CITY OF HAMILTON! OHIO - WATER 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	\$ 14,098,849	17,364,389
Cash paid for employee services and benefits	(2,809,867)	(2,570,913)
Cash paid to suppliers for goods and services	(4,896,137)	(6,465,647)
Other operating revenues	<u>93,089</u>	<u>138,528</u>
Net cash provided by operating activities	<u>6,485,934</u>	<u>8,466,357</u>
<b>Cash flows from capital and related financing activities:</b>		
Proceeds from refunding bonds	-	12,940,000
Cash received from Butler County for revenue bonds	-	34,437,550
Capital grants	45,112	-
Acquisition and construction of capital assets	(4,531,234)	(3,067,639)
Payment to escrow agent for refunding debt	-	(52,834,213)
Principal payment on debt	(500,000)	-
Interest payment on debt	<u>(507,114)</u>	<u>(2,440,982)</u>
Net cash used in capital and related financing activities	<u>(5,493,236)</u>	<u>(10,965,284)</u>
<b>Cash flows from investing activities:</b>		
Interest from investments	<u>293,636</u>	<u>599,911</u>
Net cash provided by investing activities	<u>293,636</u>	<u>599,911</u>
Net change in cash and cash equivalents	1,286,334	(1,899,016)
Cash and cash equivalents at beginning of year	<u>15,082,858</u>	<u>16,981,874</u>
Cash and cash equivalents at end of year	\$ <u>16,369,192</u>	<u>15,082,858</u>
<b>Reconciliation of operating income to net cash provided by operating activities:</b>		
Operating income	\$ 4,372,550	6,992,232
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,877,545	1,850,489
Changes in assets and liabilities:		
Accounts receivable	(5,396)	175,954
Inventories	9,030	12,419
Prepaid expenses	860	(13,766)
Accrued wages and benefits	7,693	9,708
Intergovernmental payables	10,583	15,940
Accounts payable	168,950	(312,820)
Compensated absences payable	36,589	43,410
Customer deposits	7,530	6,518
Due to other funds	<u>-</u>	<u>(313,727)</u>
Net cash provided by operating activities	\$ <u>6,485,934</u>	<u>8,466,357</u>

See notes to financial statements.

# CITY OF HAMILTON! OHIO – WATER 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 – Water System (Water System) is a utility operating as a separate enterprise fund of the City of Hamilton! Ohio (City). The Water 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 Water 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 Water 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 Water 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 Water 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 Water System is reported as cash and investments. The Water 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 Water 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 \$5,996 and \$52,569 in 2003 and 2002, respectively. Amortization of issuance costs in 2003 and 2002 amounted to \$27,906 and \$160,234, respectively.

***Compensated Absences*** - The Water 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 Water 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 Water 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 Water System totaled \$13,046,900 and \$12,088,193 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 Water 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 Water System’s uninsured and uncollateralized deposits.

**Investments** – The State of Ohio statutes, Water 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 Water 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	\$	397,851	410,504
Earned and billed consumer accounts		1,436,437	1,333,024
Other		5,334	3,359
Less allowance for uncollectible accounts		<u>(678,191)</u>	<u>(590,852)</u>
 Total	 \$	 <u>1,161,431</u>	 <u>1,156,035</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 water rate stabilization. Restrictions and related assets are as follows:

		<u>2003</u>	<u>2002</u>
Debt service	\$	246,167	345,244
Water rate stabilization		<u>3,076,125</u>	<u>2,649,421</u>
 Total	 \$	 <u>3,322,292</u>	 <u>2,994,665</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	\$ 2,754,551	-	-	2,754,551
Construction in progress	<u>3,426,301</u>	<u>2,682,659</u>	<u>(632,137)</u>	<u>5,476,823</u>
Subtotal	<u>6,180,852</u>	<u>2,682,659</u>	<u>(632,137)</u>	<u>8,231,374</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	19,665,799	6,524	-	19,672,323
Machinery and equipment	<u>73,334,922</u>	<u>2,474,188</u>	<u>(225,545)</u>	<u>75,583,565</u>
Subtotal	<u>93,000,721</u>	<u>2,480,712</u>	<u>(225,545)</u>	<u>95,255,888</u>
Totals at historical cost	<u>99,181,573</u>	<u>5,163,371</u>	<u>(857,682)</u>	<u>103,487,262</u>
Less accumulated depreciation:				
Buildings and improvements	7,056,700	547,962	-	7,604,662
Machinery and equipment	<u>20,922,012</u>	<u>1,329,583</u>	<u>(174,118)</u>	<u>22,077,477</u>
Total accumulated depreciation	<u>27,978,712</u>	<u>1,877,545</u>	<u>(174,118)</u>	<u>29,682,139</u>
Capital assets, net	\$ <u>71,202,861</u>	<u>3,285,826</u>	<u>(683,564)</u>	<u>73,805,123</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	\$ 2,737,609	16,942	-	2,754,551
Construction in progress	<u>1,780,603</u>	<u>1,645,698</u>	-	<u>3,426,301</u>
Subtotal	<u>4,518,212</u>	<u>1,662,640</u>	-	<u>6,180,852</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	19,545,211	120,588	-	19,665,799
Machinery and equipment	<u>71,868,561</u>	<u>1,605,550</u>	<u>(139,189)</u>	<u>73,334,922</u>
Subtotal	<u>91,413,772</u>	<u>1,726,138</u>	<u>(139,189)</u>	<u>93,000,721</u>
Totals at historical cost	<u>95,931,984</u>	<u>3,388,778</u>	<u>(139,189)</u>	<u>99,181,573</u>
Less accumulated depreciation:				
Buildings and improvements	6,473,603	583,097	-	7,056,700
Machinery and equipment	<u>19,766,140</u>	<u>1,267,392</u>	<u>(111,520)</u>	<u>20,922,012</u>
Total accumulated depreciation	<u>26,239,743</u>	<u>1,850,489</u>	<u>(111,520)</u>	<u>27,978,712</u>
Capital assets, net	\$ <u>69,692,241</u>	<u>1,538,289</u>	<u>(27,669)</u>	<u>71,202,861</u>

**6. LONG TERM DEBT**

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 Refunding Bonds	\$ 12,940,000	-	(500,000)	12,440,000	(510,000)
Less deferred amount:					
on refunding	(2,672,362)	-	217,033	(2,455,329)	-
for issuance discounts	<u>(73,833)</u>	<u>-</u>	<u>5,996</u>	<u>(67,837)</u>	<u>-</u>
	<u>\$ 10,193,805</u>	<u>-</u>	<u>(276,971)</u>	<u>9,916,834</u>	<u>(510,000)</u>

In April 2002, the Hamilton City Council and Board of Butler County Commissioners agreed during a jointly held meeting to settle their differences in regard to lawsuits brought by each entity for the supply and purchase of surplus water by the County from the City. The substance of that settlement was for the County to receive reduced water rates under a tiered structure with a requirement to purchase an average eight (8) million gallons of water per day with additional gallons purchased at a reduced rate. In accordance with the settlement agreement, the County was required to assume 74% of the outstanding Water System Mortgage Revenue Bonds after liquidation of the City’s Water Revenue Bond Debt Service Reserve Fund. The City has recorded the County’s assumption of outstanding debt as a special item. Furthermore, the City advance refunded the remaining outstanding debt not assumed by the County as discussed below.

The Water System issued \$12,940,000 of water revenue bonds to provide resources to purchase United States Government State and Local Government Series securities that were placed in an irrevocable trust for the purpose of generating resources for all future debt service payments of \$17,309,500 of mortgage revenue bonds. The Water System used the new bonds plus the \$5,792,733 in the mortgage revenue bond debt reserve account to defease the mortgage revenue bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the business type activities column of the statement of net assets and enterprise fund financial statements. The reacquisition price exceeded the net carrying amount of the old debt by \$2,726,620. This amount will be amortized over the remaining life of the new debt, which was issued at the same life as the refunded debt. This advance refunding was undertaken to reduce total debt service payments over the next nineteen years by \$3,723,787 and resulted in an economic gain of \$2,478,442. The 2002 refunding bonds are due serially through 2021 with an interest rate of 4.39%.

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 a municipal bond insurance policy. Under the terms of this policy, the payments of principal and interest are guaranteed by the insurer.

Debt 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>
1991 Series Bonds	\$ 51,785,000	-	(51,785,000)	-	-
Less deferred amount for issuance discounts	(1,101,591)	-	1,101,591	-	-
2002 Refunding Bonds	-	12,940,000	-	12,940,000	500,000
Less deferred amount: on refunding	-	(2,726,620)	54,258	(2,672,362)	-
for issuance discounts	<u>-</u>	<u>(75,332)</u>	<u>1,499</u>	<u>(73,833)</u>	<u>-</u>
	\$ <u>50,683,409</u>	<u>10,138,048</u>	<u>(50,627,652)</u>	<u>10,193,805</u>	<u>500,000</u>

Maturities of mortgage revenue bonds at December 31, 2003 are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 510,000	497,114	1,007,114
2005	520,000	486,914	1,006,914
2006	530,000	475,474	1,005,474
2007	545,000	462,224	1,007,224
2008	560,000	446,964	1,006,964
2009-2013	3,125,000	1,918,625	5,043,625
2014-2018	3,850,000	1,192,345	5,042,345
2019-2021	<u>2,800,000</u>	<u>257,396</u>	<u>3,057,396</u>
Total	\$ <u>12,440,000</u>	<u>5,737,056</u>	<u>18,177,056</u>

## **7. DEFINED BENEFIT PENSION PLANS AND OTHER POSTEMPLOYMENT BENEFITS**

The Water 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 Water System's required contributions to PERS for the years ended December 31, 2003, 2002, and 2001 were approximately \$278,000, \$263,000 and \$238,000 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 Water System's contributions that were used to fund postemployment benefits was approximately \$103,000 and \$97,000 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 Water 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 Water System.

#### **9. RELATED PARTY TRANSACTIONS**

The Water System purchases electricity from the City's Electric System. Purchases of approximately \$619,000 and \$792,000 from the Electric System are included in operating expenses in 2003 and 2002, respectively.

The City allocates the cost of certain administrative services. In addition, the City established internal service funds which provide services to various City departments. Charges to the Water System for these services were approximately \$2,270,000 and \$2,290,000 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 Water 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.



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**CITY OF HAMILTON WATER 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**