

***CITY OF
HAMILTON! OHIO --
WATER SYSTEM***

*Financial Statements for the Years Ended
December 31, 2000 and 1999 and
Independent Auditors' Report*



STATE OF OHIO
OFFICE OF THE AUDITOR

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Members of City Council
City of Hamilton

We have reviewed the Independent Auditor's Report of the City of Hamilton - Water System, Butler County, prepared by Deloitte & Touche LLP for the audit period January 1, 2000 through December 31, 2000. Based upon this review, we have accepted this report 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 is responsible for compliance with these laws and regulations.

JIM PETRO
Auditor of State

July 8, 2001

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INDEPENDENT AUDITORS' REPORT

Honorable City Council
City of Hamilton! Ohio and
Jim Petro, Auditor of State of Ohio:

We have audited the accompanying balance sheets of City of Hamilton! Ohio -- Water System (Water System) as of December 31, 2000 and 1999, and the related statements of operations and changes in retained earnings, and of cash flows for the years then ended. 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 referred to above present only the Water System of the City of Hamilton! Ohio and are not intended to present the financial position and results of operations and the cash flows of the proprietary fund types of the City of Hamilton! in accordance with accounting principles generally accepted in the United States of America.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Water System at December 31, 2000 and 1999, and the results of that fund's operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

May 25, 2001

CITY OF HAMILTON! OHIO -- WATER SYSTEM

**BALANCE SHEETS
DECEMBER 31, 2000 AND 1999**

ASSETS	2000	1999	LIABILITIES AND FUND BALANCES	2000	1999
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash and cash equivalents	\$ 941,617	\$ 131,569	Current portion of long-term debt	\$ 1,285,000	\$ 1,210,000
Investments	6,588,381	5,461,159	Accounts payable	561,020	591,121
Current portion of restricted assets - Investments	2,000,859	1,941,129	Interest accrued	715,859	731,129
Accounts receivable (less allowance for uncollectible accounts \$430,000 in 2000 and \$372,000 in 1999)	1,597,116	1,595,268	Customer deposits	67,672	63,639
Inventories	166,388	143,253	Accrued payroll	78,993	72,994
Prepaid expenses	51,335	56,575	Due to other City funds	450,859	450,859
Total current assets	<u>11,345,696</u>	<u>9,328,953</u>	Total current liabilities	<u>3,159,403</u>	<u>3,119,742</u>
			LONG-TERM DEBT	<u>50,591,989</u>	<u>51,783,578</u>
RESTRICTED ASSETS:			OTHER LONG-TERM OBLIGATIONS -		
Cash and cash equivalents	266,602	200,260	Accrued sick leave	<u>670,038</u>	<u>647,183</u>
Investments	4,515,763	4,445,012			
Total restricted assets	<u>4,782,365</u>	<u>4,645,272</u>	FUND BALANCES:		
			Contributed capital	13,211,892	13,538,432
WATER UTILITY PLANT:			Retained earnings	<u>18,555,072</u>	<u>15,017,881</u>
Land	2,737,609	2,710,944	Total	<u>31,766,964</u>	<u>28,556,313</u>
Buildings	15,454,028	15,426,248			
Machinery and equipment	71,303,545	70,312,273			
Accumulated depreciation	<u>89,495,182</u>	<u>88,449,465</u>			
	<u>(24,481,059)</u>	<u>(22,674,650)</u>			
Construction in progress	65,014,123	65,774,815			
Net water utility plant	<u>4,332,472</u>	<u>3,588,153</u>			
	<u>69,346,595</u>	<u>69,362,968</u>			
BOND ISSUANCE COSTS, NET	<u>713,738</u>	<u>769,623</u>			
TOTAL	<u>\$86,188,394</u>	<u>\$84,106,816</u>	TOTAL	<u>\$86,188,394</u>	<u>\$84,106,816</u>

See notes to financial statements.

CITY OF HAMILTON! OHIO -- WATER SYSTEM

STATEMENTS OF OPERATIONS AND CHANGES IN RETAINED EARNINGS FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

	2000	1999
OPERATING REVENUES	<u>\$ 16,414,104</u>	<u>\$ 15,423,457</u>
OPERATING EXPENSES:		
Personal services	2,361,459	2,867,963
Contractual services	3,085,743	3,667,717
Materials and supplies	827,491	929,426
Other operating expenses	2,589,655	2,305,451
Depreciation	1,858,040	1,817,284
Total operating expenses	<u>10,722,388</u>	<u>11,587,841</u>
OPERATING INCOME	<u>5,691,716</u>	<u>3,835,616</u>
NONOPERATING REVENUES (EXPENSES):		
Interest income	835,317	738,036
Change in unrealized gains (losses) on investments	227,135	(274,384)
Interest expense	(3,543,517)	(3,620,463)
Intergovernmental grants	-	5,000
Total	<u>(2,481,065)</u>	<u>(3,151,811)</u>
NET INCOME	3,210,651	683,805
ADD: DEPRECIATION ON FIXED ASSETS, DONATED OR ACQUIRED BY USE OF GRANT FUNDS, INCLUDED IN CONTRIBUTED CAPITAL	326,540	326,540
RETAINED EARNINGS, Beginning of year	<u>15,017,881</u>	<u>14,007,536</u>
RETAINED EARNINGS, End of year	<u>\$ 18,555,072</u>	<u>\$ 15,017,881</u>

See notes to financial statements.

CITY OF HAMILTON! OHIO -- WATER SYSTEM

NOTES TO FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2000 AND 1999

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.

Water Utility Plant - Expenditures which 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.

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 5 to 50 years.

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

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 either cash and cash equivalents or investments, as appropriate. The Water System's investments are stated at market. 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. The City Treasury includes \$666,815 (2000) and \$1,051,045 (1999) of securities issued by the City. Based on the percentage of the Water System's ownership of these funds, the Water System owns approximately \$118,000 and \$119,000 of City of Hamilton! securities at December 31, 2000 and 1999.

Cash and Cash Equivalents - The Water System considers all highly liquid investments with a maturity of three months or less when purchased to be cash and cash equivalents.

Bond Discounts and Issuance Costs - Bond discounts and issuance costs are capitalized and amortized on the interest method over the term of the related bonds. Amortization of bond discount and issuance costs amounted to \$93,411 and \$55,885, respectively, in 2000 and \$95,262 and \$56,993, respectively, in 1999.

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.

Contributed Capital - Contributed capital consists of fixed assets donated or acquired from restricted grants and are recorded at fair market value at the date received. Depreciation on contributed fixed assets resulting from grants or donated items is charged to contributed capital.

Measurement Focus, Basis of Accounting and Basis of Presentation - The financial statements are prepared in accordance with standards promulgated by the Governmental Accounting Standards Board

(GASB). These standards include the effective pronouncements of the National Council on Government Accounting and the American Institute of Certified Public Accountants which are considered to be “generally accepted accounting principles” for state and local entities, until they are altered, amended, supplemented, revoked or superseded by a subsequent GASB pronouncement. The Water System has elected to apply only Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989, that do not conflict with or contradict GASB pronouncements.

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.

Reclassification - Certain reclassifications have been made to the 1999 balances to make them consistent with the classification used in 2000.

2. ACCOUNTS RECEIVABLE

	2000	1999
Earned and unbilled consumer accounts	\$ 429,538	\$ 426,844
Earned and billed consumer accounts	758,088	734,116
Other	839,490	806,308
Less allowance for uncollectible accounts	<u>(430,000)</u>	<u>(372,000)</u>
Total	<u>\$1,597,116</u>	<u>\$1,595,268</u>

3. 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 \$7,529,998 at December 31, 2000 and consisted of demand deposits, money market funds and government securities.

Deposits - The carrying amount of the Water System deposits at December 31, 2000 was \$92,462 and the corresponding depository balance was \$97,543. The difference between the carrying amount and the depository balance is due to outstanding checks and deposits in transit. Of the deposit balance, collateralization was as follows: \$6,883 by Federal depository insurance and the remaining \$90,659 was uninsured and uncollateralized as defined by the *Governmental Accounting Standards Board*. The uncollateralized deposits were, however, covered by a pledged collateral pool not held in the City’s name, as permitted under Ohio law.

Investments - The State of Ohio statutes, Water System Revenue Bond indentures and the City Charter authorize the City to invest in obligations of the U.S. Treasury, agencies, instrumentalities, and repurchase agreements.

The Water System's investments are categorized as either (1) insured or registered, or securities held by the City or its agent in the City's name; or (2) uninsured and unregistered, with securities held by the

counterparty's trust department or agent in the City's name; or (3) uninsured and unregistered with securities held by the counterparty or its trust department or agent but not in the City's name.

	<u>Categories</u>		Total Market/Carrying Value
	<u>1</u>	<u>3</u>	
Investments:			
Categorized investments:			
Pooled investments held by City Treasurer	\$ 6,588,381	N/A	\$ 6,588,381
Investment held in Trust:			
U.S. Government Securities	N/A	\$6,516,622	6,516,622
Total categorized investments	<u>6,588,381</u>	<u>6,516,622</u>	<u>13,105,003</u>
Non-Categorized investments - STAR Ohio pooled, held by City Treasurer	N/A	N/A	<u>1,115,757</u>
Total investments	<u>\$ 6,588,381</u>	<u>\$6,516,622</u>	<u>\$ 14,220,760</u>

Reconciliation of Cash, Cash Equivalents and Investments - The classification of cash, cash equivalents and investments on the combined financial statements is based on criteria set forth in GASB Statement No. 9. Repurchase agreements and STAR Ohio are treated as cash equivalents. The classification of cash and cash equivalents (deposits) for purposes of this note are based on criteria set forth in GASB Statement No. 3.

A reconciliation between classifications of cash and investments on the financial statements and the classifications of this note are as follows:

	Cash and Cash Equivalents	Investments
Per balance sheet	\$ 1,208,219	\$ 13,105,003
Investments: STAR Ohio	<u>(1,115,757)</u>	<u>1,115,757</u>
Per GASB Statement No. 3	<u>\$ 92,462</u>	<u>\$ 14,220,760</u>

4. RESTRICTED ASSETS

Restricted assets consist of Water System 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:

	2000	1999
Debt service	\$ 776,328	\$ 770,193
Reserve for debt service	4,773,456	4,592,001
Water rate stabilization	<u>1,233,440</u>	<u>1,224,207</u>
Total	<u>\$6,783,224</u>	<u>\$6,586,401</u>

5. LONG-TERM DEBT

Long-term debt consists of the following:

	December 31,	
	2000	1999
Water System Mortgage Revenue Bonds 1991 Series A, due serially through 2021, with interest from 5.10% to 6.40%, net of unamortized discount of \$1,193,011 and \$1,286,422 at December 31, 2000 and 1999, respectively	\$ 51,876,989	\$ 52,993,578
Less current portion	<u>(1,285,000)</u>	<u>(1,210,000)</u>
Total	<u>\$ 50,591,989</u>	<u>\$ 51,783,578</u>

All property and revenue of the Water System facilities have been pledged as collateral on the 1991 Series A indebtedness.

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 1991 Series A bonds are insured under a municipal bond insurance policy. Under the terms of the policy, the payments of principal and interest are guaranteed by the insurer.

Maturities of long-term debt at December 31, 2000 for the five succeeding years are \$1,285,000 for 2001; \$1,360,000 for 2002; \$1,445,000 for 2003; \$1,535,000 for 2004; and \$1,630,000 for 2005.

6. DEFINED BENEFIT PENSION PLANS AND OTHER POSTEMPLOYMENT BENEFITS

All of the City’s full-time employees participate in one of two separate retirement systems which are cost-sharing multiple employer defined benefit pension plans. The following information was provided by Public Employees Retirement System of Ohio (the “PERS”) to assist the City in complying with GASB Statement No. 27, “*Accounting for Pensions by State and Local Government Employers.*”

All employees of the City, except full-time uniformed police officers and full-time firefighters, participate in the PERS, a cost-sharing multiple employer defined benefit pension plan. The PERS provides retirement and disability benefits, annual cost-of-living adjustments and death benefits to plan members and beneficiaries. Chapter 145 of the Ohio Revised Code provides statutory authority to establish and amend benefits. PERS issues a stand-alone financial report that includes financial statements and required supplementary information for the PERS. Interested parties may obtain a copy by making a written request to 277 East Town Street, Columbus, Ohio 43215-4642 or by calling (614) 466-2085 or 1-800-222-7377.

The Ohio Revised Code provides statutory authority for employee and employer contributions. Employees contribute 8.5% of their annual compensation. The PERS Retirement Board instituted a temporary employer contribution rate rollback for calendar year 2000. The rate rollback was 20% for state and local divisions. The employer contribution rate for 2000 was 10.84% of covered payroll; 6.54% was the portion used to fund pension obligations and 4.30% was used to fund health care for 2000. The 1999 and 1998 employer contribution rates were 13.55%. The contribution requirements of plan members and the City are established and may be amended by the Public Employees Retirement Board. The Water System's contributions to PERS for the years ending December 31, 2000, 1999, and 1998, were \$168,000, \$171,000 and \$166,000, respectively, equal to the required contributions for each year.

The PERS of Ohio provides postemployment health care benefits to age and service retirants with ten or more years of qualifying Ohio service credit and to primary survivor recipients of such retirants. Health care coverage for disability recipients is also available. The health care coverage provided by the PERS of Ohio is considered an Other Postemployment Benefit (OPEB) as described in GASB Statement No. 12. A portion of each employer's contribution to the PERS of Ohio is set aside for the funding of post retirement health care. The Ohio Revised Code provides statutory authority requiring public employers to fund postemployment health care through their contributions to the PERS of Ohio. The portion of the 2000 employer contribution rate (identified above) that was used to fund health care for the year 2000 was 4.3% of covered payroll which amounted to \$67,000.

The significant actuarial assumptions and calculations relating to postemployment health care benefits were based on the PERS of Ohio's latest actuarial review performed as of December 31, 1999. 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 1999 was 7.75%. An annual increase of 4.75% 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 4.75% base increase, were assumed to range from 0.54% to 5.1%. Health care costs were assumed to increase 4.75% annually.

Benefits are advanced-funded on an actuarially determined basis. The number of active contributing participants was 401,339. The actuarial value of the PERS of Ohio net assets available for OPEB at December 31, 1999 is \$10,805.5 million. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$12,473.6 million and \$1,668.1 million, respectively.

7. WATER SALE AGREEMENT

Under an April 1999 agreement with Butler County, Ohio, the City sells surplus water to the County for its use in serving a portion of the County outside the City. The term of the agreement is for 25 years or the period of time which debt issued by the City to expand the Water System to meet certain requirements is outstanding, whichever is longer. The City bills the County for water usage based on a stated price that is adjusted for any rate changes to the City customers. The Agreement is subject to litigation (see Note 9).

8. RELATED PARTY TRANSACTIONS

The City's Electric System sells electricity to the Water System. Electric costs of approximately \$623,000 in 2000 and \$619,000 in 1999 are included in other operating expense. Net amounts due to other funds by the Water System were approximately \$445,000 at December 31, 2000 and 1999.

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 \$4,125,000 in 2000 and \$3,929,000 in 1999 and are included in contractual services and other operating expense.

9. CONTINGENT LIABILITIES

Various claims and lawsuits are pending against the City involving the Water System. With the possible exception described in the following paragraph, 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.

The City is party to certain litigations with Butler County over matters relating to the contract under which the City sells a substantial amount of surplus water to the County. The County's claims include allegations of overbilling and failures to perform. Among remedies sought by the County are termination of the contract and damages. The City believes that its charges have been proper and that it has performed in accordance with the contract. However, the amounts claimed may be substantial and should the County prevail, it could be necessary for the City to increase rates to its other customers, and such increases could be material.

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STATE OF OHIO
OFFICE OF THE AUDITOR

JIM PETRO, AUDITOR OF STATE

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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
JULY 31, 2001**