

***City of Hamilton! Ohio --
Gas System***

*Financial Statements for the Years Ended
December 31, 2001 and 2000 and
Independent Auditors' Report*



STATE OF OHIO
OFFICE OF THE AUDITOR

JIM PETRO, AUDITOR OF STATE

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Members of City Council
City of Hamilton

We have reviewed the Independent Auditor's Report of the City of Hamilton – Gas System, Butler County, prepared by Deloitte & Touche LLP for the audit period January 1, 2001 through December 31, 2001. 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 is responsible for compliance with these laws and regulations.

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JIM PETRO
Auditor of State

July 10, 2002

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying balance sheets of the City of Hamilton! Ohio -- Gas System (Gas System) as of December 31, 2001 and 2000, 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 City of Hamilton! Ohio -- Gas System 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 Gas System at December 31, 2001 and 2000, and the results of the Gas System'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 29, 2002

CITY OF HAMILTON! OHIO -- GAS SYSTEM

BALANCE SHEETS DECEMBER 31, 2001 AND 2000

ASSETS	2001	2000	LIABILITIES AND FUND BALANCES	2001	2000
CURRENT ASSETS:					
Cash and cash equivalents	\$ 500,529	\$ 694,435		\$ 670,000	\$ 640,000
Investments	3,135,492	4,041,789		2,531,311	8,936,935
Current portion of restricted assets - investments	842,110	824,496	CURRENT LIABILITIES:		
Accounts receivable (net of allowance for uncollectible accounts of \$2,229,213 in 2001 and \$1,961,000 in 2000)	4,082,701	7,878,074	Long-term debt due within one year		
Inventories	121,110	175,020	Accounts payable	39,850	32,765
Prepaid expenses	79,692	46,651	Accrued payroll	172,110	184,496
Total current assets	<u>8,761,634</u>	<u>13,660,465</u>	Interest payable	391,682	351,027
			Due to other city funds	331,476	447,017
			Total current liabilities	<u>4,136,429</u>	<u>10,592,240</u>
			LONG-TERM DEBT	<u>15,726,990</u>	<u>16,351,674</u>
RESTRICTED ASSETS:					
Cash and cash equivalents	1,433,473	961,407	OTHER LONG-TERM OBLIGATIONS -		
Investments	1,988,638	2,244,612	Accrued sick leave	<u>355,705</u>	<u>349,727</u>
Total restricted assets	<u>3,422,111</u>	<u>3,206,019</u>			
			FUND BALANCES:		
			Contributed capital	1,674,912	1,729,661
			Retained earnings	29,734,114	28,574,256
			Total	<u>31,409,026</u>	<u>30,303,917</u>
GAS UTILITY PLANT:					
Land	92,101	92,102			
Building and improvements	418,587	418,587			
Machinery and equipment	56,316,247	55,652,210			
Total gas utility plant	56,826,935	56,162,899			
Accumulated depreciation	(18,083,595)	(16,379,708)			
Construction in progress	38,743,340	39,783,191			
Net gas utility plant	443,346	668,853			
	<u>39,186,686</u>	<u>40,452,044</u>			
BOND ISSUANCE COSTS, NET	<u>257,719</u>	<u>279,030</u>			
TOTAL	<u>\$51,628,150</u>	<u>\$57,597,558</u>	TOTAL	<u>\$51,628,150</u>	<u>\$57,597,558</u>

See notes to financial statements.

CITY OF HAMILTON! OHIO -- GAS SYSTEM

STATEMENTS OF OPERATIONS AND CHANGES IN RETAINED EARNINGS FOR THE YEARS ENDED DECEMBER 31, 2001 AND 2000

	2001	2000
OPERATING REVENUES	<u>\$28,823,243</u>	<u>\$22,448,812</u>
OPERATING EXPENSES:		
Purchased gas	20,797,121	16,300,373
Personal services	1,033,302	995,443
Contractual services	131,744	684,187
Depreciation	1,768,261	1,828,580
Materials and supplies	174,054	142,763
Other operating expenses	3,170,599	2,654,511
Total operating expenses	<u>27,075,081</u>	<u>22,605,857</u>
OPERATING INCOME (LOSS)	<u>1,748,162</u>	<u>(157,045)</u>
NONOPERATING REVENUES (EXPENSES):		
Interest income	366,038	905,323
Change in unrealized gains on investments	23,210	228,457
Interest expense	(980,035)	(1,323,837)
Loss on disposal of fixed assets	(52,266)	(5,831)
Total nonoperating expenses	<u>(643,053)</u>	<u>(195,888)</u>
NET INCOME (LOSS)	1,105,109	(352,933)
ADD: DEPRECIATION ON FIXED ASSETS, DONATED OR ACQUIRED BY USE OF GRANT FUNDS, INCLUDED IN CONTRIBUTED CAPITAL	54,749	54,749
RETAINED EARNINGS, Beginning of year	<u>28,574,256</u>	<u>28,872,440</u>
RETAINED EARNINGS, End of year	<u>\$29,734,114</u>	<u>\$28,574,256</u>

See notes to financial statements.

CITY OF HAMILTON! OHIO -- GAS SYSTEM

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2001 AND 2000

	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Operating income (loss)	\$ 1,748,162	\$ (157,045)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,768,261	1,828,580
Changes in assets and liabilities:		
Accounts receivable	3,775,365	(4,220,589)
Inventories	53,910	(13,519)
Prepaid expenses	(33,041)	14,736
Accrued payroll	7,085	1,089
Accounts payable	(6,521,165)	6,033,945
Accrued liabilities and sick leave	5,978	(48,859)
Customer deposits	40,655	17,643
Net cash provided by operating activities	<u>845,210</u>	<u>3,455,981</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(5,966,240)	
Sale of investments	7,117,350	7,608,501
Interest from investments	402,803	957,811
Net cash provided by investing activities	<u>1,553,913</u>	<u>8,566,312</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from issuance of debt	1,200,000	
Payment on debt	(1,840,000)	(8,880,000)
Interest on debt	(925,794)	(1,284,940)
Additions to gas utility plant	(555,169)	(1,056,091)
Net cash used in capital and related financing activities	<u>(2,120,963)</u>	<u>(11,221,031)</u>
INCREASE IN CASH AND CASH EQUIVALENTS	278,160	801,262
CASH AND CASH EQUIVALENTS, Beginning of year	<u>1,655,842</u>	<u>854,580</u>
CASH AND CASH EQUIVALENTS, End of year	<u>\$ 1,934,002</u>	<u>\$ 1,655,842</u>

SCHEDULE OF NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:

At December 31, 2001 and 2000, Gas System had outstanding liabilities of \$57,199 and \$179,980, respectively, included in accounts payable for the purchase of certain capital assets.

See notes to financial statements.

CITY OF HAMILTON! OHIO -- GAS SYSTEM

NOTES TO FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2001 AND 2000

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.

Gas 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. 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 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 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 either cash and cash equivalents or investments, as appropriate. The Gas 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 Gas System. The City Treasury includes \$190,000 (2001) and \$666,815 (2000) of securities issued by the City of Hamilton!. Based on the percentage of the Gas System's ownership of these funds, the Gas System owns approximately \$14,000 and \$72,000 of City of Hamilton! securities at December 31, 2001 and 2000.

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 and issuance costs amounted to \$45,316 and \$21,311 in 2001, respectively, and \$87,324 and \$41,068, respectively, in 2000.

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

Contributed Capital - Contributed capital consists of fixed assets donated or acquired from restricted grants and is recorded at fair market value at the date received. Depreciation on contributed fixed assets is charged to contributed capital. Effective January 1, 2001, the recording of contributed capital was changed in accordance with GASB No. 33.

Change in Accounting Principles - For fiscal year 2001, the System implemented GASB Statement No. 33, "Accounting and Financial Reporting for Non-exchange Transactions," and GASB Statement

No. 36, "Recipient Reporting for Certain Shared Non-exchange Revenues," an amendment of GASB No. 33, which changes how the System reports certain types of revenues. With the effect of GASB Statement No. 33, contributed capital will be reported as a non-operating revenue instead of as a direct increase in the fund balance. For the year ended December 31, 2001, no additions to contributed capital were recorded.

Measurement Focus, Basis of Accounting and Basis of Presentation - The financial statements are prepared in accordance with standards promulgated by the Government Accounting Standards Board (GASB). These standards include the effective pronouncements of the National Council on Governmental Accounting and the American Institute of Certified Public Accountants which are considered to be "accounting principles generally accepted in the United States of America" for state and local entities, until they are altered, amended, supplemented, revoked or superseded by a subsequent GASB pronouncement. The Gas 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 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

2. ACCOUNTS RECEIVABLE

	December 31,	
	2001	2000
Earned and unbilled consumer accounts	\$2,252,148	\$5,104,380
Earned and billed consumer accounts	4,024,674	4,616,713
Other	98,092	117,981
Less allowance for uncollectible accounts	<u>(2,292,213)</u>	<u>(1,961,000)</u>
Total	<u>\$4,082,701</u>	<u>\$7,878,074</u>

3. 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 \$3,636,021 at December 31, 2001, and consisted of demand deposits, money market funds, and government securities.

Deposits - The carrying amount of the Gas System's deposits at December 31, 2001 was \$1,469,688 and the corresponding depository balance was \$1,491,271. 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: \$24,904 by Federal depository insurance and the remaining \$1,466,367 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, 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.

The Gas 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.

	Category 1	Category 2	Total Fair Value
Pooled investments held by City Treasurer	\$ 3,135,492	\$ N/A	\$ 3,135,492
Investments held in trust - U.S. Government and Agency Securities	N/A	2,830,748	2,830,748
Total categorized investments	3,135,492	2,830,748	5,966,240
Non-Categorized investments - STAR Ohio pooled, held by City Treasurer	N/A	N/A	462,812
Total investments	\$ 3,135,492	\$2,830,748	\$ 6,429,052

Reconciliation of Cash, Cash Equivalents and Investments - The classification of cash, cash equivalents and investments on the 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 cash equivalents and investments on the financial statements and the classifications of this note are as follows:

	Cash and Cash Equivalents*	Investments
Per combined balance sheet	\$ 1,934,002	\$ 5,966,240
Investments: STAR Ohio	(462,812)	462,812
Per GASB Statement No. 3	\$1,471,190	\$6,429,052

*Includes cash on hand.

4. RESTRICTED ASSETS

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

	December 31,	
	2001	2000
Debt service	\$ 253,274	\$ 318,704
Reserve for debt service	1,522,808	1,909,697
Gas rate stabilization	<u>2,488,139</u>	<u>1,802,114</u>
Total	<u>\$4,264,221</u>	<u>\$4,030,515</u>

5. LONG-TERM DEBT

	2001	2000
Gas System Revenue Bonds - 1993 Series A, due serially through 2018 with interest from 3.2% to 5.15% per annum, net of \$548,010 (2001) and \$593,326 (2000) unamortized discount	\$ 16,396,990	\$ 16,991,674
Less current portion	<u>(670,000)</u>	<u>(640,000)</u>
Total	<u>\$ 15,726,990</u>	<u>\$ 16,351,674</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 1993 Series A Bond 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.

A summary of the System's long-term debt funding requirements as of December 31, 2001 is as follows:

	Principal	Interest	Total Debt Service
2002	\$ 670,000	\$ 835,060	\$ 1,505,060
2003	695,000	805,580	1,500,580
2004	730,000	775,000	1,505,000
2005	760,000	742,150	1,502,150
2006	795,000	707,190	1,502,190
2007 - 2011	4,605,000	2,916,237	7,521,237
2012 - 2016	5,895,000	1,617,207	7,512,207
2017 - 2021	<u>2,795,000</u>	<u>211,250</u>	<u>3,006,250</u>
	<u>\$ 16,945,000</u>	<u>\$ 8,609,674</u>	<u>\$ 25,554,674</u>

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 the Public Employee 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 2001. The rate rollback was 20% for state and local divisions. The employer contribution rate for 2001 was 13.55% of covered payroll; 9.25% was the portion used to fund pension obligations and 4.30% was used to fund health care for 2001. The 2000 and 1999 employer contribution rates were 10.84% and 13.55%, respectively. The contribution requirements of plan members and the City are established and may be amended by the Public Employees Retirement Board. The Gas System's contributions to PERS for the years ending December 31, 2001, 2000, and 1999, were \$96,000, \$63,500 and \$59,000, 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 2001 employer contribution rate (identified above) that was used to fund health care for the year 2001 was 4.3% of covered payroll which amounted to \$30,000.

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 2000 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 411,076. The actuarial value of the PERS of Ohio net assets available for OPEB at

December 31, 2000 is \$11,735.9 million. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$14,364.6 million and \$2,628.7 million, respectively.

7. CONTINGENT LIABILITIES

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

The City is party to certain litigations with Butler County over matters relating to the contract under which the City sells surplus water to the County. The County's claims include allegations of over billing, failures to perform and improper allocation of certain general and administrative charges of the City and expenses of the City's utility systems. Since that time, and on April 26, 2002 the legislative bodies of the City and the County directed the entering into of a settlement memorandum with the intent to resolve all issues currently in litigation. However, should this agreement be the subject of successful attack in a subsequent determination, it could be necessary for the City to increase taxes to pay any judgment against the City and such increase could be material.

8. RELATED PARTY TRANSACTIONS

The City's Gas System sells gas to the Electric System for use in the generation of electricity. Revenues of approximately \$950,000 and \$1,107,000 from the Electric System to the Gas System are included in operating revenues in 2001 and 2000, respectively.

The net amount due to other City funds was \$326,000 and \$442,000 at December 31, 2001 and 2000, respectively.

The City allocates the cost of certain administrative services. In addition, the City has established internal service funds which provide services to various City departments. Charges to the Gas System for these services were approximately \$2,309,000 in 2001 and \$2,150,000 in 2000 and are included in other operating expenses.

9. PARTIAL IN SUBSTANCE DEFEASANCE

In December, 2000, the City entered into an Escrow Trust Agreement with Fifth/Third Bank. The agreement required that the City deposit \$8,265,000 into an irrevocable trust with the bank for payment to final maturity of \$8,265,000 of the 1999 Gas System Revenue Bonds. The funds deposited were used to purchase U.S. Government Securities, the principal of which, together with interest earned thereon, will be sufficient to pay, when due, the principal on such bonds.

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**Deloitte
& Touche**

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

We have audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheet of the City of Hamilton! Ohio - Gas System (Gas System) as of December 31, 2001, and the related statements of operations and changes in retained earnings and cash flows for the year then ended, and have issued our report thereon dated May 29, 2002.

In connection with our audit, nothing came to our attention that caused us to believe that the Gas System failed to comply with the terms, covenants, provisions or conditions of Sections 5.2, 5.5, 5.6, 5.12 and 5.13 of the Indenture dated October 1, 1993, with Fifth Third Bank, trustee, insofar as they relate to financial and accounting matters. However, our audit was not directed primarily toward obtaining knowledge of noncompliance with such Sections.

This report is intended solely for the information and use of the City Council and management of the City of Hamilton! Ohio, Auditor of State of Ohio and Fifth Third Bank and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

May 29, 2002



STATE OF OHIO
OFFICE OF THE AUDITOR

JIM PETRO, AUDITOR OF STATE

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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 6, 2002**