

**CITY OF HAMILTON! OHIO
GAS SYSTEM**

**Financial Statements
Years Ended December 31, 2007 and 2006
With Independent Auditors' Report**



Mary Taylor, CPA
Auditor of State

City Council
City of Hamilton
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, 2007 through December 31, 2007. 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.

Mary Taylor

Mary Taylor, CPA
Auditor of State

August 5, 2008

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CITY OF HAMILTON! OHIO – GAS SYSTEM

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Clark, Schaefer, Hackett & Co.
CERTIFIED PUBLIC ACCOUNTANTS
BUSINESS CONSULTANTS

INDEPENDENT AUDITORS' REPORT

Honorable City Council
City of Hamilton! Ohio

We have audited the accompanying financial statements of the City of Hamilton! Ohio - Gas System, an enterprise fund of the City of Hamilton! Ohio as of and for the years ended December 31, 2007 and 2006, 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, 2007 and 2006, 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, 2007 and 2006 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 23, 2008

City of Hamilton, Ohio

Gas System

Management's Discussion and Analysis
For the Years Ended December 31, 2007 and 2006
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, 2007 and 2006. 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 2007 and 2006 are as follows:

- The assets of the Hamilton Gas System exceeded its liabilities at the close of 2007 and 2006 respectively by \$34,383,806 and \$31,253,640 (net assets). Of this amount, \$7,407,072 and \$4,963,274 (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 \$3,130,166 in 2007.
- In September 2007, the City issued bond anticipation notes in the amount of \$1,170,000 to refinance the outstanding bond anticipation notes originally issued to finance the gas distribution system.

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 approximately 23,500 customers. The City has a full requirements contract with Atmos 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, 2007 and 2006.

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 2007 and 2006. The City of Hamilton's Gas System is reported as a business-type, 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.

City of Hamilton, Ohio

Gas System

Management's Discussion and Analysis
For the Years Ended December 31, 2007 and 2006
Unaudited

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 2007 and 2006?" 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 \$34,383,806 as of December 31, 2007. 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 (70.01% for 2007, 74.13% for 2006 and 70.68% for 2005). 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.

Table 1 provides a summary of the Gas System's Statement of Net Assets for the Years Ended December 31, 2007, 2006 and 2005:

	2007	2006	2005
Current and other assets	\$15,233,069	\$13,031,161	\$18,111,077
Capital assets	36,956,446	37,975,032	39,369,228
Total assets	<u>52,189,515</u>	<u>51,006,193</u>	<u>57,480,305</u>
Long-term liabilities	9,168,294	10,180,126	11,222,732
Other liabilities	8,637,415	9,572,427	13,917,414
Total liabilities	<u>17,805,709</u>	<u>19,752,553</u>	<u>25,140,146</u>
Invested in capital assets, net of related debt	24,074,257	23,167,439	22,857,229
Restricted	2,902,477	3,122,927	2,880,840
Unrestricted	7,407,072	4,963,274	6,602,090
Total net assets	<u>\$34,383,806</u>	<u>\$31,253,640</u>	<u>\$32,340,159</u>

City of Hamilton, Ohio

Gas System

Management's Discussion and Analysis
For the Years Ended December 31, 2007 and 2006
Unaudited

As of December 31, 2007, the City reports a positive balance in the overall change in net assets of \$3,130,166 as compared to a negative change of \$1,086,519 and a positive change of \$30,019 for years 2006 and 2005, respectively. For the year ended December 31, 2007, there was an operating gain of \$3,382,547 as compared to an operating loss of \$36,231 and an operating gain of \$502,758 for years 2006 and 2005, respectively. The operating revenue increased due to the increase in the fixed or customer charge, the timing of Gas Cost Recovery (GCR) collections, as well as adding a large paper manufacturer as a new customer.

Statements of Revenues, Expenses and Changes in Net Assets

	2007	2006	2005
Operating revenues	\$37,972,254	\$33,577,717	\$33,401,337
Operating expenses:			
Purchased gas	27,483,706	26,248,049	26,880,523
Depreciation	1,948,022	1,878,911	1,830,304
Other operating expenses	5,157,979	5,486,988	4,187,752
Total operating expenses	34,589,707	33,613,948	32,898,579
Operating income	3,382,547	(36,231)	502,758
Non-Operating revenues (expenses)			
Interest and fiscal charges	(831,464)	(783,018)	(785,477)
Other non-operating revenues	579,083	(597,127)	321,882
Total non-operating revenues (expenses)	(252,381)	(1,380,145)	(463,595)
Contributions	-	342,535	-
Transfers	-	(12,678)	(9,144)
Change in net assets	3,130,166	(1,086,519)	30,019
Beginning net assets	31,253,640	32,340,159	32,310,140
Ending net assets	\$34,383,806	\$31,253,640	\$32,340,159

In 2007 the Gas System experienced high natural gas purchase costs. The City offset, or passed through, these increased gas purchase costs on to their customers by increasing the GCR component of their customer's rates.

City of Hamilton, Ohio

Gas System

Management's Discussion and Analysis
For the Years Ended December 31, 2007 and 2006
Unaudited

Capital Assets and Debt Administration

Capital Assets: The City's investment in capital assets of the Gas System as of December 31, 2007, 2006 and 2005 amounted to \$24.1 million, \$23.1 million and \$22.8 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) provide Gas System capital asset activity during 2007 and 2006.

Debt Administration: At the end of 2007, the City had one outstanding long-term revenue bond issue, the 2003 Gas System Revenue Refunding Bonds totaling \$9,730,000.

In September 2007, the City issued bond anticipation notes in the amount of \$1,170,000 to renew the \$1,890,000 outstanding bond anticipation notes (issued to finance Gas System improvements). The bond anticipation notes are issued in anticipation of long-term financing.

In March 2005, the City issued \$9,800,000 (Gas System's portion \$3,099,740) in bond anticipation notes that were authorized by Council in December 2004 for the purpose of acquiring, installing and paying all related costs for a new automated meter reading (AMR) system. The installation of meters began in March 2005 and was completed and functioning by September 2006. In September 2007, the City continued to rollover these bond anticipation notes in the amount of \$7,070,000 (Gas System's portion \$2,290,000).

See Notes 6 and 7 for a discussion of outstanding Gas System bonds, notes and related activity.

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 bond indentures to pass these cost increases to its customers. The number of customers has remained steady. The City did increase the fixed customer charge in 2007, which increased revenue.

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.

In spite of increasing costs, 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.

City of Hamilton, Ohio

Gas System

Management's Discussion and Analysis
For the Years Ended December 31, 2007 and 2006
Unaudited

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 William E. Moller, City of Hamilton Finance Director, 345 High Street, Hamilton, Ohio 45011, (513) 785-7161, (email at mollerb@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, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
ASSETS		
Current assets:		
Cash and investments	\$ 5,272,319	4,330,140
Accounts receivable (less allowance for uncollectible accounts of \$4,248,430 and \$4,676,330, respectively)	6,498,343	5,046,543
Interest receivable	46,014	17,666
Inventory of supplies at cost	161,951	153,690
Prepaid expenses	<u>103,347</u>	<u>106,479</u>
Total current assets	<u>12,081,974</u>	<u>9,654,518</u>
Restricted assets:		
Cash and investments	<u>2,942,108</u>	<u>3,122,927</u>
Bond issuance costs	<u>208,987</u>	<u>253,716</u>
Capital assets:		
Property, plant and equipment	63,484,520	62,831,439
Construction in progress	1,250,812	984,257
Accumulated depreciation	<u>(27,778,886)</u>	<u>(25,840,664)</u>
Total capital assets	<u>36,956,446</u>	<u>37,975,032</u>
Total assets	\$ <u>52,189,515</u>	<u>51,006,193</u>
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 3,932,830	3,660,369
Accrued wages and benefits	23,277	20,026
Intergovernmental payable	31,369	26,515
Accrued interest payable	134,939	160,517
General obligation notes payable	3,460,000	4,680,000
Revenue bonds payable-current	<u>1,055,000</u>	<u>1,025,000</u>
Total current liabilities	<u>8,637,415</u>	<u>9,572,427</u>
Noncurrent liabilities:		
Customer deposits payable	545,995	551,385
Compensated absences payable	255,110	272,433
Revenue bonds payable	<u>8,367,189</u>	<u>9,356,308</u>
Total noncurrent liabilities	<u>9,168,294</u>	<u>10,180,126</u>
Total liabilities	<u>17,805,709</u>	<u>19,752,553</u>
NET ASSETS		
Invested in capital assets, net of related debt	24,074,257	23,167,439
Restricted for debt service	402,477	622,927
Restricted for rate stabilization	2,500,000	2,500,000
Unrestricted	<u>7,407,072</u>	<u>4,963,274</u>
Total net assets	\$ <u>34,383,806</u>	<u>31,253,640</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, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
Operating revenues:		
Charges for services	\$ 37,952,613	33,233,099
Other operating revenues	<u>19,641</u>	<u>344,618</u>
Total operating revenues	<u>37,972,254</u>	<u>33,577,717</u>
Operating expenses:		
Personal services	1,175,352	1,125,210
Materials and supplies	134,430	121,719
Contractual services	978,778	1,033,101
Purchased gas	27,483,706	26,248,049
Depreciation	1,948,022	1,878,911
Other operating expenses	<u>2,869,419</u>	<u>3,206,958</u>
Total operating expenses	<u>34,589,707</u>	<u>33,613,948</u>
Operating income (loss)	3,382,547	(36,231)
Non-operating revenues (expenses):		
Investment earnings	584,287	478,927
Loss on disposal of capital assets	(5,204)	(1,076,054)
Interest and fiscal charges	<u>(831,464)</u>	<u>(783,018)</u>
Total non-operating revenues (expenses)	<u>(252,381)</u>	<u>(1,380,145)</u>
Income (loss) before contributions and transfers	3,130,166	(1,416,376)
Contributions	-	342,535
Transfers in	-	344,349
Transfers out	<u>-</u>	<u>(357,027)</u>
Change in net assets	3,130,166	(1,086,519)
Net assets - beginning of year	<u>31,253,640</u>	<u>32,340,159</u>
Net assets - end of year	\$ <u>34,383,806</u>	<u>31,253,640</u>

See notes to financial statements.

**CITY OF HAMILTON! OHIO - GAS SYSTEM
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2007 AND 2006**

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:		
Cash received from customers	\$ 36,520,454	37,102,967
Cash paid for employee services and benefits	(1,183,273)	(1,285,335)
Cash paid to suppliers for goods and services	(28,195,617)	(30,824,136)
Other operating expenses	<u>(3,010,071)</u>	<u>(3,515,230)</u>
Net cash provided by operating activities	<u>4,131,493</u>	<u>1,478,266</u>
Cash flows from noncapital financing activities:		
Transfers to other funds	<u>-</u>	<u>(12,678)</u>
Net cash used for noncapital financing activities	<u>-</u>	<u>(12,678)</u>
Cash flows from capital and related financing activities:		
Payments for capital acquisition	(934,640)	(1,218,234)
Debt proceeds	3,460,000	9,360,000
Debt principal payments	(5,705,000)	(10,879,740)
Debt interest payments	<u>(746,432)</u>	<u>(741,669)</u>
Net cash used in capital and related financing activities	<u>(3,926,072)</u>	<u>(3,479,643)</u>
Cash flows from investing activities:		
Interest from investments	<u>555,939</u>	<u>476,688</u>
Net cash provided by investing activities	<u>555,939</u>	<u>476,688</u>
Net change in cash and investments	761,360	(1,537,367)
Cash and investments at beginning of year	<u>7,453,067</u>	<u>8,990,434</u>
Cash and investments at end of year	\$ <u>8,214,427</u>	<u>7,453,067</u>
Reconciliation of operating income (loss) to net cash provided by operating activities:		
Operating income (loss)	\$ 3,382,547	(36,231)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,948,022	1,878,911
Changes in Assets and Liabilities:		
(Increase) decrease in receivables	(1,451,800)	3,525,500
(Increase) decrease in inventory	(8,261)	(20,574)
(Increase) decrease in prepaid items	3,132	(7,019)
Increase (decrease) in customer deposits payable	(5,390)	49,523
Increase (decrease) in payables	272,461	(3,763,728)
Increase (decrease) in accrued liabilities	(14,072)	(136,748)
Increase (decrease) in intergovernmental payables	<u>4,854</u>	<u>(11,368)</u>
Net cash provided by operating activities	\$ <u>4,131,493</u>	<u>1,478,266</u>
Schedule of noncash activities:		
Capital contributions	\$ -	342,535
Change in fair value of investments	(60,593)	(10,221)

See notes to financial statements.

CITY OF HAMILTON! OHIO – GAS SYSTEM

Notes to Financial Statements

Years Ended December 31, 2007 and 2006

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 \$78,854 and \$82,651 in 2007 and 2006, respectively. Amortization of issuance costs in 2007 and 2006 amounted to \$44,729 and \$46,881, 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 \$7,811,949 and \$6,830,140 at December 31, 2007 and 2006, respectively and consisted of demand deposits, money market funds, U.S. government securities and STAR Ohio. Cash and investments held by trustees were \$402,478 and \$622,927 at December 31, 2007 and 2006, respectively.

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, 2007.

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, 2007, 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 a AAA credit rating and an average maximum maturity of 1.38 years and STAR Ohio which has a credit rating of AAAm.

3. ACCOUNTS RECEIVABLE

Receivables at December 31, 2007 and 2006 consist of the following:

	<u>2007</u>	<u>2006</u>
Earned and unbilled consumer accounts	\$ 3,909,264	2,372,883
Earned and billed consumer accounts	6,837,509	7,343,363
Other	-	6,627
Less allowance for uncollectible accounts	<u>(4,248,430)</u>	<u>(4,676,330)</u>
Total	<u>\$ 6,498,343</u>	<u>5,046,543</u>

4. RESTRICTED ASSETS

Restricted assets consist of assets whose use has been restricted by bond indenture for debt service. Restricted assets were \$2,942,108 and \$3,122,927 December 31, 2007 and 2006, respectively.

5. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2007 and 2006 was as follows:

	Balance 1/1/07	Increases	Decreases	Balance 12/31/07
<i>Capital assets not being depreciated:</i>				
Land	\$ 92,101	-	-	92,101
Construction in progress	984,257	266,555	-	1,250,812
Subtotal	<u>1,076,358</u>	<u>266,555</u>	<u>-</u>	<u>1,342,913</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	516,419	-	-	516,419
Machinery and equipment	62,222,919	668,085	(15,004)	62,876,000
Subtotal	<u>62,739,338</u>	<u>668,085</u>	<u>(15,004)</u>	<u>63,392,419</u>
Totals at historical cost	<u>63,815,696</u>	<u>934,640</u>	<u>(15,004)</u>	<u>64,735,332</u>
Less accumulated depreciation:				
Buildings and improvements	400,803	19,448	-	420,251
Machinery and equipment	25,439,861	1,928,574	(9,800)	27,358,635
Total accumulated depreciation	<u>25,840,664</u>	<u>1,948,022</u>	<u>(9,800)</u>	<u>27,778,886</u>
Capital assets, net	\$ <u>37,975,032</u>	<u>(1,013,382)</u>	<u>(5,204)</u>	<u>36,956,446</u>
	Balance 1/1/06	Increases	Decreases	Balance 12/31/06
<i>Capital assets not being depreciated:</i>				
Land	\$ 92,101	-	-	92,101
Construction in progress	3,897,011	-	(2,912,754)	984,257
Subtotal	<u>3,989,112</u>	<u>-</u>	<u>(2,912,754)</u>	<u>1,076,358</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	516,419	-	-	516,419
Machinery and equipment	59,861,620	4,473,523	(2,112,224)	62,222,919
Subtotal	<u>60,378,039</u>	<u>4,473,523</u>	<u>(2,112,224)</u>	<u>62,739,338</u>
Totals at historical cost	<u>64,367,151</u>	<u>4,473,523</u>	<u>(5,024,978)</u>	<u>63,815,696</u>
Less accumulated depreciation:				
Buildings and improvements	381,355	19,448	-	400,803
Machinery and equipment	24,616,568	1,859,463	(1,036,170)	25,439,861
Total accumulated depreciation	<u>24,997,923</u>	<u>1,878,911</u>	<u>(1,036,170)</u>	<u>25,840,664</u>
Capital assets, net	\$ <u>39,369,228</u>	<u>2,594,612</u>	<u>(3,988,808)</u>	<u>37,975,032</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, was considered sufficient to provide for an in-substance defeasance of the existing 1993 Gas System Revenue Bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the financial statements. 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, 2007 was as follows:

	Balance 1/1/07	Additions	Reductions	Balance 12/31/07	Due Within One Year
2003 Refunding Bonds	\$ 10,755,000	-	(1,025,000)	9,730,000	1,055,000
Less deferred amount on refunding	(820,987)	-	144,735	(676,252)	-
for issuance premium	447,295	-	(78,854)	368,441	-
	<u>\$ 10,381,308</u>	<u>-</u>	<u>(959,119)</u>	<u>9,422,189</u>	<u>1,055,000</u>

Activity for the year ended December 31, 2006 was as follows:

	Balance 1/1/06	Additions	Reductions	Balance 12/31/06	Due Within One Year
2003 Refunding Bonds	\$ 11,755,000	-	(1,000,000)	10,755,000	1,025,000
Less deferred amount on refunding	(972,687)	-	151,700	(820,987)	-
for issuance premium	529,946	-	(82,651)	447,295	-
	<u>\$ 11,312,259</u>	<u>-</u>	<u>(930,951)</u>	<u>10,381,308</u>	<u>1,025,000</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>
2008	\$	1,055,000	436,762	1,491,762
2009		1,085,000	405,112	1,490,112
2010		1,120,000	372,653	1,492,653
2011		1,175,000	316,563	1,491,563
2012		1,230,000	257,813	1,487,813
2013-2015		<u>4,065,000</u>	<u>415,575</u>	<u>4,480,575</u>
Total	\$	<u>9,730,000</u>	<u>2,204,478</u>	<u>11,934,478</u>

7. NOTES PAYABLE

In September 2006, the City issued \$8,820,000 (Gas System's portion \$2,790,000) in bond anticipation notes that provided funding to rollover the bond anticipation notes issued in March 2005. In September 2007, the City issued \$7,070,000 (Gas System's portion \$2,290,000) in bond anticipation notes that provided funding to rollover the bond anticipation notes in September 2006. The purpose of the original proceeds was to provide funding for the acquisition and installation of a new automated meter reading system.

In September 2006, the City issued bond anticipation notes in the amount of \$1,890,000 that provided funding to rollover bond anticipation notes originally issued in 2005. In September 2007, the City issued bond anticipation notes in the amount of \$1,170,000 that providing funding to rollover the bond anticipation notes that were issued in September 2006. The purpose of the original proceeds was to provide funding for various Gas System distribution improvements.

Activity for the year ended December 31, 2007 was as follows:

		<u>Balance</u>		<u>Balance</u>	
		1/1/07	<u>Additions</u>	<u>Reductions</u>	12/31/07
2007 Gas System Improvement	4.00%	\$ -	1,170,000	-	1,170,000
2007 AMR System	4.00%	-	2,290,000	-	2,290,000
2006 Gas System Improvement	4.50%	1,890,000	-	(1,890,000)	-
2006 AMR System	4.25%	<u>2,790,000</u>	-	<u>(2,790,000)</u>	-
		\$ <u>4,680,000</u>	<u>3,460,000</u>	<u>(4,680,000)</u>	<u>3,460,000</u>

Activity for the year ended December 31, 2006 was as follows:

		Balance 1/1/06	Additions	Reductions	Balance 12/31/06
2006 Gas System Improvement	4.50%	\$ -	3,780,000	(1,890,000)	1,890,000
2006 AMR System	4.25%	-	5,580,000	(2,790,000)	2,790,000
2005 Gas System Improvement	3.75%	2,100,000	-	(2,100,000)	-
2005 AMR System	3.50%	<u>3,099,740</u>	<u>-</u>	<u>(3,099,740)</u>	<u>-</u>
		<u>\$ 5,199,740</u>	<u>9,360,000</u>	<u>(9,879,740)</u>	<u>4,680,000</u>

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 OPERS, 277 East Town Street, Columbus, Ohio 43215-4642.

Plan members are required to contribute 9.5% of their annual covered salary. The City was required to contribute 13.85% of covered payroll for employees. The Gas System's required contributions to PERS for the years ended December 31, 2007, 2006, and 2005 were approximately \$117,000, \$124,000, and \$140,000 respectively, equal to the required contributions for each year.

OPERS maintains a cost-sharing multiple employer defined benefit post-employment healthcare plan, which includes a medical plan, prescription drug program and Medicare Part B premium reimbursement, to qualifying members of both the Traditional Pension and the Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits, including post-employment health care coverage.

In order to qualify for post-employment health care coverage, age-and-service retirees under the Traditional Pension and Combined Plans must have 10 or more years of qualifying Ohio service credit. Health care coverage for disability benefit recipients and qualified survivor benefit recipients is available. The health care coverage provided by OPERS meets the definition of an Other Post Employment Benefit (OPEB) as described in GASB Statement 45.

The Ohio Revised Code permits, but does not mandate, OPERS to provide OPEB benefits to its eligible members and beneficiaries. Authority to establish and amend benefits is provided in Chapter 145 of the Ohio Revised Code.

The Ohio Revised Code provides the statutory authority requiring public employers to fund post retirement health care through their contributions to OPERS. A portion of each employer's contribution to OPERS is set aside for the funding of post retirement health care benefits. Employer contribution rates are expressed as a percentage of the covered payroll of active members. In 2007, the City contributed 13.85% of covered payroll. The Ohio Revised Code currently limits the employer contribution to a rate not to exceed 14.0% of covered payroll. Active members do not make contributions to the OPEB Plan.

OPERS' Post Employment Health Care plan was established under, and is administrated in accordance with, Internal Revenue Code 401(h). Each year, the OPERS Retirement Board determines the portion of the employer contribution rate that will be set aside for funding of post employment health care benefits. For 2007, the employer contribution allocated to the health care plan from January 1 through June 30, 2007 and July 1 through December 31, 2007 was 5.0% and 6.0% of covered payroll, respectively. The OPERS Retirement Board is also authorized to establish rules for the payment of a portion of the health care benefits provided, by the retiree or their surviving beneficiaries. Payment amounts vary depending on the number of covered dependents and the coverage selected. The portion of the Gas System's contributions that were used to fund post employment benefits was approximately \$46,000, \$37,000, and \$41,000 for 2007, 2006, and 2005, respectively.

The Health Care Preservation Plan adopted by the OPERS Retirement Board on September 9, 2004, was effective January 1, 2007. Members and employer contribution rates increased as of January 1, 2006, January 1, 2007 and January 1, 2008, which allowed additional funds to be allocated to the health care plan.

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 \$602,000 and \$562,000 from the Electric System to the Gas System are included in operating revenues in 2007 and 2006, 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 \$2,827,000 and \$2,510,000 in 2007 and 2006, 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, 2006, the Gas System had a contractual commitment to purchase gas of approximately \$3,212,000. There were no significant contractual commitments at December 31, 2007.



Mary Taylor, CPA
Auditor of State

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 19, 2008**