

# **City of Hamilton, Ohio – Gas System**

Financial Statements

Years Ended December 31, 2012 and 2011

With Independent Auditor's Report

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# Dave Yost • Auditor of State

## INDEPENDENT AUDITOR'S REPORT

City of Hamilton  
Butler County  
345 High Street  
Hamilton, Ohio 45011

To the City Council:

### ***Report on the Financial Statements***

We have audited the accompanying financial statements of the Gas System, an enterprise fund of City of Hamilton, Butler County, Ohio (the System), as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for preparing and fairly presenting these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes designing, implementing, and maintaining internal control relevant to preparing and fairly presenting financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to opine on these financial statements based on our audit. We audited in accordance with auditing standards generally accepted in the United States of America and the financial audit standards in the Comptroller General of the United States' *Government Auditing Standards*. Those standards require us to plan and perform the audit to reasonably assure the financial statements are free from material misstatement.

An audit requires obtaining evidence about financial statement amounts and disclosures. The procedures selected depend on our judgment, including assessing the risks of material financial statement misstatement, whether due to fraud or error. In assessing those risks, we consider internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not to the extent needed to opine on the effectiveness of the City's internal control. Accordingly, we express no opinion. An audit also includes evaluating the appropriateness of management's accounting policies and the reasonableness of their significant accounting estimates, as well as our evaluation of the overall financial statement presentation.

We believe the audit evidence we obtained is sufficient and appropriate to support our audit opinions.

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, 2012 and 2011 and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Gas System of the City of Hamilton, Butler County, Ohio, as of December 31, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in accordance with the accounting principles generally accepted in the United States of America.

**Emphasis of a Matter**

As discussed in Note 12 to the financial statements, during the year ended December 31, 2012, the System adopted the provisions of Governmental Accounting Standard No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* and No. 65, *Items Previously Reported as Assets and Liabilities*. We did not modify our opinion regarding this matter.

**Other Matters**

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require this presentation to include *Management's discussion and analysis* listed in the table of contents, to supplement the basic financial statements. Although this information is not part of the basic financial statements, the Governmental Accounting Standards Board considers it essential for placing the basic financial statements in an appropriate operational, economic, or historical context. We applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, consisting of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, to the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not opine or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to opine or provide any other assurance.



**Dave Yost**  
Auditor of State

Columbus, Ohio

June 25, 2013

# City of Hamilton, Ohio

## Gas System

Management's Discussion and Analysis  
For the Years Ended December 31, 2012 and 2011  
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, 2012 and 2011. 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 Position, Revenues, Expenses and Changes in Net Position, and Cash Flows to enhance their understanding of the system's fiscal performance.

### Financial Highlights

Key highlights for 2012 and 2011 are as follows:

- ❑ The assets and deferred outflow of resources of the Hamilton Gas System exceeded its liabilities at the close of 2012 and 2011, respectively, by \$39,172,495 and \$39,411,003 (net position). Of these amounts, \$9,238,093 and \$10,180,045 (unrestricted net position) in those years can be used to meet the system's ongoing obligations to customers and creditors.
- ❑ The system's total net position decreased by \$238,508 between 2012 and 2011, representing a 0.6% decrease.
- ❑ In 2012, the Gas System's total long-term debt, net of premiums and discounts, decreased by \$1,269,772.

### Gas System Summary and Using this Annual Report

The City has owned and operated a natural gas utility system since 1890. It is currently the largest municipal gas distribution operation in Ohio and serves approximately 23,900 customers located in the City and the immediate environs through approximately 275 miles of pipe. The City purchases natural gas from a supplier, then resells the gas to residential and general service (commercial and industrial) customers. The City also provides distribution delivery service to customers who have contracted with either the City or a natural gas supplier. In 2012, the City provided distribution delivery and gas purchasing services, by contract, for USALCO. The City provided Strawser Construction, Inc. (formerly known as Terry Materials/Barrett Paving), a transportation gas customer, with only distribution delivery service. Strawser purchased their natural gas through a supplier other than the City.

The Gas System provides full service (acquisition of gas supply, transportation of the gas supply to the City's interconnections and distribution of gas supply from the City's interconnections to the customer meter) and distribution delivery service (distribution delivery of the gas arranged for by, or on behalf of, the customer from the City's interconnections to the customer's meter.) Currently, the Gas System provides full service to residential and general service customers.

Mohawk Fine Papers was a distribution delivery service customer of the Gas System, until the closure of its Hamilton mill at the end of March 2012. The impact of this closure on the Gas System is examined later in this document. The City provides gas purchasing services to USALCO pursuant to which the City purchases gas at its City rate specifically for their individual usage. The costs of the gas supply are accounted for individually and paid for directly by the customer.

# City of Hamilton, Ohio

## Gas System

Management's Discussion and Analysis  
For the Years Ended December 31, 2012 and 2011  
Unaudited

Strawser purchases gas from their natural gas supplier and arranges for the transportation of the gas to the City's interconnections. Pursuant to their agreement with the City, the gas supply of the company is periodically balanced. If, at the end of the relevant period (monthly for Strawser), a distribution delivery service customer has used more gas than it has purchased from its supplier, it will purchase the difference from the City. Conversely, if the distribution delivery service customer has used less gas than it purchased from its supplier, the City will either buy the excess gas from the customer or will credit the price of the gas to the customer. The price of the bought, sold or credited gas is based upon the terms of the agreement.

The Gas System also arranges for the supply of gas used to fuel the City's Electric Generating Thermal Power Plant. The City also purchases gas for the American Municipal Power (AMP) OMEGA JV2 Project ("JV2"). The Thermal Power Plant and the JV2, however, pay the City for distribution delivery service and certain other charges. The JV2 is a joint venture sponsored by AMP. The City is one of 37 joint venture parties and provides for the operation of the JV2. In accordance with an amendment to the City's rate ordinance passed in March 2003, the distribution delivery service rate paid by the City's Thermal Power Plant and the JV2 is less than the distribution delivery service rate paid by other distribution delivery service customers. There are no franchise service territories for natural gas utilities in Ohio and the City is not prohibited from providing gas service in areas outside its corporate limits. Under the Ohio Constitution, however, the City's gas utility sales outside the corporate limits may not exceed 50% of the total service supplied within the City's corporate limits. Currently, less than 1% of the City's total gas sales are to customers located outside the City's corporate limits.

The City currently has a supply and transportation agreement with Atmos Energy Marketing. Pursuant to this agreement, Atmos is obligated to provide all the natural gas required by the City to serve its residential and general service customers and transport such gas to the City's gates. The City currently has an interconnection with two interstate pipelines, Texas Gas and Texas Eastern. Independent of the Atmos agreement, the City has an Interruptible Transportation (IT) Contract and Operational Balancing Agreement (OBA) with Texas Eastern. The Texas Eastern IT Contract receipt points are all the interstate gas pipelines interconnected to Texas Eastern at the Lebanon Lateral in southwest Ohio. The delivery point is the City's Texas Eastern Interconnection. Atmos is currently acting as the City's agent for both of these agreements. All interstate natural gas pipelines, including Texas Gas and Texas Eastern, are subject to rate and service regulations by the Federal Energy Regulatory Commission ("FERC"). FERC, however, does not regulate gas supply rates charged to the City's customers.

This annual report consists only of the Statement of Net Position, the Statement of Revenues, Expenses and Changes in Net Position, 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 years ended December 31, 2012 and 2011.

# City of Hamilton, Ohio

## Gas System

Management's Discussion and Analysis  
For the Years Ended December 31, 2012 and 2011  
Unaudited

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

The financial statements contained within this report include the City of Hamilton, Ohio's Gas System *only*. Readers desiring to view city-wide financial statements, as well as the impact that the Gas System has on the City's overall financial position and operating results, should refer to the City's Basic Financial Statements appearing in the Comprehensive Annual Financial Report for 2012 and 2011. 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.

In the Statement of Net Position and the Statement of Revenues, Expenses and Changes in Net Position, the view of the system looks at all financial transactions of the Gas Fund and asks the question, "How did we do financially during 2012 and 2011?" These statements provide answers to that question. The statements include all assets, deferred outflow of resources, 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 position and the changes in the net positions. The change in net position 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 position may serve over time as a useful indicator of financial position. In the case of the Gas Fund, assets and deferred outflow of resources exceeded liabilities by \$39,172,495 as of December 31, 2012. By far the largest portion of the net position 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 is still outstanding. The ratios of net investment in capital assets to total net position are as follows: 67.85% for 2012, 65.65% for 2011 and 65.06% for 2010. 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 the resources needed to repay these debts must be provided from other sources, primarily the revenues of the System, since the capital assets themselves cannot be used to liquidate the liabilities.

# City of Hamilton, Ohio

## Gas System

Management's Discussion and Analysis  
For the Years Ended December 31, 2012 and 2011  
Unaudited

Table 1 provides a summary of the Gas System's Statement of Net Position for the Years Ended December 31, 2012, 2011 and 2010:

	2012	<i>Restated</i> 2011	<i>Restated</i> 2010
Current and other assets	\$15,334,254	\$17,422,151	\$19,300,920
Capital assets	35,127,923	34,833,209	34,891,866
Total assets	<u>50,462,177</u>	<u>52,255,360</u>	<u>54,192,786</u>
 Deferred outflow of resources	 122,465	 202,279	 300,282
 Long-term liabilities	 7,447,904	 8,834,513	 10,095,858
Other liabilities	3,964,243	4,212,123	5,260,625
Total liabilities	<u>11,412,147</u>	<u>13,046,636</u>	<u>15,356,483</u>
 Net investment in capital assets	 26,577,513	 25,873,780	 25,461,377
Restricted	3,356,889	3,357,178	3,358,164
Unrestricted	9,238,093	10,180,045	10,317,044
Total net position	<u>\$39,172,495</u>	<u>\$39,411,003</u>	<u>\$39,136,585</u>

As of December 31, 2012 and 2011, the Gas System was able to report positive balances in net position of \$39,172,495 and \$39,411,003, respectively. In 2012, the Gas System reported a decrease in net position of \$238,508, and increases in net position in 2011 and 2010 of \$274,418 and \$1,362,281, respectively. For the years ended December 31, 2012, 2011 and 2010, there was operating income of \$225,580, \$812,909 and \$1,853,446, respectively. Net operating income of \$225,580, which is a decrease of \$587,329 from 2012 to 2011, is due to a loss of revenue from the City's largest distribution delivery service customer, Mohawk Fine Papers, which ceased operations in March 2012. The drop in usage also resulted in lower purchased gas expenses of \$4,845,611, resulting in the net decrease of \$587,329. Net non-operating expenses of \$464,088 decreased by \$114,903, primarily due to a decrease in interest and fiscal charges as the City continues to make its scheduled debt service payments.

# City of Hamilton, Ohio

## Gas System

Management's Discussion and Analysis  
For the Years Ended December 31, 2012 and 2011  
Unaudited

### *Statements of Revenues, Expenses and Changes in Net Position*

	2012	<i>Restated</i> 2011	<i>Restated</i> 2010
Operating revenues	\$16,574,138	\$21,930,366	\$26,793,820
Operating expenses:			
Purchased gas	8,898,738	13,744,349	17,429,023
Depreciation	1,913,431	1,887,279	1,847,513
Other operating expenses	5,536,389	5,485,829	5,663,838
Total operating expenses	16,348,558	21,117,457	24,940,374
Operating income	225,580	812,909	1,853,446
Non-Operating revenues (expenses)			
Interest and fiscal charges	(467,625)	(535,243)	(614,473)
Loss on disposal of capital assets	(34,106)	(87,844)	-
Other non-operating revenues	37,643	44,096	73,308
Total non-operating revenues (expenses)	(464,088)	(578,991)	(541,165)
Capital Contributions	-	40,500	50,000
Change in net position	(238,508)	274,418	1,362,281
Beginning net position	39,411,003	39,136,585	37,774,304
Ending net position	\$39,172,495	\$39,411,003	\$39,136,585

### **Capital Assets and Debt Administration**

*Capital Assets:* The City's net investment in capital assets of the Gas System as of December 31, 2012, 2011 and 2010 amounted to \$26.6 million, \$25.9 million and \$25.5 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 2012 and 2011.

*Debt Administration:* At the end of 2012, the City had two outstanding long-term revenue bond issues, the 2003 Gas System Revenue Refunding Bonds totaling \$4,065,000 and the 2009 Gas System Revenue Bonds totaling \$4,500,000.

See Note 6 for a discussion of outstanding Gas System bonds and related activity.

# City of Hamilton, Ohio

## Gas System

Management's Discussion and Analysis  
For the Years Ended December 31, 2012 and 2011  
Unaudited

### **Economic Factors and Future Trends**

The City's Gas System is continually monitoring the cost of natural gas and employs a structured hedging plan to mitigate price fluctuations to its customers. The cost of natural gas is highly volatile and the City is required by both ordinance and indentures to pass through these gas costs to its customers via the gas cost recovery charge (GCR). During 2012, the GCR changed from \$4.50/MCF to \$3.50/MCF. The overall number of customers has remained relatively steady while, like most gas systems, the usage per residential customer has continued to slowly decline as a result of improved efficiency of appliances.

In September 2011, City Council adopted an ordinance, creating the Natural Gas Residential Service Line Maintenance (RSLM) Program and Rider C for the Gas System. The RSLM and Rider C charges apply only to the City's residential gas accounts. The RSLM and funds collected through Rider C are earmarked for two separate and distinct activities: the replacement of Design A (field-assembled risers), in compliance with a Public Utilities Commission of Ohio (PUCO) Statewide order, and the assumption of the maintenance responsibility of gas service lines to residential customers by the City. The riser replacement portion of the RSLM is scheduled to be a five-year program, with a corresponding five-year collection period through Rider C. For 2012, the riser replacement portion of the RSLM resulted in a monthly charge to the City's residential customers of \$1.02 per month. The charge, through Rider C, for the residential gas service line normal maintenance and replacement portion of the RSLM, resulted in a monthly service charge of \$0.93 per residential customer. The total impact of the RSLM in 2012 was \$1.95 per month for all residential gas customers of the City. This rate remains unchanged in 2013.

Maps of the Gas System, generated through the City's geographical information system (GIS), are continually updated to reflect main and service line replacement and expansion. All repair and maintenance crews are supplied updated sets of maps, which provide gas infrastructure information, including pipe size, pressure levels, type of pipe and age of pipe. The City has an ongoing meter testing program to accurately calibrate its gas meters. To mitigate inaccurate measurement in obsolete meters, the City also has an on-going meter change-out program. The City has installed computerized monitoring for the largest industrial and commercial customers.

Mohawk Fine Papers/Beckett Mill ceased operations in the City in March 2012. Prior to that time, Mohawk Fine Papers/Beckett Mill was the City's largest gas customer, albeit a distribution delivery service (transportation) customer, by Ccf usage and amount billed, for the Gas System. For example, in 2011, Mohawk used almost 5.8 million Ccf and was billed almost \$3.1 million for gas service at the Beckett Mill. Additionally, Mohawk accounted for approximately 16.6% of the total gas usage and almost 13.5% of the revenues of the Gas System. Smart Papers accounted for less than 0.1% of the total usage and revenues of the Gas System in 2011; therefore, the direct financial impact of the Smart Papers closure on the Gas System was minimal. In total, the closure of Mohawk and Smart Papers had an estimated direct impact on Total Net Revenue to the City's Gas System of approximately \$366,000, based upon 2011 operations. Almost the entirety of this loss of Total Net Revenue is accounted for by Mohawk. Indirect losses, from vendors, suppliers, and other associated entities, would increase this estimate further.

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 reviewed and updated in the spring and fall of each year, or more often as deemed necessary by City Management.

# **City of Hamilton, Ohio**

## **Gas System**

Management's Discussion and Analysis  
For the Years Ended December 31, 2012 and 2011  
Unaudited

Natural gas prices have stabilized recently due to extraction of shale gas and reduced demand from recessionary pressures. The City continues to monitor potential threats to supply and maintains its disciplined hedging program. The City's Gas System has continued its strong financial performance into 2012. The City maintains an A1 bond rating with a stable outlook for its Gas System and for both its 2003 Gas System Revenue Refunding Bonds and its 2009 Gas System Revenue Bonds.

### **Requests for Information**

This financial report is designed to provide our citizens, customers, taxpayers, creditors, investors and elected officials with an overview of the City of Hamilton, Ohio's Gas System's finances and to show accountability for the money the system receives. If you have any questions about this report or need additional information, contact the City of Hamilton Finance Department, 345 High Street, Hamilton, Ohio 45011, (513) 785-7170, or visit the City website at [www.hamilton-city.org](http://www.hamilton-city.org).

**CITY OF HAMILTON, OHIO – GAS SYSTEM  
STATEMENTS OF NET POSITION  
DECEMBER 31, 2012 AND 2011**

	<u>2012</u>	<i>Restated</i> <u>2011</u>
<b>ASSETS</b>		
Current assets:		
Cash and investments	\$ 9,122,043	11,008,546
Accounts receivable (less allowance for uncollectible accounts of \$2,344,707 and \$3,179,277, respectively)	2,577,017	2,752,063
Interest receivable	932	3,575
Inventory of supplies at cost	169,798	152,109
Prepaid expenses	<u>107,575</u>	<u>148,680</u>
Total current assets	<u>11,977,365</u>	<u>14,064,973</u>
Restricted assets:		
Cash and investments	<u>3,356,889</u>	<u>3,357,178</u>
Capital assets:		
Property, plant and equipment	68,909,126	66,483,313
Construction in progress	3,082,305	3,400,043
Accumulated depreciation	<u>(36,863,508)</u>	<u>(35,050,147)</u>
Total capital assets	<u>35,127,923</u>	<u>34,833,209</u>
Total assets	<u>50,462,177</u>	<u>52,255,360</u>
<b>DEFERRED OUTFLOW OF RESOURCES</b>		
Deferred charge on debt refunding	<u>122,465</u>	<u>202,279</u>
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable	1,808,085	2,076,039
Accrued wages and benefits	65,216	62,365
Intergovernmental payable	24,118	46,511
Accrued interest payable	81,115	94,269
Customer deposits payable	579,593	568,649
Compensated absences payable-current	116,116	134,290
Revenue bonds payable-current	<u>1,290,000</u>	<u>1,230,000</u>
Total current liabilities	<u>3,964,243</u>	<u>4,212,123</u>
Noncurrent liabilities:		
Compensated absences payable	149,648	206,485
Revenue bonds payable	<u>7,298,256</u>	<u>8,628,028</u>
Total noncurrent liabilities	<u>7,447,904</u>	<u>8,834,513</u>
Total liabilities	<u>11,412,147</u>	<u>13,046,636</u>
<b>NET POSITION</b>		
Net investment in capital assets	26,577,513	25,873,780
Restricted for debt service	856,889	857,178
Restricted for rate stabilization	2,500,000	2,500,000
Unrestricted	<u>9,238,093</u>	<u>10,180,045</u>
Total net position	<u>\$ 39,172,495</u>	<u>39,411,003</u>

See notes to financial statements.

**CITY OF HAMILTON, OHIO - GAS SYSTEM**  
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION**  
**YEARS ENDED DECEMBER 31, 2012 AND 2011**

	<u>2012</u>	<i>Restated</i> <u>2011</u>
<b>Operating revenues:</b>		
Charges for services	\$ 16,525,968	21,898,395
Other operating revenues	<u>48,170</u>	<u>31,971</u>
Total operating revenues	<u>16,574,138</u>	<u>21,930,366</u>
<b>Operating expenses:</b>		
Personal services	1,724,108	1,809,149
Materials and supplies	301,450	244,220
Contractual services	1,526,734	1,522,263
Purchased gas	8,898,738	13,744,349
Depreciation	1,913,431	1,887,279
Other operating expenses	<u>1,984,097</u>	<u>1,910,197</u>
Total operating expenses	<u>16,348,558</u>	<u>21,117,457</u>
Operating income	225,580	812,909
<b>Non-operating revenues (expenses):</b>		
Investment earnings	37,643	44,096
Loss on disposal of capital assets	(34,106)	(87,844)
Interest and fiscal charges	<u>(467,625)</u>	<u>(535,243)</u>
Total non-operating revenues (expenses)	<u>(464,088)</u>	<u>(578,991)</u>
Income before contributions	(238,508)	233,918
Capital contributions	<u>-</u>	<u>40,500</u>
Change in net position	(238,508)	274,418
Net position - beginning of year	<u>39,411,003</u>	<u>39,136,585</u>
Net position - end of year	\$ <u>39,172,495</u>	<u>39,411,003</u>

See notes to financial statements.

**CITY OF HAMILTON, OHIO - GAS SYSTEM**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31, 2012 AND 2011**

	<u>2012</u>	<u>2011</u>
<b>Cash flows from operating activities:</b>		
Cash received from customers	\$ 16,760,128	23,433,835
Cash paid for employee services and benefits	(1,818,892)	(1,759,882)
Cash paid to suppliers for goods and services	<u>(13,201,391)</u>	<u>(18,419,857)</u>
Net cash provided by operating activities	<u>1,739,845</u>	<u>3,254,096</u>
<b>Cash flows from capital and related financing activities:</b>		
Capital grants	-	40,500
Payments for capital acquisition	(1,996,186)	(2,027,242)
Debt principal payments	(1,230,000)	(1,175,000)
Debt interest payments	<u>(440,737)</u>	<u>(499,488)</u>
Net cash used by capital and related financing activities	<u>(3,666,923)</u>	<u>(3,661,230)</u>
<b>Cash flows from investing activities:</b>		
Interest from investments	<u>40,286</u>	<u>45,417</u>
Net change in cash and investments	(1,886,792)	(361,717)
Cash and investments at beginning of year	<u>14,365,724</u>	<u>14,727,441</u>
Cash and investments at end of year	\$ <u>12,478,932</u>	<u>14,365,724</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 225,580	812,909
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,913,431	1,887,279
Changes in Assets and Liabilities:		
(Increase) decrease in receivables	175,046	1,500,833
(Increase) decrease in inventory	(17,689)	(3,284)
(Increase) decrease in prepaid items	41,105	18,182
Increase (decrease) in customer deposits payable	10,944	2,636
Increase (decrease) in payables	(514,019)	(919,832)
Increase (decrease) in accrued liabilities	(72,160)	27,042
Increase (decrease) in intergovernmental payables	<u>(22,393)</u>	<u>(71,669)</u>
Net cash provided by operating activities	\$ <u>1,739,845</u>	<u>3,254,096</u>
Schedule of noncash activities:		
Outstanding liabilities for purchase of certain capital assets	\$ 430,286	184,221
Change in fair value of investments	708	3,635

See notes to financial statements.

# CITY OF HAMILTON, OHIO – GAS SYSTEM

## Notes to Financial Statements Years Ended December 31, 2012 and 2011

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### 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.

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*** – Unamortized bond premiums and discounts are amortized on the interest method over the term of the related bonds. Amortization of bond premiums was \$52,620 and \$64,612 in 2012 and 2011, respectively. Amortization of bond discounts was \$12,848 and \$14,930 in 2012 and 2011, 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.

***Deferred Outflows of Resources*** – In addition to assets, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement reporting element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will *not* be recognized as an outflow of resources (expense) until then. The Gas System only has one item that qualifies for reporting in this category. It is the deferred charge on refunding reported in the statements of net position. A deferred charge on refunding results from the difference in the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.

***Net Position*** – Net position represents the difference between assets, liabilities, and deferred outflows of resources. Net position invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction, or improvement of those assets. Net position is reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the City or through external restrictions imposed by creditors, grantors or laws or regulations of other governments. The Gas System applies restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position is available.

***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.

## **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 \$11,622,043 and \$13,508,546 at December 31, 2012 and 2011, respectively and consisted of demand deposits, money market funds, U.S. government securities and STAR Ohio. Cash and investments held by trustees were \$856,889 and \$857,178 at December 31, 2012 and 2011, 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, 2012.

**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, 2012, nearly 99% of the City’s deposits with financial institutions, including the amount of pooled deposits related to the Gas System, were exposed to custodial credit risk because they are considered uninsured and uncollateralized. However, the State of Ohio has established by statute a collateral pooling system for financial institutions acting as public depositories. Public depositories must pledge qualified securities with fair values greater than the total amount of all public deposits to be secured by the collateral pool. This pooled collateral covers the Gas System’s uninsured and uncollateralized deposits.

**Investments** – The State of Ohio statutes, Gas Revenue Bond indentures, and the City Charter authorize the City to invest in obligations of the U.S. Treasury, agencies, instrumentalities, and repurchase agreements. Custodial credit risk in regards to investments is the risk that, in the event of a failure of a counter party, the City will not be able to recover the value of its investments or collateral securities that are in possession of an outside party. The City employs the use of “safekeeping” accounts to hold and maintain custody of its investments as identified within this policy and as means of mitigating this risk.

Interest rate risk is the risk that the City will incur fair value losses arising from rising interest rates. Such risk is mitigated by the investment policy by limiting investments to certain maximum maturities. As a rule, unless specified otherwise within the policy, investments are to have a maximum maturity of five years unless the investment is matched to a specific expenditure. The context of a specific investment purchase must be weighed in proportion to the remainder of the existing investment portfolio and the “prudent investor” rule to attempt to limit such risk.

The City’s pooled investments, as well as the investments held by trustees specifically for the Gas System, are invested primarily in U.S. governmental agency securities with an AA+ credit rating and an average maximum maturity of 4.92 years and STAR Ohio which has a credit rating of AAAM.

**3. ACCOUNTS RECEIVABLE**

Receivables at December 31, 2012 and 2011 consist of the following:

	<u>2012</u>	<u>2011</u>
Earned and unbilled consumer accounts	\$ 1,719,475	2,043,051
Earned and billed consumer accounts	3,202,249	3,888,289
Less allowance for uncollectible accounts	<u>(2,344,707)</u>	<u>(3,179,277)</u>
Total	\$ <u>2,577,017</u>	<u>2,752,063</u>

#### 4. RESTRICTED ASSETS

Restricted assets consist of assets whose use has been restricted by bond indenture for debt service and rate stabilization. Restricted assets were \$3,356,889 and \$3,357,178 December 31, 2012 and 2011, respectively.

#### 5. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2012 and 2011 was as follows:

	Balance 1/1/12	Increases	Decreases	Balance 12/31/12
<i>Capital assets not being depreciated:</i>				
Land	\$ 92,101	362,115	-	454,216
Construction in progress	<u>3,400,043</u>	<u>886,897</u>	<u>(1,204,635)</u>	<u>3,082,305</u>
Subtotal	<u>3,492,144</u>	<u>1,249,012</u>	<u>(1,204,635)</u>	<u>3,536,521</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	516,419	-	-	516,419
Machinery and equipment	<u>65,874,793</u>	<u>2,197,874</u>	<u>(134,176)</u>	<u>67,938,491</u>
Subtotal	<u>66,391,212</u>	<u>2,197,874</u>	<u>(134,176)</u>	<u>68,454,910</u>
Totals at historical cost	<u>69,883,356</u>	<u>3,446,886</u>	<u>(1,338,811)</u>	<u>71,991,431</u>
Less accumulated depreciation:				
Buildings and improvements	498,043	19,448	-	517,491
Machinery and equipment	<u>34,552,104</u>	<u>1,893,983</u>	<u>(100,070)</u>	<u>36,346,017</u>
Total accumulated depreciation	<u>35,050,147</u>	<u>1,913,431</u>	<u>(100,070)</u>	<u>36,863,508</u>
Capital assets, net	\$ <u>34,833,209</u>	<u>1,533,455</u>	<u>(1,238,741)</u>	<u>35,127,923</u>

	Balance			Balance
	1/1/11	Increases	Decreases	12/31/11
<i>Capital assets not being depreciated:</i>				
Land	\$ 92,101	-	-	92,101
Construction in progress	<u>3,666,816</u>	<u>1,012,172</u>	<u>(1,278,945)</u>	<u>3,400,043</u>
Subtotal	<u>3,758,917</u>	<u>1,012,172</u>	<u>(1,278,945)</u>	<u>3,492,144</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	516,419	-	-	516,419
Machinery and equipment	<u>63,983,827</u>	<u>2,183,239</u>	<u>(292,273)</u>	<u>65,874,793</u>
Subtotal	<u>64,500,246</u>	<u>2,183,239</u>	<u>(292,273)</u>	<u>66,391,212</u>
Totals at historical cost	<u>68,259,163</u>	<u>3,195,411</u>	<u>(1,571,218)</u>	<u>69,883,356</u>
Less accumulated depreciation:				
Buildings and improvements	478,595	19,448	-	498,043
Machinery and equipment	<u>32,888,702</u>	<u>1,867,831</u>	<u>(204,429)</u>	<u>34,552,104</u>
Total accumulated depreciation	<u>33,367,297</u>	<u>1,887,279</u>	<u>(204,429)</u>	<u>35,050,147</u>
Capital assets, net	\$ <u>34,891,866</u>	<u>1,308,132</u>	<u>(1,366,789)</u>	<u>34,833,209</u>

## 6. LONG TERM DEBT

Dated May 1, 2003, the City issued \$14,540,000 in Gas System Revenue Refunding Bonds to refund the 1993 Gas System Revenue Bonds. The Gas System Revenue Refunding Bonds are due serially through 2015 with interest from 4.75% to 5.0% per annum.

On September 9, 2009, the City issued \$4,500,000 in Gas System Revenue Bonds to currently refund bond anticipation notes and provide funding for various Gas System distribution improvements. These bonds are due serially through 2029 with interest from 2.75% to 5.0% per annum, with the first payment due in 2016.

Activity for the year ended December 31, 2012 was as follows:

	Balance			Balance	Due
	1/1/12	Additions	Reductions	12/31/12	Within
					One Year
2003 Refunding Bonds	\$ 5,295,000	-	(1,230,000)	4,065,000	1,290,000
2009 Revenue Bonds	4,500,000	-	-	4,500,000	-
Less deferred amount					
for issuance premium	133,359	-	(52,620)	80,739	-
for issuance discounts	<u>(70,331)</u>	-	<u>12,848</u>	<u>(57,483)</u>	-
	\$ <u>9,858,028</u>	<u>-</u>	<u>(1,269,772)</u>	<u>8,588,256</u>	<u>1,290,000</u>

Activity for the year ended December 31, 2011 was as follows:

	<u>Balance</u> <u>1/1/11</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>12/31/11</u>	<u>Within</u> <u>One Year</u>
2003 Refunding Bonds	\$ 6,470,000	-	(1,175,000)	5,295,000	1,230,000
2009 Revenue Bonds	4,500,000	-	-	4,500,000	-
Less deferred amount for issuance premium	197,971	-	(64,612)	133,359	-
for issuance discounts	(85,261)	-	14,930	(70,331)	-
	<u>\$ 11,082,710</u>	<u>-</u>	<u>(1,224,682)</u>	<u>9,858,028</u>	<u>1,230,000</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>
2013	\$ 1,290,000	379,237	1,669,237
2014	1,355,000	314,737	1,669,737
2015	1,420,000	250,375	1,670,375
2016	250,000	182,925	432,925
2017	260,000	176,050	436,050
2018-2022	1,435,000	742,675	2,177,675
2023-2027	1,740,000	434,600	2,174,600
2028-2029	<u>815,000</u>	<u>56,625</u>	<u>871,625</u>
Total	<u>\$ 8,565,000</u>	<u>2,537,224</u>	<u>11,102,224</u>

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

The Gas System contributes to the Ohio Public Employees Retirement System, the City of Hamilton Metropolitan Pension Plan, and post-employment life insurance.

### Ohio Public Employees Retirement System (OPERS)

The OPERS administers three separate pension plans:

- 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 10.0% of their annual covered salary. The City was required to contribute 14.0% of covered payroll for employees. The Gas System's required contributions to OPERS for the years ended December 31, 2012, 2011, and 2010 were approximately \$186,000, \$179,000, and \$150,000 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 coverage 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 2012, the City contributed 14.0% 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.

The 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 postemployment health care benefits. The portion of employer contributions allocated to health care for members in the Traditional Plan was 4.0% during calendar year 2012. The portion of employer contributions allocated for health care for members in the Combined Plan was 6.05% during calendar year 2012. The OPERS Retirement Board is also authorized to establish rules for the retiree, or their surviving beneficiaries, to pay a portion of the health care benefits provided. Payments 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 \$53,000, \$51,000, and \$54,000 for 2012, 2011, and 2010, respectively.

Changes to the health care plan were adopted by the OPERS Retirement Board on September 19, 2012, with a transition plan commencing January 1, 2014. With the recent passage of pension legislation under SB 343 and the approved health care changes, OPERS expects to be able to consistently allocate 4% of the employer contributions toward the health care fund after the end of the transition period.

### **Metropolitan Pension Plan**

Employees of the City who were not included under the Ohio Public Employees Retirement System (OPERS) prior to May 15, 1962 and who were included under a Group Annuity Contract of the Metropolitan Life Insurance Company participate in the City of Hamilton Metropolitan Pension Plan, a single-employer defined benefit pension plan.

Upon retirement, plan participants are entitled to a supplemental retirement benefit paid by the City, equal to the difference between OPERS benefits that would have been payable to such employee had the employee been covered by OPERS during the full period of employment and actual OPERS benefits received. Benefit provisions of the plan are established and may be amended by the City Council through ordinance. All current participants in the Metropolitan Pension Plan are retired from service with the City.

For fiscal year 2012, the portion of the Gas System's annual pension cost was \$55,782. The Gas System contributed 83.5%, or \$46,568, resulting in a net pension obligation of \$9,213. The net pension obligation for the prior year was \$5,665. The Gas System's portion of the total unfunded accrued liability at year end was \$313,174.

The actuarial valuation date was December 31, 2012 and the accrued liability was calculated using the entry age normal cost method. The Metropolitan Pension Plan currently has no assets. The amortization method used was level dollar and the amortization period was 7 years.

### **Retiree Life Insurance**

The City provides post-employment life insurance coverage through the Hartford Insurance Company. The insurance coverage provided is considered an other post-employment benefit (OPEB) as described in GASB Statement No. 45.

Eligible employees are grouped into two classes. Employees who retired prior to March 1, 1977 are eligible to receive \$2,000 in life insurance benefits. Employees who retired after March 1, 1977 are eligible to receive \$4,000 in life insurance benefits. Benefit provisions of the plan are established and may be amended by City Council through ordinance.

For fiscal year 2012, the portion of the Gas System's annual OPEB cost was \$11,346. The Gas System contributed 85.8%, or \$9,736, resulting in a net OPEB obligation of \$1,610. The net OPEB obligation for the prior year was \$1,617. The Gas System's portion of the total unfunded accrued liability at year end was \$164,697.

The actuarial valuation date was December 31, 2012 and the accrued liability was calculated using the entry age normal cost method. The City's post-employment life-insurance plan currently has no assets.

## **8. 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.

## **9. RELATED PARTY TRANSACTIONS**

The Gas System sells gas to the City's Electric System for use in the generation of electricity. Revenues of approximately \$548,000 and \$676,000 from the Electric System to the Gas System are included in operating revenues in 2012 and 2011, 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 \$2,358,000 and \$2,352,000 in 2012 and 2011, respectively, and are included in other operating expenses.

## **10. RISK MANAGEMENT**

The City is exposed to various risks of loss related to torts and liability, damage to and theft of or destruction of assets; errors and omissions; injuries to employees; and natural disasters. The City maintains comprehensive insurance coverage, for all City departments including the 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.

## **11. CONTRACTUAL COMMITMENTS**

At December 31, 2012, the Gas System had a contractual commitments related to property, plant and equipment improvements and additions, as well as various other contract and agreements to provide or receive services related to the operations of approximately \$956,000.

**12. CHANGE IN ACCOUNTING PRINCIPLE – RESTATEMENT OF NET POSITION**

For 2012, the Gas System implemented GASB Statement No. 62, “*Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*,” GASB Statement No. 63, “*Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*” and GASB Statement No. 65, “*Items Previously Reported as Assets and Liabilities*”.

Statement No. 62 incorporated into the GASB’s authoritative literature certain accounting and financial reporting guidance that is included in Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the American Institute of Certified Public Accountants’ (AICPA) Committee on Accounting Procedure issued on or before November 30, 1989 which does not conflict with or contradict GASB pronouncements.

Statement No. 63 provides guidance for reporting deferred outflow of resources, deferred inflows of resources, and net position in a statement of financial position and related disclosures. GASB 63 standardizes the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government’s net position.

Statement No. 65 provides guidance on how to properly classify items that were previously reported as assets and liabilities as deferred outflows of resources or deferred inflows of resources. In addition, guidance is provided on recognizing certain items that were previously reported as assets and liabilities as outflows of resources (expenses) or inflows of resources (revenues).

The implementation of GASB Statement Nos. 62 and 63 had no impact on beginning of year net position. The implementation of GASB Statement No. 65 resulted in the following restatement of the Gas System’s net position:

Net Position, January 1, 2011	\$ 39,325,881
Deferred bond issuance costs	<u>(189,296)</u>
Restated Net Position, January 1, 2011	<u>\$ 39,136,585</u>