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

Financial Statements

Years Ended December 31, 2011 and 2010

With Independent Auditors' Report

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## INDEPENDENT AUDITORS' REPORT

Honorable City Council  
City of Hamilton, Ohio

We have audited the accompanying financial statements of the City of Hamilton, Ohio - Water System, an enterprise fund of the City of Hamilton, Ohio as of and for the years ended December 31, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the City of Hamilton's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Water System and do not purport to, and do not, present fairly the financial position of the City of Hamilton, Ohio as of December 31, 2011 and 2010, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Hamilton, Ohio - Water System as of December 31, 2011 and 2010 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 2-6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Clark, Schaefer, Hackett & Co.*

Cincinnati, Ohio  
June 7, 2012

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# City of Hamilton, Ohio

## Water System

Management's Discussion and Analysis  
For the Years Ended December 31, 2011 and 2010  
Unaudited

The discussion and analysis of the City of Hamilton, Ohio's Water System's financial performance provide an overall review of that System's financial activities for the years ended December 31, 2011 and 2010. 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 2011 and 2010 are as follows:

- ❑ The assets of the Hamilton Water System exceeded its liabilities at the close of 2011 and 2010, respectively, by \$82,058,042 and \$82,026,004 (net assets). Of this amount, \$5,247,032 and \$6,128,027 (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 \$32,038 between 2011 and 2010, representing a 0.04% increase.
- ❑ In 2011, the Water System's long-term debt, net of discounts and unamortized loss on debt refunding, decreased by \$813,199.

### Water System Summary and Using this Annual Report

The City began operation of its Water System in 1884. The Water System initially consisted of well fields, a 6 million gallon open reservoir, and distribution mains. Due in part to the development of the Water System, the City's population grew rapidly during the next twenty-five years, necessitating the drilling of new wells and other measures to increase the Water System's capacity. By 1929, the City's population had grown to about 53,000 and the City began planning for the development of a new well field, a second reservoir, a water treatment plant, and new transmission mains. The North Water Treatment Plant (the "North Plant"), with an initial capacity of 6 million gallons per day ("MGD"), was placed in operation in 1934. Anticipating increased water demands, the City acquired existing well fields south of the City in 1947. Construction of a new 6 MGD water treatment plant, the South Water Treatment Plant (the "South Plant"), was completed in 1956 and, with the south well field and new transmission lines, began operation. The capacity of the South Plant was increased in 1973 to 16 MGD by adding filters, aerators, and high service pumps. Relative to water supply at the South Water Plant, over the last ten years, the City has added three new water wells at the south well field, installed a new raw water main from the new wells to the South Water Plant, and increased the capacity of the South Plant from 16 MGD to 40 MGD. By April 2012, the City will have completed the rehabilitation of the North Water Plant. In 2007, the City developed a Water System Master Plan, to identify storage and transmission/distribution capacity constraints within the Water System. Every significant recommendation of the Plan is either completed, under construction, or included in the Water System's current ten-year capital plan. Two significant projects of note that were completed were the six million gallon West Reservoir storage facility, off Amberly Dr. (replaced in 2008) and a new, one million gallon elevated storage facility, located adjacent to the West Reservoir (will be completed in 2012).

# City of Hamilton, Ohio

## Water System

Management's Discussion and Analysis  
For the Years Ended December 31, 2011 and 2010  
Unaudited

The System is a fully integrated water supply, treatment, transmission and distribution system. Over the last decade, the City has implemented a number of improvements to the Water System, providing increased system capabilities and enhanced reliability. The System has two water treatment facilities and two well fields that draw water from the Great Miami Valley Aquifer. The transmission and distribution system consists of more than 289 miles of various size main piping, storage facilities and pumping stations.

The Water System currently provides water service to approximately 24,600 customers who represent a diverse mixture of residential, as well as small and large commercial and industrial customers. The City Water Service Area is comprised of virtually all customers within the City's corporate boundaries and a small number of customers in some areas in the immediate surrounding environs. The County is the largest customer of the Water System and for the last several years has accounted for in excess of fifty percent of the Water System's revenue. The Water System provides water service to an area within the City limits and areas in the immediate surrounding environs. No water utility other than the Water System can serve new customers in the City without a franchise, and, under the City Charter, only the City Council has the authority to grant utility franchises. City Council has not granted any franchises.

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 Water System for the years ended December 31, 2011 and 2010.

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

The financial statements contained within this report include the City of Hamilton, Ohio's Water System *only*. Readers desiring to view city-wide financial statements, as well as the impact that the Water 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 2011 and 2010. The City of Hamilton's Water System is reported as a business-type, proprietary, enterprise fund and is considered a major fund for purposes of individual fund reporting. Payments made from the Water Fund are restricted to Water System purposes by municipal ordinance, Ohio Revised Code and indentures issued pursuant to long-term financing.

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 Water Fund and asks the question, "How did we do financially during 2011 and 2010?" 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 Water System's Financial Statements provide additional information that is essential to a full understanding of the data provided.

# City of Hamilton, Ohio

## Water System

Management's Discussion and Analysis  
For the Years Ended December 31, 2011 and 2010  
Unaudited

The System provides services that have a charge based upon the amount of usage. The City's Water System charges fees to recoup the cost of the entire operation of the Water 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 Water Fund, assets exceeded liabilities by \$82,058,042 and \$82,026,004 as of December 31, 2011 and 2010, respectively. By far, the largest portion of the net assets of the Water 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. The ratios of net assets invested in capital assets, net of related debt to total net assets are as follows: 91.58% for 2011, 90.51% for 2010 and 88.01% for 2009. The System employs these assets in the treatment and distribution of water 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 Water System's Statement of Net Assets for the Years Ended December 31, 2011, 2010 and 2009.

	2011	2010	2009
Current and Other Assets	\$16,223,038	\$15,006,922	\$20,545,430
Capital Assets	98,308,607	95,103,420	91,195,736
Total Assets	<u>114,531,645</u>	<u>110,110,342</u>	<u>111,741,166</u>
Long-term Liabilities	24,221,219	25,095,500	25,891,154
Other Liabilities	8,252,384	2,988,838	2,328,893
Total Liabilities	<u>32,473,603</u>	<u>28,084,338</u>	<u>28,220,047</u>
Invested in capital assets, net of related debt	75,147,364	74,240,188	73,505,673
Restricted	1,663,646	1,657,789	1,582,274
Unrestricted	5,247,032	6,128,027	8,433,172
Total Net Assets	<u>\$82,058,042</u>	<u>\$82,026,004</u>	<u>\$83,521,119</u>

The City reported a positive change in net assets of \$32,038 in 2011 and negative changes in net assets of \$1,495,115 and \$1,447,214 in 2010, and 2009, respectively. For the years ended December 31, 2011 and 2010, there were net operating income of \$1,419,276 and \$3,863, respectively. For the year ended December 31, 2009, there was an operating loss of \$185,882. The net operating income for 2011 was \$1,419,276, an increase of \$1,415,413 over 2010. Operating revenues increased \$132,780 in 2011, while operating expenses decreased by \$1,282,633. The decreases in operating expenses were due to reduced clean up costs of lime lagoon of \$633,200 in 2011 compared to 2010. Also in 2010, expenses were incurred to fix the leakage for the four IS Accelerator basins at the South water plant (\$225,000) and for the garage renovation project (\$300,000). This contributed to higher operating expenses in 2010 compared to 2011.

# City of Hamilton, Ohio

## Water System

Management's Discussion and Analysis  
For the Years Ended December 31, 2011 and 2010  
Unaudited

Net non-operating expenses of \$1,387,238 decreased by \$111,740 due to lower interest expenses required to be paid as the City continued to make its scheduled debt service payments.

### *Statement of Revenues, Expenses and Changes in Net Assets*

	2011	2010	2009
Operating Revenues	\$14,948,140	\$14,815,360	\$14,231,316
Operating Expenses:			
Depreciation	2,733,227	2,653,428	2,622,445
Other Operating Expenses	10,795,637	12,158,069	11,794,753
Total Operating Expenses	13,528,864	14,811,497	14,417,198
Operating income (loss)	1,419,276	3,863	(185,882)
Non-Operating revenues (expenses)			
Interest and fiscal charges	(1,319,416)	(1,454,638)	(1,003,054)
Other non-operating revenues (exp)	(67,822)	(44,340)	(258,278)
Total non-operating revenues (expenses)	(1,387,238)	(1,498,978)	(1,261,332)
Change in Net Assets	32,038	(1,495,115)	(1,447,214)
Beginning Net Assets	82,026,004	83,521,119	84,968,333
Ending Net Assets	\$82,058,042	\$82,026,004	\$83,521,119

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

*Capital Assets:* The City's investment in capital assets of the Water System as of December 31, 2011, 2010 and 2009 amounted to \$75.1 Million, \$74.2 Million and \$73.5 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) provides Water System asset activity during 2011 and 2010.

*Debt Administration:* At the end of 2011, the City had two outstanding long-term revenue bond issues, the 2002 Water System Revenue Refunding Bonds totaling \$7,975,000 and the 2009 Water System Revenue Bonds totaling \$17,925,000. The City also issued \$5,900,000 in bond anticipation notes during 2011 that mature in October 2012.

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

# City of Hamilton, Ohio

## Water System

Management's Discussion and Analysis  
For the Years Ended December 31, 2011 and 2010  
Unaudited

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

The City's Water System is continually monitoring its costs and seeking ways to maintain its rates. However, the cost of providing water continues to escalate with rising chemical costs and environmental regulation. These costs are required by both ordinance and indentures to be passed along to its customers. The number of customers has remained steady, but per capita usage is dropping. The City has implemented a series of five rate increases of 6% each, effective on February 1, 2008; January 1, 2009; January 1, 2010; January 1, 2011 and January 1, 2012.

The annual budget of the City Water 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 by necessary City Management.

The City has completed a System Master Plan to identify capacity requirements and a Distribution System Main Replacement Plan to identify funding needs for maintaining the water system integrity. The City implemented a rate rider in 2010 to cover the annual cost of the Main Replacement program with improvements beginning in 2011 and rates increases projected to begin in 2013.

In 2011, both Mohawk Fine Papers and Smart Papers both closed their facilities located in the City. For calendar year 2011, Mohawk Fine Papers/Beckett Mill was the largest private customer, by Ccf usage and amount billed, for the Water System. Mohawk accounted for approximately 6.8% of the total water usage and approximately 4.7% of the revenues of the Water System. For calendar year 2011, Smart Papers was the second largest private customer, by Ccf usage and amount billed, for the Water System. Smart accounted for approximately 1.4% of the total water usage and approximately 1.1% of the revenues of the Water System. In total, the loss of Mohawk and Smart Papers is estimated to result in a direct Total Net Revenue Loss to the City's Water System of almost \$595,000, based upon 2011 operations. Eighty percent of this Total Net Revenue Loss is accounted for by Mohawk, with the remaining 20% accounted for by Smart Papers.

In spite of increasing costs and a continued focus on main replacements, the City's Water System has prospered. The City maintains an Aa3 bond rating with a stable outlook for its Water System.

### **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 Electric 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 Peg Bradner Hancock, City of Hamilton Finance Director, 345 High Street, Hamilton, Ohio 45011, (513) 785-7174, (email at [hancockp@ci.hamilton.oh.us](mailto:hancockp@ci.hamilton.oh.us)) or visit the City website at [www.hamilton-city.org](http://www.hamilton-city.org).

**CITY OF HAMILTON, OHIO – WATER SYSTEM**  
**STATEMENTS OF NET ASSETS**  
**DECEMBER 31, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
<b>ASSETS</b>		
Current assets:		
Cash and investments	\$ 11,462,310	10,094,181
Accounts receivable (less allowance for uncollectible accounts of \$740,958 and \$752,592, respectively)	1,504,275	1,426,839
Interest receivable	4,482	13,193
Interfund receivable	800,000	1,000,000
Inventory of supplies at cost	196,039	159,464
Prepaid expenses	<u>109,932</u>	<u>129,203</u>
Total current assets	<u>14,077,038</u>	<u>12,822,880</u>
Restricted assets:		
Cash and investments	<u>1,663,646</u>	<u>1,657,789</u>
Bond issuance costs	<u>482,354</u>	<u>526,253</u>
Capital assets:		
Property, plant and equipment	136,020,327	130,863,110
Construction in progress	9,715,215	9,210,178
Accumulated depreciation	<u>(47,426,935)</u>	<u>(44,969,868)</u>
Total capital assets	<u>98,308,607</u>	<u>95,103,420</u>
Total assets	\$ <u>114,531,645</u>	<u>110,110,342</u>
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable	\$ 428,800	1,019,830
Accrued wages and benefits	119,996	122,186
Intergovernmental payable	68,933	153,454
Accrued interest payable	314,842	302,636
Customer deposits payable	138,861	135,419
Compensated absences payable-current	245,952	260,313
General obligation notes payable	5,900,000	-
Revenue bonds payable - current portion	<u>1,035,000</u>	<u>995,000</u>
Total current liabilities	<u>8,252,384</u>	<u>2,988,838</u>
Non-current liabilities:		
Compensated absences payable	445,804	466,886
Revenue bonds payable	<u>23,775,415</u>	<u>24,628,614</u>
Total noncurrent liabilities	<u>24,221,219</u>	<u>25,095,500</u>
Total liabilities	<u>32,473,603</u>	<u>28,084,338</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	75,147,364	74,240,188
Restricted for debt service	663,646	657,789
Restricted for rate stabilization	1,000,000	1,000,000
Unrestricted	<u>5,247,032</u>	<u>6,128,027</u>
Total net assets	\$ <u><u>82,058,042</u></u>	<u><u>82,026,004</u></u>

See notes to financial statements.

**CITY OF HAMILTON, OHIO - WATER SYSTEM**  
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**  
**YEARS ENDED DECEMBER 31, 2011 AND 2010**

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	<u>2011</u>	<u>2010</u>
<b>Operating revenues:</b>		
Charges for services	\$ 14,791,954	14,558,780
Other operating revenues	<u>156,186</u>	<u>256,580</u>
Total operating revenues	<u>14,948,140</u>	<u>14,815,360</u>
<b>Operating expenses:</b>		
Personal services	3,908,865	3,711,331
Materials and supplies	1,140,577	1,900,924
Contractual services	3,894,787	4,545,198
Depreciation	2,733,227	2,653,428
Other operating expenses	<u>1,851,408</u>	<u>2,000,616</u>
Total operating expenses	<u>13,528,864</u>	<u>14,811,497</u>
Operating income	1,419,276	3,863
<b>Non-operating revenues (expenses):</b>		
Investment earnings	52,574	114,782
Loss on disposal of capital assets	(120,396)	(159,122)
Interest and fiscal charges	<u>(1,319,416)</u>	<u>(1,454,638)</u>
Total non-operating revenues (expenses)	<u>(1,387,238)</u>	<u>(1,498,978)</u>
Change in net assets	32,038	(1,495,115)
Net assets - beginning of year	<u>82,026,004</u>	<u>83,521,119</u>
Net assets - end of year	<u>\$ 82,058,042</u>	<u>82,026,004</u>

See notes to financial statements.

**CITY OF HAMILTON, OHIO - WATER SYSTEM**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
<b>Cash flows from operating activities:</b>		
Cash received from customers	\$ 14,874,146	14,811,878
Cash paid for employee services and benefits	(3,936,273)	(3,718,839)
Cash paid to suppliers for goods and services	<u>(6,965,450)</u>	<u>(8,355,834)</u>
Net cash provided by operating activities	<u>3,972,423</u>	<u>2,737,205</u>
<b>Cash Flows from noncapital financing activities:</b>		
Advances in from other funds	200,000	-
Advances out to other funds	<u>-</u>	<u>(1,000,000)</u>
Net cash provided (used) by noncapital financing activities	<u>200,000</u>	<u>(1,000,000)</u>
<b>Cash flows from capital and related financing activities:</b>		
Payment for capital acquisitions	(6,683,212)	(6,309,210)
Proceeds from the sale of notes	5,900,000	-
Premiums from debt issuance	37,996	-
Debt principal payments	(995,000)	(890,000)
Debt interest payments	<u>(1,119,506)</u>	<u>(1,220,277)</u>
Net cash used by capital and related financing activities	<u>(2,859,722)</u>	<u>(8,419,487)</u>
<b>Cash flows from investing activities:</b>		
Interest from investments	<u>61,285</u>	<u>151,320</u>
Net change in cash and cash equivalents	1,373,986	(6,530,962)
Cash and cash equivalents at beginning of year	<u>11,751,970</u>	<u>18,282,932</u>
Cash and cash equivalents at end of year	\$ <u><u>13,125,956</u></u>	<u><u>11,751,970</u></u>
Reconciliation of operating income to net cash providing by operating activities:		
Operating income	\$ 1,419,276	3,863
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,733,227	2,653,428
Changes in assets and liabilities:		
(Increase) decrease in receivables	(77,436)	(7,781)
(Increase) decrease in inventory	(36,575)	(4,732)
(Increase) decrease in prepaid items	19,271	(64,053)
Increase (decrease) in customer deposits payable	3,442	4,299
Increase (decrease) in payables	33,372	66,045
Increase (decrease) in accrued liabilities	(37,633)	20,848
Increase (decrease) in intergovernmental payables	<u>(84,521)</u>	<u>65,288</u>
Net cash provided by operating activities	\$ <u><u>3,972,423</u></u>	<u><u>2,737,205</u></u>
Schedule of noncash activities:		
Outstanding liabilities for purchase of certain capital assets	\$ 131,598	756,000
Change in fair value of investments	1,568	2,191

See notes to financial statements.

# CITY OF HAMILTON, OHIO – WATER SYSTEM

## Notes to Financial Statements

Years Ended December 31, 2011 and 2010

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### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Financial Reporting Entity** – The City of Hamilton, Ohio – Water System (Water System) is a utility operating as a separate enterprise fund of the City of Hamilton, Ohio (City). The Water System is controlled by and is dependent on the City’s executive and legislative branches. Control by or dependence on the City is determined on the basis of outstanding debt secured by revenues or general obligations of the City, obligation of the City to finance any deficits that may occur, or receipt of subsidies from the City.

**Measurement Focus, Basis of Accounting and Basis of Presentation** – The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. The Water System has elected only to apply Financial Accounting Standards Board (FASB) guidance issued on or before November 30, 1989 that do not conflict with or contradict GASB pronouncements.

Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Water System’s principal ongoing operations. The principal operating revenues are charges to customers for sales and services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting these definitions are reported as non-operating revenues and expenses.

**Income Taxes** – The Water System, which is owned and operated by the City, is exempt from income taxes since it is a division of a municipality.

**Cash and Investments** – Certain Water System cash and investments are held in the City Treasury and pooled for investment management purposes. The portion of these pooled funds owned by the Water System is reported as cash and investments. The Water System’s investments are stated at fair value. Interest earned on funds invested is distributed on the basis of the relationship of the average monthly balance of all funds, including the Water System.

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

**Capital Assets** – Expenditures that increase values or extend the useful life of the respective assets are capitalized while the costs of maintenance and repairs are charged to operating expenses. Interest costs related to the construction of property, plant and equipment are capitalized. Depreciation is calculated on a straight-line basis over the estimated useful life of the various classes of assets. The range of useful lives for computing depreciation is 3 to 75 years.

***Bond Discounts and Issuance Costs*** – Unamortized bond discounts and issuance costs are amortized on the interest method over the term of the related bonds. Amortization of bond discounts was \$15,492 and \$16,996 in 2011 and 2010, respectively. Amortization of issuance costs in 2011 and 2010 amounted to \$43,899 and \$47,574, respectively.

***Compensated Absences*** - The Water System follows the provisions of GASB Statement No. 16, “Accounting for Compensated Absences”. Vacation and compensatory time benefits are accrued as a liability as the benefits are earned if the employees' rights to receive compensation are attributable to services already rendered and it is probable that the Water System will compensate the employees for the benefits through paid time off or some other means. Sick leave termination benefits are accrued using the vesting method. The liability includes the employees who are currently eligible to receive termination benefits and those employees for whom it is probable that they will become eligible to receive payment in the future. The amount is based on accumulated sick leave and employees' wage rates at year-end.

***Use of Estimates*** – The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## **2. CASH AND INVESTMENTS**

The Water System follows the practice of pooling cash and investments with the City Treasurer except for the cash and investments of certain accounts maintained by trustees. Pooled cash and investments of the Water System totaled \$12,462,310 and \$11,094,181 at December 31, 2011 and 2010, respectively and consisted of demand deposits, money market funds, U.S. government agency securities and STAR Ohio. Cash and investments held by trustees were \$663,646 and \$657,789 at December 31, 2011 and 2010, 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, 2011.

***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, 2011, nearly 98% of the City’s deposits with financial institutions, including the amount of pooled deposits related to the Water System, were exposed to custodial credit risk because they are considered uninsured and uncollateralized. However, the State of Ohio has established by statute a collateral pooling system for financial institutions acting as public depositories. Public depositories must pledge qualified securities with fair values greater than the total amount of all public deposits to be secured by the collateral pool. This pooled collateral covers the Water System’s uninsured and uncollateralized deposits.

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

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

The City’s pooled investments, as well as the investments held by trustees specifically for the Water System, are invested primarily in U.S. governmental agency securities with a credit rating of AA+ and an average maximum maturity of 4.69 years and STAR Ohio which has a credit rating of AAAM.

**3. ACCOUNTS RECEIVABLE**

Receivables at December 31, 2011 and 2010 consist of the following:

	<u>2011</u>	<u>2010</u>
Earned and unbilled consumer accounts	\$ 1,087,642	1,022,175
Earned and billed consumer accounts	1,116,258	1,123,648
Other	41,333	33,608
Less allowance for uncollectible accounts	<u>(740,958)</u>	<u>(752,592)</u>
Total	\$ <u>1,504,275</u>	<u>1,426,839</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 \$1,663,646 and \$1,657,789 at December 31, 2011 and 2010, respectively.

## 5. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2011 and 2010 was as follows:

	Balance 1/1/11	Increases	Decreases	Balance 12/31/11
<i>Nondepreciable capital assets:</i>				
Land	\$ 2,528,827	-	-	2,528,827
Construction in progress	<u>9,210,178</u>	<u>3,577,242</u>	<u>(3,072,205)</u>	<u>9,715,215</u>
Subtotal	<u>11,739,005</u>	<u>3,577,242</u>	<u>(3,072,205)</u>	<u>12,244,042</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	22,287,793	-	-	22,287,793
Machinery and equipment	<u>106,046,490</u>	<u>5,553,773</u>	<u>(396,556)</u>	<u>111,203,707</u>
Subtotal	<u>128,334,283</u>	<u>5,553,773</u>	<u>(396,556)</u>	<u>133,491,500</u>
Totals at historical cost	<u>140,073,288</u>	<u>9,131,015</u>	<u>(3,468,761)</u>	<u>145,735,542</u>
Less accumulated depreciation:				
Buildings and improvements	12,840,743	584,984	-	13,425,727
Machinery and equipment	<u>32,129,125</u>	<u>2,148,243</u>	<u>(276,160)</u>	<u>34,001,208</u>
Total accumulated depreciation	<u>44,969,868</u>	<u>2,733,227</u>	<u>(276,160)</u>	<u>47,426,935</u>
Capital assets, net	<u>\$ 95,103,420</u>	<u>6,397,788</u>	<u>(3,192,601)</u>	<u>98,308,607</u>
	Balance 1/1/10	Increases	Decreases	Balance 12/31/10
<i>Nondepreciable capital assets:</i>				
Land	\$ 2,528,827	-	-	2,528,827
Construction in progress	<u>5,190,771</u>	<u>4,352,589</u>	<u>(333,182)</u>	<u>9,210,178</u>
Subtotal	<u>7,719,598</u>	<u>4,352,589</u>	<u>(333,182)</u>	<u>11,739,005</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	22,287,793	-	-	22,287,793
Machinery and equipment	<u>103,694,948</u>	<u>2,700,827</u>	<u>(349,285)</u>	<u>106,046,490</u>
Subtotal	<u>125,982,741</u>	<u>2,700,827</u>	<u>(349,285)</u>	<u>128,334,283</u>
Totals at historical cost	<u>133,702,339</u>	<u>7,053,416</u>	<u>(682,467)</u>	<u>140,073,288</u>
Less accumulated depreciation:				
Buildings and improvements	12,233,059	607,684	-	12,840,743
Machinery and equipment	<u>30,273,544</u>	<u>2,045,744</u>	<u>(190,163)</u>	<u>32,129,125</u>
Total accumulated depreciation	<u>42,506,603</u>	<u>2,653,428</u>	<u>(190,163)</u>	<u>44,969,868</u>
Capital assets, net	<u>\$ 91,195,736</u>	<u>4,399,988</u>	<u>(492,304)</u>	<u>95,103,420</u>

## 6. LONG TERM DEBT

In 2002, the Water System issued \$12,940,000 of water revenue refunding bonds to refund outstanding mortgage revenue bonds of the Water System. The 2002 refunding bonds are due serially through 2021 with an interest rate of 4.39%.

On September 9, 2009, the City issued \$9,675,000 in Series 2009A Water System Revenue Bonds and \$8,915,000 in Series 2009B Taxable Water System Build America Revenue Bonds to currently refund bond anticipation notes and provide funding for Water System production and distribution improvements. With the issuance of the Build America Bonds, the City will be entitled to receive an interest subsidy payment of 35% from the U.S. Treasury on any interest payment date. The Series 2009A revenue bonds fully mature in 2029 with interest from 2.00% to 6.25% per annum. The Series 2009B Build America Bonds fully mature in 2039 with interest of 6.62% per annum.

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

	Balance 1/1/11	Additions	Reductions	Balance 12/31/11	Due Within One Year
Series 2002 Refunding Bonds	\$ 8,595,000	-	(620,000)	7,975,000	650,000
Series 2009A Revenue Bonds	9,385,000	-	(375,000)	9,010,000	385,000
Series 2009B Revenue BABs	8,915,000	-	-	8,915,000	-
Less deferred amount:					
on refunding	(1,082,419)	-	166,309	(916,110)	-
for issuance discounts	(188,967)	-	15,492	(173,475)	-
	<u>\$ 25,623,614</u>	<u>-</u>	<u>(813,199)</u>	<u>24,810,415</u>	<u>1,035,000</u>

Debt activity for the year ended December 31, 2010 was as follows:

	Balance 1/1/10	Additions	Reductions	Balance 12/31/10	Due Within One Year
Series 2002 Refunding Bonds	\$ 9,195,000	-	(600,000)	8,595,000	620,000
Series 2009A Revenue Bonds	9,675,000	-	(290,000)	9,385,000	375,000
Series 2009B Revenue BABs	8,915,000	-	-	8,915,000	-
Less deferred amount:					
on refunding	(1,257,844)	-	175,425	(1,082,419)	-
for issuance discounts	(205,963)	-	16,996	(188,967)	-
	<u>\$ 26,321,193</u>	<u>-</u>	<u>(697,579)</u>	<u>25,623,614</u>	<u>995,000</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 a municipal bond insurance policy. Under the terms of this policy, the payments of principal and interest are guaranteed by the insurer.

Maturities of revenue bonds at December 31, 2011 are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 1,035,000	1,287,567	2,322,567
2013	1,065,000	1,255,492	2,320,492
2014	1,095,000	1,219,717	2,314,717
2015	1,135,000	1,181,842	2,316,842
2016	1,185,000	1,134,204	2,319,204
2017-2021	6,745,000	4,867,841	11,612,841
2022-2026	2,770,000	3,756,379	6,526,379
2027-2031	3,440,000	3,083,845	6,523,845
2032-2036	4,335,000	1,909,870	6,244,870
2037-2039	<u>3,095,000</u>	<u>415,405</u>	<u>3,510,405</u>
Total	<u>\$ 25,900,000</u>	<u>20,112,162</u>	<u>46,012,162</u>

**7. NOTES PAYABLE**

On October 5, 2011, the Water System issued limited tax general obligation bond anticipation notes to finance certain Water System improvement projects. The notes bear interest at the rate of 1.25% and maturity on October 4, 2012.

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

	<u>Balance</u>		<u>Balance</u>
	<u>1/1/11</u>	<u>Additions</u>	<u>12/31/11</u>
2011 Water System Imp. BANs	\$ -	5,900,000	5,900,000

**8. DEFINED BENEFIT PENSION PLANS AND OTHER POSTEMPLOYMENT BENEFITS**

The Water 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 Water System's required contributions to OPERS for the years ended December 31, 2011, 2010, and 2009 were approximately \$406,000, \$366,000, and \$360,000 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 2011, 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 Board of Trustees 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 2011. The portion of employer contributions allocated for health care for members in the Combined Plan was 6.05% during calendar year 2011. The portion of employer contributions allocated to health care for the calendar year beginning January 1, 2012 remained the same, but they are subject to change based on Board action. Employers will be notified if the portion allocated to health care changes during calendar year 2012. The OPERS Board of Trustees 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 Water System's contributions that were used to fund post employment benefits was approximately \$116,000, \$133,000 and \$151,000 for 2011, 2010, and 2009, respectively.

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

### **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 2011, the portion of the Water System's annual pension cost was \$55,781. The Water System contributed 89.8%, or \$50,116, resulting in a net pension obligation of \$5,665. For the preceding two years, the City determined the net pension obligation to be immaterial, as annual pension cost approximated City contributions. The Water System's portion of the total unfunded accrued liability at year end was \$383,001.

The actuarial valuation date was December 31, 2011 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 8 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 2011, the portion of the Water System's annual OPEB cost was \$11,346. The Water System contributed 85.8%, or \$9,729, resulting in a net OPEB obligation of \$1,617. For the preceding two years, the City determined the net OPEB obligation to be immaterial, as the annual OPEB cost approximated City contributions. The Water System's portion of the total unfunded accrued liability at year end was \$163,186.

The actuarial valuation date was December 31, 2011 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.

## **9. CONTINGENT LIABILITIES**

Various claims and lawsuits are pending against the City involving the Water System. The City believes that the ultimate disposition of such claims and lawsuits will not have a material adverse effect on the financial position of the Water System.

## **10. RELATED PARTY TRANSACTIONS**

The Water System purchases electricity from the City's Electric System. Purchases of \$856,636 and \$900,337 from the Electric System are included in operating expenses in 2011 and 2010, respectively.

The City allocates the cost of certain administrative services. In addition, the City established internal service funds which provide services to various City departments. Charges to the Water System for these services were approximately \$2,263,000 and \$2,306,000 in 2011 and 2010, 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 Water System, with private carriers for real property, building contents, vehicle, property and general liability insurance, police professional liability, and public officials errors and omissions insurance. Vehicle policies include liability coverage for bodily injury and property damage. Claim payments have not exceeded coverage in the past three years. There was no decline in the level of coverage from the prior year.

## **12. CONTRACTUAL COMMITMENTS**

At December 31, 2011, the Water System had contractual commitments in the amounts of approximately \$1,713,000 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 Water System operations.