
City of Hamilton, Ohio – Water System

Financial Statements

Years Ended December 31, 2013 and 2012

With Independent Auditor's Report

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INDEPENDENT AUDITORS' REPORT

To the Honorable Mayor and Members of Council
City of Hamilton, Ohio:

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Hamilton, Ohio - Water System, an enterprise fund of the City of Hamilton, Ohio (the Water System), as of and for the year ended December 31, 2013 and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of the City of Hamilton, Ohio - Water System as of December 31, 2013, and the change in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Period Financial Statements

The financial statements of the City of Hamilton, Ohio - Water System as of December 31, 2012 were audited by other auditors whose report dated June 25, 2013, expressed an unmodified opinion on those statements.

Emphasis of Matters

As described 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, 2013 and 2012, and the changes in its financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 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 23, 2014

City of Hamilton, Ohio

Water System

Management's Discussion and Analysis
For the Years Ended December 31, 2013 and 2012
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, 2013 and 2012. 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 2013 and 2012 are as follows:

- ❑ The assets and deferred outflow of resources of the Hamilton Water System exceeded its liabilities at the close of 2013 and 2012, respectively, by \$81,794,889 and \$81,743,270 (net position). Of this amount, \$8,427,695 and \$9,044,644 (unrestricted net position) may be used to meet the system's ongoing obligations to customers and creditors.
- ❑ The system's total net position increased by \$51,619 between 2013 and 2012, representing a 0.6% increase.
- ❑ In 2013, the Water System's long-term debt, net of discounts, decreased by \$1,050,549.

Water System Summary

The Water 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 Buried 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. Butler 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 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 Water System for the years ended December 31, 2013 and 2012.

City of Hamilton, Ohio

Water System

Management's Discussion and Analysis
For the Years Ended December 31, 2013 and 2012
Unaudited

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 2013 and 2012. 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 Position and the Statement of Revenues, Expenses and Changes in Net Position, the view of the system looks at all financial transactions of the Water Fund and asks the question, "How did we do financially during 2013 and 2012?" 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 change in net position. 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 Water 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 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 and deferred outflow of resources exceeded liabilities by \$81,794,889 and \$81,743,270 as of December 31, 2013 and 2012, respectively. By far, the largest portion of the net position 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 investment in capital assets to total net position are as follows: 88.31% for 2013, 87.76% for 2012 and 92.12% for 2011. 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 Position for the Years Ended December 31, 2013, 2012 and 2011.

City of Hamilton, Ohio

Water System

Management's Discussion and Analysis
For the Years Ended December 31, 2013 and 2012
Unaudited

	2013	2012	2011
Current and Other Assets	\$12,803,970	\$15,472,330	\$15,740,684
Capital Assets	100,621,620	98,931,800	98,308,607
Total Assets	113,425,590	114,404,130	114,049,291
 Deferred Outflow of Resources	 620,458	 763,068	 916,110
Long-term Liabilities	22,889,193	24,020,655	25,137,329
Other Liabilities	9,361,966	9,403,273	8,252,384
Total Liabilities	32,251,159	33,423,928	33,389,713
 Net investment on capital assets	 72,236,420	 71,739,620	 75,147,364
Restricted	1,130,774	959,006	1,663,646
Unrestricted	8,427,695	9,044,644	4,764,678
Total Net Position	\$81,794,889	\$81,743,270	\$81,575,688

The Water System reported positive changes in net position of \$51,619 in 2013, \$167,582 in 2012 and \$75,937 in 2011. For the years ended December 31, 2013, 2012 and 2011, there were net operating income of \$1,279,961, \$1,131,797 and \$1,419,276, respectively. The net operating income for 2013 of \$1,279,961 was an increase of \$148,164 over 2012. Operating revenues decreased \$93,041 in 2013, while operating expenses decreased by \$241,205. The decreases in operating revenues and expenses were due to the closing of several industrial and large commercial companies.

Net non-operating expenses of \$1,228,342 decreased by \$14,568 due to lower interest expenses required to be paid as the City continued to make its scheduled debt service payments.

City of Hamilton, Ohio

Water System

Management's Discussion and Analysis
For the Years Ended December 31, 2013 and 2012
Unaudited

Statement of Revenues, Expenses and Changes in Net Position

	2013	2012	2011
Operating Revenues	\$14,656,538	\$14,749,579	\$14,948,140
Operating Expenses:			
Depreciation	2,870,911	2,748,808	2,733,227
Other Operating Expenses	10,505,666	10,868,974	10,795,637
Total Operating Expenses	13,376,577	13,617,782	13,528,864
Operating income (loss)	1,279,961	1,131,797	1,419,276
Non-Operating revenues (expenses)			
Interest and fiscal charges	(1,226,568)	(1,284,051)	(1,275,517)
Other non-operating revenues (exp)	(1,774)	41,141	(67,822)
Total non-operating revenues (expenses)	(1,228,342)	(1,242,910)	(1,343,339)
Transfers out	-	278,695	-
Change in Net Position	51,619	167,582	75,937
Beginning Net Position	81,743,270	81,575,688	81,499,751
Ending Net Position	\$81,794,889	\$81,743,270	\$81,575,688

Capital Assets and Debt Administration

Capital Assets: The City's net investment in capital assets of the Water System as of December 31, 2013, 2012 and 2011 amounted to \$72.2 million, \$71.7 million and \$75.1 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 2013 and 2012.

Debt Administration: At the end of 2013, the City had two outstanding long-term revenue bond issues, the 2002 Water System Revenue Refunding Bonds totaling \$6,650,000 and the 2009 Water System Revenue Bonds totaling \$17,150,000. The City also issued \$6,690,000 in bond anticipation notes during 2013 that mature in October 2014.

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, 2013 and 2012
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 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 necessary by City Management.

While the transmission and distribution system has been well-maintained, the age of the infrastructure has led to increases in the number of water main breaks and leaks over the last decade or so. For example, the average water main age in the City is approximately seventy years. In 2010, City Council adopted an ordinance which created the Water Main Replacement Program Rider (WMRPR). The WMRPR program is designed to renew and replace the City's water mains based upon an average 75-year useful life. Debt is expected to be issued, approximately every three years, to provide funding for the program until 2020. At that time, the Rider will fully fund the WMRPR. The WMRPR is being assessed on all City water customers, beginning in 2013. All funds collected through the WMRPR will be dedicated to meeting the capital expenditure and debt service requirements of the Water Main Replacement Program.

While the U.S. EPA establishes water quality and testing guidelines, the Ohio EPA enforces these guidelines, by using Primary and Secondary Drinking Water Standards. The Primary Drinking Water Standards focus on health concerns, by placing restrictions on water content of certain chemicals, such as lead, arsenic, mercury, fluoride and nitrates. Secondary Drinking Water Standards focus on the aesthetic quality of water, such as color, odor, iron and pH. Based on its tests and monitoring program, the City is currently in compliance with all U.S. EPA and Ohio EPA requirements. The City's treated water meets or exceeds applicable standards and is generally regarded as high quality, which is confirmed by consumer surveys. To further support this label of "high quality," the City of Hamilton won the award of "Best of the Best" in the Ohio Section of the American Water Works Association Water Tasting Contest in 2010, 2012, and 2013.

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 Water 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.

CITY OF HAMILTON, OHIO – WATER SYSTEM
STATEMENTS OF NET POSITION
DECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
Current assets:		
Cash and investments	\$ 9,481,081	12,176,829
Accounts receivable (less allowance for uncollectible accounts of \$618,655 and \$655,265, respectively)	1,527,992	1,448,553
Interest receivable	5,412	1,896
Interfund receivable	400,000	600,000
Inventory of supplies at cost	185,818	218,666
Prepaid expenses	<u>72,893</u>	<u>67,380</u>
Total current assets	<u>11,673,196</u>	<u>14,513,324</u>
Restricted assets:		
Cash and investments	<u>1,130,774</u>	<u>959,006</u>
Capital assets:		
Property, plant and equipment	145,554,452	138,662,687
Construction in progress	7,878,940	10,343,994
Accumulated depreciation	<u>(52,811,772)</u>	<u>(50,074,881)</u>
Total capital assets	<u>100,621,620</u>	<u>98,931,800</u>
Total assets	<u>113,425,590</u>	<u>114,404,130</u>
DEFERRED OUTFLOW OF RESOURCES		
Deferred charge on debt refunding	<u>620,458</u>	<u>763,068</u>
LIABILITIES		
Current liabilities:		
Accounts payable	695,531	724,026
Accrued wages and benefits	146,362	138,793
Intergovernmental payable	37,411	37,500
Accrued interest payable	274,182	311,153
Customer deposits payable	170,821	158,050
Compensated absences payable-current	252,659	278,751
General obligation notes payable	6,690,000	6,690,000
Revenue bonds payable - current portion	<u>1,095,000</u>	<u>1,065,000</u>
Total current liabilities	<u>9,361,966</u>	<u>9,403,273</u>
Non-current liabilities:		
Compensated absences payable	328,282	379,195
Revenue bonds payable	<u>22,560,911</u>	<u>23,641,460</u>
Total noncurrent liabilities	<u>22,889,193</u>	<u>24,020,655</u>
Total liabilities	<u>32,251,159</u>	<u>33,423,928</u>
NET POSITION		
Net investment in capital assets	72,236,420	71,739,620
Restricted for debt service	530,774	559,006
Restricted for rate stabilization	600,000	400,000
Unrestricted	<u>8,427,695</u>	<u>9,044,644</u>
Total net position	<u>\$ 81,794,889</u>	<u>81,743,270</u>

See notes to financial statements.

CITY OF HAMILTON, OHIO - WATER SYSTEM
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
YEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
Operating revenues:		
Charges for services	\$ 14,499,014	14,523,058
Other operating revenues	<u>157,524</u>	<u>226,521</u>
Total operating revenues	<u>14,656,538</u>	<u>14,749,579</u>
Operating expenses:		
Personal services	3,346,842	3,658,651
Materials and supplies	1,233,457	1,311,788
Contractual services	3,880,256	3,890,575
Depreciation	2,870,911	2,748,808
Other operating expenses	<u>2,045,111</u>	<u>2,007,960</u>
Total operating expenses	<u>13,376,577</u>	<u>13,617,782</u>
Operating income	1,279,961	1,131,797
Non-operating revenues (expenses):		
Investment earnings	377	48,474
Loss on disposal of capital assets	(2,151)	(7,333)
Interest and fiscal charges	<u>(1,226,568)</u>	<u>(1,284,051)</u>
Total non-operating revenues (expenses)	<u>(1,228,342)</u>	<u>(1,242,910)</u>
Income (loss) before transfers	51,619	(111,113)
Transfers out	<u>-</u>	<u>278,695</u>
Change in net position	51,619	167,582
Net position - beginning of year	<u>81,743,270</u>	<u>81,575,688</u>
Net position - end of year	<u>\$ 81,794,889</u>	<u>81,743,270</u>

See notes to financial statements.

**CITY OF HAMILTON, OHIO - WATER SYSTEM
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2013 AND 2012**

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities:		
Cash received from customers	\$ 14,589,870	14,824,490
Cash paid for employee services and benefits	(3,416,749)	(3,705,464)
Cash paid to suppliers for goods and services	<u>(7,007,258)</u>	<u>(7,220,581)</u>
Net cash provided by operating activities	<u>4,165,863</u>	<u>3,898,445</u>
Cash Flows from noncapital financing activities:		
Advances in from other funds	200,000	200,000
Transfers in from other funds	<u>-</u>	<u>278,695</u>
Net cash provided by noncapital financing activities	<u>200,000</u>	<u>478,695</u>
Cash flows from capital and related financing activities:		
Payment for capital acquisitions	(4,715,225)	(3,053,558)
Proceeds from the sale of notes	6,690,000	6,690,000
Premiums from debt issuance	26,492	34,788
Debt principal payments	(7,755,000)	(6,935,000)
Debt interest payments	<u>(1,132,970)</u>	<u>(1,154,551)</u>
Net cash used by capital and related financing activities	<u>(6,886,703)</u>	<u>(4,418,321)</u>
Cash flows from investing activities:		
Interest from investments	<u>(3,139)</u>	<u>51,060</u>
Net change in cash and cash equivalents	(2,523,979)	9,879
Cash and cash equivalents at beginning of year	<u>13,135,835</u>	<u>13,125,956</u>
Cash and cash equivalents at end of year	\$ <u><u>10,611,856</u></u>	<u><u>13,135,835</u></u>
Reconciliation of operating income to net cash providing by operating activities:		
Operating income	\$ 1,279,961	1,131,797
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,870,911	2,748,808
Changes in assets and liabilities:		
(Increase) decrease in receivables	(79,439)	55,722
(Increase) decrease in inventory	32,848	(22,627)
(Increase) decrease in prepaid items	(5,513)	42,552
Increase (decrease) in customer deposits payable	12,771	19,189
Increase (decrease) in payables	123,849	(30,550)
Increase (decrease) in accrued liabilities	(69,436)	(15,013)
Increase (decrease) in intergovernmental payables	<u>(89)</u>	<u>(31,433)</u>
Net cash provided by operating activities	\$ <u><u>4,165,863</u></u>	<u><u>3,898,445</u></u>
Schedule of noncash activities:		
Outstanding liabilities for purchase of certain capital assets	\$ 305,030	457,374
Change in fair value of investments	40,960	670

See notes to financial statements.

CITY OF HAMILTON, OHIO – WATER SYSTEM

Notes to Financial Statements

Years Ended December 31, 2013 and 2012

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.

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 – Unamortized bond discounts are amortized on the interest method over the term of the related bonds. Amortization of bond discounts was \$14,451 and \$14,935 in 2013 and 2012, 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.

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 Water 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 Water 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 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 \$10,081,081 and \$12,576,829 at December 31, 2013 and 2012, respectively and consisted of demand deposits, money market funds, U.S. government agency securities and STAR Ohio. Cash and investments held by trustees were \$530,774 and \$559,006 at December 31, 2013 and 2012, 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, 2013.

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, 2013 and 2012, approximately 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 4.36 years and STAR Ohio which has a credit rating of AAAm.

3. ACCOUNTS RECEIVABLE

Receivables at December 31, 2013 and 2012 consist of the following:

	<u>2013</u>	<u>2012</u>
Earned and unbilled consumer accounts	\$ 1,082,494	992,559
Earned and billed consumer accounts	1,056,116	1,104,206
Other	8,037	7,053
Less allowance for uncollectible accounts	<u>(618,655)</u>	<u>(655,265)</u>
Total	\$ <u>1,527,992</u>	<u>1,448,553</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 \$1,130,774 and \$959,006 at December 31, 2013 and 2012, respectively.

5. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2013 and 2012 was as follows:

	Balance			Balance
	<u>1/1/13</u>	Increases	Decreases	<u>12/31/13</u>
<i>Nondepreciable capital assets:</i>				
Land	\$ 2,617,142	-	-	2,617,142
Construction in progress	<u>10,343,994</u>	<u>2,572,693</u>	<u>(5,037,747)</u>	<u>7,878,940</u>
Subtotal	<u>12,961,136</u>	<u>2,572,693</u>	<u>(5,037,747)</u>	<u>10,496,082</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	22,287,793	2,599,012	-	24,886,805
Machinery and equipment	<u>113,757,752</u>	<u>4,428,924</u>	<u>(136,171)</u>	<u>118,050,505</u>
Subtotal	<u>136,045,545</u>	<u>7,027,936</u>	<u>(136,171)</u>	<u>142,937,310</u>
Totals at historical cost	<u>149,006,681</u>	<u>9,600,629</u>	<u>(5,173,918)</u>	<u>153,433,392</u>
Less accumulated depreciation:				
Buildings and improvements	13,987,906	619,349	-	14,607,255
Machinery and equipment	<u>36,086,975</u>	<u>2,251,562</u>	<u>(134,020)</u>	<u>38,204,517</u>
Total accumulated depreciation	<u>50,074,881</u>	<u>2,870,911</u>	<u>(134,020)</u>	<u>52,811,772</u>
Capital assets, net	<u>\$ 98,931,800</u>	<u>6,729,718</u>	<u>(5,039,898)</u>	<u>100,621,620</u>

	Balance 1/1/12	Increases	Decreases	Balance 12/31/12
<i>Nondepreciable capital assets:</i>				
Land	\$ 2,528,827	88,315	-	2,617,142
Construction in progress	<u>9,715,215</u>	<u>2,084,614</u>	<u>(1,455,835)</u>	<u>10,343,994</u>
Subtotal	<u>12,244,042</u>	<u>2,172,929</u>	<u>(1,455,835)</u>	<u>12,961,136</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	22,287,793	-	-	22,287,793
Machinery and equipment	<u>111,203,707</u>	<u>2,662,240</u>	<u>(108,195)</u>	<u>113,757,752</u>
Subtotal	<u>133,491,500</u>	<u>2,662,240</u>	<u>(108,195)</u>	<u>136,045,545</u>
Totals at historical cost	<u>145,735,542</u>	<u>4,835,169</u>	<u>(1,564,030)</u>	<u>149,006,681</u>
Less accumulated depreciation:				
Buildings and improvements	13,425,727	562,179	-	13,987,906
Machinery and equipment	<u>34,001,208</u>	<u>2,186,629</u>	<u>(100,862)</u>	<u>36,086,975</u>
Total accumulated depreciation	<u>47,426,935</u>	<u>2,748,808</u>	<u>(100,862)</u>	<u>50,074,881</u>
Capital assets, net	\$ <u>98,308,607</u>	<u>2,086,361</u>	<u>(1,463,168)</u>	<u>98,931,800</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 4.0 – 5.0%.

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 2.25% to 4.63% 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, 2013 was as follows:

	Balance 1/1/13	Additions	Reductions	Balance 12/31/13	Due Within One Year
Series 2002 Refunding Bonds	\$ 7,325,000	-	(675,000)	6,650,000	700,000
Series 2009A Revenue Bonds	8,625,000	-	(390,000)	8,235,000	395,000
Series 2009B Revenue BABs	8,915,000	-	-	8,915,000	-
Less deferred amount: for issuance discounts	<u>(158,540)</u>	<u>-</u>	<u>14,451</u>	<u>(144,089)</u>	<u>-</u>
	<u>\$ 24,706,460</u>	<u>-</u>	<u>(1,050,549)</u>	<u>23,655,911</u>	<u>1,095,000</u>

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

	Balance 1/1/12	Additions	Reductions	Balance 12/31/12	Due Within One Year
Series 2002 Refunding Bonds	\$ 7,975,000	-	(650,000)	7,325,000	675,000
Series 2009A Revenue Bonds	9,010,000	-	(385,000)	8,625,000	390,000
Series 2009B Revenue BABs	8,915,000	-	-	8,915,000	-
Less deferred amount: for issuance discounts	<u>(173,475)</u>	<u>-</u>	<u>14,935</u>	<u>(158,540)</u>	<u>-</u>
	<u>\$ 25,726,525</u>	<u>-</u>	<u>(1,020,065)</u>	<u>24,706,460</u>	<u>1,065,000</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, 2013 are as follows:

	Principal	Interest	Total
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	1,235,000	1,083,254	2,318,254
2018	1,290,000	1,029,029	2,319,029
2019-2023	5,265,000	4,324,630	9,589,630
2024-2028	3,000,000	3,517,178	6,517,178
2029-2033	3,790,000	2,685,077	6,475,077
2034-2038	4,730,000	1,323,007	6,053,007
2039	<u>1,075,000</u>	<u>71,165</u>	<u>1,146,165</u>
Total	<u>\$ 23,800,000</u>	<u>17,569,103</u>	<u>41,369,103</u>

7. NOTES PAYABLE

The Ohio Revised Code provides that notes including renewal notes issued in anticipation of the issuance of general obligation bonds may be issued and outstanding from time to time up to a maximum period of 20 years from the date of issuance of the original notes. The maximum maturity for notes anticipating general obligation bonds payable from special assessments is 5 years. Any period in excess of 5 years must be deducted from the permitted maximum maturity of the bonds anticipated, and portions of the principal amount of notes outstanding for more than five years must be retired in amounts at least equal to and payable no later than those principal maturities that would have been required if the bonds had been issued at the expiration of the initial five year period. Bond anticipation notes may be retired at maturity from the proceeds of the sale of renewal notes or of the bonds anticipated by the notes, or from available funds of the Water System or a combination of these sources.

	Balance			Balance
	1/1/13	Additions	Reductions	12/31/13
2012 Water System Imp. 1.25%	\$ 6,690,000	-	(6,690,000)	-
2013 Water System Imp. 1.00%	<u>-</u>	<u>6,690,000</u>	<u>-</u>	<u>6,690,000</u>
	<u>\$ -</u>	<u>6,690,000</u>	<u>-</u>	<u>6,690,000</u>

	Balance			Balance
	1/1/12	Additions	Reductions	12/31/12
2011 Water System Imp. 2.00%	\$ 5,900,000	-	(5,900,000)	-
2012 Water System Imp. 1.25%	<u>-</u>	<u>6,690,000</u>	<u>-</u>	<u>6,690,000</u>
	<u>\$ -</u>	<u>6,690,000</u>	<u>-</u>	<u>6,690,000</u>

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, 2013, 2012, and 2011 were approximately \$341,000, \$387,000, and \$406,000 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 2013, 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 and Combined Plans was 1.0% during calendar year 2013. 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 Water System's contributions that were used to fund post employment benefits was approximately \$24,000, \$111,000 and \$116,000 for 2013, 2012, and 2011, 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 2013, the portion of the Water System's annual pension cost was \$50,028. The Water System contributed 78.7%, or \$39,361, resulting in a net pension obligation of \$19,880. The net pension obligation for the prior year was \$9,213. The Water System's portion of the total unfunded accrued liability at year end was \$264,613.

For 2012, the portion of the Water System's annual pension cost was \$55,782. The Water 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 Water System's portion of the total unfunded accrued liability at year end was \$313,174.

The actuarial valuation date was December 31, 2013 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 2013, the portion of the Water System's annual OPEB cost was \$11,592. The Water System contributed 87.1%, or \$10,093, resulting in a net OPEB obligation of \$3,115. The net OPEB obligation for the prior year was \$1,617. The Water System's portion of the total unfunded accrued liability at year end was \$164,032.

For 2012, the portion of the Water System's annual OPEB cost was \$11,346. The Water 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 Water System's portion of the total unfunded accrued liability at year end was \$164,697.

The actuarial valuation date was December 31, 2013 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 \$790,465 and \$788,510 from the Electric System are included in operating expenses in 2013 and 2012, 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 \$2,378,000 and \$2,076,000 in 2013 and 2012, 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, 2013, the Water System had contractual commitments in the amounts of approximately \$927,000 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.