

**CITY OF HAMILTON! OHIO
ELECTRIC SYSTEM**

**Financial Statements
Years Ended December 31, 2006 and 2005
With Independent Auditors' Report**



Mary Taylor, CPA
Auditor of State

City Council
City of Hamilton
345 High Street
Hamilton, Ohio 45011

We have reviewed the *Independent Auditors' Report* of the City of Hamilton Electric System, Butler County, prepared by Clark, Schaefer, Hackett & Co., for the audit period January 1, 2006 through December 31, 2006. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

Our review was made in reference to the applicable sections of legislative criteria, as reflected by the Ohio Constitution, and the Revised Code, policies, procedures and guidelines of the Auditor of State, regulations and grant requirements. The City of Hamilton Electric System is responsible for compliance with these laws and regulations.

Mary Taylor

Mary Taylor, CPA
Auditor of State

August 7, 2007

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CITY OF HAMILTON! OHIO – ELECTRIC SYSTEM

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

INDEPENDENT AUDITORS' REPORT

Honorable City Council
City of Hamilton! Ohio

We have audited the accompanying financial statements of the City of Hamilton! Ohio - Electric System, an enterprise fund of the City of Hamilton! Ohio as of and for the years ended December 31, 2006 and 2005, 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 Electric System and do not purport to, and do not, present fairly the financial position of the City of Hamilton! Ohio as of December 31, 2006 and 2005, and the changes in its financial position and cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Hamilton! Ohio - Electric System as of December 31, 2006 and 2005 and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2-6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Clark, Schaefer, Hackett & Co.

Cincinnati, Ohio
June 27, 2007

City of Hamilton, Ohio

Electric System

Management's Discussion and Analysis
For the Year Ended December 31, 2006 and 2005
Unaudited

The discussion and analysis of the City of Hamilton, Ohio's Electric System's financial performance provide an overall review of that system's financial activities for the year ended December 31, 2006 and 2005. 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 2006 are as follows:

- ❑ The assets of the Hamilton Electric System exceeded its liabilities at the close of 2006 by \$3,112,240 and \$88,608 at the close of 2005 (net assets). At December 31, 2006 and 2005, \$14,762,874 and \$17,923,140, respectively (unrestricted net assets) may be used to meet the system's ongoing obligations to customers and creditors.
- ❑ The system's total net assets increased between 2006 and 2005 by \$3,023,632.
- ❑ The system's investment in capital assets, net of related debt increased by \$6,052,961.

Electric System Summary and Using this Annual Report

The City of Hamilton, Ohio has owned and operated an electric utility system since 1893. Currently, the system is the second largest municipally owned electric system in Ohio. The electric system is a fully integrated electric generation, transmission and distribution system. The system owns both thermal and hydroelectric generation facilities and maintains a diverse 27,500 customers. Customer rates are established by the City and are not subject to the regulatory jurisdiction of the Public Utilities Commission of Ohio (PUCO) or any other regulatory body.

This annual report consists only of the Statement of Net Assets, the Statement of Revenues, Expenses and Changes in Net Assets, and the Statement of Cash Flows as well as Notes to the Financial Statements for the City of Hamilton, Ohio's Electric System for the year ended December 31, 2006 and 2005.

Reporting Hamilton's Electric System (Whole and Significant Fund)

The financial statements contained within this report include the City of Hamilton, Ohio's Electric System *only*. Readers desiring to view city-wide financial statements, as well as the impact that the Electric 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 2006 and 2005. The City of Hamilton's Electric System is reported as a business-type, enterprise fund and is considered a major fund for purposes of individual fund reporting. Payments made from the Electric Fund are restricted to Electric System purposes by municipal ordinance, Ohio Revised Code and indentures issued pursuant to long-term financing.

City of Hamilton, Ohio

Electric System

Management's Discussion and Analysis
For the Year Ended December 31, 2006 and 2005
Unaudited

In the Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets, the view of the System looks at all financial transactions of the Electric Fund and asks the question, "How did we do financially during 2006 and 2005?" 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 Electric 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 Electric System charges fees to recoup the cost of the entire operation of the Electric 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 Electric Fund, assets exceeded liabilities by \$3,112,240 as of December 31, 2006. Unrestricted net assets of \$14,762,874, \$17,923,140 and \$14,813,088 for 2006, 2005 and 2004, respectively encompass the largest portion of the net assets of the System.

Table 1 provides a summary of the Electric System's Statement of Net Assets for the Years Ended December 31, 2006, 2005 and 2004.

	2006	2005	2004
Current and Other Assets	\$32,737,760	\$34,452,412	\$30,373,758
Capital Assets	137,698,181	141,445,188	139,955,114
Total Assets	<u>170,435,941</u>	<u>175,897,600</u>	<u>170,328,872</u>
Long-term Liabilities	149,809,753	155,554,084	160,626,130
Other Liabilities	17,516,948	20,254,908	11,072,957
Total Liabilities	<u>167,326,701</u>	<u>175,808,992</u>	<u>171,699,087</u>
Invested in capital assets, net of related debt	(19,130,231)	(25,183,192)	(22,735,080)
Restricted	7,479,597	7,348,660	6,551,777
Unrestricted	14,762,874	17,923,140	14,813,088
Total Net Assets	<u>3,112,240</u>	<u>88,608</u>	<u>(1,370,215)</u>

A vast majority of the System's assets lie within the physical property, plant and equipment of the system having a historical cost less accumulated depreciation of \$137,698,181, \$141,445,188 and \$139,955,114, respectively at December 31, 2006, 2005 and 2004. The System employs these assets in the generation, transmission, and distribution of electricity to customers; consequently,

City of Hamilton, Ohio

Electric System

Management's Discussion and Analysis
For the Year Ended December 31, 2006 and 2005
Unaudited

these assets are not readily available for future spending. The System's investment in its capital assets is reported net of related debt in the Net Assets section of the Statement of Net Assets 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.

As of December 31, 2006, the City is able to report a positive balance in net assets of \$3,112,240. Operating income of \$12,757,537 for 2006, \$9,064,912 for 2005 and \$5,683,252 for 2004 were positive, in light of depreciation expense exceeding \$9,700,000 in all three years, a great deal of which ratably allocates the cost of generation assets. Maintenance of positive operating income is primarily due to controlling the growth of expenses and maintaining rates commensurate with the costs of providing electricity. Interest expense on the City's outstanding long-term revenue bonds was reduced by more than \$2.5 million annually as a function of the refinancing that occurred in 2002.

Statement of Revenues, Expenses and Changes in Net Assets

	2006	2005	2004
Operating Revenues	\$58,694,775	\$59,461,040	\$50,994,645
Operating Expenses:			
Purchased electric	17,983,335	22,755,947	19,421,957
Depreciation	9,792,995	9,816,387	9,805,932
Other Operating Expenses	18,160,908	17,823,794	16,083,504
Total Operating Expenses	45,937,238	50,396,128	45,311,393
Operating income	12,757,537	9,064,912	5,683,252
Non-Operating revenues (expenses)			
Interest and fiscal charges	(8,370,207)	(7,955,916)	(6,974,056)
Other non-operating revenues (expenses)	(1,805,886)	362,328	253,256
Total non-operating revenues (expenses)	(10,176,093)	(7,593,588)	(6,720,800)
Contributions	1,042,400		
Transfers out	(600,212)	(12,501)	-
Change in Net Assets	3,023,632	1,458,823	(1,037,548)
Beginning Net Assets	88,608	(1,370,215)	(332,667)
Ending Net Assets	3,112,240	88,608	(1,370,215)

Purchased Power volume and cost per Mwh decreased significantly in 2006. Purchased Power volumes decreased due to a cooler than average summer weather and lower than normal output at Hamilton's Greenup Hydroelectric Plant.

City of Hamilton, Ohio

Electric System

Management's Discussion and Analysis
For the Year Ended December 31, 2006 and 2005
Unaudited

Capital Assets and Debt Administration

Capital Assets: The City's investment in capital assets of the Electric System as of December 31, 2006, 2005 and 2004 amounted to (\$19.13 Million), (\$25.18 Million) and (\$22.74 Million), respectively, (net of accumulated depreciation and related debt). The negative balances are a direct result of continued depreciation expense coupled with long-term debt balances. This investment in capital assets includes land, buildings, improvements, construction in progress, and machinery and equipment including the City's hydro-electric and thermal generation facilities. The plant and equipment of the Electric System are rigorously tested and maintenance schedules are adhered to in a strenuous fashion to insure safe, long-term, efficient operation.

Note 5 (Capital Assets) provide Electric System asset activity during 2006 and 2005.

Debt Administration: At the end of 2006, the City had outstanding long-term revenue bond issues, the 2002 Electric System Variable Rate Revenue Refunding Bonds totaling \$161,570,000. The City remarketed these bonds to a term fixed rate in 2005.

In March 2005, the City issued \$9,800,000 (Electric System's portion \$2,799,860) in bond anticipation notes that were authorized by Council in December 2004 for the purpose of acquiring, installing and paying all related costs for a new automated meter reading (AMR) system. The installation of meters began in March 2005 and was completed and functioning by September 2006. In September 2006, the City issued bond anticipation notes in the amount of \$8,820,000 (Electric System's portion \$2,520,000) to refinance the note originally issued in March 2005.

In September 2006, the City issued bond anticipation notes in the amount of \$4,500,000 to refinance notes originally issued in 2005. The proceeds of these notes were used to fund construction of an ash removal system and the rebuilding of the #9 turbine, as well as various other projects.

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

Economic Factors and the Future of the System

The City's Electric System is continually monitoring the cost of purchased power, coal and natural gas. However, the cost of coal over the past five years has increased tremendously and the City is required by both ordinance and indentures to pass these cost increases to its customers. The number of customers has remained steady. Debt service coverage has been maintained above indenture required minimums.

The annual budget of the City Electric System is adopted in accordance with ten-year projections developed by a rate consultant, and these projections are updated and reviewed in the spring and fall of each year, or more often as deemed necessary by City Management.

City of Hamilton, Ohio

Electric System

Management's Discussion and Analysis
For the Year Ended December 31, 2006 and 2005
Unaudited

In spite of increasing costs and a focus on replacement, improvement and renewal of system assets, the City's Electric System has prospered. All bond anticipation notes of the City have received a MIG-1 rating, the highest possible rating. The City's Electric System maintains an A3 underlying rating for the system and the 2002 Electric System Revenue Refunding Bonds maintained a VMIG-1 rating.

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 James A. Hanson, CPA, City of Hamilton Finance Director, 345 High Street, Hamilton, Ohio 45011, (513) 785-7161, (email at hansonj@ci.hamilton.oh.us) or visit the City website at www.hamilton-city.org.

**CITY OF HAMILTON! OHIO – ELECTRIC SYSTEM
STATEMENTS OF NET ASSETS
DECEMBER 31, 2006 AND 2005**

	<u>2006</u>	<u>2005</u>
ASSETS		
Current assets:		
Cash and investments	\$ 10,382,089	12,868,881
Accounts receivable (less allowance for uncollectible accounts of \$6,074,407 and \$5,465,802, respectively)	6,437,949	6,669,608
Interest receivable	85,326	34,408
Inventory of supplies at cost	2,801,735	2,046,747
Prepaid expenses	<u>1,762,814</u>	<u>1,337,941</u>
Total current assets	<u>21,469,913</u>	<u>22,957,585</u>
Restricted assets:		
Cash and investments	<u>7,479,597</u>	<u>7,348,660</u>
Bond issuance costs	<u>3,791,250</u>	<u>4,146,167</u>
Capital assets:		
Property, plant and equipment	346,832,902	345,409,251
Construction in progress	13,390,932	10,647,705
Accumulated depreciation	<u>(222,525,653)</u>	<u>(214,611,768)</u>
Total capital assets	<u>137,698,181</u>	<u>141,445,188</u>
Total assets	\$ <u>170,438,941</u>	<u>175,897,600</u>
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 2,401,535	4,362,610
Accrued wages and benefits	159,909	152,705
Accrued liabilities	350	-
Intergovernmental payable	200,325	265,516
Accrued interest payable	1,559,829	1,699,217
General obligation notes payable	7,020,000	7,799,860
Revenue bonds payable - current portion	<u>6,175,000</u>	<u>5,975,000</u>
Total Current Liabilities	<u>17,516,948</u>	<u>20,254,908</u>
Noncurrent Liabilities:		
Customer Deposits Payable	698,907	623,749
Compensated Absences Payable	1,686,184	2,076,815
Revenue Bonds Payable	<u>147,424,662</u>	<u>152,853,520</u>
Total noncurrent liabilities	<u>149,809,753</u>	<u>155,554,084</u>
Total liabilities	<u>167,326,701</u>	<u>175,808,992</u>
NET ASSETS		
Invested in capital assets, net of related debt	(19,130,231)	(25,183,192)
Restricted for debt service	3,479,597	3,348,660
Restricted for rate stabilization	4,000,000	4,000,000
Unrestricted	<u>14,762,874</u>	<u>17,923,140</u>
Total net assets	\$ <u>3,112,240</u>	<u>88,608</u>

See notes to financial statements.

CITY OF HAMILTON! OHIO - ELECTRIC SYSTEM
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
Operating revenues:		
Charges for services	\$ 58,110,970	58,745,995
Other operating revenues	<u>583,805</u>	<u>715,045</u>
Total operating revenues	<u>58,694,775</u>	<u>59,461,040</u>
Operating expenses:		
Personal services	9,015,108	9,558,967
Materials and supplies	907,171	1,559,411
Contractual services	5,423,110	4,403,181
Purchased electric	17,983,335	22,755,947
Depreciation	9,792,995	9,816,387
Other operating expenses	<u>2,815,519</u>	<u>2,302,235</u>
Total operating expenses	<u>45,937,238</u>	<u>50,396,128</u>
Operating income	12,757,537	9,064,912
Non-operating revenues (expenses):		
Investment earnings	900,039	672,269
Loss on disposal of capital assets	(2,705,925)	(309,941)
Interest and fiscal charges	<u>(8,370,207)</u>	<u>(7,955,916)</u>
Total non-operating revenues (expenses)	<u>(10,176,093)</u>	<u>(7,593,588)</u>
Income before contributions and transfers	2,581,444	1,471,324
Contributions	1,042,400	-
Transfers out	<u>(600,212)</u>	<u>(12,501)</u>
Change in net assets	3,023,632	1,458,823
Net assets - beginning of year	<u>88,608</u>	<u>(1,370,215)</u>
Net assets - end of year	\$ <u>3,112,240</u>	<u>88,608</u>

See notes to financial statements.

CITY OF HAMILTON! OHIO - ELECTRIC SYSTEM
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Cash received from customers	\$ 58,926,784	56,891,767
Cash paid for employee services and benefits	(9,565,906)	(9,417,182)
Cash paid to suppliers for goods and services	(25,114,398)	(25,936,698)
Other operating expenses	<u>(4,978,685)</u>	<u>(2,831,148)</u>
Net cash provided by operating activities	<u>19,267,795</u>	<u>18,706,739</u>
Cash flows from noncapital financing activities:		
Transfers to other funds	<u>(600,212)</u>	<u>(12,501)</u>
Net cash used for noncapital financing activities	<u>(600,212)</u>	<u>(12,501)</u>
Cash flows from capital and related financing activities:		
Payments for capital acquisition	(7,781,575)	(11,640,511)
Debt proceeds	14,040,000	7,799,860
Debt principal payments	(20,794,860)	(7,785,000)
Debt interest payments	(7,408,186)	(7,198,212)
Sale of capital assets	<u>72,062</u>	<u>24,109</u>
Net cash used in capital and related financing activities	<u>(21,872,559)</u>	<u>(18,799,754)</u>
Cash flows from investing activities:		
Interest from investments	<u>849,121</u>	<u>661,274</u>
Net cash provided by investing activities	<u>849,121</u>	<u>661,274</u>
Net change in cash and investments	(2,355,855)	555,758
Cash and investments at beginning of year	<u>20,217,541</u>	<u>19,661,783</u>
Cash and investments at end of year	\$ <u><u>17,861,686</u></u>	<u><u>20,217,541</u></u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating Income	\$ 12,757,537	9,064,912
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	9,792,995	9,816,387
Change in Assets and Liabilities:		
(Increase) decrease in receivables	231,659	(1,725,963)
(Increase) decrease in inventory	(754,988)	96,528
(Increase) decrease in prepaid items	(424,873)	(887,720)
Increase (decrease) in customer deposits payable	75,158	83,984
Increase (decrease) in payables	(1,961,075)	2,114,514
Increase (decrease) in accrued liabilities	(383,427)	43,807
Increase (decrease) in intergovernmental payables	<u>(65,191)</u>	<u>100,290</u>
Net cash provided by operating activities	\$ <u><u>19,267,795</u></u>	<u><u>18,706,739</u></u>
Schedule of noncash activities:		
Capital contributions	\$ 1,042,400	-
Change in fair value of investments	(28,760)	(36,385)

See notes to financial statements.

CITY OF HAMILTON! OHIO – ELECTRIC SYSTEM

Notes to Financial Statements Years Ended December 31, 2006 and 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Reporting Entity – The City of Hamilton! Ohio – Electric System (Electric System) is a utility operating as a separate enterprise fund of the City of Hamilton! Ohio (City). The Electric 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 Electric System has elected only to apply Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989 that do not conflict with or contradict GASB pronouncements.

Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Electric 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 Electric 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 Electric 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 Electric System is reported as cash and investments. The Electric 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 Electric 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 \$51,831 and \$53,621 in 2006 and 2005, respectively. Amortization of issuance costs in 2006 and 2005 amounted to \$354,917 and \$367,172, respectively.

Compensated Absences - The Electric 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 Electric System will compensate the employees for the benefits through paid time off or some other means. Sick leave termination benefits are accrued using the vesting method. The liability includes the employees who are currently eligible to receive termination benefits and those employees for whom it is probable that they will become eligible to receive payment in the future. The amount is based on accumulated sick leave and employees' wage rates at year-end.

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

Reclassifications – Certain items from the prior year financial statements have been reclassified to conform to the current year presentation.

2. CASH AND INVESTMENTS

The Electric 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 Electric System totaled \$14,382,089 and \$16,868,881 at December 31, 2006 and 2005, respectively, and consisted of demand deposits, money market funds, U.S. government securities and STAR Ohio. Cash and investments held by trustees were \$3,479,597 and \$3,348,660 as of December 31, 2006 and 2005, 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, 2006.

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, 2006, nearly 96% of the City’s deposits with financial institutions, including the amount of pooled deposits related to the Electric 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 Electric System’s uninsured and uncollateralized deposits.

Investments – The State of Ohio statutes, Electric 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 Electric System, are invested primarily in U.S. governmental agency securities with a credit rating of AAA and an average maximum maturity of 1.19 years and STAR Ohio which has a credit rating of AAAM.

3. ACCOUNTS RECEIVABLE

Receivables at December 31, 2006 and 2005 consist of the following:

		<u>2006</u>	<u>2005</u>
Earned and unbilled consumer accounts	\$	2,965,988	3,509,384
Earned and billed consumer accounts		9,341,258	8,407,768
Other		205,110	218,258
Less allowance for uncollectible accounts		<u>(6,074,407)</u>	<u>(5,465,802)</u>
Total	\$	<u>6,437,949</u>	<u>6,669,608</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 \$7,479,597 and \$7,348,660 at December 31, 2006 and 2005, respectively.

5. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2006 and 2005 was as follows:

	Balance			Balance
	<u>1/1/06</u>	<u>Increases</u>	<u>Decreases</u>	<u>12/31/06</u>
<i>Nondepreciable capital assets:</i>				
Land	\$ 2,280,646	47,491	-	2,328,137
Construction in progress	<u>10,647,705</u>	<u>5,405,195</u>	<u>(2,661,968)</u>	<u>13,390,932</u>
Subtotal	<u>12,928,351</u>	<u>5,452,686</u>	<u>(2,661,968)</u>	<u>15,719,069</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	14,611,152	37,290	-	14,648,442
Machinery and equipment	<u>328,517,453</u>	<u>5,995,967</u>	<u>(4,657,096)</u>	<u>329,856,324</u>
Subtotal	<u>343,128,605</u>	<u>6,033,257</u>	<u>(4,657,096)</u>	<u>344,504,766</u>
Totals at historical cost	<u>356,056,956</u>	<u>11,485,943</u>	<u>(7,319,064)</u>	<u>360,223,835</u>
Less accumulated depreciation:				
Buildings and improvements	5,804,997	178,585	-	5,983,582
Machinery and equipment	<u>208,806,771</u>	<u>9,614,410</u>	<u>(1,879,109)</u>	<u>216,542,072</u>
Total accumulated depreciation	<u>214,611,768</u>	<u>9,792,995</u>	<u>(1,879,109)</u>	<u>222,525,654</u>
Capital assets, net	\$ <u>141,445,188</u>	<u>1,692,948</u>	<u>(5,439,955)</u>	<u>137,698,181</u>
	Balance			Balance
	<u>1/1/05</u>	<u>Increases</u>	<u>Decreases</u>	<u>12/31/05</u>
<i>Nondepreciable capital assets:</i>				
Land	\$ 1,714,625	566,021	-	2,280,646
Construction in progress	<u>3,854,010</u>	<u>6,878,232</u>	<u>(84,537)</u>	<u>10,647,705</u>
Subtotal	<u>5,568,635</u>	<u>7,444,253</u>	<u>(84,537)</u>	<u>12,928,351</u>
<i>Capital assets being depreciated:</i>				
Buildings and improvements	14,536,918	74,234	-	14,611,152
Machinery and equipment	<u>324,819,656</u>	<u>4,206,562</u>	<u>(508,765)</u>	<u>328,517,453</u>
Subtotal	<u>339,356,574</u>	<u>4,280,796</u>	<u>(508,765)</u>	<u>343,128,605</u>
Totals at historical cost	<u>344,925,209</u>	<u>11,725,049</u>	<u>(593,302)</u>	<u>356,056,956</u>
Less accumulated depreciation:				
Buildings and improvements	5,593,417	211,580	-	5,804,997
Machinery and equipment	<u>199,376,679</u>	<u>9,604,807</u>	<u>(174,715)</u>	<u>208,806,771</u>
Total accumulated depreciation	<u>204,970,096</u>	<u>9,816,387</u>	<u>(174,715)</u>	<u>214,611,768</u>
Capital assets, net	\$ <u>139,955,113</u>	<u>1,908,662</u>	<u>(418,587)</u>	<u>141,445,188</u>

6. LONG-TERM DEBT

In 2002, the Electric System issued \$184,360,000 of variable rate revenue refunding bonds to advance refund outstanding revenue bonds of the Electric System. The proceeds from these bonds were placed in an irrevocable trust for the purpose of generating resources for all future debt service payments of the refunded revenue bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the financial statements.

In May 2005, the City converted its 2002 Series A and B Variable Rate Revenue Refunding Bonds from a seven-day floating variable interest rate to a term fixed rate for the remaining term of the bonds. The revenue bonds fully mature in 2025.

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

	Balance January 1, <u>2006</u>	<u>Additions</u>	<u>Reductions</u>	Balance December 31, 2006	Due Within <u>One Year</u>
2002 Electric Variable					
Refunding A/B Bonds	\$ 167,545,000	-	(5,975,000)	161,570,000	6,175,000
Less deferred amount:					
on refunding	(8,110,983)	-	694,311	(7,416,672)	-
for issuance discounts	<u>(605,497)</u>	<u>-</u>	<u>51,831</u>	<u>(553,666)</u>	<u>-</u>
	\$ <u>158,828,520</u>	<u>-</u>	<u>(5,228,858)</u>	<u>153,599,662</u>	<u>6,175,000</u>

Debt activity for the year ended December 31, 2005 was as follows:

	Balance January 1, <u>2005</u>	<u>Additions</u>	<u>Reductions</u>	Balance December 31, 2005	Due Within <u>One Year</u>
2002 Electric Variable					
Refunding A/B Bonds	\$ 173,330,000	-	(5,785,000)	167,545,000	5,975,000
Less deferred amount:					
on refunding	(8,829,267)	-	718,284	(8,110,983)	-
for issuance discounts	<u>(659,118)</u>	<u>-</u>	<u>53,621</u>	<u>(605,497)</u>	<u>-</u>
	\$ <u>163,841,615</u>	<u>-</u>	<u>(5,013,095)</u>	<u>158,828,520</u>	<u>5,975,000</u>

Under the terms of the revenue bond indenture, the City has agreed to certain covenants including, among other things, maintaining revenue levels and providing for operating expenses and debt service. The revenue bonds are insured under municipal bond insurance policies. Under the terms of the policies, the payments of principal and interest are guaranteed by the insurer.

A summary of the System's annual debt service requirements as of December 31, 2006 follows:

		<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$	6,175,000	4,766,315	10,941,315
2008		6,375,000	4,596,712	10,971,712
2009		6,585,000	4,396,061	10,981,061
2010		6,800,000	4,201,833	11,001,833
2011		7,025,000	4,001,233	11,026,233
2012-2016		38,720,000	16,777,276	55,497,276
2017-2021		45,505,000	10,665,840	56,170,840
2022-2025		<u>44,385,000</u>	<u>3,391,639</u>	<u>47,776,639</u>
Total	\$	<u>161,570,000</u>	<u>52,796,909</u>	<u>214,366,909</u>

7. NOTES PAYABLE

In March 2005, the City issued \$9,800,000 (Electric System's portion \$2,799,860) in bond anticipation notes that provided funding to rollover the bond anticipation notes originally issued in 2005. In September 2006, the City issued \$8,820,000 (Electric System's portion \$2,520,000) in bond anticipation notes that provided funding to rollover the bond anticipation notes issued in March 2005, to have a majority of the City's bond anticipation notes mature at the same time. The purpose of the original proceeds was to provide funding for the acquisition and installation of a new automated meter reading system.

In May 2006, the City issued bond anticipation notes in the amount of \$2,000,000 that provided funding to rollover a bond anticipation note originally issued in 2005. In June 2006, the City issued bond anticipation notes in the amount of \$3,000,000 that provided funding to rollover a bond anticipation note originally issued in 2005. In September 2006, the City issued bond anticipation notes in the amount of \$4,500,000 that providing funding to rollover the bond anticipation notes that were issued in May and June 2006, to have all of the City's bond anticipation notes mature at the same time.

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

		Balance January 1, <u>2006</u>	<u>Additions</u>	<u>Reductions</u>	Balance December 31, <u>2006</u>
2006 Electric System Imp. 4.50%	\$	-	9,000,000	(4,500,000)	4,500,000
2006 AMR System 4.25%		-	5,040,000	(2,520,000)	2,520,000
2005 Electric System Imp. 4.00%		2,000,000	-	(2,000,000)	-
2005 Electric System Imp. 3.75%		3,000,000	-	(3,000,000)	-
2005 AMR System 3.50%		<u>2,799,860</u>	<u>-</u>	<u>(2,799,860)</u>	<u>-</u>
	\$	<u>7,799,860</u>	<u>14,040,000</u>	<u>(14,819,860)</u>	<u>7,020,000</u>

Note activity for the year ended December 31, 2005 was as follows:

	Balance January 1, <u>2005</u>	<u>Additions</u>	<u>Reductions</u>	Balance December 31, <u>2005</u>
2004 Electric System Imp. 4.00%	2,000,000	-	(2,000,000)	-
2005 Electric System Imp. 4.00%	-	2,000,000	-	2,000,000
2005 Electric System Imp. 3.75%	-	3,000,000	-	3,000,000
2005 AMR System 3.50%	-	<u>2,799,860</u>	-	<u>2,799,860</u>
	\$ <u>2,000,000</u>	<u>7,799,860</u>	<u>(2,000,000)</u>	<u>7,799,860</u>

8. DEFINED BENEFIT PENSION PLANS AND OTHER POSTEMPLOYMENT BENEFITS

The Electric System contributes to the Ohio Public Employees Retirement System (OPERS) which administers three separate pension plans as described below:

- The Traditional Pension Plan – a cost-sharing multiple-employer defined benefit pension plan.
- The Member-Directed Plan – a defined contribution plan in which the member invests both member and employer contributions (employer contributions vest over five years at 20% per year). Under the Member-Directed Plan, members accumulate retirement assets equal to the value of member and vested employer contributions plus any investment earnings thereon.
- The Combined Plan – a cost sharing multiple-employer defined benefit pension plan. Under the Combined Plan, employer contributions are invested by the retirement system to provide a formula retirement benefit similar in nature to the Traditional Plan benefit. Member contributions, the investment of which is self-directed by the members, accumulate retirement assets in a manner similar to the Member-Directed Plan.

OPERS provides retirement, disability, survivor and death benefits, and annual cost of living adjustments to members and of the Traditional Plan and Combined Plan. Members of the Member-Directed Plan do not qualify for ancillary benefits. The authority to establish and amend benefits is provided by state statute per Chapter 145 of the Ohio Revised Code. OPERS issues a stand-alone financial report that may be obtained by writing to the Ohio Public Employees Retirement System, 277 East Town Street, Columbus, Ohio 43215-4642.

Plan members are required to contribute 9.0% of their annual covered salary. The City was required to contribute 13.70% of covered payroll for employees. The Electric System's required contributions to PERS for the years ended December 31, 2006, 2005, and 2004 were approximately \$935,000, \$1,001,000, and \$925,000 respectively, equal to the required contributions for each year.

OPERS provides postretirement health care coverage to age and service retirees with ten or more years of qualifying Ohio service credit and to primary survivor recipients of such retirees. Health care coverage for disability recipients is available. The health care coverage provided by the retirement system is considered an Other Postemployment Benefit (OPEB) as described in GASB Statement No. 12. A portion of each employer's contribution to PERS is set aside for the funding of postretirement health care based on authority granted by State statute. The 2006 employer contribution rate was 13.70% of covered payroll for employees and 4.0% was the portion that was used to fund health care for the year.

The assumptions and calculations below were based on the System's latest Actuarial Review performed as of December 31, 2005. An entry age normal actuarial cost method of valuation is used in determining the present value of OPEB. The difference between assumed and actual experience (actuarial gains and losses) becomes part of unfunded actuarial accrued liability. All investments are carried at market value. For actuarial valuation purposes, a smoothed market approach is used. Under this approach, assets are adjusted annually to reflect 25% of unrealized market appreciation or depreciation on investment assets. The investment assumption rate for 2005 was 6.50%. An annual increase of 4.00% compounded annually, is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees.

Additionally, annual pay increases, over and above the 4.00% base increase, were assumed to range from 0.50% to 6.3%. Health care costs were assumed to increase at the projected wage inflation rate plus an additional factor ranging from 0.50% to 6.00% for the next 9 years. In subsequent years (10 and beyond) health care costs were assumed to increase 4.00% annually.

The OPEB's are advance-funded on an actuarially determined basis. The number of active contributing participants in the Traditional and Combined Plans totaled 369,214. The portion of the Electric System's contributions that were used to fund postemployment benefits was approximately \$281,000 and \$296,000 in 2006 and 2005, respectively. At December 31, 2005, the actuarial value of the Retirement System's net assets available for OPEB was \$11.1 billion. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$31.3 billion and \$20.2 billion, respectively.

9. RELATED PARTY TRANSACTIONS

Under an arrangement with the City, the Electric System provides street lighting and traffic light services to the City, without charge. Street and traffic light facilities used approximately 10,132,000 kilowatt-hours of electrical energy in both 2006 and 2005 and the estimated operating cost of supplying these free services was \$1,064,000 in each year.

The City's Gas System provides gas to the Electric System for use in the generation of electricity. Gas costs of \$562,000 and \$835,000 in 2006 and 2005, respectively, paid to the Gas System are included in operating expenses.

The Electric System sells electricity to the City's Water and Wastewater Systems. Included in revenues are sales to the Water System and Wastewater System in 2006 and 2005 of approximately \$1,466,000 (\$942,000 and \$524,000) and \$1,395,000 (\$847,000 and \$548,000), respectively.

The Electric System is allocated from the City a portion of the City's administrative cost. In addition, it was charged expenses by the City's internal service funds, which provide services to various City departments. Total expenses for these items were approximately \$3,130,000 and \$2,497,000 in 2006 and 2005, respectively, and are included in other operating expenses.

10. CONTINGENT LIABILITIES

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

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 Electric 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. JOINT VENTURES/JOINTLY GOVERNED ORGANIZATIONS

The City of Hamilton is a member of a number of Governmental Joint Ventures and Jointly Governed Organizations as described in GASB Statement No. 14, The Financial Reporting Entity. The following is a list of organizations and a brief description of the Joint Venture and the Jointly Governed Organizations pertaining specifically to the Electric System of the City.

(a) Amp Ohio, Inc. – The City of Hamilton is a member of American Municipal Power Ohio, Inc. (AMP-OHIO). AMP-OHIO is a non-profit corporation organized under Ohio law and Internal Revenue Code Section 501 and is a jointly governed organization. The organization operates on a non-profit basis for the mutual benefit of its member municipalities, all of whom own or operate a municipal electric system. The non-profit corporation is dedicated to providing member assistance and low-cost power supplies.

The controlling board of AMP-OHIO, Inc. is based upon a representative from several of the member communities. The degree of control exercised by any participating government is limited to its representation on the board. The continued existence of the corporation is not dependent upon the City. Complete financial statements may be obtained from AMP-OHIO, Inc., 2600 Airport Drive, Columbus, Ohio 43219.

(b) Amp Ohio, Inc. – OMEGA JV2 Project – In December 2000, the City became a part of the OMEGA (Ohio Municipal Energy Generation Association) JV2 Project. The OMEGA JV2 project is a joint venture among the City of Hamilton and 35 other participating municipalities created under the auspices of the Ohio Constitution section XVIII, Sections 3 and 4 and Ohio Revised Code Section 715.02. All of the participating communities are members of AMP-OHIO, Inc. and the joint venture has appointed that non-profit corporation to perform certain management functions. The purpose of the joint venture is to create distributive generation among the participating members allowing for increased electric production capacity during peak demand. The degree of control exercised by any participating member is weighted in proportion to each participant's project share, which is 23.87% for the City (a non-majority voting position). Project share is equal to the amount of the distributive generation capacity for each of the members. Membership in the joint venture is defined as financing or non-financing Participant, as well as owner or purchasing participant, for which the City qualified as a financing, purchasing participant. As a financing participant, the City makes payments to OMEGA JV2.

Dated January 1, 2001, AMP-Ohio on behalf of OMEGA JV2 participants issued \$50,260,000 of Distributive Generation Bonds, supported by financing participant payments. The issuance of the bonds retired \$50,000,000 of AMP-OHIO, Inc.'s Distributive Generation Notes, financing the remaining un-funded portion of the project and pay issuance costs. The Bonds do not represent an obligation on behalf of the financing participants to levy or pledge any form of taxation nor any mortgage on or interest in the project or the City's electric system or fund. The following amounts were expended by the Electric Fund and recorded within the Purchase of Electric expense account to the OMEGA JV2 in 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Annual capacity	\$ 1,165,798	1,196,519
Power purchases	<u>4,032,840</u>	<u>6,200,000</u>
 Total payments	 \$ <u>5,198,638</u>	 <u>7,396,519</u>

The continued existence of OMEGA JV2 is dependent upon the City's continued participation but the City, as a purchaser participant, does not have an equity interest in OMEGA JV2. Complete financial statements may be obtained from AMP-OHIO, Inc., 2600 Airport Drive, Columbus, Ohio 43219.

13. CONTRACTUAL COMMITMENTS

As of December 31, 2006 and 2005, the Electric System had contractual commitments of approximately \$6,212,000 and \$6,719,000 respectively to purchase coal and electricity.

14. CLOSURE OF THE ELECTRIC SYSTEM TO COMPETITION

In March 2002, the Hamilton City Council adopted an ordinance effectively closing the municipal borders of the City to electric deregulation. With the adoption of the ordinance, electric customers within these corporate boundaries must purchase their electricity from the Hamilton Electric System.



Mary Taylor, CPA
Auditor of State

CITY OF HAMILTON ELECTRIC SYSTEM

BUTLER COUNTY

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
AUGUST 21, 2007**