

**Municipal Energy
Services Agency**
Financial Statements
December 31, 2006 and 2005

Municipal Energy Services Agency

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December 31, 2006 and 2005

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Report of Independent Auditors

Board of Participants
Municipal Energy Services Agency

In our opinion, the accompanying balance sheets and the related statements of revenues, expenses and changes in net assets and of cash flows present fairly, in all material respects, the financial position of Municipal Energy Services Agency ("MESA") at December 31, 2006 and 2005, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of MESA's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The management's discussion and analysis on pages 2 through 3 are not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. 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.

In accordance with *Government Auditing Standards*, we also have issued our report dated April 18, 2007 on our consideration of MESA's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants for the year ended December 31, 2006. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

PricewaterhouseCoopers LLP

Columbus, Ohio
April 18, 2007

Municipal Energy Services Agency Management's Discussion and Analysis

Financial Statement Overview

This discussion and analysis provides an overview of the financial performance of Municipal Energy Services Agency ("MESA") for the years ended December 31, 2006 and 2005. The information presented should be read in conjunction with the basic financial statements and the accompanying notes.

MESA prepares its basic financial statements on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. MESA's basic financial statements include the balance sheet; the statement of revenues, expenses and changes in net assets; and the statement of cash flows.

The balance sheet provides information about the nature and amount of assets and liabilities of MESA as of the end of the year. The statement of revenues, expenses and changes in net assets reports revenues and expenses for the year. The statement of cash flows reports cash receipts, cash payments, and net changes in cash resulting from operating, noncapital financing, investing and capital and related financing activities.

Financial Highlights

The following table summarizes the financial position of MESA as of December 31:

Condensed Balance Sheets

	2006	2005	2004
Assets			
Current assets	\$ 2,800,531	\$ 3,996,195	\$ 2,137,694
Property, net of accumulated depreciation	<u>71,271</u>	<u>66,914</u>	<u>72,553</u>
Total assets	<u>\$ 2,871,802</u>	<u>\$ 4,063,109</u>	<u>\$ 2,210,247</u>
Liabilities and Net Assets			
Current liabilities	\$ 2,871,802	\$ 4,063,109	\$ 2,210,247
Net assets	<u>-</u>	<u>-</u>	<u>-</u>
Total liabilities and net assets	<u>\$ 2,871,802</u>	<u>\$ 4,063,109</u>	<u>\$ 2,210,247</u>

Total assets of \$2,871,802 decreased \$1,191,307 or 29.3% in 2006. This compares to an increase of total assets of \$1,852,862 or 83.8% in 2005 compared to 2004.

Current assets as of December 31, 2006 were \$2,800,531. This was a decrease in 2006 of \$1,195,664 or 29.9% compared to 2005. In 2006, cash increased \$311,881. Accounts receivable decreased \$1,106,901, due primarily to a decrease of \$1,196,076 related to projects that were completed for members. Projects in progress on behalf of members not yet invoiced decreased \$334,887. Prepaid insurance decreased \$65,757 primarily as a result of timing of payments. The January 2006 health insurance premiums were paid in December 2005. In 2005, cash decreased \$33,976. Accounts receivable increased \$1,052,867, due primarily to an increase of \$1,098,425 related to projects that were completed for members. Projects in progress on behalf of members not yet invoiced increased \$904,150. Prepaid insurance decreased \$64,540 primarily as a result of timing of payments. The 2005 insurance premium was paid in December 2004.

Property, net of accumulated depreciation, at December 31, 2006 was \$71,271. This was an increase of \$4,357 or 6.5% in 2006 compared to 2005. MESA's property consists entirely of vehicles, the cost of which at the end of 2006 was \$247,765. This was an increase of \$65,721 in 2006 compared to 2005.

Municipal Energy Services Agency Management's Discussion and Analysis

Accumulated depreciation in 2006 increased \$61,364 compared to 2005. Property, net of accumulated depreciation decreased \$5,639 or 7.8% in 2005 compared to 2004 due to the purchase of vehicles net of accumulated depreciation. All vehicles are depreciated over a three year life.

Current liabilities as of December 31, 2006 were \$2,871,802. This was a decrease of \$1,191,307 or 29.3% in 2006 compared to 2005. The decrease in 2006 was due primarily to a decrease in accounts payable of \$1,737,853 relating to purchasing materials for projects constructed on behalf of members. This was offset by an increase in accrued salaries and benefits of \$141,274, an increase in compensated absences of \$168,704, and an increase in payables to related parties of \$236,568. Current liabilities increased by \$1,852,862 or 83.8% in 2005. The increase in 2005 was due primarily to an increase in accounts payable of \$1,912,037 relating to purchasing materials for projects constructed on behalf of members. In addition, there was at year-end \$346,000 payable to related parties. In 2005, advance payments for projects constructed on behalf of members decreased by \$578,384.

The following table summarizes the changes in revenues, expenses and changes in net assets of MESA for the years ended December 31:

Condensed Statement of Revenues, Expenses, and Changes in Net Assets

	2006	2005	2004
Operating revenues	\$ 12,667,892	\$ 19,799,064	\$ 8,231,712
Operating expenses	<u>12,696,055</u>	<u>19,829,309</u>	<u>8,243,692</u>
Operating loss	<u>(28,163)</u>	<u>(30,245)</u>	<u>(11,980)</u>
Nonoperating revenue			
Investment income	<u>28,163</u>	<u>30,245</u>	<u>11,980</u>
Change in net assets	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Operating revenues in 2006 were \$12,667,892, which was a decrease of \$7,131,172 or 36.0%. MESA has primarily two sources of revenues, projects for members and providing personnel services to related parties. The \$7,131,172 decrease in revenues for 2006 was due primarily to a decrease in revenue from projects being engineered, managed or constructed on-behalf of members totaling \$8,007,279. Personnel services to related parties increased \$876,107 in 2006. Operating revenues increased \$11,567,352 or 140.5% in 2005 compared to 2004. The \$11,567,352 increase in revenues for 2005 was due primarily to projects being engineered, managed or constructed on-behalf of members totaling \$10,877,868. Personnel services to related parties increased \$689,484 in 2005.

Operating expenses in 2006 were \$12,696,055, which was a decrease of \$7,133,254 or 36.0%. The decrease of \$7,133,254 in 2006 was primarily related to a decrease in expenses related to projects on-behalf of members which decreased \$8,089,583, while MESA's payroll and related benefits increased \$811,680 in 2006. Operating expenses increased \$11,585,617 or 140.5% in 2005. The increase of \$11,585,617 in 2005 was primarily related to projects on-behalf of members which increased \$10,888,942, while MESA's payroll and related benefits increased \$663,298 in 2005.

Investment income in 2006 was \$28,163, which was a decrease of \$2,082 or 6.9% for 2006. Investment income for MESA is limited to interest earned on checking account for the Operating Funds held at the bank. Investment income in 2005 was \$30,245, which was an increase of \$18,265 or 152.5%. The increase in 2005 was a result of higher average cash balances invested at higher interest rates.

Municipal Energy Services Agency

Balance Sheets

December 31, 2006 and 2005

	2006	2005
Assets		
Current assets		
Cash and cash equivalents	\$ 1,268,936	\$ 957,055
Receivables from AMP-Ohio members	58,152	1,254,228
Receivables from related parties	711,586	622,411
Costs and recoveries in excess of billings from projects constructed on behalf of members	753,857	1,088,744
Prepaid expenses	8,000	73,757
Total current assets	<u>2,800,531</u>	<u>3,996,195</u>
Property		
Vehicles	247,765	182,044
Accumulated depreciation	(176,494)	(115,130)
Total property	<u>71,271</u>	<u>66,914</u>
Total assets	<u>\$ 2,871,802</u>	<u>\$ 4,063,109</u>
Net Assets and Liabilities		
Net assets		
Invested in capital assets, net of related debt	\$ 71,271	\$ 66,914
Unrestricted	(71,271)	(66,914)
Total net assets	<u>-</u>	<u>-</u>
Current liabilities		
Accrued salaries and related benefits	586,411	445,137
Compensated absences	1,435,145	1,266,441
Accounts payable and accrued expenses	267,678	2,005,531
Payable to related party	582,568	346,000
Total current liabilities	<u>2,871,802</u>	<u>4,063,109</u>
Total net assets and liabilities	<u>\$ 2,871,802</u>	<u>\$ 4,063,109</u>

The accompanying notes are an integral part of these financial statements.

Municipal Energy Services Agency
Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended December 31, 2006 and 2005

	2006	2005
Operating Revenues		
Services	\$ 8,975,111	\$ 8,099,004
Project revenue	3,692,781	11,700,060
Total operating revenues	12,667,892	19,799,064
Operating Expenses		
Salaries and related benefits	8,598,316	7,786,636
Depreciation	61,364	46,568
Professional fees	110,202	59,981
Direct project expenses	3,708,629	11,798,212
Insurance	90,032	87,024
Utilities	32,885	26,501
Other operating expenses	94,627	24,387
Total operating expenses	12,696,055	19,829,309
Operating loss	(28,163)	(30,245)
Nonoperating Revenues		
Investment income and other	28,163	30,245
Change in net assets	-	-
Net assets, beginning of year	-	-
Net assets, end of year	\$ -	\$ -

The accompanying notes are an integral part of these financial statements.

Municipal Energy Services Agency
Statements of Cash Flows
Years Ended December 31, 2006 and 2005

	2006	2005
Cash flows from operating activities		
Cash received from AMP-Ohio members for services	\$ 5,223,744	\$ 9,119,101
Cash received from related parties for services	8,949,504	8,144,562
Cash payments to employees for services	(8,466,919)	(7,882,561)
Cash payments to suppliers and related parties for goods and services	<u>(5,529,890)</u>	<u>(9,748,045)</u>
Net cash provided by (used in) operating activities	<u>176,439</u>	<u>(366,943)</u>
Cash flows from noncapital financing activities		
Proceeds from payable to related party	<u>173,000</u>	<u>346,000</u>
Net cash provided by noncapital financing activities	<u>173,000</u>	<u>346,000</u>
Cash flows from capital and related financing activities		
Purchases of vehicles	<u>(65,721)</u>	<u>(43,278)</u>
Net cash used in capital and related financing activities	<u>(65,721)</u>	<u>(43,278)</u>
Cash flows from investing activities		
Investment income received	<u>28,163</u>	<u>30,245</u>
Net cash provided by investing activities	<u>28,163</u>	<u>30,245</u>
Net change in cash and cash equivalents	311,881	(33,976)
Cash and cash equivalents, beginning of year	<u>957,055</u>	<u>991,031</u>
Cash and cash equivalents, end of year	<u>\$ 1,268,936</u>	<u>\$ 957,055</u>
Reconciliation of operating loss to net cash provided by (used in) operating activities		
Operating loss	\$ (28,163)	\$ (30,245)
Depreciation	61,364	48,917
Changes in assets and liabilities		
Receivables from AMP-Ohio members	1,196,076	(1,098,425)
Receivables from related parties	(89,175)	45,558
Costs and estimated earnings in excess of billings from projects constructed on behalf of members	334,887	(904,150)
Prepaid expenses	65,757	64,540
Accrued salaries and related benefits	141,274	2,302
Compensated absences	168,704	160,313
Accounts payable and accrued expenses	(1,737,853)	1,922,631
Billing in excess of costs and estimated earnings for projects constructed on behalf of members	-	(578,384)
Accounts payable to related parties	<u>63,568</u>	<u>-</u>
Net cash provided by (used in) operating activities	<u>\$ 176,439</u>	<u>\$ (366,943)</u>

The accompanying notes are an integral part of these financial statements.

Municipal Energy Services Agency
Notes to Financial Statements
December 31, 2006 and 2005

1. Organization

Municipal Energy Services Agency ("MESA") was organized by 31 subdivisions of the State of Ohio (the "Participants") on December 31, 1996, pursuant to a Joint Venture Agreement (the "Agreement") under the Ohio Constitution and Section 715.02 of the Ohio Revised Code. As of December 31, 2006, there were 48 Participants in MESA. Its purpose is to provide access to a pool of personnel experienced in planning, engineering, construction, safety training, finance, administration and other aspects of the operation and maintenance of municipal electric and other utility systems. The participants are members of American Municipal Power-Ohio, Inc. ("AMP-Ohio"). MESA also provides personnel and administrative services to AMP-Ohio, the Ohio Municipal Electric Generation Agency Joint Ventures: 1, 2, 4, 5, and 6 ("OMEGA JVs"), the Ohio Municipal Electric Association ("OMEA") and the Ohio Public Power Educational Institute ("OPPEI"). The Agreement continues until December 31, 2006, and thereafter for successive terms of three years so long as at least two participants have not given notice of termination of participation. At December 31, 2006, no notice of termination has been received.

2. Summary of Significant Accounting Policies

The following summarizes the significant accounting policies followed by MESA.

Basis of Accounting

The accounts are maintained on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. MESA applies all Financial Accounting Standards Board ("FASB") statements and interpretations except those that conflict with or contradict Governmental Accounting Standards Board ("GASB") pronouncements.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents consist of unrestricted cash and highly liquid short-term investments with original maturities of three months or less. Restricted cash accounts, if any, are treated as investments in the statements of cash flows.

Property

Property is recorded at cost. Depreciation is provided on the straight-line method over three years, the estimated useful life of the assets. Major renewals, betterments and replacements are capitalized, while maintenance and repair costs are charged to operations as incurred. The cost and related accumulated depreciation of assets retired or otherwise disposed of are removed from the related accounts, and the resulting gains or losses are recognized in the statements of operations.

Property is assessed for impairment whenever events or changes in circumstances indicate that the service utility of the capital asset may have significantly and unexpectedly declined. If it is determined that an impairment has occurred, an impairment loss is recognized for the amount by which the carrying amount of the asset exceeds its estimated fair value.

Compensated Absences

MESA records a liability for compensated absences attributable to services rendered. Vacation leave for which employees can receive compensation in a future period is recorded as earned by the employees. Sick leave is recorded for those employees who currently are eligible to receive termination payments as well as other employees who are expected to become eligible in the future to receive such payments.

Municipal Energy Services Agency
Notes to Financial Statements
December 31, 2006 and 2005

Service Revenue and Expenses

Revenues are recognized as services are performed. Service revenue is charged to AMP-Ohio, the OMEGA JVs, OMEA and OPPEI at a rate to recover the cost of salaries incurred related to work performed for each entity plus an overhead rate ranging from 35 percent to 120 percent. To the extent that the overhead amount charged to the entities is different from actual overhead charges incurred, MESA adjusts the amount charged to AMP-Ohio. AMP-Ohio absorbs any undercharges and uses any excess charges to offset other administrative expenses incurred, which benefit all members of AMP-Ohio.

Project Revenue and Expenses

MESA performs short-term and long-term construction and technical service projects for the members of AMP-Ohio. Short-term service project revenues are recognized when costs are incurred. Long-term project revenues are recognized in accordance with the American Institute of Certified Public Accountants Statement of Position 81-1 ("SOP 81-1"), *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* for time and materials contracts. In accordance with SOP 81-1, revenue from time and material contracts is recognized to the extent of billable rates times hours delivered plus materials and expenses incurred. Materials and expenses are typically billed at cost. General and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted projects are made in the period in which such losses are identified. Changes in project performance, project conditions and estimated profitability are recognized in the period in which the revisions become known.

Costs and recoveries in excess of billings from projects constructed on behalf of members represent unbilled services and reimbursable materials and expenses associated with ongoing projects. Billings in excess of costs and recoveries for projects constructed on behalf of members represent advanced billings for services to be performed at a future date for ongoing projects. Direct project expenses include an allocation of operating expenses.

Use of Estimates

The preparation of 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 reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Accounting Standards

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 157 ("FAS 157"), *Fair Value Measurements*. This standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This standard applies under other accounting pronouncements that require or permit fair value measurements. This standard is effective for financial standards issued for fiscal years beginning after November 15, 2007. MESA is evaluating the effect this standard may have on its financial statements.

Municipal Energy Services Agency
Notes to Financial Statements
December 31, 2006 and 2005

3. Property

Property activity for the years ended December 31 is as follows:

	2006		
	Beginning Balance	Additions	Ending Balance
Vehicles	\$ 182,044	\$ 65,721	\$ 247,765
Less: Accumulated depreciation	(115,130)	(61,364)	(176,494)
Vehicles, net	<u>\$ 66,914</u>	<u>\$ 4,357</u>	<u>\$ 71,271</u>
	2005		
	Beginning Balance	Additions	Ending Balance
Vehicles	\$ 138,766	\$ 43,278	\$ 182,044
Less: Accumulated depreciation	(66,213)	(48,917)	(115,130)
Vehicles, net	<u>\$ 72,553</u>	<u>\$ (5,639)</u>	<u>\$ 66,914</u>

4. Related Party Transactions

Pursuant to the Agreement, AMP-Ohio was designated as an agent and provides MESA various management and operational services. As MESA's agent, AMP-Ohio enters into agreements with related entities to have MESA provide services. Revenues earned from these agreements for the years ended December 31 are as follows:

	2006	2005
AMP-Ohio	\$ 6,891,510	\$ 6,079,642
Ohio Municipal Electric Generation Agency Joint Venture 1	61,133	65,172
Ohio Municipal Electric Generation Agency Joint Venture 2	513,836	485,550
Ohio Municipal Electric Generation Agency Joint Venture 4	42,210	100,137
Ohio Municipal Electric Generation Agency Joint Venture 5	925,951	787,726
Ohio Municipal Electric Generation Agency Joint Venture 6	63,142	87,646
Ohio Municipal Electric Association	303,037	323,743
Ohio Public Power Educational Institute	174,292	169,388
AMP-Ohio Members	3,692,781	11,700,060
Total	<u>\$ 12,667,892</u>	<u>\$ 19,799,064</u>

At December 31, 2006 and 2005, MESA had receivables from affiliates of \$711,586 and \$622,411, respectively. At December 31, 2006 and 2005, MESA had a receivable from members of AMP-Ohio of \$58,152 and \$1,254,228, respectively.

During 2006 and 2005, MESA borrowed \$173,000 and \$346,000 from AMP-Ohio, respectively. AMP-Ohio is charging MESA an interest rate equivalent to the rate on AMP-Ohio's line of credit which is variable based on prime or LIBOR, depending on AMP-Ohio's interest coverage ratio. The borrowing does not have a set maturity.

Municipal Energy Services Agency
Notes to Financial Statements
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5. Cash and Cash Equivalents

Deposits

Custodial risk is the risk that in the event of a bank failure, MESA's deposits may not be returned to it. MESA does not have a custodial credit risk policy. MESA has custodial credit risk on its cash and cash equivalent balance to the extent the balance exceeds the federally insured limit of \$100,000.

Credit Risk

MESA invests in instruments allowed under the Ohio Revised Code, Chapter 135. At December 31, 2006 and 2005, MESA had investments of \$1,268,817 and \$957,055, respectively, in a public funds money market account. In general, money market funds are not rated.

6. Risk Management

MESA is covered under the insurance policies of AMP-Ohio and is billed for its proportionate share of the insurance expense. AMP-Ohio maintains insurance policies related to commercial property, motor vehicle liability, workers' compensation, excess liability, general liability, directors' and officers' insurance, fiduciary liability, crime and fidelity coverage. In addition, MESA maintains an errors and omissions policy related to engineering services it performs.

7. Pension Plans

Ohio Public Employees Retirement System

All full-time permanent employees of MESA participate in the Ohio Public Employees Retirement System ("OPERS"), a statewide cost-sharing multiple-employer defined benefit public pension plan. The Ohio Revised Code provides the statutory authority requiring public employees to fund postretirement health care through their contributions to OPERS. OPERS provides retirement and disability benefits, annual cost of living adjustments and death benefits to plan members and beneficiaries. Authority to establish and amend benefits is provided by State Statute per Chapter 145 of the Ohio Revised Code ("ORC").

The ORC provides statutory authority for employee and employer contributions. The employee contribution rate effective for 2006 was 9.0%. The contribution rate effective for 2005, 2004, and 2003 was 8.5%. The 2006 employer contribution rate was 13.7%. The 2005, 2004, and 2003 employer contribution rate was 13.55% of covered payroll.

The employee contributions to OPERS totaled \$578,480, \$498,078, and \$464,032 for the years ended December 31, 2006, 2005, and 2004, respectively. Employer contributions were \$880,574, \$793,987, and \$739,714 for the years ended December 31, 2006, 2005, and 2004, respectively.

Municipal Energy Services Agency
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Postemployment Benefits

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; and the Combined Plan—a cost-sharing, multiple-employer defined benefit pension plan that has elements of both a defined benefit and defined contribution plan.

OPERS provides retirement, disability, and survivor benefits as well as postretirement health care coverage 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 postemployment health care coverage.

In order to qualify for postretirement 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 No.12.

A portion of each employer's contribution to OPERS is set aside for the funding of postretirement health care. The ORC provides statutory authority requiring public employers to fund health care through their contributions to OPERS. The 2006 employer contribution rate was 13.7% of covered payroll; 4.5% of the employer contribution was used to fund health care for the year. These rates are the actuarially determined contribution requirement for OPERS. MESA's employer contributions to OPERS totaled \$880,574 and \$793,987 in 2006 and 2005, respectively. Of this amount, approximately \$289,269 and \$260,824 was used to fund postemployment benefits in 2006 and 2005, respectively.

The Health Care Preservation Plan (“HCPP”) adopted by the OPERS Retirement Board on September 9, 2004, is effective January 1, 2007. OPERS took additional actions to improve the solvency of the Health Care Fund in 2005 by creating a separate investment pool for health care assets. Member and employer contribution rates increased as of January 1, 2006 and January 1, 2007, which will allow additional funds to be allocated to the health care plan.

The Traditional Pension and Combined Plans had 369,214 active contributing participants as of December 31, 2006. The number of active contributing participants for both plans used in the December 31, 2005 actuarial valuation was 358,804.

The amount of \$11.1 billion represents the actuarial value of OPERS' net assets available for OPEB at December 31, 2005.

Based on the actuarial cost method used, the Actuarial Valuation as of December 31, 2005 reported the actuarial accrued liability and the unfunded actuarial accrued liability for OPEB at \$31.3 billion and \$20.2 billion, respectively.

Municipal Energy Services Agency
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The following assumptions are applicable:

Actuarial Review—The assumptions and calculations were based on OPERS' latest actuarial review performed as of December 31, 2005.

Funding Method—The individual entry age 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.

Assets Valuation Method—All investments are carried at market value. For actuarial valuation purposes, a smoothed market approach is used. Under this approach, assets are adjusted to reflect 25% of unrealized market appreciation or depreciation on investment assets annually, not to exceed a 12% corridor.

Investment Return—The investment assumption rate for 2005 was 6.50%.

Active Employee Total Payroll—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 6.30%.

Health Care—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 nine years. In subsequent years, (ten and beyond) health care costs were assumed to increase at 4.00% (the projected wage inflation rate).

OPERS issues a stand-alone financial report. Interested parties may obtain a copy by writing to: OPERS, 277 East Town Street, Columbus, OH 43215-4642.

**Report of Independent Auditors on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

Board of Participants
Municipal Energy Services Agency

We have audited the financial statements of Municipal Energy Services Agency ("MESA") as of and for the year ended December 31, 2006, and have issued our report thereon dated April 18, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered MESA's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of MESA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of MESA's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether MESA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of MESA in a separate letter dated April 18, 2007.

This report is intended solely for the information and use of the Board of Participants, management and the Auditor of the State of Ohio and is not intended to be and should not be used by anyone other than those specified parties.

PricewaterhouseCoopers LLP

Columbus, Ohio
April 18, 2007