

City of Lancaster Sewer Fund

Financial Statements and Required
Supplementary Information

Years Ended December 31, 2012 and 2011
with Independent Auditor's Report

CITY OF LANCASTER SEWER FUND

YEARS ENDED DECEMBER 31, 2012 AND 2011

TABLE OF CONTENTS

Independent Auditor's Report

Financial Statements:

Balance Sheets	1
Statements of Revenues, Expenses, and Changes in Fund Net Position	3
Statements of Cash Flows	4
Notes to Financial Statements	6

Required Supplementary Information:

Schedule of Funding Progress – Pension Plan (Unaudited) and Schedule of Employer Contributions – Pension Plan (Unaudited)	30
Schedule of Funding Progress – OPEB (Unaudited) and Schedule of Employer Contributions – OPEB (Unaudited)	31

Supplementary Information:

Schedule of Net Cost of Operations of the City Sewer System	32
Schedule of Direct Expenses and Costs	33
Schedule of Cost of Treating Each 1,000 Gallons of Sewage	34

Independent Auditor's Report

To the Honorable J. Richard Gray, Mayor
and Members of City Council
City of Lancaster, Pennsylvania

Report on the Financial Statements

We have audited the accompanying financial statements of the Sewer Fund of the City of Lancaster, as of and for the years ended December 31, 2012 and 2011, 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.

Auditor's Responsibility

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 audits 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 auditor's 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Sewer Fund of the City of Lancaster as of December 31, 2012 and 2011, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the Sewer Fund and do not purport to, and do not, present fairly the financial position of the City of Lancaster, as of December 31, 2012 and 2011, the changes in its financial position, or, where applicable, its 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

Management has omitted the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

Accounting principles generally accepted in the United States of America require that the schedules of funding progress and employer contributions on pages 30 and 31 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 audits 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.

To the Honorable J. Richard Gray, Mayor
and Members of City Council
City of Lancaster, Pennsylvania
Independent Auditor's Report
Page 3 of 3

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Sewer Fund's basic financial statements. The Schedules of Net Cost of Operations of the City Sewer System, Direct Expenses and Costs, and Cost of Treating Each 1,000 Gallons of Sewage (collectively, supplementary information) are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Maher Duessel

Harrisburg, Pennsylvania
July 25, 2013

CITY OF LANCASTER SEWER FUND

BALANCE SHEETS

DECEMBER 31, 2012 AND 2011

Assets	<u>2012</u>	<u>2011</u>
Current assets:		
Cash and cash equivalents	\$ 300	\$ 255,625
Cash and cash equivalents - restricted	31,493,524	39,812,075
Investments - restricted	1,485,644	3,134,876
Receivables:		
Regular	1,375,307	1,051,325
Bulk - net of allowance for uncollectible accounts of \$7,127,509 and \$6,324,268 in 2012 and 2011, respectively	1,255,436	747,469
Unbilled	690,882	629,422
Industrial waste surcharge	87,859	52,945
Prepaid expenses	7,822	1,158
Total current assets	<u>36,396,774</u>	<u>45,684,895</u>
Long-term assets:		
Due from other governments	53,489	43,318
Debt issuance costs, net of accumulated amortization of \$193,189 and \$132,456 in 2012 and 2011, respectively	668,763	729,496
Capital assets, not being depreciated	2,460,939	1,656,758
Capital assets, being depreciated, net	79,192,879	67,602,923
Total long-term assets	<u>82,376,070</u>	<u>70,032,495</u>
Total Assets	<u><u>\$ 118,772,844</u></u>	<u><u>\$ 115,717,390</u></u>

	2012	2011
Liabilities and Net Position		
Liabilities:		
Current liabilities:		
Accounts payable	\$ 3,539,144	\$ 2,363,290
Accrued expenses	340,320	334,746
Due to City of Lancaster general fund	3,206,487	2,265,000
Due to other governments	6,709,509	11,906,612
Unearned revenue	185,000	185,000
Compensated absences, current portion	15,382	23,977
Workers' compensation payable, current portion	481	2,483
Capital lease, current portion	97,796	93,726
Notes payable, current portion	840,000	820,000
Bonds payable, current portion	535,000	515,000
Total current liabilities	<u>15,469,119</u>	<u>18,509,834</u>
Long-term liabilities:		
Due to other governments	469,070	470,181
Compensated absences, net of current portion	50,299	47,844
Workers' compensation payable, net of current portion	1,523	8,402
Net other post-employment liability	2,495,243	2,094,900
Capital lease, net of current portion	219,926	275,107
Notes payable, net of current portion	10,670,000	11,510,000
Bonds payable, net of current portion	31,642,816	32,131,114
Total long-term liabilities	<u>45,548,877</u>	<u>46,537,548</u>
Total Liabilities	<u>61,017,996</u>	<u>65,047,382</u>
Net Position:		
Net investment in capital assets	60,089,151	47,587,737
Restricted for capital acquisition	3,781,116	6,878,471
Unrestricted	(6,115,419)	(3,796,200)
Total Net Position	<u>57,754,848</u>	<u>50,670,008</u>
Total Liabilities and Net Position	<u><u>\$ 118,772,844</u></u>	<u><u>\$ 115,717,390</u></u>

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

CITY OF LANCASTER SEWER FUND
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES
IN FUND NET POSITION

YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
Operating Revenues:		
Sewage treatment revenue:		
Sewage treatment	\$ 8,155,986	\$ 6,250,170
Industrial waste surcharge	499,064	422,829
Bulk treatment	3,145,838	3,125,620
Maintenance fee income	192,011	191,213
Miscellaneous	162,196	300,985
Total operating revenues	12,155,095	10,290,817
Operating Expenses:		
Administration	3,385,101	3,229,603
Depreciation	2,569,361	2,504,416
Collection system	641,653	595,189
Sewage pumping station	1,044,558	1,245,053
Sewage treatment plants	4,421,333	4,701,665
Sewer grounds maintenance	135,200	113,947
Wastewater and green infrastructure	199,349	-
Total operating expenses	12,396,555	12,389,873
Operating Loss	(241,460)	(2,099,056)
Non-Operating Revenue (Expenses):		
State pension contribution	85,704	79,942
Grant revenue	79,691	-
Investment income	58,247	46,818
Amortization expense	(60,732)	(47,005)
Interest expense	(1,928,101)	(1,094,628)
Loss on sale of capital assets	-	(57,396)
Total non-operating revenue (expenses)	(1,765,191)	(1,072,269)
Loss before transfers and capital contributions	(2,006,651)	(3,171,325)
Transfers in	3,613,269	143,984
Capital contributions	4,316,222	846,612
Change in Net Position before Extraordinary Item	5,922,840	(2,180,729)
Extraordinary Item:		
Legal settlement (Note 12)	1,162,000	-
Change in Net Position	7,084,840	(2,180,729)
Net Position:		
Beginning of year	50,670,008	52,850,737
End of year	\$ 57,754,848	\$ 50,670,008

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

CITY OF LANCASTER SEWER FUND

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
Cash Flows From Operating Activities:		
Cash received from users	\$ 11,216,601	\$ 9,935,577
Cash paid to suppliers	(5,541,080)	(6,217,004)
Cash paid to employees	(2,215,641)	(2,200,974)
	3,459,880	1,517,599
Cash Flows From Investing Activities:		
Net sale (purchase) of investments	1,649,232	(2,662,577)
Investment income	58,247	46,818
	1,707,479	(2,615,759)
Cash Flows From Capital and Related Financing Activities:		
Principal payments on note payable	(820,000)	(860,000)
Principal payments on capital lease	(105,649)	(106,629)
Proceeds from bonds payable	-	22,648,696
Payments for debt issuance costs	-	(340,020)
Principal payments on bonds payable	(515,000)	(435,000)
Interest paid	(1,959,157)	(997,947)
Acquisition of capital assets	(15,341,588)	(3,360,047)
Proceeds from sale of capital assets	-	7,249
Grant income received	79,691	-
Legal settlement	1,162,000	-
Net change in escrow deposits	(881,992)	9,781,521
	(18,381,695)	26,337,823
Cash Flows From Non-Capital Financing Activities:		
Transfers in	3,613,269	143,984
Due to the City of Lancaster General Fund	941,487	1,477,449
State pension contribution	85,704	79,942
	4,640,460	1,701,375
Net Increase (Decrease) in Cash and Cash Equivalents	(8,573,876)	26,941,038
Cash and Cash Equivalents:		
Beginning of year	40,067,700	13,126,662
End of year	\$ 31,493,824	\$ 40,067,700

(Continued)

CITY OF LANCASTER SEWER FUND

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2012 AND 2011

(Continued)

	2012	2011
Reconciliation of Operating Loss to Net Cash Provided by Operating Activities:		
Operating loss	\$ (241,460)	\$ (2,099,056)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Loss on sale of capital assets	-	64,645
Depreciation expense	2,569,361	2,504,416
Changes in assets and liabilities:		
Receivables	(928,323)	(375,226)
Due from other governments	(10,171)	19,986
Prepaid expenses	(6,664)	72,347
Accounts payable	1,676,669	901,271
Accrued expenses	15,146	1,201
Compensated absences	(6,140)	8,808
Workers' compensation payable	(8,881)	3,795
Net other post-employment liability	400,343	415,412
Total adjustments	3,701,340	3,616,655
Net cash provided by operating activities	\$ 3,459,880	\$ 1,517,599
Noncash Capital Financing Activities:		
Proceeds from capital lease	\$ 54,538	\$ 456,440

(Concluded)

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

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements include the transactions of the Sewer Fund of the City of Lancaster, Pennsylvania (Sewer Fund). It does not include any other funds of the City of Lancaster (City) and, therefore, does not present fairly the financial position and the changes in financial position of the City in conformity with accounting principles generally accepted in the United States of America.

Basis of Presentation and Accounting

The Sewer Fund's financial statements are presented on the full accrual basis in accordance with accounting principles generally accepted in the United States of America. All activities of the Sewer Fund are accounted for within a single proprietary (enterprise) fund. Proprietary funds are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of the Sewer Fund is charges for sewer services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The accounting and financial reporting treatment applied to the Sewer Fund is determined by its measurement focus. The transactions of the Sewer Fund are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the balance sheets. Net position (i.e., total assets, net of total liabilities) is segregated into "net investment in capital assets," "restricted for capital acquisition," and "unrestricted" components.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Cash and Cash Equivalents

For the purposes of reporting cash flows, the Sewer Fund considers money market funds and all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

Investments

Investments are stated at fair value.

Capital Assets

The sewer system's capital assets are recorded at their estimated historical cost.

Depreciation is computed on a straight-line basis utilizing the following estimated useful lives:

Sewer systems	50 years
Equipment and vehicles	5 - 30 years

The Sewer Fund capitalizes system assets valued over \$25,000 with a useful life longer than three years and general assets valued over \$10,000 with a useful life longer than three years.

Capitalization of Interest

Interest expense that relates to the cost of acquiring or constructing capital assets by the City is capitalized. Interest capitalized for the years ended December 31, 2012 and 2011 totaled \$68,187 and \$83,379, respectively.

Debt Issuance Costs/Deferred Loss on Refunding

Debt issuance costs and deferred loss on refunding are amortized on the effective interest method over the life of the bonds.

Restricted Assets

Certain cash accounts are classified as restricted assets on the balance sheets because these accounts withhold shared money to which a certain percentage is owed to various municipalities. This is due to agreements with the City and other municipalities, to share costs associated with sewer projects. These amounts owed to the municipalities are included in Due to Other Governments.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

The unexpended 2007 and 2011 bond proceeds as of December 31, 2012 and 2011 are also included in the restricted assets.

Net Position

Net position is classified in the following categories:

Net Investment in Capital Assets – This category groups all capital assets into one component of net position. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction, or improvement of these assets reduce this category. Debt related to unspent proceeds or other restricted cash and investments is excluded from the determination.

Restricted Net Position – This category presents external restrictions imposed by creditors, grantors, contributors, laws, or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.

Unrestricted Net Position – This category represents the net position of the Sewer Fund, which is not restricted for any project or other purpose.

Use of Estimates

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Pension Plans

The City sponsors and administers a defined benefit plan and defined contribution plan, which cover the Sewer Fund employees.

Pending Changes in Accounting Principles

The Governmental Accounting Standards Board (GASB) has issued Statement No. 65, “*Items Previously Reported as Assets and Liabilities*,” effective for periods beginning after December 15, 2012. This Statement reclassifies certain items currently being reported as assets and liabilities as deferred outflows of resources and deferred inflows of resources. In addition, this Statement recognizes certain items currently being reported as assets and

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

liabilities as outflows of resources and inflows of resources. The effect of implementation of this Statement has not yet been determined.

The GASB has issued Statement No. 67, “*Financial Reporting for Pension Plans*,” effective for periods beginning after June 15, 2013, and has also issued Statement No. 68, “*Accounting and Financial Reporting for Pensions*,” effective for periods beginning after June 15, 2014. These Statements revise existing guidance for the financial reports of most pension plans, and establish new financial reporting requirements for most governments that provide their employees with pension benefits. The effect of implementation of these Statements has not yet been determined.

2. DEPOSITS AND INVESTMENTS

Pennsylvania statutes provide for investment of governmental funds into certain authorized investment types including U.S. Treasury obligations, other short-term U.S. and Pennsylvania government obligations, and insured or collateralized time deposits and certificates of deposit. The statutes do not prescribe regulations related to demand deposits; however, they do allow the pooling of governmental funds for investment purposes.

The deposit and investment policy of the City adheres to state statutes, the Third Class City Code, and prudent business practice.

A. Deposits

Custodial Credit Risk - Deposits. Custodial credit risk is the risk that in the event of a bank failure, the government’s deposits may not be returned to it. The Sewer Fund does not have a deposit policy for custodial credit risk. As of December 31, 2012 and 2011, the Sewer Fund’s non-pooled book balances were \$10,490,625 and \$18,785,383, respectively, and the bank balances were \$10,490,624 and \$18,785,083, respectively. At December 31, 2012 and 2011, \$250,000 and \$250,000, respectively, was covered by federal depository insurance and \$10,240,624 and \$18,535,083, respectively, was collateralized under Act No. 72 (Act) of the 1971 Session of the Pennsylvania General Assembly, in which financial institutions were granted the authority to secure deposits of public bodies by pledging a pool of assets, as defined in the Act, to cover all public funds deposited in excess of federal depository insurance limits.

The Sewer Fund pools certain of its deposits and investments with the City. At December 31, 2012 and 2011, the book balance of the pooled deposits was \$48,374,435 and \$55,347,513, respectively, and the bank balance was \$48,645,882 and \$55,529,504, respectively. The Sewer Fund’s position in the pooled deposits was \$21,002,899 and \$21,282,317 at December 31, 2012 and 2011, respectively. At December 31, 2012, \$10,549,757 was insured by federal

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

depository insurance and the remaining balance of \$10,453,142 was collateralized under Act No. 72. At December 31, 2011, \$5,085,983 was insured by federal depository insurance and the remaining balance of \$16,196,334 was collateralized under the Act.

B. Investments

The fair value of the investments of the Sewer Fund at December 31, 2012 and 2011 is as follows:

	Fair Value
December 31, 2012	
Money market funds	\$ 1,050,644
Certificates of deposit	435,000
	\$ 1,485,644
	Fair Value
December 31, 2011	
Money market funds	\$ 2,809,876
Certificates of deposit	225,000
U.S. government agency obligations	100,000
	\$ 3,134,876

Custodial credit risk. Custodial credit risk is the risk that the counterparty to an investment transaction will fail and the government will not recover the value of the investment or collateral securities that are in possession of an outside party. The Sewer Fund does not have an investment policy for custodial credit risk. At December 31, 2012 and 2011, all investments of the Sewer Fund are held by the financial institution's trust department, in the Sewer Fund's name.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Concentration of credit risk. The Sewer Fund places no limits on the amount the Sewer Fund may invest in any one issuer. At December 31, 2012 and 2011, more than five percent of the Sewer Fund investments were held with the following issuers:

<u>December 31, 2012</u>	<u>Fair Value</u>	<u>Percent of Investments</u>
Goldman Sachs Financial Square Treasury Obligation Money Market	\$ 1,016,574	68.43%
<u>December 31, 2011</u>		
Goldman Sachs Financial Square Treasury Obligation Money Market	\$ 2,664,695	85.00%

Credit risk. The Sewer Fund does not have a formal policy that would limit its investment choices with regard to credit risk. At December 31, 2012 and 2011, the Sewer Fund's investments in money market funds and U.S. government agency obligations were rated AA+ or higher.

Interest rate risk. The Sewer Fund does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. At December 31, 2012 and 2011, the Sewer Fund's investments had maturities of less than one year.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

3. CAPITAL ASSETS

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

	December 31, 2011	Increase/ Transfers In	Decrease/ Transfers Out	December 31, 2012
Capital assets not being depreciated:				
Land	\$ 1,484,824	\$ -	\$ -	\$ 1,484,824
Construction-in-progress	171,934	976,115	(171,934)	976,115
Total capital assets, not being depreciated	<u>1,656,758</u>	<u>976,115</u>	<u>(171,934)</u>	<u>2,460,939</u>
Capital assets being depreciated:				
Sewer system	118,184,623	13,806,084	-	131,990,707
Equipment and vehicles	9,785,158	353,233	-	10,138,391
Total capital assets, being depreciated	<u>127,969,781</u>	<u>14,159,317</u>	<u>-</u>	<u>142,129,098</u>
Less accumulated depreciation for:				
Sewer system	(52,776,883)	(2,319,831)	-	(55,096,714)
Equipment and vehicles	(7,589,975)	(249,530)	-	(7,839,505)
Total accumulated depreciation	<u>(60,366,858)</u>	<u>(2,569,361)</u>	<u>-</u>	<u>(62,936,219)</u>
Capital assets being depreciated, net	<u>67,602,923</u>	<u>11,589,956</u>	<u>-</u>	<u>79,192,879</u>
Capital assets, net	<u><u>\$ 69,259,681</u></u>	<u><u>\$ 12,566,071</u></u>	<u><u>\$ (171,934)</u></u>	<u><u>\$ 81,653,818</u></u>

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

	<u>December 31,</u> <u>2010</u>	<u>Increase/ Transfers In</u>	<u>Decrease/ Transfers Out</u>	<u>December 31,</u> <u>2011</u>
Capital assets not being depreciated:				
Land	\$ 1,484,824	\$ -	\$ -	\$ 1,484,824
Construction-in-progress	<u>44,905</u>	<u>171,934</u>	<u>(44,905)</u>	<u>171,934</u>
Total capital assets, not being depreciated	<u>1,529,729</u>	<u>171,934</u>	<u>(44,905)</u>	<u>1,656,758</u>
Capital assets being depreciated:				
Sewer system	114,550,512	3,634,111	-	118,184,623
Equipment and vehicles	<u>9,250,520</u>	<u>774,007</u>	<u>(239,369)</u>	<u>9,785,158</u>
Total capital assets, being depreciated	<u>123,801,032</u>	<u>4,408,118</u>	<u>(239,369)</u>	<u>127,969,781</u>
Less accumulated depreciation for:				
Sewer system	(50,529,732)	(2,247,151)	-	(52,776,883)
Equipment and vehicles	<u>(7,437,434)</u>	<u>(257,265)</u>	<u>104,724</u>	<u>(7,589,975)</u>
Total accumulated depreciation	<u>(57,967,166)</u>	<u>(2,504,416)</u>	<u>104,724</u>	<u>(60,366,858)</u>
Capital assets being depreciated, net	<u>65,833,866</u>	<u>1,903,702</u>	<u>(134,645)</u>	<u>67,602,923</u>
Capital assets, net	<u><u>\$ 67,363,595</u></u>	<u><u>\$ 2,075,636</u></u>	<u><u>\$ (179,550)</u></u>	<u><u>\$ 69,259,681</u></u>

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

4. LONG-TERM LIABILITIES

A summary of long-term liabilities for the year ended December 31, 2012 is as follows:

<u>Date of Issue/ Maturity</u>	<u>Amount of Original Issue</u>	<u>Description and Interest Rates</u>	<u>Balance Outstanding December 31, 2012</u>
2007/2022	\$ 12,150,000	General Obligation Bonds, 4.00% - 5.00%	\$ 10,085,000
2009/2025	14,030,000	General Obligation Notes, 2.50% - 4.875%	11,510,000
2011/2041	22,460,000	General Obligation Bonds, 1.75% - 5.00%	22,460,000
			<u>\$ 44,055,000</u>

Bonds Payable

In 1998, the City issued \$61,915,000 of general obligation bonds. The portion allocable to the Sewer Fund amounted to \$27,390,000, bearing interest at rates ranging from 3.2% to 5.25%. The proceeds of the bond issuance were used to finance the acquisition of the sewer system through the refunding of the Lancaster Municipal Authority's outstanding (a) Sewer Revenue Bonds, Series of 1987; (b) Sewer Revenue Bonds, Series of 1991; and (c) Sewer Project Notes, Series of 1996. These bonds were currently refunded through the issuance of General Obligation Notes, Series of 2009.

In 2007, the City issued \$125,315,000 of general obligation bonds. The portion allocable to the Sewer Fund amounted to \$12,150,000, bearing interest at rates ranging from 4.00% to 5.00%. The proceeds of the bond issuance were used to fund general municipal projects, upgrades and improvements to the City's sewer system, and the current refunding of the 2004 note payable.

In 2011, the City issued \$38,860,000 of general obligation bonds. The portion allocable to the Sewer Fund amounted to \$22,460,000, bearing interest rates ranging from 1.75% to 5.00%. The proceeds of the bond issuance were used for improvements and upgrades to the wastewater treatment plant and various miscellaneous capital projects.

Notes Payable

In 2009, the City issued \$43,990,000 of general obligation notes. The portion allocable to the Sewer Fund amounted to \$14,030,000, bearing interest at rates ranging from 2.50% to 4.875%. The proceeds of the note issuance were used to currently refund the City's

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

outstanding General Obligation Bonds, Series A of 1998, and to pay the termination costs of the Swaption agreement with Wachovia Bank.

Principal and interest maturities on the bonds payable and notes payable are as follows:

<u>Year Ended December 31,</u>	<u>Principal Maturity</u>	<u>Interest Maturity</u>	<u>Total</u>
2013	\$ 1,375,000	\$ 1,932,175	\$ 3,307,175
2014	1,710,000	1,885,208	3,595,208
2015	1,765,000	1,830,513	3,595,513
2016	1,825,000	1,768,767	3,593,767
2017	1,910,000	1,683,651	3,593,651
2018-2022	10,170,000	6,957,659	17,127,659
2023-2027	9,030,000	4,454,349	13,484,349
2028-2032	4,680,000	3,338,557	8,018,557
2033-2037	5,855,000	2,168,728	8,023,728
2038-2041	5,735,000	682,153	6,417,153
	<u>\$ 44,055,000</u>	<u>\$ 26,701,760</u>	<u>\$ 70,756,760</u>

Capital Lease

In 2011, the City purchased multiple vehicles and equipment under long-term lease agreements that are classified as capital leases. In 2012, the City purchased a cargo van under a long-term lease agreement that is classified as a capital lease. As of December 31, 2012 and 2011, the Sewer Fund includes these vehicles and equipment at a cost of \$627,271 and \$572,733, respectively, with accumulated depreciation of \$65,041 and \$28,396, respectively.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

The future minimum payments under these capital leases and the present value of the minimum lease payments at December 31, 2012 are as follows:

Year Ended December 31,	Total
2013	\$ 113,010
2014	113,011
2015	111,528
2016	12,127
Total minimum lease payments	349,676
Less amount representing interest	(31,954)
Present value of future minimum lease payments	\$ 317,722

Changes in long-term liabilities for the years ended December 31, 2012 and 2011 are as follows:

	December 31, 2011	Increase	Decrease	December 31, 2012	Amount Due Within One Year
Bonds payable	\$ 33,060,000	\$ -	\$ (515,000)	\$ 32,545,000	\$ 535,000
Unamortized premium	763,736	-	(86,126)	677,610	-
Deferred loss on refunding	(1,177,622)	-	132,828	(1,044,794)	-
Notes payable	12,330,000	-	(820,000)	11,510,000	840,000
Capital lease	368,833	54,538	(105,649)	317,722	97,796
Compensated absences	71,821	313,313	(319,453)	65,681	15,382
Workers' compensation payable	10,885	-	(8,881)	2,004	481
	\$ 45,427,653	\$ 367,851	\$ (1,722,281)	\$ 44,073,223	\$ 1,488,659

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

	December 31, 2010	Increase	Decrease	December 31, 2011	Amount Due Within One Year
Bonds payable	\$ 11,035,000	\$ 22,460,000	\$ (435,000)	\$ 33,060,000	\$ 515,000
Unamortized premium	655,337	188,696	(80,297)	763,736	-
Deferred loss on refunding	(1,316,547)	-	138,925	(1,177,622)	-
Notes payable	13,190,000	-	(860,000)	12,330,000	820,000
Capital lease	19,022	456,440	(106,629)	368,833	93,726
Compensated absences	63,013	326,970	(318,162)	71,821	23,977
Workers' compensation payable	7,090	6,608	(2,813)	10,885	2,483
	<u>\$ 23,652,915</u>	<u>\$ 23,438,714</u>	<u>\$ (1,663,976)</u>	<u>\$ 45,427,653</u>	<u>\$ 1,455,186</u>

In conjunction with the Basis Swap transaction described in Note 5, the City received an upfront cash payment. This upfront cash payment received by the City was considered to be a borrowing at a rate of 4.4%. As of December 31, 2012 and 2011, the borrowing had an outstanding balance of \$1,565,850 and \$1,742,590, respectively, which is reflected in the governmental activities portion of the City's financial statement. Payments on the borrowing commenced on May 1, 2009, the date the Basis Swap became effective, and are scheduled to mature on May 1, 2028. Interest is currently being accreted to the principal amount annually. Accreted interest on the borrowing was \$650,261 and \$580,405 at December 31, 2012 and 2011, respectively.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

A summary of principal and interest maturities on the borrowing at December 31, 2012 is as follows:

Year Ended December 31,	Principal	Interest	Total
2013	\$ 166,053	\$ 61,174	\$ 227,227
2014	152,758	54,564	207,322
2015	138,245	48,582	186,827
2016	122,402	43,286	165,688
2017	116,794	38,234	155,028
2018-2022	526,211	120,835	647,046
2023-2027	328,330	22,346	350,676
2028	15,057	-	15,057
	<u>\$ 1,565,850</u>	<u>\$ 389,021</u>	<u>\$ 1,954,871</u>

As noted above, this borrowing is reflected in the governmental activities section of the City's financial statement and, as such, the Sewer Fund does not report a portion of the City's borrowing.

5. DERIVATIVE AGREEMENTS

Objective of the interest rate swap agreements. During the year ended December 31, 1998, the City issued its \$61,915,000, aggregate principal amount, General Obligation Bonds, Series A of 1998 (the "Series A Bonds"). During the year ended December 31, 2004, because of the market conditions, the City entered into a forward interest rate swap agreement (Basis Swap) in connection with the Series A Bonds commencing May 1, 2009 through the final maturity of the Series A Bonds (May 1, 2028).

Terms. With respect to its Series A Bonds, the City entered the Basis Swap with PNC Bank, N.A., as the counterparty. Beginning on May 1, 2009 and ending on the final maturity date of May 1, 2028, the City will pay a variable interest rate equal to the SIFMA index based on the notional amount remaining on the Series A Bonds and receive a variable interest rate equal to 67% of the 1-Month LIBOR rate. The Basis Swap agreement contains an embedded interest rate cap, providing that the floating rate to be paid by the City shall not exceed 25%. PNC Bank, N.A. paid a premium to the City in the amount of \$1,715,700 for the Basis Swap.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

The Basis Swap became effective on May 1, 2009 and has been assigned to a proportionate share of the City's General Obligation Notes, Series of 2009 which refunded the Series A Bonds. The final maturity date of May 1, 2028 remains unchanged.

Fair value. As of December 31, 2012, the Basis Swap had a fair value of (\$777,304). As the Basis Swap is considered to be an investment type derivative instrument per accounting standards, it is reported as a derivative asset and as a borrowing on the City's government-wide statement of net position. The change in fair market value of \$333,149 during the year ended December 31, 2012 is recorded as a component of investment income on the City's government-wide statement of activities. The fair value is calculated using the zero-coupon method.

Credit risk. The City solicited competitive bids in connection with the Basis Swap agreement. The City solicited bids only from counterparties with an excellent credit rating (see – The City's Interest Rate Management Plan). PNC Bank, N.A. is rated A+ by Fitch Ratings, A by Standard & Poor's, and A2 by Moody's Investors Service as of December 31, 2012. To mitigate the potential for credit risk, if PNC Bank's credit rating falls below A-/A3 (threshold ratings) the counterparty will be obligated to post a certain amount of collateral or the City will have the right to terminate the swap agreement; PNC Bank negotiated a credit support annex with the City at the time the transaction was entered into, which would require PNC Bank to collateralize its obligations with direct obligations guaranteed by the United States of America if its respective credit ratings fell below the predetermined threshold ratings.

Termination risk. The City or the counterparty may terminate the Basis Swap agreement if the other party defaults under the terms of the Agreement. In addition, the City may terminate the Basis Swap Agreement without cause at any time with notice to the counterparty of not less than two days. The termination value would be determined by the Calculation Agent (counterparty) using commercially reasonable judgment, or if disputed, the Calculation Agent shall seek bids from Reference Market-makers consistent with Section 6 of the Agreement. If the Basis Swap is terminated and has a negative fair value, the City would be liable to the counterparty for the termination payment. If the Basis Swap Agreement is terminated and has a positive fair value, the counterparty would be liable to the City for the termination payment.

Basis risk. The City is subject to basis risk because the interest index on the variable rate receipt arm of the swap is based on one-month LIBOR and the variable interest rate payment arm is based on a different index. Although expected to correlate, the relationships between different indexes vary and that variance could adversely affect the City's calculated payments and, as a result, cost savings or synthetic interest rates may not be realized. As of December

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

31, 2012, the interest rate the City is paying under the Basis Swap was .13%, whereas the interest the City is receiving at 67% of the one-month LIBOR rate was .14%.

Contingent feature. If the City's credit rating is below A- by Standard & Poor's or A3 by Moody's Investors Service, as well as fails to deliver eligible collateral, then the swap transaction may be terminated. In the event that the collateral is called, the City would have to post eligible collateral up to the fair value of the Basis Swap at that time. Eligible collateral includes cash, negotiable debt obligations issued by the U.S. Treasury Department, securities guaranteed by the Government National Mortgage, Federal National Mortgage Association, or Federal Home Loan Mortgage Corporation, and agency notes issued directly by any of the Federal Home Loan Banks, Federal National Mortgage Association, or Federal Home Loan Mortgage Corporation. As of December 31, 2012, the City's rating is not below the rating threshold and, therefore, the City had not posted any collateral due to a ratings trigger.

6. PENSION PLANS

The City administers a single-employer defined benefit pension plan for its nonuniformed employees – the Cash Balance Pension Plan (CBPP).

The CBPP does not issue stand-alone financial reports.

A. *Summary of Significant Accounting Policies*

Basis of Accounting

The Plan's financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to each plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

Method Used to Value Investments

Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair values.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

B. Plan Description and Contribution Information

Cash Balance Pension Plan

Membership of CBPP consisted of the following at January 1, 2012, the date of the latest actuarial valuation:

Retirees and beneficiaries currently receiving benefits	44
Terminated employees entitled to benefits	<u>33</u>
	<u>77</u>
Active plan participants:	
Fully-vested	180
Non-vested	<u>117</u>
	<u>297</u>
Total	<u><u>374</u></u>

Plan Description

CBPP is a single-employer defined benefit pension plan that covers all full-time, nonuniformed employees of the City. CBPP provides retirement, disability, and death benefits to plan members and their beneficiaries. Plan provisions are established and may be amended by the Nonuniformed Pension Board.

Contributions

Plan members are not required to contribute to the CBPP. The City is required to make actuarial determined periodic contributions at rates that for individual employees increases over time so that sufficient assets will be available to pay benefits when due.

The annual required contribution is determined annually during the budgeting process. The results of actuarial valuations are used in budgeting for future years.

The City contributed \$516,512 and \$504,280 to the CBPP for the years ended December 31, 2012 and 2011, respectively. Of the amount contributed by the City, the Sewer Fund contributed \$85,704 and \$79,942 for the years ended December 31, 2012 and 2011, respectively.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

C. Annual Pension Cost and Net Pension Obligation

The City's annual pension cost and net pension obligation (asset) for the CBPP for the years ended December 31, 2012 and 2011 were as follows:

	2012	2011
Annual required contribution	\$ 516,512	\$ 504,280
Interest on net pension obligation (asset)	(6,357)	(6,520)
Adjustment to annual required contribution	8,476	8,693
Annual pension cost	518,631	506,453
Contributions	516,512	504,280
Change in net pension obligation (asset)	2,119	2,173
Net pension obligation (asset), beginning of year	(84,756)	(86,929)
Net pension obligation (asset), end of year	\$ (82,637)	\$ (84,756)

The Sewer Fund does not report a portion of the City's net pension asset.

The January 1, 2012 actuarial valuation used the entry age normal actuarial cost method. The actuarial assumptions included a) 7.50% investment rate of return, b) a projected salary increase of 5%, c) level dollar closed amortization method, and d) 16-year amortization period. The actuarial value of assets from the prior valuation report (reduced for benefits paid and increased for contributions) is projected forward at an artificial investment return of 6.50% (interest rate assumption minus 1%). In no event is the actuarial value of assets allowed to be greater than 130% or less than 70% of market value.

Three-Year Information

CBPP:

Calendar Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (Asset)
2010	\$ 501,354	99.6%	\$ (86,929)
2011	506,453	99.6%	(84,756)
2012	518,631	99.6%	(82,637)

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Funded Status and Schedule of Funding Progress:

The schedule of funding progress, presented as required supplementary information following the notes to financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
1/1/2012	\$ 9,583,121	\$ 11,273,769	\$ 1,690,648	85.0%	\$ 12,365,380	13.7%

Defined Contribution Plan

The City administers a single-employer defined contribution plan, the Supplemental Savings Plan (SSP), in which all eligible, full-time, nonuniformed employees of the City may elect to participate. As of December 31, 2012 and 2011, there were 187 and 190 plan participants, respectively. Plan participants may elect to contribute up to 10% of their after-tax pay. The City will match 25% of the participant's contribution, on the first 5% contributed by each participant. Participant contributions in excess of 5% of compensation will not be matched. The Plan provisions are established and may be amended by the Nonuniformed Pension Board. During the year ended December 31, 2012, plan participants and the City made contributions of \$375,290 and \$81,386, respectively. During the year ended December 31, 2011, plan participants and the City made contributions of \$376,004 and \$83,053, respectively. Of the amount contributed by the City, the Sewer Fund contributed \$13,889 and \$13,887 for the years ended December 31, 2012 and 2011, respectively.

The SSP uses the same basis of accounting and methods to value investments as the City's defined benefit plans.

7. OTHER POST-EMPLOYMENT BENEFITS

Plan Description

In addition to the retirement benefits described in Note 6, the City provides single-employer health care benefits for all retired employees, their spouses, and dependents. These benefit provisions and all other requirements are established under the various union contracts and City policy for non-organized employees. Those employees are required to pay a portion of

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

the cost of the plan, which generally ranges from approximately 20% to 100% of the annual premiums.

Nonuniformed employees are eligible to retire after completion of 10 years of service and attainment of age 55.

Any nonuniformed employee who elects coverage will make monthly contributions. Once any retiree or spouse becomes eligible for Medicare, he/she must apply for Medicare Part A and Part B. For those eligible for Medicare coverage, medical insurance provided by the City will supplement Medicare.

A nonuniformed employee will be eligible for \$7,000 of life insurance upon 10 years of service and attainment age of 55.

The union labor contract establishes the post-retirement health care plan provisions for nonuniformed union employees. The union contract does not require City Council approval and may be amended through future negotiations. The post-retirement health care plan provisions for non-union employees are established through the City's human resources policies, which are approved by the Mayor.

Funding Policy and Annual OPEB Costs

The City's contribution is based on projected pay-as-you-go financing requirements through the General Fund. For the years ended December 31, 2012 and 2011, respectively, the City's net cost of providing health benefits and life insurance for retired employees was \$4,448,641 and \$3,685,450. Of the amount contributed by the City, the Sewer Fund contributed \$217,807 and \$131,576 for the years ended December 31, 2012 and 2011, respectively. Plan members receiving benefits contributed \$90,157 and \$117,907, through their contributions as required by the cost sharing provisions of the plans for the years ended December 31, 2012 and 2011, respectively.

The nonuniformed union labor contract and the City's human resource policies establish and amend the obligations of the plan members and the City to contribute to the plan.

Any nonuniformed employee who elects coverage will make monthly contributions. For eligible nonuniformed individuals under the age of 65, the monthly costs for the retiree, spouse, and eligible dependent children are \$65, \$110, and \$60, respectively. For eligible nonuniformed individuals over the age of 65, the monthly costs for the retiree and spouse are \$50 and the monthly costs for eligible dependent children is \$65.

The City pays the entire cost of the life insurance benefits.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

The City's annual OPEB costs (expense) for the plan is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Examples include assumptions about future employment, mortality and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the ARC are subject to continual revision as actual results are compared to past expectations and new estimate are made about the future.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan and include the types of benefits provided at the time of the valuation and on the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities consistent with the long-term perspective of the calculation. The projections of benefits for financial reporting purposes do not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future.

Information as of the latest actuarial valuation follows:

Valuation date	1/1/2012
Actuarial cost method	Entry age normal, level dollar
Actuarial assumptions	
Interest rate	4.5%
Salary increases	5% per year
Medical inflation	7.5% in 2012, decreasing by 0.5% per year to 5.5% in 2016. Rates gradually decrease from 5.3% in 2017 to 4.2% in 2089 and later
Amortization period	30 years, open period

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Annual OPEB Cost and Net OPEB Obligation

The Sewer Fund's portion of the City's annual OPEB costs and net OPEB obligations to the plan for the years ended December 31, 2012 and 2011 were as follows:

	2012	2011
Annual required contribution	\$ 652,488	\$ 574,517
Interest on net OPEB obligation	94,271	75,577
Adjustment to annual required contribution	(128,609)	(103,106)
Annual OPEB cost	618,150	546,988
Contribution made	(217,807)	(131,576)
Change in Net OPEB obligation	400,343	415,412
Net OPEB obligation, beginning	2,094,900	1,679,488
Net OPEB obligation, ending	\$ 2,495,243	\$ 2,094,900

Three-Year Trend Information

Year	Annual OPEB Cost (AOC)	Percentage of AOC Contributed	Net OPEB Obligation
2010	\$ 554,768	4.4%	\$ 1,679,488
2011	546,988	24.1%	2,094,900
2012	618,150	35.2%	2,495,243

Funded Status and Schedule of Funding Progress

The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
1/1/2012	\$ -	\$ 5,703,505	\$ 5,703,505	0.00%	\$ 1,899,710	300.23%

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

8. RISK MANAGEMENT

The City maintains both insurance contracts and self-funded arrangements to deal with the risk of loss arising from the following events: torts; theft of, damage to, or destruction of assets; business interruptions; errors and omissions; job-related illnesses or injuries to employees; acts of God; and losses resulting from providing fringe benefits to employees and their dependents.

Insurance contracts cover public officials, law enforcement, automobile, excess workers' compensation, excess health claims, and umbrella liabilities. The contracts also provide employee, tax collector/treasurer, mayor, controller, city engineer, and employee blanket bonds.

Self-Insurance-Workers' Compensation

The City has a self-funded third-party administered workers' compensation arrangement through Murray Risk Management and Insurance. During 2012, the City was limited to \$500,000 per each accident and \$500,000 per each employee for disease. Claim expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated.

A summary of workers' compensation claims for the Sewer Fund for the years ended December 31, 2012 and 2011 is as follows:

Unpaid claims as of January 1, 2011	\$ 7,090
Incurred claims during 2011	6,608
Payments during 2011	<u>(2,813)</u>
Unpaid claims as of January 1, 2012	10,885
Incurred claims during 2012	-
Payments during 2012	<u>(8,881)</u>
Unpaid claims as of December 31, 2012	<u><u>\$ 2,004</u></u>

9. CONTINGENCIES

Litigation

In the normal course of business, there are various claims and lawsuits pending against the City. In the opinion of City management, after consultation with legal counsel, the potential

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

loss, if any, on all claims and lawsuits will not materially affect the City's financial position. With the exception of workers' compensation and health insurance, the City purchases commercial insurance for all risks of loss. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years. There were no significant reductions in insurance coverage in 2012.

10. CONTRACT COMMITMENTS

Beginning in 2009, the Sewer Fund entered into various contracts for pumping stations upgrades and maintenance. As a result of this, the City entered into contracts with construction contractors totaling \$23,334,803. At December 31, 2012, \$1,223,480 was included in accounts payable. The commitment remaining on the contracts at December 31, 2012 was \$7,005,275.

11. NEGATIVE UNRESTRICTED NET POSITION

In addition to sewer rate increases for inside City customers in 2010 (10%) and 2011 (20%), City Council approved a 35% rate increase for inside City customers effective in January 2012. The additional revenues to the Sewer Fund generated by this series of rate increases reduced the Sewer Fund's need for cash borrowing from the General Fund from \$1.7 million during the year ended December 31, 2011 to \$749,000 during the year ended December 31, 2012. Additionally, the PA Public Utility Commission (PUC) approved a rate increase for outside City sewer customers in April 2013 for an annualized revenue increase of \$399,000.

The City has also formally initiated arbitration with East Lampeter seeking settlement of nearly \$3.7 million in disputed bulk sewer charges dating back as far as 1992. East Lampeter's withholding of payment for these disputed charges has caused a significant drain on the Sewer Fund's cash flow over this period. As of mid-2013, the arbitration process is ongoing.

12. EXTRAORDINARY ITEM – LEGAL SETTLEMENT

Extraordinary items are transactions or other events that are both unusual in nature and infrequent in occurrence. During the year ended December 31, 2011, the City filed legal proceedings against a business for issues relating to the design and repair of an overflow tunnel for the City's storm water/wastewater system. In April 2012, the court ordered in favor of the City and the matter was settled on October 15, 2012, in the amount of \$1,162,000. The settlement revenue has been presented on the statement of revenues,

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

expenses and changes in fund net position as an extraordinary item for the year ended December 31, 2012.

13. SUBSEQUENT EVENT

In January 2013, the City issued \$7,000,000 Guaranteed Revenue Note of 2012. This is a Pennvest loan that is for the construction of a series of green infrastructure source control practices, including porous pavement in parking lots, paths, alleys, and streets; infiltration and bio-retention systems; green roofs; rain gardens and rain barrels in order to capture storm water runoff, various other green infrastructure improvements throughout the City, and other ongoing capital improvement projects of the City.

**Required Supplementary
Information**

CITY OF LANCASTER SEWER FUND

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS - PENSION PLAN (UNAUDITED)

Cash Balance Pension Plan:

Actuarial Valuation January 1,	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)- Entry age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
2007	\$ 8,428,386	\$ 9,052,319	\$ 623,933	93.1%	\$ 10,644,441	5.9%
2008	8,747,557	9,591,825	844,268	91.2%	10,905,822	7.7%
2009	8,802,470	9,815,584	1,013,114	89.7%	10,853,541	9.3%
2010	9,311,791	10,448,552	1,136,761	89.1%	12,022,604	9.5%
2011	8,974,375	10,432,429	1,458,054	86.0%	11,972,809	12.2%
2012	9,583,121	11,273,769	1,690,648	85.0%	12,365,380	13.7%

The following changes affect the comparability of costs:

Actuarial Valuation Date	Reason	Change in Unfunded Actuarial Accrued Liability
1/1/2009	Assumption change	\$ (2,031,339)
1/1/2011	Assumption change	252,898

SCHEDULE OF EMPLOYER CONTRIBUTIONS - PENSION PLAN (UNAUDITED)

Calendar Year	Annual Required Contribution	Contributions From Employer	Percentage Contributed
2007	\$ 410,346	\$ 410,346	100.0%
2008	459,603	459,603	100.0%
2009	475,248	475,248	100.0%
2010	499,125	499,125	100.0%
2011	504,280	504,280	100.0%
2012	516,512	516,512	100.0%

Note: Contributions include state pension aid.

CITY OF LANCASTER SEWER FUND

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS - OPEB (UNAUDITED)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)- Entry age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
1/1/2008	\$ -	\$ 4,496,765	\$ 4,496,765	0.0%	\$ 1,897,820	236.94%
1/1/2010	-	4,715,588	4,715,588	0.0%	1,761,965	267.63%
1/1/2012	-	5,703,505	5,703,505	0.0%	1,899,710	300.23%

Note: Valuation as of 1/1/08 represents the initial valuation of the plan.

SCHEDULE OF EMPLOYER CONTRIBUTIONS - OPEB (UNAUDITED)

Year	Annual Required Contribution	Percentage Contributed
2008	\$ 621,535	5.6%
2009	621,535	7.9%
2010	574,517	4.3%
2011	574,517	22.9%
2012	652,488	33.4%

Supplementary Information

CITY OF LANCASTER SEWER FUND

SCHEDULE OF NET COST OF OPERATIONS OF THE CITY SEWER SYSTEM

YEAR ENDED DECEMBER 31, 2012

	Lancaster Area Sewer Authority and Manor Township	East Lampeter Sewer Authority and Suburban Lancaster Sewer Authority
Direct Expenses and Costs:		
Collection system	\$ 641,653	\$ 641,653
Sewage treatment plants	4,421,333	4,421,333
Sewage pumping station	1,044,558	1,044,558
City Bureau of Sewers	2,670,782	2,670,782
Sewer grounds maintenance	135,200	135,200
	8,913,526	8,913,526
Allowance per contracts for indirect expenses and costs (\$8,913,526 x 5.0%)	445,676	445,676
	9,359,202	9,359,202
Less reimbursements (as defined in agreements):		
Miscellaneous	331,827	331,827
Industrial waste surcharge	499,064	499,064
Management and operation service fee	192,011	192,011
	1,022,902	1,022,902
Net Cost of Operations of the City Sewer System	\$ 8,336,300	\$ 8,336,300

CITY OF LANCASTER SEWER FUND

SCHEDULE OF DIRECT EXPENSES AND COSTS

YEAR ENDED DECEMBER 31, 2012

Collection System:

Salaries and wages	\$ 410,731
Vehicle maintenance	53,085
Gasoline and oil	39,513
Miscellaneous expenses	138,324
	<hr/>
	641,653

Sewage Treatment Plants:

Salaries and wages	731,527
Chemicals and laboratory supplies	502,561
Equipment maintenance	421,164
Vehicle maintenance	18,954
Gasoline, oil, and fuel	76,431
Water utility expense	63,209
Power	1,104,338
Meter expense	220,076
Building maintenance	10,751
Sludge disposal	965,815
Miscellaneous expenses	306,507
	<hr/>
	4,421,333

Sewage Pumping Station:

Salaries and wages	600,734
Equipment maintenance	77,978
Building maintenance	726
Fuel	4,926
Power	359,228
Miscellaneous expenses	966
	<hr/>
	1,044,558

City Bureau of Sewers:

Salaries and wages	295,557
Consultant and contract services	727,089
Special training	11,657
Uniforms	7,342
Postage	31,349
Telephone	28,543
Travel	5,682
Miscellaneous expense	138,558
Fringe benefits	1,425,005
	<hr/>
	2,670,782

Sewer Grounds Maintenance:

Salaries and wages	126,305
Uniforms	608
Equipment maintenance	996
Miscellaneous expense	7,291
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	135,200

Total Direct Expenses and Costs

\$ 8,913,526

CITY OF LANCASTER SEWER FUND

SCHEDULE OF COST OF TREATING EACH 1,000 GALLONS OF SEWAGE

YEAR ENDED DECEMBER 31, 2012

	<u>Lancaster Area Sewer Authority and Manor Township</u>	<u>East Lampeter Sewer Authority and Suburban Lancaster Sewer Authority</u>
Net cost of operation of the City of Lancaster sewer system	\$ 8,336,300	\$ 8,336,300
Number of units of 1,000 gallons of sewage treated per records of the City of Lancaster (unaudited)	<u>7,050,508</u>	<u>7,050,508</u>
Net Cost of Treating 1,000 Gallons of Sewage	<u><u>\$ 1.1824</u></u>	<u><u>\$ 1.1824</u></u>