City of Lancaster Water Fund

Financial Statements and Required Supplementary Information

Years Ended December 31, 2013 and 2012
with Independent Auditor's Report

MaherDuessel
Certified Public Accountants

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CITY OF LANCASTER WATER FUND

YEARS ENDED DECEMBER 31, 2013 AND 2012

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MaherDuessel
Certified Public Accountants

Pittsburgh
503 Martindale Street
Suite 600
Pittsburgh, PA 15212
Main 412.471.5500
Fax 412.471.5508

Harrisburg
3003 North Front Street
Suite 101
Harrisburg, PA 17110
Main 717.232.1230
Fax 717.232.8230

Butler
112 Hollywood Drive
Suite 204
Butler, PA 16001
Main 724.285.6800
Fax 724.285.6875

Independent Auditor's Report

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

We have audited the accompanying financial statements of the Water Fund of the City of Lancaster, as of and for the years ended December 31, 2013 and 2012, 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 Water Fund of the City of Lancaster as of December 31, 2013 and 2012, 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 Water Fund and do not purport to, and do not, present fairly the financial position of the City of Lancaster, as of December 31, 2013 and 2012, 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 28 and 29 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.

Maher Duessel

Harrisburg, Pennsylvania
July 9, 2014

CITY OF LANCASTER WATER FUND

BALANCE SHEETS

DECEMBER 31, 2013 AND 2012

Assets and Deferred Outflows of Resources	2013	2012
Assets:		
Current assets:		
Cash and cash equivalents	$ 550	$ 550
Cash and cash equivalents - restricted	10,583,976	13,055,361
Receivables:		
Water rents	1,561,936	1,676,760
Unbilled water rents	1,835,903	1,691,176
Other	32,880	21,920
Due from other governments	63,723	45,685
Prepaid expenses	7,253	7,068
Total current assets	14,086,221	16,498,520
Long-term assets:		
Prepaid debt insurance	979,537	1,055,351
Capital assets, not being depreciated	2,930,555	2,721,743
Capital assets, being depreciated, net	135,910,178	136,277,991
Total long-term assets	139,820,270	140,055,085
Total Assets	153,906,491	156,553,605
Deferred Outflows of Resources:		
Deferred charge on refunding	1,968,143	2,196,235
Total Deferred Outflows of Resources	1,968,143	2,196,235
Total Assets and Deferred Outflows of Resources	$155,874,634	$158,749,840

(Continued)

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

Liabilities and Net Position	2013	2012
Liabilities:		
Current liabilities:		
Accounts payable	$ 1,685,559	$ 1,372,960
Accrued expenses	975,495	969,342
Due to City of Lancaster General Fund	6,795,046	5,188,043
Compensated absences, current portion	14,441	17,954
Workers' compensation payable, current portion	33,128	5,197
Capital lease, current portion	82,440	73,615
Notes payable, current portion	990,767	959,549
Bonds payable, current portion	981,600	956,200
Total current liabilities	11,558,476	9,542,860
Long-term liabilities:		
Compensated absences, net of current portion	63,742	58,706
Workers' compensation payable, net of current portion	223,570	16,435
Net other post-employment liability	3,196,592	3,339,429
Capital lease, net of current portion	176,776	153,745
Notes payable, net of current portion	11,432,702	12,423,469
Bonds payable, net of current portion	106,980,156	108,022,678
Total long-term liabilities	122,073,538	124,014,462
Total Liabilities	133,632,014	133,557,322
Net Position:		
Net investment in capital assets	30,791,724	31,899,187
Unrestricted	(8,549,104)	(6,706,669)
Total Net Position	22,242,620	25,192,518
Total Liabilities and Net Position	$155,874,634	$158,749,840

(Concluded)

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

CITY OF LANCASTER WATER FUND

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET POSITION

YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
Operating Revenues:		
Water rents	$ 20,098,781	$ 20,307,303
Meter labor reimbursement	226,709	220,076
Miscellaneous revenue	478,838	449,248
Total operating revenues	20,804,328	20,976,627
Operating Expenses:		
Susquehanna treatment plant	2,307,776	2,344,657
Conestoga treatment plant	2,242,765	2,064,395
Transmission and distribution	1,306,020	1,380,869
Meters and meter labor	647,740	628,789
Laboratory	262,587	246,233
Depreciation	3,542,853	3,408,732
Administration	5,310,231	4,720,204
Grounds maintenance	393,036	380,870
Total operating expenses	16,013,008	15,174,749
Operating Income	4,791,320	5,801,878
Non-Operating Revenues (Expenses):		
State pension contribution	168,044	139,983
Grant income	-	15,115
Investment income	20,186	27,825
Amortization expense	(75,813)	(77,296)
Interest expense	(5,471,564)	(5,491,934)
Total non-operating revenues (expenses)	(5,359,147)	(5,386,307)
Income (loss) before transfers and capital contributions	(567,827)	415,571
Transfers out	(2,499,999)	(2,300,000)
Capital contributions	117,928	705,799
Change in Net Position	(2,949,898)	(1,178,630)
Net Position:		
Beginning of year	25,192,518	26,371,148
End of year	$ 22,242,620	$ 25,192,518

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

CITY OF LANCASTER WATER FUND

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
Cash Flows From Operating Activities:		
Cash received from users	$ 20,763,465	$ 20,681,917
Cash paid to suppliers	(7,475,885)	(7,187,142)
Cash paid to employees	(4,687,171)	(4,548,753)
Net cash provided by operating activities	8,600,409	8,946,022
Cash Flows From Investing Activities:		
Investment income received	20,186	27,825
Net cash provided by investing activities	20,186	27,825
Cash Flows From Capital and Related Financing Activities:		
Principal payments on capital lease	(102,665)	(125,996)
Principal payments on notes payable	(959,549)	(933,374)
Principal payments on bonds payable	(956,200)	(420,400)
Interest paid	(5,372,611)	(5,402,390)
Grant income received	-	15,115
Acquisition of capital assets	(2,976,003)	(3,521,835)
Net cash used in capital and related financing activities	(10,367,028)	(10,388,880)
Cash Flows From Non-Capital Financing Activities:		
Transfers out	(2,499,999)	(2,300,000)
Due to City of Lancaster General Fund	1,607,003	153,043
State pension contribution	168,044	139,983
Net cash used in non-capital financing activities	(724,952)	(2,006,974)
Net Decrease in Cash and Cash Equivalents	(2,471,385)	(3,422,007)
Cash and Cash Equivalents:		
Beginning of year	13,055,911	16,477,918
End of year	$ 10,584,526	$ 13,055,911

(Continued)

CITY OF LANCASTER WATER FUND

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2013 AND 2012
(Continued)

	2013	2012
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating income	$ 4,791,320	$ 5,801,878
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	3,542,853	3,408,732
Changes in assets and liabilities:		
Receivables	(40,863)	(294,710)
Prepaid expenses	(185)	(3,721)
Accounts payable	194,613	65,627
Accrued expenses	18,919	19,155
Compensated absences	1,523	(4,806)
Workers' compensation payable	235,066	(5,836)
Net other post-employment liability	(142,837)	(40,297)
Total adjustments	3,809,089	3,144,144
Net cash provided by operating activities	$ 8,600,409	$ 8,946,022
Noncash Capital Financing Activities:		
Proceeds from capital lease	$ 134,521	$ 219,385
Developer contributions	$ 117,928	$ 705,799

(Concluded)

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

CITY OF LANCASTER WATER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2013 AND 2012

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements include the transactions of the Water Fund of the City of Lancaster, Pennsylvania (Water 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 Water 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 Water 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 Water Fund is charges for water. 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 Water Fund is determined by its measurement focus. The transactions of the Water Fund are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets, deferred outflows of resources, and liabilities associated with the operations are included on the balance sheets. Net position (i.e., total assets and deferred outflows of resources, net of total liabilities) is segregated into "net investment in capital assets," "restricted," 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.

Cash and Cash Equivalents

For the purposes of reporting cash flows, the Water 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.

Capital Assets

The water 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:

Water systems	50 years
Equipment and vehicles	5 - 30 years

The Water 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, 2013 and 2012 totaled $55,451 and $78,607, respectively.

Restricted Assets

The unexpended 2007 and 2011 bond proceeds as of December 31, 2013 and 2012 are included in the restricted assets.

Prepaid Debt Insurance/Deferred Charge on Refunding

Prepaid debt insurance and deferred charge on refunding are amortized on the effective interest method over the life of the bonds.

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. Deferred outflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt are also included in 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, or 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 Water Fund that 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, deferred outflows of resources, 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 Water Fund employees.

Adoption of Governmental Accounting Standards Board (GASB) Statement

The City has adopted GASB Statement No. 65, *"Items Previously Reported as Assets and Liabilities."* This Statement reclassifies certain items that were reported as assets and liabilities as deferred outflows of resources and deferred inflows of resources. As a result of this statement, reclassifications have been made on the Balance Sheets. Debt issuance costs previously were expensed over the life of the bonds. Under GASB Statement No. 65, debt issuance costs, excluding debt insurance, are fully expensed in the year of issuance.

Pending Pronouncements

In June 2012, the GASB issued Statements No. 67 and No. 68, *"Financial Reporting for Pension Plans"* and *"Accounting and Financial Reporting for Pensions."* In addition, in November 2013, the GASB issued Statement No. 71, *"Pension Transition for Contributions Made Subsequent to the Measurement Date."* The objective of these Statements is to revise and establish reporting requirements for most governments that provide their employees with pension benefits. The provisions of these Statements are effective for the City's December 31, 2014 and 2015 financial statements.

In April 2013, the GASB issued Statement No. 70, *"Accounting and Financial Reporting for Nonexchange Financial Guarantees."* The objective of this Statement is to improve accounting and financial reporting by governments that extend and receive nonexchange financial guarantees. The provisions of this Statement are effective for the City's December 31, 2014 financial statements.

The effect of implementation of these Statements has not yet been determined.

Reclassification

Certain reclassifications have been made to the prior year financial statements in order for them to be in conformity with the current year presentation.

2. DEPOSITS

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 Water Fund does not have a deposit policy for custodial credit risk.

The Water Fund pools certain of its deposits and investments with the City. At December 31, 2013 and 2012, the book balance of the pooled deposits was $31,351,770 and $48,374,435, respectively, and the bank balance was $31,421,424 and $48,645,882, respectively. The Water Fund's position in the pooled deposits was $10,583,976 and $13,055,361 at December 31, 2013 and 2012, respectively. At December 31, 2013 and 2012, the entire balance 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.

3. Capital Assets

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

	December 31, 2012	Increase/ Transfers In	Decrease/ Transfers Out	December 31, 2013
Capital assets not being depreciated:				
Land	$ 2,564,600	$ -	$ -	$ 2,564,600
Construction-in-progress	157,143	365,955	(157,143)	365,955
Total capital assets, not being depreciated	2,721,743	365,955	(157,143)	2,930,555
Capital assets being depreciated:				
Water system	176,781,344	2,960,506	-	179,741,850
Equipment and vehicles	4,104,896	214,534	(35,930)	4,283,500
Total capital assets, being depreciated	180,886,240	3,175,040	(35,930)	184,025,350
Less accumulated depreciation for:				
Water system	(42,173,058)	(3,291,522)	-	(45,464,580)
Equipment and vehicles	(2,435,191)	(251,331)	35,930	(2,650,592)
Total accumulated depreciation	(44,608,249)	(3,542,853)	35,930	(48,115,172)
Capital assets being depreciated, net	136,277,991	(367,813)	-	135,910,178
Capital assets, net	$ 138,999,734	$ (1,858)	$ (157,143)	$ 138,840,733

CITY OF LANCASTER WATER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2013 AND 2012

	December 31, 2011	Increase/ Transfers In	Decrease/ Transfers Out	December 31, 2012
Capital assets not being depreciated:				
Land	$ 2,564,600	$ -	$ -	$ 2,564,600
Construction-in-progress	56,980	157,143	(56,980)	157,143
Total capital assets, not being depreciated	2,621,580	157,143	(56,980)	2,721,743
Capital assets being depreciated:				
Water system	172,360,764	4,420,580	-	176,781,344
Equipment and vehicles	3,731,121	418,137	(44,362)	4,104,896
Total capital assets, being depreciated	176,091,885	4,838,717	(44,362)	180,886,240
Less accumulated depreciation for:				
Water system	(38,965,273)	(3,207,785)	-	(42,173,058)
Equipment and vehicles	(2,278,606)	(200,947)	44,362	(2,435,191)
Total accumulated depreciation	(41,243,879)	(3,408,732)	44,362	(44,608,249)
Capital assets being depreciated, net	134,848,006	1,429,985	-	136,277,991
Capital assets, net	$ 137,469,586	$ 1,587,128	$ (56,980)	$ 138,999,734

4. LONG-TERM LIABILITIES

A summary of long-term liabilities for the year ended December 31, 2013 is as follows:

Date of Issue/ Maturity	Amount of Original Issue	Description and Interest Rates	Balance Outstanding December 31, 2013
2007/2046	$ 96,460,000	General Obligation Bonds, 4.00% - 5.00%	$ 95,630,000
2002/2022	692,533	Note Payable to Financing Agency, 2.77%	343,469
2009/2030	15,875,000	General Obligation Notes, 2.50% - 4.875%	12,080,000
2010/2028	690,800	General Obligation Bonds, 2.00% - 4.00%	583,600
2011/2041	11,260,000	General Obligation Bonds, 1.75% - 5.00%	10,740,000
			$ 119,377,069

Bonds Payable

In 1998, the City issued $61,915,000 of general obligation bonds. The portion allocable to the Water Fund amounted to $26,185,000, bearing interest at rates ranging from 3.60% to 5.05%. The proceeds of the bond issuance were used to (i) finance the acquisition of the water system through the refunding of the Metropolitan Lancaster Authority's outstanding: (a) Water Revenue Bonds, Series of 1990; (b) Water Revenue Bonds, Series of 1992; (c) Water Project Notes, Series of 1997; and (d) Water Revenue Notes, Series of 1998. These bonds were currently refunded through the issuance of General Obligation Notes, Series of 2009.

In 2003, the City issued $9,995,000 of general obligation bonds. The portion allocable to the Water Fund amounted to $800,000, bearing interest at rates ranging from 2.00% to 4.45%. The proceeds of the bond issuance were used to fund transmission and distribution projects. These bonds were currently refunded through the issuance of General Obligation Bonds, Series of 2010.

In 2007, the City issued $125,315,000 of general obligation bonds. The portion allocable to the Water Fund amounted to $96,460,000, bearing interest at rates ranging from 4.00% to 5.00%. The proceeds of the bond issuance were used to fund the construction of the membrane filtration plant and refund the City’s 2004 note payable.

In 2010, the City issued $8,635,000 of general obligation bonds. The portion allocable to the Water Fund amounted to $690,800. The bonds bear interest at rates ranging from 2.00% to

4.00%. The proceeds of the bond issuance were used to currently refund the General Obligation Bonds, Series of 2003.

In 2011, the City issued $38,860,000 of general obligation bonds. The portion allocable to the Water Fund amounted to $11,260,000, bearing interest rates ranging from 1.75% to 5.00%. The proceeds of the bond issuance were used for improvements and upgrades to the water plant and various miscellaneous capital projects.

Notes Payable

In 2002, the City issued $692,533 of notes, bearing interest at 2.77%. The proceeds of the note issuance were used to construct a water main in Manor Township and to reinforce the water supply to the Borough of Millersville.

In 2009, the City issued $43,990,000 of general obligation notes. The portion allocable to the Water Fund amounted to $15,875,000, 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 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 and notes payable are as follows:

Year Ended December 31,	Principal Maturity	Interest Maturity	Total
2014	$ 1,972,367	$ 5,305,463	$ 7,277,830
2015	2,029,027	5,247,684	7,276,711
2016	2,096,132	5,179,541	7,275,673
2017	2,193,283	5,085,345	7,278,628
2018	2,290,881	4,985,000	7,275,881
2019-2023	13,192,379	23,206,232	36,398,611
2024-2028	16,423,000	19,981,735	36,404,735
2029-2033	18,315,000	16,101,497	34,416,497
2034-2038	19,405,000	12,025,350	31,430,350
2039-2043	24,180,000	7,247,925	31,427,925
2044-2046	17,280,000	1,577,925	18,857,925
	$ 119,377,069	$ 105,943,697	$ 225,320,766

Capital Lease

In 2008, the City purchased two trucks under long-term lease agreements that are classified as capital leases. Both trucks were paid in full in 2012. As of December 31, 2012, the Water Fund includes these vehicles at a cost of $231,419 and accumulated depreciation of $61,766.

In 2011 through 2013, the City purchased multiple vehicles and equipment under long-term lease agreements that are classified as capital leases. As of December 31, 2013 and 2012, the Water Fund includes these vehicles and equipment at a cost of $477,276 and accumulated depreciation of $97,355 and $22,078, respectively.

The future minimum payments under these capital leases and the present value of the minimum lease payments at December 31, 2013 are as follows:

Year Ended December 31,	Total
2014	$ 93,945
2015	83,374
2016	76,887
2017	29,051
Total minimum lease payments	283,257
Less amount representing interest	(24,041)
Present value of future minimum lease payments	$ 259,216

Changes in long-term liabilities for the years ended December 31, 2013 and 2012 are as follows:

	December 31, 2012	Increase	Decrease	December 31, 2013	Amount Due Within One Year
Bonds payable	$ 107,909,800	$ -	$ (956,200)	$ 106,953,600	$ 981,600
Unamortized premium	1,069,078	-	(60,922)	1,008,156	-
Notes payable	13,383,018	-	(959,549)	12,423,469	990,767
Capital lease	227,360	134,521	(102,665)	259,216	82,440
Compensated absences	76,660	541,550	(540,027)	78,183	14,441
Workers' compensation payable	21,632	258,450	(23,384)	256,698	33,128
	$ 122,687,548	$ 934,521	$ (2,642,747)	$ 120,979,322	$ 2,102,376

	December 31, 2011	Increase	Decrease	December 31, 2012	Amount Due Within One Year
Bonds payable	$ 108,330,200	$ -	$ (420,400)	$ 107,909,800	$ 956,200
Unamortized premium	1,130,734	-	(61,656)	1,069,078	-
Notes payable	14,316,392	-	(933,374)	13,383,018	959,549
Capital lease	133,971	219,385	(125,996)	227,360	73,615
Compensated absences	81,466	477,391	(482,197)	76,660	17,954
Workers' compensation payable	27,468	-	(5,836)	21,632	5,197
	$ 124,020,231	$ 696,776	$ (2,029,459)	$ 122,687,548	$ 2,012,515

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, 2013 and 2012, the borrowing had an outstanding balance of $1,401,230 and $1,565,850, 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 $712,867 and $650,261 at December 31, 2013 and 2012, respectively.

A summary of principal and interest maturities on the borrowing at December 31, 2013 is as follows:

Year Ended December 31,	Principal	Interest	Total
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	110,586	33,453	144,039
2019-2023	499,751	99,264	599,015
2024-2028	260,694	9,031	269,725
	$ 1,401,230	$ 326,414	$ 1,727,644

As noted above, this borrowing is reflected in the governmental activities section of the City's financial statement, and as such, the Water 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) with PNC Bank, N.A. as the counterparty in connection with the Series A Bonds through the final maturity of the Series A Bonds (May 1, 2028).

Terms. 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 one-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.

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, 2013, the Basis Swap had a fair value of ($929,079). 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 value of $316,395 during the year ended December 31, 2013 is recorded as a component of general government expense 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, 2013. 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

31, 2013, the interest rate the City is paying under the Basis Swap was 0.06%, whereas the interest the City is receiving at 67% of the one-month LIBOR rate was 0.11%.

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, 2013, 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.

B. Plan Description and Contribution Information

Cash Balance Pension Plan

Membership of CBPP consisted of the following at January 1, 2013, the date of the latest actuarial valuation:

Retirees and beneficiaries currently receiving benefits	45
Terminated employees entitled to benefits	34
	79
Active plan participants:	
Fully-vested	198
Non-vested	105
	303
Total	382

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 $658,898 and $516,512 to the CBPP for the years ended December 31, 2013 and 2012, respectively. Of the amount contributed by the City, the Water Fund contributed $168,044 and $139,983 for the years ended December 31, 2013 and 2012, respectively.

C. ***Annual Pension Cost and Net Pension Asset***

The City's annual pension cost and net pension asset for the CBPP for the years ended December 31, 2013 and 2012 were as follows:

	2013	2012
Annual required contribution	$ 658,895	$ 516,512
Interest on net pension asset	(6,199)	(6,357)
Adjustment to annual required contribution	8,264	8,476
Annual pension cost	660,960	518,631
Contributions	658,898	516,512
Change in net pension asset	2,062	2,119
Net pension asset, beginning of year	(82,637)	(84,756)
Net pension asset, end of year	$ (80,575)	$ (82,637)

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

The January 1, 2013 actuarial valuation used the entry age normal actuarial cost method. The actuarial assumptions included a) 6.50% - 7.50% investment rate of return, b) a projected salary increase of 5%, c) level dollar closed amortization method, and d) 15-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 120% or less than 80% of market value.

Three-Year Information

CBPP:

Calendar Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Asset
2011	$ 506,453	99.6%	$ (84,756)
2012	518,631	99.6%	(82,637)
2013	660,960	99.7%	(80,575)

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)
1/1/2013	$ 10,106,397	$ 12,781,267	$ 2,674,870	79.1%	$ 12,661,626	21.1%

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, 2013 and 2012, there were 192 and 187 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, 2013, plan participants and the City made contributions of $396,314 and $86,420, respectively. During the year ended December 31, 2012, plan participants and the City made contributions of $375,290 and $81,386, respectively. Of the amount contributed by the City, the Water Fund contributed $28,656 and $27,425 for the years ended December 31, 2013 and 2012, 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 the cost of the plan, which generally ranges from approximately 2% to 10% 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, 2013 and 2012, respectively, the City's net cost of providing health benefits and life insurance for retired employees was $4,823,749 and $4,448,641. Of the amount contributed by the City, the Water Fund contributed $1,155,723 and $1,052,524 for the years ended December 31, 2013 and 2012, respectively. A portion of the contributions made during the years ended December 31, 2013 and 2012, in the amount of $726,203 and $675,515, respectively, was made directly to the City's OPEB trust fund by the City's Water Fund. Plan members receiving benefits contributed $71,692 and $90,157 through their contributions as required by the cost sharing provisions of the plans for the years ended December 31, 2013 and 2012, 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.

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

Annual OPEB Cost and Net OPEB Obligation

The Water Fund portion of the City's annual OPEB costs and net OPEB obligations to the plan for the years ended December 31, 2013 and 2012 were as follows:

	2013	2012
Annual required contribution	$ 1,067,625	$ 1,067,625
Interest on net OPEB obligation	150,274	152,088
Adjustment to annual required contribution	(205,013)	(207,486)
Annual OPEB cost	1,012,886	1,012,227
Contribution made	(1,155,723)	(1,052,524)
Change in Net OPEB obligation	(142,837)	(40,297)
Net OPEB obligation, beginning	3,339,429	3,379,726
Net OPEB obligation, ending	$ 3,196,592	$ 3,339,429

Three-Year Trend Information

Year	Annual OPEB Cost (AOC)	Percentage of AOC Contributed	Net OPEB Obligation
2011	$ 1,148,880	33.4%	$ 3,379,726
2012	1,012,227	104.0%	3,339,429
2013	1,012,886	114.1%	3,196,592

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	$ -	$ 10,700,060	$ 10,700,060	0.00%	$ 3,079,389	347.47%

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 2013, the City was limited to $650,000 per each accident and $650,000 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 Water Fund for the years ended December 31, 2013 and 2012 is as follows:

Unpaid claims as of January 1, 2012	$ 27,468
Incurred claims during 2012	-
Payments during 2012	(5,836)
Unpaid claims as of January 1, 2013	21,632
Incurred claims during 2013	258,450
Payments during 2013	(23,384)
Unpaid claims as of December 31, 2013	$ 256,698

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 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 2013.

10. CONTRACT COMMITMENTS

During the year ended December 31, 2013, the Water Fund contracted to make necessary capital improvements to the water system. As a result of this, the City entered into contracts with construction contractors totaling $2,409,986. At December 31, 2013, $936,224 was included in accounts payable. The commitment remaining on the contracts at December 31, 2013 was $1,876,571.

11. NEGATIVE UNRESTRICTED NET POSITION

A series of inside City water rate increases, as well as a nearly 75% increase in rates for outside City customers approved by the PA Public Utility Commission (PUC) in July 2011, have greatly improved cash flow. However, the need for cash borrowing from the General Fund increased in 2013 by $1.7 million at year end. On June 6, 2014, the City filed a water rate increase request to the PUC for outside City customers that, if approved in whole, would increase Water Fund revenues by $6.46 million on an annualized basis. Following the conclusion of the City's PUC rate case, an increase in inside City water rates will be presented to City Council. Together, these rate increases would significantly improve cash flow in the Water Fund and eliminate the need for cash borrowing.

12. SUBSEQUENT EVENTS

In June 2014, City Council approved the issuance of General Obligation Bonds, Series of 2014, in the aggregate amount of $42,490,000. The portion allocable to the Water Fund amounted to $27,235,000. Bond proceeds will be used for the purposes of financing improvements and upgrades to the water treatment and distribution facilities. The bonds bear interest at rates ranging from 3.0% to 5.0%.

Required Supplementary Information

CITY OF LANCASTER WATER 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)
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%
2013	10,106,397	12,781,267	2,674,870	79.1%	12,661,626	21.1%

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
1/1/2013	Assumption change and actuarial amendment	787,655

SCHEDULE OF EMPLOYER CONTRIBUTIONS - PENSION PLAN (UNAUDITED)

Calendar Year	Annual Required Contribution	Contributions From Employer	Percentage Contributed
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%
2013	658,895	658,898	100.0%

Note: Contributions include state pension aid.

CITY OF LANCASTER WATER 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	$ -	$ 8,834,931	$ 8,834,931	0.0%	$ 2,914,972	303.1%
1/1/2010	-	11,365,848	11,365,848	0.0%	3,814,064	298.0%
1/1/2012	-	10,700,060	10,700,060	0.0%	3,079,389	347.5%

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

SCHEDULE OF EMPLOYER CONTRIBUTIONS - OPEB (UNAUDITED)

Year	Annual Required Contribution	Percentage Contributed
2008	$ 1,019,581	10.6%
2009	1,019,581	14.3%
2010	1,191,735	26.8%
2011	1,191,735	32.2%
2012	1,067,625	98.6%
2013	1,067,625	108.3%