

City of Lancaster Sewer Fund

Financial Statements and Required Supplementary Information

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

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CITY OF LANCASTER SEWER FUND

YEARS ENDED DECEMBER 31, 2013 AND 2012

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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 Sewer 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 Sewer 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 Sewer 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 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.

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 9, 2014

CITY OF LANCASTER SEWER FUND

BALANCE SHEETS

DECEMBER 31, 2013 AND 2012

	2013	2012
Assets and Deferred Outflows of Resources		
<u>Assets:</u>		
Current assets:		
Cash and cash equivalents	\$ 300	\$ 300
Cash and cash equivalents - restricted	29,667,195	31,493,524
Investments - restricted	467,593	1,485,644
Receivables:		
Regular	1,418,176	1,375,307
Bulk - net of allowance for uncollectible accounts of \$7,606,209 and \$7,127,509 in 2013 and 2012, respectively	1,012,937	1,255,436
Unbilled	804,081	690,882
Industrial waste surcharge	74,332	87,859
Prepaid expenses	93,804	7,822
Total current assets	33,538,418	36,396,774
Long-term assets:		
Due from other governments	153,554	53,489
Prepaid debt insurance	609,597	668,763
Capital assets, not being depreciated	1,926,014	2,460,939
Capital assets, being depreciated, net	87,627,960	79,192,879
Total long-term assets	90,317,125	82,376,070
Total Assets	123,855,543	118,772,844
<u>Deferred Outflows of Resources:</u>		
Deferred charge on refunding	918,600	1,044,794
Total Deferred Outflows of Resources	918,600	1,044,794
Total Assets and Deferred Outflows of Resources	\$ 124,774,143	\$ 119,817,638

(Continued)

Liabilities and Net Position	<u>2013</u>	<u>2012</u>
Liabilities:		
Current liabilities:		
Accounts payable	\$ 2,037,108	\$ 3,539,144
Accrued expenses	337,195	340,320
Due to City of Lancaster General Fund	2,342,599	3,206,487
Due to other governments	9,337,943	6,709,509
Unearned revenue	214,254	185,000
Compensated absences, current portion	15,055	15,382
Workers' compensation payable, current portion	127	481
Capital lease, current portion	164,041	97,796
Notes payable, current portion	870,000	840,000
Bonds payable, current portion	840,000	535,000
Total current liabilities	<u>16,158,322</u>	<u>15,469,119</u>
Long-term liabilities:		
Due to other governments	467,593	469,070
Compensated absences, net of current portion	66,455	50,299
Workers' compensation payable, net of current portion	859	1,523
Net other post-employment liability	2,884,793	2,495,243
Capital lease, net of current portion	317,843	219,926
Notes payable, net of current portion	10,392,781	10,670,000
Bonds payable, net of current portion	31,764,478	32,687,610
Total long-term liabilities	<u>45,894,802</u>	<u>46,593,671</u>
Total Liabilities	<u>62,053,124</u>	<u>62,062,790</u>
Net Position:		
Net investment in capital assets	61,709,827	60,089,151
Restricted for capital acquisition	5,218,942	3,781,116
Unrestricted	(4,207,750)	(6,115,419)
Total Net Position	<u>62,721,019</u>	<u>57,754,848</u>
Total Liabilities and Net Position	<u><u>\$ 124,774,143</u></u>	<u><u>\$ 119,817,638</u></u>

(Concluded)

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, 2013 AND 2012

	2013	2012
Operating Revenues:		
Sewage treatment revenue:		
Sewage treatment	\$ 8,357,748	\$ 8,155,986
Industrial waste surcharge	487,930	499,064
Bulk treatment	3,328,933	3,145,838
Maintenance fee income	183,021	192,011
Miscellaneous	96,421	162,196
Total operating revenues	12,454,053	12,155,095
Operating Expenses:		
Administration	3,330,533	3,385,101
Depreciation	2,878,714	2,569,361
Collection system	743,440	641,653
Sewage pumping station	1,088,048	1,044,558
Sewage treatment plants	4,116,587	4,421,333
Sewer grounds maintenance	139,120	135,200
Wastewater and green initiatives	824,299	199,349
Total operating expenses	13,120,741	12,396,555
Operating Loss	(666,688)	(241,460)
Non-Operating Revenue (Expenses):		
State pension contribution	104,586	85,704
Grant revenue	-	79,691
Investment income	43,936	58,247
Amortization expense	(59,166)	(60,732)
Interest expense	(1,921,995)	(1,928,101)
Total non-operating revenue (expenses)	(1,832,639)	(1,765,191)
Loss before transfers and capital contributions	(2,499,327)	(2,006,651)
Transfers in	1,663,636	3,613,269
Capital contributions	5,801,862	4,316,222
Change in Net Position before Extraordinary Item	4,966,171	5,922,840
Extraordinary Item:		
Legal settlement (Note 12)	-	1,162,000
Change in Net Position	4,966,171	7,084,840
Net Position:		
Beginning of year	57,754,848	50,670,008
End of year	\$ 62,721,019	\$ 57,754,848

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

CITY OF LANCASTER SEWER FUND

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
Cash Flows From Operating Activities:		
Cash received from users	\$ 12,453,946	\$ 11,216,601
Cash paid to suppliers	(8,978,721)	(5,541,080)
Cash paid to employees	(2,327,097)	(2,215,641)
	1,148,128	3,459,880
Cash Flows From Investing Activities:		
Net sale of investments	1,018,051	1,649,232
Investment income	43,936	58,247
	1,061,987	1,707,479
Cash Flows From Capital and Related Financing Activities:		
Principal payments on note payable	(840,000)	(820,000)
Principal payments on capital lease	(170,503)	(105,649)
Proceeds from note payable	592,781	-
Principal payments on bonds payable	(535,000)	(515,000)
Interest paid	(1,917,708)	(1,959,157)
Acquisition of capital assets	(10,499,167)	(15,341,588)
Grant income received	-	79,691
Legal settlement	-	1,162,000
Net change in escrow deposits	8,428,819	(881,992)
	(4,940,778)	(18,381,695)
Cash Flows From Non-Capital Financing Activities:		
Transfers in	1,663,636	3,613,269
Due to the City of Lancaster General Fund	(863,888)	941,487
State pension contribution	104,586	85,704
	904,334	4,640,460
Net Decrease in Cash and Cash Equivalents	(1,826,329)	(8,573,876)
Cash and Cash Equivalents:		
Beginning of year	31,493,824	40,067,700
End of year	\$ 29,667,495	\$ 31,493,824

(Continued)

CITY OF LANCASTER SEWER FUND

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2013 AND 2012

(Continued)

	<u>2013</u>	<u>2012</u>
Reconciliation of Operating Loss to Net Cash Provided by Operating Activities:		
Operating loss	\$ (666,688)	\$ (241,460)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation expense	2,878,714	2,569,361
Changes in assets and liabilities:		
Receivables	99,958	(928,323)
Due from other governments	(100,065)	(10,171)
Prepaid expenses	(85,982)	(6,664)
Accounts payable	(1,388,182)	1,676,669
Accrued expenses	6,012	15,146
Compensated absences	15,829	(6,140)
Workers' compensation payable	(1,018)	(8,881)
Net other post-employment liability	389,550	400,343
Total adjustments	<u>1,814,816</u>	<u>3,701,340</u>
Net cash provided by operating activities	<u>\$ 1,148,128</u>	<u>\$ 3,459,880</u>
Noncash Capital Financing Activities:		
Proceeds from capital lease	<u>\$ 334,665</u>	<u>\$ 54,538</u>
		(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, 2013 AND 2012

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, 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 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, 2013 AND 2012

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, 2013 and 2012 totaled \$58,891 and \$68,187, respectively.

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.

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, 2013 AND 2012

The unexpended 2007 and 2011 bond proceeds as of December 31, 2013 and 2012 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. 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, 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 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 Sewer 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

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2013 AND 2012

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 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.

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2013 AND 2012

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, 2013 and 2012, the Sewer Fund's non-pooled book balances were \$14,556,885 and \$10,490,625, respectively, and the bank balances were \$14,556,885 and \$10,490,624, respectively. At December 31, 2013 and 2012, \$250,000 and \$250,000, respectively, was covered by federal depository insurance and \$14,306,885 and \$10,240,624, 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, 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 Sewer Fund's position in the pooled deposits was \$15,110,310 and \$21,002,899 at December 31, 2013 and 2012, respectively. At December 31, 2013, \$750,000 was insured by federal depository insurance and the remaining balance of \$14,360,310 was collateralized under Act No. 72. At December 31, 2012, \$10,549,757 was insured by federal depository insurance and the remaining balance of \$10,453,142 was collateralized under the Act.

B. Investments

The fair value of the investments of the Sewer Fund at December 31, 2013 and 2012 is as follows:

	<u>Fair Value</u>
December 31, 2013	
<u>Money market funds</u>	<u>\$ 467,593</u>
December 31, 2012	
<u>Money market funds</u>	<u>\$ 1,050,644</u>
Certificates of deposit	435,000
	<u>\$ 1,485,644</u>

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2013 AND 2012

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, 2013 and 2012, all investments of the Sewer Fund are held by the financial institution's trust department, in the Sewer Fund's name.

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, 2013 and 2012, more than five percent of the Sewer Fund investments were held with the following issuers:

<u>December 31, 2013</u>	<u>Fair Value</u>	<u>Percent of Investments</u>
Goldman Sachs Financial Square Treasury Obligation Money Market	\$ 467,593	100.00%
<u>December 31, 2012</u>		
Goldman Sachs Financial Square Treasury Obligation Money Market	\$ 1,016,574	68.43%

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, 2013 and 2012, the Sewer Fund's investments in money market funds were rated AAA.

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, 2013 and 2012, 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, 2013 AND 2012

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	\$ 1,484,824	\$ -	\$ -	\$ 1,484,824
Construction-in-progress	976,115	441,190	(976,115)	441,190
Total capital assets, not being depreciated	2,460,939	441,190	(976,115)	1,926,014
Capital assets being depreciated:				
Sewer system	131,990,707	10,934,100	-	142,924,807
Equipment and vehicles	10,138,391	379,695	(30,480)	10,487,606
Total capital assets, being depreciated	142,129,098	11,313,795	(30,480)	153,412,413
Less accumulated depreciation for:				
Sewer system	(55,096,714)	(2,595,955)	-	(57,692,669)
Equipment and vehicles	(7,839,505)	(282,759)	30,480	(8,091,784)
Total accumulated depreciation	(62,936,219)	(2,878,714)	30,480	(65,784,453)
Capital assets being depreciated, net	79,192,879	8,435,081	-	87,627,960
Capital assets, net	\$ 81,653,818	\$ 8,876,271	\$ (976,115)	\$ 89,553,974

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2013 AND 2012

	<u>December 31,</u> <u>2011</u>	<u>Increase/ Transfers In</u>	<u>Decrease/ Transfers Out</u>	<u>December 31,</u> <u>2012</u>
Capital assets not being depreciated:				
Land	\$ 1,484,824	\$ -	\$ -	\$ 1,484,824
Construction-in-progress	<u>171,934</u>	<u>976,115</u>	<u>(171,934)</u>	<u>976,115</u>
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	<u>9,785,158</u>	<u>353,233</u>	<u>-</u>	<u>10,138,391</u>
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	<u>(7,589,975)</u>	<u>(249,530)</u>	<u>-</u>	<u>(7,839,505)</u>
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>\$ 69,259,681</u>	<u>\$ 12,566,071</u>	<u>\$ (171,934)</u>	<u>\$ 81,653,818</u>

CITY OF LANCASTER SEWER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2013 AND 2012

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
2007/2022	\$ 12,150,000	General Obligation Bonds, 4.00% - 5.00%	\$ 9,550,000
2009/2025	14,030,000	General Obligation Notes, 2.50% - 4.875%	10,670,000
2011/2041	22,460,000	General Obligation Bonds, 1.75% - 5.00%	22,460,000
2013/2035	7,000,000	Note Payable to Financing Agency, 1.495% - 2.965%	592,781
			<u>\$ 43,272,781</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

CITY OF LANCASTER SEWER FUND

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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.

In 2013, the City issued \$7,000,000 Guaranteed Revenue Note of 2012. This is a Pennvest drawdown 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. This Note bears interest at a rate of 1.495% for the first five years and 2.965% thereafter. As of December 31, 2013, \$592,781 was drawn down on this Note.

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

<u>Year Ended December 31,</u>	<u>Principal Maturity</u>	<u>Interest Maturity</u>	<u>Total</u>
2014	\$ 1,710,000	\$ 1,881,444	\$ 3,591,444
2015	1,779,213	1,831,513	3,610,726
2016	1,853,747	1,774,091	3,627,838
2017	1,939,180	1,688,741	3,627,921
2018	2,029,619	1,597,899	3,627,518
2019-2023	11,683,604	6,458,006	18,141,610
2024-2028	6,648,187	4,190,414	10,838,601
2029-2033	5,061,040	3,146,928	8,207,968
2034-2038	6,168,191	1,899,768	8,067,959
2039-2041	4,400,000	415,475	4,815,475
	<u>\$ 43,272,781</u>	<u>\$ 24,884,279</u>	<u>\$ 68,157,060</u>

Capital Lease

From 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 Sewer Fund includes these vehicles and equipment at a cost of \$915,643 and \$627,271, respectively, with accumulated depreciation of \$165,982 and \$65,041, respectively.

CITY OF LANCASTER SEWER FUND

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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	\$ 185,717
2015	184,235
2016	84,834
2017	72,708
Total minimum lease payments	527,494
Less amount representing interest	(45,610)
Present value of future minimum lease payments	\$ 481,884

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	\$ 32,545,000	\$ -	\$ (535,000)	\$ 32,010,000	\$ 840,000
Unamortized premium	677,610	-	(83,132)	594,478	-
Notes payable	11,510,000	592,781	(840,000)	11,262,781	870,000
Capital lease	317,722	334,665	(170,503)	481,884	164,041
Compensated absences	65,681	387,208	(371,379)	81,510	15,055
Workers' compensation payable	2,004	-	(1,018)	986	127
	\$ 45,118,017	\$ 1,314,654	\$ (2,001,032)	\$ 44,431,639	\$ 1,889,223

CITY OF LANCASTER SEWER FUND

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	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	-
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
	<u>\$ 46,605,275</u>	<u>\$ 367,851</u>	<u>\$ (1,855,109)</u>	<u>\$ 45,118,017</u>	<u>\$ 1,488,659</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, 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.

CITY OF LANCASTER SEWER FUND

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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
	<u>\$ 1,401,230</u>	<u>\$ 326,414</u>	<u>\$ 1,727,644</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) 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.

CITY OF LANCASTER SEWER FUND

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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

CITY OF LANCASTER SEWER FUND

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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.

CITY OF LANCASTER SEWER FUND

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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	<u>34</u>
	<u>79</u>
Active plan participants:	
Fully-vested	198
Non-vested	<u>105</u>
	<u>303</u>
Total	<u><u>382</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 \$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 Sewer Fund contributed \$104,586 and \$85,704 for the years ended December 31, 2013 and 2012, respectively.

CITY OF LANCASTER SEWER FUND

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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:

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

The Sewer 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:

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

CITY OF LANCASTER SEWER FUND

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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 Sewer Fund contributed \$14,023 and \$13,889 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

CITY OF LANCASTER SEWER FUND

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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 Sewer Fund contributed \$222,037 and \$217,807 for the years ended December 31, 2013 and 2012, respectively. 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.

CITY OF LANCASTER SEWER FUND

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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

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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, 2013 and 2012 were as follows:

	2013	2012
Annual required contribution	\$ 652,488	\$ 652,488
Interest on net OPEB obligation	112,286	94,271
Adjustment to annual required contribution	(153,187)	(128,609)
Annual OPEB cost	611,587	618,150
Contribution made	(222,037)	(217,807)
Change in Net OPEB obligation	389,550	400,343
Net OPEB obligation, beginning	2,495,243	2,094,900
Net OPEB obligation, ending	\$ 2,884,793	\$ 2,495,243

Three-Year Trend Information

Year	Annual OPEB Cost (AOC)	Percentage of AOC Contributed	Net OPEB Obligation
2011	\$ 546,988	24.1%	\$ 2,094,900
2012	618,150	35.2%	2,495,243
2013	611,587	36.3%	2,884,793

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

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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 Sewer Fund for the years ended December 31, 2013 and 2012 is as follows:

Unpaid claims as of January 1, 2012	\$ 10,885
Incurred claims during 2012	-
Payments during 2012	<u>(8,881)</u>
Unpaid claims as of January 1, 2013	2,004
Incurred claims during 2013	-
Payments during 2013	<u>(1,018)</u>
Unpaid claims as of December 31, 2013	<u><u>\$ 986</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

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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 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 \$9,624,170. At December 31, 2013, \$574,701 was included in accounts payable. The commitment remaining on the contracts at December 31, 2013 was \$2,983,521.

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. 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 additional revenues to the Sewer Fund generated by this series of rate increases eliminated the Sewer Fund's need for additional cash borrowing from the General fund in 2013, though not enough to allow the Sewer Fund to make a repayment of cash borrowings from prior years.

In early 2014, a binding arbitration decision favorable to the City was issued in a dispute with East Lampeter Township seeking settlement of nearly \$3.7 million in disputed bulk sewer charges dating back as far as 1992. The resolution of the final dollar value of the award is ongoing, but the award due to the City is estimated at approximately \$2.4 million.

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

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

13. SUBSEQUENT EVENT

In January 2014, the City issued \$5,500,000 Guaranteed Revenue Note of 2014. This is a Pennvest loan that is for the construction of a preliminary treatment facility and diversion chamber.

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 Sewer Fund amounted to \$7,415,000. Bond proceeds will be used for the purposes of financing improvements and upgrades to the water treatment and distribution facilities and improving and upgrading wastewater treatment and collection facilities. The bonds bear interest at rates ranging from 3.0% to 5.0%.

**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)
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 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%
2013	652,488	34.0%

Supplementary Information

CITY OF LANCASTER SEWER FUND

SCHEDULE OF NET COST OF OPERATIONS OF THE CITY SEWER SYSTEM

YEAR ENDED DECEMBER 31, 2013

Direct Expenses and Costs:

Collection system	\$ 743,440
Sewage treatment plants	3,889,878
Sewage pumping station	1,088,048
City Bureau of Sewers	<u>2,527,648</u>
	8,249,014
Allowance per contracts for indirect expenses and costs (\$8,249,014 x 5.0%)	<u>412,451</u>
	<u>8,661,465</u>
Less reimbursements (as defined in agreements):	
Miscellaneous	204,106
Industrial waste surcharge	487,930
Management and operation service fee	<u>183,022</u>
	<u>875,058</u>
Net Cost of Operations of the City Sewer System	<u><u>\$ 7,786,407</u></u>

CITY OF LANCASTER SEWER FUND

SCHEDULE OF DIRECT EXPENSES AND COSTS

YEAR ENDED DECEMBER 31, 2013

Collection System:

Salaries and wages	\$ 471,170
Vehicle maintenance	73,637
Gasoline and oil	36,412
Miscellaneous expenses	162,221
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	743,440
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Sewage Treatment Plants:

Salaries and wages	746,802
Chemicals and laboratory supplies	417,594
Equipment maintenance	406,560
Vehicle maintenance	17,759
Gasoline, oil, and fuel	80,275
Water utility expense	64,326
Power	1,105,648
Building maintenance	9,989
Sludge disposal	941,845
Miscellaneous expenses	99,080
	<hr/>
	3,889,878
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Sewage Pumping Station:

Salaries and wages	573,959
Equipment maintenance	100,403
Building maintenance	836
Fuel	6,059
Power	405,835
Miscellaneous expenses	956
	<hr/>
	1,088,048
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City Bureau of Sewers:

Salaries and wages	375,876
Consultant and contract services	527,539
Special training	17,197
Uniforms	7,853
Telephone	24,905
Miscellaneous expense	83,636
Fringe benefits	1,490,642
	<hr/>
	2,527,648
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Total Direct Expenses and Costs

\$ 8,249,014

CITY OF LANCASTER SEWER FUND

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

YEAR ENDED DECEMBER 31, 2013

Net cost of operation of the City of Lancaster sewer system	\$ 7,786,407
Number of units of 1,000 gallons of sewage treated per records of the City of Lancaster (unaudited)	<u>7,261,658</u>
Net Cost of Treating 1,000 Gallons of Sewage	<u><u>\$ 1.0723</u></u>