

# **City of Lancaster Sewer Fund**

Financial Statements and Required  
Supplementary Information

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

# CITY OF LANCASTER SEWER FUND

YEARS ENDED DECEMBER 31, 2012 AND 2011

## TABLE OF CONTENTS

### **Independent Auditor's Report**

### **Financial Statements:**

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

### **Required Supplementary Information:**

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

### **Supplementary Information:**

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

## Independent Auditor's Report

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

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the Sewer Fund of the City of Lancaster, as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, as listed in the table of contents.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

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

### ***Emphasis of Matter***

As discussed in Note 1, the financial statements present only the Sewer Fund and do not purport to, and do not, present fairly the financial position of the City of Lancaster, as of December 31, 2012 and 2011, the changes in its financial position, or, where applicable, its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### ***Other Matters***

#### Required Supplementary Information

Management has omitted the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Accounting principles generally accepted in the United States of America require that the schedules of funding progress and employer contributions on pages 30 and 31 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

#### Supplementary Information

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

*Maher Duessel*

Harrisburg, Pennsylvania  
July 25, 2013

# CITY OF LANCASTER SEWER FUND

## BALANCE SHEETS

DECEMBER 31, 2012 AND 2011

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

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

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

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

YEARS ENDED DECEMBER 31, 2012 AND 2011

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

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

# CITY OF LANCASTER SEWER FUND

## STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2012 AND 2011

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

(Continued)

# CITY OF LANCASTER SEWER FUND

## STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2012 AND 2011

(Continued)

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

---

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

#### *Basis of Presentation and Accounting*

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

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

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

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

---

### *Cash and Cash Equivalents*

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

### *Investments*

Investments are stated at fair value.

### *Capital Assets*

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

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

|                        |              |
|------------------------|--------------|
| Sewer systems          | 50 years     |
| Equipment and vehicles | 5 - 30 years |

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

### *Capitalization of Interest*

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

### *Debt Issuance Costs/Deferred Loss on Refunding*

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

### *Restricted Assets*

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

---

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

---

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

### ***Net Position***

Net position is classified in the following categories:

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

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

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

### ***Use of Estimates***

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

### ***Pension Plans***

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

### ***Pending Changes in Accounting Principles***

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

---

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

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

## 2. DEPOSITS AND INVESTMENTS

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

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

### A. Deposits

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

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

---

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

### **B. Investments**

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

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

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

---

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

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

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

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

### 3. CAPITAL ASSETS

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

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

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

### 4. LONG-TERM LIABILITIES

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

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

#### ***Bonds Payable***

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

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

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

#### ***Notes Payable***

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

---

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

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

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

### *Capital Lease*

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

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

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

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

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

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

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

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

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

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

### 5. DERIVATIVE AGREEMENTS

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

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

---

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

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

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

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

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

---

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

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

## 6. PENSION PLANS

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

The CBPP does not issue stand-alone financial reports.

### A. *Summary of Significant Accounting Policies*

#### Basis of Accounting

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

#### Method Used to Value Investments

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

---

### ***B. Plan Description and Contribution Information***

#### Cash Balance Pension Plan

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

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

#### Plan Description

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

#### Contributions

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

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

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

### ***C. Annual Pension Cost and Net Pension Obligation***

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

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

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

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

### Three-Year Information

#### CBPP:

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Funded Status and Schedule of Funding Progress:

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

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

***Defined Contribution Plan***

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

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

## 7. OTHER POST-EMPLOYMENT BENEFITS

Plan Description

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

---

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

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

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

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

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

### Funding Policy and Annual OPEB Costs

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

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

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

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

---

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

---

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

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

### Actuarial Methods and Assumptions

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

Information as of the latest actuarial valuation follows:

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

---

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

### Annual OPEB Cost and Net OPEB Obligation

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

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

### Three-Year Trend Information

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

### Funded Status and Schedule of Funding Progress

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

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

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

---

### 8. RISK MANAGEMENT

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

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

#### *Self-Insurance-Workers' Compensation*

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

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

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

### 9. CONTINGENCIES

#### *Litigation*

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

---

# CITY OF LANCASTER SEWER FUND

## NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

---

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

### **10. CONTRACT COMMITMENTS**

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

### **11. NEGATIVE UNRESTRICTED NET POSITION**

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

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

### **12. EXTRAORDINARY ITEM – LEGAL SETTLEMENT**

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

# **CITY OF LANCASTER SEWER FUND**

## **NOTES TO FINANCIAL STATEMENTS**

**YEARS ENDED DECEMBER 31, 2012 AND 2011**

---

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

### **13. SUBSEQUENT EVENT**

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

**Required Supplementary  
Information**

# CITY OF LANCASTER SEWER FUND

## REQUIRED SUPPLEMENTARY INFORMATION

### SCHEDULE OF FUNDING PROGRESS - PENSION PLAN (UNAUDITED)

Cash Balance Pension Plan:

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

The following changes affect the comparability of costs:

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

### SCHEDULE OF EMPLOYER CONTRIBUTIONS - PENSION PLAN (UNAUDITED)

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

Note: Contributions include state pension aid.

# CITY OF LANCASTER SEWER FUND

## REQUIRED SUPPLEMENTARY INFORMATION

### SCHEDULE OF FUNDING PROGRESS - OPEB (UNAUDITED)

| Actuarial<br>Valuation<br>Date | Actuarial<br>Value of<br>Assets (a) | Actuarial<br>Accrued<br>Liability (AAL)-<br>Entry age (b) | Unfunded<br>AAL (UAAL)<br>(b-a) | Funded<br>Ratio<br>(a/b) | Covered<br>Payroll<br>(c) | UAAL as a<br>Percentage<br>of Covered<br>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<br>Required<br>Contribution | Percentage<br>Contributed |
|------|------------------------------------|---------------------------|
| 2008 | \$ 621,535                         | 5.6%                      |
| 2009 | 621,535                            | 7.9%                      |
| 2010 | 574,517                            | 4.3%                      |
| 2011 | 574,517                            | 22.9%                     |
| 2012 | 652,488                            | 33.4%                     |

## **Supplementary Information**

# CITY OF LANCASTER SEWER FUND

## SCHEDULE OF NET COST OF OPERATIONS OF THE CITY SEWER SYSTEM

YEAR ENDED DECEMBER 31, 2012

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

# CITY OF LANCASTER SEWER FUND

## SCHEDULE OF DIRECT EXPENSES AND COSTS

YEAR ENDED DECEMBER 31, 2012

### **Collection System:**

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

### **Sewage Treatment Plants:**

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

### **Sewage Pumping Station:**

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

### **City Bureau of Sewers:**

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

### **Sewer Grounds Maintenance:**

|                       |         |
|-----------------------|---------|
| Salaries and wages    | 126,305 |
| Uniforms              | 608     |
| Equipment maintenance | 996     |
| Miscellaneous expense | 7,291   |
|                       | <hr/>   |
|                       | 135,200 |

### **Total Direct Expenses and Costs**

**\$ 8,913,526**

# CITY OF LANCASTER SEWER FUND

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

YEAR ENDED DECEMBER 31, 2012

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