

CITY OF YORK SEWER AUTHORITY
(A Component Unit of the City of York, Pennsylvania)

FINANCIAL STATEMENTS

Years Ended December 31, 2006 and 2005

CITY OF YORK SEWER AUTHORITY
(A COMPONENT UNIT OF THE CITY OF YORK, PENNSYLVANIA)

YEARS ENDED DECEMBER 31, 2006 AND 2005

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Independent Auditors' Report

To the Members of the Board
City of York Sewer Authority
York, Pennsylvania

We have audited the accompanying basic financial statements of the City of York Sewer Authority (a component unit of the City of York, Pennsylvania) as of and for the years ended December 31, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the City of York Sewer Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of York Sewer Authority as of December 31, 2006 and 2005, and the changes in financial position and cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

The City of York Sewer Authority has not presented a management's discussion and analysis that U.S. generally accepted accounting principles have determined is necessary to supplement, although not required to be part of, the basic financial statements.

Maillie, Falconiero & Company LLP

October 31, 2007

CITY OF YORK SEWER AUTHORITY

(A Component Unit of the City of York, Pennsylvania)

STATEMENTS OF NET ASSETS

DECEMBER 31, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
Assets		
Cash and cash equivalents	\$ 8,884	\$ 4,420
Restricted assets:		
Cash and cash equivalents	2,001,690	2,915,124
Investments	<u>7,148,291</u>	<u>7,464,099</u>
	9,149,981	10,379,223
Accrued interest receivable	23,438	23,790
Net investment in direct financing lease	<u>25,524,564</u>	<u>27,250,662</u>
Total Assets	<u>34,706,867</u>	<u>37,658,095</u>
Liabilities		
Funds collected in advance	177,127	174,875
Accounts payable	6,971	168,106
Liabilities payable from restricted assets:		
Funds held on behalf of the City of York	4,985,789	4,789,943
Bonds payable:		
Due within one year	3,875,000	3,875,000
Due in more than one year	<u>23,401,344</u>	<u>25,245,246</u>
Total Liabilities	<u>32,446,231</u>	<u>34,253,170</u>
Net Assets		
Restricted for:		
Debt service	3,544,934	2,887,476
Construction	619,258	1,636,420
Unrestricted	<u>(1,903,556)</u>	<u>(1,118,971)</u>
Total Net Assets	<u>\$ 2,260,636</u>	<u>\$ 3,404,925</u>

See accompanying notes to basic financial statements.

CITY OF YORK SEWER AUTHORITY

(A Component Unit of the City of York, Pennsylvania)

STATEMENTS OF ACTIVITIES

YEARS ENDED DECEMBER 31, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
Operating Revenues:		
Lease investment income	\$ 1,639,870	\$ 1,579,550
Miscellaneous income	28	10,021
Total operating revenues	<u>1,639,898</u>	<u>1,589,571</u>
Operating Expenses:		
Interest expense	2,031,098	2,163,767
Professional services	73,069	129,747
Miscellaneous expense	7,690	20,217
Total operating expenses	<u>2,111,857</u>	<u>2,313,731</u>
Operating Loss	<u>(471,959)</u>	<u>(724,160)</u>
Non-Operating Revenues (Expenses):		
Intergovernmental grants	-	121,115
Investment income	443,771	632,254
Transfer to City of York	(1,116,101)	(1,343,041)
Total net nonoperating revenues (expenses)	<u>(672,330)</u>	<u>(589,672)</u>
Change in Net Assets	<u>(1,144,289)</u>	<u>(1,313,832)</u>
Net Assets:		
Beginning of year	<u>3,404,925</u>	<u>4,718,757</u>
End of year	<u>\$ 2,260,636</u>	<u>\$ 3,404,925</u>

See accompanying notes to basic financial statements.

CITY OF YORK SEWER AUTHORITY

(A Component Unit of the City of York, Pennsylvania)

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
Cash Flows From Operating Activities:		
Cash paid for administrative expenses	\$ (241,894)	\$ (72,442)
Cash received from others	28	10,021
Net cash used in operating activities	(241,866)	(62,421)
Cash Flows From Investing Activities:		
Sales of investment securities	315,808	1,121,544
Interest received	446,375	636,358
Net cash provided by investing activities	762,183	1,757,902
Cash Flows From Capital and Related Financing Activities:		
Transfer to City of York for capital outlays	(1,116,101)	(1,343,041)
Payments received on investment in direct financing lease	3,561,814	3,394,991
Intergovernmental grants	-	198,515
Principal paid on revenue bonds	(3,875,000)	(4,080,000)
Net cash used in capital and related financing activities	(1,429,287)	(1,829,535)
Net Decrease in Cash and Cash Equivalents	(908,970)	(134,054)
Cash and Cash Equivalents:		
Beginning of year	2,919,544	3,053,598
End of year	\$ 2,010,574	\$ 2,919,544
Reconciliation of Operating Loss to Net Cash Provided by Operating Activities:		
Operating loss	\$ (471,959)	\$ (724,160)
Adjustments to reconcile operating loss to net cash used in operating activities		
Interest expense	2,031,098	2,163,767
Lease investment income	(1,639,870)	(1,579,550)
Changes in assets and liabilities		
Accounts payable	(161,135)	77,522
Total adjustments	230,093	661,739
Net cash used in operating activities	\$ (241,866)	\$ (62,421)
Non Cash Investing Capital and Financing Activities:		
Principal accretion of revenue bonds	\$ 2,031,098	\$ 2,163,767

See accompanying notes to basic financial statements.

CITY OF YORK SEWER AUTHORITY

(A Component Unit of the City of York, Pennsylvania)

NOTES TO BASIC FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2006 AND 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Purpose

The City of York Sewer Authority (Authority) was incorporated November 27, 1950, under the provisions of the Municipality Authorities Act of 1945, as amended, for all the purposes authorized by the Act and shall have and exercise all powers granted to such Authorities under the Act. Through December 31, 2006, its operations have been primarily to acquire, construct, improve, and lease sewer systems and sewage treatment works.

Reporting Entity

The Authority is a component unit of the City of York (City) reporting entity. Criteria considered in making this determination include appointment of the Authority's Board, financial interdependence, and the Authority's potential to provide specific financial benefits to, or impose specific financial burdens on, the City.

The Authority's financial statements are blended with the City's sewer fund and accounted for as the sewer fund, an Enterprise Fund in the City's basic financial statements.

Basis of Presentation

All activities of the Authority are accounted for within a single enterprise fund. Enterprise funds are used to account for activities similar to those found in the private sector where the determination of net income is necessary for sound financial administration. Costs of construction, debt reduction, and Authority administration are financed or recovered through lease rentals received from the City and income on investments held by the Authority.

The financial statements of the Authority have been prepared on the accrual basis of accounting to conform to accounting principles generally accepted in the United States of America as they apply to enterprise funds of governmental units. The Authority has elected not to follow Financial Accounting Standards Board Statements and interpretations issued after November 30, 1989 as allowed under Statement No. 20 of the Governmental Accounting Standards Board (GASB), "*Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting.*"

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YEARS ENDED DECEMBER 31, 2006 AND 2005

Enterprise 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 an enterprise fund's principal ongoing operations. The principal operating revenue of the Authority is lease rental income. Operating expenses include the interest expense of the debt and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The accounting and financial reporting treatment applied to the Authority is determined by its measurement focus. The transactions of the Authority 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 statement of net assets. Net assets (i.e., total assets net of total liabilities) are segregated into "restricted for debt service and construction," and "unrestricted" components.

Cash and Cash Equivalents

For the purpose of the statement of cash flows, the Authority considers all highly liquid instruments with original maturities of three months or less to be cash equivalents.

Investments

In accordance with the terms of the trust indentures securing the bonded debt, monies of the Authority are accounted for by various funds, segregated for specific use and for the security of the bondholders and, except for the operating account which is directly maintained by the Authority, are maintained by an independent trustee.

Restricted Assets

Certain proceeds of revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net assets because their use is limited by applicable trust indentures or other agreements.

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Funds Held on Behalf of the City

In accordance with the Lease, as referred to in Note 4, the city shall receive credits against minimum annual rentals for (1) net income of the Authority from its real property rentals, not part of the Sewer System, (2) excess funds from the debt service reserve funds, and (3) income from debt service funds, clearing funds and sinking funds. The liability due to the City is comprised of the balance of unapplied credits as well as the balance of the debt service reserve fund as of December 31, 2006.

Funds Collected in Advance

Funds collected in advance represent funds collected from several municipalities for construction projects in the upcoming year. Revenue is earned as project expenditures are incurred.

Accreted Interest

Accreted interest represents the difference between the proceeds received from the Guaranteed Sewer Revenue Bonds – Series of 1990 and the maturity value. The accreted interest is recognized as interest expense and as part of the bonds outstanding, a liability, under the effective interest method.

Net Assets

Net assets comprise the various net earnings from operating and non-operating revenues and expenses. Net assets are classified in the following two components: restricted for debt service and construction; and unrestricted net assets. Restricted for debt service and construction consists of net assets for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations, and enabling legislation, including self-imposed legal mandates, less any related liabilities. Unrestricted consists of all other net assets not included in the above categories.

Restricted Resources

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

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Transfer to City of York

Transfer to the City of York represents capital expenditures incurred by the Authority for the year to improve the City-owned sewer infrastructure.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Risk Management

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Authority purchases commercial insurance for all risks of loss. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years.

Reclassifications

Certain items in the prior year financial statements have been reclassified for comparative purposes to conform with the presentation of the current year financial statements.

2. DEPOSITS AND INVESTMENTS

The Municipal Authority Act (act) provides for investment of public funds in certain authorized investment types including U.S. Treasury bills, other short-term U.S. and Pennsylvania government obligations, and insured or collateralized time deposits and certificates of deposit. The act also allows investment of funds received as a result of debt issuance in any security in which the Commonwealth of Pennsylvania may invest.

The deposit and investment policy of the Authority adheres to state statutes, prudent business practices, and the applicable trust indentures. The Authority deposits cash in local financial institutions.

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Deposits

Custodial Credit Risk - 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 Authority does not have a deposit policy for custodial credit risk. As of December 31, 2006, the Authority's book and bank balance was \$2,010,574. Of the bank balance, \$108,884 was covered by federal depository insurance, and the remaining balance of \$1,901,690 was collateralized under Act No. 72 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.

Investments

The fair value of the investments of the Authority at December 31, 2006, was as follows:

<u>Investments</u>	<u>Fair Value</u>
U.S. Government obligations	\$ 3,469,288
Guaranteed investment contracts	<u>3,679,003</u>
Total investments	<u>\$ 7,148,291</u>

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 Authority does not have an investment policy for custodial credit risk. All investments of the Authority are held by the financial institution, not in the Authority's name.

The Authority's U.S. government obligations include U.S. Treasury principal-only STRIPS. These particular STRIPS have little credit and legal risk while the market risk is significant as principal-only STRIPS are more sensitive to fluctuations in interest rates than other traditional investments. The carrying amount of these STRIPS at December 31, 2006 was \$3,469,288 and is reported as restricted investments in the balance sheet.

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Concentration of credit risk – The Authority places no limit on the amount the Authority may invest in any one issuer. At December 31, 2006, more than 5% of the Authority’s investments were held with the following issuers:

December 31, 2006	Fair Value	Percent of Investments
Guaranteed investment contracts		
MBIA Investment Management Corporation	\$ 3,679,003	51.47%

Credit risk – The Authority’s investments had the following level of exposure to credit risk as of December 31, 2006:

	Fair Value	Rating
Guaranteed investment contracts	\$ 3,679,003	Unrated

Interest rate risk – The Authority 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. The following is a list of the Authority's investments and their related average maturities:

	Fair Value	Investment Maturities (in years)		
		Less than 1 year	1-5	5-10
Guaranteed investment contracts	\$ 3,679,003	\$ -	\$ -	\$ 3,679,003
Total	\$ 3,679,003	\$ -	\$ -	\$ 3,679,003

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3. BONDS PAYABLE

The Authority has issued revenue bonds to finance various projects and refundings. A schedule of the Authority's bonds follows:

	<u>Issue Amount</u>	<u>Maturity</u>	<u>Interest Rate</u>	<u>Purpose</u>
Guaranteed Sewer Revenue Bonds - Series of 1990	\$ 69,775,000	2016	6.45% - 7.1%	Refund a portion of the revenue bonds, Series of 1987. Upgrade Sewage Treatment System.

Long-term liability activity for the year ended December 31, 2006 was as follows:

	<u>Beginning of Year</u>	<u>Retirements</u>	<u>Accretion</u>	<u>End of Year</u>	<u>Current Portion</u>
Revenue Bonds	<u>\$ 29,120,246</u>	<u>\$ (3,875,000)</u>	<u>\$ 2,031,098</u>	<u>\$ 27,276,344</u>	<u>\$ 3,875,000</u>

Long-term liability activity for the year ended December 31, 2005 was as follows:

	<u>Beginning of Year</u>	<u>Retirements</u>	<u>Accretion</u>	<u>End of Year</u>	<u>Current Portion</u>
Revenue Bonds	<u>\$ 31,036,479</u>	<u>\$ (4,080,000)</u>	<u>\$ 2,163,767</u>	<u>\$ 29,120,246</u>	<u>\$ 3,875,000</u>

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The following table presents annual principal and interest payments for long-term debt outstanding at December 31, 2006:

<u>Years Ending December 31,</u>	<u>Sewer Revenue Bonds - Series of 1990</u>
2007	\$ 3,875,000
2008	3,875,000
2009	3,875,000
2010	3,875,000
2011	3,875,000
2012 to 2016	<u>19,360,000</u>
Total principal and interest	38,735,000
Less interest	<u>(11,458,656)</u>
	<u>\$ 27,276,344</u>

4. LEASES AND RELATED PARTY TRANSACTIONS

In 1987, the Authority entered into a 30-year direct financing lease with the City for the sewer system. The sewer system and related assets are, therefore, not reflected in the accompanying financial statements. Under this lease, the City is required to pay the Authority semiannual installments on May 15 and November 15 of each year, an amount equal to one hundred five percent (105%) of the principal, interest, and all other amounts due under the 1987 Bond Indenture. The installment payments may be reduced in certain instances.

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The following is a schedule of future minimum lease payments as of December 31, 2006.

Years Ending December 31,	Sewer Revenue Bonds - Series of 1990
2007	\$ 3,632,750
2008	3,632,750
2009	3,632,750
2010	3,632,750
2011	3,632,750
2012 to 2016	<u>18,148,000</u>
Total minimum lease receivable	36,311,750
Less unearned interest	<u>(10,787,186)</u>
Net investment in direct financing lease receivable	<u><u>\$ 25,524,564</u></u>

The Authority also leases a portion of its real estate to nonrelated parties on month-to-month leases for \$10,325 per month.

5. ECONOMIC DEFEASANCE OF GUARANTEED SEWER REVENUE BONDS AND LEASE RESTRUCTURING

The Authority has, from time to time, defeased certain debt by placing the proceeds of new debt in an irrevocable trust to provide for all future debt service payments on the old debt. The trust account assets and the liability of the defeased debt are not included in the Authority's financial statements. At December 31, 2006, the amount outstanding of the Authority's defeased Guaranteed Sewer Revenue Bonds Series 1977 was \$1,385,000 and the value of the escrow account was \$1,306,768.

On July 15, 1998, the Authority entered into an escrow deposit agreement for partial defeasance of the 1990 York City Sewer Authority Bonds. \$5,000,000 was deposited into this escrow from grant money received for reimbursement of capital improvements made by the Authority. This transaction is not considered a legal defeasance. Therefore, the bonds and restricted investments are recorded in the financial statements.

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6. COMMITMENTS AND CONTINGENCIES

Under the terms of federal and state grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures under the terms of the grants. Such audits could lead to reimbursement to the grantor agencies. Authority management believes disallowances, if any, will be immaterial.

7. SUBSEQUENT EVENTS

In April of 2007, the Authority issued Guaranteed Sewer Revenue Bonds, Series of 2007, in the principal amount of \$10,000,000. The Bonds bear interest at an annual rate of 4.20%, with semi-annual payments of interest commencing on June 1, 2007. Annual payments of principal commence on December 1, 2017, with a final payment on December 1, 2019. The Bonds were issued to provide funds for the planning, design and construction of additions, improvements, renovations and extraordinary repairs to, and the acquisition and installation of related equipment, machinery and furnishings for various buildings and facilities of the Authority.