

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

ANNUAL FINANCIAL REPORT

Years Ended December 31, 2009 and 2008

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

YEARS ENDED DECEMBER 31, 2009 AND 2008

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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, 2009 and 2008, 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 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 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide 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, 2009 and 2008, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

Maillie, Falconiero & Company LLP

Oaks, Pennsylvania
September 20, 2010

CITY OF YORK SEWER AUTHORITY

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

STATEMENTS OF NET ASSETS

DECEMBER 31, 2009 AND 2008

	<u>2009</u>	<u>2008</u>
Assets		
Cash and cash equivalents	\$ 33,199	\$ 20,757
Restricted assets:		
Cash and cash equivalents	6,343,990	3,368,844
Investments	<u>2,941,694</u>	<u>11,659,035</u>
	9,285,684	15,027,879
Accrued interest receivable	-	21,732
Grants receivable	1,000,000	-
Due from primary government	995,225	-
Net investment in direct financing lease	<u>34,328,361</u>	<u>32,163,425</u>
Total Assets	<u>45,642,469</u>	<u>47,233,793</u>
Liabilities		
Accounts payable	1,009,900	-
Deferred revenue	13,250	-
Obligation to construct	1,000,001	5,260,345
Liabilities payable from restricted assets:		
Accounts payable	1,303	284,042
Funds held on behalf of the City of York	5,419,145	5,371,936
Bonds payable:		
Due within one year	3,875,000	3,875,000
Due in more than one year	<u>31,801,301</u>	<u>29,780,429</u>
Total Liabilities	<u>43,119,900</u>	<u>44,571,752</u>
Net Assets		
Restricted for:		
Debt service	2,963,348	3,419,961
Construction	901,887	694,406
Unrestricted	<u>(1,342,666)</u>	<u>(1,452,326)</u>
Total Net Assets	<u>\$ 2,522,569</u>	<u>\$ 2,662,041</u>

See accompanying notes to basic financial statements.

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STATEMENTS OF ACTIVITIES

YEARS ENDED DECEMBER 31, 2009 AND 2008

	<u>2009</u>	<u>2008</u>
Operating Revenues:		
<u>Lease investment income</u>	\$ 2,068,828	\$ 1,935,744
Miscellaneous income	<u>124,960</u>	<u>35,405</u>
Total operating revenues	<u>2,193,788</u>	<u>1,971,149</u>
Operating Expenses:		
<u>Interest expense</u>	2,069,748	2,193,096
Professional services	122,715	46,957
Miscellaneous expense	<u>8,409</u>	<u>16,399</u>
Total operating expenses	<u>2,200,872</u>	<u>2,256,452</u>
Operating Loss	<u>(7,084)</u>	<u>(285,303)</u>
Non-Operating Revenues (Expenses):		
<u>Investment income</u>	38,263	651,220
Transfer to City of York	<u>(170,651)</u>	<u>(110,458)</u>
Total net non-operating revenues (expenses)	<u>(132,388)</u>	<u>540,762</u>
Change in Net Assets	(139,472)	255,459
Net Assets:		
<u>Beginning of year</u>	<u>2,662,041</u>	<u>2,406,582</u>
End of year	<u>\$ 2,522,569</u>	<u>\$ 2,662,041</u>

See accompanying notes to basic financial statements.

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STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2009 AND 2008

	2009	2008
Cash Flows From Operating Activities:		
Cash paid for administrative expenses	\$ (132,120)	\$ (46,382)
Cash received from others	138,210	35,405
Net cash provided by (used in) operating activities	6,090	(10,977)
Cash Flows From Investing Activities:		
Sales of investment securities	8,717,341	3,034,069
Interest received	116,441	931,514
Net cash provided by investing activities	8,833,782	3,965,583
Cash Flows From Capital and Related Financing Activities:		
Proceeds from the issuance of debt	4,279,718	461,514
Transfer to City of York for capital outlays	(170,651)	(110,458)
Payments received on investment in direct financing lease	4,230,819	3,864,581
Capital assets purchased through obligation to construct	(5,583,858)	(2,895,375)
Capital assets purchased through issuance of debt	(4,279,718)	-
Principal paid on revenue bonds	(3,875,000)	(3,875,000)
Interest paid on revenue bonds	(453,594)	(427,717)
Net cash provided by (used in) capital and related financing activities	(5,852,284)	(2,982,455)
Net Increase in Cash and Cash Equivalents	2,987,588	972,151
Cash and Cash Equivalents:		
Beginning of year	3,389,601	2,417,450
End of year	\$ 6,377,189	\$ 3,389,601
Reconciliation of Operating Loss to Net Cash Provided by (Used in) Operating Activities:		
Operating loss	\$ (7,084)	\$ (285,303)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Interest expense	2,069,748	2,193,096
Lease investment income	(2,068,828)	(1,935,744)
Changes in assets and liabilities:		
Accounts payable	(996)	16,974
Deferred revenue	13,250	-
Total adjustments	13,174	274,326
Net cash provided by (used in) operating activities	\$ 6,090	\$ (10,977)
Non-Cash Investing Capital and Financing Activities:		
Principal accretion of revenue bonds	\$ 1,616,154	\$ 1,765,379

See accompanying notes to basic financial statements.

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NOTES TO BASIC FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2009 AND 2008

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 (Act), 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, 2009, 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.

Enterprise funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with an enterprise fund's principal ongoing

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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 non-operating 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.

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, 2009 and 2008.

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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.

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.

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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.

2. DEPOSITS AND INVESTMENTS

The 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.

Deposits

As of December 31, 2009, the Authority's deposit balance was as follows:

Money market funds - presented as cash and cash equivalents	\$ 6,340,570
Cash and cash equivalents	<u>36,619</u>
	<u>\$ 6,377,189</u>
Reconciliation to Statement of Net Assets:	
Unrestricted cash and cash equivalents	\$ 33,199
Restricted cash and cash equivalents	<u>6,343,990</u>
	<u>\$ 6,377,189</u>

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, 2009, the Authority's deposit book and bank balance was \$36,619. \$33,199 of this balance was covered by federal depository insurance and \$3,420 was held by M&T Investment Group, but not invested

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and not collateralized. The remaining balance of \$6,340,570 was invested in money market funds, and is presented as cash and cash equivalents on the statement of net assets. These funds are described in further detail below.

Investments

The fair value of the investments of the Authority at December 31, 2009 was as follows:

<u>Investments</u>	<u>Fair Value</u>
Money market funds	\$ 6,340,570
U.S. Government obligations	2,941,694
	<u>\$ 9,282,264</u>
Reconciliation to Statement of Net Assets:	
Money market funds - presented as cash and cash equivalents	\$ 6,340,570
Restricted investments	2,941,694
	<u>\$ 9,282,264</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 and U.S. Treasury Investment Growth Receipts (TIGR). These particular STRIPS and TIGRs have little credit and legal risk, while the market risk is significant, as principal-only STRIPS and TIGRs are more sensitive to fluctuations in interest rates than other traditional investments. The carrying amount of the STRIPS and TIGRs at December 31, 2009 was \$2,791,787 and is reported as restricted investments in the statement of net assets.

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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, 2009, no issuer held more than 5% of the Authority's investments.

Credit risk – The Authority does not have a formal policy that would limit its investment choices with regard to credit risk. The Authority's investments had the following level of exposure to credit risk as of December 31, 2009:

	<u>Fair Value</u>	<u>Rating</u>
Money market funds	\$ 6,340,570	AAA

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:

	<u>Fair Value</u>	<u>Investment Maturities</u>		
		<u>2010</u>	<u>2011-2015</u>	<u>2016-2020</u>
Money market funds	\$ 6,340,570	\$ 6,340,570	\$ -	\$ -
U.S. Government obligations	2,941,694	584,973	2,009,060	347,661
Total	<u>\$ 9,282,264</u>	<u>\$ 6,925,543</u>	<u>\$ 2,009,060</u>	<u>\$ 347,661</u>

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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:

	Issue Amount	Maturity	Interest Rate	Purpose
Guaranteed Sewer Revenue Bonds - Series of 1990	\$69,775,000	2016	0%	Refund a portion of the revenue bonds, Series of 1987. Upgrade Sewage Treatment System.
Guaranteed Sewer Revenue Bonds - Series of 2007	\$10,000,000	2019	4.20%	Provide funds for the planning, design, and construction of additions, improvements, renovations and extraordinary repairs to, and the acquisition and installment of related equipment, machinery, and furnishings for various building and facilities of the Authority.
Guaranteed Sewer Revenue Bonds - Series of 2008	\$10,000,000 - As of December 31, 2009, \$4,741,232 has been drawn down on the bond issue.	2022	4.04%	To provide financing 1) capitalized interest; 2) a deposit to the Debt Service Reserve Fund; 3) the planning, design and construction of additions, improvements, renovations and extraordinary repairs to the various buildings and facilities of the Authority; 4) paying for issuance of 2008 Bond.

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Long-term liability activity for the year ended December 31, 2009 was as follows:

	<u>Beginning of Year</u>	<u>Additions</u>	<u>Retirements</u>	<u>Accretion</u>	<u>End of Year</u>	<u>Current Portion</u>
Revenue Bonds	<u>\$ 33,655,429</u>	<u>\$ 4,279,718</u>	<u>\$ (3,875,000)</u>	<u>\$ 1,616,154</u>	<u>\$ 35,676,301</u>	<u>\$ 3,875,000</u>

Long-term liability activity for the year ended December 31, 2008 was as follows:

	<u>Beginning of Year</u>	<u>Additions</u>	<u>Retirements</u>	<u>Accretion</u>	<u>End of Year</u>	<u>Current Portion</u>
Revenue Bonds	<u>\$ 35,303,536</u>	<u>\$ 461,514</u>	<u>\$ (3,875,000)</u>	<u>\$ 1,765,379</u>	<u>\$ 33,655,429</u>	<u>\$ 3,875,000</u>

The following table presents annual principal and interest payments for the Guaranteed Sewer Revenue Bonds – Series of 1990, capital appreciation bonds, at December 31, 2009:

<u>Years Ending December 31,</u>	
2010	\$ 3,875,000
2011	3,875,000
2012	3,870,000
2013	3,870,000
2014	3,875,000
2015 to 2016	<u>7,745,000</u>
Total principal and interest	27,110,000
Less interest	<u>(6,174,931)</u>
	<u>\$ 20,935,069</u>

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The following table presents annual principal and interest payments for the Guaranteed Sewer Revenue Bonds – Series of 2007 at December 31, 2009:

<u>Years Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2010	\$ -	\$ 420,000	\$ 420,000
2011	-	420,000	420,000
2012	-	420,000	420,000
2013	-	420,000	420,000
2014	-	420,000	420,000
2015 to 2019	10,000,000	1,673,280	11,673,280
	<u>\$ 10,000,000</u>	<u>\$ 3,773,280</u>	<u>\$ 13,773,280</u>

The following table presents annual principal and interest payments for the Guaranteed Sewer Revenue Bonds – Series of 2008 at December 31, 2009:

<u>Years Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2010	\$ -	\$ 191,546	\$ 191,546
2011	-	191,546	191,546
2012	-	191,546	191,546
2013	-	191,546	191,546
2014	-	191,546	191,546
2015 to 2019	1,115,170	946,578	2,061,748
2020 to 2022	3,626,062	260,633	3,886,695
	<u>\$ 4,741,232</u>	<u>\$ 2,164,941</u>	<u>\$ 6,906,173</u>

Guaranteed Sewer Revenue Bonds Debt Service Reserve Fund Deficiency

As of December 31, 2008, the fair market value of the investments held within the debt service reserve fund was less than the amount required under the bond indentures. The Authority addressed this issue and in June of 2009 transferred a balance of approximately \$131,000 from the Bond Redemption and Improvement Fund to the Debt Service Reserve Fund in order to bring the Debt Service Reserve Fund to the required balance in compliance with the bond indentures.

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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.

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. Under this lease, the City is required to pay the Authority an amount equal to one hundred five percent (105%) of the principal, interest, and all other amounts due under the Third Supplemental Lease of the 1987 Bond Indenture.

In July of 2008, the Authority issued Guaranteed Sewer Revenue Bonds, Series of 2008, in the principal amount of \$10,000,000. As of December 31, 2009, a total of \$4,741,232 has been drawn down on the bond issue. The Bonds bear interest at an annual rate of 4.04%, with semi-annual payments of interest commencing on December 1, 2008. Annual payments of principal commence on June 1, 2019, with a final payment on December 1, 2022. 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. Under this lease, the City is required to pay the Authority an amount equal to one hundred five percent (105%) of the principal, interest, and all other amounts due under the Fourth Supplemental Lease of the 1987 Bond Indenture.

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The following is a schedule of future minimum lease payments under the lease agreements and all supplements as of December 31, 2009:

<u>Years Ending December 31,</u>	<u>Amount</u>
2010	\$ 4,274,873
2011	4,274,873
2012	4,274,873
2013	4,269,623
2014	4,269,623
2015 to 2019	21,682,029
2020 to 2022	<u>4,081,030</u>
Total minimum lease receivable	47,126,924
Less unearned interest	<u>(12,798,563)</u>
Net investment in direct financing lease receivable	<u>\$ 34,328,361</u>

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

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.

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.

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7. CONTRACT COMMITMENT

During 2008, the Authority began upgrading projects to the waste water treatment plant. As a result, the Authority entered into contracts with several construction contractors totaling \$10,913,078. At December 31, 2009, \$855,559 was included in accounts payable. The commitment remaining on the contracts at December 31, 2009 was \$1,254,435.

8. SUBSEQUENT EVENT

In April 2010, the Authority approved the issuance of Guaranteed Sewer Revenue Bonds, Series of 2010, in the aggregate amount of \$22,745,000. Bond proceeds are to be used to finance projects of the Authority, fund a deposit to the debt service reserve fund, capitalize interest on the Bonds through December 1, 2010, and pay the costs and expenses related to the issuance of the Bonds. The Bonds bear interest at rates ranging from 4.75% to 5.00%.

In August 2010, the Authority approved the issuance of Guaranteed Sewer Revenue Bonds, Series A of 2010, in the aggregate amount not to exceed \$12,000,000. Bond proceeds are to be used to currently refund the Guaranteed Sewer Revenue Bonds, Series of 2007, funding a debt service reserve fund, and pay costs of issuance.