

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

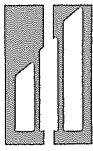
FINANCIAL STATEMENTS

Year Ended December 31, 2004

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

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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 financial statements of the City of York Sewer Authority (a component unit of the City of York) as of and for the year ended December 31, 2004, as listed in the table of contents. These financial statements are the responsibility of the 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, 2004, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

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

Maillie, Falconiero & Company LLP

August 12, 2005

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

STATEMENT OF NET ASSETS

DECEMBER 31, 2004

| | |
|---|----------------------------|
| Assets | |
| Cash and cash equivalents | <u>\$ 12,256</u> |
| Restricted assets | |
| Cash and cash equivalents | 3,041,342 |
| Investments - restricted under trust indentures | <u>8,201,020</u> |
| | <u>11,242,362</u> |
| Accrued interest receivable | 27,894 |
| Due from other governments | 77,400 |
| Net investment in direct financing lease | <u>29,066,103</u> |
| Total assets | <u>40,426,015</u> |
| Liabilities | |
| Funds collected in advance | 172,653 |
| Accounts payable | 90,584 |
| Liabilities payable from restricted assets | |
| Funds held on behalf of the City of York | 4,407,542 |
| Bonds payable | |
| Due within one year | 4,080,000 |
| Due in more than one year | <u>26,956,479</u> |
| Total liabilities | <u>35,707,258</u> |
| Net assets | |
| Restricted for | |
| Debt service | 3,944,052 |
| Construction | 2,890,766 |
| Unrestricted | <u>(2,116,061)</u> |
| Total net assets | <u><u>\$ 4,718,757</u></u> |

See accompanying notes to basic financial statements.

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

STATEMENT OF ACTIVITIES

YEAR ENDED DECEMBER 31, 2004

| | |
|--|----------------------------|
| Operating revenues | |
| Lease investment income | \$ 1,960,206 |
| Miscellaneous income | <u>70,320</u> |
| Total operating revenues | <u>2,030,526</u> |
| Operating expenses | |
| Interest expense | 2,291,165 |
| Professional services | 133,275 |
| Miscellaneous expense | <u>54,357</u> |
| Total operating expenses | <u>2,478,797</u> |
| Operating loss | <u>(448,271)</u> |
| Nonoperating revenues (expenses) | |
| Intergovernmental grants | 7,142 |
| Investment income | 441,875 |
| Transfer to City of York | <u>(1,501,457)</u> |
| Total net nonoperating revenues (expenses) | <u>(1,052,440)</u> |
| Change in net assets | (1,500,711) |
| Net assets, January 1, 2004 | <u>6,219,468</u> |
| Net assets, December 31, 2004 | <u><u>\$ 4,718,757</u></u> |

See accompanying notes to basic financial statements.

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

STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2004

| | |
|--|--------------|
| Cash flows from operating activities | |
| Cash paid for administrative expenses | \$ (69,179) |
| Cash received from others | 70,320 |
| | <hr/> |
| Net cash provided by operating activities | 1,141 |
| | <hr/> |
| Cash flows from investing activities | |
| Sales of investment securities | 436,000 |
| Interest received | 360,590 |
| | <hr/> |
| Net cash provided by investing activities | 796,590 |
| | <hr/> |
| Cash flows from capital and related financing activities | |
| Transfer to City of York for capital outlays | (1,501,457) |
| Payments received on investment in direct financing lease | 3,691,387 |
| Intergovernmental grants | 7,142 |
| Principal paid on revenue bonds | (4,115,000) |
| | <hr/> |
| Net cash used in capital and related financing activities | (1,917,928) |
| | <hr/> |
| Net decrease in cash and cash equivalents | (1,120,197) |
| | <hr/> |
| Cash and cash equivalents, January 1, 2004 | 4,173,795 |
| | <hr/> |
| Cash and cash equivalents, December 31, 2004 | \$ 3,053,598 |
| | <hr/> <hr/> |
| Reconciliation of operating loss to net cash provided by operating activities | |
| Operating loss | \$ (448,271) |
| Adjustments to reconcile operating loss to net cash provided by operating activities | |
| Decrease in due from component unit | 27,869 |
| Interest expense | 2,291,165 |
| Lease investment income | (1,960,206) |
| Changes in assets and liabilities | |
| Accounts payable | 90,584 |
| | <hr/> |
| Total adjustments | 449,412 |
| | <hr/> |
| Net cash provided by operating activities | \$ 1,141 |
| | <hr/> <hr/> |

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

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, 2004, 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*.

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 a 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.

(continued)

CITY OF YORK SEWER AUTHORITY
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NOTES TO BASIC FINANCIAL STATEMENTS

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

Funds held on behalf of the City represent funds held by the Authority under the trust indentures in the debt service fund, debt service reserve funds and escrow fund. Such funds will reduce the lease rental payments due from the City as described in Note 4.

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.

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CITY OF YORK SEWER AUTHORITY
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NOTES TO BASIC FINANCIAL STATEMENTS

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.

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 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.

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CITY OF YORK SEWER AUTHORITY
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NOTES TO BASIC FINANCIAL STATEMENTS

Deposits

The deposit and investment policy of the Authority adheres to state statutes, prudent business practices, and the applicable trust indentures, which are more restrictive than existing state statutes. Deposits are maintained in demand deposits accounts.

Deposits at December 31, 2004, are categorized below to indicate the level of risk assumed by the Authority. Category 1 includes bank balances that are fully insured or collateralized with securities held by the Authority or its agent in the Authority's name. Category 2 includes deposits which are collateralized with securities held by the pledging financial institution's trust department or agent in the Authority's name. Category 3 includes uninsured and unregistered bank balances with collateral held by a trust department or agent but not in the Authority's name. State statute requires banks to maintain a pool of collateral to cover these governmental deposits; however, the collateral is held by the bank in the bank's name. Money market pools are not categorized as they are invested in pooled funds and securities are not used as evidence of the deposit.

The bank balance, carrying amount, and category of deposits at December 31, 2004, were as follows:

| | Category 1 | Unclassified | Bank Balance | Carrying Amount |
|------------------------------|------------------|---------------------|---------------------|---------------------|
| Demand deposits | \$ 12,256 | \$ - | \$ 12,256 | \$ 12,256 |
| Money market pools | - | 3,041,342 | 3,041,342 | 3,041,342 |
| | | | | |
| Cash and cash equivalents | <u>\$ 12,256</u> | <u>\$ 3,041,342</u> | <u>\$ 3,053,598</u> | <u>\$ 3,053,598</u> |

Investments

Investments of the Authority, at December 31, 2004, are categorized according to the level of credit risk assumed by the Authority. Category 1 includes investments that are insured or registered and are held by the Authority or its agent in the Authority's name. Category 2 includes uninsured and unregistered investments with collateral held by the broker's agent in the Authority's name. Category 3 includes uninsured and unregistered investments held by a trust department or agent but not in the Authority's name. Guaranteed investment contract investments have not been categorized because securities are not used as evidence of the investment. The Authority does not have any Category 2 or Category 3 investments at December 31, 2004.

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CITY OF YORK SEWER AUTHORITY
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NOTES TO BASIC FINANCIAL STATEMENTS

At December 31, 2004, the Authority's investment balances were as follows:

| | Category 1 | Uncategorized | Carrying Value |
|---------------------------------|---------------------|---------------------|---------------------|
| U.S. government obligations | \$ 3,943,870 | \$ - | \$ 3,943,870 |
| Guaranteed investment contracts | - | 4,257,150 | 4,257,150 |
| Total investments | <u>\$ 3,943,870</u> | <u>\$ 4,257,150</u> | <u>\$ 8,201,020</u> |

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 | Amount Outstanding | Purpose |
|---|-----------------|----------|------------------|-----------------------|--|
| Guaranteed Sewer Revenue Bonds - Series of 1990 | \$ 69,775,000 | 2016 | 6.45% - 7.10% | <u>\$ 31,036,479</u> | Refund a portion of the revenue bonds, Series 1987. Upgrade Sewage Treatment System. |

Long-term liability activity for the year ended December 31, 2004 was as follows:

| | Beginning of Year | Retirements | Accretion | End of Year | Current Portion |
|---------------|----------------------|---------------------|---------------------|----------------------|---------------------|
| Revenue Bonds | <u>\$ 32,860,314</u> | <u>\$ 4,115,000</u> | <u>\$ 2,291,165</u> | <u>\$ 31,036,479</u> | <u>\$ 4,080,000</u> |

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NOTES TO BASIC FINANCIAL STATEMENTS

The following table presents annual principal and interest payments for long-term debt outstanding at December 31, 2004:

| | Sewer Revenue Bonds - Series of 1990 |
|------------------------------|--|
| 2005 | \$ 4,080,000 |
| 2006 | 3,875,000 |
| 2007 | 3,875,000 |
| 2008 | 3,875,000 |
| 2009 | 3,875,000 |
| 2010 to 2014 | 19,365,000 |
| 2015 to 2016 | 7,745,000 |
| Total principal and interest | 46,690,000 |
| Less interest | (15,653,521) |
| | \$ 31,036,479 |

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.

The following is a schedule of future minimum lease payments as of December 31, 2004.

| Years Ending December 31, | Lease Payments |
|---|----------------|
| 2005 | \$ 3,846,000 |
| 2006 | 3,632,750 |
| 2007 | 3,632,750 |
| 2008 | 3,632,750 |
| 2009 | 3,632,750 |
| 2010 to 2014 | 18,153,250 |
| 2015 to 2016 | 7,260,250 |
| Total minimum lease receivable | 43,790,500 |
| Less unearned interest | (14,724,397) |
| Net investment in direct financing lease receivable | \$ 29,066,103 |

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

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CITY OF YORK SEWER AUTHORITY
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NOTES TO BASIC FINANCIAL STATEMENTS

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, 2004, the amount outstanding of the Authority's defeased Guaranteed Sewer Revenue Bonds Series 1977 was \$2,180,000 and the value of the escrow account was \$2,029,415.

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

The Authority is involved in several lawsuits arising in the normal course of business. It is the opinion of management that any liabilities resulting from these proceedings will not materially affect the financial position of the Authority at December 31, 2004.

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.