

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

ANNUAL FINANCIAL REPORT

Years Ended December 31, 2010 and 2009



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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, 2010 and 2009, 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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.

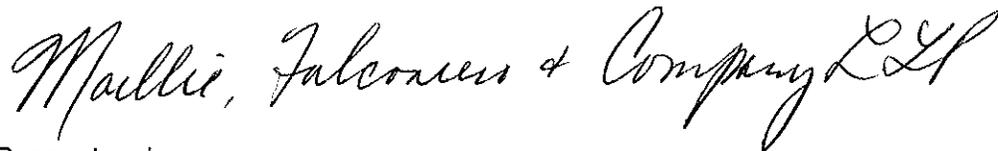
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of York Sewer Authority as of December 31, 2010 and 2009, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 4, 2011, on our consideration of the City of York Sewer Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of York Sewer Authority's basic financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The 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 financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

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.

A handwritten signature in black ink that reads "Maullie, Falconer & Company LLP". The signature is written in a cursive, flowing style.

Oaks, Pennsylvania
November 4, 2011

CITY OF YORK SEWER AUTHORITY

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

STATEMENTS OF NET ASSETS

DECEMBER 31, 2010 AND 2009

	<u>2010</u>	<u>2009</u>
Assets		
Cash and cash equivalents	\$ 43,765	\$ 33,199
Restricted assets:		
Cash and cash equivalents	17,489,443	6,343,990
Investments	11,204,647	2,941,694
	<u>28,694,090</u>	<u>9,285,684</u>
Grants receivable	1,174,100	1,000,000
Due from primary government	441,644	995,225
Net investment in direct financing lease	60,606,909	34,328,361
Total Assets	<u>90,960,508</u>	<u>45,642,469</u>
Liabilities		
Accounts payable	9,501	1,009,900
Deferred revenue	-	13,250
Obligation to construct	18,037,410	1,000,001
Liabilities payable from restricted assets:		
Accounts payable	1,627,094	1,303
Funds held on behalf of the City of York	6,497,285	5,419,145
Bonds payable:		
Due within one year	3,875,000	3,875,000
Due in more than one year	57,925,428	31,801,301
Total Liabilities	<u>87,971,718</u>	<u>43,119,900</u>
Net Assets		
Restricted for:		
Debt service	2,655,789	2,963,348
Construction	1,015,925	901,887
Unrestricted	(682,924)	(1,342,666)
Total Net Assets	<u>\$ 2,988,790</u>	<u>\$ 2,522,569</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, 2010 AND 2009

	<u>2010</u>	<u>2009</u>
Operating Revenues:		
Lease investment income	\$ 2,255,401	\$ 2,068,828
Miscellaneous income	54	124,960
Total operating revenues	<u>2,255,455</u>	<u>2,193,788</u>
Operating Expenses:		
Interest expense	2,579,668	2,069,748
Professional services	189,330	122,715
Miscellaneous expense	10,725	8,409
Total operating expenses	<u>2,779,723</u>	<u>2,200,872</u>
Operating Loss	<u>(524,268)</u>	<u>(7,084)</u>
Non-Operating Revenues (Expenses):		
Investment income	145,011	38,263
Transfer from (to) City of York	845,478	(170,651)
Total net non-operating revenue (expenses)	<u>990,489</u>	<u>(132,388)</u>
Change in Net Assets	466,221	(139,472)
Net Assets:		
Beginning of year	<u>2,522,569</u>	<u>2,662,041</u>
End of year	<u>\$ 2,988,790</u>	<u>\$ 2,522,569</u>

See accompanying notes to basic financial statements.

CITY OF YORK SEWER AUTHORITY

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STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
Cash Flows From Operating Activities:		
Cash paid for administrative expenses	\$ (205,229)	\$ (132,120)
Cash received from others	54	124,960
Net cash provided by (used in) operating activities	(205,175)	(7,160)
Cash Flows From Investing Activities:		
Sales (purchases) of investment securities	(8,262,953)	8,717,341
Interest received	184,373	116,441
Net cash provided by (used in) investing activities	(8,078,580)	8,833,782
Cash Flows From Capital and Related Financing Activities:		
Proceeds from the issuance of debt	38,543,769	4,279,718
Payment of bond issuance costs	(999,353)	-
Payment of discount	(420,029)	-
Transfer from (to) City of York	1,399,059	(170,651)
Payments received on investment in direct financing lease	4,510,259	4,244,069
Proceeds from other municipalities for capital project	1,539,256	-
Transfers to restricted investment accounts	(1,199,362)	-
Capital assets purchased through obligation to construct	-	(5,583,858)
Capital assets purchased through issuance of debt	(8,934,515)	(4,279,718)
Principal paid on revenue bonds	(13,875,000)	(3,875,000)
Interest paid on revenue bonds	(1,124,310)	(453,594)
Net cash provided by (used in) capital and related financing activities	19,439,774	(5,839,034)
Net Increase in Cash and Cash Equivalents	11,156,019	2,987,588
Cash and Cash Equivalents:		
Beginning of year	6,377,189	3,389,601
End of year	\$ 17,533,208	\$ 6,377,189
Reconciliation of Operating Loss to Net Cash Provided by (Used in) Operating Activities:		
Operating loss	\$ (524,268)	\$ (7,084)
Adjustments to reconcile operating loss to net cash provided by (used in) operating activities:		
Interest expense	2,579,668	2,069,748
Lease investment income	(2,255,401)	(2,068,828)
Changes in assets and liabilities:		
Accounts payable	(5,174)	(996)
Total adjustments	319,093	(76)
Net cash provided by (used in) operating activities	\$ (205,175)	\$ (7,160)
Non-Cash Capital and Related Financing Activities:		
Principal accretion of revenue bonds	\$ 1,455,358	\$ 1,616,154

See accompanying notes to basic financial statements.

CITY OF YORK SEWER AUTHORITY

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NOTES TO BASIC FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2010 AND 2009

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, 2010, 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 within 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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YEARS ENDED DECEMBER 31, 2010 AND 2009

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 statements 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 statements 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, 2010 and 2009.

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YEARS ENDED DECEMBER 31, 2010 AND 2009

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.

Transfer from City of York

Transfer from the City of York represents funds contributed from the City of York's Sewer Transportation Fund and Intermunicipal Sewer Fund for the purpose of funding capital projects.

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

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YEARS ENDED DECEMBER 31, 2010 AND 2009

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.

Reclassification

Certain reclassifications have been made to the prior year financial statements in order for them to be in conformity with the current year presentation.

2. DEPOSITS AND INVESTMENTS

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, 2010, the Authority's deposit balance was as follows:

Money market funds - presented as cash and cash equivalents	\$ 17,489,443
Cash and cash equivalents	43,765
	<u>\$ 17,533,208</u>
Reconciliation to Statement of Net Assets:	
Unrestricted cash and cash equivalents	\$ 43,765
Restricted cash and cash equivalents	17,489,443
	<u>\$ 17,533,208</u>

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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, 2010, the Authority's deposit book and bank balance was \$43,765. The full balance of \$43,765 was covered by federal depository insurance. The remaining balance of \$17,489,443 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, 2010 was as follows:

<u>Investments</u>	<u>Fair Value</u>
Money market funds	\$ 17,489,443
U.S. Government obligations	11,204,647
	<u>\$ 28,694,090</u>
Reconciliation to Statement of Net Assets:	
Money market funds - presented as cash and cash equivalents	\$ 17,489,443
Restricted investments	11,204,647
	<u>\$ 28,694,090</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, 2010 was \$2,487,989 and is reported as restricted investments in the statement of net assets.

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YEARS ENDED DECEMBER 31, 2010 AND 2009

Concentration of credit risk – The Authority places no limit on the amount the Authority may invest in any one issuer. At December 31, 2010, 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, 2010:

	<u>Fair Value</u>	<u>Rating</u>
Money market funds	\$ 17,489,443	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>2011</u>	<u>2012-2016</u>
Money market funds	\$ 17,489,443	\$ 17,489,443	\$ -
U.S. Government obligations	11,204,647	9,152,062	2,052,585
Total	<u>\$ 28,694,090</u>	<u>\$ 26,641,505</u>	<u>\$ 2,052,585</u>

CITY OF YORK SEWER AUTHORITY

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NOTES TO BASIC FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2010 AND 2009

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 2008	\$10,000,000	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.
Guaranteed Sewer Revenue Bonds - Series of 2010	\$22,745,000	2027	4.5-5.00%	To 1) finance projects of the Authority; 2) fund a deposit to the debt service reserve fund; 3) capitalize interest on the Bonds through December 1, 2010; 4) pay the costs and expenses related to the issuance of the Bonds.
Guaranteed Sewer Revenue Bonds - Series A of 2010	\$10,540,000	2019	2.5-4%	To 1) currently refund the Guaranteed Sewer Revenue Bonds, Series of 2007; 2) fund a debt service reserve fund; 3) pay costs of issuance.

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YEARS ENDED DECEMBER 31, 2010 AND 2009

Long-term liability activity for the year ended December 31, 2010 was as follows:

	Beginning of Year	Additions	Retirements	Accretion	End of Year	Current Portion
Revenue Bonds	\$ 35,676,301	\$ 38,543,769	\$(13,875,000)	\$ 1,455,358	\$ 61,800,428	\$ 3,875,000

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

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

The following table presents annual principal and interest payments for the Guaranteed Sewer Revenue Bonds – Series of 1990, capital appreciation bonds, at December 31, 2010:

Years Ending December 31,	
2011	\$ 3,875,000
2012	3,870,000
2013	3,870,000
2014	3,875,000
2015	3,875,000
2016	3,870,000
Total principal and interest	23,235,000
Less interest	(4,719,572)
	\$ 18,515,428

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YEARS ENDED DECEMBER 31, 2010 AND 2009

The following table presents annual principal and interest payments for the Guaranteed Sewer Revenue Bonds – Series of 2008 at December 31, 2010:

<u>Years Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ -	\$ 404,000	\$ 404,000
2012	-	404,000	404,000
2013	-	404,000	404,000
2014	-	404,000	404,000
2015	-	404,000	404,000
2016 to 2020	4,800,120	1,876,980	6,677,100
2021 to 2022	5,199,880	265,219	5,465,099
	<u>\$ 10,000,000</u>	<u>\$ 4,162,199</u>	<u>\$ 14,162,199</u>

The following table presents annual principal and interest payments for the Guaranteed Sewer Revenue Bonds – Series of 2010 at December 31, 2010:

<u>Years Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ -	\$ 1,065,119	\$ 1,065,119
2012	-	1,065,119	1,065,119
2013	-	1,065,119	1,065,119
2014	-	1,065,119	1,065,119
2015	-	1,065,119	1,065,119
2016 to 2020	-	5,325,595	5,325,595
2021 to 2025	15,660,000	4,367,493	20,027,493
2026 to 2027	7,085,000	434,444	7,519,444
	<u>\$ 22,745,000</u>	<u>\$ 15,453,127</u>	<u>\$ 38,198,127</u>

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YEARS ENDED DECEMBER 31, 2010 AND 2009

The following table presents annual principal and interest payments for the Guaranteed Sewer Revenue Bonds – Series A of 2010 at December 31, 2010:

<u>Years Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ -	\$ 307,525	\$ 307,525
2012	-	307,525	307,525
2013	-	307,525	307,525
2014	75,000	307,525	382,525
2015	115,000	304,900	419,900
2016 to 2019	10,350,000	900,375	11,250,375
	<u>\$ 10,540,000</u>	<u>\$ 2,435,375</u>	<u>\$ 12,975,375</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.

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 commenced on June 1, 2007. Annual payments of principal were to 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. These bonds were currently refunded through the issuance of Guaranteed Sewer Revenue Bonds, Series A of 2010. The City completed the current refunding to reduce its total debt service payments by \$528,963 through the year 2019 and resulted in an economic gain (difference between the present values of the old and new debt service payments) of \$505,696.

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In July of 2008, the Authority issued Guaranteed Sewer Revenue Bonds, Series of 2008, in the principal amount of \$10,000,000. 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.

In April 2010, the Authority issued Guaranteed Sewer Revenue Bonds, Series of 2010, in the principal amount of \$22,745,000. Semi-annual payments of interest commence on December 1, 2010. Annual payments of principal commence on December 1, 2022, with a final payment on December 1, 2027. The Bonds were issued 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. 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 Fifth Supplemental Lease of the 1987 Bond Indenture.

In August 2010, the Authority issued Guaranteed Sewer Revenue Bonds, Series A of 2010, in the principal amount of \$10,540,000. Semi-annual payments of interest commence on December 1, 2010. Annual payments of principal commence on December 1, 2014, with a final payment on December 1, 2019. The Bonds were issued to refund the Guaranteed Sewer Revenue Bonds, Series of 2007, fund a debt service reserve fund, and pay costs of issuance. 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 Sixth Supplemental Lease of the 1987 Bond Indenture.

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NOTES TO BASIC FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2010 AND 2009

The following is a schedule of future minimum lease payments under the lease agreements and all supplements as of December 31, 2010:

<u>Years Ending December 31,</u>	<u>Amount</u>
2011	\$ 5,498,226
2012	5,498,226
2013	5,492,976
2014	5,571,726
2015	5,616,220
2016 to 2020	28,043,224
2021 to 2025	26,767,225
2026 to 2027	<u>7,895,416</u>
Total minimum lease receivable	90,383,239
Less unearned interest	<u>(29,776,330)</u>
Net investment in direct financing lease receivable	<u>\$ 60,606,909</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.

CITY OF YORK SEWER AUTHORITY

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

NOTES TO BASIC FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2010 AND 2009

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 \$40,297,269. At December 31, 2010, \$1,605,522 was included in accounts payable. The commitment remaining on the contracts at December 31, 2010 was \$20,965,814.

8. SUBSEQUENT EVENT

In January 2011, the Authority approved the issuance of the Guaranteed Sewer Revenue Bonds, Series of 2011, in the aggregate amount of \$1,500,000. The Authority approved the financing of this obligation with the Commonwealth Financing Authority. The Authority has pledged revenues as collateral in accordance with the loan agreement and the loan is guaranteed by the City of York.



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Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards

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

We have audited the 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, 2010 and 2009, and have issued our report thereon dated November 4, 2011. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the City of York Sewer Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of York Sewer Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of York Sewer Authority's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

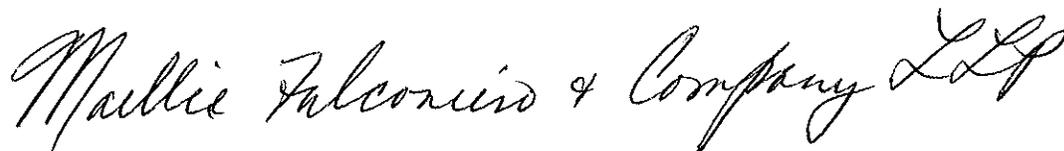
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the City of York Sewer Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the members of the City of York Sewer Authority Board, the Mayor of the City of York, Pennsylvania, members of City Council, management of the City of York Sewer Authority and the City of York, Pennsylvania and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Maitie Falcone & Company LLP". The signature is written in black ink and is positioned above the typed name and date.

Oaks, Pennsylvania
November 4, 2011



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**Independent Auditors' Report on Compliance With Requirements
That Could have a Direct and Material Effect on Each Major
Program and on Internal Control Over Compliance in
Accordance With OMB Circular A-133**

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

COMPLIANCE

We have audited the City of York Sewer Authority's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the City of York Sewer Authority's major federal programs for the year ended December 31, 2010. The City of York Sewer Authority's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the City of York Sewer Authority's management. Our responsibility is to express an opinion on the City of York Sewer Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City of York Sewer Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the City of York Sewer Authority's compliance with those requirements.

In our opinion, the City of York Sewer Authority, complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2010.

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

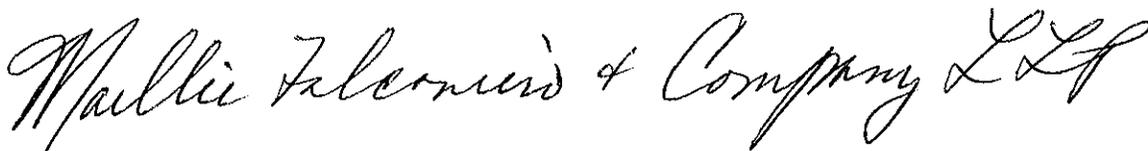
INTERNAL CONTROL OVER COMPLIANCE

Management of the City of York Sewer Authority is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the City of York Sewer Authority's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City of York Sewer Authority's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the members of the City of York Sewer Authority Board, the Mayor of the City of York, Pennsylvania, members of City Council, management of the City of York Sewer Authority and the City of York, Pennsylvania and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Mullis Felton & Company LLP". The signature is written in black ink and is positioned above the typed name and date.

Oaks, Pennsylvania
November 4, 2011

**ADDITIONAL INFORMATION - MAJOR FEDERAL
AWARD PROGRAMS AUDIT**

CITY OF YORK SEWER AUTHORITY

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

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED DECEMBER 31, 2010

Grantor/Program Title/Pass-Through Agency	CFDA #	Direct/Indirect	Grant #	Federal Expenditures
U.S. Environmental Protection Agency				
Congressionally Mandated Projects - Poorhouse Run Siphon and Interceptor Improvements	66.202	D	XP-97348301	\$ 481,700
Congressionally Mandated Projects - Wastewater Treatment Plant Biological Nutrient Removal Upgrade	66.202	D	XP-97375101	<u>192,400</u>
Total U.S. Environmental Protection Agency				<u>674,100</u>
U.S. Department of Energy				
Passed through from Pennsylvania Department of Environmental Protection ARRA - State Energy Program	81.041	I	4100052270	<u>500,000</u>
Total expenditures of federal awards				<u><u>\$ 1,174,100</u></u>

CITY OF YORK SEWER AUTHORITY
NOTE TO THE SCHEDULE OF EXPENDITURES OF
FEDERAL AWARDS
Year Ended December 31, 2010

NOTE A BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the City of York Sewer Authority (the "Authority") and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

CITY OF YORK SEWER AUTHORITY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended December 31, 2010

A. SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: **Unqualified**

Internal control over financial reporting:

Material weakness(es) identified: **No**

Significant deficiencies identified that are not considered to be material weaknesses: **No**

Noncompliance material to financial statements noted: **No**

Federal Awards

Internal control over major programs:

Material weakness(es) identified: **No**

Significant deficiencies identified that are not considered to be material weaknesses: **No**

Type of auditors' report issued on compliance for major programs: **Unqualified**

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of the Circular: **No**

Identification of major programs:

<u>Program</u>	<u>CFDA</u>
Congressionally Mandated Projects	66.202
State Energy Program - ARRA	81.041

Dollar threshold used to distinguish between Type A and Type B programs: **\$300,000**

Auditee qualified as a low-risk auditee: **No**

B. FINDINGS - FINANCIAL STATEMENTS AUDIT

None.

C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAMS AUDIT

None.