

**City of Harrisburg, Pennsylvania
Sewer Revenue Trust Fund**

Financial Statements and Supplementary
Information

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

CITY OF HARRISBURG, PENNSYLVANIA

SEWER REVENUE TRUST FUND

YEARS ENDED DECEMBER 31, 2012 AND 2011

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Independent Auditor's Report

The Honorable Linda D. Thompson, Mayor
and Honorable Members of City Council
City of Harrisburg, Pennsylvania

We have audited the accompanying financial statements of the Sewer Revenue Trust Fund (an enterprise fund) of the City of Harrisburg, Pennsylvania (City) as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

Emphasis of Matter

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

Other Matters

Required Supplementary Information

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

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Sewer Revenue Trust Fund's basic financial statements. The Second Supplemental Agreement of Lease, Third Supplemental Agreement of Lease, Fourth Supplemental Agreement of Lease, and Collection System Lease: Reserve Requirement Calculation and Bond Covenant Requirement Calculation are presented for purposes of additional analysis and are not a required part of the basic financial statements. The Second Supplemental Agreement of Lease, Third Supplemental Agreement of Lease, Fourth Supplemental Agreement of Lease, and Collection System Lease: Reserve Requirement Calculation and Bond Covenant Requirement Calculation are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Maher Duessel

Harrisburg, Pennsylvania
November 8, 2013

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

(an enterprise fund of the City of Harrisburg, Pennsylvania)

Statements of Net Position

as of December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 517,288	\$ 1,348,619
Investments	5,815,228	736,864
Accounts receivable, net of allowance for uncollectible accounts of \$3,749,648 in 2012 and \$2,111,028 in 2011	2,207,316	2,979,966
Due from component unit	174,675	388,980
Due from the City of Harrisburg	876,342	1,393,804
Other assets	807,910	1,046,458
Total current assets	<u>10,398,759</u>	<u>7,894,691</u>
Direct financing lease proceeds receivable from component unit	702,755	(718)
Capital assets, not being depreciated	4,857,143	3,833,769
Capital assets, net of accumulated depreciation of \$58,594,772 in 2012 and \$56,692,129 in 2011	<u>37,736,576</u>	<u>38,498,368</u>
	<u>43,296,474</u>	<u>42,331,419</u>
Total assets	<u>53,695,233</u>	<u>50,226,110</u>
LIABILITIES		
Current liabilities:		
Accounts payable	561,239	697,489
Due to other funds	197,658	232,588
Due to component unit	1,469,893	1,451,614
Current portion of vested compensated absences	16,914	14,327
Current portion of workers' compensation	18,517	7,960
Current portion of future lease rentals payable	80,163	79,366
Total current liabilities	<u>2,344,384</u>	<u>2,483,344</u>
Long-term liabilities:		
Vested compensated absences	243,914	238,849
Other post-employment benefits	1,411,640	1,209,847
Workers' compensation	63,599	27,370
Future lease rentals payable	<u>1,517,004</u>	<u>1,601,761</u>
Total long-term liabilities	<u>3,236,157</u>	<u>3,077,827</u>
Total liabilities	<u>5,580,541</u>	<u>5,561,171</u>
NET POSITION		
Net investment in capital assets	41,699,307	40,650,292
Unrestricted	<u>6,415,385</u>	<u>4,014,647</u>
Total net position	<u>\$ 48,114,692</u>	<u>\$ 44,664,939</u>

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

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

(an enterprise fund of the City of Harrisburg, Pennsylvania)

Statements of Revenues, Expenses, and Changes in Net Position

for the years ended December 31, 2012 and 2011

	2012	2011
Operating revenues:		
Charges for services	\$ 12,255,043	\$ 14,591,775
Operating expenses:		
Salaries and wages	1,744,080	1,795,561
Fringe benefits	1,091,994	864,702
Communications	20,963	19,237
Professional fees	95,681	126,365
Utilities	1,638,237	2,418,490
Insurance	390,509	381,829
Maintenance and repairs	574,758	388,860
Contracted services	855,433	7,308,864
Supplies	1,162,384	713,566
Depreciation	1,902,643	1,972,109
Total operating expenses	9,476,682	15,989,583
Operating income (loss)	2,778,361	(1,397,808)
Nonoperating revenue (expenses):		
Grant subsidy	1,033,017	651,473
Investment income	24,804	12,556
Interest expense	(387,203)	(492,446)
Gain on disposal of assets	774	-
Total nonoperating revenue (expenses)	671,392	171,583
Income (loss) before contributions	3,449,753	(1,226,225)
Capital contributions	-	614,447
Change in net position	3,449,753	(611,778)
Net position - beginning of year	44,664,939	45,276,717
Net position - end of year	\$ 48,114,692	\$ 44,664,939

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

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

(an enterprise fund of the City of Harrisburg, Pennsylvania)

Statements of Cash Flows

for the years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Received from user charges	\$ 13,241,998	\$ 14,531,223
Payments to employees for services	(1,736,428)	(1,823,240)
Payments for fringe benefits	(890,201)	(600,989)
Payments to suppliers for goods and services	<u>(4,429,664)</u>	<u>(11,422,804)</u>
Net cash provided by operating activities	<u>6,185,705</u>	<u>684,190</u>
Cash flows from noncapital financing activities:		
Proceeds from (payment of) advances to other City of Harrisburg funds	<u>630,881</u>	<u>(789,460)</u>
Net cash provided by (used in) noncapital financing activities	<u>630,881</u>	<u>(789,460)</u>
Cash flows from capital and related financing activities:		
Transfers to component unit	(2,050,000)	-
Proceeds from sale of assets	774	-
Acquisition and construction of capital assets	(92,247)	(51,350)
Lease and bond payments	<u>(452,884)</u>	<u>(2,469,009)</u>
Net cash used in capital and related financing activities	<u>(2,594,357)</u>	<u>(2,520,359)</u>
Cash flows from investing activities:		
Purchases of investments	(5,078,364)	(3,693)
Interest on investments	<u>24,804</u>	<u>12,556</u>
Net cash provided by (used in) investing activities	<u>(5,053,560)</u>	<u>8,863</u>
Net decrease in cash and cash equivalents	(831,331)	(2,616,766)
Cash and cash equivalents - beginning of year	<u>1,348,619</u>	<u>3,965,385</u>
Cash and cash equivalents - end of year	<u>\$ 517,288</u>	<u>\$ 1,348,619</u>

(Continued)

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

(an enterprise fund of the City of Harrisburg, Pennsylvania)

Statements of Cash Flows (continued)

for the years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of operating income (loss) to net cash provided by operating activities:		
Operating income (loss)	\$ 2,778,361	\$ (1,397,808)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	1,902,643	1,972,109
Provision for uncollectible accounts	1,638,620	52,944
Changes in assets and liabilities:		
Accounts receivable	(651,665)	(113,496)
Other assets	238,548	(391,658)
Direct financing lease	159,217	9,176
Vested compensated absences	7,652	(27,679)
Workers' compensation	46,786	(107,528)
Other post-employment benefits	201,793	263,713
Accounts payable and accrued expenses	<u>(136,250)</u>	<u>424,417</u>
Net cash provided by operating activities	<u>\$ 6,185,705</u>	<u>\$ 684,190</u>
Other cash flow information:		
Cash payments for interest	<u>\$ 387,203</u>	<u>\$ 492,446</u>
Noncash investing, capital, and financing activities:		
Capital assets purchased by The Harrisburg Authority on behalf of the Sewer Revenue Trust Fund	<u>\$ 2,006,745</u>	<u>\$ 2,137,738</u>

(Concluded)

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

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

(an enterprise fund of the City of Harrisburg, Pennsylvania)

Notes to Financial Statements

December 31, 2012 and 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. *Reporting Entity*

The City of Harrisburg, Pennsylvania (City) Sewer Revenue Trust Fund is used to account for the operating assets and liabilities of the sewage collection system and sewage conveyance and treatment system subleased and leased, respectively, by The Harrisburg Authority (Authority) to the City.

Long-term debt issued to finance capital additions relating to the sewage conveyance and treatment system and to the collection system, related debt sinking funds, and unexpended bond proceeds held in restricted trust accounts are reflected in the accounts of the Authority.

B. *Basis of Accounting*

The accounting records of the Sewer Revenue Trust Fund are maintained on the accrual basis and are accounted for as an enterprise fund.

Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

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 revenues of the Sewer Revenue Trust Fund are charges to customers for sales and services. Operating expenses for the Sewer Revenue Trust Fund include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

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

The City maintains the accounts of the Sewer Revenue Trust Fund in sufficient detail to identify accounts receivable, and revenue and expenses of the collection system separately from those of the conveyance and treatment system, as required by the terms of the respective lease agreements with the Authority. Such amounts have been combined for presentation in the Sewer Revenue Trust Fund's financial statements.

C. *Cash and Cash Equivalents*

For the purposes of the statements of cash flows, highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

(an enterprise fund of the City of Harrisburg, Pennsylvania)

Notes to Financial Statements

December 31, 2012 and 2011

D. *Investments*

The Sewer Revenue Trust Fund carries its investments at fair value. The fair value of the investments is based upon values provided by external investment managers and quoted market prices.

E. *Allowance for Uncollectible Accounts*

The allowance for uncollectible accounts is based upon historic ratios developed from experience and other such factors which, in the judgment of City officials, deserve recognition in estimating possible losses. For the years ended December 31, 2007 through 2009, the City invoiced other municipalities that use the City's sewer system at increased rates. The City reported the full receivable at December 31, 2012 and 2011, but has recorded a 100% allowance on such invoices. In addition, during the year ended December 31, 2012, the other municipalities only paid a portion of the 2012 invoices. The City has recorded a 100% allowance on these 2012 invoice amounts that were not collected. Management believes that they have adequately provided for future probable losses.

F. *Capital Assets*

Capital assets are carried at cost. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. Depreciation is computed using the straight-line method. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred and significant renewals and betterments are capitalized.

G. *Vested Compensated Absences*

Vested compensated absences represent vested portions of accumulated unpaid vacation, sick pay, and other employee benefit amounts. It is the Sewer Revenue Trust Fund's policy to permit employees to accumulate a limited amount of earned but unused vacation, sick pay, and other employee benefit amounts, which will be paid to employees upon separation from City service.

H. *Net Position*

Net position is classified in the following categories:

Net Investment in Capital Assets – This category groups all capital assets, including infrastructure, into one component of net position. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction, or improvement of these assets reduce this category.

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

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

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Notes to Financial Statements

December 31, 2012 and 2011

I. *Pending Changes in Accounting Principles*

In March 2012, Governmental Accounting Standards Board (GASB) issued Statement No. 65, *“Items Previously Reported as Assets and Liabilities.”* Statement No. 65 clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. The provisions of this statement are effective for the Sewer Revenue Trust Fund’s 2013 financial statements.

In June 2012, GASB issued Statements No. 67 and 68, *“Financial Reporting for Pension Plans”* and *“Accounting and Financial Reporting for Pensions.”* These statements revise and establish reporting requirements for most governments that provide their employees with pension benefits. The provisions of these statements are effective for the Sewer Revenue Trust Fund’s 2014 and 2015 financial statements.

In April 2013, GASB issued Statement No. 70, *“Accounting and Financial Reporting for Nonexchange Financial Guarantees.”* Statement No. 70 improves accounting and financial reporting by governments that extend and receive nonexchange financial guarantees. The provisions of this statement are effective for the Sewer Revenue Trust Fund’s December 31, 2014 financial statements.

The effect of implementation of these statements has not yet been determined.

2. **DEPOSITS AND INVESTMENTS**

The deposit and investment policy of the Sewer Revenue Trust Fund is restricted by the terms of the Second Supplemental Agreement of Lease, the Third Supplemental Agreement of Lease, the Fourth Supplemental Agreement of Lease, and the Collection System Lease between the City and the Authority. Allowable deposits and investments are limited to direct obligations of the United States of America, shares in portfolios of the Pennsylvania Local Government Investment Trust Program, and/or in savings or time deposits or certificates of deposit fully insured by the Federal Deposit Insurance Corporation, or certificates of deposit fully secured by direct obligations of the United States of America in one or more banks, savings and loan associations, or mutual savings banks (inclusive of the Trustee); such deposits shall be subject to withdrawal upon not more than six months notice or prior to the date upon which such money will be required to be expended, whichever is earlier, and, to the extent not insured, shall be secured continuously by the depository in the manner required by laws of the Commonwealth of Pennsylvania.

The policy is further restricted with respect to the reserve fund, which is comprised of amounts accumulated in the Sewer Revenue accounts, after withdrawals for operating expense obligations, until the balance is such that the reserve shall equal the sum of (1) one-half of the lease rental due under the next lease year and (2) one-half of the annual operating expenses as estimated by the consulting engineers, for the next succeeding lease year. With respect to the reserve fund, investments in direct obligations of the United States of America are limited to those having a maturity date or being subject to redemption at the option of the holder either within one year from the date of such investment or prior to the date upon which such money will be required to

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

(an enterprise fund of the City of Harrisburg, Pennsylvania)

Notes to Financial Statements

December 31, 2012 and 2011

be expended, whichever is earlier. All cash, cash equivalents, and investments are restricted pursuant to the reserve requirements.

The Sewer Revenue Trust Fund's deposit and investment policy is in compliance with the terms of the Second Supplemental Agreement of Lease, the Third Supplemental Agreement of Lease, the Fourth Supplemental Agreement of Lease, and the Collection System Lease.

A. 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 City has no policy, other than as presented above, that further limits its custodial credit deposit risk. As of December 31, 2012, the Sewer Revenue Trust Fund's book balance was \$517,288 and the bank balance was \$410,448. Of the bank balance at December 31, 2012, \$250,000 was covered by federal depository insurance. The remaining balance of \$160,448 at December 31, 2012 was collateralized under Act No. 72 of the 1971 Session of the Pennsylvania General Assembly (Act), 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.

B. Investments

The City uses an external investment pool to ensure safety and maximize efficiency, liquidity, and yield for City funds. These funds are invested in the Pennsylvania Treasurer's INVEST Program for Local Governments and Nonprofits (INVEST), which separately issues audited financial statements that are available to the public. The fair value of the City's position in the external investment pool is equivalent to the value of the pool shares. The Commonwealth of Pennsylvania provides external regulatory oversight of the pool.

The Sewer Revenue Trust Fund pools certain investments with the City. The Sewer Revenue Trust Fund's position in the pooled funds at December 31, 2012 and 2011 was \$735,036 and \$736,523, respectively.

At December 31, 2012 and 2011, the fair value of the investments of the pooled and non-pooled funds of the City was as follows:

	<u>Fair Value</u>
<u>December 31, 2012</u>	
Investments:	
Money market fund	\$ 1,167,569
External investment pool	<u>5,080,192</u>
Total	<u>\$ 6,247,761</u>
Reconciliation to total investments:	
Non-pooled funds	\$ 5,080,192
Pooled funds	<u>1,167,569</u>
Total	<u>\$ 6,247,761</u>

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

(an enterprise fund of the City of Harrisburg, Pennsylvania)

Notes to Financial Statements

December 31, 2012 and 2011

December 31, 2011

Investments:

Money market fund	\$ 1,174,063
External investment pool	341

Total	<u>\$ 1,174,404</u>
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Reconciliation to total investments:

Non-pooled funds	\$ 341
Pooled funds	1,174,063

Total	<u>\$ 1,174,404</u>
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Concentration of credit risk. The City places no limit on the amount it may invest in any one issuer. At December 31, 2012, there were no investments subject to concentration of credit risk that exceeded five percent of the Sewer Revenue Trust Fund's total investments.

Credit risk. The City has no policy, other than presented above, that would further limit the City's investment choices with regard to credit risk. The City's investments had the following level of exposure to credit risk:

	<u>Fair Value</u>	<u>Rating</u>
December 31, 2012		
Money market fund	\$ 1,167,569	Unrated
External investment pool	\$ 5,080,192	AAAm

Interest rate risk. The City's policy is to limit investments to those having a maturity date or being subject to redemption at the option of the holder either within one year from the date of such investment or prior to the date upon which such money will be required to be expended, whichever is earlier. At December 31, 2012, the Sewer Revenue Trust Fund's pooled and non-pooled investments all had maturities of less than one year.

3. WORKERS' COMPENSATION DEPOSIT

In accordance with the provisions of the Pennsylvania Workers' Compensation Act, the City has secured an exemption from the necessity of insuring its workers' compensation liability and has elected to maintain a separate fund to provide a reserve for claimants entitled to benefits. Since inception, a total of \$600,000 has been deposited in a bank trust account through December 31, 2012. Investment income of \$1,517,569 has been earned on deposits and claims of \$700,000 have been paid from the trust account from inception through December 31, 2012. During 2006, the City withdrew \$1.3 million to fund operating deficits of the General Fund. At December 31, 2006, the City had deposited \$1,050,000 back into the fund, giving the City total assets held as reserves of \$1,167,569 at December 31, 2012. The amount of the deposit relating to the Sewer Revenue Trust Fund included in investments totaled \$735,036 and \$736,523 at December 31, 2012 and 2011, respectively.

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

(an enterprise fund of the City of Harrisburg, Pennsylvania)

Notes to Financial Statements

December 31, 2012 and 2011

4. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2012 is as follows:

	Beginning of Year	Additions/ Transfers In	Retirements and Dispositions/ Transfers Out	End of Year
Capital assets, not being depreciated:				
Land	\$ 361,421	\$ -	\$ -	\$ 361,421
Construction in progress	3,472,348	2,047,992	(1,024,618)	4,495,722
Total capital assets, not being depreciated	<u>3,833,769</u>	<u>2,047,992</u>	<u>(1,024,618)</u>	<u>4,857,143</u>
Capital assets, being depreciated:				
Buildings	34,701,554	-	-	34,701,554
Improvements	2,685,962	-	-	2,685,962
Equipment and furniture	44,012,533	1,140,851	-	45,153,384
Infrastructure	13,790,448	-	-	13,790,448
Total capital assets, being depreciated	<u>95,190,497</u>	<u>1,140,851</u>	<u>-</u>	<u>96,331,348</u>
Less accumulated depreciation for:				
Buildings	(19,760,231)	(608,214)	-	(20,368,445)
Improvements	(835,012)	(28,286)	-	(863,298)
Equipment and furniture	(29,497,389)	(1,132,088)	-	(30,629,477)
Infrastructure	(6,599,497)	(134,055)	-	(6,733,552)
Total accumulated depreciation	<u>(56,692,129)</u>	<u>(1,902,643)</u>	<u>-</u>	<u>(58,594,772)</u>
Total capital assets, being depreciated, net	<u>38,498,368</u>	<u>(761,792)</u>	<u>-</u>	<u>37,736,576</u>
Capital assets, net	<u>\$ 42,332,137</u>	<u>\$ 1,286,200</u>	<u>\$ (1,024,618)</u>	<u>\$ 42,593,719</u>

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

(an enterprise fund of the City of Harrisburg, Pennsylvania)

Notes to Financial Statements

December 31, 2012 and 2011

Capital asset activity for the year ended December 31, 2011 is as follows:

	Beginning of Year	Additions	Retirements and Dispositions	End of Year
Capital assets, not being depreciated:				
Land	\$ 361,421	\$ -	\$ -	\$ 361,421
Construction in progress	1,334,610	2,137,738	-	3,472,348
Total capital assets, not being depreciated	1,696,031	2,137,738	-	3,833,769
Capital assets, being depreciated:				
Buildings	34,701,554	-	-	34,701,554
Improvements	2,685,962	-	-	2,685,962
Equipment and furniture	43,961,183	51,350	-	44,012,533
Infrastructure	13,790,448	-	-	13,790,448
Total capital assets, being depreciated	95,139,147	51,350	-	95,190,497
Less accumulated depreciation for:				
Buildings	(19,148,700)	(611,531)	-	(19,760,231)
Improvements	(808,136)	(26,876)	-	(835,012)
Equipment and furniture	(28,297,831)	(1,199,558)	-	(29,497,389)
Infrastructure	(6,465,353)	(134,144)	-	(6,599,497)
Total accumulated depreciation	(54,720,020)	(1,972,109)	-	(56,692,129)
Total capital assets, being depreciated, net	40,419,127	(1,920,759)	-	38,498,368
Capital assets, net	\$ 42,115,158	\$ 216,979	\$ -	\$ 42,332,137

Capital assets at December 31, 2012 and 2011, with estimated lives, are as follows:

	Estimated Life
Buildings	50 - 100 years
Improvements	40 years
Equipment and furniture	5 - 25 years
Infrastructure	50 - 100 years

Depreciation is taken on a straight-line basis over the estimated useful life of the asset and amounted to \$1,902,643 and \$1,972,109 for the years ended December 31, 2012 and 2011, respectively.

5. RISK MANAGEMENT

The Sewer Revenue Trust Fund 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 City purchases commercial insurance for all risks of loss including workers'

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

(an enterprise fund of the City of Harrisburg, Pennsylvania)

Notes to Financial Statements

December 31, 2012 and 2011

compensation excess coverage for those risks related to injuries of employees. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years.

The City is self-insured for workers' compensation. As a self-insurer, the City is required to fund an already established trust fund, dollar for dollar, once the City has passed a total liability threshold of \$3,594,887 as established by the Commonwealth of Pennsylvania. Accordingly, the City has established a trust fund for workers' compensation claims. The City provides coverage for up to a maximum of \$600,000 for each workers' compensation claim, and has purchased commercial coverage for claims in excess of coverage.

The Sewer Revenue Trust Fund has recorded a liability for outstanding workers' compensation claims, included with accrued expenses, in the amount of \$82,116 and \$35,330 at December 31, 2012 and 2011, respectively. This claims liability is discounted to present value at a discount rate of 5% and is based on the requirements of governmental accounting standards, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

Changes in the claims liability amounts for the years ended December 31, 2012 and 2011 were as follows:

	2012	2011
Beginning - January 1	\$ 35,330	\$ 142,858
Current year claims and changes in estimates	74,297	(79,843)
Claim payments	(27,511)	(27,685)
Ending - December 31	82,116	35,330
Current portion	18,517	7,960
Long-term portion	<u>\$ 63,599</u>	<u>\$ 27,370</u>

6. COMMITMENTS AND CONTINGENCIES

Future Lease Rentals Payable

On October 1, 1984, the City entered into a supplemental lease agreement pursuant to the refunding of the Authority's Guaranteed Sewer Revenue Bonds, Series of 1978. The 1984 Second Supplemental Agreement of Lease provides for rental payments in the amount sufficient to retire bonds issued to finance the cost of major construction improvements to the sewage conveyance and treatment system. Also included are interest and administrative costs of the Authority.

On January 15, 1988, the City entered into a Third Supplemental Agreement of Lease and a Collection System Lease pursuant to the issuance of the Authority's Sewer Revenue Bonds, Series A and B of 1988, respectively. The Third Supplemental Agreement of Lease was entered into providing for rental payments in an amount sufficient to retire bonds issued to finance the Series A Project relating to the sewage conveyance and treatment system. The Collection System

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Lease was entered into providing for rental payments in an amount sufficient to retire bonds issued to finance the Series B Project relating to the sewage collection system.

On December 23, 2009, the City entered into a Fourth Supplemental Agreement of Lease pursuant to the issuance of the Authority's 2009 Guaranteed Sewer Revenue Note (2009 Note). The Fourth Supplemental Agreement of Lease was entered into providing for rental payments in an amount sufficient to provide for the principal and interest on the 2009 Note issued to finance the construction and acquisition of certain alterations, additions, improvements and extensions to the sewage conveyance and treatment system.

In accordance with the lease agreements, the City is required to make the following minimum annual lease rental payments:

<u>Lease year ending December 31,</u>	<u>Basic Lease Rental</u>
2013	\$ 82,453
2014	100,207
2015	110,411
2016	110,411
2017	110,411
2018 - 2022	552,055
2023 - 2027	552,055
2028 - 2030	<u>331,231</u>
Total minimum lease payments	1,949,234
Less amount representing interest	<u>(352,067)</u>
Present value of net minimum lease payments	1,597,167
Current portion	<u>80,163</u>
Long-term portion	<u><u>\$ 1,517,004</u></u>

The net book value of equipment held under capital leases included in capital assets was \$20,206,660 at December 31, 2012. Construction of improvements to these systems under the lease agreements was \$2,006,745 and \$2,137,738 during the years ended December 31, 2012 and 2011, respectively. Capital assets under the lease agreement have been treated as noncash transactions in the Statements of Cash Flows.

The City is required under the terms of the Second, Third, and Fourth Supplemental Agreement of Lease and Collection System Lease to make additional rental payments within 190 days after the end of each year, equal to excess funds in the Sewer Revenue Trust Fund as defined in the respective lease agreements. Funds available were approximately \$1.83 million in excess of the reserve requirement at December 31, 2012. No payments were made by the City within the 190 days.

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7. LONG-TERM LIABILITIES

Long-term liability activity for the year ended December 31, 2012 is as follows:

	Beginning of Year	Additions	Retirements	End of Year	Current Portion
Vested compensated absences	\$ 253,176	\$ 307,287	\$ (299,635)	\$ 260,828	\$ 16,914
Workers' compensation	35,330	74,297	(27,511)	82,116	18,517
Future lease rentals payable	1,681,127	-	(83,960)	1,597,167	80,163
Total long-term liabilities	<u>\$ 1,969,633</u>	<u>\$ 381,584</u>	<u>\$ (411,106)</u>	<u>\$ 1,940,111</u>	<u>\$ 115,594</u>

Long-term liability activity for the year ended December 31, 2011 is as follows:

	Beginning of Year	Additions	Retirements	End of Year	Current Portion
Vested compensated absences	\$ 280,855	\$ 107,474	\$ (135,153)	\$ 253,176	\$ 14,327
Workers' compensation	142,858	(79,843)	(27,685)	35,330	7,960
Future lease rentals payable	3,045,269	430,629	(1,794,771)	1,681,127	79,366
Total long-term liabilities	<u>\$ 3,468,982</u>	<u>\$ 458,260</u>	<u>\$ (1,957,609)</u>	<u>\$ 1,969,633</u>	<u>\$ 101,653</u>

8. OTHER POST-EMPLOYMENT BENEFITS

Plan Description

In addition to the pension benefits described in Note 9, the City provides certain post-employment healthcare benefits to its retirees through one single-employer, defined benefit other post-employment benefit (OPEB) plan. However, within this one plan, there are four groups of employees with different types of benefits; police, firefighters, non-uniformed management, and non-uniformed union. A separate financial statement is not issued for the plan.

Non-uniformed management employees:

An inter-office memo, distributed by the Mayor to City management employees, establishes retirees' eligibility for post-employment medical benefits.

Retire prior to August 4, 2002:

Benefits: The health care coverage currently includes medical, prescription drugs, dental, and vision. The retiree would pay the full cost of coverage for the retiree and his or her spouse. If the retiree dies, the spouse may continue coverage. In such case, the spouse

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and any eligible dependents would pay for the full cost of coverage. Currently, four retirees have been “grandfathered” and the City continues to pay the cost of full coverage.

Retire after August 5, 2002 and hired prior to January 31, 2008:

Eligibility: Any non-uniformed management employee who is eligible for the Non-uniformed Pension Plan benefits.

Benefits: The health care coverage currently includes medical, prescription drugs, dental, vision, and life insurance. The City would pay the full premium for paid-up life insurance in the amount of \$5,000 for the retiree only. The City would pay the cost of coverage for medical and prescription drug for the retiree and spouse. The retiree would pay for any additional coverage for eligible dependents. Retiree would pay for dental and vision coverage. If retiree dies, full coverage for spouse and eligible dependents continues. In such case, the City would pay the full medical and prescription drug premium for the spouse and the spouse would pay for coverage for any eligible dependents.

Retire after August 5, 2002 and hired after February 1, 2008:

Eligibility: Any non-uniformed management employee who is eligible for the Non-uniformed Pension Plan benefits.

Benefits: The health care coverage currently includes medical, prescription drugs, dental, vision, and life insurance. The City would pay the full premium for paid-up life insurance in the amount of \$5,000 for the retiree only. The City would pay the cost of coverage for medical coverage for the retiree. The retiree would pay for any additional coverage for spouse and any eligible dependents. Retiree would pay for prescription drug, dental, and vision coverage. If retiree dies, full coverage for spouse and eligible dependents continues. In such case, the spouse and eligible dependents would pay the full cost of coverage.

Non-uniformed union employees:

Articles X, XI, and XII of the Collective Bargaining Agreement between the City and the Local 521 American Federation of State, County and Municipal Employees District Council 90, effective January 1, 2007, establish retirees’ eligibility for post-employment life insurance and medical benefits.

Retire prior to December 31, 1996:

Benefits: The health care coverage currently includes medical, prescription drugs, dental, and vision. The retiree would pay the cost of coverage for the retiree and his or her spouse and eligible dependents. If the retiree dies, the spouse may continue coverage. In such case, the spouse and any eligible dependents would pay for the full cost of coverage.

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Retire between January 1, 1997 and December 31, 2001:

Benefits: The health care coverage currently includes medical, prescription drugs, dental, and vision. The City would pay fifty percent of the medical premium for single coverage. The retiree would pay the remaining fifty percent of the premium for single coverage. For any coverage other than single coverage, the retiree would pay the difference. Retiree would pay full premiums for prescription drug, dental, and vision. If retiree dies, full coverage for spouse and eligible dependents continues. In such case, the spouse and eligible dependents would pay for the full cost of coverage.

Retired between January 1, 2002 and May 30 2007, except between January 1, 2004 and April 30, 2004:

Benefits: The health care coverage currently includes medical, prescription drugs, dental, and vision. The City would pay sixty percent of the medical premium for single coverage. The retiree would pay the remaining forty percent of the premium for single coverage. For any coverage other than single coverage, the retiree would pay the difference. Retiree would pay full premiums for prescription drug, dental, and vision. If retiree dies, full coverage for spouse and eligible dependents continues. In such case, the spouse and eligible dependents would pay for the full cost of coverage

Retired between January 1, 2004 and April 30, 2004:

Benefits: The health care coverage currently includes medical, prescription drugs, dental, and vision. The City would pay the cost of medical coverage for the retiree. Retiree would pay for additional premiums for coverage for his or her spouse and eligible dependents. The City would pay for seventy-five percent of the coverage for prescription drug for the retiree. Retiree would pay for the remaining twenty-five percent of the coverage for prescription drug and for any additional coverage for his or her spouse and any eligible dependents. Retiree must pay for full coverage for dental and vision coverage. If retiree dies, full coverage for spouse and eligible dependents continues. In such case, the spouse and eligible dependents would pay for the full cost of coverage.

Retire after June 1, 2007:

Eligibility: Non-uniform union employee must be eligible for the Non-Uniform Pension Plan benefits.

Benefits: The health care coverage currently includes medical, prescription drugs, dental, vision, and life insurance. The City would pay the full premium for paid-up life insurance in the amount of \$5,000 for the retiree only. The City would pay the full cost single coverage if retiree has attained age 60 and completed 20 years of service or a percentage thereof based on the retiree's age and years of service. If retiree is disabled after completion of 20 years of service, attained age 55 and completed 20 years of service or attained age 65 and completed 15 years of service, City would pay 60% of premium for single coverage. Otherwise, the retiree would pay the full cost of coverage. For any coverage other than single, the retiree would pay the difference in the premiums. Retirees

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would pay for prescription drug, dental, and vision coverage. If retiree dies, full coverage for spouse and eligible dependents continues. In such case, the spouse and eligible dependents would pay for the full cost of coverage.

A retiree may suspend coverage under the plan if the retiree and/or spouse become covered under the plan of another employer. Coverage may be reinstated only upon proof of the termination of coverage under the other employer's plan.

Funding Policy and Annual OPEB Costs

The City's contribution is based on projected pay-as-you-go financing requirements. For the year ended December 31, 2012, the City and the Sewer Revenue Trust Fund contributed \$4,476,131 and \$105,060 to the OPEB Plan, respectively. For the year ended December 31, 2011, the City and the Sewer Revenue Trust Fund contributed \$4,697,333 and \$81,459 to the OPEB Plan, respectively.

The City has opted to not fully fund the OPEB contributions and will continue to fund the annual OPEB costs on a pay-as-you-go basis.

The City would pay the cost of coverage for the non-uniform management and non-uniform union retirees (including dependents) based on the various criteria described above.

The City's annual OPEB costs are calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the ARC are subject to continual revision as actual results are compared to past expectations and new estimate are made about the future. The schedule of funding progress presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions:

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

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Information as of the latest actuarial valuation follows:

Valuation date	1/1/2012
Actuarial cost method	Entry age normal, level dollar
Actuarial assumptions	
Interest rate	4.5%
Salary increases	5.0%
Amortization period	30 year open period
Healthcare cost trend rate	7.5% in 2012, decreasing by .05% per year to 5.5% in 2016, rates gradually decrease from 5.3% in 2017 to 4.2% in 2089

Annual OPEB Cost and Net OPEB Obligation

The City's annual OPEB costs and net OPEB obligations to the Plan for the year ended December 31, 2012 were as follows:

	Governmental Activities	Business-type Activities	Total
Annual required contribution	\$ 15,118,664	\$ 536,084	\$ 15,654,748
Interest on OPEB obligation	2,091,755	102,807	2,194,562
Adjustment to ARC	(2,853,687)	(140,255)	(2,993,942)
Annual OPEB cost	14,356,732	498,636	14,855,368
Contribution made	(4,305,408)	(170,723)	(4,476,131)
Change in Net OPEB Obligation	10,051,324	327,913	10,379,237
Net OPEB Obligation, beginning	46,808,858	2,060,131	48,868,989
Net OPEB Obligation, ending	\$ 56,860,182	\$ 2,388,044	\$ 59,248,226

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December 31, 2012 and 2011

The City's annual OPEB costs and net OPEB obligations to the Plan for the year ended December 31, 2011 were as follows:

	Governmental Activities	Business-type Activities	Total
Annual required contribution	\$ 15,848,879	\$ 596,739	\$ 16,445,618
Interest on OPEB obligation	1,613,500	79,275	1,692,775
Adjustment to ARC	<u>(2,201,228)</u>	<u>(108,151)</u>	<u>(2,309,379)</u>
Annual OPEB cost	15,261,151	567,863	15,829,014
Contribution made	<u>(4,563,320)</u>	<u>(134,013)</u>	<u>(4,697,333)</u>
Change in Net OPEB Obligation	10,697,831	433,850	11,131,681
Net OPEB Obligation, beginning	<u>36,111,027</u>	<u>1,626,281</u>	<u>37,737,308</u>
Net OPEB Obligation, ending	<u>\$ 46,808,858</u>	<u>\$ 2,060,131</u>	<u>\$ 48,868,989</u>

Three-Year Trend Information

Year	Annual OPEB Cost (AOC)	Percentage of AOC Contributed	Net OPEB Obligation
2012	\$ 14,855,368	29.68%	\$ 59,248,226
2011	15,829,014	29.68%	48,868,989
2010	16,051,136	26.52%	37,737,308

Funded Status and Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (b-a/c)
1/1/2012	\$ -	\$ 173,117,094	\$ 173,117,094	0.00%	\$ 25,384,925	681.97%
1/1/2010	\$ -	\$ 177,796,013	\$ 177,796,013	0.00%	\$ 28,435,550	625.26%

The above information is for the City as a whole. The Sewer Revenue Trust Fund's participation in the City's net OPEB obligation is \$1,411,640 and \$1,209,847 at December 31, 2012 and 2011, respectively.

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Notes to Financial Statements

December 31, 2012 and 2011

9. PENSION PLANS

Basis of Accounting

The plan's financial statements are prepared using the accrual basis of accounting. Plan members' contributions are recognized in the period in which the contributions are withheld. Employer contributions are recognized in the period in which the contributions are due.

Method Used to Value Investments

Investments are reported at fair value. The plan's assets with the Pennsylvania Municipal Retirement System (PMRS) are pooled for investment purposes and, therefore, do not represent specific identifiable investment securities.

Plan Description

The Sewer Revenue Trust Fund contributes to the City's Non-uniformed Employees' pension plans with PMRS, an agent multiple-employer Public Employees Retirement System (PERS). On January 2, 2002, the assets of Plans A and B were combined, but the requirements for eligibility and benefits remain separate. Employees become eligible for participation in a plan immediately upon employment and become fully vested after 20 years of service for the City A plan and 10 years for the City B plan. The plans have been established by City ordinance in accordance with the authority for municipal contributions required by Act 205-1984 (Act 205) of the Pennsylvania legislature, as amended by Act 189-1990. The plans require covered employees to contribute a percentage of total compensation.

PMRS issues publicly available financial reports that include financial statements and required supplementary information. The PERS report may be obtained by writing to the Pennsylvania Municipal Retirement System, P.O. Box 1165, Harrisburg, PA 17108-1165 or by calling 1-800-622-7968.

The benefits provided by the plans differ by employment group and are based upon average compensation and length of service. Normal benefits are calculated at 2.5% per year of credited service multiplied by the final average annual salary for the Non-uniformed Employees' A plan. In no case may the benefit exceed 50% of the final average annual salary. The benefits provided by the Non-uniformed Employees' B plan are calculated at 2.0% per year of credited service multiplied by the final average annual salary. In no case may the benefit exceed 75% of the final average annual salary.

The plans provide retirement, disability, and death benefits to plan members and their beneficiaries. Cost-of-living allowances are provided at the discretion of the plan.

In addition, Non-uniformed Employees' A plan is closed to new entrants.

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Funding Policy

Act 205 requires that annual contributions be based upon the plan's minimum municipal obligation (MMO). The MMO is based upon the plan's bi-annual actuarial valuation.

Contributions by the City are determined under the entry age normal method. Unfunded past service liability is amortized over the average future service of active participants.

Employee contributions to the plan are based on a percentage of compensation. Non-uniformed employees contribute 4.0-6.0% and 5.0% of annual compensation for Plans A and B, respectively. An interest rate of 6.0% is applied to the employees' account. Employees' accumulated contributions plus interest (if applicable) will be returned upon termination or death if no other benefits are payable under the plan. The plans are also eligible to receive an allocation of state aid from the General Municipal Pension System State Aid Program which must be used for pension funding. Any funding requirements established by the MMO in excess of employee contributions and state aid must be paid by the City in accordance with Act 205.

The Commonwealth of Pennsylvania allocates foreign fire and casualty insurance premium collections to aid individual municipalities. The monies received must be contributed to the pension plans or used to pay debt service on unfunded pension liability bonds. Significant actuarial assumptions used to compute the actuarially determined contribution requirements are the same as those used to compute the annually required contribution. State aid received in excess of City's statutory funding requirement was not deposited to the pension plans but was utilized to fund debt service on the City's unfunded pension liability general obligation bonds issued in 1995 in accordance with Act 205 as amended.

Administrative costs, including the investment manager, custodial trustee, and actuarial services, are charged to the plan and funded through investment earnings. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Funded Status and Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (b-a/c)
1/1/2011	\$ 77,363,937	\$ 55,795,290	\$ (21,568,647)	138.66%	\$ 12,786,819	-168.68%

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Annual Pension Cost and Net Pension Obligation

The City's annual non-uniformed employees' pension cost and net pension obligation to the Plans at December 31, 2012 and 2011 are as follows:

	2012		2011	
	Plan A	Plan B	Plan A	Plan B
Annual required contribution	\$ -	\$ -	\$ -	\$ -
Contributions made	-	-	-	-
Change in net pension obligation	-	-	-	-
Net pension obligation – beginning of year	-	-	-	-
Net pension obligation – end of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Three-Year Trend Information

Non-uniformed Employees' – Plan A:

Calendar Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
January 1, 2010	\$ -	- %	\$ -
January 1, 2011	\$ -	-	\$ -
January 1, 2012	\$ -	-	\$ -

Non-uniformed Employees' – Plan B:

Calendar Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
January 1, 2010	\$ -	- %	\$ -
January 1, 2011	\$ -	-	\$ -
January 1, 2012	\$ -	-	\$ -

The annual required contribution for the current year was determined as part of the January 1, 2011 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions include (a) a 6.00% investment rate of return (net of administrative expenses) and (b) projected salary increases on a salary scale. The assumptions do not include postretirement

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December 31, 2012 and 2011

benefit increases, which are funded by State appropriation when granted. The actuarial value of assets is determined using market values determined by the trustee.

10. RELATED PARTY TRANSACTION

The City General Fund provides certain administrative and operational services to the Sewer Revenue Trust Fund. Charges to the Sewer Revenue Trust Fund for administrative services and other expenses incurred were \$846,131 and \$7,275,386 for the years ended December 31, 2012 and 2011, respectively.

11. LITIGATION

The United States Environmental Protection Agency (EPA) and Commonwealth of Pennsylvania Department of Environmental Protection have asserted that the City and the Authority may be in violation of certain environmental laws, including the federal Clean Water Act and the Pennsylvania Clean Streams Law. The alleged violations, among other things, relate to the Authority's ownership and the City's operation of a waste water treatment plan, combined sewer overflow structures, and related operations (collectively, the sewer system). As a result of such alleged violations, the City, along with the Authority, may be liable for penalties and/or obligated to undertake improvements to the sewer system. At this time, it is not possible to ascertain the costs associated with any such improvements, the scope, if any, of penalties and the breakdown of responsibility for any required improvements between the Authority and the City.

The City has an agreement to transport and treat sewage for several suburban municipalities, from whom the City collects fees for such transportation and treatment. The suburban municipalities allege that the City has overcharged for at least 10 years evidenced by the alleged excessive transfer of "administrative fees" from the sewer fund into the City's general fund. The municipalities claim they are owed approximately \$15 million in reimbursement. The Receiver, with the cooperation and agreement of the suburban municipalities, through their counsel, has negotiated a compromise of the claim and other amounts that might be owed to the suburban municipalities as a result of the overcharging of sewer rates. In settlement of these claims, in addition to the City's agreement to credit certain amounts as part of the suburban municipalities' prospective financial commitments to the comprehensive overhaul of the sewer system and subject to obtaining the necessary legislative approvals by suburban municipalities and approval and consummation of the Harrisburg Strong Plan, the City will make payments to the suburban municipalities pursuant to the following payment schedule.

<u>Year Ending December 31,</u>	
2013	\$ 4,500,000
2014	1,500,000
2015	1,500,000
2016	1,500,000
2017	1,000,000
2018-2019	1,225,000
	<u>\$ 11,225,000</u>

SUPPLEMENTARY SCHEDULES

**SECOND SUPPLEMENTAL AGREEMENT OF LEASE,
THIRD SUPPLEMENTAL AGREEMENT OF LEASE,
FOURTH SUPPLEMENTAL AGREEMENT OF LEASE, AND
COLLECTION SYSTEM LEASE**

**RESERVE REQUIREMENT CALCULATION AND
BOND COVENANT REQUIREMENT CALCULATION**

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund
 (an enterprise fund of the City of Harrisburg, Pennsylvania)
 Second Supplemental Agreement of Lease, Third Supplemental
 Agreement of Lease, Fourth Supplemental Agreement of Lease,
 and Collection System Lease
 December 31, 2012

In accordance with the respective Articles 5 of the Second Supplemental Agreement of Lease as amended by the Third and Fourth Supplemental Agreement of Lease and the Collection System Lease between The Harrisburg Authority and the City of Harrisburg, Pennsylvania (City), the Sewer Revenue Trust Fund is, at the end of each lease year, required to accumulate amounts in the Sewer Revenue accounts, after withdrawals for operating expense obligations, until the balance is such that the reserve shall equal the sum of (1) one-half of the lease rental due under the next lease year, and (2) one-half of the annual operating expenses as estimated by the consulting engineers, for the next succeeding lease year. Following is a computation of the reserve as of December 31, 2012, which the City is required to accumulate and maintain. Additionally, after the required reserve balance is attained, the City is required to pay any excess funds to The Harrisburg Authority within 190 days after the end of the year. The City may withdraw funds from the reserve account to satisfy lease payments as required by the Collection System Lease agreement.

Cash and investments - December 31, 2012 (1)	\$ 5,597,480
Amount due from the City of Harrisburg - December 31, 2012	876,342
Amount pledged by the City for full satisfaction of obligations related to operations in accordance with the lease Sections 5.02 and 5.03:	
Accounts payable	(561,239)
Accrued expenses and other current obligations	(35,431)
Current receivables pledged to satisfy current liabilities	<u>596,670</u>
Total funds available	<u>\$ 6,473,822</u>
Required reserves:	
Operation and maintenance expense reserve:	
Consulting engineers estimated operating costs - \$9,207,533 x 50%	\$ 4,603,767
2013 lease rental payment reserve:	
\$82,453 x 50%	<u>41,227</u>
Total reserve requirement	<u>\$ 4,644,993</u>
Funds available in excess of required reserves at December 31, 2012	<u>\$ 1,828,829</u>

(1) - Excludes workers' compensation investments of \$735,036

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund
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Second Supplemental Agreement of Lease, Third Supplemental
Agreement of Lease, Fourth Supplemental Agreement of Lease,
and Collection System Lease
December 31, 2012

In accordance with the respective Sections 4.04 of the Second Supplemental Agreement of Lease as amended by the Third and Fourth Supplemental Agreement of Lease and the Collection System Lease between The Harrisburg Authority and the City of Harrisburg, Pennsylvania, the following computation is provided to verify if a sewer rate change is required by the agreement:

Total operating expense (2012 cash basis), as defined in the agreement of lease	\$ 7,235,930
Minimum net rentals due - 2013	82,453
Established margin of safety (5% of minimum net rental - 2012)	<u>4,136</u>
Total covenant requirement	7,322,519
Total revenue (2012 cash basis)	13,287,222
Cash and investments - December 31, 2011 (1)	<u>1,348,960</u>
Excess revenue, cash, and investments over covenant requirement (2012 cash basis)	<u><u>\$ 7,313,663</u></u>

(1) - Excludes workers' compensation investments of \$735,036