

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

Financial Statements

For the Period January 1, 2013 through
Termination (November 4, 2013) and Year
Ended December 31, 2012 with Independent
Auditor's Report

MaherDuessel
Certified Public Accountants

Pittsburgh | Harrisburg | Butler

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Independent Auditor's Report

The Honorable Eric R. Papenfuse, 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 November 4, 2013 (date of termination) and December 31, 2012 and for the period January 1, 2013 through November 4, 2013 and the year ended December 31, 2012, 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 November 4, 2013 and December 31, 2012, and the changes in financial position and cash flows thereof for the period and year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Sewer Revenue Trust Fund

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, 2013 and 2012, 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.

Termination

As discussed in Note 1 and 2, effective November 4, 2013, Capital Region Water and the City terminated the lease and sublease of the sewer system through a transition agreement. 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.

Maher Duessel

Harrisburg, Pennsylvania
November 26, 2014

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

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

Statements of Net Position

as of November 4, 2013 and December 31, 2012

| | November 4, 2013 | December 31, 2012 |
|---|---------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ - | \$ 517,288 |
| Investments | - | 5,815,228 |
| Accounts receivable, net of allowance for uncollectible accounts of zero in 2013 and \$3,749,648 in 2012 | - | 2,207,316 |
| Due from component unit | - | 174,675 |
| Due from the City of Harrisburg | - | 876,342 |
| Other assets | - | 807,910 |
| Total current assets | - | 10,398,759 |
| Direct financing lease proceeds receivable from component unit | - | 702,755 |
| Capital assets, not being depreciated | - | 4,857,143 |
| Capital assets, net of accumulated depreciation of zero in 2013 and \$58,594,772 in 2012 | - | 37,736,576 |
| | - | 43,296,474 |
| Total assets | - | 53,695,233 |
| LIABILITIES | | |
| Current liabilities: | | |
| Accounts payable | - | 561,239 |
| Due to other funds | - | 197,658 |
| Due to component unit | - | 1,469,893 |
| Current portion of vested compensated absences | - | 16,914 |
| Current portion of workers' compensation | - | 18,517 |
| Current portion of future lease rentals payable | - | 80,163 |
| Total current liabilities | - | 2,344,384 |
| Long-term liabilities: | | |
| Vested compensated absences | - | 243,914 |
| Other post-employment benefits | - | 1,411,640 |
| Workers' compensation | - | 63,599 |
| Future lease rentals payable | - | 1,517,004 |
| Total long-term liabilities | - | 3,236,157 |
| Total liabilities | - | 5,580,541 |
| NET POSITION | | |
| Net investment in capital assets | - | 41,699,307 |
| Unrestricted | - | 6,415,385 |
| Total net position | \$ - | \$ 48,114,692 |

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 period January 1, 2013 through termination (November 4, 2013) and the year ended December 31, 2012

| | November 4, 2013 | December 31, 2012 |
|--|---------------------|----------------------|
| Operating revenues: | | |
| Charges for services | \$ 9,136,953 | \$ 12,255,043 |
| Operating expenses: | | |
| Salaries and wages | 1,440,664 | 1,744,080 |
| Fringe benefits | 633,810 | 1,091,994 |
| Communications | 19,547 | 20,963 |
| Professional fees | 91,648 | 95,681 |
| Utilities | 1,102,297 | 1,638,237 |
| Insurance | 246,586 | 390,509 |
| Maintenance and repairs | 1,386,728 | 574,758 |
| Contracted services | 853,039 | 855,433 |
| Supplies | 520,027 | 1,162,384 |
| Depreciation | 1,605,517 | 1,902,643 |
| Total operating expenses | 7,899,863 | 9,476,682 |
| Operating income | 1,237,090 | 2,778,361 |
| Nonoperating revenue (expenses): | | |
| Grant subsidy | 313,340 | 1,033,017 |
| Investment income | 20,637 | 24,804 |
| Interest expense | (845,526) | (387,203) |
| Gain on disposal of assets | 237 | 774 |
| Total nonoperating revenue (expenses) | (511,312) | 671,392 |
| Change in net position before special item | 725,778 | 3,449,753 |
| Special item: | | |
| Termination of lease | (48,840,470) | - |
| Change in net position | (48,114,692) | 3,449,753 |
| Net position - beginning of year | 48,114,692 | 44,664,939 |
| Net position - end of year | \$ - | \$ 48,114,692 |

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 period January 1, 2013 through termination (November 4, 2013) and the year ended December 31, 2012

| | November 4, 2013 | December 31, 2012 |
|---|----------------------|----------------------|
| Cash flows from operating activities: | | |
| Received from user charges | \$ 9,426,616 | \$ 13,241,998 |
| Payments to employees for services | (1,484,085) | (1,736,428) |
| Payments for fringe benefits | (680,507) | (890,201) |
| Payments to suppliers for goods and services | (3,616,268) | (4,429,664) |
| Net cash provided by operating activities | <u>3,645,756</u> | <u>6,185,705</u> |
| Cash flows from noncapital financing activities: | | |
| Proceeds from (payment of) advances to other City of Harrisburg funds | <u>(4,403,764)</u> | <u>630,881</u> |
| Net cash provided by (used in) noncapital financing activities | <u>(4,403,764)</u> | <u>630,881</u> |
| Cash flows from capital and related financing activities: | | |
| Transfers to component unit | (1,708,333) | (2,050,000) |
| Proceeds from sale of assets | 237 | 774 |
| Acquisition and construction of capital assets | (206,194) | (92,247) |
| Lease payments | (960,466) | (452,884) |
| Net cash used in capital and related financing activities | <u>(2,874,756)</u> | <u>(2,594,357)</u> |
| Cash flows from investing activities: | | |
| Sales (purchases) of investments | 3,094,839 | (5,078,364) |
| Interest on investments | 20,637 | 24,804 |
| Net cash provided by (used in) investing activities | <u>3,115,476</u> | <u>(5,053,560)</u> |
| Net decrease in cash and cash equivalents | (517,288) | (831,331) |
| Cash and cash equivalents - beginning of year | 517,288 | 1,348,619 |
| Cash and cash equivalents - end of year | <u>\$ -</u> | <u>\$ 517,288</u> |
| Noncash items transferred to Capital Region Water | <u>\$ 43,137,647</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 period January 1, 2013 through termination (November 4, 2013) and the year ended December 31, 2012

| | November 4, 2013 | December 31, 2012 |
|--|---------------------|----------------------|
| Reconciliation of operating income to net cash provided by operating activities: | | |
| Operating income | \$ 1,237,090 | \$ 2,778,361 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation | 1,605,517 | 1,902,643 |
| Provision for uncollectible accounts | 2,289,675 | 1,638,620 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (2,000,012) | (651,665) |
| Other assets | 198,598 | 238,548 |
| Direct financing lease | 983,694 | 159,217 |
| Vested compensated absences | (43,421) | 7,652 |
| Workers' compensation | (55,359) | 46,786 |
| Other post-employment benefits | (46,697) | 201,793 |
| Accounts payable and accrued expenses | (523,329) | (136,250) |
| Net cash provided by operating activities | <u>\$ 3,645,756</u> | <u>\$ 6,185,705</u> |
| Other cash flow information: | | |
| Cash payments for interest | <u>\$ 845,526</u> | <u>\$ 387,203</u> |
| Noncash investing, capital, and financing activities: | | |
| Capital assets purchased by Capital Region Water on behalf of the Sewer Revenue Trust Fund | <u>\$ 205,766</u> | <u>\$ 2,006,745</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

November 4, 2013 and December 31, 2012

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. *Reporting Entity*

The City of Harrisburg, Pennsylvania (City) Sewer Revenue Trust Fund was 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 Capital Region Water (CRW) (formerly, The Harrisburg 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 CRW.

Effective November 4, 2013, CRW and the City terminated the lease and sublease through a transition agreement, in which the City assigned all contracts for goods and services related to the wastewater conveyance system to CRW. The City's right, title, and interest in any property comprising the wastewater conveyance system was transferred from the City to CRW. In addition, the City assigned and transferred to CRW, its right to collect and keep all conveyance and collection revenues, including all those previously collected by the City. Employees were given the option to transition to CRW and, effective November 4, 2013, CRW assumed all debts, duties, liabilities, and obligations related to the employment by the City of the employees. The City and CRW also entered into a transfer agreement, effective November 4, 2013, in which the City transferred all of the City's right, title, and interest in the property comprising the sewer collection system and causing CRW to assume the obligations and liabilities of the collection system. The transfer/conveyance of all items noted above has been presented as a special item on the statements of revenues, expenses, and changes in net position.

B. *Basis of Accounting*

The accounting records of the Sewer Revenue Trust Fund were maintained on the accrual basis and were 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 were charges to customers for sales and services. Operating expenses for the Sewer Revenue Trust Fund included the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition were reported as nonoperating revenues and expenses.

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November 4, 2013 and December 31, 2012

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

The City maintained 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 CRW. 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 were considered to be cash equivalents.

D. *Investments*

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

E. *Allowance for Uncollectible Accounts*

The allowance for uncollectible accounts was 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, but recorded a 100% allowance on such invoices. In addition, during the year ended December 31, 2012 and through November 4, 2013, the other municipalities only paid a portion of the 2012 and 2013 invoices. The City has recorded a 100% allowance on the 2012 and 2013 invoice amounts that were not collected. Management believes that they have adequately provided for future probable losses.

F. *Capital Assets*

Capital assets were carried at cost. Capital assets were 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 was computed using the straight-line method. When assets were retired or otherwise disposed of, the cost and related accumulated depreciation were removed from the accounts and any resulting gain or loss was recognized in income for the period. The cost of maintenance and repairs was charged to expense as incurred and significant renewals and betterments were capitalized.

G. *Vested Compensated Absences*

Vested compensated absences represented vested portions of accumulated unpaid vacation, sick pay, and other employee benefit amounts. It was the Sewer Revenue Trust Fund's policy to

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Notes to Financial Statements

November 4, 2013 and December 31, 2012

permit employees to accumulate a limited amount of earned but unused vacation, sick pay, and other employee benefit amounts, which was to be paid to employees upon separation from City service.

H. Net Position

Net position was 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 were attributable to the acquisition, construction, or improvement of these assets reduce this category.

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

I. Special Item

Special items are significant transactions or other events within the control of management that are either unusual in nature or infrequent in occurrence.

2. SPECIAL ITEM

During November and December 2013, the City and CRW entered into several agreements resulting in the transfer of operations of the sewer segment (wastewater collection and conveyance systems) to CRW. As such, all assets, net of liabilities, were transferred to CRW, resulting in a special item in the amount of \$48.9 million in the Sewer Revenue Trust Fund. For those assets or liabilities not transferred as of December 31, 2013, amounts have been reported as due to or due from CRW in the General Fund, as appropriate. The City is currently disputing approximately \$1.2 million of the assets reported as due to CRW in the General Fund. The matter regarding a \$500,000 item from a 2004 Sewer Revenue Trust Fund overcharge funding on administrative fees is under review and analysis in relation to the complex transfers and related transactions between the City and CRW in late 2013, as well as prior agreements between the parties. With respect to the \$700,000 worker's compensation trust fund, the City considers the matter outside the scope of the transfer.

3. DEPOSITS AND INVESTMENTS

The deposit and investment policy of the Sewer Revenue Trust Fund was 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 CRW. Allowable deposits and investments were 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

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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 was further restricted with respect to the reserve fund, which was comprised of amounts accumulated in the Sewer Revenue accounts, after withdrawals for operating expense obligations, until the balance was 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 were 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 would be required to be expended, whichever was earlier. All cash, cash equivalents, and investments were restricted pursuant to the reserve requirements.

The Sewer Revenue Trust Fund's deposit and investment policy was 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.

Investments

The City used an external investment pool to ensure safety and maximize efficiency, liquidity, and yield for City funds. These funds were 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 pooled certain investments with the City. The Sewer Revenue Trust Fund's position in the pooled funds at December 31, 2012 was \$735,036.

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

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

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As discussed in Note 2, all cash and investments attributable to the Sewer Revenue Trust Fund at December 31, 2013 were transferred to the City's General Fund and reported as due to CRW.

4. 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, 2013. Investment income of \$1,511,363 has been earned on deposits and claims of \$700,000 have been paid from the trust account from inception through December 31, 2013. 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 \$1,161,363 at December 31, 2013. The amount of the deposit relating to the Sewer Revenue Trust Fund included in investments totaled \$735,036 at December 31, 2012. The portion attributable to the Sewer Revenue Trust Fund at November 4, 2013 of \$733,615 was transferred to the City's General Fund and reported as due to CRW.

5. CAPITAL ASSETS

Capital asset activity for the period ended November 4, 2013 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 | 4,495,722 | 205,766 | (4,701,488) | - |
| Total capital assets, not being depreciated | 4,857,143 | 205,766 | (5,062,909) | - |
| Capital assets, being depreciated: | | | | |
| Buildings | 34,701,554 | - | (34,701,554) | - |
| Improvements | 2,685,962 | 217,595 | (2,903,557) | - |
| Equipment and furniture | 45,153,384 | 29,846 | (45,183,230) | - |
| Infrastructure | 13,790,448 | - | (13,790,448) | - |
| Total capital assets, being depreciated | 96,331,348 | 247,441 | (96,578,789) | - |
| Less accumulated depreciation for: | | | | |
| Buildings | (20,368,445) | (503,443) | 20,871,888 | - |
| Improvements | (863,298) | (29,803) | 893,101 | - |
| Equipment and furniture | (30,629,477) | (960,604) | 31,590,081 | - |
| Infrastructure | (6,733,552) | (111,667) | 6,845,219 | - |
| Total accumulated depreciation | (58,594,772) | (1,605,517) | 60,200,289 | - |
| Total capital assets, being depreciated, net | 37,736,576 | (1,358,076) | (36,378,500) | - |
| Capital assets, net | \$ 42,593,719 | \$ (1,152,310) | \$ (41,441,409) | \$ - |

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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 | 3,833,769 | 2,047,992 | (1,024,618) | 4,857,143 |
| 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 | 95,190,497 | 1,140,851 | - | 96,331,348 |
| 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 | (56,692,129) | (1,902,643) | - | (58,594,772) |
| Total capital assets, being depreciated, net | 38,498,368 | (761,792) | - | 37,736,576 |
| Capital assets, net | \$ 42,332,137 | \$ 1,286,200 | \$ (1,024,618) | \$ 42,593,719 |

Capital assets are depreciated over their estimated useful lives 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 \$1,605,517 and \$1,902,643 for the period ended November 4, 2013 and year ended December 31, 2012, respectively.

6. 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'

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November 4, 2013 and December 31, 2012

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 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 at December 31, 2012. The portion attributable to the Sewer Revenue Trust Fund at November 4, 2013 of \$26,757 was transferred to the City's General Fund and reported as due from CRW. 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 period ended November 4, 2013 and year ended December 31, 2012 were as follows:

| | 2013 | 2012 |
|--|-----------|-----------|
| Beginning - January 1 | \$ 82,116 | \$ 35,330 |
| Current year claims and changes in estimates | 18,002 | 74,297 |
| Claim payments | (73,361) | (27,511) |
| Transferred to General Fund and due from CRW | (26,757) | - |
| Ending - December 31 | - | 82,116 |
| Current portion | - | 18,517 |
| Long-term portion | \$ - | \$ 63,599 |

7. LONG-TERM LIABILITIES

Long-term liability activity for the period ended November 4, 2013 is as follows:

| | Beginning of Year | Additions | Retirements | Termination | End of Year |
|-----------------------------|----------------------|------------|--------------|----------------|-------------|
| Vested compensated | | | | | |
| absences | \$ 260,828 | \$ 87,263 | \$ (130,684) | \$ (217,407) | \$ - |
| Workers' compensation | 82,116 | 18,002 | (73,361) | (26,757) | - |
| Future lease rentals | | | | | |
| payable | 1,597,167 | 95,907 | (70,098) | (1,622,976) | - |
| Total long-term liabilities | \$ 1,940,111 | \$ 201,172 | \$ (274,143) | \$ (1,867,140) | \$ - |

City of Harrisburg, Pennsylvania Sewer Revenue Trust Fund

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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> |

8. OTHER POST-EMPLOYMENT BENEFITS

Plan Description

In addition to the pension benefits described in Note 9, the City provided 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 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

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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.

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.

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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 between June 1, 2007 and September 18, 2013:

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. If the retiree has attained age 60 and completed 20 years of service, the City pays 100% of medical premium for single coverage. 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 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.

Retire between September 19, 2013 and December 31, 2014:

Eligibility: Non-uniformed union employee must be eligible for the Non-Uniformed Pension Plan benefits and satisfy the Rule of 85 Window requirements as of December 31, 2013.

Benefits: The health care coverage currently includes medical, prescription drugs, dental, vision (under the same plans as active employees which may be modified to the extent that coverage is modified for active employees), 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. If the retiree has attained age 55 as of December 31, 2013, the City pays full medical premiums for single

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coverage until the retiree reaches Medicare age. If the retiree has not attained age 55 as of December 31, 2013, the City pays 60% of the medical premium for single coverage until the retiree reaches Medicare age. For any coverage other than single, the retiree must pay any difference between premiums. The retiree must pay the full premium of prescription drug, dental, and vision coverage. Upon reaching Medicare age, the City will reimburse a maximum monthly amount ranging from \$250 to \$350 for a Medicare Supplement Plan.

Retire after September 19, 2013 and hired prior to September 18, 2013 (not under the Rule of 85 Window):

Eligibility: Non-uniformed union employee must be eligible for the Non-Uniformed Pension Plan benefits.

Benefits: The health care coverage currently includes medical, prescription drugs, dental, vision (under the same plans as active employees which may be modified to the extent that coverage is modified for active employees), 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. If retiree has attained age 60 and completed 20 years of service, the retiree shall pay an amount equal to the amount which the employee would pay for individual coverage as of the date of retirement. The City pays 60% of the cost of health insurance for employees retiring on or after January 1, 2002 with 20 or more years of service or at least 15 years of service at age 65. Upon reaching Medicare eligibility, the retiree shall be eligible only for Medicare supplement reimbursement schedule. Otherwise, the retiree would pay 100% of the medical premium for single coverage. For any coverage other than single, the retiree must pay any difference between the premiums. Retirees must pay full premium for prescription drug, dental, and vision coverage. Upon reaching Medicare age, the City will reimburse a maximum monthly amount ranging from \$250 to \$350 for a Medicare Supplement Plan. Retirees and their dependents shall not be eligible for post-retirement health care if the retiree or dependent has available health care coverage elsewhere at a reasonably comparable benefit level and at the same or lower cost.

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.

Hired after September 18, 2013: Not eligible for post-retirement health benefits.

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, 2013, the City and the Sewer Revenue Trust Fund contributed \$4,783,417 and \$112,079 to the OPEB Plan, respectively. 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.

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.

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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.

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 |

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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, 2013 were as follows:

| | Governmental Activities | Business-type Activities | Total |
|--------------------------------|----------------------------|-----------------------------|---------------|
| Annual required contribution | \$ 15,718,517 | \$ 476,160 | \$ 16,194,677 |
| Interest on OPEB obligation | 2,544,063 | 117,564 | 2,661,627 |
| Adjustment to ARC | (3,470,754) | (160,386) | (3,631,140) |
| Annual OPEB cost | 14,791,826 | 433,338 | 15,225,164 |
| Transfer of sewer obligation | 1,364,943 | (1,364,943) | - |
| Contribution made | (4,601,288) | (182,129) | (4,783,417) |
| Change in Net OPEB Obligation | 11,555,481 | (1,113,734) | 10,441,747 |
| Net OPEB Obligation, beginning | 56,860,180 | 2,388,044 | 59,248,224 |
| Net OPEB Obligation, ending | \$ 68,415,661 | \$ 1,274,310 | \$ 69,689,971 |

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 | 2,091,753 | 102,807 | 2,194,560 |
| Adjustment to ARC | (2,853,687) | (140,255) | (2,993,942) |
| Annual OPEB cost | 14,356,730 | 498,636 | 14,855,366 |
| Contribution made | (4,305,408) | (170,723) | (4,476,131) |
| Change in Net OPEB Obligation | 10,051,322 | 327,913 | 10,379,235 |
| Net OPEB Obligation, beginning | 46,808,858 | 2,060,131 | 48,868,989 |
| Net OPEB Obligation, ending | \$ 56,860,180 | \$ 2,388,044 | \$ 59,248,224 |

While the City still retains the OPEB liability for sewer retirees, through the shared services agreement, CRW has agreed to reimburse the City for these costs. Therefore, the OPEB liability for sewer retirees has been transferred to the City's governmental activities with a related amount due from CRW. Additionally, January 1, 2012 actuarial valuation was revised for removal of active sewer employees from the City's employee base and revision of policies during the year ended December 31, 2013.

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Three-Year Trend Information

| <u>Year</u> | <u>Annual OPEB Cost (AOC)</u> | <u>Percentage of AOC Contributed</u> | <u>Net OPEB Obligation</u> |
|-------------|-----------------------------------|--|--------------------------------|
| 2013 | \$ 15,255,164 | 31.42% | \$ 69,689,971 |
| 2012 | 14,855,366 | 30.13% | 59,248,224 |
| 2011 | 15,829,014 | 29.68% | 48,868,989 |

Funded Status and Schedule of Funding Progress

| <u>Actuarial Valuation Date</u> | <u>Actuarial Value of Assets (a)</u> | <u>Actuarial Accrued Liability (AAL) - Entry Age (b)</u> | <u>Unfunded AAL (UAAL) (b-a)</u> | <u>Funded Ratio (a/b)</u> | <u>Covered Payroll (c)</u> | <u>UAAL as a Percentage of Covered Payroll (b-a/c)</u> |
|---|--|--|--|-----------------------------------|------------------------------------|--|
| 1/1/2012 | * \$ - | \$ 148,055,171 | \$ 148,055,171 | 0.00% | \$ 23,361,420 | 633.76% |
| 1/1/2010 | \$ - | \$ 177,796,013 | \$ 177,796,013 | 0.00% | \$ 28,435,550 | 625.26% |

* - Revised for removal of active sewer employees from the City's employee base and revision of policies during the year ended December 31, 2013.

The above information is for the City as a whole. The Sewer Revenue Trust Fund's participation in the City's net OPEB obligation was \$1,364,943 and \$1,411,640 at November 4, 2013 and December 31, 2012, respectively. The portion attributable to the Sewer Revenue Trust Fund at November 4, 2013 of \$1,364,943 related to sewer retirees was transferred to the City's General Fund and reported as due from CRW.

9. PENSION PLANS

Plan Description

Prior to November 4, 2013, the Sewer Revenue Trust Fund contributed 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 remained separate. Employees became 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 were 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 required 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

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Municipal Retirement System, P.O. Box 1165, Harrisburg, PA 17108-1165 or by calling 1-800-622-7968.

On October 30, 2013, CRW established a separate PMRS pension plan for those employees transitioning from the City to CRW.

10. RELATED PARTY TRANSACTION

The City General Fund provided 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 \$846,131 for the period ended November 4, 2013, and the year ended December 31, 2012, respectively.

11. LITIGATION

The United States Environmental Protection Agency (EPA) has issued an order against the City under the Clean Water Act requiring the City to provide certain information in response to EPA inquiries into the issues involving what were the City's combined sewer overflows and its municipal separate storm water system program. The EPA has issued a letter stating that they believe the City is in violation of the Clean Water Act and other regulatory mandates. The City, CRW, and the EPA are parties to a tolling agreement that allowed for the City and CRW to negotiate a resolution of the violations to avoid monetary penalties. The Pennsylvania Department of Environmental Protection participated in the negotiations on the related claims for violations of state environmental statutory and regulatory obligations by the same alleged conduct and omissions.

In November 2013, a transfer of the City's control and interest in the water and sewer systems was consummated, under the framework of the Harrisburg Strong Plan. CRW and the City are parties to a Transfer Agreement, Transition Agreement, Shared Services Agreement, and Intergovernmental Cooperation Agreement, all to facilitate the transfer and ongoing provision of service to the rate base. These agreements have assisted the City in securing a recommendation from the U.S. Department of Justice, the EPA, and DEP for the approval of a proposed Partial Consent Decree that allows the system to be brought into regulatory compliance without the imposition of fines or penalties on the City. The City's Law Bureau anticipates these recommendations to ultimately receive the requisite judicial approval and, thereby, no longer present a material risk to the City.

The City had an agreement to transport and treat sewage for several suburban municipalities, from whom the City collected fees for such transportation and treatment. The suburban municipalities alleged that the City had 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 were 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

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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, the City is making payments to the suburban municipalities pursuant to the following payment schedule.

| <u>Year Ending December 31,</u> | |
|---------------------------------|---------------------|
| 2014 | \$ 1,500,000 |
| 2015 | 1,500,000 |
| 2016 | 1,500,000 |
| 2017 | 1,000,000 |
| 2018 | 1,000,000 |
| 2019 | 225,000 |
| | <u>\$ 6,725,000</u> |