
Lancaster Port Authority
Fairfield County, Ohio

Basic Financial Statements

December 31, 2010

(with Independent Auditors' Report)



Dave Yost • Auditor of State

Board of Directors
Lancaster Port Authority
104 East Main Street
Lancaster, Ohio 43130-3726

We have reviewed the *Independent Auditors'* Report of the Lancaster Port Authority, Fairfield County, prepared by Clark, Schaefer, Hackett & Co., for the audit period January 1, 2010 through December 31, 2010. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

Our review was made in reference to the applicable sections of legislative criteria, as reflected by the Ohio Constitution, and the Revised Code, policies, procedures and guidelines of the Auditor of State, regulations and grant requirements. The Lancaster Port Authority is responsible for compliance with these laws and regulations.

A handwritten signature in black ink that reads "Dave Yost".

Dave Yost
Auditor of State

April 6, 2012

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Lancaster Port Authority
104 East Main Street
Lancaster, Ohio 43130-3726

We have audited the statement of net assets of the Lancaster Port Authority (the Authority), a component unit of the City of Lancaster, Ohio, as of December 31, 2010 and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated January 27, 2012, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 2 - 5 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Springfield, Ohio
January 27, 2012

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**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Management's Discussion and Analysis
For the Year Ended December 31, 2010***

Unaudited

The discussion and analysis of the Lancaster Port Authority's (the "Port Authority") financial performance provides an overall review of the Port Authority's financial activities for the year ended December 31, 2010. The intent of this discussion and analysis is to look at the Port Authority's financial performance as a whole; readers should also review the financial statements and notes to the basic financial statements to enhance their understanding of the Port Authority's financial performance.

FINANCIAL HIGHLIGHTS

Key financial highlights for 2010 are as follows:

- Assets decreased from \$648,036,931 to \$631,511,197 due to prepaid gas deliveries received from Royal Canadian Bank.
- Long-term debt decreased due to scheduled debt service payments made on the Series 2008 Revenue Bonds.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of two parts – management's discussion and analysis and the basic financial statements. These statements are organized so the reader can understand the financial position of the Port Authority. Enterprise accounting uses a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included on the statement of net assets. The statement of net assets represents the basic statement of position for the Port Authority. The statement of revenues, expenses, and changes in net assets presents increases (e.g., revenues) and decreases (e.g., expenses) in net total assets. The statement of cash flows reflects how the Port Authority finances and meets its cash flow needs. Finally, the notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided on the basic financial statements.

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**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Management's Discussion and Analysis
For the Year Ended December 31, 2010***

Unaudited

FINANCIAL ANALYSIS OF THE PORT AUTHORITY

The following tables represent the Port Authority's condensed financial information for 2010 and 2009 derived from the statement of net assets and the statement of revenues, expenses, and changes in net assets.

| | <u>2010</u> | <u>2009</u> |
|--|------------------------------|------------------------------|
| Current assets | \$16,901,796 | \$17,973,793 |
| Other Assets | 613,878,200 | 629,321,813 |
| Capital assets, Net | <u>731,201</u> | <u>741,325</u> |
| Total assets | <u>631,511,197</u> | <u>648,036,931</u> |
| | | |
| Current liabilities | 95,808 | 77,401 |
| Other Liabilities | 332,766,486 | 331,958,334 |
| Long-term debt outstanding | <u>337,783,060</u> | <u>341,300,808</u> |
| Total liabilities | <u>670,645,354</u> | <u>673,336,543</u> |
| | | |
| Equity: | | |
| Invested in capital assets, net of related debt | 678,141 | 640,517 |
| Unrestricted | <u>(39,812,298)</u> | <u>(25,940,129)</u> |
| Total net assets | <u><u>(\$39,134,157)</u></u> | <u><u>(\$25,299,612)</u></u> |

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**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Management's Discussion and Analysis
For the Year Ended December 31, 2010***

Unaudited

This is the first year the Port Authority prepared financial statements in accordance with accounting principles generally accepted in the United States of America; therefore a comparison with prior year's information is not available. A comparative analysis will be provided in future years when prior year's information is available.

Changes in Net Assets – The following table shows the changes in net assets for 2010:

| | 2010 |
|---|----------------|
| Revenues | |
| Gas Supply | \$9,334,154 |
| Administrative Service Fee | 9,706 |
| Total revenues | 9,343,860 |
| Expenses | |
| Supplies and Materials - Cost of Gas Sold | 7,570,044 |
| Contractual Services | 2,260,364 |
| Depreciation | 10,124 |
| Total expenses | 9,840,532 |
| Operating Loss | (496,672) |
| Nonoperating Revenues/(Expenses) | |
| Investment Earnings | 3,421 |
| Interest and Fiscal Charges | (13,348,357) |
| Other Nonoperating Revenue | 7,063 |
| Total Change in Net Assets | (13,834,545) |
| Beginning Net Assets | (25,299,612) |
| Ending Net Assets | (\$39,134,157) |

Net assets decreased by \$13,834,545. This decrease was primarily the result of recognizing the consumption of the current year portion of the prepaid gas contract.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of 2010 the Port Authority had \$731,201 net of accumulated depreciation invested in capital assets. The following table shows 2010 and 2009 balances:

| | 2010 | 2009 | Increase (Decrease) |
|--------------------------------|-----------|-----------|------------------------|
| Land | \$106,200 | \$106,200 | \$0 |
| Buildings and Improvements | 95,745 | 95,745 | 0 |
| Infrastructure | 555,000 | 555,000 | 0 |
| Less: Accumulated Depreciation | (25,744) | (15,620) | (10,124) |
| Totals | \$731,201 | \$741,325 | (\$10,124) |

Additional information on the Port Authority's capital assets can be found in Note 3.

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Management's Discussion and Analysis
For the Year Ended December 31, 2010***

Unaudited

Debt

The following table summarizes the Port Authority's debt outstanding as of December 31, 2010 and 2009:

| | <u>2010</u> | <u>2009</u> |
|-----------------------|----------------------|----------------------|
| Revenue Bonds Payable | \$337,730,000 | \$341,200,000 |
| ORDC Loan | 53,060 | 100,808 |
| Totals | <u>\$337,783,060</u> | <u>\$341,300,808</u> |

Additional information on the Port Authority's long-term debt can be found in Note 4.

ECONOMIC FACTORS

- The Baldwin Run Trans-load Facility was operational in 2011 and will be completed in 2012.
- In partnering with the City of Lancaster, a \$1.5 million Clean Ohio Revitalization Fund Grant and a \$200,000 Federal EPA Fund Grant is being used to environmentally remediate a five (5) acre industrially zoned parcel formerly known as the Ray-O-Vac factory. The Port Authority is creating a small Industrial Park and will sell lots when the area is environmentally sound.

REQUESTS FOR INFORMATION

This financial report is designed to provide our citizens, investors and creditors with a general overview of the Port Authority's finances and to show the Port Authority's accountability for the money it receives. If you have questions about this report or need additional financial information contact R. Michael Pettit, Director of the Lancaster Port Authority.

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Statement of Net Assets
December 31, 2010***

ASSETS

Current assets:

| | |
|------------------------------|-------------------|
| Cash and Cash Equivalents | \$345,838 |
| Accounts Receivable | 709,037 |
| Prepaid Gas Supply - Current | <u>15,846,921</u> |
| Total Current Assets | <u>16,901,796</u> |

Noncurrent Assets:

| | |
|--|-------------|
| Prepaid Gas Supply - Long Term | 270,994,848 |
| Deferred Bond Issuance costs | 2,873,031 |
| Fair Value of Derivative Instruments | 191,741,248 |
| Deferred Outflow from Derivative Instruments | 141,025,238 |

Restricted Assets:

| | |
|---------------------------|-----------|
| Cash and cash equivalents | 7,243,835 |
|---------------------------|-----------|

Capital Assets

| | |
|---------------------------------------|----------------|
| Capital Assets Not Being Depreciated | 106,200 |
| Capital Assets Being Depreciated, net | <u>625,001</u> |
| Total Capital Assets | <u>731,201</u> |

| | |
|-------------------------|--------------------|
| Total Noncurrent Assets | <u>614,609,401</u> |
|-------------------------|--------------------|

| | |
|--------------|--------------------|
| Total Assets | <u>631,511,197</u> |
|--------------|--------------------|

LIABILITIES

Current Liabilities:

| | |
|---------------------------|------------------|
| Accrued Interest | 95,808 |
| ORDC Loan Payable-current | 48,924 |
| Bond Payable-current | <u>3,070,000</u> |
| Total Current Liabilities | <u>3,214,732</u> |

Noncurrent Liabilities:

| | |
|---|--------------------|
| ORDC Loan Payable-long term | 4,136 |
| Bond Payable-long term | 334,660,000 |
| Fair Value of Derivative Instruments | 141,025,238 |
| Deferred Inflow from Derivative Instruments | <u>191,741,248</u> |
| Total Noncurrent Liabilities | <u>667,430,622</u> |
| Total Liabilities | <u>670,645,354</u> |

Net Assets:

| | |
|---|------------------------------|
| Invested in Capital Assets, net of related debt | 678,141 |
| Unrestricted | <u>(39,812,298)</u> |
| Total Net Assets | <u><u>(\$39,134,157)</u></u> |

See accompanying notes to the basic financial statements

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Statement of Revenues, Expenses and Changes in Net Assets
For the Year Ended December 31, 2010***

| | |
|---|------------------------------|
| <u>Operating Revenues:</u> | |
| Gas Supply | \$9,334,154 |
| Administrative Service fee | 9,706 |
| Total Operating Revenues | <u>9,343,860</u> |
| <u>Operating Expenses:</u> | |
| Materials and supplies - cost of gas sold | 7,570,044 |
| Contractual services | 2,260,364 |
| Depreciation | 10,124 |
| Total Operating Expenses | <u>9,840,532</u> |
| Operating Loss | (496,672) |
| <u>Nonoperating Revenues (Expenses):</u> | |
| Investment Earnings | 3,421 |
| Interest and Fiscal Charges | (13,348,357) |
| Other Nonoperating Revenue | 7,063 |
| Total Nonoperating Revenues (Expenses) | <u>(13,337,873)</u> |
| Change in Net Assets | (13,834,545) |
| Net Assets at Beginning of Year | <u>(25,299,612)</u> |
| Net Assets at End of Year | <u><u>(\$39,134,157)</u></u> |

See accompanying notes to the basic financial statements

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Statement of Cash Flows
For the Year Ended December 31, 2010***

| | |
|---|----------------------------|
| <u>Cash Flows from Operating Activities:</u> | |
| Cash Received from Customers | \$9,385,616 |
| Cash Received from Swap Providers | 9,365,738 |
| Cash Payments for Goods and Services | (2,260,364) |
| Other Miscellaneous Cash Receipts | <u>7,063</u> |
| Net Cash Provided by Operating Activities | <u>16,498,053</u> |
| <u>Cash Flows from Noncapital Financing Activities:</u> | |
| Principal Payment on Revenue Bond Payable | (3,470,000) |
| Interest Paid on Debt | <u>(13,223,594)</u> |
| Net Cash Used by Noncapital Financing Activities | <u>(16,693,594)</u> |
| <u>Cash Flows from Capital and Related Financing Activities:</u> | |
| Principal Payment on ORDC Loan | (47,748) |
| Interest Paid on Debt | <u>(1,882)</u> |
| Net Cash Used by Capital and Related Financing Activities | <u>(49,630)</u> |
| <u>Cash Flows from Investing Activities:</u> | |
| Receipts of Interest Earnings | <u>3,421</u> |
| Net Cash Provided by Investing Activities | <u>3,421</u> |
| Net Decrease in Cash and Cash Equivalents | (241,750) |
| Cash and Cash Equivalents at Beginning of Year | <u>7,831,423</u> |
| Cash and Cash Equivalents at End of Year | <u><u>\$7,589,673</u></u> |
| <u>Reconciliation of Operating Loss to Net Cash Provided by Operating Activities:</u> | |
| Operating Loss | (\$496,672) |
| Adjustments to Reconcile Operating Loss to Net Cash Provided by Operating Activities: | |
| Miscellaneous Nonoperating Revenue | 7,063 |
| Depreciation Expense | 10,124 |
| Changes in Assets and Liabilities: | |
| Decrease in Accounts Receivable | 41,756 |
| Decrease in Prepaid Items | <u>16,935,782</u> |
| Total Adjustments | <u>16,994,725</u> |
| Net Cash Provided by Operating Activities | <u><u>\$16,498,053</u></u> |

See accompanying notes to the basic financial statements

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Notes to the Basic Financial Statements
For the Year Ended December 31, 2010***

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Lancaster Port Authority (the "Port Authority") was created on December 12, 2005 under the authority of Section 4582.21 et seq. of the Ohio Revised Code which provides that "a municipal corporation, a county or any combination thereof acting jointly, may create a port authority which shall be a body corporate and politic and have territorial limits coterminous with the territorial limits of the political subdivision(s) creating such port authority."

The Port Authority operates under the direction of a five-member Board of Directors appointed by the Mayor of the City of Lancaster (the "City"). The Directors must be qualified electors of, or have their businesses or places of employment in the City. The Port Authority is considered a blended component unit of the City for reporting purposes, in accordance with Governmental Accounting Standards Board (GASB) Statement No. 14 as amended by GASB Statement No. 39. The Port Authority was created for the purpose of enhancing, fostering, providing or promoting transportation, economic development, housing, recreation, education, government operations, and culture and research in the City.

The financial statements are presented as of December 31, 2010 and for the year then ended and have been prepared in conformity with generally accepted accounting principles (GAAP) applicable to local governments. The Governmental Accounting Standards Board (the "GASB") is the standard-setting body for establishing governmental accounting and financial reporting principles, which are primarily set forth in the GASB's Codification of Governmental Accounting and Financial Reporting Standards (GASB Codification).

A. Reporting Entity

The accompanying basic financial statements comply with the provisions of the GASB Statement No. 14, *"The Financial Reporting Entity,"* and GASB Statement No. 39, *"Determining Whether Certain Organizations are Component Units"* in that the financial statements include all organizations, activities, functions and component units for which the Port Authority (the primary government) is financially accountable. The Port Authority is financially accountable for an organization if it has (1) the ability to appoint a voting majority of another entity's governing body and to impose its will on that entity, (2) the potential for that entity to provide specific financial benefits to or impose specific financial burdens on others, and (3) the entity's fiscal dependency on others.

Based on the foregoing, the Port Authority's financial reporting entity has no component units.

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Notes to the Basic Financial Statements
For the Year Ended December 31, 2010***

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

B. Basis of Presentation

The Port Authority operates as a self-supporting governmental enterprise and uses accounting policies applicable to governmental enterprise funds. All transactions are accounted for in a single enterprise fund.

Pursuant to GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting," the Port Authority follows GASB guidance as applicable to proprietary funds and FASB Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989 that do not conflict with or contradict GASB pronouncements. The Port Authority has elected not to apply FASB statements and interpretations issued after November 30, 1989 to its business-type activities.

C. Measurement Focus

The enterprise fund is accounted for on a flow of economic resources measurement focus. All assets and all liabilities associated with the operation of the Port Authority are included on the statement of net assets. The statement of changes in net assets presents increases (i.e., revenues) and decreases (i.e., expenses) in net total assets. The statement of cash flows provides information about how the Port Authority finances and meets the cash flow needs of its enterprise activity.

D. Basis of Accounting

The Port Authority uses the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred.

E. Cash and Cash Equivalents

Cash and cash equivalents include amounts in demand deposits and money market funds. The Port Authority considers all highly liquid investments with original maturities of three months or less at the time of purchase to be cash equivalents.

F. Prepaid Gas Supply

The Port Authority prepaid for deliveries of natural gas supplies with the proceeds from revenue bonds. Prepaid gas supplies are stated at the present value of the remaining fixed delivery amounts, as determined by the prepay contract.

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Notes to the Basic Financial Statements
For the Year Ended December 31, 2010***

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

G. Derivative Instruments

The Port Authority's derivative financial instruments are accounted for in accordance with GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. In connection with this Statement, the fair value of the Port Authority's derivative financial instruments is recorded on the Statement of Net Assets, with an offsetting deferred outflow or inflow.

Derivative instruments are utilized by the Port Authority to manage market risk and reduce its exposure resulting from fluctuations in prices of natural gas in order to meet debt service requirements. These instruments include commodity swap agreements which convert index-priced natural gas revenues to fixed prices for servicing outstanding debt obligations and interest rate swap agreements which effectively convert the Port Authority's variable interest rate to a fixed rate. Interest expense in each operating period includes the netting adjustments of the interest rate swap agreements.

H. Capital Assets and Depreciation

Capital Assets are defined by the Port Authority as assets with an initial, individual cost of more than \$1,000.

Property, plant and equipment acquired is stated at cost (or estimated historical cost), including architectural and engineering fees where applicable. Donated capital assets are recorded at fair market value at the date received.

Depreciation has been provided using the straight-line method over the following estimated useful lives:

| <u>Description</u> | <u>Estimated Lives (in years)</u> |
|----------------------------|-----------------------------------|
| Buildings and Improvements | 40 |
| Infrastructure | 75 |

I. Bond Issuance Costs

Bond issuance costs are deferred and amortized over the term of the bonds on a straight line basis. Issuance costs are recorded as deferred charges.

J. Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Notes to the Basic Financial Statements
For the Year Ended December 31, 2010***

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

K. Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets.

L. Operating Revenues and Expenses

Enterprise funds distinguish operating revenues and expenses from nonoperating items. Operating revenues are those revenues that are generated directly from the primary activity of the proprietary funds. For the Port Authority, these revenues are charges for services for sale of natural gas. Operating expenses are necessary costs incurred to provide the good or service that is the primary activity of the fund. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

NOTE 2 - CASH, CASH EQUIVALENTS AND INVESTMENTS

Cash resources of the Port Authority are combined to form a pool of cash and investments. The Port Authority has adopted an Investment Policy that follows Ohio Revised Code Chapter 135 and applies the prudent person standard. The prudent person standard requires the Auditor and Treasurer to exercise the care, skill and experience that a prudent person would use to manage his/her personal financial affairs and to seek investments that will preserve principal while maximizing income. Statutes require the classification of funds held by the Port Authority into three categories.

Category 1 consists of "active" funds - those funds required to be kept in "cash" or "near cash" status for immediate use by the Port Authority. Such funds must be maintained either as cash in the Treasury or in depository accounts payable or withdrawable on demand, including negotiable order of withdrawal (NOW) accounts.

Category 2 consists of "inactive" funds - those funds not required for use within the current five year period of designation of depositories. Inactive funds may be deposited or invested only as certificates of deposit maturing no later than the end of the current period of designation of depositories.

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Notes to the Basic Financial Statements
For the Year Ended December 31, 2010***

NOTE 2 - POOLED CASH, CASH EQUIVALENTS AND INVESTMENTS (Continued)

Category 3 consists of "interim" funds - those funds which are not needed for immediate use, but which will be needed before the end of the current period of designation of depositories. Interim funds may be invested or deposited in the following securities:

- United States treasury notes, bills, bonds, or any other obligation or security issued by the United States treasury or any other obligation guaranteed as to principal or interest by the United States;
- Bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality, including but not limited to, the federal national mortgage association, federal home loan bank, federal farm credit bank, federal home loan mortgage corporation, government national mortgage association, and student loan marketing association. All federal agency securities shall be direct issuances of federal government agencies or instrumentalities;
- Written repurchase agreements in the securities listed above provided that the market value of the securities subject to the repurchase agreement must exceed the principal value of the agreement by at least two percent and be marked to market daily, and that the term of the agreement must not exceed thirty days;
- Interim deposits in eligible institutions applying for interim funds;
- Bonds and other obligations of the State of Ohio;
- No-load money market mutual funds consisting exclusively of obligations described in the first two bullets of this section and repurchase agreements secured by such obligations, provided that investments in securities described in this division are made only through eligible institutions, and
- The State Treasury Asset Reserve of Ohio (STAR Ohio).

Deposits

Custodial credit risk is the risk that in the event of bank failure, the government's deposits may not be returned. Protection of Port Authority cash and deposits is provided by the federal deposit insurance corporation as well as qualified securities pledged by the institution holding the assets. Ohio Law requires that deposits be placed in eligible banks or savings and loan associations located in Ohio. Any public depository in which the Port Authority places deposits must pledge as collateral eligible securities of aggregate market value equal to the excess of deposits not insured by the Federal Deposit Insurance Corporation (FDIC). The securities pledged as collateral are pledged to a pool for each individual financial institution in amounts equal to at least 105% of the carrying value of all public deposits held by each institution. Obligations that may be pledged as collateral are limited to obligations of the United States and its agencies and obligations of any state, county, municipal corporation or other legally constituted authority of any other state, or any instrumentality of such county, municipal corporation or other authority. Collateral is held by trustees including the Federal Reserve Bank and designated third party trustees of the financial institutions.

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

**Notes to the Basic Financial Statements
For the Year Ended December 31, 2010**

NOTE 2 - POOLED CASH, CASH EQUIVALENTS AND INVESTMENTS (Continued)

At year end the carrying amount of the Port Authority's deposits was \$7,589,673 and the bank balance was \$7,589,673. Federal depository insurance covered \$250,000 of the bank balance, and \$7,339,673 was uninsured. Of the remaining uninsured bank balance, the Port Authority was exposed to custodial risk as follows:

| | |
|--|-------------|
| | Balance |
| Uninsured and collateralized with securities held by the pledging institution's trust department not in the Port Authority's name | \$7,339,673 |

NOTE 3 - CAPITAL ASSETS

Summary by Category at December 31, 2010:

Historical Cost:

| Class | December 31, 2009 | Additions | Deletions | December 31, 2010 |
|---|----------------------|-----------|-----------|----------------------|
| <i>Capital assets not being depreciated:</i> | | | | |
| Land | \$106,200 | \$0 | \$0 | \$106,200 |
| Subtotal | 106,200 | 0 | 0 | 106,200 |
| <i>Capital assets being depreciated:</i> | | | | |
| Buildings and Improvements | 95,745 | 0 | 0 | 95,745 |
| Infrastructure | 555,000 | 0 | 0 | 555,000 |
| Subtotal | 650,745 | 0 | 0 | 650,745 |
| Total Cost | \$756,945 | \$0 | \$0 | \$756,945 |

Accumulated Depreciation:

| Class | December 31, 2009 | Additions | Deletions | December 31, 2010 |
|--------------------------|----------------------|------------|-----------|----------------------|
| Buildings | (\$4,520) | (\$2,724) | \$0 | (\$7,244) |
| Infrastructure | (11,100) | (7,400) | 0 | (18,500) |
| Total Depreciation | (\$15,620) | (\$10,124) | \$0 | (\$25,744) |
| <i>Net Value:</i> | \$741,325 | | | \$731,201 |

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

**Notes to the Basic Financial Statements
For the Year Ended December 31, 2010**

NOTE 4 - LONG-TERM DEBT

Long-term debt obligations of the Port Authority at December 31, 2010 were as follows:

| | | Balance December 31, 2009 | Deletions | Balance December 31, 2010 | Amount Due Within One Year |
|--|------|---------------------------------|----------------------|---------------------------------|----------------------------------|
| Long-Term Debt | | | | | |
| Variable Rate Revenue Bonds | 2008 | \$341,200,000 | (\$3,470,000) | \$337,730,000 | \$3,070,000 |
| Variable Rate Ohio Rail Development Loan | 2008 | 100,808 | (47,748) | 53,060 | 48,924 |
| Total Long-Term Debt | | <u>\$341,300,808</u> | <u>(\$3,517,748)</u> | <u>\$337,783,060</u> | <u>\$3,118,924</u> |

| Years | Revenue Bonds Payable | | ORDC Loan Payable | |
|-----------|--------------------------|----------------------|----------------------|--------------|
| | Principal | Interest | Principal | Interest |
| 2011 | \$3,070,000 | \$12,448,588 | \$48,924 | \$819 |
| 2012 | 3,200,000 | 12,334,012 | 4,136 | 9 |
| 2013 | 3,560,000 | 12,210,987 | 0 | 0 |
| 2014 | 4,045,000 | 12,071,928 | 0 | 0 |
| 2015 | 4,590,000 | 11,914,185 | 0 | 0 |
| 2016-2020 | 31,060,000 | 56,488,393 | 0 | 0 |
| 2021-2025 | 48,240,000 | 49,322,018 | 0 | 0 |
| 2026-2030 | 71,275,000 | 38,419,721 | 0 | 0 |
| 2031-2035 | 100,305,000 | 22,735,852 | 0 | 0 |
| 2036-2038 | 68,385,000 | 3,635,898 | 0 | 0 |
| Totals | <u>\$337,730,000</u> | <u>\$231,581,582</u> | <u>\$53,060</u> | <u>\$828</u> |

In 2008 the Port Authority received an Ohio Rail Development Commission Loan in the amount of \$145,163 to finance the construction of a railroad spur.

In March, 2008, the Port Authority issued \$348,750,000 of gas supply revenue bonds to fund the prepayment of 64,655,785 Mmbtus of gas from Royal Bank of Canada with deliveries beginning April 2008 and ending March 2038. The City of Lancaster will purchase the scheduled monthly gas at a specified index less a discount from such index price for the entire term of April 2008 through March 2038. The revenue bonds are secured by a pledge of the gas supply revenues derived from the related prepay transaction.

The Port Authority entered into an interest rate swap with Royal Bank of Canada in connection with the Series 2008, Gas Supply Revenue Bonds. Under the swap agreement, the Port Authority pays a fixed amount and receives a variable payment computed at a rate equal to that of the bonds. The interest payments reflected in the table above, were calculated based on the interest rate swap agreement which converts this issue to an effective fixed rate of approximately 3.7%.

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Notes to the Basic Financial Statements
For the Year Ended December 31, 2010***

NOTE 5 - GAS PURCHASE AND SALES AGREEMENTS

The Port Authority has entered into long-term gas purchase and supply contracts for which prepayments have been made and an amount remaining of \$286,841,769 is reflected in both current and noncurrent asset categories at December 31, 2010. Long-term sales agreements also exist with the City to take delivery of the natural gas over a period continuing through 2038. The sales price to the City for these contracts is at specified index prices less a discount. Swap agreements are used to convert these variable index prices to fixed prices sufficient to meet debt service requirements.

NOTE 6 - DERIVATIVE INSTRUMENTS

Composition of Derivative Instruments

The fair value balances and notional amounts of derivative instruments outstanding as of December 31, 2010, classified by type, are as follows:

| | <u>Notional Amount</u> | | <u>Fair Value</u> | <u>Counterparty Credit Rating</u> |
|--|----------------------------|----|-----------------------|---------------------------------------|
| Positive Cash Flow Hedge: | | | | |
| Pay-variable, receive fixed commodity swap | 58,754,531 mmbtu | \$ | 191,741,248 | AA-/A-1+ |
| Negative Cash Flow Hedge: | | | | |
| Pay-fixed, receive variable interest rate swap | \$ 337,730,000 | \$ | (141,025,238) | AA-/Aa1 |

All fair values are classified as derivative instruments on the Statement of Net Assets. The increase in fair values of these derivatives instruments were \$15,676,684 for 2010. As these commodity and interest rate swaps are considered hedging derivatives instruments, the increase in fair value is reflected within deferred outflows and inflows on the Statement of Net Assets. The positive and negative fair values of the commodity and interest rate swaps were not netted. The fair values of the commodity swaps are based on forward prices from established indexes for the applicable region and discounted using established interest rate indexes. The fair values of the interest rate swaps are based on the SIFMA index at year end and discounted using established interest rate indexes.

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Notes to the Basic Financial Statements
For the Year Ended December 31, 2010***

NOTE 6 - DERIVATIVE INSTRUMENTS (Continued)

Objective and Terms of Hedging Derivative Instruments

The following table displays the objective and terms of the Port Authority hedging derivative instruments outstanding at December 31, 2010:

| <u>Type</u> | <u>Objective</u> | <u>Maturity Date</u> | <u>Terms</u> |
|---|--|----------------------|---|
| Pay-fixed receive variable interest rate swap | The Port Authority entered into an interest rate swap in connection with its Series 2008 Bonds, effective on or before the date of the initial issuance of such bonds, to correlate the fixed payments it receives under the related Commodity Swap with its variable rate debt service payment on these bonds. | 2038 | The interest rate swap extends to the date of the final maturity of these bonds and requires payments based on a notional amount equal to the scheduled outstanding principal amount of these bonds. Under the interest rate swap, the Port Authority pays the counterparty a fixed payment of 3.7%, on the notional amount and receives a variable payment equal to the rate actually borne by the Series 2008 Bonds, which is based upon the SIFMA index. |
| Pay-variable, receive fixed commodity swap | The Port Authority has entered into a fixed to floating commodity swap in connection with the natural gas prepay transaction. The purpose of the Commodity Swap is to correlate gas sales revenues the Port Authority receives based on floating natural gas indices to a fixed stream of payments necessary to make debt service payments on its Bonds. | 2038 | The commodity swap extends to the date of the final maturity of the related Natural Gas Supply Agreements. The commodity swap requires monthly payments based on a notional quantity of natural gas that corresponds to the volume of natural gas sold pursuant to the related Natural Gas Supply Agreements. Payments under the commodity swap are based on nationally published gas indices at the gas delivery points. |

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Notes to the Basic Financial Statements
For the Year Ended December 31, 2010***

NOTE 6 - DERIVATIVE INSTRUMENTS (Continued)

Commodity Swap Risks

Termination Risk: The Commodity Swaps terminate in the event of a “triggering event” under the related Prepaid Natural Gas Sales Agreements, in the event of the Port Authority or counterparty nonperformance, and in connection with other specified events. Under the Commodity Swaps no payment, in the amount of the fair value or otherwise, is to be made by the Swap Counterparty in connection with an early termination of such swap. However, if the Commodity Swaps are terminated as a result of the Port Authority’s default or as a result of the termination of the Prepaid Natural Gas Sales Agreements, the Port Authority would be obligated to pay a termination payment to the Swap Counterparty based on the net present value of the remaining notional quantities of gas during the remaining term multiplied by a fixed amount.

Credit Risk: The Commodity Swaps are tied to related gas prepay transactions and terminate in the event such transactions terminate. Therefore, the only credit risk associated with the Commodity Swaps is for margins lost on future commodity deliveries associated with a termination of the related gas prepay transactions in the event of a counterparty’s inability to perform in accordance with the terms of the related Commodity Swaps. Generally, the only amounts due upon termination of the Commodity Swap would be previously accrued but unpaid amounts. If the Swap Counterparty is rated below "A1" by Moody’s Investors Service, Inc., the Swap Counterparty, is permitted to post collateral or post an alternative security arrangement within twenty-five Local Business Days of such downgrade. The Swap Counterparty must provide the Port Authority adequate assurances of Swap Counterparty’s ability to continue performing under all Transactions, which adequate assurances must be satisfactory to the Port Authority.

Interest Rate Swap Risks

Termination Risk: The Interest Rate Swaps terminate in the event of a “triggering event” under the related Prepaid Natural Gas Sales Agreements, in the event of the Port Authority or counterparty nonperformance, and in connection with other specified events. Under the Interest Rate Swaps, no termination payment, in the amount of the fair value or otherwise, is to be made by either party in connection with an early termination of such swap.

Credit risk: The Interest Rate Swaps terminate in the event of a "triggering event" under the related Prepaid Natural Gas Sales Agreements, in the event of the Port Authority or Swap Counterparty nonperformance, and in connection with other specified events. The only amounts due upon termination of the Interest Rate Swaps would be previously accrued but unpaid amounts. If the Swap Counterparty is rated below "A1" by Moody’s Investors Service, Inc., the Swap Counterparty, is permitted to post collateral or post an alternative security arrangement within twenty-five Local Business Days of such downgrade. The Swap Counterparty must provide the Port Authority adequate assurances of Swap Counterparty’s ability to continue performing under all Transactions, which adequate assurances must be satisfactory to the Port Authority.

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Notes to the Basic Financial Statements
For the Year Ended December 31, 2010***

NOTE 6 - DERIVATIVE INSTRUMENTS (Continued)

Interest Rate Risk: Under the pay-variable interest rate swap agreement entered into in connection with the Port Authority is required to pay an amount equal to the notional amount times the rate actually borne by the Series 2008 Bonds, and is to receive an amount equal to the SIFMA index. In the event the rate actually borne by the Series 2008 Bonds exceeds the rate paid by the Swap Counterparty, the Port Authority would be required to pay the Swap Counterparty an amount equal to the notational amount times the difference.

NOTE 7 - RISK MANAGEMENT

The Port Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to agents and others; and natural disasters. The Port Authority carries commercial insurance, subject to certain limits and deductibles, to reduce the financial impact for claims arising from such matters. Claims have not exceeded this commercial coverage in any of the three preceding years.

NOTE 8 - RELATED PARTY TRANSACTIONS

All of the Port Authority's natural gas sales have been to the City of Lancaster (the "City"). At December 31, 2010, accounts receivable due from the City was \$709,037. For 2010, the Port Authority reported gas sales to the City in the amount of \$9,334,154.

The Port Authority charges the City an additional fee above the prepaid gas supply purchase price. Seventy-five percent of this fee is set aside for use by the City. These funds are remitted to the City upon City Council passing an ordinance stating the specific use of the funds. In 2010, the Port Authority remitted \$462,112 to the City

NOTE 9 - SIGNIFICANT ESTIMATES AND CONCENTRATIONS

Generally accepted accounting principles require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Major Suppliers

The Port Authority purchased all of its natural gas supply from the Royal Bank of Canada. There are a limited number of national gas suppliers with which the Port Authority could contract under prepay gas transactions and any disruption of deliveries under the supply contracts could have an impact on the Port Authority's operations.

**LANCASTER PORT AUTHORITY,
LANCASTER, OHIO**

***Notes to the Basic Financial Statements
For the Year Ended December 31, 2010***

NOTE 9 - SIGNIFICANT ESTIMATES AND CONCENTRATIONS (Continued)

Current Economic Conditions

The current protracted economic decline continues to present energy companies with difficult circumstances and challenges, which in some cases have resulted in large declines in the fair value of investments and other assets, declines in revenues, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to the Port Authority.

Although the Port Authority has not currently identified any specific circumstances which would cause the difficulties noted above, economic conditions could make it difficult for consumers to maintain demand and usage levels, which could have an adverse impact on the future operating results of the Port Authority.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Board of Directors
Lancaster Port Authority
104 East Main Street
Lancaster, Ohio 43130-3726

We have audited the accompanying financial statements of the Lancaster Port Authority (the Authority), a component unit of the City of Lancaster, Ohio, as of and for the year ended December 31, 2010, and have issued our report thereon dated January 27, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Authority is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a certain deficiency in internal control over financial reporting, described in the accompanying schedule of findings and responses as item 2010-001 that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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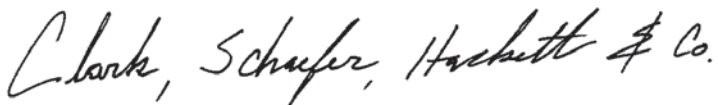
Compliance and Other Matters

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

We noted certain matters that we reported to management of the Authority in a separate letter dated January 27, 2012.

The Authority's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the Authority's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the finance committee, the Board of Directors, and the Auditor of State of Ohio and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Clark, Schufer, Hackett & Co." The signature is written in black ink and is positioned above the typed name and date.

Springfield, Ohio
January 27, 2012

Section I – Summary of Auditors’ Results

Financial Statements

| | |
|--|-------------|
| Type of auditors’ report issued: | Unqualified |
| Internal control over financial reporting: | |
| • Material weakness(es) identified? | None noted |
| • Significant deficiency(ies) identified not considered to be material weakness(es)? | Yes |
| Noncompliance material to financial statements noted? | None noted |

Section II – Financial Statement Findings

2010-001: Significant Deficiency – Segregation of Duties

The segregation of financial duties is important to adequately protect the Authority’s assets and ensure accurate financial reporting. Presently, there is not an adequate number of personnel available to properly segregate duties to provide reasonable assurance that no one employee would have access to both physical assets and related accounting records, or to all phases of a transaction. Without proper segregation of duties, the risk increases that errors and fraud could occur and not be detected within a timely basis. Efficient segregation of duties in a small environment is often difficult; however, the Authority’s Board should be aware of the risk associated with this lack of duty segregation and attempt to exercise as much oversight control in these areas as possible and feasible.

Management Response: The Port Authority is aware of the segregation of duties issues related to limited and reduced staff and is currently making every attempt to mitigate these risks through separate reviews and oversight of transactions.



At Clark Schaefer Hackett, we are the sum of our individuals. Each team member's training, experience and drive is well-suited to each client's needs and goals. We are committed to providing insightful and flexible service – from efficient compliance to sophisticated consulting – to help each client prosper today and plan for future success



Dave Yost • Auditor of State

LANCASTER PORT AUTHORITY

FAIRFIELD COUNTY

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

CERTIFIED
APRIL 19, 2012