Lancaster Port Authority
Fairfield County, Ohio

Basic Financial Statements

December 31, 2013

(with Independent Auditors' Report)

CLARK SCHAEFER HACKETT
STRENGTH IN NUMBERS

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, 2013 through December 31, 2013. 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.

Dave Yost
Auditor of State

June 12, 2014

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CLARK SCHAEFER HACKETT
STRENGTH IN NUMBERS

INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements
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, 2013, and the related notes to the financial statements, which collectively comprise the Authority's basic 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.

Auditors' Responsibility
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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 respective financial position of the Authority as of December 31, 2013, and the respective changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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Other Matters

Required Supplementary Information
Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 be presented to supplement the basic financial statements. Such 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. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*
In accordance with *Government Auditing Standards*, we have also issued our report dated May 27, 2014, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

Clark, Schaefer, Hackett & Co.

Springfield, Ohio
May 27, 2014

Management's Discussion and Analysis
For the Year Ended December 31, 2013 ***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, 2013. 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 2013 are as follows:

- Assets decreased from $474,414,408 to $457,468,508 due to a decrease in the value of the derivative instruments and a decrease in the prepaid gas contract.

- Long-term debt decreased due to scheduled debt service payments made on the Series 2008 Revenue Bonds.

- Other liabilities decreased due to the decrease in the value of the derivative instruments.

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, deferred outflows, liabilities and deferred inflows are included on the statement of net position. The statement of net position represents the basic statement of position for the Port Authority. The statement of revenues, expenses, and changes in net position presents increases (e.g., revenues) and decreases (e.g., expenses) in net total position. 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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FINANCIAL ANALYSIS OF THE PORT AUTHORITY

The following tables represent the Port Authority's condensed financial information for 2013 and 2012 derived from the statement of net position and the statement of revenues, expenses, and changes in net position.

	2013	2012
Current Assets	$15,589,489	$15,826,352
Other assets	440,999,924	457,691,204
Capital assets, Net	879,095	896,852
Total Assets	457,468,508	474,414,408
Deferred Outflows of Resources	133,316,983	136,473,632
Current Liabilities	110,311	131,238
Other Liabilities	133,316,983	136,473,632
Long-term debt outstanding	327,900,000	331,460,000
Total Liabilities	461,327,294	468,064,870
Deferred Inflows of Resources	206,510,285	209,005,703
Net Position:		
Investment in Capital Assets	879,095	896,852
Unrestricted	(77,931,183)	(67,079,385)
Total Net Position	($77,052,088)	($66,182,533)

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Management's Discussion and Analysis
For the Year Ended December 31, 2013 ***Unaudited***

Changes in Net Position – The following table shows the changes in net position for 2013 compared to 2012:

	2013	2012
Revenues		
Gas Supply	$7,730,377	$5,752,473
Other Operating Revenue	600	3,300
Total revenues	7,730,977	5,755,773
Expenses		
Supplies and Materials - Cost of Gas Sold	3,656,370	2,387,737
Contractual Services	2,163,353	2,152,720
Depreciation	17,757	17,166
Total expenses	5,837,480	4,557,623
Operating Income	1,893,497	1,198,150
Nonoperating Revenues/(Expenses)		
Intergovernmental Grants	45,186	142,366
Investment Earnings	1,988	2,779
Interest and Fiscal Charges	(12,827,365)	(12,986,227)
Other Nonoperating Revenue	17,139	42,361
Other Nonoperating Expense	0	(21,000)
Capital Contributions	0	43,600
Total Change in Net Position	(10,869,555)	(11,577,971)
Beginning Net Position	(66,182,533)	(54,604,562)
Ending Net Position	($77,052,088)	($66,182,533)

Net Position decreased by $10,869,555. 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 2013 the Port Authority had $879,095 net of accumulated depreciation invested in capital assets. The following table shows 2013 and 2012 balances:

	2013	2012	Increase (Decrease)
Land	$106,200	$106,200	$0
Buildings and Improvements	232,586	232,586	0
Infrastructure	614,326	614,326	0
Less: Accumulated Depreciation	(74,017)	(56,260)	(17,757)
Totals	$879,095	$896,852	($17,757)

Additional information on the Port Authority's capital assets can be found in Note 4.

Management's Discussion and Analysis
For the Year Ended December 31, 2013 ***Unaudited***

Debt

The following table summarizes the Port Authority's debt outstanding as of December 31, 2013 and 2012:

	2013	2012
Revenue Bonds Payable	$327,900,000	$331,460,000

Additional information on the Port Authority's long-term debt can be found in Note 5.

ECONOMIC FACTORS

The current project known as the brownfield Ray-O-Vac site, a five acre site located at 330 South Ewing Street, is near completion. Redevelopment efforts by the Lancaster Port Authority (LPA), Clean Ohio Revitalization Fund (CORF), Federal EPA Grant, and City of Lancaster have environmentally remediated the site to near residential standards. Water Lines and Wastewater Lines have been installed and a contract to build a road has been signed. The road will be completed prior to June 15, 2014 when the CORF grant will be completed, LPA match monies met, and a "No Further Action Required" letter is expected from the Ohio EPA. LPA is currently in discussion with an end-user to purchase the rear lot of approximately 1.75 acres. Up to four (4) smaller lots are available for sale as well to complete revitalization of the area. Upon completion of this project, LPA will be planning other projects targeted at both job creation and blight remediation.

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.

Statement of Net Position
December 31, 2013

ASSETS	
Current assets:	
Cash and Cash Equivalents	$776,192
Accounts Receivable	627,769
Prepaid Gas Supply - Current	14,185,528
Total Current Assets	15,589,489
Noncurrent Assets:	
Prepaid Gas Supply - Long Term	226,991,630
Land Held for Resale	140,400
Fair Value of Derivative Instruments	206,510,285
Restricted Assets:	
Cash and cash equivalents	7,357,609
Capital Assets	
Capital Assets Not Being Depreciated	106,200
Capital Assets Being Depreciated, net	772,895
Total Capital Assets	879,095
Total Noncurrent Assets	441,879,019
Total Assets	457,468,508
DEFERRED OUTFLOWS OF RESOURCES	
Deferred Outflow from Derivative Instruments	133,316,983
LIABILITIES	
Current Liabilities:	
Unearned Revenue	94,500
Accrued Interest	15,811
Bond Payable-current	4,045,000
Total Current Liabilities	4,155,311
Noncurrent Liabilities:	
Bond Payable-long term	323,855,000
Fair Value of Derivative Instruments	133,316,983
Total Noncurrent Liabilities	457,171,983
Total Liabilities	461,327,294
DEFERRED INFLOWS OF RESOURCES	
Deferred Inflow from Derivative Instruments	206,510,285
NET POSITION	
Investment in Capital Assets	879,095
Unrestricted	(77,931,183)
Total Net Position	($77,052,088)

See accompanying notes to the basic financial statements

Statement of Revenues, Expenses and Changes in Net Position
For the Year Ended December 31, 2013

Operating Revenues:	
Gas Supply	$7,730,377
Other Operating Revenue	600
Total Operating Revenues	7,730,977
Operating Expenses:	
Materials and Supplies - cost of gas sold	3,656,370
Contractual services	2,163,353
Depreciation	17,757
Total Operating Expenses	5,837,480
Operating Income	1,893,497
Nonoperating Revenues (Expenses):	
Intergovernmental Grants	45,186
Investment Earnings	1,988
Interest and Fiscal Charges	(12,827,365)
Other Nonoperating Revenues	17,139
Total Nonoperating Revenues (Expenses)	(12,763,052)
Change in Net Position	(10,869,555)
Net Position at Beginning of Year	(66,182,533)
Net Position at End of Year	($77,052,088)

See accompanying notes to the basic financial statements

Statement of Cash Flows
For the Year Ended December 31, 2013

Cash Flows from Operating Activities:	
Cash Received from Customers	$7,719,176
Cash Received from Swap Providers	10,985,215
Cash Payments for Goods and Services	(2,163,353)
Other Miscellaneous Cash Receipts	225
Net Cash Provided by Operating Activities	16,541,263
Cash Flows from Noncapital Financing Activities:	
Principal Payment on Revenue Bond Payable	(3,560,000)
Intergovernmental Grant	45,186
Interest Paid on Debt	(12,847,692)
Net Cash Used by Noncapital Financing Activities	(16,362,506)
Cash Flows from Investing Activities:	
Proceeds of Land Held for Resale	104,814
Receipts of Interest Earnings	1,988
Net Cash Provided by Investing Activities	106,802
Net Increase in Cash and Cash Equivalents	285,559
Cash and Cash Equivalents at Beginning of Year	7,848,242
Cash and Cash Equivalents at End of Year	$8,133,801
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:	
Operating Income	$1,893,497
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:	
Miscellaneous Nonoperating Revenue	225
Depreciation Expense	17,757
Changes in Assets and Liabilities:	
Increase in Accounts Receivable	(11,201)
Decrease in Prepaid Items	14,641,585
Decrease in Unearned Revenue	(600)
Total Adjustments	14,647,766
Net Cash Provided by Operating Activities	$16,541,263

See accompanying notes to the basic financial statements

Notes to the Basic Financial Statements
For the Year Ended December 31, 2013

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 accounting principles general accepted in the United States of America. 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, 2013 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 accounting principles general accepted in the United States of America 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.

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.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. Measurement Focus

The enterprise fund is accounted for on a flow of economic resources measurement focus. All assets, deferred outflows, liabilities, and deferred inflows associated with the operation of the Port Authority are included on the statement of net position. The statement of changes in net position presents increases (i.e., revenues) and decreases (i.e., expenses) in net position. 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.

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 Position, 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.

Notes to the Basic Financial Statements
For the Year Ended December 31, 2013

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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:

Description	Estimated Lives (in years)
Buildings	40
Improvements	20
Infrastructure	75

I. 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.

J. Net Position

Net position represents the difference between assets and deferred outflows and liabilities and deferred inflows. Net position 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.

K. 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 are the primary activity of the fund. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

NOTE 2 – DEFICIT NET POSITION

The accumulated deficit at December 31, 2013 of $77,052,088 is the result of recording the prepaid gas supply at the present value of the future shipments and the related bonds payable at outstanding par value. At the end of the contract period, the net result will be zero.

NOTE 3 - 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.

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;

NOTE 3 - POOLED CASH, CASH EQUIVALENTS AND INVESTMENTS (Continued)

- 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.

At year end the carrying amount of the Port Authority's deposits was $8,133,801 and the bank balance was $8,145,471. Federal depository insurance covered $250,000 of the bank balance, and $7,895,471 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	$7,895,471

Notes to the Basic Financial Statements
For the Year Ended December 31, 2013

NOTE 4 - CAPITAL ASSETS

Summary by category at December 31, 2013:

Historical Cost:

Class	December 31, 2012	Additions	Deletions	December 31, 2013
Capital assets not being depreciated:				
Land	$106,200	$0	$0	$106,200
Subtotal	106,200	0	0	106,200
Capital assets being depreciated:				
Buildings	95,745	0	0	95,745
Improvements	136,841	0	0	136,841
Infrastructure	614,326	0	0	614,326
Subtotal	846,912	0	0	846,912
Total Cost	$953,112	$0	$0	$953,112

Accumulated Depreciation:

Class	December 31, 2012	Additions	Deletions	December 31, 2013
Buildings	($12,692)	($2,724)	$0	($15,416)
Improvements	(9,081)	(6,842)	0	(15,923)
Infrastructure	(34,487)	(8,191)	0	(42,678)
Total Depreciation	($56,260)	($17,757)	$0	($74,017)
Net Value:	$896,852			$879,095

NOTE 5 - LONG-TERM DEBT

Long-term debt obligations of the Port Authority at December 31, 2013 were as follows:

		Balance December 31, 2012	Deletions	Balance December 31, 2013	Amount Due Within One Year
Long-Term Debt					
Variable Rate Revenue Bonds	2008	$331,460,000	($3,560,000)	$327,900,000	$4,045,000
Total Long-Term Debt		$331,460,000	($3,560,000)	$327,900,000	$4,045,000

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. As of December 31, 2013, aggregated debt service requirements of the Port Authority's debt (variable rate) and net payments on a hedging derivative instrument are as follows. These amounts assume that current interest rates on the variable-rate bonds and the current reference rates of the hedging derivative instruments will remain the same for their term. As these rates vary, interest payments on variable-rate bonds and the net payments on the hedging derivative instrument will vary. See Note 7 for information on the derivative instrument.

Years	Principal	Interest	Hedging Derivative Instruments, Net	Total
2014	$4,045,000	$185,231	$11,886,697	$16,116,928
2015	4,590,000	182,809	11,731,376	16,504,185
2016	5,175,000	180,559	11,554,639	16,910,198
2017	5,760,000	176,990	11,358,037	17,295,027
2018	6,170,000	173,588	11,139,779	17,483,367
2019-2023	40,425,000	807,141	51,768,286	93,000,427
2024-2028	61,445,000	664,961	42,628,153	104,738,114
2029-2033	87,895,000	455,135	29,198,916	117,549,051
2034-2038	112,395,000	160,977	10,334,721	122,890,698
Totals	$327,900,000	$2,987,391	$191,600,604	$522,487,995

NOTE 6 - 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 $241,177,158 is reflected in both current and noncurrent asset categories at December 31, 2013. 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 7 - DERIVATIVE INSTRUMENTS

Composition of Derivative Instruments

The fair value balances and notional amounts of derivative instruments outstanding as of December 31, 2013, classified by type, are as follows:

	Notional Amount	Fair Value	Counterparty Credit Rating
Positive Cash Flow Hedge:			
Pay-variable, receive fixed commodity swap	52,176,787 mmbtu	$ 206,510,285	AA-/A-1+
Negative Cash Flow Hedge:			
Pay-fixed, receive variable interest rate swap	$ 327,900,000	$ (133,316,983)	A+/A-1

All fair values are classified as derivative instruments on the Statement of Net Position. The increase in fair values of these derivatives instruments was $661,231 for 2013. As these commodity and interest rate swaps are considered hedging derivatives instruments, the change in fair value is reflected within deferred outflows and inflows on the Statement of Net Position. 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.

NOTE 7 - 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, 2013:

Type	Objective	Maturity Date	Terms
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.

NOTE 7 - 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.

Notes to the Basic Financial Statements
For the Year Ended December 31, 2013

NOTE 7 - DERIVATIVE INSTRUMENTS (Continued)

Interest Rate Risk: Under the pay-fixed interest rate swap agreement, 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 8 - 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 9 - RELATED PARTY TRANSACTIONS

All of the Port Authority's natural gas sales have been to the City of Lancaster (the "City"). At December 31, 2013, accounts receivable due from the City was $627,769. For 2013, the Port Authority reported gas sales to the City in the amount of $7,730,377.

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 2013, the Port Authority remitted $357,265 to the City.

NOTE 10 - 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:

<u>Major Suppliers</u>

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.

NOTE 10 - 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. The Port Authority continually monitors the demand for natural gas against the provisions of the pre-pay transaction to assess the long-term feasibility of continuing the program as it is currently structured. The Port Authority continues to make all financial decisions and commitments with available cash and will not borrow funds against this transaction. The Port Authority is exploring other types of projects as it moves forward to maintain its overall goal of improving the economic development within the City of Lancaster.

NOTE 11 – SUBSEQUENT EVENTS

Amendment to Cooperative Agreement between the Port Authority and the City of Lancaster

In March 2014, the City and the Port Authority agreed to amend the terms of the cooperative agreement between the two parties which provides that effective April 1, 2014, all of the scheduled "Annual Payment", which was allocated to the City under the previous agreement, will be allocated to the Authority to further the economic development efforts benefiting the City of Lancaster overall. Prior to this agreement, the City was allocated 75 percent of the amount scheduled to be allocated between the City and the Port Authority under the prepaid gas agreement.

Restructure of Prepaid Gas Agreement/Variable Rate Revenue Bonds

In October 2013, the Port Authority received notification that the pending implementation of Capital Adequacy Requirements Guideline, issued by the Office of Superintendents of Financial Institutions Canada, is viewed by the Royal Bank of Canada (RBC) as an event that will materially adversely affect the prepaid transactions contemplated under the original terms of the prepaid agreement. As such, the Port Authority has been in discussions with the RBC regarding restructuring the prepaid gas agreement in conjunction with the refunding of the Variable Rate Revenue Bonds, Series 2008, through the issuances of five-year Floating Rate Notes with serial hard maturities. While it is anticipated such a restructuring will reduce the "Annual Payment" and the permitted discount from those received under the current agreement, the exact terms and rates of any potential restructuring agreement are not known at this time. Therefore, the impact on the financial statements of the Port Authority cannot be reasonably estimated at this time.

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

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

We have audited, in accordance with the 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, the 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, 2013, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated May 27, 2014.

Internal Control Over Financial Reporting
In planning and performing our audit of the financial statements, we considered the Authority's internal control over financial reporting (internal control) to determine the auditing procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a certain deficiency in internal control, described in the accompanying schedule of findings and responses as item 2013-001 that we consider to be a significant deficiency.

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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 be reported under *Government Auditing Standards*.

Authority's Response to Finding
The Authority's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The Authority's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report
The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Authority's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Clark, Schaefer, Hackett & Co.

Springfield, Ohio
May 27, 2014

Section I – Summary of Auditors' Results

Financial Statements

Type of auditors' report issued:	Unmodified
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

2013-001: 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.

Section III – Summary Schedule of Prior Audit Findings

2012-001: Significant Deficiency – The segregation of financial duties is important to adequately protect the Authority's assets and ensure accurate financial reporting.

Status: No Change - see current year finding 2013-001

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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

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
JUNE 24, 2014

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