## NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Montgomery Township (the "Township"), located in Montgomery County, Pennsylvania, was organized in 1714. The Township is classified as a "Township of the Second Class" under the laws of the Commonwealth of Pennsylvania and provides the following services as authorized by its charter: public safety, highways and streets, culture and recreation, public improvements, planning and zoning and general and administrative services.

The basic financial statements of the Township have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The more significant of the government's accounting policies are described below.

***Reporting Entity***

The Township is governed by an elected five-member Board of Supervisors. As required by GAAP, the Township, for financial reporting purposes, includes all of the funds relevant to the operations of the Township. Management, in determining what potential component units should be included for financial reporting purposes, considers financial accountability and the nature and significance of the relationship. Fiscal accountability, the most significant of all criteria, refers to conditions of financial interdependency between two units, including budgetary adoption, taxing authority, responsibility for debt and control over or responsibility for financial management.

Based on the aforementioned criteria, the Township's component units are the Montgomery Township Municipal Sewer Authority (the "Sewer Authority") and the Fire Department of Montgomery Township (the "Fire Department"). The Sewer Authority and the Fire Department have been reported as discretely presented component units in a separate column in the financial statements to emphasize that they are legally separate from the Township.

***Montgomery Township Municipal Sewer Authority*** - The Sewer Authority is a public corporation organized in 1965 by the Board of Montgomery Township in accordance with the Municipality Authorities Act of 1945. The Sewer Authority is a lease-back and operating authority, the purpose of which is to borrow money to finance the construction or acquisition of sewer facilities and operate a sewer system. The facilities are subject to a lease-back arrangement between the Township and the Sewer Authority.

The Sewer Authority is governed by a five-member board appointed by the Township's Board of Supervisors.

The Sewer Authority's governing board is responsible for decisions made in the operation of the Sewer Authority. The Township, however, is responsible for funding any deficit which may arise in the operation of the Sewer Authority. The Township also is required to review and approve the Sewer Authority's annual operating budget and any amendment thereto. The Township has guaranteed the debt issued by the Sewer Authority in the event the Sewer Authority would not be able to meet its obligations to service the debt. In lieu of sewer charges to the Township facilities, the Township provides office space to the Sewer Authority at no charge.

The Sewer Authority is presented as a Proprietary Fund Type, and its financial statements have been prepared on the accrual basis of accounting. Separately issued financial statements of the Sewer Authority may be obtained at the Township's administrative office.

***Fire Department of Montgomery Township*** - The Fire Department provides firefighting and rescue services to the residents and businesses of Montgomery Township, Pennsylvania. The Fire Department was formed as a nonprofit corporation in 2003.

The governing body of the Fire Department is the Executive Board, which is comprised of eight members elected by the active members of the Fire Department.

In 2003, the Fire Department entered into a Fire Services Agreement with Montgomery Township. As part of this agreement, the Fire Department will prepare an annual budget. This budget will be reviewed with the Director of Fire Services, a Montgomery Township employee. The Director must approve purchases in excess of $1,000. In addition, the Township provides the use of two fire stations and equipment.

The Fire Department is presented as a Proprietary Fund Type, and its financial statements have been prepared on the accrual basis of accounting. Separately issued financial statements of the Fire Department may be obtained at the Township's administrative office.

***Fund Accounting***

The Township uses funds to maintain its financial records during the fiscal year. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain Township functions or activities. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts. The various funds of the Township are grouped into the categories governmental and fiduciary.

The Township reports the following major Governmental Funds:

> ***General Fund*** - The General Fund is the general operating fund of the Township. It is used to account for all financial resources except those required to be accounted for in another fund.
>
> ***Capital Reserve Fund*** - The Capital Reserve Fund is used to account for financial resources to be used for the acquisition or construction of major capital projects.

Additionally, the Township reports the following fund types:

> ***Special Revenue Funds*** - Special Revenue Funds are used to account for proceeds of specific revenue sources (other than expendable trusts or major capital projects) that are legally restricted to expenditures for specified purposes. The Township's Special Revenue Funds include the Fire Protection Fund, Park and Recreation Fund, Basin Maintenance Fund, Street Lights Fund, Real Estate Tax Collection Fund, Liquid Fuels Fund, Fire Relief Fund, Environmental Fund, Replacement Tree Fund and Autumn Festival Fund.

***Capital Projects Funds (Nonmajor)*** - The Capital Projects Funds are used to account for financial resources to be used for the acquisition or construction of major capital projects. The Township's nonmajor Capital Projects Funds include the Park Development Fund, the Capital Projects Fund and the Restoration Fund.

***Debt Service Fund*** - The Debt Service Fund is used to account for the accumulation of resources for and payment of general long-term debt principal, interest and related costs.

***Fiduciary Fund Types***

**Trust and Agency Funds** - Trust and Agency Funds are used to account for assets held by the Township in a trustee capacity or as an agent for individuals, private organizations, other governments and/or other funds. Agency Funds are custodial in nature and do not involve measurement of results of operations. The Township's Trust and Agency Funds consist of developer escrow deposits held by the Township and investments held for the Township's Police and Non-Uniform Employee Pension Plans.

***Basis of Presentation and Accounting***

***Government-Wide Financial Statements*** - The statement of net assets and the statement of activities display information about the Township as a whole. These statements include the financial activities of the primary government, except for Fiduciary Funds and Agency Funds. The statements distinguish between those activities of the Township that are governmental and those that are considered business-type activities.

The government-wide statements are prepared using the economic resources measurement focus and the accrual basis of accounting. This is the same approach used in the preparation of the Proprietary Funds financial statements but differs from the manner in which Governmental Funds financial statements are prepared. Governmental Funds financial statements therefore include a reconciliation with brief explanations to better identify the relationship between the government-wide statements and the statements for Governmental Funds. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The government-wide statement of activities presents a comparison between direct expenses and program revenues for each discretely presented component unit of the Township and for each function or program of the Township's governmental activities. Direct expenses are those that are specifically associated with a service, program, or department and therefore clearly identifiable to a particular function.

Program revenues include charges paid by the recipient of the goods or services offered by the program and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues, which are not classified as program revenues, are presented as general revenues of the Township, with certain limited exceptions. The comparison of direct expenses with program revenues identifies the extent to which each business segment or governmental function is self-financing or draws from the general revenues of the Township.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements.

***Fund Financial Statements*** - Fund financial statements report detailed information about the Township. The focus of Governmental Funds financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column. Nonmajor Governmental Funds are aggregated and presented in a single column (Other Governmental Funds). Fiduciary Funds are reported by fund type.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All Governmental Funds are accounted for using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Township considers revenues to be available if they are collected within 60 days of the end of the fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures and claims and judgments are recorded only when payment is due. The financial statements for Governmental Funds are a balance sheet, which generally includes only current assets and current liabilities, and a statement of revenues, expenditures and changes in fund balances, which reports on the sources (i.e., revenues and other financing sources) and uses (i.e., expenditures and other financing uses) of current financial resources.

The Township's Pension Trust Funds, discretely presented component units and Agency Funds are presented on the accrual basis of accounting, whereby revenues are recognized in the period earned, and expenses are recognized when incurred.

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

***Encumbrance Accounting***

Encumbrance accounting, under which purchase orders and other commitments for expenditures are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary integration in all funds for which budgets are prepared. Encumbrances do not constitute expenditures or liabilities under accounting principles generally accepted in the United States of America.

***Cash and Cash Equivalents***

The cash of individual funds other than the component units is combined to form a pool of cash and cash equivalents. Each fund type's portion of the pool is included on the balance sheet as "cash and cash equivalents" under each fund type's caption. The deposits and investments of the Pension Trust Funds are held separately from those of other Township funds.

Cash and cash equivalents include cash on hand and in banks and investments in short-term highly liquid investments with original maturities of less than 90 days.

***Investments, Township***

The Second Class Township Code authorizes the Township to invest in obligations of the U.S. Treasury, short-term obligations of the U.S. Government or its agencies or instrumentalities, obligations of the United States of America, the Commonwealth of Pennsylvania, or any of its agencies or instrumentalities backed by the full faith and credit of the political subdivision and insured certificates of deposit.

Investments authorized for pension plans include any investment purchased or retained in the exercise of that degree of judgment and care, which men of prudence exercise in the management of their own affairs. Investments held for the Police and Non-Uniform Employee Pension Trusts consist of investments in mutual funds and common stock.

The Township's investments are stated at fair value, determined by quoted market values.

***Deposits and Investments, Sewer Authority***

Under Section 7.1 of the Municipality Authorities Act and related laws, as amended, the Sewer Authority is permitted to invest funds in the following types of investments:

> Obligations of (1) the United States of America or any of its agencies or instrumentalities backed by the full faith and credit of the United States of America, (2) the Commonwealth of Pennsylvania or any of its agencies or instrumentalities backed by the full faith and credit of the Commonwealth, or (3) any political subdivision of the Commonwealth of Pennsylvania or any of its agencies or instrumentalities backed by the full faith and credit of the political subdivision.
>
> Deposits in savings accounts or time deposits of institutions insured by the Federal Deposit Insurance Corporation to the extent that such accounts are so insured and, for any amounts above the insured maximum, provided that the deposits are collateralized on a pooled or individual basis in accordance with Act 72 of the Commonwealth of Pennsylvania.

The Sewer Authority's investments are reported at fair value, determined by quoted market values.

***Capital Assets***

Capital assets, which include property, plant, equipment and certain limited infrastructure assets, are reported in the applicable governmental or discretely presented component units columns in the government-wide financial statements. The Township defines capital assets as assets with an initial, individual cost equal to or greater than $5,000. Such assets are recorded at historical cost or estimated historical cost. Donated capital assets are recorded at estimated fair market value at the date of the donation.

The costs of normal maintenance and repairs that do not add to the value of the assets or materially extend asset lives are not capitalized.

Property, plant, equipment and certain limited infrastructure assets are depreciated using the straight-line method over the following estimated useful lives:

| | Years |
|---|---|
| Buildings and improvements | 20-40 |
| Infrastructure | 20-25 |
| Machinery and equipment | 3-20 |

***Infrastructure***

GASB Statement No. 34 requires the inclusion of infrastructure capital assets in local governments' basic financial statements. The Township has included the value of all infrastructure in its basic financial statements for December 31, 2011.

The Township defines infrastructure as the basic physical assets, including roads, bridges, sidewalks, drainage systems and traffic signals, used by the Township in the conduct of its business. The Township will depreciate its infrastructure over the estimated useful life of the assets using the straight-line method of depreciation, except for its roads.

The Township has elected to use the modified approach as defined by GASB Statement No. 34 for reporting of its roads. The Township performed a physical assessment of the condition of the roads as of December 31, 2010. This condition assessment will be performed every three years.

***Sewer Revenues and Accounts Receivable***

Charges for services are recognized when earned. All residential and commercial customers are billed quarterly based on usage. An estimated amount has been recorded for services rendered but not yet billed as of the close of the fiscal year.

***Deferred Revenue***

The Township reports deferred revenue on its balance sheet. Deferred revenue arises when a potential revenue does not meet both the "measurable" and "available" criteria for recognition in the current period. Deferred revenue also arises when resources are received by the Township before it has a legal claim to them, as when grant monies are received prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met or when the Township has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet and revenue is recognized.

Revenues from payments made to the Sewer Authority by developers to reserve future capacity in the collection system are deferred until the agreements are executed. Revenue is recognized when the agreements are executed.

***Compensated Absences***

Township employees accumulate vacation leave hours for subsequent use or for payment upon termination, death, or retirement. Earned vacation pay to a maximum of 80 hours for nonuniform employees and 84 hours for uniform employees may be paid upon termination of employment, death, or retirement.

***Governmental Funds' Bond Discounts and Issuance Costs - Township***

Bond discounts and issuance costs are deferred and amortized over the life of the related bonds using the straight-line method. The unamortized portion of the discounts and issue costs is presented as an asset in the government-wide financial statements.

***Unamortized Bond Discount and Issuance Costs - Sewer Authority***

Bond discount and issuance costs are deferred and amortized over the life of the related bonds using the interest method. For financial reporting purposes, the bond discount is netted against the bonds payable, and the issuance costs are presented as deferred charges.

***Interest Rate Swap***

The Township entered into an interest rate swap agreement to modify interest rates on outstanding debt. Other than the net interest expenditures resulting from these agreements, no amounts are recorded in the fund financial statements.

***Real Estate Property Tax***

Property taxes are levied on March 1 based upon the assessed value of property listed on the previous January 1. Assessed values are an approximation of market value.

Property taxes are payable under the following terms: 2% discount March 1 through May 1, face amount May 2 through July 1 and a 10% penalty after July 1. Unpaid taxes are liened in February of the subsequent year.

***Tax Collection***

The Real Estate Tax Collector, who is responsible for collecting real estate taxes on behalf of the Township, Montgomery County and the North Penn School District, is an elected official. The Township, in accordance with state law, regards the Tax Collector's office as a separate entity, and only activity as it relates to the Township is recorded in the financial statements.

***Fund Equity***

Beginning with the year ended December 31, 2011, the Township has implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions.* This statement provides more clearly defined fund balance categories to make the nature and extent of the constraints placed on the Township's fund balances more transparent. The following classifications describe the relative strength of the spending constraints:

- ***Nonspendable Fund Balance*** - Amounts that are not in spendable form (such as inventory) or are required to be maintained intact.
- ***Restricted Fund Balance*** - Amounts constrained to specific purposes by their providers (such as grantors, bondholders and higher levels of government) through constitutional provisions or by enabling legislation.
- ***Committed Fund Balance*** - Amounts constrained to specific purposes by the Township itself, using its highest level of decision-making authority (the Board of Supervisors). To be reported as committed, amounts cannot be used for any other purpose unless the Township takes the same highest level action to remove or change the constraint.
- ***Assigned Fund Balance*** - Amounts the Township intends to use for a specific purpose. Intent can be expressed by the Board of Supervisors or by an official or body to which the Board of Supervisors delegates the authority.
- ***Unassigned Fund Balance*** - Amounts available for any purpose. Positive amounts are reported only in the General Fund.

Beginning fund balances for the Township's Governmental Funds have been restated to reflect the above classifications.

The Board of Supervisors establishes (and modifies or rescinds) fund balance commitments by passage of a resolution. This is typically done through adoption and amendment of the budget. A fund balance commitment is further indicated in the budget document as a commitment of the fund. Assigned fund balance is intended to be used by the government for specific purposes but does not meet the criteria to be classified as restricted or committed.

The Township will typically use restricted fund balances first, followed by committed resources and then assigned resources, as appropriate opportunities arise, but reserves the right to selectively spend unassigned resources first to defer the use of these other classified funds.

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

## NOTE B DEPOSITS AND INVESTMENTS

### *Deposits*

***Custodial Credit Risk*** - Custodial credit risk is the risk that, in the event of a bank failure, the Township's deposits may not be returned to it. The Township follows state statute as it relates to custodial credit risk. Pennsylvania statutes provide for investment of Governmental and Proprietary Funds resources into certain authorized investment types, including U.S. Treasury bills, other short-term U.S. and Pennsylvania Government obligations and insured or collateralized time deposits and certificates of deposit. The statutes do not prescribe regulations related to demand deposits; however, they do allow the pooling of Governmental Funds for investment purposes. In addition to the investments authorized for Governmental and Proprietary Funds, Fiduciary Fund investments also may be made in corporate stocks and bonds, real estate and other investments consistent with sound business practice.

As of December 31, 2011, $6,683,915 of the Township's bank balance of $7,262,496 was exposed to custodial credit risk as follows:

| | |
|---|---|
| Uninsured and collateralized with securities held by the pledging bank's trust department not in the Township's name | |
| Township governmental activities | $ 5,991,392 |
| Escrow | $ 692,523 |

As of December 31, 2011, the following amounts of the component units were exposed to custodial credit risk:

**Sewer Authority** - At December 31, 2011, $6,372,958 of the Sewer Authority's bank balance of $6,622,958 was exposed to custodial credit risk as follows:

| | |
|---|---|
| Uninsured and collateralized with securities held by the pledging bank's trust department not in the Sewer Authority's name | $ 6,372,958 |

**Fire Department** - At December 31, 2011, the bank deposits of the Fire Department were fully insured and not exposed to custodial credit risk.

***Investments***

As of December 31, 2011, the Township had the following investments and maturities:

| Investment Type | Fair Value | Investment Maturities Less Than One Year |
|---|---|---|
| GOVERNMENTAL ACTIVITIES | | |
| Certificate of deposit | $ 13,000,000 | $ 13,000,000 |
| PENSION ACTIVITIES | | |
| Common stocks | $ 2,778,800 | $ 2,778,800 |
| Domestic mutual funds | 6,882,594 | 6,882,594 |
| Closed-end mutual funds | 3,527,953 | 3,527,953 |
| | $ 13,189,347 | $ 13,189,347 |

As of December 31, 2011, the Sewer Authority had the following investments and maturities:

| Investment Type | Fair Value | Investment Maturities Less Than One Year |
|---|---|---|
| U.S. Government agency obligations | $ 2,970,891 | $ 2,970,891 |

***Interest Rate Risk*** - The Township does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

***Credit Risk*** - The Second Class Township Code authorizes the Township to invest in obligations of the U.S. Treasury, short-term obligations of the U.S. Government or its agencies or instrumentalities, obligations of the United States of America, the Commonwealth of Pennsylvania, or any of its agencies or instrumentalities backed by the full faith and credit of the political subdivision and insured certificates of deposit.

Investments authorized for pension plans include any investment purchased or retained in the exercise of that degree of judgment and care, which men of prudence exercise in the management of their own affairs. Investments held for the Police and Non-Uniform Employee Pension Trusts consist of investments in mutual funds and common stock.

The Township's investment policy does not further limit its investment choices.

***Concentration of Credit Risk*** - More than 5% of the Township's and component units' investments are in certificates of deposits, common stocks, domestic mutual funds, domestic closed-end mutual funds and U.S. Government agency obligations. These investments are 44%, 10%, 24%, 12% and 10%, respectively, of the Township's and component units' total investments.

## NOTE C CAPITAL ASSETS

A summary of changes in capital assets is as follows:

| | Balance January 1, 2011 | Additions | Deletions | Balance December 31, 2011 |
|---|---|---|---|---|
| GOVERNMENTAL ACTIVITIES | | | | |
| Capital assets not being depreciated | | | | |
| Land | $ 2,132,829 | $ 749,483 | $ - | $ 2,882,312 |
| Infrastructure | 95,385,006 | 138,487 | - | 95,523,493 |
| TOTAL CAPITAL ASSETS NOT BEING DEPRECIATED | 97,517,835 | 887,970 | - | 98,405,805 |
| Capital assets being depreciated | | | | |
| Buildings and improvements | 10,521,613 | - | - | 10,521,613 |
| Land improvements | 103,720 | - | - | 103,720 |
| Infrastructure | 2,553,410 | 315,154 | - | 2,868,564 |
| Machinery and equipment | 5,647,137 | 440,249 | (199,221) | 5,888,165 |
| TOTAL CAPITAL ASSETS BEING DEPRECIATED | 18,825,880 | 755,403 | (199,221) | 19,382,062 |
| Accumulated depreciation | | | | |
| Buildings and improvements | (3,210,656) | (315,916) | - | (3,526,572) |
| Land improvements | (58,885) | (3,716) | - | (62,601) |
| Infrastructure | (1,559,015) | (66,186) | - | (1,625,201) |
| Machinery and equipment | (3,124,810) | (438,568) | 195,032 | (3,368,346) |
| TOTAL ACCUMULATED DEPRECIATION | (7,953,366) | (824,386) | 195,032 | (8,582,720) |
| TOTAL CAPITAL ASSETS BEING DEPRECIATED, net | 10,872,514 | (68,983) | (4,189) | 10,799,342 |
| GOVERNMENTAL ACTIVITIES CAPITAL ASSETS, net | $ 108,390,349 | $ 818,987 | $ (4,189) | $ 109,205,147 |

| | Balance January 1, 2011 | Additions | Deletions | Balance December 31, 2011 |
|---|---|---|---|---|
| COMPONENT UNIT, SEWER AUTHORITY | | | | |
| Capital assets not being depreciated | | | | |
| Land | $ 673,095 | $ - | $ - | $ 673,095 |
| Construction in progress | 1,464,422 | 606,999 | - | 2,071,421 |
| TOTAL CAPITAL ASSETS NOT BEING DEPRECIATED | 2,137,517 | 606,999 | - | 2,744,516 |
| Capital assets being depreciated | | | | |
| Wastewater treatment and collection systems | | | | |
| Hatfield Waste Water Treatment Plant | 13,168,086 | 476,277 | - | 13,644,363 |
| Eureka Treatment Plant | 20,160,092 | - | - | 20,160,092 |
| Other sewer system improvements | 4,308,848 | 516,978 | - | 4,825,826 |
| Developer dedications | 13,818,225 | - | - | 13,818,225 |
| TOTAL WASTEWATER TREATMENT AND COLLECTION SYSTEMS | 51,455,251 | 993,255 | - | 52,448,506 |
| Equipment | 1,268,957 | - | - | 1,268,957 |
| TOTAL CAPITAL ASSETS BEING DEPRECIATED | 52,724,208 | 993,255 | - | 53,717,463 |
| Accumulated depreciation | | | | |
| Wastewater treatment and collection systems | | | | |
| Hatfield Waste Water Treatment Plant | (9,582,095) | (279,045) | - | (9,861,140) |
| Eureka Treatment Plant | (4,401,460) | (504,281) | - | (4,905,741) |
| Other sewer system improvements | (1,470,939) | (281,338) | - | (1,752,277) |
| Developer dedications | (2,780,109) | (460,607) | - | (3,240,716) |
| TOTAL WASTEWATER TREATMENT AND COLLECTION SYSTEMS ACCUMULATED DEPRECIATION | (18,234,603) | (1,525,271) | - | (19,759,874) |
| Equipment | (693,515) | (51,392) | - | (744,907) |
| TOTAL ACCUMULATED DEPRECIATION | (18,928,118) | (1,576,663) | - | (20,504,781) |
| TOTAL CAPITAL ASSETS BEING DEPRECIATED, net | 33,796,090 | (583,408) | - | 33,212,682 |
| COMPONENT UNIT, SEWER AUTHORITY CAPITAL ASSETS, net | $ 35,933,607 | $ 23,591 | $ - | $ 35,957,198 |

## NOTE D LONG-TERM DEBT

The following is a summary of changes in long-term debt for governmental activities for the year ended December 31, 2011:

| | Original Principal | Principal Outstanding January 1, 2011 | Proceeds from New Obligations | Retired During Year | Principal Outstanding December 31, 2011 | Due Within One Year |
|---|---|---|---|---|---|---|
| GOVERNMENTAL ACTIVITIES | | | | | | |
| Bonds and notes | | | | | | |
| 1999 Series Note | $ 1,500,000 | $ 652,529 | $ - | $ (108,696) | $ 543,833 | $ 108,813 |
| 2002 Series Note | 725,000 | 252,961 | - | (80,504) | 172,457 | 172,456 |
| 2003 Series Bonds | 1,590,000 | 505,000 | - | (160,000) | 345,000 | 170,000 |
| TOTAL BONDS AND NOTES | 3,815,000 | 1,410,490 | - | (349,200) | 1,061,290 | 451,269 |
| Net OPEB obligation | - | 555,342 | 164,914 | - | 720,256 | - |
| TOTAL LONG-TERM LIABILITIES | $ 3,815,000 | $ 1,965,832 | $ 164,914 | $ (349,200) | $ 1,781,546 | $ 451,269 |

***1999 Series Note***

In December 1999, the Township obtained a $1,500,000 loan for the purpose of park improvements. The loan bears interest at a fixed rate equal to 1.6625% per annum and may be adjusted from time to time in accordance with the agreement. The loan is payable semiannually in 40 equal consecutive installments of $54,665, including interest.

***2002 Series Note and Interest Rate Swap***

On December 4, 2002, the Township issued a General Obligation Note "A" and obtained a $725,000 floating rate loan from a bank for the purpose of acquiring fire equipment.

***Objective of the Interest Rate Swap*** - The Township has entered into a ten-year interest rate swap agreement to reduce the impact of changes in interest rates on its $725,000 floating rate debt. The intention of the swap was to effectively fix the rate under the terms of the swap agreement, whereby the Township pays a fixed rate of 4.47% on the debt.

***2003 Series Bonds***

On September 15, 2003, the Township issued $1,590,000 of General Obligation Bonds, Series of 2003, for the purpose of currently refunding the General Obligation Bonds, Series of 1993, in the outstanding principal amount of $1,495,000. The Township deposited $1,529,250 in a Sinking Fund for the purpose of paying the interest and principal of the Series of 1993 Bonds, which were called for redemption on December 1, 2003. This refunding was undertaken to reduce total debt service payments over the next ten years by approximately $60,000, which was the approximate amount of the economic gain.

The bonds have varying maturities from December 2003 to December 2013, with interest being paid semiannually on June 1 and December 1 at rates ranging from 2.00% to 4.00%.

Future annual principal and interest requirements to retire the general obligation bonds and notes are as follows:

| Year Ending December 31, | Principal | Interest | Totals |
|---|---|---|---|
| 2012 | $ 451,269 | $ 27,831 | $ 479,100 |
| 2013 | 283,925 | 7,414 | 291,339 |
| 2014 | 109,036 | 303 | 109,339 |
| 2015 | 217,060 | 111 | 217,171 |
| | $ 1,061,290 | $ 35,659 | $ 1,096,949 |

The annual debt service for the 2002 note is based on the annual debt service using the swap interest rate of 4.47%.

***Montgomery Township Municipal Sewer Authority***

The Sewer Authority issued $10,000,000 of Guaranteed Sewer Revenue Bonds, Series of 2001, dated November 15, 2001, to provide resources to fund various capital projects and to currently refund the Sewer Authority's outstanding Guaranteed Sewer Revenue Current Interest Bonds, Series A of 1991, in the amount of $2,115,000.

The Sewer Authority issued $9,340,000 of Guaranteed Sewer Revenue Bonds, Series of 2005, dated January 1, 2005, to currently refund the Sewer Authority's outstanding Guaranteed Sewer Revenue Bonds, Series of 2001, in the amount of $8,930,000.

In connection with the issuance of the 2005 Series Bonds, the Sewer Authority used funds it had available to purchase securities that were placed in an irrevocable trust for the purpose of generating resources for all future debt service payments on the Sewer Authority's 2001 Guaranteed Sewer Revenue Bonds. As a result, the 2001 Series Bonds are considered to be defeased, and the liability has been removed from the Sewer Authority's financial statements.

The 2005 Series Bonds were issued in denominations of $5,000 and have varying maturities from May 15, 2006 through May 15, 2021, with interest being paid semiannually on May 15 and November 15. Interest rates range from 2.00% to 4.25%.

The Township has guaranteed all principal and interest payments on the 2005 Series Bonds in the event the Sewer Authority does not meet its obligations.

In 2011, the Authority issued $6,765,000 of Guaranteed Sewer Revenue Bonds, Series of 2011, dated February 17, 2011, to currently refund the Sewer Authority's outstanding Guaranteed Sewer Revenue Bonds, Series of 2005, in the amount of $6,710,000.

In connection with the issuance of the 2011 Series Bonds, the Sewer Authority used funds it had available to purchase securities that were placed in an irrevocable trust for the purpose of generating resources for all future debt service payments on the Sewer Authority's Guaranteed Sewer Revenue Bonds, Series of 2005. As a result, the 2005 Series Bonds are considered to be defeased, and the liability has been removed from the Sewer Authority's financial statements. The transaction resulted in an economic gain of $181,913 and a reduction of $175,362 in future debt service payments.

The 2011 Series Bonds were issued in denominations of $5,000 and have varying maturities from May 15, 2011 through November 15, 2021, with interest being paid semiannually on May 15 and November 15. Interest rates range from .75% to 4.00%.

The Township has guaranteed all principal and interest payments on the 2011 Series Bonds in the event the Sewer Authority does not meet its obligations.

The following is a summary of changes in long-term debt for the Sewer Authority for the year ended December 31, 2011:

| | Balance Outstanding January 1, 2011 | Additions | Principal Retired | Balance Outstanding December 31, 2011 | Due Within One Year |
|---|---|---|---|---|---|
| SEWER AUTHORITY | | | | | |
| Bonds | | | | | |
| 2005 Series Bonds | $ 6,710,000 | $ - | $ (6,710,000) | $ - | $ - |
| 2011 Series Bonds | - | 6,765,000 | (325,000) | 6,440,000 | 550,000 |
| Deferred amounts | | | | | |
| 2005 issuance discounts | (23,009) | - | 23,009 | - | - |
| 2005 loss on refunding | (372,722) | - | 372,722 | - | - |
| 2011 issuance premium | - | 144,145 | (14,414) | 129,731 | - |
| 2011 loss on defeasance | - | (552,188) | 55,218 | (496,970) | - |
| TOTAL BONDS | 6,314,269 | 6,356,957 | (6,598,465) | 6,072,761 | 550,000 |
| Compensated absences | - | 43,372 | - | 43,372 | - |
| TOTAL LONG-TERM LIABILITIES | $ 6,314,269 | $ 6,400,329 | $ (6,598,465) | $ 6,116,133 | $ 550,000 |

Future principal maturities and scheduled interest payments of the 2011 Series Bonds outstanding are as follows:

| Year Ending December 31, | Principal | Interest | Totals |
|---|---|---|---|
| 2012 | $ 550,000 | $ 197,748 | $ 747,748 |
| 2013 | 570,000 | 185,573 | 755,573 |
| 2014 | 590,000 | 167,723 | 757,723 |
| 2015 | 605,000 | 146,323 | 751,323 |
| 2016 | 630,000 | 122,716 | 752,716 |
| Thereafter | 3,495,000 | 286,485 | 3,781,485 |
| | $ 6,440,000 | $ 1,106,568 | $ 7,546,568 |

## NOTE E DERIVATIVE INSTRUMENTS - INTEREST RATE HEDGE SWAP

***GASB Statement No. 53, Accounting and Financial Reporting for Derivative Instruments***

The Township adopted GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, for the year ended December 31, 2011. Upon implementation of this statement, the Township was required to record the derivative instrument in the government-wide financial statements.

In order to implement this statement, the Township had to evaluate the derivative to determine if the financial instruments effectively hedge risks utilizing the methods defined under GASB Statement No. 53. The accounting for recording these derivative instruments is different for derivative instruments that are determined to be effective versus those that are determined to be ineffective. For those derivative instruments that are determined to be effective, the derivative asset or liability is recorded in the statement of net assets, and a corresponding deferred inflow or outflow will be recorded in the statement of net assets as well. For those derivative instruments that are determined to be ineffective, the derivative asset or liability is recorded in the statement of net assets; however, the change in fair value of the instrument will be reported in the investment revenue (expense) classification in the statement of activities.

Hedge accounting under GASB Statement No. 53 terminates if the hedge is no longer effective based on the qualitative and quantitative methods. If the hedged asset or liability is sold or retired, or if the government entity is re-exposed to the hedged financial risk, hedge accounting will no longer apply. Once the hedge no longer qualifies for hedge accounting, the fair value changes are recorded as investment gain or loss.

***Interest Rate Hedge Swap***

***Interest Rate Hedge Swap, Series of 2002*** - On December 4, 2002, the Township entered into an interest rate swap agreement (the "2002 Note Swap") with Sovereign Bank (the "Swap Provider") having a commencement date of December 4, 2002, to coincide with the issuance of the 2002 Series Note and having a term ending on December 4, 2012, which was the final maturity date of the 2002 Series Note.

The Authority has entered into the swap for the purpose of creating a synthetic fixing of the interest rate obligation of the 2002 Series Note, subject to the inherent risks associated with the 2002 Note Swap.

As of December 31, 2011, the Series of 2002 Interest Rate Hedge Swap was active as disclosed in the following paragraphs.

The Interest Rate Hedge Swap on the 2002 Series Note became active on December 4, 2002. Under this agreement, the Township will pay a fixed rate of interest equal to 4.47% under the 2002 Note Swap and receive in exchange a variable rate of interest equal to 70% of the 30-day London Interbank Offered Rate (LIBOR) plus 1.75%, on the initial notional amount of $725,000, which will be reduced annually. The variable rate received by the Township will be used by the Township to offset the variable rate interest on its 2002 Series Note, thereby making the interest rate on the 2002 Series Note "synthetically" fixed on a "net basis" through the 2002 Note Swap.

As of December 31, 2011, the counterparty was rated A+ by Standard & Poor's, Aa3 by Moody's Investors Service and A by Fitch.

The objectives, terms and values of the three hedging derivatives outstanding at the end of the period are summarized as follows:

| Type | Objective | Fair Market Value of Derivative at December 31, 2011 Positive (Negative) | Notional Amount as of December 31, 2011 | Note Outstanding at December 31, 2011 | Effective Date | Termination Date | Terms |
|---|---|---|---|---|---|---|---|
| 2002 Pay-fixed interest rate swap | Hedge changes in cash flows on 2002 Series Note | $ (4,043) | $ 172,457 | $ 172,457 | December 4, 2002 | December 4, 2012 | Pay 4.47%; receive variable rate equal to 70% of 30-day LIBOR plus 1.75% |

The derivative instrument activity during the reporting period and balances at the end of the period are summarized below.

***Change in Fair Value for the Period Ended December 31, 2011***

| | Classification | Amount |
|---|---|---|
| Cash flow hedges, 2002 pay-fixed interest rate swap | Deferred inflow | $ 6,002 |

***Fair Value at December 31, 2011***

| | Classification | Fair Value Positive (Negative) | Notional Amount |
|---|---|---|---|
| Cash flow hedges, 2002 pay-fixed interest rate swap | Debt | $ (4,043) | $ 172,457 |

***Fair Market Value Determination*** - The fair value of the interest rate swap was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

***Evaluation of Effectiveness and Recording of Derivative*** - The Township evaluated the hedge effectiveness for the interest rate swap described previously under the methods as defined by GASB Statement No. 53. The interest rate swap for the 2002 Series Note was determined to be effective under the synthetic instrument method. The synthetic instrument method combines the net cash flows from the derivative with the variable cash flows of the hedged item to simulate a third synthetic instrument. The synthetic rate is calculated based on the combined cash flows and is compared against the fixed rate on the derivative. If the synthetic rate is not less than 90% or no greater than 111% of the fixed rate on the derivative, the hedge passes the test and is considered effective. The interest rate swap for the 2002 Series Note was determined to be effective under the regression analysis method. The regression analysis method measures the relationship between the fair value or cash flows of the potential hedging derivative and the hedgeable item. In order for the interest rate swap to be effective, certain statistical criteria must be met to demonstrate that the changes in cash flows or fair values of the potential hedging derivative substantially offset the changes in cash flows or fair values of the hedgeable item.

The derivative described above was determined to be effective and the fair market value of the interest rate swap was a negative ($4,043) as of December 31, 2011. Therefore, pursuant to GASB Statement No. 53, the instrument was recorded in the government-wide statement of net assets as a liability and a corresponding deferred outflow was recorded.

***Swap Payments and Associated Debt*** - As of December 31, 2011, debt service requirements of the Series of 2008 Bonds were as follows:

**2002 Series Note**

| Year Ending December 31, | Principal | Interest |
|---|---|---|
| 2012 | $ 172,457 | $ 6,047 |

Assumptions:

(1) Bond interest based on a rate of 4.47% as of December 31, 2011.

***Risks Associated With Interest Rate Hedge Swap***

**Credit Risk** - As of December 31, 2011, the Township is not exposed to credit risk since the interest rate hedge swap has negative value and therefore is a liability. However, should interest rates change and the net fair market value of the interest rate hedge swap become positive, the Township would be subject to credit risk in the amount of the net fair market value.

**Interest Rate Risk** - As of December 31, 2011, the Township is exposed to interest rate risk on its pay-fixed, receive-variable interest rate swap; as the LIBOR index decreases, the Township's net payment on the swap increases.

**Basis Risk** - The Township's variable rate note interest payments are equivalent to the amounts received under its swap agreement. However, the interest rate on its note payable shall not exceed 5.75% per year. If a change occurs that results in the variable rate received exceeding the maximum variable rate on the note payable of 5.75%, there may be a cost savings.

**Termination Risk** - The Township or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. If, at the time of termination, the swap has a negative fair value, the Township would be liable to the counterparty for a payment equal to the swap's fair value.

## NOTE F FUND BALANCE

As of December 31, 2011, the Township has adopted GASB Statement No. 54, which redefined how fund balances of the Governmental Funds are presented in the financial statements. Fund balances are classified as follows:

- ***Nonspendable*** - Amounts that cannot be spent either because they are not in a spendable form or because they are legally or contractually required to be maintained intact.
- ***Restricted*** - Amounts that can be spent only for specific purposes because of state or federal laws or externally imposed conditions by grantors or creditors.
- ***Committed*** - Amounts that can be used only for specific purposes determined by a formal action by a Board of Supervisors resolution. This includes the budget reserve account.
- ***Assigned*** - Amounts that are intended to be used for a specific purpose, as expressed by the Board of Supervisors or by an official or body to which the Board of Supervisors delegates the authority.
- ***Unassigned*** - All amounts not included in other spendable classifications.

The details of the fund balances are included in the Governmental Funds balance sheet (page 30). As discussed in Note A, restricted funds are used first as appropriate, followed by committed resources and then assigned resources, to the extent that expenditure authority has been budgeted by the Board of Supervisors. The Township does reserve the right to first reduce unassigned fund balance to defer the use of these other classified funds. In the event that unassigned fund balance becomes zero, then assigned and committed fund balances are used in that order.

## NOTE G POLICE PENSION PLAN

***Summary of Significant Accounting Policies***

Financial information of the Township's Police Pension Plan is presented on the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to each plan are recognized when due as required by the Act. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Investments are reported using an asset smoothing method. This method calculates investments as the fair market value of assets as of the most recent actuarial valuation, adjusted by a weighted average of the unrealized gains and losses of the last three years.

***Plan Description***

The Montgomery Township Police Pension Plan (the "Plan") is a single-employer public employee retirement system (PERS) established by the Township to provide pension benefits for its full-time sworn police officers working at least 40 hours per week. The Plan is managed and administered by the Township's Board of Supervisors with the assistance of an independent investment management company. The PERS Plan is part of the Township's financial reporting entity and is included in the Township's financial statements as a Pension Trust Fund. The Plan does not issue separate, stand-alone financial statements.

The Plan provides retirement benefits to participating employees. Retirement benefits vest after 12 years of service. Employees who retire at or after age 50 with 25 years of credited service are entitled to an annual retirement benefit, payable monthly for life, in an amount equal to 50% of their average compensation. Average compensation is the employee's average monthly compensation (defined as base and longevity wages) on the 36 latest compensation dates.

The Plan also provides certain death and disability benefits to participating employees who have met retirement eligibility requirements and to their dependents when the cause of death or disability is employment related. The amount and/or duration of these benefits depend upon the circumstances of the death or disability.

At January 1, 2011, the date of the most recent actuarial valuation, participants in the Plan consisted of:

| | |
|---|---|
| Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them | 10 |
| Disabled participants | 2 |
| Current employees | |
| Vested | 17 |
| Nonvested | 13 |
| TOTAL MEMBERSHIP | 42 |

The Township follows GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. Under GASB Statement No. 25, a financial reporting framework is established for reporting of defined benefit pension plans, which requires the Township to present a statement of plan assets, a statement of changes in plan assets, a schedule of funding progress and a schedule of employees' contributions. Under GASB Statement No. 27, the Township is required to measure and disclose an amount for annual pension cost on the accrual basis of accounting equal to the Township's annual required contributions to the Plan unless the employee has a net pension obligation for past under or over contributions.

***Funding Policy and Contribution Information***

The authority under which obligations to contribute to the Police Pension Plan by the Plan members, employer and other contributing entities are established or may be amended include Act 600 and Act 205 (the "Act") of the Commonwealth of Pennsylvania and Montgomery Township Ordinances. The Act requires that annual contributions be based upon the calculation of the minimum municipal obligation (MMO). The MMO is based upon the biennial actuarial valuation.

As a condition of participation, participants are required to make weekly contributions to the Plan. The amount of the contribution is equal to 5% of the participant's base and longevity pay. The participant's pay is the fixed rate of pay in effect on the first day of the contract year. If the Plan actuary finds that the participants' contributions are no longer needed to fund the Plan, the Township may reduce or eliminate these required contributions.

The Township allocates state aid received from the Commonwealth of Pennsylvania to the Plan. On-behalf payments of fringe benefits and salaries for the government's employees were recognized as revenues and expenditures/expenses during the period. To the extent that these fundings are not adequate, the Township would then be required to contribute. In accordance with Act 205, the Township was required to contribute $432,497 to the Plan for the year 2011. The Township's actual contributions for the Plan year 2011 were $432,497.

***Financial Requirement and Minimum Municipal Obligation Budget for 2011***

| | | |
|---|---|---|
| Normal cost | $ | 316,262 |
| Estimated administrative expenses | | 27,264 |
| Estimated member contributions | | (140,831) |
| Amortization requirement | | 229,802 |
| MINIMUM MUNICIPAL OBLIGATION | $ | 432,497 |
| ACTUAL FUNDS DEPOSITED INTO PLAN | $ | 432,497 |
| STATE AID PORTION OF FUNDS DEPOSITED | $ | 410,011 |

***Annual Pension Cost***

The Plan's annual pension cost for the current year and related information are as follows:

| | |
|---|---|
| Contribution rates | |
| Municipal | 17% |
| Plan members | 5% |
| Annual pension cost (MMO) | $432,497 |
| State contributions made | $410,011 |

***Three-Year Trend***

| Year Ended December 31, | Annual Pension Cost (APC) | Percentage of APC Contributed | Net Pension Obligation |
|---|---|---|---|
| 2009 | $ 377,294 | 100% | $ - |
| 2010 | 371,881 | 100% | - |
| 2011 | 432,497 | 100% | - |

***Funded Status and Funding Progress***

As of January 1, 2011, the most recent actuarial valuation date, the plan was 82.1% funded. The actuarial accrued liability for benefits was $12.4 million and the actuarial value of assets was $10.2 million, resulting in an unfunded actuarial accrued liability (UAAL) of $2.2 million. The covered payroll (annual payroll of active employees covered in the plan) was $2.6 million, and the ratio of the UAAL to the covered payroll was 86.8%.

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the AALs for benefits.

Additional information as of the latest actuarial valuation for the plan follows:

| | |
|---|---|
| Valuation date | January 1, 2011 |
| Actuarial cost method | Entry age normal |
| Amortization method | Level dollar, closed |
| Remaining amortization period | 9 years |
| Asset valuation method | 4-year smoothing |
| Actuarial assumptions | |
| Investment rate of return | 4% |
| Projected salary increases | 6% |
| Inflation rate | Based on long-term average rates |

***Investments that Represent 5% or More of Net Assets Available for Benefits***

At December 31, 2011, there were no investments in any one organization that represented 5% or more of total plan assets available for benefits other than mutual funds, which do not require disclosure of concentration per GASB Statement No. 40.

## NOTE H NON-UNIFORM EMPLOYEE PENSION PLAN

***Plan Description***

The Township has established the Montgomery Township Non-Uniform Employee Pension Plan (the "Plan"), which provides pension benefits for its full-time, non-uniform employees and its part-time, non-uniform employees working initially at least 1,000 hours per year. The Plan is a single-employer defined contribution money purchase pension plan under Section 401(a) of the Internal Revenue Code. In a defined contribution plan, the benefits to be received by an employee depend solely on the amount contributed to the participant's account and related returns on investments of those contributions. Benefits Consulting Group, Inc. serves as the third-party administrator for the Plan, maintaining records of individual account balances and administering receipt and payment of funds. All funds contributed by the employees and employer are invested with the American Funds through Smith Barney. The Plan does not issue separate, stand-alone financial statements.

***Funding Policy***

Each eligible employee who elects to be covered under the Plan must contribute 4% of gross wages. The Township contributes 8% of each participating employee's gross wages to the Plan. The contributions for employees and earnings allocated to their accounts are immediately vested. Retirement benefits may be obtained at age 55.

The Township made contributions of $213,683, of which $200,000 was funded by state-shared revenues and $13,683 was funded by the Township. Employee contributions to the plan were $106,841.

At December 31, 2011, there were no investments in any one organization that represented 5% or more of total plan assets available for benefits other than mutual funds, which do not require disclosure of concentration per GASB Statement No. 40.

## NOTE I DEFERRED COMPENSATION PLANS

***Montgomery Township***

The Township has a Deferred Compensation Plan (the "Plan") for its full-time and part-time permanent employees. The Plan, which is designed under the provisions of Section 457 of the Internal Revenue Code, permits employees to make voluntary contributions from their salary, which are excluded from federal taxable income. The Township contributes 1% to 7% of compensation to the Township Manager's and Department Heads' accounts based on completed years of service. Up to 25% of each participant's salary can be contributed and deferred under the Plan.

All amounts of compensation deferred under the Plan, all property and rights purchased with those amounts and all income attributable to those amounts, property, or rights are held in trust for the exclusive benefits of participants and their beneficiaries. The compensation deferred is managed by outside trustees under various investment options. As a result, the financial statements of the Deferred Compensation Plan are excluded from the accompanying financial statements.

***Montgomery Township Municipal Sewer Authority***

The Sewer Authority offers its employees a Deferred Compensation Plan (the "Plan") created in accordance with Internal Revenue Code Section 457. The Plan, available to full-time Sewer Authority employees, permits the employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. The compensation deferred is managed by an outside trustee under various investment options. The assets of the Plan are held in trust for the exclusive benefit of the Plan participants and their beneficiaries and shall not be diverted for any other purpose. As a result, the Sewer Authority excludes the financial statements of the Plan from its financial statements.

## NOTE J POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS (OPEB)

***Plan Description***

The Township provides medical, prescription drug, dental and vision insurance benefits to eligible retired police officers and spouses through a single-employer defined benefit plan. The plan is not accounted for as a trust fund, as an irrevocable trust has not been established to account for the plan. The plan does not issue a stand-alone financial report. The activity of the plan is reported in the Township's General Fund.

***Funding Policy***

The Township pays 75% of the total cost of the employee and spouse for the medical (PPO or HMO), prescription drug, dental and vision plans for the first five years. Thereafter, the Township will pay 75% of the fifth year premium and 50% of the premium increase for the sixth and succeeding years. Coverage will cease upon eligibility for Medicare. The costs of administering the plan are paid by the Township.

***Annual OPEB Cost and Net OPEB Obligation***

The Township's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The General Fund has been used to pay the net OPEB obligation in the past. The following shows the components of the Township's annual OPEB cost for the year, the amount actually contributed to the plan and changes in the Township's net OPEB obligation to the plan:

| | |
|---|---|
| Normal cost | $ 116,576 |
| Amortization of unfunded actuarial accrued liability | 141,722 |
| ANNUAL REQUIRED CONTRIBUTION (ARC) | 258,298 |
| Interest on net OPEB obligation | 24,990 |
| Adjustment to ARC | (34,093) |
| ANNUAL OPEB EXPENSE | 249,195 |
| Net OPEB contributions during the year | (84,281) |
| INCREASE IN NET OPEB OBLIGATION | 164,914 |
| Net OPEB obligation at beginning of year | 555,342 |
| NET OPEB OBLIGATION AT END OF YEAR | $ 720,256 |

| Year | Annual OPEB Cost | Percentage of Annual OPEB Cost Contributed | Net OPEB Obligation |
|---|---|---|---|
| 2009 | $ 242,343 | 28.69% | $ 368,901 |
| 2010 | 252,252 | 26.08% | 555,342 |
| 2011 | 249,195 | 33.82% | 720,256 |

***Funded Status and Funding Progress***

As of January 1, 2010, the most recent actuarial valuation date, the actuarial accrued liability for benefits was $2,308,499 and the actuarial value of assets was $0, all of which was unfunded. The covered payroll (annual payroll of active employees covered by the plan) was $2,943,079, and the ratio of the UAAL to the covered payroll was 78.44%.

The projection of future benefit payments for an ongoing plan involves estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

***Methods and Assumptions***

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the January 1, 2010 actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 4.5% investment rate of return (net of administrative expenses), which is a blended rate of the expected long-term investment returns on plan assets and on the employer's own investments calculated based on the funded level of the plan at the valuation date, and an annual medical inflation rate of 7.5%, reduced by decrements of .5% to an ultimate rate of 5.5% in 2014. The UAAL is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at December 31, 2010, was 28 years.

## NOTE K LEASE

A lease agreement dated May 15, 1965, was executed between the Township and the Sewer Authority. Terms of the lease, which expire May 15, 2021, require the Township to lease the "sewage system" from the Sewer Authority. The lease agreement was amended on April 15, 1970, March 15, 1988, December 1, 1991, November 15, 2001 and January 1, 2005.

Under the lease, the Township is committed to make payments to the Sewer Authority in the event that sewer revenues are insufficient to cover operating and administrative expenses plus 110% of the required amount to be transferred to the Sewer Authority's Debt Service Fund, as required in the Sewer Authority's 2005 Trust Indenture.

As of December 31, 2011, sewer revenues exceeded sewer expenditures, and the Township has not been required to make the above-noted rental payments to the Sewer Authority. Additionally, the Sewer Authority's consulting engineer has estimated that the net revenues to be received from the sewer system will be sufficient to pay the debt service requirements on the bonds when due.

The lease allows the Township to exercise an option to delegate the operation of the sewage system, together with the performance of any of the obligations under the lease, to an independent entity. The Township, however, is to remain liable for the due and proper performance of its obligations under the lease. Pursuant to an operating agreement dated May 15, 1965, the Township has delegated the operation of the sewer system to the Sewer Authority and has discharged all of its obligations under the sewage system leases with regard to the operation of the sewage system to the extent that revenues derived from the operation satisfy current operating expenditures.

## NOTE L FIRE SERVICES AGREEMENT

As discussed in Note A, during 2003, the Township entered into a Fire Services Agreement (the "Agreement") with the Fire Department. Among other things under the Agreement, the Fire Department agreed to recruit qualified volunteers and to provide fire protection and related services to the Township during the term of the Agreement. The Agreement continues on a year-to-year basis, unless terminated by either party. The Agreement may be terminated by the Township upon 120 days advance written notice to the Fire Department and may be terminated by the Fire Department upon 180 days advance written notice to the Township.

## NOTE M AGREEMENT WITH HATFIELD TOWNSHIP MUNICIPAL AUTHORITY

The Sewer Authority has entered into an agreement with the Hatfield Township Municipal Authority ("Hatfield") whereby Hatfield agrees to accept sewage for treatment from the Sewer Authority's collection system. The agreement provides for the payment of a deferred capacity charge resulting in the Sewer Authority owning 1/3 of the capacity of the Hatfield Sewage Treatment Plant. The agreement also provides for a new expansion and upgrading of the treatment plant.

The Sewer Authority pays to Hatfield, in quarterly installments, an Annual Operating Charge, which is the Sewer Authority's pro rata share of the net operating and maintenance expense of the Hatfield Sewage Treatment Plant. The 2011 expenses were $917,439. In addition, the Sewer Authority pays a Semi-Annual Lease Rental Charge representing its pro rata share of Hatfield's annual debt service on bonds issued and attributable to Hatfield's 1970 project to increase the Sewer Authority's reserve capacity.

## NOTE N RISK MANAGEMENT

***Montgomery Township***

The Township is exposed to various risks of loss related to third-party liability claims, damage to and loss of Township-owned property, errors and omissions by public officials, injuries to employees and claims for medical benefits provided by the Township to its employees and dependents. As a method of financing these risks, the Township joined the Delaware Valley Insurance Trust (DVIT), Delaware Valley Workers' Compensation Trust (DVWCT) and the Delaware Valley Health Insurance Trust (DVHIT).

DVIT is an association of municipalities, which has formed a self-insurance risk-sharing pool. The pool covers the following risks: comprehensive general liability, business automobile liability, police professional liability, real and personal property liability and first party automobile physical damage. In addition, DVIT also purchases public employees blanket bond, crime, public officials and boiler/machinery coverage for the Township. DVIT is funded by annual contributions by its member municipalities, which are assessed at the beginning of each year. The Township's liability limits per incident range from $0 to $3,500, except for incidents involving floods, in which the Townships liability limits per incident is $25,000.

DVWCT is a regional municipal risk retention pool formed under the authority granted by the Pennsylvania Department of Labor and Industry, Bureau of Workers' Compensation. DVWCT provides a method of financing an employer's medical and indemnity obligations due to municipal employees under the Pennsylvania Workers' Compensation Act. For the pool coverage, there is a total risk and cost sharing for all participants. Liabilities in excess of assets of DVWCT may be assessed to participating members. Specific excess insurance is provided to protect against catastrophic losses. The Township does not have any claim liability in addition to premiums, unless an assessment is made by DVWCT.

DVHIT is an intergovernmental risk sharing pool authorized under the Pennsylvania Intergovernmental Cooperation Act. DVHIT serves as a vehicle to provide health insurance coverage to participating municipal employees and dependents. DVHIT acts as the primary administrator of the coverage and contracts with Aetna to provide substantially all services, including claims administration and payment processing, as well as network access services and reinsurance coverage. DVHIT maintains specific stop loss insurance/reinsurance coverage that limits losses on individual claims up to the maximum lifetime benefit of the plan. DVHIT may impose an assessment on current and former members to recover deficits.

There have been no significant reductions in insurance coverage during the year ended December 31, 2011, and settlements have not exceeded coverage in the past three years.

***Montgomery Township Municipal Sewer Authority***

The Sewer Authority is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; worker's compensation; healthcare costs; and natural disasters for which the Sewer Authority carries commercial insurance. There have been no significant reductions in coverage from the prior years, and settlements have not exceeded coverage in the past three years.

## NOTE O COMMITMENTS AND CONTINGENCIES

The Township has a number of tax assessment appeals pending before the Court of Common Pleas of Montgomery County. Management of the Township has indicated that no definitive opinion can be expressed as to the ultimate outcome of the litigation.

The Township is involved in various other legal matters. Management believes the outcome of any potential claims will not have a material effect on the financial statements.

## NOTE P COMBINING STATEMENTS OF FIDUCIARY FUNDS

The following is a combining schedule of fiduciary net assets for the Pension Trust Funds:

| | Police Pension Fund | Non-Uniform Employee Pension Fund | Total Pension Trust Funds |
|---|---|---|---|
| ASSETS | | | |
| Cash | $ 392,433 | $ - | $ 392,433 |
| Investments | | | |
| Stocks | 2,778,800 | - | 2,778,800 |
| Mutual funds | 6,835,471 | 3,575,076 | 10,410,547 |
| TOTAL ASSETS | $ 10,006,704 | $ 3,575,076 | $ 13,581,780 |
| LIABILITIES AND NET ASSETS | | | |
| LIABILITIES | | | |
| Accounts payable | $ 226,707 | $ - | $ 226,707 |
| NET ASSETS | | | |
| Held in trust for pension benefits | 9,779,997 | 3,575,076 | 13,355,073 |
| TOTAL LIABILITIES AND NET ASSETS | $ 10,006,704 | $ 3,575,076 | $ 13,581,780 |

The following is a combining schedule of changes in fiduciary net assets for the Pension Trust Funds:

| | Police Pension Fund | Non-Uniform Employee Pension Fund | Total Pension Trust Funds |
|---|---|---|---|
| ADDITIONS | | | |
| Plan member contributions | $ 143,654 | $ 106,841 | $ 250,495 |
| Employer contributions | 22,486 | 13,683 | 36,169 |
| Other contributions | | | |
| Commonwealth of Pennsylvania | 410,011 | 200,000 | 610,011 |
| TOTAL CONTRIBUTIONS | 576,151 | 320,524 | 896,675 |
| Investment earnings (loss) | | | |
| Interest income | 227,857 | 68,084 | 295,941 |
| Loss on investments | (280,335) | (73,336) | (353,671) |
| Investment expenses | (31,038) | (1,070) | (32,108) |
| INVESTMENT EARNINGS (LOSS), net | (83,516) | (6,322) | (89,838) |
| TOTAL ADDITIONS | 492,635 | 314,202 | 806,837 |
| DEDUCTIONS | | | |
| Employee benefit payments | 433,799 | 101,345 | 535,144 |
| CHANGE IN NET ASSETS | 58,836 | 212,857 | 271,693 |
| NET ASSETS AT BEGINNING OF YEAR | 9,721,161 | 3,362,219 | 13,083,380 |
| NET ASSETS AT END OF YEAR | $ 9,779,997 | $ 3,575,076 | $ 13,355,073 |