



# **Water Utility Fund of the City of Norfolk, Virginia**

Financial and Compliance Report  
Year Ended June 30, 2010

# Water Utility Fund of the City of Norfolk, Virginia

Financial and Compliance Report  
Year Ended June 30, 2010

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KPMG LLP  
Suite 1900  
440 Monticello Avenue  
Norfolk, VA 23510

## Independent Auditor's Report

The Honorable Members of the City Council  
Water Utility Fund of the City Norfolk, Virginia:

We have audited the accompanying statement of net assets of the Water Utility Fund of the City of Norfolk, Virginia (the Fund), as of and for the year ended June 30, 2010 and 2009, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of the management of the City of Norfolk. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *Specifications for Audits of Counties, Cities and Towns* (Specifications), issued by the Auditor of Public Accounts of the Commonwealth of Virginia. Those standards and specifications require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note 1 to the financial statements, the accompanying financial statements present only the Water Utility Fund and do not purport to, and do not, present fairly the financial position of the City of Norfolk, Virginia, the changes in its financial position or its cash flows, where applicable, in conformity with U.S. generally accepted accounting policies.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Fund of the City of Norfolk, Virginia as of June 30, 2010 and 2009, and changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

The Fund has not presented Management's Discussion and Analysis that U.S. generally accepted accounting principles has determined is necessary to supplement, although not be a part of, the financial statements.

Our audits were conducted for the purpose of forming an opinion on the financial statements of the Fund, taken as a whole. The supplemental schedule is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audits of the financial statements and, in our opinion, is fairly stated, in all material respects in relation to the financial statements taken as a whole.



In accordance with *Government Auditing Standards*, we have also issued our report dated January 14, 2011 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

KPMG LLP

January 14, 2011

Water Utility Fund of the City of Norfolk, Virginia  
*Statements of Net Assets*  
June 30, 2010 and 2009

	2010	2009
<b>ASSETS</b>		
Current assets:		
Cash and short term investments	\$ 32,855,827	\$ 29,216,859
Receivables:		
Accounts (net)	8,680,574	9,157,426
Unbilled accounts	5,899,822	4,226,869
Accrued investment income	3,242	6,108
Other receivables	-	115,000
Inventories	1,539,030	1,627,194
Restricted cash held in escrow	126,638	114,904
Restricted short term investments:		
Restricted investment held with fiscal agent	9,246,492	8,279,648
Reserve funds	14,735,202	12,759,726
Investment restricted for construction	-	17,014,387
Total current assets	<u>73,086,827</u>	<u>82,518,121</u>
Capital assets:		
Non-depreciable assets	36,630,843	34,348,717
Depreciable assets	561,637,712	548,374,786
Accumulated depreciation and amortization	(155,720,259)	(144,750,965)
Total noncurrent assets	<u>442,548,296</u>	<u>437,972,538</u>
Total assets	<u>515,635,123</u>	<u>520,490,659</u>
<b>LIABILITIES</b>		
Current liabilities:		
Vouchers payable	987,465	980,514
Vouchers payable for CIP projects	2,222,432	2,094,902
Contract retainage	475,890	794,072
Accrued interest	161,252	112,682
Accrued payroll	280,507	281,198
Due to General Fund and other funds	534,574	3,369,643
Payable to employees' retirement system	2,170,730	1,696,500
Compensated absences	664,254	656,331
Current portion of bonds payable	12,697,993	12,232,578
Accrued revenue bond interest payable	2,598,695	2,655,047
Other liabilities	862,105	1,160,744
Total current liabilities	<u>23,655,897</u>	<u>26,034,211</u>
Noncurrent liabilities:		
General obligation bonds payable	3,759,419	6,594,840
Revenue bonds payable	291,435,604	300,897,242
Liability for other postemployment benefits (OPEB)	830,437	466,000
Compensated absences	433,910	341,367
Other long-term liabilities	-	640,000
Total noncurrent liabilities	<u>296,459,370</u>	<u>308,939,449</u>
Total liabilities	<u>320,115,267</u>	<u>334,973,660</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	134,655,280	135,262,265
Restricted	24,108,332	14,769,879
Unrestricted	36,756,244	35,484,855
	<u>\$ 195,519,856</u>	<u>\$ 185,516,999</u>

See Notes to Financial Statements

Water Utility Fund of the City of Norfolk, Virginia

*Statements of Revenues, Expenses and Changes in Net Assets*  
 Years Ended June 30, 2010 and 2009

	2010	2009
Operating revenues:		
Charges for services	\$ 78,982,990	\$74,453,906
Miscellaneous	3,161,097	2,666,962
Total operating revenues	<u>82,144,087</u>	<u>77,120,868</u>
Operating expenses:		
Personnel services	14,284,882	13,972,816
Plant operations	5,896,843	6,844,241
Chemicals	3,761,744	4,963,652
Provision for bad debts	301,294	419,459
Depreciation and amortization	11,494,781	11,335,890
Retirement contribution	2,170,730	2,126,353
OPEB expense	364,437	114,492
Administrative expenses	1,563,029	1,710,050
Other	8,935,390	10,656,564
Total operating expenses	<u>48,773,130</u>	<u>52,143,517</u>
Operating income	33,370,957	24,977,351
Nonoperating revenue (expenses):		
Interest income, net of interest capitalized	325,933	899,684
Interest expense and fiscal charges	(15,543,012)	(14,826,222)
Gain (Loss) on sale or disposal of assets	2,842,616	(20,392)
Total nonoperating expenses	<u>(12,374,463)</u>	<u>(13,946,930)</u>
Net income before contributions and transfers	20,996,494	11,030,421
Capital contributions	366,363	503,658
Transfers out	(11,360,000)	(8,500,000)
Change in net assets	<u>10,002,857</u>	<u>3,034,079</u>
Total net assets - beginning	185,516,999	182,482,920
Total net assets - ending	<u>\$ 195,519,856</u>	<u>\$185,516,999</u>

See Notes to Financial Statements

Water Utility Fund of the City of Norfolk, Virginia

*Statements of Cash Flows*

Years Ended June 30, 2010 and 2009

	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Receipts from customers	\$ 80,761,692	\$ 75,869,912
Payments to suppliers	(9,563,472)	(12,102,164)
Payments to employees	(15,881,607)	(15,686,553)
Other payments	(11,437,058)	(14,711,524)
Net cash provided by operating activities	<u>43,879,555</u>	<u>33,369,671</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>		
Internal activity, payments to other funds	(2,835,069)	1,271,964
Transfers out	(11,360,000)	(8,500,000)
Net cash used by noncapital financing activities	<u>(14,195,069)</u>	<u>(7,228,036)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATING FINANCING ACTIVITIES:</b>		
Proceeds from sale of debt	-	3,700,816
Proceeds from sale of Fixed Assets	2,860,000	-
Capital contributions	366,363	503,658
Purchases of capital assets	(16,278,575)	(11,748,215)
Refunding of debt principal	-	(3,708,424)
Principal paid on capital debt	(12,232,578)	(11,807,732)
Interest paid and bond service charges	(15,149,860)	(15,877,862)
Net cash provided (used) by capital and related financing activities	<u>(40,434,650)</u>	<u>(38,937,759)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sale of investments	57,350,804	14,810,424
Purchase of investments	(30,278,737)	(9,395,451)
Purchase of certificates of deposit	(13,000,000)	-
Interest and dividends	328,799	1,014,374
Net cash provided (used) by investing activities	<u>14,400,866</u>	<u>6,429,347</u>
Net increase in cash and cash equivalents	3,650,702	(6,366,777)
Cash and cash equivalents - beginning of year	29,331,763	35,698,540
Cash and cash equivalents - end of year	<u>\$ 32,982,465</u>	<u>\$ 29,331,763</u>

(Continued)

Water Utility Fund of the City of Norfolk, Virginia

*Statements of Cash Flows (Continued)*

Years Ended June 30, 2010 and 2009

**Reconciliation of Operating Income to Net Cash**

**Provided by Operating Activities:**

Operating income	\$ 33,370,957	\$ 24,977,351
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense	11,494,781	11,335,890
Provision for bad debt	301,294	419,459
Change in assets and liabilities:		
Accounts receivable (net), billed and unbilled	(1,497,395)	(1,365,956)
Other receivables	115,000	115,000
Inventories	88,164	89,019
Vouchers payable	6,951	(383,290)
Accrued payroll	574,005	635,148
Other liabilities	(574,202)	(2,452,950)
Net cash provided by operating activities	<u>\$ 43,879,555</u>	<u>\$ 33,369,671</u>

**Reconciliation of cash and short term investments to the statement of net assets:**

Cash and short term investments	\$ 32,855,827	\$ 29,216,859
Restricted cash held in escrow	126,638	114,904
Total cash and short term investments per statement of net assets	<u>\$ 32,982,465</u>	<u>\$ 29,331,763</u>

**Noncash investing, capital and financing activities:**

Gain (loss) on sale or disposal of capital assets	\$ 2,842,616	\$ (20,392)
Acquisition of capital assets through change in contract retainage	\$ (318,182)	\$ 142,971
Acquisition of capital assets through change in vouchers payable	\$ 127,530	\$ 1,405,011
Capitalized interest	<u>\$ 1,195,740</u>	<u>\$ 897,276</u>

See Notes to Financial Statements

## Water Utility Fund of the City of Norfolk, Virginia

### Notes to Financial Statements

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#### Note 1. Summary of Significant Accounting Policies

The Water Utility Fund (the "Fund") was established at the direction of Norfolk City Council as an enterprise fund on July 1, 1979. The Fund accounts for the provision of water services to City of Norfolk (the "City") residents, municipal customers and others outside the City. Activities necessary to provide water services, including operations, maintenance, financing and related debt service, and billing and collection, are accounted for in the Fund. Although separate financial statements have been presented for the Fund, it is also included in the City of Norfolk's Comprehensive Annual Financial Report as a major Enterprise Fund.

A summary of the Fund's significant accounting policies is as follows:

Basis of accounting: The financial statements are presented on the accrual-basis of accounting, wherein revenues are recognized in the accounting period in which they are earned and expenses are recognized in the accounting period in which the related liabilities are incurred. The Fund adopted Statement No. 20 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. Accordingly, the Fund has elected not to apply Statements and Interpretations issued by the Financial Accounting Standards Board after November 30, 1989.

Deposits and Investments: The Fund's cash and short-term investments include cash on hand, demand deposits, and short-term investments with original maturities of one year or less from the date of acquisition.

Investments of the Fund are stated at fair value. Short-term investments are recorded at cost, which approximates fair value. The fair value of the State Treasurer's Local Government Investment Pool (LGIP) is the same as the value of the pool shares. The LGIP is not registered with the Securities and Exchange Commission (SEC) as an investment company, but maintains a policy to operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. The external investment pool is administered by the Treasury Board of Virginia. Other investments are stated at their fair value. Securities traded on a national securities exchange are valued at the last reported sales price on the last business day of the fiscal year. Investments that do not have an established market are reported at estimated fair value, primarily net asset value determined based on the fair value of the underlying securities. These investments are reported in the accompanying financial statements as cash and short-term investments, unless the original investment period exceeded one year, in which case they are reported as investments.

Investment income includes both realized and unrealized gain and loss components.

Accounts receivable: Accounts receivable are receivables due at the end of the fiscal year which have not been collected by year-end, net of allowance for doubtful accounts. The Fund determines past due status of individual water account receivables based on contractual terms and generally does not charge interest on past-due amounts. The Fund estimates its allowance for doubtful accounts based on a combination of factors, including the Fund's historical loss experience and any anticipated effects related to current economic conditions, as well as management's knowledge of the current composition of water receivables. Accounts that management believes to be ultimately not collectible are written off upon such determination. Unbilled accounts, net, are estimated at each fiscal year-end based on water usage by customers for whom billings have not yet been processed.

Inventories: Inventories are stated at the lower of cost (using the first-in, first-out method) or market.

## Water Utility Fund of the City of Norfolk, Virginia

### Notes to Financial Statements

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Restricted assets: Certain unspent proceeds of the revenue bonds as well as certain resources set aside for their repayment are classified as restricted assets on the statement of net assets because they are maintained in separate bank accounts and their use is limited by applicable bond covenants.

Capital assets: Capital assets are recorded at cost, less accumulated depreciation. Assets acquired prior to July 1977, for which historical cost records were not available, were appraised and valued at estimated historical cost by means of accepted-price-indexing methodology.

Depreciation: Depreciation is computed using the straight-line method over the following estimated useful lives:

	<u>Years</u>
Buildings and improvements	35 - 100
Transmission and distribution mains	40 - 100
Service meters and meter installation	35 - 50
Pumping and other water equipment	10 - 60
Furniture, fixtures and equipment	5 - 25
Intangible Assets	5 - 10

When an asset is retired or otherwise disposed of, the related cost and accumulated depreciation are eliminated from the accounts and any resulting gain or loss is reflected as nonoperating revenue or expense.

Interest costs incurred on funds borrowed for construction projects are capitalized, net of interest earned on the temporary investment of the unexpended portion of those funds.

The Fund evaluates prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. A capital asset is generally considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset. Impaired capital assets that will no longer be used by the government are reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government are measured using the method that best reflects the diminished service utility of the capital asset. Any insurance recoveries received as a result of impairment events or changes in circumstances resulting in the impairment of a capital asset are netted against the impairment loss.

Compensated absences: It is the Fund's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. Vacation leave is fully vested when earned by Fund employees. Sick leave does not vest for Fund employees; however, upon retirement, Fund employees receive credit for each day of accumulated sick leave toward their pension benefit. There is no liability for unpaid accrued sick leave service since the Fund does not pay when the employee separates from service.

Net assets: Net assets in the financial statements are classified as invested in capital assets, net of related debt; restricted; and unrestricted. Restricted net assets represent constraints on resources that are either externally imposed by creditors, grants, contributions, laws and regulations of other governments or imposed by law through state statute.

## Water Utility Fund of the City of Norfolk, Virginia

### Notes to Financial Statements

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Operating and nonoperating revenues: The Fund reports as operating revenues all charges for services generated through service fees and certain other miscellaneous revenues. Other revenues, including interest revenue and grants, are reported as nonoperating. When both restricted and unrestricted resources are available for use, the policy is to use restricted resources first, and then unrestricted resources as they are needed.

General allocations: The General Fund of the City provides administrative services to the Fund, which totaled \$2,064,197 and \$2,211,218 for the fiscal years ended June 30, 2010 and 2009, respectively. Charges for these services are treated as expenses by the Fund. In addition the Fund recorded, as other expenses, payments to the General Fund in lieu of taxes of \$2,710,608 and \$ 2,625,254 for the fiscal years ended June 30, 2010 and 2009, respectively.

Bond discount/premium: Discount and premium on bonds are amortized, using the effective-interest method, over the life of the debt and is included in interest expense.

Deferred gain (loss) on advance refunding: Gain (loss) on advance refunding is amortized, using the effective-interest method, over the shorter of the life of the refunded bonds or the life of the new bonds.

Estimates: The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Note 2. Cash and Investments

At June 30, 2010 and 2009, the Fund's cash and investments consist of the following:

	2010	2009
Investment in LGIP	\$ 18,504,273	\$ 16,008,394
Other investments	12,981,694	29,053,761
Certificates of deposit	22,000,000	9,000,000
Cash	3,478,192	13,323,369
	<u>\$ 56,964,159</u>	<u>\$ 67,385,524</u>
Cash and short term investments	\$ 32,855,827	\$ 29,216,859
Restricted cash held in escrow	126,638	114,904
Restricted cash and short term investments held with fiscal agent	9,246,492	8,279,648
Other restricted assets	14,735,202	29,774,113
	<u>\$ 56,964,159</u>	<u>\$ 67,385,524</u>

Deposits: All cash of the Fund is maintained in accounts collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 et. seq. of the Code of Virginia or covered by federal depository insurance.

## Water Utility Fund of the City of Norfolk, Virginia

### Notes to Financial Statements

The Fund's restricted assets on the statement of net assets include \$11,000,000 and \$9,000,000 of certificates of deposits at June 30, 2010 and 2009. These deposits have an original maturity of one year or less from the date of acquisition and therefore are classified as restricted short-term investments.

Investments: Statutes authorize the Fund to invest in obligations of the United States or agencies thereof, obligations of the Commonwealth of Virginia or political subdivisions thereof, obligations of the International Bank for Reconstruction and Development ("World Bank") and Asian Development Bank, the African Development Bank, commercial paper rated A-1 by Standard and Poor's or P-1 by Moody's Commercial Paper Record, banker's acceptances, repurchase agreements, and the State Treasurer's Local Government Investment Pool ("LGIP"), certain mutual funds, corporate notes, asset-backed securities, and savings accounts or time deposits.

The Fund has no formal policy regarding credit risk, interest rate risk, concentration of credit risk, custodial credit risk, or foreign investment risk.

The Fund had \$18,504,273 and \$16,008,394 deposited in the LGIP at June 30, 2010 and 2009, respectively, which carries a Standard and Poor's rating of AAAm which is included in cash and short-term investments.

The Fund's investments for the years ended June 30, 2010 and 2009, other than in LGIP, are categorized below to give an indication of the level of interest rate risk for each investment type by the entity at year-end.

Investment Type	Fiscal Year 2010		Fiscal Year 2009	
	Fair Value		Fair Value	
	Less than 1 year	1-5 years	Less than 1 year	1-5 years
SNAP Money Market Mutual Funds	\$ -	\$ -	\$ 17,014,387	\$ -
US Agency Notes	3,735,202	-	3,750,899	-
PFM Funds Government Series	9,246,492	-	8,288,475	-
	<b>\$ 12,981,694</b>	<b>\$ -</b>	<b>\$ 29,053,761</b>	<b>\$ -</b>

The Fund's rated debt investments, other than in LGIP, as of June 30, 2010 and 2009 were rated by Standard and Poor's and the ratings are presented below using the Standard and Poor's rating scale.

Investment Type	Fiscal Year 2010						Total
	AAA	AAAm	A-1+	AA+	AA	AA-	
Money Market Mutual Fund							
PFM Funds Government Series	\$ -	\$ 9,246,492	\$ -	\$ -	\$ -	\$ -	\$ 9,246,492
US Agency Notes	3,735,202						3,735,202
	<b>\$ 3,735,202</b>	<b>\$ 9,246,492</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 12,981,694</b>

## Water Utility Fund of the City of Norfolk, Virginia

### Notes to Financial Statements

Investment Type	Fiscal Year 2009						Total
	AAA	AAA <sub>m</sub>	A-1+	AA+	AA	AA-	
Money Market Mutual Funds							
SNAP Money Market Mutual Funds	\$ -	\$ 17,014,387	\$ -	\$ -	\$ -	\$ -	\$ 17,014,387
PFM Funds Government Series	-	8,288,475	-	-	-	-	8,288,475
US Agency Notes	3,750,899	-	-	-	-	-	3,750,899
	<u>\$ 3,750,899</u>	<u>\$ 25,302,862</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 29,053,761</u>

The Fund has combined amounts restricted for capital projects and amounts for which the nature of the transaction generated a related liability with amounts available for general operating use in the statements for the Fund. These amounts are not available to meet obligations arising from the operating activities of the Fund.

A summary of the liabilities payable from restricted assets at June 30, 2010 and 2009 is as follows:

	2010	2009
Accrued revenue bond interest payable	<u>\$ 2,598,695</u>	<u>\$ 2,655,047</u>

Certain of the Fund's cash and investments are combined with other City monies for investment purposes. These amounts were covered by federal depository insurance or collateralized in accordance with the Virginia Security for Public Deposits Act. Reference should be made to the Comprehensive Annual Financial Report of the City of Norfolk for further cash and investment disclosures.

#### Note 3. Accounts Receivable

Accounts receivable at June 30, 2010 and 2009 is comprised of the following:

	2010	2009
Governmental	\$ 2,585,981	\$ 3,120,938
Residential	2,761,497	2,979,731
Refuse disposal fees	3,172,769	3,111,652
Commercial	1,059,578	1,169,797
Utility taxes	699,839	783,255
Industrial	177,482	408,279
Other	1,063,735	996,793
	<u>11,520,881</u>	<u>12,570,445</u>
Less allowance for uncollectible accounts	<u>(2,840,307)</u>	<u>(3,413,019)</u>
	<u>\$ 8,680,574</u>	<u>\$ 9,157,426</u>

Utility taxes and refuse disposal fees receivable are remitted to the City's General Fund when collected.

## Water Utility Fund of the City of Norfolk, Virginia

### Notes to Financial Statements

#### Note 4. Unbilled Accounts Receivable

At June 30, 2010 and 2009, the Fund recognized \$5,899,822 and \$4,226,869 as unbilled accounts receivable, respectively. These amounts were billed in July 2010 and July 2009, respectively.

#### Note 5. Capital Assets

Capital assets at June 30, 2010 and 2009 are comprised of the following:

	Restated per GASB 51				Balance June 30, 2010
	Balance June 30, 2009	Additions	Retirements	Transfers	
<b>Nondepreciable assets:</b>					
Land	\$ 10,200,187	\$ -	\$ -	\$ 39,309	\$ 10,239,496
Intangible assets	2,304,237	-	-	-	2,304,237
Construction in progress	21,844,293	14,918,287	(702,423)	(11,973,047)	24,087,110
Total nondepreciable assets	34,348,717	14,918,287	(702,423)	(11,933,738)	36,630,843
<b>Depreciable &amp; amortized assets:</b>					
Buildings	178,822,669	-	-	-	178,822,669
Equipment	364,873,857	1,860,789	(531,601)	11,341,828	377,544,873
Intangible assets	4,678,260	-	-	591,910	5,270,170
Total	548,374,786	1,860,789	(531,601)	11,933,738	561,637,712
Less accumulated depreciation and amortization	(144,750,965)	(11,494,781)	525,487	-	(155,720,259)
Depreciable assets, net	403,623,821	(9,633,992)	(6,114)	11,933,738	405,917,453
Total capital assets, net	\$ 437,972,538	\$ 5,284,295	\$ (708,537)	\$ -	\$ 442,548,296

	Restated per GASB 51				Restated per GASB 51 Balance June 30, 2009
	Balance June 30, 2008	Additions	Retirements	Transfers	
<b>Nondepreciable assets:</b>					
Land	\$ 10,093,687	\$ -	\$ -	\$ 106,500	\$ 10,200,187
Intangible assets	2,268,737	35,500	-	-	2,304,237
Construction in progress	24,141,710	13,142,698	(1,837,213)	(13,602,902)	21,844,293
Total nondepreciable assets	36,504,134	13,178,198	(1,837,213)	(13,496,402)	34,348,717
<b>Depreciable assets:</b>					
Buildings	178,742,621	-	-	80,048	178,822,669
Equipment	352,075,785	1,073,551	(1,656,333)	13,380,854	364,873,857
Intangible assets	3,752,224	926,036	-	-	4,678,260
Total	534,570,630	1,999,587	(1,656,333)	13,460,902	548,374,786
Less accumulated depreciation and amortization	(135,042,141)	(11,335,890)	1,627,066	-	(144,750,965)
Depreciable assets, net	399,528,489	(9,336,303)	(29,267)	13,460,902	403,623,821
Total capital assets, net	\$ 436,032,623	\$ 3,841,895	\$ (1,866,480)	\$ (35,500)	\$ 437,972,538

## Water Utility Fund of the City of Norfolk, Virginia

### Notes to Financial Statements

During fiscal year 2010, the Fund implemented Governmental Accounting Standards Board (GASB) Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which addresses how to identify, account for, and report various intangible assets. The Fund applied the criteria of GASB Statement No. 51 and recorded nondepreciable intangible assets of \$2,304,237 as of June 30, 2010 and June 30, 2009. Depreciable intangible assets, net of accumulated amortization totaled \$3,372,752 and \$3,375,758 as of June 30, 2010 and 2009, respectively.

The Fund capitalized \$1,209,737 of interest expense and \$13,997 of interest income for the fiscal year ended June 30, 2010. For the fiscal year ended June 30, 2009, the Fund capitalized \$1,151,110 of interest expense and \$253,834 of interest income. The total interest cost was \$16,752,749 and \$15,977,332 for the fiscal year ended June 30, 2010 and 2009, respectively.

#### Note 6. Long-Term Obligations

General obligation bonds: A summary of general obligation bond transactions for the fiscal year ended June 30, 2010 and 2009 follows:

	2010	2009
General obligation bonds outstanding at July 1	\$ 9,532,260	\$ 13,297,600
Bonds retired/refunded	(2,812,578)	(7,466,156)
Bonds issued	-	3,700,816
Bonds outstanding at June 30	6,719,682	9,532,260
Unamortized discount/premium	(137,270)	(124,842)
General obligation bonds outstanding at June 30, adjusted for unamortized discount/premium	6,582,412	9,407,418
Less current portion	(2,822,993)	(2,812,578)
	<u>\$ 3,759,419</u>	<u>\$ 6,594,840</u>

Water utility general obligation bonds outstanding are comprised of the following individual issues:

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2010	2009
Series 1998 Refunding	06/15/1998	\$ 49,190,000	4.25 - 5.00%	-	\$ 1,320,556
Series 2002 Refunding	02/13/2002	47,200,000	2.00 - 5.00%	1,465,281	2,213,020
Series 2002B Refunding	11/01/2002	39,890,000	5.00 - 5.25%	807,316	840,102
Series 2004 Refunding	03/16/2004	96,395,000	2.00 - 5.00%	746,269	1,457,766
Series 2009 Refunding	5/21/2009	21,895,000	3.00 - 5.00%	3,700,816	3,700,816
Total Water Utility General Obligation Bonds				<u>\$ 6,719,682</u>	<u>\$ 9,532,260</u>

## Water Utility Fund of the City of Norfolk, Virginia

### Notes to Financial Statements

A summary of the requirements to amortize general obligation bonds outstanding at June 30, 2010 is as follows:

Year Ending June 30,	Principal	Interest
2011	\$ 2,822,993	\$ 304,804
2012	2,058,267	163,900
2013	739,589	82,154
2014	551,047	41,165
2015	547,786	13,695
	<u>\$ 6,719,682</u>	<u>\$ 605,718</u>

General obligation bonds are payable first from the revenue of the specific funds in which they are recorded; however, the full faith and credit of the City are pledged to the payment of the principal and interest on general obligation bonds.

Revenue bonds: A summary of revenue bond transactions for the fiscal year ended June 30, 2010 and 2009 follows:

	2010	2009
Revenue bonds outstanding at July 1	\$ 312,775,000	\$ 320,825,000
Bonds retired	(9,420,000)	(8,050,000)
Bonds outstanding at June 30	303,355,000	312,775,000
Less unamortized discount	(2,044,396)	(2,457,758)
Revenue bonds outstanding at June 30, adjusted for unamortized discount/premium	301,310,604	310,317,242
Less current portion	(9,875,000)	(9,420,000)
	<u>\$ 291,435,604</u>	<u>\$ 300,897,242</u>

Water utility revenue bonds outstanding are comprised of the following individual issues:

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2010	2009
Series 1993 Water Revenue	11/01/1993	\$ 68,430,000	2.80 - 5.375%	\$ 44,575,000	\$ 46,665,000
Series 1995 Water Revenue	08/15/1995	115,680,000	4.75 - 7.00%	84,425,000	87,535,000
Series 1998 Water Revenue and Refunding	11/01/1998	84,605,000	4.00 - 5.125%	66,095,000	68,150,000
Series 2001 Water Revenue and Refunding	10/15/2001	35,000,000	4.00 - 5.00%	29,660,000	30,425,000
Series 2005 Water Revenue and Refunding	03/23/2005	22,810,000	3.50 - 5.00%	21,150,000	21,585,000
Series 2008 Water Revenue	04/23/2008	58,415,000	3.00 - 5.00%	57,450,000	58,415,000
Total Water Utility Revenue Bonds				<u>\$ 303,355,000</u>	<u>\$ 312,775,000</u>

## Water Utility Fund of the City of Norfolk, Virginia

### Notes to Financial Statements

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A summary of the requirements to amortize water revenue bonds outstanding at June 30, 2010 is as follows:

Year Ending June 30,	Principal	Interest
2011	9,875,000	15,467,723
2012	10,375,000	14,973,521
2013	10,900,000	14,446,373
2014	11,455,000	13,889,785
2015	12,055,000	13,295,473
2016 - 2020	70,745,000	55,977,634
2021 - 2025	87,940,000	34,273,502
2026 - 2030	51,700,000	14,421,786
2031 - 2035	23,610,000	6,067,831
2036 - 2039	14,700,000	1,336,034
	<u>\$ 303,355,000</u>	<u>\$ 184,149,662</u>

Water revenue bonds are payable solely from the revenue of the Fund. The most restrictive covenant of the water revenue bonds requires that the Fund's net revenue to be not less than the greater of (i) the sum of 1.1 times senior debt service and 1.0 times subordinated debt service for the fiscal year or (ii) 1.0 times the funding requirements for transfers from the Revenue Fund to the Operating Fund, the Bond Fund, the Parity Debt Service Fund, the Debt Service Revenue Fund, the Subordinated Debt Service Fund and the Repair and Replacement Reserve Fund. Pursuant to the terms of the revenue bond indenture, certain resources have been set aside for the repayment of the revenue bonds. These resources are classified as restricted cash held with fiscal agent on the balance sheet because their use is limited by applicable bond covenants.

Bonds authorized and unissued as of June 30, 2010 and 2009 were \$51,425,000 and \$32,775,000, respectively.

#### Note 7. Retirement Obligations

The Fund contributes to the Employees' Retirement System of the City of Norfolk (the "System"), a single-employer noncontributory defined benefit plan, which is accounted for as a separate Pension Trust Fund. Reference should be made to the Comprehensive Annual Financial Report of the System for a further description of the plan. Retirement expense was \$2,170,730 and \$2,126,353 for the years ended June 30, 2010 and 2009, respectively.

#### Note 8. Other Liabilities

In 2006, a current liability of \$853,000 was recorded in the Water Utilities Fund to reflect over-recovery of revenue from a wholesale customer during fiscal year 2006 under the water contract. In 2007, an additional liability of \$1,067,000 was recorded for this same wholesale customer. Pursuant to the terms of the water services contract, billings to the customer were based on budgeted Water Utility Fund capital and operating expenditures during the fiscal years. The liability reflects the adjustments to billings based on the difference between budgeted expenditures and actual cost of service for that customer (capital and operating). In accordance with a settlement agreement dated March 12, 2008, the Fund began reimbursing the wholesale customer \$1,920,000 over three years in equal monthly installments starting July 2008.

## Water Utility Fund of the City of Norfolk, Virginia

### Notes to Financial Statements

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#### **Note 9. Significant Customers**

Billed and unbilled accounts receivable includes \$6,015,240 and \$3,920,604 due from the City of Virginia Beach and \$671,303 and \$679,611 due from the United States Navy for water sales at June 30, 2010 and 2009, respectively. Net charges for services include \$26,742,250 and \$25,256,779 for water sales to the City of Virginia Beach and \$8,107,730 and \$8,122,459 for the United States Navy for the fiscal years ended June 30, 2010 and 2009.

#### **Note 10. Commitments and Contingencies**

Commitments for completion of capital projects authorized at June 30, 2010 and 2009 were approximately \$14,082,000 and \$17,391,000, respectively.

As discussed above, amounts received under a certain contract are subject to audit and adjustment by third-party experts and the contracting party. Differences identified, including amounts already collected, may constitute a liability of the Fund. The difference, if any, between revenue earned and recorded cannot be determined at this time.

#### **Note 11. Litigation**

From time-to-time the Fund and the City are defendants in a number of lawsuits. Although it is not possible to determine the final outcome of these matters, management and the City Attorney are of the opinion that the ultimate liability will not be material and will not have a significant effect on the Fund's financial condition.

#### **Note 12. Risk Management**

The Fund is exposed to various risks of loss related to: theft of, damage to, and destruction of assets; injuries to employees; general liability; automobile liability; crime and employee dishonesty; professional liability; and directors and officers' liability. The Fund's coverage is provided through the City of Norfolk's combination of purchased insurance policies and self-insurance plans.

#### **Note 13. Other Postemployment Benefits (OPEB)**

The City's annual OPEB cost (expense) is calculated based on the annual required contribution (ARC), an amount actuarially determined in accordance with GASB Statement No. 45. Under this Statement, governments report on an accrual basis, benefit costs related to the period in which benefits are earned rather than to the period of benefit distribution. The ARC represents a level of funding that, if paid on an on-going basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years. The ARC as computed for the City is allocated to the Fund based on payroll.

The Fund and the City use the pay as you go method to calculate the OPEB liability for June 30, 2010 as the City has not funded a trust for the OPEB liability. Using the most recent OPEB plan valuation date of July 1, 2009, the following table shows the components of the Fund's annual OPEB costs projected for the current fiscal year, the amount contributed to the Plan and the changes in the net OPEB obligation:

## Water Utility Fund of the City of Norfolk, Virginia

### Notes to Financial Statements

	2010	2009
Net beginning OPEB obligation	\$ 466,000	\$ 351,508
Annual required contributions	569,341	396,610
Interest on net OPEB obligation	21,288	10,402
Adjustment to ARC	(16,834)	(7,940)
Annual OPEB cost	573,795	399,072
Less: contributions made	209,358	284,580
Increase in net OPEB obligation	364,437	114,492
Net ending OPEB obligation	\$ 830,437	\$ 466,000

The total unfunded actuarial accrued liability (UAAL) for 2010 and 2009 is \$3,545,026 and \$2,604,959, respectively, and is allocated to the Fund on the same basis as the ARC. The allocation is based on covered payroll and does not purport to represent the OPEB liability of the Fund on a stand-alone basis. Reference should be made to the Comprehensive Annual Financial Report of the City of Norfolk for further information.

#### Note 14. Accounting Pronouncements Issued But Not Yet Implemented

The GASB has issued a pronouncement prior to June 30, 2010 that has an effective date that may impact future financial presentations.

Management has not currently determined what, if any, impact implementation of the following statement may have on the financial statements of the Fund.

- GASB Statement 54, *Funds Balance Reporting and Governmental Fund Type Definitions*. GASB 54 more clearly defines the classifications of fund balance for more consistent application, and also clarifies the definition of existing governmental fund types. The new classifications of fund balance will comprise a hierarchy based on the extent to which the government is bound to observe constraints imposed upon the use of the financial resources of the funds. Fund balance will be reported in the following categories: nonspendable, restricted, committed, assigned and unassigned, depending on the relative strength of the constraints that control how the resources are spent. Disclosures are required about the processes through which constraints are imposed on amounts in the committed and assigned categories. Disclosures must also include the government's policies that determine the type of fund balance categories spent. There is also guidance in the statement regarding classification of stabilization amounts on the financial statements and related note disclosures. The changes to fund balance required by GASB 54 are effective for periods beginning after June 15, 2010, with reclassifications of fund balance applied retroactively for all periods presented.

## Water Utility Fund of the City of Norfolk, Virginia

### Supplementary Schedule

#### Debt Capacity Information - Revenue Bonds Debt Service Coverage Last Ten Fiscal Years

Fiscal Year	Revenue Available for Debt Service (1)	Operating Expenses Less Depreciation & Amortization (2)	Income Available for Debt Service	Debt Service			Coverage
				Principal	Interest	Total	
2001	\$ 64,459,300	\$ 29,732,203	\$ 34,727,097	\$ 4,680,000	\$ 13,411,636	\$ 18,091,636	1.92
2002	63,681,665	29,021,459	34,660,206	4,890,000	14,090,180	18,980,180	1.83
2003	67,760,029	30,867,286	36,892,743	5,700,000	14,600,283	20,300,283	1.82
2004	64,366,942	36,623,654	27,743,288	5,955,000	14,336,043	20,291,043	1.37
2005	69,183,154	37,584,692	31,598,462	6,250,000	14,041,059	20,291,059	1.56
2006	78,788,158	37,086,776	41,701,382	6,580,000	14,827,960	21,407,960	1.95
2007	76,013,563	35,050,694	40,962,869	7,310,000	14,379,821	21,689,821	1.89
2008	78,730,024	39,559,202	39,170,822	7,665,000	14,022,200	21,687,200	1.81
2009	78,020,552	40,807,627	37,212,925	8,050,000	16,411,343	24,461,343	1.52
2010	82,470,020	37,278,349	45,191,671	9,420,000	15,929,680	25,349,680	1.78

1. Includes operating revenue plus interest income, net of interest capitalized.

2. Includes operating expenses less depreciation and amortization.



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**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***

The Honorable Members of the City Council  
Water Utility Fund of the City Norfolk, Virginia:

We have audited the financial statements of the Water Utility Fund of the City of Norfolk, Virginia (the Fund) as of and for the year ended June 30, 2010 and 2009, and have issued our report thereon dated January 14, 2011. As discussed in note 1 to the financial statements, the accompanying financial statements present on the Water Utility Fund and do not purport to, and do not, present fairly the financial position of the City of Norfolk, Virginia, the changes in its financial position or its cash flows, where applicable, in conformity with U.S. generally accepted accounting principles. Our report also discusses that the Fund has not presented a Management's Discussion and Analysis that U.S. generally accepted accounting principles has determined is necessary to supplement, although not required to be a part of, the financial statements. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control over Financial Reporting**

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

A deficiency in internal control over financial reporting 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 combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.



### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Fund'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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, City Council, others within the entity, and is not intended to be and should not be used by anyone other than these specified parties.

*KPMG LLP*

January 14, 2011