



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

**Financial and Compliance Report  
Year Ended June 30, 2008**



**KPMG LLP  
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Norfolk, VA 23510**

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**KPMG LLP**  
Suite 2100  
999 Waterside Drive  
Norfolk, VA 23510

## **Independent Auditors' Report**

The Honorable Members of the City Council  
Water Utility Fund of the City of 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 June 30, 2008, and the related statement of revenues, expenses and changes in fund net assets and cash flows for the year then ended. These financial statements are the responsibility of the management of the City of Norfolk. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Specifications or 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 principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Water Utility Fund of the City of Norfolk, Virginia as of June 30, 2008, and the changes in its financial position and its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

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.

Our audit was 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 audit 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 February 10, 2009 on our consideration of the Fund's internal control over financial reporting and 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 read in conjunction with this report in assessing the results of our audit.

KPMG LLP

February 10, 2009

Water Utility Fund of the City of Norfolk, Virginia  
*Statement of Net Assets*  
 June 30, 2008

	<u>2008</u>
<b>ASSETS</b>	
Current assets:	
Cash and short term investments	\$ 27,469,306
Receivables:	
Accounts (net)	7,875,823
Unbilled accounts	4,561,975
Accrued investment income	120,798
Other receivables	230,000
Inventories	1,716,213
Restricted cash and short term investments held with fiscal agent	8,229,234
Total current assets	<u>50,203,349</u>
Restricted investments:	
Reserve funds	12,674,049
Revenue bonds proceeds	30,794,685
Total restricted investments	<u>43,468,734</u>
Capital assets	
Land and construction in progress	36,480,589
Buildings, improvements & equipment	534,594,175
Accumulated depreciation	(135,042,141)
Total noncurrent assets	<u>436,032,623</u>
Total assets	<u>529,704,706</u>
<b>LIABILITIES</b>	
Current liabilities:	
Vouchers payable	2,053,695
Contract retainage	651,101
Accrued interest	265,200
Accrued payroll	265,440
Due to General Fund and Capital Projects Fund	2,097,679
Payable to employees' retirement system	1,144,608
Compensated absences	657,900
Current portion of bonds payable	11,807,731
Liabilities payable from restricted assets	2,778,165
Liability for other postemployment benefits (OPEB)	351,508
Other liabilities	3,088,186
Total current liabilities	<u>25,161,213</u>
Noncurrent liabilities:	
General obligations payable	10,539,072
Revenue bonds payable	309,969,201
Compensated absences	272,300
Other long-term liabilities	1,280,000
Total noncurrent liabilities	<u>322,060,573</u>
Total liabilities	<u>347,221,786</u>
<b>NET ASSETS</b>	
Invested in capital assets, net of related debt	115,739,567
Unrestricted	66,743,353
	<u>\$ 182,482,920</u>

See Notes to Financial Statements

Water Utility Fund of the City of Norfolk, Virginia

*Statement of Revenues, Expenses and Changes in Fund Net Assets*  
Year Ended June 30, 2008

	<u>2008</u>
Operating revenues:	
Charges for services	\$ 74,239,988
Miscellaneous	2,915,980
Total operating revenues	<u>77,155,968</u>
Operating expenses:	
Personal services	13,120,146
Plant operations	6,625,810
Chemicals	3,446,908
Provision for bad debts	710,185
Depreciation	11,096,511
Retirement contribution	1,144,608
OPEB expense	351,508
Administrative expenses	1,809,616
Other	12,350,421
Total operating expenses	<u>50,655,713</u>
Operating income	26,500,255
Nonoperating revenue (expenses):	
Interest income, net of interest capitalized	1,574,056
Interest expense and fiscal charges	(14,199,647)
Loss on sale or disposal of assets	(21,484)
Total nonoperating expenses	<u>(12,647,075)</u>
Net income before contributions and transfers	13,853,180
Capital contributions	175,778
Transfers out	(8,500,000)
Change in net assets	<u>5,528,958</u>
Total net assets - beginning	176,953,962
Total net assets - ending	<u><u>\$ 182,482,920</u></u>

See Notes to Financial Statements

Water Utility Fund of the City of Norfolk, Virginia

*Statement of Cash Flows*  
Year Ended June 30, 2008

	<u>2008</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
Receipts from customers	\$ 76,414,860
Payments to suppliers	(12,277,358)
Payments to employees	(14,612,069)
Other payments	(12,238,464)
Net cash provided by operating activities	<u>37,286,969</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>	
Internal activity, payments to other funds	(11,745,048)
Transfers out	(8,500,000)
Net cash used by noncapital financing	<u>(20,245,048)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATING FINANCING:</b>	
<b>ACTIVITIES:</b>	
Proceeds from sale of debt	59,226,015
Capital contributions	175,778
Purchases of capital assets	(15,732,538)
Purchase of other assets held for sale	(17,493)
Principal paid on capital debt	(11,577,746)
Interest paid and bond service charges	(13,840,582)
Net cash provided by capital and related financing activities	<u>18,233,434</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>	
Proceeds from sale or maturity of investments	28,810,994
Purchase of investments	(63,279,728)
Interest and dividends	1,541,345
Net cash used by investing activities	<u>(32,927,389)</u>
Net increase in cash and cash equivalents	2,347,966
Cash and cash equivalents - beginning of the year	<u>33,350,574</u>
Cash and cash equivalents - end of the year	<u>\$ 35,698,540</u>

(Continued)

Water Utility Fund of the City of Norfolk, Virginia

*Statement of Cash Flows (Continued)*

Year Ended June 30, 2008

**Reconciliation of Operating Income to Net Cash**

**Provided by Operating Activities:**

Operating income	\$ 26,500,255
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation expense	11,096,511
Provision for bad debt	710,185
Change in assets and liabilities:	
Accounts receivable (net), billed and unbilled	(856,108)
Other receivables	115,000
Inventories	(215,037)
Vouchers payable	(1,989,603)
Accrued payroll	(347,315)
Other liabilities	2,273,081
Net cash provided by operating activities	<u><u>\$ 37,286,969</u></u>

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

Cash and short term investments	\$ 27,469,306
Restricted cash and short term investments held with fiscal agent	<u>\$ 8,229,234</u>
Total cash and short term investments per statement of net assets	<u><u>\$ 35,698,540</u></u>

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

Loss on sale or disposal of capital assets	<u>\$ (3,991)</u>
Acquisition of capital assets through change in contract retainage	<u>\$ 186,023</u>
Acquisition of capital assets through vouchers payable	<u>\$ (440,122)</u>
Capitalized interest, less interest earned on certain long-term construction contracts	<u><u>\$ 564,336</u></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 three months 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; these investments are reported in the accompanying financial statements as cash and short-term investments, unless the original investment period exceeded three months, 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.

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.

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

### Notes to Financial Statements

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#### Note 1. Summary of Significant Accounting Policies (Continued)

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	40 - 75
Transmission and distribution mains	50 - 99
Service meters and meter installation	35 - 50
Pumping and other water equipment	10 - 30
Furniture, fixtures and equipment	5 - 25

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 upon 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.

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.

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

### Notes to Financial Statements

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#### Note 1. Summary of Significant Accounting Policies (Continued)

Due to/from other funds transactions: The General Fund of the City provides administrative services to the Fund, which totaled \$8,500,000 for the year ended June 30, 2008. 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 \$2,532,674 for the year ended June 30, 2008.

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

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.

The Fund's restricted assets on the statement of net assets include \$9,000,000 of certificates of deposits at June 30, 2008. These deposits mature at a date later than three months after year-end and therefore do not meet the definition of cash and 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 \$18,154,210 deposited in the LGIP at June 30, 2008, which carries a Standard and Poor's rating of AAAm which is included in cash and short-term investments.

Water Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

Note 2. Cash and Investments (Continued)

The Fund's investments for the year ended June 30, 2008, 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 2008	
	Fair Value	
	Less than 1 year	1-5 years
SNAP Money Market Mutual Funds	\$ 30,799,687	\$ -
US Agency Notes	-	3,669,047
Money market funds	8,229,234	-
	<u>\$ 39,028,921</u>	<u>\$ 3,669,047</u>

The Fund's rated debt investments, other than in LGIP, as of June 30, 2008 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 2008						Total
	AAA	AAAm	A-1+	AA+	AA	AA-	
Money Market Mutual Funds							
SNAP Money Market Mutual Funds	\$ 4,188,077	\$ -	\$ 25,097,668	\$ 800,662	\$ 61,589	\$ 646,689	\$ 30,794,685
CCRF SNAP Federal Portfolio MMF	-	5,002	-	-	-	-	5,002
US Agency Notes							
SNAP Portfolio FNMA Note (Callable)	3,669,047	-	-	-	-	-	3,669,047
Money market funds	8,229,234	-	-	-	-	-	8,229,234
	<u>\$ 16,086,358</u>	<u>\$ 5,002</u>	<u>\$ 25,097,668</u>	<u>\$ 800,662</u>	<u>\$ 61,589</u>	<u>\$ 646,689</u>	<u>\$ 42,697,968</u>

The City's Water Utility 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 Water Utility 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, 2008 is as follows:

Accrued interest	<u>2008</u>
	<u>\$ 2,778,165</u>

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

### Notes to Financial Statements

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#### Note 2. Cash and Investments (Continued)

At June 30, 2008, the Fund's cash and investments consist of the following:

Investment in LGIP	\$ 18,154,210
Other investments	42,697,968
Certificates of deposit	9,000,000
Cash	9,315,096
	<u>\$ 79,167,274</u>
Cash and short term investments	\$ 27,469,306
Restricted cash and short term investments held with fiscal agent	8,229,234
Other restricted assets	43,468,734
	<u>\$ 79,167,274</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, 2008 is comprised of the following:

	<u>2008</u>
Governmental	\$ 1,356,650
Residential	2,701,057
Refuse disposal fees	2,561,102
Commercial	1,280,130
Utility taxes	930,411
Industrial	417,814
Other	1,475,320
	<u>10,722,484</u>
Less allowance for uncollectible accounts	(2,846,661)
	<u>\$ 7,875,823</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, 2008, the Fund also recognized \$4,561,975 as unbilled accounts receivable.

**Note 5. Capital Assets**

Capital assets at June 30, 2008 are comprised of the following:

	Balance June 30, 2007	Additions	Retirements	Transfers	Balance June 30, 2008
Nondepreciable assets:					
Land	\$ 12,338,879	\$ -	\$ -	\$ -	\$ 12,338,879
Construction in progress	18,110,342	16,572,228	(2,420,102)	(8,120,758)	24,141,710
Total nondepreciable assets	<u>30,449,221</u>	<u>16,572,228</u>	<u>(2,420,102)</u>	<u>(8,120,758)</u>	<u>36,480,589</u>
Depreciable assets:					
Buildings and equipment	525,484,284	1,326,313	(337,180)	8,120,758	534,594,175
Less accumulated depreciation	(124,278,819)	(11,096,511)	333,189	-	(135,042,141)
Depreciable assets, net	401,205,465	(9,770,198)	(3,991)	8,120,758	399,552,034
Total capital assets, net	<u>\$ 431,654,686</u>	<u>\$ 6,802,030</u>	<u>\$ (2,424,093)</u>	<u>\$ -</u>	<u>\$ 436,032,623</u>

The Fund capitalized \$1,011,255 of interest expense and \$446,919 of interest income for the fiscal year ended June 30, 2008. The total interest cost was \$15,210,902 for the fiscal year ended June 30, 2008.

**Note 6. Long-Term Obligations**

General obligation bonds: A summary of general obligation bond transactions for the fiscal year ended June 30, 2008 follows:

	2008
General obligation bonds outstanding at July 1	\$ 17,210,346
Bonds retired	<u>(3,912,746)</u>
Bonds outstanding at June 30	13,297,600
Unamortized discount/premium	<u>999,203</u>
General obligation bonds outstanding at June 30, adjusted for unamortized discount/premium	14,296,803
Less current portion	<u>(3,757,731)</u>
	<u>\$ 10,539,072</u>

Water Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

Note 6. Long -Term Obligations (Continued)

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

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2008
Series 1998 Refunding	06/15/1998	\$ 49,190,000	4.25 - 5.00%	\$ 6,361,491
Series 2002 Refunding	02/01/2002	47,200,000	2.00 - 5.00%	2,964,699
Series 2002B Refunding	11/01/2002	39,890,000	5.00 - 5.25%	874,899
Series 2004 Refunding	03/01/2004	96,395,000	2.00 - 5.00%	3,096,511
Total Water Utility General Obligation Bonds				<u>\$ 13,297,600</u>

A summary of the requirements to amortize general obligation bonds outstanding at June 30, 2008 is as follows:

Year Ending June 30,	Principal	Interest
2009	\$ 3,757,732	\$ 625,238
2010	2,812,578	437,701
2011	2,822,993	304,804
2012	2,058,267	163,900
2013	747,197	74,546
2014-2015	1,098,833	54,860
	<u>\$ 13,297,600</u>	<u>\$ 1,661,049</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, 2008 follows:

	2008
Revenue bonds outstanding at July 1	\$ 270,075,000
Bonds retired	(7,665,000)
Bonds issued	58,415,000
Bonds outstanding at June 30	320,825,000
Less unamortized discount	(2,805,799)
Revenue bonds outstanding at June 30, adjusted for unamortized discount/premium	318,019,201
Less current portion	(8,050,000)
	<u>\$ 309,969,201</u>

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

### Notes to Financial Statements

#### Note 6. Long -Term Obligations (Continued)

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

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2008
Series 1993 Water Revenue	11/01/1993	\$ 68,430,000	2.80 - 5.375%	\$ 48,650,000
Series 1995 Water Revenue	08/15/1995	115,680,000	4.75 - 7.00%	90,480,000
Series 1998 Water Revenue and Refunding	11/01/1998	84,605,000	4.00 - 5.125%	70,115,000
Series 2001 Water Revenue and Refunding	10/15/2001	35,000,000	4.00 - 5.00%	31,160,000
Series 2005 Water Revenue and Refunding	03/23/2005	22,810,000	3.50 - 5.00%	22,005,000
Seires 2008 Water Revenue	04/23/2008	58,415,000	3.00 - 5.00%	58,415,000
				<u>\$ 320,825,000</u>

A summary of the requirements to amortize water revenue bonds outstanding at June 30, 2008 is as follows:

Year Ending June 30,	Principal	Interest
2009	\$ 8,050,000	\$ 16,411,343
2010	9,420,000	15,929,680
2011	9,875,000	15,467,723
2012	10,375,000	14,973,521
2013	10,900,000	14,446,373
2014 - 2018	63,680,000	63,047,765
2019 - 2023	83,090,000	43,640,474
2024 - 2028	71,455,000	20,897,512
2029 - 2033	30,965,000	8,550,791
2034 - 2038	19,440,000	3,040,597
2039	3,575,000	84,906
	<u>\$ 320,825,000</u>	<u>\$ 216,490,685</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 (1) 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, 2008 were \$3,075,000.

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

### Notes to Financial Statements

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#### **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 City System for a further description of the plan. Retirement expense was \$1,144,608 for the year ended June 30, 2008.

#### **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 Water Utilities Fund will reimburse the wholesale customer \$1,920,000 payable over three years in equal monthly installments starting July 2008.

Pursuant to a water services contract between the City of Norfolk and a wholesale customer, the Water Fund conducts a rate true-up every two years to bring the projected rates developed at the start of the two-year period to the actual cost incurred during the period. In fiscal year 2008, the Water Utilities Fund recorded a liability of \$1,897,615 to reflect the true-up result. This amount will be reimbursed to the wholesale customer by crediting each of their monthly billings during fiscal year 2009.

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

Billed and unbilled accounts receivable includes \$2,130,545 due from the City of Virginia Beach and \$914,497 due from the United States Navy for water sales at June 30, 2008. Net charges for services includes \$23,060,612 for water sales to the City of Virginia Beach and \$8,318,612 for the United States Navy for the fiscal year ended June 30, 2008.

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

Commitments for completion of capital projects authorized at June 30, 2008 were approximately \$13,000,000.

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.

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

### Notes to Financial Statements

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#### **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 Fund adopted GASB Statement No. 45, Accounting and Financial Reporting by Employers for Other Postemployment Benefits (OPEB) in FY2008.

The City of Norfolk provides post-retirement health care benefits, in accordance with state statutes which require extending access to healthcare benefits to certain retirees. General City employees are eligible to participate at the earlier of age 55 and 15 years of creditable service or 25 years of creditable service. Employees who retire on accidental disability are also eligible. Retirees that elect to participate may purchase health care coverage using the same health care plans and premium structures available to active employees. Retiree participation, plan/benefit elections and contributions, are administered by the City's Retirement Bureau based on the participation guidelines established by the Norfolk City Council.

Projections of benefits for financial reporting purposes are based on the plan and include the types of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The actuarial valuation was performed as of July 1, 2007 with results projected for the fiscal year ended June 30, 2008.

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 annual required contribution 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 Fund used the pay as you go method to calculate the OPEB liability for June 30, 2008 as the City Council had not voted as June 2008 to put any OPEB money in a trust. Using the most recent OPEB Plan Valuation Date of July 1, 2007 prepared by Cheiron, the City's actuary, the City has allocated to the Fund an ARC cost of \$351,508 and total OPEB liability for 2008 of \$2,534,556. 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 several pronouncements prior to June 30, 2008 that has effective dates that may impact future financial presentations.

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

Notes to Financial Statements

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**Note 14. Accounting Pronouncements Issued But Not Yet Implemented (Continued)**

- GASB Statement 49, *Accounting and Financial Reporting of Pollution Remediation Obligations*. GASB 49 identifies the circumstances under which a governmental entity would be required to report a liability related to pollution remediation. According to the standard, a government would have to estimate its expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:
  - Pollution poses an imminent danger to the public or environment and the government has little or no discretion to avoid fixing the problem.
  - A government has violated a pollution prevention-related permit or license.
  - A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the clean up.
  - A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution.
  - A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

Statement 49 requires governments to disclose information about their pollution obligations associated with clean up efforts in the notes of the financial statements. Statement 49 will be effective for financial statements for periods beginning after December 15, 2007, but liabilities should be measured at the beginning of that period so that the beginning net assets can be restated.

- GASB Statement 51, *Accounting and Financial Reporting for Intangible Assets*. GASB 51 requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. Additionally, GASB 51 establishes a specified-conditions approach to recognizing intangible assets that are internally generated and establishes criteria for when such expenditures should be capitalized. GASB 51 is effective for periods beginning after June 15, 2009 and generally requires its provisions to be applied retroactively.
- GASB Statement 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB 53 addresses the recognition, measurement and disclosure of information regarding derivative instruments entered into by state and local governments to manage specific risks or to make investments. A key provision of this statement is that derivative instruments covered in its scope with limited exception, are reported at fair value. For many derivative instruments, historical prices are zero because their terms are developed so that the instruments may be entered into without a payment being received or made. The changes in fair value of derivative instruments used for investment purposes are reported within the investment revenue classification. Alternatively, changes in fair value of derivative instruments that are classified as hedging derivative instruments are reported in the statement of net assets as deferred inflows or outflows. Effectiveness of the instruments is to be analyzed. Objectives, terms and risks of hedging derivative instruments are required disclosures. Disclosures also will include a summary of derivative instrument activity that provides an indication of the fair value amounts reported on the financial statements. The improvements under GASB 53, which becomes effective for periods beginning after June 15, 2009, should allow users of a government's financial statements to more fully understand resources available to provide services.

## 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
				Principle	Interest	Total	
1999	73,326,682	26,067,025	47,259,657	3,113,577	11,325,353	14,438,930	3.27
2000	64,456,322	28,198,244	36,258,078	4,475,000	13,616,718	18,091,718	2.00
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

1. Includes operating revenue plus interest income not 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 Audit Standards***

The Honorable Members of City Council  
Water Utility Fund of the City of 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, 2008, and have issued our report thereon dated February 10, 2009. 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 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 opinions 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.

Our consideration of internal control over financial reporting was for the purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and,



accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be 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 the 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, and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.

**KPMG LLP**

February 10, 2009