



Water Utility Fund of the City of Norfolk, Virginia

**Financial and Compliance Report
Year Ended June 30, 2009**

Contents

Independent Auditors' Report	1 - 2
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Financial Statements	
Statements of Net Assets	3
Statements of Revenues, Expenses and Changes in Fund Net Assets	4
Statements of Cash Flows	5 - 6
Notes to Financial Statements	7 - 18

Supplementary Schedule	19
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Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	20 - 21
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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 statements of net assets of the Water Utility Fund of the City of Norfolk, Virginia (the Fund) as of June 30, 2009 and 2008, 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 an opinion 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; 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 audits provide 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, 2009 and 2008, and the 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 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 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 19, 2010 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 audits.

KPMG LLP

January 19, 2010

Water Utility Fund of the City of Norfolk, Virginia
Statements of Net Assets
June 30, 2009 and 2008

	2009	2008
ASSETS		
Current assets:		
Cash and short term investments	\$ 29,216,859	\$ 27,469,306
Receivables:		
Accounts (net)	9,157,426	7,875,823
Unbilled accounts	4,226,869	4,561,975
Accrued investment income	6,108	120,798
Other receivables	115,000	230,000
Inventories	1,627,194	1,716,213
Restricted cash held in escrow	114,904	-
Restricted short term investments:		
Restricted cash held with fiscal agent	-	8,229,234
Restricted investment held with fiscal agent	8,279,648	-
Reserve funds	12,759,726	12,674,049
Investment restricted for construction	17,014,387	30,794,685
Total current assets	<u>82,518,121</u>	<u>93,672,083</u>
Capital assets		
Non-depreciable assets	34,325,172	36,480,589
Depreciable assets	548,398,331	534,594,175
Accumulated depreciation	(144,750,965)	(135,042,141)
Total noncurrent assets	<u>437,972,538</u>	<u>436,032,623</u>
Total assets	<u>520,490,659</u>	<u>529,704,706</u>
LIABILITIES		
Current liabilities:		
Vouchers payable	980,514	1,363,804
Vouchers payable for CIP projects	2,094,902	689,891
Contract retainage	794,072	651,101
Accrued interest	112,682	265,200
Accrued payroll	281,198	265,440
Due to General Fund and other funds	3,369,643	2,097,679
Payable to employees' retirement system	1,696,500	1,144,608
Compensated absences	656,331	657,900
Current portion of bonds payable	12,232,578	11,807,731
Accrued revenue bond interest payable	2,655,047	2,778,165
Other liabilities	1,160,744	3,088,186
Total current liabilities	<u>26,034,211</u>	<u>24,809,705</u>
Noncurrent liabilities:		
General obligations payable	6,594,840	10,539,072
Revenue bonds payable	300,897,242	309,969,201
Liability for other postemployment benefits (OPEB)	466,000	351,508
Compensated absences	341,367	272,300
Other long-term liabilities	640,000	1,280,000
Total noncurrent liabilities	<u>308,939,449</u>	<u>322,412,081</u>
Total liabilities	<u>334,973,660</u>	<u>347,221,786</u>
NET ASSETS		
Invested in capital assets, net of related debt	135,262,265	134,511,304
Restricted	14,769,879	14,674,049
Unrestricted	35,484,855	33,297,567
	<u>\$ 185,516,999</u>	<u>\$ 182,482,920</u>

See Notes to Financial Statements

Water Utility Fund of the City of Norfolk, Virginia

**Statements of Revenues, Expenses and Changes in Fund Net Assets
Years Ended June 30, 2009 and 2008**

	2009	2008
Operating revenues:		
Charges for services	\$ 74,453,906	\$74,239,988
Miscellaneous	2,666,962	2,915,980
Total operating revenues	<u>77,120,868</u>	<u>77,155,968</u>
Operating expenses:		
Personnel services	13,972,816	13,120,146
Plant operations	6,844,241	6,625,810
Chemicals	4,963,652	3,446,908
Provision for bad debts	419,459	710,185
Depreciation	11,335,890	11,096,511
Retirement contribution	2,126,353	1,144,608
OPEB expense	114,492	351,508
Administrative expenses	1,710,050	1,809,616
Other	10,656,564	12,350,421
Total operating expenses	<u>52,143,517</u>	<u>50,655,713</u>
Operating income	<u>24,977,351</u>	<u>26,500,255</u>
Nonoperating revenue (expenses):		
Interest income, net of interest capitalized	899,684	1,574,056
Interest expense and fiscal charges	(14,826,222)	(14,199,647)
Loss on sale or disposal of assets	(20,392)	(21,484)
Total nonoperating expenses	<u>(13,946,930)</u>	<u>(12,647,075)</u>
Net income before contributions and transfers	11,030,421	13,853,180
Transfers out	<u>(8,500,000)</u>	<u>(8,500,000)</u>
Change in net assets	<u>3,034,079</u>	<u>5,528,958</u>
Total net assets - beginning	182,482,920	176,953,962
Total net assets - ending	<u>\$ 185,516,999</u>	<u>\$182,482,920</u>

See Notes to Financial Statements

Water Utility Fund of the City of Norfolk, Virginia

Statements of Cash Flows

Years Ended June 30, 2009 and 2008

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	\$ 75,869,912	\$ 76,414,860
Payments to suppliers	(12,102,164)	(12,277,358)
Payments to employees	(15,686,553)	(14,612,069)
Other payments	(14,711,524)	(12,238,464)
Net cash provided by operating activities	<u>33,369,671</u>	<u>37,286,969</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Internal activity, payments to other funds	1,271,964	(11,745,048)
Transfers out	(8,500,000)	(8,500,000)
Net cash used by noncapital financing activities	<u>(7,228,036)</u>	<u>(20,245,048)</u>
CASH FLOWS FROM CAPITAL AND RELATING FINANCING ACTIVITIES:		
Proceeds from sale of debt	3,700,816	59,226,015
Capital contributions	503,658	175,778
Purchases of capital assets	(11,748,215)	(15,732,538)
Purchase of other assets held for sale	-	(17,493)
Refunding of debt principal	(3,708,424)	-
Principal paid on capital debt	(11,807,732)	(11,577,746)
Interest paid and bond service charges	(15,877,862)	(13,840,582)
Net cash provided (used) by capital and related financing activities	<u>(38,937,759)</u>	<u>18,233,434</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of investments	14,810,424	28,810,994
Purchase of investments	(9,395,451)	(63,279,728)
Interest and dividends	1,014,374	1,541,345
Net cash provided (used) by investing activities	<u>6,429,347</u>	<u>(32,927,389)</u>
Net increase in cash and cash equivalents	(6,366,777)	2,347,966
Cash and cash equivalents - beginning of year	35,698,540	33,350,574
Cash and cash equivalents - end of year	<u>\$ 29,331,763</u>	<u>\$ 35,698,540</u>

(Continued)

Water Utility Fund of the City of Norfolk, Virginia

Statements of Cash Flows (Continued)

Years Ended June 30, 2009 and 2008

Reconciliation of Operating Income to Net Cash

Provided by Operating Activities:

Operating income	\$ 24,977,351	\$ 26,500,255
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	11,335,890	11,096,511
Provision for bad debt	419,459	710,185
Change in assets and liabilities:		
Accounts receivable (net), billed and unbilled	(1,365,956)	(856,108)
Other receivables	115,000	115,000
Inventories	89,019	(215,037)
Vouchers payable	(383,290)	(1,989,603)
Accrued payroll	635,148	(347,315)
Other liabilities	(2,452,950)	2,273,081
Net cash provided by operating activities	<u>\$ 33,369,671</u>	<u>\$ 37,286,969</u>

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

Cash and short term investments	\$ 29,216,859	\$ 27,469,306
Restricted cash held in escrow	114,904	\$ -
Restricted cash and short term investments held with fiscal agent	-	\$ 8,229,234
Total cash and short term investments per statement of net assets	<u>\$ 29,331,763</u>	<u>\$ 35,698,540</u>

Noncash investing, capital and financing activities:

Loss on sale or disposal of capital assets	\$ (20,392)	\$ (3,991)
Acquisition of capital assets through change in contract retainage	<u>\$ 142,971</u>	<u>\$ 186,023</u>
Acquisition of capital assets through vouchers payable	<u>\$ 1,405,011</u>	<u>\$ 440,122</u>
Capitalized interest	<u>\$ 897,276</u>	<u>\$ 564,336</u>

Water Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

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

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

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.

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

Water Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

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 \$2,211,218 and \$1,809,616 for the fiscal years ended June 30, 2009 and 2008, 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 \$2,625,254 and \$2,532,674 for the fiscal years ended June 30, 2009 and 2008, 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.

Reclassifications: Certain reclassifications have been made to balances at June 30, 2008 to conform to the June 30, 2009 financial statement presentation.

Note 2. Cash and Investments

At June 30, 2009 and 2008, the Fund's cash and investments consist of the following:

	2009	2008
Investment in LGIP	\$ 16,008,394	\$ 18,154,210
Other investments	29,053,761	42,697,968
Certificates of deposit	9,000,000	9,000,000
Cash	13,323,369	9,315,096
	<u>\$ 67,385,524</u>	<u>\$ 79,167,274</u>
Cash and short term investments	\$ 29,216,859	\$ 27,469,306
Restricted cash held in escrow	114,904	-
Restricted cash and short term investments held with fiscal agent	8,279,648	8,229,234
Other restricted assets	29,774,113	43,468,734
	<u>\$ 67,385,524</u>	<u>\$ 79,167,274</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 \$9,000,000 of certificates of deposits at June 30, 2009 and 2008. 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 \$16,008,394 and \$18,154,210 deposited in the LGIP at June 30, 2009 and 2008, 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, 2009 and 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 2009		Fiscal Year 2008	
	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	\$ -	\$ 30,799,687	\$ -
US Agency Notes	3,750,899	-	-	3,669,047
PFM Funds Government Series	8,288,475	-	-	-
Money market funds	-	-	8,229,234	-
	\$ 29,053,761	\$ -	\$ 39,028,921	\$ 3,669,047

The Fund's rated debt investments, other than in LGIP, as of June 30, 2009 and 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 2009						Total
	AAA	AAAm	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							
PFM Funds Bonds/Notes	3,750,899	-	-	-	-	-	3,750,899
	\$ 3,750,899	\$ 25,302,862	\$ -	\$ -	\$ -	\$ -	\$ 29,053,761

Water Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

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 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, 2009 and 2008 is as follows:

	2009	2008
Liabilities payable from restricted assets	<u>\$ 2,655,047</u>	<u>\$ 2,778,165</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, 2009 and 2008 is comprised of the following:

	2009	2008
Governmental	\$ 3,120,938	\$ 1,356,650
Residential	2,979,731	2,701,057
Refuse disposal fees	3,111,652	2,561,102
Commercial	1,169,797	1,280,130
Utility taxes	783,255	930,411
Industrial	408,279	417,814
Other	996,793	1,475,320
	<u>12,570,445</u>	<u>10,722,484</u>
Less allowance for uncollectible accounts	<u>(3,413,019)</u>	<u>(2,846,661)</u>
	<u>\$ 9,157,426</u>	<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, 2009 and 2008, the Fund recognized \$4,226,869 and \$4,561,975 as unbilled accounts receivable, respectively. These amounts were billed in July 2009 and July 2008, respectively.

Note 5. Capital Assets

Capital assets at June 30, 2009 and 2008 are comprised of the following:

	Balance				Balance
	June 30, 2008	Additions	Retirements	Transfers	June 30, 2009
Nondepreciable assets:					
Land	\$ 12,338,879	\$ -	\$ -	\$ 142,000	\$ 12,480,879
Construction in progress	24,141,710	13,142,698	(1,837,213)	(13,602,902)	21,844,293
Total nondepreciable assets	36,480,589	13,142,698	(1,837,213)	(13,460,902)	34,325,172
Depreciable assets:					
Buildings	178,742,621	-	-	80,048	178,822,669
Equipment	355,851,554	1,999,587	(1,656,333)	13,380,854	369,575,662
Total	534,594,175	1,999,587	(1,656,333)	13,460,902	548,398,331
Less accumulated depreciation	(135,042,141)	(11,335,890)	1,627,066	-	(144,750,965)
Depreciable assets, net	399,552,034	(9,336,303)	(29,267)	13,460,902	403,647,366
Total capital assets, net	\$ 436,032,623	\$ 3,806,395	\$ (1,866,480)	\$ -	\$ 437,972,538

	Balance				Balance
	June 30, 2007	Additions	Retirements	Transfers	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	30,449,221	16,572,228	(2,420,102)	(8,120,758)	36,480,589
Depreciable assets:					
Buildings	178,553,024	-	-	189,597	178,742,621
Equipment	346,931,260	1,326,313	(337,180)	7,931,161	355,851,554
Total	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	\$ 431,654,686	\$ 6,802,030	\$ (2,424,093)	\$ -	\$ 436,032,623

The Fund capitalized \$1,151,110 of interest expense and \$253,834 of interest income for the fiscal year ended June 30, 2009. For the fiscal year ended June 30, 2008, the Fund capitalized \$1,011,255 of interest expense and \$446,919 of interest income. The total interest cost was \$15,977,332 and \$15,210,902 for the fiscal year ended June 30, 2009 and 2008, respectively.

Water Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

Note 6. Long-Term Obligations

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

	2009	2008
General obligation bonds outstanding at July 1	\$ 13,297,600	\$ 17,210,346
Bonds retired/refunded	(7,466,156)	(3,912,746)
Bonds issued	3,700,816	(3,912,746)
Bonds outstanding at June 30	9,532,260	9,384,854
Unamortized discount/premium	(124,842)	999,203
General obligation bonds outstanding at June 30, adjusted for unamortized discount/premium	9,407,418	10,384,057
Less current portion	(2,812,578)	(3,757,731)
	\$ 6,594,840	\$ 6,626,326

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

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2009	2008
Series 1998 Refunding	06/15/1998	\$ 49,190,000	5.00%	\$ 1,320,556	\$ 6,361,491
Series 2002 Refunding	02/13/2002	47,200,000	2.00 - 5.00%	2,213,020	2,964,699
Series 2002B Refunding	11/01/2002	39,890,000	4.00 - 5.25%	840,102	874,899
Series 2004 Refunding	03/16/2004	96,395,000	4.00 - 5.00%	1,457,766	3,096,511
Series 2009 Refunding	5/21/2009	21,895,000	3.00 - 5.00%	3,700,816	-
Total Water Utility General Obligation Bonds				\$ 9,532,260	\$ 13,297,600

On May 13, 2009, the City sold \$21,895,000 of general obligation bonds which were used to defease \$17,060,000 of the City's Series 1998 General Obligation Bonds and \$5,400,000 of the City's Series 2002 General obligation Bonds. \$3,700,816 of these bonds were liabilities of this Fund. The advance refunding will reduce the City's total debt service payments for bonds and result in an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$1,505,606.

A summary of the requirements to amortize general obligation bonds outstanding at June 30, 2009 and 2008 is as follows:

Water Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

Year Ending June 30,	Principal	Interest
2010	\$ 2,812,578	\$ 437,694
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>\$ 9,532,260</u>	<u>\$ 1,043,412</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, 2009 and 2008 follows:

	2009	2008
Revenue bonds outstanding at July 1	\$ 320,825,000	\$ 270,075,000
Bonds retired	(8,050,000)	(7,665,000)
Bonds issued	-	58,415,000
Bonds outstanding at June 30	312,775,000	320,825,000
Less unamortized discount	(2,457,758)	(2,805,799)
Revenue bonds outstanding at June 30, adjusted for unamortized discount/premium	310,317,242	318,019,201
Less current portion	(9,420,000)	(8,050,000)
	\$ 300,897,242	\$ 309,969,201

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

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2009	2008
Series 1993 Water Revenue	11/01/1993	\$ 68,430,000	2.80 - 5.375%	\$ 46,665,000	\$ 48,650,000
Series 1995 Water Revenue	08/15/1995	115,680,000	4.75 - 7.00%	87,535,000	90,480,000
Series 1998 Water Revenue and Refunding	11/01/1998	84,605,000	4.00 - 5.125%	68,150,000	70,115,000
Series 2001 Water Revenue and Refunding	10/15/2001	35,000,000	4.00 - 5.00%	30,425,000	31,160,000
Series 2005 Water Revenue and Refunding	03/23/2005	22,810,000	3.50 - 5.00%	21,585,000	22,005,000
Series 2008 Water Revenue	04/23/2008	58,415,000	3.00 - 5.00%	58,415,000	58,415,000
Total Water Utility Revenue Bonds				\$ 312,775,000	\$ 320,825,000

A summary of the requirements to amortize water revenue bonds outstanding at June 30, 2009 and 2008 is as follows:

Water Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

Year Ending June 30,	Principal	Interest
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	11,455,000	13,889,785
2015 - 2019	67,105,000	59,623,713
2020 - 2024	87,705,000	39,029,981
2025 - 2029	62,315,000	17,369,170
2030 - 2034	24,670,000	7,216,575
2035 - 2039	18,955,000	2,132,822
	<u>\$ 312,775,000</u>	<u>\$ 200,079,343</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, 2009 and 2008 were \$32,775,000 and \$3,075,000, 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 \$2,126,353 and \$1,144,608 for the years ended June 30, 2009 and 2008, 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

Note 9. Significant Customers

Billed and unbilled accounts receivable includes \$3,920,604 and \$2,130,545 due from the City of Virginia Beach and \$679,611 and \$914,497 due from the United States Navy for water sales at June 30, 2009 and 2008, respectively. Net charges for services include \$25,256,779 and \$23,060,612 for water sales to the City of Virginia Beach and \$8,122,459 and \$8,318,612 for the United States Navy for the fiscal years ended June 30, 2009 and 2008.

Note 10. Commitments and Contingencies

Commitments for completion of capital projects authorized at June 30, 2009 and 2008 were approximately \$17,391,000 and \$13,000,000, 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 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, 2008 with results projected for the fiscal year ended June 30, 2009.

Water Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

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, 2009 as the City has not funded a trust for the OPEB liability. Using the most recent OPEB Plan Valuation Date of July 1, 2008 prepared by Cheiron, the City's actuary, the City has allocated to the Fund an ARC cost of \$466,000 and total OPEB liability for 2009 of \$2,604,959. In FY2008, the City, based on Cherion's OPEB Plan Valuation, allocated to the Fund an ARC cost of \$351,508 and total OPEB liability 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. Subsequent Event

The City of Norfolk has reached an agreement with the Western Tidewater Authority to provide water over next 40 years. The sale of water will generate \$1.2 million in the first year and increase over time to approximately \$6 million annually based on current dollar value.

Note 15. Accounting Pronouncements Issued But Not Yet Implemented

The GASB has issued several pronouncements prior to June 30, 2009 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.

- 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

Water Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

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.

- 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		Total	Coverage
				Principle	Interest		
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
2009	78,020,552	40,807,627	37,212,925	8,050,000	16,411,343	24,461,343	1.52

1. Includes operating revenue plus interest income, net of interest capitalized 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 years ended June 30, 2009 and 2008, and have issued our report thereon dated January 19, 2010. 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 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.

Internal Control over Financial Reporting

In planning and performing our audits, 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.

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 the 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 the 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 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

January 19, 2010