

McGladrey & Pullen

Certified Public Accountants

Wastewater Utility Fund of the City of Norfolk, Virginia

Financial and Compliance Report
Year Ended June 30, 2007

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McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report

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

We have audited the accompanying statements of net assets of the Wastewater Utility Fund of the City of Norfolk, Virginia as of June 30, 2007 and 2006, 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 *Specifications for Audits of Counties, Cities and Towns*, issued by the Auditor of Public Accounts of the Commonwealth of Virginia. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 opinions.

As discussed in Note 1 to the financial statements, the accompanying financial statements present only the Wastewater 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 accounting principles generally accepted in the United States of America. Furthermore, management has chosen not to present a Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to supplement, although not be part of the basic financial statements.

In our opinion, except for the omission of the information in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the Wastewater Utility Fund of the City of Norfolk, Virginia as of June 30, 2007 and 2006, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13 to the financial statements, the Fund restated beginning Net Assets to correct errors associated with improper capitalization of capital assets.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 20, 2007 on our consideration of the Wastewater Utility Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

McGladrey & Pullen, LLP

Greensboro, North Carolina
December 20, 2007

Wastewater Utility Fund of the City of Norfolk, Virginia

Statements of Net Assets
June 30, 2007 and 2006

	2007	2006 (As Restated)
Assets		
Current assets:		
Cash and cash equivalents	\$ 9,191,979	\$ 10,141
Receivables:		
Accounts, net	2,126,763	1,682,334
Unbilled accounts	884,224	877,421
Other receivables	151,976	2,754
Due from other funds	-	110,275
Inventories	46,984	46,747
Restricted cash held in escrow	134,953	21,752
Total current assets	12,536,879	2,751,424
Restricted investments	13,087,519	12,402,744
Capital assets (Note 13):		
Land and construction in progress	25,524,240	22,160,348
Buildings and equipment, net of accumulated depreciation	121,495,506	103,073,788
Total assets	147,019,746	125,234,136
	172,644,144	140,388,304
Liabilities		
Current liabilities:		
Vouchers payable	4,148,019	3,172,084
Contract retainage	736,085	561,864
Due to other funds	10,204,698	3,308,386
Accrued interest	873,673	522,000
Accrued payroll	85,071	84,655
Contribution to Employees Retirement System	481,579	456,990
Current portion of bonds payable	4,624,412	4,322,011
Compensated absences	196,362	201,623
Other liabilities	371,077	334,655
Total current liabilities	21,720,976	12,964,268
Noncurrent liabilities:		
General obligation bonds payable	78,556,642	59,308,919
Compensated absences	114,538	83,077
Total noncurrent liabilities	78,671,180	59,391,996
Total liabilities	100,392,156	72,356,264
Commitments and contingencies (Notes 7, 8, 10 and 11)		
Net Assets		
Invested in capital assets, net of related debt	76,190,127	73,444,086
Unrestricted (deficit)	(3,938,139)	(5,412,046)
	\$ 72,251,988	\$ 68,032,040

See Notes to Financial Statements.

Wastewater Utility Fund of the City of Norfolk, Virginia

Statements of Revenues, Expenses and Changes in Fund Net Assets
Years Ended June 30, 2007 and 2006

	2007	2006 (As Restated)
Operating revenues:		
Charges for services	\$ 22,314,109	\$ 22,374,452
Miscellaneous	612,522	438,477
Total operating revenues	22,926,631	22,812,929
Operating expenses:		
Personal services	4,414,184	4,229,450
Plant operations	3,374,842	4,242,826
Chemicals	88,415	148,129
Provision of bad debts	(78,153)	161,327
Depreciation	3,101,499	2,567,099
Retirement contribution	481,585	456,990
Administrative expenses	1,569,499	1,536,166
Other	3,326,661	2,947,361
Total operating expenses	16,278,532	16,289,348
Operating income	6,648,099	6,523,581
Nonoperating revenue (expenses):		
Interest income	285,455	23,984
Interest expense and fiscal charges, net of interest capitalized	(1,098,816)	(695,493)
Gain on sale or disposal of capital assets	-	2,710
Total nonoperating expenses	(813,361)	(668,799)
Income before contributions and transfers	5,834,738	5,854,782
Capital contributions	135,710	19,186
Transfers out	(1,750,500)	(1,500,000)
Change in net assets	4,219,948	4,373,968
Net assets:		
Beginning, as previously reported (Note 13)	68,032,040	71,038,889
Adjustment to ending balance (Note 13)	-	(7,380,817)
Beginning, as restated	68,032,040	63,658,072
Ending	\$ 72,251,988	\$ 68,032,040

See Notes to Financial Statements.

Wastewater Utility Fund of the City of Norfolk, Virginia

Statements of Cash Flows
Years Ended June 30, 2007 and 2006

	2007	2006 (As Restated)
Cash Flows From Operating Activities		
Receipts from customers	\$ 22,404,330	\$ 22,704,254
Payments to suppliers	(11,885,429)	(10,371,540)
Payments to employees	(4,362,977)	(4,165,385)
Other receipts (payments)	36,422	(220,065)
Net cash provided by operating activities	6,192,346	7,947,264
Cash Flows From Noncapital Financing Activities		
Operating subsidies and transfers to other funds	(1,750,500)	(1,500,000)
Internal activity, receipts from other funds	7,006,587	3,011,212
Net cash provided by noncapital financing activities	5,256,087	1,511,212
Cash Flows From Capital and Related Financing Activities		
Proceeds from capital debt	24,488,957	11,500,000
Contributed capital	135,710	19,186
Purchases of capital assets	(18,780,409)	(10,973,567)
Proceeds on sale of capital assets	-	2,710
Principal paid on capital debt	(5,073,365)	(4,441,648)
Refunding of debt principal	(316,590)	-
Interest paid on capital debt	(2,208,377)	(1,686,661)
Net cash used in capital and related financing activities	(1,754,074)	(5,579,980)
Cash Flows From Investing Activities		
Net purchases of investments	(684,775)	(5,110,683)
Interest and dividends	285,455	23,984
Net cash used in investing activities	(399,320)	(5,086,699)
Net increase (decrease) in cash and cash equivalents	9,295,039	(1,208,203)
Cash and cash equivalents:		
Beginning	31,893	1,240,096
Ending	\$ 9,326,932	\$ 31,893

(Continued)

Wastewater Utility Fund of the City of Norfolk, Virginia

Statements of Cash Flows (Continued)
Years Ended June 30, 2007 and 2006

	2007	2006 (As Restated)
Reconciliation of Operating Income to Net Cash Provided By Operating Activities		
Operating income	\$ 6,648,099	\$ 6,523,581
Adjustment to reconcile operating income to net cash provided by operating activities:		
Provision for bad debts	(78,153)	161,327
Depreciation expense	3,101,499	2,567,099
Changes in assets and liabilities:		
(Increase) decrease in:		
Receivables, net	(373,079)	(113,298)
Other receivables	(149,222)	4,623
Inventories	(237)	(19,832)
Increase (decrease) in:		
Accounts/vouchers payables	(3,044,190)	(1,020,236)
Accrued payroll	416	2,955
Other liabilities	87,213	(158,955)
Net cash provided by operating activities	\$ 6,192,346	\$ 7,947,264
Reconciliation of Cash and Cash Equivalents to the Statement of Net Assets		
Cash and cash equivalents	\$ 9,191,979	\$ 10,141
Restricted cash held in escrow	134,953	21,752
Total cash and cash equivalents per statements of net assets	\$ 9,326,932	\$ 31,893
Noncash Investing, Capital and Financing Activities		
Adjustment to beginning balance		
Gain on sale or disposal of capital assets	\$ -	\$ (2,710)
Acquisition of capital assets through change in contract retainage	\$ 174,221	\$ 561,864
Acquisition of capital assets included in vouchers payable	\$ 4,020,126	\$ 2,061,759
Capitalized interest	\$ 1,912,355	\$ 1,309,683

See Notes to Financial Statements.

Wastewater Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

The Wastewater Utility Fund of the City of Norfolk, Virginia (the "Fund") was established at the direction of Norfolk City Council as an enterprise fund on July 1, 1984. The Fund accounts for the operation of the wastewater system owned by the City of Norfolk (the "City"). The costs of providing services on a continuing basis are financed or recovered through user charges to the City's residential and commercial customers. Activities necessary to provide wastewater 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 an Enterprise Fund.

A summary of the Fund's significant accounting policies are 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 it is 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 ("GASB"), *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.

Cash and cash equivalents: All highly liquid investments with an original maturity of three months or less are considered to be cash equivalents. Such investments are valued at cost which approximates fair value.

Investments: The Fund reports investments at fair value. 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 wastewater utility 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 wastewater 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 wastewater usage by customers for which billings have not been processed.

Inventories: Inventories are stated at the lower of cost (using the moving average 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.

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.

Wastewater Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

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 wastewater equipment	10 - 30
Furniture, fixtures and equipment	5 - 25

When an asset is retired or otherwise disposed of, the related cost and accumulated depreciation is 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 available for use, the policy is to use restricted resources first, and then unrestricted resources as they are needed.

Transfer to/from other funds: The General Fund of the City provides administrative services to the Fund, which totaled \$1,569,499 and \$1,536,166 for the years ended June 30, 2007 and 2006, respectively. Charges for these services are treated as expenses by the Fund and as revenue by the General Fund. In addition the Fund recorded, as other expenses, payments to the General Fund in lieu of taxes of \$82,160 and \$79,000 for the years ended June 30, 2007 and 2006, respectively.

Wastewater Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Bond premium or discount: Premiums and discounts on bonds are amortized, using the effective interest method, over the life of the related debt with the amortization included in interest expense.

Deferred gain (loss) on advance refunding: Gain or (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.

Use of 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.

Reclassification: The Fund's policy is to reclassify certain amounts reported in prior years' financial statements when necessary for conformity with classifications adopted in the current year. These reclassifications did not have an effect on the prior year's change in net assets or net assets.

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.

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, bankers' 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 has \$9,000,000 and \$10,000 deposited in the State Treasurer's LGIP at June 30, 2007 and 2006, respectively, which has a Standard and Poor's rating of AAAM and is included in cash and cash equivalents.

The Fund's investments are considered to be mutual fund investment types and have a maturity of less than one year.

Wastewater Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

Note 2. Cash and Investments (Continued)

The Fund's rated debt investments, other than in LGIP, as of June 30, 2007 and 2006 was rated by Standard and Poor's and the ratings are presented below using the Standard and Poor's rating scale.

Investment Type	Fiscal Year 2007				
	AAA	A-1+	A-1	A+	Total
CCRF Va AIM Prime Portfolio	\$ 279,628	\$ 1,138,138	\$ 173,337	\$ 44,152	\$ 1,635,255
Virginia Resource Authority	11,452,264	-	-	-	11,452,264
	<u>\$ 11,731,892</u>	<u>\$ 1,138,138</u>	<u>\$ 173,337</u>	<u>\$ 44,152</u>	<u>\$ 13,087,519</u>

Investment Type	Fiscal Year 2006				
	AAA	A-1+	A-1	A+	Total
Virginia Resource Authority	\$ 12,402,744	\$ -	\$ -	\$ -	\$ 12,402,744

Note 3. Restricted Investments

The following is a summary of the Wastewater Fund's restricted investments, other than LGIP, as of June 30, 2007 and 2006:

	2007		2006	
	Cost	Fair Value	Cost	Fair Value
Virginia Resource Authority	\$ 11,452,264	\$ 11,452,264	\$ 12,402,744	\$ 12,402,744
CCRF Va AIM Prime Portfolio	1,635,255	1,635,255	-	-
	<u>\$ 13,087,519</u>	<u>\$ 13,087,519</u>	<u>\$ 12,402,744</u>	<u>\$ 12,402,744</u>

The City's Wastewater 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 Wastewater Fund. These amounts are not available to meet obligations arising from the operating activities of the Fund. These amounts are restricted by covenant related to the general obligation bond issue and/or by the external source of the originating transaction.

Note 4. Accounts Receivable

Accounts receivable at June 30, 2007 and 2006 are comprised of the following:

	2007	2006
Wastewater maintenance fees	\$ 2,577,968	\$ 2,211,692
Less allowance for uncollectible accounts	(451,205)	(529,358)
	<u>\$ 2,126,763</u>	<u>\$ 1,682,334</u>

Wastewater Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

Note 5. Unbilled Accounts Receivable

At June 30, 2007 and 2006, the Fund recognized \$884,224 and \$877,421 as unbilled accounts receivable related to unread meters. The associated revenue is included in net charges for services.

Note 6. Capital Assets

Capital assets at June 30, 2007 and 2006 are comprised of the following:

	Balance June 30, 2006	Additions	Retirements	Transfers	Balance June 30, 2007
Nondepreciable assets:					
Land	\$ 85,262	\$ -	\$ -	\$ -	\$ 85,262
Construction-in-progress	22,075,086	22,686,422	-	(19,322,530)	25,438,978
Total nondepreciable assets	22,160,348	22,686,422	-	(19,322,530)	25,524,240
Depreciable assets:					
Buildings and equipment	138,070,823	2,200,687	-	19,322,530	159,594,040
Less accumulated depreciation	(34,997,035)	(3,101,499)	-	-	(38,098,534)
Total depreciable assets, net	103,073,788	(900,812)	-	19,322,530	121,495,506
Total capital assets, net	\$ 125,234,136	\$ 21,785,610	\$ -	\$ -	\$ 147,019,746

	Balance June 30, 2005 (Previously Reported)	Restatement Amount	Balance June 30, 2005 (As Restated)	Additions	Retirements	Transfers	Balance June 30, 2006 (As Restated)
Nondepreciable assets:							
Land	\$ 85,262	\$ -	\$ 85,262	\$ -	\$ -	\$ -	\$ 85,262
Construction-in-progress	41,458,312	(21,914,641)	19,543,671	12,840,749	-	(10,309,334)	22,075,086
Total nondepreciable assets	41,543,574	(21,914,641)	19,628,933	12,840,749	-	(10,309,334)	22,160,348
Depreciable assets:							
Buildings and equipment	110,264,860	15,840,233	126,105,093	1,656,396	-	10,309,334	138,070,823
Less accumulated depreciation	(31,123,527)	(1,306,409)	(32,429,936)	(2,567,099)	-	-	(34,997,035)
Total depreciable assets, net	79,141,333	14,533,824	93,675,157	(910,703)	-	10,309,334	103,073,788
Total capital assets, net	\$ 120,684,907	\$ (7,380,817)	\$ 113,304,090	\$ 11,930,046	\$ -	\$ -	\$ 125,234,136

The Fund capitalized \$1,912,355 and \$1,309,683 of interest expense and \$-0- of interest income for the fiscal years ended June 30, 2007 and 2006, respectively. Total interest cost for 2007 and 2006 amount to \$3,011,171 and \$2,005,176, respectively.

Wastewater Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

Note 7. Long -Term Obligations

General obligation bonds: A summary of general obligation bond transactions for the fiscal year ended June 30, 2007 and 2006 follows:

	2007	2006
Beginning, July 1	\$ 65,384,352	\$ 58,326,000
Bonds retired	(5,073,365)	(4,441,648)
Bonds refunded	(316,590)	-
Bonds issued	24,488,957	11,500,000
Bonds outstanding at June 30	84,483,354	65,384,352
Unamortized discount/premium	(1,302,300)	(1,753,422)
General obligation bonds outstanding at June 30, adjusted for unamortized discount/premium	83,181,054	63,630,930
Less current portion	(4,624,412)	(4,322,011)
	\$ 78,556,642	\$ 59,308,919

Wastewater utility development bonds outstanding are comprised of the following individual issues:

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2007	2006
Series 1997 Capital Improvement	04/15/1997	\$ 43,975,000	5.25 - 5.375%	\$ 450,000	\$ 250,000
Series 1998 Capital Improvement	06/15/1998	44,330,000	4.25 - 5.00%	1,496,278	900,000
Series 1998 Refunding	06/15/1998	49,190,000	4.25 - 5.00%	2,281,621	4,674,039
Series 2002 Capital Improvement	02/01/2002	27,000,000	2.00 - 5.00%	949,770	1,371,890
Series 2002 Refunding	02/01/2002	47,200,000	2.00 - 5.00%	5,163,218	5,170,566
Series 2002B Refunding	11/01/2002	39,890,000	5.00 - 5.25%	2,588,223	3,356,439
Series 2003 VRA	04/08/2003	10,000,000	3.50%	8,498,943	9,634,954
Series 2003 Capital Improvement	11/15/2003	57,110,000	2.00 - 5.00%	934,933	989,923
Series 2003 Refunding	11/15/2003	12,265,000	3.00 - 4.00%	502,500	1,029,432
Series 2004 Refunding	03/01/2004	96,395,000	2.00 - 5.00%	7,298,359	7,899,898
Series 2004 VRA	09/17/2004	11,100,000	3.10%	10,890,660	11,100,000
Series 2005 Capital Improvement	03/16/2005	59,320,000	2.50 - 5.00%	1,785,000	1,850,000
Series 2005 Refunding	03/16/2005	35,035,000	2.50 - 5.00%	5,654,783	5,657,211
Series 2005 VRA	03/14/2006	11,500,000	3.00%	11,500,000	11,500,000
Series 2006 VRA	09/28/2006	14,250,000	none	14,250,000	-
Series 2006 Capital Improvement	11/15/2006	99,225,000	4.00 - 5.00%	9,889,500	-
Series 2006 Refunding	11/15/2006	15,830,000	4.00 - 5.00%	349,566	-
Wastewater utility development bonds outstanding				\$ 84,483,354	\$ 65,384,352

Wastewater Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

Note 7. Long-Term Obligations (Continued)

A summary of the requirements to amortize general obligation bonds outstanding at June 30, 2007 is as follows:

Year Ending June 30,	Principal	Interest
2008	\$ 4,624,412	\$ 2,565,079
2009	5,962,537	2,580,101
2010	5,775,615	2,345,140
2011	5,811,060	2,149,019
2012	5,697,873	1,916,804
2013 - 2017	22,605,522	6,726,325
2018 - 2022	17,519,113	3,480,961
2023 - 2027	15,388,881	1,055,822
2028	1,098,341	5,788
	<u>\$ 84,483,354</u>	<u>\$ 22,825,039</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.

Bonds authorized and unissued as of June 30, 2007 were \$9,373,272.

Advance refunding: In 2005, the Fund defeased certain general obligation bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Fund's financial statements. At June 30 2007 and 2006, \$4.12 million and \$7.85 million, respectively, of bonds outstanding for the Fund are considered defeased.

Note 8. 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 of Norfolk for a further description of the plan. Retirement expense was \$481,585 and \$456,990 for the years ended June 30, 2007 and 2006, respectively.

Note 9. Concentration of Credit Risk

Certain cash and investments of the Fund 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.

Wastewater Utility Fund of the City of Norfolk, Virginia

Notes to Financial Statements

Note 10. Commitments

Commitments for completion of capital projects authorized at June 30, 2007 were approximately \$15,955,000.

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. Adjustments to Beginning Capital Assets and Net Assets

The Fund's beginning capital asset and net assets have been restated to adjust historical cost and accumulated depreciation on the Fund's capital assets. The Fund did not properly reclassify construction in progress ("CIP") assets to capitalized assets when projects were completed and the assets were placed into service, or expense those costs associated with previously capitalized CIP for projects that were subsequently abandoned.

	Land and Construction in Process	Buildings, and Improvements and Equipment, Net of Accumulated Depreciation	Total Capital Assets, Net	Invested in Capital Assets, Net of Related Debt	Unrestricted	Total Net Assets
As previously reported, June 30, 2005	\$ 41,543,574	\$ 79,141,333	\$ 120,684,907	\$ 71,346,777	\$ (307,888)	\$ 71,038,889
Restatement adjustments	(21,914,641)	14,533,824	(7,380,817)	(7,380,817)	-	(7,380,817)
As restated, June 30, 2005	19,628,933	93,675,157	113,304,090	63,965,960	(307,888)	63,658,072
Net changes, as previously reported	5,222,902	8,243,988	13,466,890	11,014,970	(5,104,158)	5,910,812
Restatement adjustments	(2,691,487)	1,154,643	(1,536,844)	(1,536,844)	-	(1,536,844)
As restated, June 30, 2006	\$ 22,160,348	\$ 103,073,788	\$ 125,234,136	\$ 73,444,086	\$ (5,412,046)	\$ 68,032,040
	Depreciation	Other	Total			
As previously reported, for the year ended June 30, 2006	\$ 2,205,891	\$ 1,771,725	\$ 3,977,616			
Restatement adjustments	361,208	1,175,636	1,536,844			
As restated, for the year ended June 30, 2006	\$ 2,567,099	\$ 2,947,361	\$ 5,514,460			

Note 14. Subsequent Event

On November 9, 2007, the City issued \$17,000,000 in Wastewater Revenue Bonds, utilizing a federally subsidized interest rate loan program administered by the Virginia Resource Authority (VRA). The bonds were sold at a true interest cost of 0.00%.

Notes to Financial Statements

Note 15. Accounting Pronouncements Issued But Not Yet Implemented

The Governmental Accounting Standards Board ("GASB") has issued several pronouncements prior to June 30, 2007 that have 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 No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes standards for the measurement, recognition and display of expenses/expenditures and related liabilities (assets), note disclosures and if applicable, required supplementary information in the financial reports of state and local governmental employers on other postemployment benefits ("OPEB"). The Fund is required to adopt this Statement in fiscal year 2008.
- GASB Statement No. 47, *Accounting for Termination Benefits*. This Statement requires financial statements prepared on the accrual basis of accounting to recognize a liability and expense for voluntary termination benefits when the offer is accepted and the amount can be estimated. A liability and expense for involuntary termination benefits should be recognized when a plan of termination has been approved by those with the authority to commit the entity to the plan, the plan has been communicated to employees, and the amount can be estimated. The Fund is required to adopt this Statement the same time it adopts GASB Statement No. 45 mentioned above.
- GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. This Statement establishes criteria that governments will use to ascertain whether the proceeds received should be reported as revenue or as a liability. The criteria should be used to determine the extent to which a transferor government either retains or relinquishes control over the receivables or future revenues through its continuing involvement with those receivables or future revenues. This Statement establishes that a transaction will be reported as a collateralized borrowing unless the criteria indicating that a sale has taken place are met. If it is determined that a transaction involving *receivables* should be reported as a sale, the difference between the carrying value of the receivables and the proceeds should be recognized in the period of the sale in the change statements. If it is determined that a transaction involving future revenues should be reported as a sale, the revenue should be deferred and amortized, except when specific criteria are met. This Statement also provides additional guidance for sales of receivables and future revenues within the same financial reporting entity.

This Statement includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. Therefore, any assets (or future revenues) sold or donated within the same financial reporting entity should continue to be reported at their current carrying value when those assets or future revenues are transferred.

This Statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions. The disclosures pertaining to future revenues that have been pledged or sold are intended to provide financial statement users with information about which revenues will be unavailable for other purposes and how long they will continue to be so. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2006.

Notes to Financial Statements

Note 15. Accounting Pronouncements Issued But Not Yet Implemented (Continued)

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, 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 a 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).

GASB Statement No. 49 also will require governments to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements. Statement No. 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 beginning net assets can be restated.

- GASB Statement No. 50, *Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27*. This Statement more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits (“OPEB”) and, in doing so, enhances information disclosed in notes to financial statements or presented as required supplementary information (“RSI”) by pension plans and by employers that provide pension benefits. The reporting changes required by this Statement amend applicable note disclosure and RSI requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers*, to conform with requirements of Statements No. 43, *Financial Reporting for OPEB Plans*, and No. 45, *Accounting and Financial Reporting by Employers for OPEB*.
- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement 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, this Statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated and establishes criteria for when such expenditures should be capitalized. This Statement is effective for periods beginning after June 15, 2009 (the Fund’s fiscal year ended June 30, 2010) and generally requires its provisions to be applied retroactively.

McGladrey & Pullen

Certified Public Accountants

**Independent Auditor's Report
on Internal Control Over Financial
Reporting and on Compliance and Other
Matters Based on an Audit of Financial
Statements Performed in Accordance With
*Government Auditing Standards***

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

We have audited the financial statements of the Wastewater Utility Fund (the "Fund") of the City of Norfolk, Virginia as of and for the year ended June 30, 2007, and have issued our report thereon dated December 20, 2007. 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 the *Specifications for Audits of Counties, Cities, and Towns* issued by the Auditor of Public Accounts of the Commonwealth of Virginia. As described in Note 13 to the financial statements, the Fund restated net asset balances at June 30, 2006 and 2005 to correct errors associated with improper capitalization of capital assets.

Internal Control Over Financial Reporting

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

A 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.

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. However, we believe that the significant deficiency described below is a material weakness:

Restatement of prior year capital assets and net assets

An entity is required by accounting principles generally accepted in the United States of America ("GAAP") to reclassify construction in progress ("CIP") assets to capitalized assets when projects have been completed and the assets have been placed in service. Capitalized assets should be depreciated over their estimated useful lives and be subject to impairment analysis. Costs associated with CIP projects that have been abandoned should be expensed.

During the audit of the capital asset CIP account it was noted that several of the projects had no activity during the current fiscal year. Upon further investigation, it was discovered that certain projects were completed and should have been placed in service in prior years. In addition, it was discovered that there were several CIP projects that were abandoned that should have been expensed.

The condition noted above resulted in the overstatement of capital assets and net assets at June 30, 2006, in the amount of approximately \$8.9 million in the Fund.

We recommend that reviews of CIP projects be performed to determine the status of CIP projects as to whether or not a project is substantially complete or has been abandoned, so that the Fund has the requisite information to properly record capital assets in accordance with GAAP.

Management's Response: Management concurs with the finding. This finding has been corrected and the prior year's capital asset balance has been restated. In addition, management has put procedures in place to verify the status of each CIP asset.

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*.

Management's written response to the material weakness identified in our audit has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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

McGladrey & Pullen, LLP

Greensboro, North Carolina
December 20, 2007