



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

Financial and Compliance Report  
Year Ended June 30, 2011

# Water Utility Fund of the City of Norfolk, Virginia

Financial and Compliance Report  
Year Ended June 30, 2011

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KPMG LLP  
Suite 1900  
440 Monticello Avenue  
Norfolk, VA 23510

## Independent Auditors' Report

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

We have audited the accompanying statement of net assets of the Water Utility Fund of the City of Norfolk, Virginia (the Fund), as of June 30, 2011 and 2010, 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *Specifications for Audits of Counties, Cities and Towns* (Specifications), issued by the Auditor of Public Accounts of the Commonwealth of Virginia. Those standards and Specifications require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1 to the financial statements, the accompanying financial statements present only the 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 respective financial position of the Water Utility Fund of the City of Norfolk, Virginia as of June 30, 2011 and 2010, and changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated December 13, 2011 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.



Our audits were made 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.

KPMG LLP

December 13, 2011

Water Utility Fund of the City of Norfolk, Virginia  
*Statements of Net Assets*  
June 30, 2011 and 2010

	2011	2010
<b>ASSETS</b>		
Current assets:		
Cash and short term investments (Note 2)	\$ 23,874,446	\$ 32,855,827
Unrestricted short term investments (Note 2)	13,263,144	-
Receivables:		
Accounts (net) (Note 3)	6,652,303	8,680,574
Unbilled accounts (Note 4)	7,707,220	5,899,822
Accrued investment income	4,120	3,242
Inventories	1,419,063	1,539,030
Restricted cash held in escrow (Note 2)	246,313	126,638
Restricted short term investments (Note 2):		
Restricted investment held with fiscal agent	10,369,965	9,246,492
Reserve funds	17,504,604	14,735,202
Investment restricted for construction	32,834,522	-
Total current assets	<u>113,875,700</u>	<u>73,086,827</u>
Capital assets (Note 5):		
Non-depreciable assets	35,070,601	36,630,843
Depreciable assets	580,884,524	561,637,712
Accumulated depreciation and amortization	(167,222,416)	(155,720,259)
Total noncurrent assets	<u>448,732,709</u>	<u>442,548,296</u>
Total assets	<u>562,608,409</u>	<u>515,635,123</u>
<b>LIABILITIES</b>		
Current liabilities:		
Vouchers payable	1,209,790	987,465
Vouchers payable for CIP projects	3,635,806	2,222,432
Contract retainage	435,885	475,890
Accrued interest	90,666	161,252
Accrued payroll	510,836	280,507
Due to General Fund and other City funds	1,335,003	534,574
Payable to employees' retirement system	2,770,254	2,170,730
Compensated absences	729,300	664,254
Current portion of bonds payable (Note 6)	13,343,267	12,697,993
Accrued revenue bond interest payable	2,839,254	2,598,695
Other liabilities	175,661	862,105
Total current liabilities	<u>27,075,722</u>	<u>23,655,897</u>
Noncurrent liabilities:		
General obligation bonds payable (Note 6)	1,759,117	3,759,419
Revenue bonds payable (Note 6)	329,244,547	291,435,604
Liability for other postemployment benefits (OPEB) (Note 12)	1,199,565	830,437
Compensated absences	366,812	433,910
Total noncurrent liabilities	<u>332,570,041</u>	<u>296,459,370</u>
Total liabilities	<u>359,645,763</u>	<u>320,115,267</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	154,341,182	147,763,612
Restricted	11,000,000	11,000,000
Unrestricted	37,621,464	36,756,244
	<u>\$ 202,962,646</u>	<u>\$ 195,519,856</u>

See Notes to Financial Statements

Water Utility Fund of the City of Norfolk, Virginia

*Statements of Revenues, Expenses and Changes in Net Assets*  
 Years Ended June 30, 2011 and 2010

	2011	2010
Operating revenues:		
Charges for services	\$ 80,573,611	\$78,982,990
Miscellaneous	2,936,138	3,161,097
Total operating revenues	<u>83,509,749</u>	<u>82,144,087</u>
Operating expenses:		
Personnel services	14,703,327	14,284,882
Plant operations	6,493,701	5,896,843
Chemicals	3,524,658	3,761,744
Provision for bad debts	429,970	301,294
Depreciation and amortization	11,915,059	11,494,781
Retirement contribution	2,770,254	2,170,730
OPEB expense	369,128	364,437
Administrative expenses	2,263,435	1,563,029
Other	9,224,888	8,935,390
Total operating expenses	<u>51,694,420</u>	<u>48,773,130</u>
Operating income	31,815,329	33,370,957
Nonoperating revenues (expenses):		
Interest income, net of interest capitalized	227,695	325,933
Intergovernmental Revenues	85,261	-
Interest expense and fiscal charges	(16,157,923)	(15,543,012)
Gain (Loss) on sale or disposal of assets	(157,224)	2,842,616
Total nonoperating expenses, net	<u>(16,002,191)</u>	<u>(12,374,463)</u>
Net income before contributions and transfers	15,813,138	20,996,494
Capital contributions	129,652	366,363
Transfers out	(8,500,000)	(11,360,000)
Change in net assets	<u>7,442,790</u>	<u>10,002,857</u>
Total net assets - beginning	195,519,856	185,516,999
Total net assets - end	<u>\$ 202,962,646</u>	<u>\$195,519,856</u>

See Notes to Financial Statements

Water Utility Fund of the City of Norfolk, Virginia

*Statements of Cash Flows*

Years Ended June 30, 2011 and 2010

	2011	2010
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Receipts from customers	\$ 83,300,652	\$ 80,761,692
Payments to suppliers	(9,676,067)	(9,563,472)
Payments to employees	(16,645,780)	(15,881,607)
Other payments	(12,174,767)	(11,437,058)
Net cash provided by operating activities	<u>44,804,038</u>	<u>43,879,555</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>		
Internal activity, payments from (to) other funds	800,429	(2,835,069)
Transfers out	(8,500,000)	(11,360,000)
Other nonoperating revenue	85,261	-
Net cash used in noncapital financing activities	<u>(7,614,310)</u>	<u>(14,195,069)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATING FINANCING ACTIVITIES:</b>		
Proceeds from sale of debt	47,415,000	-
Proceeds from sale of Fixed Assets	-	2,860,000
Capital contributions	129,652	366,363
Purchases of capital assets	(16,883,327)	(16,278,575)
Principal paid on capital debt	(12,697,993)	(12,232,578)
Interest paid and bond service charges	(14,251,042)	(15,149,860)
Net cash provided by (used in) capital and related financing activities	<u>3,712,290</u>	<u>(40,434,650)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sale of investments	54,286,514	57,350,804
Purchase of investments	(104,277,055)	(30,278,737)
Purchase of certificates of deposit	-	(13,000,000)
Interest and dividends	226,817	328,799
Net cash provided by (used in) investing activities	<u>(49,763,724)</u>	<u>14,400,866</u>
Net increase (decrease) in cash and cash equivalents	<u>(8,861,706)</u>	<u>3,650,702</u>
Cash and cash equivalents - beginning of year	<u>32,982,465</u>	<u>29,331,763</u>
Cash and cash equivalents - end of year	<u>\$ 24,120,759</u>	<u>\$ 32,982,465</u>

(Continued)

Water Utility Fund of the City of Norfolk, Virginia

*Statements of Cash Flows (Continued)*

Years Ended June 30, 2011 and 2010

**Reconciliation of Operating Income to Net Cash**

**Provided by Operating Activities:**

Operating income	\$ 31,815,329	\$ 33,370,957
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense	11,915,059	11,494,781
Provision for bad debt	429,970	301,294
Change in assets and liabilities:		
Accounts receivable (net), billed and unbilled	(209,097)	(1,382,395)
Inventories	119,967	88,164
Vouchers payable	222,325	6,951
Accrued payroll	827,801	574,005
Other liabilities	(317,316)	(574,202)
Net cash provided by operating activities	<u>\$ 44,804,038</u>	<u>\$ 43,879,555</u>

**Reconciliation of cash and short term investments to the**

**Statement of Net Assets:**

Cash and short term investments	\$ 23,874,446	\$ 32,855,827
Restricted cash held in escrow	246,313	126,638
Total cash and short term investments per Statement of Net Assets	<u>\$ 24,120,759</u>	<u>\$ 32,982,465</u>

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

Gain (loss) on sale or disposal of capital assets	\$ (157,224)	\$ 2,842,616
Acquisition of capital assets through change in contract retainage	<u>\$ (40,005)</u>	<u>\$ (318,182)</u>
Acquisition of capital assets through change in vouchers payable	<u>\$ 1,413,374</u>	<u>\$ 127,530</u>
Capitalized interest	<u>\$ 1,160,204</u>	<u>\$ 1,195,740</u>

See Notes to Financial Statements

Notes to Financial Statements

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

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

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

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

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

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

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 moving average method) or market.

Notes to Financial Statements

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

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

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

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

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

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

The Fund evaluates prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. A capital asset is generally considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset. Impaired capital assets that will no longer be used by the Fund are reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the Fund 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

Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2011

Notes to Financial Statements

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grants, are reported as nonoperating. When both restricted and unrestricted resources are available for use, the policy is to use restricted resources first and then unrestricted resources as they are needed.

General allocations: The General Fund of the City provides administrative services to the Fund, which totaled \$2,789,935 and \$2,064,197 for the fiscal years ended June 30, 2011 and 2010, respectively. Charges for these services are treated as expenses by the Fund. In addition the Fund recorded, as other expenses, payments to the General Fund in lieu of taxes of \$2,710,608 for the fiscal years ended June 30, 2011 and 2010.

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

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

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

**Note 2. Cash and Investments**

At June 30, 2011 and 2010, the Fund's cash and investments consist of the following:

	2011	2010
Investment in LGIP	\$ 11,000,010	\$ 18,504,273
Other investments	62,972,235	12,981,694
Certificates of deposit	-	22,000,000
Cash	24,120,749	3,478,192
	<u>\$ 98,092,994</u>	<u>\$ 56,964,159</u>
Cash and short term investments	\$ 23,874,446	\$ 32,855,827
Restricted cash held in escrow	246,313	126,638
Restricted short term investments held with fiscal agent	10,369,965	9,246,492
Unrestricted short term investments	13,263,144	-
Reserve funds	17,504,604	14,735,202
Investment restricted for construction	32,834,522	-
	<u>\$ 98,092,994</u>	<u>\$ 56,964,159</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  
June 30, 2011

Notes to Financial Statements

The Fund's restricted assets on the statement of net assets include \$0 and \$11,000,000 of certificates of deposits at June 30, 2011 and 2010. 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.

At June 30, 2011 and 2010, the Fund had \$11,000,010 and \$18,504,273 deposited, respectively, in the LGIP which carries a Standard and Poor's rating of AAAm and is included in cash and short-term investments and reserve funds.

The Fund's investments for the years ended June 30, 2011 and 2010, 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 2011		Fiscal Year 2010	
	Fair Value		Fair Value	
	Less than 1 year		Less than 1 year	
SNAP Money Market Mutual Funds	\$	46,097,666	\$	-
US Agency Notes		6,504,604		3,735,202
PFM Funds Government Series		10,369,965		9,246,492
	\$	62,972,235	\$	12,981,694

The Fund's rated debt investments, other than in LGIP, as of June 30, 2011 and 2010 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 2011		
	AAA	AAAm	Total
Money Market Mutual Fund			
SNAP Money Market Mutual Funds	\$ -	\$ 46,097,666	\$ 46,097,666
PFM Funds Government Series	-	10,369,965	10,369,965
US Agency Notes	6,504,604	-	6,504,604
	\$ 6,504,604	\$ 56,467,631	\$ 62,972,235

Investment Type	Fiscal Year 2010		
	AAA	AAAm	Total
Money Market Mutual Fund			
SNAP Money Market Mutual Funds	\$ -	\$ -	\$ -
PFM Funds Government Series	-	9,246,492	9,246,492
US Agency Notes	3,735,202	-	3,735,202
	\$ 3,735,202	\$ 9,246,492	\$ 12,981,694

Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2011

Notes to Financial Statements

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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 financial 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, 2011 and 2010 is as follows:

	2011	2010
Accrued revenue bond interest payable	<u>\$ 2,839,254</u>	<u>\$ 2,598,695</u>

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 for further cash and investment disclosures.

**Note 3. Accounts Receivable**

Accounts receivable at June 30, 2011 and 2010 is comprised of the following:

	2011	2010
Governmental	\$ 766,085	\$ 2,585,981
Residential	2,907,543	2,761,497
Refuse disposal fees	3,297,228	3,172,769
Commercial	1,052,717	1,059,578
Utility taxes	705,442	699,839
Industrial	156,523	177,482
Other	986,368	1,063,735
	<u>9,871,906</u>	<u>11,520,881</u>
Less allowance for uncollectible accounts	<u>(3,219,603)</u>	<u>(2,840,307)</u>
	<u>\$ 6,652,303</u>	<u>\$ 8,680,574</u>

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

**Note 4. Unbilled Accounts Receivable**

At June 30, 2011 and 2010, the Fund recognized \$7,707,220 and \$5,899,822 as unbilled accounts receivable, respectively. These amounts were billed in July 2011 and July 2010, respectively.

Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2011

Notes to Financial Statements

Note 5. Capital Assets

Capital assets at June 30, 2011 and 2010 are comprised of the following:

	Balance June 30, 2010	Additions	Retirements	Balance June 30, 2011
<b>Nondepreciable assets:</b>				
Land	\$ 10,239,496	\$ 369,500	\$ -	\$ 10,608,996
Intangible assets	2,304,237	-	-	2,304,237
Construction in progress	24,087,110	16,702,058	(18,631,800)	22,157,368
Total nondepreciable assets	36,630,843	17,071,558	(18,631,800)	35,070,601
<b>Depreciable &amp; amortized assets:</b>				
Land improvements	7,040,090	12,836,523	-	19,876,613
Buildings	178,822,669	-	(305,401)	178,517,268
Equipment	370,504,783	6,997,092	(286,436)	377,215,439
Intangible assets	5,270,170	5,034	-	5,275,204
Total depreciable & amortized assets	561,637,712	19,838,649	(591,837)	580,884,524
<b>Less accumulated depreciation for</b>				
Land improvements	(3,097,046)	(236,510)	-	(3,333,556)
Buildings	(39,106,479)	(2,944,725)	146,981	(41,904,223)
Equipment	(111,619,316)	(7,803,002)	265,921	(119,156,397)
Intangible assets	(1,897,418)	(930,822)	-	(2,828,240)
Total accumulated depreciation	(155,720,259)	(11,915,059)	412,902	(167,222,416)
Depreciable assets, net	405,917,453	7,923,590	(178,935)	413,662,108
Total capital assets, net	\$ 442,548,296	\$ 24,995,148	\$ (18,810,735)	\$ 448,732,709

	Restated per GASB 51			
	Balance June 30, 2009	Additions	Retirements	Balance June 30, 2010
<b>Nondepreciable assets:</b>				
Land	\$ 10,200,187	\$ 39,309	\$ -	\$ 10,239,496
Intangible assets	2,304,237	-	-	2,304,237
Construction in progress	21,844,293	14,918,287	(12,675,470)	24,087,110
Total nondepreciable assets	34,348,717	14,957,596	(12,675,470)	36,630,843
<b>Depreciable assets:</b>				
Land improvements	7,101,351	-	(61,261)	7,040,090
Buildings	178,822,669	-	-	178,822,669
Equipment	357,772,506	13,202,617	(470,340)	370,504,783
Intangible assets	4,678,260	591,910	-	5,270,170
Total depreciable & amortized assets	548,374,786	13,794,527	(531,601)	561,637,712
<b>Less accumulated depreciation for</b>				
Land improvements	(3,027,863)	(130,445)	61,262	(3,097,046)
Buildings	(36,154,555)	(2,951,924)	-	(39,106,479)
Equipment	(104,266,045)	(7,817,496)	464,225	(111,619,316)
Intangible assets	(1,302,502)	(594,916)	-	(1,897,418)
Total accumulated depreciation	(144,750,965)	(11,494,781)	525,487	(155,720,259)
Depreciable assets, net	403,623,821	2,299,746	(6,114)	405,917,453
Total capital assets, net	\$ 437,972,538	\$ 17,257,342	\$ (12,681,584)	\$ 442,548,296

Water Utility Fund of the City of Norfolk, Virginia  
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Notes to Financial Statements

The Fund capitalized \$1,290,620 of interest expense and \$130,416 of interest income for the fiscal year ended June 30, 2011. For the fiscal year ended June 30, 2010 the Fund capitalized \$1,209,737 of interest expense and \$13,997 of interest income. The total interest cost was \$17,448,543 and \$16,752,749 for the fiscal year ended June 30, 2011 and 2010, respectively.

**Note 6. Long-Term Obligations**

General obligation bonds: A summary of general obligation bond transactions for the fiscal year ended June 30, 2011 and 2010 follows:

	2011	2010
General obligation bonds outstanding at July 1	\$ 6,719,682	\$ 9,532,260
Bonds retired/refunded	(2,822,993)	(2,812,578)
Bonds outstanding at June 30	3,896,689	6,719,682
Unamortized discount/premium, net	(79,305)	(137,270)
General obligation bonds outstanding at June 30, adjusted for unamortized discount/premium	3,817,384	6,582,412
Less current portion	(2,058,267)	(2,822,993)
	<u>\$ 1,759,117</u>	<u>\$ 3,759,419</u>

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

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2011	2010
Series 2002 Refunding	2/13/2002	47,200,000	2.00 - 5.00%	\$ 730,014	\$ 1,465,281
Series 2002B Refunding	11/1/2002	39,890,000	5.00 - 5.25%	773,372	807,316
Series 2004 Refunding	3/16/2004	96,395,000	2.00 - 5.00%	-	746,269
Series 2009 Refunding	5/21/2009	21,895,000	3.00 - 5.00%	2,393,303	3,700,816
Total Water Utility General Obligation Bonds				<u>\$ 3,896,689</u>	<u>\$ 6,719,682</u>

A summary of the requirements to amortize general obligation bonds outstanding at June 30, 2011 is as follows:

Year Ending June 30,	Principal	Interest
2012	\$ 2,058,267	\$ 163,900
2013	739,589	82,154
2014	551,047	41,165
2015	547,786	13,695
	<u>\$ 3,896,689</u>	<u>\$ 300,914</u>

Water Utility Fund of the City of Norfolk, Virginia  
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Notes to Financial Statements

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 is 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, 2011 and 2010 follows:

	2011	2010
Revenue bonds outstanding at July 1	\$ 303,355,000	\$ 312,775,000
Bonds retired	(9,875,000)	(9,420,000)
Bonds issued	47,415,000	-
Bonds outstanding at June 30	340,895,000	303,355,000
Unamortized discount/premium, net	(365,453)	(2,044,396)
Revenue bonds outstanding at June 30, adjusted for unamortized discount/premium	340,529,547	301,310,604
Less current portion	(11,285,000)	(9,875,000)
	<u>\$ 329,244,547</u>	<u>\$ 291,435,604</u>

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

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2011	2010
Series 1993 Water Revenue	11/1/1993	\$ 68,430,000	2.80 - 5.375%	\$ 42,375,000	\$ 44,575,000
Series 1995 Water Revenue	8/15/1995	115,680,000	4.75 - 7.00%	81,135,000	84,425,000
Series 1998 Water Revenue and Refunding	11/1/1998	84,605,000	4.00 - 5.125%	63,950,000	66,095,000
Series 2001 Water Revenue and Refunding	10/15/2001	35,000,000	4.00 - 5.00%	28,865,000	29,660,000
Series 2005 Water Revenue and Refunding	3/23/2005	22,810,000	3.50 - 5.00%	20,695,000	21,150,000
Series 2008 Water Revenue	4/23/2008	58,415,000	3.00 - 5.00%	56,460,000	57,450,000
Series 2010 Water Revenue	9/23/2010	47,415,000	2.00 - 4.50%	47,415,000	-
Total Water Utility Revenue Bonds				<u>\$ 340,895,000</u>	<u>\$ 303,355,000</u>

Water Utility Fund of the City of Norfolk, Virginia  
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Notes to Financial Statements

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A summary of the requirements to amortize water revenue bonds outstanding at June 30, 2011 is as follows:

Year Ending June 30,	Principal	Interest
2012	\$ 11,285,000	\$ 16,773,159
2013	11,825,000	16,227,660
2014	12,400,000	15,652,373
2015	13,025,000	15,034,060
2016	13,690,000	14,365,657
2017-2021	80,180,000	60,079,259
2022-2026	94,890,000	36,341,084
2027-2031	48,605,000	17,483,284
2032-2036	32,465,000	8,552,447
2037-2041	22,530,000	1,986,487
	<u>\$ 340,895,000</u>	<u>\$ 202,495,470</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, 2011 and 2010 were \$51,720,626 and \$51,425,000, 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 \$2,770,254 and \$2,170,730 for the years ended June 30, 2011 and 2010, respectively.

**Note 8. Significant Customers**

Billed and unbilled accounts receivable includes \$5,516,678 and \$6,015,240 due from the City of Virginia Beach and \$771,725 and \$671,303 due from the United States Navy for water sales at June 30, 2011 and 2010, respectively. Net charges for services include \$28,702,893 and \$26,742,250 for water sales to the City of Virginia Beach and \$8,836,936 and \$8,107,730 for the United States Navy for the fiscal years ended June 30, 2011 and 2010.

Notes to Financial Statements

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**Note 9. Commitments and Contingencies**

Commitments for completion of capital projects authorized at June 30, 2011 and 2010 were approximately \$23,275,000 and \$14,082,000, respectively.

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 10. 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 11. 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's combination of purchased insurance policies and self-insurance plans.

**Note 12. Other Postemployment Benefits (OPEB)**

The City's annual OPEB cost (expense) is calculated based on the annual required contribution (ARC), an amount actuarially determined in accordance with GAAP wherein governments report on an accrual basis, benefit costs related to the period in which benefits are earned rather than to the period of benefit distribution. The ARC represents a level of funding that, if paid on an on-going basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years. The ARC as computed for the City is allocated to the Fund based on payroll.

The Fund and the City use the pay as you go method to calculate the OPEB liability for June 30, 2011 as the City has not funded a trust for the OPEB liability. Using the most recent OPEB plan valuation date of July 1, 2010, the following table shows the components of the Fund's annual OPEB costs projected for the current fiscal year, the amount contributed to the Plan and the changes in the net OPEB obligation:

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	2011	2010
Net beginning OPEB obligation	\$ 830,437	\$ 466,000
Annual required contributions	488,671	569,341
Interest on net OPEB obligation	38,315	21,288
Adjustment to ARC	(35,579)	(16,834)
Annual OPEB cost	491,407	573,795
Less: contributions made	122,279	209,358
Increase in net OPEB obligation	369,128	364,437
Net ending OPEB obligation	\$ 1,199,565	\$ 830,437

The total unfunded actuarial accrued liability (UAAL) for 2011 and 2010 is \$3,702,557 and \$3,545,026, respectively, and is allocated to the Fund on the same basis as the ARC. The allocation is based on covered payroll and does not purport to represent the OPEB liability of the Fund on a stand-alone basis. Reference should be made to the Comprehensive Annual Financial Report of the City of Norfolk for further information.

**Note 13. Accounting Pronouncements Issued But Not Yet Implemented**

The GASB has issued several pronouncements that may impact future financial presentations. Management has not determined what, if any, impact implementation of the following statements will have on the Fund.

- GASB Statement 60: *Accounting and Reporting for Service Concession Arrangements*. GASB 60 addresses issues related to accounting for, financial reporting and disclosure requirements of certain service concession arrangements, which are a type of public-private partnership. The provisions of GASB 60 are effective for fiscal years beginning after December 15, 2011.
- GASB Statement 62: *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. GASB 62 incorporates into GASB's authoritative literature certain accounting and financial reporting guidance issued on or before November 30, 1989 from the following sources: FASB statements and interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the AICPA, so long as it does not contradict or conflict with GASB pronouncements. This statement also supersedes Statement No. 20: *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*. The provisions of GASB 62 are effective for fiscal years beginning after December 15, 2011.
- GASB Statement 63: *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. GASB 63 provides financial reporting guidance for deferred outflows and inflows of resources. These terms are defined as the consumption or acquisition of net assets by the government that is applicable to a future reporting period respectively. The provisions of GASB 62 are effective for fiscal years beginning after December 15, 2011.
- GASB Statement 64: *Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53*, GASB 64 will clarify whether an effective hedging relationship will continue after the replacement of a swap counterparty or swap counterparty's credit support provider. The statement will also set forth

Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2011

Notes to Financial Statements

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criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The provisions of GASB 64 are effective for fiscal years beginning after June 15, 2011.

Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2011

Supplementary Schedule

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

Fiscal Year	Revenue Available for Debt Service (1)	Operating Expenses Less Depreciation & Amortization (2)	Income Available for Debt Service	Debt Service			Coverage
				Principal	Interest	Total	
2001	\$ 64,459,300	\$ 29,732,203	\$ 34,727,097	\$ 4,680,000	\$ 13,411,636	\$ 18,091,636	1.92
2002	63,681,665	29,021,459	34,660,206	4,890,000	14,090,180	18,980,180	1.83
2003	67,760,029	30,867,286	36,892,743	5,700,000	14,600,283	20,300,283	1.82
2004	64,366,942	36,623,654	27,743,288	5,955,000	14,336,043	20,291,043	1.37
2005	69,183,154	37,584,692	31,598,462	6,250,000	14,041,059	20,291,059	1.56
2006	78,788,158	37,086,776	41,701,382	6,580,000	14,827,960	21,407,960	1.95
2007	76,013,563	35,050,694	40,962,869	7,310,000	14,379,821	21,689,821	1.89
2008	78,730,024	39,559,202	39,170,822	7,665,000	14,022,200	21,687,200	1.81
2009	78,020,552	40,807,627	37,212,925	8,050,000	16,411,343	24,461,343	1.52
2010	82,470,020	37,278,349	45,191,671	9,420,000	15,929,680	25,349,680	1.78
2011	83,737,444	39,779,361	43,958,083	9,875,000	16,527,844	26,402,844	1.66

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

2. Includes operating expenses less depreciation and amortization.

(See accompanying independent auditor's report)



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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 *Government Auditing Standards***

The Honorable Members of the 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, 2011 and 2010, and have issued our report thereon dated December 13, 2011. As discussed in note 1 to the financial statements, the accompanying financial statements present on the Water Utility Fund and do not purport to, and do not, present fairly the financial position of the City of Norfolk, Virginia, the changes in its financial position or its cash flows, where applicable, in conformity with U.S. generally accepted accounting principles. Our report also discusses that the Fund has not presented a Management's Discussion and Analysis that U.S. generally accepted accounting principles has determined is necessary to supplement, although not required to be a part of, the financial statements. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control over Financial Reporting**

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

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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



### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

**KPMG LLP**

December 13, 2011