



Water Utility Fund of the City of Norfolk, Virginia

Financial and Compliance Report
Year Ended June 30, 2012

Water Utility Fund of the City of Norfolk, Virginia

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KPMG LLP
Suite 1900
440 Monticello Avenue
Norfolk, VA 23510

Independent Auditors' Report

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

We have audited the accompanying statement of net assets of the Water Utility Fund of the City of Norfolk, Virginia (the Fund), as of June 30, 2012 and 2011, 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 audit.

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 City'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, 2012 and 2011, and the respective changes in 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 January 15, 2013 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.

U.S. generally accepted accounting principles requires that the Supplemental Other Post Employment Benefit (OPEB) Information on page 21 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Fund's basic financial statements. The Supplemental Debt Capacity Information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The Supplemental Debt Capacity Information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Supplemental Debt Capacity Information is fairly stated in all material respects in relation to the basic financial statements as a whole.

KPMG LLP

January 15, 2013

Water Utility Fund of the City of Norfolk, Virginia
Statements of Net Assets
June 30, 2012 and 2011

	2012	2011
ASSETS		
Current assets:		
Cash and short term investments (Note 2)	\$ 33,477,706	\$ 23,874,446
Unrestricted short term investments (Note 2)	11,785,201	13,263,144
Receivables:		
Accounts (net) (Note 3)	7,000,856	6,652,303
Unbilled accounts (Note 4)	4,717,107	7,707,220
Accrued investment income	24,433	4,120
Inventories	1,479,257	1,419,063
Restricted cash held in escrow (Note 2)	325,953	246,313
Restricted short term investments (Note 2):		
Restricted investment held with fiscal agent	5,655,167	10,369,965
Reserve funds	17,522,624	17,504,604
Investment restricted for construction	2,081,210	32,834,522
Total current assets	<u>84,069,514</u>	<u>113,875,700</u>
Capital assets (Note 5):		
Non-depreciable assets	53,478,329	35,070,601
Depreciable assets	596,364,005	580,884,524
Accumulated depreciation and amortization	<u>(178,746,840)</u>	<u>(167,222,416)</u>
Total noncurrent assets	<u>471,095,494</u>	<u>448,732,709</u>
Total assets	<u>555,165,008</u>	<u>562,608,409</u>
LIABILITIES		
Current liabilities:		
Vouchers payable	1,029,210	1,209,790
Vouchers payable for CIP projects	3,690,709	3,635,806
Contract retainage	888,773	435,885
Accrued interest	50,784	90,666
Accrued payroll	243,886	510,836
Due to General Fund and other City funds	1,488,031	1,335,003
Payable to employees' retirement system	2,629,548	2,770,254
Compensated absences	597,785	729,300
Current portion of bonds payable (Note 6)	7,739,589	13,343,267
Accrued revenue bond interest payable	2,498,910	2,839,254
Other liabilities	211,312	175,661
Total current liabilities	<u>21,068,537</u>	<u>27,075,722</u>
Noncurrent liabilities:		
General obligation bonds payable (Note 6)	1,069,428	1,759,117
Revenue bonds payable (Note 6)	319,417,625	329,244,547
Liability for other postemployment benefits (OPEB) (Note 12)	1,527,018	1,199,565
Compensated absences	446,904	366,812
Total noncurrent liabilities	<u>322,460,975</u>	<u>332,570,041</u>
Total liabilities	<u>343,529,512</u>	<u>359,645,763</u>
NET ASSETS		
Invested in capital assets, net of related debt	157,453,707	154,341,182
Restricted	11,000,099	11,000,000
Unrestricted	43,181,690	37,621,464
	<u>\$ 211,635,496</u>	<u>\$ 202,962,646</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, 2012 and 2011

	2012	2011
Operating revenues:		
Charges for services	\$ 78,148,051	\$80,573,611
Miscellaneous	3,052,421	2,936,138
Total operating revenues	<u>81,200,472</u>	<u>83,509,749</u>
Operating expenses:		
Personnel services	13,783,048	14,703,327
Plant operations	6,589,857	6,493,701
Chemicals	2,967,518	3,524,658
Provision for bad debts	230,670	429,970
Depreciation and amortization	11,902,145	11,915,059
Retirement contribution	2,629,548	2,770,254
OPEB expense	327,453	369,128
Administrative expenses	1,852,927	2,263,435
Other	8,997,111	9,224,888
Total operating expenses	<u>49,280,277</u>	<u>51,694,420</u>
Operating income	31,920,195	31,815,329
Nonoperating revenues (expenses):		
Interest income, net of interest capitalized	94,747	227,695
Intergovernmental Revenues	137,555	85,261
Interest expense and fiscal charges	(15,171,047)	(16,157,923)
Gain (Loss) on sale or disposal of assets	25,788	(163,629)
Other nonoperating revenue	(21,764)	6,405
Total nonoperating expenses, net	<u>(14,934,721)</u>	<u>(16,002,191)</u>
Net income before contributions and transfers	16,985,474	15,813,138
Capital contributions	187,376	129,652
Transfers out	(8,500,000)	(8,500,000)
Change in net assets	<u>8,672,850</u>	<u>7,442,790</u>
Total net assets - beginning	202,962,646	195,519,856
Total net assets - end	<u>\$ 211,635,496</u>	<u>\$202,962,646</u>

See Notes to Financial Statements

Water Utility Fund of the City of Norfolk, Virginia

Statements of Cash Flows

Years Ended June 30, 2012 and 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	\$ 83,611,362	\$ 83,300,652
Payments to suppliers	(9,798,149)	(9,676,067)
Payments to employees	(16,871,675)	(16,645,780)
Other payments	(10,830,883)	(12,353,702)
Net cash provided by operating activities	<u>46,110,655</u>	<u>44,625,103</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Internal activity, payments from (to) other funds	153,028	800,429
Transfers out	(8,500,000)	(8,500,000)
Intergovernmental revenues	137,555	85,261
Net cash used in noncapital financing activities	<u>(8,209,417)</u>	<u>(7,614,310)</u>
CASH FLOWS FROM CAPITAL AND RELATING FINANCING ACTIVITIES:		
Proceeds from sale of debt	176,925,000	47,415,000
Proceeds from sale of fixed assets	42,284	15,306
Capital contributions	187,376	129,652
Purchases of capital assets	(33,757,139)	(16,726,103)
Refunding of debt principal	(210,160,000)	-
Principal paid on capital debt	(13,343,267)	(12,697,993)
Interest paid and bond service charges	14,906,705	(14,251,042)
Net cash (used in) provided by capital and related financing activities	<u>(65,199,041)</u>	<u>3,884,820</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of investments	70,378,732	54,292,919
Purchase of investments	(33,472,463)	(104,277,055)
Interest and dividends	74,434	226,817
Net cash provided by (used in) investing activities	<u>36,980,703</u>	<u>(49,757,319)</u>
Net increase (decrease) in cash and cash equivalents	9,682,900	(8,861,706)
Cash and cash equivalents - beginning of year	<u>24,120,759</u>	<u>32,982,465</u>
Cash and cash equivalents - end of year	<u>\$ 33,803,659</u>	<u>\$ 24,120,759</u>

(Continued)

Water Utility Fund of the City of Norfolk, Virginia

Statements of Cash Flows (Continued)

Years Ended June 30, 2012 and 2011

Reconciliation of Operating Income to Net Cash

Provided by Operating Activities:

Operating income	\$ 31,920,195	\$ 31,815,329
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense	11,902,145	11,915,059
Provision for bad debt	230,670	429,970
Loss on disposal of assets	(16,496)	(178,935)
Change in assets and liabilities:		
Accounts receivable (net), billed and unbilled	2,410,890	(209,097)
Inventories	(60,194)	119,967
Vouchers payable	(180,580)	222,325
Accrued payroll	(459,079)	827,801
Other liabilities	363,104	(317,316)
Net cash provided by operating activities	<u>\$ 46,110,655</u>	<u>\$ 44,625,103</u>

Reconciliation of cash and short term investments to the

Statement of Net Assets:

Cash and short term investments	\$ 33,477,706	\$ 23,874,446
Restricted cash held in escrow	325,953	246,313
Total cash and short term investments per Statement of Net Assets	<u>\$ 33,803,659</u>	<u>\$ 24,120,759</u>

Noncash investing, capital and financing activities:

Unrealized gain/(loss) on investments	\$ (21,764)	\$ 6,405
Acquisition of capital assets through change in contract retainage	\$ 452,888	\$ (40,005)
Acquisition of capital assets through change in vouchers payable	\$ 54,903	\$ 1,413,374
Capitalized interest	<u>\$ 1,433,603</u>	<u>\$ 1,160,204</u>

See Notes to Financial Statements

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.

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

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, 2012

Notes to Financial Statements

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 \$2,379,427 and \$2,789,935 for the fiscal years ended June 30, 2012 and 2011, 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, 2012 and 2011.

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, 2012 and 2011, the Fund's cash and investments consist of the following:

	2012	2011
Investment in LGIP	\$ 11,000,100	\$ 11,000,010
Other investments	26,044,103	62,972,235
Cash	33,803,658	24,120,749
	<u>\$ 70,847,861</u>	<u>\$ 98,092,994</u>
Cash and short term investments	\$ 33,477,706	\$ 23,874,446
Restricted cash held in escrow	325,953	246,313
Restricted short term investments held with fiscal agent	5,655,167	10,369,965
Unrestricted short term investments	11,785,201	13,263,144
Reserve funds	17,522,624	17,504,604
Investment restricted for construction	2,081,210	32,834,522
	<u>\$ 70,847,861</u>	<u>\$ 98,092,994</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.

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

Water Utility Fund of the City of Norfolk, Virginia
June 30, 2012

Notes to Financial Statements

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, 2012 and 2011, the Fund had \$11,000,100 and \$11,000,010 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, 2012 and 2011, 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 2012		Fiscal Year 2011	
	Fair Value		Fair Value	
	Less than 1 year		Less than 1 year	
SNAP Money Market Mutual Funds	\$	13,866,411	\$	46,097,666
US Agency Notes		6,522,525		6,504,604
PFM Funds Government Series		5,655,167		10,369,965
	\$	26,044,103	\$	62,972,235

The Fund's rated debt investments, other than in LGIP, as of June 30, 2012 and 2011 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 2012		
	AA+	AAAm	Total
Money Market Mutual Fund			
SNAP Money Market Mutual Funds	\$ -	\$ 13,866,411	\$ 13,866,411
PFM Funds Government Series	-	5,655,167	5,655,167
US Agency Notes	6,522,525	-	6,522,525
	\$ 6,522,525	\$ 19,521,578	\$ 26,044,103

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

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.

Water Utility Fund of the City of Norfolk, Virginia
June 30, 2012

Notes to Financial Statements

A summary of the liabilities payable from restricted assets at June 30, 2012 and 2011 is as follows:

	<u>2012</u>	<u>2011</u>
Accrued revenue bond interest payable	<u>\$ 2,498,910</u>	<u>\$ 2,839,254</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, 2012 and 2011 is comprised of the following:

	<u>2012</u>	<u>2011</u>
Governmental	\$ 657,166	\$ 766,085
Residential	2,801,978	2,907,543
Refuse disposal fees	3,235,566	3,297,228
Commercial	1,134,756	1,052,717
Utility taxes	731,926	705,442
Industrial	297,809	156,523
Other	1,101,073	986,368
	<u>9,960,274</u>	<u>9,871,906</u>
Less allowance for uncollectible accounts	<u>(2,959,418)</u>	<u>(3,219,603)</u>
	<u>\$ 7,000,856</u>	<u>\$ 6,652,303</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, 2012 and 2011, the Fund recognized \$4,717,107 and \$7,707,220 as unbilled accounts receivable, respectively. These amounts were billed in July 2012 and July 2011, respectively.

Water Utility Fund of the City of Norfolk, Virginia
June 30, 2012

Notes to Financial Statements

Note 5. Capital Assets

Capital assets at June 30, 2012 and 2011 are comprised of the following:

	Balance June 30, 2011	Additions	Retirements / Transfers	Balance June 30, 2012
Nondepreciable assets:				
Land	\$ 10,608,996	\$ 1,162,215	\$ -	\$ 11,771,211
Intangible assets	2,304,237	26,445	-	2,330,682
Construction in progress	22,157,368	32,912,749	(15,693,681)	39,376,436
Total nondepreciable assets	35,070,601	34,101,409	(15,693,681)	53,478,329
Depreciable & amortized assets:				
Land improvements	19,876,613	-	-	19,876,613
Buildings	178,517,268	-	(26,854)	178,490,414
Equipment	377,215,439	15,337,510	(367,365)	392,185,584
Intangible assets	5,275,204	536,190	-	5,811,394
Total depreciable & amortized assets	580,884,524	15,873,700	(394,219)	596,364,005
Less accumulated depreciation for				
Land improvements	(3,333,556)	(388,170)	-	(3,721,726)
Buildings	(41,904,223)	(2,952,020)	11,816	(44,844,427)
Equipment	(119,156,397)	(7,907,669)	365,905	(126,698,161)
Intangible assets	(2,828,240)	(654,286)	-	(3,482,526)
Total accumulated depreciation	(167,222,416)	(11,902,145)	377,721	(178,746,840)
Depreciable assets, net	413,662,108	3,971,555	(16,498)	417,617,165
Total capital assets, net	\$ 448,732,709	\$ 38,072,964	\$ (15,710,179)	\$ 471,095,494

	June 30, 2010	Additions	Retirements / Transfers	Balance June 30, 2011
Nondepreciable assets:				
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
Depreciable assets:				
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
Less accumulated depreciation for				
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

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

The Fund capitalized \$1,569,114 of interest expense and \$135,511 of interest income for the fiscal year ended June 30, 2012. For the fiscal year ended June 30, 2011 the Fund capitalized \$1,290,620 of interest expense and \$130,416 of interest income. The total interest cost was \$16,740,161 and \$17,448,543 for the fiscal year ended June 30, 2012 and 2011, respectively.

Note 6. Long-Term Obligations

General obligation bonds: A summary of general obligation bond transactions for the fiscal year ended June 30, 2012 and 2011 follows:

	2012	2011
General obligation bonds outstanding at July 1	\$ 3,896,689	\$ 6,719,682
Bonds retired/refunded	(2,058,267)	(2,882,993)
Bonds outstanding at June 30	1,838,422	3,896,689
Unamortized discount/premium, net	(29,405)	(79,305)
General obligation bonds outstanding at June 30, adjusted for unamortized discount/premium	1,809,017	3,817,384
Less current portion	(739,589)	(2,058,267)
	<u>\$ 1,069,428</u>	<u>\$ 1,759,117</u>

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

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2012	2011
Series 2002 Refunding	2/13/2002	47,200,000	2.00 - 5.00%	\$ -	\$ 730,014
Series 2002B Refunding	11/1/2002	39,890,000	5.00 - 5.25%	739,589	773,372
Series 2009 Refunding	5/21/2009	21,895,000	3.00 - 5.00%	1,098,833	2,393,303
Total Water Utility General Obligation Bonds				<u>\$ 1,838,422</u>	<u>\$ 3,896,689</u>

A summary of the requirements to amortize general obligation bonds outstanding at June 30, 2012 is as follows:

Year Ending June 30,	Principal	Interest
2013	\$ 739,589	\$ 82,154
2014	551,047	41,165
2015	547,786	13,695
	<u>\$ 1,838,422</u>	<u>\$ 137,014</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 is pledged to the payment of the principal and interest on general obligation bonds.

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

Revenue bonds: A summary of revenue bond transactions for the fiscal year ended June 30, 2012 and 2011 follows:

	2012	2011
Revenue bonds outstanding at July 1	\$ 340,895,000	\$ 303,355,000
Bonds retired	(221,445,000)	(9,875,000)
Bonds issued	176,925,000	47,415,000
Bonds outstanding at June 30	296,375,000	340,895,000
Unamortized discount/premium, net	30,042,625	(365,453)
Revenue bonds outstanding at June 30, adjusted for unamortized discount/premium	326,417,625	340,529,547
Less current portion	(7,000,000)	(11,285,000)
	<u>\$ 319,417,625</u>	<u>\$ 329,244,547</u>

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

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2012	2011
Series 1993 Water Revenue	11/1/1993	\$ 68,430,000	2.80 - 5.375%	-	\$ 42,375,000
Series 1995 Water Revenue	8/15/1995	115,680,000	4.75 - 7.00%	-	81,135,000
Series 1998 Water Revenue and Refunding	11/1/1998	84,605,000	4.00 - 5.125%	-	63,950,000
Series 2001 Water Revenue and Refunding	10/15/2001	35,000,000	4.00 - 5.00%	-	28,865,000
Series 2005 Water Revenue and Refunding	3/23/2005	22,810,000	3.50 - 5.00%	17,505,000	20,695,000
Series 2008 Water Revenue	4/23/2008	58,415,000	3.00 - 5.00%	55,440,000	56,460,000
Series 2010 Water Revenue	9/23/2010	47,415,000	2.00 - 4.50%	46,505,000	47,415,000
Series 2012 Water Revenue Refunding	4/4/2012	176,925,000	2.00 - 5.0%	176,925,000	-
Total Water Utility Revenue Bonds				<u>\$ 296,375,000</u>	<u>\$ 340,895,000</u>

A summary of the requirements to amortize water revenue bonds outstanding at June 30, 2012 is as follows:

Water Utility Fund of the City of Norfolk, Virginia
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Year Ending June 30,	Principal	Interest
2013	\$ 7,000,000	\$ 14,276,059
2014	7,250,000	13,476,719
2015	7,805,000	13,244,769
2016	8,750,000	12,894,294
2017	10,655,000	12,438,018
2018-2022	78,845,000	51,726,069
2023-2027	84,255,000	30,331,387
2028-2032	44,495,000	15,155,841
2033-2037	30,305,000	7,108,875
2038-2041	17,015,000	1,134,831
	<u>\$ 296,375,000</u>	<u>\$ 171,786,862</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.

Current and Advanced Refunding: On April 4, 2012, the City sold \$176,925,000 of water revenue refunding bonds. The Series 2012 Bonds were used to defease \$40,055,000 of the City's Series 1993 Water Revenue Bonds, \$77,650,000 of the City's Series 1995 Water Revenue Bonds, \$61,700,000 of the City's Series 1998 Water Revenue Bonds, \$28,035,000 of the City's Series 2001 Water Revenue Bonds and \$2,720,000 of the City's Series 2005 Water Revenue Bonds. The 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 \$39,272,782. Based on the City's long-standing wholesale contract with Virginia Beach, a portion of the refunding savings will be shared in accordance with the applicable contract terms.

Bonds authorized and unissued as of June 30, 2012 and 2011 were \$75,520,626 and \$51,720,626, 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. The System provides retirement benefits as well as death and disability benefits. All benefits vest after 5 years of creditable service. Cost-of-living adjustments ("COLAs") are provided at the discretion of the City Council. The System and its benefits are established by Section 37 of the Code of the City of Norfolk, Virginia as amended. All employees hired on or after October 5, 2010 contribute 5% of compensation to the benefit plan with the exception of Norfolk Community Services Board employees at June 30, 2012 who will become City employees on July 1, 2012. Reference should be made to the Comprehensive Annual

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

Financial Report of the System for a further description of the plan. Retirement expense was \$2,629,548 and \$2,770,254 for the years ended June 30, 2012 and 2011, respectively.

Note 8. Significant Customers

Billed and unbilled accounts receivable includes \$2,140,403 and \$5,516,678 due from the City of Virginia Beach and \$614,748 and \$771,725 due from the United States Navy for water sales at June 30, 2012 and 2011, respectively. Net charges for services include \$25,519,014 and \$28,702,893 for water sales to the City of Virginia Beach and \$8,534,182 and \$8,836,936 for the United States Navy for the fiscal years ended June 30, 2012 and 2011.

Note 9. Commitments and Contingencies

Commitments for completion of capital projects authorized at June 30, 2012 and 2011 were approximately \$16,617,410 and \$23,275,000, 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 is a defendant 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, 2012 as the City has not funded a trust for the OPEB liability. Using the most recent OPEB plan valuation date of July 1, 2011, 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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	2012	2011
Net beginning OPEB obligation	\$ 1,199,565	\$ 830,437
Annual required contributions	495,054	488,671
Interest on net OPEB obligation	51,047	38,315
Adjustment to ARC	(47,402)	(35,579)
Annual OPEB cost	498,699	491,407
Less: contributions made	171,246	122,279
Increase in net OPEB obligation	327,453	369,128
Net ending OPEB obligation	\$ 1,527,018	\$ 1,199,565

The total unfunded actuarial accrued liability (UAAL) for 2012 and 2011 is \$3,616,202 and \$3,702,557, 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 61: *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34*. The objectives of GASB 61 are to improve financial reporting for governmental entities. The statement modifies certain requirements for inclusion of component units, by clarifying the manner in which the determination should be made and the type of relationships that should be considered when making that determination. The statement also amends the criteria for reporting blended component units. The provisions of GASB 61 are effective for fiscal years beginning after June 15, 2012.
- 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

Notes to Financial Statements

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 No. 65: *Items Previously Reported as Assets and Liabilities*. The objective of this Statement is to clarify GASB's conceptual definitions of deferred outflows of resources and deferred inflows of resources elements to a broader range of items to enhance consistency in state and local government financial statements. The statement reclassifies or recognizes certain items currently reported as assets and liabilities as one of four financial statement elements — deferred outflows of resources, outflows of resources, deferred inflows of resources or inflows of resources. Before this guidance, many items that appeared to meet the definition of deferred outflows of resources and deferred inflows of resources in Concepts Statement No. 4, *Elements of Financial Statements*, were not specifically identified as such in the GASB's authoritative literature, because the Concepts Statement limits recognition of deferred outflows and deferred inflows to those instances identified in authoritative GASB pronouncement. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.
- GASB Statement 66: *Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62*. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This Statement also amends Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type. As a result, governments should base their decisions about fund type classification on the nature of the activity to be reported, as required in Statement 54 and Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.
- GASB Statement 67: *Financial Reporting for Pension Plans—an amendment of GASB Statement No.25 and No.50*. This Statement replaces the requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and Statement 50 for pension plans that are administered through trusts or similar arrangements meeting certain criteria. The objective of this Statement is to improve financial reporting by state and local governmental pension plans. Statement 67 enhances note disclosures and required supplementary information for both defined benefit and defined contribution pension plans. It also requires the presentation of new information about annual money-weighted rates of return in the notes to the financial statements and in 10-year required supplementary information. The provisions of Statement 67 are effective for financial statements for fiscal years beginning after June 15, 2013. Earlier application is encouraged.
- GASB Statement 68: *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No.27*. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The objective of GASB 68 is to improve accounting and financial reporting by state and local governments for pensions. Governments providing defined benefit pensions will be required to recognize their long-term obligation for pension benefits as a liability and to recognize more pension expense immediately. The Statement also requires revised and new disclosures, and required supplementary information. It also requires cost-sharing employers to record a liability and expense equal to their proportionate share of the collective net pension liability and expense for the

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

cost-sharing plan. The provisions of Statement 68 are effective for fiscal years beginning after June 15, 2014; however, earlier application is encouraged.

Water Utility Fund of the City of Norfolk, Virginia
June 30, 2012

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 and PILOT (2)	Income Available for Debt Service	Debt Service			Coverage
				Principal	Interest	Total	
2003	\$ 67,760,029	\$ 27,967,179	\$ 39,792,850	\$ 5,700,000	\$ 14,600,283	\$ 20,300,283	1.96
2004	64,366,942	33,740,297	30,626,645	5,955,000	14,336,043	20,291,043	1.51
2005	69,183,154	34,643,668	34,539,486	6,250,000	14,041,059	20,291,059	1.70
2006	78,788,158	34,144,763	44,643,395	6,580,000	14,827,960	21,407,960	2.09
2007	76,013,563	32,427,377	43,586,186	7,310,000	14,379,821	21,689,821	2.01
2008	78,730,024	37,026,528	41,703,496	7,665,000	14,022,200	21,687,200	1.92
2009	78,020,552	38,182,373	39,838,179	8,050,000	16,411,343	24,461,343	1.63
2010	82,470,020	34,567,741	47,902,279	9,420,000	15,929,680	25,349,680	1.89
2011	83,737,444	37,068,753	46,668,691	9,875,000	16,527,844	26,402,844	1.77
2012	81,295,219	34,667,524	46,627,695	11,285,000	11,184,363	22,469,363	2.08

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

2. Includes operating expenses less depreciation / amortization and payment in lieu of taxes (PILOT).

Water Utility Fund of the City of Norfolk, Virginia
 June 30, 2012

Supplementary Schedule

Supplemental Other Post Employment Benefit (OPEB) Information
 Schedule of Funding Progress
 Water Utility Fund
 Last Three Fiscal Years
 (Unaudited)

Actuarial valuation date	Actuarial value of assets (a)	Actuarial accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Estimated covered payroll (c)	UAA as a percentage of covered payroll (b-a)/c
July 1, 2011	\$ -	\$ 3,610,202	\$ 3,610,202	0%	\$ 10,566,480	34.2%
July 1, 2010	-	3,702,557	3,702,557	0%	10,822,491	34.2%
July 1, 2009	-	3,545,026	3,545,026	0%	10,174,204	34.8%



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**Report on Internal Control over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Honorable Members of the City Council
Water Utility Fund of the City 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, 2012 and 2011, and have issued our report thereon dated January 15, 2013. 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 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 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 Fund 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 15, 2013