



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

Financial and Compliance Report  
Year Ended June 30, 2013

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Financial and Compliance Report  
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KPMG LLP  
Suite 1900  
440 Monticello Avenue  
Norfolk, VA 23510

## Independent Auditors' Report

The Honorable Members of the City Council  
City of Norfolk, Virginia:

### Report on the Financial Statements

We have audited the accompanying statements of net position of the Water Utility Fund of the City of Norfolk, Virginia (the Fund), as of and for the years ended June 30, 2013 and 2012, and the related statements of revenues, expenses, and changes in fund net position and cash flows for the years then ended, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditors' Responsibility*

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 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



## ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Water Utility Fund of the City of Norfolk, Virginia, as of June 30, 2013 and 2012, and the respective changes in financial position, and cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

As discussed in note 1 to the financial statements, the accompanying financial statements present only the Water Utility Fund and do not purport to, and do not, present fairly the financial position of the City of Norfolk, Virginia, the changes in its financial position or its cash flows, where applicable, in conformity with U.S. generally accepted accounting principles.

## ***Other Matters***

### *Required Supplementary Information*

U.S. generally accepted accounting principles require that the Supplemental Other Post Employment Benefits (OPEB) on page 19 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.

Management has omitted Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

### *Supplementary and Other Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City'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. The Supplemental Debt Capacity Information is responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such 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 basic 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.



**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated December 23, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

KPMG LLP

Norfolk, Virginia  
December 23, 2013

**Water Utility Fund of the City of Norfolk, Virginia**  
**Statements of Position**  
**June 30, 2013 and 2012**

	2013	2012
<b>ASSETS</b>		
Current assets:		
Cash and short term investments (Note 2)	\$ 52,186,630	\$ 33,477,706
Unrestricted short term investments (Note 2)	330,203	11,785,201
Receivables:		
Accounts (net) (Note 3)	9,126,689	7,000,856
Unbilled accounts (Note 4)	4,998,701	4,717,107
Accrued investment income	24,433	24,433
Other receivables	80,402	-
Inventories	1,424,894	1,479,257
Restricted cash held in escrow (Note 2)	18,175	325,953
Restricted short term investments (Note 2):		
Restricted investment held with fiscal agent	9,027,017	5,655,167
Reserve funds	17,554,654	17,522,624
Investment restricted for construction	32,820,327	2,081,210
Total current assets	<u>127,592,125</u>	<u>84,069,514</u>
Capital assets (Note 5):		
Non-depreciable assets	34,315,258	53,478,329
Depreciable assets	637,098,904	596,364,005
Accumulated depreciation and amortization	(190,415,252)	(178,746,840)
Total noncurrent assets	<u>480,998,910</u>	<u>471,095,494</u>
Total assets	<u>608,591,035</u>	<u>555,165,008</u>
<b>LIABILITIES</b>		
Current liabilities:		
Vouchers payable	866,770	1,029,210
Vouchers payable for CIP projects	2,471,819	3,690,709
Contract retainage	623,251	888,773
Accrued interest	27,471	50,784
Accrued payroll	295,064	243,886
Due to General Fund and other City funds	1,311,152	1,488,031
Payable to employees' retirement system	2,427,534	2,629,548
Compensated absences	610,884	597,785
Current portion of bonds payable (Note 6)	7,801,047	7,739,589
Accrued revenue bond interest payable	2,615,241	2,498,910
Other liabilities	236,390	211,312
Total current liabilities	<u>19,286,623</u>	<u>21,068,537</u>
Noncurrent liabilities:		
General obligation bonds payable (Note 6)	538,179	1,069,428
Revenue bonds payable (Note 6)	359,545,343	319,417,625
Liability for other postemployment benefits (OPEB) (Note 12)	1,635,335	1,527,018
Compensated absences	473,598	446,904
Other long-term liabilities	3,325,128	-
Total noncurrent liabilities	<u>365,517,583</u>	<u>322,460,975</u>
Total liabilities	<u>384,804,206</u>	<u>343,529,512</u>
<b>NET POSITION</b>		
Invested in capital assets, net of related debt	161,534,514	157,453,707
Restricted	11,000,000	11,000,099
Unrestricted	51,252,315	43,181,690
Total net position	<u>\$ 223,786,829</u>	<u>\$ 211,635,496</u>

See Notes to Financial Statements

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

**Statements of Revenues, Expenses and Changes in Net Position  
Years Ended June 30, 2013 and 2012**

	2013	2012
Operating revenues:		
Charges for services	\$ 76,392,882	\$78,148,051
Miscellaneous	3,564,166	3,052,421
Total operating revenues	<u>79,957,048</u>	<u>81,200,472</u>
Operating expenses:		
Personnel services	14,364,816	13,783,048
Plant operations	6,489,193	6,589,857
Chemicals	3,110,828	2,967,518
Provision for bad debts	236,310	230,670
Depreciation and amortization	12,348,880	11,902,145
Retirement contribution	2,427,534	2,629,548
OPEB expense	108,317	327,453
Administrative expenses	1,663,129	1,852,927
Other	9,121,183	8,997,111
Total operating expenses	<u>49,870,190</u>	<u>49,280,277</u>
Operating income	<u>30,086,858</u>	<u>31,920,195</u>
Nonoperating revenues (expenses):		
Interest income, net of interest capitalized	134,172	94,747
Intergovernmental Revenues	1,284,157	137,555
Interest expense and fiscal charges	(11,010,925)	(15,171,047)
Gain on sale or disposal of assets	11,009	25,788
Other nonoperating revenue	(45,530)	(21,764)
Total nonoperating expenses, net	<u>(9,627,117)</u>	<u>(14,934,721)</u>
Net income before contributions and transfers	<u>20,459,741</u>	<u>16,985,474</u>
Capital contributions	191,592	187,376
Transfers out	(8,500,000)	(8,500,000)
Change in net position	<u>12,151,333</u>	<u>8,672,850</u>
Total net position - beginning	<u>211,635,496</u>	<u>202,962,646</u>
Total net position - end	<u>\$ 223,786,829</u>	<u>\$211,635,496</u>

See Notes to Financial Statements



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

**Statements of Cash Flows**

**Years Ended June 30, 2013 and 2012**

	<b>2013</b>	<b>2012</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Receipts from customers	<b>\$ 77,232,909</b>	\$ 83,611,362
Payments to suppliers	<b>(9,708,098)</b>	(9,798,149)
Payments to employees	<b>(16,903,393)</b>	(16,871,675)
Other payments	<b>(7,434,106)</b>	(10,830,883)
Net cash provided by operating activities	<b>43,187,312</b>	46,110,655
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>		
Internal activity, payments from (to) other funds	<b>(176,879)</b>	153,028
Transfers out	<b>(8,500,000)</b>	(8,500,000)
Intergovernmental revenues	<b>1,284,157</b>	137,555
Net cash used in noncapital financing activities	<b>(7,392,722)</b>	(8,209,417)
<b>CASH FLOWS FROM CAPITAL AND RELATING FINANCING ACTIVITIES:</b>		
Proceeds from sale of debt	<b>43,070,000</b>	176,925,000
Proceeds from sale of fixed assets	<b>25,397</b>	42,284
Capital contributions	<b>191,592</b>	187,376
Purchases of capital assets	<b>(23,751,096)</b>	(33,757,139)
Refunding of debt principal	<b>-</b>	(210,160,000)
Principal paid on capital debt	<b>(7,739,589)</b>	(13,343,267)
Interest paid and bond service charges	<b>(6,590,391)</b>	14,906,705
Net cash provided by (used in) capital and related financing activities	<b>5,205,913</b>	(65,199,041)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sale of investments	<b>53,005,805</b>	70,378,732
Purchase of investments	<b>(75,739,334)</b>	(33,472,463)
Interest and dividends	<b>134,172</b>	74,434
Net cash (used in) provided by investing activities	<b>(22,599,357)</b>	36,980,703
Net increase in cash and cash equivalents	<b>18,401,146</b>	9,682,900
Cash and short-term investments - beginning of year	<b>33,803,659</b>	24,120,759
Cash and short-term investments - end of year	<b>\$ 52,204,805</b>	\$ 33,803,659

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

**Statements of Cash Flows (Continued)**

**Years Ended June 30, 2013 and 2012**

**Reconciliation of Operating Income to Net Cash**

**Provided by Operating Activities:**

Operating income	<b>\$ 30,086,858</b>	\$ 31,920,195
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense	<b>12,348,880</b>	11,902,145
Provision for bad debt	<b>236,310</b>	230,670
Loss on disposal of assets	-	(16,496)
Change in assets and liabilities:		
Accounts receivable (net), billed and unbilled	<b>(2,724,139)</b>	2,410,890
Inventories	<b>54,363</b>	(60,194)
Vouchers payable	<b>(162,440)</b>	(180,580)
Accrued payroll	<b>(111,043)</b>	(459,079)
Other liabilities	<b>3,458,523</b>	363,104
Net cash provided by operating activities	<b>\$ 43,187,312</b>	\$ 46,110,655

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

**Statement of Net Assets:**

Cash and short term investments	<b>\$ 52,186,630</b>	\$ 33,477,706
Restricted cash held in escrow	<b>18,175</b>	325,953
Total cash and short term investments per Statement of Net Assets	<b>\$ 52,204,805</b>	\$ 33,803,659

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

Unrealized (loss) on investments	<b>\$ (45,530)</b>	\$ (21,764)
Acquisition of capital assets through change in contract retainage	<b>\$ (265,522)</b>	\$ 452,888
Acquisition of capital assets through change in vouchers payable	<b>\$ (1,218,890)</b>	\$ 54,903
Capitalized interest	<b>\$ 993,407</b>	\$ 1,433,603

See Notes to Financial Statements

**Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2013**

**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 estimated at 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 maturity exceeded one year, in which case they are reported as investments.

The City uses the pooled cash investment method, as a result income from the investment of pooled cash is allocated to the various funds based on the percentage of cash and temporary investments of each fund to the total pooled cash and temporary investments. For purposes of the statement of cash flows, all highly liquid debt instruments and certificates of deposit are grouped into cash and short-term investments. The cash and investment pool discussed above is considered cash, since it has the same characteristics as a demand account.

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.

**Water Utility Fund of the City of Norfolk, Virginia**  
**June 30, 2013**

**Notes to Financial Statements**

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Inventories: Inventories are stated at the lower of cost (using the moving average method) or market.

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

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

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 position: Net position in the financial statements are classified as invested in capital assets, net of related debt; restricted; and unrestricted. Restricted net position represents 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.

**Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2013**

**Notes to Financial Statements**

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Operating and nonoperating revenues: The Fund reports as operating revenues all charges for services generated through service fees and certain other miscellaneous revenues. Other revenues, including interest revenue and grants, are reported as nonoperating. When both restricted and unrestricted resources are available for use, the policy is to use restricted resources first and then unrestricted resources as they are needed.

General allocations: The General Fund of the City provides administrative services to the Fund, which totaled \$2,189,629 and \$2,379,427 for the fiscal years ended June 30, 2013 and 2012, 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, 2013 and 2012.

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, 2013 and 2012, the Fund's cash and investments consist of the following:

	<b>2013</b>	2012
Investment in LGIP	<b>\$ 11,000,001</b>	\$ 11,000,100
Other investments	<b>48,732,201</b>	26,044,103
Cash and short-term investments	<b>52,204,804</b>	33,803,658
	<b>\$ 111,937,006</b>	\$ 70,847,861
Cash and short term investments	<b>\$ 52,186,630</b>	\$ 33,477,706
Restricted cash held in escrow	<b>18,175</b>	325,953
Restricted short term investments held with fiscal agent	<b>9,027,017</b>	5,655,167
Unrestricted short term investments	<b>330,203</b>	11,785,201
Reserve funds	<b>17,554,654</b>	17,522,624
Investment restricted for construction	<b>32,820,327</b>	2,081,210
	<b>\$ 111,937,006</b>	\$ 70,847,861

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. Under the Act, any public depository that receives or holds public deposits ("Qualified Public Depositories") shall elect to secure deposits by either the Pooled Method or the Dedicated Method (which became available by amendments made to the Act effective July

**Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2013**

**Notes to Financial Statements**

1, 2010). The Pooled Method requires any public depository that receives or holds public deposits to pledge collateral, ranging from 50 to 100 percent of the public deposits, to the State Treasury Board to cover public deposits in excess of Federal deposit insurance. The Pooled Method also provide that if any member financial institution fails, the entire collateral pool becomes available to satisfy the claims of participating governmental entities. If the value of the pool's collateral were inadequate to cover a loss, additional amounts would be assessed on a pro rata bases to members of the pool. Under the Dedicated Method, Qualified Public Depositories are responsible for securing their own public deposits, by the pledge and deposit of eligible collateral with qualified escrow agent, equal to or in excess of required collateral amounts, priced at a minimum of 105% to 130% of all public deposits held by the bank, based on rating determined under the Act; and therefore will not be assessed for losses of another bank that is in default or has become insolvent. The State Treasury Board is responsible for monitoring compliance with the collateralization and reporting requirements of the Act and for notifying local governments of compliance by banks. Both methods of securing public deposits are similar to depository insurance. Funds deposited in accordance with the Act are considered to be fully insured. The City's primary banking institutions has elected to be governed by the Dedicated Method.

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.

Certain cash and short-term investments of the Fund are combined with other City funds 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.

At June 30, 2013 and 2012, the Fund had \$11,000,001 and \$11,000,100 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, 2013 and 2012, 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	<b>Fiscal Year 2013</b>	Fiscal Year 2012
	<b>Fair Value</b>	Fair Value
	<b>Less than 1 year</b>	Less than 1 year
SNAP Money Market Mutual Funds	<b>\$ 33,150,530</b>	\$ 13,866,411
US Agency Notes	<b>6,554,654</b>	6,522,525
PFM Funds Government Series	<b>9,027,017</b>	5,655,167
	<b>\$ 48,732,201</b>	\$ 26,044,103

The Fund's rated debt investments, other than in LGIP, as of June 30, 2013 and 2012 were rated by Standard and Poor's and the ratings are presented below using the Standard and Poor's rating scale.

**Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2013**

**Notes to Financial Statements**

Investment Type	Fiscal Year 2013		
	AA+	AAAm	Total
Money Market Mutual Funds:			
SNAP Money Market Mutual Funds	\$ -	\$ 33,150,530	\$ 33,150,530
PFM Funds Government Series	-	9,027,017	9,027,017
US Agency Notes	6,554,654	-	6,554,654
	<u>\$ 6,554,654</u>	<u>\$ 42,177,547</u>	<u>\$ 48,732,201</u>

Investment Type	Fiscal Year 2012		
	AAA	AAAm	Total
Money Market Mutual Funds:			
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
	<u>\$ 6,522,525</u>	<u>\$ 19,521,578</u>	<u>\$ 26,044,103</u>

**Note 3. Accounts Receivable**

Accounts receivable at June 30, 2013 and 2012 is comprised of the following:

	2013	2012
Governmental	\$ 2,536,733	\$ 657,166
Residential	2,628,865	2,801,978
Refuse disposal fees	3,089,425	3,235,566
Commercial	1,159,362	1,134,756
Utility taxes	679,781	731,926
Industrial	261,460	297,809
Other	1,471,063	1,101,073
	<u>11,826,689</u>	<u>9,960,274</u>
Less allowance for uncollectible accounts	<u>(2,700,000)</u>	<u>(2,959,418)</u>
	<u>\$ 9,126,689</u>	<u>\$ 7,000,856</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, 2013 and 2012, the Fund recognized \$4,998,701 and \$4,717,107 as unbilled accounts receivable, respectively. These amounts were billed in July 2013 and July 2012, respectively.

Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2013

Notes to Financial Statements

Note 5. Capital Assets

Capital assets at June 30, 2013 and 2012 are comprised of the following:

	Balance June 30, 2012	Additions	Retirements / Transfers	Balance June 30, 2013
<b>Nondepreciable assets:</b>				
Land	\$ 11,771,211	\$ -	\$ -	\$ 11,771,211
Intangible assets	2,330,682	67,783	-	2,398,465
Construction in progress	39,376,436	19,833,539	(39,064,393)	20,145,582
Total nondepreciable assets	53,478,329	19,901,323	(39,064,393)	34,315,258
<b>Depreciable &amp; amortized assets:</b>				
Land improvements	19,876,613	862,333	-	20,738,946
Buildings	178,490,414	15,110,844	(10,662)	193,590,596
Equipment	392,185,584	25,102,765	(684,194)	416,604,155
Intangible assets	5,811,394	353,813	-	6,165,207
Total depreciable & amortized assets	596,364,005	41,429,755	(694,856)	637,098,904
<b>Less accumulated depreciation for</b>				
Land improvements	(3,721,726)	(390,698)	-	(4,112,424)
Buildings	(44,844,427)	(3,064,223)	10,662	(47,897,988)
Equipment	(126,698,161)	(8,279,726)	669,805	(134,308,081)
Intangible assets	(3,482,526)	(614,233)	-	(4,096,759)
Total accumulated depreciation	(178,746,840)	(12,348,880)	680,467	(190,415,252)
Depreciable assets, net	417,617,165	29,080,875	(14,388)	446,683,652
Total capital assets, net	\$ 471,095,494	\$ 48,982,198	\$ (39,078,782)	\$ 480,998,910

	Balance June 30, 2011	Additions	Retirements / Transfers	Balance June 30, 2012
<b>Nondepreciable assets:</b>				
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
<b>Depreciable &amp; amortized assets:</b>				
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
<b>Less accumulated depreciation for</b>				
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



**Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2013**

**Notes to Financial Statements**

The Fund capitalized \$1,121,665 of interest expense and \$128,258 of interest income for the fiscal year ended June 30, 2013. For the fiscal year ended June 30, 2012 the Fund capitalized \$1,569,114 of interest expense and \$135,511 of interest income. The total interest cost was \$12,132,590 and 16,740,161 for the fiscal year ended June 30, 2013 and 2012, respectively.

**Note 6. Long-Term Obligations**

General obligation bonds: A summary of general obligation bond transactions for the fiscal year ended June 30, 2013 and 2012 follows:

	<u>2013</u>	<u>2012</u>
General obligation bonds outstanding at July 1	\$ 1,838,422	\$ 3,896,689
Bonds retired/refunded	(739,589)	(2,058,267)
Bonds outstanding at June 30	1,098,833	1,838,422
Unamortized discount/premium, net	(9,607)	(29,405)
General obligation bonds outstanding at June 30, adjusted for unamortized discount/premium	1,089,226	1,809,017
Less current portion	(551,047)	(739,589)
	<u>\$ 538,179</u>	<u>\$ 1,069,428</u>

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

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	<u>2013</u>	<u>2012</u>
Series 2002B Refunding	11/1/2002	39,890,000	5.00 - 5.25%	\$ -	\$ 739,589
Series 2009 Refunding	5/21/2009	21,895,000	3.00 - 5.00%	1,098,833	1,098,833
Total Water Utility General Obligation Bonds				<u>\$ 1,098,833</u>	<u>\$ 1,838,422</u>

A summary of the requirements to amortize general obligation bonds outstanding at June 30, 2013 is as follows:

Year Ending June 30,	Principal	Interest
2014	\$ 551,047	\$ 41,165
2015	547,786	13,695
	<u>\$ 1,098,833</u>	<u>\$ 54,860</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  
June 30, 2013**

**Notes to Financial Statements**

Revenue bonds: A summary of revenue bond transactions for the fiscal year ended June 30, 2013 and 2012 follows:

	<b>2013</b>	2012
Revenue bonds outstanding at July 1	<b>\$ 296,375,000</b>	\$ 340,895,000
Bonds retired	<b>(7,000,000)</b>	(221,445,000)
Bonds issued	<b>43,070,000</b>	176,925,000
Bonds outstanding at June 30	<b>332,445,000</b>	296,375,000
Unamortized discount/premium, net	<b>34,350,343</b>	30,042,625
Revenue bonds outstanding at June 30, adjusted for unamortized discount/premium	<b>366,795,343</b>	326,417,625
Less current portion	<b>(7,250,000)</b>	(7,000,000)
	<b>\$ 359,545,343</b>	\$ 319,417,625

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

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	<b>2013</b>	2012
Series 2005 Water Revenue and Refunding	3/23/2005	22,810,000	3.50 - 5.00%	<b>\$ 17,020,000</b>	\$ 17,505,000
Seires 2008 Water Revenue	4/23/2008	58,415,000	3.00 - 5.00%	<b>54,385,000</b>	55,440,000
Seires 2010 Water Revenue	9/23/2010	47,415,000	2.00 - 4.50%	<b>45,580,000</b>	46,505,000
Seires 2012 Water Revenue Refunding	4/4/2012	176,925,000	2.00 - 5.00%	<b>172,390,000</b>	176,925,000
Series 2013 Water Revenue	2/20/2013	43,070,000	2.00 - 5.00%	<b>43,070,000</b>	-
Total Water Utility Revenue Bonds				<b>\$ 332,445,000</b>	<b>\$ 296,375,000</b>

A summary of the requirements to amortize water revenue bonds outstanding at June 30, 2013 is as follows:

Year Ending June 30,	Principal	Interest
2014	7,250,000	15,630,219
2015	7,805,000	15,398,269
2016	8,750,000	15,047,794
2017	10,655,000	14,591,519
2018	13,860,000	13,994,269
2019-2023	83,990,000	58,512,743
2024-2028	82,380,000	36,581,581
2029-2033	48,575,000	21,352,163
2034-2038	42,395,000	11,175,565
2039-2042	26,785,000	2,556,681
	<b>\$ 332,445,000</b>	<b>\$ 204,840,803</b>

**Water Utility Fund of the City of Norfolk, Virginia**  
**June 30, 2013**

**Notes to Financial Statements**

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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, 2013 and 2012 were \$75,235,932 and \$75,520,626, 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. Reference should be made to the Comprehensive Annual Financial Report of the System for a further description of the plan. Retirement expense was \$2,427,534 and \$2,629,548 for the years ended June 30, 2013 and 2012, respectively.

**Note 8. Significant Customers**

Billed and unbilled accounts receivable includes \$4,341,481 and \$2,140,403 due from the City of Virginia Beach and \$676,012 and \$614,748 due from the United States Navy for water sales at June 30, 2013 and 2012, respectively. Net charges for services include \$25,968,026 and \$25,519,014 for water sales to the City of Virginia Beach and \$8,767,765 and \$8,534,182 for the United States Navy for the fiscal years ended June 30, 2013 and 2012.

**Note 9. Commitments and Contingencies**

Commitments for completion of capital projects authorized at June 30, 2013 and 2012 were approximately \$17,040,756 and \$16,617,410, respectively.

**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.

**Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2013**

**Notes to Financial Statements**

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**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, 2013 as the City has not funded a trust for the OPEB liability. Using the most recent OPEB plan valuation date of July 1, 2012, 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:

	<u>2013</u>	<u>2012</u>
Net beginning OPEB obligation	\$ 1,527,018	\$ 1,199,565
Annual required contributions	362,335	495,054
Interest on net OPEB obligation	49,318	51,047
Adjustment to ARC	<u>(48,613)</u>	<u>(47,402)</u>
Annual OPEB cost	363,040	498,699
Less: contributions made	<u>254,723</u>	<u>171,246</u>
Increase in net OPEB obligation	108,317	327,453
Net ending OPEB obligation	<u>\$ 1,635,335</u>	<u>\$ 1,527,018</u>

The total unfunded actuarial accrued liability (UAAL) for 2013 and 2012 is \$3,259,474 and \$3,616,202, 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. Other long-term liabilities**

In FY2013, a long-term liability of \$3,325,128 was recorded in the Fund to reflect the cost of service true-up for a wholesale customer during fiscal year 2012 and 2013 under a water services contract. Pursuant to the terms of the water services contract, billings to the customer were based on a projected water rate applicable to the customer. The liability reflects the adjustments to billings based on the difference between the projected water rate and actual cost of service for that customer. In accordance with the water services contract, this liability will be reduced in fiscal year 2015 through credits to the customer billings.

**Note 14. 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.

Notes to Financial Statements

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- 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.
- 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 cost-sharing plan. The provisions of Statement 68 are effective for fiscal years beginning after June 15, 2014.
- GASB Statement 69: *Government Combinations and Disposals of Government Operations*. This Statement provides specific accounting and financial reporting guidance for the combination and disposal of entities in a governmental environment. This Statement also enhances the disclosures around these types of activities to improve the usefulness of financial reporting in this area. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2013. Earlier application is encouraged.
- GASB Statement 70: *Accounting and Financial Reporting for Non-exchange Financial Guarantees*. This Statement requires specific accounting for governments that extend a non-exchange financial guarantee as well as governments that have issued obligations guaranteed in non-exchange transactions. This Statement also specifies the information required to be disclosed in relation to these types of transactions. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2013. Earlier application is encouraged.

Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2013

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, 2012	\$ -	\$ 3,259,474	\$3,259,474	0%	\$ 9,551,246	34.1%
July 1, 2011	-	3,616,202	3,616,202	0%	10,566,480	34.2%
July 1, 2010	-	3,702,557	3,702,557	0%	10,822,491	34.2%

**Water Utility Fund of the City of Norfolk, Virginia  
June 30, 2013**

**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	
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
2013	80,091,220	34,810,702	45,280,518	7,000,000	14,700,777	21,700,777	2.09

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).



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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  
City of Norfolk, Virginia:

We have audited, in accordance with the 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, the financial statements of the Water Utility Fund of the City of Norfolk, Virginia (the Fund), which comprise the statements of net position as of June 30, 2013 and 2012, and the related statements of revenues, expenses, and changes in fund net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 23, 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.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of Fund's internal control.

A deficiency in internal control 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, 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. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.





### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Fund's financial statements are free from 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*.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

**KPMG LLP**

Norfolk, Virginia  
December 23, 2013