



Water Utility Fund

An Enterprise Fund of the City of Norfolk, Virginia

Financial and Compliance Report Fiscal Year Ended June 30, 2014

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Financial and Compliance Report

Fiscal Year Ended June 30, 2014

Contents

Independent Auditors' Report	1 - 3
------------------------------	-------

Financial Statements

Management's Discussion and Analysis (Unaudited)	4 - 7
--	-------

Statement of Net Position	8 - 9
---------------------------	-------

Statement of Revenues, Expenses and Changes in Net Position	10
---	----

Statement of Cash Flows	11-12
-------------------------	-------

Notes to Financial Statements	13 - 23
-------------------------------	---------

Supplementary Schedules	24 - 25
-------------------------	---------

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	26 - 27
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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 statement of net position of the Water Utility Fund of the City of Norfolk, Virginia (the Fund), as of and for the year ended June 30, 2014, and the related statements of revenues, expenses, and changes in net position and cash flows for the year then ended, which collectively comprise the Fund's basic financial statements as listed in the accompanying 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 audit. 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, 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, 2014, and the



respective changes in financial position, and cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in note 1 to the basic 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 the U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

As discussed in note 1 to the basic financial statements, in fiscal year 2014, the Fund adopted new accounting guidance described in Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that management's discussion and analysis on pages 4 through 7, the Supplemental Other Post-Employment Benefits (OPEB) Information – Schedule of Funding Progress on page 24 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.

Supplementary and Other Information

Our audit was conducted for the purpose of forming an opinion 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.

The Supplemental Debt Capacity 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. 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 January __, 2015 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
January 29, 2015`

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Management's Discussion and Analysis (Unaudited)
For the Fiscal Year Ended June 30, 2014

The following discussion and analysis of the Water Utility Fund of the City of Norfolk, Virginia's (the "Fund") financial performance provides an overview of the Fund's financial activities for the fiscal year ended June 30, 2014.

Financial Highlights for the Fiscal year 2014

The Fund's financial statements are reported on the full accrual basis as required by U.S. Generally Accepted Accounting Principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

- For the fiscal year ended June 30, 2014, the Fund has reported net operating revenues of \$81,968,928, which represents an increase of 2.8% from fiscal year 2013 operating revenues.
- The Fund's operating expenses for fiscal year 2014 were \$50,221,173, an increase of \$587,293 over fiscal year 2013 operating expenses of \$49,633,880.
- Total net position of \$235,353,203, which is defined as total assets and deferred outflows of resources less total liabilities and deferred inflows, includes net investment in capital assets of \$143,231,180; restricted net position of \$25,478,070 required by the Water Revenue Bonds Master Indenture of Trust as reserve funds for operating, repair and replacement, rate stabilization, and debt service; and \$66,643,953 unrestricted net position as of June 30, 2014.
- At the close of the fiscal year, the Fund's total cash and investments were \$110,170,521.
- For fiscal year 2014, the Fund had total outstanding bonds payable of \$361,994,278. There were no new bonds issued for the Fund in the fiscal year ended June 30, 2014. Total amount of bonds retired was \$7,801,047.
- For the fiscal year ended June 30, 2014, the Fund implemented GASB 65 *Items Previously Reported as Assets and Liabilities*, which required debt issuance cost to be treated as a period cost and expensed in the year incurred. The Fund had a restatement of the beginning net position of \$2,995,952 related to prior years' bonds issuance costs. The fiscal year 2013 comparative statements have not been restated for purposes of this management disclosure and analysis. As a result of this adoption, the Fund also reclassified a loss on debt refunding as a deferred outflow of resources of \$2,121,773 at July 1, 2013.

Basic Financial Statements

The statement of net position presents information on all Fund assets, deferred outflow of resources, and liabilities, with the difference reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Fund is improving or deteriorating.

The statement of revenues, expenses and changes in net position presents information showing how net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for those items that will result in cash flows in future fiscal periods.

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Management's Discussion and Analysis (Unaudited)
For the Fiscal Year Ended June 30, 2014

The statement of cash flows, when taken together with the statement of net position and statement of revenues, expenses, and changes in net position, provides the reader a complete "snapshot" of the financial condition and results of operations of the Fund as of June 30, 2014 and for the year then ended. Notes to the financial statements are an integral part of the statements and should be read in conjunction with the financial statements and Management's Discussion and Analysis.

Financial Analysis

The following financial analysis provides insight into the factors that had a significant impact on the variance between fiscal years 2014 and 2013.

The following table provides a summary of the Fund's net position as of June 30, 2014 and 2013:

	2014	2013
Current assets	\$ 127,104,365	\$ 127,592,125
Capital assets	487,577,220	480,998,910
Deferred outflows of resources	2,010,101	-
Total assets and deferred outflows of resources	\$ 616,691,686	\$ 608,591,035
Current liabilities	\$ 25,466,567	\$ 19,286,623
Long-term liabilities	355,871,916	365,517,583
Total liabilities	\$ 381,338,483	\$ 384,804,206
Net position:		
Net investment in capital assets	\$ 143,231,180	\$ 161,534,514
Restricted	25,478,070	11,000,000
Unrestricted	66,643,953	51,252,315
Total net position	\$ 235,353,203	\$ 223,786,829

Overall, total net position increased by approximately \$11.6 million. The increase in position was a result of the positive change in net position in the fiscal year ended June 30, 2014 of approximately \$14.6 million and restatement of the beginning fund balance of approximately \$3.0 million for implementation of GASB 65.

The table below provides a summary of the Fund's revenues, expenses and changes in net position for the years ended June 30, 2014 and 2013.

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Management's Discussion and Analysis (Unaudited)
For the Fiscal Year Ended June 30, 2014

	2014	2013
Operating revenues, net	\$ 81,968,928	\$ 79,720,738
Operating expenses	50,221,173	49,633,880
Operating income	<u>\$ 31,747,755</u>	<u>\$ 30,086,858</u>
Non-operating revenues	\$ 109,074	\$ 1,418,329
Non-operating expenses	(19,954,919)	(11,045,446)
Total non-operating expenses	<u>(19,845,845)</u>	<u>(9,627,117)</u>
Net income before contributions	11,901,910	20,459,741
Capital contributions	2,660,416	191,592
Change in net position	<u>\$ 14,562,326</u>	<u>\$ 20,651,333</u>
Net position - beginning, as previously reported	223,786,829	211,635,496
Effect of implementation of GASB 65	(2,995,952)	-
Net position - beginning, as restated	<u>220,790,877</u>	<u>211,635,496</u>
Total net position - end	<u><u>\$ 235,353,203</u></u>	<u><u>\$ 232,286,829</u></u>

The 2014 net operating revenues increase is a result of the planned annual water rates increase and are in line with the approved budgeted amount for the fiscal year ended June 30, 2014. The decrease in non-operating revenues of approximately \$1.3 million in 2014 is due to the one-time receipt of a grant in 2013 with the proceeds used towards the construction of capital assets of the Fund. The increase in capital contributions of approximately \$2.5 million in 2014 is due to the construction costs charged back to a wholesale raw water customer.

Capital Assets

A summary of the Fund's net capital assets at June 30, 2014 and 2013 is as follows:

	2014	2013
Land	\$ 11,771,211	\$ 11,771,211
Land improvements	16,269,870	16,626,522
Buildings	142,543,312	145,692,608
Equipment	281,315,688	282,296,074
Intangible assets	4,203,293	4,466,913
Construction in progress	31,473,846	20,145,582
	<u>\$ 487,577,220</u>	<u>\$ 480,998,910</u>

The Fund's capital assets totaled \$487.6 million (net of accumulated depreciation) and accounted for 79.3% of total assets at June 30, 2014. Total increase in the Fund's net capital assets for fiscal year 2014 was \$6.6 million which is due to an increase in the number of projects remained in the construction phase at year end. During fiscal year 2014, major capital projects spending included replacing and rehabilitating water mains, upgrading water treatment plants and pump stations, and designing and constructing dams and spillways.

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Management's Discussion and Analysis (Unaudited)
For the Fiscal Year Ended June 30, 2014

Additional information on the Fund's capital assets can be found in Note 5 of the financial statements.

Debt Administration

For fiscal year 2014, the Fund had outstanding bonds payable of \$362.0 million. The outstanding bonds payable consisted primarily of revenue bonds. The City of Norfolk (the "City") manages debt in accordance with the City's debt policies. Water revenue bond proceeds are used to finance capital projects that improve the City's water system. Water system revenue secures outstanding bonds. A summary of the Fund's outstanding bonds as of June 30, 2014 and 2013 is as follows:

	2014	2013
Revenue bonds	\$ 361,446,492	\$ 366,795,343
General obligation bonds	547,786	1,089,226
Total	\$ 361,994,278	\$ 367,884,569

The table below is the latest credit rating for the Fund's water revenue bond programs as of the date of this report.

Bonding Program	Fitch Ratings	Standard and Poor's	Moody's Investors Service
Water Revenue	AA+	AA+	Aa2

Future Outlook

The Fund continues to support the City of Norfolk's long-term objective of being a well-managed government and strives to enhance quality of life by providing excellent and sustainable water services at the best value to the City's customers. The Fund aims its attention on ensuring a sufficient supply of safe drinking water is available to the City's customers and promotes opportunities for the City's businesses growth.

Contacting the Fund's Financial Management

This financial report is designed to provide our citizens, clients, and taxpayers with a general overview of the Fund's finances and to demonstrate the Fund's accountability for the money it receives. Questions concerning this report or requests for additional financial information should be forwarded to the Director of Utilities Department, City of Norfolk.

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Statement of Net Position
June 30, 2014

	2014
Assets	
Current assets:	
Cash and short term investments (Note 2)	\$ 57,194,861
Unrestricted short term investments (Note 2)	11,848,217
Receivables:	
Accounts (net) (Note 3 and 8)	8,915,238
Unbilled accounts (Note 4 and 8)	4,883,796
Accrued investment income	24,433
Other receivables	71,582
Inventories	3,038,795
Restricted cash held in escrow (Note 2)	107,696
Restricted short term investments (Note 2):	
Restricted investment held with fiscal agent	7,796,378
Reserve funds	17,585,232
Investments restricted for construction	15,638,137
Total current assets	127,104,365
Capital assets (Note 5):	
Non-depreciable assets	45,680,822
Depreciable assets	644,639,164
Accumulated depreciation and amortization	(202,742,766)
Total noncurrent assets	487,577,220
Total assets	614,681,585
Deferred outflows of resources	
Loss on revenue bonds refunding	2,010,101
Total assets and deferred outflows of resources	
	616,691,686
Liabilities	
Current liabilities:	
Vouchers payable	1,223,926
Vouchers payable for CIP projects	3,875,145
Contract retainage	777,296
Accrued interest	13,695
Accrued payroll	312,152
Due to General Fund and other City funds	1,740,789
Payable to employees' retirement system	2,268,623
Compensated absences	631,185
Current portion of bonds payable (Note 6)	8,352,786
Accrued revenue bonds interest payable	2,591,186
Other liabilities (Note 13)	3,679,784
Total current liabilities	25,466,567

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Statement of Net Position (Continued)
June 30, 2014

	<u>2014</u>
Noncurrent liabilities:	
General obligation bonds payable (Note 6)	-
Revenue bonds payable (Note 6)	353,641,492
Liability for other post employment benefits (OPEB) (Note 12)	1,807,691
Compensated absences	422,733
Total noncurrent liabilities	<u>355,871,916</u>
Total liabilities	<u>381,338,483</u>
Net Position	
Net investment in capital assets	143,231,180
Restricted	25,478,070
Unrestricted	66,643,953
Total net position	<u><u>\$ 235,353,203</u></u>

See Notes to Financial Statements

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Statement of Revenues, Expenses and Changes in Net Position
For Fiscal Year Ended June 30, 2014

	2014
Operating Revenues:	
Charges for services, net	\$ 79,096,905
Miscellaneous	2,872,023
Total operating revenues	81,968,928
Operating Expenses:	
Personnel services	14,844,295
Plant operations	6,650,541
Chemicals	3,173,508
Depreciation and amortization	12,917,853
Retirement contribution (Note 7)	2,268,623
OPEB expense (Note 12)	172,356
Administrative expenses	1,376,142
Other	8,817,855
Total operating expenses	50,221,173
Operating income	31,747,755
Nonoperating Revenue (Expenses):	
Interest income, net of interest capitalized	109,074
Interest expense and fiscal charges	(11,328,582)
Loss on sale or disposal of assets	(67,120)
Other nonoperating revenue	(59,217)
Payments to General Fund	(8,500,000)
Total nonoperating expenses, net	(19,845,845)
Net income before contributions	11,901,910
Capital contributions	2,660,416
Change in Net Position	14,562,326
Net Position:	
Total net position - beginning, as previously reported	223,786,829
Adoption of GASB 65 (Note 1)	(2,995,952)
Total net position - beginning, as restated	220,790,877
Total net position - end	\$ 235,353,203

See Notes to Financial Statements

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Statement of Cash Flows
For Fiscal Year Ended June 30, 2014

	2014
Cash Flows From Operating Activities:	
Receipts from customers	\$ 82,304,104
Payments to suppliers	(11,080,794)
Payments to employees	(17,285,305)
Other payments	(10,075,731)
Net cash provided by operating activities	43,862,274
Cash Flows From Noncapital Financing Activities:	
Internal activity, payments from other funds	429,637
Payments to General Fund	(8,500,000)
Net cash used in noncapital financing activities	(8,070,363)
Cash Flows From Capital and Relating Financing Activities:	
Capital contributions	2,660,416
Purchases of capital assets	(18,005,912)
Principal paid on capital debt	(7,801,047)
Interest paid and bond service charges	(14,461,710)
Net cash used in capital and related financing activities	(37,608,253)
Cash Flows From Investing Activities:	
Proceeds from sale of investments	48,819,413
Purchase of investments	(42,122,089)
Interest and dividends	109,074
Net cash provided by investing activities	6,806,398
Net increase in cash and cash equivalents	4,990,056
Cash and short-term investments - beginning of year	52,204,805
Cash and short-term investments - end of year	\$ 57,194,861

(Continued)

An Enterprise Fund of the City of Norfolk, Virginia

Statement of Cash Flows (Continued)
For Fiscal Year Ended June 30, 2014

	2014
Reconciliation of Operating Income to Net Cash	
Provided by Operating Activities:	
Operating income	\$ 31,747,755
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization expense	12,917,853
Accounts receivable (net), billed and unbilled	335,176
Inventories	(1,613,901)
Vouchers payable	357,156
Accrued payroll	(172,387)
Other liabilities	290,622
Net cash provided by operating activities	<u>\$ 43,862,274</u>
Noncash investing, capital and financing activities:	
Unrealized loss on investments	<u>\$ (59,217)</u>
Loss on sale or disposal of capital assets	<u>\$ (67,120)</u>
Acquisition of capital assets through change in contract retainage	<u>\$ 154,045</u>
Acquisition of capital assets through change in vouchers payable	<u>\$ 1,403,326</u>
Capitalized interest, net	<u>\$ 1,083,073</u>

See Notes to Financial Statements

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Notes to Financial Statements
For the Fiscal Year Ended June 30, 2014

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. These financial statements are those of the Fund and not of the City of Norfolk, Virginia as a whole.

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

Basis of accounting: The accounting policies of the Fund are based upon accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Boards (GASB). The financial statements are presented on the accrual-basis of accounting, wherein revenues are recognized in the accounting period in which it is earned and expenses are recognized in the accounting period in which the related liabilities are incurred.

New Accounting Standards Adopted: In March 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities. The Fund has adopted this Statement retrospectively in fiscal year 2014. In connection with the adoption of GASB Statement No. 65, the Fund's deferred loss on the refunding of debt has been reclassified from long-term liabilities to deferred outflows of resources on the statement of net position. In addition, bond issuance costs are expensed and no longer amortized annually. The effect of adoption of GASB 65 is the reduction of beginning net position by \$2,995,952.

Net Position:	2014
Total net position - beginning, as previously reported	\$ 223,786,829
Adoption of GASB 65	<u>(2,995,952)</u>
Total net position - beginning, as restated	<u>\$ 220,790,877</u>

The new standard requires the disclosure of gain and loss on defeasance as deferred inflows and outflows. The reclassified amount for the Fund is \$2,121,773 at July 1, 2013.

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.

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Notes to Financial Statements
For the Fiscal Year Ended June 30, 2014

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.

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 net position on the Statement of Net Position 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

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Notes to Financial Statements
For the Fiscal Year Ended June 30, 2014

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 net investment in capital assets, 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.

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 \$1,993,002 for the fiscal year ended June 30, 2014. 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 \$2,836,443 for the fiscal year ended June 30, 2014.

Bond premium, discounts and issuance costs: Bond premiums and discounts are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are expensed in the period incurred.

Loss on bond refunding: In accordance with GASB 65, loss on bond refunding is reported as deferred outflows of resources in the fund's financial statements and is amortized using straight line method over the term of the debt.

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, 2014, the Fund's cash and investments consist of the following:

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Notes to Financial Statements
For the Fiscal Year Ended June 30, 2014

	2014
Investment in LGIP	\$ 11,011,236
Other investments	61,862,144
Cash	37,297,141
	\$ 110,170,521
Cash and short term investments	\$ 57,194,861
Restricted cash held in escrow	107,696
Restricted short term investments held with fiscal agent	7,796,378
Unrestricted short term investments	11,848,217
Reserve funds	17,585,232
Investment restricted for construction	15,638,137
	\$ 110,170,521

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 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 provides 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 basis 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 have 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 are treated as cash because they have the same characteristics as a demand deposit account and are reflected as cash and short term investments in the accompanying statement of net position. These amounts were covered by federal depository insurance or collateralized in accordance with the Virginia Security for Public Deposits Act.

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Notes to Financial Statements
For the Fiscal Year Ended June 30, 2014

At June 30, 2014, the Fund had \$11,011,236 deposited 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 year ended June 30, 2014, 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	Fair Value Less than 1 year
SNAP Money Market Mutual Funds	\$ 27,486,354
US Agency Notes	6,573,996
PFM Funds Government Series	7,796,378
SunTrust Bank Money market funds	20,005,416
	\$ 61,862,144

The Fund's rated debt investments, other than in LGIP, as of June 30, 2014 were rated by Standard and Poor's and the ratings are presented below using the Standard and Poor's rating scale.

Investment Type	AA+	AAAm	Total
Money Market Mutual Funds:			
SNAP Money Market Mutual Funds	\$ -	\$ 27,486,354	\$ 27,486,354
PFM Funds Government Series	-	7,796,378	7,796,378
US Agency Notes	6,573,996	-	6,573,996
	\$6,573,996	\$ 35,282,732	\$ 41,856,728

Note 3. Accounts Receivable

Accounts receivable at June 30, 2014 was comprised of the following:

	2014
Governmental	\$ 2,205,633
Residential	2,853,698
Refuse disposal fees	3,189,397
Commercial	1,144,943
Utility taxes	714,728
Industrial	418,815
Other	1,115,758
	11,642,972
Less allowance for uncollectible accounts	(2,727,734)
	\$ 8,915,238

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

The Fund recorded \$75,495 of provision for bad debts which was offset against the operating revenue for the fiscal year ended June 30, 2014.

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Notes to Financial Statements
For the Fiscal Year Ended June 30, 2014

Note 4. Unbilled Accounts Receivable

At June 30, 2014, the Fund recognized \$4,883,796 as unbilled accounts receivable. These amounts were billed in July 2014.

Note 5. Capital Assets

Capital assets at June 30, 2014 were comprised of the following:

	Balance June 30, 2013	Additions	Retirements / Transfers	Balance June 30, 2014
Nondepreciable assets:				
Land	\$ 11,771,211	\$ -	\$ -	\$ 11,771,211
Intangible assets	2,398,465	37,300	-	2,435,765
Construction in progress	20,145,582	18,292,913	(6,964,649)	31,473,846
Total nondepreciable assets	<u>34,315,258</u>	<u>18,330,213</u>	<u>(6,964,649)</u>	<u>45,680,822</u>
Depreciable & amortized assets:				
Land improvements	20,738,946	48,499	-	20,787,445
Buildings	193,590,596	51,497	-	193,642,093
Equipment	416,604,155	7,850,275	(734,031)	423,720,399
Intangible assets	6,165,207	324,020	-	6,489,227
Total depreciable & amortized assets	<u>637,098,904</u>	<u>8,274,291</u>	<u>(734,031)</u>	<u>644,639,164</u>
Less accumulated depreciation for				
Land improvements	(4,112,424)	(405,151)	-	(4,517,575)
Buildings	(47,897,988)	(3,200,793)	-	(51,098,781)
Equipment	(134,308,081)	(8,686,969)	590,339	(142,404,711)
Intangible assets	(4,096,759)	(624,940)	-	(4,721,699)
Total accumulated depreciation	<u>(190,415,252)</u>	<u>(12,917,853)</u>	<u>590,339</u>	<u>(202,742,766)</u>
Depreciable assets, net	<u>446,683,652</u>	<u>(4,643,562)</u>	<u>(143,692)</u>	<u>441,896,398</u>
Total capital assets, net	<u>\$ 480,998,910</u>	<u>\$ 13,686,651</u>	<u>\$ (7,108,341)</u>	<u>\$ 487,577,220</u>

The Fund capitalized \$1,209,674 of interest expense and \$126,601 of interest income for the fiscal year ended June 30, 2014. The total interest cost was \$12,538,256 for the fiscal year ended June 30, 2014.

Note 6. Long-Term Obligations

General obligation bonds: A summary of general obligation bond transactions for the fiscal year ended June 30, 2014 follows:

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Notes to Financial Statements
For the Fiscal Year Ended June 30, 2014

	2014
General obligation bonds outstanding at July 1	\$ 1,098,833
Bonds retired/refunded	(551,047)
Bonds outstanding at June 30	547,786
Unamortized discount/premium, net	-
General obligation bonds outstanding at June 30, adjusted for unamortized discount/premium	547,786
Less current portion bond payable	(547,786)
	\$ -

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

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2014
Series 2009 Refunding	5/21/2009	21,895,000	3.00 - 5.00%	\$ 547,786
Total Water Utility General Obligation Bonds				\$ 547,786

A summary of the requirements to amortize general obligation bonds outstanding at June 30, 2014 is as follows:

Year Ending June 30,	Principal	Interest
2015	\$ 547,786	\$ 13,695
	\$ 547,786	\$ 13,695

General obligation bonds are payable first from the revenue of the specific funds in which they are recorded; however, the full faith and credit of the City is pledged to the payment of the principal and interest on general obligation bonds.

Revenue bonds: A summary of revenue bond transactions for the fiscal year ended June 30, 2014 follows:

	2014
Revenue bonds outstanding at July 1	\$ 332,445,000
Bonds retired	(7,250,000)
Bonds issued	-
Bonds outstanding at June 30	325,195,000
Unamortized discount/premium, net	36,251,492
Revenue bonds outstanding at June 30, adjusted for unamortized discount/premium	361,446,492
Less current portion	(7,805,000)
	\$ 353,641,492

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

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Notes to Financial Statements
For the Fiscal Year Ended June 30, 2014

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2014
Series 2005 Water Revenue and Refunding	3/23/2005	22,810,000	3.50 - 5.00%	\$ 16,520,000
Series 2008 Water Revenue	4/23/2008	58,415,000	3.00 - 5.00%	53,300,000
Series 2010 Water Revenue	9/23/2010	47,415,000	2.00 - 4.50%	44,635,000
Series 2012 Water Revenue Refunding	4/4/2012	176,925,000	2.00 - 5.00%	167,670,000
Series 2013 Water Revenue	2/20/2013	43,070,000	2.00 - 5.00%	43,070,000
Total Water Utility Revenue Bonds				<u>\$ 325,195,000</u>

A summary of the requirements to amortize water revenue bonds outstanding at June 30, 2014 is as follows:

Year Ending June 30,	Principal	Interest
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	14,820,000	13,291,244
2020-2024	89,310,000	54,270,393
2025-2029	75,720,000	32,717,994
2030-2034	43,325,000	19,207,962
2035-2039	43,000,000	9,177,290
2040-2043	17,950,000	1,513,850
	<u>\$ 325,195,000</u>	<u>\$ 189,210,584</u>

Water revenue bonds are payable solely from the revenue of the Fund. The most restrictive covenant of the water revenue bonds requires that the Fund's net revenue to be not less than the greater of (i) the sum of 1.1 times senior debt service and 1.0 times subordinated debt service for the fiscal year or (ii) 1.0 times the funding requirements for transfers from the Revenue Fund to the Operating Fund, the Bond Fund, the Parity Debt Service Fund, the Debt Service Revenue Fund, the Subordinated Debt Service Fund and the Repair and Replacement Reserve Fund. Pursuant to the terms of the revenue bond indenture, certain resources have been set aside for the repayment of the revenue bonds. These resources are classified as restricted cash held with fiscal agent on the balance sheet because their use is limited by applicable bond covenants.

Bonds authorized and unissued as of June 30, 2014 were \$90,085,932.

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

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Notes to Financial Statements
For the Fiscal Year Ended June 30, 2014

Report of the System for a further description of the plan. Retirement expense was \$2,268,623 for the year ended June 30, 2014.

Note 8. Significant Customers

Billed and unbilled accounts receivable includes \$3,918,034 due from the City of Virginia Beach and \$990,730 due from the United States Navy for water sales at June 30, 2014. Net charges for services include \$23,188,120 for water sales to the City of Virginia Beach and \$9,927,016 for water sales to the United States Navy for the fiscal year ended June 30, 2014.

Note 9. Commitments and Contingencies

Commitment for completion of capital projects authorized at June 30, 2014 was approximately \$39,719,600.

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 provides post-retirement health care benefits, in accordance with state statutes, which require extending access to healthcare benefits to certain retirees. General City employees are eligible to participate at the earlier of age 55 and 15 years of creditable service or 25 years of creditable service. Employees who retire on accidental disability are also eligible. Retirees that elect to participate may purchase health care coverage using the same health care plans and premium structures available to active employees. Retiree participation, plan/benefit elections and contributions are administered by the City's Retirement Bureau based on the participation guidelines established by the Norfolk City Council. Effective January 1, 2014, the City eliminated health care coverage for post 65 retirees (e.g. retirees eligible for Medicare).

Projections of benefits for financial reporting purposes are based on the plan and include the types of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The actuarial valuation was performed as of July 1, 2013 with results projected for the fiscal year ended June 30, 2014.

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 costs 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.

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Notes to Financial Statements
For the Fiscal Year Ended June 30, 2014

The Fund and the City use the pay as you go method to calculate the OPEB liability for June 30, 2014 as the City has not funded a trust for the OPEB liability. Using the most recent OPEB plan valuation date of July 1, 2013, 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:

	2014	2013	2012
Net beginning OPEB obligation	\$ 1,635,335	\$ 1,527,018	\$ 1,199,565
Annual required contributions	305,780	362,335	495,054
Interest on net OPEB obligation	65,140	49,318	51,047
Adjustment to ARC	(60,488)	(48,613)	(47,402)
Annual OPEB cost	310,432	363,040	498,699
Less: contributions made	138,076	254,723	171,246
Increase in net OPEB obligation	172,356	108,317	327,453
Net ending OPEB obligation	\$ 1,807,691	\$ 1,635,335	\$ 1,527,018

The total unfunded actuarial accrued liability (UAAL) for 2014, 2013 and 2012 is \$3,028,083, \$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 short-term liabilities

In fiscal year 2013, 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. This liability was reclassified as current liability as of June 30, 2014 and, in accordance with the water services contract, it 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.

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; however, earlier application is encouraged.

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Notes to Financial Statements
For the Fiscal Year Ended June 30, 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.

GASB Statement 71: Pension Transition for Contributions Made Subsequent to the Measurement Date. This statement will eliminate the source of a potentially significant understatement of restated beginning net position and expense in the first year of implementation of GASB 68 in the accrual-basis financial statements of employers and non-employer contributing entities. The provisions of this Statement should be applied with the implementation of GASB 68.

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Supplementary Schedules
For the Fiscal Year Ended June 30, 2014

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, 2013	\$ -	\$ 3,028,082	\$ 3,028,082	0%	\$ 10,444,697	29.0%
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%

Water Utility Fund
An Enterprise Fund of the City of Norfolk, Virginia

Supplementary Schedules
For the Fiscal Year Ended June 30, 2014

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	
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
2014	82,078,002	34,466,877	47,611,125	7,250,000	15,630,219	22,880,219	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).



KPMG LLP
Suite 1900
440 Monticello Avenue
Norfolk, VA 23510

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 basic financial statements of the Water Utility Fund of the City of Norfolk, Virginia (the Fund), which comprise the statement of net position as of June 30, 2014, and the related statements of revenues, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the basic financial statements, and have issued our report thereon dated January 29, 2015, which included a paragraph emphasizing that in fiscal year 2014, the Fund adopted new accounting guidance described in Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the 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 basic 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 the 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
January 29, 2015