McGladrey & Pullen
Certified Public Accountants

Water Utility Fund of the City of Norfolk, Virginia

Financial and Compliance Report
Year Ended June 30, 2007

Contents

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Certified Public Accountants

Independent Auditor's Report

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

We have audited the accompanying statements of net assets of the Water Utility Fund of the City of Norfolk, Virginia as of June 30, 2007 and 2006, and the related statements of revenues, expenses and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of the management of the City of Norfolk. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States and *Specifications for Audits of Counties, Cities and Towns*, issued by the Auditor of Public Accounts of the Commonwealth of Virginia. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

In our opinion, except for the omission of the information discussed in the preceding paragraph, 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, 2007 and 2006, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

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

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Water Utility Fund, taken as a whole. The supplemental material on page 20 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

McGladrey & Pullen, LLP

Greensboro, North Carolina
December 20, 2007

Water Utility Fund of the City of Norfolk, Virginia

Statements of Net Assets
June 30, 2007 and 2006

	2007	2006 (As Restated)
Assets		
Current Assets		
Cash and cash equivalents	$ 25,773,253	$ 18,001,900
Investments	-	6,079,201
Receivables:		
Accounts, net	11,250,348	11,526,794
Unbilled accounts	1,041,527	1,154,313
Accrued investment income	88,087	74,301
Other receivable	345,000	460,000
Due from other funds	421,666	418,926
Inventories	1,501,176	1,485,161
Restricted cash held with fiscal agent	7,577,321	7,404,483
Total current assets	47,998,378	46,605,079
Restricted investments	9,000,000	8,900,000
Capital assets (Note 13):		
Land and construction in process	30,449,221	23,060,366
Buildings, improvements and equipment, net of accumulated depreciation	401,205,465	400,624,736
	431,654,686	423,685,102
Total assets	488,653,064	479,190,181
Liabilities		
Current Liabilities		
Vouchers payable	4,483,420	1,520,878
Contract retainage	465,078	428,189
Accrued interest	316,500	374,000
Accrued payroll	250,191	263,767
Due to other funds	14,264,393	3,914,202
Contribution to Employees Retirement System	1,582,672	1,529,200
Current portion of bonds payable	11,577,746	11,036,450
Liabilities payable from restricted assets	2,367,800	2,424,600
Compensated absences	581,200	720,700
Other liabilities	2,446,613	1,185,390
Total current liabilities	38,335,613	23,397,376
Noncurrent Liabilities		
General obligation bonds payable	14,579,318	18,840,442
Revenue bonds payable	258,510,671	265,837,368
Compensated absences	273,500	112,800
Total noncurrent liabilities	273,363,489	284,790,610
Total liabilities	311,699,102	308,187,986
Commitments and contingencies (Notes 7, 8, 11 and 12)		
Net Assets		
Invested in capital assets, net of related debt	155,521,873	136,442,653
Unrestricted	21,432,089	34,559,542
	$ 176,953,962	$ 171,002,195

See Notes to Financial Statements.

Water Utility Fund of the City of Norfolk, Virginia

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

	2007	2006 (As Restated)
Operating revenues:		
Charges for services	$ 69,815,932	$ 74,218,336
Miscellaneous	2,941,067	3,472,406
Total operating revenues	72,756,999	77,690,742
Operating expenses:		
Personal services	12,737,845	12,333,921
Plant operations	5,780,847	7,631,051
Chemicals	3,318,311	3,227,636
Provision of bad debts	52,634	155,116
Depreciation	10,796,178	10,232,808
Retirement contribution	1,582,668	1,529,200
Administrative expenses	2,064,339	1,612,230
Other	10,117,700	10,835,628
Total operating expenses	46,450,522	47,557,590
Operating income	26,306,477	30,133,152
Nonoperating revenue (expenses):		
Interest income	1,704,565	1,097,416
Intergovernmental Revenues	333,350	-
Interest expense and fiscal charges	(14,060,054)	(14,760,173)
Gain (loss) on sale or disposal of capital assets	(6,032)	1,126,108
Total nonoperating expenses	(12,028,171)	(12,536,649)
Income before contributions and transfers	14,278,306	17,596,503
Capital contributions	594,926	59,059
Transfers out	(8,921,465)	(10,117,535)
Change in net assets	5,951,767	7,538,027
Net assets:		
Beginning	171,002,195	164,758,881
Adjustment to beginning balance (Note 13)	-	(1,294,713)
Ending	$ 176,953,962	$ 171,002,195

See Notes to Financial Statements.

Water Utility Fund of the City of Norfolk, Virginia

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

	2007	2006 (As Restated)
Cash Flows From Operating Activities		
Receipts from customers	$ 73,208,597	$ 72,475,228
Payments to suppliers	(19,917,338)	(24,060,416)
Payments to employees	(12,676,749)	(12,188,456)
Other receipts (payments)	1,261,223	(3,128,461)
Net cash provided by operating activities	41,875,733	33,097,895
Cash Flows From Noncapital Financing Activities		
Operating subsidies and transfers to other funds	(8,921,465)	(10,117,535)
Intergovernment revenue	333,350	-
Internal activity, receipts from other funds	10,347,451	4,104,225
Net cash provided by (used in) noncapital financing activities	1,759,336	(6,013,310)
Cash Flows From Capital and Related Financing Activities		
Contributed capital	594,926	59,059
Purchases of capital assets	(18,029,010)	(9,518,389)
Proceeds from sale of capital assets	-	1,410,625
Principal paid on capital debt	(11,036,450)	(10,722,778)
Interest paid and bond service charges	(14,890,324)	(15,314,961)
Net cash used in capital and related financing activities	(43,360,858)	(34,086,444)
Cash Flows From Investing Activities		
Net proceeds from sales and maturities of investments	6,079,201	8,976,910
Net purchases of certificates of deposits	(100,000)	(1,000,000)
Interest and dividends	1,690,779	1,050,285
Net cash provided by investing activities	7,669,980	9,027,195
Net increase in cash and cash equivalents	7,944,191	2,025,336
Cash and cash equivalents:		
Beginning	25,406,383	23,381,047
Ending	$ 33,350,574	$ 25,406,383

(Continued)

Water Utility Fund of the City of Norfolk, Virginia

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

	2007	2006 (As Restated)
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	$ 26,306,477	$ 30,133,152
Adjustment to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	10,796,178	10,232,808
Provision for bad debt	52,634	155,116
Changes in assets and liabilities:		
(Increase) decrease in:		
Receivables, net	336,598	(5,340,097)
Other receivables	115,000	124,583
Inventories	(16,015)	162,465
Other assets	-	99,346
Increase (decrease) in:		
Vouchers payable	2,962,542	612,864
Accrued payroll	(13,576)	(133)
Other liabilities	1,335,895	(3,082,209)
Net cash provided by operating activities	$ 41,875,733	$ 33,097,895
Reconciliation of Cash and Cash Equivalents to the Statement of Net Assets		
Cash and cash equivalents	$ 25,773,253	$ 18,001,900
Restricted cash with fiscal agent	7,577,321	7,404,483
Total cash and cash equivalents per statement of net assets	$ 33,350,574	$ 25,406,383
Noncash Investing, Capital and Financing Activities		
(Gain) loss on sale or disposal of capital assets	$ 6,032	$ (1,126,108)
Acquisition of capital assets through change in contract retainage	$ 465,078	$ 428,189
Capitalized interest, less interest earned on certain long-term construction contracts	$ 705,895	$ 620,554

See Notes to Financial Statements.

Note 1. Summary of Significant Accounting Policies

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

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

Investments: The Fund reports investments at fair market value. Investment income includes both realized and unrealized gain and loss components.

Accounts receivable: Accounts receivable are receivables due at the end of the fiscal year which have not been collected by year-end, net of allowance for doubtful accounts. The Fund determines past due status of individual 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 and based on water usage by customers for which billings have not yet been processed.

Inventories: Inventories are stated at the lower of cost (using the first-in, first-out 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.

Note 1. Summary of Significant Accounting Policies (Continued)

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

	Years
Buildings and improvements	40 - 75
Transmission and distribution mains	50 - 99
Service meters and meter installation	35 - 50
Pumping and other water equipment	10 - 30
Furniture, fixtures and equipment	5 - 25

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 government are reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government are measured using the method that best reflects the diminished service utility of the capital asset. Any insurance recoveries received as a result of impairment events or changes in circumstances resulting in the impairment of a capital asset are netted against the impairment loss.

Compensated absences: It is Fund's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. Vacation leave is fully vested when earned by Fund employees. Sick leave does not vest for Fund employees; however, upon retirement, Fund employees receive credit for each day of accumulated sick leave toward their pension benefit. There is no liability for unpaid accrued sick leave service since the Fund does not pay when the employee separates from service.

Net assets: Net assets in the financial statements are classified as invested in capital assets, net of related debt; restricted; and unrestricted. Restricted net assets represent constraints on resources that are either externally imposed by creditors, grants, contributions, laws and regulations of other governments or imposed by law through state statute.

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

Note 1. Summary of Significant Accounting Policies (Continued)

Transfers to/from other funds: The General Fund of the City provides administrative services to the Fund, which totaled $2,064,339 and $1,612,230 for the years ended June 30, 2007 and 2006, respectively. Charges for these services are treated as expenses by the Fund and as revenue by the General Fund. In addition the Fund recorded, as other expenses, payments to the General Fund in lieu of taxes of $2,623,317 and $2,942,013 for the years ended June 30, 2007 and 2006, respectively.

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

Deferred gain (loss) on advance refunding: Gain or (loss) on advance refunding is amortized, using the effective 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.

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

Note 2. Cash and Investments

Deposits: All cash of the Fund is maintained in accounts collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 et. seq. of the Code of Virginia or covered by federal depository insurance.

The Fund's restricted assets on the statement of net assets includes $9,000,000 and $8,900,000 of certificates of deposits at June 30, 2007 and 2006, respectively. These deposits mature at a date later than three months after year-end and therefore do not meet the definition of cash and cash equivalents.

Investments: Statutes authorize the Fund to invest in obligations of the United States or agencies thereof, obligations of the Commonwealth of Virginia or political subdivisions thereof, obligations of the International Bank for Reconstruction and Development ("World Bank") and Asian Development Bank, the African Development Bank, commercial paper rated A-1 by Standard and Poor's or P-1 by Moody's Commercial Paper Record, bankers' acceptances, repurchase agreements, and the State Treasurer's Local Government Investment Pool ("LGIP"), certain mutual funds, corporate notes, asset-backed securities, and savings accounts or time deposits.

The Fund has no formal policy regarding credit risk, interest rate risk, concentration of credit risk, custodial credit risk, or foreign investment risk.

The Fund had $21,370,000 and $18,000,000 deposited in the State Treasurer's LGIP at June 30, 2007 and 2006, respectively, which has a Standard and Poor's rating of AAAm and is included in cash and cash equivalents.

Note 2. Cash and Investments (Continued)

The Fund's investments for the years ended June 30, 2007 and 2006, 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.

	Fiscal Year 2007		Fiscal Year 2006	
Investment Type	Fair Value	Less Than 1 year	Fair Value	Less Than 1 year
SNAP Mutual Fund	$ -	$ -	$ 6,079,201	$ 6,079,201

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

	Fiscal Year 2006				
Investment Type	AAA	A-1+	A-1	A+	Total
SNAP Mutual Fund	$ 595,762	$ 3,410,432	$ 1,617,067	$ 455,940	$ 6,079,201

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

	2007		2006	
	Cost	Fair Value	Cost	Fair Value
SNAP Mutual Fund	$ -	$ -	$ 6,079,201	$ 6,079,201

The City's Water Utility Fund has combined amounts restricted for capital projects and amounts for which the nature of the transaction generated a related liability with amounts available for general operating use in the statements for the Water Utility Fund. These amounts are not available to meet obligations arising from the operating activities of the Fund.

A summary of the liabilities payable from restricted assets at June 30, 2007 and 2006, follows:

	2007	2006
Accrued interest	$ 2,367,800	$ 2,424,600

Note 3. Accounts Receivable

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

	2007	2006
City of Virginia Beach	$ 2,223,264	$ 4,201,089
United States Navy	1,852,704	1,364,852
Residential	1,979,310	1,934,304
Refuse disposal fees	1,523,443	1,231,558
Commercial	931,737	863,433
Utility taxes	586,134	523,481
Industrial	216,577	133,850
Penalties	190,530	166,750
Other	3,264,940	2,777,907
	12,768,639	13,197,224
Less allowance for uncollectible accounts	(1,518,291)	(1,670,430)
	$ 11,250,348	$ 11,526,794

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, 2007 and 2006, the Fund recognized $1,041,527 and $1,154,313, respectively, as unbilled accounts receivable related to unread meters. The associated revenue is included in net charges for services.

Note 5. Capital Assets

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

	Balance June 30, 2006	Additions	Retirements	Transfers	Balance June 30, 2007
Nondepreciable assets:					
Land	$ 12,338,879	$ -	$ -	$ -	$ 12,338,879
Construction-in-progress	10,721,487	16,442,433	-	(9,053,578)	18,110,342
Total nondepreciable assets	23,060,366	16,442,433	-	(9,053,578)	30,449,221
Depreciable assets:					
Buildings and equipment	515,920,583	2,323,329	(1,813,205)	9,053,578	525,484,285
Less accumulated depreciation	(115,295,847)	(10,796,178)	1,813,205	-	(124,278,820)
Total depreciable assets, net	400,624,736	(8,472,849)	-	9,053,578	401,205,465
Total capital assets, net	$ 423,685,102	$ 7,969,584	$ -	$ -	$ 431,654,686

Note 5. Capital Assets (Continued)

	Balance June 30, 2005 (Previously Reported)	Restatement Amount	Balance June 30, 2005 (As Restated)	Additions	Retirements	Transfers	Balance June 30, 2006 (As Restated)
Nondepreciable assets:							
Land	$ 11,790,455	$ -	$ 11,790,455	$ -	$ (49,004)	$ 597,428	$ 12,338,879
Construction-in-progress	31,833,767	(3,143,656)	28,690,111	8,446,629	-	(26,415,253)	10,721,487
Total nondepreciable assets	43,624,222	(3,143,656)	40,480,566	8,446,629	(49,004)	(25,817,825)	23,060,366
Depreciable assets:							
Buildings and equipment	486,860,437	2,139,694	489,000,131	2,102,680	(1,000,053)	25,817,825	515,920,583
Less accumulated depreciation	(105,536,828)	(290,751)	(105,827,579)	(10,232,808)	764,540	-	(115,295,847)
Total depreciable assets, net	381,323,609	1,848,943	383,172,552	(8,130,128)	(235,513)	25,817,825	400,624,736
Total capital assets, net	$ 424,947,831	$ (1,294,713)	$ 423,653,118	$ 316,501	$ (284,517)	$ -	$ 423,685,102

The Fund capitalized $1,129,893 and $1,263,351 of interest expense and $423,998 and $642,797 of interest income for the fiscal years ended June 30, 2007 and 2006, respectively. The total interest cost was $15,189,947 and $16,023,524 for the fiscal years ended June 30, 2007 and 2006, respectively.

Note 6. Long -Term Obligations

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

	2007	2006
General obligation bonds outstanding at July 1	$ 20,936,796	$ 25,079,574
Bonds retired	(3,726,450)	(4,142,778)
Bonds outstanding at June 30	17,210,346	20,936,796
Unamortized discount/premium	1,281,718	1,630,096
General obligation bonds outstanding at June 30, adjusted for unamortized discount/premium	18,492,064	22,566,892
Less current portion	(3,912,746)	(3,726,450)
	$ 14,579,318	$ 18,840,442

Note 6. Long -Term Obligations (Continued)

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

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2007	2006
Series 1998 Refunding	06/15/1998	$ 49,190,000	4.25 - 5.00%	$ 7,703,784	$ 9,056,946
Series 2002 Refunding	02/01/2002	47,200,000	2.00 - 5.00%	3,006,589	3,734,008
Series 2002B Refunding	11/01/2002	39,890,000	5.00 - 5.25%	1,688,141	1,693,392
Series 2004 Refunding	03/01/2004	96,395,000	2.00 - 5.00%	4,811,832	6,452,450
Total Water Utility General Obligation Bonds				$ 17,210,346	$ 20,936,796

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

Year Ending June 30,	Principal	Interest
2008	$ 3,912,746	$ 783,218
2009	3,757,732	625,238
2010	2,812,578	437,701
2011	2,822,993	304,804
2012	2,058,267	163,900
2013 - 2015	1,846,030	129,406
	$ 17,210,346	$ 2,444,267

Note 6. Long -Term Obligations (Continued)

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

Revenue bonds: A summary of revenue bond transactions for the fiscal years ended June 30, 2007 and 2006 follows:

	2007	2006
Revenue bonds outstanding at July 1	$ 277,385,000	$ 283,965,000
Bonds retired	(7,310,000)	(6,580,000)
Bonds outstanding at June 30	270,075,000	277,385,000
Less unamortized discount	(3,899,329)	(4,237,632)
Revenue bonds outstanding at June 30, adjusted for unamortized discount/premium	266,175,671	273,147,368
Less current portion	(7,665,000)	(7,310,000)
	$ 258,510,671	$ 265,837,368

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

Bond Issue/Purpose	Dated	Issue Amount	Interest Rate	2007	2006
Series 1993 Water Revenue	11/01/1993	$ 68,430,000	2.80 - 5.375%	$ 50,530,000	$ 52,320,000
Series 1995 Water Revenue	08/15/1995	115,680,000	5.00 - 7.00%	93,265,000	95,905,000
Series 1998 Water Revenue and Refunding	11/01/1998	84,605,000	4.00 - 5.125%	72,000,000	73,805,000
Series 2001 Water Revenue and Refunding	10/15/2001	35,000,000	4.00 - 5.00%	31,865,000	32,545,000
Series 2005 Water Revenue and Refunding	03/23/2005	22,810,000	3.50 - 5.00%	22,415,000	22,810,000
				$ 270,075,000	$ 277,385,000

Note 6. Long -Term Obligations (Continued)

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

Year Ending June 30,	Principal	Interest
2008	$ 7,665,000	$ 14,022,200
2009	8,050,000	13,639,869
2010	8,455,000	13,232,930
2011	8,885,000	12,800,298
2012	9,355,000	12,336,246
2013 - 2017	54,815,000	53,617,616
2018 - 2022	71,595,000	36,823,926
2023 - 2027	70,925,000	15,808,114
2028 - 2032	25,240,000	3,596,237
2033 - 2036	5,090,000	484,701
	$ 270,075,000	$ 176,362,137

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 (1) 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 statement of net assets because their use is limited by applicable bond covenants.

Bonds authorized and unissued as of June 30, 2007 were approximately $32,457,000.

Advance refunding: Previously, the Fund defeased certain general obligation bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Fund’s financial statements. At June 30, 2007 and 2006, $1.10 million of bonds outstanding for the Fund are considered defeased.

Note 7. Retirement Obligations

The Fund contributes to the Employees' Retirement System of the City of Norfolk (the "System"), a single-employer noncontributory defined benefit plan, which is accounted for as a separate Pension Trust Fund. Reference should be made to the Comprehensive Annual Financial Report of the City System for a further description of the plan. Retirement expense was $1,582,668 and $1,529,200 for the years ended June 30, 2007 and 2006, respectively.

Note 8. Other Liabilities

In 2006, a current liability of $853,000 was recorded in the Water Utilities Fund to reflect over-recovery of revenue from a wholesale customer during fiscal year 2006 under the water contract. In 2007 an additional liability of $1,067,000 was recorded for this same wholesale customer. Pursuant to the terms of the water services contract, billings to the customer were based on budgeted Water Utility Fund capital and operating expenditures during the fiscal years. The liability reflects the adjustments to billings based on the difference between budgeted expenditures and actual cost of service for that customer (capital and operating). In accordance with the water services contract, this liability is planned to be reduced in fiscal years 2010 and 2011 through credits to the customer billings. At June 30, 2007, the liability was $1,920,000 for this customer.

Note 9. Concentration of Credit Risk and Significant Customers

Accounts receivable includes $2,223,264 and $4,201,089 due from the City of Virginia Beach and $1,852,704 and $1,364,852 due from the United States Navy for water sales at June 30, 2007 and 2006, respectively. Net charges for services includes $25,171,343 and $29,923,627 for water sales to the City of Virginia Beach and $7,420,050 and $8,130,309 for the United States Navy for the fiscal years ended June 30, 2007 and 2006, respectively.

Certain of the Fund's cash and investments are combined with other City monies for investment purposes. These amounts were covered by federal depository insurance or collateralized in accordance with the Virginia Security for Public Deposits Act. Reference should be made to the Comprehensive Annual Financial Report of the City of Norfolk for further cash and investment disclosures.

Note 10. Commitments

Commitments for completion of capital projects authorized at June 30, 2007 were approximately $14,400,000.

Note 11. Litigation

From time-to-time the Fund and the City are defendants in a number of lawsuits. Although it is not possible to determine the final outcome of these matters, management and the City attorney are of the opinion that the ultimate liability will not be material and will not have a significant effect on the Fund's financial condition.

During fiscal year 2006, the Fund and a wholesale customer became involved in a dispute over the amount of water usage by the customer and related water billings going back to 2002. The Fund has recorded amounts it believes is consistent with the requisite water contracts with this customer (see Note 8).

Note 12. Risk Management

The Fund is exposed to various risks of loss related to: theft of, damage to, and destruction of assets; injuries to employees; general liability; automobile liability; crime and employee dishonesty; professional liability; and directors and officers' liability. The Fund’s coverage is provided though the City of Norfolk’s combination of purchased insurance policies and self-insurance plans.

Note 13. Adjustments to Beginning Capital Assets and Net Assets

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

Restatement of the Fund's net assets are as follows:

	Land and Construction in Process	Buildings, and Improvements and Equipment, Net of Accumulated Depreciation	Total Capital Assets, Net	Invested in Capital Assets, Net of Related Debt	Unrestricted	Total Net Assets
As previously reported, June 30, 2005	$ 43,624,222	$ 381,323,609	$ 424,947,831	$ 126,615,836	$ 38,143,045	$ 164,758,881
Restatement adjustments	(3,143,656)	1,848,943	(1,294,713)	(1,294,713)	-	(1,294,713)
As restated, June 30, 2005	40,480,566	383,172,552	423,653,118	125,321,123	38,143,045	163,464,168
Net changes, as previously reported	(15,509,141)	15,849,879	340,738	11,430,284	(3,583,503)	7,846,781
Restatement adjustments	(1,911,059)	1,602,305	(308,754)	(308,754)	-	(308,754)
As restated, June 30, 2006	$ 23,060,366	$ 400,624,736	$ 423,685,102	$ 136,442,653	$ 34,559,542	$ 171,002,195

	Depreciation	Other	Total
As previously reported, for the year ended June 30, 2006	$ 10,162,060	$ 10,597,622	$ 20,759,682
Restatement adjustments	70,748	238,006	308,754
As restated, for the year ended June 30, 2006	$ 10,232,808	$ 10,835,628	$ 21,068,436

Note 14. Accounting Pronouncements Issued But Not Yet Implemented

The GASB has issued several pronouncements prior to June 30, 2007 that have effective dates that may impact future financial presentations.

Management has not currently determined what, if any, impact implementation of the following statements may have on the financial statements of the Fund.

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes standards for the measurement, recognition and display of expenses/expenditures and related liabilities (assets), note disclosures and if applicable, required supplementary information in the financial reports of state and local governmental employers on other postemployment benefits ("OPEB"). The Fund is required to adopt this Statement in fiscal year 2008.

Note 14. Accounting Pronouncements Issued But Not Yet Implemented (Continued)

- GASB Statement No. 47, *Accounting for Termination Benefits*. This Statement requires financial statements prepared on the accrual basis of accounting to recognize a liability and expense for voluntary termination benefits when the offer is accepted and the amount can be estimated. A liability and expense for involuntary termination benefits should be recognized when a plan of termination has been approved by those with the authority to commit the entity to the plan, the plan has been communicated to employees, and the amount can be estimated. The Fund is required to adopt this Statement the same time it adopts GASB Statement No. 45 mentioned above.

- GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. This Statement establishes criteria that governments will use to ascertain whether the proceeds received should be reported as revenue or as a liability. The criteria should be used to determine the extent to which a transferor government either retains or relinquishes control over the receivables or future revenues through its continuing involvement with those receivables or future revenues. This Statement establishes that a transaction will be reported as a collateralized borrowing unless the criteria indicating that a sale has taken place are met. If it is determined that a transaction involving *receivables* should be reported as a sale, the difference between the carrying value of the receivables and the proceeds should be recognized in the period of the sale in the change statements. If it is determined that a transaction involving future revenues should be reported as a sale, the revenue should be deferred and amortized, except when specific criteria are met. This Statement also provides additional guidance for sales of receivables and future revenues within the same financial reporting entity.

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

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

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations,* identifies the circumstances under which a governmental entity would be required to report a liability related to pollution remediation. According to the standard, a government would have to estimate its expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

  - Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem
  - A government has violated a pollution prevention-related permit or license
  - A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the clean up

Note 14. Accounting Pronouncements Issued But Not Yet Implemented (Continued)

- A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution
- A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

GASB Statement No. 49 also will require governments to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements. Statement No. 49 will be effective for financial statements for periods beginning after December 15, 2007, but liabilities should be measured at the beginning of that period, so that beginning net assets can be restated.

- GASB Statement No. 50, *Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27*. This Statement more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits ("OPEB") and, in doing so, enhances information disclosed in notes to financial statements or presented as required supplementary information ("RSI") by pension plans and by employers that provide pension benefits. The reporting changes required by this Statement amend applicable note disclosure and RSI requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans,* and No. 27, *Accounting for Pensions by State and Local Governmental Employers,* to conform with requirements of Statements No. 43, *Financial Reporting for OPEB Plans,* and No. 45, *Accounting and Financial Reporting by Employers for OPEB*.

- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. Additionally, this Statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated and establishes criteria for when such expenditures should be capitalized. This Statement is effective for periods beginning after June 15, 2009 (the Fund's fiscal year ended June 30, 2010) and generally requires its provisions to be applied retroactively.

City of Norfolk, Virginia
Water Utility Fund

Annual Budgets (Cash Basis) (Unaudited)
Years Ended June 30, 2007 and 2006

	2007	2006
Revenues:		
Total water revenues	$ 74,816,668	$ 75,071,336
Interest income	1,704,565	1,097,416
Miscellaneous	2,941,067	3,472,406
Total revenues	$ 79,462,300	$ 79,641,158
Appropriations:		
Personal services	$ 12,737,845	$ 12,333,921
Materials, supplies, and repairs	10,540,818	8,884,760
General operations and fixed charges	12,197,655	16,175,033
Equipment	843,725	635,237
Allocated overhead	1,986,265	1,986,265
Debt service and expenses:		
Revenue bond	22,033,797	20,326,247
General obligation bond debt	7,577,212	7,858,671
Payment in lieu of taxes (PILOT)	3,044,983	2,941,024
Transfer to General Fund	8,500,000	8,500,000
Total appropriations	$ 79,462,300	$ 79,641,158

McGladrey & Pullen
Certified Public Accountants

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

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

We have audited the financial statements of the Water Utility Fund (the "Fund") of the City of Norfolk, Virginia as of and for the year ended June 30, 2007, and have issued our report thereon dated December 20, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the *Specifications for Audits of Counties, Cities, and Towns* issued by the Auditor of Public Accounts of the Commonwealth of Virginia. As discussed in Note 13 to the financial statements, the Fund restated net asset balances at June 30, 2006 and 2005 to correct errors associated with improper capitalization of capital assets.

Internal Control Over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential, will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described below is a material weakness:

Restatement of prior year capital assets and net assets

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

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

The condition noted above resulted in the overstatement of capital assets and net assets at June 30, 2005 and June 30, 2006, in the amount of approximately $1.3 million and $309,000, respectively, $1.6 million in the Fund.

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

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

Compliance and Other Matters

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

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

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

McGladrey & Pullen, LLP

Greensboro, North Carolina
December 20, 2007