



JAMES CITY SERVICE AUTHORITY

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November 14, 2007

To the Citizens of James City County:

The Comprehensive Annual Financial Report of the James City Service Authority, a component unit of the County of James City, Virginia, for the fiscal year ending June 30, 2007, is hereby submitted. This report presents the financial position of all fund types of the James City Service Authority (JCSA) and the results of operations for the year then ended.

The JCSA financial records have been audited by Goodman & Company L.L.P. Their opinion and management's accompanying statements comprise the Financial Section of this report. This report was prepared by the JCSA, and responsibility for both the accuracy of the information presented and the completeness and fairness of the presentation, including all disclosures, rests with the JCSA. We believe the information as presented is accurate in all material aspects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of the JCSA as measured by the financial activity of its various legal funds; and that all disclosures necessary to enable the reader to gain the maximum understanding of the JCSA's financial activity have been included. The funds included in our Comprehensive Annual Financial Report are controlled solely by the JCSA.

GAAP requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. JCSA's MD&A can be found immediately following the report of the independent auditors on pages 3-7 of this report.

The Reporting Entity and Its Services

The James City Service Authority is a public body politic and corporate of the Commonwealth of Virginia. The JCSA was created in 1969 by the James City County Board of Supervisors pursuant to the Virginia Water and Sewer Authorities Act (Code of Virginia, 1950, as amended). The JCSA was created to acquire, construct, operate and maintain, to the extent determined by the JCSA to be financially feasible, an integrated water system and an integrated sewer collection system in James City County. The Board of Directors is appointed by the Board of Supervisors. Since 1976, the Board of Supervisors has appointed its members as Directors of the JCSA to more fully coordinate JCSA activities with those of the County in the planning and development of utility systems.

The Board of Directors has authorized water and sewer operations for the JCSA within the Primary Service Area (PSA) in the County. The JCSA also provides water and/or sewer service to limited sections of York County and the City of Williamsburg with the concurrence of the appropriate governing bodies.

The JCSA's water system includes the central water system with 10 water production facilities, and six independent water production facilities that are located outside the PSA. There are approximately 329 miles of water transmission and distribution lines throughout the entire system. The water system facilities supply approximately 4.9 million gallons of water per day to 18,300 water customers.

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The JCSA's sewer system includes 74 pump stations with approximately 370 miles of sewer collection lines. The sewer system facilities collect and move approximately 4.6 million gallons of sewage per day for 18,500 sewer customers. The JCSA has no sewage treatment facilities. Sewage treatment for areas served by the JCSA, as well as for other Hampton Roads communities, is provided by the Hampton Roads Sanitation District (HRSD).

As of June 30, 2007, the JCSA had 88 full-time employees with the responsibility to operate and maintain its utility facilities and lines. The JCSA's operating funds are self-supporting and the JCSA receives no share of any local or property tax levies. The Board of Directors has the sole power to set water and sewer utility rates and related fees. The Board of Directors adopted an inverted-block or inclining rate structure in 1996 to be effective for fiscal year 1997 for residential customers which incorporates a unit charge that increases with increasing consumption. The primary objective of establishing the inverted-block rate structure was to discourage water consumption, particularly from large-volume residential customers. On July 1, 2006, the residential water consumption service charge was set at the first block for \$2.50 per 1,000 gallons for less than 15,000 gallons consumed per quarter, the second block was set at \$3.00 per 1,000 gallons for more than 15,000 gallons but less than 30,000 gallons consumed per quarter, and a third block was set at \$8.50 per 1,000 gallons for more than 30,000 gallons consumed per quarter. Commercial and industrial customers was set at a flat or uniform rate structure of \$3.00 per 1,000 gallons. The sewer service charge for all categories of customers was set at \$2.80 per 1,000 gallons.

Economic Condition and Outlook

James City County has a strong, diverse, and growing economic base. The County is located near the cities of Hampton, Newport News, Williamsburg, and York County. Major employers within commuting distance include Anheuser-Busch, Owens Brockway, Ball Metal, Newport News Shipbuilding, Langley Air Force Base, Fort Eustis, Fort Monroe, Colonial Williamsburg Foundation, and National Aeronautics Space Administration. The County's population grew 38.0 percent from 1990 to 2000 while the State population has increased only 15.7 percent during the same time period. Several new retail clusters are breaking ground or are under construction, and will provide continued growth in the commercial sector over the next several years.

Major Initiatives

While a fast-growing population and expanding commercial base enhance the economic outlook for the JCSA, they also continue to increase demand for its services.

The JCSA currently has groundwater permits for its central system to withdraw 8.9 million gallons per day to support the residential and commercial customers. With the current rate of growth, it is estimated that this amount of water will meet the County's needs through 2013. The JCSA is pursuing separate initiatives to meet its long-term water demand by participating in a regional effort to supplement the JCSA groundwater with surface water from the proposed King William Reservoir or the construction of a second groundwater desalination facility. Currently, purchasing water from Newport News through the King William Reservoir appears to be the more likely of the two options. Water Conservation is also an important component of meeting the future water needs. The JCSA has initiated the "Let's be Water Smart" program which is a partnership with local businesses involved in the landscape industry. The partnership promotes the importance of using water wisely.

To meet the long-term water supply demand, James City County participates in the Regional Raw Water Study Group, led by the City of Newport News, to obtain a permit to construct a water supply reservoir in King William County on Cohoke Creek. The Regional Raw Water Study Group recently obtained the necessary permits for construction of this project, James City County can contract with the City of Newport News to obtain

the rights to at least two and possibly four million gallons per day supply to the JCSA from the King William Reservoir Project. In February 2001, the JCSA entered into an agreement with Newport News Waterworks to purchase up to 1.8 million gallons per day of water to help meet peak demands. This water will be available, if needed, until 2011 when Newport News' water demand is projected to require this surplus.

In FY 2005, the JCSA completed the first phase of a 5.0 million gallon per day groundwater treatment facility which has reverse osmosis technology to treat water from the Potomac Aquifer. The first phase of the project is capable of treating 2.5 mgd. The second phase was completed in FY 07 providing full capacity of 5.0 mgd. The facility, along with other water production facilities, is projected to meet the JCSA's water needs through 2013. The cost of this project was approximately \$20 million. Additionally, the JCSA is nearing the completion of two 1.25 million gallon water storage tanks that will enhance flows and pressures during peak demands in the water system.

There are currently 74 pump stations in the JCSA sewer collection system. A significant number of the JCSA sanitary sewer pumping stations are beginning to show signs of deterioration due to their age. A systematic plan has been developed to analyze and determine what upgrade and rehabilitative measures are required to extend their life and meet the demands of increased usage. Projected growth within the County's Primary Service Area will impact existing infrastructure. Existing pump stations and force mains will have to be upgraded or replaced to accommodate future planned developments.

JCSA has completed a major upgrade project for the Lift Station 1-2 (John Tyler Highway) service area. This rather large service area is developing rapidly, and the existing collection and conveyance system is currently operating near maximum capacity.

HRSD assumed the ownership of LS 1-2 (Route 5) and LS 1-5 (Longhill Road) in early FY 2007. Both lift stations are large and complex. Transfer of the stations to HRSD eliminated the JCSA's maintenance and operation responsibilities associated with these two wastewater facilities.

In FY 2008, the JCSA will begin the rehabilitation of the Powhatan Sewer Interceptor, the JCSA's largest gravity sewer line. The line was installed in the 1970's using what is now known to be inferior materials. The estimated costs for all phases are \$7.0 million.

The Hampton Roads region is participating in discussions with the U.S. Environmental Protection Agency and the Virginia Department of Environmental Quality regarding sewer system overflows. In June 2007, the Board of Directors authorized the General Manager to sign a Consent Order with DEQ to establish milestones and a time line to increase its efforts in reducing infiltration and inflow of extraneous water into the sewer system. This will be an expensive effort and long-term, which will compliment the JCSA's on-going efforts to reduce infiltration and inflow of extraneous water and, in turn, minimize sewer system overflows.

JCSA has completed implementation of a Supervisory Control and Data Acquisition (SCADA) System, which will enable the JCSA to maintain and control water and wastewater facility operations during normal conditions and emergencies while compiling historical data. SCADA is a highly reliable system that takes advantage of modern computer technologies, which are highly efficient and cost effective. SCADA was installed for monitoring all water system facilities and sewer pump stations. SCADA systems provide water and sewer utilities a tool to improve both their reliability and quality of service.

Accounting System and Budgetary Control

The JCSA's accounting records are maintained on a full accrual basis incorporating the principles of an enterprise fund accounting. Basically, this approach presents the statements on a profit and loss basis, including a provision for depreciation which is comparable to private industry.

In developing and evaluating the JCSA accounting system, consideration is given to the adequacy of internal accounting controls. The controls are designed to provide reasonable, but not absolute, assurance regarding: 1) the safeguarding of assets against loss from unauthorized use or disposition; and, 2) the reliability of financial records for preparing the financial statements.

All internal control evaluations occur within the above framework using the concept of reasonable assurance and recognize that: 1) the cost of control should not exceed the benefits likely to be derived; and, 2) the evaluation of costs and benefits requires estimates and judgments by management.

We believe the JCSA's internal accounting controls adequately safeguard assets and provide reasonable assurance of the proper recording of financial transactions.

Budgetary control for the JCSA is maintained by the Accounting Office under the guidelines of the Treasurer. Encumbrance of estimated purchase amounts is an important part of the system.

Debt Administration

The James City Service Authority issues revenue bonds for the financing of major capital improvements or system acquisitions. At June 30, 2007, JCSA had a \$11,690,000 outstanding bond obligation. This bond was issued in FY 2003 to help finance the construction of a groundwater treatment facility.

The ratio of income available for debt service requirements, as compared to the annual debt service requirements, is considered a good indication of an entity's debt position for rating services, municipal management, citizens, and investors. Additional data relating to the bond issue is included in Tables 5 and 6 of the Statistical Section.

Insurance

In our opinion, the JCSA maintains a practical insurance program which affords adequate protection against loss and includes comprehensive public liability insurance for bodily injury and property damage in amounts approved by our consulting engineer. A schedule of insurance at June 30, 2007, is included in Table 9 of the Statistical Section.

Cash Management

The JCSA has a conservative cash management policy administered by its bank. Temporary idle funds are automatically invested in overnight repurchase agreements that are secured or collateralized by government securities as required by the Code of Virginia. Longer term investments consisted of U.S. Government obligations, commercial paper rated A-1 by Standards and Poor's Corporation, or P-1 by Moody's and repurchase agreements. This investment program generated \$1,503,939 in investment income for the year.

Awards

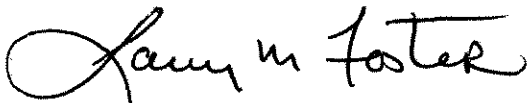
For the twenty-second year, the Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to James City Service Authority, for its component unit financial report for the fiscal year ended June 30, 2006. In order to be awarded a Certificate of Achievement, the JCSA must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to Certificate of Achievement Program requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgments

We wish to express our appreciation to the staff of Financial and Management Services who participated in the preparation of the report. Also, we would like to thank the members of the Board of Directors for their continued support in the planning and implementation of the financial affairs and water and sewer development of the JCSA.

Sincerely,



Larry M. Foster
General Manager



Robert H. Smith
Assistant Manager/Treasurer