

# CITY OF NEWPORT NEWS, VIRGINIA

Notes to Basic Financial Statements

June 30, 2004

## (1) Summary of Significant Accounting Policies

### (a) *The Reporting Entity*

The City of Newport News, Virginia (the City or the Primary Government) was established by act of the Virginia General Assembly in 1958. It is a political subdivision of the Commonwealth of Virginia operating under the council-manager form of government. City Council consists of a mayor and six other council members. The City is not part of a county and has taxing powers subject to statewide restrictions and tax limits. The City provides a full range of municipal services including police and fire, sanitation, health and social services, public improvements, planning and zoning, general administrative services, education, and water and sewer system administered by the Newport News Department of Public Utilities.

The City's reporting entity consists of the Primary Government, as well as its component units, which are legally separate organizations for which the elected officials of the Primary Government are financially accountable. Financial accountability is defined as appointment of a voting majority of the component unit's board, and either (a) the ability to impose will by the Primary Government, or (b) the possibility that the component unit will provide a financial benefit or impose a financial burden on the Primary Government.

The accompanying financial statements present the City (the primary government) and its component units. The financial data of the component units are included in the City's reporting entity because of the significance of their operational or financial relationships with the City.

**Blended component units.** The Public Utility and the Parking Authority serve all the citizens of the City and are governed by a board comprised of the City's elected council. Both the rates for user charges and bond issuance authorizations are approved by the City Council and the legal liability for the general obligation portion of the debt resides with the City. These funds are reported as enterprise funds.

**Discretely presented component units.** Three of the City's component units are discretely presented. Discretely presented component units are entities that are legally separate from the City, but for which the City is financially accountable, or whose relationships with the City are such that exclusion would cause the City's financial statements to be misleading or incomplete. These component units are reported in separate columns to emphasize that they are legally separate from the City. All of the component units have a fiscal year end of June 30.

- The Newport News Public Schools (Public Schools or School Board) are responsible for elementary and secondary education within the City. The School Board is elected by the voters of Newport News and operates the three early childhood centers, 27 elementary, eight middle, and five high schools and one elementary-middle school combination in the City. The School Board may not issue debt. City Council makes an annual appropriation to the School Board, but is prohibited from exercising any control over specific expenditures of School Board operating funds. Transfers within the School Operating Fund are under the control of the School Board at the categorical level. Expenditures are controlled in the School Cafeteria and School Grants Funds through use of budgets approved by the School Board. Separate audited financial statements are available from the Newport News Public Schools at 12465 Warwick Boulevard, Newport News, Virginia 23606.

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- The Economic and Industrial Development Authorities (E/IDA) are legally separate entities included in the City's financial statements due to financial/legal inter-dependency with the City. The E/IDA acquires, maintains and develops land for sale or lease, and promotes both economic and industrial development and growth in the City. The City Council approves the E/IDA's budget. Separate audited financial statements are available from E/IDA, at Department of Planning and Development, 2400 Washington Avenue, Newport News, Virginia 23607.
- The Peninsula Airport Commission (PAC) is a legally separate entity included in the City's financial statements due to financial/legal inter-dependency with the City. The PAC operates the Newport News/Williamsburg International Airport. Separate audited financial statements are available from PAC at 900 Bland Boulevard, Newport News, Virginia 23602.

#### **(b) *Government-wide and Fund Financial Statements***

The government-wide financial statements report information on all of the nonfiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for services. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

The statement of activities demonstrates the degree to which the direct expenses of a given function or activity is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Included in direct expenses are certain indirect costs that have been allocated to the various programs. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not properly included among program revenues are reported as general revenues.

Separate fund financial statements are provided for governmental funds, proprietary funds, and the fiduciary funds, even though the latter is excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

#### **(c) *Measurement Focus, Basis of Accounting, and Financial Statement Presentation***

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the current financial resources

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measurement focus and the modified accrual basis of accounting. Revenues are recognized when they are susceptible to accrual (i.e., both measurable and available). Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period, usually within 30-45 days after year-end. Expenditures, other than interest on long-term debt which is recorded when due, are recorded when the related fund liability is incurred.

In applying the susceptible to accrual concept to intergovernmental revenues, the legal and contractual requirements of the numerous individual programs are used as guidance. There are, however, essentially two types of these revenues. In one, monies must be expended on the specific purpose or project before any amounts will be paid to the City; therefore, revenues are recognized based upon the expenditures recorded. In the other, monies are virtually unrestricted as to purpose of expenditure and are usually revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenues at the time of receipt or earlier if the accrual criteria are met.

In the fund financial statements, real and personal property taxes are recorded as revenues and receivables when levied and billed, net of allowances for uncollectible amounts. Property tax receivables not collected within 45 days after year-end are reflected as deferred revenues. Sales and utility taxes, which are collected by the Commonwealth of Virginia or utility companies by year-end and subsequently remitted to the City, are recognized as revenues and receivables upon collection by the Commonwealth of Virginia or utility company, which is generally in the month preceding receipt by the City.

Licenses and permits, fines and forfeitures, charges for services and miscellaneous revenues (except interest on temporary investments) are recorded as revenues when received in cash because they are generally not measurable until actually received.

The City reports the following major governmental funds:

The *General Fund* is the City's primary operating fund. It is used to account for all financial resources except those required to be accounted for in another fund.

The *Debt Service Fund* accounts for the accumulation of resources for the payment of principal, interest, and related costs on long-term debt of governmental funds.

The *Bond Fund* is a capital projects fund used to account for the proceeds of all general obligation bond issues except those of the Proprietary Funds. Proceeds are used for various capital outlays in accordance with the respective bond ordinances.

The City reports the following major proprietary fund:

The *Public Utility Fund* accounts for the water utility that provides water service to the City and various surrounding localities. Operation of the proprietary fund is designed to be primarily self-supporting through user charges. This fund services its own debt and construction projects and records the acquisition of its depreciable assets and land.

Additionally, the City reports the following fund types:

The *Internal Service Fund* accounts for the financing of vehicle and equipment services provided to other departments or agencies of the City on a cost reimbursement basis.

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*Pension Trust Employees' Retirement Fund* accounts for all contributions and investments accumulated for employees' retirement. Also, the fund pays for all related expenses incurred as well as retiree benefits. The City's pension plan covers all full-time City and School employees. The Fund is accounted for in essentially the same manner as proprietary funds.

*The Agency Funds* account for assets held by the City in a trustee capacity or as an agent or custodian for the individuals, private organizations, and other funds. Agency funds are custodial in nature and do not involve measurement of results of operations.

#### ***Nonmajor governmental funds:***

*Special Revenue Funds* account for revenues and expenditures related to programs that are restricted in nature for specific purposes. Examples include providing services to mental health, mental retardation and substance abuse programs, activities of the Community Development Block Grant Program, individual grant programs, and rendering economic aid to certain qualifying citizens under several different programs.

*Capital Projects Funds*, excluding the Bond Fund, account for the federal entitlements used for capital expenditures as well as various federal and state grants for capital outlay in accordance with the respective grant agreements.

#### ***Nonmajor proprietary fund:***

*Parking Authority Enterprise Fund* accounts for the operation of certain parking facilities within the City.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*, the government-wide financial statements and the fund financial statements of the enterprise fund type follow all applicable GASB pronouncements and all Financial Accounting Standards Board (FASB) pronouncements and predecessor APB Opinions and Accounting Research Bulletins issued on or before November 30, 1989 that do not contradict or conflict with GASB pronouncements. Under paragraph 7 of Statement No. 20, the City has elected not to apply FASB pronouncements issued after November 30, 1989.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments-in-lieu of taxes and other charges between the City's public utility function and various other functions of the City. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's proprietary funds are charges to customers for sales and services. The Public Utilities Enterprise Fund also recognizes certain rental fees as operating revenue. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

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In all funds, when both restricted and unrestricted resources are available for a particular use and have not been earmarked for other purposes, it is the City's policy to use restricted resources first for any allowable costs. After restricted resources have been depleted, unrestricted resources are used as they are needed unless the City determines and documents otherwise.

#### **(d) *Cash and Cash Equivalents and Investments***

The City utilizes the pooled cash investment method, except for the Peninsula Airport Commission. Income from the investment of pooled cash is allocated to the various funds, based on the percentage of cash and cash equivalents of each fund to the total pooled cash and cash equivalents. In addition, the City has restricted deposits held by trustees for future retirements of bonds at the appropriate call date, retirements of certain certificates of participation at maturity and construction projects.

Investments are stated at fair value, except for cash equivalents where cost approximates fair value. Retirement plan investments are reported at fair value. Plan short-term investments that are reported at cost approximate fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. The fair value of real estate investments is based on independent appraisals. All other investments are valued based on amounts provided by the investment advisor or fund administrator.

For purposes of the statement of cash flows, all highly liquid debt instruments with original maturities of three months or less from the date of purchase are considered to be cash equivalents.

#### **(e) *Receivables and Payables***

Activities between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" or "advances to/from other funds" in the fund statements or as "internal balances" in the statement of net assets. All other outstanding balances between funds are reported as "due to/from other funds." Any residual balances outstanding between governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

In the fund statements, long-term interfund advances and advances to component units are recorded as a receivable with a corresponding reservation of fund balance by the advancing fund.

Provisions for uncollectible water, sewer, stormwater and emergency medical bills are based upon a historical analysis of uncollected accounts and are applied as a percentage of delinquent/terminated accounts in the year-end accounts receivable balance. Provision for uncollectible property taxes is based upon a historical percentage of accounts written off applied to the total levies of all years carried in taxes receivable.

The two major sources of property taxes are described below as reported in the fund financial statements:

*Real Estate* – Each year as of July 1, the City levies real estate taxes on all real estate within its boundaries, except that exempted by statute. Real estate taxes are levied on the estimated market value of the property and become a lien on real property the first day of the levy year. The City follows the practice of reassessing all property annually.

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Real estate taxes are collected in semi-annual payments due December 5 and June 5. During the fiscal year, the current year real estate taxes reported as revenue are the levies on assessed valuation on July 1, less an allowance for uncollectible amounts and taxes not collected within 45 days after year-end. The tax rate for 2004 was \$1.27 per \$100 of assessed value.

*Personal Property* – The City levies personal property taxes on motor vehicles and tangible personal business property. These levies are made each year as of January 1 with payment due the following June 5 and December 5. The current year personal property taxes reported as revenue are the levies on assessed valuation at January 1, 2004 less an allowance for uncollectible amounts and taxes not collected within 45 days after year-end. The tax rates for 2004 were \$1.27, \$.90, \$1.00, \$3.50, and \$4.15 per \$100 of assessed value for mobile homes, trawlers, pleasure boats, machinery and tools, and motor vehicles, respectively.

**(f) Allowances for Uncollectibles**

The City calculates allowances for uncollectibles using historical collection data, specific account analysis and management’s judgment. The allowance at June 30, 2004, is composed of the following:

General Fund –		
Taxes receivable:		
Real Estate	\$	1,703,987
Personal Property		<u>3,815,923</u>
Total Taxes	\$	<u>5,519,910</u>
Special Revenue Funds –		
Accounts receivable	\$	<u>491,355</u>

**(g) Inventories**

Inventories, which consist of materials and supplies held for future consumption, are stated at cost using the first-in, first-out and average cost methods. Inventory is accounted for under the purchase method. The costs are recorded as expenditures at the time of purchase.

**(h) Capital Assets**

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$2,000. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed. Interest of \$4,366,675 was capitalized during fiscal year 2004.

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Under Virginia law, certain property maintained by the School Board is subject to tenancy-in-common with the City if the City incurred a financial obligation for the property payable over more than one fiscal year. The School Board and the City have agreed that such property will be carried on the City's financial statements until the outstanding debt is repaid. At June 30, 2004, the City holds capital assets related to school property with a net book value of \$123,039,478.

Capital assets of the primary government, as well as the component units, are depreciated using the straight line method over the following estimated useful lives:

Buildings	50 - 60 years
Building improvements	25 - 30 years
Infrastructure (including water system)	15 - 100 years
Machinery and equipment	4 - 20 years

**(i) Land Held for Resale**

Land held for resale by the E/IDA is stated at acquisition cost plus improvements and capitalized interest, if applicable, but not in excess of net realizable value. Capitalized costs of projects are assigned to individual components of the projects based on specific identification. If specific identification is not practicable, capitalized interest costs are allocated to each parcel benefited, based on relative fair value before construction. As land is sold, all costs associated with that land are charged to cost of land sold.

**(j) Compensated Absences**

City employees are granted vacation and sick pay in varying amounts as services are provided. They may accumulate, subject to certain limitations, unused vacation leave, and upon retirement, termination or death, may be compensated for certain amounts at their then current rates of pay. The costs of accumulated vacation are accrued as a liability as the benefits are earned by the employees if attributable to services already rendered and compensation through time off or some other means is probable. Sick leave liability is recorded by the City when paid. Upon termination, City employees are not paid for accumulated sick leave. Unused sick leave is added to the actual years of service for the purpose of computing pension benefits. These liabilities are accounted for in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in governmental funds only if they have matured, as a result of employee resignations and retirements.

The Public Schools Component Unit employees are granted vacation and sick pay in varying amounts as services are provided. They may accumulate, subject to certain limitations, unused vacation leave, and upon retirement, termination or death, may be compensated for certain amounts at their then current rates of pay. Upon termination, School Board employees are not paid for accumulated sick leave. Upon retirement, sick leave may be taken in cash between \$50 to \$65 per day depending upon employment status or may be used as a lifetime subsidy (based on number of unused days) for retiree health insurance.

**(k) Long-term Obligations**

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the

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applicable government activities, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs, 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 reported as other assets and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

**(l) Fund Equity**

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

**(m) Encumbrances**

The City employs encumbrance accounting under which obligations in the form of purchase orders, contracts and other commitments for the expenditure of funds are reported as reservations of fund balances, since they do not constitute expenditures or liabilities. Appropriations with outstanding commitments or encumbrances are carried into the following year. According to the City Code, unexpended, unencumbered appropriations lapse at the end of the year.

**(2) Deposits and Investments**

Cash consists of cash on hand, deposits in banks, certificates of deposit, and cash equivalents comprised of repurchase agreements, commercial paper and investments in the Local Government Investment Pool (LGIP), the State Non-Arbitrage Program (SNAP) and the Arbitrage Investment Management Program (AIM). Cash in excess of current needs is invested on a pooled basis. Earnings are allocated monthly to each fund on the basis of its average daily cash balance. Interest allocable to bond proceeds is recorded as revenue in the General Fund since that fund provides the resources for debt service. Participation in the pool is available to all funds, except the PAC (Component Unit) and School Activity Funds (Component Unit), as the City's Treasurer does not maintain cash for these funds.

**Deposits**

At year-end, the carrying value of the City's deposits with banks and savings institutions was \$10,001,998, and the bank balance was \$16,483,734. The bank balance is fully covered by federal depository insurance or collateralized in accordance with the Virginia Security for Public Deposits Act (the Act). Under the Act, banks holding public deposits in excess of the amounts insured by the FDIC must pledge collateral of 50% of the excess deposits to a collateral pool in the name of the State Treasury Board. Savings and loan institutions are required to collateralize 100% of deposits in excess of the FDIC limits and are considered insured. The State Treasury Board is responsible for monitoring compliance with the collateralization and reporting requirements of the Act and for notifying

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local governments of compliance by banks and savings and loans.

***Investments***

At year-end, the government's investment balances were as follows:

<b>Investments</b>	<b>Risk Category</b>			<b>Carrying amount</b>
	<b>1</b>	<b>2</b>	<b>3</b>	
Primary government:				
Common and international stocks - not on securities loan	\$ 398,349,307	-	-	398,349,307
Corporate and government bonds:				
Not on securities loan	167,757,826	-	-	167,757,826
On securities loan - Collateralized by securities	1,214,712	-	-	1,214,712
Component units:				
US Treasury notes	1,674,341	-	-	1,674,341
Government Agencies - Discount notes	1,007,107	-	-	1,007,107
Repurchase agreements	-	4,434,517	-	4,434,517
Common stock	11,687	-	-	11,687
Subtotal	<u>\$ 570,014,980</u>	<u>4,434,517</u>	<u>-</u>	<u>574,449,497</u>
Investments not categorized - Real estate trust funds				<u>23,608,865</u>
Total investments				<u>598,058,362</u>
Cash and short term investments:				
Cash on hand				20,265
Local Government Investment Pool (LGIP)				102,568,179
Deposits with banks				1,685,075
Deposits with banks - Money market accounts				7,559,993
Deposits with banks - Repurchase agreements				4,584,731
Commonwealth cash reserve				38,478,912
Investments on Pension securities loaned, collateralized by cash:				
Common and international stocks				25,315,712
Corporate and government bonds				21,111,656
Securities lending collateral - short-term investment pool				48,522,394
Pension trust fund money markets				17,417,595
Total deposits and investments				<u>\$ 865,322,874</u>

The City investments are categorized above to give an indication of the level of risk assumed by the City at year-end. These three categories of credit risk are as follows:

- (1) Insured or registered, or securities held by the City or its agent in the City's name.
- (2) Uninsured and unregistered, with securities held by the counter-party's trust department or agent in the City's name.
- (3) Uninsured and unregistered, with securities held by the counter-party, or by its trust department or agent, but not in the City's name.

Investments are generally stated at fair value, except for short-term cash equivalents where cost approximates market value. Investments in pools and funds are not subject to categorization as to assumed risks because they are not evidenced by securities that exist in physical or book entry form.

Statutes authorize the City to invest in obligations of the U.S. or agencies thereof, obligations of the Commonwealth of Virginia, or political subdivisions thereof, obligations of the International Bank for Reconstruction and Development (World Bank), the Asian Development Bank, the African Development Bank, "prime quality" commercial paper and certain corporate notes, bankers acceptances, repurchase agreements, the State Treasurer's LGIP and SNAP.

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The LGIP and AIM investments are in governmental external investment pools, managed in accordance with the “2a-7 like pool” risk limiting requirements of GASB Statement No. 31. Investments are stated at amortized cost, approximating market value as permitted by rule 2a-7. The fair value of the positions in the external pools is the same as the value of the pools. The City enters into repurchase agreements only with banks deemed to be creditworthy. The repurchase agreements are stated at amortized cost and income from investments is recognized in the fund reporting the investments.

The Pension Trust Fund (the Fund) can be invested in obligations of the U.S. or agencies thereof, obligations of the Commonwealth of Virginia, or political subdivisions thereof, corporate bonds rated A or higher by two of three nationally known security rating concerns, federally insured mortgages under Titles 203, 207, 220 and 221 of the National Housing Act, equities, certificates of deposit, guaranteed investment contracts and real estate. Pension Trust Fund investments are subject to restrictions placed by policies of the City Council and the Retirement Board (the Board).

State statutes do not prohibit the Board or the Fund from participating in securities lending transactions, and the Board has, via a Securities Lending Authorization Agreement, authorized State Street Bank and Trust Company (State Street) to lend the Fund’s securities to broker-dealers and banks pursuant to a form of loan agreement. Cash collateral received in respect of such loans was invested at the direction of the Board, in the Quality Fund, a pooled external investment vehicle. Please note the following:

- (i) Method for Determining Fair Value: The fair value of investments held by the Quality Fund is based upon valuations provided by a recognized pricing service.
- (ii) Policy for Utilizing Amortized Cost Method: Because the Quality Fund does not meet the requirements of Rule 2a-7 of the Investment Company Act of 1940, State Street has valued the Fund’s investments at fair value for reporting purposes.
- (iii) Regulatory Oversight: The Quality Fund is not registered with the Securities and Exchange Commission. State Street, and consequently the investment vehicles it sponsors are subject to the oversight of the Federal Reserve Board and the Massachusetts Commissioner of Banks. The fair value of the City’s position in the Quality Fund is not the same as the value of the Pension Fund shares.
- (iv) Involuntary Participation: There was no involuntary participation in an external investment pool for the fiscal year.
- (v) Income Assignment: No income from one fund was assigned to another fund by State Street during the fiscal year.

During fiscal year 2004, State Street lent, at the direction of the Board, the Fund’s securities and received cash (including both U.S. and foreign currency), securities issued or guaranteed by the U. S. Government or its agencies, sovereign debt of foreign countries and irrevocable bank letters of credit as collateral. State Street did not have the ability to pledge or sell collateral securities delivered; therefore, there cannot be a borrower default. Borrowers were required to deliver collateral for each loan in amounts not less than 100% of the market value of the loaned securities.

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The Board did not impose any restrictions during the fiscal year on the amount of the loans that State Street made on its behalf. State Street indemnified the Board by agreeing to purchase replacement securities, or to return the cash collateral, in the event any borrower failed to return loaned securities or pay distributions thereon during the fiscal year. There were no such failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from default of the borrowers or State Street.

During the fiscal year, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool. The average duration of such investment pool as of June 30, 2004, was 52 days and an average weighted maturity of 118 days. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. On June 30, 2004, the Board had no credit risk exposure to borrowers. The collateral held and the market value of securities on loan for the Board as of June 30, 2004, were \$48,522,394 and \$47,642,080, respectively. The collateral includes securities and tri-party credit totaling \$1,233,887 that cannot be pledged or sold unless the borrower defaults.

***Component Units***

The cash and investments of the Public Schools and the Economic and Industrial Development Authorities component units have been pooled with the cash and investments of the primary government and, therefore, are included in the above information. The remaining component unit, Peninsula Airport Commission, with cash and investments amounting to \$8,515,360, has been excluded because categorization information is not available.

A reconciliation of the carrying value of deposits and investments as reported above to amounts reported in the statement of net assets and statement of fiduciary net assets for the reporting entity is as follows:

Per pages 13 and 22:	
Cash and cash equivalents	\$ 109,268,113
Cash and cash equivalents - Pension Trust Fund	18,950,016
Restricted cash	48,807,135
Securities lending	48,522,394
Investments	637,358,077
Investments	2,417,139
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Total cash and investments per pages 13 and 22	\$ <u><u>865,322,874</u></u>

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**(3) Accounts Receivable**

Net Accounts receivable in the statement of net assets are as follows:

	<u>Governmental activities</u>	<u>Business-type activities</u>
Taxes receivable:		
Real Estate	\$ 2,406,105	-
Personal Property	<u>5,937,548</u>	-
Total taxes receivable, net	8,343,653	-
Accounts receivable	<u>7,923,075</u>	9,274,883
Total receivables, net	<u>\$ 16,266,728</u>	<u>9,274,883</u>

Accounts receivable and receivables from other governments as of year-end for the City's individual major funds and nonmajor and fiduciary funds, in the aggregate, including the applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	<u>Public Utility</u>	<u>Fiduciary Funds</u>	<u>Nonmajor Funds</u>	<u>Total</u>
Receivables:					
Taxes	\$ 13,863,564	-	-	-	13,863,564
Accounts	5,722,264	9,619,953	2,544,377	1,925,355	19,811,949
Intergovernmental:					
Federal	-	-	-	3,632,781	3,632,781
State	5,742,762	-	-	7,920,565	13,663,327
Local	-	-	-	-	-
Gross receivables	<u>25,328,590</u>	<u>9,619,953</u>	<u>2,544,377</u>	<u>13,478,701</u>	<u>50,971,621</u>
Less allowance for doubtful accounts	<u>(5,519,910)</u>	<u>(345,070)</u>	<u>-</u>	<u>(491,355)</u>	<u>(6,356,335)</u>
Net total receivables	<u>\$ 19,808,680</u>	<u>9,274,883</u>	<u>2,544,377</u>	<u>12,987,346</u>	<u>44,615,286</u>

In addition to the above, net receivables for the Parking Authority and Internal Service totaled \$25,336 and \$26,261, respectively. Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, deferred revenue of \$469,272 was reported in the governmental nonmajor funds. The general fund deferred revenue of \$6,989,632 includes approximately \$6.5 million in property tax deferrals.

**CITY OF NEWPORT NEWS, VIRGINIA**  
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**(4) Capital Assets, Net**

Capital asset activity for the year ended June 30, 2004 was as follows:

<b>Primary</b>	<b>Balance**</b>			<b>Government</b>
	<b>July 1, 2003</b>	<b>Increases</b>	<b>Decreases</b>	<b>Balance</b>
	<u>July 1, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2004</u>
<b>Governmental activities:</b>				
Capital assets, not being depreciated:				
Land	\$ 74,969,669	-	113,437	74,856,232
Construction in progress	<u>43,646,988</u>	<u>17,243,019</u>	<u>29,420,515</u>	<u>31,469,492</u>
Total capital assets, not being depreciated	<u>118,616,657</u>	<u>17,243,019</u>	<u>29,533,952</u>	<u>106,325,724</u>
Capital assets, being depreciated:				
Buildings	236,920,279	26,803,925	8,935,719	254,788,485
Improvements	89,395,211	4,746,785	359,830	93,782,166
Machinery and equipment	89,774,694	7,089,217	5,345,225	91,518,686
Infrastructure	<u>383,927,365</u>	<u>4,886,658</u>	<u>-</u>	<u>388,814,023</u>
Total capital assets being depreciated	<u>800,017,549</u>	<u>43,526,585</u>	<u>14,640,774</u>	<u>828,903,360</u>
Less accumulated depreciation for:				
Buildings	54,721,540	4,467,424	2,003,533	57,185,431
Improvements	36,720,479	3,486,465	242,587	39,964,357
Machinery and equipment	54,694,403	8,874,337	3,879,580	59,689,160
Infrastructure	<u>236,392,550</u>	<u>7,989,185</u>	<u>-</u>	<u>244,381,735</u>
Total accumulated depreciation	<u>382,528,972</u>	<u>24,817,411</u>	<u>6,125,700</u>	<u>401,220,683</u>
Total capital assets being depreciated, net	<u>417,488,577</u>	<u>18,709,174</u>	<u>8,515,074</u>	<u>427,682,677</u>
Capital assets, net	<u>\$ 536,105,234</u>	<u>35,952,193</u>	<u>38,049,026</u>	<u>534,008,401</u>

\*\* Restated due to Prior Period Adjustments (See Note 12)

Depreciation expense for governmental activities was charged to functions of the primary government as follows:

General Government	\$ 7,172,997
Judicial Administration	38,889
Public Safety	786,025
Public Works	7,025,023
Health and Welfare	30,636
Education	2,429,847
Parks, Recreation and Culture	4,486,051
Community Development	192,513
Internal Service Fund	<u>2,655,430</u>
	<u>\$ 24,817,411</u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
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Construction in progress for the City at June 30, 2004 is composed of the following project authorizations:

	Project authorization	Expended through June 30, 2004	Balance of authorization	Future requirements
General government	\$ 12,068,921	2,599,120	9,469,801	2,370,000
Parks and recreation	9,981,487	5,970,443	4,011,044	800,000
Economic development and urban renewal	11,391,794	5,190,441	6,201,353	1,825,000
Public Schools	22,235,437	17,709,489	4,525,948	8,620,000
<b>Totals</b>	<b>\$ 55,677,639</b>	<b>31,469,493</b>	<b>24,208,146</b>	<b>13,615,000</b>

In addition, the City had commitments of approximately \$20.5 million relating to infrastructure at June 30, 2004.

	Balance July 1, 2003	Increases	Decreases	Balance June 30, 2004
<b>Business-type activities:</b>				
Capital assets, not being depreciated:				
Land	\$ 5,858,724	535,000	-	6,393,724
Construction in progress	102,830,006	13,774,732	3,088,220	113,516,518
Total capital assets, not being depreciated	108,688,730	14,309,732	3,088,220	119,910,242
Capital assets, being depreciated:				
Buildings	15,897,396	279,108	-	16,176,504
Improvements	3,532,823	-	-	3,532,823
Water system	365,533,578	5,907,205	277,076	371,163,707
Machinery and equipment	15,750,563	1,236,522	320,418	16,666,667
Total capital assets being depreciated	400,714,360	7,422,835	597,494	407,539,701
Less accumulated depreciation for:				
Buildings	569,347	328,243	-	897,590
Improvements	1,638,429	108,999	-	1,747,428
Water system	103,818,863	7,534,309	174,070	111,179,102
Machinery and equipment	9,624,225	1,427,609	293,189	10,758,645
Total accumulated depreciation	115,650,864	9,399,160	467,259	124,582,765
Total capital assets being depreciated, net	285,063,496	(1,976,325)	130,235	282,956,936
Capital assets, net	\$ 393,752,226	12,333,407	3,218,455	402,867,178

**CITY OF NEWPORT NEWS, VIRGINIA**  
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Depreciation expense for business-type activities was charged to functions of the primary government as follows:

Water	\$	9,313,687
Parking		<u>108,999</u>
Total	\$	<u><u>9,422,686</u></u>

	<u>Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u>
	<u>July 1, 2003</u>			<u>June 30, 2004</u>
<b>Public Utility:</b>				
Capital assets, not being depreciated:				
Land	\$ 5,126,877	535,000	-	5,661,877
Construction in progress	<u>102,830,006</u>	<u>19,872,670</u>	<u>9,186,158</u>	<u>113,516,518</u>
Total capital assets, not being depreciated	<u>107,956,883</u>	<u>20,407,670</u>	<u>9,186,158</u>	<u>119,178,395</u>
Capital assets, being depreciated:				
Buildings	15,897,396	279,108	-	16,176,504
Improvements	365,533,578	5,907,205	277,076	371,163,707
Machinery and equipment	<u>15,716,845</u>	<u>1,236,522</u>	<u>317,711</u>	<u>16,635,656</u>
Total capital assets being depreciated	<u>397,147,819</u>	<u>7,422,835</u>	<u>594,787</u>	<u>403,975,867</u>
Less accumulated depreciation for:				
Buildings	533,077	328,243	-	861,320
Improvements	103,818,862	7,534,309	174,070	111,179,101
Machinery and equipment	<u>9,596,367</u>	<u>1,432,815</u>	<u>293,189</u>	<u>10,735,993</u>
Total accumulated depreciation	<u>113,948,306</u>	<u>9,295,367</u>	<u>467,259</u>	<u>122,776,414</u>
Total capital assets being depreciated, net	<u>283,199,513</u>	<u>(1,872,532)</u>	<u>127,529</u>	<u>281,199,452</u>
Capital assets, net	<u>\$ 391,156,396</u>	<u>18,535,138</u>	<u>9,313,687</u>	<u>400,377,847</u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
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**Discretely Presented Component Units**

	<u>Balance</u> <u>July 1, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2004</u>
<b>Public Schools:</b>				
Capital assets, not being depreciated:				
Land	\$ 2,505,084	-	-	2,505,084
Construction in progress	<u>1,102,329</u>	<u>5,874,810</u>	<u>2,377,823</u>	<u>4,599,316</u>
Total capital assets, not being depreciated	<u>3,607,413</u>	<u>5,874,810</u>	<u>2,377,823</u>	<u>7,104,400</u>
Capital assets, being depreciated:				
Buildings	45,483,942	6,932,186	-	52,416,128
Improvements	10,706,829	443,240	-	11,150,069
Machinery and equipment	<u>81,292,843</u>	<u>6,012,976</u>	<u>9,814,618</u>	<u>77,491,201</u>
Total capital assets being depreciated	<u>137,483,614</u>	<u>13,388,402</u>	<u>9,814,618</u>	<u>141,057,398</u>
Less accumulated depreciation for:				
Buildings	20,845,913	901,447	-	21,747,360
Improvements	4,268,457	406,854	-	4,675,311
Machinery and equipment	<u>44,903,055</u>	<u>7,371,653</u>	<u>7,175,102</u>	<u>45,099,606</u>
Total accumulated depreciation	<u>70,017,425</u>	<u>8,679,954</u>	<u>7,175,102</u>	<u>71,522,277</u>
Total capital assets being depreciated, net	<u>67,466,189</u>	<u>4,708,448</u>	<u>2,639,516</u>	<u>69,535,121</u>
Capital assets, net	<u>\$ 71,073,602</u>	<u>10,583,258</u>	<u>5,017,339</u>	<u>76,639,521</u>

Depreciation of \$8,679,954 was charged to the Public School's governmental functions.

Construction in progress for the Public Schools at June 30, 2004 is composed of project authorizations of \$9,034,260, amounts expended through June 30, 2004 of \$4,802,959 with a remaining balance of \$4,231,301.

**CITY OF NEWPORT NEWS, VIRGINIA**

Notes to Basic Financial Statements

June 30, 2004

	<u>Balance</u> <u>July 1, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2004</u>
<b>E/IDA:</b>				
Capital assets, not being depreciated -				
Construction in progress	\$ 15,509,766	328,564	14,024,262	1,814,068
Capital assets, being depreciated:				
Buildings	99,565,390	12,465,741	11,105,518	100,925,613
Improvements	9,904,937	26,941	-	9,931,878
Infrastructure	-	1,521,049	-	1,521,049
Machinery and equipment	74,174	22,500	-	96,674
Total capital assets being depreciated	<u>109,544,501</u>	<u>14,036,231</u>	<u>11,105,518</u>	<u>112,475,214</u>
Less accumulated depreciation for:				
Buildings	8,561,475	2,208,784	1,792,588	8,977,671
Improvements	1,420,700	250,840	-	1,671,540
Machinery and equipment	73,700	4,224	-	77,924
Total accumulated depreciation	<u>10,055,875</u>	<u>2,463,848</u>	<u>1,792,588</u>	<u>10,727,135</u>
Total capital assets being depreciated, net	<u>99,488,626</u>	<u>11,572,383</u>	<u>9,312,930</u>	<u>101,748,079</u>
Capital assets, net	\$ <u>114,998,392</u>	<u>11,900,947</u>	<u>23,337,192</u>	<u>103,562,147</u>

	<u>Balance</u> <u>July 1, 2003</u>	<u>Increases</u>	<u>Balance</u> <u>June 30, 2004</u>
<b>Peninsula Airport Commission</b>			
Capital assets, not being depreciated :			
Land	\$ 4,694,207	185,303	4,879,510
Construction in progress	27,698,880	3,286,123	30,985,003
Total capital assets, not being depreciated	<u>32,393,087</u>	<u>3,471,426</u>	<u>35,864,513</u>
Capital assets, being depreciated:			
Airfield	22,831,303	-	22,831,303
Terminal	34,132,723	117,858	34,250,581
Other	3,094,536	31,545	3,126,081
Machinery and equipment	2,031,344	-	2,031,344
Total capital assets being depreciated	<u>62,089,906</u>	<u>149,403</u>	<u>62,239,309</u>
Less accumulated depreciation for:			
Airfield	18,371,655	537,178	18,908,833
Terminal	10,966,955	964,480	11,931,435
Other	2,016,101	103,537	2,119,638
Machinery and equipment	1,951,794	19,528	1,971,322
Total accumulated depreciation	<u>33,306,505</u>	<u>1,624,723</u>	<u>34,931,228</u>
Total capital assets being depreciated, net	<u>28,783,401</u>	<u>(1,475,320)</u>	<u>27,308,081</u>
Capital assets, net	\$ <u>61,176,488</u>	<u>1,996,106</u>	<u>63,172,594</u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
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**(5) Interfund Receivables, Payables, and Transfers**

The composition of interfund balances as of June 30, 2004, is as follows:

Due to / from other funds:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General fund	Community development	\$ 103,632
General fund	Street maintenance	2,821,967
General fund	Comprehensive Services Act	2,081,824
General fund	Other federal and state special projects	2,635,271
		<u>\$ 7,642,694</u>

Due to / from Primary Government and component units:

<u>Receivable Entity</u>	<u>Payable Entity</u>	<u>Amount</u>
City of Newport News	Industrial Development Authority	\$ 17,834,151
Newport News Public Schools	City of Newport News	303,725

Individual fund interfund transfers for the primary government at June 30, 2004 are as follows:

	<u>Transfers to Other Funds</u>		<u>Transfers From Other Funds</u>	
	<u>Operating Transfers</u>	<u>Capital Transfers</u>	<u>Operating Transfers</u>	<u>Capital Transfers</u>
General Fund	\$ 25,235,324	850,000	9,237,783	-
Debt Service Fund	-	-	29,366,015	-
Nonmajor governmental funds	5,041,942	-	168,468	1,489,000
Public Utility	9,134,000	-	-	-
Total interfund transfers	<u>\$ 39,411,266</u>	<u>850,000</u>	<u>38,772,266</u>	<u>1,489,000</u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
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**(6) Lease Agreements**

**(a) Capital Lease Payments – Primary Government**

The City has entered into a lease agreement through 2009 to finance the acquisition of equipment. This lease is accounted for as a capital lease and recorded at the present value of the future minimum lease payments at the date of inception. The cost of equipment under a capital lease is \$387,740 and is included in capital assets. The future minimum lease obligations and the net present value of these minimum lease payments as of June 30, 2004 were as follows:

Year ending June 30:	
2005	\$ 93,996
2006	93,996
2007	93,996
2008	93,996
2009	<u>54,811</u>
Total	\$430,795
Less Interest	<u>78,827</u>
Total Lease Payments	<u>\$351,968</u>

**(b) Capital Lease Payments – Public Schools (Component Unit)**

The School Board has entered into three lease agreements for financing the acquisition of property and equipment. These lease agreements qualify as capital leases for accounting purposes and, therefore, have been recorded at the present value of their future minimum lease payments as of the inception date.

The assets acquired through capital leases are as follows:

Buildings	\$ 1,435,000
Machinery and equipment	4,412,510
Less accumulated depreciation	<u>(1,164,459)</u>
Net assets acquired through capital leases	<u>\$ 4,683,051</u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
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The future minimum lease obligations and the net present value of these minimum lease payments as of June 30, 2004, were as follows:

Years ending June 30:		
2005	\$	1,122,232
2006		1,117,185
2007		1,112,144
2008		398,435
2009		371,429
2010 - 2014		573,597
2015 - 2019		446,454
2020 - 2024		54,413
Total minimum lease payments	\$	<u>5,195,889</u>
Less amounts representing interest		<u>(915,278)</u>
Present value of minimum capital lease payments	\$	<u><u>4,280,611</u></u>

**(c) Operating Lease Payments – Component Units**

The School Board leases machinery, equipment and buildings under noncancelable operating leases.

The Authorities lease land and property in Newport News. Original lease terms ranged from one to five years.

PAC leases equipment under long-term noncancelable operating leases. Original lease terms ranged from three to five years.

The future minimum lease payments for these leases are as follows:

Years ending June 30:	<u>Newport News Public Schools</u>	<u>Economic and Industrial Development Authorities</u>	<u>Peninsula Airport Commission</u>
2005	\$ 217,124	320,575	17,341
2006	—	218,949	16,546
2007	—	76,380	13,779
2008	—	77,144	12,060
2009	—	77,915	7,035
	<u>\$ 217,124</u>	<u>770,963</u>	<u>66,761</u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
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**(d) Operating Lease Revenue – Component Units**

The Authorities have developed several properties in which they own the land and buildings. These properties were developed with the purpose of entering into lease agreements with private companies. These lease agreements are made to increase the economic activity of the City.

The following schedule shows the composition of the Authorities' investment in property in operating leases:

Land	\$	3,049,960
Buildings		88,459,872
Less accumulated depreciation		<u>(8,977,671)</u>
Net investment in property held for lease	\$	<u><u>82,532,161</u></u>

PAC leases property to tenants including terminal space, hangars and land.

Minimum future rental income on operating leases as of June 30, 2004 is as follows:

	<b>E/IDA</b>	<b>PAC</b>
Year ending June 30:		
2005	\$ 8,642,220	1,582,712
2006	8,260,366	381,527
2007	7,721,152	301,891
2008	6,781,663	257,992
2009	6,904,527	216,305
2010-2014	30,444,916	—
2015-2019	24,617,298	—
2020-2024	7,654,227	—
2025-2029	5,837,116	—
2030-2031	<u>2,053,845</u>	<u>—</u>
Total	<u>\$ 108,917,330</u>	<u><u>2,740,427</u></u>

Rental income on operating leases for year ended 2004 was \$7,777,635 and \$1,388,427 for E/IDA and PAC, respectively.

**(e) Net Investment in Direct Financing Leases – E/IDA (Component Unit)**

The E/IDA is lessor in three direct financing leases on various properties within the City. These lease agreements are agreements with private companies and the Newport News Public Schools to increase the economic activity in the City. The following schedule lists the composition of the net investment in the direct financing leases as of June 30, 2004:

**CITY OF NEWPORT NEWS, VIRGINIA**  
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Minimum lease payments to be received	\$	26,505,682
Less unearned income		<u>(5,616,055)</u>
Net investment in direct financing leases	\$	<u><u>20,889,627</u></u>

Minimum future rental income on these direct financing leases as of June 30, 2004 are as follows:

Year ending June 30:		
2005	\$	3,198,351
2006		3,198,351
2007		1,938,351
2008		1,938,351
2009		1,938,351
2010-2014		9,691,755
2015-2019		4,478,397
2020		<u>123,775</u>
Total	\$	<u><u>26,505,682</u></u>

**(7) Long-Term Liabilities**

- (a) A summary of changes in long-term liabilities for governmental activities for the year ended June 30, 2004 follows:

		<u>Balance</u> <u>July 1, 2003</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2004</u>	<u>Due within</u> <u>one year</u>
Bonds payable:						
General obligation bonds	\$	397,113,966	99,631,892	(97,502,011)	399,243,847	38,301,412
Deferred amounts:						
Add bonds premiums		7,945,746	9,014,768	(1,344,138)	15,616,376	1,688,569
Net loss on refunded bonds		<u>(4,444,184)</u>	<u>(6,373,894)</u>	<u>796,820</u>	<u>(10,021,258)</u>	<u>(1,077,290)</u>
Total bonds payable		<u>400,615,528</u>	<u>102,272,766</u>	<u>(98,049,329)</u>	<u>404,838,965</u>	<u>38,912,691</u>
Literary loan bonds		4,902,580	—	(669,249)	4,233,331	669,249
Capital leases payable		45,405	387,740	(72,249)	360,896	68,107
Landfill liability		6,815,000	—	(153,000)	6,662,000	161,000
Accrued vacation		17,533,010	9,045,332	(8,732,393)	17,845,949	8,887,283
Net pension obligation		—	10,453,000	—	10,453,000	—
Workers' compensation and other claims		9,209,415	4,016,109	(2,413,416)	10,812,108	2,100,000
Incurred but not reported claims		<u>2,591,000</u>	<u>22,930,824</u>	<u>(22,526,824)</u>	<u>2,995,000</u>	<u>2,995,000</u>
Total long-term liabilities	\$	<u><u>441,711,938</u></u>	<u><u>149,105,771</u></u>	<u><u>(132,616,460)</u></u>	<u><u>458,201,249</u></u>	<u><u>53,793,330</u></u>

Long-term liabilities are normally paid from the General Fund.

**CITY OF NEWPORT NEWS, VIRGINIA**  
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General obligation bonds of \$4.5 million are authorized but unissued.

On March 1, 2004, the City issued \$25,000,000 of general obligation bonds Series 04A with an effective interest rate of 3.5%.

During the fiscal year, the City received one loan from the Virginia Resources Authority (VRA) for a total amount of \$3,180,000 with an interest rate of 3.5%. The loan will be used to finance the replacement or rehabilitation of sanitary sewers and related improvements in the City.

In July 2003, the City issued \$29,640,000 of general improvement refunding bonds Series 03C with a true interest cost of 2.36% to refund a portion of an outstanding issue with interest rates from 5.3% to 5.45%. The net proceeds of \$32,440,218 (after an original issue premium of \$3,070,020 and payment of \$269,803 for underwriting fees and other issuance costs) were used to purchase U.S. securities and deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liabilities have been removed from the governmental activities column of the statement of net assets. On June 30, 2004, \$30,985,000 remain outstanding. The reacquisition price exceeded the net carrying amount of the old debt by \$1,455,218. This amount is being netted against the new debt and amortized over the remaining life of the refunded debt. This advance refunding resulted in an economic gain of \$2,351,230. This issuance resulted in a cash flow savings from fiscal years 2004 through 2010 totaling \$2,591,801.

In December 2003, the City received \$1,090,819 of qualified zone academy bonds (QZAB) Series 03A and \$1,351,675 QZAB Series 03B, both with interest costs of 0.0%, to fund school renovations. The bonds will be fully paid December 28, 2018 via annual sinking fund payments of \$58,475 and \$72,450, respectively, with an expected interest rate of 3.02.

In March 2004, the City issued \$30,645,000 of general improvement refunding bonds Series 04B with a true interest rate of 3.31% to refund portions of three outstanding issues with interest rates from 4.875% to 5.75%. The net proceeds of \$34,142,586 (after an original issue premium of \$3,753,013 and payment of \$255,427 for underwriting fees and other issuance costs) were used to purchase U.S. securities and deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liabilities have been removed from the governmental activities column of the statement of net assets. On June 30, 2004, \$30,645,000 remain outstanding. The reacquisition price was less than the net carrying amount of the old debt by \$3,497,586. This amount is being netted against the new debt and amortized over the remaining life of the refunded debt. This advance refunding resulted in an economic gain of \$1,318,083. This issuance resulted in a cash flow savings from fiscal years 2005 through 2018 totaling \$1,368,441.

In March 2004, the City issued \$10,165,000 of general improvement refunding bonds Series 04C with a true interest rate of 3.59% to refund a portion of an outstanding issue with interest rates from 5.4% to 5.75%. The net proceeds of \$11,426,090 (after an original issue premium of \$1,340,210 and payment of \$79,119 for underwriting fees and other issuance costs) were used to purchase U.S. securities and deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liabilities have been removed from the governmental activities column of the statement of net assets. On June 30, 2004, \$10,165,000 remain outstanding. The reacquisition price was less than the net carrying amount of the old debt by \$1,261,090. This amount is being netted against the new debt and amortized over the remaining life of the refunded debt. This advance refunding resulted in an economic gain of \$390,634 (the present

**CITY OF NEWPORT NEWS, VIRGINIA**

Notes to Basic Financial Statements

June 30, 2004

value of the savings). This issuance resulted in a cash flow savings from fiscal years 2004 through 2020 totaling \$394,583.

At June 30, 2004, approximately \$71.6 million of general obligation bonds are considered defeased because refunding trusts were established to pay for them.

*Landfill Liability:* The City closed its Denbigh landfill site on June 30, 1996. State and federal laws and regulations require a final cover and the performance of certain maintenance monitoring functions at the site for 30 years after closure. The \$6.66 million liability at June 30, 2004 represents the total estimated cost of closure and postclosure care through fiscal year 2027 and reflects what it would cost to perform all closure/postclosure care in 2004. Actual costs may be higher due to inflation, technology changes or regulation changes.

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2004

General Obligation Bond Series	Bond Date	Final Maturity Date	Effective Interest Rate (At Issue)	Balance June 30, 2004
VPSA 91	07/15/91	07/15/11	6.4%	\$ 1,852,887
Series 93B	04/01/93	11/01/09	5.4%	6,760,000
Series 93C	07/15/93	06/01/06	5.0%	180,000
Series 93E	11/15/93	01/01/06	5.1%	4,935,000
VRA 93D	09/03/93	06/01/15	4.5%	586,464
VRA 94A	06/02/94	01/01/16	4.5%	2,923,895
VMPL 95A	05/25/95	07/15/04	4.2%	90,188
Series 95A	06/15/95	07/01/16	5.5%	6,990,000
VMPL 95C	09/28/95	07/15/15	4.3%	6,487,565
VPSA 95C	12/01/95	07/15/15	5.2%	3,805,512
Series 96A	01/15/96	01/15/18	5.2%	1,695,000
Series 96B	01/15/96	01/15/25	6.9%	12,355,000
VRA 96C	06/24/96	10/01/16	4.8%	2,128,509
Series 96D	12/01/96	01/15/17	5.4%	5,075,000
VRA 97A	01/30/97	10/01/17	4.8%	2,174,414
VRA 98A	06/22/98	12/01/17	4.8%	1,756,939
Series 98A	03/01/98	03/01/18	4.0%	29,545,000
Series 98C	12/01/98	12/01/09	4.2%	3,025,000
Series 99A	04/01/99	07/01/07	4.1%	9,585,000
VRA 99A	03/09/99	12/01/19	4.3%	2,315,074
Series 99B	03/01/99	03/01/19	4.6%	21,000,000
VRA 00A	03/15/00	03/01/21	3.5%	2,483,697
Series 00A	05/01/00	05/01/20	5.6%	8,940,000
VPSA 00B	11/16/00	07/15/21	5.2%	5,058,203
VRA 01A	05/24/01	05/01/22	4.1%	1,986,093
Series 01A	08/15/01	08/15/21	4.3%	22,500,000
Series 01B	08/15/01	08/15/04	4.3%	10,000,000
VRA 02A	05/16/02	01/01/23	3.8%	2,620,972
Series 02A	09/26/02	07/01/22	3.5%	26,600,000
Series 02B	09/26/02	07/01/16	3.4%	57,180,000
Series 03A	03/01/03	06/01/12	3.6%	10,165,000
Series 03B	06/03/03	11/01/23	3.8%	27,000,000
VRA 03A	06/24/03	06/01/24	3.5%	1,475,597
Series 03C	07/15/03	11/01/09	5.0%	29,640,000
QZAB 03A	12/31/03	12/28/18	0.0%	1,090,819
QZAB 03B	12/31/03	12/28/18	0.0%	1,351,675
Series 04A	03/01/04	07/15/24	5.0%	25,000,000
Series 04B	03/01/04	01/15/18	4.5%	30,645,000
Series 04C	03/01/04	05/01/20	5.0%	10,165,000
VRA 04A	06/30/04	09/01/25	3.5%	75,344
Totals				\$ 399,243,847

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
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Outstanding literary loan funds at June 30, 2003 of the Primary government governmental activities are comprised of the following issues:

<u>Project</u>	<u>Bond date</u>	<u>Final maturity date</u>	<u>Effective interest rate (at issue)</u>	<u>Balance June 30, 2004</u>
Greenwood Elementary	12/01/86	12/01/06	3.0%	\$ 300,000
Menchville High	12/15/86	12/15/06	3.0%	144,000
New Horizons Tech	07/01/87	07/01/07	3.0%	200,000
Watkins Elementary	07/01/89	07/01/09	3.0%	600,000
Ferguson High	03/01/90	03/01/10	4.0%	300,000
Huntington Middle	03/01/90	03/01/10	4.0%	213,000
Huntington Elementary	04/01/90	04/01/10	4.0%	60,000
Denbigh High	10/01/89	10/01/09	3.0%	481,962
Gildersleeve Middle	03/01/91	03/01/11	3.0%	700,000
Warwick High	09/01/99	09/01/19	2.0%	147,200
Washington Middle	09/15/00	09/15/06	2.0%	30,000
Menchville High-2	10/01/00	10/01/20	2.0%	212,500
Denbigh High-2	08/01/01	08/01/21	2.0%	220,783
Crittenden Middle	08/15/01	08/15/06	2.0%	45,000
Gildersleeve Middle-2	08/15/01	08/15/21	2.0%	112,500
Dozier Middle	08/15/01	08/15/21	2.0%	112,500
Reservoir Middle	05/01/02	05/01/22	2.0%	112,500
Hines Middle	05/01/02	05/01/22	2.0%	112,500
Huntington Middle	09/01/02	09/01/22	2.0%	128,886
Totals				\$ <u>4,233,331</u>

The following table summarizes future debt service requirements as of June 30, 2003:

	<u>Governmental activities</u>			
	<u>General Obligation Bonds</u>		<u>Literary Loans</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
Fiscal year ending June 30:				
2005	\$ 38,221,412	17,465,948	669,249	120,387
2006	28,910,298	16,173,992	669,249	100,311
2007	30,710,104	14,858,114	654,249	80,236
2008	31,761,109	13,672,304	491,249	60,462
2009	32,871,544	12,314,014	441,249	45,426
2010-2014	123,906,844	43,286,726	806,202	88,191
2015-2019	81,323,165	17,128,762	328,760	37,038
2020-2024	29,224,371	4,082,995	173,124	6,752
2025-2026	2,315,000	101,645	—	—
Total future debt service	\$ <u>399,243,847</u>	<u>139,084,500</u>	<u>4,233,331</u>	<u>538,803</u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2004

**Business-Type Activities**

A summary of changes in long-term liabilities for business-type activities for the year ended June 30, 2004 follows:

	<u>Balance July 1, 2003</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2004</u>	<u>Due within one year</u>
Bonds payable:					
General obligation bonds	\$ 189,110,000	42,205,000	53,290,000	178,025,000	11,815,000
Deferred amounts:					
Add bond premiums	2,941,268	5,136,254	459,306	7,618,216	379,605
Total bonds payable	<u>\$ 192,051,268</u>	<u>47,341,254</u>	<u>53,749,306</u>	<u>185,643,216</u>	<u>12,194,605</u>

Outstanding public utility bonds at June 30, 2004 are comprised of the following issues:

<u>Public Utility Bond Series</u>	<u>Issue Date</u>	<u>Final Maturity Date</u>	<u>Interest Rate (At Issue)</u>	<u>Balance Jun 30, 2004</u>
Series 93B	04/15/93	11/01/08	5.4%	\$ 3,355,000
Series 93E	11/15/93	01/01/14	5.1%	1,860,000
Series 96E	12/01/96	01/15/17	5.4%	5,075,000
Series 98B	03/01/98	03/01/12	4.0%	17,085,000
Series 99A	04/01/99	07/01/07	4.5%	4,635,000
Series 99B	03/01/99	03/01/19	4.7%	23,110,000
Series 00A	05/01/00	05/01/20	5.6%	7,180,000
Series 01C	08/15/01	08/15/21	4.3%	32,970,000
Series 02A	09/26/02	07/01/22	4.3%	21,055,000
Series 02B	09/26/02	07/01/16	3.5%	9,905,000
Series 03B	06/03/03	06/30/24	4.1%	9,590,000
Series 03C	07/15/03	11/01/08	2.3%	5,750,000
Series 04B	06/05/03	01/15/18	3.6%	16,325,000
Series 04C	06/06/03	05/01/20	3.9%	20,130,000
<b>Totals</b>				<u>\$ 178,025,000</u>

Public utility bonds of \$10.0 million are authorized but unissued.

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2004

The following table summarizes future debt service requirements of Business-type Activities as of June 30, 2004.

	<b>Business-type Activities</b>	
	<b>Public Utilities</b>	
	<b>Principal</b>	<b>Interest</b>
Fiscal year ending June 30:		
2005	\$ 12,805,000	9,697,928
2006	13,475,000	8,954,318
2007	10,075,000	8,272,341
2008	11,050,000	7,645,455
2009	10,275,000	7,084,740
2010-2014	52,315,000	26,915,848
2015-2019	48,460,000	13,530,379
2020-2024	19,570,000	3,410,408
Totals	<u>\$ 178,025,000</u>	<u>85,511,417</u>

**Public Schools – Component Unit**

A summary of changes in long-term liabilities for the discretely presented component unit – Public Schools for the year ended June 30, 2004 follows:

	<b>Balance</b>			<b>Balance</b>	<b>Due within</b>
	<b>July 1, 2003</b>	<b>Additions</b>	<b>Reductions</b>	<b>June 30, 2004</b>	<b>one year</b>
Compensated absences	\$ 3,245,857	1,935,064	1,586,906	3,594,015	179,701
Workers' compensation claims	1,228,414	1,451,291	1,000,487	1,679,218	387,986
Capital leases payable	4,028,637	1,135,950	883,976	4,280,611	919,349
Capital facilities notes payable	—	9,006,249	—	9,006,249	710,000
Incurred but not reported claims	2,000,000	17,979,068	17,962,068	2,017,000	2,017,000
Totals	<u>\$ 10,502,908</u>	<u>31,507,622</u>	<u>21,433,437</u>	<u>20,577,093</u>	<u>4,214,036</u>

The *Code of Virginia*, Section 22, sets forth the powers and responsibilities of the local school boards. School boards in Virginia have no taxing authority, but they are authorized to borrow money from the Commonwealth and to sell local school bonds through the City to the Virginia Public School Authority (VPSA). The City recorded the sale of school bonds to the VPSA as “other financing sources” in the City’s Debt Service Fund.

In February 2002, the Virginia General Assembly passed Senate Bill 276 which was subsequently signed by the Governor of Virginia, that provides that localities have a tenancy in common with the school board whenever a locality incurs a financial obligation for school property which is payable over more than one fiscal year. As a result, the City records on its statement of net assets any school property that is purchased with City long-term obligations. However, the Public Schools are still tasked with all care, management, and control over these properties.

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2004

**E/IDA and PAC – Component Units**

Industrial Revenue Bonds and Notes Payable (the Bonds and Notes) have been issued in the name of E/IDA to finance construction projects. The Bonds and Notes, both as to principal and interest, are payable solely from lease proceeds. In the event of default by the lessee, the holders of the Bonds and Notes have no recourse to the Authorities but must look to the property and lessee for indemnity. Approximately \$48 million of the Bonds and Notes are considered a moral obligation of the City. A moral obligation of the City is a contingent guarantee of a third party's debt. It is referred to as a "moral" obligation because it is not a legal obligation of the City but a good faith obligation, which, if called upon, would require appropriations by City Council of amounts sufficient to pay the guaranteed amounts.

The E/IDA bonds at June 30, 2004 are comprised of the following:

	<u>Issue date</u>	<u>Maturity date</u>	<u>Effective interest rates</u>	<u>Balance July 1, 2003</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2004</u>	<u>Amount due within one year</u>
Bonds payable:								
UPS, 95*	03/22/95	06/01/05	8.25%	\$ 7,897,939	—	7,897,939	—	—
UPS, 04	06/04/04	07/01/15	5.58%	—	8,046,249	42,494	8,003,755	581,167
MCI, 95A*	12/28/95	04/01/06	6.35%	1,199,155	—	412,830	786,325	439,808
MCI, 95B*	12/28/95	04/01/06	6.65%	23,048	—	7,896	15,152	8,437
OPTON*	03/01/96	08/01/16	6.15%	2,044,740	—	103,005	1,941,735	109,858
EDA-NNS, 96*	03/22/96	07/15/06	7.00%	3,348,965	—	1,005,474	2,343,491	1,080,264
ICELAND*	04/10/97	10/01/17	4.10%	7,980,000	—	433,333	7,546,667	366,667
CTII, 97A*	04/29/97	08/01/22	7.28%	3,967,739	—	99,668	3,868,071	107,207
CTII, 97B*	04/29/97	08/01/22	6.20%	880,405	—	24,897	855,508	26,493
TWINPAK	05/01/97	06/01/07	7.65%	5,268,152	—	5,268,152	—	—
SEARS*	03/01/98	10/01/18	6.48%	11,523,159	—	453,034	11,070,125	485,784
VSS*	03/01/98	10/01/18	6.48%	10,454,135	—	411,007	10,043,128	440,717
Coats and Clarke	01/01/99	12/01/18	4.24%	1,567,368	—	97,961	1,469,407	97,961
Hiddenwood Center	03/30/00	04/01/20	8.78%	1,319,063	—	171,608	1,147,455	73,366
Downtown Engineering	04/05/00	07/01/31	7.64%	28,500,000	—	1,060,000	27,440,000	1,060,000
VASCIC	07/27/00	09/30/10	4.54%	34,410,000	—	3,565,000	30,845,000	3,745,000
OPTC Merchant's Walk	08/24/01	08/01/26	4.52%	12,900,000	—	300,000	12,600,000	300,000
HRSD - Bond A	04/29/03	07/01/08	2.64%	2,190,958	—	—	2,190,958	—
HRSD - Bond B	04/29/03	07/01/08	2.45%	2,325,880	—	—	2,325,880	—
Port Warwick/Light Rail	10/01/02	09/30/05	2.70%	1,056,804	—	366,667	690,137	366,667
PrintPack	08/15/03	09/01/18	3.61%	—	5,400,000	300,000	5,100,000	360,000
Totals				<u>138,857,510</u>	<u>13,446,249</u>	<u>22,020,965</u>	<u>130,282,794</u>	<u>9,649,396</u>
Notes payable:								
Police Headquarters	02/01/03	08/01/03		<u>1,250,000</u>	<u>250,000</u>	<u>—</u>	<u>1,500,000</u>	<u>1,500,000</u>
Total bonds and notes payable				<u>\$ 140,107,510</u>	<u>13,696,249</u>	<u>22,020,965</u>	<u>131,782,794</u>	<u>11,149,396</u>

\* Moral obligation of the City.

The lessees of the Opton Building are the following:  
Custom Vinyl Products LLC  
Iceland Seafood Co.

## CITY OF NEWPORT NEWS, VIRGINIA

### Notes to Basic Financial Statements

June 30, 2004

*Conduit Debt Obligations:* From time to time the E/IDA have issued Industrial Revenue Bonds (the Bonds) to provide financial assistance to private-sector and nonprofit entities for the acquisition and construction of industrial, commercial and residential facilities deemed to be in the public interest. The Bonds are secured by the property financed and are payable solely from payments received on the underlying mortgage loans. Upon repayment of the Bonds, ownership of the acquired facilities transfers to the private-sector entity served by the bond issuance. Neither the City, the State, nor any political subdivision thereof is obligated in any manner for repayment of the Bonds. Furthermore, in the event of default by the lessee, the holders of the Bonds have no recourse to the E/IDA, but must look to the property and lessee for indemnity. Accordingly, the Bonds are not reported as liabilities in the accompanying basic financial statements.

As of June 30, 2004, there are 17 series of the Bonds outstanding, with an aggregate principal amount payable of approximately \$19 million. Approximately \$2.5 million of the Bonds and Notes are considered a moral obligation of the City.

*Interest Rate Swap Agreement:* On April 6, 2000, the EDA entered into an interest rate swap agreement, a derivative instrument, with First Union National Bank, N.A. (First Union) whereby the EDA agreed to pay First Union a 7.64% fixed rate of interest on the EDA Taxable Incremental Variable Rate Demand Bonds, Series A, in the original principal amount of \$5 million in exchange for the receipt of a floating rate. The floating rate is determined weekly by the Remarketing Agent at a rate equal to the rate of interest certified to the Trustee by the Remarketing Agent on and as of each Wednesday (the Determination Date) as the minimum rate of interest which, in the judgment of the Remarketing Agent taking into account market conditions prevailing on the Determination Date, would be necessary to enable the Remarketing Agent to arrange for sale of all the Bonds in the secondary market on the Determination Date at a price equal to the principal amount thereof. This agreement is to continue in effect until July 1, 2016 (the Termination Date).

Interest is payable monthly and mandatory sinking fund redemption payments are due quarterly in July, October, January, and April commencing October 1, 2001. The debt service requirements through the Termination Date for these bonds are based on the fixed rate. The EDA will be exposed to variable interest rates if the swap agreement is terminated or if there occurs an event of default. A termination of the swap agreement may also result in the EDA making or receiving a termination payment.

In connection with the 2004 United Parcel Service, Inc. Bond refinancing initiative, the IDA entered into an interest rate swap on April 4, 2004 with the Bank of America, N.A., whereby the IDA agreed to pay Bank of America a 5.58% fixed rate of interest on the IDA Taxable Industrial Development Revenue and Refunding Bond, Series 2004 (United Parcel Service, Inc. Project) in the amount of \$8,046,278 in exchange for the receipt of a floating rate.

*Bond Refundings:* A significant portion of the E/IDA's outstanding debt is payable from lease proceeds. Lease agreements are setup to at least cover the principal and interest payments of the outstanding debt associated with that specific lease. At the request of two tenants, the E/IDA issued Taxable Refunding Bonds, Series 2003, in the amount of \$5,400,000 and Taxable Refunding Bonds, Series 2004, in the amount of \$8,046,249 for a current refunding of \$5,268,152 and \$7,897,939 of previously issued industrial revenue bonds, respectively. Each refunding was undertaken to lower the interest rate the E/IDA pays on the outstanding debt, and ultimately, lower the tenants' monthly lease payments.

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2004

In order to refinance the bonds, a \$400,000 prepayment fee was paid and expensed in FY04. The cost of the prepayment has been included in the minimum lease payments due to and will ultimately be recouped by the E/IDA as lease revenue. Accordingly, no loss has been reported.

The two current refundings resulted in an economic gain of \$1,120,708 and a reduction in future debt service payments. This benefit will be passed on to the E/IDA tenants through lower lease payments.

The PAC, Airport Improvement Revenue Bonds at June 30, 2004, are comprised of the following:

<u>Series</u>	<u>Issue Date</u>	<u>Maturity Date</u>	<u>Eff. Int. Rate (%)</u>	<u>Balance July 1, 2003</u>	<u>Reductions</u>	<u>Balance June 30, 2004</u>
2001	04/15/01	07/16/21	5.05-5.5	\$ 6,450,000	205,000	6,245,000
2002	07/03/02	07/01/27	4.5	2,444,536	58,301	2,386,235
Totals				<u>\$ 8,894,536</u>	<u>263,301</u>	<u>8,631,235</u>

Maturities of industrial revenue bonds and notes payable for succeeding fiscal years are as follows:

	<u>Other Component Units</u>			
	<u>EIDA</u>		<u>PAC</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
Fiscal year ending June 30:				
2005	\$ 11,149,396	7,094,653	275,954	416,646
2006	10,145,752	6,566,693	293,728	402,636
2007	8,740,528	6,030,398	301,628	387,995
2008	13,570,067	5,554,277	319,660	372,717
2009	9,460,375	4,895,407	332,830	356,669
2010-2014	37,034,680	17,245,265	1,956,984	1,595,534
2015-2019	24,352,334	8,939,494	2,530,897	1,048,181
2020-2024	9,429,661	4,095,572	2,155,707	335,549
2025-2029	6,960,000	1,415,647	463,847	37,095
2030-2032	940,000	32,277	—	—
Total	<u>\$ 131,782,793</u>	<u>61,869,683</u>	<u>8,631,235</u>	<u>4,953,022</u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2004

**(8) Defined Benefit Retirement Plans**

**(a) Newport News Employees' Retirement Fund (NNERF)**

**1. Plan Description**

The NNERF is a single employer, defined benefit, public employee retirement system established and administered by the City to provide pension benefits for employees of the local government, including the Newport News School System. For those school teachers and administrative support personnel employed by the Newport News School Board, the City plan is a supplement to the Virginia Retirement System.

NNERF is a separate pension trust fund and is considered part of the City's financial reporting entity. The City issues a publicly available financial report that includes financial statements and required information for NNERF. That report may be obtained by writing to NNERF, 2400 Washington Avenue, Newport News, VA 23607.

All full-time regular employees are members of this fund. For the year ended June 30, 2004, the total payroll of the City was approximately \$301.2 million, with approximately \$281.9 million covered by NNERF. At June 30, 2004, NNERF membership consisted of:

	<u>Retirees and beneficiaries</u>	<u>Vested terminated employees</u>	<u>Active employees vested</u>	<u>Non-vested</u>	<u>Total</u>
City general	612	430	1,195	593	2,830
City police and fire	389	126	639	264	1,418
Public utilities	138	89	279	75	581
School VRS	1,481	185	2,043	1,655	5,364
School Non-VRS	532	22	612	468	1,634
Total	<u>3,152</u>	<u>852</u>	<u>4,768</u>	<u>3,055</u>	<u>11,827</u>

NNERF provides retirement benefits as well as death and disability benefits. All benefits vest after five years of credited service. Employees who retire at or after age 60 (50 for police officers, firefighters and deputy sheriffs) with five years of credited service are entitled to an annual retirement benefit, payable monthly for life, in an amount equal to 2.0% of their final average salary for each year of credited service. Final average salary means the average rate of salary received during the highest paid 36 consecutive months of credited service. Employees with 30 years (25 for police officers, firefighters and deputy sheriffs) credited service may retire at any age with full benefits. Employees (other than police officers, firefighters and deputy sheriffs) with 25 years of service may retire prior to age 60 and receive a reduced benefit. Covered employees do not contribute to NNERF.

Benefits and contribution provisions are established by City Ordinance and may be amended only by the City Council. An actuarial service is employed to advise the City Council and the Retirement Board of the contributions necessary to fund the benefits.

**2. Concentrations**

There are no significant investments (other than U.S. Government and U.S. Government-guaranteed obligations) in any one organization that represents 5% or more of net assets available for benefits.

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**3. Contributions Required and Contributions Made**

NNERF funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate sufficient assets to pay benefits when due. Level percentage of payroll employer contribution rates are determined using the entry age actuarial cost method. NNERF uses the level payment method to amortize the unfunded liability over a 40-year period.

Contributions for normal costs totaling \$12,281,798 were made by the employer during the year ended June 30, 2004. The contributions were made in accordance with actuarially determined requirements computed through an actuarial valuation performed as of June 30, 2003. The percentage of employer contributions to current year covered payroll was 1.24% for employees covered by VRS and 3.12% for all others.

The percentage of normal cost to current year covered payroll was 4.4%. The employer's annual pension cost and net pension obligation to NNERF for 2004 were as follows:

(000's Omitted)

Annual Required Contribution (ARC)	\$	27,856
Interest on net pension obligation		(411)
Adjustment to ARC		431
Annual pension cost		27,876
Contributions made		(12,282)
Increase in net pension obligation		15,594
Net pension obligation (asset), beginning of year		(5,141)
Net pension obligation (asset), end of year	\$	10,453

The annual required contribution for the current year was determined as part of the June 30, 2003 actuarial valuation using the entry age actuarial cost method. The actuarial assumptions included (a) 8.0% investment rate of return (net of administrative expenses) (b) projected salary increase of 5% per year and (c) 2.1% per year cost-of-living adjustments. All assumptions include an inflation component of 3.5%. The assumptions did not include post-retirement benefit increases. The actuarial value of assets was determined under the average value method. The unfunded accrued actuarial liability is being amortized as a level dollar of payroll on an open basis and is amortized over a period of 40 years. The net pension asset is included in the fund balance restricted for employees' retirement.

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**4. Three-Year Trend Information**

(000's Omitted)

<u>Fiscal year ended</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC contributed</u>	<u>Net pension obligation (asset)</u>
June 30, 2004	\$ 27,846	44.1%	\$ 10,453
June 30, 2003	15,920	73.2%	(5,141)
June 30, 2002	11,336	99.7%	(9,406)

**(b) Newport News School System (NNSS) and Peninsula Airport Commission (PAC)**

**1. Plan Description**

The NNSS and the PAC contribute to the Virginia Retirement System (VRS or the System), an agent multiple-employer defined benefit pension plan administered by the System.

All full-time, salaried permanent employees of participating employers must participate in the VRS. Benefits vest after five years of service. Employees are eligible for an unreduced retirement benefit at age 65 with five years of service (age 60 for participating law enforcement officers and firefighters) and at 50 with 30 years of service for participating employees (age 50 with 25 years for participating law enforcement officers and firefighters) payable monthly for life in an amount equal to 1.7% of their average final contribution (AFC) for each year of credited service. Benefits are actuarially reduced for retirees who retire prior to becoming eligible for full retirement benefits. In addition, retirees qualify for annual cost-of-living adjustments (COLA) beginning in their second year of retirement. The COLA is limited to 5% per year. AFC is defined as the highest consecutive 36 months of salary. Participating law enforcement officers and firefighters may receive a monthly benefit supplement if they retire prior to age 65. The VRS also provides death and disability benefits. Title 51.1 of the *Code of Virginia* (1950), as amended, assigns the authority to establish and amend benefit provisions to the state legislature.

The System issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information for VRS. A copy of that report may be obtained by writing the System at P.O. Box 2500, Richmond, VA 23218-2500.

**2. Funding Policy**

Plan members are required by Title 51.1 of the *Code of Virginia* (1950), as amended, to contribute 5% of their annual reported compensation to the VRS. This 5% member contribution has been assumed by the employer. In addition, the NNSS and the PAC are required to contribute the remaining amounts necessary to fund their participation in the VRS using the actuarial bases specified by the *Code of Virginia* and approved by the VRS Board of Trustees. The contribution rates for the fiscal year ended 2004 were 8.77% and 1.0% of covered annual payroll for the NNSS and the PAC, respectively.

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**3. Annual Pension Cost**

For 2004, the annual pension cost of \$12,204,566 and \$15,097 for the NNSS and the PAC, respectively, was equal to the required and actual contributions. The annual required contributions were determined as part of the June 30, 2003 actuarial valuation. The actuarial assumptions included (a) a rate of return on investment of 8%, (b) projected salary increases ranging from 4.25% to 6.10% per year, and (c) cost-of-living adjustments of 3%. Both (a) and (b) included an inflation component of 3%. The actuarial values of the respective entities' assets are equal to the modified market value of the assets. This method was determined using techniques that smooth the effects of short-term volatility in the market value of assets over a five-year period. The NNSS' and the PAC's unfunded actuarial accrued liability is being amortized as a level percentage of payroll on an open basis within a period of 30 years or less.

**4. Three-Year Trend Information**

	<b>Fiscal year ending</b>	<b>Pension Cost (APC)</b>	<b>Percentage of APC contributed</b>	<b>Net pension obligation</b>
NNSS	06/30/04	\$ 12,204,566	100.0%	-
	06/30/03	11,629,435	100.0%	-
	06/30/02	10,790,348	100.0%	-
PAC	06/30/04	15,097	100.0%	-
	06/30/03	14,398	100.0%	-
	06/30/02	17,366	100.0%	-

**(c) Post-Retirement Benefits**

The City provides health and dental insurance for City retirees under the City's group plans. The City contributes 75% of the cost and the retiree contributes 25% of the cost. At age 65, the retiree's coverage converts to Medicare Extended. The City also provides life insurance at one-half salary without cost to retirees.

There is a legal requirement that the City provide health and dental benefits to retirees. Since 1958, the City has allowed employees to continue their coverage after retirement. Life insurance to retirees at one-half salary at no cost is provided by Ordinance Sec. 2-151 and 2-148.

The City funds the costs of retiree health and life insurance through the annual pension contribution amount. The actuary computes the current and next years' cost of these in the bi-annual actuary study. The pension plan then pays the premiums out of its funds.

The actual costs to the fund for the 3,152 retirees for fiscal year 2004 were: health \$6,808,775 (1,573 participating); dental \$267,891 (1,642 participating); and life \$1,068,046 (1,005 participating).

The School Board provides health and dental insurance for School Board retirees under the school's group plans. The School Board also provides life insurance for retirees not covered by VRS. The amount of coverage is \$10,000 or \$5,000 depending on the retiree's position at time of retirement, and the Board pays the entire cost. The actual costs for the 2,013 retirees for fiscal year 2004 were: health and dental \$3,608,214 (1,720 participating), and life \$61,019 (278 participating).

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There is a legal requirement that the School Board provide health and dental benefits to retirees. Since 1978, the School Board has allowed employees to continue their coverage after retirement. The life insurance benefit for non-VRS retirees was implemented on January 1, 1991.

The School Board funds the cost of retiree health, dental and life insurance through the annual pension contribution amount. The actuary computes the current and next years' cost of these on a pay-as-you-go basis in the annual actuary study and incorporates it in the percent of contributions required for the pension fund. The pension plan then pays the premiums out of its funds.

**(d) *Deferred Compensation***

Employees of the City, except those of the School System, may participate in a deferred compensation plan adopted under the provisions of Internal Revenue Code Sec. 457 (Deferred Compensation Plans With Respect to Service for State and Local Governments). Under the plan, employees may elect to defer a portion of their salaries and postpone paying taxes on the deferred portion until the withdrawal date. The deferred compensation amount is not available for withdrawal by employees until termination, retirement, death or unforeseeable emergency.

The deferred compensation plan is administered by an unrelated financial institution on behalf of the City. Investment options available to employees include common stock, corporate and government bonds, guaranteed interest, or combinations thereof. Under the terms of an IRC Sec. 457 Deferred Compensation Plan, all deferred compensation and income attributable to the investment of the deferred compensation amounts are held by the financial institution, until paid or made available to the employees or beneficiaries.

**(9) Self Insurance**

**(a) *Medical Benefits***

The School Board is self-insured for medical benefits through the respective General Funds for employees up to \$150,000, per employee per year, or 110% of adjusted subscriber charges for the year (\$19,247,108 for 2004). The City self-insures for medical benefits for its employees up to \$200,000 per employee per year, or 125% of adjusted subscriber charges for the year (estimated to be approximately \$31,700,000), whichever is less. Claims in excess of the limitation are covered by third-party insurance. Expenditures are charged to the fund to which the employees' payroll expenditure is charged at amounts that approximate what third-party insurers would have charged. The insurance coverage is substantially the same as in prior fiscal years.

Claims processing and payments for the medical claims are made through a third-party administrator. The City and the School Board's settlement using reinsurance did not exceed insurance for fiscal years 2004, 2003 or 2002. Both the City and the School Board uses the information provided by the third-party administrator to aid in the determination of self-insurance liabilities. Amounts due in future years on claims as of June 30, 2004 are recognized as a long-term liability in the statement of net assets.

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Changes in the incurred but not reported amount during the fiscal years ended June 30, 2004 and 2003 for the City and the Public Schools were as follows:

	City		Public Schools	
	2004	2003	2004	2003
Claims payable at beginning of year	\$ 2,591,000	2,208,000	2,000,000	2,091,000
Claims and changes in estimates	22,930,824	19,566,061	17,979,068	16,309,750
Claim payments	(22,526,824)	(19,183,061)	(17,962,068)	(16,400,750)
Claims payable at end of year	\$ 2,995,000	2,591,000	2,017,000	2,000,000

**(b) Workers' Compensation**

The City and the School Board self-insure for workers' compensation through the respective General Funds up to \$750,000 and \$350,000 respectively, per claim. Expenditures are charged to the various departments at amounts that approximate what third-party insurers would have charged. Amounts due in future years on claims made as of June 30, 2004 are accounted for in the long-term liabilities. The following is a reconciliation of changes in workers' compensation other claims payable for years ended June 30, 2004 and 2003 for the City and the Public Schools were as follows:

	City		Public Schools	
	2004	2003	2004	2003
Claims payable at beginning of year	\$ 9,209,415	8,495,564	1,228,414	1,118,971
Claims and changes in estimates	1,165,050	3,764,417	1,451,291	884,927
Claim payments	(2,413,416)	(3,050,566)	(1,000,487)	(775,484)
Claims payable at end of year	\$ 7,961,049	9,209,415	1,679,218	1,228,414

A loss analysis was conducted by Mercer Oliver Wyman on this fund. The total actuarially computed liability as of June 30, 2004 for the City and School Board was determined to be approximately \$7.8 million and \$1.7 million, respectively.

**(c) Other**

The City self-insures for automotive and general liability through the General Fund up to \$1 million per occurrence, which is included in accrued liabilities, and up to \$250,000 for each fire and property claim. The School Board insures for property losses with self-insured retention per occurrence of \$25,000 for basic, \$5,000 for floods, and \$25,000 for earthquakes. The School Board is self-insured for losses resulting from vehicular accidents of up to \$1,000,000. Claims in excess of the self-insured retention limitations are covered by third party insurance.

Included in the fund balances of the General Fund of the City and the School Board are reserved and designated fund balances related to self-insurance activities.

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**(10) Contingent Liabilities**

**(a) Grants**

The City received grant funds, principally from the U.S. Government, for construction and various other programs. Expenditures from these grants are subject to audit by the grantor, and the City is contingently liable to refund amounts received in excess of allowable expenditures. In the opinion of the management of the City, no material refunds will be required as a result of expenditures disallowed by the grantors.

**(b) Litigation**

The City is involved in several lawsuits arising in the ordinary course of operations. The City is self-insured with respect to automotive liability, general liability, and property damage and workers' compensation. It is the opinion of City management, based on the advice of the City Attorney, that any losses incurred as a result of claims not included in accrued liabilities as of June 30, 2004, will not be material to the financial statements.

**(c) Regional Raw Water Project**

As of June 30, 2004, the City's Public Utility has incurred cumulative costs of approximately \$26.3 million related to the Regional Raw Water Project (the Project) known as the King William Reservoir. Although the project began in 1987, as of June 30, 2004, the necessary federal permit has not been obtained. On August 12, 2004, the Virginia Marine Resources Commission granted the last remaining State permit which authorizes construction and operation of a water intake structure in the Mattaponi River.

**(11) Jointly Governed Organizations and Joint Ventures**

**(a) Hampton-Newport News Community Services Board (CSB)**

The CSB operates as an agent for the cities of Hampton and Newport News in the establishment and operation of community mental health, mental retardation and substance abuse programs as provided for in Chapter 10 of Title 37.1 of the Code of Virginia. The CSB designates its own management and adopts its own budget. The operations are financed principally by state and federal funds. Separate financial statements are available from the CSB, 2501 Washington Avenue, 1<sup>st</sup> Floor, Newport News, Virginia 23607.

**(b) Hampton Roads Regional Jail Authority (HRRJA)**

The HRRJA is a political subdivision of the Commonwealth of Virginia, created December 14, 1993, by the cities of Hampton, Newport News, Norfolk and Portsmouth. The HRRJA is governed by a twelve-member board, consisting of three members from each city. The purpose of the intergovernmental authority is to develop, construct, equip, maintain and operate a regional jail. No one locality contributes more than 50% of the HRRJA's funding or has responsibility over its operations. Separate financial statements are available from the Hampton Roads Regional Jail Authority, 2690 Elmhurst Lane, Portsmouth, Virginia 23701-2745.

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**(12) Prior Period Adjustments**

The net assets of the Primary Government at the beginning of FY 2004 have been restated to correct for misclassifications and incorrect valuations identified in the prior period balances. The net asset amount was increased by \$7.6 million as follows:

	<u>Balance</u> <u>June 30, 2003</u>	<u>Adjustment</u>	<u>Restated Balance</u> <u>June 30, 2003</u>
<b>Governmental activities:</b>			
Capital assets, not being depreciated:			
Land	\$ 74,969,669	-	74,969,669
Construction in progress	<u>43,646,862</u>	<u>126</u>	<u>43,646,988</u>
Total capital assets, not being depreciated	<u>118,616,531</u>	<u>126</u>	<u>118,616,657</u>
Capital assets, being depreciated:			
Buildings	236,920,279	-	236,920,279
Improvements	89,395,211	-	89,395,211
Machinery and equipment	97,313,095	(7,538,402)	89,774,693
Infrastructure	<u>383,927,365</u>	<u>-</u>	<u>383,927,365</u>
Total capital assets being depreciated	<u>807,555,950</u>	<u>(7,538,402)</u>	<u>800,017,548</u>
Less accumulated depreciation for:			
Buildings	52,963,138	1,758,401	54,721,539
Improvements	37,362,529	(642,050)	36,720,479
Machinery and equipment	70,968,856	(16,274,453)	54,694,403
Infrastructure	<u>236,392,550</u>	<u>-</u>	<u>236,392,550</u>
Total accumulated depreciation	<u>397,687,073</u>	<u>(15,158,102)</u>	<u>382,528,971</u>
Total capital assets being depreciated, net	<u>409,868,877</u>	<u>7,619,700</u>	<u>417,488,577</u>
Capital assets, net	<u>\$ 528,485,408</u>	<u>7,619,826</u>	<u>536,105,234</u>

The net assets of the Primary Government at the beginning of FY 2004 have also been restated to reflect proper revenue recognition in accordance with GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions." Under GASB 33, government-mandated nonexchange transactions are to be reported as revenue when the City meets the eligibility criteria established under the Statement. The effect on the City's beginning net assets is an increase of \$2,410,225.

This adjustment also affects the beginning fund balance of the Other Federal and State Special Revenue Fund. The effect on this Fund's beginning fund balance is as follows:

Fund balance, as previously stated	\$ 621,269
Adjustment under GASB 33	<u>2,410,225</u>
Fund Balance, as adjusted	<u>\$ 3,031,494</u>

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The net assets of the Primary Government's governmental activities at the beginning of FY 2004 have also been restated to correct an improper recognition of unearned revenue under GASB 34. The City's fiscal year 2003 conversion entries include an adjustment to deferred revenue to reflect unearned income under the full accrual method of accounting and revenue recognition criteria under GASB 34. A portion of the adjustment was actually not earned as of June 30, 2004, and resulted in a decrease in beginning net assets of \$731,248.

The following is a summary of the above prior period adjustments' effect on beginning net assets:

Governmental activities net assets, July 1, 2003, as previously stated	\$ 196,466,072
Net adjustment:	
Reclassification and re-valuations of capital assets	7,619,826
Recognition of revenue under GASB 33	2,410,225
Improper revenue recognition under GASB 34	<u>(731,248)</u>
Governmental activities net assets, July 1, 2003, as adjusted	<u>\$ 205,764,875</u>

**E/IDA Prior Period Adjustment :**

In accordance with generally accepted accounting principles, unearned income associated with direct financing leases is to be amortized over the lease term using the effective interest method of amortization. Historically, the Authorities have used a straight-line method to amortize the unearned income associated with their direct financing leases with the assumption that amortization of the unearned income using the straight-line method would not vary significantly from the effective interest method. For fiscal year 2004, management has adopted a change in accounting to amortize the unearned income using the effective interest method. This accounting change requires restatement of the Authorities' net assets in prior fiscal years.

The effective interest method recognizes more revenue earlier in the lease term; hence, using the straight-line method of amortization has understated the Authorities' net assets.

The adjustment to the Authorities' net assets at the beginning of fiscal year 2004 is as follows:

Net assets, July 1, 2003, as previously stated	\$ 30,771,010
Net adjustment to investment in direct financing leases using the effective interest method:	1,181,105
Net assets, July 1, 2003, as adjusted	<u>\$ 31,952,115</u>

**(13) Subsequent Events**

On December 7, 2004, the City issued \$29,170,000 of general obligation bonds. These bonds mature between December 1, 2013 and December 1, 2034 and bear an average interest rate of 4.6%. The bonds were issued to pay the costs of certain improvement projects for the City.