

## CITY OF NEWPORT NEWS, VIRGINIA

Notes to Basic Financial Statements

June 30, 2005

### (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 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

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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 the Stormwater Fund, the Solid Waste Fund, and 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 an 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.

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The City follows the practice of reassessing all property annually.

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 2005 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, 2005 less an allowance for uncollectible amounts and taxes not collected within 45 days after year-end. The tax rates for 2005 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, 2005, is composed of the following:

General Fund –		
Taxes receivable:		
Real Estate	\$	832,691
Personal Property		<u>3,986,248</u>
Total Taxes	\$	<u>4,818,939</u>
Special Revenue Funds –		
Accounts receivable	\$	<u>460,448</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 \$5,063,912 was capitalized during fiscal year 2005.

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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, 2005, the City holds capital assets related to school property with a net book value of \$122,947,056.

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, Investments and Securities Lending**

***Deposits***

All cash of the City is maintained in accounts collateralized in accordance with the Virginia Security for Public Deposits Act (the Act), Section 2.2-4400 et. Seq. of the Code of Virginia or covered by federal depository insurance. 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 local governments of compliance by banks and savings and loans.

To increase returns and minimize fees, the City follows the practice of pooling cash and investments of all funds held with the City Treasurer except for certain restricted funds requiring separate tracking or held by outside custodians. At year-end, the government's cash and investment balances were as follows:

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<u>Investments</u>	<u>Carrying amount</u>
Cash and deposits:	
Cash on hand	49,523
Deposits with banks	4,572,103
Total cash and deposits	<u>4,621,626</u>
Investments:	
Local Government Investment Pool (LGIP)	102,561,815
Deposits with banks - Money market accounts	28,389,205
Deposits with banks - Repurchase agreements	337,015
Peninsula Airport Commision - Time Deposits	1,113,128
Commonwealth cash reserve	17,359,746
VA SNAP	30,611,085
Common stock - IDA	11,687
IDA escrow funds	381,606
Total deposits and investments	<u>\$ 185,386,913</u>

Cash and investments as of June 30, 2005 are classified in the accompanying financial statements as follows:

<u>Statements of net assets</u>	<u>June 30, 2005</u>
Primary Government:	
Cash and cash equivalents	\$ 78,689,948
Restricted cash	40,808,470
Component Units:	
Cash and cash equivalents	37,685,276
Restricted cash	26,887,686
Fiducuiary Funds (page 23):	
Cash and cash equivalents - Agency Funds	1,315,533
Total cash and investments	<u>\$ 185,386,913</u>

***Investment Policy***

In accordance with the Code of Virginia and other applicable law, including regulations, the City Investment Policy (Policy) permits investments in obligations of the United States or agencies thereof, obligations of the Commonwealth of Virginia or political subdivision thereof, obligations of the International Bank for Reconstructions and Development (World Bank), the Asian Development Bank, the African Development Bank, “prime quality” commercial paper and certain corporate notes, banker’s acceptances, repurchase agreements, the State Treasurer’s Local Government Investment Pool (the Virginia LGIP, a 2a-7 like pool), the State Non-Arbitrage Pool (“SNAP”) or similar fund, Open-end mutual funds (provided the funds are registered under the Security Act of Virginia or the Federal Investment Act of 1940), and negotiable certifications of deposits and negotiable bank deposit notes of domestic banks and domestic offices of foreign banks with a rating of at least A-1/P-1 .

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The City Investment Policy prohibits any other security not specifically authorized in the policy. No investment shall be purchased if the yield is less than that of the most recently auctioned issue of the United States Treasury of a similar term. At no time, shall more than 35% of the portfolio be invested in commercial paper. No more than five percent of the portfolio shall be invested in the commercial paper of a single entity. At no time shall an investment bear a maturity date greater than thirty-six (36) months from date of purchase. The City Policy does not set a limit on the amount that may be invested in any single Federal Agency issuer or in any obligation of the United States. However, the Treasurer shall endeavor to maintain an appropriate diversification in the portfolio. The Treasurer shall avoid an excessive concentration in any type of investment and excessive number of investment transactions with any financial institution or broker/dealer.

**Interest Rate Risk:** As a means of limiting exposure to fair value losses arising from rising interest rates, investment maturity is managed to proceed or coincide with expectance need of funds. The City's Policy limits the investment of operating funds to investments with a stated maturity of no more than thirty-six (36) months from the date of purchase. Purchases of securities are laddered with staggered maturity dates. Proceeds from the sale of bonds must be invested in compliance with the specific requirements of the bond covenants and may be invested in securities with longer maturities. As of June 30, 2005, the carrying value and weighted average maturity of the city's investments are listed below.

**Custodial Credit Risk - Investments:** The policy requires that all securities purchased for the City shall be held by the City Treasurer or by the City Treasurer's designated third party custodian. If held by a custodian, the securities must be in the City's or in the custodian's nominee name and identifiable on the custodian's books as belonging to the City and the custodian must be a third party, not a counter-party (buyer or seller).

**Credit Risk of Debt Securities of Primary Government**

The City's rated debt investments as of June 30, 2005, were rated by Standard & Poor and Moody. The ratings are presented below using the Standard & Poor rating scale. The component units, School Boards and IDA, are pooled with the city and not separately identified.

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<u>Assets held by the Treasurer</u>	<u>Fair Value</u>	<u>Credit Rating</u>	<u>Weighted Average Maturity (Years)</u>
Local Government Investment Pool (LGIP)	\$ 102,626,898	AAAm	N/A
Money Market Mutual Funds - Underlying			
U.S. Gov. Securities	913,145	AAA	N/A
U.S. Agencies	1,011,667	A-1+	0.89
U.S. Gov. Bonds	498,063	AAA	0.89
U.S. Gov. Bonds	1,390,890	AAA	0.18
Commercial Paper	693,798	A-1	0.18
Repurchase Agreements	373,358	A-1+	N/A
Money Market Mutuals	158,749	N/A	N/A
Commonwealth Cash Reserve (AIM) - Underlying:			
U.S. Agencies	1,825,467	AAA	0.02
U.S. Treasury Bonds	246,377	N/A	0.02
Money Markets	15,287,902	AAAm	0.02
VA SNAP	30,611,085	AAAm	0.02
Total Deposits and Investments	<u>\$ 155,637,399</u>		

**Deposits of Pension Fund**

At year-end, the Pension Fund's cash and investment balances were as follows:

	<u>Investments</u>	<u>Carrying amount</u>
Investments		
Common and international stocks		
Not on securities loan		\$ 423,017,224
On securities loan - Collateralized by securities		858,660
Corporate & government bonds - not on securities loan		204,941,093
Pension fund real estate trust funds		29,450,439
Total investments		<u>\$ 658,267,416</u>
Cash and deposits		
Deposits with banks		52,256
Deposits with banks - Repurchase agreements		697,814
Investments on Pension securities loaned, collateralized by cash:		
Common and international stocks		22,523,830
Corporate and government bonds		2,862,248
Securities lending collateral - short-term investment pool		27,028,176
Pension trust fund money markets		11,919,911
Total deposits and investments		<u>\$ 723,351,651</u>

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The Pension fund's cash and investments as of June 30, 2005 are classified in the accompanying financial statements as follows:

	<u>June 30, 2005</u>
Cash and cash equivalents	\$ 750,070
Cash and cash equivalents with trustee	11,919,911
Securities lending	27,028,176
Investments	
Corporate and government bonds	207,803,341
Common stock	326,782,972
International stock	89,514,823
International emerging markets	30,101,919
Real estate	29,450,439
Total deposits and investments	<u>\$ 723,351,651</u>

***Investment Policy of the Pension Fund***

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).

**Credit Risk of Pension Fund**

The credit risk profile for the Pension Fund securities by investment type as of June 30, 2005 is as follows:

		<u>S &amp; P's Ratings as of June 30, 2005</u>				
<u>Investment Types</u>		<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>BBB</u>	<u>Not Rated</u>
Asset-backed	\$ 5,182,691	4,514,522	-	668,169	-	-
Corporate Bonds	58,641,378	2,939,366	7,566,848	46,955,428	1,179,736	-
Mortgage-backed	60,253,765	57,300,444	-	-	-	2,953,321
Mutual Funds	768,807	-	-	-	-	768,807
Real Estate Inv.	852,194	-	-	-	-	852,194
Short-Term	12,075,442	-	-	-	-	12,075,442
U.S. Agencies	21,916,047	21,916,047	-	-	-	-
Exempt from disclosure	563,661,327	-	-	-	-	563,661,327
Total	<u>\$ 723,351,651</u>	<u>86,670,379</u>	<u>7,566,848</u>	<u>47,623,597</u>	<u>1,179,736</u>	<u>580,311,091</u>

***Concentration of Credit Risk – Pension Fund***

There were no investments in any one issuer that represented 5% or more of the total Pension Fund investments.

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***Custodial Risk – Pension Fund***

The Pension Fund Custodian (State Street Bank) holds investment securities in the Pension's name. Accordingly, the fund is not exposed to custodial credit risk.

***Foreign Currency Risk – Pension Fund***

The Pension Fund does not have a formal policy to limit foreign currency risk. Risk of loss arises from changes in currency exchange rates. The Pension Fund's exposure to foreign currency risk is as follows:

<u>Investment</u>	<u>Currency</u>	<u>Fair Value</u>
Cash equivalent	Brazilian Real	\$ 13,591
Common stock	Canadian dollar	100,368
Common stock	Euro currency	10,035,895
Cash equivalent	Euro currency	2,921
Common stock	Japanese yen	4,570,436
Cash equivalent	Japanese yen	35,816
Common stock	New Zealand dollar	310,077
Common stock	Pound sterling	4,223,437
Common stock	Singapore dollar	564,726
Rights	Singapore dollar	22,936
Common stock	Swiss franc	1,700,241
Total		<u>\$21,580,444</u>

State statutes do not prohibit the Pension 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.

**CITY OF NEWPORT NEWS, VIRGINIA**

Notes to Basic Financial Statements

June 30, 2005

(v) Income Assignment: No income from one fund was assigned to another fund by State Street during the fiscal year.

During fiscal year 2005, 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 102% of the market value of the loaned securities.

The Board did not impose any restrictions during the fiscal year on the amount of the loans that State Street made on its behalf. 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 in a commingled investment pool. The average duration of such investment pool as of June 30, 2005, was 25 days and an average weighted maturity of 174 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, 2005, 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, 2005, were \$17,028,176 and \$26,244,738, respectively. The collateral includes securities totaling \$885,660 that cannot be pledged or sold unless the borrower defaults.

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2005

**(3) Accounts Receivable**

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

	<b>Governmental activities</b>	<b>Business-type activities</b>
Taxes receivable:		
Real Estate	\$ 4,105,413	-
Personal Property	6,271,442	-
Total taxes receivable, net	10,376,855	-
Accounts receivable	8,176,810	9,062,430
Total receivables, net	\$ 18,553,665	9,062,430

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:

	<b>General</b>	<b>Public Utility</b>	<b>Fiduciary Funds</b>	<b>Nonmajor Funds</b>	<b>Total</b>
Receivables:					
Taxes	\$ 15,195,795	-	-	-	15,195,795
Accounts	6,339,358	9,426,623	2,846,845	2,297,900	20,910,726
Intergovernmental:					
Federal	-	-	-	3,018,864	3,018,864
State	6,345,950	-	-	11,238,243	17,584,193
Local	-	-	-	-	-
Gross receivables	27,881,103	9,426,623	2,846,845	16,555,007	56,709,578
Less allowance for doubtful accounts	(4,818,940)	(364,193)	-	(460,448)	(5,643,581)
Net total receivables	\$ 23,062,163	9,062,430	2,846,845	16,094,559	51,065,997

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 \$0.7 million was reported in the governmental nonmajor funds. The general fund deferred revenue of \$8.1 million includes approximately \$6.3 million in property tax deferrals.

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2005

**(4) Capital Assets, Net**

Capital asset activity for the year ended June 30, 2005 was as follows:

<b>Primary</b>				<b>Government</b>
	<b>Balance**</b>			<b>Balance</b>
	<b>July 1, 2004</b>	<b>Increases</b>	<b>Decreases</b>	<b>June 30, 2005</b>
<b>Governmental activities:</b>				
Capital assets, not being depreciated:				
Land	\$ 75,445,332	28,635	-	75,473,967
Construction in progress	31,469,493	10,542,433	20,189,987	21,821,939
Total capital assets, not being depreciated	<u>106,914,825</u>	<u>10,571,068</u>	<u>20,189,987</u>	<u>97,295,906</u>
Capital assets, being depreciated:				
Buildings	254,788,485	4,446,953	-	259,235,438
Improvements	93,782,166	17,403,894	-	111,186,060
Machinery and equipment	94,259,111	7,800,521	4,611,759	97,447,873
Infrastructure	388,814,023	10,547,952	-	399,361,975
Total capital assets being depreciated	<u>831,643,785</u>	<u>40,199,320</u>	<u>4,611,759</u>	<u>867,231,346</u>
Less accumulated depreciation for:				
Buildings	57,185,431	5,280,982	-	62,466,413
Improvements	39,964,357	4,084,235	-	44,048,592
Machinery and equipment	60,956,528	5,863,468	4,489,910	62,330,086
Infrastructure	244,381,735	8,212,936	233	252,594,438
Total accumulated depreciation *	<u>402,488,051</u>	<u>23,441,621</u>	<u>4,490,143</u>	<u>421,439,529</u>
Total capital assets being depreciated, net	<u>429,155,734</u>	<u>16,757,699</u>	<u>121,616</u>	<u>445,791,817</u>
Capital assets, net	<u>\$ 536,070,559</u>	<u>27,328,767</u>	<u>20,311,603</u>	<u>543,087,723</u>

\* Increases in accumulated depreciation for Governmental Activities above include accumulated depreciation for tenancy-in-common assets transferred to the City in FY05 (\$68,686).

\*\* 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	\$ 2,760,472
Judicial Administration	410,058
Public Safety	1,895,967
Public Works	8,548,209
Health and Welfare	186,497
Education	2,817,308
Parks, Recreation and Culture	3,271,618
Community Development	718,725
Internal Service Fund	2,764,081
	<u>\$ 23,372,935</u>

**CITY OF NEWPORT NEWS, VIRGINIA**

Notes to Basic Financial Statements

June 30, 2005

Construction in progress for the City at June 30, 2005 is composed of the following project authorizations (in millions):

	<u>Project Authorization</u>	<u>Expended as of June 30, 2005</u>	<u>Balance of Authorization</u>	<u>Future Requirements</u>
General Government	\$ 38.2	4.7	33.6	11.4
Parks and Recreation	7.8	5.9	1.9	12.0
Economic Development and Urban Renewal	19.6	2.5	17.1	11.6
Public Schools	27.0	8.7	18.2	8.4
Totals	<u>\$ 92.6</u>	<u>21.8</u>	<u>70.8</u>	<u>43.4</u>

In addition, the City had commitments of approximately \$29.9 million relating to infrastructure at June 30, 2005.

	<u>Balance July 1, 2004</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2005</u>
<b>Business-type activities:</b>				
Capital assets, not being depreciated:				
Land	\$ 6,393,724	150,000	4,179	6,539,545
Construction in progress	113,516,518	8,221,843	72,388	121,665,973
Total capital assets, not being depreciated	<u>119,910,242</u>	<u>8,371,843</u>	<u>76,567</u>	<u>128,205,518</u>
Capital assets, being depreciated:				
Buildings	16,176,504	52,022	-	16,228,526
Improvements	3,532,823	-	-	3,532,823
Water system	371,163,707	5,012,234	474,128	375,701,813
Machinery and equipment	16,666,667	1,192,903	879,673	16,979,897
Total capital assets being depreciated	<u>407,539,701</u>	<u>6,257,159</u>	<u>1,353,801</u>	<u>412,443,059</u>
Less accumulated depreciation for:				
Buildings	897,590	332,044	-	1,229,634
Improvements	1,747,428	107,885	-	1,855,313
Water system	111,179,102	7,565,373	408,950	118,335,525
Machinery and equipment	10,758,645	1,513,834	849,721	11,422,758
Total accumulated depreciation	<u>124,582,765</u>	<u>9,519,136</u>	<u>1,258,671</u>	<u>132,843,230</u>
Total capital assets being depreciated, net	<u>282,956,936</u>	<u>(3,261,977)</u>	<u>95,130</u>	<u>279,599,829</u>
Capital assets, net	\$ <u>402,867,178</u>	<u>5,109,866</u>	<u>171,697</u>	<u>407,805,347</u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2005

Depreciation expense for business-type activities was charged to functions of the primary government as follows:

Water	\$	9,411,251
Parking		<u>107,885</u>
Total	\$	<u><u>9,519,136</u></u>

	<u>Balance July 1, 2004</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2005</u>
<b>Public Utility:</b>				
Capital assets, not being depreciated:				
Land	\$ 5,661,877	150,000	4,179	5,807,698
Construction in progress	<u>113,516,518</u>	<u>8,221,843</u>	<u>72,388</u>	<u>121,665,973</u>
Total capital assets, not being depreciated	<u>119,178,395</u>	<u>8,371,843</u>	<u>76,567</u>	<u>127,473,671</u>
Capital assets, being depreciated:				
Buildings	16,176,504	52,022	-	16,228,526
Improvements	371,163,707	5,012,234	474,128	375,701,813
Machinery and equipment	<u>16,635,656</u>	<u>1,192,903</u>	<u>878,556</u>	<u>16,950,003</u>
Total capital assets being depreciated	<u>403,975,867</u>	<u>6,257,159</u>	<u>1,352,684</u>	<u>408,880,342</u>
Less accumulated depreciation for:				
Buildings	861,320	332,045	-	1,193,365
Improvements	111,179,101	7,565,372	408,951	118,335,522
Machinery and equipment	<u>10,735,993</u>	<u>1,513,834</u>	<u>848,602</u>	<u>11,401,225</u>
Total accumulated depreciation	<u>122,776,414</u>	<u>9,411,251</u>	<u>1,257,553</u>	<u>130,930,112</u>
Total capital assets being depreciated, net	<u>281,199,453</u>	<u>(3,154,092)</u>	<u>95,131</u>	<u>277,950,230</u>
Capital assets, net	<u>\$ 400,377,848</u>	<u>5,217,751</u>	<u>171,698</u>	<u>405,423,901</u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2005

**Discretely Presented Component Units**

	<u>Balance</u> <u>July 1, 2004</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2005</u>
<b>Public Schools:</b>				
Capital assets, not being depreciated:				
Land	\$ 2,505,084	-	-	2,505,084
Construction in progress	4,599,316	11,459,093	15,937,258	121,151
Total capital assets, not being depreciated	<u>7,104,400</u>	<u>11,459,093</u>	<u>15,937,258</u>	<u>2,626,235</u>
Capital assets, being depreciated:				
Buildings	52,416,128	-	1,018,307	51,397,821
Improvements	11,150,069	20,729,276	1,063,328	30,816,017
Machinery and equipment	77,491,201	7,465,867	5,152,611	79,804,457
Total capital assets being depreciated	<u>141,057,398</u>	<u>28,195,143</u>	<u>7,234,246</u>	<u>162,018,295</u>
Less accumulated depreciation for:				
Buildings	21,747,360	894,476	491,945	22,149,891
Improvements	4,675,311	790,695	148,866	5,317,140
Machinery and equipment	45,099,606	7,731,916	4,854,365	47,977,157
Total accumulated depreciation	<u>71,522,277</u>	<u>9,417,087</u>	<u>5,495,176</u>	<u>75,444,188</u>
Total capital assets being depreciated, net	<u>69,535,121</u>	<u>18,778,056</u>	<u>1,739,070</u>	<u>86,574,107</u>
Capital assets, net	<u>\$ 76,639,521</u>	<u>30,237,149</u>	<u>17,676,328</u>	<u>89,200,342</u>

Depreciation of \$9,417,087 was charged to the Public School's governmental functions.

Construction in progress for the Public Schools at June 30, 2005 is composed of project authorizations of \$9,122,380, amounts expended through June 30, 2005 of \$121,151 with a remaining balance of \$9,001,229.

**CITY OF NEWPORT NEWS, VIRGINIA**

Notes to Basic Financial Statements

June 30, 2005

	<u>Balance</u> <u>July 1, 2004</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2005</u>
<b>E/IDA:</b>				
Capital assets, not being depreciated -				
Construction in progress	\$ 1,814,068	10,453,596	202,960	12,064,704
Capital assets, being depreciated:				
Buildings	100,925,613	-	1,823,483	99,102,130
Improvements	9,931,878	-	-	9,931,878
Infrastructure	1,521,049	-	-	1,521,049
Machinery and equipment	96,674	-	-	96,674
Total capital assets being depreciated	<u>112,475,214</u>	<u>-</u>	<u>1,823,483</u>	<u>110,651,731</u>
Less accumulated depreciation for:				
Buildings	8,977,671	2,209,644	120,822	11,066,493
Improvements	1,671,540	276,942	-	1,948,482
Infrastructure	-	46,645	-	46,645
Machinery and equipment	77,924	3,750	-	81,674
Total accumulated depreciation	<u>10,727,135</u>	<u>2,536,981</u>	<u>120,822</u>	<u>13,143,294</u>
Total capital assets being depreciated, net	<u>101,748,079</u>	<u>(2,536,981)</u>	<u>1,702,661</u>	<u>97,508,437</u>
Capital assets, net	\$ <u>103,562,147</u>	<u>7,916,615</u>	<u>1,905,621</u>	<u>109,573,141</u>

	<u>Balance</u> <u>July 1, 2004</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2005</u>
<b>PAC:</b>				
Capital assets, not being depreciated -				
Land	\$ 4,879,510	832,560	-	5,712,070
Construction in progress	30,985,003	8,530,586	32,178,855	7,336,734
Total capital assets not being depreciated	<u>35,864,513</u>	<u>9,363,146</u>	<u>32,178,855</u>	<u>13,048,804</u>
Capital assets, being depreciated:				
Airfield	22,831,303	30,547,078	-	53,378,381
Terminal	34,250,581	759,218	-	35,009,799
Other	3,126,081	51,486	-	3,177,567
Machinery and equipment	2,031,344	-	-	2,031,344
Total capital assets being depreciated	<u>62,239,309</u>	<u>31,357,782</u>	<u>-</u>	<u>93,597,091</u>
Less accumulated depreciation for:				
Airfield	18,908,833	2,059,177	-	20,968,010
Terminal	11,931,435	990,561	-	12,921,996
Other	2,119,638	171,291	-	2,290,929
Machinery and equipment	1,971,322	19,526	-	1,990,848
Total accumulated depreciation	<u>34,931,228</u>	<u>3,240,555</u>	<u>-</u>	<u>38,171,783</u>
Total capital assets being depreciated, net	<u>27,308,081</u>	<u>28,117,227</u>	<u>-</u>	<u>55,425,308</u>
Capital assets, net	\$ <u>63,172,594</u>	<u>36,647,813</u>	<u>32,178,855</u>	<u>68,474,112</u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2005

**(5) Interfund Receivables, Payables, and Transfers**

The composition of interfund balances as of June 30, 2005, is as follows:

Due to / from other funds:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General fund	Nonmajor Gov. fund: Community Dev.	\$ 21,213
General fund	Nonmajor Gov. fund: Street Maintenance	2,919,849
General fund	Nonmajor Gov. fund: Comprehensive Services Act	2,499,719
General fund	Nonmajor Gov. fund: Other Federal & State	5,217,607
General fund	Debt Service	5,904,094
		<u>\$ 16,562,482</u>

All interfund balances resulted from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur and (2) payments between funds are made.

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	\$ 17,407,180
Newport News Public Schools	City of Newport News	104,201

The IDA Payable of \$17,407,180 represents the outstanding balance of the City's financing of the Applied Research Center (ARC). The repayment includes interest at 3.729%. Annual payments represent net revenues from the ARC.

Individual fund interfund transfers for the primary government at June 30, 2005 are as follows:

	<u>Transfers to Other Funds</u>	<u>Transfers From Other Funds</u>
	<u>Operating</u>	<u>Operating</u>
General Fund	\$ 30,230,988	9,134,000
Debt Service Fund	-	30,275,043
Nonmajor governmental funds	5,234,353	5,190,298
Public Utility	9,134,000	-
Total interfund transfers	<u>\$ 44,599,341</u>	<u>44,599,341</u>

Transfers are used when another governmental fund is required, legally or through budgetary design to provide resources for the payment of current debt requirements. One fund is responsible for the initial receipt of funds and another fund is authorized to use the resources to finance its operating expenditures or expenses. Transfer from the Public Utility Fund to the General Fund is used to finance general governmental expenditures.

**CITY OF NEWPORT NEWS, VIRGINIA**

Notes to Basic Financial Statements

June 30, 2005

**(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, 2005 were as follows:

Year ending June 30:	
2006	\$ 93,996
2007	93,996
2008	93,996
2009	<u>54,811</u>
Total	\$336,799
Less Interest	<u>44,010</u>
Total Lease Payments	<u>\$292,789</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>(2,071,892)</u>
Net assets acquired through capital leases	<u>\$ 3,775,618</u>

**CITY OF NEWPORT NEWS, VIRGINIA**

Notes to Basic Financial Statements

June 30, 2005

The future minimum lease obligations and the net present value of these minimum lease payments as of June 30, 2005, were as follows:

Years ending June 30:		
2006	\$	1,168,888
2007		1,163,847
2008		450,138
2009		418,970
2010		124,811
2011 - 2015		548,368
2016 - 2020		401,285
Total minimum lease payments	\$	<u>4,276,307</u>
Less amounts representing interest		<u>(750,586)</u>
Present value of minimum capital lease payments	\$	<u><u>3,525,721</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:

	<u>Newport News Public Schools</u>	<u>Economic and Industrial Development Authorities</u>	<u>Peninsula Airport Commission</u>
Years ending June 30:			
2006	\$ 223,776	347,903	23,281
2007	230,489	360,213	21,627
2008	237,404	360,980	19,908
2009	244,526	361,755	19,908
2010	251,862	362,537	11,613
2011-2015	—	572,579	—
	\$ <u>1,188,057</u>	<u>2,365,967</u>	<u>96,337</u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2005

**(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	\$	2,652,960
Buildings		86,636,389
Less accumulated depreciation		<u>(10,754,847)</u>
Net investment in property held for lease	\$	<u><u>78,534,502</u></u>

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

Minimum future rental income on operating leases as of June 30, 2005 is as follows:

	<b>E/IDA</b>	<b>PAC</b>
Year ending June 30:		
2006	\$ 7,546,539	1,769,710
2007	7,207,920	1,739,846
2008	6,267,224	1,754,104
2009	6,387,395	1,809,332
2010	6,163,697	1,856,795
2011-2015	29,528,893	—
2016-2020	21,201,006	—
2021-2025	7,243,524	—
2026-2030	<u>4,904,238</u>	<u>—</u>
Total	<u><u>\$ 96,450,436</u></u>	<u><u>8,929,787</u></u>

Rental income on operating leases for year ended 2005 was \$7,025,739 and 1,582,712 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, 2005:

**CITY OF NEWPORT NEWS, VIRGINIA**  
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Minimum lease payments to be received	\$ 25,552,401
Less unearned income	<u>(4,933,435)</u>
Net investment in direct financing leases	<u>\$ 20,618,966</u>

Minimum future rental income on these direct financing leases as of June 30, 2005 are as follows:

Year ending June 30:	
2006	\$ 3,399,397
2007	2,139,397
2008	2,139,397
2009	2,139,397
2010	2,139,397
2011-2015	10,696,985
2016-2020	<u>2,898,431</u>
Total	<u>\$ 25,552,401</u>

**(7) Long-Term Liabilities**

- (a) A summary of changes in long-term liabilities for governmental activities for the year ended June 30, 2005 follows:

	<u>Balance</u> <u>July 1, 2004</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2005</u>	<u>Due within</u> <u>one year</u>
Bonds payable:					
General obligation bonds	\$ 399,243,847	45,066,111	(49,956,413)	394,353,545	30,490,298
Deferred amounts:					
Add bonds premiums	15,616,376	1,109,184	(1,720,920)	15,004,640	1,744,028
Net loss on refunded bonds	(10,021,258)	(756,701)	1,093,053	(9,684,906)	(1,115,125)
Total bonds payable	<u>404,838,965</u>	<u>45,418,594</u>	<u>(50,584,280)</u>	<u>399,673,279</u>	<u>31,119,201</u>
Literary loan bonds	4,233,331	—	(669,249)	3,564,082	669,249
Capital leases payable	360,896	—	(68,107)	292,789	73,644
Land lease payable	2,440,467	—	(127,861)	2,312,606	135,747
Landfill liability	6,662,000	—	(161,000)	6,501,000	169,000
Accrued vacation	17,845,949	10,946,054	(10,256,668)	18,535,335	10,639,282
Net pension obligation	10,453,000	35,421,000	(13,629,000)	32,245,000	—
Workers' compensation and other claims	10,812,108	3,842,704	(3,035,884)	11,618,928	2,100,000
Incurred but not reported claims	2,995,000	23,243,851	(23,438,851)	2,800,000	2,800,000
Total long-term liabilities	<u>\$ 460,641,716</u>	<u>118,872,203</u>	<u>(101,970,900)</u>	<u>477,543,019</u>	<u>47,706,123</u>

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

General obligation bonds of \$36.4 million are authorized but unissued.

**CITY OF NEWPORT NEWS, VIRGINIA**

Notes to Basic Financial Statements

June 30, 2005

In December 2004, the City issued \$29,170,000 of general improvement bonds Series 04D with a true interest cost of 5.0%. The net proceeds of \$30,299,976 (after an original issue premium of \$1,109,184 and payment of \$279,184 for underwriting fees and other issuance costs) were used for various capital projects.

In February 2005, the City issued \$12,720,000 of general improvement refunding bonds Series 05A with a true interest rate of 5.0% to refund a portion of the 1996B issue with an interest rate of 6.9%. The net proceeds of \$12,758,786 (after a payment of \$178,299 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, 2005, \$295,000 remain outstanding. The reacquisition price was greater than the net carrying amount of the old debt by \$45,000. 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 loss of \$756,701. This issuance resulted in a cash flow savings from fiscal years 2005 through 2015 totaling \$1,360,570.

At June 30, 2005, approximately \$89.0 million of general obligation bonds are considered defeased because refunding trusts have been 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 \$6.5 million liability at June 30, 2005 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 2005. 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, 2005

Outstanding general obligation bonds at June 30, 2005, of the Primary Government governmental activities are comprised of the following issues:

<b>G.O. Bond Series</b>	<b>Bond Date</b>	<b>Final Maturity Date</b>	<b>Effective Interest Rate (At Issue)</b>	<b>Balance June 30, 2005</b>
VPSA 91	07/15/91	07/15/11	6.4%	\$ 1,645,335
Series 93B	04/01/93	11/01/05	5.4%	-
Series 93C	07/15/93	06/01/12	5.0%	90,000
Series 93E	11/15/93	01/01/14	5.1%	2,535,000
VRA 93D	09/17/93	06/01/15	4.5%	544,205
VRA 94A	06/02/94	01/01/16	4.5%	2,724,779
VMPL 95A	05/25/95	07/15/04	4.2%	-
Series 95A	06/15/95	07/01/06	5.5%	4,810,000
VMPL 95C	09/28/95	07/15/14	4.3%	5,912,565
VPSA 95C	12/01/95	07/15/15	5.2%	3,535,601
Series 96A	01/15/96	01/15/07	5.2%	1,160,000
Series 96B	01/15/96	01/15/25	6.9%	295,000
VRA 96C	01/24/96	10/01/16	4.8%	2,000,346
Series 96D	12/01/96	01/15/08	5.4%	3,905,000
VRA 97A	01/30/97	10/01/17	4.8%	2,056,279
VRA 98A	01/22/98	10/01/17	4.8%	1,661,485
Series 98A	03/01/98	03/01/18	4.0%	28,065,000
Series 98C	12/01/98	12/01/09	4.2%	2,575,000
Series 99A	04/01/99	07/01/07	4.1%	7,330,000
VRA 99A	03/09/99	12/01/19	4.3%	2,207,312
Series 99B	03/01/99	03/01/19	4.6%	19,600,000
VRA 00A	03/01/00	03/01/21	3.5%	2,374,592
Series 00A	05/01/00	05/01/10	5.6%	6,405,000
VPSA 00B	11/16/00	07/15/21	5.2%	4,819,149
VRA 01A	04/24/01	05/01/22	4.1%	1,909,653
Series 01A	09/15/01	09/15/21	4.3%	21,250,000
Series 01B	09/15/01	09/15/04	4.3%	-
VRA 02A	05/15/02	01/01/23	3.8%	2,520,599
Series 02A	09/26/02	07/01/22	3.5%	25,200,000
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%	25,650,000
VRA 03A	06/24/03	06/01/24	3.5%	2,970,689
Series 03C	07/15/03	11/01/09	5.0%	29,640,000
QZAB 03A	12/31/03	12/28/18	3.5%	1,090,819
QZAB 03B	12/31/03	12/28/18	3.5%	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%	30,455,000
Series 04C	03/01/04	05/01/20	5.0%	10,130,000
VRA 04A	06/30/04	09/01/25	3.5%	1,698,462
Series 04D	12/01/04	12/01/24	5.0%	29,170,000
Series 05A	02/01/05	01/15/15	4.0%	12,720,000
<b>Totals</b>				<b>\$ 394,353,545</b>

**CITY OF NEWPORT NEWS, VIRGINIA**

Notes to Basic Financial Statements

June 30, 2005

Outstanding literary loans at June 30, 2005, of the Primary Government governmental activities are comprised of the following issues:

<b>Project</b>	<b>Bond Date</b>	<b>Final Maturity Date</b>	<b>Effective Interest Rate (at issue)</b>	<b>Balance June 30, 2005</b>
Greenwood Elementary	12/01/86	12/01/06	3%	\$ 200,000
Menchville High	12/15/86	12/15/06	3%	96,000
New Horizons Tech	07/01/87	07/01/07	3%	150,000
Watkins Elementary	07/01/89	07/01/09	3%	500,000
Ferguson High	03/01/90	03/01/10	4%	250,000
Huntington Middle	03/01/90	03/01/10	4%	177,500
Hidenwood Elementary	04/01/90	04/01/10	4%	50,000
Denbigh High	10/01/89	10/01/09	3%	401,962
Gildersleeve Middle	03/01/91	03/01/11	3%	600,000
Warwick High	09/01/99	09/01/19	2%	138,000
Washington Middle	09/15/00	09/15/06	2%	15,000
Menchville High-2	10/01/00	10/01/20	2%	200,000
Denbigh High-2	08/01/01	08/01/21	2%	208,517
Crittenden Middle	08/15/01	08/15/06	2%	30,000
Gildersleeve Middle-2	08/15/01	08/15/21	2%	106,250
Dozier Middle	08/15/01	08/15/21	2%	106,250
Reservoir Middle	05/1/02	05/1/22	2%	106,250
Hines Middle	05/1/02	05/1/22	2%	106,250
Huntington Middle-2	09/1/02	09/1/22	2%	122,103
Totals				\$ <u><u>3,564,082</u></u>

The following table summarizes future debt service requirements as of June 30, 2005:

Fiscal year ending June 30:	General Obligation Bonds		Literary Loans	
	Principal	Interest	Principal	Interest
2006	\$ 30,490,298	18,264,099	\$ 669,249	100,311
2007	32,275,636	17,014,822	654,249	80,236
2008	33,400,761	15,834,878	491,249	60,462
2009	34,515,090	14,299,882	441,249	45,426
2010	28,838,860	12,580,054	443,211	31,891
2011 - 2015	125,101,277	42,557,959	428,745	66,338
2016 - 2020	77,643,771	15,809,742	328,750	30,462
2021 - 2025	27,622,852	3,865,615	107,380	3,300
2026	4,465,000	1,667	-	-
Total future debt service	\$ <u><u>394,353,545</u></u>	<u><u>140,228,718</u></u>	\$ <u><u>3,564,082</u></u>	<u><u>418,426</u></u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2005

**Business-Type Activities**

A summary of changes in long-term liabilities for business-type activities for the year ended June 30, 2005 follows:

	<b>Balance</b>			<b>Balance</b>	<b>Due within</b>
	<b>July 1, 2004</b>	<b>Additions</b>	<b>Reductions</b>	<b>June 30, 2005</b>	<b>one year</b>
Bonds payable:					
General obligation bonds	\$ 178,025,000	—	12,805,000	165,220,000	13,320,000
Deferred amounts:					
Add bond premiums	7,618,216	—	597,018	7,021,198	149,943
	<u>185,643,216</u>	<u>—</u>	<u>13,402,018</u>	<u>172,241,198</u>	<u>13,469,943</u>
Total bonds payable	\$ 185,643,216	—	13,402,018	172,241,198	13,469,943

Outstanding public utility bonds at June 30, 2005 are comprised of the following issues:

<b>Public Utility</b>	<b>Issue</b>	<b>Final Maturity</b>	<b>Interest Rate</b>	<b>Balance</b>
<b>Bond Series</b>	<b>Date</b>	<b>Date</b>	<b>(At Issue)</b>	<b>June 30, 2005</b>
Series 93B	04/15/93	11/01/08	5.4%	\$ —
Series 93E	11/15/93	01/01/14	5.1%	955,000
Series 96E	12/01/96	01/15/17	5.4%	3,905,000
Series 98B	03/01/98	03/01/12	4.0%	15,320,000
Series 99A	04/01/99	07/01/07	4.5%	3,545,000
Series 99B	03/01/99	03/01/19	4.7%	22,060,000
Series 00A	05/01/00	05/01/20	5.6%	6,150,000
Series 01C	08/15/01	08/15/21	4.3%	31,870,000
Series 02A	09/26/02	07/01/22	4.3%	20,240,000
Series 02B	09/26/02	07/01/16	3.5%	9,905,000
Series 03B	06/03/03	06/30/24	4.1%	9,245,000
Series 03C	07/15/03	11/01/08	2.3%	5,750,000
Series 04B	06/05/03	01/15/18	3.6%	16,210,000
Series 04C	06/06/03	05/01/20	3.9%	20,065,000
<b>Totals</b>				<b>\$ 165,220,000</b>

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

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2005

The following table summarizes future debt service requirements of Business-type Activities as of June 30, 2005.

	<b>Business-type Activities</b>	
	<b>Public Utilities</b>	
	<b>Principal</b>	<b>Interest</b>
Fiscal year ending June 30:		
2006	\$ 13,320,000	7,529,079
2007	9,995,000	6,978,342
2008	11,065,000	6,532,831
2009	10,345,000	6,062,061
2010	10,480,000	5,607,149
2011-2015	52,460,000	20,782,158
2016-2020	44,915,000	8,722,363
2021-2024	12,640,000	865,754
Totals	<u>\$ 165,220,000</u>	<u>63,079,737</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, 2005 follows:

	<b>Balance</b>			<b>Balance</b>	<b>Due within</b>
	<b>July 1, 2004</b>	<b>Additions</b>	<b>Reductions</b>	<b>June 30, 2005</b>	<b>one year</b>
Compensated absences	\$ 3,594,015	2,012,468	1,971,980	3,634,503	181,725
Workers' compensation claims	1,679,218	619,239	712,190	1,586,267	222,198
Capital leases payable	4,280,611	—	754,890	3,525,721	991,991
Capital facilities notes payable	9,006,249	3,648,791	12,655,040	—	—
Network wiring notes payable	—	10,847,560	10,847,560	—	—
Capital facilities notes payable	—	22,792,600	—	22,792,600	1,672,419
Incurred but not reported claims	2,017,000	21,051,652	21,042,852	2,025,800	2,025,800
Totals	<u>\$ 20,577,093</u>	<u>60,972,310</u>	<u>47,984,512</u>	<u>33,564,891</u>	<u>5,094,133</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, 2005

**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 \$45 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, 2005 are comprised of the following:

	<u>Issue date</u>	<u>Maturity date</u>	<u>Effective interest rates</u>	<u>Balance July 1, 2004</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2005</u>	<u>Amount due within one year</u>
Bonds payable:								
UPS, 04	06/04/04	07/01/15	5.58%	8,003,755	—	581,167	7,422,588	568,424
MCI, 95A*	12/28/95	04/01/06	6.35%	786,325	—	439,828	346,497	346,498
MCI, 95B*	12/28/95	04/01/06	6.65%	15,152	—	8,438	6,714	6,714
OPTON*	03/01/96	08/01/16	6.15%	1,941,735	—	109,858	1,831,877	116,802
EDA-NNS, 96*	03/22/96	07/15/06	7.00%	2,343,491	—	1,079,474	1,264,017	1,159,741
ICELAND*	04/10/97	10/01/17	4.10%	7,546,667	—	400,000	7,146,667	400,000
CTII, 97A*	04/29/97	08/01/22	7.28%	3,868,071	—	107,144	3,760,927	115,273
CTII, 97B*	04/29/97	08/01/22	6.20%	855,508	—	26,480	829,028	28,182
SEARS*	03/01/98	10/01/18	6.48%	11,070,125	—	485,784	10,584,341	518,679
VSS*	03/01/98	10/01/18	6.48%	10,043,128	—	440,717	9,602,411	470,560
Coats and Clarke	01/01/99	12/01/18	4.24%	1,469,407	—	97,961	1,371,446	97,961
Hidewood Center	03/30/00	04/01/20	8.78%	1,147,455	—	75,972	1,071,483	73,366
Downtown Engineering	04/05/00	07/01/31	7.64%	27,440,000	—	1,060,000	26,380,000	1,060,000
VASCIC	07/27/00	09/30/10	4.54%	30,845,000	—	3,745,000	27,100,000	3,940,000
OPTIC Merchant's Walk	08/24/01	08/01/26	4.52%	12,600,000	—	300,000	12,300,000	560,000
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%	690,137	—	366,667	323,470	323,470
PrintPack	08/15/03	09/01/18	3.61%	5,100,000	—	360,000	4,740,000	360,000
City Ops Center	12/07/04	07/01/26	4.63%	—	2,160,000	—	2,160,000	—
Conf Center	12/07/04	07/01/31	4.63%	—	29,335,000	—	29,335,000	—
Totals				<u>130,282,794</u>	<u>31,495,000</u>	<u>9,684,490</u>	<u>152,093,304</u>	<u>10,145,670</u>
Notes payable:								
Police Headquarters	02/01/03	01/31/05		<u>1,500,000</u>	<u>—</u>	<u>1,500,000</u>	<u>—</u>	<u>—</u>
Total bonds and notes payable				<u>\$ 131,782,794</u>	<u>31,495,000</u>	<u>11,184,490</u>	<u>152,093,304</u>	<u>10,145,670</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, 2005

*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, 2005, there are 16 series of the Bonds outstanding, with an aggregate principal amount payable of approximately \$42 million. Approximately \$2.3 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.

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2005

The PAC Airport Improvement Revenue Bonds at June 30, 2005, are comprised of the following:

Series	Issue Date	Maturity Date	Eff. Int. Rate (%)	Balance July 1, 2004	Reductions	Balance June 30, 2005
2001	04/15/01	07/16/21	5.05-5.5	\$ 6,245,000	215,000	6,030,000
2002	07/03/02	07/01/27	4.5	2,386,235	60,954	2,325,281
Totals				<u>\$ 8,631,235</u>	<u>275,954</u>	<u>8,355,281</u>

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

	<u>E/IDA</u>		<u>PAC</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
Fiscal year ending June 30:				
2006	\$ 10,145,669	6,780,917	293,728	402,636
2007	8,741,370	6,450,342	301,628	387,995
2008	11,126,555	6,162,354	319,660	372,717
2009	19,342,207	5,452,683	332,830	356,669
2010	11,568,525	5,094,283	351,144	356,382
2011-2015	41,710,616	19,830,164	2,060,959	1,497,806
2016-2020	24,065,881	11,422,554	2,669,601	915,093
2021-2025	13,322,484	6,161,133	1,710,318	229,205
2026-2030	6,615,000	2,405,606	315,413	17,872
2031-2032	5,455,000	428,093	—	—
Total	<u>\$ 152,093,307</u>	<u>70,188,129</u>	<u>8,355,281</u>	<u>4,536,375</u>

**CITY OF NEWPORT NEWS, VIRGINIA**  
Notes to Basic Financial Statements  
June 30, 2005

**(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, 2005, the total payroll of the City was approximately \$304.5 million, with approximately \$284.6 million covered by NNERF. At June 30, 2005, 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	657	567	1,829	630	3,683
City police and fire	441	183	892	269	1,785
Public utilities	154	100	353	68	675
School VRS	1,540	654	3,503	1,514	7,211
School Non-VRS	551	93	1,081	447	2,172
Total	<u>3,343</u>	<u>1,597</u>	<u>7,658</u>	<u>2,928</u>	<u>15,526</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. The amortization period for the unfunded actuarial accrued liability has been reduced from 40 years to 30 years to comply with the requirements of GASB Statement No. 27.

Contributions for normal costs totaling \$13,628,798 were made by the employer during the year ended June 30, 2005. The percentage of employer contributions to current year covered payroll was 1.28 for employees covered by VRS and 3.51 for all others.

The percentage of normal cost to current year covered payroll was 4.8%. The employer's annual pension cost and net pension obligation to NNERF for 2005 were as follows:

(000's Omitted)

Annual Required Contribution (ARC)	\$	35,462
Interest on net pension obligation		836
Adjustment to ARC		(877)
Annual pension cost		35,421
Contributions made		(13,629)
Increase in net pension obligation		21,792
Net pension obligation (asset), beginning of year		10,453
Net pension obligation (asset), end of year	\$	32,245

The annual required contribution for the current year was determined as part of the June 30, 2004 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 5.25% per year and (c) 3.0% per year cost-of-living adjustments. All assumptions include an inflation component of 3.0%. The assumptions did not include funding of post-retirement benefit. Actuarial assumptions have been changed to reflect the actuarial experience analysis for the period July 1, 1998 to June 30, 2003. The actuarial value of assets was determined under the average value method.

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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, 2005	\$ 35,421	38.4%	\$ 32,245
June 30, 2004	27,846	44.1%	\$ 10,453
June 30, 2003	15,920	73.2%	(5,141)

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

**1. Plan Description**

The NNS 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 NNS 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 2005 were 11.03% and 5.0% of covered annual payroll for the NNS and the PAC, respectively.

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**3. Annual Pension Cost**

For 2005, the annual pension cost of \$15,805,364 and \$78,575 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, 2004 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	06/30/05	\$ 15,805,364	100.0%	-
	06/30/04	12,204,566	100.0%	-
	06/30/03	11,629,435	100.0%	-
PAC	06/30/05	78,575	100.0%	-
	06/30/04	15,097	100.0%	-
	06/30/03	14,398	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 3,343 retirees for fiscal year 2005 were: health \$7,588,973 (858 participating); dental \$293,621 (901 participating); and life \$1,164,389 (1,112 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 2,091 retirees for fiscal year 2005 were: health and dental \$4,165,348 (1,836 participating), and life \$71,481 (303 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 (\$22,606,109 for 2005). 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 2003, 2004 or 2005. 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, 2005 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, 2005 and 2004 for the City and the Public Schools were as follows:

	City		Public Schools	
	2005	2004	2005	2004
Claims payable at beginning of year	\$ 2,995,000	2,591,000	2,017,000	2,000,000
Claims and changes in estimates	23,243,851	22,930,824	21,051,652	17,979,068
Claim payments	(23,438,851)	(22,526,824)	(21,042,852)	(17,962,068)
Claims payable at end of year	\$ <u>2,800,000</u>	<u>2,995,000</u>	<u>2,025,800</u>	<u>2,017,000</u>

**(b) Workers' Compensation**

The City and the School Board self-insure for workers' compensation through the respective General Funds up to \$1,000,000 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, 2005 are accounted for in the long-term liabilities. The following is a reconciliation of changes in workers' compensation claims payable for years ended June 30, 2005 and 2004 for the City and the Public Schools.

	City		Public Schools	
	2005	2004	2005	2004
Claims payable at beginning of year	\$ 7,961,049	9,209,415	1,679,218	1,228,414
Claims and changes in estimates	4,167,246	1,165,050	619,239	1,451,291
Claim payments	(3,035,884)	(2,413,416)	(712,190)	(1,000,487)
Claims payable at end of year	\$ <u>9,092,411</u>	<u>7,961,049</u>	<u>1,586,267</u>	<u>1,679,218</u>

A loss analysis was conducted by Mercer Oliver Wyman on this fund. The total actuarially computed liability as of June 30, 2005 for the City and School Board was determined to be approximately \$7.8 million and \$1.6 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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	City	
	2005	2004
Claims payable at beginning of year	\$ 2,851,059	2,414,826
Claims and changes in estimates	372,403	953,699
Claim payments	(696,945)	(517,466)
Claims payable at end of year	\$ 2,526,517	2,851,059

**(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, 2005, will not be material to the financial statements.

**(c) Regional Raw Water Project**

As of June 30, 2005, the City's Public Utility has incurred cumulative costs of approximately \$28.8 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, 2005, the necessary federal permit had not been obtained. On November 16, 2005, the U.S. Army Corps of Engineers issued the long awaited Federal permit. This was the final permit needed to begin implementing the project to create a 12 billion gallon reservoir in King William County to store water withdrawn from the Mattaponi River. Completion of this project in 2018 will add 20 million gallons per day to the water supply of the Peninsula.

**(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, VA 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.

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Separate financial statements are available from the Hampton Roads Regional Jail Authority, 2690 Elmhurst Lane, Portsmouth, Virginia 23701-2745.

**(12) Prior Period Adjustments**

The net assets of the Primary Government at the beginning of FY 2005 have been restated to correct for misclassifications and incorrect valuations identified in the prior period balances. The net asset amount was increased by \$2.06 million as follows:

	<u>Balance</u> <u>June 30, 2004</u>	<u>Adjustment</u>	<u>Restated Balance</u> <u>June 30, 2004</u>
<b>Governmental activities:</b>			
Capital assets, not being depreciated:			
Land	\$ 74,856,232	589,100	75,445,332
Construction in progress	<u>31,469,493</u>	<u>-</u>	<u>31,469,493</u>
Total capital assets, not being depreciated	<u>106,325,725</u>	<u>589,100</u>	<u>106,914,825</u>
Capital assets, being depreciated:			
Buildings	254,788,485	-	254,788,485
Improvements	93,782,166	-	93,782,166
Machinery and equipment	91,518,686	2,740,425	94,259,111
Infrastructure	<u>388,814,023</u>	<u>-</u>	<u>388,814,023</u>
Total capital assets being depreciated	<u>828,903,360</u>	<u>2,740,425</u>	<u>831,643,785</u>
Less accumulated depreciation for:			
Buildings	57,185,431	-	57,185,431
Improvements	39,964,357	-	39,964,357
Machinery and equipment	59,689,161	1,267,367	60,956,528
Infrastructure	<u>244,381,735</u>	<u>-</u>	<u>244,381,735</u>
Total accumulated depreciation	<u>401,220,684</u>	<u>1,267,367</u>	<u>402,488,051</u>
Total capital assets being depreciated, net	<u>427,682,676</u>	<u>1,473,058</u>	<u>429,155,734</u>
Capital assets, net	<u>\$ 534,008,401</u>	<u>2,062,158</u>	<u>536,070,559</u>

The net assets of the Primary Government's governmental activities at the beginning of FY 2005 have also been restated to reflect a capital lease obligation associated with the purchase of a parcel of land. The capital lease obligation was not previously reflected in the governmental activities of the Primary Government. The following is a summary of the above prior period adjustments' effect on beginning assets:

Governmental activities net assets, July 1, 2004, as previously stated	\$195,681,706
Net adjustment:	
Reclassification and revaluations of capital assets	2,062,158
Omission of capital lease obligation	<u>(2,440,467)</u>
Governmental activities net assets, July 1, 2004, as adjusted	<u>\$195,303,397</u>

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**E/IDA Prior Period Adjustment:**

In accordance with generally accepted accounting principles (GAAP), the recognition of profit on real estate sales transactions must not be recognized in full until certain criteria is met. One of these criteria is a sale must be consummated and all consideration must be exchanged. The revenue from the sale of land to Wolsey PLC/Ferguson Enterprises was recognized and a note receivable was set up in 1998 when an agreement was reached, however, all consideration had not been exchanged. In 2005, the actual transaction occurred and the sale was consummated. Management has elected to restate the Authorities' net assets in prior fiscal years and recognized the revenue in 2005 in accordance with GAAP.

The adjustment to the Authorities' net assets at the beginning of fiscal year 2005 is as follows:

Net assets, July 1, 2004, as previously stated	\$ 31,363,297
Net adjustment removing note receivable	<u>(540,000)</u>
Net assets, July 1, 2004, as adjusted	<u><u>\$ 30,823,297</u></u>

**(13) Subsequent Events**

On August 24, 2005, the City received a loan of \$3,400,000 from the Virginia Water Facilities Revolving Fund. This loan will be paid for over twenty years at an annual interest rate of 3.0%. The loan will be used to finance the replacement and rehabilitation of sanitary sewers and related improvements throughout the City.