

CITY OF NEWPORT NEWS, VIRGINIA

Notes to Basic Financial Statements

June 30, 2006

(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, sewer and water 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 four early childhood centers, 27 elementary, seven 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. The City approves PAC's budget and appoints four of their six board members. 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

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considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period, usually within 30-45 days after year-end. Expenditures, other than interest on long-term debt which is recorded when due, are recorded when the related fund liability is incurred.

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

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

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

The City reports the following major governmental funds:

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

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

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

The City reports the following major proprietary fund:

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

Additionally, the City reports the following fund types:

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

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

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

Nonmajor governmental funds:

Special Revenue Funds account for revenues and expenditures related to programs that are restricted in nature for specific purposes. Examples include 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 2006 was \$1.24 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, less an allowance for uncollectible amounts and taxes not collected within 45 days after year-end. The 2006 tax rates per \$100 of assessed value were:

Mobile homes	\$1.24
Trawlers	\$0.90
Pleasure boats	\$1.00
Machinery & Tools	\$3.50
Motor Vehicles	\$4.25

(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, 2006, is composed of the following:

General Fund –

Taxes receivable:

Real Estate	\$	509,217
Personal Property		<u>4,804,479</u>
Total Taxes	\$	<u>5,313,696</u>

Special Revenue Funds –

Accounts receivable	\$	<u>486,460</u>
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(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.

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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 \$2,238,820 was capitalized during fiscal year 2006.

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, 2006, the City holds capital assets related to school property with a net book value of \$126,016,135.

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

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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 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.

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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:

<u>Investments</u>	<u>Carrying amount</u>
Cash and deposits:	
Cash on hand	\$ 63,448
Deposits with banks	11,786,102
Total cash and deposits	<u>11,849,550</u>
Investments:	
Local Government Investment Pool (LGIP)	116,089,352
Deposits with banks - Money market accounts	8,231,393
Deposits with banks - Repurchase agreements	4,264,149
Peninsula Airport Commission - Time Deposits	1,138,813
Commonwealth cash reserve	12,594,247
VA SNAP	28,897,914
Common Stock - IDA	22,594
IDA escrow funds	45,841,891
Total deposits and investments	<u>\$ 228,929,903</u>

Cash and investments as of June 30, 2006 are classified in the accompanying financial statements as follows:

<u>Statements of net assets:</u>	<u>June 30, 2006</u>
Primary Government:	
Cash and cash equivalents	\$ 100,042,899
Restricted cash	36,395,284
Component Units:	
Cash and cash equivalents	28,162,145
Restricted cash	62,816,809
Fiduciary Funds (page 23):	
Cash and cash equivalents - Agency Funds	1,512,766
Total cash and investments	<u>\$ 228,929,903</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 .

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.

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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, 2006, 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, 2006, 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.

<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)	\$ 116,089,352	AAAm	N/A
Money Market Mutual Funds - Underlying			
U. S. Agencies	1,186,937	AAA	0.31
U.S. Gov. Bonds	401,037	AAA	0.31
U.S. Gov. Bonds	1,077,593	AAA	0.33
Commercial Paper	705,051	A-1+	0.31
Commercial Paper	689,471	A-1	0.33
Repurchase Agreements	787,091	A-1+	0.33
Money Market Mutuals	383,105	N/A	N/A
Commonwealth Cash Reserve (AIM) - Underlying:			
U.S. Agencies	1,747,918	AAA	0.06
U.S. Agencies	930,232	A-1+	0.06
Money Markets	9,916,097	AAAm	0.06
VA SNAP	28,897,914	AAAm	0.06
Total Deposits and Investments	<u>\$ 162,811,798</u>		

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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		\$ 424,660,510
Corporate & government bonds - not on securities loan		184,984,424
Pension fund real estate trust funds		<u>37,059,400</u>
Total investments		<u>\$ 646,704,334</u>
Cash and deposits		
Deposits with banks		(751,810)
Deposits with banks - Repurchase agreements		1,752,996
Investments on Pension securities loaned, collateralized by cash:		
Common and international stocks		60,050,066
Corporate and government bonds		17,575,538
Securities lending collateral - short-term investment pool		78,618,934
Pension trust fund money markets		<u>16,759,122</u>
Total deposits and investments		<u>\$ 820,709,180</u>

The Pension fund's cash and investments as of June 30, 2006 are classified in the accompanying financial statements as follows:

	<u>Pension</u>	<u>June 30, 2006</u>
Cash and cash equivalents		\$ 1,001,186
Cash and cash equivalents with trustee		16,759,122
Securities lending		78,618,934
Investments		
Corporate and government bonds		202,559,962
Common stock		355,095,658
International stock		99,034,471
International emerging markets		30,580,447
Real estate		<u>37,059,400</u>
Total deposits and investments		<u>\$ 820,709,180</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).

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Credit Risk of Pension Fund

The credit risk profile for the Pension Fund securities by investment type as of June 30, 2006 is as follows:

S & P's Ratings as of June 30, 2006

<u>Investment Types</u>		<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>BBB</u>	<u>Not Rated</u>
Asset-backed	\$ 1,774,008	1,187,712	-	586,296	-	-
Corporate Bonds	47,163,585	2,989,199	10,907,215	32,461,684	805,487	-
Mortgage-backed	62,035,479	60,590,925	-	-	-	1,444,554
Mutual Funds	113,637,621	-	-	-	-	113,637,621
Real Estate Inv.	739,927	-	-	-	-	739,927
Short-Term	17,719,707	-	-	-	-	17,719,707
U.S. Agencies	42,276,913	42,276,913	-	-	-	-
U.S. Treasury	535,361,940	-	-	-	-	535,361,940
Total	<u>\$ 820,709,180</u>	<u>107,044,749</u>	<u>10,907,215</u>	<u>33,047,980</u>	<u>805,487</u>	<u>668,903,749</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.

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>
Common stock	Canadian dollar	\$ 230,145
Common stock	Euro currency	12,062,967
Common stock	Japanese yen	5,294,971
Cash equivalent	Japanese yen	29,624
Common stock	New Zealand dollar	182,780
Common stock	Pound sterling	5,309,376
Common stock	Singapore dollar	784,642
Common stock	Swiss franc	1,616,838
Total		<u>\$ 25,511,343</u>

State statutes do not prohibit the Pension Fund from participating in securities lending transactions, and the

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Board has, via a Securities Lending Authorization Agreement, authorized State Street Bank and Trust Company (State Street) to lend the Fund's securities to broker-dealers and banks pursuant to a form of loan agreement. Cash collateral received in respect of such loans was invested at the direction of the Board, in the Quality Fund, a pooled external investment vehicle. Please note the following:

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

During fiscal year 2006, State Street lent, at the direction of the Board, the Fund's securities and received cash (including both U.S. and foreign currency), securities issued or guaranteed by the U. S. Government or its agencies, sovereign debt of foreign countries and irrevocable bank letters of credit as collateral. State Street did not have the ability to pledge or sell collateral securities delivered; therefore, there cannot be a borrower default. Borrowers were required to deliver collateral for each loan in amounts not less than 100% of the market value of the loaned securities.

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, 2006, was 50.49 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, 2006, 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, 2006, were \$78,618,934 and \$77,625,604, respectively.

CITY OF NEWPORT NEWS, VIRGINIA
Notes to Basic Financial Statements
June 30, 2006

(3) Accounts Receivable

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

	Governmental activities	Business-type activities
Taxes receivable:		
Real Estate	\$ 4,727,335	-
Personal Property	3,473,651	-
Total taxes receivable, net	8,200,986	-
Accounts receivable	8,964,972	9,577,178
Total receivables, net	\$ 17,165,958	9,577,178

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:

	General	Bond Fund	Public Utility	Fiduciary Funds	Nonmajor Funds	Total
Receivables:						
Taxes	\$ 13,511,682	-	-	-	-	13,511,682
Accounts	7,568,041	-	9,987,235	3,523,757	1,396,931	22,475,964
Intergovernmental:						
Federal	1,503,461	1,462,400	-	-	809,588	3,775,449
State	14,610,282	-	-	-	3,371,563	17,981,845
Local	-	-	-	-	28,819	28,819
Gross receivables	37,193,466	1,462,400	9,987,235	3,523,757	5,606,901	57,773,759
Less allowance for doubtful accounts	(5,310,696)	-	(410,057)	-	(486,460)	(6,207,213)
Net total receivables	\$ 31,882,770	1,462,400	9,577,178	3,523,757	5,120,441	51,566,546

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 \$0.3 million was reported in the governmental nonmajor funds. The general fund deferred revenue of \$6.3 million includes approximately \$5.8 million in property tax deferrals.

CITY OF NEWPORT NEWS, VIRGINIA
Notes to Basic Financial Statements
June 30, 2006

(4) Capital Assets, Net

Capital asset activity for the year ended June 30, 2006 was as follows:

Primary				Government
	Balance			Balance
	July 1, 2005	Increases	Decreases	June 30, 2006
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 75,473,967	3,975,382	-	79,449,349
Construction in progress	21,821,939	23,284,803	2,932,195	42,174,547
Total capital assets, not being depreciated	<u>97,295,906</u>	<u>27,260,185</u>	<u>2,932,195</u>	<u>121,623,896</u>
Capital assets, being depreciated:				
Buildings	259,235,438	6,263,063	-	265,498,501
Improvements	111,186,060	3,823,151	5,271	115,003,940
Machinery and equipment	97,447,873	12,145,479	1,822,897	107,770,455
Infrastructure	399,361,975	13,740,600	3,664	413,098,911
Total capital assets being depreciated	<u>867,231,346</u>	<u>35,972,293</u>	<u>1,831,832</u>	<u>901,371,807</u>
Less accumulated depreciation for:				
Buildings	62,466,412	4,889,166	-	67,355,578
Improvements	44,048,592	4,320,048	-	48,368,640
Machinery and equipment	62,330,086	6,960,498	1,701,777	67,588,807
Infrastructure	252,594,438	8,472,969	-	261,067,407
Total accumulated depreciation	<u>421,439,528</u>	<u>24,642,681</u>	<u>1,701,777</u>	<u>444,380,432</u>
Total capital assets being depreciated, net	<u>445,791,818</u>	<u>11,329,612</u>	<u>130,055</u>	<u>456,991,375</u>
Capital assets, net	<u>\$ 543,087,724</u>	<u>38,589,797</u>	<u>3,062,250</u>	<u>578,615,271</u>

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

General Government	\$ 2,717,670
Judicial Administration	407,802
Public Safety	2,225,999
Public Works	8,859,003
Health and Welfare	180,159
Education	3,080,510
Parks, Recreation and Culture	3,432,999
Community Development	739,395
Non-departmental	36,741
Internal Service Fund	2,962,402
	<u>\$ 24,642,680</u>

CITY OF NEWPORT NEWS, VIRGINIA

Notes to Basic Financial Statements

June 30, 2006

Construction in progress for the City at June 30, 2006 is composed of the following project authorizations (in millions):

	Project Authorization	Expended as of June 30, 2006	Balance of Authorization	Future Requirements
General Government	\$ 50.0	17.3	32.7	17.0
Parks and Recreation	13.8	7.1	6.7	1.6
Economic Development and Urban Renewal	27.0	6.3	20.7	3.5
Public Schools	28.8	11.6	17.2	10.0
Totals	<u>\$ 119.6</u>	<u>42.3</u>	<u>77.3</u>	<u>32.1</u>

In addition, the City had commitments of approximately \$19.0 million relating to infrastructure at June 30, 2006.

	Balance July 1, 2005	Increases	Decreases	Balance June 30, 2006
Business-type activities:				
Capital assets, not being depreciated:				
Land	\$ 6,539,545	171,573	535,000	6,176,118
Construction in progress, restated	121,688,313	8,872,900	89,757,421	40,803,792
Total capital assets, not being depreciated	<u>128,227,858</u>	<u>9,044,473</u>	<u>90,292,421</u>	<u>46,979,910</u>
Capital assets, being depreciated:				
Buildings	16,228,526	29,071	-	16,257,597
Improvements	3,532,823	-	-	3,532,823
Water system	375,701,813	95,630,641	465,631	470,866,823
Machinery and equipment	16,979,897	1,277,301	45,957	18,211,241
Total capital assets being depreciated	<u>412,443,059</u>	<u>96,937,013</u>	<u>511,588</u>	<u>508,868,484</u>
Less accumulated depreciation for:				
Buildings	1,229,634	333,646	-	1,563,280
Improvements	1,855,313	104,997	-	1,960,310
Water system	118,335,525	8,998,997	382,867	126,951,655
Machinery and equipment	11,422,758	1,531,437	45,957	12,908,238
Total accumulated depreciation	<u>132,843,230</u>	<u>10,969,077</u>	<u>428,824</u>	<u>143,383,483</u>
Total capital assets being depreciated, net	<u>279,599,829</u>	<u>85,967,936</u>	<u>82,764</u>	<u>365,485,001</u>
Capital assets, net	\$ <u>407,827,687</u>	<u>95,012,409</u>	<u>90,375,185</u>	<u>412,464,911</u>

CITY OF NEWPORT NEWS, VIRGINIA

Notes to Basic Financial Statements

June 30, 2006

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

Water	\$	10,863,580
Parking		<u>105,497</u>
Total	\$	<u><u>10,969,077</u></u>

	<u>Balance</u> <u>July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2006</u>
Public Utility:				
Capital assets, not being depreciated:				
Land	\$ 5,807,698	171,573	535,000	5,444,271
Construction in progress	<u>121,665,973</u>	<u>8,869,880</u>	<u>89,757,421</u>	<u>40,778,432</u>
Total capital assets, not being depreciated	<u>127,473,671</u>	<u>9,041,453</u>	<u>90,292,421</u>	<u>46,222,703</u>
Capital assets, being depreciated:				
Buildings	16,228,526	29,071	-	16,257,597
Improvements	375,701,813	95,630,641	465,631	470,866,823
Machinery and equipment	<u>16,950,003</u>	<u>1,277,301</u>	<u>40,063</u>	<u>18,187,241</u>
Total capital assets being depreciated	<u>408,880,342</u>	<u>96,937,013</u>	<u>505,694</u>	<u>505,311,661</u>
Less accumulated depreciation for:				
Buildings	1,193,365	333,646	-	1,527,011
Improvements	118,335,522	8,998,997	382,867	126,951,652
Machinery and equipment	<u>11,401,225</u>	<u>1,530,937</u>	<u>40,063</u>	<u>12,892,099</u>
Total accumulated depreciation	<u>130,930,112</u>	<u>10,863,580</u>	<u>422,930</u>	<u>141,370,762</u>
Total capital assets being depreciated, net	<u>277,950,230</u>	<u>86,073,433</u>	<u>82,764</u>	<u>363,940,899</u>
Capital assets, net	\$ <u><u>405,423,901</u></u>	<u><u>95,114,886</u></u>	<u><u>90,375,185</u></u>	<u><u>410,163,602</u></u>

CITY OF NEWPORT NEWS, VIRGINIA
Notes to Basic Financial Statements
June 30, 2006

Discretely Presented Component Units

	<u>Balance</u> <u>July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2006</u>
Public Schools:				
Capital assets, not being depreciated:				
Land	\$ 2,505,084	-	-	2,505,084
Construction in progress	121,151	11,288	-	132,439
Total capital assets, not being depreciated	<u>2,626,235</u>	<u>11,288</u>	<u>-</u>	<u>2,637,523</u>
Capital assets, being depreciated:				
Buildings	51,397,821	-	-	51,397,821
Improvements	30,816,017	1,819,877	-	32,635,894
Machinery and equipment	79,804,457	11,267,145	7,390,637	83,680,965
Total capital assets being depreciated	<u>162,018,295</u>	<u>13,087,022</u>	<u>7,390,637</u>	<u>167,714,680</u>
Less accumulated depreciation for:				
Buildings	22,149,891	889,476	-	23,039,367
Improvements	5,317,140	1,227,373	-	6,544,513
Machinery and equipment	47,977,157	12,298,302	6,033,436	54,242,023
Total accumulated depreciation	<u>75,444,188</u>	<u>14,415,151</u>	<u>6,033,436</u>	<u>83,825,903</u>
Total capital assets being depreciated, net	<u>86,574,107</u>	<u>(1,328,129)</u>	<u>1,357,201</u>	<u>83,888,777</u>
Capital assets, net	<u>\$ 89,200,342</u>	<u>(1,316,841)</u>	<u>1,357,201</u>	<u>86,526,300</u>

Depreciation of \$14,415,152 was charged to the Public School's governmental functions.

Construction in progress for the Public Schools at June 30, 2006 is composed of project authorizations of \$13,655,012, amounts expended through June 30, 2006 of \$132,439 with a remaining balance of \$13,522,573.

CITY OF NEWPORT NEWS, VIRGINIA

Notes to Basic Financial Statements

June 30, 2006

	<u>Balance</u>			<u>Balance</u>
	<u>July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2006</u>
E/IDA:				
Capital assets, not being depreciated -				
Construction in progress	\$ 12,064,704	28,866,782	457,187	40,474,299
Capital assets, being depreciated:				
Buildings	99,102,130	-	-	99,102,130
Improvements	9,931,878	335,371	-	10,267,249
Infrastructure	1,521,049	-	-	1,521,049
Machinery and equipment	96,674	-	-	96,674
Total capital assets being depreciated	<u>110,651,731</u>	<u>335,371</u>	<u>-</u>	<u>110,987,102</u>
Less accumulated depreciation for:				
Buildings	11,066,493	2,182,291	-	13,248,784
Improvements	1,948,482	276,942	-	2,225,424
Infrastructure	46,645	46,645	-	93,290
Machinery and equipment	81,674	3,750	-	85,424
Total accumulated depreciation	<u>13,143,294</u>	<u>2,509,628</u>	<u>-</u>	<u>15,652,922</u>
Total capital assets being depreciated, net	<u>97,508,437</u>	<u>(2,174,257)</u>	<u>-</u>	<u>95,334,180</u>
Capital assets, net	\$ <u>109,573,141</u>	<u>26,692,525</u>	<u>457,187</u>	<u>135,808,479</u>

	<u>Balance</u>			<u>Balance</u>
	<u>July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2006</u>
PAC:				
Capital assets, not being depreciated -				
Land	\$ 5,712,070	-	-	5,712,070
Construction in progress	7,336,734	6,942,575	7,222,254	7,057,055
Total capital assets not being depreciated	<u>13,048,804</u>	<u>6,942,575</u>	<u>7,222,254</u>	<u>12,769,125</u>
Capital assets, being depreciated:				
Airfield	53,378,381	4,287,317	-	57,665,698
Terminal	35,009,799	2,679,973	-	37,689,772
Other	3,177,567	126,880	-	3,304,447
Machinery and equipment	2,031,344	-	-	2,031,344
Total capital assets being depreciated	<u>93,597,091</u>	<u>7,094,170</u>	<u>-</u>	<u>100,691,261</u>
Less accumulated depreciation for:				
Airfield	20,968,010	2,116,106	-	23,084,116
Terminal	12,921,996	1,066,987	-	13,988,983
Other	2,290,929	110,285	-	2,401,214
Machinery and equipment	1,990,848	19,527	-	2,010,375
Total accumulated depreciation	<u>38,171,783</u>	<u>3,312,905</u>	<u>-</u>	<u>41,484,688</u>
Total capital assets being depreciated, net	<u>55,425,308</u>	<u>3,781,265</u>	<u>-</u>	<u>59,206,573</u>
Capital assets, net	\$ <u>68,474,112</u>	<u>10,723,840</u>	<u>7,222,254</u>	<u>71,975,698</u>

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CITY OF NEWPORT NEWS, VIRGINIA
Notes to Basic Financial Statements
June 30, 2006

(5) Interfund Receivables, Payables, and Transfers

The composition of interfund balances as of June 30, 2006, 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.	\$ 29,399
General fund	Nonmajor Gov. fund: Waste Water	225,865
General fund	Nonmajor Gov. fund: Comprehensive Services Act	937,346
		<u>\$ 1,192,610</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	\$ 16,929,071
Newport News Public Schools	City of Newport News	33,765

The IDA Payable of \$16,929,071 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 are as follows:

	<u>Transfers to Other Funds</u>	<u>Transfers From Other Funds</u>
	<u>Operating</u>	<u>Operating</u>
General Fund	\$ 37,250,800	9,134,000
Debt Service Fund	598,749	32,310,688
Bond Fund	-	598,749
Nonmajor governmental funds	4,979,150	9,919,262
Public Utility	9,134,000	-
Total interfund transfers	<u>\$ 51,962,699</u>	<u>51,962,699</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, 2006

(6) Lease Agreements

(a) Capital Lease Payments – Primary Government

The City has entered into a lease agreements through 2017 to finance the acquisition of equipment and a parcel of land. These leases are accounted for as capital leases and recorded at the present value of the future minimum lease payments at the date of inception. The cost of equipment and land for these capital leases are \$387,740 and \$3,115,000, respectively and are included in capital assets. The future minimum lease obligations and the net present value of these minimum lease payments as of June 30, 2006 were as follows:

Years ending June 30:

<u>Equipment</u>		<u>Land Parcel</u>	
2007	\$ 93,996	2007	\$ 270,811
2008	93,996	2008	270,811
2009	<u>54,811</u>	2009	270,811
Total	242,803	2010	270,811
Less Interest	<u>23,658</u>	2011	270,811
Present Value	<u>\$ 219,145</u>	2012 - 2016	1,354,055
		2017	<u>270,811</u>
		Total	\$ 2,978,921
		Less Interest	<u>802,062</u>
		Present Value	<u>\$ 2,176,859</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>(2,977,347)</u>
Net assets acquired through capital leases	<u>\$ 2,870,163</u>

CITY OF NEWPORT NEWS, VIRGINIA

Notes to Basic Financial Statements

June 30, 2006

The future minimum lease obligations and the net present value of these minimum lease payments as of June 30, 2006, were as follows:

Years ending June 30:		
2007		\$ 1,163,847
2008		450,138
2009		418,824
2010		124,811
2011		119,763
2012 - 2016		523,142
2017 - 2021		306,748
Total minimum lease payments		\$ <u>3,107,273</u>
Less amounts representing interest		<u>(573,543)</u>
Present value of minimum capital lease payments		\$ <u><u>2,533,730</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:			
2007	\$ 249,843	361,769	21,627
2008	257,338	362,552	19,908
2009	265,058	363,342	19,908
2010	273,010	364,141	14,931
2011	281,200	246,822	—
2012-2016	—	334,014	—
	\$ <u><u>1,326,449</u></u>	<u><u>2,032,640</u></u>	<u><u>76,374</u></u>

CITY OF NEWPORT NEWS, VIRGINIA
Notes to Basic Financial Statements
June 30, 2006

(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>(12,625,495)</u>
Net investment in property held for lease	\$	<u><u>76,663,854</u></u>

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

Minimum future rental income on operating leases as of June 30, 2006 is as follows:

	E/IDA	PAC
Year ending June 30:		
2007	\$ 8,893,312	1,753,623
2008	7,007,638	1,759,087
2009	6,825,574	1,810,625
2010	6,254,057	1,859,463
2011	6,111,723	162,463
2012-2016	29,071,539	1,868,951
2017-2021	17,077,285	—
2022-2026	6,835,074	—
2027-2030	<u>3,684,147</u>	<u>—</u>
Total	<u>\$ 91,760,349</u>	<u><u>9,214,212</u></u>

Rental income on operating leases for year ended 2006 was \$7,546,539 and 1,769,710 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, 2006:

CITY OF NEWPORT NEWS, VIRGINIA
Notes to Basic Financial Statements
June 30, 2006

Minimum lease payments to be received	\$ 20,108,985
Less unearned income	<u>(4,014,446)</u>
Net investment in direct financing leases	<u><u>\$ 16,094,539</u></u>

Minimum future rental income on these direct financing leases as of June 30, 2006 are as follows:

Year ending June 30:	
2007	\$ 1,938,349
2008	1,938,349
2009	1,938,349
2010	1,938,349
2011	1,938,349
2012-2016	8,799,038
2017-2020	<u>1,618,202</u>
Total	<u><u>\$ 20,108,985</u></u>

(7) Long-Term Liabilities

- (a) A summary of changes in long-term liabilities for governmental activities for the year ended June 30, 2006 follows:

	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2006</u>	<u>Due within</u> <u>one year</u>
Bonds payable:					
General obligation bonds	\$ 394,353,545	65,892,991	(59,226,837)	401,019,699	34,247,302
Deferred amounts:					
Add bonds premiums	15,004,640	3,115,756	(2,589,558)	15,530,838	2,363,614
Net loss on refunded bonds	<u>(9,684,906)</u>	<u>(1,792,569)</u>	<u>1,147,710</u>	<u>(10,329,765)</u>	<u>(1,264,506)</u>
Total bonds payable	<u>399,673,279</u>	<u>67,216,178</u>	<u>(60,668,685)</u>	<u>406,220,772</u>	<u>35,346,410</u>
Literary loan bonds	3,564,082	—	(669,249)	2,894,833	654,249
Capital leases payable	292,789	—	(73,644)	219,145	72,756
Land lease payable	2,312,606	—	(135,747)	2,176,859	144,120
Landfill liability	6,501,000	—	(169,000)	6,332,000	177,000
Accrued vacation	18,759,822	12,283,371	(11,273,725)	19,769,468	11,721,654
Net pension obligation	32,245,000	42,089,000	(19,160,000)	55,174,000	—
Workers' compensation and other claims	11,618,928	3,818,769	(3,658,228)	11,779,469	3,300,000
Incurred but not reported claims	<u>2,800,000</u>	<u>24,933,697</u>	<u>(25,041,697)</u>	<u>2,692,000</u>	<u>2,692,000</u>
Total long-term liabilities	<u><u>\$ 477,767,506</u></u>	<u><u>150,341,015</u></u>	<u><u>(120,849,975)</u></u>	<u><u>507,258,546</u></u>	<u><u>54,108,189</u></u>

The beginning accrued vacation liability has been increased \$224,487 for the prior year due to a reclassification of internal service fund liabilities from current to long-term.

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

CITY OF NEWPORT NEWS, VIRGINIA

Notes to Basic Financial Statements

June 30, 2006

General obligation bonds of \$46.7 million are authorized but unissued.

On August 24, 2005, the City received a loan of \$3,400,000 from the Virginia Revolving Authority (VRA). This loan will be paid 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. Through June 30, 2006, \$2,346,812 has been drawn against the loan.

In February 2006, the City issued \$34,285,000 of general improvement bonds Series 06A with a true interest cost of 4.29%. The net proceeds of \$35,269,936 (after \$269,936 for underwriting fees and other issuance cost) were used to pay the cost of various capital improvement projects.

In February 2006, the City issued \$28,020,000 of general improvement refunding bonds Series 06B with a true interest rate of 3.9%. The proceeds of the sale, exclusive of the accrued interest and costs of issuance, was applied to the refunding of \$23,140,000 outstanding principal amount of the City's 1998A series, \$5,600,000 outstanding principal amount of the City's 1999B series with interest rates of 3.9% and 4.0% respectively. The net proceeds of \$30,532,568 (after a payment of \$217,001 for underwriting fees and other issuance costs) were invested in Government Obligations with an escrow agent to provide for all future debt service payments on the refunded bonds. The City is undertaking the refunding in order to reduce its annual debt service expenditures. 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, 2006, \$15,965,000 remain outstanding. This advance refunding resulted in economic gains of \$782,018 (1998A) and \$215,764 (1999B). This issuance resulted in a cash flow savings of \$1,419,361.

At June 30, 2006, 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 \$6.3 million liability at June 30, 2006 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 2006. 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, 2006

Outstanding general obligation bonds at June 30, 2006, of the Primary Government governmental activities are comprised of the following issues:

G.O. Bond Series	Bond Date	Final Maturity Date	Effective Interest Rate (At Issue)	Balance June 30, 2006
VPSA 91	07/15/91	07/15/11	6.4%	\$ 1,431,799
VRA 93D	09/17/93	06/01/15	4.5%	500,022
VRA 94A	06/02/94	01/01/16	4.5%	2,516,602
Series 95A	06/15/95	07/01/06	5.5%	2,485,000
VMPL 95C	09/28/95	07/15/14	4.3%	5,337,565
VPSA 95C	12/01/95	07/15/15	5.2%	3,256,444
Series 96A	01/15/96	01/15/07	5.2%	595,000
VRA 96C	01/24/96	10/01/16	4.8%	1,866,023
Series 96D	12/01/96	01/15/08	5.4%	2,670,000
VRA 97A	01/30/97	10/01/17	4.8%	1,932,464
VRA 98A	01/22/98	10/01/17	4.8%	1,561,443
Series 98A	03/01/98	03/01/18	4.0%	3,365,000
Series 98C	12/01/98	12/01/09	4.2%	2,105,000
Series 99A	04/01/99	07/01/07	4.1%	4,980,000
VRA 99A	03/09/99	12/01/19	4.3%	2,094,865
Series 99B	03/01/99	03/01/19	4.6%	12,600,000
VRA 00A	03/01/00	03/01/21	3.5%	2,261,635
Series 00A	05/01/00	05/01/10	5.6%	5,080,000
VPSA 00B	11/16/00	07/15/21	5.2%	4,575,120
VRA 01A	04/24/01	05/01/22	4.1%	1,830,047
Series 01A	09/15/01	09/15/21	4.3%	20,000,000
VRA 02A	05/15/02	01/01/23	3.8%	2,416,427
Series 02A	09/26/02	07/01/22	3.5%	23,800,000
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%	24,300,000
VRA 03A	06/24/03	06/01/24	3.5%	2,935,142
Series 03C	07/15/03	11/01/09	5.0%	22,675,000
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%	23,750,000
Series 04B	03/01/04	01/15/18	4.5%	30,445,000
Series 04C	03/01/04	05/01/20	5.0%	10,095,000
VRA 04A	06/30/04	09/01/25	3.5%	2,859,795
Series 04D	12/01/04	12/01/24	5.0%	27,710,000
Series 05A	02/01/05	01/15/15	4.0%	12,550,000
VRA 05A	08/24/05	09/01/26	3.5%	2,346,812
Series 06A	02/16/06	02/01/26	4.0%	34,285,000
Series 06B	02/16/06	02/01/26	4.0%	28,020,000
Totals				<u>\$ 401,019,699</u>

CITY OF NEWPORT NEWS, VIRGINIA

Notes to Basic Financial Statements

June 30, 2006

Outstanding literary loan funds at June 30, 2006 of the Primary government governmental activities are comprised of the following issues:

Project	Bond Date	Final Maturity Date	Effective Interest Rate (at issue)	Balance June 30, 2006
Greenwood Elementary	12/01/86	12/01/06	3%	\$ 100,000
Menchville High	12/15/86	12/15/06	3%	48,000
New Horizons Tech	07/01/87	07/01/07	3%	100,000
Watkins Elementary	07/01/89	07/01/09	3%	400,000
Ferguson High	03/01/90	03/01/10	4%	200,000
Huntington Middle	03/01/90	03/01/10	4%	142,000
Hiddenwood Elementary	04/01/90	04/01/10	4%	40,000
Denbigh High	10/01/89	10/01/09	3%	321,962
Gildersleeve Middle	03/01/91	03/01/11	3%	500,000
Warwick High	09/01/99	09/01/19	2%	128,800
Menchville High-2	10/01/00	10/01/20	2%	187,500
Denbigh High-2	08/01/01	08/01/21	2%	196,251
Crittenden Middle	08/15/01	08/15/06	2%	15,000
Gildersleeve Middle-2	08/15/01	08/15/21	2%	100,000
Dozier Middle	08/15/01	08/15/21	2%	100,000
Reservoir Middle	05/1/02	05/1/22	2%	100,000
Hines Middle	05/1/02	05/1/22	2%	100,000
Huntington Middle-2	09/1/02	09/1/22	2%	115,320
Totals				\$ 2,894,833

The following table summarizes future debt service requirements as of June 30, 2006:

Fiscal year ending June 30:	General Obligation Bonds		Literary Loans	
	Principal	Interest	Principal	Interest
2007	\$ 34,247,302	18,634,958	\$ 654,249	80,236
2008	35,379,094	17,430,399	491,249	60,462
2009	36,493,331	15,955,292	441,249	45,426
2010	30,797,002	14,445,112	443,211	31,891
2011	27,834,664	13,184,258	165,749	18,298
2012 - 2016	129,789,957	46,330,658	328,720	56,762
2017 - 2021	72,574,139	16,702,158	319,570	23,888
2022 - 2026	33,904,210	2,012,684	50,836	1,152
Total future debt service	\$ 401,019,699	144,695,519	\$ 2,894,833	318,115

CITY OF NEWPORT NEWS, VIRGINIA
Notes to Basic Financial Statements
June 30, 2006

Business-Type Activities

In conjunction with the refinancing of general obligation bonds in February 2006, Public Utilities issued \$7,555,000 of water refunding bonds Series 06B with a true interest rate of 4.0%. The proceeds of the sale, exclusive of the accrued interest and costs of issuance, was applied to the refunding of \$7,980,000 outstanding principal amount of Public Utilities series 1999B with an interest rate 4.0%. The net proceeds of \$8,530,938 were invested in Government Obligations with an escrow agent to provide for all future debt service payments on the refunded bonds. Public Utilities is undertaking the refunding in order to reduce its annual debt service expenditures. 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, 2006, \$12,975,000 remain outstanding. This advance refunding resulted in economic gains of \$308,275. This issuance resulted in a cash flow savings of \$500,513.

A summary of changes in long-term liabilities for business-type activities for the year ended June 30, 2006 follows:

	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2006</u>	<u>Due within</u> <u>one year</u>
Bonds payable:					
General obligation bonds	\$ 165,220,000	22,555,000	21,300,000	166,475,000	10,510,000
Deferred amounts:					
Add bond premiums	7,021,198	1,220,720	745,049	7,496,869	745,000
	<u>172,241,198</u>	<u>23,775,720</u>	<u>22,045,049</u>	<u>173,971,869</u>	<u>11,255,000</u>
Total bonds payable	\$ <u>172,241,198</u>	<u>23,775,720</u>	<u>22,045,049</u>	<u>173,971,869</u>	<u>11,255,000</u>

Outstanding public utility bonds at June 30, 2006 are comprised of the following issues:

<u>Public Utility</u> <u>Bond Series</u>	<u>Issue</u> <u>Date</u>	<u>Final Maturity</u> <u>Date</u>	<u>Interest Rate</u> <u>(At Issue)</u>	<u>Balance</u> <u>June 30, 2006</u>
Series 96E	12/01/96	01/15/17	5.4%	2,670,000
Series 98B	03/01/98	03/01/12	4.0%	13,460,000
Series 99A	04/01/99	07/01/07	4.5%	2,410,000
Series 99B	03/01/99	03/01/19	4.7%	12,975,000
Series 00A	05/01/00	05/01/20	5.6%	5,060,000
Series 01C	08/15/01	08/15/21	4.3%	30,705,000
Series 02A	09/26/02	07/01/22	4.3%	19,405,000
Series 02B	09/26/02	07/01/16	3.5%	9,905,000
Series 03B	06/03/03	06/30/24	4.1%	8,895,000
Series 03C	07/15/03	11/01/08	2.3%	2,235,000
Series 04B	06/05/03	01/15/18	3.6%	16,200,000
Series 04C	06/06/03	05/01/20	3.9%	20,000,000
Series 06A	02/15/06	02/01/26	4.3%	15,000,000
Series 06B	02/15/06	02/01/19	4.3%	7,555,000
Totals				<u>\$ 166,475,000</u>

Public utility bonds of \$40.0 million are authorized but unissued.

CITY OF NEWPORT NEWS, VIRGINIA
Notes to Basic Financial Statements
June 30, 2006

The following table summarizes future debt service requirements of Business-type Activities as of June 30, 2006.

Fiscal year ending June 30:	<u>Principal</u>	<u>Interest</u>
2007	\$ 10,510,000	7,597,028
2008	11,575,000	7,172,094
2009	10,875,000	6,680,925
2010	11,030,000	6,204,813
2011	11,580,000	5,725,073
2012-2016	54,780,000	20,851,723
2017-2021	43,130,000	8,221,554
2022-2026	12,995,000	1,054,990
Totals	<u>\$ 166,475,000</u>	<u>63,508,200</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, 2006 follows:

	<u>Balance</u>			<u>Balance</u>	<u>Due within</u>
	<u>July 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2006</u>	<u>one year</u>
Compensated absences	\$ 3,634,503	1,256,721	1,357,107	3,534,117	504,874
Workers' compensation claims	1,586,267	585,868	568,963	1,603,172	374,083
Capital leases payable	3,525,721	—	991,991	2,533,730	1,034,999
Capital facilities notes payable	22,792,600	—	1,672,419	21,120,181	1,559,737
Incurred but not reported claims	2,025,800	21,637,395	21,827,695	1,835,500	1,835,500
Totals	<u>\$ 33,564,891</u>	<u>23,479,984</u>	<u>26,418,175</u>	<u>30,626,700</u>	<u>5,309,193</u>

The capital facility notes payable provided financing for a fiber wide-area-network linking all School Board computers as well as a variety of energy conservation and water savings improvements.

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, 2006

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 \$37.5 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. Since 1995, when the first moral obligation was issued by the Authorities, there has never been a need to call upon the City to appropriate any funds on morally obligated debt.

The E/IDA bonds and Notes at June 30, 2006 are comprised of the following:

	<u>Issue date</u>	<u>Maturity date</u>	<u>Eff Int rates</u>	<u>Balance 7/1/05</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance 6/30/06</u>	<u>Ant due in one year</u>
Bonds payable:								
UPS, 04	06/04/04	07/01/15	5.58%	7,422,588	—	568,423	6,854,165	601,428
MCI, 95A*	12/28/95	04/01/06	6.35%	346,497	—	346,497	—	—
MCI, 95B*	12/28/95	04/01/06	6.65%	6,714	—	6,714	—	—
OPTON*	03/01/96	08/01/16	6.15%	1,831,877	—	1,831,877	—	—
EDA-NNS, 96*	03/22/96	07/15/06	7.00%	1,264,017	—	1,158,855	105,162	105,162
ICELAND*	04/10/97	10/01/17	4.10%	7,146,667	—	400,000	6,746,667	400,000
CTII, 97A*	04/29/97	08/01/22	7.28%	3,760,927	—	115,177	3,645,750	123,932
CTII, 97B*	04/29/97	08/01/22	6.20%	829,028	—	28,162	800,866	29,978
SEARS*	03/01/98	10/01/18	6.48%	10,584,341	—	518,679	10,065,662	553,801
VSS*	03/01/98	10/01/18	6.48%	9,602,411	—	470,560	9,131,851	502,424
Coats and Clarke	01/01/99	12/01/18	4.24%	1,371,446	—	97,960	1,273,486	97,961
Hidenwood Center	03/30/00	04/01/20	8.78%	1,071,483	—	73,366	998,117	73,366
Downtown Engineering	04/05/00	07/01/31	7.64%	26,380,000	—	1,060,000	25,320,000	1,060,000
VASCIC	07/27/00	09/30/10	4.54%	27,100,000	—	3,940,000	23,160,000	4,150,000
OPTIC Merchant's Walk	08/24/01	08/01/26	4.52%	12,300,000	—	560,000	11,740,000	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%	323,470	—	323,470	—	—
PrintPack	08/15/03	09/01/18	3.61%	4,740,000	—	360,000	4,380,000	360,000
City Ops Center	12/07/04	07/01/26	2.25%	2,160,000	—	—	2,160,000	—
Fountain Way Garage	12/07/04	07/01/31	3.40%	16,685,000	—	—	16,685,000	—
Conference Center	12/07/04	07/01/31	3.40%	8,585,000	—	—	8,585,000	—
Hotl Cap Loan	12/07/04	07/01/31	3.40%	4,065,000	—	—	4,065,000	—
Rouse Project	12/07/04	01/15/31	5.14%	—	16,850,000	—	16,850,000	315,000
Third Garage	12/07/04	01/15/31	5.14%	—	16,150,000	—	16,150,000	670,000
Conf Center	06/30/06	.	4.00%	—	18,900,000	—	18,900,000	—
Totals				<u>152,093,304</u>	<u>51,900,000</u>	<u>11,859,740</u>	<u>192,133,564</u>	<u>9,603,052</u>
Premium on Bonds Payable				—	995,414	—	995,414	39,817
Discount on Bonds Payable				(106,972)	—	4,114	(102,858)	4,114
Total bonds and notes payable				<u>\$ 151,986,332</u>	<u>52,895,414</u>	<u>11,855,626</u>	<u>193,026,120</u>	<u>9,646,983</u>

*Moral obligation of the City.

CITY OF NEWPORT NEWS, VIRGINIA

Notes to Basic Financial Statements

June 30, 2006

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 the end of the fiscal year, there are 11 series of the Bonds outstanding, with an aggregate principal amount payable of approximately \$39 million. Approximately \$0.3 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 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 floating rate.

CITY OF NEWPORT NEWS, VIRGINIA
Notes to Basic Financial Statements
June 30, 2006

The PAC Airport Improvement Revenue Bonds at June 30, 2006, are comprised of the following:

Series	Issue Date	Maturity Date	Eff. Int. Rate (%)	Balance July 1, 2005	Reductions	Balance June 30, 2006
2001	04/15/01	07/16/21	5.05-5.5	\$ 6,030,000	230,000	5,800,000
2002	07/03/02	07/01/27	4.5	2,325,281	63,494	2,261,787
2005A	12/15/05	01/15/32	4.3	7,000,000	—	7,000,000
2005B	12/15/05	01/15/32	5.8	3,000,000	—	3,000,000
Totals				<u>\$ 18,355,281</u>	<u>293,494</u>	<u>18,061,787</u>

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

	E/IDA		PAC	
	Principal	Interest	Principal	Interest
Fiscal year ending June 30:				
2007	\$ 9,603,053	9,046,248	389,772	862,609
2008	16,541,609	8,872,848	538,349	839,228
2009	12,435,697	8,447,370	562,000	812,699
2010	12,849,263	8,011,951	591,309	801,418
2011	13,369,902	7,563,772	621,306	771,589
2012-2016	43,233,518	30,545,069	3,623,082	3,369,690
2017-2021	33,841,339	18,914,408	4,658,009	2,359,427
2022-2026	25,724,183	10,671,094	3,566,730	1,244,013
2027-2031	22,525,000	3,517,723	3,117,850	474,014
2032	2,010,000	46,178	393,380	6,320
Total	<u>\$ 192,133,564</u>	<u>105,636,661</u>	<u>18,061,787</u>	<u>11,541,007</u>

CITY OF NEWPORT NEWS, VIRGINIA
Notes to Basic Financial Statements
June 30, 2006

(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, 2006, the total payroll of the City was approximately \$317.8 million, with approximately \$298.9 million covered by NNERF. At June 30, 2006, 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	715	557	1,235	644	3,151
City police and fire	502	186	595	282	1,565
Public utilities	169	97	277	66	609
School VRS	1,666	851	2,006	1,481	6,004
School Non-VRS	573	115	647	484	1,819
Total	<u>3,625</u>	<u>1,806</u>	<u>4,760</u>	<u>2,957</u>	<u>13,148</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 \$19,159,947 were made by the employer during the year ended June 30, 2006. The percentage of employer contributions to current year covered payroll was 0.73% for employees covered by VRS and 5.68% for all others.

The percentage of normal cost to current year covered payroll was 6.41%. The employer's annual pension cost and net pension obligation to NNERF for 2006 were as follows:

(000's Omitted)

Annual Required Contribution (ARC)	\$	42,214
Interest on net pension obligation		2,580
Adjustment to ARC		(2,704)
Annual pension cost		42,090
Contributions made		(19,160)
Increase in net pension obligation		22,930
Net pension obligation (asset), beginning of year		32,244
Net pension obligation (asset), end of year	\$	55,174

The annual required contribution for the current year was determined as part of the June 30, 2006 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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June 30, 2006

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, 2006	\$ 42,089	45.0%	\$ 55,174
June 30, 2005	35,421	38.4%	32,245
June 30, 2004	27,846	44.1%	10,453

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

1. Plan Description

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

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

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

2. Funding Policy

Plan members are required by Title 51.1 of the *Code of Virginia* (1950), as amended, to contribute 5% of their annual reported compensation to the VRS. This 5% member contribution has been assumed by the employer. In addition, the NNSS and the PAC are required to contribute the remaining amounts necessary to fund their participation in the VRS using the actuarial bases specified by the *Code of Virginia* and approved by the VRS Board of Trustees. The contribution rates for the fiscal year ended 2006 were 11.62% and 5.0% of covered annual payroll for the NNSS and the PAC, respectively.

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3. Annual Pension Cost

For 2006, the annual pension cost of \$17,188,757 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, 2005 actuarial valuation. The actuarial assumptions included (a) a rate of return on investment of 7.5% to 8%, (b) projected salary increases ranging from 3.5% to 5.73% per year, and (c) cost-of-living adjustments of 2.5% to 3%. Both (a) and (b) included an inflation component of 2.5% to 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

	Fiscal year ending	Pension Cost (APC)	Percentage of APC contributed	Net pension obligation
NNSS	06/30/06	\$ 17,188,757	100.0%	-
	06/30/05	15,805,364	100.0%	-
	06/30/04	12,204,566	100.0%	-
PAC	06/30/06	81,229	100.0%	-
	06/30/05	78,575	100.0%	-
	06/30/04	15,097	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 3,625 retirees for fiscal year 2006 were: health \$9,794,782 (933 participating); dental \$328,621 (854 participating); and life \$1,281,411 (881 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 2,239 retirees for fiscal year 2006 were: health and dental \$4,548,413 (1,896 participating), and life \$74,523 (317 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 (\$25,021,082 for 2006). 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 \$31,750,000), 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 2006 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, 2006 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, 2006 and 2005 for the City and the Public Schools were as follows:

	City		Public Schools	
	2006	2005	2006	2005
Claims payable at beginning of year	\$ 2,800,000	2,995,000	2,025,800	2,017,000
Claims and changes in estimates	24,933,697	23,243,851	21,637,395	21,051,652
Claim payments	(25,041,697)	(23,438,851)	(21,827,695)	(21,042,852)
Claims payable at end of year	\$ 2,692,000	2,800,000	1,835,500	2,025,800

(b) Workers' Compensation

The City and the School Board self-insure for workers' compensation through the respective General Funds up to \$1,500,000 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, 2006 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, 2006 and 2005 for the City and the Public Schools.

	City		Public Schools	
	2006	2005	2006	2005
Claims payable at beginning of year	\$ 9,092,411	7,961,049	1,586,267	1,679,218
Claims and changes in estimates	3,171,777	4,167,246	585,868	619,239
Claim payments	(2,563,158)	(3,035,884)	(568,963)	(712,190)
Claims payable at end of year	\$ 9,701,030	9,092,411	1,603,172	1,586,267

A loss analysis was conducted by Mercer Oliver Wyman on this fund. The total actuarially computed liability as of June 30, 2006 for the City and School Board was determined to be approximately \$9.7 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.

CITY OF NEWPORT NEWS, VIRGINIA

Notes to Basic Financial Statements

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	City	
	2006	2005
Claims payable at beginning of year	\$ 2,526,517	2,851,059
Claims and changes in estimates	646,992	372,403
Claim payments	(1,095,070)	(696,945)
Claims payable at end of year	<u>\$ 2,078,439</u>	<u>2,526,517</u>

(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, 2006, will not be material to the financial statements.

(c) Regional Raw Water Project

As of June 30, 2006, the City's Public Utility has incurred cumulative costs of approximately \$30.0 million related to the Regional Raw Water Project (the Project) known as the King William Reservoir. The project began in 1987, with the necessary federal permit issued on November 16, 2005, by the U.S. Army Corps of Engineers. 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, 200 Medical Drive, Hampton, VA 23666.

(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.

(c) Hampton Roads Economic Development Alliance (HREDA)

The HREDA is a non-profit, public-private partnership that aggressively markets Virginia's Hampton Roads region as the primary region of choice for economic investment and business expansion. All HREDA business attraction initiatives and activities are designed to promote the jurisdictions of Chesapeake, Gloucester, Hampton, Isle of Wight County, James City County, Newport News, Norfolk, Poquoson, Portsmouth, Suffolk, Virginia Beach, Williamsburg and York County, Virginia. The business affairs is managed by a Board of not less than fifty nor more than 300 Directors. The City's Mayor and the Director of E/IDA are board members. HREDA receives funding from both private and public entities. Newport News contributes \$1.40 per capita. Separate financial statements are available from the HREDA, 500 E. Main Street, Suite 1300, Norfolk, Virginia 23510.

(12) Prior Period Adjustments

The fund balance of the solid waste special revenue fund (part of nonmajor governmental funds) at the beginning of FY 2006 have been restated to properly defer revenue under modified accrual basis of accounting. Prior year billings had been recorded as revenue even though they did not meet the availability criteria under modified accrual accounting. This adjustment does not effect the governmental activities of the primary government. The following is a summary of the prior period adjustments' effect on beginning assets:

	<u>Solid Waste</u>	<u>Nonmajor</u>
Fund balance, July 1, 2005, as previously stated	\$ 2,823,826	\$ 12,594,362
Net adjustment: Defer solid waste revenue due to availability criteria	(659,633)	(659,633)
Fund balance, July 1, 2005, as adjusted	<u>\$ 2,164,193</u>	<u>\$ 11,934,729</u>

The net assets of the Parking Authority at the beginning of FY 2005 have been restated to properly classify capital assets. The net asset amount was increased by \$22,340.

	<u>Balance</u>		<u>Restated Balance</u>
	<u>June 30, 2006</u>	<u>Adjustment</u>	<u>June 30, 2006</u>
Invested in capital assets, net of related debt	\$ 2,381,446	\$ 22,340	\$ 2,403,786
Restricted for capital projects	225,000	-	225,000
Unrestricted	747,702	-	747,702
Total net assets	<u>\$ 3,354,148</u>	<u>\$ 22,340</u>	<u>\$ 3,376,488</u>

(13) Subsequent Events

In October 2006, the City issued \$20,000,000 of general improvement bond anticipation notes (BANs) Series 06A with a true interest cost of 3.5% and a maturity date of April 11, 2007. The net proceeds of \$20,000,000 (after an original issue premium of \$1,109,184 and payment of \$279,184 for underwriting fees and other issuance costs) were used to fund on-going capital projects.

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In October 2006, the City received a \$3,200,000 Virginia Resources Authority (VRA) loan with an interest rate of 3.5%. The loan will be used to finance the replacement and rehabilitation of sanitary sewers and related improvements in the City.