

Notes to Basic Financial Statements

June 30, 2004

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Portsmouth, Virginia (the City) was established by act of the Virginia General Assembly in 1858. It is a political subdivision of the Commonwealth of Virginia operating under the council-manager form of government. City Council consists of a mayor and six other council members. The City is not part of a county and has taxing powers subject to statewide restrictions and tax limits.

The City provides a full range of municipal services including police and fire, sanitation, health and social services, public improvements, planning and zoning, general administrative services, education, and water and sewer systems administered by the Portsmouth Department of Public Utilities.

The following is a summary of the more significant policies:

A. Financial Reporting Entity

The City's financial reporting entity is defined and its financial statements are presented in accordance with GASB Statement No. 14, *The Financial Reporting Entity*. This Statement defines the distinction between the City as a primary government and its related entities. The financial reporting entity consists of the primary government and 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 primary government may also be financially accountable if the component unit is fiscally dependent on the primary government regardless of whether the component unit has a separately elected governing board. As such, the City of Portsmouth School Board (School Board), Portsmouth Parking Authority (Parking Authority), The Industrial Development Authority of the City of Portsmouth, Virginia (Industrial Development Authority), and the Portsmouth Port and Industrial Commission are reported as separate and discretely presented component units in the City's reporting entity. The primary government is hereafter referred to as the "City" and the reporting entity, which includes the City and its component units, is hereafter referred to as the "Reporting Entity".

As required by generally accepted accounting principles, the accompanying financial statements include all activities of the City, such as general operation and support services. The School Board's governmental operations and the proprietary operations of the Parking Authority, the Industrial Development Authority and the Portsmouth Port and Industrial Commission are included on Exhibit G-2.

Discretely Presented Component Units

The component unit columns in the basic financial statements include the financial data of the City's four component units. The discretely presented component units are reported in a separate column in the government-wide financial statements to emphasize that they are legally separate from the primary government. These component units are fiscally dependent on the City and provide services primarily to the citizens of Portsmouth. All component units have a June 30 year-end. A description of the discretely presented component units follows:

1. The School Board operates the public education system in the City for grades kindergarten through twelve. Complete, audited financial statements for the School Board may be obtained as follows:

Portsmouth School Board
Department of Business Affairs
Third Floor, City Hall Building
801 Crawford Street
Portsmouth, Virginia 23704

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2. The Parking Authority is responsible for the operation and maintenance of five parking garages, eleven parking lots, and all street parking meters. In addition, the Parking Authority receives fines from parking meter violations. The Parking Authority has only one fund. Separately audited financial statements are not available for the Parking Authority.
3. The Industrial Development Authority is authorized to acquire, own, lease and dispose of properties to the extent that such activities may promote industry and develop trade by inducing enterprises to locate and remain in Portsmouth. The Industrial Development Authority has only one fund. Complete, audited financial statements may be obtained as follows:

Industrial Development Authority
c/o Department of Finance
801 Crawford Street
Portsmouth, Virginia 23704

4. The Portsmouth Port and Industrial Commission is authorized to acquire, own, lease and dispose of properties in and around the various ports within the City to the extent that such activities may promote industry and develop trade by inducing enterprises to locate and remain in Portsmouth. The Portsmouth Port and Industrial Commission has only one fund. Complete, audited financial statements may be obtained as follows:

Portsmouth Port and Industrial Commission
c/o Department of Finance
801 Crawford Street
Portsmouth, Virginia 23704

B. Basis of Presentation**Government-wide and Fund Financial Statements**

The basic financial statements include both government-wide (based on the City as a whole) and fund financial statements. Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as either governmental or business type. In the government-wide Statement of Net Assets, both the governmental and business-type activities columns (a) are reported by columns, and (b) are reflected on a full accrual, economic resources basis, which incorporates long-term assets and receivables as well as long-term debt and obligations. Each presentation provides valuable information that can be analyzed and compared (between years and between governments) to enhance the usefulness of the information. For the most part, the effect of interfund activity has been removed from the government-wide financial statements.

The government-wide Statement of Activities reflects both the gross and net cost per functional category (public safety, public works, health and welfare, etc.) that are otherwise being supported by general government revenues (property, sales and use taxes, certain intergovernmental revenues, fines, permits and charges, etc.). The Statement of Activities reduces gross expenses (including depreciation) by directly related program revenues, operating and capital grants, and contributions. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function and grants and contributions that are restricted to meeting the operation or capital requirements of a particular function or segment. Taxes and other items not specifically restricted to the various programs are reported as general revenues. The City does not allocate indirect expenses. The operating grants include operating-specific and discretionary (either operating or capital) grants while the capital grants column reflects capital-specific grants.

In the fund financial statements, financial transactions and accounts of the City are organized on the basis of funds. The operation of each fund is considered to be an independent fiscal and separate accounting entity, with a self-balancing set of accounts recording cash and/or other financial resources together with all related

Notes to Basic Financial Statements, Continued

liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. The nonmajor funds are combined in a single column in the fund financial statements and detailed in the combining statements. The fund statements are presented on a current financial resources measurement focus and modified accrual basis of accounting. This is the manner in which these funds are normally budgeted. Since the governmental fund statements are presented on a different measurement focus and basis of accounting than the government-wide statements' governmental activities column, a reconciliation is presented which briefly explains the adjustment necessary to reconcile the fund financial statements to the governmental activities column of the government-wide financial statements.

Internal service funds of the City (which traditionally provide services primarily to other funds of the government) are presented in summary form as part of the proprietary fund financial statements. Since the principal users of the internal services are the City's governmental activities, financial statements of internal service funds are consolidated into the governmental activities column when presented at the government-wide level. To the extent possible, the costs of these services are reflected in the appropriate functional activity (public safety, judicial, health and welfare, etc.).

The City's fiduciary funds are presented in the fund financial statements by type (pension trust funds and agency). Since by definition these assets are being held for the benefit of a third party and cannot be used to address activities or obligations of the City, these funds are not incorporated into the government-wide statements. The following is a brief description of the specific funds used by the City.

Governmental Fund Types

Governmental funds are those through which most governmental functions of the City are financed. The acquisition, use and balances of the City's expendable financial resources and the related liabilities are accounted for through governmental funds, except those accounted for in proprietary funds and similar trust funds.

The City reports the following major governmental funds:

General Fund - The General Fund is the general operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund.

Capital Projects Fund – Capital Improvements Fund – The Capital Improvements Fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary funds).

The City reports the following nonmajor governmental funds:

Special Revenue Funds - Special revenue funds are used to account for the proceeds of certain specific revenue sources that are legally restricted to expenditures for specified purposes.

Capital Projects Fund – Community Development Fund – The Community Development Fund is used to account for the implementation of a variety of capital project programs pursuant to the provisions of the 1974 Housing and Community Development Act.

Permanent Fund – Cemetery Fund – The Cemetery Fund is used to account for the sale of cemetery lots, perpetual care payments and donations and legacies made for the care of cemetery lots. The principal of such funds shall not be expended for any purpose.

Proprietary Fund Types

Proprietary funds are used to account for the City's ongoing organizations and activities which are similar to those often found in the private sector. The measurement focus is upon determination of net income. Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues

Notes to Basic Financial Statements, Continued

and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Operating revenues include charges for services, certain rental fees and recovered costs. Operating expenses include the cost of sales and services, administrative expenses and depreciation. All revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses. In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting* (Statement No. 20), proprietary fund types follow all applicable GASB pronouncements as well as all Financial Accounting Standards Board (FASB) pronouncements and predecessor APB Opinions and Accounting Research Bulletins issued on or before November 30, 1989. Under paragraph 7 of Statement No. 20, the City has elected not to apply FASB pronouncements issued after November 30, 1989.

Enterprise Funds - Enterprise funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes. The City has three major enterprise funds: Public Utility Fund, which accounts for the utility activity provided to the city; Golf Fund, which accounts for ownership and operation of 2 golf courses; and Waste Management Fund, which accounts for waste disposal services and operation of Craney Island landfill.

The nonmajor enterprise fund is the Port Facility and Economic Development Fund which is used to account for the lease of a marine terminal facility to Universal Maritime and lease-purchase sale of certain land to the Virginia Port Authority.

The City reports the following nonmajor fund types:

Internal Service Funds

Internal service funds are used to account for the financing of goods or services provided by one department to other departments or agencies of the City, or to some agencies external to the City, on a cost-reimbursement basis. The City has three internal service funds: City Garage Fund, Information Technology Fund and Risk Management and Insurance Fund.

Fiduciary Fund Types

Fiduciary funds are used to account for assets held by the City in a trustee capacity or as an agent for individuals, private organizations, other governmental units, and/or other funds. The City maintains pension trust and agency funds. The pension trust funds account for the assets of the City's retirement plans. Agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations. Fiduciary funds are not included in the government-wide financial statements.

Reconciliation of Government-wide and Fund Financial Statements

A summary reconciliation of the difference between total fund balances as reflected on the governmental funds Balance Sheet and total net assets for governmental activities as shown on the government-wide Statement of Net Assets is presented in a schedule accompanying the governmental funds Balance Sheet. A summary reconciliation of the differences between net change in total fund balances as reflected on the governmental funds Statement of Revenues, Expenditures, and Changes in Fund Balances, and the change in net assets for governmental activities as shown on the government-wide Statement of Activities, is presented in a schedule accompanying the governmental funds Statement of Revenues, Expenditures, and Changes in Fund Balances. The reconciliation differences stem from governmental funds using the current financial resources measurement focus and the modified accrual basis of accounting while the government-wide financial statements use the economic resources measurement focus and the accrual basis of accounting.

Notes to Basic Financial Statements

June 30, 2004

C. Basis of Accounting

All governmental funds are accounted for using the current financial resources measurement focus wherein only current assets and current liabilities are included on the Balance Sheet in the funds statements and the focus is on the determination of, and changes in, financial position. Long-term assets and long-term liabilities are included in the government-wide statements. Operating statements of government funds present increases (i.e., revenues and other financial sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

Measurable means the amount of the transaction can be determined and available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Revenues are recognized in the accounting period in which they become both measurable and available to finance expenditures of the fiscal period. 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. 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 to eligibility criteria are met. Real estate and personal property taxes are recorded as revenues and receivables when levied and billed, net of allowances for uncollectible amounts. Property taxes levied but not collected within 45 days after year-end are reflected as deferred revenues. Sales and utility taxes, which are collected by the State or utility companies and subsequently remitted to the City, are recognized as revenues and receivables upon collection by the State or utility companies, which is generally in the month preceding receipt by the City, because they are generally not measurable until actually received. Licenses and permits, fines and forfeitures, charges for services (except those charges for services recognized when billed) 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. Stormwater management fees are also recognized as revenue when earned. Expenditures are recorded when the related liability is incurred and payment is due, except for principal and interest on long-term debt which is recorded when due.

The government-wide financial statements (i.e., Statement of Net Assets and Statement of Activities) include all assets and liabilities associated with governmental and business-type activities. Assets and liabilities associated with fiduciary activities are included on the Statement of Fiduciary Net Assets. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. The pension trust funds' contributions from members are recorded when the employer makes payroll deductions from plan members. Nonexchange transactions, in which the City either gives or receives value without directly receiving or giving equal value in exchange, include sales and income taxes, property taxes, grants, entitlements, and donations. On an accrual basis, revenue from sales and income taxes are recognized when the underlying exchange transaction takes place. Revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

The Agency Fund uses the accrual basis of accounting and does not measure the results of operations.

The accrual basis of accounting is followed by the proprietary funds and pension trust funds. Accordingly, their revenues are recognized when earned and expenses are recognized when they are incurred. Unbilled utility service receivables are recorded in the enterprise funds when earned.

D. Property Taxes

The two major sources of property taxes are described below:

Real Estate Taxes

The City levies real estate taxes on all real estate within its boundaries, except that exempted by statute, each year as of July 1 on the estimated market value of the property. Real estate taxes become a lien on real property the first day of the levy year. The City, as required by state statute, follows the practice of reassessing all

Notes to Basic Financial Statements, Continued

property annually. Real estate taxes are collected in equal quarterly payments due September 30, December 31, March 31 and June 30 and are considered delinquent after each due date. The tax rate during 2004 was \$1.42 per \$100 of assessed value.

Personal Property Taxes

The City levies personal property taxes on motor vehicles and business and other tangible personal property. Personal property taxes do not create a lien on property; however, City vehicle tags, which are required by law for all vehicles garaged in the City, may not be issued to any individual having outstanding personal property taxes. These levies are made each year as of January 1 with payment due the following June 5. Taxes on motor vehicles bought and sold after January 1 are prorated and the tax levies are adjusted. During the fiscal year, the personal property taxes reported as revenue are the adjusted levies less an allowance for uncollectibles. Personal property taxes are considered delinquent after the June 5 due date or, in the case of supplemental levies, thirty days after the taxes are levied and billed. The personal property tax rate for 2004, excluding machinery and tools, boats and recreational vehicles, was \$4.35 per \$100 of assessed value. The personal property tax rate on machinery and tools, boats, mobile homes, and recreational vehicles was \$3.00, \$.01, \$1.42, and \$1.50 per \$100 of assessed value, respectively.

E. Allowance for Uncollectibles

Provision for uncollectible property taxes is based on a historical percentage of accounts written off applied to the total levies of all years carried in taxes receivable. Provision for uncollectible accounts receivable is based on an evaluation of delinquent accounts and adequacy of the allowance.

Governmental Activities:	
General Fund:	
Allowance for taxes receivable	\$ 2,619,448
Allowance for doubtful accounts receivable	1,624,384
Total General Fund	4,243,832
Special Revenue Fund - Stormwater Management Fund -	
Allowance for doubtful accounts receivable	211,311
Total governmental activities	\$ 4,455,143
Business-Type Activities - allowance for doubtful accounts receivable:	
Enterprise Funds:	
Public Utility Fund	\$ 356,783
Waste Management Fund	366,077
Total business-type activities	\$ 722,860
Component Units - allowance for doubtful accounts receivable:	
Portsmouth Parking Authority	\$ 279,060

F. Cash and Temporary Investments

Cash and temporary investments from certain funds are combined and invested in local bank repurchase agreements and certificates of deposit. Each fund's share of the pooled cash is accounted for within the individual fund. Pooled cash overdrafts have been reclassified as interfund receivables and payables. The income from the pooled monies has been allocated to the respective funds based on the pooled cash balances of each fund at the end of each month. For purposes of the statement of cash flows, investments with original maturities of three months or less from date of purchase are considered cash equivalents and are reported as cash and temporary investments.

Notes to Basic Financial Statements, Continued

G. Investments

Investments are carried at fair value. Fair value is determined by quoted market prices. Investments in corporate bonds and commercial paper are valued at amortized cost if the maturity date is less than one year.

H. Inventories

Inventories consist of expendable materials and supplies held for future consumption and are valued at cost using the first-in, first-out (FIFO) basis. All inventories are recorded under the purchases method, as expenditures or expenses when purchased, rather than when consumed.

I. Capital Assets

Capital assets and improvements include substantially all land, buildings, equipment, water distribution and sewage collection systems, and other elements of the City's infrastructure having a minimum useful life of 30 years, and having a cost of more than \$5,000. Capital assets, which are used for general governmental purposes and are not available for expenditure, are accounted for and reported in the government-wide financial statements. Infrastructure elements include the roads, bridges, curbs and gutters, streets and sidewalks, parkland and improvements, and subway tracks and tunnels.

Capital assets are generally stated at historical cost, or at estimated historical cost based on appraisals or on other acceptable methods when historical cost is not available. Donated capital assets are stated at their fair market value as of the date of the donation. Capital leases are classified as capital assets in amounts equal to the lesser of the fair market value or the present value of net minimum lease payments at the inception of the lease. Accumulated depreciation and amortization are reported as reductions of fixed assets. Capital asset depreciation has been provided over the estimated useful lives using the straight-line method annually as follows:

	Estimated Useful Life in Years
Governmental Activities:	
Infrastructure	30-50
Site improvements	20
Buildings and building improvements	20-40
Machinery, furniture and equipment	5-15
Business-Type Activities:	
Public Utility Fund:	
Buildings	50
Improvements other than buildings	50
Machinery, furniture and equipment	5
Port Facilities and Economic Development Fund:	
Buildings	40
Improvements other than buildings	20-50
Golf Fund:	
Buildings	25
Machinery, furniture and equipment	5-6
Component Unit – School Board:	
Buildings and Improvements	20-50
Machinery, furniture and equipment	5-30
Component Unit - Parking Authority:	
Buildings	20-40
Improvements other than buildings	10-20
Machinery, furniture and equipment	5-20

Notes to Basic Financial Statements, Continued

Compensated Absences

City and Parking Authority employees are granted vacation time in varying amounts based on length of service. They may accumulate unused vacation time earned and, upon retirement, termination or death, may be compensated for the accumulated amounts at their current rates of pay not to exceed 352 hours. For nonexempt employees, overtime earned but not received in hours or compensation will accumulate and be paid in the event of retirement, termination or death.

City and Parking Authority employees accrue sick leave at the rate of eight hours for each full calendar month of work completed. Sick leave may be accumulated and carried forward until the time of retirement, termination or death when the leave is forfeited.

The liability for compensated absences has been recorded in accordance with the provisions of GASB Statement No. 16, *Accounting for Compensated Absences*. The cost of the compensated absences expected to be paid from future expendable financial resources is accounted for as a liability. In the governmental funds, the amount of compensated absences recorded as an expenditure is the amount utilized by the employees during the year. In the government-wide and proprietary fund financial statements, the amount of compensated absences recorded as an expense is the amount earned.

J. Intra-entity Activity

Payments from a fund receiving revenue to a fund through which the revenue is to be expended are reported as transfers. Such payments include transfers for debt service and capital construction. Resource flows between the primary government and the discretely presented component units are reported as if they were external transactions.

K. Estimates and Assumptions

A number of estimates and assumptions relating to the reporting of revenues, expenses, expenditures, assets and liabilities, and the disclosure of contingent liabilities were used to prepare these financial statements in conformity with generally accepted accounting principles (GAAP). Actual results could differ from those estimates.

(2) EQUITY

The fund equity balances have been classified to reflect the limitations and restrictions placed on the respective funds. Reserved fund balance represents that portion of fund balance not available for appropriation or expenditure. Designated fund balance represents amounts that are tentatively planned for financial resource utilization in a future period. Undesignated fund balance represents the remainder of the City's equity in governmental fund type fund balances. Fund balances reserved at June 30, 2004 are composed of the following:

	General Fund	Capital Improvements	Other Nonmajor
Current year encumbrances	\$ 3,260,540	2,021,166	730,859
Prior year encumbrances	22,442	-	-
Revenue maximization	-	-	320,223
Inventory	36,981	-	-
Cemetery care	-	-	1,000,000
	\$ 3,319,963	2,021,166	2,051,082

Notes to Basic Financial Statements, Continued

(3) CASH AND TEMPORARY INVESTMENTS, INVESTMENTS, AND RESTRICTED CASH AND TEMPORARY INVESTMENTS**Deposits and Restricted Cash**

At June 30, 2004, the carrying value of the City's deposits with banks and savings institutions was \$18,941,603 and the bank balance was \$17,986,506. Of the bank balance, \$608,105 was covered by the Federal Depository Insurance Corporation (the FDIC). The bank balances exceeding those covered by FDIC are protected under the provisions of the Virginia Security for Public Deposits Act (the Act). Under the Act, banks holding public deposits in excess of the amounts insured by FDIC must pledge collateral in the amount of 50% of 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 FDIC limits. 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. Cash from all funds, except that restricted for specific purposes or managed by fiscal agents, is pooled for investment purposes. Both the carrying value and bank balance of restricted cash as of June 30, 2004 was \$2,200,000.

Investments (Including Restricted Investments)

State statutes and City ordinances authorize the City to invest in obligations of the United States or agencies thereof, obligations of the Commonwealth of Virginia or political subdivisions thereof, obligations of the International Bank for Reconstruction and Development (World Bank), the Asian Development Bank, the African Development Bank, "prime quality" commercial paper and certain corporate notes, banker's acceptances, repurchase agreements, and the State Treasurer's Local Government Investment Pool (LGIP). The pension trust funds are also authorized to invest in common stocks and marketable debt securities which mature within twenty years with credit ratings no lower than Baa or BBB as measured by Moody's, Standard and Poor's, or Fitch IBCA's rating services.

Investments (including investments restricted for specific purposes of \$5,944,790) are categorized below to give an indication of the level of risk assumed by the City at year-end. Category 1 includes investments that are insured or registered or securities that are held by the City or its safekeeping agent in the City's name. Category 2 includes uninsured or unregistered investments for which the securities are held by the dealer bank's trust department or agent in the City's name. Category 3 includes uninsured and unregistered investments which are held by the broker or dealer, or by the dealer bank but not in the City's name.

Investments in the State Non-Arbitrage Program (SNAP), money market funds, Virginia Arbitrage and Investment Management Program (AIM), and retirement investments are not subject to categorization as to assumed risks because, in the aggregate, they are considered pooled investments in nature and are not evidenced by securities that exist in physical or book entry form. The fair value of the position in these pooled investments is the same as the value of the pool shares.

Notes to Basic Financial Statements, Continued

At June 30, 2004, the City's deposit and investment balances were as follows:

	Category 1	Category 2	Category 3	Carrying Amount
Restricted deposits	\$ 2,200,000	-	-	2,200,000
Deposits	18,941,603	-	-	18,941,603
Total	21,141,603	-	-	21,141,603
Investments in SNAP				8,563,173
Investments in AIM				1,882,907
Money market funds				11,094,027
Retirement investments in a Common Collective Trust Fund:				
U.S., State and Municipal government securities				16,491,394
Mortgage and mortgage-backed securities				15,189,442
Corporate bonds and debentures				11,717,570
Real Estate				6,500,000
Diversified alternatives				6,500,000
Corporate stocks				74,013,482
Total City deposits and investments				\$ 173,093,598
Cash on hand				41,967
Total City cash, deposits and investments				\$ 173,135,565

The pension trust funds own 100 percent of the investments listed above as retirement investments.

Component Unit - School Board

At year end, the carrying value of deposits with banks for the School Board, a discretely presented component unit, was \$3,222,346 and the bank balance was \$6,641,551. The carrying value excludes \$534,062 related to Student Activity Funds not reported in Exhibit G-1. The entire bank balance was covered by Federal depository insurance or collateralized in accordance with the Act.

The School Board's investments consist of repurchase agreements of \$15,874,561. These investments are stated at fair value. The repurchase agreements are categorized in accordance with GASB Statement No. 3 as uninsured and unregistered investments for which the securities are held by a broker or dealer, or by its trust department or safekeeping agent, but not in the School Board's name.

Component Unit - Parking Authority

At year end, the carrying value and bank balance of cash deposits with banks for the Parking Authority, a discretely presented component unit, was zero. Cash on hand totaled \$375. The Parking Authority had investments in SNAP of \$403,087 at June 30, 2004.

Component Unit - Industrial Development Authority

At year end, the carrying value of deposits with banks for the Industrial Development Authority, a discretely presented component unit, was \$202,117 which was also the bank balance. Of the bank balance, \$100,000 was covered by the FDIC. The bank balances exceeding those covered by FDIC are protected under the provisions of the Act. Cash on hand totaled \$100.

Notes to Basic Financial Statements, Continued

Component Unit – Portsmouth Port and Industrial Commission

At year end, the carrying value and bank balances of deposits with banks for the Portsmouth Port and Industrial Commission, a discretely presented component unit, were \$1,425,984 and \$1,923,999, respectively. Of the bank balance, \$100,000 was covered by Federal depository insurance. The bank balances exceeding those covered by FDIC are protected under the provisions of the Act.

(4) CAPITAL ASSETS

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

Primary Government - Governmental Activities	Balance July 1, 2003	Additions	Deletions	Balance June 30, 2004
Capital assets not being depreciated:				
Land	\$ 25,513,771	-	15,500	25,498,271
Construction in progress	43,775,431	12,464,778	399,819	55,840,390
Total capital assets not being depreciated	69,289,202	12,464,778	415,319	81,338,661
Capital assets being depreciated:				
Infrastructure	452,721,687	1,823,881	-	454,545,568
Site improvements	1,436,092	-	-	1,436,092
Buildings	162,980,866	-	-	162,980,866
Machinery, furniture and equipment	33,092,303	2,403,105	3,064,715	32,430,693
Total capital assets being depreciated	650,230,948	4,226,986	3,064,715	651,393,219
Less accumulated depreciation for:				
Infrastructure	(264,692,109)	(12,021,270)	-	(276,713,379)
Site improvements	(159,573)	(71,805)	-	(231,378)
Buildings	(42,980,907)	(3,595,100)	-	(46,576,007)
Machinery, furniture and equipment	(20,785,332)	(2,624,366)	(3,014,149)	(20,395,549)
Total accumulated depreciation	(328,617,921)	(18,312,541)	(3,014,149)	(343,916,313)
Total capital assets being depreciated, net	321,613,027	(14,085,555)	50,566	307,476,906
Governmental activities capital assets, net	\$ 390,902,229	(1,620,777)	465,885	388,815,567

Notes to Basic Financial Statements, Continued

Depreciation expense was charged to functions as follows:

General government	\$ 22,757
Judicial	698,192
Public safety	1,086,564
Public works	12,341,934
Health and welfare	174,081
Parks, recreation and cultural	374,126
Community development	974,596
Education	1,144,819
Total governmental funds	16,817,069
Depreciation on capital assets held by the City's internal service funds (see Exhibit E-2) is charged to the various functions based on their usage of the assets.	1,495,472
Total governmental activities	\$ 18,312,541

Construction in progress for the City is composed of the following:

	Project Authorization	Expended to June 30, 2004	Commitments/ Encumbrances
Victory Boulevard	\$ 6,775,000	348,641	77,162
Midtown Redevelopment Acquisition	6,150,000	3,161,922	3,150
Brighton	5,391,593	2,275,904	-
Computerized Traffic Signals	3,599,060	3,512,043	9,284
Tower Mall Redevelopment	5,558,000	5,057,054	254,409
Behavioral Health Building	4,529,003	29,003	-
Douglass Park Elementary School	4,401,645	4,401,645	-
PAC - Ntelos Pavilion	4,180,000	2,448,741	
Port Centre EDA Grant	4,160,162	4,238,625	38,291
City Hall Repairs	4,127,500	3,884,976	185,483
Drainage Facilities Repair & Lake Mgt.	4,053,394	3,393,496	338,793
Westhaven Elementary School	3,672,943	3,672,943	-
Churchland High School - Air Quality	3,116,306	2,373,053	40,673
North Truxton	2,506,205	2,535,352	6,793
Lee Avenue Improvements	2,500,000	422,111	452,057
Highland Biltmore Improvements	2,097,000	1,851,962	13,059
Frederick Boulevard	1,878,586	1,786,550	48,981
Civic Center Specifications	1,779,453	1,754,558	24,333
Simonsdale Street Improvements	1,593,131	1,566,117	23,516
Substructure Painting London Blvd Bridge	1,500,000	79,750	-
Bridge Repairs	1,397,985	1,218,186	-
Renovations to Various Buildings	1,100,731	1,043,198	19,871
Various projects under \$1,000,000 each	11,825,518	4,784,560	336,097
	\$ 87,893,215	55,840,390	1,871,952

Notes to Basic Financial Statements, Continued

When a project is authorized, financing is either presently available or general obligation bonds are authorized to be issued. In anticipation of the issuance of general obligation bonds, bond anticipation notes may be utilized to provide temporary financing. Commitments totaling \$2,021,166 have been reserved for encumbrances in the capital improvements fund.

Primary Government - Business-Type Activities	Balance July 1, 2003	Additions	Deletions	Balance June 30, 2004
Capital assets not being depreciated:				
Land	\$ 14,531,594	-	-	14,531,594
Construction in progress	44,207,471	8,986,891	-	53,194,362
Total capital assets not being depreciated	58,739,065	8,986,891	-	67,725,956
Capital assets being depreciated:				
Buildings	3,629,804	-	-	3,629,804
Improvements other than buildings	140,758,658	1,182,373	-	141,941,031
Machinery, furniture and equipment	11,306,902	1,533,162	-	12,840,064
Total capital assets being depreciated	155,695,364	2,715,535	-	158,410,899
Less accumulated depreciation for:				
Buildings	(1,330,187)	(122,675)	-	(1,452,862)
Improvements other than buildings	(45,599,769)	(2,778,126)	-	(48,377,895)
Machinery, furniture and equipment	(8,638,824)	(1,018,813)	-	(9,657,637)
Total accumulated depreciation	(55,568,780)	(3,919,614)	-	(59,488,394)
Total capital assets being depreciated, net	100,126,584	(1,204,079)	-	98,922,505
Business-type activities capital assets, net	\$ 158,865,649	7,782,812	-	166,648,461

Notes to Basic Financial Statements, Continued

Primary Government - Major Enterprise Funds	Balance July 1, 2003	Additions	Deletions	Balance June 30, 2004
<u>Public Utility Fund</u>				
Capital assets not being depreciated:				
Land	\$ 186,779	-	-	186,779
Construction in progress	44,207,471	8,966,471	-	53,173,942
Total capital assets not being depreciated	44,394,250	8,966,471	-	53,360,721
Capital assets being depreciated:				
Buildings	67,864	-	-	67,864
Improvements other than buildings	136,211,100	1,182,373	-	137,393,473
Machinery, furniture and equipment	5,588,977	344,037	-	5,933,014
Total capital assets being depreciated	141,867,941	1,526,410	-	143,394,351
Less accumulated depreciation for:				
Buildings	(64,139)	(1,713)	-	(65,852)
Improvements other than buildings	(42,177,217)	(2,727,063)	-	(44,904,280)
Machinery, furniture and equipment	(5,794,892)	(396,692)	-	(6,191,584)
Total accumulated depreciation	(48,036,248)	(3,125,468)	-	(51,161,716)
Total capital assets being depreciated, net	93,831,693	(1,599,058)	-	92,232,635
Public utility capital assets, net	\$ 138,225,943	7,367,413	-	145,593,356
<u>Golf Fund</u>				
Capital assets not being depreciated -				
Land	\$ 9,605,289	-	-	9,605,289
Construction in progress	-	20,420	-	20,420
Total capital assets not being depreciated	9,605,289	20,420	-	9,625,709
Capital assets being depreciated:				
Buildings	2,127,591	-	-	2,127,591
Machinery, furniture and equipment	808,692	63,769	-	872,461
Total capital assets being depreciated	2,936,283	63,769	-	3,000,052
Less accumulated depreciation for:				
Buildings	(297,863)	(85,104)	-	(382,967)
Machinery, furniture and equipment	(569,567)	(132,765)	-	(702,332)
Total accumulated depreciation	(867,430)	(217,869)	-	(1,085,299)
Total capital assets being depreciated, net	2,068,853	(154,100)	-	1,914,753
Golf capital assets, net	\$ 11,674,142	(133,680)	-	11,540,462

Notes to Basic Financial Statements, Continued

Construction in progress in the Public Utility Fund is composed of the following:

	Project Authorization	Expended to June 30, 2004	Commitments
Public Utility Fund:			
Lake Kilby-Pilot Testing Program	\$ 18,492,301	18,475,739	14,700
Suction Well Rehabilitation	1,370,290	501,167	81,146
Miscellaneous Sewer Improvements	1,344,500	780,253	561,175
Infrastructure Improvements	12,053,383	8,102,248	3,289,692
Godwin Street Reservoir Replacement	9,290,923	3,916,465	4,393,501
Electrical Facility Relocation - Lake Kilby	5,200,500	3,728,990	338,837
Drought Emergency Water Main	4,838,287	4,838,287	-
Replacement of Water Plant Equipment	2,418,213	935,184	144,276
Water Plant Residuals Mgt. & Disposal	3,033,500	2,378,380	39,421
Miscellaneous Water Improvements	2,021,563	1,518,281	373,353
Four Dams	1,086,500	986,403	3,094
Various projects under \$1,000,000 each	2,976,021	1,918,811	293,151
	\$ 64,125,981	48,080,208	9,532,346

In addition to the amount of \$48,080,208 shown above as expended to June 30, 2004, \$5,093,734 is included in construction in progress for capitalized interest, bringing total construction in progress to \$53,173,942. When a project is authorized, financing is either presently available or general obligation public utility bonds or revenue bonds are authorized to be issued. In anticipation of the issuance of general obligation public utility bonds or revenue bonds, bond anticipation notes may be utilized to provide temporary financing.

School Board Component Unit

	Balance July 1, 2003	Additions	Deletions	Balance June 30, 2004
Capital assets not being depreciated:				
Land	\$ 6,575,831	-	76,366	6,499,465
Construction in progress	27,176	2,706,406	130,470	2,603,112
Total capital assets not being depreciated	6,603,007	2,706,406	206,836	9,102,577
Capital assets being depreciated:				
Buildings	52,601,871	130,470	505,285	52,227,056
Machinery, furniture and equipment	12,058,056	3,038,282	936,119	14,160,219
Total capital assets being depreciated	64,659,927	3,168,752	1,441,404	66,387,275
Less accumulated depreciation for:				
Buildings	(29,436,749)	(1,122,464)	(464,862)	(30,094,351)
Machinery, furniture and equipment	(7,253,509)	(1,377,103)	(930,118)	(7,700,494)
Total accumulated depreciation	(36,690,258)	(2,499,567)	(1,394,980)	(37,794,845)
Total capital assets being depreciated, net	27,969,669	669,185	46,424	28,592,430
School Board capital assets, net	\$ 34,572,676	3,375,591	253,260	37,695,007

Notes to Basic Financial Statements, Continued

(5) LONG - TERM DEBT

Details of Long-Term Indebtedness

At June 30, 2004, the long-term indebtedness of the City consisted of the following:

	Interest Rate	Amount Outstanding
Governmental Activities		
General obligation bonds, net:		
1996 Public Improvement Bonds	5.00%	\$ 4,000,000
1997 Public Improvement Bonds	6.27 - 6.65%	7,925,000
1997 Public Improvement Bonds	4.25 - 5.25%	20,160,000
1999 Qualified Zone Academy Bonds	0%	4,392,614
2001 Public Improvement Bonds	4.00 - 5.50%	16,951,614
2001 Qualified Zone Academy Bonds	0%	817,193
2001 Virginia Public School Authority Bonds	3.10 - 5.35%	2,956,236
2003 Public Improvement Refunding Bonds	2.0 - 5.0%	64,855,529
Total general obligation bonds, net		122,058,186
General obligation notes payable	2.64 - 4.37%	7,980,000
Obligations under capital leases		22,343,357
Obligations under cooperation agreements (note 6)		53,143,736
Literary loans		4,800,000
Bond anticipation notes		5,139,951
Compensated absences		6,270,966
Total governmental activities		\$ 221,736,196
Business Type-Activities		
General obligation bonds, net:		
1992 Port Improvement Bonds	6.25 - 6.60%	\$ 1,145,000
1996 Public Utility Bonds	5.00 - 5.25%	3,715,007
1997 Public Utility Bonds	4.25 - 5.25%	3,394,274
2001 Public Utility Bonds	4.00 - 5.00%	20,448,243
2003 Public Utility Bonds	2.0 - 5.0%	30,742,701
Revenue bonds, net -		
1998 Golf Course System Improvement Bonds	4.00 - 5.00%	8,422,996
Total general obligation and revenue bonds, net		67,868,221
Obligations under capital leases		563,622
Bond anticipation notes		2,860,494
Landfill closure and postclosure care		5,179,473
Compensated absences		687,536
Total business type-activities		\$ 77,159,346

General obligation and revenue bonds are stated net of unamortized bond premiums, discounts, and deferred amounts on refunding.

Notes to Basic Financial Statements, Continued

At June 30, 2004, the long-term indebtedness of Component Units consisted of the following:

	Amount Outstanding
School Board:	
Obligations under capital leases	\$ 283,003
Net pension obligation	113,026
Compensated absences	3,892,009
	\$ 4,288,038
Parking Authority:	
General obligation bond	\$ 7,709,292
Notes payable to City	4,825,233
Compensated absences	24,651
	\$ 12,559,176
Industrial Development Authority:	
Revenue bonds:	
1997 Variable Rate Taxable Demand Revenue Bonds (note 13)	\$ 6,180,000
1997 Variable Rate Demand Revenue Bonds	6,395,000
	\$ 12,575,000

Changes in Indebtedness

Changes in the total short-term liabilities during the fiscal year ended June 30, 2004 are summarized below:

Primary Government - Governmental Activities				
	Balance July 1, 2003	Additions	Deletions	Balance June 30, 2004
Revenue anticipation note	\$ -	10,000,000	10,000,000	-

On August 14, 2003, the City issued \$10,000,000 of General Obligation Revenue Anticipation Notes to provide short-term financing for shortfalls in cash due to timing delays in the receipt of tax revenues. Principal and interest, at a rate of 1.48%, was due when the notes matured on June 30, 2004.

Notes to Basic Financial Statements, Continued

The following is a summary of changes in long-term indebtedness of the City for the year ended June 30, 2004:

	Balance at July 1, 2003	Increases	Decreases	Balance at June 30, 2004	Due Within One Year
Primary Government -					
Governmental Activities:					
General obligation bonds, net	\$ 128,879,496	64,855,529	(71,676,839)	122,058,186	6,288,981
General obligation notes payable	-	7,980,000	-	7,980,000	-
Compensated absences	6,166,128	135,786	(30,948)	6,270,966	4,203,476
Bond anticipation notes	2,231,858	2,908,093	-	5,139,951	-
Cooperation agreements (note 6)	55,173,736	-	(2,030,000)	53,143,736	2,130,000
Literary loans	5,275,000	-	(475,000)	4,800,000	475,000
Capital leases (note 7)	22,892,651	1,588,957	(2,138,251)	22,343,357	2,180,828
Total Governmental Activities	\$ 220,618,869	77,468,365	(76,351,038)	221,736,196	15,278,285
Business-Type Activities:					
General obligation and revenue bonds, net	\$ 70,987,510	32,195,711	(35,315,000)	67,868,221	3,012,128
Bond anticipation notes	-	2,860,494	-	2,860,494	-
Landfill closure and postclosure care	3,714,312	1,465,161	-	5,179,473	-
Compensated absences	674,471	38,716	(25,651)	687,536	687,536
Capital leases (note 7)	338,661	655,000	(430,039)	563,622	125,472
Total Business-Type Activities	\$ 75,714,954	37,215,082	(35,770,690)	77,159,346	3,825,136
Major Enterprise Funds:					
<i>Public Utility Fund</i>					
General obligation bonds, net	\$ 60,619,356	31,045,869	(33,365,000)	58,300,225	2,390,921
Bond anticipation notes	-	2,860,494	-	2,860,494	-
Compensated absences	381,748	-	(19,332)	362,416	362,416
Total Public Utility Fund	\$ 61,001,104	33,906,363	(33,384,332)	61,523,135	2,753,337
<i>Golf Fund</i>					
Revenue bonds, net	\$ 8,698,154	4,842	(280,000)	8,422,996	285,158
Compensated absences	70,024	-	(6,319)	63,705	63,705
Total Golf Fund	\$ 8,768,178	4,842	(286,319)	8,486,701	348,863

Long-term liabilities applicable to the City's governmental activities are not due and payable in the current period and accordingly are not reported as fund liabilities in the governmental funds. Interest on long-term debt is not accrued in governmental funds, but rather is recognized as an expenditure when due. All liabilities, both current and long-term, are reported in the Statement of Net Assets. The amount due within one year for compensated absences has been estimated and is generally liquidated by the fund for which the employee works.

Notes to Basic Financial Statements, Continued

Section 148 of the Internal Revenue Code of 1986 requires public entities to refund interest earned in excess of interest paid over the first five years outstanding on tax exempt borrowings. The regulations are applicable to borrowings incurred subsequent to August 1986. The City has calculated the rebate due as if June 30, 2004 was the settlement date, and reflected the liability, if any, in either the Public Utility Fund or the governmental activities column of the Statement of Net Assets, depending on the bond issue and timing of payment.

The following is a summary of changes in long-term indebtedness of the Component Units for the year ended June 30, 2004:

	Balance at July 1, 2003	Increases	Decreases	Balance at June 30, 2004	Due Within One Year
School Board:					
Capital leases	\$ 398,939	-	(115,936)	283,003	121,865
Net pension obligation	118,060	9,445	(14,479)	113,026	-
Compensated absences	3,888,470	1,533,468	(1,529,929)	3,892,009	1,530,000
	\$ 4,405,469	1,542,913	(1,660,344)	4,288,038	1,651,865
Parking Authority:					
Note payable	\$ 7,500,000	-	(7,500,000)	-	-
General obligation bonds	-	7,709,292	-	7,709,292	250,715
Notes payable to City	5,138,106	-	(312,873)	4,825,233	320,073
Compensated absences	24,700	306	(355)	24,651	24,651
	\$ 12,662,806	7,709,598	(7,813,228)	12,559,176	595,439
Industrial Development Authority:					
Revenue bonds	\$ 12,875,000	-	(300,000)	12,575,000	315,000
Note payable	219,026	-	(219,026)	-	-
	\$ 13,094,026	-	(519,026)	12,575,000	315,000

The debt recorded in the enterprise and internal service funds is paid from revenues earned in those funds. General obligation debt is paid from the General Fund for which the primary funding sources are utility taxes paid by the customers of public utility service companies.

As of June 30, 2004, there were \$26,174,084 of bonds for public improvements and \$20,502,000 of bonds for public utility improvements that were authorized but unissued.

Management believes that the City is in compliance with all significant financial covenants contained in the various bond indentures at June 30, 2004.

Defeased Debt

In the current and prior years, the City defeased certain general obligation public improvement, public utility, and port improvement bonds by placing funds in irrevocable escrow accounts to provide for future debt service payments on the defeased debt. Accordingly, the escrow account assets and liabilities for the defeased debt are not included in the City's financial statements. At June 30, 2004, the outstanding balance of the defeased debt is \$99,380,000, of which \$30,470,000 is for the Public Utility Fund, and \$1,145,000 is for the Port Facility and Economic Development Fund.

Debt Issued

On August 15, 2003, the City entered into a third addendum equipment lease financing agreement totaling \$655,000 with Banc of America Leasing & Capital, LLC. The financing consists of a five-year term with an average annual interest of 3.37%. The proceeds of the lease were used for waste management equipment.

Notes to Basic Financial Statements, Continued

On November 14, 2003, the City issued a \$5,450,000 General Obligation Note (Series 2003) to provide financing for the acquisition of the property known as the Mid-City Shopping Center. The effective interest rate is 2.64% and is due semi-annually in April and October. The note matures on October 15, 2006.

On December 16, 2003, the City issued \$103,915,000 of General Obligation Refunding Bonds (Series 2003) with a premium of \$7,849,183. The Refunding Bonds were issued pursuant to City Council resolution to advance refund \$64,365,000 of outstanding Public Improvement bonds (various series), \$30,470,000 of Public Utility bonds, \$1,145,000 of Port bonds, and a \$7,500,000 Parking Note maturing on February 26, 2004. The total amount of refunding payments made of \$103,291,661 were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds have been removed from the City's financial statements. The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$4,971,929. This difference, reported in the accompanying government-wide financial statements as a deduction from bonds payable, is being amortized over the life of the new debt. The City completed the advance refunding to reduce its total debt service payments over the next 17 years by \$5,330,940 and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) using a discount rate of 3.499% of approximately \$4,132,530.

On April 30, 2004, the City entered into a Master Lease agreement totaling \$24,000,000 with an approximate 40 month term with Banc of America Leasing and Capital, LLC. The purpose of this lease is to provide funds to finance the costs of the acquisition of various pieces of equipment.

On June 30, 2004, the City issued a \$2,530,000 Taxable General Obligation Note (Series 2004) to provide funds to pay the costs, in whole or in part, of the acquisition and installation of the replacement canopy for the NTelos Pavilion at Harbor Center. The effective interest rate is 4.37% and is due semiannually on February 1 and August 1 maturing on August 7, 2007.

On May 14, 2002, the City authorized the issuance and sale of \$15,869,648 General Obligation Bond Anticipation Notes in anticipation of the issuance and receipt of the proceeds of sale of bonds for public improvement and public utility capital improvement projects. Of the total amount authorized, \$1,418,859 and \$2,860,494 was drawn in the current year for capital improvement and public utility projects, respectively.

On August 13, 2002, the City authorized the issuance and sale of \$2,000,000 General Obligation Taxable Bond Anticipation Notes in anticipation of the issuance and receipt of the proceeds of sale of bonds for economic development capital projects. Of the total amount authorized, \$1,489,234 was drawn for the Tower Mall capital improvement project.

Component Unit Debt with City

During fiscal years 1983 and 1989, the Portsmouth Parking Authority entered into \$5,000,000 and \$2,845,000, respectively, 8.0% unsecured notes payable to the City in order to repay expenditures by the City in prior years for the construction of new parking garages. During fiscal year 1981, the Parking Authority entered into a \$2,400,000, 6.0% unsecured note payable to finance the Central Parking Garage. According to the agreements, if sufficient revenues are not available to the Parking Authority in any given year, interest expense on these notes will be abated. However, principal payments will remain the liability of the Parking Authority to be repaid during the remaining portion of these agreements. During the fiscal year 1986, an additional agreement was executed to include the same provisions for abatement of interest and deferral of principal on the notes payable for the Central Parking Garage from the Parking Authority. Interest payments of \$391,349 due on long-term debt for fiscal year 2004 from the Parking Authority were abated by the City.

CITY OF PORTSMOUTH, VIRGINIA

Exhibit H, Continued

Notes to Basic Financial Statements, Continued

Debt Compliance and Repayment

The annual requirements to amortize to maturity all long-term indebtedness of the City which is outstanding as of June 30, 2004 (except line of credit, compensated absences, landfill closure and postclosure care and net pension obligation) are as follows:

Governmental Activities

Fiscal Year Ending	General Obligation Bonds		General Obligation Notes		Cooperation Agreements		Literary Loans		Capital Leases	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2005	\$ 6,288,981	555,869	-	208,374	2,130,000	2,367,020	475,000	99,000	2,180,828	1,459,026
2006	8,104,319	5,063,833	-	254,441	2,240,000	2,277,731	475,000	88,500	1,753,838	1,403,198
2007	9,571,437	4,753,061	5,450,000	182,501	2,350,000	2,182,295	475,000	78,000	1,297,592	1,378,020
2008	9,574,493	4,366,493	2,530,000	55,280	2,460,000	2,082,675	375,000	67,500	995,681	1,306,895
2009	9,596,488	3,970,116	-	-	2,585,000	1,976,052	375,000	60,000	930,520	1,237,346
2010-2014	44,498,707	8,032	-	-	11,380,000	8,286,900	1,625,000	190,000	4,384,707	5,464,102
2015-2019	30,887,656	4,182,342	-	-	8,450,000	6,385,735	1,000,000	50,000	5,904,167	3,343,690
2020-2024	3,536,105	259,411	-	-	10,433,736	4,209,652	-	-	3,381,024	537,989
2025-2029	-	-	-	-	11,115,000	1,721,250	-	-	1,515,000	70,200
	\$ 122,058,186	23,159,157	7,980,000	700,596	53,143,736	31,489,310	4,800,000	633,000	22,343,357	16,200,466

Business-Type Activities

Fiscal Year Ending	General Obligation and Revenue Bonds		Capital Leases	
	Principal	Interest	Principal	Interest
2005	\$ 3,012,128	3,280,703	125,472	17,433
2006	4,078,387	3,015,491	129,759	13,147
2007	2,911,156	2,867,159	134,190	8,715
2008	2,964,833	2,766,042	138,773	4,133
2009	3,045,564	2,628,833	35,428	299
2010-2014	15,843,973	11,025,312	-	-
2015-2019	16,628,299	7,171,882	-	-
2020-2024	15,034,950	3,082,312	-	-
2025-2026	4,348,931	332,000	-	-
	\$ 67,868,221	36,169,734	563,622	43,727

Notes to Basic Financial Statements, Continued

(6) OBLIGATIONS UNDER COOPERATION AGREEMENTS

On March 1, 1999, the Industrial Development Authority (IDA), a discretely presented component unit, issued \$39,270,000 of Revenue Bonds, Series 1999 (the bonds), net of \$380,639 of original issue discount, to construct a hotel, conference center and parking garage. In lieu of providing upfront funding to the IDA to fund the cost of this project, the City and the IDA entered into a Cooperation Agreement in which the City agrees to contribute funds to the IDA, subject to appropriation by City Council and upon the request of the IDA, to pay annual debt service costs on the bonds. The bonds are limited obligations of the IDA payable solely from payments received by the IDA from the City under the terms of the Cooperation Agreement and from certain funds established under the Indenture. The payment of principal and interest on the bonds is additionally secured by the City Hall and the Civic Center, currently owned by the City, a leasehold interest which was conveyed by the City to the IDA for such purpose. The City maintains the right to use and operate such properties through a separate lease agreement. Accordingly, the City Hall and the Civic Center are being maintained in the City's capital assets and the obligation, equal to the amount of bonds outstanding, are reflected as long-term debt. The balance outstanding at June 30, 2004 was \$36,360,000.

On September 7, 2000, the City entered into a Cooperation Agreement with the Portsmouth Redevelopment and Housing Authority (PRHA) for the purpose of facilitating the Redevelopment Plan for the Tower Redevelopment Project (the Plan). The Plan is intended to eliminate blight and bring about the commercial redevelopment of properties within and around the area encompassed within the Plan. The Plan imposes certain financial obligations on PRHA which cannot be made without the financial backing of the City. A responsibility of the City under the Cooperation Agreement was to provide the cost of acquiring the Tower Mall property. The City, through the IDA, utilized the cash from the sale of a commercial building to fund the purchase of Tower Mall by PRHA. As PRHA sells parcels of this property for redevelopment, the proceeds are remitted to the IDA and reduce the amount of the City's obligation under this cooperation agreement. During fiscal year 2004, the City's obligation was reduced by \$140,000. The amount payable to the IDA under this Cooperation Agreement is \$5,403,736 at June 30, 2004.

On July 19, 2001, the IDA issued \$13,000,000 of Taxable Variable Rate Public Facility Revenue Bonds, Series 2001 (the bonds), to construct a performing arts center. In lieu of providing upfront funding to the IDA to fund the cost of this project, the City and the IDA entered into a Cooperation Agreement in which the City agrees to contribute funds to the IDA to pay annual debt service costs on the bonds. The Cooperation Agreement is a general obligation of the City backed by the City's full faith and credit. The bonds are limited obligations of the IDA payable from payments received by the IDA from the City under the terms of the Cooperation Agreement and from certain funds established under the indenture. The amount payable to the IDA under this Cooperation Agreement is \$11,380,000 at June 30, 2004.

(7) LEASING ARRANGEMENTS**As Lessee**

The City leases certain land, buildings, equipment and vehicles under capital leases and certain facilities under operating leases that expire in years through 2028. Included in capital assets are the following amounts applicable to capital leases:

		Governmental	Internal Service
Land	\$	6,555,000	-
Buildings		12,347,000	-
Equipment and vehicles		5,498,883	3,149,491
Less accumulated depreciation		(2,680,049)	(1,706,887)
	\$	21,720,834	1,442,604

Depreciation expense on leased assets was \$4,386,936 for the fiscal year ended June 30, 2004.

Notes to Basic Financial Statements, Continued

The present value of future minimum capital and operating lease payments of the City as of June 30, 2004 are as follows:

Fiscal Year Ending	Capital	Operating
2005	\$ 3,782,761	1,074,506
2006	3,299,940	468,755
2007	2,818,517	326,486
2008	2,720,477	324,386
2009	2,211,370	255,986
2010-2014	9,566,037	191,673
2015-2019	9,247,857	-
2020-2024	3,919,013	-
2025-2028	1,585,200	-
Total minimum lease payments	39,151,172	2,641,792
Less amount representing interest	(16,244,193)	
Present value of minimum capital lease payments	\$ 22,906,979	

Total governmental operating lease payments for the year ended June 30, 2004 were \$1,345,953.

As Lessor

The City has a long-term lease with the Virginia Port Authority for real property that has been accounted for as a sales-type lease in the Port Facility and Economic Development Fund and is included in notes receivable. The property, identified as the East Waterfront Tract, is located adjacent to Portsmouth Marine Terminal and is leased through October 2005.

The City also has a long-term lease with Universal Maritime for real property that has been accounted for as an operating lease in the Port Facility and Economic Development Fund. The property, identified as the Universal Maritime Facility, is located in the Pinner's Point section of Portsmouth and is leased through October 2004. The lessee contributed \$650,093 toward construction cost which has been accounted for as deferred revenue and is being amortized using the straight-line method over the term of the lease.

Included in capital assets of the Port Facility and Economic Development Fund are the following amounts applicable to the operating lease:

Land	\$ 1,830,251
Buildings	1,434,349
Improvements other than buildings	4,547,558
Less accumulated depreciation	(4,477,658)
	\$ 3,334,500

Notes to Basic Financial Statements, Continued

Future minimum lease receipts under capital and operating leases as of June 30, 2004 are:

Fiscal Year Ending	Capital	Operating
2005	\$ 112,280	181,612
2006	35,639	-
Total minimum lease receipts	147,919	181,612
Less amount representing interest	(8,773)	
Present value of minimum capital lease receipts	\$ 139,146	

Rental income under these operating leases was \$544,836 for the year ended June 30, 2004.

(8) RETIREMENT PLANS

Most full-time employees of the City are eligible for benefits in the event of retirement, death, or disability under the State administered Virginia Retirement System (VRS) or under one of the two retirement plans administered by the City.

In addition, professional and nonprofessional employees of the School Board are covered by VRS. Professional employees participate in a VRS statewide teacher cost sharing pool and nonprofessional employees participate as a separate group in the agent multiple-employee retirement system.

All of these plans are defined benefit pension plans. These City and State Retirement Systems are described below.

Portsmouth Retirement Systems***Plan Description - Portsmouth Supplemental Retirement System***

The Portsmouth Supplemental Retirement System (PSRS) is a single-employer retirement system that was established on October 1, 1953. It was designed to provide retirement, death, or disability benefits for all regular full-time, permanent employees who were not eligible for membership in VRS or the Portsmouth Fire and Police Retirement System (FPRS). On December 1, 1984, the City offered an option to all employees of the PSRS to either remain with their current system or transfer to VRS. All regular full-time employees hired after December 1, 1984 are members of VRS as required by State statutes. Therefore, the PSRS has become a "closed" system.

All regular full-time permanent employees (except for members of VRS and FPRS, as noted above) that were hired prior to December 1, 1984 were eligible to participate in the PSRS. Benefits vest after five years of service. Employees at age 55 with five years of service are eligible for an unreduced annual retirement benefit payable monthly for life in an amount equal to 2% of their average final compensation (AFC) for each year of credited service. AFC is defined as the highest consecutive 36 months of compensation. An optional reduced retirement benefit is available to members of PSRS as early as age 50 with five years of credited service. At age 65, the annual retirement benefit is adjusted to an amount equal to the greater of 1.15% of their AFC multiplied by years of credited service or the excess of 2% of such salary multiplied by years of credited service over 2% of the primary social security benefit multiplied by years of credited service not in excess of 25 years.

Benefits may be increased from time to time by percentage adjustments approved by City Council. Effective July 1, 1994, retirees receive a supplement of \$200 per month until age 65 and an automatic 50% survivor option was added for all retirees at no cost to the retirees. The PSRS also provides death and disability benefits. These benefit provisions and all other requirements are established by City Council.

The employer is required by City Code to contribute the amounts necessary to fund the system based on an actuarially determined percentage of payroll. There are no required contributions from the employees.

Notes to Basic Financial Statements, Continued

Plan Description - Portsmouth Fire and Police Retirement System

The Fire and Police Retirement System is a single-employer retirement system that was established on January 1, 1957. Its membership is comprised of every firefighter or police officer, hired prior to July 1, 1995, who is a full-time permanent employee. All full-time firefighters and police officers hired after June 30, 1995 are members of VRS Law Enforcement Officers (LEO) retirement system as required by State statutes. Therefore, the FPRS has become a "closed" system.

Benefits vest after five years of service. Employees may retire at any time with 20 years service, regardless of age. Employees 50 or older may retire at any time with less than 20 years service provided the vesting requirement has been satisfied. Employees are entitled to an annual retirement benefit payable in an amount equal to 3% of the average final compensation (AFC) for the first 20 years and 2% for each of the next 5 years of service and 1% for each year thereafter multiplied by years of credited service. AFC is defined as the highest consecutive 36 months of compensation. Benefits begin at age 60 by members if they terminate employment prior to age 50 with less than 20 years of credited service.

Benefits may be increased from time to time by percentage adjustments approved by City Council. Effective July 1, 1994, retirees receive a supplement of \$200 per month until age 65 and an automatic 50% survivor option was added for all retirees at no cost to the retirees. The FPRS also provides death and disability benefits. These benefit provisions and all other requirements are established by City Council.

The employer is required by City Code to contribute the amounts necessary to fund the system based on an actuarially determined percentage of payroll. There are no required contributions from the employees.

Payroll and Participants

The payroll at June 30, 2004 for employees covered by PSRS and FPRS and the total payroll for all City employees was as follows:

Payroll for employees covered by PSRS	\$ 5,700,000
Payroll for employees covered by FPRS	12,394,000
Total City payroll	69,155,000

Participation in the Portsmouth Supplemental Retirement System and the Fire and Police Retirement System consisted of the following as of July 1, 2004:

	PSRS	FPRS
Retirees and beneficiaries	331	457
Vested terminated employees not yet receiving benefits	65	78
Current vested employees	133	244
	529	779

Summary of Significant Accounting Policies

The City accounts for the Portsmouth Supplemental Retirement System and the Fire and Police Retirement System as pension trust funds and does not separately issue financial reports for these plans. The financial statements of the pension trust funds are prepared using the accrual basis of accounting. Contributions to each plan are recognized when due. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

Investments are reported at fair value. Securities traded on a national exchange are valued at the last reported sales price. Investments that do not have an established market value are reported at estimated fair value.

Notes to Basic Financial Statements, Continued

Contributions

The funding policy of PSRS and FPRS provides for periodic employer contributions at actuarially determined rates which will remain relatively level over time as a percentage of payroll and will accumulate sufficient assets to meet the cost of all basic benefits when due. Rates necessary to support post-retirement supplements which may be payable in addition to the basic benefits are determined separately on a pay-as-you-go basis.

Total contributions to the PSRS and FPRS for fiscal year 2004 were \$1,116,961 and \$5,790,202, respectively. Contributions were made in accordance with actuarially determined requirements computed through an actuarial valuation performed as of July 1, 2003.

Annual Pension Cost

The required contributions were determined as part of the July 1, 2003 actuarial valuation using the entry age actuarial cost method. The actuarial assumptions included (a) 8% investment rate of return, and (b) projected salary increases of 5.5% per year. The actuarial value of the City's assets is equal to the market value of assets. The annual pension cost and net pension asset for the current fiscal year were as follows:

	PSRS	FPRS
Annual required contribution	\$ 1,116,961	5,790,202
Interest on net pension obligation (asset)	(12,821)	(23,952)
Adjustment to annual required contribution	26,341	49,211
Annual pension cost	1,130,481	5,815,461
Contributions made	1,066,422	5,625,001
Decrease in net pension obligation (asset)	64,059	190,460
Net pension obligation (asset) at beginning of year	(320,517)	(598,795)
Net pension obligation (asset) at end of year	\$ (256,458)	(408,335)

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.

Virginia Retirement System**Plan Description**

The City of Portsmouth and the School Board Component Unit contribute to the Virginia Retirement System (VRS), an agent and cost-sharing multiple-employer defined benefit pension plan administered by the Virginia Retirement System (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 with 5 years of service for participating law enforcement officers and firefighters) and at age 50 with 30 years of service for participating employers (age 50 with 25 years of service for participating law enforcement officers and firefighters) payable monthly for life in an amount equal to 1.7 percent of their average final compensation (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 an annual cost-of-living adjustment (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 reported compensation. 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 General Assembly of Virginia.

Notes to Basic Financial Statements, Continued

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.

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 may be assumed by the employer. In addition, the City and the School Board are required to contribute the remaining amounts necessary to fund their participation in the VRS using the actuarial basis specified by the statute and approved by the VRS Board of Trustees. The City's and School Board's contribution rates for the fiscal year ended June 30, 2004 were 6.0% and 8.0% of the annual covered payroll, respectively.

Additionally, required and actual contributions to the VRS state-wide teacher pool for the current year and each of the two preceding years were \$5,542,073, \$5,556,769, and \$5,389,165, respectively. These contributions represent contribution rates of 8.00%, 8.15%, and 8.63% respectively.

Annual Pension Cost

For the fiscal year ended June 30, 2004, the City's annual pension cost of \$3,051,138, which includes the 5% employee contribution assumed by the City, was equal to the City's required and actual contributions. The School Board's annual pension cost of \$664,786 was not equal to the School Board's required or actual contributions. The School Board's actual contributions were \$669,820. The required contributions were determined as part of the June 30, 2001 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 8% investment rate of return, (b) projected salary increases ranging from 4.25% to 6.10% per year, and (c) 3.0% per year cost-of-living adjustments. Both (a) and (b) included an inflation component of 3%. The actuarial value of the City's and School Board's assets is equal to the modified market value of 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 School Board's unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis within a period of 19 years.

The City and School Board's annual pension cost and net pension obligation to VRS for the current year were as follows:

	City	School Board
Annual required contribution	\$ 3,051,138	669,820
Interest on net pension obligation	-	9,445
Adjustment to annual required contribution	-	(14,479)
Annual pension cost	3,051,138	664,786
Contributions made	3,051,138	669,820
Decrease in net pension obligation	-	(5,034)
Net pension obligation at beginning of year	-	118,060
Net pension obligation at end of year	\$ -	113,026

Notes to Basic Financial Statements, Continued

Total Retirement Plans***Three-Year Trend Information***

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (Asset)
VRS - City:			
June 30, 2004	\$ 3,051,138	100%	\$ -
June 30, 2003	2,952,972	100%	-
June 30, 2002	3,403,212	100%	-
VRS - School Board:			
June 30, 2004	664,786	100%	113,026
June 30, 2003	667,578	100%	118,060
June 30, 2002	836,138	100%	123,318
Portsmouth Supplemental:			
June 30, 2004	1,130,481	94%	(256,458)
June 30, 2003	1,205,312	99%	(320,517)
June 30, 2002	710,637	98%	(334,633)
Portsmouth Fire and Police:			
June 30, 2004	5,815,461	97%	(408,335)
June 30, 2003	5,784,881	100%	(598,795)
June 30, 2002	4,267,819	99%	(625,166)

(9) DEFERRED COMPENSATION PLAN

The City offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all full-time permanent City employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are held in trust for the participants. The assets are not included in the accompanying financial statements.

Notes to Basic Financial Statements, Continued

(10) INTERFUND BALANCES AND TRANSFERS**Due From/To Other Funds**

Individual fund interfund receivable and payable balances at June 30, 2004 are as follows:

Due From Other Funds	Due To Other Funds				Total
	Capital Improvements Fund	Nonmajor Governmental Funds	Nonmajor Enterprise Funds	Internal Service Funds	
General Fund	\$ 1,345,740	2,104,215	402,622	4,084,867	7,937,444

These interfund balances are a result of operating transfers and are due within one year.

Due From/To Primary Government/Component Units

Amounts due at June 30, 2004 between the City and the Component Units are as follows:

Due From (To) Component Units	Due To (From) Primary Government		Total
	Parking Authority	School Board	
General Fund	\$ 33,858	1,018,243	1,052,101
Nonmajor governmental funds	-	(65,877)	(65,877)
Public Utility Fund	-	(13,474)	(13,474)
Internal service funds	-	55,485	55,485
	33,858	994,377	1,028,235

The Statement of Net Assets reflects \$1,107,586, as due from component units and \$79,351 as due to component units for a net due from component units of \$1,028,235 as noted in the above table.

Transfers From/To Other Funds

Individual fund interfund transfers for the primary government were made for operating as well as capital purposes. These interfund transfers for the year ended June 30, 2004 are as follows:

Transfers From Other Funds	Transfers To Other Funds			Total
	General Fund	Nonmajor Governmental Funds	Public Utility Fund	
General Fund	\$ -	-	3,513,997	3,513,997
Capital Improvements Fund	250,000	915,000	-	1,165,000
Public Utility Fund	2,000,000	-	-	2,000,000
Golf Fund	122,192	-	-	122,192
Nonmajor governmental funds	4,745,453	-	-	4,745,453
Nonmajor enterprise funds	1,035,994	-	-	1,035,994
	\$ 8,153,639	915,000	3,513,997	12,582,636

Notes to Basic Financial Statements, Continued

(11) DUE FROM/TO OTHER GOVERNMENTS**Due From Other Governments**

Amounts due from other governments at June 30, 2004 are as follows:

	Federal	State	Other	Total
Governmental activities:				
General Fund:				
Street and highway maintenance funds	\$ -	2,105,787	-	2,105,787
Personal property tax relief	-	3,298,731	-	3,298,731
Correctional facilities block grant	-	311,888	-	311,888
Other	-	1,365,531	-	1,365,531
Total General Fund	-	7,081,937	-	7,081,937
Capital Improvements Fund	150,000	-	-	150,000
Nonmajor governmental funds:				
Virginia Public Assistance Fund	-	1,618,097	-	1,618,097
Grants Fund	976,922	883,479	-	1,860,401
Community Development Fund	1,096,888	-	-	1,096,888
Total nonmajor governmental funds	2,073,810	2,501,576	-	4,575,386
Total governmental activities	\$ 2,223,810	9,583,513	-	11,807,323
Business-type activities:				
Public Utility Fund	\$ -	-	800,000	800,000
Golf Fund	-	-	1,400,000	1,400,000
Total business-type activities	\$ -	-	2,200,000	2,200,000

Included in due from other governments for the enterprise funds are amounts due from the City of Suffolk from the sale of the Sleepy Hole Golf Course. Final payment is due to the City upon completion of the construction of a new water main, which is not expected to be completed within the next year. The amounts have been classified as noncurrent and the revenue in the Public Utility Fund has been deferred until construction of the new water main is complete.

Due To Other Governments

The City's amount due to other governments at June 30, 2004 is \$18,158 in the Donations Fund owed to the State government.

(12) DEFERRED REVENUES

Deferred revenues represent amounts for which asset recognition criteria have been met, but for which revenue recognition criteria have not been met. Under the modified accrual basis of accounting, such amounts are measurable, but not available. Deferred revenues for the primary government's fund-based financial statements are comprised of the following:

Notes to Basic Financial Statements, Continued

	Governmental Activities			Business-Type Activity - Enterprise Funds
	General Fund	Capital Improvements Fund	Total	
Property taxes	\$ 4,249,000	-	4,249,000	-
Notes receivable from component unit (note 5)	4,825,233	-	4,825,233	-
Notes receivable	-	6,216	6,216	-
Due from other governments (note 11)	-	-	-	800,000
Leases	-	-	-	333,340
Other	61,920	-	61,920	50,075
Total deferred revenues	\$ 9,136,153	6,216	9,142,369	1,183,415

All deferred revenues are included in the government-wide financial statements with the exception of property taxes, which are recognized on the full accrual basis of accounting.

(13) COMMITMENTS**Capital Improvement Program**

The City Council adopted a five-year Capital Improvement Program (CIP) on June 15, 2004, the total estimated cost of which amounted to \$161,508,808. The program is to be funded from anticipated State and Federal funds, general obligation and public utility bond issues and funds on hand. The CIP does not represent a legal commitment to expend funds, and appropriations for projects contained in the CIP are made on a project by project basis. The CIP is prepared annually and funding sources are identified in the CIP for only one year at a time.

A summary of the source of funds for the first year of the proposed five-year capital improvement program is as follows:

General Obligation Bonds (includes Qualified Zone Academy Bonds)	\$ 10,170,836
Public Utility Bonds	5,334,000
Stormwater funds	1,519,833
Non-local funds	1,726,545
Other local funds	7,000,000
	\$ 25,751,214

Public Utility Bond Referendum

The City Council authorized the issuance of \$22.9 million in general obligation public utility bonds on August 23, 1994, of which \$13 million have been issued to date. This authorization was approved by referendum on November 8, 1994. The City Council also authorized the issuance of \$24.135 million in general obligation public utility bonds on December 9, 1997. This authorization was approved by referendum on May 5, 1998.

Landfill Closure and Postclosure Care Cost

State and federal laws and regulations require the City to place a final cover on its Craney Island landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for thirty years after closure. The \$5,179,473 reported as landfill closure and postclosure care liability at June 30, 2004 represents the cumulative amount reported to date based on the use of 56 percent of the estimated capacity of the landfill. The City

Notes to Basic Financial Statements, Continued

will recognize the remaining estimated cost of closure and postclosure care of \$4,069,586 as the remaining estimated capacity is filled. These amounts are based on what it would cost to perform all closure and postclosure care in 2004. Actual costs may be higher due to inflation, changes in technology or changes in laws and regulations. The remaining landfill life is estimated to be 40 years. The City is required by Federal and State statute to prepare a Local Government Financial Test Worksheet to demonstrate how closure and postclosure care financial assurance requirements will be met.

Moral Obligation – Industrial Development Authority

On November 12, 1997, the Industrial Development Authority (IDA) issued \$8,500,000 of Variable Rate Taxable Demand Revenue Bonds, Series 1997B (the bonds) to purchase and construct a commercial building in the PortCentre Commerce Park. In lieu of providing upfront funding to the IDA to fund the cost of this project, the City and the IDA entered into a Coordination Agreement in which the City agrees to contribute funds to the IDA, subject to appropriation by City Council and upon the request of the IDA, to (a) pay annual debt service costs on the bonds up to an annual total of \$750,000; and (b) to pay operating expenses up to an annual total of \$100,000; for a maximum annual moral obligation of \$850,000. The building was sold in January 2001. The proceeds from the sale of the building were used to pay down the original amount of the bonds and to provide funds to the City to be used for acquisition of property for redevelopment. Bank of America, the letter of credit holder on the bonds executed a release to allow the City to utilize these proceeds rather than pay off the bonds. The amount of bonds outstanding at June 30, 2004 was \$6,180,000. See also Note (5).

(14) CONTINGENT LIABILITIES**Litigation**

Various claims and lawsuits are pending against the City. The City is vigorously defending all cases as it expects no losses will be incurred which would have a material effect on the City's financial position.

Federally Assisted Grant Programs

The City participates in a number of federally assisted grant programs. Although the City has been audited in accordance with the provisions of OMB Circular A-133, these programs are still subject to financial and compliance audits by the grantors or their representatives. Such audits could lead to requests for reimbursements to the grantor agency for expenditures disallowed under terms of the grant. Based on prior experience, City management believes such disallowances, if any, will not be significant.

Joint Ventures***Southeastern Public Service Authority***

The City has guaranteed approximately \$5,460,000 in bonds and the interest thereon, issued by the Southeastern Public Service Authority (SPSA). The purpose of SPSA is to provide and operate a regional system for the reception, transfer, processing, and disposal of solid waste. The SPSA is governed by a board of directors consisting of a representative appointed by each of the member cities and counties. Under the guaranty agreement, the City has agreed to make payments to the trustee for deposit in a reserve account, if necessary, to maintain in such account the sum of the amount of interest due on the next succeeding interest payment date for the bonds and the amount required to pay principal of all the bonds maturing on the next July 1. The City's allocable portion of the \$26 million Revenue Series A bonds is 21% or \$5,460,000, with the remaining balance being due from neighboring localities as follows: 23%, Chesapeake; 54%, Norfolk; and 2%, Franklin. No payments were made under the provisions of the guaranty agreement to the reserve account during the year ended June 30, 2004.

Additionally, should SPSA perform any act constituting default under the bond debenture, the entire bond principal could be considered due, of which the City would be liable for its allocable portion.

The full faith and credit of the City is pledged to redeem its allocable portion of the interest and bonds if SPSA revenues are insufficient to meet the obligations.

Notes to Basic Financial Statements, Continued

Complete, audited financial statements for SPSA can be obtained from their administrative offices at 723 Woodlake Drive, Chesapeake, Virginia 23320.

Hampton Roads Regional Jail Authority

The City has agreed to pay its proportionate share of the debt service on \$55,935,000 in bonds issued by the Hampton Roads Regional Jail Authority (the Jail Authority), subject to the appropriation of funds for such purpose, if the Jail Authority lacks sufficient funds to do so. The purpose of the Jail Authority is to operate a jail facility in the City to hold prisoners primarily from member jurisdictions and from other jurisdictions on a space available basis. The Jail Authority is governed by a twelve-member board consisting of three representatives from each member jurisdiction, namely the City Manager, the Sheriff and one member of the City Council (as designated by the City Council). The agreement of the member jurisdictions to pay is not legally binding and is allocated as follows: Portsmouth, 21.43%; Hampton, 22.00%; Newport News, 25.14%; and Norfolk, 31.43%. No payments were made under the provisions of this agreement during the year ended June 30, 2004.

Complete, audited financial statements for the Jail Authority can be obtained from the administrative office at 2690 Elmhurst Lane, Portsmouth, Virginia 23701.

(15) NET ASSET DEFICITS AND EXPENDITURES IN EXCESS OF APPROPRIATIONS

The Information Technology Fund has an accumulated net asset deficit balance of \$1,224,681 at June 30, 2004. The deficit is expected to be eliminated by revenues in subsequent fiscal years.

The Risk Management and Insurance Fund has an accumulated net asset deficit balance of \$19,727,877 at June 30, 2004. The deficit is expected to be eliminated by charging other City funds, as well as participants in the City's health insurance plans, for risk management and insurance costs in subsequent fiscal years.

The judicial, public works, and parks, health and welfare functions in the General Fund had expenditures in excess of appropriations of \$406,307, \$78,638, and \$20,633, respectively, at June 30, 2004.

(16) RISK MANAGEMENT**Self-Insurance Program*****City***

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The City uses its Risk Management and Insurance Fund, an internal service fund, to account for and finance its uninsured risks of loss and to pay insurance premiums. Under this program, the Risk Management and Insurance Fund provides total coverage for worker's compensation claims and general liability claims, and a maximum of \$100,000 for each property damage claim. The City purchases commercial insurance for claims in excess of coverage provided by the fund for property damage. For the fiscal years ended June 30, 2004, 2003, and 2002, no individual property damage claim has exceeded \$100,000.

All funds of the City and the Parking Authority participate in the program and make payments to the Risk Management and Insurance Fund based on actuarial estimates of the amounts needed to pay prior and current year claims and to establish a reserve for catastrophe losses. The claims liability of \$15,076,510 (undiscounted) reported in the fund at June 30, 2004 is based on the requirements of GASB Statement No. 10, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. A loss analysis, which included an estimate of incurred but not reported claims, was conducted by Mercer Oliver Wyman Actuarial Consulting, Incorporated as of June 30, 2004 to compute this liability. City management anticipates funding the deficit in the Risk Management and Insurance Fund of \$19,727,877 over subsequent fiscal years.

Notes to Basic Financial Statements, Continued

Changes in the fund's claims liability amount in fiscal years 2004 and 2003 were:

		2004	2003
Claims payable at beginning of year	\$	17,848,493	12,374,424
Claims and changes in estimates		(1,328,407)	7,803,940
Claim payments		(1,443,576)	(2,329,871)
Claims payable at end of year	\$	15,076,510	17,848,493

The City is also exposed to the risk of loss for employee and retired employee medical benefits. Effective January 1, 2001, the City established a self-insured health care benefits program for all City employees and retired employees. These benefits are accounted for in the Risk Management and Insurance Fund. Certain claims expenses paid on behalf of each employee during a single policy year are covered by excess loss insurance with a specific stop-loss limit of either \$100,000 or \$125,000 depending on the specific medical plan. Claims processing and payments for all health care claims are made through third party administrators. The computed liability as of June 30, 2004 is \$1,593,000 (undiscounted). Changes in the medical claim liability amount in fiscal years 2004 and 2003 were:

		2004	2003
Medical claims payable at beginning of year	\$	1,338,000	1,714,120
Medical claims and changes in estimates		12,243,181	10,788,031
Medical claim payments		(11,988,181)	(11,164,151)
Medical claims payable at end of year	\$	1,593,000	1,338,000

Hospitalization Benefits for Retired Employees

Under administrative regulation, the City offers health care benefits to all retired employees and their dependents who choose to remain on the City's health insurance plans. As of June 30, 2004, 490 retired employees and their dependents were receiving these benefits. These benefits are included in the medical claims liability above. The City contributes to the costs of the retiree health care. The General Fund expenditures made by the City for the year ended June 30, 2004 were \$1,150,000.

School Board

The School Board uses its Risk Management and Insurance Fund, an internal service fund, to account for and finance its uninsured risks of loss and to pay insurance premiums. The fund services all claims for risk of loss to which the School Board is exposed, including worker's compensation, automobile and general liability. A loss analysis was conducted by Mercer Oliver Wyman Actuarial Consulting, Inc on this fund. The actuarially computed liability as of June 30, 2004 was determined to be \$2,070,510 (undiscounted).

Changes in the school's claim liability amount in fiscal years 2004 and 2003 were:

		2004	2003
Claims payable at beginning of year	\$	1,639,702	1,652,201
Claims and changes in estimates		538,405	(12,499)
Claim payments		(107,597)	-
Claims payable at end of year	\$	2,070,510	1,639,702

Notes to Basic Financial Statements, Continued

(17) RELATED ORGANIZATIONS

The City Council is responsible for appointing members of the board of the Portsmouth Redevelopment and Housing Authority, but the City's accountability for this organization does not extend beyond making these appointments.

(18) PRIOR PERIOD ADJUSTMENT FOR COMPONENT UNIT

The School Board made a prior period adjustment of \$2,398,309 to recognize certain revenues that were deferred in a prior year. The net assets previously reported at June 30, 2003 were \$43,028,450 while the restated net assets are \$45,426,759.

(19) SUBSEQUENT EVENTS

On July 1, 2004, the City issued \$10,000,000 of General Obligation Revenue Anticipation Notes to provide short term financing for shortfalls in cash due to timing delays in the receipt of tax revenues. Principal and interest, at a rate of 2.29% are due when the notes mature on June 30, 2005.

On July 15, 2004, the Industrial Development Authority of the City of Portsmouth issued \$4,665,000 of Lease Revenue Bonds to provide financing for the construction of a facility for the City's Department of Behavioral Healthcare Services. The principal amount will be paid from rental payments made by the City under the Lease, secured by the pledge of the City's full faith and credit.

On October 29, 2004, the City amended the \$15,800,000 General Obligation Qualified Bond Anticipation Note extending the maturity until October 31, 2005. Principal and interest at a rate of 2.35%, are due upon maturity.

On October 29, 2004, the City amended the \$2,000,000 General Obligation Taxable Bond Anticipation Note extending the maturity until October 31, 2005. Principal and interest, at a rate of 2.9%, are due upon maturity.