

Notes to Basic Financial Statements

June 30, 2005

(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 Economic Development Authority of the City of Portsmouth, Virginia (Economic Development Authority), and the Portsmouth Port and Industrial Commission (the 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 Economic Development Authority and the Portsmouth Port and Industrial Commission are included on Exhibit G-2.

The Governmental Accounting Standards Board (GASB) has issued the following pronouncement, the provisions of which have been implemented within these financial statements:

- GASB Statement No. 40, *Deposit and Investment Risk Disclosure*, an amendment of GASB Statement No. 3. Deposits and investment resources often represent significant assets of governmental, proprietary, and fiduciary funds. These resources are necessary for the delivery of governmental services and programs, or to carry out fiduciary responsibilities. This Statement enhances the disclosure requirements to inform financial statement users about deposit and investment risks.

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:

Notes to Basic Financial Statements, Continued

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

2. The Parking Authority is responsible for the operation and maintenance of six parking garages, nine 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 Economic 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 Economic Development Authority has only one fund. Complete, audited financial statements may be obtained as follows:

Economic 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.

Notes to Basic Financial Statements, Continued

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 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.

Notes to Basic Financial Statements, Continued

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 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 two 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, Continued

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

Notes to Basic Financial Statements, Continued

property the first day of the levy year. The City, as required by state statute, follows the practice of reassessing all 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 2005 was \$1.45 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 2005, excluding machinery and tools, boats and recreational vehicles, was \$5.00 per \$100 of assessed value. The personal property tax rate on machinery and tools, boats, mobile homes, and recreational vehicles was \$3.00, \$.01, \$1.45, 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	1,465,213
Total General Fund	4,084,661
Special Revenue Fund - Stormwater Management Fund -	
Allowance for doubtful accounts receivable	157,490
Total governmental activities	\$ 4,242,151
Business-Type Activities - allowance for doubtful accounts receivable:	
Enterprise Funds:	
Public Utility Fund	\$ 616,643
Waste Management Fund	405,131
Total business-type activities	\$ 1,021,774
Component Units - allowance for doubtful accounts receivable:	
Portsmouth School Board	\$ 279,060
Portsmouth Parking Authority	51,124
	\$ 330,184

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 useful life of more than one year with a cost of more than \$5,000 with the exception of infrastructure assets, which have a threshold of \$100,000. 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 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.

L. Reclassifications

Certain reclassifications have been made to prior year numbers.

(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, 2005 are composed of the following:

	General Fund	Capital Improvements	Other Nonmajor
Current year encumbrances	\$ 1,150,541	3,876,230	1,807,328
Prior year encumbrances	148,246	-	-
Revenue maximization	-	-	61,466
Future debt requirements	644,071	-	-
Inventory	54,925	-	-
Cemetery care	-	-	1,000,000
	\$ 1,997,783	3,876,230	2,868,794

Notes to Basic Financial Statements, Continued

(3) CASH

Deposits and Restricted Cash

At June 30, 2005, the carrying value of the City's deposits with banks and savings institutions was \$16,522,751, which includes \$789,450 in the fiduciary funds. All cash of the City except petty cash of \$42,219 is maintained in accounts collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 et. Seq. of the Code of Virginia or covered by federal depository insurance. As of June 30, 2005, restricted cash totaled \$7,109,947, of which \$6,465,876 represented unspent bond proceeds, while the remaining \$644,071 was a required debt service reserve.

Investments

State statutes authorize the City to invest in obligations of the United States or agencies thereof, securities unconditionally guaranteed by 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. The City's investment policy addresses custodial credit risk, interest rate risk, concentration of risk, and credit risk, in which instruments are to be diversified and maturities timed according to anticipated needs in order to minimize any exposure. The City's policy does not address foreign currency risk. As of June 30, 2005, the City's investment balances were as follows:

	Carrying Amount	Actual Credit Ratings	Required Credit Ratings	Average Days/Years to Maturity
SNAP investments	\$ 2,748,487	AAA	n/a	27 days
CCRF	874,702	AAA	n/a	19 days
Money market funds	29,167,327	AAA	n/a	1 day
U.S. government securities:				
FNMA Discount Note	2,275,250	A-1	n/a	106 days
FNMA Global Benchmark Notes	687,544	AAA	n/a	1.8 years
	\$ 35,753,310			

The investments below are grouped according to type of investment and indicate the level of risks, if any:

Virginia State Non-Arbitrage Program (SNAP), Commonwealth Cash Reserve Fund (CCRF), and Money Market Funds

As of June 30, 2005, the SNAP Fund's investment portfolio as well as CCRF was comprised of investments which were, in aggregate, rated AAA by Standard and Poor's. The SNAP funds are subject to credit risk.

U.S. Government Securities

The City also invests in U.S. Government Securities. The FNMA Discount note is held in the name of VML/VACO for the benefit of U.S. Bank, the trustee. Wachovia, Bank N.A. is the custodial bank for the FNMA Benchmark Notes. Both notes are subject to custodial credit risk, because they are not held in the City's name.

Notes to Basic Financial Statements, Continued

Common Collective Trust Fund

The City's pension investments are professionally managed by Frank Russell Trust Company which invests primarily in fixed income and equity funds. The fair value of the funds is determined by daily trades of securities with the exception of the Russell Diversified Alternatives Fund and the Russell Real Estate Equity Fund investments which are priced quarterly. The allocation of the investment accounts are authorized between the Board of Trustees of the Portsmouth Supplemental Retirement System and Frank Russell Trust Company for the Portsmouth Supplemental Retirement System and the Portsmouth Fire and Police Retirement System. The City owns units in Russell's commingled Employee Benefit Fund Trusts. The target allocation for all funds is 60% for equities, 30% for fixed income securities and 10% for alternative investments, which include real estate.

Russell Fixed Income I Fund - This fund represents 30% of the City's total pension investment portfolio. The fund is subject to interest rate and credit risk.

Russell International Fund - This fund invests in non-U.S. stocks. International equities are sensitive to foreign currency fluctuations, thus subjecting the investment to foreign currency risk. The estimated percentage invested in each foreign currency is illustrated below by allocating the total investment value (in U.S. dollars) to the specific currency represented in the fund's portfolio. At June 30, 2005, the fair value of the City's pension investments is as follows:

Fund Name	Investment Type	Weighted Average Maturity	Fair Value	Actual Credit Ratings	Required Credit Ratings
Russell Fixed Income I Fund	Fixed Income	5.8 years	\$ 38,981,911	N/R	BBB
Russell International Fund:					
Japanese Yen	Equity	1 day	3,826,970	N/R	BBB
Euro dollar	Equity	1 day	3,222,711	N/R	BBB
Swiss Franc	Equity	1 day	1,208,517	N/R	BBB
Pound Sterling	Equity	1 day	11,883,748	N/R	BBB
Russell Large Cap Structured	Equity	1 day	25,804,262	N/R	BBB
Russell Equity I Fund	Equity	1 day	25,783,608	N/R	BBB
Russell Small Cap Fund	Equity	1 day	7,142,010	N/R	BBB
Russell Real Estate Equity Fund	Other	1 day	7,558,712	N/R	BBB
Russell Diversified Alternatives	Other	1 day	6,724,964	N/R	BBB
			\$ 132,137,413		

Component Unit - School Board

All of the deposits of the School Board, a discretely presented component unit, of \$4,220,792 are maintained in accounts collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 et. seq. of the Code of Virginia or covered by Federal depository insurance. The School Board had \$12,225,648 invested in the Evergreen Money Market fund as of June 30, 2005. These funds had a credit rating of AAAM by Standard & Poor's. The City Treasurer's policies on deposits and investments, as noted above, also apply to the School Board.

Component Unit - Parking Authority

At year end, the carrying value of deposits with banks for the Parking Authority, a discretely presented component unit, was \$102,372. The Parking Authority also had investments in SNAP of \$177,419 and petty cash of \$625 at June 30, 2005. The SNAP fund's investment portfolio is comprised of investments which were in aggregate, rated AAA by Standard & Poor's. As of June 30, 2005, restricted cash totaled \$177,419, which represented the Authority's unspent bond proceeds.

Notes to Basic Financial Statements, Continued

Component Unit – Economic Development Authority

At year end, the carrying value of deposits with banks for the Economic Development Authority, a discretely presented component unit, was \$1,184,300. All cash is maintained in accounts collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 et. Seq. of the Code of Virginia or covered by federal depository insurance. As of June 30, 2005, restricted cash totaled \$909,445 which represents the Authority's debt service reserve.

Component Unit – Portsmouth Port and Industrial Commission

At year end, the carrying value of deposits with banks for the Portsmouth Port and Industrial Commission, a discretely presented component unit, was \$1,934,495. All cash of the Commission is maintained in accounts collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 et. Seq. of the Code of Virginia or covered by federal depository insurance.

(4) CAPITAL ASSETS

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

Primary Government - Governmental Activities	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005
Capital assets not being depreciated:				
Land	\$ 25,498,271	-	1,997,837	23,500,434
Construction in progress	55,840,390	14,957,473	8,398,787	62,399,076
Total capital assets not being depreciated	81,338,661	14,957,473	10,396,624	85,899,510
Capital assets being depreciated:				
Infrastructure	454,545,568	274,430	-	454,819,998
Site improvements	1,436,092	-	-	1,436,092
Buildings	162,980,866	8,074,588	-	171,055,454
Machinery, furniture and equipment	32,430,693	5,171,374	1,408,945	36,193,122
Total capital assets being depreciated	651,393,219	13,520,392	1,408,945	663,504,666
Less accumulated depreciation for:				
Infrastructure	(276,713,379)	(12,077,337)	-	(288,790,716)
Site improvements	(231,378)	(71,805)	-	(303,183)
Buildings	(46,576,007)	(3,662,598)	-	(50,238,605)
Machinery, furniture and equipment	(20,395,549)	(2,842,155)	(1,324,983)	(21,912,721)
Total accumulated depreciation	(343,916,313)	(18,653,895)	(1,324,983)	(361,245,225)
Total capital assets being depreciated, net	307,476,906	(5,133,503)	83,962	302,259,441
Governmental activities capital assets, net	\$ 388,815,567	9,823,970	10,480,586	388,158,951

Under Virginia Law, certain property, with a net book value of \$54,252,889 maintained by the School Board is subject to tenancy in common with the City, if the City has incurred a financial obligation for the property, which is payable over more than one fiscal year. The School Board and City have agreed that such property will be carried on the City's financial statements until the outstanding debt is repaid.

Notes to Basic Financial Statements, Continued

Depreciation expense was charged to functions as follows:

General government	\$ 46,337
Judicial	239,614
Public safety	1,217,865
Public works	12,196,398
Health and welfare	491,907
Parks, recreation and cultural	378,880
Community development	985,629
Education	1,544,644
Total governmental funds	17,101,274
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.	1,552,621
Total governmental activities	\$ 18,653,895

Construction in progress for the governmental activities is comprised of the following:

	Project Authorization	Expended to June 30, 2005	Commitments
Victory Boulevard	\$ 6,775,000	426,220	27,116
Midtown Redevelopment acquisition	6,150,000	5,883,530	127,594
Tower Mall redevelopment	5,558,000	5,076,734	68,706
Brighton	5,391,593	4,874,733	-
Drainage facilities repair	5,373,227	4,302,531	459,635
Behavioral Health building	4,529,003	37,882	-
Hodges Manor	2,670,149	2,617,441	-
Port Centre EDA grant	4,324,916	4,306,866	17,043
City Hall repairs	4,152,500	4,012,283	136,352
Computerized traffic signals	3,599,060	3,594,563	734
PAC Ntelos pavilion	3,410,467	3,069,675	257,438
Churchland High School - air quality	3,116,306	2,439,045	40,682
North Truxton	2,507,705	2,507,617	-
Lee Avenue improvements	2,500,000	991,670	31,703
Simonsdale Street improvements	2,293,131	1,590,725	10,909
Highland Biltmore improvements	2,197,000	1,861,384	3,636
Emergency Operations Center relocation	1,929,000	1,528,821	332,509
Frederick Boulevard	1,878,586	1,793,738	-
Roof / Mechanical renovation	1,837,404	416,527	-
Civic Center specifications	1,779,453	1,762,919	16,278
Substructure painting - London Boulevard Bridge	1,759,217	131,000	1,495,905
Bridge repairs	1,497,985	1,249,784	12,090
Renovations to various buildings	1,300,731	1,183,782	-
John Tyler	1,094,021	100,288	-
Various projects under \$1,000,000 each	14,159,362	6,639,318	711,250
	\$ 91,783,816	62,399,076	3,749,580

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 \$3,876,230 have been reserved for encumbrances in the capital improvements fund.

Primary Government - Business-Type Activities	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005
Capital assets not being depreciated:				
Land	\$ 14,531,594	-	-	14,531,594
Construction in progress	53,194,362	11,172,084	1,227,948	63,138,498
Total capital assets not being depreciated	67,725,956	11,172,084	1,227,948	77,670,092
Capital assets being depreciated:				
Buildings	3,629,804	-	-	3,629,804
Improvements other than buildings	141,941,031	1,706,179	-	143,647,210
Machinery, furniture and equipment	12,840,064	867,214	1,156,634	12,550,644
Total capital assets being depreciated	158,410,899	2,573,393	1,156,634	159,827,658
Less accumulated depreciation for:				
Buildings	(1,439,601)	(122,676)	-	(1,562,277)
Improvements other than buildings	(50,380,349)	(2,799,660)	-	(53,180,009)
Machinery, furniture and equipment	(7,668,444)	(1,007,640)	(1,000,915)	(7,675,169)
Total accumulated depreciation	(59,488,394)	(3,929,976)	(1,000,915)	(62,417,455)
Total capital assets being depreciated, net	98,922,505	(1,356,583)	155,719	97,410,203
Business-type activities capital assets, net	\$ 166,648,461	9,815,501	1,383,667	175,080,295

Notes to Basic Financial Statements, Continued

Primary Government - Major Enterprise Funds	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005
<u>Public Utility Fund</u>				
Capital assets not being depreciated:				
Land	\$ 186,779	-	-	186,779
Construction in progress	53,173,942	11,172,084	1,227,948	63,118,078
Total capital assets not being depreciated	53,360,721	11,172,084	1,227,948	63,304,857
Capital assets being depreciated:				
Buildings	67,864	-	-	67,864
Improvements other than buildings	137,393,473	1,677,179	-	139,070,652
Machinery, furniture and equipment	5,933,014	230,764	-	6,163,778
Total capital assets being depreciated	143,394,351	1,907,943	-	145,302,294
Less accumulated depreciation for:				
Buildings	(52,591)	(1,713)	-	(54,304)
Improvements other than buildings	(46,906,734)	(2,747,870)	-	(49,654,604)
Machinery, furniture and equipment	(4,202,391)	(391,450)	-	(4,593,841)
Total accumulated depreciation	(51,161,716)	(3,141,033)	-	(54,302,749)
Total capital assets being depreciated, net	92,232,635	(1,233,090)	-	90,999,545
Public utility capital assets, net	\$ 145,593,356	9,938,994	1,227,948	154,304,402
<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	9,625,709	-	-	9,625,709
Capital assets being depreciated:				
Buildings	2,127,591	-	-	2,127,591
Improvements other than buildings	-	29,000	-	29,000
Machinery, furniture and equipment	872,461	-	-	872,461
Total capital assets being depreciated	3,000,052	29,000	-	3,029,052
Less accumulated depreciation for:				
Buildings	(382,967)	(85,103)	-	(468,070)
Improvements other than buildings	-	(725)	-	(725)
Machinery, furniture and equipment	(702,332)	(80,575)	-	(782,907)
Total accumulated depreciation	(1,085,299)	(166,403)	-	(1,251,702)
Total capital assets being depreciated, net	\$ 11,540,462	(137,403)	-	11,403,059

Notes to Basic Financial Statements, Continued

	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005
<u>Waste Management Fund</u>				
Capital assets not being depreciated:				
Land	\$ 2,909,275	-	-	2,909,275
Total capital assets not being depreciated	2,909,275	-	-	2,909,275
Capital assets being depreciated:				
Machinery, furniture and equipment	6,034,589	636,450	1,156,634	5,514,405
Total capital assets being depreciated	6,034,589	636,450	1,156,634	5,514,405
Less accumulated depreciation for:				
Machinery, furniture and equipment	(2,763,721)	(535,616)	(1,000,915)	(2,298,422)
Total accumulated depreciation	(2,763,721)	(535,616)	(1,000,915)	(2,298,422)
Total capital assets being depreciated, net	3,270,868	100,834	155,719	3,215,983
Waste Management capital assets, net	\$ 6,180,143	100,834	155,719	6,125,258

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

	Authorization	June 30, 2005	Commitments
<u>Public Utility Fund:</u>			
Lake Kilby-Pilot testing program	\$ 18,492,301	18,475,739	-
Suction Well rehabilitation	1,130,290	534,907	44,531
Miscellaneous sewer improvements	1,609,500	1,317,545	55,732
Infrastructure improvements	14,571,883	11,244,545	3,154,242
Godwin Street Reservoir replacement	9,290,923	8,165,711	1,441,176
Electrical facility relocation - Lake Kilby	5,240,500	4,370,292	17,164
Drought emergency water main	4,838,287	4,838,287	-
Replacement of water plant equipment	2,967,213	1,073,493	33,055
Water plant residuals management and disposal	3,783,500	2,798,748	286
Miscellaneous water improvements	2,141,563	666,623	35,400
Sewer cave-in repair	1,096,762	781,190	317,941
Four Dams	1,086,500	986,403	-
Various projects under \$1,000,000 each	3,210,759	1,837,629	109,379
	\$ 69,459,981	57,091,112	5,208,906

In addition to the amount of \$57,091,112 shown above as expended to June 30, 2005, \$6,026,966 is included in construction in progress for capitalized interest, bringing total construction in progress to \$63,118,078. 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.

Notes to Basic Financial Statements, Continued

School Board Component Unit

	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005
Capital assets not being depreciated:				
Land	\$ 6,499,465	-	-	6,499,465
Construction in progress	2,603,112	2,263,237	42,130	4,824,219
Total capital assets not being depreciated	9,102,577	2,263,237	42,130	11,323,684
Capital assets being depreciated:				
Buildings	52,227,056	-	-	52,227,056
Machinery, furniture and equipment	14,160,219	1,571,882	545,912	15,186,189
Total capital assets being depreciated	66,387,275	1,571,882	545,912	67,413,245
Less accumulated depreciation for:				
Buildings	(30,094,351)	(1,018,161)	-	(31,112,512)
Machinery, furniture and equipment	(7,700,494)	(1,453,908)	(545,912)	(8,608,490)
Total accumulated depreciation	(37,794,845)	(2,472,069)	(545,912)	(39,721,002)
Total capital assets being depreciated, net	28,592,430	(900,187)	-	27,692,243
School Board capital assets, net	\$ 37,695,007	1,363,050	42,130	39,015,927

Notes to Basic Financial Statements, Continued

(5) LONG - TERM DEBT

Details of Long-Term Indebtedness

At June 30, 2005, 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%	\$	3,000,000
1997	Public Improvement Bonds	6.46 - 6.65%		7,415,000
1997	Public Improvement Bonds	4.40 - 5.25%		17,975,000
1999	Qualified Zone Academy Bonds	0%		3,843,539
2001	Public Improvement Bonds	4.00 - 5.50%		15,907,108
2001	Qualified Zone Academy Bonds	0%		761,136
2001	Virginia Public School Authority Bonds	4.10 - 5.35		2,817,832
2003	Public Improvement Refunding Bonds	3.00 - 5.00%		64,049,590
2004	BHS Lease Revenue Bonds	3.00 - 5.00%		4,615,074
Total general obligation bonds, net				120,384,279
General obligation notes payable		2.64 - 4.37%		7,980,000
Obligations under capital leases				22,584,303
Obligations under cooperation agreements (note 6)				51,013,736
Literary loans				4,325,000
Bond anticipation notes				11,642,000
Compensated absences				6,485,792
Total governmental activities				\$ 224,415,110
Business-Type Activities				
General obligation bonds, net:				
1996	Public Utility Bonds	5.00 - 5.25%	\$	3,344,622
1997	Public Utility Bonds	4.45 - 5.25%		2,997,687
2001	Public Utility Bonds	4.00 - 5.00%		19,088,778
2003	Public Utility Bonds	3.00 - 5.00%		30,478,218
2003	Port Improvement Bonds	3.00 - 5.00%		672,173
Revenue bonds, net -				
1998	Golf Course System Improvement Bonds	4.25 - 5.00%		8,137,839
Total general obligation and revenue bonds, net				64,719,317
Obligations under capital leases				970,005
Bond anticipation notes				6,158,000
Landfill closure and postclosure care				5,436,375
Compensated absences				707,945
Total business type-activities				\$ 77,991,642

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, 2005, the long-term indebtedness of Component Units consisted of the following:

	Amount Outstanding
School Board:	
Obligations under capital leases	\$ 161,138
Net pension obligation	112,951
Compensated absences	4,130,898
	\$ 4,404,987
Parking Authority:	
General obligation bond	\$ 7,458,577
Notes payable to City	4,505,160
Compensated absences	27,433
	\$ 11,991,170
Economic Development Authority:	
Revenue bonds:	
1997 Variable Rate Taxable Demand Revenue Bonds (note 13)	\$ 6,030,000
1997 Variable Rate Demand Revenue Bonds	6,230,000
	\$ 12,260,000

Changes in Indebtedness

Changes in the total short-term liabilities during the fiscal year ended June 30, 2005 are summarized below:

Primary Government - Governmental Activities				
	Balance July 1, 2004	Additions	Deletions	Balance June 30, 2005
Revenue anticipation note	\$ -	10,000,000	10,000,000	-

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. The principal amount of the note, plus interest of 2.29%, was paid on June 9, 2005 in advance of the June 30, 2005 maturity date.

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, 2005:

	Balance at July 1, 2004	Increases	Decreases	Balance at June 30, 2005	Due Within One Year
Primary Government -					
Governmental Activities:					
General obligation bonds, net	\$ 122,058,186	4,615,074	(6,288,981)	120,384,279	8,102,320
General obligation notes payable	7,980,000	-	-	7,980,000	-
Compensated absences	6,270,966	219,711	(4,885)	6,485,792	4,278,204
Bond anticipation notes	5,139,951	6,502,049	-	11,642,000	11,642,000
Cooperation agreements (note 6)	53,143,736	-	(2,130,000)	51,013,736	2,240,000
Literary loans	4,800,000	-	(475,000)	4,325,000	475,000
Capital leases (note 7)	22,343,357	3,924,352	(3,683,406)	22,584,303	2,479,463
Total Governmental Activities	\$ 221,736,196	15,261,186	(12,582,272)	224,415,110	29,216,987
Business-Type Activities:					
General obligation and revenue bonds, net	\$ 67,868,221	56,412	(3,205,316)	64,719,317	3,941,613
Bond anticipation notes	2,860,494	3,297,506	-	6,158,000	6,158,000
Landfill closure and postclosure care	5,179,473	256,902	-	5,436,375	-
Compensated absences	687,536	24,797	(4,388)	707,945	707,945
Capital leases (note 7)	563,622	554,716	(148,333)	970,005	252,615
Total Business-Type Activities	\$ 77,159,346	4,190,333	(3,358,037)	77,991,642	11,060,173
Major Enterprise Funds:					
<i>Public Utility Fund</i>					
General obligation bonds, net	\$ 58,300,225	51,569	(2,442,489)	55,909,305	2,974,282
Bond anticipation notes	2,860,494	3,297,506	-	6,158,000	6,158,000
Compensated absences	362,416	7,867	-	370,283	370,283
Total Public Utility Fund	\$ 61,523,135	3,356,942	(2,442,489)	62,437,588	9,502,565
<i>Golf Fund</i>					
Revenue bonds, net	\$ 8,422,996	4,843	(290,000)	8,137,839	295,158
Compensated absences	63,705	-	(4,388)	59,317	59,317
Total Golf Fund	\$ 8,486,701	4,843	(294,388)	8,197,156	354,475
<i>Waste Management Fund</i>					
Landfill closure and postclosure care	5,179,473	256,902	-	5,436,375	-
Compensated absences	\$ 261,415	16,930	-	278,345	278,345
Capital leases	563,622	554,716	(148,333)	970,005	252,615
Total Waste Management Fund	\$ 6,004,510	828,548	(148,333)	6,684,725	530,960

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, 2005 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, 2005:

	Balance at July 1, 2004	Increases	Decreases	Balance at June 30, 2005	Due Within One Year
School Board:					
Capital leases	\$ 283,003	-	(121,865)	161,138	128,100
Net pension obligation	113,026	9,042	(9,117)	112,951	-
Compensated absences	3,892,009	1,916,617	(1,677,728)	4,130,898	1,680,000
	\$ 4,288,038	1,925,659	(1,808,710)	4,404,987	1,808,100
Parking Authority:					
General obligation bonds	\$ 7,709,292	-	(250,715)	7,458,577	260,715
Notes payable to City	4,825,233	-	(320,073)	4,505,160	327,718
Compensated absences	24,651	2,782	-	27,433	27,433
	\$ 12,559,176	2,782	(570,788)	11,991,170	615,866
Economic Development Authority:					
Revenue bonds	\$ 12,575,000	-	(315,000)	12,260,000	330,000

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 general property taxes and other local taxes.

As of June 30, 2005, there were \$36,477,213 of bonds for public improvements and \$30,362,000 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, 2005. As of June 30, 2005 the City's legal margin for additional debt is \$219,463,454.

Defeased Debt

In 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, 2005, the outstanding balance of the defeased debt is \$70,900,000 of which \$19,175,000 is for the Public Utility Fund.

Debt Issued

On July 15, 2004, the Economic Development Authority of the City of Portsmouth issued a \$4,665,000 Lease Revenue Bond Series 2004, with a discount of \$49,926 through the Industrial Development Authority of the County of Stafford and the City of Staunton, Virginia as part of the Virginia Municipal League / Virginia Association of Counties (VML /VACO) Finance Program. The purpose of the Bond is to provide financing for the construction of a facility for the City's Department of Behavioral Healthcare Services. The payment of principal and interest on the bonds are secured by the full faith and credit of the City. Accordingly, all activity relating to this bond issuance has been reflected on the City's financial statements.

Notes to Basic Financial Statements, Continued

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. On October 29, 2004, the City extended the maturity on these Notes until October 31, 2005. In addition, the Note was amended from a variable interest rate to a fixed rate of 2.35%.

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. On October 29, 2004, the City extended the maturity on these Notes until October 31, 2005. In addition, the Note was amended from a variable interest rate to a fixed rate of 2.9%.

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 \$368,654 due on long-term debt for fiscal year 2005 from the Parking Authority were abated by the City.

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.

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, 2005 (except bond anticipation notes, compensated absences, landfill closure and postclosure care, and net pension obligation) are as follows:

Governmental Activities

Fiscal Year Ending	General Obligation Bonds, net		General Obligation Notes		Cooperation Agreements		Literary Loans		Capital Leases	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2006	\$ 8,102,320	5,271,099	-	254,441	2,240,000	2,277,731	475,000	88,500	2,479,463	1,474,877
2007	9,689,440	4,958,527	5,450,000	182,501	2,350,000	2,182,295	475,000	78,000	2,045,983	1,426,938
2008	9,697,496	4,568,284	2,530,000	55,280	2,460,000	2,082,675	375,000	67,500	2,004,804	1,332,334
2009	9,719,491	4,168,157	-	-	2,585,000	1,976,052	375,000	60,000	1,522,495	1,241,336
2010	9,739,313	3,770,810	-	-	2,715,000	1,864,416	375,000	52,500	1,258,304	1,158,431
2011-2015	43,853,516	12,721,477	-	-	10,180,000	7,851,652	1,500,000	157,500	4,844,562	4,967,161
2016-2020	25,192,891	3,512,109	-	-	8,910,000	5,987,779	750,000	30,000	6,357,296	2,542,338
2021-2025	2,984,798	583,655	-	-	10,468,736	3,734,190	-	-	2,071,396	110,138
2026-2030	1,405,014	183,625	-	-	9,105,000	1,165,500	-	-	-	-
	\$ 120,384,279	39,737,743	7,980,000	492,222	51,013,736	29,122,290	4,325,000	534,000	22,584,303	14,253,553

Business-Type Activities

Fiscal Year Ending	General Obligation		Revenue Bonds		Capital Leases	
	Principal	Interest	Principal	Interest	Principal	Interest
2006	\$ 3,646,455	2,617,456	295,158	398,035	252,615	28,284
2007	2,600,998	2,481,874	310,158	385,285	260,817	20,079
2008	2,639,676	2,394,145	325,157	371,897	269,292	11,609
2009	2,705,406	2,271,373	340,158	357,460	123,132	4,149
2010	2,773,606	2,155,948	355,158	342,280	64,149	1,275
2011-2015	13,685,474	8,831,054	2,030,788	1,443,910	-	-
2016-2020	14,863,075	5,484,752	2,590,788	881,250	-	-
2021-2025	11,437,325	2,166,312	1,890,474	193,500	-	-
2026	2,229,463	112,500	-	-	-	-
	\$ 56,581,478	28,515,414	8,137,839	4,373,617	970,005	65,396

Notes to Basic Financial Statements, Continued

(6) OBLIGATIONS UNDER COOPERATION AGREEMENTS

On March 1, 1999, the Economic Development Authority (EDA), 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 EDA to fund the cost of this project, the City and the EDA entered into a Cooperation Agreement in which the City agrees to contribute funds to the EDA, subject to appropriation by City Council and upon the request of the EDA, to pay annual debt service costs on the bonds. The bonds are limited obligations of the EDA payable solely from payments received by the EDA 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 EDA 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, is reflected as long-term debt. The balance outstanding at June 30, 2005 was \$35,560,000.

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 EDA, 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 EDA and reduce the amount of the City's obligation under this cooperation agreement. During fiscal year 2005, the City's obligation was reduced by \$150,000. The amount payable to the EDA under this Cooperation Agreement is \$5,253,736 at June 30, 2005.

On July 19, 2001, the EDA 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 EDA to fund the cost of this project, the City and the EDA entered into a Cooperation Agreement in which the City agrees to contribute funds to the EDA 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 EDA payable from payments received by the EDA from the City under the terms of the Cooperation Agreement and from certain funds established under the indenture. The amount payable to the EDA under this Cooperation Agreement is \$10,200,000 at June 30, 2005.

(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 2030. Included in capital assets are the following amounts applicable to capital leases:

		Governmental	Internal Service
Land	\$	5,199,603	-
Buildings		12,347,181	-
Equipment and vehicles		7,214,237	6,591,256
Less accumulated depreciation		(3,607,882)	(2,590,689)
Capital assets, net	\$	21,153,139	4,000,567

The total amount of equipment acquired through a capital lease during fiscal year ended June 30, 2005 was \$4,479,068. Depreciation expense on leased assets was \$1,811,635 for the fiscal year ended June 30, 2005.

Notes to Basic Financial Statements, Continued

The present value of future minimum capital and operating lease payments of the City as of June 30, 2005 are as follows:

Fiscal Year Ending	Capital	Operating
2006	\$ 4,235,239	1,254,431
2007	3,753,817	534,860
2008	3,618,039	532,835
2009	2,891,112	461,014
2010	2,482,159	316,447
2011-2015	9,811,723	95,643
2016-2020	8,899,634	-
2021-2025	2,181,534	-
Total minimum lease payments	37,873,257	\$ 3,195,230
Less amount representing interest	(14,318,949)	
Present value of minimum capital lease payments	\$ 23,554,308	

Total governmental operating lease payments for the year ended June 30, 2005 were \$1,214,043.

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 2005. The lessee contributed \$650,093 toward construction cost of which the remaining \$21,671 has been accounted for as unearned 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:

	Port and Economic Development Fund
Land	\$ 1,830,251
Buildings	1,434,349
Improvements other than buildings	4,547,558
Less accumulated depreciation	(4,564,582)
Capital assets, net	\$ 3,247,576

Notes to Basic Financial Statements, Continued

Future minimum lease receipts under capital and operating leases as of June 30, 2005 are:

Fiscal Year Ending	Capital	Operating
2006	\$ 35,639	181,612
Total minimum lease receipts	35,639	\$ 181,612
Less amount representing interest	(833)	
Present value of minimum capital lease receipts	\$ 34,806	

Rental income under these operating leases was \$544,836 for the year ended June 30, 2005.

(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. In addition, an automatic 50% survivor option has been 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. In addition, an automatic 50% survivor option has been 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, 2005 for employees covered by PSRS and FPRS and the total payroll for all City employees was as follows:

Payroll for employees covered by PSRS	\$ 4,821,000
Payroll for employees covered by FPRS	11,823,000
Total City payroll	73,101,000

Participation in the Portsmouth Supplemental Retirement System and the Fire and Police Retirement System consisted of the following as of July 1, 2005:

	PSRS	FPRS
Retirees and beneficiaries	349	474
Vested terminated employees not yet receiving benefits	68	77
Current vested employees	112	224
	529	775

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 2005 were \$1,657,997 and \$8,474,541, respectively. Contributions were made in accordance with actuarially determined requirements computed through an actuarial valuation performed as of July 1, 2004.

Annual Pension Cost

The required contributions were determined as part of the July 1, 2004 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 net pension asset is recorded in the government-wide Statement of Net Assets. The annual pension cost and net pension asset for the current fiscal year were as follows:

	PSRS	FPRS
Annual required contribution	\$ 1,678,576	8,544,079
Interest on net pension obligation (asset)	(20,517)	(32,667)
Adjustment to annual required contribution	21,887	34,849
Annual pension cost	1,679,946	8,546,261
Contributions made	1,657,997	8,474,541
Decrease in net pension obligation (asset)	21,949	71,720
Net pension obligation (asset) at beginning of year	(256,458)	(408,335)
Net pension obligation (asset) at end of year	\$ (234,509)	(336,615)

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.

The financial statements for the PSRS and the PPRS are as follows:

Statement of Fiduciary Net Assets**June 30, 2005**

	PSRS	FPRS
Assets:		
Cash and temporary investments	\$ 114,812	617,047
Investments:		
Common stock	26,849,197	52,022,628
Corporate bonds	5,537,874	10,807,242
Mortgage and mortgage-backed securities	4,526,414	8,770,316
U.S., state, and municipal government securities	3,179,504	6,160,562
Real estate	2,573,103	4,985,609
Alternatives	2,289,282	4,435,682
Total investments	44,955,374	87,182,039
Total assets	\$ 45,070,186	87,799,086
Net assets held in trust for pension benefits	\$ 45,070,186	87,799,086

Notes to Basic Financial Statements, Continued

**Statement of Changes in Fiduciary Net Assets
Year Ended June 30, 2005**

	PSRS	FPRS
Additions:		
Contributions	\$ 1,657,997	8,474,541
Investment income -		
Net increase in the fair value of investments	4,158,544	7,854,095
Less investment expense	(237,352)	(447,469)
Net investment income	3,921,192	7,406,626
Total additions	5,579,189	15,881,167
Deductions - benefits and refunds	6,201,763	12,801,209
Change in net assets	(622,574)	3,079,958
Net plan assets held in trust for pension benefits, beginning of year	45,692,760	84,719,128
Net plan assets held in trust for pension benefits, end of year	\$ 45,070,186	87,799,086

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) or at age 50 with 30 years of service for participating employees (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.

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, 2005 were 9.0% 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 \$7,308,906, \$5,542,073, and \$5,556,769, respectively. These contributions represent contribution rates of 11.14%, 8.00%, and 8.15% respectively.

Notes to Basic Financial Statements, Continued

Annual Pension Cost

For the fiscal year ended June 30, 2005, the City's annual pension cost of \$4,786,372, 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 \$958,145 was not equal to the School Board's required or actual contributions. The School Board's actual contributions were \$958,220. The required contributions were determined as part of the June 30, 2003 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	\$ 4,786,372	958,220
Interest on net pension obligation	-	9,042
Adjustment to annual required contribution	-	(9,117)
Annual pension cost	4,786,372	958,145
Contributions made	4,786,372	958,220
Decrease in net pension obligation	-	(75)
Net pension obligation at beginning of year	-	113,026
Net pension obligation at end of year	\$ -	112,951

Three-Year Trend Information

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (Asset)
VRS - City:			
June 30, 2005	\$ 4,786,372	100%	\$ -
June 30, 2004	3,051,138	100%	-
June 30, 2003	2,952,972	100%	-
VRS - School Board:			
June 30, 2005	958,145	100%	112,951
June 30, 2004	664,786	100%	113,026
June 30, 2003	667,578	100%	118,060
Portsmouth Supplemental:			
June 30, 2005	1,679,946	99%	(234,509)
June 30, 2004	1,130,481	94%	(256,458)
June 30, 2003	1,205,312	99%	(320,517)
Portsmouth Fire and Police:			
June 30, 2005	8,546,261	99%	(336,615)
June 30, 2004	5,815,461	97%	(408,335)
June 30, 2003	5,784,881	100%	(598,795)

Notes to Basic Financial Statements, Continued

(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.

(10) INTERFUND BALANCES AND TRANSFERS

Due From/To Other Funds

Individual fund interfund receivable and payable balances at June 30, 2005 are as follows:

Due From Other Funds	Due To Other Funds						Total
	Capital Improvements Fund	Nonmajor Governmental Funds	Public Utility Fund	Golf Fund	Waste Management Fund	Internal Service Funds	
General Fund	\$ 2,450,815	2,734,257	1,219	760	54,484	2,838,402	8,079,937

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, 2005 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	\$ 432	297,158	297,590
Nonmajor governmental funds	-	(22,565)	(22,565)
	\$ 432	274,593	275,025

The Statement of Net Assets reflects \$297,590 as due from component units and \$22,565 as due to component units for a net due from component units of \$275,025 as noted in the above table.

Notes to Basic Financial Statements, Continued

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, 2005 are as follows:

Transfers From Other Funds	Transfers To Other Funds			Total
	General Fund	Nonmajor Governmental Funds	Public Utility Fund	
General Fund	\$ -	40,000	8,961,087	9,001,087
Capital Improvements Fund	936,486	1,065,880	-	2,002,366
Nonmajor governmental funds	5,343,488	-	-	5,343,488
Golf Fund	505,759	-	-	505,759
Total	6,785,733	1,105,880	8,961,087	16,852,700

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

Amounts due from other governments at June 30, 2005 are as follows:

	Federal	State	Total
Governmental activities:			
General Fund:			
Street and highway maintenance funds	\$ -	1,493,321	1,493,321
Sales and use tax	-	594,923	594,923
Personal property tax relief	-	3,944,488	3,944,488
FEMA	209,982	-	209,982
Correctional facilities block grant	-	309,675	309,675
Other	-	729,270	729,270
Total General Fund	209,982	7,071,677	7,281,659
Capital Improvements Fund	-	1,566,967	1,566,967
Nonmajor governmental funds:			
Social Services Fund	-	1,566,023	1,566,023
Grants Fund	1,600,589	695,160	2,295,749
Community Development Fund	557,345	-	557,345
Total nonmajor governmental funds	2,157,934	2,261,183	4,419,117
Total governmental activities	\$ 2,367,916	10,899,827	13,267,743
Business-type activities:			
Waste Management Fund -			
Street and highway maintenance funds	\$ -	685,995	685,995

Due To Other Governments

The City's amount due to other governments at June 30, 2005 is \$21,265 in the Donations Fund owed to the Commonwealth of Virginia.

Notes to Basic Financial Statements, Continued

(12) DEFERRED AND UNEARNED REVENUES

Deferred and unearned 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 and unearned revenues for the primary government's fund-based financial statements and government-wide financial statements are comprised of the following:

	Governmental Funds				Business-Type	
	General Fund	Capital Improvements Fund	Nonmajor Governmental Funds	Total	Governmental Activities	Enterprise Funds
Property taxes	\$ 5,095,736	-	-	5,095,736	-	-
Notes receivable from component unit (note5)	4,505,160	-	-	4,505,160	4,505,160	-
VDOT funding	-	1,416,967	-	1,416,967	-	-
Notes receivable	-	4,152	-	4,152	4,152	-
Stormwater fees	-	-	82,786	82,786	-	-
Leases	-	-	-	-	-	203,283
Other	22,843	-	-	22,843	22,843	-
Total deferred and unearned revenues	\$ 9,623,739	1,421,119	82,786	11,127,644	4,532,155	203,283

(13) COMMITMENTS**Capital Improvement Program**

The City Council adopted a five-year Capital Improvement Program (CIP) on May 3, 2005, the total estimated cost of which amounted to \$190,548,728. 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	\$ 10,303,129
Public Utility Bonds	9,860,000
Stormwater funds	2,375,845
Non-local funds	4,110,862
Other local funds	3,169,098
	\$ 29,818,934

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 \$5,436,375 reported as landfill closure and postclosure care liability at June 30, 2005 represents the cumulative amount reported to date based on the use of 57 percent of the estimated capacity of the landfill. The City will recognize the remaining estimated cost of closure and postclosure care of \$4,034,661 as the remaining estimated capacity is filled. These amounts are based on what it would cost to perform all closure and postclosure care in 2005.

Notes to Basic Financial Statements, Continued

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 15 years. The City is required by Federal and State statutes to prepare a Local Government Financial Test Worksheet to demonstrate how closure and postclosure care financial assurance requirements will be met.

Moral Obligation – Economic Development Authority

On November 12, 1997, the Economic Development Authority (EDA) 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 EDA to fund the cost of this project, the City and the EDA entered into a Cooperation Agreement in which the City agrees to contribute funds to the EDA, subject to appropriation by City Council and upon the request of the EDA, 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 to be 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, 2005 was \$6,030,000. 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 guaranteed approximately \$5,460,000 in bonds and the interest thereon, issued by the Southeastern Public Service Authority (SPSA). The City's allocable portion of the \$26 million Revenue Series A bonds was 21% or \$5,460,000, with the remaining balance being due from neighboring localities. These bonds were paid off during fiscal year 2005, therefore, the City no longer has a contingent liability.

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, 2005.

Notes to Basic Financial Statements, Continued

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

The Risk Management and Insurance Fund has an accumulated net asset deficit balance of \$20,004,896 at June 30, 2005. 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.

(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, 2005, 2004, and 2003, 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 risk management claims liability of \$16,921,682 (undiscounted) reported in the fund at June 30, 2005 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. The amount due within one year is \$3,321,333. 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, 2005 to compute this liability.

Changes in the fund's claims liability amount in fiscal years 2005 and 2004 were:

	2005	2004
Risk management claims payable at beginning of year	\$ 15,076,510	17,848,493
Risk management claims expense and changes in estimates	(2,884,048)	(1,328,407)
Risk management claims payments, net	4,729,220	(1,443,576)
Risk management claims payable at end of year	\$ 16,921,682	15,076,510

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 medical claims are made through third party administrators. The computed medical claims liability as of June 30, 2005 is \$1,570,000 (undiscounted) and is due within one year.

Notes to Basic Financial Statements, Continued

Changes in the medical claim liability amount in fiscal years 2005 and 2004 were:

	2005	2004
Medical claims payable at beginning of year	\$ 1,593,000	1,338,000
Medical claims expense and changes in estimates	12,302,730	12,243,181
Medical claims payments	(12,325,730)	(11,988,181)
Medical claims payable at end of year	\$ 1,570,000	1,593,000

Hospitalization Benefits for Retired Employees

Under administrative regulation, the City offers health care benefits to all retired employees and their dependents that choose to remain on the City's health insurance plans. As of June 30, 2005, 519 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.

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, 2005 was determined to be \$2,362,185 (undiscounted), of which \$1,268,568 is due within one year.

Changes in the school's claim liability amount in fiscal years 2005 and 2004 were:

	2005	2004
Claims payable at beginning of year	\$ 2,070,510	1,639,702
Claims and changes in estimates	1,085,279	538,405
Claim payments	(793,604)	(107,597)
Claims payable at end of year	\$ 2,362,185	2,070,510

(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) RESTATED BEGINNING NET ASSETS

In fiscal year 2002, the Golf Fund recorded a gain of \$3,600,000 from the sale of the Sleepy Hole Golf Course and a water main to the City of Suffolk. As part of the agreement of sale, the City of Suffolk agreed to defer receipt of the water main until such time as the City was able to construct a replacement water main. At completion, the City would receive the final payment of \$2,200,000, and Suffolk would gain ownership of the water main. During fiscal year 2005, the replacement water main was completed and the final payment of \$2,200,000 was received. Upon recording this transaction, it was determined that the original gain recorded in the Golf Fund in fiscal year 2002 was overstated by \$900,000 as indicated in the following table.

Notes to Basic Financial Statements, Continued

Net assets, beginning of year	\$	6,858,401
Overstatement of gain on sale of assets		(900,000)
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Net assets, beginning of year, as restated	\$	5,958,401

(19) SUBSEQUENT EVENTS

On August 25, 2005, the City issued a \$3,600,000 General Obligation Public Utility Bond Anticipation Note to provide for interim financing for public utility water and sewer capital projects. The effective interest rate of the note was 3.39%. The principal and interest of the note was paid on October 18, 2005 in advance of the stated maturity of October 31, 2005.

On October 18, 2005, the City issued \$81,630,000 of General Obligation and Refunding Bonds, Series 2005A. The proceeds of the Series 2005A Bonds will be used to pay the costs of various capital improvement projects and to refund all or a portion of the outstanding balance of the City's a) General Obligation Public Improvement and Refunding Bonds, Series 1997A; b) Golf Course System Revenue Bonds, Series 1998; c) General Obligation Public Improvement and Refunding Bonds, Series 2001A; d) Amended General Obligation Public Improvement Bond Anticipation Note, Series 2002 (Tax Exempt); and e) General Obligation Public Utility Bond Anticipation Note, Series 2005; and refund, on a tax-exempt basis, a portion of the Economic Development Authority's Variable Rate Demand Revenue Bonds, Series 1997A.

On October 18, 2005, the City issued \$17,390,000 of General Obligation Public Utility Refunding Bonds, Series 2005B. A portion of the proceeds of the Series 2005B Bonds will be used to refund all or a portion of the outstanding balance of the City's General Obligation Public Utility Bonds, Series 1996 and General Obligation Public Utility and Refunding Bonds, Series 2001B.

On October 18, 2005, the City issued \$21,090,000 of Taxable General Obligation Refunding Bonds, Series 2005C to refund all of the outstanding balance of the City's Amended General Obligation Public Improvement Bond Anticipation Note, Series 2002 (Taxable); refund, on a taxable basis, a portion of the Economic Development Authority's Variable Rate Demand Revenue Bonds, Series 1997A; and refund all of the outstanding balance of the Economic Development Authority's Taxable Variable Rate Demand Revenue Bonds, Series 1997B and Taxable Variable Rate Public Facility Revenue Bonds, Series 2001. A portion of the Economic Development Authority's Variable Rate Demand Revenue Bonds, Series 1997A will be redeemed on a taxable basis as a result of private use of a portion of the facilities financed with such bonds.