

Notes to Basic Financial Statements

June 30, 2006

(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.

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*, as amended. 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), the Economic Development Authority of the City of Portsmouth, Virginia (Economic Development Authority or the EDA), 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 Portsmouth Parking Authority (Parking Authority) is presented as a blended component unit of the City. 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 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 pronouncements, the provisions of which have been implemented within these financial statements:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This statement also clarifies and establishes accounting requirements for insurance recoveries.
- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment of NCGA Statement No. 1, Governmental Accounting and Financial Reporting Principles*. The objective of this statement is to improve the understandability and usefulness of the information that local governments present as supplementary information in the statistical section.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation*. The objective of this statement is to enhance the usefulness and comparability of net assets information reported by local government by clarifying the meaning of the phrase "legally enforceable" as it applies to restrictions imposed on net asset use by enabling legislation and by specifying the accounting and financial reporting requirements for those restricted assets.

Notes to Basic Financial Statements, Continued
Discretely Presented Component Units

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

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

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

2. 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

3. 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

Blended Component Unit

Blended component units are entities that are legally separate from the City, but which provide services entirely, or almost entirely, to the City or otherwise exclusively benefit the City. Activities of blended component units are considered to be so intertwined with the City's that they are, in substance, part of the City's operations. The Parking Authority is considered to be a blended component unit in the City's financial statements. 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. No distinction is made between the activities of the Parking Authority and the City. As a result, the Parking Authority is reported as an enterprise fund in the City's financial statements. Separately audited financial statements are not available for the Parking Authority.

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

Notes to Basic Financial Statements, Continued

Assets, both the governmental and business-type activities columns are (a) reported by columns, and (b) 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 is otherwise being supported by general government revenues (property taxes, utility taxes, and other local taxes, etc.). The Statement of Activities reduces gross expenses (including depreciation) by directly related program revenues. 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 operational or capital requirements of a particular function or segment. Taxes and other items not specifically restricted to the various programs are reported as general revenues. The City does not allocate indirect expenses. The operating grants include operating-specific and discretionary (either operating or capital) grants while the capital grants column reflects capital-specific grants.

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

Notes to Basic Financial Statements, Continued

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 restricted to expenditures for specified purposes.

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

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

Proprietary Fund Types

Proprietary funds are used to account for the City's ongoing organizations and activities which are similar to those often found in the private sector. The measurement focus is upon determination of net income. Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues 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 two major enterprise funds: Public Utility Fund, which accounts for the utility activity provided to the City, and the Parking Authority, a blended component unit, which is responsible for the operation and maintenance of parking garages, parking lots, and all street parking meters for the City.

The nonmajor enterprise funds are: 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 Golf Fund, which accounts for ownership and operation of two golf courses; and the Waste Management Fund, which accounts for waste disposal services and operation of Craney Island landfill.

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 four nonmajor internal service funds: City Garage Fund, Information Technology Fund, Risk Management Fund, and Health Insurance Fund.

Notes to Basic Financial Statements, Continued

The City reports the following other nonmajor fund types:

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.

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

Notes to Basic Financial Statements, Continued

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 taxes, property taxes, grants, entitlements, and donations. On an accrual basis, revenue from sales taxes are recognized when the underlying exchange transaction takes place. Revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements, and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

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

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

D. Property Taxes

The two major sources of property taxes are described below:

Real Estate Taxes

The City levies real estate taxes on all real estate within its boundaries, except that exempted by statute, each year as of July 1 on the estimated market value of the property. Real estate taxes become a lien on real property the first day of the levy year. The City, as required by state statute, follows the practice of reassessing all 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 2006 was \$1.44 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. 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 2006, 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.

Notes to Basic Financial Statements, Continued

Governmental Activities:	
General Fund:	
Allowance for taxes receivable	\$ 2,619,448
Allowance for doubtful accounts receivable	410,650
Total General Fund	3,030,098
Special Revenue Fund - Stormwater Management Fund -	
Allowance for doubtful accounts receivable	175,224
Total governmental activities	\$ 3,205,322
Business-Type Activities - allowance for doubtful accounts receivable:	
Enterprise Funds:	
Public Utility Fund	\$ 831,828
Portsmouth Parking Authority	955
Waste Management Fund	484,431
Total business-type activities	\$ 1,317,214
Component Units - allowance for doubtful accounts receivable:	
Portsmouth School Board	\$ 25,304

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.

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.

Notes to Basic Financial Statements, Continued

Capital asset depreciation has been provided over the estimated useful lives using the straight-line method annually as follows:

	Estimated Useful Life in Years
Primary government:	
Site improvements	20
Infrastructure	30 - 50
Buildings	20 - 50
Improvements other than buildings	10 - 50
Machinery, furniture, and equipment	5 - 15
Component unit - School Board:	
Buildings	20 - 50
Machinery, furniture, and equipment	5 - 30

Compensated Absences

City 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 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. A liability for compensated absences is reported in the governmental funds only if they have matured.

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.

Notes to Basic Financial Statements, Continued

(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, 2006 are composed of the following:

	General Fund	Capital Improvements	Other Nonmajor
Current year encumbrances	\$ 1,380,448	10,514,327	2,078,012
Prior year encumbrances	2,977	-	-
Advances	4,177,442	-	-
Revenue maximization	-	-	204,358
Future debt requirements	683,337	-	-
Inventory	56,556	-	-
Cemetery care	-	-	1,000,000
	\$ 6,300,760	10,514,327	3,282,370

(3) CASH**Deposits and Restricted Cash**

At June 30, 2006, the carrying value of the City's deposits with banks and savings institutions was \$5,241,119 which includes \$64,266 in the fiduciary funds. All cash of the City except petty cash of \$43,207 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, 2006, restricted cash totaled \$20,868,587, of which \$20,185,250 represented unspent bond proceeds, while the remaining \$683,337 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.

Notes to Basic Financial Statements, Continued

As of June 30, 2006, the City's investment balances were as follows:

	Carrying Amount	Actual Credit Ratings	Required Credit Ratings	Average Days/Years to Maturity
SNAP investments	\$ 20,771,956	AAA	n/a	1 day
CCRF	714,684	AAA	n/a	1 day
Money market funds	66,115,159	AAA	n/a	1 day
U.S. government securities:				
FHLMC Discount Note	6,553,628	A-1	n/a	240 days
FHLMC Global Notes	2,154,699	AAA	n/a	1.1 years
	\$ 96,310,126			

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, 2006, 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 as well as interest rate risk.

U.S. Government Securities

The City also invests in U.S. Government Securities. The FHLMC Discount Note and FHLMC Global Notes are both subject to interest rate risk.

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 63% for equities, 26% for fixed income securities and 11% for alternative investments, which include real estate. None of the City's pension investments have credit ratings.

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.

Notes to Basic Financial Statements, Continued

At June 30, 2006, the fair value of the City's pension investments is as follows:

Fund Name	Investment Type	Weighted Average Maturity	Fair Value
Russell International Fund:			
Japanese Yen	Equity	1 day	\$ 4,557,123
Euro Dollar	Equity	1 day	6,422,786
Swiss Franc	Equity	1 day	941,512
Pound Sterling	Equity	1 day	4,145,716
Bermuda Dollar	Equity	1 day	21,386
Canadian Dollar	Equity	1 day	548,321
Cayman Dollar	Equity	1 day	4,608
Hong Kong Dollar	Equity	1 day	88,063
Australian Dollar	Equity	1 day	333,385
New Guinea Kina	Equity	1 day	6,409
Sweden Krona	Equity	1 day	285,718
Denmark and Norway Krone	Equity	1 day	197,223
Mexican Peso	Equity	1 day	160,284
Brazilian Real	Equity	1 day	86,046
Signapore Dollar	Equity	1 day	105,272
Taiwan Dollar	Equity	1 day	54,292
United States Dollar	Equity	1 day	1,479,011
South Korean Won	Equity	1 day	150,923
Chinese Yuan	Equity	1 day	3,600
Russell Multi-Manager Fund	Fixed Income	6.1 years	33,006,267
Russell Large Cap Structured	Equity	1 day	27,241,905
Russell Equity I Fund	Equity	1 day	27,248,277
Russell Small Cap Fund	Equity	1 day	6,883,445
Russell Real Estate Equity Fund	Other	1 day	14,763,809
Russell Diversified Alternatives	Other	1 day	7,326,076
			\$ 136,061,457

Component Unit - School Board

All of the deposits of the School Board, a discretely presented component unit, of (\$267,073) 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 \$12,372,000 invested in the Evergreen Money Market Fund and \$3,271,116 invested in Fidelity Treasury Fund as of June 30, 2006. 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.

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 \$149,324. 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.

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 \$1,700,562. 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, 2006 was as follows:

Primary Government - Governmental Activities	Balance		Deletions	Balance
	July 1, 2005	Additions		June 30, 2006
Capital assets not being depreciated:				
Land	\$ 23,500,434	161,820	-	23,662,254
Construction in progress	62,399,076	12,240,874	12,643,746	61,996,204
Total capital assets not being depreciated	85,899,510	12,402,694	12,643,746	85,658,458
Capital assets being depreciated:				
Infrastructure	454,819,998	2,932,882	-	457,752,880
Site improvements	1,436,092	-	-	1,436,092
Buildings	171,055,454	10,523,209	-	181,578,663
Machinery, furniture, and equipment	36,193,122	4,868,636	962,720	40,099,038
Total capital assets being depreciated	663,504,666	18,324,727	962,720	680,866,673
Less accumulated depreciation for:				
Infrastructure	(288,790,716)	(12,125,446)	-	(300,916,162)
Site improvements	(303,183)	(71,805)	-	(374,988)
Buildings	(50,238,605)	(3,858,846)	-	(54,097,451)
Machinery, furniture, and equipment	(21,912,721)	(3,249,388)	(957,012)	(24,205,097)
Total accumulated depreciation	(361,245,225)	(19,305,485)	(957,012)	(379,593,698)
Total capital assets being depreciated, net	302,259,441	(980,758)	5,708	301,272,975
Governmental activities capital assets, net	\$ 388,158,951	11,421,936	12,649,454	386,931,433

Under Virginia Law, certain property, with a net book value of \$61,339,053 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	\$ 59,526
Judicial	363,736
Public safety	1,122,899
Public works	12,248,141
Health and welfare	515,095
Parks, recreation and cultural	393,057
Community development	1,004,473
Education	1,829,537
<hr/>	
Total governmental funds	17,536,464
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.	
	1,769,021
<hr/>	
Total governmental activities	\$ 19,305,485

Notes to Basic Financial Statements, Continued

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

	Project Authorization	Expended to June 30, 2006	Commitments
Victory Boulevard	\$ 8,500,000	948,369	7,243,100
Midtown redevelopment acquisition	6,814,986	6,664,018	11,268
Downtown Crawford roundabout	2,200,000	-	-
Midtown Corridor	2,700,000	-	-
Tidewater Community College infrastructure	2,000,000	-	-
Tower Mall redevelopment	5,558,000	5,125,125	52,818
New library joint with Suffolk	3,352,590	761,967	429,719
Drainage facilities repair	7,099,072	6,197,621	664,671
Behavioral Health building	4,529,003	37,882	-
City / Schools joint financial management system	2,936,486	248,145	-
Port Centre EDA grant	4,357,916	4,313,311	-
City Hall repairs	4,292,500	4,213,521	17,988
Computerized traffic signals	3,599,060	3,597,613	12
PAC Ntelos pavilion	3,410,467	3,124,325	229,725
Churchland High School - air quality	3,616,307	2,542,308	41,365
Parkview School	2,864,938	2,746,359	-
New courts complex	3,500,000	-	-
Lee Avenue improvements	2,500,000	991,670	31,703
Simonsdale Street improvements	2,293,131	1,800,868	492,215
Highland Biltmore improvements	2,857,000	1,874,306	19,348
Emergency Operations Center relocation	1,987,800	1,983,589	2,196
Frederick Boulevard/ Bart St.	1,878,586	1,793,738	-
Roof / mechanical renovation	4,321,542	761,161	-
Civic Center specifications	1,834,453	1,812,370	16,993
Substructure painting - London Boulevard Bridge	1,759,217	1,479,353	158,563
Bridge repairs	1,597,985	1,277,878	5,336
Renovations to various buildings	1,240,094	1,356,950	1,207
McLean Street / Cavalier Boulevard	1,500,000	-	-
Children's Museum expansion	1,075,000	689,775	303,524
Various projects under \$1,000,000 each	13,022,222	5,653,982	716,502
	\$ 109,198,355	61,996,204	10,438,253

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 \$10,514,327 have been reserved for encumbrances in the capital improvements fund.

Notes to Basic Financial Statements, Continued

Primary Government - Business-Type Activities	Balance, as adjusted July 1, 2005	Additions	Deletions	Balance June 30, 2006
Capital assets not being depreciated:				
Land	\$ 15,211,274	-	-	15,211,274
Construction in progress	63,374,114	7,959,691	1,298,207	70,035,598
Total capital assets not being depreciated	78,585,388	7,959,691	1,298,207	85,246,872
Capital assets being depreciated:				
Buildings	22,297,714	-	-	22,297,714
Improvements other than buildings	143,889,819	2,233,923	-	146,123,742
Machinery, furniture, and equipment	12,794,917	1,029,698	603,018	13,221,597
Total capital assets being depreciated	178,982,450	3,263,621	603,018	181,643,053
Less accumulated depreciation for:				
Buildings	(8,639,170)	(593,830)	-	(9,233,000)
Improvements other than buildings	(53,353,943)	(2,861,884)	-	(56,215,827)
Machinery, furniture, and equipment	(7,887,148)	(972,262)	(578,374)	(8,281,036)
Total accumulated depreciation	(69,880,261)	(4,427,976)	(578,374)	(73,729,863)
Total capital assets being depreciated, net	109,102,189	(1,164,355)	24,644	107,913,190
Business-type activities capital assets, net	\$ 187,687,577	6,795,336	1,322,851	193,160,062

Notes to Basic Financial Statements, Continued

Primary Government - Major Enterprise Funds	Balance, as adjusted July 1, 2005	Additions	Deletions	Balance June 30, 2006
<u>Public Utility Fund</u>				
Capital assets not being depreciated:				
Land	\$ 186,779	-	-	186,779
Construction in progress	63,118,078	7,931,963	1,014,443	70,035,598
Total capital assets not being depreciated	63,304,857	7,931,963	1,014,443	70,222,377
Capital assets being depreciated:				
Buildings	67,864	-	-	67,864
Improvements other than buildings	139,070,652	2,233,923	-	141,304,575
Machinery, furniture, and equipment	6,163,778	225,301	223,795	6,165,284
Total capital assets being depreciated	145,302,294	2,459,224	223,795	147,537,723
Less accumulated depreciation for:				
Buildings	(54,304)	(1,713)	-	(56,017)
Improvements other than buildings	(49,654,604)	(2,795,636)	-	(52,450,240)
Machinery, furniture, and equipment	(4,593,841)	(350,760)	(223,795)	(4,720,806)
Total accumulated depreciation	(54,302,749)	(3,148,109)	(223,795)	(57,227,063)
Total capital assets being depreciated, net	90,999,545	(688,885)	-	90,310,660
Public utility capital assets, net	\$ 154,304,402	7,243,078	1,014,443	160,533,037
<u>Parking Authority</u>				
Capital assets not being depreciated:				
Land	\$ 679,680	-	-	679,680
Construction in progress	235,616	27,728	263,344	-
Total capital assets not being depreciated	915,296	27,728	263,344	679,680
Capital assets being depreciated:				
Buildings	18,667,910	-	-	18,667,910
Improvements other than buildings	242,609	-	-	242,609
Machinery, furniture, and equipment	244,273	263,344	76,534	431,083
Total capital assets being depreciated	19,154,792	263,344	76,534	19,341,602
Less accumulated depreciation for:				
Buildings	(7,076,893)	(471,154)	-	(7,548,047)
Improvements other than buildings	(173,934)	(13,735)	-	(187,669)
Machinery, furniture, and equipment	(211,979)	(22,882)	(76,534)	(158,327)
Total accumulated depreciation	(7,462,806)	(507,771)	(76,534)	(7,894,043)
Total capital assets being depreciated, net	\$ 12,607,282	(216,699)	263,344	12,127,239

Notes to Basic Financial Statements, Continued

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

	Project Authorization	Expended to June 30, 2006	Commitments
Public Utility Fund:			
Lake Kilby-Pilot testing program	\$ 18,492,301	18,475,739	-
Lake Kilby raw water pumping station	1,051,000	48,319	556,005
Miscellaneous sewer improvements	1,659,500	1,581,284	63,704
Infrastructure improvements	19,669,500	15,625,158	2,510,772
Godwin Street reservoir replacement	10,040,923	8,985,445	300,964
Electrical facility relocation - Lake Kilby	5,225,740	4,370,292	-
Drought emergency water main	4,838,287	4,838,287	-
Replacement of water plant equipment	4,081,213	1,125,935	137,647
Water plant residuals management and disposal	4,433,500	3,537,576	777,565
Miscellaneous water improvements	1,156,615	764,117	16,685
Sewer cave-in repair	1,626,762	1,069,143	184,703
Camden Avenue sewer rehabilitation	1,489,000	654,605	52,937
Suction well rehabilitation	1,920,290	609,364	1,288,987
Downtown master utility	2,500,000	-	-
Various projects under \$1,000,000 each	3,204,004	1,224,927	67,458
	\$ 81,388,635	62,910,191	5,957,427

In addition to the amount of \$62,910,191 shown above as expended to June 30, 2006, \$7,125,407 is included in construction in progress for capitalized interest, bringing total construction in progress to \$70,035,598. 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. When a project is authorized, financing is either presently available or general obligation public bonds are authorized to be issued.

Construction in progress in the Parking Authority is composed of the following:

	Project Authorization	Expended to June 30, 2006	Commitments
City Hall garage repairs	\$ 200,000	-	-

Notes to Basic Financial Statements, Continued

School Board Component Unit				
	Balance July 1, 2005	Additions	Deletions	Balance June 30, 2006
Capital assets not being depreciated:				
Land	\$ 6,499,465	-	161,820	6,337,645
Construction in progress	4,824,219	7,351,616	4,358,673	7,817,162
Total capital assets not being depreciated	11,323,684	7,351,616	4,520,493	14,154,807
Capital assets being depreciated:				
Buildings	52,227,056	4,359,673	6,142,094	50,444,635
Machinery, furniture, and equipment	15,186,189	1,975,977	817,753	16,344,413
Total capital assets being depreciated	67,413,245	6,335,650	6,959,847	66,789,048
Less accumulated depreciation for:				
Buildings	(31,112,513)	(1,018,161)	(5,519,781)	(26,610,893)
Machinery, furniture, and equipment	(8,608,489)	(1,532,800)	(817,753)	(9,323,536)
Total accumulated depreciation	(39,721,002)	(2,550,961)	(6,337,534)	(35,934,429)
Total capital assets being depreciated, net	27,692,243	3,784,689	622,313	30,854,619
School Board capital assets, net	\$ 39,015,927	11,136,305	5,142,806	45,009,426

Notes to Basic Financial Statements, Continued

(5) LONG - TERM DEBT

Details of Long-Term Indebtedness

At June 30, 2006, the long-term indebtedness of the City consisted of the following:

	Rate	Outstanding
Governmental Activities		
General obligation bonds, net:		
1996 Public Improvement Bonds	5.00%	\$ 2,000,000
1997 Public Improvement Bonds	6.46 - 6.65%	6,875,000
1997 Public Improvement Bonds	4.40 - 5.25%	11,725,000
1999 Qualified Zone Academy Bonds	0%	3,294,464
2001 Public Improvement Bonds	4.50 - 5.25%	11,648,403
2001 Qualified Zone Academy Bonds	0%	705,079
2001 Virginia Public School Authority Bonds	4.10 - 5.35%	2,677,829
2003 Public Improvement Refunding Bonds	3.00 - 5.00%	61,504,915
2004 BHS Lease Revenue Bonds	3.00 - 5.00%	4,617,071
2005 Public Improvement Bonds	3.50 - 5.00%	45,370,197
2005 Public Improvement Refunding Bonds	3.50 - 5.00%	20,893,277
Total general obligation bonds, net		171,311,235
General obligation notes payable	2.64 - 4.37%	7,980,000
Obligations under capital leases		18,949,199
Obligations under cooperation agreements (note 6)		34,725,000
Literary loans		3,850,000
Compensated absences		7,107,476
Total governmental activities		\$ 243,922,910
Business-Type Activities		
General obligation bonds, net:		
1996 Public Utility Bonds	5.00 - 5.25%	\$ 410,323
1997 Public Utility Bonds	4.45 - 5.25%	2,606,102
2001 Public Utility Bonds	4.00 - 5.00%	3,904,648
2003 Public Utility Bonds	3.00 - 5.00%	29,615,376
2003 Public Improvement	3.00 - 5.00%	7,197,863
2005 Public Utility Bonds	3.50 - 5.00%	30,669,568
2005 Public Utility Refunding Bonds	3.50 - 5.00%	16,591,270
2005 Public Improvement Bonds	3.50 - 5.00%	7,377,550
Total general obligation bonds, net		98,372,700
Obligations under capital leases		1,226,587
Landfill closure and postclosure care		5,436,375
Compensated absences		790,221
Total business type-activities		\$ 105,825,883

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

Notes to Basic Financial Statements, Continued

At June 30, 2006, the long-term indebtedness of Component Units consisted of the following:

	Amount Outstanding
School Board:	
Obligations under capital leases	\$ 8,504,696
Net pension obligation	113,112
Compensated absences	4,153,236
	\$ 12,771,044

Changes in Indebtedness

The following is a summary of changes in long-term indebtedness of the City for the year ended June 30, 2006:

	Balance, as adjusted July 1, 2005	Increases	Decreases	Balance June 30, 2006	Due Within One Year
Primary Government -					
Governmental Activities:					
General obligation bonds, net	\$ 120,384,279	66,263,474	(15,336,518)	171,311,235	12,239,757
General obligation notes payable	7,980,000	-	-	7,980,000	5,450,000
Compensated absences	6,485,792	660,964	(39,280)	7,107,476	4,752,111
Bond anticipation notes	11,642,000	-	(11,642,000)	-	-
Cooperation agreements (note 6)	51,013,736	-	(16,288,736)	34,725,000	870,000
Literary loans	4,325,000	-	(475,000)	3,850,000	475,000
Capital leases (note 7)	22,584,303	3,710,827	(7,345,931)	18,949,199	2,610,439
Total Governmental Activities	\$ 224,415,110	70,635,265	(51,127,465)	243,922,910	26,397,307
Business-Type Activities:					
General obligation	\$ 72,177,894	54,761,165	(28,566,359)	98,372,700	3,890,991
Bond anticipation notes	6,158,000	3,600,000	(9,758,000)	-	-
Landfill closure and postclosure care	5,436,375	-	-	5,436,375	-
Compensated absences	735,378	54,843	-	790,221	790,221
Capital leases (note 7)	970,005	509,197	(252,615)	1,226,587	354,805
Total Business-Type Activities	\$ 85,477,652	58,925,205	(38,576,974)	105,825,883	5,036,017
Major Enterprise Funds:					
<i>Public Utility Fund</i>					
General obligation bonds, net	\$ 55,909,305	47,296,454	(19,408,472)	83,797,287	3,328,999
Bond anticipation notes	6,158,000	3,600,000	(9,758,000)	-	-
Compensated absences	370,283	19,465	-	389,748	389,748
Total Public Utility Fund	\$ 62,437,588	50,915,919	(29,166,472)	84,187,035	3,718,747
<i>Parking Authority</i>					
General obligation bonds, net	\$ 7,458,577	205,359	(260,714)	7,403,222	269,804
Compensated absences	27,433	5,986	-	33,419	33,419
Total Parking Authority	\$ 7,486,010	211,345	(260,714)	7,436,641	303,223

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, 2006 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, 2006:

	Balance, As restated July 1, 2005	Increases	Decreases	Balance June 30, 2006	Due Within One Year
School Board:					
Capital leases	\$ 8,632,796	-	(128,100)	8,504,696	421,507
Net pension obligation	112,951	8,471	(8,310)	113,112	-
Compensated absences	4,130,898	1,722,452	(1,700,114)	4,153,236	1,700,000
Total School Board	\$ 12,876,645	1,730,923	(1,836,524)	12,771,044	2,121,507
Economic Development Authority:					
Revenue Bonds	\$ 12,260,000	-	(12,260,000)	-	-

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, 2006, there were no bonds that were authorized but unissued. As of June 30, 2006, the City's legal margin for additional debt is \$240,814,757.

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, 2006, the outstanding balance of the defeased debt is \$98,360,000 of which \$35,890,000 is for the Public Utility Fund.

Debt Issued

a. On August 25, 2005, the City issued a \$3,600,000 General Obligation Bond Anticipation Note to provide 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.

b. On October 18, 2005, the City issued \$81,630,000 of General Obligation and Refunding Bonds, Series 2005A with a premium of \$2,524,306. The proceeds were primarily used to pay the costs of \$24,835,213 of public improvement and \$20,604,000 of public utility capital improvement projects and to advance refund the following:

Series 1997 - Tax Exempt	G.O. Public Improvement	\$ 4,040,000
Series 2001A	G.O. Public Improvement	3,180,000
Series 1998 Golf Bonds	Revenue Bonds	8,225,000

Notes to Basic Financial Statements, Continued

In addition, the following bond anticipation notes were paid off:

Series 2002 Amended BAN	G.O. Public Improvement	\$ 9,642,000
Series 2002 Amended BAN	G.O. Public Utility	6,158,000
Series 2005 BAN	G.O. Public Utility	3,600,000

Lastly, the City paid in full the Series 1997A Fairwood Homes – Tax Exempt EDA Variable Rate Demand Revenue Bonds of \$2,672,670. This was debt of the EDA, a component of the City.

Of the total amount of refunding payments made, \$15,910,954 was used to purchase U.S. Treasury Securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from general long term debt.

The advance refunding of the General Obligation Public Improvement Bonds resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$240,388. This difference, reported in the accompanying government-wide financial statements as a deduction from bonds payable, is being amortized over the life of the new debt. The advance refunding of the Series 1998 Golf Revenue Bonds resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$496,603. The City completed the advance refunding to reduce its total debt service payments over the next 22 years by \$1,443,731 and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$269,333.

c. On October 18, 2005, the City issued \$17,390,000 of General Obligation Public Utility Refunding Bonds, Series 2005B with a premium of \$139,495. The proceeds were used to advance refund \$2,540,000 of outstanding General Obligation 1996 Series Bonds and \$14,175,000 of outstanding General Obligation 2001B Series bonds. The total amount of refunding payments made, \$17,320,847, was used to purchase U.S. Treasury Securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from Public Utility Fund.

The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$938,225. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being amortized over the life of the new debt. The City completed the advance refunding to reduce its total debt service payments over the next 20 years by \$870,256 and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$662,375.

d. On October 18, 2005, the City issued \$21,090,000 of Taxable General Obligation Refunding Bonds, Series 2005C with a discount of \$67,183. The proceeds were used to advance refund the Series 2001 Performing Arts Center General Obligation Taxable Variable Rate Public Facility Revenue Bonds of \$8,955,000.

In addition, proceeds from the Series 2005C bonds were used to pay off the \$2,000,000 Series 2002 General Obligation Taxable Public Improvement Bond Anticipation Note (Amended).

Lastly, the City paid in full the Series 1997A Fairwood Homes – Taxable EDA Variable Rate Demand Revenue Bonds of \$3,557,330 and the Series 1997B Port Centre I – Taxable EDA Variable Rate Demand Revenue Bonds of \$6,030,000. This was debt of the EDA, a component unit of the City.

The advance refunding of the Series 2001 Performing Arts Center Taxable Revenue Bonds resulted in an increase in total debt service payments over the next six years by \$704,786 and an economic loss (difference between the present value of the debt service payments on the old and new debt) of \$288,131. The refunding of the Series

Notes to Basic Financial Statements, Continued

1997A Fairwood Homes – Taxable Revenue Bonds resulted in an increase in total debt service payments over the next 22 years by \$618,147 and an economic loss of \$269,878. The advance refunding of the Series 1997B Port Centre I – Taxable Revenue Bonds resulted in an increase in total debt service payments of \$827,329 and an economic loss of \$356,676. The total amount of refunding costs deposited with the escrow agent was \$18,753,994. These funds were invested in U.S. Government Securities to pay interest and principal on the refunded bonds at their stated redemption dates. Of this amount, \$9,084,541 was for the refunded Series 2001 Performing Arts Center Bonds.

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CITY OF PORTSMOUTH, VIRGINIA

Exhibit H, Continued

Notes to Basic Financial Statements, Continued

Debt Compliance and Repayment

The annual requirements to amortize to maturity all long-term indebtedness of the City which is outstanding as of June 30, 2006 (except compensated absences and landfill closure and postclosure care) are as follows:

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
2007	\$ 12,239,759	7,717,909	5,450,000	182,501	870,000	1,701,218	475,000	78,000	2,610,439	1,420,016
2008	12,367,678	7,315,951	2,530,000	55,280	900,000	1,665,549	375,000	67,500	2,593,319	1,301,908
2009	12,514,536	7,057,093	-	-	940,000	1,627,749	375,000	60,000	2,136,228	1,186,395
2010	12,674,178	6,531,658	-	-	980,000	1,587,329	375,000	52,500	1,752,581	1,079,633
2011	12,845,885	5,988,756	-	-	1,025,000	1,544,209	1,500,000	157,500	1,338,998	1,028,366
2012 - 2016	51,788,034	21,988,577	-	-	5,890,000	6,956,037	750,000	30,000	3,747,312	4,131,323
2017 - 2021	29,717,440	10,556,972	-	-	7,525,000	5,316,200	-	-	4,770,322	1,596,334
2022 - 2026	13,924,633	5,045,941	-	-	9,605,000	3,235,000	-	-	-	-
2027 - 2031	13,239,092	1,745,955	-	-	6,990,000	710,250	-	-	-	-
	\$ 171,311,235	73,948,812	7,980,000	237,781	34,725,000	24,343,541	3,850,000	445,500	18,949,199	11,743,975

Business-Type Activities

Fiscal Year Ending	General Obligation		Capital Leases	
	Principal	Interest	Principal	Interest
2007	\$ 3,890,992	4,453,129	354,806	39,384
2008	3,969,484	4,321,940	367,052	27,143
2009	4,090,347	4,146,186	224,813	15,761
2010	4,208,727	3,977,575	169,911	8,807
2011	4,350,020	3,799,716	110,005	3,288
2012 - 2016	22,053,965	15,924,083	-	-
2017 - 2021	25,503,601	10,389,312	-	-
2022 - 2026	21,100,962	4,796,818	-	-
2027 - 2031	9,204,602	1,265,635	-	-
	\$ 98,372,700	53,074,394	1,226,587	94,383

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, 2006 was \$34,725,000.

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 2006, the City's obligation was reduced by \$150,000. The amount payable to the EDA under this Cooperation Agreement is zero at June 30, 2006.

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 zero at June 30, 2006.

(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	-
Machinery, furniture, and equipment		7,214,237	10,279,755
Less accumulated depreciation		(4,653,687)	(3,788,071)
Capital assets, net	\$	20,107,334	6,491,684

The total amount of equipment acquired through a capital lease during fiscal year ended June 30, 2006, was \$4,220,024. Depreciation expense on leased assets was \$2,261,794 for the fiscal year ended June 30, 2006.

Notes to Basic Financial Statements, Continued

The present value of future minimum capital and operating lease payments of the City as of June 30, 2006 is as follows:

Fiscal Year Ending	Capital	Operating
2007	\$ 4,424,645	1,281,747
2008	4,289,422	973,177
2009	3,563,197	958,516
2010	3,010,932	705,107
2011	2,480,657	460,087
2012-2016	7,878,635	-
2017-2021	6,366,656	-
Total minimum lease payments	32,014,144	\$ 4,378,634
Less amount representing interest	(11,838,358)	
Present value of minimum capital lease payments	\$ 20,175,786	

Total governmental operating lease payments for the year ended June 30, 2006 were \$1,302,804.

As Lessor

The City 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 2009.

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	(4,651,504)
Capital assets, net	\$ 3,160,654

Future minimum lease receipts under operating leases as of June 30, 2006 are:

Fiscal Year Ending	Operating
2007	\$ 580,000
2008	580,000
2009	580,000
2010	193,333
Total minimum lease receipts	\$ 1,933,333

Rental income under these operating leases was \$568,279 for the year ended June 30, 2006.

Notes to Basic Financial Statements, Continued

(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.

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 for members who terminate employment prior to age 50 with less than 20 years of credited service.

Notes to Basic Financial Statements, Continued

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, 2006 for employees covered by PSRS and FPRS and the total payroll for all City employees was as follows:

Payroll for employees covered by PSRS	\$ 4,472,000
Payroll for employees covered by FPRS	11,642,000
Total City payroll	77,862,000

Participation in the Portsmouth Supplemental Retirement System and the Fire and Police Retirement System consisted of the following as of July 1, 2006:

	PSRS	FPRS
Retirees and beneficiaries	347	488
Vested terminated employees not yet receiving benefits	66	76
Current vested employees	107	204
	520	768

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.

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 2006 were \$2,084,812 and \$8,455,194 respectively. The annual required contributions of \$2,084,812 and \$8,583,893 were calculated in accordance with actuarially determined requirements computed through an actuarial valuation performed as of July 1, 2005.

Annual Pension Cost

The required contributions were determined as part of the July 1, 2005 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 8% investment rate of return, and (b) projected salary increases ranging from 5.0% to 6.0% per year, and (c) 1.5% per year cost-of-living adjustments. 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.

Notes to Basic Financial Statements, Continued

The annual pension cost and net pension asset for the current fiscal year were as follows:

	PSRS	FPRS
Annual required contribution	\$ 2,084,812	8,583,893
Interest on net pension asset	(18,761)	(26,924)
Adjustment to annual required contribution	20,239	29,051
Annual pension cost	2,086,290	8,586,020
Contributions made	2,084,812	8,455,194
Decrease in net pension asset	1,478	130,826
Net pension asset at beginning of year	(234,509)	(336,615)
Net pension asset at end of year	\$ (233,031)	(205,789)

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, 2006**

	PSRS	FPRS
Assets -		
Investments:		
Common stock	\$ 26,920,876	54,504,435
Corporate bonds	3,002,169	6,078,238
Mortgage and mortgage-backed securities	4,250,382	8,605,391
U.S., state, and municipal government securities	3,507,910	7,102,171
Real estate	4,881,218	9,882,591
Alternatives	2,422,151	4,903,925
Total investments	44,984,706	91,076,751
Total assets	\$ 44,984,706	91,076,751

Notes to Basic Financial Statements, Continued

Statement of Changes in Fiduciary Net Assets
Year Ended June 30, 2006

	PSRS	FPRS
Additions:		
Contributions	\$ 2,084,812	8,455,194
Investment income -		
Net increase in fair value of investments	4,571,610	9,057,954
Less investment expense	(242,418)	(482,300)
Net investment income	4,329,192	8,575,654
Total additions	6,414,004	17,030,848
Deductions - benefits and refunds		
	6,499,484	13,753,183
Change in net assets	(85,480)	3,277,665
Net plan assets held in trust for pension benefits, beginning of year	45,070,186	87,799,086
Net plan assets held in trust for pension benefits, end of year	\$ 44,984,706	91,076,751

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, 2006 were 9.0% and 11.5% 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 \$8,230,067, \$7,308,906, and \$5,542,073, respectively. These contributions represent contribution rates of 11.62%, 11.14%, and 8.00% respectively.

Notes to Basic Financial Statements, Continued

Annual Pension Cost

For the fiscal year ended June 30, 2006, the City's annual pension cost of \$5,183,087, 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 \$903,037 was not equal to the School Board's required or actual contributions. The School Board's actual contributions were \$902,876. 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	\$ 5,183,087	902,876
Interest on net pension obligation	-	8,471
Adjustment to annual required contribution	-	(8,310)
Annual pension cost	5,183,087	903,037
Contributions made	5,183,087	902,876
Increase in net pension obligation	-	161
Net pension obligation at beginning of year	-	112,951
Net pension obligation at end of year	\$ -	113,112

Three-Year Trend Information

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (Asset)
VRS - City:			
June 30, 2006	\$ 5,183,087	100%	\$ -
June 30, 2005	4,786,372	100%	-
June 30, 2004	3,051,138	100%	-
VRS - School Board:			
June 30, 2006	903,037	100%	113,112
June 30, 2005	958,145	100%	112,951
June 30, 2004	664,786	100%	113,026
Portsmouth Supplemental:			
June 30, 2006	2,086,290	100%	(233,031)
June 30, 2005	1,679,946	94%	(234,509)
June 30, 2004	1,130,481	99%	(256,458)
Portsmouth Fire and Police:			
June 30, 2006	8,586,020	98%	(205,789)
June 30, 2005	8,546,261	97%	(336,615)
June 30, 2004	5,815,461	100%	(408,335)

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, 2006 are as follows:

Due from Other Funds	Due to Other Funds		Total
	Nonmajor Governmental Funds	Internal Service Funds	
General Fund	\$ 3,799,964	2,522,016	6,321,980

These interfund balances result from short-term operational borrowing and are due within one year. At June 30, 2006, the General Fund has a long-term advance receivable from Parking Authority in the amount of \$4,177,442.

Due From/To Primary Government/Component Units

Amounts due at June 30, 2006 between the City and the Component Units are as follows:

Due From (To) Component Units	Due To (From) Primary Government		Total
	Economic Development Authority	School Board	
General Fund	\$ 43,047	99,044	142,091
Nonmajor governmental funds	-	(56,917)	(56,917)
	\$ 43,047	42,127	85,174

The Statement of Net Assets reflects \$142,091 as due from component units and \$56,917 as due to component units for a net due from component units of \$85,174 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, 2006 are as follows:

Transfers to:	Transfers from:				Total
	General Fund	Nonmajor Governmental Funds	Internal Service Funds	Public Utility Fund	
General Fund	\$ -	10,000	-	8,202,776	8,212,776
Capital Improvements Fund	3,896,406	1,775,845	-	-	5,672,251
Nonmajor governmental funds	5,788,060	18,004	183,365	-	5,989,429
Parking Authority	355,620	-	-	-	355,620
Nonmajor proprietary funds	241,956	-	-	-	241,956
Total	\$ 10,282,042	1,803,849	183,365	8,202,776	20,472,032

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

Amounts due from other governments at June 30, 2006 are as follows:

	Federal	State	Total
Governmental activities:			
General Fund:			
Sales and use tax	\$ -	594,158	594,158
Personal property tax relief	-	9,874,470	9,874,470
Correctional facilities block grant	-	324,655	324,655
Constitutional officers	-	665,420	665,420
Other	-	4,536	4,536
Total General Fund	-	11,463,239	11,463,239
Nonmajor governmental funds:			
Community Services Fund	-	1,186,115	1,186,115
Social Services Fund	-	2,388,415	2,388,415
Grants Fund	1,190,629	247,345	1,437,974
Community Development Fund	406,640	-	406,640
Total nonmajor governmental funds	1,597,269	3,821,875	5,419,144
Total governmental activities	\$ 1,597,269	15,285,114	16,882,383

(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.

Notes to Basic Financial Statements, Continued

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				Total	Business-Type	
	General Fund	Capital Improvements Fund	Nonmajor Governmental Funds	Governmental Activities		Parking Authority	
Property taxes	\$ 5,997,914	-	-	5,997,914	-	-	
Parking space rentals	-	-	-	-	-	48,613	
Notes receivable	-	4,152	-	4,152	4,152	-	
Stormwater fees	-	-	63,603	63,603	-	-	
Total deferred and unearned revenues	\$ 5,997,914	4,152	63,603	6,065,669	4,152	48,613	

(13) COMMITMENTS

Capital Improvement Program

The City Council adopted a five-year Capital Improvement Program (CIP) on April 25, 2006, the total estimated cost of which amounted to \$292,511,312. 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	\$ 10,500,000
General obligation notes	3,500,000
Public Utility bonds	17,325,000
Stormwater funds	3,341,515
Non-local funds	4,827,250
Other local funds	26,911,420
	\$ 66,405,185

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 then 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, 2006 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 \$4,299,850 as the remaining estimated capacity is filled. These amounts are based on what it would cost to perform all closure and postclosure care in 2006. 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 12 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.

Notes to Basic Financial Statements, Continued

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, 2006 was zero, as a result of the City refunding the Series 1997B bonds. See 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***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, 2006.

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

(15) Self-Insurance Programs***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 the Risk Management Fund and the Health Insurance Funds, internal service funds, to account for and finance its uninsured risks of loss and to pay insurance premiums. Under this program, the Risk Management Fund and the Health 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, 2006, 2005, and 2004, no individual property damage claim has exceeded \$100,000.

Notes to Basic Financial Statements, Continued

All funds of the City participate in the program and make payments to the Risk Management Fund based on actuarial estimates of the amounts needed to pay prior and current year claims and to establish a reserve for catastrophic losses. The risk management claims liability of \$15,388,946 (undiscounted) reported in the fund at June 30, 2006 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 \$2,989,927. 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, 2006 to compute this liability.

Changes in the fund's claims liability amount in fiscal years 2006 and 2005 were:

	2006	2005
Risk management claims payable at beginning of year	\$ 16,921,682	15,076,510
Risk management claims expense and changes in estimates	1,195,406	4,729,220
Risk management claims payments, net	(2,728,142)	(2,884,048)
Risk management claims payable at end of year	\$ 15,388,946	16,921,682

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 Health Insurance Fund, an internal service 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, 2006 is \$1,581,000 (undiscounted) and is due within one year. 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, 2006 to compute this liability.

Changes in the medical claim liability amount in fiscal years 2006 and 2005 were:

	2006	2005
Medical claims payable at beginning of year	\$ 1,570,000	1,593,000
Medical claims expense and changes in estimates	13,703,872	12,302,730
Medical claims payments	(13,692,872)	(12,325,730)
Medical claims payable at end of year	\$ 1,581,000	1,570,000

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, 2006, 549 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, 2006 was determined to be \$2,759,322 (undiscounted), of which \$1,422,277 is due within one year.

Notes to Basic Financial Statements, Continued

Changes in the school's claim liability amount in fiscal years 2006 and 2005 were:

		2006	2005
Claims payable at beginning of year	\$	2,362,185	2,070,510
Claims and changes in estimates		1,390,549	1,085,279
Claim payments		(993,412)	(793,604)
Claims payable at end of year	\$	2,759,322	2,362,185

(16) 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.

The City Council is responsible for appointing members of the board of the New Port Community Development Authority, but the City's accountability for this organization does not extend beyond making these appointments.

(17) NET ASSET/FUND BALANCE DEFICITS

The Social Services Fund has an accumulated deficit fund balance of \$426,809 at June 30, 2006. The deficit is expected to be eliminated through transfers from the General Fund in subsequent fiscal years.

The Health Insurance Fund has an accumulated net asset deficit balance of \$3,879,318 at June 30, 2006. The deficit is expected to be eliminated by charging other City funds for health insurance costs in subsequent fiscal years.

The Risk Management Fund has an accumulated net asset deficit balance of \$11,729,244 at June 30, 2006. The deficit is expected to be eliminated by charging other City funds for risk management costs in subsequent fiscal years.

(18) ADJUSTED BEGINNING BALANCES

In fiscal year 2006, the Parking Authority was determined to be a blended component unit while in prior years it was considered to be a discretely presented component unit. As a result, the beginning net assets for governmental activities for fiscal year 2006 has been adjusted as follows:

Net assets, beginning of year	\$	191,742,475
Adjustment related to blended component unit		4,505,160
Net assets, beginning of year, as adjusted	\$	196,247,635

The General Fund has a corresponding adjustment to its fund balance:

Fund balance, beginning of year	\$	29,490,308
Adjustment related to blended component unit		4,177,442
Fund balance, beginning of year, as adjusted	\$	33,667,750

Notes to Basic Financial Statements, Continued

Additionally, the beginning net assets for business-type activities for fiscal year 2006 has been adjusted as follows:

Net assets, beginning of year	\$ 120,141,779
Net assets as of June 30, 2005 for the Parking Authority as a discretely presented component unit	716,980
Net assets, beginning of year, as adjusted	\$ 120,858,759

As a result of this reclassification, the capital assets and long-term indebtedness of the Parking Authority are included in the beginning of year balances in business-type activities for each of these areas in Notes (4) and (5). These adjustments are as follows:

Capital assets, net, beginning of year	\$ 175,080,295
Capital assets, net, as of June 30, 2005 for the Parking Authority as a discretely presented component unit	12,607,282
Capital assets, net, beginning of year, as adjusted	\$ 187,687,577
Long-term indebtedness, beginning of year	\$ 77,991,642
Long-term indebtedness, as of June 30, 2005 for the Parking Authority as a discretely presented component unit	7,486,010
Long-term indebtedness, beginning of year, as adjusted	\$ 85,477,652

(19) SUBSEQUENT EVENTS

On August 24, 2006, the City issued \$63,540,000 of General Obligation and Refunding Bonds, Series 2006A. The proceeds will be used to pay the cost of various capital improvement projects and to refund the EDA's Series 1999 Revenue Bonds, for which the City is obligated under a cooperation agreement as discussed in Note (6).

On August 24, 2006 the City issued \$8,095,000 of Taxable General Obligation Refunding Bonds, Series 2006B. The proceeds of the 2006B Bonds will be used to refund certain City taxable general obligation notes.

On August 24, 2006 the City issued \$6,800,000 of General Obligation Notes, Series 2006C. The proceeds of the Series 2006C Notes will be used to pay the costs of various capital improvements, including but not limited to a new courts complex, the existing courts building and the costs related to the temporary relocation of the courts.

(20) SPECIAL ITEM

A special item is one that is unusual or infrequent, and under the control of management. As discussed in Note 5, the City incurred new debt in the current year to retire outstanding revenue bonds of the EDA, a component unit of the City. As a result, the payment to the EDA to retire these bonds is reported as a special item.