



**SOUTHEASTERN PUBLIC SERVICE
AUTHORITY OF VIRGINIA**

Financial Statements

June 30, 2005 and 2004

(With Independent Auditors' Reports Thereon)

**SOUTHEASTERN PUBLIC SERVICE
AUTHORITY OF VIRGINIA**

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KPMG LLP
2100 Dominion Tower
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Independent Auditors' Report

The Board of Directors
Southeastern Public Service Authority of Virginia:

We have audited the accompanying financial statements of the business-type activities of Southeastern Public Service Authority of Virginia (the Authority) as of and for the years ended June 30, 2005 and 2004, which collectively comprise the Authority's basic financial statements, as listed in the accompanying table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the Authority as of June 30, 2005 and 2004, and the changes in financial position and cash flows, thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 10, 2006 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



The Management's Discussion and Analysis (MD&A) on pages 3 through 8 and the Schedule of Pension Funding Progress on page 32 are not required parts of the basic financial statements, but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

February 10, 2006

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Management's Discussion and Analysis (Unaudited)

June 30, 2005 and 2004

This discussion and analysis of Southeastern Public Service Authority of Virginia (the Authority or SPSA) provides an overview of the Authority's financial condition as of June 30, 2005 and its financial activities for the fiscal year ended June 30, 2005, with selected comparative information as of and for the year ended June 30, 2004. This discussion and analysis should be read in conjunction with the basic financial statements.

Highlights

FY2005 Financial Highlights

- The Authority's net assets decreased by \$11 million as a result of this year's operations. Net assets (deficit) at June 30, 2005 equaled \$(2.6 million), versus \$8.4 million at June 30, 2004.
- Operating revenues were \$78.2 million, an increase of \$4.7 million over the prior year.
- Operating expenses were \$76.9 million, an increase of \$9.2 million over the prior year.
- Operating income (i.e., income before nonoperating income and nonoperating expenses) was \$1.3 million, a decrease of \$4.5 million from the prior year due to the combined effect of the changes in operating revenues and expenses noted above.
- During November 2004, the Authority issued \$13.1 million of tax-exempt Senior Subordinated Revenue Bonds for Disposal System capital projects and \$2.3 million of taxable Senior Subordinated Revenue Bonds for Power Plant projects.

These financial highlights are discussed in further detail in the section entitled "**Financial Analysis.**"

FY2005 Operating Highlights

- The Authority completed construction work on a new Suffolk Transfer Station located at the Regional Landfill. This new transfer station was completed in June 2005 and will enable the Authority to receive an additional 50,000 tons per year of waste capable of being converted to RDF for the Power Plant (i.e., processable waste).

Overview of the Financial Report

The Authority's financial report consists of the following: Management's Discussion and Analysis (MD&A) and the basic financial statements and required supplementary information.

MD&A serves as an introduction to the basic financial statements, and includes management's examination and analysis of the financial condition and performance of the Authority. Summary financial statement data and key financial and operational indicators are used for this analysis. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board (GASB). The Authority's basic financial statements report information based upon accounting methods similar to those used by private sector companies. The balance sheets include the nature and amounts of investments in resources (assets) and obligations to creditors (liabilities), with the difference reported as net assets. The statements of revenues, expenses, and changes in net assets present information showing how the Authority's net assets changed during the fiscal year. These statements measure the success of the Authority's operations and can be used to determine the Authority's profitability, credit worthiness, and whether it has successfully recovered all of its costs through user fees and other charges. The statements of cash flows provide information about the cash receipts and cash payments made by the Authority during the reporting period. The statements report cash receipts, cash payments, and net changes

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in cash resulting from operating, investing, and capital and noncapital financing activities, without consideration of the earnings event, when an obligation arose, or depreciation of capital assets and other noncash expenses. The notes to the basic financial statements provide required disclosures and other information essential to a full understanding of data provided in the statements. The notes present information about the Authority's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies, and subsequent events, if any.

Financial Analysis

One of the most important questions asked about the Authority's financial performance is whether or not the Authority is better or worse off as a result of the year's activities. The balance sheets and the statements of revenues, expenses, and changes in net assets report information about the Authority's activities in a way that will help answer this question. Net assets represent the difference between assets and liabilities. An evaluation of net assets, their dollar amount and whether that amount is increasing or decreasing, is one way to measure financial health or financial position. Over time, increases or decreases in the Authority's net assets are one indicator of whether its financial health is improving or deteriorating, respectively. However, a comprehensive assessment of financial condition should include consideration of all financial and nonfinancial factors.

The Authority's net assets decreased from last year by \$11 million. The analysis below focuses on the changes in assets and liabilities, which result in the change in net assets. The \$2.2 million, or 1.2% decrease in capital assets is primarily due to depreciation expense offset by capital asset additions. The \$1.6 million, or .7%, decrease in long-term liabilities results primarily from the debt retired during FY2005 through scheduled principal payments. Current and restricted assets are utilized to pay current and long-term liabilities.

	2005	2004	Change	
			Amount	Percent
Assets:				
Current assets	\$ 11,050,337	13,153,614	(2,103,277)	(16.0)%
Restricted assets	53,040,224	54,003,108	(962,884)	(1.8)
Maintenance parts, net	2,475,851	2,454,343	21,508	0.9
Capital assets, net	186,804,830	189,036,026	(2,231,196)	(1.2)
Other assets, net	7,121,091	7,836,732	(715,641)	(9.1)
Total assets	<u>\$ 260,492,333</u>	<u>266,483,823</u>	<u>(5,991,490)</u>	<u>(2.2)%</u>
Liabilities:				
Current liabilities	\$ 30,382,438	23,779,977	6,602,461	27.8%
Long-term liabilities	232,687,051	234,327,594	(1,640,543)	(0.7)
Total liabilities	<u>263,069,489</u>	<u>258,107,571</u>	<u>4,961,918</u>	<u>1.9%</u>
Net assets (deficit):				
Invested in capital assets, net of related debt	(24,244,096)	(13,899,689)	(10,344,407)	(74.4)%
Restricted	19,636,896	15,715,735	3,921,161	25.0
Unrestricted	2,030,044	6,560,206	(4,530,162)	(69.1)
Total net assets (deficit)	<u>(2,577,156)</u>	<u>8,376,252</u>	<u>(10,953,408)</u>	<u>(130.8)%</u>
Total liabilities and net assets (deficit)	<u>\$ 260,492,333</u>	<u>266,483,823</u>	<u>(5,991,490)</u>	<u>(2.2)%</u>

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Management's Discussion and Analysis (Unaudited)

June 30, 2005 and 2004

The changes in the Authority's net assets can be determined by reviewing the following condensed statements of revenues, expenses, and changes in net assets:

	<u>2005</u>	<u>2004</u>	<u>Change</u>	
			<u>Amount</u>	<u>Percent</u>
Operating revenue, net	\$ 78,167,751	73,422,195	4,745,556	6.5%
Less operating expenses:				
Compensation and related payroll costs	24,851,440	22,510,337	2,341,103	10.4
Depreciation and depletion	16,728,746	16,543,097	185,649	1.1
Routine maintenance and vehicle operations	9,404,098	9,764,527	(360,429)	(3.7)
Swap waste expense	5,657,780	5,076,383	581,397	11.5
Other operating expenses	20,258,195	13,805,200	6,452,995	46.7
Total operating expenses	<u>76,900,259</u>	<u>67,699,544</u>	<u>9,200,715</u>	<u>13.6%</u>
Operating income	1,267,492	5,722,651	(4,455,159)	(77.9)
Less nonoperating expenses, net	<u>(12,220,903)</u>	<u>(12,163,038)</u>	<u>(57,865)</u>	<u>0.5</u>
Change in net assets	(10,953,411)	(6,440,387)	(4,513,024)	70.1
Net assets:				
Beginning of year	<u>8,376,252</u>	<u>14,816,639</u>	<u>(6,440,387)</u>	<u>(43.5)</u>
End of year	<u>\$ (2,577,159)</u>	<u>8,376,252</u>	<u>(10,953,411)</u>	<u>(130.8)%</u>

Operating revenue increased by \$4.7 million, or 6.5%, in FY2005 compared to FY2004. This increase is primarily attributable to the following factors:

- A 16% increase in non-contract commercial waste quantities resulted in a \$1.2 million increase in revenue from this source.
- A 26.7% increase in electric sales resulted in a \$1.9 million increase in revenue from this source.
- A 50% increase in proprietary waste quantities resulted in a \$0.8 million increase in revenue from this source.
- A \$2 increase in the tipping fee rate for contract commercial waste resulted in a \$0.7 million increase in revenue from this source.
- Operating revenue is net of bad debt expense. The city of Suffolk, a SPSA member community, represented approximately \$900,000 of that bad debt expense in FY2004. The city of Suffolk has contested SPSA's charges for the disposal of Hurricane Isabel-related storm debris.
- While there were changes in other operating revenue categories, the combined net impact of those changes was neutral.

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Operating expenses experienced an increase of \$9.2 million in FY2005 compared to FY2004. Primary factors contributing to this increase are as follows:

- A \$3.9 million increase in landfill closure and postclosure care expense. This item reflects the change from FY2004 to FY2005 in SPSA's responsibility for closure and postclosure care of both the Authority's solid waste facilities and the Virginia Beach landfill (as required by the Ash and Process Residue Agreement). At June 30, 2005, the liability had increased by \$5.4 million over that of June 30, 2004 before reduction for \$3 million of actual closure cost work paid during FY2005.
- A \$2.3 million increase in compensation and related payroll costs.
- A \$0.7 million increase in equipment fuel.
- A \$0.6 million increase in swap waste expense; a requirement under SPSA's contracts with private haulers.
- A \$0.5 million increase in Virginia Beach Ash Disposal Agreement costs.
- A \$0.5 million increase in legal and professional services.
- In combination, all other FY2005 expense categories resulted in a net increase of approximately \$0.8 million when compared to FY2004.
- Operating income decreased \$4.5 million from FY2004 to FY2005, due to the combined effect of the increases in operating revenue and expenses noted above. Nonoperating expenses (net of nonoperating income) decreased by less than \$0.1 million during FY2005.

As a result of the above revenue and expense factors, the Authority experienced a decrease in net assets of \$11 million in FY2005, compared to a decrease of \$6.4 million in FY2004.

Capital Assets and Debt Administration

Capital Assets

At the end of 2005, the Authority had \$186,804,830 (net of accumulated depreciation and depletion) invested in a broad range of capital assets, including the power plant, refuse derived fuel plant, landfill, transfer stations, heavy equipment, and rolling stock. This amount represents a net decrease (net of additions and deductions) of \$2.2 million, or 1.2% over last year. The detail of capital asset values for the various categories are included in note 4 of the basic financial statements.

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Debt

At year end, the Authority had a total of \$247.7 million in bonds outstanding, versus \$247.9 million last year, a decrease of 0.1%.

**Summary of Outstanding Long-Term Bonds
June 30, 2005 and 2004**

	2005	2004
Senior debt	\$ 142,355,000	148,185,000
Senior subordinated and other debt	105,295,000	99,730,000
Total outstanding debt	\$ 247,650,000	247,915,000

For the past several years, the Authority has utilized the Virginia Resources Authority's (VRA) Pooled Loan Bond Program to fund its capital budgets and for refundings. VRA has a blended Aaa/AAA and Aa/AA bond rating. By issuing its financings through VRA, the Authority has been able to realize the benefits of VRA's excellent ratings, allowing the Authority to borrow at lower interest rates.

More detailed information about the Authority's debt is presented in note 5 to the basic financial statements.

Overall Financial Position and Results of Operations

During FY2005, the Authority incurred a net decrease in net assets of \$11 million, versus a net decrease of \$6.4 million during FY2004. Additionally, in each of those years, noncash expenses (e.g., depreciation, depletion, and amortization) far exceeded the losses recognized on the required accrual basis of accounting.

Current Conditions Posing Future Challenges

The Authority faces a number of challenges, as noted below:

- *Commercial Contracts.* The Authority and the several largest commercial haulers doing business in its service area are in the fourth year of five-year contracts. These contracts require those commercial haulers to deliver to the Authority all of the processable waste (i.e., waste capable of being processed into fuel at the Authority's power plant) they collect within the Authority's service area. The Authority is in discussions with those haulers regarding an extension of the term of the contracts. The renewal of these commercial contracts is important to the Authority both in terms of tipping fee revenues and waste-to-energy revenues (i.e., as a fuel source to generate steam and electricity for sale to the U.S. Navy and Dominion Virginia Power).
- *Virginia Beach Tipping Fee Cap.* The city of Virginia Beach is the largest of the Authority's eight member communities, providing approximately 35% of the municipal waste quantities. The Ash and Process Residue Agreement between that city and the Authority provides for maximum levels for the city of Virginia Beach's tipping fees. For example, during FY2005, the city of Virginia Beach's tipping fee is capped at \$44.90 per ton. Also during FY2005, however, the Authority's municipal tipping fee was set at \$46.00 per ton. Unless the Authority is able to generate revenues from other sources, which would allow the municipal tipping fee to be set at or below the cap for Virginia Beach, the other Authority member communities will be required to pay rates higher than that city.

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- *Member Community Contracts.* The Authority has Use and Support Agreements with its member communities, which require that those communities deliver to the Authority their municipal solid waste and pay the tipping fees on that waste necessary to support the Authority's system. Those contracts provide the underlying credit support for the Authority's debt financings. All of the contracts are set to expire in FY2018. As a result, the Authority financings during FY2005 could not exceed a term of 12 years. During FY2006, these financing terms will be limited to 11 years, and so on, assuming no change in the expiration dates of the member contracts. This decreasing term for financings could have a dramatic effect on annual debt service requirements, with a resulting need for increased revenues and, perhaps, municipal tipping fees. In addition, if the member contracts are not soon extended capital asset maintenance and replacement decisions may be significantly impacted. The renewal/extension of the member contracts is a major strategic issue now being considered by the Authority's board of directors.

Contacting Authority's Financial Management

This financial report is designed to provide our customers and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have questions about this report or need additional financial information regarding the Authority, contact the Director of Finance at 723 Woodlake Drive, Chesapeake, VA 23320.

Enterprise Fund Financial Statements

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Enterprise Fund

Balance Sheets

June 30, 2005 and 2004

Assets	<u>2005</u>	<u>2004</u>
Current assets:		
Cash and cash equivalents	\$ 3,157,221	4,081,796
Accounts receivable:		
Authority members	3,482,770	3,733,385
Other customers	4,701,866	4,327,274
Allowance for doubtful accounts	(1,063,941)	(1,064,518)
Insurance proceeds receivable	—	1,426,627
Prepaid expenses	664,571	541,291
Current portion of net investment in direct financing lease	101,307	107,759
Accrued interest receivable	6,543	—
	<u>11,050,337</u>	<u>13,153,614</u>
Noncurrent assets:		
Restricted assets:		
Investments	52,931,077	53,947,738
Accrued interest receivable	109,147	55,370
	<u>53,040,224</u>	<u>54,003,108</u>
Maintenance parts	2,475,851	2,454,343
Capital assets, net of accumulated depreciation and depletion	186,804,830	189,036,026
Net investment in direct financing lease	102,527	202,437
Intangible assets, net of accumulated amortization	6,351,801	7,062,823
Debt issue costs	666,760	571,472
	<u>249,441,993</u>	<u>253,330,209</u>
Total noncurrent assets	<u>249,441,993</u>	<u>253,330,209</u>
Total assets	<u>\$ 260,492,330</u>	<u>266,483,823</u>

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Enterprise Fund

Balance Sheets

June 30, 2005 and 2004

Liabilities and Net Assets (Deficit)	2005	2004
Liabilities:		
Current liabilities, payable from current assets:		
Accounts payable	\$ 2,079,220	1,106,927
Accrued expenses	2,202,995	2,028,868
Total current liabilities, payable from current assets	<u>4,282,215</u>	<u>3,135,795</u>
Current liabilities, payable from restricted assets:		
Accounts payable	1,112,994	1,200,116
Current maturities of bonds payable	20,760,000	15,625,000
Accrued interest on revenue bonds	4,227,229	3,819,066
Total current liabilities, payable from restricted assets	<u>26,100,223</u>	<u>20,644,182</u>
Total current liabilities	<u>30,382,438</u>	<u>23,779,977</u>
Noncurrent liabilities:		
Long-term debt:		
Line of credit	—	1,200,000
Bonds payable	218,351,642	221,150,378
Total long-term debt	<u>218,351,642</u>	<u>222,350,378</u>
Landfill closure and postclosure care liability	14,335,409	11,977,216
Total noncurrent liabilities	<u>232,687,051</u>	<u>234,327,594</u>
Total liabilities	<u>263,069,489</u>	<u>258,107,571</u>
Net assets (deficit):		
Invested in capital assets, net of related debt	(24,244,099)	(13,899,689)
Restricted for debt service	15,738,583	13,870,062
Restricted for other purposes	3,898,313	1,845,673
Unrestricted	2,030,044	6,560,206
Total net assets (deficit)	<u>(2,577,159)</u>	<u>8,376,252</u>
Total liabilities and net assets	<u>\$ 260,492,330</u>	<u>266,483,823</u>

See accompanying notes to basic financial statements.

**SOUTHEASTERN PUBLIC SERVICE
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Enterprise Fund

Statements of Revenues, Expenses, and Changes in Net Assets (Deficit)

Years ended June 30, 2005 and 2004

	2005	2004
Operating revenue:		
Charges for services, net of bad debt expense of \$5,350 in 2005 and \$1,025,634 in 2004	\$ 78,167,751	73,422,195
Operating expenses:		
Compensation and related payroll costs	24,851,440	22,510,337
Payment for temporary services	658,648	277,329
Depreciation, depletion and amortization of intangibles	16,952,404	16,543,097
Postage, printing and supplies	770,948	796,357
Rent and utilities	1,923,852	1,740,225
Equipment fuel	1,766,759	1,111,357
Routine maintenance and vehicle operations	9,404,098	9,764,527
Non-routine maintenance and repairs	4,113,290	4,140,230
Insurance	1,864,993	1,648,335
Virginia Beach Ash Disposal Agreement costs	1,097,394	776,600
Aluminum recycling	40,011	41,330
Legal and professional services	1,622,814	1,126,976
Landfill closure and postclosure care costs	5,397,731	1,480,270
Swap waste expense	5,657,780	5,076,383
Proprietary waste expense	508,390	349,610
Other	269,707	316,581
Total operating expenses	76,900,259	67,699,544
Operating income	1,267,492	5,722,651
Nonoperating expense (revenue):		
Net loss on disposal of capital assets	322,467	501,858
Net decrease in fair value of investments	397,296	225,372
Interest expense:		
Interest on long-term debt	11,915,783	11,946,062
Amortization of loss on defeasance	2,156,675	2,160,022
Amortization of bond issue costs, discounts and premiums, net	8,232	433,478
Total interest expense	14,080,690	14,539,562
Other revenue:		
Insurance recoveries	(849,392)	(1,676,627)
Interest income	(1,672,273)	(980,565)
Other	(57,885)	(446,562)
Total other revenue	(2,579,550)	(3,103,754)
Total nonoperating expense, net	12,220,903	12,163,038
Change in net assets (deficit)	(10,953,411)	(6,440,387)
Total net assets (deficit):		
Beginning of year	8,376,252	14,816,639
End of year	\$ (2,577,159)	8,376,252

See accompanying notes to basic financial statements.

**SOUTHEASTERN PUBLIC SERVICE
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Enterprise Fund

Statements of Cash Flows

Years ended June 30, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Receipts from customers	\$ 78,037,847	72,442,333
Payments to suppliers for operations	(31,333,842)	(27,017,085)
Payments to employees for compensation	(25,335,960)	(22,991,444)
Net cash provided by operating activities	21,368,045	22,433,804
Cash flows from capital and related financing activities:		
Purchases of capital assets	(14,771,494)	(12,215,805)
Proceeds from sale of capital assets	438,841	77,842
Proceeds from insurance recoveries	2,276,019	2,550,000
Payments received under direct financing lease	106,362	69,283
Principal payments on notes payable	—	(876,196)
Proceeds from issuance of bonds payable	15,360,000	57,790,000
Principal payments on bonds payable	(15,625,000)	(56,945,000)
Proceeds from bond premium, net of debt issue costs	438,037	1,695,648
Interest paid	(11,507,620)	(14,232,768)
Other income	57,885	446,562
Net cash used in capital and related financing activities	(23,226,970)	(21,640,434)
Cash flows from noncapital financing activities – payments on line of credit	(1,200,000)	(200,000)
Cash flows from investing activities:		
Proceeds from maturity and sale of investments	99,781,141	74,459,139
Payments for investments purchased	(99,258,744)	(74,647,902)
Interest and dividends received from investments	1,611,953	1,102,739
Net cash provided by investing activities	2,134,350	913,976
Increase (decrease) in cash and cash equivalents	(924,575)	1,507,346
Cash and cash equivalents at beginning of year	4,081,796	2,574,450
Cash and cash equivalents at end of year	\$ 3,157,221	4,081,796
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 1,267,492	5,722,651
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation, depletion and amortization of intangibles	16,952,404	16,543,097
Provision for bad debts	5,350	1,025,634
Landfill closure and postclosure care costs	5,397,731	1,480,270
Changes in operating assets and liabilities:		
Accounts receivable	(129,904)	(2,005,496)
Maintenance parts	(21,508)	567,326
Prepaid expenses	(123,280)	(123,542)
Accounts payable – operations	972,293	(844,447)
Accrued expenses	174,127	(203,778)
Accounts payable – restricted	(87,122)	1,017,934
Landfill closure and postclosure care liability settlement	(3,039,538)	(745,845)
Net cash provided by operating activities	\$ 21,368,045	22,433,804
Noncash transactions – decrease in fair value of investments	\$ (296,366)	(36,609)

See accompanying notes to basic financial statements.

**SOUTHEASTERN PUBLIC SERVICE
AUTHORITY OF VIRGINIA**

Notes to Basic Financial Statements

June 30, 2005 and 2004

(1) Nature of Business and Significant Accounting Policies

(a) Nature of Business

Southeastern Public Service Authority of Virginia (the Authority or SPSA) is a public body politic and corporate created pursuant to the Virginia Water and Waste Authorities Act. The Authority is a special purpose government entity engaged in business-type activities with no component units. The members of the Authority are the cities of Chesapeake, Franklin, Norfolk, Portsmouth, Suffolk, and Virginia Beach and the counties of Isle of Wight and Southampton (collectively, the Members). The Authority is governed by a board of directors consisting of representatives appointed by each of the Members.

All eight of the Members have entered into Agreements for Use and Support of a Solid Waste Disposal System (the Solid Waste Disposal Agreements) with the Authority. More specifically, each community has agreed to deliver or cause to be delivered to the Authority at least 95% of all disposable solid waste generated within, collected by, or otherwise under the control of the contracting community. Each of the Members are assessed a per ton tipping fee (with the exception of the city of Suffolk), as established under fee schedules imposed by the Authority in accordance with the Virginia Water and Waste Authorities Act, for the disposal of disposable solid waste delivered to any of the Authority's specified delivery points.

Operating revenues from (charges for services to) Members were \$27,149,378 and \$27,735,194 for the years ended June 30, 2005 and 2004, respectively.

For seven of the Members, the Solid Waste Disposal Agreements became effective on January 22, 1985, the date on which the Authority's landfill (the Regional Landfill) began accepting solid waste. In the case of the city of Virginia Beach, the Solid Waste Disposal Agreement became effective on the date fixed under a contract with the U.S. Navy that began in 1984 (the Navy Contract) as the start-up date of a Refuse Derived Fuel (RDF) plant (the RDF Plant). Under the Navy Contract, RDF produced at the RDF Plant was to be provided to the Navy to produce steam and electricity at the U.S. Navy's power plant. The Solid Waste Disposal Agreements remain in effect until January 2018.

Effective July 1, 1999, in a modification of the Navy Contract, the Navy contributed to the Authority all of the assets of the U.S. Navy's power plant (the Power Plant). These assets included \$105.2 million of property and equipment, \$3.6 million of materials and supplies, and \$0.8 million of cash restricted for power plant improvements. In addition, unamortized costs related to the contract were eliminated and long-term obligations and payables were satisfied. These transactions resulted in \$100.1 million of capital contributions to the Authority's net assets.

Subsequent to the contract modification, the U.S. Navy is assessed a per megawatt usage fee for electricity and a per unit fee for steam used by the U.S. Navy produced at the Power Plant, as established by the fee schedule included in the Navy Contract.

One of the purposes of the Authority, as stated in its Articles of Incorporation, is to acquire, finance, construct, operate and maintain a garbage and refuse collection and disposal system. Although the Authority's purposes under its Articles of Incorporation and its powers include the furnishing of

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water to the Members, the Authority has not pursued development of a regional water system. Any obligations and expenses incurred by the Authority in connection with the furnishing of water to the Members would not be payable from revenues of the garbage and refuse collection and disposal system.

As stated above, the Authority's operations consist of the disposal of solid waste through a solid waste disposal system (the Disposal System) and the production of steam and electricity at the Power Plant (the Power Plant System). These operations are each accounted for as separate activities within the Enterprise Fund.

(b) Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting. The Authority reports as a special purpose government entity engaged in business-type activities, as defined by the Governmental Accounting Standards Board (GASB). Business-type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

The Authority's activities are accounted for similar to those often found in the private sector using the flow of economic resources measurement focus and the accrual basis of accounting. Assets, liabilities, net assets, revenues, and expenses are accounted for through an enterprise fund with revenues recorded when earned and expenses recorded at the time liabilities are incurred. Current assets include cash and amounts convertible to cash during the next normal operating cycle, or one year. Current liabilities include those obligations to be liquidated with current assets. All expenses related to operating the Disposal System and Power Plant are reported as operating expenses. Charges for services provided by the Authority are reported as operating revenues. Interest expense and financing costs, loss on disposal of capital assets and net decrease in fair value of investments are reported as nonoperating expenses. Interest income and nonrecurring items including insurance recoveries are reported as nonoperating revenue.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Authority has elected to apply all GASB pronouncements as well as all Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principal Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

The Authority sets its rates (tipping fees) based upon the anticipated cash flow needs to fund current operations and to meet its debt service requirements. The Authority's results of operations may not be indicative of its operating results used for budgetary purposes.

(c) Change in Reporting Entity

The Authority previously reported its operations as two individual major funds. During 2005, the Authority changed its policy to report its activity in a single fund. Management of the Authority believes that the change in reporting entity is a better reflection of how its operations are managed. Consequently, the Authority's 2005 financial statements have omitted the funds statements.

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(d) Net Assets

Net assets represent the residual interest in the Authority's assets after liabilities are deducted and consist of three sections: invested in capital assets, net of related debt; restricted; and unrestricted. Net assets invested in capital assets, net of related debt includes capital assets, net of accumulated depreciation and depletion, reduced by outstanding debt attributable to capital expenditures, net of unspent bond proceeds. Net assets are reported as restricted when constraints are imposed by third parties or enabling legislation. The Authority's restricted net assets are expendable and relate primarily to amounts restricted for debt service. All other net assets are unrestricted. Unrestricted net assets may be designated for specific purposes by action of management or the board of directors.

(e) Cash and Cash Equivalents

Cash and cash equivalents are defined as being cash and short-term, interest-bearing investments consisting of certificates of deposit and other income producing securities of less than or equal to three months maturity when purchased. These investments are readily convertible to cash, and are stated at cost, which approximates fair value.

(f) Investments

In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, the Authority reports its investment securities at fair value. Fair value is determined as of the balance sheet date, based on quoted market prices.

(g) Restricted Assets

Restricted assets are principally restricted for the payment of obligations under the Authority's bond agreements and for capital improvements (see note 3) and are recorded as noncurrent assets in the accompanying financial statements. When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first.

(h) Maintenance Parts

Maintenance parts are valued at the lower of cost (determined on the average-cost basis) or market.

(i) Capital Assets

Capital assets are recorded at cost. The costs include interest expense incurred from the date of issuance of the debt to finance construction until the completion of the capital project. No interest costs were capitalized in 2005. Assets are depreciated by using the straight-line method over the estimated useful lives of the various classes as follows:

Buildings and improvements	30 years
Equipment and vehicles	3-30 years
Furniture, office equipment, software and hardware	3-10 years

The Regional Landfill is recorded at cost and depleted based upon estimated usage of capacity.

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Expenditures that extend the useful lives of capital assets beyond their initial estimated useful lives or improve their efficiency or capacity are capitalized, whereas expenditures for repairs and maintenance are expensed. When an asset is retired, replaced or otherwise disposed of, the related cost and accumulated depreciation are eliminated from the accounts and any resulting gain or loss is reflected as nonoperating income or expense.

(j) *Intangible Assets*

Intangible assets consist of various payments made to or on the behalf of the city of Virginia Beach under the Ash Disposal Agreement (see note 7). As a result of such payments, the Authority has acquired the right to use land located in the city of Virginia Beach for the disposal of ash generated from the Power Plant and the residue generated in the production of RDF. Intangible assets are being amortized using the straight-line method over a period of 15 years.

(k) *Unamortized Discounts and Premiums*

Discounts and premiums are amortized by the effective interest method over the life of the bonds to which they relate and are netted against long-term debt.

(l) *Payables*

The accounts payable balances in the accompanying financial statements are payable to vendors for operating expenses. The accrued expense balances in the accompanying financial statements are payable to employees or for employee-related expenses, including accrued annual leave. Employees accrue annual leave on a bi-weekly basis in amounts which vary depending on years of service. A liability for unused annual leave is recorded as accrued by the employee.

(m) *Deferred Loss on Defeasance of Debt*

The Authority records the loss on defeasance of debt as an offset to bonds payable. Deferred losses on defeasance of debt are amortized as a component of interest expense over the shorter of the life of the new bonds or the old bonds.

(n) *Landfill Closure and Postclosure Care Liability*

In accordance with GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*, the Authority records landfill closure and postclosure care costs as an operating expense based on the landfill capacity used as of the balance sheet date and the current estimated costs for closure and postclosure care.

(o) *Accounts Receivable*

Provisions for uncollectible accounts receivable are based on specifically identified accounts that management believes may not be collectible as well as a percentage of delinquent accounts in the year end accounts receivable balance.

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(p) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(q) Reclassifications

Certain 2004 amounts have been reclassified to conform with the 2005 presentation.

(2) Cash and Cash Equivalents

At June 30, 2005 and 2004, the Authority's cash and cash equivalents balance totaled \$3,157,221 and \$4,081,796, respectively. The deposits are covered by federal depository insurance or collateralized in accordance with the Virginia Security for Public Deposits Act (the Act).

At June 30, 2005 and 2004, cash and cash equivalents included registered money market mutual funds of \$2,545,375 and \$2,434,906, respectively.

(3) Restricted Assets

Total restricted assets amounted to \$53,040,224 and \$54,003,108 as of June 30, 2005 and 2004, respectively, and are held for the purposes and in the respective accounts described below:

	2005		
	Investments	Accrued interest receivable	Total
Revenue Bond Construction Accounts	\$ 11,455,313	26,577	11,481,890
Debt Service Reserve Account	17,631,659	62,161	17,693,820
Bond Accounts	19,953,540	12,661	19,966,201
Landfill Closure Fund	1,254,203	2,273	1,256,476
Environmental Trust Fund Accounts	600,179	2,243	602,422
Reserve and Contingency Account	2,036,183	3,232	2,039,415
	\$ 52,931,077	109,147	53,040,224

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	2004		
	Investments	Accrued interest receivable	Total
Revenue Bond Construction Accounts	\$ 15,561,177	931	15,562,108
Debt Service Reserve Account	18,858,502	47,697	18,906,199
Bond Accounts	17,684,384	4,744	17,689,128
Environmental Trust Fund Accounts	575,131	957	576,088
Reserve and Contingency Account	1,268,544	1,041	1,269,585
	\$ 53,947,738	55,370	54,003,108

(a) Revenue Bond Construction Accounts

The Authority holds bond proceeds for the improvement of the Power Plant, closure of the Regional Landfill, and other approved projects. Any amounts remaining in the Revenue Bond Construction Accounts upon completion of the program may be transferred to the Bond Accounts for the payment, purchase or redemption of bonds.

(b) Debt Service Reserve Account

This account is required to be maintained by the Authority's senior bond resolution which provides for, among other things, maintenance of a reserve account at levels specified in the bond resolution for future payments of principal and interest.

(c) Bond Accounts

The Authority's bond resolutions require monthly deposits to Bond Accounts equal to one-sixth of the semi-annual interest and one-twelfth of the principal payments next becoming due.

(d) Landfill Closure Fund

These accounts hold funds restricted for the closure of the Suffolk landfill.

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(e) Environmental Trust Fund Accounts

These accounts were established through agreements between the Authority and the cities of Suffolk and Virginia Beach. The Environmental Trust Fund Accounts include the Suffolk Environmental Trust Fund and the Virginia Beach Environmental Trust Fund. The purpose of these accounts is to provide for all costs relating to legal suits and other similar claims activity relating to environmental pollution that are made against the Regional Landfill and the Virginia Beach Landfill (see note 7) during a 30-year period after cessation of each landfill's operations. The Authority must contribute a minimum of \$5,000 and \$10,000 annually to the Suffolk and Virginia Beach Environmental Trust Funds, respectively. Upon expiration of the 30-year period, all remaining amounts will be proportionately distributed to each of the Members using the Disposal System during the terms of the Environmental Trust Funds, based upon the tipping fees generated by such Members. The Members' proportionate shares of the Environmental Trust Funds at June 30, 2005 and 2004 are as follows:

	2005		2004	
	Suffolk Environmental Trust Fund	Virginia Beach Environmental Trust Fund	Suffolk Environmental Trust Fund	Virginia Beach Environmental Trust Fund
Cities:				
Norfolk	\$ 76,706	73,678	74,548	70,011
Chesapeake	66,804	65,127	64,280	61,334
Virginia Beach	101,989	101,759	99,091	96,974
Portsmouth	31,628	30,557	30,332	28,654
Franklin	5,280	5,051	5,237	4,902
Counties:				
Southampton	9,324	9,158	9,016	8,674
Isle of Wight	11,604	11,514	11,191	10,887
	\$ 303,335	296,844	293,695	281,436

(f) Reserve and Contingency Account

The Authority's bond resolutions restrict the use of funds in this account for certain defined expenditures.

Investment Policy

In accordance with the Code of Virginia and other applicable law, including regulations, SPSA's investment policy (Policy) permits investments in U.S. Government obligations (including Government Sponsored Enterprise Obligations), obligations of the Commonwealth of Virginia or political subdivisions thereof, repurchase agreements, commercial paper, bankers acceptances, corporate notes, negotiable certificates of deposit, bank deposit notes, mutual funds that invest exclusively in securities specifically permitted under the Policy, and the State Treasurer's Local Government Investment Pool (the State of Virginia LGIP, a 2a-7 like pool, as defined by GASB 31).

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The Policy establishes limitations on the holdings of non-U.S. Government obligations. The maximum percentage of the portfolio (book value at the date of acquisition) permitted in each security is as follows:

U.S. Government Obligations	100% maximum
Government Sponsored Enterprise Obligations	50% maximum
Registered Money Market Mutual Funds	100% maximum
State of Virginia LGIP	75% maximum
Repurchase Agreements	50% maximum
Bankers' Acceptances	40% maximum
Commercial Paper	35% maximum
Negotiable Certificates of Deposit/Bank Notes	20% maximum
Bank Deposits	25% maximum
Corporate Notes	15% maximum

Further, the combined amount of bankers' acceptances, commercial paper, negotiable certificates of deposit/bank notes and corporate notes may not exceed fifty percent (50%) of the total book value of the portfolio at the date of acquisition.

Credit Risk

As required by state statute, the Policy requires that commercial paper have a short-term debt rating of no less than "A-1" (or its equivalent) from at least two of the following; Moody's Investors Service, Standard & Poor's and Fitch's Investors Service. Corporate notes, negotiable Certificates of Deposit and bank deposit notes maturing in less than one year must have a short-term debt rating of at least "A-1" by Standard & Poor's and "P-1" by Moody's Investors Service. Notes having a maturity of greater than one year must be rated at least "AA" by Standard & Poor's and "Aa" by Moody's Investors Service.

Although state statute does not impose credit standards on repurchase agreement counterparties, bankers' acceptances or money market mutual funds, SPSA has established certain credit standards for these investments to minimize portfolio risk.

As of June 30, 2005, the credit risk of the restricted assets portfolio holdings were:

	<u>Rating</u>	<u>Percentage</u>
Government Sponsored Enterprise Obligations	AAA	29.7%
Government Sponsored Enterprise Obligations	A-1+	19.9%
Registered Money Market Mutual Funds	AAAm	31.1%
State of Virginia LGIP	AAAm	15.2%
Repurchase Agreements	A-1	3.8%
Certificate of Deposit	No rating	0.3%

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As of June 30, 2004, the credit risk of restricted assets portfolio holdings were:

	<u>Rating</u>	<u>Percentage</u>
Government Sponsored Enterprise Obligations	AAA	12.2%
Government Sponsored Enterprise Obligations	A-1+	27.7%
Registered Money Market Mutual Funds	AAAm	51.1%
State of Virginia SNAP	AAAm	1.9%
Repurchase Agreements	A-1	6.8%
Certificate of Deposit	No rating	0.3%

Concentration of Credit Risk

The Policy establishes limitations on portfolio composition by issuer in order to control concentration of credit risk. SPSA's policy limits the amount that may be invested in the securities of a single issuer to 5% of the portfolio with the following exceptions:

U.S. Treasury	100% maximum
Each Registered Money Market Mutual Fund	100% maximum
State of Virginia LGIP	75% maximum
Each Federal Agency or Government Sponsored Enterprise	50% maximum
Each Repurchase Agreement Counterparty	25% maximum
Each Bank Depository	25% maximum

As of June 30, 2005, approximately 25% of SPSA's restricted assets portfolio was invested in Federal Home Loan Bank (FHLB) notes; 21.2% in Federal National Mortgage Association (FNMA) notes; 3.8% in Merrill Lynch Repurchase Agreements; 3.4% in Federal Home Loan Mortgage Corp. (FHLMC) notes; and 0.3% in a Bank of Hampton Roads certificate of deposit.

As of June 30, 2004, approximately 24.7% of SPSA's restricted assets portfolio was invested in FNMA notes; 10.6% in FHLMC notes; 6.8% in Merrill Lynch Repurchase Agreements; 4.6% in FHLB notes; and 0.3% in a Bank of Hampton Roads certificate of deposit.

Interest Rate Risk

As a means of limiting exposure to fair value losses arising from rising interest rates, SPSA's Policy limits the investment of operating funds to investments with a stated maturity of no more than five years from the date of purchase. The average maturity of the investment portfolio may not exceed 24 months.

Proceeds from the sale of bonds must be invested in compliance with the specific requirements of the bond covenants and may be invested in securities with longer maturities.

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As of June 30, 2005, SPSA had the following investments and maturities in its restricted assets portfolio (including accrued interest):

<u>Investment type</u>	<u>Fair value</u>	<u>Investment maturity (in years)</u>	
		<u>Less than 1 year</u>	<u>Less than 2 years</u>
Registered money market mutual fund – CCRF Prime	\$ 10,633,756	10,633,756	—
Registered money market mutual fund – CCRF SNAP	4,670,574	4,670,574	—
Government Sponsored Entity discount notes	10,530,865	10,530,865	—
Government Sponsored Entity bond/notes	15,729,557	5,080,417	10,649,140
State of Virginia LGIP	8,063,535	8,063,535	—
Repurchase Agreements – Merrill Lynch	2,001,366	2,001,366	—
Registered money market mutual fund – STI Classic – Treasury MMF	1,256,476	1,256,476	—
Certificate of deposit	154,095	154,095	—
Total investments	<u>\$ 53,040,224</u>	<u>42,391,084</u>	<u>10,649,140</u>

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As of June 30, 2004, SPSA had the following investments and maturities in its restricted assets portfolio (including accrued interest):

<u>Investment type</u>	<u>Fair value</u>	<u>Investment maturity (in years)</u>	
		<u>Less than 1 year</u>	<u>Less than 2 years</u>
Registered money market mutual fund – CCRF Prime	\$ 27,590,821	27,590,821	—
Registered money market mutual fund – CCRF – SNAP	1,041,066	1,041,066	—
Government Sponsored Entity discount notes	14,969,499	14,969,499	—
Government Sponsored Entity bond/notes	6,590,996	5,569,732	1,021,264
Repurchase Agreements – Merrill Lynch	3,657,568	3,657,568	—
Registered money market mutual fund – STI Classic – Treasury MMF	1,552	1,552	—
Certificate of deposit	151,606	151,606	—
Total investments	<u>\$ 54,003,108</u>	<u>52,981,844</u>	<u>1,021,264</u>

Custodial Credit Risk

The Policy requires that all investment securities purchased by SPSA or held as collateral on deposits or investments shall be held by SPSA or by a third-party custodial agent who may not otherwise be a counterparty to the investment transaction. As of June 30, 2005 and 2004, all of SPSA's restricted asset investments were held in a bank's trust department in SPSA's name.

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(4) Capital Assets

Capital assets of the Authority as a whole as of June 30, 2005 and 2004 consist of the following:

	Beginning balance July 1, 2004	Additions	Deletions	Ending balance June 30, 2005
Capital assets not being depreciated or depleted:				
Land	\$ 5,190,069	142,958	(382,922)	4,950,105
Construction in process	6,321,430	14,771,494	(14,712,673)	6,380,251
Total capital assets not being depreciated or depleted	<u>11,511,499</u>	<u>14,914,452</u>	<u>(15,095,595)</u>	<u>11,330,356</u>
Other capital assets:				
Buildings	81,374,270	4,401,147	(90,291)	85,685,126
Heavy equipment	11,922,070	3,618,000	(1,941,593)	13,598,477
Motor vehicles	14,235,470	3,748,492	(389,386)	17,594,576
Suffolk landfill	43,316,199	—	—	43,316,199
Disposal System equipment	23,193,097	1,829,330	(110,447)	24,911,980
Power Plant equipment	124,978,340	306,719	(80,000)	125,205,059
Bi-metals system	1,639,302	—	—	1,639,302
Yard waste shredder	1,266,111	—	—	1,266,111
Furniture, office equipment, software and hardware	4,589,396	433,852	(516,936)	4,506,312
Miscellaneous equipment	1,801,195	935,138	(77,497)	2,658,836
Total other assets	<u>308,315,450</u>	<u>15,272,678</u>	<u>(3,206,150)</u>	<u>320,381,978</u>
Less accumulated depreciation and depletion:				
Buildings	35,713,239	2,938,656	(21,006)	38,630,889
Heavy equipment	4,382,116	1,446,991	(1,087,632)	4,741,475
Motor vehicles	8,558,659	1,396,822	(324,030)	9,631,451
Suffolk landfill	33,967,487	2,632,297	—	36,599,784
Disposal System equipment	11,329,030	1,069,341	(92,959)	12,305,412
Power Plant equipment	30,703,115	5,758,742	(27,672)	36,434,185
Bi-metals system	1,613,757	25,544	—	1,639,301
Yard waste shredder	1,000,852	53,215	—	1,054,067
Furniture, office equipment, software and hardware	2,103,858	723,900	(516,844)	2,310,914
Miscellaneous equipment	1,418,810	195,877	(54,661)	1,560,027
Total accumulated depreciation and depletion	<u>130,790,923</u>	<u>16,241,384</u>	<u>(2,124,803)</u>	<u>144,907,504</u>
Other capital assets, net	<u>177,524,527</u>	<u>(968,706)</u>	<u>(1,081,347)</u>	<u>175,474,474</u>
Total	<u>\$ 189,036,026</u>	<u>13,945,746</u>	<u>(16,176,942)</u>	<u>186,804,830</u>

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	Beginning balance July 1, 2003	Additions	Deletions	Ending balance June 30, 2004
Capital assets not being depreciated or depleted:				
Land	\$ 5,190,069	—	—	5,190,069
Construction in process	8,141,002	5,675,373	(7,494,945)	6,321,430
Total capital assets not being depreciated or depleted	<u>13,331,071</u>	<u>5,675,373</u>	<u>(7,494,945)</u>	<u>11,511,499</u>
Other capital assets:				
Buildings	80,614,902	1,794,429	(1,035,061)	81,374,270
Heavy equipment	10,402,135	2,839,232	(1,319,297)	11,922,070
Motor vehicles	14,834,105	987,843	(1,586,478)	14,235,470
Suffolk landfill	39,345,616	3,970,583	—	43,316,199
Disposal System equipment	21,758,026	2,075,250	(640,179)	23,193,097
Power Plant equipment	124,225,960	1,362,267	(609,887)	124,978,340
Bi-metals system	1,628,121	11,181	—	1,639,302
Yard waste shredder	1,266,111	—	—	1,266,111
Furniture, office equipment, software and hardware	3,584,899	2,207,064	(1,202,567)	4,589,396
Miscellaneous equipment	3,398,901	150,549	(1,748,255)	1,801,195
Total other assets	<u>301,058,776</u>	<u>15,398,398</u>	<u>(8,141,724)</u>	<u>308,315,450</u>
Less accumulated depreciation and depletion:				
Buildings	32,519,721	3,353,019	(159,501)	35,713,239
Heavy equipment	3,751,637	1,624,453	(993,974)	4,382,116
Motor vehicles	8,955,824	1,181,455	(1,578,620)	8,558,659
Suffolk landfill	31,477,893	2,489,594	—	33,967,487
Disposal System equipment	10,631,230	1,147,893	(450,093)	11,329,030
Power Plant equipment	25,075,858	5,706,344	(79,087)	30,703,115
Bi-metals system	1,501,488	112,269	—	1,613,757
Yard waste shredder	939,055	61,797	—	1,000,852
Furniture, office equipment, software and hardware	2,593,751	707,688	(1,197,581)	2,103,858
Miscellaneous equipment	3,000,372	158,585	(1,740,147)	1,418,810
Total accumulated depreciation and depletion	<u>120,446,829</u>	<u>16,543,097</u>	<u>(6,199,003)</u>	<u>130,790,923</u>
Other capital assets, net	<u>180,611,947</u>	<u>(1,144,699)</u>	<u>(1,942,721)</u>	<u>177,524,527</u>
Total	<u>\$ 193,943,018</u>	<u>4,530,674</u>	<u>(9,437,666)</u>	<u>189,036,026</u>

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(5) Long-Term Debt

(a) Bonds Payable

Bonds payable at June 30, 2005 and 2004 consist of the following:

	2005	2004
Senior Revenue Refunding Bonds, dated October 15, 1993, and issued in the original amount of \$147,250,000, due July 2010	\$ 68,070,000	75,260,000
Senior Revenue Refunding Bonds, dated April 1, 1998, and issued in the original amount of \$33,535,000, due July 2015	33,535,000	33,535,000
Senior Refunding Revenue Bonds, Tax-Exempt, dated June 30, 2004, and issued in the original amount of \$39,390,000, due April 2013	39,390,000	39,390,000
Senior Subordinated Revenue Bonds, Series 2, dated December 1, 1998, and issued in the original amount of \$1,440,000, due July 2005	1,440,000	1,440,000
Senior Refunding Revenue Bonds, Taxable, dated June 30, 2004, and issued in the original amount of \$1,360,000, due April 2013	1,360,000	1,360,000
Guaranteed Subordinated Revenue Refunding Bonds, dated October 15, 1993, and issued in the original amount of \$10,485,000, paid in full in July 2004	—	2,385,000
Senior Subordinated Tax-Exempt Bonds, Series 6, dated June 28, 2001, and issued in the original amount of \$11,030,000, due April 2011 (held by VRA)	11,030,000	11,030,000
Senior Subordinated Taxable Bonds, Series 8, dated December 14, 2001, and issued in the original amount of \$3,400,000, due April 2017 (held by VRA)	2,915,000	3,085,000
Senior Subordinated Tax-Exempt Bonds, Series 9, dated December 1, 2002, and issued in the original amount of \$16,155,000, due April 2014 (held by VRA)	13,355,000	14,555,000
Senior Subordinated Tax-Exempt Bonds, Series 11, dated May 21, 2003, and issued in the original amount of \$39,950,000, due April 2017 (held by VRA)	38,160,000	39,950,000
Senior Subordinated Tax-Exempt Bonds, Series 12, dated December 4, 2003, and issued in the original amount of \$13,650,000, due October 2011 (held by VRA)	12,230,000	13,650,000
Senior Subordinated Tax-Exempt Bonds, Series 14, dated November 1, 2004, and issued in the original amount of \$13,060,000, due October 2013 (held by VRA)	13,060,000	—
Bonds payable – Disposal System	234,545,000	235,640,000

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AUTHORITY OF VIRGINIA**

Notes to Basic Financial Statements

June 30, 2005 and 2004

	2005	2004
Senior Subordinated Taxable Bonds, Series 7, dated June 28, 2001, and issued in the original amount of \$9,480,000, due April 2008 (held by VRA)	5,245,000	6,120,000
Senior Subordinated Taxable Bonds, Series 10, dated December 1, 2002, and issued in the original amount of \$3,000,000, due April 2014 (held by VRA)	2,525,000	2,765,000
Senior Subordinated Taxable Bonds, Series 13, dated December 4, 2003, and issued in the original amount of \$3,390,000, due October 2011 (held by VRA)	3,035,000	3,390,000
Senior Subordinated Taxable Bonds, Series 15, dated November 1, 2004, and issued in the original amount of \$2,300,000, due October 2013 (held by VRA)	2,300,000	—
Bonds payable – Power Plant	13,105,000	12,275,000
	247,650,000	247,915,000
Plus:		
Unamortized bond premiums	5,311,643	5,306,103
Less:		
Unamortized bond discounts	(3,751,212)	(4,190,261)
Deferred loss on defeasance	(10,098,789)	(12,255,464)
Current maturities of bonds payable	(20,760,000)	(15,625,000)
Noncurrent portion of bonds payable	\$ 218,351,642	221,150,378

Rates of interest on the bonds payable listed above ranged from 2.255% to 5.59% for the year ended June 30, 2005 and from 1.711% to 6.042% for the year ended June 30, 2004.

In November 2004, the Authority obtained funding for Disposal System capital improvements through the Virginia Resources Authority's (VRA) issuance of \$13,060,000 of nontaxable bonds (the Series 14 Bonds). Principal payments are to be made on an annual basis and interest payments will be made semi-annually on April 1 and October 1 each year. The bonds will mature on October 1, 2013.

Also in November 2004, the Authority obtained funding for Power Plant capital improvements through the VRA's issuance of \$2,300,000 of taxable bonds (the Series 15 Bonds). Principal payments are to be made on an annual basis and interest payments will be made semi-annually on April 1 and October 1 each year. The bonds will mature on October 1, 2013.

In June 2004, the Authority issued through VRA \$39,390,000 of Senior Refunding Revenue Bonds (Tax-Exempt). This issuance was to refund certain callable portions of the 1993A Senior Refunding Bonds. The first principal payment is not due until April 1, 2011. Principal payments are then to be made on an annual basis and interest payments will be made semi-annually on April 1 and October 1 each year.

Also in June 2004, the Authority issued through VRA \$1,360,000 of Senior Refunding Revenue Bonds (Taxable). This issuance was to refund certain callable portions of the 1993A Senior Refunding Bonds. The only principal payment of \$1,360,000 is due on April 1, 2013. Interest payments will be made semi-annually on April 1 and October 1 each year.

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June 30, 2005 and 2004

The two refundings that occurred in June 2004 resulted in a loss on defeasance of \$1,137,086 that has been deferred and is being amortized as a component of interest expense over the life of the old debt, which is the same as the new debt. The Authority reduced its aggregate debt service payments by \$2,863,216 over a nine-year period and attained an economic gain (difference between the present values of the old and new debt service payments) of approximately \$1,821,000.

At June 30, 2005 and 2004, the total amount of debt that remains outstanding which has been considered defeased was \$0 and \$42,500,000, respectively.

A portion of the investment income on certain of the Authority's bonds may be subject to Internal Revenue Service arbitrage rebate requirements, but based on its current calculations, management believes that the effect on the Authority is not significant.

The following presents the changes in bonds payable for the Authority as a whole for the year ended June 30, 2005:

Balances as of June 30, 2004		\$ <u>247,915,000</u>
Bonds issued:		
VRA Tax-Exempt Bonds, Series 14, dated November 1, 2004		13,060,000
VRA Taxable Bonds, Series 15, dated November 1, 2004		<u>2,300,000</u>
Total bonds issued		<u>15,360,000</u>
Bonds refunded		—
Principal payments		<u>(15,625,000)</u>
Balances as of June 30, 2005		\$ <u><u>247,650,000</u></u>

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Notes to Basic Financial Statements

June 30, 2005 and 2004

The following presents the changes in bonds payable for the Authority as a whole for the year ended June 30, 2004:

Balances as of June 30, 2003	\$ <u>247,070,000</u>
Bonds issued:	
Senior Revenue Refunding Bonds, Tax-Exempt, dated June 30, 2004	39,390,000
Senior Subordinated Revenue Refunding Bonds, Taxable, dated June 30, 2004	1,360,000
VRA Tax-Exempt Bonds, Series 12, dated December 4, 2003	13,650,000
VRA Taxable Bonds, Series 13, dated December 4, 2003	<u>3,390,000</u>
Total bonds issued	<u>57,790,000</u>
Bonds refunded -	
Portion of the 1993A Senior Revenue Refunding Bonds for years 2011-2013 only	<u>(42,500,000)</u>
Principal payments	<u>(14,445,000)</u>
Balances as of June 30, 2004	\$ <u><u>247,915,000</u></u>

Aggregate maturities of bonds payable (principal and interest) at June 30, 2005, are as follows:

	Principal	Interest	Total
Year ended June 30:			
2006	\$ 20,760,000	11,412,607	32,172,607
2007	20,250,000	10,538,682	30,788,682
2008	21,115,000	9,623,281	30,738,281
2009	22,055,000	8,641,474	30,696,474
2010	23,065,000	7,613,296	30,678,296
2011-2015	106,085,000	20,712,898	126,797,898
2016-2017	<u>34,320,000</u>	<u>1,788,797</u>	<u>36,108,797</u>
	<u>\$ 247,650,000</u>	<u>70,331,035</u>	<u>317,981,035</u>

(b) Line of Credit

At June 30, 2005, there was \$0 outstanding and \$3,500,000 available on an uncollateralized line of credit expiring August 31, 2006, with interest at LIBOR plus 0.35%. At June 30, 2004, there was \$1,200,000 outstanding and \$2,300,000 available on an uncollateralized line of credit expiring August 31, 2006, with interest at LIBOR plus 0.35%. The line of credit is used for operating purposes.

(6) Direct Financing Lease

During August 1995, the Authority entered into an agreement with the Hampton Roads Planning District Commission (the HRPDC) to lease to the HRPDC through April 1, 2007, the office in the original Authority's headquarters (the Regional Office Building) prior to the expansion in 1995. For such use, the

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June 30, 2005 and 2004

HRPDC has agreed to pay the Authority the principal sum of \$1,050,000 with interest at 6.17% in equal monthly installments. Upon payment in full of the principal sum, the HRPDC may acquire for one dollar title to the building in proportion to the total cost of the building it incurred.

Income under this direct financing lease is recognized by a method that produces a constant periodic rate of return on the outstanding investment in the lease, with minimum lease payments receivable as follows:

Year ended June 30:		
2006	\$	124,057
2007		82,705
Minimum lease payments receivable		206,762
Less amounts relating to interest		2,928
	\$	203,834

(7) Ash Disposal Agreement with the City of Virginia Beach

The Authority entered into an agreement with the city of Virginia Beach (the City) for disposal of ash generated from the Power Plant and the residue generated in the production of RDF. The Authority has acquired the right to use land located in the City for disposal of the materials. The City incurred costs in developing the land for use as a landfill and the Authority reimbursed the City for its share of these costs. Such costs are included in intangible assets. The Authority also must reimburse the City for operating and maintenance costs incurred by the City in the operation of the Virginia Beach Landfill, and for its share of the closure and postclosure care (see note 8). These costs are reduced by income received by the City from private haulers for use of the Virginia Beach Landfill and by the City's own use of the landfill for municipal waste. During fiscal 2005 and 2004, the Authority recorded \$1,097,394 and \$776,600, respectively, for expenses related to reimbursements to the City for operating and maintenance costs of the Virginia Beach Landfill.

(8) Landfill Closure and Postclosure Care Costs

State and federal laws and regulations require the Authority to place a final cover on the Regional Landfill when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for 30 years after closure. Although closure and postclosure care costs will be paid only near or after the date that each discrete section of the landfill stops accepting waste, the Authority reports a portion of these closure and postclosure care costs as an operating expense in each period based on landfill capacity used as of each balance sheet date, in accordance with GASB Statement No. 18. The total landfill closure and postclosure care liability at June 30, 2005 and 2004 is \$14,335,409 and \$11,977,216, respectively. The three components are described below.

Of this liability, \$6,082,307 and \$4,346,233 represents the cumulative amount reported as of June 30, 2005 and 2004, respectively, based upon the use of substantially all of the estimated capacity of Cells I-IV of the Regional Landfill. The amounts for Cells I-IV are based on what it would cost to perform all closure and postclosure care as of June 30, 2005 and 2004, respectively.

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Notes to Basic Financial Statements

June 30, 2005 and 2004

The cumulative amount of liabilities reported to date based upon the use of approximately 85% and 66% of the estimated capacity of Cell V of the Regional Landfill is \$3,712,923 and \$3,072,923 as of June 30, 2005 and 2004, respectively. The Authority will recognize the remaining estimated cost of closure and postclosure care for Cell V as the remaining capacity is used. The remaining estimated capacity of Cell V is approximately 1,071,000 and 2,098,000 cubic yards as of June 30, 2005 and 2004, respectively. The Authority estimates that the closure of Cell V of the Regional Landfill will occur in fiscal year 2007. The amounts for Cell V are based on what it would cost to perform all closure and postclosure care as of June 30, 2005 and 2004, respectively.

The Authority has recorded \$4,540,179 and \$4,558,060 for its share of the landfill closure and postclosure care liabilities for the Virginia Beach Landfill Phase I cell (see note 7) as of June 30, 2005 and 2004, respectively. This amount is based upon data provided by the City and calculations made by the Authority. As of June 30, 2002, the Virginia Beach Landfill Phase I cell was essentially at full capacity. During 2003, the City applied for a permit to expand the allowed deposits vertically with estimated closure in 2008. The amounts for the Virginia Beach Landfill Phase I cell are based on what it would cost to perform all closure and postclosure care as of June 30, 2005 and 2004, respectively.

Actual closure and postclosure care costs for the Regional and Virginia Beach Landfills may differ due to inflation, changes in technology, or changes in regulations. The Authority currently plans to finance the landfill closure and postclosure care costs through bond issuances. The Authority meets its closure and postclosure care financial assurance requirements through bank issued letters of credit.

The following presents the changes in the combined landfill closure and post closure care liability for the year ended June 30, 2005:

Balance as of June 30, 2004	\$ 11,977,216
Additional expenses accrued	5,397,731
Payments made	<u>(3,039,538)</u>
Balance as of June 30, 2005	<u>\$ 14,335,409</u>

The following presents the changes in the combined landfill closure and post closure care liability for the year ended June 30, 2004:

Balance as of June 30, 2003	\$ 11,242,791
Additional expenses accrued	1,480,270
Payments made	<u>(745,845)</u>
Balance as of June 30, 2004	<u>\$ 11,977,216</u>

(9) Commitments

In the normal course of operating the Disposal System and the Power Plant, the Authority enters into various construction contracts. As of June 30, 2005 and 2004, total commitments under these contracts amounted to approximately \$3,050,000 and \$6,030,000, respectively.

**SOUTHEASTERN PUBLIC SERVICE
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Notes to Basic Financial Statements

June 30, 2005 and 2004

(10) RDF Plant Fire

During June 2003, a fire occurred at the RDF Plant. During 2005 and 2004, other income of \$548,382 and \$1,676,627, respectively, related to fire insurance recoveries was recognized.

(11) Retirement Plan

Substantially all employees of the Authority participate in the Virginia Retirement System (VRS), an agent multiple-employer public employee retirement system acting as a common investment and administrative agent for political subdivisions in the Commonwealth of Virginia, which bills the Authority for the employer's and employee's share of contributions. Benefits vest after five years of service. VRS provides retirement, disability and death benefits. Title 51.1 of the Code of Virginia, as amended, assigns the authority to establish and amend benefit provisions to the General Assembly of Virginia. The base payroll amounts for employees covered by the VRS plan for the years ended June 30, 2005, 2004 and 2003 were \$16,399,577, \$15,715,233, and \$16,120,128, respectively.

The contributions are actuarially determined and revised every two years by VRS actuaries using the entry age normal cost method. VRS is obligated to pay a monthly benefit to participants upon normal retirement or disability retirement, with the amount of the benefit depending on the length of service and earnings. Significant assumptions used to compute the contribution requirements are the same as those used to compute the present value of accumulated plan benefits. The Authority's payments to VRS to cover normal pension costs were made in accordance with actuarially determined requirements in the amounts of \$1,475,962, \$1,021,490, and \$1,043,642 for the years ended June 30, 2005, 2004 and 2003, respectively. These amounts are equal to the annual pension costs for each year. Employees are required by Title 51.1 of the Code of Virginia, as amended, to contribute 5% of their annual salary to VRS. However, the Authority has assumed these payments and they are included in the above discussed data.

Significant actuarial assumptions used to determine the standardized measure of the present value of accumulated plan benefits for the June 30, 2005 actuarial valuation are summarized below:

Actuarial cost method	Entry age normal
Amortization method	Level percent, open
Payroll growth rate	3.00%
Remaining amortization period	21 years
Asset valuation method	Modified market
Actuarial assumptions:	
Investment rate of return*	7.50%
Projected salary increase*	3.50% to 5.73%
Cost-of-living adjustments	2.50%

*Includes inflation at 2.5%

Ten-year historical trend information showing VRS' progress in accumulating sufficient assets to pay benefits when due is presented in the VRS Comprehensive Annual Financial Report. A copy of that report may be obtained by writing to the Virginia Retirement System at Post Office Box 2500, Richmond, Virginia 23218-2500.

**SOUTHEASTERN PUBLIC SERVICE
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Notes to Basic Financial Statements

June 30, 2005 and 2004

(12) Employee Contribution Plan

During fiscal 1993, the Authority established a deferred compensation plan through Hartford Life Insurance Company (the Company). The plan was established under the guidelines of Section 457 of the Internal Revenue Code (IRC). The plan is a voluntary employee contribution plan in which employees elect a certain dollar amount to be withheld each pay period.

All of the Authority's employees are eligible to participate with a minimum contribution of \$10 per pay period. Maximum contributions made by an employee are subject to IRC limitations.

The plan is funded by the Authority's employees. All underlying funds charge an investment management fee that varies according to the funds selected by the employee.

(13) Contingencies

The Authority is exposed to asserted and unasserted potential claims encountered in the normal course of business. The Authority intends to defend itself against these complaints and management believes the Authority will prevail and that the final resolution of these complaints will not have a material adverse effect on the Authority's financial position.

The Authority is also exposed to various risks of loss related to theft of, damage to, and destruction of assets and natural disasters for which it carries commercial insurance.

Required Supplementary Information (Unaudited)

**SOUTHEASTERN PUBLIC SERVICE
AUTHORITY OF VIRGINIA**

Required Supplementary Information

Schedule of Pension Funding Progress (Unaudited)

June 30, 2005

Valuation date	(1)	June 30, 2005	June 30, 2004	June 30, 2003
Actuarial value of assets (AVA)	(2)	\$ 26,414,774	\$ 24,762,321	\$ 23,627,843
Actuarial accrued liability (AAL)	(3)	\$ 29,815,594	\$ 24,406,148	\$ 21,247,495
(Overfunded) unfunded actuarial accrued liability (UAAL)				
(3)-(2)	(4)	\$ 3,400,820	\$ (356,173)	\$ (2,380,348)
Funded ratio (2)/(3)	(5)	89%	101%	111%
Annual covered payroll	(6)	\$ 16,859,070	\$ 15,667,427	\$ 13,937,321
UAAL as % of payroll (4)/(6)	(7)	20.2%	-2.3%	-17.1%

Unaudited – see independent auditors’ report.



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Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters

The Board of Directors
Southeastern Public Service Authority of Virginia:

We have audited the financial statements of the business-type activities of Southeastern Public Service Authority of Virginia (the Authority) as of and for the years ended June 30, 2005 and 2004, which collectively comprise the Authority's basic financial statements and have issued our report thereon dated February 10, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

We noted certain matters that are reported to management of the Authority in a separate letter dated February 10, 2006.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported in accordance with *Government Auditing Standards*.

This report is intended solely for the information and use of the Authority's board of directors, audit committee and management and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

February 10, 2006