SOUTHEASTERN PUBLIC SERVICE AUTHORITY OF VIRGINIA

Financial Statements

June 30, 2006 and 2005

(With Independent Auditors' Reports Thereon)

SOUTHEASTERN PUBLIC SERVICE AUTHORITY OF VIRGINIA

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KPMG LLP
2100 Dominion Tower
999 Waterside Drive
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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, 2006 and 2005, 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 opinion.

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, 2006 and 2005, 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 September 29, 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 9 and the Schedule of Pension Funding Progress on page 35 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

September 29, 2006

SOUTHEASTERN PUBLIC SERVICE AUTHORITY OF VIRGINIA

Management's Discussion and Analysis (Unaudited)

June 30, 2006 and 2005

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, 2006 and its financial activities for the fiscal year ended June 30, 2006, with selected comparative information as of and for the year ended June 30, 2005. This discussion and analysis should be read in conjunction with the basic financial statements.

Highlights

FY2006 Financial Highlights

The Authority's net cash provided by operating activities increased by $1.7 million in fiscal year 2006 compared to the prior year.

The Authority's net assets decreased by $18.5 million as a result of this year's operations. Net assets (deficit) at June 30, 2006 equaled $(21 million), versus $(2.5 million) at June 30, 2005.

- Operating revenues were $84.7 million, an increase of $6.5 million over the prior year.
- Operating expenses were $91.3 million, an increase of $14.4 million over the prior year.
- Operating income (loss) (i.e., income before nonoperating income and nonoperating expenses) was $(6.5 million), a decrease of $7.8 million from the prior year due to the combined effect of the changes in operating revenues and expenses noted above.
- During June 2006, the Authority issued $14.2 million of tax-exempt Senior Subordinated Revenue Bonds for Disposal System capital projects and $3.5 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**."

FY2006 Operating Highlights

- The Authority was successful in negotiating new 5-year contracts with commercial waste haulers that took effect July 1, 2006. The tipping fee for the contracts for the fiscal year ending June 30, 2007 is set at $28 per ton and will be adjusted for inflation thereafter. All previous contract provisions for "swap waste" have been eliminated along with the associated expenses.
- Favorable settlement was obtained regarding market infringement litigation that was filed against the Authority by a competing landfill operator. All other litigation pending as of June 30, 2006 is deemed to be of little merit or less than material in potential impact to SPSA financial operations.

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 (deficit). The statements of revenues, expenses, and changes in net assets (deficit) present information showing how the Authority's net assets (deficit) 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 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 (deficit) report information about the Authority's activities in a way that will help answer this question. Net assets (deficit) represent the difference between assets and liabilities. An evaluation of net assets (deficit), 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 (deficit) 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.

There was a material increase in total net assets (deficit) for fiscal year 2006 from ($2,577,159) to ($21,031,665). A substantial portion of this increase was due to recognition of non-cash increases in certain costs such as depreciation, depletion, and landfill closure and post closure care costs. The liability for landfill closure and post closure care alone increased from $14,335,409 to $26,717,995 as a result of changes in the estimated total cost of Municipal Solid Waste Landfill (MSWLF) closure and post closure cost. These changes included increases in costs due to inflation, changes in technology, changes in closure and post closure care requirements, revision of assumptions in budgeted estimates, and changes in the extent of environmental remediation required. Changes in these estimates are to be reported in the period in which the change is probable and reasonably estimable.

The Authority's net assets (deficit) decreased from last year by $18.5 million. The analysis below focuses on the changes in assets and liabilities, which result in the change in net assets. The $2 million or 1.1% increase in capital assets is primarily due to capital asset additions offset by depreciation expense. The $12.4 million, or 5.4%, increase in long-term liabilities results primarily from the net of new debt issued and debt retired during FY2006 through scheduled principal payments. Current and restricted assets are utilized to pay current and long-term liabilities.

The following table presents condensed balance sheet information as of June 30, 2006 and 2005.

			Change	
	2006	**2005**	**Amount**	**Percent**
Assets:				
Current assets	$ 11,658,706	11,050,337	608,369	5.5%
Restricted assets	43,970,398	53,040,224	(9,069,826)	(17.1)
Maintenance parts, net	2,634,308	2,475,851	158,457	6.4
Capital assets, net	188,895,044	186,804,830	2,090,214	1.1
Other assets, net	6,311,325	7,121,088	(809,763)	(11.4)
Total assets	$ 253,469,781	260,492,330	(7,022,549)	(2.7)%
Liabilities:				
Current liabilities	$ 31,432,088	32,382,438	(950,350)	(2.9)%
Long-term liabilities	243,069,358	230,687,051	12,382,307	5.4
Total liabilities	274,501,446	263,069,489	11,431,957	4.3%
Net assets (deficit):				
Invested in capital assets, net of related debt	(28,558,975)	(24,244,099)	(4,314,876)	17.8%
Restricted	17,651,209	19,636,896	(1,985,687)	(10.1)
Unrestricted	(10,123,899)	2,030,044	(12,153,943)	(598.7)
Total net assets (deficit)	(21,031,665)	(2,577,159)	(18,454,506)	716.1%
Total liabilities and net assets (deficit)	$ 253,469,781	260,492,330	(7,022,549)	(2.7)%

(Continued)

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:

			Change	
	2006	**2005**	**Amount**	**Percent**
Operating revenue, net	$ 84,717,236	78,167,751	6,549,485	8.4%
Less operating expenses:				
Compensation and related payroll costs	26,370,911	24,851,440	1,519,471	6.1
Depreciation and depletion	17,504,808	16,728,746	776,062	4.6
Routine maintenance and vehicle operations	10,199,738	9,404,098	795,640	8.5
Swap waste expense	5,151,864	5,657,780	(505,916)	(8.9)
Other operating expenses	32,031,551	20,258,195	11,773,356	58.1
Total operating expenses	91,258,872	76,900,259	14,358,613	18.7%
Operating income (loss)	(6,541,636)	1,267,492	(7,809,128)	(616.1)
Less nonoperating expenses, net	(11,912,870)	(12,220,903)	308,033	2.5
Change in net assets (deficit)	(18,454,506)	(10,953,411)	(7,501,095)	(68.5)
Net assets (deficit):				
Beginning of year	(2,577,159)	8,376,252	(10,953,411)	(130.8)
End of year	$ (21,031,665)	(2,577,159)	(18,454,506)	716.1%

Operating revenue increased by $6.5 million, or 8.4%, in FY2006 compared to FY2005. This increase is primarily attributable to the following factors:

- A 5% increase in noncontract commercial waste quantities resulted in a $1.8 million increase in revenue from this source.
- A 20% increase in electric sales resulted in a $1.7 million increase in revenue from this source.
- A $2 increase in the tipping fee rate for contract commercial waste resulted in a $1.8 million increase in revenue from this source.
- A $6 increase in the tipping fee rate for municipal waste resulted in a $2 million increase in revenue from this source.
- While there were changes in other operating revenue categories, the combined net impact of those changes was neutral.

Operating expenses experienced an increase of $14.4 million in FY2006 compared to FY2005. Primary factors contributing to this increase are as follows:

- A $8.8 million increase in landfill closure and post closure care expense. This item reflects the change from FY2005 to FY2006 in SPSA's responsibility for closure and post closure 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, 2006, the liability had increased by $14.1 million over that of June 30, 2005 before reduction for $1.7 million of actual closure cost work paid during FY2006.

- A $1.5 million increase in compensation and related payroll costs.
- A $0.7 million increase in equipment fuel.
- A $1.2 million increase in Virginia Beach Ash Disposal Agreement costs.
- A $0.4 million increase in legal and professional services.
- In combination, all other FY2006 expense categories resulted in a net increase of approximately $1 million when compared to FY2005.
- Operating income decreased $7.8 million from FY2005 to FY2006, due to the combined effect of the increases in operating revenue and expenses noted above. Nonoperating expenses (net of nonoperating income) decreased by $0.3 million during FY2006.

As a result of the above revenue and expense factors, the Authority experienced a decrease in net assets of $18.5 million in FY2006, compared to a decrease of $11 million in FY2005.

Capital Assets and Debt Administration

Capital Assets

At the end of 2006, the Authority had $188,895,044 (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 increase (net of additions and deductions) of $2.1 million, or 1.12% over last year. The detail of capital asset values for the various categories are included in note 4 of the basic financial statements.

Debt

At year end, the Authority had a total of $244.6 million in bonds outstanding, versus $247.7 million last year, a decrease of 1.2%.

Summary of Outstanding Long-Term Bonds

June 30, 2006 and 2005

		2006	2005
Senior debt	$	132,335,000	142,355,000
Senior subordinated and other debt		112,295,000	105,295,000
Total outstanding debt	$	244,630,000	247,650,000

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 accomplishing 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.

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Overall Financial Position and Results of Operations

During FY2006, the Authority experienced a net decrease in net assets of $18.5 million, versus a net decrease of $11 million during FY2005. Additionally, in each of those years, noncash expenses (e.g., closure and post closure costs, depreciation, depletion, and amortization) far exceeded the losses recognized on the required accrual basis of accounting.

Overall Financial Position and Results of Operations

The Authority's cash and cash equivalents increased to $3.8 million at the end of FY2006 from $3.2 million at the end of FY2005. While a decrease in net assets may be considered a negative change in financial position, the improvement over the prior year's operating cash flows indicate an improvement in financial performance.

Current Conditions Posing Future Challenges

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

- *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, for FY2006, the city of Virginia Beach's tipping fee is capped at $44.90 per ton. During FY2006, however, the Authority's municipal tipping fee was set at $51.98 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. Effective July 1, 2006, the municipal tipping fee has increased to $57.00 per ton and effective January 1, 2007, it will increase to $75.00 per ton.
- *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 FY2006 could not exceed a term of 11 years. During FY2007, these financing terms will be limited to 10 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.

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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

SOUTHEASTERN PUBLIC SERVICE
AUTHORITY OF VIRGINIA

Enterprise Fund

Balance Sheets

June 30, 2006 and 2005

Assets	**2006**	**2005**
Current assets:		
Cash and cash equivalents	$ 3,753,152	3,157,221
Accounts receivable:		
Authority members	2,569,336	3,482,770
Other customers	4,568,864	4,701,866
Allowance for doubtful accounts	(113,107)	(1,063,941)
Insurance proceeds receivable	84,503	—
Prepaid expenses	692,951	664,571
Current portion of net investment in direct financing lease	92,066	101,307
Accrued interest receivable	10,941	6,543
Total current assets	11,658,706	11,050,337
Noncurrent assets:		
Restricted assets:		
Investments	43,791,099	52,931,077
Accrued interest receivable	179,299	109,147
Total restricted assets	43,970,398	53,040,224
Maintenance parts	2,634,308	2,475,851
Capital assets, net of accumulated depreciation and depletion	188,895,044	186,804,830
Net investment in direct financing lease	—	102,527
Intangible assets, net of accumulated amortization	5,626,270	6,351,801
Debt issue costs	685,055	666,760
Total noncurrent assets	241,811,075	249,441,993
Total assets	$ 253,469,781	260,492,330

(Continued)

Liabilities and Net Assets (Deficit)	2006	2005
Liabilities:		
Current liabilities, payable from current assets:		
Accounts payable	$ 1,746,550	2,079,220
Accrued expenses	2,433,196	2,202,995
Landfill closure and post-closure care liability – current portion	2,000,000	2,000,000
Total current liabilities, payable from current assets	6,179,746	6,282,215
Current liabilities, payable from restricted assets:		
Accounts payable	1,059,794	1,112,994
Current maturities of bonds payable	20,250,000	20,760,000
Accrued interest on revenue bonds	3,942,548	4,227,229
Total current liabilities, payable from restricted assets	25,252,342	26,100,223
Total current liabilities	31,432,088	32,382,438
Noncurrent liabilities:		
Long-term debt:		
Bonds payable	218,351,363	218,351,642
Total long-term debt	218,351,363	218,351,642
Landfill closure and postclosure care liability – noncurrent	24,717,995	12,335,409
Total noncurrent liabilities	243,069,358	230,687,051
Total liabilities	274,501,446	263,069,489
Net assets (deficit):		
Invested in capital assets, net of related debt	(28,558,975)	(24,244,099)
Restricted for debt service	15,212,832	15,738,583
Restricted for other purposes	2,438,377	3,898,313
Unrestricted	(10,123,899)	2,030,044
Total net assets (deficit)	(21,031,665)	(2,577,159)
Total liabilities and net assets (deficit)	$ 253,469,781	260,492,330

See accompanying notes to basic financial statements.

SOUTHEASTERN PUBLIC SERVICE AUTHORITY OF VIRGINIA

Enterprise Fund

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

Years ended June 30, 2006 and 2005

	2006	2005
Operating revenue:		
Charges for services, net of bad debt expense of $0 in 2006 and $5,350 in 2005	$ 84,717,236	78,167,751
Operating expenses:		
Compensation and related payroll costs	26,370,911	24,851,440
Payment for temporary services	538,202	658,648
Depreciation, depletion and amortization of intangibles	17,505,653	16,952,404
Postage, printing, and supplies	741,402	770,948
Rent and utilities	2,293,916	1,923,852
Equipment fuel	2,516,619	1,766,759
Routine maintenance and vehicle operations	10,199,738	9,404,098
Non-routine maintenance and repairs	4,553,567	4,113,290
Insurance	2,039,247	1,864,993
Virginia Beach Ash Disposal Agreement costs	2,270,768	1,097,394
Aluminum recycling	35,668	40,011
Legal and professional services	2,036,616	1,622,814
Landfill closure and postclosure care costs	14,208,510	5,397,731
Swap waste expense	5,151,864	5,657,780
Proprietary waste expense	538,055	508,390
Other	258,136	269,707
Total operating expenses	91,258,872	76,900,259
Operating income (loss)	(6,541,636)	1,267,492
Nonoperating revenue (expense):		
Net loss on disposal of capital assets	(320,370)	(322,467)
Net decrease in fair value of investments	(125,617)	(397,296)
Interest expense:		
Interest on long-term debt	(11,472,893)	(11,915,783)
Amortization of loss on defeasance	(1,936,336)	(2,156,675)
Amortization of bond issue costs, discounts and premiums, net	(37,254)	(8,232)
Total interest expense	(13,446,483)	(14,080,690)
Other revenue:		
Insurance recoveries	118,833	849,392
Interest income	1,820,722	1,672,273
Other	40,045	57,885
Total other revenue	1,979,600	2,579,550
Total nonoperating expense, net	(11,912,870)	(12,220,903)
Change in net assets (deficit)	(18,454,506)	(10,953,411)
Total net assets (deficit):		
Beginning of year	(2,577,159)	8,376,252
End of year	$ (21,031,665)	(2,577,159)

See accompanying notes to basic financial statements.

SOUTHEASTERN PUBLIC SERVICE AUTHORITY OF VIRGINIA

Enterprise Fund

Statements of Cash Flows

Years ended June 30, 2006 and 2005

		2006	2005
Cash flows from operating activities:			
Receipts from customers	$	84,812,838	78,037,847
Payments to suppliers for operations		(35,034,227)	(31,333,842)
Payments to employees for compensation		(26,678,912)	(25,335,960)
Net cash provided by operating activities		23,099,699	21,368,045
Cash flows from capital and related financing activities:			
Purchases of capital assets		(19,381,750)	(14,771,494)
Proceeds from sale of capital assets		191,044	438,841
Proceeds from insurance recoveries		34,330	2,276,019
Payments received under direct financing lease		111,768	106,362
Proceeds from issuance of notes payable		15,000,000	—
Principal payments on notes payable		(15,000,000)	—
Proceeds from issuance of bonds payable		17,740,000	15,360,000
Principal payments on bonds payable		(20,760,000)	(15,625,000)
Proceeds from bond premium, net of debt issue costs		544,104	438,037
Interest paid		(11,757,574)	(11,507,620)
Other income		40,045	57,885
Net cash used in capital and related financing activities		(33,238,033)	(23,226,970)
Cash flows from noncapital financing activities – payments on line of credit		—	(1,200,000)
Cash flows from investing activities:			
Proceeds from maturity and sale of investments		62,261,654	99,781,141
Payments for investments purchased		(53,273,561)	(99,258,744)
Interest and dividends received from investments		1,746,172	1,611,953
Net cash provided by investing activities		10,734,265	2,134,350
Increase (decrease) in cash and cash equivalents		595,931	(924,575)
Cash and cash equivalents at beginning of year		3,157,221	4,081,796
Cash and cash equivalents at end of year	$	3,753,152	3,157,221
Reconciliation of operating income to net cash provided by operating activities:			
Operating income (loss)	$	(6,541,636)	1,267,492
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation, depletion and amortization of intangibles		17,505,653	16,952,404
Provision for bad debts		—	5,350
Landfill closure and postclosure care costs		14,208,510	5,397,731
Changes in operating assets and liabilities:			
Accounts receivable		95,602	(129,904)
Maintenance parts		(158,457)	(21,508)
Prepaid expenses		(28,380)	(123,280)
Accounts payable – operations		(332,670)	972,293
Accrued expenses		230,201	174,127
Accounts payable – restricted		(53,200)	(87,122)
Landfill closure and postclosure care liability settlement		(1,825,924)	(3,039,538)
Net cash provided by operating activities	$	23,099,699	21,368,045
Noncash transactions – increase (decrease) in fair value of investments	$	98,442	(296,366)

See accompanying notes to basic financial statements.

(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 $30,138,216 and $27,149,378 for the years ended June 30, 2006 and 2005, 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 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.

(Continued)

(c) Net Assets (Deficit)

Net assets (deficit) 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.

(d) 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.

(e) 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.

(f) 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.

(g) Maintenance Parts

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

(h) 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 2006 and 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.

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.

(i) 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.

(j) 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.

(k) 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.

(l) 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.

(m) Landfill Closure and Post Closure Care Liability

In accordance with GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Post closure Care Costs*, the Authority records landfill closure and post closure 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 post closure care.

(n) 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.

(o) 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.

(p) Reclassifications

Certain 2005 amounts have been reclassified to conform with the 2006 presentation.

(2) Cash and Cash Equivalents

At June 30, 2006 and 2005, the Authority's cash and cash equivalents balance totaled $3,753,152 and $3,157,221, 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, 2006 and 2005, cash and cash equivalents included registered money market mutual funds of $3,574,005 and $2,545,375, respectively.

(3) Restricted Assets

Total restricted assets amounted to $43,970,398 and $53,040,224 as of June 30, 2006 and 2005, respectively, and are held for the purposes and in the respective accounts described below:

	2006		
	Investments	Accrued interest receivable	Total
Revenue Bond Construction Accounts	$ 4,472,356	15,560	4,487,916
Debt Service Reserve Account	17,734,753	79,912	17,814,665
Bond Accounts	19,145,584	73,635	19,219,219
Landfill Closure Fund	1,800,460	7,304	1,807,764
Environmental Trust Fund Accounts	637,946	2,888	640,834
	$ 43,791,099	179,299	43,970,398

	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

(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.

(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 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, 2006 and 2005 are as follows:

	2006		2005	
	Suffolk Environmental Trust Fund	**Virginia Beach Environmental Trust Fund**	**Suffolk Environmental Trust Fund**	**Virginia Beach Environmental Trust Fund**
Cities:				
Norfolk	$ 80,521	79,051	76,706	73,678
Chesapeake	70,673	70,342	66,804	65,127
Virginia Beach	107,565	109,333	101,989	101,759
Portsmouth	33,097	32,663	31,628	30,557
Franklin	5,436	5,313	5,280	5,051
Counties:				
Southampton	9,747	9,765	9,324	9,158
Isle of Wight	12,136	12,273	11,604	11,514
	$ 319,175	318,740	303,335	296,844

(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).

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, 2006, the credit risk of the restricted assets portfolio holdings were:

	Rating	Percentage
Government Sponsored Enterprise Obligations	AAA	35.9%
Government Sponsored Enterprise Obligations	A-1+	1.4
Registered Money Market Mutual Funds	AAAm	18.5
State of Virginia LGIP	AAAm	39.6
Repurchase Agreements	A-1	4.2
Certificate of Deposit	No rating	0.4

(Continued)

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

	Rating	Percentage
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

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, 2006, approximately 21.6% of SPSA's restricted assets portfolio was invested in Federal Home Loan Bank (FHLB) notes; 11.6% in Federal National Mortgage Association (FNMA) notes; 4.2% in Merrill Lynch Repurchase Agreements; 4.1% in Federal Home Loan Mortgage Corp. (FHLMC) notes; and 0.4% in a Bank of Hampton Roads certificate of deposit.

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.

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.

(Continued)

As of June 30, 2006, SPSA had the following investments and maturities in its restricted assets portfolio (including accrued interest):

		Investment maturity (in years)		
Investment type	**Fair value**	**Less than 1 year**	**1 – 3 years**	**3 – 5 years**
Registered money market mutual fund – CCRF Prime	$ 3,228,705	3,228,705	—	—
Registered money market mutual fund – CCRF SNAP	3,112,095	3,112,095	—	—
Government Sponsored Entity discount notes	635,737	635,737	—	—
Government Sponsored Entity bond/notes	15,777,290	10,542,485	2,613,337	2,621,468
State of Virginia LGIP	17,390,090	17,390,090	—	—
Repurchase Agreements – Merrill Lynch	1,860,080	1,860,080	—	—
Registered money market mutual fund – STI Classic – Treasury MMF	1,807,764	1,807,764	—	—
Certificate of deposit	158,637	158,636	—	—
Total investments	$ 43,970,398	38,735,592	2,613,337	2,621,468

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

		Investment maturity (in years)	
Investment type	**Fair value**	**Less than 1 year**	**Less than 2 years**
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	$ 53,040,224	42,391,084	10,649,140

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, 2006 and 2005, all of SPSA's restricted asset investments were held in a bank's trust department in SPSA's name.

(4) Capital Assets

Capital assets of the Authority as a whole as of June 30, 2006 and 2005 consist of the following:

	Beginning balance July 1, 2005	Additions	Deletions	Ending balance June 30, 2006
Capital assets not being depreciated or depleted:				
Land	$ 4,950,105	—	—	4,950,105
Construction in process	6,380,251	19,381,750	(22,559,812)	3,202,189
Total capital assets not being depreciated or depleted	11,330,356	19,381,750	(22,559,812)	8,152,294
Other capital assets:				
Buildings	85,685,126	3,674,328	(83,845)	89,275,609
Heavy equipment	13,598,477	1,875,525	(597,629)	14,876,373
Motor vehicles	17,594,576	3,397,559	(2,508,960)	18,483,175
Suffolk landfill	43,316,199	10,145,529	—	53,461,728
Disposal System equipment	24,911,980	566,281	(342,678)	25,135,583
Power Plant equipment	125,205,059	278,277	(40,000)	125,443,336
Bi-metals system	1,639,302	—	—	1,639,302
Yard waste shredder	1,266,111	291,690	(875,874)	681,927
Furniture, office equipment, software and hardware	4,506,312	229,975	(21,698)	4,714,589
Miscellaneous equipment	2,658,836	2,100,650	(182,499)	4,576,987
Total other capital assets	320,381,978	22,559,814	(4,653,183)	338,288,609
Less accumulated depreciation and depletion:				
Buildings	38,630,889	3,172,052	(46,751)	41,756,190
Heavy equipment	4,741,475	1,695,922	(493,878)	5,943,519
Motor vehicles	9,631,451	1,481,926	(2,360,502)	8,752,875
Suffolk landfill	36,599,784	2,155,787	—	38,755,571
Disposal System equipment	12,305,412	1,141,670	(291,596)	13,155,486
Power Plant equipment	36,434,184	5,782,245	(8,197)	42,208,232
Bi-metals system	1,639,302	—	—	1,639,302
Yard waste shredder	1,054,067	58,340	(826,378)	286,029
Furniture, office equipment, software and hardware	2,310,914	770,711	(21,698)	3,059,927
Miscellaneous equipment	1,560,026	521,469	(92,767)	1,988,728
Total accumulated depreciation and depletion	144,907,504	16,780,122	(4,141,767)	157,545,859
Other capital assets, net	175,474,474	5,779,692	(511,416)	180,742,750
Total	$ 186,804,830	25,161,442	(23,071,228)	188,895,044

(Continued)

SOUTHEASTERN PUBLIC SERVICE AUTHORITY OF VIRGINIA

Notes to Basic Financial Statements

June 30, 2006 and 2005

		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		11,511,499	14,914,452	(15,095,595)	11,330,356
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		308,315,450	15,272,678	(3,206,150)	320,381,978
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	5,758,741	(27,672)	36,434,184
Bi-metals system		1,613,757	25,545	—	1,639,302
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)	1,560,026
Total accumulated depreciation and depletion		130,790,923	16,241,385	(2,124,804)	144,907,504
Other capital assets, net		177,524,527	(968,707)	(1,081,346)	175,474,474
Total	$	189,036,026	13,945,745	(16,176,941)	186,804,830

(5) Long-Term Debt

(a) Bonds Payable

Bonds payable at June 30, 2006 and 2005 consist of the following:

	2006	2005
Senior Revenue Refunding Bonds, dated October 15, 1993, and issued in the original amount of $147,250,000, due July 2010	$ 58,050,000	68,070,000
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 2006	—	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
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)	2,740,000	2,915,000
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)	12,105,000	13,355,000
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)	36,335,000	38,160,000
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)	10,630,000	12,230,000
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)	11,865,000	13,060,000
Senior Subordinated Tax-Exempt Bonds, Series 16, dated June 8, 2006, and issued in the original amount of $14,245,000, due October 2013 (held by VRA)	14,245,000	—
Bonds payable – Disposal System	231,285,000	234,545,000

		2006	2005
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)	$	2,830,000	5,245,000
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)		2,280,000	2,525,000
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)		2,645,000	3,035,000
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)		2,095,000	2,300,000
Senior Subordinated Taxable Bonds, Series 17, dated June 8, 2006, and issued in the original amount of $3,495,000, due October 2013 (held by VRA)		3,495,000	—
Bonds payable – Power Plant		13,345,000	13,105,000
		244,630,000	247,650,000
Plus:			
Unamortized bond premiums		5,245,043	5,311,643
Less:			
Unamortized bond discounts		(3,111,227)	(3,751,212)
Deferred loss on defeasance		(8,162,453)	(10,098,789)
Current maturities of bonds payable		(20,250,000)	(20,760,000)
Noncurrent portion of bonds payable	$	218,351,363	218,351,642

Rates of interest on the bonds payable listed above ranged from 2.35% to 5.7108% for the year ended June 30, 2006 and from 2.255% to 5.59% for the year ended June 30, 2005.

In June 2006, the Authority obtained funding for Disposal System capital improvements through the Virginia Resources Authority's (VRA) issuance of $14,245,000 of nontaxable bonds (the Series 16 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 June 2006, the Authority obtained funding for Power Plant capital improvements through the VRA's issuance of $3,495,000 of taxable bonds (the Series 17 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 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.

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, 2006:

Balances as of June 30, 2005	$	247,650,000
Bonds issued:		
VRA Tax-Exempt Bonds, Series 16, dated June 8, 2006		14,245,000
VRA Taxable Bonds, Series 17, dated June 8, 2006		3,495,000
Total bonds issued		17,740,000
Principal payments		(20,760,000)
Balances as of June 30, 2006	$	244,630,000

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

Aggregate maturities of bonds payable (principal and interest) at June 30, 2006, are as follows:

		Principal	Interest	Total
Year ended June 30:				
2007	$	20,250,000	11,367,632	31,617,632
2008		21,115,000	10,547,189	31,662,189
2009		22,055,000	9,565,382	31,620,382
2010		23,065,000	8,537,204	31,602,204
2011		36,795,000	7,440,306	44,235,306
2012-2016		112,315,000	17,145,985	129,460,985
2017		9,035,000	465,406	9,500,406
	$	244,630,000	65,069,104	309,699,104

(b) Line of Credit

At June 30, 2006 and 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%. The line of credit is used for operating purposes.

(6) Direct Financing Lease

In 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, offices in the Authority's original headquarters (the Regional Office Building) prior to the expansion in 1995. For such use, the HRPDC 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:		
Minimum lease payments receivable	$	96,962
Less amounts relating to interest		4,896
	$	92,066

(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 post closure 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 2006 and 2005, the Authority recorded $2,270,768 and $1,097,394, respectively, for expenses related to reimbursements to the City for operating and maintenance costs of the Virginia Beach Landfill.

(8) Landfill Closure and Post Closure 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 post closure 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 post closure 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 post closure care liabilities at June 30, 2006 and 2005 are $26,717,995 and $14,335,409, respectively. The three components are described below.

Of these liabilities, $7,432,795 and $6,082,307 represents the cumulative amount reported as of June 30, 2006 and 2005, 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 estimates of what it would cost to perform all closure and post closure care as of June 30, 2006 and 2005, respectively.

The cumulative amount of liabilities reported to date based upon the use of approximately 96% and 85% of the estimated capacity of Cell V of the Regional Landfill is $14,651,200 and $3,712,923 as of June 30, 2006 and 2005, respectively. The Authority will recognize the remaining estimated cost of closure and post closure care for Cell V as the remaining capacity is used. The remaining estimated capacity of Cell V is approximately 230,000 and 1,071,000 cubic yards as of June 30, 2006 and 2005, 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 post closure care as of June 30, 2006 and 2005, respectively.

The Authority has recorded $4,634,000 and $4,540,179 for its share of the landfill closure and post closure care liabilities for the Virginia Beach Landfill Phase I cell (see note 7) as of June 30, 2006 and 2005, respectively. This amount is based upon data provided by the City and calculations made by the Authority. The amounts for the Virginia Beach Landfill Phase I cell are based on what it would cost to perform all closure and post closure care as of June 30, 2006 and 2005, respectively.

Actual closure and post closure 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 post closure care costs through bond issuances. The Authority meets its closure and post closure care financial assurance requirements through bank issued letters of credit (approximately $20,000,000 at June 30, 2006).

Once Cell VI of the Regional Landfill is opened, additional estimated closure costs and post closure costs will be recognized.

(Continued)

The following presents the changes in the combined landfill closure and post closure care liability for the year ended June 30, 2006:

Balance as of June 30, 2005	$	14,335,409
Additional expenses accrued		14,208,510
Payments made		(1,825,924)
Balance as of June 30, 2006	$	26,717,995

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		(3,039,538)
Balance as of June 30, 2005	$	14,335,409

(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, 2006 and 2005, total commitments under these contracts amounted to approximately $706,000 and $3,050,000, respectively.

(10) RDF Plant Fire

During June 2003, a fire occurred at the RDF Plant. During 2006 and 2005, other income of $0 and $548,382, 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, 2006, 2005 and 2004 were $17,103,487, $16,399,577, and $15,715,233, 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 $1,539,314, $1,475,962, and $1,021,490 for the years ended June 30, 2006, 2005 and 2004, respectively.

(Continued)

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:

Assumption	June 30, 2005
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.

(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.

(14) Short-term Promissory Notes

The Authority issued two separate Promissory Notes during the year, each for $7,500,000. The first Note was issued in October 2005. In accordance with the Note provisions, the Authority obtained the second Note of $7,500,000 once the aggregate funds remaining in the first Note was less than $1,000,000. The Authority paid a total of $265,735 in interest related to the two Promissory Notes.

The Promissory Notes were repaid in 2006 from proceeds of bonds issued in 2006.

(15) Retirement Health Plan Liability

The Authority offers a Retiree Health Plan subject to eligibility. Under the plan, the Authority will pay part of the retiree's monthly health insurance premium up through the age at which the retiree becomes eligible to apply for full social security benefits. To be eligible for SPSA's contribution, the retiree must be approved for service or disability retirement through the VRS; must have been employed with SPSA at least five years; and must have been enrolled in one of SPSA's health care plans for the last five consecutive years immediately preceding retirement. The amount of the contribution is up to 50% of the amount SPSA normally pays for active employees with the same level of coverage. The amount is calculated based on 5% per year of completed service with SPSA. SPSA accounts for these benefits as they are incurred and the expenses are included as part of SPSA's operating budget. The expenditures for the year ended June 30, 2006 were $5,792.

REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

SOUTHEASTERN PUBLIC SERVICE AUTHORITY OF VIRGINIA

Required Supplementary Information

Schedule of Pension Funding Progress (Unaudited)

June 30, 2006

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)		20.20%		(2.30)%		(17.10)%

Unaudited – see independent auditors' report.

KPMG LLP
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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 year ended June 30, 2006, which collectively comprise the Authority's basic financial statements and have issued our report thereon dated September 29, 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 opinion 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 September 29, 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

September 29, 2006