Virginia Military Institute

Audited Financial Statements

For the year ended 30 June 2013

- T A B L E O F C O N T E N T S -

MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview

Virginia Military Institute (VMI or Institute) is pleased to present its financial statements for the fiscal year ended 30 June 2013, along with the financial statements of its affiliate component units. This management's discussion and analysis is designed to facilitate the reader's understanding of the accompanying financial statements and to provide an objective, easily readable analysis of the Institute's financial activities based on currently known facts, decisions and conditions. This discussion focuses primarily on VMI's fiscal year 2013 as compared to the prior year and includes highly summarized data that should be read in conjunction with the accompanying financial statements, notes to the financial statements and other supplementary information.

VMI's financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) standards and include three basic statements: the Statement of Net Position; the Statement of Revenues, Expenses, and Changes in Net Position; and the Statement of Cash Flows. Using criteria provided in GASB Statement 39, *Determining Whether Certain Organizations are Component Units*, the Institute determined that its affiliates, the VMI Alumni Agencies, Inc., and the VMI Research Laboratories, Inc., are both component units of the Institute. The affiliates' financial statements are prepared in accordance with Financial Accounting Standards Board (FASB) standards and include the Statement of Financial Condition and the Statement of Activities. They are presented discretely on a separate page within the Institute's financial statements. The following analysis discusses elements from VMI's statements and provides an overview of the Institute's activities. VMI's affiliated entities are excluded from this management's discussion and analysis.

Financial Highlights

The overall financial position of the Institute continued to improve during fiscal year 2013 as net position (the residual interest in assets after liabilities are deducted) increased by $5.3 million over the previous fiscal year to $248.1 million. This increase is due in large part to another increase in enrollment over the previous year. The Institute's opening fall enrollment numbers for the Corps increased to 1,664 in fiscal year 2013 from 1,638 cadets in fiscal year 2012, continuing the trend from the past several years. Tuition and fees increased by $2.4 million or 13.2% to $20.7 million in fiscal year 2013 and auxiliary enterprise revenues increased $1.9 million or 12.0% to $18.1 million.

State appropriations for operations totaled $12.2 million in fiscal year 2013, an increase of $1.3 million or 11.6% from the previous fiscal year. However, state appropriations are still $2.4 million less than the $14.6 million received five years ago, during the 2008 fiscal year. In addition, state capital contributions increased by approximately $1.3 million over fiscal 2012.

VMI also recognized a net investment gain of $1.6 million for fiscal year 2013, compared to a $0.2 million loss in the previous fiscal year.

Several capital construction and renovation projects were completed or were nearing completion at the end of fiscal 2013. The South Institute Hill Parking project ($2.8 million) and the Post Hospital renovation ($5.1 million) were both completed in August 2012. In addition, the renovation of Maury-Brooke Hall (formally the New Science Building) ($19.6 million) continued during fiscal 2013 and is scheduled for completion during the first half of fiscal 2014. During fiscal year 2013, the Institute also substantially completed detail planning associated with construction of the Corps Physical Training Facilities (CPTF) Project with estimated total project costs of approximately $119 million.

Statement of Net Position

The Statement of Net Position presents the financial position of the Institute at the end of the fiscal year and includes all assets and liabilities of the Institute. The difference between total assets and total liabilities—net position—is one indicator of the current financial condition of the Institute. The purpose of this statement is to present financial statement readers with a fiscal snapshot as of 30 June 2013. From the data presented, readers are able to determine the assets available to continue the Institute's operations. It also allows readers to determine how much the Institute owes to vendors, creditors and others.

The Institutes net position is classified as follows:

- **Net investment in capital assets -** Net position invested in capital, net of debt, represents the Institute's total investment in property, plant, and equipment, net of accumulated depreciation and outstanding debt obligations related to those capital assets. Debt incurred, but not yet expended for capital assets, is not included as a component of invested in capital assets, net of related debt.

- **Restricted net position – expendable** – Restricted net position - expendable consist of resources that must be expended by the Institute in accordance with the stipulations of donors and/or other external entities which have placed time or purpose restrictions on the use of the assets.

- **Restricted net position – nonexpendable** – Restricted net position - nonexpendable typically represent the corpus of endowments and similar type funds where donors or other external entities have stipulated that the principal is to be maintained inviolate and in perpetuity and invested for the purpose of producing present and future income to be expended or added to the principal.

- **Unrestricted net position** – Unrestricted net position consists of resources used for the general operations of the Institute and is available for any lawful purpose in support of the Institute.

Statement of Net Position

	30 June 2013	30 June 2012	Variance	
Assets:				
Current assets	$ 20,552,570	$ 24,828,700	$ (4,276,130)	-17.22%
Capital assets, net	241,222,530	233,208,739	8,013,791	3.44%
Other noncurrent assets	14,635,439	14,833,023	(197,584)	-1.33%
Total assets	$ 276,410,539	$ 272,870,462	$ 3,540,077	1.30%
Liabilities:				
Current liabilities	$ 11,611,124	$ 12,820,344	$ (1,209,220)	-9.43%
Noncurrent liabilities	16,693,864	17,232,918	(539,054)	-3.13%
Total liabilities	$ 28,304,988	$ 30,053,262	$ (1,748,274)	-5.82%

Net position:				
Net investment in capital assets	$ 227,315,348	$ 219,254,126	$ 8,061,222	3.68%
Restricted - expendable	9,059,342	8,922,438	136,904	1.53%
Restricted - nonexpendable	1,267,844	1,267,844	-	0.00%
Unrestricted	10,463,017	13,372,792	(2,909,775)	-21.76%
Total net position	$ 248,105,551	$ 242,817,200	$ 5,288,351	2.18%

As of 30 June 2013 VMI's total assets increased by $3.5 million over the prior year to $276.4 million. This increase primarily relates to an increase in capital assets ($8.0 million) related to construction projects. This increase was partially offset by a decrease in amounts due from the Commonwealth for reimbursement of construction costs ($3.5 million) and a decrease in cash and cash equivalents, unrestricted and restricted ($2.6 million).

VMI's current assets as of 30 June 2013 decreased by $4.3 million or 17.2% from the prior year. Amounts due from the commonwealth for reimbursement of Virginia College Building Authority (VCBA) funded construction expenditures decreased by $3.5 million due to the completion of the Post Hospital in early fiscal 2013 and the timing of expenditures for Maury-Brooke Hall. These projects require the Institute to first incur the expenses and then seek reimbursement from the Commonwealth on a monthly basis. In addition, cash and cash equivalents decreased $1.6 million or 16.1% from the prior year. The lower balance is primarily the result of $3.4 million of detail planning expenditures for the Corps Physical Training Facilities Project expected to begin construction in fiscal 2014. VMI expects the Commonwealth to reimburse these planning costs in fiscal 2014 once the construction phase of the project is funded. These decreases were slightly offset by an increase in military store inventory ($0.3 million) and accounts receivable ($0.3 million).

Noncurrent assets increased by $7.8 million to $255.9 million, a 3.2% increase from the previous year. Capital assets, net of depreciation, increased by $8.0 million or 3.4% to $241.2 million. This increase is primarily attributable to project costs associated with the renovation of Maury-Brooke Hall and completion of the South Institute Hill parking project. In addition, investments held with trustees increased by $0.8 million as a result of net investment gains, which exceeded distributions of funds for use in current operations. This was offset by a decrease in restricted cash of $1.2 million. Restricted cash consists of proceeds held through the Commonwealth's State Non-Arbitrage Program (SNAP), which were expended in fiscal 2013 for completion of the South Institute Hill Parking project.

As of 30 June 2013 the Institute's total liabilities decreased by $1.7 million from the prior year to $28.3 million. The decrease was primarily driven by a decrease in accounts payable ($1.5 million) and scheduled long-term debt repayments ($0.8 million). The decrease in accounts payable was primarily related to the timing of construction costs. In addition, unearned revenue decreased by $0.5 million from the prior year due to the elimination of the pre-registration deposit for returning cadets, which impacted the timing of receipts for tuition and fees for the upcoming fall semester. These were partially offset by an increase in accrued liabilities and a short-term borrowing for small capital projects.

Statement of Revenues, Expenses, and Changes in Net Position

The Statement of Revenues, Expenses and Changes in Net Position (SRECNP) presents the Institute's operating results as well as nonoperating revenues and expenses and gains or losses incurred by the Institute. Changes in the total net position as presented on the Statement of Net Position are based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Position.

In general, operating revenues are recognized when goods and services are provided to cadets and other constituencies of the Institute. Operating expenses are recognized when incurred in the acquisition or production of those goods and services.

Nonoperating revenues are revenues for which goods and services are not directly provided. Included in this category are state appropriations and gifts which supplement paying the Institute's operating expenses and support student scholarships. Therefore, the Institute, like most public higher-education institutions, will expect to show an operating loss.

Statement of Revenues, Expenses, and Changes in Net Position

	30 June 2013	30 June 2012	Variance	
Operating revenues:				
Tuition and fees	$ 20,736,302	$ 18,325,749	$ 2,410,553	13.2%
Grants and contracts	315,950	354,494	(38,544)	-10.9%
Auxiliary enterprises	18,050,564	16,123,084	1,927,480	12.0%
Unique military activities	2,915,038	2,541,074	373,964	14.7%
Other sources	1,858,285	1,725,026	133,259	7.7%
Total operating revenues	43,876,139	39,069,427	4,806,712	12.3%
Operating expenses:				
Educational and general	48,067,197	44,060,585	4,006,612	9.1%
Auxiliary enterprises	23,459,150	22,932,392	526,758	2.3%
Unique military activity	8,095,396	7,139,912	955,484	13.4%
Other expense	19,003	6,288	12,715	202.2%
Total operating expenses	79,640,746	74,139,177	5,501,569	7.4%
Operating loss	(35,764,607)	(35,069,750)	(694,857)	2.0%
Nonoperating revenues (expenses):				
State appropriations	12,231,459	10,958,994	1,272,465	11.6%
Gifts, grants and contributions	15,078,386	16,106,540	(1,028,154)	-6.4%
Investments	1,583,789	(200,216)	1,784,005	-891.0%
Other	(1,369,244)	(584,686)	(784,558)	134.2%
Net nonoperating revenues	27,524,390	26,280,632	1,243,758	4.7%
Income (loss) before other revenues	(8,240,217)	(8,789,118)	548,901	-6.2%
Other revenues/reductions	13,528,568	12,250,509	1,278,059	10.4%
Increase (decrease) in net position	5,288,351	3,461,391	1,826,960	52.8%
Net position - beginning of year	242,817,200	239,355,809	3,461,391	1.4%
Net position - end of year	$ 248,105,551	$ 242,817,200	$ 5,288,351	2.2%

Operating revenues increased by 12.3% or $4.8 million to $43.9 million and operating expenses increased by 7.4% or $5.5 million to $79.6 million. The increase to operating revenues is attributed to tuition and fee increases as well as an increase in enrollment. The opening enrollment for fiscal year 2013 increased by 26 cadets over the previous year to 1,664, while total tuition and fees increased by 4.5% for in-state Cadets and 4.9% for out-of-state Cadets. The largest portion of the increase in operating expenses was in operation and maintenance of physical plant, primarily related to equipment and contractual services associated with the Post Hospital and Maury-Brooke Hall renovations that did not meet the Institute's capitalization criteria. In addition, compensation and benefit expense increased across all programs largely due to a 12% increase in health insurance costs and a 2.2% increase in the cost of other benefits.

Non-operating revenues increased $1.2 million or 4.7% to $27.5 million. State appropriations increased approximately $1.3 million over the previous fiscal year, while net investment gains were $1.6 million during fiscal year 2013 compared to a loss of $0.2 million in fiscal year 2012. These increases were offset by a decrease of $0.9 million in gifts and contributions from the prior year as well as a loss of $0.8 million from the disposition of capital assets disposed of during renovations. The decrease in gifts and contributions reflects the use of one-time athletic contributions in the prior fiscal year that did not reoccur in fiscal year 2013 and a decrease in spendable endowment income resulting from stock market declines in prior years that impact the calculation of spendable income.

Other revenues, net increased by $1.3 million to $13.5 million in fiscal year 2013. The increase was the result of slightly higher capital funding for state projects based on the timing of construction.

Statement of Cash Flows

The Statement of Cash Flows presents detailed information about the Institute's cash activity during the year. Cash flows from operating activities will always differ from the operating loss on the SRECNP. The SRECNP is prepared on the accrual basis of accounting and includes noncash items, such as depreciation, whereas the Statement of Cash Flows presents cash inflows and outflows without regard to accrual items. The Statement of Cash Flows helps the reader assess the Institute's ability to generate cash flows sufficient to meet its obligations. It is divided into five parts: operating activities, noncapital financing activities, investing activities, capital and related financing activities, and reconciliation of the net cash used, to the operating income or loss reflected on the SRECNP.

Statement of Cash Flows

	30 June 2013	30 June 2012	Variance	
Net cash used by operating activities	$ (28,329,341)	$ (27,093,784)	$ (1,235,557)	4.6%
Net cash provided by noncapital financing activities	27,251,329	26,935,383	315,946	1.2%
Net cash used by capital and related financing activities	(1,364,419)	(5,371,909)	4,007,490	-74.6%
Net cash provided by investing activities	980,418	904,281	76,137	8.4%
Net increase (decrease) in cash	(1,462,013)	(4,626,029)	3,164,016	-68.4%
Cash - beginning of year	10,425,148	15,051,177	(4,626,029)	-30.7%
Cash - end of year	$ 8,963,135	$ 10,425,148	$ (1,462,013)	-14.0%

Net cash provided by or used in operating activities will always result in a net use for the Institute because all state appropriations and private gifts are treated as cash sources for noncapital or capital financing activities rather than cash sources for operating activities. Tuition and fees ($20.0 million) and auxiliary enterprise revenues ($18.0 million) represent the largest sources of operating cash, while compensation and benefits ($40.9 million) and payments for supplies and services ($29.5 million) are the most significant uses of operating cash. Overall, net cash used for operations increased slightly ($1.2 million) for fiscal year 2013 compared to the previous fiscal year. This was primarily as a result of greater operating expenses, which were not fully offset by increases revenues from tuition and fees and auxiliary enterprises.

Net cash provided by noncapital financing activities for operations consists largely of state appropriations ($12.2 million) and private fund support ($14.3 million). Overall, cash provided by noncapital financing activities increased slightly by $0.3 million during fiscal year 2013 compared to fiscal year 2012.

Net cash provided by or used in capital and related financing activities consists primarily of gifts and contributions ($17.2 million) from the Commonwealth VCBA bond funding and VMI Development Board. The purchase and construction of capital assets ($17.4 million) and principal and interest paid on capital debt ($1.4 million) account for the largest uses of cash for capital and related financing activities.

Net cash provided by investing activities increased slightly by $0.1 million from $0.9 million in fiscal year 2012 to $1.0 million in fiscal year 2013.

Capital Asset and Debt Administration

Fiscal year 2013 was the eleventh year of the implementation of VMI's Vision 2039. Vision 2039 is a leadership plan rather than a construction plan; however, construction of new facilities and the renovation of older buildings on Post are essential components of Vision 2039. Since 2003, VMI has made significant and comprehensive improvements to its facilities totaling approximately $233 million. This includes renovation of academic buildings, construction of a new Center for Leadership and Ethics, construction of a new outdoor Military and Leadership Field Training Ground, expansion and renovation of the Barracks and the Mess Hall, construction of a new Physical Plant facility, renovation of the Post Hospital, improvements to athletic facilities and construction of parking facilities.

During fiscal year 2013 renovation and construction continued on a number of these projects, including the completion of renovations to the Post Hospital and construction of the South Institute Hill Parking as well as near completion of renovations to Maury-Brooke Hall (formally the New Science Building). Both the renovations of the Post Hospital and Maury-Brooke Hall were financed with funds requested through the state's capital outlay process from VCBA 21^{st} Century Bond funds. The Post Hospital received $5.1 million in financing and Maury-Brooke Hall received $19.6 million in financing from the bonds. The South Institute Hill Parking project was financed with $2.8 million of VCBA pooled bond funds that were sold in October 2010. Unlike the VCBA 21^{st} Century bond funds, which are an obligation of the state, the pooled bond funds are an obligation of the Institute and are reflected as a liability in the Institute's Statement of Net Position.

During fiscal year 2013 the Institute also substantially completed detail planning associated with construction of the Corps Physical Training Facilities (CPTF). The 2012 General Assembly approved for the Institute to spend $3.4 million of non-general fund operating revenue for detailed planning associated with construction of the CPTF project. The Institute will be reimbursed by the Commonwealth for non-general funds used when the project is funded for construction by the state. The CPTF project is currently

VMI's highest priority project and consists of two phases: Phase I ($81 million) to construct a new Indoor Corps Physical Training Facility and Phase II ($38 million) to renovate Cocke Hall and Cormack Hall, which support VMI's physical education department and provide cadet physical conditioning facilities. Phase I of the project is scheduled to begin construction in fiscal year 2014 and will be funded by capital contributions from the Commonwealth of Virginia, through the VCBA 21st Century bond funds. Planning for Phase II will continue in fiscal year 2014 and may also be funded for construction in fiscal year 2014.

All of the improvements noted above provide the most modernized and technologically advanced facilities in the long history of VMI. Since VMI began its Vision 2039 capital program, the Institute has incurred long-term debt only on Jackson Memorial Hall, the Cocke Hall Annex, Crozet Hall and the South Institute Hill Parking projects. The remaining projects have been financed with state funds, auxiliary funds, or private gifts and contributions resulting in no debt obligations for the Institute. As of 30 June 2013, the debt outstanding on these projects totaled approximately $13.9 million with annual debt service payments of approximately $1.5 million, the majority of which is being funded by the VMI Foundation and VMI Development Board. VMI's Board of Visitors adopted debt guidelines in August 2005 to help ensure sound management and control of debt and annually monitors VMI's position relative to those guidelines.

The Institute's long-term debt consists of $8.2 million of bonds and $5.7 million of notes payable. The bonds payable were issued in August 2004 pursuant to Section 9(c) of Article X of the Constitution of Virginia by the Department of Treasury for the Commonwealth of Virginia on behalf of the Institute for renovation and expansion of Crozet Hall, the Institute dining facility, and parking. The bonds bear interest at an average coupon rate of 4.8% and are payable over 20 years through June 2025. The revenue bonds are secured by the net revenues of the facility, which is comprised primarily of cadet fees.

The Institute's notes payable consists of debt obligations between VCBA and the Institute. VCBA issued bonds through the pooled bond program and used the proceeds to purchase debt obligations (notes) of the Institute. Notes related to the Cocke Hall Annex and the Jackson Memorial Hall renovations, initially issued in 2002, have an average coupon rate of 4.3% and are payable over 20 years through 2023. Notes related to the South Institute Hill Parking project were issued in 2010 at an average coupon rate of 4.8% and are payable over 20 years through 2031. The Cocke Hall Annex and South Institute Hill Parking notes will be paid from auxiliary reserve funds, which consist primarily of cadet fees. The Jackson Memorial Hall note is secured by funds paid by the VMI Foundation, Inc. on a year-to-year basis as a gift to the Institute. Should the gift be discontinued, repayment will be made from the general revenues of the Institute.

In May 2013, the Institute entered into a treasury loan authorization with the Commonwealth of Virginia Department of Planning & Budget in the amount of $1,436,969. The authorization was obtained for the purpose of providing cash for the design, planning and improvements to various Post facilities. As of 30 June 2013, the Institute had withdrawn $240,000 against this authorization, which is reflected in the Statement of Net Position as a short-term borrowing. Interest is payable quarterly, at the primary liquidity portfolio rate, compiled by the Commonwealth of Virginia Department of Treasury. Unless renewed, borrowings under the treasury loan authorization are due on 31 October 2013. VMI expects to repay borrowings against the treasury loan authorization with the $4.0 million of proceeds anticipated in October 2013 from VCBA pooled bonds.

Economic Outlook

The Institute's economic outlook is generally favorable due to its continuing strong student demand and national reputation especially for its engineering programs. The Institute has consistently ranked high on the U.S. News and World Reports list of public liberal arts colleges with a current ranking of #4 behind the three federal service academies. VMI is also currently ranked #65 on the list of national liberal arts colleges (both public and private). As a public institution with significant private support, the Institute continues to be well positioned to provide excellent programs and services to its cadets as it maintains a clear educational focus and a well-established niche in the higher education marketplace.

VMI received 2,012 student applications for its fall 2013 new cadet class resulting in an average for the past three years of about 2,134 applications, to include a record 2,244 applications for fall 2011. VMI accepted 47% of the applicants for fall 2013 with a yield of 53% or 504 new cadets. VMI accepted 45% of the applicants for fall 2012 with a yield of also 53% or 509 new cadets. The academic credentials of the cadets enrolled continue to be above average with a significant percentage (50% for fall 2013) in the top quarter of their high school class.

VMI remains committed to a Corps size of about 1,600 cadets with an appropriate mix of in-state and out-of-state cadets to help maintain financial stability. In-state cadets totaled 58% of the Corps for fiscal year 2013 and 59% for fiscal year 2014. VMI also continues to keep its tuition and fees affordable and competitive, while offering significant financial assistance for cadets with demonstrated need. Operating revenues, consisting mostly of cadet tuition and fees, provided about 60% of total revenues and support in fiscal year 2013, with this percentage expected to increase in the years ahead.

State appropriations provided $12.2 million or 17% of VMI's total revenues and support for operations in fiscal year 2013 excluding funding for capital projects. State grants and contributions provided $13.1 million for capital projects, consisting primarily of the renovation of Maury-Brooke Hall (sciences). State support for operations is expected to total about $13.5 million in fiscal year 2014, for an increase of about 10% over fiscal year 2013. This increase reflects funding for State-initiated salary and fringe benefit cost increases and support for base operations. State grants and contributions for capital projects for fiscal year 2014 is estimated to total about $18 million and consists primarily of initial funding of VMI's $119 million Corps Physical Training Facilities capital project approved by the 2013 Session of the State General Assembly.

Because State support is significant, VMI is directly impacted by changes in the State's economic outlook. According to the Governor's Office, Virginia continues to experience a modest but steady economic recovery. However, the slow growth in the economy in general and the continued uncertainty in federal fiscal policy actions make it likely that Virginia will see limited revenue growth and that funding for higher education will also be limited.

Private gifts and contributions provided $13.8 million or 19% of VMI's total revenues and support for operations in fiscal year 2013, excluding funding for capital projects. Private grants and contributions provided $0.5 million for capital projects to include debt service. Private support is derived mostly from VMI Alumni Agencies, Inc. and continues to remain strong due to on-going fund-raising efforts and the professional management of their diversified portfolio of endowment assets. The endowment had a market value of $329 million as of 30 June 2013 reflecting an increase of about 10% over fiscal year 2012. VMI Alumni Agencies, Inc. is currently engaged in a new fund raising campaign that over the next several years is expected to increase donations and endowments in support of new and existing programs.

VMI's executive management believes that growth in State and private support in the next few years will be modest. However, VMI remains committed to on-going improvement of its academic programs, to cost containment, and to keeping its tuition and fees affordable and competitive. These commitments along with continuing major investments and improvements in its facilities are expected to bolster the favorable student demand for the VMI education and keep VMI's overall financial position strong.

FINANCIAL STATEMENTS

VIRGINIA MILITARY INSTITUTE
Statement of Net Position
As of 30 June 2013

ASSETS	
Current assets	
Cash and cash equivalents (Note 2)	$ 8,476,669
Cash equivalent held by Treasurer of Virginia (Note 2)	713,496
Collateral held for securities lending (Note 2)	38,470
Accounts receivable, *Net of allowance for doubtful accounts of $90,061* (Note 3)	1,590,793
Due from the Commonwealth (Note 4)	2,399,327
Due from federal government	28,973
Prepaid expenditures	1,057,939
Inventories (Note 5)	5,982,751
Loans receivable	264,152
Total current assets	20,552,570
Noncurrent assets	
Cash and cash equivalents (Note 2)	486,466
Cash equivalent-restricted (Note 2)	13,186
Investments held with trustees (Note 2)	12,712,049
Accounts receivable (Note 3)	42,022
Loans receivable, *Net of allowance for doubtful accounts of $24,676*	1,381,716
Nondepreciable capital assets (Note 6)	24,045,100
Depreciable capital assets, *Net of accumulated depreciation* (Note 6)	217,177,430
Total noncurrent assets	255,857,969
Total assets	276,410,539
LIABILITIES	
Current liabilities	
Accounts payable and accrued expenses (Note 7)	7,357,714
Unearned revenue	1,087,215
Obligations under securities lending	751,966
Deposits held for others	757,689
Short-term liability-Due to Commonwealth (Note 8)	240,000
Long-term liabilities-current portion (Note 9)	581,540
Long-term debt-current portion: (Note 9, Note 10)	835,000
Total current liabilities	11,611,124
Noncurrent liabilities	
Accrued liabilities (Note 7)	1,527,852
Federal loan program contributions refundable	1,326,032
Long-term liabilities-noncurrent portion (Note 9)	767,797
Long-term debt-noncurrent portion: (Note 9, Note 10)	13,072,183
Total noncurrent liabilities	16,693,864
Total liabilities	28,304,988
NET POSITION	
Net investment in capital assets	227,315,348
Restricted-nonexpendable	
Endowment	1,267,844
Restricted-expendable	
Scholarships and other	103,204
Loan funds	577,810
Quasi-endowment-restricted	8,378,328
Unrestricted	10,463,017
Total net position	248,105,551
Total liabilities and net position	$ 276,410,539

The accompanying Notes to Financial Statements are an integral part of this statement.

COMBINED STATEMENT OF FINANCIAL POSITION
Component Units of Virginia Military Institute
As of 30 June 2013

ASSETS	
Current assets:	
Cash and cash equivalents	$ 5,821,243
Contributions receivable (Note 19)	7,605,235
Accounts receivable	130,938
Note receivable	114,472
Other	53,092
Total current assets	13,724,980
Noncurrent assets:	
Contributions receivable (Note 19)	12,691,002
Note receivable	694,563
Investments held by trustees (Note 19)	311,151,283
Investments, other (Note 19)	13,874,887
Investment securities	150,785
Cash surrender of life insurance	5,450,195
Property and equipment, net of accumulated depreciation	276,502
Total noncurrent assets	344,289,217
Total assets	358,014,197
LIABILITIES	
Current liabilities:	
Accounts payable and accrued expenses	1,060,552
Unearned revenue	2,685
Long-term liabilities-current portion:	
Trust and annuity obligations	594,264
Total current liabilities	1,657,501
Noncurrent liabilities:	
Other liabilities	117,560
Long-term liabilities-noncurrent portion:	
Bonds payable (Note 19)	44,632,015
Trust and annuity obligations	3,568,061
Total noncurrent liabilities	48,317,636
Total liabilities	49,975,137
NET ASSETS	
Unrestricted	52,592,845
Temporarily restricted	133,443,890
Permanently restricted	122,002,325
Total net assets	308,039,060
Total liabilities and net assets	$ 358,014,197

The accompanying Notes to Financial Statements are an integral part of this statement.

VIRGINIA MILITARY INSTITUTE
Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ended 30 June 2013

Operating revenues:	
Tuition and fees, *Net of scholarships allowances of $5,803,501*	$ 20,736,302
Federal grants and contracts	283,316
State and private grants and contracts	32,634
Sales and services of educational departments	391,550
Auxiliary enterprise, *Net of scholarship allowances of $4,767,162*	18,050,564
Unique military activities, *Net of scholarships allowances of $880,602*	2,915,038
Other sources:	
Museum programs	609,562
Rents and commissions	356,132
Miscellaneous	501,041
Total operating revenues	43,876,139
Operating expenses:	
Educational and general	
Instruction	19,021,122
Research	294,501
Public service	1,497,423
Academic support	7,418,068
Student services	3,835,849
Institutional support	5,874,203
Operation and maintenance of physical plant	9,215,967
Scholarships and related expense	910,064
Auxiliary enterprises	23,459,150
Unique military activities	8,095,396
Loan cancellations and write-offs bad debt expense	19,003
Total operating expenses (Note 12)	79,640,746
Net operating income (loss)	(35,764,607)
Nonoperating revenues/(expenses):	
State appropriations (Note 13)	12,231,459
Gifts and contributions	14,064,301
Federal student financial aid (Pell)	979,318
Federal stabilization funds (ARRA)	34,767
Investment income (loss)	1,583,789
Interest on capital asset - related debt	(508,851)
Gain/(loss) on disposal of plant assets	(760,658)
Other nonoperating expense	(99,735)
Net nonoperating revenues	27,524,390
Income (loss) before other revenues and extraordinary items	(8,240,217)
Other revenues and reductions:	
Grants and contributions-capital	13,527,551
Investment income-capital	1,017
Total other revenues and reductions	13,528,568
Increase/(Decrease) in net position	5,288,351
Net position beginning of the year	242,817,200
Net position end of year	$ 248,105,551

The accompanying Notes to the Financial Statements are an integral part of this statement.

COMBINED STATEMENT OF ACTIVITIES
Component Units of Virginia Military Institute
For the Year Ended 30 June 2013

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES				
Amounts raised on behalf of VMI	$ 6,761,914	$ 8,454,126	$ 9,498,673	$ 24,714,713
Grants, contributions and contracts	468,602	19,166	-	487,768
Investment income	85,591	2,426	-	88,017
Actuarial gain/(loss) on trust and annuity obligations	(265,682)	(237,044)	115,489	(387,237)
Administrative fees	40,000	-	-	40,000
Other income	36,250	-	-	36,250
Net assets released from restrictions and reclassifications	7,892,462	(7,892,462)	-	-
Total revenues	15,019,137	346,212	9,614,162	24,979,511
EXPENSES				
Amounts remitted directly to or on behalf of VMI:				
Unrestricted	7,709,391	-	-	7,709,391
Designated	9,906,502	-	-	9,906,502
Cost of operations	6,017,311	-	-	6,017,311
Conference, research and education	599,477	-	-	599,477
Total expenses	24,232,681	-	-	24,232,681
Change in net assets before net realized and unrealized gain/(loss) on investments	(9,213,544)	346,212	9,614,162	746,830
Net realized and unrealized gain/(loss) on investments	12,322,715	21,952,889	-	34,275,604
Change in net assets	3,109,171	22,299,101	9,614,162	35,022,434
NET ASSETS				
Beginning	49,483,674	111,144,789	112,388,163	273,016,626
Ending	$ 52,592,845	$ 133,443,890	$ 122,002,325	$ 308,039,060

VIRGINIA MILITARY INSTITUTE

Statement of Cash Flows
For the Year Ended 30 June 2013

Cash provided/(used) by operating activities:	
Tuition and fees	$ 20,055,222
Federal grants and contracts	283,316
State and private grants and contracts	32,634
Sales and services-educational and general	403,757
Auxiliary charges	17,990,136
Unique military activity charges	2,914,811
Other operating receipts	1,524,488
Payments to employees for salaries and benefits	(40,935,992)
Payments for supplies and services	(29,542,555)
Payments for scholarships and fellowships	(962,244)
Loan funds issued to students	(286,797)
Collections of loans from students	193,883
Net cash provided/(used) by operating activities	(28,329,341)
Cash provided/(used) by noncapital financing activities:	
State appropriations	12,231,459
Nonoperating grants and contracts	537,938
Gifts and contributions for other than capital purposes	14,270,505
Federal Direct Lending Program-receipts	7,173,722
Federal Direct Lending Program-disbursements	(7,173,722)
Agency receipts	1,190,245
Agency disbursements	(978,818)
Net cash provided/(used) by noncapital financing activities	27,251,329
Cash provided/(used) by capital and related financing activities:	
Capital gifts and contributions	17,226,003
Proceeds from capital assets	6,559
Purchase and construction of capital assets	(17,434,838)
Proceeds from capital debt	240,000
Principal paid on capital debt, leases and installments	(795,733)
Interest paid on capital debt, leases and installments	(607,427)
Investment income-capital	1,017
Net cash provided/(used) by capital and relating financing activities	(1,364,419)
Cash provided/(used) by investing activities:	
Interest on investments	120,288
Investment/Endowment income	232,540
Sale of investments	627,590
Net cash provided/(used) by investing activities	980,418
Net increase/(decrease) in cash	(1,462,013)
Cash-beginning of year	10,425,148
Cash-end of year	$ 8,963,135

VIRGINIA MILITARY INSTITUTE
Statement of Cash Flows
For the Year Ended 30 June 2013

Reconciliation of net operating expenses to net cash used by operating activities:

Operating loss	$	(35,764,607)
Adjustments to reconcile net operating expenses to cash used by operating activities:		
Depreciation expense		8,183,508
Changes in assets and liabilities:		
Accounts receivable		(457,018)
Inventories		(303,098)
Prepaid expenditures		(59,996)
Due from Commonwealth		(5,601)
Loans receivable		(74,623)
Accounts payable and accrued liabilities		623,426
Unearned revenue		(454,968)
Compensated absences		(16,962)
Federal loan program contributions refundable		598
Net cash used in operating activities	$	(28,329,341)

Noncash investing, noncapital financing, and capital related financing transactions:

Change in fair value of investments recognized as a component of investment income	$	431,473
Capital assets purchased with SNAP Funds	$	(1,151,828)
Capital assets acquired through in-kind donations as a component of capital gifts and contributions income		282,935
	$	(437,420)

Reconciliation of cash and cash equivalents to the Statement of Net Position:

Cash and cash equivalents classified as current assets	$	8,476,669
Cash and cash equivalents classified as noncurrent assets		486,466
	$	8,963,135

- NOTES TO FINANCIAL STATEMENTS -

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by the Virginia Military Institute (VMI or Institute) are as follows:

A. Reporting Entity

The Virginia Military Institute believes that the measure of a college lies in the quality and performance of its graduates and their contributions to society. Therefore, it is the mission of the Virginia Military Institute to produce educated, honorable men and women prepared for the varied work of civil life, imbued with love of learning, confident in the functions and attitudes of leadership, possessing a high sense of public service, advocates of the American Democracy and free enterprise system, and ready as citizen-soldiers to defend their country in time of national peril.

To accomplish this result, Virginia Military Institute shall provide to qualified young men and women undergraduate education of highest quality – embracing engineering, science, and the arts – conducted in, and facilitated by, the unique VMI system of military discipline.

VMI is part of the Commonwealth of Virginia's statewide system of public higher education. The Board of Visitors, appointed by the Governor, is responsible for overseeing the Institute's governance. A separate report is prepared for the Commonwealth of Virginia which includes all agencies, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority. The Institute is a component unit of the Commonwealth of Virginia and is included in the general purpose financial statements of the Commonwealth.

The Governmental Accounting Standards Board (GASB) Statement 39, *Determining Whether Certain Organizations Are Component Units*, provides guidance to determine whether certain organizations for which the Institute is not financially accountable should be reported as component units. Generally, it requires reporting as a component unit, an organization that raises and holds economic resources for the direct benefit of the Institute.

The VMI Alumni Agencies is a legally separate, tax-exempt entity whose purpose is to organize the alumni of the Institute and to aid in the promotion of its welfare and the successful prosecution of its educational purposes. It accomplishes this through fund-raising to supplement and the tuition and fees charged to cadets and the support VMI receives from the Commonwealth of Virginia. Because the VMI Alumni Agencies' resources are held almost entirely for the benefit of the Institute and these resources are considered significant to the Institute, we have determined that the Alumni Agencies should be included as a component unit.

The VMI Research Laboratories (VMIRL) is a legally separate, tax-exempt entity whose purpose is to administer contract and grant research at the Institute. Because of the VMIRL's close relationship to the Institute, we believe in our professional judgment, it should be included as a component unit in our financial statements. Both the VMI Alumni Agencies and the VMIRL have been discretely presented in these statements.

Because the VMI Alumni Agencies and the VMIRL report under a different reporting model, the Financial Accounting Standards Board (FASB) standards, the VMI Board of Visitors and the administration of the Institute believe the Institute's financial statements should be presented on a page separate from the Institute's component units as allowed by GASB Statement 39. Separate financial statements for the VMI Alumni Agencies may be obtained by writing the Chief Financial Officer, VMI Foundation, Inc., P.O. Box 932, Lexington, Virginia 24450. Separate financial statements for the VMI Research Laboratories, Inc., may be obtained by writing the Treasurer, VMI Research Laboratories, Inc., Virginia Military Institute, Lexington, Virginia 24450.

B. Reporting Basis

The financial statements have been prepared in accordance with GASB standards, including GASB Statement 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities.*

The VMI Alumni Agencies and the VMI Research Laboratories, Inc. are private, nonprofit organizations that report under FASB standards including FASB Statement 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the VMI Alumni Agencies' or the VMI Research Laboratories' financial information included in the Institute's financial report for these differences.

C. Basis of Accounting

For financial statement purposes, the Institute is considered a special-purpose government engaged only in business-type activities. Accordingly, the Institute's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. All significant intra-agency transactions have been eliminated.

D. Cash, Cash Equivalents and Investments

In accordance with GASB Statement 9, *Definition of Cash and Cash Equivalents,* cash represents cash with the Treasurer, cash on hand, and cash deposits, including certificate of deposits, and temporary investments with original maturities of three months or less.

In accordance with GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools,* purchased investments, interest-bearing temporary investments classified with cash, and investments received as gifts are recorded at fair value. All investment income, including changes in the fair value of investments (unrealized gains and losses), is reported as nonoperating revenue in the Statement of Revenues, Expenses, and Changes in Net Position.

E. Capital Assets

Capital assets include land, buildings and other improvements, library materials, equipment, infrastructure assets, such as sidewalks, steam tunnels, and electrical and computer network cabling systems, and intangible assets. The Institute capitalizes construction costs that have a value or cost in excess of $100,000 at the date of acquisition. Renovations in excess of $100,000 are capitalized if they significantly extend the useful life of the existing asset. Expenses for major capital assets and improvements are capitalized within construction in progress as projects are constructed. Interest expense relating to construction is capitalized, net of interest income earned on resources set aside for this purpose. The costs of normal maintenance and repairs that do not add to an asset's value or materially extend its useful life are expensed as incurred.

The Institute capitalizes moveable equipment that has a value or initial cost of $5,000 or more and an estimated useful life in excess of one year. Buildings and equipment are stated at cost, where determinable, or appraised value upon initial recognition. Land is stated at cost. Library materials are initially valued using published average prices for library acquisitions. Intangible assets are capitalized with an acquisition cost of $100,000 and a useful life of one or more years.

Depreciation is computed using the straight-line method over the estimated useful life of the asset. Average useful lives by asset categories are listed below:

Buildings	50 years
Other improvements	10-30 years
Equipment	5-25 years
Library materials	10 years
Intangible assets	5 years to indefinite

The Institute does not capitalize works of art, historical treasures and similar assets. Such items are held for public exhibition, education or research in the furtherance of public service rather than financial gain. Institute collections may be sold but the proceeds must be used for the acquisition of similar type Institute collections. Exceptions to this requirement must be pre-approved by the Deputy Superintendent for Finance, Administration and Support.

F. Inventories

The Institute maintains inventory in its military store, museums, post hospital and physical plant. The military store inventory is valued at cost using the first-in first-out method. Inventory for the museum, post hospital and physical plant are valued at cost determined by using the weighted average method.

G. Unearned Revenue

Unearned revenue represents revenues collected but not earned as of 30 June 2013. This is primarily composed of revenue for student tuition and fees received in advance of the next semester or term.

H. Interest Capitalization

Interest expense incurred during the construction of capital assets is capitalized, if material, net of interest income earned on resources set aside for this purpose. The Institute incurred interest expense totaling $508,850 for the fiscal year ended 30 June 2013, none of which was capitalized as construction period interest.

I. Accrued Compensated Absences

The amount of leave earned, but not taken by classified salaried employees is recorded as a liability on the Statement of Net Position. The amount reflects, as of 30 June, all unused vacation leave, overtime leave, compensatory leave, and the amount payable upon termination under the Commonwealth's sick leave payout policy. The applicable share of employer-related taxes payable on the eventual termination payments is also included.

J. Federal Financial Assistance Programs

The Institute participates in federally funded Pell Grants, Supplemental Educational Opportunity Grants, Federal Work-Study and Perkins Loans programs. Federal programs are audited in accordance with the Single Audit Act Amendments of 1996, the Office of Management and Budget Revised Circular A-133, *Audit of States, Local Governments and Non-Profit Organizations*, and the Compliance Supplement.

K. Net Position

The Institute's net position is classified as follows:

Net investment in capital assets: This represents the Institute's total investment in capital assets, net of accumulated depreciation and outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Restricted net position – nonexpendable: Nonexpendable restricted net position consists of endowment funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to the principal.

Restricted net position – expendable: Restricted expendable net position includes resources for which the Institute is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

Unrestricted net position: Unrestricted net position represents resources derived from student tuition and fees, state appropriations, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the Institute, and may be used at the discretion of the governing board to meet current expenses for any purpose. These resources also include auxiliary enterprises, which are substantially self-supporting activities that provide services for cadets, faculty and staff. Also included in unrestricted net position are funds that have been set aside by the Board of Visitors as quasi-endowments. These funds are treated the same as true endowment funds; however, unlike true endowments they may be expended.

The Institute has no policy regarding flow assumption to determine which assets (restricted or unrestricted) are being used when both restricted and unrestricted assets are available for the same purpose. Our practice is to allow Department Heads to make this determination and they typically spend unrestricted assets prior to spending restricted resources.

L. Classification of Revenues

The Institute has classified its revenues as either operating or nonoperating revenues according to the following criteria:

Operating revenues: Operating revenues include activities that have the characteristics of exchange transactions, such as (1) student tuition and fees, net of scholarship discounts and allowances, (2) sales and services of auxiliary enterprises, net of scholarship discounts and allowances, (3) most federal, state and local grants and contracts, and (4) interest on student loans.

Nonoperating revenues: Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, and other revenue sources that are defined as nonoperating revenues by GASB 9 *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting,* GASB 33 *Accounting and Financial Reporting for Nonexchange Transactions,* and GASB 34, such as state appropriations and investment income.

Scholarship Discounts and Allowances: Student tuition and fee revenues are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net position. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the Institute and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as Pell grants, and other federal, state or nongovernmental programs, are recorded as either operating or nonoperating revenues in the Institute's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees, the Institute has recorded a scholarship discount and allowance.

M. Recently Adopted Accounting Pronouncements

In fiscal year 2013, the Institute adopted GASB Statement 60 – *Accounting and Financial Reporting for Service Concession Arrangements*. This statement provides guidance on accounting for service concession arrangements, which are a type of public-private or public-public partnership. This statement applies only to those arrangements in which specific criteria determining whether a transferor has control over the facility are met. The Institute reviewed its arrangements, including its food service arrangement, and determined that it did not have any service concession arrangements meeting the criteria of the new standard.

In fiscal year 2013, the Institute adopted GASB Statement 62 – *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this Statement is to incorporate into the GASB authoritative literature certain accounting and financial reporting guidance included in Accounting Research Bulletins (ARB), Accounting Principles Board (APB) Opinions and Financial Accounting

Standards Board (FASB) Statements and Interpretations issued before 30 November 1989. The adoption of this Statement had no impact on the Institute's financial statements.

In fiscal year 2013, the Institute adopted GASB Statement 63 – *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This statement amends the net asset reporting requirements in Statement 34 – *Basic Financial Statements- and Management's Discussion and Analysis-for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definition of the required components of the residual measure and by renaming that measure as net position, rather than net assets. Previous financial reporting standards did not include guidance for reporting deferred outflows of resources and deferred inflows of resources, which are distinct from assets and liabilities. As of 30 June 2013, the Institute did not have any items that were required to be presented as deferred outflows of resources or deferred inflows of resources. However, the Institute did rename the residual measure as net position on its financial statements.

NOTE 2: CASH AND CASH EQUIVALENTS AND INVESTMENTS

The following information is provided with respect to the Institute's cash, cash equivalents, and investments as of 30 June 2013. The following risk disclosures are required by GASB Statement 40, *Deposit and Investment Risk Disclosures*.

Custodial credit risk (Category 3 deposits and investments) – The custodial risk for deposits is the risk that, in the event of a failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in possession of an outside party. The Institute had no category 3 deposits or investments for fiscal year 2013.

Credit risk – The risk that an issuer or other counterparty to an investment will not fulfill its obligations. GASB Statement 40 requires the disclosure of the credit quality ratings of all investments subject to credit risk.

Concentration of credit risk – The risk of loss attributed to the magnitude of a government's investment in a single issuer is referred to as a credit risk. GASB Statement Number 40 requires disclosure of any issuer with more than five percent of total investments.

Interest rate risk - This is the risk that interest rate changes will adversely affect the fair value of an investment. GASB Statement 40 requires disclosure of maturities for any investments subject to interest rate risk. The Institute does not have an interest rate risk policy.

Foreign currency risk – This risk refers to the possibility that changes in exchange rates will adversely affect the fair value of an investment or a deposit.

The Institute's credit risk, concentration of credit risk, interest rate risk, and foreign currency risk are described in the Investments note below.

Cash and Cash Equivalents

Pursuant to Section 2.2-1800, et seq., Code of Virginia, all state funds of VMI are maintained by the Treasurer of Virginia, who is responsible for the collection, disbursement, custody, and investment of state funds. Cash deposits held by VMI are maintained in accounts that are collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400, et seq., Code of Virginia.

Cash and cash equivalents consist of the following balances as of 30 June 2013:

	Current	Noncurrent	Total
Cash with Treasurer of Virginia	$ 7,494,619	$ 345,495	$ 7,840,114
BB&T public fund checking	944,400	140,971	1,085,371
Petty cash	9,650	-	9,650
Wells Fargo time deposit	28,000	-	28,000
Total cash and cash equivalents	$ 8,476,669	$ 486,466	$ 8,963,135

Investments

Investments include endowment and similar funds pooled and invested with VMI affiliates and retirement fund investments for selected employees. It also includes VMI's allocated share of securities held for security lending transactions conducted by the Commonwealth. Investments consist of the following balances as of 30 June 2013:

	Current	Noncurrent	Total
Investments with the Treasurer of Virginia:			
Securities under securities lending	$ 38,470	$ -	$ 38,470
Investments with trustees:			
Investments pooled with VMI affiliates	-	11,334,197	$ 11,334,197
Mutual fund investments (retirement accounts)	-	1,377,852	$ 1,377,852
Total with trustees	-	12,712,049	$ 12,712,049
Total investments	$ 38,470	$ 12,712,049	$ 12,750,519

VMI's endowment, loan and similar funds are pooled for investment purposes with the endowment funds of its affiliate, the VMI Alumni Agencies (the VMI Foundation, Inc., the VMI Development Board, Inc., and the VMI Keydet Club) and the George C. Marshall Foundation. VMI owns units in the pooled fund (the "Fund") that operates similar to a mutual fund. VMI Investment Holdings, LLC (LLC) manages and operates the unitized investment pool with BNY Mellon serving as custodian. The VMI Foundation, Inc. is the sole member of the LLC and acts as an intermediary between the LLC and VMI and the other agencies. Deposits to and withdrawals from the pool by VMI and the other agencies are made through the LLC. A separate board of directors manages the LLC. The board has approved an investment policy that outlines the standards and disciplines adopted, and the investment objectives, principles, and guidelines for managing the Fund. Authorized investments are set forth in the Uniform Prudent Management of Institutional Funds Act, Section 55-268 et seq. of the Code of Virginia and may include any real or personal property, whether or not it produces a current return, including mortgages, stocks and bonds, debentures, and other securities of profit or nonprofit corporations, shares in or obligations of associations, partnerships, or individuals, and obligations of any government or subdivision.

The market value of the Fund as of 30 June 2013 was $328.7 million, of which, VMI owned $11.3 million or 3.4 percent of the Fund assets. The Fund annually approves an asset allocation which includes how assets are invested in major categories of investments. The Fund held $33.6 million in debt securities with an average maturity of 7.6 years. The average quality rating was AA- (Moody's). The Fund held $53.1 million in US equity investments. The Fund held $50.0 million in developed markets international funds with equities denominated primarily in the Euro, the Pound, and the Yen, and $29.6 million in emerging markets international funds with equities denominated in a variety of currencies. The Fund held $90.8 million in absolute return fund investments which may also hold fixed income and equity securities. The Fund held $34.0 million in private investments and $13.5 million in master limited partnerships. The remaining investments are held in cash and other diversifying investments. The custodians for the Fund are independently audited annually.

Funds Held In Trust By Others

Individual assets of funds held by trustees for the benefit of the Institute are not reflected in the accompanying Statement of Net Position. The Institute has irrevocable rights to all or a portion of the income of these funds. However, individual assets of the funds are not under the management discretion of the Institute according to the trust agreements. Income from funds held by trustees for the benefit of the Institute totaled $69,842 for fiscal year 2013 and is included in the endowment income.

Securities Lending Transactions

Collateral held for securities lending and the securities lending transactions reported on the financial statements represent the Institute's allocated share of securities received for securities lending transactions held in the General Account of the Commonwealth. Information related to the credit risk of these investments and securities lending transactions held in the General Account is available on a statewide level in the Commonwealth of Virginia's *Comprehensive Annual Financial Report.* The Commonwealth's policy is to record unrealized gains and losses in the General Fund in the Commonwealth's basic financial statements. When gains or losses are realized, the actual gains and losses are recorded by the affected agencies.

NOTE 3: ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following at 30 June 2013:

	Current	Noncurrent	Total
Student tuition and fees	$ 792,795	$ -	$ 792,795
Other educational and general	54,704	-	54,704
Auxiliary enterprises	327,573	-	327,573
Unique military activity	4,301	-	4,301
Private gifts	407,704	-	407,704
Agency funds	25,689	-	25,689
Other operating	45,141	42,022	87,163
Retirement of indebtedness	22,947	-	22,947
	$ 1,680,854	$ 42,022	$ 1,722,876
Less: Allowance for doubtful accounts	(90,061)	-	(90,061)
Total accounts receivable, net	$ 1,590,793	$ 42,022	$ 1,632,815

NOTE 4: COMMONWEALTH REIMBURSEMENT PROGRAMS

The Commonwealth has established several programs to provide state-supported institutions of higher education with bond proceeds for financing the acquisition and replacement of instructional and research equipment and facilities. During the 2013 fiscal year, funding has been provided to the Institute from two programs (21st Century program and the Equipment Trust Fund) managed by the Virginia College Building Authority (VCBA). The VCBA issues bonds and uses the proceeds to reimburse the Institute for expenses incurred in the acquisition of equipment and facilities.

The line item, "Due from the Commonwealth" on the Statement of Net Position for the year ended 30 June 2013 represents pending reimbursements from the following programs:

Credit card rebate/accrued interest	$ 108,696
VCBA Equipment Trust Fund program	476,628
VCBA 21st Century program	1,814,003
Total Due from Commonwealth	$ 2,399,327

NOTE 5: INVENTORIES

Inventories consisted of the following at 30 June 2013:

Military Store	$ 5,397,932
Physical Plant	345,010
Museums	215,698
VMI Hospital	24,111
Total	$ 5,982,751

NOTE 6: CAPITAL ASSETS

A summary of changes in the various capital asset categories is presented as follows:

	Beginning Balance 1 July 2012	Additions	Reductions	Ending Balance 30 June 2013
Nondepreciable capital assets:				
Land	$ 3,445,091	$ -	$ -	$ 3,445,091
Construction in progress	12,870,939	15,185,952	(7,456,882)	20,600,009
Total nondepreciable capital assets	16,316,030	15,185,952	(7,456,882)	24,045,100
Depreciable capital assets:				
Buildings	261,182,845	4,574,333	(1,532,248)	264,224,930
Improvements other than buildings	27,322,791	3,111,036	-	30,433,827
Equipment	14,332,906	1,275,318	(39,045)	15,569,179
Library books	11,557,000	274,760	(65,648)	11,766,112
Total depreciable capital assets	314,395,542	9,235,447	(1,636,941)	321,994,048

Less accumulated depreciation for:				
Buildings	71,892,514	5,369,926	(765,030)	76,497,410
Improvements other than buildings	4,706,254	1,415,079	-	6,121,333
Equipment	10,836,943	1,131,565	(39,045)	11,929,463
Library books	10,067,122	266,938	(65,648)	10,268,412
Total accumulated depreciation	97,502,833	8,183,508	(869,723)	104,816,618
Depreciable capital assets, net	216,892,709	1,051,939	(767,218)	217,177,430
Total capital assets, net	$ 233,208,739	$ 16,237,891	$ (8,224,100)	$ 241,222,530

NOTE 7: ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following at 30 June 2013:

	Current	Noncurrent	Total
Employee salaries, wages and benefits payable	$ 3,966,166	$ -	$ 3,966,166
Vendors and supplies accounts payable	2,454,433	-	2,454,433
Accrued interest payable	119,046	-	119,046
Retainage payable	768,069	-	768,069
Contractual liability	50,000	150,000	200,000
Retirement annuities	-	1,377,852	1,377,852
Total accounts payable and accrued expenses	$ 7,357,714	$ 1,527,852	$ 8,885,566

NOTE 8: SHORT-TERM BORROWING

In May 2013, the Institute entered into a treasury loan authorization with the Commonwealth of Virginia Department of Planning & Budget in the amount of $1,436,969. The authorization was obtained for the purpose of providing cash for the design, planning and improvements to various Post facilities. As of 30 June 2013, the Institute had withdrawn $240,000 against this authorization, which is reflected in the Statement of Net Position as a short-term borrowing. Interest is payable quarterly, at the primary liquidity portfolio rate, compiled by the Commonwealth of Virginia Department of Treasury. Unless renewed, borrowings under the treasury loan authorization are due on 31 October 2013.

NOTE 9: LONG-TERM LIABILITIES SUMMARY

The Institute's long-term liabilities primarily consist of long-term debt (further described in Note 9) and accrued compensated absences. A summary of changes in long-term liabilities for the year ending 30 June 2013 is presented as follows:

	Beginning Balance 1 July 2012	Additions	Reductions	Ending Balance 30 June 2013	Current Portion 30 June 2013
Long-term debt:					
Bonds payable	$ 8,728,160	$ -	$ (550,040)	$ 8,178,120	$ 500,000
Notes payable	6,074,126	-	(345,063)	5,729,063	335,000
Installment purchases	733	-	(733)	-	-
Total long-term debt	$ 14,803,019	$ -	$ (895,836)	$ 13,907,183	$ 835,000
Accrued compensated absences	1,366,299	797,271	(814,233)	1,349,337	581,540
Total long-term liabilities	$ 16,169,318	$ 797,271	$ (1,710,069)	$ 15,256,520	$ 1,416,540

NOTE 10: LONG-TERM INDEBTEDNESS DETAIL

Bonds payable:

In August 2004, pursuant to Section 9(c) of Article X of the Constitution of Virginia, $11,240,000 of revenue bonds, Series 2004A, were issued by the Department of Treasury for the Commonwealth of Virginia, on behalf of the Institute for renovation and expansion of Crozet Hall, the Institute dining facility, and parking. The bonds bear interest at an average coupon rate of 4.8% and are payable over 20 years through June 2025. Net proceeds after the cost of issuance totaled $11,889,591 and included a premium realized on the sale. The revenue bonds are secured by the net revenues of the facility, which is comprised primarily of cadet fees.

Bonds Payable:	Interest Rates (%)	Maturity	Balance 30 June 2013
Crozet Hall:			
Series 2004A, issued $11,240,000 - partial refunding *	3.75 - 5.00	2014	$ 532,480
Series 2009D, issued $4,241,860 - refunding Series 2004A *	2.50 - 5.00	2022	4,596,685
Series 2012A, issued $3,018,620 - refunding Series 2004A *	2.00 - 5.00	2025	3,048,955
			$ 8,178,120

* See Note 11 Long-Term Debt Defeasance

Notes payable:

Notes payable consists of debt obligations between the Virginia College Building Authority (VCBA) and the Institute. The VCBA issued bonds through the Pooled Bond Program and used the proceeds to purchase debt obligations (notes) of the Institute. The Cocke Hall Annex and South Institute Hill Parking notes will be paid from auxiliary reserve funds, which consist predominantly of cadet fees. The JM Hall Renovation note is secured by funds paid by the VMI Foundation, Inc. on a year-to-year basis as a gift to the Institute. Should the gift be discontinued, repayment will be made from the general revenues of the Institute.

Notes Payable:	**Interest Rates (%)**	**Maturity**	**Balance 30 June 2013**
Cocke Hall Annex:			
Series 2007B, issued $735,000 - refunding Series 2002A *	4.00 - 4.50	2020	752,759
Series 2010B, issued $555,000 - refunding Series 2002A *	2.00 - 5.00	2023	572,973
Jackson Memorial Hall Renovation:			
Series 2007B, issued $850,000 - refunding Series 2002A *	4.00 - 4.50	2020	870,519
Series 2010B, issued $650,000 - refunding Series 2002A *	2.00 - 5.00	2023	670,789
South Institute Hill Parking:			
Series 2010A1/2, issued $2,850,000	3.75 - 5.00	2031	2,862,023
			$ 5,729,063

* See Note 11 Long-Term Debt Defeasance

Maturities on notes and bonds payable for years succeeding 30 June 2013 are as follows:

Year	**Bonds Payable**	**Notes Payable**	**Total**
2014	500,000	335,000	835,000
2015	530,006	350,000	880,006
2016	296,860	370,000	666,860
2017	580,000	390,000	970,000
2018	610,000	400,000	1,010,000
2019-2023	3,547,290	2,285,000	5,832,290
2024-2028	1,696,324	850,000	2,546,324
2029-2031	-	585,000	585,000
Total principal payments	7,760,480	5,565,000	13,325,480
Unamortized premium	1,105,277	280,613	1,385,890
Deferral on debt defeasance	(687,637)	(116,550)	(804,187)
Total long-term debt, net	$ 8,178,120	$ 5,729,063	$ 13,907,183

A summary of future interest commitments for fiscal years subsequent to 30 June 2013 is presented as follows:

Year	**Bonds Payable**	**Notes Payable**	**Total**
2014	374,165	255,272	629,437
2015	344,051	239,397	583,448
2016	322,851	223,535	546,386
2017	306,907	206,466	513,373
2018	277,907	188,723	466,630
2019-2023	889,857	652,091	1,541,948
2024-2028	76,165	275,759	351,924
2029-2031	-	48,813	48,813
Total future interest requirements	$ 2,591,903	$ 2,090,056	$ 4,681,959

Operating Leases

VMI is committed under various operating leases for equipment. Operating leases do not give rise to property rights and are not reflected as obligations in the Institute's Statement of Net Position. In general, the leases have a three year term and the Institute has renewal options. In most cases, the Institute expects these leases will be replaced by similar leases in the normal course of business. Rental expense was approximately $87,579 for the year ended 30 June 2013. Minimum lease payments for subsequent fiscal years are as follows:

Year Ending 30 June	Amount
2014	$ 1,551
2015	1,157
Total	$ 2,708

Capital Improvement Commitments

As of 30 June 2013, the Institute had outstanding construction contract commitments of $919,710. This amount represents the value of obligations remaining on capital improvement project contracts. These obligations are for future efforts and as such have not been accrued as expenses or liabilities on the Institute's financial statements.

NOTE 11: LONG-TERM DEBT DEFEASANCE

In previous fiscal years, bonds and notes were issued to refund a portion of previously outstanding bonds and notes payable. Funds relating to the refunding were deposited into irrevocable trusts with escrow agents to provide for future debt service on the refunded bonds. The trust account assets and liabilities for the defeased bonds are not included in the Institute's financial statements. At 30 June 2013, the outstanding balance of the prior years' in-substance defeased bonds and notes totaled $10,255,000.

NOTE 12: EXPENSES BY NATURAL CLASSIFICATIONS

The Institute's operating expenses by natural classification were as follows for the year ended 30 June 2013:

Program	Compensation and benefits	Supplies, Equipment, Utilities and Other Services	Student Aid	Other Expenses	Depreciation	Total
Instruction	$ 15,889,885	$ 1,070,320	$ -	$ 78,172	$ 1,982,745	$ 19,021,122
Research	117,632	92,269	-	84,600	-	294,501
Public service	714,486	444,116	-	8,984	329,836	1,497,422
Academic support	4,578,901	1,858,796	-	50,845	929,526	7,418,068
Student services	2,432,031	1,081,102	-	83,410	239,306	3,835,849
Institutional support	4,064,584	1,283,370	-	397,547	128,701	5,874,202
Operation of plant	3,644,198	4,556,936	-	382,437	632,397	9,215,968
Student aid	12,679	18,179	879,206	-	-	910,064
Auxiliary enterprises	5,212,417	10,493,568	83,038	5,021,884	2,648,243	23,459,150
Unique military activities	4,619,364	1,563,537	-	619,742	1,292,754	8,095,397
Other	-	-	-	19,003	-	19,003
TOTAL	$ 41,286,177	$ 22,462,193	$ 962,244	$ 6,746,624	$ 8,183,508	$ 79,640,746

NOTE 13: STATE APPROPRIATIONS

Virginia Military Institute receives state appropriations from the General Fund of the Commonwealth of Virginia. The Appropriation Act specifies that such unexpended appropriations shall revert, as specifically provided by the General Assembly, at the end of the biennium. For years ending at the middle of the biennium, unexpended appropriations that have not been approved for reappropriation in the next year by the Governor become part of the General Fund of the Commonwealth and are, therefore, no longer available to VMI for disbursement. Fiscal year 2014 ends the biennium.

During the fiscal year ended 30 June 2013, the Institute received the following supplemental appropriations and reversions in accordance with the Appropriation Act:

Original legislative appropriation:	
Educational and general programs	$ 8,065,051
Unique military activity	3,294,904
Student financial assistance	823,760
Adjustments:	
Compensation adjustments	456,677
ETF lease payment - NGF portion	(88,844)
Student financial assistance	23,688
Debt service fee - Non-Virginia cadets	(347,490)
Appropriations transfers:	
SCHEV programs	5,052
Educational and general	(1,339)
Adjusted appropriations	$ 12,231,459

NOTE 14: RETIREMENT AND PENSION SYSTEMS

Employees of the Institute are employees of the Commonwealth of Virginia. Most full-time classified salaried employees of the Institute participate in the defined benefit retirement plan administered by the Virginia Retirement System (VRS). VRS is an agent multiple-employer public employee retirement system (PERS) that acts as a common investment and administrative agency for the Commonwealth of Virginia and its political subdivisions.

Information regarding types of employees covered, benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions as well as employer and employee obligations to contribute are established, can be found in the Commonwealth's Comprehensive Annual Financial Report (CAFR).

VRS does not measure assets and pension benefit obligations separately for individual state institutions. The CAFR provides disclosure of the Commonwealth's unfunded pension benefit obligation at 30 June 2013. The Commonwealth, not the Institute, has overall responsibility for contributions to this plan. The same report contains historical trend information showing VRS's progress in accumulating sufficient assets to pay benefits when due.

The Institute's total VRS contribution was $1,428,060 for the year ended 30 June 2013. This contribution was calculated based on total base salary of participants of approximately

$16,010,547. The Institute's total payroll costs were $33,114,568 for the year ended 30 June 2013.

Optional Retirement Plan

Some full-time faculty and contracted administrative staff participate in a defined contribution plan administered by two different providers other than VRS; TIAA/CREF Insurance Companies and Fidelity Investments Tax-Exempt Services Co. This is a fixed-contribution program where the retirement benefits received are based entirely upon the employer's (10.4%) contributions for employees enrolled prior to 1 July 2010, plus interest and dividends, with the employer assuming the employee's contribution share. For employees enrolled after 1 July 2010, the employer provides a contribution of 8.5% while the employee must contribute 5%.

Individual contracts issued under the plan provide for full and immediate vesting of both the Institute's and the employees' contributions. Total pension costs under this plan were approximately $1,085,264 for the year ended 30 June 2013. Contributions to this defined contribution plan were calculated using the base salary amount of participants of approximately $10,757,430 for fiscal year 2013.

Deferred Compensation Plan

Employees of the Commonwealth may participate in the Commonwealth's Deferred Compensation Plan. Participating employees can contribute to the plan each pay period with the Commonwealth matching up to $20 per pay period or $40 per month. The dollar amount match can change depending on the funding available in the Commonwealth's budget. The Deferred Compensation Plan is a qualified defined contribution plan under Section 401(a) of the Internal Revenue Code. Employer contributions under the Deferred Compensation Plan were approximately $137,063 for the fiscal year 2013.

NOTE 15: POST-EMPLOYMENT BENEFITS

The Commonwealth participates in the VRS administered statewide group life insurance program which provides postemployment life insurance benefits to eligible retired and terminated employees. The Commonwealth also provides health care credits against the monthly health insurance premiums of its retirees who have at least 15 years of service and participate in the State's health plan. Information related to these plans is available at the statewide level in the Commonwealth's *Comprehensive Annual Financial Report*.

NOTE 16: RISK MANAGEMENT

The Institute is exposed to various risks of loss related to torts; theft or, damage to, and destruction of assets; errors and omissions; non-performance of duty; injuries to employees; and natural disasters. The Institute participates in insurance plans maintained by the Commonwealth of Virginia. The state employee health care and worker's compensation plans are administered by the Department of Human Resource Management and the risk management insurance plans are administered by the Department of Treasury, Division of Risk Management. Risk management insurance includes property, general liability, medical malpractice, faithful performance of duty bond, automobile, and air and watercraft plans. The Institute pays premiums to each of these Departments for its insurance coverage. Information relating to the

Commonwealth's insurance plans is available at the statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report.

NOTE 17: CONTINGENCIES

The Institute has received federal grants for specific purposes that are subject to review and audit by the grantor agencies. Claims against these resources are conditional upon compliance with the terms and conditions of grant agreements and applicable federal regulations, including the expenditure of resources for allowable purposes. Any disallowance resulting from a federal audit may become a liability of the Institute.

In addition, the Institute is required to comply with various federal regulations issued by the Office of Management and Budget. Failure to comply with certain systems requirements of these regulations may result in questions concerning the allowance of related direct and indirect charges pursuant to such agreements. As of 30 June 2013 the Institute estimates that no material liabilities will result from such audits or questions.

In October 2003, VMI entered into a contract amendment with ARAMARK Educational Services (ARAMARK), VMI's contracted dining services vendor. Under this agreement, ARAMARK provided $1,000,000 in fiscal 2004 and $200,000 in fiscal 2005 to VMI to support the expansion and renovation of the Crozet Hall dining facility. The agreement requires ARAMARK to amortize these contributions on a straight-line basis over a ten-year period commencing with the disbursement of funds. In the event that VMI or ARAMARK terminates the relationship prior to the end of the amortization period, VMI must re-pay any unamortized balance to ARAMARK within 90 days of termination.

In August 2007, the Institute entered into a new five year contract (with one optional renewal term of five years) with ARAMARK to provide dining services to cadets. Under this agreement, ARAMARK agreed to contribute $750,000 for food service facility renovations, the purchase and installation of food service equipment, area treatment, signage and marketing materials and other costs associated with the food service program on our premises. In accordance with the agreement, the Institute received $500,000 of this commitment in fiscal 2008 and the balance of $250,000 during fiscal 2012. The agreement requires ARAMARK to amortize this contribution on a straight-line basis over a ten-year period through 2017. Upon expiration or termination of this agreement by either party prior to 2017, VMI agreed to pay ARAMARK the unamortized balance plus accrued but unbilled interest (prime rate plus two percentage points per annum, compounded monthly) within 30 days.

In July 2012, the Institute exercised its right to renew the contract with ARAMARK through 2017. In consideration for the renewal, ARAMARK agreed to contribute $350,000 for food service facility renovations and retail enhancements to dining facilities in the PX. In accordance with the agreement, $250,000 of this commitment was due in fiscal 2013 and the balance of $100,000 is due in fiscal 2014. The agreement requires ARAMARK to amortize this contribution on a straight-line basis through 2017 commencing with the complete expenditure of the funds. Upon expiration or termination of this agreement by either party prior to 2017, VMI agreed to pay ARAMARK the unamortized balance plus accrued but unbilled interest (prime rate plus two percentage points per annum, compounded monthly) within 30 days.

NOTE 18: SUBSEQUENT EVENTS

The 2013 General Assembly of the Commonwealth of Virginia approved VMI's request for $4.0 million of VCBA bond financing to make improvements to Post facilities. The bonds to support this project are expected to be issued by the Commonwealth of Virginia in October 2013 and will result in a note payable between VCBA and the Institute. Bond financing for this project is projected to total $4.0 million, plus bond issue costs and capitalized interest during construction. The bonds will be repaid over 20 years with an expected interest rate of approximately 4%. This new debt would increase the book value of VMI's total outstanding debt, including unamortized premiums and refunding losses, to approximately $18.0 million.

NOTE 19: VMI ALUMNI AGENCIES

The VMI Alumni Agencies (the "Agencies") are comprised of four organizations that share the common purpose of raising funds, investing funds, and performing other activities on behalf of VMI alumni and other donors in support of VMI. Significant sources of revenue consist of contributions and investment return. Due to their shared purpose, the Agencies have elected to present their financial statements on a combined basis. All significant interagency accounts and transactions have been eliminated in combination. The individual organizations comprising the Agencies and their purposes are as follows:

The VMI Alumni Association
The purpose of The VMI Alumni Association is to organize the alumni of VMI into one general body.

VMI Foundation, Incorporated
The purposes of the VMI Foundation, Incorporated are to solicit and to accept various funds and to disburse such funds, or income earned from those funds, for the advancement of VMI and the Alumni Association.

VMI Development Board, Incorporated
The purposes of the VMI Development Board, Incorporated are to support VMI by coordinating development and fundraising efforts conducted on behalf of VMI Alumni and other donors.

VMI Keydet Club, Incorporated
The purposes of the VMI Keydet Club, Incorporated are to support, strengthen, and develop the intercollegiate athletic program at VMI.

Contributions receivable

Contributions receivable consist of the following as of 30 June:

	2013
Unconditional promises to give	$ 20,122,309
Charitable trusts held by others	173,928
Total contributions receivable	20,296,237
Less: current portion	(7,605,235)
Noncurrent contributions receivable	$ 12,691,002

Gross amounts expected to be collected in:	
Less than one year	$ 8,698,789
One to five years	11,846,306
More than five years	3,430,831
	23,975,926
Less:	
Discount	(1,299,489)
Allowance for uncollectible contributions	(2,380,200)
Fair value	$ 20,296,237

The distribution of contributions receivable for each class of net assets as of 30 June is as follows:

Temporarily restricted	$ 13,397,373
Permanently restricted	6,898,864
	$ 20,296,237

At 30 June 2013, the Agencies had also received bequest and other intentions of approximately $122.7 million. These intentions to give are not recognized as assets and, if they are received, they will generally be restricted for specific purposes stipulated by the donors.

For 2013 approximately 45% of the contributions receivable balance was from five donors.

Investments held by trustees

The Agencies participate in a combined investment fund (the "Fund") controlled by the VMI Investment Committee, a committee comprised of representatives from each agency. BNY Mellon, N.A. serves as custodian for the Fund's assets. The Fund's investments consist of the following as of 30 June:

	2013		
Equities	$ 138,129,716	44.4	%
Absolute return funds	85,966,629	27.6	
Private equities	32,156,430	10.3	
Fixed income	31,819,540	10.2	
Master limited partnerships	12,731,916	4.1	
Commodities	5,490,160	1.8	
Cash and cash equivalents	4,856,892	1.6	
	$ 311,151,283	100.0	%

These investments, which comprise the majority of the Agencies' assets, are subject to market risk. However, the Agencies' investment funds are managed by a number of investment managers, which limits the amount of risk in any one fund. The Agencies' Investment Committee establishes investment guidelines and performance standards which further reduce its exposure to market risk.

Investments held by trustees activity for the year ended 30 June is reflected in the table below:

	2013
Investments, beginning	$ 283,132,907
Investments returns:	
Dividends and interest	1,840,203
Net realized and unrealized losses	32,675,203
Less: investment fees	(2,260,575)
	32,254,831
Net disbursements used to fund operations	(4,236,455)
Investments, ending	$ 311,151,283

VMI Investment Holdings, LLC

On 29 April 2009, VMI Investment Holdings, LLC (LLC) was formed to manage the investments held by trustees. On 1 June 2009, all investments held by trustees and for which BNY Mellon, N.A. serves as custodian were transferred to the LLC. The Foundation is the sole member of the LLC, and acts as an intermediary between the LLC and the other agencies. As stated in the Deposit and Management Agreement, the LLC will operate the unitized investment pool and issue a number of units in the pool to each depositor based on the amount of its deposit divided by the then unit value. Each depositor is entitled to its pro rata share of the value, taking into account aggregate investment returns. Deposits to and withdrawals from the pool by the other agencies will be made through the Foundation. A separate board of directors was established to manage the LLC.

Investments, Other

Investments, other, as of 30 June consists of the following:

	2013			
	Held by Agent	Held by Foundation	Held in Irrevocable Trusts*	Total at Fair Value**
Equities	$ 1,349,869	$ 9	$ 6,991,592	$ 8,341,470
Fixed income	8,445	5,891	2,547,868	2,562,204
Real estate	-	1,701,667	-	1,701,667
Alternative investments	-	-	627,678	627,678
Cash and cash equivalents	371,446	792	252,502	624,740
Limited partnerships	-	17,128	-	17,128
	$ 1,729,760	$ 1,725,487	$ 10,419,640	$ 13,874,887

*Investments held in irrevocable trusts are not available for use until the occurrence of a future event as noted in the applicable trust agreements.

**For certain components of these investments, primarily real estate, limited partnerships, and common stocks of closely held companies where fair values were not readily determinable, cost was used.

Long-term Debt

Long-term debt consists of bonds and notes payable at 30 June as follows:

	2013
Variable Rate Educational Facilities Revenue Bonds, Series 2006, payable in varying installments from $5,000,000 to $22,475,000, commencing 2021 through 2037	$ 42,475,000
Add: bond premium - net	2,157,015
	$ 44,632,015

Debt matures as follows for future years ending 30 June:

Year ending 30 June:	
2014	-
2015	-
2016	-
2017	-
2018	-
Thereafter	42,475,000
	$ 42,475,000

Effective 15 July 2010, the Industrial Development Authority of the City of Lexington, Virginia approved a request by the Agencies to remarket Variable Rate Educational Facilities Revenue Bonds, Series 2006. This remarketing superseded the original issuance, dated 13 July 2006. The bonds were initially issued in a single series bearing interest at a variable rate. The bonds were remarketed at a premium of $2,525,000, net of expenses. The premium is being amortized over the life of the loan and amortization of the premium totaled $122,622 for 2013. The bonds were remarketed in three series, Series 2006A-1 ($5,000,000) and 2006A-2 ($5,000,000), 2006B ($10,000,000), and 2006C ($22,475,000), and interest was converted to a fixed rate on each series. Series 2006A-1 bears interest of 4.25%, the remainder each bear interest at 5.00%. Interest accrues at these rates and payments commenced on 1 December 2010. Payments are due each 1 June and 1 December. The first principal payment, of $10,000,000, is due in fiscal year 2021. Upon this conversion, the bonds are no longer collateralized by any credit or liquidity facility, nor are the bonds collateralized by any of the Agencies' assets.

During 2011, the Agencies borrowed $2,500,000 and issued a promissory note in the same amount. The proceeds of the note were used to terminate the interest rate swap agreement in place at 30 June 2010. The promissory note was repaid during 2013.

Endowment Funds

The Agencies employ a total return spending policy that establishes the amount of investment return that is available to support current needs and restricted purposes. This policy is designed to insulate program spending from capital market fluctuations and increase the amount of return that is reinvested in the corpus of the fund in order to enhance its long-term value. For the year ended 30 June 2013, the Board-approved spending formula for the endowment provided for an annual spending rate of 4.8% of the average of the prior twelve quarters' 31 December market values adjusting these market values upward to reflect subsequent receipt of gifts, or downward to reflect extraordinary withdrawals. If cash yield (interest and dividends) is less than the spending rate, realized gains can be used to make up the deficiency. Any income in excess of the spending rate is to be reinvested in the endowment. The primary investment objective is long-term capital appreciation and total return. The Agencies utilize diversified investment classes that provide the opportunity to achieve the return objective without exposing the funds to unnecessary risk.

NOTE 20: COMPONENT UNITS

Condensed financial statements for the component units of the Institute are as follows:

CONDENSED STATEMENTS OF NET ASSETS As of 30 June 2013	**VMI Research Laboratories Inc.**	**VMI Alumni Agencies**	**TOTAL**
Assets:			
Current assets	$ 464,199	$ 13,260,781	$ 13,724,980
Noncurrent assets	271,711	344,017,506	344,289,217
Total assets	735,910	357,278,287	358,014,197
Liabilities:			
Current liabilities	33,127	1,624,374	1,657,501
Noncurrent liabilities	42,022	48,275,614	48,317,636
Total liabilities	75,149	49,899,988	49,975,137
Net Assets:			
Unrestricted	614,025	51,978,820	52,592,845
Temporarily restricted	36,736	133,407,154	133,443,890
Permanently restricted	10,000	121,992,325	122,002,325
Total net assets	660,761	307,378,299	308,039,060
Total net assets and liabilities	$ 735,910	$ 357,278,287	$ 358,014,197

CONDENSED STATEMENTS OF REVENUES EXPENSES AND CHANGES IN NET ASSETS As of 30 June 2013	**VMI Research Laboratories Inc.**	**VMI Alumni Agencies**	**TOTAL**
Total revenues	$ 541,865	$ 24,437,646	$ 24,979,511
Total expenses	(599,477)	(23,633,204)	(24,232,681)
Total net realized and unrealized losses on investments	-	34,275,604	34,275,604
Total change in net assets	(57,612)	35,080,046	35,022,434
Total beginning net assets	718,373	272,298,253	273,016,626
Total ending net assets	$ 660,761	$ 307,378,299	$ 308,039,060

Commonwealth of Virginia

Auditor of Public Accounts

Martha S. Mavredes, CPA
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

May 1, 2014

The Honorable Terence R. McAuliffe
Governor of Virginia

The Honorable John M. O'Bannon, III
Chairman, Joint Legislative Audit
and Review Commission

Board of Visitors
Virginia Military Institute

INDEPENDENT AUDITOR'S REPORT

Report on Financial Statements

We have audited the accompanying financial statements of the business-type activities and aggregate discretely presented component units of the **Virginia Military Institute**, a component unit of the Commonwealth of Virginia, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Institute's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the aggregate discretely presented component units of the Institute, which are discussed in Notes 1 and 20. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the component units of the Institute, is based on the reports of the other auditors.

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the component units of the Institute that were audited by other auditors upon whose reports we are relying were audited in accordance with auditing standards generally accepted in the United States of America, but not in accordance with Government Auditing Standards.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall financial statement presentation.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a reasonable basis for our audit opinions.

Opinion

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities and aggregate discretely presented component units of the Virginia Military Institute as of June 30, 2013, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 1 through 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with Government Auditing Standards, we have also issued our report dated May 1, 2014, on our consideration of the Virginia Military Institute'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 in considering the Institute's internal control over financial reporting and compliance.

Martha S. Mavredes

AUDITOR OF PUBLIC ACCOUNTS

GDS/alh

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