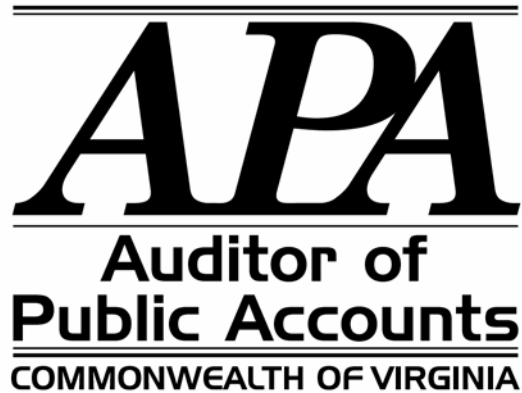


VIRGINIA MILITARY INSTITUTE

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2005**



AUDIT SUMMARY

Our audit of Virginia Military Institute for the year ended June 30, 2005, found:

- the financial statements are presented fairly, in all material respects;
- an internal control matter that we consider to be a reportable condition; however, we do not consider this matter to be a material weakness; and
- no instances of noncompliance or other matters required to be reported.

- TABLE OF CONTENTS -

AUDIT SUMMARY

INTERNAL CONTROL FINDING AND RECOMMENDATION

MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL STATEMENTS:

Statement of Net Assets

Combined Statement of Financial Position – Component Units

Statement of Revenues, Expenses, and Changes in Net Assets

Combined Statement of Activities – Component Units

Statement of Cash Flows

Notes to Financial Statements

SUPPLEMENTARY INFORMATION:

Schedule of Operations - Auxiliary Enterprises

INDEPENDENT AUDITOR'S REPORTS:

Report on Financial Statements

Report on Internal Control over Financial Reporting and
on Compliance and Other Matters

INSTITUTE RESPONSE

INSTITUTE OFFICIALS

INTERNAL CONTROL FINDING AND RECOMMENDATION

Improve Policies and Procedures Covering System Access

Virginia Military Institute (VMI) does not have sufficient policies and procedures to ensure the removal of system access for terminated employees in a timely manner. VMI's current policy does not state a time limit for departments to submit Account Deletion Forms to the Information Technology Department after an employee's termination date. During our review of access to the Colleague system, we found that for 13 out of 31 account deletions for separated employees, departments had sent the requests to the Information Technology Department more than 11 days after the employees' termination dates, five of which were over 30 days after the termination dates. In addition, we found that VMI lacked procedures for adding, reviewing, maintaining, and deleting users in the eVA procurement system.

The failure to remove separated employee accounts in a timely manner or not at all can result in inappropriate access to critical systems and data. VMI should strengthen and enforce their "Termination of Access" policy by giving a specific number of days after an employee has separated from the VMI for the employee's department to submit the Account Deletion Form to the Information Technology Department. In addition, management should consider having the Human Resources Department notify Information Technology of an employee's termination as part of the separation process, instead of relying on the employee's department for notification. The Information Technology Department should also include the eVA procurement system in its policy to review user access on a semi-annual basis. This review process should entail the department signing off that each employee in their department has the appropriate level of access. Without adequate system access processes, VMI cannot ensure the proper level of protection over their critical and sensitive data against unauthorized access.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

Overview

VMI is pleased to present its financial statements for the fiscal year ended June 30, 2005, along with the financial statements of its affiliates as required under Governmental Accounting Standards Board (GASB) Statement Number 39. This management discussion and analysis is designed to help readers to understand the accompanying financial statements and provides an objective, easily readable analysis of VMI's financial activities based on currently known facts, decisions and conditions. This discussion focuses primarily on VMI's fiscal year 2005 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 GASB and include three basic statements: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. The affiliates' financial statements are prepared in accordance with Financial Accounting Standards (FASB) and include the Statement of Financial Condition and the Statement of Activities. The following analysis discusses elements from VMI's statements and provides an overview of VMI's activities. It also includes a separate section that addresses the financial statements of VMI's affiliates.

Executive Summary

After two straight years of decreases in funding support for operations from the state, VMI received an increase of \$.9 million over the preceding year. State appropriations for the 2005 fiscal year totaled \$12.3 million compared to \$13.5 million received for operations during the 2002 fiscal year, an 8.9 percent reduction. Similar to Virginia's other state-supported institutions; VMI has been forced to increase its tuition and fees to avoid undermining the quality of its educational programs. Tuition, fees, and other operating income in fiscal year 2005 total \$23.0 million, an increase of \$.9 million, or 4.0 percent. Private gifts and contributions for operations total \$13.4 million, which represents no change over the preceding year. Support for VMI's capital projects and related debt service from the State and from private sources totals \$22.4 million for the 2005 fiscal year compared to \$4.1 million for the 2004 fiscal year, an increase of 449 percent. Revenues and support from all sources total \$73.0 million in fiscal year 2005, an increase of \$19.2 million, or 35.6 percent.

Expenses for fiscal year 2005 total \$52.0 million, an increase of \$2.5 million, or 5.0 percent. Personal services costs total \$29.3 million, an increase of \$1.7 million, or 6.3 percent, and primarily reflect increases in faculty salaries, health insurance, and retirement contributions.

Net assets for fiscal year 2005 total \$97.8 million, an increase of \$20.9 million, or 27.2 percent. The investment in capital assets, net of related debt grew by \$7.9 million to \$60.6 million and reflects VMI's on-going capital projects program that include Nichols Engineering Hall, Cocke Hall Annex, Jackson Memorial Hall, Crozet Hall, emergency repairs to Barracks and Alumni Stadium renovations. Expendable restricted net assets total \$24.2 million, an increase of \$11.7 million, or 48 percent, and reflect appreciation of the endowment as well as additional funding received from the State for capital projects. Unrestricted net assets total \$8.5 million, an increase of \$1.3 million, or 15.8 percent.

During the 2005 fiscal year, VMI commenced the Emergency Repairs to Barracks project (\$4.1 million) and continued the renovation of Crozet Hall (\$12.1 million), Nichols Engineering Hall (\$17.8 million), the construction of the Cocke Hall Annex (\$2.2 million), and the renovation of Jackson Memorial Hall (\$2.7 million). Also during 2005, VMI began acquiring properties along North Main Street (\$.9 million) and began planning for storm water improvements (\$1.3 million), the renovation and expansion of Kilbourne Hall (\$16.5 million), renovation of Mallory Hall (\$9.1 million), expansion of Barracks (\$1.9 million), the renovation and expansion of Athletic facilities (\$18 million), and the construction of a Leadership and Ethics Center (\$15 million). Construction-in-progress totaled \$26.5 million as of fiscal year end compared to \$6.4 million as of the end of 2004, an increase of 314 percent.

Statement of Net Assets

The Statement of Net Assets presents VMI's assets, liabilities, and net assets as of the end of the fiscal year. This statement presents a fiscal snapshot at June 30, 2005. Readers of the Statement of Net Assets should be able to determine the assets available to continue VMI's operations. They should also be able to determine how much VMI owes vendors, creditors, and others.

Net Assets are divided into three major categories. The first category, "Invested in capital assets, net of related debt," provides VMI's equity in property, plant, and equipment. The next category is "Restricted" net assets which comprise two subcategories, expendable and nonexpendable. Expendable restricted resources are available for expenditure by VMI in accordance with stipulation of donors and/or other entities that have placed time or purpose restrictions on the use of the assets. Nonexpendable restricted resources typically represent the corpus of endowments and are available only for investment purposes. The final category is "Unrestricted" net assets, which are available for any lawful purpose of VMI.

Statement of Net Assets

	<u>June 30, 2005</u>	<u>June 30, 2004</u>
Assets:		
Current assets	\$ 16,096,997	\$15,577,958
Capital assets, net	75,857,113	55,089,375
Other non-current assets	<u>36,884,816</u>	<u>23,148,077</u>
Total assets	<u>128,838,926</u>	<u>93,815,410</u>
Liabilities:		
Current liabilities	11,331,556	9,303,089
Non-current liabilities	<u>19,667,601</u>	<u>7,580,968</u>
Total liabilities	<u>30,999,157</u>	<u>16,884,057</u>
Net Assets:		
Invested in capital assets, net of related debt	60,630,443	52,741,136
Restricted – expendable	24,227,324	12,544,701
Restricted – non-expendable	4,516,682	4,517,682
Unrestricted	<u>8,465,320</u>	<u>7,127,834</u>
Total net assets	<u>\$ 97,839,769</u>	<u>\$76,931,353</u>

VMI's current assets increased by \$.5 million, or 3.3 percent, and primarily reflect an increase of \$.4 million in inventory and an increase of \$.2 million in collateral held for securities lending. The inventory increase is attributable to additional clothing items being issued to cadets. Collateral held for securities lending totals \$1.4 million and represents VMI's allocated share of collateral received in connection with securities lending transactions of the State Treasury. This asset and corresponding offsetting liability are required to be reflected in VMI's financial statements in accordance with GASB Statement Number 28 although these are assets and liabilities of the Commonwealth of Virginia and not VMI.

Capital assets increased by \$20.8 million to \$75.9 million and consist primarily of the acquisition of property along North Main Street and construction-in-progress related to the renovations of Nichols Engineering Hall, the renovation, and expansion of Crozet Hall, emergency repairs to Barracks, Alumni Stadium renovations, and the expansion and renovation of Cocke Hall Annex.

Other non-current assets increased \$13.7 million and primarily reflects a \$8.9 million increase in cash and cash equivalents, a \$4.0 million increase in investments held with the Treasurer of Virginia, and a \$.9 million increase in cash and investments with trustees. All of these increases can be attributed to the capital projects referenced above as well as four other capital projects: the renovation of Kilbourne Hall, the construction of the Leadership and Ethics Center, the expansion of Barracks and renovations to Jackson Memorial Hall.

Current liabilities increased \$2.0 million and consist primarily of construction costs payable on capital projects. Noncurrent liabilities increased by \$12.1 million and primarily reflect the debt incurred on the Crozet Hall capital project.

Net assets total \$97.8 million at year end, or an increase of \$20.9 million, due largely to construction-in-progress on VMI's capital projects at year end.

Statement of Revenues, Expenses, and Changes in Net Assets

Changes in the total net assets as presented on the Statement of Net Assets are based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of this statement is to present VMI's operating and non-operating revenues recognized and expenses paid and any other revenues, expenses, gains, and losses received or incurred by VMI.

Operating revenues are generally recognized when goods and services are provided to students and other constituencies of VMI. Operating expenses are the cost incurred to acquire or produce the goods and services provided and to carry out VMI's programs and activities.

Non-operating revenues generally represent income and support for which goods and services are generally not provided. For example, it includes state appropriations for VMI's educational, general, and Unique Military Activities Programs for which goods and services are not directly provided to the state by VMI.

Statement of Revenues, Expenses, and Changes in Net Assets

	<u>Year Ended June 30, 2005</u>	<u>Year Ended June 30, 2004</u>
Operating revenues:		
Tuition and fees	\$10,659,410	\$10,266,132
Grants and contracts	754,830	666,826
Auxiliary enterprises	9,171,146	8,836,428
Unique military activities	1,441,323	1,097,012
Other sources	<u>958,889</u>	<u>1,229,545</u>
Total operating revenues	<u>22,985,598</u>	<u>22,095,943</u>
Operating expenses:		
Educational and general	33,640,292	31,173,104
Auxiliary enterprises	13,110,167	12,808,332
Unique military activities	<u>4,683,463</u>	<u>4,953,554</u>
Total operating expenses	<u>51,433,922</u>	<u>48,934,990</u>
Operating loss	<u>(28,448,324)</u>	<u>(26,839,047)</u>
Non-operating revenues (expenses):		
State appropriations	12,316,526	11,387,742
Private gifts and contributions	13,389,131	13,363,437
Investments	1,907,676	2,881,681
Other	<u>(615,986)</u>	<u>(687,110)</u>
Net non-operating revenues	<u>26,997,347</u>	<u>26,945,750</u>
Income/(loss) before other revenues	(1,450,977)	106,703
Other revenues	<u>22,359,393</u>	<u>4,071,887</u>
Increase in net assets	20,908,416	4,178,590
Net assets – beginning of year	<u>76,931,353</u>	<u>72,752,763</u>
Net assets – end of year	<u>\$97,839,769</u>	<u>\$76,931,353</u>

Operating revenues totaled \$23.0 million, an increase of \$.9 million, or 4.0 percent, for fiscal year 2005. This is due primarily to a 4.8 percent increase in total tuition and fee revenues. This reflects tuition and fee rate increases of 5.3 percent for in-state cadets (52.3 percent of the Corps) and 5.6 percent for out-of-state cadets (47.7 percent of the Corps).

Operating expenses increased by \$2.5 million, or 5.1 percent, to \$51.4 million and consist of the following increases and decreases: Educational and General Program (increase of \$2.5 million, or 7.9 percent), Auxiliary Enterprises Program (increase of \$.3 million, or 2.4 percent), and the Unique Military Activities Program (decrease of \$.3 million, or 5.4 percent). The increases include a 3.0 percent salary increase for all employees effective in December 2004. The Educational and General Program also reflects an increase of \$.7 million in physical plant costs due primarily to heating and air conditioning maintenance and utilities costs. The decrease in Unique Military Activities Program expenses primarily reflects the return of cadet uniform costs to normal levels after some inventory adjustments in fiscal year 2004 that resulted in greater than normal uniform costs.

Non-operating revenues total \$27.0 million, an increase of \$.1 million, or .2 percent. This consists primarily of the net effect of a decrease in investment income of \$1.0 million offset by an increase in State appropriations of \$.9 million, and a \$.1 million decrease in the loss on disposal of plant assets over the previous year. The increase in state appropriations reflects the state's desire to turn around the trend of budget cuts to higher education experienced for the last several years. The decrease in investment income is a result of a slight decline in the stock market impacting the return on the endowment.

Other revenues total \$22.4 million, an increase of \$18.3 million, and is attributed primarily to state support of \$8.6 million for the Nichols Engineering Hall project compared to \$2.1 million during the 2004 fiscal year, \$5.3 million for Kilbourne Hall, \$2.0 million for emergency repairs to Barracks, \$1.9 million for the expansion of Barracks and \$.5 million for storm sewer drainage repairs. Additionally, VMI received \$1.0 million in private support for the acquisition of property along North Main Street and \$.5 million for improvements to the Patchin Field House and Alumni Stadium.

Statement of Cash Flows

This statement presents detailed information about the VMI's cash activity during the year. 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 Statement of Revenues, Expenses, and Changes in Net Assets.

Statement of Cash Flows

	<u>Year Ended June 30, 2005</u>	<u>Year Ended June 30, 2004</u>
Net cash used by operating activities	\$(26,340,114)	\$(22,954,504)
Net cash provided by non-capital financing activities	25,028,608	24,754,417
Net cash provided/(used) by capital and related financing activities	8,297,191	(1,587,971)
Net cash provided by investing activities	<u>1,154,041</u>	<u>1,179,307</u>
Net increase in cash	8,139,726	1,391,249
Cash – beginning of year	<u>10,606,888</u>	<u>9,215,639</u>
Cash – end of year	<u>\$18,746,614</u>	<u>\$10,606,888</u>

Net cash provided from non-capital financing activities consists largely of state and private fund support of operations.

The \$8.3 million of net cash provided by capital and related financing activities consists primarily of appropriations and proceeds from capital debt received for capital projects (Nichols Engineering Hall, Kilbourne Hall, expansion of Barracks, emergency repairs to Barracks, and improvements to Alumni Memorial and Patchin Fields), less amounts expended for these projects and their related debt obligations.

The \$1.2 million in net cash provided by investing activities primarily reflects spendable income from VMI's endowment assets that support various programs and activities.

Capital Asset and Debt Administration

Fiscal year 2005 was the third year of VMI's Vision 2039 capital projects program that is expected to be on-going for the remainder of this decade. During the year, planning and/or renovation and construction occurred on several academic facilities: Nichols Engineering Hall (\$17.8 million), Mallory Hall (\$9.1 million), Kilbourne Hall (\$16.5 million), Jackson Memorial Hall (\$2.5 million), Cocke Hall Annex (\$2.2 million), and a new Leadership and Ethics Center (\$15 million).

The Nichols Engineering Hall and the Mallory Hall projects were funded from the state's 2002 General Obligation (GOB) Bonds. The main Nichols Engineering Hall building was completed in August 2005 and returned to service; the annexes will be completed in 2006. The Mallory Hall renovation project is scheduled to begin construction in 2006 and be completed in 2007.

The Kilbourne Hall project consists of three components: the construction of a new Buildings and Grounds facility; the renovation and expansion of Kilbourne Hall and the renovation of the old Buildings and Grounds facility; and improvements to storm water lines along Main Street (this storm water project also includes additional funding of \$1.3 million from a separate storm water project). Construction on the new Buildings and Grounds facility began in September 2005 and construction on the storm water project is expected to begin in October 2005; both projects are scheduled to be completed in 2006. The Kilbourne Hall and old Buildings and Grounds facility renovation and expansion component is scheduled to begin construction in 2006 and be completed in 2007. Kilbourne Hall is funded by state funds.

The Jackson Memorial Hall project is expected to be completed in 2006 and the Cocke Hall Annex project was completed in October 2005. These two projects were financed under the Virginia College Building Authority (VCBA) "pooled bond" program in 2002, with debt service being funded from cadet fees and private funds.

Planning began in fiscal year 2005 for the Leadership and Ethics Center, which is scheduled to begin construction in 2006 with completion in 2007. This project is being financed by one of VMI's alumni agencies and from a private gift to VMI; VMI will not incur any debt on this project. The current appropriation for this project is \$13 million, but VMI plans to request an increase to \$15 million in October 2005.

VMI also has two major auxiliary enterprise projects: the renovation and expansion of Crozet Hall (\$12.1 million) and the renovation of the VMI football and baseball stadiums (\$18 million). Crozet Hall is VMI's sole dining facility (mess hall) and is scheduled to be fully completed in 2006. A major component of this project was a new kitchen which was completed and placed in service in October 2005. This project has been financed with state revenue bonds (9c debt) and debt service is being funded from VMI private funds. The stadiums project is scheduled to begin construction in October 2005 and be completed in 2006 (football) and 2007 (baseball). This project is being financed by one of VMI's alumni agencies; VMI will not incur any debt on this project.

Emergency repairs were completed to the VMI Barracks (\$4.1 million) as of October 2005. This project was funded totally from state funds. The 2005 General Assembly also appropriated an additional \$1.9 million of state funds to begin planning the renovation and expansion of the VMI Barracks. The total cost of this project is estimated to be \$40 million and will provide much needed repairs and replacements to this historic building and allow VMI to grow the Corps to 1,500 cadets beginning in fall 2010.

In summary, VMI has approximately \$100 million in capital projects in progress at the end of fiscal year 2005. These projects are being funded mostly from state and private sources. VMI has incurred debt on only the Jackson Memorial Hall, Cocke Hall Annex, and Crozet Hall projects. The debt on these projects totals approximately \$15.6 million and results in annual debt service payments of \$1.3 million. VMI's Board of Visitors adopted debt guidelines in August 2005 to help ensure sound management and control of debt.

Affiliates' Financial Statements

VMI's affiliates consist of the VMI Alumni Agencies (VMIAA) and the VMI Research Laboratories, Inc. (VMIRL). The VMIAA is comprised of four separate entities: the VMI Alumni Association, the VMI Foundation, Inc., the VMI Development Board, Inc., and the VMI Keydet Club, Inc. These entities share a common purpose of raising funds, investing funds, and performing other activities in support of VMI, and accordingly, present their financial statements on a combined basis. The VMIRL exists to administer grant and contract research, symposia, and other educational programs at VMI.

Total net assets of the VMIAA and the VMIRL amounted to \$304.2 million and \$.3 million, respectively, as of June 30, 2005 as compared to \$270 million and \$.2 million as of June 30, 2004. VMIAA net assets consist of \$63.7 million in unrestricted net assets and \$240.5 million in temporarily or permanently restricted net assets. VMIAA revenues totaled \$31.8 million for fiscal year 2005 and \$15.8 million for fiscal year 2004. This 100 percent increase in revenue is largely attributable to a successful fund raising year to include two large contributions, one bequest, and one gift, not previously reflected as a receivable. Amounts remitted directly to or on behalf of VMI for fiscal year 2005 were \$15.7 million compared to \$14.6 million for fiscal year 2004, a 7.5 percent increase.

Economic Outlook

State appropriations provided 24.3 percent of VMI's total operating and non-operating revenues in fiscal year 2005. This reflects a modest increase over the 23.3 percent in support provided in fiscal year 2004. State support is expected to remain at approximately this level in fiscal year 2006 or may drop slightly since increases in state support for fiscal year 2006 relate primarily to only state approved salary and fringe benefit increases. State support for operations beyond fiscal year 2006 is expected to continue to grow based on state approved salary and fringe benefit increases. VMI also expects to receive some additional state support for other costs as indicated in its Six-Year Institutional Plan submitted to the state on October 1, 2005 as required by the 2005 Restructured Higher Education Financial and Administrative Operations Act.

The 2005 General Assembly appropriated \$9.3 million in state funds for VMI capital projects consisting of an additional \$7.4 million for Kilbourne Hall and \$1.9 million for the planning of the Barracks expansion and renovation. VMI is asking the state for an additional \$62.5 million for capital projects during the 2006-2008 biennium (fiscal year 2007 and fiscal year 2008). This includes \$40 million for the Barracks expansion/renovation. VMI believes that a substantial portion of this funding will be approved.

Private fund support from VMI's alumni agencies represented approximately 26 percent of VMI's total operating revenues in fiscal year 2005, down slightly from 27 percent in fiscal year 2004. The alumni agencies have agreed to provide VMI with a constant level of unrestricted fund support during the period fiscal year 2005 to fiscal year 2010. This level funding will help to minimize any drop in the proportion of private support for VMI's programs and operations in the years ahead. Private fund support for capital projects totaled \$2.2 million in fiscal year 2005 and \$1.6 million in fiscal year 2004. VMI estimates approximately \$8 million to be received in fiscal year 2006 for construction costs on the Leadership and Ethics Center and the stadiums projects.

VMI increased fiscal year 2006 tuition and fees by 5.9 percent for in-state cadets and 5.7 percent for out-of-state cadets. VMI expects increases in the next few years to approximate this level or greater due to the likelihood of little new state funding and some decrease in the proportion of out-of-state cadets. VMI will continue its efforts to reduce costs and increase efficiencies to minimize the costs borne by cadets.

VMI enrolled a record 1,405 cadets in fall 2005 consisting of 54 percent in-state cadets. VMI estimates the fall enrollment to approximate 1,400 cadets for the next few years with 54 percent to 55 percent in-state cadets.

VMI's administration is committed to maintaining a strong financial position and will continue its efforts to reduce costs and increase revenues as appropriate to minimize any erosion of its net assets.

FINANCIAL STATEMENTS

VIRGINIA MILITARY INSTITUTE
STATEMENT OF NET ASSETS
As of June 30, 2005

ASSETS

Current assets:

Cash and cash equivalents (Note 2)	\$ 8,842,818
Collateral held for securities lending (Note 2)	1,446,929
Accounts receivable, net of allowance for doubtful accounts of \$95,787 (Note 3)	1,453,127
Due from the Commonwealth (Note 8)	70,573
Prepaid expenditures	617,969
Inventory (Note 4)	3,025,261
Loans receivable	640,320

Total current assets	<u>16,096,997</u>
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Non-current assets:

Cash and cash equivalents (Note 2)	9,903,796
Cash and investment with trustees (Note 2)	17,749,670
Investments held with the Treasurer of Virginia (Note 2)	8,269,259
Notes receivable	210,000
Loans receivable, net of allowance for doubtful accounts of \$28,009	752,091
Non-depreciable capital assets (Note 5)	28,437,934
Depreciable capital assets, net of accumulated depreciation (Note 5)	47,419,179

Total non-current assets	<u>112,741,929</u>
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Total assets	<u>128,838,926</u>
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LIABILITIES

Current liabilities:

Accounts payable and accrued expenses (Note 6)	7,242,071
Deferred revenue	605,199
Obligations under securities lending	1,446,929
Deposits held for others	538,781
Long-term liabilities-current portion: (Note 7)	
Compensated absences	730,996
Bonds payable (Note 8)	350,000
Notes payable (Note 8)	405,000
Capital lease payable (Note 8)	2,340
Installment purchase obligation (Note 8)	10,240

Total current liabilities	<u>11,331,556</u>
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Non-current liabilities:

Accrued liabilities	309,953
Federal loan program contributions refundable	1,233,038
Retainage payable (Note 9)	946,391
Long-term liabilities-noncurrent portion: (Note 7)	
Compensated absences	536,978
Bonds payable (Note 8)	11,507,112
Notes payable (Note 8)	5,109,946
Installment purchase obligation (Note 8)	24,183

Total non-current liabilities	<u>19,667,601</u>
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Total liabilities	<u>30,999,157</u>
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VIRGINIA MILITARY INSTITUTE
STATEMENT OF NET ASSETS
As of June 30, 2005

NET ASSETS	
Invested in capital assets, net of related debt	60,630,443
Restricted-non-expendable	
Endowment	4,516,682
Restricted-expendable	
Scholarships and other	2,284,433
Loan funds	537,194
Quasi-endowment-restricted	10,532,669
Capital projects	10,873,028
Unrestricted	<u>8,465,320</u>
Total net assets	<u>\$ 97,839,769</u>

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

VIRGINIA MILITARY INSTITUTE - COMPONENT UNITS
 COMBINED STATEMENT OF FINANCIAL POSITION
 As of June 30, 2005

ASSETS	
Current assets:	
Cash and cash equivalents	\$ 7,373,980
Contributions receivable (Note 16)	12,010,708
Accounts receivable	78,599
Other	<u>350,550</u>
Total current assets	<u>19,813,837</u>
Non-current assets:	
Contributions receivable (Note 16)	19,170,325
Notes receivable	23,249
Investments held by trustees (Note 16)	251,908,728
Investments, other (Note 16)	18,427,974
Funds restricted for affiliate	9,486,422
Investment securities	96,807
Cash surrender of life insurance	4,027,659
Property and equipment, net of accumulated depreciation	<u>444,224</u>
Total non-current assets	<u>303,585,388</u>
Total assets	<u>323,399,225</u>
LIABILITIES	
Current liabilities:	
Accounts payable and accrued expenses	1,345,948
Long-term liabilities-current portion:	
Bonds payable (Note 16)	232,000
Notes payable	30,000
Trust and annuity obligations	<u>863,842</u>
Total current liabilities	<u>2,471,790</u>
Non-current liabilities:	
Deferred revenue	12,260
Other liabilities	399,773
Long-term liabilities-non-current portion:	
Bonds payable (Note 16)	10,126,000
Trust and annuity obligations	<u>5,908,337</u>
Total non-current liabilities	<u>16,446,370</u>
Total liabilities	<u>18,918,160</u>
NET ASSETS	
Unrestricted	63,899,764
Temporarily restricted	147,345,441
Permanently restricted	<u>93,235,860</u>
Total net assets	<u>304,481,065</u>
Total liabilities and net assets	<u>\$ 304,481,065</u>

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

VIRGINIA MILITARY INSTITUTE
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2005

Operating revenues:	
Tuition and fees, net of scholarship allowances of \$3,613,629	\$ 10,659,410
Federal grants and contracts	631,147
State and private grants and contracts	123,683
Sales and services of educational departments	48,795
Auxiliary enterprises, net of scholarship allowances of \$2,878,887	9,171,146
Unique military activities, net of scholarship allowances of \$412,947	1,441,323
Other sources:	
Museum programs	419,713
Rents and commissions	212,206
Miscellaneous	278,175
Total operating revenues	<u>22,985,598</u>
Operating expenses:	
Educational and general	
Instruction	14,376,327
Research	489,994
Public service	971,309
Academic support	4,904,689
Student services	3,138,579
Institutional support	4,320,772
Operation and maintenance of physical plant	4,767,292
Scholarships and related expense	671,330
Auxiliary enterprises	13,110,167
Unique military activities	4,683,463
Total operating expenses (Note 10)	<u>51,433,922</u>
Net operating loss	<u>(28,448,324)</u>
Non-operating revenues/(expenses):	
State appropriations (Note 11)	12,316,526
Private gifts and contributions	13,389,131
Investment income	1,907,676
Interest on capital asset - related debt	(305,055)
Loss on disposal of plant assets	(310,931)
Net non-operating revenues	<u>26,997,347</u>
Income/(loss) before other revenues	<u>(1,450,977)</u>
Other revenues:	
State appropriations-capital	19,873,414
Grants and gifts-capital	2,223,553
Investment income-capital	262,426
Total other revenues	<u>22,359,393</u>
Increase in net assets	20,908,416
Net assets - beginning of the year	<u>76,931,353</u>
Net assets - end of year	<u>\$ 97,839,769</u>

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

VIRGINIA MILITARY INSTITUTE - COMPONENT UNITS
 COMBINED STATEMENT OF ACTIVITIES
 For the Year Ended June 30, 2005

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues:				
Amounts raised on behalf of VMI	\$ 5,727,226	\$ 17,939,020	\$ 4,538,578	\$ 28,204,824
Grants, contributions and contracts	259,774	74,720	-	334,494
Investment income	436,536	1,248,662	-	1,685,198
Actuarial loss on trust and annuity obligations	(127,600)	(235,586)	18,855	(344,331)
Administrative fees	2,220,665	-	-	2,220,665
Other income	293,555	-	-	293,555
Net assets released from restrictions and reclassifications	5,727,138	(9,378,023)	3,650,885	-
Total revenues	14,537,294	9,648,793	8,208,318	32,394,405
Expenses:				
Amounts remitted directly to or on behalf of VMI:				
Unrestricted	8,112,302	-	-	8,112,302
Designated	7,577,418	-	-	7,577,418
Cost of operations	4,738,168	-	-	4,738,168
Conference, research and education	559,107	-	-	559,107
Total expenses	20,986,995	-	-	20,986,995
Change in net assets before net realized and unrealized losses on investments	(6,449,701)	9,648,793	8,208,318	11,407,410
Net realized and unrealized losses on investments	6,069,801	16,344,902	-	22,414,703
Change in net assets	(379,900)	25,993,695	8,208,318	33,822,113
Net assets - beginning of year	64,279,664	121,351,746	85,027,542	270,658,952
Net assets - end of year	\$63,899,764	\$ 147,345,441	\$93,235,860	\$ 304,481,065

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

VIRGINIA MILITARY INSTITUTE
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2005

Cash provided/(used) by operating activities:	
Tuition and fees	\$ 10,320,258
Federal grants and contracts	631,147
State and private grants and contracts	123,683
Sales and services - educational and general	55,329
Auxiliary charges	9,038,307
Unique military activity charges	1,443,772
Other operating receipts	856,945
Payments to employees for salaries and benefits	(28,991,288)
Payments for supplies and services	(19,031,774)
Payments for scholarships and fellowships	(767,700)
Loans issued to students	(265,888)
Collections of loans from students	247,095
Net cash used by operating activities	(26,340,114)
Cash provided/(used) by non-capital financing activities:	
State appropriations	12,316,526
Gifts and grants for other than capital purposes	12,715,454
Federal Direct Lending Program - receipts	3,546,283
Federal Direct Lending Program - disbursements	(3,546,283)
Agency receipts	3,983,137
Agency disbursements	(3,986,509)
Net cash provided by noncapital financing activities	25,028,608
Cash provided/(used) by capital and related financing activities:	
Capital appropriations	19,873,413
Capital gifts	2,223,553
Proceeds from sale of capital assets	5,360
Proceeds from capital debt	7,163,908
Purchase and construction of capital assets	(20,306,238)
Principal paid on capital debt, leases and installments	(371,762)
Interest paid on capital debt, leases and installments	(305,599)
Investment income - capital	14,556
Net cash provided by capital and relating financing activities	8,297,191
Cash provided/(used) by investing activities:	
Interest on investments	162,670
Investment/endowment income	292,235
Sale of investments	721,636
Purchase of investments	(22,500)
Net cash provided by investing activities	1,154,041
Net increase in cash	8,139,726
Cash - beginning of year	10,606,888
Cash - end of year	\$ 18,746,614

RECONCILIATION OF NET OPERATING EXPENSES TO NET CASH

USED BY OPERATING ACTIVITIES:

Net operating expenses \$ (28,448,324)

Adjustments to reconcile net operating expenses to cash used by operating activities:

Depreciation expense 2,961,317

Changes in net assets and liabilities:

Accounts receivable 67,390

Inventories (395,358)

Prepaid expenditures 24,019

Due from Commonwealth (6,486)

Accounts payable and accrued liabilities 21,760

Deposits held in custody for others-security deposits (35,499)

Deferred revenue (545,601)

Loans receivable (26,510)

Compensated absences 35,461

Federal loan program contributions refundable 7,717

Net cash used in operating activities \$ (26,340,114)

Non-cash investing, noncapital financing, and capital related financing transactions:

Fixed asset acquired by incurring capital lease obligation \$ 22,855

Change in fair value of investments recognized as a component of investment income/(loss)

\$ 163,725

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

Cash and cash equivalents classified as current assets 8,842,818

Cash and cash equivalents classified as non-current assets 9,903,796

\$ 18,746,614

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

NOTES TO FINANCIAL STATEMENTS

VIRGINIA MILITARY INSTITUTE

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of VMI have been prepared in accordance with generally accepted accounting principles for colleges and universities. The significant accounting policies followed by VMI are as follows:

A. Reporting Entity

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

GASB Statement Number 39, *Determining Whether Certain Organizations Are Component Units*, issued May 2002, became effective for the fiscal year ended June 30, 2004. This statement amended GASB Statement Number 14, *The Financial Reporting Entity*. GASB Statement Number 39 provides guidance to determine whether certain organizations for which VMI 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 VMI.

The VMI Alumni Agencies is a legally separate, tax-exempt entity whose purpose is to organize the alumni of VMI 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 the support VMI receives from the Commonwealth and the tuition and fees charged to cadets. Because the VMI Alumni Agencies' resources are held almost entirely for the benefit of VMI and these resources are considered significant to VMI, the Alumni Agencies should be included as a component unit.

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

Because the VMI Alumni Agencies report under a different reporting model, the FASB standards, the VMI Board of Visitors, and the administration of VMI believe, VMI's financial statements should be presented on a page separate from VMI's component units as allowed by GASB Statement Number 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. Financial Statement Presentation

VMI's accounting policies conform to generally accepted accounting principles as prescribed by the GASB pronouncements as well as applicable FASB statements and interpretations, Accounting Principles Board opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The financial statements have been prepared in accordance with GASB Statement Number 34, *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments*, and GASB Statement Number 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 in VMI's financial report for these differences.

C. Basis of Accounting

For financial statement purposes, VMI is considered a special-purpose government engaged only in business-type activities. Accordingly, VMI'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. Investments

In accordance with GASB Statement Number 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 non-operating revenue in the Statement of Revenues, Expenses, and Changes in Net Assets.

E. Capital Assets

Capital assets include land, buildings and other improvements, library materials, equipment and infrastructure assets such as sidewalks, steam tunnels, and electrical and computer network cabling systems. Capital assets are generally defined by VMI as assets with an initial cost of \$5,000 or more and an estimated useful life in excess of two years. Buildings and equipment are stated at appraised value or actual cost where determinable. Land is stated at cost. Library materials are valued using published average prices for library acquisitions. Expenses for major capital assets and improvements are capitalized (construction-in-progress) as projects are constructed. Operating expenditures of \$10,000 or greater for renewals and replacement are capitalized only to the extent that such expenditures represent long-term improvement to properties. 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 not capitalized.

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

Buildings	50 years
Other improvements	10-30 years
Equipment	5-25 years
Library materials	10 years

F. Inventories

Inventories are valued at cost using the first-in, first-out method.

G. Deferred Revenue

Deferred revenue represents revenues collected but not earned as of June 30, 2005. This is primarily composed of revenue for student tuition and fees received in advance of the next semester or term.

H. Accrued Compensated Absences

Non-faculty salaried employee's attendance and leave regulations make provisions for the granting of a specified number of days of leave with pay each year. Instructional personnel do not earn leave. The amount of leave earned but not taken as of June 30, 2005 is recorded as a liability on the Statement of Net Assets. The liability reflects all earned vacation, compensatory and overtime leave not taken as well as the amount payable under the Commonwealth's sick leave payout policy upon termination, which is the lesser of 25 percent of sick leave not taken, or \$5,000 per employee with five or more years of service. Also included is an estimation of sick leave for those employees who, while not currently vested, will probably attain the five years of service required to vest. The last element reflected in the liability is Social Security and Medicaid taxes to be paid by VMI on all accrued compensated absences.

I. Federal Financial Assistance Programs

VMI 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.

J. Net Assets

GASB Statement Number 34 requires that the Statement of Net Assets report the difference between assets and liabilities as net assets, not fund balances.

VMI's net assets are classified as follows:

- *Invested in capital assets, net of related debt:* This represents VMI's total investment in capital assets, net of 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 assets – non-expendable:* Non-expendable restricted net assets consist 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 assets – expendable:* Restricted expendable net assets include resources in which VMI is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.
- *Unrestricted net assets:* Unrestricted net assets represent 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 VMI, 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 students, faculty and staff. Also included in unrestricted net assets 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.

VMI 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. Current practice is to allow department heads to make this determination and they typically spend unrestricted assets prior to spending restricted resources.

K. Classification of Revenues

VMI has classified its revenues as either operating or non-operating 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.
- *Non-operating revenues:* Non-operating revenues include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, and other revenue sources that are defined as non-operating revenues by GASB Statement Number 9 *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, GASB Statement Number 33 *Accounting and Financial Reporting for Nonexchange Transactions*, and GASB Statement Number 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 statements of revenues, expenses, and changes in net assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by VMI, 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 non-governmental programs, are recorded as either operating or non-operating revenues in VMI's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees, VMI has recorded a scholarship discount and allowance.

2. CASH AND CASH EQUIVALENTS AND INVESTMENTS

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

Cash and cash equivalents consist of the following balances as of June 30, 2005:

Cash with Treasurer of Virginia	\$15,561,551
Money market funds*	3,146,393
State Non-Arbitrage Program (SNAP)**	8,269,259
Securities under securities lending	1,193,349
Petty cash	10,670
Time deposits	<u>28,000</u>
Total cash and cash equivalents	<u>\$28,209,222</u>

*The U.S. Government Securities Money Market Fund invests in U.S. Treasury obligations issued or guaranteed as to principal and interest by agencies or instrumentalities of the U.S. Government. There are no significant holdings of government agencies without the backing of the U.S. Government. The Business Money Market Account is maintained by SunTrust for investment purchases and loans and earns money market rates. The account is rated P-1 by Moody's.

** Rated as 'AAAm' by Standard and Poor

B. 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 June 30, 2005:

Investments with the Treasurer of Virginia:	
Securities under Securities Lending	<u>\$ 253,580</u>
Investments with Trustees:	
Investments pooled with VMI Affiliates	17,499,717
Mutual fund investments (retirement accounts)	<u>249,953</u>
Total with Trustees	<u>17,749,670</u>
Total investments	<u>\$18,003,250</u>

VMI's endowment, loan, and similar funds are pooled for investment purposes with the endowment funds of its four alumni agencies (the VMI Foundation, Inc., the VMI Development Board, Inc., the VMI Keydet Club, and the VMI Alumni Association) and the George C. Marshall Foundation. VMI owns units in the pooled fund that operates similar to a mutual fund. The Board of Trustees of the VMI Foundation, Inc. is responsible for the management of these endowment funds (the Fund) and has appointed an Investment Committee to supervise the Fund's assets. The Committee includes representation from the VMI Board of Visitors and is responsible for setting and implementing the investment policies and guidelines adopted by the Committee. Authorized investments are set forth in the Uniform Management of Institutional Funds Act, Section 55-268 et seq. of the Code of Virginia and include cash equivalents, preferred and common stocks, bonds, and real estate.

The market value of the Fund as of June 30, 2005 was \$277.0 million, of which, VMI owned \$17.5 million, or 6.32 percent of the Fund assets. The Fund held \$38.0 million in debt securities with an average maturity of 6.87 years. The average quality rating was AAA (Moody's). Bonds must be rated above investment grade by two of the following rating agencies: Moody's, Fitch Rating, and Standard and Poors at the time of purchase and cannot be more than 20 percent of the total assets invested in bonds (at market). No stock may be in excess of five percent of the equity portfolio at cost or ten percent at market. No more than 25 percent of the equity portfolio at market value may be invested in any one general industry as defined by the S&P 500 industry classifications. No more than three percent of the outstanding shares of any company may be owned in the equity portfolio. The Fund held \$56.5 million in international equities denominated primarily in the Euro, the Pound, and the Yen. The custodians for the Fund are independently audited annually.

C. Securities Lending Transactions

Collateral held for securities lending and the securities lending transactions reported on the financial statements represent VMI'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's Comprehensive Annual Financial Report (CAFR).

D. Funds Held In Trust By Others

Assets of funds held by trustees for the benefit of VMI are not reflected in the accompanying Statement of Net Assets. VMI has irrevocable rights to all or a portion of the income of these funds. However, assets of the funds are not under the management discretion of VMI according to the trust agreements. Income from funds held by trustees for the benefit of VMI totaled \$79,923 for the year ended June 30, 2005, and is included in the endowment income.

3. ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following at June 30, 2005:

Student tuition and fees	\$ 212,224
Other educational and general	25,657
Auxiliary enterprises	7,141
Unique military activities	6,756
Private gifts	717,887
Agency funds	257,860
Other operating	268,369
Retirement of indebtedness	<u>53,020</u>
Total	1,548,914
Less: Allowance for doubtful accounts	<u>(95,787)</u>
Net accounts receivable	<u>\$1,453,127</u>

4. INVENTORIES

Inventories consisted of the following at June 30, 2005:

Physical plant	\$ 408,960
Military store	2,489,197
Museums	108,756
VMI hospital	<u>18,348</u>
Total	<u>\$3,025,261</u>

5. CAPITAL ASSETS

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

	Beginning Balance July 1, 2004	Additions	Reductions	Ending Balance June 30, 2005
Nondepreciable capital assets:				
Land	\$ 1,667,896	\$ 251,734	\$ -	\$ 1,919,630
Construction-in-progress	<u>6,392,321</u>	<u>21,525,528</u>	<u>(1,399,545)</u>	<u>26,518,304</u>
Total nondepreciable capital assets	<u>8,060,217</u>	<u>21,777,262</u>	<u>(1,399,545)</u>	<u>28,437,934</u>
Depreciable capital assets:				
Buildings	86,623,115	2,216,287	-	88,839,402
Land improvements	2,950,413	67,075	-	3,017,488
Equipment	9,454,538	1,288,328	(1,107,588)	9,635,278
Library books	<u>9,738,463</u>	<u>241,598</u>	<u>(12,682)</u>	<u>9,967,379</u>
Total depreciable capital assets	<u>108,766,529</u>	<u>3,813,288</u>	<u>(1,120,270)</u>	<u>111,459,547</u>
Less accumulated depreciation for:				
Buildings	46,409,165	1,848,115	-	48,257,280
Land improvements	1,413,990	147,214	-	1,561,204
Equipment	5,533,494	703,311	(626,255)	5,610,550
Library books	<u>8,380,721</u>	<u>243,295</u>	<u>(12,682)</u>	<u>8,611,334</u>
Total accumulated depreciation	<u>61,737,370</u>	<u>2,941,935</u>	<u>(638,937)</u>	<u>64,040,368</u>
Depreciable capital assets	<u>47,029,159</u>	<u>871,353</u>	<u>(481,333)</u>	<u>47,419,179</u>
Total capital assets, net	<u>\$ 55,089,376</u>	<u>\$22,648,615</u>	<u>\$(1,880,878)</u>	<u>\$ 75,857,113</u>

6. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following at June 30, 2005:

Employee salaries, wages and benefits payable	\$2,695,008
Vendors and supplies accounts payable	4,384,445
Accrued interest payable	132,091
Other accrued liabilities	<u>30,527</u>
Total accounts payable and accrued liabilities	<u>\$7,242,071</u>

7. NON-CURRENT LIABILITIES

VMI's long-term liabilities primarily consist of long-term debt (further described in Note 8) and accrued compensated absences. A summary of changes in long-term liabilities for the year ending June 30, 2005 is presented as follows:

	Beginning Balance July 1, 2004	Additions	Reductions	Ending Balance June 30, 2005	Current Portion
Long-term debt:					
Bonds payable	\$ -	\$11,889,591	\$ (32,480)	\$11,857,112	\$ 350,000
Notes payable	5,912,590	-	(397,644)	5,514,946	405,000
Capital leases	8,200	-	(5,860)	2,340	2,340
Installment purchases	<u>15,325</u>	<u>30,781</u>	<u>(11,683)</u>	<u>34,423</u>	<u>10,240</u>
Total long-term debt	5,936,115	11,920,372	(447,667)	17,408,821	767,580
Accrued compensated absences	<u>1,232,515</u>	<u>882,919</u>	<u>(847,459)</u>	<u>1,267,974</u>	<u>730,996</u>
Total long-term liabilities	<u>\$7,168,630</u>	<u>\$12,803,291</u>	<u>\$(1,295,126)</u>	<u>\$18,676,795</u>	<u>\$1,498,576</u>

8. LONG-TERM INDEBTEDNESS

A. 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, on behalf of VMI for renovation and expansion of Crozet Hall, VMI dining facility, and parking. The bonds bear interest at an average coupon rate of 4.8 percent and are payable over 20 years through June 2025. Net proceeds after the cost of issuance total \$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.

	Interest Rates (%)	Maturity	Balance June 30, 2005
Bonds Payable:			
Crozet Hall, Series 2004A	4.63 – 5.00	2025	\$11,857,112

B. Notes payable:

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

	Interest Rates <u>(%)</u>	<u>Maturity</u>	Balance <u>June 30, 2005</u>
Notes payable:			
Barracks Wiring, Series 1998A	3.70 – 4.10	2008	\$1,080,000
Cocke Hall Annex, Series 2002A	4.00 – 5.25	2022	2,059,890
JM Hall Renovation, Series 2002A	4.00 – 5.25	2022	<u>2,375,056</u>
Total notes payable			<u>\$5,514,946</u>

Maturities on notes and bonds payable for years succeeding June 30, 2005 are as follows:

<u>Year Ending June 30,</u>	<u>Bonds Payable</u>	<u>Notes Payable</u>	<u>Total</u>
2006	\$ 350,000	\$ 405,000	\$ 755,000
2007	360,000	425,000	785,000
2008	380,000	440,000	820,000
2009	400,000	460,000	860,000
2010	415,000	180,000	595,000
2011-2015	2,395,000	1,050,000	3,445,000
2016-2020	3,055,000	1,355,000	4,410,000
2021-2025	3,885,000	985,000	4,870,000
Plus: Unamortized premium	<u>617,112</u>	<u>214,946</u>	<u>832,058</u>
Total future principal requirements	<u>\$11,857,112</u>	<u>\$5,514,946</u>	<u>\$17,372,058</u>

C. Installment Purchase Obligations

VMI has future obligations under installment purchase agreements. The book value of the assets capitalized under these installment purchase agreements is \$81,860 with no interest. A summary of future obligations under these agreements as of June 30, 2005 follows:

<u>Year Ending June 30,</u>	<u>Principal</u>
2006	\$10,240
2007	6,596
2008	6,595
2009	6,595
2010	<u>4,397</u>
Total	<u>\$34,423</u>

D. Capital Leases Payable

VMI is the lessee of equipment under capital leases expiring in fiscal year 2006. The assets under capital leases are recorded as property, plant and equipment at the lower of the net present value of the minimum lease payments during the lease term or the fair market value of the asset.

VMI received allocations made by the VCBA from the Higher Education Equipment Trust Fund for the purpose of acquiring equipment under leasing agreements with the Authority.

For all capital leases, the minimum lease payments together with the present value of the net minimum lease payments as of June 30, 2005 are as follows. All amounts are due in the year ending June 30, 2006.

Total Minimum Lease Payments	\$3,280
Less: Executory Costs	(880)
Interest	<u>(60)</u>
Present value of net minimum lease payments	<u>\$2,340</u>

Interest rates on capitalized leases vary from 5.5 percent to 6.75 percent.

E. Equipment Trust Fund

The Equipment Trust Fund (ETF) program was established to provide state-supported institutions of higher education bond proceeds for financing the acquisition and replacement of instructional and research equipment. The VCBA manages the program. The VCBA issues bonds and uses the proceeds to reimburse VMI and other institutions of higher education for equipment purchased. For fiscal years prior to 1999, the VCBA purchased the equipment and leased it to VMI. For fiscal years 1999 and following, financing agreements for ETF were changed so that VMI owns the equipment from the date of purchase.

The Statement of Net Assets line "Due from the Commonwealth" totaling \$70,573 represents equipment purchased by VMI that was not reimbursed by the VCBA as of June 30, 2005.

F. Operating Leases

VMI is committed under various operating leases for equipment. Operating leases do not give rise to property rights or lease obligations, and therefore the results of the lease agreements are not reflected in VMI's Statement of Net Assets. In general, the leases are for a three-year term and VMI has renewal options. In most cases, VMI expects these leases will be replaced by similar leases in the normal course of business. Rental expense was approximately \$86,583 for the year ended June 30, 2005.

Year Ending <u>June 30,</u>	<u>Amount</u>
2006	\$ 68,352
2007	50,325
2008	<u>20,740</u>
Total	<u>\$139,417</u>

9. RETAINAGE PAYABLE

At June 30, 2005, \$946,391 was held by VMI as retainage on various contracts for work, which had been performed. The retainage will be remitted to the various contractors upon satisfactory completion of the projects.

10. EXPENSES BY NATURAL CLASSIFICATIONS

VMI's operating expenses by natural classification were as follows:

Year Ended June 30, 2005

Program	Personal Services	Supplies	Contractual Services	Equipment	Utilities	Student Aid	Other Operating Expenses	Depreciation Expense	Total
Instruction	\$12,257,829	\$ 170,887	\$ 454,484	\$ 560,961	\$ -	\$ -	\$ 40,958	\$ 891,208	\$14,376,327
Research	242,668	26,014	135,573	35,622	-	-	12,590	37,527	489,994
Public service	560,614	120,453	225,949	5,190	-	-	10,339	48,764	971,309
Academic support	3,036,244	81,594	838,392	264,766	-	-	85,225	598,468	4,904,689
Student services	1,796,168	89,938	898,970	58,885	-	-	78,236	216,382	3,138,579
Institutional support	2,577,884	291,371	993,812	142,269	4,141	-	221,541	89,754	4,320,772
Operation and maintenance of plant	2,100,309	823,661	560,982	198,722	707,570	-	133,127	242,921	4,767,292
Student aid	2,384	1,507	29,739	-	-	637,700	-	-	671,330
Auxiliary enterprises	3,828,880	380,489	5,055,273	235,254	206,583	130,000	2,601,582	672,106	13,110,167
Unique military activities	<u>2,872,998</u>	<u>1,086,571</u>	<u>100,626</u>	<u>17,566</u>	<u>-</u>	<u>-</u>	<u>441,515</u>	<u>164,187</u>	<u>4,683,463</u>
Total	<u>\$29,275,978</u>	<u>\$3,072,485</u>	<u>\$9,293,800</u>	<u>\$1,519,235</u>	<u>\$918,294</u>	<u>\$767,700</u>	<u>\$3,625,113</u>	<u>\$2,961,317</u>	<u>\$51,433,922</u>

11. STATE APPROPRIATIONS

VMI receives state appropriations from the General Fund of the Commonwealth. 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 2006 ends the biennium.

During the fiscal year ended June 30, 2005, VMI received the following supplemental appropriations and reversions in accordance with the Appropriation Act:

Original legislative appropriation:	
Educational and general programs	\$ 8,957,303
Unique military activity	3,794,037
Student financial assistance	598,494
Adjustments:	
Salary adjustments	28,862
Fringe benefit adjustments	(6,165)
ETF lease payment – NGF portion	(22,690)
Information technology savings	(36,135)
Appropriation transfers:	
Authorized fiscal year 2004 transfer, educational and general programs	150,000
SCHEV programs	25,644
Virginia Polytechnic Institute and University	<u>(1,172,824)</u>
Adjusted appropriations	<u>\$12,316,526</u>

12. RETIREMENT AND PENSION SYSTEMS

Employees of VMI are employees of the Commonwealth. Most full-time classified salaried employees of VMI participate in the defined benefit retirement plan administered by the Virginia Retirement System (VRS). VMI Post Police officers participate in the Virginia Law Officers Retirement System, (VaLORS), instead of VRS. Both VRS and VaLORS are agent multiple-employer public employee retirement systems (PERS) that acts as a common investment and administrative agency for the Commonwealth and its political subdivisions.

VMI's payroll costs for employees covered by VRS totaled \$12,205,156 for the year ended June 30, 2005. VMI's total payroll costs were \$24,004,820 for the year ended June 30, 2005.

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 CAFR.

VMI's total VRS contribution was \$1,285,327 for the year ended June 30, 2005, which included the five percent employee contribution assumed by the employer. These contributions represent 10.56 percent of covered payrolls for 2005.

VMI's payroll costs for employees covered by VaLORS were \$197,598 for the year ended June 30, 2005. VMI's total VaLORS contribution was \$46,443 for the year ended June 30, 2005, which represents 23.64 percent of the covered payroll for the 2005 fiscal year.

The 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 June 30, 2005. The same report contains historical trend information showing VRS's progress in accumulating sufficient assets to pay benefits when due.

A. TIAA/CREF Insurance Company

Some full-time faculty and contracted administrative staff participate in a retirement annuity program through TIAA/CREF Insurance Companies rather than the VRS. This is a fixed-contribution program where the retirement benefits received are based entirely upon the employer's (10.4 percent) contributions, plus interest and dividends, with the employer assuming the employee's contribution share.

Individual contracts issued under the plan provide for full and immediate vesting of both VMI's and the employees' contributions. Total pension costs under this plan were approximately \$677,513 for year ended June 30, 2005. Contributions to the TIAA/CREF insurance companies were calculated using the base salary amount of approximately \$6,514,555 for fiscal year 2005.

B. Fidelity Investments

VMI also contributed to one other defined contribution pension plan, which is insignificant in relation to VRS and TIAA/CREF. Full-time faculty, certain administrative staff who hold academic rank, and athletic coaches are eligible to participate in this program (ORP) other than VRS and TIAA/CREF. Retirement benefits received are based entirely upon the employer's (10.4 percent) contributions, plus interest and dividends, with the employer assuming the employee's contribution share.

Amounts contributed to Fidelity Investments were calculated using the base salary amount of approximately \$1,041,561 for fiscal year ended June 30, 2005. Total pension costs under this plan was approximately \$108,323 for fiscal year 2005.

13. POST-EMPLOYMENT BENEFITS

The Commonwealth participates in the VRS administered statewide group life insurance program, which provides post-employment 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 CAFR.

14. RISK MANAGEMENT

VMI is exposed to various risks of loss related to torts, theft or, damage to, and destruction of assets, errors and omissions, on-performance of duty, injuries to employees, and natural disasters. VMI participates in insurance plans maintained by the Commonwealth. 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. VMI 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 CAFR.

15. CONTINGENCIES

VMI has received federal grants for specific purposes that are subject to review and audit by the grantor agencies. Claims against these resources are generally 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 VMI.

In addition, VMI 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 allowability of related direct and indirect charges pursuant to such agreements. As of June 30, 2005 VMI estimates that no material liabilities will result from such audits or questions.

In October 2003, VMI entered into a contract modification with Aramark Educational Services, VMI's contracted dining services vendor. Under this agreement, Aramark provided \$1,200,000 to VMI to support the expansion and renovation of the Crozet Hall dining facility. The agreement requires Aramark to amortize this cost on a straight-line basis over a ten-year period. In the event that VMI or Aramark terminates the contract, VMI must re-pay any unamortized balance to Aramark within 90 days of the termination.

16. 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, 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.

A. Contributions Receivable

Contributions receivable consist of the following at June 30, 2005:

Unconditional promises to give	\$30,775,700
Charitable trust held by others	<u>257,268</u>
	31,032,968
Less:	
Current portion	<u>(11,862,643)</u>
Total	<u>\$19,170,325</u>
Gross amounts expected to be collected in:	
Less than one year	\$13,180,714
One to five years	23,453,829
More than five years	<u>10,709,361</u>
Total	47,343,904
Less:	
Discount to net present value at three percent - six percent	(11,576,546)
Allowance for uncollectible contributions	<u>(4,734,390)</u>
Total	<u>\$31,032,968</u>

The ownership of contributions receivable for each class of net assets as of June 30, 2005, is as follows:

Temporarily restricted	\$28,712,610
Permanently restricted	<u>2,320,358</u>
Total	<u>\$31,032,968</u>

At June 30, 2005, the Agencies had also received bequest and other intentions of approximately \$80.1 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 the year ended June 30, 2005, approximately 54 percent of the contributions receivable balance was from two donors.

B. 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. Mellon Trust of Boston, N.A. serves as custodian for the Fund's assets. The Fund's investments consist of the following:

Equities	\$211,863,649	83.9%
Fixed income bond	31,017,276	12.3%
Cash and cash equivalents	<u>9,612,957</u>	<u>3.8%</u>
Total	252,493,882	<u>100.0%</u>
Less: Amount payable for securities purchased, net	<u>(585,154)</u>	
Total	<u>\$251,908,728</u>	

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 is reflected in the table below:

Investments, beginning	<u>\$230,658,558</u>
Investment returns:	
Dividends and interest	4,250,726
Net realized and unrealized gains	20,544,993
Less investment fees	<u>(1,442,216)</u>
Total	<u>23,353,503</u>
Amounts appropriated for operations, net transfers to operational accounts and other activity	(10,718,809)
Cash receipts used to fund amounts available to spend in accordance with the Board approved spending policy and other activity	<u>8,615,476</u>
Investments, ending	<u>\$251,908,728</u>

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 June 30, 2005, the Board-approved spending formula for the endowment provided for an annual spending rate of not more than 5.2 percent of the average of the prior twelve quarters' December 31 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.

C. Investments, Other

Investments, other, consist of the following:

	Held by <u>Agent</u>	Held by <u>Foundation</u>	Held in Irrevocable <u>Trusts*</u>	Total at Fair <u>Value**</u>
Equities	\$1,939,535	\$ 19	\$ 7,628,841	\$ 9,568,395
Fixed income	959,562	5,891	4,332,925	5,298,378
Real estate	-	1,423,667	-	1,423,667
Cash and cash equivalents	290,757	783	1,823,423	2,114,963
Limited partnerships	<u>5,443</u>	<u>17,128</u>	<u>-</u>	<u>22,571</u>
Total	<u>\$3,195,297</u>	<u>\$1,447,488</u>	<u>\$13,785,189</u>	<u>\$18,427,974</u>

*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.

D. Bonds Payable

Bonds payable consists of the following:

Industrial Development Authority bonds payable in varying installments from \$265,000 to \$570,000, commencing 2011 through 2035. Interest is at a variable rate ranging from 1.47 percent to 3.02 percent during the year ending June 30, 2005. Secured by a \$10,113,334 letter of credit.	\$10,000,000
Variable rate Master Revenue Bond, payable \$232,000 in 2006, and \$126,000 in 2007. The bond bears interest at the Tax Exempt Note Rate ("TENR") plus 0.6 percent (TENR as of June 30, 2005 was 3.0 percent), capped at 6.75 percent. Unsecured.	<u>358,000</u>
Total bonds payable	10,358,000
Less current maturities	<u>(232,000)</u>
Total non-current maturities	<u>\$10,126,000</u>

Debt matures as follows:

Year ending <u>June 30,</u>	
2006	\$ 232,000
2007	126,000
2008	-
2009	-
2010	-
2011 and later years	<u>10,000,000</u>
Total	<u>\$10,358,000</u>

The variable rate Master Revenue Bond is not collateralized; however, the Agencies are under covenant not to create or allow, without the prior consent of the bond agent, any lien, or encumbrance upon the Agencies' assets in an aggregate amount, based on market value, of 110 percent of the then-outstanding principal amount of the bond.

17. COMPONENT UNITS

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

Condensed Statements of Financial Condition As of June 30, 2005	VMI Research Laboratories, Inc.	VMI Alumni Agencies	Total
Assets:			
Current assets	\$423,195	\$ 19,390,642	\$ 19,813,837
Noncurrent assets	<u>96,807</u>	<u>303,488,581</u>	<u>303,585,388</u>
Total assets	<u>520,002</u>	<u>322,879,223</u>	<u>323,399,225</u>
Liabilities:			
Current liabilities	240,729	2,231,061	2,471,790
Noncurrent liabilities	<u>12,260</u>	<u>16,434,110</u>	<u>16,446,370</u>
Total liabilities	<u>252,989</u>	<u>18,665,171</u>	<u>18,918,160</u>
Net Assets:			
Unrestricted	197,673	63,702,091	63,899,764
Temporarily restricted	59,340	147,286,101	147,345,441
Permanently restricted	<u>10,000</u>	<u>93,225,860</u>	<u>93,235,860</u>
Total net assets	<u>\$267,013</u>	<u>\$304,214,052</u>	<u>\$304,481,065</u>
Condensed Statements of Activities For the year ended June 30, 2005	VMI Research Laboratories, Inc.	VMI Alumni Agencies	Total
Total revenues	\$635,632	\$ 31,758,773	\$ 32,394,405
Total expenses	(604,039)	(20,382,956)	(20,986,995)
Total net realized and unrealized gains on investments	<u>-</u>	<u>22,414,703</u>	<u>22,414,703</u>
Total change in net assets	31,593	33,790,520	33,822,113
Total beginning net assets	<u>235,420</u>	<u>270,423,532</u>	<u>270,658,952</u>
Total ending net assets	<u>\$267,013</u>	<u>\$304,214,052</u>	<u>\$304,481,065</u>

SUPPLEMENTARY INFORMATION

VIRGINIA MILITARY INSTITUTE
STATEMENT OF OPERATIONS - AUXILIARY ENTERPRISES
For the Year Ended June 30, 2005

	Food Services	Residential Facilities	Laundry	Student Health
Operating revenues:				
Cadet fees	\$ 3,761,106	\$ 1,681,898	\$ 234,187	\$ 157,178
Sales and services	40,728	274,074	-	-
Total operating revenues per SRECNA	3,801,834	1,955,972	234,187	157,178
Federal funds-Work study	-	-	-	577
Add back items netted on SRECNA:				
Scholarship allowances for auxiliary fees	1,318,253	589,727	84,937	57,315
Auxiliary sales to other Institute departments	-	22,803	4,126	-
Total operating revenues	5,120,087	2,568,502	323,250	215,070
Operating expenditures:				
Personal services	-	338,279	167,700	141,384
Supplies and materials	12,384	153,351	18,123	-
Equipment	556	47,941	4,037	2,868
Contractual services	3,653,711	314,746	3,872	5,714
Continuous charges	541,612	1,131,301	23,144	14,978
Site/property Improvements	-	-	-	-
Cost of goods sold	-	-	-	-
Depreciation expense	13,392	161,634	7,094	2,232
Total operating expenses per SRECNA	4,221,655	2,147,252	223,970	167,176
Add back items netted on SRECNA:				
Expenses for auxiliary sales to VMI departments	-	22,803	4,126	-
Depreciation expense	(13,392)	(161,634)	(7,094)	(2,232)
Total operating expenses	4,208,263	2,008,421	221,002	164,944
Net income/(loss) from operations	911,824	560,081	102,248	50,126
Non-operating revenues/(expenses):				
Investment income	-	-	-	-
Gifts	-	-	3,000	10,482
Net non-operating revenues/(expenses)	-	-	3,000	10,482
Net income/(loss) before transfers	911,824	560,081	105,248	60,608
Transfers: Non-mandatory				
Transfers (to)/from endowment	-	-	-	-
Transfers (to)/from net invested in plant	-	(59,359)	(77,383)	-
Transfers (to)/from retirement of indebtedness	-	-	-	-
Transfers (to)/from renewals and replacements	-	-	-	-
Transfers (to)/from unrestricted	-	-	-	-
Net increase/(decrease) for the year	\$ 911,824	\$ 500,722	\$ 27,865	\$ 60,608
Fund balance at beginning of year				
Fund balance at end of year				

(A) These expenditures are related to the Auxiliary Administration account and the Auxiliary Contingency account and are not identified with a specific auxiliary.

(B) Interest earned on the auxiliary reserve cash balance at the Commonwealth, not allocable to any particular auxiliary enterprise.

Stores and Shops	Student Union	Parking	Cameron Hall	Athletics	Other	Total
\$ 94,953	\$ 685,850	\$ -	\$ 225,178	\$ 1,258,021	\$ -	\$ 8,098,371
41,045	-	11,370	1,525	592,118	111,915	1,072,775
135,998	685,850	11,370	226,703	1,850,139	111,915 (A)	9,171,146
-	4,328	-	-	577	-	5,482
34,527	249,287	-	82,175	462,666	-	2,878,887
1,900	-	-	-	-	-	28,829
172,425	939,465	11,370	308,878	2,313,382	111,915	12,084,344
31,905	384,694	-	74,430	2,510,676	179,813	3,828,881
2,118	86,759	-	8,820	48,265	6,426	336,246
1,900	32,353	-	20,124	125,476	-	235,255
130,525	152,593	-	87,967	706,143	-	5,055,271
71,716	264,754	-	110,042	658,442	122,176	2,938,165
-	-	-	-	-	-	-
44,243	-	-	-	-	-	44,243
13,657	32,513	6,580	112,544	297,452	25,008	672,106
296,064	953,666	6,580	413,927	4,346,454	333,423 (A)	13,110,167
1,900	-	-	-	-	-	28,829
(13,657)	(32,513)	(6,580)	(112,544)	(297,452)	(25,008)	(672,106)
284,307	921,153	-	301,383	4,049,002	308,415	12,466,890
(111,882)	18,312	11,370	7,495	(1,735,620)	(196,500)	(382,546)
-	-	-	-	-	117,121 (B)	117,121
-	9,070	-	-	1,557,835	-	1,580,387
-	9,070	-	-	1,557,835	117,121	1,697,508
(111,882)	27,382	11,370	7,495	(177,785)	(79,379)	1,314,962
-	-	-	-	177,000	-	177,000
-	(11,900)	-	(1,523)	(35,424)	(14,002)	(199,591)
-	-	-	-	-	(167,160)	(167,160)
-	-	-	-	-	(300,000)	(300,000)
(346,000)	-	-	-	-	(18,338)	(364,338)
\$ (457,882)	\$ 15,482	\$ 11,370	\$ 5,972	\$ (36,209)	\$ (578,879)	460,873
						3,537,359
						\$ 3,998,232



Commonwealth of Virginia

Walter J. Kucharski, Auditor

**Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218**

March 17, 2006

The Honorable Timothy M. Kaine
Governor of Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission

Board of Visitors
Virginia Military Institute

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic financial statements of **Virginia Military Institute**, a component unit of the Commonwealth, and its aggregate discretely presented component units as of and for the year ended June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of the Institute's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the component units of the Institute, which are discussed in Note 1. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

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 Virginia Military Institute and of its aggregate discretely presented component units as of June 30, 2005, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages two through nine is not a required part of the basic financial statements, but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of the Institute. The accompanying Schedule of Operations- Auxiliary Enterprises is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The information in that schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statement taken as a whole.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER

FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Institute's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Institute's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition, entitled "Improve Policies and Procedures Covering System Access," is described in the section titled "Internal Control Finding and Recommendation."

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable condition described above is not a material weakness.

Compliance and Other Matters

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

The "Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters" is intended solely for the information and use of the Governor and General Assembly of Virginia, the Board of Visitors, and management, and is not intended to be and should not be used by anyone, other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on April 24, 2006.

AUDITOR OF PUBLIC ACCOUNTS

WHC:sks
sks: 45

VIRGINIA MILITARY INSTITUTE

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(FINANCE, ADMINISTRATION AND SUPPORT)
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25 April 2006

Mr. Walter J. Kucharski
Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

RE: Internal Control Finding and Recommendation
Improve Policies and Procedures Covering System Access

Dear Mr. Kucharski:

We have reviewed the internal control finding and recommendation included in our audit report and discussed during the exit conference held 24 April 2006.

As a result of last year's audit and the oral comment we received from the APA regarding this same matter, VMI drafted and approved General Order #2, Employee Clearance Procedures, dated 20 July 2005. These procedures require the supervisor to provide "timely" notification of separation from employment of any full or part time employee. Rather than identify a specific time limit for supervisors to provide the appropriate forms to terminate access to the Institute's systems, we believe it is best to "freeze" system access initially based on notification received from the Human Resources Office. This prevents separated employees from gaining access to our systems while we determine if access should be terminated permanently.

Information Technology (IT) has the ability to freeze accounts as of the close of business of an employee's last day of employment or as soon as notification is received from Human Resources. When accounts are frozen, IT will save a "screen image" of that activity that reflects the date the account was frozen for documentation purposes. Once the supervisor of the separated employee has completed the Computer Account Deletion Form and forwarded it to IT, the account will then be terminated.

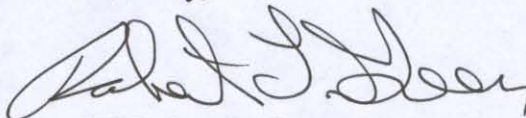
The Employee Clearance Procedures also includes language that states, "Supervisors who fail to report an employment termination may be held responsible for property replacement costs, unauthorized charges, and unpaid obligations to VMI of a former employee." The Human Resources Office will be responsible for monitoring compliance with these procedures by supervisors and department heads, and providing notification to the appropriate individuals in IT and the Comptroller's Office prior to an employee's separation.



In order to ensure control over access to the electronic Virginia (eVA) procurement system, we will implement a semi-annual review of all active eVA user accounts to ensure that only authorized VMI employees have access to the eVA system. This will be accomplished using the existing semi-annual Colleague user account reviews and will be documented with the review of the Colleague Finance Modules. This review will be performed by the Purchasing Office staff, led by the Director of Purchasing and Disbursements. The Purchasing Office staff best understands the eVA system and can determine who at VMI should have access to the system. In addition to this semi-annual review, we have already begun to obtain periodic notification from the Human Resources Office of employee terminations to assist in identifying users whose access should be deleted.

Additionally, through coordination with IT, we will incorporate eVA account maintenance into the existing procedures for access and maintenance of other systems at VMI. This will help ensure that all requirements for access to eVA and account deletions are met and accomplished in a timely manner.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert L. Green", written in a cursive style.

BG Robert L. Green
Deputy Superintendent for Finance,
Administration and Support

C – GEN J. H. Binford Peay, III
COL Robert W. Gilbert
COL Thomas F. Hopkins
COL Robert B. Spore

VIRGINIA MILITARY INSTITUTE
Lexington, Virginia

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