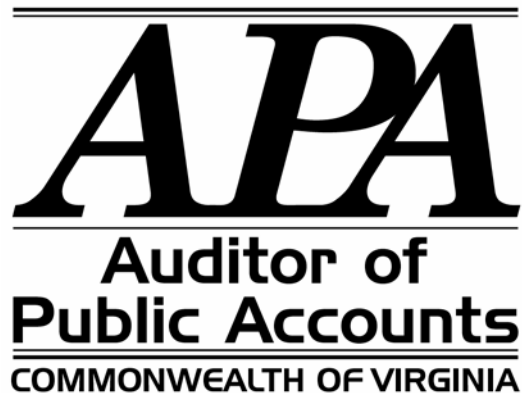


**VIRGINIA MILITARY INSTITUTE**

**REPORT ON AUDIT  
FOR THE YEAR ENDED  
JUNE 30, 2006**



## **AUDIT SUMMARY**

Our audit of Virginia Military Institute for the year ended June 30, 2006, found:

- the financial statements are presented fairly, in all material respects;
- no internal control matters that we consider to be material weaknesses; and
- no instances of noncompliance or other matters required to be reported.

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## MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

### Overview

Virginia Military Institute (VMI) is pleased to present its financial statements for the fiscal year ended June 30, 2006, along with the financial statements of its affiliates as required under Governmental Accounting Standards Board Statement 39. This management's discussion and analysis is designed to help readers understand the accompanying financial statements and to provide an objective, easily readable analysis of the Institute's financial activities based on currently known facts, decisions, and conditions. This discussion focuses primarily on VMI's fiscal year 2006 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 the Governmental Accounting Standards Board (GASB) reporting model 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 Board (FASB) standards 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 the Institute's activities. It also includes a separate section that addresses the financial statements of VMI's affiliates.

### Financial Highlights

The financial position of VMI continues to get stronger, with assets of \$159.2 million and liabilities of \$30.5 million at June 30, 2006, compared to assets of \$128.8 million and liabilities of \$31.0 million at June 30, 2005. Net assets, which represent the residual interest in the Institute's assets after liabilities are deducted, increased \$30.9 million in the 2006 fiscal year, to \$128.8 million at June 30, 2006. Net assets increased by \$20.9 million during the 2005 fiscal year. This \$10 million improvement is largely attributable to state appropriations and private contributions received specifically for capital construction.

The investment in capital assets, net of related debt, accounts for the largest portion of the increase in net assets. Of the \$30.9 million increase in net assets, \$27.6 million can be attributed to the investment in capital assets, growing from \$60.6 million at June 30, 2005, to \$88.2 million at June 30, 2006. This reflects VMI's on-going capital projects program that includes the complete renovation of Nichols Engineering Hall, Cocke Hall Annex, Jackson Memorial Hall, Crozet Hall, emergency repairs to Barracks, the Football and Baseball Stadiums, Mallory Hall, Kilbourne Hall, storm sewer drainage improvements and the construction of an addition to Barracks and a new Leadership and Ethics Center.

During the 2006 fiscal year, VMI commenced the Expansion and Renovation of Barracks project (\$46.8 million) and continued the Emergency Repairs to Barracks project (\$4.5 million), the renovation of Crozet Hall (\$14.6 million), Nichols Engineering Hall (\$17.8 million), the construction of the Cocke Hall Annex (\$2.2 million), the renovation of Jackson Memorial Hall (\$3.9 million), the acquisition of properties along North Main Street (\$1 million), storm sewer drainage improvements (\$1.3 million), the renovation and expansion of Kilbourne Hall (\$20.9 million), renovation of Mallory Hall (\$12.1 million), the renovation and expansion of Athletic facilities (\$20 million), the construction of a Leadership and Ethics Center (\$21 million), and North Institute Hill Parking (\$2 million). Construction-in-progress totaled \$57.1 million as of fiscal year end compared to \$26.5 million as of the end of 2005, an increase of 115 percent.

While operating revenues increased by \$1.8 million over the preceding year or 7.65 percent, to \$24.7 million, and non-operating revenues increased by \$1.6 million or 5.81 percent, to \$28.6 million, operating expenses increased by \$5.3 million or 10.38 percent, to \$56.8 million. The largest portion of this increase in operating expenses is attributable to a \$2.4 million increase in operation and maintenance of physical plant. This increase can be traced to a \$1.8 million increase in funds expended from capital projects for non-capitalizable equipment during the 2006 fiscal year over the previous fiscal year, and utility expenses increased by \$.5 million over the previous fiscal year.

### Statement of Net Assets

The Statement of Net Assets presents the financial position of VMI at the end of the fiscal year and includes all assets and liabilities of the Institute. The difference between total assets and total liabilities-net assets is one indicator of the current financial condition of VMI, while the change in net assets is an indicator of whether the overall financial condition has improved or worsened during the year. 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 non-expendable. 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. Non-expendable 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 the Institute.

### Statement of Net Assets

	<u>June 30, 2006</u>	<u>June 30, 2005</u>	<u>Variance</u>	
Assets:				
Current assets	\$ 13,707,706	\$ 16,096,997	\$(2,389,291)	(14.8%)
Capital assets, net	110,219,165	75,857,113	34,362,052	45.3%
Other non-current assets	<u>35,321,897</u>	<u>36,884,816</u>	<u>(1,562,919)</u>	<u>(4.2%)</u>
Total assets	<u>159,248,768</u>	<u>128,838,926</u>	<u>30,409,842</u>	<u>23.6%</u>
Liabilities:				
Current liabilities	10,607,491	11,331,556	(724,065)	(6.4%)
Non-current liabilities	<u>19,855,539</u>	<u>19,667,601</u>	<u>187,938</u>	<u>1.0%</u>
Total liabilities	<u>30,463,030</u>	<u>30,999,157</u>	<u>(536,127)</u>	<u>(1.7%)</u>
Net assets:				
Invested in capital assets, net of related debt	88,242,815	60,630,443	27,612,372	45.5%
Restricted – expendable	27,747,733	24,227,324	3,520,409	14.5%
Restricted – non-expendable	4,267,460	4,516,682	(249,222)	(5.5%)
Unrestricted	<u>8,527,730</u>	<u>8,465,320</u>	<u>62,410</u>	<u>0.7%</u>
Total net assets	<u>\$128,785,738</u>	<u>\$ 97,839,769</u>	<u>\$30,945,969</u>	<u>31.6%</u>

VMI's current assets decreased by \$2.4 million, or 14.8 percent, primarily attributable to a decrease of \$2.1 million in cash and cash equivalents. This decrease in cash and cash equivalents is the result of paying an extra payroll (\$1.3 million) and using a cash contribution (\$1.2 million) received during the 2004 and 2005 fiscal years from the food services provider to pay for capital improvements made to Crozet Hall, the dining facility, during the 2006 fiscal year.

Capital assets, net of depreciation, increased by \$34.4 million to \$110.2 million and consist primarily of an increase in construction-in-progress of \$30.5 million, (\$4.5 million Nichols Hall, \$6.1 million Crozet Hall, \$8.4 million Football and Baseball Stadiums, \$1.6 million Barracks Expansion, \$.9 million Storm Sewer Drainage, \$.9 million Leadership and Ethics Center, \$1.9 million Jackson Memorial Hall, and \$6.3 million Kilbourne Hall). Buildings increased approximately \$3 million as a result of the completion of the Emergency Repairs to Barracks capital project. This project involved structural repairs to concrete stairways and walkways within Barracks as well as replacement of drain lines and a new courtyard surface in New Barracks, which also serves as the roof for work areas below.

Current liabilities consisting primarily of accrued compensation and accounts payable, decreased approximately \$.7 million as a result of processing the last payroll of the fiscal year in June 2006 rather than July as is typical. This decision was made by the Governor of the Commonwealth as a result of the General Assembly's failure to adopt the 2007 fiscal year budget until just prior to the fiscal year end.

Net assets totaled \$128.8 million at year-end. This represented an increase of \$30.9 million over the prior year, due largely to the increase of 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 and 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>June 30, 2006</u>	<u>June 30, 2005</u>	<u>Variance</u>	
Operating revenues:				
Tuition and fees	\$ 11,188,980	\$10,659,410	\$ 529,570	5.0%
Grants and contracts	1,211,096	754,830	456,266	60.4%
Auxiliary enterprises	9,686,439	9,171,146	515,293	5.6%
Unique military activities	1,399,448	1,441,323	(41,875)	(2.9%)
Other sources	<u>1,257,203</u>	<u>958,889</u>	<u>298,314</u>	<u>31.1%</u>
Total operating revenues	<u>24,743,166</u>	<u>22,985,598</u>	<u>1,757,568</u>	<u>7.6%</u>
Operating expenses:				
Educational and general	37,047,095	33,640,292	3,406,803	10.1%
Auxiliary enterprises	14,975,541	13,110,167	1,865,374	14.2%
Unique military activities	<u>4,747,962</u>	<u>4,683,463</u>	<u>64,499</u>	<u>1.4%</u>
Total expenses	<u>56,770,598</u>	<u>51,433,922</u>	<u>5,336,676</u>	<u>10.4%</u>
Operating loss	(32,027,432)	(28,448,324)	(3,579,108)	12.6%
Non-operating revenues (expenses):				
State appropriations	12,971,013	12,316,526	654,487	5.3%
Gifts and contributions	13,629,188	13,389,131	240,057	1.8%
Investments	2,037,749	1,907,676	130,073	6.8%
Other	<u>(73,233)</u>	<u>(615,986)</u>	<u>542,753</u>	<u>(88.1%)</u>
Net non-operating revenues	<u>28,564,717</u>	<u>26,997,347</u>	<u>1,567,370</u>	<u>5.8%</u>
Income/(loss) before other revenues	<u>(3,462,715)</u>	<u>(1,450,977)</u>	<u>(2,011,738)</u>	<u>138.6%</u>
Other revenues	<u>34,408,684</u>	<u>22,359,393</u>	<u>12,049,291</u>	<u>53.9%</u>
Increase/(decrease) in net assets	30,945,969	20,908,416	10,037,553	48.0%
Net assets - beginning of year	<u>97,839,769</u>	<u>76,931,353</u>	<u>20,908,416</u>	<u>27.2%</u>
Net assets - end of year	<u>\$128,785,738</u>	<u>\$97,839,769</u>	<u>\$30,945,969</u>	<u>31.6%</u>

Operating revenues totaled \$24.7 million, an increase of \$1.8 million, or 7.6 percent, for fiscal year 2006. A 5 percent increase in total tuition and fee revenue (\$.5 million) and a 5.6 percent increase in auxiliary enterprise revenue (\$.5 million) can be attributed to tuition and fee rate increases of 5.9 percent for in-state cadets (54.5 percent of the Corps) and 5.7 percent for out-of-state cadets (45.5 percent of the Corps). Grants and contracts increased approximately \$.5 million as a result of a \$300,000 grant received from the Virginia Department of Transportation and \$241,000 received from the U.S. Department of Education for a Science and Security grant.

Operating expenses increased by \$5.3 million, or 10.4 percent, to \$56.8 million. Educational and general (E&G) program expenses increased by \$3.4 million, or 10.1 percent. This increase can be traced to a significant amount of non-capitalizable equipment (\$1.8 million over the previous year) being acquired through capital projects and reflected as an operating expense under operations and maintenance of plant, and an increase in utility costs of approximately \$5 million. The remaining increase in E&G expenses, \$1.1 million can be attributed to a 4 percent to 4.5 percent salary increase. Auxiliary enterprise expenses increased \$1.9 million, or 14.2 percent, which is largely attributable to unreimbursed equipment purchases for Equipment Trust Fund activity, an increase in contracted service expenses for work done in Post housing, and personal service cost increases in Athletics.

Non-operating revenues total \$28.6 million, an increase of \$1.6 million, or 5.8 percent. State appropriations increased approximately \$.7 million to fund a 25<sup>th</sup> payroll for the 2006 fiscal year (\$453,000) and to provide the general fund share of an average 4 percent salary increase for all employees during 2006. Other revenues within the non-operating revenue category increased slightly more than \$.5 million as a result of an increase in the amount of capital debt interest being capitalized (\$274,000) and a smaller loss on the disposal of plant assets over the previous fiscal year (\$301,000).

Other revenues total \$34.4 million, an increase of \$12 million, or 53.9 percent. Private funds from the VMI Foundation for capital projects increased by \$9.1 million, of which \$8.8 million was provided for the Football and Baseball Stadiums project. State support for capital projects also increased by \$3 million and is attributed to increases and decreases in funding over the previous year for a number of projects: Kilbourne Hall funding increased \$7.9 million, Expansion of Barracks Planning funding decreased by \$1.9 million, funding for Nichols Engineering Building decreased by \$1.9 million, Mallory Hall funding increased by \$.6 million and Maintenance Reserve Program funding decreased by \$1.6 million over the previous year.

#### Statement of Cash Flows

This statement presents detailed information about the Institute's cash activity during the year. It is divided into five parts: operating activities, non-capital 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>June 30, 2006</u>	<u>June 30, 2005</u>	<u>Variance</u>	
Net cash used by operating activities	\$(29,749,367)	\$(26,340,114)	\$(3,409,253)	12.9%
Net cash provided by non-capital financing activities	26,821,243	25,028,608	1,792,635	7.2%
Net cash provided by capital and related financing activities	3,627,087	8,297,191	(4,670,104)	(56.3%)
Net cash provided by investing activities	<u>1,411,023</u>	<u>1,154,041</u>	<u>256,982</u>	<u>22.3%</u>
Net increase in cash	2,109,986	8,139,726	(6,029,740)	(74.1%)
Cash - beginning of year	<u>18,746,614</u>	<u>10,606,888</u>	<u>8,139,726</u>	<u>76.7%</u>
Cash - end of year	<u>\$ 20,856,600</u>	<u>\$ 18,746,614</u>	<u>\$ 2,109,986</u>	<u>11.3%</u>

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

The \$3.6 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, improvements to Alumni Memorial and Patchin Fields, Mallory Hall and the new Leadership and Ethics Center), less amounts expended for these projects and their related debt obligations.

The \$1.4 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 2006 was the fourth year of VMI's Vision 2039 capital projects program and is expected to continue 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 (\$12.1 million), Kilbourne Hall (\$20.9 million), Jackson Memorial Hall (\$3.9 million), Cocke Hall Annex (\$2.2 million), and a new Leadership and Ethics Center (\$21 million).

The Nichols Engineering Hall and the Mallory Hall projects were funded from the state's 2002 General Obligation Bonds with some additional funding received from the state's general fund. The main Nichols Engineering Hall building was completed in August 2005 and returned to service; the annexes will be completed in July 2006. The Mallory Hall renovation project is scheduled to be completed in July 2007.

The Kilbourne Hall project consists of three components: the construction of a new Physical Plant 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 Physical Plant began in September 2005 and construction on the storm water project began in October 2005. The new Physical Plant facility will be completed in September 2006 and the storm water project is scheduled to be completed in December 2006. The Kilbourne Hall renovation and old Buildings and Grounds facility renovation and expansion component started in October 2006 and is scheduled to be done in phases. The first phase, renovation of the old Buildings and Grounds facility and expansion of Kilbourne Hall, is scheduled to be completed in September 2007 and the second phase, renovation of Kilbourne Hall, is scheduled to be completed in May of 2008. The Kilbourne Hall project is funded predominantly by state general funds with some support from private funds received through the VMI Foundation.

The Jackson Memorial Hall and Cocke Hall Annex projects will be completed in July 2006. 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 October 2006 with completion scheduled for August 2008. This project is being financed by one of VMI's alumni agencies and from a private gift; VMI will not incur any debt on this project.

VMI also has two major auxiliary enterprise projects: the renovation and expansion of Crozet Hall (\$14.6 million) and the renovation of the VMI football and baseball stadiums (\$20 million). Crozet Hall is VMI's sole dining facility (mess hall) and was completed in July 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 began construction in October 2005 and was scheduled to be completed in December 2006. This project is being financed by one of VMI's alumni agencies; VMI will not incur any debt on this project.

The 2005 General Assembly appropriated \$1.9 million of state funds to begin planning the renovation and expansion of the VMI Barracks. This past year the General Assembly appropriated \$46.8 million to expand and renovate Barracks. This will provide much needed repairs and upgrades to this historic building and allow VMI to grow the Corps to 1,500 cadets beginning in fall 2010. The addition to Barracks is scheduled to be completed in July 2008 and the renovation is scheduled for completion in December 2010.

In October 2006, the North Institute Hill Parking project (\$2 million) got underway. This surface parking facility is being funded from private sources and is scheduled to be completed in May 2007.

In summary, VMI has approximately \$168 million in capital projects in progress at the end of fiscal year 2006. 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 \$321 million and \$.5 million, respectively, as of June 30, 2006 as compared to \$304.2 million and \$.3 million as of June 30, 2005. VMIAA net assets consist of \$58.8 million in unrestricted net assets and \$262.2 million in temporarily or permanently restricted net assets. VMIAA revenues totaled \$23 million for fiscal year 2006 and \$31.8 million for fiscal year 2005. This \$9 million decrease in revenue is largely attributable to two large contributions, one bequest, and one gift not previously reflected as a receivable, received during the 2005 fiscal year. The amount remitted directly to or on behalf of VMI for fiscal year, 2006 was \$24.5 million compared to \$15.7 million for fiscal year 2005, a 56.3 percent increase. This increase can be attributed to funds provided for capital improvements to the Football and Baseball Stadiums, an \$8.8 million increase over funding provided the previous year for this project.

#### Economic Outlook

State appropriations provided 24.3 percent of VMI's total revenue and support for operations in fiscal year 2006 and fiscal year 2005. It is expected to remain at approximately this level in fiscal year 2007. State appropriations are normally increased to cover the state's share of cost increases related to salary and fringe benefit increases approved by the General Assembly, growth in in-state student enrollment, and new or renovated facilities coming on-line. The 2006 General Assembly also appropriated additional state funds of \$280,000 in fiscal year 2007 and \$410,000 in fiscal year 2008 for VMI's Unique Military Activities Program. VMI's 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) describes VMI's needs for additional State funds through fiscal year 2012.

State appropriations also provided funding for capital projects of \$22.9 million in fiscal year 2006 and \$19.9 million in fiscal year 2005. The 2006 General Assembly appropriated \$51.6 million in state funds for VMI capital projects in fiscal year 2007 consisting of \$46.8 million for Barracks expansion and renovation and supplemental funds of \$2.9 million for the Mallory Hall renovation and \$1.9 million for the Kilbourne Hall expansion/renovation. VMI is planning a request to the 2007 General Assembly for \$14 million in supplemental funds in fiscal year 2008 for the Barracks capital project due to construction cost escalations.

Private fund support from VMI's alumni agencies represented approximately 26 percent of VMI's total revenues and support for operations in fiscal year 2006 and fiscal year 2005. Private support for operations is expected to continue at approximately this level in fiscal year 2007 with some modest increase in the following years. Private fund support for capital projects totaled \$11.3 million in fiscal year 2006 and \$2.2 million in fiscal year 2005. This support is expected to approximate \$23 million in fiscal year 2007 and \$13 million in fiscal year 2008 and is attributable to alumni agencies debt financing of several VMI capital projects including the renovation of the football and baseball stadiums and the new Leadership and Ethics Center.

VMI increased fiscal year 2007 tuition and fees by 7.5 percent for in-state cadets and 5.9 percent for out-of-state cadets. VMI expects increases during the next few years to approximate this level with some decrease possible as VMI continues its efforts to achieve an appropriate enrollment of in-state and out-of-state cadets and to reduce costs and increase efficiencies in programs and operations.

VMI enrolled a record 1,410 cadets in fall 2006 consisting of 56 percent in-state cadets. VMI estimates a fall enrollment of approximately 1,400 cadets for the next few years with 54 percent to 56 percent in-state cadets.

VMI's executive management believes that VMI is well positioned to continue providing excellent programs and services to its cadets as it maintains a clear educational focus and a well-established niche in the higher education marketplace. The Board and the Superintendent have adopted an aggressive strategy called Vision 2039 that is focusing efforts and resources to sustain and enhance VMI's academic, military, leadership, and athletic programs and facilities. VMI's commitment to Vision 2039 and its strong state and private support will ensure that the Institute continues to increase its financial strength in the future.

## **FINANCIAL STATEMENTS**

VIRGINIA MILITARY INSTITUTE  
STATEMENT OF NET ASSETS  
As of June 30, 2006

ASSETS	
Current assets:	
Cash and cash equivalents (Note 2)	\$ 6,698,600
Cash equivalents held by Treasurer of Virginia (Note 2)	678,647
Collateral held for securities lending (Note 2)	671,599
Accounts receivable, net of allowance for doubtful accounts of \$49,269 (Note 3)	1,122,289
Due from the Commonwealth (Note 8)	247,549
Prepaid expenditures	713,701
Inventory (Note 4)	3,311,065
Loans receivable	264,256
Total current assets	13,707,706
Non-current assets:	
Cash and cash equivalents (Note 2)	14,158,000
Cash and investments with trustees (Note 2)	18,574,093
Cash equivalents held with the Treasurer of Virginia (Note 2)	1,350,885
Notes receivable	210,000
Loans receivable, net of allowance for doubtful accounts of \$27,060	1,028,919
Nondepreciable capital assets (Note 5)	59,020,932
Depreciable capital assets, net of accumulated depreciation (Note 5)	51,198,233
Total non-current assets	145,541,062
Total assets	159,248,768
LIABILITIES	
Current liabilities:	
Accounts payable and accrued expenses (Note 6)	6,186,157
Deferred revenue	922,376
Obligations under securities lending	1,350,246
Deposits held for others	561,993
Long-term liabilities-current portion: (Note 7)	
Compensated absences	769,746
Bonds payable (Note 8)	360,000
Notes payable (Note 8)	425,000
Installment purchase obligation (Note 8)	31,973
Total current liabilities	10,607,491
Non-current liabilities	
Accrued liabilities (Note 6)	497,163
Federal loan program contributions refundable	1,260,182
Retainage payable (Note 9)	1,703,941
Long-term liabilities-noncurrent portion: (Note 7)	
Compensated absences	500,910
Bonds payable (Note 8)	11,114,632
Notes payable (Note 8)	4,672,302
Installment purchase obligation (Note 8)	106,409
Total non-current liabilities	19,855,539
Total liabilities	30,463,030

VIRGINIA MILITARY INSTITUTE  
STATEMENT OF NET ASSETS  
As of June 30, 2006

NET ASSETS	
Invested in capital assets, net of related debt	88,242,815
Restricted-non-expendable:	
Endowment	4,267,460
Restricted-expendable:	
Scholarships and other	1,122,752
Loan funds	556,345
Quasi-endowment-restricted	11,295,672
Capital projects	14,772,964
Unrestricted	8,527,730
Total net assets	128,785,738
Total liabilities and net assets	\$ 159,248,768

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

COMPONENT UNITS OF VIRGINIA MILITARY INSTITUTE  
 COMBINED STATEMENT OF FINANCIAL POSITION  
 As of June 30, 2006

ASSETS	
Current assets:	
Cash and cash equivalents	\$ 10,406,657
Contributions receivable (Note 16)	4,878,151
Accounts receivable	173,530
Other	325,903
Total current assets	<u>15,784,241</u>
Non-current assets:	
Contributions receivable (Note 16)	17,506,045
Notes receivable	20,799
Investments held by trustees (Note 16)	282,577,602
Investments, other (Note 16)	18,720,128
Investment securities	101,992
Cash surrender of life insurance	4,277,038
Property and equipment, net of accumulated depreciation	671,742
Total non-current assets	<u>323,875,346</u>
Total assets	<u><u>\$ 339,659,587</u></u>
LIABILITIES	
Current liabilities:	
Accounts payable and accrued liabilities	\$ 1,132,357
Long-term liabilities-current portion:	
Bonds payable (Note 16)	126,000
Trust and annuity obligations	817,017
Total current liabilities	<u>2,075,374</u>
Non-current liabilities:	
Unearned revenue	14,140
Other liabilities	348,008
Long-term liabilities-noncurrent portion:	
Bonds payable (Note 16)	10,142,630
Trust and annuity obligations	5,574,628
Total non-current liabilities	<u>16,079,406</u>
Total liabilities	<u>18,154,780</u>
NET ASSETS	
Unrestricted	59,176,959
Temporarily restricted	165,811,235
Permanently restricted	96,516,613
Total net assets	<u>321,504,807</u>
Total liabilities and net assets	<u><u>\$ 339,659,587</u></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, 2006

Operating revenues:	
Tuition and fees, net of scholarships allowances of \$3,517,485	\$ 11,188,980
Federal grants and contracts	1,142,609
State and private grants and contracts	68,487
Sales and services of educational departments	63,419
Auxiliary enterprise, net of scholarship allowances of \$2,809,797	9,686,439
Unique military activities, net of scholarships allowances of \$431,913	1,399,448
Other sources:	
Museum programs	438,124
Rents and commissions	206,706
Miscellaneous	548,954
Total operating revenues	24,743,166
Operating expenses:	
Educational and general:	
Instruction	14,705,636
Research	386,394
Public service	1,063,064
Academic support	4,813,719
Student services	3,732,911
Institutional support	4,394,535
Operation and maintenance of physical plant	7,140,843
Scholarships and related expense	809,993
Auxiliary enterprises	14,975,541
Unique military activities	4,747,962
Total operating expenses (Note 10)	56,770,598
Net operating loss	(32,027,432)
Non-operating revenues/(expenses):	
State appropriations (Note 11)	12,971,013
Gifts and contributions	13,629,188
Net investment income	2,037,749
Interest on capital asset - related debt	(63,717)
Loss on disposal of plant assets	(9,516)
Net non-operating revenues	28,564,717
Income/(loss) before other revenues	(3,462,715)
Other revenues:	
State appropriations-capital	22,900,475
Grants and gifts-capital	11,321,143
Investment income-capital	187,066
Total other revenues	34,408,684
Increase in net assets	30,945,969
Net assets beginning of the year	97,839,769
Net assets end of year	\$ 128,785,738

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

COMPONENT UNITS OF VIRGINIA MILITARY INSTITUTE  
 COMBINED STATEMENT OF ACTIVITIES  
 For the Year Ended June 30, 2006

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues:				
Amounts raised on behalf of VMI	\$ 6,549,838	\$ 9,201,394	\$ 3,282,928	\$ 19,034,160
Grants, contributions and contracts	251,132	168,585	-	419,717
Investment income	1,530,939	723	-	1,531,662
Actuarial loss on trust and annuity obligations	(132,951)	(151,011)	(2,175)	(286,137)
Unrealized loss on swap contract	-	(142,630)	-	(142,630)
Administrative fees	2,879,999	-	-	2,879,999
Other income	307,965	-	-	307,965
Net assets released from restrictions and reclassifications	7,102,431	(7,102,431)	-	-
Total revenues	18,489,353	1,974,630	3,280,753	23,744,736
Expenses:				
Amounts remitted directly to or on behalf of VMI:				
Unrestricted	16,721,798	-	-	16,721,798
Designated	7,797,010	-	-	7,797,010
Cost of operations	4,743,665	-	-	4,743,665
Conference, research, and education	486,958	-	-	486,958
Total expenses	29,749,431	-	-	29,749,431
Change in net assets before net realized and unrealized gains on investments	(11,260,078)	1,974,630	3,280,753	(6,004,695)
Net realized and unrealized gains on investments	6,537,274	16,491,163	-	23,028,437
Change in net assets	(4,722,804)	18,465,793	3,280,753	17,023,742
Net assets beginning of the year	63,899,764	147,345,441	93,235,860	304,481,065
Net assets end of year	\$ 59,176,960	\$ 165,811,234	\$ 96,516,613	\$ 321,504,807

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, 2006

Cash provided/(used) by operating activities:	
Tuition and fees	\$ 11,456,830
Federal grants and contracts	978,598
State and private grants and contracts	445,520
Sales and services-educational and general	56,338
Auxiliary charges	9,653,890
Unique military activity charges	1,401,595
Other operating receipts	1,275,808
Payments to employees for salaries and benefits	(32,341,929)
Payments for supplies and services	(21,979,574)
Payments for scholarships and fellowships	(822,821)
Loans issued to students	(235,732)
Collections of loans from students	362,110
Net cash used by operating activities	(29,749,367)
Cash provided/(used) by non-capital financing activities:	
State appropriations	12,971,013
Gifts and grants for other than capital purposes	13,629,188
Federal Direct Lending Program-receipts	3,581,765
Federal Direct Lending Program-disbursements	(3,581,765)
Agency receipts	4,442,885
Agency disbursements	(4,221,843)
Net cash provided by non-capital financing activities	26,821,243
Cash provided/(used) by capital and related financing activities:	
Capital appropriations	22,900,475
Capital gifts	11,321,143
Proceeds from sale of capital assets	4,407
Proceeds from capital debt	7,104,789
Purchase and construction of capital assets	(36,826,585)
Principal paid on capital debt, leases and installments	(767,580)
Interest paid on capital debt, leases and installments	(110,213)
Investment income-capital	651
Net cash provided by capital and relating financing activities	3,627,087
Cash provided/(used) by investing activities:	
Interest on investments	274,223
Investment/endowment income	275,317
Sale of investments	951,863
Purchase of investments	(90,380)
Net cash provided by investing activities	1,411,023
Net increase/(decrease) in cash	2,109,986
Cash-beginning of year	18,746,614
Cash-end of year	\$ 20,856,600

VIRGINIA MILITARY INSTITUTE  
STATEMENT OF CASH FLOWS  
For the Year Ended June 30, 2006

Reconciliation of net operating loss to net cash used by operating activities:	
Net operating loss	\$ (32,027,432)
Adjustments to reconcile net operating loss to cash used by operating activities:	
Depreciation expense	3,267,858
Changes in net assets and liabilities:	
Accounts receivable	179,114
Inventories	(285,803)
Prepaid expenses	(95,731)
Due from Commonwealth	(176,977)
Accounts payable and accrued liabilities	(1,045,796)
Deposits held in custody for others-security deposits	(10,837)
Unearned revenue	317,177
Loans receivable	99,235
Compensated absences	2,682
Federal loan program contributions refundable	27,143
Net cash used by operating activities	<u>\$ (29,749,367)</u>
Non-cash investing, non-capital financing, and capital related financing transactions:	
Change in fair value of investments recognized as a component of investment income	<u>\$ 535,262</u>
Reconciliation of cash and cash equivalents to the Statement of Net Assets:	
Cash and cash equivalents classified as current assets	\$ 6,698,600
Cash and cash equivalents classified as noncurrent assets	<u>14,158,000</u>
Total	<u>\$ 20,856,600</u>

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, 2006

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 the Virginia Military Institute to produce educated, honorable men and women prepared for the varied work of civil life, imbued with love of learning, confident in the functions and attitudes of leadership, possessing a high sense of public service, advocates of the American Democracy and free enterprise system, and ready as citizen-soldiers to defend their country in time of national peril.

To accomplish this result, 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 of Virginia's (Commonwealth) statewide system of public higher education. The Board of Visitors, appointed by the Governor, is responsible for overseeing the Institute's governance. A separate report is prepared for the Commonwealth, 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.

The Governmental Accounting Standards Board (GASB) Statement 39, *Determining Whether Certain Organizations Are Component Units*, became effective for the fiscal year ended June 30, 2004. This statement amended GASB Statement 14, *The Financial Reporting Entity*. GASB Statement 39 provides guidance to determine whether certain organizations for which the Institute is not financially accountable should be reported as component units. Generally, it requires reporting as a component unit, an organization that raises and holds economic resources for the direct benefit of 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 the Institute and these resources are considered significant to the Institute, the Alumni Agencies are included as a component unit.

The VMI Research Laboratories (VMIRL) is a legally separate, tax-exempt entity whose purpose is to administer contract and grant research at the Institute. Because of the VMIRL's close relationship to VMI, it is also included as a component unit in the financial statements. The VMI Alumni Agencies and the VMIRL are presented in the aggregate in these financial statements and condensed financial statements are provided for each in Note 17.

Because the component units report under a different reporting model, the Financial Accounting Standards Board (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 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 with generally accepted accounting principles as prescribed by 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 34, *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities*.

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

C. Basis of Accounting

For financial statement purposes, the Institute is considered a special-purpose government engaged only in business-type activities. Accordingly, 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 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, 2006. This is primarily composed of revenue for student tuition and fees received in advance of the next semester or term.

H. Interest Capitalization

Interest expense incurred during the construction of capital assets is capitalized, if material, net of interest income earned on resources set aside for this purpose. The Institute incurred net interest expense totaling \$745,335 for the fiscal year ended June 30, 2006. Interest capitalized for the fiscal year ended June 30, 2006, totaled \$681,618.

I. Accrued Compensated Absences

Non-faculty salaried employees' 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, 2006 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 for employees 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.

J. 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.

K. Net Assets

GASB Statement 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 the Institute'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 – nonexpendable:* 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 the Institute 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 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. The practice is to allow department heads to make this determination and they typically spend unrestricted assets prior to spending restricted resources.

## L. Classification of Revenues

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 non-exchange transactions, such as gifts and contributions, and other revenue sources that are defined as non-operating revenues by GASB Statement 9 *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, GASB Statement 33 *Accounting and Financial Reporting for Non-exchange Transactions*, and GASB Statement 34 *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments*, 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 the 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

The following information is provided with respect to VMI's cash, cash equivalents, and investments as of June 30, 2006. The following risk disclosures are required by GASB Statement 40, *Deposit, and Investment Risk Disclosures*:

Custodial credit risk (Category 3 deposits and investments)—The custodial risk for deposits is the risk that, in the event of a failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a

government will not be able to recover the value of investment or collateral securities that are in possession of an outside party. VMI had no category 3 deposits or investments for fiscal year 2006.

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

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

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

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

Information regarding VMI's credit risk, concentration of credit risk, interest rate risk, and foreign currency risk follows in the Investments section of this note.

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

Cash and cash equivalents consist of the following balances as of June 30, 2006:

Cash with Treasurer of Virginia	\$18,669,116
Cash deposits with banks	2,151,514
State Non-Arbitrage Program (SNAP)*	1,350,885
Securities under securities lending	678,647
Petty cash	7,970
Time deposits	<u>28,000</u>
Total cash and cash equivalents	<u>\$22,886,132</u>

\*Rated as 'AAAm' by Standard and Poor

## 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, 2006:

Investments with the Treasurer of Virginia:	
Securities under Securities Lending	\$ 671,599
Investments with Trustees:	
Investments pooled with VMI Affiliates	18,126,444
Mutual fund investments (retirement accounts)	<u>447,649</u>
Total Investments with Trustees	<u>18,574,093</u>
Total investments	<u>\$19,245,692</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., 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, 2006 was \$308.8 million, of which, VMI owned \$18.1 million, or 5.87 percent of the Fund assets. The Fund held \$36.7 million in debt securities with an average maturity of 7.02 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 \$66.9 million in international equities denominated primarily in the Euro, the Pound, and the Yen. The custodians for the Fund are independently audited annually.

### 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 of Virginia's Comprehensive Annual Financial Report.

### 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 \$90,531 for the year ended June 30, 2006, and is included in the endowment income.

## 3. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following at June 30, 2006:

Student tuition and fees	\$ 132,900
Other educational and general	99,413
Auxiliary enterprises	120,418
Unique military activities	4,783
Private gifts	310,854
Federal grants	164,011
Agency funds	66,579
Other	180,022
Retirement of indebtedness	<u>92,578</u>
Total	1,171,558
Less: Allowance for doubtful accounts	<u>(49,269)</u>
Net accounts receivable	<u>\$1,122,289</u>

## 4. INVENTORIES

Inventories consist of the following at June 30, 2006:

Physical plant	\$ 362,939
Military store	2,782,852
Museums	150,968
VMI hospital	<u>14,306</u>
Total	<u>\$3,311,065</u>

## 5. CAPITAL ASSETS

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

	Beginning Balance July 1, 2005	Additions	Reductions	Ending Balance June 30, 2006
Non-depreciable capital assets:				
Land	\$ 1,919,630	\$ -	\$ -	\$ 1,919,630
Construction-in-progress	<u>26,518,304</u>	<u>32,292,977</u>	<u>(1,709,979)</u>	<u>57,101,302</u>
Total non-depreciable capital assets	<u>28,437,934</u>	<u>32,292,977</u>	<u>(1,709,979)</u>	<u>59,020,932</u>
Depreciable capital assets:				
Buildings	88,839,402	5,011,542	-	93,850,944
Improvements other than buildings	3,017,488	32,644	-	3,050,132
Equipment	9,635,278	1,573,076	(200,810)	11,007,544
Library books	<u>9,967,379</u>	<u>449,459</u>	<u>(20,469)</u>	<u>10,396,369</u>
Total depreciable capital assets	<u>111,459,547</u>	<u>7,066,721</u>	<u>(221,279)</u>	<u>118,304,989</u>
Less accumulated depreciation for:				
Buildings	48,257,280	1,992,950	-	50,250,230
Improvements other than buildings	1,561,204	132,797	-	1,694,001
Equipment	5,610,550	894,105	(179,098)	6,325,557
Library books	<u>8,611,334</u>	<u>246,103</u>	<u>(20,469)</u>	<u>8,836,968</u>
Total accumulated depreciation	64,040,368	3,265,955	(199,567)	67,106,756
Depreciable capital assets	<u>47,419,179</u>	<u>3,800,766</u>	<u>(21,712)</u>	<u>51,198,233</u>
Total capital assets, net	<u>\$ 75,857,113</u>	<u>\$36,093,743</u>	<u>\$(1,731,691)</u>	<u>\$110,219,165</u>

## 6. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consist of the following at June 30, 2006:

Current liabilities:	
Employee salaries, wages and benefits payable	\$1,357,522
Vendors and supplies accounts payable	4,677,887
Accrued interest payable	125,153
Other	<u>25,595</u>
Total current accounts payable and accrued expenses	<u>\$6,186,157</u>

Non-current liabilities:	
Accrued liabilities:	
Retirement annuities	\$447,649
Other	<u>49,514</u>
Total non-current accrued liabilities	<u>\$497,163</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, 2006 is presented as follows:

	Beginning Balance July 1, 2005	Additions	Reductions	Ending Balance June 30, 2006	Current Portion
Long-term debt:					
Bonds payable	\$11,857,112	\$ -	\$ (382,480)	\$11,474,632	\$ 360,000
Notes payable	5,514,946	-	(417,644)	5,097,302	425,000
Capital leases	2,340	-	(2,340)	-	-
Installment purchases	<u>34,423</u>	<u>126,888</u>	<u>(22,929)</u>	<u>138,382</u>	<u>31,973</u>
Total long-term debt	<u>17,408,821</u>	<u>126,888</u>	<u>(825,393)</u>	<u>16,710,316</u>	<u>816,973</u>
Accrued compensated absences	<u>1,267,974</u>	<u>925,779</u>	<u>(923,097)</u>	<u>1,270,656</u>	<u>769,746</u>
Total long-term liabilities	<u>\$18,676,795</u>	<u>\$1,052,667</u>	<u>\$(1,748,490)</u>	<u>\$17,980,972</u>	<u>\$1,586,719</u>

## 8. LONG-TERM INDEBTEDNESS

### 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, the 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, 2006
Bonds Payable:			
Crozet Hall, Series 2004A	4.63 - 5.00	2025	<u>\$11,474,632</u>

### Notes payable

Notes payable are debt obligations between the Virginia College Building Authority (VCBA) and 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 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.

	<u>Interest Rates (%)</u>	<u>Maturity</u>	<u>Balance June 30, 2006</u>
Notes payable:			
Barracks Wiring, Series 1998A	3.70 - 4.10	2009	\$ 825,000
Cocke Hall Annex, Series 2002A	4.00 - 5.25	2022	1,984,014
JM Hall Renovation, Series 2002A	4.00 - 5.25	2022	<u>2,288,288</u>
Total			<u>\$5,097,302</u>

Future maturities on notes and bonds payable are as follows:

	<u>Bonds Payable</u>	<u>Notes Payable</u>	<u>Total</u>
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	440,000	190,000	630,000
2012-2016	2,510,000	1,105,000	3,615,000
2017-2021	3,205,000	1,425,000	4,630,000
2022-2025	3,180,000	670,000	3,850,000
Plus: Unamortized premium	<u>584,632</u>	<u>202,302</u>	<u>786,934</u>
Total future principal requirements	<u>\$11,474,632</u>	<u>\$5,097,302</u>	<u>\$16,571,934</u>

Future interest commitments on notes and bonds payable are as follows:

	<u>Bonds Payable</u>	<u>Notes Payable</u>	<u>Total</u>
2007	\$ 527,856	\$ 234,327	\$ 762,183
2008	509,856	215,535	725,391
2009	490,856	195,692	686,548
2010	470,856	180,975	651,831
2011	450,106	171,725	621,831
2012-2016	1,929,531	699,706	2,629,237
2017-2021	1,235,531	370,257	1,605,788
2022-2025	<u>373,550</u>	<u>35,438</u>	<u>408,988</u>
Total future interest requirements	<u>\$5,988,142</u>	<u>\$2,103,655</u>	<u>\$8,091,797</u>

### Installment Purchase Obligations

The Institute has future obligations under installment purchase agreements. The book value of the assets capitalized under these installment purchase agreements is \$157,669 with no interest. A summary of future obligations under these agreements as of June 30, 2006 follows:

Year Ending <u>June 30,</u>	<u>Principal</u>
2007	\$ 31,973
2008	31,973
2009	31,973
2010	29,774
2011	<u>12,689</u>
Total	<u>\$138,382</u>

### 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 Virginia College Building Authority (VCBA) manages the program. The VCBA issues bonds and uses the proceeds to reimburse the Institute and other institutions of higher education for equipment purchased. For fiscal years prior to 1999, the VCBA purchased the equipment and leased it to the Institute. For fiscal years 1999 and following, financing agreements for ETF were changed so that VMI now owns the equipment from the date of purchase.

The Statement of Net Assets line "Due from the Commonwealth of Virginia" totaling \$247,549 represents equipment purchased by VMI that had not been reimbursed by the VCBA as of June 30, 2006.

### 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 the Institute'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 \$65,905 for the year ended June 30, 2006.

Year Ending <u>June 30,</u>	<u>Amount</u>
2007	\$107,884
2008	78,299
2009	35,310
2010	7,127
2011	<u>7,127</u>
Total	<u>\$235,747</u>

### Capital Improvement Commitments

As of June 30, 2006, VMI had outstanding construction contract commitments of \$29,806,466. This amount represents the value of obligations remaining on capital improvement project contracts. These obligations are for future efforts and as such have not been accrued as expenses or liabilities on the Institute's financial statements.

#### 9. RETAINAGE PAYABLE

At June 30, 2006, \$1,703,941 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 for the year ended June 30, 2006:

Program	Personal Services	Supplies	Contractual Services	Equipment	Utilities	Student Aid	Other Operating Expenses	Depreciation	Total
Instruction	\$12,654,860	\$ 167,391	\$ 540,080	\$ 284,347	\$ -	\$ -	\$ 31,881	\$1,027,077	\$14,705,636
Research	283,477	24,233	39,649	1,508	-	-	-	37,527	386,394
Public service	597,404	74,505	326,615	3,603	-	-	-	60,937	1,063,064
Academic support	3,112,518	90,358	774,509	88,939	-	-	126,456	620,939	4,813,719
Student services	1,691,091	101,955	837,688	54,040	-	-	834,622	213,515	3,732,911
Institutional support	2,660,450	134,891	968,445	244,372	1,232	-	290,666	94,479	4,394,535
Operation and maintenance of plant	2,282,748	1,021,726	337,192	2,324,757	877,525	-	98,323	198,572	7,140,843
Student aid	3,429	2,248	33,436	-	-	770,880	-	-	809,993
Auxiliary enterprises	4,418,801	460,797	5,524,542	589,635	239,304	51,941	2,897,837	792,684	14,975,541
Unique military activities	<u>3,297,415</u>	<u>811,224</u>	<u>67,697</u>	<u>12,455</u>	<u>-</u>	<u>-</u>	<u>337,042</u>	<u>222,129</u>	<u>4,747,962</u>
Total operating expenditures	<u>\$31,002,193</u>	<u>\$2,889,328</u>	<u>\$9,449,853</u>	<u>\$3,603,656</u>	<u>\$1,118,061</u>	<u>\$822,821</u>	<u>\$4,616,827</u>	<u>\$3,267,859</u>	<u>\$56,770,598</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, 2006, VMI received the following supplemental appropriations and reversions in accordance with the Appropriation Act:

Original legislative appropriation:	
Educational and general programs	\$ 9,130,970
Unique military activities	3,944,037
Student financial assistance	640,389
Adjustments:	
Salary adjustments	111,314
Fringe benefit adjustments	114,306
Equipment Trust Fund lease payments	
non-general fund portion	(88,844)
Debt service fee	(36,135)
Additional appropriation for change in	
June 24, 2006 payroll timing	452,602
Appropriations transfers:	
SCHEV programs	25,198
Virginia Tech	<u>(1,322,824)</u>
Adjusted appropriations	<u>\$12,971,013</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 \$13,358,296 for the year ended June 30, 2006. The Institute's total payroll costs were \$26,707,736 for the year ended June 30, 2006.

Information regarding types of employees covered, benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit

provisions as well as employer and employee obligations to contribute are established, can be found in the Commonwealth's Comprehensive Annual Financial Report (CAFR).

VMI's total VRS contribution was \$1,410,634 for the year ended June 30, 2006, which included the 5 percent employee contribution assumed by the employer. These contributions represent 10.56 percent of covered payrolls for 2006.

VMI's payroll cost for employees covered by VaLORS was \$205,561 for the year ended June 30, 2006. VMI's total VaLORS contribution was \$48,595 for the year ended June 30, 2006, which represents 23.64 percent of the covered payroll for the 2006 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, 2006. The same report contains historical trend information showing VRS's progress in accumulating sufficient assets to pay benefits when due.

#### Other Retirement Plans

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 the Institute's and the employees' contributions. Total pension costs under this plan were approximately \$762,595 for year ended June 30, 2006. Contributions to the TIAA/CREF Insurance Companies were calculated using the base salary amount of approximately \$7,332,657 for fiscal year 2006.

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 that 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 \$1,023,583 for fiscal year ended June 30, 2006. Total pension costs under this plan were approximately \$106,453 for fiscal year 2006.

### 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 Commonwealth's 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; non-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 Commonwealth's 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, 2006, the Institute 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 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 and to accept various funds and to disburse such funds, or income earned from those funds, for the advancement of VMI and the Alumni Association.
- VMI Development Board, Incorporated The purposes of the VMI Development Board, Incorporated are to support VMI by coordinating development and fundraising efforts conducted on behalf of VMI Alumni and other donors.
- VMI Keydet Club, Incorporated The purposes of the VMI Keydet Club, Incorporated are to support, strengthen, and develop the intercollegiate athletics program at VMI.

#### Contributions Receivable

Contributions receivable at June 30, 2006 is presented as follows:

Unconditional promises to give	\$22,197,788
Charitable trust held by others	<u>186,408</u>
Total contributions receivable	22,384,196
Less:	
Current portion	<u>(4,878,151)</u>
Total non-current portion	<u>\$17,506,045</u>
Gross amounts expected to be collected in:	
Less than one year	\$ 5,420,168
One to five years	18,685,312
More than five years	<u>8,240,763</u>
Total	32,346,243
Less:	
Discount net present value at three percent - six percent	(4,433,653)
Allowance for uncollectible contributions	<u>(5,528,394)</u>
Total contributions receivable	<u>\$22,384,196</u>

The ownership of contributions receivable for each class of net assets as of June 30, 2006 is presented as follows:

Temporarily restricted	\$21,020,323
Permanently restricted	<u>1,363,873</u>
Total contributions receivable	<u>\$22,384,196</u>

At June 30, 2006, the Agencies had also received bequest and other intentions of approximately \$82.5 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, 2006, approximately 37 percent of the contributions receivable balance was from two donors.

#### Investments held by trustees

The Agencies participate in a combined investment fund (the "Fund") controlled by the VMI Investment Committee, a committee comprised of representatives from each agency. Mellon Trust of Boston, N.A. serves as custodian for the Fund's assets. The Fund's investments consist of the following as of June 30, 2006:

Equities	\$243,553,240	85.9%
Fixed income bond	30,647,911	10.8%
Cash and cash equivalent	<u>9,413,948</u>	<u>3.3%</u>
Total	283,615,099	<u>100.0%</u>
Less: Amount payable for securities purchased, net	<u>(1,037,497)</u>	
Total investments held by trustees	<u>\$282,577,602</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 for the year ended June 30, 2006 is presented as follows:

Investments, beginning	\$251,908,728
Investment returns:	
Dividends and interest	4,377,593
Net realized and unrealized gains	21,604,752
Less: investment fees	<u>(1,686,861)</u>
Total investment returns	24,295,484
Net receipts added to investment balances	<u>6,373,390</u>
Investments, ending	<u>\$282,577,602</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, 2006, the board-approved spending formula for the endowment provided for an annual spending rate of between 4.5 percent and 5.5 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.

#### Investments - Other

Investments - other consist of the following as of June 30, 2006:

	Held by <u>Agent</u>	Held by <u>Foundation</u>	Held in <u>Irrevocable Trusts*</u>	Total at Fair <u>Value**</u>
Equities	\$2,409,641	\$ 10	\$ 8,741,451	\$11,151,102
Fixed income	989,759	5,891	4,651,846	5,647,496
Real estate	-	1,440,667	-	1,440,667
Cash and cash equivalents	246,254	2,212	215,269	463,735
Limited partnerships	<u>-</u>	<u>17,128</u>	<u>-</u>	<u>17,128</u>
Total	<u>\$3,645,654</u>	<u>\$1,465,908</u>	<u>\$13,608,566</u>	<u>\$18,720,128</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.

#### Bonds Payable

Bonds payable consists of the following as of June 30, 2006:

Industrial Development Authority bonds payable in varying installments from \$265,000 to \$570,000, commencing 2011 through 2035. Interest is variable and ranged from 2.27 percent to 3.56 percent during the year ending June 30, 2006. Collateralized by a \$10.1 million letter of credit.	\$10,000,000
Variable rate Master Revenue Bond, payable \$126,000 in 2007. The bond bears interest at the Tax Exempt Note (TENR) rate plus 0.6 percent (TENR rate as of June 30, 2006 was 4.58 percent), capped at 6.75 percent. Uncollateralized.	126,000
Mark-to-market estimate of bank swap transaction related to Industrial Development Authority Bonds	<u>142,630</u>
Total bonds payable	10,268,630
Less: current maturities	<u>(126,000)</u>
Total non-current maturities	<u>\$10,142,630</u>

Debt matures as follows:

<u>Year ending June 30,</u>	
2007	\$ 126,000
2011	265,000
2012 and later years	9,735,000
Mark-to-market on interest rate swap	<u>142,630</u>
Total	<u>\$10,268,630</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.

### Subsequent Event

In July 2006, the Industrial Development Authority of the City of Lexington, Virginia issued to the VMI Development Board Tax-Exempt Adjustable Mode Educational Facilities Bonds, Series 2006 in the amount of \$45,000,000 of which \$10,000,000 will be used to refund Variable Rate Tax Exempt Bonds, Series 2004. Wachovia Bank, NA, issued a letter of credit to the bond trustees for the principal amount of \$45,000,000, covering the entire bond issue plus 34 days of accrued interest, which will expire July 2009, unless otherwise terminated or extended. The bonds are secured by the letter of credit. The bonds will initially bear interest at a daily rate and will require mandatory annual redemptions, commencing December 2012, for a thirty-year term.

## 17. COMPONENT UNITS

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

Condensed Statements Of Financial Position As of June 30, 2006	VMI Research Laboratories Inc.	VMI Alumni Agencies	Total
Assets:			
Current assets	\$600,356	\$ 15,183,885	\$ 15,784,241
Non-current assets	<u>277,921</u>	<u>323,597,425</u>	<u>323,875,346</u>
Total assets	<u>878,277</u>	<u>338,781,310</u>	<u>339,659,587</u>
Liabilities:			
Current liabilities	393,818	1,681,556	2,075,374
Non-current liabilities	<u>14,140</u>	<u>16,065,266</u>	<u>16,079,406</u>
Total liabilities	<u>407,958</u>	<u>17,746,822</u>	<u>18,154,780</u>
Net assets:			
Unrestricted	369,250	58,807,709	59,176,959
Temporarily restricted	91,069	165,720,166	165,811,235
Permanently restricted	<u>10,000</u>	<u>96,506,613</u>	<u>96,516,613</u>
Total net assets	<u>470,319</u>	<u>321,034,488</u>	<u>321,504,807</u>
Total net assets and liabilities	<u>\$878,277</u>	<u>\$338,781,310</u>	<u>\$339,659,587</u>

Condensed Statements Of Activities As of June 30, 2006	VMI Research Laboratories Inc.	VMI Alumni Agencies	Total
Total revenues	\$738,090	\$ 23,006,646	\$ 23,744,736
Total expenses	(534,784)	(29,214,647)	(29,749,431)
Total net realized and unrealized gains on investments	-	<u>23,028,437</u>	<u>23,028,437</u>
Total change in net assets	203,306	16,820,436	17,023,742
Total beginning net assets	<u>267,013</u>	<u>304,214,052</u>	<u>304,481,065</u>
Total ending net assets	<u>\$470,319</u>	<u>\$321,034,488</u>	<u>\$321,504,807</u>

## **SUPPLEMENTARY INFORMATION**

VIRGINIA MILITARY INSTITUTE  
STATEMENT OF OPERATIONS - AUXILIARY ENTERPRISES  
For the Year Ended June 30, 2006

	Food Services	Residential Facilities	Laundry	Student Health
Operating revenues:				
Cadet fees	\$ 3,913,975	\$ 1,738,870	\$ 250,483	\$ 167,910
Sales and services	60,026	233,979	-	-
Total operating revenues per SRECNA	3,974,001	1,972,849	250,483	167,910
Federal funds-work study	-	-	-	550
Add back items netted on SRECNA:				
Scholarship allowances for auxiliary fees	1,275,460	570,476	81,786	54,749
Auxiliary sales to other Institute departments	-	-	3,275	-
Total operating revenues	5,249,461	2,543,325	335,544	223,209
Operating expenses:				
Personal services	-	433,893	163,496	125,163
Supplies and materials	32,632	110,371	17,961	9,642
Equipment	757	111,723	-	-
Contractual services	3,607,598	565,158	618	112
Continuous charges	603,337	1,223,356	81,812	51,582
Cost of goods sold	-	-	-	-
Depreciation expense	36,677	247,610	7,597	2,232
Total operating expenses per SRECNA	4,281,001	2,692,111	271,484	188,731
Add back items netted on SRECNA:				
Expenses for sales to Institute departments	-	-	3,275	-
Depreciation expense	(36,677)	(247,610)	(7,597)	(2,232)
Total operating expenses	4,244,324	2,444,501	267,162	186,499
Net income/(loss) from operations	1,005,137	98,824	68,382	36,710
Non-operating revenues/(expenses):				
Investment income	-	-	-	-
Gifts	-	-	-	8,303
Net non-operating revenues/(expenses)	-	-	-	8,303
Net income/(loss) before transfers	1,005,137	98,824	68,382	45,013
Non-mandatory transfers:				
Transfers from endowment	-	-	-	-
Transfers to net invested in plant	-	-	(38,679)	-
Transfers to retirement of indebtedness	-	-	-	-
Transfers to renewals and replacements	-	-	-	-
Transfers to unrestricted	-	-	-	-
Net increase/(decrease) for the year	\$ 1,005,137	\$ 98,824	\$ 29,703	\$ 45,013

(A)These revenues and expenses 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
\$ 101,367	\$ 775,471	\$ -	\$ 254,786	\$ 1,386,339	\$ -	\$ 8,589,201
34,649	343	11,780	950	754,714	797	1,097,238
136,016	775,814	11,780	255,736	2,141,053	797 (A)	9,686,439
-	5,223	-	-	550	-	6,323
33,120	254,822	-	83,814	455,570	-	2,809,797
2,308	-	-	-	-	-	5,583
171,444	1,035,859	11,780	339,550	2,597,173	797	12,508,142
43,529	509,551	-	71,846	2,887,732	183,591	4,418,801
3,027	59,107	-	64,941	82,081	18,105	397,867
39	26,517	-	7,678	177,099	265,822	589,635
145,278	151,371	-	136,763	781,185	136,460	5,524,543
61,598	288,056	-	119,398	705,807	54,136	3,189,082
62,929	-	-	-	-	-	62,929
13,224	48,656	6,580	101,106	302,747	26,255	792,684
329,624	1,083,258	6,580	501,732	4,936,651	684,369 (A)	14,975,541
2,308	-	-	-	-	-	5,583
(13,224)	(48,656)	(6,580)	(101,106)	(302,747)	(26,255)	(792,684)
318,708	1,034,602	-	400,626	4,633,904	658,114	14,188,440
(147,264)	1,257	11,780	(61,076)	(2,036,731)	(657,317)	(1,680,298)
-	-	-	-	-	157,211 (B)	157,211
-	10,040	-	-	1,729,657	247,549	1,995,549
-	10,040	-	-	1,729,657	404,760	2,152,760
(147,264)	11,297	11,780	(61,076)	(307,074)	(252,557)	472,462
-	-	-	-	179,000	-	179,000
-	-	-	(35,922)	(12,043)	-	(86,644)
-	-	-	-	-	(169,225)	(169,225)
-	-	-	-	-	(689,695)	(689,695)
(380,000)	-	-	-	-	-	(380,000)
\$ (527,264)	\$ 11,297	\$ 11,780	\$ (96,998)	\$ (140,117)	\$ (1,111,477)	(674,102)
Fund balance at beginning of year						3,998,232
Fund balance at end of year						\$ 3,324,130



# Commonwealth of Virginia

**Walter J. Kucharski, Auditor**

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

March 7, 2007

The Honorable Timothy M. Kaine  
Governor of Virginia

The Honorable Thomas K. Norment, Jr.  
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 of Virginia, and its aggregate discretely presented component units as of and for the year ended June 30, 2006, 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, 2006, 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 one through eight 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 Virginia Military Institute. The accompanying Statement of Operations – Auxiliary Enterprises is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The Statement of Operations – Auxiliary Enterprises 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

##### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Institute'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.

### Status of Prior Findings

Virginia Military Institute has taken adequate corrective action with respect to audit findings reported in the prior year.

### EXIT CONFERENCE

We discussed this report with management at an exit conference held on March 22, 2007.

AUDITOR OF PUBLIC ACCOUNTS

JHS:sks  
sks:

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