VIRGINIA MILITARY INSTITUTE

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2004

APA

Auditor of Public Accounts

COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of Virginia Military Institute for the year ended June 30, 2004, 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 DISCUSSION AND ANALYSIS
"unaudited"

Overview

Virginia Military Institute (VMI) is pleased to present its financial statements for the fiscal year ended June 30, 2004, along with the financial statements of its affiliates as required under Governmental Accounting Standards Board (GASB) Statement 39. This management discussion and analysis is designed to help readers to understand the accompanying financial statements and provides an objective, easily readable analysis of the Institute's financial activities based on currently known facts, decisions and conditions. This discussion focuses primarily on VMI's FY 2004 and includes highly summarized data that should be read in conjunction with the accompanying financial statements, Notes to Financial Statements, and other supplementary information.

VMI's financial statements are prepared in accordance with GASB and include three basic statements: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. The affiliates' financial statements are prepared in accordance with Financial Accounting Standards (FASB) and include the Statement of Financial Condition and the Statement of Activities. The following analysis discusses elements from VMI's statements and provides an overview of the Institute's activities. It also includes a separate section that addresses the financial statements of VMI's affiliates.

Executive Summary

The state's continued sluggish economy resulted in state appropriations for operations totaling $11.4 million in FY 2004, which is a reduction of $1.2 million, or 9.3%, over FY 2003. Since FY 2002, state appropriations for operations have declined by $2.1 million, or 15.4%. Similar to Virginia's other state-supported institutions, VMI has been forced to increase its tuition and fees to avoid undermining the quality of its educational programs. Tuition, fees, and other operating income in FY 2004 total $22.1 million, an increase of $2.5 million, or 13.0%. Private gifts and contributions for operations total $13.4 million, an increase of $.06 million, or .5%. The rebound in the stock market resulted in investment income of $2.9 million, a dramatic improvement over the $18,000 for FY 2003. Support for VMI's capital projects and related debt service from the state and from private sources totals $2.4 million and $1.6 million, respectively. Revenues and support from all sources total $53.8 million in FY 2004, an increase of $6.8 million, or 14.6%.

Expenses for FY 2004 total $49.6 million, an increase of $2.9 million, or 6.3%. Personal services costs total $27.6 million, an increase of $1.6 million, or 6.2%, and primarily reflect increases in faculty salaries, health insurance, and retirement contributions. Supplies costs total $3.4 million, an increase of $1.1 million, or 43%, and primarily reflect increases in physical plant maintenance expense and cadet uniforms expense. The increase in cadet uniforms expense reflects the write-down of some obsolete inventory items and the correction of an inventory overstatement from last year.

Net assets for FY 2004 total $76.9 million, an increase of $4.2 million, or 5.7%. The investment in capital assets accounts for the largest portion of the increase growing by $3.6 million to $52.7 million and reflects VMI's on-going capital projects program that include Nichols Engineering Hall, Cocke Hall Annex, Jackson Memorial Hall, and Crozet Hall. Restricted net assets total $17.1 million, an increase of $1.5 million, or 10%, and reflect appreciation of the endowment and a $1.0 million contribution from ARAMARK Educational Services, Inc. (ARAMARK) toward the renovation of Crozet Hall. Unrestricted net assets total $7.1 million, down $1 million, or 12%.

VMI commenced the renovation of Crozet Hall ($10.4 million) in FY 2004 and continued the renovations of Nichols Engineering Hall ($14.7 million) and Jackson Memorial Hall ($2.5 million) and the construction of the Cocke Hall Annex ($2.1 million). VMI also substantially completed major repairs ($.8 million) to stabilize the foundation of the football stadium seating system. Construction in progress totaled $6.4 million as of year end.

Statement of Net Assets

The Statement of Net Assets presents the Institute's assets, liabilities, and net assets as of the end of the fiscal year. This statement presents a fiscal snapshot at June 30, 2004. Readers of the Statement of Net Assets should be able to determine the assets available to continue the Institute's operations. They should also be able to determine how much the Institute 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 the Institute's equity in property, plant, and equipment. The next category is "Restricted" net assets, which comprise two subcategories: expendable and nonexpendable. Expendable restricted resources are available for expenditure by the Institute in accordance with stipulation of donors and/or other entities that have placed time or purpose restrictions on the use of the assets. Nonexpendable restricted resources typically represent the corpus of endowments and are available only for investment purposes. The final category is "Unrestricted" net assets, which are available for any lawful purpose of the Institute.

Statement of Net Assets

	June 30, 2004	June 30, 2003
Assets:		
Current assets	$15,577,958	$13,613,491
Capital assets, net	55,089,375	51,001,043
Other noncurrent assets	23,148,077	21,605,363
Total assets	93,815,410	86,219,897
Liabilities:		
Current liabilities	9,303,089	5,643,469
Noncurrent liabilities	7,580,968	7,823,665
Total liabilities	16,884,057	13,467,134
Net assets:		
Invested in capital assets, net of related debt	52,741,136	49,134,144
Restricted – expendable	12,544,701	11,008,236
Restricted – nonexpendable	4,517,682	4,517,247
Unrestricted	7,127,834	8,093,136
Total net assets	$76,931,353	$72,752,763

VMI's current assets increased by $2.0 million, or 14.4%, and primarily reflect an increase of $1.5 million in cash and cash equivalents and an increase of $.8 million in collateral held for securities lending. The cash and cash equivalents increase reflect a $1.0 million contribution from VMI's food service provider, ARAMARK, toward the renovation of VMI's Crozet Hall renovation project. Collateral held for securities lending totals $1.2 million and represents VMI's allocated share of collateral received in connection with securities lending transactions of the State Treasury. This asset and corresponding offsetting liability are required to be reflected in VMI's financial statements in accordance with GASB Statement 28 although these are assets and liabilities of the state and not VMI.

Capital assets increased by $4.1 million to $55.1 million and consist primarily of construction-in-progress related to the renovation of Nichols Engineering Hall and the renovation and expansion of Crozet Hall. These projects are scheduled to be completed in 2006 and 2005, respectively.

Other non-current assets increased $1.5 million and primarily reflect a $1.8 million increase in VMI's endowment funds due to appreciation of investments resulting from a rebound in the stock market in FY 2004.

Current liabilities increased $3.7 million and consist primarily of construction costs payable on capital projects including a $1.0 million temporary bridge loan from the State Treasury related to the Crozet Hall capital project. This bridge loan was repaid in August 2004 after the state issued revenue bonds to finance this project. Obligations under securities lending also increased $.8 million as described above regarding current assets.

Net assets total $76.9 million at year end, or an increase of $4.2 million, due largely to construction-in-progress on VMI's capital projects at year end.

Statement of Revenues, Expenses, and Changes in Net Assets

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

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

Nonoperating 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

	Year Ended June 30, 2004	Year Ended June 30, 2003
Operating revenues:		
Tuition and fees	$ 10,266,132	$ 8,742,716
Grants and contracts	666,826	914,448
Auxiliary enterprises	8,836,428	7,889,225
Unique military activities	1,097,012	916,059
Other sources	1,229,545	1,089,738
Total operating revenues	22,095,943	19,552,186
Operating expenses:		
Educational and general	31,173,104	29,881,903

Auxiliary enterprises	12,808,332	12,265,577
Unique military activities	4,953,554	3,907,288
Total operating expenses	48,934,990	46,054,768
Operating loss	(26,839,047)	(26,502,582)
Nonoperating revenues (expenses):		
State appropriations	11,387,742	12,553,013
Private gifts and contributions	13,363,437	13,303,221
Investments	2,881,681	17,697
Other	(687,110)	(648,348)
Net nonoperating revenues	26,945,750	25,225,583
Income (loss) before other revenues	106,703	(1,276,999)
Other revenues	4,071,887	1,527,461
Increase in net assets	4,178,590	250,462
Net assets – beginning of year	72,752,763	72,502,301
Net assets – end of year	$ 76,931,353	$ 72,752,763

Operating revenues totaled $22.1 million, an increase of $2.5 million, or 13.0%, for FY 2004. This is due primarily to a 12.3% increase in total tuition and fee revenues. This reflects tuition rate increases of 8.2% for in-state cadets (52% of the Corps) and 7.9% for out-of-state cadets (48% of the Corps). It also reflects a 3.6% increase in average enrollment for the year arising from a larger fall semester enrollment (1,362 vs. 1,330) plus significant improvement in the retention of cadets during the year. This improvement was primarily in out-of-state cadets and yielded almost $.5 million in tuition and fee revenue.

Operating expenses increased by $2.9 million, or 6.3%, to $48.9 million and consist of the following increases: Educational and General Program ($1.3 million, or 4.3%), Auxiliary Enterprises Program ($.5 million, or 4.4%), and the Unique Military Activities Program ($1.0 million, or 26.8%). The increases include a 2.25% salary increase for all employees effective in December 2003 and an additional 4.7% average increase for all teaching faculty to bring those salaries closer to the 60th percentile of VMI's faculty peer group institutions. The UMA Program cost increase reflects a cadet uniform inventory write-down of approximately $225,000 for obsolete items and $300,000 to correct an inadvertent overstatement of the prior year end inventory. These adjustments result in a $525,000 charge to supplies expense for FY 2004.

Non-operating revenues (net) total $26.9 million, an increase of $1.7 million, or 6.8%. This consists primarily of the net effect of an increase in investment income of $2.9 million offset by a reduction in state appropriations of $1.2 million, or 9.3%. The reduction in state appropriations reflects the state's continuing revenue shortfall and budget cuts to higher education. The rebound in the stock market resulted in the appreciation of the endowment.

Other revenues total $4.1 million, an increase of $2.5 million, and is attributed primarily to $2.1 million in state support for the Nichols Engineering Hall project and $1.1 million in private support for the improvements to the Patchin Field House. State support for the Nichols Engineering Hall project totals $14.7 million, but is being allocated to VMI in annual installments as needed to pay project costs.

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, noncapital financing activities, capital and related financing activities, investing activities, and the 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

	Year Ended June 30, 2004	Year Ended June 30, 2003
Net cash used by operating activities	$(22,954,504)	$(24,020,607)
Net cash provided by noncapital financing activities	24,754,417	25,936,909
Net cash used by capital and related financing activities	(1,587,971)	(2,639,088)
Net cash provided by investing activities	1,179,307	1,308,408
Net increase in cash	1,391,249	585,622
Cash – beginning of year	9,215,639	8,630,017
Cash – end of year	$ 10,606,888	$ 9,215,639

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

The $1.6 million of net cash used by capital and related financing activities consists primarily of cash expended on capital projects (Nichols Engineering Hall, Crozet Hall, and football stadium seating repairs), equipment, and debt service less the amount of related state funding (capital appropriations) and debt funding (Crozet Hall temporary bridge loan) received for such activities.

The $1.2 million in net cash provided by investing activities primarily reflects spendable income from VMI's endowment assets that support various programs and activities. It also includes $450,000 from the Collins Endowment to help fund improvements at New Market Battlefield State Historical Park.

Capital Asset and Debt Administration

FY 2004 marked the second year of VMI's major capital projects program that will last for at least the remainder of this decade. This program includes the renovation and/or expansion of several academic facilities (Nichols Engineering Hall, Mallory Hall, Jackson Memorial Hall, Cocke Hall, and Kilbourne Hall) and two major auxiliary facilities (Crozet Hall and the Barracks). The Nichols Engineering Hall ($14.7 million) and the Mallory Hall ($9.1 million) projects are being funded from State General Obligation (GOB) bonds approved in 2002. The Nichols Engineering Hall project commenced in 2003 and is expected to be completed in 2006. The Mallory Hall renovation project will commence in 2005 and is scheduled for completion in 2007. The Jackson Memorial Hall ($2.5 million) project and the Cocke Hall Annex ($2.1 million) project are being financed by Virginia College Building Authority (VCBA) revenue bonds that were issued in 2002 and for which debt service is being funded by VMI with cadet fees and private funds. These projects are underway and should be completed in 2006. The $10.4 million Crozet Hall project commenced in 2003 and is being financed from revenue bonds with debt service being paid from VMI private funds.

The General Assembly approved state funding for capital projects in FY 2005 consisting of $9.1 million for the renovation and expansion of Kilbourne Hall, $4.1 million for emergency repairs to the VMI Barracks, and $.9 million for storm water improvements. Planning for these projects is underway and construction will begin in 2005. VMI also received the Governor's approval in September 2004 for a $10 million project to renovate and expand the football and the baseball stadiums. The VMI Development Board, Inc., has agreed to finance this project for VMI and be responsible for payment of the debt.

VMI is requesting the Governor and the General Assembly to appropriate state funds in FY 2006 consisting of an additional $7.4 million for the Kilbourne Hall project and $3.6 million to begin planning the renovation and expansion of the Barracks. VMI is also requesting state approval to use private funds to construct a $12 million leadership center with parking garage and a $13.6 million leadership/athletic facilities project. Private funding for these two projects will come from one or more of VMI's alumni agencies. An additional $1.0 million in revenue bond financing is also being requested for the Crozet Hall renovation project.

In summary, VMI had $29.7 million in capital projects in progress at the end of FY 2004 and funding approved for an additional $33.2 million to start in FY 2005. Plans are also underway for $37.6 million in additional projects beginning in FY 2006 subject to appropriation of state funds and/or receipt of private funds. This brings VMI's current and proposed capital projects program total to a record $100.5 million. VMI is seeking a combination of state and private funding for these projects as appropriate and is committed to minimizing the amount of debt service that must be paid by cadets.

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 $270 million and $.2 million, respectively, as of June 30, 2004. VMIAA net assets consist of $64 million in unrestricted net assets and $206 million in temporarily or permanently restricted net assets. VMIAA revenues total $15.8 million for FY 2004 and include $12.5 million raised on behalf of VMI, of which $7.9 million, or 63%, consists of temporarily or permanently restricted revenue.

Economic Outlook

State support for VMI's programs continues to decline making up only 23% of total operating and non-operating revenues in FY 2004 compared to 28% in FY 2003. This support is expected to remain at approximately 23% in FY 2005 due to approximately $450,000 of additional state funding for operations including salary increases. Increases in state support for operations beyond FY 2005 will likely be linked primarily to state approved salary and fringe benefit increases. State funding for other costs is uncertain since the state has adopted a "base budget adequacy" funding formula that indicates that VMI is already fully funded. However, VMI will continue to strive to increase its share of state funding for operations in order to minimize the need for tuition and fee increases.

VMI received $2.4 million in state support for capital projects in FY 2004, an increase of $1.4 million over FY 2003 and directly related to the on-going renovation of Nichols Engineering Hall. The state also appropriated $14.1 million in new projects for FY 2005. VMI is asking the state for an additional $11.0 million in FY 2006 for new projects. VMI believes that there is a reasonable possibility that some or all of this funding may be received.

Private fund support from VMI's alumni agencies represented approximately 27% of VMI's total operating and non operating revenues in FY 2004 compared to 29% in FY 2003. The alumni agencies agreed, beginning in FY 2005, to provide VMI with a constant level of unrestricted fund support through FY 2010. This level of funding will help minimize any drop in the proportion of private support for VMI's programs and operations in the years ahead. Private fund support for capital projects totaled $1.6 million in FY 2004 and $10 million of support for FY 2005 is already promised for the stadium projects. VMI estimates an additional $12 million in FY 2005 for a leadership and ethics center and parking garage may be realized.

VMI increased FY 2005 tuition and fees by 5.3% for in-state cadets and 5.6% for out-of-state cadets. VMI expects increases in the next few years to approximate this level due to the likelihood of little new state funding. VMI will continue its efforts to reduce costs and increase efficiencies to minimize the costs borne by cadets.

VMI enrolled a record 1,393 cadets in fall 2004 consisting of 52% in-state cadets. VMI plans for the next few years to enroll approximately 1,340 cadets consisting of approximately 52% to 54% in-state cadets.

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

VIRGINIA MILITARY INSTITUTE
STATEMENT OF NET ASSETS
As of June 30, 2004

ASSETS	
Current assets:	
Cash and cash equivalents (Note 2)	$ 9,594,789
Collateral held for securities lending (Note 2)	1,201,835
Accounts receivable, net of allowance for doubtful accounts of $60,774 (Note 3)	779,729
Due from the Commonwealth (Note 9)	64,086
Prepaid expenditures	641,988
Inventory (Note 4)	2,629,903
Loans receivable	665,628
Total current assets	15,577,958
Noncurrent assets:	
Cash and cash equivalents (Note 2)	1,012,099
Cash and investment with trustees (Note 2)	16,884,848
Accounts receivable (Note 3)	45,152
Investments held with the Treasurer of Virginia (Note 2)	4,295,706
Notes receivable	210,000
Loans receivable, net of allowance for doubtful accounts of $32,939	700,272
Nondepreciable capital assets (Note 5)	8,060,217
Depreciable capital assets, net of accumulated depreciation (Note 5)	47,029,158
Total noncurrent assets	78,237,452
Total assets	93,815,410
LIABILITIES	
Current liabilities:	
Accounts payable and accrued expenses (Note 6)	4,204,860
Bond anticipation treasury loan (Note 7)	1,000,000
Deferred revenue	1,150,799
Obligations under securities lending	1,201,835
Deposits held for others	571,362
Long-term liabilities-current portion: (Note 8)	
Compensated absences	773,157
Notes payable (Note 9)	385,000
Capital lease payable (Note 9)	5,860
Installment purchase obligation (Note 9)	10,216
Total current liabilities	9,303,089
Noncurrent liabilities:	
Accrued liabilities	213,766
Federal loan program contributions refundable	1,225,322
Retainage payable (Note 10)	147,483
Long-term liabilities-noncurrent portion: (Note 8)	
Compensated absences	459,358
Notes payable (Note 9)	5,527,590
Capital lease payable (Note 9)	2,340
Installment purchase obligation (Note 9)	5,109
Total noncurrent liabilities	7,580,968
Total liabilities	16,884,057

NET ASSETS

Invested in capital assets, net of related debt	52,741,136
Restricted-Nonexpendable:	
Endowment	4,517,682
Restricted-Expendable:	
Scholarships and other	2,143,889
Loan funds	515,307
Quasi-endowment-restricted	9,885,505
Unrestricted	7,127,834
Total net assets	$76,931,353

The accompanying notes to financial statements are an integral part of this statement.

VIRGINIA MILITARY INSTITUTE - COMPONENT UNITS
COMBINED STATEMENT OF FINANCIAL POSITION
As of June 30, 2004

ASSETS	
Current assets:	
Cash and cash equivalents	$ 2,699,540
Contributions receivable (Note 18)	8,250,335
Accounts receivable	27,136
Other	282,196
Total current assets	11,259,207
Noncurrent assets:	
Contributions receivable (Note 18)	15,786,932
Accounts receivable	73,720
Notes receivable	23,249
Investments held by trustees (Note 18)	230,658,558
Investments, other (Note 18)	17,061,197
Investment securities	91,145
Cash surrender of life insurance	3,964,556
Property and equipment, net of accumulated depreciation	425,980
Total noncurrent assets	268,085,337
Total assets	279,344,544
LIABILITIES	
Current liabilities:	
Accounts payable and accrued expenses	496,408
Other liabilities	630,417
Long-term liabilities - current portion:	
Bonds payable	232,000
Notes payable	30,000
Trust and annuity obligations	841,993
Total current liabilities	2,230,818
Noncurrent liabilities:	
Deferred revenue	11,521
Accrued liabilities	45,152
Long-term liabilities - noncurrent portion:	
Bonds payable	358,000
Trust and annuity obligations	6,040,101
Total noncurrent liabilities	6,454,774
Total liabilities	8,685,592
NET ASSETS	
Unrestricted	64,279,664
Temporarily restricted	121,351,746
Permanently restricted	85,027,542
Total net assets	270,658,952
Total liabilities and net assets	$ 279,344,544

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, 2004

Operating revenues:	
Tuition and fees, net of scholarships allowances of $3,611,888	$ 10,266,132
Federal grants and contracts	626,975
State and private grants and contracts	39,851
Sales and services of educational departments	84,154
Auxiliary enterprise, net of scholarship allowances of $2,824,709	8,836,428
Unique military activities, net of scholarships allowances of $384,722	1,097,012
Other sources:	
Museum programs	460,209
Rents and commissions	237,985
Miscellaneous	447,197
Total operating revenues	22,095,943
Operating expenses:	
Educational and general:	
Instruction	13,476,471
Research	280,571
Public service	1,067,814
Academic support	5,134,162
Student services	2,625,597
Institutional support	4,014,642
Operation and maintenance of physical plant	3,876,849
Scholarships and related expense	696,998
Auxiliary enterprises	12,808,332
Unique military activities	4,953,554
Total operating expenditures (Note 11)	48,934,990
Net operating loss	(26,839,047)
Nonoperating revenues/(expenses):	
State appropriations (Note 12)	11,387,742
Private gifts and contributions	13,363,437
Investment income	2,881,681
Interest on capital asset - related debt	(263,746)
Loss on disposal of plant assets	(423,364)
Net nonoperating revenues (expenses)	26,945,750
Income before other revenues	106,703
Other revenues:	
State appropriations - capital	2,403,141
Grants and gifts - capital	1,622,497
Investment income - capital	46,249
Total other revenues	4,071,887
Increase in net assets	4,178,590
Net assets - beginning of year	72,752,763
Net assets - end of year	$ 76,931,353

The accompanying notes to financial statements are an integral part of this statement.

VIRGINIA MILITARY INSTITUTE - COMPONENT UNITS
COMBINED STATEMENT OF ACTIVITIES
For the Year Ended June 30, 2004

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues:				
Amounts raised on behalf of VMI	$ 4,609,587	$ 6,087,188	$ 1,816,516	$ 12,513,291
Grants, contributions, and contracts	167,987	41,681	-	209,668
Investment income	754,832	336,212	-	1,091,044
Actuarial loss on trust and annuity obligations	(184,946)	374,564	(174,481)	15,137
Administrative fees	2,150,000	-	-	2,150,000
Other Income	392,448	-	-	392,448
Net assets released from restrictions and reclassifications	7,653,019	(7,653,019)	-	-
Total revenues	15,542,927	(813,374)	1,642,035	16,371,588
Expenses:				
Amounts remitted directly to or on behalf of VMI:				
Unrestricted	6,210,933	-	-	6,210,933
Designated	8,386,996	-	-	8,386,996
Cost of operations	4,495,268	-	-	4,495,268
Conference, research and education	568,355	-	-	568,355
Total expenses	19,661,552	-	-	19,661,552
Change in net assets before net realized and unrealized losses on investments	(4,118,625)	(813,374)	1,642,035	(3,289,964)
Net realized and unrealized gains (losses) on investments	10,253,315	27,916,208	-	38,169,523
Change in net assets	6,134,690	27,102,834	1,642,035	34,879,559
Net assets - Beginning of year	58,144,974	94,248,912	83,385,507	235,779,393
Net assets - End of year	$ 64,279,664	$ 121,351,746	$ 85,027,542	$ 270,658,952

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, 2004

Cash provided/(used) by operating activities:	
Tuition and fees	$ 10,458,184
Federal grants and contracts	626,975
State and private grants and contracts	120,168
Sales and services - educational and general	65,278
Auxiliary charges	8,784,480
Unique military activity charges	1,133,077
Other operating receipts	1,033,064
Payments to employees for salaries and benefits	(27,414,244)
Payments for supplies and services	(17,071,242)
Payments for scholarships and fellowships	(696,998)
Loans issued to students	(280,783)
Collections of loans from students	287,537
Net cash used by operating activities	(22,954,504)
Cash provided/(used) by noncapital financing activities:	
State appropriations	11,387,742
Gifts and grants for other than capital purposes	13,363,437
Federal Direct Lending Program - receipts	3,253,024
Federal Direct Lending Program - disbursements	(3,253,024)
Agency receipts	3,732,381
Agency disbursements	(3,729,143)
Net cash provided by noncapital financing activities	24,754,417
Cash provided/(used) by capital and related financing activities:	
Capital appropriations	2,403,141
Capital gifts	556,282
Proceeds from sale of capital assets	2,275
Proceeds from capital debt	1,380,309
Purchase and construction of capital assets	(5,403,002)
Principal paid on capital debt, leases, and installments	(251,101)
Interest paid on capital debt, leases, and installments	(276,390)
Investment income - capital	515
Net cash used by capital and relating financing activities	(1,587,971)
Cash provided/(used) by investing activities:	
Interest on investments	88,425
Investment/Endowment income	225,819
Sale of investments	1,269,407
Purchase of investments	(404,344)
Net cash provided by investing activities	1,179,307
Net increase in cash	1,391,249
Cash and cash equivalents - beginning of year	9,215,639
Cash and cash equivalents - end of year	$ 10,606,888

RECONCILIATION OF NET OPERATING EXPENSES TO NET CASH USED BY OPERATING ACTIVITIES:	
Operating loss	$ (26,839,047)
Adjustments to reconcile net operating expenses to cash used by operating activities:	
Depreciation expense	2,797,377
Changes in net assets and liabilities:	
Accounts receivable	(147,085)
Inventories	459,414
Prepaid expenditures	(48,443)
Due from Commonwealth	(31,306)
Accounts payable and accrued liabilities	578,485
Deposits held in custody for others-security deposits	21,396
Deferred revenue	255,740
Loans receivable	(23,540)
Compensated absences	(2,905)
Federal loan program contributions refundable	25,410
Net cash used in operating activities	$ (22,954,504)
Noncash investing, noncapital financing, and capital related financing transactions:	
Fixed assets acquired by donation	$ 1,066,214
Change in fair value of investments recognized as a component of investment income/(loss)	$ 1,325,649

The accompanying notes to financial statements are an integral part of this statement.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

A. Reporting Entity

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

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

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

The Governmental Accounting Standards Board (GASB) Statement 39, *Determining Whether Certain Organizations Are Component Units,* issued May 2002, became effective for the fiscal year ended June 30, 2004. This statement amended GASB Statement 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 the Institute.

The VMI Alumni Agencies is a legally separate, tax-exempt entity whose purpose is to organize the alumni of the Institute and to aid in the promotion of its welfare and the successful prosecution of its educational purposes. It accomplishes this through fund-raising to supplement the support VMI receives from the Commonwealth of Virginia 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, we have determined that the Alumni Agencies should be included as a component unit.

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

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

B. Financial Statement Presentation

The Institute'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 Association's or the VMI Research Laboratories' financial information in the Institute's financial report for these differences.

C. Basis of Accounting

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

D. 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 nonoperating 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 the Institute 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, 2004. This is primarily composed of revenue for student tuition and fees received in advance of the next semester or term.

H. Accrued Compensated Absences

Nonfaculty salaried employee's attendance and leave regulations make provisions for the granting of a specified number of days of leave with pay each year. Instructional personnel do not earn leave. The amount of leave earned, but not taken as of June 30, 2004, 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 of Virginia's sick leave payout policy upon termination which is the lesser of 25% of sick leave not taken or $5,000 per employee with five or more years of service. Also included is an estimation of sick leave for those employees who, while not currently vested, will probably attain the five years of service required to vest. The last element reflected in the liability is Social Security and Medicaid taxes to be paid by the Institute on all accrued compensated absences.

I. Federal Financial Assistance Programs

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

J. 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.

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

Restricted net assets – nonexpendable: Nonexpendable 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 of the Institute and may be used at the discretion of the governing board to meet current expenses for any purpose. These resources also include auxiliary enterprises, which are substantially self-supporting activities that provide services for 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.

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

K. Classification of Revenues

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

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

Nonoperating revenues: Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, and other revenue sources that are defined as nonoperating revenues by GASB 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 Nonexchange Transactions,* and GASB Statement 34, such as state appropriations and investment income.

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

2. CASH AND CASH EQUIVALENTS AND INVESTMENTS

A. Cash Equivalents

All of VMI's cash is maintained in accounts that are collateralized in accordance with the Virginia Securities for Public Deposits Act, Section 2.2-4400 et. seq., of the Code of Virginia.

B. Cash and Investments with Trustees

VMI's investments are categorized below to give an indication of the level of credit risk assumed by the Institute at June 30, 2004. Credit risk is the risk that the Institute may not be able to obtain possession of its investment or collateral at maturity.

Category 1: Insured or registered securities or securities held by the Institute or its safekeeping agent in the Institute's name.

Category 2: Uninsured or unregistered with securities held by the counter party's trust department or agent in the Institute's name.

Category 3: Uninsured or unregistered with securities held by the counter party, or by its trust department or agent, but not in the Institute's name.

	Fair Value June 30, 2004
Cash:	
Deposits with financial institutions	$ 729,156
Cash with Treasurer of Virginia	6,631,737
Petty cash	10,970
Total cash	7,371,863
Cash equivalents (Category 3):	
Business money market performance account	3,235,025
Cash and Investments with Trustees:	
Noncategorized	16,884,848
Investments with the Treasurer of Virginia:	
State Non-Arbitrage Program (SNAP)	4,295,706
Collateral held for securities lending	1,201,835
Total investments with Treasurer of Virginia	5,497,541
Total cash, cash equivalents and investments	$32,989,277

C. Securities Lending Transactions

Collateral held for securities lending and the securities lending transactions reported on the financial statements represent the Institute's allocated share of securities received for securities lending transactions held in the General Account of the Commonwealth. Information related to the credit risk of these investments and securities lending transactions held in the General Account is available on a statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report.

D. Funds Held In Trust By Others

Assets of funds held by trustees for the benefit of the Institute are not reflected in the accompanying Statement of Net Assets. The Institute 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 the Institute according to the trust agreements. Income from funds held by trustees for the benefit of the Institute totaled $78,423 for the year ended June 30, 2004, and is included in the endowment income.

3. ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following at June 30, 2004:

Student tuition and fees	$212,283
Other educational and general	33,440
Auxiliary enterprises	46,827
Unique military activity	9,257
Private grants	14,212
Agency funds	261,836
Other operating	250,718
Retirement of indebtedness	57,082
Total	885,655
Less: Allowance for doubtful accounts	(60,774)
Net accounts receivable	$824,881

4. INVENTORIES

Inventories consisted of the following at June 30, 2004:

Physical plant	$ 375,032
Military store	2,140,481
Museums	109,140
VMI hospital	5,250
Total	$2,629,903

5. CAPITAL ASSETS

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

	Beginning Balance July 1, 2003	Additions	Reductions	Ending Balance June 30, 2004
Nondepreciable capital assets:				
Land	$ 1,667,896	$ -	$ -	$ 1,667,896
Construction in progress	2,029,394	5,159,755	(796,828)	6,392,321
Total nondepreciable capital assets	3,697,290	5,159,755	(796,828)	8,060,217
Depreciable capital assets:				
Buildings	85,693,547	1,097,668	(168,101)	86,623,114
Land improvements	2,297,264	653,149	-	2,950,413
Equipment	9,133,331	627,924	(306,718)	9,454,537
Library books	9,523,512	219,997	(5,046)	9,738,463
Total depreciable capital assets	106,647,654	2,598,738	(479,865)	108,766,527

Less accumulated depreciation for:				
Buildings	44,823,498	1,748,629	(162,962)	46,409,165
Land improvements	1,276,391	137,598	-	1,413,989
Equipment	5,080,546	688,850	(235,902)	5,533,494
Library books	8,163,467	222,300	(5,046)	8,380,721
Total accumulated depreciation	59,343,902	2,797,377	(403,910)	61,737,369
Depreciable capital assets	47,303,752	(198,639)	(75,955)	47,029,158
Total capital assets, net	$ 51,001,042	$4,961,116	$(872,783)	$ 55,089,375

6. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following at June 30, 2004:

Current liabilities:	
Employee salaries, wages, and benefits payable	$2,461,305
Vendors and supplies accounts payable	1,651,981
Accrued interest payable	91,574
Total current liabilities-accounts payable and accrued liabilities	$4,204,860

7. BOND ANTICIPATION TREASURY LOAN

Effective December 12, 2003, the Institute obtained a Virginia Treasury Loan authorizing up to $10 million for a term of 12 months in order to provide cash for payment of obligations incurred prior to the sale of 9(c) revenue bonds for the renovation and enlargement of Crozet Hall and parking. As of June 30, 2004, the Institute had drawn $1 million from this loan to meet obligations.

8. NONCURRENT LIABILITIES

The Institute's long-term liabilities primarily consist of long-term debt (further described in Note 9) and accrued compensated absences. A summary of changes in long-term liabilities for the year ending June 30, 2004 is presented as follows:

	Beginning Balance July 1, 2003	Additions	Reductions	Ending Balance	Current Portion June 30, 2004
Long-term debt:					
Notes payable	$6,160,233	$ -	$ (247,643)	$5,912,590	$ 385,000
Capital leases	14,085	-	(5,885)	8,200	5,860
Installment purchases	25,541	-	(10,216)	15,325	10,216
Total long-term debt	6,199,859	-	(263,744)	5,936,115	401,076
Accrued compensated absences	1,235,419	837,466	(840,370)	1,232,515	773,157
Total long-term liabilities	$7,435,278	$837,466	$(1,104,114)	$7,168,630	$1,174,233

9. LONG-TERM INDEBTEDNESS

Notes Payable

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

Revenue bonds 9(d):	Interest Rates (%)	Maturity	2004
Barracks Wiring, Series 1998A	3.70 – 4.10	2008	$1,325,000
Cocke Hall Annex, Series 2002A	4.00 – 5.25	2022	2,130,766
JM Hall Renovation, Series 2002A	4.00 – 5.25	2022	2,456,824
Total notes payable			$5,912,590

Maturities of notes payable for years succeeding June 30, 2004, are as follows:

Year	Notes Payable
2005	$ 385,000
2006	405,000
2007	425,000
2008	440,000
2009	460,000
2010-2014	1,000,000
2015-2019	1,285,000
2020-2023	1,285,000
Plus: Unamortized premium	227,590
Total future principal requirements	$5,912,590

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 $51,080 with no interest. A summary of future obligations under these agreements as of June 30, 2004, follows:

Year Ending June 30,	Principal	Interest	Total
2005	$10,216	$ -	$10,216
2006	5,109	-	5,109
Total	$15,325	$ -	$15,325

Capital Leases Payable

VMI is the lessee of equipment under capital leases expiring in various years through 2005. The assets under capital leases are recorded as property, plant and equipment at the lower of the net present value of the minimum lease payments during the lease term or the fair market value of the asset.

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

For all capital leases, the minimum lease payments together with the present value of the net minimum lease payments as of June 30, 2004 are as follows:

Year Ending June 30,	Other Capital Leases
2005	$ 8,916
2006	3,280
Total minimum lease payments	12,196
Less: Executory costs	(3,412)
Interest	(584)
Present value of net minimum lease payments	$ 8,200

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

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 the Institute now owns the equipment from the date of purchase.

The Statement of Net Assets line "Due from the Commonwealth of Virginia" totaling $64,086 includes $60,798 for equipment purchased by the Institute that was not reimbursed by the VCBA as of June 30, 2004.

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 the Institute has renewal options. In most cases, the Institute expects these leases will be replaced by similar leases in the normal course of business. Rental expense was approximately $93,944 for the year ended June 30, 2004.

Year Ending June 30,	Amount
2005	$ 50,513
2006	31,260
2007	14,157
2008	4,320
Total	$100,250

10. RETAINAGE PAYABLE

At June 30, 2004, $147,483 was held by the Institute 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.

11. EXPENSES BY NATURAL CLASSIFICATIONS

The Institute's operating expenses by natural classification for the year ended June 30, 2004, were as follows:

Program	Personal Services	Supplies	Contractual Services	Equipment	Utilities	Student Aid	Other Operating Expense	Depreciation Expense	Total
Instruction	$11,377,134	$ 219,590	$ 618,097	$ 364,351	$ -	$ -	$ 28,313	$ 868,986	$13,476,471
Research	128,625	33,552	69,955	1,382	-	-	9,530	37,527	280,571
Public service	550,862	152,673	316,423	11,766	-	-	25	36,065	1,067,814
Academic support	3,121,125	109,483	876,630	283,858	-	-	139,596	603,470	5,134,162
Student services	1,564,716	99,869	557,279	68,191	-	-	120,079	215,463	2,625,597
Institutional support	2,588,647	-	971,242	111,649	10,790	-	243,669	88,645	4,014,642
Operation and maintenance of plant	1,907,921	690,636	294,617	76,545	600,991	-	77,082	229,057	3,876,849
Student aid	-	2,323	31,389	-	-	663,286	-	-	696,998
Auxiliary enterprises	3,635,860	454,842	5,017,694	169,140	230,743	-	2,749,247	550,806	12,808,332
Unique military activities	2,676,476	1,601,509	66,079	11,505	-	-	430,627	167,358	4,953,554
Total	$27,551,366	$3,364,477	$8,819,405	$1,098,387	$842,524	$663,286	$3,798,168	$2,797,377	$48,934,990

12. STATE APPROPRIATIONS

VMI receives state appropriations from the General Fund of the Commonwealth of Virginia. The Appropriation Act specifies that any 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. FY 2004 ends the biennium.

During the fiscal year ended June 30, 2004, the Institute received the following supplemental appropriations and reversions in accordance with the Appropriation Act:

Original legislative appropriation:	
Educational and general programs	$ 8,133,897
Unique military activity	3,794,037
Student financial assistance	562,947
Adjustments:	
Salary adjustments	80,782
Fringe benefit adjustments	11,568
Airline ticket savings	(4,639)
ETF lease payment – NGF portion	(22,690)
Student financial assistance adjustment	7,707
Insurance premium adjustments	10,236
Debt service fee	(36,135)
Information technology savings	(685)
Appropriation transfers:	
SCHEV programs	23,541
Virginia Polytechnic Institute and State University	(1,172,824)
Adjusted appropriations	$11,387,742

13. RETIREMENT AND PENSION SYSTEMS

Employees of the Institute are employees of the Commonwealth of Virginia. Most full-time classified salaried employees of the Institute participate in the defined benefit retirement plan administered by the Virginia Retirement System (VRS). The Institute 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 act as a common investment and administrative agency for the Commonwealth of Virginia and its political subdivisions.

The Institute's payroll costs for employees covered by VRS totaled $12,130,075 for the year ended June 30, 2004. The Institute's total payroll costs were $23,069,070 for the year ended June 30, 2004.

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).

The Institute's total VRS contribution was $1,175,284 for the year ended June 30, 2004, which included the five percent employee contribution assumed by the employer. These contributions represent 9.84% of covered payrolls for 2004.

The Institute's payroll costs for employees covered by VaLORS were $186,226 for the year ended June 30, 2004. The Institute's total VaLORS contributions was $37,801 for the year ended June 30, 2004, which represents 20.37% of the covered payroll for the 2004 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, 2004. The same report contains historical trend information showing VRS's progress in accumulating sufficient assets to pay benefits when due.

TIAA/CREF Insurance Company ORP

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%) 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 $552,961 for year ended June 30, 2004. Contributions to the TIAA/CREF Insurance Companies were calculated using the base salary amount of approximately $5,316,928 for fiscal year 2004.

Other Defined Contribution Pension Plans

The Institute also contributed to four other defined contribution pension plans, which are insignificant in relation to VRS and TIAA/CREF. Full-time faculty, certain administrative staff who hold academic rank, and athletic coaches are eligible to participate in several optional retirement programs (ORP) other than VRS and TIAA/CREF. Retirement benefits received are based entirely upon the employer's (10.4%) contributions, plus interest and dividends, with the employer assuming the employee's contribution share.

Amounts contributed to VALIC were calculated using the base salary amount of approximately $373,014 for fiscal year ended June 30, 2004. Total pension costs under this plan were approximately $38,793 for fiscal year 2004.

Amounts contributed to Fidelity Investments were calculated using the base salary amount of approximately $473,306 for fiscal year ended June 30, 2004. Total pension costs under this plan were approximately $49,224 for fiscal year 2004.

Amounts contributed to T. Rowe Price were calculated using the base salary amount of approximately $310,523 for fiscal year ended June 30, 2004. Total pension costs under this plan were approximately $32,294 for fiscal year 2004.

Amounts contributed to Met Life were calculated using the base salary amount of approximately $108,523 for the fiscal year ended June 30, 2004. Total pension costs under this plan were approximately $11,286 for fiscal year 2004.

Effective July 1, 2004, VALIC, T. Rowe Price, and Met Life were terminated as optional retirement programs offered by the Commonwealth.

14. POST-EMPLOYEMENT 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 Comprehensive Annual Financial Report.

15: RISK MANAGEMENT

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

16. CONTINGENCIES

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

In addition, the Institute is required to comply with various federal regulations issued by the Office of Management and Budget. Failure to comply with certain systems requirements of these regulations may result in questions concerning the allowability of related direct and indirect charges pursuant to such agreements. As of June 30, 2004, the Institute estimates that no material liabilities will result from such audits or questions.

17. SUBSEQUENT EVENTS

On August 4, 2004, $11,240,000 of Section 9(c) revenue bonds, Series 2004A, were sold by the Department of Treasury in connection with VMI's capital project to renovate and enlarge Crozet Hall and parking, and to repay a $1 million treasury loan. The Institute received authorization for a $10 million treasury loan on December 12, 2003, but only drew $1 million of these funds. The bonds bear interest at an average coupon rate of 4.8% and are payable over 20 years through June 2025. The net proceeds after the cost of issuance total approximately $11,893,000 and include bond premium realized on the sale.

18. VMI ALUMNI AGENCIES

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

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

Contributions receivable

Contributions receivable consist of the following:

Unconditional promises to give	$ 23,779,999
Charitable trust held by others	257,268
Less: Current portion	(8,250,335)
Total	$ 15,786,932

Gross amounts expected to be collected in:	
Less than one year	$ 9,167,039
One to five years	16,044,799
More than five years	14,013,854
Less:	
Discount to net present value at 3% - 6%	(11,291,583)
Allowance for uncollectible contributions	(3,896,842)
Total	$ 24,037,267

The ownership of contributions receivable for each class of net assets as of June 30, 2004, is as follows:

Temporarily restricted	$20,974,565
Permanently restricted	3,062,702
Total	$24,037,267

At June 30, 2004, the Agencies had also received bequest and other intentions of approximately $81.4 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, 2004, approximately 41% of the contributions receivable balance was from one donor.

Investments held by trustees

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

Equities	$198,525,124	85.9%
Fixed income bond	26,267,273	11.4%
Cash and cash equivalents	6,241,500	2.7%
Total	231,033,897	100.0%
Less: Amount payable for securities purchased, net	(375,339)	
Total	$230,658,558	

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 trusties activity is reflected below:

Investments, beginning	$196,065,787
Investment returns:	
Dividends and interest	3,293,040
Net realized and unrealized gains	34,613,239
Less investment fees	(1,421,996)
Total	36,484,283
Amounts appropriated for operations, net transfers to operational accounts and other activity	(1,891,512)
Investments, ending	$230,658,558

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, 2004, the Board-approved spending formula for the endowment provided for an annual spending rate of not more than 5.3% 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:

	Held by Agent	Held by Foundation	Held in Irrevocable Trusts*	Total at Fair Value**
Equities	$ 820,896	$ 12	$ 7,552,933	$ 8,373,841
Fixed income	1,626,654	5,891	4,154,964	5,787,509
Real estate	-	701,136	-	701,136
Cash and cash equivalents	429,303	783	1,721,564	2,151,650
Limited partnerships	24,973	22,088	-	47,061
Total	$2,901,826	$729,910	$13,429,461	$17,061,197

*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.

19. COMPONENT UNITS

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

Condensed Statement of Net Assets as of June 30, 2004

	VMI Research Laboratories, Inc.	VMI Alumni Agencies	Total
Assets:			
Current assets	$335,862	$ 10,923,345	$ 12,175,911
Noncurrent assets	164,865	267,920,472	267,168,633
Total assets	500,727	278,843,817	279,344,544
Liabilities:			
Current liabilities	208,634	2,022,184	2,230,818
Noncurrent liabilities	56,673	6,398,101	6,454,774
Total liabilities	265,307	8,420,285	8,685,592
Net assets:			
Unrestricted	192,044	64,087,620	65,251,031
Temporarily restricted	33,376	121,318,370	120,380,379
Permanently restricted	10,000	85,017,542	85,027,542
Total net assets	235,420	270,423,532	270,658,952
Total net assets and liabilities	$500,727	$278,843,817	$279,344,544

Condensed Statements of Revenues, Expenses and Changes in Net Assets
For the Year Ended June 30, 2004

	VMI Research Laboratories, Inc.	VMI Alumni Agencies	Total
Total revenues	$ 614,770	$ 15,756,818	$ 16,371,588
Total expenses	(612,031)	(19,049,521)	(19,661,552)
Total net realized and unrealized gains on investments	-	38,169,523	38,169,523
Total change in net assets	2,739	34,876,820	34,879,559
Total beginning net assets	232,681	235,546,712	235,779,393
Total ending net assets	$ 235,420	$270,423,532	$270,658,952

VIRGINIA MILITARY INSTITUTE
SCHEDULE OF OPERATIONS - AUXILIARY ENTERPRISES
For the Year Ended June 30, 2004

	Food Services	Residential Facilities	Laundry	Student Health
Operating revenues:				
Cadet fees	$ 3,512,813	$ 1,564,920	$ 217,342	$ 151,363
Sales and services	231,202	345,724	198	-
Total operating revenues per SRECNA	3,744,015	1,910,644	217,540	151,363
Federal funds-Work study	-	-	-	742
Add back items netted on SRECNA:				
Scholarship allowances for auxiliary fees	1,309,011	577,766	83,220	55,935
Auxiliary sales to other Institute departments	-	43,019	3,616	-
Total operating revenues	5,053,026	2,531,429	304,376	208,040
Operating expenditures:				
Personal services	-	455,606	177,917	131,727
Supplies and materials	24,956	157,622	4,160	10,816
Equipment	5,404	41,003	2,431	-
Contractual services	3,482,265	337,235	759	1,297
Continuous charges	562,323	1,187,143	23,737	19,448
Site/Property Improvements	-	32,163	-	-
Cost of goods sold	-	-	-	-
Depreciation expense	13,392	98,660	7,744	2,232
Total operating expenses per SRECNA	4,088,340	2,309,432	216,748	165,520
Add back items netted on SRECNA:				
Expenses for auxiliary sales to Institute departments	-	43,019	3,616	-
Depreciation expense	(13,392)	(98,660)	(7,744)	(2,232)
Total operating expenses	4,074,948	2,253,791	212,620	163,288
Net income (loss) from operations	978,078	277,638	91,756	44,752
Nonoperating revenues (expenses):				
Investment income	-	-	-	-
Gifts	-	-	-	7,275
Net nonoperating revenues (expenses)	-	-	-	7,275
Net income (loss) before transfers	978,078	277,638	91,756	52,027
Transfers: Nonmandatory				
Transfers (to)/from endowment	-	-	-	-
Transfers (to)/from net invested in plant	27,709	(155,803)	-	-
Transfers (to)/from retirement of indebtedness	-	-	-	-
Transfers (to)/from renewals and replacements	-	-	-	-
Transfers (to)/from unrestricted	-	-	-	-
Net increase (decrease) for the year	$ 1,005,787	$ 121,835	$ 91,756	$ 52,027
Fund balance at beginning of year, as restated				
Fund balance at end of year				

(A) These revenues and expenditures are related to the Auxiliary Administration account and the Auxiliary Contingency account and are not identified with a specific auxiliary.
(B) Interest earned on the auxiliary reserve cash balance at the Commonwealth, not allocable to any particular auxiliary enterprise.

Stores and Shops	Student Union	Parking	Cameron Hall	Athletics	Other	Total
$ 90,264	$ 618,346	$ -	$ 205,888	$ 1,174,450	$ -	$ 7,535,386
25,721	-	11,265	4,150	632,782	50,000	1,301,042
115,985	618,346	11,265	210,038	1,807,232	50,000 (A)	8,836,428
-	1,854	-	-	742	-	3,338
34,107	236,700	-	79,127	448,843	-	2,824,709
1,087	-	-	-	-	-	47,722
151,179	856,900	11,265	289,165	2,256,817	50,000	11,712,197
5,051	258,733	-	74,443	2,289,320	243,063	3,635,860
10,227	121,378	-	9,457	87,364	1,827	427,806
-	26,564	-	5,540	88,198	-	169,140
75,830	213,145	-	16,644	744,073	146,446	5,017,694
11,947	280,132	-	115,005	671,345	76,747	2,947,827
-	-	-	-	-	-	32,163
27,036	-	-	-	-	-	27,036
13,657	32,512	6,580	90,474	265,198	20,357	550,806
143,748	932,464	6,580	311,563	4,145,498	488,440 (A)	12,808,332
1,087	-	-	-	-	-	47,722
(13,657)	(32,512)	(6,580)	(90,474)	(265,198)	(20,357)	(550,806)
131,178	899,952	-	221,089	3,880,300	468,083	12,305,249
20,001	(43,052)	11,265	68,076	(1,623,483)	(418,083)	(593,052)
-	-	-	-	-	71,606 (B)	71,606
-	11,049	-	-	1,501,683	-	1,520,007
-	11,049	-	-	1,501,683	71,606	1,591,613
20,001	(32,003)	11,265	68,076	(121,800)	(346,477)	998,561
-	-	-	-	182,000	-	182,000
-	-	-	-	(97,147)	(33,552)	(258,793)
-	-	-	-	-	(103,466)	(103,466)
-	-	-	-	-	(800,000)	(800,000)
-	-	-	-	-	(115,233)	(115,233)
$ 20,001	$ (32,003)	$ 11,265	$ 68,076	$ (36,947)	$ (1,398,728)	(96,931)
						3,634,290
						$ 3,537,359

Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

April 8, 2005

The Honorable Mark R. Warner
Governor of Virginia

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

The 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, 2004, 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 opinions, insofar as it relates the amounts included for the component units of the Institute are 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, 2004, 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.

As described in the Notes to Financial Statements, the Institute has implemented the provisions of Governmental Accounting Standards Board Statement 39, which addresses the conditions under which institutions should include associated foundations as component units and how such component units should be displayed in the financial statements.

The management's discussion and analysis on pages 1 through 7 is not a required part of the basic financial statements, but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

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

EXIT CONFERENCE

We discussed this report with management at an exit conference held on April 29, 2005.

AUDITOR OF PUBLIC ACCOUNTS

WHC/kva

VIRGINIA MILITARY INSTITUTE
Lexington, Virginia