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# Notes to the Financial Statements

June 30, 2004

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### A. Basis of Presentation

The accompanying financial statements have been prepared in conformance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB).

### B. Reporting Entity

For financial reporting purposes, the Commonwealth of Virginia's (the "Commonwealth's") reporting entity consists of (1) the primary government, (2) component unit organizations for which the primary government is financially accountable (blended component units), and (3) other component unit organizations for which the nature and significance of their relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete, and they are financially accountable to the primary government (discrete component units). The funds of all agencies, boards, commissions, foundations, and authorities that have been identified as part of the primary government or a component unit have been included. GASBS No. 39 was implemented in fiscal year 2004 and requires the inclusion of numerous organizations that raise and hold funds for the direct benefit of the primary government.

Section 2100 of the *GASB Codification of Governmental Accounting and Financial Reporting Standards* (GASB Codification) describes the criteria for determining which organizations, functions, and activities should be considered part of the Commonwealth for financial reporting purposes. The basic criteria include appointing a voting majority of an organization's governing body, and the Commonwealth's ability to impose its will on that organization or the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Commonwealth.

- (1) **Primary Government** – A primary government consists of all the organizations that make up its legal entity. All funds, organizations, institutions, agencies, and departments are, for financial reporting purposes, part of the primary government.
- (2) **Blended Component Units** – Though legally separate entities, these component units are, in substance, part of the primary government's operations. The blended component unit serves or benefits the primary government almost exclusively. Financial information from

these units is combined with that of the primary government. Blended component units are:

**Pocahontas Parkway Association** (Major Enterprise Fund) – The Association, a private, non-stock, nonprofit corporation was created to develop, construct, and provide financing for the Route 895 Connector Project. The Association is a blended component unit of the Department of Transportation (Primary Government) because it is fiscally dependent on the primary government and provides services entirely to the benefit of the Commonwealth. Ernst & Young, LLP audited the Association, and a separate report is available from the Association, Post Office Box 35033, Richmond, Virginia 23235.

**Virginia Public Building Authority (VPBA)** (Nonmajor Governmental Funds) – The Authority was created as a body politic and corporate and is fiscally independent. A government instrumentality, the Authority finances the acquisition and construction of buildings for the use of the Commonwealth and other approved purposes. The Governor appoints the seven-member board, and the primary government is able to impose its will on the Authority. The Auditor of Public Accounts audits the Authority, and a separate report is issued from the Department of the Treasury, Post Office Box 1879, Richmond, Virginia 23218.

**Virginia Land Conservation Foundation (VLCF)** (Nonmajor Special Revenue Fund) – The Foundation was created as a body politic and corporate to serve the Department of Conservation and Recreation (Primary Government) by acquiring interests in preservation land and providing grants to other entities to acquire interests in preservation land. The Governor appoints the 18-member board, and the primary government can impose its will on the Foundation. The administrative offices of the Foundation are located at 203 Governor Street, Suite 402, Richmond, Virginia 23219. The Auditor of Public Accounts audits the Foundation as part of the Department of Conservation and Recreation and discloses its existence in that report.

**Virginia Arts Foundation** (Nonmajor Permanent Fund) – The Foundation was created as a body politic and corporate to serve the Virginia Commission for the Arts (Primary Government) by promoting the arts in the Commonwealth. The Governor appoints the Board of Trustees for the Virginia Commission for the Arts, which also serves as the Board for the Virginia Arts Foundation. The

Director of the Virginia Commission for the Arts serves as the Board chairman. In addition, the primary government can impose its will on the Foundation. The administrative offices of the Foundation are located at 223 Governor Street, Richmond, VA 23219. The Auditor of Public Accounts audits the foundation as part of the Virginia Commission for the Arts.

- (3) **Discrete Component Units** – Discretely presented component units are reported in a separate column in the government-wide financial statements to emphasize that they are legally separate from the primary government. They are financially accountable to the primary government, or have relationships with the primary government such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. These discrete component units serve or benefit those outside of the primary government.

GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, is effective for fiscal year 2004. This Statement generally requires any organization that raises and holds economic resources for the direct benefit of the reporting entity to be reported as a component unit, even if the reporting entity is not financially accountable for the organization. The entities are included in the Commonwealth's reporting entity function as nonprofit charitable organizations and exist solely to support the Commonwealth's higher education institutions or museums. The higher education institution nonprofit organizations are included in the applicable higher education institution's column in the accompanying financial statements. The museum foundations, which are discretely presented, are more fully described later in this footnote. The Virginia Horse Center Foundation, a component unit of the Virginia Equine Center (Center) (Nonmajor Component Unit), is included in the Center's column in the accompanying financial statements. In all instances where separate disclosure of these nonprofit organizations is required in the accompanying footnotes, the entities' totals are aggregated and disclosed as "Foundations." Discretely presented component units are:

**Higher Education Institutions** – The Commonwealth's higher education institutions are granted broad corporate powers by State statutes. The Governor appoints the members of each institution's Board of Trustees. In addition to the annual appropriations to support the institutions' operations, the State provides funding for, and construction of, major academic plant facilities for the institutions. Therefore, there is a financial benefit/burden to the primary government. The bonds issued to finance the construction of these facilities are obligations of the State. The major higher education institutions are: University of

Virginia, including the University of Virginia Hospital and the University of Virginia's College at Wise (formerly reported as Clinch Valley College); Virginia Polytechnic Institute and State University; and Virginia Commonwealth University, including the Virginia Commonwealth University Health System Authority (formerly reported as MCV Health Systems Authority). The nonmajor Higher Education Institutions are: the College of William & Mary, including Richard Bland College and the Virginia Institute of Marine Science; Virginia Military Institute; Virginia State University; Norfolk State University; Mary Washington College; James Madison University; Radford University; Old Dominion University; George Mason University; Virginia Community College System; Christopher Newport University; and Longwood University. The Southwest Virginia Higher Education Center and the Roanoke Higher Education Authority are also included as nonmajor higher education institutions. The colleges and universities are funded through State appropriations, tuition, Federal grants, and private donations and grants. As noted previously, certain Foundations are considered component units of the higher education institutions and are included in the accompanying financial statements and the higher education institutions' individually published financial statements. The APA does not audit component units of the higher education institutions, including Foundations, but relies on the reports issued by other auditors to render their opinion.

The Auditor of Public Accounts (APA) audits the colleges and universities, and individual reports are issued under separate cover. Complete financial statements for each institution may be obtained from their respective administrative offices. The addresses for these institutions may be obtained from the Virginia Department of Accounts, 101 North 14th Street, Richmond, Virginia 23219.

**Virginia Housing Development Authority (VHDA)** (Major) – The Authority was created as a political subdivision and instrumentality of the Commonwealth and is granted both political and corporate powers by the *Code of Virginia*. The Governor appoints a majority of the Authority's Board members and the remainder of the Board members are ex-officio. The Commonwealth may make grants to the Authority including, but not limited to, reserve funds, which is a potential financial benefit/burden to the primary government. The State is not legally obligated by the debt of the Authority. The Authority was created in the public interest to provide investment in and stimulate construction of low to moderate income housing which benefits the citizens of the Commonwealth. The administrative offices of the Authority are located at 601 South

Belvidere Street, Richmond, Virginia 23220. KPMG, LLP audited the Authority, and a separate report is available.

**Virginia Public School Authority (VPSA)** (Major) – The Authority was created as a public body corporate, and an agency and instrumentality of the Commonwealth to finance capital projects of city and county school boards. The Governor appoints the board members, who serve at his pleasure. Therefore, the primary government is able to impose its will on the Authority. The Auditor of Public Accounts audits the Authority, and a separate report is issued from the Department of the Treasury, Post Office Box 1879, Richmond, Virginia 23218.

**Virginia Economic Development Partnership (VEDP)** (Nonmajor) – The Partnership was created as a body corporate and operates to encourage, stimulate, and support the development and expansion of commerce in the Commonwealth. The Governor appoints the 15-member board, and there is a financial benefit/burden to the primary government. The administrative offices are located at 901 East Byrd Street, Post Office Box 798, Richmond, Virginia 23218-0798. The Auditor of Public Accounts audits the Partnership, and a separate report is issued.

**Virginia Outdoors Foundation** (Nonmajor) – The Foundation was created as a body politic and is administratively assigned to the Department of Conservation and Recreation (Primary Government) and charged with promoting preservation through the acceptance of donated conservation easements and raising funds for the purchase of preservation land. The Governor appoints the seven-member Board of Trustees, and the primary government can impose its will on the Foundation. The administrative offices of the Foundation are located at 302 Royal Lane, Blacksburg, Virginia 24060. The Auditor of Public Accounts audits the Foundation as part of the Department of Conservation and Recreation and discloses its existence in that report.

**Virginia Port Authority (VPA)** (Nonmajor) – The Authority was established as a corporate body and operates to serve the citizens and promote commerce through the harbors and ports of Virginia. The Governor appoints a majority of the 12-member board, and the primary government is able to impose its will on the Authority. There is also a financial benefit/burden to the primary government. The administrative offices of the Authority are located at 600 World Trade Center, Norfolk, Virginia 23510. The Auditor of Public Accounts audits the Authority, and a separate report is issued.

**Virginia Resources Authority (VRA)** (Nonmajor) – The Authority was created as a statewide public body corporate political subdivision of the Commonwealth to provide financing of infrastructure projects for water supply, wastewater, storm water, solid waste treatment, airports, public safety, brownfields remediation and redevelopment, and recycling. The Governor appoints the 11-member board and the Executive Director of the Authority. The primary government is able to impose its will on the Authority, and there is a financial benefit/burden to the primary government. The Commonwealth does not guarantee any bonds issued by the Virginia Resources Authority. The administrative offices of the Authority are located at 707 East Main Street, Suite 1350, Richmond, Virginia 23219. Goodman and Company, LLP audited the Authority, and a separate report is available.

**Virginia Tourism Authority** (Nonmajor) – The Authority was created as a public body corporate and as a political subdivision of the Commonwealth. The Authority encourages, stimulates, and promotes tourism and film production industries of the Commonwealth. The Governor appoints all of the board members, and there is a financial benefit/burden to the primary government. The administrative offices are located at 901 East Byrd Street, Nineteenth Floor, Richmond, Virginia 23219. The Auditor of Public Accounts audits the Authority, and a separate report is issued.

**Virginia Tobacco Settlement Foundation** (Nonmajor) – The Foundation was created as a body corporate and as a political subdivision of the Commonwealth. The Foundation was established to determine the appropriate recipients of monies in the Virginia Tobacco Settlement Fund and to distribute monies in this fund for such efforts as restricting the use of tobacco products by minors and the enforcement of laws restricting the distribution of tobacco products to minors. The Governor appoints the majority of the board, and there is a financial benefit/burden to the primary government. The administrative offices are located at 701 East Franklin Street, Fifth Floor, Richmond, Virginia, 23219. The Auditor of Public Accounts audits the Authority, and a separate report is issued.

**Tobacco Indemnification and Community Revitalization Commission** (Nonmajor) – The Commission was created as a body corporate and as a political subdivision of the Commonwealth. The Commission was established to determine the appropriate recipients of the monies in the Tobacco Indemnification and Community Revitalization Fund. This fund is to provide payments to tobacco farmers as compensation for the adverse economic effects resulting from loss of investment in specialized tobacco equipment

and barns, and lost tobacco production opportunities. It also provides monies to revitalize tobacco dependent communities. The Governor appoints the majority of the board, and there is a financial benefit/burden to the primary government. The administrative offices are located at 701 East Franklin Street, Suite 501, Richmond, Virginia 23219. The Auditor of Public Accounts audits the Commission, and a separate report is issued.

**Hampton Roads Sanitation District Commission** (Nonmajor) – The Commission was established as a political subdivision of the Commonwealth and a government instrumentality. The Commission, which is the governing Board of the District, was granted corporate powers by the *Code of Virginia*. The Governor appoints the Commission members, who serve at his pleasure. Therefore, the primary government is able to impose its will on the Commission. The Commonwealth is not obligated by the debt of the Commission. The Commission was established to benefit the inhabitants of the District and operates a sewage system for 17 localities in the Chesapeake Bay area. The address for the administrative offices of the Commission is 1436 Air Rail Ave, Post Office Box 5915, Virginia Beach, Virginia 23471. KPMG, LLP, audited the Commission, and a separate report is available.

**Virginia Biotechnology Research Park Authority** (Nonmajor) – The Authority is a legally separate, political subdivision of the Commonwealth created by the General Assembly to assist in the development of a biotechnology research park. The Governor appoints the board members of the Authority, and there is a potential financial benefit/burden to the primary government. The administrative offices of the Authority are located at 800 East Leigh Street, Richmond, Virginia 23219. The Auditor of Public Accounts audits the Authority, and a separate report is issued.

**Small Business Financing Authority (SBFA)** (Nonmajor) – The Virginia Small Business Financing Act of 1984 (Chapter 28, Title 9, *Code of Virginia*) established the Authority as a public body corporate and a political subdivision of the Commonwealth. The Governor appoints the 11-member board, and the primary government is able to impose its will on the Authority. The Authority was created to assist small businesses in the Commonwealth in obtaining financing for new businesses or the expansion of existing businesses. The Authority can provide financial assistance to small businesses by providing loans, guarantees, insurance, and other assistance, thereby encouraging the investment of private capital in small businesses in the Commonwealth. The Authority can loan money to local governments as defined by the *Code of Virginia* for

economic development purposes. The Authority also guarantees loans made to small businesses by banks. The administrative offices of the Authority are located at 707 East Main Street, Suite 300, Richmond, Virginia 23219. The Auditor of Public Accounts audits the Authority, and a separate report is issued.

**Virginia Schools for the Deaf and Blind Foundation** (Nonmajor) – The Foundation operates as a non-private educational and fund raising organization solely in connection with, and exclusively for the benefit of the Virginia School for the Deaf and Blind at Staunton (Primary Government) and the Virginia School for the Deaf, Blind and Multi-Disabled at Hampton (Primary Government), and within the jurisdiction and management of the Virginia Board of Education. The Foundation uses a December 31 calendar year end. The administrative offices of the Foundation are located at the Virginia Department of Education, 101 North 14th Street, Richmond, Virginia, 23219. The Auditor of Public Accounts audits the Foundation along with the audit of the Department of Education, and a separate report is issued.

**Science Museum of Virginia Foundation** (Nonmajor) – The Foundation is a non-stock, non-profit corporation established to implement and fund programs, projects, and operations that are authorized and approved by the Trustees of the Science Museum of Virginia (Primary Government). The administrative offices of the Foundation are located at the Science Museum of Virginia, 2500 W. Broad Street, Richmond, Virginia 23220. The Foundation is audited by Rose, Sanderson & Creasy, LLC, and a separate report is available.

**Virginia Museum of Fine Arts Foundation** (Nonmajor) – The Foundation operates as a non-profit corporation under the laws of Virginia to fund exhibitions, programs, and capital asset expansion to ensure that the Virginia Museum of Fine Arts (Primary Government) has the space and resources for art to help improve the quality of life for many. The administrative offices of the Foundation are located at 2800 Grove Avenue, Richmond, Virginia 23221. KPMG, LLP, audits the Foundation and a separate report is issued.

**A. L. Philpott Manufacturing Extension Partnership** (Nonmajor) – The Partnership has the mission to foster economic growth by enhancing the competitiveness of Virginia's manufacturers. The Partnership provides manufacturing firms with fee-based technology consulting services, access to business modernization resources, and support for interfirm collaboration. Further, the Partnership provides direct assistance to increase sales, decrease costs, and improve quality, productivity, and competitiveness. The

Partnership has a 23-member Board of Trustees. The Board consists of the presidents of two public four-year institutions of higher education; three community college presidents; the director of Virginia's Center for Innovative Technology; Virginia's Secretary of Commerce and Trade; and fifteen citizen members, representing manufacturing industries, appointed by the Governor. There is also a financial benefit/burden to the primary government. The administrative office is located at Patrick Henry Community College, 645 Patriot Avenue, Post Office Box 5311, Martinsville, Virginia 24115. The Auditor of Public Accounts audits the Partnership, and a separate report is issued.

**Virginia Equine Center Foundation** (Nonmajor) – The Foundation was created as a body politic and corporate, and operates the Virginia Equine Center (Center) for the benefit of the equine and tourism industries. In 1994, the Commonwealth began making grant payments to the Foundation to keep the Center from falling into default on its debt. The Governor appoints a majority of the 11-member board, and there is a financial benefit/burden to the primary government. As previously noted, the Center includes the Virginia Horse Center Foundation as part of its report, pursuant to GASBS No. 39. The address for the administrative offices of the Foundation is Post Office Box 1051, Lexington, Virginia 24450. The accounting firm of William White, Sr., CPA audited the Foundation, and a separate report is available.

**Certified Nursing Facility Education Initiative** (Nonmajor) – The Initiative was created as a nonprofit corporation by the *Code of Virginia* to assist the Department of Medical Assistance Services (DMAS) (Primary Government). The Initiative provides early on-site training and assistance to certified nursing facilities to improve quality of care and life to certified nursing facility residents. The address for the administrative offices of the Initiative is Post Office Box 465, Orange, Virginia 22960. Cole & King, LLC, CPA's audited the Initiative, and a separate report is available. A note to the audited financial statements disclosed that the Initiative has relied on funding from DMAS to meet operating expenses and expressed concern that the Initiative might not be able to continue operations past June 30, 2005, should that funding not be renewed or replaced by another source.

**Innovative Technology Authority (ITA)** (Nonmajor) – The Authority is granted corporate powers by the *Code of Virginia*. The Authority serves to facilitate the marketing, organization, and development of scientific research and technology by the State's institutions of higher education and private industry in the Commonwealth. The Governor appoints the 16-member board, and there is a

financial benefit/burden to the primary government. The Authority's combined financial statements include the accounts of the Center for Innovative Technology (CIT) after elimination of all significant intercompany balances and transactions. CIT is a nonstock, not-for-profit corporation, which acts as the operating arm of the Authority. The address for the administrative offices of the Authority is CIT Building, Suite 600, 2114 Rock Hill Road, Herndon, Virginia 22070. The Auditor of Public Accounts audits the Authority, and a separate report is issued.

**Virginia College Building Authority (VCBA)** (Nonmajor) – The Authority was created as a public body corporate, a political subdivision, and an agency and instrumentality of the Commonwealth. The Governor appoints a majority of the board and members serve at his pleasure. Therefore, the primary government is able to impose its will on the Authority. The Authority finances certain capital projects and equipment purchases of State-supported colleges and universities. The Auditor of Public Accounts audits the Authority, and a separate report is issued from the Department of the Treasury, Post Office Box 1879, Richmond, Virginia 23218.

Only the activity of the Authority that relates to the financing of capital projects and equipment purchases by State-supported colleges and universities is included in the financial statements. The Authority assists private institutions of higher education in the financing and refinancing of a broad range of facilities. The Authority is authorized to issue obligations and lend the proceeds to private institutions; however, such financings or refinancings are not obligations of the Commonwealth nor the Authority, but are payable solely from the revenues pledged by the respective private institution. This indebtedness, totaling \$358.6 million, is not included in the financial statements.

- (4) **Related Organizations** – Organizations for which a primary government is accountable because that government appoints a majority of the Board, but is not financially accountable, are related organizations. Related organizations are:

**Virginia Recreational Facilities Authority** – The Authority was created as a political subdivision and instrumentality of the Commonwealth and given separate corporate powers by the *Code of Virginia*. The Governor appoints the 13-member board of directors. The Authority operates educational programs, tourism, and commerce in the Roanoke Valley. The address for the administrative offices of the Authority is 3900 Rutrough Road, Roanoke, Virginia 24014. Foti, Flynn, Lowen and Company audited the Authority, and a separate report is available.

**Miller School of Albemarle** – The School was created through the will of Samuel Miller of Lynchburg to provide a quality education for poor and orphaned children in central Virginia. Initially, the Commonwealth was charged with oversight of the Miller Trust Fund, which supported the School. The Governor still appoints one-third of the board. The administrative offices of the School are located at 1000 Samuel Miller Loop, Charlottesville, Virginia 22903. Joseph J. Saunders, III, CPA, Inc. audited the School, and a separate report is available.

**Jamestown-Yorktown Educational Trust** – The Trust was created as a nonprofit corporation by the *Code of Virginia* to assist the Jamestown-Yorktown Foundation (Foundation). The Trust Board consists of six members selected from the Foundation's Board of Trustees. Several Commonwealth officials serve as ex-officio members of the Foundation's Board, and the Governor appoints twelve members. The Trust operates the Jamestown Settlement and Yorktown Victory Centers' gift shops and café, oversees investments, and sponsors events. The address for the administrative offices of the Trust is Post Office Box 3605, Williamsburg, Virginia 23187. Goodman and Company, LLP, audited the Trust, and a separate report is available.

**Virginia Birth-Related Neurological Injury Compensation Program** – The Program was created to provide a no-fault alternative for birth-related neurological injuries. The Governor appoints the 7-member board. The administrative offices of the Program are located at 9100 Arboretum Parkway Suite 365, Richmond, Virginia 23236. Cherry, Bekaert, & Holland audited the Program, and a separate report is available.

**Chesapeake Bay Bridge and Tunnel Commission** – The Commission was created to establish policy and administer operations of the Chesapeake Bay Bridge Tunnel District. Any of the 11 members of the Commission appointed or reappointed on or after July 1, 1998, shall be appointed by the Governor, subject to confirmation by each house of the General Assembly. The administrative offices of the Commission are located at Post Office Box 111, 32386 Lankford Highway, Cape Charles, Virginia 23310. KPMG, LLP, audited the Commission, and a separate report is available.

**Assistive Technology Loan Fund Authority** – The Authority was created as a political subdivision and public body corporate by the *Code of Virginia*. The Governor appoints the board of directors as directed by the *Code*. The Authority manages a fund to provide loans to individuals to acquire assistive technology, other equipment, or other

authorized purposes designed to help disabled individuals become more independent. The administrative offices are located at 1602 Rolling Hills Drive, Suite 106, Richmond, Virginia 23229. The Authority is audited by Wells, Coleman and Company, LLP.

### C. Government-wide and Fund Financial Statements

The government-wide financial statements, the Statement of Net Assets and the Statement of Activities, report information on all nonfiduciary activities of the primary government and component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which are normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Also, the primary government activity is reported separately from the legally separate component units for which the Commonwealth is financially accountable.

The Statement of Activities demonstrates the degree to which direct expenses of a specific function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function, segment, or component unit. In addition, to the extent that indirect costs are allocated to the various functions, the program expenses will include both direct and indirect costs. Program revenues include charges to customers who purchase, use, or directly benefit from goods or services provided by a given function, segment, or component unit, as well as investment income generated by operations. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function, segment, or component unit. Taxes and other items properly excluded from program revenues are reported as general revenues.

Net assets are restricted when constraints are placed on them that are imposed by external parties or constitutional provisions. Designations solely imposed by the Commonwealth's management are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, the Commonwealth's policy is to use the restricted resources first. Some institutions of higher education may follow a different policy.

Separate financial statements are provided for governmental funds, proprietary funds, fiduciary funds, and component units. However, fiduciary funds are not included in the government-wide statements. Major governmental funds, enterprise funds, and component units are reported as separate columns in the fund financial statements, with nonmajor funds being aggregated into a single column.

#### D. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

**Government-wide Financial Statements** – The government-wide financial statements are reported using the economic resources measurement focus and the full accrual basis of accounting. Revenues are recorded when earned and expenses are recognized when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

**Governmental Fund Financial Statements** – The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Commonwealth considers revenues to be available if they are collected within 60 days of the end of the current fiscal year (or one year for Medicaid). Significant revenues subject to accrual include Federal grants and income and sales taxes. Income tax revenues for tax underpayments are only recognized to the extent of the Commonwealth's estimated refunds for tax overpayments received. Revenues that the Commonwealth earns by incurring obligations are recognized in the same period as when the obligations are recognized.

Expenditures generally are recorded when a liability is incurred, as under full accrual accounting. However, expenditures related to debt service, compensated absences, and claims and judgements are recorded only when the payment is due.

The Commonwealth reports the following major governmental funds:

**General Fund** – Accounts for the transactions related to resources received and used for those services traditionally provided by a State government, which are not accounted for in any other fund. These services include general government, legislative and judicial activities, public safety, health and mental health programs, resources and economic development, licensing and regulation, and primary and secondary education.

**Commonwealth Transportation Special Revenue Fund** – Accounts for the revenues and expenditures associated with highway operations, maintenance, construction, and other transportation related activities. Funding for these programs is received from highway user taxes, fees, and funds received from the Federal government.

**Federal Trust Special Revenue Fund** – Accounts for all federal dollars received by the

Commonwealth except those received by the Commonwealth Transportation Fund, the Unemployment Compensation Fund, and institutions of higher education. In addition, federal funds received from Medicaid intergovernmental transfers and for the Commonwealth's share of claims are reported in the Other – Special Revenue Fund.

**Literary Fund Special Revenue Fund** – Accounts for revenues from fines, forfeitures, and proceeds from unclaimed property used primarily to support public education in the Commonwealth. This fund provides low interest loans to school divisions for construction, renovations, and expansion of school buildings.

**Proprietary Funds, Fiduciary Funds, and Component Units Financial Statements** – The financial statements of the proprietary funds, fiduciary funds, and component units are reported using the economic resources measurement focus and the full accrual basis of accounting. As with the government-wide statements, revenues are recorded when earned and expenses are recognized when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating.

*GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, provides governments two options for reporting their enterprise funds (including component units reporting as business-type activities). All enterprise funds reported herein, with the exception of the Pocahontas Parkway (Major Enterprise Fund), the Virginia Port Authority (Nonmajor Component Unit), the A. L. Philpott Manufacturing Extension Partnership (Nonmajor Component Unit), the Virginia Equine Center (Nonmajor Component Unit), Mary Washington College (Nonmajor Component Unit), the Roanoke Higher Education Authority (Nonmajor Component Unit), and the Innovative Technology Authority (Nonmajor Component Unit) apply all applicable GASB pronouncements and all FASB Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989, unless they conflict with or contradict GASB pronouncements. The Pocahontas Parkway (Major Enterprise Fund), the Virginia Port Authority (Nonmajor Component Unit), the A. L. Philpott Manufacturing Extension Partnership (Nonmajor Component Unit), the

Virginia Equine Center (Nonmajor Component Unit), Mary Washington College (Nonmajor Component Unit), the Roanoke Higher Education Authority (Nonmajor Component Unit), and the Innovative Technology Authority (Nonmajor Component Unit) apply all of these pronouncements, and also apply all FASB Statements and Interpretations issued after November 30, 1989, except those that conflict with or contradict GASB pronouncements.

Foundations' (Component Units) financial statements are prepared using the economic resources measurement focus and the full accrual basis of accounting. The financial statements are prepared under FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*. FASB rather than GASB pronouncements are followed. In some instances, activities of the Foundations (Component Units) are reported separately within the footnotes because of the different reporting standards. Also, some Foundations (Component Units) have a calendar rather than a fiscal year end. Foundations (Component Units) with a calendar year end are included in these financial statements for the year ending December 31, 2003.

The Commonwealth reports the following major enterprise funds:

**State Lottery Fund** – Accounts for all receipts and expenses of the State Lottery.

**Virginia College Savings Plan Fund** – Administers the Virginia Prepaid Education Program.

**Pocahontas Parkway Fund** – Accounts for the Route 895 Connector Project. The Pocahontas Parkway Association is a blended component unit of the Department of Transportation (Primary Government).

**Unemployment Compensation Fund** – Accounts for receipts from employers and expenses incurred to provide benefits to eligible unemployed workers.

Additionally, the Commonwealth reports the following fund types:

#### **Governmental Fund Types:**

**Special Revenue Funds** – Account for transactions related to resources received and used for restricted or specific purposes. Examples include conservation, health care, public building construction, acquisition, and operation, and other miscellaneous activity.

**Debt Service Funds** – Account for transactions related to resources retained and used for the payment of interest and principal on long-term obligations.

**Capital Project Funds** – Account for transactions related to resources received and used for the acquisition, construction, or

improvement of capital facilities not reported in the other governmental or proprietary funds. The primary resource for these funds is the proceeds of bond issues. Principal uses are for construction and improvement of State office buildings, correctional and mental health facilities, and parks.

**Permanent Funds** – Account for transactions of the Commonwealth Health Research Fund, Virginia Arts Foundation Fund, and Mental Health Endowment Funds whose principal must be maintained intact and whose income is used to benefit the Commonwealth's citizens and mental health patients.

#### **Proprietary Fund Types:**

**Enterprise Funds** – Account for transactions related to resources received and used for financing self-supporting activities of the Commonwealth that offer products and services on a user-charge basis to external users.

**Internal Service Funds** – Account for transactions related to the financing and sale of goods or services provided by the agencies of the Commonwealth to other agencies and institutions of the Commonwealth. Activities include the provision of information technology, manufacturing activities, insurance programs, fleet services, facilities and property management, and engineering services.

#### **Fiduciary Fund Types:**

**Private Purpose Trust Funds** – Account for transactions of all other trust arrangements in which the principal and income benefit individuals, private organizations, or other governments. These trusts include those for escheat property, educational savings plans, and others.

**Pension Trust Funds** – Account for transactions of the Commonwealth administered retirement systems and other employment benefits.

**Investment Trust Funds** – Account for the external portions of the State Non-Arbitrage Program and Local Government Investment Pools that are sponsored by the Commonwealth.

**Agency Funds** – Account for amounts held in trust by the Commonwealth for others. Agency funds include those funds established to account for the collection of taxes and fees for distribution to localities and other states, employee benefits, deposits of insurance carriers, child support collections and other miscellaneous accounts.

## E. Budgetary Process

Budgetary amounts shown in the Required Supplementary Information and Combining and Individual Fund Statements Sections represent the total of the original budgeted amounts and all supplemental appropriations. The Commonwealth's budget is prepared principally on a cash basis and represents appropriations as authorized by the General Assembly. Unexpended appropriations at the end of the fiscal year generally lapse. However, they may be reappropriated for expenditure in the following fiscal year. The Governor, as required by the *Code of Virginia*, submits a budget composed of all proposed expenditures for the State, and of estimated revenues and borrowing for a biennium, to the General Assembly. Budgets are adopted for the General and Special Revenue Funds, except for the Literary (major) – Special Revenue Fund. Formal budgetary integration is not employed for the Capital Projects (nonmajor), Debt Service (nonmajor), Permanent Funds (nonmajor), and the Literary – Special Revenue (major) because effective budgetary control is alternatively achieved through the General Fund and the remaining Special Revenue Funds.

The budget is prepared on a biennial basis; however, the budgets of the General and Special Revenue Funds contain separate appropriations for each year within the biennial budget, as approved by the General Assembly and signed into law by the Governor. For management control purposes, the budget is controlled at the program level. The Governor may transfer an appropriation within a State agency or from one State agency to another, provided that total fund appropriations, as contained within the budget, are not exceeded. Increases in General Fund appropriations must be approved by the General Assembly.

Appropriations for programs funded from Special Revenue Funds may allow expenditures in excess of the original appropriations to the extent that revenues of the funds exceed original budget estimates and such additional expenditures are approved by the Governor through supplemental appropriations.

## F. Cash, Cash Equivalents, and Investments

### Cash

In order to maximize the Commonwealth's earning potential, the majority of the Primary Government's cash balances are pooled together in the general account for investment purposes. The amounts required for operations are liquidated as needed. Since all amounts not required for operations are held in investment securities, it is possible that the cash balances could be negative due to timing differences in liquidating the investments.

As of June 30, 2004, the General Fund had a negative cash balance of \$3.1 billion. In order to properly reflect the general account position, this negative cash balance has been eliminated in the accompanying statements and offset against the

Primary Government's cash equivalents and investments (see Note 4).

### Cash Equivalents

Cash equivalents are investments with an original maturity of three months or less.

### Investments

Investments are principally comprised of monies held by component units, Pension Trust Funds, and monies held by the State Treasurer in both the general account and other fiduciary accounts.

Governmental and proprietary funds, both primary government and component units, report investments in money market and in the Commonwealth sponsored investment pools at amortized cost. All other investments are reported at fair value, in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*.

Investments administered by the Virginia Retirement System (VRS) are reported at fair value. The cost of investments sold is the average cost of the aggregate holding of the specific investment sold. Investments in affiliated organizations are accounted for on the equity method of accounting and the VRS' share of their earnings (losses) for the period is included in investment income using the equity method.

Investments of higher education institutions (Component Units) are reported at fair value, except for money market investments and investments in the Commonwealth sponsored investment pools, which are reported at amortized cost.

### Derivatives

Derivative instruments are used to improve return on investments and modify risk exposures (see Note 4).

## G. Receivables

Receivables in the governmental funds consist primarily of the accrual of taxes, as well as Federal receivables of the Commonwealth's Medicaid program. Receivables in the Proprietary Funds consist primarily of tuition contributions receivable. Receivables of Fiduciary Funds are primarily the accrual of member and employer contributions in the Pension Trust Funds and the accrual of local sales taxes in the Agency Funds. Receivables of the Component Units consist primarily of mortgage receivables, loans receivable, patient receivables, and student receivables. Receivables are recorded net of allowances for doubtful accounts (see Note 5).

## H. Contributions Receivable, Net

Contributions Receivable reported by the foundations (Component Units) represent pledges or unconditional promises to give that have been discounted (see Note 6).

## I. Internal Balances

Interfund receivables and payables have been eliminated from the Statement of Net Assets, except for the residual amounts due between governmental and business-type activities (see Note 7).

## J. Inventory

Inventories consist of materials and supplies and are reported as expenditures when consumed. These assets are offset by a fund balance reserve that indicates they are not available for spending. Inventories exceeding \$1 million of the General and the Special Revenue Funds are maintained at cost using the first-in, first-out (FIFO) methodology, except for the following:

- Department of State Police (VSP)
- Virginia Department of Transportation (VDOT)
- Department of Health (VDH)

VSP inventories are recorded in the General (major) and Dedicated Special Revenue (nonmajor) Funds using the average cost methodology and are maintained at cost. VDOT inventories are recorded in the Commonwealth Transportation Fund (major) using the average cost methodology. VDH inventories are recorded in the General (major), Other Special Revenue (nonmajor), and Federal Trust (major) Funds. These inventories are maintained at cost based on either FIFO or the average cost methodology.

Inventories maintained by Correctional Enterprises (Internal Service Fund) are stated at the lower of cost or market using FIFO. Inventories maintained by the Virginia Museum of Fine Arts (Nonmajor Enterprise Fund), the Science Museum of Virginia (Nonmajor Enterprise Fund) and the Consolidated Laboratory (Nonmajor Enterprise Fund) are stated at cost using FIFO. Inventories maintained by the Internal Service Funds except for Correctional Enterprises are stated at cost using FIFO.

The Department of Alcoholic Beverage Control (Nonmajor Enterprise Fund) maintains inventories using the average cost methodology. The Virginia Industries for the Blind (Nonmajor Enterprise Fund) maintains inventories at cost using the average cost methodology. The State Lottery Department's (Major Enterprise Fund) inventory consists of unsold instant tickets that are valued at cost and expensed over the life of each game as it is sold to retailers.

Institutions of higher education (Component Units) use several methods for inventory valuations, including cost using FIFO, the lower of cost or market using FIFO, or weighted average methods.

Inventories maintained by the Virginia Equine Center Foundation (Nonmajor Component Unit) are stated at the lower of cost or market using FIFO. Inventories maintained by the Virginia Port Authority (Nonmajor Component Unit) are reported using the moving average cost methodology. The Virginia Housing Development Authority (Major Component Unit) maintains inventories at the lower of cost or fair value.

## K. Prepaid Items

Prepaid assets for rent, insurance, and similar items are recognized when purchased and expensed when used.

## L. Interfund Loans Receivable/Payable

Loans Receivable/Payable represent working capital advances from one fund to another (see Note 7).

## M. Other Assets

Other Assets include those balances of a miscellaneous nature that are not specifically classified elsewhere (see Note 8).

## N. Capital Assets

Capital assets of governmental funds are recorded as expenditures at the time of purchase and capitalized in the governmental activities column of the Government-wide Statement of Net Assets. Capital assets of the other funds and component units are capitalized in the fund in which they are utilized. All depreciable capital assets are depreciated on the straight-line basis over their useful lives (see Note 10).

Capital assets are stated at historical cost or, in some instances, estimated historical cost. Donated capital assets are stated at fair market value at the time of donation. The Commonwealth capitalizes all equipment that has a cost or value greater than \$50,000 and expected useful life of greater than two years. The Commonwealth capitalizes all property, plant, and infrastructure that have a cost or value greater than \$100,000 and an expected useful life of greater than two years. Selected agencies and institutions of higher education utilize a capitalization limit lower or higher than the Commonwealth's established thresholds for various reasons. Accordingly, reported capital assets may include some items that cost less than those thresholds. Infrastructure, including highways, bridges, and rights-of-way, is capitalized using the historical approach.

The Commonwealth's capitalization policy regarding works of art/historical treasures is that capitalization is encouraged, but not required, for works of art/historical treasures that meet the following conditions:

- The collection is held for public exhibition, education, or research in furtherance of public service, rather than financial gain;

- The collection is protected, kept unencumbered, cared for and preserved; and
- The collection is subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for the collection.

The Commonwealth capitalizes construction-in-progress when project expenditures exceed \$100,000. Interest incurred during construction is not capitalized in governmental funds. Interest incurred during the construction of proprietary fund assets is included in the capitalized value of the asset. Expenditures are classified as construction-in-progress if:

- (1) they extend the asset life, improve productivity, or improve the quality of service; and
- (2) they fall into the planning, acquisition, construction, improvement, renovation, repair, replacement, relocation or demolition phase of the asset life.

The estimated lives of capital assets are as follows:

	<u>Years</u>
Buildings	15–50
Equipment	2–20
Infrastructure	5–50

Selected institutions of higher education may utilize estimated lives that differ from the above for various reasons.

#### **O. Accounts Payable**

Accounts payable represent amounts, including salaries and wages, owed for goods and services received prior to year-end. In accordance with GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, accounts payable also include payments for nonexchange transactions that met eligibility requirements prior to year-end (see Note 17).

#### **P. Deferred Revenue**

Deferred revenue represents monies received or revenues accrued but not earned as of June 30, 2004. The majority of the amount is reported by higher education institutions (Component Unit), where it is primarily composed of revenue for student tuition accrued in advance of the semester and advance payments on grants and contracts. In the General Fund (major), deferred revenue represents receivables that will be collected after August 31, 2004. In the Special Revenue Funds, deferred revenue is composed primarily of Federal grant money received but not spent. In the Enterprise Funds, a majority represents unearned premiums of Risk Management (nonmajor), unearned revenues of Consolidated Laboratory (nonmajor), and on-line ticket monies received by the State Lottery (major) for which corresponding

drawings have not been held. In the Internal Service Funds, it represents primarily unearned premiums for the Risk Management Fund and prepaid rent and work orders for the Maintenance and Repair Fund. Deferred revenues in the other component units consist primarily of the deferral of fees related to various activities.

#### **Q. Deferred Taxes**

Deferred taxes represent the deferral of income taxes withheld or received for the period January through June 2004. This amount is the estimate to be refunded (overpayments by taxpayers) reduced by the estimate to be received (underpayments from taxpayers) that will be finalized when income tax returns are filed in subsequent years. Individual income tax estimated overpayments total \$506,795,209 and estimated underpayments total \$275,395,356. This results in deferred taxes of \$231,399,853. Corporate income tax estimated overpayments total \$37,023,989 and estimated underpayments total \$46,976,397. When underpayments exceed overpayments, revenue on the fund statements is only recognized to the extent of estimated overpayments. Since underpayments exceed overpayments for corporate income taxes, the deferred tax amount is zero for the fiscal year.

#### **R. Claims Payable**

Claims payable, reported in the proprietary funds of the primary government, represent both health and liability insurance claims payable at June 30, 2004. This includes both actual claims submitted, as well as actuarially determined claims incurred but not reported. Claims relating to the Commonwealth's liability insurance programs are reported in the Risk Management – Internal Service Fund, and the Risk Management – Nonmajor Enterprise Fund. Also, health insurance claims are reported in the Health Care – Internal Service Fund and the Local Choice Health Care – Nonmajor Enterprise Fund (see Note 16.A. and 16.B.).

The claims payable reported in the Private Purpose Trust Fund reflects the amount of anticipated payments to the claimants of unclaimed property receipts.

#### **S. Obligations Under Securities Lending Program**

In accordance with GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, liabilities resulting from these transactions have been recorded as obligations under security lending transactions.

#### **T. Other Liabilities**

Other liabilities represent amounts owed for various governmental and proprietary activities. Some of these amounts will be paid shortly after fiscal year end (see Note 18).

Short-term debt results from borrowings from anticipation notes, lines of credit, and similar loans with parties external to the Commonwealth. The

Commonwealth's policy is to disclose activity related to short-term borrowings occurring during the fiscal year. Any short-term debt balances outstanding at June 30 are reported as Other Liabilities. For fiscal year 2004, the Commonwealth's agencies did not participate in short-term borrowings with external parties. Higher Education Institutions' Foundations (Component Units) have lines of credit outstanding as of year-end that amount to approximately \$56.1 million. The University of Virginia and the Virginia Commonwealth University (Major Component Units) have short-term debt that amount to approximately \$44.7 million as of year-end.

#### **U. Long-Term Liabilities**

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities or business-type activities column. The governmental fund statements reflect the portion of long-term liabilities that will be paid from expendable resources. The proprietary fund statements and discrete component unit statements reflect total long-term liabilities and distinguish between those portions payable within one year and those payable in future years (see Note 19).

Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bond. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

Expenditures for principal and interest payments for governmental fund general obligation bonds and revenue bonds are recognized in the Debt Service Fund (nonmajor) when due. In these fund statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuance are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures (see Note 19).

#### **V. Reserved Fund Balances**

Reserved fund balances indicate that portion of fund balance that is not available to fund operations or is legally segregated for specific future use. Fund balance reservations are not specifically denoted in instances where the nature of the fund dictates the entire amount is reserved.

#### **W. Unreserved, Designated Fund Balances**

Designations of fund balance, as shown in Note 2, are established to reflect tentative plans for future utilization of current financial resources. It is the policy of the Commonwealth to designate the portion of fund balance set aside by the General

Assembly through the Appropriation Act to fund tentative but approved future plans. Unexpended appropriations approved by the Governor to be used to fund expenditures of the ensuing fiscal year are also reflected through a designation of fund balance. It is the policy of the Commonwealth to limit such designations in the event that their accumulation and presentation would cause a negative unreserved, undesignated fund balance to occur.

#### **X. Unreserved, Undesignated Fund Balances**

The unreserved, undesignated basis of budgeting fund balance is the amount of fund balance remaining from operations of the current and prior years, net of amounts established as reserved and designated fund balance described in Notes 1.V. and 1.W. above.

#### **Y. Cash Management Improvement Act**

Included in "Due to Other Governments" is the Commonwealth's Cash Management Improvement Act (CMIA) interest liability to the Federal government, which is calculated in accordance with the interest calculation and exchange provisions of the Federal Cash Management Improvement Act of 1990. The Commonwealth's interest liability is subject to review and final confirmation by the Financial Management Service (FMS) of the U.S. Treasury. The payment is to be made on or before March 1, 2005. Payment will be made from a sum sufficient appropriation authorized for this purpose by the Appropriation Act. The CMIA interest rate of exchange is based by law on the annualized average earnings rate of 13-week Treasury Bills.

#### **Z. Interest, Dividends, Rents, and Other Investment Income**

In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, all investment income is reported in this line item. Since this amount includes changes in the fair value of investments, the amount reported may be negative. In addition, the amount reported also includes rent payments received on properties owned by the Commonwealth.

#### **AA. Intrafund Eliminations**

Eliminations have been incorporated into the report to eliminate intrafund transactions within the related fund type. These eliminations prevent overstatement of financial activity.

#### **BB. Interfund Activity**

Generally, the effect of interfund activity has been eliminated from the government-wide statements. Exceptions to this rule are 1) activities between funds reported as governmental activities and funds reported as business-type activities and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of

these activities would distort the direct costs and program revenues for the functions.

In the fund financial statements, transfers represent flows of assets without equivalent flows of assets in

return or a requirement for repayment. In addition, transfers are recorded when a fund receiving revenue provides it to a different fund that expends the resources.

## 2. GENERAL FUND ANALYSIS – BASIS OF BUDGETING

The following schedule represents reservations and designations of General Fund balance on the basis of budgeting. The designated amounts differ from those presented in the General Fund Preliminary (Unaudited) Annual Report dated August 13, 2004, due to the effects of the reclassification of tax amnesty revenues originally reported in the General Fund Preliminary Report as transfers in.

### Reservations and Designations of Fund Balance General Fund, Basis of Budgeting

June 30, 2004

*(Dollars in Thousands)*

Fund Balance, June 30, 2004		\$	1,109,571
Reserved Fund Balance:			
Revenue Stabilization Reserve Fund	\$		340,067
Payroll Reserve for July 1, 2004 Payroll			69,714
Unexpended Lottery Proceeds			22,701
Total Reserved Fund Balance			432,482
Unreserved Fund Balance:			
Designated:			
Amount Required for Reappropriation of 2004 Unexpended Balances:			
Mandatory Reappropriations		82,668	
Capital Outlay		21,086	
Amount Required to Balance Chapter 4, 2004 Acts of Assembly		127,898	
Virginia Water Quality Improvement Fund - Part A		32,378	
Natural Disaster Sum Sufficient		26,034	
Accelerated Sales Tax for Transportation Trust Fund		23,814	
Revenue Stabilization Fund Contribution		181,936	
Revenue Stabilization Fund - Super Deposit		134,468	
Delay in Effective Date of House Bill 5018 (Tax Reform)		39,239	
Non-General Fund Interest Payment		7,568	
Total Designated Fund Balance			677,089
Undesignated Fund Balance, June 30, 2004		\$	-

## 3. REVENUE STABILIZATION FUND

In accordance with Article X, Section 8 of the *Constitution of Virginia*, the amount estimated as required for deposit to the Revenue Stabilization Fund must be appropriated for that purpose by the General Assembly. The Revenue Stabilization Fund has principal and interest on deposit of \$340.1 million reserved as a part of General Fund equity. The amount on deposit cannot exceed ten percent of the Commonwealth's average annual tax revenues derived from taxes on income and retail sales for the preceding three fiscal years. The maximum amount allowed is \$958.3 million and \$977.8 million for fiscal year 2004 and fiscal year 2005, respectively. Upon appropriation by the General Assembly, an additional \$316.4 million will be deposited to the fund in future years.

## 4. CASH, CASH EQUIVALENTS, AND INVESTMENTS

At June 30, 2004, the carrying amount of cash for the primary government was \$2,245,573,801 and the bank balance was \$267,079,783. In addition, cash balances related to executory costs attributable to capital leases in the amount of (\$1,371,466) are not reported in the Government-wide Statement of Net Assets, but are included in the Governmental Fund Balance Sheet. The carrying amount of cash for the component units was \$967,107,355 and the bank balance was \$227,521,034. Cash equivalents are investments with an original maturity of three months or less. Cash and cash equivalents for Foundations (Component Units) total \$162,847,188 as of year-end. A portion of this amount and some balances during the year exceeded Federal

Deposit Insurance Corporation (FDIC) insurance coverage.

The deposits of the primary government and the component units, excluding Foundations (Component Units), are secured in accordance with the provisions of the Virginia Security for Public Deposits Act, Section 2.2-4400 of the *Code of Virginia*. The Act requires any public depository that receives or holds public deposits to pledge collateral to the Treasury Board to cover public deposits in excess of Federal deposit insurance. The required collateral percentage is determined by the Treasury Board and ranges from 50 percent to 100 percent of public deposits in the case of a bank and 100 percent to 110 percent for a savings institution.

Securities pledged by banks and savings institutions, under the Act, are held by an approved escrow agent for the Treasury Board. In the event a depository bank defaults or becomes insolvent, the Treasury Board first assesses the collateral of the defaulting or insolvent institution and then assesses the collateral pledged by other public depositories on a statutory based ratio to the extent necessary to satisfy the assessment against the defaulting bank. The collateral pledged by all banks is sufficient to cover the uncollateralized public deposits of any single bank. Upon default or insolvency of a savings institution, the Treasury Board assesses the institution the amount of public funds on deposit in excess of FDIC insurance. The State Treasurer liquidates the necessary pledged collateral of the institution to reimburse public depositors to the extent of the institution's deposit liability to them. As a result, these deposits are considered insured.

Certain deposits are held by trustees in accordance with the Trust Subsidiary Act, Section 6.1–32.8 et seq. of the *Code of Virginia*. The Act requires that cash held by trustees while awaiting investment or distribution is not to be used by an affiliate bank of the trustee in the conduct of its business unless the affiliate bank delivers securities to the trust department as collateral that is at least equal to the fair value of the trust funds held on deposit in excess of amounts insured by the FDIC.

The Commonwealth is authorized, in accordance with the guidelines set forth in Section 2.2-4500 et seq. of the *Code of Virginia*, to invest in the following:

- U.S. Treasury and agency securities
- Corporate debt securities of domestic corporations
- Asset-backed securities
- Mortgage-backed securities
- AAA rated obligations of foreign governments
- Bankers acceptances and bank notes
- Negotiable certificates of deposit
- Repurchase agreements
- Money market funds

Permitted investments include agency mortgage-backed securities, reported as U.S. Treasury and agency securities, and asset-backed securities, reported as corporate notes, which by definition usually expose the investor to prepayment risk.

Prepayment risk, or the prepayment option granted the borrower, can create uncertainty concerning cash flows, can affect the price of the security causing negative

convexity, and can expose the investor to reinvestment risk. Similarly, many agency and corporate securities are callable after some predetermined date at a predetermined price. The call options in regular agency debentures and some corporate securities can be open ended and may significantly impact cash flows, security pricing, and reinvestment risks of these securities.

Certain investments held in trust by the Treasurer of Virginia in accordance with bond indentures and resolutions may have more restrictive investment policies. Investment policies of institutions of higher education (Component Units) are established by the institutions' governing boards.

The Board of Trustees of the Virginia Retirement System (VRS) (Primary Government) has full power to invest and reinvest the trust funds in accordance with Section 51.1–124.30 of the *Code of Virginia*, as amended. This section requires the Board to discharge its duties solely in the interest of the beneficiaries and to invest the assets with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. The Board must also diversify such investments so as to minimize the risk of large losses unless under the circumstances it is clearly prudent not to do so.

The information presented for the external investment pools was obtained from audited financial statements. Copies of the State Non-Arbitrage Program (SNAP) report may be obtained by writing Evergreen Investment Management Company, LLC, Riverfront Plaza, 951 East Byrd Street, Richmond, Virginia 23219. Copies of the Local Government Investment Pool (LGIP) report may be obtained by writing the Department of the Treasury, Post Office Box 1879, Richmond, Virginia 23218. Participation in these pools is voluntary, except for participants who borrow through the Virginia Public School Authority's pooled bond program and must participate in SNAP.

SNAP is an open-end management investment company registered with the Securities Exchange Commission (SEC). LGIP is not SEC-registered; however, it maintains a policy to operate in a manner consistent with SEC Rule 2a7.

### **Custodial Risk**

Investments held by the Commonwealth at June 30, 2004, have been categorized according to the level of credit risk associated with its custodial arrangements at fiscal year end.

Credit risk, as used below, refers to the risk that the Commonwealth may not be able to obtain possession of its investments in the event of default by counterparty. The three types of credit risk are:

- Category 1, which includes investments that are insured or registered, or securities held by the Commonwealth or its agent in the Commonwealth's name;

- Category 2, which includes uninsured and unregistered investments for which securities are held by the counterparty's trust department or agent in the Commonwealth's name; and,
- Category 3, which includes uninsured and unregistered investments for which securities are held by the counterparty, or by its trust department or agent, but not in the Commonwealth's name.

Securities lent at year-end for cash collateral are presented as unclassified. Securities lent for non-cash collateral are classified according to the custodial arrangements.

The investments of the Pension Trust Funds are approximately 77 percent of the primary government investments that are in Category 1 and 97 percent of those in Category 3. Additionally, the entire amounts of Equity Index and Pooled Funds, Real Estate, foreign currencies, and The Boston Company Pooled Employee Trust Fund included in the primary government schedule are attributable to the Pension Trust Funds, and cannot be categorized because the investments are not evidenced by physical securities.

**Cash Equivalents - Primary Government**  
June 30, 2004

*(Dollars in Thousands)*

Type of Securities	Category			Fair Value
	1	2	3	
<b>Cash Equivalents - Categorized</b>				
U. S. Treasury and				
Agency Securities	\$ 267,503	\$ -	\$ -	\$ 267,503
Corporate Notes	219,985	-	-	219,985
Corporate and Other Bonds	109,186	-	-	109,186
Commercial Paper	1,101,902	-	-	1,101,902
Nonnegotiable Certificates of Deposit	55,016	-	-	55,016
Negotiable Certificates of Deposit	277,446	-	-	277,446
Repurchase Agreements	1,043,670	-	17,883	1,061,553
Guaranteed Investment Contracts	47,769	-	-	47,769
	<u>\$ 3,122,477</u>	<u>\$ -</u>	<u>\$ 17,883</u>	
<b>Cash Equivalents - Not categorized</b>				
Deposits with the U. S. Treasury for Unemployment Compensation				295,682
Mutual and Money Market Funds				1,568,770
Total Cash Equivalents				<u>5,004,812</u>
Less: Component Unit portion of the Local Government Investment Pool				(93,884)
Less: General Fund Cash Drawn Against Cash Equivalents				<u>(1,579,221)</u>
Adjusted Total				<u>\$ 3,331,707</u>

Note: Fiduciary cash and cash equivalents in the amount of \$3,013,256 (dollars in thousands) are not included in the Government-wide Statement of Net Assets.

**Investments - Primary Government**

June 30, 2004

*(Dollars in Thousands)*

Type of Securities	Category			Fair Value
	1	2	3	
Investments - Categorized				
U. S. Treasury and				
Agency Securities	\$ 6,029,762	\$ -	\$ 86,889	\$ 6,116,651
Common and Preferred Stocks	13,652,302	-	3,923	13,656,225
Corporate Notes	526,360	-	-	526,360
Corporate and Other Bonds	1,713,161	-	6,290	1,719,451
Commercial Paper	231,953	-	378	232,331
Negotiable Certificates of Deposit	471,716	-	-	471,716
Municipal Securities	57,150	-	-	57,150
Repurchase Agreements	684,654	-	-	684,654
Investments held by broker-dealers under securities loans				
U. S. Government and				
Agency Securities	102,976	-	82,598	185,574
Common and Preferred Stocks	-	-	38,843	38,843
	<u>\$ 23,470,034</u>	<u>\$ -</u>	<u>\$ 218,921</u>	
Investments - Not categorized				
Mutual and Money Market Funds				7,448,614
Foreign Currencies				39,092
Equity Index and Pooled Funds				11,729,044
Index Funds				169,393
Real Estate				1,092,179
The Boston Company Pooled Employee Trust Fund				1,336,210
Guaranteed Investment Contracts				158,946
Fixed Income and Commingled Funds				1,255,556
Other				3,473,914
Investments held by broker-dealers under securities loans:				
U. S. Government and Agency Securities				2,873,360
VRS Separate Account				3,134,769
Common and Preferred Stocks				971,266
Corporate Notes				21,017
Corporate Bonds				138,902
Total Investments				<u>57,531,217</u>
Less: Component Unit portion of the Local Government Investment Pool				(90,202)
Less: General Fund Cash Drawn Against Investments				<u>(1,482,688)</u>
Adjusted Total				<u>\$ 55,958,327</u>

Note: Fiduciary investments in the amount of \$52,438,790 (dollars in thousands) are not included in the Government-wide Statement of Net Assets.

**Cash Equivalents - Component Units**

June 30, 2004

*(Dollars in Thousands)*

<b>Type of Securities</b>	<b>Category</b>			<b>Fair Value</b>
	<b>1</b>	<b>2</b>	<b>3</b>	
Cash Equivalents - Categorized				
U. S. Treasury and				
Agency Securities	\$ 120,915	\$ -	\$ -	\$ 120,915
Corporate Bonds	993	-	-	993
Commercial Paper	36,399	-	-	36,399
Municipal Securities	150	-	-	150
Repurchase Agreements	348,722	9,306	4,305	362,333
Nonnegotiable Certificates of Deposit	6,065	-	-	6,065
Mutual and Money Market Funds	-	-	7,847	7,847
Other	23	46	-	69
	<u>\$ 513,267</u>	<u>\$ 9,352</u>	<u>\$ 12,152</u>	
Cash Equivalents - Not categorized				
Mutual and Money Market Funds				449,578
U. S. Government Securities				1,037
Other				6,903
Component Units' Investment in Local Government's Investment Pool				157,539
				<u>\$ 1,149,828</u>

**Investments - Component Units**

June 30, 2004

*(Dollars in Thousands)*

Type of Securities	Category			Fair Value
	1	2	3	
Investments - Categorized				
U. S. Treasury and Agency Securities	\$ 569,582	\$ 11,248	\$ 5,016	\$ 585,846
Common and Preferred Stocks	166,985	-	10,052	177,037
Corporate Notes	193,086	-	-	193,086
Corporate Bonds	67,846	-	129	67,975
Commercial Paper	36,662	985	-	37,647
Negotiable Certificates of Deposit	7,682	-	-	7,682
Municipal Securities	2,340,494	-	156	2,340,650
Repurchase Agreements	108,561	-	16,386	124,947
Asset Backed Securities	379,852	-	-	379,852
Agency Mortgage Backed	100,966	-	-	100,966
Mutual and Money Market Funds	2,298	-	-	2,298
Other	160	-	1,798,834	1,798,994
	<u>\$ 3,974,174</u>	<u>\$ 12,233</u>	<u>\$ 1,830,573</u>	
Investments - Not categorized				
Mutual and Money Market Funds				246,136
Real Estate				62,703
U. S. Government Securities				139,670
Index Funds				123,793
Guaranteed Investment Contracts				360,359
Other				152,232
Component Units' Investment in Local Government's Investment Pool				19,628
Investments held by broker-dealers under securities loans:				
Securities held in a Collateral Investment Pool				91,612
Subtotal				<u>7,013,113</u>
Investments for Foundations (1) - Not categorized				
U. S. Treasury and Agency Securities				234,833
Common and Preferred Stocks				547,965
Corporate Notes				10,418
Corporate Bonds				119,896
Commercial Paper				507
Negotiable Certificates of Deposit				3,605
Municipal Securities				16,010
Asset Backed Securities				25
Agency Mortgage Backed Securities				4,361
Mutual and Money Market Funds				799,813
Banker's Acceptance				37
Real Estate				58,498
Index Funds				92,525
Other				442,525
Component Units' Investment in Local Government's Investment Pool				3,388
Subtotal (2)				<u>2,334,406</u>
Total				<u>\$ 9,347,519</u>

Note (1): Foundations represent FASB reporting entities defined in Note 1.B.

Note (2): A portion of these amounts are reported at cost rather than fair value because fair value was not available or readily determinable.

## Primary Government

### Securities Lending

The State Treasury's securities lending program is managed by its Master Custodian, JP Morgan Chase and Company, under a contract dated December 1, 2000. The enabling legislation for the securities lending program is Section 2.2-4506 of Chapter 45 Investment of Public Funds of the *Code of Virginia*, as amended. No violations of legal or contractual provisions were noted during the year. The general account participated in the securities lending program for the entire year.

All securities lending loans are on an open-ended or one-day basis and may be terminated by Treasury with a 24-hour notice. Per the contract with JP Morgan Global Securities Lending, all pledged cash and other collateral attributable to loans made on the Commonwealth's behalf shall be maintained by the Master Custodian Bank, and Treasury cannot pledge or sell such collateral absent a default.

The State Treasury's contract with JP Morgan Global Securities Lending provides for loss indemnification against borrower default as defined in the applicable Master Securities Lending Agreement. Additionally, JP Morgan Chase is liable for any losses experienced from reinvestment of cash collateral in investments not authorized by the provisions of the investment guidelines for the Commonwealth of Virginia agreed upon by both parties and made a part of the Securities Lending Agreement. There were no losses resulting from default during the reporting period, nor recoveries of prior period losses during this reporting period.

When securities are loaned, the collateral received is at least 102 percent of fair value of the securities loaned and must be maintained at 100 percent or greater. There are no stated restrictions on the amount of securities that may be loaned, but the basic composition of the general account portfolio effectively caps the maximum percentage of the portfolio that may be loaned. During the past fiscal year, approximately 20 percent of the general account securities were on loan.

During the past year, a combination of U.S. Treasury, Agency, Agency Mortgage and corporate securities have been loaned, with the majority of the loaned securities being U.S. Government securities. Collateral received included a combination of cash and non-cash securities, with the non-cash collateral being U.S. Government securities.

Securities loaned for the general account as of June 30, 2004, had a carrying value of \$1,392,478,902 and a fair value of \$1,355,505,523. The fair value of the collateral received was \$1,379,733,869 providing for coverage of 101.8 percent. As a result, the State Treasury assumes no credit risk.

Current cash investment guidelines allow for a maximum weighted-average portfolio maturity of 120 days. At June 30, 2004, the open portion of the cash reinvestment portfolio had a weighted average maturity of 47 days. Treasury's current cash reinvestment guidelines allow for investment in Government

securities, AAA rated sovereign governments, commercial paper and corporate notes, negotiable certificates of deposit, certificates of deposit and time-deposits collateralized under the Virginia Security for Public Deposits Act, bankers' acceptances, bank notes, repurchase agreements collateralized by U.S. Treasury and Agency issues, and registered money market funds. At June 30, 2004, cash reinvestments were as follows: \$755 million in repurchase agreements and cash, \$232 million in floating rate corporate notes, \$31 million in negotiable certificates of deposit. Non-cash collateral value at June 30, 2004, was approximately \$361 million in U.S. Government securities.

Under authorization of the Board of Trustees, the VRS lends its fixed income and equity securities to various broker-dealers on a temporary basis. The program is administered through an agreement with the VRS' agent custodial bank. All security loan agreements are collateralized by cash, securities or irrevocable letter of credit issued by major banks, having a fair value equal to at least 102 percent of the fair value on domestic securities and 105 percent on international securities. Securities received as collateral cannot be pledged or sold by the VRS unless the borrower defaults. Contracts with the lending agents require them to indemnify the VRS if the borrowers fail to return the securities lent and related distributions, and the collateral is inadequate to replace the securities lent.

All security loans can be terminated on demand by either the VRS or the borrowers. The majority of loans are open loans meaning the rebate is set daily, resulting in a maturity of one or two days on average for loans, although securities are often out on loan for a longer period of time. The maturity of loans generally does not match the maturity of collateral investments, which averages 84 days. At year-end, the VRS has no credit risk exposure to borrowers because the amounts the VRS owes the borrowers exceed the amounts the borrowers owe the VRS. The fair value of securities on loan at June 30, 2004, was \$3,319,263,000 and the value of collateral (cash and non-cash) was \$3,364,650,000.

Securities out on loan are included with investments on the Combining Statement of Plan Net Assets and are classified in the summary of custodial risk. The invested cash collateral is included in the statement as an asset and corresponding liability. The invested cash collateral is also classified in the summary of custodial risk.

Under authorization of the Board of the University of Virginia Investment Management Company, the University of Virginia, through its agent, Mellon Bank, lends U.S. Government and equity securities to various broker-dealers on a temporary basis for collateral. All security loan agreements are collateralized by readily marketable and liquid securities, loans or other obligations secured by a lien or similar interest on an asset, thereof totaling at least 102 percent of the market value of the loaned securities. The University of Virginia retains the right to pledge or sell these securities held as collateral at their discretion. All security loans can be terminated on demand by either the University or the borrower, and the average term of the security loans as well as collateral held is less than one week. Under the

University's security lending program, securities loaned as of June 30, 2004 have a carrying value of \$78,510,481 and a market value of \$102,576,789. Collateral received totals \$104,418,847. In addition, the University participates in the State treasury's security lending program. Collateral held for securities lending transactions of \$13,542,836 represents the University's allocated share of cash collateral received and reinvested and securities received for the State Treasury's securities lending program.

As authorized by Section 2.2-4506 of the *Code of Virginia*, the Virginia Lottery, through its master custodian, JP Morgan Chase Bank, New York, N. Y., N. A., lends securities to various security brokers and lenders on a temporary basis for a fee. Up to 100 percent of the securities may be available for loan. All security loan agreements are collateralized at loan inception at 102 percent of market value by cash or U.S. Government obligations and adjusted to market daily to cover fair value fluctuations. As a result management assumes no credit risk.

The Virginia Lottery does not have the ability to use cash collateral or to pledge or sell collateral securities absent borrower default. The Lottery's contract with JP Morgan Chase Bank provides for loss indemnification against borrower default as a result of bankruptcy, insolvency, reorganization, liquidation, receivership, or similar event. There were no losses resulting from default during the reporting period, nor recoveries of prior period losses during this reporting period. At June 30, 2004, the fair value of investment account securities on loan was \$277,234,328 secured by \$281,550,302 in cash deposits, and \$52,112,490 secured by \$53,154,740 in market value securities that cannot be pledged or loaned.

### **Derivative Financial Instruments**

Derivative instruments are financial contracts whose values depend on the values of one or more underlying assets, reference rates, or financial indexes. They include futures, forwards, options, or swap contracts. Some traditional securities, such as structured notes, can have derivative-like characteristics. In this case, the return may be linked to one or more indexes and asset-backed securities such as collateralized mortgage obligations (CMO), which are sensitive to changes in interest rates and prepayments. Futures, forwards, options, and swaps are generally not recorded on the financial statements, whereas structured notes and asset-backed investments generally are recorded.

The VRS is a party, both directly and indirectly, to various derivative financial investments that may or may not appear on the financial statements that are used in the normal course of business to enhance returns on investments and manage risk exposure to changes in value resulting from fluctuations in market conditions. These investments may involve, to varying degrees, elements of credit and market risk in excess of amounts recognized on the financial statements. Credit risk is the possibility that loss may occur from failure of a counterparty to perform according to the terms of the contract. Market risk arises from adverse changes in market prices, interest rates and foreign exchange rates

that may result in a decrease in the market value of a financial investment or an increase in its funding cost, or both.

In addition to exposure from directly held derivative financial instruments, the VRS may have indirect exposure to risk through its ownership interests in commingled investment funds that use, hold, or write derivative financial instruments. Indirect exposure may also arise from stock lending programs in which the commingled funds participate. Such programs usually reinvest a portion of their cash collateral holdings in derivative instruments. The VRS' pro rata share of the contractual or notional amounts of outstanding derivative transactions in commingled investment funds and their related security lending programs approximated \$412,888,000 at June 30, 2004.

### **Forward, Futures, and Options Contracts**

Forward contracts are contracts to purchase or sell, and futures contracts are contracts to deliver or receive financial instruments, foreign currencies or commodities at a specified future date and at a specified price or yield. Futures contracts are traded on organized exchanges (exchange traded) and require initial margin (collateral) in the form of cash or marketable securities. The net change in the futures contract value is settled daily in cash with the exchanges. Holders of futures contracts look to the exchange for performance under the contract and not to the entity holding the offsetting futures position. Accordingly, the amount at risk posed by nonperformance of counterparties to futures contracts is minimal. In contrast, forward contracts traded over-the-counter are generally negotiated between two counterparties. They are subject to credit risks resulting from nonperformance of one of the counterparties and to market risks resulting from adverse fluctuations in market prices, interest rates, and foreign exchange rates.

Options may be either exchange traded or negotiated directly between two counterparties over-the-counter. Options grant the holder the right, but not the obligation, to purchase or sell a financial instrument at a specified price and within a specified period of time from the 'writer' of the option. As a purchaser of options, the VRS typically pays a premium at the outset. The premium is reflected as an asset on the financial statements. The VRS then retains the right but not the obligation to exercise the option and purchase the underlying financial instrument. Should the option not be exercised, it expires worthless and the premium is recorded as a loss. A writer of options assumes the obligation to deliver or receive the underlying financial instrument on exercise of the option. Certain option contracts may involve cash settlements based on specified indexes such as stock indexes. As a writer of options, the VRS receives a premium at the outset. The premium is reflected as a liability on the financial statements and the VRS bears the risk of an unfavorable change in the price of the financial instrument underlying the option.

Forward, futures, and options contracts provide the VRS with the opportunity to build passive benchmark positions, manage portfolio duration in relation to various benchmarks, adjust portfolio yield curve

exposure, and gain market exposure to various indexes in a more efficient way and at lower transaction costs. Credit risks depend on whether the contracts are exchange traded or are exercised over-the-counter. Market risks arise from adverse changes in market prices, interest rates, and foreign exchange rates. At June 30, 2004, the VRS had purchased S & P, Russell Index Treasury Bonds and notes and global indices futures and options with a notional value of \$3,684,005,000 and sold Treasury bonds and notes global indices futures and options with a notional value of \$570,095,000. At June 30, 2004, VRS had pledged as collateral U.S. Treasury and U.S. Government Agency securities with a total market value of \$92,170,000 as the margin requirement for futures contracts.

In addition to unsettled purchases and sales, accounts receivable and accounts payable for security transactions at June 30, 2004, include receivables for deposits with brokers for securities sold short of \$820,698,000 and payables for securities sold short and not covered with market values of \$796,912,000.

### **Asset-Backed Securities**

Among the instruments with derivative-like characteristics that the VRS invests in and that appear on the financial statements are various asset-backed securities such as collateralized mortgage obligations (CMO), principal-only strips (PO), and interest-only strips (IO). These instruments are used primarily to enhance returns by taking advantage of opportunities available in this sector of the securities markets. CMO securities are bonds collateralized by mortgage-backed securities and issued in several tranches that represent a reallocation of the underlying mortgage-backed securities cash flows. Both PO and IO securities are created by splitting the asset-backed securities into principal-only and interest-only portions. At June 30, 2004, the VRS held CMO securities with a fair market value of \$217,916,000, and IO and PO securities with a fair market value of \$2,777,000.

The credit risks on the various asset-backed securities in which the VRS invests are usually very low. Many of the securities held by the VRS are issued by quasi-U.S. governmental agencies. Others are issued by organizations with AAA or AA credit ratings. The market risk of these securities depends on changes in interest rates and the level of the underlying prepayments, i.e., when the mortgagors repay the underlying principal and interest.

### **Foreign Exchange Contracts**

Foreign exchange contracts include forward, futures, and options contracts. They involve either the exchange of specific amounts of two currencies or the delivery of a fixed amount of a currency at a future date and specified exchange rate. Forward and futures contracts settle three or more business days from the contract date. Forward contracts are negotiated over-the-counter between two counterparties, while futures contracts are exchange traded. Foreign currency options, which are either negotiated between two counterparties or are exchanged traded, grant the buyer the right, but not the obligation, to purchase or sell at a specified price, a

stated amount of an underlying currency at a future date. At June 30, 2004, the VRS had sold foreign currency contracts with a notional value of \$1,190,129,000 and had purchased foreign currency contracts with a notional value of \$1,127,966,000.

Foreign exchange contracts are used by the VRS to effect settlements and to protect the base currency (\$US) value of portfolio assets denominated in foreign currencies against fluctuations in the exchange rates of those currencies. The credit risk of currency contracts that are exchange traded lies with the clearinghouse of the exchange where the contracts are traded. The credit risk of currency contracts traded over-the-counter lies with the counterparty, and exposure is usually equal to the unrealized profit on in-the-money contracts. The market risk in foreign currency contracts is related to adverse movements in currency exchange rates.

### **Swap Agreements**

Swaps are negotiated contracts between two counter parties for the exchange of payments at certain intervals over a predetermined time frame. The payments are based on a notional principal amount and calculated using either fixed or floating interest rates or total returns from certain instruments or indices. During fiscal year 2004, the VRS entered into interest rate and total return swaps with a total notional value of \$126,500,000. Swaps are used to manage risk and enhance returns. To reduce the risk of counter party non-performance, the VRS generally requires collateral on any material gains from these transactions.

### **Component Units**

#### **Derivative Financial Instruments**

Derivative instruments are financial contracts whose values depend on the values of one or more underlying assets, reference rates, or financial indexes. A derivative instrument generally has one or more underlying investment, requires little or no initial net investment, and requires or permits a net settlement. In addition, some traditional securities can have derivative-like characteristics. Examples of common derivatives include, but are not limited to, futures, forwards, options, or swap contracts. Although the contract or notional amount of the derivative is not recorded on the financial statements, all derivative instruments are recognized as either an asset or a liability depending on the rights or obligations of the contract measured at fair value.

The Virginia Housing Development Authority (Authority) (major) manages its interest risk on single and multi-family loan commitments through short sales of investment securities. These transactions meet the requirements for hedge accounting as all hedged items are specifically identified, probable of occurring, and highly correlated to the hedging instrument. The gain or loss from hedging transactions is recorded as an unamortized premium or discount and recognized as an adjustment to yield over the remaining life of the loan. The Authority periodically assesses correlation in order to determine the ongoing appropriateness of hedge accounting. During the year ended June 30, 2004, the Authority experienced a net gain of \$2,463,723 from hedging transactions settled during the year. At June

30, 2004, \$6,723,156 of short sales were outstanding which had an unrealized gain of \$19,185. The Authority's policy is to make adjustments to interest rates of loans related to such hedging transactions to reflect the losses or gains on such hedging transactions.

The University of Virginia (major) from time to time may use, through its investments and through investments in pooled funds, a variety of derivative securities including futures, options, and forward foreign currency contracts. These financial instruments are used to modify market risk exposure. Futures contracts and options on futures contracts are traded on organized exchanges and require collateral or margin in the form of cash or marketable securities. The net change in the futures contract value, if any, is settled with a cash transaction on a daily basis. Holders of futures contracts look to the exchange for performance under the contract and not

the entity holding the offsetting futures position. Accordingly, the amount of risk due to non-performance of counterparties to the futures contracts is minimal. Foreign exchange contracts are used to protect the University's portfolio against fluctuations in the values of foreign currencies. The credit risk of forward currency contracts traded over-the-counter lies with the counterparty. Asset swap contracts are privately negotiated agreements between two participants to exchange the return stream derived from their assets to each other without exchanging underlying assets. The University uses asset swaps to gain exposure to certain market sectors in lieu of direct investment. The credit risk lies with the intermediary who arranges the asset swap. The University has no direct exposure to derivative instruments at June 30, 2004.

## 5. RECEIVABLES

The following schedule details the accounts, loans, taxes, and other receivables presented in the major funds, aggregated nonmajor funds by type, internal service funds, fiduciary funds, major component units, and aggregated nonmajor component units, as of June 30, 2004:

	Accounts Receivables	Loans Receivables	Taxes Receivable	Other Receivables	Allowance for Doubtful Accounts	Net Accounts Receivable	Amounts to be Collected Greater than One Year
<b>Primary Government:</b>							
General	\$ 474,244	\$ -	\$ 552,905	\$ 12,089	\$ (252,869)	\$ 786,369	\$ 5,653
Major Special Revenue Funds:							
Commonwealth Transportation	104,342	56,895	100,134	12,620	(1,966)	272,025	56,981
Federal Trust	405,410	231	-	-	(2,762)	402,879	1
Literary	169,878	415,566	-	234	(151,981)	433,697	383,700
Major Enterprise Funds:							
State Lottery	57,944	-	-	-	-	57,944	-
Virginia College Savings Plan	1,701	-	-	226,281	-	227,982	169,712
Pocahontas Parkway	-	-	-	771	-	771	-
Unemployment Compensation	129,039	-	-	-	(27,158)	101,881	-
Nonmajor Governmental Funds	131,568	88	5,473	23	(74,140)	63,012	1,108
Nonmajor Enterprise Funds	22,995	-	2,236	-	(5)	25,226	-
Internal Service Funds	17,254	-	-	70	(15)	17,309	-
Private Purpose	245	347	-	312	(49)	855	210
Pension Trust (2)	103,720	-	-	2,371,546	-	2,475,266	-
Investment Trust Funds	-	-	-	5,807	-	5,807	-
Agency Funds	637	-	55,611	-	-	56,248	-
<b>Total Primary Government (1)</b>	<b>\$ 1,618,977</b>	<b>\$ 473,127</b>	<b>\$ 716,359</b>	<b>\$ 2,629,753</b>	<b>\$ (510,945)</b>	<b>\$ 4,927,271</b>	<b>\$ 617,365</b>
<b>Discrete Component Units:</b>							
Virginia Housing Development Authority	\$ -	\$ 116,372	\$ -	\$ 2,105	\$ (3,793)	\$ 114,684	\$ -
Virginia Public School Authority	-	-	-	51,652	-	51,652	-
University of Virginia	306,081	28,559	-	43,268	(98,333)	279,575	59,660
Virginia Polytechnic Institute and State University	8,137	32,392	-	29,540	(2,317)	67,752	30,684
Virginia Commonwealth University	310,349	28,304	-	28,070	(226,927)	139,796	14,393
Nonmajor Component Units	228,893	1,686,459	4,186	56,375	(11,090)	1,964,823	1,606,000
<b>Total Component Units</b>	<b>\$ 853,460</b>	<b>\$ 1,892,086</b>	<b>\$ 4,186</b>	<b>\$ 211,010</b>	<b>\$ (342,460)</b>	<b>\$ 2,618,282</b>	<b>\$ 1,710,737</b>

Note (1): Fiduciary net receivables in the amount of \$2,538,176 (dollars in thousands) are not included in the Government-wide Statement of Net Assets.

Note (2): The Other Receivables amount includes deposits for pending security transactions.

## 6. CONTRIBUTIONS RECEIVABLE, NET

The following schedule details the contributions receivable for Foundations<sup>(1)</sup> included with the major component units, and aggregated nonmajor component units, as of June 30, 2004:

(Dollars in Thousands)

	Due in Less Than One Year	Due Between One and Five Years	Due in More Than Five Years	Subtotal	Present Value Discount (2)	Allowance for Doubtful Accounts	Contributions Receivable, Net
<b>Discrete Component Units:</b>							
University of Virginia	\$ 20,756	\$ 44,269	\$ 13,964	\$ 78,989	\$ (6,809)	\$ (8,217)	\$ 63,963
Virginia Polytechnic Institute & State University	14,370	17,347	4,242	35,959	(1,946)	(1,443)	32,570
Virginia Commonwealth University	6,580	13,128	5,100	24,808	(2,739)	(363)	21,706
Nonmajor Component Units	45,330	75,367	24,512	145,209	(19,690)	(7,806)	117,713
<b>Total Component Units</b>	<u>\$ 87,036</u>	<u>\$ 150,111</u>	<u>\$ 47,818</u>	<u>\$ 284,965</u>	<u>\$ (31,184)</u>	<u>\$ (17,829)</u>	<u>\$ 235,952</u>

Note (1): Foundations represent FASB reporting entities defined in Note 1.B.

Note (2): The discount rate used to determine present value ranges from 0.5% to 10.0%.

## 7. INTERFUND ASSETS/LIABILITIES

### Due from/to Other Funds

Due from Other Funds are amounts to be received from one fund by another fund for goods sold or services rendered. Due to Other Funds are amounts owed by one fund to another fund for goods purchased or services obtained.

Included in the category Due from Other Funds are "Due from Other Funds and Primary Government," "Due from External Parties (Fiduciary Funds)," and "Due from Component Units." Included in the category Due to Other Funds are "Due to Other Funds and Primary Government," "Due to External Parties (Fiduciary Funds)," and "Due to Component Units." The following schedule shows the Due from/to Other Funds as of June 30, 2004.

**Schedule of Due from/to Other Funds**

June 30, 2004

*(Dollars in Thousands)*

Due From	Amount	Due To	Amount
<b>Primary Government</b>		<b>Primary Government</b>	
General	\$ 6,826	Major Enterprise Funds:	
		State Lottery	\$ 351
		Nonmajor Enterprise Funds	6,423
		Agency	52
Major Special Revenue Funds:		<b>Primary Government</b>	
Commonwealth Transportation	30,489	General	28,002
		Nonmajor Enterprise Funds	2,487
Federal Trust	2,221	<b>Primary Government</b>	
		General	2,221
Major Enterprise Funds:		<b>Primary Government</b>	
Virginia College Savings Plan	104	General	104
Unemployment Compensation	513	<b>Primary Government</b>	
		General	260
		Major Special Revenue Funds:	
		Commonwealth Transportation	39
		Federal Trust	86
		Nonmajor Governmental Funds	101
		Nonmajor Enterprise Funds	27
Nonmajor Governmental Funds	5,614	<b>Primary Government</b>	
		General	762
		Major Special Revenue Funds:	
		Commonwealth Transportation	3,606
		Major Enterprise Funds:	
		Unemployment Compensation	120
		Nonmajor Governmental Funds	73
		Nonmajor Enterprise Funds	954
		Agency	99
Nonmajor Enterprise Funds	268	<b>Primary Government</b>	
		General	268
Internal Service Funds	29,718	<b>Primary Government</b>	
		General	13,539
		Major Special Revenue Funds:	
		Commonwealth Transportation	5,889
		Federal Trust	5,189
		Major Enterprise Funds:	
		State Lottery	189
		Virginia College Savings Plan	25
		Nonmajor Governmental Funds	4,302
		Nonmajor Enterprise Funds	412
		Internal Service Funds	173
Private Purpose	7	<b>Primary Government</b>	
		General	7
Pension Trust	17,986	<b>Primary Government</b>	
		Pension	17,626
		Agency	360
Agency	1,953	<b>Primary Government</b>	
		General	37
		Major Enterprise Funds:	
		Unemployment Compensation	101
<b>Total Primary Government</b>	<u>95,699</u>	Pension	<u>1,815</u>
			<u>95,699</u>

*Continued on next page*

**Schedule of Due from/to Other Funds**

June 30, 2004

*(continued)*

*(Dollars in Thousands)*

Due From	Amount	Due To	Amount
<b>Component Units</b>		<b>Primary Government</b>	
University of Virginia	7,096	Nonmajor Governmental Funds	1,630
		<b>Component Units</b>	
		Nonmajor Component Units	5,466
Virginia Polytechnic Institute & State University	8,041	<b>Primary Government</b>	
		Nonmajor Governmental Funds	833
		<b>Component Units</b>	
		Nonmajor Component Units	7,208
Virginia Commonwealth University	5,885	<b>Primary Government</b>	
		Nonmajor Governmental Funds	1,590
		<b>Component Units</b>	
		Nonmajor Component Units	4,295
Nonmajor Component Units	22,665	<b>Primary Government</b>	
		Nonmajor Governmental Funds	3,814
		<b>Component Units</b>	
		Nonmajor Component Units	18,851
Total Component Units	<u>43,687</u>		<u>43,687</u>
Total	<u>\$ 139,386</u>		<u>\$ 139,386</u>

Note: The above schedule does not include \$19.7 million due to the Commonwealth Transportation Fund from Pocahontas Parkway nor \$5.0 million due to eVA (Nonmajor Enterprise Fund) from the Special Revenue – Dedicated (Nonmajor Governmental Fund) that will not be repaid within one year.

## Interfund Receivables/Payables

Interfund Receivables/Payables are short-term loans made by one fund to another.

The following schedule shows the Interfund Receivables/Payables for the Primary Government as of June 30, 2004. There were no Interfund Receivables/Payables for the Component Units as of June 30, 2004.

### Interfund Receivables/Payables

June 30, 2004

(Dollars in Thousands)

Receivable From:	Amount	Payable To:	Amount
<b>Primary Government</b>		<b>Primary Government</b>	
Nonmajor Governmental Funds	\$ 79,563	Major Special Revenue Funds:	
		Federal Trust	\$ 4,975
		Nonmajor Governmental Funds	33,267
		Nonmajor Enterprise Funds	32,470
		Internal Service	8,851
<b>Total</b>	<u>\$ 79,563</u>	<b>Total</b>	<u>\$ 79,563</u>

### Loans Receivable/Payable Between Primary Government and Component Units

The \$65.2 million in Loans Receivable from Component Units represents loans from the Special Revenue Fund to Higher Education (Component Unit). The Virginia College Building Authority's (Nonmajor Component Unit) loan of \$52 million and the Virginia Military Institute's (Nonmajor Component Unit) loan of \$1.0 million were used to fund programs until bonds were issued. George Mason University's (Nonmajor Component Unit) loan of \$8.5 million, the College of William and Mary's (Nonmajor Component Unit) loan of \$1.0 million and the Virginia Community College System's (Nonmajor Component Unit) loan of \$1.7 million were used to advance fund federally-funded grant programs. Longwood University's (Nonmajor Component Unit) loan of \$1.0 million will be used for the University's housing sprinkler project.

In previous years, the Literary Fund (Major Special Revenue Fund) reported loans receivable to the Virginia Public School Authority (VPSA) (Major Component Unit) due to the fact that permanent loans were transferred to the VPSA for use as collateral on bonds. In the current year, the loans were not transferred to VPSA for use as collateral; therefore the outstanding loans receivable balance is not a loan receivable. The Literary Fund loan receivable is included in Receivables in the accompanying financial statements.

The \$170.5 million in Loans Receivable from Primary Government represents loans from the VPSA to the Literary Fund. The VPSA makes grants to local school divisions to finance the purchase of educational technology equipment. The VPSA makes these grants using the proceeds of notes issued for that purpose which will be repaid from appropriations to be made by the Virginia General Assembly from the Literary Fund.

## 8. OTHER ASSETS

The following table summarizes Other Assets as of June 30, 2004:

*(Dollars in Thousands)*

	Cash and Travel Advances	Unamortized Bond Issuance Expense	Other Assets	Total Other Assets
<b>Primary Government:</b>				
General	\$ 1,463	\$ -	\$ -	\$ 1,463
Major Special Revenue Funds:				
Commonwealth Transportation	906	-	24	930
Federal Trust	1,314	-	-	1,314
Major Enterprise Funds:				
State Lottery	3	-	-	3
Pocahontas Parkway	-	5,426	-	5,426
Nonmajor Governmental Funds	926	-	641	1,567
Nonmajor Enterprise Funds (1)	239	-	5,020	5,259
Internal Service Funds	1,038	-	-	1,038
Investment Trust Funds	-	-	77	77
Total Primary Government (2)	<u>\$ 5,889</u>	<u>\$ 5,426</u>	<u>\$ 5,762</u>	<u>\$ 17,077</u>
<b>Discrete Component Units:</b>				
Virginia Housing Development Authority	\$ -	\$ -	\$ 5,699	\$ 5,699
University of Virginia	524	-	11,646	12,170
Virginia Polytechnic Institute and State University	-	271	3,612	3,883
Virginia Commonwealth University	262	2,763	19,899	22,924
Nonmajor Component Units	515	4,382	15,767	20,664
Total Component Units	<u>\$ 1,301</u>	<u>\$ 7,416</u>	<u>\$ 56,623</u>	<u>\$ 65,340</u>

Note (1): The \$5,020 (dollars in thousands) shown above includes \$5,019 (dollars in thousands), which represents an interfund receivable from Nonmajor Governmental Funds that will not be repaid within one year. This amount is reclassified to an internal balance on the Government-wide Statement of Net Assets.

Note (2): Other Fiduciary assets in the amount of \$77,000 are not included in the Government-wide Statement of Net Assets.

## 9. RESTRICTED ASSETS

Restricted assets represent monies or other resources that must be used for specific legal or contractual requirements. The Virginia Housing Development Authority (Major Component Unit) reported restricted assets totaling \$5.6 billion (of which \$9.9 million is reported as Depreciable Capital Assets, net). The Virginia Public School Authority (Major Component Unit) reported restricted assets of \$122.0 million. Both Major Component Unit's assets are restricted for debt service under a bond indenture agreement or other agreements. The Virginia Port Authority (Non-major Component Unit) reported restricted assets of \$136.8 million. Of this amount \$96.9 million is assets placed in escrow account for a construction project, \$26.5 million for debt service under a bond indenture agreement, and \$13.4 million for other bond service projects. The Virginia Resources Authority (Non-major Component Unit) reported restricted assets of \$133.1 million. Of this amount \$128.1 million is restricted for loans to local

governments, bond indentures, or federal and state regulations for various revolving funds. \$5.0 million is restricted for the Operating Reserve Fund for the newly structured Virginia Pooled Financing Program. The Higher Education Institutions (Component Units) reported restricted assets totaling approximately \$2.3 billion primarily for endowment and other contractual obligations. Included in this amount is approximately \$1.8 billion of Foundations' restricted assets. The two museum foundations, the Virginia Museum of Fine Arts Foundation (Nonmajor Component Unit) and the Science Museum of Virginia Foundation (Nonmajor Component Unit) had restricted assets of \$111.6 million and \$9.9 million, respectively, primarily for donor-imposed restricted endowments. The remaining \$7.7 million is spread among the Hampton Roads Sanitation District Commission (Nonmajor Component Unit), the Virginia Equine Center (Nonmajor Component Unit), and the Small Business Financing Authority (Nonmajor Component Unit).

## 10. CAPITAL ASSETS

The following schedule presents the changes in the Capital Assets:

### Schedule of Changes in Capital Assets Governmental Activities

(Dollars in Thousands)

	Balance July 1, as restated	Increases	Decreases	Balance June 30
<b>Nondepreciable Capital Assets:</b>				
Land	\$ 1,313,374	\$ 197,598	\$ (62,583)	\$ 1,448,389
Construction in Progress	2,942,520	1,298,899	(1,557,004)	2,684,415
Total Nondepreciable Capital Assets	<u>4,255,894</u>	<u>1,496,497</u>	<u>(1,619,587)</u>	<u>4,132,804</u>
<b>Depreciable Capital Assets:</b>				
Buildings	2,147,018	13,087	(22,965)	2,137,140
Equipment	567,846	41,647	(22,989)	586,504
Infrastructure	15,368,677	1,501,581	(194,678)	16,675,580
Total Capital Assets being Depreciated	<u>18,083,541</u>	<u>1,556,315</u>	<u>(240,632)</u>	<u>19,399,224</u>
<b>Less Accumulated Depreciation for:</b>				
Buildings	694,588	56,638	(17,004)	734,222
Equipment	333,485	44,696	(22,306)	355,875
Infrastructure	8,059,914	365,265	(930)	8,424,249
Total Accumulated Depreciation	<u>9,087,987</u>	<u>466,599</u>	<u>(40,240)</u>	<u>9,514,346</u>
Total Depreciable Capital Assets, Net	<u>8,995,554</u>	<u>1,089,716</u>	<u>(200,392)</u>	<u>9,884,878</u>
Total Capital Assets, Net	<u>\$ 13,251,448</u>	<u>\$ 2,586,213</u>	<u>\$ (1,819,979)</u>	<u>\$ 14,017,682</u>

Note: Beginning balances have been restated by \$253,796 (dollars in thousands) due to prior year errors, as discussed in Note 28.

**Depreciation Expense Charged to Functions of the Primary Government**  
June 30, 2004

*(Dollars in Thousands)*

Governmental Activities:	
General Government	\$ 9,666
Education	6,093
Transportation	380,170
Resources and Economic Development	8,156
Individual and Family Services	12,806
Administration of Justice	33,413
Capital Assets held by the Internal Service	
Funds are charged to various functions	16,295
Total	\$ 466,599

**Schedule of Changes in Capital Assets**  
**Business-Type Activities**

*(Dollars in Thousands)*

	Balance July 1	Increases	Decreases	Balance June 30
<b>Nondepreciable Capital Assets:</b>				
Land	\$ 16,117	\$ 295	\$ -	\$ 16,412
Total Nondepreciable Capital Assets	16,117	295	-	16,412
<b>Depreciable Capital Assets:</b>				
Buildings	10,403	355	(6)	10,752
Equipment	75,401	4,487	(1,413)	78,475
Infrastructure	314,643	94	-	314,737
Total Capital Assets being Depreciated	400,447	4,936	(1,419)	403,964
<b>Less Accumulated Depreciation for:</b>				
Buildings	9,624	164	(2)	9,786
Equipment	38,360	9,657	(1,192)	46,825
Infrastructure	8,741	10,551	-	19,292
Total Accumulated Depreciation	56,725	20,372	(1,194)	75,903
Total Depreciable Capital Assets, Net	343,722	(15,436)	(225)	328,061
Total Capital Assets, Net	\$ 359,839	\$ (15,141)	\$ (225)	\$ 344,473

**Schedule of Changes in Capital Assets**  
**Component Units**

(Dollars in Thousands)

	Balance July 1, as restated	Increases	Decreases	Subtotal June 30	Foundations (1)	Total June 30
<b>Nondepreciable Capital Assets:</b>						
Land	\$ 351,058	\$ 8,757	\$ (7)	\$ 359,808	\$ 101,452	\$ 461,260
Construction in Progress	612,056	632,366	(381,073)	863,349	58,742	922,091
Inexhaustible Works of Art / Historical Treasures	69,143	899	-	70,042	11,803	81,845
Livestock	779	172	-	951	2,182	3,133
Total Nondepreciable Capital Assets	<u>1,033,036</u>	<u>642,194</u>	<u>(381,080)</u>	<u>1,294,150</u>	<u>174,179</u>	<u>1,468,329</u>
<b>Depreciable Capital Assets:</b>						
Buildings	4,666,794	306,913	(6,798)	4,966,909	393,084	5,359,993
Infrastructure	1,332,714	37,115	(903)	1,368,926	559	1,369,485
Equipment	1,830,879	220,826	(161,241)	1,890,464	74,065	1,964,529
Improvements Other Than Buildings	340,024	16,941	(5,536)	351,429	9,935	361,364
Library Books	533,989	28,155	(3,494)	558,650	-	558,650
Total Capital Assets being Depreciated	<u>8,704,400</u>	<u>609,950</u>	<u>(177,972)</u>	<u>9,136,378</u>	<u>477,643</u>	<u>9,614,021</u>
<b>Less Accumulated Depreciation for:</b>						
Buildings	(1,765,185)	(136,453)	5,384	(1,896,254)	(85,103)	(1,981,357)
Infrastructure	(682,759)	(42,223)	855	(724,127)	(391)	(724,518)
Equipment	(1,198,093)	(154,797)	141,790	(1,211,100)	(51,667)	(1,262,767)
Improvements Other Than Buildings	(177,749)	(17,571)	5,423	(189,897)	(6,018)	(195,915)
Library Books	(421,000)	(26,057)	3,467	(443,590)	-	(443,590)
Total Accumulated Depreciation	<u>(4,244,786)</u>	<u>(377,101)</u>	<u>156,919</u>	<u>(4,464,968)</u>	<u>(143,179)</u>	<u>(4,608,147)</u>
Total Depreciable Capital Assets, Net	<u>4,459,614</u>	<u>232,849</u>	<u>(21,053)</u>	<u>4,671,410</u>	<u>334,464</u>	<u>5,005,874</u>
Total Capital Assets, Net	<u>\$ 5,492,650</u>	<u>\$ 875,043</u>	<u>\$ (402,133)</u>	<u>\$ 5,965,560</u>	<u>\$ 508,643</u>	<u>\$ 6,474,203</u>

Note (1): Foundations represent FASB reporting entities defined in Note 1.B.

Beginning balances have been restated due to reclassifications and corrections of prior year errors. The following schedule is a summary of the restatement amounts.

**Capital Asset Restatement - Component Units**

(Dollars in Thousands)

	Balance July 1 Increase/(Decrease)
<b>Nondepreciable Capital Assets:</b>	
Land	\$ 11,352
Construction in Progress	(28,520)
Total Nondepreciable Capital Assets	<u>(17,168)</u>
<b>Depreciable Capital Assets:</b>	
Buildings	34,045
Infrastructure	5,051
Equipment	(60)
Improvements Other Than Buildings	(19,245)
Total Capital Assets being Depreciated	<u>19,791</u>
<b>Less Accumulated Depreciation for:</b>	
Buildings	(29,204)
Infrastructure	(21,410)
Equipment	184
Improvements Other Than Buildings	53,053
Total Accumulated Depreciation	<u>2,623</u>
Total Depreciable Capital Assets, Net	<u>17,168</u>
Total Capital Assets, Net	<u>\$ -</u>

## 11. RETIREMENT AND PENSION SYSTEMS

A separately issued financial report that includes financial statements and required supplemental information for each of the individual plans discussed below is publicly available. Copies may be obtained by writing to Virginia Retirement System, P. O. Box 2500, Richmond, Virginia 23218-2500.

### A. Plan Description

The Virginia Retirement System (VRS), a mixed agent and cost-sharing multiple-employer retirement plan, provides defined benefit pension plan coverage for State employees, teachers, political subdivision employees, and other qualifying employees. The assets accumulated by the plan may legally be used to pay all benefits provided by the plan to any of the plan members or beneficiaries. At June 30, 2004, the VRS had 798 contributing employers. The State Police Officers' Retirement System (SPORS), the Judicial Retirement System (JRS), and the Virginia Law Officers' Retirement System (VaLORS) are single-employer defined benefit retirement plans. The SPORS provides retirement benefits to Virginia state police officers, the JRS provides retirement benefits to the Commonwealth's judiciary, and the

VaLORS provides benefits to law enforcement and correctional officers other than state police officers. All retirement systems are administered by the Virginia Retirement System (System), an independent agency of the Commonwealth.

Benefit provisions and all other requirements are established by Title 51.1 of the *Code of Virginia*. All full-time, salaried, permanent employees of the Commonwealth, with the exception of certain full-time faculty and administrative staff of higher education institutions and eligible employees of the Commonwealth's teaching hospitals who have the option not to participate in the VRS, must participate in the VRS, SPORS, JRS, or VaLORS. Benefits vest after five years of service.

Employees are eligible for an unreduced retirement benefit at age 65 with five years of service (age 60 for participating law enforcement officers) or at age 50 with at least 30 years of service if elected by the employer (age 50 with at least 25 years of service for participating law enforcement officers). Employees may retire with a reduced benefit at age 50 with at least ten years of credited service or at age 55 (age 50 for participating law enforcement officers) with at least five years of credited service.

Annual retirement benefits are payable monthly for life in an amount equal to 1.7 percent of their average final salary (AFS) for each year of credited service. AFS is defined as the highest consecutive 36 months of salary. Benefits are actuarially reduced for retirees who retire prior to becoming eligible for full retirement benefits. Members of the SPORS and VaLORS may receive a monthly benefit supplement if they retire prior to age 65. Members of VaLORS hired before July 1, 2001, were allowed to make a one-time election to increase the multiplier from 1.7 percent to 2.0 percent instead of receiving the supplement. Members of VaLORS hired after June 30, 2001, have their benefit computed using the 2.0 percent multiplier and are not eligible for the supplement. Members of the JRS receive weighted years of creditable service for each year of actual service under JRS. The VRS, SPORS, VaLORS, and JRS also provide death and disability benefits. These benefit provisions and all other requirements are established by State statute.

## **B. Summary of Significant Accounting Policies**

### **Basis of Accounting**

The financial statements of the pension trust funds are prepared using the economic resources measurement focus and the accrual basis of accounting. Employee and employer contributions are recognized as revenues in the period in which employee services are performed, and investment

income is recognized as earned by the pension plans. Benefits and refunds are recognized when due and payable in accordance with the terms of the plans.

### **Method Used to Value Investment**

Investments are reported at fair value as determined by the System's master custodian, Mellon Trust, from its Global Pricing System. This system assigns a price source, based on asset type and the vendor pricing products to which the master custodian subscribes, for every security held immediately following its acquisition. Prices supplied by these sources are monitored on a daily basis by the master custodian.

The pricing sources utilized by the master custodian provide daily prices for equity securities, corporate, government and mortgage-backed fixed income securities, private placement securities, futures and options on futures, open-ended funds, and foreign exchange rates. Depending on the vendor, collateralized mortgage obligations, adjustable rate mortgages, and asset-backed securities are priced either daily, weekly or twice a month, and at month end. Municipal fixed income securities and options on Treasury/Government National Mortgage Association securities are priced at month end.

When a pricing source is unable to provide a price, quotes are sought from major investment brokers and market-making dealers or internal calculations are applied if feasible. As a last resort, the master custodian will contact investment managers for a price. The master custodian prices commingled funds, partnerships, and real estate assets from statements received from the funds, partnerships, or investment managers.

The retirement plans have no concentrations of investments in any one organization that represent 5 percent or more of plan net assets available for benefits.

## **C. Funding Policy**

Employer and employee contributions are required by Title 51.1 of the *Code of Virginia*. The Commonwealth pays the 5 percent of employees' annual salaries that employees are required to contribute to the retirement system.

The annual required contributions for the current year were determined during the actuarial valuations conducted as of June 30, 2001. Employer contributions by the Commonwealth to VRS, SPORS, VaLORS, and JRS were 3.77 percent, 12.79 percent, 13.95 percent, and 32.03 percent, respectively, of covered payrolls.

#### D. Annual Pension Cost and Net Pension Obligation

The following table (dollars in thousands) shows the Commonwealth's annual pension cost and net pension obligation to the VRS, SPORS, JRS, and VaLORS for the current and prior years.

	VRS			SPORS		
	2004	2003	2002	2004	2003	2002
Annual required contribution	\$ 156,192	\$ 145,138	\$ 141,175	\$ 23,031	\$ 21,791	\$ 21,296
Interest on net pension obligation	39,209	27,322	20,728	3,266	2,203	1,292
Adjustment to annual required contribution	(34,269)	(23,880)	(17,754)	(2,854)	(1,925)	(1,106)
Annual pension cost	161,132	148,580	144,149	23,443	22,069	21,482
Contributions made	(108,412)	-	(61,716)	(10,328)	(8,781)	(10,095)
Increase in net pension obligation	52,720	148,580	82,433	13,115	13,288	11,387
Net pension obligation, beginning of year, as restated (1)	490,120	341,532	259,099	40,826	27,538	16,151
Net pension obligation, end of year	<u>\$ 542,840</u>	<u>\$ 490,112</u>	<u>\$ 341,532</u>	<u>\$ 53,941</u>	<u>\$ 40,826</u>	<u>\$ 27,538</u>
Percentage of annual pension cost contributed	67.3%	0.0%	42.8%	44.1%	39.8%	47.0%

Note (1): Effective July 1, 2003, the Virginia Information Providers Network was restructured to become part of the Commonwealth's reporting entity instead of a related organization. Accordingly, the beginning balance has been restated by \$8,439.

	JRS			VaLORS		
	2004	2003	2002	2004	2003	2002
Annual required contribution	\$ 23,114	\$ 22,266	\$ 21,655	\$ 79,569	\$ 76,564	\$ 77,599
Interest on net pension obligation	2,029	1,322	436	7,801	4,423	213
Adjustment to annual required contribution	(1,773)	(1,156)	(373)	(6,818)	(3,865)	(182)
Annual pension cost	23,370	22,432	21,718	80,552	77,122	77,630
Contributions made	(15,190)	(13,604)	(10,641)	(40,596)	(34,895)	(25,006)
Increase in net pension obligation	8,180	8,828	11,077	39,956	42,227	52,624
Net pension obligation, beginning of year	25,359	16,531	5,454	97,511	55,284	2,660
Net pension obligation, end of year	<u>\$ 33,539</u>	<u>\$ 25,359</u>	<u>\$ 16,531</u>	<u>\$ 137,467</u>	<u>\$ 97,511</u>	<u>\$ 55,284</u>
Percentage of annual pension cost contributed	65.0%	60.6%	49.0%	50.4%	45.2%	32.2%

The VRS pension liability for the Virginia Economic Development Partnership (VEDP) (Component Unit), the Virginia Tourism Authority (VTA) (Component Unit), and the Virginia Outdoors Foundation (VOF) (Component Unit) are reported in the financial statements. However, since the Commonwealth is not considered the employer for VEDP, VTA, or VOF, the Commonwealth's net pension obligation shown above at the end of the year does not include VEDP's pension liability of \$1.3 million, VTA's pension liability of \$315,663, or VOF's pension liability of \$6,432.

The most recent actuarial valuations were conducted as of June 30, 2003. The valuations were prepared using the entry age normal cost method. The actuarial assumptions included (a) 8.00% investment rate of return, per year compounded annually; (b) projected salary increases ranging from 4.00% to 6.30%, including a 3.00% inflation component; and (c) 3.00% per year COLA. Valuation techniques were applied to smooth the effects of short-term volatility in the market value of investments over a five-year period. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll. The remaining closed amortization period at June 30, 2004, was 23 years or less.

**E. Defined Contribution Plan for Political Appointees**

Officers appointed by the Governor, officers elected by popular vote or the General Assembly, and executive branch chief deputies and confidential assistants may participate in the Deferred Contribution Plan for Political Appointees, rather than the VRS. This optional retirement plan is authorized by the *Code of Virginia* and offered through the Great West Company. This is a defined contribution plan where the retirement benefits are based upon the Commonwealth's (3.77 percent) and the employee's (5.0 percent) contributions, plus interest and dividends. The Commonwealth pays the required employee contributions. During the year ended June 30, 2004, the total contributions to this plan were \$712,630.

The summary of significant accounting policies for the plan is in accordance with those discussed in Section B. The plan has no concentration of investments in any one organization that represents 5.0 percent or more of the plan net assets available for benefits.

**F. Higher Education Fund (Component Unit)**

The Commonwealth's colleges and universities participate in the VRS, a mixed agent and cost-sharing multiple-employer retirement plan. The VRS issues a separate stand-alone report that is publicly available as previously discussed.

In addition, full-time faculty and certain administrative staff of the Commonwealth's colleges and universities may participate in an optional retirement annuity program, rather than the

VRS. Optional Retirement Plans are authorized by the *Code of Virginia* and provide retirement and death benefits. The optional retirement annuity programs are offered through Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF) Insurance Companies, Variable Annuity Life Insurance Company (VALIC), Fidelity Investments, Inc., Great West Life, Inc., T. Rowe Price, Inc., Metropolitan Life and Vanguard. These are defined contribution programs where the retirement benefits received are based upon the Commonwealth's (5.4 percent) and employees' (5.0 percent) contributions, plus interest and dividends. The Commonwealth pays the required employee contributions. During the year ended June 30, 2004, the total contributions to these plans were:

TIAA-CREF	\$	66,456,956
VALIC		4,108,460
Fidelity Investments		25,455,098
Great West Life		243,824
T. Rowe Price		1,091,819
Metropolitan Life		218,329
Vanguard		559,086
Total	\$	<u>98,133,572</u>

The Virginia Commonwealth University Health System Authority (Authority) (a blended component unit of the Virginia Commonwealth University – Major) contributes to the VRS. The VRS issues a separate stand-alone report that is publicly available as previously discussed. Effective July 1, 1997, the Authority established the Virginia Commonwealth University Health System Authority Defined Contribution Plan (the Plan). All employees working at least 35 hours of service per week are eligible to participate in the Plan. Per the Plan document as approved by the Authority's Board of Directors, the Authority contributes 8.0 percent of the participant's salary to the Plan, up to a maximum of \$30,000. Total contributions for the year ended June 30, 2004, were approximately \$8,831,000. The Authority has the right at anytime, and without the consent of any party, to terminate the Plan in its entirety. The Authority's Board of Directors must approve any changes to the provisions of the Plan, including the contribution requirements, in writing. The Authority has also established the Virginia Commonwealth University Health System Authority Health Care Providers Defined Contribution Plan (the HCP Plan). All persons hired as a health care provider on or after July 1, 1993, and prior to July 1, 1997, and working at least 35 hours of service per week are eligible to participate in the HCP Plan. At June 30, 2004, there were participants in the HCP Plan. All significant provisions of the HCP Plan, including the contribution requirements, are similar to the Plan. Total contributions to the HCP Plan for the year ended June 30, 2004, were approximately \$31,000.

The Medical College of Virginia Associated Physicians (MCVAP) (a Component Unit of the Authority) sponsors the MCVAP 403(b) Retirement Fund (the 403(b) Plan), a defined contribution plan

which covers substantially all non-medical employees of MCVAP. As of January 1, 2002, no additional contributions were made to this Plan.

MCVAP also sponsors the MCVAP 401(a) Retirement Plan (the 401(a) Plan), a noncontributory, defined contribution plan which covers substantially all full time clinical providers of MCVAP. Contributions to the 401(a) Plan, as determined annually at the discretion of the Board of Directors were approximately \$4,906,000 for the year ended June 30, 2004.

MCVAP also sponsors the VCUHS 401(a) Retirement, a defined contribution plan which covers all non-medical employees of MCVAP and the VCUHS 457(b) Retirement Plan, a salary reduction plan that represents employee contributions. These plans became effective on January 1, 2002, and replaced the MCVAP 403 9(b) plan for all non-medical staff. The contributions to the VCUHS 401(a) and VCUHS 457(b) Plan for the period ended June 30, 2004, were approximately \$3,160,000.

VA Premier (a Component Unit of the Authority) adopted a 401(k) plan sponsored by Prudential Mutual Fund Management, Inc. Employees may enter into the plan on the first day of the month coinciding with or following the date on which the employee begins employment. There is no minimum service or age requirement to be in the 401(k) plan. Employees may contribute 1 percent to 15 percent of their compensation. VA Premier will match 50 percent of the employees' contributions up to 4 percent of the employees' compensation. Matching will occur based on the bi-weekly pay periods. In addition, VA Premier contributes 3 percent of the employee's compensation after each bi-weekly payroll effective when the employee begins employment. Employees are fully vested after four years of service in which the employees have at least 1,000 hours of service each year. The total expense to VA Premier in fiscal year 2004 was approximately \$313,000.

Effective January 1, 1997, James Madison University (nonmajor) established a Supplemental Retirement Plan for tenured faculty members. The plan was designed to provide flexibility in the allocation of faculty positions. The plan is a qualified plan within the meaning of section 401(c) of the Internal Revenue Code of 1986 (the Code) and is a governmental plan within the meaning of section 414(d) of the Code. Since it is a governmental plan, the plan is not subject to the Employee Retirement Income Security Act of 1974 as amended. Since inception, 109 faculty members have elected to enroll in the plan. As of June 30, 2004, 61 participants remain, including 6 new participants who retired under this plan during fiscal year 2004. In order to satisfy IRS requirements, a trust fund has been established as means to make the payments to the plan participants. The University prepaid the entire fiscal year 2005 plan contribution of \$1,202,472 in fiscal year 2004.

The Innovative Technology Authority (ITA) (nonmajor) has a defined contribution retirement plan covering substantially all employees. Under the plan, contributions are fixed at a percentage of each employee's compensation to pay premiums for individual retirement annuity contracts written by TIAA-CREF. Pension contributions for the plan totaled \$412,793 in fiscal year 2004.

## **G. Other Component Units**

Note 1.B. outlines the component units included in the Commonwealth's reporting entity. The Virginia Historic Preservation Foundation (Blended - Primary Government), the Virginia Public Building Authority (Blended - Primary Government), the Virginia Public School Authority (major), the Virginia College Building Authority (nonmajor), the Virginia State Parks Foundation (Blended - Primary Government), the Virginia Schools for the Deaf and Blind Foundation (nonmajor), and the Pocahontas Parkway Association (Blended - Primary Government) have no employees. The Virginia Economic Development Partnership, the Small Business Financing Authority, the Hampton Roads Sanitation District Commission, the Virginia Biotechnology Research Park Authority, the A. L. Philpott Manufacturing Extension Partnership, the Virginia Outdoors Foundation, the Virginia Tourism Authority, the Tobacco Indemnification and Community Revitalization Commission, the Virginia Tobacco Settlement Foundation (all nonmajor), and the Virginia Land Conservation Foundation (Blended - Primary Government) contribute solely to the VRS, a mixed agent and cost-sharing multiple-employer retirement plan. The VRS issues a separate stand-alone report that is publicly available as previously discussed.

Full-time employees of the Virginia Housing Development Authority (major) participate in a defined contribution employees' retirement savings plan administered by the Authority. This is a noncontributory plan where the Authority incurs employment retirement savings expense equal to 8.0 percent of full-time employees' compensation. Total retirement savings expense under this plan was \$1,391,207 in fiscal year 2004. The retirement expense is fully funded as incurred; therefore, there is no unfunded future retirement liability.

The Virginia Port Authority (nonmajor) contributes to the VRS. The Authority also sponsors two single-employer noncontributory defined benefit pension plans. The Virginia Port Authority Pension Plans are administered by the Authority and provide retirement, disability, and death benefits to plan members and beneficiaries. Benefit provisions and obligations are established and may be amended by the Board of Commissioners of the Authority. The Authority's policy is to fund annually the plan's normal cost as calculated under a generally accepted actuarial funding method and the amortization of any unfunded past service liabilities over a period not to exceed 30 years. In addition, the plan was restated October 1, 2001, to ensure compliance with additional regulations. On

February 28, 2002, the plan was amended to provide for a one-time Voluntary Retirement Opportunity Program (VROP). The program provided for early retirement of selected employees who were 58 years of age and had at least ten years of creditable service as of April 1, 2002. The effect on this amendment, an increase in the actuarial present value of accumulated plan

benefits of \$2,337,300, was accounted for and fully funded during the fiscal year ended June 30, 2002.

The components of annual pension cost and prepaid pension obligation for the first single-employer noncontributory defined benefit pension plan are as follows:

<b>Trend Information</b>			
	<b>2004</b>	<b>2003</b>	<b>2002</b>
Service cost - benefits earned during the year	\$ 1,156,600	\$ 987,000	\$ 982,000
Interest cost on projected benefit obligation	2,260,700	2,144,000	1,910,000
Expected return on assets	(2,675,000)	(2,429,000)	(2,550,000)
Net amortization and deferral	151,300	76,400	42,700
One time recognition - VROP	-	-	2,337,300
Annual pension cost	893,600	778,400	2,722,000
Contributions made	(1,299,000)	(2,916,100)	(2,840,200)
Increase in prepaid pension obligation	(405,400)	(2,137,700)	(118,200)
Prepaid pension obligation, beginning of year	(7,762,400)	(5,624,700)	(5,506,500)
Prepaid pension obligation, end of year	<u>\$ (8,167,800)</u>	<u>\$ (7,762,400)</u>	<u>\$ (5,624,700)</u>

The annual pension cost for the current year was determined as part of the September 30, 2003, actuarial valuation using the aggregate actuarial cost method, which does not identify and separately amortize unfunded actuarial liabilities. The discount rate used in determining the actuarial present value of projected benefit obligation was 7.5 percent in fiscal year 2004 and 8.0 percent in fiscal years 2003 and 2002. The expected long-term rate of return on assets used in determining net periodic pension cost was 7.5 percent.

The following table sets forth the plan's funded status and the related amounts recorded in the Authority's balance sheets at June 30, 2004, 2003, and 2002.

<b>Trend Information</b>			
<b>Fiscal Year Ended June 30</b>	<b>Annual Pension Cost (APC)</b>	<b>Percentage of APC Contributed</b>	<b>Prepaid Pension Obligation</b>
2004	\$ 893,600	145 %	\$ (8,167,800)
2003	\$ 778,400	375 %	\$ (7,762,400)
2002	\$ 2,722,000	104 %	\$ (5,624,700)

In November 2001, the second plan was amended to provide benefits to sworn police officers that more closely resemble the new retirement benefits provided to members of the Virginia Law Enforcement Officers Retirement System. The effect of those changes is included in the accompanying pension data.

The components of annual pension cost and prepaid pension obligation for the second single-employer noncontributory defined benefit pension plan are as follows:

**Trend Information**

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Service cost - benefits earned during the year	\$ 348,524	\$ 197,071	\$ 142,820
Interest cost on projected benefit obligation	138,803	111,771	44,309
Expected return on assets	(167,011)	(36,821)	13,025
Net amortization and deferral	<u>183,283</u>	<u>87,904</u>	<u>(6,465)</u>
Annual pension cost	503,599	359,925	193,689
Contributions made	(149,822)	(802,299)	(209,420)
Additional minimum liability	<u>(435,518)</u>	<u>158,952</u>	<u>689,672</u>
Increase in pension obligation	(81,741)	(283,422)	673,941
Pension obligation, beginning of year	583,758	867,180	193,239
Pension obligation, end of year	<u>\$ 502,017</u>	<u>\$ 583,758</u>	<u>\$ 867,180</u>

The annual pension cost for the current year was determined as part of the August 2004 actuarial valuation using the aggregate actuarial cost method, which does not identify and separately amortize unfunded actuarial liabilities. Actual value of assets was determined using market value. The discount rate used in determining the actuarial present value of the projected benefit obligation was 6.3 percent in 2004, 6.0 percent in 2003, and 7.0 percent in 2002. The expected long-term rate of return on assets used in determining net periodic pension cost was 8.0 percent.

The following table sets forth the plan's funded status and the related amounts recorded in the Authority's balance sheets at June 30, 2004, 2003, and 2002.

**Trend Information**

<u>Fiscal Year Ended June 30</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Prepaid Pension Obligation</u>
2004	\$ 503,599	30 %	\$ 502,017
2003	\$ 359,925	223 %	\$ 583,758
2002	\$ 193,689	108 %	\$ 867,180

The Authority also sponsors two noncontributory supplemental plans covering certain key employees. The Authority's current policy is not to fund the costs of these plans. The plans had assets of \$1,876,388 and an accrued liability of \$2,125,712.

The Virginia Resources Authority sponsors a retirement savings plan whereby 12 percent of eligible employees' salary is contributed on an annual basis. Total retirement savings expense was \$84,739 for the year ended June 30, 2004, a portion of which is reimbursed.

The Virginia Equine Center Foundation has a defined contribution plan which covers all full-time employees of the Foundation who have one year of service and are age twenty-one or older. The plan is subject to the provisions of the Employee Retirement Income Security Act of 1974. Contributions to the plan are discretionary and the Foundation will determine the amount to contribute to the plan each year. No contributions were made on behalf of the employees for the fiscal year ended June 30, 2004.

**12. OTHER EMPLOYMENT BENEFITS**

In addition to the pension plans, the Commonwealth participates in three other employment benefit plans, Group Life Insurance, Retiree Health Insurance Credit, and Virginia Sickness and Disability Program, which are administered by the Virginia Retirement System (VRS). The VRS administers a fourth other employment benefit plan, the Volunteer Firefighters' and Rescue Squad Workers' Fund, in which the Commonwealth does not participate, but may provide funding. The significant accounting policies for all four plans are the same as those described in Note 11 for pension plans. A separately issued financial report that includes financial statements for Group Life Insurance, Retiree Health Insurance Credit, and Virginia Sickness and Disability Program is publicly available. Copies may be obtained by writing to Virginia Retirement System, P. O. Box 2500, Richmond, Virginia 23218-2500.

**Group Life Insurance**

The Group Life Insurance Plan provides life insurance benefits for State employees, teachers, employees of political subdivisions participating in the VRS, State police officers, judges, and other qualifying employees. In fiscal year 2004 there were approximately 331,897 state employees and 106,933 retirees in the program.

As part of this plan, the State provides life insurance benefits for retired employees in accordance with Title 51.1 of the *Code of Virginia*. To be eligible, the

employee must have retired or terminated employment after age 50 and have had at least ten years of service (including five years of continuous service) or at age 55 and have had five years of continuous service (age 50 for participating law enforcement officers and judges) or retired because of disability. At retirement or termination, natural death coverage starts to reduce by 25 percent each year until coverage reaches 25 percent of its value at retirement or termination.

Postemployment life insurance benefits are advance funded on an actuarially determined basis using the aggregate cost actuarial method. Rates were determined in a June 30, 2001, actuarial valuation using the same actuarial assumptions used for determining pension plan contribution rates. The modified market value of plan assets was used for valuation purposes. Retirees are not required to contribute to the group life plan. The Commonwealth's actuarially required contribution rate for the current year was 0.98 percent of payroll. This contribution covers premiums for active employees and actual death claims for retirees.

The accrued liabilities for postemployment death benefits actuarially determined through an actuarial valuation performed as of June 30, 2003, were \$1,671.2 million. The actuarial value of the program's assets available for benefits on that date was \$902.1 million, leaving a present value of future contributions of \$769.1 million. In April 2002, the General Assembly suspended contributions for the remainder of fiscal year 2002 through fiscal year 2004.

#### **Retiree Health Insurance Credit**

The Retiree Health Insurance Credit Plan provides health insurance credits against the monthly health insurance premiums for retired State employees, State police officers, and judges with at least 15 years of creditable service on the current disbursement basis. Benefit provisions and eligibility requirements are established by Title 51.1-1400 of the *Code of Virginia*. Approximately 65,163 state retirees were receiving health insurance credits at June 30, 2004.

The monthly credit amounts to \$4.00 per year of service not to exceed a maximum allowance of \$120.00. The contribution rate was determined as part of the June 30, 2001, actuarial valuation that determined the pension plan contribution rates. The Commonwealth's actuarially required contribution rate for "full funding" and "pay-as-you-go" would have been 1.86 and 1.37 percent of payroll, respectively, for the current year; however, contributions were paid at 0.89 percent of payroll. The Commonwealth recognized Retiree Health Insurance Credit expenses of \$64.9 million during the fiscal year ended June 30, 2004.

#### **Virginia Sickness and Disability Program**

The Virginia Retirement System (System) administers the Virginia Sickness and Disability Program to provide income protection for absences due to sickness or disability from the first day on the job. After a seven calendar-day waiting period following the first incident of disability, eligible employees receive short-term disability benefits ranging from 60 to 100 percent of compensation up to a maximum of 125 work days,

based upon months of State service. After a 180 calendar-day waiting period (125 work days of short-term disability), eligible employees receive long-term disability benefits equal to 60 percent of compensation until they return to work, until age 65 (age 60 for State police officers), or until death.

The VSDP was established on January 1, 1999, for all full-time, classified State employees, including State police officers and other State law enforcement and corrections officers, hired on or after January 1, 1999. Part-time, classified employees who work at least 20 hours a week on a salaried basis and who accrue leave are also covered. Eligible State employees and State police officers of the Commonwealth employed prior to January 1, 1999, had the option to elect to participate in the VSDP or to remain in the Commonwealth's existing disability retirement and sick leave program (see Notes 11 and 15). Eligible employees enrolled in the VSDP are not eligible for disability retirement benefits under the Virginia Retirement System (VRS), the State Police Officers' Retirement System (SPORS), or the Virginia Law Officers Retirement System (VaLORS).

Faculty of Virginia institutions of higher education, hired or appointed on or after January 1, 1999, who elected the VRS as their retirement plan, must make an irrevocable election to participate in the VSDP or in the institution's disability program. If there is no institution program, the faculty is covered under this program.

All State agencies are required to contribute to the cost of providing long-term disability benefits. Initial contribution requirements to fund the program were determined by the System's actuary based on an estimate of the amount of the liability for disability benefits that would transfer from the VRS and SPORS to the VSDP for the anticipated new participants in the VSDP. This contribution requirement was 1.07 percent of payroll for State employees and 1.42 percent of payroll for State police officers and VaLORS employees during the fiscal year. The Commonwealth recognized long-term disability expenses of \$23.8 million during the fiscal year. As of June 30, 2004, there were approximately 64,715 participants.

#### **Volunteer Firefighters' and Rescue Squad Workers' Fund**

Volunteer firefighters and rescue squad workers may participate in an optional postemployment benefit plan. This optional plan is authorized by the *Code of Virginia*. The Board of Trustees of the VRS manages the investments of the Fund as custodian. Members of the plan contribute \$30 per quarter. The Commonwealth will contribute an amount determined by the Board and appropriated by the General Assembly, if such funds are appropriated, for a period not to exceed twenty years. For fiscal year 2004, \$250,000 was appropriated. At June 30, 2004, there were 1,001 workers participating in the Fund.

### **13. DEFERRED COMPENSATION PLANS**

The Commonwealth offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The Virginia Retirement

System (VRS) administers the deferred compensation plan, pursuant to the Government Employees Deferred Compensation Plan Act, Section 51.1, Chapter 6 et seq. of the *Code of Virginia*. The VRS contracts with private corporations or institutions subject to the standards set forth in the *Code* to provide investment products as well as any other goods and services related to the administration of the deferred compensation plan. The Department of Accounts is responsible for the accounting, reconciliations, and record keeping associated with State employees' enrollment, payment to the plan through payroll deductions, and timely transfer of withheld funds to the trustee designated by the VRS for investment. The plan provides a number of investment options and is designed so that each participant retains investment control of his/her individual account. The plan, available to all State employees, permits them to defer a portion of their salary until future years. The deferred compensation is held in trust for the exclusive benefit of plan participants and their beneficiaries and is not available to employees until termination, retirement, death, or unforeseeable emergency. Since the VRS has no fiduciary relationship with plan participants, plan assets of \$620.8 million are not included in the financial statements.

In addition, the Commonwealth provides a cash match under Internal Revenue Code Section 401(a) for employees participating in the deferred compensation plan who have been employed at least one year. The match amount for an employee was established at 50 percent of the voluntary contributions to the deferred compensation plan. During the current fiscal year, the maximum match was \$20 per pay period or \$40 per month. The fair value of assets in the cash match savings plan at June 30, 2004, was \$51.7 million, which is also excluded from the financial statements.

The Virginia Housing Development Authority (Major Component Unit) and the Virginia Resources Authority (Nonmajor Component Unit) have a deferred compensation plan available to all employees created in accordance with Internal Revenue Section 457. The Plan permits participants to defer a portion of their salary or wage until future years. The deferred compensation is not available to employees until termination, retirement, or death. The assets of the Plan are in an irrevocable trust with an external trustee and, accordingly, no assets or liabilities are reflected in the financial statements.

The Virginia Port Authority (VPA) (Nonmajor Component Unit) offers three deferred compensation plans and two matching savings plans under Internal Revenue Code Sections 457 and 401(a), respectively. Employees who maintain status under VRS are covered under the Deferred Compensation Plan administered by the VRS as discussed above. The VPA deferred compensation plan covers all employees hired after July 1, 1997, and those employees electing coverage under the Authority's deferred compensation plan. The VPA also offers a matching savings plan that covers substantially all employees. The matching savings plan requires the VPA to match contributions in an amount equal to 50 percent of the first 6 percent of the participant's base pay contributed to the plan. VPA's total contribution to the matching savings plan was

\$101,019 for the fiscal year ended June 30, 2004. Further, the right to modify, alter, amend, or terminate the deferred compensation plan and matching savings plan rests with the VPA Board of Commissioners.

The third deferred compensation plan and second matching savings plan covers substantially all nonunion employees with 90 days or more of service. The matching savings plan requires the VPA to match employee contributions in an amount equal to 50 percent of the first 3 percent of the participant's base pay contributed to the deferred compensation plan. VPA's total contribution to the matching savings plan was \$312,269 for the fiscal year ended June 30, 2004.

The Hampton Road Sanitation District's (the District) Commission adopted a post-retirement health benefit for qualifying employees beginning after July 1, 2002. The program furnishes health and dental benefits for life for all employees with at least 15 years of service and who also qualify for an unreduced retirement benefit through the Virginia Retirement System. The program allows the retiree at their expense to cover their spouse and dependent under the District's health care provider. The District funded the estimated prior service cost of approximately \$7,000,000 in a separate trust established for this purpose from the sale of land and additional designated revenue. For the year ended June 30, 2004, the estimated ongoing annual required contribution is approximately \$500,000, and is funded through operations. The fair market value of the Trust as of June 30, 2004, was \$7,939,000.

## 14. COMMITMENTS

### A. Construction Projects

#### Highway Projects

At June 30, 2004, the Department of Transportation (Primary Government) had contractual commitments of approximately \$1,771.1 million for construction of various highway projects. Funding for these expenditures is expected to be provided as follows: (1) Federal Funds – approximately 39.6 percent or \$700.8 million, (2) State Funds – approximately 54.7 percent or \$968.5 million, and (3) Proceeds from Bonds – approximately 5.7 percent or \$101.8 million.

#### Mass Transit Projects

At June 30, 2004, the Department of Rail and Public Transportation (Primary Government) had contractual commitments of approximately \$129.7 million for various public transportation and rail preservation projects. Funding of the future expenditures is expected to be as follows: (1) State Funds – approximately 86 percent or \$111.1 million, and (2) Federal Funds – approximately 14 percent or \$18.6 million.

#### Port Projects

At June 30, 2004, the Virginia Port Authority (Nonmajor Component Unit) was committed to construction contracts totaling \$81.3 million.

## Sanitation District Project

At June 30, 2004, the Hampton Roads Sanitation District Commission (Nonmajor Component Unit) was committed to construction programs totaling \$30.9 million.

## Higher Education Institutions

Many of the colleges and universities (Component Units) are committed to construction contracts. As of June 30, 2004, these commitments totaled approximately \$509.0 million. Higher Education Foundations' commitments total approximately \$33.7 million and are primarily for construction contracts.

## B. Operating Leases

The Commonwealth has entered into numerous agreements to lease land, buildings, and equipment. Most of the operating leases contain the provision that the Commonwealth may renew the operating leases at the expiration date of the lease on a month-to-month basis. In most cases, management expects that in the normal course of business, leases will be renewed or replaced by other leases of a similar nature. Rental expense for the primary government under these operating leases for the year ended June 30, 2004, was \$73.8 million for governmental activities (including Internal Service Funds) and \$14.1 million for business-type activities. Rental expense for the discrete component units (excluding Foundations) for the year ended June 30, 2004, was \$73.4 million. The Commonwealth has, as of June 30, 2004, the following minimum rental payments due under the above leases (dollars in thousands):

	Primary Government		
	Governmental Activities	Business-Type Activities	Component Units (1)
2005	\$ 56,706	\$ 10,706	\$ 37,572
2006	36,857	7,822	26,321
2007	25,794	5,634	20,679
2008	19,874	3,542	14,065
2009	14,134	1,497	8,417
2010-2014	32,891	1,185	26,740
2015-2019	7,082	-	12,748
2020-2024	2,080	-	1,981
2025-2029	743	-	1,168
2030-2034	264	-	939
2035-2039	-	-	823
2040-2044	-	-	823
2045-2049	-	-	823
Total	\$ 196,425	\$ 30,386	\$ 153,099

Note (1): The above amounts exclude operating lease obligations of Foundations.

## Foundations (2)

2005	\$ 6,896
2006	6,688
2007	6,555
2008	6,492
2009	6,434
Thereafter	75,466
Total	\$ 108,531

Note (2): Foundations represent FASB reporting entities defined in Note 1.B. Rental expense for the year ended June 30, 2004, was approximately \$5.4 million.

Lease agreements are for various terms and all leases contain nonappropriation clauses indicating that continuation of the lease is subject to funding by the General Assembly.

## C. Investment Commitments – Virginia Retirement System

The Virginia Retirement System extends investment commitments in the normal course of business, which, at June 30, 2004, amounted to \$1.8 billion.

## D. Tobacco Grants

The Tobacco Indemnification and Community Revitalization Commission (Commission) (Nonmajor Component Unit) has \$54.3 million in grant award commitments not reflected in these statements since eligibility requirements were not met as of June 30, 2004 in accordance with GASBS No. 33. The Commission awarded an additional \$3.5 million in July 2004 and is obligated for \$3 million of indemnification payments in August 2004 that are also not reflected in these statements.

The Virginia Tobacco Settlement Foundation (Nonmajor Component Unit) has \$5 million in grant commitments and \$7 million in outstanding contracts not reflected in these statements since eligibility requirements were not met as of June 30, 2004 in accordance with GASBS No. 33.

## E. Maintenance Contracts

The Virginia Economic Development Partnership (Nonmajor Component Unit) entered into a 3-year contract for maintenance on its Microsoft products for a total cost of \$135,223. One year's expense of \$45,077 has been paid, leaving two years totaling \$90,149.

## 15. ACCRUED LIABILITY FOR COMPENSATED ABSENCES

Employees accrue annual leave at a rate of four to nine hours semimonthly, depending on their length of service. The maximum leave accumulation is dependent upon years of service, but in no case may it exceed 432 hours. The maximum compensation for annual leave

balances is also dependent upon years of service, but in no case may an employee be compensated for more than 336 hours.

All employees hired after January 1, 1999, are required to enroll in the Virginia Sickness and Disability Program (VSDP) (see Note 12). Under the VSDP, employees receive a specified number of sick and personal leave hours, depending on their length of service, and any balances at the end of the calendar year revert. Individuals employed at January 1, 1999, had the option of converting to the VSDP or remaining in the original sick leave plan. If converting, the employee's sick leave balance could be used to purchase retirement credits or be converted to disability credits. If an employee opted to remain in the original sick leave program, sick leave accrues at a rate of five hours semimonthly. Employees who leave State service after a minimum of five years employment receive the lesser of 25 percent of the value of their disability credits or accumulated sick leave at their current earnings rate or \$5,000. All employees leaving State service are paid for accrued annual leave up to the maximum calendar year limit at their current earnings rate.

In conformance with Section C60 of GASB Codification, the monetary value of accumulated annual and sick leave and disability credits payable upon termination is included in the accompanying financial statements. In the government-wide statements, proprietary fund statements, and discrete component unit fund statements, amounts are segregated into two components – the amount due within one year and the amounts due in more than one year. In the governmental fund statements, amounts to be paid from expendable resources are recognized as fund liabilities in the applicable governmental fund types as long-term liabilities and represent payments for separations that occurred prior to June 30. Amounts not payable from expendable resources are reflected in the governmental activities column in the Government-wide Statement of Net Assets (see Note 19). All amounts related to the fiduciary funds are recognized in those funds.

The liability at June 30, 2004, was computed using salary rates effective at that date, and represents vacation, compensatory and sick leave earned or disability credits held up to the allowable ceilings. In accordance with GASB Statement No. 16, *Accounting for Compensated Absences*, an additional liability amount has been included for those employees remaining in the original sick leave program with less than 5 years of service based on the probability that they will eventually become vested. Also included in the liability is the Commonwealth's share of FICA taxes on leave balances for which employees will be compensated.

## 16. INSURANCE

### A. Self-Insurance

The Commonwealth maintains two types of self-insurance plans. The first type of self-insurance is a health care plan administered by the Department of Human Resource Management for State

employees. The plan is accounted for in the Health Care – Internal Service Fund. Interfund premiums are accounted for as internal activity receipts from other funds. At June 30, 2004, \$85.7 million is reported as the estimated claims payable for this fund. The estimated liability is based upon actual claims that have been submitted as well as actuarially determined claims incurred but not reported as described in Note 1.R. Changes in the balances of claims liabilities (dollars in thousands) during the current and prior fiscal years are as follows:

	<b>Balance</b>	<b>Current</b>	<b>Claim</b>	<b>Balance</b>
	<b>July 1,</b>	<b>Year Claims</b>	<b>Payments</b>	<b>June 30,</b>
		<b>and Changes</b>		
		<b>in Estimates</b>		
2003-2004	\$ 78,800	\$ 613,508	\$ (606,602)	\$ 85,706
2002-2003	\$ 79,608	\$ 579,001	\$ (579,809)	\$ 78,800

The second type of plan, risk management insurance, is administered by the Department of the Treasury, Division of Risk Management and the Department of Human Resource Management, Worker's Compensation Program. This plan is accounted for in the Risk Management – Internal Service Fund. Interfund premiums are accounted for as internal activity receipts from other funds. Risk management insurance includes workers' compensation, property, general (tort) liability, medical malpractice, and automobile plans. At June 30, 2004, \$220.0 million is reported as the estimated claims payable for these self-insurance plans. The estimated losses are based upon actual claims that have been submitted, as well as claims incurred but not reported. Changes in the balances of claims liabilities (dollars in thousands) during the current and prior fiscal years are as follows:

	<b>Balance</b>	<b>Current</b>	<b>Claim</b>	<b>Balance</b>
	<b>July 1,</b>	<b>Year Claims</b>	<b>Payments</b>	<b>June 30,</b>
		<b>and Changes</b>		
		<b>in Estimates</b>		
2003-2004	\$ 189,185	\$ 80,445	\$ (50,125)	\$ 219,505
2002-2003	\$ 178,328	\$ 72,356	\$ (61,499)	\$ 189,185

For workers' compensation, the Commonwealth assumes the full risk of claims filed. For tort, including general and automobile liability, liability is assumed to \$2,000,000 per occurrence. Medical malpractice liability is assumed to \$1,000,000 per occurrence. For property damage, Risk Management purchases \$400,000,000 of insurance with a \$1,000,000 deductible.

The Commonwealth has not had any insurance settlements exceed the coverage during the past three years.

The Virginia Port Authority (Nonmajor Component Unit) is partially self-insured for certain workers'

compensation claims. The Authority maintains insurance coverage of \$5,000,000 per claim, but is obligated to pay the first \$1,000,000 of any individual's claims per incident. The Authority is also partially self-insured for employee health coverage. The Authority is responsible for actual claim costs up to \$75,000 per individual per calendar year. Insurance coverage is maintained for claims in excess of the individual employee limit and for aggregate claims in excess of \$3,866,745.

## B. Public Entity Risk Pools

The Commonwealth administers two types of public entity risk pools for the benefit of local governmental units: health care and risk management insurance. The Local Choice Health Care plan was established to make comprehensive health care insurance available to localities and political subdivisions at affordable rates and with stable premiums. During the fiscal year, there were 228 local government units participating in the pool. This includes 26 school districts, 28 counties, 85 cities/towns, and 89 other subdivisions. This program is accounted for in the Local Choice Health Care Enterprise Fund (nonmajor).

The Department of Human Resource Management, under Section 2.2-1204 of the *Code of Virginia*, has the authority to design, set rates, and administer the Local Choice Health Care fund. The pool's standard contract period is one year. However, a member group may withdraw on the last day of any month with three month's written notice. Contributions are based on the current necessary contribution and the amortization of experience adjustments in the pool. At June 30, 2004, \$15.2 million is reported as the actuarially determined estimated claims payable for this fund based on claims incurred but not reported.

The actuarial liability is determined for the membership pool in total and then adjusted for each locality based on individual historic and demographic data. If the pool's assets were to be exhausted, the program participants would share the responsibility for any liabilities or deficits.

The Department of Treasury, Division of Risk Management administers risk management pools for errors and omissions liability insurance and law enforcement professional liability insurance in accordance with Section 2.2-1839 of the *Code of Virginia*. They also administer a commuter rail liability pool for both the Northern Virginia and the Potomac & Rappahannock Transportation Commissions. These pools were established to provide an economical low-cost, internally managed

alternative to the commercial insurance market for the Commonwealth's political subdivisions. These risk programs are accounted for in the Risk Management Enterprise Fund (nonmajor). The pool is established subject to the approval of the Governor. It may be insurance, self-insurance, or any combination thereof, and must provide protection and legal defense against liability. Local participation is voluntary and open to any political subdivision. As of June 30, 2004, there were 528 units of local government in the pool. This includes 5 cities, 45 towns, and 39 counties. The balance includes a large variety of boards, commissions, authorities, and special districts.

The pool has a minimum membership period of one year. However, a member group can cancel their membership and withdraw from the plan on their coverage anniversary date or at the end of the fiscal year with thirty days notice.

The pool is actuarially valued annually and is considered sound. Investment income is considered in the anticipation of premium deficiencies. No excess insurance or reinsurance is provided, but a "stability fund" is incorporated into the actuarially determined required reserves. If, however, the plan assets and reserves were to be exhausted, the members would be responsible for any deficits or liabilities.

For the liability insurance pool, local participation is voluntary and open to any political subdivision. The risk assumed by the local public entity pool for member liability is \$1,000,000 per occurrence. The commuter rail liability pool was established to fulfill the liabilities of the Commissions. As a result of the Commissions' agreement with several localities, participating localities contribute to the pool based on the number of residents riding the commuter rail and their total population. This pool assumes liability up to \$5,000,000 per occurrence, and commercial insurance has been purchased to pay larger claims subject to an annual aggregate limit of \$200,000,000.

At June 30, 2004, \$10.7 million is reported as estimated claims payable for these programs. This figure is actuarially determined for the fund in total and is reported at gross and does not reflect possible reimbursements for insurance recoveries.

The following schedule (dollars in thousands) shows the changes in claims liabilities for the past two fiscal years.

	Local Choice Health Care		Risk Management	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Unpaid Claims and Claim Adjustment Expenses at Beginning of Fiscal Year	\$ 12,993	\$ 14,886	\$ 9,895	\$ 10,878
Incurred Claims and Claim Adjustment Expenses:				
Provision for Insured Events of the Current Fiscal Year	124,887	104,453	4,603	5,174
Changes in Provision for Insured Events of Prior Fiscal Years	-	-	(1,786)	(3,209)
Total Incurred Claims and Adjustment Expenses	124,887	104,453	2,817	1,965
Payments:				
Claims and Claim Adjustment Expenses Attributable to Insured Events of the Current Fiscal Year	122,682	106,346	161	380
Claims and Claim Adjustment Expenses Attributable to Insured Events of the Prior Fiscal Year	-	-	2,144	3,036
Total Payments	122,682	106,346	2,305	3,416
Change in Provision for Discounts	-	-	322	468
Total Unpaid Claims and Claim Adjustment Expenses at End of the Fiscal Year (Discounted)	\$ 15,198	\$ 12,993	\$ 10,729	\$ 9,895
Total Unpaid Claims and Claim Adjustment Expenses at End of the Fiscal Year (Undiscounted)	\$ 15,198	\$ 12,993	\$ 10,914	\$ 10,246

## 17. ACCOUNTS PAYABLE

The following table (dollars in thousands) summarizes Accounts Payable as of June 30, 2004.

	<u>Vendor</u>	<u>Salary/ Wage</u>	<u>Retainage</u>	<u>Other</u>	<u>Foundations (1)</u>	<u>Total</u>
<b>Primary Government:</b>						
General	\$ 94,252	\$ 92,979	\$ 231	\$ -	\$ -	\$ 187,462
Major Special Revenue Funds:						
Commonwealth Transportation	134,405	33,121	10,909	-	-	178,435
Federal Trust	72,204	14,957	1,577	4	-	88,742
Literary	223	-	-	-	-	223
Major Enterprise Funds:						
State Lottery	1,319	2,525	-	7,376	-	11,220
Virginia College Savings Plan	45	138	-	718	-	901
Pocahontas Parkway	42	-	1,024	-	-	1,066
Nonmajor Governmental Funds	26,508	23,747	700	2	-	50,957
Nonmajor Enterprise Funds	20,831	3,764	-	-	-	24,595
Internal Service Funds	21,022	2,728	-	3,615	-	27,365
Private Purpose	230	96	-	127	-	453
Pension Trust	401	923	-	22,782	-	24,106
Agency Funds	-	-	-	4,992	-	4,992
<b>Total Primary Government (2)</b>	<u>\$ 371,482</u>	<u>\$ 174,978</u>	<u>\$ 14,441</u>	<u>\$ 39,616</u>	<u>\$ -</u>	<u>\$ 600,517</u>
<b>Discrete Component Units:</b>						
Virginia Housing Development Authority	\$ 27,465	\$ -	\$ -	\$ -	\$ -	\$ 27,465
Virginia Public School Authority	890	-	-	234	-	1,124
University of Virginia	50,537	53,956	5,269	42,668	36,251	188,681
Virginia Polytechnic Institute and State University	36,395	39,377	3,566	-	8,296	87,634
Virginia Commonwealth University	47,754	51,949	555	-	1,553	101,811
Nonmajor Component Units	109,119	101,240	15,095	3,810	20,024	249,288
<b>Total Component Units</b>	<u>\$ 272,160</u>	<u>\$ 246,522</u>	<u>\$ 24,485</u>	<u>\$ 46,712</u>	<u>\$ 66,124</u>	<u>\$ 656,003</u>

Note (1): Foundations represent FASB reporting entities defined in Note 1.B.

Note (2): Fiduciary liabilities of \$29,551 (dollars in thousands) are not included in the Government-wide Statement of Net Assets. In addition, Governmental Fund liabilities of \$72,968 (dollars in thousands) are included in the Government-wide Statement of Net Assets, but excluded from the above amounts.

## 18. OTHER LIABILITIES

The following table (dollars in thousands) summarizes Other Liabilities as of June 30, 2004.

	Primary Government				Virginia College Savings Plan
	General	Commonwealth Transportation	Federal Trust	State Lottery	
Lottery Prizes Payable	\$ -	\$ -	\$ -	\$ 58,774	\$ -
Due to Program Participants, Escrows, and Providers	-	-	-	-	133
Medicaid Payable	170,591	-	196,113	-	-
Family Access to Medical Insurance Security Payable	612	-	1,137	-	-
Accrued Interest Payable	-	-	-	-	-
Tax Refunds Payable	231,367	-	-	-	-
Premium on Bonds Sold	-	-	-	-	-
Other Liabilities	-	-	-	-	-
Deposits Pending Distribution	2,090	5,630	49	-	-
Short-term Debt	-	-	-	-	-
Car Tax Refund Payable	39,503	-	-	-	-
Matured Debt Payable	-	-	-	-	-
Grants Payable	-	-	-	-	-
Total Other Liabilities	<u>\$ 444,163</u>	<u>\$ 5,630</u>	<u>\$ 197,299</u>	<u>\$ 58,774</u>	<u>\$ 133</u>

	Primary Government				Internal Service Funds
	Pocahontas Parkway (1)	Unemployment Compensation	Nonmajor Governmental Funds	Nonmajor Enterprise Funds	
Lottery Prizes Payable	\$ -	\$ -	\$ -	\$ -	\$ -
Due to Program Participants, Escrows, and Providers	-	22,797	-	-	-
Medicaid Payable	-	-	-	-	-
Family Access to Medical Insurance Security Payable	-	-	-	-	-
Accrued Interest Payable	3,420	-	-	-	-
Tax Refunds Payable	-	-	-	-	-
Premium on Bonds Sold	-	-	-	-	-
Other Liabilities	19,651	-	2,736	1,138	6,162
Deposits Pending Distribution	-	-	5,553	175	1
Short-term Debt	-	-	-	-	-
Car Tax Refund Payable	-	-	-	-	-
Matured Debt Payable	-	-	15	-	-
Grants Payable	-	-	-	-	-
Total Other Liabilities	<u>\$ 23,071</u>	<u>\$ 22,797</u>	<u>\$ 8,304</u>	<u>\$ 1,313</u>	<u>\$ 6,163</u>

(Continued on next page)

Note (1): The \$19,651 (dollars in thousands) shown above represents an interfund liability to the Commonwealth Transportation Fund that will not be repaid within one year. This amount is reclassified to an internal balance on the Government-wide Statement of Net Assets.

**Primary Government (continued from previous page)**

	<b>Private Purpose Funds</b>	<b>Pension Trust Funds</b>	<b>Investment Trust Funds</b>	<b>Agency Funds</b>	<b>Total Primary Government (2)</b>
Lottery Prizes Payable	\$ -	\$ -	\$ -	\$ -	\$ 58,774
Due to Program Participants, Escrows, and Providers	8	-	-	427,665	450,603
Medicaid Payable	-	-	-	-	366,704
Family Access to Medical Insurance Security Payable	-	-	-	-	1,749
Accrued Interest Payable	-	-	-	-	3,420
Tax Refunds Payable	-	-	-	-	231,367
Premium on Bonds Sold	-	-	-	-	-
Other Liabilities	-	1,077	379	10,471	41,614
Deposits Pending Distribution	-	-	-	26,769	40,267
Short-term Debt	-	-	-	-	-
Car Tax Refund Payable	-	-	-	-	39,503
Matured Debt Payable	-	-	-	-	15
Grants Payable	-	-	-	-	-
<b>Total Other Liabilities</b>	<b>\$ 8</b>	<b>\$ 1,077</b>	<b>\$ 379</b>	<b>\$ 464,905</b>	<b>\$ 1,234,016</b>

Note (2): Fiduciary liabilities of \$466,369 (dollars in thousands) are not included in the Government-wide Statement of Net Assets. In addition, Governmental Fund liabilities of \$231,400 (dollars in thousands) are included in the Government-wide Statement of Net Assets, but excluded from the above amounts.

**Component Units**

	<b>Virginia Housing Development Authority</b>	<b>Virginia Public School Authority</b>	<b>University of Virginia</b>	<b>Virginia Polytechnic Institute &amp; State University</b>	<b>Virginia Commonwealth University</b>
Lottery Prizes Payable	\$ -	\$ -	\$ -	\$ -	\$ -
Due to Program Participants, Escrows, and Providers	-	-	-	-	-
Medicaid Payable	-	-	-	-	-
Family Access to Medical Insurance Security Payable	-	-	-	-	-
Accrued Interest Payable	63,256	50,577	41	1,186	3,384
Tax Refunds Payable	-	-	-	-	-
Premium on Bonds Sold	-	34,050	-	-	-
Other Liabilities	-	550	20,563	23,897	88,449
Deposits Pending Distribution	-	-	144,781	15,736	26,456
Short-term Debt	-	-	37,230	-	25,000
Car Tax Refund Payable	-	-	-	-	-
Matured Debt Payable	139,670	-	-	-	-
Grants Payable	-	-	-	-	-
<b>Total Other Liabilities</b>	<b>\$ 202,926</b>	<b>\$ 85,177</b>	<b>\$ 202,615</b>	<b>\$ 40,819</b>	<b>\$ 143,289</b>

	<b>Component Units</b>	
	<b>Nonmajor Component Units</b>	<b>Total Component Units</b>
Lottery Prizes Payable	\$ -	\$ -
Due to Program Participants, Escrows, and Providers	-	-
Medicaid Payable	-	-
Family Access to Medical Insurance Security Payable	-	-
Accrued Interest Payable	38,768	157,212
Tax Refunds Payable	-	-
Premium on Bonds Sold	-	34,050
Other Liabilities	49,122	182,581
Deposits Pending Distribution	11,167	198,140
Short-term Debt	38,597	100,827
Car Tax Refund Payable	-	-
Matured Debt Payable	-	139,670
Grants Payable	9,919	9,919
Total Other Liabilities	<u>\$ 147,573</u>	<u>\$ 822,399</u>

### Medicaid Payable

Medicaid Payable represents services rendered but not billed by providers and potential liability resulting from cost reports not settled as of year-end. Providers subject to cost settlement are paid in the interim based on established per diem or diagnosis related group rates for services.

The Department of Medical Assistance Services (DMAS) estimates, based on past experience, the total amount of Medicaid claims that will be paid from the Medicaid program in the future which relate to services provided before year-end. At June 30, 2004, the estimated liability related to Medicaid claims totaled \$366.7 million. Of this amount \$170.6 million is reflected in the General Fund (major) and \$196.1 million in the Federal Trust Special Revenue Fund (major).

### Family Access to Medical Insurance Security Payable

DMAS estimates the total amount of claims that will be paid from the Family Access to Medical Insurance Security program in the future which relate to services provided before year-end. At June 30, 2004, the estimated liability related to claims totaled \$1.7 million. Of this amount, \$0.6 million is reflected in the General Fund (major) and \$1.1 million in the Federal Trust Special Revenue Fund (major).

### Tax Refunds Payable

Tax refunds payable represent refunds due on individual tax returns filed for the calendar year ended December 31, 2003, and on business tax returns filed for corporate fiscal years ending on or before June 30,

2004. The individual tax return filing deadline is May 1 of each year for the preceding calendar year. The corporate tax return filing deadline is the 15th day of the fourth month following the close of the corporate fiscal year.

### Car Tax Refund Payable

During the year ended June 30, 1998, the General Assembly passed the Personal Property Tax Relief Act. Under the terms of this legislation, the Commonwealth will assume financial responsibility for the personal property taxes assessed by localities over a five-year period beginning in 1998. The amount reported on the balance sheet represents personal property taxes assessed by the localities before June 30, 2004, and paid by the Commonwealth after June 30, 2004. The majority of the amount pertains to the 2004 personal property taxes. However, some prior year reimbursements are also included due to delinquent taxpayer payments. The tax years and applicable rates are as follows:

2004	70.0%
2003	70.0%
2002	70.0%
2001	70.0%
2000	47.5%
1999	27.5%
1998	12.5%

## Short-term Debt

Various Higher Education Institutions' Foundations (Component Units) have lines of credit with banks. University of Virginia Foundations (Major Component Unit) report \$17.5 million and Nonmajor Component Unit Foundations report \$38.6 million. This short-term debt is for working capital, property acquisition, and construction costs. University of Virginia (Major Component Unit) reports \$19.7 million in commercial paper that will be refinanced with bonds. Virginia Commonwealth University (Major Component Unit) reports \$25 million in a line of credit for working capital that will be repaid with a new bond.

The balance of Other Liabilities is spread among various other funds.

## 19. LONG-TERM LIABILITIES

Commonwealth bonds are issued pursuant to Section 9 of Article X of the Constitution of Virginia. Section 9(a) bonds have been issued to redeem previous debt obligations. Section 9(b) bonds have been authorized by the citizens of Virginia through bond referenda to finance capital projects. These bonds are retired through the use of State appropriations. Section 9(c) bonds are issued to finance capital projects which, when completed, will generate revenue to repay the debt. Section 9(a), 9(b), and 9(c) bonds are tax-supported general obligation bonds and are backed by the full faith, credit, and taxing power of the Commonwealth. No other long-term debt or obligations are backed by the full faith, credit, and taxing power of the Commonwealth.

Section 9(d) bonds are revenue bonds and are not backed by the full faith, credit and taxing power of the Commonwealth. These bonds are not general obligation bonds and are not deemed to constitute a legal liability of the Commonwealth. This debt may be supported by State appropriations in whole or in part, as in the case of certain debt of the VPA (Nonmajor Component Unit), VPBA (Primary Government), ITA (Nonmajor Component Unit), and VCBA (Nonmajor Component

Unit). Other 9(d) revenue bonds are payable from general revenues of the component units, or from revenues of specific revenue-producing capital projects such as the teaching hospitals, dormitories, student centers, and dining halls at the various State colleges and universities (Component Units). Additionally, the 9(d) Transportation Bonds (Primary Government) are payable solely from revenues or earnings, and other available sources of funds appropriated by the General Assembly. The 9(d) Pocahontas Parkway Association Bonds (Primary Government) are special, limited obligations of the Association, secured by a gross revenue pledge and payable solely from revenues prior to payment of current expenses and from monies held in certain funds and accounts held in trust.

Certain 9(d) bonds are considered, with 9(a), 9(b), and 9(c) bonds, to be tax-supported debt of the Commonwealth. Tax-supported debt includes all bond issues and short-term debt supported by State tax revenues (net of sinking fund requirements), for which debt service payments are made or are ultimately pledged to be made from general governmental funds.

Other 9(d) revenue bonds are considered debt not supported by taxes. For this debt, the Commonwealth has no direct or indirect pledge of tax revenues. However, in some cases, the Commonwealth has made a moral obligation pledge. A government's moral obligation pledge provides a deficiency make-up for bondholders should underlying project revenues prove insufficient. The mechanics involve funding a debt service reserve fund when the bonds are issued. If a revenue deficiency exists, reserve fund monies are used to pay bondholders. The issuer then informs the legislative body requesting that it replenish the reserve fund before subsequent debt service is due. The legislative body may, but is not legally required to, replenish the reserve fund. These bonds are considered to be moral obligation debt.

The following schedule presents the total long-term liabilities of the Commonwealth, and the portion of these amounts which are due within one year, as reported on the Government-wide Statement of Net Assets.

**Total Long-Term Liabilities**

June 30, 2004

<i>(Dollars in Thousands)</i>	<b>Amount Due Within One Year (3)</b>	
<b>Primary Government:</b>		
Governmental Activities:(1)		
<b>General Obligation Bonds (2)</b>		
9(b) Transportation Facilities (3)	\$ 35,316	\$ 4,370
9(b) Public Facilities (3)	378,847	33,185
9(c) Parking Facilities (3)	5,717	806
9(c) Transportation Facilities (3) (4)	98,029	10,470
Total General Obligation Bonds	<u>517,909</u>	<u>48,831</u>
<b>Non-General Obligation Bonds - 9(d)</b>		
Transportation Debt (3) (5)	1,836,546	119,055
Virginia Public Building Authority (3) (4)	869,266	55,297
Total Non-General Obligation Bonds	<u>2,705,812</u>	<u>174,352</u>
<b>Other Long-Term Obligations:</b>		
Pension Liability (6)	542,471	-
Compensated Absences	304,839	150,812
Capital Lease Obligations	235,775	19,196
Regional Jail Financing Payable	16,654	1,624
Notes Payable	33,616	2,461
Installment Purchases Obligations	29,228	8,788
Industrial Development Authority Obligations	30,845	3,745
Other Liabilities	20,928	3,100
Total Other Long-Term Obligations	<u>1,214,356</u>	<u>189,726</u>
Total Governmental Activities (3) (4)	<u>4,438,077</u>	<u>412,909</u>
Business-Type Activities: (1) (7)		
<b>Non-General Obligation Bonds - 9(d)</b>		
Pocahontas Parkway Association Bonds (4)	447,372	-
<b>Other Long-Term Obligations:</b>		
Pension Liability (6)	11,601	-
Compensated Absences	7,852	3,542
Installment Purchases Obligations	12,475	4,745
Tuition Benefits Payable	1,157,712	44,900
Lottery Prizes Payable	398,195	57,646
Total Other Long-Term Obligations	<u>1,587,835</u>	<u>110,833</u>
Total Business-Type Activities (4)	<u>2,035,207</u>	<u>110,833</u>
<b>Total Primary Government</b>	<u>6,473,284</u>	<u>523,742</u>

*(Continued on next page)*

**Total Long-Term Liabilities**  
June 30, 2004  
(continued from previous page)

<i>(Dollars in Thousands)</i>	<b>Amount Due Within One Year (3)</b>	
<b>Component Units:</b>		
<b>General Obligation Bonds (2)</b>		
Higher Education Fund - 9(c) Bonds (3) (4)	316,923	28,418
<b>Non-General Obligation Bonds</b>		
Higher Education Institutions - 9(d) (3) (7)	563,986	18,739
Virginia College Building Authority	389,390	50,940
Innovative Technology Authority	9,345	710
Virginia Port Authority (8)	359,225	13,228
Virginia Housing Development Authority (4) (9)	4,211,798	266,763
Virginia Resources Authority (4) (9)	1,241,219	38,905
Virginia Public School Authority (3) (9)	2,308,256	140,643
Hampton Roads Sanitation District Commission (7)	133,567	10,323
Virginia Equine Center Foundation (7)	15,745	205
Virginia Biotechnology Research Park Authority (10)	94,820	3,975
Foundations (11)	195,632	4,551
Total Non-General Obligation Bonds	<u>9,522,983</u>	<u>548,982</u>
<b>Other Long-Term Obligations:</b>		
Pension Liability (6)	220,290	-
Compensated Absences	182,306	103,039
Capital Lease Obligations	44,123	3,287
Notes Payable (7)	718,361	80,085
Installment Purchase Obligations	25,227	6,675
Other Liabilities (7)	285,264	36,665
Total Other Long-Term Obligations (Excluding Foundations)	<u>1,475,571</u>	<u>229,751</u>
<b>Other Long-Term Obligations (Foundations): (11)</b>		
Compensated Absences	866	417
Capital Lease Obligations	358	133
Notes Payable (7)	156,472	9,331
Trust and Annuity Obligations (12)	78,617	1,528
Other Liabilities (7)	52,202	790
Total Other Long-Term Obligations - Foundations	<u>288,515</u>	<u>12,199</u>
Total Other Long-Term Obligations	<u>1,764,086</u>	<u>241,950</u>
<b>Total Component Units</b>	<u>11,603,992</u>	<u>819,350</u>
<b>Total Long-Term Liabilities</b>	<u>\$ 18,077,276</u>	<u>\$ 1,343,092</u>

1. Pursuant to GASB Statement No. 34, governmental activities include Internal Service Funds. Business-Type Activities are considered Enterprise Funds.
2. Total general obligation debt of the Commonwealth is \$834.8 million.
3. Amounts include any amortized discounts, premiums, and deferrals.
4. Net of unamortized discounts and/or premiums.
5. This debt includes \$786.6 million that is not supported by taxes.
6. This includes pension obligations that do not relate to the Virginia Retirement System from Virginia Commonwealth University of \$4.1 million and Virginia Port Authority of \$2.5 million. It does not include pension obligations from fiduciary funds of \$1.8 million.
7. This debt is not supported by taxes.
8. This debt includes \$146.4 million that is not supported by taxes.
9. This debt is not supported by taxes; however, \$735.6 million from VHDA, \$724.8 million from VRA, and \$248.8 million from VPSA is considered moral obligation debt.
10. This debt includes \$13.5 million that is not supported by taxes.
11. Foundations represent FASB reporting entities defined in Note 1.B.
12. These generally represent split-interest agreements that represent donor contributed assets with the requirement that an annual distribution be made to the donor or specified beneficiary. The annual distributions are usually for a fixed dollar amount or a fixed percentage of the trust's fair market value. The present value of these commitments is reported as Trust and Annuity Obligations.

**Primary Government**

**Transportation Facilities Debt**

Transportation Facilities Bonds include \$35,316,000 of 9(b) general obligation bonds, \$98,028,552 of 9(c) general obligation bonds, and \$1,836,546,346 of 9(d) revenue bonds. Principal and interest requirements for the current year totaled \$223,068,623. The Section 9(b) transportation facilities bonds represent Powhite Refunding Bonds. The Section 9(c) Transportation Facilities Bonds were issued to fund the construction and improvement of the Omer L. Hirst - Adelard L. Brault Expressway and the George P. Coleman Bridge. The Section 9(d) Transportation Facilities Bonds were issued to fund the construction of State Route 28, U.S. Route 58, the Northern Virginia Transportation District Program, and the Oak Grove Connector (Chesapeake). The interest rates for these bonds range from 2.00 percent to 7.25 percent and the issuance dates range from June 28, 1989, to November 1, 2000.

The following schedules detail the annual funding requirements necessary to amortize Transportation Facilities 9(b), 9(c) and 9(d) bonds:

**9(b) TRANSPORTATION FACILITIES BONDS  
Debt Service Requirements to Maturity**

<i>Maturity</i>	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2005	\$ 4,370,000	\$ 1,829,100	\$ 6,199,100
2006	4,620,000	1,588,750	6,208,750
2007	4,885,000	1,357,750	6,242,750
2008	5,130,000	1,113,500	6,243,500
2009	5,415,000	857,000	6,272,000
2010-2014	11,725,000	886,750	12,611,750
Less:			
Deferral on Debt Defeasance	(829,000)	-	(829,000)
<b>Total</b>	<b>\$ 35,316,000</b>	<b>\$ 7,632,850</b>	<b>\$ 42,948,850</b>

**9(c) TRANSPORTATION FACILITIES BONDS  
Debt Service Requirements to Maturity**

<i>Maturity</i>	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2005	\$ 10,469,540	\$ 4,337,441	\$ 14,806,981
2006	10,775,117	3,957,561	14,732,678
2007	10,798,630	3,581,732	14,380,362
2008	10,844,756	3,191,150	14,035,906
2009	7,539,000	2,808,613	10,347,613
2010-2014	25,395,000	10,665,531	36,060,531
2015-2019	20,565,000	4,257,638	24,822,638
2020-2024	6,430,000	498,406	6,928,406
Less:			
Unamortized Discount	(2,675,491)	-	(2,675,491)
Deferral on Debt Defeasance	(2,113,000)	-	(2,113,000)
<b>Total</b>	<b>\$ 98,028,552</b>	<b>\$ 33,298,072</b>	<b>\$ 131,326,624</b>

**9(d) TRANSPORTATION FACILITIES DEBT  
Debt Service Requirements to Maturity**

<i>Maturity</i>	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2005	\$ 119,055,000	\$ 88,353,546	\$ 207,408,546
2006	126,740,000	83,028,811	209,768,811
2007	132,415,000	76,982,474	209,397,474
2008	138,860,000	70,476,945	209,336,945
2009	145,665,000	63,521,051	209,186,051
2010-2014	610,705,000	211,940,976	822,645,976
2015-2019	341,610,483	104,587,588	446,198,071
2020-2024	181,865,473	31,755,713	213,621,186
2025-2029	41,775,534	2,505,000	44,280,534
2030-2034	5,457,178	-	5,457,178
Add:			
Accretion on Capital Appreciation Bonds	3,280,079	-	3,280,079
Less:			
Deferral on Debt Defeasance	(10,882,400)	-	(10,882,400)
<b>Total</b>	<b>\$ 1,836,546,347</b>	<b>\$ 733,152,104</b>	<b>\$ 2,569,698,451</b>

**Pocahontas Parkway Association Bonds**

The Pocahontas Parkway Association Route 895 Connector Toll Road Revenue Bonds, Senior Current Interest Bonds, Series 1998A were issued on July 9, 1998 in the amount of \$168,862,562. Bonds mature in annual installments on August 15 in the years 2005 through 2011, and 2026 through 2028. Interest is payable on each February 15 and August 15 beginning in 1999 at rates varying from 5.0 percent to 5.5 percent.

The Pocahontas Parkway Association Route 895 Connector Toll Road Revenue Bonds, Senior Capital Appreciation Bonds, Series 1998B were issued on July 9, 1998, in the principal amount of \$148,310,627 and the maturity value of \$690,200,000. Bonds mature in annual installments on August 15 in the years 2012 through 2025, and 2029 through 2035. The Senior Capital Appreciation Bonds were issued at a discount to yield, approximately, 5.50 percent to 5.95 percent. Principal accreted for the year ended June 30, 2004, was \$11,640,962.

The Pocahontas Parkway Association Route 895 Connector Toll Road Revenue Bonds, First Tier Subordinate Capital Appreciation Bonds, Series 1998C were issued on July 9, 1998, in the principal amount of \$35,867,236 and the maturity value of \$137,300,000. Bonds mature in annual installments on August 15 in the years 2005 through 2035. The First Tier Subordinate Capital Appreciation Bonds were issued at a discount to yield, approximately, 5.40 percent to 6.25 percent. Principal accreted for the year ended June 30, 2004, was \$2,891,002.

The Second Tier Subordinate Toll Road Revenue Bond, Series 1998D was issued on July 9, 1998, in the principal amount of \$18,000,000 to the Commonwealth Transportation Board (CTB). The Series 1998D Bond was issued in exchange for \$18,000,000 loaned to the Association for paying certain non-construction costs of the Project, and shall mature on August 15, 2028. The Series 1998D Bond shall bear interest at a floating rate equal to the Commonwealth's Transportation Trust

Fund Earnings Rate, compounded semiannually. The Series 1998D Bond shall bear interest from the date that amounts are advanced from the Series 1998D Bond Proceeds Account for application to non-construction costs of the Project on the amount of such advances until paid. Also earnings on the Series 1998D Bond Proceeds Account shall be transferred monthly to the Virginia Department of Transportation. The original proceeds disbursed for non-construction costs as of June 30, 2004, were \$17,989,424 and accrued interest was \$5,072,043. The monthly interest rate at June 30, 2004, was 2.25 percent.

During 2002, the Association issued a non-interest bearing Second Tier Subordinate Bond, Series 2001A to the Commonwealth for \$443,386. In 2004, the Association issued another non-interest bearing Second Tier Subordinate Bond, Series 2004A to the Commonwealth for \$2,362,136. These amounts represent previously incurred operating expenses for which the Association was to reimburse the Commonwealth. These bonds are issued on a parity in terms of payment with other Second Tier Subordinate Bonds. These bonds are subordinate to the Senior Bonds and First Tier Subordinate Bonds and will be payable only after all payments of principal, accreted value, premium, if any, and interest on the Senior Bonds and First Tier Subordinate Bonds then due have been paid.

The Route 895 Connector Toll Road Revenue Bonds are special limited obligations of the Association, secured by a gross revenue pledge and payable solely from revenues and other property included in the Trust Estate. The Association is a private, non-stock, nonprofit corporation and has no taxing powers. Neither the 1998, 2001, nor the 2004 Bonds are a debt of the Commonwealth, the Virginia Department of Transportation, the CTB, or any other agency, instrumentality or political subdivision of the Commonwealth, moral or otherwise. Neither the full faith and credit nor taxing power of the Commonwealth, is pledged to the payment of this debt.

The following schedule details the annual funding requirements necessary to repay the Series 1998A, 1998B, 1998C, 1998D, 2001A and 2004A bonds:

<b>POCAHONTAS PARKWAY ASSOCIATION</b>			
<b>Debt Service Requirements to Maturity</b>			
<i>Maturity</i>	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2005	\$ -	9,121,250	9,121,250
2006	5,300,000	9,046,250	14,346,250
2007	8,000,000	8,841,250	16,841,250
2008	9,000,000	8,548,500	17,548,500
2009	10,100,000	8,199,375	18,299,375
2010-2014	77,900,000	34,635,250	112,535,250
2015-2019	118,900,000	32,037,500	150,937,500
2020-2024	158,200,000	32,037,500	190,237,500
2025-2029	227,803,577	22,712,250	250,515,827
2030-2034	268,700,000	-	268,700,000
2035-2039	134,100,000	-	134,100,000
Less:			
Unamortized Discount	(844,832)	-	(844,832)
Imputed interest on 2001A, 2004A bonds	(2,081,626)	2,081,626	-
Unaccreted Capital Appreciation Bonds	(567,705,537)	-	(567,705,537)
Total	<u>\$ 447,371,582</u>	<u>\$ 167,260,751</u>	<u>\$ 614,632,333</u>

**Public Facilities Bonds**

Section 9(b) general obligation bonds consist of Public Facilities Bonds, Series 1993B, 1996, 1996 refunding, 1997, 1998 refunding, 1998 bonds, 1999A, 2002 Refunding, and 2003A Refunding. All bonds were issued to fund construction projects for higher educational institutions, mental health, and/or park facilities. The Series 2003A bonds were issued to advance refund outstanding Series 1993A and B, Series 1994, and Series 1996 bonds. Principal and interest requirements for the current year totaled \$52,447,657. The interest rates for all bonds range from 2.5 percent to 5.7 percent and the issuance dates range from June 15, 1993, to June 1, 2003. The following schedule details the annual funding requirements necessary to repay these bonds:

<b>9(b) PUBLIC FACILITIES BONDS</b>			
<b>Debt Service Requirements to Maturity</b>			
<i>Maturity</i>	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2005	\$ 33,185,000	\$ 18,156,584	\$ 51,341,584
2006	33,795,000	16,661,609	50,456,609
2007	33,605,000	15,139,319	48,744,319
2008	33,475,000	13,538,556	47,013,556
2009	33,370,000	11,944,144	45,314,144
2010-2014	158,820,000	36,033,945	194,853,945
2015-2019	49,605,000	6,311,213	55,916,213
2020-2024	10,100,000	1,010,000	11,110,000
Less:			
Deferral on Debt Defeasance	(7,108,183)	-	(7,108,183)
Total	<u>\$ 378,846,817</u>	<u>\$ 118,795,370</u>	<u>\$ 497,642,187</u>

## Parking Facilities Bonds

Section 9(c) general obligation bonds consist of Parking Facilities Bonds, Series 1996, 2002 Refunding, and 2003A Refunding bonds. The Series 1996 bond was issued to fund the renovation of the Seventh and Marshall Street parking deck. The Series 2002 and 2003A bonds were issued to advance refund outstanding Series 1996 and Series 1993 Refunding bonds. The interest rates for these bonds range from 2.5 percent to 5.7 percent and the issuance dates range from June 6, 1996, to June 1, 2003. Current year principal and interest requirements totaled \$1,120,561.

The following schedule details the annual funding requirements necessary to repay these bonds:

### 9(c) PARKING FACILITIES BONDS Debt Service Requirements to Maturity

Maturity	Principal	Interest	Total
2005	\$ 805,649	\$ 311,490	\$ 1,117,139
2006	854,572	267,373	1,121,945
2007	890,042	224,026	1,114,068
2008	958,715	178,886	1,137,601
2009	800,426	130,276	930,702
2010-2014	1,775,087	153,409	1,928,496
2015-2019	35,000	1,750	36,750
Less:			
Deferral on			
Debt Defeasance	(402,000)	-	(402,000)
Total	\$ 5,717,491	\$ 1,267,210	\$ 6,984,701

## Virginia Public Building Authority

The Virginia Public Building Authority (VPBA) has issued Section 9(d) revenue bonds for the purpose of constructing, improving, furnishing, maintaining, and acquiring public buildings for the use of the Commonwealth and also to reimburse localities, regional jail authorities or other combination of localities under the Regional Jail Financing Program. The VPBA bonds, Series 2004A were issued in March, 2004 in the amount of \$187,105,000. A portion of the proceeds was used to advance refund \$3,600,000 of Series 1994A bonds, \$118,245,000 of Series 1995 bonds, and \$72,740,000 of Series 1997A bonds. The interest rates for all bonds range from 2.5 percent to 6.6 percent and the issuance dates range from February 6, 1992, to March 10, 2004. Current year principal and interest requirements totaled \$115,690,027. The following schedule details the annual funding requirements necessary to repay these bonds:

### 9(d) VIRGINIA PUBLIC BUILDING AUTHORITY BONDS Debt Service Requirements to Maturity

Maturity	Principal	Interest	Total
2005	\$ 61,025,000	\$ 38,244,141	\$ 99,269,141
2006	64,210,000	35,926,226	100,136,226
2007	69,295,000	33,440,041	102,735,041
2008	71,800,000	30,851,402	102,651,402
2009	74,440,000	28,166,626	102,606,626
2010-2014	330,905,000	95,416,053	426,321,053
2015-2019	193,030,000	31,923,947	224,953,947
2020-2024	44,455,000	3,082,875	47,537,875
Less:			
Unamortized			
Discount	(15,918,701)	-	(15,918,701)
Deferral on			
Debt Defeasance	(23,975,605)	-	(23,975,605)
Total	\$ 869,265,694	\$ 297,051,311	\$ 1,166,317,005

## Regional Jail Financing Program

The Regional Jail Financing Program of the Commonwealth of Virginia Treasury Board was created during the 1993 Session of the General Assembly to establish a method of reimbursing localities, regional jail authorities or other combination of localities for a portion of the capital and financing costs of a jail project, made pursuant to Sections 53.1-80, 53.1-81, or 53.1-82 of the *Code of Virginia*. The General Assembly, upon recommendation from the Department of Planning and Budget, may determine to reimburse localities for approved capital costs over time through a contractual Reimbursement Agreement between the localities or authority and the Treasury Board. The Board of Corrections determines the amount of reimbursable capital costs. If approved for reimbursement over time, the Treasury Board determines the amount of reimbursable financing costs and calculates the periodic reimbursement payments.

In 1996, the General Assembly adopted legislation that authorized funding of jail project reimbursements through bonds issued by the Virginia Public Building Authority (VPBA). As of June 30, 1998, all future jail reimbursements were approved for funding through the VPBA as opposed to the Treasury Board. All reimbursements, whether up front or over time, are subject to appropriation by the General Assembly.

The following schedule details the annual funding requirements necessary to repay these obligations:

### REGIONAL JAILS FINANCING Financial Obligations to Maturity

Calendar Year Obligations	Capital Costs	Financing Costs	Total
2005	\$ 1,624,198	\$ 1,009,103	\$ 2,633,301
2006	1,655,357	981,369	2,636,726
2007	1,681,599	951,891	2,633,490
2008	1,712,928	919,166	2,632,094
2009	1,749,353	884,436	2,633,789
2010-2014	8,230,707	2,500,745	10,731,452
Total	\$ 16,654,142	\$ 7,246,710	\$ 23,900,852

## Industrial Development Authority Obligations

In fiscal year 2002, the Newport News Industrial Development Authority (IDA) issued Section 9(d) revenue bonds to pay a portion of the cost of construction and equipping of the Virginia Advanced Shipbuilding and Carrier Integration Center for use by the Newport News Shipbuilding and Dry Dock Company. The Commonwealth's obligation is set out in a payment agreement between Newport News IDA and the Treasury Board, in which the Treasury Board agrees to make payments equal to the debt service from amounts appropriated by the General Assembly. The interest rates for these bonds range from 2.75 percent to 5.03 percent and the issue date is July 27, 2000. Current year principal and interest requirements totaled \$5,324,341. The following schedule details the annual funding requirements necessary to repay these bonds:

### NEWPORT NEWS INDUSTRIAL DEVELOPMENT AUTHORITY Debt Service Requirements to Maturity

Maturity	Principal	Interest	Total
2005	\$ 3,745,000	\$ 1,545,296	\$ 5,290,296
2006	3,940,000	1,352,190	5,292,190
2007	4,150,000	1,144,390	5,294,390
2008	4,370,000	920,545	5,290,545
2009	4,615,000	678,288	5,293,288
2010-2014	10,025,000	558,937	10,583,937
Total	<u>\$ 30,845,000</u>	<u>\$ 6,199,646</u>	<u>\$ 37,044,646</u>

## Component Units

### Higher Education Institution Bonds

Higher Educational Institution Bonds are comprised of both 9(c) general obligation bonds and 9(d) revenue bonds. Section 9(d) bonds are from several sources as shown on the following schedule (dollars in thousands):

College and university bonds backed by pledge of general revenue or revenue from specific revenue-producing capital projects	\$ 456,816
College and university debt backed exclusively by pledged revenues of an institution	<u>107,170</u>
Total Higher Educational Institutional 9(d) debt	<u>\$ 563,986</u>

The interest rates for these bonds range from 1.5 percent to 9.25 percent and the issuance dates range from June 30, 1979 to May 25, 2004. The following schedules detail the annual funding requirements necessary to amortize Higher Educational Institution 9(c) and 9(d) bonds:

### 9(c) HIGHER EDUCATIONAL INSTITUTION BONDS Debt Service Requirements to Maturity

Maturity	Principal	Interest	Total
2005	\$ 30,034,811	\$ 15,060,302	\$ 45,095,113
2006	28,375,311	13,728,705	42,104,016
2007	27,966,328	12,500,780	40,467,108
2008	29,046,529	11,249,357	40,295,886
2009	28,449,574	9,952,793	38,402,367
2010-2014	106,271,913	32,137,048	138,408,961
2015-2019	56,665,000	11,474,519	68,139,519
2020-2024	17,825,000	1,914,606	19,739,606
Less:			
Unamortized Discount	(1,687,000)	-	(1,687,000)
Deferral on Debt Defeasance	(6,024,000)	-	(6,024,000)
Total	<u>\$ 316,923,466</u>	<u>\$ 108,018,110</u>	<u>\$ 424,941,576</u>

### 9(d) HIGHER EDUCATIONAL INSTITUTION BONDS Debt Service Requirements to Maturity

Maturity	Principal	Interest	Total
2005	\$ 18,739,319	\$ 25,910,276	\$ 44,649,595
2006	20,802,472	24,681,891	45,484,363
2007	25,375,721	23,717,372	49,093,093
2008	25,989,067	22,739,481	48,728,548
2009	22,107,515	21,674,115	43,781,630
2010-2014	121,728,049	93,585,491	215,313,540
2015-2019	95,171,285	66,133,981	161,305,266
2020-2024	85,266,936	43,990,367	129,257,303
2025-2029	45,560,000	27,286,763	72,846,763
2030-2034	114,325,000	13,951,225	128,276,225
Less:			
Deferral on Debt Defeasance	(11,079,300)	-	(11,079,300)
Total	<u>\$ 563,986,064</u>	<u>\$ 363,670,962</u>	<u>\$ 927,657,026</u>

### 9(d) VIRGINIA COLLEGE BUILDING AUTHORITY BONDS Debt Service Requirements to Maturity

Maturity	Principal	Interest	Total
2005	\$ 50,940,000	\$ 18,896,971	\$ 69,836,971
2006	29,620,000	16,222,559	45,842,559
2007	30,965,000	14,878,291	45,843,291
2008	21,620,000	13,471,110	35,091,110
2009	15,395,000	12,427,685	27,822,685
2010-2014	88,870,000	50,241,497	139,111,497
2015-2019	99,930,000	26,068,316	125,998,316
2020-2024	52,050,000	5,352,800	57,402,800
Total	<u>\$ 389,390,000</u>	<u>\$ 157,559,229</u>	<u>\$ 546,949,229</u>

Various Higher Education Institutions' Foundations (Component Units) have bonds outstanding as of year-end. The purpose of a majority of these bonds are for construction, property acquisition, and defeasance of prior debt. Many principal and interest payments are to banks or industrial development authorities located throughout the Commonwealth. The following schedule details the future principal payments:

**HIGHER EDUCATION INSTITUTIONS' FOUNDATIONS' BONDS (1)**  
**Debt Service Requirements to Maturity**

<i>Maturity</i>	<i>Principal</i>
2005	\$ 4,550,770
2006	9,888,676
2007	5,571,685
2008	5,696,593
2009	5,612,522
Thereafter	<u>164,311,399</u>
<b>Total</b>	<b>\$ <u>195,631,645</u></b>

Note (1): Foundations represent FASB reporting entities defined in Note 1.B.

**Innovative Technology Authority**

The Innovative Technology Authority (ITA) has issued Taxable Lease Revenue Bonds, Series 1989, and Series 1997 refunding. The Series 1989 bonds were issued to cover a portion of the costs related to the construction of a software development center and office building. Series 1997 bonds were issued to advance refund \$11.2 million of the outstanding 1989 bonds.

The 1989 bonds had an average interest rate of 10.3 percent and the 1997 bonds have an average interest rate of 7.4 percent. The bonds were issued on March 1, 1989, and May 1, 1997, respectively. The following schedule details the annual funding requirements necessary to amortize ITA bonds:

**9(d) INNOVATIVE TECHNOLOGY AUTHORITY BONDS**  
**Debt Service Requirements to Maturity**

<i>Maturity</i>	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2005	\$ 710,000	\$ 692,691	\$ 1,402,691
2006	700,000	641,855	1,341,855
2007	790,000	591,525	1,381,525
2008	875,000	534,013	1,409,013
2009	855,000	470,050	1,325,050
2010-2014	<u>5,415,000</u>	<u>1,275,017</u>	<u>6,690,017</u>
<b>Total</b>	<b>\$ <u>9,345,000</u></b>	<b>\$ <u>4,205,151</u></b>	<b>\$ <u>13,550,151</u></b>

**Virginia Port Authority**

The Virginia Port Authority (VPA) has issued Section 9(d) revenue bonds and notes pursuant to powers provided to its Board of Commissioners by the *Code of Virginia*. The interest rates for these bonds range from 2.0 percent to 6.0 percent and the issuance dates range from October 23, 1996, to June 26, 2003. Series 1998 bonds were issued to advance refund \$71.0 million of the outstanding 1988 bonds. The following schedule details the annual funding requirements necessary to amortize VPA bonds:

**9(d) VIRGINIA PORT AUTHORITY DEBT**  
**Debt Service Requirements to Maturity**

<i>Maturity</i>	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2005	\$ 13,228,127	\$ 18,092,150	\$ 31,320,277
2006	15,338,326	17,408,225	32,746,551
2007	16,610,244	16,602,999	33,213,243
2008	18,524,872	15,700,556	34,225,428
2009	19,487,279	14,713,901	34,201,180
2010-2014	<u>54,714,936</u>	<u>64,532,543</u>	<u>119,247,479</u>
2015-2019	63,519,684	48,548,478	112,068,162
2020-2024	69,971,426	31,453,606	101,425,032
2025-2029	72,515,074	11,483,143	83,998,217
2030-2034	<u>15,315,348</u>	<u>1,781,438</u>	<u>17,096,786</u>
<b>Total</b>	<b>\$ <u>359,225,316</u></b>	<b>\$ <u>240,317,039</u></b>	<b>\$ <u>599,542,355</u></b>

**Virginia Housing Development Authority**

The Virginia Housing Development Authority (VHDA) issued Section 9(d) revenue bonds. The interest rates for these bonds range from 2.36 percent to 10.88 percent and the origination dates range from June 30, 1982, to June 10, 2004. The following schedule details the annual funding requirements necessary to amortize these bonds:

**9(d) VIRGINIA HOUSING DEVELOPMENT AUTHORITY BONDS**  
**Debt Service Requirements to Maturity**

<i>Maturity</i>	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2005	\$ 266,763,453	\$ 213,109,620	\$ 479,873,073
2006	206,595,334	204,154,321	410,749,655
2007	199,963,940	194,462,203	394,426,143
2008	194,880,301	185,001,820	379,882,121
2009	187,365,923	175,538,050	362,903,973
2010-2014	<u>891,119,159</u>	<u>736,917,870</u>	<u>1,628,037,029</u>
2015-2019	816,583,747	501,673,530	1,318,257,277
2020-2024	561,459,477	299,333,427	860,792,904
2025-2029	439,939,286	147,673,772	587,613,058
2030-2034	<u>148,533,486</u>	<u>72,036,836</u>	<u>220,570,322</u>
2035-2039	162,305,000	32,374,315	194,679,315
2040-2044	108,850,000	9,589,649	118,439,649
2045-2049	<u>30,700,000</u>	<u>366,025</u>	<u>31,066,025</u>
Add:			
Unamortized Premium	3,376,506	-	3,376,506
Less:			
Unamortized Discount	<u>(6,638,000)</u>	<u>-</u>	<u>(6,638,000)</u>
<b>Total</b>	<b>\$ <u>4,211,797,612</u></b>	<b>\$ <u>2,772,231,438</u></b>	<b>\$ <u>6,984,029,050</u></b>

## Virginia Resources Authority

The Virginia Resources Authority (VRA) issued Section 9(d) revenue bonds. The interest rates for these bonds range from 1.36 percent to 8.70 percent and the origination dates range from December 1, 1985, to June 30, 2004. The following schedule details the annual funding requirements necessary to amortize these bonds:

### 9(d) VIRGINIA RESOURCES AUTHORITY BONDS Debt Service Requirements to Maturity

Maturity	Principal	Interest	Total
2005	\$ 38,905,000	\$ 53,661,178	\$ 92,566,178
2006	41,715,000	54,385,534	96,100,534
2007	45,480,000	52,779,392	98,259,392
2008	49,305,000	50,977,546	100,282,546
2009	52,345,000	48,977,131	101,322,131
2010-2014	311,455,000	205,342,743	516,797,743
2015-2019	282,760,000	133,678,891	416,438,891
2020-2024	240,115,000	69,489,095	309,604,095
2025-2029	138,575,000	28,315,401	166,890,401
2030-2034	61,085,000	13,432,509	74,517,509
2035-2039	31,825,000	1,219,141	33,044,141
Add:			
Unamortized Premium	16,946,308	-	16,946,308
Less:			
Unamortized Discounts and Issuance Expenses	(14,647,980)	-	(14,647,980)
Unaccreted Capital Appreciation Bonds	(54,644,329)	-	(54,644,329)
Total	<u>\$ 1,241,218,999</u>	<u>\$ 712,258,561</u>	<u>\$ 1,953,477,560</u>

## Virginia Public School Authority

The Virginia Public School Authority (VPSA) issued Section 9(d) revenue bonds. The interest rates for these bonds range from 2.00 percent to 6.00 percent and the origination dates range from July 1, 1994, to June 1, 2004. The following schedule details the annual funding requirements necessary to amortize these bonds:

### 9(d) VIRGINIA PUBLIC SCHOOL AUTHORITY BONDS Debt Service Requirements to Maturity

Maturity	Principal	Interest	Total
2005	\$ 145,695,000	\$ 114,272,100	\$ 259,967,100
2006	167,515,000	105,358,096	272,873,096
2007	164,790,000	97,655,886	262,445,886
2008	154,185,000	89,691,071	243,876,071
2009	153,605,000	82,113,596	235,718,596
2010-2014	678,950,000	301,556,332	980,506,332
2015-2019	546,012,063	147,951,603	693,963,666
2020-2024	275,740,000	42,098,209	317,838,209
2025-2029	57,325,000	7,141,375	64,466,375
2030-2034	3,870,000	91,913	3,961,913
Less:			
Deferral on Debt Defeasance	(39,430,900)	-	(39,430,900)
Total	<u>\$ 2,308,256,163</u>	<u>\$ 987,930,181</u>	<u>\$ 3,296,186,344</u>

## Hampton Roads Sanitation District Commission

The Hampton Roads Sanitation District Commission issued bonds under a Master Trust Indenture and a Trust Agreement dated December 1, 1993, and March 1, 2003. The interest cost for these bonds ranges from 2.5 percent to 4.75 percent. The following schedule details the annual funding requirements necessary to amortize these bonds:

### HAMPTON ROADS SANITATION DISTRICT COMMISSION Debt Service Requirements to Maturity

Maturity	Principal	Interest	Total
2005	\$ 10,323,000	\$ 4,731,000	\$ 15,054,000
2006	11,524,000	4,358,000	15,882,000
2007	11,919,000	3,941,000	15,860,000
2008	8,339,000	4,678,000	13,017,000
2009	8,617,000	4,492,000	13,109,000
2010-2014	48,889,000	16,098,000	64,987,000
2015-2019	27,063,000	5,893,000	32,956,000
2020-2024	2,665,000	2,297,000	4,962,000
2025-2029	4,228,000	417,000	4,645,000
Total	<u>\$ 133,567,000</u>	<u>\$ 46,905,000</u>	<u>\$ 180,472,000</u>

## Virginia Equine Center Foundation

The Virginia Equine Center Foundation issued Series 2001 IDA of Rockbridge County Virginia Horse Center Revenue Bonds. Coupon interest rates range from 6.125 percent to 8.0 percent.

### VIRGINIA EQUINE CENTER FOUNDATION Debt Service Requirements to Maturity

Maturity	Principal	Interest	Total
2005	\$ 205,000	1,055,353	\$ 1,260,353
2006	1,535,000	1,000,612	2,535,612
2007	515,000	935,269	1,450,269
2008	3,135,000	4,094,109	7,229,109
2009	4,330,000	2,844,463	7,174,463
2010-2014	6,025,000	1,085,896	7,110,896
Total	<u>\$ 15,745,000</u>	<u>\$ 11,015,702</u>	<u>\$ 26,760,702</u>

The above listed debt of the Virginia Equine Center Foundation is not an obligation of the Commonwealth, and neither the full faith and credit nor taxing power of the Commonwealth is pledged to the payment of this debt.

## Virginia Biotechnology Research Park Authority

The Virginia Biotechnology Research Park Authority issued Series 1996, 1998, 1999A, 1999B, and 2001 Commonwealth of Virginia Lease Revenue bonds. Coupon interest rates range from 4.0 percent to 6.4 percent.

### VIRGINIA BIOTECHNOLOGY RESEARCH PARK AUTHORITY Debt Service Requirements to Maturity

<i>Maturity</i>	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2005	\$ 3,975,000	4,717,394	8,692,394
2006	4,185,000	4,516,773	8,701,773
2007	4,405,000	4,303,530	8,708,530
2008	4,620,000	4,092,598	8,712,598
2009	4,845,000	3,870,820	8,715,820
2010-2014	29,075,000	15,300,783	44,375,783
2015-2019	30,490,000	7,144,997	37,634,997
2020-2024	13,225,000	1,014,375	14,239,375
Total	<u>\$ 94,820,000</u>	<u>\$ 44,961,270</u>	<u>\$ 139,781,270</u>

Total principal outstanding at June 30, 2004, on all Component Unit bonds amounted to \$9.8 billion.

The following schedule summarizes the changes in long-term liabilities:

Schedule of Changes in Long-term Debt and Obligations (1) (2)

(Dollars in Thousands)

	Balance July 1, 2003 as restated	Issuances and Other Increases	Retirements and Other Decreases	Subtotal June 30, 2004
<b>Primary Government</b>				
<b>Governmental Activities:</b>				
<b>Long-term Debt Bearing the Pledge of the Full Faith and Credit of the Commonwealth:</b>				
General Obligation Bonds - 9(b) and 9(c):				
Public Facilities Bonds	\$ 410,669	\$ 1,238	\$ (33,060)	\$ 378,847
Parking Facilities Bonds	6,457	46	(786)	5,717
Transportation Facilities Bonds	150,767	1,240	(18,662)	133,345
Total General Obligation Bonds	<u>567,893</u>	<u>2,524</u>	<u>(52,508)</u>	<u>517,909</u>
<b>Long-term Debt / Obligations Not Bearing the Pledge of the Full Faith and Credit of the Commonwealth:</b>				
<b>Debt:</b>				
Non-General Obligation Bonds - 9(d)				
Transportation Facilities Bonds	1,936,944	2,866	(103,264)	1,836,546
Virginia Public Building Authority Bonds	956,495	192,200	(279,429)	869,266
Regional Jails Financing Payable	18,252	-	(1,598)	16,654
Industrial Development Authority Obligations	34,410	-	(3,565)	30,845
Installment Purchase Obligations	34,780	6,811	(12,363)	29,228
Notes Payable - Virginia Public Broadcasting Board	20,005	-	(2,055)	17,950
Notes Payable - Transportation	12,325	-	-	12,325
Notes Payable - Aviation	3,627	-	(286)	3,341
<b>Obligations:</b>				
Compensated Absences	303,479	4,440	(3,080)	304,839
Capital Lease Obligations (3)	251,475	117	(15,817)	235,775
Pension Liability	452,550	89,921	-	542,471
Other	20,082	3,446	(2,600)	20,928
Total Long-Term Debt / Obligations Not Bearing the Pledge of the Full Faith and Credit of the Commonwealth	<u>4,044,424</u>	<u>299,801</u>	<u>(424,057)</u>	<u>3,920,168</u>
<b>Total Governmental Activities</b>	<u>4,612,317</u>	<u>302,325</u>	<u>(476,565)</u>	<u>4,438,077</u>
<b>Business-type Activities:</b>				
<b>Long-term Debt / Obligations Not Bearing the Pledge of the Full Faith and Credit of the Commonwealth:</b>				
<b>Debt:</b>				
Non-General Obligation Bonds - 9(d)				
Pocahontas Parkway Association Bonds	432,563	14,809	-	447,372
Installment Purchase Obligations	15,917	910	(4,352)	12,475
<b>Obligations:</b>				
Compensated Absences	8,202	3,971	(4,321)	7,852
Pension Liability (4)	9,917	1,684	-	11,601
Lottery Prizes Payable	421,721	6,862	(30,388)	398,195
Tuition Benefits Payable	1,177,780	-	(20,068)	1,157,712
Total Business-Type Activities	<u>2,066,100</u>	<u>28,236</u>	<u>(59,129)</u>	<u>2,035,207</u>
<b>Total Primary Government</b>	<u>\$ 6,678,417</u>	<u>\$ 330,561</u>	<u>\$ (535,694)</u>	<u>\$ 6,473,284</u>
<b>Component Units</b>				
<b>Long-term Debt Bearing the Pledge of the Full Faith and Credit of the Commonwealth:</b>				
General Obligation Bonds - Higher Education 9(c):	\$ 349,185	\$ 1,438	\$ (33,700)	\$ 316,923
<b>Long-Term Debt / Obligations Not Bearing the Pledge of the Full Faith and Credit of the Commonwealth:</b>				
<b>Debt:</b>				
Bonds	9,407,625	1,948,184	(2,028,458)	9,327,351
Installment Purchase Obligations	17,844	17,210	(9,827)	25,227
Capital Lease Obligations (5)	42,834	4,570	(3,281)	44,123
Notes Payable	606,984	175,998	(64,621)	718,361
<b>Obligations:</b>				
Compensated Absences	174,296	122,551	(114,541)	182,306
Pension Liability	202,913	24,599	(7,222)	220,290
Bond Anticipation Notes	1,303	-	(1,303)	-
Trust and Annuity Obligations	-	-	-	-
Other (6)	285,465	166,980	(167,181)	285,264
Total Component Units	<u>\$ 11,088,449</u>	<u>\$ 2,461,530</u>	<u>\$ (2,430,134)</u>	<u>\$ 11,119,845</u>

Foundations (7)	Balance June 30, 2004	Due Within One Year
\$ -	\$ 378,847	\$ 33,185
-	5,717	806
-	133,345	14,840
-	<u>517,909</u>	<u>48,831</u>
-	1,836,546	119,055
-	869,266	55,297
-	16,654	1,624
-	30,845	3,745
-	29,228	8,788
-	17,950	2,175
-	12,325	-
-	3,341	286
-	304,839	150,812
-	235,775	19,196
-	542,471	-
-	20,928	3,100
-	<u>3,920,168</u>	<u>364,078</u>
-	<u>4,438,077</u>	<u>412,909</u>
-	447,372	-
-	12,475	4,745
-	7,852	3,542
-	11,601	-
-	398,195	57,646
-	1,157,712	44,900
-	<u>2,035,207</u>	<u>110,833</u>
\$ -	<u>\$ 6,473,284</u>	<u>\$ 523,742</u>
\$ -	\$ 316,923	\$ 28,418
195,632	9,522,983	548,982
-	25,227	6,675
358	44,481	3,420
156,472	874,833	89,416
866	183,172	103,456
-	220,290	-
-	-	-
78,617	78,617	1,528
52,202	337,466	37,455
\$ 484,147	<u>\$ 11,603,992</u>	<u>\$ 819,350</u>

- (1) Pursuant to GASB Statement No. 34, governmental activities include Internal Service Funds. Business-Type Activities are considered Enterprise Funds.
- (2) Payments on bonded debt that pertain to the Commonwealth's governmental activities are made through the debt service funds. Payments for installment purchases, compensated absences, capital leases, pension, and other obligations that pertain to the Commonwealth's governmental activities are made through the general and special revenue funds. Internal service funds predominantly serve the governmental funds. Accordingly, long-term liabilities for these funds are included as part of the totals for governmental activities. Enterprise funds, or business-type activities, are self-supporting funds. Accordingly, long-term liabilities are paid from each respective fund.
- (3) The beginning balance has been increased from the prior year to reflect the restatement of capital lease obligations.
- (4) Beginning balances have been restated to reflect the Virginia Information Providers Network.
- (5) The beginning balance has been decreased from the prior year due to a reclassification of fund balances.
- (6) The beginning balance has been decreased from the prior year by a higher education component unit to reflect a restatement.
- (7) Foundations represent FASB reporting entities defined in Note 1.B.

## Bond Defeasance

### Primary Government

In March 2004, the Virginia Public Building Authority (VPBA) issued \$187,105,000 State Building Revenue Bonds Series 2004A. A portion of the proceeds refunded \$3,600,000 of Series 1994A bonds, \$118,245,000 of series 1995 bonds, and \$72,740,000 of series 1997A bonds. Bond proceeds of \$211,690,466 were placed with an escrow agent to provide for the redemption of the bonds. An additional amount of \$6,473,595 in excess interest earnings held by the Authority was placed in escrow to complete the redemption. The redemption dates of the Series 1994A, Series 1995 and Series 1997A bonds are August 1, 2004, 2005, and 2007 respectively. The total debt service payments over the life of the bonds have been reduced by \$17,158,178 resulting in an economic gain (savings) of \$13,639,359 discounted at 2.99 percent. In accordance with GASB Statement No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*, the difference between the reacquisition price and the net carrying amount of the bonds defeased with refunding debt is amortized as a component of interest on bonds over the remaining life of the refunded debt. Therefore, bonds payable, as reflected on the government-wide statements, has been reduced by \$23,975,605 to reflect the remaining deferral on debt defeasance at June 30, 2004.

### Component Units

In March 2004, Virginia Commonwealth University (Major) issued \$43,460,000 in General Revenue Pledge Refunding Bonds, Series 2004A and 2004B for a current refunding of \$41,030,000 in General Revenue Pledge Bonds, Series 1995, 1996A, and 1996B. The reacquisition price exceeded the net carrying amount of the old debt by \$4,751,137. This amount is being netted against the new debt and amortized over the remaining life of the refunded debt or the new debt, whichever is shorter. The refunding resulted in an economic gain of \$3,813,168 discounted at the rate of 3.83 percent and a reduction of \$4,300,000 in future debt service payments.

In April 2004, Virginia Polytechnic Institute and State University (Major) issued \$45,035,000 in General Revenue Bonds, Series 2004 A, B, C, and D to advance refund \$42,950,000 in General Revenue Pledge Bonds, Series 1996A, 1996B, and 1996C. The reacquisition price exceeded the net carrying amount of the old debt by \$4,540,000. This amount is being netted against the new debt and amortized over the remaining life of the refunded debt or the new debt, whichever is shorter. The refunding resulted in an economic gain of \$742,000 discounted at the rate of 3.80 percent and a reduction of \$772,000 in future debt service payments.

In November 2003, the Hampton Roads Sanitation District (District) (Nonmajor) issued \$55,890,000 of Series 2003 primary pledge revenue bonds with a true interest cost of 3.11 percent to currently refund the Series 1993 outstanding. The net proceeds of \$57,796,000, including a premium of \$1,907,000 along with \$1,510,000 of District funds, were utilized to retire

\$57,205,000 (after a payment of \$342,000 for underwriter fees and other issuance costs and a call premium of \$1,759,000) of existing primary debt. The refinancing resulted in \$14.2 million savings over the life of the issue with present value savings of \$6.2 million.

GASB Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt*, provides that refunded debt and assets placed in escrow for the payment of related debt service be excluded from the financial statements. As of June 30, 2004, there were \$291.9 million in bonds from the Primary Government that have been refunded and defeased in-substance from the governmental activities column by placing existing assets and the proceeds of new bonds in irrevocable trusts to provide for all future debt service payments. In addition, there were \$496.1 million in bonds outstanding considered defeased from the Component Units.

### Arbitrage Rebate

The Tax Reform Act of 1986 requires that governmental entities issuing tax-exempt debt subsequent to August 1986, calculate and rebate arbitrage earnings to the Federal government. The U.S. Treasury has issued regulations on calculating the rebate amount and complying with the provisions of the Tax Reform Act of 1986. Governmental issuers must comply with the rebate regulations in order for their bonds to maintain tax-exempt status. The regulations require the excess of the aggregate amount earned on investments purchased with bond proceeds over the amount that would have been earned if the proceeds were invested at a rate equal to the bond yield, to be rebated to the Federal government. Income earned on excess earnings is also subject to rebate. Rebate liability, if any, must be paid every five years over the life of the bonds. Some bonds may be exempt from the rebate requirements if they qualify for certain regulatory exceptions. Governmental issuers may elect to pay a penalty in lieu of rebate. If the issuer meets one of the exceptions, the issuer retains any arbitrage earnings. Rebate and penalty payments are calculated and paid as required by law on bond issues that do not qualify for an exception.

Amounts remitted to the Federal government for rebate liability are generally paid from earnings derived from the issue. However, if all proceeds (including earnings) have been expended and depending on the type of issue, it may be necessary to use project revenues or general or non-general fund appropriations to satisfy any rebate liability. During the year, the Commonwealth paid \$77,025 to the Federal government for rebate liability on Commonwealth general obligation bonds, Series 1998. The Virginia Public Building Authority paid a total of \$1,094,829 on its Series 1996A and 1998B Bonds. The Virginia College Building Authority remitted \$324,670 in rebate liability on its Series 1998 Pooled Bond Program.

Rebate liability on bonds of the Virginia Public School Authority (Major Component Unit) is payable from earnings on related bond funds and from local issuers whose local school bonds were purchased by the VPSA. During the year, \$532,242 was paid to the

Federal government for rebate on various VPSA School Financing Bonds.

### Capital Leases

The Commonwealth leases buildings and equipment under various agreements that are accounted for as capital leases. The lease agreements are for various terms and all leases contain nonappropriation clauses indicating that continuation of the lease is subject to funding by the General Assembly.

Gross minimum lease payments, together with the present value of the net minimum lease payments as of June 30, 2004, are shown in the following table (dollars in thousands). There were no capital lease amounts associated with business-type activities.

	<u>Governmental Activities</u>	<u>Component Units (1)</u>
2005	\$ 30,060	\$ 5,620
2006	28,257	5,510
2007	27,523	5,223
2008	26,688	5,107
2009	25,892	5,132
2010-2014	124,053	22,524
2015-2019	81,640	10,379
2020-2024	<u>14,273</u>	<u>1,478</u>
Total Gross Minimum Lease Payments	358,386	60,973
Less: Amount Representing Executory Costs	<u>10,256</u>	<u>3</u>
Net Minimum Lease Payments	348,130	60,970
Less: Amount Representing Interest	<u>112,355</u>	<u>16,847</u>
Present Value of Net Minimum Lease Payments	<u>\$ 235,775</u>	<u>\$ 44,123</u>

Note (1): The above amounts exclude capital lease obligations of Foundations.

	<u>Foundations (2)</u>
2005	\$ 136
2006	110
2007	81
2008	21
2009	<u>14</u>
Net Minimum Lease Payments	362
Less: Amount Representing Interest	<u>4</u>
Present Value of Net Minimum Lease Payments	<u>\$ 358</u>

Note (2): Foundations represent FASB reporting entities defined in Note 1.B.

At June 30, 2004, assets purchased under capital leases were included in depreciable capital assets as follows (dollars in thousands). The amounts are net of accumulated depreciation where applicable. For a portion of these assets, ownership will pass to the Commonwealth at the end of the lease term.

	<u>Buildings</u>	<u>Equipment</u>	<u>Total</u>
<b>Governmental Activities:</b>			
Gross Capital Assets	\$ 297,655	\$ 3,728	\$ 301,383
Less: Accumulated Depreciation	<u>58,171</u>	<u>2,779</u>	<u>60,950</u>
<b>Total Governmental Activities</b>	<u>\$ 239,484</u>	<u>\$ 949</u>	<u>\$ 240,433</u>
<b>Component Units:</b>			
Gross Capital Assets	\$ 38,201	\$ 23,909	\$ 62,110
Less: Accumulated Depreciation	<u>5,923</u>	<u>10,745</u>	<u>16,668</u>
Subtotal (excluding Foundations)	<u>32,278</u>	<u>13,164</u>	<u>45,442</u>
Foundations:			
Gross Capital Assets	-	550	550
Less: Accumulated Depreciation	<u>-</u>	<u>173</u>	<u>173</u>
Subtotal Foundations	<u>-</u>	<u>377</u>	<u>377</u>
<b>Total Component Units</b>	<u>\$ 32,278</u>	<u>\$ 13,541</u>	<u>\$ 45,819</u>
Total Capital Lease Assets	<u>\$ 271,762</u>	<u>\$ 14,490</u>	<u>\$ 286,252</u>

## Notes Payable

Notes Payable consist of several items as shown in the following schedule (dollars shown in thousands):

<b>Primary Government</b>	
Transportation Note	\$ 12,325
Virginia Public Broadcasting Board Note	17,950
Aviation Note	3,341
Installment Notes	<u>41,703</u>
<b>Total Primary Government</b>	<u>75,319</u>
<b>Component Units</b>	
Virginia Public School Authority	170,520
University of Virginia	77,052
Virginia Polytechnic Institute and State University	97,185
Virginia Commonwealth University	106,855
Nonmajor Component Units	266,749
Installment Notes	<u>25,227</u>
Subtotal (excluding Foundations)	<u>743,588</u>
Foundations:	
Notes Payable	<u>156,472</u>
Subtotal - Foundations	<u>156,472</u>
<b>Total Component Units</b>	<u>900,060</u>
<b>Total Notes Payable</b>	<u>\$ 975,379</u>

The Transportation (Primary Government) Note listed above represents an interest free note payable to Fairfax County, Virginia, of \$4,325,000 which was issued pursuant to the State Revenue Bond Act, Article 5, Title 33.1, *Code of Virginia* to pay for the acquisition and construction of the Omer L. Hirst - Adelard L. Brault Expressway. This note is to be repaid on December 1, 2008. Additionally, the Virginia Department of Transportation (Primary Government) entered into an interest free note payable to Chesterfield County, Virginia, of \$8,000,000 for the repayment of the Powhite Parkway Extension Toll Road from surplus net revenues of the project prior to the retirement of all the bonds issued.

The Virginia Public Broadcasting Board (Primary Government) Note listed above represents a loan agreement entered into with the Harrisonburg Industrial Development Authority for \$23,840,000. The purpose of the loan was to grant funds to Virginia's public television stations to assist with the cost of conversion to the Federal Communication Commission's new digital standard. The agreement was entered into February 27, 2001, and has a variable rate of interest. The General Assembly authorized these grants in Chapter 1073 of the 2000 Appropriation Act.

The Aviation Note listed above represents a loan agreement with the Virginia Resources Authority in the amount of \$6,600,000. The purpose of the loan was to finance and refinance grants-in-aid made to The Peninsula Airport Commission to provide funding for capital improvements at the Newport News/Williamsburg International Airport. The principal

amount shall be paid semi-annually with the final payment due in 2017.

The Virginia Public School Authority (Major Component Unit) notes of \$170,520,000 are for the School Equipment Financing Notes Educational Technology program. The note proceeds were used to make grants to school divisions for the purchase of educational technology equipment. The notes will be repaid from appropriations to be made by the Virginia General Assembly from the Literary Fund (Major Special Revenue Fund).

An additional amount of \$547,841,000 is comprised primarily of Higher Education (Component Unit) promissory notes with the Virginia College Building Authority (Nonmajor Component Unit) to finance the construction of various higher education facilities. The principal amount of \$537,035,000 with interest rates ranging from 2.0 percent to 6.0 percent shall be paid semi-annually. The final principal payment is due in 2030. The Virginia Biotechnology Research Park Authority (Nonmajor Component Unit) has a deed of trust note payable dated July 18, 2002, in the amount of \$532,637 for the purchase of property. The interest rate is LIBOR plus 3.0 percent with a minimum principal payment requirement due on October 1, 2005, at which time it becomes LIBOR plus 2.0 percent, with a final payment due October 1, 2008. The Virginia Equine Center (Nonmajor Component Unit) has a note payable in the amount of \$39,705 for a Chevrolet Tahoe to be used as a company car. The interest rate is 1.9 percent and the note is due in 2009.

The Higher Education Institutions (Component Units) also have notes payable. The University of Virginia (Major Component Unit) has notes payable of \$1,656,981 which are three to five year notes for equipment and other working capital expenses at an interest rate of 3.0 percent to 6.0 percent. The College of William and Mary (Nonmajor Component Unit) has notes payable of \$6,029,581 with SunTrust Bank to partially finance the multi-year implementation of a new administrative and financial system. This first note matures in 2008 and has an interest rate of 5.82 percent. The second note has an interest rate of 3.75 percent and matures in 2011. Virginia State University (Nonmajor Component Unit) has a note payable of \$2,429,040, which is the result of a loan agreement with the U.S. Department of Housing and Urban Development to repair seven dormitories. The loan is to be repaid over 30 years at 3.0 percent interest per annum, and is secured by a lien on the net revenues from the ownership, operation, and use of the seven dormitories under repair. Norfolk State University (Nonmajor Component Unit) has a note payable of \$118,598, which is the result of an agreement with the City of Norfolk to purchase the Brambleton Center. The loan is payable in six full scholarships each year varying from \$4,593 to \$13,308 with the final amount due in 2019.

Various Foundations (Component Units) have notes outstanding as of year-end. The purpose of a majority of these notes are for property acquisition, working capital, and refinancing. Most of these notes are with

banks. Future principal payments as of June 30, 2004, are shown in the following table (dollars in thousands).

**Foundations' Notes Payable (Component Units) (1)**  
June 30, 2004

<b>Maturity</b>	<b>Principal</b>
2005	\$ 9,331
2006	22,280
2007	5,482
2008	20,951
2009	26,326
Thereafter	<u>72,102</u>
<b>Total</b>	<b>\$ <u>156,472</u></b>

Note (1): Foundations represent FASB reporting entities defined in Note 1.B.

Installment notes have been entered into by agencies and institutions of the Commonwealth. These agreements, other than those in the component units and certain institutions of higher education, contain nonappropriation clauses indicating that continuation of the installment note is subject to funding by the General Assembly. Installment notes represent \$66,929,733 of the total outstanding debt of the Commonwealth. The Foundations (Component Units) did not have any outstanding installment notes as of year-end. Presented in the following tables are repayment schedules for installment notes.

**Installment Notes - Governmental Funds**  
June 30, 2004

<b>Maturity</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2005	\$ 8,788,331	\$ 1,000,900	\$ 9,789,231
2006	8,430,013	725,520	9,155,533
2007	5,043,283	473,720	5,517,003
2008	2,342,901	313,040	2,655,941
2009	2,125,685	200,495	2,326,180
2010-2014	<u>2,498,010</u>	<u>101,447</u>	<u>2,599,457</u>
<b>Total</b>	<b>\$ <u>29,228,223</u></b>	<b>\$ <u>2,815,122</u></b>	<b>\$ <u>32,043,345</u></b>

**Installment Notes - Business Type Activities**  
June 30, 2004

<b>Maturity</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2005	\$ 4,744,874	\$ 412,652	\$ 5,157,526
2006	4,945,931	214,706	5,160,637
2007	2,384,836	58,238	2,443,074
2008	308,037	6,493	314,530
2009	<u>91,326</u>	<u>823</u>	<u>92,149</u>
<b>Total</b>	<b>\$ <u>12,475,004</u></b>	<b>\$ <u>692,912</u></b>	<b>\$ <u>13,167,916</u></b>

**Installment Notes - Component Units (1)**

June 30, 2004

<b>Maturity</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2005	\$ 6,675,733	\$ 815,047	\$ 7,490,780
2006	5,598,870	598,674	6,197,544
2007	4,122,389	406,994	4,529,383
2008	2,621,236	285,351	2,906,587
2009	1,586,777	218,477	1,805,254
2010-2014	4,375,082	404,031	4,779,113
2015-2019	<u>246,419</u>	<u>2,653</u>	<u>249,072</u>
<b>Total</b>	<b>\$ <u>25,226,506</u></b>	<b>\$ <u>2,731,227</u></b>	<b>\$ <u>27,957,733</u></b>

Note (1): The above amounts exclude capital lease obligations of Foundations.

**Lottery Prizes Payable**

Lottery prizes are paid in 20, 25, 26, or 30 installments. The first installment is paid on the day the prize is claimed. The subsequent annual payments are funded with U.S. Treasury STRIPS purchased by the Virginia Lottery. For Life prizes payable represent estimated prizes payable monthly, quarterly or annually for the life of the winner based on life expectancy tables from the Virginia Bureau of Insurance, and funded with a pool of U.S. Treasury STRIPS.

Lottery prizes payable represent the future annual prize payments valued at cost plus accrued interest (present value of securities held to maturity) of the investment securities funding the payments.

Lottery prizes payable for the fiscal year ended June 30, 2004, are shown in the following table:

	<b>Lottery</b>	<b>For Life</b>	<b>Total</b>
Due within one year	\$ 56,121,612	\$ 1,524,512	\$ 57,646,124
Due in subsequent years	<u>321,235,498</u>	<u>19,313,634</u>	<u>340,549,132</u>
Total (present value)	377,357,110	20,838,146	398,195,256
Add:			
Interest to Maturity	<u>145,516,890</u>	<u>20,373,854</u>	<u>165,890,744</u>
Lottery Prizes Payable at Maturity	<b>\$ <u>522,874,000</u></b>	<b>\$ <u>41,212,000</u></b>	<b>\$ <u>564,086,000</u></b>

**Tuition Benefits Payable**

The Virginia College Savings Plan administers the Virginia Prepaid Education Program (VPEP). VPEP offers contracts which, for actuarially determined amounts, provide for guaranteed full future tuition payments at State higher education institutions. The contract provisions also allow the benefits to be used for private or out-of-state institutions at a prorated amount based upon the amounts charged by the State's higher education institutions.

At June 30, 2004, tuition benefits payable of \$1.2 billion have been recorded for the VPEP program on the balance sheet for the actuarially determined present value of future obligations anticipated for payment of benefits and administrative expenses for the VPEP program. In addition, a receivable in the amount of \$224.2 million has been recorded to reflect the actuarially determined present value of future payments anticipated from contract holders.

## 20. OTHER REVENUE

The following table (dollars in thousands) summarizes Other Revenue for the fiscal year ended June 30, 2004.

	<b>Assessments and Receipts for Support of Special Services</b>	<b>Fines, Forfeitures, Court Fees, Penalties, and Escheats</b>	<b>Receipts from Cities Counties, and Towns</b>	<b>Private Gifts, Grants, and Contracts</b>	<b>Sales of Property</b>
<b>Primary Government:</b>					
General	\$ 310	\$ 196,358	\$ 8,962	\$ 1	\$ 2,035
Major Special Revenue Funds:					
Commonwealth Transportation	16,206	9,344	54,621	-	4,512
Federal Trust	1	103	-	-	153
Literary	-	64,304	-	-	-
Major Enterprise Funds:					
Virginia College Savings Plan	-	-	-	-	-
Nonmajor Governmental Funds	79,903	46,742	87,805	7,907	21,716
Nonmajor Enterprise Funds	-	9,747	-	-	-
Internal Service Funds	-	-	-	-	-
Private Purpose	-	-	-	-	-
Pension Trust	-	-	-	-	-
Total Primary Government	<u>\$ 96,420</u>	<u>\$ 326,598</u>	<u>\$ 151,388</u>	<u>\$ 7,908</u>	<u>\$ 28,416</u>

	<b>Contributions</b>	<b>Tobacco Master Settlement</b>	<b>Taxes</b>	<b>Other</b>	<b>Total Other Revenue</b>
<b>Primary Government:</b>					
General	\$ -	\$ 51,359	\$ -	\$ 70,018	\$ 329,043
Major Special Revenue Funds:					
Commonwealth Transportation	-	-	-	31,748	116,431
Federal Trust	-	-	-	36,989	37,246
Literary	-	-	-	49,992	114,296
Major Enterprise Funds:					
Virginia College Savings Plan	-	-	-	1,136	1,136
Nonmajor Governmental Funds	-	-	-	74,591	318,664
Nonmajor Enterprise Funds	1,096	-	12,152	485	23,480
Internal Service Funds	-	-	-	392	392
Private Purpose	-	-	-	45	45
Pension Trust	-	-	-	908	908
Total Primary Government	<u>\$ 1,096</u>	<u>\$ 51,359</u>	<u>\$ 12,152</u>	<u>\$ 266,304</u>	<u>\$ 941,641</u>

## 21. PRIZES AND CLAIMS

The following table summarizes Prizes and Claims Expense for the fiscal year ended June 30, 2004.

*(Dollars in Thousands)*

	<u>Insurance Claims</u>	<u>Lottery Prize Expense</u>	<u>Total Prizes and Claims</u>
<b>Proprietary Funds:</b>			
Major Enterprise Funds:			
State Lottery	\$ -	\$ 707,179	\$ 707,179
Unemployment Compensation	484,875	-	484,875
Nonmajor Enterprise Funds	128,540	-	128,540
Total Enterprise Funds	<u>\$ 613,415</u>	<u>\$ 707,179</u>	<u>\$ 1,320,594</u>
Internal Service Funds	<u>\$ 694,629</u>	<u>\$ -</u>	<u>\$ 694,629</u>

## 22. DEPRECIATION AND AMORTIZATION

The following table summarizes Depreciation and Amortization Expense for the fiscal year ended June 30, 2004.

*(Dollars in Thousands)*

	<u>Depreciation</u>	<u>Amortization</u>	<u>Total Depreciation and Amortization</u>
<b>Proprietary Funds:</b>			
Major Enterprise Funds:			
State Lottery	\$ 5,987	\$ -	\$ 5,987
Virginia College Savings Plan	71	-	71
Pocahontas Parkway	10,552	306	10,858
Nonmajor Enterprise Funds	3,762	-	3,762
Total Enterprise Funds	<u>\$ 20,372</u>	<u>\$ 306</u>	<u>\$ 20,678</u>
Internal Service Funds	<u>\$ 16,295</u>	<u>\$ -</u>	<u>\$ 16,295</u>

## 23. OTHER EXPENSES

The following table summarizes Other Expenses for the fiscal year ended June 30, 2004.

*(Dollars in Thousands)*

	<u>Grants and Distributions to Localities</u>	<u>Expendable Equipment</u>	<u>Other</u>	<u>Total Other Expenses</u>
<b>Proprietary Funds:</b>				
Major Enterprise Funds:				
Virginia College Savings Plan	\$ -	\$ 183	\$ 25	\$ 208
Nonmajor Enterprise Funds	98	1,951	696	2,745
Total Enterprise Funds	<u>\$ 98</u>	<u>\$ 2,134</u>	<u>\$ 721</u>	<u>\$ 2,953</u>
Internal Service Funds	<u>\$ -</u>	<u>\$ 1,783</u>	<u>\$ 2,855</u>	<u>\$ 4,638</u>

## 24. OTHER NON-OPERATING REVENUE/EXPENSES

The following table summarizes Other Non-Operating Revenue/Expenses for the fiscal year ended June 30, 2004.

(Dollars in Thousands)

	Gain (Loss)		Total Non- Operating Revenue/ Expenses
	on Sale of Capital Assets	Other	
<b>Proprietary Funds:</b>			
Major Enterprise Funds:			
State Lottery	\$ -	\$ 21	\$ 21
Virginia College Savings Plan	-	(24)	(24)
Nonmajor Enterprise Funds	(5)	(291)	(296)
Total Enterprise Funds	<u>\$ (5)</u>	<u>\$ (294)</u>	<u>\$ (299)</u>
Internal Service Funds	<u>\$ (274)</u>	<u>\$ (87)</u>	<u>\$ (361)</u>

## 25. TRANSFERS

The following table summarizes Transfers In and Transfers Out for the fiscal year ended June 30, 2004 (dollars in thousands).

Transfers Out (Reported In):	Transfers In (Reported In):					
	General	Commonwealth Transportation	Federal Trust	Literary Fund	Virginia College Savings Plan	Nonmajor Governmental Funds
<b>Primary Government</b>						
General	\$ -	\$ 175,223	\$ 28	\$ -	\$ 104	\$ 293,085
Major Special Revenue Funds:						
Commonwealth Transportation	124,544	-	421	-	-	224,321
Federal Trust	479	17,494	-	-	-	1,103
Major Enterprise Funds:						
State Lottery	408,052	-	-	13,035	-	-
Virginia College Savings Plan	103	-	-	-	-	-
Pocahontas Parkway	-	14,921	-	-	-	-
Unemployment Compensation	-	-	18,045	-	-	-
Nonmajor Governmental Funds	68,194	13,873	1,056	4	-	32,547
Nonmajor Enterprise Funds	95,433	-	35	8	-	130
Internal Service Funds	4,452	-	-	-	-	49
<b>Total Primary Government</b>	<u>\$ 701,257</u>	<u>\$ 221,511</u>	<u>\$ 19,585</u>	<u>\$ 13,047</u>	<u>\$ 104</u>	<u>\$ 551,235</u>

Transfers are used to (1) move revenues from the fund that the *Code of Virginia* or budget requires to collect them to the fund that the *Code of Virginia* or budget requires to expend them; (2) move receipts restricted for debt service from the funds holding the resources to the debt service fund as principal and interest payments become due; (3) use unrestricted revenues collected in the general fund to finance various programs accounted for in other funds in accordance with budgetary authorizations; and (4) to reimburse the General Fund for expenses incurred on behalf of nongeneral funds.

During the fiscal year, the following significant transfers were made that do not occur on a routine basis or are inconsistent with the activities of the fund making the transfer.

- Various non-general funds transferred approximately \$112.4 million to the General Fund for disbursements appropriated by Chapter 943, 2004 Acts of Assembly.
- Various non-general funds transferred approximately \$15.2 million to the General Fund resulting from reduced retirement and post-employment benefit contributions disbursements appropriated by Chapter 943, 2004 Acts of Assembly.
- The Pocahontas Parkway Fund transferred approximately \$14.9 million of surplus monies to the Commonwealth Transportation Fund pursuant to the Master Indenture of Trust agreement.

<b>Nonmajor Enterprise Funds</b>	<b>Internal Service Funds</b>	<b>Total Primary Government</b>
\$ 268	\$ 510	\$ 469,218
-	283	349,569
144	-	19,220
-	-	421,087
-	-	103
-	-	14,921
-	-	18,045
-	360	116,034
-	-	95,606
-	-	4,501
<u>\$ 412</u>	<u>\$ 1,153</u>	<u>\$ 1,508,304</u>

- The Debt Service Fund transferred approximately \$12.8 million to the Commonwealth Transportation Fund. These monies represent previous collections from localities that were returned to the locality for locality debt service payments.
- Various non-general funds transferred approximately \$10.9 million to the General Fund resulting from savings from information technology enterprise projects as required by Chapter 943, 2004 Acts of Assembly.
- The Department of Motor Vehicles transferred increased fees of \$10 million to the General Fund as required by Chapter 943, 2004 Acts of Assembly.
- The State Corporation Commission transferred \$6.5 million to the General Fund since the General Assembly deferred consumer training related to energy deregulation.

## 26. ON-BEHALF PAYMENTS

Higher Education Institutions (Component Units) recognized various foundation and association on-behalf payments for fringe benefits and salaries during fiscal year 2004 totaling \$369,283. This activity was recorded as Program Revenue – Operating Grants and Contributions in the amount of \$314,850; and Program Revenue – Charges for Services in the amount of \$54,433, with corresponding expenditures.

Network was an Authority and reported as a Related Organization in fiscal year 2003. Effective July 1, 2003, the Network is a division within the Virginia Information Technologies Agency.

- Component Units have been restated due to the implementation of GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, effective for the fiscal year ending June 30, 2004.

The various individual fund amounts have been restated due to the following:

- The General Fund restatement is due to prior year corrections of errors related to receivables and inventory.
- The Special Revenue Commonwealth Transportation Fund has been restated due to a prior year error related to inventory.
- Enterprise Funds, as mentioned above, have been restated due to legislative changes affecting the Virginia Information Providers Network (Network).
- Investment Trust Funds were restated due to a change in reporting entity.
- As mentioned above, the Commonwealth implemented GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, effective for the fiscal year ending June 30, 2004. Accordingly, Higher Education Institutions, the Science Museum of Virginia Foundation, the Virginia Museum of Fine Arts Foundation, and the Virginia Equine Center Foundation amounts have been restated.

## 27. CHANGE IN ACCOUNTING ESTIMATE

### Primary Government

The Department of Taxation changed the process for estimating the allowance for doubtful accounts during the year to more effectively predict future collections according to the receivable type and historical collection data. As a result of this procedural change, the allowance for doubtful accounts was reduced by \$27.3 million as of June 30, 2004.

## 28. RESTATEMENT OF BEGINNING BALANCES

The Government-wide beginning balance restatements resulted from the following:

- Governmental Activities have been restated for correction of prior year errors regarding capital assets, capital leases, receivables, and inventory. The restatement is primarily attributable to refinements made in the infrastructure valuation methodology for capital assets.
- Business-Type Activities have been restated due to legislative changes affecting the Virginia Information Providers Network (Network). The

### Beginning Balance Restatement

(Dollars in Thousands)

	Balance as of June 30, 2003	Correction of Prior Year Errors	Change in Reporting Entity	Balance June 30, 2003 as restated
<b>Government-wide Activities:</b>				
Primary Government:				
Governmental Activities	\$ 11,133,664	\$ 245,191	\$ -	\$ 11,378,855
Business-type Activities	171,448	-	248	171,696
Total Primary Government	<u>\$ 11,305,112</u>	<u>\$ 245,191</u>	<u>\$ 248</u>	<u>\$ 11,550,551</u>
Component Units	<u>\$ 9,096,734</u>	<u>\$ -</u>	<u>\$ 2,545,467</u>	<u>\$ 11,642,201</u>
<b>Major Governmental Funds:</b>				
General	\$ 63,564	\$ (9,694)	\$ -	\$ 53,870
Special Revenue Funds:				
Commonwealth Transportation	1,251,569	1,368	-	1,252,937
Federal Trust	141,348	-	-	141,348
Literary	372,819	-	-	372,819
<b>Total Nonmajor Governmental Funds</b>	<u>721,456</u>	<u>-</u>	<u>-</u>	<u>721,456</u>
<b>Total Governmental Funds</b>	<u>\$ 2,550,756</u>	<u>\$ (8,326)</u>	<u>\$ -</u>	<u>\$ 2,542,430</u>

**Beginning Balance Restatement  
Proprietary Funds**

*(Dollars in Thousands)*

	<b>Balance as of June 30, 2003</b>	<b>Change in Reporting Entity</b>	<b>Balance June 30, 2003 as restated</b>
<b>Major Enterprise Funds:</b>			
State Lottery	\$ (2,067)	\$ -	\$ (2,067)
Virginia College Savings Plan	(232,718)	-	(232,718)
Pocahontas Parkway	(75,338)	-	(75,338)
Unemployment Compensation	414,196	-	414,196
<b>Nonmajor Enterprise Funds:</b>			
Department of Alcoholic Beverage Control	(5,619)	-	(5,619)
Risk Management	24,154	-	24,154
Local Choice Health Care	8,574	-	8,574
Virginia Industries for the Blind	4,821	-	4,821
Consolidated Laboratory	439	-	439
eVA Procurement System	(1,715)	-	(1,715)
Department of Environmental Quality	8,311	-	8,311
Virginia Information Providers Network	-	248	248
Wireless E-911 Service Board	26,978	-	26,978
Virginia Museum of Fine Arts	979	-	979
Science Museum of Virginia	232	-	232
Mental Health Local Funds	288	-	288
Division of Legislative Services	6	-	6
School for the Deaf and Blind - Staunton	2	-	2
<b>Total Nonmajor Enterprise Funds</b>	<b>67,450</b>	<b>248</b>	<b>67,698</b>
<b>Total Enterprise Funds</b>	<b>\$ 171,523</b>	<b>\$ 248</b>	<b>\$ 171,771</b>
<b>Total Internal Service Funds</b>	<b>\$ (83,758)</b>	<b>\$ -</b>	<b>\$ (83,758)</b>

**Beginning Balance Restatement  
Fiduciary Funds**

*(Dollars in Thousands)*

	<b>Balance as of June 30, 2003</b>	<b>Change in Reporting Entity</b>	<b>Balance June 30, 2003 as restated</b>
Private Purpose Funds	\$ 3,686,759	\$ -	\$ 3,686,759
Pension Trust Funds	34,704,280	-	34,704,280
Investment Trust Funds:			
Local Government Investment Pool (LGIP)	2,345,638	(5,010)	2,340,628
State Non-Arbitrage Pool (SNAP)	1,154,186	(5,907)	1,148,279
SNAP Individual Investment Accounts	146,805	-	146,805
Total Investment Trust Funds	3,646,629	(10,917)	3,635,712
<b>Total Fiduciary Funds</b>	<b>\$ 42,037,668</b>	<b>\$ (10,917)</b>	<b>\$ 42,026,751</b>

**Beginning Balance Restatement  
Component Units**

*(Dollars in Thousands)*

	<b>Balance as of June 30, 2003</b>	<b>Change in Reporting Entity</b>	<b>Balance June 30, 2003 as restated</b>
<b>Major Component Units</b>			
Virginia Housing Development Authority	\$ 1,442,815	\$ -	\$ 1,442,815
Virginia Public School Authority	27,933	-	27,933
University of Virginia	3,405,361	680,698	4,086,059
Virginia Polytechnic Institute and State University	463,074	444,496	907,570
Virginia Commonwealth University	672,821	269,437	942,258
<b>Nonmajor Component Units</b>			
Virginia Economic Development Partnership	501	-	501
Virginia Outdoors Foundation	8,163	-	8,163
Virginia Port Authority	325,075	-	325,075
Virginia Resources Authority	860,174	-	860,174
Virginia Tourism Authority	960	-	960
Virginia Tobacco Settlement Foundation	10,771	-	10,771
Tobacco Indemnification and Community Revitalization Commission	75,390	-	75,390
Virginia Museum of Fine Arts Foundation	-	130,770	130,770
Science Museum of Virginia Foundation	-	10,781	10,781
Hampton Roads Sanitation District Commission	347,069	-	347,069
Virginia Biotechnology Research Park Authority	12,077	-	12,077
Virginia Small Business Financing Authority	31,700	-	31,700
Virginia School for the Deaf and Blind Foundation	2,151	-	2,151
A. L. Philpott Manufacturing Extension Partnership	685	-	685
Virginia Equine Center Foundation	2,031	970	3,001
Certified Nursing Facility Education Initiative	336	-	336
College of William and Mary	275,933	375,614	651,547
Virginia Military Institute	68,985	235,780	304,765
Virginia State University	73,027	4,960	77,987
Norfolk State University	39,304	11,438	50,742
Mary Washington College	59,701	29,426	89,127
James Madison University	222,961	38,997	261,958
Radford University	96,426	29,064	125,490
Old Dominion University	165,117	88,306	253,423
George Mason University	214,261	68,149	282,410
Virginia Community College System	400,354	78,966	479,320
Christopher Newport University	79,447	11,510	90,957
Longwood University	59,788	36,105	95,893
Southwest Virginia Higher Education Center	7,181	-	7,181
Roanoke Higher Education Authority	12,075	-	12,075
Innovative Technology Authority	20,247	-	20,247
Virginia College Building Authority	(387,160)	-	(387,160)
<b>Total Nonmajor Component Units</b>	<b>3,084,730</b>	<b>1,150,836</b>	<b>4,235,566</b>
<b>Total Component Units</b>	<b>\$ 9,096,734</b>	<b>\$ 2,545,467</b>	<b>\$ 11,642,201</b>

The Contractor Deposits Fund has been restated to incorporate the balances for the Department of Transportation and Department of Motor Vehicles. These funds were inadvertently omitted in the prior year.

**Beginning Balance Restatement  
Agency Funds**

*(Dollars in Thousands)*

	<b>Balance as of July 1, 2003</b>	<b>Correction of Prior Year Errors</b>	<b>Balance July 1, 2003 as restated</b>
<b>Agency Funds</b>			
Funds for the Collection of Taxes and Fees	\$ 220,741	\$ -	\$ 220,741
Employee Benefits Fund	2,910	-	2,910
Contractor Deposits Fund (formerly Mined Land Deposits Fund)	10,683	11,356	22,039
Deposits of Insurance Carriers Fund	418,669	-	418,669
Inmate and Ward Fund	5,469	-	5,469
Child Support Collections Fund	29,496	-	29,496
Mental Health Patient Trust Fund	2,579	-	2,579
Mental Health Non-patient Trust Fund	20	-	20
Optional Life Insurance Fund	2,943	-	2,943
Comptroller's Debt Setoff Fund	1,166	-	1,166
Unclaimed Property of Other States	2,827	-	2,827
Legal Settlement Fund	771	-	771
Consumer Services Fund	435	-	435
Department of State Police Fund	400	-	400
Aviation Fund	116	-	116
Virginia School for the Deaf and Blind Fund	37	-	37
Woodrow Wilson Rehabilitation Center Fund	7	-	7
Dog and Cat Sterilization Fund	2	-	2
Milk Commission Fund	1	-	1
State Corporation Commission	16,781	-	16,781
<b>Total Agency Funds</b>	<b>\$ 716,053</b>	<b>\$ 11,356</b>	<b>\$ 727,409</b>

Enterprise Funds have been restated due to legislative changes affecting the Virginia Information Providers Network (Network). The Network was an Authority and reported as a Related Organization in fiscal year 2003. Effective July 1, 2003, the Network is a division within the Virginia Information Technologies Agency.

**Beginning Cash and Cash Equivalents Restatement  
Proprietary Funds**

*(Dollars in Thousands)*

	<b>Balance as of June 30, 2003</b>	<b>Change in Reporting Entity</b>	<b>Balance June 30, 2003 as restated</b>
<b>Major Enterprise Funds:</b>			
State Lottery	\$ 10,382	\$ -	\$ 10,382
Virginia College Savings Plan	81,513	-	81,513
Pocahontas Parkway	19,697	-	19,697
Unemployment Compensation	396,471	-	396,471
<b>Nonmajor Enterprise Funds:</b>			
Department of Alcoholic Beverage Control	755	-	755
Risk Management	21,664	-	21,664
Local Choice Health Care	11,954	-	11,954
Virginia Industries for the Blind	1,956	-	1,956
Consolidated Laboratory	2,035	-	2,035
eVA Procurement System	266	-	266
Department of Environmental Quality	10,498	-	10,498
Virginia Information Providers Network	-	667	667
Wireless E-911 Service Board	26,170	-	26,170
Virginia Museum of Fine Arts	685	-	685
Science Museum of Virginia	181	-	181
Mental Health Local Funds	364	-	364
Division of Legislative Services	6	-	6
School for the Deaf and Blind - Staunton	2	-	2
<b>Total Nonmajor Enterprise Funds</b>	<b>76,536</b>	<b>667</b>	<b>77,203</b>
<b>Total Enterprise Funds</b>	<b>\$ 584,599</b>	<b>\$ 667</b>	<b>\$ 585,266</b>
<b>Total Internal Service Funds</b>	<b>\$ 158,073</b>	<b>\$ -</b>	<b>\$ 158,073</b>

## 29. DEFICIT FUND BALANCES / NET ASSETS

The State Lottery (Major Enterprise Fund) and Department of Alcoholic Beverage Control (Nonmajor Enterprise Fund) ended the year with deficit net assets of \$2.3 million and \$6.7 million respectively. This was solely attributable to the net pension obligation resulting from GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. Since the Commonwealth is the employer, the agencies do not report this liability in their individually published financial statements.

The Virginia College Savings Plan (Major Enterprise Fund) ended the year with a deficit net assets balance of \$128.5 million. This is attributable to a projected unfunded actuarial liability caused primarily by unprecedented tuition increases in recent years as well as the expectation of additional significant increases in both university and community college tuitions for at least the next two years. An additional factor was the downturn in the stock market in the prior year, which resulted in a decrease in the long-term investment return assumption used by the actuary. The Board will continue to address this issue by working with the actuary and investment consultant to continually monitor the investment allocation ensuring the Plan has proper diversification to enhance long-term investment returns. It remains the Board's intention to reduce the actuarial deficit over time by creating an actuarial reserve and implementing appropriate premium pricing in any future enrollment periods.

The Pocahontas Parkway (Major Enterprise Fund) ended the year with a deficit net assets balance of \$115.1 million. This is attributable to debt service and operating expenses exceeding revenues and a deficit in beginning net assets.

The eVA Procurement System (Nonmajor Enterprise Fund) ended the year with a deficit net assets balance of \$4.3 million. This is attributable to operating expenses exceeding revenues due to start up costs and the net pension obligation resulting from GASB Statement No. 27, as previously explained.

The Health Care Fund (Internal Service Fund) ended the year with a deficit net assets balance of \$24.8 million. The deficit is attributable to increased health care costs.

Maintenance and Repair (Internal Service Fund) ended the year with a deficit net assets balance of \$1.1 million due to revenue refunds to agencies which were mandated by the Department of Planning and Budget.

The Risk Management Fund (Internal Service Fund) ended the year with a deficit net assets balance of \$169.4 million. The deficit was the result of estimated claims payable exceeding the available equity in the fund. Claims are paid on a pay-as-you-go basis. To the extent that claims exceed current resources, they will ultimately become a liability of the fund from which the claim originated.

The Virginia Public Building Authority Capital Projects Fund (Nonmajor Governmental Fund) ended the year with a deficit fund balance of \$33.7 million. This was attributable to the delay of the spring bond issuance Series 2004B resulting from the General Assembly's lengthy budget negotiations.

The Virginia College Building Authority (Nonmajor Component Unit) ended the year with a deficit net assets balance of \$497.9 million. This deficit occurs because the Authority issues 21<sup>st</sup> Century and Equipment bonds subject to future appropriations from the General Fund of the Commonwealth without any other security.

## 30. ENDOWMENTS

Donor restricted endowments reside primarily within the higher education institutions and the Virginia Museum of Fine Arts. The net appreciation available for expenditure is \$627,208,037, and of this amount, \$624,119,749 is reported as restricted net assets and \$3,088,288 is reported as unrestricted net assets. The *Code of Virginia* authorizes acceptance of donations. The governing boards of these entities and the donor agreements determine whether net appreciation can be spent and the accepted spending rate. These policies are entity specific and vary with each institution.

### 31. CASH FLOWS – ADDITIONAL DETAILED INFORMATION

The following table (dollars in thousands) summarizes specific cash flows for the fiscal year ended June 30, 2004.

	State Lottery	Virginia College Savings Plan	Pocahontas Parkway	Unemployment Compensation
Cash Flows Resulting from:				
Payments for Prizes, Claims, and Loss Control:				
Lottery Prizes	\$ (759,788)	\$ -	\$ -	\$ -
Claims and Loss Control	-	-	-	(489,904)
Total	<u>\$ (759,788)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (489,904)</u>
Other Operating Revenues:				
Other Operating Revenue	\$ -	\$ -	\$ -	\$ -
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Other Operating Expenses:				
Payments for Contractual Services	\$ (17,554)	\$ (1,237)	\$ -	\$ -
Other Operating Expenses	-	-	(258)	-
Total	<u>\$ (17,554)</u>	<u>\$ (1,237)</u>	<u>\$ (258)</u>	<u>\$ -</u>
Other Noncapital Financing Receipt Activities:				
Advances/Contributions from the Commonwealth	\$ -	\$ -	\$ -	\$ -
Receipts from Taxes	-	-	-	-
Other Noncapital Financing Receipt Activities	997	-	-	-
Total	<u>\$ 997</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Other Noncapital Financing Disbursement Activities:				
Repayments of Advances/Contributions from the Commonwealth	\$ -	\$ -	\$ -	\$ -
Other Noncapital Financing Disbursement Activities	-	-	-	-
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Other Capital and Related Financing Disbursement Activities:				
Disbursements for Capital Expenditures	\$ -	\$ -	\$ (94)	\$ -
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (94)</u>	<u>\$ -</u>

Nonmajor Enterprise Funds	Total Enterprise Funds	Internal Service Funds
\$ -	\$ (759,788)	\$ -
(125,856)	(615,760)	(656,727)
<u>\$ (125,856)</u>	<u>\$ (1,375,548)</u>	<u>\$ (656,727)</u>
\$ 15,568	\$ 15,568	\$ 402
<u>\$ 15,568</u>	<u>\$ 15,568</u>	<u>\$ 402</u>
\$ (38,488)	\$ (57,279)	\$ (111,324)
(82)	(340)	(7,948)
<u>\$ (38,570)</u>	<u>\$ (57,619)</u>	<u>\$ (119,272)</u>
\$ 10,170	\$ 10,170	\$ -
122,161	122,161	-
41	1,038	1
<u>\$ 132,372</u>	<u>\$ 133,369</u>	<u>\$ 1</u>
\$ -	\$ -	\$ (982)
(80)	(80)	-
<u>\$ (80)</u>	<u>\$ (80)</u>	<u>\$ (982)</u>
\$ -	\$ (94)	\$ -
<u>\$ -</u>	<u>\$ (94)</u>	<u>\$ -</u>

## 32. TOBACCO SETTLEMENT

On November 23, 1998, 46 states' Attorneys General and the major tobacco companies signed a proposed settlement that reimburses states for smoking-related medical expenses paid through Medicaid and other health care programs. Virginia could receive approximately \$4.1 billion over the next 25 years. The settlement was approved in a Consent Decree in December 1998. On March 29, 1999, the General Assembly enacted a law approving the establishment of the Virginia Tobacco Indemnification and Community Revitalization Commission (Commission), in compliance with the Consent Decree, to help communities in Virginia hurt by the decline of tobacco.

The Commission was established for the purposes of determining the appropriate recipients of monies in the Tobacco Indemnification and Community Revitalization Fund. The monies are to be used to provide payments to tobacco farmers as compensation for the tobacco equipment and barns and lost tobacco production opportunities associated with a decline in quota. The monies are also to be used to revitalize tobacco dependent communities.

The General Assembly also created The Virginia Tobacco Settlement Foundation (Foundation). The purpose of the Foundation is to determine the appropriate recipients of monies in the Virginia Tobacco Settlement Fund. The Foundation will also be responsible for distributing monies for the purposes provided in the legislation. Disbursements can be made to assist in financing efforts to restrict the use of tobacco products by minors, through educational and awareness programs describing the health effects of tobacco use on minors, and laws restricting the distribution of tobacco products to minors. The Virginia Tobacco Indemnification and Community Revitalization Commission and the Virginia Tobacco Settlement Foundation are included in the Comprehensive Annual Financial Report as governmental component units.

Additionally, the General Assembly created two special non-reverting funds. The Tobacco Settlement monies will be deposited to these funds and the General Fund. Fifty percent of the Settlement monies will be deposited into the Tobacco Indemnification and Community Revitalization Fund. Ten percent of the Settlement monies will be deposited into the Virginia Tobacco Settlement Fund. The remaining 40 percent will be deposited to the General Fund.

## 33. PUBLIC-PRIVATE PARTNERSHIP

The Department of Taxation (Department) has entered into a partnership agreement with the American Management Systems, Inc. (AMS). The purpose of this partnership is to finance the Department's technology needs. As of June 30, 2004, enough revenue has been generated to fully fund the total contract cost. As of June 30, 2004, the Department has paid AMS \$131.2 million towards the \$168.2 million contract cost.

## 34. INTERGOVERNMENTAL TRANSFERS

In making payments under an approved Medicaid State Plan per Title XIX of the Social Security Act, Federal regulation allows states to pay different rates to different classes of providers. The Virginia Medicaid State Plan allows the Commonwealth, without violating the upper payment limit regulation, to make enhanced Medicaid payments to nursing homes, hospitals, and clinics owned and operated by local governments. Payments may also be made to state owned hospitals and health clinics. These enhanced payments are capped by an upper payment limit. The Department of Medical Assistance Services (DMAS) plans to make these enhanced payments to locally owned hospitals, health clinics, and nursing homes as well as state owned health clinics using "intergovernmental transfers." The fiscal year 2004 activity is reported in Other Special Revenue (nonmajor). In fiscal year 2005 the transfers will take place between the Commonwealth and one or more localities that own or operate Medicaid certified nursing homes, health clinics, or hospitals. Transfers will also take place between DMAS and the Virginia Department of Health, which operates health clinics in the Commonwealth. The governmental entities will provide funds to the Commonwealth, which will be matched with Federal Medicaid dollars. The Commonwealth will then pay the locally owned nursing homes, health clinics, and hospitals as well as the applicable state health clinics, for services rendered during fiscal year 2005. If the intergovernmental transfers take place in fiscal year 2005, as planned, the transaction could result in a net gain to the participating localities and the Commonwealth in the amount of approximately \$560,000 and \$10,500,000, respectively. The transactions are contingent upon intergovernmental agreements being signed between the Commonwealth and the participating localities. The transactions are also contingent on negotiations between the Centers for Medicare and Medicaid Services and DMAS regarding the possible phase out of intergovernmental transactions for fiscal year 2006.

## 35. CONTINGENCIES

### A. Grants and Contracts

The Commonwealth 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 Commonwealth.

Institutions of higher education (Component Units) and other State agencies are required to comply with various Federal regulations issued by the Office of Management and Budget, if such agencies are recipients of Federal grants, contracts, or other sponsored agreements. Failure to comply with certain requirements of these regulations may result in questions concerning the allowability of related direct and indirect charges pursuant to such

agreements. It is believed that the ultimate disallowance pertaining to these regulations, if any, will be immaterial to the overall financial condition of the Commonwealth.

The U.S. Department of Health and Human Services (DHHS) Office of the Inspector General conducted a review and indicated that the Commonwealth's Statewide Indirect Cost Allocation Plan rates have allowed over-recoveries in the Internal Service Funds. The U.S. DHHS has reviewed and approved the 2005 cost allocation plan, which is based on state fiscal year 2003 data. The Commonwealth believes this liability has the potential to total \$2,088,869 as of June 30, 2004.

Virginia's combined overpayment and underpayment food stamp error rate for federal fiscal year 2003 was 5.46 percent. The national average combined error rate was 6.64 percent. States whose error rate exceeds the national average are subject to a penalty. Since Virginia's combined error rate was below the national average, Virginia was not sanctioned. At June 30, 2004, there is no outstanding liability.

## **B. Litigation**

The Commonwealth is named as a party in legal proceedings and investigations that occur in the normal course of governmental operations, some involving substantial amounts. It is not possible at the present time to estimate ultimate outcome or liability, if any, of the Commonwealth in respect to the various proceedings; however, it is believed that any ultimate liability resulting from these suits or investigations will not have a material, adverse effect on the financial condition of the Commonwealth.

## **C. Subject to Appropriation**

Both the primary government and the discretely presented component units enter into agreements and issue debt secured solely by future appropriations from the General Fund of the Commonwealth. The primary government has leases and other agreements of such debt of \$1.1 billion. The discretely presented component units have such debt of \$389.4 million.

## **36. SUBSEQUENT EVENTS**

### **Primary Government**

In August 2004, the Commonwealth issued \$186,325,000 in General Obligation Bonds, Series 2004A to fund capital projects for educational facilities, parks and recreational facilities of the Commonwealth, a parking facility, and various institutions of higher education.

In August 2004, the Virginia Public Building Authority issued \$207,065,000 in Public Facilities Revenue Bonds, Series 2004B to finance or refinance the acquisition, construction, improvement, rehabilitation,

furnishing, and equipping of various public facilities for use by the Commonwealth and its agencies or the Commonwealth's share of various regional and local jail and juvenile detention facility projects.

In August 2004, the Virginia Public Building Authority also issued \$39,260,000 in Public Facilities Revenue Bonds, Series 2004C to refund all of certain lease revenue bonds secured and payable from a lease agreement with the Commonwealth of Virginia.

In November 2004, the Commonwealth Transportation Board issued \$321,660,000 in Transportation Revenue Refunding Bonds consisting of \$89,400,000 in Series 2004A and \$232,260,000 in Series 2004B sold for the Northern Virginia Transportation District Program and the U.S. Route 58 Corridor Development Program, respectively. Net proceeds were used to redeem a portion of the outstanding balances.

In November 2004, the Commonwealth issued \$170,530,000 in General Obligation Refunding Bonds, Series 2004B to redeem a portion of the outstanding balances.

### **Component Units**

In July 2004, the Virginia College Building Authority issued \$172,745,000 in Educational Facilities Revenue Bonds (21<sup>st</sup> Century College and Equipment Programs), Series 2004A to finance capital projects and acquire equipment at various higher education institutions.

In July 2004, the Virginia Housing Development Authority redeemed \$19,285,000 in Commonwealth Mortgage Bonds.

In July 2004, the Virginia Port Authority financed the purchase of three container cranes and four straddle carriers, with an acquisition cost of \$14.3 million, under a master lease agreement with Banc of America Leasing and Capital, LLC.

Effective July 1, 2004, the University of Virginia Investment Management Company (UVIMCO) was formed as a legally separate non-profit, non stock corporation organized under Virginia law exclusively for charitable and educational purposes and more specifically to provide investment and investment management related services to the University and the private and independent foundations and other entities affiliated with the University. The University has entered into a Deposit and Management Agreement delegating investment management responsibility for endowment and other assets to UVIMCO. Upon the occurrence of several managerial and operational objectives, the University will deposit securities and cash items with UVIMCO to be held in custody and control and in the name of UVIMCO for the benefit of the University.

In August 2004, the Virginia Housing Development Authority redeemed \$73,745,000 in Commonwealth Mortgage Bonds.

In September 2004, the Virginia Housing Development Authority sold \$56,230,000 in Rental Housing Bonds, 2004 Series F/G, and redeemed an additional \$28,010,000 in Commonwealth Mortgage Bonds.

In October 2004, the Virginia College Building Authority issued \$112,935,000 and \$103,205,000 in Public Higher Educational Financing Program Series 2004A and Series 2004B, respectively, to acquire or refinance certain Institutional Notes from various higher education institutions participating in the Public Higher Education Financing Program.

In November 2004, the Virginia Public School Authority issued \$145.3 million in School Financing Bonds (1997 Resolution), Series 2004B to purchase certain local school bonds to finance capital projects for public schools.

In December 2004, the Virginia College Building Authority issued \$61,395,000 in Educational Facilities Revenue Refunding Bonds (21st Century College Program), Series 2004B to redeem a portion of the outstanding balances.

