



GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Basic Financial Statements

September 30, 2005

(With Independent Auditors' Report Thereon)

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

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Independent Auditors' Report

The Honorable Governor of the Government of the
United States Virgin Islands:

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Government of the United States Virgin Islands (the Government), as of and for the year ended September 30, 2005, which collectively comprise the Government's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Government's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the following component units:

- The Virgin Islands Public Finance Authority (PFA), a blended component unit, which represents 100% of the assets, fund balance, and revenue of the PFA Debt Service Fund (a major fund); 100% of the assets, net assets, and revenue of the PFA Capital Projects Fund (a major fund); 100% of the assets, net assets, and revenue of the West Indian Company (a major fund); 1.29%, 1.29%, and 0.75% of the assets, net assets/fund balance, and revenue of the aggregate remaining fund information; 26.64%, 390.25%, and 18.64% of the assets, net assets, and revenue of the governmental activities; and 60.52%, 52.49%, and 23.17% of the assets, net assets, and revenue of the business-type activities, respectively.
- Virgin Islands Lottery (VI Lottery), a nonmajor enterprise fund, which represents 0.22%, 0.30%, and 3.21%, respectively, of the assets, net assets/fund balance, and revenue of the aggregate remaining fund information, and 3.73%, 8.15%, and 30.48%, respectively, of the assets, net assets, and revenue of the business-type activities.
- The Tobacco Settlement Financing Corporation, a blended component unit, which represents 0.13%, 0.16%, and 0.24%, respectively, of the assets, fund balance, and revenue of the aggregate remaining fund information, and 0.29%, 8.80%, and 0.11%, respectively, of the assets, net assets, and revenue of the governmental activities.
- The Virgin Islands Port Authority, Virgin Islands Water and Power Authority, Virgin Islands Housing Authority (VIHA), University of the Virgin Islands, Virgin Islands Public Television System, Virgin Islands Economic Development Authority (VIEDA), Magens' Bay Authority, Virgin Islands Government Hospital and Health Facilities Corporation (Roy L. Schneider Hospital and Juan F. Luis Hospital and Medical Center), and the Virgin Islands Housing Finance Authority (VIHFA), discretely presented component units, which collectively represent 100% of the assets, net assets, and revenue of the aggregate discretely presented component units.

These financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for the activities, funds, and component units indicated above, are based on the reports of the other auditors.



We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Government's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

The report of the other auditors on the 2005 financial statements of VIHFA, a discretely presented component unit, was qualified because they were unable to obtain sufficient audit evidence to determine whether land held for sale amounting to \$25.1 million was fairly stated.

The report of the other auditors on the 2005 financial statements of VIEDA, a discretely presented component unit, was qualified because they were unable to obtain sufficient audit evidence to determine whether loan receivables of \$1.7 million, other current liabilities of \$348 thousand, and other noncurrent liabilities of \$9.2 million were fairly stated.

The report of the other auditors on the 2005 financial statements of the Juan F. Luis Hospital and Medical Center, a discretely presented component unit, was qualified because they were unable to obtain sufficient audit evidence to determine whether accounts payable amounting to \$9.0 million was fairly stated.

The report of the other auditors on the 2005 financial statements of the VI Lottery, a nonmajor enterprise fund, was qualified because they were unable to obtain sufficient audit evidence to determine whether capital assets of \$215 thousand, net accounts receivables of \$1.1 million, due to the general fund of \$4.7 million, and other liabilities of \$98 thousand were fairly stated.

The basic financial statements do not include a liability for workers' compensation claims. The Government's records do not permit, nor is it practical to extend our auditing procedures sufficiently to determine the extent by which the business-type activities as of and for the year ended September 30, 2005 may have been affected by this condition.

The Employees' Retirement System of the Government of the Virgin Islands (GERS), a fiduciary component unit (pension trust fund), is recording contributions pursuant to the Early Retirement Act of 1994 as the cash is received which, in our opinion, should be accrued in order to conform with U.S. generally accepted accounting principles. If these contributions were accrued, contributions receivable and net assets held in trust for employees' pension benefits would be increased by \$6.7 million and the change in net assets would be decreased by \$600 thousand. In addition, GERS maintains its real estate investment in the GERS complex related to the portion of the St. Thomas building held for lease based on historical cost. As of September 30, 2005, this real estate investment amounted to approximately \$8.6 million. Such investment should be presented at fair value in accordance with U.S. generally accepted accounting principles. GERS has not performed a recent valuation of this real estate investment. Since fiscal year 2004, GERS has maintained its real estate investment in Havensight Mall based on historical cost less accumulated depreciation. As of September 30, 2005, the real estate investment in Havensight Mall amounted to \$60.3 million. Such investment should be presented at fair value in accordance with U.S. generally accepted accounting principles. The most recent valuation performed by GERS of its real estate investment in Havensight Mall was September 1, 2003. Finally, we were unable to obtain sufficient audit evidence about the cash overdraft balance reported by GERS with the Department of Finance of \$10.5 million in specially designated pooled accounts.



Because of the matters discussed in the sixth and seventh paragraphs of this report, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial position of the business-type activities as of September 30, 2005 and the changes in financial position for the year then ended.

In our opinion, based on our audit and the report of other auditors, except for:

- The effects of the adjustments, if any, as might have been determined to be necessary, had the other auditors been able to obtain sufficient audit evidence to determine whether 1) land held for sale amounting to \$25.1 million in the financial statements of VIHFA; 2) loan receivables of \$1.7 million, other current liabilities of \$348 thousand, and other noncurrent liabilities of \$9.2 million in the financial statements of VIEDA; and 3) accounts payable amounting to \$9.0 million in the financial statements of the Juan F. Luis Hospital and Medical Center, respectively, were fairly stated, as described in paragraphs three, four, and five above, the financial statements referred to above present fairly, in all material respects, the financial position of the aggregate discretely presented component units of the Government of the United States Virgin Islands, as of September 30, 2005, and the respective changes in financial position thereof for the year then ended in conformity with U.S. generally accepted accounting principles; and
- The effects of (i) GERS not accruing contributions pursuant to the Early Retirement Act of 1994 and not recording its real estate investments in the GERS complex related to the portion of the St. Thomas building held for lease and in Havensight Mall at fair value and (ii) the adjustments, if any, as might have been determined to be necessary, had we been able to obtain satisfactory evidence with respect to the cash overdraft of GERS with the Department of Finance, as described in paragraph eight above, the financial statements referred to above present fairly, in all material respects, the financial position of the aggregate remaining fund information of the Government of the United States Virgin Islands, as of September 30, 2005, and the respective changes in financial position thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

Finally, in our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Government of the United States Virgin Islands, as of September 30, 2005, and the respective changes in financial position and, where applicable, cash flows thereof, and the respective budgetary comparison for the general fund for the year then ended in conformity with U.S. generally accepted accounting principles.



The management's discussion and analysis on pages 5 through 14 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

January 18, 2008

Stamp No. 2221990 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2005

Introduction

The following discussion and analysis presents an overview of the financial position and activities of the Government of the United States Virgin Islands (the Government) as of and for the fiscal years ended September 30, 2005 and 2004.

Government-wide Financial Statements

The government-wide financial statements are designed to present an overall picture of the financial position of the Government. These statements consist of the statement of net assets and the statement of activities, which are prepared using the economic resources measurement focus and the accrual basis of accounting. This means that current year's revenue and expenses are included regardless of when cash is received or paid, producing a view of financial position similar to that presented by most private sector companies.

The statement of net assets combines and consolidates the Government's current financial resources with capital assets and long-term obligations.

Both of the above-mentioned financial statements have separate sections for three different types of the Government programs or activities. These three types of activities are as follows:

Governmental Activities – The activities in this section are mostly supported by taxes and intergovernmental revenue (federal grants). Most services normally associated with the primary government (PG) fall into this category, including general government, public safety, health, public housing and welfare, education, transportation and communication, and culture and recreation.

Business-Type Activities – These functions normally are intended to recover all or a significant portion of their costs through user fees and charges to external users of goods and services. These business-type activities of the Government include the operations of the (i) unemployment insurance program and (ii) the West Indian Company (WICO). Both these programs operate with minimal assistance from the governmental activities of the Government.

Discretely Presented Component Units – These are operations for which the Government has financial accountability even though they have certain independent qualities as well. For the most part, these entities operate similar to private sector businesses and the business-type activities described above. The Government's discretely presented component units are presented in two categories, major and nonmajor. This separation is determined by the relative size of the entities' assets, liabilities, revenue, and expenses in relation to the total of all component units.

As disclosed in note 1 to the financial statements, the Government adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosure, an amendment of GASBS No. 3*, during 2005.

Fund Financial Statements

Fund financial statements focus on the most significant (or major) funds of the Government. A fund is a separate accounting entity with a self-balancing set of accounts. The Government uses funds to keep track of sources of funding and spending related to specific activities. The Government uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

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A major fund is a fund whose revenue, expenditures or expenses, assets, or liabilities (excluding extraordinary items) are at least 10% of the corresponding totals for all governmental or enterprise funds and at least 5% of the aggregate amount for all governmental and enterprise funds for the same item. The general fund is always considered a major fund. In addition to funds that meet the major fund criteria, any other governmental or enterprise fund that the Government believes is particularly important to the financial statements may be reported as a major fund.

All of the funds of the Government are divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental Funds

Governmental funds are accounted for using the modified accrual basis of accounting, which measures cash and other assets that can be readily converted to cash. The governmental fund statements provide a detailed short-term view of the PG's general governmental operations and the basic services it provides. The reconciliation following the fund financial statements explains the differences between the governmental activities, reported in the government-wide financial statements, and the governmental funds' financial statements. The General Fund, the PFA Debt Service, and the PFA Capital Projects Fund are reported as major governmental funds.

The General Fund is the PG's primary operating fund. It accounts for all financial resources of the PG, except those required to be accounted for in another fund.

The PFA Debt Service accounts for the resources accumulated, and payments made, for principal and interest on long-term general obligation debt issued by the Virgin Islands Public Finance Authority (PFA) on behalf of the Government.

The PFA Capital Projects Fund accounts for bond proceeds of debt issued by the PFA on behalf of the Government. The bond proceeds have been designated for certain necessary public safety and capital development projects, which are accounted for in this fund.

Proprietary Funds

Services provided to outside (nongovernmental) customers are reported in enterprise funds. Enterprise funds are accounted for using the economic resources measurement focus and the accrual basis of accounting. These are the same business-type activities reported in the government-wide financial statements.

The unemployment insurance fund and the WICO fund are major proprietary funds.

The unemployment insurance fund is a federally mandated program to manage unemployment insurance.

The WICO fund accounts for the activities of WICO, which owns a port facility including a cruise ship pier, and manages a shopping mall and a rental complex.

Fiduciary Funds

The Government is the trustee, or fiduciary, for several agency funds.

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The fiduciary activities are reported in a separate statement of fiduciary net assets and a statement of changes in fiduciary net assets.

Financial Analysis of the Government as a Whole

The PG and its component units experienced an economic downturn following the slowdown of the U.S. economy in fiscal year 2002 and the events of September 11, 2001. As explained in note 14 to the basic financial statements, the Government initiated specific actions to improve its future cash flows through the issuance of long-term debt, the development of a series of detailed revenue enhancement and expenditure reduction initiatives, and the enactment of certain laws directed toward improving the Government's financial situation.

In fiscal year 2005, the Government issued the 2004 Series A Bonds amounting to \$94 million to fund wastewater treatment and solid waste capital projects of the PG; and the Series 2005 Subordinate Lien Revenue Notes amounting to \$6.35 million to finance the acquisition of a fleet of vehicles for the police department. In fiscal year 2004, the Government issued the 2003 Series A Revenue Bonds amounting to \$268 million to repay the bond anticipation note and to fund necessary capital projects of the PG.

Financial Analysis of the Primary Government

Total assets of the Government as of September 30, 2005 and 2004 were \$1.856 billion and \$1.564 billion, respectively, an increase of approximately \$292 million. Total liabilities as of September 30, 2005 and 2004 were \$1.993 billion and \$1.836 billion, respectively, an increase of approximately \$157 million.

For the year ended September 30, 2005, the PG net deficit of \$137 million consisted of \$247 million invested in capital assets, net of related debt; \$189 million restricted by statute or other legal requirements that were not available to finance day-to-day operations of the Government; and an unrestricted net deficit of \$573 million. For the year ended September 30, 2004, the PG net asset deficit of \$272 million consisted of \$239 million invested in capital assets, net of related debt; \$173 million restricted by statute or other legal requirements and were not available to finance day-to-day operations of the Government; and an unrestricted net deficit of \$684 million.

For the fiscal year ended September 30, 2005, the PG earned program and general revenue amounting to \$1.116 billion, and reported expenses of \$981 million, resulting in a decrease in the net deficit of \$134.8 million. For the fiscal year ended September 30, 2004, the PG earned program and general revenue amounting to \$977 million, and reported expenses of \$946 million, resulting in a decrease in the net deficit of \$31 million.

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Management's Discussion and Analysis

September 30, 2005

Overall, revenue demonstrated an increase of approximately \$139 million in fiscal year 2005, when compared to fiscal year 2004. The increase in tax revenue of \$124.6 million is primarily due to expired income tax exemptions that were not renegotiated and to the audit efforts of the Internal Revenue Bureau over income tax exemptions claimed by the taxpayers. Expenses increased in fiscal year 2005 when compared to fiscal year 2004 by \$35 million. The decrease noted in general government expenses of \$10.2 million is primarily related to the recognition of a provision for landfill closure and post closure costs in the prior year of \$28.8 million that did not occur in the current year. Excluding the provision for landfill closure and post closure costs that was recognized in the prior year, general government expenses increased by \$18.6 million in the current year primarily due to a general increase in costs due to inflation. A summary of net assets (deficit) and changes in net assets (deficit) for the PG follows:

Net Assets (Deficit) – Primary Government

September 30, 2005 and 2004

(In thousands)

	Governmental activities		Business-type activities		Total	
	2005	2004	2005	2004	2005	2004
Assets						
Current assets	\$ 1,075,307	836,161	42,021	43,833	1,117,328	879,994
Capital assets	677,530	625,530	43,823	42,693	721,353	668,223
Other assets	16,545	15,421	407	437	16,952	15,858
Total assets	1,769,382	1,477,112	86,251	86,963	1,855,633	1,564,075
Liabilities						
Long-term debt outstanding	1,143,194	1,061,655	20,545	21,376	1,163,739	1,083,031
Other liabilities	818,520	743,737	10,843	9,610	829,363	753,347
Total liabilities	1,961,714	1,805,392	31,388	30,986	1,993,102	1,836,378
Net Assets						
Invested in capital assets, net of related debt	224,141	217,677	23,278	21,318	247,419	238,995
Restricted	156,663	131,496	31,838	41,375	188,501	172,871
Unrestricted (deficit)	(573,136)	(677,453)	(253)	(6,716)	(573,389)	(684,169)
Total net assets (deficit)	\$ (192,332)	(328,280)	54,863	55,977	(137,469)	(272,303)

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Management's Discussion and Analysis

September 30, 2005

Changes in Net Assets (Deficit) – Primary Government

September 30, 2005 and 2004

(In thousands)

	Governmental activities		Business-type activities		Total	
	2005	2004	2005	2004	2005	2004
Revenue:						
Program revenue:						
Charges for services	\$ 31,110	28,932	48,895	41,294	80,005	70,226
Operating grants and contributions	162,504	151,118	—	—	162,504	151,118
Capital grants and contributions	8,459	9,553	—	—	8,459	9,553
General revenue:						
Taxes	789,122	664,510	—	—	789,122	664,510
Interest and other	72,596	77,848	2,427	2,749	75,023	80,597
Other general revenue	1,094	1,102	—	—	1,094	1,102
Total revenue	<u>1,064,885</u>	<u>933,063</u>	<u>51,322</u>	<u>44,043</u>	<u>1,116,207</u>	<u>977,106</u>
Expenses:						
General government	371,052	381,282	—	—	371,052	381,282
Public safety	54,101	55,677	—	—	54,101	55,677
Health	99,681	92,694	—	—	99,681	92,694
Public housing and welfare	67,228	62,712	—	—	67,228	62,712
Education	205,419	186,122	—	—	205,419	186,122
Transportation and communication	63,109	45,987	—	—	63,109	45,987
Culture and recreation	9,879	7,549	—	—	9,879	7,549
Interest on long-term debt	61,996	60,024	—	—	61,996	60,024
Unemployment insurance	—	—	7,568	7,117	7,568	7,117
WICO	—	—	9,763	9,926	9,763	9,926
Workmen's Compensation	—	—	9,112	8,431	9,112	8,431
V.I. lottery	—	—	10,733	11,663	10,733	11,663
Other business-type activities	—	—	11,732	17,004	11,732	17,004
Total expenses	<u>932,465</u>	<u>892,047</u>	<u>48,908</u>	<u>54,141</u>	<u>981,373</u>	<u>946,188</u>
Increase (decrease) in net assets before transfers	<u>132,420</u>	<u>41,016</u>	<u>2,414</u>	<u>(10,098)</u>	<u>134,834</u>	<u>30,918</u>
Transfers	3,528	395	(3,528)	(395)	—	—
Change in net assets	<u>135,948</u>	<u>41,411</u>	<u>(1,114)</u>	<u>(10,493)</u>	<u>134,834</u>	<u>30,918</u>
Net assets (deficit), beginning of year, as previously reported	(328,280)	(369,691)	55,977	69,608	(272,303)	(300,083)
Restatements to beginning net assets	—	—	—	(3,138)	—	(3,138)
Net assets (deficit), end of year, as restated	<u>\$ (192,332)</u>	<u>(328,280)</u>	<u>54,863</u>	<u>55,977</u>	<u>(137,469)</u>	<u>(272,303)</u>

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Management's Discussion and Analysis

September 30, 2005

The Virgin Islands Office of Management and Budget of the PG prepares an annual executive budget subject to approval by the Governor and the Legislature of the Virgin Islands. The executive budget is prepared on a budgetary basis similar to the cash basis of accounting. The executive budget includes only those funds that are subject to appropriation by law. More information regarding budgetary procedures is provided in note 3 of the basic financial statements. A summary of the budgetary report for the General Fund of the PG, included on page 19 of the financial statements, follows:

**Revenue and Expenditures – Budget and Actual –
Budgetary Basis – General Fund**

Year ended September 30, 2005

(In thousands)

	<u>Original budget</u>	<u>Amended budget</u>	<u>Actual</u>	<u>Variance</u>
Total revenue	\$ 498,654	498,654	541,954	43,300
Total expenditures	<u>571,510</u>	<u>640,377</u>	<u>575,545</u>	<u>(64,832)</u>
Excess of expenditures over revenue	(72,856)	(141,723)	(33,591)	108,132
Other financing sources (uses)	<u>72,967</u>	<u>71,767</u>	<u>90,602</u>	<u>18,835</u>
Excess (deficiency) of revenue and other financing sources (uses) over (under) expenditures	<u>\$ 111</u>	<u>(69,956)</u>	<u>57,011</u>	<u>126,967</u>

For fiscal year 2005, the PG realized a revenue variance \$43 million primarily due to an increase in tax revenues resulting from the expiration of tax exemptions of certain taxpayers resulting in an increase in the amount of taxes paid in the current year. The PG realized a \$76 million variance in general government expenditures offset by opposite expenditure variances in all other functions. The \$76 million variance in general government expenditures was primary due to the fact that the actual expenditures are reported on an accrual basis of accounting whereas budgeted expenditures is based on a cash basis. Overall, the PG realized a \$65 million variance in expenditures due to controlled spending. The PG realized a \$19 million variance in other financing sources due to the fact that transfers to the General Fund were higher than budgetary estimates.

Capital Assets

Capital assets additions during fiscal years 2005 and 2004 amounted to \$70.9 million and \$36 million, respectively for governmental activities, and \$3.3 million and \$1.6 million, respectively, for business-type activities.

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September 30, 2005

The Government's capital assets include land, land improvements, buildings, building improvements, machinery, equipment, infrastructure, and construction in progress as follows:

Capital Assets – Primary Government

(In thousands)

	Governmental activities		Business-type activities		Total	
	2005	2004	2005	2004	2005	2004
Land and improvements	\$ 188,798	188,523	5,317	5,357	194,115	193,880
Building and improvements	427,852	402,450	49,137	47,575	476,989	450,025
Machinery and equipment	93,535	78,159	4,375	3,791	97,910	81,950
Infrastructure	127,471	126,249	—	—	127,471	126,249
Construction in progress	52,461	24,578	1,757	809	54,218	25,387
Total assets	890,117	819,959	60,586	57,532	950,703	877,491
Less accumulated depreciation	(212,587)	(194,429)	(16,763)	(14,839)	(229,350)	(209,268)
Total capital assets	\$ 677,530	625,530	43,823	42,693	721,353	668,223

Note 9 provides detailed information regarding the capital assets of the PG and the component units of the Government.

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Management's Discussion and Analysis

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Debt Administration

The Government issues both general obligation bonds and revenue bonds. The Revised Organic Act [48 U.S.C. Section 1574 (b)(ii)] restricts the principal amount of general obligation debt that the Government may issue to no greater than 10% of the aggregate assessed valuation of taxable real property in the U.S. Virgin Islands. Following is a summary of bonds outstanding as of September 30, 2005:

Primary Government – Bonds Payable

(In thousands)

<u>Bonds payable</u>	<u>Final maturity</u>	<u>Interest rates (%)</u>	<u>Balance</u>
1998 Series A, C, D, and E Revenue and Refunding Bonds	2023	5.50 to 7.11	\$ 459,790
1999 Series A General Obligation Bonds	2010	6.50	4,765
1999 Series A Revenue Bonds	2033	4.20 to 6.40	278,570
2001 Series A Tobacco Bonds	2031	5.00	21,940
2002 Series Garvee Bonds	2009	2.50 to 5.00	12,940
2003 Series A Revenue Bonds	2033	4.00 to 5.25	268,020
2003 Series A Revenue Bonds	2024	4.00 to 5.25	94,000
Subtotal			1,140,025
Deferred amount on refundings			(1,848)
Bond premium			8,035
Bond discount			(8,104)
Bond accretion			(764)
Total			\$ <u>1,137,344</u>

Note 10 provides detailed information regarding all bonds of the U.S. Virgin Islands.

During fiscal year 2005, the 2004 Series A Revenue Bonds amounting to \$94 million were issued.

The PG made bond principal payments on all outstanding general and special revenue bonds amounting to \$24.4 million during fiscal year 2005, and \$24.7 million during fiscal year 2004.

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Management's Discussion and Analysis

September 30, 2005

Other liabilities of the PG include:

Primary Government – Other Liabilities

September 30, 2005 and 2004

(In millions)

	<u>2005</u>	<u>2004</u>
Accrued compensated absences	\$ 48	60
Retroactive union arbitration liability	396	384
Accrued litigation	23	15
Landfill closure and post closure costs	29	29
Accrued federal cost disallowances	6	6
Total other liabilities	<u>\$ 502</u>	<u>494</u>

Economic Condition and Outlook

The PG ended fiscal year 2005 with a deficit amounting to \$137 million, of which \$573 million relates to an unrestricted deficit. The PG is working towards a recovery from the recession of 2002 through a combination of revenue initiatives and budgetary restraint on expenditures.

Revenue Initiatives

The PG collects income tax revenue under the “mirror” income tax system. The Government’s tax laws mirror the U.S. Internal Revenue Service (IRS) code, rules, and regulations. The 2003 and 2004 Tax Acts passed by U.S. Congress may have a negative impact on revenue due to changes in sourcing of revenue rules as defined for the U.S. Virgin Islands, restrictions on residency rules, a decrease in tax rates, expanded tax credits, and expanded tax deductions. In January 2006, the U.S. Treasury issued final tax regulations for the territories and possessions defining residency and source of income. The Government has responded to these changes through meetings with the U.S. Treasury and the final regulations on residency were subsequently revised in November 2006.

In connection with a real property tax case instituted against the PG in the U.S. District Court of the Virgin Islands, the Government was enjoined for a four-month period in fiscal year 2003 from appraising and assessing any real property taxes until it modified its system of appraisal to comply with certain court mandates. As a result, effective August 2003, it has been using the 1998 assessment value to issue tax bills and collect taxes, and expects to continue to do so until a new appraisal system is implemented, which is intended to satisfy the court’s decision, or the decision is reversed on appeal. In fiscal year 2004, the Government retained a consultant to modify its system of appraisal and to comply with the court mandates. In fiscal year 2006, legislation has been introduced to Congress to move the control of property tax assessments from the federal government to the Government of the Virgin Islands.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2005

The Government is currently in litigation challenging the computation of its corporate franchise tax. Of the four cases brought against the Government, one is currently before the Virgin Islands Territorial Court, and the remaining three cases are currently on appeal.

Budgetary Control of Expenditures

The PG faces the challenge of carryforward expenditures from prior fiscal years and increasing expenditures in the current fiscal year. Carryforward expenditures consist mainly of retroactive salary increases, which accumulated following Hurricanes Hugo, Marilyn, and Bertha in the years of 1990 through 1998. At September 30, 2005 and 2004, unpaid retroactive salary increases amounted to \$396 million and \$384 million, respectively, which are reported as a liability of the Government within other noncurrent liabilities.

Current increasing governmental expenditures include increased health insurance premiums, pharmaceutical premiums, and salary expense. Expenditures are closely monitored and controlled through the budgetary process.

Deficit Reduction Measures

The PG has implemented a number of deficit reducing measures including: (i) withholding of local taxes on Government invoice payments; (ii) increasing local taxes such as the highway users tax and stamp tax; (iii) implementation of new local taxes including an excise tax on importation of personal goods and a petroleum tax; (iv) exerting greater control of expenditures through the budgetary process; and (v) implementation of tax amnesties for property and gross receipts taxes.

These initiatives have reduced the PG deficit from \$432 million for fiscal year 2002, to \$137 million for fiscal year 2005, a reduction of \$295 million.

Contacting the Government's Financial Management

This financial report is designed to provide the Government's citizens, taxpayers, customers, and investors and creditors with a general overview of the Government's finances. If you have questions about this report, or need additional financial information, contact the Government of the United States Virgin Islands, Department of Finance, No. 2314 Kronprindsens Gade, St. Thomas, VI 00802.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Net Assets (Deficit)

September 30, 2005

(In thousands)

	Primary government		Total	Component units
	Governmental activities	Business-type activities		
Assets:				
Cash and cash equivalents	\$ 248,848	10,883	259,731	63,628
Investments	499,831	840	500,671	37,387
Receivables, net	262,172	2,496	264,668	54,064
Internal balances	8,790	(8,790)	—	—
Loans and advances	—	—	—	1,588
Due from component units	30,880	—	30,880	—
Note receivable	—	—	—	8,165
Due from primary government	—	—	—	3,979
Due from federal government	23,516	—	23,516	5,884
Inventories	—	459	459	25,894
Other assets	1,270	848	2,118	25,138
Restricted:				
Cash and cash equivalents	—	35,285	35,285	38,468
Investments	—	—	—	78,269
Other	—	—	—	46
Capital assets	677,530	43,823	721,353	779,513
Deferred and other expenses	16,545	407	16,952	20,437
Total assets	1,769,382	86,251	1,855,633	1,142,460
Liabilities:				
Current liabilities:				
Accounts payable and accrued liabilities	96,091	6,412	102,503	86,744
Tax refunds payable	86,608	—	86,608	—
Unemployment insurance benefits	—	2,064	2,064	—
Customer deposits	—	—	—	17,198
Due to primary government	—	—	—	30,880
Due to component units	3,979	—	3,979	—
Due to federal government	—	—	—	5,414
Interest payable	30,979	—	30,979	5,123
Unearned revenue	96,429	—	96,429	4,819
Other current liabilities	2,286	2,367	4,653	10,053
Due within one year:				
Loans payable	2,051	851	2,902	1,024
Bonds payable	27,520	—	27,520	8,860
Other liabilities	28,081	—	28,081	—
Noncurrent liabilities:				
Due in more than one year:				
Loans payable	3,799	19,694	23,493	8,070
Bonds payable	1,109,824	—	1,109,824	274,825
Other liabilities	474,067	—	474,067	28,941
Total liabilities	1,961,714	31,388	1,993,102	481,951

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Net Assets (Deficit)

September 30, 2005

(In thousands)

	Primary government		Total	Component units
	Governmental activities	Business-type activities		
Net assets:				
Invested in capital assets, net of related debt	\$ 224,141	23,278	247,419	546,537
Restricted for:				
Unemployment insurance	—	30,046	30,046	—
Debt service	156,663	—	156,663	—
Other purposes	—	1,792	1,792	88,128
Unrestricted (deficit)	<u>(573,136)</u>	<u>(253)</u>	<u>(573,389)</u>	<u>25,844</u>
Total net assets (deficit)	\$ <u>(192,332)</u>	<u>54,863</u>	<u>(137,469)</u>	<u>660,509</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Activities

Year ended September 30, 2005

(In thousands)

	Expenses	Program revenue		Net revenue (expense) and changes in net assets		Component units	
		Charges for services	Operating grants and contributions	Capital grants and contributions	Primary government		
					Governmental activities		Business-type activities
\$							
Functions:							
Primary government:							
Governmental activities:							
General government	371,052	26,958	42,864	—	(301,230)	(301,230)	
Public safety	54,101	721	12,716	—	(40,664)	(40,664)	
Health	99,681	254	24,656	—	(74,771)	(74,771)	
Public housing and welfare	67,228	1,141	46,273	—	(19,814)	(19,814)	
Education	205,419	—	34,852	—	(170,567)	(170,567)	
Transportation and communication	63,109	2,021	8,459	—	(51,776)	(51,776)	
Culture and recreation	9,879	15	290	—	(9,574)	(9,574)	
Interest on long-term debt	61,996	—	—	—	(61,996)	(61,996)	
Total governmental activities	932,465	31,110	162,504	8,459	(730,392)	(730,392)	
Business-type activities:							
Unemployment insurance	7,568	1,898	—	—	(5,670)	(5,670)	
West Indian Company	9,763	11,358	—	—	1,595	1,595	
Workmen's compensation	9,112	7,828	—	—	(1,284)	(1,284)	
V.I. lottery	10,733	15,645	—	—	4,912	4,912	
Other	11,732	12,166	—	—	434	434	
Total business-type activities	48,908	48,895	—	—	(13)	(13)	
Total primary government	981,373	80,005	162,504	8,459	(730,392)	(730,405)	
Component units:							
Virgin Islands Housing Authority	46,136	5,121	31,426	4,213	—	(5,376)	
Virgin Islands Port Authority	45,660	37,375	—	7,219	—	(1,066)	
Virgin Islands Water and Power Authority:							
Electric system	165,887	169,631	—	996	—	4,740	
Water system	26,817	28,284	—	958	—	2,425	
Hospital and Health Facilities Corporation:							
Roy L. Schneider Hospital	69,613	44,232	20,235	12,672	—	7,526	
Juan F. Luis Hospital	53,484	26,962	17,481	4,225	—	(4,816)	
University of the Virgin Islands	66,223	14,449	40,256	3,192	—	(8,326)	
Other component units	12,830	3,359	6,435	1,270	—	(1,766)	
Total component units	486,650	329,413	115,833	34,745	—	(6,659)	

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Activities

Year ended September 30, 2005

(In thousands)

	Net revenue (expense) and changes in net assets			Component units
	Governmental activities	Business-type activities	Total	
Total primary government and component units	\$ (730,392)	(13)	(730,405)	(6,659)
General revenue:				
Taxes	789,122	—	789,122	—
Interest and other	72,596	2,427	75,023	10,739
Tobacco settlement rights	1,094	—	1,094	—
Transfers – internal activities of primary government	3,528	(3,528)	—	—
Total general revenue and transfers	866,340	(1,101)	865,239	10,739
Changes in net assets (deficit)	135,948	(1,114)	134,834	4,080
Net assets (deficit), beginning of year (as restated)	(328,280)	55,977	(272,303)	656,429
Net assets (deficit), end of year	\$ (192,332)	\$ 54,863	\$ (137,469)	\$ 660,509

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Balance Sheet – Governmental Funds

September 30, 2005

(In thousands)

Assets	General	PFA debt service	PFA capital projects	Other governmental	Total governmental
Cash and cash equivalents	\$ 171,280	—	43,984	33,584	248,848
Investments	141,438	174,791	171,949	11,653	499,831
Receivables:					
Taxes	206,189	55,157	—	—	261,346
Accrued interest and other	689	—	—	547	1,236
Due from:					
Other funds	9,063	—	313	12,038	21,414
Component units	30,880	—	—	—	30,880
Federal government	—	—	—	23,516	23,516
Other assets	—	—	—	34	34
Total assets	\$ 559,539	229,948	216,246	81,372	1,087,105
Liabilities and Fund Balances					
Accounts payable and accrued liabilities	\$ 65,501	18	2,833	27,739	96,091
Tax refunds payable	86,608	—	—	—	86,608
Due to:					
Other funds	9,446	—	—	3,178	12,624
Component units	3,979	—	—	—	3,979
Deferred revenue	213,903	92,517	5,548	5,219	317,187
Other current liabilities	—	—	—	2,286	2,286
Total liabilities	379,437	92,535	8,381	38,422	518,775
Fund balances reserved for:					
Encumbrances	49,430	—	—	—	49,430
Debt service	—	137,413	—	19,250	156,663
Unreserved fund balance, reported in:					
General fund	130,672	—	—	—	130,672
Special revenue funds	—	—	—	29,495	29,495
Capital projects funds	—	—	207,865	(5,795)	202,070
Total fund balances	180,102	137,413	207,865	42,950	568,330
Total liabilities and fund balances	\$ 559,539	229,948	216,246	81,372	
Amounts reported for governmental activities in the statement of net assets (deficit) are different because:					
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.					677,530
Bond issue costs are not financial resources and, therefore, are not reported in the funds.					16,545
Because the focus of governmental funds is on short-term financing, some assets, primarily taxes receivable, will not be available to pay for current period expenditures. Those assets are offset by deferred revenue in the funds.					221,584
Interest on long-term debt is not accrued in the funds, but rather is recognized as an expenditure when due.					(30,979)
Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds.					(1,645,342)
Deficit of governmental activities					\$ (192,332)

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Revenue, Expenditures, and Changes in Fund Balances – Governmental Funds

Year ended September 30, 2005

(In thousands)

	<u>General</u>	<u>PFA debt service</u>	<u>PFA capital projects</u>	<u>Other governmental</u>	<u>Total governmental</u>
Revenue:					
Taxes	\$ 533,141	169,077	—	18,445	720,663
Federal grants and contributions	—	3,648	—	167,315	170,963
Charges for services	22,883	—	—	8,227	31,110
Tobacco settlement rights	—	—	—	1,094	1,094
Interest and other	30,646	10,935	11,531	19,484	72,596
Total revenue	<u>586,670</u>	<u>183,660</u>	<u>11,531</u>	<u>214,565</u>	<u>996,426</u>
Expenditures:					
Current:					
General government	278,554	—	1,574	78,359	358,487
Public safety	41,563	—	—	10,967	52,530
Health	75,486	—	5,181	15,641	96,308
Public housing and welfare	31,230	—	1,218	34,780	67,228
Education	151,303	—	—	48,372	199,675
Transportation and communication	34,618	—	4,162	19,793	58,573
Culture and recreation	6,282	—	—	3,326	9,608
Capital outlays	5,849	—	37,846	27,222	70,917
Debt service:					
Principal	—	21,620	500	2,805	24,925
Interest	—	59,044	—	1,106	60,150
Bond issuance costs	—	2,050	—	—	2,050
Total expenditures	<u>624,885</u>	<u>82,714</u>	<u>50,481</u>	<u>242,371</u>	<u>1,000,451</u>
Excess (deficiency) of revenue over (under) expenditures	<u>(38,215)</u>	<u>100,946</u>	<u>(38,950)</u>	<u>(27,806)</u>	<u>(4,025)</u>
Other financing sources (uses):					
Bonds issued	—	5,000	89,000	—	94,000
Loans issued	—	—	6,350	—	6,350
Transfers from other funds	97,542	1,420	—	10,392	109,354
Transfers to other funds	(6,940)	(88,317)	(569)	(10,000)	(105,826)
Premium on bonds issued	—	4,765	—	—	4,765
Total other financing sources (uses), net	<u>90,602</u>	<u>(77,132)</u>	<u>94,781</u>	<u>392</u>	<u>108,643</u>
Net change in fund balances	52,387	23,814	55,831	(27,414)	104,618
Fund balance, beginning of year	<u>127,715</u>	<u>113,599</u>	<u>152,034</u>	<u>70,364</u>	<u>463,712</u>
Fund balance, end of year	<u>\$ 180,102</u>	<u>137,413</u>	<u>207,865</u>	<u>42,950</u>	<u>568,330</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

**Reconciliation of the Statement of Revenue, Expenditures, and Changes in
Fund Balances to the Statement of Activities – Governmental Funds**

Year ended September 30, 2005

(In thousands)

Net change in fund balances – total governmental funds	\$ 104,618
Government funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.	52,000
Tax revenue in the statement of activities, which do not provide current financial resources, are not reported as revenue in the funds.	68,459
The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of the governmental funds. These transactions have no effect on net assets. This is the amount by which bond and loan proceeds of \$100,350 exceeded principal retirement of \$24,925 in the current period.	(75,425)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. This is the amount by which the increase in certain liabilities reported in the statement of net assets of the previous year increased expenses reported in the statement of activities that do not require the use of current financial resources.	(6,868)
Bond issue costs are expended in the governmental funds when paid, and are capitalized and amortized in the statement of activities. This is the amount by which current year bond issue costs exceeded amortization expense in the current period.	1,124
Bond premiums and discounts are reported as other financing sources and uses in the governmental funds when the bonds are issued, and are capitalized and amortized in the government-wide financial statements. This amount represents the capitalization of premiums on bonds issued during the current year of \$4,765 and the additional net interest expense of \$1,349 reported in the statement of activities related to the amortization of premiums, discounts deferred refunding loss, and accreted interest on capital appreciation bonds during the current year.	(6,114)
Certain interest reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. This amount represents the increase in interest payable reported in the statement of net assets.	<u>(1,846)</u>
Change in net assets of governmental activities	<u>\$ 135,948</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Revenue and Expenditures – Budget and Actual –
Budgetary Basis – General Fund

Year ended September 30, 2005

(In thousands)

	<u>Original budget</u>	<u>Amended budget</u>	<u>Actual</u>	<u>Variance</u>
Revenue:				
Taxes	\$ 470,006	470,006	511,247	41,241
Charges for services	9,146	9,146	9,193	47
Interest and other	<u>19,502</u>	<u>19,502</u>	<u>21,514</u>	<u>2,012</u>
Total revenue	<u>498,654</u>	<u>498,654</u>	<u>541,954</u>	<u>43,300</u>
Expenditures:				
Current:				
General government	148,240	176,806	252,470	(75,664)
Public safety	58,572	58,797	40,713	18,084
Health	54,118	86,843	70,581	16,262
Public housing and welfare	43,850	45,850	31,043	14,807
Education	200,123	200,573	145,253	55,320
Transportation and communication	46,657	51,168	33,597	17,571
Culture and recreation	<u>19,950</u>	<u>20,340</u>	<u>1,888</u>	<u>18,452</u>
Total expenditures	<u>571,510</u>	<u>640,377</u>	<u>575,545</u>	<u>64,832</u>
Excess of expenditures over revenue	<u>(72,856)</u>	<u>(141,723)</u>	<u>(33,591)</u>	<u>108,132</u>
Other financing sources (uses):				
Transfers from other funds	79,467	79,467	97,542	18,075
Transfer to other funds	<u>(6,500)</u>	<u>(7,700)</u>	<u>(6,940)</u>	<u>760</u>
Total other financing sources (uses), net	<u>72,967</u>	<u>71,767</u>	<u>90,602</u>	<u>18,835</u>
Excess (deficiency) of revenue and other financing sources over (under) expenditures	\$ <u>111</u>	<u>(69,956)</u>	<u>57,011</u>	<u>126,967</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Net Assets – Proprietary Funds

September 30, 2005

(In thousands)

	Business-type activities – enterprise funds			
	Unemployment insurance	West Indian Company	Other	Totals
Assets:				
Current assets:				
Cash and cash equivalents	\$ 21	6,132	4,730	10,883
Investments at fair value	—	840	—	840
Receivables, net:				
Premiums receivable	822	—	—	822
Accrued interest and other	—	456	60	516
Other receivables	—	—	1,158	1,158
Due from other funds	—	—	300	300
Inventories and other current assets	—	—	459	459
Other assets	—	798	50	848
Total current assets	843	8,226	6,757	15,826
Noncurrent assets:				
Restricted cash and cash equivalents	33,493	1,792	—	35,285
Capital assets	—	35,480	8,343	43,823
Deferred expenses	—	407	—	407
Total noncurrent assets	33,493	37,679	8,343	79,515
Total assets	34,336	45,905	15,100	95,341
Liabilities:				
Current liabilities:				
Accounts payable and accrued liabilities	—	1,837	4,575	6,412
Due to other funds	—	1,000	8,090	9,090
Unemployment insurance benefits	2,064	—	—	2,064
Unearned revenue	2,226	—	141	2,367
Loans payable related to capital assets	—	851	—	851
Total current liabilities	4,290	3,688	12,806	20,784
Noncurrent liabilities:				
Loans payable related to capital assets	—	19,694	—	19,694
Total liabilities	4,290	23,382	12,806	40,478
Net assets:				
Invested in capital assets, net of related debt	—	14,935	8,343	23,278
Restricted	30,046	1,792	—	31,838
Unrestricted (deficit)	—	5,796	(6,049)	(253)
Total net assets	\$ 30,046	22,523	2,294	54,863

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS
Statement of Revenue, Expenses, and Changes in Fund Net Assets – Proprietary Funds
Year ended September 30, 2005
(In thousands)

	Business-type activities – enterprise funds			
	Unemployment insurance	West Indian Company	Other	Total
Operating revenue:				
Charges for services	\$ 1,898	11,358	35,639	48,895
Total operating revenue	<u>1,898</u>	<u>11,358</u>	<u>35,639</u>	<u>48,895</u>
Operating expenses:				
Cost of services	7,568	7,341	31,007	45,916
Depreciation and amortization	—	1,475	570	2,045
Total operating expenses	<u>7,568</u>	<u>8,816</u>	<u>31,577</u>	<u>47,961</u>
Operating income (loss)	<u>(5,670)</u>	<u>2,542</u>	<u>4,062</u>	<u>934</u>
Nonoperating revenue (expenses):				
Interest income	1,876	147	404	2,427
Interest expense	—	(947)	—	(947)
Total nonoperating revenue (expenses), net	<u>1,876</u>	<u>(800)</u>	<u>404</u>	<u>1,480</u>
Income (loss) before operating transfers	<u>(3,794)</u>	<u>1,742</u>	<u>4,466</u>	<u>2,414</u>
Transfers from other funds	—	—	550	550
Transfers to other funds	—	(1,000)	(3,078)	(4,078)
Change in net assets	<u>(3,794)</u>	<u>742</u>	<u>1,938</u>	<u>(1,114)</u>
Net assets, beginning of year	<u>33,840</u>	<u>21,781</u>	<u>356</u>	<u>55,977</u>
Net assets, end of year	<u>\$ 30,046</u>	<u>22,523</u>	<u>2,294</u>	<u>54,863</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Cash Flows – Proprietary Funds

Year ended September 30, 2005

(In thousands)

	Business-type activities – enterprise funds			
	Unemployment insurance	West Indian Company	Other	Total
Cash flows from operating activities:				
Receipts from customers and users	\$ 2,209	12,008	35,687	49,904
Payments to beneficiaries	(7,248)	—	—	(7,248)
Payments to suppliers and employees	—	(6,494)	(31,093)	(37,587)
Net cash provided by (used in) operating activities	(5,039)	5,514	4,594	5,069
Cash flows from noncapital financing activities:				
Transfer from other funds	—	—	550	550
Transfers to other funds	—	(1,000)	(1,287)	(2,287)
Net cash provided by (used in) noncapital financing activities	—	(1,000)	(737)	(1,737)
Cash flows from capital and related financing activities:				
Acquisition and construction of capital assets	—	(1,334)	(1,841)	(3,175)
Principal paid on long-term debt	—	(831)	—	(831)
Interest paid on long-term debt	—	(947)	—	(947)
Net cash used in capital and related financing activities	—	(3,112)	(1,841)	(4,953)
Cash flows from investing activities:				
Interest and dividends on investments	1,876	147	404	2,427
Purchase of investments	—	(840)	—	(840)
Net cash provided by (used in) investing activities	1,876	(693)	404	1,587
Net increase (decrease) in cash and cash equivalents	(3,163)	709	2,420	(34)
Cash and cash equivalents – beginning of year	36,677	7,215	2,310	46,202
Cash and cash equivalents – end of year	\$ 33,514	7,924	4,730	46,168
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:				
Operating income (loss)	\$ (5,670)	2,542	4,062	934
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:				
Depreciation expense	—	1,475	570	2,045
Change in assets and liabilities:				
Receivables, net	314	635	(93)	856
Deferred charges	—	30	—	30
Other assets	—	(15)	(14)	(29)
Accounts payable and accrued expenses	320	847	(72)	1,095
Unearned revenue	(3)	—	141	138
Net cash provided by (used in) operating activities	\$ (5,039)	5,514	4,594	5,069
Reconciliation of cash and cash equivalents to the statement of net assets:				
Cash and cash equivalents – current	\$ 21	6,132	4,730	10,883
Cash and cash equivalents – restricted	33,493	1,792	—	35,285
Cash and cash equivalents at end of year on statement of cash flows	\$ 33,514	7,924	4,730	46,168

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Fiduciary Net Assets – Fiduciary Funds

September 30, 2005

(In thousands)

	Pension trust funds	Agency funds
	<hr/>	<hr/>
Assets:		
Cash and cash equivalents:		
Unrestricted	\$ 100,673	4,193
Restricted	78	—
Investments	1,491,192	4,156
Receivables, net:		
Loans and advances	111,434	—
Accrued interest	5,078	—
Other	9,176	—
Other assets	6,251	—
	<hr/>	<hr/>
Total assets	1,723,882	8,349
	<hr/>	<hr/>
Liabilities:		
Accounts payable and accrued liabilities	—	8,349
Cash overdraft with the Department of Finance	10,454	—
Cash overdraft with bank	422	—
Unsettled securities purchased	40,784	—
Securities lending collateral	221,849	—
Notes payable	10,000	—
Other liabilities	5,740	—
	<hr/>	<hr/>
Total liabilities	289,249	8,349
	<hr/>	<hr/>
Net assets held in trust for employees' pension benefits	\$ 1,434,633	—
	<hr/> <hr/>	<hr/> <hr/>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Changes in Fiduciary Net Assets

Year ended September 30, 2005

(In thousands)

	<u>Pension trust funds</u>
Additions:	
Contributions:	
Employer	\$ 51,542
Plan members	30,416
Total contributions	<u>81,958</u>
Investment income:	
Net appreciation of fair value of investments	119,001
Interest, dividends, and other, net	45,072
Real estate – rental income	3,469
	<u>167,542</u>
Less investment expense	12,548
Net investment income	<u>154,994</u>
Other income	422
Total additions	<u>237,374</u>
Deductions:	
Benefits paid	141,383
Refunds of contributions	2,376
Administrative and operational expenses	9,288
Total deductions	<u>153,047</u>
Change in net assets	84,327
Net assets, beginning of year	<u>1,350,306</u>
Net assets, end of year	<u><u>\$ 1,434,633</u></u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2005

(1) Summary of Significant Accounting Policies

The Government of the United States Virgin Islands (the Government) is an unincorporated organized territory of the United States of America (United States). The powers of the Government are derived from and set forth in the Revised Organic Act of 1954, as amended. The Government assumes responsibility for public safety, health, public housing and welfare, education, transportation and communication, and culture and recreation.

The accompanying basic financial statements of the Government have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

The accompanying basic financial statements have been prepared primarily from accounts maintained by the Department of Finance of the Government. Additional data has been derived from reports prepared by other departments, agencies, and public corporations based on independent or subsidiary accounting systems maintained by them.

(a) *Financial Reporting Entity*

The Government follows the provisions of GASB Statement No. 14, *The Financial Reporting Entity*, as amended by GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. These standards require that the Government's financial reporting entity be defined according to specific criteria. According to the standard for financial reporting purposes, the Government is a primary government (PG). The PG includes all Government departments, agencies, boards, and organizations that are not legally separate. In addition to the PG, the financial reporting entity includes blended and discretely presented component units. Component units include all legally separate organizations for which the Government's elected officials are financially accountable, and other organizations for which the nature and significance of their relationship with the Government are such that exclusion would cause the basic financial statements to be misleading or incomplete. The criteria used to define financial accountability include appointment of a voting majority of an organization's governing body and (i) the ability of the PG to impose its will on that organization or (ii) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the PG. The financial statements of the following component units are included in the financial reporting entity either as blended or as discretely presented component units in accordance with GAAP.

(i) **Blended Component Units**

The following public benefit corporations, while legally separate from the Government, meet the criteria to be reported as part of the PG because they provide services entirely or almost entirely to the Government:

Virgin Islands Public Finance Authority

The Virgin Islands Public Finance Authority (PFA) was created as a public corporation and autonomous governmental instrumentality by Act No. 5365, the Government Capital Improvement Act of 1988, with the purpose of aiding the Government in the performance of its fiscal duties and in effectively carrying out its governmental responsibility of raising capital

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2005

for essential public projects. Under the enabling legislation, PFA has the power, among other matters, to borrow money and issue bonds and to lend the proceeds of its bonds to the Government or any governmental instrumentality. The powers of PFA are exercised by a board of directors consisting of the Governor (Chairperson), the Commissioner of Finance, the Director of the Office of Management and Budget, and two representatives of the private sector appointed by the Governor with the advice and consent of the Legislature. PFA activities are blended within the PG because it is so intertwined with the Government that, in substance, they are the same.

PFA has a component unit, the West Indian Company (WICO), which is presented as an enterprise fund in the Government's basic financial statements as further described in note 1(d).

Tobacco Settlement Financing Corporation

The Tobacco Settlement Financing Corporation (TSFC) was created in September 2001 under Act No. 6428 as a separate and independent corporation of the Government to purchase the rights, title, and interest in tobacco settlement litigation awards and to issue revenue bonds supported by the tobacco settlement rights. The responsibility for the operations of TSFC is vested in a board of directors composed of three Government officials appointed by the Governor and two private citizens. The activities of TSFC are limited to activities conducted on behalf of the Government.

Complete audited financial statements of the PFA and TSFC blended component units can be obtained directly by contacting their respective administrative offices:

Administrative Offices of Blended Component Units

Virgin Islands Public Finance Authority
2400 Honduras, 2nd Floor
St. Thomas, VI 00802

Tobacco Settlement Financing Corporation
2400 Honduras, 2nd Floor
St. Thomas, VI 00802

(ii) Discretely Presented Component Units

The following component units, consistent with GASB Statements No. 14 and 39, are discretely presented in the basic financial statements because of the nature of the services they provide and the Government's ability to impose its will. The component units are reported in a separate column to emphasize that they are legally separate from the PG and governed by separate boards.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2005

(iii) Major Component Units

Virgin Islands Housing Authority

The Virgin Islands Housing Authority (VIHA) was created as a body corporate and politic constituting a public corporation and autonomous governmental instrumentality by Act No. 903 on June 18, 1962 with the purpose of providing housing for low-income families. Up until August 2003, the powers of VIHA were exercised by a board of commissioners consisting of seven members as follows: the Commissioner of Housing and Community Renewal and six other members appointed by the Governor. In August 2003, the U.S. Department of Housing and Urban Development (HUD) determined that because of the severity of compliance violations, VIHA was declared to be in substantial default of its annual contributions contract (ACC) dated July 12, 1996 with HUD. The VIHA was placed in receivership and HUD assumed possession of all assets, projects, and programs.

Given the nature of VIHA's operations and the significance of its relationship with the Government, management believes that its exclusion from the financial reporting entity would cause the Government's basic financial statements to be incomplete and misleading. Accordingly, VIHA continues to be reported as a major component unit of the Government even though the Government no longer appoints its commissioners.

Virgin Islands Port Authority

The Virgin Islands Port Authority (VIPA) was created as a body corporate and politic constituting a public corporation and autonomous government instrumentality by Act No. 2375 of December 23, 1968, with the purposes of owning, operating, and managing all types of air and marine terminals. The powers of VIPA are exercised by a board of governors consisting of the Commissioner of Economic Development and Agriculture (Chairperson), the Attorney General, the Commissioner of Public Works, the Director of the Small Business Development Agency, and five other persons appointed by the Governor with the advice and consent of the Legislature.

Virgin Islands Water and Power Authority

The Virgin Islands Water and Power Authority (WAPA) was created as a body corporate and politic constituting a public corporation and autonomous governmental instrumentality by Act No. 1248 of August 13, 1964, with the purpose of operating the water production and electric generation plants in the U.S. Virgin Islands. The powers of WAPA are exercised by a governing board consisting of nine members, all appointed by the Governor with the advice and consent of the Legislature, from which three are heads of cabinet-level executive departments or agencies and six other persons, who shall not be employees of the Government. WAPA is required by its bond resolutions to maintain separate audited financial statements for each system (the Electric and Water Systems).

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2005

Virgin Islands Government Hospital and Health Facilities Corporation

The Virgin Islands Government Hospital and Health Facilities Corporation (VIGHHFC) was created by Act No. 6012 on August 23, 1994 and became active on May 1, 1999. Its purpose is to provide healthcare services and hospital facilities to the people of the U. S. Virgin Islands. The powers of VIGHHFC are exercised by a board of directors consisting of 15 members as follows: the Director of the Office of Management and Budget, the Commissioner of Finance, and 13 other members appointed by the Governor with the advice and consent of the Legislature. The VIGHHFC is composed of the Roy L. Schneider Hospital located in St. Thomas, and the Juan F. Luis Hospital and Medical Center located in St. Croix. Both entities issue separate audited financial statements. The Roy L. Schneider Hospital's financial statements include its component units: the Myra Keating Smith Community Health Center (Health Center) of St. John, and the Charlotte Kimelman Cancer Institute (Cancer Institute) on St. Thomas. The Health Center and Cancer Institute are legally separate organizations for which the hospital is financially accountable. The Cancer Institute was under construction as of September 30, 2005.

University of the Virgin Islands

The University of the Virgin Islands (the University) was organized as an instrumentality of the Government under Act No. 852 of March 16, 1962, in accordance with Section 16(a) of the Revised Organic Act of 1954, as amended. The purpose of the University is the stimulation and utilization of the intellectual resources of the people of the U.S. Virgin Islands and the development of a center of higher education. The powers of the University are exercised by a board of trustees consisting of 17 members as follows: Chairman of the Board of Education, Commissioner of Education, and the President of the University, all serving as members ex-officio, nine other members appointed by the Governor with the advice and consent of the Legislature, two other members elected by the board of trustees, one representative of the student body, one alumnus of the University, and another of the teaching faculty. The University was not organized as a self-sustaining entity and therefore receives substantial financial and other support from the Government.

The University's financial statements include its component units: The Foundation for the University of the Virgin Islands, The Reichhold Foundation, and the University of the Virgin Islands Research and Technology Park. The Foundation for the University of the Virgin Islands is a not-for-profit corporation whose purpose is to assist and support the University in accomplishing its charitable and educational mission. The Reichhold Foundation is a not-for-profit corporation that supports the arts and provides financial assistance in operating the Reichhold Center for the Arts on St. Thomas. The University of the Virgin Islands Research and Technology Park is a nontaxable public corporation developed to promote economic growth, development, and diversification in the Virgin Islands.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2005

(iv) Nonmajor Component Units

Virgin Islands Economic Development Authority

The Virgin Islands Economic Development Authority (EDA) was created by Act No. 6390 of December 21, 2000 as a body corporate and politic constituting a public corporation and semiautonomous instrumentality of the Government. EDA was created as an umbrella authority to assume, integrate, and unify the functions of the Economic Development Commission, the Small Business Development Administration, the Government Development Bank, and the Virgin Islands Industrial Development Park Corporation. The powers of EDA are exercised by a board of directors consisting of the members of the Virgin Islands Economic Development Commission, the Director of the Virgin Islands' Bureau of Internal Revenue, and five members not employed by the Government, but appointed by the Governor with the advice and consent of the Legislature.

Magens' Bay Authority

Magens' Bay Authority (MBA) was created as a corporate instrumentality by Act No. 2085 on December 20, 1967, with the purpose of acquiring, improving, and operating parks and beaches. The powers of MBA are exercised by a board of directors consisting of the Governor and six members initially appointed by the Governor. The board of directors is responsible for the appointment and reappointment of subsequent board members except that the Governor, with the advice and consent of the Legislature may, by appointment, fill any vacancy on the board of directors remaining unfilled for sixty days.

Virgin Islands Housing Finance Authority

The Virgin Islands Housing Finance Authority (VIHFA) was created as a body corporate and politic constituting a public corporation and autonomous governmental instrumentality of the Government by Act No. 4636 of October 20, 1981, with the purpose of stimulating low- and moderate-income housing construction and home ownership through the issuance of revenue bonds to obtain funds to be used for low-interest mortgage loans to qualified purchasers of low- and moderate-income housing. The powers of VIHFA are exercised by a board of directors consisting of the Commissioner of the Department of Housing, Parks, and Recreation (the Chairman), the Director of the Office of Management and Budget, and three persons not employed by the Government appointed by the Governor with advice and consent of the Legislature.

Virgin Islands Public Television System

The Virgin Islands Public Television System (PTS) was created as a body corporate and politic constituting a public corporation and autonomous instrumentality by Act No. 2364 on November 15, 1968, with the purpose of advancing the general welfare, education, cultural development, and awareness of public affairs of all the population of the U.S. Virgin Islands and to provide an effective supplement to the in-school education of children. The powers of PTS are exercised by a board of directors consisting of the Commissioner of Education, the Chairman of the Board of Education, three members appointed by the President of the Legislature, and four members, not more than two of whom should be employed by the

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2005

Government and appointed by the Governor with the advice and consent of the Legislature. In addition, the Director of the Office of Management and Budget, the President of the University of the Virgin Islands, and the General Manager of PTS are ex-officio members of the board who are not entitled to vote.

Complete audited financial statements of the discretely presented component units can be obtained directly by contacting their administrative offices:

Administrative Offices of Discretely Presented Component Units

Virgin Islands Housing Authority
402 Estate Anna's Retreat
PO Box 7668
St. Thomas, VI 00801

Virgin Islands Port Authority
PO Box 301707
St. Thomas, VI 00803

Virgin Islands Water and Power Authority
PO Box 1450
St. Thomas, VI 00804

Virgin Islands Government Hospital and Health Facilities Corporation
9048 Sugar Estate
St. Thomas, VI 00802

University of the Virgin Islands
2 John Brewer's Bay
St. Thomas, VI 00802

Virgin Islands Economic Development Authority
1050 Norre Gade #5
St. Thomas, VI 00802

Magens' Bay Authority
PO Box 10583
St. Thomas, VI 00802

Virgin Islands Housing Finance Authority
3202 Demarara
Frenchtown Plaza, Suite 200
St. Thomas, VI 00802

Virgin Islands Public Television System
PO Box 7879
St. Thomas, VI 00801

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Notes to Basic Financial Statements

September 30, 2005

All financial statements of the discretely presented component units have a fiscal year-end of September 30, 2005, except for WAPA and VIHA that have a year-end of June 30, 2005 and December 31, 2004, respectively.

(v) Fiduciary Component Units

The following public benefit corporation is legally separate from the Government, meets the definition of a blended component unit, and is presented in the fund financial statements along with other fiduciary funds of the Government. Fiduciary funds are not reported in the government-wide financial statements.

Employees' Retirement System of the Government of the Virgin Islands

The Employees' Retirement System of the Government of the Virgin Islands (known as GERS) was created as an independent and separate agency of the Government with the purpose of administering the Government's defined benefit pension plan established on October 1, 1959. Component units of the Government also participate in the cost sharing, multiple employer defined benefit plan. The responsibility for the proper operation of GERS is vested in a board of trustees composed of seven members appointed by the Governor with the advice and consent of the Legislature.

Employee and employer contributions to GERS are recognized as additions to net assets held in trust for employees' pension benefits in the period in which employee services are performed, except for contributions pursuant to the Early Retirement Act of 1994, which are recorded as the cash is received. Benefits and refunds are recognized when due and payable in accordance with the terms at the plan, except for benefits pursuant to sections 8(a) and 8(b) of the Early Retirement Act of 1994, which are recorded when the subsidy provided by the Government is receivable and payable.

Complete audited financial statements of this component unit can be obtained directly by contacting their administrative office:

Employees' Retirement System of the Government of the Virgin Islands
3438 Kronprindsens Gade
St. Thomas, VI 00802

(b) Government-Wide and Fund Financial Statements

The government-wide financial statements (that is, the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the PG and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenue, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the PG is reported separately from certain legally separate component units for which the PG is financially accountable. The statement of net assets (deficit) presents the reporting entities' nonfiduciary assets and liabilities, with the difference reported as net assets.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2005

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenue. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenue includes (i) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (ii) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenue are reported instead as general revenue.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

(c) *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 accrual basis of accounting. Revenue is recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements 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. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available when it is collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Government considers most revenue to be available if collected within 90 days of the end of the current fiscal year-end. Specifically, gross receipts taxes, property taxes, and income taxes are considered to be available if collected within 30, 60, and 90 days, respectively, after the end of the current fiscal year-end. Grant revenue is considered to be available if collected within the 12 months after the end of the current fiscal year-end. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when payment is due.

Income taxes, gross receipts taxes, real property taxes, and grant funding are all considered to be susceptible to accrual and so have been recognized as revenue of the current fiscal period to the extent they are considered available. All other revenue items are considered to be measurable and available only when cash is received by the Government.

Proprietary Funds, Fiduciary Funds, and Discretely Presented Component Units Financial Statements – The financial statements of the proprietary funds, fiduciary funds, and discretely presented component units are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide financial statements described above.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2005

Each proprietary fund has the option under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, to elect and apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless these conflict with a GASB pronouncement. The PG and most blended and discretely presented component units have elected not to apply FASB pronouncements issued after November 30, 1989 for its proprietary fund types. VIPA has elected to follow the FASB's pronouncements issued after November 30, 1989.

Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations.

(d) Fund Accounting

The Government reports its financial position and results of operations in funds, which are considered separate accounting entities and discrete presentations of those component units, which are not required to be blended. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions. GASB No. 34, *Basic Financial Statements – and Management's Discussions and Analysis – for State and Local Governments*, establishes criteria (percentage of the assets, liabilities, revenue, or expenditures/expenses of either fund category or the governmental and enterprise funds combined) for the determination of major funds. Indirect costs are automatically allocated and reported in the program expense for each fund. Nonmajor funds are combined in a single column in the fund financial statements. The Government reports the following major funds:

Governmental Funds

The Government reports the following major governmental funds:

- **General Fund** – The General Fund is the government's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.
- **PFA Debt Service** – The PFA Debt Service accounts for the resources accumulated, and payments made, for principal and interest on long-term general obligation debt issued by PFA on behalf of the Government.
- **PFA Capital Projects Fund** – The PFA Capital Projects Fund accounts for bond proceeds of debt issued by the PFA on behalf of the Government. The bond proceeds have been designated for certain necessary public safety and capital development projects, which are accounted for in this fund.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2005

Proprietary Funds

These funds account for those activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to the general public. The government reports the following major proprietary funds:

- **Unemployment Insurance Fund** – The unemployment insurance fund accounts for the collection of unemployment premiums from employers in the U.S. Virgin Islands, and the payment of unemployment benefits to eligible unemployed recipients.
- **West Indian Company** – WICO, a component unit of PFA, accounts for the activities of a cruise ship pier and shopping mall complex on the island of St. Thomas.

Fiduciary Funds

Fiduciary funds are used to account for assets held by the Government in a trustee capacity, or as an agent for individuals, private organizations, and other governmental units. The following are the Government's fiduciary funds:

- **Pension Trust Fund**– The pension trust fund accounts for the activities of the Employees' Retirement System of the Government of the Virgin Islands, which accumulates resources for pension benefit payments to qualified employees.
- **Agency Fund** – The agency fund is custodial in nature (assets equal liabilities) and does not involve measurement of the results of operations.

(e) *Cash and Cash Equivalents*

The Government follows the practice of pooling cash. The balance in the pooled cash accounts is available to meet current operating requirements, and any excess is invested in various interest-bearing accounts and time deposits with eligible depository institutions.

Cash equivalents of the proprietary funds and discretely presented component units consist of demand accounts, money market accounts, certificates of deposit with maturities of not more than 90 days from the date of acquisition, short-term U.S. government and its agencies' obligations and repurchase agreements with a U.S. commercial bank maturing within three months and collateralized by U.S. government obligations. Cash and cash equivalents of the discretely presented component units are maintained in separate bank accounts, from those of the PG, in their own names.

(f) *Adoption of New Accounting Standard*

The primary Government and its component units adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures, an Amendment of GASB Statement No. 3* in the current fiscal year. GASB Statement No. 40 establishes and modifies disclosure requirements related to investment risks: credit risk (including custodial credit risk and concentrations of credit risk), interest rate risk, and foreign currency risk. Investment note disclosures for the years ended September 30, 2005 have been prepared in accordance with GASB Statement No. 40.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

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(g) *Investment Policies*

Investment policies of the PG, its blended component units, major funds, and major component units are as follows:

- ***Primary Government Investment Policies*** – Title 33, Chapter 117 of the Virgin Islands Code (V.I. Code) authorizes the Government to invest in U.S. Government and agencies obligations, mortgage-backed securities, repurchase agreements, commercial paper, local government obligations, and corporate debt and equity obligations. As of September 30, 2005, the PG General Fund and Agency Fund had invested in certificates of deposit with a local bank. Investments are reported at fair value.
- ***Public Finance Authority Investment Policies*** – Under GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for Most External Investment Pools*, investments of the PFA are reported at fair value. Various bond resolutions of the PFA restrict investments to direct obligations of the U.S. government, territories, possessions and states, specific bank obligations, investment agreements or similar funding agreements, shares or other interests in mutual funds, trusts or investment companies, corporate commercial paper, and money market portfolios consisting of any of the foregoing. The PFA has retained investment managers and investments are held in trust by a commercial bank on behalf of the PFA. The PFA handles investments for two major governmental funds of the Government, the PFA Debt Service Fund, and the PFA Capital Projects Fund.
- ***Tobacco Settlement Financing Corporation Investment Policies*** – Various bond resolutions of this blended component unit restrict investments to direct obligations of the U.S. government, territories, possessions and states, specific bank obligations, investment agreements or similar funding agreements, shares or other interests in mutual funds, trusts or investment companies, corporate commercial paper, and money market portfolios consisting of any of the foregoing. The TFSC has retained investment managers and investments are held in trust by a commercial bank on behalf of the TFSC. Investments are reported at fair value in the nonmajor governmental fund of the Government.
- ***West Indian Company Limited Investment Policies*** – This blended business-type major fund of the Government maintains an investment policy that 1) limits investments in bonds to a maximum remaining maturity of 30 years (or estimated average life on mortgage-backed issues), 2) limits fixed income securities to a maximum of 40% and a minimum of 30% of the overall assets of the WICO portfolio, 3) limits corporate bond exposure to 45% of the fixed income portfolio, and 4) has no provision which limits or restricts investments in U.S. government treasury or agency issues. WICO reports investments at fair value.
- ***Pension Trust Fund Investment Policies*** – The board of trustees of GERS have enacted policies that limit investments in certain investment categories and provide requisites for the institutions with which investment transactions may be entered into. Under those policies, GERS may invest in U.S. government and agencies' obligations, bonds or notes of any state, territory or possession of the United States, municipal bonds and obligations, foreign bonds, bonds of domestic railroad corporations, public utility bonds, industrial corporate bonds or certificate trust certificates, common and preferred shares of foreign and domestic corporations, mutual funds, mortgage or personal loans to GERS members or retirees, and

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

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mortgage and asset-backed securities. Investments in bonds are subject to rating restrictions of BBB and may not exceed 2% of the portfolio. Investments in stock of a single corporation may not exceed 1% of the market value of the fund, or exceed 1% of the outstanding stock of the corporation. The aggregate amount of investments in stocks may not exceed 60% of the total investments of GERS. Any investment of 20% or more of the aggregate value of the portfolio must be approved by two-thirds of the membership of the board of trustees. The investments are administered by several professional investment managers and are held in trust by a commercial bank on behalf of the system.

Investments in equity securities in the GERS pension trust fund are reported at quoted market values. Shares of mutual funds are reported at the net asset value of shares held by GERS at year-end. Purchases and sales are recorded on a trade-date basis. Realized gains and losses on securities are determined by the average cost method.

Investment by GERS in the Havensight Mall is carried at historical cost less accumulated depreciation. Investment by GERS in the GERS facilities in St. Thomas and St. Croix are carried at historical cost net of accumulated depreciation and amortization on the portion of the facilities occupied by GERS.

- ***Virgin Islands Water and Power Authority Investment Policies*** – This major component unit is authorized under bond resolutions and the V.I. Code to invest in open accounts, time deposits, certificates of deposit, repurchase agreements, obligations of the United States government, and obligations of any state within the United States, mutual funds, and corporate commercial paper. Investments are reported at fair value.
- ***Virgin Islands Port Authority Investment Policies*** – This major component unit is authorized under bond resolutions and the V.I. Code to invest in open accounts, time deposits, certificates of deposit, repurchase agreements, obligations of the United States government, and obligations of any state within the United States, mutual funds, and corporate commercial paper. Investments are reported at fair value.
- ***University of the Virgin Islands Investment Policies*** – The board of trustees of this major component unit is responsible for the management of the University's investments which consist of U.S. government securities and securities backed by the U.S. government or its agencies and instrumentalities, common and preferred stocks, and mutual funds. Currently, the University's policies do not address risks associated with investments.
- ***Virgin Islands Government Hospital and Health Facilities Corporation Investment Policies*** – The board of trustees of this major component unit have not developed a formal investment policy. At September 30, 2005, investments were comprised of certificates of deposit, which were reported at fair value.
- ***Virgin Islands Housing Authority Investment Policies*** – This major component unit is required by the U.S. Department of HUD (HUD) to invest excess funds in obligations of the United States, certificates of deposit, or any other federally insured investment. HUD requires that deposits be fully collateralized at all times, and may be held by an unaffiliated bank or trust company for the account of the VIHA.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2005

(h) Receivables

Taxes receivable represent amounts owed by taxpayers for individual and corporate income taxes, gross receipts taxes, and real property taxes. Tax revenue is recognized in the governmental fund financial statements when they become both measurable and available based on actual collections during the months subsequent to September 30.

Federal government receivables represent amounts owed to the Government for reimbursement of expenditures incurred pursuant to federally funded programs.

Accounts receivable are reported net of estimated allowances for uncollectible amounts, which are determined based upon past collection experience and current economic conditions.

Subject to the provisions of the retirement law and subject to rules and regulations prescribed by the board of trustees of GERS, participants of the Pension Trust Fund have the right of obtaining loans from the Pension Trust Fund to finance a home, automobile, or other personal needs. The maximum mortgage loan that could be granted to members who have been contributing to the Pension Trust Fund for at least five years is \$250,000. The interest rate on new first mortgages was 8% and on second mortgages, 9% throughout the year. Members may also borrow up to \$50,000 to buy land.

Members who have contributed to the Pension Trust Fund for at least five years can borrow up to \$18,000 for the purchase of an automobile. The loans bear interest at 11% with a maximum term of four years. A member may also borrow up to 75% of their contributions to the Pension Trust Fund to a maximum borrowing of \$20,000 as a personal loan. The interest rate offered on personal loans was 9% throughout the year.

Member loans in the pension trust fund are valued at the outstanding loan principal balance less an allowance for estimated loan losses.

The accounts receivable from nongovernmental customers of the discretely presented component units are net of estimated uncollectible amounts. These receivables arise primarily from service charges to users. Accounts receivable from the PG and other component units that arise from service charges do not have significant allowances for uncollectible accounts.

(i) Inventories

In governmental fund types, the costs of inventories are recorded as expenditures when purchased. The proprietary fund types and component units recognize an asset when the inventory is purchased and an expense when it is consumed. Inventories in proprietary fund types are primarily valued at the lower of cost or market using the first-in, first-out method.

(j) Restricted Assets

Restricted assets in the PG and discretely presented component units are set aside primarily for the payment of bonds, notes, construction funds, and other specific purposes.

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(k) Capital Assets

Capital assets, which include land, land improvements, buildings, building improvements, machinery and equipment, construction in progress, and infrastructure assets are reported in the applicable governmental, business-type activities, and component unit columns in the government-wide financial statements as well as in the applicable proprietary funds reported in the fund financial statements.

The PG defines capital assets as assets that have an initial, individual cost, and useful lives of: (i) \$5,000 for personal property with a useful life of five years; (ii) \$50,000 for buildings and building improvements with an estimated useful lives of 40 and 20 years, respectively; (iii) \$100,000 for land improvements; and (iv) \$200,000 for infrastructure with an estimated useful life of 30 years. The value of all land acquired is capitalized.

Capital assets purchased or acquired are carried at historical cost or normal cost. The normal costing method to estimate cost is based on replacement cost indexed by a reciprocal factor of the price increase from the appraisal date to the actual or estimated acquisition date and was used to estimate the historical cost of certain land, buildings, and building improvements because invoices and similar documentation were no longer available in certain instances. Donated capital assets are recorded at fair value at the time of donation. Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest costs are capitalized during the construction period only for business-type activities and various component units. The costs of routine maintenance and repairs that do not add value to the assets or materially extend asset lives are not capitalized.

Capital assets utilized in the governmental funds are recorded as expenditures in the governmental fund financial statements. Depreciation expense is recorded in the government-wide financial statements, as well as the proprietary funds and component units' financial statements.

Capital assets of the PG are depreciated on the straight-line method over the assets' estimated useful lives. There is no depreciation recorded for land and construction in progress.

The capital assets of the component units are recorded in accordance with the applicable GASB and FASB statements and under their own individual capitalization thresholds. The estimated useful lives of capital assets reported by the component units are (i) 7 to 50 years for buildings and building improvements; (ii) 20 to 40 years for airports and marine terminals; and (iii) 3 to 20 years for vehicles and equipment.

The Government chose the option available under GASB No. 34 to defer the recording of wastewater treatment facilities as information for this network of infrastructure assets was not available. These assets were deemed to be nonmajor relative to total infrastructure assets and are not reported.

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(l) Tax Refunds Payable

During the calendar year, the Government collects individual income taxes through withholdings and payments from taxpayers. At September 30, the Government estimates the amount owed to taxpayers for overpayments during the first nine months of the calendar year. These estimated amounts and the actual tax refunds claimed for prior years but not paid at year-end are recorded as tax refunds payable and as a reduction of tax revenue.

(m) Deferred and Unearned Revenue

Deferred revenue at the governmental fund level arises when potential revenue neither meets measurable nor available criteria for revenue recognition in the current period. Deferred revenue also arises when resources are received before the Government has a legal claim to them, as when grant moneys are received prior to incurring the qualifying expenditures. In subsequent periods, when the revenue recognition criteria is met, or when the Government has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet and the revenue is recognized. Unearned revenue at the government-wide and proprietary fund levels arises only when the Government receives resources before it has a legal claim to them.

(n) Long-Term Debt

The liabilities reported in the government-wide financial statements include the Government's bonds, long-term notes, and other long-term liabilities including vacation, retroactive union arbitration salaries, legal claims, and noncurrent federal fund cost disallowances related to expenditures of federal grants. Bond premiums and discounts, losses incurred on bond refundings, and debt issuance costs are deferred and amortized over the life of the bonds using the effective-interest method. Bonds payable are reported net of the applicable bond premiums or discounts and deferred refunding losses. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, government 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 issuances are reported as other financing uses. Losses incurred on bond refundings are not recognized in the fund financial statements as the corresponding liability for the bonds is only recorded in the government-wide financial statements. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

(o) Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

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(p) Net Assets

Net assets are reported in three categories:

- **Invested in Capital Assets, Net of Related Debt** – These consist of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets. Debt pertaining to significant unspent debt proceeds is not included in the calculation of invested in capital assets, net of related debt. The unspent portion of the debt is presented, net of the related debt, as restricted net assets for capital projects.
- **Restricted Net Assets** – These result when constraints placed on the use of net assets are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted Net Assets** – These consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

When both restricted and unrestricted resources are available for use, generally it is the Government's policy to use restricted resources first, then the unrestricted resources as they are needed.

(q) Postemployment Benefits

In addition to the pension benefits described in note 13, the Government provides postretirement healthcare benefits, in accordance with the V.I. Code to all employees who retire from the Government on or after attaining age 55 with at least 30 years of service; except for policemen and firemen who can retire with at least 20 years of service. Currently, approximately 4,100 retirees meet those eligibility requirements. Healthcare benefits are provided through insurance companies whose premiums are paid by the retiree and the Government. The Government contributes three-fourths of the healthcare benefits' premiums. The Government does not accrue a liability for postemployment benefit costs, which are recognized on a pay-as-you-go basis. During the year ended September 30, 2005, the cost of providing healthcare benefits amounted to approximately \$18.8 million.

(r) Compensated Absences

The vacation policy of the Government provides for the accumulation of four, six, or eight hours for each full biweekly pay period depending on the time of entry into government service. At the beginning of each calendar year, vacation leave is limited to 480 hours (60 days). However, the excess of 480 hours is considered by GERS for service credit towards the employees' retirement. This vacation policy does not apply to professional educational personnel of the Virgin Islands Department of Education, who receive compensation during the school breaks. Upon retirement, an employee receives compensation for unused vacation leave at the employee's base rate pay. As of September 30, 2005, the Government had accrued compensated absences amounting to

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\$47.8 million, including related benefits, of which \$27.6 million was included in current liabilities in the government-wide financial statements.

Employees accumulate sick leave at a rate of four hours for each full biweekly pay period up to a maximum of 180 days. Separated employees do not receive payment for unused sick leave, therefore, a provision for accumulated sick leave is not required.

Compensated absences accumulation policies for the blended component units and discretely presented component units vary from entity to entity, depending upon negotiated bargaining agreements and other factors agreed upon between the management of these entities and its employees.

(s) *Interfund and Intra-Entity Transactions*

The Government has the following types of transactions among funds:

- *Interfund Transfers* – Transfers of resources between funds are reported as interfund transfers in (out) when incurred.
- *Intra-Entity Transactions* – These are transactions between the PG and its component units, and among the component units. Transfers between the PG and its blended component units are reported as interfund transfers, except for transfers within the same fund type. Similarly, receivables and payables between the PG and its blended component units are reported as amounts due to, and due from other funds. Transfers between the PG and discretely presented component units (and among those component units) are reported separately as revenue and expenses or expenditures. Amounts owed to and from discretely presented component units by the PG are reported separately from interfund payables and receivables.

(t) *Risk Management*

With some exceptions, the Government does not carry general casualty or liability insurance coverage on its properties or acts of its employees. Instead, the Government believes it is more economical to manage its risks internally and set aside funds as needed for estimated current claim settlements and unfavorable judgments through annual appropriations and supplemental appropriations. The Government accrues a provision for legal claims and judgments based on historical experience of similar claims and judgments and facts and circumstances of the individual claims and judgments. As a result of an agreement with the Federal Emergency Management Agency (FEMA), with respect to properties and structures damaged by Hurricane Hugo and repaired with federal disaster assistance funds, the Government has obtained insurance for certain hospitals, schools, and other insurable public buildings that were repaired with such federal assistance. The Government also purchases commercial insurance covering physical losses or damages against its property. The limit of liability for all risks, excluding earthquake, windstorm, and flood, is \$1 million for each and every occurrence except for windstorm and flood losses, which has a \$45 million limit. For physical losses arising from earthquake, the insurance policy has a limit of \$100 million for each and every occurrence and in the annual aggregate. Also, the Government has an enterprise fund that provides workers' compensation to both public and private employees.

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Under Title 33, Section 3411(c) of the V.I. Code, no judgment shall be awarded against the Government in excess of \$25,000 for tort claims filed under Government statutes. In cases involving several survivors, each award must be construed separately for purposes of applying the limitation upon recovery imposed by the Tort Claims Act. Under Title 27, Section 166(e) of the V.I. Code, the Government's waiver of immunity is expanded to \$250,000 for medical malpractice actions, including actions for wrongful death based on malpractice. Under certain circumstances, as provided in Title 33, Section 3414 of the V.I. Code, the Government may assume the payment of a judgment entered against an officer or employee acted reasonably and within the scope of his employment. The Government may pay up to a maximum amount of \$100,000 of the settlement.

The Government does not maintain accounting records in support of individual claim liabilities or for claims incurred but not reported (IBNR). Accordingly, workers' compensation claims are accounted for on a cash basis. As such, the basic financial statements do not include a liability for workers' compensation claims outstanding, including related IBNR, as of September 30, 2005.

Certain component units are exposed to various risks of loss related to their specialized operations, which are mitigated by purchasing commercial insurance.

(u) Future Adoption of Accounting Requirements

GASB has issued the following statements that the Government or its component units have not yet adopted:

GASB Statement No.		Adoption required in fiscal year
42	Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	2006
43	Financial Reporting for Postemployment Benefit Plans Other than Pension Plans	2007
44	Economic Condition Reporting: The Statistical Section – An amendment of NCGA Statement 1	2006
45	Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions	2008
46	Net Assets Restricted by Enabling Legislation – An amendment of GASB Statement No. 34	2006
47	Accounting for Termination Benefits	2006
48	Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues	2008

The impact of these statements has not yet been determined.

(v) Use of Estimates

Management of the Government has made a number of estimates and assumptions relating to the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date

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of the basic financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

(2) Component Units

The basic financial statements include the financial statements of the following discretely presented component units:

- Virgin Islands Housing Authority
- Virgin Islands Port Authority
- Virgin Islands Water and Power Authority
- Virgin Islands Government Hospital and Health Facilities Corporation
- University of the Virgin Islands
- Economic Development Authority
- Magens' Bay Authority
- Virgin Islands Housing Finance Authority
- Virgin Islands Public Television System

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Condensed financial information of all discretely presented component units follows (expressed in thousands):

Information on net assets	Virgin Islands Housing Authority	Virgin Islands Port Authority	Virgin Islands Water and Power Authority				Virgin Islands Government Hospital and Health Facilities Corporation			University of the Virgin Islands	Other entities	Total component units
			Electric System	Water System	Roy L. Schneider Hospital	Juan F. Luis Hospital						
Assets:												
Current assets	\$ 8,491	21,932	62,782	19,633	21,933	11,695	54,838	14,560	215,864			
Due from primary government	—	2,966	—	—	—	—	978	35	3,979			
Due from federal government	1,386	1,389	—	—	—	566	2,543	—	5,884			
Restricted assets	1,150	8,312	51,698	8,899	—	—	35,827	10,897	116,783			
Capital assets, net	63,881	275,080	200,430	48,638	74,078	28,328	41,544	47,534	779,513			
Deferred expenses	—	1,615	16,785	1,308	—	—	729	—	20,437			
Total assets	74,908	311,294	331,695	78,478	96,011	40,589	136,459	73,026	1,142,460			
Liabilities:												
Current liabilities	7,093	9,127	57,821	3,259	14,795	18,122	11,057	2,663	123,937			
Due to primary government	—	—	—	—	7,469	19,168	—	4,243	30,880			
Due to federal government	114	—	5,300	—	—	—	—	—	5,414			
Bonds payable	—	42,034	159,802	33,313	—	—	43,791	4,745	283,685			
Loans payable	—	910	5,600	—	—	—	1,736	848	9,094			
Other noncurrent liabilities	3,883	—	—	—	1,318	23	28	23,689	28,941			
Total liabilities	11,090	52,071	228,523	36,572	23,582	37,313	56,612	36,188	481,951			
Net assets:												
Invested in capital assets -- net of related debt	63,881	234,084	69,144	16,118	72,204	28,030	25,964	37,112	546,537			
Restricted	54	6,890	17,749	7,986	2,039	—	48,550	4,860	88,128			
Unrestricted (deficit)	(117)	18,249	16,279	17,802	(1,814)	(24,754)	5,333	(5,134)	25,844			
Total net assets	\$ 63,818	259,223	103,172	41,906	72,429	3,276	79,847	36,838	660,509			

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Information on statements of activities	Expenses	Program revenue			Total component units
		Charges for services	Operating grants and contributions	Capital grants and contributions	
Virgin Islands Housing Authority	\$ 46,136	5,121	31,426	4,213	(5,376)
Virgin Islands Port Authority	45,660	37,375		7,219	(1,066)
Virgin Islands Water and Power Authority:					
Electric System	165,887	169,631		996	4,740
Water System	26,817	28,284		958	2,425
Virgin Islands Government Hospital and Health Facilities Corporation:					
Roy L. Schneider Hospital	69,613	44,232	20,235	12,672	7,526
Juan F. Luis Hospital	53,484	26,962	17,481	4,225	(4,816)
University of the Virgin Islands	66,223	14,449	40,256	3,192	(8,326)
Other component units	12,830	3,359	6,435	1,270	(1,766)
Total activities	\$ 486,650	329,413	115,833	34,745	(6,659)
General revenue:					
Interest and other					10,739
Changes in net assets					4,080
Net assets, beginning of year (as restated)					656,429
Net assets, end of year					\$ 660,509

(3) Stewardship, Compliance, and Accountability

(a) Budgetary Process and Control

The V.I. Code requires the Governor to submit an annual balanced executive budget to be adopted by the Legislature for the ensuing fiscal year. The Governor is required by law to submit to the Legislature the annual executive budget no later than May 30. The annual executive budget is prepared essentially on a GAAP basis, except for encumbrances, which are reported as expenditures for budget reporting purposes, by the Virgin Islands Office of Management and Budget (OMB) working in conjunction with other Government offices and agencies. If the annual executive budget has not been approved before the commencement of any fiscal year, then the appropriations for the preceding fiscal year, insofar as they may be applicable, are automatically deemed reappropriated item by item. The annual executive budget, which includes those funds of the Government subject to appropriation pursuant to law, is composed of all proposed expenditures and estimated revenue for the Government. The Legislature enacts the annual executive budget through passage of lump-sum appropriations for each department. The Legislature may add, change, or delete any items in the annual executive budget proposed by the Governor. Upon passage by the Legislature, the annual executive budget is submitted to the Governor, who may veto the budget partially or in its entirety and return it to the Legislature with his objections. A veto by the Governor can be overridden only by a two-third majority of all members of the Legislature. The Legislature is obligated by law to pass a final annual executive budget no later than September 30, the last day of the fiscal year. Supplemental budgetary appropriations' bills that are signed into law may be created during the year without the identification of a specific revenue source to finance them. In August 1999, the

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Legislature enacted the Financial Accountability Act (Act No. 6289). The purpose of the Financial Accountability Act is to require by law that the budget of the Government be balanced each year, and the appropriations in each fiscal year not exceed a verifiable revenue source.

Once the budget has been enacted, fiscal control over expenditures made pursuant thereto is exercised by the Governor through the Director of OMB. During any fiscal year in which the resources available to the Government are not sufficient to cover the appropriations approved for such year, the Governor, through the Director of OMB, may take administrative measures to reduce expenditures. The Governor may also make recommendations to the Legislature for new taxes or any other necessary action to meet the estimated deficiency.

Budgetary control is exercised at the department level through an allotment process. Encumbrances and expenditures cannot exceed total allotment amounts. The Government's department heads may make transfers of appropriations within the department. Appropriation transfers between departments and supplemental appropriations require executive and legislative branch approval. Unencumbered and unexpended appropriations, not designated, lapse at fiscal year-end. Also, encumbrances are established at fiscal year-end to pay certain expenditures for travel and utility costs payable against current year appropriation authority, but to be expended in the subsequent year.

(b) Budget/GAAP Reconciliation

The following schedule presents comparisons of the General Fund legally adopted budget with actual data on a budgetary basis. Because accounting principles applied for purposes of developing data on a budgetary basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of timing and entity difference in the excess of revenue and other financing sources over expenditures and other financing uses for the year ended September 30, 2005 is presented below (expressed in thousands):

Excess of revenue and other financing sources (uses)	
over expenditures – budget basis	\$ 57,011
Timing difference – change in encumbrances	(8,253)
Entity difference – excess of revenue and other financing sources over expenditures and other financing uses – activities with budgets not legally adopted	<u>3,629</u>
Excess of revenue and other financing sources over expenditures – GAAP basis	<u>\$ 52,387</u>

Controls over spending in special revenue funds and nonappropriated funds are maintained at the Department of Finance by use of budgets and available resources (revenue). The Government makes appropriations to authorize expenditures for various capital projects. Budgets for capital projects normally remain available until completion of the project unless modified or rescinded.

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(4) Cash and Cash Equivalents

(a) Primary Government

The PG and its blended component units consider all highly liquid investments purchased with an initial maturity of three months or less to be cash and cash equivalents. By law, banks, or trust companies designated as depository of public funds of the Government and are to maintain corporate surety bond or pledge collateral satisfactory to the Commissioner of Finance to secure all governmental funds deposited.

At September 30, 2005, the PG held \$260.0 million in unrestricted cash and cash equivalents, and \$35.3 million in restricted cash and cash equivalents. Banco Popular de Puerto Rico held \$229 million, or 87% of the PG's cash and cash equivalents, which was fully collateralized.

(b) Pension Trust Fund

The Government's retirement system (GERS) considers all highly liquid investments purchased with an initial maturity of three months or less to be cash equivalents. At September 30, 2005, GERS held \$78.9 million in money market accounts, and \$7.9 million in operational accounts.

(c) Component Units

All component units of the Government consider all highly liquid investments purchased with an initial maturity of three months or less to be cash and cash equivalents. By law, banks, or trust companies designated as depository of public funds of the Government are to maintain corporate surety bond or pledge collateral satisfactory to secure all governmental funds deposited.

At September 30, 2005, component units held \$63.6 million in unrestricted cash and cash equivalents and \$38.5 million in restricted cash and cash equivalents, of which \$1.5 million was not insured, bonded, or collateralized as required for public funds of the Government.

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(5) Investments

(a) Primary Government Investments

The PG and its component units adopted the provisions of GASB Statement No. 40, *Deposit and Investment Risk Disclosures, an Amendment of GASB Statement No. 3* in the current fiscal year. Following is a summary of the investments of the PG, categorized by investment type and maturity as of September 30, 2005:

Primary Government Investments				
(In thousands)				
	Fair value	Maturity (in years)		
		Less than 1 year	1 to 5 years	Over 5 years
Investments with contractual maturities:				
Certificates of deposit	\$ 97,570	97,570	—	—
Commercial paper	141,133	141,133	—	—
Corporate bonds	142	18	66	58
U.S. government agencies and notes	<u>32,626</u>	<u>32,407</u>	<u>39</u>	<u>180</u>
Total investments with maturities	<u>271,471</u>	<u>\$ 271,128</u>	<u>105</u>	<u>238</u>
Investments without contractual maturities:				
Equity securities	451			
Money market and mutual funds	<u>228,749</u>			
Total primary government investments	<u>\$ 500,671</u>			

Interest Rate Risk – Interest rate risk represents the exposure to fair market value losses arising from increasing interest rates. The PG does not have a formal investment policy that limits investment maturities as a means of managing such exposure. As a means of keeping the interest rate risk low, all investments held by the PG are short term in nature.

Credit Risk – The authorizing legislation of the PG does not limit investments by credit rating categories. Authorizing legislation does limit the investment choices of the PG to: direct obligations or obligations guaranteed by the United States, obligations of states, territories, possessions, and commonwealths of the United States, obligations of international banking institutions, repurchase agreements, investment contracts, certificates of deposit, guaranteed investment contracts, shares in mutual funds, investment companies, corporate commercial paper, money market portfolio investments, and investment pools.

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At September 30, 2005, the PG's investment in money market funds were rated AAA by Standard & Poor's, and Aaa by Moody's Investor Service; PG's investment in commercial paper were rated A-1 or A-1+ by Standard & Poor's, and P-1 by Moody's Investor Services; and the PG's investment in U.S. government agencies were rated AAA by both Standard & Poor's and Moody's Investor Services.

Concentration of Credit Risk – The PG places no limit on the amount that may be invested in one issuer. At September 30, 2005, more than 5% of the PG's investments were invested in: Fidelity Treasury Money Market #696, Class 3 (25.55%), Banco Popular de Puerto Rico Certificates of Deposit (20.15%), Goldman Financial Securities Money Market 474 (12.88%), General Electric Capital Corporation Commercial Paper (10.55%), AIM Short Term Investment Money Market Treasury No. 2 (6.88%), Federal Home Loan Mortgage Corporation (5.27%), and Commoloco, Inc. Commercial Paper (5.19%).

Custodial Credit Risk – The PG does not have a custodial risk policy. This is the risk that the PG will not be able to recover the value of its investments that are in the possession of an outside party. At September 30, 2005, \$97.6 million of certificates of deposit of the PG were held in the name of the Government by Banco Popular de Puerto Rico, \$402.3 million of investments were held in the name of The Bank of New York Trust Company, NA, as trustee for the Government, and \$840 thousand were held in the name of Merrill Lynch, as trustee for the Government.

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(b) Pension Trust Fund Investments

The pension trust fund (GERS) has implemented GASB Statement No. 40 by establishing separate investment guidelines and restrictions for each investment manager. Following is a summary of pension trust fund investments as of September 30, 2005:

		Pension Trust Fund Investments (In thousands)				
		Fair value	Maturity (in years)			
			Less than 1 year	1 to 5 years	6 to 10 years	More than 10 years
Investments with contractual maturities:						
U.S. government and agency obligations	\$	30,103	8,073	2,830	18,249	951
U.S. Treasury notes		109,188	—	90,098	19,090	—
U.S. Treasury bonds		8,064	—	—	—	8,064
Corporate obligations		35,610	—	16,687	13,014	5,909
Foreign bonds		2,407	—	—	2,407	—
Government obligations – foreign		87,898	—	—	—	87,898
Mortgage and asset-backed securities		119,581	—	2,288	2,883	114,410
Total investments with maturities		<u>392,851</u>	<u>\$ 8,073</u>	<u>111,903</u>	<u>55,643</u>	<u>217,232</u>
Investments without contractual maturities:						
Equity securities:						
Common stocks – U.S.		655,407				
Common stocks – foreign		136,278				
Preferred stocks – foreign		1,049				
Real estate investments:						
Real estate investment trusts		792				
Havensight Mall – U.S. Virgin Islands		60,339				
GERS Complex – U.S. Virgin Islands		13,023				
Securities lending short-term collateral investment pool		221,849				
Mutual funds		9,604				
Total pension fund investments	\$	<u>1,491,192</u>				

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Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. GERS does not have a specific policy to manage interest rate risk, but requires investment managers to diversify by issue, maturity, sector, coupon, and geography. Investment managers retained by GERS follow specific investment guidelines and are evaluated against specific market benchmarks that represent their investment style. Any exception from general guidelines requires approval from the GERS’ board of trustees.

Credit Risk – GERS’ investment policy is designed to minimize credit risk by restricting authorized investments to only those investments permitted by statute, subject to certain additional limitations. These additional limitations consist of prohibitions against investments in derivative securities, options, futures, or short positions. GERS’ investment policy allows investments in mortgage pass-through securities. The credit ratings of GERS debt and equity securities include:

Pension Trust Fund Investment Credit Ratings
(In thousands)

	Fair value	Credit ratings	
		Standard and poor	Moody’s
U.S. government and agency obligations	\$ 10,842	AA-	AA2
U.S. government and agency obligations	5,763	AAA	Not rated
U.S. government and agency obligations	13,498	Not rated	Not rated
U.S. Treasury notes	109,188	AAA	AAA
U.S. Treasury bonds	8,064	AAA	AAA
Corporate obligations	35,610	BBB to AAA	BAA1 to AAA
Foreign bonds	2,407	AA	AA2
Government obligations – foreign	57,128	AAA	AAA
Government obligations – foreign	10,842	AA-	AA2
Government obligations – foreign	6,434	AAA	Not rated
Government obligations – foreign	13,494	Not rated	Not rated
Mortgage and asset backed securities	88,268	AAA	AAA
Mortgage and asset backed securities	31,313	Not rated	Not rated
Common stocks – U.S.	655,407	Not rated	Not rated
Common stocks – foreign	136,278	Not rated	Not rated
Preferred stocks – foreign	1,049	Not rated	Not rated
Real estate investment trust	792	Not rated	Not rated
Real estate holdings – U.S. Virgin Islands	73,362	Not rated	Not rated
Securities lending short-term collateral investment pool	221,849	Not rated	Not rated
Mutual funds	9,604	Not rated	Not rated
Total investments	\$ 1,491,192		

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Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributed to the magnitude of the GERS investment in a single issuer of securities. GERS investment policies place limitations on portfolio composition by investment type to limit its exposure to concentration of credit risk. The investment policy provides that a maximum of 60% of GERS investment portfolio be invested in equity stocks and a minimum of 40% be invested in fixed income investments. At September 30, 2005, there were no investments in any one issuer that represent 5% or more of total investments.

Custodial Credit Risk – The custodial credit risk for investments is the risk that, in the event of the failure of a counterparty to a transaction, GERS will not be able to recover the value of an investment or collateral securities that are in the possession of an outside party. With the exception of underlying securities on loan secured by noncash collateral, the investment portfolio of GERS was held with a single third-party custodian on behalf of GERS as of September 30, 2005. The fair value of underlying securities on loan secured by noncash collateral amounted to \$6.02 million at September 30, 2005.

Foreign Currency Risk – Foreign currency risk is the risk of holding investments in foreign currencies and the risk that those foreign currencies may devalue. As of September 30, 2005, \$227.7 of GERS portfolio was held in foreign currencies, with \$68.6 million held in Japanese yen, \$62.9 million held in Euro currency, \$30 million held in pound sterling, \$17.8 million held in Canadian dollars, \$15 million held in Australian dollars, and \$12.3 million held in Swiss francs. GERS entered into various forward currency exchange contracts to manage exposure to changes in foreign currency exchange rates, and to facilitate the settlement of foreign security transactions. Risks associated with foreign exchange contracts include the movement in the value of foreign currency relative to the U.S. dollar and the ability of the counterparty to perform in accordance with the terms of the contract. Changes in the market value of open and closed forward contracts are reported with interest, dividends, and other income or losses reported at fair value. During the fiscal year ended September 30, 2005, GERS reported \$26.7 million in forward currency purchases, \$26.8 million in forward currency sales, and a foreign exchange loss of \$1.3 million.

Securities Lending Transactions – The Government's statutes permit GERS to participate in securities lending transactions, and GERS has, via a securities lending authorization agreement (the Agreement), authorized State Street Bank and Trust Company (the Custodian) to lend its securities to broker-dealers and banks pursuant to a form of loan agreement. Lent securities are collateralized with cash, securities issued or guaranteed by the U.S. government, or irrevocable bank letters of credit. GERS does not have the ability to pledge or sell collateral securities delivered absent a borrower default. No restrictions were imposed during 2005 as to the amount of loans the Custodian can make on behalf of the GERS. Under the terms of the Agreement the Custodian must indemnify the Government for losses attributable to violations by the Custodian under the "standard of care" clause described in the Agreement. There were neither such violations during the fiscal year 2005 nor losses resulting from the default of the borrowers or the Custodian.

Loans are generally terminable on demand. The collateral received shall, in the case of loaned securities denominated in U.S. dollars or whose primary trading market is located in the U.S. or sovereign debt issued by foreign governments, have a market value of 102% of the market value of the security for domestic borrowers and 105% for foreign borrowers at the inception of the securities

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lending transaction. Such collateral should be kept at a minimum of 100% of the market value of the security for all borrowers throughout the outstanding period of the transaction. At September 30, 2005, approximately \$221.8 million of U.S. government and agency securities, fixed income, and equity corporate securities were on loan. The cash collateral received with a corresponding liability of an equal amount, is recorded in the statement of fiduciary net assets. The cash collateral received on each loan was invested, together with the cash collateral of other lenders, in a collective investment pool. As of September 30, 2005, such investment pool had a weighted average maturity of 40 days and an average expected maturity of 410 days. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral.

(c) **Component Unit Investments**

Following is a summary of component unit investments, and maturities, as of September 30, 2005:

Component Unit Investments					
(In thousands)					
		Maturity (in years)			
	Fair value	Less than 1 year	1 to 5 years	6 to 10 years	Over 10 years
Investments with contractual maturities:					
Certificates of deposit	\$ 2,605	2,605	—	—	—
Mortgage-backed securities	4,498	—	—	—	4,498
Corporate bonds	4,391	—	—	—	4,391
U.S. government agencies and notes	36,425	2,681	32,079	831	834
Investments with contractual maturities					
	47,919	\$ 5,286	32,079	831	9,723
Investments without contractual maturities:					
Common stock	9,001				
Foreign investments	87				
Mutual funds	38,211				
Investment contracts	19,418				
Other investments	1,020				
Total component unit investments					
	\$ 115,656				

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The component units of the Government have not established formal policies, which limit investment maturities as a means of managing such exposure and have some exposure to interest rate risk.

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Credit Risk. The authorizing legislation of the component units does not limit investments by credit rating categories. Authorizing legislation limits the investment choices of the component units, as described in note 1(g). The WAPA Electric System investments include a \$19.4 million guaranteed investment contract with the Royal Bank of Canada. The investment contract is rated Aa3 by Moody's and AA- by Standard & Poor's. The University of the Virgin Islands investments include corporate bonds amounting to \$1.8 million with a rating of AAA by Standard & Poor's.

Concentration of Credit Risk. The component units have no limits on the amount that may be invested in one issuer of securities. As of the fiscal year-end, the component units reported \$36.4 million in U.S. government and agency securities issued or explicitly guaranteed by the U.S. government, and \$38.2 million in mutual funds, which are excluded from concentration of credit risk. As of June 30, 2005, WAPA Electric held a guaranteed investment contract with the Royal Bank of Canada in the amount of \$19.4 million, which represented 16.79% of component unit investments.

Custodial Credit Risk. The component units of the Government do not have custodial credit risk policies. This is the risk that the component unit will not be able to recover the value of its investments that are held in the possession of an outside party. At September 30, 2005, \$2.3 million of VIPA investments were held in the name of HSBC Bank USA, as trustee, and \$19 million of University of the Virgin Islands mutual funds were held by a third party on behalf of the university.

(6) Receivables

Receivables at September 30, 2005 consist of the following (expressed in thousands):

	<u>General fund</u>	<u>PFA debt service fund</u>	<u>Total</u>
Income taxes	\$ 159,194	—	\$ 159,194
Real property taxes	46,995	—	46,995
Gross receipts taxes	—	55,157	55,157
Tax receivables	<u>\$ 206,189</u>	<u>55,157</u>	261,346
Other long-term receivables – tobacco settlement rights			<u>826</u>
Total receivables reported in the statement of net assets			\$ <u>262,172</u>

The Naval Appropriations Act created a separate tax structure for the U.S. Virgin Islands that mirrors the Internal Revenue Code of 1986, as amended. Income taxes are due from every corporation, partnership, individual, association, estate, or trust that meets the filing requirements of the U.S. Internal Revenue Code. A U.S. taxpayer who is a permanent resident of the U.S. Virgin Islands satisfies his Virgin Islands income tax obligations by filing his return with and paying income taxes to the Government. Virgin Islands residents are taxed by the Virgin Islands on their world-wide income. A nonresident of the U.S. Virgin Islands pays income taxes on his U.S. Virgin Islands source income to the Government. The revenue is recognized in the General Fund in the fiscal period for which the income tax return was filed. The revenue

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from income tax withholding and estimated payments is recognized in the General Fund as collected, net of estimated tax refunds.

Corporate income taxes are due by the 15th day of the third month following the close of the fiscal year and become delinquent if not paid on or before the due date.

Partnership and trust income taxes are due by April 15 of the following year for which the income tax was levied. Trust income taxes must be paid by the tax filing date.

Property taxes are levied each calendar year on all taxable real property located in the U.S. Virgin Islands. The revenue is recognized in the General Fund and in the fiscal period for which the property tax was levied, provided the tax is collected within 60 days subsequent to fiscal year-end, unless the facts justify a period greater than 60 days.

The Office of the Tax Assessor is responsible for the assessment of all taxable real property. Noncommercial real property subject to taxation is reassessed once every five years and commercial real property subject to taxation is reassessed biannually. The tax assessor prepares an annual assessment roll and schedule of collections for each parcel of real property that is used by the Department of Finance, as the basis for issuing tax bills to all taxpayers in the U.S. Virgin Islands.

Property taxes are to be levied by May 15 of each year in the name of the record owner on January 15 of the same year. The taxes are due on September 30 and become delinquent if not paid by October 30.

For businesses with gross receipts of \$120,000 per annum or less, gross receipts taxes are levied on an annual basis, based on 4% of gross receipts in excess of \$5,000. Businesses with annual gross receipts greater than \$120,000 and up to \$150,000 are levied on a monthly basis, based on 4% of gross receipts in excess of \$5,000 per month. Businesses with annual gross receipts of more than \$150,000, lose the \$5,000 monthly exemption and are levied on a monthly basis of 4% of gross receipts. The gross receipts tax is due within 30 calendar days following the last day of the calendar month collected.

Component unit receivables at September 30, 2005, consist of the following (expressed in thousands):

Utility service charges	\$	26,654
Port fees		3,237
Students		3,452
Patients		19,196
Other		<u>1,525</u>
Total	\$	<u><u>54,064</u></u>

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Loans and advances receivable at September 30, 2005, consist of the following (expressed in thousands):

	Fiduciary funds pension trust	Component units
Mortgage loans	\$ 18,928	—
Personal loans	94,903	—
Other loans and advances	603	1,638
Subtotal	114,434	1,638
Less allowance for uncollectible accounts	(3,000)	(50)
Loans and advances, net	\$ 111,434	1,588

(7) Interfund Transactions

(a) Interfund Transfers

Interfund transfers constitute the transfer of resources from the fund that receives the resources to the fund that utilizes them. The most significant transfers to the General Fund from other governmental funds include a \$86 million transfer from the PFA Debt Service representing gross receipt tax revenue in excess of bond service requirements, and a \$10 million transfer from the nonmajor debt service fund representing \$10 million of property tax revenue in excess of debt service requirements.

Significant transfers made from the General Fund include a transfer of \$4.4 million to the Emergency Molasses Fund (a nonmajor governmental fund), a transfer of \$1 million to the Crisis Intervention Fund (a nonmajor governmental fund), and a transfer of \$1.4 million to the PFA Debt Service Fund. Significant transfers from the PFA Debt Service Fund include transfers of \$2.2 million to the PFA Operating Account.

Transfers from the Virgin Islands Lottery (a nonmajor business-type fund) include transfers of \$459 thousand to the General Fund, \$1.5 million to the Pharmaceutical Assistance to the Aged Fund (a nonmajor governmental fund), and \$1.1 million to the Virgin Islands Educational Initiative Fund (also a nonmajor governmental fund).

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Interfund transfers for the year ended September 30, 2005 consisted of the following (expressed in thousands):

<u>Transfer to</u>	<u>General fund</u>	<u>PFA debt service fund</u>	<u>PFA capital projects fund</u>	<u>Nonmajor governmental funds</u>	<u>Enterprise fund - West Indian Company</u>	<u>Nonmajor enterprise funds</u>	<u>Total</u>
General fund	\$ —	86,083	—	10,000	1,000	459	97,542
PFA debt service fund	1,420	—	—	—	—	—	1,420
Nonmajor governmental funds	5,520	2,234	19	—	—	2,619	10,392
Nonmajor enterprise funds	—	—	550	—	—	—	550
Total	\$ 6,940	88,317	569	10,000	1,000	3,078	109,904
<u>Transfer from</u>							
General fund	\$ —	1,420	—	5,520	—	—	6,940
PFA debt service fund	86,083	—	—	2,234	—	—	88,317
PFA capital projects fund	—	—	—	19	—	550	569
Nonmajor governmental funds	10,000	—	—	—	—	—	10,000
Major enterprise fund - WICO	1,000	—	—	—	—	—	1,000
Nonmajor enterprise funds	459	—	—	2,619	—	—	3,078
Total	\$ 97,542	1,420	—	10,392	—	550	109,904

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(b) Due from/to Other Funds

The following table summarizes interfund receivables and payables at September 30, 2005 (expressed in thousands):

<u>Due to</u>	<u>General fund</u>	<u>PFA capital projects fund</u>	<u>Nonmajor governmental funds</u>	<u>Enterprise fund – West Indian Company</u>	<u>Nonmajor enterprise funds</u>	<u>Total</u>
General fund	\$ —	—	3,178	1,000	4,885	9,063
PFA capital projects fund	—	—	—	—	313	313
Nonmajor governmental funds	9,146	—	—	—	2,892	12,038
Total governmental funds	9,146	—	3,178	1,000	8,090	21,414
Propriety fund – nonmajor enterprise fund	300	—	—	—	—	300
Total	<u>\$ 9,446</u>	<u>—</u>	<u>3,178</u>	<u>1,000</u>	<u>8,090</u>	<u>21,714</u>
<u>Due from</u>						
General fund	\$ —	—	9,146	—	300	9,446
Nonmajor governmental funds	3,178	—	—	—	—	3,178
Total governmental funds	3,178	—	9,146	—	300	12,624
Enterprise fund – West Indian Company	1,000	—	—	—	—	1,000
Nonmajor enterprise funds	4,885	313	2,892	—	—	8,090
Total enterprise funds	5,885	313	2,892	—	—	9,090
Total	<u>\$ 9,063</u>	<u>313</u>	<u>12,038</u>	<u>—</u>	<u>300</u>	<u>21,714</u>

The due from/to other funds include \$4.9 million due from the General Fund to the Emergency Molasses Fund (nonmajor governmental fund) from unpaid appropriations. Other balances composing the due from/to other funds include \$2.7 million from the bond proceeds fund (nonmajor governmental fund) to the General Fund and \$2.2 million from the General Fund to the PFA Operating Fund (a nonmajor governmental fund). The due to the General Fund from the nonmajor enterprise fund amounting to \$ 4.9 million is mainly composed of the amount owed by the Virgin Islands Lottery to the General Fund amounting to \$4.7 million, consisting primarily of 8% of the total lottery revenue that is required to be transferred to the General Fund. The due to nonmajor governmental funds from the nonmajor enterprise fund amounting to \$2.9 million is mainly composed of the amount of \$1.5 million due from the Virgin Islands Lottery to the Pharmaceutical Assistance to the Aged Fund, and \$973 thousand due to the VI Educational Initiative Fund,

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consisting primarily of 15% and 25% of total lottery revenue that is required to be transferred to these funds.

(8) Restricted Assets

(a) Primary Government

Restricted assets of proprietary funds and business-type activities include cash and cash equivalents as follows (expressed in thousands):

Restricted Assets – Proprietary Funds and Business-type Activities	
Unemployment insurance funds	\$ 33,493
WICO debt service funds	<u>1,792</u>
Total restricted assets of proprietary funds and business-type activities	<u>\$ 35,285</u>

(b) Component Units

Restricted assets of component units include cash and cash equivalents, investments, and receivables as follows (expressed in thousands):

Restricted Assets – Component Units	
Debt service and sinking fund requirements	\$ 15,325
Construction funds	85
Endowment funds	16,614
HUD project funds	1,150
Revolving loan funds	4,830
Other	<u>464</u>
Total cash and cash equivalents	<u>38,468</u>
Investments:	
Debt service and sinking fund requirements	22,674
Construction funds	22,101
Endowment funds	19,214
Renewal and replacement funds	8,763
Revolving loan funds	<u>5,517</u>
Total investments	<u>78,269</u>
Other:	
Accrued interest receivable	<u>46</u>
Total restricted assets of component units	<u>\$ 116,783</u>

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(9) Capital Assets

(a) Primary Government

The capital assets activity for the governmental activities for the year ended September 30, 2005, is summarized as follows (expressed in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets, not being depreciated:				
Land	\$ 184,939	275	—	185,214
Construction in progress	24,578	57,714	29,831	52,461
Total capital assets, not depreciated	<u>209,517</u>	<u>57,989</u>	<u>29,831</u>	<u>237,675</u>
Capital assets, being depreciated:				
Land improvements	3,584	—	—	3,584
Infrastructure	126,249	1,222	—	127,471
Buildings and improvements	402,450	25,402	—	427,852
Machinery and equipment	78,159	16,135	759	93,535
Total capital assets, being depreciated	<u>610,442</u>	<u>42,759</u>	<u>759</u>	<u>652,442</u>
Less accumulated depreciation for:				
Land improvements	1,659	153	—	1,812
Infrastructure	17,577	4,287	—	21,864
Buildings and improvements	129,043	5,939	—	134,982
Machinery and equipment	46,150	8,470	691	53,929
Total accumulated depreciation	<u>194,429</u>	<u>18,849</u>	<u>691</u>	<u>212,587</u>
Total capital assets, being depreciated, net	<u>416,013</u>	<u>23,910</u>	<u>68</u>	<u>439,855</u>
Governmental activities capital assets, net	\$ <u>625,530</u>	<u>81,899</u>	<u>29,899</u>	<u>677,530</u>

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Capital assets activity for the business-type activities for the year ended as of September 30, 2005, is summarized as follows (expressed in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets, not being depreciated:				
Land and land improvements	\$ 5,357	—	40	5,317
Construction in progress	809	1,045	97	1,757
Total capital assets, not depreciated	<u>6,166</u>	<u>1,045</u>	<u>137</u>	<u>7,074</u>
Capital assets, being depreciated:				
Buildings and improvements	47,575	1,593	31	49,137
Machinery and equipment	3,791	723	139	4,375
Total capital assets, being depreciated	<u>51,366</u>	<u>2,316</u>	<u>170</u>	<u>53,512</u>
Less accumulated depreciation for:				
Buildings and improvements	13,028	1,851	—	14,879
Machinery and equipment	1,811	194	121	1,884
Total accumulated depreciation	<u>14,839</u>	<u>2,045</u>	<u>121</u>	<u>16,763</u>
Total capital assets, being depreciated, net	<u>36,527</u>	<u>271</u>	<u>49</u>	<u>36,749</u>
Business-type activities capital assets, net	\$ <u><u>42,693</u></u>	<u><u>1,316</u></u>	<u><u>186</u></u>	<u><u>43,823</u></u>

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Depreciation and amortization expense was charged to functions/programs of the PG for the year ended September 30, 2005 as follows (expressed in thousands):

Governmental activities:

General government	\$	3,619
Public safety		1,544
Health		3,315
Education		5,647
Culture and recreation		265
Transportation and communication		4,459
Total depreciation expense – governmental activities	\$	<u>18,849</u>

Business-type activities:

WICO (major enterprise fund) – depreciation and amortization	\$	1,475
Nonmajor enterprise fund – depreciation		570
Total depreciation and amortization – business-type activities	\$	<u>2,045</u>

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The capital assets activity for the discretely presented component units for the year ended September 30, 2005 is summarized as follows (expressed in thousands):

	Beginning balance (as restated)	Additions	Reductions	Ending balance
Capital assets, not being depreciated:				
Land	\$ 92,003	17,925	593	109,335
Construction in progress	<u>76,602</u>	<u>47,596</u>	<u>68,485</u>	<u>55,713</u>
Total capital assets, not depreciated	<u>168,605</u>	<u>65,521</u>	<u>69,078</u>	<u>165,048</u>
Capital assets being depreciated:				
Buildings and improvements	1,126,558	62,176	1,505	1,187,229
Airport and marine terminal facilities	102,665	5,377	—	108,042
Personal property and equipment	<u>91,997</u>	<u>4,386</u>	<u>11,949</u>	<u>84,434</u>
Total capital assets being depreciated	<u>1,321,220</u>	<u>71,939</u>	<u>13,454</u>	<u>1,379,705</u>
Less accumulated depreciation:				
Buildings and improvements	604,631	44,094	6,701	642,024
Airport and marine terminal facilities	65,227	4,138	—	69,365
Personal property and equipment	<u>51,456</u>	<u>5,748</u>	<u>3,353</u>	<u>53,851</u>
Total accumulated depreciation	<u>721,314</u>	<u>53,980</u>	<u>10,054</u>	<u>765,240</u>
Total capital assets being depreciated, net	<u>599,906</u>	<u>17,959</u>	<u>3,400</u>	<u>614,465</u>
Component unit capital assets, net	<u>\$ 768,511</u>	<u>83,480</u>	<u>72,478</u>	<u>779,513</u>

Beginning balances of component unit capital assets were restated due to the elimination of \$50 million of fully depreciated assets by the Virgin Islands Housing Authority and an increase in the opening balance of construction in progress of the Virgin Islands Housing Authority of \$3 million. The net restatement of beginning balances of component unit capital assets was \$4.186 million.

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Depreciation expense charged to each component unit for the year ended September 30, 2005 was as follows (expressed in thousands):

Virgin Islands Housing Authority	\$	11,161
Virgin Islands Port Authority		15,168
Virgin Islands Water and Power Authority:		
Electric system		15,398
Water system		2,704
Virgin Islands Government Hospital and Health Facilities Corporation:		
Roy L. Schneider Hospital		3,957
Juan F. Luis Hospital		2,307
University of the Virgin Islands		2,065
Other component units		<u>1,220</u>
Total depreciation – component units	\$	<u><u>53,980</u></u>

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(10) Long-Term Liabilities

Long-term liabilities activities for the year ended September 30, 2005 were as follows (expressed in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Amounts due within one year</u>	<u>Amounts due thereafter</u>
Governmental activities:						
Bonds payable:						
1998 Series Revenue and Refunding Bonds	\$ 473,745	—	(13,955)	459,790	14,765	445,025
1999 Project Revenue Bonds	1,550	—	(1,550)	—	—	—
1999 General Obligation Bonds, Series A	5,650	—	(885)	4,765	945	3,820
1999 Series A Revenue Bonds	283,335	—	(4,765)	278,570	5,005	273,565
2001 Series A Tobacco Bonds	22,310	—	(370)	21,940	—	21,940
2002 Series Garvee Bonds	15,840	—	(2,900)	12,940	3,000	9,940
2003 Series A Revenue Bonds	268,020	—	—	268,020	2,875	265,145
2004 Series A Revenue Bonds	—	94,000	—	94,000	2,295	91,705
Subtotal bonds payable	1,070,450	94,000	(24,425)	1,140,025	28,885	1,111,140
Less:						
Deferred amount on refundings	(2,464)	—	616	(1,848)	(616)	(1,232)
Bonds premium	3,819	4,765	(549)	8,035	549	7,486
Bonds discount	(9,052)	—	948	(8,104)	(948)	(7,156)
Bonds accretion	(1,098)	—	334	(764)	(350)	(414)
Total bonds payable, net	1,061,655	98,765	(23,076)	1,137,344	27,520	1,109,824
Loans payable:						
Series 2005 Note	—	6,350	(500)	5,850	2,051	3,799
Total loans payable	—	6,350	(500)	5,850	2,051	3,799
Other liabilities:						
Accrued compensated absences	60,210	—	(12,425)	47,785	27,631	20,154
Retroactive union arbitration	384,258	11,758	—	396,016	—	396,016
Litigation	15,175	7,868	—	23,043	450	22,593
Landfill closure and postclosure costs	28,821	469	—	29,290	—	29,290
Accrued disallowed costs	6,014	—	—	6,014	—	6,014
Total other liabilities	494,478	20,095	(12,425)	502,148	28,081	474,067
Total governmental activities	\$ 1,556,133	125,210	(36,001)	1,645,342	57,652	1,587,690
Business-type activities:						
Notes payable:						
WICO	\$ 21,376	—	(831)	20,545	851	19,694
Fiduciary activities:						
Note payable						
Pension trust fund	\$ 6,781	10,000	(6,781)	10,000	10,000	—

Accrued compensated absences, retroactive union arbitration liabilities, accrued litigation, and the landfill closure and post-closure costs are generally expected to be liquidated with resources derived from the General Fund. Accrued disallowed costs are generally expected to be liquidated with resources derived from the General Fund.

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(a) Debt Margin

Pursuant to 48 U.S.C. Section 1574(b)(i) of the Revised Organic Act, the Government may issue revenue bonds for public improvements or undertakings authorized by an act of the Legislature, without limitation as to principal amount. Such revenue bonds are payable solely from the revenue directly derived from and attributable to such public improvements or undertakings. Pursuant to 48 U.S.C. Section 1574(b)(ii), the Government is authorized to issue general obligation bonds for any public purpose provided that no such indebtedness is in excess of 10% of the aggregate assessed valuation of the taxable real property in the U.S. Virgin Islands. In addition, pursuant to 48 U.S.C. Section 1574(a) (Public Law 94-932), the U.S. Virgin Islands is authorized to cause to be issued bonds or other obligations in anticipation of the matching funds to be received from the federal government pursuant to 26 U.S.C. Section 7652(b)(3). There is no legal limit on the value of bonds that the Government may issue pursuant to 48 U.S.C. Section 1574(a). The Legislature of the U.S. Virgin Islands must authorize all bond issuances. PFA is authorized to issue bonds for the purpose of financing any project or for the purpose authorized by the Legislature. Given that PFA's powers to issue bonds are derived from 48 U.S.C. Section 1574(b), the bonds issued by PFA are subject to the limitations of said 48 U.S.C. Section 1574(b). On August 23, 1999, the Legislature amended the V.I. Code to add a mandatory balanced budget provision. Such provisions, specifically Title 2 of the V.I. Code Section 256, provide that the amount of debt of the Government existing on October 1, 2000 shall be the debt limit of the Government, exclusive of bond principal and interest that may become due. The debt limit specified under Title 2 of the V.I. Code Section 256 does not include bonds authorized by law for which a specific source of revenue is identified and committed to retiring those bonds. As used in Title 2 of the V.I. Code Section 256, the term "debt" means the total accumulated unpaid obligations that are due and payable, including unpaid income tax refunds, amounts owed to vendors, and current year unpaid debt service obligations, if any. As used in the statute, the term "debt" does not include that portion of principal or interest on bonds that is not yet due and payable.

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(b) Bonds Payable

Bonds payable outstanding at September 30, 2005 are comprised of the following (expressed in thousands):

Primary Government – Bonds Payable			
<u>Bonds payable</u>	<u>Final maturity</u>	<u>Interest rates (%)</u>	<u>Balance</u>
1998 Series A, C, D, and E Revenue and Refunding Bonds	2023	5.50 – 7.11	\$ 459,790
1999 Series A General Obligation Bonds	2010	6.50	4,765
1999 Series A Revenue Bonds	2033	4.20 – 6.50	278,570
2001 Series A Tobacco Bonds	2031	5.00	21,940
2002 Series Garvee Bonds	2009	2.50 – 5.00	12,940
2003 Series A Revenue Bonds	2033	4.00 – 5.25	268,020
2004 Series A Revenue Bonds	2024	4.00 – 5.25	<u>94,000</u>
Subtotal			1,140,025
Less:			
Deferred amount on refundings			(1,848)
Bonds premium			8,035
Bonds discount			(8,104)
Bonds accretion			<u>(764)</u>
Total			\$ <u><u>1,137,344</u></u>

On May 1, 1998, PFA issued the revenue and refunding bonds Series 1998 A, B, C, D, and E amounting to \$541.8 million, secured by general obligation notes issued by the Government. These bonds were issued for the purpose of, among other things, advance refunding of previously issued bonds in order to obtain lower interest rates.

The proceeds of the 1998 Series A and B Bonds were placed in an irrevocable trust account to provide for all future debt service payments on the Highway Revenue Bonds Series 1989, Series 1991, Series 1992, Series 1993, and Series 1994 Bonds. At September 30, 2005, \$182.8 million of the above-mentioned defeased bonds were outstanding.

The proceeds of the Series 1992 Revenue Bonds were placed in an irrevocable trust to provide for all future debt service payments on the Series 1989 Revenue Bonds. At September 30, 2005, \$159.9 million of defeased bonds were outstanding. All assets held by irrevocable trusts for refunding of prior outstanding debt and the corresponding liabilities are not included in the Government's basic financial statements.

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The 1998 Series C Bonds and the 1998 Series D Bonds were issued to pay, on behalf of the Government, the full principal balance and interest due and payable on the Revenue Anticipation Note, issued in February 1998. The remaining balance of the 1998 Series D Bonds amounting to approximately \$11.6 million was primarily provided to the Government for additional working capital. The net proceeds of the 1998 Series E Bonds amounting to \$104 million were primarily designated to fund the construction of certain capital projects amounting to \$94 million. The remaining \$10 million was deposited in a debt service reserve account.

The U.S. Department of the Treasury makes certain transfers to the Government of substantially all excise taxes imposed and collected under the Internal Revenue laws of the United States in any fiscal year on certain products produced in the U.S. Virgin Islands (primarily rum) and exported to the United States from the Virgin Islands. The amount required to be remitted to the Government by the U.S. Department of the Treasury is an amount no greater than the total amount of local revenue (primarily taxes) collected by the Government in each fiscal year. As a result, the term "matching fund revenue" is used to denote these payments. The Government has pledged the matching fund revenue, as described above, to the timely payment of principal and interest on the 1998 Series A, B, C, D, and E Bonds. Thus, amounts to be received by the Government from federal excise taxes, mostly in rum, are deposited directly in a trust account until the 1998 Bonds are paid in accordance with the indenture of trust.

Estimated prepayments of matching fund revenue are made to the Government prior to the beginning of each fiscal year, subject to adjustment for the amount of local revenue actually collected by the U.S. Department of the Treasury during such year. Prepayments of matching fund revenue are recorded as deferred revenue in the accompanying statement of net assets and the balance sheet of the governmental funds and reversed against revenue in the following year. The adjustments for actual collections made to the estimated prepayments are recorded in the year determined.

In November 1999, the U.S. Congress approved an increase in the rate of federal excise taxes on rum transferred to the Government from \$10.50 to \$13.25 per proof gallon. The increase was retroactive to July 1999. The increase in rate has subsequently been extended two times and in December 2005, Congress again extended the \$13.25 per proof gallon rate to December 31, 2006.

Interest on the Revenue and Refunding Bonds Series 1998 A, B, C, D, and E and 1999 Bonds are payable semiannually on April 1 and October 1, and principal is payable annually on October 1. The Government is responsible for all principal and interest payments on the 1998 Series bonds. The principal due on October 1 and interest payments due on October 1 and April 1, are funded by the matching fund revenue and deposited into the debt service reserve accounts.

On April 13, 1999, a loan agreement was made between and among the Government, the PFA, International Business Machine Corporation (IBM), Banco Popular de Puerto Rico, and U.S. Trust Company of New York (Y2K Loan). The purpose of this loan was to finance certain costs of compliance by the Government with Year 2000 computer system issues. The loan was evidenced by the Government's issuance of General Obligation Bonds Series 1999 A amounting to \$18 million. Principal and interest are payable semiannually on January 1 and July 1. On July 9, 2001, the Government paid the outstanding IBM portion of the bonds amounting to \$7.4 million.

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The bonds are secured by the full faith and credit and taxing power of the Government, including a pledge on annual real property tax revenue from its taxation of the Hovensa Oil Refinery (the Refinery), which revenue is deposited in the Hovensa Property Tax Fund, and a contingent pledge of all franchise taxes on foreign sales corporations collected by the Government (Franchise Tax Revenue). Pursuant to the Hovensa Oil Contract, the Refinery agreed to pay \$14 million annually of real property taxes on the Refinery properties. Foreign sales corporations qualified to do business in the Virgin Islands must pay a franchise tax of \$1.50 for each thousand dollars of capital stock issued (Franchise Tax).

On April 13, 1999, PFA also issued Project Revenue Bonds (the 1999 Project Revenue Bonds), amounting to \$13.5 million on behalf of the Government, to finance a portion of the Government's Year 2000 (Y2K) compliance efforts, including the costs related to transportation, installation, and related hardware, software, consulting services, and related expenses. The 1999 Project Revenue Bonds are secured by lease payments made by the Government to PFA pursuant to a municipal lease purchase agreement, dated April 13, 1999. Such lease payments shall be funded by appropriation from the real property taxes deposited in the Hovensa Property Tax Fund and all franchise taxes on a subordinated basis and subject to any superior rights of the Series 1999 A General Obligation Bonds. The 1999 Project Revenue Bonds matured on January 1, 2005.

On November 16, 1999, PFA issued the 1999 Series A Revenue Bonds amounting to \$299.9 million. These bonds were issued to (i) pay certain working capital obligations of the Government, (ii) repay the Government outstanding tax and revenue anticipation notes, (iii) fund the Series debt service accounts, and (iv) pay certain costs of issuing the bonds.

The Government pledged gross receipts taxes for the timely payment of the principal and interest on the 1999 Series A Bonds. Interest is payable semiannually on April 1 and October 1, and principal is payable annually on October 1. Gross receipts revenue amounted to \$129 million for the year ended September 30, 2005. As discussed in note 16, on September 28, 2006, a portion of the 1999 Series A Revenue Bonds were refunded with the issuance of the 2006 Series Gross Receipts Revenue Bonds.

On November 20, 2001, TSFC issued Tobacco Settlement Asset-Backed Bonds amounting to \$23.6 million of the aggregate principal. The proceeds were used for the purpose of (i) purchasing all rights, title, and interest in certain litigation awards under the master settlement agreement (MSA) entered into by participating cigarette manufacturers, (ii) issuance of Tobacco Settlement Asset-Backed Bonds to pay the purchase price for the rights, and (iii) to provide funds for hospital and healthcare projects in the U.S. Virgin Islands.

Interest on the 2001 Bonds is payable semiannually on each May and November 15, beginning with May 2002 for the term bonds amounting to \$15.5 million and convertible capital appreciation bonds amounting to \$8.2 million, with a nominal value of \$6.2 million.

The convertible capital appreciation bonds accrete interest prior to November 15, 2007 and accrue interest subsequent to that date. Interest on the capital appreciation bonds will compound on May 15th and November 15th.

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Bonds payable at September 30, 2005, amounted to \$21.9 million with accumulated accretion of \$764 thousand. Under early redemption provisions, any MSA payments exceeding annual debt service requirements of the 2001 Series A Tobacco Bonds must be applied to early redemption of principal. MSA payments and interest earnings on the trust funds during the year ended September 30, 2005, resulted in early redemption of \$370 thousand during fiscal year 2005.

On October 1, 2002, PFA issued the Series 2002 Revenue Bonds (Garvee Bonds), the proceeds of which amounted to \$20.8 million. The Garvee Bonds are special, limited obligations, secured solely by the pledge and assignment of the Government's security interest in Federal Highway Reimbursement Revenues. The bonds were issued to (i) fund construction costs related to renovation and construction of two sea docks, (ii) fund the Debt Service Reserve Accounts, and (iii) pay certain costs of issuing the bonds. The Series 2002 Bonds are not subject to redemption prior to maturity.

Interest and principal on the Series 2002 Revenue Bonds are payable semiannually on March 1 and September 1. As of September 30, 2005, the outstanding 2002 Revenue Bonds amounted to \$12.9 million.

On February 28, 2003, PFA entered into a swaption contract that provided PFA with an up front payment of \$8.3 million. PFA has outstanding \$278,570,000 Series of 1999A Bonds with maturities from 2011 to 2029. The 1999A Bonds are callable by PFA on October 1, 2010 at 101%. Having been advised by its underwriters and financial advisor that there were no net present value savings available to it by issuing conventional advance refunding bonds, PFA sold a LIBOR-based swaption to Lehman Brothers Special Financing, Inc. on the 2024 and 2029 maturities, totaling \$162,870,000. Lehman purchased the swaption for \$8.3 million and it is exercisable on July 1, 2010 only. The objective of PFA was to monetize the economics of the Series of 1999A Bonds call option and lock in the favorable interest rates prevailing on February 28, 2003 without currently issuing refunding bonds. The swaption was the most efficient mechanism available to PFA to effect savings from the Series 1999A Bonds at that time. As a synthetic refunding of its 1999 Series A Bonds, this payment represents the risk-adjusted, present-value savings of the refunding as of October 1, 2010, without issuing refunding funds at February 2003. The swaption gave the counterparty the option to make PFA enter into a pay-fixed, receive-variable interest rate swap. If the option is exercised, PFA would then expect to issue variable rate refunding bonds.

The \$8.3 million payment was based on a notional amount of \$174.9 million. The counterparty has the option to exercise the agreement on October 1, 2010 – PFA's 1999 Bonds' first call date. If the swap is exercised, it will also commence on October 1, 2010. The fixed swap rate (5.27%) was set at a rate that, when added to an assumption for remarketing and liquidity costs, will approximate the coupons of the refunded bonds. The swap's variable payment would be 64% of the London Interbank Offered Rate (LIBOR).

The up front payment of \$8.3 million was received by PFA on behalf of the PG. The Government has deferred the recognition of revenue from the \$8.3 million received in advance, and is amortizing it into income through October 1, 2010, which is the exercise date of the swaption. The up front payment was restricted to capital expenditures. In 2004, PFA authorized the use of \$2 million of the up front payment for a Micro Loan Financing Program, which is managed by the Economic

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Development Authority. As of September 30, 2005, the PFA had expended \$257 thousand on capital projects and \$639 thousand on micro-loans.

As of September 30, 2005, the swap had a negative fair value of approximately \$29.3 million in favor of the counterparty estimated using the zero-coupon method. This method calculated the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipated future spot interest rates. These payments were then discounted using the spot rates implied by the current yield curve for the hypothetical zero-coupon bonds due on the date of each future net settlement on the swap. On September 28, 2006, in conjunction with the defeasance of a portion of the Series 1999A Revenue Bonds, the PG terminated the 2003 Swap Agreement. Due to the negative fair value of the hedging transaction, the PG paid a termination fee of \$26.9 million to Lehman Brothers to terminate the hedging agreement.

On December 17, 2003, PFA issued the Series 2003A Revenue Bonds, the proceeds of which amounted to approximately \$268 million. The bonds were issued to: (i) repay the Government outstanding Revenue Bond Anticipation Notes, Series 2003, (ii) fund certain necessary public safety and other public sector capital development projects, (iii) fund debt service accounts for the bond issuance, and (iv) to pay certain costs of issuing the bonds.

The Government has pledged gross receipts taxes for the timely payment of the principal and interest on the Series 2003A Revenue Bonds. Interest is payable semiannually on April 1 and October 1, and principal is payable annually on October 1, beginning October 1, 2005. The Series 2003A Revenue Bonds are not subject to optional redemption prior to October 1, 2014.

On December 1, 2004, PFA issued the 2004 Series A Bonds, the proceeds of which amounted to \$94 million. The Government has pledged the matching fund revenues to the timely payment of principal and interest on the 2004 Series A Bonds. The bonds bear interest at 4.00% to 5.25% and mature from 2005 to 2024. The proceeds of the bonds were issued to: (i) finance the planning, development, constructing, renovating and equipping of wastewater treatment facilities and collection systems on St. Thomas and St. Croix, (ii) finance the repairs, renovations, and construction of solid waste facilities in the territory, (iii) finance the repair and construction of public roads in the territory, (iv) provide start-up capital for the Virgin Islands Waste Management Authority, (v) fund the Series 2004A Senior Lien Debt Service Reserve Subaccount, and (vi) pay certain costs of issuing the Series 2004A Bonds. The Series 2004A Bonds are not subject to optional redemption prior to October 1, 2014.

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Debt service requirements at September 30, 2005 were as follows (expressed in thousands):

Governmental activities – bonds										
	Revenue Bonds Series 1998 A		Revenue Bonds Series 1998 C		Revenue Bonds Series 1998 D		Revenue Bonds Series 1998 E		Revenue Bonds Series 1998 Total	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
Year(s):										
2006	\$ —	15,821	10,555	2,236	4,210	974	—	6,261	14,765	25,292
2007	—	15,821	11,150	1,640	4,470	714	—	6,261	15,620	24,436
2008	—	15,821	11,780	1,009	4,750	434	—	6,261	16,530	23,525
2009	—	15,821	12,455	343	4,915	147	—	6,261	17,370	22,572
2010	13,135	15,480	—	—	—	—	—	6,261	13,135	21,741
2011 – 2015	77,205	65,861	—	—	—	—	30,095	25,396	107,300	91,257
2016 – 2020	78,930	45,386	—	—	—	—	39,665	14,695	118,595	60,081
2021 – 2025	81,700	21,951	—	—	—	—	36,670	2,443	118,370	24,394
2026 – 2029	38,105	1,072	—	—	—	—	—	—	38,105	1,072
Total	\$ 289,075	213,034	45,940	5,228	18,345	2,269	106,430	73,839	459,790	294,370

	General Obligation Bonds Series 1999 A		Revenue Bonds Series 1999 A		Tobacco Bonds Series A 2001		Garvee Bonds Series 2002		Revenue Bonds Series 2003 A	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
Year(s):										
2006	\$ 945	295	5,005	17,210	—	687	3,000	647	2,875	13,244
2007	1,005	232	5,285	16,921	—	686	3,155	497	2,990	13,126
2008	1,075	166	5,585	16,615	910	687	3,310	339	3,110	13,004
2009	1,140	95	5,900	16,292	1,030	687	3,475	174	3,230	12,877
2010	600	19	6,230	15,951	1,100	686	—	—	3,360	12,746
2011 – 2015	—	—	37,155	73,471	5,170	3,433	—	—	19,165	61,244
2016 – 2020	—	—	50,540	59,625	—	3,432	—	—	24,550	55,685
2021 – 2025	—	—	69,015	40,522	5,685	2,296	—	—	31,660	48,415
2026 – 2030	—	—	93,855	15,054	—	2,011	—	—	40,450	39,411
2031 – 2034	—	—	—	—	8,045	402	—	—	136,630	14,079
Total	\$ 4,765	807	278,570	271,661	21,940	15,007	12,940	1,657	268,020	283,831

	Revenue Bonds Series 2004 A		Total governmental activities	
	Principal	Interest	Principal	Interest
Year(s):				
2006	\$ 2,295	4,778	28,885	62,153
2007	2,980	4,658	31,035	60,556
2008	3,130	4,505	33,650	58,841
2009	3,285	4,345	35,430	57,042
2010	3,450	4,176	27,875	55,319
2011 – 2015	20,025	18,045	188,815	247,450
2016 – 2020	25,675	12,212	219,360	191,035
2021 – 2025	33,160	4,530	257,890	120,157
2026 – 2030	—	—	172,410	57,548
2031 – 2034	—	—	144,675	14,481
Total	\$ 94,000	57,249	1,140,025	924,582

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(c) Conduit Debt

In February 2004, the PFA issued private activity bonds amounting to \$50.6 million to finance costs of construction of a coker plant for a refinery on the island of St. Croix. The bonds are limited obligations of PFA and will be payable solely from and secured by a pledge and assignment of the amounts payable under the loan agreement between PFA and the refinery. The refinery is responsible for all debt service payments of the private activity bonds. The Government is not obligated for the repayment of the bonds. The bonds are not reported as liabilities in the Government's basic financial statements.

(d) Notes Payable

On September 7, 2005, PFA issued the Subordinate Lien Revenue Notes, Series 2005 (Virgin Islands Gross Receipts Taxes Loan Note) in the aggregate amount of \$6.35 million (the Series 2005 Notes). The Series 2005 Notes accrue interest monthly at a rate of 4% for 36 months. The proceeds of the Series 2005 Notes were loaned to the PG under the same terms, for the purposes of (i) financing the acquisition of a fleet of vehicles for the Virgin Islands Police Department and (ii) paying certain costs of issuing the Series 2005 Notes. On September 22, 2005, the PFA made a prepayment on the loan balance in the amount of \$500 thousand, from unexpended loan proceeds.

Debt service requirements for the Series 2005 Notes at September 30, 2005 were as follows (expressed in thousands):

Year:		
2006	\$	2,051
2007		2,137
2008		<u>1,662</u>
Total	\$	<u><u>5,850</u></u>

On November 20, 2002, WICO consolidated and refinanced the 1993 and 2000 loans, and obtained an additional \$2 million in financing for infrastructure improvements. The consolidated loan amounts to \$22.5 million, to be repaid in 239 monthly installments of \$142 thousand, and a final payment of outstanding principal balance plus any unpaid interest accrued to the date of the final payment. The consolidated loan has a fixed interest rate of 4.5% for the first four years of the loan. After the first four years, WICO will have the option to adjust the interest rate to one of the following: (i) prime rate plus 75 basis points, (ii) one-year LIBOR rate plus 200 basis points, or (iii) three-year treasury note rate plus 125 basis points. The revenue of WICO and lease agreements is pledged for the payment of principal and interest on the loan. WICO paid approximately \$947 thousand in interest expense during fiscal year 2005.

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Debt service requirements for the WICO loan at September 30, 2005 were as follows (expressed in thousands):

Year(s):		
2006	\$	852
2007		870
2008		879
2009		920
2010		951
2011 – 2015		5,354
2016 – 2020		6,874
2021 – 2023		<u>3,845</u>
Total	\$	<u><u>20,545</u></u>

(e) *Fiduciary Funds – Notes Payable*

On December 30, 2002, the pension trust fund entered into a line-of-credit agreement with a bank to provide working capital. The pension trust fund obtained a line of credit of \$10 million, which accrues interest at a fixed interest rate of 4.8% calculated on a 360-day basis and is due and payable quarterly in arrears commencing on the first day of the fourth calendar month following the closing of the loan. The terms of the line of credit require the pension trust fund to repay the line of credit in a period of 30 consecutive days during each 12-month period. The bank retains a certificate of deposit in the amount of \$10 million as security on the note payable. As of September 30, 2005, the outstanding balance on the line of credit agreement was \$10 million.

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(f) Component Units – Bonds Payable

Bonds payable of discretely presented component units are those liabilities that are paid out of resources pledged by such entities. These revenue bonds do not constitute a liability or debt of the PG. Bonds payable outstanding at September 30, 2005 are as follows (expressed in thousands):

<u>Bonds payable</u>	<u>Final maturity</u>	<u>Interest rates (%)</u>	<u>Balance</u>
University of the Virgin Islands:			
General obligation bonds of 2004	2035	2.02 – 5.38	\$ 21,150
General obligation bonds of 1999	2029	4.75 – 5.95	23,210
Virgin Islands Water and Power Authority (Electric System):			
Revenue bonds of 2003	2023	4.00 – 5.00	69,960
Revenue bonds of 1998	2022	4.25 – 5.30	87,995
Virgin Islands Water and Power Authority (Water System):			
Revenue bonds of 1999	2017	4.90 – 5.50	35,550
Virgin Islands Port Authority:			
Series A Revenue bonds of 2003	2023	5.00 – 5.25	18,005
Series B Revenue bonds of 2003	2015	3.73 – 5.43	14,315
Series C Revenue bonds of 2003	2023	4.40	9,476
Virgin Islands Housing Finance Authority:			
Revenue bonds of 1995	2025	5.50 – 6.50	2,145
Revenue bonds of 1998	2028	4.10 – 5.25	2,600
Subtotal			<u>284,406</u>
Plus unamortized premium			5,342
Less unamortized discount			(832)
Less deferred amount on debt refunding and reacquisition costs			<u>(5,231)</u>
Bonds payable, net			283,685
Less amount due within one year			<u>(8,860)</u>
Bonds payable, due in more than one year			<u>\$ 274,825</u>

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Following is a schedule of changes in long-term debt for discretely presented component units for fiscal year 2005 (expressed in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Amounts due within one year</u>	<u>Amounts due thereafter</u>
Bonds payable:						
University of the Virgin Islands	\$ 44,059	—	(268)	43,791	575	43,216
Virgin Islands Water and Power Authority:						
Electric System	163,845	—	(4,043)	159,802	4,580	155,222
Water System	34,909	—	(1,596)	33,313	1,995	31,318
Virgin Islands Port Authority	37,221	6,504	(1,691)	42,034	1,610	40,424
Virgin Islands Housing Finance Authority	6,365	—	(1,620)	4,745	100	4,645
Total bonds payable, net	\$ 286,399	6,504	(9,218)	283,685	8,860	274,825
Loans payable:						
Virgin Islands Economic Development Authority	\$ 901	—	(53)	848	58	790
Virgin Islands Water and Power Authority:						
Electric System	5,600	—	—	5,600	—	5,600
Virgin Islands Port Authority	890	1,600	(1,580)	910	910	—
University of the Virgin Islands	3,490	—	(1,754)	1,736	56	1,680
Total loans payable	\$ 10,881	1,600	(3,387)	9,094	1,024	8,070
Other long-term liabilities:						
University of the Virgin Islands	\$ 132	—	(104)	28	—	28
Virgin Islands Housing Authority	6,484	—	(2,601)	3,883	—	3,883
Virgin Islands Economic Development Authority	8,513	1,062	—	9,575	—	9,575
Juan F. Luis Hospital	298	—	(275)	23	—	23
Roy L. Schneider Hospital	558	760	—	1,318	—	1,318
Virgin Islands Housing Finance Authority	12,723	1,391	—	14,114	—	14,114
Total other long-term liabilities	\$ 28,708	3,213	(2,980)	28,941	—	28,941

On December 1, 1999, the University issued the 1999 Series A Bonds. The University issued these bonds to finance a portion of the construction, furnishing, and equipping of various facilities of the University, to refund the 1994 Series A Bonds issued by the University, to fund a debt service reserve fund for the 1999 Series A Bonds, and to pay certain costs issued under and secured by an indenture of trust. The 1999 Series A Bonds maturing on or after December 1, 2010 are subject to redemption prior to maturity at the option of the University, as a whole or in part of any date, on and after December 1, 2009, at redemption prices ranging between 100% and 102% of their principal amount plus accrued interest to the date fixed for redemption. As of September 30, 2005, the 1994 Series A Bonds were retired.

In fiscal year 2004, the University of the Virgin Islands General Obligation Improvement Bonds, 2004 Series A (the 2004 Series A Bonds) were issued in the amount of \$21.2 million under and secured by the indenture of trust dated as of December 1, 1999 and a first supplemental indenture of trust dated as of June 1, 2004, between the University and the trustees. The bonds were used to finance the costs of construction, furnishings, and equipping of various facilities of the University, to fund the debt service reserve fund and to pay the cost of issuance.

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In June 2003, the Virgin Islands Water and Power Authority (Electric System) issued the Electric System Revenue Bonds, Series 2003, amounting to \$69.9 million. The proceeds from the bonds were used to finance capital improvements, repay \$18 million of then outstanding lines of credit, cover underwriters' costs, and establish a debt service fund.

In June 1998, the Electric System issued \$110.9 million of 1998 Series A Electric System Revenue and Refunding Bonds. The proceeds from the bonds, and approximately \$14 million in funds from the existing debt service and debt service funds, were used to repay outstanding line-of-credit balances, to provide for approximately \$30 million in funds for the construction of certain capital projects, and to pay underwriters' discount and issuance costs of approximately \$1.7 million. The remaining proceeds were used to purchase direct obligations of the U.S. government which were placed in an irrevocable trust with an escrow agent to provide all future debt service on the remaining \$69 million principal amount of the 1991 Series A Electric System Revenue Bonds.

Under the terms of the Bond Resolution relating to the Electric System Revenue and Refunding Bonds, payment of the principal and interest is secured by an irrevocable lien on the Electric System's net revenue, (exclusive of any funds that may be established pursuant to the Bond Resolution for certain specified purposes), including the investments and income, if any, thereof.

The Bond Resolution contains certain restrictions and commitments, including the Electric System's covenant to establish and maintain reasonable rates, fees, rentals, and other charges to produce net electric revenue, as defined, that will be at least 125% of aggregate annual principal and interest. The Electric System's net electric revenue for the fiscal year ended June 30, 2005 was 225% of the aggregate debt service as defined in the Bond Resolution.

The Series 2003 Bonds maturing on or after July 1, 2013 are subject to redemption prior to their stated maturity date, at the option of the Electric System, on or after July 1, 2013, as a whole or in part at any time, at a redemption price equal to the principal amount thereof plus accrued interest thereon to the date fixed for redemption.

The 1998 Series Electric System Revenue and Refunding Bonds are subject to redemption on or after July 1, 2008, as a whole or in part at any time, at a redemption price of 101% in 2008, 100.5% in 2009, and 100% thereafter. The Electric System Revenue Bonds are subject to mandatory redemption if (i) any significant part of the Electric System was damaged, destroyed, taken, or condemned, or (ii) any for-profit nongovernmental investor shall acquire an ownership interest in some or all of the assets of the Electric System.

In December 1998, the Virgin Islands Water and Power Authority (Water System) issued the 1998 Water System Revenue and Refunding Bonds amounting to \$44.1 million. The proceeds from the bonds were used to repay the 1990 Series A Water System Revenue Bonds at a redemption price of 100% and to refund the 1992 Series B Water System Revenue Bonds, repay outstanding lines of credit balances, pay underwriters' costs, provide funding for a Renewal and Replacement Reserve Fund, and to purchase obligations of the United States government, which were placed in an irrevocable trust with an escrow agent to provide all future debt service on the remaining principal amount of the 1992 Series B Bonds. At June 30, 2005, \$35.6 million of the original principal amount of the defeased 1992 Series B Bonds remained outstanding.

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Payment of principal and interest of the 1998 Series Bonds is secured by an irrevocable lien on the Water System's net revenues (exclusive of any funds that may be established pursuant to the Bond Resolution for certain other specified purposes) and funds established under the Bond Resolution, including investment securities. To provide additional security, the Water System has conveyed to the bond trustee, a subordinate lien and security interest in the Water System's General Fund. The Water System is also required to make deposits in a debt service reserve fund in accordance with the Bond Resolution.

The Bond Resolution contains certain restrictions and commitments, including the Water System's covenant to establish and maintain reasonable rates, fees, rentals, and other charges to produce net water revenue, as defined, that will be at least 125% of aggregate annual principal and interest payments. The Water System's net water revenue for the fiscal year ended June 30, 2005 was 134% of the aggregate debt service.

The 1998 Series Bonds maturing on or after July 1, 2010 are subject to redemption prior to their stated maturity date, at the option of the Water System, as a whole or in part at any time, at a redemption price of 101% during July 1, 2009 through June 30, 2010 and 100% thereafter. The Water System Revenue Bonds are subject to mandatory redemption if (i) any significant part of the water system shall be damaged, destroyed, taken, or condemned or (ii) any for-profit nongovernmental investor shall acquire an ownership interest in some or all assets of the Water System.

On January 16, 2003, VIPA issued the Marine Revenue Bonds Series 2003A (AMT) and 2003B (federally taxable) with principal amounts of approximately \$18 million and \$17.4 million, respectively. VIPA is using the proceeds of the bonds to finance the dredging, rehabilitation, and construction of berthing piers for seagoing vessels and cruise ships and mixed-use commercial facilities on the island of St. Thomas.

On October 20, 2003, VIPA issued the Marine Revenue Bonds Series 2003C (non-AMT), in the amount of \$3 million with an authorized principal amount not to exceed approximately \$10.8 million. VIPA is using the proceeds of the bonds to finance the completion of several projects of rehabilitation and construction of berthing piers and dredging for cruise and seagoing vessels on the island of St. Thomas.

The bonds' indentures contain certain account restrictions and funding covenants to cover interest, debt service, maintenance, and other costs as specified in the corresponding bond indentures.

The bonds' indentures also specify certain debt service coverage requirements determined from net available revenue of the Rohlsen Terminal, Airport System, and the Marine Division. The provisions of each of the bonds' indentures require that rates and fees charged for the use of each facility should be sufficient to generate enough revenue to pay all operation and maintenance expenses, exclusive of depreciation and certain noncash charges, of the respective facilities, plus: (i) at least 125% of the principal and interest and redemption account sinking fund deposit requirement of each of the bonds becoming due during such year; (ii) the amount of the debt service reserve fund deposit requirement for such period; (iii) the deposit required to the Renewal and Replacement Fund; and (iv) the amount

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of the capital improvements appropriations for such period. The Management of VIPA asserts that VIPA has complied with all bond indenture requirements.

VIHFA issued the 1995 A Revenue Bonds in the amount of \$6.2 million, and the 1998 A Revenue Bonds, in the amount of \$3 million, for the purpose of building single-family housing. The indenture agreements for the bonds require the VIHFA to deposit with the trustee the full amount of the bond proceeds, to purchase Government National Mortgage Association (GNMA) certificates. The servicer is obligated to pay the principal and interest due on the GNMA certificates to the trustee in an amount equal to the scheduled principal and interest payments of the underlying mortgages. All mortgage loans issued by the VIHFA must be originated by the participants and secured by a first priority mortgage lien on the applicable single-family residences.

Fixed maturities required to pay principal and interest on discretely presented component units' bonds payable with fixed maturities at September 30, 2005 are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year(s):			
2006	\$ 8,860	14,567	23,427
2007	10,980	13,374	24,354
2008	11,520	14,131	25,651
2009	12,095	13,580	25,675
2010	12,720	12,989	25,709
2011 – 2015	60,685	49,113	109,798
2016 – 2020	73,675	34,137	107,812
2021 – 2025	50,486	19,289	69,775
2026 – 2030	29,395	7,494	36,889
2031 – 2035	13,990	1,877	15,867
	<u>284,406</u>	<u>\$ 180,551</u>	<u>464,957</u>
Total			
Plus unamortized premium	5,342		
Less unamortized discount	(832)		
Less deferred amount on debt refunding and reacquisition costs	<u>(5,231)</u>		
Bonds payable, net	\$ <u>283,685</u>		

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(11) General Tax Revenue

For the year ended September 30, 2005, general tax revenue of the PG consisted of the following (expressed in thousands):

	<u>General fund</u>	<u>PFA debt service fund</u>	<u>Other governmental funds</u>	<u>Total</u>
Income taxes	\$ 402,785	—	—	402,785
Real property taxes	26,426	—	15,500	41,926
Gross receipts taxes	—	129,019	250	129,269
Other taxes	103,930	40,058	2,695	146,683
Tax revenue	<u>\$ 533,141</u>	<u>169,077</u>	<u>18,445</u>	<u>720,663</u>
Tax revenue not recognized on the modified accrual basis				<u>68,459</u>
Total tax revenue – government-wide			<u>\$ 789,122</u>	

(12) Commitments and Contingencies

(a) Primary Government

The current labor relations environment of the Government is defined by 13 distinct labor organizations subject to approximately 26 collective bargaining agreements. 14 bargaining units are without collective bargaining agreements. As specific disciplines are not grouped under a single pay plan, it is common to have clerical and nonprofessional workers in different departments throughout the Government, represented by different unions. Of the approximately 9,566 government workers, including employees of the executive branch of the Government, approximately 7,143 belong to unions. The present collective bargaining statute requires binding arbitration for certain classified employees in the event of an impasse during salary negotiations between the Government and any union. Under this process, each side chooses an arbitrator and a third impartial arbitrator is selected by the chosen arbitrators. The arbitration panel investigates and reviews the issues in dispute and renders a final and binding decision. For other classified employees, the Government must decide to go to impasse or to enjoin any strike. The Government has contractual liabilities for retroactive union arbitration salary increases aggregating \$396 million accruing from fiscal years 1993 through 2005. Pursuant to Title 24 of the V.I. Code Section 374(h), no such contractual amount is due until appropriation of funds is made by the Legislature. Upon action of the Legislature, the General Fund will have the responsibility to satisfy the obligations arising from the retroactive wages. Until such time, the liability is recorded as a long-term debt in the governmental activities column in the government-wide financial statements. Retroactive union negotiated salaries account increased by \$11.8 million from fiscal year 2004 to fiscal year 2005.

The Government receives financial assistance from the federal government in the form of loans, grants, and entitlements. Monetary and nonmonetary federal financial assistance amounted to approximately \$150.7 million and \$21.1 million, respectively, for the year ended September 30, 2005.

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Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal regulations, including the expenditure of resources for eligible purposes. Substantially, all grants are subject to audit under Office Management and Budget (OMB) Circular A-133. Disallowances as a result of these audits may become liabilities of the Government. At September 30, 2005, based on an evaluation of pending disallowances, the Government has recorded approximately \$6 million as other long-term liabilities in the governmental activities column of the government-wide financial statements.

Management of the Government believes that the future outcome of any changes in federal financial assistance programs will not have a material effect on the basic financial statements.

On September 23, 2002, the Government entered into a three-year compliance agreement with the U.S. Department of Education requiring that the Government develop integrated and systemic solutions to problems in managing its federally funded education programs. The compliance agreement focuses on the areas of program design and evaluation, financial management, human capital, and property management and procurement. The compliance agreement expired on September 23, 2005. The Government had not fully complied with all terms and conditions of the compliance agreement. The U.S. Department of Education subsequently implemented a special condition for the Government to designate a third-party fiduciary to administer U.S. Department of Education grants. The terms and conditions of the original compliance agreement have been extended until the Government is in full compliance with the agreement.

The Government is a defendant in numerous legal proceedings pertaining to matters incidental to the performance of routine governmental operations. With respect to pending and threatened litigation, the Government has accrued a provision for legal claims and judgments of approximately \$25 million for awarded and anticipated unfavorable judgments as of September 30, 2005. Management believes that the ultimate liability in excess of amounts provided would not be significant.

Changes in the reported estimated litigation payable since September 30, 2003, resulted from the following activity (expressed in thousands):

	Beginning fiscal year liability	Current year claims and changes in estimates	Claim payments	Ending fiscal year liability
2003 – 2004	\$ 13,235	2,478	(538)	15,175
2004 – 2005	15,175	7,868	—	23,043

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The breakdown of the estimated litigation payable at September 30, 2005 is as follows (expressed in thousands):

Governmental activities:	
Current portion of estimated litigation payable	\$ 450
Long-term portion of estimated litigation payable	<u>22,593</u>
	<u>\$ 23,043</u>

As of September 2002, the Government was a defendant in a lawsuit regarding the assessment of property taxes. Under the lawsuit, taxpayers asserted that properties should be assessed at actual value in accordance with the Organic Act of 1933. The U.S. District Court agreed with the plaintiffs and, in May 2003, imposed an injunction on the collection of real property taxes for years subsequent to 1998. The Government complied with the Court order to develop a plan to implement the new valuation method, and the injunction was lifted in August 2003. Assessments will continue at the 1998 level until the new assessment method is in place.

State and federal laws and regulations require the Government to place a final cover on its landfill sites when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for 30 years after closure. Although closure and post-closure care costs will be paid only near or after the date that the landfill stops accepting waste, the Government reports a portion of these closure and post-closure care costs as an operating expense in each period based on landfill capacity used as of each balance sheet date. The \$29.3 million reported as landfill closure and post-closure care liability at September 30, 2005, represents the cumulative amount reported to date based on the use of the estimated capacity of each landfill. The Government will recognize the remaining estimated cost of closure and post-closure care of \$9.7 million as the remaining estimated capacities are filled. These amounts are based on what it would cost to perform all closure and post-closure care in 2005.

The estimated used capacity and expected closure of each of the Government landfills is as follows:

<u>Landfill</u>	<u>Estimated used capacity</u>	<u>Estimated closure date</u>
Bovoni	57.41%	2020
Angilla	82.86	2010
Susannaberg	91.65	1993

Actual cost may be higher due to inflation, changes in technology, or changes in regulations. The Government is required by state and federal laws and regulations to make annual contributions to a trust to finance closure and post-closure care. The Government will begin to make annual contributions to a trust in 2006 to finance closure and post-closure costs. The Government expects that future inflation costs will be paid from interest earnings on these annual contributions. However, if interest earnings are inadequate or additional post-closure care requirements are determined (due to changes in technology or applicable laws or regulations, for example), these costs may need to be covered by charges to future landfill users.

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Since 1985, the Government has been subject to a consent decree issued by the Virgin Islands District Court, governing the operation of its wastewater treatment plants. The consent decree was amended in 1996 and further modified with the 2002 Stipulation to the Amended Consent Decree (the Stipulation) to establish deadlines for the construction of new secondary treatment facilities, including the replacement of the existing St. Croix and Airport Lagoon (Charlotte Amalie) wastewater treatment plants. The Stipulation requires that the new St. Croix wastewater treatment plants be completed by the end of 2005 and the new Charlotte Amalie wastewater treatment plants be completed by the end of 2005. The cost of both facilities is estimated at approximately \$50 million. The Stipulation also establishes certain interim deadlines and performance standards that must be met by the Government pending completion of the new facilities. In addition, the Stipulation establishes specified penalties for violation of any of the deadlines or performance standards set forth therein. As of the date of the basic financial statements, all of the Government's outstanding obligations pursuant to the Stipulation are current. In January 2004, the Government's Legislature authorized the creation of the Virgin Islands Waste Management Authority (WMA) for the purpose of meeting environmental requirements of waste treatment in the U.S. Virgin Islands. On December 2004, the PFA issued revenue bonds amounting to \$94 million for the purpose of constructing and rehabilitating wastewater treatment plants noted above.

On August 21, 2002, the Government and the United States Environmental Protection Agency (EPA) entered into a memorandum of understanding documenting the EPA's agreement to support the renewal of the Territorial Pollutant Discharge Elimination System permit for its St. Croix distillery operations provided that the Government make certain funding available to (i) conduct treatability studies regarding the Virgin Islands Rum Industries, Ltd. effluent and the means to mitigate its potential environmental effects in the vicinity of the discharge, (ii) identify practicable, available, reliable, and cost-effective potential mitigation measures, and (iii) implement (or assist in the implementation of) such mitigation measures in the event such measures are determined by the V.I. Department of Planning and Natural Resources after consultation with EPA to be necessary and appropriate. Pursuant to the memorandum of understanding, the Government's obligation to fund such activities is limited to \$6 million in the aggregate, commencing on October 13, 2003. In June 2004, the Government entered into a three-year contract with a locally licensed environmental consulting firm to facilitate the Government's commitments with the memorandum of understanding with the EPA.

As of September 2005, the Government was a defendant in a lawsuit regarding the assessment of franchise taxes. Under the lawsuit, taxpayers asserted that franchise taxes should be assessed in accordance with Title 13 Virgin Islands Code Section 531(a). The plaintiff taxpayers interpret the definition of "capital stocks used in conducting business in the Virgin Islands" in the V.I. Code as tax collected only on the par value of the stock, while the Government's position is that the amount allocated should be over the par value and additional paid-in capital upon a subsequent reorganization. The Government also imposed a six-year statute of limitations on tax refund claims against the Government. Management believes that the ultimate liability of this case would not have a material adverse impact on the Government's overall financial position as reported in the government-wide financial statements.

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(b) *Discretely Presented Component Units*

In September 1989, WAPA electric facilities were damaged by Hurricane Hugo. WAPA reconstructed the facilities with proceeds from insurance and FEMA. Subsequent to the receipt of funds, FEMA deobligated approximately \$7.9 million in questioned costs. Approximately \$2.6 million of these questioned costs related to an oil spill that was subsequently settled with FEMA. During 1998, WAPA submitted a second appeal for \$4.4 million of the remaining questioned costs, and agreed to refund approximately \$900 thousand. During 1999, FEMA denied the second appeal and formally closed the disaster claim. WAPA has recorded a liability for \$5.3 million related to the questioned costs. FEMA has not made a formal request for repayment of the funds.

In September 1995, WAPA electric facilities were again damaged by a hurricane – Hurricane Marilyn. WAPA again reconstructed its facilities with proceeds from insurance and FEMA. In March 1999, FEMA denied WAPA's claim for \$8.9 million in remaining expenditures related to the reconstruction. WAPA subsequently reduced its claim to \$5.7 million. In the year ended June 30, 2005, WAPA settled its claim with FEMA by offsetting the \$5.7 million claim against an amount payable to FEMA, resulting in an amount due to WAPA of \$150 thousand.

In September 2004, WAPA electric facilities sustained damages amounting to \$1.3 million due to Tropical Storm Jeanne. WAPA reported \$978 thousand as a FEMA claim receivable for the year ended June 30, 2005.

WAPA estimates that capital expenditures in connection with continuing capital improvements will be approximately \$37.6 million for the Electric System and \$8.2 million for the Water System during the year ended June 30, 2006.

In August 2003, VIHA was declared to be in substantial default of its annual contributions contract with the U.S. Department of Housing and Urban Development. Due to the severity of the compliance violations, VIHA was placed in receivership. As of September 30, 2005, VIHA remained in receivership.

VIHA has received approval for two capital fund advances from HUD totaling \$12 million dollars. As of December 31, 2004, VIHA had drawn down \$11.4 million of the advances with \$579 thousand received in the current fiscal year. The advances do not bear interest and are to be repaid through reduction of future capital grants from HUD. No repayments were made as of December 31, 2004.

In July 2004, VIHA executed a memorandum of understanding with WAPA for the repayment of \$4.16 million in overdue utility accounts. The terms of the memorandum call for monthly payments of \$175 thousand, with the remainder to be paid by March 2006.

In 2002, the Federal Aviation Administration (FAA) conducted an on-site wildlife evaluation of the St. Croix landfill, which is located next to the St. Croix airport. The FAA determined that the landfill posed an environmental and navigational threat to the airport due to flocks of birds that reside in the landfill area. The FAA may require VIHA to repay \$9.3 million in federal grants and has refused further discretionary grants for the airport until VIHA shows progress toward closing the landfill. The landfill is under the jurisdiction of the PG. The PG has negotiated a remediation plan with FAA to

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close the landfill within the next four years. FAA accepted the plan, if such measures are implemented.

In connection with the purchase of lands adjacent to the airport, VIPA was awarded federal financial assistance in 2002 amounting to \$8 million under a Real Property Acquisition Relocation Assistance Program. VIPA is in noncompliance with certain federal requirements of the assistance program. Noncompliance with requirements of federal financial assistance programs may result in a refund of the funds granted. VIPA management believes that noncompliance instances should not materially affect VIPA's financial position.

In 2004, VIGHHFC entered into contracts for the purchase of equipment and the construction of a Cancer Institute on the island of St. Thomas. As of September 30, 2005, the St. Thomas hospital had outstanding contracts and commitments amounting to \$8.9 million, and the St. Croix hospital had outstanding contracts and commitments of \$194 thousand.

WAPA, VIPA, and other discretely presented component units are presently defendants or codefendants in various lawsuits. The financial managers of the component units have advised the PG that any adverse outcome involving a material claim is expected to be substantially covered by insurance. Government property is exempt from lien, levy, or sale as a result of any judgment under the V. I. Code.

(13) Retirement Systems

(a) Plan Description

GERS is the administrator of a cost sharing, multiple employer defined benefit pension plan established as of October 1, 1959 by the Government to provide retirement, death, and disability benefits to its employees. The following description of the plan is provided for general information purposes only. Refer to the actual text of the retirement law in the V.I. Code, Title 3, Chapter 27 for more complete information. Regular employees are eligible for a full-service retirement annuity when they have completed 30 years of credited service or have attained the age of 60 with at least 10 years of credited service. Members who are considered "safety employees," as defined in the V.I. Code, are eligible for full retirement benefits when they have earned at least 20 years of government service or have reached the age of 55 with at least 10 years of credited service. Regular employees who have attained the age of 50 with at least 10 years of credited service can elect to retire early with a reduced benefit. Senators and members of the Legislature may receive a retirement annuity when they have attained the age of 50 and completed six years of credited service or earned at least six years of credited service as a member of the Legislature.

The monthly annuity benefit payment is determined by applying a stipulated benefit ratio to the member's average compensation. Average compensation is determined by averaging the three highest years of salary the member earned within the last 10 years of service. The maximum annual salary that can be used in this computation is \$65,000. The annuity payment to retirees 60 years or older increases by 1.5% of the original amount on July 1 of each year after the first year of payments.

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GERS is a blended component unit included in the financial reporting entity and is presented as a pension trust fund of the PG. GERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Employees' Retirement System of the Government of the Virgin Islands, 3438 Kronprindsens Gade, Veterans Drive, St. Thomas, VI 00802.

(b) Funding Policy

Contributions to GERS are made by the Government and the members. Government and members' contributions are not actuarially determined but are set by statute. The Government and members' contributions together with the income of GERS should be sufficient to provide an adequate actuarially determined reserve for the benefits prescribed by the VI Code.

The contributions required to fund GERS on an actuarial reserve basis are calculated periodically by the GERS actuarial consultant. The actuarial valuation as of September 30, 2003 indicates that the current combined statutory employer and employee contribution rates are not sufficient to meet the cost of GERS on an actuarial basis.

The Government's required contribution for the year ended September 30, 2005 was 14.5% of the member's annual salary. Since April 1, 1991, required member contributions are 8% of annual salary for regular employees, 9% for senators, and 10% for Act 5226 eligible employees. Through September 30, 2000, member contributions were refundable without interest upon withdrawal from employment before retirement. Subsequent to September 30, 2000, legislation was passed that provided for 4% annual interest on refunded contributions. The Government's contractually required contributions, actual contributions made, and percentage contributed to the plan for the years ended September 30, 2005, 2004, and 2003, are as follows (expressed in thousands):

	<u>Contractually required contributions</u>	<u>Contributions made</u>	<u>Percentage contributed</u>
2003	\$ 51,588	51,588	100%
2004	54,085	54,085	100
2005	51,542	51,542	100

In August 1994, legislation providing an early retirement incentive was passed. The legislation was subsequently amended on October 13, 1994, December 30, 1994, and December 5, 1995. Among other matters, the legislation allows a member of GERS who has a combined aggregate number of years of credited service plus number of years of age, equal to at least 75 years as of the date of the legislation, to retire without reduction of annuity. Members, who have attained the age of 50 with at least 10 but less than 30 years of credited service, may add an additional three years to their age for this computation. Members with 30 years of service or who can retire without penalty under the V.I. Code shall have their average compensation increased by four percentage points.

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For each employee electing to retire pursuant to Section 8(a) of the Early Retirement Act of 1994 (the Act), the Government contributes to GERS, on a quarterly basis, an amount equal to the employer and employee contributions that would have been made until the employee reached the age of 62 had the employee not elected to retire under this provision.

For employees electing to retire under Section 8(b) of the Act, the Government contributes to GERS a sum equal to the additional contribution the employer and employee would have made had the employee received a salary 4% higher during the three years used to compute the employee's average compensation figure plus a sum of \$5,000. Based on this calculation, the amount was \$25.7 million as of September 30, 2005. As of September 30, 2005, GERS has received \$18.9 million, and the Government has accrued a liability of \$6.8 million in the accompanying basic financial statements.

The actuaries of GERS have determined that the specific funding provided under the Act is inadequate to cover the costs of the program. GERS is seeking to recover any unfunded costs of the program under a newly enacted provision of the retirement law, which provides that the employer will compensate GERS for the costs of any special early retirement program.

The University has two retirement plans in which all eligible employees are required to participate. The Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) is a defined contribution pension plan covering participating, full-time faculty members, and other exempt employees, under which the contributions, including employees' contributions, are used to purchase annuities. There are no unfunded past service costs, and vested benefits are equal to the annuities purchased under TIAA-CREF. As of September 30, 2005, 219 faculty members and other employees were TIAA-CREF participants. The number of active participants from the University participating in GERS as of September 30, 2005 was 272. Total contributions made by the University to TIAA-CREF and GERS participant accounts amounted to \$1.7 million and \$1.1 million, respectively.

(14) Liquidity

At September 30, 2005, the Government had a net deficit in the governmental activities amounting to \$192.3 million, mostly attributable to approximately \$268 million in long-term debt that was issued to provide resources for working capital and other noncapital related purposes. The Government has initiated specific actions to improve its future cash flows through the issuance of long-term debt, engaging a consulting firm to assist it in its efforts to develop a series of detailed revenue enhancement and expenditure reduction initiatives and the enactment of certain laws directed toward improving the Government's financial situation. In October 1999, the Government and the U.S. Department of Interior (DOI) entered into a memorandum of understanding (the MOU) whereby the Government agreed to use its best efforts to undertake certain deficit reduction initiatives. As a condition to certain new and additional federal financial and technical assistance included in or being proposed by federal appropriations or other legislation, certain financial performance and accountability standards were agreed upon by the Government, which the DOI believes are necessary for the Government to achieve long-term economic recovery. Pursuant to the MOU, the release of such new and additional federal funds to the Government is subject to compliance with such performance and verifiable objectives agreed upon in such agreement. The accountability and financial performance standards agreed upon in the MOU include: (i) preparation of

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five-year financial recovery plan to be provided to DOI within 90 days of the date of the MOU; (ii) a fiscal year 2000 budget mandating substantial reductions in departmental budgets and overall General Fund fiscal year 2000 expenditures not to exceed \$432.1 million; (iii) absent extraordinary circumstances to maintain balanced budgets after fiscal year 2003 with any generated surpluses applied to the reduction of the accumulated deficit and unfunded obligations; (iv) annual preparation of financial reports; and (v) efforts to reduce the outstanding debt of the Government. On October 29, 1999, the DOI and the Government entered into an amendment of the MOU, which amended the Government's requirement to seek change in the Virgin Islands public labor relations law to comply with federal labor law. Pursuant to such amendment, the Government, in collaboration with union representatives, is encouraged to pursue reform initiatives through collective bargaining to bring fiscal solvency to the Government. In addition to the financial performance standards set forth in the MOU, the MOU further provides for the DOI and the Government to enter into a program of preservation and enhancement of the natural, cultural, and historic resources of the U.S. Virgin Islands to stimulate local economic growth through sustainable tourism. The Government is discussing with DOI certain events of noncompliance, remedial actions necessary to comply with the provisions of the MOU, and its effect on the Government's financial condition and results of operations.

In April 2000, the Economic Recovery Task Force submitted the five-year operating and strategic financial plan to the Governor for action. The plan provides over 200 recommendations that propose to reduce and eventually eliminate the structural budget deficit by restructuring and reforming Government operations and forging a partnership with the private sector intended to result in sustained growth.

In January 2003, the U.S. Department of Interior issued an audit report concluding that all criteria of the (the proposed MOU) were partially or substantially achieved except: (i) implementation of collective bargaining reforms to assist the fiscal solvency of the Government and (ii) completion of comprehensive annual reports within 120 days of year-end and single audits within nine months of year-end. As part of the MOU, the Government has committed to maintaining balanced budgets after the fiscal year ended September 30, 2003, with any surpluses applied to liquidating outstanding debt. The U.S. Department of Interior acknowledged that it had not achieved its objective of providing funding for the V.I. Conservation Fund and committed to providing funds for capital improvements, technical assistance, and other assistance once the Government has achieved substantial compliance.

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(15) Restatements of Net Assets and Fund Balances

(a) Component Units

Beginning net assets of four discretely presented component units were restated to correct errors identified in previously reported balances related to receivables, loans and advances, investments, capital assets, and accounts payable and accrued expenses. The restated beginning net asset balances are as follows (expressed in thousands):

<u>Component unit</u>	<u>Beginning net assets</u>		
	<u>As previously reported</u>	<u>Prior period adjustment</u>	<u>As restated</u>
University of the Virgin Islands	\$ 76,471	6,723	83,194
Virgin Islands Housing Authority	63,802	4,679	68,481
WAPA Water	38,895	379	39,274
WAPA Electric	96,116	1,134	97,250
Other component units	368,230	—	368,230
Net assets	<u>\$ 643,514</u>	<u>12,915</u>	<u>656,429</u>

(16) Subsequent Events

(a) Primary Government

In September 2005, the U.S. Department of Education extended indefinitely the three-year compliance agreement entered with the PG in 2002 to address problems in administering federal education grants; and imposed the requirement that the PG designate a third-party fiduciary to administer U.S. Department of Education grants. In August 2006, the PG entered into a contract with a private firm to be the designated third-party fiduciary.

In December 2005, Congress passed legislation extending the excise tax on rum of 13.5 cents per gallon to December 31, 2006. The rate was set to expire on December 31, 2005.

In January 2006, the U.S. Department of the Treasury issued final regulations determining residency for U.S. territories and possessions as required by the American Jobs Creation Act which was passed in October 2004. The PG has retained an independent consultant to evaluate the effect of the regulations on the economy of the territory and to pursue revisions of the final regulations through congressional intervention. In November 2006, the final regulations were revised by the U.S. Department of the Treasury. The PG continues to pursue further revisions to these regulations.

In March 2006, the TSFC issued the 2006 Tobacco Settlement Financing Corporation Asset-Backed Bonds amounting to \$7.29 million, the proceeds of which will be used to finance hospital capital improvements.

In June 2006, the PFA approved the issuance of \$104 million in private activity bonds to be issued on behalf of the HOVENSA oil refinery. HOVENSA plans to use the proceeds to refinance outstanding loans and for capital improvements.

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In August 2006, Moody's Investors Services gave the PG an investment grade rating of Baa3 on its outstanding bonds. In September 2006, Standard and Poor provided the government a rating of BBB-. The investment grade ratings will enable the PG to access new capital markets and to reduce the costs of future bond issuances.

In September 2006, the Public Finance Authority refinanced portions of the 1999 Series A Revenue Bonds through the issuance of the 2006 Series Gross Receipts Revenue Bonds (2006 Series Bonds). The 2006 Series Bonds have a notional amount of \$219.49 million, and resulted in realized interest savings on the defeasance of \$21 million. The proceeds of the bonds will be used to (i) refund a portion of the Series 199A Revenue Bonds (\$162.8 million), (ii) pay the costs of a termination fee in connection with an outstanding swap option agreement, (iii) fund certain capital projects, (iv) fund the debt service account, and (v) pay costs associated with issuing the 2006 Series Bonds.

In September 2006, the Public Finance Authority issued the Series 2005 Subordinate Lien Revenue Notes in the amount of \$6.35 million. The proceeds will be used to finance acquisition of a fleet of vehicles for the fire department of the PG.

(b) Component Units

In September 2005, the Legislature of the PG appropriated \$16.1 million for operating expenses of the Waste Management Authority (WMA). The creation of the WMA was approved in January 2004 as a separate and independent corporation of the Government for the purpose of meeting environmental requirements of waste treatment in the U.S. Virgin Islands. The responsibility for the operations of WMA is vested in a board of seven directors composed of three Government officials including the Commissioner of the Department of Public Works, and four private citizens appointed by the Governor. The activities of WMA are limited to activities conducted on behalf of the Government. WMA became operational in fiscal year 2006.

In October 2005, the Governor Juan Luis Hospital and Medical Center entered into a payment agreement with the WAPA Electric System and WAPA Water System to pay off outstanding utility bills amounting to \$3.7 million over a four-year period.