

VIRGINIA MILITARY INSTITUTE



Financial Statements For the year ended 30 June 2011 (Audited)

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MANAGEMENT'S DISCUSSION AND ANALYSIS

VIRGINIA MILITARY INSTITUTE
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
For the Year Ended 30 June 2011

Overview

Virginia Military Institute (VMI) is pleased to present its financial statements for the fiscal year ended 30 June 2011, along with the financial statements of its affiliates as required under Governmental Accounting Standards Board Statement Number 39. This management discussion and analysis (MD&A) is designed to facilitate the reader's understanding of the accompanying financial statements and to provide an objective, easily readable analysis of the Institute's financial activities based on currently known facts, decisions and conditions. This discussion focuses primarily on VMI's fiscal year 2011 and includes highly summarized data that should be read in conjunction with the accompanying financial statements, notes to the financial statements, and other supplementary information.

VMI's financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) standards and include three basic statements: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. Using criteria provided in GASB Statement 39, *Determining Whether Certain Organizations are Component Units*, the Institute determined that the VMI Alumni Agencies, Inc., and the VMI Research Laboratories, Inc. are both component units of the Institute. The affiliates' financial statements are prepared in accordance with Financial Accounting Standards Board (FASB) standards and include the Statement of Financial Condition and the Statement of Activities. They are presented discretely on a separate page within the Institute's financial statements. The following analysis discusses elements from VMI's statements and provides an overview of the Institute's activities. VMI's affiliated entities are excluded from this MD&A.

Financial Highlights

The overall financial position of the Institute continued to improve during FY 2011 due in large part to another increase in enrollment over the previous year and the further recovery of investment losses incurred during fiscal years 2008 and 2009. Net assets (the residual interest in assets after liabilities are deducted) increased by \$11.6 million over the previous fiscal year to \$239.4 million. The Institute's opening fall enrollment numbers for the Corps has continued to increase from 1,408 cadets for FY 2008, to 1,456 cadets for FY 2009, to 1,527 cadets for FY 2010, and to 1,603 cadets for FY 2011.

Tuition and fees increased by \$1.5 million to \$16.7 million in FY 2011 for a 9.6% increase while auxiliary enterprise revenues increased \$2.1 million to \$15.2 million for a 16.1% increase.

State appropriations for operations totaled \$12 million in FY 2011, an increase of nearly \$0.7 million or 5.9% from the previous fiscal year. This is the first increase in State appropriations for the last four years. State appropriations are still \$2.6 million less than the \$14.6 million received during the 2008 fiscal year.

VMI incurred a net investment gain of \$2.5 million for FY 2011, \$0.9 million over the previous fiscal year.

Construction of the Military and Leadership Field Training Grounds (\$17.1 million) progressed significantly over the course of the year and is scheduled for completion in November 2011. The South Institute Hill Parking project (\$2.8 million) was initiated in the fall of 2010 when the Institute received pooled bond funds from the Virginia College Building Authority (VCBA), and is scheduled for completion in August 2012. The Institute received confirmation in June that funding for the renovation of the Science Building and the Post Hospital had been approved. Funding for these projects will come through the VCBA's 21st Century Bond program. The Science Building project (\$19 million) is scheduled to be completed September 2013 and the Post Hospital project (\$5.1 million) is scheduled for completion August 2012.

Statement of Net Assets

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

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should be able to determine the assets available to continue the Institute's operations. They should also be able to determine how much the Institute owes vendors, creditors, and others.

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

Statement of Net Assets				
	30 June 2011	30 June 2010	Variance	
Assets:				
Current assets	\$ 23,083,739	\$ 21,609,072	\$ 1,474,667	6.82%
Capital assets, net	224,733,849	219,172,608	5,561,241	2.54%
Other noncurrent assets	18,431,657	14,877,950	3,553,707	23.89%
Total assets	\$ 266,249,245	\$ 255,659,630	\$ 10,589,615	4.14%
Liabilities:				
Current liabilities	\$ 8,744,890	\$ 12,331,145	\$ (3,586,255)	29.08%
Noncurrent liabilities	18,148,546	15,568,355	2,580,191	16.57%
Total liabilities	\$ 26,893,436	\$ 27,899,500	\$ (1,006,064)	-3.61%
Net assets:				
Invested in capital assets, net of related debt	\$ 211,927,205	\$ 205,827,518	\$ 6,099,687	2.96%
Restricted - expendable	10,615,225	9,541,747	1,073,478	11.25%
Restricted - nonexpendable	1,267,021	1,267,021	-	0.00%
Unrestricted	15,546,358	11,123,844	4,422,514	39.76%
Total net assets	\$ 239,355,809	\$ 227,760,130	\$ 11,595,679	5.09%

VMI's current assets as of 30 June 2011 increased by \$1.5 million, or 6.8% from the 30 June 2010 balance. Accounts receivable increased approximately \$0.8 million due to a slight increase in the number of cadets with outstanding balances due and an outstanding settlement payment due from the architect for the Crozet Hall Renovation Project. Inventories increased approximately \$0.8 million over the previous fiscal year due to the need for more uniforms with the larger Corps size and the timing of the receipt of uniform orders.

Capital assets, net of depreciation, increased by \$5.6 million or 2.5% to \$224.7 million. This increase is attributable to additional construction in progress for the Military Leadership Field Training Grounds project.

Other noncurrent assets increased by \$3.6 million to \$18.4 million, a 23.9% increase over the previous year. Of this increase, \$2.8 million is attributable to proceeds received through the Commonwealth's State Non-Arbitrage Program (SNAP) to fund the South Institute Hill Parking project. The remaining increase can be attributed to fewer unreimbursed capital expenses as of 30 June for VCBA 21st Century bond funded projects. These projects require the Institute to first incur the expenses and seek reimbursement from the Commonwealth on a monthly basis.

Current liabilities decreased 29.1% or \$3.6 million from the previous year to \$8.7 million. The largest portion of this decrease is attributed to a decrease (\$2.5 million) in the Institute's obligations under the Commonwealth's securities lending program. These obligations represent VMI's allocated share of securities held in the General Account of the Commonwealth. The remainder of this decrease in current liabilities is the result of a smaller number of vouchers payable to contractors for capital projects because of fewer ongoing projects. Noncurrent liabilities increased by \$2.6 million or 16.6% as a result of the issuance of debt for the South Institute Hill project.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
For the Year Ended 30 June 2011

As a result of the changes explained above, net assets increased by \$11.6 million or 5.1% over the previous fiscal year to \$239.4 million.

Statement of Revenues, Expenses, and Changes in Net Assets

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

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

Nonoperating revenues generally represent income and support for which goods and services are generally not provided. For example, it includes State appropriations for VMI's Educational and General and Unique Military Activities Programs for which goods and services are not directly provided to the State by VMI.

Statement of Revenues, Expenses, and Changes in Net Assets				
	30 June 2011	30 June 2010	Variance	
Operating revenues:				
Tuition and fees	\$ 16,721,836	\$ 15,251,565	\$ 1,470,271	9.6%
Grants and contracts	650,451	407,318	243,133	59.7%
Auxiliary enterprises	15,245,485	13,128,557	2,116,928	16.1%
Unique military activities	2,415,390	2,058,314	357,076	17.3%
Other sources	1,295,881	1,531,428	(235,547)	-15.4%
Total operating revenues	36,329,043	32,377,182	3,951,861	12.2%
Operating expenses:				
Educational and general	43,827,863	43,541,100	286,763	0.7%
Auxiliary enterprises	19,955,041	18,223,371	1,731,670	9.5%
Unique military activity	6,111,772	6,001,428	110,344	1.8%
Other expense	9,281	4,764	4,517	100.0%
Total operating expenses	69,903,957	67,770,663	2,133,294	3.1%
Operating loss	(33,574,914)	(35,393,481)	1,818,567	-5.1%
Nonoperating revenues (expenses):				
State appropriations	11,988,934	11,325,528	663,406	5.9%
Gifts, grants and contributions	18,059,890	17,309,785	750,105	4.3%
Investments	2,514,685	1,569,522	945,163	60.2%
Other	(389,088)	(1,712,558)	1,323,470	-77.3%
Net nonoperating revenues	32,174,421	28,492,277	3,682,144	12.9%
Income (loss) before other revenues	(1,400,493)	(6,901,204)	5,500,711	-79.7%
Other revenues/reductions	12,996,172	20,707,206	(7,711,034)	-37.2%
Increase (decrease) in net assets	11,595,679	13,806,002	(2,210,323)	-16.0%
Net assets - beginning of year	227,760,130	213,954,128	13,806,002	6.5%
Net assets - end of year	\$ 239,355,809	\$ 227,760,130	\$ 11,595,679	5.1%

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
For the Year Ended 30 June 2011

Operating revenues increased by 12.2% or \$4 million to \$36.3 million while operating expenses increased by 3.1% or \$2.1 million to \$69.9 million. The increase to operating revenues can be attributed to tuition and fee increases as well as an increase in enrollment. The opening enrollment increased by 76 cadets to 1,603 over the previous year, while tuition and fees increased by 8.2% for in-state Cadets and 5.4% for out-of-state Cadets. The largest portion of the increase in operating expenses was in auxiliary enterprises where the cost of services provided to Cadets increased due to the increase in enrollment.

Non-operating revenues increased \$3.7 million or 12.9% to \$32.2 million. State Appropriations increased approximately \$0.7 million over the previous fiscal year while investments realized a gain of \$0.9 million during FY 2011. During 2011, the Institute received additional Federal stabilization funds of approximately \$1.9 million, an increase of approximately \$1.1 million over the previous fiscal year.

Other revenues and/or reductions changed by \$7.7 million from an increase of \$20.7 million during fiscal year 2010 to an increase of \$13 million during the 2011 fiscal year. While the Institute did receive the Stonewall Jackson House property and Museum as a contribution from the Stonewall Jackson House Foundation, a gift valued at \$1.2 million, we received less capital funding from both the State and the VMI Foundation for projects.

Statement of Cash Flows

This statement presents detailed information about the Institute's cash activity during the year. Cash flows from operating activities will always differ from the operating loss on the Statement of Revenues, Expenses and Changes in Net Assets (SRECNA). The SRECNA is prepared on the accrual basis of accounting and includes noncash items such as accounts receivable and accrued liabilities as well as such expenses as depreciation, whereas the Statement of Cash Flows presents cash inflows and outflows without regard to accrual items. The Statement of Cash Flows helps the reader assess the Institute's ability to generate cash flows sufficient to meet its obligations. It is divided into five parts: operating activities, noncapital financing activities, investing activities, capital and related financing activities, and reconciliation of the net cash used, to the operating income or loss reflected on the SRECNA.

Statement of Cash Flows				
	30 June 2011	30 June 2010	Variance	
Net cash used by operating activities	\$ (27,674,420)	\$ (28,444,752)	\$ 770,332	-2.7%
Net cash provided by noncapital financing activities	30,519,425	30,413,154	106,271	0.3%
Net cash used by capital and related financing activities	1,265,278	(1,629,251)	2,894,529	177.7%
Net cash provided by investing activities	1,209,774	934,849	274,925	29.4%
Net increase (decrease) in cash	5,320,057	1,274,000	4,046,057	317.6%
Cash - beginning of year	9,731,121	8,457,121	1,274,000	15.1%
Cash - end of year	\$ 15,051,178	\$ 9,731,121	\$ 5,320,057	54.7%

Cash provided and/or (used) by operating activities will always result in a net use for the Institute because all State appropriations and private gifts are treated as cash sources for noncapital or capital financing activities rather than cash sources for operating activities. Tuition and fees (\$16.4 million) and auxiliary enterprise revenues (\$15.2 million) represent the largest sources of operating cash, while compensation and benefits (\$37.8 million) and payments for supplies and services (\$24.9 million) are the most significant uses of operating cash. Overall, net cash used for operations decreased slightly for fiscal year 2011 from the previous fiscal year by \$0.8 million.

Net cash provided by noncapital financing activities for operations consists largely of State appropriations (\$12 million) and private fund support (\$15.1 million). Overall, cash provided by noncapital financing activities increased only \$0.1 million during FY 2011 over FY 2010.

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For the Year Ended 30 June 2011

Net cash provided or used by capital and related financing activities consists primarily of gifts and contributions from the VMI Development Board and State VCBA bond funding (\$16.5 million). The purchase and construction of capital assets (\$14.5 million) and principal and interest paid on capital debt (\$2.5 million) account for the largest uses of cash for capital and related financing activities.

Net cash provided by investing activities increased slightly by \$0.3 million from \$0.9 million in FY 2010 to \$1.2 million in FY 2011.

Capital Asset and Debt Administration

FY 2011 was the ninth year of the implementation of VMI's Vision 2039 master plan. Vision 2039 is a leadership plan rather than a construction plan; however, construction of new facilities and the renovations of older buildings on Post are essential components of Vision 2039. During the year, planning and/or renovation and construction was initiated or continued on a number of academic as well as other mission essential facilities: the Military Leadership Field Training Grounds, Science Building renovation, Post Hospital renovation and South Institute Hill Parking.

The 2008 General Assembly appropriated VCBA bond financing for two new VMI capital projects beginning in FY 2009 consisting of \$15.1 million for VMI's Military Leadership Field Training Grounds (MLFTG) project and \$0.8 million in detailed planning funds to renovate the Science Building. During June 2010, the Institute appropriated an additional \$2 million for the MLFTG project (\$1 million from private funds and \$1 million from auxiliary funds). Construction of the MLFTG project commenced in September 2009 and is scheduled for completion in November 2011. The Institute requested through the State's new capital outlay process, funds to complete the Science Building Renovation project and was notified at the conclusion of the 2011 General Assembly session that this project was approved to be funded with VCBA 21st Century bond funds (\$18.2 million). Renovations of the Science Building will support changes in VMI's revised Core Curriculum, increases in the size of the Corps of Cadets, and support increases in the number of Science, Technology, Engineering and Math (STEM) graduates and energy conservation and life safety measures. This project is scheduled to be completed in September 2013.

The 2008 General Assembly also appropriated bond financing for the South Institute Hill Parking project. The debt is being financed with VCBA pooled bond funds that were sold in October 2010. This \$2.8 million project is scheduled to be completed in August 2012.

Detailed planning on the Post Hospital was initiated with authorization granted from the 2009 General Assembly, to utilize \$0.2 million of non-general funds. Planning was completed and resulted in drawings to the preliminary phase. This renovation project (\$4.9 million) was approved to be funded with VCBA 21st Century bond funds during the 2011 General Assembly session. This renovation is scheduled to be completed in August 2012 as well.

VMI had four capital projects totaling \$44.1 million in progress at the end of FY 2011. Except for the South Institute Hill Parking project, these projects are all financed with State funds or private funds from VMI's alumni agencies resulting in no debt obligations for VMI. Since VMI began its Vision 2039 capital program, it has incurred debt only on the Jackson Memorial Hall, the Cocke Hall Annex, the Crozet Hall and the South Institute Hill Parking capital projects. As of 30 June 2011, the debt on these projects totaled approximately \$15.6 million with annual debt service payments of approximately \$1.5 million, most of which is being funded by the VMI Foundation and VMI Development Board. VMI's Board of Visitors adopted debt guidelines in August 2005 to help ensure sound management and control of debt.

Economic Outlook

State appropriations for operations totaled \$12.0 million in FY 2011 and \$11.3 million in FY 2010 for an increase of \$0.7 million or 5.9%. State appropriations represented 17.4% of VMI's total revenue and support for operations in FY 2011 compared to 18.1% in FY 2010. State appropriations were supplemented with approximately \$1.9 million

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in Federal Stabilization Funds (federal "stimulus" funds) for FY 2011 compared to \$0.8 million in FY 2010. Federal "stimulus" funding was available for FY 2010 and FY 2011 only.

State appropriations for FY 2012 are projected to total approximately \$11.1 million for a decrease of \$0.9 million or 7.6% compared to FY 2011. The decrease primarily reflects the continuation of State cuts due to shortfalls in State revenues. State appropriations for the 2012-2014 biennium are not expected to significantly change from FY 2012. Slow and uneven economic growth with a significant downside risk creates uncertainty as to the level of State support for the next few years. However, the State's Higher Education Opportunity Act (2011) is expected to result in some new funding for higher education in 2012-2014 mostly as incentives to help grow the number of in-state graduates and to achieve certain cost-containment objectives. VMI's Six-Year Plan submitted to the State on 1 July 2011 addresses many of the objectives outlined in the Act to include provision of student financial aid to help maintain access and affordability, growth in the number of graduates majoring in science, technology, engineering, and mathematics (STEM), year-round utilization of institutional facilities, instructional resource sharing, initiatives for improvement of programs, and technology enhanced instruction.

Private gifts and contributions in support of operations totaled \$15.0 million in FY 2011 and \$15.5 million in FY 2010. This support represented 21.8% of VMI's total revenues and support for operations in FY 2011 compared to 24.8% in FY 2010. Gifts and contributions consist primarily of donations and endowment income from VMI's alumni agencies. The VMI alumni agencies' refinancing of \$45 million of debt (that financed various VMI capital projects from 2004 to 2009) in July 2010 has resulted in an increase in annual debt service costs. This has reduced the amount of private unrestricted income that can be distributed to VMI annually for support of its programs. However, VMI has obtained a commitment from its alumni agencies for level-funding of unrestricted income from FY 2012 to FY 2014 at \$2.6 million annually or about \$0.9 million less than in FY 2011. Plans are also underway for a new fund raising campaign during the next several years that is expected to increase donations and endowments in support of new and existing programs.

State funding for capital projects totaled \$11.6 million in FY 2011 and \$19.0 million in FY 2010. State funding for existing projects is projected to approximate \$5.5 million in FY 2012 and \$12.1million in FY 2013. VMI has submitted requests for State funding for new capital projects totaling \$169 million for the 2012-2014 biennium; however, State funding for new projects is uncertain for the next few years due to slow economic growth and its impact on the State's debt capacity.

Private funding for capital projects totaled \$1.4 million in FY 2011 and \$1.7 million in FY 2010. Private funding for FY 2012 is projected to total about \$1.0 million for an on-going capital project. No private funding for new capital projects is currently planned for the next several years.

VMI continues to enjoy favorable student demand and a national reputation especially for its engineering programs. VMI received a record 2,244 applications for its new cadet class in fall 2011 (FY 2012) for an increase of 25% compared to fall 2010. A total of 1,010 or 45% of the applicants were offered admissions and a total of 509 students or about 50% enrolled in August 2011. This new cadet class helped to contribute to a record 1,637 total cadets for fall 2011 for an increase of 34 cadets or 2.1% over fall 2010. In-state cadets made up 58.8% of the Corps compared to 59.6% in fall 2010. VMI is planning for approximately 1,640 cadets in fall 2012 (FY 2013) with about 59.3% in-state cadets. VMI projects fall enrollment for the next few years to be maintained at approximately 1,600 to 1,640 cadets with the proportion of in-state cadets at about 58% to 60%.

VMI increased tuition and fees in FY 2012 by 6.0% for in-state cadets and 5.8% for out-of-state cadets. VMI estimates that increases for FY 2013 will be in the 5% to 6% range depending upon State appropriations for operations. VMI plans to keep its tuition and fees competitive and continue to offer attractive financial assistance packages that will help to sustain enrollment and the quality of its programs and services. This is important especially as the percentage of cadets who receive Reserve Officers Training Corps (ROTC) scholarships has declined to about 21% of the Corps in FY 2012 compared to 25% in FY 2011. This percentage is projected to drop more in the next few years in anticipation that the Federal Government will reduce the number of scholarships awarded due mostly to budget constraints.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
For the Year Ended 30 June 2011

In spite of modest growth projected for State appropriations and private funding in the next few years, VMI's executive management believes that the Institute is well positioned to continue to provide excellent programs and services to its cadets as it maintains a clear educational focus and a well-established niche in the higher education marketplace.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
For the Year Ended 30 June 2011

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FINANCIAL STATEMENTS

VIRGINIA MILITARY INSTITUTE
Statement of Net Assets
As of 30 June 2011

ASSETS	
Current assets	
Cash and cash equivalents (Note 2)	\$ 14,266,014
Cash equivalent held by Treasurer of Virginia (Note 2)	309,080
Collateral held for securities lending (Note 2)	94,776
Accounts receivable, <i>Net of allowance for doubtful accounts of \$55,639</i> (Note 3)	1,666,648
Due from the Commonwealth (Note 4)	246,307
Due from federal government	21,537
Prepaid expenditures	950,196
Inventories (Note 5)	5,425,312
Loans receivable	103,869
Total current assets	<u>23,083,739</u>
Noncurrent assets	
Cash and cash equivalents (Note 2)	785,164
Cash equivalent-restricted (Note 2)	2,811,134
Investments held with trustees (Note 2)	12,963,713
Accounts receivable (Note 3)	33,292
Due from Commonwealth (Note 4)	498,515
Loans receivable, <i>Net of allowance for doubtful accounts of \$31,186</i>	1,339,839
Nondepreciable capital assets (Note 6)	20,378,878
Depreciable capital assets, <i>Net of accumulated depreciation</i> (Note 6)	204,354,971
Total noncurrent assets	<u>243,165,506</u>
Total assets	<u><u>266,249,245</u></u>
LIABILITIES	
Current liabilities	
Accounts payable and accrued expenses (Note 7)	4,836,849
Unearned revenue	1,395,660
Obligations under securities lending	403,856
Deposits held for others	470,105
Long-term liabilities-current portion (Note 8)	970,604
Long-term debt-current portion (Note 8, Note 9)	667,816
Total current liabilities	<u>8,744,890</u>
Noncurrent liabilities	
Accrued liabilities (Note 7)	924,511
Federal loan program contributions refundable	1,328,828
Retainage payable (Note 11)	650,446
Long-term liabilities-noncurrent portion (Note 8)	333,279
Long-term debt-noncurrent portion (Note 8, Note 9)	14,911,482
Total noncurrent liabilities	<u>18,148,546</u>
Total liabilities	<u>26,893,436</u>
NET ASSETS	
Invested in capital assets, net of related debt	211,927,205
Restricted-nonexpendable	
Endowment	1,267,021
Restricted-expendable	
Scholarships and other	777,749
Loan funds	562,295
Quasi-endowment-restricted	8,831,243
Capital projects	443,938
Unrestricted	15,546,358
Total net assets	<u>239,355,809</u>
Total liabilities and net assets	<u><u>\$ 266,249,245</u></u>

COMBINED STATEMENT OF FINANCIAL POSITION
Component Units of Virginia Military Institute
As of 30 June 2011

ASSETS

Current assets:

Cash and cash equivalents	\$ 5,671,372
Contributions receivable (Note 18)	6,436,960
Accounts receivable	110,518
Other	781,228
Total current assets	<u>13,000,078</u>

Noncurrent assets:

Contributions Receivable (Note 18)	9,576,450
Investments held by trustees (Note 18)	296,894,439
Investments, other (Note 18)	16,570,119
Investment securities	125,264
Cash surrender of life insurance	5,252,485
Property and equipment, net of accumulated depreciation	411,992
Total noncurrent assets	<u>328,830,749</u>

Total assets 341,830,827

LIABILITIES

Current liabilities:

Accounts payable and accrued expenses	675,929
Unearned revenue	10,766
Long-term liabilities-current portion:	
Trust and annuity obligations	800,255
Total current liabilities	<u>1,486,950</u>

Noncurrent liabilities:

Other liabilities	153,492
Long-term liabilities-noncurrent portion:	
Note payable (Note 18)	2,500,000
Bonds payable (Note 18)	44,877,338
Trust and annuity obligations	4,198,175
Total noncurrent liabilities	<u>51,729,005</u>

Total liabilities 53,215,955

NET ASSETS

Unrestricted	56,618,403
Temporarily restricted	123,271,451
Permanently restricted	108,725,018
Total net assets	<u>288,614,872</u>

Total liabilities and net assets \$ 341,830,827

VIRGINIA MILITARY INSTITUTE
Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended 30 June 2011

Operating revenues:

Tuition and fees, <i>Net of scholarships allowances of \$5,358,163</i>	\$ 16,721,836
Federal grants and contracts	631,553
State and private grants and contracts	18,898
Sales and services of educational departments	379,292
Auxiliary enterprise, <i>Net of scholarship allowances of \$4,618,061</i>	15,245,485
Unique military activities, <i>Net of scholarships allowances of \$843,976</i>	2,415,390
Other sources:	
Museum programs	463,009
Rents and commissions	310,608
Miscellaneous	142,972
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Total operating revenues	36,329,043
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Operating expenses:

Educational and general	
Instruction	17,651,617
Research	245,025
Public service	1,311,379
Academic support	6,938,019
Student services	3,827,164
Institutional support	5,467,801
Operation and maintenance of physical plant	7,363,402
Scholarships and related expense	1,023,456
Auxiliary enterprises	19,955,041
Unique military activities	6,111,772
Loan cancellations and write-offs bad debt expense	9,281
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Total operating expenses (Note 12)	69,903,957
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Net operating income (loss)	(33,574,914)
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Nonoperating revenues/(expenses):

State appropriations (Note 13)	11,988,934
Gifts and contributions	15,041,160
Federal student financial aid (Pell)	1,056,439
Federal stabilization funds (ARRA)	1,962,291
Investment income	2,514,685
Interest on capital asset - related debt	(495,833)
Gain on capital assets	157,010
Other nonoperating expense	(50,265)
	<hr/>
Net nonoperating revenues	32,174,421
	<hr/>
Income (loss) before other revenues and extraordinary items	(1,400,493)
	<hr/>

Other revenues and reductions:

Grants and contributions-capital	12,992,080
Investment income-capital	4,092
	<hr/>
Total other revenues and reductions	12,996,172
	<hr/>
Increase in net assets	11,595,679
Net assets beginning of the year	227,760,130
	<hr/>
Net assets end of year	\$ 239,355,809
	<hr/> <hr/>

COMBINED STATEMENT OF ACTIVITIES
Component Units of Virginia Military Institute
For the Year Ended 30 June 2011

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
REVENUES				
Amounts raised on behalf of VMI	\$ 5,329,867	\$ 5,709,081	\$ 5,940,148	\$ 16,979,096
Grants, contributions and contracts	480,508	10,592	-	491,100
Investment income	1,580,827	1,129,790	-	2,710,617
Actuarial gain/(loss) on trust and annuity obligations	(191,402)	(164,607)	(89,672)	(445,681)
Realized loss on swap contact	-	(183,538)	-	(183,538)
Administrative fees	40,000	-	-	40,000
Other income	3,941,132	-	-	3,941,132
Net assets released from restrictions and reclassifications	7,815,169	(7,815,169)	-	-
Total revenues	<u>18,996,101</u>	<u>(1,313,851)</u>	<u>5,850,476</u>	<u>23,532,726</u>
EXPENSES				
Amounts remitted directly to or on behalf of VMI:				
Unrestricted	8,286,137	-	-	8,286,137
Designated	10,319,503	-	-	10,319,503
Cost of operations	5,876,353	-	-	5,876,353
Conference, research and education	525,467	-	-	525,467
Total expenses	<u>25,007,460</u>	<u>-</u>	<u>-</u>	<u>25,007,460</u>
Change in net assets before net realized and unrealized gains on investments	(6,011,359)	(1,313,851)	5,850,476	(1,474,734)
Net realized and unrealized gains on investments	<u>17,317,023</u>	<u>32,094,161</u>	<u>-</u>	<u>49,411,184</u>
Change in net assets	11,305,664	30,780,310	5,850,476	47,936,450
NET ASSETS				
Beginning	<u>45,312,739</u>	<u>92,491,141</u>	<u>102,874,542</u>	<u>240,678,422</u>
Ending	<u>\$ 56,618,403</u>	<u>\$ 123,271,451</u>	<u>\$ 108,725,018</u>	<u>\$ 288,614,872</u>

VIRGINIA MILITARY INSTITUTE

Statement of Cash Flows

For the Year Ended 30 June 2011

Cash provided/(used) by operating activities:

Tuition and fees	\$ 16,376,427
Federal grants and contracts	555,561
State and private grants and contracts	18,898
Sales and services-educational and general	387,253
Auxiliary charges	15,214,999
Unique military activity charges	2,413,422
Other operating receipts	1,162,341
Payments to employees for salaries and benefits	(37,820,927)
Payments for supplies and services	(24,935,345)
Payments for scholarships and fellowships	(975,277)
Loan funds issued to students	(313,245)
Collections of loans from students	241,473
Net cash provided/(used) by operating activities	<u>(27,674,420)</u>

Cash provided/(used) by noncapital financing activities:

State appropriations	11,988,934
Nonoperating grants and contracts	3,018,731
Gifts and contributions for other than capital purposes	15,051,712
Federal Direct Lending Program-receipts	6,250,907
Federal Direct Lending Program-disbursements	(6,250,907)
Agency receipts	1,000,518
Agency disbursements	(540,470)
Net cash provided/(used) by noncapital financing activities	<u>30,519,425</u>

Cash provided/(used) by capital and related financing activities:

Capital appropriations	3,607
Capital gifts and contributions	16,535,707
Proceeds from capital assets	417,291
Purchase and construction of capital assets	(14,527,682)
Proceeds from capital debt	1,304,289
Principal paid on capital debt, leases and installments	(1,904,894)
Interest paid on capital debt, leases and installments	(567,132)
Investment income-capital	4,092
Net cash provided/(used) by capital and relating financing activities	<u>1,265,278</u>

Cash provided/(used) by investing activities:

Interest on investments	93,440
Investment/Endowment income	243,692
Sale of investments	872,642
Net cash provided/(used) by investing activities	<u>1,209,774</u>
Net increase in cash	5,320,057
Cash-beginning of year	9,731,121
Cash-end of year	<u>\$ 15,051,178</u>

VIRGINIA MILITARY INSTITUTE
Statement of Cash Flows
For the Year Ended 30 June 2011

Reconciliation of net operating expenses to net cash used by operating activities:

Operating loss	\$ (33,574,914)
Adjustments to reconcile net operating expenses to cash used by operating activities:	
Depreciation expense	7,304,729
Changes in assets and liabilities:	
Accounts receivable	(134,809)
Inventories	(828,259)
Prepaid expenditures	(96,437)
Due from Commonwealth	(124,510)
Loans receivable	(72,959)
Accounts payable and accrued liabilities	(31,648)
Unearned revenue	(84,689)
Compensated absences	(39,704)
Federal loan program contributions refundable	8,780
Net cash used in operating activities	<u>\$ (27,674,420)</u>

Noncash investing, noncapital financing, and capital related financing transactions:

Change in fair value of investments recognized as a component of investment income	\$ 1,315,061
Capital assets acquired through in-kind donations as a component of capital gifts and contributions income	<u>1,184,000</u>
	<u>\$ 2,499,061</u>

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

Cash and cash equivalents classified as current assets	14,266,014
Cash and cash equivalents classified as noncurrent assets	785,164
	<u>\$ 15,051,178</u>

- NOTES TO FINANCIAL STATEMENTS -

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NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

A. Reporting Entity

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

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

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

The Governmental Accounting Standards Board (GASB) Statement 39, *Determining Whether Certain Organizations Are Component Units*, provides guidance to determine whether certain organizations for which the Institute is not financially accountable should be reported as component units. Generally, it requires reporting as a component unit, an organization that raises and holds economic resources for the direct benefit of the Institute.

The VMI Alumni Agencies is a legally separate, tax-exempt entity whose purpose is to organize the alumni of the Institute and to aid in the promotion of its welfare and the successful prosecution of its educational purposes. It accomplishes this through fundraising to supplement the support VMI receives from the Commonwealth of Virginia and the tuition and fees charged to cadets. Because the VMI Alumni Agencies’ resources are held almost entirely for the benefit of the Institute and these resources are considered significant to the Institute, we have determined that the Alumni Agencies should be included as a component unit.

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

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

B. Reporting Basis

The Institute's accounting policies conform with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB) pronouncements as well as applicable Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before 30 November 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The financial statements have been prepared in accordance with GASB Statement 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities*.

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

C. Basis of Accounting

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

D. Cash, Cash Equivalents and Investments

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

In accordance with GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, purchased investments, interest-bearing

temporary investments classified with cash, and investments received as gifts are recorded at fair value. All investment income, including changes in the fair value of investments (unrealized gains and losses), is reported as nonoperating revenue in the Statement of Revenues, Expenses, and Changes in Net Assets.

E. Capital Assets

Capital assets include land, buildings and other improvements, library materials, equipment, infrastructure assets such as sidewalks, steam tunnels, and electrical and computer network cabling systems, and intangible assets. The Institute capitalizes construction costs that have a value or cost in excess of \$100,000 at the date of acquisition. Renovations in excess of \$100,000 are capitalized if they significantly extend the useful life of the existing asset. Expenses for major capital assets and improvements are capitalized (construction in progress) as projects are constructed. Routine repairs and maintenance are charged to operating expense in the year the expense is incurred. Interest expense relating to construction is capitalized net of interest income earned on resources set aside for this purpose. The costs of normal maintenance and repairs that do not add to an asset's value or materially extend its useful life are not capitalized.

The Institute capitalizes moveable equipment at a value or initial cost of \$5,000 or more and an estimated useful life in excess of two years. Buildings and equipment are stated at appraised value or actual cost where determinable. Land is stated at cost. Library materials are valued using published average prices for library acquisitions. Intangible assets are capitalized with an acquisition cost of \$100,000 and a useful life of one or more years.

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

Buildings	50 years
Other improvements	10-30 years
Equipment	5-25 years
Library materials	10 years
Intangible assets	5 years to indefinite

The Institute does not capitalize works of art, historical treasures and similar assets. Such items are held for public exhibition, education or research in the furtherance of public service rather than financial gain. Institute collections may be sold but the proceeds must be used for the acquisition of similar type Institute collections. Exceptions to this requirement must be pre-approved by the Deputy Superintendent for Finance, Administration and Support.

F. Inventories

Inventory cost values for the museum, post hospital and physical plant are determined by using the weighted average method. The military store inventory is valued at cost using the first-in first-out method.

G. Unearned Revenue

Unearned revenue represents revenues collected but not earned as of 30 June 2011. This is primarily composed of revenue for student tuition and fees received in advance of the next semester or term.

H. Interest Capitalization

Interest expense incurred during the construction of capital assets is capitalized, if material, net of interest income earned on resources set aside for this purpose. The Institute incurred interest expense totaling \$578,850 for the fiscal year ended 30 June 2011, of which \$83,017 was capitalized as construction period interest.

I. Accrued Compensated Absences

Nonfaculty salaried employee's attendance and leave regulations make provisions for the granting of a specified number of days of leave with pay each year. Instructional personnel do not earn leave. The amount of leave earned but not taken as of 30 June 2011 is recorded as a liability on the Statement of Net Assets. The liability reflects all earned vacation, compensatory and overtime leave not taken as well as the amount payable under the Commonwealth of Virginia's sick leave payout policy upon termination which is the lesser of 25% of sick leave not taken or \$5,000 per employee with five or more years of service. Also included is an estimation of sick leave for those employees who, while not currently vested, will probably attain the 5 years of service required to vest. The last element reflected in the liability is Social Security and Medicaid taxes to be paid by the Institute on all accrued compensated absences.

J. Federal Financial Assistance Programs

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

K. Net Assets

The Institute's net assets are classified as follows:

Invested in capital assets, net of related debt: This represents the Institute's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Restricted net assets – nonexpendable: Nonexpendable restricted net assets consist of endowment funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to the principal.

Restricted net assets – expendable: Restricted expendable net assets include resources in which the Institute is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

Unrestricted net assets: Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the Institute, and may be used at the discretion of the governing board to meet current expenses for any purpose. These resources also include auxiliary enterprises, which are substantially self-supporting activities that provide services for students, faculty and staff. Also included in unrestricted net assets are funds that have been set aside by the Board of Visitors as quasi-endowments. These funds are treated the same as true endowment funds; however, unlike true endowments they may be expended.

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

L. Classification of Revenues

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

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

Nonoperating revenues: Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, and other revenue sources that are defined as nonoperating revenues by GASB 9 *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, GASB 33 *Accounting and Financial Reporting for Nonexchange Transactions*, and GASB 34, such as state appropriations and investment income.

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

NOTE 2: CASH AND CASH EQUIVALENTS AND INVESTMENTS

The following information is provided with respect to the Institute's cash, cash equivalents, and investments as of 30 June 2011. The following risk disclosures are required by GASB Statement 40, *Deposit and Investment Risk Disclosures*.

Custodial credit risk (Category 3 deposits and investments) – The custodial risk for deposits is the risk that, in the event of a failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in possession of an outside party. The Institute had no category 3 deposits or investments for fiscal year 2011.

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

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

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

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

The Institute's credit risk, concentration of credit risk, interest rate risk, and foreign currency risk are described in the Investments note below.

Cash and Cash Equivalents

Pursuant to Section 2.2-1800, et seq., Code of Virginia, all state funds of VMI are maintained by the Treasurer of Virginia, who is responsible for the collection, disbursement, custody, and investment of state funds. Cash deposits held by VMI are maintained in accounts that are collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400, et seq., Code of Virginia.

Cash and cash equivalents consist of the following balances as of 30 June 2011:

	Current	Noncurrent	Total
Cash with Treasurer of Virginia	\$ 11,075,342	\$ 489,910	\$ 11,565,252
SunTrust NOW checking	3,151,952	295,254	3,447,206
Securities under securities lending	309,080	-	309,080
Cash equivalent (State nonarbitrage program)	-	2,811,134	2,811,134
Petty cash	10,720	-	10,720
Wachovia Bank time deposit	28,000	-	28,000
Total cash and cash equivalents	<u>\$ 14,575,094</u>	<u>\$ 3,596,298</u>	<u>\$ 18,171,392</u>

Investments

Investments include endowment and similar funds pooled and invested with VMI affiliates and retirement fund investments for selected employees. It also includes VMI's allocated share of securities held for security lending transactions conducted by the Commonwealth. Investments consist of the following balances as of 30 June 2011:

	Current	Noncurrent	Total
Investments with the Treasurer of Virginia:			
Securities under securities lending	\$ 94,776	\$ -	\$ 94,776
Investments with trustees:			
Investments pooled with VMI affiliates	-	12,039,202	\$ 12,039,202
Mutual fund investments (retirement accounts)	-	924,511	\$ 924,511
Total with trustees	-	12,963,713	\$ 12,963,713
Total investments	<u>\$ 94,776</u>	<u>\$ 12,963,713</u>	<u>\$ 13,058,489</u>

VMI's endowment, loan and similar funds are pooled for investment purposes with the endowment funds of its affiliate, the VMI Alumni Agencies (the VMI Foundation, Inc., the VMI Development Board, Inc., and the VMI Keydet Club) and the George C. Marshall Foundation. VMI owns units in the pooled fund (the "Fund") that operates similar to a mutual fund. VMI Investment Holdings, LLC (LLC) manages and operates the unitized investment pool with BNY Mellon serving as custodian. The VMI Foundation, Inc. is the sole member of the LLC and acts as an intermediary between the LLC and VMI and the other agencies. Deposits to and withdrawals from the pool by VMI and the other agencies are made through the LLC. A separate board of directors manages the LLC. The board has approved an investment policy that outlines the standards and disciplines adopted, and the investment objectives, principles, and guidelines for managing the Fund. Authorized investments are set forth in the Uniform Prudent Management of Institutional Funds Act, Section 55-268 et seq. of the Code of Virginia and may include any real or personal property, whether or not it produces a current return, including mortgages, stocks and bonds, debentures, and other securities of profit or nonprofit corporations, shares in or obligations of associations, partnerships, or individuals, and obligations of any government or subdivision.

The market value of the Fund as of 30 June 2011 was \$315.8 million, of which, VMI owned \$12.0 million or 3.8 percent of the Fund assets. The Fund annually approves an asset allocation which includes how assets are invested in major categories of investments. The Fund held \$41.0 million in debt securities with an average maturity of 6.9 years. The average quality rating was AA- (Moody's). The Fund held \$77.3 million in US equity investments. The Fund held \$47.7

million in developed markets international funds with equities denominated primarily in the Euro, the Pound, and the Yen, and \$17.8 million in emerging markets international funds with equities denominated in a variety of currencies. The Fund held \$78.8 million in absolute return fund investments which may also hold fixed income and equity securities. The remaining investments are held in cash and other diversifying investments. The custodians for the Fund are independently audited annually.

Securities Lending Transactions

Collateral held for securities lending and the securities lending transactions reported on the financial statements represent the Institute’s allocated share of securities received for securities lending transactions held in the General Account of the Commonwealth. Information related to the credit risk of these investments and securities lending transactions held in the General Account is available on a statewide level in the Commonwealth of Virginia’s *Comprehensive Annual Financial Report*. The Commonwealth’s policy is to record unrealized gains and losses in the General Fund in the Commonwealth’s basic financial statements. When gains or losses are realized, the actual gains and losses are recorded by the affected agencies.

Funds Held In Trust By Others

Assets of funds held by trustees for the benefit of the Institute are not reflected in the accompanying Statement of Net Assets. The Institute has irrevocable rights to all or a portion of the income of these funds. However, assets of the funds are not under the management discretion of the Institute according to the trust agreements. Income from funds held by trustees for the benefit of the Institute totaled \$47,544 for fiscal year 2011 and is included in the endowment income.

NOTE 3: ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following at 30 June 2011:

<i>Current:</i>	
Student tuition and fees	\$ 704,420
Other educational and general	51,735
Auxiliary enterprises	150,430
Unique military activity	5,494
Private gifts	250,000
Federal grants	75,992
Gain on capital asset	390,000
Other	69,365
Retirement of indebtedness	24,851
	\$ 1,722,287
Less: Allowance for doubtful accounts	(55,639)
	\$ 1,666,648
 <i>Noncurrent:</i>	
Other operating	33,292
	\$ 1,699,940

NOTE 4: COMMONWEALTH REIMBURSEMENT PROGRAMS

The Commonwealth has established several programs to provide state-supported institutions of higher education with bond proceeds for financing the acquisition and replacement of instructional and research equipment and facilities. During the 2011 fiscal year, funding has been provided to the Institute from two programs (21st Century program and the Equipment Trust Fund) managed by the Virginia College Building Authority (VCBA). The VCBA issues bonds and uses the proceeds to reimburse the Institute for expenses incurred in the acquisition of equipment and facilities.

The line item, “Due from the Commonwealth” on the Statement of Net Assets for the year ended 30 June 2011 represents pending reimbursements from the following programs:

	<u>Current</u>	<u>Noncurrent</u>	<u>Total</u>
Credit card rebate/accrued interest	\$ 91,431	\$ -	\$ 91,431
VCBA Equipment Trust Fund program	154,876	-	154,876
VCBA 21st Century program	-	498,515	498,515
 Total Due from Commonwealth	 \$ 246,307	 \$ 498,515	 \$ 744,822

NOTE 5: INVENTORIES

Inventories consisted of the following at 30 June 2011:

Physical Plant	\$ 392,170
Military Store	4,825,808
Museums	190,546
VMI Hospital	<u>16,788</u>
 Total	 <u>\$ 5,425,312</u>

NOTE 6: CAPITAL ASSETS

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

	Beginning Balance 1 July 2010	Additions	Reductions	Ending Balance 30 June 2011
Nondepreciable capital assets:				
Land	\$ 3,008,976	\$ 436,115	\$ -	\$ 3,445,091
Construction in progress	7,549,247	10,007,947	(623,407)	16,933,787
Total nondepreciable capital assets	10,558,223	10,444,062	(623,407)	20,378,878
Depreciable capital assets:				
Buildings	254,458,777	1,333,333	(85,252)	255,706,858
Improvements other than buildings	13,265,450	876,986	(61,008)	14,081,428
Equipment	13,866,750	639,720	(937,240)	13,569,230
Library books	11,073,880	234,398	(21,169)	11,287,109
Total depreciable capital assets	292,664,857	3,084,437	(1,104,669)	294,644,625
Less accumulated depreciation for:				
Buildings	61,612,625	5,274,842	(48,314)	66,839,153
Improvements other than buildings	3,116,587	637,877	(61,008)	3,693,456
Equipment	9,727,007	1,132,980	(935,055)	9,924,932
Library books	9,594,253	259,029	(21,169)	9,832,113
Total accumulated depreciation	84,050,472	7,304,728	(1,065,546)	90,289,654
Depreciable capital assets, net	208,614,385	(4,220,291)	(39,123)	204,354,971
Total capital assets, net	\$ 219,172,608	\$ 6,223,771	\$ (662,530)	\$ 224,733,849

NOTE 7: ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following at 30 June 2011:

Current liabilities:	
Employee salaries, wages and benefits payable	\$ 3,757,179
Vendors and supplies accounts payable	951,446
Accrued interest payable	128,224
Total current-accounts payable and accrued expenses	<u>\$ 4,836,849</u>
Noncurrent liabilities:	
Retirement annuities	924,511
Total noncurrent-accrued liabilities	<u>\$ 924,511</u>

NOTE 8: LONG-TERM LIABILITIES SUMMARY

The Institute's long-term liabilities primarily consist of long-term debt (further described in Note 9) and accrued compensated absences. A summary of changes in long-term liabilities for the year ending 30 June 2011 is presented as follows:

	Beginning Balance 1 July 2010	Additions	Reductions	Ending Balance 30 June 2011	Current Portion 30 June 2011
Long-term debt:					
Bonds payable	\$ 9,779,037	\$ -	\$ (512,478)	\$ 9,266,559	\$ 455,000
Notes payable	3,540,541	4,229,880	(1,461,231)	6,309,190	210,000
Capital leases	7,689	-	(7,073)	616	616
Installment purchases	17,822	-	(14,889)	2,933	2,200
Total long-term debt	\$ 13,345,089	\$ 4,229,880	\$ (1,995,671)	\$ 15,579,298	\$ 667,816
Accrued compensated absences	1,343,586	1,059,798	(1,099,501)	1,303,883	970,604
Total long-term liabilities	\$ 14,688,675	\$ 5,289,678	\$ (3,095,172)	\$ 16,883,181	\$ 1,638,420

NOTE 9: LONG-TERM INDEBTEDNESS DETAIL

Bonds payable:

In August 2004, pursuant to Section 9(c) of Article X of the Constitution of Virginia, \$11,240,000 of revenue bonds, Series 2004A, were issued by the Department of Treasury for the Commonwealth of Virginia, on behalf of the Institute for renovation and expansion of Crozet Hall, the Institute dining facility, and parking. The bonds bear interest at an average coupon rate of 4.8% and are payable over 20 years through June 2025. Net proceeds after the cost of issuance total \$11,889,591 and included a premium realized on the sale. The revenue bonds are secured by the net revenues of the facility which is comprised primarily of cadet fees.

Bonds Payable:	Interest Rates (%)	Maturity	Balance 30 June 2011
Crozet Hall:			
Series 2004A, issued \$11,240,000 - partial refunding *	3.75 - 5.00	2025	\$ 4,589,878
Series 2009D, issued \$4,241,860 - refunding Series 2004A *	2.50 - 5.00	2022	4,676,681
			<u>\$ 9,266,559</u>

* See Note 10 Long-Term Debt Defeasance

Notes payable:

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

Notes Payable:	Interest Rates (%)	Maturity	Balance 30 June 2011
Cocke Hall Annex:			
Series 2002A, issued \$2,025,000 - partial refunding *	4.00 - 5.25	2022	\$ 206,752
Series 2007B, issued \$735,000 - refunding Series 2002A *	4.00 - 4.50	2020	764,015
Series 2010B, issued \$555,000 - refunding Series 2002A *	2.00 - 5.00	2022	576,549
Jackson Memorial Hall Renovation:			
Series 2002A, issued \$2,335,000 - partial refunding *	4.00 - 5.25	2022	228,536
Series 2007B, issued \$850,000 - refunding Series 2002A *	4.00 - 4.50	2020	883,530
Series 2010B, issued \$650,000 - refunding Series 2002A *	2.00 - 5.00	2022	674,921
South Institute Hill Parking:			
Series 2010A1/2, issued \$2,850,000	3.75 - 5.00	2031	2,974,887
			\$ 6,309,190

* See Note 10 Long-Term Debt Defeasance

Maturities on notes and bonds payable for years succeeding 30 June 2011 are as follows:

Year	Bonds Payable	Notes Payable	Total
2012	\$ 455,000	\$ 210,000	\$ 665,000
2013	475,000	320,000	795,000
2014	500,000	335,000	835,000
2015	525,000	350,000	875,000
2016	296,860	370,000	666,860
2017-2021	3,205,000	2,100,000	5,305,000
2022-2026	3,180,000	1,470,000	4,650,000
2027-2031	-	940,000	940,000
Unamortized premium	871,060	357,116	1,228,176
Deferral on debt defeasance	(241,361)	(142,926)	(384,287)
Total future principal requirements	\$ 9,266,559	\$ 6,309,190	\$ 15,575,749

A summary of future interest commitments for fiscal years subsequent to 30 June 2011 is presented as follows:

Year	Bonds Payable	Notes Payable	Total
2012	\$ 420,699	\$ 284,697	\$ 705,396
2013	397,949	271,548	669,497
2014	374,199	255,272	629,471
2015	349,199	239,398	588,597
2016	322,949	223,535	546,484
2017-2021	1,235,531	849,669	2,085,200
2022-2026	373,552	389,357	762,909
2027-2031	-	132,825	132,825
Total future interest requirements	\$ 3,474,078	\$ 2,646,301	\$ 6,120,379

Installment Purchase Obligations

The Institute has future obligations under installment purchase agreements. The book value of the assets capitalized under these installment purchase agreements is \$18,800 with no interest. A summary of future obligations under these agreements as of 30 June 2011 follows:

Year Ending 30 June	Principal
2012	\$ 2,200
2013	733
Total	\$ 2,933

Capital Leases Payable

VMI is the lessee of equipment under capital leases expiring in 2012. The assets acquired under capital leases are recorded as property, plant, and equipment at the lower of the net present value of the minimum lease payments during the lease term or the fair market value of the asset.

For all capital leases, the minimum lease payments together with the present value of the net minimum lease payments as of 30 June 2011 are as follows:

Year Ending 30 June	Capital Leases
2012	\$ 827
Total minimum lease payments	827
Less: Executory costs	(207)
Less: Interest	(4)
Present value of net minimum lease payments	\$ 616

Operating Leases

VMI is committed under various operating leases for equipment. Operating leases do not give rise to property rights or lease obligations, and therefore the results of the lease agreements are not reflected in the Institute's Statement of Net Assets. In general, the leases are for a three year term and the Institute has renewal options. In most cases, the Institute expects these leases will be replaced by similar leases in the normal course of business. Rental expense was approximately \$96,128 for the year ended 30 June 2011. Rental expense commitments for subsequent fiscal years are as follows:

<u>Year Ending 30 June</u>	<u>Amount</u>
2012	\$ 79,071
2013	41,907
2014	9,858
2015	1,099
Total	<u>\$ 131,935</u>

Capital Improvement Commitments

As of 30 June 2011, the Institute had outstanding construction contract commitments of \$847,469. This amount represents the value of obligations remaining on capital improvement project contracts. These obligations are for future efforts and as such have not been accrued as expenses or liabilities on the Institute's financial statements.

NOTE 10: LONG-TERM DEBT DEFEASANCE

Current Year:

On 27 October 2010, the Virginia College Building Authority (VCBA), on behalf of the Institute, issued \$1,392,604 of Section 9(d) revenue bonds to advance-refund \$1,242,932 of section 9(d) debt in fiscal year 2011. The advance refunding reduced the aggregate debt service by \$41,687, representing a net present-value savings of \$37,433.

Previous Years:

In previous fiscal years, bonds and notes were issued to refund a portion of previously outstanding bonds and notes payable. Funds relating to the refunding were deposited into irrevocable trusts with escrow agents to provide for future debt service on the refunded bonds. The trust account assets and liabilities for the defeased bonds are not included in the Institute's financial statements. At 30 June 2011, the outstanding balance of the prior years' in-substance defeased bonds and notes totaled \$6,085,000.

NOTE 11: RETAINAGE PAYABLE

At 30 June 2011, \$650,446 was held by the Institute as retainage on various contracts for work, which had been performed. The retainage will be remitted to the various contractors upon satisfactory completion of the projects.

NOTE 12: EXPENSES BY NATURAL CLASSIFICATIONS

The Institute's operating expenses by natural classification were as follows for the year ended 30 June 2011:

Program	Compensation and benefits	Supplies, Equipment, Utilities and Other Services	Student Aid	Other Expenses	Depreciation	Total
Instruction	\$ 14,820,596	\$ 671,518	\$ -	\$ 94,814	\$ 2,064,689	\$ 17,651,617
Research	107,839	43,479	-	84,325	9,382	245,025
Public service	584,810	398,602	-	15,173	312,794	1,311,379
Academic support	4,098,124	1,986,078	-	83,399	770,418	6,938,019
Student services	2,489,062	1,016,425	-	95,751	225,926	3,827,164
Institutional support	3,985,317	1,060,682	-	271,544	150,258	5,467,801
Operation of plant	3,251,743	3,145,204	-	362,546	603,909	7,363,402
Student aid	11,760	106,859	904,837	-	-	1,023,456
Auxiliary enterprises	4,598,172	8,347,475	61,098	4,220,081	2,728,215	19,955,041
Unique military activities	3,974,476	1,353,946	9,342	334,870	439,138	6,111,772
Other	-	-	-	9,281	-	9,281
TOTAL	\$ 37,921,899	\$ 18,130,268	\$ 975,277	\$ 5,571,784	\$ 7,304,729	\$ 69,903,957

NOTE 13: STATE APPROPRIATIONS

Virginia Military Institute receives state appropriations from the General Fund of the Commonwealth of Virginia. The Appropriation Act specifies that such unexpended appropriations shall revert, as specifically provided by the General Assembly, at the end of the biennium. For years ending at the middle of the biennium, unexpended appropriations that have not been approved for reappropriation in the next year by the Governor become part of the General Fund of the Commonwealth and are, therefore, no longer available to VMI for disbursement. Fiscal year 2012 ends the biennium.

During the fiscal year ended 30 June 2011, the Institute received the following supplemental appropriations and reversions in accordance with the Appropriation Act:

Original legislative appropriation:	
Educational and general programs	\$ 8,306,364
Unique military activity	3,139,904
Student financial assistance	750,632
Adjustments:	
Compensation adjustments	132,560
ETF lease payment - NGF portion	(88,844)
Student financial assistance	28,881
Debt service fee - Non-Virginia cadets	(292,118)
Appropriations transfers:	
SCHEV programs	11,555
Adjusted appropriations	<u>\$ 11,988,934</u>

NOTE 14: RETIREMENT AND PENSION SYSTEMS

Employees of the Institute are employees of the Commonwealth of Virginia. Most full-time classified salaried employees of the Institute participate in the defined benefit retirement plan administered by the Virginia Retirement System (VRS). VRS is an agent multiple-employer public employee retirement system (PERS) that acts as a common investment and administrative agency for the Commonwealth of Virginia and its political subdivisions.

The Institute's payroll costs for employees covered by VRS totaled \$14,679,578 for the year ended 30 June 2011. The Institute's total payroll costs were \$30,708,382 for the year ended 30 June 2011.

Information regarding types of employees covered, benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions as well as employer and employee obligations to contribute are established, can be found in the Commonwealth's Comprehensive Annual Financial Report (CAFR).

The Institute's total VRS contribution was \$1,045,537 for the year ended 30 June 2011. These contributions represent 7.12% of covered payrolls for 2011. Additionally, the Institute redirected \$571,352 of funds designated for VRS contributions, to the Commonwealth's general fund in accordance with Item 469 of Chapter 890, 2011 Virginia Acts of Assembly.

The VRS does not measure assets and pension benefit obligations separately for individual state institutions. The CAFR provides disclosure of the Commonwealth's unfunded pension benefit obligation at 30 June 2011. The same report contains historical trend information showing VRS's progress in accumulating sufficient assets to pay benefits when due.

Optional Retirement Plan

Some full-time faculty and contracted administrative staff participate in a defined contribution plan administered by two different providers other than VRS; TIAA/CREF Insurance Companies and Fidelity Investments Tax-Exempt Services Co. This is a fixed-contribution program where the retirement benefits received are based entirely upon the employer's (10.4%) contributions for employees enrolled prior to 1 July 2010, plus interest and dividends, with the employer assuming the employee's contribution share. For employees enrolled after 1 July 2010, the employer provides a contribution of 8.5% while the employee must contribute 5%.

Individual contracts issued under the plan provide for full and immediate vesting of both the Institute's and the employees' contributions. Total pension costs under this plan were approximately \$1,057,493 for the year ended 30 June 2011. Contributions to this defined contribution plan were calculated using the base salary amount of approximately \$10,227,147 for fiscal year 2011.

Deferred Compensation Plan

Employees of the Commonwealth may participate in the Commonwealth's Deferred Compensation Plan. Participating employees can contribute to the plan each pay period with the Commonwealth matching up to \$10 per pay period. The dollar amount match can change depending on the funding available in the Commonwealth's budget. The Deferred Compensation Plan is a qualified defined contribution plan under Section 401(a) of the Internal Revenue Code.

Employer contributions under the Deferred Compensation Plan were approximately \$74,440 for the fiscal year 2011.

NOTE 15: POST-EMPLOYMENT BENEFITS

The Commonwealth participates in the VRS administered statewide group life insurance program which provides postemployment life insurance benefits to eligible retired and terminated employees. The Commonwealth also provides health care credits against the monthly health insurance premiums of its retirees who have at least 15 years of service and participate in the State's health plan. Information related to these plans is available at the statewide level in the Commonwealth's *Comprehensive Annual Financial Report*.

NOTE 16: RISK MANAGEMENT

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

NOTE 17: CONTINGENCIES

The Institute has received federal grants for specific purposes that are subject to review and audit by the grantor agencies. Claims against these resources are generally conditional upon compliance with the terms and conditions of grant agreements and applicable federal regulations, including the expenditure of resources for allowable purposes. Any disallowance resulting from a federal audit may become a liability of the Institute.

In addition, the Institute is required to comply with various federal regulations issued by the Office of Management and Budget. Failure to comply with certain systems requirements of these regulations may result in questions concerning the allowability of related direct and indirect charges pursuant to such agreements. As of 30 June 2011 the Institute estimates that no material liabilities will result from such audits or questions.

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

In August 2007, the Institute entered into a five year contract (with the option of one additional renewal term of five years) with ARAMARK to provide dining services to cadets. Under this agreement, ARAMARK agreed to provide a \$750,000 financial commitment for food service facility renovations and for the purchase and installation of food service equipment, area treatment, signage and marketing materials and other costs associated with the Campus Food Service Program on our premises. During the first year of this contract (2008 fiscal year), the Institute received \$500,000 of this commitment with the remaining balance (\$250,000) to be paid during the fourth year (2012 fiscal year). In accordance with the agreement, ARAMARK agrees to amortize this commitment on a straight-line basis over a ten year period through 2017. Upon expiration or termination of this agreement by either party prior to 2017, VMI agrees to pay ARAMARK the unamortized balance plus all accrued but unbilled interest (prime rate plus two percentage points per annum, compounded monthly) within 30 days.

NOTE 18: VMI ALUMNI AGENCIES

The VMI Alumni Agencies (the “Agencies”) are comprised of four organizations that share the common purpose of raising funds, investing funds, and performing other activities on behalf of VMI alumni and other donors in support of Virginia Military Institute (“VMI”). Significant sources of revenue consist of contributions and investment return. Due to their shared purpose, the Agencies have elected to present their financial statements on a combined basis. All significant interagency accounts and transactions have been eliminated in combination. The individual organizations comprising the Agencies and their purposes are as follows:

The VMI Alumni Association

The purpose of The VMI Alumni Association is to organize the alumni of VMI into one general body.

VMI Foundation, Incorporated

The purposes of the VMI Foundation, Incorporated are to solicit and to accept various funds and to disburse such funds, or income earned from those funds, for the advancement of VMI and the Alumni Association.

VMI Development Board, Incorporated

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

VMI Keydet Club, Incorporated

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

Contributions receivable

Contributions receivable consist of the following as of 30 June:

	2011
Unconditional promises to give	\$ 15,832,375
Charitable trusts held by others	181,035
Total contributions receivable	<u>16,013,410</u>
Less: current portion	<u>(6,436,960)</u>
 Noncurrent contributions receivable	 <u>\$ 9,576,450</u>
Gross amounts expected to be collected in:	
Less than one year	\$ 7,359,166
One to five years	10,232,963
More than five years	1,850,788
	<u>19,442,917</u>
Less:	
Discount	(1,926,188)
Allowance for uncollectible contributions	<u>(1,503,319)</u>
 Fair value	 <u>\$ 16,013,410</u>

The distribution of contributions receivable for each class of net assets as of 30 June is as follows:

Temporarily restricted	\$ 11,927,864
Permanently restricted	<u>4,085,546</u>
	<u>\$ 16,013,410</u>

At 30 June 2011, the Agencies had also received bequest and other intentions of approximately \$85.7 million. These intentions to give are not recognized as assets and, if they are received, they will generally be restricted for specific purposes stipulated by the donors.

For the year ended 30 June 2011 approximately 41% of the contributions receivable balance was from five donors.

Investments held by trustees

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

	2011	
Equities	\$ 149,302,412	50.2 %
Absolute return funds	74,132,687	25.0
Fixed income	38,534,324	13.0
Cash and cash equivalents	19,697,308	6.6
Commodities	8,818,101	3.0
Private equities	6,409,607	2.2
	\$ 296,894,439	100.0 %

These investments, which comprise the majority of the Agencies' assets, are subject to market risk. However, the Agencies' investment funds are managed by a number of investment managers, which limits the amount of risk in any one fund. The Agencies' Investment Committee establishes investment guidelines and performance standards which further reduce its exposure to market risk.

Investments held by trustees activity for the year ended 30 June is reflected in the table below:

Investments held by trustees	2011
Investments, beginning	\$ 249,352,856
Investments returns:	
Dividends and interest	4,007,119
Net realized and unrealized gains	46,848,406
Less: investment fees	(2,190,238)
	48,665,287
Net disbursements used to fund operations	(1,123,704)
Investments, ending	\$ 296,894,439

VMI Investment Holdings, LLC

On 29 April 2009, VMI Investment Holdings, LLC (LLC) was formed to manage the investments held by trustees. On 1 June 2009, all investments held by trustees and for which BNY Mellon, N.A. serves as custodian were transferred to the LLC. The Foundation is the sole member of the LLC, and acts as an intermediary between the LLC and the other agencies. As stated in the Deposit and Management Agreement, the LLC will operate the unitized investment pool and issue a number of units in the pool to each depositor based on the amount of its deposit divided by the then unit value. Each depositor is entitled to its pro rata share of the value, taking into account aggregate investment returns. Deposits to and withdrawals from the pool by the other agencies will be made through the Foundation. A separate board of directors was established to manage the LLC.

Investments, Other

Investments, other, as of 30 June consists of the following:

	2011			
	Held by Agent	Held by Foundation	Held in Irrevocable Trusts*	Total at Fair Value**
Equities	\$ 1,689,903	\$ 9	\$ 7,142,602	\$ 8,832,514
Fixed income	16,677	5,891	5,222,022	5,244,590
Real estate	-	1,751,667	-	1,751,667
Cash and cash equivalents	31,356	783	689,012	721,151
Limited partnerships	3,069	17,128	-	20,197
	<u>\$ 1,741,005</u>	<u>\$ 1,775,478</u>	<u>\$ 13,053,636</u>	<u>\$ 16,570,119</u>

*Investments held in irrevocable trusts are not available for use until the occurrence of a future event as noted in the applicable trust agreements.

**For certain components of these investments, primarily real estate, limited partnerships, and common stocks of closely held companies where fair values were not readily determinable, cost was used.

Long-term Debt

Long-term debt consists of bonds and notes payable at 30 June as follows:

	2011
Variable Rate Educational Facilities Revenue Bonds, Series 2006, payable in varying installments from \$5,000,000 to \$22,475,000, commencing 2021 through 2037	\$ 42,475,000
Promissory note, principal and any accrued interest payable is due in fiscal year 2014. Interest accrues at the 1-month London Interbank Offered Rate (LIBOR) plus .85% (1.04% at 30 June 2011) and is payable monthly, uncollateralized.	2,500,000
	<u>44,975,000</u>
Add: bond premium - net	2,402,338
	<u>\$ 47,377,338</u>

Debt matures as follows for future years ending 30 June:

Year ending 30 June:	
2012	-
2013	-
2014	2,500,000
2015	-
2016	-
Thereafter	42,475,000
	<hr/>
	\$ 44,975,000
	<hr/>

Effective 15 July 2010, the Industrial Development Authority of the City of Lexington, Virginia approved a request by the Agencies to remarket Variable Rate Educational Facilities Revenue Bonds, Series 2006. This remarketing superseded the original issuance, dated 13 July 2006. The bonds were initially issued in a single series bearing interest at a variable rate. The bonds were remarketed at a premium of \$2,525,000, net of expenses. The premium is being amortized over the life of the loan and amortization of the premium totaled \$122,622 for 2011. The bonds were remarketed in three series, Series 2006A-1 (\$5,000,000) and 2006A-2 (\$5,000,000), 2006B (\$10,000,000), and 2006C (\$22,475,000), and interest was converted to a fixed rate on each series. Series 2006A-1 bears interest of 4.25%, the remainder each bear interest at 5.00%. Interest accrues at these rates and payments commenced on 1 December 2010. Payments are due each 1 June and 1 December. The first principal payment, of \$10,000,000, is due in fiscal year 2021. Upon this conversion, the bonds are no longer collateralized by any credit or liquidity facility, nor are the bonds collateralized by any of the Agencies' assets.

During 2011, the Agencies borrowed \$2,500,000 and issued a promissory note in the same amount. The proceeds of the note were used to terminate the interest rate swap agreement in place at 30 June 2010.

Endowment Funds

The Agencies employ a total return spending policy that establishes the amount of investment return that is available to support current needs and restricted purposes. This policy is designed to insulate program spending from capital market fluctuations and increase the amount of return that is reinvested in the corpus of the fund in order to enhance its long-term value. For the year ended 30 June 2011, the Board-approved spending formula for the endowment provided for an annual spending rate of 4.8% of the average of the prior twelve quarters' 31 December market values adjusting these market values upward to reflect subsequent receipt of gifts, or downward to reflect extraordinary withdrawals. If cash yield (interest and dividends) is less than the spending rate, realized gains can be used to make up the deficiency. Any income in excess of the spending rate is to be reinvested in the endowment. The primary investment objective is long-term capital appreciation and total return. The Agencies utilize diversified investment classes that provide the opportunity to achieve the return objective without exposing the funds to unnecessary risk.

Impact of Subsequent Stock Market Declines

Subsequent to 30 June 2011, significant declines in the fair value occurred in worldwide securities markets. As of 30 September 2011, the fair value of investments had declined by approximately \$19,205,000, or 6.2% from the fair value at 30 June 2011. Fair value estimates for

securities are currently volatile, difficult to predict and subject to material changes that could affect the Agencies' financial condition and results of operations in the near term.

NOTE 19: COMPONENT UNITS

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

CONDENSED STATEMENTS OF NET ASSETS As of 30 June 2011	VMI Research Laboratories Inc.	VMI Alumni Agencies	TOTAL
Assets:			
Current assets	\$ 485,474	\$ 12,514,604	\$ 13,000,078
Noncurrent assets	377,531	328,453,218	328,830,749
Total assets	<u>863,005</u>	<u>340,967,822</u>	<u>341,830,827</u>
Liabilities:			
Current liabilities	94,904	1,392,046	1,486,950
Noncurrent liabilities	33,292	51,695,713	51,729,005
Total liabilities	<u>128,196</u>	<u>53,087,759</u>	<u>53,215,955</u>
Net Assets:			
Unrestricted	693,950	55,924,453	56,618,403
Temporarily restricted	30,859	123,240,592	123,271,451
Permanently restricted	10,000	108,715,018	108,725,018
Total net assets	<u>734,809</u>	<u>287,880,063</u>	<u>288,614,872</u>
Total net assets and liabilities	<u>\$ 863,005</u>	<u>\$ 340,967,822</u>	<u>\$ 341,830,827</u>

CONDENSED STATEMENTS OF REVENUES EXPENSES AND CHANGES IN NET ASSETS As of 30 June 2011	VMI Research Laboratories Inc.	VMI Alumni Agencies	TOTAL
Total revenues	\$ 538,834	\$ 22,993,892	\$ 23,532,726
Total expenses	(575,020)	(24,432,440)	(25,007,460)
Total net realized and unrealized gains on investments	-	49,411,184	49,411,184
Total change in net assets	(36,186)	47,972,636	47,936,450
Total beginning net assets	<u>770,995</u>	<u>239,907,427</u>	<u>240,678,422</u>
Total ending net assets	<u>\$ 734,809</u>	<u>\$ 287,880,063</u>	<u>\$ 288,614,872</u>

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Commonwealth of Virginia

Auditor of Public Accounts

Walter J. Kucharski
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

April 16, 2012

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable Charles J. Colgan
Chairman, Joint Legislative Audit
and Review Commission

Board of Visitors
Virginia Military Institute

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the business-type activities and aggregate discretely presented component units of the Virginia Military Institute, a component unit of the Commonwealth of Virginia, as of and for the year ended June 30, 2011, which collectively comprise the Institute's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Institute's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the component units of the Institute which are discussed in Note 1. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the component units of the Institute is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the component units of the Institute that were audited by other auditors upon whose reports we are relying were audited in accordance with auditing standards generally accepted in the United States of America, but not in accordance with Government Auditing Standards. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities and aggregate discretely presented component units of the Institute as of June 30, 2011, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

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

In accordance with Government Auditing Standards, we have also issued our report dated April 16, 2012 on our consideration of the Virginia Military Institute's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.


AUDITOR OF PUBLIC ACCOUNTS

VIRGINIA MILITARY INSTITUTE

Lexington, Virginia

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as of June 30, 2011

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