

**VIRGINIA PUBLIC SCHOOL AUTHORITY**  
**FINANCIAL STATEMENTS (Unaudited)**  
**FOR THE YEAR ENDING JUNE 30, 2006**



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## **MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)**

This section of the annual financial report of the Virginia Public School Authority (the "Authority") presents an analysis of the Authority's financial performance during the fiscal year that ended on June 30, 2006. This information should be considered in conjunction with the information contained in the financial statements, which follow this section.

### **Authority Activities and Highlights**

The Virginia Public School Authority, created by Chapter 11, Title 22.1, *Code of Virginia*, 1950, as amended, provides financing to localities under the pooled bond program through the sale of its bonds. With the proceeds of its bond issues, the Authority purchases a "pool" of general obligation bonds from localities (the "Local Issuers"). Each Local Issuer uses the proceeds for the purpose of financing capital projects for public schools.

The Authority currently has bonds outstanding under the 1997 Resolution. The 1997 Resolution, adopted on October 23, 1997, currently serves as the primary instrument under which the Authority issues bonds under its pooled bond program. The 1997 Resolution bonds are secured by general obligation local school bonds purchased; the State Aid Intercept Provision; and, a sum sufficient appropriation, first from available Literary Fund monies and then from the Commonwealth's General Fund. During the fiscal year, the Authority issued \$401,520,000 under its pooled bond program.

In addition to its pooled bond program, the Authority also issues special obligation bonds under its stand-alone program. Bonds issued under the stand-alone program are secured solely by the local school bonds purchased from one or more specific localities. The Authority acts as a conduit issuer under the stand-alone program. The Authority also issues obligations to finance technology equipment purchases for local public school systems within the Commonwealth. These obligations are payable from, or otherwise secured by, the assets and income of the Literary Fund and now benefit from a sum sufficient appropriation from the Commonwealth's General Fund. The Authority issued \$56,620,000 under the educational technology equipment note program during the fiscal year, but did not issue any new special obligation bonds.

### **Overview of the Financial Statements**

This discussion and analysis is an introduction to the Authority's basic financial statements, which are comprised of two components: 1) fund financial statements, and 2) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements. The Authority is not required to present government-wide financial statements since all of its activity is reported in an enterprise fund, which would not change in measurement focus (economic resources) or basis of accounting (accrual) for government-wide statements.

The financial statements of the Authority offer short- and long-term financial information about its activities. The Statement of Net Assets provides information about the nature and amounts of the Authority's cash, investments, and receivables (assets) and their obligations to creditors

(liabilities). All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Fund Net Assets. This statement measures whether the Authority successfully recovered all its costs through investment earnings, bond proceeds, appropriations from the Commonwealth, and the collection of receivables. The Statement of Cash Flows provides information on the Authority's cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financial activities.

### Financial Analysis of the Authority

The Authority provides a vehicle for financing capital projects for primary and secondary public schools in the Commonwealth's counties, cities and towns. On local school bonds held by the Authority, localities pay interest 10 basis points (0.10%) above the rates paid by the Authority on corresponding maturities of its bonds. This revenue is deposited to the Authority's 1987 Resolution General Fund and used to pay the operating costs attributable to its financing programs, including costs of issuance and administration, such as rebate compliance expenses. The Department of the Treasury provides staff support for the Authority. The Authority owns no capital assets.

#### Virginia Public School Authority's Net Assets (in millions)

	Enterprise Fund	
	2006	2005
Current assets	\$ 7	\$ 6
Noncurrent assets	2,979	2,737
Total Assets	2,986	2,743
Current Liabilities	355	325
Noncurrent liabilities	2,624	2,403
Total Liabilities	2,979	2,728
Net assets:		
Restricted for debt service	-	9
Unrestricted	7	6
Total net assets	\$ 7	\$ 15

Total assets increased during the year by \$243 million, or 9%. This is primarily due to an increase in local school bonds outstanding (\$233 million). Total liabilities increased by \$251 million, or 9%, during the same period as a result of an increase in outstanding bonds payable (\$247 million). Accordingly, a decrease of \$8 million is reflected in net assets.

**Virginia Public School Authority's Changes in Net Assets  
(in millions)**

	Enterprise Fund	
	2006	2005
Revenues:		
Operating revenues:		
Charges for Services	\$ 118	\$ 124
Non-operating revenues:		
Investment earnings	4	3
Total revenues	<u>122</u>	<u>127</u>
Expenses:		
Interest on long-term debt	135	121
Other	2	20
Total expenses	<u>137</u>	<u>141</u>
Transfers	7	4
Change in net assets	(8)	(10)
Net assets July 1	15	25
Net assets June 30	<u>\$ 7</u>	<u>\$ 15</u>

**Debt Administration**

As a financing entity, the whole business of the Authority is debt administration. The Authority issues bonds, pursuant to its pooled bond programs, to finance capital projects approved by the local governing bodies of counties, cities, and towns of the Commonwealth of Virginia. Such bonds are secured by general obligation bonds of the participating local issuers, which provide payment of principal and interest when due. Obligations issued pursuant to the technology notes programs, in conjunction with the Board of Education, are paid from, and secured by, appropriations made from the Literary Fund. The following table summarizes bond issuance activity during the year under each program:

**Summary of Authority Bond Obligations  
(in millions)**

	Outstanding at 6/30/05	Issued During Year	Retired During Year	Outstanding at 6/30/06 *
Pooled Bond Programs	\$ 2,367	\$ 401	\$ (153)	\$ 2,615
Technology Notes Programs	168	57	(55)	170
Special Obligation Bonds	73	-	(9)	64
Total	<u>\$ 2,608</u>	<u>\$ 458</u>	<u>\$ (217)</u>	<u>\$ 2,849</u>

\* Excludes deferral on debt defeasance.

The Authority obtains bond ratings from Moody’s Investors Service (Moody’s), Standard and Poor’s Rating Service (S&P) and Fitch Ratings, Inc. (Fitch). The table below summarizes the ratings on outstanding Authority bonds.

**Virginia Public School Authority Bond Ratings**

	Moody’s	S&P	Fitch
Pooled Bond Programs <sup>1</sup>	Aa1	AA+	AA+
School Educational Technology	Aa1	AA+	AA+

<sup>1</sup> 1997 Resolution Bonds

Since the Authority’s bond programs are either backed by state appropriations (School Educational Technology Notes Programs) or carry the credit support of the State Aid Intercept Provision (Pooled Bond Program), the bond ratings are a direct reflection of the Commonwealth’s triple-A rating from each of the three rating agencies.

**Future Impact to Financial Position**

In November 2006, the Authority plans to issue approximately \$262.0 million of School Financing Bonds (1997 Resolution) Series 2006 B to purchase certain general obligation local school bonds to finance capital projects for public schools.

## **Financial Statements**

VIRGINIA PUBLIC SCHOOL AUTHORITY  
STATEMENT OF NET ASSETS (Unaudited)  
As of June 30, 2006

ASSETS

Current assets:

Cash and cash equivalents (Note 2)	\$ 7,345,994
Interest receivable	217
Due from Literary Fund (Note 9)	<u>138,041</u>
Total current assets	<u>7,484,252</u>

Noncurrent assets:

Restricted cash and cash equivalents (Note 2)	97,593,119
Loans to localities:	
Local school bonds (Note 3)	2,667,050,991
Interest receivable (Note 8)	43,539,576
Due from Literary Fund (Note 5)	<u>170,385,000</u>
Total noncurrent assets	<u>2,978,568,686</u>
 Total assets	 <u>2,986,052,938</u>

LIABILITIES

Current liabilities:

Accounts payable	<u>22,160</u>
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Current liabilities payable from restricted assets:

Interest payable	55,526,585
Accrued interest sold	511,517
Due to localities (Note 5)	61,812,451
Notes payable (Notes 4 and 5)	54,760,000
Bonds payable (net of interest deferral) (Notes 4 and 7)	177,009,600
Premium on bonds sold	<u>5,382,023</u>
Total current liabilities payable from restricted assets	<u>355,002,176</u>

Noncurrent liabilities payable from restricted assets:

Notes payable (Notes 4 and 5)	115,625,000
Bonds payable (net of interest deferral) (Notes 4 and 7)	2,448,897,963
Premium on bonds sold	<u>58,222,218</u>
Total noncurrent liabilities payable from restricted assets	<u>2,622,745,181</u>

Total liabilities	<u>2,977,769,517</u>
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NET ASSETS

Restricted for debt service	821,329
Unrestricted	<u>7,462,092</u>
Total net assets	<u>\$ 8,283,421</u>

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



VIRGINIA PUBLIC SCHOOL AUTHORITY  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES  
IN FUND NET ASSETS (Unaudited)  
For the Year Ended June 30, 2006

Operating Revenues:	
Interest on:	
Local school bonds	\$ 118,966,283
Cash, cash equivalents, and investments	3,764,179
Premium on bonds sold	659,396
Net increase in fair value of investments	<u>73,637</u>
Total Operating Revenues	<u>123,463,495</u>
Operating Expenses:	
Interest on bonds	135,600,355
Financial advisor fees	158,600
Legal fees	380,880
Bond rating fees	231,847
Printing and electronic distribution	16,468
Board expenses	167
Staffing expenses	117,276
Underwriters' discount	659,667
Rebate and penalty payments and calculation fees (Note 10)	263,151
Other	<u>48,284</u>
Total Operating Expenses	<u>137,476,695</u>
Operating Loss	<u>(14,013,200)</u>
Nonoperating Transfers:	
Transfers from Literary Fund (Note 9)	7,338,643
Transfer to the General Fund of the Commonwealth (Note 9)	<u>(170,221)</u>
Total Nonoperating Transfers	<u>7,168,422</u>
Change in Net Assets	(6,844,778)
Net Assets, July 1, 2005	<u>15,128,199</u>
Net Assets, June 30, 2006	<u><u>\$ 8,283,421</u></u>

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

VIRGINIA PUBLIC SCHOOL AUTHORITY  
STATEMENT OF CASH FLOWS (Unaudited)  
For the Year Ended June 30, 2006

Cash flows from operating activities:	
Interest on cash equivalents	\$ 571,085
Purchase of local school bonds	(401,516,041)
Principal received on local school bonds	168,447,218
Interest received on local school bonds	121,957,521
Payments to vendors for goods and services	(1,011,766)
Payments received from the Literary Fund	62,037,603
	<hr/>
Net cash provided by operating activities	(49,514,380)
Cash flows from noncapital financial activities:	
Proceeds from the sale of bonds	458,140,000
Principal paid on VPSA bonds	(216,430,000)
Interest paid on VPSA bonds	(120,663,990)
Premium on bonds sold	2,687,413
Underwriters' discount	(684,952)
Rebate calculation fees	(252,301)
Accrued interest sold	135,859
Transfers to the Literary Fund	(287,620)
Transfer to the General Fund of the Commonwealth (Note 7)	(170,221)
Payments to localities (Education Technology Notes)	(58,602,494)
	<hr/>
Net cash used by noncapital financing activities	63,871,694
Cash flows from investing activities:	
Interest on investments	3,203,344
Increase in fair value of cash equivalents	73,637
	<hr/>
Net cash provided by investing activities	3,276,981
	<hr/>
Net increase in cash and cash equivalents	17,634,295
Cash and cash equivalents, July 1, 2005	87,304,818
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Cash and cash equivalents, June 30, 2006	\$ 104,939,113
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Reconciliation of operating income to net cash provided by operating activities:

Operating loss	<u>\$ (14,013,200)</u>
Adjustments to reconcile operating income to net cash provided by operating activities:	
Decrease in interest receivable	9,741,074
Decrease in accounts payable	(47,394)
Increase in interest payable	7,984,765
Payments from the Literary Fund	62,037,603
Principal received on local school bonds	168,447,218
Purchase of local school bonds	(401,516,041)
Rebate and penalty payments to the Internal Revenue Service	252,301
Amount paid to paying agent for overpayment	(213,181)
Amortization of premium	(6,526,405)
Underwriters' discount	659,667
Premium on bonds sold	(659,396)
Amortization of interest deferral	6,951,600
Interest paid on VPSA bonds	120,663,990
Increase in fair value of investments	(73,637)
Interest on investments	<u>(3,203,344)</u>
Total adjustments	<u>(35,501,180)</u>
Net cash provided by operating activities	<u>\$ (49,514,380)</u>

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

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## **Notes to the Financial Statements**

**VIRGINIA PUBLIC SCHOOL AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS (Unaudited)**  
**AS OF JUNE 30, 2006**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

A. Financial Reporting Entity

The Virginia Public School Authority (the “Authority” or “VPSA”) was created by Chapter 11, Title 22.1, *Code of Virginia* 1950, as amended (the “Enabling Act”). The Authority provides financing to localities through the sale of its bonds. With the proceeds of its bonds, the Authority purchases a predetermined number of general obligation bonds issued by localities. The Enabling Act authorizes the Authority to purchase local school bonds issued by counties, cities, and towns under the provisions of Section 15.2-2600, et seq., *Code of Virginia* (the “Public Finance Act of 1991”). The Enabling Act further authorizes the Authority to issue bonds which are payable from the funds of the Authority including:

- 1) principal and interest received on local school bonds held by the Authority;
- 2) proceeds from the sale of such local school bonds;
- 3) any moneys transferred from the Literary Fund or funds appropriated from the General Assembly; and
- 4) a reserve fund(s) created from bond proceeds pledged to secure designated bonds.

Currently, the Authority has pooled bonds outstanding under its 1997 Resolution. Bonds issued under the 1997 Resolution are secured by local school bonds purchased and a “sum sufficient appropriation,” first from available Literary Fund monies and then from the Commonwealth’s General Fund.

In addition to its pooled bond program, the Authority also issues special obligation bonds under its stand-alone program. Bonds issued under the stand-alone program are secured solely by the local school bonds purchased from one or more specific localities. The Authority acts as a conduit issuer under the stand-alone program.

As directed by the General Assembly, the Authority has also issued obligations to finance technology equipment purchases for local public school systems within the Commonwealth. These obligations are payable from, or otherwise secured by, the assets and income of the Literary Fund.

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 Authority is a component unit of the Commonwealth of Virginia and is included in the basic financial statements of the Commonwealth.

The accounting and reporting policies of the Authority conform to generally accepted accounting principles (GAAP) applicable to governmental units as prescribed by the Governmental Accounting Standards Board (GASB), the accepted standard-setting

body for establishing governmental accounting and financial reporting principles. The following is a summary of the Authority's significant policies.

B. Basis of Accounting

The accompanying financial statements are reported using the economic resources measurement focus and the accrual basis of accounting under which revenues are recognized when they are earned and expenses are recognized when a liability is incurred, regardless of the timing of related cash flows. The cash basis of accounting is used during the year. The financial statements are prepared on the accrual basis at the end of the fiscal year by the Authority.

C. Fund Accounting

The activities of the Authority are accounted for in an enterprise fund, used to account for governmental operations that are financed and operated in a manner similar to private business enterprises. Enterprise fund accounting is used where the governing body has decided that periodic determination of revenues earned, expenses incurred, and net income is appropriate. All fund accounts of the Authority are presented in total on the financial statements.

D. Bond Issuance Costs, Discounts, and Premiums

Costs associated with issuing debt, which are either offset by fees collected over the life of the respective pooled bond issues from local issuers, reimbursed directly by localities participating in stand-alone issues, or paid from Literary Fund contributions, are expensed in the year incurred. The original issue discount or premium, for each bond issuance, is also expensed or recorded as revenue in the year incurred unless it exceeds 1% of the amount of bonds issued. In that case, the original issue discount or premium is deferred and amortized, on a straight-line basis, over the life of the outstanding debt.

## 2. CASH AND CASH EQUIVALENTS (Unrestricted and Restricted)

Cash and cash equivalents of the Authority are held by the Treasurer of Virginia. Cash is defined as demand deposits, non-negotiable time deposits, and certificates of deposit in accordance with Section 2.2-4400 of the *Code of Virginia*. Cash equivalents are defined as investments with an original maturity of less than three months.

Deposits with banks are covered by the Federal Deposit Insurance Corporation (FDIC) and collateralized in accordance with the Virginia Security for Public Deposits Act (the “Act”). Under the Act, banks holding public deposits in excess of the amount insured by the FDIC must pledge collateral that ranges in amounts from 50% to 100% of excess deposits in the case of a bank, and 100% to 110% for a savings institution to a collateral pool in the name of the Commonwealth of Virginia Treasury Board. Accordingly, all deposits are considered fully collateralized.

Section 2.2-4500 and Section 2.2-4501 of the *Code of Virginia* outline the instruments in which public sinking funds and other public funds may legally invest. The Authority adheres to these general guidelines unless bond resolutions require more restrictive investment policies. All investments of the Authority are held in the Authority’s name. The Authority’s investments are valued at fair value, which approximates market value. Details of cash and cash equivalents are presented below. Standard and Poor’s ratings, where available, have also been presented below.

### Summary of Cash and Cash Equivalents As of June 30, 2006

|                                             | <u>Fair Value</u>     | <u>Rating</u> |
|---------------------------------------------|-----------------------|---------------|
| U.S. Treasury and Agency Securities         | \$ 32,883,458         | A - 1         |
| Negotiable Certificates of Deposit          | 1,394,881             | Not Rated     |
| Short Term Investment Fund <sup>1</sup>     | 4,937,458             | AAA           |
| State Non-Arbitrage Program <sup>sm 2</sup> | <u>65,723,316</u>     | AAAm          |
| Total cash and cash equivalents             | <u>\$ 104,939,113</u> |               |

1 The Authority invests certain short-term cash balances held within its accounts in the JP Morgan Treasury Plus Money Market Fund. This is a rated fund, which maintains a policy of investing all assets in U.S. Treasury obligations and repurchase agreements backed by those obligations.

2 The Virginia State Non-Arbitrage Program<sup>sm</sup> (“SNAP<sup>sm</sup>”) offers a professionally-managed money market mutual fund, which provides issuers with a temporary pooled investment vehicle for proceeds pending expenditure, and with record keeping, depository and arbitrage rebate calculation services. SNAP<sup>sm</sup> is an external investment pool registered under the Investment Company Act of 1940, as amended. Participants in the Authority’s various bond programs are required to invest their bond proceeds in SNAP<sup>sm</sup>.

The Authority does not limit the amount that may be invested in any one issuer. The Authority had investments of 5 percent or more in the State Non-Arbitrage Program<sup>sm</sup> (63%) and the Federal Home Loan Bank (31%).



### 3. LOCAL SCHOOL BONDS

The Authority purchases bonds from (makes loans to) various localities throughout the Commonwealth, which are issued to finance the construction of local public school facilities. These bonds are recorded at purchase price that is equal to the face value of the bonds. Local school bonds purchased under the 1997 Resolution are held in a pledge account of the General Pledge Fund established under its bond resolution. Local school bonds purchased under the stand-alone program are deposited in separate purchase funds established for each issue. Assets of the Authority that are held or received in purchase funds, pledge funds, or debt service funds are classified as restricted assets because their use is limited to the purpose of the funds in which they reside, in accordance with applicable bond resolutions. The local school bonds are held and pledged to repay the Authority's bonds.

The interest rates on the local school bonds are determined by the Authority and fixed at the time of sale of the Authority bonds issued to fund the acquisition of the local school bonds. For pooled bond sales, the interest rate on each maturity of the local bonds is ten basis points (0.10%) higher than the interest rate paid by the Authority on the corresponding maturity on its bonds.

Shown below are the local school bonds held by the Authority as of June 30, 2006.

|                                                  |                         |
|--------------------------------------------------|-------------------------|
| Local school bonds:                              |                         |
| Held in 1995 Purchase Fund                       |                         |
| (Cheaspeake, City of , Stand Alone)              | \$ 6,000,000            |
| Held in 1997 Pledge Account                      | 2,604,513,809           |
| Held in 1999 Purchase Fund                       |                         |
| (Northampton County Qualified Zone Academy Bond) | 1,050,000               |
| Held in 2001 Purchase Fund                       |                         |
| (Northampton County Qualified Zone Academy Bond) | 324,490                 |
| Held in 2002 Purchase Fund                       |                         |
| (Accomack County Qualified Zone Academy Bond)    | 1,182,692               |
| Held in 2004 Purchase Fund                       |                         |
| (Chesterfield County Stand Alone)                | 53,980,000              |
| Total local school bonds                         | <u>\$ 2,667,050,991</u> |

#### 4. LONG-TERM INDEBTEDNESS

##### A. Changes in Long-Term Debt

The following is a summary of changes in long-term debt of the Authority for the year ended June 30, 2006.

|                                      | <u>Current<br/>Liability</u> | <u>Long-Term<br/>Liability</u> | <u>Total</u>            |
|--------------------------------------|------------------------------|--------------------------------|-------------------------|
| Balance July 1, 2005                 | \$ 216,430,000               | \$ 2,391,217,063               | \$ 2,607,647,063        |
| Issued during fiscal 2006            | 18,670,000                   | 439,470,000                    | 458,140,000             |
| Retired during fiscal 2006           | (216,430,000)                | -                              | (216,430,000)           |
| Maturing fiscal 2007                 | 219,970,000                  | (219,970,000)                  | -                       |
| Subtotal                             | <u>238,640,000</u>           | <u>2,610,717,063</u>           | <u>2,849,357,063</u>    |
| Less: Deferral on<br>debt defeasance | <u>(6,870,400)</u>           | <u>(46,194,100)</u>            | <u>(53,064,500)</u>     |
| Balance June 30, 2006                | <u>\$ 231,769,600</u>        | <u>\$ 2,564,522,963</u>        | <u>\$ 2,796,292,563</u> |

##### B. Annual Requirements to Amortize Bonds Payable and Notes Payable

The following schedule provides the annual funding requirements necessary to amortize long-term debt of the Authority outstanding at June 30, 2006.

| <u>Year Ending<br/>June 30</u>      | <u>Principal</u>       | <u>Interest</u>        | <u>Total</u>           |
|-------------------------------------|------------------------|------------------------|------------------------|
| 2007                                | \$ 238,640,000         | \$ 135,839,397         | \$ 374,479,397         |
| 2008                                | 226,165,000            | 124,414,573            | 350,579,573            |
| 2009                                | 215,880,000            | 113,485,309            | 329,365,309            |
| 2010                                | 200,155,000            | 102,860,925            | 303,015,925            |
| 2011                                | 183,060,000            | 92,948,309             | 276,008,309            |
| 2012-2016                           | 768,509,060            | 341,871,766            | 1,110,380,826          |
| 2017-2021                           | 609,938,003            | 166,913,925            | 776,851,928            |
| 2022-2026                           | 334,955,000            | 50,696,922             | 385,651,922            |
| 2027-2031                           | 69,315,000             | 6,480,356              | 75,795,356             |
| 2032                                | 2,740,000              | 61,650                 | 2,801,650              |
| Subtotal                            | <u>2,849,357,063</u>   | <u>1,135,573,132</u>   | <u>3,984,930,195</u>   |
| Less Deferral on<br>Debt defeasance | <u>(53,064,500)</u>    | <u>-</u>               | <u>(53,064,500)</u>    |
| Total                               | <u>\$2,796,292,563</u> | <u>\$1,135,573,132</u> | <u>\$3,931,865,695</u> |

## 5. EQUIPMENT NOTES

Periodically, the Authority issues Equipment Financing Notes, the proceeds of which are used to make grants to school divisions for the purchase of educational technology equipment. The proceeds are invested in the Virginia State Non-Arbitrage Program<sup>sm</sup> until requisitioned by localities. The following schedule details the notes that have been issued which still have either bonds outstanding or funds remaining to be disbursed to localities as of June 30, 2006.

### Educational Technology Notes

| Issue              | Description | Amount Issued         | Outstanding Balance   | Remaining Available for Disbursement |
|--------------------|-------------|-----------------------|-----------------------|--------------------------------------|
| Ed Tech Series II  | 2002 Notes  | \$ 55,555,000         | \$ 11,515,000         | \$ 107,657                           |
| Ed Tech Series III | 2003 Notes  | 55,325,000            | 22,430,000            | 158,832                              |
| Ed Tech Series IV  | 2004 Notes  | 56,835,000            | 35,015,000            | 943,598                              |
| Ed Tech Series V   | 2005 Notes  | 55,255,000            | 44,805,000            | 14,220,842                           |
| Ed Tech Series VI  | 2006 Notes  | 56,620,000            | 56,620,000            | 46,381,522                           |
|                    |             | <u>\$ 279,590,000</u> | <u>\$ 170,385,000</u> | <u>\$ 61,812,451</u>                 |

## 6. QUALIFIED ZONE ACADEMY BOND

On October 29, 1999, the Authority issued \$2,100,000 in Special Obligations School Financing Bond (County of Northampton Qualified Zone Academy Financing) Series of 1999 as a Qualified Zone Academy Bond ("QZAB"). On December 21, 2001, the Authority issued \$419,060 in Special Obligations School Financing Bond (County of Northampton Qualified Zone Academy Financing) Series 2001 as a QZAB. Also, on December 31, 2002, the Authority issued \$1,433,003 in Special Obligations School Financing Bond (County of Accomack Qualified Zone Academy Financing) Series 2002 as a QZAB. These bonds were issued pursuant to Section 1297E of the Internal Revenue Code of 1986, as amended, and the Authority purchased certain general obligation school bonds of Northampton County and Accomack County to finance capital projects for public schools.

The localities will make annual principal payments to the Authority on the anniversary date of each issuance. Such payments received by the Authority will be held in trust and invested in certificates of deposit maturing on the next anniversary date of each issuance in accordance with the funding agreements. The agreements provide that maturing certificate of deposit proceeds will be combined with the current annual payment and reinvested to the next anniversary date. The final annual principal payments on the 1999 QZAB, the 2001 QZAB and the 2002 QZAB are due October 29, 2011, December 21, 2015, and December 31, 2016, respectively, at which dates the QZABs will mature.

## 7. DEFEASANCE OF DEBT

From time to time, when interest rates indicate that it would be favorable to do so, the Authority has issued refunding bonds to defease outstanding bonds. These refundings have placed the proceeds of the new bonds in irrevocable trusts with escrow agents to provide for all future debt service on the defeased bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included on the Authority's financial statements.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 23, "Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities," the difference between the reacquisition price and the net carrying amount of the bonds defeased with refunding debt is amortized as a component of Interest on Bonds over the remaining life of the refunded debt. Therefore, Bonds Payable has been reduced by \$53,064,500 to reflect the remaining deferral on debt defeasance at June 30, 2006.

At June 30, 2006, \$441,040,000 of bonds outstanding are considered defeased for financial reporting purposes.

## **8. INTEREST RECEIVABLE**

Interest receivable has been reduced by \$14,646,963. This amount represents the localities' share of refunding savings resulting from the Authority's refunding of its Series 2003 D, 2004 C, 2004 D, 2005 A and 2005 B bonds. In past years, similar savings have been passed on to localities in the form of lump sum payments, which were restricted as to use, or through an exchange of bonds, in which the savings to the localities were realized over time. This year, the Authority determined that the best method to return these savings to the localities would be in the form of a credit, for each locality's allocable share of the refunding savings, applied to the local school bond payments due on July 15, 2006. This had the effect of ensuring proper use of the refunding savings, by applying them to current debt service payments, while providing maximum flexibility to the localities in the use of their funds which would no longer be needed for this portion of their budgeted debt service payments.

## **9. TRANSFERS**

During the year, the Authority received \$7,487,603 from the Literary Fund to pay interest on the various outstanding Educational Technology Notes. In April 2006, after final rebate computation and payment on the Educational Technology Notes Series I, the residual earnings of \$287,001 on the related bond proceeds were transferred to the Literary Fund, which had been the source of the debt service appropriation for these Notes. Also, in June 2006, the Authority transferred \$170,221 to the General Fund of the Commonwealth pursuant to Section 3-3.01 of Chapter 951 of the 2005 Virginia Acts of Assembly.

Finally, in August 2006, the Literary Fund transferred \$138,041 to the Authority representing actual costs of issuance related to the VPSA Educational Technology Notes Series VI, in accordance with the 2006 Appropriations Act, Item 135(c) 14. This amount has been presented on the Statement of Net Assets as a current asset due from the Literary Fund.

## **10. ARBITRAGE EARNINGS**

The Tax Reform Act of 1986 requires that governmental entities issuing tax-exempt debt subsequent to August 1986, calculate and rebate arbitrage earnings to the federal government. The U.S. Treasury has issued regulations on calculating the rebate amount and complying with the provisions of the Tax Reform Act of 1986. The Authority and the issuers of local school bonds purchased by the Authority must comply with the rebate regulations in order for the Authority's bonds to maintain a tax-exempt status. The regulations require the excess of the aggregate amount earned on investments purchased with the bond proceeds over the amount that would have been earned if the proceeds were invested at a rate equal to the bond yield to be rebated to the federal government.

Income earned on excess earnings is also subject to rebate. Rebate payments, if required, are due at least every five years over the life of the bonds. Some Authority bonds may be exempt from the rebate requirement if they meet statutory exceptions per the rebate regulations. The Authority may also elect, on or before the date of the bond issue, to pay a penalty in lieu of rebate if it does not meet certain expenditure schedules. If such an election is made and if the Authority (local issuer) meets the expenditure schedule, the Authority (local issuer) retains any arbitrage earnings. The Authority, to date, has not elected penalty in lieu of rebate due to the difficulty in estimating local issuer's expenditure schedules. Rebate and penalty payments are calculated and paid by the Authority as required by law on bond issues that do not meet the statutory exceptions. Rebate installments must be paid no later than 60 days after the computation date.

In most cases, rebate liability is payable by local issuers whose local school bonds were purchased by the Authority. During the year, the Authority's rebate calculation agent, or the locality's rebate calculation agent in the case of special obligation stand-alone bonds, calculate rebate liability or penalty in lieu of rebate if selected by a locality. The Authority paid liability, if applicable, on the following bond issues:

| Bond Issue                            | Computation             |                  | Liability |
|---------------------------------------|-------------------------|------------------|-----------|
|                                       | Initial 5 Year or Final | Computation Date |           |
| (91 Resolution) 1995 Series A         | 5 year                  | 5/1/2005         | \$ -      |
| (91 Resolution) 1995 Series C         | Final*                  | 8/1/2005         | 124,706   |
| (91 Resolution) 1995 Series A         | Final*                  | 8/1/2005         | -         |
| (91 Resolution) 1995 Series B         | Final*                  | 8/1/2005         | -         |
| (97 Resolution) 2000 Series A         | 5 year                  | 5/18/2005        | -         |
| (97 Resolution) 2000 Series B         | 5 year                  | 11/16/2005       | -         |
| (91 Resolution) 1996 Series A         | 5 year                  | 5/1/2006         | 39,995    |
| Educational Technology Notes Series 1 | Final*                  | 4/15/2006        | -         |

\* Reports prepared as of the final redemption of the bonds

The Authority paid \$87,600 to its rebate calculation agent for services provided in connection with the above rebate calculations.

The previously refunded Series 1996 A (1991 Resolution) and Series 1996 B (1991 Resolution) had final rebate computations due as of August 1, 2006. The Series 1996 A final rebate liability of \$30,251 was paid on September 11, 2006. The Series 1996 B final rebate computation indicated no rebate was owed.

The VPSA School Financing Bonds Series 2001 B (1997 Resolution), the VPSA School Financing Bonds Series 2002 A (1997 Resolution), and the VPSA School Educational Technology Notes Series II, will require a rebate computation as of November 15, 2006, May 16, 2007, and May 29, 2007, respectively.

## **10. SUBSEQUENT EVENTS**

In November 2006, the Authority plans to issue approximately \$262.0 million of School Financing Bonds (1997 Resolution) Series 2006 B to purchase certain general obligation local school bonds to finance capital projects for public schools.

## **11. RISK MANAGEMENT**

The Authority 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 Department of Treasury participates in insurance plans maintained by the Commonwealth of Virginia on behalf of the Authority. 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 Department of Treasury 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.

## **Supplementary Information**

**Virginia Public School Authority**  
**Detail of Long-Term Indebtedness**  
**June 30, 2006**  
**(Dollars in Thousands)**

**Detail of Long-Term Indebtedness by Series**

|                                         | Dated<br>Date | Bond<br>Resolution | True Interest<br>Cost ("TIC") | Amount<br>Issued (a) | Local<br>School Bonds<br>Purchased | Outstanding<br>July 1,<br>2005 | Issued<br>(Retired)<br>During<br>Year | Outstanding<br>June 30,<br>2006 (b) | Original<br>Maturity |
|-----------------------------------------|---------------|--------------------|-------------------------------|----------------------|------------------------------------|--------------------------------|---------------------------------------|-------------------------------------|----------------------|
| 1994 Series York County                 | 07/01/94      | Stand Alone        | 5.76%                         | \$ 25,000            | \$ 25,000                          | \$ 1,195                       | \$ (1,195)                            | \$ -                                | 07/15/14             |
| 1995 Series Chesapeake City             | 06/01/95      | Stand Alone        | 5.63%                         | 102,000              | 102,000                            | 11,000                         | (5,000)                               | 6,000                               | 06/01/15             |
| Series 1997 I                           | 11/01/97      | 1997               | 4.92%                         | 224,285              | 140,818                            | 75,855                         | (9,160)                               | 66,695                              | 08/01/17             |
| Series 1998 A                           | 04/01/98      | 1997               | 4.71%                         | 130,715              | 50,730                             | 56,430                         | (6,765)                               | 49,665                              | 08/01/18             |
| Series 1998 B                           | 11/01/98      | 1997               | 4.56%                         | 105,025              | 105,311                            | 24,395                         | (4,175)                               | 20,220                              | 08/01/18             |
| Series 1999 A                           | 05/01/99      | 1997               | 4.60%                         | 153,040              | 153,040                            | 65,910                         | (6,220)                               | 59,690                              | 08/01/19             |
| Series 1999 B                           | 11/01/99      | 1997               | 5.54%                         | 91,770               | 91,770                             | 24,040                         | (4,765)                               | 19,275                              | 08/01/19             |
| Series 1999 QZAB,<br>Northampton County | 10/29/99      | Stand Alone        | 0.00%                         | 2,100                | 2,100                              | 2,100                          | -                                     | 2,100                               | 10/29/11             |
| Series 2000 A                           | 05/01/00      | 1997               | 5.38%                         | 100,175              | 100,175                            | 33,310                         | (3,520)                               | 29,790                              | 08/01/20             |
| Series 2000 B                           | 11/01/00      | 1997               | 5.11%                         | 106,200              | 106,197                            | 88,180                         | (4,730)                               | 83,450                              | 08/01/20             |
| Series 2001 A                           | 05/01/01      | 1997               | 4.84%                         | 153,940              | 153,940                            | 132,150                        | (7,390)                               | 124,760                             | 08/01/21             |
| Series 2001 Ed Tech Series I            | 05/01/01      | Equip. Notes       | 3.53%                         | 55,765               | -                                  | 11,790                         | (11,790)                              | -                                   | 04/15/06             |
| Series 2001 B                           | 11/01/01      | 1997               | 4.87%                         | 142,400              | 142,400                            | 121,805                        | (6,880)                               | 114,925                             | 08/01/21             |
| Series 2001 C                           | 11/01/01      | 1997               | 4.87%                         | 41,500               | 41,500                             | 40,450                         | (1,095)                               | 39,355                              | 08/01/26             |
| Series 2001 QZAB,<br>Northampton County | 12/21/01      | Stand Alone        | 0.00%                         | 419                  | 419                                | 419                            | -                                     | 419                                 | 12/21/15             |
| Series 2002 A                           | 05/01/02      | 1997               | 4.70%                         | 111,510              | 111,510                            | 101,490                        | (5,080)                               | 96,410                              | 08/01/22             |
| Series 2002 Ed Tech Series II           | 05/01/02      | Equip. Notes       | 2.94%                         | 55,555               | -                                  | 22,480                         | (10,965)                              | 11,515                              | 04/15/07             |
| Series 2002 B                           | 11/01/02      | 1997               | 4.12%                         | 155,545              | 155,545                            | 140,940                        | (7,900)                               | 133,040                             | 08/01/22             |
| Series 2002 QZAB,<br>Accomack County    | 12/31/02      | Stand Alone        | 0.00%                         | 1,433                | 1,433                              | 1,433                          | -                                     | 1,433                               | 12/31/16             |
| Series 2003 A                           | 05/01/03      | 1997               | 4.00%                         | 113,155              | 113,155                            | 107,650                        | (5,520)                               | 102,130                             | 08/01/28             |
| Series 2003 Ed Tech Series III          | 05/01/03      | Equip. Notes       | 1.92%                         | 55,325               | -                                  | 32,950                         | (10,520)                              | 22,430                              | 04/15/08             |
| Series 2003 B                           | 05/01/03      | 1997               | 2.93%                         | 74,850               | 74,850                             | 62,720                         | (7,915)                               | 54,805                              | 08/01/13             |
| Series 2003 C                           | 11/01/03      | 1997               | 4.39%                         | 190,645              | 190,645                            | 184,390                        | (6,395)                               | 177,995                             | 08/01/28             |
| Series 2003 D                           | 12/11/03      | 1997               | 3.23%                         | 286,670              | -                                  | 257,995                        | (41,330)                              | 216,665                             | 08/01/19             |
| 2004 Series Chesterfield County         | 02/15/04      | Stand Alone        | 3.80%                         | 56,825               | 56,825                             | 56,825                         | (2,845)                               | 53,980                              | 01/15/25             |
| Series 2004 A                           | 05/01/04      | 1997               | 4.33%                         | 123,585              | 123,585                            | 123,585                        | (4,505)                               | 119,080                             | 08/01/29             |
| Series 2004 Ed Tech Series IV           | 06/01/04      | Equip. Notes       | 2.82%                         | 56,835               | -                                  | 45,840                         | (10,825)                              | 35,015                              | 04/15/09             |

(a) Includes refunding bonds issued.

(b) Excludes deferral on debt defeasance.



**Virginia Public School Authority**  
**Detail of Long-Term Indebtednes**  
**June 30, 2006**  
**(Dollars in Thousands)**

**Detail of Long-Term Indebtedness by Series (continued)**

|                               | Dated<br>Date | Bond<br>Resolution | True Interest<br>Cost ("TIC") | Amount<br>Issued (a) | Local<br>School Bonds<br>Purchased | Outstanding<br>July 1,<br>2005 | Issued<br>(Retired)<br>During<br>Year | Outstanding<br>June 30,<br>2006 (b) | Original<br>Maturity |
|-------------------------------|---------------|--------------------|-------------------------------|----------------------|------------------------------------|--------------------------------|---------------------------------------|-------------------------------------|----------------------|
| Series 2004 B                 | 11/01/04      | 1997               | 3.91%                         | 145,340              | 145,337                            | 145,340                        | (6,210)                               | 139,130                             | 08/01/29             |
| Series 2004 C                 | 12/08/04      | 1997               | 3.34%                         | 156,125              | -                                  | 156,125                        | (7,015)                               | 149,110                             | 08/01/16             |
| Series 2004 D                 | 12/08/04      | 1997               | 3.34%                         | 3,460                | -                                  | 3,460                          | (3,460)                               | -                                   | 08/01/05             |
| Series 2005 A                 | 03/15/05      | 1997               | 3.64%                         | 55,200               | -                                  | 55,200                         | (2,310)                               | 52,890                              | 08/01/17             |
| Series 2005 B                 | 04/20/05      | 1997               | 4.07%                         | 230,580              | -                                  | 230,580                        | (500)                                 | 230,080                             | 08/01/20             |
| Series 2005 C                 | 05/01/05      | 1997               | 4.13%                         | 134,360              | 134,360                            | 134,360                        | -                                     | 134,360                             | 08/01/30             |
| Series 2005 Ed Tech Series V  | 05/25/05      | Equip. Notes       | 2.97%                         | 55,255               | -                                  | 55,255                         | (10,450)                              | 44,805                              | 04/15/10             |
| Series 2005 D                 | 11/01/05      | 1997               | 4.19%                         | 199,345              | 199,341                            | -                              | 199,345                               | 199,345                             | 08/01/30             |
| Series 2006 A                 | 05/01/06      | 1997               | 4.39%                         | 202,175              | 202,175                            | -                              | 202,175                               | 202,175                             | 08/01/31             |
| Series 2006 Ed Tech Series VI | 05/25/06      | Equip. Notes       | 3.71%                         | 56,620               | -                                  | -                              | 56,620                                | 56,620                              | 04/15/11             |
| Total                         |               |                    |                               | <u>\$ 3,954,727</u>  | <u>\$ 2,724,161</u>                | <u>\$ 2,607,647</u>            | <u>\$ 241,710</u>                     | <u>\$ 2,849,357</u>                 |                      |

**Detail of Long-Term Indebtedness by Resolution**

|                    | Amount<br>Issued (a) | Local<br>School Bonds<br>Purchased | Outstanding<br>July 1,<br>2005 | Issued<br>(Retired)<br>During<br>Year | Outstanding<br>June 30,<br>2006 (b) |
|--------------------|----------------------|------------------------------------|--------------------------------|---------------------------------------|-------------------------------------|
| 1997 Resolution    | \$ 3,431,595         | \$ 2,536,384                       | \$ 2,366,360                   | \$ 248,680                            | \$ 2,615,040                        |
| Stand Alone Issues | 187,777              | 187,777                            | 72,972                         | (9,040)                               | 63,932                              |
| Equipment Notes    | 335,355              | -                                  | 168,315                        | 2,070                                 | 170,385                             |
| Total              | <u>\$ 3,954,727</u>  | <u>\$ 2,724,161</u>                | <u>\$ 2,607,647</u>            | <u>\$ 241,710</u>                     | <u>\$ 2,849,357</u>                 |

(a) Includes refunding bonds issued.

(b) Excludes deferral on debt defeasance.

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VIRGINIA PUBLIC SCHOOL AUTHORITY  
Richmond, Virginia

BOARD OF COMMISSIONERS

As of June 30, 2006

James J. Wheaton, Chairman

James M. Holland, Vice Chairman

Hady Amr

Tammy Esteves, Ph.D

Brenda L. Skidmore

EX OFFICIO

J. Braxton Powell, Secretary and Treasurer, State Treasurer

David Von Moll, State Comptroller

Patricia Wright, Acting Superintendent of Public Instruction