



GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Basic Financial Statements

September 30, 2004

(With Independent Auditors' Report Thereon)

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

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KPMG LLP
American International Plaza
Suite 1100
250 Muñoz Rivera Avenue
San Juan, PR 00918-1819

Independent Auditors' Report

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

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Government of the United States Virgin Islands (the Government) as of and for the year ended September 30, 2004, which collectively comprise the Government's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Government's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the following component units:

- The Virgin Islands Public Finance Authority (PFA), a blended component unit, which represents 100% of the assets, fund balance, and revenue of the PFA Debt Service Fund (a major fund); 100% of the assets, net assets, and revenue of the PFA Capital Projects Fund (a major fund); 100% of the assets, net assets, and revenue of the West Indian Company (a major fund); 1.17%, 1.29%, and 1.96% of the assets, net assets/fund balance, and revenue of the aggregate remaining fund information; 25.2%, 87.6%, and 17.6% of the assets, net assets, and revenue of the governmental activities; and 59.65%, 49.56%, and 35.34% of the assets, net assets, and revenue of the business-type activities, respectively.
- Virgin Islands Lottery (VI Lottery), a nonmajor enterprise fund, which represents 0.06%, 0.48%, and 2.06%, respectively, of the assets, net assets/fund balance, and revenue of the aggregate remaining fund information, and 1.14%, 11.26%, and 21.21%, respectively, of the assets, net assets, and revenue of the business-type activities.
- The Tobacco Settlement Financing Corporation, a blended component unit, which represents 0.73%, 1.09%, and 0.28%, respectively, of the assets, fund balance, and revenue of the aggregate remaining fund information, and 0.91%, 4.10%, and 0.14%, respectively, of the assets, net assets, and revenue of the governmental activities.
- The Virgin Islands Port Authority, Virgin Islands Water and Power Authority, Virgin Islands Housing Authority (VIHA), University of the Virgin Islands, Virgin Islands Public Television System, Virgin Islands Economic Development Authority (VIEDA), Magens' Bay Authority, Virgin Islands Government Hospital and Health Facilities Corporation (Roy L. Schneider Hospital and Juan F. Luis Hospital and Medical Center), and the Virgin Islands Housing Finance Authority (VIHFA), discretely presented component units, which collectively represent 100% of the assets, net assets, and revenue of the aggregate discretely presented component units.



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

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

The basic financial statements include a receivable for corporate income taxes in the general fund (a major fund) and the governmental activities of \$8.7 million as of September 30, 2004. The basic financial statements of September 30, 2003 did not include a receivable for corporate income taxes pertaining to tax year 2002 in the general fund (a major fund) and the governmental activities due to inadequate records. The receivable for corporate income taxes at September 30, 2003, enters into the determination of revenue and change in fund balance/net assets for the year ended September 30, 2004. The Government's records do not permit, nor is it practicable to extend our auditing procedures sufficiently to determine the extent to which the revenue and change in fund balance/net assets of the general fund (a major fund) and the governmental activities for the year ended September 30, 2004 may have been affected by this condition.

The report of the other auditors on the financial statements of VIHA, a discretely presented component unit, as of and for the year ended December 31, 2003, was qualified because they were unable to obtain sufficient audit evidence to determine whether capital assets amounting to \$67 million were fairly stated.

The report of the other auditors on the 2004 financial statements of VIHFA, a discretely presented component unit, was qualified because they were unable to obtain sufficient audit evidence to determine whether land held for sale amounting to approximately \$25.7 million was fairly stated.

The basic financial statements include a receivable for unemployment insurance contributions in the unemployment insurance fund (a major fund) and the business-type activities of \$1.1 million as of September 30, 2004. The basic financial statements of September 30, 2003 did not include a receivable for unemployment insurance contributions in the unemployment insurance fund (a major fund) and the business-type activities due to inadequate records. The receivable for unemployment insurance contributions at September 30, 2003, enters into the determination of revenue, change in net assets, and, where applicable, cash flows for the year ended September 30, 2004. The Government's records do not permit, nor is it practicable to extend our auditing procedures sufficiently to determine the extent to which the revenue, change in net assets, and, where applicable, cash flows of the unemployment insurance fund (a major fund) and the business-type activities for the year ended September 30, 2004 may have been affected by this condition.



The report of the other auditors on the 2004 financial statements of the VI Lottery, a nonmajor enterprise fund, was qualified because they were unable to obtain sufficient audit evidence to determine whether capital assets of \$45 thousand, net accounts receivables of \$887 thousand, due to the general fund of \$4.5 million, and other liabilities of \$115 thousand were fairly stated.

The basic financial statements do not include a liability for workers' compensation claims. The Government's records do not permit, nor is it practical to extend our auditing procedures sufficiently to determine the extent by which the business-type activities as of and for the year ended September 30, 2004 may have been affected by this condition.

The Employees' Retirement System of the Government of the Virgin Islands (GERS), a fiduciary component unit (pension trust fund), is recording contributions pursuant to the Early Retirement Act of 1994 as the cash is received which, in our opinion, should be accrued in order to conform with U.S. generally accepted accounting principles. If these contributions were accrued, contributions receivable and net assets held in trust for employees' pension benefits would be increased by \$7.2 million and the change in net assets would be increased by \$1.1 million. In addition, GERS maintains its real estate investment in the GERS complex related to the portion of the St. Thomas building held for lease based on historical cost. As of September 30, 2004, this real estate investment amounted to approximately \$8.6 million. Such investment should be presented at fair value in accordance with U.S. generally accepted accounting principles. GERS has not performed a recent valuation of this real estate investment. Finally, we were unable to obtain sufficient audit evidence about the cash overdraft balance reported by GERS with the Department of Finance of approximately \$10.5 million in specially designated pooled accounts.

The basic financial statements include a provision for landfill closure and postclosure costs as required by U.S. generally accepted accounting principles in the governmental activities of \$28.8 million as of September 30, 2004. The basic financial statements of September 30, 2003 did not include a provision for landfill closure and postclosure costs in the governmental activities because no calculation had been made. The provision for landfill closure and postclosure costs at September 30, 2003, enters into the determination of expenses and change in net assets for the year ended September 30, 2004. The Government's records do not permit, nor is it practicable to extend our auditing procedures sufficiently to determine the extent to which the expenses and change in net assets of the governmental activities for the year ended September 30, 2004 may have been affected by this condition.

Because of the matters discussed in the sixth, seventh, and eighth paragraphs of this report, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the business-type activities as of September 30, 2004 and the changes in financial position for the year then ended.

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

- the effects of not being able to determine the extent to which the expenses and change in net assets of the governmental activities may have been affected by the exclusion of a provision for landfill closure and postclosure costs in the beginning net assets, as described in paragraph ten above, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the Government as of September 30, 2004 and the changes in financial position thereof for the year then ended in conformity with U.S. generally accepted accounting principles;
- the effects of not being able to determine the extent to which the revenue and change in fund balance/net assets of the general fund (a major fund) and the governmental activities may have been affected by the exclusion of a receivable for corporate income taxes pertaining to tax year 2002 in the beginning fund balance/net assets due to inadequate records, as described in paragraph three above, the financial statements referred to above present fairly, in all material respects, the financial position of the general fund and the governmental activities of the Government as of September 30,



2004 and the changes in financial position thereof for the year then ended in conformity with U.S. generally accepted accounting principles;

- the effects of not being able to determine the extent to which the revenue, change in net assets, and cash flows of the unemployment insurance fund (a major fund) may have been affected by the exclusion of a receivable for unemployment insurance contributions in the beginning net assets due to inadequate records, as described in paragraph six above, the financial statements referred to above present fairly, in all material respects, the financial position of the unemployment insurance fund of the Government as of September 30, 2004, and the changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with U.S. generally accepted accounting principles;
- the effects of the adjustments as might have been determined to be necessary, had the other auditors been able to obtain sufficient audit evidence to determine whether capital assets and land held for sale amounting to \$67 million and \$26 million in the financial statements of VIHA and VIHFA, respectively, were fairly stated, as described in paragraphs four and five above, the financial statements referred to above present fairly, in all material respects, the financial position of the discretely presented component units of the Government of the United States Virgin Islands as of September 30, 2004, and the respective changes in financial position thereof for the year then ended in conformity with U.S. generally accepted accounting principles; and
- the effects of (i) GERS not accruing contributions pursuant to the Early Retirement Act of 1994 and not recording its real estate investment in the GERS complex related to the portion of the St. Thomas building held for lease at fair value, and (ii) the adjustments as might have been determined to be necessary, had we been able to obtain satisfactory evidence with respect to the cash overdraft of GERS with the Department of Finance, as described in paragraph nine above, the financial statements referred to above present fairly, in all material respects, the financial position of the aggregate remaining fund information of the Government of the United States Virgin Islands, as of September 30, 2004, and the respective changes in financial position thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

Finally, in our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the PFA Debt Service Fund, PFA Capital Projects Fund, and the West Indian Company of the Government of the United States Virgin Islands as of September 30, 2004, and the respective changes in financial position and, where applicable, cash flows thereof, and the respective budgetary comparison for the general fund for the year then ended in conformity with U.S. generally accepted accounting principles.

As discussed in note 14 to the basic financial statements, the Government has restated beginning net assets and fund balances.



The management's discussion and analysis on pages 6 through 15 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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.

KPMG LLP

June 7, 2006

Stamp No. 2102947 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2004

Introduction

The following discussion and analysis presents an overview of the financial position and activities of the Government of the United States Virgin Islands (the Government) as of and for the fiscal years ended September 30, 2004 and 2003.

Government-wide Financial Statements

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

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

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

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

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

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

Fund Financial Statements

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

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2004

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

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

Governmental Funds

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

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

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

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

Proprietary Funds

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

The unemployment insurance fund and the West Indian Company (WICO) fund are major proprietary funds.

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

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

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Management's Discussion and Analysis

September 30, 2004

Fiduciary Funds

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

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

Financial Analysis of the Government as a Whole

The primary government (PG) and its component units experienced an economic downturn following the slowdown of the U.S. economy in fiscal year 2002 and the events of September 11, 2001. As explained in note 13 to the basic financial statements, the Government has initiated specific actions to improve its future cash flows through the issuance of long-term debt, the development of a series of detailed revenue enhancement and expenditure reduction initiatives, and the enactment of certain laws directed toward improving the Government's financial situation.

In fiscal year 2004, the Government issued the 2003A Series Revenue Bonds amounting to \$268 million to repay the bond anticipation note and to fund necessary capital projects of the PG.

Financial Analysis of the Primary Government

Total assets of the government as of September 30, 2004 and 2003 were \$1.564 billion and \$1.337 billion, respectively, an increase of approximately \$227 million. Total liabilities as of September 30, 2004 and 2003 were \$1.836 billion and \$1.637 billion, respectively, an increase of approximately \$199 million.

For the year ended September 30, 2004, the PG net deficit of \$272 million consisted of \$239 million invested in capital assets, net of related debt; \$173 million restricted by statute or other legal requirements that were not available to finance day to day operations of the government; and an unrestricted net deficit of \$684 million. For the year ended September 30, 2003, the PG net asset deficit of \$300 million consisted of \$245 million invested in capital assets, net of related debt; \$148 million restricted by statute or other legal requirements and were not available to finance day to day operations of the government; and an unrestricted net deficit of \$693 million.

For the fiscal year ended September 30, 2004, the PG earned program and general revenue amounting to \$977 million, and reported expenses of \$946 million, resulting in a decrease in the net deficit, before transfers, of \$31 million. For the fiscal year ended September 30, 2003, the PG earned program and general revenue amounting to \$854 million, and reported expenses of \$888 million, resulting in an increase in the net deficit, before a special item and transfers, of \$34 million. During fiscal year 2003, the Government reported a special item of \$159 million resulting from the forgiveness of the 1996 Community Disaster Loan (CDL) resulting in an overall reduction in the net deficit of \$125 million.

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Management's Discussion and Analysis

September 30, 2004

In overall, revenue demonstrated an increase of approximately \$123 million in fiscal year 2004, when compared to fiscal year 2003. Expenses increased in fiscal year 2004 when compared to fiscal year 2003 by \$58 million, including \$29 million in landfill closure and postclosure care cost recognized in fiscal year 2004. A summary of net assets (deficit) and changes in net assets (deficit) for the primary government follows:

Net Assets (Deficit) – Primary Government

September 30, 2004 and 2003

(In thousands)

	<u>Governmental activities</u>		<u>Business-type activities</u>		<u>Total</u>	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003 (a)</u>	<u>2004</u>	<u>2003 (a)</u>
Assets						
Current assets	\$ 836,161	626,829	43,833	54,979	879,994	681,808
Capital assets	625,530	608,158	42,693	43,008	668,223	651,166
Other assets	15,421	3,211	437	553	15,858	3,764
Total assets	1,477,112	1,238,198	86,963	98,540	1,564,075	1,336,738
Liabilities						
Long-term debt outstanding	1,061,655	913,925	21,376	22,015	1,083,031	935,940
Other liabilities	743,737	693,964	9,610	6,917	753,347	700,881
Total liabilities	1,805,392	1,607,889	30,986	28,932	1,836,378	1,636,821
Net Assets						
Invested in capital assets, net of related debt	217,677	224,189	21,318	20,993	238,995	245,182
Restricted	131,496	105,633	41,375	42,464	172,871	148,097
Unrestricted (deficit)	(677,453)	(699,513)	(6,716)	6,151	(684,169)	(693,362)
Total net assets (deficit)	\$ (328,280)	(369,691)	55,977	69,608	(272,303)	(300,083)

- (a) The 2003 balances were not restated to reflect the restatements that were made to the beginning net asset balances because the 2003 information is not readily available.

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Management's Discussion and Analysis

September 30, 2004

Changes in Net Assets (Deficit) – Primary Government

September 30, 2004 and 2003

(In thousands)

	Governmental activities		Business-type activities		Total	
	2004	2003	2004	2003 (a)	2004	2003 (a)
Revenue:						
Program revenue:						
Charges for services	\$ 28,932	26,988	41,294	29,590	70,226	56,578
Operating grants and contributions	151,118	143,295	—	—	151,118	143,295
Capital grants and contributions	9,553	20,564	—	—	9,553	20,564
General revenue:						
Taxes	664,510	594,616	—	—	664,510	594,616
Interest and other	77,848	33,991	2,749	3,785	80,597	37,776
Other general revenue	1,102	1,577	—	—	1,102	1,577
Total revenue	933,063	821,031	44,043	33,375	977,106	854,406
Expenses:						
General government	381,282	350,600	—	—	381,282	350,600
Public safety	55,677	49,394	—	—	55,677	49,394
Health	92,694	97,243	—	—	92,694	97,243
Public housing and welfare	62,712	63,874	—	—	62,712	63,874
Education	186,122	186,293	—	—	186,122	186,293
Transportation and communication	45,987	29,240	—	—	45,987	29,240
Culture and recreation	7,549	14,365	—	—	7,549	14,365
Interest on long-term debt	60,024	49,633	—	—	60,024	49,633
Unemployment insurance	—	—	7,117	19,664	7,117	19,664
West Indian Company	—	—	9,926	8,432	9,926	8,432
Workmen's Compensation	—	—	8,431	8,922	8,431	8,922
VI Lottery	—	—	11,663	—	11,663	—
Other business-type activities	—	—	17,004	10,521	17,004	10,521
Total expenses	892,047	840,642	54,141	47,539	946,188	888,181
Increase (decrease) in net assets before special item and transfers	41,016	(19,611)	(10,098)	(14,164)	30,918	(33,775)
Special item	—	159,271	—	—	—	159,271
Transfers	395	(1,379)	(395)	1,379	—	—
	395	157,892	(395)	1,379	—	159,271
Change in net assets	41,411	138,281	(10,493)	(12,785)	30,918	125,496
Net assets (deficit), beginning of year, as previously reported	(369,691)	(508,798)	69,608	77,212	(300,083)	(431,586)
Restatements to beginning net assets	—	826	(3,138)	5,181	(3,138)	6,007
Net assets (deficit), end of year, as restated	\$ (328,280)	(369,691)	55,977	69,608	(272,303)	(300,083)

(a) The 2003 balances were not restated to reflect the restatements that were made to the beginning net asset balances because the 2003 information is not readily available.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2004

The Virgin Islands Office of Management and Budget of the PG prepares an annual executive budget subject to approval by the Governor and the Legislature of the Virgin Islands. The executive budget is prepared on a budgetary basis similar to the cash basis of accounting. The executive budget includes only those funds that are subject to appropriation by law. More information regarding budgetary procedures is provided in note 3 of the basic financial statements. A summary of the budgetary report for the General Fund of the PG, included on page 23 of the financial statements, follows:

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

Year ended September 30, 2004

(In thousands)

	<u>Original budget</u>	<u>Amended budget</u>	<u>Actual</u>	<u>Variance</u>
Total revenue	\$ 526,849	526,849	478,387	(48,462)
Total expenditures	<u>566,282</u>	<u>596,545</u>	<u>531,007</u>	<u>65,538</u>
Excess of expenditures over revenue	<u>(39,433)</u>	<u>(69,696)</u>	<u>(52,620)</u>	<u>17,076</u>
Other financing sources (uses)	<u>70,968</u>	<u>70,968</u>	<u>81,709</u>	<u>10,741</u>
Excess of revenue and other financing sources (uses) over expenditures	<u>\$ 31,535</u>	<u>1,272</u>	<u>29,089</u>	<u>27,817</u>

For fiscal year 2004, the PG realized a revenue variance \$(48) million due to a slower-than-expected recovery following the 2002 recession. The PG realized a \$66 million variance in expenditures due to control spending imposed by revenue shortfalls. The PG realized a \$11 million variance in other financing sources due to the fact that transfers to the General Fund were higher than budgetary estimates.

Capital Assets

Capital assets additions during fiscal years 2004 and 2003 amounted to \$36 million and \$34 million, respectively, for governmental activities and \$1.6 million and \$7.5 million, respectively, for business-type activities.

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Management's Discussion and Analysis

September 30, 2004

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

Capital Assets – Primary Government

(In thousands)

	Governmental activities		Business-type activities		Total	
	2004	2003	2004	2003 (a)	2004	2003 (a)
Land and improvements	\$ 188,523	188,109	5,357	5,358	193,880	193,467
Building and improvements	402,450	400,309	47,575	46,490	450,025	446,799
Machinery and equipment	78,159	69,788	3,791	2,585	81,950	72,373
Infrastructure	126,249	121,413	—	—	126,249	121,413
Construction in progress	24,578	4,046	809	722	25,387	4,768
Total assets	819,959	783,665	57,532	55,155	877,491	838,820
Less accumulated depreciation	(194,429)	(175,507)	(14,839)	(12,147)	(209,268)	(187,654)
Total capital assets	\$ <u>625,530</u>	<u>608,158</u>	<u>42,693</u>	<u>43,008</u>	<u>668,223</u>	<u>651,166</u>

(a) The 2003 balances were not adjusted to reflect the restatements that were made to the beginning net asset balances because the 2003 information is not readily available.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2004

Debt Administration

The Government issues both general obligation bonds and revenue bonds. The Revised Organic Act [48 U.S.C. Section 1574 (b)(ii)] restricts the principal amount of general obligation debt that the Government may issue to no greater than 10% of the aggregate assessed valuation of taxable real property in the U.S. Virgin Islands. Following is a summary of bonds outstanding as of September 30, 2004:

Primary Government – Bonds Payable

(In thousands)

<u>Bonds payable</u>	<u>Final maturity</u>	<u>Interest rates (%)</u>	<u>Balance</u>
1998 Series A, C, D, and E Revenue and Refunding Bonds	2023	5.50 to 7.11	\$ 473,745
1999 Project Revenue Bonds	2005	6.25	1,550
1999 Series A General Obligation Bonds	2010	6.50	5,650
1999 Series A Revenue Bonds	2033	4.20 to 6.40	283,335
2001 Series A Tobacco Bonds	2031	5.00	22,310
2002 Series Garvee Bonds	2009	2.50 to 5.00	15,840
2003 Series A Revenue Bonds	2033	4.00 to 5.25	<u>268,020</u>
Subtotal			1,070,450
Deferred amount on refundings			(2,464)
Bond premium			3,819
Bond discount			(9,052)
Bond accretion			<u>(1,098)</u>
Total			\$ <u><u>1,061,655</u></u>

Note 9 provides detailed information regarding all bonds of the U.S. Virgin Islands.

During fiscal year 2004, the 2003 Series A revenue bonds amounting to \$268 million were issued.

The PG made bond principal payments on all outstanding general and special revenue bonds amounting to \$25 million during fiscal year 2004, and \$24 million during fiscal year 2003.

The Government's bonds carry insured ratings of "AAA" and "Aaa" from Fitch Ratings and Moody's Investors Services, respectively. Ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained from the respective rating agency.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2004

Other liabilities of the PG include:

Primary Government – Other Liabilities

September 30, 2004 and 2003

(In millions)

	<u>2004</u>	<u>2003</u>
Accrued compensated absences	\$ 60	52
Retroactive union arbitration liability	384	375
Accrued litigation	15	13
Landfill closure and post closure costs	29	—
Accrued federal cost disallowances	6	13
Total other liabilities	<u>\$ 494</u>	<u>453</u>

Economic Condition and Outlook

The PG ended fiscal year 2004 with a deficit amounting to \$272 million, of which \$684 million relates to an unrestricted deficit. The PG is working towards a recovery from the recession of 2002 through a combination of revenue initiatives and budgetary restraint on expenditures.

Revenue Initiatives

The PG collects income tax revenue under the “mirror” income tax system. The Government’s tax laws mirror the U.S. Internal Revenue Service (IRS) Code, Rules, and Regulations. The 2003 and 2004 Tax Acts passed by U.S. Congress may have a negative impact on revenue due to changes in sourcing of revenue rules as defined for the U.S. Virgin Islands, restrictions on residency rules, a decrease in tax rates, expanded tax credits, and expanded tax deductions. In April 2005, the U.S. Treasury issued draft tax regulations for the territories and possessions defining residency and source of income. The Government has proactively responded to these changes through meetings with the U.S. Treasury. The regulations have not been issued and the Government’s response is under review by the U.S. Treasury.

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

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

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Management's Discussion and Analysis

September 30, 2004

Budgetary Control of Expenditures

The PG faces the challenge of carryforward expenditures from prior fiscal years and increasing expenditures in the current fiscal year. Carryforward expenditures consist mainly of retroactive salary increases, which accumulated following Hurricanes Hugo, Marilyn, and Bertha in the years of 1990 through 1998.

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

Deficit Reduction Measures

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

Contacting the Government's Financial Management

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

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Net Assets (Deficit)

September 30, 2004

(In thousands)

	Primary Government		Total	Component units
	Governmental activities	Business-type activities		
Assets:				
Cash and cash equivalents	\$ 247,100	8,004	255,104	58,153
Investments	349,120	—	349,120	29,388
Receivables, net	179,632	3,352	182,984	54,210
Internal balances	6,999	(6,999)	—	—
Loans and advances	—	—	—	1,622
Due from component units	29,382	—	29,382	—
Note receivable	—	—	—	7,486
Due from primary government	—	—	—	3,531
Due from federal government	22,963	—	22,963	4,204
Inventories	—	435	435	20,866
Other assets	965	843	1,808	18,856
Restricted:				
Cash and cash equivalents	—	38,198	38,198	34,544
Investments	—	—	—	91,794
Other	—	—	—	1,188
Capital assets	625,530	42,693	668,223	764,325
Deferred expenses	15,421	437	15,858	21,167
Total assets	1,477,112	86,963	1,564,075	1,111,334
Liabilities:				
Current liabilities:				
Accounts payable and accrued liabilities	52,003	5,637	57,640	73,605
Tax refunds payable	75,352	—	75,352	—
Unemployment insurance benefits	—	1,744	1,744	—
Customer deposits	—	—	—	16,710
Due to primary government	—	—	—	29,382
Due to component units	3,531	—	3,531	—
Due to federal government	—	—	—	5,690
Interest payable	29,133	—	29,133	5,281
Unearned revenue	87,250	—	87,250	4,545
Other current liabilities	1,990	2,229	4,219	6,619
Due within one year:				
Loans payable	—	813	813	8,298
Bonds payable	22,467	—	22,467	8,476
Other liabilities	39,663	—	39,663	—
Noncurrent liabilities:				
Due in more than one year:				
Loans payable	—	20,563	20,563	2,583
Bonds payable	1,039,188	—	1,039,188	277,923
Other liabilities	454,815	—	454,815	28,708
Total liabilities	\$ 1,805,392	30,986	1,836,378	467,820

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Net Assets (Deficit), continued

September 30, 2004

(In thousands)

	Primary Government		Total	Component units
	Governmental activities	Business-type activities		
Net assets:				
Invested in capital assets, net of related debt	\$ 217,677	21,318	238,995	538,835
Restricted for:				
Unemployment insurance	—	33,840	33,840	—
Debt service	131,496	—	131,496	—
Other purposes	—	7,535	7,535	71,790
Unrestricted (deficit)	(677,453)	(6,716)	(684,169)	32,889
Total net assets (deficit)	\$ (328,280)	55,977	(272,303)	643,514

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Activities

Year ended September 30, 2004

(In thousands)

Functions:	Program revenue			Net revenue (expense) and changes in net assets			Component units	
	Expenses	Charges for services	Operating grants and contributions	Capital grants and contributions	Primary government			Total
					Governmental activities	Business-type activities		
Primary government:								
Governmental activities:								
General government	\$ 381,282	24,853	36,729	4,982	(314,718)	—	—	
Public safety	55,677	1,296	16,833	—	(37,548)	—	—	
Health	92,694	416	29,065	—	(63,213)	—	—	
Public housing and welfare	62,712	409	36,510	—	(25,793)	—	—	
Education	186,122	—	31,481	—	(154,641)	—	—	
Transportation and communication	45,987	1,947	350	4,571	(39,119)	—	—	
Culture and recreation	7,549	11	150	—	(7,388)	—	—	
Interest on long-term debt	60,024	—	—	—	(60,024)	—	—	
Total governmental activities	892,047	28,932	151,118	9,553	(702,444)	—	—	
Business-type activities:								
Unemployment insurance	7,117	3,771	—	—	(3,346)	—	—	
West Indian Company	9,926	12,381	—	—	2,455	—	—	
Workmen's compensation	8,431	7,169	—	—	(1,262)	—	—	
VI Lottery	11,663	9,390	—	—	(2,273)	—	—	
Other	17,004	8,583	—	—	(8,421)	—	—	
Total business-type activities	54,141	41,294	—	—	(12,847)	—	—	
Total primary government	946,188	70,226	151,118	9,553	(702,444)	(12,847)	(715,291)	
Component units:								
Virgin Islands Housing Authority	\$ 44,206	5,121	30,766	5,437	—	—	(2,882)	
Virgin Islands Port Authority	41,910	36,651	—	10,037	—	—	4,778	
Virgin Islands Water and Power Authority:								
Electric system	146,378	144,745	—	820	—	—	(813)	
Water system	21,637	25,406	—	1,088	—	—	4,857	
Virgin Islands Government Hospital and Health Facilities Corporation:								
Roy L. Schneider Hospital	66,171	40,235	21,778	4,541	—	—	383	
Juan F. Luis Hospital	50,843	24,867	18,249	1,631	—	—	(6,096)	
University of the Virgin Islands	59,484	13,607	45,476	3,192	—	—	2,791	
Other component units	12,028	2,695	6,370	1,711	—	—	(1,252)	
Total component units	442,657	293,327	122,639	28,457	—	—	1,766	

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Activities, continued

Year ended September 30, 2004

(In thousands)

	Net revenue (expense) and changes in net assets			Component units
	Governmental activities	Primary government Business-type activities	Total	
Total primary government and component units	\$ (702,444)	(12,847)	(715,291)	1,766
General revenue:				
Taxes	664,510	—	664,510	—
Interest and other	77,848	2,749	80,597	9,425
Tobacco settlement rights	1,102	—	1,102	—
Transfers – internal activities of primary government	395	(395)	—	—
Total general revenue and transfers	743,855	2,354	746,209	9,425
Changes in net assets (deficit)	41,411	(10,493)	30,918	11,191
Net assets (deficit), beginning of year (as restated)	(369,691)	66,470	(303,221)	632,323
Net assets (deficit), end of year	\$ (328,280)	55,977	(272,303)	643,514

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Balance Sheet – Governmental Funds

September 30, 2004

(In thousands)

Assets	General	PFA debt service	PFA capital projects	Other governmental	Total governmental
Cash and cash equivalents	\$ 136,279	—	46,135	64,686	247,100
Investments	72,888	150,285	112,729	13,218	349,120
Receivables:					
Taxes	140,553	38,253	—	—	178,806
Accrued interest and other	390	—	—	541	931
Due from:					
Other funds	8,846	—	313	10,794	19,953
Component units	29,382	—	—	—	29,382
Federal government	—	—	—	22,963	22,963
Other assets	—	—	—	34	34
Total assets	\$ 388,338	188,538	159,177	112,236	848,289
Liabilities and Fund Balances					
Accounts payable and accrued liabilities	\$ 33,893	—	346	17,764	52,003
Tax refunds payable	75,352	—	—	—	75,352
Due to:					
Other funds	7,654	2,000	158	3,178	12,990
Component units	3,531	—	—	—	3,531
Deferred revenue	140,193	72,939	6,639	18,976	238,747
Other current liabilities	—	—	—	1,954	1,954
Total liabilities	260,623	74,939	7,143	41,872	384,577
Fund balances reserved for:					
Encumbrances	48,340	—	—	—	48,340
Debt service	—	113,599	—	17,898	131,497
Unreserved fund balance, reported in:					
General fund	79,375	—	—	—	79,375
Special revenue funds	—	—	—	55,925	55,925
Capital projects funds	—	—	152,034	(3,459)	148,575
Total fund balances	127,715	113,599	152,034	70,364	463,712
Total liabilities and fund balances	\$ 388,338	188,538	159,177	112,236	

Amounts reported for governmental activities in the statement of net assets (deficit) are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.	625,530
Bond issue costs are not financial resources and, therefore, are not reported in the funds.	15,421
Because the focus of governmental funds is on short-term financing, some assets, primarily taxes receivable, will not be available to pay for current period expenditures. Those assets are offset by deferred revenue in the funds.	152,323
Interest on long-term debt is not accrued in the funds, but rather is recognized as an expenditure when due.	(29,133)
Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds.	(1,556,133)
Deficit of governmental activities	\$ (328,280)

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

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

Year ended September 30, 2004

(In thousands)

	<u>General</u>	<u>PFA debt service</u>	<u>PFA capital projects</u>	<u>Other governmental</u>	<u>Total governmental</u>
Revenue:					
Taxes	\$ 459,809	152,449	—	18,248	630,506
Federal grants and contributions	—	3,651	—	157,020	160,671
Charges for services	21,424	—	—	7,508	28,932
Tobacco settlement rights	—	—	—	1,102	1,102
Interest and other	42,514	5,143	2,608	27,583	77,848
Total revenue	<u>523,747</u>	<u>161,243</u>	<u>2,608</u>	<u>211,461</u>	<u>899,059</u>
Expenditures:					
Current:					
General government	246,658	—	2,702	87,717	337,077
Public safety	40,954	—	—	13,152	54,106
Health	70,808	—	—	18,514	89,322
Public housing and welfare	31,231	—	426	31,055	62,712
Education	149,077	—	—	31,300	180,377
Transportation and communication	29,950	—	6,562	4,939	41,451
Culture and recreation	6,203	—	—	1,076	7,279
Capital outlays	—	—	22,461	14,089	36,550
Debt service:					
Principal	—	120,570	—	4,125	124,695
Interest	—	50,155	—	1,365	51,520
Bond issuance costs	—	13,033	—	—	13,033
Total expenditures	<u>574,881</u>	<u>183,758</u>	<u>32,151</u>	<u>207,332</u>	<u>998,122</u>
Excess (deficiency) of revenue over (under) expenditures	<u>(51,134)</u>	<u>(22,515)</u>	<u>(29,543)</u>	<u>4,129</u>	<u>(99,063)</u>
Other financing sources (uses):					
Bonds issued	—	126,520	141,500	—	268,020
Transfers from other funds	87,302	—	1,015	15,314	103,631
Transfers to other funds	(5,593)	(85,562)	(4,000)	(8,081)	(103,236)
Premium on bonds issued	—	2,830	—	—	2,830
Total other financing sources (uses), net	<u>81,709</u>	<u>43,788</u>	<u>138,515</u>	<u>7,233</u>	<u>271,245</u>
Net change in fund balances	<u>30,575</u>	<u>21,273</u>	<u>108,972</u>	<u>11,362</u>	<u>172,182</u>
Fund balance, beginning of year (as restated)	97,140	92,326	43,062	59,002	291,530
Fund balance, end of year	\$ <u>127,715</u>	<u>113,599</u>	<u>152,034</u>	<u>70,364</u>	<u>463,712</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS
Reconciliation of the Statement of Revenue, Expenditures, and Changes in
Fund Balances to the Statement of Activities – Governmental Funds

Year ended September 30, 2004

(In thousands)

Net change in fund balances – total governmental funds	\$	172,182
Government funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.		17,372
Tax revenue in the statement of activities, which do not provide current financial resources, are not reported as revenue in the funds.		34,004
The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of the governmental funds. These transactions have no effect on net assets. This is the amount by which bond and loan proceeds of \$268,020 exceeded principal retirement of \$124,695 in the current period.		(143,325)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. This is the amount by which the increase in certain liabilities reported in the statement of net assets of the previous year increased expenses reported in the statement of activities that do not require the use of current financial resources.		(40,521)
Bond issue costs are expended in the governmental funds when paid, and are capitalized and amortized in the statement of activities. This is the amount by which current year bond issue costs exceeded amortization expense in the current period.		12,210
Bond premiums and discounts are reported as other financing sources and uses in the governmental funds when the bonds are issued, and are capitalized and amortized in the government-wide financial statements. This amount represents the capitalization of premiums on bonds issued during the current year of \$2,830 and the additional net interest expense of \$1,575 reported in the statement of activities related to the amortization of premiums, discounts deferred refunding loss, and accreted interest on capital appreciation bonds during the current year.		(4,405)
Certain interest reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. This amount represents the increase in interest payable reported in the statement of net assets less the portion of accrued interest.		(6,106)
Change in net assets of governmental activities	\$	<u>41,411</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

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

Year ended September 30, 2004

(In thousands)

	<u>Original budget</u>	<u>Amended budget</u>	<u>Actual</u>	<u>Variance</u>
Revenue:				
Taxes	\$ 493,048	493,048	436,422	(56,626)
Charges for services	10,259	10,259	15,055	4,796
Interest and other	23,542	23,542	26,910	3,368
Total revenue	<u>526,849</u>	<u>526,849</u>	<u>478,387</u>	<u>(48,462)</u>
Expenditures:				
Current:				
General government	123,578	136,318	211,439	(75,121)
Public safety	62,242	64,895	40,446	24,449
Health	84,539	87,812	65,030	22,782
Public housing and welfare	43,046	41,771	31,846	9,925
Education	190,192	197,675	145,723	51,952
Transportation and communication	43,924	48,928	27,402	21,526
Culture and recreation	18,761	19,146	9,121	10,025
Total expenditures	<u>566,282</u>	<u>596,545</u>	<u>531,007</u>	<u>65,538</u>
Excess of expenditures over revenue	<u>(39,433)</u>	<u>(69,696)</u>	<u>(52,620)</u>	<u>17,076</u>
Other financing sources (uses):				
Transfers from other funds	78,043	78,043	87,302	9,259
Transfer to other funds	(7,075)	(7,075)	(5,593)	1,482
Total other financing sources (uses), net	<u>70,968</u>	<u>70,968</u>	<u>81,709</u>	<u>10,741</u>
Excess of revenue and other financing sources over expenditures	<u>\$ 31,535</u>	<u>1,272</u>	<u>29,089</u>	<u>27,817</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Net Assets – Proprietary Funds

September 30, 2004

(In thousands)

	Business-type activities – Enterprise funds			
	Unemployment insurance	West Indian Company	Other	Totals
Assets:				
Current assets:				
Cash and cash equivalents	\$ 244	5,450	2,310	8,004
Receivables, net:				
Premiums receivable	1,136	—	—	1,136
Accrued interest and other	—	1,091	60	1,151
Other receivables	—	—	1,065	1,065
Due from other funds	—	—	300	300
Inventories and other current assets	—	—	435	435
Other assets	—	783	60	843
Total current assets	1,380	7,324	4,230	12,934
Noncurrent assets:				
Restricted cash and cash equivalents	36,433	1,765	—	38,198
Capital assets	—	35,621	7,072	42,693
Deferred expenses	—	437	—	437
Total noncurrent assets	36,433	37,823	7,072	81,328
Total assets	37,813	45,147	11,302	94,262
Liabilities:				
Current liabilities:				
Accounts payable and accrued liabilities	—	990	4,647	5,637
Due to other funds	—	1,000	6,299	7,299
Unemployment insurance benefits	1,744	—	—	1,744
Unearned revenue	2,229	—	—	2,229
Loans payable related to capital assets	—	813	—	813
Total current liabilities	3,973	2,803	10,946	17,722
Noncurrent liabilities:				
Loans payable related to capital assets	—	20,563	—	20,563
Total liabilities	3,973	23,366	10,946	38,285
Net assets:				
Invested in capital assets, net of related debt	—	14,246	7,072	21,318
Restricted	33,840	7,535	—	41,375
Unrestricted (deficit)	—	—	(6,716)	(6,716)
Total net assets	\$ 33,840	21,781	356	55,977

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Revenue, Expenses, and Changes in Fund Net Assets
Proprietary Funds

Year ended September 30, 2004

(In thousands)

	Business-type activities – Enterprise funds			Total
	Unemployment insurance	West Indian Company	Other	
Operating revenue:				
Charges for services	\$ 3,771	12,381	25,143	41,295
Total operating revenue	<u>3,771</u>	<u>12,381</u>	<u>25,143</u>	<u>41,295</u>
Operating expenses:				
Cost of services	7,117	7,511	36,528	51,156
Depreciation and amortization	—	1,435	569	2,004
Total operating expenses	<u>7,117</u>	<u>8,946</u>	<u>37,097</u>	<u>53,160</u>
Operating income (loss)	<u>(3,346)</u>	<u>3,435</u>	<u>(11,954)</u>	<u>(11,865)</u>
Nonoperating revenue (expenses):				
Interest income	2,118	95	535	2,748
Interest expense	—	(981)	—	(981)
Total nonoperating revenue (expenses), net	<u>2,118</u>	<u>(886)</u>	<u>535</u>	<u>1,767</u>
Income (loss) before operating transfers	<u>(1,228)</u>	<u>2,549</u>	<u>(11,419)</u>	<u>(10,098)</u>
Transfers from other funds	—	—	2,500	2,500
Transfers to other funds	—	(2,000)	(895)	(2,895)
Change in net assets	<u>(1,228)</u>	<u>549</u>	<u>(9,814)</u>	<u>(10,493)</u>
Net assets, beginning of year (as restated)	<u>35,068</u>	<u>21,232</u>	<u>10,170</u>	<u>66,470</u>
Net assets, end of year	<u>\$ 33,840</u>	<u>21,781</u>	<u>356</u>	<u>55,977</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Cash Flows
Proprietary Funds

Year ended September 30, 2004

(In thousands)

	Business-type activities – Enterprise funds			Total
	Unemployment insurance	West Indian Company	Other	
Cash flows from operating activities:				
Receipts from customers and users	\$ 2,635	13,173	31,167	46,975
Payments to beneficiaries	(9,036)	—	(6,748)	(15,784)
Payments to suppliers and employees	—	(8,065)	(27,122)	(35,187)
Net cash provided by (used in) operating activities	(6,401)	5,108	(2,703)	(3,996)
Cash flows from noncapital financing activities:				
Contribution from U.S. Government	2,229	—	—	2,229
Transfer from other funds	—	—	2,500	2,500
Transfers to other funds	—	(2,000)	—	(2,000)
Net cash provided by (used in) noncapital financing activities	2,229	(2,000)	2,500	2,729
Cash flows from capital and related financing activities:				
Acquisition and construction of capital assets	—	(1,205)	(353)	(1,558)
Principal paid on long-term debt	—	(639)	—	(639)
Proceeds from sale of asset	—	2	—	2
Interest paid on long-term debt	—	(981)	—	(981)
Net cash used in capital and related financing activities	—	(2,823)	(353)	(3,176)
Cash flows from investing activities:				
Interest and dividends on investments	2,118	95	535	2,748
Net cash provided by investing activities	2,118	95	535	2,748
Net increase (decrease) in cash and cash equivalents	(2,054)	380	(21)	(1,695)
Cash and cash equivalents – beginning of year (as restated)	38,731	6,835	2,331	47,897
Cash and cash equivalents – end of year	\$ 36,677	7,215	2,310	46,202
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:				
Operating income (loss)	\$ (3,346)	3,435	(11,954)	(11,865)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:				
Depreciation expense	—	1,435	569	2,004
Change in assets and liabilities:				
Receivables, net	(1,136)	575	6,024	5,463
Deferred charges	—	114	—	114
Other assets	—	103	(60)	43
Accounts payable and accrued expenses	(1,919)	(554)	2,718	245
Net cash provided by (used in) operating activities	\$ (6,401)	5,108	(2,703)	(3,996)
Reconciliation of cash and cash equivalents to the statement of net assets:				
Cash and cash equivalents – current	\$ 244	5,450	2,310	8,004
Cash and cash equivalents – restricted	36,433	1,765	—	38,198
Cash and cash equivalents at end of year on statement of cash flows	\$ 36,677	7,215	2,310	46,202

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Fiduciary Net Assets – Fiduciary Funds

September 30, 2004

(In thousands)

	Pension trust funds	Agency funds
	<u> </u>	<u> </u>
Assets:		
Cash and cash equivalents:		
Unrestricted	\$ 139,443	6,898
Restricted	72	—
Investments	1,453,090	4,048
Receivables, net:		
Loans and advances	108,135	—
Accrued interest	4,553	—
Other	48,299	—
Due from other funds	36	—
Other assets	<u>10,966</u>	<u>—</u>
Total assets	<u>1,764,594</u>	<u>10,946</u>
Liabilities:		
Accounts payable and accrued liabilities	—	10,946
Cash overdraft with the Department of Finance	10,454	—
Cash overdraft with bank	1,598	—
Unsettled securities purchased	110,876	—
Securities lending collateral	275,453	—
Notes payable	6,781	—
Other liabilities	<u>9,126</u>	<u>—</u>
Total liabilities	<u>414,288</u>	<u>10,946</u>
Net assets held in trust for employees' pension benefits	<u>\$ 1,350,306</u>	<u>—</u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Changes in Fiduciary Net Assets

Year ended September 30, 2004

(In thousands)

	Pension trust funds
Additions:	
Contributions:	
Employer	\$ 54,085
Plan members	30,801
Total contributions	<u>84,886</u>
Investment income:	
Net appreciation of fair value of investments	95,818
Interest, dividends, and other, net	40,202
Real estate – rental income	3,392
	<u>139,412</u>
Less investment expense	<u>7,443</u>
Net investment income	<u>131,969</u>
Other income	<u>300</u>
Total additions	<u>217,155</u>
Deductions:	
Benefits paid	131,691
Refunds of contributions	2,838
Administrative and operational expenses	8,096
Total deductions	<u>142,625</u>
Change in net assets	74,530
Net assets, beginning of year	<u>1,275,776</u>
Net assets, end of year	<u><u>\$ 1,350,306</u></u>

See accompanying notes to basic financial statements.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2004

(1) Summary of Significant Accounting Policies

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

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

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

(a) *Financial Reporting Entity*

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

(i) **Blended Component Units**

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

Virgin Islands Public Finance Authority

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

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2004

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

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

Tobacco Settlement Financing Corporation

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

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

Administrative Offices of Blended Component Units

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

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

(ii) Discretely Presented Component Units

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

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

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(iii) Major Component Units

Virgin Islands Housing Authority

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

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

Virgin Islands Port Authority

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

Virgin Islands Water and Power Authority

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

Virgin Islands Government Hospital and Health Facilities Corporation

The Virgin Islands Government Hospital and Health Facilities Corporation (VIGHHFC) was created by Act No. 6012 on August 23, 1994 and became active on May 1, 1999. Its purpose is

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

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to provide healthcare services and hospital facilities to the people of the U. S. Virgin Islands. The powers of VIGHHFC are exercised by a board of directors consisting of 15 members as follows: the Director of the Office of Management and Budget, the Commissioner of Finance, and 13 other members appointed by the Governor with the advice and consent of the Legislature. The VIGHHFC is composed of the Roy L. Schneider Hospital located in St. Thomas and the Juan F. Luis Hospital and Medical Center located in St. Croix. Both entities issue separate audited financial statements.

University of the Virgin Islands

The University of the Virgin Islands (the University) was organized as an instrumentality of the Government under Act No. 852 of March 16, 1962, in accordance with Section 6(a) of the Revised Organic Act of 1954, as amended. The purpose of the University is the stimulation and utilization of the intellectual resources of the people of the U.S. Virgin Islands and the development of a center of higher education. The powers of the University are exercised by a board of trustees consisting of 17 members as follows: Chairman of the Board of Education, Commissioner of Education, and the President of the University, all serving as members ex-officio, 9 other members appointed by the Governor with the advice and consent of the Legislature, two other members elected by the board of trustees, one representative of the student body, one alumnus of the University, and another of the teaching faculty. The University was not organized as a self-sustaining entity and therefore receives substantial financial and other support from the Government.

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

(iv) Nonmajor Component Units

Virgin Islands Economic Development Authority

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

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Magens' Bay Authority

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

Virgin Islands Housing Finance Authority

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

Virgin Islands Public Television System

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

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

Administrative Offices

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

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Notes to Basic Financial Statements

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

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

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

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

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

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

Virgin Islands Housing Finance Authority
210-3A Altona
Frostco Center Building, Suite 101
St. Thomas, VI 00802

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

All financial statements of the discretely presented component units have a fiscal year-end of September 30, 2004, except for WAPA and VIHA that have a year-end of June 30, 2004 and December 31, 2003, respectively.

(v) Fiduciary Component Units

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

Employees' Retirement System of the Government of the Virgin Islands

The Employees' Retirement System of the Government of the Virgin Islands (known as GERS) was created as an independent and separate agency of the Government with the

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

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purpose of administering the Government employees' defined-benefit pension plan established as of October 1, 1959. The responsibility for the proper operation of GERS is vested in a board of trustees composed of seven members appointed by the Governor with the advice and consent of the Legislature.

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

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

Employees' Retirement System of the Government of the Virgin Islands
GERS Building, 3rd Floor
St. Thomas, VI 00802

(b) *Government-wide and Fund Financial Statements*

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

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

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

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

September 30, 2004

(c) *Measurement Focus, Basis of Accounting, and Financial Statement Presentation*

Government-wide Financial Statements

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

Governmental Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified-accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available when it is collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Government considers most revenue to be available if collected within 90 days of the end of the current fiscal year-end. Specifically, gross receipts taxes, property taxes, and income taxes are considered to be available if collected within 30, 60, and 90 days, respectively, after the end of the current fiscal year-end. Grant revenue is considered to be available if collected within the 12 months after the end of the current fiscal year-end. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when payment is due.

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

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

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

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

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Notes to Basic Financial Statements

September 30, 2004

(d) *Fund Accounting*

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

Governmental Funds

The Government reports the following major governmental funds:

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

Proprietary Funds

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

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

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

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Fiduciary Funds

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

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

(e) Cash and Cash Equivalents

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

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

(f) Investments

Title 33, Chapter 117 of the Virgin Islands Code (V.I. Code) authorizes the Government to invest in U.S. Government and agencies' obligations, mortgage-backed securities, repurchase agreements, commercial paper, local government obligations, and corporate debt and equity obligations. Investments are reported at fair value.

Investments in equity securities in the pension trust fund are carried at quoted market values. Realized gains and losses on securities are determined by the average cost method. Investments in real estate are carried at appraised value to the extent available. Investments without appraisals are carried at cost.

(g) Receivables

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

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

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

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

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

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

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

(h) Inventories

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

(i) Restricted Assets

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

(j) Capital Assets

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

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

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for land improvements; and (iv) \$200,000 for infrastructure with an estimated useful life of 30 years. The value of all land acquired is capitalized.

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

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

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

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

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

(k) Tax Refunds Payable

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

(l) Deferred and Unearned Revenue

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

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Unearned revenue at the government-wide and proprietary fund levels arises only when the Government receives resources before it has a legal claim to them.

(m) Long-term Debt

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

In the fund financial statements, government fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Losses incurred on bond refundings are not recognized in the fund financial statements as the corresponding liability for the bonds is only recorded in the government-wide financial statements. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

(n) Fund Equity

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

(o) Net Assets

Net assets are reported in three categories:

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

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

(p) *Postemployment Benefits*

In addition to the pension benefits described in note 12, the Government provides postretirement healthcare benefits, in accordance with the V.I. Code to all employees who retire from the Government on or after attaining age 55 with at least 30 years of service; except for policemen and firemen who can retire with at least 20 years of service. Currently, 4,048 retirees meet those eligibility requirements. Healthcare benefits are provided through insurance companies whose premiums are paid by the retiree and the Government. The Government contributes three-fourths of the healthcare benefits' premiums. The Government does not accrue a liability for postemployment benefit costs, which are recognized on a pay-as-you-go basis. During the year ended September 30, 2004, the cost of providing healthcare benefits amounted to approximately \$19.5 million.

(q) *Compensated Absences*

The vacation policy of the Government provides for the accumulation of four, six, or eight hours for each full biweekly pay period depending on the time of entry into government service. At the beginning of each calendar year, vacation leave is limited to 480 hours (60 days). However, the excess of 480 hours is considered by GERS for service credit towards the employees' retirement. This vacation policy does not apply to professional educational personnel of the Virgin Islands Department of Education, who receive compensation during the school breaks. Upon retirement, an employee receives compensation for unused vacation leave at the employee's base rate pay. As of September 30, 2004, the Government had accrued compensated absences amounting to \$60.2 million, including related benefits, of which \$39.2 million was included in current liabilities in the government-wide financial statements.

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

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

(r) *Interfund and Intra-entity Transactions*

The Government has the following types of transactions among funds:

- ***Interfund Transfers*** – Legally required transfers are reported as interfund transfers in (out) when incurred.
- ***Intra-entity Transactions*** – These are transactions between the PG and its component units, and among the component units. Transfers between the PG and its blended component units are reported as interfund transfers, except for transfers within the same fund type. Similarly,

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receivables and payables between the PG and its blended component units are reported as amounts due to, and due from other funds. Transfers between the PG and discretely presented component units (and among those component units) are reported separately as revenue and expenses or expenditures. Amounts owed to and from discretely presented component units by the PG are reported separately from interfund payables and receivables.

(s) Risk Management

With some exceptions, the Government does not carry general casualty or liability insurance coverage on its properties or the acts of its employees, relying instead on self-insurance and/or statutory liability limitations. However, as a result of an agreement with the Federal Emergency Management Agency (FEMA), with respect to properties and structures damaged by Hurricane Hugo and repaired with federal disaster assistance funds, the Government has obtained insurance for certain hospitals, schools, and other insurable public buildings that were repaired with such federal assistance. The Government purchases commercial insurance covering physical losses or damages against its property. The limit of liability for all risks, excluding earthquake, windstorm, and flood, is \$1 million for each and every occurrence except for windstorm and flood losses, which has a \$45 million limit. For physical losses arising from earthquake, the insurance policy has a limit of \$100 million for each and every occurrence and in the annual aggregate. Also, the Government has an enterprise fund that provides workers' compensation to both public and private employees.

The Government does not maintain accounting records in support of individual claim liabilities or for claims incurred but not reported (IBNR). Accordingly, workers' compensation claims are accounted for on a cash basis. As such, the basic financial statements do not include a liability for workers' compensation claims outstanding, including related IBNR, as of September 30, 2004.

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

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(t) *Future Adoption of Accounting Requirements*

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

<u>GASB Statement number</u>		<u>Adoption required in fiscal year</u>
40	Deposit and Investment Risk Disclosures – An Amendment of GASB Statement No. 3	2005
42	Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	2006
43	Financial Reporting for Postemployment Benefit Plans Other than Pension Plans	2007
44	Economic Condition Reporting: The Statistical Section – An amendment of NCGA Statement I	2006
45	Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions	2008
46	Net Assets Restricted by Enabling Legislation – An amendment of GASB Statement No. 34	2006
47	Accounting for Termination Benefits	2006

The impact of these statements has not yet been determined.

(u) *Use of Estimates*

Management of the Government has made a number of estimates and assumptions relating to the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

(2) **Component Units**

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

- Virgin Islands Housing Authority
- Virgin Islands Port Authority
- Virgin Islands Water and Power Authority
- Virgin Islands Government Hospital and Health Facilities Corporation

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- University of the Virgin Islands
- Economic Development Authority
- Magens' Bay Authority
- Virgin Islands Housing Finance Authority
- Virgin Islands Public Television System

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

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Information on net assets	Virgin Islands Housing Authority	Virgin Islands Port Authority	Virgin Islands Government				University of the Virgin Islands	Other entities	Total component units
			Virgin Islands Water and Power Authority	Virgin Islands Hospital Roy L. Schneider Hospital	Juan F. Luis Hospital	Hospital and Health Facilities Corporation			
Assets:									
Current assets	\$ 7,067	19,974	50,071	18,407	17,370	11,737	50,774	15,181	190,581
Due from primary government	—	674	—	—	—	—	2,737	120	3,531
Due from federal government	2,515	235	—	—	200	—	1,254	—	4,204
Restricted assets	300	15,002	52,853	8,388	2,655	—	37,325	11,003	127,526
Capital assets, net	67,038	267,263	201,770	48,992	64,862	26,140	41,514	46,746	764,325
Deferred expenses	—	1,950	17,526	1,691	—	—	—	—	21,167
Total assets	76,920	305,098	322,220	77,478	85,087	37,877	133,604	73,050	1,111,334
Liabilities:									
Current liabilities	6,634	8,737	51,359	3,674	12,085	11,909	9,452	2,910	106,760
Due to primary government	—	—	—	—	7,609	17,530	—	4,243	29,382
Due to federal government	—	—	5,300	—	—	390	—	—	5,690
Bonds payable	—	37,221	163,845	34,909	—	—	44,059	6,365	286,399
Loans payable	6,484	890	5,600	—	—	—	3,490	901	10,881
Other noncurrent liabilities	—	—	—	—	558	299	132	21,235	28,708
Total liabilities	13,118	46,848	226,104	38,583	20,252	30,128	57,133	35,654	467,820
Net assets:									
Invested in capital assets – net of related debt	67,038	237,596	70,117	14,942	63,882	25,579	22,623	37,058	538,835
Restricted	—	7,149	17,486	7,674	—	—	37,003	2,478	71,790
Unrestricted (deficit)	(3,236)	13,505	8,513	16,279	953	(17,830)	16,845	(2,140)	32,889
Total net assets	\$ 63,802	258,250	96,116	38,895	64,835	7,749	76,471	37,396	643,514

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Information on statements of activities	Expenses	Program revenue		Total component units	
		Charges for services	Operating grants and contributions		Capital grants and contributions
Virgin Islands Housing Authority	\$ 44,206	5,121	30,766	5,437	(2,882)
Virgin Islands Port Authority	41,910	36,651	—	10,037	4,778
Virgin Islands Water and Power Authority:					
Electric System	146,378	144,745	—	820	(813)
Water System	21,637	25,406	—	1,088	4,857
Virgin Islands Government Hospital and Health Facilities Corporation:					
Roy L. Schneider Hospital	66,171	40,235	21,778	4,541	383
Juan F. Luis Hospital	50,843	24,867	18,249	1,631	(6,096)
University of the Virgin Islands	59,484	13,607	45,476	3,192	2,791
Other component units	12,028	2,695	6,370	1,711	(1,252)
Total activities	<u>\$ 442,657</u>	<u>293,327</u>	<u>122,639</u>	<u>28,457</u>	<u>1,766</u>
General revenue:					
Interest and other					9,425
Changes in net assets					11,191
Net assets, beginning of year (as restated)					632,323
Net assets, end of year					<u>\$ 643,514</u>

(3) Stewardship, Compliance, and Accountability

(a) Budgetary Process and Control

The V.I. Code requires the Governor to submit an annual balanced executive budget to be adopted by the Legislature for the ensuing fiscal year. The Governor is required by law to submit to the Legislature the annual executive budget no later than May 30. The annual executive budget is prepared essentially on a GAAP basis, except for encumbrances, which are reported as expenditures for budget reporting purposes, by the Virgin Islands Office of Management and Budget (OMB) working in conjunction with other Government offices and agencies. If the annual executive budget has not been approved before the commencement of any fiscal year, then the appropriations for the preceding fiscal year, insofar as they may be applicable, are automatically deemed reappropriated item by item. The annual executive budget, which includes those funds of the Government subject to appropriation pursuant to law, is composed of all proposed expenditures and estimated revenue for the Government. The Legislature enacts the annual executive budget through passage of lump-sum appropriations for each department. The Legislature may add, change, or delete any items in the annual executive budget proposed by the Governor. Upon passage by the Legislature, the annual executive budget is submitted to the Governor, who may veto the budget partially or in its entirety and return it to the Legislature with his objections. A veto by the Governor can be overridden only by a two-third majority of all members of the Legislature. The Legislature is obligated by law to pass a final annual executive budget no later than September 30, the last day of the fiscal year. Supplemental budgetary appropriations' bills that are signed into law may be created during the year

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without the identification of a specific revenue source to finance them. In August 1999, the Legislature enacted the Financial Accountability Act (Act No. 6289). The purpose of the Financial Accountability Act is to require by law that the budget of the Government be balanced each year, and the appropriations in each fiscal year not exceed a verifiable revenue source.

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

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

(b) Budget/GAAP Reconciliation

The following schedule presents comparisons of the General Fund legally adopted budget with actual data on a budgetary basis. Because accounting principles applied for purposes of developing data on a budgetary basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of timing and entity difference in the excess of revenue and other financing sources over expenditures and other financing uses for the year ended September 30, 2004 is presented below (expressed in thousands):

Excess of revenue and other financing sources (uses)	
over expenditures – budget basis	\$ 29,089
Timing difference – change in encumbrances	(3,494)
Entity difference – excess of revenue and other financing sources over expenditures and other financing uses – activities with budgets not legally adopted	<u>4,980</u>
Excess of revenue and other financing sources over expenditures – GAAP basis	<u>\$ 30,575</u>

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

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(4) Cash and Investments

By law, banks or trust companies designated as depository of public funds of the Government and its various agencies, authorities, and instrumentalities are to maintain corporate surety bond or pledge collateral satisfactory to the Commissioner of Finance to secure all governmental funds deposited.

At September 30, 2004, the PG and the discretely presented component units carrying amounts of cash and cash equivalents were covered by federal deposit insurance, corporate surety bonds, or by collateral held by the Government.

Legally authorized investments vary by fund, but generally include obligations of the United States or its States, Commonwealth of Puerto Rico, the Government of the U.S. Virgin Islands, or of any agency thereof, common and preferred stocks of any U.S. corporation, common and preferred stocks of any foreign corporation listed in any internationally recognized security exchange, certain bonds or other indebtedness issued by foreign governments or foreign corporations, certificates of deposit, collateralized repurchase agreements, and certain corporate bonds. Specific bond indentures also provide investment requirements.

For the fiscal year ended September 30, 2004, the PG, discretely presented component units and fiduciary funds have classified their investments into three risk categories. Category 1 includes investments that were insured or registered or for which the securities were held by a government entity, or its agent, in the entity's name and investments for which the entity has safekeeping responsibilities but no equity or ownership interest or control. Category 2 includes uninsured and unregistered investments for which the securities were held by the counterparty's trust department or agent in a government entity's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty, or by its trust department or agent but not in a government entity's name. The investments of the PG and the discretely presented component units by custodial credit risk categories at September 30, 2004 were as follows (expressed in thousands):

	Primary Government – Investments			Reported amount
	Category			
	1	2	3	
Commercial paper	\$ 93,572	—	—	93,572
Certificates of deposit	41,072	—	—	41,072
Federal Home Loan Bank	4,024	—	—	4,024
	<u>\$ 138,668</u>	<u>—</u>	<u>—</u>	<u>138,668</u>
Investments not categorized:				
Mutual funds				<u>210,452</u>
Total investments				<u>\$ 349,120</u>

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Discretely Presented Component Units – Investments				Reported amount
Category				
<u>1</u>	<u>2</u>	<u>3</u>		
U.S. government and agency securities	\$ 60,038	—	—	60,038
Common stocks	1,785	—	—	1,785
Corporate bonds	5,005	—	—	5,005
Certificates of deposit	113	—	2,857	2,970
Money market funds	145	—	—	145
Investment contracts	306	—	—	306
Mortgage-backed securities	—	4,851	—	4,851
Other investments	—	2,353	—	2,353
	<u>\$ 67,392</u>	<u>7,204</u>	<u>2,857</u>	<u>77,453</u>
Investments not subject to classification:				
Mutual funds				<u>43,729</u>
Total investments				<u>\$ 121,182</u>

The investment balance consists of the following:

Unrestricted	\$ 29,388
Restricted	<u>91,794</u>
Total investments	<u>\$ 121,182</u>

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	Fiduciary Funds – Investments			Reported amount
	Category			
	<u>1</u>	<u>2</u>	<u>3</u>	
U.S. government and agency securities	\$ 7,098	—	—	7,098
Corporate obligations	28,836	—	—	28,836
Foreign bonds	88,646	—	—	88,646
Common stocks – U.S.	573,248	—	—	573,248
Certificates of deposit	4,048	—	—	4,048
Common stocks – foreign	84,967	—	—	84,967
Mortgage- and asset-backed securities	50,103	—	—	50,103
	<u>\$ 836,946</u>	<u>—</u>	<u>—</u>	<u>836,946</u>
Investments not categorized:				
Mutual funds				4,625
Investments held by broker – dealers under security loans:				
U.S. government and agency securities				126,804
Corporate obligations				3,286
Common stocks – U.S.				41,425
Common stocks – foreign				30,420
Mortgage- and asset-backed securities				67,216
Securities lending short-term collateral investment pool				275,453
Real estate				70,963
Total investments				<u>\$ 1,457,138</u>

The investment balance consists of the following:

Pension trust funds	\$ 1,453,090
Agency funds	<u>4,048</u>
Total investments	<u>\$ 1,457,138</u>

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The pension trust fund's investments in marketable securities are administered by several professional investment managers and are held in trust by a commercial bank in the name of GERS. The investments in marketable securities generated interest and dividend income of \$25 million, which is reported in interest, dividends, and other, net in the accompanying statement of change in the fiduciary net assets. During the year ended September 30, 2004, GERS' investments (including gains and losses on investments bought and sold, as well as held during the year) (depreciated) appreciated in value as follows (expressed in thousands):

U.S. government and government-guaranteed obligations	\$	(366)
Corporate bonds – U.S.		(1,585)
Corporate bonds – foreign		3,233
Common stocks – U.S.		79,378
Common stocks – foreign		11,322
Collateralized debt obligations		3,235
Mutual funds		601
		<hr/>
Net appreciation of fair value of investments	\$	<u>95,818</u>

The Government's statutes permit GERS to participate in securities lending transactions, and GERS has, via a securities lending authorization agreement (the Agreement), authorized State Street Bank and Trust Company (the Custodian) to lend its securities to broker-dealers and banks pursuant to a form of loan agreement. Lent securities are collateralized with cash, securities issued or guaranteed by the U.S. government, or irrevocable bank letters of credit. GERS does not have the ability to pledge or sell collateral securities delivered absent a borrower default. No restrictions were imposed during 2004 as to the amount of loans the Custodian can make on behalf of the GERS. Under the terms of the Agreement the Custodian must indemnify the Government for losses attributable to violations by the Custodian under the "standard of care" clause described in the Agreement. There were neither such violations during the fiscal year 2004 nor losses resulting from the default of the borrowers or the Custodian.

Loans are generally terminable on demand. The collateral received shall, in the case of loaned securities denominated in U.S. dollars or whose primary trading market is located in the U.S. or sovereign debt issued by foreign governments, have a market value of 102% of the market value of the security for domestic borrowers and 105% for foreign borrowers at the inception of the securities lending transaction. Such collateral should be kept at a minimum of 100% of the market value of the security for all borrowers throughout the outstanding period of the transaction. At September 30, 2004, approximately \$273.1 million of U.S. government and agency securities, fixed income, and equity corporate securities were on loan. The cash collateral received with a corresponding liability of an equal amount, is recorded in the statement of fiduciary net assets. The cash collateral received on each loan was invested, together with the cash collateral of other lenders, in a collective investment pool. As of September 30, 2004, such investment pool had a weighted average maturity of 40 days and an average expected maturity of 410 days. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral.

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(5) Receivables

Receivables at September 30, 2004 consist of the following (expressed in thousands):

	General fund	PFA debt service fund	Total
Income taxes	\$ 113,528	—	113,528
Real property taxes	27,025	—	27,025
Gross receipts taxes	—	38,253	38,253
Tax receivables	\$ 140,553	38,253	178,806
Other long-term receivables – tobacco settlement rights			826
Total receivables reported in the statement of net assets		\$ 179,632	

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

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

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

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

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

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

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

Component unit receivables at September 30, 2004, consist of the following (expressed in thousands):

Utility service charges	\$	26,816
Port fees		3,862
Students		2,231
Patients		17,796
Other		3,505
		54,210
Total	\$	54,210

Loans and advances receivable at September 30, 2004, consist of the following (expressed in thousands):

	Fiduciary funds pension trust	Component units
Mortgage loans	\$ 21,455	—
Personal loans	88,786	—
Other loans and advances	894	1,672
Subtotal	111,135	1,672
Less allowance for uncollectible accounts	(3,000)	(50)
Loans and advances, net	\$ 108,135	1,622

(6) Interfund Transactions

(a) Interfund Transfers

Interfund transfers constitute the transfer of resources from the fund that receives the resources to the fund that utilizes them. The most significant transfers to the General Fund from other governmental funds include a \$79.2 million transfer from the PFA Debt Service representing tax revenue in excess of bond service requirements, and a \$7.1 million transfer from the nonmajor governmental funds primarily representing \$2.3 million of property tax revenue in excess of debt service requirements and \$4.8 million of transfers from the special revenue fund. Transfers to nonmajor governmental funds consisted of \$4 million from the General Fund to the Emergency Molasses Fund. Transfers from the PFA Debt Service to the nonmajor governmental funds amounting to approximately \$6.3

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million represents revenue in excess of bond service requirements that were transferred to PFA operating fund (nonmajor governmental fund).

Interfund transfers for the year ended September 30, 2004 consisted of the following (expressed in thousands):

<u>Transfer to</u>	<u>General fund</u>	<u>PFA debt service fund</u>	<u>PFA capital projects fund</u>	<u>Nonmajor governmental funds</u>	<u>Enterprise fund – West Indian Company</u>	<u>Nonmajor enterprise funds</u>	<u>Total</u>
General fund	\$ —	79,196	—	7,106	1,000	—	87,302
PFA capital projects fund	—	40	—	975	—	—	1,015
Nonmajor governmental funds	5,593	6,326	1,500	—	1,000	895	15,314
Nonmajor enterprise funds	—	—	2,500	—	—	—	2,500
Total	\$ 5,593	85,562	4,000	8,081	2,000	895	106,131
Transfer from							
General fund	\$ —	—	—	5,593	—	—	5,593
PFA debt service fund	79,196	—	40	6,326	—	—	85,562
PFA capital projects fund	—	—	—	1,500	—	2,500	4,000
Nonmajor governmental funds	7,106	—	975	—	—	—	8,081
Major enterprise fund – WICO	1,000	—	—	1,000	—	—	2,000
Nonmajor enterprise funds	—	—	—	895	—	—	895
Total	\$ 87,302	—	1,015	15,314	—	2,500	106,131

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(b) Due From/To Other Funds

The following table summarizes interfund receivables and payables at September 30, 2004 (expressed in thousands):

<u>Due to</u>	<u>General fund</u>	<u>PFA debt service fund</u>	<u>PFA capital projects fund</u>	<u>Nonmajor governmental funds</u>	<u>Enterprise fund – West Indian Company</u>	<u>Nonmajor enterprise funds</u>	<u>Pension trust fund</u>	<u>Total</u>
General fund	\$ —	—	—	3,178	1,000	4,668	—	8,846
PFA capital projects fund	—	—	—	—	—	313	—	313
Nonmajor governmental funds	7,318	2,000	158	—	—	1,318	—	10,794
Total governmental funds	7,318	2,000	158	3,178	1,000	6,299	—	19,953
Propriety fund – nonmajor Enterprise fund	300	—	—	—	—	—	—	300
Fiduciary funds – pension Trust fund	36	—	—	—	—	—	—	36
Total	\$ 7,654	2,000	158	3,178	1,000	6,299	—	20,289
Due from								
General fund	\$ —	—	—	7,318	—	300	36	7,654
PFA debt service fund	—	—	—	2,000	—	—	—	2,000
PFA capital projects fund	—	—	—	158	—	—	—	158
Nonmajor governmental funds	3,178	—	—	—	—	—	—	3,178
Total governmental funds	3,178	—	—	9,476	—	300	36	12,990
Enterprise fund – West Indian Company	1,000	—	—	—	—	—	—	1,000
Nonmajor enterprise funds	4,668	—	313	1,318	—	—	—	6,299
Total propriety funds	5,668	—	313	1,318	—	—	—	7,299
Total	\$ 8,846	—	313	10,794	—	300	36	20,289

The due from/to other funds include \$3.5 million due from the General Fund to the Emergency Molasses Fund (nonmajor governmental fund) from unpaid appropriations. Other balances composing the due from/to other funds include \$2.7 million from the bond proceeds fund (nonmajor governmental fund) to the General Fund and \$2.0 million from the PFA Debt Service to PFA operating fund (nonmajor governmental fund). The due to the General Fund from the nonmajor enterprise fund amounting to \$4,668 is mainly composed of the amount owed by the Virgin Islands Lottery to the General Fund amounting to \$4,468, consisting primarily of 8% of the total lottery revenue that is required to be transferred to the General Fund.

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Notes to Basic Financial Statements

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(7) Restricted Assets

(a) Primary Government

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

Restricted Assets – Proprietary Funds and Business-type Activities	
Unemployment insurance funds	\$ 36,433
WICO debt service funds	<u>1,765</u>
Total restricted assets of proprietary funds and business-type activities	<u>\$ 38,198</u>

(b) Component Units

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

Restricted Assets – Component Units	
Debt service and sinking fund requirements	\$ 18,281
Construction funds	1,647
Endowment funds	10,601
HUD project funds	300
Revolving loan funds	3,244
Other	<u>471</u>
Total cash and cash equivalents	<u>34,544</u>
Investments:	
Debt service and sinking fund requirements	25,400
Construction funds	25,442
Endowment funds	26,723
Renewal and replacement funds	7,025
Revolving loan funds	<u>7,204</u>
Total investments	<u>91,794</u>
Other:	
Accrued interest receivable	<u>1,188</u>
Total restricted assets of component units	<u>\$ 127,526</u>

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Notes to Basic Financial Statements

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(8) Capital Assets

(a) Primary Government

The capital assets activity for the governmental activities for the year ended September 30, 2004, is summarized as follows (expressed in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets, not being depreciated				
Land	\$ 184,525	414	—	184,939
Construction in progress	4,046	24,450	3,918	24,578
Total capital assets, not depreciated	<u>188,571</u>	<u>24,864</u>	<u>3,918</u>	<u>209,517</u>
Capital assets, being depreciated:				
Land improvements	3,584	—	—	3,584
Infrastructure	121,413	4,836	—	126,249
Buildings and improvements	400,309	2,141	—	402,450
Machinery and equipment	69,788	8,627	256	78,159
Total capital assets, being depreciated	<u>595,094</u>	<u>15,604</u>	<u>256</u>	<u>610,442</u>
Less accumulated depreciation for:				
Land improvements	1,494	165	—	1,659
Infrastructure	13,458	4,119	—	17,577
Buildings and improvements	121,140	7,903	—	129,043
Machinery and equipment	39,415	6,991	256	46,150
Total accumulated depreciation	<u>175,507</u>	<u>19,178</u>	<u>256</u>	<u>194,429</u>
Total capital assets, being depreciated, net	<u>419,587</u>	<u>(3,574)</u>	<u>—</u>	<u>416,013</u>
Governmental activities capital assets, net	<u>\$ 608,158</u>	<u>21,290</u>	<u>3,918</u>	<u>625,530</u>

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Capital assets activity for the business-type activities for the year ended as of September 30, 2004, is summarized as follows (expressed in thousands):

	<u>Beginning balance (as adjusted)</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets, not being depreciated				
Land and land improvements	\$ 5,357	—	—	5,357
Construction in progress	722	87	—	809
Total capital assets, not depreciated	<u>6,079</u>	<u>87</u>	<u>—</u>	<u>6,166</u>
Capital assets, being depreciated:				
Buildings and improvements	46,490	1,088	3	47,575
Machinery and equipment	3,478	383	70	3,791
Total capital assets, being depreciated	<u>49,968</u>	<u>1,471</u>	<u>73</u>	<u>51,366</u>
Less accumulated depreciation for:				
Buildings and improvements	11,215	1,813	—	13,028
Machinery and equipment	1,690	191	70	1,811
Total accumulated depreciation	<u>12,905</u>	<u>2,004</u>	<u>70</u>	<u>14,839</u>
Total capital assets, being depreciated, net	<u>37,063</u>	<u>(533)</u>	<u>3</u>	<u>36,527</u>
Business-type activities capital assets, net	\$ <u>43,142</u>	<u>(446)</u>	<u>3</u>	<u>42,693</u>

Depreciation and amortization expense was charged to functions/programs of the PG for the year ended September 30, 2004 as follows (expressed in thousands):

Governmental activities:		
General government	\$ 3,953	
Public safety	1,571	
Health	3,373	
Education	5,744	
Transportation and communication	4,537	
Total depreciation expense – governmental activities	\$ <u>19,178</u>	
Business-type activities:		
WICO (major enterprise fund) – depreciation and amortization	\$ 1,435	
Nonmajor enterprise fund – depreciation	569	
Total depreciation and amortization – business-type activities	\$ <u>2,004</u>	

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Notes to Basic Financial Statements

September 30, 2004

The capital assets activity for the discretely presented component units for the year ended September 30, 2004 is summarized as follows (expressed in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets, not being depreciated:				
Land	\$ 93,789	1,906	—	95,695
Construction in progress	52,114	78,207	56,848	73,473
Total capital assets, not depreciated	<u>145,903</u>	<u>80,113</u>	<u>56,848</u>	<u>169,168</u>
Capital assets being depreciated:				
Buildings and improvements	1,122,835	54,286	539	1,176,582
Airport and marine terminal facilities	96,914	5,751	—	102,665
Personal property and equipment	90,303	8,511	4,394	94,420
Total capital assets being depreciated	<u>1,310,052</u>	<u>68,548</u>	<u>4,933</u>	<u>1,373,667</u>
Less accumulated depreciation:				
Buildings and improvements	(617,030)	37,974	7	(654,997)
Airport and marine terminal facilities	(60,807)	4,420	—	(65,227)
Personal property and equipment	(56,022)	6,621	4,357	(58,286)
Total accumulated depreciation	<u>(733,859)</u>	<u>49,015</u>	<u>4,364</u>	<u>(778,510)</u>
Total capital assets being depreciated, net	<u>576,193</u>	<u>19,533</u>	<u>569</u>	<u>595,157</u>
Component unit capital assets, net	\$ <u>722,096</u>	<u>99,646</u>	<u>57,417</u>	<u>764,325</u>

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Notes to Basic Financial Statements

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Depreciation expense charged to each component unit for the year ended September 30, 2004 was as follows (expressed in thousands):

Virgin Islands Housing Authority	\$	9,375
Virgin Islands Port Authority		13,802
Virgin Islands Water and Power Authority:		
Electric system		10,323
Water system		5,407
Virgin Islands Government Hospital and Health Facilities Corporation:		
Roy L. Schneider Hospital		3,947
Juan F. Luis Hospital		2,723
University of the Virgin Islands		2,930
Other component units		<u>508</u>
Total depreciation – component units	\$	<u><u>49,015</u></u>

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

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(9) Long-Term Liabilities

Long-term liabilities activities for the year ended September 30, 2004 were as follows (expressed in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Amounts due within one year</u>	<u>Amounts due thereafter</u>
Governmental activities:						
Bonds payable:						
1998 Series Revenue and Refunding Bonds	\$ 486,970	—	(13,225)	473,745	13,955	459,790
1999 Project Revenue Bonds	4,510	—	(2,960)	1,550	1,550	—
1999 General Obligation Bonds, Series A	6,480	—	(830)	5,650	885	4,765
1999 Series A Revenue Bonds	287,875	—	(4,540)	283,335	4,765	278,570
2001 Series A Tobacco Bonds	22,645	—	(335)	22,310	—	22,310
2002 Series Garvee Bonds	18,645	—	(2,805)	15,840	2,900	12,940
2003 Series A Revenue Bonds	—	268,020	—	268,020	—	268,020
Subtotal bonds payable	827,125	268,020	(24,695)	1,070,450	24,055	1,046,395
Less:						
Deferred amount on refundings	(3,080)	—	616	(2,464)	(616)	(1,848)
Bonds premium	1,299	2,830	(310)	3,819	311	3,508
Bonds discount	(10,001)	—	949	(9,052)	(948)	(8,104)
Bonds accretion	(1,418)	—	320	(1,098)	(335)	(763)
Total bonds payable, net	813,925	270,850	(23,120)	1,061,655	22,467	1,039,188
Loans payable:						
Bond anticipation note	100,000	—	(100,000)	—	—	—
Total loans payable	100,000	—	(100,000)	—	—	—
Other liabilities:						
Accrued compensated absences	52,358	7,852	—	60,210	39,213	20,997
Retroactive union arbitration	375,252	9,006	—	384,258	—	384,258
Litigation	13,235	2,478	(538)	15,175	450	14,725
Landfill closure and postclosure costs	—	28,821	—	28,821	—	28,821
Accrued disallowed costs	13,112	—	(7,098)	6,014	—	6,014
Total other liabilities	453,957	48,157	(7,636)	494,478	39,663	454,815
Total governmental activities	\$ 1,367,882	319,007	(130,756)	1,556,133	62,130	1,494,003
Business-type activities:						
Notes payable:						
WICO	\$ 22,015	—	(639)	21,376	813	20,563
Fiduciary activities:						
Note payable						
Pension trust fund	\$ 10,000	—	(3,219)	6,781	6,781	—

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

(a) Debt Margin

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

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(b) Bonds Payable

Bonds payable outstanding at September 30, 2004 are comprised of the following (expressed in thousands):

Primary Government – Bonds Payable			
Bonds payable	Final maturity	Interest rates (%)	Balance
1998 Series A, C, D, and E Revenue and Refunding Bonds	2023	5.50 – 7.11	\$ 473,745
1999 Project Revenue Bonds	2005	6.25	1,550
1999 Series A General Obligation Bonds	2010	6.50	5,650
1999 Series A Revenue Bonds	2033	4.20 – 6.50	283,335
2001 Series A Tobacco Bonds	2031	5.00	22,310
2002 Series Garvee Bonds	2009	2.50 – 5.00	15,840
2003 Series A Revenue Bonds	2033	4.00 – 5.25	268,020
Subtotal			1,070,450
Less:			
Deferred amount on refundings			(2,464)
Bonds premium			3,819
Bonds discount			(9,052)
Bonds accretion			(1,098)
Total			\$ 1,061,655

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

The proceeds of the 1998 Series A and B Bonds were placed in an irrevocable trust account to provide for all future debt service payments on the Highway Revenue Bonds Series 1989, Series 1991, Series 1992, Series 1993, and Series 1994 Bonds. At September 30, 2004, \$194.6 million of the above-mentioned defeased bonds were outstanding.

The proceeds of the Series 1992 Revenue Bonds were placed in an irrevocable trust to provide for all future debt service payments on the Series 1989 Revenue Bonds. At September 30, 2004, \$165.9 million of defeased bonds were outstanding. All assets held by irrevocable trusts for refunding of prior outstanding debt and the corresponding liabilities are not included in the Government's basic financial statements.

The 1998 Series C Bonds and the 1998 Series D Bonds were issued to pay, on behalf of the Government, the full principal balance and interest due and payable on the Revenue Anticipation Note, issued in February 1998. The remaining balance of the 1998 Series D Bonds amounting to approximately \$11.6 million was primarily provided to the Government for additional working

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capital. The net proceeds of the 1998 Series E Bonds amounting to \$104 million were primarily designated to fund the construction of certain capital projects amounting to \$94 million. The remaining \$10 million was deposited in a debt service reserve account.

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

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

In November 1999, the U.S. Congress approved an increase in the rate of federal excise taxes on rum transferred to the Government from \$10.50 to \$13.25 per proof gallon. The increase was retroactive to July 1999 and effective through December 31, 2003. In October 2004, Congress extended the \$13.25 per proof gallon rate to December 31, 2005.

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

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

The Bonds are secured by the full faith and credit and taxing power of the Government, including a pledge on annual real property tax revenue from its taxation of the Hovensa Oil Refinery (the Refinery), which revenue is deposited in the Hovensa Property Tax Fund, and a contingent pledge of all franchise taxes on foreign sales corporations collected by the Government

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(Franchise Tax Revenue). Pursuant to the Hovensa Oil Contract, the Refinery agreed to pay \$14 million annually of real property taxes on the Refinery properties. Foreign sales corporations qualified to do business in the Virgin Islands must pay a franchise tax of \$1.50 for each thousand dollars of capital stock issued (Franchise Tax).

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

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

The Government pledged gross receipts taxes for the timely payment of the principal and interest on the 1999 Series A Bonds. Interest is payable semiannually on April 1 and October 1, and principal is payable annually on October 1. Gross receipts revenue amounted to \$112.4 million for the year ended September 30, 2004.

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

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

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

Bonds payable at September 30, 2004, amounted to \$22.3 million with accumulated accretion of \$1.1 million. Under early redemption provisions, any MSA payments exceeding annual debt service requirements of the 2001 Series A Tobacco Bonds must be applied to early redemption of principal. MSA payments and interest earnings on the trust funds during the year ended September 30, 2004, resulted in early redemption of \$335 thousand during fiscal year 2004.

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

Interest and principal on the Series 2002 Revenue Bonds are payable semiannually on March 1 and September 1. As of September 30, 2004, the outstanding 2002 Revenue Bonds amounted to \$15.8 million.

On February 28, 2003, PFA entered into a swaption contract that provided PFA with an up-front payment of \$8.3 million. PFA has outstanding \$243,985,000 Series of 1999A Bonds with maturities from 2011 to 2029. The 1999A Bonds are callable by PFA on October 1, 2010 at 101%. Having been advised by its underwriters and financial advisor that there were no net present value savings available to it by issuing conventional advance refunding bonds, PFA sold a LIBOR-based swaption to Lehman Brothers Special Financing, Inc. on the 2024 and 2029 maturities, totaling \$162,870,000. Lehman purchased the swaption for \$8.3 million and it is exercisable on July 1, 2010 only. The objective of PFA was to monetize the economics of the Series of 1999A Bonds call option and lock in the favorable interest rates prevailing on February 28, 2003 without currently issuing refunding bonds. The swaption was the most efficient mechanism available to PFA to effect savings from the Series 1999A Bonds at that time. As a synthetic refunding of its 1999 Series A Bonds, this payment represents the risk-adjusted, present-value savings of the refunding as of October 1, 2010, without issuing refunding funds at February 2003. The swaption gave the counterparty the option to make PFA enter into a pay-fixed, receive-variable interest rate swap. If the option is exercised, PFA would then expect to issue variable-rate refunding bonds.

The \$8.3 million payment was based on a notional amount of \$174.9 million. The counterparty has the option to exercise the agreement on October 1, 2010—PFA's 1999 bonds' first call date. If the swap is exercised, it will also commence October 1, 2010. The fixed swap rate (5.2%) was set at a rate that, when added to an assumption for remarketing and liquidity costs, will approximate the coupons of the refunded bonds. The swap's variable payment would be 64% of the London Interbank Offered Rate (LIBOR).

The up-front payment of \$8.3 million was received by PFA on behalf of the PG. The Government has deferred the recognition of revenue from the \$8.3 million received in advance, and is amortizing it into income through October 1, 2010, which is the exercise date of the swaption. The up-front payment was restricted to capital expenditures. In 2004, PFA authorized the use of \$2 million of the up-front payment for a Micro Loan Financing Program, which is managed by the Economic Development Authority. As of September 30, 2004, the PFA had expended \$104 thousand on capital projects and \$78 thousand on micro-loans.

As of September 30, 2004, the swap had a negative fair value of approximately \$21.8 million in favor of the counterparty estimated using the zero-coupon method. This method calculated the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipated future spot interest rates. These payments were then discounted

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using the spot rates implied by the current yield curve for the hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

If the option is exercised and refunding bonds are not issued, the 1999 bonds would not be refunded and PFA would make net swap payments as required by the terms of the contract – that is, making a fixed payment to the counterparty for the term of the swap at 5.27% and receiving a variable payment of 64% of LIBOR. If the option is exercised and the variable rate bonds issued, the actual savings ultimately recognized by the transaction will be affected by the relationship between the interest rate terms of the to-be issued variable-rate bonds versus the variable payment on the swap (64 % of LIBOR). If the option is not exercised, PFA is not obligated to repay the up-front payment.

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

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

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Debt service requirements at September 30, 2004 were as follows (expressed in thousands):

Governmental Activities – Bonds										
	Revenue Bonds Series 1998 A		Revenue Bonds Series 1998 C		Revenue Bonds Series 1998 D		Revenue Bonds Series 1998 E		Revenue Bonds Series 1998 Total	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
Year:										
2005	\$ —	15,821	9,990	2,801	3,965	1,220	—	6,261	13,955	26,103
2006	—	15,821	10,555	2,236	4,210	974	—	6,261	14,765	25,292
2007	—	15,821	11,150	1,640	4,470	714	—	6,261	15,620	24,436
2008	—	15,821	11,780	1,009	4,750	437	—	6,261	16,530	23,528
2009	—	15,821	12,455	343	4,915	147	—	6,261	17,370	22,572
2010 – 2014	73,175	69,891	—	—	—	—	30,095	27,178	103,270	97,069
2015 – 2019	96,095	50,199	—	—	—	—	39,665	17,098	135,760	67,297
2020 – 2024	81,700	26,444	—	—	—	—	36,670	4,366	118,370	30,810
2025 – 2029	38,105	3,215	—	—	—	—	—	—	38,105	3,215
Total	\$ 289,075	228,854	55,930	8,029	22,310	3,492	106,430	79,947	473,745	320,322
	General Obligation Bonds Series 1999 A		Project Revenue Bonds Series 1999		Revenue Bonds Series 1999 A		Tobacco Bonds Series A 2001		Garvee Bonds Series 2002	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
Year:										
2005	\$ 885	353	1,550	48	4,765	17,470	—	705	2,900	748
2006	945	295	—	—	5,005	17,210	—	705	3,000	646
2007	1,005	232	—	—	5,285	16,921	—	705	3,155	497
2008	1,075	166	—	—	5,585	16,615	910	705	3,310	339
2009	1,140	95	—	—	5,900	16,292	1,030	705	3,475	173
2010 – 2014	600	19	—	—	35,020	75,693	6,270	3,525	—	—
2015 – 2019	—	—	—	—	47,510	62,751	—	3,525	—	—
2020 – 2024	—	—	—	—	64,815	44,865	6,055	2,465	—	—
2025 – 2029	—	—	—	—	88,385	20,664	—	2,011	—	—
2030 – 2034	—	—	—	—	21,065	645	8,045	603	—	—
Total	\$ 5,650	1,160	1,550	48	283,335	289,126	22,310	15,654	15,840	2,403
	Revenue Bonds Series 2003 A		Total governmental activities							
	Principal	Interest	Principal	Interest						
Year:										
2005	\$ —	13,301	24,055	58,728						
2006	2,875	13,244	26,590	57,392						
2007	2,990	13,126	28,055	55,917						
2008	3,110	13,004	30,520	54,357						
2009	3,230	12,877	32,145	52,714						
2010 – 2014	18,315	62,130	163,475	238,436						
2015 – 2019	23,335	56,937	206,605	190,510						
2020 – 2024	30,115	49,995	219,355	128,135						
2025 – 2029	38,520	41,386	165,010	67,276						
2030 – 2034	145,530	21,133	174,640	22,381						
Total	\$ 268,020	297,133	1,070,450	925,846						

(c) Conduit Debt

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

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repayment of the bonds. The bonds are not reported as liabilities in the Government's basic financial statements.

(d) *Notes Payable*

On September 4, 2003, the PG issued \$100 million Bond Anticipation Notes (BANs) in anticipation of the issuance of the 2003 Series A Revenue Bonds. Interest accrued quarterly at a rate of 3.25%. The proceeds of the BANs were used for the purpose of (i) funding vendor payments and tax refunds, (ii) funding capitalized interest, and (iii) paying the cost of issuance of the BANs. On December 17, 2003, the 2003 Series A Series Bonds were issued, and the BANs were repaid.

On November 20, 2002, WICO consolidated and refinanced the 1993 and 2000 loans, and obtained an additional \$2 million in financing for infrastructure improvements. The consolidated loan amounts to \$22.5 million, to be repaid in 239 monthly installments of \$142 thousand, and a final payment of outstanding principal balance plus any unpaid interest accrued to the date of the final payment. The consolidated loan has a fixed interest rate of 4.5% for the first four years of the loan. After the first four years, WICO will have the option to adjust the interest rate to one of the following: (i) prime rate plus 75 basis points, (ii) one-year LIBOR rate plus 200 basis points, or (iii) three-year treasury note rate plus 125 basis points. The revenue of WICO and lease agreements are pledged for the payment of principal and interest on the loan. WICO paid approximately \$981 thousand in interest expense during fiscal year 2004.

Debt service requirements for the WICO loan at September 30, 2004 were as follows (expressed in thousands):

Year:		
2005	\$	768
2006		804
2007		840
2008		879
2009		920
2010 – 2014		5,271
2015 – 2019		6,598
2020 – 2023		5,296
Total	\$	<u>21,376</u>

(e) *Fiduciary Funds – Notes Payable*

On December 30, 2002, the pension trust fund entered into a line-of-credit agreement with a bank to provide working capital. The pension trust fund obtained a line-of-credit of \$10 million, which accrues interest at a fixed interest rate of 4.8% calculated on a 360-day basis and is due and payable quarterly in arrears commencing on the first day of the fourth calendar month following the closing of the loan. The terms of the line-of-credit require the pension trust fund to repay the line-of-credit in a period of 30 consecutive days during each 12-month period. The bank retains a certificate of deposit in the amount of \$10 million as security on the note payable. As of September 30, 2004, the outstanding balance on the line-of-credit agreement was \$6.8 million.

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(f) Component Units – Bonds Payable

Bonds payable of discretely presented component units are those liabilities that are paid out of resources pledged by such entities. These revenue bonds do not constitute a liability or debt of the PG. Bonds payable outstanding at September 30, 2004 are as follows (expressed in thousands):

<u>Bonds payable</u>	<u>Final maturity</u>	<u>Interest rates (%)</u>	<u>Balance</u>
University of the Virgin Islands:			
General obligation bonds of 2004	2035	2.02 – 5.38	\$ 21,150
General obligation bonds of 1999	2029	6.50 – 7.75	23,500
Virgin Islands Water and Power Authority (Electric System)			
Revenue bonds of 2003	2023	4.00 – 5.00	69,960
Revenue bonds of 1998	2022	4.25 – 5.30	92,350
Virgin Islands Water and Power Authority (Water System)			
Revenue bonds of 1999	2017	4.90 – 5.50	37,450
Virgin Islands Port Authority			
Revenue bonds of 2003	2023	3.73 – 5.43	33,440
Revenue bonds of 1998	2005	3.45 – 4.50	496
Revenue draw down bonds of 2003	2023	4.40	2,972
Virgin Islands Housing Finance Authority:			
Revenue bonds of 1995	2025	5.50 – 6.50	3,715
Revenue bonds of 1998	2028	4.10 – 5.25	2,650
Subtotal			<u>287,683</u>
Plus unamortized premium			5,648
Less unamortized discount			(876)
Less deferred amount on debt refunding and reacquisition costs			<u>(6,056)</u>
Bonds payable, net			286,399
Less amount due within one year			<u>(8,476)</u>
Bonds payable, due in more than one year			<u><u>\$ 277,923</u></u>

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Following is a schedule of changes in long-term debt for discretely presented component units for fiscal year 2004 (expressed in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Amounts due within one year</u>	<u>Amounts due thereafter</u>
Bonds payable:						
University of the Virgin Islands	\$ 23,533	21,150	(624)	44,059	290	43,769
Virgin Islands Water and Power Authority:						
Electric System	167,673	—	(3,828)	163,845	4,355	159,490
Water System	36,415	—	(1,506)	34,909	1,900	33,009
Virgin Islands Port Authority	35,738	3,038	(1,555)	37,221	1,806	35,415
Virgin Islands Housing Finance Authority	6,485	—	(120)	6,365	125	6,240
Total bonds payable, net	<u>269,844</u>	<u>24,188</u>	<u>(7,633)</u>	<u>286,399</u>	<u>8,476</u>	<u>277,923</u>
Loans payable:						
Virgin Islands Economic Development Authority	947	—	(46)	901	55	846
Virgin Islands Water and Power Authority:						
Electric System	—	5,600	—	5,600	5,600	—
Virgin Islands Port Authority	913	1,200	(1,223)	890	890	—
University of the Virgin Islands	3,540	—	(50)	3,490	1,753	1,737
Total loans payable	<u>5,400</u>	<u>6,800</u>	<u>(1,319)</u>	<u>10,881</u>	<u>8,298</u>	<u>2,583</u>
Other long-term liabilities:						
University of the Virgin Islands	132	—	—	132	—	132
Virgin Islands Housing Authority	5,538	946	—	6,484	—	6,484
Virgin Islands Economic Development Authority	8,106	407	—	8,513	—	8,513
Juan F. Luis Hospital	561	—	(263)	298	—	298
Roy L. Schneider Hospital	474	508	(424)	558	—	558
Virgin Islands Housing Finance Authority	12,433	290	—	12,723	—	12,723
Total other long-term liabilities	<u>\$ 27,244</u>	<u>2,151</u>	<u>(687)</u>	<u>28,708</u>	<u>—</u>	<u>28,708</u>

On December 1, 1999, the University issued the 1999 Series A Bonds. The University issued these bonds to finance a portion of the construction, furnishing, and equipping of various facilities of the University, to refund the 1994 Series A bonds issued by the University, to fund a debt service reserve fund for the 1999 Series A Bonds, and to pay certain costs issued under and secured by an indenture of trust dated. The 1999 Series A Bonds maturing on or after December 1, 2010 are subject to redemption prior to maturity at the option of the University, as a whole or in part of any date, on and after December 1, 2009, at redemption prices ranging between 100% and 102% of their principal amount plus accrued interest to the date fixed for redemption. At September 30, 2004, \$14.1 million of the 1994 Series A Bonds are considered defeased and outstanding.

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

In June 2003, the Virgin Islands Water and Power Authority (Electric System) issued the Electric System Revenue Bonds, Series 2003, amounting to \$69.9 million. The proceeds from the bonds were

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used to finance capital improvements, repay \$18 million of then outstanding lines-of-credit, cover underwriters' costs, and establish a debt service fund.

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

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

The Bond Resolution contains certain restrictions and commitments, including the Electric System's covenant to establish and maintain reasonable rates, fees, rentals, and other charges to produce net electric revenue, as defined, that will be at least 125% of aggregate annual principal and interest. The Electric System's net electric revenue for the fiscal year ended June 30, 2004 was 199% of the aggregate debt service as defined in the Bond Resolution.

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

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

In December 1998, the Virgin Islands Water and Power Authority (Water System) issued the 1998 Water System Revenue and Refunding Bonds amounting to \$44.1 million. The proceeds from the bonds were used to repay the 1990 Series A Water System Revenue Bonds at a redemption price of 100% and to refund the 1992 Series B Water System Revenue Bonds, repay outstanding lines of credit balances, pay underwriters' costs, provide funding for a Renewal and Replacement Reserve Fund, and to purchase obligations of the United States Government, which were placed in an irrevocable trust with an escrow agent to provide all future debt service on the remaining principal amount of the 1992 Series B Bonds. At June 30, 2004, \$37.4 million of the original principal amount of the defeased 1992 Series B Bonds remained outstanding.

Payment of principal and interest of the 1998 Series Bonds is secured by an irrevocable lien on the Water System's net revenues (exclusive of any funds that may be established pursuant to the Bond

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Resolution for certain other specified purposes) and funds established under the Bond Resolution, including investment securities. To provide additional security, the Water System has conveyed to the bond trustee, a subordinate lien and security interest in the Water System's General Fund. The Water System is also required to make deposits in a debt service reserve fund in accordance with the Bond Resolution.

The Bond Resolution contains certain restrictions and commitments, including the Water System's covenant to establish and maintain reasonable rates, fees, rentals, and other charges to produce net water revenue, as defined, that will be at least 125% of aggregate annual principal and interest payments. The Water System's net water revenue for the fiscal year ended June 30, 2004 was 135% of the aggregate debt service.

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

In October 1998, the VIPA issued the 1998 Rohlsen Terminal Airport Revenue Bonds Series A, with a principal amount of \$3.1 million. The bonds were issued for the advance refunding of previously issued bonds. The Rohlsen Terminal Bonds constitute special obligations payable solely from, and secured by a pledge of, net revenue of VIPA derived from the Rohlsen Terminal. In addition, net marine revenue is pledged for payment of the Rohlsen Terminal Bonds if revenue from the Rohlsen Terminal is not enough to meet the debt service requirements.

On January 16, 2003 VIPA issued the Marine Revenue Bonds Series 2003A (AMT) and 2003B (federally taxable) with principal amounts of approximately \$18.4 million and \$17.4 million, respectively. VIPA is using the proceeds of the bonds to finance the dredging, rehabilitation, and construction of berthing piers for cruise and seagoing vessels on the island of St. Thomas and the construction of mixed used commercial facilities.

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

The revenue of the Airport System is not available for the payment of principal or interest on the Rohlsen Terminal Bonds; likewise, the revenue of the Marine Division and the Rohlsen Terminal are not available to pay Airport system obligations except for any surplus or marine revenue, which is available as designated by VIPA. Neither the credit of the Government nor any of its subdivisions or independent corporations is pledged or available for the payment of the principal or interest of the Bonds.

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

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Management of VIPA believes that VIPA has established the aforementioned required accounts and has complied with the contribution requirements with respect to the bonds. In addition, it is VIPA's management's opinion that VIPA has complied with limitations and restrictions imposed by the bonds' indentures.

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

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

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Fixed maturities required to pay principal and interest on discretely presented component units' bonds payable with fixed maturities at September 30, 2004 are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year:			
2005	\$ 8,476	14,896	23,372
2006	8,850	14,815	23,665
2007	11,010	14,314	25,324
2008	11,555	13,782	25,337
2009	12,130	13,215	25,345
2010 – 2014	64,457	52,150	116,607
2015 – 2019	66,075	36,970	103,045
2020 – 2024	54,875	23,088	77,963
2025 – 2029	33,900	8,111	42,011
2030 – 2034	16,355	2,701	19,056
	<u>287,683</u>	<u>\$ 194,042</u>	<u>481,725</u>
Plus unamortized premium	5,648		
Less unamortized discount	(876)		
Less deferred amount on debt refunding and reacquisition costs	<u>(6,056)</u>		
Bonds payable, net	<u>\$ 286,399</u>		

(10) General Tax Revenue

For the year ended September 30, 2004, general tax revenue of the PG consisted of the following (expressed in thousands):

	<u>General fund</u>	<u>PFA debt service fund</u>	<u>Other governmental funds</u>	<u>Total</u>
Income taxes	\$ 313,735	—	—	313,735
Real property taxes	48,007	—	16,000	64,007
Gross receipts taxes	—	112,387	250	112,637
Other taxes	98,067	40,062	1,998	140,127
Tax revenue	<u>\$ 459,809</u>	<u>152,449</u>	<u>18,248</u>	630,506
Tax revenue not recognized on the modified accrual basis				<u>34,004</u>
Total tax revenue – government-wide				<u>\$ 664,510</u>

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(11) Commitments and Contingencies

(a) *Primary Government*

The current labor relations environment of the Government is defined by 13 distinct labor organizations subject to approximately 26 collective bargaining agreements. Fourteen bargaining units are without collective bargaining agreements. As specific disciplines are not grouped under a single pay plan, it is common to have clerical and nonprofessional workers in different departments throughout the Government, represented by different unions. Of the approximately 9,566 government workers, including employees of the executive branch of the Government, approximately 7,143 belong to unions. The present collective bargaining statute requires binding arbitration for certain classified employees in the event of an impasse during salary negotiations between the Government and any union. Under this process, each side chooses an arbitrator and a third impartial arbitrator is selected by the chosen arbitrators. The arbitration panel investigates and reviews the issues in dispute and renders a final and binding decision. For other classified employees, the Government must decide to go to impasse or to enjoin any strike. The Government has contractual liabilities for retroactive union arbitration salary increases aggregating \$384 million accruing from fiscal years 1993 through 2004. Pursuant to Title 24 of the V.I. Code Section 374(h), no such contractual amount is due until appropriation of funds is made by the Legislature. Upon action of the Legislature, the General Fund will have the responsibility to satisfy the obligations arising from the retroactive wages. Until such time, the liability is recorded as a long-term debt in the governmental activities column in the government-wide financial statements. Retroactive union negotiated salaries account increased by \$9 million from fiscal year 2003 to fiscal year 2004.

The Government receives financial assistance from the federal government in the form of loans, grants, and entitlements. Loans received are described in note 9(c). Monetary and nonmonetary federal financial assistance amounted to approximately \$137.4 million and \$19.8 million, respectively, for the year ended September 30, 2004.

Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal regulations, including the expenditure of resources for eligible purposes. Substantially, all grants are subject to audit under OMB Circular A-133. Disallowances as a result of these audits may become liabilities of the Government. At September 30, 2004, based on an evaluation of pending disallowances, the Government has recorded approximately \$6 million as other long-term liabilities in the governmental activities column of the government-wide financial statements.

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

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

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condition for the Government to designate a third-party fiduciary to administer U.S. Department of Education grants. The terms and conditions of the original compliance agreement have been extended until the Government is in full compliance with the agreement.

The Government is a defendant in numerous legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Title 33, Section 3411(c) of the V.I. Code, no judgment shall be awarded against the Government in excess of \$25,000 for tort claims filed under Government statutes. In cases involving several survivors, each award must be construed separately for purposes of applying the limitation upon recovery imposed by the Tort Claims Act. Under Title 27, Section 166(e) of the V.I. Code, the Government's waiver of immunity is expanded to \$250,000 for medical malpractice actions, including actions for wrongful death based on malpractice. Under certain circumstances, as provided in Title 33, Section 3414 of the V.I. Code, the Government may assume the payment of a judgment entered against an officer or employee acted reasonably and within the scope of his employment. The Government may pay up to a maximum amount of \$100,000 of the settlement. With respect to pending and threatened litigation, the Government has accrued a provision for legal claims and judgments of approximately \$15.2 million for awarded and anticipated unfavorable judgments as of September 30, 2004. Management believes that the ultimate liability in excess of amounts provided would not be significant.

Changes in the reported estimated litigation payable since September 30, 2002, resulted from the following activity (expressed in thousands):

	<u>Beginning fiscal year liability</u>	<u>Current year claims and changes in estimates</u>	<u>Claim payments</u>	<u>Ending fiscal year liability</u>
2002 – 2003	\$ 4,171	9,504	(440)	13,235
2003 – 2004	\$ 13,235	2,478	(538)	15,175

The breakdown of the estimated litigation payable at September 30, 2004 is as follows (expressed in thousands):

<u>Governmental activities</u>	
Current portion of estimated litigation payable	\$ 450
Long-term portion of estimated litigation payable	<u>14,725</u>
	<u>\$ 15,175</u>

As of September 2002, the Government was a defendant in a lawsuit regarding the assessment of property taxes. Under the lawsuit, taxpayers asserted that properties should be assessed at actual value in accordance with the Organic Act of 1933. The U.S. District Court agreed with the plaintiffs and, in May 2003, imposed an injunction on the collection of real property taxes for years

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subsequent to 1998. The Government complied with the Court order to develop a plan to implement the new valuation method, and the injunction was lifted in August 2003. Assessments will continue at the 1998 level until the new assessment method is in place.

State and federal laws and regulations require the Government to place a final cover on its landfill sites when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for 30 years after closure. Although closure and post-closure care costs will be paid only near or after the date that the landfill stops accepting waste, the Government reports a portion of these closure and post-closure care costs as an operating expense in each period based on landfill capacity used as of each balance sheet date. The \$28.8 million reported as landfill closure and post-closure care liability at September 30, 2004, represents the cumulative amount reported to date based on the use of the estimated capacity of each landfill. The Government will recognize the remaining estimated cost of closure and post-closure care of \$9.6 million as the remaining estimated capacities are filled. These amounts are based on what it would cost to perform all closure and post-closure care in 2004.

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

<u>Landfill</u>	<u>Estimated used capacity</u>	<u>Estimated closure date</u>
Bovoni	57.41%	2020
Angilla	82.86	2009
Susannaberg	100	1993

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

Since 1985, the Government has been subject to a consent decree issued by the Virgin Islands District Court, governing the operation of its wastewater treatment plants. The consent decree was amended in 1996 and further modified with the 2002 Stipulation to the Amended Consent Decree (the Stipulation) to establish deadlines for the construction of new secondary treatment facilities, including the replacement of the existing St. Croix and Airport Lagoon (Charlotte Amalie) wastewater treatment plants. The Stipulation requires that the new St. Croix wastewater treatment plants be completed by the end of 2005 and the new Charlotte Amalie wastewater treatment plants be completed by the end of 2006. The cost of both facilities is estimated at approximately \$50 million. The Stipulation also establishes certain interim deadlines and performance standards that must be met by the Government pending completion of the new facilities. In addition, the Stipulation establishes specified penalties for violation of any of the deadlines or performance standards set forth therein. As of the date of the basic financial statements, the Government is current on all of its

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outstanding obligations pursuant to the Stipulation. In January 2004, the Government's Legislature authorized the creation of the Virgin Islands Waste Management Authority (WMA) for the purpose of meeting environmental requirements of waste treatment in the U.S. Virgin Islands. On December 2004, the PFA issued revenue bonds amounting to \$94 million for the purpose of constructing and rehabilitating wastewater treatment plants noted above. The bond proceeds will be administered by WMA.

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

As of September 2004, the Government was a defendant in a lawsuit regarding the assessment of franchise taxes. Under the lawsuit, taxpayers asserted that franchise taxes should be assessed in accordance with Title 13 Virgin Islands Code Section 531(a). The plaintiff taxpayers interpret the definition of "capital stocks used in conducting business in the Virgin Islands" in the V.I. Code as tax collected only on the par value of the stock, while the Government's position is that the amount allocated should be over the par value and additional paid-in capital upon a subsequent reorganization. The Government also imposed a six-year statute of limitations on tax refund claims against the Government. Management believes that the ultimate liability of this case would not have a material adverse impact on the Government's overall financial position as reported in the government-wide financial statements.

(b) *Discretely Presented Component Units*

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

In September 1995, WAPA electric facilities were again damaged by a hurricane—Hurricane Marilyn. WAPA again reconstructed its facilities with proceeds from insurance and FEMA. In

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March 1999, FEMA denied WAPA's claim for \$8.9 million in remaining expenditures related to the reconstruction. WAPA reduced its claim to \$5.7 million and is negotiating with FEMA regarding these remaining reimbursements. WAPA has not recorded any amounts related to this recovery pending final resolution.

In September 2004, WAPA electric facilities sustained damages amounting to \$1.3 million due to Tropical Storm Jeanne. WAPA is pursuing recovery of these costs from FEMA.

WAPA estimates that capital expenditures in connection with continuing capital improvements will be approximately \$37.6 million for the Electric System and \$8.2 million for the Water System during the year ended June 30, 2005.

In August 2003, VIHA was declared to be in substantial default of its annual contributions contract with the U.S. Department of Housing and Urban Development. Due to the severity of the compliance violations, VIHA was placed in receivership. As of September 30, 2004, VIHA remained in receivership.

In July 2004, VIHA executed a memorandum of understanding with WAPA for the repayment of \$4.16 million in overdue utility accounts. The terms of the memorandum call for monthly payments of \$175 thousand with the remainder to be paid by December 2005.

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

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

In 2004, VIGHHFC entered into two agreements for the purchase of equipment. VIGHHFC paid 10% down on the equipment, with a balance due of \$3.6 million for equipment purchased for the St. Thomas hospital and \$2.5 million for equipment purchased for the St. Croix hospital.

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

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(12) Retirement Systems

(a) Plan Description

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

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

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

(b) Funding Policy

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

The contributions required to fund GERS on an actuarial reserve basis are calculated periodically by the GERS actuarial consultant. The actuarial valuation as of September 30, 2001 indicates that the current combined statutory employer and employee contribution rates are not sufficient to meet the cost of GERS on an actuarial basis.

The Government's required contribution for the year ended September 30, 2004 was 14.5% of the member's annual salary. Since April 1, 1991, required member contributions are 8% of annual salary for regular employees, 9% for senators, and 10% for Act 5226 eligible employees. Through September 30, 2000, member contributions were refundable without interest upon withdrawal from

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employment before retirement. Subsequent to September 30, 2000, legislation was passed that provided for 4% annual interest on refunded contributions. The Government's contractually required contributions, actual contributions made, and percentage contributed to the plan for the years ended September 30, 2004, 2003, and 2002, are as follows (expressed in thousands):

	<u>Contractually required contributions</u>	<u>Contributions made</u>	<u>Percentage contributed</u>
2002	\$ 50,595	50,595	100%
2003	51,588	51,588	100
2004	54,085	54,085	100

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

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

For employees electing to retire under Section 8(b) of the Act, the Government contributes to GERS a sum equal to the additional contribution the employer and employee would have made had the employee received a salary 4% higher during the three years used to compute the employee's average compensation figure plus a sum of \$5,000. Based on this calculation, the amount was \$24.8 million as of September 30, 2004. As of September 30, 2004, GERS has received \$17.6 million of such amount.

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

The University has two retirement plans in which all eligible employees are required to participate. The Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) is a defined-contribution pension plan covering participating, full-time faculty members and other exempt employees, under which the contributions, including employees' contributions, are used to purchase annuities. There are no unfunded past service costs, and vested benefits are equal to the annuities purchased under TIAA-CREF. As of September 30, 2004, 213 faculty members and other employees were TIAA-CREF participants. The number of active participants from the University

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participating in GERS as of September 30, 2004 was 269. Total contributions made by the University to TIAA-CREF and GERS participant accounts amounted to \$1.7 million and \$1.1 million, respectively.

(13) Liquidity

At September 30, 2004, the Government had a net deficit in the governmental activities amounting to \$328.2 million, mostly attributable to approximately \$268 million in long-term debt that was issued to provide resources for working capital and other noncapital related purposes. The Government has initiated specific actions to improve its future cash flows through the issuance of long-term debt, engaging a consulting firm to assist it in its efforts to develop a series of detailed revenue enhancement and expenditure reduction initiatives and the enactment of certain laws directed toward improving the Government's financial situation. In October 1999, the Government and the U.S. Department of Interior (DOI) entered into a memorandum of understanding (the MOU) whereby the Government agreed to use its best efforts to undertake certain deficit reduction initiatives. As a condition to certain new and additional federal financial and technical assistance included in or being proposed by federal appropriations or other legislation, certain financial performance and accountability standards were agreed upon by the Government, which the DOI believes are necessary for the Government to achieve long-term economic recovery. Pursuant to the MOU, the release of such new and additional federal funds to the Government is subject to compliance with such performance and verifiable objectives agreed upon in such agreement. The accountability and financial performance standards agreed upon in the MOU include: (i) preparation of five-year financial recovery plan to be provided to DOI within 90 days of the date of the MOU; (ii) a fiscal year 2000 budget mandating substantial reductions in departmental budgets and overall General Fund fiscal year 2000 expenditures not to exceed \$432.1 million; (iii) absent extraordinary circumstances to maintain balanced budgets after fiscal year 2003 with any generated surpluses applied to the reduction of the accumulated deficit and unfunded obligations; (iv) annual preparation of financial reports; and (v) efforts to reduce the outstanding debt of the Government. On October 29, 1999, the DOI and the Government entered into an amendment of the MOU, which amended the Government's requirement to seek change in the Virgin Islands public labor relations law to comply with federal labor law. Pursuant to such amendment, the Government, in collaboration with union representatives, is encouraged to pursue reform initiatives through collective bargaining to bring fiscal solvency to the Government. In addition to the financial performance standards set forth in the MOU, the MOU further provides for the DOI and the Government to enter into a program of preservation and enhancement of the natural, cultural, and historic resources of the U.S. Virgin Islands to stimulate local economic growth through sustainable tourism. The Government is discussing with DOI certain events of noncompliance, remedial actions necessary to comply with the provisions of the MOU, and its effect on the Government's financial condition and results of operations.

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

In January 2003, the U.S. Department of Interior issued an audit report concluding that all criteria of the (the proposed MOU) were partially or substantially achieved except: (i) implementation of collective bargaining reforms to assist the fiscal solvency of the Government and (ii) completion of comprehensive

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annual reports within 120 days of year-end and single audits within nine months of year-end. As part of the MOU, the Government has committed to maintaining balanced budgets after the fiscal year ended September 30, 2003, with any surpluses applied to liquidating outstanding debt. The U.S. Department of Interior acknowledged that it had not achieved its objective of providing funding for the V.I. Conservation Fund and committed to providing funds for capital improvements, technical assistance, and other assistance once the Government has achieved substantial compliance.

The DOI and the Government are currently negotiating a proposed memorandum of understanding (the proposed MOU) regarding the fiscal and economic recovery of the Government to supersede the existing MOU. The proposed MOU is expected to provide standards of financial performance and accountability to guide the Government in developing and implementing its fiscal and economic recovery program and in achieving a balanced budget. The proposed MOU is expected to set forth the goals and commitments of the DOI with respect to additional federal financial and technical assistance that may be required to achieve the fiscal and economic objectives under the proposed MOU.

(14) Restatements of Net Assets and Fund Balances

(a) Adoption of New Accounting Standard

Effective October 1, 2003, the PG and its component units adopted the provisions of GASB Statement No. 39, *Determining Whether Organizations Are Component Units*. In adopting this statement, UVI included the Reichhold Foundation for the Arts and the Virgin Islands Research and Technology Park into its audited financial statements. The beginning net assets of UVI increased by \$3.2 million due to the inclusion of these entities. Beginning net assets of the component units have been restated as follows (expressed in thousands):

Beginning net assets, as previously reported	\$	629,102
Restatement – UVI		<u>3,221</u>
Beginning net assets as restated	\$	<u><u>632,323</u></u>

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(b) Reclassification of the PFA Capital Projects Fund as a Major Fund

The following table illustrates the change to fund balances at the beginning of the year, as previously reported, in the statement of revenue, expenditures, and changes in fund balances – governmental funds. The change is due to the reclassification of the PFA capital projects fund as a major fund. Previously, the PFA capital projects fund was reported in other governmental funds as a nonmajor governmental fund.

	Other governmental funds	PFA capital projects fund
Beginning fund balance, as previously reported	\$ 102,064	—
PFA capital projects fund	(43,062)	43,062
Beginning fund balance, as restated	\$ 59,002	43,062

(c) Inclusion of VI Lottery Financial Information

The following table summarizes the change in net assets at the beginning of the year in the statement of activities and statement of revenue, expenses, and changes in fund net assets – proprietary funds from the amounts previously reported. The change resulted from the inclusion of the VI Lottery (nonmajor enterprise fund) financial information as of and for the fiscal year ended September 30, 2004. Previously, this financial information had not been included because it was not available. The beginning net assets of the business type-activities and the other enterprise funds have been restated as follows (expressed in thousands):

	Business-type activities	Other enterprise funds
Beginning net assets, as previously reported	\$ 69,608	13,308
Inclusion of VI Lottery financial information	(3,138)	(3,138)
Beginning net assets, as restated	\$ 66,470	10,170

(15) Subsequent Events

(a) Primary Government

In October 2004, the excise tax on rum of 13.5 cents per gallon, which was scheduled to expire on December 31, 2003, was extended to December 31, 2005.

In October 2004, the President of the United States signed the American Jobs Creation Act, which changes the residency requirements and source of income requirements for U.S. territories and possessions, including the U.S. Virgin Islands. The PG retained an independent consultant to evaluate the effect of this legislation on the territorial economy and tax structure. The independent consultant's report was issued in February 2005 and concludes that the American Jobs Creation Act

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is detrimental to the economy of the U.S. Virgin Islands. In April 2005, the U.S. Department of the Treasury issued draft regulations for residency and source of income requirements for U.S. territories and possessions. In July 2005, the U.S. Department of the Treasury accepted testimony regarding the draft regulations. The PG provided testimony regarding the effect of the proposed regulations on the economy of the U.S. Virgin Islands.

In December 2004, the PFA issued the Series 2004A Internal Revenue Matching Fund Bonds in the amount of \$94 million. The proceeds of the bonds will be used to finance the construction of two wastewater treatment plants to be built on the islands of St. Thomas and St. Croix, the rehabilitation of other wastewater facilities, and provide start-up capital for the newly created Virgin Islands' WMA. The Government has pledged rum excise tax matching funds for the repayment of the bonds.

In July 2005, the PFA issued \$7.5 million in revenue notes to finance the acquisition of a fleet of police vehicles for the PG and to pay the costs of issuance of the notes.

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

(b) Component Units

In March 2005, UVI's board of trustees approved a resolution authorizing the issuance of a one-time payout of 100% of merit earned for fiscal years 2001 – 2004 and the balance of the merit accumulation through fiscal year 2000. The payout amount of \$2.7 million was disbursed in April 2005.

As authorized with the passage of Act No. 6638 by the Government's Legislature in January of 2004, WMA was created in June 2005 as a separate and independent corporation of the Government for the purpose of meeting environmental requirements of waste treatment in the U.S. Virgin Islands. The responsibility for the operations of WMA is vested in a board of seven directors composed of three Government officials including the Commissioner of the Department of Public Works, and four private citizens appointed by the Governor. The activities of WMA are limited to activities conducted on behalf of the Government. In December 2004, PFA issued revenue bonds amounting to \$94 million for the purpose of constructing and rehabilitating wastewater treatment plants, as authorized by Act No. 6663. The bond proceeds will be administered by WMA.