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# GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Basic Financial Statements

September 30, 2003

(With Independent Auditors' Report Thereon)

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

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(Continued)

## GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

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**KPMG LLP**
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## Independent Auditors' Report

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

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Government of the United States Virgin Islands (the Government) as of and for the year ended September 30, 2003, 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 West Indian Company (a major fund); 3.73%, 4.36%, and 0.24% of the assets, net assets/fund balance, and revenue of the aggregate remaining fund information; 18.8%, 43.4%, and 15.3% of the assets, net assets, and revenue of the governmental activities; and 51.1%, 35.9%, and 31.6% of the assets, net assets, and revenue of the business-type activities, respectively.
- The Tobacco Settlement Financing Corporation, a blended component unit, which represents 0.99%, 1.22%, and 0.09%, respectively, of the assets, fund balance, and revenue of the aggregate remaining fund information, and 1.4%, 4.6%, and 0.22% 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, 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 seven 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinions.

The Government did not maintain accounting records for corporate income tax receivables related to tax year 2002. Corporate income tax receivables amounting to $44.6 million in the general fund and governmental activities as of September 30, 2003, excludes receivables pertaining to tax year 2002. It was impracticable to extend our procedures sufficiently to determine the extent to which the general fund and the governmental activities as of and for the year ended September 30, 2003 may have been affected by these conditions.

The report of the other auditors on the 2002 financial statements of VIHA, a discretely presented component unit, was qualified because they were unable to obtain sufficient audit evidence as to the proprietary of the revenue and expenses reported by VIHA, or to determine whether capital assets amounting to $71 million were fairly stated. In addition, the report was also qualified because VIHA did not report an equity interest in a joint venture because it had not been able to determine its carrying value. Total revenue and expenses reported for the year ended December 31, 2002 amounted to $55.5 million and $59.6 million, respectively.

The report of the other auditors on the 2003 financial statements of the 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 million was fairly stated.

The basic financial statements do not include a receivable for unemployment insurance contributions in the unemployment insurance fund (a major fund) and the business-type activities as of September 30, 2003 due to inadequate records. The Government's records do not permit, nor is it practicable to extend our auditing procedures sufficiently to determine the extent to which the unemployment insurance fund (a major fund) and business-type activities as of and for the year ended September 30, 2003 may have been affected by this condition.

The Government has not included the Virgin Islands Lottery Fund (the Lottery) in the basic financial statements. Accounting principles generally accepted in the United States of America require the Lottery to be presented as a nonmajor enterprise fund and financial information about the Lottery to be part of the business-type activities, thus increasing the assets, liabilities, revenue, expenses, and changes in net assets of the aggregate remaining fund information and business-type activities. The amount by which this omission would affect the assets, liabilities, net assets, revenue, and expenses of the business-type activities is not reasonably determinable.

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, 2003 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 not recording contributions pursuant to the Early Retirement Act of

The Employees' Retirement System of the Government of the Virgin Islands (GERS), a fiduciary component unit (pension trust fund), is not recording contributions pursuant to the Early Retirement Act of 1994. If these contributions were accrued, contributions receivable and plan net assets would be increased by $9.8 million. Additionally, plan net assets would be increased by $1.4 million. During fiscal year 2003, GERS reappraised its real estate investments resulting in appreciation in value of approximately $25.4 million. We were not able to determine the portion of such appreciation that pertains to prior years. Finally, we were unable to obtain sufficient audit evidence through independent confirmation or other alternative procedures about (i) the bank overdraft balance reported by GERS with the Department of Finance of approximately $10.5 million in specially designated pooled accounts, and (ii) the reasonableness of amounts reported by GERS as due from the Department of Finance amounting to $523,000.

The basic financial statements do not include a provision for landfill closure and postclosure costs as required by accounting principles generally accepted in the United States of America. The effects of this departure from accounting principles generally accepted in the United States of America on the governmental activities have not been determined.

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, 2003, 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 maintaining accounting records for corporate income tax receivables related to tax year 2002 in the general fund and governmental activities and not recording a provision for landfill closure and postclosure costs in governmental activities, as described in paragraphs three and ten above, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the general fund of the Government as of September 30, 2003, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America;
- the effects of not being able to determine the extent to which the unemployment insurance fund (a major fund) may have been affected by the exclusion of a receivable for unemployment insurance contributions due to inadequate records, as described in paragraph six above, the financial statements referred to above present fairly, in all material respects, the respective financial position of the unemployment insurance fund (a major fund) of the Government as of September 30, 2003, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America;
- the effects of VIHA not reporting an equity interest in a joint venture and the adjustments, if any, as might have been determined to be necessary, had the other auditors been able to (i) satisfy themselves as to the proprietary of the revenue and expenses of VIHA reported in the statement of activities for the year ended September 30, 2003, and (ii) obtain sufficient audit evidence to determine whether capital assets and land held for sale amounting to $71 million and $25 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, 2003, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America; and

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- the effects of GERS not accruing contributions pursuant to the Early Retirement Act of 1994 as described in paragraph nine above and the adjustments, if any, as might have been determined to be necessary, had we been able to (i) obtain satisfactory evidence with respect to the cash overdraft with and amounts due from the Department of Finance, and (ii) allocate the appreciation in real estate investments between this and prior years, 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, 2003, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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 and the West Indian Company of the Government of the United States Virgin Islands as of September 30, 2003, and the respective changes in financial position and cash flows, where applicable, thereof, and the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 5 through 14 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

May 6, 2005

Stamp No. 2056644 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

## 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, 2003 and 2002.

## 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 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 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.



(Continued)

A major fund is a fund whose revenue, expenditures or expense, 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 and the PFA debt service 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 Fund 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.

***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, that owns a port facility including a cruise ship pier, and manages a shopping mall and a rental complex.

***Fiduciary Funds***

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

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 2003, the PG reported the Community Disaster Loan (CDL) forgiveness of $127.2 million of principal and $32.1 million of interest. Prior to September 30, 2003, the Government had met all the federal requirements for Administrative Loan Cancellation of the 1996 CDL related to Hurricane Marilyn and had petitioned the Federal Emergency Management Agency (FEMA) for forgiveness of the principal and related accrued interest. The PG was advised on October 25, 2004 that FEMA had granted full forgiveness of the 1996 CDL.

### *Financial Analysis of the Primary Government*

Total assets of the government as of September 30, 2003 and 2002 were $1.337 billion and $1.248 billion, respectively, an increase of approximately $89 million. Total liabilities as of September 30, 2003 and 2002 were $1.637 billion and $1.680 billion, respectively, a decrease of approximately $43 million.

For the year ended September 30, 2003, the PG net 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 as of $693 million. For the year ended September 30, 2002, the PG net asset deficit of $432 million consisted of $201 million invested in capital assets, net of related debt; $225 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 $857 million. The reduction in the PG net deficit was primarily caused by the CDL loan forgiveness.

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 the special item and transfers, of $34 million. During the fiscal year ended September 30, 2003, the Government reported a special item of $159.3 million resulting from the forgiveness of the 1996 CDL resulting in an overall reduction in the net deficit of $125 million. For the fiscal year ended September 30, 2002, the PG earned program and general revenue amounting to $854 million, and reported expenses of $891 million, resulting in an increase in the net asset deficit of $37 million. In overall, revenue and expenses remained fairly stable in fiscal year 2003 when compared to fiscal year 2002. The change in net assets was primarily caused by the CDL loan forgiveness in fiscal year 2003. A summary of net assets (deficit) and changes in net assets (deficit) for the primary government follows:

**Net Assets (Deficit) – Primary Government**

September 30, 2003 and 2002

(In thousands)

| | Governmental activities | | Business–type activities | | Total | |
|---|---|---|---|---|---|---|
| | **2003** | **2002** | **2003** | **2002** | **2003** | **2002** |
| **Assets** | | | | | | |
| Current assets | $ 626,829 | 542,653 | 54,979 | 72,856 | 681,808 | 615,509 |
| Capital assets | 608,158 | 592,969 | 43,008 | 37,279 | 651,166 | 630,248 |
| Other assets | 3,211 | 1,975 | 553 | 497 | 3,764 | 2,472 |
| Total assets | 1,238,198 | 1,137,597 | 98,540 | 110,632 | 1,336,738 | 1,248,229 |
| **Liabilities** | | | | | | |
| Current liabilities | 393,313 | 260,259 | 7,652 | 13,096 | 400,965 | 273,355 |
| Other liabilities | 1,214,576 | 1,386,136 | 21,280 | 20,324 | 1,235,856 | 1,406,460 |
| Total liabilities | 1,607,889 | 1,646,395 | 28,932 | 33,420 | 1,636,821 | 1,679,815 |
| **Net Assets** | | | | | | |
| Invested in capital assets, net of related debt | 224,189 | 183,746 | 20,993 | 16,955 | 245,182 | 200,701 |
| Restricted | 105,633 | 166,257 | 42,464 | 58,786 | 148,097 | 225,043 |
| Unrestricted (deficit) | (699,513) | (858,801) | 6,151 | 1,471 | (693,362) | (857,330) |
| Total net assets (deficit) | $ (369,691) | (508,798) | 69,608 | 77,212 | (300,083) | (431,586) |



(Continued)

**Changes in Net Assets (Deficit) – Primary Government**

September 30, 2003 and 2002

(In thousands)

| | Governmental activities | | Business–type activities | | Total | |
|---|---|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| Revenue: | | | | | | |
| Program revenue: | | | | | | |
| Charges for services | $ 26,988 | 11,469 | 29,590 | 45,690 | 56,578 | 57,159 |
| Operating grants and contributions | 143,295 | 132,686 | — | — | 143,295 | 132,686 |
| Capital grants and contributions | 20,564 | 18,636 | — | — | 20,564 | 18,636 |
| General revenue: | | | | | | |
| Taxes | 594,616 | 599,315 | — | — | 594,616 | 599,315 |
| Interest and other | 33,991 | 40,349 | 3,785 | 4,715 | 37,776 | 45,064 |
| Other general revenue | 1,577 | 1,263 | — | — | 1,577 | 1,263 |
| Total revenue | 821,031 | 803,718 | 33,375 | 50,405 | 854,406 | 854,123 |
| Expenses: | | | | | | |
| General government | 350,600 | 335,084 | — | — | 350,600 | 335,084 |
| Public safety | 49,394 | 45,230 | — | — | 49,394 | 45,230 |
| Health | 97,243 | 96,473 | — | — | 97,243 | 96,473 |
| Public housing and welfare | 63,874 | 62,440 | — | — | 63,874 | 62,440 |
| Education | 186,293 | 168,809 | — | — | 186,293 | 168,809 |
| Transportaion and communication | 29,240 | 38,534 | — | — | 29,240 | 38,534 |
| Culture and recreation | 14,365 | 9,410 | — | — | 14,365 | 9,410 |
| Interest on long-term debt | 49,633 | 71,190 | — | — | 49,633 | 71,190 |
| Unemployment insurance | — | — | 19,664 | 22,276 | 19,664 | 22,276 |
| West Indian Company | — | — | 8,432 | 8,671 | 8,432 | 8,671 |
| Lottery | — | — | — | 14,054 | — | 14,054 |
| Workmen's Compensation | — | — | 8,922 | 7,426 | 8,922 | 7,426 |
| Other business-type activities | — | — | 10,521 | 11,676 | 10,521 | 11,676 |
| Total expenses | 840,642 | 827,170 | 47,539 | 64,103 | 888,181 | 891,273 |
| Decrease in net assets before special item and transfers | (19,611) | (23,452) | (14,164) | (13,698) | (33,775) | (37,150) |
| Special item | 159,271 | — | — | — | 159,271 | — |
| Transfers | (1,379) | (1,294) | 1,379 | 1,294 | — | — |
| | 157,892 | (1,294) | 1,379 | 1,294 | 159,271 | — |
| Change in net assets | 138,281 | (24,746) | (12,785) | (12,404) | 125,496 | (37,150) |
| Net assets (deficit), beginning of year, as previously reported | (508,798) | (484,052) | 77,212 | 89,616 | (431,586) | (394,436) |
| Adjustments to beginning net assets | 826 | — | 5,181 | — | 6,007 | — |
| Net assets (deficit), end of year, as adjusted | $ (369,691) | (508,798) | 69,608 | 77,212 | (300,083) | (431,586) |

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 22 of the financial statements, follows:

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

**Year ended September 30, 2003**

(In thousands)

| | Original budget | Amended budget | Actual | Variance |
|---|---|---|---|---|
| Total revenue | $ 489,673 | 489,673 | 464,232 | (25,441) |
| Total expenditures | 581,367 | 630,022 | 564,050 | 65,972 |
| Excess of expenditures over revenue | (91,694) | (140,349) | (99,818) | 40,531 |
| Other financing sources (uses) | 99,925 | 199,925 | 174,803 | (25,122) |
| Excess of revenue and other financing sources (uses) over expenditures | $ 8,231 | 59,576 | 74,985 | 15,409 |

For fiscal year 2003, the PG realized a revenue variance ($25.4) million due to declining revenue 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 $74.9 million variance in other financing sources due to the proceeds from long-term debt issuance of $100 million and transfers to other funds of ($25.1) million.

## Capital Assets

Capital assets additions during fiscal years 2003 and 2002 amounted to $34 million and $38.7 million, respectively, for governmental activities and $7.5 million and $4.5 million, respectively, for business-type activities.



(Continued)

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 | |
|---|---|---|---|---|---|---|
| | **2003** | **2002** | **2003** | **2002** | **2003** | **2002** |
| Land and improvements | $ 188,109 | 187,187 | 5,358 | 5,375 | 193,467 | 192,562 |
| Building and improvements | 400,309 | 390,630 | 46,490 | 38,859 | 446,799 | 429,489 |
| Machinery and equipment | 69,788 | 63,438 | 2,585 | 3,310 | 72,373 | 66,748 |
| Infrastructure | 121,413 | 103,170 | — | — | 121,413 | 103,170 |
| Construction in progress | 4,046 | 5,544 | 722 | 1,119 | 4,768 | 6,663 |
| Total assets | 783,665 | 749,969 | 55,155 | 48,663 | 838,820 | 798,632 |
| Less accumulated depreciation | (175,507) | (157,000) | (12,147) | (11,384) | (187,654) | (168,384) |
| Total capital assets | $ 608,158 | 592,969 | 43,008 | 37,279 | 651,166 | 630,248 |

## 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 which 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, 2003:

**Primary Government – Bonds Payable**

(In thousands)

| Bonds payable | Final maturity | Interest rates | | Balance |
|---|---|---|---|---|
| 1998 Series A, B, C, D, and E revenue and refunding bonds | 2023 | 5.50% to 7.11% | $ | 486,970 |
| 1999 Project revenue bonds | 2005 | 6.25% | | 4,510 |
| 1999 Series A general obligation bonds | 2010 | 6.50% | | 6,480 |
| 1999 Series A revenue bonds | 2033 | 4.20% to 6.40% | | 287,875 |
| 2001 Series A tobacco bonds | 2031 | 5% | | 22,645 |
| 2002 Series revenue bonds | 2009 | 2.50% to 5.00% | | 18,645 |
| Subtotal | | | | 827,125 |
| Deferred amount on refundings | | | | (3,080) |
| Bond premium | | | | 1,299 |
| Bond discount | | | | (10,001) |
| Bond accretion | | | | (1,418) |
| Total | | | $ | 813,925 |

Note 9 provides detailed information regarding all bonds of the territory.

During fiscal year 2003, the 2002 Series revenue bonds amounting to $21 million were issued. During fiscal year 2002, the Tobacco Settlement Financing Corporation, a blended component unit, issued the 2001 Series A, Term, and Serial Bonds amounting to $24 million.

The PG made bond principal payments on all outstanding general and special revenue bonds amounting to $24 million during fiscal year 2003, and $19 million during fiscal year 2002.

The Government's bonds carry insured ratings of "BBB" and "Aaa" from Standard and Poor's 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.

At September 30, 2003, the PG issued a bond anticipation note in the amount of $100 million in anticipation of the issuance of the 2003 Series A Bonds, which were issued in December 2003.

At September 30, 2002, the PG had an outstanding Community Disaster Loan amounting to $127.2 million and accrued interest of $32.1 million. The PG received notification of full forgiveness of the loan principal and interest on October 25, 2004, and reported the forgiveness in the fiscal year ended September 30, 2003 because all requirements for Administrative Loan Cancellation had been met as of September 30, 2003.

Other liabilities of the PG include:

**Primary Government – Other Liabilities**
September 30, 2003 and 2003
(In millions)

| | | 2003 | 2002 |
|---|---|---|---|
| Accrued compensated absences | $ | 52 | 54 |
| Retroactive union arbitration liability | | 375 | 368 |
| Accrued litigation | | 13 | 4 |
| Accrued federal cost disallowances | | 13 | 19 |
| Total other liabilities | $ | 453 | 445 |

### Economic Condition and Outlook

The PG ended fiscal year 2003 with a deficit amounting to $300 million, of which $693 million relates to an unrestricted deficit. The PG is experiencing the combined challenge of revenue decreases and expenditure increases.

### Revenue Decreases

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.

New Tax Acts passed by U.S. Congress in fiscal year 2003 and 2002 had a negative impact on revenue due to changes in sourcing of revenue rules as defined for the US Virgin Islands, restrictions on residency rules, decreases in tax rates, expanded tax credits, and expanded tax deductions.

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.

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.

Congress passed legislation in October 2004, which changes the source of income requirements and residency requirements for tax reporting purposes in United States territories. The PG is assessing the effect of this legislation on the US Virgin Islands economy.

**Expenditure Increases**

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, unemployment insurance benefits, and salary expense.

In addition, the Government is still experiencing the impact of the general economic decline in the United States and the impact of the terrorist attacks on September 11, 2001.

**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.

**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, 2003

(In thousands)

| | Primary Government | | | |
|---|---|---|---|---|
| | Governmental activities | Business–type activities | Total | Component units |
| Assets: | | | | |
| Cash and cash equivalents | $ 109,327 | 5,954 | 115,281 | 46,247 |
| Investments | 298,634 | — | 298,634 | 26,530 |
| Receivables, net | 169,216 | 3,522 | 172,738 | 51,549 |
| Internal balances | 1,606 | (1,606) | — | — |
| Loans and advances | — | 5,417 | 5,417 | 2,475 |
| Due from component units | 22,797 | — | 22,797 | — |
| Note receivable | — | — | — | 7,387 |
| Due from primary government | — | — | — | 5,231 |
| Due from federal government | 22,703 | — | 22,703 | 7,164 |
| Inventories | — | 435 | 435 | 20,933 |
| Other assets | 2,546 | 886 | 3,432 | 21,927 |
| Restricted: | | | | |
| Cash and cash equivalents | — | 40,371 | 40,371 | 24,966 |
| Investments | — | — | — | 116,432 |
| Other | — | — | — | 119 |
| Capital assets | 608,158 | 43,008 | 651,166 | 722,096 |
| Deferred expenses | 3,211 | 553 | 3,764 | 12,535 |
| Total assets | 1,238,198 | 98,540 | 1,336,738 | 1,065,591 |
| Liabilities: | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued liabilities | 52,098 | 3,254 | 55,352 | 73,495 |
| Tax refunds payable | 75,761 | — | 75,761 | — |
| Unemployment insurance benefits | — | 3,663 | 3,663 | — |
| Customer deposits | — | — | — | 16,912 |
| Due to primary government | — | — | — | 22,797 |
| Due to component units | 5,231 | — | 5,231 | — |
| Due to federal government | — | — | — | 5,300 |
| Interest payable | 23,027 | — | 23,027 | 3,798 |
| Deferred revenue | 81,987 | — | 81,987 | 6,502 |
| Other current liabilities | 1,903 | — | 1,903 | 5,197 |
| Due within one year: | | | | |
| Loans payable | 100,000 | 735 | 100,735 | 1,016 |
| Bonds payable | 22,694 | — | 22,694 | 7,994 |
| Other liabilities | 30,612 | — | 30,612 | — |
| Noncurrent liabilities: | | | | |
| Due in more than one year: | | | | |
| Loans payable | — | 21,280 | 21,280 | 4,384 |
| Bonds payable | 791,231 | — | 791,231 | 261,850 |
| Other liabilities | 423,345 | — | 423,345 | 27,244 |
| Total liabilities | $ 1,607,889 | 28,932 | 1,636,821 | 436,489 |



(Continued)

## GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Net Assets (Deficit), continued

September 30, 2003

(In thousands)

| | Primary Government | | | |
|---|---|---|---|---|
| | **Governmental activities** | **Business–type activities** | **Total** | **Component units** |
| Net assets: | | | | |
| Invested in capital assets, net of related debt | $ 224,189 | 20,993 | 245,182 | 534,190 |
| Restricted for: | | | | |
| Unemployment insurance | — | 35,068 | 35,068 | — |
| Debt service | 102,782 | — | 102,782 | — |
| Capital projects | 2,851 | — | 2,851 | — |
| Other purposes | — | 7,396 | 7,396 | 66,038 |
| Unrestricted (deficit) | (699,513) | 6,151 | (693,362) | 28,874 |
| Total net assets (deficit) | $ (369,691) | 69,608 | (300,083) | 629,102 |

See accompanying notes to basic financial statements.

## GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Activities

Year ended September 30, 2003

(In thousands)

| | Expenses | Program revenue: Charges for services | Program revenue: Operating grants and contributions | Program revenue: Capital grants and contributions | Net (expense) revenue and changes in net assets — Primary government: Governmental activities | Primary government: Business-type activities | Primary government: Total | Component units |
|---|---|---|---|---|---|---|---|---|
| Functions: | | | | | | | | |
| Primary government: | | | | | | | | |
| Governmental activities: | | | | | | | | |
| General government | $ 350,600 | 15,062 | 21,663 | 8,605 | (305,270) | — | (305,270) | — |
| Public safety | 49,394 | 869 | 10,865 | — | (37,660) | — | (37,660) | — |
| Health | 97,243 | 1,508 | 30,046 | — | (65,689) | — | (65,689) | — |
| Public housing and welfare | 63,874 | 2,132 | 42,787 | — | (18,955) | — | (18,955) | — |
| Education | 186,293 | 871 | 33,521 | — | (151,901) | — | (151,901) | — |
| Transportation and communication | 29,240 | 6,531 | 4,094 | 11,959 | (6,656) | — | (6,656) | — |
| Culture and recreation | 14,365 | 15 | 319 | — | (14,031) | — | (14,031) | — |
| Interest on long-term debt | 49,633 | — | — | — | (49,633) | — | (49,633) | — |
| Total governmental activities | 840,642 | 26,988 | 143,295 | 20,564 | (649,795) | — | (649,795) | — |
| Business-type activities: | | | | | | | | |
| Unemployment insurance | 19,664 | 2,223 | — | — | — | (17,441) | (17,441) | — |
| West Indian Company | 8,432 | 9,950 | — | — | — | 1,518 | 1,518 | — |
| Workmen's compensation | 8,922 | 7,275 | — | — | — | (1,647) | (1,647) | — |
| Other | 10,521 | 10,142 | — | — | — | (379) | (379) | — |
| Total business-type activities | 47,539 | 29,590 | — | — | — | (17,949) | (17,949) | — |
| Total primary government | 888,181 | 56,578 | 143,295 | 20,564 | (649,795) | (17,949) | (667,744) | — |
| Component units: | | | | | | | | |
| Virgin Islands Housing Authority | 59,607 | 3,258 | 46,395 | 5,885 | — | — | — | (4,069) |
| Virgin Islands Port Authority | 43,660 | 35,565 | 15,163 | — | — | — | — | 7,068 |
| Virgin Islands Water and Power Authority: | | | | | | | | |
| Electric system | 129,994 | 134,459 | — | 349 | — | — | — | 4,814 |
| Water system | 30,505 | 26,395 | — | 485 | — | — | — | (3,625) |
| University of the Virgin Islands | 56,672 | 10,753 | 40,099 | 3,074 | — | — | — | (2,746) |
| Other component units | 118,999 | 56,359 | 47,271 | 7,816 | — | — | — | (7,553) |
| Total component units | $ 439,437 | 266,789 | 148,928 | 17,609 | — | — | — | (6,111) |



(Continued)

GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Statement of Activities, continued

Year ended September 30, 2003

(In thousands)

| | Net (expense) revenue and changes in net assets — Primary government: Governmental activities | Business-type activities | Total | Component units |
|---|---|---|---|---|
| Total primary government and component units | $ (649,795) | (17,949) | (667,744) | (6,111) |
| General revenue: | | | | |
| Taxes | 594,616 | — | 594,616 | — |
| Interest and other | 33,991 | 3,785 | 37,776 | 10,299 |
| Tobacco Settlement Rights | 1,577 | — | 1,577 | — |
| Special item – loan forgiveness | 159,271 | — | 159,271 | — |
| Transfers – internal activities of primary government | (1,379) | 1,379 | — | — |
| Total general revenue, special item, and transfers | 788,076 | 5,164 | 793,240 | 10,299 |
| Changes in net assets (deficit) | 138,281 | (12,785) | 125,496 | 4,188 |
| Net assets (deficit), beginning of year (as adjusted) | (507,972) | 82,393 | (425,579) | 624,914 |
| Net assets (deficit), end of year | $ (369,691) | 69,608 | (300,083) | 629,102 |

See accompanying notes to basic financial statements.

## GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS

Balance Sheet – Governmental Funds

September 30, 2003

(In thousands)

| Assets | | General | PFA Debt Service | Other governmental funds | Total governmental funds |
|---|---|---|---|---|---|
| Cash and cash equivalents | $ | 72,647 | — | 36,680 | 109,327 |
| Investments | | 102,201 | 128,571 | 67,862 | 298,634 |
| Receivables (net of allowance for uncollectible): | | | | | |
| Taxes | | 150,976 | 11,969 | — | 162,945 |
| Accrued interest and other | | 4,930 | — | 515 | 5,445 |
| Due from: | | | | | |
| Other funds | | 4,378 | — | 11,842 | 16,220 |
| Component units | | 22,797 | — | — | 22,797 |
| Federal government | | — | — | 22,703 | 22,703 |
| Other assets | | — | — | 2,546 | 2,546 |
| Total assets | $ | 357,929 | 140,540 | 142,148 | 640,617 |
| **Liabilities and Fund Balances** | | | | | |
| Accounts payable and accrued liabilities | $ | 38,512 | — | 13,586 | 52,098 |
| Tax refund payable | | 75,761 | — | — | 75,761 |
| Due to: | | | | | |
| Other funds | | 9,959 | 2,000 | 3,178 | 15,137 |
| Component units | | 5,231 | — | — | 5,231 |
| Deferred revenue | | 131,326 | 46,214 | 21,940 | 199,480 |
| Other current liabilities | | — | — | 1,380 | 1,380 |
| Total liabilities | | 260,789 | 48,214 | 40,084 | 349,087 |
| Fund balances reserved for: | | | | | |
| Encumbrances | | 44,839 | — | — | 44,839 |
| Debt service | | — | 92,326 | 10,456 | 102,782 |
| Unreserved fund balance, reported in: | | | | | |
| General fund | | 52,301 | — | — | 52,301 |
| Special revenue funds | | — | — | 47,586 | 47,586 |
| Capital projects funds | | — | — | 44,022 | 44,022 |
| Total fund balances | | 97,140 | 92,326 | 102,064 | 291,530 |
| Total liabilities and fund balances | $ | 357,929 | 140,540 | 142,148 | |
| 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. | | | | | 608,158 |
| Bond issue costs are not financial resources and, therefore, are not reported in the funds. | | | | | 3,211 |
| Because the focus of governmental funds is on short-term financing, some assets, primarily tax receivables, will not be available to pay for current period expenditures. Those assets are offset by deferred revenue in the funds. | | | | | 118,319 |
| Interest on long-term debt is not accrued in the funds, but rather is recognized as an expenditure when due. | | | | | (23,027) |
| Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds. | | | | | (1,367,882) |
| Deficit of governmental activities | | | | | $ (369,691) |

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, 2003

(In thousands)

| | General | PFA Debt Service | Other governmental funds | Total governmental funds |
|---|---|---|---|---|
| Revenue: | | | | |
| Taxes | $ 421,371 | 141,442 | 28,204 | 591,017 |
| Federal grants and contributions | — | 2,921 | 160,938 | 163,859 |
| Charges for services | 19,907 | — | 7,081 | 26,988 |
| Tobacco settlement rights | — | — | 1,577 | 1,577 |
| Interest and other | 25,599 | 4,683 | 3,709 | 33,991 |
| Total revenue | 466,877 | 149,046 | 201,509 | 817,432 |
| Expenditures: | | | | |
| Current: | | | | |
| General government | 254,110 | — | 83,666 | 337,776 |
| Public safety | 42,291 | — | 5,742 | 48,033 |
| Health | 70,106 | — | 26,013 | 96,119 |
| Public housing and welfare | 31,935 | — | 31,939 | 63,874 |
| Education | 149,538 | — | 29,544 | 179,082 |
| Transportation and communication | 23,193 | — | 6,230 | 29,423 |
| Culture and recreation | 5,554 | — | 3,745 | 9,299 |
| Capital outlays | — | — | 34,022 | 34,022 |
| Debt service: | | | | |
| Principal | — | 19,030 | 4,605 | 23,635 |
| Interest | — | 46,286 | 1,633 | 47,919 |
| Bond issuance costs | — | 1,625 | — | 1,625 |
| Total expenditures | 576,727 | 66,941 | 227,139 | 870,807 |
| Excess (deficiency) of revenue over (under) expenditures | (109,850) | 82,105 | (25,630) | (53,375) |
| Other financing sources (uses): | | | | |
| Bond anticipation note issued | 100,000 | — | — | 100,000 |
| Bonds issued | — | 2,345 | 18,500 | 20,845 |
| Transfers from other funds | 96,251 | 5,299 | 18,148 | 119,698 |
| Transfers to other funds | (18,148) | (80,501) | (22,428) | (121,077) |
| Premium on bonds issued | — | 1,516 | — | 1,516 |
| Total other financing sources (uses), net | 178,103 | (71,341) | 14,220 | 120,982 |
| Net change in fund balances | 68,253 | 10,764 | (11,410) | 67,607 |
| Fund balance, beginning of year | 28,887 | 81,562 | 113,474 | 223,923 |
| Fund balance, end of year | $ 97,140 | 92,326 | 102,064 | 291,530 |

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, 2003

(In thousands)

| | | |
|---|---|---|
| Net change in fund balances – total governmental funds | $ | 67,607 |
| 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. | | 15,189 |
| Tax revenue in the statement of activities that do not provide current financial resources are not reported as revenue in the funds. | | 3,599 |
| 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 $120,845 exceeded principal retirement of $23,635 in the current period. | | (97,210) |
| Forgiveness of FEMA loan that did not provide current financial resources to the governmental funds and, as such, is not reported as revenue in the funds. | | 159,271 |
| 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 exceeded expenses reported in the statement of activities that do not require the use of current financial resources. | | (8,570) |
| Bond issue costs are expended in the governmental funds when paid, and are capitalized and amortized in the statement of activities. This is the amount by which current year bond issue costs exceeded amortization expense in the current period. | | 1,237 |
| 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 $1,516 and the additional net interest expense of $1,653 reported in the statement of activities related to the amortization of premiums and discounts during the current year. | | (3,169) |
| 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 decrease in interest payable reported in the statement of net assets less the portion of accrued interest forgiven by FEMA and included with the loan forgiveness amount above. | | 327 |
| Change in net assets of governmental activities | $ | 138,281 |

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, 2003

(In thousands)

| | | Original budget | Amended budget | Actual | Variance |
|---|---|---|---|---|---|
| Revenue: | | | | | |
| Taxes | $ | 458,207 | 458,207 | 421,371 | (36,836) |
| Charges for services | | 9,796 | 9,796 | 19,907 | 10,111 |
| Interest and other | | 21,670 | 21,670 | 22,954 | 1,284 |
| Total revenue | | 489,673 | 489,673 | 464,232 | (25,441) |
| Expenditures: | | | | | |
| Current: | | | | | |
| General government | | 134,903 | 150,862 | 243,984 | (93,122) |
| Public safety | | 55,548 | 56,148 | 41,779 | 14,369 |
| Health | | 91,787 | 98,787 | 69,692 | 29,095 |
| Public housing and welfare | | 42,224 | 44,324 | 31,935 | 12,389 |
| Education | | 183,006 | 183,006 | 148,436 | 34,570 |
| Transportation and communication | | 56,286 | 78,902 | 22,040 | 56,862 |
| Culture and recreation | | 17,613 | 17,993 | 6,184 | 11,809 |
| Total expenditures | | 581,367 | 630,022 | 564,050 | 65,972 |
| Excess of expenditures over revenue | | (91,694) | (140,349) | (99,818) | 40,531 |
| Other financing sources (uses): | | | | | |
| Bond anticipation note issued | | — | 100,000 | 100,000 | — |
| Transfers from other fund | | 105,500 | 105,500 | 92,951 | (12,549) |
| Transfer to other fund | | (5,575) | (5,575) | (18,148) | (12,573) |
| Total other financing sources (uses) | | 99,925 | 199,925 | 174,803 | (25,122) |
| Excess of revenue and other financing sources (uses) over expenditures | $ | 8,231 | 59,576 | 74,985 | 15,409 |

See accompanying notes to basic financial statements.

**GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS**

Statement of Net Assets – Proprietary Funds

September 30, 2003

(In thousands)

| | Business-type activities – enterprise funds | | | |
|---|---|---|---|---|
| | **Unemployment insurance** | **West Indian Company** | **Other funds** | **Totals** |
| Assets: | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | $ 98 | 5,097 | 759 | 5,954 |
| Receivables, net: | | | | |
| Loans and advances | — | — | 5,417 | 5,417 |
| Accrued interest and other | — | 1,666 | 1,856 | 3,522 |
| Due from other funds | — | — | 300 | 300 |
| Inventories and other current assets | — | 886 | 435 | 1,321 |
| Total current assets | 98 | 7,649 | 8,767 | 16,514 |
| Noncurrent assets: | | | | |
| Restricted cash and cash equivalents | 38,633 | 1,738 | — | 40,371 |
| Capital assets | — | 35,851 | 7,157 | 43,008 |
| Deferred expenses | — | 553 | — | 553 |
| Total noncurrent assets | 38,633 | 38,142 | 7,157 | 83,932 |
| Total assets | 38,731 | 45,791 | 15,924 | 100,446 |
| Liabilities: | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued liabilities | — | 1,544 | 1,710 | 3,254 |
| Due to other funds | — | 1,000 | 906 | 1,906 |
| Unemployment insurance benefits | 3,663 | — | — | 3,663 |
| Loans payable related to capital assets | — | 735 | — | 735 |
| Total current liabilities | 3,663 | 3,279 | 2,616 | 9,558 |
| Noncurrent liabilities: | | | | |
| Loans payable related to capital assets | — | 21,280 | — | 21,280 |
| Total liabilities | 3,663 | 24,559 | 2,616 | 30,838 |
| Net assets: | | | | |
| Invested in capital assets, net of related debt | — | 13,836 | 7,157 | 20,993 |
| Restricted | 35,068 | 7,396 | — | 42,464 |
| Unrestricted | — | — | 6,151 | 6,151 |
| Total net assets | $ 35,068 | 21,232 | 13,308 | 69,608 |

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, 2003

(In thousands)

| | Business-type activities – enterprise funds | | | |
|---|---|---|---|---|
| | Unemployment insurance | West Indian Company | Other funds | Total |
| Operating revenue: | | | | |
| Charges for services | $ 2,223 | 9,950 | 17,417 | 29,590 |
| Total operating revenue | 2,223 | 9,950 | 17,417 | 29,590 |
| Operating expenses: | | | | |
| Cost of services | 19,664 | 6,166 | 19,008 | 44,838 |
| Depreciation and amortization | — | 1,227 | 435 | 1,662 |
| Total operating expenses | 19,664 | 7,393 | 19,443 | 46,500 |
| Operating (loss) income | (17,441) | 2,557 | (2,026) | (16,910) |
| Nonoperating revenue (expenses): | | | | |
| Gain on sale of assets | — | 218 | — | 218 |
| Interest income | 2,933 | 158 | 476 | 3,567 |
| Interest expense | — | (1,039) | — | (1,039) |
| Total nonoperating revenue (expenses), net | 2,933 | (663) | 476 | 2,746 |
| (Loss) income before operating transfers | (14,508) | 1,894 | (1,550) | (14,164) |
| Transfers from other funds | — | — | 2,379 | 2,379 |
| Transfers to other funds | — | (1,000) | — | (1,000) |
| Change in net assets | (14,508) | 894 | 829 | (12,785) |
| Net assets, beginning of year (as adjusted) | 49,576 | 20,338 | 12,479 | 82,393 |
| Net assets, end of year | $ 35,068 | 21,232 | 13,308 | 69,608 |

See accompanying notes to basic financial statements.

**GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS**

Statement of Cash Flows – Proprietary Funds

Year ended September 30, 2003

(In thousands)

| | | Business-type activities – enterprise funds | | | |
|---|---|---|---|---|---|
| | | Unemployment insurance | West Indian Company | Other funds | Total |
| Cash flows from operating activities: | | | | | |
| Receipts from customers and users | $ | — | 9,950 | 17,462 | 27,412 |
| Receipts from employers | | 2,223 | — | — | 2,223 |
| Payments to beneficiaries | | (24,611) | — | — | (24,611) |
| Payments to suppliers and employees | | — | (5,866) | (18,088) | (23,954) |
| Net cash (used in) provided by operating activities | | (22,388) | 4,084 | (626) | (18,930) |
| Cash flows from noncapital financing activities: | | | | | |
| Transfers (to) from other funds | | — | (500) | 2,672 | 2,172 |
| Net cash (used in) provided by noncapital financing activities | | — | (500) | 2,672 | 2,172 |
| Cash flows from capital and related financing activities: | | | | | |
| Acquisition and construction of capital assets | | — | (6,021) | (1,860) | (7,881) |
| Principal paid on long-term debt | | — | (20,809) | — | (20,809) |
| Proceeds from issuance of long-term debt | | — | 22,500 | — | 22,500 |
| Proceeds from sale of assets | | — | 614 | — | 614 |
| Interest paid on long-term debt | | — | (1,039) | — | (1,039) |
| Net cash used in capital and related financing activities | | — | (4,755) | (1,860) | (6,615) |
| Cash flows from investing activities: | | | | | |
| Interest and dividends on investments | | 2,933 | 97 | 476 | 3,506 |
| Net cash provided by investing activities | | 2,933 | 97 | 476 | 3,506 |
| Net decrease (increase) in cash and cash equivalents | | (19,455) | (1,074) | 662 | (19,867) |
| Cash and cash equivalents, beginning of year (as adjusted) | | 58,186 | 7,909 | 97 | 66,192 |
| Cash and cash equivalents, end of year | $ | 38,731 | 6,835 | 759 | 46,325 |
| Reconciliation of operating income (loss) to net cash (used in) provided by operating activities: | | | | | |
| Operating (loss) income | $ | (17,441) | 2,557 | (2,026) | (16,910) |
| Adjustments to reconcile operating income (loss) to net cash (used in) provided by operating activities: | | | | | |
| Depreciation and amortization | | — | 1,227 | 435 | 1,662 |
| Change in assets and liabilities: | | | | | |
| Receivables, net | | — | — | 47 | 47 |
| Deferred charges | | — | 71 | — | 71 |
| Accounts payable and accrued expenses | | — | 229 | 918 | 1,147 |
| Other liabilities | | (4,947) | — | — | (4,947) |
| Net cash (used in) provided by operating activities | $ | (22,388) | 4,084 | (626) | (18,930) |
| Reconciliation of cash and cash equivalents to the statement of net assets: | | | | | |
| Cash and cash equivalents | $ | 98 | 5,097 | 759 | 5,954 |
| Restricted cash and cash equivalents | | 38,633 | 1,738 | — | 40,371 |
| Cash and cash equivalents at end of year on statement of cash flows | $ | 38,731 | 6,835 | 759 | 46,325 |

See accompanying notes to basic financial statements.

**GOVERNMENT OF THE UNITED STATES VIRGIN ISLANDS**

Statement of Fiduciary Net Assets – Fiduciary Funds

September 30, 2003

(In thousands)

| | | Pension trust funds | Agency funds |
|---|---|---|---|
| Assets: | | | |
| Cash and cash equivalents: | | | |
| Unrestricted | $ | 138,175 | — |
| Restricted | | 110 | — |
| Investments | | 1,274,662 | 2,925 |
| Receivables, net: | | | |
| Loans and advances | | 105,500 | — |
| Accrued interest | | 3,967 | — |
| Other | | 34,993 | — |
| Due from other funds | | 523 | — |
| Other assets | | 12,912 | — |
| Total assets | | 1,570,842 | 2,925 |
| Liabilities: | | | |
| Accounts payable and accrued liabilities | | — | 2,925 |
| Cash overdraft with the Department of Finance | | 10,454 | — |
| Cash overdraft with bank | | 5,593 | — |
| Unsettled securities purchased | | 91,827 | — |
| Securities lending collateral | | 169,682 | — |
| Line of credit | | 10,000 | — |
| Other liabilities | | 7,510 | — |
| Total liabilities | | 295,066 | 2,925 |
| Net assets held in trust for employees' pension benefits | $ | 1,275,776 | — |

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, 2003

(In thousands)

| | | Pension trust funds |
|---|---|---|
| Additions: | | |
| Contributions: | | |
| Employer | $ | 51,588 |
| Plan members | | 30,509 |
| Total contributions | | 82,097 |
| Investment income: | | |
| Net appreciation of fair value of investments | | 131,112 |
| Appreciation in Havensight Mall | | 25,398 |
| Interest, dividends, and other, net | | 37,460 |
| Real estate – rental income (net of related expenses) | | 3,096 |
| | | 197,066 |
| Less investment expense | | 5,000 |
| Net investment income | | 192,066 |
| Other income | | 2,598 |
| Total additions | | 276,761 |
| Deductions: | | |
| Benefits paid | | 126,797 |
| Refunds of contributions | | 2,894 |
| Administrative and operational expenses | | 8,268 |
| Total deductions | | 137,959 |
| Change in net assets | | 138,802 |
| Net assets, beginning of year | | 1,136,974 |
| Net assets, end of year | $ | 1,275,776 |

See accompanying notes to basic financial statements.

## (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 accounting principles generally accepted in the United States of America (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* (GASB No. 14). This standard requires 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.

#### 1. 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 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 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, V.I. 00802

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

**(2) Discretely Presented Component Units**

The following component units, consistent with GASB No. 14, 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.

**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.

***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, 10 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, 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.

***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



(Continued)

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).

**Nonmajor Component Units**

***Virgin Islands Economic Development Authority***

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

***Magens' Bay Authority***

Magens' Bay Authority (MBA) was created as a corporate instrumentality by Act No. 2085 on December 20, 1967, with the purpose of acquiring, improving, and operating parks and beaches. The powers of MBA are exercised by a board of directors consisting of the Governor and six members appointed by the board of directors.

***Virgin Islands Government Hospital and Health Facilities Corporation***

The Virgin Islands Government Hospital and Health Facilities Corporation (VIGHHFC) was created by Act No. 6012 on August 23, 1994 and became active on May 1, 1999. Its purpose is to provide healthcare services and hospital facilities to the people of the U. S. Virgin Islands. The powers of VIGHHFC are exercised by a board of directors consisting of 15 members as follows: the Director of the Office of Management and Budget, the Commissioner of Finance, and 13 other members appointed by the Governor with the advice and consent of the Legislature. The VIGHHFC is composed of the Roy L. Schneider Hospital located in St. Thomas and the Juan F. Luis Hospital and Medical Center located in St. Croix. Both entities issue separate audited financial statements.

***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**

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

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

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

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

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



(Continued)

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

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

Virgin Islands Housing Authority
42 Annas Retreat
St. Thomas, V.I. 00802

Virgin Islands Housing Finance Authority
210-3A Altona
Frostco Center Building
St. Thomas, V.I. 00802

All financial statements of the discretely presented component units have a fiscal year-end of September 30, 2003, except for WAPA and VIHA that have a year-end of June 30, 2003 and December 31, 2002, respectively.

**(3) Fiduciary Component Units**

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

***Employees' Retirement System of the Government of the Virgin Islands***

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

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, V.I. 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.

### *(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.



(Continued)

***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.

***(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. The new model as defined in 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 Fund*** – The PFA Debt Service Fund 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.

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

**Fiduciary Funds**

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

- ***Pension Trust Fund Accounts*** – 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 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 marketable 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*

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

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

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

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 (see note 7).

### (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 which have an initial, individual cost of and a useful life 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 life of 40 and 20 years, respectively; (iii) $100,000 for land improvements; and (iv) $200,000 for infrastructure with an estimated useful life of 30 years. The value of land 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 Revenue*

Deferred revenue at the governmental fund level arises when potential revenue does not meet both the "measurable" and "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. Deferred 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 consists 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.

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 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, 5,042 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. During the year ended September 30, 2003, the cost of providing healthcare benefits amounted to approximately $18.9 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, 2003, the Government had accrued compensated absences amounting to $52.4 million, including related benefits, of which $30.6 million was included in current liabilities in the government-wide financial statements.

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

Compensated absences accumulation policies for the blended component units, the public university funds, 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 that are reported when incurred as "operating transfers from" by the recipient fund, and as "operating transfers to" by the disbursing fund.
- ***Intra-entity Transactions*** – These are transactions between the PG and its component units, and among the component units. Transfers between the PG and its blended component units are reported as interfund transfers, except for transfers within the same fund type. Similarly, receivables and payables between the PG and its blended component units are reported as amounts due to, and due from other funds. Balances and transfers between the PG and



(Continued)

discretely presented component units (and among those component units) are reported separately.

***(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. For workmen's compensation, the Government has an enterprise fund that provides workmen's 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, 2003.

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



(Continued)

### *(t) Future Adoption of Accounting Requirements*

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

| Statement number | | Adoption required in fiscal year |
|---|---|---|
| 39 | Determining Whether Certain Organizations Are Component Units – An Amendment of GASB Statement No. 14 | 2004 |
| 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 |
| 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 |

The impact of these statements has not yet been determined.

### *(u) Reclassifications*

The presentation of the separately issued financial statements of certain component units have been reclassified to conform to the account classifications used by the Government in the 2003 basic financial statements.

### *(v) Use of Estimates*

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

- University of the Virgin Islands
- Virgin Islands Port Authority

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

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

| Information on net assets | Virgin Islands Housing Authority | Virgin Islands Port Authority | Virgin Islands Water and Power Authority Electric System | Virgin Islands Water and Power Authority Water System | University of the Virgin Islands | Other entities | Total component units |
|---|---|---|---|---|---|---|---|
| Assets: | | | | | | | |
| Current assets | $ 5,980 | 15,988 | 53,057 | 17,871 | 41,854 | 42,298 | 177,048 |
| Due from primary government | — | 746 | — | — | 4,338 | 147 | 5,231 |
| Due from federal government | 4,000 | 788 | — | — | 2,176 | 200 | 7,164 |
| Restricted assets | 278 | 29,668 | 80,143 | 8,586 | 10,942 | 11,900 | 141,517 |
| Capital assets, net | 71,021 | 251,033 | 170,193 | 50,132 | 42,596 | 137,121 | 722,096 |
| Deferred expenses | — | 1,858 | 9,752 | 925 | — | — | 12,535 |
| Total assets | 81,279 | 300,081 | 313,145 | 77,514 | 101,906 | 191,666 | 1,065,591 |
| Liabilities and net assets: | | | | | | | |
| Current liabilities | 9,133 | 10,806 | 44,208 | 7,277 | 10,174 | 24,306 | 105,904 |
| Due to primary government | — | — | — | — | — | 22,797 | 22,797 |
| Due to federal government | — | — | 5,300 | — | — | — | 5,300 |
| Bonds payable | — | 35,738 | 167,673 | 36,415 | 23,533 | 6,485 | 269,844 |
| Loans payable | — | 913 | — | — | 3,540 | 947 | 5,400 |
| Other noncurrent liabilities | 5,538 | — | — | — | 132 | 21,574 | 27,244 |
| Total liabilities | 14,671 | 47,457 | 217,181 | 43,692 | 37,379 | 76,109 | 436,489 |
| Net assets: | | | | | | | |
| Invested in capital assets – net of related debt | 71,021 | 235,320 | 64,371 | 14,642 | 22,986 | 125,850 | 534,190 |
| Restricted | — | 2,758 | 20,455 | 7,581 | 30,526 | 4,718 | 66,038 |
| Unrestricted (deficit) | (4,413) | 14,546 | 11,138 | 11,599 | 11,015 | (15,011) | 28,874 |
| Total net assets | $ 66,608 | 252,624 | 95,964 | 33,822 | 64,527 | 115,557 | 629,102 |



(Continued)

| Information on statements of activities | Expenses | Program revenue: Charges for services | Operating grants and contributions | Capital grants and contributions | Total component units |
|---|---|---|---|---|---|
| Virgin Islands Housing Authority | $ 59,607 | 3,258 | 46,395 | 5,885 | (4,069) |
| Virgin Islands Port Authority | 43,660 | 35,565 | 15,163 | — | 7,068 |
| Virgin Islands Water and Power Authority: | | | | | |
| Electric system | 129,994 | 134,459 | — | 349 | 4,814 |
| Water system | 30,505 | 26,395 | — | 485 | (3,625) |
| University of the Virgin Islands | 56,672 | 10,753 | 40,099 | 3,074 | (2,746) |
| Other entities | 118,999 | 56,359 | 47,271 | 7,816 | (7,553) |
| Total activities | $ 439,437 | 266,789 | 148,928 | 17,609 | (6,111) |
| General revenue: | | | | | |
| Interest and other | | | | | 10,299 |
| Changes in net assets | | | | | 4,188 |
| Net assets, beginning of year | | | | | 624,914 |
| Net assets, end of year | | | | | $ 629,102 |

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

Act No. 6587, approved on July 24, 2003, authorized the issuance of debt to finance vendor payments and tax refunds in an amount up to $100 million. On September 4, 2003, the PG issued $100 million in Bond Anticipation Notes to finance its working capital needs as provided in Act No. 6587 (see note 9).

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 deficiency of revenue and other financing sources over expenditures and other financing uses for the year ended September 30, 2003 is presented below (expressed in thousands):

| | | |
|---|---|---|
| Excess of revenue and other financing sources (uses) over expenditures – budget basis | $ | 74,985 |
| Timing difference – change in encumbrances | | (10,080) |
| Entity difference – deficiency of revenue and other financing sources over expenditures and other financing uses – activities with budgets not legally adopted | | 3,348 |
| Excess of revenue and other financing sources (uses) over expenditures – GAAP basis | $ | 68,253 |

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.

### (c) *Deficit Fund Equity*

As of September 30, 2003, fund deficits exceeding 10% of the total assets were reported in the following funds (expressed in thousands):

| | |
|---|---|
| Nonmajor governmental fund: | |
| Paternity and child support | $ 11,649 |
| Nonmajor proprietary fund: | |
| Reciprocal insurance fund | $ 9,673 |

## (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, 2003, 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, 2003, the PG, discretely presented component units and fiduciary funds and has 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, 2003, were as follows (expressed in thousands):

**Primary Government – Investments**

| | Category | | | Reported |
|---|---|---|---|---|
| | 1 | 2 | 3 | amount |
| Commercial paper | $ 107,752 | — | — | 107,752 |
| Certificates of deposit | 41,949 | — | — | 41,949 |
| Federal Home Loan Bank | 1,782 | — | — | 1,782 |
| | $ 151,483 | — | — | 151,483 |
| Investments not categorized: | | | | |
| Mutual funds | | | | 147,151 |
| Total investments | | | | $ 298,634 |

**Discretely Presented Component Units – Investments**

| | Category 1 | Category 2 | Category 3 | Reported amount |
|---|---|---|---|---|
| U.S. government and agency securities | $ 104,396 | — | — | 104,396 |
| Common stocks | 1,433 | — | — | 1,433 |
| Corporate bonds | 3,829 | — | — | 3,829 |
| Certificates of deposit | 1,237 | — | 3,141 | 4,378 |
| Money market funds | 138 | — | — | 138 |
| Investment contracts | 306 | — | — | 306 |
| Mortgage-backed securities | — | 5,496 | — | 5,496 |
| Other investments | — | 1,610 | — | 1,610 |
| | $ 111,339 | 7,106 | 3,141 | 121,586 |
| Investments not subject to classification: | | | | |
| Mutual funds | | | | 21,376 |
| Total investments | | | | $ 142,962 |

The investment balance consists of the following:

| | |
|---|---|
| Unrestricted | $ 26,530 |
| Restricted | 116,432 |
| Total investments | $ 142,962 |

**Fiduciary Funds – Investments**

| | Category 1 | Category 2 | Category 3 | Reported amount |
|---|---|---|---|---|
| U.S. government and agency securities | $ 66,787 | — | — | 66,787 |
| Corporate obligations | 61,132 | — | — | 61,132 |
| Foreign bonds | 81,953 | — | — | 81,953 |
| Certificates of deposit | 2,925 | — | — | 2,925 |
| Common stocks – U.S. | 578,223 | — | — | 578,223 |
| Common stocks – foreign | 98,930 | — | — | 98,930 |
| Collateralized debt obligations | 142,535 | — | — | 142,535 |
| | $ 1,032,485 | — | — | 1,032,485 |
| Investments not categorized: | | | | |
| Investments held by broker – dealers under security loans: | | | | |
| U.S. government and agency securities | | | | 120,945 |
| Common stocks – U.S. | | | | 30,730 |
| Common stocks – foreign | | | | 18,008 |
| Mutual funds | | | | 4,361 |
| Real estate | | | | 71,058 |
| Total investments | | | | $ 1,277,587 |

The investment balance consists of the following:

| | |
|---|---|
| Pension Trust funds | $ 1,274,662 |
| Agency funds | 2,925 |
| Total investments | $ 1,277,587 |



(Continued)

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 $26.4 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, 2003, 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 | $ | (3,374) |
| Corporate bonds – U.S. | | 2,920 |
| Corporate bonds – foreign | | 14,795 |
| Common stocks – U.S. | | 94,797 |
| Common stocks – foreign | | 17,654 |
| Collaterized debt obligations | | 2,493 |
| Mutual funds | | 1,827 |
| Net appreciation of fair value of investments | $ | 131,112 |

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. The Government does not have the ability to pledge or sell collateral securities delivered absent a borrower default. No restrictions were imposed during 2003 as to the amount of loans the Custodian can make on behalf of the Government, and the Custodian indemnified the Government for losses attributable to violations by the Custodian of the "Standard of Care" clause described in the Agreement. There were no such violations during the fiscal year 2003. In addition, there were no losses during the fiscal year resulting from the default of the borrowers or the Custodian.

Loans are generally terminable on demand. The system may be exposed to off-balance sheet risk in the event a borrower is unable to meet its contractual obligation. The Custodian must receive collateral at a minimum 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, 2003, approximately $165.7 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, 2003, such investment pool had an average duration of 68 days and an average weighted maturity of 482 days. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral.



(Continued)

## (5) Receivables

Receivables at September 30, 2003 consist of the following (expressed in thousands):

| | General fund | PFA debt service fund | Other governmental funds | Total |
|---|---|---|---|---|
| Income taxes | $ 102,058 | — | — | 102,058 |
| Real property taxes | 48,918 | — | — | 48,918 |
| Gross receipts taxes | — | 11,969 | — | 11,969 |
| Tax receivables | $ 150,976 | 11,969 | — | 162,945 |
| Accrued interest and other current receivables | $ 4,930 | — | 515 | 5,445 |
| Other long-term receivables — tobacco taxes | | | | 826 |
| Total receivables — government-wide | | | | $ 169,216 |

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 15$^{th}$ 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



(Continued)

and schedule of collections for each parcel of real property that is used by the Department of Finance, as the basis for issuing tax bills to all taxpayers in the U.S. Virgin Islands.

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

For fiscal year 2003, property tax assessments were not issued until August 20, 2003, were due on or before October 31, 2003, and penalties were assessed if not paid by November 30, 2003. The delay in assessment was due to a District Court injunction imposed in connection with a property tax lawsuit. Assessments for 2003 were made at the 1998 level to comply with a District Court order.

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, 2003, consist of the following (expressed in thousands):

| | | |
|---|---|---|
| Utility receivable | $ | 28,541 |
| Port fees | | 2,634 |
| Students | | 2,960 |
| Patients | | 17,022 |
| Other | | 392 |
| Total | $ | 51,549 |

Loans and advances receivable at September 30, 2003, consist of the following (expressed in thousands):

| | | Primary government business-type activities | Fiduciary funds pension trust | Component units |
|---|---|---|---|---|
| Mortgage loans | $ | 9,625 | 24,250 | — |
| Personal loans | | — | 83,040 | — |
| Other loans and advances | | 963 | 1,210 | 2,475 |
| Subtotal | | 10,588 | 108,500 | 2,475 |
| Less allowance for uncollectible accounts | | (5,171) | (3,000) | — |
| Loans and advances, net | $ | 5,417 | 105,500 | 2,475 |



(Continued)

## (6) Interfund Transactions

### *(a) Operating Transfers*

Operating 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 $80.5 million transfer from the debt service fund representing tax revenue in excess of bond service requirements and a $14.8 million transfer from the nonmajor governmental funds primarily representing $12.0 million of property tax revenue in excess of debt service requirements and $2.0 million of transfers from the land bank fund, and $1 million from WICO related to payment in lieu of tax. Transfers to nonmajor governmental funds consisted of $11 million from the general fund to the VI Wastewater Fund to be used for the construction of a water treatment plant and $3.5 million to the Emergency Molasses Fund to be used for molasses subsidies provided to local rum producers.

Interfund transfers for the year ended September 30, 2003 consisted of the following (expressed in thousands):

| Transfer to | | General fund | PFA Debt Service fund | Nonmajor governmental funds | Enterprise fund – West Indian Company | Nonmajor enterprise funds | Total |
|---|---|---|---|---|---|---|---|
| General fund | $ | — | 80,501 | 14,750 | 1,000 | — | 96,251 |
| PFA Debt Service fund | | — | — | 5,299 | — | — | 5,299 |
| Nonmajor governmental | | 18,148 | — | — | — | — | 18,148 |
| Nonmajor enterprise | | — | — | 2,379 | — | — | 2,379 |
| Total | $ | 18,148 | 80,501 | 22,428 | 1,000 | — | 122,077 |
| **Transfer from** | | | | | | | |
| General fund | $ | — | — | 18,148 | — | — | 18,148 |
| PFA Debt Service fund | | 80,501 | — | — | — | — | 80,501 |
| Nonmajor governmental | | 14,750 | 5,299 | — | — | 2,379 | 22,428 |
| Enterprise fund – West Indian Company | | 1,000 | — | — | — | — | 1,000 |
| Total | $ | 96,251 | 5,299 | 18,148 | — | 2,379 | 122,077 |



(Continued)

### *(b) Due From/To Other Funds*

The following table summarizes interfund receivables and payables at September 30, 2003 (expressed in thousands):

| Due to | General fund | PFA Debt Service fund | Nonmajor governmental funds | Enterprise fund – West Indian Company | Nonmajor enterprise funds | Pension trust fund |
|---|---|---|---|---|---|---|
| General fund | $ — | — | 3,178 | 1,000 | 200 | — |
| Nonmajor governmental | 9,136 | 2,000 | — | — | 706 | — |
| Total governmental funds | 9,136 | 2,000 | 3,178 | 1,000 | 906 | — |
| Proprietary fund – nonmajor enterprise | 300 | — | — | — | — | — |
| Fiduciary funds – pension trust fund | 523 | — | — | — | — | — |
| Total | $ 9,959 | 2,000 | 3,178 | 1,000 | 906 | — |
| **Due from** | | | | | | |
| General fund | $ — | — | 9,136 | — | 300 | 523 |
| PFA Debt Service fund | — | — | 2,000 | — | — | — |
| Nonmajor governmental | 3,178 | — | — | — | — | — |
| Total governmental funds | 3,178 | — | 11,136 | — | 300 | 523 |
| Enterprise fund – West Indian Company | 1,000 | — | — | — | — | — |
| Nonmajor enterprise | 200 | — | 706 | — | — | — |
| Total proprietary funds | 1,200 | — | 706 | — | — | — |
| Total | $ 4,378 | — | 11,842 | — | 300 | 523 |

The due from/to other funds include $4.9 million due from the general fund to the Emergency Molasses Fund (nonmajor governmental fund) from unpaid appropriations. Other balances composing the due from/to other funds include $2.7 million from the Bond Proceeds Fund (nonmajor governmental fund) to the general fund, $1 million from WICO (nonmajor enterprise fund) to the general fund and $2 million from the PFA Debt Service Fund to PFA Operating Fund (nonmajor governmental fund).

The due to PG balance reported by the discretely presented component units is composed of $18.6 million due from VIGHHFC and $4.2 million due from VIHFA, both discretely presented component units. These receivables exist because a portion of payroll expenditures that the Government processes are ultimately the responsibility of these component units. The due from PG reported by the discretely presented component units is mainly composed of $4.3 million and $746 thousand due to the University and VIPA, respectively.

## (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 | $ | 38,633 |
| WICO debt service funds | | 1,738 |
| Total restricted assets of proprietary funds and business-type activities | $ | 40,371 |

### *(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 | $ | 14,935 |
| Construction funds | | 84 |
| Endowment funds | | 4,958 |
| HUD project funds | | 278 |
| Revolving loan funds | | 4,560 |
| Other | | 151 |
| Total cash and cash equivalents | | 24,966 |
| Investments: | | |
| Debt service and sinking fund requirements | | 42,694 |
| Construction funds | | 54,765 |
| Endowment funds | | 5,984 |
| Renewal and replacement funds | | 5,883 |
| Revolving loan funds | | 7,106 |
| Total investments | | 116,432 |
| Other: | | |
| Accrued interest receivable | | 119 |
| Total restricted assets of component units | $ | 141,517 |

## (8) Capital Assets

### *(a) Primary Government*

The capital assets activity for the governmental-type activities funds for the year ended September 30, 2003, is summarized as follows (expressed in thousands):

| | Beginning balance | Additions | Reductions | Ending balance |
|---|---|---|---|---|
| Capital assets, not being depreciated: | | | | |
| Land | $ 183,630 | 895 | — | 184,525 |
| Construction in progress | 5,544 | 408 | 1,906 | 4,046 |
| Total capital assets, not depreciated | 189,174 | 1,303 | 1,906 | 188,571 |
| Capital assets, being depreciated: | | | | |
| Land improvements | 3,557 | 27 | — | 3,584 |
| Infrastructure | 103,170 | 18,243 | — | 121,413 |
| Buildings and improvements | 390,630 | 9,679 | — | 400,309 |
| Machinery and equipment | 63,438 | 6,676 | 326 | 69,788 |
| Total capital assets, being depreciated | 560,795 | 34,625 | 326 | 595,094 |
| Less accumulated depreciation for: | | | | |
| Land improvements | 1,307 | 187 | — | 1,494 |
| Infrastructure | 8,990 | 4,468 | — | 13,458 |
| Buildings and improvements | 114,487 | 6,653 | — | 121,140 |
| Machinery and equipment | 32,216 | 7,420 | 221 | 39,415 |
| Total accumulated depreciation | 157,000 | 18,728 | 221 | 175,507 |
| Total capital assets, being depreciated, net | 403,795 | 15,897 | 105 | 419,587 |
| Governmental-type activities capital assets, net | $ 592,969 | 17,200 | 2,011 | 608,158 |

Capital assets activity for the business-type activities for the year ended as of September 30, 2003, is summarized as follows (expressed in thousands):

| | Beginning balance (as adjusted) | Additions | Reductions | Ending balance |
|---|---|---|---|---|
| Capital assets, not being depreciated: | | | | |
| Land and land improvements | $ 5,375 | — | 17 | 5,358 |
| Construction in progress | 1,119 | — | 397 | 722 |
| Total capital assets, not depreciated | 6,494 | — | 414 | 6,080 |
| Capital assets, being depreciated: | | | | |
| Buildings and improvements | 38,859 | 7,631 | — | 46,490 |
| Machinery and equipment | 2,451 | 249 | 115 | 2,585 |
| Total capital assets, being depreciated | 41,310 | 7,880 | 115 | 49,075 |
| Less accumulated depreciation for: | | | | |
| Buildings and improvements | 7,430 | 1,104 | — | 8,534 |
| Machinery and equipment | 3,189 | 558 | 134 | 3,613 |
| Total accumulated depreciation | 10,619 | 1,662 | 134 | 12,147 |
| Total capital assets, being depreciated, net | 30,691 | 6,218 | (19) | 36,928 |
| Business-type activities capital assets, net | $ 37,185 | 6,218 | 395 | 43,008 |

Depreciation and amortization expense was charged to functions/programs of the PG for the year ended September 30, 2003, as follows (expressed in thousands):

| | | |
|---|---|---|
| Governmental activities: | | |
| General government | $ | 4,255 |
| Public safety | | 1,361 |
| Health | | 1,124 |
| Education | | 7,211 |
| Transportation and communication | | 4,777 |
| Total depreciation expense – governmental activities | $ | 18,728 |
| Business-type activities: | | |
| WICO (major enterprise fund) – depreciation and amortization | $ | 1,227 |
| Nonmajor enterprise funds – depreciation | | 435 |
| Total depreciation and amortization- business-type activities | $ | 1,662 |

The capital assets activity for the discretely presented component units for the year ended September 30, 2003, is summarized as follows (expressed in thousands):

| | Beginning balance | Additions | Reductions | Ending balance |
|---|---|---|---|---|
| Capital assets, not being depreciated: | | | | |
| Land | $ 77,677 | 16,112 | — | 93,789 |
| Construction in progress | 32,735 | 45,550 | 26,171 | 52,114 |
| Total capital assets, not depreciated | 110,412 | 61,662 | 26,171 | 145,903 |
| Capital assets being depreciated: | | | | |
| Buildings and improvements | 1,109,609 | 27,293 | 14,067 | 1,122,835 |
| Airport and marine terminal facilities | 84,487 | 12,427 | — | 96,914 |
| Personal property and equipment | 85,145 | 6,015 | 857 | 90,303 |
| Total capital assets being depreciated | 1,279,241 | 45,735 | 14,924 | 1,310,052 |
| Less accumulated depreciation: | | | | |
| Buildings and improvements | (579,795) | 39,642 | 2,407 | (617,030) |
| Airport and marine terminal facilities | (57,195) | 3,612 | — | (60,807) |
| Personal property and equipment | (48,283) | 8,496 | 757 | (56,022) |
| Total accumulated depreciation | (685,273) | 51,750 | 3,164 | (733,859) |
| Total capital assets being depreciated, net | 593,968 | (6,015) | 11,760 | 576,193 |
| Component unit capital assets, net | $ 704,380 | 55,647 | 37,931 | 722,096 |



(Continued)

Depreciation expense charged to each component unit for the year ended September 30, 2003 was as follows (expressed in thousands):

| | | |
|---|---|---|
| Virgin Islands Housing Authority | $ | 9,365 |
| Virgin Islands Port Authority | | 12,947 |
| Virgin Islands Water and Power Authority: | | |
| Electric system | | 13,644 |
| Water system | | 2,566 |
| University of the Virgin Islands | | 3,707 |
| Other component units | | 9,521 |
| Total depreciation – component units | $ | 51,750 |

## (9) Long-Term Liabilities

Long-term liabilities activities for the year ended September 30, 2003, were as follows (expressed in thousands):

| | Beginning balance | Additions | Reductions | Debt forgiveness | Ending balance | Amounts due within one year | Amounts due thereafter |
|---|---|---|---|---|---|---|---|
| Governmental activities: | | | | | | | |
| Bonds payable: | | | | | | | |
| 1998 Series Revenue and Refunding Bonds | $ 499,495 | — | (12,525) | — | 486,970 | 13,225 | 473,745 |
| 1999 Project Revenue Bonds | 7,295 | — | (2,785) | — | 4,510 | 2,960 | 1,550 |
| 1999 General Obligation Bonds, Series A | 7,260 | — | (780) | — | 6,480 | 830 | 5,650 |
| 1999 Series A Revenue Bonds | 292,180 | — | (4,305) | — | 287,875 | 4,540 | 283,335 |
| 2001 Series A, Tobacco Bonds | 23,685 | — | (1,040) | — | 22,645 | — | 22,645 |
| 2002 Series Garvee Bonds | — | 20,845 | (2,200) | — | 18,645 | 2,805 | 15,840 |
| Subtotal bonds payable | 829,915 | 20,845 | (23,635) | | 827,125 | 24,360 | 802,765 |
| Less: | | | | | | | |
| Deferral on refundings | (3,696) | — | 616 | — | (3,080) | (616) | (2,464) |
| Bonds premium | — | 1,516 | (217) | — | 1,299 | 217 | 1,082 |
| Bonds discount | (10,949) | — | 948 | — | (10,001) | (948) | (9,053) |
| Bonds accretion | (1,723) | — | 305 | — | (1,418) | (319) | (1,099) |
| Total bonds payable, net | 813,547 | 22,361 | (21,983) | — | 813,925 | 22,694 | 791,231 |
| Loans payable: | | | | | | | |
| Bond Anticipation Note | — | 100,000 | — | — | 100,000 | 100,000 | — |
| Marilyn CDL | 127,200 | — | — | (127,200) | — | — | — |
| Total loans payable | 127,200 | 100,000 | — | (127,200) | 100,000 | 100,000 | — |
| Other liabilities: | | | | | | | |
| Accrued compensated absences | 54,002 | 5,424 | (7,068) | — | 52,358 | 30,561 | 21,797 |
| Retroactive union arbitration | 368,512 | 6,740 | — | — | 375,252 | — | 375,252 |
| Litigation | 4,171 | 9,064 | — | — | 13,235 | 51 | 13,184 |
| Accrued disallowed costs | 18,704 | — | (5,592) | — | 13,112 | — | 13,112 |
| Total other liabilities | 445,389 | 21,228 | (12,660) | — | 453,957 | 30,612 | 423,345 |
| Total governmental activities | $ 1,386,136 | 143,589 | (34,643) | (127,200) | 1,367,882 | 153,306 | 1,214,576 |
| Business-type activities: | | | | | | | |
| Notes payable: | | | | | | | |
| WICO | $ 20,324 | 22,500 | (20,809) | — | 22,015 | 735 | 21,280 |
| Fiduciary activities: | | | | | | | |
| Line of credit | | | | | | | |
| GERS Pension Trust | $ — | 10,000 | — | — | 10,000 | 10,000 | — |

Accrued compensated absences, retroactive union arbitration liabilities, and litigation reserves 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 either the general fund or the grant funds.

### *(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 1574a (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 1574a. 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.

### (b) *Bonds Payable*

Bonds payable outstanding at September 30, 2003, are comprised of the following (expressed in thousands):

**Primary Government – Bonds Payable**

| Bonds payable | Final maturity | Interest rates | | Balance |
|---|---|---|---|---|
| 1998 Series A, B, C, D, and E revenue and refunding bonds | 2023 | 5.50% to 7.11% | $ | 486,970 |
| 1999 Project revenue bonds | 2005 | 6.25% | | 4,510 |
| 1999 Series A general obligation bonds | 2010 | 6.50% | | 6,480 |
| 1999 Series A revenue bonds | 2033 | 4.20% to 6.40% | | 287,875 |
| 2001 Series A tobacco bonds | 2031 | 5% | | 22,645 |
| 2002 Series revenue bonds | 2009 | 2.50% to 5.00% | | 18,645 |
| Subtotal | | | | 827,125 |
| Less: | | | | |
| Deferred amount on refundings | | | | (3,080) |
| Bonds premium | | | | 1,299 |
| Bonds discount | | | | (10,001) |
| Bonds accretion | | | | (1,418) |
| Total | | | $ | 813,925 |

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 economic gain obtained by this advance refunding is the difference between the present value of old debt service requirements and the new debt service. This refunding resulted in a debt service saving of approximately $40 million and an economic gain of approximately $19 million.

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, 2003, $205.6 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, 2003, $171.6 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 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

(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 $107.8 million for the year ended September 30, 2003.

On November 20, 2001, TSFC issued Tobacco Settlement Asset-Backed Bonds amounting to $21.7 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 $15^{th}$ and November $15^{th}$.

Bonds payable at September 30, 2003, amounted to $23 million with accumulated accretion of $1.4 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, 2003, resulted in early redemption of $1.04 million during fiscal year 2003.



(Continued)

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, 2003, the outstanding 2002 Revenue Bonds amounted to $18.6 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 up-front payment of $8.3 million was received by PFA on behalf of the primary Government. The Government has deferred the recognition of revenue from the $8.3 million received in advance, and is amortizing it into income using the straight-line method which approximates the effective-interest method through October 1, 2010 which is the exercise date of the swaption. The proceeds received in advance is restricted for capital projects. As of September 30, 2003, PFA had expended $1.4 million of the up-front payment.

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 (5.27%) was set at a rate that, when added to an assumption for remarketing and liquidity costs, will approximate the coupons of the "refunded" bonds. The swap's variable payment would be 64% of the LIBOR.

As of September 30, 2003, the swap had a negative fair value of approximately $18,960,000 in favor of the counterparty estimated using the zero-coupon method. This method calculated the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipated future spot interest rates. These payments were then discounted using the spot rates implied by the current yield curve for the hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

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.

Debt service requirements at September 30, 2003, 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: | | | | | | | | | | |
| 2004 | $ — | 15,821 | 9,480 | 3,313 | 3,745 | 1,442 | — | 4,441 | 13,225 | 25,017 |
| 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 |
| 2009-2013 | 56,930 | 73,343 | 12,455 | 343 | 4,915 | 147 | 30,095 | 28,715 | 104,395 | 102,548 |
| 2014-2018 | 51,545 | 54,260 | — | — | — | — | 76,335 | 19,362 | 127,880 | 73,622 |
| 2019-2023 | 142,495 | 32,610 | — | — | — | — | — | 6,581 | 142,495 | 39,191 |
| 2024-2028 | 38,105 | 5,359 | — | — | — | — | — | 245 | 38,105 | 5,604 |
| 2029-2033 | — | — | — | — | — | — | — | — | — | — |
| Total | $ 289,075 | 244,677 | 65,410 | 11,342 | 26,055 | 4,934 | 106,430 | 84,388 | 486,970 | 345,341 |

| | General Obligation Bonds Series 1999 A | | Project Revenue Bonds Series 1999 | | Revenue Bonds Series A 1999 | | Tobacco Bonds Series A 2001 | | Garvee Bonds Series 2002 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Principal | Interest | Principal | Interest | Principal | Interest | Principal | Interest | Principal | Interest |
| Year: | | | | | | | | | | |
| 2004 | $ 830 | 408 | 2,960 | 236 | 4,540 | 17,703 | — | 715 | 2,805 | 890 |
| 2005 | 885 | 353 | 1,550 | 48 | 4,765 | 17,470 | — | 705 | 2,900 | 792 |
| 2006 | 945 | 295 | — | — | 5,005 | 17,210 | — | 705 | 3,000 | 647 |
| 2007 | 1,005 | 232 | — | — | 5,285 | 16,921 | — | 705 | 3,155 | 857 |
| 2008 | 1,075 | 166 | — | — | 5,585 | 16,615 | 910 | 705 | 3,310 | 339 |
| 2009-2013 | 1,740 | 114 | — | — | 33,055 | 77,745 | 5,895 | 3,525 | 3,475 | 178 |
| 2014-2018 | — | — | — | — | 44,665 | 65,689 | 1,405 | 3,525 | — | — |
| 2019-2023 | — | — | — | — | 60,885 | 48,929 | 6,390 | 2,806 | — | — |
| 2024-2028 | — | — | — | — | 83,175 | 26,004 | — | 2,011 | — | — |
| 2029-2033 | — | — | — | — | 40,915 | 2,543 | 8,045 | 1,056 | — | — |
| Total | $ 6,480 | 1,568 | 4,510 | 284 | 287,875 | 306,829 | 22,645 | 16,458 | 18,645 | 3,703 |

| | Total governmental activities | |
|---|---|---|
| | Principal | Interest |
| Year: | | |
| 2004 | $ 24,360 | 44,969 |
| 2005 | 24,055 | 45,471 |
| 2006 | 23,715 | 44,149 |
| 2007 | 25,065 | 43,151 |
| 2008 | 27,410 | 41,353 |
| 2009-2013 | 148,560 | 184,110 |
| 2014-2018 | 173,950 | 142,836 |
| 2019-2023 | 209,770 | 90,926 |
| 2024-2028 | 121,280 | 33,619 |
| 2029-2033 | 48,960 | 3,599 |
| | $ 827,125 | 674,183 |

### (c) *Notes Payable*

The Government and FEMA entered into a Community Disaster Loan Agreement (CDL) on June 14, 1996. The purpose of the 1996 CDL was to enable the Government to continue to provide vital municipal services such as public health and safety, police and fire protection, and the operation of public schools, among other things, after the Government had suffered a substantial loss of tax and other revenue as a result of Hurricane Marilyn, which occurred in 1995. The loan proceeds were not intended to provide funds to finance capital projects nor the repair or restoration of public property damaged by Hurricane Marilyn. The CDL, by its terms, was secured by a pledge of the full faith, credit, and taxing power of the Government.

Pursuant to 44 Code of Federal Regulations (CFR) Section 206.366, Subpart K, the Government submitted an Application for Administrative Loan Cancellation in connection with the Hurricane Marilyn 1067-60 CDL in June 2001. By this application, the Government requested cancellation of $127.2 million in principal drawdowns and the corresponding accumulated interest to date.

In October 2004, FEMA notified the Government the results of its review of the Application for Administrative Loan Cancellation in connection with Hurricane Marilyn. As a result of such review, FEMA concluded that all principal and associated interest was eligible for cancellation.

The 1996 CDL accrued interest at the annual rate of 6.35%.

Given that the requirements for Administrative Loan Cancellation were effectively met prior to September 30, 2003 and notification of FEMA's decision was received prior to the release of the basic financial statements, the Government reported the forgiveness of the 1996 CDL in the amount of $127.2 million and related accrued interest of $32.1 million as a special item in the statement of activities for the year ended September 30, 2003.

On September 4, 2003, the PG issued $100 million Bond Anticipation Notes (BANs) in anticipation of the issuance of the 2003 Series A 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 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 $1 million in interest expense during fiscal year 2003.

Debt service requirements for the WICO loan at September 30, 2003 were as follows (expressed in thousands):

| | | |
|---|---|---|
| Year: | | |
| 2004 | $ | 735 |
| 2005 | | 768 |
| 2006 | | 804 |
| 2007 | | 840 |
| 2008 | | 879 |
| Thereafter | | 17,989 |
| Total | $ | 22,015 |

### *(d) Fiduciary Funds – Line of Credit*

On December 30, 2002, the GERS entered into a loan agreement with a bank to provide working capital. GERS 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 GERS 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 loan. As of September 30, 2003, the outstanding balance on the line of credit was $10 million.

### *(e) 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, 2003, are as follows (expressed in thousands):

| Bonds payable | Final maturity | Interest rates | | Balance |
|---|---|---|---|---|
| University of the Virgin Islands: | | | | |
| General obligation bonds of 1999 | 2029 | 6.50% to 7.75% | $ | 23,740 |
| Various building bonds | 2004 | 3.00% to 7.50% | | 224 |
| Virgin Islands Water and Power Authority (Electric System) | | | | |
| Revenue bonds of 2003 | 2023 | 4.00% to 5.00% | | 69,960 |
| Revenue bonds of 1999 | 2022 | 4.25% to 5.30% | | 96,490 |
| Virgin Islands Water and Power Authority (Water System) | | | | |
| Revenue bonds of 1999 | 2017 | 4.90% to 5.50% | | 39,260 |
| Virgin Islands Port Authority | | | | |
| Revenue bonds of 2003 | 2023 | 3.73% to 5.43% | | 34,520 |
| Revenue bonds of 1998 | 2005 | 3.45% to 4.50% | | 971 |
| Virgin Islands Housing Finance Authority: | | | | |
| Revenue bonds of 1995 | 2027 | 5.50% to 6.50% | | 3,785 |
| Revenue bonds of 1998 | 2028 | 4.10% to 5.25% | | 2,700 |
| Subtotal | | | | 271,650 |
| Plus unamortized premium | | | | 5,812 |
| Less unamortized discount | | | | (738) |
| Less deferred amount on debt refunding and reacquisition costs | | | | (6,880) |
| Bonds payable, net | | | | 269,844 |
| Less amount due within one year | | | | (7,994) |
| Bonds payable, due in more than one year | | | $ | 261,850 |

Following is a schedule of changes in long-term debt for discretely presented component units for fiscal year 2003 (expressed in thousands):

| | Beginning balance | Additions | Reductions | Ending balance | Amounts due within one year | Amounts due thereafter |
|---|---|---|---|---|---|---|
| Bonds payable: | | | | | | |
| University of the Virgin Islands | $ 24,701 | — | (1,168) | 23,533 | 369 | 23,164 |
| Virgin Islands Water and Power Authority: | | | | | | |
| Electric System | 96,108 | 74,996 | (3,431) | 167,673 | 4,140 | 163,533 |
| Water System | 37,836 | — | (1,421) | 36,415 | 1,810 | 34,605 |
| Virgin Islands Port Authority | 10,163 | 35,815 | (10,240) | 35,738 | 1,555 | 34,183 |
| Virgin Islands Housing Finance Authority | 7,115 | — | (630) | 6,485 | 120 | 6,365 |
| Total bonds payable, net | 175,923 | 110,811 | (16,890) | 269,844 | 7,994 | 261,850 |
| Loans payable: | | | | | | |
| Roy L. Schneider Hospital | 82 | — | (82) | — | — | — |
| Virgin Islands Economic Development Authority | 342 | 671 | (66) | 947 | 53 | 894 |
| Virgin Islands Port Authority | — | 2,000 | (1,087) | 913 | 913 | — |
| University of the Virgin Islands | 3,585 | — | (45) | 3,540 | 50 | 3,490 |
| Total loans payable | 4,009 | 2,671 | (1,280) | 5,400 | 1,016 | 4,384 |
| Other long-term liabilities: | | | | | | |
| University of the Virgin Islands | 132 | — | — | 132 | — | 132 |
| Virgin Islands Housing Authority | 6,781 | — | (1,243) | 5,538 | — | 5,538 |
| Virgin Islands Economic Development Authority | 8,380 | — | (274) | 8,106 | — | 8,106 |
| Juan Luis Hospital | 812 | — | (251) | 561 | — | 561 |
| Roy L. Schneider Hospital | 407 | 67 | — | 474 | — | 474 |
| Virgin Islands Industrial Development Park | 42 | — | (42) | — | — | — |
| Virgin Islands Housing Finance Authority | 8,856 | 3,850 | (273) | 12,433 | — | 12,433 |
| Total other long-term liabilities | $ 25,410 | 3,917 | (2,083) | 27,244 | — | 27,244 |

The University issued general obligation bonds in 1994 for the financing or refinancing of the construction of the St. Croix and St. Thomas residence halls and ancillary facilities. These bonds have sinking fund requirements whereby principal payments and interest are being deposited quarterly into a debt service account held by the trustee. These bonds are general obligations of the University and are collateralized by gross revenue, excluding the required appropriations for debt service made by the Government.

On December 29, 1994, the University issued additional general obligation bonds totaling $5 million to be used for the refinancing of certain equipment. These bonds also require the University to establish a debt service reserve fund, which is to be maintained at a sum equal to 5% of the bond proceeds. These bonds are secured by the refinanced equipment and are being paid in semiannual installments of approximately $413,000, including interest.

During fiscal year 2000, 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 $14.1 million outstanding principal amount of general obligation bonds 1994 Series A 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 as of December 1, 1999, between the University and the trustee. 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 the redemption prices ranging between 100% and 102% of their principal amount plus accrued interest to the date fixed for redemption. At September 30, 2003, $14.1 million of 1994 Bonds are considered defeased and outstanding.

The various building bonds payable of the University as of September 30, 2003, are collateralized by mortgages on its property, by a pledge of the gross revenue derived from the operation of certain student and faculty housing and service facilities, a lien and pledge of funds available to the University for general operation purposes as required under the bond indenture agreements, and by annual grant payments that the U.S. government has agreed to fund as a debt subsidy. The bonds are subject to redemption at predetermined amounts, which may include penalties, as provided in the indentures' agreements. These indentures require the University to meet certain funding requirements for repair and replacement reserves, and bond sinking funds.

The bonds payable of the Virgin Islands Water and Power Authority (Electric System) consist of Electric System Revenue and Refunding Bonds. In June 2003, the Authority issued $75 million in Electric System Revenue Bonds, Series 2003. The proceeds from the bonds were used to finance capital improvements, repay the $18 million outstanding lines of credit, underwriters' costs, and establish a debt service fund.

In June 1998, the Electric System issued Revenue and Refunding Bonds of $110.9 million. The proceeds from the bonds, and approximately $14 million in funds from the existing debt service and debt service funds, were used to repay the lines of credit of the Electric System in the amount of $18 million, 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 which 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, 2003, was 199% of the aggregate debt service.

The Series 2003 Bonds maturing on or after July 1, 2013, shall be subject to redemption prior to their stated maturity date, at the option of the Authority, 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.



(Continued)

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 Authority.

The bonds payable of the Virgin Islands Water and Power Authority (Water System) consist of Water System Revenue and Refunding Bonds amounting to $42.6 million, issued in December 1998. The proceeds from the bonds and approximately $750,000 in funds from the existing debt service reserve fund were used to repay the lines of credit balances of the Water System in the amount of $2 million; to pay underwriters' discount and issuance costs of approximately $865,000; and to provide for $750,000 in funding for a renewal and replacement reserve fund. The remaining proceeds were used to refund the 1990 Series A Bonds at a redemption price of 100% of the principal amount and to purchase 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 $17 million principal amount of the 1992 Series B Bonds.

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

The Bond Resolution contains certain restrictions and commitments, including the Water System's covenant to establish and maintain reasonable rates, fees, rentals, and other charges to produce net water revenue, as defined, that will be at least 125% of aggregate annual principal and interest payments. The Water System's net water revenue for the year ended June 30, 2003 was 141% 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.

In October 1998, the VIPA issued the 1998 Airport Revenue Bonds Refunding Series A, the 1998 Rohlsen Terminal Airport Revenue Bonds Series A, and the 1998 Marine Revenue Bonds Refunding Series A with principal amounts of $19.3 million, $3.1 million, and $2.7 million, respectively. The bonds were issued for the advance refunding of previously issued bonds. The refunding resulted in a debt service savings of approximately $3.2 million and an economic gain of $2.4 million.

The Airport Revenue Bonds constitute special obligations payable solely from, and secured by a pledge of, net revenue of VIPA derived from its Airport System which consists of the airside and landside operations at the Cyril E. King Airport in St. Thomas and airside operations at the Henry E. Rohlsen Airport in St. Croix. 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. The Marine Revenue Bonds are secured solely by the net available revenue of VIPA's Marine Division.

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 plans to use the bond proceeds 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.

The Airport Revenue Bonds, the Marine Revenue Bonds, and the Rohlsen Terminal Bonds do not constitute general obligations of VIPA, the Aviation Statute or Marine Division, the Government, or the United States. The revenues of the Airport System are not available for the payment of principal or interest on the Marine Revenue Bonds or Rohlsen Terminal Bonds; likewise, the revenue of the Marine Division and the Rohlsen Terminal is not available to pay the principal and interest of the Airport Revenue Bonds except for any surplus of marine revenue which is available for any lawful purpose designated by VIPA. Neither the credit of the U.S. Virgin Islands nor that of its political subdivisions is pledged or available for the payment of principal or interest on the bonds. VIPA has no taxing power.

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. 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 VIPA's Airport System, the Rohlsen Terminal, 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.

The VIHFA issued the 1995 A and 1998 A Revenue Bonds for the purpose of building single-family housing. As of September 30, 2003, the 1995 A Revenue Bond Series amount was $3.8 million and the 1998 A Revenue Bond Series amount was $2.7 million.

The VIHFA has agreed in the indenture agreements for the bonds to deposit with the trustee the full amount of the bond proceeds. The funds will be used to purchase Government National Mortgage Association (GNMA) certificates acquired by the bond servicer. 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 Authority must be originated by the participants and secured by a first priority mortgage lien on the applicable single-family residences.

Fixed maturities required to pay principal and interest on discretely presented component units' bonds payable with fixed maturities at September 30, 2003, are as follows (expressed in thousands):

| | Principal | Interest | Total |
|---|---|---|---|
| Year: | | | |
| 2004 | $ 7,994 | 10,574 | 18,568 |
| 2005 | 8,381 | 13,596 | 21,977 |
| 2006 | 8,285 | 13,045 | 21,330 |
| 2007 | 10,420 | 12,636 | 23,056 |
| 2008 | 10,940 | 12,119 | 23,059 |
| 2009-2013 | 63,710 | 49,022 | 112,732 |
| 2014-2018 | 65,580 | 34,409 | 99,989 |
| 2019-2023 | 57,150 | 20,184 | 77,334 |
| 2024-2028 | 35,560 | 6,540 | 42,100 |
| 2029 | 3,630 | 230 | 3,860 |
| Total | 271,650 | $ 172,355 | 444,005 |
| Plus unamortized premium | 5,812 | | |
| Less unamortized discount | (738) | | |
| Less deferred amount on debt refunding and reacquisition costs | (6,880) | | |
| Bonds payable, net | $ 269,844 | | |

## (10) General Tax Revenue

For the year ended September 30, 2003, general tax revenue of the PG consisted of the following (expressed in thousands):

| | | General fund | PFA Debt Service fund | Other governmental funds | Total |
|---|---|---|---|---|---|
| Income taxes | $ | 270,554 | — | — | 270,554 |
| Real property taxes | | 40,184 | — | 15,500 | 55,684 |
| Gross receipts taxes | | — | 101,387 | 250 | 101,637 |
| Other taxes | | 110,633 | 40,055 | 12,454 | 163,142 |
| Tax receivables | $ | 421,371 | 141,442 | 28,204 | 591,017 |
| Tax revenue not recognized on the modified accrual basis | | | | | 3,599 |
| Total tax revenue – government-wide | | | | | $ 594,616 |

## (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 25 collective bargaining agreements, 5 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 9,871 government workers, including employees of the executive branch of the Government, approximately 6,943 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 $375 million accruing from fiscal years 1993 through 2003. Pursuant to Title 24 of the V.I. Code Section 374(h), no such contract is binding 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 arbitration salaries account increased by $6.7 million from fiscal year 2002 to fiscal year 2003.

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). Noncash federal financial assistance programs received by the Government during fiscal year ended September 30, 2003, amounted to approximately $19 million.



(Continued)

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, 2003, based on an evaluation of pending disallowances, the Government has recorded approximately $13.1 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. In the event of noncompliance, the U.S. Department of Education may impose additional conditions or enforcement actions against the Government as authorized by the compliance agreement or by law.

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 $13.2 million for awarded and anticipated unfavorable judgments as of September 30, 2003. Management believes that the ultimate liability in excess of amounts provided would not be significant.

As of September 2002, the Government was a defendant in a lawsuit regarding the assessment of property taxes. Under the lawsuit, taxpayers asserted that properties should be assessed at actual value in accordance with the Organic Act of 1933. The U.S. District Court agreed with the plaintiffs and, in May 2003, imposed an injunction on the collection of real property taxes for years subsequent to 1998. The Government complied with the Court order to develop a plan to implement the new valuation method, and the injunction was lifted in August 2003. Assessments will continue at the 1998 level until the new assessment method is in place, which is scheduled for fiscal year 2005.

State and federal laws and regulations require the Government to place a final cover on the Government landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site until compliance is achieved. In accordance with GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Cost* (GASB



(Continued)

No. 18), the Government should perform a study of the activities that need to be implemented at the Government landfill to guarantee the maximum yield of available space and to comply with applicable state and federal regulations. In addition, GASB No. 18 requires that estimated landfill closure and postclosure care costs be accrued as a liability in the basic financial statements. The Government has not conducted the study needed to comply with the requirements of GASB No. 18; therefore, no liability has been accrued as of September 30, 2003.

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 in 2002 (the "2002 Stipulation to the Amended Consent Decree") 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 2002 Stipulation to the Amended Consent Decree 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 2002 Stipulation to the Amended Consent Decree also establishes certain interim deadlines and performance standards that must be met by the Government pending completion of the new facilities. In addition, the 2002 Stipulation to the Amended Consent Decree establishes stipulated penalties for violation of any of the deadlines or performance standards set forth in the 2002 Stipulation to the Amended Consent Decree. As of the date of the basic financial statements, the Government is current on all of its outstanding obligations pursuant to the 2002 Stipulation to the Amended Consent Decree. In January 2004, the Government created the Waste Management Authority, a nonprofit, public corporation for the purpose of meeting environmental requirements of waste treatment in the Territory. In 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 the Waste Management Authority.

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 $6,000,000 per year, commencing on October 13, 2003.

As of September 2003, 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 imposes a six-year statute of limitations of six years on tax refund claims against the Government. Management believes that the ultimate liability of this case would not have a material impact on the Government's overall financial position as reported in the government-wide financial statements.

***(b) Discretely Presented Component Units***

WAPA estimates that capital expenditures in connection with continuing capital improvements will be approximately \$58.7 million for the Electric System and \$16.6 million for the Water System during the year ended June 30, 2004. WAPA is presently a defendant or codefendant in various lawsuits; however, any adverse outcome involving a material claim is expected to be substantially covered by the insurance. WAPA facilities were damaged by Hurricane Hugo in September 1989. WAPA reconstructed its system with proceeds from insurance and FEMA. On March 23, 1998, FEMA issued an audit report concluding that WAPA should refund approximately \$7.9 million aggregated questioned costs. Approximately \$2.6 million of these questioned costs are 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 \$900,000 of questioned costs to FEMA. During 1999, FEMA denied WAPA's second appeal and formally closed the Hurricane Hugo disaster. At June 30, 2003, WAPA has recorded a liability of \$5.3 million for amounts owed to FEMA for overpayments related to these questioned costs. FEMA has not made a formal request for repayment of these funds.

In September 1995, WAPA's facilities suffered extensive damage from Hurricane Marilyn. During 1996, WAPA reconstructed its system with proceeds from insurance and FEMA. In March 1999, FEMA denied WAPA's claim for \$8.9 million of remaining expenditures related to the reconstruction. WAPA has subsequently reduced its claim to \$5.7 million and is currently negotiating with FEMA regarding reimbursement of these remaining expenditures. Although management of WAPA believes the ultimate resolution of this matter will result in WAPA receiving additional reimbursement for prior expenditures, WAPA has not recorded any amounts to reflect these potential recoveries in the accompanying financial statements.

In connection with federal grant programs, VIPA is obligated to administer and spend the grant money in accordance with regulatory restrictions, and is subject to audit by the grantor agencies. In cases of noncompliance, the agencies involved may require VIPA to refund programs' moneys. During the normal course of business, VIPA is a defendant in various lawsuits. In the opinion of management and legal counsel, the outcome of these cases and resulting liability, if any, is either adequately covered by insurance or should not materially affect VIPA's financial position.

The Federal Aviation Administration (FAA) has conducted an on-site wildlife evaluation of the landfill, airport, and surrounding area of the Anguilla Landfill at St. Croix. The landfill, which is adjacent to St. Croix airport (Henry E. Rohlsen), caused environmental and navigational problems to the airport. The landfill attracts flocks of birds and there have been plane crashes elsewhere when birds have flown into jet engines. The FAA is threatening to force VIPA to repay \$9.3 million in grants and to refuse further grants for the airport unless VIPA and the Government show rapid progress toward closing the landfill.

## (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. 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, V.I. 00802.

### *(b) Funding Policy*

The Government's required contribution for the year ended September 30, 2003 was 14.5% of the member's annual salary. Since April 1, 1991, required member contributions are 8% of annual salary for regular employees, 9% for senators, and 10% for Act 5226 eligible employees. Through September 30, 2000, member contributions were refundable without interest upon withdrawal from employment before retirement. Subsequent to September 30, 2000, legislation was passed that provided for 4% annual interest on refunded contributions. The Government's annual required contributions, actual contributions made, and percentage contributed to the plan for the years ended September 30, 2003, 2002, and 2001, are as follows (expressed in thousands):

| | Annual required contributions | Contributions made | Percentage contributed |
|---|---|---|---|
| 2001 | $ 64,179 | 43,387 | 67.60% |
| 2002 | 95,186 | 50,595 | 53.15% |
| 2003 | 117,125 | 51,588 | 44.05% |

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 the calculation, this amount was $17.8 million as of September 30, 2003. As of September 30, 2003, GERS has received $7.9 million of such amount.

The actuaries of GERS have determined that the specific funding provided under the Early Retirement Act of 1994 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, 2003, 232 faculty members and other employees were TIAA-CREF participants. The number of active participants from the University participating in GERS as of September 30, 2003 was 275. Total contributions made by the University to TIAA-CREF participant accounts amounted to $1.7 million.

## (13) Liquidity

At September 30, 2003, the Government had an unrestricted deficit in the governmental activities amounting to $700 million mostly attributed approximately $500 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 MOU were partially or substantially achieved except: (i) implementation of collective bargaining reforms to assist the fiscal solvency of the Government and (ii) completion of comprehensive annual reports within 120 days of year-end and single audits within nine months of year-end. As part of the MOU, the Government has committed to maintaining balanced budgets after the fiscal year ended September 30, 2003, with any surpluses applied to liquidating outstanding debt. The U.S. Department of Interior acknowledged that it had not achieved its objective of providing funding for the V.I. Conservation Fund and committed to providing funds for capital improvements, technical assistance, and other assistance once the Government has achieved substantial compliance.

The DOI and the Government are currently negotiating a proposed Memorandum of Understanding (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 and Other Changes to Net Assets

### *(a) Restatement*

The following table illustrates the change to net assets at the beginning of the year as previously reported in the governmental activities' statement of net assets. The change is due to the early adoption of GASB Technical Bulletin 2004-1, *Tobacco Settlement Reporting and Financial Reporting Entity Issues,* by the TSFC in which they accrued an estimate of the fiscal year 2003 tobacco settlement revenues as of September 30, 2003, based on the payments received subsequent to September 30, 2003. The beginning net assets of the governmental activities have been restated as follows (expressed in thousands):

| | | |
|---|---|---|
| Beginning net assets, as previously reported | $ | (508,798) |
| Restatement | | — |
| Tobacco Settlement Financing Corporation | | 826 |
| Beginning net assets as restated | $ | (507,972) |

### *(b) Other Changes to Beginning Net Assets*

The following table summarizes the change in net assets at the beginning of the year in the statement of net assets and statement of net assets—proprietary funds as previously reported in the statement of net assets. The change resulted from the exclusion of the VI Lottery (nonmajor enterprise fund) financial statements as of and for the fiscal year ended September 30, 2003 due to their unavailability. The beginning net assets of the business-type activities and the other enterprise funds have been adjusted as follows (expressed in thousands):

| | | Business-type activities | Enterprise funds<br>Other funds |
|---|---|---|---|
| Beginning net assets, as previously reported | $ | 77,212 | 7,298 |
| Exclusion of VI Lottery financial statements | | 5,181 | 5,181 |
| Beginning net assets, as adjusted | $ | 82,393 | 12,479 |

## (15) Subsequent Events

### *(a) Primary Government*

In December 2003, the PFA issued $257.9 million in Series 2003 A Revenue Bonds. The proceeds of the bonds will be used to: (i) repay the Revenue Bond Anticipation Note, Series 2003 of $100 million mentioned above, (ii) fund certain necessary public safety and other public sector capital development projects, (iii) fund the Debt Service Reserve Account, and (iv) pay the costs of issuing the Series 2003A Bonds. The bonds are supported by pledged gross receipts taxes.

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 refinery is responsible for all debt service payments of the private activity bonds.

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, FEMA notified the PG that it had received full forgiveness of the Hurricane Marilyn Community Disaster Loan of $127.2 million and accrued interest of $32.1 million. Under FEMA guidelines, the loan became a capital grant at the date in which the requirements for Administrative Loan Cancellation were met and notification of forgiveness was received from FEMA. The loan forgiveness is recognized as a special item in the statement of activities for the fiscal year ended September 30, 2003.

In October 2004, the President 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 Government has retained an independent consultant to evaluate the effect of this legislation on the Territorial economy and tax structure.

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' Waste Management Authority. The Government has pledged rum excise tax matching funds for the repayment of the bonds.

***(b) Component Units***

In October 2003, VIPA issued the Series 2003C Marine Revenue Bonds amounting to $10.8 million. Bond proceeds will be used to finance the rehabilitation and construction of berthing piers on the island of St. Thomas.

In January 2004, the Virgin Islands' Waste Management Authority was created by Act No. 6638 as a nonprofit, public body corporate and politic of the Government with the purpose of providing environmentally sound management for the collection and disposal of solid waste, including operation and closure of landfills, and wastewater collection, transport, treatment, and disposal in the Territory. A board of directors consisting of seven members will be appointed by the Governor.

On July 2004, the University of Virgin Islands issued $21.1 million in Series 2004A General Obligation Improvement Bonds. The proceeds of the bonds will be used to (i) finance a portion of the costs of the construction, furnishing and equipment of the 2004 project, (ii) fund the Debt Service Reserve Requirement, and (iii) pay certain cost of issuance of the 2004 Series A Bonds.