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AGENCY OFFICIALS

December 14, 1998

The Honorable James S. Gilmore, III  
Governor of Virginia  
State Capitol  
Richmond, Virginia

The Honorable Richard J. Holland  
Chairman, Joint Legislative Audit  
and Review Commission  
General Assembly Building  
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the balance sheet of the **Virginia Public School Authority** as of June 30, 1998, and the related statement of revenues, expenses, and changes in retained earnings, and the statement of cash flows for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Virginia Public School Authority as of June 30, 1998, and the results of its operations and cash flows for the year then ended in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplementary information listed in the Table of Contents is presented for the purpose of additional analysis and is not a required part of the financial statements of the Authority. The information in those schedules has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, such information is fairly presented in all material respects to the financial statements taken as a whole.

AUDITOR OF PUBLIC ACCOUNTS

JBS:aom  
aom:33

VIRGINIA PUBLIC SCHOOL AUTHORITY  
BALANCE SHEET  
As of June 30, 1998

ASSETS	
Unrestricted Assets:	
Cash and cash equivalents with Treasurer of Virginia (Note 2)	\$ 4,428,460
Interest receivable	9,425
Accounts receivable	<u>130,541</u>
Total Unrestricted Assets	<u>4,568,426</u>
Restricted Assets:	
Cash and cash equivalents with Treasurer of Virginia (Note 2)	71,856,055
Cash with paying agents	48,561
Investments:	
Short term investments (Note 2)	562,683
Long term investments (Note 2)	56,846,093
Loans to Localities:	
Local school bonds (Note 3)	1,489,817,041
Literary Fund loan obligations (Note 3)	255,869,999
Interest receivable	28,231,731
Due from Literary Fund (Note 5)	111,945,000
Discount on bonds sold	<u>4,908,554</u>
Total Restricted Assets	<u>2,020,085,717</u>
Total Assets	<u><u>\$2,024,654,143</u></u>
LIABILITIES AND FUND EQUITY	
Liabilities:	
Current Liabilities (payable from unrestricted assets):	
Accounts payable	<u>\$ 57,866</u>
Current Liabilities (payable from restricted assets):	
Matured interest and bonds payable	48,561
Interest payable	38,009,634
Accrued interest sold	1,223,298
Due to Literary Fund	18,531,704
Due to localities (Note 5)	27,937,771
Notes payable (Notes 4 and 5)	28,835,000
Bonds payable (net of interest deferral) (Notes 4 and 6)	<u>107,697,400</u>
Total Current Liabilities	<u>222,283,368</u>
Long-term Liabilities (payable from restricted assets):	
Notes payable (Notes 4 and 5)	83,110,000
Bonds payable (net of interest deferral) (Notes 4 and 6)	1,435,936,200
Premium on bonds sold	5,286,872
Advance from Literary Fund	<u>255,869,999</u>
Total Long-term Liabilities	<u>1,780,203,071</u>
Total Liabilities	2,002,544,305
Fund equity - Retained earnings	<u>22,109,838</u>
Total Liabilities and Fund Equity	<u><u>\$2,024,654,143</u></u>

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

VIRGINIA PUBLIC SCHOOL AUTHORITY  
STATEMENT OF REVENUES, EXPENSES AND CHANGES  
IN RETAINED EARNINGS

For the Year Ended June 30, 1998

Revenues:	
Interest on:	
Local School Bonds	\$ 84,990,468
Literary Fund loans	7,843,492
Cash and cash equivalents and investments	8,323,384
Net increase in fair value of investments	106,841
Other	<u>198,834</u>
Total revenues	<u>101,463,019</u>
Operating Expenses:	
Interest on bonds	87,550,162
Financial advisor fees	167,717
Escrow agent fees	11,181
Legal fees	353,465
Bond rating fees	160,189
Printing	33,906
Board expenses	3,375
Underwriters' discount	1,643,751
Rebate and penalty payments and calculation fees (Note 8)	956,398
Collateral custody and valuation fees	18,350
Bond Buyer fees	1,313
Other	<u>92,691</u>
Total operating expenses	<u>90,992,498</u>
Operating income	<u>10,470,521</u>
Nonoperating Transfers:	
Transfers to Literary Fund (Note 7)	(6,612,100)
Transfer to the General Fund of the Commonwealth (Note 7)	<u>(137,000)</u>
Total nonoperating transfers	<u>(6,749,100)</u>
Net income	3,721,421
Retained Earnings, July 1, 1997	<u>18,388,417</u>
Retained Earnings, June 30, 1998	<u><u>\$ 22,109,838</u></u>

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

VIRGINIA PUBLIC SCHOOL AUTHORITY  
STATEMENT OF CASH FLOWS  
For the Year Ended June 30, 1998

Cash flows from operating activities:	
Interest on cash equivalents	\$ 820,963
Principal received on Literary Fund loans	26,227,384
Interest received on Literary Fund loans	7,843,492
Principal received on local school bonds	93,228,926
Interest received on local school bonds	80,594,101
Payments to vendors for goods and services	(825,858)
Payments received from the Literary Fund	22,314,126
Other operating revenues	68,294
	<u>230,271,428</u>
Net cash provided by operating activities	
Cash flows from non-capital financing activities:	
Proceeds from the sale of bonds	401,925,000
Principal paid on VPSA bonds	(116,125,000)
Interest paid on VPSA bonds	(82,267,521)
Premium on bonds sold	5,409,615
Underwriters' discount	(1,643,751)
Accrued interest sold	430,229
Transfers to the Literary Fund	(34,794,338)
Transfer to the General Fund of the Commonwealth (Note 7)	(137,000)
Payments to localities (Education Technology Notes)	(47,217,576)
Payments to escrow agent	(185,222,231)
Rebate and penalty payments to the Internal Revenue Service	(943,253)
	<u>(60,585,826)</u>
Net cash provided from noncapital financing activities	
Cash flows from investing activities:	
Purchase of investment securities	(11,403,634)
Proceeds from sale and maturities of investments	32,492,137
Interest on investments	7,970,195
Increase in fair value of investments	106,841
Purchase of local school bonds	(191,548,269)
	<u>(162,382,730)</u>
Net cash used in investing activities	
Net increase in cash and cash equivalents	
	7,302,872
Cash and cash equivalents, July 1, 1997	<u>68,981,643</u>
Cash and cash equivalents, June 30, 1998	<u>\$ 76,284,515</u>
Reconciliation of operating income to net cash provided by operating activities	
Operating income	<u>\$ 10,470,521</u>
Adjustments to reconcile operating income to	
Net cash provided by operating activities:	
Increase in accounts receivable	(130,541)
Increase in interest receivable	(3,805,850)
Increase in accounts payable	29,474
Increase in interest payable	1,201,584
Payments from the Literary Fund	22,314,126
Principal received on Literary Fund loans	26,227,384
Principal received on local school bonds	93,228,926
Rebate and penalty payments to the Internal Revenue Service	943,253
Underwriters' discount	1,643,751
Amortization of discount	381,826
Amortization of premium	(122,742)
Amortization of interest deferral	3,699,231
Interest paid on VPSA bonds	82,267,521
Increase in fair value of investments	(106,841)
Interest on investments	(7,970,195)
	<u>219,800,907</u>
Total adjustments	
Net cash provided by operating activities	
	<u>\$ 230,271,428</u>

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

VIRGINIA PUBLIC SCHOOL AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

AS OF JUNE 30, 1998

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Reporting Entity

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

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

The Authority issues bonds for its pooled bond program under different bond resolutions. Prior to August 1987, the Authority issued bonds for its pooled bond program under provisions of a bond resolution adopted in 1963 (the "1963 Resolution"). In August 1987, the Authority adopted the 1987 Resolution under which most subsequent pooled bonds have been issued. Under the provision of the 1963 Resolution and 1987 Resolution, bonds issued thereunder are secured by the local school bonds purchased and payments received on Literary Fund loan obligations held in the VPSA 1987 Reserve Fund. In June 1993, all outstanding 1963 Resolution bonds were defeased. In September 1993, the VPSA Board temporarily suspended issuance of bonds under the 1987 Resolution until Literary Fund loan note transfers resume, thereby maintaining debt service coverage at levels deemed acceptable by the Authority.

In recent years, the Authority has developed alternatives to the 1987 Resolution. The Authority has created and issued pooled bonds under its 1990 Insured Resolution, 1991 Resolution and 1997 Resolution. Bonds issued under the 1991 Resolution are secured by local school bonds purchased and a debt service reserve account. The Authority is limited by statute to no more than \$800 million in bonds outstanding at any one time which utilize a debt service reserve account backed by a moral obligation of the Commonwealth of Virginia to restore deficiencies therein.

On October 23, 1997, the Authority adopted the 1997 Resolution to supplant the Authority's 1991 Resolution. Bonds issued under the 1997 Resolution are secured by local school bonds purchased and a "sum sufficient appropriation," first from available Literary Fund monies and then from the Commonwealth's General Fund.

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

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

A separate report is prepared for the Commonwealth of Virginia which includes all agencies, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority. The Authority is included in the general purpose financial statements of the Commonwealth.

The accounting and reporting policies of the Authority conform to generally accepted accounting principles (GAAP) applicable to governmental units as prescribed by the Governmental Accounting Standards Board (GASB), the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The following is a summary of the Authority's significant policies.

B. Basis of Accounting

The accompanying financial statements are reported on the accrual basis of accounting under which revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred. The cash basis of accounting is used during the year. The financial statements are prepared on the accrual basis at the end of the fiscal year by the Authority.

C. Fund Accounting

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

D. Bond Issuance Costs, Discounts and Premiums

Costs associated with issuing debt, which are either offset by fees collected over the life of the respective pooled bond issues from local issuers, reimbursed directly by localities participating in stand alone issues, or paid from Literary Fund contributions, are expensed in the year incurred. The original issue discount or premium, for each bond issuance, is also expensed or recorded as revenue in the year incurred unless it exceeds one percent of the

amount of bonds issued. In that case, the original issue discount or premium is deferred and amortized, on a straight-line basis, over the life of the outstanding debt.

2. CASH, CASH EQUIVALENTS AND INVESTMENTS (Unrestricted and Restricted)

Cash and investments of the Authority are held by the Treasurer of Virginia. Cash is defined as demand deposits, time deposits, and certificates of deposit in accordance with Section 2.1-329 of the Code of Virginia. Cash equivalents are defined as investments with an original maturity of less than three months. Short-term investments are investments with maturities of one year or less. Long-term investments have maturities of over one year.

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

Section 2.1-327 and Section 2.1-328 of the Code of Virginia outline the instruments in which public sinking funds and other public funds may legally invest. The Authority adheres to these general guidelines unless bond resolutions require more restrictive investment policies. All investments of the Authority are held in the Authority's name. With the exception of flexible repurchase agreements, the Authority's investments are valued at fair value, which approximates market value. The flexible repurchase agreements are considered to be nonparticipating investment contracts, and as such, are valued at cost. Details of cash, cash equivalents, and investments are presented on the below.

Summary of Cash, Cash Equivalents and Investments  
As of June 30, 1998

	<u>Carrying Amount</u>	<u>Fair Value</u>
Cash and cash equivalents:		
Deposits	\$ 192,407	\$ 192,407
Mutual fund investments <sup>1</sup>	14,956,000	14,956,000
U. S. Government Securities	30,813,566	30,920,407
State Non-Arbitrage Program <sup>2</sup>	<u>30,215,701</u>	<u>30,215,701</u>
Total cash and cash equivalents	<u>\$76,177,674</u>	<u>\$76,284,515</u>
Short-term investments:		
Flexible Repurchase Agreements	<u>\$ 562,683</u>	<u>\$ 562,683</u>
Total short-term investments	<u>\$ 562,683</u>	<u>\$ 562,683</u>
Long-term investments:		
Flexible Repurchase Agreements	<u>\$56,846,093</u>	<u>\$56,846,093</u>
Total long-term investments	<u>\$56,846,093</u>	<u>\$56,846,093</u>

- 1 The Authority invests certain short-term cash balances held within its accounts in the Fidelity Institutional Cash Portfolio – Class A – U.S. Treasury Portfolio II open-end mutual fund. This fund is a rated fund, which maintains a policy of investing all assets in U.S. Treasury obligations and repurchase agreements backed by those obligations.
- 2 The Virginia State Non-Arbitrage Program (“SNAP”) offers a professionally-managed money market mutual fund, which provides issuers with a temporary pooled investment vehicle for proceeds pending expenditure, and with record keeping, depository and arbitrage rebate calculation services. SNAP is an external investment pool registered under the Investment Company Act of 1940, as amended. Participants in the Authority’s various bond programs are required to invest their bond proceeds in SNAP.

### 3. LOCAL SCHOOL BONDS AND LITERARY FUND LOAN OBLIGATIONS

The Authority purchases bonds from (makes loans to) various localities throughout the Commonwealth which are issued to finance the construction of local public school facilities. These bonds are recorded at purchase price which is equal to the face value of the bonds. Local school bonds purchased under the 1987, 1990 Insured, and 1991 Resolutions are held in the purchase fund established under the respective pooled bond resolution. Local school bonds purchased under the 1997 Resolution are held in a pledge account of the General Pledge Fund established under its bond resolution. Local school bonds purchased under the stand alone program are deposited in separate purchase funds established for each issue. Assets of the Authority that are held or received in purchase funds, pledge funds, or debt service funds are classified as restricted assets because their use is limited to the purpose of the funds in which they reside, in accordance with applicable bond resolutions. The local school bonds are held and pledged to repay the Authority’s bonds.

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

Other loans to localities held by the Authority consist of Literary Fund loan obligations, which are recorded at face value. Literary Fund loan obligations are transferred to the Authority semiannually on January 1<sup>st</sup> and July 1<sup>st</sup>. Interest rates charged on Literary Fund loans are established by the State Board of Education. Section 22.1-170 of the Code of Virginia provides that Literary Fund loan obligations remain an asset of the Literary Fund but may be used by the Authority as if such assets were the property of the Authority. Accordingly, these assets are reflected as being due to the Literary Fund.

Shown below are the local school bonds and Literary Fund loan obligations held by the Authority as of June 30, 1998:

Local school bonds:

Held in 1987 Purchase Fund	\$ 471,015,000
Held in 1990 Purchase Fund (Henrico County Stand Alone)	1,865,000
Held in 1990 Insured Purchase Fund	23,240,000
Held in 1991 Purchase Fund	497,548,466
Held in 1993 Purchase Fund (Henrico County Stand Alone)	25,600,000
Held in 1994 Purchase Fund (York County Stand Alone)	22,785,000
Held in 1995 Purchase Fund (City of Chesapeake, Stand Alone)	102,000,000
Held in 1997 Pledge Account	<u>345,763,575</u>
 Total local school bonds	 <u>\$1,489,817,041</u>
 Literary Fund loan obligations:	
Held in 1987 Reserve Fund	<u>\$ 255,869,999</u>

#### 4. LONG-TERM INDEBTEDNESS

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

The following is a summary of changes in long-term debt of the Authority for the year ended June 30, 1998.

	<u>Current Liability</u>	<u>Long-Term Liability</u>	<u>Total</u>
Balance July 1, 1997	\$ 116,125,000	\$1,462,810,000	\$1,578,935,000
Bonds Issued	20,770,000	381,155,000	401,925,000
Bonds Retired	(116,125,000)	-	(116,125,000)
Bonds Defeased	-	(171,785,000)	(171,785,000)
Bonds Maturing fiscal 1999	<u>119,350,000</u>	<u>(119,350,000)</u>	<u>-</u>
 Subtotal	 140,120,000	 \$1,552,830,000	 \$1,692,950,000
Less: Deferral on debt defeasance	<u>(3,587,600)</u>	<u>(33,783,800)</u>	<u>(37,371,400)</u>
 Balance June 30, 1998	 <u>\$ 136,532,400</u>	 <u>\$1,519,046,200</u>	 <u>\$1,655,578,600</u>

B. Annual Requirements to Amortize Bonds Payable and Notes Payable

The following schedule provides the annual funding requirements necessary to amortize long-term debt of the Authority outstanding at June 30, 1998.

Year Ending June 30	Principal	Interest	Total
1999	\$ 131,720,000	\$ 89,058,919	\$ 220,778,919
2000	135,905,000	80,428,595	216,333,595
2001	122,380,000	73,849,136	196,229,136
2002	122,355,000	67,692,363	190,047,363
2003	108,405,000	61,575,094	169,980,094
2004-2018	<u>1,072,185,000</u>	<u>364,891,677</u>	<u>1,437,076,677</u>
Subtotal	1,692,950,000	737,495,784	2,430,445,784
Less: Deferral on debt defeasance	<u>(37,371,400)</u>	-	<u>(37,371,400)</u>
Total	<u>\$1,655,578,600</u>	<u>\$737,495,784</u>	<u>\$2,393,074,384</u>

5. EQUIPMENT NOTES

In September 1995, the Authority issued \$46,205,000 School Equipment Financing Notes Educational Technology Issue III (the "1995 Notes"). In March 1997, the Authority issued \$55,910,000 School Equipment Financing Notes Educational Technology Issue IV (the "1997 Notes"). In March 1998, the Authority issued \$46,925,000 School Equipment Financing Notes Educational Technology Issue V (the "1998 Notes"). The proceeds of each issue were used to make grants to school divisions for the purchase of educational technology equipment. The notes are to be repaid from appropriations to be made by the Virginia General Assembly from the Literary Fund. The proceeds are invested in the Virginia State Non-Arbitrage Program until requisitioned by localities. As of June 30, 1998 the amount remaining to be requisitioned by localities is \$27,937,771 for the 1998 Notes.

6. DEFEASANCE OF DEBT

In November 1997 the Authority issued \$224.2 million of its School Financing and Refunding Bonds Series 1997-I, a portion of which was used to advance refund \$11,230,000 of 1991 Series A bonds (1987 Resolution), \$6,630,000 of 1992 Series A bonds (1987 Resolution), and \$69,570,000 of Series 1991 A bonds (1991 Resolution). Bond proceeds totaling \$84,927,707 along with released debt service reserves of \$8,954,296 were placed with an escrow agent to provide for all future debt service on the advance refunded bonds. The refunding resulted in an accounting loss of \$6,452,003, which is being charged to operations through 2012 using the effective interest method. Total debt service payments over the life of the bonds have been reduced by \$18,499,748 resulting in an economic gain (savings) of \$4,511,953 discounted at 4.8575 percent.

In April 1998 the Authority issued \$130.7 million of its School Financing and Refunding Bonds Series 1998 A, a portion of which was used to advance refund \$28,870,000 of Series 1992 bonds (1991 Resolution) and \$55,485,000 of Series 1994 B bonds (1991 Resolution). Bond proceeds totaling \$81,649,318 along with released debt service reserves of \$9,690,909 were placed with an

escrow agent to provide for all future debt service on the advance refunded bonds. The refunding resulted in an accounting loss of \$6,985,227, which is being amortized as discussed below. Total debt service payments over the life of the bonds have been reduced by \$18,865,909 resulting in an economic gain (savings) of \$2,983,356 discounted at 4.7104 percent.

In 1987, 1991 and 1993 the Authority issued refunding bonds to defease bonds issued under the 1963, 1987, and 1990 Insured Resolutions. These refundings placed the proceeds of the new bonds in irrevocable trusts with escrow agents to provide for all future debt service on the defeased bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included on the Authority's financial statements.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 23, "Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities," the difference between the reacquisition price and the net carrying amount of the bonds defeased with refunding debt is amortized as a component of Interest on Bonds over the remaining life of the refunded debt. Therefore, Bonds Payable has been reduced by \$37,371,400 to reflect the remaining deferral on debt defeasance at June 30, 1998.

Additionally, in 1996, the Authority used \$1,508,852 of available funds held in the 1987 General Fund to defease portions of certain maturities of the School Financing Bonds (1987 Resolution) 1992 Series B in the amount of \$1,475,000. These funds were placed in an irrevocable trust with an escrow agent to provide for all future debt service on the defeased bonds. Accordingly, the liability for the defeased bonds is not included on the Authority's financial statements.

At June 30, 1998, \$293,075,000 of bonds outstanding is considered defeased for financial reporting purposes.

## 7. TRANSFERS

The Enabling Act provides that the 1987 Reserve Fund balance, other than that portion which comprises the Literary Fund loans, shall be transferred to the Literary Fund on or before January 10<sup>th</sup> of each year. During the year ended June 30, 1998, \$33,794,338, comprised of \$8,450,282 of interest on Literary Fund loan obligations and short-term investments, and \$25,344,056 of loan principal repayments, was transferred to the Literary Fund from the 1987 Reserve Fund.

The Enabling Act also requires transfers from the Literary Fund to the VPSA 1987 Reserve Fund each January 1<sup>st</sup> and July 1<sup>st</sup>. Eight Literary Fund loan obligations in the amount of \$15,095,000 were transferred on July 1, 1997 and twenty Literary Fund loan obligations totaling \$38,147,492 were transferred on January 1, 1998.

On June 23, 1998, the Authority transferred \$137,000 to the General Fund of the Commonwealth pursuant to Section 3-1.01(S) of Chapter 924 of the 1997 Virginia Acts of Assembly, representing reimbursement to the Commonwealth for staff and other administrative services provided by the Department of the Treasury. Also in accordance with Chapter 924, the Authority transferred \$1,000,000 to the Literary Fund on June 23, 1998 in compliance with Section 3-1.02(F).

8. **ARBITRAGE EARNINGS**

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

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

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

<u>Bond Issue</u>	<u>Computation Initial 5 year or final</u>	<u>Computation Date</u>	<u>Liability</u>
Equipment Financing Notes Educational Technology Issue III, Series 1995	Final	10/1/97	\$ 720,433
(91 Resolution) Series 1992	5 year	11/12/97	\$ -
(87 Resolution) 1992 Series B	5 year	12/17/97	\$ -
(87 Resolution) 1988 Series A	Final	1/1/98	\$ -
(87 Resolution) 1988 Series B	Final	1/1/98	\$ 31,000
(87 Resolution) 1993 Series A	5 year	4/29/98	\$ -
(87 Resolution) Series 1993 B Refunding	5 year	6/8/98	\$ -
Henrico County Stand Alone Series 1993	5 year	6/10/98	\$ -

The Authority paid \$204,965 to its rebate calculation agent for computation of the amounts owed to the federal government.

The VPSA School Financing Bonds (1987 Resolution) 1993 Series C will require a rebate computation as of November 18, 1998. The estimated liability for arbitrage earnings on this issue has not been determined; however, it is expected that any rebate liability will be payable by applicable localities. The Authority completed the final rebate computation on the VPSA School Financing Bonds (1990 Insured Resolution) Refunding Series 1993 on August 20, 1998 for the August 12, 1998 computation date. There was no rebate liability owed.

#### 9. SUBSEQUENT EVENTS

In November 1998, the Authority plans to issue approximately \$105 million of School Financing Bonds (1997 Resolution) Series 1998 B to purchase certain general obligation local school bonds to finance capital projects for public schools.

#### 10. SURETY BOND

Susan F. Dewey, Treasurer of Virginia and Treasurer of the Authority, was covered under a Faithful Performance of Duty Bond in the amount of \$500,000 with the Fidelity and Deposit Company of Maryland as surety.

The Commonwealth of Virginia, through its Department of General Services, Division of Risk Management, provides employee dishonesty coverage to its agencies and institutions with coverage in the amount of \$500,000 for each loss. All employees of the Commonwealth, as well as parties acting on behalf of the Commonwealth, such as the board members of the Authority, are covered under the policy.

#### 11. YEAR 2000 READINESS

Many existing computer programs use only two digits to identify a year in the date field. These programs were designed and developed without considering the impact of the upcoming change in the century. If not corrected, these programs could fail or create additional problems. The Authority recognizes the need to ensure that its operations will not be adversely impacted by Year 2000 software failures.

The Authority does not have any internal critical systems. In addition, management has received assurance from the financial institutions used by the Authority that Year 2000 compliant systems have been implemented or will be implemented prior to the Year 2000.

VIRGINIA PUBLIC SCHOOL AUTHORITY

Detail of Long-Term Indebtedness

June 30, 1998

(Dollars in Thousands)

Detail of Long-Term Indebtedness by Series	Dated Date	Bond Resolution	True Interest Cost ("TIC")	Amount Issued *	Local School Bonds Purchased	Outstanding July 1, 1997	Issued	Outstanding June 30, 1998	Original Maturity
							(Retired) During Year		
1988 Series A	04/01/88	1987	6.85%	\$ 52,395	\$ 52,395	\$ 3,120	\$ (3,120)	\$ -	01/01/08
1988 Series B	10/01/88	1987	7.06%	61,995	61,995	3,355	(3,355)	-	01/01/09
1989 Series B	10/01/89	1987	6.86%	55,730	55,730	6,185	(3,105)	3,080	01/01/10
1990 Series A	04/01/90	1987	7.02%	58,865	58,865	7,300	(3,700)	3,600	01/01/10
1990 Series B	12/01/90	1987	6.62%	28,440	28,440	4,910	(1,210)	3,700	01/01/11
1990 Series Henrico County	07/15/90	Stand Alone	6.84%	37,305	37,305	3,730	(1,865)	1,865	01/15/11
1990 Series Insured	08/15/90	1990 Insured	6.88%	33,105	33,105	3,070	(1,520)	1,550	08/01/10
1991 Series A	05/01/91	1987	6.39%	40,940	40,940	19,030	(13,830)	5,200	01/01/11
Series 1991 A	06/15/91	1991	6.36%	91,115	80,125	73,455	(73,455)	-	08/01/12
1991 Series B	11/01/91	1987	6.12%	55,105	55,105	16,380	(2,600)	13,780	01/01/12
1991 Series C Refunding Bonds	12/01/91	1987	6.25%	127,285	-	111,800	(4,145)	107,655	01/01/09
1992 Series A	04/15/92	1987	6.13%	68,365	68,365	24,145	(11,915)	12,230	01/01/12
Series 1992	10/15/92	1991	5.76%	36,200	32,793	30,415	(30,415)	-	08/01/13
1992 Series B	12/01/92	1987	5.75%	60,460	60,460	43,690	(2,160)	41,530	01/01/13
1993 Series A	04/01/93	1987	5.21%	45,710	45,710	37,200	(2,590)	34,610	01/01/13
1993 Series C	10/01/93	1987	4.62%	80,135	80,135	61,725	(6,435)	55,290	01/01/14
1993 Series Henrico County	05/15/93	Stand Alone	5.20%	32,000	32,000	27,200	(1,600)	25,600	07/15/13
1993 Series B Refunding Bonds	05/01/93	1987	5.16%	293,160	-	233,300	(19,795)	213,505	01/01/12
1993 Series Refunding Bonds	07/01/93	1990 Insured	5.29%	24,080	-	24,080	(40)	24,040	08/01/10
Series 1994 A	04/01/94	1991	6.07%	115,425	104,045	101,145	(5,285)	95,860	08/01/14
Series 1994 B	11/01/94	1991	6.23%	63,660	57,235	58,340	(58,340)	-	08/01/15
1994 Series York County	07/01/94	Stand Alone	5.76%	25,000	25,000	23,560	(775)	22,785	07/15/14
Series 1995 A	05/01/95	1991	5.64%	63,595	57,460	60,670	(2,920)	57,750	08/01/16
1995 Series Chesapeake City	06/01/95	Stand Alone	5.63%	102,000	102,000	102,000	-	102,000	06/01/15
Series 1995 B	09/01/95	1991	5.60%	26,070	23,620	24,880	(1,180)	23,700	08/01/16
Series 1995 C	12/01/95	1991	5.10%	121,610	110,528	116,310	(5,285)	111,025	08/01/16
Series 1995 Ed Tech Issue III	09/15/95	Equip. Notes	4.17%	46,205	-	28,105	(8,950)	19,155	04/01/00
Sereis 1996 A	04/15/96	1991	5.45%	49,205	44,555	49,205	(2,270)	46,935	08/01/17
Series 1996 B	11/01/96	1991	5.20%	132,545	120,396	132,545	(6,005)	126,540	08/01/17
Series 1997A	04/01/97	1991	5.49%	92,175	83,325	92,175	-	92,175	08/01/18
Series 1997 Ed Tech Issue IV	02/15/97	Equip. Notes	4.17%	55,910	-	55,910	(10,045)	45,865	04/01/02
Series 1997 I	11/01/97	1997	4.92%	224,285	140,818	-	224,285	224,285	08/01/17
Series 1998 Ed Tech Issue V	02/15/98	Equip. Notes	4.04%	46,925	-	-	46,925	46,925	04/01/03
Series 1998 A	04/01/98	1997	4.71%	130,715	50,730	-	130,715	130,715	08/01/18
<b>Total</b>				<b>\$ 2,577,715</b>	<b>\$ 1,743,180</b>	<b>\$ 1,578,935</b>	<b>\$ 114,015</b>	<b>\$ 1,692,950</b>	

Detail of Long-Term Indebtedness by Resolution	Amount Issued *	Local School Bonds Purchased	Outstanding July 1, 1997	Issued	Outstanding June 30, 1998
				(Retired) During Year	
1987 Resolution	\$ 1,028,585	\$ 608,140	\$ 572,140	\$ (77,960)	\$ 494,180
1991 Resolution	791,600	714,082	739,140	(185,155)	553,985
1997 Resolution	355,000	191,548	-	355,000	355,000
Stand Alone Issues	196,305	196,305	156,490	(4,240)	152,250
Equipment Notes	149,040	-	84,015	27,930	111,945
1990 Insured Resolution	57,185	33,105	27,150	(1,560)	25,590
<b>Total</b>	<b>\$ 2,577,715</b>	<b>\$ 1,743,180</b>	<b>\$ 1,578,935</b>	<b>\$ 114,015</b>	<b>\$ 1,692,950</b>

\* Includes refunding bonds issued.

VIRGINIA PUBLIC SCHOOL AUTHORITY

1987 Resolution Income Coverage <sup>(1)</sup>

As of June 30, 1998

Calendar Year	Schedule of Total Income						Schedule of Total Debt Service					Total Coverage <sup>(3)</sup>
	Local School Bonds Held in 1987 Purchase Fund			Literary Fund Obligations Held In 1987 Reserve Fund <sup>(2)</sup>			Total Income	1987 Resolution Bonds				
	Principal	Interest	Total	Principal	Interest	Total		Principal	Interest	Total Debt Service		
1998	\$ 53,020,000	\$ 30,599,221	\$ 83,619,221	\$ 26,361,215	\$ 8,215,897	\$ 34,577,113	\$ 118,196,334	\$ 57,300,000	\$ 26,302,163	\$ 83,602,163	1.41	
1999	51,560,000	27,134,478	78,694,478	26,315,778	7,922,776	34,238,554	112,933,032	55,430,000	23,251,353	78,681,353	1.44	
2000	45,990,000	23,789,944	69,779,944	24,886,768	7,100,325	31,987,093	101,767,037	49,360,000	20,401,955	69,761,955	1.46	
2001	42,525,000	20,768,219	63,293,219	23,467,243	6,331,166	29,798,409	93,091,628	45,485,000	17,768,270	63,253,270	1.47	
2002	39,875,000	17,965,713	57,840,713	22,024,270	5,595,463	27,619,733	85,460,446	42,420,000	15,364,965	57,784,965	1.48	
2003	40,085,000	15,325,010	55,410,010	20,561,697	4,925,359	25,487,056	80,897,065	42,275,000	13,076,375	55,351,375	1.46	
2004	36,840,000	12,691,186	49,531,186	19,169,452	4,281,902	23,451,354	72,982,540	38,650,000	10,823,285	49,473,285	1.48	
2005	34,325,000	10,310,879	44,635,879	17,936,444	3,684,262	21,620,706	66,256,585	35,815,000	8,762,918	44,577,918	1.49	
2006	31,605,000	8,093,846	39,698,846	16,524,635	3,123,613	19,648,248	59,347,094	32,615,000	6,844,935	39,459,935	1.50	
2007	26,895,000	6,049,477	32,944,477	15,303,366	2,605,337	17,908,703	50,853,180	27,650,000	5,075,000	32,725,000	1.55	
2008	23,915,000	4,291,676	28,206,676	14,007,993	2,124,356	16,132,349	44,339,025	24,440,000	3,565,183	28,005,183	1.58	
2009	18,040,000	2,704,629	20,744,629	11,703,854	1,685,968	13,389,822	34,134,451	18,255,000	2,275,678	20,530,678	1.66	
2010	11,840,000	1,566,143	13,406,143	9,317,164	1,325,037	10,642,201	24,048,344	11,860,000	1,309,513	13,169,513	1.83	
2011	9,380,000	851,773	10,231,773	7,568,721	1,038,585	8,607,306	18,839,079	9,300,000	677,205	9,977,205	1.89	
2012	4,020,000	294,258	4,314,258	5,612,715	809,276	6,421,991	10,736,248	2,865,000	178,148	3,043,148	3.53	
2013	780,000	65,240	845,240	4,379,092	572,686	4,951,778	5,797,018	460,000	22,540	482,540	12.01	
2014	320,000	21,120	341,120	4,292,639	447,713	4,740,352	5,081,472	-	-	-	-	
2015	-	-	-	4,243,710	325,439	4,569,149	4,569,149	-	-	-	-	
2016	-	-	-	3,933,490	204,634	4,138,124	4,138,124	-	-	-	-	
2017	-	-	-	3,323,664	167,019	3,490,683	3,490,683	-	-	-	-	
2018	-	-	-	911,539	71,603	983,142	983,142	-	-	-	-	
Totals	\$ 471,015,000	\$ 182,522,811	\$ 653,537,811	\$ 281,845,449	\$ 62,558,414	\$ 344,403,864	\$ 997,941,674	\$ 494,180,000	\$ 155,699,483	\$ 649,879,483	1.51	

(1) Numbers may not add to totals due to rounding.

(2) Includes scheduled payments on Literary Fund Obligations held in 1987 Reserve Fund as of January 1, 1998 and on Literary Fund Obligations in the principal amount of \$38,147,492 transferred to the Authority on January 1, 1998 and \$13,875,614 on July 1, 1998.

(3) Total Coverage equals Total Income divided by Total Debt Service.

(4) Debt service shown includes interest due on July 1 of the indicated calendar year and principal and interest due on January 1 of the next calendar year.

VIRGINIA PUBLIC SCHOOL AUTHORITY  
1991 Resolution Income Coverage  
As of June 30, 1998

Income Available to Pay Debt Service

	Local School Bond Income	Debt Service Reserve Cash Flow (1)	(A) Total Income	(B) Total Debt Service Requirements	Debt Service Coverage (A) / (B)
8/1/98	\$ 40,549,514	\$ 2,130,900	\$ 42,680,413	\$ 42,556,173	100.29%
2/1/99	13,115,944	1,552,293	14,668,237	14,418,053	101.74%
8/1/99	39,956,253	2,671,504	42,627,757	42,478,053	100.35%
2/1/00	12,395,314	1,521,466	13,916,780	13,677,991	101.75%
8/1/00	39,327,065	2,872,953	42,200,018	42,042,991	100.37%
2/1/01	11,672,302	1,484,280	13,156,582	12,930,098	101.75%
8/1/01	38,598,186	2,992,450	41,590,636	41,440,098	100.36%
2/1/02	10,951,964	1,443,087	12,395,051	12,181,363	101.75%
8/1/02	37,593,829	3,217,872	40,811,701	40,681,363	100.32%
2/1/03	10,224,442	1,394,937	11,619,379	11,416,820	101.77%
8/1/03	36,992,128	2,804,972	39,797,100	39,671,820	100.32%
2/1/04	9,460,839	1,356,239	10,817,078	10,624,803	101.81%
8/1/04	36,365,828	2,823,737	39,189,565	39,054,803	100.35%
2/1/05	8,658,735	1,316,008	9,974,743	9,791,554	101.87%
8/1/05	35,716,577	2,828,988	38,545,565	38,421,554	100.32%
2/1/06	7,843,551	1,274,617	9,118,168	8,943,364	101.95%
8/1/06	35,042,726	2,837,377	37,880,103	37,753,364	100.34%
2/1/07	7,055,307	1,231,884	8,287,191	8,122,784	102.02%
8/1/07	34,319,533	2,802,849	37,122,382	37,002,784	100.32%
2/1/08	6,301,202	1,188,991	7,490,193	7,338,401	102.07%
8/1/08	33,626,352	2,705,629	36,331,980	36,218,401	100.31%
2/1/09	5,556,043	1,147,347	6,703,389	6,564,858	102.11%
8/1/09	33,022,789	2,547,708	35,570,497	35,474,858	100.27%
2/1/10	4,798,937	1,108,871	5,907,808	5,781,952	102.18%
8/1/10	32,418,276	2,541,029	34,959,305	34,856,952	100.29%
2/1/11	4,033,908	1,069,529	5,103,437	4,990,648	102.26%
8/1/11	31,470,994	2,854,890	34,325,885	34,215,648	100.32%
2/1/12	3,270,823	1,021,219	4,292,041	4,192,743	102.37%
8/1/12	30,796,095	2,519,802	33,315,897	33,227,743	100.27%
2/1/13	2,502,143	979,471	3,481,614	3,395,879	102.52%
8/1/13	30,226,315	2,383,275	32,609,590	32,525,879	100.26%
2/1/14	1,725,852	934,888	2,660,740	2,594,282	102.56%
8/1/14	24,329,947	7,995,740	32,325,687	31,929,282	101.24%
2/1/15	1,109,864	733,418	1,843,282	1,785,213	103.25%
8/1/15	23,915,223	2,035,420	25,950,643	25,685,213	101.03%
2/1/16	488,525	702,221	1,190,745	1,145,628	103.94%
8/1/16	13,574,622	12,018,111	25,592,733	25,010,628	102.33%
2/1/17	131,740	393,065	524,805	499,381	105.09%
8/1/17	4,836,740	9,939,153	14,775,893	14,294,381	103.37%
2/1/18	-	142,868	142,868	133,838	106.75%
8/1/18	-	5,390,543	5,390,543	5,113,838	105.41%
Total	<u>\$ 753,976,424</u>	<u>\$ 102,911,600</u>	<u>\$ 856,888,024</u>	<u>\$ 850,185,470</u>	

- (1) Represents principal and interest income. For each series of Bonds, interest income is computed at the lesser of the arbitrage yield on the applicable series of Bonds and the investment rate reasonably estimated by the State Treasurer. The corpus of the Account is drawn down as the Debt Service Account Requirement declines.

VIRGINIA PUBLIC SCHOOL AUTHORITY  
Richmond, Virginia

As of June 30, 1998

BOARD OF COMMISSIONERS

Robert T. Copeland, Chairman

Kenneth C. Clarry, Vice Chairman

John P. Ireland

Richard F. Neel, Jr.

William D. Sessoms, Jr.

EX OFFICIO

Susan F. Dewey, Secretary and Treasurer, State Treasurer

William E. Landside, State Comptroller

Paul D. Stapleton, Superintendent of Public Instruction