

**POTOMAC AND RAPPAHANNOCK
TRANSPORTATION COMMISSION**

FINANCIAL STATEMENTS

JUNE 30, 2006

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FINANCIAL SECTION



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INDEPENDENT AUDITORS' REPORT

To the Honorable Commission Board Members
Potomac and Rappahannock Transportation Commission
Woodbridge, Virginia

We have audited the accompanying financial statements of the Potomac and Rappahannock Transportation Commission ("PRTC" or the "Commission") as of and for the year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the Commission's management. Our responsibility is to express opinions on these financial statements based on our audit. The financial statements of the Commission as of and for the year ended June 30, 2005 were audited by other auditors whose report, dated October 6, 2005, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and *Specifications for Audits of Authorities, Boards, and Commissions*, issued by the Auditor of Public Accounts of the Commonwealth of Virginia. Those standards and specifications 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission, as of June 30, 2006, and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 14, 2006 on our consideration of the Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis (pages 3 to 8) and the required supplementary information (page 29) are not a required part of the financial statements but are 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.

Our audit was conducted for the purpose of forming an opinion on the financial statements. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. The accompanying Schedule of Expenses of Federal Awards is presented for purposes of additional analysis as required by the U. S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

PBGH, LLP

Harrisonburg, Virginia
September 14, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

The management of the Potomac and Rappahannock Transportation Commission ("PRTC") offers the users of PRTC's financial statements this narrative overview and analysis of the financial activities for the fiscal year ended June 30, 2006. This discussion and analysis is designed to assist the reader to focus on significant financial activities and identify any significant changes in the financial position of PRTC. It should be read in conjunction with the financial statements that follow this section.

FINANCIAL HIGHLIGHTS

As of June 30, 2006, total assets of PRTC exceeded total liabilities by \$72,797,675. Of this amount, \$12,142,441 may be used to meet PRTC's on-going obligations.

The net assets of PRTC increased by \$6,545,010 during the current fiscal year.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Management's Discussion and Analysis is intended to serve as an introduction to PRTC's basic financial statements. The basic financial statements are comprised of four components: statements of net assets; statements of revenues, expenses, and changes in net assets; statements of cash flows; and notes to the financial statements. This report also contains other supplementary information in addition to the financial statements themselves.

The *statements of net assets* present information on all of PRTC's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of PRTC is improving or declining.

The *statements of revenues, expenses and changes in net assets* present information on revenues, expenses, and how PRTC's net assets changed during the two most recent fiscal years. All changes in net assets are reported as soon as the underlying event giving rise to the changes occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in the statements for some items that will only result in cash flows in future fiscal periods. The increase or decrease in net assets may serve as an indicator of the effect of PRTC's current year operation on its financial position.

The *statements of cash flows* summarize all of PRTC's cash flows into four categories: cash flows from operating activities; cash flows from capital and related financing activities; cash flows from noncapital financing activities; and cash flows from investing activities. The statements of cash flows, along with related notes and information in other financial statements, can be used to assess the following:

- PRTC's ability to generate future cash flows,
- PRTC's ability to pay its debt as the debt matures,
- Explanations of differences between PRTC's operating cash flows and operating loss, and
- The effect on PRTC's financial position of cash and non-cash transactions from investing, capital and financing activities.

The *notes to the financial statements* provide additional information that is essential to a full understanding of the data provided in the statements of net assets; statements of revenues, expenses and changes in net assets; and statements of cash flows. The notes to the financial statements can be found immediately following the financial statements.

The financial statements briefly discussed above provide information on all functions of PRTC as a business-type activity. The activities of PRTC are supported by the 2% motor fuel tax within the member jurisdictions, fare collections from passengers, and federal, state, and local assistance.

FINANCIAL ANALYSIS

Statements of Net Assets

Total assets of PRTC exceeded total liabilities by \$72,797,675 as of June 30, 2006. A significant portion of this (41%) is invested in net capital assets less any related debt that is still outstanding. PRTC uses these capital assets to provide express bus service from the Prince William County and Manassas areas to various points in the metropolitan Washington, D.C. area, and local bus service within Prince William County, and the cities of Manassas and Manassas Park. These capital assets are not available for future spending.

A condensed summary of PRTC's net assets at June 30, 2006 and 2005 is shown below.

	June 30,	
	2006	2005
ASSETS:		
Current assets	\$ 48,022,465	\$ 41,754,717
Noncurrent assets	3,078,328	3,027,363
Capital assets, net	33,532,153	30,210,159
Total assets	84,632,946	74,992,239
LIABILITIES:		
Current liabilities	8,858,522	5,096,736
Noncurrent liabilities	2,976,749	3,642,838
Total liabilities	11,835,271	8,739,574
NET ASSETS:		
Invested in capital assets, net of related debt	29,697,153	25,705,159
Restricted	30,958,081	30,159,589
Unrestricted	12,142,441	10,387,917
Total net assets	\$ 72,797,675	\$ 66,252,665

About 43% of PRTC's net assets represent resources that are restricted. Of the restricted net assets, at June 30, 2006, \$28,999,580 is restricted cash for member jurisdictions, and the remaining \$1,958,501 is restricted for debt service.

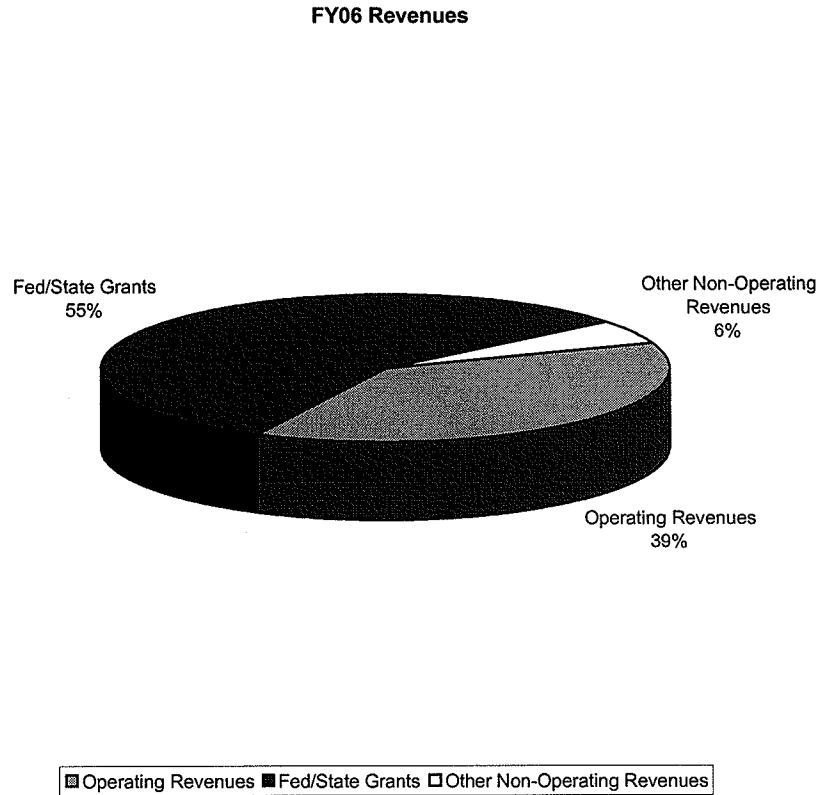
Statements of Revenues, Expenses and Changes in Net Assets

During fiscal year 2006, PRTC's activities resulted in an increase in net assets of \$6,545,010. The key elements of the changes in net assets are shown in the following table.

	Years Ended June 30,		Percent Increase (Decrease)
	2006	2005	
REVENUES:			
Operating revenues	\$ 25,554,810	\$ 20,834,040	23%
Federal and state grants	35,808,209	30,400,521	18%
Other nonoperating revenues	3,609,030	2,503,657	44%
Total revenues	64,972,049	53,738,218	21%
EXPENSES:			
Operating expenses	35,274,679	27,095,648	30%
Pass-through grants	22,948,962	18,690,330	23%
Other nonoperating expenses	203,398	1,061,316	(81)%
Total expenses	58,427,039	46,847,294	25%
Change in net assets	6,545,010	6,890,924	(5%)
Net Assets, beginning	66,252,665	59,361,741	12%
Net Assets, ending	\$ 72,797,675	\$ 66,252,665	10%

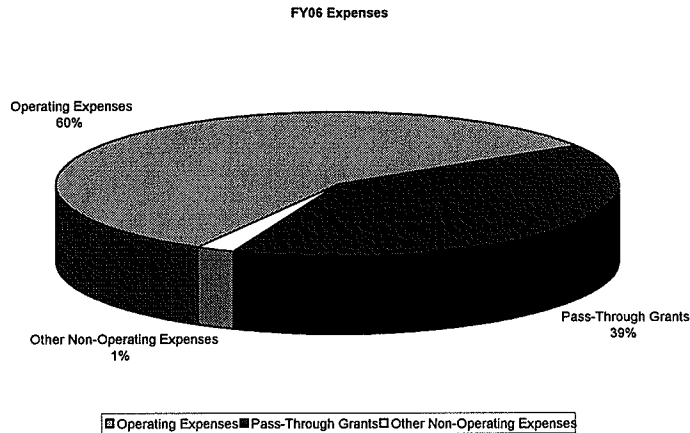
The increase in operating revenues of \$4,720,770 from fiscal year 2005 is due primarily to an increase of 26% in the 2% motor fuel tax revenue as a result of higher fuel prices and an increase of 15% in farebox revenues as a result of more passenger trips. The increase in federal and state grants of \$5,407,688 is principally the result of federal funds being received for various Virginia Railway Express (VRE) projects.

The following chart shows revenues by source for the fiscal year ended June 30, 2006.



Total operating expenses increased by \$8,179,031, principally due to direct transportation expenses, contractual services, and material, supplies, and minor equipment. Direct transportation increased as a result of the member jurisdictions authorizing more disbursements from their respective 2% motor fuel tax revenues for transportation projects operating or originating within their jurisdiction. Contractual services increased mainly as a result of new bus services introduced in fiscal year 2006. These new services include supplemental Route One OmniRide and OmniLink services. Materials, supplies, and minor equipment increased due to a combination of much higher diesel fuel expense and Transit Center repairs. Fuel costs increased from \$1,167,134 in fiscal year 2005 to \$1,867,171 in fiscal year 2006 due to higher diesel fuel costs and an increase in fuel usage as a result of new bus services. The Transit Center had significant repairs in fiscal year 2006 as the concrete pads in the bus turnaround area were failing and had to be reconstructed. Pass-through grants increased by \$4,258,632 as the result of additional federal funds received for various VRE projects. The decrease in other nonoperating expenses is the result of the early retirement of the OmniLink Champion buses in the prior fiscal year.

The following chart shows expenses for the fiscal year ended June 30, 2006.



CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

PRTC's investment in capital assets as of June 30, 2006, amounts to \$33,532,153 (net of accumulated depreciation). This investment in capital assets includes buses and related equipment, other vehicles, construction in process, furniture and equipment, bus shelters, building, and building improvements.

Major capital asset events during the current fiscal year included the following:

- Eleven OmniRide buses were delivered with a total cost of \$4,668,624.
- Six OmniLink buses were delivered with a total cost of \$1,592,706.

The following table summarizes capital assets net of depreciation.

	June 30,	
	2006	2005
Buses and related equipment	\$ 26,985,513	\$ 23,573,839
Other vehicles	15,050	26,433
Construction in process	314,371	113,932
Furniture and equipment	146,448	129,422
Bus shelters	70,338	74,692
Building	5,772,598	6,041,010
Building improvements	227,835	250,831
Total	\$ 33,532,153	\$ 30,210,159

Additional information on PRTC's capital assets is shown in Note 7.

Long-Term Debt

At the end of the fiscal year, PRTC had total revenue bonds payable outstanding of \$3,835,000. These bonds are secured by Prince William County's portion of the 2% motor fuel tax revenues, basic rent payments made by Prince William County under the lease of transportation facilities, and certain funds established under the Indenture.

Additional information on PRTC's long-term debt is shown in Note 8.

REQUEST FOR INFORMATION

This financial report is designed to provide our member jurisdictions, customers, and investors and creditors with a general overview of PRTC's finances. If you have questions concerning any of the information provided in this report or need additional financial information, contact the Director of Finance and Administration at the Potomac and Rappahannock Transportation Commission, 14700 Potomac Mills Road, Woodbridge, VA 22192, telephone (703) 583-7782. The web address for PRTC is www.prtctransit.org.

FINANCIAL STATEMENTS

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

**STATEMENTS OF NET ASSETS
June 30, 2006 and 2005**

ASSETS	2006	2005
Current Assets		
Cash and investments in bank	\$ 10,778,334	\$ 7,897,498
Cash and investments in pooled funds	789,222	716,107
Cash and investments in pooled funds - member jurisdictions	23,568,183	25,396,297
Receivables:		
Due from other governments	11,466,985	6,334,443
Miscellaneous	224,080	223,373
Prepaid expenses and other assets	26,383	16,451
Restricted Assets:		
Investments held by trustee	1,169,278	1,168,683
Interest receivable	-	1,865
Total current assets	48,022,465	41,754,717
Noncurrent Assets		
Other Assets:		
Unamortized bond issuance costs	42,552	51,671
Net investment in direct financing lease	3,035,776	2,975,692
Total other assets	3,078,328	3,027,363
Capital Assets:		
Transportation Equipment:		
Buses and related equipment	40,030,113	33,766,608
Other vehicles	98,483	98,483
Less: accumulated depreciation	(13,128,033)	(10,264,819)
Transportation equipment, net	27,000,563	23,600,272
Building and Equipment:		
Construction in process	314,371	113,932
Furniture and equipment	505,931	538,130
Bus shelter	207,495	182,484
Building improvements	315,815	312,819
Building	8,052,341	8,052,341
Less: accumulated depreciation	(2,864,363)	(2,589,819)
Building and equipment, net	6,531,590	6,609,887
Total capital assets, net	33,532,153	30,210,159
Total noncurrent assets	36,610,481	33,237,522
Total assets	\$ 84,632,946	\$ 74,992,239

See Notes to Financial Statements.

LIABILITIES AND NET ASSETS	2006	2005
Current Liabilities		
Accounts payable and other liabilities	\$ 4,156,116	\$ 1,271,884
Accrued payroll and benefits	456,667	401,248
Due to other governments	3,488,158	2,508,343
Deferred revenue	-	155,764
Retainage payable	-	22,201
Liabilities Payable from Restricted Assets:		
Bond interest payable	57,581	67,296
Revenue bonds payable - current portion	700,000	670,000
Total current liabilities	8,858,522	5,096,736
Noncurrent Liabilities		
Revenue bonds payable - net of unamortized discount	2,976,749	3,642,838
Total liabilities	11,835,271	8,739,574
Net Assets		
Invested in capital assets, net of related debt	29,697,153	25,705,159
Restricted	30,958,081	30,159,589
Unrestricted	12,142,441	10,387,917
Total net assets	72,797,675	66,252,665
Total liabilities and net assets	\$ 84,632,946	\$ 74,992,239

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POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Years Ended June 30, 2006 and 2005

	2006	2005
Operating Revenues:		
2% Motor fuels tax revenues	\$ 18,571,127	\$ 14,774,993
Farebox revenues	5,833,683	5,093,832
Advertising revenue	450,000	400,000
From member jurisdictions	700,000	565,215
	<hr/>	<hr/>
Total operating revenues	25,554,810	20,834,040
	<hr/>	<hr/>
Operating Expenses:		
Direct transportation	13,163,131	8,252,236
Salaries and related benefits	3,200,691	2,949,860
Contractual services	12,495,810	10,758,390
Other services	793,212	717,601
Materials, supplies and minor equipment	2,331,066	1,368,930
Depreciation and amortization	3,290,769	3,048,631
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Total operating expenses	35,274,679	27,095,648
	<hr/>	<hr/>
Operating loss	(9,719,869)	(6,261,608)
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Nonoperating Revenues (Expenses):		
Federal and state operating grants	35,808,209	30,400,521
Pass-through grants - VRE	(22,771,855)	(18,688,946)
Pass-through grants - member jurisdictions	(177,107)	(1,384)
Reimbursement from member jurisdiction	139,629	133,378
Investment income	1,389,292	647,786
Direct financing lease interest income	201,887	229,408
Bond interest expense	(196,331)	(224,392)
Other revenue	1,878,222	1,493,085
Loss on disposal of fixed assets	(7,067)	(836,924)
	<hr/>	<hr/>
Total nonoperating revenues, net	16,264,879	13,152,532
	<hr/>	<hr/>
Change in net assets	6,545,010	6,890,924
	<hr/>	<hr/>
Net Assets, beginning	66,252,665	59,361,741
	<hr/>	<hr/>
Net Assets, ending	\$ 72,797,675	\$ 66,252,665
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See Notes to Financial Statements.

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2006 and 2005

	2006	2005
Cash Flows from Operating Activities:		
Receipts from 2% motor fuels tax	\$ 17,993,023	\$ 14,493,964
Receipts from customers	5,367,892	4,811,577
Receipt from member jurisdiction	700,000	565,215
Receipts from advertising	450,000	400,000
Payments to suppliers	(12,767,987)	(13,145,794)
Payments to member jurisdictions	(13,163,131)	(8,252,236)
Payments to employees	(3,145,272)	(2,896,594)
	<u>(4,565,475)</u>	<u>(4,023,868)</u>
Net cash used in operating activities		
Cash Flows from Capital and Related Financing Activities:		
Interest payments on revenue bonds	(201,887)	(229,408)
Principal payments on revenue bonds	(670,000)	(640,000)
Proceeds from sale of assets	90	179,263
Receipts from direct financing lease	871,888	869,408
Purchase of buses and related equipment	(6,276,342)	(8,006,501)
Payments for building improvements, construction in process, bus shelters, furniture and equipment	(304,709)	(114,203)
	<u>(6,580,960)</u>	<u>(7,941,441)</u>
Net cash used in capital and related financing activities		
Cash Flows from Noncapital Financing Activities:		
Federal and state operating grants	31,563,092	29,909,952
Payments for VRE grant - related expenditures	(21,792,040)	(17,925,980)
Payments for jurisdiction grant - related expenditures	(177,107)	(1,384)
	<u>9,593,945</u>	<u>11,982,588</u>
Net cash provided by noncapital financing activities		

See Notes to Financial Statements.

	2006	2005
Cash Flows From Investing Activities:		
Investment income	\$ 1,391,157	\$ 666,088
Sales and maturities of investments	871,888	775,632
Purchase of investments	(872,485)	(736,675)
Other revenues	1,287,767	1,493,085
	<u>2,678,327</u>	<u>2,198,130</u>
Net cash provided by investing activities	2,678,327	2,198,130
	<u>1,125,837</u>	<u>2,215,409</u>
Net increase in cash and cash equivalents	1,125,837	2,215,409
Cash and Cash Equivalents		
Beginning	34,009,902	31,794,493
Ending	<u>\$ 35,135,739</u>	<u>\$ 34,009,902</u>
Reconciliation of Operating Loss to Net Cash Used in Operating Activities:		
Operating loss	\$ (9,719,869)	\$ (6,261,608)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	3,290,769	3,048,631
Changes in assets and liabilities:		
(Increase) decrease in:		
Due from other governments	(887,422)	(493,894)
Miscellaneous receivables	(707)	49,656
Prepaid expenses and other assets	(9,932)	98,466
Increase (decrease) in:		
Accounts payable and other liabilities	2,884,232	(402,771)
Accrued payroll and benefits	55,419	53,266
Retainage payable	(22,201)	3,432
Deferred revenue	(155,764)	(119,046)
	<u>\$ (4,565,475)</u>	<u>\$ (4,023,868)</u>

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POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 1. Organization

The Potomac and Rappahannock Transportation Commission (“PRTC” or the “Commission”) was created on June 19, 1986, as a public body corporate and politic under the provisions of Chapter 32, Article 2, Title 15.1, of the *Code of Virginia*, 1950, as amended, for the purpose of facilitating the planning and development of an improved transportation system. The transportation system is composed of transit facilities, public highways, and other modes of transportation required in order to promote orderly transportation into, within, and from the various contiguous counties and cities composing the Commission, and to secure the comfort, convenience, and safety of its citizens through joint action by those contiguous counties and cities. The Commission includes the counties of Prince William and Stafford, as well as the cities of Fredericksburg, Manassas, and Manassas Park (collectively referred to as “member jurisdictions”). The Commission was created to manage and control the function, affairs, and property of PRTC.

The Commission has 15 members, including three from the General Assembly and one ex-officio representative from the Virginia Department of Rail and Public Transportation. The governing body of each member jurisdiction appoints, from among its members, its representatives to act as Commissioners. The composition of the Commission is as follows:

	Members	Represented Jurisdictions
Prince William County	6	1
Stafford County	2	1
Manassas	1	1
Manassas Park	1	1
Fredericksburg	1	1
Commonwealth House	2	1
Commonwealth Senate	1	1
Virginia Department of Rail and Public Transportation	1	-
	15	7

Each Commission member, including the Virginia Department of Rail and Public Transportation representative, is entitled to one vote in all matters requiring action by the Commission. A majority vote of the Commission members present and voting, and a majority of the jurisdictions represented are required to act. For purposes of determining the number of jurisdictions present, the Virginia Department of Rail and Public Transportation is not counted as a separate jurisdiction.

Member jurisdictions do not have an explicit equity interest in PRTC. Each jurisdiction controls PRTC’s use of the motor fuel tax proceeds from that jurisdiction.

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 1. Organization (Continued)

Revenues of PRTC consist principally of a 2% motor fuel tax and federal and state operating grants. The fuel tax revenues represent a sales tax on retail sales of motor vehicle fuels levied by the Commonwealth of Virginia through its Department of Taxation. The Department of Taxation collects the tax and remits funds to PRTC monthly, after deducting its administrative costs. These funds are separately maintained by PRTC for the benefit of each member jurisdiction and are used to pay administrative costs of PRTC and transportation projects operating or originating within a particular jurisdiction.

Note 2. Summary of Significant Accounting Policies

The following summarizes PRTC's significant accounting policies:

Reporting entity: PRTC has considered its relationship with the member jurisdictions in establishing the appropriate reporting entity in terms of financial accountability and fiscal dependency. None of the member jurisdictions appoint a voting majority of the Commission. Although action by PRTC, including adoption of a budget and issuance of debt, requires approval of a majority of the member jurisdictions, each jurisdiction controls PRTC's use of its 2% motor fuel tax proceeds. PRTC is not fiscally dependent on one particular jurisdiction. Thus, PRTC does not consider itself a component unit of any government.

The Virginia Railway Express ("VRE") is jointly operated and controlled by PRTC and the Northern Virginia Transportation Commission ("NVTC") (see Note 10). Neither PRTC nor NVTC appoints a voting majority of the Operations Board of VRE. PRTC has no equity investment in VRE. VRE is fiscally dependent on PRTC, NVTC, its member jurisdictions, and grants from the Commonwealth of Virginia and the federal government, and, therefore, is not included as a component unit of PRTC.

Basis of presentation: The accounting policies of PRTC conform to accounting principles generally accepted in the United States of America as applicable to enterprise funds of governmental units. While separate funds are maintained to account for each member jurisdiction's 2% motor fuel tax revenues, one combined enterprise fund is used for financial statement presentation. The activities of PRTC are similar to those of proprietary funds of local jurisdictions.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, PRTC has elected to apply all applicable GASB pronouncements, as well as FASB Statements and Interpretations, APB Opinions, and Accounting Research Bulletins, issued on or before November 30, 1989, that do not conflict with or contradict GASB pronouncements.

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 2. Summary of Significant Accounting Policies (Continued)

Basis of accounting: Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to timing of the measurements made, regardless of the measurement focus applied. PRTC uses the accrual basis of accounting, where revenues are recognized when they are earned and expenses are recognized when they are incurred.

Cash and investments in pooled funds: Cash and investments in pooled funds represent PRTC's share of the pooled cash and investments held by the Local Government Investment Pool ("LGIP") as the trustee for the jurisdictional funds. The LGIP holds and invests certain funds of PRTC on its behalf. The investment in the LGIP (a 2a7-like pool) is reported at the pool's share price.

Cash and investments in pooled funds – member jurisdictions: These assets represent the portion of funds held for the benefit of the member jurisdictions.

The Commission classifies as cash and cash equivalents amounts on deposit with banks and cash invested temporarily in various instruments with maturities of three months or less at time of purchase.

Restricted assets: Cash and investments held by trustee include bond proceeds and funds designated for specific purposes. The Trustee, The Bank of New York, maintains the resources in appropriate accounts in accordance with the Master Indenture of Trust.

Capital assets: Capital assets are stated at historical cost. Capital assets are defined by PRTC as assets with an initial, individual cost of more than \$2,500 and an estimated useful life in excess of one year.

Depreciation of all exhaustible equipment and building is charged as an expense against operations using the straight-line method over the following estimated useful lives:

Building and improvements	5 - 30 years
Buses and related equipment	4 - 12 years
Other vehicles	5 years
Bus shelters	5 years
Furniture and equipment	5 years

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 2. Summary of Significant Accounting Policies (Continued)

Net investment in direct financing lease: Net investment in direct financing lease is recorded at the gross minimum lease payments receivable less unearned income representing interest on the transaction and undisbursed proceeds. Unearned income is recognized over the term of the lease in amounts equal to interest on the related outstanding bonds.

Compensated absences: PRTC employees are granted annual and sick leave based on years of service. In the event of termination, an employee is reimbursed for accumulated annual leave in full, and if applicable, a portion of sick leave. Compensatory time earned by PRTC employees is also payable upon termination of employment. The liability for compensated absences is included in accrued payroll and benefits in the accompanying financial statements as a current liability.

Bond discounts and issuance costs: Bond discounts and issuance costs are deferred and amortized over the term of the bonds using a method which approximates the effective interest method.

Revenue recognition: Intergovernmental revenues, consisting primarily of Federal and Commonwealth of Virginia grants, designated for payment of specific expenses, are recognized at the time that the expenses are incurred. Capital grants and assistance are recognized as additions are made to capital assets and operating resources are included in the Statements of Revenues and Expenses and Changes in Net Assets when expended.

Operating revenues and expenses: Operating revenues are generated from activities related to providing public transportation services to PRTC's customers. PRTC's operating revenues include 2% motor fuel tax revenues, farebox revenues, advertising revenue, and contributions from member jurisdictions. Nonoperating revenues include federal and state grants, investment income, and reimbursement from member jurisdictions.

Operating expenses are incurred for activities related to providing public transportation services to PRTC's customers. PRTC's operating expenses include direct transportation expenses and general and administrative expenses. Nonoperating expenses include interest expense.

Statement of cash flows: For purposes of reporting cash flows, cash and cash equivalents include cash on hand, demand deposits, pooled funds, money market funds, overnight repurchase agreements, and U. S. Government agency obligations having an original maturity of three months or less.

Use of estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 3. Cash and Investments

Deposits: All cash of PRTC is maintained in accounts collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 et. seq. of the *Code of Virginia* or covered by federal depository insurance.

Investments: Statutes authorize local governments and other public bodies to invest in obligations of the United States or its agencies thereof, obligations of the Commonwealth of Virginia or political subdivisions thereof, obligations of the International Bank for Reconstruction and Development (World Bank), the Asian Development Bank, the African Development Bank, "prime quality" commercial paper and certain corporate notes; banker's acceptances, repurchase agreements and the State Treasurer's Local Government Investment Pool (LGIP).

The Commission has investments in the LGIP, Dreyfus Cash Management Fund (DCMF), and STI Classic Institutional Government Funds (STI). The LGIP, DCMF, and the STI are professionally managed money market funds which invest in qualifying obligations and securities as permitted by Virginia statutes. Pursuant to Section 2.2-4605 *Code of Virginia*, the Treasury Board of the Commonwealth sponsors the LGIP and has delegated certain functions to the State Treasurer. The LGIP reports to the Treasury Board at their regularly scheduled monthly meetings. The fair value of the position of the LGIP is the same as the value of the pool shares, i.e., the LGIP maintains a stable net asset value of \$1 per share. The LGIP and STI have been assigned an "AAAm" and the DCMF has been assigned an "Aaa" rating by Standard and Poors. The maturity of the LGIP, DCMF, and STI is less than one year.

Interest rate risk is defined as the risk that changes in interest rates will adversely affect the fair value of an investment if the investment is held for a long period of time. Interest rate risk does not apply to the LGIP since it is a 2a7-like pool.

As of June 30, 2006, the carrying values and maturity of PRTC's investments were as follows:

Investment Type	Fair Value	Maturities Less Than One Year
LGIP	\$ 24,357,405	\$ 24,357,405
Money market funds	11,960,278	11,960,278
Total investments	\$ 36,317,683	\$ 36,317,683

PRTC has adopted a formal investment policy. The policy specifies eligible and ineligible investments; diversification requirements; maximum length of time for various types of investments; and the process for purchasing securities.

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 3. Cash and Investments (Continued)

PRTC's investment policy establishes the maximum percentages of the portfolio permitted on each of the following instruments:

Authorized Investments

Authorized investments for public funds are set forth in Chapter 18, Section 2.1-327 to 2.1-329.1 of the *Code of Virginia*. The following are included on the list of authorized investments:

1. Obligations issued or guaranteed by the U. S. Government, an agency thereof, or U. S. Government sponsored corporation.
2. Certificates of deposit and time deposits in any of Virginia's qualified public depositories federally insured to the maximum extent possible and collateralized under the Virginia Security for Public Deposits Act.
3. Repurchase agreements collateralized by U. S. Treasury/agency securities.
4. Bankers' acceptances from "prime quality" major U. S. banks and domestic offices of international banks.
5. "Prime quality" commercial paper issued by domestic corporations.
6. Short-term corporate notes and/or bank notes of domestic corporations/banks.
7. The LGIP as established by the Virginia Department of the Treasury.

Diversification

Diversification of investments by security type and by issuer will be consistent with the following guidelines:

1. The portfolio will be diversified with not more than 5% of the value of the investment pool's assets invested in the securities of any single issuer. This limitation will not apply to securities of the U. S. Government or agency thereof, government sponsored corporation securities, or fully insured and/or collateralized certificates of deposit.
2. PRTC's investment policy establishes the maximum percentages of the portfolio permitted in each of the following instruments:

LGIP	100% maximum
U. S. Treasury and Agency Securities	100% maximum
Certificates of Deposit	25% maximum
Repurchase Agreements	50% maximum
Bankers' Acceptances	40% maximum
Commercial Paper	35% maximum
Corporate Notes and Bank Notes	25% maximum

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 3. Cash and Investments (Continued)

Funds are held in the LGIP for the benefit of the various member jurisdictions as follows:

	2006	2005
Stafford County	\$ 2,919,498	\$ 7,302,491
Prince William County	11,820,156	11,678,333
City of Manassas	1,995,157	1,459,467
City of Manassas Park	1,587,855	1,241,438
City of Fredericksburg	5,245,517	3,714,568
	<hr/>	<hr/>
	\$ 23,568,183	\$ 25,396,297

Note 4. Restricted Assets

Restricted assets held by the Trustee represent the portion of resources held by the Trustee on behalf of PRTC in accordance with the applicable bond covenants. These assets include cash and investments. The accounts established under the indenture of trust have the following restricted assets held by the Trustee at June 30, 2006 and 2005:

	2006	2005
Bond fund	\$ 359,051	\$ 386,320
Debt service reserve fund	810,227	782,363
Interest receivable	-	1,865
	<hr/>	<hr/>
Total restricted assets held by trustee	\$ 1,169,278	\$ 1,170,548

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 5. Due To/From Other Governments

Amounts due from other governments are as follows:

	2006	2005
Virginia Department of Taxation - 2% motor fuel tax receipts	\$ 3,454,741	\$ 2,876,637
Virginia Department of Rail and Public Transportation	1,530,727	206,330
VRE direct reimbursement	868,310	581,952
Federal Transit Administration:		
Grant proceeds	3,394,218	166,139
VRE grant expenditures	1,934,025	2,241,383
Washington Metropolitan Area Transit Authority	284,964	262,002
	<u>\$ 11,466,985</u>	<u>\$ 6,334,443</u>

Amounts due to other governments are as follows:

	2006	2005
Virginia Railway Express	<u>\$ 3,488,158</u>	<u>\$ 2,508,343</u>

Note 6. Net Investment in Direct Financing Lease

PRTC has entered into a lease agreement with Prince William County (the "County") for transportation facilities constructed with the proceeds from the transportation facilities lease revenue bonds (see Note 8). In accordance with this agreement, PRTC has made available to the County \$5,500,000 of the \$9,405,000 bond proceeds. The lease agreement indicates the County is responsible for acquiring land, constructing, and maintaining two railway stations – Broad Run and Rippon – located within the County. Rentals under the lease are equal to the bond debt service and related fees and expenses. The lease term is equivalent to the life of the bonds, and ownership of the constructed facilities reverts to the County at the end of the lease term. Accordingly, the future net rentals have been capitalized as a direct financing lease receivable as follows:

Year Ending June 30,	Amount
2007	\$ 872,742
2008	876,942
2009	874,235
2010	874,810
2011	<u>873,410</u>
Net minimum rentals	4,372,139
Less: Unearned income	(537,139)
Deferred contributions	<u>(799,224)</u>
Net investment in lease	<u>\$ 3,035,776</u>

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 7. Capital Assets

Changes in capital assets for the year ended June 30, 2006 are as follows:

	Balance June 30, 2005	Increases	Reclassifications/ Decreases	Balance June 30, 2006
Capital assets not being depreciated:				
Construction in progress	\$ 113,932	\$ 212,039	\$ (11,600)	\$ 314,371
Capital assets being depreciated:				
Buses and related equipment	33,766,608	6,276,342	(12,837)	40,030,113
Other vehicles	98,483	-	-	98,483
Furniture and equipment	538,130	65,238	(97,437)	505,931
Bus shelters	182,484	18,184	6,827	207,495
Building improvements	312,819	9,248	(6,252)	315,815
Buildings	8,052,341	-	-	8,052,341
Total capital assets being depreciated	42,950,865	6,369,012	(109,699)	49,210,178
Less accumulated depreciation for:				
Buses and related equipment	10,192,769	2,864,668	(12,837)	13,044,600
Other vehicles	72,050	11,383	-	83,433
Furniture and equipment	408,707	47,312	(96,536)	359,483
Bus shelters	107,792	31,910	(2,545)	137,157
Building improvements	61,988	28,214	(2,222)	87,980
Buildings	2,011,332	268,411	-	2,279,743
Total accumulated depreciation	12,854,638	3,251,898	(114,140)	15,992,396
Total capital assets being depreciated, net	30,096,227	3,117,114	4,441	33,217,782
Totals	\$ 30,210,159	\$ 3,329,153	\$ (7,159)	\$ 33,532,153

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 7. Capital Assets (Continued)

Changes in capital assets for the year ended June 30, 2005 are as follows:

	Balance June 30, 2004	Increases	Reclassifications/ Decreases	Balance June 30, 2005
Capital assets not being depreciated:				
Construction in progress	\$ 49,300	\$ 73,332	\$ (8,700)	\$ 113,932
Capital assets being depreciated:				
Buses and related equipment	27,711,220	8,006,501	(1,951,113)	33,766,608
Other vehicles	98,483	-	-	98,483
Furniture and equipment	529,176	17,124	(8,170)	538,130
Bus shelters	161,672	20,812	-	182,484
Building improvements	302,216	11,635	(1,032)	312,819
Buildings	8,052,341	-	-	8,052,341
Total capital assets being depreciated	36,855,108	8,056,072	(1,960,315)	42,950,865
Less accumulated depreciation for:				
Buses and related equipment	8,512,308	2,617,079	(936,618)	10,192,769
Other vehicles	57,653	14,397	-	72,050
Furniture and equipment	365,193	50,901	(7,387)	408,707
Bus shelters	75,401	32,391	-	107,792
Building improvements	35,532	26,579	(123)	61,988
Buildings	1,742,920	268,412	-	2,011,332
Total accumulated depreciation	10,789,007	3,009,759	(944,128)	12,854,638
Total capital assets being depreciated, net	26,066,101	5,046,313	(1,016,187)	30,096,227
Totals	\$ 26,115,401	\$ 5,119,645	\$ (1,024,887)	\$ 30,210,159

Note 8. Long-Term Liabilities

Revenue bonds payable: On February 1, 1991, PRTC issued Transportation Facilities Lease Revenue Bonds, Series 1991A in the aggregate principal amount of \$9,405,000. The Series 1991A bonds were issued to: (1) finance part of the costs of the acquisition, design, and construction of transportation facilities in Prince William County, (2) make certain deposits to the Debt Service Reserve Fund, and (3) pay certain costs of issuance.

On December 1, 1997, PRTC issued \$7,445,000 in Transportation Facilities Lease Revenue Refunding Bonds. The 1997 bonds were issued to “refinance” PRTC’s 1991 bonds to achieve interest cost savings. The refunding of the 1991 bonds was a “crossover” refunding. The proceeds of the 1997 bonds were placed in an escrow account with the Trustee until March 1, 2000 (the crossover refunding date). Through the crossover refunding date, interest on the 1997 bonds was payable from the escrow account. On March 1, 2000, the escrow account crossed over and paid the remaining principal on the 1991 bonds. PRTC continued to pay debt service on the 1991 bonds through March 1, 2000. Beginning with the first interest payment due after the crossover date, which was September 1, 2000, PRTC began making debt service payments on the 1997 bonds, taking advantage of the lower interest rates.

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 8. Long-Term Liabilities (Continued)

A summary of changes in long-term debt for the year ended June 30, 2006 is as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
1997 facility lease revenue refunding bond, \$7,445,000, 4.0%-4.6%	\$ 4,505,000	\$ -	\$ (670,000)	\$ 3,835,000	\$ 700,000
1997 bond discount	(192,162)	-	(33,911)	(158,251)	-
Total long-term liabilities	\$ 4,312,838	\$ -	\$ (636,089)	\$ 3,676,749	\$ 700,000

A summary of changes in long-term debt for the year ended June 30, 2005 follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
1997 facility lease revenue refunding bond, \$7,445,000, 4.0%-4.6%	\$ 5,145,000	\$ -	\$ (640,000)	\$ 4,505,000	\$ 670,000
1997 bond discount	(226,073)	-	(33,911)	(192,162)	-
Total long-term liabilities	\$ 4,918,927	\$ -	\$ (606,089)	\$ 4,312,838	\$ 670,000

Debt Service Requirements

The 1997 bonds mature annually beginning in 2001 in increasing amounts through 2011, with \$835,000 due March 1, 2011. The 1997 bonds bear interest at rates from 4.0% to 4.6% with interest payable semi-annually on March 1 and September 1. Revenue bond debt service requirements to maturity are as follows:

Year Ending June 30,	Principal	Interest	Total
2007	\$ 700,000	\$ 172,742	\$ 872,742
2008	735,000	141,942	876,942
2009	765,000	109,235	874,235
2010	800,000	74,810	874,810
2011	835,000	38,410	873,410
	\$ 3,835,000	\$ 537,139	\$ 4,372,139

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 8. Long-Term Liabilities (Continued)

Pledged Funds

The payment of principal and interest on the 1997 bonds is secured by a pledge of (1) Prince William County's portion of 2% motor fuel tax revenues, (2) basic rent payments made by Prince William County under the lease of the transportation facilities (see Note 6), and (3) certain funds established under the Indenture.

Accounts Established in Accordance with the Indentures

The following funds are established under the 1991 Indentures and carried over to the 1997 Indenture:

- (1) Project Fund, with a Capitalized Interest Account, a Commuter Stations Account, and an Optional Facilities Account
- (2) Bond Fund
- (3) Debt Service Reserve Fund
- (4) Cost of Issuance Fund

All revenues and all money in the Project Fund, the Bond Fund, the Cost of Issuance Fund, and the Debt Service Reserve Fund are trust funds and are pledged to the payment of principal and interest on the bonds.

The Indenture requires PRTC to make monthly deposits from Prince William County's portion of 2% motor fuel tax revenues to the Bond Fund so that it will contain the amount required for the next succeeding principal and/or interest payment on the bonds 60 days before the payment date. To the extent the County's portion of 2% motor fuel tax revenues is not sufficient to meet the scheduled debt service payment, the County will make lease payments to PRTC.

The following funds are established under the 1997 Indenture:

- (1) Cost of Issuance Fund
- (2) Escrow Account

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 9. Net Assets

Restricted net assets represent net assets that are subject to restrictions beyond PRTC's control. Following is a summary of the components of restricted net assets as of June 30, 2006 and 2005:

	2006	2005
Member jurisdictions	\$ 28,999,580	\$ 28,272,934
Debt service	1,958,501	1,886,655
Total restricted net assets	\$ 30,958,081	\$ 30,159,589

Unrestricted net assets consist of the following as of June 30, 2006 and 2005:

	2006	2005
Designations of unrestricted net assets:		
Carryforward to support next year budget	\$ 1,817,412	\$ 1,342,659
Local match for grants	1,862,344	1,609,373
Total designations	3,679,756	2,952,032
Undesignated unrestricted net assets	8,462,685	7,435,885
Total unrestricted net assets	\$ 12,142,441	\$ 10,387,917

Note 10. Virginia Railway Express

PRTC and the NVTC entered into a Master Agreement dated October 27, 1989, establishing the VRE. VRE provides commuter rail service originating in Manassas, Virginia, and Fredericksburg, Virginia, to Union Station in the District of Columbia, using existing rail tracks.

VRE is managed by an Operations Board consisting of three commissioners appointed from each of PRTC and NVTC and one ex-officio representative of the Virginia Department of Rail and Public Transportation. The Operations Board is responsible for the financial management of VRE. NVTC serves as the repository of all monies. Operational and capital costs of the rail service are financed by bond issues, Federal and state grants, local jurisdiction assistance, and passenger revenue. Assistance to be provided by the local jurisdictions is based on a population and ridership formula for participating jurisdictions and a predetermined contribution amount from contributing jurisdictions. Participating jurisdictions include the counties of Fairfax, Prince William and Stafford and the cities of Manassas, Manassas Park, and Fredericksburg. Contributing jurisdictions include Arlington County and the City of Alexandria.

For the years ended June 30, 2006 and 2005, PRTC paid \$3,465,655 and \$3,148,454, respectively, for VRE support on behalf of its member jurisdictions.

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 11. Revenue from Member Jurisdictions

Effective May 13, 1991, Prince William County transferred operating responsibility of its OmniRide (Commuteride) Program to PRTC. The program consists of express commuter bus service from the County to the District of Columbia, as well as ridesharing services. During the fiscal year 1995, PRTC began operating local bus service ("OmniLink") within Prince William County and in fiscal year 1996 began local bus service in the cities of Manassas and Manassas Park. These services are financed by passenger fares, state grants, 2% motor fuel tax, and other jurisdictional payments.

During the years ended June 30, 2006 and 2005, PRTC recognized \$700,000 and \$565,215, respectively, as revenue from Prince William County in addition to the 2% motor fuel tax.

Note 12. Direct Transportation Expenses

In addition to PRTC administrative costs, the member jurisdictions authorize disbursement from their respective 2% motor fuel tax revenues for transportation projects operating or originating within their jurisdiction. During the years ended June 30, 2006 and 2005, amounts expended for joint and jurisdictional transportation projects consisted of:

	2006	2005
VRE support	\$ 3,465,655	\$ 3,148,454
Other jurisdictional projects and fees	8,170,954	3,584,844
Deposits to 1997 bond funds	871,888	869,408
Lease participation certificates debt service	654,634	649,530
	<u>\$ 13,163,131</u>	<u>\$ 8,252,236</u>

VRE payments are made in accordance with a capital budget prepared by VRE and adopted by its Operations Board.

Note 13. Pass-Through Grants – VRE

PRTC receives Federal and State financial assistance on behalf of the VRE. VRE submits reimbursement requests to PRTC who then submits them to the granting agency. Upon receipt of the funds, they are passed on to VRE. For the years ended June 30, 2006 and 2005, grant revenue in the accompanying financial statements includes \$22,771,855 and \$18,688,946, respectively, in Federal, State, and local assistance received by PRTC that was passed on to VRE.

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 14. Risk Management

PRTC is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Commercial insurance is purchased to address these risks, including workers' compensation and employee health and accidental insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Note 15. Related Parties

For the years ended June 30, 2006 and 2005, expenses incurred for legal services provided by Prince William County were \$39,000 each year.

Note 16. Deferred Compensation Benefits

PRTC offers a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan is available to all employees and permits them to defer a portion of their current salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are held in trust for the exclusive benefit of plan participants and/or beneficiaries. PRTC has the duty of due care that would be required of any prudent investor.

PRTC contributions to the deferred compensation plan for the years ended June 30, 2006 and 2005 were \$39,105 and \$34,877, respectively.

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 17. Defined Benefit Pension Plan

A. Plan Description

Name of Plan: Virginia Retirement System (VRS)

Identification of Plan: Agent and Cost-Sharing Multiple-Employer Defined Benefit Pension Plan

Administering Entity: Virginia Retirement System (System)

PRTC contributes to the Virginia Retirement System (“VRS”), an agent and cost-sharing multiple-employer defined benefit pension plan administered by the VRS.

All full-time, salaried permanent employees of participating employers must participate in the VRS. Benefits vest after five years of service. Employees are eligible for an unreduced retirement benefit at age 65 with five years of service or at age 50 with 30 years of service if elected by the employer, payable monthly for life in an amount equal to 1.7% of their average final compensation (“AFC”) for each year of credited service. Benefits are actuarially reduced for retirees who retire prior to becoming eligible for full retirement benefits. In addition, retirees qualify for an annual cost-of-living adjustment (“COLA”) beginning in their second year of retirement. The COLA is limited to 5% per year. AFC is defined as the highest consecutive 36 months of reported compensation. The VRS also provides death and disability benefits. Title 51.1 of the *Code of Virginia* (1950), as amended, assigns the authority to establish and amend benefit provisions to the General Assembly of Virginia.

The System issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information for VRS. A copy of that report may be downloaded from their website at <http://www.varetire.org/pdf/2005annurept.pdf> or obtained by writing the Virginia Retirement System at P. O. Box 2500, Richmond, VA, 23218-2500.

B. Funding Policy

Plan members are required by Title 51.1 of the *Code of Virginia* (1950), as amended, to contribute 5% of their annual reported salary to the VRS. This 5% member contribution has been assumed by PRTC for its employees. In addition, PRTC is required to contribute the remaining amounts necessary to fund its participation in the VRS using the actuarial basis specified by the *Code of Virginia* and approved by the VRS Board of Trustees. The PRTC contribution rate for the fiscal year ended June 30, 2006, was 11.5% of the annual covered payroll.

PRTC’s payroll for employees covered by the VRS for the years ended June 30, 2006, 2005, and 2004 was \$2,233,450, \$2,087,250, and \$1,890,293, respectively, for PRTC employees and \$2,394,250, \$2,126,337, and \$1,976,069, respectively, for VRE employees. Total payroll for the years ended June 30, 2006, 2005, and 2004 was \$2,473,800, \$2,296,429, and 2,099,939, respectively, for PRTC and \$2,496,176, \$2,207,029, and \$2,107,310, respectively, for VRE.

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO FINANCIAL STATEMENTS

Note 17. Defined Benefit Pension Plan (Continued)

C. Annual Pension Cost (APC)

For fiscal year 2006, PRTC's annual pension cost of \$532,236 was equal to the required and actual contribution. The required contributions were determined as part of an actuarial valuation performed as of June 30, 2005, using the entry age normal actuarial cost method. The actuarial assumptions include (a) 8% investment rate of return, (b) projected salary increases ranging from 4% to 7% per year, and (c) a 3% per year cost-of-living adjustment. Both (a) and (b) included an inflation component of 3%. The actuarial value of the assets is equal to the modified market value of assets. This method uses techniques that smooth the effects of short-term volatility in the market value of assets over a five-year period. PRTC's unfunded actuarial accrual liability is being amortized as a level percentage of payroll on an open basis within a period of 30 years or less.

Three-year trend information for PRTC is as follows:

<u>Fiscal Year Ended</u>	<u>Annual Pension Cost</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
June 30, 2006	\$ 532,236	100%	\$ -
June 30, 2005	484,562	100%	-
June 30, 2004	473,629	100%	-

Note 18. Pending GASB Statements

At June 30, 2006 the Governmental Accounting Standards Board (GASB) had issued several statements not yet implemented by PRTC. The statements which might impact PRTC are as follows:

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, establishes standards from the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and required supplemental information. Statement No. 45 will be effective for periods beginning after December 15, 2008.

GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, establishes criteria that governments will use to ascertain whether the proceeds received collateralized by future collections of receivables or revenues should be reported as revenues or as a liability. This Statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. Statement No. 48 will be effective for periods beginning after December 15, 2006.

Note 19. Reclassifications

Certain amounts in the financial statements for the year ended June 30, 2005 were reclassified to conform with their presentation for the year ended June 30, 2006 with no effect on total net assets.

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REQUIRED SUPPLEMENTARY INFORMATION

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Annual Covered Payroll	Unfunded Actuarial Accrued Liability as a Percentage of Covered Payroll
June 30, 2005	\$3,224,034	\$3,541,143	\$317,109	91.05%	\$4,425,778	7.17%
June 30, 2004	2,704,610	2,944,583	239,973	91.85%	3,972,514	6.04%
June 30, 2003	2,127,851	2,275,767	147,916	93.50%	3,590,741	4.12%

Note: Since PRTC and VRE are combined for the actuarial valuation, the amounts above include both entities.

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SUPPLEMENTARY INFORMATION

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

SCHEDULE OF MEMBER JURISDICTIONS' FUNDS

Year Ended June 30, 2006

	City of Fredericksburg	City of Manassas	City of Manassas Park	County of Prince William	County of Stafford	Totals
Funds Available - June 30, 2005	\$ 3,961,345	\$ 1,722,287	\$ 1,376,493	\$ 13,323,936	\$ 7,888,873	\$ 28,272,934
Funds Received:						
2% fuel tax	1,475,756	1,396,362	889,878	10,989,275	3,819,856	18,571,127
Other	-	26,729	-	1,189,745	-	1,216,474
Interest	185,689	74,135	54,301	471,247	167,863	953,235
Total funds received	1,661,445	1,497,226	944,179	12,650,267	3,987,719	20,740,836
Funds Disbursed:						
Direct transportation expenses:						
VRE capital support	73,827	276,306	179,422	2,236,676	699,424	3,465,655
Other projects	-	370,327	251,496	-	7,549,131	8,170,954
Deposits to 1997 bond fund	-	-	-	871,888	-	871,888
Debt service for lease participation certificates	-	-	-	654,634	-	654,634
Transfers to PRTC:						
Administrative expenses	14,954	19,675	15,847	162,630	29,280	242,386
OmniRide, OmniLink, Capital Improvement, Marketing	-	254,436	118,745	6,235,492	-	6,608,673
Total funds disbursed	88,781	920,744	565,510	10,161,320	8,277,835	20,014,190
Funds Available - June 30, 2006	\$ 5,534,009	\$ 2,298,769	\$ 1,755,162	\$ 15,812,883	\$ 3,598,757	\$ 28,999,580

Note 1 - This schedule is prepared on an accrual basis and reflects the funds held by the Potomac and Rappahannock Transportation Commission (PRTC) for the benefit of the various member jurisdictions and the activity for the year ended June 30, 2006. Total funds available reconcile to amounts reported on the Statement of Net Assets as follows:

Cash and investments in pooled funds - member jurisdictions	\$ 23,568,183
Due from other governments - 2% motor fuels tax revenue receipts	3,454,741
Due from other governments - DRPT	52,301
Due from governments - FTA	1,924,355
	<u>\$ 28,999,580</u>

Note 2 - Expenses for other jurisdictional projects consist of:

Road improvements, traffic signals	\$ -	\$ 327,900	\$ 128,302	\$ -	\$ 6,668,927	\$ 7,125,129
Sidewalks	-	-	123,194	-	461,300	584,494
Street signs, human services transportation, airport authority, FRED transit, bike trails	-	-	-	-	418,904	418,904
Commuter parking leases	-	42,427	-	-	-	42,427
	<u>\$ -</u>	<u>\$ 370,327</u>	<u>\$ 251,496</u>	<u>\$ -</u>	<u>\$ 7,549,131</u>	<u>\$ 8,170,954</u>

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

SCHEDULE OF EXPENSES OF STATE AWARDS

Year Ended June 30, 2006

	State Grant Number	Expenses
VIRGINIA DEPARTMENT OF RAIL AND PUBLIC TRANSPORTATION:		
<u>Direct Payments:</u>		
Formula assistance	72005-32; 72006-50	\$ 3,120,349
Ridesharing assistance	71005-10; 71006-11	114,000
Transportation intern	71205-04; 71206-09	23,793
Capital - FY02	73002-13	99,999
Capital - FY03	73003-15	201,765
Capital - FY04	73004-07	226,901
Capital - FY05	73005-15	411,968
Capital - FY06	73006-22	104,681
Capital - FY06 buses		955,378
Bus Shelter	73002-30	3,614
State Roadeo	71106-09	18,500
		<u>5,280,948</u>
<u>Passthrough to VRE:</u>		
Capital - FY00	73000-04	32,253
Capital - FY01	73001-21	31,606
Capital - FY05	73005-15	2,505
SmarTrip expansion program	73501-52	5,534
		<u>71,898</u>
Total expenses of State awards		<u><u>\$ 5,352,846</u></u>

COMPLIANCE SECTION

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

SCHEDULE OF EXPENSES OF FEDERAL AWARDS

Year Ended June 30, 2006

Federal Granting Agency/Recipient State Agency/ Program/Grant Number	Grant	Federal CFDA Number	Expenses
DEPARTMENT OF TRANSPORTATION:			
<u>Direct Payments:</u>			
Federal Transit Administration:			
VA-03-0102		20.500	\$ 787,542
VA-03-0105		20.500	777,422
VA-90-X207		20.500	72,071
VA-90-X232		20.500	104,495
VA-90-X250		20.500	418,274
VA-90-X269		20.500	248,260
VA-90-X271		20.500	1,924,914
VA-90-X284 Buses		20.500	3,025,825
			<u>7,358,803</u>
Passthrough to VRE:			
VA-03-0067		20.500	276,897
VA-03-0074		20.500	149,696
VA-03-0078		20.500	740,208
VA-03-0079		20.500	303,188
VA-03-0091		20.500	771,665
VA-03-0094		20.500	2,682,734
VA-03-0097		20.500	559,046
VA-03-0102		20.500	630,434
VA-40-X003		20.500	19,438
VA-90-X106		20.500	43,896
VA-90-X184		20.500	287,063
VA-90-X195		20.500	35,029
VA-90-X207		20.500	5,519,027
VA-90-X232		20.500	22,133
VA-90-X240		20.500	552,220
VA-90-X250		20.500	513,239
VA-90-X251		20.500	1,684,502
VA-90-X269		20.500	4,930,598
VA-90-X271		20.500	2,928,291
			<u>22,649,304</u>
Passthrough Payments:			
Federal Highway Administration:			
CMP via VDR&PT		20.000	447,256
Total expenses of Federal awards			<u><u>\$ 30,455,363</u></u>

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

NOTES TO SCHEDULE OF EXPENSES OF FEDERAL AWARDS

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation and Accounting

The accompanying Schedule of Expenses of Federal Awards includes the federal grant activity of PRTC and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements.

Federal Financial Assistance – The Single Audit Act Amendments of 1996 (Public Law 104-156) and OMB Circular A-133 define federal financial assistance as grants, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations or other assistance.

Direct Payments – Assistance received directly from the Federal government is classified as direct payments on the “Schedule of Expenses of Federal Awards.”

Major Programs – The Single Audit Act Amendments of 1996 and OMB Circular A-133 establish the criteria to be used in defining major programs. Major programs for PRTC were determined using a risk-based approach in accordance with OMB Circular A-133.

Catalog of Federal Domestic Assistance – The Catalog of Federal Domestic Assistance (CFDA) is a government-wide compendium of individual federal programs. Each program included in the catalog is assigned a five-digit program identification number (CFDA Number), which is reflected in the accompanying schedule.

Note 2. Pass-Through Payments to VRE

PRTC receives federal financial assistance on behalf of the VRE. VRE submits reimbursement requests to PRTC who then submits them to the granting agency. Upon receipt of the funds, they are passed on to VRE.

Note 3. Other

The following abbreviations are used in the Schedule of Expenses of Federal Awards:

VDR&PT	Virginia Department of Rail and Public Transportation
VRE	Virginia Railway Express
CMP	Congestion Mitigation Program



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**INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

To the Honorable Commission Board Members
Potomac and Rappahannock Transportation Commission
Woodbridge, Virginia

We have audited the financial statements of the Potomac and Rappahannock Transportation Commission, as of and for the year ended June 30, 2006, and have issued our report thereon dated September 14, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *Specifications for Audits of Authorities, Boards, and Commissions*, issued by the Auditor of Public Accounts of the Commonwealth of Virginia.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Potomac and Rappahannock Transportation Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Potomac and Rappahannock Transportation Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions and specifications was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Commissioners, management, the Auditor of Public Accounts, and other Federal and state agencies and is not intended to be and should not be used by anyone other than these specified parties.

PBGH, LLP

Harrisonburg, Virginia
September 14, 2006

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE
WITH REQUIREMENTS APPLICABLE TO EACH MAJOR
PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

To the Honorable Commission Board Members
Potomac and Rappahannock Transportation Commission
Woodbridge, Virginia

Compliance

We have audited the compliance of the Potomac and Rappahannock Transportation Commission (Commission), with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement*, and the *Specifications for Audits of Authorities, Boards and Commissions*, issued by the Auditor of Public Accounts of the Commonwealth of Virginia, that are applicable to its major Federal program for the year ended June 30, 2006. The Commission's major Federal program is identified in the Summary of Independent Auditors' Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major Federal program is the responsibility of the Commission's management. Our responsibility is to express an opinion on the Commission's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*; and the *Specifications for Audits of Authorities, Boards and Commissions*, issued by the Auditor of Public Accounts of the Commonwealth of Virginia. Those standards, specifications, and circular require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major Federal program occurred. An audit includes examining, on a test basis, evidence about the Commission's compliance with those requirements, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Commission's compliance with those requirements.

In our opinion, the Commission complied, in all material respects, with the requirements referred to above that are applicable to its major Federal program for the year ended June 30, 2006.

Internal Control Over Compliance

The management of the Commission is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to Federal programs. In planning and performing our audit, we considered the Commission's internal control over compliance with requirements that could have a direct and material effect on a major Federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133 and the *Specifications for Audits of Authorities, Boards and Commissions*, issued by the Auditor of Public Accounts of the Commonwealth of Virginia.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major Federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Commissioners, management, the Auditor of Public Accounts and other Federal and state agencies and is not intended to be and should not be used by anyone other than these specified parties.

PBGH, LLP

Harrisonburg, Virginia
September 14, 2006

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended June 30, 2006

I. SUMMARY OF INDEPENDENT AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

Material weaknesses identified	_____ Yes	<input checked="" type="checkbox"/> No
Reportable conditions identified that are not considered to be material weaknesses	_____ Yes	<input checked="" type="checkbox"/> None Reported
Noncompliance material to financial statements noted	_____ Yes	<input checked="" type="checkbox"/> No

Federal awards

Internal control over major programs:

Material weaknesses identified	_____ Yes	<input checked="" type="checkbox"/> No
Reportable conditions identified that are not considered to be material weaknesses	_____ Yes	<input checked="" type="checkbox"/> None Reported

Type of auditors' report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?	_____ Yes	<input checked="" type="checkbox"/> No
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Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
20.500	Department of Transportation Federal Transit Administration

Dollar threshold used to distinguish between type A and type B programs: \$913,660

Auditee qualified as low-risk auditee?	<input checked="" type="checkbox"/> Yes	_____ No
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended June 30, 2006

II. FINDINGS RELATING TO THE FINANCIAL STATEMENT AUDIT AS REQUIRED TO BE REPORTED IN ACCORDANCE WITH GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS

A. Reportable Conditions in Internal Control

None Reported

B. Compliance Findings

None

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARDS

None

POTOMAC AND RAPPAHANNOCK TRANSPORTATION COMMISSION

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Year Ended June 30, 2006

The prior year single audit disclosed no findings in the Schedule of Findings and Questioned Costs and no uncorrected or unresolved findings exist from prior audits' Summary Schedule of Prior Audit Findings.