Virginia Railway Express

FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

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VIRGINIA RAILWAY EXPRESS

FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2005 AND 2004

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TABLE OF CONTENTS

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Introductory Section

Virginia Railway Express
A Transportation Partnership

December 15, 2005

Commissioners
The Northern Virginia Transportation Commission
The Potomac and Rappahannock Transportation Commission

I am pleased to present the Virginia Railway Express' (VRE) audited financial statements for fiscal year 2005, ended June 30, 2005. This report conforms to accounting principles generally accepted in the United States of America (GAAP) and provides full disclosure of VRE's financial position and operations for fiscal year 2005. The information provided in this report assists the VRE Operations Board, Commissions and other officials in making management decisions and provides all interested parties with comprehensive financial data in a format that will enable them to gain a true understanding of VRE's financial affairs.

This report is presented in four sections. The introductory section includes this transmittal letter and a list of VRE Operations Board members and key VRE staff. The financial section includes the independent auditors' report, an analysis of the financial operations of VRE during the year, the financial statements, and the footnotes to the financial statements. The statistical section contains tables of revenues and expenses for the past ten years and other useful information intended to provide a more complete picture of VRE. The compliance section contains the independent auditors' report on compliance and internal controls in accordance with *Government Auditing Standards*.

Fiscal Year 2005 Operations

During fiscal year 2005, VRE continued its ridership growth, while still providing dependable commuter rail service. Our average daily ridership was 15,086, which was a 5.1 percent increase over the previous year. The on-time performance system wide was 85 percent, with 77 percent on the Fredericksburg Line and 93 percent on the Manassas Line.

Despite these positive statistics, we are seeing the effects of the rapid increase in ridership on our operations. Our growth continues to slow as we approach system capacity. The crowding on trains is not only affecting growth, but our customer satisfaction as well. Approval ratings are still high - 70 percent overall satisfaction rate – but they are dropping below previous levels. In order to address potential future growth, we completed a Long-Range Strategic Plan in 2004.

The plan identifies the projected ridership demand through 2025, and the capital and operating expenses necessary to meet the demand. It also examines potential network extensions, their impacts on ridership, and the costs of such expansions. The Strategic Plan will provide technical support to make important policy decisions in the upcoming years.

Equipment

With increasing ridership comes the challenge of providing sufficient seats and station parking for our customers. Many of our peak period trains are at or above capacity today. In fiscal year 2004, VRE procured 35 used bi-level Gallery cars to replace 33 single-level Mafersas. Following re-qualification, 22 of those cars had been placed into service by the end of fiscal year 2005, bringing VRE's Gallery fleet to 32 active and 5 ready reserve cars; the remaining 13 Gallery cars will be placed into service during fiscal year 2006. Converting from 33 single level Mafersas to 30 additional Gallery coaches will add 800 additional seats, for a total of 8,990 seats, capacity for a total of 17,980 round trips, if off-peak trains are included. The Strategic Plan, however, projects average daily ridership demand to be up to 16,200 in 2005, and continue to increase to 20,000 by Fiscal year 2010. VRE is procuring 11 new bi-level Gallery cab cars to go into service by January 2007 with an option to purchase 50 more bi-level Gallery cars to address short-term demand. In addition to railcars, VRE completed a program to overhaul the locomotive head-end power units as well as the top deck overhaul of three locomotives. These overhauls are a short-term fix to help improve the reliability of VRE's trains. As a longer-term measure, we are exploring the possibility of purchasing new, higher horsepower, Tier II locomotives with greater head end power (HEP) capacities so that we will be able to operate longer train consists and reduce locomotive emissions.

Station Parking

Nine of our 13 station parking lots have been found to be at or above capacity in 2005. As a result, we have undertaken several projects to alleviate the parking constraint on our system. A new surface lot at Woodbridge opened in the summer of 2004 and temporary parking was provided at Broad Run. This year, projects were also initiated at Burke Centre and Manassas to construct parking decks to accommodate increasing demand. At the same time, VRE worked with Fairfax County to continue the EZ Bus, a subscription bus service designed to alleviate parking pressure at the Burke Centre Station parking lot. The program is successful, with over 50 people using the service every day. However, even with these steps, system-wide parking demand still exceeds supply, and we are exploring additional options for improving parking and access to our stations.

Critical Needs

Despite all the improvements VRE has made over the last year, we are still stretched to the limits of our capacity. In order to meet even the minimum estimates of demand, the Strategic Plan calls for a capital investment of approximately $39.6 to $51.7 million annually through 2010, up from the current capital program of $25 million per year. Even at this level of investment VRE will struggle to meet the demand for commuter rail service in the I-66 and I-95/395 corridors.

As part of the recommended capital investment, the Strategic Plan calls for 80 to 110 additional bi-level coaches by 2025 in order to run longer consists and additional trains. The first 50-railcars in that estimate are an immediate need for VRE. The cars are needed to replace leased and aging equipment in the next six years, as well as provide the capacity to meet the projected ridership demand of approximately 30,000 trips per day by 2011.

New, cleaner, high powered locomotives, additional mid-day storage, and maintenance facilities at the outlying yards will also be necessary to maintain existing service as the railroad matures, as well as provide increased capacity to meet demand. In addition, the Strategic Plan calls for 7,000 to 9,000 additional parking spaces system-wide by 2010.

Summary

The focus of the VRE Operations Board and VRE management continues to be providing safe, reliable commuter rail service to the citizens of Northern Virginia. With the Washington, DC metropolitan area designated as an ozone non-attainment area, public transit will play an increasingly vital role in addressing the area's need to improve air quality and reduce congestion. VRE currently takes the equivalent of one full lane of traffic off of both Interstate 95 and Interstate 66 each morning and evening rush hour. Without continued capital investment, VRE will not be able to continue to offer the high-quality, cost effective service that we have provided for the past 13 years.

Respectfully submitted,

Dale Zehner
Chief Executive Officer

DIRECTORY OF PRINCIPAL OFFICIALS AND KEY PERSONNEL

Operations Board

Officers

Chairman	Hon. Elaine McConnell, Fairfax County
Vice-Chairman	Hon. Maureen Caddigan, Prince William County
Secretary	Hon. Dana Kauffman, Fairfax County
Treasurer	Hon. Robert Gibbons, Stafford County

Members

Hon. Sharon Bulova, Fairfax County
Hon. John Jenkins, Prince William County
Karen Rae, VDRPT

Alternates

Hon. Hilda Barg, Prince William County
Hon. Wally Covington, Prince William County
Hon. William Greenup, City of Fredericksburg
Hon. Doug Waldron, City of Manassas
Hon. Christopher Zimmerman, Arlington County

Management

Chief Executive Officer	Dale Zehner
Deputy Chief Executive Officer	Jennifer Straub
Director of Finance	Donna J. Boxer, CPA
Director, Construction and Facilities	Sirel Mouchantaf
Superintendent Operations, Safety, and Security	David A. Snyder
Manager of Operations Support	Dennis Larson
Manager of Public Affairs and Government Relations	Mark Roeber
Manager of Customer Service	Wendy Lemieux
Manager of Market Development	Ann King
Manager of Personnel and Administration	Anna Gotthardt
Manager of Information Technology	Don Chism

Financial Section

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INDEPENDENT AUDITORS' REPORT

To the Commissioners
The Northern Virginia Transportation Commission
The Potomac and Rappahannock Transportation Commission

We have audited the accompanying basic financial statements of the Virginia Railway Express, a joint venture of the Northern Virginia Transportation Commission and the Potomac and Rappahannock Transportation Commission, as of and for the years ended June 30, 2005 and 2004, as listed in the table of contents. These financial statements are the responsibility of the Virginia Railway Express' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 audits 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Virginia Railway Express as of June 30, 2005 and 2004 and the changes in financial position and cash flows for the years 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 October 28, 2005 on our consideration of the Virginia Railway Express' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contract 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 on pages 7 through 13 is not a required part of the basic financial statements but is supplementary information required by the 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 audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise Virginia Railway Express' basic financial statements. The accompanying introductory and statistical sections as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. This information has not been subjected to the auditing procedures applied in the audits of the basic financial statements and, accordingly, we express no opinion on it.

PBGH, LLP

Harrisonburg, Virginia
October 28, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis (MD&A) of the Virginia Railway Express' activities and performance provides the reader with an introduction and overview of the financial statements of the Virginia Railway Express (VRE) for the Fiscal year ended June 30, 2005. Following this MD&A are the basic financial statements of the VRE, together with the notes that are essential to understanding the data contained in the financial statements.

Railway Activities and Highlights

For fiscal year 2005, ridership exceeded fiscal year 2004. This is a continual trend of year-to-year increases. The table below illustrates VRE's growth:

	2005	2004
Ridership	3,756,453	3,517,154
% Increase	6.8%	7.1%

In addition to continued population growth in the areas served by VRE, the ridership increases may be attributed to the inclusion of additional bi-level cars into service, the additional parking at VRE commuter lots and traffic congestion on Interstates 95 and 66, two major interstate arterial roadways.

Financial Operations and Highlights

VRE was able to achieve positive financial results for the fiscal year, as follows:

- Operating revenues increased by 14.3 percent from $17,117,885 to $19,573,535 largely due to a 6.8 percent increase in ridership coupled with a 6 percent fare increase.
- Operating expenses, excluding depreciation, increased by 9.4 percent from $37,438,289 to $40,961,058. The major elements of this change are as follows:
  - Diesel fuel costs increased by 64% to $2.4 million, an expenditure increase of $928,000 over the prior year. Increasing fuel costs will continue to be an issue in future years.
  - There are contractually set escalators in the contract with Amtrak (the contract operator) and the track access fees paid to CSX Transportation and Norfolk Southern. Additional access fee costs, along with additional equipment and parking lease costs accounted for increases of $919,000. In addition, the costs for repair and maintenance of rolling stock increased by $1,095,000.
  - Insurance expense increased by $258,000. Due to increasing liability premiums and the need to purchase terrorism insurance we anticipate insurance costs to continue to remain high in the out years.

The net result of the above was an operating loss, before depreciation, of $21,387,523. This represents an increase from the previous year of 5.3 percent. Depreciation increased from $6,595,698 to $6,699,409 in fiscal years 2004 and 2005, respectively. The operating loss before non-operating revenues and expenses increased from a loss of $26,916,102 to a loss of $28,086,932. Local, federal and state support is accounted for as non-operating income and are used to offset these losses.

Non-operating revenue increased by 6.5 percent from $30,662,001 to $32,655,500. This was due principally to an increase in federal operating grants for track access costs and federal capital grants for specific projects. This increase was offset by the in-kind revenue in fiscal year 2004 associated with the purchase of Gallery railcars from Chicago METRA for the bargain price of $1 per car. Grants from the Commonwealth of Virginia decreased slightly.

During fiscal year 2005, VRE sold 23 single-level Mafersa railcars to the Connecticut Department of Transportation, however, VRE retained the use of seven of the cars until they can be replaced with new bi-level Gallery cars. The Mafersa cars were sold for $13.25 million; $9.61 million was paid to VRE during the fiscal year and the remaining $3.64 million will be paid once the final seven cars are sent to ConnDOT. VRE recognized a book loss of $3,590,995 on this transaction.

In the latter part of fiscal year 2005, VRE executed a contract for the purchase of 11 bi-level Gallery railcars. The cars will be delivered in fiscal year 2007 and are funded with the proceeds of a capital lease financing in the amount of $25.1 million.

Summary of Operations

The change in net assets for fiscal year 2005 was $927,640 as compared to $3,745,899 for fiscal year 2004.

	2005	2004
Operating revenues	$ 19,573,535	$ 17,117,885
Operating expenses	40,961,058	37,438,289
Loss before depreciation and non operating income	(21,387,523)	(20,320,404)
Depreciation	(6,699,409)	(6,595,698)
Loss before non operating revenue	(28,086,932)	(26,916,102)
Non operating revenue, net	32,655,500	30,662,001
Special item – loss on sale of assets	(3,640,928)	-
Change in net assets	$ 927,640	$ 3,745,899

Financial Position Summary

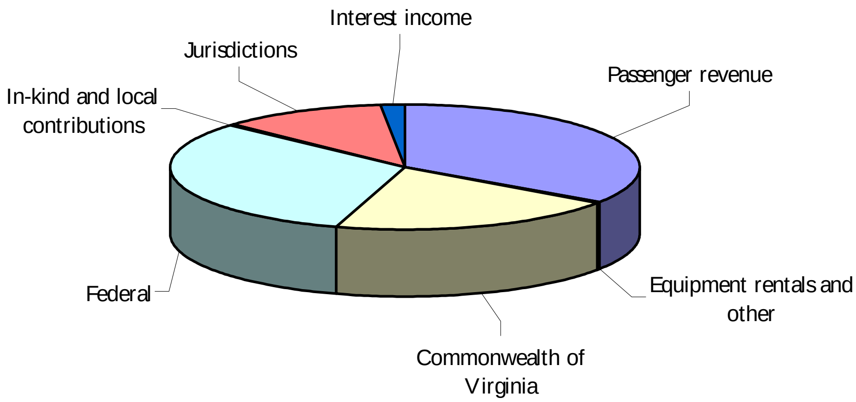
A condensed summary of VRE's net assets at June 30, 2005, as compared to June 30, 2004 is shown as below:

	2005	2004
ASSETS:		
Current and other assets	$ 62,854,627	$ 33,003,867
Capital assets, net	129,503,622	135,342,388
Total assets	192,358,249	168,346,255
LIABILITIES:		
Current portion of long term debt	6,245,727	5,200,987
Other current liabilities	12,148,075	9,165,110
Non-current liabilities	89,281,059	70,224,410
Total liabilities	107,674,861	84,590,507
NET ASSETS:		
Invested in capital assets, net of related debt	56,669,086	60,040,916
Restricted	20,038,608	22,146,604
Unrestricted	7,975,694	1,568,228
Total net assets	$ 84,683,388	$ 83,755,748

Net assets may serve over time as a useful indicator of VRE's financial position. The largest portion of VRE's net assets each year represents its investment in capital assets (e.g., land, buildings, improvements, rolling stock and other equipment), less the related indebtedness outstanding used to acquire those capital assets. VRE uses these assets to provide services to its riders; consequently these assets are not available for future spending. VRE's investment in its capital assets is reported net of accumulated depreciation and net of related debt. The resources required to repay this debt must be provided annually from operations and federal, state and local support since it is unlikely that the capital assets themselves will be liquidated to pay liabilities. The sale of 23 single level Mafersa railcars, described above, resulted in a decrease to the investment in capital assets category and an increase to unrestricted net assets.

Revenues

The following chart shows the major sources of revenues for the year ended June 30, 2005:

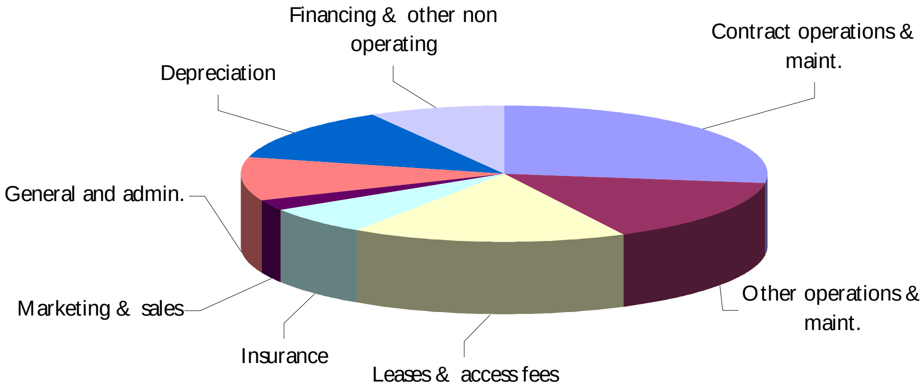


A summary of revenues for the year ended June 30, 2005, and the amount and percentage change in relation to prior year amounts is as follows:

	2005 Amount	Percent of total	Increase (decrease) from 2004	Percent increase (decrease)
Operating revenues:				
Passenger revenue	$ 19,452,162	34.44%	$ 2,522,533	14%
Equipment rentals and other	121,373	0.21%	(66,883)	(35%)
Total operating revenues	19,573,535	34.65%	2,455,650	14%
Non operating revenues:				
Subsidies and grants:				
Commonwealth of Virginia	11,391,168	20.17%	(300,217)	(2%)
Federal	17,948,799	31.78%	5,032,589	38%
Jurisdictional contributions	6,352,999	11.25%	109	0%
In-kind and other local contributions	266,148	0.47%	(2,877,171)	(92%)
Interest income	953,564	1.68%	71,590	8%
Total non operating revenues	36,912,678	65.35%	1,926,900	6%
Total revenues	$ 56,486,213	100.00%	$ 4,382,550	8%

Expenses

The following chart shows the major cost centers of expenses for the year ended June 30, 2005:



A summary of expenses for the year ended June 30, 2005, and the amount and percentage of change in relation to prior year amounts is as follows:

	2005 Amount	Percent of total	Increase (decrease) from 2004	Percent increase (decrease)
Operating expenses:				
Contract operations and maintenance	$ 14,144,414	25.46%	$ (68,062)	(.15%)
Other operations and maintenance	7,928,107	14.27%	2,461,794	45.03%
Property leases and access fees	8,769,866	15.78%	606,234	7.42%
Insurance	3,533,503	6.36%	258,422	7.89%
Marketing and sales	1,302,527	2.34%	22,978	1.79%
General and administrative	5,282,641	9.51%	241,403	4.78%
Total operating expenses	40,961,058	73.72%	3,522,769	19.13%
Other expenses:				
Depreciation	6,699,409	12.06%	103,711	1.57%
Interest, financing costs and other	4,257,178	7.66%	(66,598)	(1.54%)
Total other expenses	10,956,587	19.72%	37,113	0.34%
Special item – loss on sale of assets	3,640,928	6.56%	3,640,928	N/A
Total expenses	$ 55,558,573	100.00%	$ 7,200,810	14.89%

Financial Statements

VRE's financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (GAAP) as promulgated by the Governmental Accounting Standards Board (GASB). VRE is structured as a single enterprise fund with revenues recognized when earned, not when received. Expenses are recognized when incurred, not when they are paid. Capital assets with a cost of over $5,000 are capitalized and, except for land, are depreciated over their estimated useful lives. Certain cash and investment funds are restricted for debt service, capital expenditures or insurance purposes. See note 1 of the financial statements for a summary of VRE's significant accounting policies.

Capital Acquisitions and Construction Activities

During fiscal year 2005, VRE expended $18,099,126 for capital activities. Completed projects totaling $7,523,567 were closed from construction in progress to their respective capital accounts. The completed projects were in the following categories and amounts:

Project		Amount
Rolling stock	$	3,319,306
Facilities		4,204,261
	$	7,523,567

The major completed projects were: acceptance of seven re-qualified Gallery cars ($1,786,097); overhaul and rebuilding of locomotives ($1,346,280); renovation of a station building at Quantico ($1,454,013); construction of a locomotive inspection pit at Broad Run ($2,030,659); and the construction of additional parking at Woodbridge and Broad Run ($719,588).

Property and equipment are capitalized at cost of acquisition. Acquisitions are funded using a variety of financing techniques, including Federal grants with matching funds from the Commonwealth and from local subsidies. Additional information on VRE's capital assets and commitments can be found in notes 3 and 10 to the financial statements.

Debt Administration

At June 30, 2005, VRE had total debt outstanding of $97,012,951. The debt for VRE is issued under the name of the Northern Virginia Transportation Commission (NVTC). VRE revenues back the bonds and VRE is responsible for making debt service payments. A financial guaranty bond guarantees payment of each bond series. The note payable is secured by VRE's office condominium.

	2005	2004
Revenue bonds	$ 69,540,000	$ 74,315,000
Capital leases	26,752,951	2,018,938
Note payable	720,000	780,000
Total	$ 97,012,951	$ 77,113,938

VRE's total debt increased $19,899,013 during the fiscal year as a result of a capital lease financing in the amount of $25.1 million for the purchase of 11 railcars. VRE has access to a line of credit of up to $1 million with SunTrust Bank; the line was not exercised during 2005. For further information, please refer to note 7 in the financial statements.

Economic Factors and Next Year's Budget

Population growth in Northern Virginia, especially in the outer suburbs, continues to remain robust. In combination with the congestion on major highways and on-going highway construction projects, this growth will continue to increase demand for VRE service. The constraining factors to VRE growth are station parking, availability of seats and not sustaining an on-time train service.

The budget for fiscal year 2005 assumed that the constraints facing VRE will limit ridership growth to 4 percent. The revenue generated by this growth is insufficient to fund the increases expected in expenses and the continued capital investments needed. Therefore, a fare restructuring went into effect on July 1, 2005, that increased fare revenues by 2.75 percent. In addition, the local subsidy contribution to the VRE operations was increased $525,060 to a total of $6,878,060 for fiscal year 2005. The ever increasing cost of diesel fuel poses a continuing budget problem. Since January 2005, fuel costs have increased 55 percent and currently there is no indication that they will return to the price levels of fiscal year 2004.

Request for Information

This financial report is designed to provide a general overview of VRE's finances for all those interested. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Director of Finance, Virginia Railway Express, 1500 King Street, Alexandria, Virginia 22314-2730 or by email to dboxer@vre.org.

Respectfully submitted,

Donna J. Boxer, CPA
Director of Finance

VIRGINIA RAILWAY EXPRESS

STATEMENTS OF NET ASSETS
June 30, 2005 and 2004

ASSETS	2005	2004
Current Assets:		
Cash and cash equivalents	**$ 6,253,268**	$ 1,448,522
Accounts receivable:		
Federal grants	**2,629,236**	2,493,825
Commonwealth of Virginia grants	**2,079,947**	1,152,681
Trade receivables, net of allowance for doubtful accounts	**2,616,522**	2,282,732
Other receivables	**3,689,860**	-
Inventory	**1,910,706**	1,682,415
Prepaid expenses	**618,258**	767,675
Restricted cash, cash equivalents, and investments	**42,004,404**	22,270,530
Total current assets	**61,802,201**	32,098,380
Noncurrent Assets:		
Deferred bond costs, net	**1,052,426**	905,487
Capital assets:		
Rolling stock	**61,953,818**	82,669,253
Vehicles	**45,550**	22,882
Facilities	**41,416,189**	37,208,822
Track and signal improvements	**27,628,930**	27,628,930
Equipment	**4,862,101**	4,676,483
Construction in progress	**31,451,741**	21,221,222
Equity in local properties	**4,998,368**	4,998,368
Office furniture and equipment	**2,272,467**	2,262,817
	174,629,164	180,688,777
Less accumulated depreciation	**(45,125,542)**	(45,346,389)
Total capital assets, net	**129,503,622**	135,342,388
Total noncurrent assets	**130,556,048**	136,247,875
Total assets	**$ 192,358,249**	$ 168,346,255

See Notes to Financial Statements.

LIABILITIES AND NET ASSETS	2005	2004
Current Liabilities:		
Accounts payable	**$ 4,496,684**	$ 3,051,626
Payable to Commissions	**598,222**	519,637
Compensated absences	**218,277**	174,551
Accrued expenses	**3,058,852**	2,799,796
Accrued interest	**2,029,157**	1,952,919
Deferred revenue	**1,233,226**	648,112
Contract retainage	**513,657**	18,469
Current portion of capital lease obligations	**1,235,727**	365,987
Current portion of long-term debt	**5,010,000**	4,835,000
Total current liabilities	**18,393,802**	14,366,097
Noncurrent Liabilities		
Capital lease obligations	**25,577,224**	1,652,951
Note payable	**660,000**	720,000
Bonds payable	**63,043,835**	67,851,459
Total noncurrent liabilities	**89,281,059**	70,224,410
Total liabilities	**107,674,861**	84,590,507
Net Assets:		
Invested in capital assets, net of related debt	**56,669,086**	60,040,916
Restricted for liability insurance plan	**12,439,017**	15,290,158
Restricted for debt service and capital lease	**6,873,135**	6,856,446
Restricted grants or contributions	**726,456**	-
Unrestricted assets	**7,975,694**	1,568,228
Total net assets	**84,683,388**	83,755,748
Total liabilities and net assets	**$ 192,358,249**	$ 168,346,255

VIRGINIA RAILWAY EXPRESS

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended June 30, 2005 and 2004

	2005	2004
Operating Revenues:		
Passenger revenue	**$ 19,452,162**	$ 16,929,629
Equipment rentals and other	**121,373**	188,256
Total operating revenues	**19,573,535**	17,117,885
Operating Expenses:		
Contract operations and maintenance	**14,144,414**	14,212,476
Other operations and maintenance	**7,928,107**	5,466,313
Property leases and access fees	**8,769,866**	8,163,632
Insurance	**3,533,503**	3,275,081
Marketing and sales	**1,302,527**	1,279,549
General and administrative	**5,282,641**	5,041,238
Total operating expenses	**40,961,058**	37,438,289
Operating loss before depreciation	**(21,387,523)**	(20,320,404)
Depreciation	**(6,699,409)**	(6,595,698)
Operating loss	**(28,086,932)**	(26,916,102)
Nonoperating Revenues (Expenses):		
Subsidies:		
Commonwealth of Virginia grants	**7,613,022**	7,453,276
Federal grants	**8,124,763**	6,226,445
Jurisdictional operating contributions	**6,352,999**	6,352,890
Capital grants and assistance:		
Commonwealth of Virginia grants	**3,778,146**	4,238,109
Federal grants	**9,824,036**	6,689,765
In-kind and other local contributions	**266,148**	3,143,319
Interest income:		
Operating funds	**214,888**	44,390
Insurance trust	**688,816**	837,583
Other restricted funds	**49,860**	-
Interest, amortization and other nonoperating expenses, net	**(4,257,178)**	(4,323,776)
Total nonoperating revenues, net	**32,655,500**	30,662,001
Loss on sale of assets	**(3,640,928)**	-
Change in net assets	**927,640**	3,745,899
Net Assets, beginning	**83,755,748**	80,009,849
Net Assets, ending	**$ 84,683,388**	$ 83,755,748

See Notes to Financial Statements.

VIRGINIA RAILWAY EXPRESS

STATEMENTS OF CASH FLOWS
Years Ended June 30, 2005 and 2004

		2005		2004
Cash Flows From Operating Activities:				
Receipts from customers	$	19,098,403	$	16,780,584
Payments to suppliers		(35,441,877)		(33,778,928)
Payments to employees		(2,928,889)		(3,086,354)
Net cash used in operating activities		(19,272,363)		(20,084,698)
Cash Flows From Noncapital Financing Activities:				
Governmental subsidies		21,637,064		19,694,980
Cash Flows From Capital and Related Financing Activities:				
Acquisition and construction of capital assets		(18,099,126)		(8,443,695)
Capitalized debt issuance costs		(252,500)		-
Capital grants and assistance		13,985,832		15,818,247
Proceeds from sale of capital assets		9,610,000		-
Principal borrowed on capital lease		25,100,000		-
Principal paid on capital lease obligations		(365,987)		(758,718)
Principal paid on note		(60,000)		-
Interest paid on capital lease obligation		(298,190)		(136,917)
Principal paid on bonds and note		(4,775,000)		(4,620,000)
Interest paid on bonds and note		(3,574,813)		(3,989,211)
Net cash provided by (used in) capital and related financing activities		21,270,216		(2,130,294)
Cash Flows From Investing Activities:				
Interest received on investments		903,703		881,973
Increase (decrease) in cash and cash equivalents		24,538,620		(1,638,039)
Cash and Cash Equivalents, beginning		23,719,052		25,357,091
Cash and Cash Equivalents, ending	$	48,257,672	$	23,719,052
Reconciliation of operating loss to net cash used in operating activities:				
Operating loss	$	(28,086,932)	$	(26,916,102)
Adjustments to reconcile operating loss to net cash used in operating activities:				
Depreciation		6,699,409		6,595,698
Increase in:				
Accounts receivable		(333,790)		(454,003)
Advances and deposits		(250)		-
Decrease (increase) in:				
Inventory		119,264		16,271
Prepaid expenses		149,667		(62,329)
Accounts payable and accrued expenses		1,826,423		722,629
Increase (decrease) in:				
Deferred ticket sales		(141,342)		116,702
Contract retainage		495,188		(103,564)
Net cash used in operating activities	$	(19,272,363)	$	(20,084,698)

See Notes to Financial Statements.

Note 1. Summary of Significant Accounting Policies

Reporting Entity

The Virginia Railway Express ("VRE") is a joint venture of the Northern Virginia Transportation Commission ("NVTC") and the Potomac and Rappahannock Transportation Commission ("PRTC"). Pursuant to a Master Agreement signed in 1989, NVTC and PRTC ("the Commissions") jointly own and operate VRE. VRE provides commuter rail service on two railroad lines originating in Fredericksburg and Manassas, Virginia and terminating at Union Station, Washington, D.C. The service uses existing tracks of the CSX Transportation Corporation ("CSX"), and the Norfolk Southern Railway Company, under respective operating access agreements. Trains are operated and maintained pursuant to a Purchase of Services Agreement between Amtrak and the Commissions.

VRE is managed by the Commissions. Certain functions have been delegated to the VRE Operations Board, consisting of three commissioners appointed from each of NVTC and PRTC and one representative of the Commonwealth of Virginia's Department of Rail and Public Transportation. The system is not currently configured for fare revenues alone to produce positive net income. In addition to fares, the project is financed with proceeds from the Commuter Rail Revenue Bonds, Federal and Commonwealth of Virginia grants and jurisdictional contributions based on a population/ridership formula that are supplemented by voluntary donations from contributing jurisdictions. Grants and contributions fund both operations and capital projects. Participating jurisdictions include the counties of Fairfax, Prince William, and Stafford; and the cities of Manassas, Manassas Park and Fredericksburg, Virginia. Contributing jurisdictions include Arlington County and the City of Alexandria, Virginia.

Measurement Focus, Basis of Accounting

VRE prepares its financial statements using the accrual basis of accounting. The activities of VRE are similar to those of proprietary funds of local jurisdictions. The Governmental Accounting Standards Board ("GASB") is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*, VRE has elected to apply all applicable GASB pronouncements as well as Financial Accounting Standards Board ("FASB") pronouncements and Accounting Principles Board ("APB") opinions unless those pronouncements conflict with or contradict GASB pronouncements.

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. VRE records monetary and in-kind contributions as it assesses matching obligations to the jurisdictions or other construction partners. Any excess of revenues or expenses at year end are recorded as deferred revenue or accounts receivable, respectively. Passenger revenues received in advance are deferred until earned.

Note 1. Summary of Significant Accounting Policies (Continued)

Cash and Investments: VRE considers all highly liquid investments with maturities of three months or less to be cash equivalents. Investments in U.S. government securities and commercial paper are carried at fair value based on quoted market prices. The investment in the Local Government Investment Pool (LGIP, a 2a7-like pool) is reported at the Pool's share price.

Restricted Cash and Cash Equivalents: Restricted cash, cash equivalents and investments of $42,004,404 and $22,270,530 at June 30, 2005 and 2004, respectively, are comprised of funds related to bond compliance requirements, the Liability Insurance Plan and proceeds from the lease purchase of the fare collection system and the Gallery IV-A railcars that had not been fully disbursed as of June 30, 2005. Also included in restricted cash is grant proceeds received from the U. S. Department of Homeland Security.

Allowance for Uncollectible Accounts: VRE calculates its allowance for uncollectible accounts using historical collection data and specific account analysis. The allowance was $91,409 at June 30, 2005 and 2004.

Inventory: VRE has purchased an inventory of spare parts for rolling stock that is maintained and managed by Amtrak pursuant to its maintenance responsibilities under the Purchase of Services Agreement with the Commissions. Inventory is stated at cost, which approximates market, and is valued using the First-In-First-Out method. In addition, VRE has established an inventory of parts for rolling stock at its own warehouse located at Broad Run.

Capital Assets: For constructed assets, all costs necessary to bring assets to the condition and location necessary for the intended use are capitalized. Asset costs include allocation of certain common construction costs, based on the relationship of associated direct costs. Assets constructed directly by jurisdictions in satisfaction of system financial responsibilities have been capitalized at the estimated fair market value as of the date of donation.

When assets are substantially complete and ready for use, these costs are transferred from construction in progress to property and equipment and depreciated. Major improvements and replacements of property are capitalized. Maintenance, repairs and minor improvements and replacements are expensed.

Costs of improvements to track and signal facilities owned by the railroads have been capitalized in recognition of the increased efficiency afforded VRE operations over their useful lives. The Commissions retain a residual interest in these assets such that net salvage value will be reimbursed by the railroads upon cessation of commuter rail service. Similarly, shared investments in jurisdictional facilities ("equity in local properties") recognize the right of access for commuter rail patrons granted to the Commissions.

VRE capitalizes assets which have an initial cost of $5,000 or more per unit and a useable life of two or more years.

Note 1. Summary of Significant Accounting Policies (Continued)

Provision for depreciation has been calculated using the group depreciation method. Under this method homogeneous groups of assets with similar useful lives are grouped together and depreciation is applied to the entire group. The estimated useful lives of the assets are as follows:

Rolling stock	8-40 years
Facilities	30-40 years
Track and signal improvements	30 years
Equity in local properties	35 years
Station equipment	5 years
Vehicles	5 years
Office furniture and equipment	3-10 years

When, in the opinion of management, certain assets are impaired, any estimated decline in value is accounted for as a non-operating expense. There were no impaired assets as of June 30, 2005.

Compensated Absences: VRE employees are granted vacation leave based on length of employment. Employees with less than ten years of service may carry over a total of 225 hours of leave from year to year, while those with more than ten years may carry over 300 hours. Excess leave may convert to sick leave or may be paid out with the approval of the Chief Executive Officer. Employees may accumulate sick leave without limitation. Employees who separate in good standing after five or more years of service will be paid out for 25 percent of their sick leave credit in excess of 450 hours. Certain employees may accumulate compensatory leave for overtime worked. Compensated absences are accrued when incurred.

Long-Term Obligations: Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight line method.

Reclassification: Certain prior year information is reclassified to conform with current year presentation.

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 and disclosure of contingent 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.

New Accounting Pronouncements Adopted: In March 2003, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 40, *Deposits and Investment Risk Disclosures*, an amendment of GASB Statement No. 3, which requires certain disclosures of investments that are highly sensitive to interest rate risk and modifies the custodial credit risk disclosures of Statement No. 3. The provisions of GASB Statement No. 40 became effective for the fiscal year ended June 30, 2005.

Note 2. Cash, Cash Equivalents and Investments

Deposits: All cash of the VRE 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. Under the Act, banks holding public deposits in excess of the amounts insured by FDIC must pledge collateral in the amount of 50% of excess deposits to a collateral pool in the name of the State Treasury Board. If any member bank fails, the entire collateral pool becomes available to satisfy the claims of governmental entities. With the ability to make additional assessments, the multiple bank collateral pool functions similarly to depository insurance. The Commonwealth of Virginia Treasury Board is responsible for monitoring compliance with the collateralization and reporting requirements of the Act. At June 30, 2005 the book balance of VRE's deposits with banks was $675,912; these funds are swept into a U.S. Government Securities money market fund at the end of each business day.

Investments: State statutes authorize local governments and other public bodies to invest in obligations of the United States or 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, bankers' acceptances, repurchase agreements, and the State Treasurer's Local Government Investment Pool (LGIP).

The VRE Operations Board 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.

VRE's investment policy establishes the maximum percentages of the portfolio permitted in each of the following instruments:

	Length	Percent
Bonds, notes, and other evidence of indebtedness of the Commonwealth of Virginia and the United States	60 months or less	100%
Bonds, notes, and other evidence of indebtedness of any public body of the Commonwealth of Virginia	36 months or less	100%
Bonds and notes of FNMA and FHLB	36 months or less	75%
Savings accounts or CD's of any bank or savings and loan association within the Commonwealth of Virginia	12 months or less	20%
Money market mutual funds	13 months or less	20%
Repurchase agreements	24 months or less	20%
Bankers' acceptances	24 months or less	10%

Note 2. Cash, Cash Equivalents and Investments (Continued)

	Length	Percent
Prime Quality Commercial Paper	270 days or less	35%
High Quality Corporate Notes	24 months or less	50%
Certificates representing ownership in treasury bond principal	24 months or less	50%
LGIP	N/A	100%
SNAP	N/A	N/A
Negotiable CD's and negotiable bank deposit notes	24 months or less	25%

At June 30, 2005, the VRE had investments of $5,576,822 in the LGIP. The LGIP is a professionally managed money market fund that invests in qualifying obligations and securities as permitted by Virginia Statutes. Pursuant to Section 2.2-4605 of the *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 the Board's 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 has been assigned an "AAAm" rating by Standard & Poors.

The Commonwealth of Virginia Department of Treasury manages the VRE Insurance Trust. State statutes govern the portion of assets invested in the Commonwealth's pooled accounts, while the remainder is invested by an external portfolio manager. At June 30, 2005, VRE had $12,439,017 invested in the Insurance Trust.

Unexpended lease proceeds for the fare collection system and the purchase of additional railcars in the recorded amounts at June 30, 2005 of $123,925 and $22,568,328, respectively, were invested in various U.S. Treasury money market accounts with J.P. Morgan and SunTrust Bank. Accumulated bond interest and principal payments in the amount of $6,873,135 at June 30, 2005 were held by the bond trustee, SunTrust Bank, in U.S. Treasury money market accounts. Investments in U. S. Treasury money market accounts held with SunTrust Bank has been assigned an "AAAm" rating by Standard & Poors.

Note 2. Cash, Cash Equivalents and Investments (Continued)

As of June 30, 2005, the carrying values and maturity of VRE's investments were as follows:

Investment Type		Fair Value		Maturities Less than 1 Year
LGIP	$	5,576,822	$	5,576,822
Insurance trust fund		12,439,017		12,439,017
Money market funds		29,565,388		29,565,388
Total investments		47,581,227		47,581,227
Total deposits		675,912		675,912
Total deposits and investments	$	48,257,139	$	48,257,139

Custodial Credit Risk

VRE does not have any uninsured and unregistered investments held by a counterparty's agent or its safekeeping department but not in VRE's name.

Concentration of Credit Risk

VRE does not have an investment in any one issuer that is in excess of five percent of total investments (excluding U.S. government debt, debt explicitly guaranteed by the U.S. government, and pooled investments such as mutual funds or external investment pools).

Note 3. Capital Assets

Capital asset activity for the year ended June 30, 2005 was as follows:

	Beginning Balance	Increases	(Deletions) Reclassifications	Ending Balance
Capital assets not being depreciated:				
Construction in progress	$ 21,221,222	$ 17,878,084	$ (7,647,565)	$ 31,451,741
Capital assets being depreciated:				
Rolling stock	82,669,253	-	(20,715,435)	61,953,818
Vehicles	22,882	22,668	-	45,550
Facilities	37,208,822	3,106	4,204,261	41,416,189
Track and signal improvements	27,628,930	-	-	27,628,930
Equipment	4,676,483	185,618	-	4,862,101
Equity in local properties	4,998,368	-	-	4,998,368
Office furniture and equipment	2,262,817	9,650	-	2,272,467
Total capital assets being depreciated	159,467,555	221,042	(16,511,174)	143,177,423
Less accumulated depreciation for:				
Rolling stock	27,119,918	4,179,215	(6,920,256)	24,378,877
Vehicles	2,288	4,576	-	6,864
Facilities	9,160,225	880,284	-	10,040,509
Track and signal improvements	4,121,334	867,962	-	4,989,296
Equipment	2,597,455	602,317	-	3,199,772
Equity in local properties	1,675,770	75,993	-	1,751,763
Office furniture and equipment	669,399	89,062	-	758,461
Total accumulated depreciation	45,346,389	6,699,409	(6,920,256)	45,125,542
Total capital assets being depreciated, net	114,121,166	(6,478,367)	(9,590,918)	98,051,881
Totals	$ 135,342,388	$ 11,399,717	$ (17,238,483)	$ 129,503,622

Note 4. Related Parties Transactions

VRE reimburses the Commissions for expenditures made on behalf of VRE. During 2005 and 2004, these payments included $2,842,657 and $2,747,743 of salary-related costs and $8,762 and $42,408 of administrative costs, respectively, which are functionally classified with similar payments made directly to vendors and contractors. In addition, VRE pays the Commissions for direct labor and associated indirect costs incurred for services rendered under budgeted activities for VRE. These staff support payments totaled $90,000 and $91,574 to NVTC and $161,753and $187,758 to PRTC during 2005 and 2004, respectively.

VRE also contracts with PRTC for connecting bus service to selected stations on an as needed basis. PRTC bus service costs amounted to approximately $1,173 and $1,970 in 2005 and 2004, respectively. Amounts payable to NVTC and PRTC were $16,269 and $581,952 at June 30, 2005 and $7,870 and $511,767, respectively at June 30 2004.

Note 5. 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)

All full-time, permanent employees of VRE participate in the VRS through the PRTC. 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 at least 30 years of service, if elected by the employer, payable monthly for life in an amount equal to 1.7 percent of their average final compensation (AFC) for each year of credited service. AFC is defined as the highest consecutive 36 months of reported compensation. Benefits are actuarially reduced for retirees who retire prior to becoming eligible for full retirement benefits. In addition, retirees qualify for annual cost of living increases limited to 5% per year beginning in their second year of retirement. 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 included 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/2004AnnuRept.pdf or obtained by writing to the 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 compensation to the VRS. VRE has assumed this 5% member contribution. In addition, VRE 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.

VRE's contribution rate for fiscal year 2005 was 11.5% of annual covered payroll, inclusive of the 5% member contribution.

Note 5. Defined Benefit Pension Plan (Continued)

C. Annual Pension Cost

For fiscal year 2005, VRE's annual pension cost of $244,529 was equal to VRE's required and actual contributions. The required contribution was determined as part of the June 30, 2003 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 8% investment rate of return (b) projected salary increases ranging from 4% to 7% per year, and (c) 3% per year cost of living adjustments. Both (a) and (b) included an inflation component of 3%. The actuarial value of the PRTC's assets exceeds modified market value of the assets (VRE's assets are not separated from PRTC's). This method uses techniques that smooth the effects of short term volatility in the market value of assets over a five year period. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on an open basis within a period of 30 years or less.

VRE's payroll for the employees covered by the VRS for the years ended June 30, 2005 and 2004 was $2,207,029 and $2,107,310 respectively.

Note 6. Operating Leases and Agreements

Operating Access Agreements with the CSX and Norfolk Southern provide the Commissions the right to use tracks owned by the railroads in the provision of commuter rail passenger service. These agreements require the Commissions to pay the railroads a monthly base fee and to reimburse the railroads for any incremental cost incurred by the railroads as a result of providing commuter rail service. During 2005 and 2004, annual track usage fees totaled approximately $5,116,536 and $5,268,140 respectively, and facility and other identified costs totaled $423,207 and $393,094, respectively.

Under the Purchase of Services Agreement, Amtrak operates and maintains the VRE service and rolling stock, and permits the Commissions to use its terminal, station, and equipment maintenance facilities at Union Station, Washington, D.C. Actual costs of these services, which are based on annual budgets prepared in advance by Amtrak, amounted to $15,670,663 in 2005 and $15,269,724 in 2004. During July 2005, an amended agreement was signed that extended the agreement until July 1, 2010, effective July 1, 2005.

VRE has entered into a series of operating leases with Sound Transit for bi-level rail cars and locomotives. At June 30, 2005, six rail cars had been returned to Sound Transit, leaving twelve rail cars and two locomotives still under lease. An additional rail car was returned in July 2005. Prior to the return of the seven cars, the leases provided for monthly payments in the amount of $142,892, adjusted annually by the urban CPI. After the return of the cars, the monthly lease amount dropped to $95,440. The remaining leases are subject to termination upon 120 days notice.

Note 7. Long-Term Debt Obligations

The following is a summary of long-term liability activity for the year ended June 30, 2005:

	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
Revenue Bonds	$ 74,315,000	$ -	$ (4,775,000)	$ 69,540,000	$ 5,010,000
Capital Leases	2,018,938	25,100,000	(365,987)	26,752,951	1,175,727
Note Payable	780,000	-	(60,000)	720,000	60,000
	77,113,938	25,100,000	(5,200,987)	97,012,951	6,245,727
Compensated Absences	174,551	43,726	-	218,277	218,277
	$ 77,288,489	$ 25,143,726	$ (5,200,987)	$ 97,231,228	$ 6,464,004

Revenue Bonds:

$37,625,000 Commuter Rail Revenue Refunding Bonds, series 1993; due in annual maturities of $3,950,000 to $5,065,000 through July 2010, plus semi-annual interest at 4.9% to 5.25%	$ 26,895,000
$23,000,000 Commuter Rail Revenue Bonds, series 1997; due in annual maturities of $955,000 to $2,115,000 through July 2017, plus semi-annual interest at 4.7% to 6.0%	17,645,000
$31,700,000 Commuter Rail Revenue Refunding Bonds, series 1998; due in annual maturities of $105,000 to $6,555,000 through July 1, 2014, plus semi-annual interest at 4.3% to 5.375%	25,000,000
	69,540,000
Plus (less) unamortized:	
Deferred loss	(1,885,292)
Discount	(154,913)
(Premiums)	554,040
Total bonded debt, net	$ 68,053,835

The 1993, 1997 and 1998 Series Bonds are payable from a pledge of revenues attributable to VRE, including government grants, local jurisdictional contributions and passenger revenue. A financial guaranty bond guarantees payments of each bond series. Mandatory debt service requirements consist of the following:

Years Ended June 30,	Principal	Interest	Total Required
2006	$ 5,010,000	$ 3,550,539	$ 8,560,539
2007	5,255,000	3,296,729	8,551,729
2008	5,520,000	3,027,016	8,547,016
2009	5,795,000	2,731,522	8,526,522
2010	6,105,000	2,411,369	8,516,369
2011-2015	35,825,000	6,622,227	42,447,227
2016-2018	6,030,000	499,770	6,529,770
	$ 69,540,000	$ 22,139,172	$ 91,679,172

Note 7. Long-Term Debt Obligations (Continued)

Deferred bond costs, consisting of bond issuance costs and insurance premiums are shown net of accumulated amortization. These costs are amortized on a straight-line basis over the life of the bonds. Amortization of deferred bond costs, approximating $56,982, is included in interest expense in 2005 and 2004.

The Indentures of Trust for the 1997 Commuter Rail Revenue Bonds required VRE to maintain a debt service reserve. During fiscal year 2000, VRE purchased a surety in substitution of the debt service reserve fund, releasing the proceeds from the reserve. The Indentures of Trust for the 1997 issue also require the maintenance of an operating reserve equivalent to one-third (33.3%) of annual budgeted operating expenses. As of June 30, 2005 and 2004, VRE designated $26,052,674 and $15,916,621 respectively of its cash, the restricted bond interest and principal funds, inventory and receivables as this operating reserve. The reserves represented 73.9% and 51.6% of budgeted operating expenses for June 30, 2005 and 2004, respectively.

Funds are invested by the Trustee pursuant to the Indentures of Trust and are classified as restricted. Funds held by the Trustee as of June 30, 2005 and 2004, are as follows:

	2005	2004
Bond Interest Fund	$ 1,848,451	$ 1,968,456
Bond Principal Fund	5,024,684	4,887,991
Total Held by Trustee	$ 6,873,135	$ 6,856,447

Capitalized leases:

$2,717,409 capitalized lease obligation due $39,347 monthly, interest at 5.73%, maturing in 2009, collateralized with a fare collection system with a carrying value of $1,549,249	$ 1,652,951

Future minimum lease payments as of June 30, 2005 are as follows:

Year	Amount
2006	$ 472,160
2007	472,160
2008	472,160
2009	432,813
Total minimum lease payments	1,849,293
Lease amount representing interest	196,342
Present value of lease payments	$ 1,652,951

Capitalized Lease-Gallery IV

$25,100,000 capitalized lease obligation due $965,679 semi-annually, interest at 4.59%, maturing in 2025, collateralized with Gallery IV cars. First payment will be in November 2005	$25,100,000

Note 7. Long-Term Debt Obligations (Continued)

Future minimum lease payments as of June 30, 2005 are as follows:

Year		Amount
2006	$	1,931,357
2007		1,931,357
2008		1,931,357
2009		1,931,357
2010		1,931,357
2011-2015		9,656,785
2016-2020		9,656,785
2021-2025		9,656,785
Total minimum lease payments		38,627,140
Lease amount representing interest		13,527,140
Present value of lease payments	$	25,100,000

Note Payable:

In June 2002, VRE entered into a borrowing with SunTrust Bank in the amount of $900,000 to refinance a previous borrowing used to purchase the VRE offices. This note carries a repayment schedule of 15 years, with the terms of the note subject to revision June 2007. The current note is secured by the office condominium and bears interest at 68% of the one-month LIBOR plus 47 basis points. Principal of $5,000 plus interest is payable monthly. The interest rate at June 30, 2005 was 2.605%. During fiscal year 2005, VRE paid $60,000 in principal and $15,181 in interest.

Note 8. Short-Term Debt

VRE uses a revolving line of credit to finance certain grant-funded capital projects prior to the receipt of reimbursements from the granting agencies. The revolving line of credit was not used during the year ended June 30, 2005.

Note 9. Liability Insurance Plan

The Virginia Department of Treasury, Division of Risk Management has established the terms of VRE’s Commuter Rail Operations Liability Plan (the Insurance Plan). The Insurance Plan consists of a combination of self-insurance reserves and purchased insurance in amounts actuarially determined to meet the indemnification requirements of the Operating Access Agreements and the Purchase of Services Agreement. The Commissions indemnify each of the railroads in an amount up to $250,000,000 for any claims against persons or property associated with commuter rail operations.

Note 9. Liability Insurance Plan (Continued)

Division of Risk Management manages the Insurance Trust Fund pursuant to provisions of the Insurance Plan. In fiscal year 2005, approximately one-half of plan assets were invested in the Department of Treasury common pool, and the remainder were invested in a portfolio managed by external financial consultants. Activity in the Insurance Trust Fund for the years ended June 30, 2005 and 2004 was as follows:

	2005	2004
Beginning Balance, July 1	$ 15,290,158	$ 17,648,836
Insurance premiums paid	(3,412,960)	(2,961,485)
Claims mitigation costs and losses incurred	-	(116,982)
Investment income	688,816	837,583
Actuarial and administrative charges	(126,997)	(117,794)
Ending Balance, June 30	$ 12,439,017	$ 15,290,158

An actuarial study is performed annually to determine the adequacy of the Insurance Trust Fund for the risk retained and to determine the required contribution to reserves.

Note 10. Contingencies and Contractual Commitments

At June 30, 2005, there were disputes between the VRE and certain vendors. The amount of any settlements, should they occur, are not determinable at this time. However, such amounts are not expected to be material in relation to the recorded amounts.

The Commissions have outstanding commitments for construction of facilities and equipment. A combination of Federal and Commonwealth of Virginia grants will be used to finance these capital projects. The following is a summary of the more significant contractual commitments, net of expenditures incurred as of June 30, 2005:

Station and parking lots	$ 648,474
Railcars	22,343,900
Maintenance and layover yards	1,299,249
Track and signal improvements	12,098,632
Other administrative	841,816
	$ 37,232,071

Note 11. Pending GASB Statements

At June 30, 2005, the Governmental Accounting Standards Board (GASB) had issued several statements not yet implemented by the Commissions. The statements which might impact the Commissions are as follows:

GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* requires evaluation and reporting the effects of capital asset impairments and insurance recoveries when they occur. The provisions of Statement No. 42 will be effective for fiscal years beginning after December 15, 2004.

GASB Statement No. 44, *Economic Condition Reporting: the Statistical Section, an amendment of NCGA Statement No. 1*, clarifies and establishes objectives of the statistical section and its five categories of information: financial trends, revenue capacity, debt capacity, demographic and economic, and operating.

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions* establishes standards for 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. 46, *Net Assets Restricted by Enabling Legislation*, establishes and modifies requirements related to restrictions of net assets resulting from enabling legislation. Statement No. 46 will be effective for periods beginning after June 15, 2005.

GASB Statement No. 47, *Accounting for Termination Benefits*, establishes accounting standards for termination benefits offered by an employer to employees to hasten an employee's voluntary termination of services, sometimes referred to as early-retirement incentives. Statement No. 47 will be effective for financial statements for periods beginning after June 15, 2005.

Statistical Section

Virginia Railway Express

Expenses by Function

Last Ten Fiscal Years

Fiscal Year	Contract Operations and Maintenance	Other Operations and Maintenance	Property Leases and Access fees	Insurance	Marketing and Sales	General and Administrative	Depreciation	Financing and other Nonoperating Costs	Totals
1996	$ 8,327,348	$ 1,757,034	$ 3,106,246	$ 2,013,759	$ 701,502	$ 1,694,394	$ 3,964,793	$ 4,840,251	$ 26,405,327
1997	9,069,346	1,989,717	3,499,324	1,842,283	719,874	1,678,625	4,475,630	4,658,821	27,933,620
1998	9,238,341	2,129,560	3,403,352	942,196	719,689	2,036,545	4,697,006	5,868,344	29,035,033
1999	9,426,764	2,468,107	3,841,159	1,662,073	781,955	2,011,298	4,358,362	5,482,403	30,032,121
2000	10,861,997	2,927,389	4,451,130	1,596,382	942,040	2,804,978	4,556,921	5,586,847	33,727,684
2001	11,340,419	4,301,643	5,046,537	1,049,905	1,073,257	3,402,105	5,246,347	5,113,403	36,573,616
2002	12,188,085	4,558,318	6,308,712	1,340,527	1,549,752	4,496,015	5,261,679	6,250,481	41,953,569
2003	13,095,504	4,741,041	7,307,905	2,429,993	1,482,131	5,462,768	5,837,560	3,960,846	44,317,748
2004	14,212,476	5,466,313	8,163,632	3,275,081	1,279,549	5,041,238	6,595,698	4,323,776	48,357,763
2005	14,144,414	7,928,107	8,769,866	3,533,503	1,302,527	5,282,641	6,699,409	4,257,178	51,917,645

Source: VRE Department of Finance

Virginia Railway Express

Revenues by Source
Last Ten Fiscal Years

Fiscal Year	Passenger Revenue	Equipment Rentals & Other	Subsidies and Grants: Commonwealth	Subsidies and Grants: Federal	Subsidies and Grants: Local and Other	Interest	Totals
1996	$ 8,519,735	$ 760,851	$ 5,898,628	$ 7,487,174	$ 6,370,767	$ 2,097,496	$ 31,134,651
1997	7,650,245	778,798	6,485,430	9,311,521	5,752,891	2,117,111	32,095,996
1998	6,475,680	172,326	6,538,183	10,146,384	5,752,889	3,120,338	32,205,800
1999	7,526,837	140,822	6,323,508	8,469,164	5,752,890	2,803,056	31,016,277
2000	8,761,919	363,972	8,823,209	16,622,941	6,238,306	2,181,406	42,991,753
2001	10,358,348	130,110	11,984,626	21,157,431	7,090,662	1,904,672	52,625,849
2002	12,753,214	206,796	13,281,956	16,224,151	6,452,265	1,417,195	50,335,577
2003	15,048,262	292,086	11,152,320	15,766,058	6,210,039	1,259,476	49,728,241
2004	16,929,629	188,256	11,691,385	12,916,210	9,496,209	881,973	52,103,662
2005	19,452,162	121,373	11,391,168	17,948,799	6,619,147	953,564	56,486,213

Source: VRE Department of Finance

Virginia Railway Express

Ridership
Last Ten Fiscal Years

Fiscal Year	Total Ridership
1996	1,875,411
1997	1,751,210
1998	1,502,845
1999	1,741,922
2000	2,032,147
2001	2,437,995
2002	2,783,260
2003	3,282,722
2004	3,517,154
2005	3,756,453

Virginia Railway Express

Miscellaneous Statistics

Began Operation:		
	Fredericksburg Line	June 1, 1992
	Manassas Line	July 1, 1992
Number of Stations		18
Rolling Stock: [1]		
	Locomotives	20
	Rail Cars	112
Employees		34
Average Daily Ridership, 2005		15,086
Parking Spaces		6,081

[1] Rolling stock owned and leased as of June 30, 2005.

Compliance Section

PBGH
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A LIMITED LIABILITY PARTNERSHIP
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Mensel D. Dean
Gregory W. Geisert
Herman W. Hale
John L. Vincie, III
Keith L. Wampler
Daniel B. Martin
Sean R. O'Connell

Kevin D. Humphries
Bradford R. Jones
Virginia B. Miller
John E. Zigler, Jr
Michael T. Kennison
Michael A. Garber
Donald W. Knotts

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 Commissioners
The Northern Virginia Transportation Commission
The Potomac and Rappahannock Transportation Commission

We have audited the basic financial statements of the Virginia Railway Express as of and for the year ended June 30, 2005, and have issued our report thereon dated October 28, 2005. 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 Virginia Railway Express' 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 assurance 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 Virginia Railway Express' 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 or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Commissioners, 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 those specified parties.

PBGH, LLP

Harrisonburg, Virginia
October 28, 2005