Virginia Railway Express
FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2006 AND 2005




RAILWAY VIRGINIA EXPRESS ™

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VIRGINIA RAILWAY EXPRESS

FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2006 AND 2005

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Introductory Section

VIRGINIA RAILWAY EXPRESS

Virginia Railway Express

A Transportation Partnership

November 17, 2006

To the Honorable Commission Board Members
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 ended June 30, 2006. 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 2006. 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 three 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 compliance section contains the independent auditors' report on compliance and other matters and internal controls in accordance with *Government Auditing Standards*, and OMB Circular A-133 and related schedules to comply with the requirements of a Single Audit.

Fiscal Year 2006 Operations

The effect of VRE's rapid growth during its 14-year history was apparent during fiscal year 2006. As trains, stations and the railroad infrastructure reached capacity, VRE's ridership growth moderated, and the average daily ridership of 14,667 was a decrease of 2.96 percent compared to the previous year. Major railroad infrastructure projects designed to increase reliability, safety and capacity in the long run, resulted in a significant decline in VRE's on time performance (OTP) in the short run and ridership was impacted as a result. VRE management, in conjunction with the freight railroads who own and maintain the track on which VRE operates, has implemented appropriate strategies to improve OTP as well as continue needed track improvements. The results of these efforts have been seen in recent months as ridership is returning to previous levels.

During fiscal year 2006, VRE focused on improving systems that would ensure the future health of the rail line. Approval for financing the largest fleet purchase in VRE's history occurred during the fiscal year. These cars will allow VRE to replace aging and leased equipment as well as make improvements to capacity. The next step in fleet improvements, as described more fully below, will be the purchase of new locomotives. Also during the fiscal year, work proceeded on VRE's largest track project, the construction of an additional railroad bridge across Quantico Creek at a cost in excess of $26 million. Scheduled for completion during fiscal year 2007, the additional track will relieve one of the more difficult bottlenecks in the system.

In order to help prioritize future needs and address potential future growth, a Long-Range Strategic Plan was completed 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 provides the technical underpinning for policy and planning decisions in the upcoming years.

Equipment

Many of our peak period trains continue to be at or above capacity. At the end of fiscal year 2005, VRE signed a contract for the purchase of 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 and replace aging cars. The initial 11 cab cars were in construction during fiscal year 2006 and financing for the remaining 50 cars was approved. The contract for the 50-car option was signed in July 2006, with delivery planned to begin in December 2007. Also during the fiscal year, the last 13 of the re-qualified used Gallery cars procured from Chicago Metra were placed in service, bringing VRE's Gallery fleet at year end to 45 active and five ready reserve cars. In addition, VRE has initiated a program to overhaul the head-end power (HEP) units and top decks of the locomotive fleet; four units have been completed. These overhauls are a short-term, cost-effective fix to help improve the reliability of VRE's trains. As a longer-term measure, we are beginning to identify funding for the purchase of new, higher horsepower, Tier II locomotives with greater HEP capacities so that we will be able to operate longer train consists, reduce locomotive emissions, and reduce equipment-related service delays.

Station Parking and Platforms

Many of VRE's station parking lots were at or above capacity in 2006, and two major parking garage projects are underway to address this constraint. A parking facility in Manassas is currently in design, and in July 2006 a groundbreaking ceremony was held for a $28.8 million parking project at the Burke Centre VRE station. The Burke Centre project is estimated to open in 2008 and will add 1,290 garage spaces and 225 surface parking spaces. For Fredericksburg line passengers, a study was completed during 2006 that analyzed options for either surface or structured parking at both the Leeland and Brooke stations. Funding is currently being assembled to implement the recommendations of this study. Finally, a station access study was completed that looked at ways to improve passenger access to the stations through options such as carpooling, biking or walking. The first phase of improvements, including additional bike facilities, will be implemented in fiscal year 2007. Also to address larger passenger loads, a platform extension at the Manassas Park station was completed in December 2005. This 305-foot platform extension also included a canopy to provide additional shelter for passengers waiting for the train.

Critical Needs

Despite all the improvements described above, we are still stretched to the limits of our capacity. The Strategic Plan calls for an annual capital investment of significantly more than the current capital program of $25 million per year. Even if additional funding were received, VRE will struggle to meet the demand for commuter rail service in the I-66 and I-95/395 corridors. Additional bi-level coaches, over and above the current purchases; new, cleaner, high powered locomotives; additional parking spaces; 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.

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 14 years.

Respectfully submitted,

Dale Zehner
Chief Executive Officer

DIRECTORY OF PRINCIPAL OFFICIALS AND KEY PERSONNEL

Operations Board

Officers

Chairperson	Hon. Maureen Caddigan, Prince William County
Vice-Chairman	Hon. Dana Kauffman, Fairfax County
Secretary	Hon. Douglas Waldron, City of Manassas
Treasurer	Hon. Sharon Bulova, Fairfax County

Members

Hon. Robert Gibbons, Stafford County
Hon. Elaine McConnell, Fairfax County
Matthew Tucker, VDRPT

Alternates

Hon. Hilda Barg, Prince William County
Hon. Wally Covington, Prince William County
Hon. William Greenup, City of Fredericksburg
Hon. John Jenkins, Prince William County
Hon. Christopher Zimmerman, Arlington County

Management

Chief Executive Officer	Dale Zehner
Deputy Chief Executive Officer	Jennifer Straub
Director, Finance	Donna Boxer, CPA
Director, Construction and Facilities	Sirel Mouchantaf, P.E.
Superintendent Operations, Safety, and Security	David Snyder
Director, Rail Equipment & Services	Dennis Larson

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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 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, 2006 and 2005, 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, 2006 and 2005 and the respective 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 September 1, 2006 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 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' financial statements. The accompanying Schedule of Expenditures 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.

The accompanying introductory section as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the financial statements. This information has not been subjected to the auditing procedures applied in the audits of the financial statements and, accordingly, we express no opinion on it.

PBGH, LLP

Harrisonburg, Virginia
September 1, 2006

Financial Section

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, 2006. 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

After a seven-year trend of year-to-year increases, fiscal year 2006 ridership was slightly below the level of ridership for the prior year. This decrease was the result of a significant decline in the system's on time performance (OTP) because of railroad infrastructure improvement work that disrupted service and a larger than normal number of weather related delays.

	2006	2005
Ridership	3,637,043	3,763,740
% Increase (Decrease)	(3.4%)	5.7%

VRE management, in conjunction with the freight railroads who own and maintain the rail lines on which VRE operates, has implemented both short and long-term strategies to enhance on time performance. The underlying factors that have fueled VRE's growth in the past, population growth in the areas served by VRE and traffic congestion on Interstates 95 and 66, two major arterial roadways, coupled with railroad capacity improvements, are expected to lead to increased ridership in the future.

Financial Operations and Highlights

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

- Operating revenues increased by 1.6 percent from $19,573,535 to $19,895,953.
- Operating expenses, excluding depreciation, increased by 4.1 percent from $40,961,058 to $42,657,540. The major elements of this change are as follows:
  - Diesel fuel costs increased by 31% to $3.1 million, an expenditure increase of $736,022 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. Access fee and contract operations and maintenance costs increased by $1.1 million or 5.2%; this amount includes $500,000 for the lease of additional mid-day storage space at Washington Union Terminal.
  - Repair and maintenance costs increased by slightly more than $481,000 or 15%, primarily as the result of increased station maintenance costs. Equipment lease costs and marketing costs decreased from the prior year.

The net result of the above was an operating loss, before depreciation, of $22,761,587. This represents an increase from the previous year of 6.4 percent. Depreciation increased from $6,699,409 to $8,217,233, which reflects the completion of various capital projects. The operating loss before non-operating revenues and expenses increased from a loss of $28,086,932 to a loss of $30,978,820. Local, federal and state support is accounted for as non-operating income and is used to offset these losses.

Non-operating revenue increased by 28 percent from $32,655,500 to $42,279,580. The components of this increase were: an increase in federal grants of $5.6 million for debt service, track access costs and specific capital projects; an increase in state grants of $3.5 million for operating expenses and debt service; and an increase in jurisdictional contributions of $.5 million.

At the end of fiscal year 2006, VRE recognized $20,000,000 of deferred revenue from the Commonwealth of Virginia for the purchase of 50 additional railcars. The contract for the purchase of these railcars was signed early in fiscal year 2007. The cars will be delivered in fiscal year 2008 and will be funded with a combination of loan and grant funds.

Summary of Operations

The change in net assets for fiscal year 2006 was $9,934,229 as compared to $927,640 for fiscal year 2005.

	2006	2005
Operating revenues	$ 19,895,953	$ 19,573,535
Operating expenses	42,657,540	40,961,058
Operating loss before depreciation	(22,761,587)	(21,387,523)
Depreciation	(8,217,233)	(6,699,409)
Operating loss	(30,978,820)	(28,086,932)
Non-operating revenue, net	42,279,580	32,655,500
Special item – loss on disposal of assets	(1,366,531)	(3,640,928)
Change in net assets	$ 9,934,229	$ 927,640

Financial Position Summary

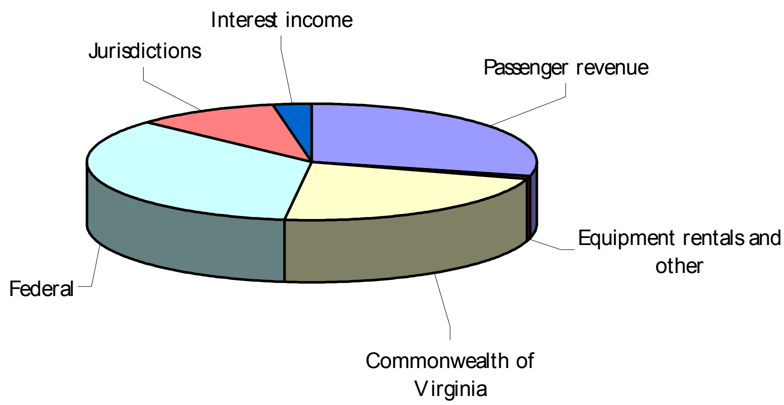
A condensed summary of VRE's net assets at June 30, 2006, as compared to June 30, 2005 is shown below:

		2006		2005
ASSETS:				
Current and other assets	$	81,065,102	$	62,854,627
Capital assets, net		135,482,041		129,503,622
Total assets		216,547,143		192,358,249
LIABILITIES:				
Current portion of long term debt		6,550,118		6,305,727
Other current liabilities		32,446,091		12,088,075
Non-current liabilities		82,933,317		89,281,059
Total liabilities		121,929,526		107,674,861
NET ASSETS:				
Invested in capital assets, net of related debt		67,535,067		55,182,924
Restricted		17,226,881		20,038,608
Unrestricted		9,855,669		9,461,856
Total net assets	$	94,617,617	$	84,683,388

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.

Revenues

The following chart shows the major sources of revenues for the year ended June 30, 2006:

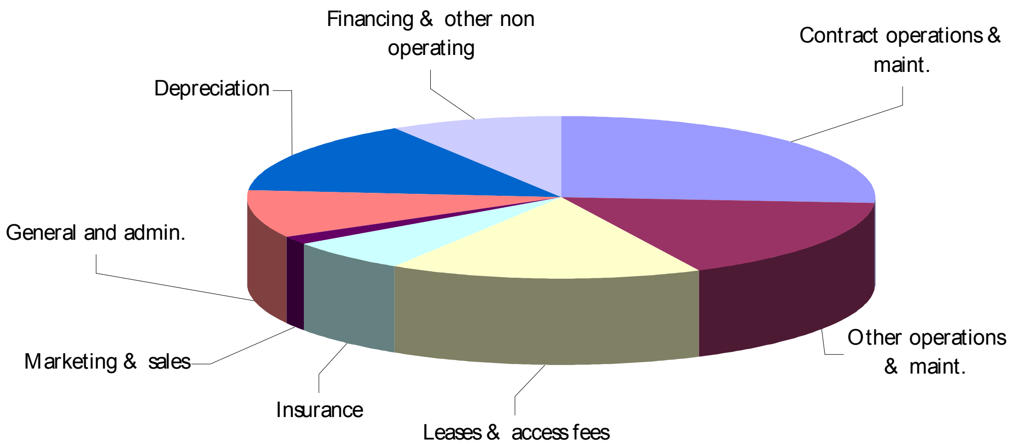


A summary of revenues for the year ended June 30, 2006, and the amount and percentage change in relation to prior year amounts is as follows:

	2006 Amount	Percent of total	Increase (decrease) from 2005	Percent increase (decrease)
Operating revenues:				
Passenger revenue	$ 19,453,436	28.98%	$ 1,274	-
Equipment rentals and other	442,517	0.66%	321,144	265.59%
Total operating revenues	19,895,953	29.64%	322,418	1.65%
Non-operating revenues:				
Subsidies and grants:				
Commonwealth of Virginia	14,907,204	22.21%	3,516,036	30.87%
Federal	23,518,164	35.03%	5,569,365	31.03%
Jurisdictional contributions	6,878,061	10.25%	525,062	8.26%
In-kind and other local contributions	-	0.00%	(266,148)	(100.00%)
Interest income	1,929,594	2.87%	976,030	102.37%
Total non-operating revenues	47,233,023	70.36%	10,320,345	27.96%
Total revenues	$ 67,128,976	100.00%	$ 10,642,763	18.84%

Expenses

The following chart shows the major cost centers of expenses for the year ended June 30, 2006:



A summary of expenses for the year ended June 30, 2006, and the amount and percentage of change in relation to prior year amounts is as follows:

	2006 Amount	Percent of total	Increase (decrease) from 2005	Percent increase (decrease)
Operating expenses:				
Contract operations and maintenance	$ 14,619,521	25.56%	$ 475,107	3.36%
Other operations and maintenance	9,304,325	16.27%	1,376,218	17.36%
Property leases and access fees	8,986,974	15.71%	217,108	2.48%
Insurance	3,521,858	6.16%	(11,645)	(0.33%)
Marketing and sales	1,005,348	1.76%	(297,179)	(22.82%)
General and administrative	5,219,514	9.13%	(63,126)	(1.19%)
Total operating expenses	42,657,540	74.59%	1,696,483	4.14%
Other expenses:				
Depreciation	8,217,233	14.37%	1,517,824	22.66%
Interest, financing costs and other	4,953,443	8.66%	696,265	16.36%
Total other expenses	13,170,676	23.03%	2,214,089	20.21%
Loss on disposal of assets	1,366,531	2.38%	(2,274,397)	(62.47%)
Total expenses	$ 57,194,747	100.00%	$ 1,636,175	2.95%

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 2006, VRE expended $15,600,057 for capital activities. Completed projects totaling $21,154,691 were closed from construction in progress to their respective capital accounts and an additional $1,176,137 was charged directly to the capital accounts. The completed projects were in the following categories and amounts:

Project	Amount
Rolling stock	$ 3,892,943
Facilities	17,081,397
Equipment	746,272
Equity in local properties	246,430
Office furniture and equipment	363,786
	$ 22,330,828

The major completed projects were: Re-qualification of 13 Gallery cars ($3,313,608); overhaul of Gallery trucks and rebuilding of locomotives ($579,336); renovation of Washington Union terminal ($11,271,958); Manassas Park platform extension ($1,241,731); power installation and re-grading at Broad Run and Crossroads yards ($1,235,803); various projects at Ivy City yard ($462,135); and the construction of additional parking at Manassas Park and Broad Run ($1,052,688).

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, 2006, VRE had total debt outstanding of $90,767,224. 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, and the capital leases are secured by the related equipment.

		2006		2005
Revenue bonds	$	64,530,000	$	69,540,000
Capital leases		25,577,224		26,752,951
Note payable		660,000		720,000
Total	$	90,767,224	$	97,012,951

VRE has access to a line of credit of up to $1 million with SunTrust Bank; the line was not exercised during 2006. 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.

As the result of increases to fuel costs, access fees, equipment maintenance costs and contributions to the insurance trust fund, the fiscal year 2007 budget included an increase to both fare rates and local subsidy contributions. A fare restructuring went into effect on July 1, 2006 that increased fare revenues by 6 percent. In addition, the local subsidy contribution to the VRE operations was increased by $1,924,701 to a total of $8,802,762.

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, 2006 and 2005

ASSETS	2006	2005
Current Assets:		
Cash and cash equivalents	**$ 6,974,333**	$ 6,253,268
Accounts receivable:		
Federal grants	**2,639,847**	2,629,236
Commonwealth of Virginia grants	**1,094,012**	2,079,947
Trade receivables, net of allowance for doubtful accounts	**2,542,348**	2,616,522
Other receivables	**3,923,656**	3,689,860
Inventory	**2,361,863**	1,910,706
Prepaid expenses	**545,149**	618,258
Restricted cash, cash equivalents, and investments	**60,047,130**	42,004,404
Total current assets	**80,128,338**	61,802,201
Noncurrent Assets:		
Deferred bond and lease costs, net	**936,764**	1,052,426
Capital assets:		
Rolling stock	**65,846,762**	61,953,818
Vehicles	**45,550**	45,550
Facilities	**58,494,479**	41,416,189
Track and signal improvements	**27,628,930**	27,628,930
Equipment	**5,608,372**	4,862,101
Construction in progress	**23,319,672**	31,451,741
Equity in local properties	**5,244,798**	4,998,368
Office furniture and equipment	**2,636,253**	2,272,467
	188,824,816	174,629,164
Less accumulated depreciation	**(53,342,775)**	(45,125,542)
Total capital assets, net	**135,482,041**	129,503,622
Total noncurrent assets	**136,418,805**	130,556,048
Total assets	**$ 216,547,143**	$ 192,358,249

LIABILITIES AND NET ASSETS	2006	2005
Current Liabilities:		
Accounts payable	**$ 6,054,671**	$ 4,496,684
Payable to Commissions	**882,278**	598,222
Compensated absences	**199,909**	218,277
Accrued expenses	**2,038,916**	3,058,852
Accrued interest	**1,899,386**	2,029,157
Deferred revenue	**20,464,351**	1,233,226
Contract retainage	**906,580**	513,657
Note payable	**60,000**	60,000
Current portion of capital lease obligations	**1,235,118**	1,235,727
Current portion of long-term debt	**5,255,000**	5,010,000
Total current liabilities	**38,996,209**	18,393,802
Noncurrent Liabilities:		
Capital lease obligations	**24,342,106**	25,577,224
Note payable	**600,000**	660,000
Bonds payable, net	**57,991,211**	63,043,835
Total noncurrent liabilities	**82,933,317**	89,281,059
Total liabilities	**121,929,526**	107,674,861
Net Assets:		
Invested in capital assets, net of related debt	**67,535,067**	55,182,924
Restricted for liability insurance plan	**10,204,517**	12,439,017
Restricted for debt service and capital lease	**7,008,351**	6,873,135
Restricted grants or contributions	**14,013**	726,456
Unrestricted assets	**9,855,669**	9,461,856
Total net assets	**94,617,617**	84,683,388
Total liabilities and net assets	**$ 216,547,143**	$ 192,358,249

VIRGINIA RAILWAY EXPRESS

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended June 30, 2006 and 2005

	2006	2005
Operating Revenues:		
Passenger revenue	$ 19,453,436	$ 19,452,162
Equipment rentals and other	442,517	121,373
Total operating revenues	19,895,953	19,573,535
Operating Expenses:		
Contract operations and maintenance	14,619,521	14,144,414
Other operations and maintenance	9,304,325	7,928,107
Property leases and access fees	8,986,974	8,769,866
Insurance	3,521,858	3,533,503
Marketing and sales	1,005,348	1,302,527
General and administrative	5,219,514	5,282,641
Total operating expenses	42,657,540	40,961,058
Operating loss before depreciation	(22,761,587)	(21,387,523)
Depreciation	(8,217,233)	(6,699,409)
Operating loss	(30,978,820)	(28,086,932)
Nonoperating Revenues (Expenses):		
Subsidies:		
Commonwealth of Virginia grants	13,137,477	7,613,022
Federal grants	10,721,335	8,124,763
Jurisdictional operating contributions	6,878,061	6,352,999
Capital grants and assistance:		
Commonwealth of Virginia grants	1,769,727	3,778,146
Federal grants	12,796,829	9,824,036
In-kind and other local contributions	-	266,148
Interest income:		
Operating funds	367,292	214,888
Insurance trust	721,919	688,816
Other restricted funds	840,383	49,860
Interest, amortization and other nonoperating expenses, net	(4,953,443)	(4,257,178)
Total nonoperating revenues, net	42,279,580	32,655,500
Loss on disposal of assets	(1,366,531)	(3,640,928)
Change in net assets	9,934,229	927,640
Net Assets, beginning	84,683,388	83,755,748
Net Assets, ending	$ 94,617,617	$ 84,683,388

See Notes to Financial Statements.

VIRGINIA RAILWAY EXPRESS

STATEMENTS OF CASH FLOWS
Years Ended June 30, 2006 and 2005

	2006	2005
Cash Flows From Operating Activities:		
Receipts from customers	$ 19,727,708	$ 19,098,403
Payments to suppliers	(39,361,587)	(35,937,065)
Payments to employees	(2,870,261)	(2,928,889)
Net cash used in operating activities	(22,504,140)	(19,767,551)
Cash Flows From Noncapital Financing Activities:		
Governmental subsidies	30,448,991	21,637,064
Cash Flows From Capital and Related Financing Activities:		
Acquisition and construction of capital assets	(15,169,261)	(17,603,938)
Capitalized debt issuance costs	-	(252,500)
Capital grants and assistance	35,103,306	13,985,832
Proceeds from sale of capital assets	-	9,610,000
Principal borrowed on capital lease	-	25,100,000
Principal paid on capital lease obligations	(1,175,727)	(365,987)
Principal paid on note	(60,000)	(60,000)
Principal paid on bonds and note	(5,010,000)	(4,775,000)
Interest paid on capital lease obligation	(1,217,690)	(298,190)
Interest paid on bonds and note	(3,547,486)	(3,574,813)
Net cash provided by capital and related financing activities	8,923,142	21,765,404
Cash Flows From Investing Activities:		
Interest received on investments	1,895,798	903,703
Increase in cash and cash equivalents	18,763,791	24,538,620
Cash and Cash Equivalents, beginning	48,257,672	23,719,052
Cash and Cash Equivalents, ending	$ 67,021,463	$ 48,257,672
Operating loss	$ (30,978,820)	$ (28,086,932)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	8,217,233	6,699,409
Increase in:		
Accounts receivable	(125,826)	(333,790)
Advances and deposits	-	(250)
Decrease (increase) in:		
Inventory	(451,157)	119,264
Prepaid expenses	73,109	149,667
Accounts payable and accrued expenses	803,740	1,826,423
Increase (decrease) in deferred ticket sales	(42,419)	(141,342)
Net cash used in operating activities	$ (22,504,140)	$ (19,767,551)
Schedule of Noncash Capital Activities		
Capital assets acquired through accounts payable	$ 430,796	$ 495,188

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 $60,047,130 and $42,004,404 at June 30, 2006 and 2005, respectively, are comprised of funds related to bond compliance requirements, the Liability Insurance Plan and proceeds from the lease purchase of the Gallery IV-A railcars that had not been fully disbursed as of June 30, 2006. Also included in restricted cash is grant proceeds received from the Commonwealth of Virginia.

Allowance for Uncollectible Accounts: VRE calculates its allowance for uncollectible accounts using historical collection data and specific account analysis. The allowance was $97,147 at June 30, 2006 and $91,409 at June 30, 2005.

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 that 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
Vehicles	5 years
Facilities	30-40 years
Track and signal improvements	30 years
Equipment	5 years
Equity in local properties	35 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, 2006.

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, discounts, and deferred losses, 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 to 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.

Note 2. Cash, Cash Equivalents and Investments

Deposits: All cash of 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, 2006 the book balance of VRE's deposits with banks was $2,790,892; 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, 2006, VRE had investments of $24,196,918 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, 2006, VRE had $10,204,517 invested in the Insurance Trust.

Unexpended lease proceeds for the purchase of additional railcars in the recorded amount at June 30, 2006 of $22,820,250 were invested in U.S. Treasury money market accounts with SunTrust Bank. Accumulated bond interest and principal payments in the amount of $7,008,351 at June 30, 2006 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 have been assigned an "AAAm" rating by Standard & Poors.

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

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

Investment Type	Fair Value	Maturities Less than 1 Year
LGIP	$ 24,196,918	$ 24,196,918
Insurance trust fund	10,204,517	10,204,517
Money market funds	29,828,601	29,828,601
Total investments	$ 64,230,036	$ 64,230,036

Note 3. Capital Assets

Capital asset activity for the year ended June 30, 2006 was as follows:

	Beginning Balance	Increases	(Deletions) Reclassifications	Ending Balance
Capital assets not being depreciated:				
Construction in progress	$ 31,451,741	$ 14,617,393	$ (22,749,462)	$ 23,319,672
Capital assets being depreciated:				
Rolling stock	61,953,818	318,033	3,574,911	65,846,762
Vehicles	45,550	-	-	45,550
Facilities	41,416,189	83,465	16,994,825	58,494,479
Track and signal improvements	27,628,930	-	-	27,628,930
Equipment	4,862,101	253,740	492,531	5,608,372
Equity in local properties	4,998,368	-	246,430	5,244,798
Office furniture and equipment	2,272,467	327,426	36,360	2,636,253
Total capital assets being depreciated	143,177,423	982,664	21,345,057	165,505,144
Less accumulated depreciation for:				
Rolling stock	24,378,877	4,896,474	-	29,275,351
Vehicles	6,864	11,377	-	18,241
Facilities	10,040,509	1,360,410	-	11,400,919
Track and signal improvements	4,989,296	920,955	-	5,910,251
Equipment	3,199,772	722,266	-	3,922,038
Equity in local properties	1,751,763	146,331	-	1,898,094
Office furniture and equipment	758,461	159,420	-	917,881
Total accumulated depreciation	45,125,542	8,217,233	-	53,342,775
Total capital assets being depreciated, net	98,051,881	(7,234,569)	21,345,057	112,162,369
Totals	$ 129,503,622	$ 7,382,824	$ (1,404,405)	$ 135,482,041

Note 3. Capital Assets (Continued)

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 2006 and 2005, these payments included $3,132,516 and $2,842,657 of salary-related costs and $343 and $8,762 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 $80,000 and $90,000 to NVTC and $145,107 and $161,753 to PRTC during 2006 and 2005, 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 $17,858 and $1,173 in 2006 and 2005, respectively. Amounts payable to NVTC and PRTC were $14,438 and $867,840 at June 30, 2006 and $16,269 and $581,952 at June 30 2005.

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, salaried permanent employees of VRE participate in the VRS through 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 percent 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/2005AnnuRept.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 percent of their annual salary to the VRS. VRE has assumed this 5 percent 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 2006 was 11.5% of annual covered payroll, inclusive of the 5 percent member contribution.

Note 5. Defined Benefit Pension Plan (Continued)

C. Annual Pension Cost

For fiscal year 2006, VRE's annual pension cost of $275,340 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) eight percent investment rate of return (b) projected salary increases ranging from four percent to seven percent per year, and (c) three percent per year cost of living adjustments. Both (a) and (b) included an inflation component of 3 percent. The actuarial value of PRTC's assets is equal to the 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.

To obtain more information pertaining to three-year trend information and a Schedule of Funding Progress for PRTC and VRE, a request should be sent to PRTC, 14700 Potomac Mills Road, Woodbridge, VA, 22192.

VRE's payroll for the employees covered by the VRS for the years ended June 30, 2006 and 2005 was $2,394,250 and $2,207,029, 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 2006 and 2005, annual track usage fees totaled approximately $5,189,660 and $5,116,536 respectively, and facility and other identified costs totaled $422,322 and $423,207, 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 $16,459,485 in 2006 and $15,670,663 in 2005. During July 2006, an amended agreement was signed that extended the agreement until July 1, 2010, effective July 1, 2006.

VRE has entered into a series of operating leases with Sound Transit for bi-level rail cars and locomotives. At June 30, 2006, eight rail cars had been returned to Sound Transit, leaving ten rail cars and two locomotives still under lease. The current monthly lease amount for the remaining cars is $92,267. 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, 2006:

	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
Revenue Bonds	$ 69,540,000	$ -	$ (5,010,000)	$ 64,530,000	$ 5,255,000
Capital Leases	26,752,951	-	(1,175,727)	25,577,224	1,235,118
Note Payable	720,000	-	(60,000)	660,000	60,000
	97,012,951	-	(6,245,727)	90,767,224	6,550,118
Compensated Absences	218,277	-	(18,368)	199,909	199,909
	$ 97,231,228	$ -	$ (6,264,095)	$ 90,967,133	$ 6,750,027

Revenue Bonds:

$37,625,000 Commuter Rail Revenue Refunding Bonds, series 1993; due in annual maturities of $4,145,000 to $5,065,000 through July 2010, plus semi-annual interest at 4.9% to 5.25%	$ 22,945,000
$23,000,000 Commuter Rail Revenue Bonds, series 1997; due in annual maturities of $1,000,000 to $2,115,000 through July 2017, plus semi-annual interest at 4.7% to 6.0%	16,690,000
$31,700,000 Commuter Rail Revenue Refunding Bonds, series 1998; due in annual maturities of $110,000 to $6,555,000 through July 1, 2014, plus semi-annual interest at 4.3% to 5.375%	24,895,000
	64,530,000
Plus (less) unamortized:	
Deferred loss	(1,649,630)
Discount	(124,393)
Premiums	490,234
Total bonded debt, net	$ 63,246,211

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
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	6,435,000	2,073,792	8,508,792
2012-2016	31,295,000	4,822,619	36,117,619
2017-2018	4,125,000	225,585	4,350,585
	$ 64,530,000	$ 18,588,632	$ 83,118,632

Note 7. Long-Term Debt Obligations (Continued)

Deferred bond and lease costs, consisting of 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 debt. Amortization of deferred bond and lease costs, approximating $67,000 and $60,000, is included in interest expense in 2006 and 2005, respectively.

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, 2006 and 2005, VRE designated $26,544,436 and $26,052,674 respectively, of its cash, the restricted bond interest and principal funds, inventory and receivables as this operating reserve. The reserves represented 71.21% and 73.9% of budgeted operating expenses for June 30, 2006 and 2005, 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, 2006 and 2005, are as follows:

	2006	2005
Bond Interest Fund	$ 1,730,071	$ 1,848,451
Bond Principal Fund	5,278,280	5,024,684
Total Held by Trustee	$ 7,008,351	$ 6,873,135

Capitalized Lease - Fare Collection

$2,717,409 capitalized lease obligation; $39,347 due monthly, interest at 5.73%, maturing in 2009, collateralized with a fare collection system with a carrying value of $1,037,250	$ 1,265,433

Future minimum lease payments as of June 30, 2006 are as follows:

Years Ended June 30,	Amount
2007	$ 472,160
2008	472,160
2009	432,813
Total minimum lease payments	1,377,133
Lease amount representing interest	111,700
Present value of lease payments	$ 1,265,433

Capitalized Lease - Gallery IV

$25,100,000 capitalized lease obligation; $965,679 due semi-annually, interest at 4.59%, maturing in 2025, collateralized with Gallery IV railcars.	$ 24,311,791

Note 7. Long-Term Debt Obligations (Continued)

Future minimum lease payments as of June 30, 2006 are as follows:

Years Ended June 30,	Amount
2007	$ 1,931,357
2008	1,931,357
2009	1,931,357
2010	1,931,357
2011	1,931,357
2012-2016	9,656,785
2017-2021	9,656,785
2022-2025	7,725,428
Total minimum lease payments	36,695,783
Lease amount representing interest	12,383,992
Present value of lease payments	$ 24,311,791

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, 2006 was 3.96%.

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, 2006.

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)

The Division of Risk Management manages the Insurance Trust Fund pursuant to provisions of the Insurance Plan. Since November 2005, all plan assets have been invested in the Department of Treasury common pool. Prior to that time, approximately one-half of plan assets were invested in the 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, 2006 and 2005 was as follows:

	2006	2005
Beginning Balance, July 1	$ 12,439,017	$ 15,290,158
Contribution to reserves	500,000	-
Insurance premiums paid	(3,509,438)	(3,412,960)
Claims mitigation costs and losses incurred	(41,300)	-
Investment income	721,919	688,816
Actuarial and administrative charges	94,319	(126,997)
Ending Balance, June 30	$ 10,204,517	$ 12,439,017

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, 2006, there were disputes between VRE and certain vendors. The amounts 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, 2006:

Station and parking lots	$ 343,171
Railcars	22,551,139
Maintenance and layover yards	332,671
Track and signal improvements	9,290,669
Other administrative	216,477
TOTAL	$ 32,734,127

VRE has received proceeds from several federal and state grant programs. In the event of an audit of these grants certain costs may be questioned as not being appropriate expenditures under the grant agreements. Such findings may result in the refund of grant monies to the grantor agencies. Based on VRE's policies and past experience, management believes that no refunds would be due in the case of an audit and accordingly no provision has been made in the accompanying financial statements for the refund of grant monies.

Note 11. Pending GASB Statements

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

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. 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.

Compliance Section

VIRGINIA RAILWAY EXPRESS

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended June 30, 2006

Federal Grantor/ Program Title	Federal CFDA Number		Expenditures
DEPARTMENT OF HOMELAND SECURITY			
Direct payments:			
Urban Areas Security Initiative	97.008	$	550,890
Total Department of Homeland Security		$	550,890

VIRGINIA RAILWAY EXPRESS

NOTE TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation and Accounting

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of VRE 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 Expenditures 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 VRE 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.

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www.pbgh.com

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 Honorable Commission Board Members
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, 2006, and have issued our report thereon dated September 1, 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 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
September 1, 2006

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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
The Northern Virginia Transportation Commission
The Potomac and Rappahannock Transportation Commission

Compliance

We have audited the compliance of the Virginia Railway Express, 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. Virginia Railway Express' 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 Virginia Railway Express' management. Our responsibility is to express an opinion on Virginia Railway Express' 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 Virginia Railway Express' 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 Virginia Railway Express' compliance with those requirements.

In our opinion, Virginia Railway Express 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 Virginia Railway Express 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 Virginia Railway Express' 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 1, 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	√ No
Reportable conditions identified that are not considered to be material weaknesses	______ Yes	√ None Reported
Noncompliance material to financial statements noted	______ Yes	√ No

Federal awards

Internal control over major programs:

Material weaknesses identified	______ Yes	√ No
Reportable conditions identified that are not considered to be material weaknesses	______ Yes	√ 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	√ No

Identification of major programs:

CFDA Number	Name of Federal Program
97.008	Urban Areas Security Initiative

Dollar threshold used to distinguish between type A and type B programs: $300,000

Auditee qualified as low-risk auditee? ______ Yes √ No

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