

**FAUQUIER COUNTY WATER AND
SANITATION AUTHORITY**

Warrenton, Virginia

FINANCIAL REPORT

JUNE 30, 2005

OFFICERS AND BOARD MEMBERS

L. Paul Blackmer, Jr.- Chairperson
James R. Green, Jr. - Vice Chairperson
Earle H. Double, Jr. - Secretary/Treasurer
Maureen S. Riordan, Esquire
Raymond E. Graham

AUDIT COMMITTEE

L. Paul Blackmer, Jr.
James R. Green, Jr.

SENIOR MANAGEMENT

Barney E. Durrett, Jr., General Manager
Dennis K. Drummond, Director of Finance
J. Wayne Stephens, Engineer
Thomas P. Dineen, Executive Assistant and Personnel Administrator
Wesley Basore, Director of Operations

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INDEPENDENT AUDITOR'S REPORT

Yount, Hyde & Barbour, P.C.

Certified Public Accountants
and Consultants

To the Board of Directors of the Fauquier
County Water and Sanitation Authority
Warrenton, Virginia

We have audited the accompanying basic financial statements of Fauquier County Water and Sanitation Authority 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 Authority's management. Our responsibility is to express opinions 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, Specifications for Audits of Local Authorities, Boards and Commissions issued by the Auditor of Public Accounts of the Commonwealth of Virginia and the standards applicable to financial audits contained in "Government Auditing Standards," issued by the Comptroller General of the United States. Those standards 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 financial position of Fauquier County Water and Sanitation Authority as of June 30, 2005 and 2004, 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 August 18, 2005 on our consideration of Fauquier County Water and Sanitation Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of that report is to describe the scope of our testing of 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 audits.

Management's Discussion and Analysis and the Schedule of Funding Progress, as indicated in the table of contents, are required parts of the basic financial statements but are supplementary information required by the accounting principals 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.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
August 18, 2005

50 S. Cameron St.
P.O. Box 2560
Winchester, VA 22604
(540) 662-3417

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the Fauquier County Water and Sanitation Authority's financial performance provides a narrative overview of the financial activities of the Authority for the fiscal year ended June 30, 2005. We encourage readers to consider the information presented here in conjunction with the audited financial statements that follow this section.

FINANCIAL HIGHLIGHTS

- The Authority received \$10,631,041 in availability fees and developer contributions during FY2005.
- Total revenues and expenses were \$7,803,262 and \$5,255,868 respectively during FY2005. Operating revenues increased by 18.3% as a result of a 6.6% increase in the total number of accounts and the implementation of revised plan review and inspection fees.
- Total net assets increased by \$10,135,814 to \$32,564,546 during FY2005.
- Construction continues on the New Baltimore collection system. Design of the project is complete; easement acquisition is approximately 85% complete with construction approximately 32% complete. The first phase of the project is expected to enter service in February of 2006. Total project expenditures through FY2005 were \$1.2 million against a \$2.8 million budget.
- The Authority's user rates remained at FY 2004 levels, and have not been increased for the tenth consecutive year. User rates were in fact reduced in FY2000 and FY2002.
- The Authority has received unqualified audits for over thirty years.

OVERVIEW OF THE FINANCIAL STATEMENTS

There are three types of financial statements included in the financial section of this report – Statement of Net Assets, Statement of Revenues, Expenses and Changes in Retained Earnings and Statement of Cash Flows. The Statement of Net Assets includes all of the Authority's assets and liabilities using the accrual basis of accounting. It provides the basis for evaluating the capital structure of the Authority and assessing the liquidity and flexibility of the Authority. All current and prior year's revenues and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Net Assets. This statement measures the performance of the Authority's operations over the past year and it can be used to determine whether the Authority has successfully recovered its costs through user fees and other charges. The Statement of Cash Flows reports the cash provided and used by operating activities as well as other cash sources such as investment income and cash payments for debt and capital additions. The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the statements.

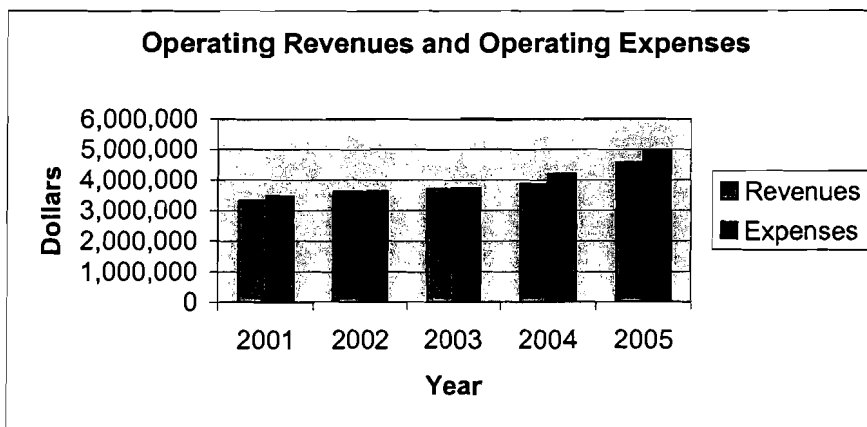
FINANCIAL ANALYSIS

The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Retained Earnings report information about the Authority's activities to determine if, overall, the financial position improved over the year. These reports help determine the financial health of the Authority and whether the Authority's financial position is improving or deteriorating. Non-financial factors such as economic conditions, population growth and changes in governmental legislation need to be considered as well. The Authority's financial strength continued to improve during FY 2005 as described in the following sections of this report.

Net Assets and Liabilities The Authority's total assets increased by \$8,854,122, or 22%, during FY 2005. A significant portion of this increase was due to the availability fees and developer contributions collected in FY 2005, almost \$7 million of which are restricted for use in upgrading and expanding the Vint Hill WWTP. Total liabilities decreased by \$1,281,692 during this period. The table below depicts the Authority's assets and liabilities as of June 30, 2005 and 2004.

	<u>2005</u>	<u>2004</u>
Current and other assets	\$ 16,961,038	\$ 8,924,280
Capital assets, net	<u>30,420,033</u>	<u>29,602,669</u>
Total assets	\$ 47,381,071	\$ 38,526,949
Long-Term Liabilities	13,157,584	14,720,633
Other liabilities	<u>1,658,941</u>	<u>1,377,584</u>
Total liabilities	\$ 14,816,525	\$ 16,098,217
Net Assets:		
Invested in capital assets, net of related debt	\$ 21,781,511	\$ 20,206,661
Restricted	8,988,420	2,000,000
Unrestricted	<u>1,794,615</u>	<u>222,071</u>
Total net assets	<u>\$ 32,564,546</u>	<u>\$ 22,428,732</u>

Operating Income. Operating revenues totaled \$4.56 million in FY 2005, an increase of 18.3% over FY 2004. This increase can be attributed to a 6.6% increase in the customer base and the implementation of revised plan review and inspection fees. Operating expenses totaled \$4.94 million in FY 2005, an increase of 17.9% over FY 2004. This increase was due to a number of factors, including an increase in depreciation expense, growth of the customer base, high fuel cost, increased cost of medical insurance, higher legal costs and employee cost of living and longevity increases. The chart below depicts operating revenues compared to operating expenses during the last five years.



As a governmental entity, the Authority's goal is to match revenues with expenses and not generate a profit. As such, the Authority will generally experience a small loss or profit, neither of which adversely affects the financial condition of the organization.

The table below shows a comparison between operating revenues, operating expenses, non-operating revenues and expenses, net income and capital contributions at June 30, 2005 and 2004.

	2005	2004
Operating Revenues		
Water Service	\$ 1,666,859	\$ 1,631,604
Sewer Service	1,955,416	1,813,615
Other operating revenues	<u>938,632</u>	<u>417,170</u>
Total Operating Revenues	<u>\$ 4,560,907</u>	<u>\$ 3,862,389</u>
Operating Expenses		
Salaries	\$ 1,420,246	\$ 1,368,152
Fringe Benefits	472,686	459,436
Administrative	515,867	256,417
Operations	896,003	792,361
Depreciation	<u>1,630,648</u>	<u>1,309,308</u>
Total Operating Expenses	<u>\$ 4,935,450</u>	<u>\$ 4,185,674</u>
Operating Income/(Loss)	<u>\$ (374,543)</u>	<u>\$ (323,285)</u>
Non-operating Revenue and Expense		
Availability fees	\$ 3,042,621	\$ 2,124,691
Gain (loss) on sale of fixed assets	325	(1,500)
Interest earned	178,609	103,165
Contribution	20,800	49,920
Bad debt expense	(2,279)	(4,485)
Interest expense	<u>(318,139)</u>	<u>(342,623)</u>
Net income before capital contributions	<u>\$ 2,547,394</u>	<u>\$ 1,605,883</u>
Capital contributions	<u>7,588,420</u>	<u>--</u>
Change in net assets	<u>\$ 10,135,814</u>	<u>\$ 1,605,883</u>
Total net assets, beginning of year	<u>22,428,732</u>	<u>20,822,849</u>
Total net assets, end of year	<u>\$ 32,564,546</u>	<u>\$ 22,428,732</u>

BUDGET HIGHLIGHTS

The Authority prepares annual operating and capital budgets that are presented to the Board of Directors for approval. Department managers have line item control of their budget. Mid-year budget adjustments are prepared by management and approved by the Board.

In FY 2005, operating revenues showed a positive variance of \$358,064 and operating expenses exceeded the budget by \$154,727, due mainly to increased legal and depreciation expenses. Revenue growth continues to outpace increases in operating expenses.

CAPITAL ASSETS AND LONG TERM DEBT

Capital Assets. The increase in capital assets for FY 2005 is the result of several CIP projects having been completed and placed into service, and the purchase of a track excavator and a sewer camera. The detail of these major capital asset additions is as follows:

Machines/ Equipment	\$ 78,397
R&R's	627,347
Vint Hill WWTP	42,998
Marshall WWTP	262,324
MacRidge/High Rock Connec.	76,876
New Balt. Collection System	311,843
BNR – Remington	100,324
RT 600 & 676 Water Lines	354,486
WSA Headquarters Building	482,538

The table below shows the changes in capital assets for 2005.

	2005	2004	Change
Water Facilities	\$ 12,326,164	\$ 12,158,695	\$ 167,470
Sewer Facilities	28,860,316	23,404,785	5,455,531
Headquarters Building	857,919	56,963	800,956
Machines/Equipment	3,886,987	3,828,959	58,028
Construction Equipment	346,449	308,027	38,422
Land	1,553,425	1,553,425	--
CIP and R&R's	3,193,706	7,252,170	(4,058,464)
Total property and equipment	\$ 51,024,966	\$ 48,563,024	\$ 2,461,943
Less: Depreciation	20,604,933	18,960,355	1,644,578
Net property and equipment	\$ 30,420,033	\$ 29,602,669	\$ 817,365

Cash Balances. The Authority's June 30, 2005 cash balance was about \$16,000,000. This cash position has been accumulated specifically to fund a number of capital projects. The following is the estimated cost of these projects between FY 2006 and FY 2007:

New Baltimore Collection System	\$ 1,500,000
Vint Hill WWTP	8,430,000
NBRWS Zones G&H Well Development	1,980,000
NBRWS Route 600&676 Water Lines	<u>634,000</u>
Totals	<u>\$ 12,544,000</u>

In addition, there are a number of smaller capital and replacements and renewals projects that will be completed during this time period.

Based on a conservative cash forecast, the following is the projected ending cash balances for the next five years:

FY 2006	\$ 4,194,000
FY 2007	\$ 3,179,000
FY 2008	\$ 2,994,000
FY 2009	\$ 3,006,000
FY 2010	\$ 2,358,000

Capital Projects

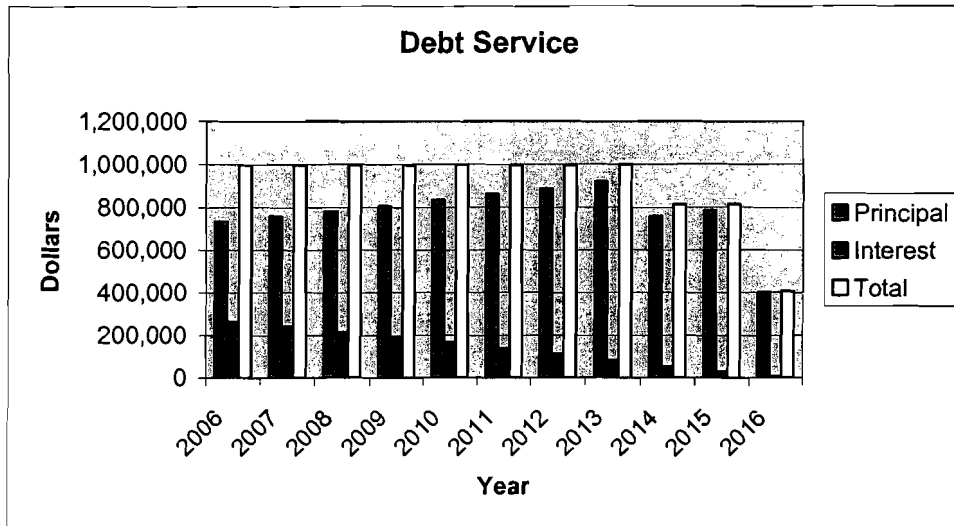
Below is a summary schedule of our planned capital projects and replacement and renewals for the next five years:

FY 2006 Five Year Capital Improvements Program Schedule

Project	Project Number	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	5 YR Totals
Construct New Baltimore Sewage Collection System	#02-01-xxxx	\$1,500,000	\$0	\$0	\$0	\$0	\$1,500,000
Construct Vint Hill WWTP Expansion	#04-01-0137	\$7,200,000	\$1,050,000	\$0	\$0	\$0	\$8,250,000
Develop NBRWS Zone G Wells	#03-01-0139	\$1,600,000	\$380,000	\$0	\$0	\$0	\$1,980,000
Construct NBRWS Route 600&676 Water Line Extensions	#04-01-xxxx	\$634,000	\$0	\$0	\$0	\$0	\$634,000
Update Utility Master Plan, Maps&Models	#98-99-0091	\$100,000	\$40,000	\$0	\$0	\$0	\$140,000
Construct BRWS Well B-1	#01-04-xxxx	\$50,000	\$0	\$0	\$0	\$0	\$50,000
Conduct Plains Hydrogeological Investigation	#03-06-0140	\$80,000	\$0	\$0	\$0	\$0	\$80,000
Upgrade Remington WWTP Biosolids & Septage Treatment	#05-09-0141	\$0	\$0	\$150,000	\$900,000	\$0	\$1,050,000
Construct Maintenance Yard	#06-99-xxxx	\$50,000	\$0	\$0	\$0	\$0	\$50,000
Design Catlett/Calverton WWTP	03-03-0122	\$400,000	\$0	\$0	\$0	\$0	\$400,000
Design Catlett/Calverton Collection System	03-03-0121	\$400,000	\$0	\$0	\$0	\$0	\$400,000
Upgrade WWTP BNR Treatment	#05-99-xxxx	\$0	\$100,000	\$500,000	\$400,000	\$0	\$1,000,000
New Service Water Meters		\$15,000	\$15,000	\$15,000	\$15,000	\$15,000	\$75,000
Cash Funded		\$11,229,000	\$1,485,000	\$165,000	\$915,000	\$15,000	\$13,809,000
Debt Funded		\$0	\$0	\$0	\$0	\$0	\$0
County Funded		\$800,000	\$0	\$0	\$0	\$0	\$800,000
Not Funded		\$0	\$100,000	\$500,000	\$400,000	\$0	\$1,000,000

Long-Term Debt. The Authority's outstanding debt as of June 30, 2005 consists of two separate notes. The first note is with the Virginia Resource Authority (VRA). The June 30, 2005 outstanding balance of this note was \$1,245,000 with an interest rate ranging from 3% to 4% over the next nine years. The second note is with the Virginia Revolving Loan Fund (VRLF). The June 30, 2005 outstanding balance of this note is \$7,270,375 with an interest rate of 3%.

The graph below provides the detail of how much principal and interest are due each year until the last payment is made in 2016.



Deferred Revenue. The Authority has entered into an agreement with Fauquier County to extend availability of public sewer services to the New Baltimore Service District (the "NBSD") by the construction of a wastewater collection system. The County has agreed to finance the Project through a non-recourse, no interest loan agreement with the Authority in the amount of \$2,800,000. As of June 30, 2005, construction of the NBSD Project is 32% complete with an estimated completion date of October 31, 2006. A total of \$1,167,034 has been expended through FY2005 and is included as construction-in-progress in capital assets. The Authority is required to repay the loan only to the extent of availability fee surcharges collected. These surcharges are remitted to the County on a monthly basis.

ECONOMIC FACTORS.

The Authority enjoyed a good FY 2005, particularly in terms of availabilities fees and developer contributions collected. Although it is possible that the region's favorable economic conditions will continue into FY 2006, revenues will continue to be forecast in a conservative manner. In addition, the Authority will continue to monitor its operational and capital requirements in order to ensure that water and wastewater services will meet customer needs.

The Authority's rates, fees and other charges are structured to produce sufficient revenue to service debt and to meet all operational expenses. While user rates met these goals in FY 2005, a rate review and analysis is currently being performed to ensure that future revenue requirements are satisfied.

REQUEST FOR INFORMATION

This report is intended to provide our customers, note holders and creditors with a general overview of the Authority's financial position and to demonstrate its ability to provide services to its customers. Questions concerning information provided in this report or request for additional financial information should be directed to the Authority at 540-349-2092 or to our administrative office located at 7172 Kennedy Road, Warrenton, VA 20187.

Liabilities	<u>2005</u>	<u>2004</u>
Current Liabilities		
Accounts payable	\$ 415,446	\$ 85,696
Accrued interest	155,730	108,039
Current maturities of long-term debt	733,669	711,105
Current maturities of notes payable	50,000	50,000
Accrued payroll and related liabilities	185,965	163,879
Other current liabilities	85,519	222,371
Total current liabilities	<u>\$ 1,626,329</u>	<u>\$ 1,341,090</u>
Liabilities Payable from Restricted Assets		
Capital improvement funds due to other governments	\$ 2,737	\$ 5,519
Security deposits	29,875	30,975
Total liabilities payable from restricted assets	<u>\$ 32,612</u>	<u>\$ 36,494</u>
Long-Term Liabilities		
Long-term debt	\$ 7,754,853	\$ 8,484,902
Notes payable	551,831	601,831
Refundable advances	968,100	953,100
Other long-term liabilities	1,082,800	1,880,800
Total long-term liabilities	<u>\$ 10,357,584</u>	<u>\$ 11,920,633</u>
Deferred grant revenue	<u>\$ 2,800,000</u>	<u>\$ 2,800,000</u>
Total liabilities	<u>\$ 14,816,525</u>	<u>\$ 16,098,217</u>
Net Assets		
Invested in capital assets, net of related debt	\$ 21,781,511	\$ 20,206,661
Restricted net assets	8,988,420	2,000,000
Unrestricted net assets	1,794,615	222,071
Total net assets	<u>\$ 32,564,546</u>	<u>\$ 22,428,732</u>
Total liabilities and net assets	<u>\$ 47,381,071</u>	<u>\$ 38,526,949</u>

FAUQUIER COUNTY WATER AND SANITATION AUTHORITY

Statements of Revenue, Expenses and Changes in Net Assets

Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues		
Water service	\$ 1,666,859	\$ 1,631,604
Sewer service	1,955,416	1,813,615
Septic service	250,467	180,353
Plan review and inspection fees	312,890	--
Late charges	81,252	78,335
Vint Hill reimbursement	51,078	57,771
Marshall WW reimbursement	110,498	--
Other operating revenues	132,447	100,711
Total operating revenues	<u>\$ 4,560,907</u>	<u>\$ 3,862,389</u>
Operating expenses		
Salaries	\$ 1,420,246	\$ 1,368,152
Fringe benefits	472,686	459,436
General and administrative	515,867	256,417
Operations and maintenance	896,003	792,361
Depreciation expense	1,630,648	1,309,308
Total operating expenses	<u>\$ 4,935,450</u>	<u>\$ 4,185,674</u>
Operating (loss)	<u>\$ (374,543)</u>	<u>\$ (323,285)</u>
Nonoperating revenue and expense		
Availability fees	\$ 3,042,621	\$ 2,124,691
Gain (loss) on sale of assets	325	(1,500)
Interest earned	178,609	103,165
Contribution	20,800	49,920
Bad debt expense	(2,279)	(4,485)
Interest expense	(318,139)	(342,623)
Net nonoperating revenue	<u>\$ 2,921,937</u>	<u>\$ 1,929,168</u>
Net income before capital contributions	\$ 2,547,394	\$ 1,605,883
Capital Contributions	<u>7,588,420</u>	<u>--</u>
Change in net assets	\$ 10,135,814	\$ 1,605,883
Net assets, at beginning of year	<u>22,428,732</u>	<u>20,822,849</u>
Net assets, at end of year	<u>\$ 32,564,546</u>	<u>\$ 22,428,732</u>

See Accompanying Notes to Financial Statements.

FAUQUIER COUNTY WATER AND SANITATION AUTHORITY

Statements of Cash Flows
Years Ended June 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash Flows from Operating Activities		
Cash received from customers	\$ 4,399,557	\$ 3,629,353
Payments to suppliers for goods and services	(1,038,800)	(1,136,702)
Payments to employees for services	<u>(1,870,846)</u>	<u>(1,798,928)</u>
Net cash provided by operating activities	<u>\$ 1,489,911</u>	<u>\$ 693,723</u>
Cash Flows from Capital and Related Financing Activities		
Acquisitions of property, equipment and construction in progress	\$ (1,792,755)	\$ (4,887,119)
Proceeds received for other current liabilities	--	222,371
Payments on other current liabilities	(136,853)	--
Contributions from developers and other governments	6,988,420	2,322,000
Interest payments	(321,760)	(331,064)
Principal payments on long-term debt	(711,105)	(2,191,036)
Proceeds from refundable advances	18,000	--
Payments on refundable advances	(3,000)	(1,500)
Principal payments on other long-term liabilities	(798,000)	(588,000)
Proceeds from availability fees	<u>3,042,621</u>	<u>2,124,691</u>
Net cash provided by (used in) capital and related financing activities	<u>\$ 6,285,568</u>	<u>\$ (3,329,657)</u>
Cash Flows from Investing Activities,		
Interest on deposits and investments	<u>\$ 178,609</u>	<u>\$ 103,165</u>
Increase (decrease) in cash and cash equivalents	\$ 7,954,088	\$ (2,532,769)
Cash and Cash Equivalents, at beginning of year	<u>8,041,226</u>	<u>10,573,995</u>
Cash and Cash Equivalents, at end of year	<u>\$ 15,995,314</u>	<u>\$ 8,041,226</u>

See Accompanying Notes to Financial Statements.

FAUQUIER COUNTY WATER AND SANITATION AUTHORITY

**Statements of Cash Flows
(Continued)**

Years Ended June 30, 2005 and 2004

	2005	2004
Cash Flows from Operating Activities		
Operating (loss)	\$ (374,543)	\$ (323,285)
Noncash (revenues) expenses included in operating (loss):		
Depreciation	1,630,648	1,309,308
Bad debts	(2,279)	(4,485)
Amortization of bond issuance costs	1,839	1,839
Contributed rent	20,800	49,920
Noncash loan reduction	(50,000)	(50,000)
(Increase) decrease in:		
Receivables	(13,400)	(162,642)
Receivables, other	(94,571)	(16,834)
Prepaid and other assets	13,463	(32,376)
Performance bond	10,000	(20,000)
Increase (decrease) in:		
Accounts payable and accrued expenses	351,836	(57,066)
Security deposits	(1,100)	925
Capital improvement funds due to other governments	(2,782)	(1,581)
Net cash provided by operating activities	\$ 1,489,911	\$ 693,723
 Noncash Investing, Capital and Financing Activities		
Estimated Fair Value of Property, Plant and Equipment received	\$ 600,000	\$ --
Capitalized Depreciation on self-constructed assets	70,890	36,873
Noncash reduction in note payable	50,000	50,000
Seller-financed note payable for headquarters building	--	250,000
 Reconciliation of Cash		
Cash and temporary investments	\$ 7,367,628	\$ 6,048,152
Restricted cash and temporary investments	8,627,686	1,993,074
	\$ 15,995,314	\$ 8,041,226

See Accompanying Notes to Financial Statements.

FAUQUIER COUNTY WATER AND SANITATION AUTHORITY

Notes to Financial Statements

June 30, 2005 and 2004

Note 1. Nature of Business and Summary of Significant Accounting Policies

Fauquier County Water and Sanitation Authority (the "Authority") is a Virginia corporation organized and existing under the provisions of the Virginia Water and Waste Authorities Act, Sec. 15.2-5100, et seq., Code of Virginia, (1997), as amended. The Authority is governed by a five-member board. Each board member is appointed by the Fauquier County Board of Supervisors to serve a four-year term. The Authority is authorized to acquire, construct, operate, and maintain an integrated water and sewer system for Fauquier County, Virginia. The Authority is exempt from Federal and state income taxes.

The following is a summary of the more significant accounting policies:

Basis of Presentation and Accounting

The accounting policies of the Authority conform to accounting principles generally accepted in the United States of America as applicable to enterprise funds of governmental units. An enterprise fund is a propriety type fund used to account for operations that are financed and operated in a manner similar to private business enterprises. The Authority's intent is that the costs of providing goods or services to customers on a continuing basis be financed or recovered primarily through user charges. Periodic determination of revenues earned, expenses incurred, and/or change in net assets is appropriate for capital maintenance, public policy, management control and accountability. In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and other Governmental Entities that use Proprietary Fund Accounting*, the Authority has elected to apply all applicable GASB pronouncements as well as FASB Statements and Interpretations, APB Opinions, and Accounting Research Bulletins, issued on or before November 30, 1989 that do not conflict with or contradict GASB pronouncements. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Authority has elected not to follow subsequent private-sector guidance.

The Authority follows the accrual basis of accounting. Under this basis of accounting, revenue is recognized when earned and expenses are recorded when incurred. Operating revenues and expenses consist of those revenues and expenses that result from the ongoing principal operations of the Authority. Operating revenues consist primarily of charges for services. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing type activities and result from nonexchange transactions or ancillary services.

When an expense is incurred for purposes in which both restricted and unrestricted net assets are available, it is the Authority's policy to first apply restricted resources.

Notes to Financial Statements
June 30, 2005 and 2004

Reporting Entity

To determine the appropriate reporting entity for the Authority, its relationship with the County was considered in terms of financial accountability as defined in Statement No. 14 of the GASB, *The Financial Reporting Entity*. Based on the application of these criteria, the Authority is not a component unit of the County and all governmental entities operating within the County are excluded from the Authority's financial statements. Although the members of the Authority's Board of Directors are appointed by the Board of County Supervisors, the County is not financially accountable for the Authority. In addition, there is no potential for the Authority to provide specific financial benefit to, or impose specific financial burdens on, the County, and the Authority is not fiscally dependent on the County.

Cash and Cash Equivalents

For reporting cash flows, the Authority considers all investments with an original maturity of three months or less to be cash equivalents.

Investments

Investments are reported at their fair value. Investment income is recognized as revenue in the year it is earned.

Investment Policy:

In accordance with the Code of Virginia and other applicable law, the Authority holds an investment with the State Treasurer's Local Government Investment Pool (the Virginia LGIP, a 2a-7 like pool). However, as of June 30, 2005, the Authority has not adopted a formal investment policy.

Credit Risk:

As of June 30, 2005, 100% of the Authority's portfolio was invested in the "AAAm" rated obligations of the Virginia LGIP as rated by Standard & Poor's Ratings Services.

Concentration of Credit Risk:

The Virginia LGIP establishes limitations on portfolio composition in order to control the concentration of credit risk. The maximum percentage of the portfolio permitted in each eligible asset category is as follows:

U.S. Treasury and Agency Securities	100% maximum
Repurchase Agreements	50% maximum
Bankers Acceptances, Negotiable CD and/or Negotiable Bank Deposit Notes	40% maximum
Commercial Paper	35% maximum
Non-Negotiable Certificates of Deposit	5% maximum
Corporate Notes and Bank Notes	25% maximum
Taxable Municipal Obligations	10% maximum

Notes to Financial Statements
June 30, 2005 and 2004

Interest Rate Risk:

As a means of limiting exposure to fair value losses arising from rising interest rates, the LGIP limits the investment of funds to investments with a stated maturity of no more than 397 days from the time of purchase with the exception of adjustable rate government securities which may have a maturity of up to 762 calendar days. The average dollar weighted maturity for the LGIP portfolio may not exceed 90 days.

As of June 30, 2005, the fair value and maturity of investments/cash equivalents were as follows:

<u>Investment</u>	<u>Maturity</u>	<u>Fair Value</u>
Virginia LGIP	1 day/cash equivalent	\$15,920,912

Accounts Receivable

Service charges are determined by monthly billings to customers. Service charges earned but unbilled are accrued based on the last billing and reported in the financial statement as operating revenues.

Property and Equipment

The Authority capitalizes all property and equipment with a purchase price greater than \$500.

Purchased property and equipment are stated at historical cost. Donated property is recorded at estimated fair market value on the date of donation. The fair market value is based on the Authority's estimated cost to construct or purchase similar assets.

Property and equipment includes construction in progress, which represents costs associated with the construction of assets that will be used in the Authority's operations when completed. Expenditures for repairs and upgrading which materially add to the value or life of an asset are capitalized. Other maintenance and repair costs are expensed as incurred.

Notes to Financial Statements
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Interest is capitalized on qualifying construction in process. For assets acquired with tax-exempt debt, the amount of capitalized interest equals the difference between the interest cost associated with the tax-exempt borrowing to finance the project and the interest earned from temporary investment of the debt proceeds. Capitalized interest is amortized using the straight-line method over the useful life of the asset. There was no interest capitalized during the years ended June 30, 2005 and 2004.

The Authority depreciates its assets, using the straight-line method, over the following estimated useful lives:

Treatment plant	28 years
Headquarters	28 years
Water and sewer lines	50 years
Meters	10-15 years
Vehicles	6 years
Other furnishings and equipment	5-10 years

Depreciation expense was \$1,701,538 and \$1,346,181 for the years ended June 30, 2005 and 2004, respectively. A portion of depreciation is capitalized as part of self-constructed assets, totaling \$70,890 and \$36,873 for the years ended June 30, 2005 and 2004, respectively.

Long-Term Obligations and Costs

Long-term obligations are reported at face value, net of applicable premiums and discounts. Premiums and discounts, issuance costs, and gains or losses on refundings are deferred and amortized over the life of the bonds using the straight line method.

Compensated Absences

The Authority allows employees to accumulate unlimited unused sick leave. Earned vacation time can be accumulated to a maximum limit. Vacation time unused in excess of maximum at December 31 will be forfeited. Upon termination, the Authority pays accumulated vacation time to the maximum limit, and accumulated sick leave is forfeited. Accrued compensated absences amounted to \$121,720 and \$119,483 for the years ending June 30, 2005 and 2004, respectively and are reflected in the accompanying financial statements as a current liability.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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.

Notes to Financial Statements
June 30, 2005 and 2004

Nonexchange Transactions

The Authority receives voluntary nonexchange transactions from developers of cash, property, lines and improvements. As a result of implementing GASB Statement No. 33, these nonexchange transactions are considered capital contributions on the Statements of Revenues, Expenses and Changes in Net Assets. The effect on net income resulted in an increase for the year ended June 30, 2005 and 2004 for \$7,588,420 and \$0, respectively.

Accounting Pronouncements Adopted

In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments* (Statement 34). Statement 34 establishes standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets, a statement of revenues, expenses and changes in net assets and a statement of cash flows. It requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. In June 2001, the GASB issued two standards to be implemented simultaneously with Statement 34. GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for Statement of Local Governments: Omnibus* (Statement 37) clarifies certain provisions of Statement 34 for more consistent application and modifies other provisions to meet changing requirements. GASB Statement No. 38, *Certain Financial Statement Note Disclosures* (Statement 38) modifies, adds and deletes various note disclosure requirements. In May 2002, the GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units – an amendment of GASB Statement No. 14* (Statement 39). This statement continues the requirement in Statement 14 to apply professional judgment in determining whether the relationship between the County and the Authority meet criteria for continued exclusion of reporting of the Authority as a component of the County.

In July 2002, the Authority adopted GASB Statements Nos. 33, 34, 37, 38, and 39. The effect of the adoption of these Statements was the reformatting of the basic financial statements, including the implementation of the direct method for the statements of cash flows and the classification of net assets, the inclusion of a Management's Discussion and Analysis (MD&A) section and changes in footnote disclosures.

In March 2003, the GASB issued Statement No. 40, *Deposits and Investment Risk Disclosures – an amendment of GASB Statement No. 3* (Statement 40). This Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. The Authority has adopted Statement 40 for the fiscal year ending June 30, 2005. The effect of the adoption of this statement was the establishment of comprehensive disclosure requirements for certain risks relating to the Authority's investment portfolio. These risks include: credit risk, concentration of credit risk, interest rate risk, and foreign currency risk.

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* (Statement 42). This Statement requires governments to report the effects of capital asset impairment in

Notes to Financial Statements
June 30, 2005 and 2004

their financial statements when it occurs and requires all governments to account for insurance recoveries in the same manner. The Authority has adopted Statement 42 for the fiscal year ending June 30, 2005. The adoption of this Statement has no effect on the presentation of the financial statements.

New Accounting Pronouncements

GASB Statement No. 43, *Financial Reporting for Postretirement Benefit Plans Other Than Pension Plans* (Statement 43) establishes uniform financial reporting standards for other postretirement benefit plans. Statement 43 will be effective for the Authority beginning with its year ending June 30, 2009.

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postretirement Benefits Other Than Pensions* (Statement 45) establishes standards for measurement, recognition, and display of other postemployment benefit expense/expenditures and related liabilities (assets), note disclosures and, if applicable, required supplementary information (RSI) in the financial reports of state and local government employers. Statement 45 will be effective for the Authority beginning with its fiscal year ending June 30, 2010.

GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation – An Amendment for GASB Statement No. 34* (Statement 46) requires governments to disclose the portion of total net assets that is restricted by enabling legislation. Statement 46 aims at improving the understandability and comparability of net asset information by making the assessment of legal enforceability more uniform across governments. Statement 46 will be effective for the Authority beginning with its fiscal year ending June 30, 2006.

GASB Statement No. 47, *Accounting for Termination Benefits* (Statement 47) establishes accounting standards for termination benefits. Statement 47 will be effective for the Authority beginning with its fiscal year ending June 30, 2006.

The Authority's management has not yet determined the effect these Statements will have on its financial statements.

Note 2. Cash and Temporary Investments

Deposits

At year end, the carrying value of the Authority's deposits with banks at June 30, 2005 and 2004 was \$73,952 and \$104,264, respectively. The bank balance was \$862,559 and \$441,401 at June 30, 2005 and 2004, respectively. The bank lists the deposits of the Authority as public funds. Under the Virginia Security for Public Deposits 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. Savings and loan institutions are required to collateralize 100% of deposits in excess of FDIC limits.

Notes to Financial Statements
June 30, 2005 and 2004

Temporary Investments

Statutes authorize the Authority to invest in obligations of the United States or agencies thereof, the Commonwealth of Virginia or political subdivisions thereof, the International Bank of Reconstruction and Development ("World Bank") and Asian Development Bank, commercial paper rated A-1 by Standard & Poor's Corporation or P-1 by Moody's Commercial Paper Record, banker's acceptances, repurchase agreements, and the State Treasurer's Local Government Investment Pool ("LGIP").

The Authority invested \$15,920,912 and \$7,936,512 as of June 30, 2005 and 2004, respectively, with the LGIP. The carrying amount approximates the market value for these accounts.

Note 3. Restricted Cash and Temporary Investments

The Authority has entered into an agreement with Fauquier County (the County) to extend the availability of public sewer services to additional properties in the New Baltimore Service District (the "NBSD") by the construction of required infrastructure and related facilities. The County has agreed to finance the Project through a loan agreement with the Authority in the amount of \$2,800,000 (see Note 7 for additional disclosure on terms). During fiscal years ending June 30, 2005 and 2004, the County transferred \$0 and \$2,322,000, respectively to finance the Project. Unexpended funds were \$1,606,654 and \$1,956,580 at June 30, 2005 and 2004, respectively, and are recorded as restricted assets in the Statements of Net Assets.

In May, 2002, the Authority entered into an agreement with a developer whereby the developer contributed cash to the Authority for a sewer upgrade. The construction project is not completed and the unexpended funds are reported as restricted cash in the amounts of \$8,988,420 and \$2,000,000 at June 30, 2005 and 2004, respectively.

Notes to Financial Statements
June 30, 2005 and 2004

Note 4. Defined Benefit Pension Plan

Plan Description

The Fauquier County Water and Sanitation Authority contributes to the Virginia Retirement System (VRS), an agent and cost-sharing multiple-employer defined benefit pension plan administered by Virginia Retirement System (System). The Fauquier County Water and Sanitation Authority payroll for employees covered by the VRS for the years ended June 30, 2005 and 2004 was \$1,404,636 and \$1,336,486, respectively. Total payroll was \$1,420,246 and \$1,368,152 for the same periods, respectively.

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

The System issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information for VRS. A copy of that report may be obtained by writing to the System at P. O. Box 2500, Richmond, Virginia 23218-2500.

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. This 5% member contribution has been assumed by the employer. In addition, each participating employer is required to contribute the remaining amounts necessary to fund its participation in the VRS using the actuarial basis specified by the statute and approved by the VRS Board of Trustees. The Fauquier County Water and Sanitation Authority contribution rate for the fiscal year ended June 30, 2005 and 2004 was 6.5% and 5.5%, respectively, of annual covered payroll.

Notes to Financial Statements
June 30, 2005 and 2004

Annual Pension Cost

For the years ended June 30, 2005 and 2004, the Authority's annual pension cost was \$91,301 and \$73,908, respectively. The required contribution was determined as part of the June 30, 2004 valuation using the entry age actuarial cost method. The actuarial assumptions as of June 30, 2003 included (a) a rate of return on the investment of present and future assets of 8% per year compounded annually; (b) projected salary increase that range between 4.25% and 6.10% and (c) 3% per year cost-of-living adjustment. Both (a) and (b) included an inflation component of 3.0%. The actuarial value of Fauquier County Water and Sanitation Authority assets was determined using techniques that smooth the effect of short-term volatility in the market value of investments over a five-year period.

**Three-Year Trend Information for
Fauquier County Water and Sanitation Authority**

<u>Fiscal Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
06/30/03	\$ 59,640	100%	\$ --
06/30/04	73,908	100%	--
06/30/05	91,301	100%	--

Notes to Financial Statements
June 30, 2005 and 2004

Note 5. Property and Equipment

	<u>Balance, July 1, 2004</u>	<u>Additions</u>	<u>Deletions/ Transfers</u>	<u>Balance, June 30, 2005</u>
Property and equipment not being depreciated:				
Land	\$ 1,553,425	\$ --	\$ --	\$ 1,553,425
Construction in progress	<u>7,252,170</u>	<u>1,837,559</u>	<u>5,896,023</u>	<u>3,193,706</u>
Total property and equipment not being depreciated	<u>\$ 8,805,595</u>	<u>\$ 1,837,559</u>	<u>\$ 5,896,023</u>	<u>\$ 4,747,131</u>
Other property and equipment:				
Structures and improvements	\$ 31,982,924	\$ 3,983,880	\$ --	\$ 35,966,804
Vehicles	619,537	--	38,422	581,115
Machinery and equipment	<u>7,154,968</u>	<u>2,631,909</u>	<u>56,961</u>	<u>9,729,916</u>
Total other property and equipment	<u>\$ 39,757,429</u>	<u>\$ 6,615,789</u>	<u>\$ 95,383</u>	<u>\$ 46,277,835</u>
Subtotal	<u>\$ 48,563,024</u>	<u>\$ 8,453,348</u>	<u>\$ 5,991,406</u>	<u>\$ 51,024,966</u>
Less accumulated depreciation for:				
Structures and improvements	\$ 13,066,223	\$ 990,421	\$ --	\$ 14,056,644
Vehicles	388,995	52,426	(1,601)	443,022
Machinery and equipment	<u>5,505,137</u>	<u>658,692</u>	<u>58,562</u>	<u>6,105,267</u>
Total accumulated depreciation	<u>\$ 18,960,355</u>	<u>\$ 1,701,539</u>	<u>\$ 56,961</u>	<u>\$ 20,604,933</u>
Net property and equipment	<u>\$ 29,602,669</u>	<u>\$ 6,751,809</u>	<u>\$ 5,934,445</u>	<u>\$ 30,420,033</u>
	<u>Balance, July 1, 2003</u>	<u>Additions</u>	<u>Deletions/ Transfers</u>	<u>Balance, June 30, 2004</u>
Property and equipment not being depreciated:				
Land	\$ 1,553,425	\$ --	\$ --	\$ 1,553,425
Construction in progress	<u>2,568,363</u>	<u>4,683,807</u>	<u>--</u>	<u>7,252,170</u>
Total property and equipment not being depreciated	<u>\$ 4,121,788</u>	<u>\$ 4,683,807</u>	<u>\$ --</u>	<u>\$ 8,805,595</u>
Other property and equipment:				
Structures and improvements	\$ 31,982,924	\$ --	\$ --	\$ 31,982,924
Vehicles	452,327	167,210	--	619,537
Machinery and equipment	<u>6,833,493</u>	<u>321,475</u>	<u>--</u>	<u>7,154,968</u>
Total other property and equipment	<u>\$ 39,268,744</u>	<u>\$ 488,685</u>	<u>\$ --</u>	<u>\$ 39,757,429</u>
Subtotal	<u>\$ 43,390,532</u>	<u>\$ 5,172,492</u>	<u>\$ --</u>	<u>\$ 48,563,024</u>
Less accumulated depreciation for:				
Structures and improvements	\$ 12,199,428	\$ 866,795	\$ --	\$ 13,066,223
Vehicles	342,832	46,163	--	388,995
Machinery and equipment	<u>5,071,914</u>	<u>433,223</u>	<u>--</u>	<u>5,505,137</u>
Total accumulated depreciation	<u>\$ 17,614,174</u>	<u>\$ 1,346,181</u>	<u>\$ --</u>	<u>\$ 18,960,355</u>
Net property and equipment	<u>\$ 25,776,358</u>	<u>\$ 3,826,311</u>	<u>\$ --</u>	<u>\$ 29,602,669</u>

Notes to Financial Statements
June 30, 2005 and 2004

Note 6. Long-Term Liabilities

Long-Term Debt

Long-term debt as of June 30, 2005 and 2004 are as follows:

	<u>2005</u>	<u>2004</u>
Revenue bonds, payable to Virginia Resources Authority, ("VRA") dated November 5, 2002, variable interest ranging from 3% to 4%, payable in semi-annual installments ranging from \$91,500 to \$93,600 through 2013 (including unamortized premium of \$32,459 and \$36,835, and net of deferral on refunding of \$59,311 and \$67,308 for 2005 and 2004, respectively.)	\$ 1,218,147	\$ 1,344,527
Revenue bonds, payable to Virginia Water Resources Facilities Fund, ("VRLF") dated May 1, 1994, up to \$12,800,000, fixed interest at 3%, payable in equal semi-annual installments of \$435,899 from 1996 through 2016.	<u>7,270,375</u>	<u>7,851,480</u>
Total long-term debt	\$ 8,488,522	\$ 9,196,007
Less current maturities	<u>(733,669)</u>	<u>(711,105)</u>
	<u>\$ 7,754,853</u>	<u>\$ 8,484,902</u>

Notes to Financial Statements
June 30, 2005 and 2004

Annual requirements to amortize long-term debt are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 733,669	\$ 264,179	\$ 997,848
2007	756,764	240,684	997,448
2008	780,406	216,442	996,848
2009	804,611	190,712	995,323
2010	834,395	164,927	999,322
2011-2015	4,205,340	413,074	4,618,414
2016	<u>400,189</u>	<u>6,002</u>	<u>406,191</u>
Total	\$ 8,515,374	\$ 1,496,020	\$ 10,011,394
Less: Deferral on refunding of debt	(59,311)		
Add: Amortization of premium	<u>32,459</u>		
	<u>\$ 8,488,522</u>		

On July 11, 2001, the Authority entered into an agreement with the Commonwealth of Virginia for \$885,138 Water Quality Improvement Fund grant. In future years, a portion of this grant will be applied to the principal payments of the Virginia Water Resources Facilities Fund (VRLF) revenue bond payable dated May 1, 1994.

On November 5, 2002, the Authority issued \$1,530,000 of long-term debt from the Virginia Resources Authority to refund \$1,735,000 of outstanding Virginia Resources Authority debt dated May 1, 1994. The refunded debt is considered defeased and the liability has been removed from the Statement of Net Assets. The current refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$79,970. This difference, reported in the accompanying financial statements as a deduction from long-term debt, is being amortized to operations through the year 2013. The Authority completed the current refunding to reduce its total debt service payments by \$453,155 over 11 years and to obtain an economic gain (difference between the present value of the old and new debt service payments) of \$113,003.

Notes payable as of June 30, 2005 and 2004 are as follows:

	<u>2005</u>	<u>2004</u>
Note payable to Vint Hill Economic Development Authority with interest at 4% beginning May 2005, payable in annual principal installments of \$50,000.	\$ 150,000	\$ 200,000
The Authority has non-negotiable conditional promissory notes with various entities as a condition for expanding sewer services to Opal, Virginia. These notes shall mature and become payable only in the event that the Authority receives payment for more than 458 sewer availability fees. The notes, if not paid in full, are cancelled fifteen years from the dates of the notes.	<u>451,831</u>	<u>451,831</u>
Total	<u>\$ 601,831</u>	<u>\$ 651,831</u>

Notes to Financial Statements
June 30, 2005 and 2004

Annual requirements to service notes payable are:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 50,000	\$ --	\$ 50,000
2007	50,000	4,000	54,000
2008	50,000	2,000	52,000
2009	451,831	--	451,831
Total	<u>\$ 601,831</u>	<u>\$ 6,000</u>	<u>\$ 607,831</u>

Refundable Advances

The Authority entered into an agreement on March 9, 2000 to provide customers in the New Baltimore area sewer services after the completion of the necessary lines. Should the project not be completed or if the project is terminated, then the \$6,000 availability fee must be refunded to all customers that have paid in advance. Therefore, \$968,100 and \$953,100 were recorded as liabilities as of June 30, 2005 and 2004, respectively.

Other Long-Term Liabilities

The Authority entered into an agreement on February 25, 2000 to purchase the Vint Hill Wastewater Treatment Plant (WWTP). The Authority must pay the Vint Hill Farms Economic Development Authority (VHEDA) \$6,000 for each connection made to the Vint Hill Sewer System. There are a total of 577 connections available to repay the debt. The Authority must pay this liability each year in correlation to the number of connections sold. The agreement terminates in 30 years upon which time the debt is considered paid in full regardless of the number of connections made by Vint Hill site customers. As of June 30, 2001, a liability in the amount of \$3,462,000 was recorded since the title to the plant was transferred to the Authority during fiscal year 2001. As of June 30, 2005 and 2004, \$1,082,800 and \$1,880,800, respectively, was outstanding on the liability.

After taking title to the WWTP, the Authority is responsible for the operations and maintenance of the WWTP. Each year the VHEDA will repay the Authority any excess of operating expenses over revenues collected relating to the WWTP. The Authority will grant the VHEDA a \$50,000 credit towards the excess of operating expenses over revenues.

Notes to Financial Statements
June 30, 2005 and 2004

The following is a summary of the changes in total long-term debt for the years ended June 30:

	2005				
	Balance June 30, 2004	Proceeds	Reductions	Balance June 30, 2005	Due Within One Year
Long-term debt	\$ 9,226,480	\$ --	\$ (711,106)	\$ 8,515,374	\$ 733,669
Deferred amounts:					
For issuance premiums	36,835	--	(4,376)	32,459	--
Gain on refundings	(67,308)	--	7,997	(59,311)	--
Total long-term debt	<u>\$ 9,196,007</u>	<u>\$ --</u>	<u>\$ (707,485)</u>	<u>\$ 8,488,522</u>	<u>\$ 733,669</u>
Other liabilities:					
Notes payable	651,831	--	(50,000)	601,831	50,000
Refundable advances	953,100	18,000	(3,000)	968,100	--
Other long-term liabilities	1,880,800	--	(798,000)	1,082,800	--
Total long-term liabilities	<u>\$12,681,738</u>	<u>\$ 18,000</u>	<u>\$ (1,558,485)</u>	<u>\$11,141,253</u>	<u>\$ 783,669</u>
	2004				
	Balance June 30, 2003	Proceeds	Reductions	Balance June 30, 2004	Due Within One Year
Long-term debt	\$11,417,516	\$ --	\$ (2,191,036)	\$ 9,226,480	\$ 711,105
Deferred amounts:					
For issuance premiums	41,211	--	(4,376)	36,835	--
Gain on refundings	(75,305)	--	7,997	(67,308)	--
Total long-term debt	<u>\$11,383,422</u>	<u>\$ --</u>	<u>\$ (2,187,415)</u>	<u>\$ 9,196,007</u>	<u>\$ 711,105</u>
Other liabilities:					
Notes payable	451,831	250,000	(50,000)	651,831	50,000
Refundable advances	954,600	--	(1,500)	953,100	--
Other long-term liabilities	2,468,800	--	(588,000)	1,880,800	--
Total long-term liabilities	<u>\$15,258,653</u>	<u>\$ 250,000</u>	<u>\$ (2,826,915)</u>	<u>\$12,681,738</u>	<u>\$ 761,105</u>

Notes to Financial Statements
June 30, 2005 and 2004

Note 7. Deferred Grant Revenue

The Authority has entered into an agreement with Fauquier County to extend availability of public sewer services to additional properties in the New Baltimore Service District (the "NBSD") by the construction of required infrastructure and related facilities. The County has agreed to finance the Project through a non-recourse, no interest loan agreement with the Authority in the amount of \$2,800,000. As of June 30, 2005, the NBSD Project is not complete and a total of \$1,193,346 has been expended and is included as construction-in-progress in capital assets. The Authority is required to repay the loan only to the extent of availability fee surcharges collected in the NBSD through March, 2030. These are remitted to the County on a monthly basis.

The loan proceeds are treated as deferred grant revenue under generally accepted accounting principles, and have been recorded as Deferred Revenue until the Project is completed. Once the Project is placed in service, the deferred revenue will be amortized over the same period as the depreciable life of the related fixed assets.

Note 8. Lease Commitment

The Authority entered into an agreement with Vint Hill Economic Development Authority to lease office facilities in the amount of \$4,160 per month. The rent payment ceased upon closing of the purchase agreement. The lease terminated in November 2004.

The rent expense for the years ending June 30, 2005 and 2004 was \$20,800 and \$49,920, respectively.

Note 9. Interest Cost

The total interest cost incurred during the fiscal year ended June 30, 2005 and 2004 was \$264,022 and \$342,623, respectively, of which none was capitalized as part of construction in progress.

Note 10. Accounts Receivable - Other

During fiscal year 1999, the Authority entered into an agreement with Canterbury for the Authority to take over their system. Several improvements were needed before the Authority could take over their system. The Canterbury residents agreed to cover the cost of the improvements. Residents were allowed to pay up front and be reimbursed for any differences in their share of the actual costs or they could pay monthly installments over 20 years once the project was completed. The project was completed during the fiscal year 2000 and the total cost of the improvements totaled \$129,100. In fiscal year 1999, forty-nine residents decided to pay in

Notes to Financial Statements
June 30, 2005 and 2004

monthly installments. Their cost per share was \$1,721 upon completion of the project and had been paid down to \$1,382 and \$1,447 as of June 30, 2005 and 2004, with forty-two and forty-four remaining residents, respectively. The Canterbury receivable as of June 30, 2005 and 2004 was \$58,035 and \$63,678, respectively. In addition to the Canterbury receivable, the Authority has other receivables related to various projects of \$153,901 and \$53,687 for the years ended June 30, 2005 and 2004, respectively.

Note 11. Commitments and Contingencies

The Authority is currently involved in several suits regarding contracts with various parties. Suits alleging damages ranging from \$4 million to \$12 million have been filed against the Authority. However, the outcome of this litigation is currently unknown.

Also, the Authority is, from time to time, subject to routine litigation incidental to its business. The Authority believes that the results of the pending matters will not have a materially adverse effect on the Authority's financial condition.

The Authority entered into a contract for billing software and support for a contract price of \$31,000. As of June 30, 2005, the entire \$31,000 remains a commitment of the Authority.

Note 12. Construction Commitments

The Authority has entered into a construction contract with Dewberry & Davis for the Design and Construction Management Services for the Catlett & Calverton Sewage Collection System and Pump Station in the amount of \$565,000 of which \$66,484 has already been expended. The remaining construction commitment as of June 30, 2005 is \$498,516.

The Authority has entered into a construction contract with Emery & Garrett Groundwater, Inc. for general and incidental engineering services for the Opal Sewer District in the amount of \$186,000 of which \$170,042 has already been expended. The remaining construction commitment as of June 30, 2005 is \$15,958.

The Authority has entered into a construction contract with Rummel, Klepper & Kahl, LLP for the Design and Construction Management Services for the Vint Hill Wastewater Treatment Plant Facility Upgrade in the amount of \$529,125 of which \$504,368 has already been expended. The remaining construction commitment as of June 30, 2005 is \$24,757.

The Authority has entered into a construction contract with Rummel, Klepper & Kahl, LLP for the Design and Construction Management Services for the Catlett & Calverton Wastewater Treatment Plant in the amount of \$560,000 of which \$51,614 has already been expended. The remaining construction commitment as of June 30, 2005 is \$508,386.

The Authority has entered into a construction contract with Whitman, Requardt and Associates, L.L.P. for general and incidental engineering services in the amount of \$194,171 of which \$129,603 has already been expended. The remaining construction commitment as of June 30, 2005 is \$64,568.

Notes to Financial Statements
June 30, 2005 and 2004

The Authority has entered into a construction contract with Whitman, Requardt and Associates, L.L.P. for Telephone Road Sewage Pump Station for New Baltimore Sewage Collection System in the amount of \$29,275 of which \$24,952 has already been expended. The remaining construction commitment as of June 30, 2005 is \$4,323.

The Authority has entered into construction contract with English Construction Company, Inc. for Upgrade and Expansion of Vint Hill Waste Water Treatment Plant for \$8,204,150. No amounts have been expended to date; therefore, \$8,204,150 is the remaining construction commitment at June 30, 2005.

The Authority has entered into a financing agreement with the County, for the NBSD Project. The Authority is required to repay the loan only to the extent of sewer availability surcharges collected.

Note 13. Capital Improvement Funds for Other Governments

The Fauquier County and other governmental entities provide funds to the Authority to perform projects on their behalf. These amounts vary from year to year depending on the projects being performed. The amounts are included as a liability by the Authority until the project is performed. As of June 30, 2005 and 2004, there were \$1,609,391 and \$1,962,099, respectively, available for these projects.

Note 14. Marshall WW Reimbursement

The Authority entered into an agreement with the Marshall Water Works, Inc., (MWW). Under the terms of this agreement, the Authority will operate and maintain the MWW operations and plant. The Authority prepares and collects the customer billings related to the MWW, and the Authority must reimburse MWW for any excess of billing collections over operating and maintenance expenses paid. The amount of billing collections, expenses on behalf of the MWW paid by the Authority, and the reimbursable amounts to MWW were as follows for the fiscal year ending June 30, 2005:

	7/1/04 to	10/1/04 -	1/1/05 -	4/1/05 -	
For the period:	9/30/04	12/31/04	3/31/05	6/30/05	Total
Billing collections	\$ 76,127	\$ 60,274	\$ 62,005	\$ 68,749	\$ 267,155
Expenditures by the Authority	<u>21,374</u>	<u>24,902</u>	<u>36,992</u>	<u>27,230</u>	<u>110,498</u>
Reimbursable amounts to MWW	<u>\$ 54,753</u>	<u>\$ 35,372</u>	<u>\$ 25,013</u>	<u>\$ 41,519</u>	<u>\$ 156,657</u>

The Authority recognized \$110,498 as revenue in order to properly record the reimbursement of their expenses under the MWW agreement.

Notes to Financial Statements
June 30, 2005 and 2004

Note 15. Prior Period Adjustment

The financial statements for the fiscal year ended June 30, 2004 have been restated to properly reflect a note payable for the acquisition of the headquarters building. This adjustment resulted in an increase in liabilities in the amount of \$200,000 and a corresponding increase in property and equipment in the amount of \$250,000. A \$50,000 other operating revenue was also recognized to properly reflect the credit towards the operating expenses over revenues for the Vint Hill WWTP, which is used to repay the note payable.

REQUIRED SUPPLEMENTARY INFORMATION

**Schedule of Funding Progress - Virginia Retirement System
(As required by GASB #27)**

<u>Valuation Date</u>	<u>Actuarial Value of Assets (AVA)</u>	<u>Actuarial Accrued Liability (AAL)</u>	<u>Unfunded Actuarial Accrued Liability (UAAL)</u>	<u>Funded Ratio</u>	<u>Annual Covered Payroll</u>	<u>UAAL as % of Payroll</u>
06/30/04	\$ 1,818,114	\$ 1,374,487	\$ (443,627)	132.28%	\$ 1,271,989	(34.88)%
06/30/03	1,732,997	1,301,918	(431,079)	133.11	1,125,284	(38.31)
06/30/02	1,611,476	1,048,602	(562,874)	153.7	947,712	(59.4)
06/30/01	1,493,483	899,276	(594,207)	166.1	919,232	(64.7)
06/30/00	1,303,727	741,026	(562,701)	175.9	801,300	(70.2)
06/30/99	1,086,558	719,782	(366,776)	151.0	784,444	(46.8)
06/30/98	918,001	546,320	(371,681)	168.0	710,263	(52.3)
06/30/96	605,399	349,772	(255,627)	173.1	727,441	(35.1)
06/30/94	421,227	335,595	(85,632)	125.5	854,366	(10.0)

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROLS 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 Board of the Fauquier County
Water and Sanitation Authority
Warrenton, Virginia

We have audited the financial statements of Fauquier County Water and Sanitation Authority as of and for the years ended June 30, 2005 and 2004, and have issued our report thereon dated August 18, 2005. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in "Government Auditing Standards," issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audits, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide 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 controls over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

This report is intended solely for the information and use of the audit committee, board of directors and management and is not intended to be and should not be used by anyone other than those specified parties.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
August 18, 2005

