VIRGINIA COMMUNITY COLLEGE SYSTEM

RICHMOND, VIRGINIA

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2003

APA
Auditor of
Public Accounts
COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the Virginia Community College System for the year ended June 30, 2003, found:

- the financial statements are presented fairly, in all material respects;

- internal control matters that we consider reportable conditions; however, we do not consider any of these to be material weaknesses;

  > These matters are reported fully in the section of the report entitled "Internal Control and Compliance Findings and Recommendations" and include our recommendation that the Virginia Community College System improve its capital asset management and reporting.

- instances of noncompliance required to be reported that are described fully in the section of the report entitled "Internal Control and Compliance Findings and Recommendations;" and

- adequate corrective action of prior audit findings except that J. Sargeant Reynolds and Virginia Western Community Colleges did not complete capital asset inventories, as required.

-TABLE OF CONTENTS-

Commonwealth of Virginia

Walter J. Kucharski, Auditor

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

May 28, 2004

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Lacey E. Putney
Vice Chairman, Joint Legislative Audit
and Review Commission

The State Board for Community Colleges

We have audited the accounts and records of **Virginia Community College System,** as of and for the year ended June 30, 2003, and submit herewith our complete reports on financial statements and compliance and internal control over financial reporting.

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic financial statements of Virginia Community College System, a component unit of the Commonwealth of Virginia, as of and for the year ended June 30, 2003, as listed in the table of contents. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Virginia Community College System as of June 30, 2003, and the changes in its financial position and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages seven through thirteen is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements of the Virginia Community College System as of and for the year ended June 30, 2003, we considered internal controls over financial reporting and tested compliance with certain provisions of laws, regulations, contracts, and grants 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.

Compliance

As part of obtaining reasonable assurance about whether the Virginia Community College System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 instances of noncompliance that are required to be reported under Government Auditing Standards. These instances of noncompliance are described in the section of the report titled "Internal Control and Compliance Findings and Recommendations."

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System'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. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the System's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the section of the report titled "Internal Control and Compliance Findings and Recommendations."

A material weakness is a 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 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Status of Prior Findings

The System and its Colleges have taken adequate corrective action with respect to audit findings reported in the prior year report, except that J. Sargeant Reynolds and Virginia Western Community Colleges did not complete capital asset inventories, as required. This finding is repeated in the section of our report entitled "Internal Control and Compliance Findings and Recommendations" in the finding "Improve Capital Assets Management and Reporting."

The "Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting" is intended solely for the information and use of the Governor and General Assembly of Virginia, the State Board for Community Colleges, its audit committee and management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on June 17, 2004.

AUDITOR OF PUBLIC ACCOUNTS

DBC:whb
whb:74

INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Improve Capital Assets Management and Reporting

VCCS reports capital assets for all twenty-three Community Colleges in the System. This includes Land, Land Improvements, Buildings, Infrastructure, Construction-in-Progress, Equipment, Library Books, and Works of Art. During fiscal year 2003, VCCS reported $445 million in capital assets, net of accumulated depreciation. Individual colleges are primarily responsible for entering equipment information in the Fixed Asset Information System (FAIS), performing inventories for equipment, and tracking locally-funded assets.

During the fiscal year 2003 audit, we found the following colleges did not properly perform inventories or did not adequately record changes in assets throughout the year.

- ❖ Danville Community College
- ❖ J. Sargeant Reynolds Community College
- ❖ Lord Fairfax Community College
- ❖ Rappahannock Community College
- ❖ Southwest Virginia Community College
- ❖ Virginia Western Community College
- ❖ Wytheville Community College
- ❖ Patrick Henry Community College

The Commonwealth's accounting policies require the colleges to perform a complete capital asset inventory every two years. Danville, Rappahannock, and J. Sargeant Reynolds have not performed a complete inventory during the past three years. The other five colleges did not perform complete inventory counts timely or did not always record asset changes throughout the year. VCCS Internal Audit performed an audit on capital asset procedures in March 2004. In addition to reporting that some Colleges did not complete inventories timely, the internal audit report also noted internal control issues at several Colleges relating to recording assets promptly and accurately, tagging and recording asset locations, and having written procedures. We recommend that the System Office work with the Colleges cited here and in the internal audit report to resolve their capital asset accounting and control issues and ensure that all Colleges have procedures in place to ensure continued adequate accounting and control over capital assets.

VCCS has not formally updated the FAIS procedures manual since its issuance to the Colleges in January 1992. The System Office provides the Colleges specific guidance and changes to procedures in memorandums and directives. We recommend that the System Office formalize this guidance by updating the FAIS manual for changes to procedures and accounting policies since its issuance. In addition, the System Office should formalize and document its year-end procedures to compile capital asset and depreciation information for the financial statements.

The System Office uses FAIS as a data collection system for the Colleges to enter equipment purchases and produce reports for inventory counts. The System Office uses spreadsheets to track land, buildings, and construction in progress. The System Office then uses formula driven spreadsheets to compile and calculate year end capital asset information based on data from the manual spreadsheets and retrievals of equipment information from FAIS. FAIS is a legacy system that does not provide the reporting capabilities of newer systems and using spreadsheets for this process can be inefficient. We recommend that System management consider obtaining an automated capital asset management reporting system.

Improve Procedures for Computer System Access

Applicable to: Central Virginia Community College
Piedmont Virginia Community College
Tidewater Community College

Employees at three Colleges had unauthorized access to the financial or administrative computer systems either because they had terminated employment or the College did not properly document their authorization. Central Virginia Community College did not revoke access to the computer systems promptly after employees terminated and supervisors did not closely monitor the annual listing of employees in their department with computer access. Piedmont Virginia Community College did not properly document the authorization for employees granted access to the Student Information System. Tidewater Community College did not promptly delete access to the Commonwealth's central financial and payroll system when employees terminated.

We recommend that all Community Colleges follow established procedures relating to the authorization, monitoring, and deletion of access to the College's financial and administrative computer systems. This includes properly documenting authorization and approvals for necessary access to computer systems, periodic monitoring by supervisors for the need for continued computer access for employees, and the prompt revocation of access upon termination of employment. Failure to restrict computer access to current employees who need such access to perform their duties places the College at risk for inappropriate changes or disclosure of important financial, administrative, and personal information.

Promptly Reconcile Local Bank Accounts

Applicable to: Tidewater Community College

Tidewater Community College did not promptly reconcile four of its eight local bank accounts as of June 30, 2003. Three of these accounts had been reconciled at the time of our audit; however, one account still had not been reconciled nine months after year end. While these bank accounts do not have large balances or extensive activity, prompt reconciliation of bank accounts is an essential internal control to safeguard cash assets.

Failure to reconcile bank accounts may result in misstatement of cash and eliminates the chance to detect and resolve errors between the accounting systems and bank statements. The College should reconcile all its local bank accounts promptly at the end of each month.

Discontinue Inappropriate Advance Payments

Applicable to: Wytheville Community College

Wytheville Community College inappropriately made advance payments on multiple janitorial contracts and one security contract before June 30, 2003, for the upcoming fiscal year. The College made advances payments to avoid reverting funds at year end. While the State Comptroller allows advance payments in certain circumstances, the Comptroller does not allow advance payments for security and janitorial contracts and standard industry practice does not recommend prepayment more than 30 days in advance. After an agency or institution makes an advance payment, there is no absolute guarantee that the vendor will deliver the goods or perform the requested services, placing the Commonwealth's assets at risk.

College management had identified this issue and was working with the System Office and the state Department of Accounts to resolve these payments before our on-site audit.

We recommend that Wytheville Community College discontinue inappropriate advance payments for contractual services.

Implement and Improve Procurement Policies and Procedures over Bookstore Operations

Applicable to: Danville Community College

Danville Community College does not have procedures for procuring and administering local contracts for the bookstore. As a result, the College does not have contracts for the book buyback agreements or for purchases of supplies and inventories for the bookstore. The Business Office does not monitor revenue generating contracts to ensure the College is properly receiving revenue from book buybacks. The College risks contract disputes and overpayment of goods and services if it does not properly prepare and administer contracts and contract changes.

Management should document its policies and procedures for the Bookstore. The policies and procedures should address contract authorization, preparation, and administration. The College should adhere to state policy that requires competitive bidding of contracts over $50,000.

Properly Administer Return of Title IV Funds

Applicable to: Central Virginia Community College
Mountain Empire Community College
Northern Virginia Community College
Paul D. Camp Community College

Central Virginia Community College failed to properly calculate Title IV refund amounts. Paul D. Camp and Northern Virginia Community Colleges performed Title IV refunds accurately, but did not return federal funds to the federal Department of Education in a timely manner. Additionally, Mountain Empire, Paul D. Camp, and Central Virginia Community Colleges do not have adequate procedures to identify students who withdraw or cease attendance without notifying college staff.

The Code of Federal Regulations, 34 CFR Part 668.22 (c), requires that colleges have a mechanism in place to identify students who have withdrawn or ceased attendance, in order to promptly and properly calculate any return of Title IV funds. Part 668.22 (e) sets forth the manner to properly calculate the amounts due to be refunded to the Title IV programs. Part 668.22 (j) requires that colleges return unearned Title IV funds as soon as possible to the federal Department of Education, but no later than 30 days after the college determined the student withdrew.

Colleges should follow the return of Title IV funds procedures prescribed by the federal government to ensure that they properly identify students, who withdraw and properly calculate refunds and return the funds to the federal Department of Education.

MANAGEMENT DISCUSSION AND ANALYSIS

The following discussion and analysis provides an overview of the financial position and activities of the Virginia Community College System (VCCS) for the year ended June 30, 2003. This discussion has been prepared by management and should be read in conjunction with the financial statements and footnotes. A comparative analysis of prior year financial data, as restated, accompanies the June 30, 2003, analysis.

Financial Highlights

The following events impacted net assets of the VCCS in fiscal year 2003:

- The VCCS was assessed a $36.3 million general fund budget cut resulting from the Commonwealth's general fund budget shortfall in fiscal year 2003. In addition, the VCCS lost a total of $7 million anticipated general funding from maintenance reserve, equipment trust fund program, and the fiscal year 2002 carryover. The overall cumulative impact of these cuts resulted in a loss of funding for the VCCS of $43.3 million.

- The State Board for Community Colleges voted to increase tuition and fees by $3.34 per credit hour to in-state students and $15.39 per credit hour to out-of-state students in the summer 2002 and by $12.25 per credit hour to all students in the spring 2003. These actions increased net assets by approximately $23.9 million in fiscal year 2003.

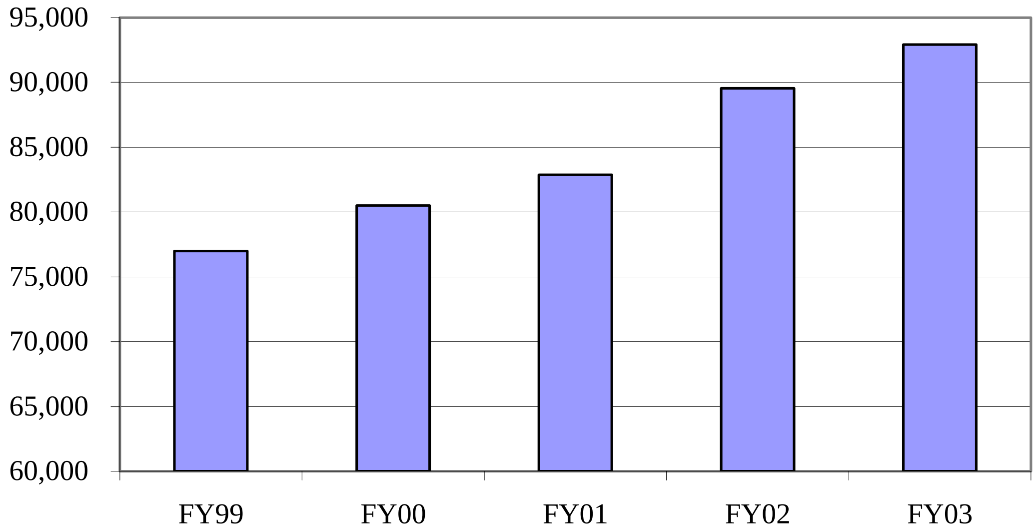
- Capital appropriations and grants increased net assets by $29 million. The principal source of funding for these projects was the 21st Century Bond Program.

Total net assets increased by $14 million due to increased investment in capital assets, net of related debt of $10 million and $4 million in cash.

Enrollment Information

Enrollments are at an all-time high at the VCCS. Below is a chart depicting full-time equivalent students attending the VCCS over the past 5 years. The VCCS mission is to provide comprehensive higher education and workforce training programs and services of superior quality that are financially and geographically accessible and that meet individual, business, and community needs of the Commonwealth.

VCCS Enrollment - Full Time Equivalents



One full time equivalent represents 30 credit hours of classes taken by a student over an academic year. It is calculated on an annual basis by taking the total credit hours taught divided by 30.

<u>Financial Statements</u>

The three financial statements presented are the Statement of Net Assets; the Statement of Revenues, Expenses, and Change in Net Assets; and the Statement of Cash Flows.

<u>Statement of Net Assets</u>

The Statement of Net Assets presents the assets and liabilities of the VCCS at the end of the fiscal year. The Statement also provides the amount of net assets and their availability for expenditure. Net assets are divided into three major categories. The first category, invested in capital assets net of related debt, consists of capital assets, net of accumulated depreciation and reduced by outstanding balances of any borrowings that are attributable to the acquisition, construction, or improvement of those assets. The next category is restricted net assets, which are classified as nonexpendable or expendable. Nonexpendable restricted net assets are loan funds and permanent endowments that are available for investment purposes. Expendable restricted net assets are available for expenditure by the VCCS but must be spent for purposes determined by external entities. Unrestricted net assets are not subject to externally imposed restrictions and may be designated for specific purposes by management of the VCCS.

A summarized Statement of Net Assets is as follows:

(In thousands of dollars)

	As of June 30: 2003	2002
Assets		
Current assets	$ 96,975	$ 90,126
Capital assets, net	445,402	420,123
Other non-current assets	22,066	32,713
Total Assets	564,443	542,962
Liabilities		
Current liabilities	63,627	63,270
Non-current liabilities	61,936	54,421
Total Liabilities	125,563	117,691
Net Assets		
Invested in capital assets, net of debt	403,425	382,733
Restricted-nonexpendable	429	453
Restricted-expendable	14,435	23,664
Unrestricted	20,591	18,421
Total Net Assets	$ 438,880	$ 425,271

Current assets consist primarily of $84 million in cash and investments, accounts and notes receivable of $8 million and prepaid expenses of $3 million. Current assets increased by $7 million principally due to increased cash. Higher deferred revenue and technology fund balances are the main components.

Net capital assets increased by $25 million. Capital additions of $25 million were principally equipment, land improvements, and library book purchases of $17, $3, and $2 million, respectively. Construction-in-progress additions of $25 million were principally comprised of $19 million at Northern Virginia Community College for the Medical Education Campus, $1.1 million at Germanna Community College for the Fredericksburg Campus, $.6 million at Rappahannock Community College for the Workforce Development Center and $1.3 million at Blue Ridge Community College for the Business Technology Center. These projects were funded with appropriations and bond proceeds. Current year depreciation expense was $24 million. Net retirements were $1 million.

At June 30, 2003, the VCCS had future commitments for construction contracts totaling $28.9 million. Commitments are primarily comprised of $4.3 million for the Manufacturing Technology Center at Central Virginia Community College, $4.2 million for the Fredericksburg Campus at Germanna Community College, $4.8 million for the Downtown Parking Deck for J. Sargeant Reynolds Community College, $2.4 million for the Medical Education Campus at Northern Virginia Community College, $1.3 million for the College Services Building at Virginia Western Community College and $1.4 million for the major mechanical project at Southwest Virginia Community College.

Other noncurrent assets are principally comprised of cash held for the acquisition of capital assets. This cash decreased by $11 million due to capital spending.

Current liabilities consist primarily of accounts payable of $12 million, accrued compensation of $30 million, deferred revenue of $13 million, and debt obligations of $6 million. Current liabilities did not change significantly from fiscal year 2002. Noncurrent liabilities are comprised of accrued leave of $15 million, long-term debt of $42 million and amounts due to the federal government of $5 million. Noncurrent liabilities increased by $8 million principally due to additional installment purchase and bond debt.

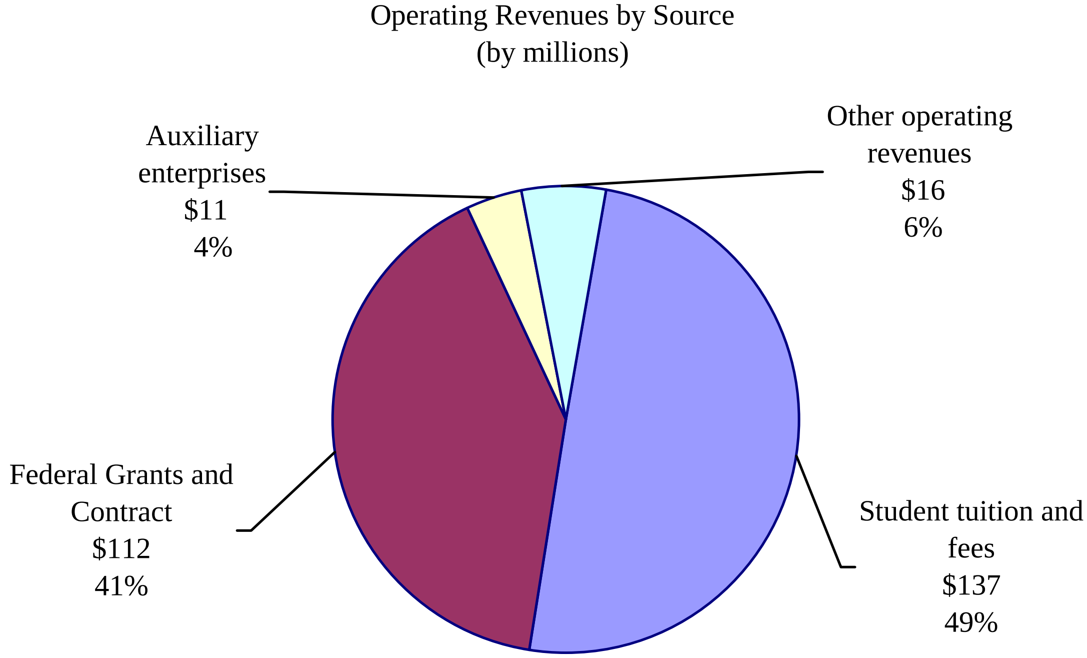
Statement of Revenues, Expenses, and Changes in Net Assets

The purpose of the Statement of Revenues, Expenses, and Changes in Net Assets is to present operating and non-operating revenues received by the System, operating and non-operating expenses incurred, and any other revenues, expenses, gains, and losses. Changes in net assets as presented on the Statement of Net Assets are based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Assets.

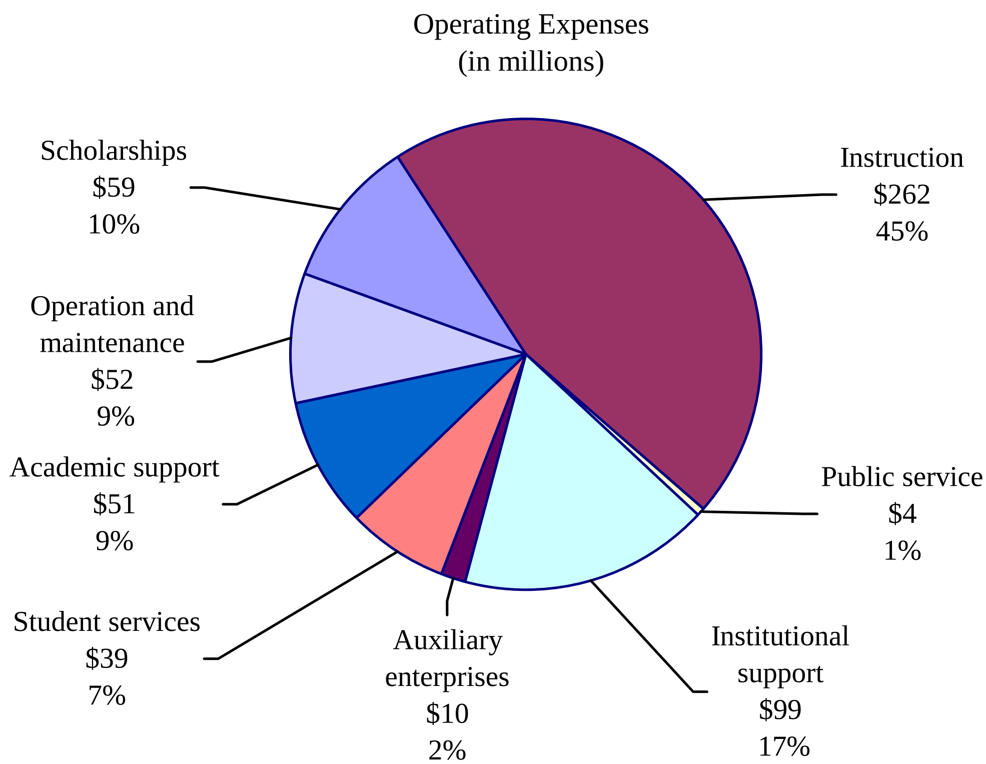
A summarized statement of revenues, expenses, and changes in net assets follows:
(in thousands of dollars)

	For the years ended June 30: 2003	2002
Operating revenue	$ 275,669	$ 245,464
Operating expenses	575,605	555,838
Operating loss	(299,936)	(310,374)
Nonoperating revenues(expenses):		
State appropriations	282,879	307,015
Local appropriations	1,807	1,859
Private gifts and grants	808	774
Investment income	1,244	1,575
Interest expense	(1,798)	(2,183)
Other	(773)	(1,598)
Net nonoperating revenue	284,167	307,442
Loss before other revenues, expenses, gains or losses	(15,769)	(2,932)
Capital appropriations-state	22,372	11,842
Capital appropriations-local	3,466	2,646
Capital grants and contracts	3,540	4,867
Increase in net assets	13,609	16,423
Net assets, beginning of year as restated	425,271	408,848
Net assets, end of year	$ 438,880	$ 425,271

A graphic presentation of fiscal year 2003 operating revenues by source is below:



A graphic presentation of fiscal year 2003 operating expenses by major function is below:



Statement of Cash Flows

The Statement of Cash Flows provides additional information about the financial results of the VCCS by reporting the major sources and uses of cash. A summary of the cash flows is as follows:

(In thousands of dollars)

	For the years ended June 30:	
	2003	2002
Cash received from operations	$ 278,172	$ 242,759
Cash used in operations	546,916	538,597
Net cash used in operations	(268,744)	(295,838)
Net cash provided by non-capital financing activities	286,609	310,146
Net cash used in capital and related financing activities	(21,122)	(27,183)
Net cash provided (used) by investing activities	1,031	(77)
Net decrease in cash and cash equivalents	(2,226)	(12,952)
Cash and cash equivalents, beginning of year	101,483	114,435
Cash and cash equivalents, end of year	$ 99,257	$ 101,483

Cash and cash equivalents decreased by $2.2 million in fiscal year 2003 compared to a $13 million decrease in fiscal year 2002. Net cash used in operating activities in fiscal year 2003 was $269 million. This was $27 million lower than the net amount of cash used in operating activities in fiscal year 2002. Increased revenues that were only partially offset by higher expenditures contributed to the decrease in the amount of cash used in operating activities. Net cash provided by investing activities increased by $1 million compared to the previous year. Net cash provided by non-capital financing decreased by $23 million due to lower state appropriations. Net cash used in capital financing activities decreased by $6 million due to an increase in appropriations of $10 million offset by $4 million of increased spending on capital projects.

Economic Outlook

When economic conditions began deteriorating in the Commonwealth in fiscal year 2002, it resulted in a general fund budget cut in fiscal year 2002, and ultimately general fund budget cuts in each year of the 2002-2004 biennium. The VCCS will, therefore, be assessed a general fund budget cut in fiscal year 2004 totaling $47.1 million. This general fund budget cut will reflect an ongoing reduction to the VCCS general fund base budget in future biennia.

The State Board for Community Colleges approved a tuition increase of $6.89 per credit hour to all students effective fall 2003. It is anticipated that this will generate an additional $16.4 million in fiscal year 2004. This will help address general fund budget cuts and help serve some of the new full-time equivalent students as enrollment continues to grow in the VCCS. Past tuition increases in summer 2002 and spring 2003 will provide approximately $43.8 million in fiscal year 2004. In addition, the technology fee increased $.15 per credit hour to all students and will generate an estimated $359,000 in fiscal year 2004. The increase in the technology fee will be earmarked for the VCCS distance learning initiative.

During fiscal year 2003, the State Board for Community Colleges adopted a strategic plan for the VCCS entitled *Dateline* 2009. The plan outlines a set of seven strategic directions for the VCCS to be accomplished by fiscal year 2009 with the ultimate goal for the VCCS to achieve world-class status. A significant part of this initiative relies on expansion of the VCCS funding base. The VCCS will strive to obtain new federal, state, local, and private funding (including donations to VCCS foundations) to support the *Dateline* 2009 initiatives.

In November 2002, voters in the Commonwealth of Virginia passed a bond resolution that will ultimately provide $159 million to the VCCS for more than 45 construction and renovation projects. The VCCS will begin construction projects associated with the bond issue in fiscal year 2004.

FINANCIAL STATEMENTS

VIRGINIA COMMUNITY COLLEGE SYSTEM
STATEMENT OF NET ASSETS
As of June 30, 2003

ASSETS	
Current assets:	
Cash and cash equivalents (Note 3)	$ 80,830,528
Short term investments (Note 3)	3,216,343
Accounts receivable (Note 4)	5,372,025
Due from Commonwealth	1,133,703
Interest receivable	42,515
Prepaid expenses	3,341,270
Inventories	1,961,468
Notes receivable (Note 4)	1,077,289
Total current assets	96,975,141
Noncurrent assets:	
Restricted cash and cash equivalents (Note 3)	13,138,756
Cash with trustees (Note 3)	4,930,884
Endowment cash and cash equivalents (Note 3)	357,333
Notes receivable (Note 4)	3,638,732
Non-depreciable capital assets (Note 5)	77,008,631
Depreciable capital assets, net (Note 5)	368,393,624
Total noncurrent assets	467,467,960
Total assets	564,443,101
LIABILITIES	
Current liabilities:	
Accounts and retainage payable (Note 6)	12,376,296
Accrued payroll expense	19,840,058
Deferred revenue	12,521,217
Long-term liabilities-current portion (Note 7)	15,382,355
Due to Commonwealth	165,750
Deposits	3,341,749
Total current liabilities	63,627,425
Noncurrent liabilities:	
Deferred gifts and grants (Note 7)	49,624
Retainage payable-noncurrent portion (Note 7)	72,622
Long-term liabilities (Note 7)	57,171,098
Due to federal government (Note 7)	4,642,708
Total noncurrent liabilities	61,936,052
Total liabilities	125,563,477
NET ASSETS	
Invested in capital assets, net of related debt	403,424,495
Restricted for:	
Nonexpendable	428,789
Expendable	14,435,278
Unrestricted	20,591,062
Total net assets	$ 438,879,624

The accompanying Notes to the Financial Statements are an integral part of this statement.

VIRGINIA COMMUNITY COLLEGE SYSTEM
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2003

Operating revenue:	
Tuition and fees (net of scholarship allowances of $33,929,297)	$ 137,260,536
Federal grants and contracts	111,812,768
State and local grants	3,711,996
Nongovernmental grants	5,032,564
Sale and services of education departments	390,069
Auxiliary enterprises (net of scholarship allowances of $3,748,579)	11,351,699
Other operating revenues	6,109,064
Total operating revenue	275,668,696
Operating expenses:	
Instruction	262,394,659
Public service	3,542,891
Academic support	50,664,748
Student services	38,729,623
Institutional support	99,013,609
Operation and maintenance	51,766,354
Scholarships and fellowships	59,107,038
Auxiliary enterprises	10,386,518
Total operating expenses	575,605,440
Operating loss	(299,936,744)
Nonoperating revenues/(expenses):	
State appropriations (Note 12)	282,879,325
Local appropriations	1,806,975
Grants and gifts	808,067
Investment income	1,244,409
Interest on capital asset related debt	(1,798,954)
Other nonoperating expenses	(772,689)
Net nonoperating revenue	284,167,133
Income (loss) before other revenues, expenses, gains or losses	(15,769,611)
Capital appropriations-state	22,372,275
Capital appropriations-local	3,466,666
Capital grants and contracts	3,539,537
Increase in net assets	13,608,867
Net assets - beginning of year as restated (Note 1)	425,270,757
Net assets - end of year	$ 438,879,624

The accompanying Notes to the Financial Statements are an integral part of this statement.

VIRGINIA COMMUNTIY COLLEGE SYSTEM
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2003

Cash flows from operating activities:	
Tuition and fees	$ 138,963,944
Grants and contracts	120,407,883
Auxiliary enterprises revenues	11,200,925
Payments for employee wages	(314,091,874)
Payments for employee fringes	(64,301,145)
Payments to suppliers and others	(97,490,266)
Payment for scholarships	(60,284,182)
Payments for utilities	(9,478,739)
Sales and services of education department	390,069
Loans issued to students	(1,269,437)
Loans collected from students	1,371,154
Other	5,837,981
Net cash used by operating activities	(268,743,687)
Cash flows from non-capital financing activities:	
State appropriations	282,879,325
Local appropriations	1,806,975
Grants and gifts	805,407
Agency receipts	3,868,067
Agency disbursements	(3,525,379)
PLUS, Stafford and Direct Lending loan receipts	15,237,596
PLUS, Stafford and Direct Lending loan disbursements	(15,232,195)
Loan receipts	1,867,829
Loan repayments	(1,102,390)
Other non-operating revenue	3,708
Net cash provided by non-capital financing activities	286,608,943
Cash flows from capital financing activities:	
Capital appropriations-state	20,382,736
Capital appropriations-local	3,606,632
Capital grants and gifts	363,252
Purchase capital assets	(44,424,708)
Proceeds from sale of capital assets	39,431
Proceeds from bond issue	4,215,000
Debt interest payments	(709,415)
Debt principal payments	(4,594,590)
Net cash used by capital financing activities	(21,121,662)
Cash flows from investing activities:	
Purchases of investments	(4,667,784)
Sale of investments	4,497,045
Investment income	1,201,704
Net cash provided by investing activities	1,030,965
Net decrease in cash and cash equivalents	(2,225,441)
Cash and cash equivalents - beginning of year	101,482,942
Cash and cash equivalents - end of year	$ 99,257,501

Reconciliation of operating income (loss) to net cash used in operating activities:	
Operating income (loss)	$ (299,936,744)
Adjustment to reconcile operating income (loss) to net cash used in operating activities:	
Depreciation expense	23,855,417
Changes in assets and liabilities:	
Accounts receivable, net	577,524
Prepaid expenses and other	1,071,207
Accrued compensation and leave	3,307,179
Accounts payable and other	1,179,499
Deferred revenue	1,212,463
Deposits pending distribution	(10,232)
Net cash used in operating activities	$ (268,743,687)
Noncash investing, noncapital financing, and capital and related transactions:	
Equipment Trust Fund assets	$ 1,826,428
Assets acquired through capital leases or installment purchases	$ 4,385,508
Donated fixed assets	$ 1,349,855
Debt principal and interest payments made by Treasury	$ 1,989,539

The accompanying Notes to the Financial Statements are an integral part of this statement.

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Virginia Community College System (VCCS) was established as an institution of higher education in 1965. The System includes the State Board for Community Colleges, a System Office located in Richmond, 23 community colleges located on 40 campuses throughout the Commonwealth, and the Information Technology Utility. The State Board for Community Colleges is the governing body and is charged with the responsibility to establish, control, and administer a statewide system of publicly supported comprehensive community colleges. The System therefore functions as a statewide institution of higher learning.

The accompanying financial statements include all of the individual community colleges and the System Office under the control of the State Board for Community Colleges. Each individual college and the System Office have educational foundations that are further described in Note 2. The assets of these educational foundations, which are separately incorporated and managed by their own boards, are not included in these statements.

The VCCS has no component units, as defined by GASB Statement 14, *The Financial Reporting Entity.*

The System is a discrete component unit of the Commonwealth of Virginia and is included in the basic financial statements of the Commonwealth. A separate report is prepared for the Commonwealth of Virginia that includes all agencies, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority.

B. Accounting Policy Changes

The VCCS adopted the following accounting and reporting change for the year ended June 30, 2003:

GASB Statement 38 – *Certain Financial Statement Note Disclosures.* This Statement requires detail about the major components of receivable and payable balances.

In addition, some policy changes were made as a result of implementing GASB Statements 34 and 35. The Commonwealth of Virginia advised higher education agencies to begin reporting capital appropriations available as cash on the financial statements. Local capital appropriations have been separately identified on the Statement of Revenues, Expenses, and Changes in Net Assets. The Statement of Cash Flows has also been revised to identify all Stafford and Plus loan activity in addition to direct lending transactions. Additional detail was added for expenses and agency transactions.

C. Basis of Accounting

For financial reporting purposes, the VCCS is considered a special purpose government engaged in only business-type activities. Business-type activities are those that are financed in whole or in part by fees charged to external parties for goods and services. Accordingly, the financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. All material internal transactions have been eliminated.

Revenues and expenses of the summer academic term occur within two fiscal years, because the term extends from May through August and the fiscal year ends on June 30. Expenses and an equal amount of revenue have been reported in the current period for the portion of the summer academic term from May 16 through June 30, 2003.

The VCCS has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The VCCS has elected not to apply FASB pronouncements issued after the applicable date.

D. Inventories

Inventories are stated at cost (primarily first-in, first-out method) and consist mainly of goods purchased for resale and expendable supplies.

E. Investments

Investments meeting the valuation standards outlined in GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, have been shown at fair value.

F. Capital Assets

Capital assets consisting of land, buildings, infrastructure, equipment, library books, and construction in progress are stated at appraised historical cost or actual cost where determinable. Improvements to buildings, infrastructure, and land that significantly increase the usefulness, efficiency, or life of the asset are capitalized. Routine maintenance and repairs are charged to operations when incurred. Interest expense relating to construction is capitalized. All equipment purchased under the Equipment Trust Fund program that is titled to the Virginia College Building Authority has been capitalized on these statements. Donated assets are recorded at the estimated fair value at the date of donation. The fixed asset values presented in these financial statements are extracted from the financial data maintained by the System's Financial Records System and the Fixed Asset Inventory System (FAIS). Expenditures for equipment are capitalized when the unit acquisition cost is $5,000 or greater and the estimated useful life is one year or more. Occupancy permits are used to determine when to reclassify buildings from construction-in-progress. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, generally 50 years for buildings, 20 to 25 years for infrastructure and land improvements, 3 to 25 years for equipment, and 10 years for library books.

G. Accrued Compensated Absences

The amount of leave earned but not taken by all classified employees, administrative/professional faculty, teaching faculty, and presidents is recorded as a liability on the Statement of Net Assets. The amount reflects, as of June 30, all unused annual leave, compensatory leave, and the amount payable upon termination under the Commonwealth of Virginia's sick leave pay out policy. An additional liability amount has been included for those employees with less than five years of service based on the probability they will eventually become vested. The applicable share of employer related taxes payable on the eventual termination payment is also included.

H. System Office Expenditures

The central office (System Office) of the VCCS provides a variety of functions ranging from management control to centralized support services. Because most of these activities are management in nature and cover the operation of the entire System, they have been classified as Institutional Support.

I. Classification of Revenues and Expenses

The VCCS has classified its revenues as either operating or nonoperating revenues according to the following criteria:

Operating revenues include activities that have the characteristics of exchange transactions, such as tuition and fees, sales and services of auxiliary enterprises, most federal, state and local grants and contracts, and interest on student loans.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, state appropriations, and investment income.

Nonoperating expenses include interest on debt related to the purchase of capital assets and losses on disposal of capital asset. All other expenses are classified as operating expenses.

J. Scholarship Discounts and Allowances

Student tuition and fees revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the Statements of Revenues, Expenses, and Changes in Net Assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the VCCS, and the amount that is paid by students and/or third parties making payments on the student's behalf. Certain governmental grants, such as Pell grants, and other federal, state or nongovernmental programs are recorded as either operating or nonoperating revenues in the financial statements. To the extent that such revenues are used to satisfy tuition and fees and other student charges, the VCCS has recorded a scholarship discount and allowance.

K. Net Assets

Net assets are classified as follows:

Invested in capital, net of related debt: Consists of capital assets, net of accumulated depreciation and reduced by outstanding debt attributable to the acquisition, construction, or improvement of those assets.

Restricted net assets-nonexpendable: Restricted nonexpendable net assets are endowment funds in which donors have stipulated, as a condition of the gifts, that the principal is to remain inviolate in perpetuity.

Restricted net assets-expendable: Restricted expendable net assets include resources in which the VCCS is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

Unrestricted net assets: Unrestricted net assets represent resources that may be used at the discretion of the governing board for any lawful purpose.

When an expense is incurred that can be paid from either restricted or unrestricted resources, it is the policy of the VCCS to first apply the expense towards restricted resources and then towards unrestricted resources.

A policy change was implemented regarding the timing of capitalizing fixed assets. The occupancy permits, rather than the project completion reports, are used to determine the date the asset is placed in service. Two other adjustments for a System Office software addition and a correction to deferred revenue were also recorded. As a result, beginning net assets have been restated as follows:

Net Assets as of June 30, 2002, as previously reported	$ 428,071,074
Adjustment to record depreciation on fixed assets reclassified from construction in progress	(3,151,172)
Software addition	483,835
Deferred revenue	(132,980)
Net Assets as of July 1, 2002, restated	$ 425,270,757

2. AFFILIATED ORGANIZATIONS

Each College and the System Office have organized educational foundations that provide exclusive benefit to the colleges and System. The educational foundations are non-profit organizations created to raise funds supporting college programs, students, and related activities.

Limited members of the College Boards, locality appointed advisory boards of the System, represent the college on the related foundation's governing board. All educational foundations are independently audited. The State Board requires submission of yearly financial statements to the System Office. The following is a condensed summary of the financial condition of the foundations at June 30, 2003 except for Danville, John Tyler, New River and Virginia Western that are as of December 31, 2002, and Southwest Virginia that is as of June 30, 2002.

Assets	$77,120,809
Liabilities	$ 1,016,683
Net Assets	76,104,126
Total	$77,120,809
Revenues	$13,272,555
Expenditures	$12,193,988

3. CASH AND INVESTMENTS

Cash and Cash Equivalents

Cash of the Virginia Community College System that is maintained by the Treasurer of Virginia is invested and collateralized pursuant to Section 2.2-1800, et seq., Code of Virginia, who is responsible for the collection, disbursement, custody and investment of State funds.

Local deposits with banks and savings institutions not with the Treasurer of Virginia are covered by federal depository insurance or collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 et seq. of the Code of Virginia.

Cash equivalents maintained by the System are investments with maturities of less than three months.

Investments

Certain deposits and investments are held by the System. Such investments are reported separately from cash and cash equivalents. Investments represent securities with maturities of more than three months and for which management intends to hold the securities to maturity.

Credit Risk

The System's cash equivalents and investments are categorized below to give an indication of the level of credit risk assumed by the System at June 30, 2003. Credit risk is the risk the System may not be able to obtain possession of its investment instrument or collateral at maturity.

Category 1 - Insured or registered securities or securities held by the Virginia Community College System or its agent in the name of the Virginia Community College System.

Category 2 - Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the name of the Virginia Community College System.

Category 3 - Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the name of the Virginia Community College System. At June 30, 2003, the System had no investments in category 3.

Categorization of cash equivalents and investments held at June 30, 2003:

	Category 1	Category 2	Fair Value
Cash			$ 67,526,274
Cash equivalents:			
Categorized:			
U.S. Government Securities	$ 498,615	$ -	498,615
Repurchase Agreements	3,133,194	2,084,412	5,217,606
Non-Categorized:		-	
Money Market	-	-	625,382
Local Government Investment Pool	-		25,389,624
Investments:			
Categorized:			
U.S. Government Securities	2,647,961	-	2,647,961
Non-Categorized:			
Mutual Funds	-	-	568,382
Total	$ 6,279,770	$ 2,084,412	$ 102,473,844

4. RECEIVABLES AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

The following receivables included an allowance for doubtful accounts at June 30, 2003:

Gross Accounts Receivable:	
Tuition and fees	$ 3,036,869
Auxiliary enterprises	832,433
Federal, state, local and nongovernmental grants, gifts, contracts	1,157,602
Other activities	601,604
Total Gross Accounts Receivable	5,628,508
Less: Allowance for doubtful accounts	256,483
Net Accounts Receivable	$ 5,372,025
Gross Loans and Notes Receivable	$ 4,865,260
Less: Allowance for doubtful accounts	149,239
Net Loans and Notes Receivable	$ 4,716,021

The only receivables not expected to be collected within one year are $3,638,732 in student notes and loans receivable.

5. CAPITAL ASSETS

A summary of changes in the various capital asset categories for the year ended June 30, 2003, is presented as follows. Beginning balance amounts were restated as explained in Note 1.

	Beginning Balance	Additions	Retirements	Ending Balance
Non-depreciable capital assets:				
Land	$ 25,608,437	$ 438,900	$ -	$ 26,047,337
Inexhaustible works of art	83,242	-	-	83,242
Construction in progress	56,199,933	24,691,242	30,013,123	50,878,052
Total non-depreciable capital assets	81,891,612	25,130,142	30,013,123	77,008,631
Depreciable capital assets:				
Buildings	356,268,431	31,119,196	-	387,387,627
Infrastructure	17,234,481	1,706,168	-	18,940,649
Equipment	101,225,391	16,977,314	8,549,002	109,653,703
Land improvements	45,998,862	3,012,082	-	49,010,944
Library books	37,323,201	2,018,590	711,192	38,630,599
Total depreciable capital assets	558,050,366	54,833,350	9,260,194	603,623,522
Less accumulated depreciation for:				
Buildings	(98,206,484)	(8,325,232)	-	(106,531,716)
Infrastructure	(6,410,035)	(875,586)	-	(7,285,621)
Equipment	(62,799,683)	(11,851,147)	(7,733,172)	(66,917,658)
Land improvements	(23,007,636)	(1,218,292)	-	(24,225,928)
Library books	(29,395,010)	(1,585,160)	(711,195)	(30,268,975)
Total accumulated depreciation	(219,818,848)	(23,855,417)	(8,444,367)	(235,229,898)
Depreciable capital assets, net	338,231,518	30,977,933	815,827	368,393,624
Total capital assets, net	$420,123,130	$ 56,108,075	$ 30,828,950	$ 445,402,255

Construction in progress additions include capitalized interest of $387,318.

6. ACCOUNTS AND RETAINAGE PAYABLE

Accounts and retainage payable consisted of the following as of June 30, 2003:

Vendor payables	$ 9,401,709
Retainage payable	2,970,235
Taxes payable	4,352
Total	$12,376,296

7. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2003 is as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts due within one year
Debt:					
Bonds payable	$ 2,393,188	$ 3,870	$ 366,710	$ 2,030,348	$ 395,530
ETF leases	1,482,789	-	1,482,789	-	-
Other capital leases	25,579,090	-	1,207,799	24,371,291	1,285,333
Notes payable:					
Installment purchases	5,535,562	4,385,508	2,402,293	7,518,777	1,705,212
Pooled bonds	7,575,000	4,215,000	35,000	11,755,000	415,000
Other notes payable	1,002,390	1,867,829	1,102,390	1,767,829	1,767,829
Total bonds, notes & capital leases	43,568,019	10,472,207	6,596,981	47,443,245	5,568,904
Other liabilities:					
Compensated absences	24,200,396	14,431,281	13,521,469	25,110,208	9,813,451
Retainage payable:					
Long term portion	-	72,622	-	72,622	-
Deferred gifts and grants	19,817	42,878	13,071	49,624	-
Federal loan program contributions	4,501,145	167,376	25,813	4,642,708	-
Total other liabilities	28,721,358	14,714,157	13,560,353	29,875,162	9,813,451
Total long-term liabilities	$ 72,289,377	$ 25,186,364	$20,157,334	$ 77,318,407	$15,382,355

8. BONDS PAYABLE

Long-term debt in the form of Bonds payable of the System as of June 30, 2003, consists of the following:

Higher Education Bonds, Series 1994 (9c), issued $1,685,000 to finance construction of a parking lot on the Portsmouth campus of Tidewater Community College. The bond was re-financed, Refunding Bonds, Series 2002 and the balance payable is $228,870 with an average coupon rate of 6.00 percent payable semiannually. The final installment of $228,870 is due June 1, 2004. The outstanding balance at June 30, 2003 is $228,870.

Higher Education Refunding Bonds, Series 1999, issued $1,868,800 to advance refund a portion of the Higher Education Bonds, Series 1992A noted above. The balance is payable in annual installments ranging from approximately $167,000 to $240,000 with an average coupon rate of 4.32 percent payable semiannually. The final installment of $239,167 is due June 1, 2012. The outstanding balance at June 30, 2003 is $1,801,478.

Aggregate annual maturities of bonds payable for fiscal years after 2003:

Year Ending June 30	Principal	Interest	Total
2004	$ 395,530	$ 89,913	$ 485,443
2005	175,138	73,259	248,397
2006	178,778	65,377	244,155
2007	185,933	58,048	243,981
2008	200,833	48,751	249,584
2009-2012	894,136	103,557	997,693
Total debt service requirements	$2,030,348	$ 438,905	$ 2,469,253

The debt issue is coordinated and monitored by the Treasurer of Virginia on behalf of the VCCS.

9. NOTES PAYABLE – POOLED BONDS

Notes payable-pooled bonds represent an agreement with the Virginia College Building Authority (VCBA) to finance the following projects:

Parking improvements for the Midlothian campus of John Tyler Community College. The balance is to be repaid in ten annual installments ranging from $35,000 to $45,000 with an average interest rate of 4.56 percent payable semiannually. The final installment of $45,000 is due September 1, 2008. The outstanding balance at June 30, 2003 is $255,000.

Parking garage for the Medical Education campus of Northern Virginia Community College. The balance is to be repaid in twenty annual installments ranging from $265,000 to $555,000 with an average coupon rate of 4.61 percent payable annually. The final installment of $555,000 is due September 1, 2021. The outstanding balance at June 30, 2003 is $7,285,000.

Parking garage for the J. Sargeant Reynolds Community College. The balance is to be repaid in twenty annual installments ranging from $110,000 to $330,000 with an average coupon rate of 4.59 percent payable annually. The final installment of $330,000 is due September 1, 2022. The outstanding balance at June 30, 2003 is $4,215,000.

Other notes payable of $1,767,829 represents advances received from the Commonwealth of Virginia in anticipation of federal grant funding.

Scheduled maturities of notes payable are as follows:

Year Ending June 30	Principal	Interest	Total Payments
2004	$ 2,182,829	$ 539,940	$ 2,722,769
2005	445,000	526,170	971,170
2006	460,000	510,710	970,710
2007	480,000	493,198	973,198
2008	500,000	473,770	973,770

Year Ending June 30	Principal	Interest	Total Payments
2009-2013	2,640,000	2,024,373	4,664,373
2014-2018	3,260,000	1,357,400	4,617,400
2019-2023	3,555,000	463,018	4,018,018
Totals	$ 13,522,829	$ 6,388,579	$19,911,408

10. EQUIPMENT TRUST FUND

The System participates in the Higher Education Equipment Trust Fund of the Virginia College Building Authority (VCBA). The Higher Education Equipment Trust Fund provides funds to public colleges and universities for equipment acquisition. In prior years, funds were provided in the form of a lease. During the year ended June 30, 2003, the VCBA financed the ETF program with state funds, which will not require repayment. However, debt obligations were outstanding for prior fiscal years. All remaining obligations under prior lease agreements have been paid in the fiscal year ending June 30, 2003.

11. LEASE COMMITMENTS AND INSTALLMENT PURCHASES

The System is committed under various capital lease, operating lease, and installment purchase agreements. The cost of assets capitalized under capital lease and installment purchase agreements total $32,093,741 and $7,164,571, respectively. Rent expense under operating lease agreements amounted to $6,665,281 for the year. A summary of future obligations under lease agreements as of June 30, 2003, follows:

Year Ending June 30	Capital Lease Obligations	Installment Purchase Obligations	Operating Lease Obligations
2004	$ 2,566,432	$ 1,922,931	$ 2,272,107
2005	2,511,892	1,908,851	2,388,855
2006	2,390,212	1,858,179	1,702,026
2007	2,394,271	1,565,048	1,373,645
2008	2,389,004	756,978	1,153,539
2009-2013	11,946,472	43,469	3,955,619
2014-2018	9,379,573	-	1,862,370
2019-2021	2,585,865	-	661,250
Total obligation and gross minimum lease payment	36,163,721	8,055,456	$ 15,369,411
Less: Interest	11,792,430	536,679	
Present value of minimum lease payments	$ 24,371,291	$ 7,518,777	

12. STATE APPROPRIATIONS

All Commonwealth Unrestricted Revenues must be appropriated by the Legislature and are provided on an annual basis. Unspent balances of these appropriations at the close of the fiscal year revert to the Commonwealth's General Fund. These reverted funds are eligible for reappropriation in fiscal year 2003-04 provided that the VCCS meets the Management Standards established by the Secretary of Education and the Secretary of Finance and approved by the Governor.

The following is a summary of state appropriations received by the System including all supplemental appropriations and reversions:

Original legislative appropriation per Chapter 1042	$ 279,541,259
Additions:	
Salaries and benefits	10,223,638
Other additions	76,059
Reductions:	
Benefit reductions and savings	(10,138,338)
Reversions	(6,319,001)
Other reductions	(1,482,172)
Adjusted unrestricted appropriations	$ 271,901,445

Other restricted appropriations were $10,977,880 for a total of $282,879,325.

13. COMMITMENTS

At June 30, 2003, the System had future commitments for construction contracts totaling approximately $28,946,401. The System held $3,042,857 as retainage payable on construction and architectural/engineering contracts for work performed. Of this retainage payable, $72,622 is estimated to be payable beyond June 30, 2004. The retainage payable will be remitted to the various contractors upon satisfactory completion of the construction projects.

14. RETIREMENT PLANS

Virginia Retirement System

Employees of the Virginia Community College System are employees of the Commonwealth of Virginia. Substantially all full-time classified salaried employees of the System participate in a defined benefit pension plan administered by the Virginia Retirement System (VRS). VRS is an agent multiple-employer public employee retirement system that acts as a common investment and administrative agency for the Commonwealth of Virginia and its political subdivisions.

Total pension costs employees covered under VRS were $9,257,007 for year ended June 30, 2003, using the base salary amount of $185,140,134.

The VRS does not measure assets and pension benefit obligations separately for individual State institutions. Information relating to this plan is available at the statewide level only in the Commonwealth of Virginia's Comprehensive Annual Financial Report (CAFR). The Commonwealth of Virginia, not the System, has overall responsibility for contributions to this plan. The CAFR provides disclosure of the Commonwealth's unfunded pension benefit obligation at June 30, 2003. The same report contains historical trend information showing VRS's progress in accumulating sufficient assets to pay benefits when due.

Optional Retirement Plans

Most full-time faculty and certain administrative staff participate in one of five optional retirement plans. Each is a fixed-contribution plan where the retirement benefits received are based on the employer's (10.4 percent) contributions, plus interest and dividends. As with VRS, the employees' contributions are assumed by the employer. Individual contracts issued under the ORP plan provide for full and immediate vesting of the VCCS contributions.

Total pension costs under these optional retirement plans were $3,831,950 for year ended June 30, 2003 using the base salary amount of $36,845,673.

The VCCS total payroll for fiscal year 2003 was $307,215,106.

15. POST-EMPLOYMENT BENEFITS

The Commonwealth participates in the VRS-administered statewide group life insurance program which provides post-employment life insurance benefits to eligible retired and terminated employees. The Commonwealth also provides health care credits against the monthly health insurance premiums of its retirees who have at least 15 years of State service and participate in the State's health plan. Information related to these plans is available at the statewide level in the Commonwealth's Comprehensive Annual Financial Report.

16. OPERATING EXPENSES BY NATURAL AND FUNCTIONAL CLASSIFICATIONS

The following table shows a classification of expenses both by function as listed in the Statement of Revenues, Expenses, and Changes in Net Assets and by natural classification, which is the basis for amounts shown in the Statement of Cash Flows.

	Natural Classification					
Functional Classification	Salaries and Benefits	Utilities	Scholarships	Depreciation	Supplies, Services and Other	Total
Instruction	$221,248,993	$ 87,160	$ 1,058,865	$ 12,885,018	$ 27,114,623	$262,394,659
Public Service	2,098,868	-	-	53,065	1,390,958	3,542,891
Academic Support	41,212,100	21,825	3,643	3,013,904	6,413,276	50,664,748
Student Services	35,723,570	71	101,353	58,947	2,845,682	38,729,623
Institutional Support	66,410,634	-	53,362	6,878,373	25,671,240	99,013,609
Operation and Maintenance of Plant	13,099,831	9,272,466	183	966,110	28,427,764	51,766,354

Scholarships and Fellowships	-	-	59,107,038	-	-	59,107,038
Auxiliary Enterprises	1,335,456	121,293	-	-	8,929,769	10,386,518
Total Expenses	$381,129,452	$9,502,815	$ 60,324,444	$ 23,855,417	$100,793,312	$575,605,440

17. DONOR-RESTRICTED ENDOWMENTS

VCCS has two donor-restricted endowments totaling $14,000 in restricted principal. The net appreciation on investments of donor-restricted endowments that is available for expenditure by the governing board for the year ended June 30, 2003 is $218. These amounts are reported as restricted expendable net assets. Total-return policy is followed for authorizing and spending investment income.

18. CONTINGENCIES

Grants

The System and its Colleges receive assistance from non-state grantor agencies in the form of grants. Entitlement to these resources is generally conditional upon compliance with the terms and conditions of grant agreements. Substantially all grants are subject to financial and compliance audits by the grantors. All disallowances as a result of these audits become a liability of the System. As of June 30, 2003, System management estimates that no material liabilities will result from such audits.

Litigation

The System has been named as a defendant in a lawsuit involving a contract dispute with a construction vendor. The final outcome of this lawsuit cannot be determined at this time and it is not possible to estimate the loss or range of loss at this time. System management is of the opinion that any ultimate liability to which the System may be exposed will not have a material effect upon the System's financial position.

19. RISK MANAGEMENT

The System is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; non-performance of duty; injuries to employees; and natural disasters. The System participates in insurance plans maintained by the Commonwealth of Virginia. The state employee health care and worker's compensation plan are administered by the Department of Human Resource Management and the risk management insurance plans are administered by the Department of Treasury, Division of Risk Management. Risk management insurance includes property, general liability, faithful performance of duty bonds, automobile, and air and watercraft plans. The System pays premiums to each of these Departments for its insurance coverage. Information relating to the Commonwealth's insurance plans is available at the statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report.

20. SUBSEQUENT EVENT – POOLED BONDS ISSUED AFTER JUNE 30, 2003

On November 5, 2003, the Virginia College Building Authority (VCBA) issued the Series A Bonds $7,910,000 due August 1, 2023 on behalf of the Northern Virginia Community College for parking improvements. The bonds will be repaid in 20 annual principal installments with annual coupon payments ranging from 2 – 5 percent payable semi-annually in March and August. The total annual principal and interest payments range from $735,000 to the low of the final installment of $409,000 due August 1, 2024.

On the same day, the VCBA issued the Series A Bonds $1,040,000 due August 1, 2013 on behalf of John Tyler Community College for parking improvements. The bonds will be repaid in 10 annual principal installments with annual coupon payments ranging from 2 – 5 percent payable semi-annually in March and August. The total annual principal and interest payments range from $135,444 to the low of the final installment of $133,250 due August 1, 2013.

21. PENDING GOVERNMENTAL ACCOUNTING BOARD STATEMENT

Governmental Accounting Standards Board Statement 39, "Determining Whether Certain Organizations are Component Units," issued May 2002 will be effective for the fiscal year ending June 30, 2004. This Statement provides additional guidance to determine whether certain organizations for which the System and its Colleges are not financially accountable should be reported as component units. Generally, it requires reporting, as a component unit, an organization that raises and holds economic resources for the direct benefit of System or its Colleges. As a result, where in the past the System presented summary financial information of certain of the foundations related to the System and its Colleges in the notes to the financial statements, the System will be required under Statement 39 to include selected foundations in the body of its financial statements. The System and its Colleges have assessed which of the foundations should be included as component units and are planning for the implementation of this standard.

VIRGINIA COMMUNITY COLLEGE SYSTEM
Richmond, Virginia

COMMUNITY COLLEGE PRESIDENTS
As of June 30, 2003

Blue Ridge Community College	Dr. James R. Perkins
Central Virginia Community College	Dr. Darrel W. Staat
Dabney S. Lancaster Community College	Dr. Richard R. Teaff
Danville Community College	Dr. B. Carlyle Ramsey
Eastern Shore Community College	Dr. Richard E. Jenkins
Germanna Community College	Dr. Francis S. Turnage
J. Sargeant Reynolds Community College	Dr. Gary L. Rhodes
John Tyler Community College	Dr. Marshall W. Smith
Lord Fairfax Community College	Dr. Marilyn C. Beck
Mountain Empire Community College	Dr. Terrance Suarez
New River Community College	Dr. Jack M. Lewis
Northern Virginia Community College	Dr. Robert Templin
Patrick Henry Community College	Dr. Max F. Wingett
Paul D. Camp Community College	Dr. Douglas Boyce
Piedmont Virginia Community College	Dr. Frank Friedman
Rappahannock Community College	Dr. Norman H. Scott
Southside Virginia Community College	Dr. John J. Cavan
Southwest Virginia Community College	Dr. Charles R. King
Thomas Nelson Community College	Dr. Shirley R. Pippins
Tidewater Community College	Dr. Deborah M. DiCroce
Virginia Highlands Community College	Dr. F. David Wilkin
Virginia Western Community College	Dr. Robert H. Sandel
Wytheville Community College	Dr. Ann Alexander

VIRGINIA COMMUNITY COLLEGE SYSTEM
James Monroe Building • 101 North Fourteenth Street • Richmond, Virginia 23219

June 28, 2004

Mr. Walter J. Kucharski
Auditor of Public Accounts
P. O. Box 1295
Richmond, VA 23218

Dear Mr. Kucharski:

We are providing this letter in response to your report on the audit of the financial records of the Virginia Community College System for the fiscal year ended June 30, 2003.

We confirm that we have reviewed the findings and recommendations and have prepared the attached response and corrective action plan.

If you have any questions, please contact David Mair, VCCS Controller, at (804) 819-4929.

Sincerely,

Glenn DuBois

Glenn DuBois
Chancellor

Enclosure

C: Ms. Karen Petersen
Mr. John Brilliant
Mr. David Mair

804-819-4901, FAX 804-819-4766, TDD 804-371-8504
An Equal Employment Opportunity/Affirmative Action Employer
www.vccs.edu

Improve Capital Asset Management and Reporting

During the fiscal year 2003 audit, we found the following colleges did not properly perform inventories and/or did not adequately record changes in assets throughout the year.

- Danville Community College
- J. Sargeant Reynolds Community College
- Lord Fairfax Community College
- Patrick Henry Community College
- Rappahannock Community College
- Southwest Virginia Community College
- Virginia Western Community College
- Wytheville Community College

The Commonwealth's accounting policies require the colleges to perform a complete capital asset inventory every two years. Danville, Rappahannock, and J. Sargeant Reynolds have not performed a complete inventory during the past three years. The other five colleges did not perform complete inventory counts timely or did not always record asset changes throughout the year. VCCS Internal Audit performed an audit on capital asset procedures in March 2004. In addition to reporting that some Colleges did not complete inventories timely, the internal audit report also noted internal control issues at several Colleges relating to recording assets promptly and accurately, tagging and recording asset locations, and having written procedures. We recommend that the System Office work with the Colleges cited here and in the internal audit report to resolve their capital asset accounting and control issues and ensure that all Colleges have procedures in place to ensure continued adequate accounting and control over capital assets.

VCCS has not formally updated the FAIS procedures manual since its issuance to the Colleges in January 1992. The System Office provides the Colleges specific guidance and changes to procedures in memorandums and directives. We recommend that the System Office formalize this guidance by updating the FAIS manual for changes to procedures and accounting policies since its issuance. In addition, the System Office should formalize and document its year-end procedures to compile capital asset and depreciation information for the financial statements.

The System Office uses FAIS as a data collection system for the Colleges to enter equipment purchases and produce reports for inventory counts. The System Office uses spreadsheets to track land, buildings, and construction in progress. The System Office then uses formula driven spreadsheets to compile and calculate year end capital asset information based on data from the manual spreadsheets and retrievals of equipment information from FAIS. FAIS is a legacy system that does not provide the reporting capabilities of newer systems and using spreadsheets for this process can be inefficient. We recommend that System management consider obtaining an automated capital asset management reporting system.

Danville Community College Response:

The staff has begun a systematic review of capital assets to ensure that items are identified and inventoried properly. Additional part-time staff has been added to assist in this process. Currently, there is one building undergoing renovation and most of the contents of that building have been placed in storage. The inventory process on that building will be delayed until the renovation project is complete and the building is reoccupied. The inventory process and asset identification will be complete by December 2004. Complete inventories will be performed every two years. During and following the inventory process, all new capital equipment will be identified and added to the FAIS system as it is received. Status of this effort will be reviewed monthly in staff meetings.

J. Sargeant Reynolds Community College Response:

The College has performed a physical inventory this year. The FAIS records will be updated by July 2004.

Lord Fairfax Community College Response:

Lord Fairfax Community College agrees with the observed situation and recommendation. Immediate measures were put in place to ensure that all asset changes are properly recorded. The College is also planning to complete an inventory count by September 2004.

Patrick Henry Community College Response:

The support documentation has been obtained and the two missing items have been removed from inventory. To eliminate the potential for miscommunication between the individual now handling surplus property and the one maintaining inventory, the responsibility for surplus property will be transferred to the Inventory Specialist. The Inventory Specialist will not be vested with responsibility for asset acquisition, ownership or initiation of asset disposal to respect segregation of duties. The Business Office Manager will ensure that the Inventory Specialist is trained in the new responsibility and given a copy of the pertinent sections of the CAPP Manual. The Inventory Specialist will be instructed to perform an inventory and to promptly delete assets from FAIS.

Rappahannock Community College Response:

Even though a physical inventory had not been taken, the college worked diligently to report and control fixed assets. During the period of the audit, the College implemented a new electronic inventory system and there was turnover in the position responsible for the implementation. The College will complete a physical inventory for the fiscal year 2004.

Southwest Virginia Community College Response:

The College has performed ongoing inventory management and has conducted a broad based, college-wide inventory each year. We agree with the findings of the APA that some items were not properly recorded in FAIS. The college is currently conducting another physical inventory and will repeat the counts next summer after the completion of two major building renovations. Emphasis will be placed on the accuracy of the data in FAIS.

Virginia Western Community College Response:

The College will place increased emphasis on performing timely inventory counts and recording asset changes correctly.

Wytheville Community College Response:

The College has completely evaluated the Fixed Asset Inventory procedures for accounting of fixed assets to ensure that capital asset purchases, disposals, and movements are promptly and accurately recorded on FAIS.

These new policies and procedures will ensure a comprehensive capital asset inventory that includes tracing assets from FAIS listings to the actual asset and surveying capital assets physically on hand to ensure that all assets have been recorded on FAIS and recorded at the appropriate locations. We relocated our Receiving Department in an office right across from the Purchasing Department. This relocation has fostered mutual coordination between the two departments.

System's Office Response:

The capital asset findings in this report and the VCCS Internal Audit Report have been reviewed with the college Business Managers. The System Office will conduct a training session in the fall on capital asset accounting policies and procedures. On-site training at the colleges will be conducted where needed and requested.

Only minor procedural changes have been made since the FAIS manual was published. The manual will be updated with these changes. The year-end procedures for compiling fixed asset information for the financial statements will be documented.

The VCCS is in the initial stage of evaluating current administrative systems for modification or replacement.

Improve Procedures for Computer System Access

Applicable to: Central Virginia Community College
Piedmont Virginia Community College
Tidewater Community College

Employees at three Colleges had unauthorized access to the financial or administrative computer systems either because they had terminated employment or the College did not properly document their authorization. Central Virginia Community College did not revoke access to the computer systems promptly after employees terminated and supervisors did not closely monitor the annual listing of employees in their department with computer access. Piedmont Virginia Community College did not properly document the authorization for employees granted access to the Student Information System. Tidewater Community College did not promptly delete access to the Commonwealth's central financial and payroll system when employees terminated.

We recommend that all Community Colleges follow established procedures relating to the authorization, monitoring, and deletion of access to the College's financial and administrative computer systems. This includes properly documenting authorization and approvals for necessary access to computer systems, periodic monitoring by supervisors for the need for continued computer access for employees, and the prompt revocation of access upon termination of employment. Failure to restrict computer access to current employees who need such access to perform their duties places the College at risk for inappropriate changes or disclosure of important financial, administrative, and personal information.

Central Virginia Community College Response:

In order to ensure that system access is properly revoked in a timely manner, Central VA Community College (CVCC) will follow the procedures outlined below:

Full Time Employees:

Full-time employees currently have an exit form which must be signed by all appropriate departments prior to their final working day. This has been very effective in the past, and will continue to be the procedure for full-time employees.

Part Time Employees (P-14, Work Study):

The supervisor will be required to notify the Information Technology Department within two (2) working days of the termination of any part-time employee. Failure to properly notify IT of employee termination will be addressed by the President's Staff.

Adjunct Faculty:

Division Deans will make sure that adjunct faculty access is reviewed on a semester-by-semester basis to determine access needs. In some cases adjunct faculty may still need access. The Division Deans are best equipped to make those decisions.

Increased Awareness:

CVCC will use the fall convocation as a point to make supervisors aware of the need to closely monitor the annual listing of employees' computer access.

Piedmont Virginia Community College

The College is currently developing new procedures relating to the authorization, monitoring and deletion of access to the College's Student Information System. These procedures will be distributed to employees and supervisors in August 2004.

Tidewater Community College Response:

The College has made several unsuccessful attempts to delete CARS access for terminated employees. The protocol for adding and deleting CARS access has changed within the VCCS, and we are making efforts to determine the appropriate contacts to expedite processing of security access changes. Existing procedures will be revised to reflect the changes necessary to ensure compliance.

Promptly Reconcile Local Bank Accounts

Applicable to: Tidewater Community College

Tidewater Community College did not promptly reconcile four of its eight local bank accounts as of June 30, 2004. Three of these accounts had been reconciled at the time of our audit; however, one account still had not been reconciled nine months after year end. While these bank accounts do not have large balances or extensive activity, prompt reconciliation of bank accounts is an essential internal control to safeguard cash assets.

Failure to reconcile bank accounts may result in misstatement of cash and eliminates the chance to detect and resolve errors between the accounting systems and bank statements. The College should reconcile all its local bank accounts promptly at the end of each month.

Tidewater Community College Response:

The College's practice has been to reconcile its bank accounts on a monthly basis. An accountant from a temporary agency was assigned this task and completed the reconciliations monthly. Subsequent to the termination of the accountant, it was discovered that the outstanding checklists supporting the reconciliations contained inaccuracies. It became necessary to redo the bank reconciliations for the time period the accountant was employed to determine their accuracy. This was completed promptly after the problem was detected for three of the four accounts, and reconciliations have been kept up to date since. The financial aid bank account, which can contain up to 4,000 transactions per month, took longer to complete the review. We did not find any instances of missing deposits or checks; the majority of the errors were a result of cleared checks being recorded in the wrong months. Accounts are now reconciled monthly and reviewed by a financial manager.

Discontinue Inappropriate Advance Payments

Applicable to: Wytheville Community College

Wytheville Community College inappropriately made advance payments on multiple janitorial contracts and one security contract before June 30, 2003 for the upcoming fiscal year. The College made advances payments to avoid reverting funds at year end. While the State Comptroller allows advance payments in certain circumstances, the Comptroller does not allow advance payments for security and janitorial contracts and standard industry practice does not recommend prepayment more than 30 days in advance. After an agency or institution makes an advance payment, there is no absolute guarantee that the vendor will deliver the goods or perform the requested services, placing the Commonwealth's assets at risk. College management had identified this issue and was working with the System Office and the state Department of Accounts to resolve these payments before our on-site audit.

We recommend that Wytheville Community College discontinue inappropriate advance payments for contractual services.

Wytheville Community College Response:

Inappropriate advance payments for contractual services have been discontinued. The new Vice President of Finance & Administration has initiated internal controls to prevent such inappropriate payments at year end. Procedures have been put in place to monitor internal controls associated with year-end closing.

Implement and Improve Procurement Policies and Procedures over Bookstore Operations

Applicable to: Danville Community College

Danville Community College does not have procedures for procuring and administering local contracts for the bookstore. As a result, the College does not have contracts for the book buyback agreements or for purchases of supplies and inventories for the bookstore. The Business Office does not monitor revenue generating contracts to ensure the College is properly receiving revenue from book buybacks. The College risks contract disputes and overpayment of goods and services if it does not properly prepare and administer contracts and contract changes.

Management should document its policies and procedures for the Bookstore. The policies and procedures should address contract authorization, preparation, and administration. The College should adhere to state policy that requires competitive bidding of contracts over $50,000.

Danville Community College Response:

The Danville Community College bookstore is currently establishing book buyback agreements and will have those in place by August 2004. Purchases of supplies (in amounts less than $50,000) will be handled by using manufacturer's current published price lists. Invoices will be checked to ensure that items are invoiced at or below the published prices. This will be implemented immediately. The Business Office will review revenue-generating contracts semi-annually (January and July) to ensure proper contract administration. This will be implemented immediately. A Bookstore Policy Manual will be developed and implemented by September 2004.

Properly Administer Return of Title IV Funds

Applicable to: Central Virginia Community College
Mountain Empire Community College
Northern Virginia Community College
Paul D. Camp Community College

Control and Compliance Finding: Central Virginia Community College failed to properly calculate Title IV refund amounts. Paul D. Camp and Northern Virginia Community Colleges performed Title IV refunds accurately, but did not return federal funds to the federal Department of Education in a timely manner. Additionally, Mountain Empire, Paul D. Camp, and Central Virginia Community Colleges do not have adequate procedures to identify students who withdraw or cease attendance without notifying college staff.

Requirement: 34 CFR Part 668.22 (c) requires that colleges have a mechanism in place to identify students who have withdrawn or ceased attendance, in order to promptly and properly calculate any return of Title IV funds. Part 668.22 (e) sets forth the manner to properly calculate the amounts due to be refunded to the Title IV programs. Part 668.22 (j) requires that colleges return unearned Title IV funds as soon as possible to the federal Department of Education, but no later than 30 days after the college determined the student withdrew.

Recommendation: Colleges should follow the return of Title IV funds procedures prescribed by the federal government to ensure that they properly identify students, who withdraw and properly calculate refunds and return the funds to the federal Department of Education.

Central Virginia Community College Response:

All Title IV refunds are now being calculated using the percentage calculation for the last date of attendance that is used by the college in withdrawing students.

Effective with the Spring 04 term, faculty members will receive an e-mail reminding them to notify the Financial Aid Officer when students have ceased attendance and/or failed to start attending classes. In addition, the College has instituted a new process with the Admission and Records Office that requires them to term withdraw all students that withdraw from all classes at the college. This enables the Office of Financial Aid Services to identify those students earlier. A follow-up procedure will be developed and implemented at the end of the term to ensure that the College has identified students who have withdrawn or ceased attendance.

Mountain Empire Community College Response:

The College will continue to rely on faculty members to provide notification to the Financial Aid Office of students who fail to attend. However, to enhance this current policy and ensure compliance with the Federal Student Handbook, the College will also implement the following course of action as identified by the finding of the Auditor of Public Accounts:

At the end of each semester, students with all failing grades or a combination of failing and withdrawal grades will be identified and reviewed to determine if they stopped attending all classes prior to the passage of 60% of the semester. Title IV refund calculations will be performed on these students to determine the appropriate amount of financial aid dollars that must be refunded to the Title IV financial aid accounts by the College and the student.

Northern Virginia Community College Response:

Northern Virginia Community College (NVCC) has effective procedures to provide for the timely return of Title IV in accord with federal regulations. There is one business office responsible for the timely restoration of funds after receiving the calculation from the Financial Aid Office. The business office processes hundreds of refunds in a timely manner, however, in these cases there were extenuating circumstances that precluded efficient processing.

Normal procedure is to process refunds as they arrive at the business office. During the April/May time period the staff was undergoing extensive training in PeopleSoft for the conversion of the Student Information System. This caused some processing delays in the business office. These were exceptions rather than the rule and were one-time occurrences.

NVCC has reviewed the procedures with the appropriate staff and trained additional personnel in order to process refunds in accordance with federal requirements. Internal follow-ups will be conducted to ensure that these measures are met.

Paul D. Camp Community College Response:

A new business process will be developed and implemented to ensure that federal funds are returned in a timely manner. The new procedures will also allow the College to identify students who withdraw or cease attendance without notifying the college staff.