B A L A N C E

VIRGINIA TECH FINANCIAL REPORT 2002~2003

This financial report is prepared using the new Governmental Accounting Standards Board reporting model. Virginia Tech's use of this model for the second year provides balance to the way financial statements are presented and organized. The Management's Discussion and Analysis helps guide the reader through the intricacies of the university's financial response to the challenges experienced during fiscal year 2002-2003. The university has a strong financial foundation for the future and is well positioned with its strategic planning to move forward into 2004 and beyond.

Virginia Tech

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Virginia Tech

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VIRGINIA POLYTECHNIC INSTITUTE
AND STATE UNIVERSITY

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Special Notes about the Table of Contents within this PDF version: This version of the university's financial statements contains two Table of Contents pages. This page was not printed in the printed copy and is only included in the on-line version. The Table of Contents for Notes to Financial Statements is included in both the on-line version and the printed copy. Both Table of Contents pages have imbedded links within them that allow the reader to click on a content item and go to that page. Clicking on a page will return the reader to the Table of Contents page. In the Notes to Financial Statements, click on the mobile/page number to return to the main Table of Contents, otherwise the reader is returned to the Table of Contents for Notes to Financial Statements.

Document Responsibility: This document was produced by the Office of the University Controller. Kenneth E. Miller, CPA, is the University Controller. Stacy A. King, CPA, is the Manager of Financial Reporting. Questions about this document or requests for copies of the printed version should be referred to Ms. King either via e-mail: kings@vt.edu or phone: (540) 231-8624.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING AND INTERNAL CONTROLS

The information in this *Annual Financial Report*, including the accompanying basic financial statements, notes, Management's Discussion and Analysis, and other information is the responsibility of management. Responsibility for the accuracy of the financial information and fairness of its presentation, including all disclosures, rests with the management of the university. Management believes the information is accurate in all material respects and fairly presents the university's financial position as well as revenues, expenses and changes in net assets. This report was prepared in accordance with generally accepted accounting principles for public colleges and universities in the United States of America as prescribed by the Governmental Accounting Standards Board. Management is responsible for the objectivity and integrity of all representations herein. The *Annual Financial Report* includes all disclosures necessary for the reader of this report to gain a broad understanding of the university's operations for the year ended June 30, 2003.

The administration is responsible for establishing and maintaining the university's system of internal controls. Key elements of the university's system of internal controls include: careful selection and training of administrative personnel; organizational structure that provides appropriate division of duties; thorough and continuous monitoring, control, and reporting of operating budgets versus actual operating results; well communicated written policies and procedures; annual self-assessments led by the Office of the University Controller; and an extensive internal audit function that provides both financial audit and management services functions. Although there are inherent limitations to the effectiveness of any system of accounting controls, management believes that the university's system provides reasonable, but not absolute, assurances that assets are safeguarded from unauthorized use or disposition, and that the accounting records are sufficiently reliable to permit the preparation of financial statements and the appropriate accountability of assets and liabilities.

The Finance and Audit Committee of the board of visitors reviews and monitors the university's financial reporting and accounting practices. The committee meets with the external independent auditors annually to review the *Annual Financial Report* and the results of audit examinations. The committee also meets with internal auditors and university financial officers at least quarterly. These meetings include a review of the scope, quality, and results of the internal audit program, and a review of issues related to internal controls and the quality of financial reporting.

The Auditor of Public Accounts (APA), the Commonwealth of Virginia's auditors, have examined our annual financial statements and their report thereon appears on the facing page. Their examination includes a study and evaluation of the university's system of internal controls, financial systems, and policies and procedures, resulting in the issuance of a management letter describing various issues they consider worthy of management's attention. The university has implemented policies and procedures for the adequate and timely resolution of such issues. No reportable conditions or material weaknesses were found on internal control matters by the APA for the fiscal year ended June 30, 2003.

Minnis E. Ridenour

Executive Vice President and Chief Operating Officer

REPORT OF THE INDEPENDENT AUDITOR

October 20, 2003

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Kevin G. Miller
Chairman, Joint Legislative Audit
and Review Commission

The Board of Visitors
Virginia Polytechnic Institute and State University

We have audited the accompanying Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets, and Statement of Cash Flows of Virginia Polytechnic Institute and State University (a component unit of the Commonwealth of Virginia) as of June 30, 2003, and for the year then ended, which collectively comprise the university's basic financial statements. These financial statements are the responsibility of the university's management. Our responsibility is to express an opinion on the 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 Virginia Polytechnic Institute and State University 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 20, 2003 on our consideration of the university's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis on pages 28 through 37 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.

Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Schedule of Auxiliary Enterprises Revenues, Expenditures, and Changes in Fund Balances on page 59 is presented for the purpose of additional analysis and is not a required part of the financial statements of the university. The information in that schedule has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, such information is fairly presented in all material respects to the financial statements taken as a whole.

Sincerely,

Walter J. Kucharski
Auditor of Public Accounts

MANAGEMENT'S DISCUSSION AND ANALYSIS

Virginia Polytechnic Institute and State University, popularly known as Virginia Tech, is a comprehensive, land-grant university located in Blacksburg, Virginia. The university offers 220 graduate, undergraduate, and professional degree programs through its eight academic colleges (Agriculture and Life Sciences, Architecture and Urban Studies, Pamplin College of Business, Engineering, Science, Liberal Arts and Human Sciences, Natural Resources, and the Virginia-Maryland Regional College of Veterinary Medicine). The university serves 27,750 students and employs 1,980 full-time teaching and research faculty members.

Virginia Tech has evolved into a position of increasing national prominence since its founding in 1872, consistently ranking among the nation's top universities for undergraduate and graduate programs. The university also ranks among the top 50 institutions in the United States in annual research expenditures as reported by the National Science Foundation.

The university is an agency of the Commonwealth of Virginia, and therefore included as a component unit in the Commonwealth of Virginia's *Comprehensive Annual Financial Report*. The 14 members of the Virginia Tech Board of Visitors govern university operations. Members of the board are appointed by the governor of the Commonwealth of Virginia.

OVERVIEW

This unaudited Management's Discussion and Analysis (MD&A) is required supplemental information under the Governmental Accounting Standards Board's (GASB) reporting model. It is designed to assist readers in understanding the accompanying financial statements and provides an objective, easily readable analysis of the university's financial activities based on currently known facts, decisions, and conditions. This discussion includes an analysis of the university's financial condition and results of operations for the fiscal year ended June 30, 2003. Comparative numbers are for the fiscal year ended June 30, 2002. Since this presentation includes highly summarized data, it should be read in conjunction with the accompanying basic financial statements (including notes), and other supplementary information. The university's management is responsible for all of the financial information presented, including this discussion and analysis.

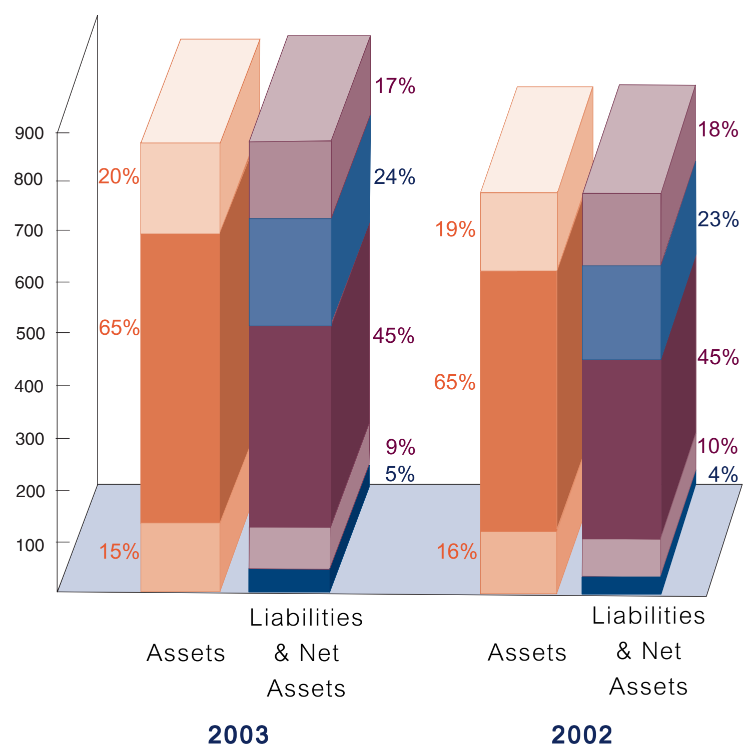
The university's financial statements have been prepared in accordance with GASB Statement Number 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities,* as amended by GASB Statement Numbers 37 and 38. The three required financial statements are the Statement of Net Assets (balance sheet), the Statement of Revenues, Expenses, and Changes in Net Assets (operation statement), and the Statement of Cash Flows. These statements are summarized and analyzed in the following paragraphs. Combining schedules are included in the supplementary information. These schedules indicate how major fund groups were aggregated to arrive at the single column totals.

STATEMENT OF NET ASSETS

The Statement of Net Assets (SNA) presents the assets, liabilities, and net assets of the university as of the end of the fiscal year. The purpose of the statement is to present a snapshot of the university's financial position to the readers of the financial statements.

The data presented in the SNA aids readers in determining the assets available to continue the operations of the university. It also allows readers to determine how much the university owes to vendors, investors, and lending institutions. Finally, the SNA provides a picture of net assets and their availability for expenditure by the university. Sustained increases in net assets over time are one indicator of the financial health of the organization.

The mix of Assets, Liabilities, and Net Assets
is basically unchanged over the past two fiscal years
(all dollars in millions)



The university's net assets are classified as follows:

➢ Invested in capital assets—Invested in capital assets, net of related debt represents the university's total investment in capital assets, net of accumulated depreciation and outstanding debt obligations related to those capital assets. Debt incurred, but not yet expended for capital assets, is not included as a component of invested in capital assets, net of related debt.

➢ Restricted net assets, expendable—Expendable restricted net assets include resources the university is legally or contractually obligated to expend in accordance with restrictions imposed by external third parties. These assets partially consist of quasi-endowments totaling $35.9 million. The quasi-endowments are managed by the Virginia Tech Foundation.

➢ Restricted net assets, nonexpendable—Nonexpendable restricted net assets consist of endowment and similar type funds where donors or other outside sources have stipulated, as a condition of the gift instrument, the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, to be expended or added to principal. The Virginia Tech Foundation, Inc. (VTF) is an affiliated corporation that receives gifts to support university programs as described in Notes 1 and 2 of the Notes to Financial Statements and in the supplementary information. Since VTF is currently not reported as a component unit of the university, the amount of nonexpendable endowments included in the university's financial statements was only $0.4 million. The foundation owned or managed for the university endowments and similar funds with a market value exceeding $331.7 million at June 30, 2003.

➢ Unrestricted net assets—Unrestricted net assets represent resources used for transactions relating to academic departments and general operations of the university, and may be used at the discretion of the university's board of visitors to meet current expenses for any lawful purpose in support of its primary missions of instruction, research, and outreach or public service. The resources are derived from student tuition and fees, state appropriations, recoveries of facilities and administrative (indirect) costs, and sales and services of auxiliary enterprises and educational departments. The auxiliary enterprises are self-supporting activities that provide services for students, faculty, and staff. Some examples of the university's auxiliaries include student residential and dining programs, and intercollegiate athletics.

SUMMARY OF ASSETS, LIABILITIES, AND NET ASSETS

For the years ended June 30, 2003 and 2002
(all dollars in millions)

	2003	2002	Increase (Decrease) Amount	Increase (Decrease) Percent
ASSETS				
Current assets	$170.0	$150.7	$ 19.3	12.8%
Capital assets, net of accumulated depreciation	557.8	498.9	58.9	11.8%
Other assets	133.4	120.1	13.3	11.1%
Total assets	$861.2	$769.7	$ 91.5	11.9%
LIABILITIES				
Current liabilities	$148.7	$140.2	$ 8.5	6.1%
Non-current liabilities	206.8	181.0	25.8	14.3%
Total liabilities	$355.5	$321.2	$ 34.3	10.7%
NET ASSETS				
Invested in capital assets, net of related debt	$386.3	$344.0	$ 42.3	12.3%
Restricted	80.2	73.7	6.5	8.8%
Unrestricted	39.2	30.8	8.4	27.3%
Total net assets	$505.7	$448.5	$ 57.2	12.8%

Total university assets increased by $91.5 million or 11.9% during fiscal year 2003, bringing the total to $861.2 million at year-end. Almost 65% of the growth was directly related to a net increase of $58.9 million in capital assets, discussed in the next section of this analysis. Current assets also rose by $19.3 million over the prior year. This increase was due to a $21.4 million rise in current cash and cash equivalents. Revenue generated by non-revertible fund sources, such as facilities and administrative (indirect) cost recoveries and sales and services of auxiliary enterprises, is the primary reason for the growth in cash and cash equivalents. Facilities and administrative (indirect) cost recoveries rose by over $4.2 million as a result of the upward trend in sponsored program activity the university experienced over the past fiscal year. Auxiliary enterprise cash and cash equivalents balances have increased as a result of revenues generated from ticket sales related to the Lane Stadium Expansion Project (south end zone), the assessment of the athletic capital fee, and collections from the university's pouring rights contract. The additional cash generated by the Athletic Auxiliary will be used to cover future years' debt service cost related to the expansion. Minimal decreases in accounts receivable and in the amount due from the Commonwealth of Virginia, $1.7 million and $1.5 million, respectively, partially offset the growth noted in current cash and cash equivalents.

Total university liabilities increased by $34.3 million or 10.7% during fiscal year 2003. Much of this increase in total liabilities can be attributed to a net increase in non-current liabilities of $25.8 million. This change is discussed in the Capital Asset and Debt Administration section. Current liabilities had a net increase of $8.5 million over the previous year due to growth in accounts payable and accrued liabilities. The $13.0 million rise in accounts payable and accrued liabilities is due to an increase in accrued severance expense payable and in general accounts payable. Accrued severance expense payable grew from $7.1 million in 2002 to $14.0 million in 2003. This severance liability is the result of university employees being laid off on or before the end of fiscal year 2003 to meet the reductions in state general fund appropriations from the commonwealth. Not all of these layoffs were involuntary. Under certain conditions, employees could elect to be laid off in place of employees originally targeted. Laid off employees could convert their severance pay to retirement contributions under the provisions of the Alternative Severance Options. Severance payments converted to retirement contributions were to be paid to the Virginia Retirement System (VRS) within 12 months of the retirement date. The university elected to pay $6.7 million of the amount due to the VRS at the beginning of fiscal year 2004. The remaining liability is a result of employees with retirement dates during fiscal year 2003 with the liability to be paid over the next 12 months. General accounts payable also grew by about $7.0 million over the past year. This growth was primarily due to an increase in payables to subcontractors under sponsored program agreements and an increase in capital project payables. The expansion noted previously was partially offset by a $5.5 million decrease in deferred revenue. Tobacco Indemnification Commission funds available in the prior fiscal year were spent in fiscal year 2003 resulting in the decrease in deferred revenue.

Total assets grew by a greater margin than total liabilities with the university's net assets increasing by a corresponding amount of $57.2 million. This amount represents substantial growth from the $7.4 million increase experienced in fiscal year 2002. Invested in capital assets, net of related debt, accounted for $42.3 million of the increase in the current fiscal year (see discussion below).

CAPITAL ASSET AND DEBT ADMINISTRATION

One of the critical factors in continuing the quality of the university's academic, research, and residential life operations is the development and renewal of its capital assets. The university continues to maintain and upgrade its current structures as well as pursue opportunities for additional facilities. Investment in new and upgrade of current structures serves to facilitate current high-quality instructional programs, residential lifestyles, and expand research facilities to position the university to meet its goal to become a "top 30" research institution by 2010.

Note 8 of the Notes to Financial Statements describes the university's significant investment in depreciable capital assets with gross additions of $51.5 million during fiscal year 2003. The capitalization of the Lane Stadium Expansion project was the primary component of building additions totaling $7.4 million. Ongoing investments in instructional, research, and computer equipment totaled $24 million. Depreciation expense was $44.1 million with net retirements of $1.3 million resulting in a net increase in depreciable capital assets of $6.1 million. The Chemistry/Physics and Bioinformatics projects were the major contributors to the increase in the non-depreciable assets category, Construction in Progress (CIP). The largest decrease in CIP was from the completion of the Lane Stadium Expansion project. The growth in Land is due to the donation of the Fort Pickett property from the federal government valued at over $14 million.

Non-current liabilities had a net increase of $25.8 million. During fiscal year 2003, the university issued $29.2 million (net of a bond premium of $1.2 million) in notes payable to the Virginia College Building Authority who issued bonds on behalf of the university through its Pooled Bonds Program to finance the following projects: Bioinformatics Phase I ($21.9 million), the Career Services building ($4.4 million), and the Electric Service facility ($2.9 million). The university also issued $975,000 of 9 (c) general obligation bonds to finance the construction of parking projects. Additionally, the university issued $14.4 million of 9 (c) general obligation bonds to refund $15.2 million of section 9 (c), resulting in a gain of $731,000 that will be amortized over the life of the new debt. The Student Services and Southgate Center Addition buildings were leased to the university by the Virginia Tech Foundation for $9.7 million resulting in a net increase of $7.8 million in capital leases payable. These increases were partially offset by the normal reclassification of $14.1 million from the non-current to the current category for the amount being retired in the next fiscal year (see Note 11 in the Notes to the Financial Statements). Installment purchases decreased, as well, from $2.7 million to $108,000 when the university paid the amount owed to the Virginia Department of Treasury's Master Equipment Lease Program.

Commitments to construction contractors, architects, and engineers for capital projects totaled $60.5 million as of June 30, 2003. Two projects constituted most of this total: the Virginia Tech Alumni and Conference Center Complex—comprising The Inn at Virginia Tech, Skelton Conference Center, and Holtzman Alumni Center—for $31.2 million and the Bioinformatics Phase II for $15.9 million. These commitments represent only a portion of the university's capital projects authorized by the Commonwealth of Virginia. The table below summarizes authorized capital projects, both current and future, and the major sources of funding for each group.

The education and general portion of the university's capital outlay program represents 14 projects currently in various stages of completion. Some of the larger projects in progress include Bioinformatics Phases I and II, Chemistry/Physics Phase II, and the Agriculture and Natural Resources Research Laboratory. In addition to the capital projects underway, there are 10 approved new construction and renovation projects for instructional and research facilities. These projects include the biology building, the fine arts center, the Institute for Critical Technologies and Applied Science Phase I, and the vivarium facility. The Commonwealth of Virginia will provide the major funding for these projects from the voter-approved Virginia Higher Education Bond Referendum. This referendum provides $900 million in debt-financed capital projects to provide quality educational facilities for the commonwealth's universities and colleges. These bonds are the obligation of the Commonwealth of Virginia. The university will receive $95.3 million of this financing for building construction and renovation projects in support of instructional programs and research initiatives. The university plans to provide additional funding for these projects by issuing $65.7 million in debt.

The university's auxiliary enterprises have approval for 13 capital projects that are also in various stages of completion. Some of the larger projects currently in progress include the Virginia Tech Alumni and Conference Center Complex, Lane Stadium Phase II (west side), and various parking auxiliary projects. Three future capital projects are also approved for auxiliary enterprises including the dining and student union facility. Since auxiliaries are required to be self-supporting, no state general fund capital appropriations are provided for these projects. The projects have been or will be funded from a combination of private gifts, student fees, other customer revenues, and debt financing.

Virginia Tech had authorization for $520.8 million in capital building projects as of June 30, 2003, requiring approximately $202 million in additional debt financing.

In fiscal year 2002, the university secured up to $30 million of short-term financing through Wachovia Bank to cover construction draws and interest expense for the following capital projects: Virginia Tech Alumni and Conference Center Complex, Bioinformatics Phase I, Electric Service facility, and Career Services building. The funds from this line of credit will be repaid from the proceeds of the permanent financing for these projects. At June 30, 2003, the amount owed under this line of credit was $1.3 million, solely for the financing of the Virginia Tech Alumni and Conference Center Complex. Permanent financing for the complex totaling $21.6 million will be issued in November 2003.

The university's bond rating from Moody's has been upgraded from A1 to Aa3. The upgrade, according to Moody's, reflects the strong student demand, balanced operating performance, flexibility to weather tightened state funding, and a healthy cushion for debt and operations. The university continued its high quality AA rating from Standard & Poor's.

FUNDING FOR AUTHORIZED CURRENT AND FUTURE CAPITAL PROJECTS

As of June 30, 2003
(all dollars in millions)

	State Funds (1)	Other University Funds (2)	University Debt Issued Before June 30, 2003	University Debt To Be Issued After June 30, 2003	Total Funding	Cash Basis Project-To-Date Expenses
Current education and general	$ 93.1	$ 26.2	$ 26.5	$ -	$ 145.8	$ 50.6
Current auxiliary enterprise	-	54.2	42.1	129.7	226.0	64.4
Total current	93.1	80.4	68.6	129.7	371.8	115.0
Future education and general	66.7	8.0	-	65.7	140.4	
Future auxiliary enterprise	-	2.3	-	6.3	8.6	-
Total future	66.7	10.3	-	72.0	149.0	-
Total authorized	$ 159.8	$ 90.7	$ 68.6	$ 201.7	$ 520.8	$ 115.0

(1) Includes the general fund, capital appropriations and the general obligation bonds of the Commonwealth of Virginia.
(2) Includes private gifts, auxiliary surpluses, student fees, and other customer revenues.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The operating and non-operating activities creating changes in the university's total net assets are presented in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of the statement is to present all revenues received and accrued, all expenses paid and accrued, and gains or losses from investments and capital assets.

Generally, operating revenues are received for providing goods and services to the various customers and constituencies of the university. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the missions of the university. Salaries and fringe benefits for faculty and staff are the largest type of operating expense. Non-operating revenues are revenues received for which goods and services are not directly provided. State appropriations and gifts, while included in this category, still provide substantial support for paying the operating expenses of the university. Therefore, the university, like most public institutions, will expect to show an operating loss.

SUMMARY OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

For the years ended June 30, 2003 and 2002

(all dollars in millions)

	2003	2002	Increase (Decrease)
Operating revenues	$ 442.1	$ 393.5	$ 48.6
Operating expenses	694.6	696.5	(1.9)
Operating loss	(252.5)	(303.0)	50.5
Non-operating revenues and expenses	252.8	286.1	(33.3)
Income (loss) before other revenues, expenses, gains or losses	0.3	(16.9)	17.2
Other revenues, expenses, gains or losses	56.9	24.3	32.6
Increase in net assets	57.2	7.4	49.8
Net assets—beginning of year	448.5	441.1	7.4
Net assets—end of year	$ 505.7	$ 448.5	$ 57.2

OPERATING REVENUES

Total operating revenues increased by $48.6 million or 12.4% from the prior fiscal year. The increase resulted from growth in student tuition and fee revenue and in federal grant and contract revenue which expanded by $21.7 million and $20.1 million, respectively. The rise in student tuition and fees was expected given the 9.0% increase in both in-state and out-of-state tuition rates for the Fall 2002 semester and the additional $400.00 per student tuition increase for Spring 2003. The tuition assessment allowed the university to partially offset additional state appropriation reductions. Without these fee increases the funding cuts would have resulted in additional layoffs and more extensive program cuts. A large part of the growth in federal grant and contract revenue was directly related to funding received for grants and contracts through the Virginia Bioinformatics Institute. The institute's federal revenues grew by over $4.6 million from the prior fiscal year. The remaining increase in federal funding was spread through various areas of the university. These increases can be attributed to the university's push to become a "top 30" research institution by 2010. Overall, the university's operating revenue increased to $442.1 million in fiscal year 2003, compared to $393.5 million in fiscal year 2002.

NON-OPERATING AND OTHER REVENUES

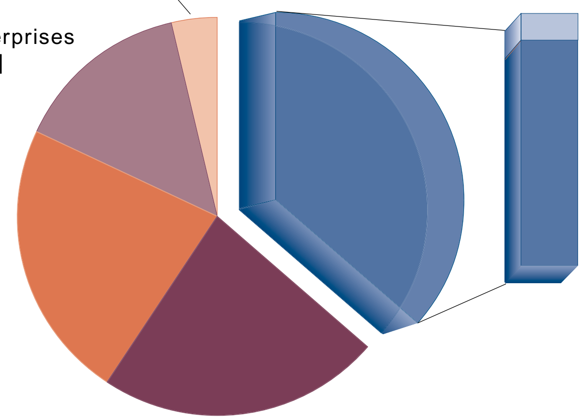
Non-operating revenue decreased by over $33 million from the previous year's total. Due to ongoing economic challenges and their impact on state tax revenues, university state appropriations were reduced by $37.9 million to $214.5 million in fiscal year 2003. This reduction was in addition to the $10.6 million decrease the university experienced in fiscal year 2002. The decline in state appropriations revenue was partially offset by modest increases in gift and investment income resulting in net non-operating revenues of $252.8 million.

Capital revenues, summarized to the right, increased by $32.5 million. This growth was due to a $15.0 million increase in capital appropriations revenue and a $19.8 million increase in capital grants and gifts revenue. The rise in capital appropriations resulted from funding received from the commonwealth through its 21st Century College Program. The program allows the Virginia College Building Authority to issue debt and distribute the proceeds to institutions of higher education to finance specified capital projects. This financing is the debt of the commonwealth, not the university, and the proceeds are allocated to Virginia Tech as non-general fund appropriations. The growth in capital grants and gifts was primarily due to the donation of the Fort Pickett property from the federal government. The donation was valued at over $14 million.

Total revenues increased at a rate greater than total expenses, resulting in an increase to net assets of $57.2 in fiscal year 2003, up from $7.4 million in fiscal year 2002. As noted in the Statement of Net Assets analysis, the majority of the growth in net assets occurred in the invested in capital assets, net of related debt, category which increased by $42.3 million.

The table to the right shows revenue trends over the past two fiscal years.

The following is a graphic illustration of revenues by source (both operating and non-operating) used to fund the university's operating activities for the year ended June 30, 2003. Significant recurring sources of the university's revenues are considered non-operating, as defined by GASB Statement Number 35. These sources are presented in the breakout on the graph below (all dollars in millions).



INCREASE (DECREASE) IN REVENUES

For the years ended June 30, 2003 and 2002

(all dollars in millions)

	2003	2002	Increase (Decrease) Amount	Increase (Decrease) Percent
OPERATING REVENUES				
Student tuition and fees, net of scholarship allowance	$ 159.4	$ 137.7	$ 21.7	15.8 %
Federal, state, local, and nongovernmental grants and contracts	157.6	135.3	22.3	16.5 %
Auxiliary enterprises	99.2	95.6	3.6	3.8 %
Other operating revenue	25.9	24.9	1.0	4.0 %
Total operating revenues	442.1	393.5	48.6	12.4 %
NON-OPERATING ACTIVITY				
State appropriations	214.5	252.4	(37.9)	(15.0)%
Gifts, investment income, interest expense on debt related to capital assets, and other non-operating revenues	38.3	33.7	4.6	(13.7)%
Total non-operating revenues (expenses)	252.8	286.1	(33.3)	(11.6)%
CAPITAL REVENUES, GAINS (LOSSES)				
Capital appropriations	28.3	13.3	15.0	112.8 %
Capital appropriations reverted to the Commonwealth of Virginia	(3.7)	(0.4)	(3.3)	(825.0)%
Capital grants and gifts	33.0	13.2	19.8	150.0 %
Gain (loss) on disposal of capital assets	(0.8)	(1.8)	1.0	55.6 %
Total capital revenues, gains (losses)	56.8	24.3	32.5	133.7 %
Total revenues	$ 751.7	$ 703.9	$ 47.8	6.8 %

TOTAL EXPENSES

The university is committed to recruiting and retaining outstanding faculty and staff. The personnel compensation package is one way to successfully compete with peer institutions and nonacademic employers. The natural expense category, compensation and benefits, comprises 65.6% of the university's total operating expenses. The commonwealth provides merit based or across-the-board salary increases on a periodic basis; however, economic conditions during fiscal year 2003 did not accommodate such increases.

Continued statewide economic uncertainty resulted in significant reductions of state appropriations to the university. These reductions forced the university to implement strategic cost containment measures. These measures included programmatic changes, workforce reductions, and cuts in discretionary spending.

Operating expenses for fiscal year 2003 totaled $694.6 million, down $1.9 million from fiscal year 2002. The net decrease was the result of offsetting variances. The largest reductions were noted in the instruction and public service expense categories which dropped by $5.5 million and $9.6 million, respectively. These decreases were the direct result of the cost containment measures implemented to meet the state appropriation reductions noted above. These reductions are also discussed in the Operating and Non-Operating Revenues analysis. Other areas experiencing decreases included institutional support ($2.0 million) and operations and maintenance of plant ($2.1 million). The largest operating expense increase occurred in the research area, which grew by $13.9 million. The Virginia Bioinformatics Institute experienced the most significant expansion over the prior fiscal year. Of the $13.9 million increase in research expenses, over $8.0 million was generated by the institute. Auxiliary expenses also went up by $3.4 million or 4.0% with the majority of the increase attributable to the Athletics Auxiliary.

The university's operating revenues increased while operating expenses dropped resulting in the operating loss decreasing by $50.5 million over the previous fiscal year. The primary reasons for the drop in the operating loss were the growth in tuition and fee revenue coupled with the operating expense reductions.

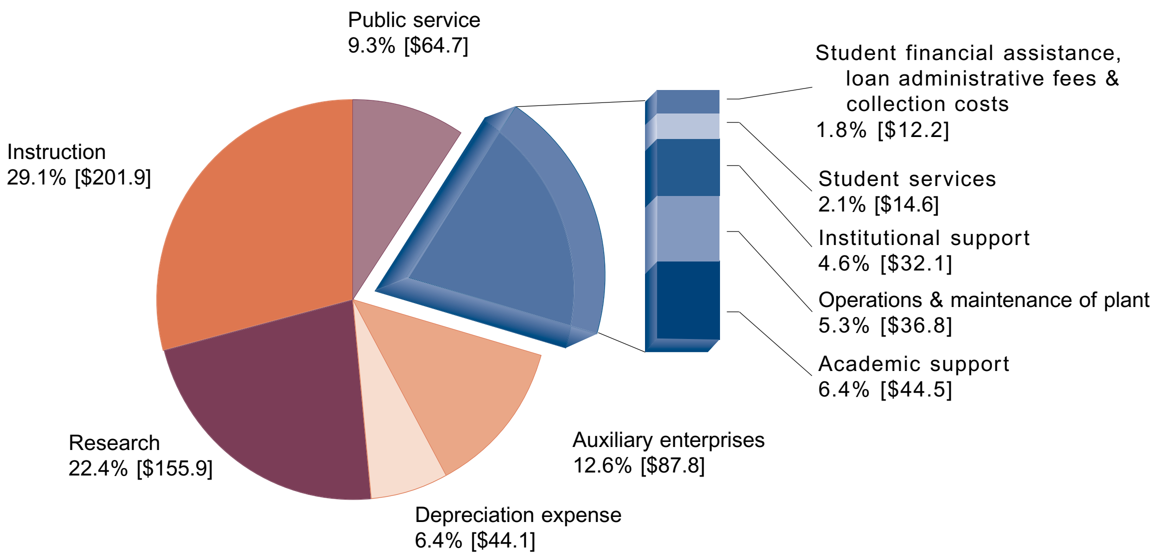
INCREASE (DECREASE) IN OPERATING EXPENSES BY FUNCTION

For the years ended June 30, 2003 and 2002

(all dollars in millions)

			Increase (Decrease)	
	2003	2002	Amount	Percent
Instruction	$ 201.9	$ 207.4	$ (5.5)	(2.7)%
Research	155.9	142.0	13.9	9.8 %
Public service	64.7	74.3	(9.6)	(12.9)%
Auxiliary enterprises	87.8	84.4	3.4	4.0 %
Depreciation expense	44.1	44.9	(0.8)	(1.8)%
Subtotal	554.4	553.0	1.4	0.3 %
Support, maintenance, and other expenses				
Academic support	44.5	43.9	0.6	1.4 %
Student services	14.6	14.5	0.1	0.7 %
Institutional support	32.1	34.1	(2.0)	(5.9)%
Operations and maintenance of plant	36.8	38.9	(2.1)	(5.4)%
Student financial assistance, loan administrative fees and collection costs	12.2	12.1	0.1	0.8 %
Total support, maintenance, and other expenses	140.2	143.5	(3.3)	(2.3)%
Total expenses	$ 694.6	$ 696.5	$ (1.9)	(0.3)%

The following graphic illustration presents operating expenses by function for the year ended June 30, 2003.



INCREASE (DECREASE) IN OPERATING EXPENSES BY NATURAL CLASSIFICATION

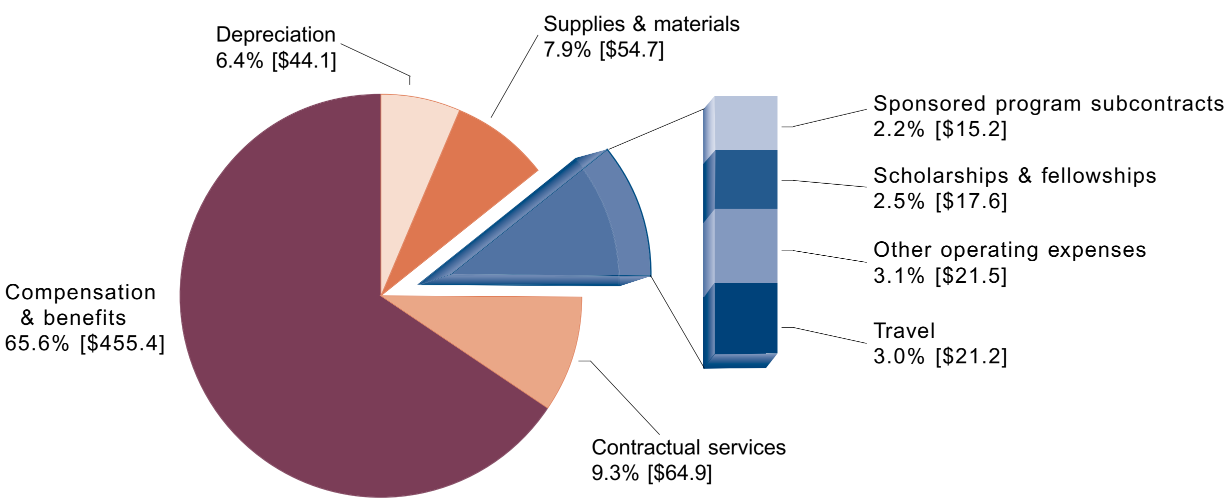
For the years ended June 30, 2003 and 2002

(all dollars in millions)

			Increase (Decrease)	
	2003	2002	Amount	Percent
Compensation and benefits	$ 455.4	$ 458.4	$ (3.0)	(0.7)%
Contractual services	64.9	66.1	(1.2)	(1.8)%
Supplies and materials	54.7	56.4	(1.7)	(3.0)%
Travel	21.2	21.6	(0.4)	(1.9)%
Other operating expenses	21.5	19.6	1.9	9.7 %
Scholarships and fellowships*	17.6	16.9	0.7	4.1 %
Sponsored program subcontracts	15.2	12.6	2.6	20.6 %
Depreciation	44.1	44.9	(0.8)	(1.8)%
Total operating expenses by natural classification	$ 694.6	$ 696.5	$ (1.9)	(0.3)%

* *Includes research grant and contract fellowships, see Note 28 in Notes to Financial Statements.*

The following graphic illustration presents operating expenses by natural classification for the year ended June 30, 2003.



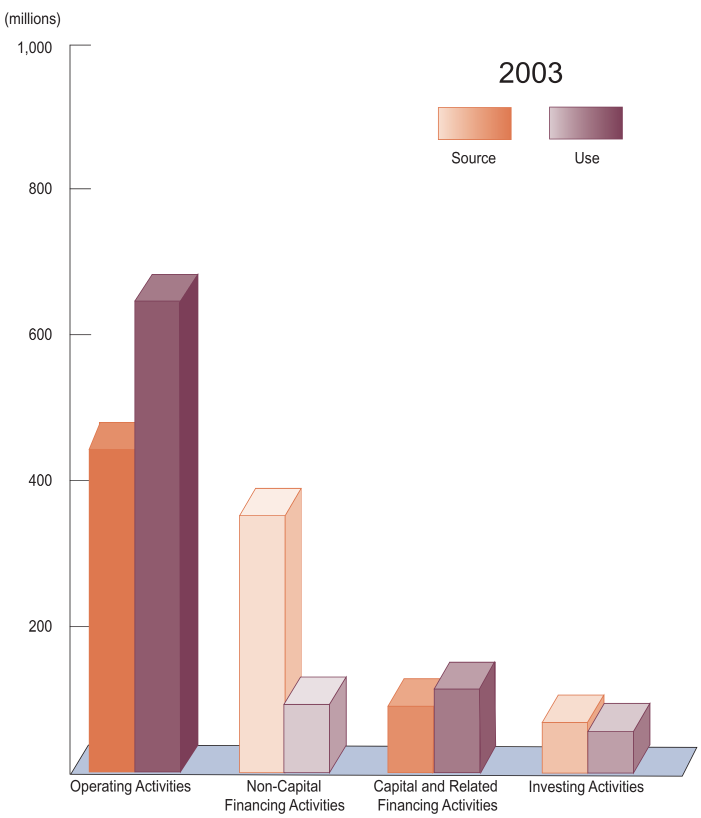
STATEMENT OF CASH FLOWS

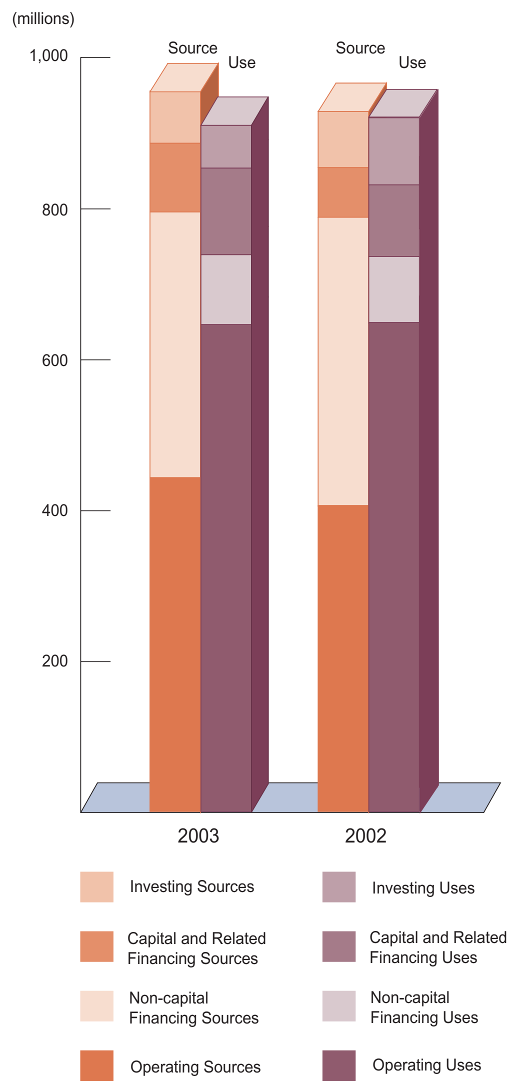
The Statement of Cash Flows presents detailed information about the cash activity of the university during the year. Cash flows from operating activities will always be different from the operating loss on the Statement of Revenues, Expenses and Changes in Net Assets (SRECNA). This difference occurs because the SRECNA is prepared on the accrual basis of accounting and includes non-cash items, such as depreciation expenses, and the Statement of Cash Flows presents cash inflows and outflows without regard to accrual items. The Statement of Cash Flows should help readers assess the ability of an institution to generate future cash flows necessary to meet obligations and evaluate its potential for additional financing.

The statement is divided into five sections. The first section, Cash Flows from Operating Activities, deals with operating cash flows and shows the net cash used by the operating activities of the university. The Cash Flows from Non-capital Financing Activities section is second. GASB required that general appropriations from the commonwealth and non-capital gifts be shown as cash flows from non-capital financing activities. This section reflects the cash received and spending for items other than operating, investing, and capital financing purposes. Cash Flows from Capital and Related Financing Activities, the third section, presents cash used for the acquisition and construction of capital and related items. Included in cash flows from capital financing activities are all plant funds and related long-term debt activities (except depreciation and amortization), as well as gifts to endowments. Cash Flows from Investing Activities, the fourth section, reflects the cash flows from investing activities and shows the purchases, proceeds, and interest received. The last section reconciles the net cash used to the operating income or loss reflected on the Statement of Revenues, Expenses, and Changes in Net Assets.

Major operating activity cash sources for the university included student tuition and fees ($162.4 million), grants and contracts ($151.8 million), and auxiliary enterprise revenues ($98.0 million). Major operating activity uses included compensation and benefits ($452.0 million) and operating expenses ($176.9 million). Operating activity uses significantly exceed operating activity sources due to state appropriations ($214.5 million) and gifts ($43.6 million) being classified as non-capital financial activities.

SOURCES AND USES OF CASH COMPARISONS





The graphs above demonstrate the relationships between sources and uses of cash. Cash inflows from non-capital financing activities are used to balance the cash outflows from operating activities. The graph on the left shows fiscal year 2003 activity grouped by related sources and uses. The graph on the right compares that same activity across fiscal years 2003 and 2002 in a stacked format.

SUMMARY OF CASH FLOWS

For the year ended June 30, 2003 and 2002

(all dollars in millions)

	2003	2002	Increase (Decrease) Amount	Increase (Decrease) Percent
Net cash used by operating activities	$ (203.0)	$ (245.8)	$ 42.8	17.4 %
Net cash provided by non-capital financing activities	258.6	294.0	(35.4)	(12.0)%
Net cash used by capital and related financing activities	(23.7)	(29.6)	5.9	19.9 %
Net cash provided by investing activities	12.5	(14.9)	27.4	183.9 %
Net increase in cash and cash equivalents	44.4	3.7	40.7	1100.0 %
Cash and cash equivalents—beginning of year	118.1	114.4	3.7	3.2 %
Cash and cash equivalents—end of year	$ 162.5	$ 118.1	$ 44.4	37.6 %

ECONOMIC OUTLOOK

The university is closely tied to the Commonwealth of Virginia and reductions in state funding support have had a significant impact on the university. The university expects to have sustained general fund reductions from the commonwealth of $72.5 million, thus losing 27.5% of its overall general fund operating support by the end of fiscal year 2004 as compared to fiscal year 2001. Given that general fund appropriations represented nearly 31% of the support for the university's total operating expenses in 2003, these reductions are substantial. The reductions include cuts in state appropriations for instructional activities, Virginia Cooperative Extension and Agricultural Experiment Stations, Higher Education Equipment Trust Fund, Maintenance Reserve, and Unique Military funding (Virginia Tech Corps of Cadets support). Management has implemented strategic plans and reorganized units and programs. The intent of this action was to minimize the impact on the university's core missions of instruction, research, and public service and to create efficiencies by eliminating or consolidating certain administrative and academic programs.

Offsetting some of the general fund reductions has been accomplished by increases in tuition and fee revenues. Tuition increases in Fall 2002 were used to partially cover the reductions for fiscal years 2003 and 2004. A rare, mid-academic year tuition increase of $400 per student was imposed on all students for the Spring 2003 semester and generated $20.0 million in revenue. The Fall 2003 tuition increase will generate approximately $11.2 million, net of increases in student financial assistance. Despite these tuition and fee increases, the university remains a bargain when compared to the total cost of education at other public institutions in its national peer group as well as other public institutions within the Commonwealth of Virginia. Even with the increases, the university's tuition and fees remain substantially below the 60th percentile of the rates charged by its benchmark institutions. The university also continues to attract quality students with over 78% of its enrolled freshmen ranking in the top 25% of their high school class.

Executive Management believes the university will continue to maintain its solid financial foundation and is well positioned to continue its excellence in teaching, research and public service.

The university looks forward to a period of continued growth and expansion as it works toward the goal to become a "top 30" research university by the year 2010. The financial position of the university is strong as evidenced by its diversified portfolio of research funding, Aa3 rating from Moody's, and AA rating from Standard and Poor's. Outstanding fund-raising capabilities, continued support from the commonwealth, and an impressive university community of students, faculty, and staff also serve to ground the university. Virginia Tech will use these diversified factors to sustain its bright future and incorporate this flexibility along with efforts toward revenue diversification and cost containment to remain Virginia's largest university offering more career options than any other Virginia university.

Even though the university is dealing with reductions in state support, the university's net assets increased by $57.2 million over the last fiscal year. This increase is not the only indicator of the university's ability to surmount these challenging economic times. Virginia Tech continues to have outstanding growth in research and receives an overwhelmingly larger number of students applying than can be accepted.

Management continues to wrestle with the implications of a slow economic recovery, both nationally and in Virginia. Increased strictures on commonwealth spending requirements for state activities such as the Standards of Quality, reimbursement to local governments for the car tax, homeland security, the Medicaid program for the elderly and poor, and retirement benefits for state and local workers create uncertainty as to whether the commonwealth will need to implement additional measures to balance the budget for the upcoming biennium. As a result, it is unclear to what extent institutions of higher education will be further impacted by changes in state support. However, the university's prudent use of resources, cost-containment, reorganization, and strengthening of other revenue streams have allowed non-general fund revenues to grow substantially and sustain a 12.8% growth of net assets between 2002 and 2003 during a period of declining state support and economic weakness. The university's overall financial position remains strong. Management will continue to maintain a close watch over resources to ensure the ability to react to unknown internal and external issues and maintain its current high quality financial position.

STATEMENT OF NET ASSETS

As of June 30, 2003 and 2002
(all dollars in thousands)

	2003	2002 (as restated)
ASSETS		
Current assets		
Cash and cash equivalents (Note 4)	$ 113,557	$ 92,167
Short-term investments (Note 4)	1,003	759
Investments, securities lending (Note 5)	859	811
Accounts receivable, net of allowance for doubtful accounts of $1,198 in 2003 and $1,172 in 2002 (Note 7)	31,121	32,875
Notes receivable, net of allowance for doubtful accounts of $90 in 2003 and $107 in 2002	1,718	2,051
Due from Commonwealth of Virginia (Note 6)	3,272	4,809
Inventories	8,456	7,754
Prepaid expenses	10,022	9,522
Total current assets	170,008	150,748
Non-current assets		
Cash and cash equivalents (Note 4)	48,954	25,929
Short-term investments (Note 4)	6,218	13,645
Accrued interest receivable	186	356
Accounts receivable, net of allowance for doubtful accounts of $759 in 2003 and $602 in 2002 (Note 7)	500	551
Notes receivable, net of allowance for doubtful notes of $200 in 2003 and $162 in 2002	13,035	12,056
Long-term investments (Note 4)	63,822	65,849
Prepaid expenses	736	1,662
Depreciable capital assets, net of accumulated depreciation of $504,372 in 2003 and $478,739 in 2002 (Note 8)	455,266	449,104
Non-depreciable capital assets (Note 8)	102,509	49,803
Total non-current assets	691,226	618,955
Total assets	$ 861,234	$ 769,703
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (Note 9)	$ 90,348	$ 77,331
Obligations under security lending (Note 5)	859	892
Accrued compensated absences (Notes 1, 14)	11,909	13,369
Deferred revenue (Notes 1, 21)	25,496	30,958
Funds held in custody for others	4,654	4,629
Annuities payable (Note 14)	25	25
Bond anticipation notes payable (Note 10)	1,303	895
Long-term debt payable (Notes 6, 11, 12)	14,110	12,067
Total current liabilities	148,704	140,166
Non-current liabilities		
Accrued compensated absences (Notes 1, 14)	16,639	16,558
Federal loan program contributions refundable (Note 14)	13,128	12,710
Annuities payable (Note 14)	1,738	1,277
Long-term debt payable (Notes 6, 11, 12)	175,331	150,471
Total non-current liabilities	206,836	181,016
Total liabilities	$ 355,540	$ 321,182
NET ASSETS		
Invested in capital assets, net of related debt	$ 386,313	$ 344,070
Restricted, nonexpendable	381	375
Restricted, expendable		
Scholarships, research, instruction, and other	47,370	48,634
Loans	2,795	2,878
Capital projects	9,844	8,506
Debt service	19,849	13,245
Unrestricted	39,142	30,813
Total net assets	$ 505,694	$ 448,521

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

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

For the years ended June 30, 2003 and 2002
(all dollars in thousands)

	2003	2002
OPERATING REVENUES		
Student tuition and fees, net of scholarship allowance of $24,020 in 2003 and $20,672 in 2002 (Note 1)	$ 159,419	$ 137,689
Federal appropriations	14,382	13,394
Federal grants and contracts	107,400	87,323
State grants and contracts	14,256	13,240
Local grants and contracts (Note 3)	12,389	13,165
Nongovernmental grants and contracts	23,599	21,603
Sales and services of educational activities	9,223	8,951
Auxiliary enterprise revenue, net of scholarship allowance of $8,987 in 2003 and $9,055 in 2002 (Note 1)	99,182	95,555
Other operating revenues	2,230	2,599
Total operating revenues	442,080	393,519
OPERATING EXPENSES		
Instruction	201,895	207,475
Research	155,927	142,002
Public service	64,715	74,309
Academic support	44,527	43,922
Student services	14,560	14,477
Institutional support	32,088	34,098
Operation and maintenance of plant	36,811	38,918
Student financial assistance	11,996	12,012
Auxiliary enterprises	87,761	84,384
Loan administrative fees and collection costs	204	47
Depreciation expense	44,086	44,880
Total operating expenses	694,570	696,524
OPERATING LOSS	(252,490)	(303,005)
NON-OPERATING REVENUES (EXPENSES)		
State appropriations (Note 19)	214,478	252,387
Gifts	43,229	41,088
Investment income, net of investment expense of $654 in 2003 and $759 in 2002	3,223	327
Other additions	125	116
Interest expense on debt related to capital assets	(8,245)	(7,805)
Net non-operating revenues	252,810	286,113
INCOME (LOSS) BEFORE OTHER REVENUES, EXPENSES, GAINS, OR LOSSES	320	(16,892)
Capital appropriations (Note 20)	28,315	13,289
Capital appropriations reverted to the Commonwealth of Virginia (Note 20)	(3,717)	(444)
Capital grants and gifts	33,044	13,286
Gain (loss) on disposal of capital assets	(789)	(1,804)
Total other revenues	56,853	24,327
Increase in net assets	57,173	7,435
Net assets—beginning of year	448,521	441,086
Net assets—end of year	$ 505,694	$ 448,521

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

STATEMENT OF CASH FLOWS

For the years ended June 30, 2003 and 2002
(all dollars in thousands)

	2003	2002 (as restated)
CASH FLOWS FROM OPERATING ACTIVITIES		
Student tuition and fees	$162,419	$136,887
Federal appropriations	14,382	13,394
Grants and contracts	151,812	140,397
Sales and services of educational activities	9,223	8,951
Auxiliary enterprises	98,044	99,607
Other operating receipts	2,185	2,550
Payments for compensation and fringe benefits	(451,966)	(454,710)
Payments for operating expenses	(176,857)	(180,831)
Payments for scholarships and fellowships	(11,866)	(11,891)
Loans issued to students	(4,626)	(3,786)
Collection of loans from students	4,238	3,683
Net cash used by operating activities	(203,012)	(245,749)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
State appropriations	214,478	252,387
Gifts received for other than capital purposes	43,647	41,345
Federal Direct Lending Program—receipts	70,239	68,874
Federal Direct Lending Program—disbursements	(70,240)	(68,871)
Funds held in custody for others—receipts	23,744	20,365
Funds held in custody for others—disbursements	(23,303)	(20,075)
Net cash provided by non-capital financing activities	258,565	294,025
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital appropriations	24,598	18,807
Capital grants and gifts	16,809	17,202
Proceeds from capital debt	49,655	29,806
Acquisition and construction of capital assets	(74,865)	(70,962)
Principal paid on capital debt and leases	(32,081)	(17,003)
Interest paid on capital debt and leases	(7,809)	(7,473)
Net cash used by capital and related financing activities	(23,693)	(29,623)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	65,936	73,200
Interest on investments	3,393	1,205
Purchase of investments and related fees	(56,774)	(89,327)
Net cash provided by investing activities	12,555	(14,922)
Net increase (decrease) in cash and cash equivalents	44,415	3,731
Cash and cash equivalents—beginning of year	118,096	114,365
Cash and cash equivalents—end of year	$162,511	$118,096

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

STATEMENT OF CASH FLOWS (continued)

For the years ended June 30, 2003 and 2002
(all dollars in thousands)

	2003	2002 (as restated)
RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
Operating loss	$(252,490)	$(303,005)
Adjustments to reconcile operating loss to net cash used by operating activities		
Depreciation expense	44,086	44,880
Changes in assets and liabilities		
Receivables, net of allowance for doubtful accounts	1,492	1,197
Inventories	(702)	(863)
Prepaid items	426	(1,120)
Notes receivable, net of allowance for doubtful accounts	(646)	(499)
Accounts payable and accrued liabilities	6,397	1,575
Accrued payroll	(1,974)	(1,249)
Accrued severance liability	6,823	7,142
Compensated absences	(1,379)	(1,320)
Deferred revenue	(5,462)	7,120
Federal loan program contributions refundable	417	393
Total adjustments	49,478	57,256
Net cash used by operating activities	$(203,012)	$(245,749)
NON-CASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Principal on capital lease debt paid by the Virginia Department of Treasury on behalf of the university	$ 1,414	$ 4,612
Change in accounts receivable related to non-operating income	$ 313	$ 6,487
Capital assets acquired through in-kind donations	$ (17,644)	$ (2,314)
Change in fair value of investments recognized as a component of interest income	$ 3	$ (827)
Change in fair value of interest payable affecting interest paid	$ 436	$ 332
Capital assets acquired through installment purchase agreements	$ 9,736	$ 52
Change in interest receivable affecting interest received	$ 170	$ 51

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

TABLE OF CONTENTS: NOTES TO FINANCIAL STATEMENTS

NOTES TO FINANCIAL STATEMENTS

For the Year Ended June 30, 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Virginia Polytechnic Institute and State University is a public land-grant university serving the Commonwealth of Virginia, the nation, and the world community. The discovery and dissemination of new knowledge are central to its mission. Through its focus on teaching and learning, research, and outreach, the university creates, conveys, and applies knowledge to expand personal growth and opportunity, advance social and community development, foster economic competitiveness, and improve the quality of life.

The university includes all funds and account groups, and all entities over which the university exercises or has the ability to exercise oversight authority for financial reporting purposes.

The university has no component units, as defined by Section 2200, of the Governmental Accounting Standards Board (GASB) *Codification of Governmental Accounting and Financial Reporting Standards;* however, the university does have related party corporations whose combined financial conditions are stated in Note 2. These organizations are separate legal entities from Virginia Tech and the university exercises no control over them. For these reasons, the university's related parties are not included in these financial statements. The component unit designation for university related parties may change when the university implements GASB Statement Number 39, *Determining Whether Certain Organizations are Component Units* in fiscal year 2004.

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. The university is a component unit of the Commonwealth of Virginia and is included in the basic financial statements of the commonwealth.

Financial Statement Presentation

GASB Statement Number 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*, issued November 1999, establishes accounting and financial reporting standards for public colleges and universities within the financial reporting guidelines of GASB Statement Number 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.* The standards are designed to provide financial information that responds to the needs of three groups of primary users of general-purpose external financial reports: the citizenry, legislative and oversight bodies, and investors and creditors. The university is required under this guidance to include Management's Discussion and Analysis (MD&A), and basic financial statements—including notes in its financial statement presentation.

Basis of Accounting

For financial reporting purposes, the university is considered a special-purpose government engaged only in business-type activities. Accordingly, the university's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. All significant intra-agency transactions have been eliminated.

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

Cash Equivalents

For purposes of the statements of net assets and cash flows, the university considers all highly liquid investments with an original maturity of 90 days or less to be cash equivalents.

Investments

In accordance with GASB Statement Number 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, purchased investments, interest-bearing temporary investments classified with cash, and investments received as gifts are recorded at fair value (see Note 4). Changes in unrealized gain (loss) on the carrying value of the investments are reported as a component of investment income in the Statement of Revenues, Expenses, and Changes in Net Assets.

Accounts Receivable

Accounts receivable consists of tuition and fee charges to students and auxiliary enterprise services provided to students, faculty and staff. Accounts receivable also include amounts due from federal, state and local governments, and nongovernmental sources, in connection with reimbursement of allowable expenses made pursuant to the university's grants and contracts. Accounts receivable are recorded net of allowance for doubtful accounts.

Inventories

Inventories are stated at the lower of cost or market (primarily first-in, first-out method) and consist mainly of expendable supplies, fuel for the physical plant, and publications.

Non-current Cash and Investments

Non-current cash and investments are externally restricted to make debt service payments or purchase other non-current assets.

Capital Assets

Capital assets consisting of land, buildings, infrastructure, and equipment are stated at appraised historical cost or actual cost where determinable. Construction in progress and equipment in process is capitalized at actual cost as expenses are incurred. Library materials are valued using published average prices for library acquisitions, and livestock is stated at estimated market value. All gifts of capital assets are recorded at fair market value as of the date of donation.

Equipment is capitalized when the unit acquisition cost is $2,000 or greater and the estimated useful life is one year or more. Renovation costs are capitalized when expenses total more than $100,000, the asset value significantly increases, or the useful life is significantly extended. Routine repairs and maintenance are charged to operating expense in the year the expense is incurred.

Depreciation is computed using the straight-line method over the useful life of the assets. The useful life is 40 to 60 years for buildings, 10 to 50 years for infrastructure and land improvements, 10 years for library books, and 3 to 30 years for fixed and movable equipment. Livestock is not depreciated, as it tends to appreciate over the university's normal holding period.

Special collections are not capitalized due to the collections being: (1) held for public exhibition, education, or research in the furtherance of public service rather than financial gain; (2) protected, kept unencumbered, cared for, and preserved; and (3) subject to university policy requiring the proceeds from the sales of collection items to be used to acquire other items for collections.

Interest Capitalization

Interest expense incurred during the construction of capital assets is capitalized, if material, net of interest income earned on resources set aside for this purpose. The university incurred net interest expense of $945,000 and $619,000 for the fiscal years ended June 30, 2003 and 2002, respectively. Interest capitalized for the fiscal years ended June 30, 2003 and 2002, totaled $945,000 and $472,000, respectively.

Accrued Compensated Absences

Certain salaried employees' attendance and leave regulations make provisions for the granting of a specified number of days of leave with pay each year. The amount reflects, as of June 30, all unused vacation leave, sabbatical leave, and the amount payable upon termination under the Commonwealth of Virginia's sick leave pay out policy. The applicable share of employer related taxes payable on the eventual termination payments is also included. The university's liability and expense for the amount of leave earned by employees but not taken, at June 30, 2003 and 2002, is recorded in the Statement of Net Assets, and is included in the various functional categories of operating expenses in the Statement of Revenues, Expenses, and Changes in Net Assets.

Deferred Revenues

Deferred revenue represents revenues collected but not earned as of June 30, 2003 and 2002. This amount is primarily composed of revenue for grants and contracts, prepaid athletic ticket sales, and prepaid student tuition and fees. See Note 21 for a detailed list of deferred revenue amounts.

Non-current Liabilities

Non-current liabilities include (1) the principal amounts of revenue bonds payable, notes payable, and capital lease obligations with maturities greater than one year and (2) estimated amounts for accrued compensated absences and other liabilities that will not be paid within the next fiscal year.

Net Assets

The university's net assets are classified as follows:

➢ Invested in capital assets, net of related debt—Invested in capital assets, net of related debt represents the university's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

➢ Restricted net assets, expendable—Expendable restricted net assets include resources for which the university is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

➢ Restricted net assets, nonexpendable—Nonexpendable restricted net assets consist of endowment and similar type funds where donors or other outside sources have stipulated, as a condition of the gift instrument, the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, to be expended or added to principal.

➢ Unrestricted net assets—Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, recoveries of facilities and administrative (indirect) cost, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions relating to the educational departments and the general operations of the university, and may be used at the discretion of the university's board of visitors to meet current expenses for any lawful purpose.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the university's policy is to first apply the expense towards restricted resources, and then towards unrestricted resources.

Income Taxes

The university, as a political subdivision of the Commonwealth of Virginia, is excluded from federal income taxes under Section 115 (1) of the Internal Revenue Code, as amended.

Classifications of Revenues

The university has classified its revenues as either operating or non-operating revenues according to the following criteria:

➢ Operating revenues—Operating revenues include activities that have the characteristics of exchange transactions, such as (1) student tuition and fees, net of scholarship allowance; (2) sales and services of auxiliary enterprises, net of scholarship allowance; (3) most federal, state, local, and nongovernmental grants and contracts and federal appropriations; and (4) interest on institutional student loans.

➢ Non-operating revenues—Non-operating revenues are revenues received for which goods and services are not provided. State appropriations, gifts, and other revenue sources that are defined as non-operating revenues by GASB Statement Number 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, and GASB Statement Number 34, *Basic Financial Statements and Management's Discussion and Analysis—for State and Local Governments* are included in this category.

Scholarship Allowance

Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship allowance in the Statement of Revenues, Expenses, and Changes in Net Assets. Scholarship allowance is the difference between the stated charge for goods and services provided by the university and the amount paid by students and/or third parties making payments on the students' behalf. Financial aid to students is reported using the alternative method as prescribed by the National Association of College and University Business Officers (NACUBO). The alternative method is an algorithm that computes scholarship allowance on a university-wide basis.

Restatement of Prior Year Amounts

The restatement of prior year amounts relates to the treatment of capital appropriations available at the end of the fiscal year. A capital appropriations receivable of $8,521,000 was reported on the Statement of Net Assets (SNA) and no cash inflow was reported on the Statement of Cash Flow (SCF) for the amount of appropriations available at year end in fiscal year 2002. Due to the nature of capital appropriations, the actual revenue from the appropriation allotments is available when allotted by the commonwealth. Thus, the university should report unspent capital appropriations as cash on the SNA and report the inflow of cash on the SCF.

The 2002 comparative data presented in these 2003 statements have been restated to reflect the change. The amount noted above has been reclassified from capital appropriations receivable to cash and cash equivalent on the SNA and reported as a cash inflow on the SCF.

2. RELATED PARTIES

The financial statements incorporate the instruction, research, and public service programs of the university. These financial statements do not include the assets, liabilities, and net assets of the related parties that support university programs. The related parties of the university are: Virginia Tech Foundation, Inc.; Virginia Tech Services, Inc.; Virginia Tech Alumni Association; Virginia Tech Athletic Fund, Inc.; Virginia Tech Intellectual Properties, Inc.; Virginia Tech Corps of Cadets Alumni, Inc.; WPI, Inc.; and any of the subsidiaries of these corporations.

The organizations were examined by other auditors whose reports have been furnished to the university. Amounts included for these organizations are based solely upon the reports of the other auditors. The following is a condensed summary of the combined financial positions of these organizations (all dollars in thousands):

	2003	2002
Assets		
Cash and investments	$ 397,719	$ 400,773
Other assets	177,937	173,976
Total assets	$ 575,656	$ 574,749
Liabilities and Net Assets		
Current liabilities	$ 42,899	$ 39,693
Non-current liabilities	82,437	80,307
Net assets	450,320	454,749
Total liabilities and net assets	$ 575,656	$ 574,749

The aggregate revenues and expenses of these organizations, determined as if in consolidation with the university, were $53,369,000 and $57,798,000, respectively, in 2003 and $41,742,000 and $65,716,000, respectively, in 2002.

Virginia Tech Foundation Activity

The foundation receives gifts and expends funds for the benefit of the university. The revenues and expenses of the university include funds expended by the foundation and paid directly to the university of approximately $25,858,000 in 2003 and $33,639,000 in 2002. The university's revenues and expenses also include restricted funds paid by the foundation to parties other than the university on behalf of the university of approximately $9,875,000 in 2003 and $9,828,000 in 2002.

All assets and income of the university's quasi-endowment funds are managed by the foundation through an agency agreement executed with the university.

Related Party Operating Lease Activity

The university has entered into various operating lease agreements with the foundation for rental of facilities. Rental expense related to these agreements totaled $3,662,000 for the fiscal year ended June 30, 2003.

Related Party Capital Lease Activity

The university entered into two capital lease agreements with the foundation effective April 2001. Under the terms of these agreements, the foundation would construct and lease the Student Services and Southgate Center Addition buildings to the university.

The foundation completed construction of the buildings during fiscal year 2003, and the university entered into lease agreement amendments with the foundation to establish lease terms. The lease agreements terminate in 20 years, at which time the title to the buildings will transfer to the university. The capital lease obligation related to these agreements totaled $9,531,000 at June 30, 2003.

3. LOCAL GOVERNMENT SUPPORT

The university, through the operation of its Cooperative Extension Service, maintains offices in numerous cities and counties throughout the Commonwealth of Virginia. Personnel assigned to these locations receive a portion of their compensation from the local governments. Also included in the expenses of these extension offices are unit support services, which include such items as rent, telephone, supplies, equipment, and extension program expenses. The amount contributed by the various local governments totaled $10,935,000 and $11,474,000 in 2003 and 2002, respectively, and has been included in revenues and expenses of the accompanying financial statements. The university received other local government support of $1,454,000 and $1,691,000 in 2003 and 2002, respectively.

4. CASH, CASH EQUIVALENTS, AND INVESTMENTS

The following information is provided with respect to the credit risk associated with the university's cash, cash equivalents, and investments at June 30, 2003 and 2002.

Cash and Cash Equivalents

Pursuant to Section 2.2-1800, et seq., *Code of Virginia*, all state funds of the university are maintained by the Treasurer of Virginia who is responsible for the collection, disbursement, custody, and investment of state funds. Cash deposits held by the university are maintained in accounts that are collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400, et seq., *Code of Virginia*. Cash and cash equivalents represent cash with the treasurer, cash on hand, and cash deposits including certificates of deposit and temporary investments with original maturities of 90 days or less in accordance with GASB Statement Number 9, *Definition of Cash and Cash Equivalents*.

Investments

The investment policy of the university is established by the board of visitors and monitored by the Finance and Audit Committee of the board. Investments fall into two groups: short and long-term. Short-term investments have an original maturity of over 90 days but less than or equal to one year. Long-term investments have an original maturity greater than one year. Credit risk is the risk the university may not be able to obtain possession of its investment instrument or collateral at maturity. The university's investments, including cash equivalents, are categorized as follows to give an indication of the level of credit risk assumed by the university at June 30, 2003 and 2002:

- Category 1—Insured or registered securities or securities held by the university or its agent in the university's name.
- Category 2—Uninsured or unregistered, with securities held by the counter party's trust department or agent in the university's name. The university has no category 2 investments for 2003 or 2002.
- Category 3—Uninsured or unregistered, with securities held by the counter party, or by its trust department or agent but not in the university's name. The university has no category 3 investments for 2003 or 2002.
- Non-categorized investments—Primarily money market and mutual funds, common fund, and pooled investments maintained by Virginia Tech Foundation, Inc.

The categorization of investment risk for assets held on June 30, 2003, follows (all dollars in thousands):

	Category 1	Non-categorized	Fair Value
Cash equivalents			
U.S. government securities and U.S. government agency securities	$ 12,140	$ -	$ 12,140
Money market funds	-	47,123	47,123
Total cash equivalents	12,140	47,123	59,263
Investments: short and long-term			
Current			
U.S. government securities and U.S. government agency securities	292	-	292
Corporate bonds	711	-	711
Total current investments	1,003	-	1,003
Non-current			
U.S. government securities and U.S. government agency securities	32,300	-	32,300
Corporate bonds	1,832	-	1,832
Other—maintained by Virginia Tech Foundation, Inc.	-	35,908	35,908
Total non-current investments	34,132	35,908	70,040
Total investments	35,135	35,908	71,043
Total cash equivalents and investments	$ 47,275	$ 83,031	$ 130,306

The categorization of investment risk for assets held on June 30, 2002, follows (all dollars in thousands):

	Category 1	Non-categorized	Fair Value
Cash equivalents			
U.S. government securities and U.S. government agency securities	$ 1,518	$ -	$ 1,518
Money market funds	-	36,688	36,688
Total cash equivalents	1,518	36,688	38,206
Investments: short and long-term			
Current			
U.S. government securities and U.S. government agency securities	71	-	71
Corporate bonds	688	-	688
Total current investments	759	-	759
Non-current			
U.S. government securities and U.S. government agency securities	39,240	-	39,240
Corporate bonds	3,041	-	3,041
Other—maintained by Virginia Tech Foundation, Inc.	-	37,213	37,213
Total non-current investments	42,281	37,213	79,494
Total investments	43,040	37,213	80,253
Total cash equivalents and investments	$ 44,558	$ 73,901	$ 118,459

5. SECURITIES LENDING TRANSACTIONS

GASB Statement Number 28, *Accounting and Financial Reporting for Securities Lending Transactions*, establishes standards of accounting and financial reporting for transactions where governmental entities transfer securities to broker-dealers and other entities for collateral and simultaneously agree to return the collateral for the same securities in the future.

The investments under securities lending and the securities lending transactions reported on the financial statements represent the university's allocated share of securities received for securities lending transactions held in the general account of the Commonwealth of Virginia. The securities lending investment totaled $859,000 and $811,000 for the fiscal years ended June 30, 2003 and 2002, respectively. The corresponding securities lending obligations are shown on the Statement of Net Assets. For the years ended June 30, 2003 and 2002, respectively, securities lending transactions totaled $26,000 and $41,000 of securities lending income and $22,000 and $37,000 of securities lending cost. These totals have been included as investment income on the Statement of Revenues, Expenses, and Changes in Net Assets. Information related to the credit risk of these investments and securities lending transactions held in the general account is available in the Commonwealth of Virginia's *Comprehensive Annual Financial Report*.

6. HIGHER EDUCATION EQUIPMENT TRUST FUND

The Equipment Trust Fund (ETF) Program was established to provide state-supported institutions of higher education bond proceeds for financing the acquisition and replacement of instructional and research equipment. The program is managed by the Virginia College Building Authority (VCBA). The VCBA issues bonds and uses the proceeds to reimburse the university and other institutions of higher education for equipment purchased. For fiscal years prior to 1999, the VCBA purchased the equipment and leased it to the university. The Statement of Revenues, Expenses, and Changes in Net Assets (SRECNA) includes $1,415,000 and $4,612,000 for the years ended June 30, 2003 and 2002, respectively, in capital appropriations received to cover capital lease payments for equipment purchased in fiscal years prior to 1999. The final payment related to these capital leases was made in 2003. For fiscal years 1999 and following, financing agreements were changed so that the university owns the equipment from the date of purchase. The SRECNA includes $5,072,000 and $6,997,000 for the years ended June 30, 2003 and 2002, respectively, in capital grants and gifts as reimbursement for equipment purchased using the ETF allocation. The line item, Due from the Commonwealth of Virginia, on the Statement of Net Assets totaling $3,272,000 and $4,809,000 for the years ended June 30, 2003 and 2002, respectively, represents equipment purchased by the university not yet reimbursed by VCBA.

7. ACCOUNTS RECEIVABLE

Accounts receivable consists of the following at June 30, 2003 and 2002 (all dollars in thousands):

	2003	2002
Current receivables		
Grants and contracts	$26,816	$27,411
Student tuition and fees	2,094	1,659
Auxiliary enterprises and other operating activities	3,409	4,977
Total current receivables before allowance	32,319	34,047
Less allowance for doubtful accounts	1,198	1,172
Net current accounts receivable	31,121	32,875
Non-current receivables		
Grants and contracts	627	621
Capital gifts and grants	456	350
Auxiliary enterprises and other operating activities	176	182
Total non-current receivables before allowance	1,259	1,153
Less allowance for doubtful accounts	759	602
Net non-current accounts receivable	500	551
Total receivables	$31,621	$33,426

8. CAPITAL ASSETS

A summary of changes in capital assets for the year ending June 30, 2003 is presented as follows (all dollars in thousands):

	Beginning Balance	Additions	Retirements	Adjustments	Ending Balance
Depreciable capital assets					
Buildings	$ 478,510	$20,945	$ 116	$ -	$499,339
Moveable equipment	277,677	24,023	19,375	82	282,407
Fixed equipment	39,060	318	55	-	39,323
Infrastructure	77,895	3,033	-	-	80,928
Library books	54,701	3,160	225	5	57,641
Total depreciable capital assets, at cost	927,843	51,479	19,771	87	959,638
Less accumulated depreciation					
Buildings	166,089	11,786	105	-	177,770
Moveable equipment	192,585	24,512	18,098	101	199,100
Fixed equipment	24,626	1,773	27	-	26,372
Infrastructure	56,823	3,062	-	(103)	59,782
Library books	38,616	2,953	223	2	41,348
Total accumulated depreciation	478,739	44,086	18,453	-	504,372
Total depreciable capital assets, net of accumulated depreciation	449,104	7,393	1,318	87	455,266
Non-depreciable capital assets					
Land	28,964	14,233	426	-	42,771
Livestock	824	-	45	-	779
Construction in progress	20,015	52,167	14,168	-	58,014
Equipment in process	-	945	-	-	945
Total non-depreciable capital assets	49,803	67,345	14,639	-	102,509
Total capital assets, net of accumulated depreciation	$ 498,907	$74,738	$15,957	$ 87	$557,775

A summary of changes in capital assets for the year ending June 30, 2002 is presented as follows (all dollars in thousands):

	Beginning Balance	Additions	Retirements	Ending Balance
Depreciable capital assets				
Buildings	$ 445,262	$ 34,076	$ 828	$ 478,510
Moveable equipment	263,037	30,408	15,768	277,677
Fixed equipment	38,940	1,046	926	39,060
Infrastructure	73,922	4,075	102	77,895
Library books	51,800	3,173	272	54,701
Total depreciable capital assets, at cost	872,961	72,778	17,896	927,843
Less accumulated depreciation				
Buildings	155,108	11,540	559	166,089
Moveable equipment	180,570	25,807	13,792	192,585
Fixed equipment	23,343	1,804	521	24,626
Infrastructure	53,970	2,853	-	56,823
Library books	36,012	2,876	272	38,616
Total accumulated depreciation	449,003	44,880	15,144	478,739
Total depreciable capital assets, net of accumulated depreciation	423,958	27,898	2,752	449,104
Non-depreciable capital assets				
Land	28,964	-	-	28,964
Livestock	907	-	83	824
Construction in progress	15,817	39,736	35,538	20,015
Total non-depreciable capital assets	45,688	39,736	35,621	49,803
Total capital assets, net of accumulated depreciation	$ 469,646	$ 67,634	$ 38,373	$ 498,907

9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2003 and 2002 consist of the following (all dollars in thousands):

	2003	2002
Accounts payable	$ 36,214	$ 29,232
Accrued salaries and wages payable	37,685	39,659
Accrued severance expense payable	13,965	7,142
Retainage payable	2,484	1,298
Total accounts payable and accrued liabilities	$ 90,348	$ 77,331

Retainage payable represents funds held by the university as retainage on various construction contracts for work performed. The retainage will be remitted to the various contractors upon satisfactory completion of the construction projects.

10. BOND ANTICIPATION NOTES

The university entered into a bond anticipation note obligation with Wachovia Bank National Association during fiscal year 2002. The amount available under the note is $30,000,000, as a line of credit, secured by general revenues of the university. The note served as temporary financing for the following capital projects: Virginia Tech Alumni and Conference Center Complex, Bioinformatics Phase II, electric service facility, and career services facility. For the fiscal years ending June 30, 2003 and 2002, the outstanding obligation totaled $1,303,000 and $895,000, respectively.

The university issued $29,210,000 in 9 (d) notes through the Virginia College Building Authority's Pooled Bond Program on November 6, 2002 as permanent financing for three of the four projects noted above. The university issued notes for $21,930,000 for the Bioinformatics Phase II, $4,405,000 for the Career Services building, and $2,875,000 for the Electric Service facility. The university used proceeds from these notes to repay the bond anticipation note obligation to Wachovia related to these three projects.

The balance outstanding at June 30, 2003, is a result of draws for the construction of the Virginia Tech Alumni and Conference Center Complex.

11. SUMMARY OF LONG-TERM INDEBTEDNESS

Bonds Payable

The university has issued two categories of bonds pursuant to section 9 of Article X of the *Constitution of Virginia.*

Section 9 (d) bonds are revenue bonds which are limited obligations of the university payable exclusively from pledged general revenues and are not a debt of the Commonwealth of Virginia, legally, morally, or otherwise. Pledged general revenues include general fund appropriations, student tuition and fees, facilities and administrative (indirect) cost recoveries, auxiliary enterprise revenues, and other revenues not required by law to be used for another purpose. The university has issued section 9 (d) bonds directly through underwriters and also participates in the Public Higher Education Financing Program (Pooled Bond Program) created by the Virginia General Assembly in 1996. Through the Pooled Bond Program, the Virginia College Building Authority issues section 9 (d) bonds and uses the proceeds to purchase debt obligations (notes) of the university and various other institutions of higher education. The notes are secured by the pledged general revenues of the university (see Notes Payable below and Note 12, Detail of Long-term Debt Payable, Notes Payable).

Section 9 (c) bonds are general obligation revenue bonds issued by the Commonwealth of Virginia on behalf of the university and secured by the net revenues of the completed project and the full faith, credit, and taxing power of the Commonwealth of Virginia.

Bond covenants related to some of these bonds, both 9 (c) and 9 (d), established or continued groups of accounts called systems. The Treasurer of Virginia holds these systems in trust for managing the net revenues and debt service of certain university auxiliaries. The revenue bonds issued by the Dorm and Dining Hall System, the University Services System (comprised of the Student Centers, Recreational Sports, and Student Health auxiliaries), and the Utility System (the Electric Service auxiliary) are secured by a pledge of each system's net revenues generated from student or customer fees, and are further secured by the pledged general revenues of the university.

Notes Payable

Notes payable are debt obligations between the Virginia College Building Authority (VCBA) and the university. The VCBA issues bonds through the Pooled Bond Program and uses the proceeds to purchase debt obligations (notes) of the university. The notes are secured by the pledged general revenues of the university.

Capital Leases

Capital leases represent the university's allocations from the Higher Education Equipment Trust Fund (ETF) managed by the VCBA for the purpose of acquiring equipment under lease agreements with the authority and the university's obligation to the Virginia Tech Foundation for lease agreements related to the Student Services and Southgate Center Addition buildings. The assets under capital leases are recorded at the net present value of the minimum lease payments during the lease term.

Installment Purchase Obligations

The university has entered into various installment purchase contracts to finance the acquisition of equipment. The length of the purchase agreements range from two to five years with variable rates of interest. The outstanding principal is included in the long-term debt payable line item on the Statement of Net Assets. There were no future interest commitments on installment purchase obligations

A summary of changes in long-term debt payable activity for the year ending June 30, 2003 is presented as follows (all dollars in thousands):

	Beginning Balance	Additions	Retirements	Ending Balance	Current Portion
Bonds payable					
Section 9 (c) general obligation revenue bonds	$ 45,296	$ 16,127	$ 19,934	$ 41,489	$ 5,103
Section 9 (d) revenue bonds	62,395	-	4,045	58,350	5,480
Notes payable	50,385	30,458	880	79,963	3,115
Capital lease obligations	1,747	9,736	1,952	9,531	340
Installment purchase obligations	2,715	-	2,607	108	72
Total long-term debt payable	$ 162,538	$ 56,321	$ 29,418	$ 189,441	$ 14,110

A summary of future principal commitments for fiscal years subsequent to June 30, 2003 is presented as follows (all dollars in thousands):

Year ending June 30:	Section 9 (c) Bonds	Section 9 (d) Bonds	Notes Payable	Capital Lease Obligations	Installment Purchase Obligations	Total Long-Term Debt Payable
2004	$ 5,103	$ 5,480	$ 3,115	$ 340	$ 72	$ 14,110
2005	3,450	3,590	3,695	355	20	11,110
2006	3,636	3,785	3,765	375	15	11,576
2007	3,815	3,990	3,840	395	1	12,041
2008	3,993	4,195	2,505	415	-	11,108
2009 – 2013	13,568	20,225	14,460	2,430	-	50,683
2014 – 2018	7,145	15,645	18,490	3,140	-	44,420
2019 – 2023	145	1,440	16,620	2,081	-	20,286
2024 – 2028	-	-	12,225	-	-	12,225
Less: Unamortized premium (discount)	(100)	-	1,248	-	-	1,148
Add: Deferral on debt defeasance	734	-	-	-	-	734
Total future principal requirements	$41,489	$58,350	$79,963	$ 9,531	$108	$ 189,441

A summary of future interest commitments for fiscal years subsequent to June 30, 2003 is presented as follows (all dollars in thousands):

Year's ending June 30:	Section 9 (c) Bonds	Section 9 (d) Bonds	Notes Payable	Capital Lease Obligations	Total Interest
2004	$ 1,971	$ 3,151	$ 3,733	$ 341	$ 9,196
2005	1,755	2,862	3,616	329	8,562
2006	1,579	2,669	3,479	317	8,044
2007	1,403	2,456	3,328	304	7,491
2008	1,212	2,251	3,191	290	6,944
2009 – 2013	3,677	8,003	13,978	1,216	26,874
2014 – 2018	987	2,324	9,851	744	13,906
2019 – 2023	8	120	5,002	163	5,293
2024 – 2028	-	-	1,454	-	1,454
Total future interest requirements	$ 12,592	$ 23,836	$ 47,632	$ 3,704	$ 87,764

12. DETAIL OF LONG-TERM DEBT PAYABLE

Bonds Payable

Bonds payable at June 30, 2003 and 2002 consists of the following (all dollars in thousands):

	Interest rates	Maturity	2003	2002
Revenue Bonds:				
Dormitory and dining hall system:				
Series 1996B, issued $3,020 **	3.80% - 5.70%	2004	$ 440	$ 860
Series 1996B, issued $5,475 **	3.80% - 5.35%	2009	2,935	3,345
Series 1996B, issued $1,730	3.80% - 5.70%	2016	1,395	1,470
Utility system, series 1996D, issued $2,570 **	3.80% - 5.35%	2009	1,375	1,570
Veterinary medicine, series 1996A, issued $1,040 **	3.80% - 5.75%	2008	525	610
Northern Virginia Graduate Center, series 1996A, issued $10,080 **	3.80% - 5.75%	2020	8,490	8,790
Architectural/engineering, series 1996A, issued $6,805	3.80% - 5.50%	2016	5,510	5,795
Athletic facility – addition, series 1996A, issued $3,540	3.80% - 5.75%	2004	1,630	2,020
Athletic facility – improvements, series 1996A, issued $6,250	3.80% - 5.75%	2016	4,895	5,150
Coal fired facility, series 1996A, issued $11,035	3.80% - 5.50%	2016	8,935	9,400
Donaldson Brown Hotel and Conference Center:				
Series 1996A, issued $3,945	3.80% - 5.50%	2016	3,195	3,360
Series 1996A, issued $2,495	3.80% - 5.50%	2016	1,960	2,060
University services systems:				
Student Health and Fitness Center, series 1996C, issued $21,175	3.80% - 5.50%	2016	17,065	17,965
Total revenue bonds			58,350	62,395
General Obligation Revenue Bonds:				
Dormitory and dining hall system:				
Series 1992C, issued $4,990 – partial refunding – refinanced *	5.10% - 5.80%	2004	-	470
Series 1992D, issued $2,680 – partial refunding – refinanced *	4.60% - 5.60%	2006	-	535
Series 1992D, issued $2,790 – partial refunding – refinanced *	4.60% - 5.60%	2006	-	555
Series 1993B, issued $3,050 – refunding series 1991A – refinanced *	3.50% - 5.00%	2011	-	2,871
Series 1996, issued $272 – refunding series 1991A **	4.75%	2003	-	258
Series 1997, issued $15,895	3.79% - 5.40%	2017	13,020	13,655
Series 1998, issued $3,158 – refinanced 1992C **	3.50% - 4.70%	2013	3,028	3,050
Series 1998, issued $1,380 – refinanced 1992D **	3.50% - 4.70%	2013	1,330	1,339
Series 1998, issued $1,440 – refinanced 1992D **	3.50% - 4.70%	2013	1,388	1,397
Series 2000, issued $3,255	4.00% - 5.50%	2018	2,670	2,790
Series 2000A, issued $1,800	4.75% - 5.25%	2019	1,615	1,680
Series 2002, issued $468 – refunding series 1992C *	2.50% - 4.00%	2004	244	-
Series 2002, issued $538 – refunding series 1992D *	2.50% - 4.00%	2006	421	-
Series 2002, issued $558 – refunding series 1992D *	2.50% - 4.00%	2006	437	-
Series 2003A, issued $2,694 – refunding series 1993B *	2.50% - 4.00%	2011	2,694	-

	Interest rates	Maturity	2003	2002
Telecommunication, series 1989A, issued $24,259	6.40% - 7.20%	2004	1,724	3,445
University services system – student center:				
Series 1993A, issued $10,885 – refunding series 1988B – refinanced *	3.75% - 5.20%	2008	-	6,780
Series 1993B, issued $942 – refunding series 1990B – refinanced *	3.50% - 5.00%	2010	-	806
Series 1993B, issued $1,987 – refunding series 1991A – refinanced *	3.50% - 5.00%	2011	-	1,870
Series 1996, issued $176 – refunding series 1991A**	4.75%	2003	-	167
Series 2003A, issued $5,457 – refunding series 1993A*	2.50% - 5.50%	2008	5,457	-
Series 2003A, issued $684 – refunding series 1993B*	2.50% - 5.50%	2010	684	-
Series 2003A, issued $1,755 – refunding series 1993B*	2.50% - 5.50%	2011	1,755	-
Parking facilities:				
Series 1993B, issued $2,569 – refunding series 1991A – refinanced*	3.50% - 5.00%	2011	-	2,418
Series 1996, issued $230 – refunding series 1991A **	4.75%	2003	-	217
Series 1997, issued $1,550	5.00%	2017	1,235	1,295
Series 2002, issued $975	5.00%	2017	885	-
Series 2003A, issued $2,268 – refunding series 1993B*	2.50% - 5.50%	2011	2,268	-
Unamortized discount			(100)	(302)
Deferral on debt defeasance			734	-
Total general obligation revenue bonds			41,489	45,296
Total bonds payable			$ 99,839	$ 107,691

* *See Bond defeasance – current year*

* * *See Bond defeasance – previous years*

Notes Payable

Notes payable to VCBA under the pooled 9 (d) bond program at June 30, 2003 and 2002 consists of (all dollars in thousands):

	Average coupon rate	Maturity	2003	2002
Dormitory and dining hall system:				
Series 1999, issued $10,145	4.53%	2018	$ 8,715	$ 9,090
Series 1999A, issued $10,905	5.73%	2019	10,190	10,555
Utility system:				
Series 2000A, issued $2,925	5.25%	2020	2,765	2,855
Series 2002A, issued $2,875	5.19%	2023	2,875	-
Infectious waste facility, series 2000A, issued $1,640	5.25%	2020	1,550	1,600
Stadium expansion, series 2001A, issued $26,285	4.60%	2026	26,285	26,285
Biomedical facility, series 2002A, issued $21,930	5.11%	2027	21,930	-
Career services facility, series 2002A, issued $4,405	5.19%	2023	4,405	-
Unamortized premium (discount)			1,248	-
Total notes payable			$ 79,963	$ 50,385

Other Long-term Debt

Other long-term debt at June 30, 2003 and 2002 consists of:

	2003	2002
Capital leases payable for Higher Education Equipment Trust Fund with interest rates of 4.10% to 5.35% and for agreements related to the Student Services and Southgate Center Addition buildings.	$ 9,531	$ 1,747
Installment purchase obligations for equipment purchases through June 2003 with various interest rates and maturing through 2007. The book value of capitalized equipment is $3,017 for 2003 and $3,357 for 2002.	108	2,715
Total other long-term debt	$ 9,639	$ 4,462

Total Long-term Debt Payable Summary

	2003	2002
Total bonds payable	$ 99,839	$107,691
Total notes payable	79,963	50,385
Total other long-term debt	9,639	4,462
Total long-term debt payable	$189,441	$162,538

13. BOND DEFEASANCE

Current Year

The university issued $14,422,000 of section 9 (c) general obligation revenue bonds to refund $15,153,000 of section 9 (c) debt in fiscal year 2003. The resulting net gain of $731,000 will be amortized over the life of the new debt. For financial reporting purposes, these bonds are considered an in-substance defeasance and have therefore been removed from the long-term debt payable line item of the Statement of Net Assets. The assets in escrow have similarly been excluded. The current year amortization of the accounting net gain recognized on the 1992 series refundings resulted in a loss of $4,000. The details of each bond issue refunded are presented below (all dollars in thousands):

	True Interest Cost	Bonds Refunded	Refunding Bonds Issued	Accounting Gain (Loss)	Reduction in Debt Service	Gain Discounted at TIC	Defeased Debt
Series 1992C, issued $4,900	3.19%	$ 470	$ 468	$ 2	$ 23	$ 23	$ 240
Series 1992D, issued $2,790	3.19%	555	558	(3)	28	28	425
Series 1992D, issued $2,680	3.19%	535	538	(3)	27	27	410
Series 1993A, issued $10,885, refunding series 1988B	2.65%	5,780	5,457	323	427	394	5,780
Series 1993B, issued $942, refunding series 1990B	2.65%	719	684	35	41	37	719
Series 1993B, issued $3,050, refunding series 1991A	2.65%	2,845	2,694	151	193	170	2,845
Series 1993B, issued $1,987, refunding series 1991A	2.65%	1,853	1,755	98	126	110	1,853
Series 1993B, issued $2,569, refunding series 1991A	2.65%	2,396	2,268	128	163	143	2,396
Total		$15,153	$14,422	$731	$1,028	$932	$14,668

Previous Years

In previous fiscal years in accordance with Governmental Accounting Standards Board Statement Number 7, *Advance Refundings Resulting in the Defeasance of Debt*, we have excluded from our financial statements the assets in escrow and the section 9 (c) or 9 (d) bonds payable that were defeased in-substance. For the years ended June 30, 2003 and 2002, bonds payable considered defeased in previous years totaled $23,800,000 and $26,115,000, respectively.

14. CHANGE IN OTHER LIABILITIES

A summary of changes in other liabilities for the year ended June 30, 2003 follows (all dollars in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Accrued compensated absences	$ 29,927	$ 16,885	$ 18,264	$ 28,548	$ 11,909
Federal loan program contribution refundable	12,710	456	38	13,128	-
Annuities payable	1,302	638	177	1,763	25
Total other liabilities	$ 43,939	$ 17,979	$ 18,479	$ 43,439	$ 11,934

15. LEASE COMMITMENTS

The university is committed under various operating leases for equipment and space. In general, the leases are for a three to five-year term and the university has renewal options. During the normal course of business the university expects similar leases will replace these leases. Rental expense was approximately $13,541,000 and $11,982,000 for the years ended June 30, 2003 and 2002, respectively.

A summary of future minimum lease payments under operating leases as of June 30, 2003, follows (all dollars in thousands):

Year's ending June 30:	2004	$ 6,729
	2005	4,687
	2006	3,958
	2007	3,160
	2008	845
	2009 – 2013	3,050
	2014 – 2018	3,018
	Total	$ 25,447

16. CAPITAL IMPROVEMENT COMMITMENTS

The amounts listed below represent the value of obligations remaining on capital improvement project contracts. These obligations are for future effort and as such have not been accrued as expenses or liabilities on the university's financial statements. Outstanding contractual commitments for capital improvement projects at June 30, 2003, included (all dollars in thousands):

Virginia Tech Alumni and Conference Center Complex	$ 31,150
Bioinformatics Phase II	15,871
Bioinformatics Phase I	2,937
Career Services building	2,859
Livestock arena	2,048
Chemistry/Physics Phase II	1,173
Electric service facility	981
Upper quad conversion	883
Other projects	2,570
Total	$ 60,472

These commitments are funded by the following: $21,945,000 from general obligation bond proceeds, $18,929,000 from capital appropriations, $16,607,000 from auxiliary enterprise funds, $1,335,000 from facilities and administrative (indirect) cost recoveries and university education and general funds, $987,000 from state general appropriations, and $669,000 from private funds.

17. CONTRIBUTIONS TO PENSION PLANS

Virginia Retirement System

Employees of the university are employees of the Commonwealth of Virginia. Substantially all full-time classified salaried employees of the university participate in a defined benefit retirement 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.

The VRS does not measure assets and pension benefit obligations separately for individual state institutions. Information related to this plan is available at the statewide level only and can be found in the Commonwealth of Virginia's *Comprehensive Annual Financial Report*. The commonwealth, not the university, has the overall responsibility for contributions to this plan.

The university's expenses include the amount assessed by the commonwealth for contributions to VRS, which totaled approximately $8,844,000 and $13,908,000 for the years ended June 30, 2003 and 2002, respectively. VRS retirement contribution rates assessed to the university were lowered from 9.24% to 5.00% as part of the state budget reduction process. This rate decrease resulted in a reduction of retirement contribution expense.

Optional Retirement Plan

Full-time faculty and certain administrative staff participate in a defined contribution plan administered by six different providers other than the VRS. The six different providers are TIAA/CREF Insurance Companies; Fidelity Investments Tax-Exempt Services Co.; Met Life Securities, Inc.; Great-West Life Assurance Co.; T. Rowe Price Associates; and VALIC. This plan is a fixed-contribution program where the retirement benefits received are based upon the employer's (5.4%) and employees' (5%) contributions, plus interest and dividends.

Individual contracts issued under the plan provide for full and immediate vesting of both the university's and the employees' contributions. Total pension costs under this plan were approximately $11,788,000 and $11,573,000 for years ended June 30, 2003 and 2002, respectively. Contributions to the optional retirement plan were calculated using the base salary amount of approximately $113,432,000 and $111,364,000 for fiscal years 2003 and 2002, respectively.

Deferred Compensation Plan

Employees of the university are employees of the Commonwealth of Virginia. State employees may participate in the commonwealth's Deferred Compensation Plan. Participating employees can contribute to the plan each pay period with the commonwealth matching up to $20 per pay period. The dollar amount match can change depending on the funding available in the commonwealth's budget. The Deferred Compensation Plan is a qualified defined contribution plan under section 401(a) of the Internal Revenue Code. The university expense for contributions under the Deferred Compensation Plan, which is an amount assessed by the commonwealth, was approximately $1,473,000 and $1,397,000 for the fiscal years 2003 and 2002, respectively.

Federal Pension Plans

Certain Cooperative Extension Service (CES) professional employees are participants in either the Federal Employee Retirement System (FERS) or the Federal Civil Service Retirement System (CSRS). FERS and CSRS are defined benefit plans in which benefits are based upon the highest basic pay over any three consecutive years and the years of creditable service. Pension costs under these plans were approximately $542,000 and $1,086,000 for the years ended 2003 and 2002, respectively. Contributions to FERS and CSRS were calculated using the base salary amount of approximately $6,632,000 and $12,388,000 for the fiscal years 2003 and 2002, respectively. Contributions decreased as a result of high participation in Alternative Severance Options by CES employees.

In addition, the university contributed $48,000 and $55,000 for the years ended June 30, 2003 and 2002, respectively, in employer contributions to the Thrift Savings Plan. The Thrift Savings Plan is a defined contribution plan in which the university matches employee contributions within certain limitations.

18. POST-EMPLOYMENT BENEFITS

The commonwealth participates in the VRS administered, statewide group life insurance program that 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 service and participate in the state health plan. Information related to these plans is available at the statewide level in the commonwealth's *Comprehensive Annual Financial Report*.

19. APPROPRIATIONS

The Appropriation Act specifies that unexpended general fund appropriations that remain on the last day of the current year, ending on June 30, 2003, shall be reappropriated for expenditure in the first month of the next year, beginning on July 1, 2003, except as may be specifically provided otherwise by the General Assembly. The governor may, at his discretion, un-allot funds from the reappropriated balances that relate to unexpended appropriations for payments to individuals, aid-to-localities, or any pass-through grants.

During the year ended June 30, 2003, the following adjustments were made to the university's original appropriation (all dollars in thousands):

Original legislative appropriation per Chapter 899 as amended:	
Education and general programs	$222,866
Student financial assistance	10,683
Commonwealth Technology Research Fund	2,426
Uncapitalized maintenance reserve	1,229
Unique military activities	1,200
Eminent scholar program	599
Engineering research center fund	300
Total appropriation as amended	239,303
Adjustments:	
Reduction of general fund appropriation	(22,239)
Virginia Retirement System rate reduction savings	(6,684)
Bonus for higher education faculty	4,938
Health insurance premium	4,402
Accounting Technical Bulletin reductions	(4,261)
Group life rate suspension	(1,799)
Bonus for higher education non-faculty	1,349
E procurement change	(494)
Retiree health care credit savings	(471)
Transfer from student financial assistance program for undergraduate internships and graduate assistantships	211
Agricultural education program	150
Virginia Sickness and Disability Program rate increase	80
Other	(7)
Total adjustments	(24,825)
Adjusted appropriation	$214,478

20. CAPITAL APPROPRIATIONS

Following are the capital appropriations received by the university from the commonwealth for the year ended June 30, 2003 (all dollars in thousands):

21st Century appropriations	$ 26,545
Equipment trust fund	1,415
Capital project appropriations	355
Total before reversions	28,315
Reversions to the commonwealth	(3,717)
Total capital appropriations	$ 24,598

21. DEFERRED REVENUE

Deferred revenue consists of the following at June 30, 2003 and 2002 (all dollars in thousands):

	2003	2002
Grants and contracts	$ 9,921	$ 16,088
Prepaid athletic tickets	9,046	9,254
Prepaid tuition and fees	5,498	4,434
Other auxiliary enterprises	1,031	1,182
Total deferred revenue	$ 25,496	$ 30,958

22. GRANTS AND CONTRACTS CONTINGENCIES

The university has received federal grants for specific purposes that are subject to review and audit by the grantor agencies. Claims against these resources are generally conditional upon compliance with the terms and conditions of grant agreements and applicable federal regulations, including the expenditure of resources for allowable purposes. Any disallowance resulting from a federal audit may become a liability of the university.

In addition, the university is required to comply with various federal regulations issued by the Office of Management and Budget. Failure to comply with certain system requirements of these regulations may result in questions concerning the allowance of related direct and indirect charges pursuant to such agreements. As of June 30, 2003, the university estimates that no material liabilities will result from such audits or questions.

23. FEDERAL DIRECT LENDING PROGRAM

The university participates in the Federal Direct Lending Program. Under this program, the university receives funds from the U.S. Department of Education for Stafford and Plus Parent Loan Programs and disburses these funds to eligible students. The funds can be applied to outstanding student tuition and fee charges or refunded directly to the student.

These loan programs are treated as student payments with the university acting as a fiduciary agent for the student. Therefore, the receipt of the funds from the federal government is not reflected in the federal government grants and contracts total on the Statement of Revenues, Expenses, and Changes in Net Assets. The activity is included in the non-capital financing section of the Statement of Cash Flows. For the fiscal years ended June 30, 2003 and 2002, cash provided by the program totaled $70,239,000 and $68,874,000 and cash used by the program totaled $70,240,000 and $68,871,000, respectively.

24. RISK MANAGEMENT AND EMPLOYEE HEALTH CARE PLANS

The university 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 university participates in insurance plans maintained by the Commonwealth of Virginia. The state employee health care and worker's compensation plans 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, medical malpractice, faithful performance of duty bond, automobile, and air and watercraft plans. The university pays premiums to each of these departments for its insurance coverage. Information relating to the commonwealth's insurance plans is available in the Commonwealth of Virginia's *Comprehensive Annual Financial Report.*

25. JOINT VENTURES

The Hotel Roanoke Conference Center Commission was created by a joint resolution of the university and the City of Roanoke. The purpose of the commission is to establish and operate a publicly owned conference center in the City of Roanoke adjacent to the renovated Hotel Roanoke. The powers of the commission are vested in commissioners. Each participating, governing body appoints three commissioners for a total of six commissioners. The commission has the authority to issue debt, and such debt is the responsibility of the commission. The intention of the commission is to be self-supporting through its user fees. The university and the City of Roanoke equally share in any operating deficit or additional funding needed for capital expenditures. The university made contributions of $125,000 and $175,000 to the commission for the fiscal years ended June 30, 2003 and 2002, respectively.

26. JOINTLY GOVERNED ORGANIZATIONS

Blacksburg-Christiansburg & VPI Water Authority

Created by a concurrent resolution of the university and the towns of Blacksburg and Christiansburg, the authority operates and maintains the water supply system for the university and the other participating governing bodies. A five-member board governs the authority with one member appointed by each governing body and two at-large members appointed by the joint resolution of each of the governing bodies. The authority's indebtedness is not an obligation of the university and is payable solely from the revenues of the authority. The university paid $469,000 and $439,000 to the authority for the purchase of water for the fiscal years ended June 30, 2003 and 2002, respectively.

Blacksburg-VPI Sanitation Authority

Created by a concurrent resolution of the university and the town of Blacksburg, the authority operates and maintains the wastewater treatment system for the participating governing bodies. Each participating governing body appoints one member of the five-member board of directors. Three at-large members are appointed by the joint resolution of each of the governing bodies. The authority's indebtedness is not an obligation of the university and is payable solely from the revenues of the authority. The university paid $510,000 and $404,000 to the authority for the purchase of sewer services for the fiscal years ended June 30, 2003 and 2002, respectively.

Montgomery Regional Solid Waste Authority

Created by a joint resolution of the university, the towns of Blacksburg and Christiansburg, and the county of Montgomery, the authority represents its members in solid waste and recycling issues as well as operating a substantial recycling reprocessing facility. The authority is governed by its board with each participating governing body appointing one board member, and jointly all governing bodies appointing a fifth member. Each governing body provides collection of solid waste and recyclables from within its jurisdiction and delivers the collected materials to the authority for disposal of the waste, and the processing and marketing of the recyclables. All indebtedness is the obligation of the authority and payable from its revenues. The university paid $255,000 and $241,000 to the authority for tipping fees for the fiscal years ended June 30, 2003 and 2002, respectively.

Virginia Tech/Montgomery Regional Airport Authority

Created by a joint resolution of the university, the towns of Blacksburg and Christiansburg, and the county of Montgomery, this authority serves to develop a regional airport based on the mission of servicing corporate executive markets and other general aviation markets; obtaining grants, loans and other funding for airport improvements and other activities; and in promoting and assisting in regional economic development. The authority is governed by its board, which consists of five members. Each participating governing body appoints one member of the board, and jointly all governing bodies appointing a fifth member. All indebtedness is the obligation of the authority and payable from its revenues. The authority began operations on July 1, 2002. The university's funding commitment for fiscal year 2003 was $50,000, of which Virginia Tech paid $27,000 and performed the balance as in-kind service for the authority.

27. PENDING GOVERNMENTAL ACCOUNTING STANDARDS BOARD STATEMENT

Governmental Accounting Standards Board Statement Number 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 university is 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 the university. In the past the university presented summary financial information for some of its related parties in the Notes to Financial Statements. Under statement number 39 the university will be required to discretely present selected related parties as component units in its financial report. The university is in the process of assessing which of the related parties should be included as component units.

28. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses by functional classification were as follows for the year ended June 30, 2003 (all dollars in thousands):

	Compensation & Benefits	Contractual Services	Supplies & Materials	Travel	Other Operating Expenses	Scholarships & Fellowships	Sponsored Program Subcontracts	Total
Instruction	$ 179,754	$ 11,707	$ 5,027	$ 3,606	$ 1,216	$ 519	$ 66	$ 201,895
Research	104,575	10,922	13,236	5,940	3,010	4,824	13,420	155,927
Public service	40,626	15,779	1,452	4,414	636	143	1,665	64,715
Academic support	29,827	4,936	7,616	657	1,442	49	-	44,527
Student services	10,453	2,843	624	331	280	29	-	14,560
Institutional support	27,879	1,241	395	867	1,541	165	-	32,088
Operation and maintenance of plant	18,310	2,644	9,291	132	6,426	8	-	36,811
Student financial assistance	130	11	158	2	53	11,642	-	11,996
Auxiliary enterprises	43,882	14,864	16,890	5,284	6,627	214	-	87,761
Total before fees, costs & depreciation	$ 455,436	$ 64,947	$ 54,689	$ 21,233	$ 21,231	$ 17,593	$ 15,151	$ 650,280
Loan administrative fees and collection costs								204
Depreciation expense								44,086
Total operating expenses								$ 694,570

The university's operating expenses by functional classification were as follows for the year ended June 30, 2002 (all dollars in thousands):

	Compensation & Benefits	Contractual Services	Supplies & Materials	Travel	Other Operating Expenses	Scholarships & Fellowships	Sponsored Program Subcontracts	Total
Instruction	$ 180,998	$ 13,824	$ 5,953	$ 4,436	$ 1,685	$ 532	$ 47	$ 207,475
Research	98,704	8,989	11,087	5,563	2,395	4,067	11,197	142,002
Public service	48,633	16,715	1,974	4,813	655	123	1,396	74,309
Academic support	28,858	5,428	7,796	960	807	73	-	43,922
Student services	9,664	3,104	794	478	420	17	-	14,477
Institutional support	29,639	871	513	1,025	1,912	138	-	34,098
Operation and maintenance of plant	18,652	2,986	8,175	155	8,937	13	-	38,918
Student financial assistance	122	13	67	-	-	11,810	-	12,012
Auxiliary enterprises	43,108	14,206	20,049	4,201	2,670	150	-	84,384
Total before fees, costs & depreciation	$ 458,378	$ 66,136	$ 56,408	$ 21,631	$ 19,481	$ 16,923	$ 12,640	$ 651,597
Loan administrative fees and collection costs								47
Depreciation expense								44,880
Total operating expenses								$ 696,524

SOURCES AND USES OF FUNDS FOR THE INSTRUCTION MISSION

Virginia Tech is a comprehensive land-grant university with instruction, research, and public service missions. The Commonwealth of Virginia provides state appropriations to the university in support of the following major mission areas: instruction, Agricultural Experiment Station and Cooperative Extension programs, graduate and undergraduate scholarships, and various capital outlay projects. This page diagrams financial activity related to instruction only—the largest major area.

The university receives both operating and non-operating revenues to support the instruction mission. Revenues, except state appropriations, are reported as operating revenue on the Statement of Revenues, Expenses, and Changes in Net Assets (SRECNA). State appropriations are included as non-operating on the SRECNA. These appropriations are used to support instruction and comprise 45.9% of the total revenues highlighted below.

Expenses related to the instruction mission, detailed below, represent 46.1% of total operating expenses for the university as reported on the SRECNA.

Since the Commonwealth of Virginia budgets and appropriates funds on a cash basis, the totals presented are on a cash, not accrual, basis.

REVENUES

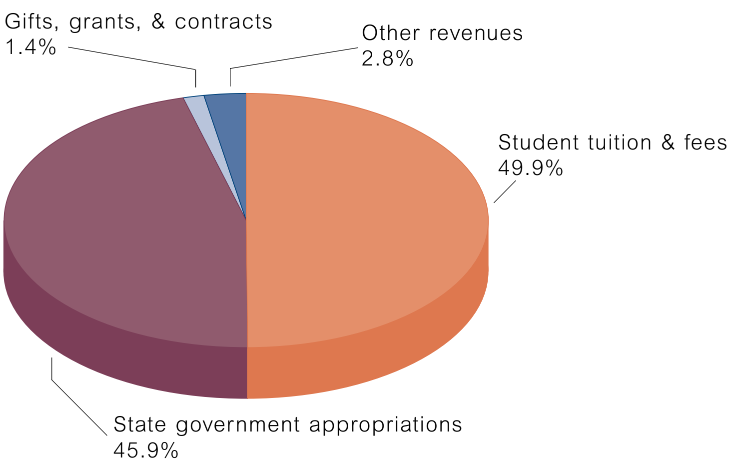
For the year ended June 30, 2003
(all dollars in thousands)

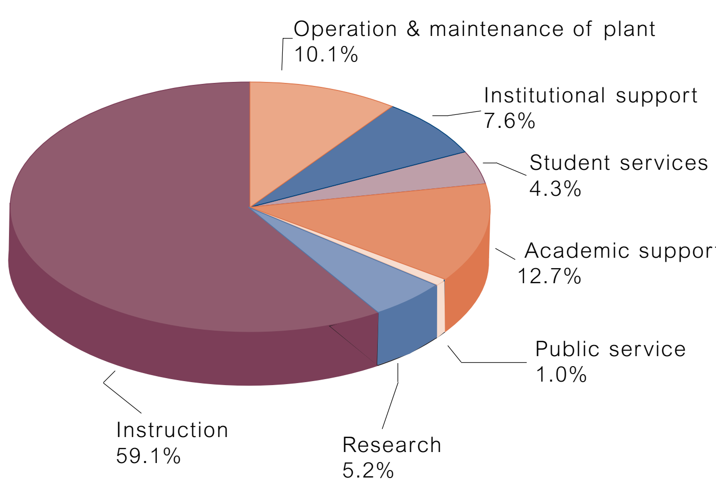
Student tuition and fees	$ 159,945
State appropriations For carrying on the general academic programs; excludes appropriations for Agricultural Experiment Station and Cooperative Extension.	146,851
Gifts, grants, and contracts Facilities and administrative (indirect) cost recoveries.	4,611
Other revenues Includes departmental receipts from sales and services related to instructional programs and other revenues.	8,893
Total revenues	$ 320,300

EXPENSES

For the year ended June 30, 2003
(all dollars in thousands)

Instruction Exclusive of sponsored instruction programs.	$ 189,375
Research Exclusive of the Agricultural Experiment Station and sponsored research programs.	16,644
Public service Exclusive of Cooperative Extension and sponsored public service programs.	2,963
Academic support Library, Learning Resources Center, and academic administration.	40,785
Student services Student admissions, counseling services, and other student activities.	13,761
Institutional support Executive management, business, and finance operations.	24,355
Operation and maintenance of plant	32,417
Total expenses	$ 320,300





SCHEDULE OF AUXILIARY ENTERPRISES

REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

For the year ended June 30, 2003
(all dollars in thousands)

	Dormitory and Dining Hall System (1)	Utility System (1)	University Services System (1)	Information Systems & Services	Athletic Department	All Other (2)	Total (3)
REVENUES:							
Student fees	$ 38,018	$ -	$ 14,239	$ 2,662	$ 5,786	$ 2,766	$ 63,471
Sales and services	6,680	13,570	2,019	10,406	20,849	10,003	63,527
Total fees and sales	44,698	13,570	16,258	13,068	26,635	12,769	126,998
Contributions	110	-	64	-	2,480	-	2,654
Interest and dividends	24	-	8	319	223	228	802
Total revenues	44,832	13,570	16,330	13,387	29,338	12,997	130,454
EXPENSE OF OPERATIONS:							
Personal services	15,222	1,573	7,935	5,007	9,656	3,998	43,391
Contractual services	2,916	435	1,953	4,044	8,431	3,201	20,980
Supplies and materials	11,483	1,252	1,079	113	1,579	1,350	16,856
Continuous charges	4,671	10,368	1,109	1,448	3,830	835	22,261
Equipment	680	312	105	648	656	466	2,867
Total expenses of operation	34,972	13,940	12,181	11,260	24,152	9,850	106,355
EXCESS OF REVENUES OVER EXPENSES OF OPERATIONS BEFORE TRANSFERS:	9,860	(370)	4,149	2,127	5,186	3,147	24,099
TRANSFERS AMONG FUNDS—ADDITIONS (DEDUCTIONS):							
Mandatory transfers:							
Debt service—current year	(5,841)	(1,535)	(3,601)	(898)	(1,823)	(1,217)	(14,915)
Debt service—future years	(1,644)	2,312	(61)	-	-	-	607
Nonmandatory transfers:							
Capital transfers	(1,591)	(350)	(104)	(22)	(744)	(478)	(3,289)
Allocation of funds	(784)	(57)	(383)	(338)	98	921	(543)
Total transfers	(9,860)	370	(4,149)	(1,258)	(2,469)	(774)	(18,140)
Net increase (decrease) for year	-	-	-	869	2,717	2,373	5,959
Fund balances, July 1, 2002	-	-	-	5,650	5,641	7,179	18,470
Fund balances, June 30, 2003	$ -	$ -	$ -	$ 6,519	$ 8,358	$ 9,552	$ 24,429

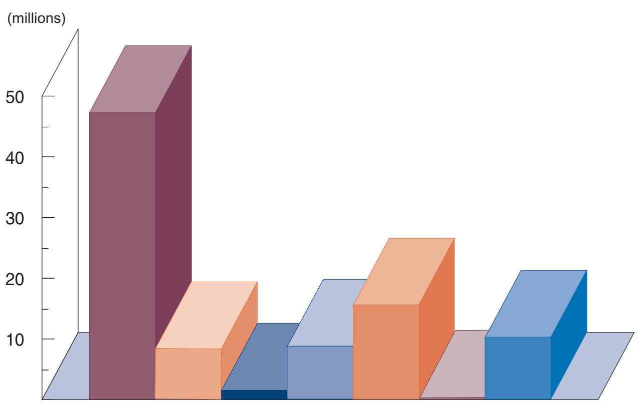
(1) *These system accounts are funds held by the trustee and no fund balances are reported.*

(2) *All Other includes the following auxiliaries: University Licensing, Student Orientation, Parking Services, Tailor Shop, Donaldson Brown Hotel and Conference Center, Library Services, Golf Course, Tennis Pavilion, Hokie Passport, Software Sales, and Central Auxiliary Direct Assistance.*

(3) *This schedule accounts for purchases of capital assets as expenses and does not include depreciation. Additionally, all revenues are recorded as charged, including student charges and internal activities. Management uses this method of accounting to monitor individual auxiliary enterprises and to set rates.*

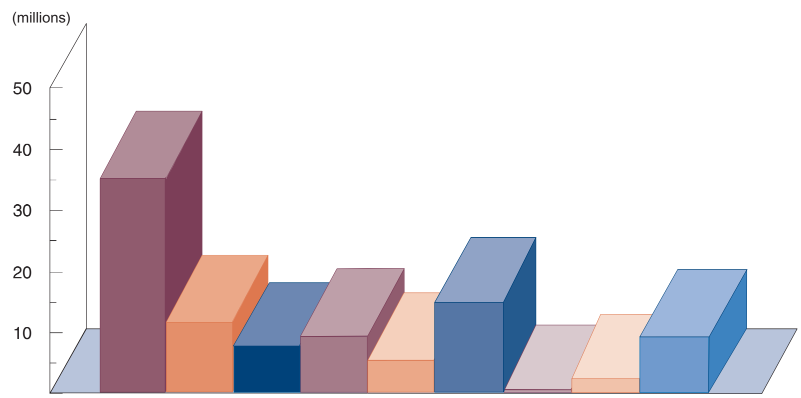
VIRGINIA TECH FOUNDATION, INC.

The purpose of the Virginia Tech Foundation, Inc. is to receive, invest, and manage private funds given for the support of programs at Virginia Tech and to foster and promote the growth, progress, and general welfare of the university. During the current fiscal year, the foundation recognized $47.3 million in contributions for support of the university. Investment income of $8.6 million, along with net gains on investments of $1.5 million, resulted in a $10.1 million gain on investments. Property rental, hotel operating, and golf course income totaled $24.9 million. Other income accounted for $10.3 million. Total income of $92.6 million was offset by $86.0 million in expenses that supported the university and its programs. Direct support to various university programs aggregated $54.1 million, which included $11.5 million in scholarship support to students and faculty and $7.7 million towards university capital projects. Additional expenses such as fund raising and management and general, as well as research center, hotel operating, and golf course costs totaled $31.9 million. Total net assets decreased by $1.8 million even though revenues exceeded expenses. This decrease is due to a $9.1 million impairment loss in intangibles related to a patent given in fiscal year 2001.



2003 REVENUES, GAINS & OTHER SUPPORT

- Contributions
- Investment income
- Net gain on investments
- Rental income
- Hotel Roanoke
- River Course
- Other income



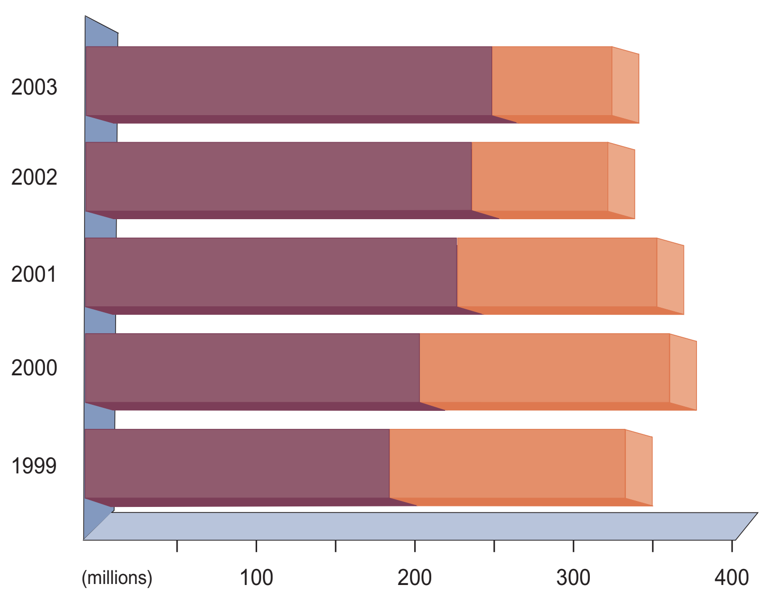
2003 EXPENSES

- Program support
- Student financial aid
- University capital outlay
- Fund raising
- Research park
- Hotel Roanoke
- River Course
- General management
- Impairment loss on intangibles

ENDOWMENT MARKET VALUE 1999-2003

* Market value of Endowment Funds includes agency deposits held in trust of $41.9 million (Source: Virginia Tech Investment Managers, unaudited)

- Contributions
- Appreciation



AFFILIATED CORPORATIONS FINANCIAL HIGHLIGHTS

For the years ended June 30, 2003-1999
(all dollars in thousands)

	2003	2002	2001	2000	1999
ASSETS					
Virginia Tech Foundation, Inc.	$ 613,456	$ 601,277	$ 624,529	$ 574,358	$ 540,613
Virginia Tech Services, Inc.	10,938	11,072	9,803	11,560	10,449
Virginia Tech Alumni Association	3,577	3,676	3,967	4,174	3,923
Virginia Tech Intellectual Properties, Inc.	1,685	2,188	1,061	1,174	2,032
WPI, Inc.	5,444	6,761	6,960	7,043	8,801
Total assets	$ 635,100	$ 624,974	$ 646,320	$ 598,309	$ 565,818
REVENUES					
Virginia Tech Foundation, Inc.	$ 92,611	$ 65,978	$ 96,687	$ 104,537	$ 95,359
Virginia Tech Services, Inc.	19,831	20,142	21,866	22,056	21,208
Virginia Tech Alumni Association	103	(225)	(140)	325	2,567
Virginia Tech Intellectual Properties, Inc.	1,004	1,220	892	749	726
WPI, Inc.	6,101	10,392	12,751	14,275	19,397
Total revenues	$ 119,650	$ 97,507	$ 132,056	$ 141,942	$ 139,257
EXPENSES					
Virginia Tech Foundation, Inc.	$ 94,381	$ 89,122	$ 78,040	$ 73,589	$ 60,891
Virginia Tech Services, Inc.	20,128	20,652	21,866	22,049	21,365
Virginia Tech Alumni Association	202	67	67	74	91
Virginia Tech Intellectual Properties, Inc.	979	984	1,057	1,046	1,776
WPI, Inc.	7,360	10,653	12,726	14,262	19,787
Total expenses	$ 123,050	$ 121,478	$ 113,756	$ 111,020	$ 103,910

The organizations included above are related to the university by affiliation agreements. These agreements, approved by the board of visitors, require an annual audit to be performed by independent auditors. Such auditors have examined the financial records of the organizations presented in the table above and copies of their audit reports have been provided to the university. Values presented in this table are based solely upon these audit reports and do not include any consolidation entries to alter these amounts. Affiliated organizations that hold no financial assets and certify all financial activities or transactions through the Virginia Tech Foundation may be exempt from the independent audit requirement. The Virginia Tech Athletic Fund, Inc. and the Virginia Tech Corp of Cadets Alumni, Inc. meet exemption requirements and are not presented separately in this table.

CONSOLIDATING SCHEDULE OF NET ASSETS

As of June 30, 2003
(all dollars in thousands)

	Current Funds Unrestricted	Current Funds Restricted	Loan Funds	Endowment & Similar funds	Plant Funds	Agency Funds	Total
ASSETS							
Current assets							
Cash and cash equivalents	$ 84,008	$ 23,493	$ 1,240	$ -	$ -	$ 4,816	$ 113,557
Short-term investments	1,003	-	-	-	-		1,003
Investments, securities lending	859	-	-	-	-	-	859
Accounts receivable, net of allowance for doubtful accounts	4,587	26,534	-	-	-	-	31,121
Notes receivable	-	-	1,718	-	-	-	1,718
Due from Commonwealth of Virginia	3,272	-	-	-	-	-	3,272
Inventories	8,456	-	-	-	-	-	8,456
Prepaid expenses	9,634	388	-	-	-	-	10,022
Due to (from) other funds	14,886	(11,292)	(70)	1,282	(4,806)	-	-
Total current assets	126,705	39,123	2,888	1,282	(4,806)	4,816	170,008
Non-current assets							
Cash and cash equivalents	-	-	-	-	48,954	-	48,954
Short-term investments	-	-	-	-	6,218	-	6,218
Accrued interest receivable	-	-	-	-	186	-	186
Accounts receivable, net of allowance for doubtful accounts	44	-	-	-	456	-	500
Notes receivable	-	-	13,035	-	-	-	13,035
Long-term investments	10,176	-	-	36,367	17,176	103	63,822
Prepaid expenses	736	-	-	-	-	-	736
Depreciable capital assets	-	-	-	-	455,266	-	455,266
Non-depreciable capital assets	-	-	-	209	102,300	-	102,509
Total non-current assets	10,956	-	13,035	36,576	630,556	103	691,226
Total assets	$ 137,661	$ 39,123	$ 15,923	$ 37,858	$ 625,750	$ 4,919	$ 861,234
LIABILITIES							
Current liabilities							
Accounts payable and accrued expenditures	$ 64,496	$ 13,273	$ -	$ -	$ 12,314	$ 265	$ 90,348
Obligations under securities lending	859	-	-	-	-	-	859
Accrued compensated absences	9,492	2,417	-	-	-	-	11,909
Deferred revenue	15,425	10,071	-	-	-	-	25,496
Funds held in custody for others	-	-	-	-	-	4,654	4,654
Annuities payable	10	-	-	15	-	-	25
Bond anticipation notes	-	-	-	-	1,303	-	1,303
Long-term debt payable	-	-	-	-	14,110	-	14,110
Total current liabilities	90,282	25,761	-	15	27,727	4,919	148,704
Non-current liabilities							
Accrued compensated absences	13,243	3,396	-	-	-	-	16,639
Federal loan program contributions refundable	-	-	13,128	-	-	-	13,128
Annuities payable	1,680	-	-	58	-	-	1,738
Long-term debt payable	-	-	-	-	175,331	-	175,331
Total non-current liabilities	14,923	3,396	13,128	58	175,331	-	206,836
Total liabilities	$ 105,205	$ 29,157	$ 13,128	$ 73	$ 203,058	$ 4,919	$ 355,540
NET ASSETS							
Invested in capital assets, net of related debt	$ -	$ -	$ -	$ -	$ 386,313	$ -	$ 386,313
Restricted, nonexpendable	-	-	-	381	-	-	381
Restricted, expendable							
Scholarships, research, & instruction	-	9,966	-	37,404	-	-	47,370
Loans	-	-	2,795	-	-	-	2,795
Capital projects	-	-	-	-	9,844	-	9,844
Debt service	-	-	-	-	19,849	-	19,849
Unrestricted	32,456	-	-	-	6,686	-	39,142
Total net assets	$ 32,456	$ 9,966	$ 2,795	$ 37,785	$ 422,692	$ -	$ 505,694

CONSOLIDATING SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

For the year ended, June 30, 2003
(all dollars in thousands)

	Current Funds Unrestricted	Current Funds Restricted	Loan Funds	Endowment & Similar Funds	Plant Funds	Total
OPERATING REVENUES						
Student tuition and fees, net of scholarship allowance	$159,419	$ -	$ -	$ -	$ -	$ 159,419
Federal appropriations	-	14,382	-	-	-	14,382
Federal grants and contracts	19,111	88,289	-	-	-	107,400
State grants and contracts	759	13,497	-	-	-	14,256
Local grants and contracts	135	12,254	-	-	-	12,389
Nongovernmental grants and contracts	3,877	19,722	-	-	-	23,599
Sales and services of educational departments	9,223	-	-	-	-	9,223
Auxiliary enterprise revenue, net of scholarship allowance	99,182	-	-	-	-	99,182
Other operating revenues	2,206	(27)	51	-	-	2,230
Total operating revenues	293,912	148,117	51	-	-	442,080
OPERATING EXPENSES						
Instruction	192,437	9,458	-	-	-	201,895
Research	42,967	112,960	-	-	-	155,927
Public service	30,197	34,518	-	-	-	64,715
Academic support	42,033	2,494	-	-	-	44,527
Student services	13,687	873	-	-	-	14,560
Institutional support	24,694	7,394	-	-	-	32,088
Operation and maintenance of plant	31,608	4	-	-	5,199	36,811
Student financial assistance	132	11,864	-	-	-	11,996
Auxiliary enterprises	87,761	-	-	-	-	87,761
Loan administrative fees and collection costs	-	-	204	-	-	204
Depreciation expense	-	-	-	-	44,086	44,086
Total operating expenses	465,516	179,565	204	-	49,285	694,570
OPERATING LOSS	(171,604)	(31,448)	(153)	-	(49,285)	(252,490)
NON-OPERATING REVENUES (EXPENSES)						
State appropriations	198,040	15,208	-	-	1,230	214,478
Gifts	5,339	37,882	8	-	-	43,229
Investment income, net of investment expense	1,267	664	-	206	1,086	3,223
Other additions	-	-	3	-	122	125
Interest expense debt related to capital assets	-	-	-	-	(8,245)	(8,245)
Net non-operating revenues	204,646	53,754	11	206	(5,807)	252,810
INCOME (LOSS) BEFORE OTHER REVENUES, EXPENSES, GAINS, AND LOSSES	33,042	22,306	(142)	206	(55,092)	320
Capital appropriations	-	-	-	-	28,315	28,315
Capital appropriations reverted to the commonwealth	-	-	-	-	(3,717)	(3,717)
Capital grants and gifts	-	2,614	-	-	30,430	33,044
Gain (loss) on disposal of plant assets	-	-	-	-	(789)	(789)
Total other revenues	-	2,614	-	-	54,239	56,853
INCREASE IN NET ASSETS BEFORE TRANSFERS	33,042	24,920	(142)	206	(853)	57,173
Mandatory transfers	(19,782)	(118)	-	-	19,900	-
Nonmandatory transfers	(4,483)	1,560	59	(1,601)	4,465	-
Equipment and library book transfers	(14,062)	(6,250)	-	-	20,312	-
Scholarship allowance transfer	19,975	(19,975)	-	-	-	-
Total transfers	(18,352)	(24,783)	59	(1,601)	44,677	-
Increase (decrease) in net assets after transfers	14,690	137	(83)	(1,395)	43,824	57,173
Net assets—beginning of year	17,766	9,829	2,878	39,180	378,868	448,521
Net assets—end of year	$ 32,456	$ 9,966	$ 2,795	$ 37,785	$ 422,692	$ 505,694

BUSINESS AND FINANCIAL PERSONNEL

MINNIS E. RIDENOUR
Executive Vice President and Chief Operating Officer

RAYMOND D. SMOOT, JR.
Vice President for Administration and Treasurer

M. DWIGHT SHELTON, JR.
Vice President for Budget and Financial Management

WILLIAM M. ELVEY
Interim Assistant Vice President for Facilities

KENNETH E. MILLER
University Controller

JOHN C. RUDD
Director of Internal Audit and Management Services

JOHN J. CUSIMANO
Director of Investments and Debt Management