VIRGINIA STATE UNIVERSITY

PETERSBURG, VIRGINIA

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2002

APA
Auditor of
Public Accounts
COMMONWEALTH OF VIRGINIA

<u>AUDIT SUMMARY</u>

Our audit of Virginia State University for the year ended June 30, 2002, found:

- the financial statements are presented fairly, in all material respects;
- internal control matters that we consider to be reportable conditions; however, we do not consider any of these to be a material weakness;
    - we recommend that the University improve its administration of time and materials contracts.
    - we recommend that the University document and improve the FRS to CARS reconciliation process.
    - we recommend that the University test its disaster recovery plan.
- no instances of noncompliance that are required to be reported under <u>Government Auditing Standards</u>; and
- the University has not taken corrective action with respect to the previously reported findings entitled, "Improve Reconciliation Process and System Efficiency" and "Update Disaster Recovery Plan." Adequate corrective action has been taken with respect to audit findings reported in the prior year that are not repeated in this report.

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Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

May 21, 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 State University

We have audited the accounts and records of **Virginia State University,** as of and for the year ended June 30, 2002, and submit herewith our complete reports on financial statements and compliance and internal control over financial reporting.

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic financial statements of Virginia State University, a component unit of the Commonwealth of Virginia, as of and for the year then ended June 30, 2002, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Virginia State University as of June 30, 2002, 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.

As described in Note 1, the University has implemented a new finanical reporting model, as required by the provisions of Government Accounting Standards Board Statement 34, *Basic Financial Statements -*

and Management's Discussion and Analysis - for State and Local Governments, and Statement 35, *Basic Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities* as of June 30, 2002.

The Management's Discussion and Analysis on pages 7 through 14 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 conducted for the purpose of forming an opinion on the basic financial statements of Virginia State University. The accompanying Schedule of Auxiliary Enterprises Revenues and Expenditures is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The Schedule of Auxiliary Enterprises Revenues and Expenditures has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statement taken as a whole.

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

In planning and performing our audit of the financial statements of Virginia State University as of and for the year ended June 30, 2002, we considered internal controls over financial reporting and tested compliance with certain provisions of laws, regulations, contracts, and grants in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the University's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the section titled, "Internal Control and Compliance Findings and Recommendations."

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected promptly by employees in the normal course of performing their duties. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Status of Prior Findings

The University has not taken adequate corrective action with respect to the previously reported findings "Improve Reconciliation Process and System Efficiency" and "Update Disaster Recovery Plan." Accordingly, we included these findings in the section entitled, "Internal Control and Compliance Findings and Recommendations." The University has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

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

EXIT CONFERENCE

We discussed this report with management at an exit conference held on June 16, 2003.

AUDITOR OF PUBLIC ACCOUNTS

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INTERNAL CONTROL FINDINGS AND RECOMMENDATIONS

Improve Contract Administration

Background

In the past fiscal year, the University's internal auditor and Auditor of Public Accounts staff have found over $800,000 in questionable contracting practices and procedures and have questions about the quality of work performed over a three-year period. The University has investigated the work of at least three contractors and found violations of the procurement act, disregarding of internal procurement procedures, and a lack of inspections and other reviews to ensure the quality of work performed.

The University's Director of Residence Life had primary responsibility for scheduling and determining the scope of the work and had to coordinate the work with Facilities Management. The University has an outsourced contractor operating its Facilities Management and related procurement responsibilities. The University expected that its employees and the contractor would fully comply with the State's Public Procurement Law and University procurement policies as well as exercise all due diligence procedures over contracts and work performed. The Director of Residence Life and the contractor's on-site manager appear to have placed timely completion of work as their priority ahead of complying with State procurement policies.

As a result, the Director of Residence Life and the contractor's managers used several standing time and material contracts with different vendors to perform work and bypassed both internal and state policies and procedures. Listed below are some examples of how these individuals used time and material contracts to bypass established procedures. To understand these examples, the reader needs to have the following basic understanding of the time and material contracts.

The University awards time and material contracts for various construction trades to perform small non-routine or emergency work, and larger work for which the University does not have adequate staff to meet scheduled deadlines. As an example, the University may issue a plumbing contract and building and grounds would use the contract for emergency plumbing work to reconnect a moved cafeteria sink, or the University may engage a painting firm to repaint an entire dormitory during an available two week period in the summer

University policy requires special budgetary and other approvals for any work over $5,000 and this dollar level of work requires the start of a competitive selection process for choosing a vendor. Any work over $50,000 requires the publication of job requirements and written bids and evaluations.

Findings

The review found the following types of transactions:

- Issuing purchase orders to perform work not covered by the trade time and materials contract. As example, having electricians perform carpentry work.

- Issuing multiple purchase orders under $5,000 for work on a single project thereby avoiding having to seek competitive bids or to prepare written requirements.

- Providing the trade contractor with a detailed description of the work, but omitting this information on the purchase orders accompanying the contractor's invoice approved for payment.

- Issuing purchase orders without any specific description of the work performed, only the agreed dollar amount.

- Maintaining no documentation or indication of any inspection or approval of work performed.

- Allowing vendors to submit invoices with only references to the purchase order, thereby precluding payment processing from having information to review the billing. The time and material contracts require the vendor's invoice to include information on time spent by level of employee so payment processing would be able to compare the hours and amounts charged to the contract.

Internal Actions Taken

The University is continuing to investigate if it received full value for the services it purchased and whether the University can recover payment for any times when it did not receive full value. Additionally, the Vice President for Administration and Finance issued new policies and procedures for time and materials contracts on February 26, 2003, and April 3, 2003. Management also conducted mandatory attendance workshops on the use of, and responsibilities under, time and materials contracts. Management should continue to improve their administration of these contracts to ensure that the University is obtaining quality services at a competitive price.

Remaining Issues

The Facilities Management contractor employed managers who participated in the authorization, approval, oversight, and management of these contracts. While it appears that the contractor agreed to comply with both the Commonwealth and University procurement requirements, contractual provisions governing this contract are not as clear as to the obligations of each party.

The University and the contractor have made numerous changes to the original contract over time and some of these changes do not clearly define what duties and responsibilities the contractor and University are assuming.

As an example, without properly defined responsibilities included in the contract, the University cannot ensure that they are receiving the appropriate services. The University could be paying for outsourced work orders when the vendor is responsible for those tasks under the contract.

Additionally, the University needs to evaluate how it wants the contractor to operate and what oversight duties the University is willing to assume. If the University is going to require contractors to comply with Commonwealth and University policies and procedures in areas, such as procurement or the use of standing contracts, then the University needs to take a more active role in supervising the contractor and monitoring their understanding and compliance with these policies.

The University cannot assume that the contractor will have the knowledge and training to follow these policies or that their business process will adapt to this environment. A contractor agrees to deliver and maintain a level of service while still making a profit. Sometimes, compliance with Commonwealth and University policies may require competition to the exclusion of other matters.

Document and Improve the FRS to CARS Reconciliation Process

In previous audits, we recommended management improve the University's reconciliations of its financial systems to transactions recorded in the Commonwealth's Accounting and Reporting System (CARS). In February 2002, the University implemented an electronic interface between their financial accounting system and CARS. This electronic interface enables the University to complete its reconciliations and submit required adjustments to the Department of Accounts by their deadline, approximately four weeks after the end of the month.

However, this new reconciliation process takes about two and a half weeks to complete and involves the work of several individuals. The expenditure reconciliation alone requires about 40 staff hours to complete. Supervisors and management have difficulty reviewing the reconciliation because the staff doing the work do not document the source and resolution of all differences. Additionally, financial accounting has not adequately documented the reconciliation process and procedures, which may lead to staff inefficiencies, errors, or incorrect adjustments.

We commend the University for implementing the electronic interface, meeting deadlines for adjustments, and meeting minimal documentation standards for the reconciliation. However, we recommend the University develop and implement further improvements to create additional efficiencies.

The University must also document its current reconciliation procedures, including documentation standards for the source and resolution of differences. This is especially important since management would have difficulty in assigning the reconciliation to other staff in case of absences or turnover. As the University improves its reconciliations, staff should also find ways to complete the reconciliations in less time and concisely communicate to supervisors and management the results of the reconciliation.

Test the University's Disaster Recovery Plan

The University has not tested its disaster recovery plan even though their policy requires testing the plan twice each year. Not testing the disaster recovery plan puts the University at risk that when a disaster occurs, unfamiliarity with or flaws in the plan may prevent the University from promptly recovering its computing ability and its data.

The University should test its disaster recovery plan twice each year as outlined in its policies. The tests should include at least one system restoration test and one walk-through to validate the effectiveness of the plan, as well as enable involved staff to become familiar with the process.

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Virginia State University (the University) annual financial report represents a discussion and analysis of the financial performance of the University during the fiscal year ended June 30, 2002. This discussion has been prepared by management along with the financial statements and related footnote disclosures and should be read in conjunction with, and is qualified in its entirety by, the financial statements and footnotes. The discussion and analysis is designed to focus on current activities, resulting change and current known facts. Since this is the transition year for this format, only one year of financial data is presented. In future years, comparative analysis will be presented.

The financial statements, footnotes, and this discussion are the responsibility of management.

Using the Annual Report

This annual report consists of a series of financial statements, prepared in accordance with the Governmental Accounting Standards Board (GASB) Statement 35, *Basic Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities*. These financial statements differ significantly, in both the form and the accounting principles utilized, from prior financial statements presented. The financial statements presented in prior years focused on the accountability of funds, while these statements focus on the financial condition of University, the results of operations, and cash flows of the University as a whole.

In December 1998, GASB released Statement 33, *Accounting and Financial Reporting for Non-exchange Transactions*. In June 1999, GASB released Statement 34, *Basic Financial Statements and Management's Discussion and Analysis - for State and Local Governments*. Changes in reporting resulting from Statement 34 require a comprehensive look at the entity as a whole. In November 1999, GASB issued Statement 35, *Basic Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities*. The University, as a component unit of the Commonwealth of Virginia, is required to adopt this statement for the year ended June 30, 2002.

The financial statements required by GASB Statement 35 are the Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; and Statement of Cash Flows. They are prepared under the accrual basis of accounting, whereby revenues and assets are recognized when the services are provided and expenses and liabilities are recognized when services are rendered, regardless of when cash is exchanged.

The Statement of Net Assets includes all assets and liabilities using the accrual basis of accounting. Net assets - the difference between assets and liabilities - are one way to measure the financial health of the University. The increase or decrease in net assets over time demonstrates the financial health of the University. Net assets include three major categories. The first category, "invested in capital assets, net of related debt," shows the University's equity in property, plant and equipment. The next category, "restricted net assets," shows the amount of net resources available for certain University expenditures. These net assets must be used for purposes determined by external entities at the time they were transferred to the University. The third category, "unrestricted net assets," are the net resources available the University to fund general operations.

The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and the expenses incurred during the year creating the changes in the University's net assets. Activities are reported as either operating or nonoperating. Generally, operating revenues are received for providing goods and services to students and other constituencies of the institution. Operating expenses are those expenses incurred to acquire or produce the goods and services provided in return for the operating revenues and to carry out the University's mission. Nonoperating revenues are revenues received for which goods and services are not directly provided. The financial reporting model classifies state appropriations and gifts as nonoperating revenues. Since state appropriations and private gifts are reported as non-operating revenue, although the University depends on them to fund operating expenses, the Statement of Revenues, Expenses, and Changes in Net Assets will display an operating deficit. The utilization of long-lived assets, referred to as Capital Assets, is reflected in financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

The Statement of Cash Flows presents information relating to cash inflows and outflows summarized by operating, noncapital financing, capital financing and related investing activities, and helps measure the ability to meet financial obligations as they mature.

Financial Highlights

The implementation of GASB Statement 34 required several significant accounting changes.

- The University had never previously recorded depreciation. The recording of depreciation reduces the University's audited beginning net assets by $78.3 million.

- The University removed assets below the $5,000 capitalization threshold, which had been purchased through the Virginia College Building Authority Equipment Trust Fund Program prior to FY99 in the amount of $5.0 million. Also, the University made a $1.0 million adjustment to buildings and construction and progress to properly record several transactions.

- In previous financial statements, the Perkins Loan Fund was shown as a part of the University's net assets. With the implementation of GASB Statement 34, the federal government's equity in the Perkins Loan Fund has been reclassified as a liability offset against the proportionate share of the assets, similar to the former reporting of agency funds. This adjustment reduces the audited net assets by $692,000.

- The University's artwork collection was not previously recorded as an asset. Its fair market value at July 1, 2001, was $354,645; the audited net assets were increased by this amount.

These changes are further discussed in Note 1 of the Notes to Financial statements.

The University had an increase in net assets of approximately $22.0 million in fiscal year 2002. The increase was due to three factors:

- Following last year's reversion of $18.3 million for capital outlay projects, the Commonwealth reestablished funding for some of the projects in fiscal year 2002 primarily through the 21st Century Bond Program for the Johnston Memorial Library, Owens Hall and Repair of the Steam Tunnel of which $15.4 million was unspent and increased Appropriations Available. The funding reestablished by the Commonwealth was approximately $16.7 million, of which we have drawn $1.3 million leaving $15.4 million as the residual amount in Appropriations Available. Other increases for Appropriations Available for capital outlay projects approximate $300,000 for the renovation of Owens Hall.

- The capitalized net assets of the University increased by approximately $3.0 million during fiscal year 2002 through the purchase of equipment, capital outlay projects, improvements and other acquisitions. This shows that the University is reinvesting in the assets needed to sustain its mission.

- The University's unrestricted net assets increased by approximately $3.3 million. The two major items affecting this are an increase in prepaid expenses of $1.2 million (primarily insurance) and a reduction in liabilities of $2.1 million.

Condensed Financial Statement Information

Condensed Statement of Net Assets
As of June 30, 2002

ASSETS	
Current assets	$ 17,206,732
Noncurrent assets:	
Capital	64,178,260
Capital appropriations available	16,355,554
Investments	7,098,326
Other	3,704,978
Total noncurrent assets	91,337,118
Total assets	108,543,850
LIABILITIES	
Current liabilities	10,795,148
Noncurrent liabilities	12,678,466
Total liabilities	23,473,614
NET ASSETS	
Invested in capital assets, Net of related debt	53,588,721
Restricted:	
Nonexpendable	1,260,570
Expendable	25,132,530
Unrestricted	5,088,415
Total net assets	$ 85,070,236

The University's total assets were $108.5 million at June 30, 2002. Capital assets, the largest single class of assets, totaled $64.1 million and accounted for 59 percent of the University's assets at June 30, 2002.

The largest receivable to the University is for Capital Appropriation Available, $16.4 million.

The debt of the University totaled $23.5 million at the end of the fiscal year. Obligations for bonds and notes equaled $10.7 million and accrued compensated absences equaled $2.8 million. The amount payable to employees and vendors at the end of the period was $4.6 million.

The current assets of the University, $17.2 million, were sufficient to cover the current liabilities of $10.7 million, as the current ratio is $1.59 in current assets for every $1 in current liabilities.

As previously discussed, the total net assets of the University increased by $22.0 million in fiscal year 2002. The net assets of the University now total $85.0 million. The total expendable net assets, $30.2 million, represent 36 percent of the University's total net assets.

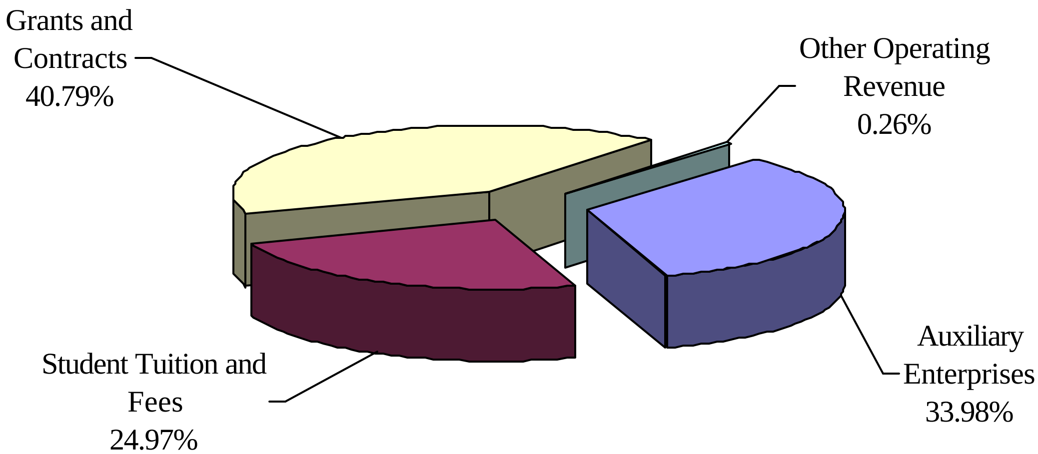
Condensed Statement of Revenues, Expenses, and Changes in Net Assets
For the year ended June 30, 2002

Operating revenues	$ 45,636,476
Operating expenses	74,439,969
Operating loss	(28,803,493)
Non-operating revenues and expenses:	
State appropriations	31,497,030
Other non-operating income and expenses	(185,698)
Net non-operating revenues and expenses	31,311,332
Income before other revenues	2,507,839
Capital appropriations	18,778,220
Capital grants and gifts	595,938
Additions to endowments	96,988
Total other revenue	19,471,146
Total increase in net assets	21,978,985
Net assets, Beginning of year	63,091,251
Net assets, End of year	$ 85,070,236

The operating revenue for fiscal year 2002 totaled $45,636,476. The distribution is as follows:

Student tuition and fees	$ 11,395,185
Grants and contracts	18,612,382
Auxiliary enterprises	15,509,115
Other operating revenue	119,794
Total operating revenue	$ 45,636,476

Operating Revenue - FY 2002



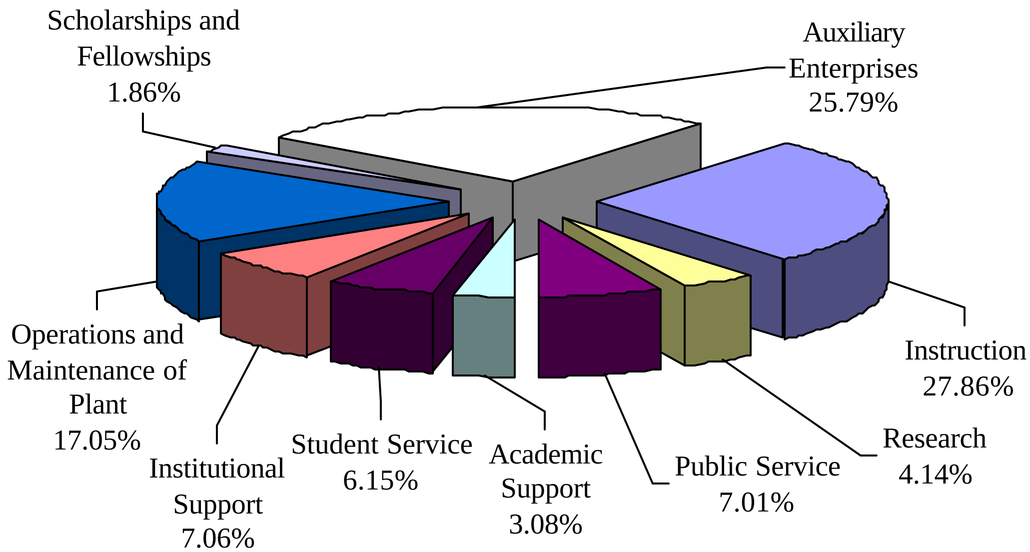
The student tuition and fee revenue is shown net of tuition discounts and scholarship allowances. A tuition discount or scholarship allowance is the difference between the stated charge for goods and services provided by the University and the amount that is paid by students and/or third parties on their behalf. The implementation of GASB Statements 34 and 35 effectively eliminate the historical practice of double-counting revenues. For example, previously, revenue for student aid was initially recorded as restricted revenue and paid out to the University where it was recorded a second time as unrestricted operating revenue. The gross student tuition and fees was $16,313,298 and auxiliary enterprise revenue was $21,766,271. The tuition discounts and scholarship allowances totaled $11,175,269; this is divided between tuition and fees, $4,918,113, and auxiliary enterprises, $6,257,156.

Operating Expenses

Operating expenses totaled $74.4 million in fiscal year 2002. This year, for the first time, the University recorded depreciation expense; the amount recorded was $5,835,183. The operating expenditures distributed functionally are as follows:

Description	Amount
Instruction	$20,728,863
Research	3,081,688
Public service	5,216,718
Academic support	2,291,524
Student service	4,574,867
Institutional support	5,249,543
Operations and maintenance of plant	12,683,055
Scholarships and fellowships	1,380,466
Auxiliary enterprises	19,186,873
Other operating expenses	46,372
Total operating expenses	$74,439,969

Operating Expenses - FY 2002



Non-Operating Revenues and Expenses

The University received state appropriations totaling $50,275,250. The appropriations were divided between operations and capital; $31,497,030 and $18,778,220, respectively. In addition, the University received capital appropriations from the Commonwealth for Equipment Trust Fund purchases of $595,938.

Due to losses on its investments, the University showed a negative investment income for the year of $998,396. Interest on debt related to capital items was $488,695.

Condensed Statement of Cash Flows
For the Fiscal Year Ended June 30, 2002

Cash provided (used) by:	
Operating activities	$(27,295,058)
Noncapital financing activities	33,305,090
Capital and related capital financing activities	(4,016,999)
Investing activities	(1,174,356)
Net increase in cash and cash equivalents	818,677
Cash and cash equivalents, Beginning of year	11,393,403
Cash and cash equivalents, End of year	$ 12,212,080

The purpose of the Statement of Cash Flows is to provide information on the University's receipts and payments of cash. From this statement, the users should be able to assess the:

- University's ability to generate future net cash flows
- Ability to meet obligations as they come due
- Need for external financing

Operating activities were the major use of cash during the fiscal year. The cash in this area comes from tuition ($11.4 million), grants and contracts ($17.5 million) and auxiliary enterprise activities ($15.5 million). The major payments were to employees ($36.9 million) and suppliers ($29.2 million).

Noncapital financing activities were the major source of cash for the year. The major contributing factor was the University's receipt of $31.5 million in appropriations from the Commonwealth. Capital and related capital financing activities, the acquisition and construction of capital assets, including related debt payments, was the second major use cash for the year. $7.4 million was used to acquire new assets and $1.3 million was used retire existing debt. The University also spent $4.1 million in previous capital appropriations.

Capital Assets and Debt Administration

Below is a summary of the fiscal year changes in capital assets:

	July 1, 2001	Change	June 30, 2002
Non-depreciable	$11,897,245	$1,897,766	$13,795,011
Depreciable (net)	50,868,511	(485,262)	50,383,249
Total	$62,765,756	$1,412,504	$64,178,260

Non-depreciable assets consist of land, inexhaustible works of art, and construction in progress. Construction in progress, the most significant of these assets, changed $1,897,766 for the year, increasing from $11,275,516 to $13,173,282.

Net depreciable assets are distributed as follows at June 30, 2002:

Description	Amount
Buildings	$36,151,504
Infrastructure assets	3,272,220
Equipment	6,703,206
Improvements other than buildings	2,928,954
Library books	1,327,365
Total depreciable assets	$50,383,249

The most significant increases this fiscal year to depreciable assets were equipment purchases, the completion of improvement projects, and library books; $1,167,764, $1,198,397, and $440,276, respectively. Due primarily to depreciation, the other depreciable assets had decreases in value for the fiscal year; buildings $2,851,031 and infrastructure $440,668.

Debt Administration

The University had outstanding long-term debt from financing activities of $11,970,613 at the beginning of the fiscal year. By year-end, this debt had been reduced by $1,305,912 to $10,664,701. The June 30, 2002 long-term debt was General Obligation Revenue Bonds $7,677,021, Notes Payable $2,629,472, Capital Lease Obligations $237,238, and Installment Purchases $120,970. The current portion of this long-term debt totals $1,018,646; this is the amount due in fiscal year 2003.

As of June 30, 2002, the University was a party to construction contracts totaling approximately $10,360,190, of which $8,354,883 had been incurred. Unpaid commitments at June 30, 2002, are primarily for the second phase of repairs to the dormitory, the renovation of the Johnston Library and renovation of Rogers Stadium. Further information relating to capital assets, construction, and capital debt is included in the Notes to Financial Statements in Notes 4 and 6.

Factors Impacting Future Periods

The Commonwealth is currently experiencing a budget shortfall due to current economic conditions, which has resulted in reductions to the University's educational and general funding. In fiscal year 2003, the University's funding was reduced by approximately $2 million; the fiscal year 2004 reduction is proposed at $2.3 million.

A portion of the University's funding was exempted from the budget reduction. In November 2001, the Governor and the Attorney General, representing the Commonwealth of Virginia, entered into a formal accord with the Office of Civil Rights of the United States Department of Education. Under the Accord, the Commonwealth committed to fund specific new programs, new facilities and other improvements at the University. These commitments include new bachelor degree programs in Computer Engineering, Computer Science, Manufacturing Engineering, Mass Communications, Criminal Justice and the University's first doctoral program Educational Administration; renovation of Johnston Library, Owens Hall, Rogers Stadium and the construction of additional dormitory space; also, campus wide wiring for the internet and campus wide deferred maintenance. The University estimates that the value of these commitments in fiscal year 2002 approximated $7.8 million. The estimate for fiscal year 2003 is $16.9 million and $16.3 million for fiscal year 2004.

The University and an affiliated university organization, the Virginia State University Real Estate Foundation (Foundation), a newly created 501(c) 3, are associating to build an apartment complex that will house University students. The Foundation is a newly created organization and has no assets; therefore, the University has made loans to it of approximately $1.5 million to defray start up costs of the project. The Foundation has secured permanent funding for the project through the issuance of bonds by the Chesterfield County Industrial Development Authority, which closed on November 18, 2002. Of the $1.5 million advanced to the Foundation, approximately $610,000 has been returned to the University. Remaining as a receivable to the University will be approximately $893,000 as of November 2002. This balance will be recovered as follows; $55,000 in September 2003; $400,000 in November 2004 and the balance, $438,000 over the next 27.5 years, the life of the bonds.

On September 14, 2002, the University's Board of Visitors gave approval for the University to request funding of the renovation of Rogers Stadium through the issuance of 9(d) bonds, as authorized by the General Assembly. These bonds were issued as a portion of the Commonwealth's bond issue that closed October 23, 2002. The bond repayment may be funded through Auxiliary Enterprise Reserves.

VIRGINIA STATE UNIVERSITY
STATEMENT OF NET ASSETS
As of June 30, 2002

ASSETS	
Current assets:	
Cash and cash equivalents (Note 2)	$ 10,942,777
Short-term investments (Note 2)	1,430,892
Accounts receivable, net of allowance for doubtful accounts of $189,667 (Note 3)	3,074,517
Prepaid expenses	1,391,145
Inventories	313,717
Notes receivable, net (Note 3)	53,684
Total current assets	17,206,732
Noncurrent assets:	
Restricted cash and cash equivalents (Note 2)	1,269,303
Restricted investments (Note 2)	180,239
Endowment investments (Note 2)	5,843,445
Notes receivable, net of allowance for doubtful accounts of $97,872 (Note 3)	2,386,392
Other long-term investments (Note 2)	1,074,642
Appropriations available	16,355,554
Unamortized bond issuance costs	49,283
Capital assets, net (Note 4)	64,178,260
Total noncurrent assets	91,337,118
Total assets	108,543,850
LIABILITIES	
Current liabilities:	
Accounts payable and accrued expenses (Note 5)	4,673,492
Deferred revenue (Note 1)	2,281,469
Obligations under securities lending (Note 2)	714,598
Deposits held in custody for others	739,086
Long-term liabilities - current portion (Note 6)	2,322,815
Other liabilities	63,688
Total current liabilities	10,795,148
Noncurrent liabilities:	
Long-term liabilities - noncurrent portion	11,104,875
Other noncurrent liabilities	1,573,591
Total noncurrent liabilities	12,678,466
Total liabilities	23,473,614

VIRGINIA STATE UNIVERSITY
STATEMENT OF NET ASSETS
As of June 30, 2002

NET ASSETS

Invested in capital assets, net of related debt	53,588,721
Restricted for:	
Nonexpendable:	
Scholarships and fellowships	811,745
Departmental uses	448,825
Expendable:	
Capital projects	19,615,803
Scholarships and fellowships	4,675,874
Loans	484,481
Other	356,372
Unrestricted	5,088,415
Total net assets	$ 85,070,236

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

VIRGINIA STATE UNIVERSITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2002

Operating revenues:	
Student tuition and fees, net of scholarship allowances of $4,918,113	$ 11,395,185
Federal grants and contracts	15,655,487
State and local grants and contracts	2,956,895
Auxiliary enterprises, net of scholarship allowances of $6,257,156	15,509,115
Other operating revenues	119,794
Total operating revenues	45,636,476
Operating expenses: (Note 10)	
Education and general:	
Instruction	20,728,863
Research	3,081,688
Public service	5,216,718
Academic support	2,291,524
Student services	4,574,867
Institutional support	5,249,543
Operation and maintenance of plant	12,683,055
Scholarships and fellowships	1,380,466
Auxiliary enterprises (Note 9)	19,186,873
Other operating expenses	46,372
Total operating expenses	74,439,969
Operating loss	(28,803,493)
Nonoperating revenues (expenses):	
State appropriations (Note 8)	31,497,030
Gifts	1,262,086
Net investment expense	(998,396)
Interest on capital asset related debt	(488,695)
Other nonoperating revenues	39,307
Net nonoperating revenues	31,311,332
Income before other revenues, expenses, gains or losses	2,507,839
Capital appropriations (Note 8)	18,778,220
Capital grants and gifts	595,938
Additions to permanent endowments	96,988
Net other revenues	19,471,146
Increase in net assets	21,978,985
Net assets - beginning of year as restated (Note 1)	63,091,251
Net assets - end of year	$ 85,070,236

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

VIRGINIA STATE UNIVERSITY
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2002

Cash flows from operating activities:	
Student tuition and fees	$11,402,816
Grants and contracts	17,526,338
Auxiliary enterprises	15,486,229
Other receipts	50,783
Payments to employees	(36,871,198)
Payments to suppliers	(29,191,821)
Payments for utilities	(2,378,191)
Payments for scholarships and fellowships	(3,087,160)
Loans issued to students	(184,319)
Collections of loans from students	159,142
Other payments	(207,677)
Net cash used by operating activities	(27,295,058)
Cash flows from noncapital financing activities:	
State appropriations	31,497,030
Gifts	1,359,075
Direct lending receipts	16,727,727
Direct lending payments	(16,473,948)
Agency receipts	96,414
Agency payments	(106,536)
Other nonoperating revenue	205,328
Net cash provided by noncapital financing activities	33,305,090
Cash flows from capital financing activities:	
Capital appropriations	4,061,683
Capital gifts and grants	595,938
Purchase of capital assets	(7,378,334)
Principal paid on capital - related debt	(846,842)
Interest paid on capital - related debt	(449,444)
Net cash used by capital financing activities	(4,016,999)
Cash flows from investing activities:	
Investment income	1,448,609
Investment expense	(2,622,965)
Net cash provided by investing activities	(1,174,356)
Net increase in cash	818,677
Cash - beginning of the year	11,393,403
Cash - end of the year	$12,212,080

VIRGINIA STATE UNIVERSITY
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2002

Reconciliation of operating loss to net cash used by operating activities:	
Operating loss	$ (28,803,493)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Depreciation expense	5,835,183
Changes in assets and liabilities:	
Receivables, net	(636,686)
Inventories	15,375
Prepaid expenses	(1,256,610)
Accounts payable	(1,840,901)
Deferred revenue	(652,478)
Compensated absences	69,729
Notes receivable, net	(25,177)
Net cash used by operating activities	$ (27,295,058)
Non-cash investing, capital, and financing activities:	
Loss on disposal of assets	$ (19,693)
Change in fair value of investments	$ (1,212,364)
Principal and interest on capital debt paid by state agency on behalf of the university	$ 515,976

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

VIRGINIA STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2002

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

Virginia State University, founded in 1882, is one of two land grant universities in the state, having been so designated in 1920. As a land grant institution, the University engages in natural resources related research projects and agricultural extension services. The institution attained university status in 1979. The University offers programs at the graduate and undergraduate levels in science, education, humanities, social science, and business. The University's stated mission is to prepare students to advance intellectually, socially, economically, and politically, so they and the University will make significant contributions to the enhancement of society.

Virginia State University is a component unit of the Commonwealth of Virginia and is included in the Comprehensive Annual Financial Report (CAFR) of the Commonwealth. These basic financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB) applicable to colleges and universities. They are prepared for and at the direction of the Commonwealth of Virginia for inclusion in the Commonwealth's CAFR, which includes all agencies, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority.

The University has no component units, as defined by the GASB Statement 14, *The Financial Reporting Entity*; however, the University does have related party corporations whose financial conditions are stated in Note 14. These organizations are separate legal entities from Virginia State University and the University exercises no control over them. For these reasons, the University's related parties are not included in these financial statements.

B. Basis of Presentation

The University's accounting policies conform with generally accepted accounting principles as prescribed by GASB, including all applicable GASB pronouncements, as well as applicable Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure issued on or before November 30, 1989, unless those pronouncements that conflict with or contradict GASB pronouncements. The financial statements have been prepared in accordance with GASB Statement 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements - and Management's Discussion and Analysis - for Public University and Universities*. These new statements are effective for the Commonwealth and all of its component units for the fiscal year ending June 30, 2002. The University now follows GASB Statement 34 requirements for "reporting by special-purpose governments engaged only in business-type activities." The change in financial statement presentation provides a comprehensive entity-wide look at the University's financial activities and replaces the fund-group perspective previously required.

C. Basis of Accounting

The University's financial statements have been prepared 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 a liability is incurred, regardless of the timing of related cash flows. All significant intra-agency transactions have been eliminated.

D. Accounting Changes

With the implementation of GASB Statement 34, several accounting changes were necessary. In the past, there had been no provision made for depreciation of assets. Depreciation is currently recorded on the straight-line basis over the estimated useful life of the assets. The Perkins Loan Program advances previously recorded as an increase to the net assets of the University are accounted for as a liability. Also, the University currently records its inexhaustible works of art.

Due to these changes, the University has reduced its beginning net assets by $82,612,474. A schedule documenting these changes is presented below:

Total fund balances at June 30, 2001	$145,703,725
Beginning balance adjustment for capital assets	(3,964,895)
Accumulated depreciation on capital assets at June 30, 2001, not previously recorded	(78,310,150)
Inexhaustible works of art at June 30, 2001, not previously recorded	354,645
Federal loan program contributions previously recorded as fund balance in loan funds, now recorded as liabilities	(692,074)
Net asset balance at July 1, 2001	$ 63,091,251

E. Cash Equivalents

The University considers all highly liquid investments with an original maturity of 90 days or less to be cash equivalents. Funds invested through the State Non-Arbitrage Program (SNAP) and portions of the funds invested in the State Securities Lending Program are considered cash equivalents.

F. Investments

In accordance with GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, investments are recorded at fair market value at June 30, 2002. All investment income, including changes in the fair value of investments (unrealized gains and losses), is reported as nonoperating revenue in the Statement of Revenues, Expenses, and Changes in Net Assets.

G. Inventories

Inventory is valued at the lower of cost or market. The inventory held by the University consists of supplies held for consumption.

H. Capital Assets

Capital assets consisting of land, building, improvements, equipment, and construction in progress are stated at appraised historical cost or actual cost where determinable. Purchased or constructed fixed assets are reported at cost. Donated fixed assets are reported at fair value on the date of acquisition. Library books are valued at replacement cost as determined by the State Council of Higher Education. Equipment expenditures are capitalized when the acquisition cost is $5,000 or greater and the estimated useful life is one year or more. Expenditures for construction in progress are capitalized as incurred. Infrastructure assets are recorded at cost. Depreciation for building, improvements, and equipment is calculated using the straight-line method over the estimated useful life as follows:

Buildings	40-50 years
Infrastructure assets	15-20 years
Equipment	7-10 years
Library books	5 years
Other improvements	20 years

I. Restricted and Unrestricted Net Assets

Resources restricted by outside sources are distinguished from unrestricted resources allocated for specific purposes by action of the Board of Visitors. Externally-restricted resources may be utilized only in accordance with the purposes established by the source of such resources and are in contrast with unrestricted resources, of which the governing board retains full control to use in achieving the institutional purpose.

Restricted net assets can be expendable or nonexpendable. Nonexpendable restricted net assets are endowments and similar type funds where the donor(s) or some other outside source has stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to principal. Expendable restricted net assets are resources, which the University is legally or contractually obligated to spend in accordance with the restrictions imposed by external parties.

Unrestricted net assets are resources derived primarily from state appropriations, sales and services of educational departments, student tuition and fees, and auxiliary enterprises. Auxiliary enterprises are self-supporting activities that provide services for students, faculty, and staff. These unrestricted resources are used for transactions relating to the educational and general operations of the University and at the discretion of the governing board to meet current expenses.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the University's policy is first to apply the expense toward restricted resources, and then toward unrestricted. Restricted funds remain classified as such until restrictions have been satisfied.

J. Deferred Revenue

Deferred revenue represents moneys received, but not earned as of June 30, 2002. Amounts for student tuition and fees received in advance of the academic term and revenues received from grant and contract sponsors but not spent or earned are considered as deferred revenue.

K. Accrued Compensated Absences

The amount of leave earned, but not taken by 12-month faculty and salaried employees is recorded as a liability on the Statement of Net Assets. The amount reflects all unused vacation leave, overtime leave, compensatory leave, and the amount payable upon termination under the Commonwealth of Virginia's sick leave payout policy as of June 30, 2002. The applicable share of employer-related taxes payable on the eventual termination payments is also included.

L. Revenue and Expense Classifications

Operating revenues include activities that have the characteristics of exchange transactions, such as: (1) student tuition and fees, net of scholarship discounts and allowances; (2) federal, state, and nongovernmental grants and contracts; and (3) sales and services of auxiliary enterprises, net of scholarship allowances.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as gifts, and other revenue sources that are defined as nonoperating revenues by GASB Statement 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, and GASB Statement 34, such as state appropriations and investment and interest income.

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

M. Scholarship Discounts and Allowances

Student tuition and fee revenues and certain other revenues from students, are reported net of scholarship allowances. To the extent that revenues from certain governmental and nongovernmental grants and programs reported as either operating or nonoperating revenues in the financial statements are used to satisfy tuition and fees and other student charges, these revenues have been defined as scholarship allowances and allocated to reduce student tuition and fee revenues. This is a change in fiscal year to eliminate the historical practice of double counting restricted revenues received and used to pay for tuition and fees.

N. Federal Financial Assistance Programs

The University participates in federally funded programs such as Pell Grants, Supplemental Educational Opportunity Grants, Federal Work-Study, and the Perkins Loans programs. Federal programs are audited in accordance with the Single Audit Act Amendments of 1996, the Office of Management and Budget Revised Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, and the Compliance Supplement.

2. CASH AND CASH EQUIVALENTS AND INVESTMENTS

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

A. Cash and Cash Equivalents

Pursuant to Section 22-1800, et seq., Code of Virginia (1950) as amended, all state funds of the University are held 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 covered by federal depository insurance or collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 of the Code of Virginia. In accordance with the GASB Statement 9 definition of cash and cash equivalents, cash represents cash with the Treasurer of Virginia, cash on hand, and cash deposits including certificates of deposit and temporary investments with original maturities of three months or less. At June 30, 2002, the carrying amount of cash was $12,212,080.

Investments

Statutes authorize the investment of local funds held by the University in obligations of the Commonwealth, federal government, other states of political subdivisions thereof, Virginia political subdivisions, the International Bank for Reconstruction and Development, the Asian Development Bank, and the African Development Bank. In addition, the University may invest in prime quality commercial paper rated Prime 1 by Moody's Investment Service or A-1 by Standard and Poor's Incorporated. The University may also invest in overnight term or open repurchase agreements, and money market funds.

The University's investments, including short-term investments, are categorized below to give an indication of the level of credit risk assumed by the University at June 30, 2002. Credit risk is the risk that the University may not be able to obtain possession of its investment instrument or collateral at maturity. Risk category 1 includes investments which are insured or registered or for which the University or its safekeeping agent in the University's name hold the securities. Risk category 2 includes uninsured or unregistered investments for which the broker's or dealer or its trust department or safekeeping agent in the University's name holds the securities. Risk category 3 includes uninsured or unregistered investments for which the securities are held by the broker or dealer, or by its trust department or safekeeping agent, but not in the University's name. The University held no assets in either risk category 2 or 3 at June 30, 2002.

The composition and categorization of investments held by the University at June 30, 2002, is as follows:

Description	Category 1	Market Value	Cost
Investments:			
U.S. government securities	$ 863,525	$ 863,525	$ 840,635
Corporate stock	4,507,265	4,507,265	3,339,911
Corporate bonds	907,766	907,766	886,852
Subtotal	6,278,556	6,278,556	5,067,398
Money market funds	-	819,769	819,769
State non-arbitrage program	-	780,609	780,609
Total investments	$6,278,556	$7,878,934	$6,667,776
Money market funds/Cash equivalents	$ -	$1,950,702	$1,950,702

Securities Lending Transactions

Investments held by the Treasurer of Virginia include the University's allocated share of securities totaling $714,598 of which $64,314 are cash equivalents received for securities lending transactions held in the General Account of the Commonwealth. Information related to the credit risk of these investments and securities lending transactions held in the General Account is available on a statewide level in the Commonwealth of Virginia's *Comprehensive Annual Financial Report*.

3. ACCOUNTS RECEIVABLE AND NOTES RECEIVABLE

A. Accounts Receivable

Accounts Receivable is shown net of allowance for doubtful accounts in the accompanying Statement of Net Assets. At June 30, 2002, accounts receivable consisted of the following:

Student tuition and fees	$ 306,454
Federal, state, and nongovernmental grants and contracts	2,383,985
Auxiliary enterprises	62,381
Pledges	334,190
Due from the Commonwealth	76,262
Other	100,912
Total	3,264,184
Less: Allowance for doubtful accounts	189,667
Net accounts receivable	$3,074,517

Pledges receivable represent pledges of financial support from corporations, foundations and individuals. Pledges have been recorded as gifts and certain pledges are recorded at present value using a discount rate of five percent. Allowance for doubtful accounts on pledges receivable amounted to $66,838 and was computed using a 20 percent uncollectible rate. This percentage was based on a historical trend of pledges received.

Due from the Commonwealth represents reimbursements receivables for equipment purchases made by the University under the Equipment Trust Fund (ETF) Program. On a reimbursement basis, this program provides state-supported institutions of higher education with bond proceeds for financing the acquisition and replacement of instructional and research equipment.

B. Notes Receivable

Notes Receivable is shown net of allowance for doubtful accounts in the accompanying Statement of Net Assets. At June 30, 2002, notes receivable consisted of the following:

Federal student loans	$1,763,215
Other	774,733
Total	2,537,948
Less: Allowance for doubtful accounts	97,872
Net notes receivable	$2,440,076

4. CAPITAL ASSETS

A summary of changes in the various capital asset categories for the year ended June 30, 2002, is presented as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Nondepreciable capital assets:				
Land	$ 267,084	$ -	$ -	$ 267,084
Inexhaustible works of art and/or historical treasures	354,645	-	-	354,645
Construction in progress	11,275,516	3,913,684	2,015,918	13,173,282
Total nondepreciable capital assets	11,897,245	3,913,684	2,015,918	13,795,011
Depreciable capital assets:				
Buildings	88,304,441	809,195	165,475	88,948,161
Infrastructure assets	8,293,948	-	-	8,293,948
Equipment	16,929,440	2,456,699	377,038	19,009,101
Other improvements	2,445,120	1,362,739	-	3,807,859
Library books	13,205,712	980,421	592,353	13,593,780
Total depreciable capital assets	129,178,661	5,609,054	1,134,866	133,652,849

Less accumulated depreciation for:				
Buildings	49,301,906	3,651,243	156,492	52,796,657
Infrastructure assets	4,581,060	440,668	-	5,021,728
Equipment	11,393,998	1,038,786	126,889	12,305,895
Other improvements	714,563	164,342	-	878,905
Library books	12,318,623	540,144	592,352	12,266,415
Total accumulated depreciation	78,310,150	5,835,183	875,733	83,269,600
Depreciable capital assets, Net	50,868,511	(226,129)	259,133	50,383,249
Total capital assets, Net	$ 62,765,756	$3,687,555	$2,275,051	$ 64,178,260

5. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following at June 30, 2002:

Current liabilities:	
Employee salaries, wages, and fringe benefits payable	$2,950,969
Vendors and suppliers accounts payable	1,534,505
Retainage payable	138,597
Matured interest payable	49,421
Total current liabilities – Accounts payable and accrued liabilities	$4,673,492

6. NONCURRENT LIABILITIES

The University's noncurrent liabilities consist of long-term debt (further described in Note 7) and other noncurrent liabilities. A summary of changes in noncurrent liabilities for the year ending June 30, 2002, is presented as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Long-term debt:					
General obligation bonds	$ 8,290,269	$ -	$ 613,248	$ 7,677,021	$ 645,000
Notes payable	2,725,300	-	95,828	2,629,472	98,373
Capital leases	747,810	-	510,572	237,238	237,238
Installment purchases	207,234	-	86,264	120,970	38,035
Total long-term debt	11,970,613	-	1,305,912	10,664,701	1,018,646
Accrued compensated absences	2,693,260	1,663,101	1,593,372	2,762,989	1,304,169
Total long-term liabilities	14,663,873	1,663,101	2,899,284	13,427,690	2,322,815

Other noncurrent liabilities:					
Perkins loan program contributions	1,548,599	24,992	-	1,573,591	-
Total noncurrent liabilities	$16,212,472	$1,688,093	$2,899,284	$15,001,281	$2,322,815

7. LONG-TERM INDEBTEDNESS

Bonds Payable

The University's bonds are issued pursuant to Section 9 of Article X of the Constitution of Virginia. All bonds of the University are Section 9(c) bonds. These bonds are backed by the full faith, credit, and taxing power of the Commonwealth, and are issued to finance capital projects which, when completed, will generate revenue to repay the debt.

The University had a total of $7,677,021 in bonds outstanding at June 30, 2002, consisting of the following:

	Interest Rates	Maturity	Amount
General obligation revenue bonds:			
Langston Hall Project, Series 1995	4.60-5.10%	2010	$1,621,447
Foster Hall Project, Series 1995	4.60-5.10%	2010	1,455,766
Dorm Renovation Project, Series 1995	4.60-5.10%	2010	1,691,731
Jones Dining Hall Project, Series 1996	5.38%	2016	2,006,974
Jones Dining Hall Project, Series 1996	4.67%	2018	901,103
Total bonds payable			$7,677,021

Aggregate annual maturities of bonds payable for fiscal years after 2002 are:

Year	Principal	Interest	Total
2003	$ 645,000	$ 380,643	$ 1,025,643
2004	670,000	350,341	1,020,341
2005	705,000	318,408	1,023,408
2006	735,000	284,795	1,019,795
2007	775,000	248,638	1,023,638
2008-2012	2,975,000	653,120	3,628,120
2013-2017	1,065,000	163,827	1,228,827
2018	75,000	3,525	78,525
Add unamortized premium	32,021	-	32,021
Total	$7,677,021	$2,403,297	$10,080,318

Notes Payable

The University entered into a loan agreement with the Department of Housing and Urban Development in 1989 and closed the agreement in 1992 to borrow funds to repair seven dormitories. The loan is to be repaid over 30 years at three percent interest per annum, and is secured by a lien on the net revenues from the ownership, operation, and use of the seven dormitories under repair. At

June 30, 2002, the outstanding balance of the loan was $2,629,472. A summary of future principal and interest requirements as of June 30, 2002, are as follows:

Year	Principal	Interest	Total
2003	$ 98,373	$ 78,149	$ 176,522
2004	101,708	76,165	177,873
2005	84,702	72,291	156,993
2006	107,749	68,924	176,673
2007	111,212	64,781	175,993
2008-2012	608,559	275,806	884,365
2013-2017	707,257	177,689	884,946
2018-2022	790,281	64,727	855,008
2023	19,631	-	19,631
Total	$2,629,472	$878,532	$3,508,004

Capital Leases Payable

The University is committed under capital lease agreements with the Virginia College Building Authority (VCBA) in the combined principal amount of $237,238. The agreements entered in 1997 will mature in fiscal year 2003 with interest rates ranging from 3.50 percent to 5.35 percent. Under the terms of the leases, the University is authorized to purchase equipment from an approved list of equipment in an amount not to exceed the principal amount of the lease. Payment of such purchases are to be reimbursed to the University or directly paid by the VCBA from the VCBA Equipment Trust Fund which is financed from the proceeds of bonds issued by the VCBA for such purposes. The General Assembly has appropriated from the General Fund of the Commonwealth amounts sufficient to repay principal and interest requirements under the lease agreements. The University is also committed under other capital leases for equipment. A summary of future principal and interest requirements as of June 30, 2002, are as follows:

	Equipment Trust Fund Capital Lease Obligations
Total principal and interest, FY 2003	$248,507
Interest cost	(11,269)
Total capital lease obligations	$237,238

Installment Purchases

The University has entered into installment purchase contracts to finance the acquisition of copiers and a mainframe. The length of the purchase agreements is for three years and the interest rate ranges from 4.0 to 5.1 percent. In July 2000, the University entered into a five-year master lease agreement with IBM Corporation to provide financing of lighting equipment for Rogers Stadium Athletic Complex at Virginia State University. The interest rate for this financing is 5.75 percent. Principal and interest payments on these commitments for fiscal years subsequent to June 30, 2002 are as follows:

Year	Principal	Interest	Total
2003	$ 38,035	$ 5,961	$ 43,996
2004	40,279	3,717	43,996
2005	42,656	1,340	43,996
Total	$120,970	$11,018	$131,988

8. STATE APPROPRIATIONS

The University receives state appropriations from the General Fund of the Commonwealth. The Appropriation Act specifies that certain unexpended appropriations shall revert, as specifically provided by the General Assembly, at the end of a biennium. The following is a summary of state appropriations received by the University for the year ended June 30, 2002.

Virginia State University:	
Educational and general programs	$26,624,796
Higher education student financial assistance	2,236,980
Higher education equipment trust fund	515,976
Financial assistance for educational and general programs	219,888
Central appropriations	(794,130)
Capital projects appropriations:	
Capital improvements	1,539,309
21st Century Bond program	16,778,183
Central maintenance reserve	460,728
State grants	186,609
VSU Cooperative Extension and Agricultural Research Services:	
Educational and general programs	2,506,911
Total appropriations	$50,275,250

9. AUXILIARY ACTIVITIES

The University uses Board approved auxiliary reserves to pay debt service and capital improvements of $1,277,091 and $1,622,193 respectively in fiscal year 2002. Current year operating revenues and expenses for auxiliary operations were received and distributed as follows:

Revenues:	
Food service	$ 5,648,865
Residential facilities	7,778,765
Student unions and recreational facilities	22,347
Intercollegiate athletics	424,166
Other auxiliary and sales and services	7,892,128
Total auxiliary enterprises revenues	21,766,271
Less: Scholarship allowances	6,257,156
Net auxiliary enterprises revenues	$15,509,115

Expenses:	
Salaries and wages	$ 3,296,772
Contractual services	6,583,867
Supplies and materials	512,609
Equipment	675,632
Current charges and obligations	1,509,964
Scholarships	1,280,795
Indirect costs	3,105,011
Depreciation expense	2,191,650
Other auxiliary expenses	30,573
Total auxiliary enterprises expenses	$19,186,873

10. EXPENSES BY NATURAL CLASSIFICATIONS

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

	Salaries and Wages	Fringe Benefits	Services and Supplies	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	$13,281,282	$2,380,452	$ 3,536,037	$ 58,201	$ 147	$1,472,744	$20,728,863
Research	1,700,222	181,880	843,860	72,810	1,934	280,982	3,081,688
Public service	2,281,908	618,984	1,863,909	111,178	59,757	280,982	5,216,718
Academic support	2,071,322	601,250	(879,320)	104,167	732	393,373	2,291,524
Student services	2,199,459	600,432	1,320,427	117,384	(12)	337,177	4,574,867
Institutional support	2,783,727	1,613,987	490,581	43,460	1,474	316,314	5,249,543
Operation and maintenance of plant	1,493,900	475,084	8,343,845	1,037	1,807,228	561,961	12,683,055
Scholarships and fellowships	21,303	(63)	111,588	1,247,638	-	-	1,380,466
Auxiliary activities	3,296,772	694,985	11,165,249	1,331,286	506,931	2,191,650	19,186,873
Other expenses	-	-	46,372	-	-	-	46,372
Total	$29,129,895	$7,166,991	$26,842,548	$3,087,161	$2,378,191	$5,835,183	$74,439,969

11. COMMITMENTS

As of June 30, 2002, the University was a party to construction contracts totaling approximately $10,360,190, of which $8,354,883 had been incurred.

The University is committed under operating leases for equipment and building space. In most cases, the University expects that in the normal course of business, these leases will be replaced by similar leases. Rental expense for the fiscal year ended June 30, 2002, was $1,018,794. The University has, as of June 30, 2002, the following total future minimum rental payments:

Fiscal Year	Operating Leases
2003	$1,471,768

12. RETIREMENT 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 (PERS) 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 for individual state institutions. Therefore, all information relating to this plan is available at the statewide level in the Commonwealth's Comprehensive Annual Financial Report (CAFR). The CAFR discloses the unfunded pension benefit obligation at June 30, 2002, as well as the ten-year historical trend information showing VRS' progress in accumulating sufficient assets to pay benefits when due.

The University's payroll costs for employees covered by the VRS for the year ended June 30, 2002, was $20,835,450. The University's total payroll costs for the year then ended was $33,157,441. The University's total VRS contributions were $1,605,238 for the year ended June 30, 2002, which included the five percent employee contribution assumed by the employer. These contributions represent 7.7 percent of covered payroll for the year.

Optional Retirement Plans

Full-time faculty and certain administrative may participate in six optional retirement plans. University employees currently participate in four of these plans, which include: Fidelity Investments Institutional Services, Teacher Insurance and Annuity Association/College Retirement Equity Fund (TIAA/CREF), T. Rowe Price and Associates, and Variable Annuity Life Insurance (VALIC). These are fixed-contribution programs where the retirement benefits received are based upon the employer and employee contributions totaling 10.4 percent, plus interest and dividends.

Individual contracts issued under these plans provide full and immediate vesting of both the University and the participants' contributions. Total pension costs under these plans were approximately $537,132 for the year ended June 30, 2002. Contributions to the optional retirement plan were calculated using the base salary amount of approximately $5,164,732. The University's total payroll in fiscal year 2002 was approximately $33,157,441.

13. POST-EMPLOYMENT BENEFITS

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

14. AFFILIATED ORGANIZATION

Virginia State University Foundation

The Virginia State University Foundation is separately incorporated and managed by its own board. Assets and liabilities of the Foundation are not included in the accompanying financial statements. The Foundation was organized for fund-raising activities, which support the University. Its annual financial statements are audited by an independent certified public accountant. The audit for June 30, 2002 is not yet complete.

The financial statements of the Foundation's financial position as of June 30, 2002, which are not audited, are as follows:

ASSETS	
Cash	$ 456,797
Other receivables	4,733
Investment in securities	4,021,132
Total assets	$4,482,662
LIABILITIES AND NET ASSETS	
Total liabilities	$ 8,401
Total net assets	4,474,261
Total liabilities and net	$4,482,662

The University and the Foundation have been pursuing jointly the development of an off-campus housing project for the purpose of housing Virginia State University students. To enable this project, the University obtained Appropriation Act language to authorize it to purchase a tract of land, ground lease the land to a related foundation, provide pre-closing funding of some predevelopment cost of the Foundation, and obtain a Treasury loan to be used for reimbursing the predevelopment costs and providing construction financing. Concurrently, the Foundation has created a separate legal entity, the Virginia State University Real Estate Foundation (Real Estate Foundation). The Real Estate Foundation will serve as borrower for the permanent financing, ground lease the land from the University, and own and manage the improvements to be developed on the land for the period of the ground lease, after which it will revert to University ownership. Permanent financing will be provided by the sale of tax-exempt bonds issued through the Chesterfield County Industrial Development Authority. Authorization for the University's role in this project appears as Item C-82 in the 2002-2004 Appropriation Act. Permanent financing was approved as of November 18, 2002.

Virginia State University Real Estate Foundation

The Virginia State University Real Estate Foundation (VSUREF) is separately incorporated and managed by its own Board of Directors. The Foundation was organized for development of an off-campus student housing project known as the Ettrick Apartments Project, which will house Virginia State University students. The University agreed to advance VSUREF sufficient monies to hire consultants to conduct preliminary research and to represent the interest of the University. Additionally, the University agreed to loan VSUREF $700,000 for start up costs for this project. VSUREF will manage the complex after completion. The VSUREF as of June 30, 2002, had a liability of $755,142 owed to the University. This will be reimbursed to the University through bond proceeds after the completion of the project. The project is scheduled to be completed in the fall of fiscal year 2004.

15. 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 Virginia State University.

In addition, the University is required to comply with various regulations issued by the Office of Management and Budget. Failure to comply with these regulations may result in questions concerning the allowability of related direct and indirect charges pursuant to such agreements. As of June 30, 2002, the University estimates that no material liabilities will result from such audits or questions.

The University has been a defendant in several legal actions. The final outcome is unpredictable at this time, but management is of the opinion that the liability, if any, for these legal actions will not have a material effect on the University's financial position.

16. RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft or, 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 at the statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report.

17. SUBSEQUENT EVENTS

On September 14, 2002, the University's Board of Visitors adopted a resolution to participate in the 2002 Virginia College Building Authority Pooled Bond Program for the sale of 9(d) bonds as authorized by the General Assembly for the renovations of Rogers Stadium.

VIRGINIA STATE UNIVERSITY
SCHEDULE OF AUXILIARY ENTERPRISES - REVENUES AND EXPENDITURES
For the Year Ended June 30, 2002

	Food Services	Bookstore	Residential Services	Parking and Transportation
Operating revenues:				
Student fees	$ 5,516,887	$ -	$ 7,524,162	$ -
Sales and services	131,978	160,680	151,951	232,225
Interest revenue	-	-	-	-
Rental fees	-	-	102,652	-
Gifts	-	-	-	-
Total operating revenues	5,648,865	160,680	7,778,765	232,225
Operating expenditures:				
Personal services	-	-	796,367	43,736
Employee benefits	-	-	106,927	21,027
Contractual services	3,449,313	8,960	1,793,714	39,449
Supplies and materials	13,622	-	93,337	(34,109)
Equipment	12,982	-	364,807	2,379
Current charges and obligations	-	-	851,341	6,673
Scholarships	-	-	394,276	-
Indirect costs	819,666	2,098	1,048,083	14,797
Miscellaneous	-	-	565	-
Total operating expenditures	4,295,583	11,058	5,449,417	93,952
Excess of revenues over expenditures before transfers	1,353,282	149,622	2,329,348	138,273
Transfers to other funds:				
Mandatory transfers - debt service	(75,000)	-	-	-
Nonmandatory transfers	(1,256,705)	(149,177)	(2,215,622)	(26,904)
Net increase (decrease) for the year	21,577	445	113,726	111,369
Fund balance at beginning of year	108,749	13,017	(196,152)	149,676
Fund balance at end of year	$ 130,326	$ 13,462	$ (82,426)	$ 261,045

Note: This schedule accounts for purchases of capital assets as expenses and does not include depreciation. Management uses this method of accounting to monitor individual auxiliary enterprises and to set rates.

Telecom- munications	Student Health Services	Student Union & Recreational Facilities	Other Auxiliary Functions	Inter- collegiate Athletics	Reserves	Total
$ -	$ 41,082	$ -	$ 6,371,823	$ 2,838	$ -	$ 19,456,792
111,305	-	11,717	649,595	406,328	-	1,855,779
-	-	-	298,231	-	-	298,231
-	-	10,630	27,187	-	-	140,469
-	-	-	-	15,000	-	15,000
111,305	41,082	22,347	7,346,836	424,166	-	21,766,271
84,142	269,931	596,547	776,852	720,266	-	3,287,841
15,767	36,745	61,320	116,369	65,886	-	424,041
(53,061)	67,199	293,377	604,122	380,794	-	6,583,867
2,190	30,282	100,021	130,636	176,630	-	512,609
25,524	7,147	125,785	127,736	9,272	-	675,632
275	-	9,295	593,110	49,270	-	1,509,964
-	-	101,966	300,307	484,246	-	1,280,795
8,271	103,499	303,420	373,494	431,683	-	3,105,011
(903)	-	4,746	18,462	(5,108)	-	17,762
82,205	514,803	1,596,477	3,041,088	2,312,939	-	17,397,522
29,100	(473,721)	(1,574,130)	4,305,748	(1,888,773)	-	4,368,749
-	-	-	(10,559)	-	(1,191,532)	(1,277,091)
2,918	515,595	1,575,871	(4,301,377)	1,903,899	1,296,819	(2,654,683)
32,018	41,874	1,741	(6,188)	15,126	105,287	436,975
(89,329)	(36,762)	(110,538)	35,538	(18,423)	4,558,524	4,414,300
$ (57,311)	$ 5,112	$ (108,797)	$ 29,350	$ (3,297)	$ 4,663,811	$ 4,851,275