NORFOLK STATE UNIVERSITY

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2006

APA
Auditor of
Public Accounts
COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of Norfolk State University for the year ended June 30, 2006, 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 these matters to be material weaknesses;
- an instance of non-compliance required to be reported; and
- the University has taken adequate corrective action with respect to the audit findings reported in the prior year.

- T A B L E   O F   C O N T E N T S -

INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Follow the University's Systems Change Management Procedures

Employees are making changes to critical computer hardware and information systems programs without documentation of approval and authorization. Best practices for change management require management to authorize and approve changes to all critical computer hardware and information systems programs.

Without management's authorization and approval for hardware and software program changes, the University risks that employees with access could make changes to data or applications without proper authorization and approval. Such changes may not fully meet the data owner's requirements, and changes to one system or network component may not work with other hardware or systems. Additionally, management may not be able to determine whether changes comply with the University's information systems strategies or information security policies.

The University's change management policies and procedures are very comprehensive and follow industry best practices. However, neither management nor the staff is using the University's policies and procedures.

We recommend that the University management and staff follow the University's change management policies and procedures. University management should work with the Office of Information Technology management to ensure that supervisors use this best practices model.

Strengthen Controls over Capital Project Management

In reviewing the University's capital outlay projects, we noted that University management does not formally assign Contract Administrators nor do they provide the Contract Administrators with formal written responsibilities. Procurement staff did not always verify that architects and engineers had licenses to do business in the Commonwealth during the bidding process. Facilities Management did not maintain the documentation to support the contractor, architect and engineers' invoices and change orders. Finally, Facilities Management did not always obtain management approval when authorizing change orders exceeding 25 percent of the original contract amount.

In the past, the University decentralized the maintenance of contract files among several different departments. The decentralization of contract files has led to inconsistencies in documentation and difficulties in coordination and project supervision. Decentralization also diminishes the ability of senior management to provide proper oversight to ensure that the University complies with all procurement regulations and is obtaining quality work at a reasonable price.

We recommend that Facilities Management develop, implement, and follow formal policies and procedures for monitoring and documenting capital outlay projects. Facilities Management should follow the Construction and Professional Services Manual and the Agency Procurement and Surplus Property Manual regarding procurement and management of capital outlay projects. The University should consider having one central location or position maintain all construction and architect and engineering contract files. Improved capital project procedures will assist the University in ensuring that it receives proper value in construction of important building projects.

Complete Biennial Equipment Inventories

The Financial Services Department did not perform a complete inventory of the University's capital assets within a two-year period, as required by University and state policies, for 17 of the University's 35 buildings. The inventory helps establish that assets have not been lost, stolen, improperly disposed of, or misplaced and not available for academic use. Additionally, the resulting inaccuracies in the fixed asset system may result in overstating or understating the value of capital assets reported in the financial statements.

We recommend that Financial Services complete an inventory of all capital assets within a two-year period. If staffing is not available for a complete inventory, the University may wish to consider completing the inventory based on statistical sampling or materiality. We further recommend that management revise, document, implement, and follow adequate capital asset inventory policies and procedures. Accurate capital asset records will enable the University to ensure that all equipment is available for use by the appropriate department and that the University's asset value is accurate for financial statements and insurance purposes.

Develop Formal Capital Asset Accounting Policies and Procedures

The Financial Services Department does not have written accounting and reporting policies and procedures for impaired assets and capital outlay projects, including construction in progress. In addition, Financial Services does not have written policies and procedures for assigning useful lives or salvage value to purchased capital assets. Not having these policies could lead to inconsistencies or inaccuracies in reporting capital assets in the financial statements. Documenting these policies and procedures will provide for consistent accounting and reporting when there are financial reporting staffing changes.

We recommend that Financial Services develop and implement formal capital asset policies and procedures for accounting and reporting impaired assets; capital outlay projects and construction in progress; assigning useful lives; and recording salvage value. Financial Services should make sure that the financial reporting staff is aware of the updated policies and follow the documented policies and procedures throughout the year.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(unaudited)

Overview

The following Management's Discussion and Analysis (MD&A) is required supplemental information under the Governmental Accounting Standards Board (GASB) reporting model. It is designed to assist readers in understanding the accompanying financial statements and provides an objective, easily readable analysis of 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, 2006. Note that although the University's foundations identified as component units under GASB Statement 39 are reported in the financial statements, they are excluded from this MD&A, except where specifically noted. Comparative numbers, where presented, are for the fiscal year ended June 30, 2005. Since this presentation includes highly summarized data, it should be read in conjunction with the accompanying financial statements, notes to financial statements, and other supplementary information. University management is responsible for all of the financial information presented, including this discussion and analysis.

Statement of Net Assets

The Statement of Net Assets presents the University's assets, liabilities, and net assets as of the end of the fiscal year. The purpose of this statement is to present to the financial statement readers a fiscal snapshot at June 30, 2006. From the data presented, readers of the Statement of Net Assets are able to determine the assets available to continue the University's operations. They are also able to determine how much the University owes vendors and creditors.

Net assets are divided into three major categories. The first category, "Invested in capital assets, net of debt," provides the University's equity in property, plant, and equipment owned by the University. The next category is "Restricted net assets - Expendable" which are restricted resources available for expenditure by the University, but must be spent for purposes as determined by the donors and/or other entities that have placed time or purpose restrictions on the use of the asset. Unrestricted net assets are available to the University for any lawful purpose of the University.

Statement of Net Assets
(amounts in thousands)

	As of June 30,		Increase/Decrease	
	2006	2005	Amount	Percent
Assets:				
Current	$ 16,882	$ 16,726	$ 156	0.9%
Capital, net of accumulated depreciation	111,567	75,196	36,371	48.4%
Other non-current	35,235	50,452	(15,217)	(30.2%)
Total assets	163,684	142,374	21,310	15.0%
Liabilities:				
Current	21,509	15,669	5,840	37.3%
Non-current	52,060	54,958	(2,898)	(5.3%)
Total liabilities	73,569	70,627	2,942	4.2%

Net assets:				
Invested in capital assets, net of related debt	77,976	53,421	24,555	46.0%
Restricted	10,819	15,605	(4,786)	(30.7%)
Unrestricted	1,320	2,721	(1,401)	(51.5%)
Total net assets	$ 90,115	$ 71,747	$ 18,368	25.6%

In 2006, the University's total assets increased by $21,309,788 due to an increase in capital assets. Nondepreciable capital assets increased due to the construction of the Marie V. McDemmond Center for Applied Research, Robinson Technology building renovation, and campus wide infrastructure wiring to enhance student access to technology. Total liabilities increased by $2,941,737 primarily due to accounts payable related to capital projects.

Statement of Revenues, Expenses, and Changes in Net Assets

Changes in total net assets as presented on the Statement of Net Assets are based on the activity as presented in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of this statement is to present the University's operating and nonoperating revenues recognized and expenses incurred and any other revenues, expenses, gains, and losses.

Generally speaking, operating revenues are received for providing goods and services to students and other constituencies of the University. 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 provided. For example, the University's state appropriations are nonoperating because they are provided by the state legislature without the legislature directly receiving commensurate goods and services for those revenues.

Statement of Revenues, Expenses, and Changes in Net Assets
(amounts in thousands)

	Year ended June 30,		Increase/Decrease	
	2006	2005	Amount	Percent
Operating revenues:				
Student tuition and fees, net of scholarship allowances of $5,687 and $5,626	$ 24,790	$ 23,011	$ 1,779	7.7%
Federal grants and contracts	19,508	25,754	(6,246)	(24.3%)
State grants and contracts	1,708	1,533	175	11.4%
Nongovernmental grants and contracts	2,231	1,665	566	34.0%
Auxiliary enterprises, net of scholarship allowances of $4,974 and $5,084	18,973	19,937	(964)	(4.8%)
Other operating revenues	819	557	262	47.0%
Total operating revenues	68,029	72,457	(4,428)	(6.1%)

Operating expenses:				
Instruction	34,258	32,561	1,697	5.2%
Research	5,972	6,663	(691)	(10.4%)
Public service	2,214	1,618	596	36.8%
Academic support	15,490	13,479	2,011	14.9%
Student services	5,214	4,551	663	14.6%
Institutional support	15,499	12,932	2,567	19.8%
Operation and maintenance of plant	12,769	9,607	3,162	32.9%
Depreciation	5,290	5,181	109	2.1%
Student aid	11,474	14,657	(3,183)	(21.7%)
Auxiliary activities	16,410	17,985	(1,575)	(8.8%)
Total operating expenses	124,590	119,234	5,356	4.5%
Operating loss	(56,561)	(46,777)	(9,784)	(20.9%)
Net nonoperating revenues and expenses	49,688	44,726	4,962	11.1%
Decrease before other revenues, expenses, gains, and losses	(6,873)	(2,051)	(4,822)	(235.1%)
Net other revenues	23,236	14,425	8,811	61.1%
Increase in net assets	16,363	12,374	3,989	32.2%
Net assets - beginning of year, restated	73,752	59,373	14,379	24.2%
Net assets - end of year	$ 90,115	$ 71,747	$ 18,368	25.6%

Operating revenues primarily include tuition and fees, auxiliary enterprises, and revenues from grants and contracts. The decrease in operating revenues of $4,428,495 is mainly attributable to a decrease in federal grants and contracts revenue which resulted from a revision in the scholarship and allowance discount calculation in 2006. This decrease was offset by a growth in operating revenue due to tuition rate increases. Total operating expenses increased $5,356,358 primarily due to increases in operation and maintenance of plant and institutional support expenses.

The increase of $4,962,740 in nonoperating revenues and expenses is attributable to an increase in state appropriations of $3,750,070. Other revenues increased $8,811,373 due to an overall increase in General Obligation Bond and 21st Century funding for the construction of the Marie V. McDemmond Center for Applied Research and renovation of the Robinson Technology Building.

Statement of Cash Flows

The final statement presented by the University is the Statement of Cash Flows. This statement presents detailed information about the University's cash activity during the year and aids in the assessment of the University's ability to generate cash to meet present and future obligations. Operating cash flows shows the net cash used by the operating activities of the University. Significant sources of cash include student tuition and fees ($23,729,086), grants and contracts ($23,605,348) and auxiliary enterprises receipts ($18,952,382). Major uses of cash include payments for salaries, wages, and fringe benefits ($73,873,246), payments for services and supplies ($12,179,608), and payments for scholarships and fellowships ($17,365,258).

The next section reflects the cash flows from non-capital financial activities and includes state appropriations for the University's educational and general programs and financial aid ($48,568,919). The cash flows from capital financing activities section reflects cash used for capital and related items. Primary sources of cash include capital appropriations ($22,892,168). Significant cash outflows include the purchase of capital assets ($40,804,196) and the repayment of principal and interest on capital related debt ($2,791,056). Cash flows from investing activities include interest income on investments ($984,086) and the conversion of investment portfolio to money market funds ($11,011,289). The final section of the cash flow statement reconciles the net cash used by operating activities to the operating loss reflected on the Statement of Revenue, Expenses, and Changes in Net Assets.

Statement of Cash Flows
(amounts in thousands)

	Year ended June 30,		Increase/Decrease	
	2006	2005	Amount	Percent
Cash flows from operating activities	$ (44,232)	$ (39,893)	$ (4,339)	10.9%
Cash flows from noncapital financial activities	48,687	45,186	3,501	7.7%
Cash flows from capital financing activities	(20,359)	27,219	(47,578)	(174.8%)
Cash flows from investing activities	11,999	(8,163)	20,162	(247.0%)
Net change in cash	$ (3,905)	$ 24,349	$ (28,254)	(116.0%)

Capital Asset and Debt Administration

Overall, invested in capital assets increased $24,554,367. New long-term debt (9d bond) of $21,520,000 was issued in 2005 to construct a new student center which has a scheduled completion date of September 2008. Other capital projects currently underway at the University include the construction of the Marie V. McDemmond Center for Applied Research, Energy Project – Phase II, and renovation of the Robinson Technology Building. All had an October 2006 completion date. As calculated under the State Council of Higher Education in Virginia's formula, the University's 2006 debt service to expenditures ratio was 2.24 percent. This ratio measures the University's ability to satisfy its long-term debt as it becomes due.

Overall, unpaid construction and other related contractual commitments on capital projects decreased from $19,479,042 in 2005 to $15,206,244 in 2006. Construction in progress on all capital projects totaled $50,112,071, as of June 30, 2006.

Economic Outlook

The University's economic outlook is closely related to its role as one of the Commonwealth's comprehensive higher education institutions. As such, it is largely dependent upon ongoing financial and political support from the state government. To offset projected shortfalls for fiscal year 2006, the University's Board of Visitors approved an overall increase of 9 percent in tuition and fees for in-state undergraduates.

The University's financial position remains strong with an overall increase of $18,368,051 in net assets for the 2006 fiscal year. In an effort to enhance operational efficiency and fiscal stability, management continues to evaluate and review current policies and procedures. The University's goals, priorities and vision are reflected throughout strategic plan, most specifically in the areas of funding, facilities and grounds, and organizational effectiveness. Management will continue to closely monitor resources to ensure its ability to counter unknown internal and external issues.

FINANCIAL STATEMENTS

NORFOLK STATE UNIVERSITY
STATEMENT OF NET ASSETS
As of June 30, 2006

ASSETS	Norfolk State University	Component Units
Current assets:		
Cash and cash equivalents (Note 2)	$ 10,950,237	$ 1,236,559
Cash held for securities lending (Note 2)	1,222,365	-
Restricted cash and cash equivalents	-	322,758
Short-term investments (Note 2)	1,209,671	2,591,681
Accounts receivable, net of allowance for doubtful accounts of $248,850 (Note 3)	2,772,512	134,558
Contributions receivable (Note 3)	-	253,511
Due from the Commonwealth	62,671	-
Prepaid expenses	429,545	81,147
Notes receivable, net of allowance for doubtful accounts of $128,855	110,970	-
Unamortized bond issuance expense	123,731	1,698,293
Other assets	-	137,300
Total current assets	16,881,702	6,455,807
Noncurrent assets:		
Restricted cash and cash equivalents (Note 2)	33,735,967	2,336,221
Investments (Note 2)	-	9,503,577
Contributions receivable (Note 3)	-	2,115,955
Notes receivable, net of allowance for doubtful accounts of $1,767,127	1,498,956	-
Nondepreciable capital assets (Note 4)	54,898,169	261,589
Depreciable capital assets, net (Note 4)	56,668,894	29,842,762
Total noncurrent assets	146,801,986	44,060,104
Total assets	163,683,688	50,515,911
LIABILITIES		
Current liabilities:		
Accounts payable and accrued expenses (Note 5)	8,582,283	747,109
Deferred revenue	3,006,781	34,512
Obligations under securities lending	2,432,036	-
Deposits held in custody for others	1,807,064	-
Long-term liabilities - current portion (Note 6)	5,680,959	38,447
Total current liabilities	21,509,123	820,068
Noncurrent liabilities (Note 6)	52,059,600	34,540,098
Total liabilities	73,568,723	35,360,166
NET ASSETS		
Invested in capital assets, net of related debt	77,975,571	29,887,073
Restricted for:		
Nonexpendable - permanently restricted	-	8,138,375
Expendable	10,819,079	3,875,344
Unrestricted	1,320,315	(26,745,047)
Total net assets	$ 90,114,965	$ 15,155,745

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

NORFOLK STATE UNIVERSITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2006

	Norfolk State University	Component Units
Operating revenues:		
Student tuition and fees, net of scholarship allowances of $5,686,595	$ 24,790,000	$ -
Gifts and contributions	-	3,706,637
Federal grants and contracts	19,507,841	-
State grants and contracts	1,708,200	-
Nongovernmental grants and contracts	2,231,015	-
Auxiliary enterprises, net of scholarship allowances of $4,973,794 (Note 8)	18,973,172	-
Other operating revenues	818,641	3,689,183
Total operating revenues	68,028,869	7,395,820
Operating expenses		
Instruction	34,258,196	-
Research	5,971,782	-
Public service	2,214,201	-
Academic support	15,489,939	-
Student services	5,214,391	-
Institutional support	15,499,047	2,893,810
Operation and maintenance of plant	12,768,745	414,601
Depreciation	5,290,404	691,977
Student aid	11,473,945	655,508
Auxiliary activities (Note 8)	16,409,472	-
		-
Total operating expenses (Note 9)	124,590,122	4,655,896
Operating gain (loss)	(56,561,253)	2,739,924
Nonoperating revenues (expenses):		
State appropriations (Note 10)	48,568,919	-
Investment income net of investment expense	1,130,712	39,654
Interest on capital asset - related debt	(595,132)	539,070
Gifts	583,638	137,000
Net nonoperating revenues (expenses)	49,688,137	715,724
Increase (decrease) before other revenues, expenses, gains or losses	(6,873,116)	3,455,648
Capital appropriations	22,892,168	-
Capital gifts and grants	344,369	-
Net other revenues	23,236,537	-
Increase (decrease) in net assets	16,363,421	3,455,648
Net assets - beginning of year, restated (Note 18)	73,751,544	11,700,097
Net assets - end of year	$ 90,114,965	$ 15,155,745

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

NORFOLK STATE UNIVERSITY
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2006

Cash flows from operating activities:	
Student tuition and fees	$ 23,729,085
Grants and contracts	23,605,348
Auxiliary enterprises	18,952,382
Other receipts	1,223,744
Payments to employees	(57,699,471)
Payments for fringe benefits	(16,173,775)
Payments for services and supplies	(12,179,608)
Payments for utilities	(3,453,051)
Payments scholarships and fellowships	(17,365,258)
Payments for noncapitalized plant improvements and equipment	(4,835,973)
Collections of loans from students	10,349,961
Loans issued to students	(10,385,180)
Net cash used by operating activities:	(44,231,796)
Cash flows from noncapital financing activities:	
State appropriations	48,568,919
Gifts and grants for other than capital purposes	168,187
Direct lending receipts	31,527,394
Direct lending payments	(31,617,981)
Agency receipts	479,975
Agency payments	(446,373)
Other non-operating expenses	6,794
Net cash provided by noncapital financing activities	48,686,915
Cash flows from capital financing activities:	
Capital appropriations	22,892,168
Capital gifts	344,369
Purchase of capital assets	(40,804,196)
Principal paid on capital debt, leases, and installments	(2,337,538)
Interest paid on capital debt, leases, and installments	(453,518)
Net cash provided by capital financing activities	(20,358,715)
Cash flows from investing activities:	
Interest on investments	984,086
Purchase of investments	11,011,289
Payment of bond issue cost	3,225
Net cash provided by investing activities	11,998,600
Net decrease in cash	(3,904,996)
Cash and cash equivalents-beginning of the year	48,591,200
Cash and cash equivalents-end of the yeaı	$ 44,686,204

Reconciliation of net operating loss to net cash used by operating activities:

Operating loss	$ (56,561,253)
Adjustments to reconcile net loss to net cash used by operating activities:	
Depreciation expense	5,290,404
Changes in assets and liabilities:	
Receivables, net	648,536
Due from the Commonwealth	14,181
Notes receivable, net	113,002
Prepaid expenses	549,097
Accounts payable and accrued expenses	6,472,065
Deferred revenue	(1,719,783)
Deposits held in custody of others	961,955
Net cash used by operating activities	$ (44,231,796)

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

NOTES TO FINANCIAL STATEMENTS

NORFOLK STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

Norfolk State University (the "University") is a comprehensive university that is part of the Commonwealth of Virginia's statewide system of public higher education. The University's Board of Visitors, appointed by the Governor, is responsible for overseeing governance of the University. A separate report is prepared for the Commonwealth of Virginia, which includes all agencies, higher education institutions, 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.

The Norfolk State University Foundation, Inc., and Subsidiary, the Athletics Foundation of Norfolk State University, Inc. and the Enterprise and Empowerment Foundation at Norfolk State University meet criteria under GASB Statement 39 qualifying them as component units of the University.

The Norfolk State University Foundation, Inc. and its wholly owned subsidiary, Marshall Avenue Properties, Inc. is a legally separate, not-for-profit organization established to provide financial support to Norfolk State University.

The Athletics Foundation of Norfolk State University, Inc. is a legally separate, not-for-profit charitable organization governed by a local Board of Directors dedicated to raising funds for the benefit, scholarship, and educational needs of students attending and participating in athletic programs at Norfolk State University.

The Enterprise and Empowerment Foundation is a legally separate, not-for-profit charitable organization governed by a Board of Directors dedicated to raising funds for the Marie V. McDemmond Center for Applied Research. The development is organized around a public private partnership and is designed to create a digital village that acts as a hub for the Hampton Roads region's technology-led economic development agenda.

Complete financial statements for the component units can be obtained by writing the Fiscal Officer/Budget Manager, Norfolk State University Foundation, c/o University Advancement, 700 Park Ave., Suite 410, Norfolk, VA, 23504.

Although the University does not control the timing or amount of receipts from the foundations, the majority of resources or income thereon that the foundations hold and invest is restricted to the activities of the University by the donors. These restricted resources held by the foundations can only be used by, or for the benefit of the University. Therefore, the foundations are considered component units of the University and are discretely presented in the financial statements.

During the year ended June 30, 2006, the Norfolk State University Foundation, Inc. and the Norfolk State Athletic Foundation, Inc. made distributions of $425,872 to or on behalf of the University for both restricted and unrestricted purposes.

B. Basis of Presentation

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 Government,* and GASB Statement 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities.* The University follows Statement 34 requirements for reporting by special purpose governments engaged only in business-type activities. The financial statement presentation provides a comprehensive entity-wide look at the University's financial activities and replaces the fund-group perspective previously reported.

Effective with fiscal year 2006, the University implemented GASB Statement 42, *Accounting and Reporting for Impairment of Capital Assets and for Insurance Recoveries;* GASB Statement 46, *Net Assets Restricted by Enabling Legislation;* and GASB Statement 47, *Accounting for Termination Benefits.* Statement 42 establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This Statement also clarifies and establishes accounting requirements for insurance recoveries. Statement 46 enhances the usefulness and comparability of net asset information reported by state and local governments by clarifying the meaning of the phrase *legally enforceable* as it applies to restrictions imposed on net asset use by enabling legislation and by specifying the accounting and financial reporting requirements for those restricted net assets. Statement 47 establishes accounting standards for termination benefits.

The foundations are private, non-profit organizations that report under Financial Accounting Standards Board (FASB) standards, including FASB Statement 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition and presentation features. No modifications have been made to the foundation's financial information in the University's financial reporting entity for these differences.

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. Bond premiums and discounts are deferred and amortized over the life of the debt. All significant intra-agency transactions have been eliminated.

The University's accounting policies conform with generally accepted accounting principles as prescribed by GASB, including all applicable GASB pronouncements, as well as applicable 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 conflict with or contradict GASB pronouncements.

D. Cash and Cash Equivalents

In accordance with the GASB Statement 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, definition, cash and cash equivalents consist of cash on hand, money market funds, and temporary highly liquid investments with an original maturity of three months or less.

E. Investments

In accordance with GASB Statement 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. All investment income, including changes in the fair value of investments (unrealized gains and losses), are reported as non-operating revenue in the Statement of Revenues, Expenses, and Changes in Net Assets.

F. Prepaid Expenses

The University's prepaid expenses included items such as insurance premiums, advertising, and publication subscriptions, which include initial and renewal annual subscriptions for technical and professional publications.

G. Receivables

Receivables consist of tuition and fee charges to students and auxiliary enterprises' sales and services. Receivables also include amounts due from the Federal government, state and local governments, or private sources, in connection with reimbursement of allowable expenditures made pursuant to grants and contracts. Receivables are recorded net of estimated uncollectible amounts.

H. Capital Assets

Capital assets include land, buildings and other improvements, library materials, equipment and infrastructure assets such as parking lots, sidewalks, campus lighting, and computer network cabling systems. The University generally defines capital assets as assets with an initial cost of $5,000 or more and an estimated useful life in excess of two years. Library materials are valued using published average prices for library acquisitions. Such assets are recorded at historical cost or estimated historical cost except for land acquired prior to 1979, which is valued at appraisal value. Donated capital assets are recorded at the estimated fair market value at the date of contribution. Expenses for major capital assets and improvements are capitalized (construction-in-progress) as projects are constructed. Interest expense relating to construction is capitalized net of interest income earned on resources set aside for this purpose. The costs of normal maintenance and repairs that do not add to an asset's value or materially extend its useful life are not capitalized.

Depreciation is computed using the straight-line method over the estimated useful life of the asset and is not allocated to the functional expense categories. Useful lives by asset categories are listed below:

Buildings	30 years
Other improvements and infrastructure	8 to 25 years
Equipment	4 to 20 years
Library materials	5 years

The University' art collections are held for public exhibition, education, and research in furtherance of public service rather than financial gain; are protected, kept unencumbered, cared for, and preserved; and are subject to University policy that requires the proceeds from sales of collection items to be used to acquire other items for the collection. Since these conditions exist and historical cost data for the collections are not available; in accordance with GASB Statement 34, no balances are reported in the accompanying financial statements.

I. Non-current Cash and Investments

Cash and investments that are externally restricted to make debt service payments, maintain sinking or replacement reserve funds or to purchase or construct capital and other non-current assets are classified as non-current assets in the Statement of Net Assets.

J. Deferred Revenue

Deferred revenue represents monies received, but not earned as of June 30, 2006. This primarily includes amounts received for tuition and fees and certain auxiliary activities in advance of the academic term as well as advance payments on grants and contracts that have not been spent or earned before the end of the fiscal year.

K. Accrued Compensated Absences

The amount of leave earned, but not taken by non-faculty salaried employees is recorded as a liability on the Statement of Net Assets. 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 payout policy. The applicable share of employer-related taxes payable on the eventual termination payments is also included.

L. Non-current Liabilities

Non-current liabilities include principal amounts of bonds payable and notes payable with contractual maturities greater than one year, as well as estimated amounts for accrued compensated absences that will not be paid within the next fiscal year.

M. Federal Financial Assistance Programs

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

N. Net Assets

GASB Statement 34 requires that the Statement of Net Assets report the difference between assets and liabilities as net assets, not fund balances. Accordingly, the University's net assets are classified as follows:

Invested in capital assets, net of related debt – consists of total investment in capital assets, net of accumulated depreciation and outstanding debt obligations.

Restricted Net Assets – Expendable – represents funds that have been received for specific purposes and the University is legally or contractually obligated to spend the resources in accordance with restrictions imposed by external parties.

Unrestricted Net Assets – represents resources derived from student tuition and fees, state appropriations, unrestricted gifts, interest income, and sales and services of educational departments and auxiliary enterprises.

O. 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) sales and services of auxiliary enterprises, net of scholarship allowances; and (3) federal, state, and nongovernmental grants and contracts.

Non-operating revenues include activities that have the characteristics of non-exchange transactions, such as gifts, and other revenue sources that are defined as non-operating revenues by GASB Statement 9 and GASB Statement 34, such as state appropriations and investment and interest income.

Non-operating expenses include interest on debt related to the purchase of capital assets and state appropriation reversions. All other expenses are classified as operating expenses.

P. Scholarship Discounts and Allowances

Student tuition and fees revenues and certain other revenues from students are reported net of scholarship discounts and allowances in the Statements of Revenue, Expenses, and Changes in Net Assets. Scholarship discounts and allowances are 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 making payments on the student's behalf. Certain governmental grants, such as Pell grants, and other federal, state, or nongovernmental programs are recorded as either operating or non-operating revenues in the University's financial statements. To the extent that such revenues are used to satisfy tuition and fees and other student charges, the University has recorded a scholarship discount and allowance.

2. CASH, CASH EQUIVALENTS AND INVESTMENTS

A. Cash and Cash Equivalents

Pursuant to Section 2.2-1800, et seq., Code of Virginia, all state funds of the College are maintained by the Treasurer of Virginia, who is responsible for the collection, disbursement, custody and investment of State funds. Certain deposits held by the College are maintained in accounts that are collateralized in accordance with the Virginia Securities for Public Deposits Act, Section 2.2-4400, et seq., Code of Virginia, or covered by depository insurance. Under this Act, banks holding public deposits in excess of amounts insured by FDIC must pledge collateral in the amount of 50 percent of excess deposits to a collateral pool in the name of the State Treasury board. Savings institutions are required to collateralize 100 percent of deposits in excess of FSLIC limits. In accordance with GASB Statement 9 definition of cash and cash equivalents, cash represents Cash with the Treasurer, cash on hand, and cash deposits including certificates of deposit, and temporary investments with original maturities of three months or less. Cash equivalents also include the Virginia State Non-Arbitrage Program (SNAP). SNAP is an open-end management investment company registered with the federal Security and Exchange Commission.

The carrying amount of cash not held by the Treasurer of Virginia is $3,188,213. The carrying amount is the University's bank balance reported at June 30, 2006, for the University's energy lease project activity. The Virginia Security for Public Deposits Act eliminates any custodial credit risk for the College.

B. Investments

The investment policy of the University is established by the Board of Visitors and monitored by the Board's Audit and Finance Committee. Authorized investments are set forth in the Investment of Public Funds Act of the Code of Virginia, Sections 2.2-4500 through 2.2-4516. Authorized investments include Certificates of Deposit, Commercial Paper, Bankers Acceptances, Repurchase Agreements, Agency Notes and Bonds, and Treasury Bills. The University's investments are in investment pools held by the Treasurer of Virginia and are not categorized as to levels of risk. 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.

GASB Statement 40, *Deposit and Investment Risk Disclosures*, effective for fiscal periods beginning after June 15, 2004, amends GASB Statement 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreement), and Reverse Repurchase Agreements*. GASB Statement 40 eliminates the custodial credit risk disclosures required for category 1 and 2 deposits and investments, but maintains disclosures for category 3. GASB Statement 40 requires the following risk disclosures:

- Concentration of Credit Risk - Concentration of credit risk requires the disclosure by amount and issuer of any investments in any one issuer that represents five percent or more of total investments. As of June 30, 2006, none of the University's investments involve concentration of credit risk.

- Custodial Credit Risk - Custodial credit risk is the risk that, in the event of failure of the counterparty, the University will not be able to recover the value of its investment or collateral securities that are in the possession of the outside party. All investments are registered and held in the name of the University and therefore, the University does not have this risk.

- Interest Rate Risk - The interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The University limits its exposure to interest rate risk by limiting the maximum maturity lengths of investments and structuring the portfolio to maintain adequate liquidity to ensure the University's ability to meet its operating requirements.

- Foreign Currency Risk - Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The University does not have investments in foreign currency.

C. Securities Lending Transactions

Securities lending transactions represent the College's allocated share of securities received for securities lending transactions held in the General Account of the Commonwealth. Loaned securities, for which the collateral is reported on the Statement of Net Assets, are non-categorized as to credit risk. Details of the General Account securities lending program are included in the Commonwealth's Annual Financial Report.

Type of Investment	Fair Value	0-3 months	Credit Rating
Cash equivalents:			
Repurchase agreements	$ 4,166,023	$ 4,166,023	AAA
Money market funds	764,589	764,589	A-1
Securities lending	1,222,365	1,222,365	Unrated
SNAP	21,717,028	21,717,028	AAAm
Investments:			
Securities lending	1,209,671	1,209,671	Unrated
Totals	$ 29,079,676	$ 29,079,676	

3. ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following at June 30, 2006:

Student tuition and fees	$ 1,132,679
Federal, state, and nongovernmental grants and contracts	1,185,265
Other activities	703,418
Gross receivables	3,021,362
Less: Allowance for doubtful accounts	(248,850)
Net accounts receivable	$ 2,772,512

Contributions Receivable - Norfolk State University Foundation

Pledges receivable represent pledges made by individuals, corporations, and organizations for various purposes. The following details the timing of expected receipts on pledges receivable at June 30, 2006:

Contributions currently due	$ 604,912
Less – time value discount	(232,476)
Less – allowance for uncollectible pledges	(118,925)
Current contributions receivable	$ 253,511
Contributions due in one to five years	$ 1,975,455
Contributions due in more than five years	140,500
Non-current contributions receivable	$ 2,115,955

4. CAPITAL ASSETS

	Balance July 1, 2005	Increases	Decreases	Balance June 30, 2006
Nondepreciable capital assets:				
Land	$ 4,786,099	$ -	$ -	$ 4,786,099
Construction in progress	16,402,379	37,690,355	(3,980,664)	50,112,070
Total nondepreciable capital assets	21,188,478	37,690,355	(3,980,664)	54,898,169
Depreciable capital assets:				
Buildings	119,765,255	4,195,913	-	123,961,168
Infrastructure	5,394,616	-	-	5,394,616
Equipment	27,890,012	1,150,269	(74,479)	28,965,802
Other improvements	60,823	-	-	60,823
Library materials	6,549,419	134,470	(58,639)	6,625,250
Total depreciable capital assets	159,660,125	5,480,652	(133,118)	165,007,659
Less Accumulated depreciation for:				
Buildings	75,447,783	2,726,839	-	78,174,622
Infrastructure	4,569,107	130,242	-	4,699,349
Equipment	17,020,933	2,316,361	(71,194)	19,266,100
Other improvements	13,813	3,618	-	17,431
Library materials	6,126,558	113,344	(58,639)	6,181,263
Total accumulated depreciation	103,178,194	5,290,404	(129,833)	108,338,765
Total depreciable capital assets, net	56,481,931	190,248	(3,285)	56,668,894
Total capital assets, net	$77,670,409	$37,880,603	$(3,983,949)	$111,567,063

Capital Assets – Component Units

	Norfolk State University Foundation	The Athletics Foundation	Enterprise and Empowerment Foundation	Total
Nondepreciable capital assets:				
Land	$ 24,310	$ -	$ 237,279	$ 261,589
Depreciable capital assets:				
Buildings	-	-	28,257,566	28,257,566
Equipment	235,462	23,530	2,051,035	2,310,027
Total depreciable capital assets	235,462	23,530	30,308,601	30,567,593
Less accumulated depreciation	(113,572)	(4,177)	(607,082)	(724,831)
Total depreciable capital assets, net	121,890	19,353	29,701,519	29,842,762
Total capital assets, net	$ 146,200	$ 19,353	$ 29,938,798	$30,104,351

5. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following at June 30, 2006:

Employee salaries, wages, and fringe benefits payable	$ 1,370,301
Vendors and suppliers accounts payable	6,197,582
Accrued interest payable	30,535
Payroll Loan from Commonwealth of Virginia	983,865
Total accounts payable and accrued liabilities	$ 8,582,283

6. NONCURRENT LIABILITIES

The University's non-current liabilities consist of long-term debt (further described in Note 7) and other non-current liabilities. A summary of changes in non-current liabilities for the year ending June 30, 2006, is presented as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Long-term debt:					
Bonds payable	$ 13,918,618	$ -	$ 1,517,934	$ 12,400,684	$ 1,584,441
Notes payable	23,882,883	-	118,528	23,764,355	476,115
Installment purchases	15,241,399	-	622,826	14,618,573	711,534
Unamoritized bond premium	391,360	-	12,625	378,735	12,625
Total long-term debt	53,434,260	-	2,271,913	51,162,347	2,784,715
Accrued compensated absences	2,952,121	1,300,762	1,107,000	3,145,883	1,199,020
Capital projects retainage payable	271,861	1,607,568	247,830	1,631,599	1,631,599
Federal loan capital contributions	1,496,576	-	10,000	1,486,576	-
Deferred gain of early retirement of debt	379,779	-	65,625	314,154	65,625
Total long-term liabilities	$ 58,534,597	$2,908,330	$ 3,702,368	$ 57,740,559	$ 5,680,959

7. LONG TERM DEBT

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 debt of the Commonwealth, legally, morally, or otherwise. Pledged general fund revenues include general fund appropriations, tuition and fees, auxiliary enterprise revenues, and other revenues not required by law to be used for another purpose. The University issued the 9(d) bond 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 (VCBA) also issues 9(d) bonds and uses the proceeds to purchase debt obligations (notes) of the University and various other institutions of higher education. The University's general revenue also secures these notes.

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

The University entered into a deed of bargain and sale with the City of Norfolk for the acquisition of the Brambleton Center. The note is payable in six full scholarships each year varying from $4,953 to $10,394 with the final amount due in 2019.

At June 30, 2006, installment purchases consist of the current and long-term portions of obligations resulting from various contracts used to finance the acquisition of equipment. The length of the purchase agreements are for five years and the interest rate charged are from 2.151 percent to 3.091 percent.

	Interest Rates (%)	Maturity	Balance at June 30, 2006
Revenue bonds:			
Dormitory:			
Charles Smith Hall Series 2003 (c)	5.00	2010	$ 1,183,418
Midrise Hall Series 2003 (c)	5.00	2011	3,394,986
Athletic Facility:			
Dick Price Stadium Series 1996 (d)	4.650 - 5.375	2018	6,345,000
Cafeteria:			
Mary Scott Dozier Series 2003 (c)	5.00	2011	1,477,280
Total revenue bonds			12,400,684
Unamortized bond premium			378,735
Net revenue bonds			12,779,419
Notes payable:			
Dormitory Series 1985 (d)	3.00	2022	2,148,573
Brambleton Center, Series 1998		2019	317,968
Student Center 2004 (d)	3.00 - 5.00	2036	21,520,000
Total notes payable			23,986,541
Less: Unamortized bond discount			(222,186)
Net notes payable			23,764,355
Installment purchases:			
Master Equipment Lease Program	2.151 - 3.091	2010	967,103
Energy lease project	3.739 - 4.500	2016 - 2021	13,651,470
Total installment purchases			14,618,573
Total long-term debt			$ 51,162,347

Long term debt matures as follows:

Year ending June 30,	Principal	Interest
2007	$ 2,783,355	$ 2,580,472
2008	3,231,592	2,110,654
2009	3,339,356	1,974,446
2010	3,387,650	1,829,633
2011	2,983,919	1,683,009

2012-2016	11,093,802	6,819,672
2017-2021	9,770,235	4,393,444
2022-2026	3,820,889	2,944,763
2027-2031	4,690,000	1,967,928
2032-2036	5,905,000	726,869
Unamortized discount	(222,186)	-
Unamortized premium	378,735	-
Total	$ 51,162,347	$ 27,030,890

A. Bond Defeasance

During fiscal years 2003, 1996 and 1994, certain 1990B, 1991A and 1993B General Obligation Bonds were defeased by the University. The net proceeds from the sale of those bonds were placed in an irrevocable trust with an escrow agent to provide for all future debt service on the refunded bonds.

Accordingly, the trust account assets and the related liability for the defeased bonds are not reflected in the University's financial statements. At June 30, 2006, the following amounts of the defeased bonds were outstanding:

1990 Series B	$ 1,265,000
1991 Series A	5,145,000
1993 Series B	6,447,865
Total	$ 12,857,865

B. Enterprise and Empowerment Foundation Debt

In February 2005, the Enterprise and Empowerment Foundation entered into an agreement to finance the construction of a 620-bed student housing facility. The terms of the agreement obligate the Foundation pursuant to $32,000,000 Tax-Exempt Variable Rate Demand Qualified 501(c)(3) Bonds Series 2005. The terms of the indenture call for varying annual maturities through July 1, 2034, with a variable interest rate determined based on the flexible weekly rate as determined by the remarketing agent; principal payments are due semiannually starting January 1, 2008. On June 30, 2006, interest was computed based on an annualized weekly rate of 2.3 percent. The terms of the agreement require a debt service coverage ratio of at least 1.2:1 beginning July 1, 2006.

As of June 30, 2006, the Enterprise and Empowerment Foundation's bonds payable mature as follows:

2008	$ 25,000
2009	50,000
2010	50,000
2011	70,000
2012	130,000

Thereafter	31,675,000
Total	$ 32,000,000

The bonds payable bear interest at a variable interest rate based on the flexible weekly rate as determined by the remarketing agent. To minimize the effect of changes in the variable rate, the Foundation entered an interest rate swap contract with a notional amount of $32,000,000 with a term of 29 years. The contract pays interest at a fixed 3.733 percent rate and receives interest at 67 percent of LIBOR. The net interest gain of $539,070 from changes in the swap contract's fair value during the fiscal year is included as interest on capital asset related debt in the Statement of Revenues, Expenses and Changes in Net Assets. The contract includes a provision for three optional early termination periods between January 2016 and January 2018.

8. AUXILIARY ACTIVITIES

Auxiliary operating revenues and expenses are distributed as shown in the following table for the year ended June 30, 2006. Additionally, the University used auxiliary revenues to pay debt service of $2,303,311. This amount is not included in the auxiliary operating expenses below.

Revenues:	
Residential, net of scholarship allowances of $1,350,939	$ 5,164,752
Athletics, net of scholarship allowances of $1,411,906	5,320,582
Food services, net of scholarship allowances of $862,107	3,295,908
Auxiliary enhancement, net of scholarship allowances of $237,876	923,867
Student activities, Net of scholarship allowances of $282,653	1,080,606
Other auxiliary revenues, net of scholarship allowances of $828,313	3,187,457
Total auxiliary enterprises revenues	$18,973,172
Expenses:	
Residential	$ 4,246,341
Athletics	5,817,775
Food services	2,739,623
Auxiliary enhancement	753,114
Student activities	1,087,533
Other auxiliary activities	1,765,086
Total auxiliary enterprises expenses	$16,409,472

9. EXPENSES BY NATURAL CLASSIFICATION

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	Plant and equipment	Depreciation	Total
Instruction	$22,694,929	$ 6,098,335	$ 3,037,717	$1,379,185	$ -	$1,048,030	$ -	$ 34,258,196
Research	1,829,627	518,169	1,848,225	374,397	-	1,401,364	-	5,971,782
Public service	890,241	149,744	846,311	140,559	-	187,346	-	2,214,201
Academic support	7,911,277	2,306,302	3,048,834	279,729	-	1,943,797	-	15,489,939
Student services	2,905,570	976,244	794,688	442,320	-	95,569	-	5,214,391
Institutional support	9,595,111	3,120,346	1,373,593	231,071	961,393	217,533	-	15,499,047
Operation and maintenance of plant	3,177,750	1,241,585	2,132,141	-	1,605,078	4,612,191	-	12,768,745
Depreciation	-	-	-	-	-	-	5,290,404	5,290,404
Scholarships and Fellowship	-	-	-	11,473,945	-	-	-	11,473,945
Auxiliary activities	4,441,000	1,356,854	5,781,300	3,701,836	761,297	367,185	-	16,409,472
Total	$53,445,505	$15,767,579	$18,862,809	$18,023,042	$3,327,768	$9,873,015	$5,290,404	$124,590,122

10. STATE APPROPRIATIONS

The University receives state appropriations from the General Fund of the Commonwealth. The Appropriation Act specifies that such unexpended appropriations shall revert, as specifically provided by the General Assembly, at the end of the biennium. For years ending at the middle of a biennium, unexpended appropriations that have not been approved for reappropriation in the next year by the Governor become part of the General Fund of the Commonwealth and are, therefore, no longer available to the University for disbursements. The following is a summary of education and general state appropriations received by the University including all supplemental appropriations and reversions:

Original legislative appropriation per Chapter 4:	
Educational and general programs	$41,967,061
Student financial assistance	4,639,710
Adjustments:	
Salary annualization, increases and regrades	328,883
Employer fringe benefit changes	348,201
Military in-state tuition adjustment	204,485
VIVA allocation and Eminent Scholars	33,671
Additional appropriation for change in June 24, 2006 payroll timing	1,046,908
Adjusted appropriation	$48,568,919

11. COMMITMENTS

At June 30, 2006, the University was committed to construction contracts totaling approximately $48,770,410. Outstanding commitments on these contracts totaled $15,206,244 as of June 30, 2006.

The University is committed under various operating leases for equipment and facilities. In general, the leases are for a one-year term and the University has renewal options on equipment and facilities for another one-year term. 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, 2006, was $1,173,976.

The City of Newport News lease contains an escalation clause, which allows for a base rent adjustment every two years. The percentage increase is equal to one-half of the percentage increase of the consumer price index for the corresponding period.

Norfolk State University has as of June 30, 2006, the following total future minimum rental payments due under the above leases:

Year	Operating lease obligation
2007	$ 1,149,963
2008	1,089,608
2009	1,097,333
2010	1,051,112
2011	908,933
2012-2016	3,616,803
2017-2021	2,462,054
Total	$ 11,375,806

12. RETIREMENT AND PENSION PLANS

A. 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 separately for individual state institutions. Therefore, all information relating to this plan is available at the statewide level only and can be found in the Commonwealth's *Comprehensive Annual Financial Report* (CAFR). The Commonwealth of Virginia, not the University, has the overall responsibility for contributions to this plan. The CAFR provides disclosure of the Commonwealth's unfunded pension benefit obligation at June 30, 2006. The same report contains historical trend information showing VRS's progress in accumulating sufficient assets to pay benefits when due.

The University's expenses include the amount assessed by the Commonwealth for contributions to VRS, which totaled approximately $3,229,816 for the year ended, June 30, 2006. The retirement contribution rate was 8.91 percent for fiscal year 2006. Contributions to VRS were calculated using the base salary amount of approximately

$36,249,338 for the year ended June 30, 2006. The University's total payroll was approximately $56,207,182 for the fiscal year ended June 30, 2006.

B. Optional Retirement Plans

Full-time faculty and certain administrative staff participate in a defined contribution plan administered by two different providers rather than the VRS. The two different providers are TIAA/CREF Insurance Companies and Fidelity Investments. This plan is a fixed-contribution program where the retirement benefits received are based upon the employer's (5.4 percent) and employee's (5.0 percent) contributions, plus interest and dividends.

Individual contracts issued under the plan provide for full and immediate vesting of both the University's and the employee's contributions. Total pension costs under this plan were approximately $1,282,402 for year ended June 30, 2006. Contributions to the optional retirement plan were calculated using the base salary amount of approximately $12,330,788 for fiscal year 2006.

C. Deferred Compensation Plan

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. Employer contributions under the Deferred Compensation Plan were approximately $193,726 for the fiscal year 2006.

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 state service and participate in the state's health plan. Information related to these plans is available at the statewide level in the Commonwealth's *Comprehensive Annual Financial Report.*

14. STATE STUDENT LOAN FUND

The University makes loans to qualified students from its Commonwealth of Virginia Student Loan Fund. During the fiscal year, new loans totaling $33,600 were made to 16 students. At June 30, 2006, total loans outstanding were $71,879 and the allowance for doubtful accounts was $28,026. Summarized below is the fund activity of the State Student Loan Fund for the fiscal year ended June 30, 2006:

Beginning fund balance	$ 341,590
Interest income and collection fees	69,780
Loan write-offs and expenses	(47,997)
Ending fund balance	$ 363,373

15. CONTINGENCIES

A. Grants and Contracts

The University has received 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 expenditures 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 the various federal regulations issued by the Office of Management and Budget. Failure to comply with certain requirements of these regulations may result in questions concerning the allowability of related direct and indirect charges pursuant to such agreements. As of June 30, 2006, the University estimates that no material liabilities will result from such audits or questions.

B. Litigation

The University has been named as a defendant in a number of lawsuits. The final outcome of these lawsuits cannot be determined at this time. However, management is of the opinion that any ultimate liability to which the University may be exposed will not have a material effect upon the University’s financial position.

16. 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 at the statewide level in the Commonwealth’s *Comprehensive Annual Financial Report*.

17. COMPONENT UNITS

Summary of Statement of Net Assets

	Norfolk State University Foundation	The Athletics Foundation	Enterprise and Empowerment Foundation	Total
Assets:				
Current assets	$ 3,156,037	$ 380,007	$ 2,919,763	$ 6,455,807
Noncurrent assets	11,765,732	19,353	32,275,019	44,060,104
Total assets	14,921,769	399,360	35,194,782	50,515,911
Liabilities:				
Current liabilities	88,345	24,117	707,606	820,068
Noncurrent liabilities	-	-	34,540,098	34,540,098
Total liabilities	88,345	24,117	35,247,704	35,360,166
Net assets	$ 14,833,424	$ 375,243	$ (52,922)	$ 15,155,745

Summary Statement of Revenues, Expenses, and Changes in Net Assets

	Norfolk State University Foundation	The Athletics Foundation	Enterprise and Empowerment Foundation	Total
Operating revenues	$ 2,851,895	$ 283,052	$ 4,260,873	$ 7,395,820
Operating expenses	1,453,780	433,590	2,768,526	4,655,896
Operating gain	1,398,115	(150,538)	1,492,347	2,739,924
Net nonoperating revenues	767,394	151,247	(202,917)	715,724
Increase (decrease) in net assets	2,165,509	709	1,289,430	3,455,648
Net assets - beginning of year	12,667,915	374,534	(1,342,352)	11,700,097
Net assets - end of year	$ 14,833,424	$ 375,243	$ (52,922)	$15,155,745

18. RESTATEMENT OF BEGINNING NET ASSETS

The following prior period adjustments were made to the beginning net assets previously reported in the University's financial statements at June 30, 2005.

Net assets reported at June 30, 2005	$71,746,914
Correction of prior year equipment purchases expensed in error	2,010,203
Correction of prior year depreciation	(5,573)
Net assets reported at July 1, 2005	$73,751,544

SUPPLEMENTARY INFORMATION

NORFOLK STATE UNIVERSITY
STATEMENT OF AUXILIARY ENTERPRISES REVENUES AND EXPENDITURES
FOR THE YEAR ENDED JUNE 30, 2006

	Total	Food Services	Residential Services	Student Activities
Revenues:				
Student fees	$ 10,312,160	$ -	$ -	$ 1,189,089
Sales and services	13,080,998	4,158,015	6,495,834	174,170
Investment income	380,633	-	19,857	-
Other fund additions	173,174	-	-	-
Total revenues	23,946,965	4,158,015	6,515,691	1,363,259
Expenses:				
Personal services	4,243,388	-	1,162,484	5,100
Fringe benefits	1,359,758	-	412,618	390
Supplies and materials	872,726	18,909	196,253	137,163
Equipment and property improvements	2,011,239	-	66,416	19,149
Current charges and obligations	1,294,553	52,884	674,319	127,871
Scholarships and fellowships	3,728,679	6,519	922,334	349,508
Contractual services	7,924,072	3,523,418	1,594,324	587,781
Indirect costs	1,664,415	-	546,447	133,327
Auxiliary administration	(9,056)	-	22,085	9,897
Total expenses	23,089,774	3,601,730	5,597,280	1,370,186
Nonoperating revenue - gifts and grants	375,477	-	-	43,722
Mandatory transfers for debt service	(2,303,311)	-	(1,231,605)	-
Nonmandatory transfers	164,706	-	130,658	-
Net increase (decrease) in fund balance	(905,937)	556,285	(182,536)	36,795
Fund balance - beginning of year	9,439,432	1,030,640	600,150	125,837
Fund balance - end of year	$ 8,533,495	$ 1,586,925	$ 417,614	$ 162,632

This schedule accounts for the purchase 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 set rates.

Auxiliary Security	Student Center	Athletics	Auxiliary Administration	Parking	Contingency Fund	Printing Services
$ 575,535	$ 385,309	$ 5,688,862	$ -	$ 168,153	$ 229,655	$ -
-	44,454	1,043,626	4,779	507,886	-	342,744
-	-	-	71,338	-	-	-
16,729	-	-	98,089	-	58,356	-
592,264	429,763	6,732,488	174,206	676,039	288,011	342,744
369,753	230,324	1,865,941	247,288	276,858	-	30,194
112,874	75,385	565,011	85,151	93,608	-	6,587
3,690	7,885	181,669	282,472	29,896	-	7,778
6,422	2,097	24,674	164,504	21,241	-	-
2,004	70,507	30,802	-	2,919	-	331,497
-	-	2,450,318	-	-	-	-
-	195,886	1,320,221	-	16,225	-	28,595
53,761	63,252	699,652	-	47,894	-	43,971
2,173	2,556	91,394	(605,209)	15,461	-	23,073
550,677	647,892	7,229,681	174,206	504,102	-	471,695
-	-	331,755	-	-	-	-
-	-	-	-	-	-	-
-	38,429	15,371	-	-	(30,000)	5,124
41,587	(179,700)	(150,067)	-	171,937	258,011	(123,827)
(479,253)	535,968	(1,157,952)	11,500	759,016	4,812,466	(794,738)
$ (437,666)	$ 356,268	$ (1,308,019)	$ 11,500	$ 930,953	$ 5,070,477	$ (918,565)

	Fitness Center	Communication Systems Enhancement	Auxiliary Enhancement	Debt Service	Maintenance Reserve
Revenues:					
Student fees	$ 153,087	$ 110,843	$ 563,566	$ 1,248,061	$ -
Sales and services	447	304	308,739	-	-
Investment income	-	-	289,438	-	-
Other fund additions	-	-	-	-	-
Total revenues	153,534	111,147	1,161,743	1,248,061	-
Expenses:					
Personal services	55,446	-	-	-	-
Fringe benefits	8,134	-	-	-	-
Supplies and materials	7,011	-	-	-	-
Equipment and property improvements	228	-	-	-	1,706,508
Current charges and obligations	-	-	1,750	-	-
Scholarships and fellowships	-	-	-	-	-
Contractual services	11,822	110,577	505,459	29,764	-
Indirect costs	8,980	12,016	55,116	-	-
Auxiliary administration	363	486	428,665	-	-
Total expenses	91,984	123,078	990,990	29,764	1,706,508
Nonoperating revenue - gifts and grants	-	-	-		-
Mandatory transfers for debt service	-	-	-	(1,071,706)	-
Nonmandatory transfers	2,562	-	2,562	-	-
Net increase (decrease) in fund balance	64,112	(11,931)	173,315	146,591	(1,706,508)
Fund balance - beginning of year	95,393	147,806	1,732,599	-	2,020,000
Fund balance - end of year	$ 159,505	$ 135,875	$ 1,905,914	$ 146,591	$ 313,492

Commonwealth of Virginia

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

Walter J. Kucharski, Auditor

May 11, 2007

The Honorable Timothy M. Kaine
Governor of Virginia

The Honorable Thomas K. Norment, Jr.
Chairman, Joint Legislative Audit
and Review Commission

Board of Visitors
Norfolk State University

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic financial statements of **Norfolk State University**, a component unit of the Commonwealth of Virginia, and its aggregate discretely presented component units as of and for the year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the component units of the University, which are discussed in Note 1. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates the amounts included for the component units of the University is based on the reports of the other auditors.

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. The financial statements of the component units of the University that were audited by other auditors upon whose reports we are relying were audited in accordance with auditing standards generally accepted in the United States of America, but not in accordance with Government Auditing Standards. 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 and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of University and of its aggregate discretely presented component units as of June 30. 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages three through seven is not a required part of the basic financial statements, but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of the 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 has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statement taken as a whole.

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

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 in the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted 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, entitled "Follow the University's Systems Change Management Procedures," "Strengthen Controls over Capital Project Management," "Complete Biennial Equipment Inventories" and "Develop Formal Capital Asset Accounting Policies and Procedures" 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 caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. 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 the reportable conditions described above are not material weaknesses.

Compliance and Other Matters

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 grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported under Government Auditing Standards. The instance of noncompliance, entitled "Complete Biennial Equipment Inventories" is described in the section titled "Internal Control and Compliance Findings and Recommendations." There were no other matters that are required to be reported.

Status of Prior Findings

The University has taken adequate corrective action with respect to the audit findings reported in the prior year.

The "Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters" is intended solely for the information and use of the Governor and General Assembly of Virginia, the 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 July 3, 2007.

AUDITOR OF PUBLIC ACCOUNTS

JHS/whb

NSU
NORFOLK STATE UNIVERSITY®

Vice President for Finance and Business
700 Park Avenue, Suite 310 • Norfolk, Virginia 23504-8004
Tel: (757) 823-8011 Fax: (757) 823-8084
Email: finance&business@nsu.edu Web: http://www.nsu.edu

July 10, 2007

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

Dear Mr. Kucharski:

Attached is management's response to the findings in Norfolk State University's audit report for the year ended June 30, 2006. Please contact me if you have any questions.

Sincerely,

Ralph W. Johnson

Ralph W. Johnson
Vice President for Finance and Business

Cc: Dr. Carolyn W. Meyers
Dr. Adebisi Oladipupo
Mr. Earlie P. Horsey
Ms. Michelle Martin
Mr. Ernest Ellis

NSU
NORFOLK STATE UNIVERSITY®

Vice President for Finance and Business
700 Park Avenue, Suite 310 • Norfolk, Virginia 23504-8004
Tel: (757) 823-8011 Fax: (757) 823-8084
Email: finance&business@nsu.edu Web: http://www.nsu.edu

Follow the University's Systems Change Management Procedures

Management Response

Norfolk State University does concur that the documentation of the approvals and authorizations (which is most typically given in email format) to the programmer(s) assigned to make the changes was not present in all of the samples examined by the state auditor. To ensure this is done in the future, we have put steps in place to see that all relevant approvals given via email are attached to the request forms henceforth. University management will ensure records specifically required by the policy and all appropriate approvals and authorizations are documented as required by best practices.

Strengthen Controls over Capital Project Management

Management Response

Norfolk State University has shown its commitment to strengthening controls over the capital projects by reorganizing Facilities Management in January 2007. As a result of the restructuring, a Procurement Officer and Administrative Assistant position was created to improve procurement processes and maintain central files related to capital projects. While significant progress has been made in the area of capital project management, the University concurs that additional improvements are needed to further strengthen controls. Formal policies and procedures will be developed with management oversight to ensure adherence and consistent application for monitoring and documenting capital outlay projects. Policies and procedures will be in place for fiscal year 2008 following approval by the Vice President for Finance and Business and Executive Cabinet.

Complete Biennial Equipment Inventories

Management Response

Norfolk State University is committed to improving capital asset internal controls by performing a complete inventory every two years to ensure that assets are properly valued for financial statement and insurance purposes. The University has established a process to make certain no material misstatements exist with the FY07 financial statements. Management is also revising inventory policies and procedures to eliminate inefficiencies and inadequacies in current inventory processes. A revised inventory policy will be in place for fiscal year 2008 following approval by the Vice President for Finance and Business and Executive Cabinet.

NSU
NORFOLK STATE UNIVERSITY®

Vice President for Finance and Business
700 Park Avenue, Suite 310 • Norfolk, Virginia 23504-8004
Tel: (757) 823-8011 Fax: (757) 823-8084
Email: finance&business@nsu.edu Web: http://www.nsu.edu

Develop Formal Capital Asset Accounting Policies and Procedures

Management Response

Norfolk State University is committed to improving capital asset internal controls by developing written policies and procedures for accounting and reporting impaired assets and capital outlay (including construction in progress) to ensure consistent accounting and reporting for financial statement purposes. Additionally, written policies and procedures will be developed for assigning useful lives or salvage value to fixed assets that is consistent with current asset replacement practices at the University. Policies and procedures will be in place for fiscal year 2008 following approval by the Vice President for Finance and Business and Executive Cabinet.

NORFOLK STATE UNIVERSITY
Norfolk, Virginia