VIRGINIA COMMUNITY COLLEGE SYSTEM

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2005

Auditor of Public Accounts
COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the Virginia Community College System for the year ended June 30, 2005, found:

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

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

  These matters are reported fully in the section of the report entitled "Internal Control and Compliance Findings and Recommendations" and include our recommendation that the Virginia Community College System finalize and improve its information systems security plans;

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

- adequate corrective action of prior audit findings except that Southwest Virginia and Central Office have not adequately implemented policies and procedures over systems' security. Central Virginia, Danville, and Germanna do not follow policies and procedures related to critical system access.

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INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Improve Systems Security Documentation and Policies

Applicable to: Virginia Community College System Office
Southwest Virginia Community College

The System Office has finalized and approved their Information Systems Security Plan, however, the plan still does not address variations between the plan and the current operating environment that we identified in our prior report. A good information systems security plan sets the tone and provides the necessary guidance to staff for protecting sensitive and critical data. In our review of the Security Plan, we noted several instances where the Risk Assessment documented within the Security Plan set specific operating standards, however, the Systems Office was not meeting these standards and is willing to accept those risks, without documenting the compensating controls or mitigating factors. The System Office has begun a review and update of the Security Plan. We encourage them to continue with this effort, as the update should eliminate any variations between the System Office's actual operating environment and its security plan thus increasing the validity of the System Office's policies and procedures.

Additionally, the System Office's policies and procedures relating to the Resource Access Control Facility (RACF) security system still do not include documented and approved security configurations. Such documentation first requires an identification of weaknesses, vulnerabilities, and resulting risks that may exist in the current RACF security configuration. Once assessed, the System Office should document an approved standard RACF security configuration based on this security evaluation and considering industry best practices.

Southwest Virginia has not developed adequate Information Technology Security Policies. The policies do not address monitoring and controlling systems access; incident handling, identification, authorization, and authentication; and systems interoperability security. Additionally, Southwest Virginia does not have adequate policies addressing encryption, physical security, and risk and vulnerability.

Southwest Virginia does have policies and procedures to address encryption and physical security; however, they do not address all the critical aspects as required by the Commonwealth's Security Standard. The encryption policy does not address how and when to encrypt data, including sensitive data transfers, storage of passwords, and VPN data encryption. The physical security policies do not address how to track visitors, monitor the fire suppression systems, use and monitor the security system, and monitor environmental controls, such as HVAC and water detection systems. Additionally, the risk and vulnerability policy does not address how and when the college monitors logs.

Once the System Office has updated the Security Plan and operating policies and procedures, management should ensure all staff are aware of the applicable portions of the Information Technology Security Plan and operating policies and procedures related to their job. Finally, the System Office should review and approve all policies and procedures periodically to ensure the policy conforms to current business and technology practices. Documenting the review and approval process will also increase the validity and enforcement of policies, procedures, and standards. Southwest Virginia should address and document the areas noted to comply with the Commonwealth's Security Standard and to avoid possible risks to the critical systems. Failure to document and follow the procedures can increase the risks to Southwest Virginia's computer network and network resources.

Establish Procedures to Monitor Energy Performance Contracts

Applicable to: Virginia Community College System, including all Community Colleges

VCCS has not properly planned the monitoring of their energy savings performance contract. In February 2005, VCCS contracted with TAC Americas to identify and implement facility improvements at the various community college campuses to reduce energy cost and obtain needed equipment replacements. As of April 2006, VCCS has committed to $10.6 million in facility improvements at various community colleges. These colleges include: John Tyler, Northern Virginia, Patrick Henry, Piedmont, Virginia Highlands, and Wytheville. VCCS has Treasury Board approval to finance $20 million in energy contracts. VCCS may fund additional improvement through other funding sources.

Prior to beginning the facility improvements phase at each college, VCCS and TAC sign a memorandum of understanding outlining the scope of work, the costs associated, and energy guaranteed savings amount. Additionally, the contract stipulates that TAC must provide the monitoring and tracking of the energy costs and savings. If VCCS does not use TAC, they will not guarantee the energy savings.

Although VCCS must use TAC to monitor and track the energy cost and savings, VCCS has the right to review and certify the savings calculations provided by TAC. If the two entities cannot agree on the calculations, they may use a mutually agreeable third party professional engineer to come to an acceptable solution. If VCCS uses TAC to monitor the savings, TAC must pay VCCS the difference if guaranteed savings are less than expected. If TAC writes VCCS a savings shortfall check (savings less than amounts guaranteed) and TAC later determines the actual savings meet TAC's guaranteed dollar savings, VCCS must return the shortfall check to TAC. VCCS retains any savings in excess of the guaranteed savings. Since compensation is dependent on energy savings, VCCS should monitor and verify all energy savings calculations. However, VCCS has not established procedures for verifying the savings or identified who will be responsible for this task.

The facilities improvement phase is near completion at Patrick Henry and Virginia Highlands. Even though none of the TAC projects are complete, VCCS must establish procedures to monitor and verify energy savings in anticipation of these completed projects. Since we identified this issue, VCCS began the process by designating the college vice presidents the responsibility for monitoring and verifying the energy savings for their college. In addition, the vice presidents are responsible for properly training college employees in these areas. We encourage the vice presidents, in coordination with the VCCS Facilities Management Office, to develop specific procedures and training to monitor and verify the energy savings at their college prior to completion of any energy improvements. Without proper monitoring controls, VCCS risks losing the dollar savings guaranteed under the contract and may forfeit the right to recover funds from the vendor.

Include Operating System and Infrastructure Changes in the Change Management Process

Applicable to: Virginia Community College System Office

The System Office has not included all operating system and infrastructure device changes in their current change management process. Currently, the System Office uses IssueTrak, an automated change management system, to record and approve necessary application changes. However, the System Office does not use IssueTrak for hardware changes due to the security risk caused by the individual college's ability to view IssueTrak documentation. While we agree with this decision, we found that the System Office has not adopted an alternative change management process for infrastructure device and operating system changes. An approved, documented process would include procedures for requesting, reviewing, adequately testing, and approving changes such as applying patches and releases to network devices and operating systems.

We recommend that the System Office create and approve policies and procedures as well as a manual tracking process that will provide for control over operating systems and infrastructure device changes. While we recognize that the System Office is currently researching automated systems to provide for change management over these areas, such a system would not replace the need for approved, documented policies and procedures as recommended above. Failure to adequately establish change management could result in a lack of audit trails, reduced staff accountability, and an increased risk that unauthorized or fraudulent changes could go undetected.

Properly Calculate Accruals for Financial Reporting

Applicable to: Northern Virginia Community College

Northern Virginia Community College does not have procedures and trained staff in place to calculate the accrual of payroll expense at fiscal year end. Northern Virginia has improperly calculated the accrual of payroll expense for the current and prior fiscal years. This improper calculation resulted in material audit adjustments to the overall Community College System financial statements of $1,869,682 in fiscal year 2005 and $764,103 in fiscal year 2004.

The American Institute of Certified Public Accountants recently issued Statement on Auditing Standards (SAS) 112, Communicating Internal Control Related Matters Identified in an Audit, which becomes effective in fiscal year 2007. Under SAS 112, material audit adjustments, such as this finding at Northern Virginia, have the potential to be a material weakness in internal controls over the preparation of the financial statements. A material weakness indicates that internal controls are not sufficient to ensure that the financial statements do not contain material misstatements.

To establish good internal controls and prepare for this new auditing standard, Northern Virginia should establish procedures and train staff to properly perform the accrual calculation. In addition, the System Office should continue to ensure that they review financial information reported by each of the 23 community colleges for consistency and reasonableness before inclusion in the Community College System's statewide financial statements.

Follow System Access Policies and Procedures

Applicable to: Central Virginia Community College
Danville Community College
Germanna Community College

Employees at each of these colleges had unauthorized access to financial or administrative computer systems either because the access had not been properly approved, they had terminated employment, or the access was not necessary for their job function. Central Virginia did not revoke access to computer systems promptly after employees terminated with a lag time of up to seven months. Danville and Germanna did not properly approve access granted to employees due to a lack of approval signatures on the request forms. Additionally, Danville granted inappropriate systems access to an employee that allowed her to update CARS even though her job function did not require this level of access.

We recommend that all Colleges follow established procedures relating to approval and termination of access to the College's financial and administrative computer systems. This includes proper approval prior to granting access and prompt revocation of access upon termination of employment. Failure to restrict computer access to current employees who need such access to perform duties places the College at risk for inappropriate changes or disclosures of important financial and administrative information.

Properly Administer Return of Title IV Funds

Applicable to: Blue Ridge Community College
Dabney S. Lancaster Community College
J. Sargeant Reynolds Community College
New River Community College
Southside Virginia Community College
Southwest Virginia Community College
Thomas Nelson Community College
Virginia Western Community College

Blue Ridge, Dabney S. Lancaster, J. Sargeant Reynolds, Southside Virginia, and Southwest Virginia did not return Title IV refund amounts timely. Southside Virginia, Southwest Virginia, and J. Sargeant Reynolds did not notify students promptly of grant overpayments. Dabney S. Lancaster, Thomas Nelson, New River, and Virginia Western did not identify students who unofficially withdrew timely. This resulted in untimely Title IV refund calculations and returns to the U. S. Department of Education. There are no questioned costs reported because the colleges have returned all identified funds.

The Code of Federal Regulations, 34 CFR Part 668.22 (c), requires that colleges have a mechanism in place to identify students who have withdrawn or ceased attendance, in order to promptly and properly calculate any return of Title IV funds. Part 668.22 (e) sets forth the manner to properly calculate the refund amounts due to Title IV programs. Part 668.22 (j) requires that colleges return unearned Title IV funds as soon as possible to the U. S. Department of Education, but no later than 30 days after the college determined the student withdrew. Part 668.22 (h) requires that within 30 days of the date that the college determines that the student withdrew, the college must send a notice to the student notifying them of any over-award amounts owed.

Colleges should follow the return of Title IV fund procedures prescribed by the federal government to ensure that they properly identify students who withdraw, calculate refunds, notify students of over-award amounts owed, and return the funds to the U. S. Department of Education promptly.

Disburse Federal Drawdowns Timely

Applicable to: New River Community College

New River did not disburse two out of seven federal drawdowns timely, with time lags ranging from six to ten days. Additionally, New River does not have policies and procedures to ensure the disbursement of drawdowns in accordance with Student Financial Aid Regulations. There are no questioned costs since New River has disbursed the funds and any accrued interested was less than $10,000.

34 CFR 668.162(b)(3) requires institutions to disburse funds requested as soon as administratively feasible but no later than three business days following the date the institution received the funds.

New River should develop policies and procedures to ensure disbursements of drawdowns within the required three business days. The College should properly define, disseminate, and adhere to these policies and procedures.

Continue to Improve Capital Asset Management and Reporting

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

VCCS reports capital assets for all 23 Community Colleges in the System, which includes Land, Land Improvements, Buildings, Infrastructure, Construction-in-Progress, Equipment, Library Books, and Works of Art. During fiscal year 2005, VCCS reported $477 million in capital assets, net of depreciation. Individual Colleges are primarily responsible for entering equipment information in the Fixed Asset Information System (FAIS), performing inventories, and tracking locally-funded assets.

During the fiscal year 2005 audit, we found Central Virginia, Tidewater, and Virginia Western Community Colleges did not properly maintain asset records or adequately record changes in assets throughout the year.

The Commonwealth's accounting policies and procedures require agencies to record disposed assets in the fiscal year when the disposal occurs. Central Virginia and Virginia Western did not remove assets promptly from FAIS. Additionally, the Commonwealth's accounting policies require assets not in current use and located on-site be shown as surplus assets. Tidewater recorded two assets as active, which were in the warehouse unused. Central Virginia could not locate four surplused assets on the campus.

The Commonwealth's accounting polices also require agencies to record assets within 60 days of receipt and acceptance. Agencies should capitalize and record assets at market value. Tidewater did not record three assets totaling $22,500 donated to the college in September 2001.

By failing to follow polices and properly maintain the Fixed Asset Inventory System, VCCS could have a material misstatement to the financial statements. VCCS should ensure that each college properly maintains and records capital assets in FAIS.

Maintain and Renew Contracts

Applicable to: Eastern Shore Community College

Eastern Shore did not maintain three revenue generating contracts and procurement files for vending and phone services. Eastern Shore has not been able to locate the contracts for several years. All three of these contracts have come up for renewal since 2003; therefore, Eastern Shore is participating in these vending and phone services without a current contract. Additionally, Eastern Shore cannot verify if they are receiving the correct revenue commissions and services originally guaranteed.

Eastern Shore should properly maintain all contracts and procurement files by ensuring they have proper record retention procedures in place. Record retention is a key component of any college and critical to its accountability and performance. Eastern Shore should also establish procedures to ensure timely renewal of contracts.

Improve Bank Reconciliation Process

Applicable to: J. Sargeant Reynolds Community College

J. Sargeant Reynolds does not adequately perform monthly bank reconciliations of their Local Funds Bank Account. The three monthly bank reconciliations reviewed did not reconcile. The reconciling differences were immaterial; however, these unexplained differences varied in two out of the three months. One of the reconciling items on the June 2005 reconciliation was a check included on the outstanding check list that had actually cleared the bank over a year earlier. On the February 2006 reconciliation, J. Sargeant Reynolds had 15 checks, totaling $392.48 outstanding for over a year. J. Sargeant Reynolds voided 14 of these checks totaling $377.48 and sent the funds to the Treasurer of Virginia Division of Unclaimed Property in October 2005. The remaining check for $15 is still outstanding because the payee remains unresponsive to the college's directives to deposit the check. Still, J. Sargeant Reynolds erroneously listed the 14 checks on the February 2006 reconciliation as outstanding. Proper exclusion of these checks would have resulted in a larger, unreconciled difference. Additionally, J. Sargeant Reynolds did not post interest, bank fees and charges to the Financial Reporting System for up to four months after reconciliation.

J. Sargeant Reynolds should properly perform monthly bank reconciliations. The college should identify all reconciling differences and post any necessary adjustments or transactions promptly to the Financial Reporting System. Additionally, J. Sargeant Reynolds should ensure that its reconciling items do not include cleared or voided checks. Inadequate controls and procedures over the reconciliation process can increase the risk and opportunity for fraud to occur.

Develop and Update Accounts Receivable Policies and Procedures

Applicable to: Blue Ridge Community College
Danville Community College
Northern Virginia Community College

Blue Ridge does not have Accounts Receivable Policies and Procedures as required by the Commonwealth's accounting polices to cover the establishment, administration, collection, and write-off of receivables. In addition, the Business Manager, who currently supervises the accounts receivable function, is approving all write-offs. Internal controls suggest that upper management should approve accounts receivables write-off. Approvers could include the Vice President of Finance and Administration, the President, or a designee in the System Office.

Additionally, Danville has not updated their policies and procedures pertaining to the collection of past-due receivables since July 1998. As a result, the policies do not reflect changes resulting in the implementation of PeopleSoft. Northern Virginia did not report an allowance for doubtful accounts due to problems the college experienced in obtaining accurate data from PeopleSoft relating to this estimate. This resulted in an overstatement of Northern Virginia's receivables; however, the overstatement was not material and did not result in an adjustment.

These colleges should develop and update accounts receivable policies and procedures. Failure to develop and update policies and procedures, which establish strong internal controls, can increase the risk of improper write-offs and allowances for bad debt.

Follow Virginia Sickness and Disability Program Policies and Procedures

Applicable to: Lord Fairfax Community College

Lord Fairfax improperly approved and overpaid an employee under the Virginia Sickness and Disability Program (VSDP). VSDP policies and procedures require agencies and colleges to adjust short-term benefits by any payments the employee receives or is eligible to receive. A Lord Fairfax employee received full short-term benefit pay along with pay for a separate contract with the college. Lord Fairfax did not adjust the short-term benefit pay by the contract pay.

After paying the employee, Lord Fairfax realized the error and overpayment. However, management chose to allow the overpayment instead of requesting a reimbursement. VSDP policies and procedures do not give agencies and colleges the authority to approve short-term benefit overpayments.

Lord Fairfax should ensure short-term disability benefits are not overpaid. Additionally, Lord Fairfax should not approve short-term disability benefit overpayments and should request reimbursements for any outstanding overpayment. Lord Fairfax should follow VSDP policies and procedures.

Strengthen Internal Controls over the Small Purchase Charge Card Program

Applicable to: Thomas Nelson Community College

VCCS has issued charge cards to over 1,080 employees at the System Office and Community Colleges for purchasing of various goods and services. VCCS employees purchased over $20.1 million under the program during fiscal year 2005. The System Office and each of the colleges have developed policies and procedures for the program to ensure compliance with state guidelines. However, we found Thomas Nelson did not follow the established procedures.

Thomas Nelson did not maintain receipts and invoices for purchases made with the Small Purchase Charge Card. Additionally, Thomas Nelson paid sales tax when purchasing tax-exempt items on the Small Purchase Charge Card.

The Commonwealth's accounting policies requires agencies to maintain all receipts and invoices for purchases made with the small purchase charge card. Additionally, the policies require that small purchase charge cardholders not pay Virginia Sales tax on goods and services. Individual cardholders who mistakenly pay sales tax should take necessary steps with the vendor to credit their account with the amount of the tax paid.

Thomas Nelson should ensure that cardholders are aware of policies and procedures regarding maintaining support for all purchases and the tax-exempt nature of purchases. Additionally, cardholder supervisors should review all purchases to ensure that purchases comply with policies and procedures.

<u>MANGEMENT'S DISCUSSION AND ANALYSIS</u>
(unaudited)

The following discussion and analysis provides an overview of the financial position and activities of the Virginia Community College System (VCCS) for the year ended June 30, 2005. This discussion has been prepared by management and should be read in conjunction with the financial statements and footnotes.

The VCCS financial statements have been prepared in accordance with GASB Statement 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, as amended by GASB Statements 37, 38, and 39. The three required financial statements are the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows.

Beginning in fiscal year 2004, the VCCS adopted GASB Statement 39, *Determining Whether Certain Organizations are Component Units*. Accordingly, the community college foundations are included in the accompanying financial statements as a discrete component unit in a separate column. The following discussion and analysis does not include the financial condition and activities of the foundations.

<u>Financial Highlights</u>

The following represents significant financial highlights for the VCCS in fiscal year 2005:

- $22 million in general funds were provided by the General Assembly to address enrollment growth and base operating needs of the VCCS. This amount reflects a portion of general fund support needed to provide adequate base support of the VCCS core academic functions. These additional funds will allow the VCCS to serve more students, retain existing students more effectively, increase the number of students receiving a degree or certificate, and enhance the quality and rigor of academic programs.

- $4.1 million in general funds were provided by the General Assembly for three percent increases in classified and faculty salaries effective November 25, 2004.

- $4.7 million in general funds were provided by the General Assembly to offset a portion of the operating costs for the Medical Education Campus of Northern Virginia Community College.

- $8.2 million was received from bonds issued by the Virginia College Building Authority (VCBA) to provide equipment for new buildings that opened in fiscal year 2005. In addition, $11.9 million was provided by VCBA bond funds for major mechanical system upgrades and replacement.

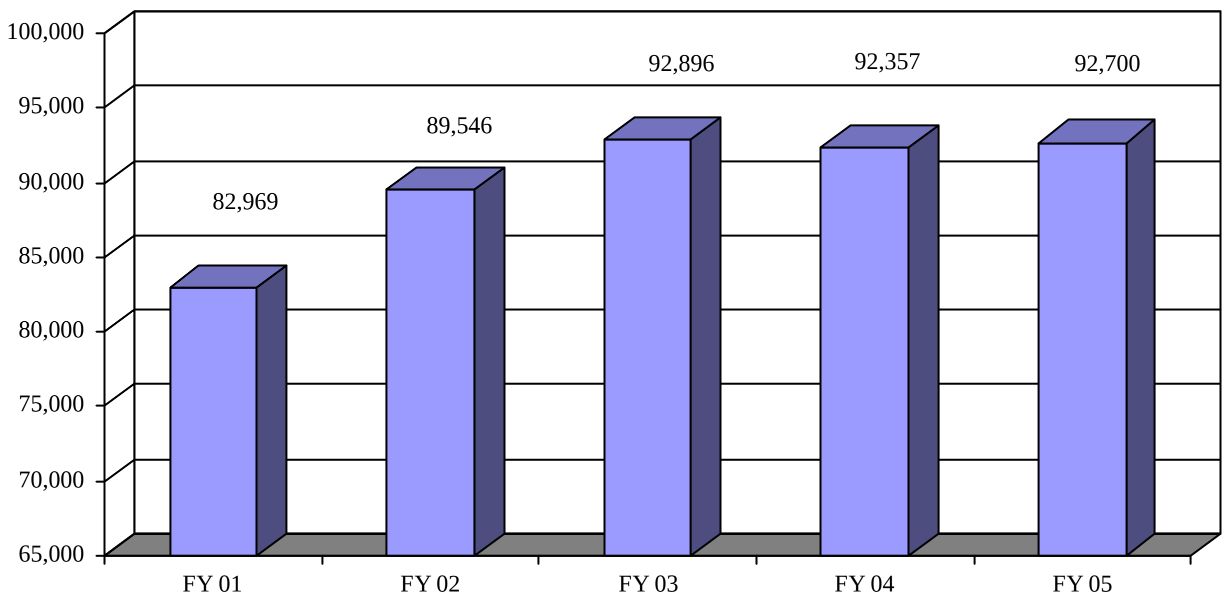
- The State Board for Community Colleges voted to increase tuition and fee rates by $4.10 per credit hour applicable to all students effective fall 2004. This increase generated approximately $9.8 million in fiscal year 2005.

- Net assets increased $23.8 million in fiscal year 2005 principally due to the increased investment in capital assets.

Enrollment Information

Below is a chart depicting full-time equivalent students attending the VCCS over the past five years. The VCCS mission is to provide comprehensive higher education and workforce training programs and services of superior quality that are financially and geographically accessible and that meet individual, business, and community needs of the Commonwealth. While there have been declines in out-of-state student enrollments, in-state enrollments reflecting our primary mission have continued to increase.

VCCS Enrollment - Full-Time Equivalents



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

Financial Statements

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

Statement of Net Assets

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

A summarized Statement of Net Assets* as of June 30 is as follows:

	2005	2004
Assets:		
Current assets	$106,482	$101,768
Capital assets, net	477,387	454,768
Other noncurrent assets	36,456	36,560
Total assets	620,325	593,096
Liabilities:		
Current liabilities	71,362	64,725
Noncurrent liabilities	63,843	66,342
Total liabilities	135,205	131,067
Net assets:		
Invested in capital assets, net of debt	429,370	412,654
Restricted-nonexpendable	438	430
Restricted-expendable	36,643	22,984
Unrestricted	18,669	25,961
Total net assets	$485,120	$462,029

*in thousands

Current assets consist of $92 million in cash and investments, accounts and notes receivable of $7 million, prepaid expenses of $4.5 million and inventories of $2 million. Current assets increased by $5 million primarily due to increases in general obligation funding for capital projects of nearly $10 million. This was offset by a decrease in accounts receivable and amounts due from the Commonwealth of $5 million.

Net capital assets increased by $22.6 million primarily due to increase in construction in progress and buildings in fiscal year 2005. Construction-in-progress additions were principally comprised of $13.8 million at NVCC for various projects including $7.2 million for a parking deck at the Annandale campus and $2.1 million for building renovations at the Annandale campus, $4.4 million for GCC's Workforce Development Center, $2.8 million at DCC for the Applied Technology Building, and $1.4 million at JTCC for parking improvements. In addition, completed projects moved out of construction in progress to buildings including $6.2 million at JSRCC for the downtown parking deck, $5.6 million at GCC for the Fredericksburg campus, $3 million at NVCC for three projects, $1.7 million at MECC for renovations, and $1.3 million at LFCC for the maintenance building. These projects were funded with appropriations and bond proceeds. Current year depreciation expense was $27 million.

At June 30 2005, the VCCS had future commitments for construction contracts totaling $18.5 million. Commitments were primarily comprised of $4.6 million at GCC for the Culpepper Technical Center, $3.6 million at NVCC for the parking deck at the Annandale campus, $2.6 million at NVCC for the Science Building at Loudoun, $1.5 million at NVCC for the renovation at the Alexandria campus, and $1.2 million for VCCS maintenance reserve projects.

Non-current assets did not change significantly in fiscal year 2005 from fiscal year 2004.

Current liabilities consist primarily of accounts payable of $10.4 million, accrued compensation of $35.2 million, deferred revenue of $17.6 million, debt obligations of $5 million and deposits of $3 million. Current liabilities increased primarily due to accrued payroll of $2.5 million and $3.5 million for increases in deferred revenue attributable to tuition increases effective in the summer term 2005 and the first time deferral of technology fees for summer 2005 collections. Non-current liabilities are comprised of accrued leave of $14 million, long-term debt of $45 million and amounts due to the federal government of $5 million. Noncurrent liabilities decreased $2.5 million in fiscal year 2005 due to decreases in bond, capital lease, and pooled bond debt.

Statement of Revenues, Expenses and Changes in Net Assets

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

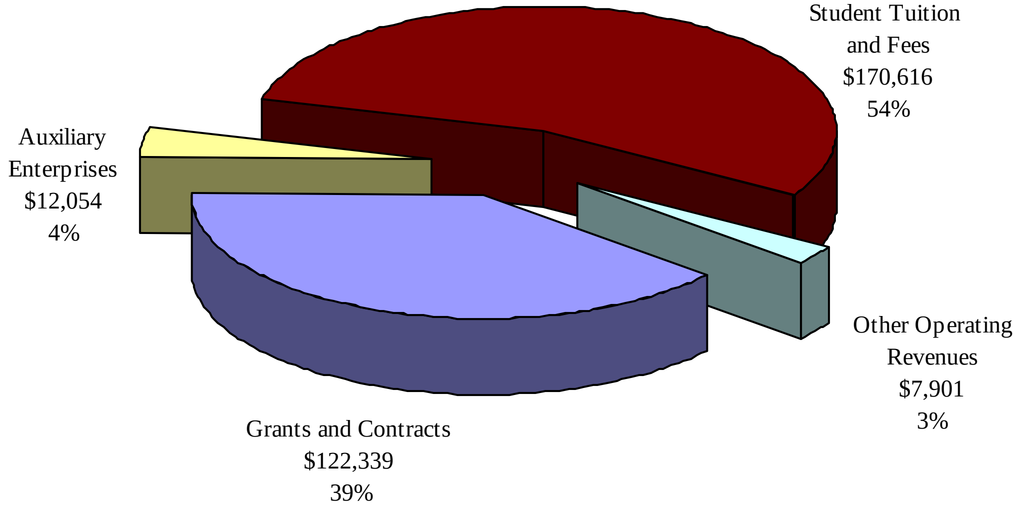
A summarized Statement of Revenues, Expenses and Changes in Net Assets* for the year ended June 30, follows:

	2005	2004
Operating revenue	$ 312,910	$ 310,107
Operating expenses	650,697	609,620
Operating loss	(337,787)	(299,513)
Nonoperating revenues/(expenses):		
State appropriations	306,465	280,484
Local appropriations	2,062	1,872
Grants and gifts	6,714	5,568
Investment income	1,140	1,173
Interest expense	(1,820)	(1,631)
Other	(866)	(776)
Net nonoperating revenue	313,695	286,690
Loss before other revenues, expenses, gains or losses	(24,092)	(12,823)
Capital appropriations-state	38,407	29,940
Capital appropriations-local	4,693	3,585
Capital gifts and grants	4,856	2,447
Increase in net assets	23,864	23,149
Net assets, beginning of year as restated	461,256	438,880
Net assets, end of year	$ 485,120	$ 462,029

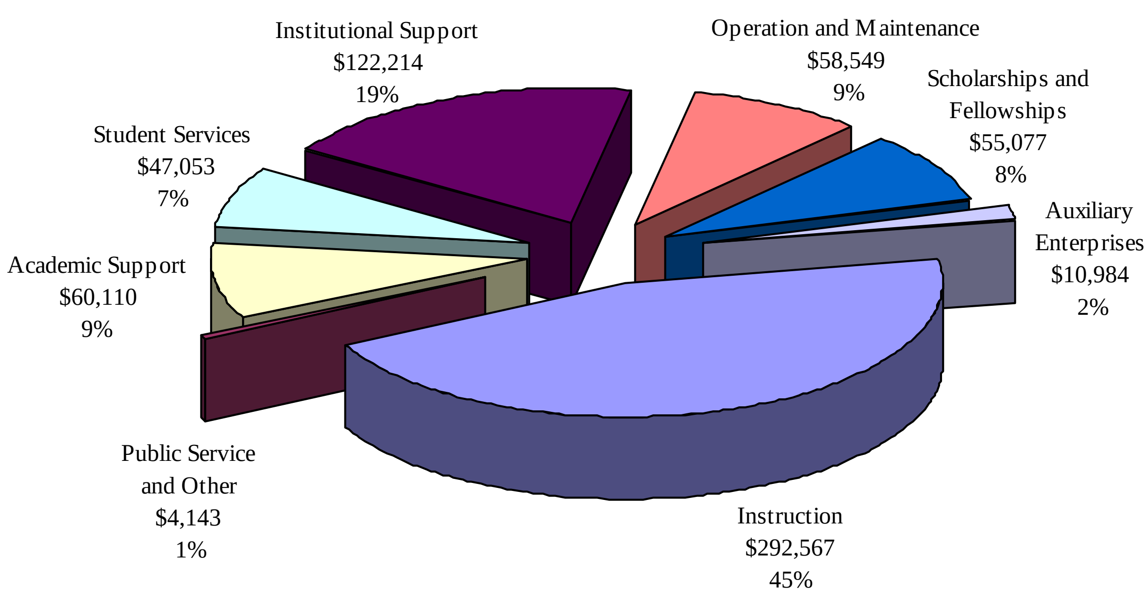
*in thousands

A graphic presentation of fiscal year 2005 operating revenues and operating expenses by source (per the Statement of Revenues, Expenses, and Changes in Net Assets) is below:

Operating Revenues *



Operating Expenses *



* in thousands

Statement of Cash Flows

The Statement of Cash Flows provides additional information about the financial results of the VCCS by reporting the major sources and uses of cash. A summary of the cash flows* for the years ended June 30 is as follows:

	2005	2004
Cash received from operations	$ 320,137	$309,808
Cash used in operations	616,139	579,970
Net cash used in operations	(296,002)	(270,162)
Net cash provided by noncapital financing activities	309,367	281,965
Net cash provided by/(used by) capital and related financing activities	(4,933)	284
Net cash provided by investing activities	2,522	944
Net increase in cash and cash equivalents	10,954	13,031
Cash and cash equivalents, beginning of year	112,289	99,258
Cash and cash equivalents, end of year	$ 123,243	$ 112,289

*in thousands

Cash and cash equivalents increased by $11 million in fiscal year 2005 compared to a $13 million increase in fiscal year 2004. This increase is primarily in the area of appropriations available for new capital project design and construction funding allotted but not spent in fiscal year 2005. Net cash used in operating activities in fiscal year 2005 was $296 million compared to $270 million in fiscal year 2004. This can be attributed to additional general fund and tuition resources in fiscal year 2005 available for expenditure. Net cash provided by non-capital financing increased by $27.4 million in fiscal year 2005 compared to fiscal year 2004 principally due to increased state appropriations of $26.3 million (net of reversion). Net cash provided by capital financing activities decreased $5.2 million. While capital and local appropriations increased $11.5 million, capital asset purchases decreased $7 million and proceeds from bond issues decreased $9 million reflecting no new pooled bond debt in fiscal year 2005.

Economic Outlook

The VCCS receives approximately 61 percent of its operating budget through general fund appropriations. The Commonwealth of Virginia ended fiscal 2005 with a significant budget surplus and it is predicted by economists that the U.S. economy will be strong through fiscal year 2008 with Virginia's economy expected to outperform the U.S. economy. With the implementation of the *Higher Education Restructuring Act*, a commitment was made by the 2005 General Assembly to fund enrollment growth and core operations of higher education institutions. The *Higher Education Restructuring Act* endorsed the concept of restoring full responsibility and authority for establishing tuition and fees to the Boards of Visitors at all institutions. In addition, the 2005 General Assembly retained the existing language in the *Appropriations Act* that provides explicit authority to the Board of Visitors to set tuition and fee rates as well as the expectation that in-state students pay one-third of their costs and out-of-state students pay one hundred percent of their costs. The State Board for Community Colleges has committed to funding the *Dateline 2009* initiative along with moderate tuition increases representing the VCCS share of base budget funding and goals of the *Dateline 2009* initiative that outlines the strategic direction for the VCCS. A significant part of this initiative relies on expansion of the VCCS funding base.

The State Board for Community Colleges approved a tuition increase of $4.30 per credit hour applicable to all in-state students and $4.35 per credit hour applicable to all out-of-state students effective summer term 2005. It is anticipated that this will generate approximately $12 million in tuition and fee revenues in fiscal year 2006.

In the fiscal year 2006 budget, the VCCS received approximately $16 million new general fund dollars specifically earmarked to address base funding needs identified by the Joint Subcommittee of Higher Education Funding Policies.

In November 2002, voters in the Commonwealth of Virginia passed a bond resolution that will ultimately provide $159 million to the VCCS for more than forty-five construction and renovation projects. The VCCS began construction on twenty-five of these projects in fiscal year 2004. Total fiscal year 2005 expenditures charged to general obligation bond projects were $8,687,181. Due to significant increases in the cost of construction materials and labor, it is estimated that the VCCS will not be adequately funded for projects originally approved under the general obligation bond campaign in fiscal year 2003. The original shortfall in fiscal year 2005 was estimated at $60 million. During the 2005 legislative session, the General Assembly provided the VCCS with additional $25 million general fund dollars to help offset the shortfall. The funding shortfall has been updated in fiscal year 2006 and is again estimated at $60 million. The VCCS will work with the colleges, the Department of Planning and Budget, and the General Assembly to address the remaining shortfall.

FINANCIAL STATEMENTS

VIRGINIA COMMUNITY COLLEGE SYSTEM
STATEMENT OF NET ASSETS
As of June 30, 2005

	VCCS	Component Units Foundations
ASSETS		
Current assets:		
Cash and cash equivalents (Note 2)	$ 90,402,646	$ 8,257,917
Short term investments (Note 2)	2,071,420	923,755
Accounts receivable (Note 3)	6,011,987	222,485
Pledges receivable (Note 3)	-	2,932,771
Due from Commonwealth	57,841	-
Interest receivable	35,368	95,915
Prepaid expenses	4,542,824	51,820
Inventories	2,027,604	-
Notes receivable (Note 3)	1,332,554	1,120
Total current assets	106,482,244	12,485,783
Noncurrent assets:		
Restricted cash and cash equivalents (Note 2)	31,219,441	-
Cash with trustees (Note 2)	1,260,348	-
Endowment cash and cash equivalents (Note 2)	360,951	418,729
Endowment investments (Note 2)	-	32,680,686
Other long-term investments (Note 2)	-	47,206,629
Investments in real estate	-	1,257,988
Pledges receivable (Note 3)	-	4,323,941
Notes receivable (Note 3)	3,615,367	33,258
Non-depreciable capital assets, net (Note 8)	73,159,916	1,462,981
Depreciable capital assets, net (Note 8)	404,227,229	2,358,470
Total noncurrent assets	513,843,252	89,742,682
Total assets	620,325,496	102,228,465
LIABILITIES		
Current liabilities:		
Accounts and retainage payable (Note 6)	10,395,350	406,959
Accrued payroll expense	23,110,421	15,470
Deferred revenue	17,611,529	38,128
Long-term liabilities-current portion (Note 9)	16,981,440	96,955
Due to Commonwealth	165,750	-
Deposits	3,097,736	26,552
Total current liabilities	71,362,226	584,064
Noncurrent liabilities:		
Deferred revenue (Note 9)	5,593	13,554
Long-term liabilities (Note 9)	58,861,270	453,096
Due to federal government (Note 9)	4,976,118	-
Total noncurrent liabilities	63,842,981	466,650
Total liabilities	135,205,207	1,050,714

VIRGINIA COMMUNITY COLLEGE SYSTEM
STATEMENT OF NET ASSETS
As of June 30, 2005

	VCCS	Component Units Foundations
NET ASSETS		
Invested in capital assets, net of related debt	429,370,666	3,821,451
Restricted for:		
Nonexpendable	437,765	33,480,513
Expendable	36,643,074	39,107,596
Unrestricted	18,668,784	24,768,191
Total net assets	$ 485,120,289	$ 101,177,751

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

VIRGINIA COMMUNITY COLLEGE SYSTEM
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2005

	VCCS	Component Units Foundations
Operating revenue:		
Tuition and fees (net of scholarship allowance of $43,988,652)	$ 170,615,647	$ -
Federal grants and contracts	113,955,117	-
State and local grants	3,257,849	-
Nongovernmental grants	5,125,764	1,955,842
Sales/services of education department	334,688	-
Auxiliary enterprises (net of scholarship allowance of $3,472,496)	12,054,005	-
Gifts and contributions	-	10,145,332
Endowment income	-	1,989,450
Other operating revenues	7,566,584	1,298,221
Total operating revenue	312,909,654	15,388,845
Operating expenses:		
Instruction	292,566,993	492,536
Public service	4,057,696	30,769
Academic support	60,109,783	2,779,317
Student services	47,053,243	-
Institutional support	122,214,368	6,380,520
Operation and maintenance	58,549,050	1,825,697
Scholarships and fellowships	55,077,072	2,842,522
Auxiliary enterprises	10,984,423	-
Fundraising	-	994,976
Other expenses	84,684	72,553
Total operating expenses	650,697,312	15,418,890
Operating income/(loss)	(337,787,658)	(30,045)
Nonoperating revenues/(expenses):		
State appropriations (Note 5)	306,464,767	-
Local appropriations	2,062,052	-
Grants and gifts	6,713,764	117,951
Investment income	1,140,632	3,562,198
Interest on capital asset related debt	(1,820,134)	-
Other nonoperating revenue/(expense)	(866,176)	-
Net nonoperating revenue	313,694,905	3,680,149
Income before other revenues, expenses or gains/(losses)	(24,092,753)	3,650,104
Capital appropriations-state	38,407,276	-
Capital appropriations-local	4,693,437	-
Capital gifts, grants and contracts	4,856,427	26,500
Additions to permanent and term endowments	-	5,263,516
Increase in net assets	23,864,387	8,940,120
Net assets - beginning of year as restated (Note 1)	461,255,902	92,237,631
Net assets - end of year	$ 485,120,289	$ 101,177,751

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

VIRGINIA COMMUNITY COLLEGE SYSTEM
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2005

Cash flows from operating activities:	
Tuition and fees	$ 177,091,503
Grants and contracts	121,667,629
Payments to suppliers and others	(123,763,964)
Payments for employee wages	(341,395,915)
Payments for employee fringes	(82,238,710)
Payment for scholarships	(57,290,180)
Payments for utilities	(10,546,575)
Sales and services of education department	334,688
Auxiliary enterprises	12,294,697
Loans issued to students	(903,391)
Loans collected from students	1,223,152
Other	7,524,919
Net cash used by operating activities	(296,002,147)
Cash flows from non-capital financing activities:	
State appropriations	306,832,915
Local appropriations	2,013,477
Grants and gifts	979,483
Agency receipts	10,787,210
Agency disbursements	(10,243,868)
PLUS, Stafford and Direct Lending loan receipts	25,430,862
PLUS, Stafford and Direct Lending loan disbursements	(25,209,606)
Borrowings	198,260
Loan repayments	(1,427,000)
Other non-operating revenue	4,967
Net cash provided by non-capital financing activities	309,366,700
Cash flows from capital and related financing activities:	
Capital appropriations-state	38,407,276
Capital appropriations-local	4,693,437
Capital grants and gifts	638,797
Purchase capital assets	(42,733,703)
Proceeds from sale of capital assets	47,370
Debt interest payments	(1,820,134)
Debt principal payments	(4,165,574)
Net cash used by capital and related financing activities	(4,932,531)
Cash flows from investing activities:	
Purchases of investments	(3,511,891)
Sale of investments	4,916,109
Investment income	1,118,077
Net cash provided by investing activities	2,522,295
Net increase in cash and cash equivalents	10,954,317
Cash and cash equivalents - beginning of year	112,289,069
Cash and cash equivalents - end of year	$ 123,243,386

VIRGINIA COMMUNITY COLLEGE SYSTEM
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2005

Reconciliation of operating income/(loss) to net cash used in operating activities:	
Operating income/(loss)	$ (337,787,658)
Adjustment to reconcile operating income/(loss) to net cash used in operating activities:	
Depreciation expense	26,832,774
Changes in assets and liabilities:	
Accounts receivable, net	4,881,937
Prepaid expenses and other	5,840,287
Accrued compensation and leave	2,622,808
Accounts payable and other	(1,938,750)
Deferred revenue	3,448,290
Deposits pending distribution	98,165
Net cash used in operating activities	$ (296,002,147)
Noncash transactions:	
ETF equipment	$ 8,194,498
Assets acquired through capital leases or installment purchases	$ 1,778,527
Donated fixed assets	$ 1,890,597
Debt principal and interest payments made by Treasury	$ 1,921,919

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

NOTES TO FINANCIAL STATEMENTS

VIRGINIA COMMUNITY COLLEGE SYSTEM

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

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

The accompanying financial statements include all of the individual community colleges and the System Office under the control of the State Board for Community Colleges.

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

B. Community College Foundations

The community college foundations are legally separate, tax-exempt organizations formed to promote the achievements and further the aims and purposes of the colleges. The foundations accomplish their purposes through fundraising and funds management efforts that benefit the colleges and their programs. Although the colleges do not control the timing or amount of receipts from the foundations, the majority of resources, or income thereon that the foundations hold and invest are restricted to the activities of the colleges by the donors. Because these restricted resources held by the foundations can only be used by, or for the benefit of the colleges, the foundations are considered component units under GASB Statement 39, *Determining Whether Certain Organizations are Component Units.* Accordingly, the community college foundations are presented as discrete component units in the financial statements.

During the year ended June 30, 2005, the foundations distributed $6,784,695 to the colleges for both restricted and unrestricted purposes. Complete financial statements for the foundations can be obtained by writing the VCCS Office of Fiscal Services, 101 N. 14th St., Richmond, VA 23219.

C. Accounting Policy Changes

The VCCS adopted the following accounting and reporting change for the year ended June 30, 2005. GASB Statement 40, *Deposit and Investment Risk Disclosure*, updates the custodial credit risk disclosure requirements of GASB Statement 3 and establishes more comprehensive disclosure requirements addressing other common risks of the deposits and investments of state and local governments. The VCCS deposits and investments are disclosed in Note 2.

D. Basis of Accounting

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

Revenues and expenses of the summer academic term occur within two fiscal years, because the term extends from May through August and the fiscal year ends on June 30. Expenses and an equal amount of revenue have been reported in the current period for the portion of the summer academic term from May 16 through June 30, 2005.

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

The community college foundations are private, nonprofit organizations that report under 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. No modifications have been made to the financial information of the foundations in the financial statements of the VCCS regarding these criteria and presentation features.

The financial statements for the community college foundations are for the year ending June 30, 2005 except for Dabney S. Lancaster, Danville, John Tyler, and Virginia Western that are as of December 31, 2004.

E. Inventories

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

F. Investments

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

G. Capital Assets

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

H. Accrued Compensated Absences

The amount of leave earned but not taken by all classified employees, administrative/professional faculty, teaching faculty, and presidents is recorded as a liability on the balance sheet. The amount reflects, as of June 30, all unused annual leave, compensatory leave, and the amount payable upon termination under the Commonwealth of Virginia's sick leave pay out policy. An additional liability amount has been included for those employees with less than five years of service based on the probability they will eventually become vested. Also included in the liability is the System's share of the FICA taxes on leave balances for which employees will be compensated.

I. System Office Expenditures

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

J. Classification of Revenues and Expenses

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

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

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

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

K. 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 VCCS, and the amount that is paid by students and/or third parties making payments on the student's behalf. Certain governmental grants, such as Pell grants, and other federal, state or nongovernmental programs are recorded as either operating or nonoperating revenues in the financial statements. To the extent that such revenues are used to satisfy tuition and fees and other student charges, the VCCS has recorded a scholarship discount and allowance.

L. Net Assets

Net assets are classified as follows:

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

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

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

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

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

Beginning net assets have been adjusted to correct prior year reporting errors as follows:

Community College Foundations

Net Assets as of June 30, 2004, as previously reported	$91,972,841
Reclassifications	264,790
Net Assets as of July 1, 2004, restated	$92,237,631

2. CASH AND INVESTMENTS

Cash and Cash Equivalents

Cash equivalents maintained by VCCS are investments with original maturities of less than three months.

Pursuant to Section 2.2-1800, et seq., Code of Virginia, all state funds of the VCCS are maintained by the Treasurer of Virginia who is responsible for the collection, disbursement, custody, and investment of state funds.

Deposits

Local cash deposits with banks and savings institutions not with the Treasurer of Virginia are covered by federal depository insurance or collateralized in accordance with the Virginia Security of Public Deposits Act, Section 2.2-4400 et seq., Code of Virginia. Amounts of deposits covered by the Virginia Security of Public Deposits Act totaled $19,780,683 at June 30, 2005.

Investments

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

Investments of the member colleges of the Virginia VCCS are limited to those allowed under Chapter 45, Investments of Public Funds Act, Sections 2.2-4500 and 2.2-4501 of the Code of Virginia. Commonwealth of Virginia law limits investments in stocks, bonds, notes, and other evidences of indebtedness of the Commonwealth and those unconditionally guaranteed as to the payment of principal and interest by the Commonwealth. Investments in United States agencies all carry the explicit guarantee of the United States government. Additionally, Virginia's community colleges may participate in the Local Government Investment Pool as authorized by Chapter 46 of the Code of Virginia and managed by the Commonwealth of Virginia Treasury Board. Authorized investments in the Local Government Investment Pool are limited to those set forth for local officials in Chapter 45, Sections 2.2-4500 of the Code of Virginia.

GASB Statement 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statement 3*, issued March 2003, became effective for the fiscal year ending June 30, 2005, and imposes new standards for financial reporting. The Plan implemented the necessary changes to be in compliance with this Statement. The deposits and investments of state and local governments are exposed to risks that have the potential to result in losses. This Statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, foreign currency risk, and any other risks. As an element of interest rate risk, this Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. As an element of credit risk, this Statement requires disclosure of credit quality ratings for investments in debt securities as well as investments in external investment pools, money market mutual funds, bond mutual funds, and other pooled investment of fixed-income securities. As an element of foreign currency risk, this Statement requires certain disclosures of investments that have fair values that could be adversely affected by changes in exchange rates. Deposit and investment policies related to the risks identified in the Statement are also required to be disclosed.

Custodial Credit Risk

GASB Statement 40 amends the requirements set out in GASB Statement 3 by requiring disclosure only of uncollateralized deposits and uninsured and unregistered securities held by counterparty or its trust department or agent, but not in the government's name. VCCS had no investments exposed to custodial credit risk for 2005.

Interest Rate Risk

Disclosure of the maturities of investments is required when the fair market value is adversely affected by changes in interest rates. Investments subject to interest rate risk are outlined in the accompanying chart.

Credit Risk

Disclosure of the credit quality rating is required for investments exposed to the risk that an issuer or other counterparty will not fulfill its obligations. Investments subject to credit rate risk are outlined in the accompanying chart.

Concentration of Credit Risk

Disclosure of any one issuer is required when it represents five percent or more of total investments. VCCS does not have such concentration of credit risk for 2005.

Foreign Currency Risk

Disclosure is required for investments exposed to changes in exchange rates that will adversely affect the fair value of an investment or a deposit. VCCS has no investments or deposits subject to Foreign Currency Risk for 2005.

Cash Equivalents	Credit Rating	Maturities	Fair Value
Local Government Investment Pool	AAA	0-3 months	$25,155,671
Certificates of deposit	Not rated	0-3 months	6,702,179
Repurchase agreements	Not rated	0-3 months	4,954,184
U.S. government treasury bills	Not rated	0-3 months	3,027,193
Money market	Not rated	0-3 months	638,777
Total			$40,478,004

Investments	Credit Rating	Maturities	Fair Value
U.S. government treasury bills	Not rated	4-12 months	$1,088,325
Mutual funds	AAA	4.5 years avg	581,100
J.P. Morgan Corporation bonds	AA	8/2006	152,627
Ford Motor Credit Corporation bonds	BB	2/2006	150,430
Federal National Mortgage Association	AAA	2/2006	98,938
Total			$2,071,420

Community College Foundations

The Foundations had the following cash, cash equivalents and investments as of June 30, 2005:

Cash and cash equivalents	$ 8,676,646
Investments:	
Mutual funds and money markets	$43,202,538
Stocks	15,148,830
U.S. government securities	10,675,857
Corporate bonds	5,607,018
UVA investment fund	2,930,302
Mortgage- backed securities	1,439,258
Investment in real estate	1,257,988
Certificates of deposits	607,797
Split interest agreement	563,737
Cash surrender value of life insurance	485,691
Other property investments	109,259
Limited partnership	40,783
Total	$82,069,058

Some foundations had balances in bank and saving institutions that exceed the federally-insured limits. However, the foundations do not believe this poses any significant credit risk.

3. RECEIVABLES AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

The following receivables included an allowance for doubtful accounts at June 30, 2005:

Gross accounts receivable:	
Tuition and fees	$4,136,561
Auxiliary enterprises	545,500
Federal, state, local and nongovernmental grants, gifts, and contracts	1,208,846
Other activities	434,853
Total gross accounts receivable	6,325,760
Less: Allowance for doubtful accounts	313,773
Net accounts receivable	$6,011,987
Gross loans and notes receivable	$5,101,373
Less: Allowance for doubtful accounts	153,452
Net loans and notes receivable	$4,947,921

The only receivables not expected to be collected within one year are $3,615,367 in notes and loans receivable.

Community College Foundations

The foundations have the following receivables as of June 30, 2005:

Gross accounts receivable	$ 261,393
Less: Allowance for doubtful accounts	38,908
Net accounts receivable	$ 222,485
Pledges receivable:	
Due in one year	$ 3,011,361
Due in 1-5 years	4,475,692
Due in more than 5 years	1,557,994
Less: Allowance for doubtful accounts	357,496
Present value discount	1,430,839
Net pledges receivable	$ 7,256,712
Gross loans and notes receivable	$ 34,378
Less: Allowance for doubtful accounts	-
Net loans and notes receivable	$ 34,378

The only receivables not expected to be collected within one year are $33,258 in notes and loans receivable and $4,323,941 in pledges receivable.

4. PENSION PLAN

All qualified salaried employees of the VCCS must participate in one of two retirement benefit plans - the Virginia Retirement System (VRS) or the Optional Retirement Plan (ORP). Classified employees are eligible to participate in the VRS only while faculty rank employees are eligible to participate in either the VRS or the ORP.

The VRS is an agent multiple-employer public employee retirement system that acts as a common investment and administrative agency for the Commonwealth of Virginia and its political subdivisions. This is a fixed benefit plan, with benefits vesting after five years of service. Current benefit provisions are based on a formula using years of service, salary, and age. The VRS does not measure assets and pension benefit obligations separately for individual State institutions. Information relating to this plan is available at the statewide level only in the Commonwealth of Virginia's Comprehensive Annual Financial Report (CAFR). The Commonwealth, not the VCCS, has overall responsibility for contributions to this plan.

Participants in the ORP may select from one of five plan administrators for the receipt and investment of contributions. This is a fixed-contribution plan where the retirement benefits received are based on the employer's (10.4 percent) contributions, plus interest and dividends.

Individual contracts issued under the ORP plan provide for full and immediate vesting of the VCCS contributions. Total pension costs under this plan were $4,229,664 and $3,919,328 for years ended June 30, 2005 and 2004, respectively. Contributions to the ORP plan were calculated using the base salary amount of $40,669,846 and $37,685,846 for fiscal years 2005 and 2004, respectively.

The VCCS total payroll for fiscal years 2005 and 2004 was $338,411,991 and $316,892,165 respectively.

5. STATE APPROPRIATIONS

All Commonwealth unrestricted revenues must be appropriated by the Legislature and are provided on an annual basis. Unspent balances of these appropriations at the close of the fiscal year revert to the Commonwealth's General Fund. These reverted funds are eligible for re-appropriation in fiscal year 2005-2006 provided that the VCCS meets the Management Standards established by the Secretary of Education and the Secretary of Finance and approved by the Governor.

During the year ended June 30, 2005, the Virginia Community College System received the following supplemental appropriations in accordance with the Appropriation Act of 2005, Chapter 951, Acts of Assembly.

Original legislative appropriations	$302,335,887
Less: TCC Norfolk rent reversion to Treasury	(404,860)
Appropriated - Chapter 951- Approved May 4, 2005	301,931,027
Additions:	
Transfers from central appropriations:	
Classified salary Increase	978,731
Employee health care insurance premium increase	2,075,829
Additional rent – Monroe Building	7,825
VSDP rate increase	591,073
COVANET charges	927
Less:	
Retirement rate decrease	(244,768)
Group life insurance premium reduction	(847,820)
Retiree health credit rate reduction	(180,162)
Other:	
Transfer from SCHEV – VIVA	27,031
Carryover (re-appropriated) FY04 year-end balance	3,908,131
Transfer E&G appropriation (VHCC) to Capital appropriation	(137,243)
Transfer from SCHEV – Military tuition waiver	933,506
Retirement rate decrease (NGF)	(231,647)
Equipment Trust Fund lease payment	(512,750)
Group life insurance premium rate reduction	(744,782)
Transfer capital fee	(258,960)
Retiree health credit reduction	(167,934)
Philpott Manufacturing	(508,140)
Reversion	(14,187,232)
Adjusted unrestricted appropriations	$292,432,642

Other restricted appropriations were $14,032,125 for a total of $306,464,767.

6. ACCOUNTS AND RETAINAGE PAYABLE

Accounts and retainage payable consisted of the following as of June 30, 2005:

Vendor payables	$ 8,720,962
Retainage payable	1,670,849
Taxes payable	3,539
Total	$10,395,350

7. EQUIPMENT TRUST FUND

The System participates in the Higher Education Equipment Trust Fund of the Virginia College Building Authority (VCBA). The Higher Education Equipment Trust Fund provides funds to public colleges and universities for equipment acquisition. In prior years, funds were provided in the form of a lease. During the year ended June 30, 2005, the VCBA financed the ETF program with state funds, which will not require repayment.

8. CAPITAL ASSETS

Changes in capital assets for the year ended June 30, 2005 are as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Nondepreciable capital assets:				
Land	$ 26,055,514	$ 532,430	$ -	$ 26,587,944
Land improvements	9,890,145	125,413	-	10,015,558
Inexhaustible works of art	83,242	-	-	83,242
Construction in progress *	23,414,393	32,214,186	19,155,407	36,473,172
Total nondepreciable capital assets	59,443,294	32,872,029	19,155,407	73,159,916
Depreciable capital assets:				
Buildings	432,618,013	17,796,929	-	450,414,942
Infrastructure	19,663,841	1,424,301	-	21,088,142
Equipment	115,493,073	13,977,465	9,791,427	119,679,111
Land improvements	44,318,107	1,216,203	-	45,534,310
Library books	39,232,534	2,239,293	1,628,859	39,842,968
Total depreciable capital assets	651,325,568	36,654,191	11,420,286	676,559,473
Less accumulated depreciation for:				
Buildings	(116,113,405)	(9,851,285)	-	(125,964,690)
Infrastructure	(8,383,863)	(997,342)	-	(9,381,205)
Equipment	(75,261,185)	(12,881,170)	(8,872,648)	(79,269,707)
Land improvements	(25,601,947)	(1,300,793)	-	(26,902,740)
Library books	(30,640,578)	(1,802,183)	(1,628,859)	(30,813,902)
Total accumulated depreciation	(256,000,978)	(26,832,773)	(10,501,507)	(272,332,244)
Depreciable capital assets, net	395,324,590	20,576,085	11,673,446	404,227,229
Total capital assets, net	$ 454,767,884	$ 53,448,114	$ 30,828,853	$ 477,387,145

* includes capitalized interest of $654,596

Community College Foundations

The foundations had the following capital assets as of June 30, 2005:

Nondepreciable capital assets:	
Land	$ 1,234,832
Works of art	228,149
Total nondepreciable capital assets	1,462,981
Depreciable capital assets:	
Buildings	2,666,114
Equipment	974,070
Infrastructure	304,547
Site improvement	25,988
Total depreciable capital assets	3,970,719
Less: Accumulated depreciation	(1,612,249)
Depreciable capital assets, net	2,358,470
Total capital assets, net	$ 3,821,451

9. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2005, is as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Debt:					
Bonds payable	$ 1,634,818	$ -	$ 175,138	$ 1,459,680	$ 178,778
Other capital leases	23,957,310	-	1,367,320	22,589,990	1,279,357
Notes payable:					
Installment purchases	5,019,810	2,334,519	1,779,834	5,574,495	1,796,090
Pooled bonds	20,290,000	-	825,000	19,465,000	950,000
Other notes payable	1,636,740	570,000	1,498,740	708,000	708,000
Total bonds, notes and capital leases	52,538,678	2,904,519	5,646,032	49,797,165	4,912,225
Other liabilities:					
Compensated absences	25,292,326	15,142,256	14,389,037	26,045,545	12,069,215
Deferred revenue	28,569	-	22,976	5,593	-
Federal loan program contributions	4,810,047	167,376	1,305	4,976,118	-
Total other liabilities	30,130,942	15,309,632	14,413,318	31,027,256	12,069,215
Total long-term liabilities	$82,669,620	$18,214,151	$20,059,350	$80,824,421	$16,981,440

10. BONDS PAYABLE

Long-term debt in the form of bonds payable of the System as of June 30, 2005, consists of the following:

Higher Education Refunding Bonds, Series 1999, issued $1,868,800 to advance refund a portion of the Higher Education Bonds, Series 1992A. The balance is payable in annual installments ranging from approximately $175,000 to $240,000 with an average coupon rate of 4.32% payable semiannually. The final installment of $239,167 is due June 1, 2012. The outstanding balance at June 30, 2005 is $1,459,680.

Aggregate annual maturities of bonds payable for fiscal years after 2005:

Year Ending June 30,	Principal	Interest	Total
2006	$ 178,778	$ 65,377	$ 244,155
2007	185,933	58,048	243,981
2008	200,833	48,751	249,584
2009	207,909	40,215	248,124
2010	219,967	31,119	251,086
2011-2012	466,260	32,223	498,483
Total debt service requirements	$1,459,680	$275,733	$1,735,413

11. NOTES PAYABLE

Notes payable represents an agreement with the Virginia College Building Authority (VCBA) to finance the following projects:

Parking improvements for the Midlothian campus of John Tyler Community College – The Balance is to be repaid in ten annual installments ranging from $40,000 to $45,000 with an average interest rate of 3.52% payable semiannually. The final installment of $45,000 is due September 1, 2008. The outstanding balance at June 30, 2005 is $175,000.

Parking garage for the Medical Education campus of Northern Virginia Community College - The balance is to be repaid in twenty annual installments ranging from $280,000 to $555,000 with an average coupon rate of 4.43% payable semiannually. The final installment of $555,000 is due September 1, 2021. The outstanding balance at June 30, 2005 is $6,750,000.

Parking garage for J. Sargeant Reynolds Community College - The balance is to be repaid in twenty annual installments ranging from $140,000 to $330,000 with an average coupon rate of 5.07% payable semiannually. The final installment of $330,000 is due September 1, 2022. The outstanding balance at June 30, 2005 is $3,970,000.

Parking deck for the Annandale Campus of Northern Virginia Community College - The balance is to be repaid in twenty annual installments of $400,000 with an average coupon rate of 4.40% payable semiannually. The final installment of $400,000 is due September 1, 2023. The outstanding balance at June 30, 2005 is $7,600,000.

Parking and access road improvements for John Tyler Community College - The balance is to be repaid in ten annual installments ranging from $90,000 to $130,000 with an average coupon rate of 4.21% payable semiannually. The final installment of $130,000 is due September 1, 2013. The outstanding balance at June 30, 2005 is $970,000.

Other notes payable of $708,000 represents advances received from the Commonwealth of Virginia in anticipation of federal grant funding.

Scheduled maturities of notes payable are as follows:

Year Ending June 30,	Principal	Interest	Total Payments
2006	$ 1,658,000	$ 882,022	$ 2,540,022
2007	975,000	850,435	1,825,435
2008	1,000,000	810,157	1,810,157
2009	1,020,000	768,429	1,788,429
2010	1,000,000	725,788	1,725,788
2011-2015	5,320,000	2,867,928	8,187,928
2016-2020	5,580,000	1,576,988	7,156,988
2021-2024	3,620,000	285,500	3,905,500
Total	$20,173,000	$8,767,247	$28,940,247

12. COMMITMENTS

At June 30, 2005, the VCCS had future commitments for construction contracts totaling approximately $18,523,466. The System held $1,670,849 as retainage payable on construction and architectural/engineering contracts for work performed. The retainage payable will be remitted to the various contractors upon satisfactory completion of the construction projects.

13. LEASE COMMITMENTS AND INSTALLMENT PURCHASES

The System is committed under various capital lease, operating lease, and installment purchase agreements. The cost of assets capitalized under capital lease and installment purchase agreements total $33,192,111 and $9,950,758, respectively. Rent expense under operating lease agreements amounted to $7,602,611 for the year. A summary of future obligations under lease agreements as of June 30, 2005, follows:

Year Ending June 30,	Capital Lease Obligations	Installment Purchase Obligations	Operating Lease Obligations
2006	$ 2,355,857	$1,897,704	$3,707,009
2007	2,431,603	1,909,649	3,729,119
2008	2,394,739	1,274,419	3,138,556
2009	2,387,922	709,149	2,068,553
2010	2,387,347	11,156	1,825,117
2011-2015	11,930,070	-	2,563,467
2016-2020	6,817,401	-	1,380,000
2021-2025	369,194	-	-
Total obligation and gross minimum lease payments	31,074,133	5,802,077	18,411,821
Less: Interest	8,484,143	227,582	-
Present value of minimum lease payments	$22,589,990	$5,574,495	$18,411,821

14. DONOR-RESTRICTED ENDOWMENTS

VCCS has two donor-restricted endowments totaling $13,964 in restricted principal. The net appreciation on investments of donor-restricted endowments that is available for expenditure by the governing board for the year ended June 30, 2005 is $308. These amounts are reported as restricted expendable net assets. Total-return policy is followed for authorizing and spending investment income.

15. CONTINGENCIES

Grants

VCCS receives assistance from non-state grantor agencies in the form of grants. Entitlement to these resources is generally conditional upon compliance with the terms and conditions of grant agreements. Substantially all grants are subject to financial and compliance audits by the grantors. All disallowances as a result of these audits become a liability of the VCCS. As of June 30, 2005, the VCCS estimates that no material liabilities will result from such audits.

16. RISK MANAGEMENT

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

A Faithful Performance Duty Bond administered by the Commonwealth of Virginia's Department of Treasury, Division of Risk Management, covers the employees of the VCCS. The Faithful Performance Duty Bond provides coverage with liability limits of $500,000 for each occurrence.

17. POST-EMPLOYMENT BENEFITS

The Commonwealth participates in the VRS-administered statewide group life insurance program which provides post-employment life insurance to eligible retired and terminated employees. The Commonwealth also provides health care credit against the monthly 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.

18. ACCOUNTING CHANGES – REPORTING ENTITY

As of July 1, 2004, the VCCS agency, Information Technology Utility, was abolished and merged with the System Office. This reflects operational changes only. There is no effect on the total net assets of the VCCS.

19. OPERATING EXPENSES BY NATURAL AND FUNCTIONAL CLASSIFICATIONS

VCCS' operating expenses for the year ended June 30, 2005 were as follows:

	Natural Classification					
Functional Classification	Salaries and Benefits	Utilities	Scholarships	Depreciation	Supplies, Services, and Other	Total
Instruction	$240,639,280	$ 102,772	$ 1,369,940	$14,206,848	$ 36,248,153	$292,566,993
Public service	2,091,112	-	4,355	43,756	1,918,473	4,057,696
Academic support	45,854,832	36,806	37,810	3,211,475	10,968,860	60,109,783
Student services	41,356,262	-	153,425	229,552	5,314,004	47,053,243
Institutional support	78,637,268	59,478	452,089	8,059,019	35,006,514	122,214,368
Operation and maintenance of plant	15,732,163	10,108,776	23,563	992,263	31,692,285	58,549,050
Scholarships and fellowships	-	-	54,927,378	-	149,694	55,077,072
Auxiliary enterprises	1,784,539	87,682	320,932	89,861	8,701,409	10,984,423
Total	$426,095,456	$10,395,514	$57,289,492	$26,832,774	$129,999,392	$650,612,628

20. SUBSEQUENT EVENTS

In October 2005, the Treasury Board approved up to $20 million in financing for energy efficiency performance contracts at VCCS' various community college campuses. As of April 2006, VCCS has committed to $10.6 million various energy efficiency performance contracts. VCCS has secured $4.3 million in financing for these projects.

In February 2006, a building on the Portsmouth Campus of Tidewater Community College caught fire. The building was valued at approximately $797,328. The building housed surplus furnishings, building supplies and other materials, which were valued at approximately $183,000. The fire destroyed the building and its contents; however, Tidewater insured these items through Risk Management.

21. COMPONENT UNIT FINANCIAL INFORMATION

VCCS' component units are presented in the aggregate on the financial statements. Below is a condensed summary of the major foundations and an aggregate summary of the non-major foundations.

VCCS has four major component units – Northern Virginia Community College Educational Foundation, Lord Fairfax Community College Educational Foundation, Patrick Henry Community College Foundation, and Southwest Virginia Community College Educational Foundation. Additionally, the system has twenty-two non-major component units – Blue Ridge Community College Educational Foundation, Central Virginia Community College Educational Foundation, Dabney S. Lancaster Community College Educational Foundation, Danville Community College Educational Foundation, Eastern Shore Community College Educational Foundation, Germanna Community College Educational Foundation, J. Sargeant Reynolds Community College Educational Foundation, J. Sargeant Reynolds Community College Real Estate Foundation, John Tyler Community College Foundation, Mountain Empire Community College Educational Foundation, New River Community College Educational Foundation, Paul D. Camp Community College Educational Foundation, Piedmont Community College Educational Foundation, Rappahannock Community College Educational Foundation, Southside Virginia Community College Educational Foundation, Thomas Nelson Community College Educational Foundation, Tidewater Community College Educational Foundation, Virginia Highlands Community College Educational Foundation, Virginia Western Community College Educational Foundation, Wytheville Community College Educational Foundation, Wytheville Community College Scholarship Foundation, and Community Colleges of Virginia Educational Foundation. These organizations are separately incorporated entities and other auditors examine the related financial statements.

VIRGINIA COMMUNITY COLLEGE SYSTEM FOUNDATIONS
STATEMENT OF NET ASSETS
As of June 30, 2005

	Northern Virginia Community College Educational Foundation	Lord Fairfax Community College Educational Foundation	Patrick Henry Community College Educational Foundation	Southwest Virginia Community College Educational Foundation
ASSETS				
Total current assets	$ 732,192	$ 1,408,093	$ 124,541	$ 1,221,237
Noncurrent assets:				
Other noncurrent assets	11,290,702	6,380,680	9,030,937	9,866,287
Capital assets, net	-	179,650	-	679,325
Total noncurrent assets	11,290,702	6,560,330	9,030,937	10,545,612
Total assets	12,022,894	7,968,423	9,155,478	11,766,849
LIABILITIES				
Total current liabilities	141,346	1,689	4,174	2,500
Noncurrent liablities:				
Long-term liablities	-	-	-	-
Other noncurrent liablities	-	-	-	-
Total noncurrent liablities	-	-	-	-
Total liabilities	141,346	1,689	4,174	2,500
NET ASSETS				
Invested in capital assets, net of related debt	-	179,650	-	679,325
Restricted for:				
Nonexpendable	1,922,076	2,384,239	5,731,017	-
Expendable	3,239,911	4,942,715	2,010,814	7,281,569
Unrestricted	6,719,561	460,130	1,409,473	3,803,455
Total net assets	$ 11,881,548	$ 7,966,734	$ 9,151,304	$ 11,764,349

Combined Non-Major Component Units	Total Component Units
$ 8,999,720	$ 12,485,783
49,352,625	85,921,231
2,962,476	3,821,451
52,315,101	89,742,682
61,314,821	102,228,465
434,355	584,064
453,096	453,096
13,554	13,554
466,650	466,650
901,005	1,050,714
2,962,476	3,821,451
23,443,181	33,480,513
21,632,587	39,107,596
12,375,572	24,768,191
$ 60,413,816	$ 101,177,751

VIRGINIA COMMUNITY COLLEGE SYSTEM FOUNDATIONS
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2005

	Northern Virginia Community College Educational Foundation	Lord Fairfax Community College Educational Foundation	Patrick Henry Community College Educational Foundation	Southwest Virginia Community College Educational Foundation
Total operating revenue	$ 418,509	$ 135,803	$ 880,927	$ 3,602,125
Total operating expenses	1,840,649	1,601,692	930,086	594,437
Operating income/(loss)	(1,422,140)	(1,465,889)	(49,159)	3,007,688
Nonoperating revenues/(expenses):				
Investment income	737,541	128,841	499,572	608,891
Other nonoperating revenue/(expenses)	-	-	-	-
Net nonoperating revenue	737,541	128,841	499,572	608,891
Income before other revenues, expenses, gains or losses	(684,599)	(1,337,048)	450,413	3,616,579
Capital gifts, grants, and contracts	-	-	-	-
Additions to permanent and term endowments	1,454,148	831,001	101,946	-
Increase/(decrease) in net assets	769,549	(506,047)	552,359	3,616,579
Net assets - beginning of year	11,111,999	8,472,781	8,598,945	8,147,770
Net assets - end of year	$11,881,548	$ 7,966,734	$ 9,151,304	$11,764,349

Combined Non-Major Component Units	Total Component Units
$ 10,351,481	$ 15,388,845
10,452,026	15,418,890
(100,545)	(30,045)
1,587,353	3,562,198
117,951	117,951
1,705,304	3,680,149
1,604,759	3,650,104
26,500	26,500
2,876,421	5,263,516
4,507,680	8,940,120
55,906,136	92,237,631
$ 60,413,816	$ 101,177,751

Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

May 16, 2005

The Honorable Timothy M. Kaine
Governor of Virginia

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

The State Board for Community Colleges

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic financial statements of the **Virginia Community College System**, a component unit of the Commonwealth of Virginia, and its aggregate discretely presented component units as of and for the year ended June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of the System'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 System, 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 to the amounts included for the component units of the System 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 System 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 the Virginia Community College System and of its aggregate discretely presented component units as of June 30, 2005, 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 9 through 15 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.

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

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System'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 instances of noncompliance or other matters that are required to be reported under Government Auditing Standards. Instances of noncompliance and other matters are described in the section titled "Internal Control and Compliance Findings and Recommendations."

Status of Prior Findings

The System and its Colleges have not taken adequate corrective action with respect to the previously reported findings "Improve System Security Documentation," "Improve Procedures for Computer System Access," and "Follow Small Purchase Charge Card Procedures." Accordingly, we included these findings in the section entitled "Internal Control and Compliance Findings and Recommendations." The System and its Colleges have 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 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 June 6, 2005.

AUDITOR OF PUBLIC ACCOUNTS

DBC/kva

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

June 19, 2006

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

Dear Mr. Kucharski:

We are providing this letter in response to your report on the audit of the financial records of the Virginia Community College System for the fiscal year ended June 30, 2005.

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

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

Sincerely,

Glenn DuBois
VCCS Chancellor

GD/dsm

Enclosure

cc: Ms. Karen Petersen
Mr. John Brilliant
Mr. Dave Mair

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INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Improve Systems Security Documentation and Policies

Applicable to: Virginia Community College System Office
Southwest Virginia Community College

The System Office has finalized and approved their Information Systems Security Plan, however, the plan still does not address variations between the plan and the current operating environment that we identified in our prior report. A good information systems security plan sets the tone and provides the necessary guidance to staff for protecting sensitive and critical data. In our review of the Security Plan, we noted several instances where the Risk Assessment documented within the Security Plan set specific operating standards, however, the Systems Office was not meeting these standards and is willing to accept those risks, without documenting the compensating controls or mitigating factors. The System Office has begun a review and update of the Security Plan. We encourage them to continue with this effort, as the update should eliminate any variations between the System Office's actual operating environment and its security plan thus increasing the validity of the System Office's policies and procedures.

Additionally, the System Office's policies and procedures relating to the Resource Access Control Facility (RACF) security system still do not include documented and approved security configurations. Such documentation first requires an identification of weaknesses, vulnerabilities, and resulting risks that may exist in the current RACF security configuration. Once assessed, the System Office should document an approved standard RACF security configuration based on this security evaluation and considering industry best practices.

Southwest Virginia has not developed adequate Information Technology Security Policies. The policies do not address monitoring and controlling systems access; incident handling, identification, authorization, and authentication; and systems interoperability security. Additionally, Southwest Virginia does not have adequate policies addressing encryption, physical security, and risk and vulnerability.

In addition, Southwest Virginia does have policies and procedures to address encryption and physical security; however, they do not address all the critical aspects as required by the Commonwealth's Security Standard. The encryption policy does not address how and when to encrypt data, including sensitive data transfers, storage of passwords, and VPN data encryption. The physical security policies do not address how to track visitors, monitor the fire suppression systems, use and monitor the security system, and monitor environmental controls, such as HVAC and water detection systems. Additionally, the risk and vulnerability policy does not address how and when the college monitors logs.

Once VCCS has updated the Security Plan and operating policies and procedures, VCCS management should ensure all staff are aware of the applicable portions of the Information Technology Security Plan and operating policies and procedures related to their job. Finally, VCCS should review and approve all policies and procedures periodically to ensure the policy conforms to current business and technology practices. Documenting the review and approval process will also increase the validity and enforcement of VCCS policies, procedures, and standards. Southwest Virginia should address and document the areas noted to comply with the Commonwealth's Security Standard and to avoid possible risks to the critical systems. Failure to document and follow the procedures can increase the risks to Southwest Virginia's computer network and network resources.

***Virginia Community College System Office Response*:**

The Information Technology Office has developed and received approval of a plan for updating the System Office and the twenty-three college business recovery plans. The proposal was initially presented to the VCCS IT governing body in June 2005. Due to unexpected delays encountered in receiving the COV ITRM Standard 501-01 from Virginia Information Technology Agency (VITA) as originally announced in early 2005 the VCCS plan was revised and resubmitted on two different occasions (October 2005 and February 2006). Neither the colleges nor the System Office was expected to make any major changes in their business recovery plans during the 2005 calendar year.

VCCS has developed a plan that clearly documents the issues and proposal for updating VCCS internal guidance as well as the business recovery plans for the colleges and System Office. As noted in the finding, the System Office has made substantial progress although much of the planning and the work that has been completed were based on a draft copy of the COV standard. Assuming the new standard is released by VITA as currently scheduled all VCCS colleges and the System Office will have updated plans by December 31, 2006 or 6 months from the date the standard is actually released.

Responsible Manager: Director of Client Services

***Southwest Virginia Community College Response*:**

Southwest will develop and implement procedures dealing with the monitoring and control of systems access. We do monitor the network currently; however, there are no written procedures on when and how the network should be monitored. Southwest does have Incident Handling forms and policies developed but not implemented. Logs are randomly checked depending on personnel workload and are checked more frequently if a problem is suspected. We utilize encryption; however, we have not documented this in our ITRM-2001 plan.

While the distribution of keys to server locations and wiring closets is very limited and all areas are monitored with security cameras, we do not have a written procedure on who is allowed in the rooms. Southwest will develop a written procedure to document personnel allowed in server rooms and wiring closets. Campus police utilizes the Best Lock system on distributing keys to College personnel. Southwest has installed fire extinguishers (Halotron 1) in all network closets and server rooms. With the main server room being on the third floor of Tazewell Hall we have not installed any water detection system, however we did install a separate HVAC system keeping the room at 70 degrees.

Southwest has implemented Active Directory for authorization and authentications. Southwest has also developed written procedures on password creation and maintenance. Lastly, regarding System Interoperability Security, Southwest is developing written procedures on the use of VPN, (Virtual Private Network), FTP, Telnet, and digital certificates.

All areas listed above will be revised or new written procedures in place by June 30, 2006.

Title of Position Responsible for Corrective Action: Information Services Manager

<u>Establish Procedures to Monitor Energy Performance Contracts</u>

Applicable to: Virginia Community College System, including all Community Colleges

VCCS has not properly planned the monitoring of their energy savings performance contract. In February 2005, VCCS contracted with TAC Americas to identify and implement facility improvements at the various community college campuses to reduce energy cost and obtain needed equipment replacements. As of April 2006, VCCS has committed to $10.6 million in facility improvements at various community colleges. These colleges include: John Tyler, Northern Virginia, Patrick Henry, Piedmont, Virginia Highlands, and Wytheville. VCCS has Treasury Board approval to finance $20 million in energy contracts. VCCS may fund additional improvement through other funding sources.

Prior to beginning the facility improvements phase at each college, VCCS and TAC sign a memorandum of understanding outlining the scope of work, the costs associated, and energy guaranteed savings amount. Additionally, the contract stipulates that TAC must provide the monitoring and tracking of the energy costs and savings. If VCCS does not use TAC, they will not guarantee the energy savings.

Although VCCS must use TAC to monitor and track the energy cost and savings, VCCS has the right to review and certify the savings calculations provided by TAC. If the two entities cannot agree on the calculations, they may use a mutually agreeable third party professional engineer to come to an acceptable solution. If VCCS uses TAC to monitor the savings, TAC must pay VCCS the difference if guaranteed savings are less than expected. If TAC writes VCCS a savings shortfall check (savings less than amounts guaranteed) and TAC later determines the actual savings meet TAC's guaranteed dollar savings, VCCS must return the shortfall check to TAC. VCCS retains any savings in excess of the guaranteed savings. Since compensation is dependent on energy savings, VCCS should monitor and verify all energy savings calculations. However, VCCS has not established procedures for verifying the savings or identified who will be responsible for this task.

The facilities improvement phase is near completion at Patrick Henry and Virginia Highlands. Even though none of the TAC projects are complete, VCCS must establish procedures to monitor and verify energy savings in anticipation of these completed projects. Since we identified this issue, VCCS began the process by designating the college vice presidents the responsibility for monitoring and verifying the energy savings for their college. In addition, the vice presidents are responsible for properly training college employees in these areas. We encourage the vice presidents, in coordination with the VCCS Facilities Management Office, to develop specific procedures and training to monitor and verify the energy savings at their college prior to completion of any energy improvements. Without proper monitoring controls, VCCS risks losing the dollar savings guaranteed under the contract and may forfeit the right to recover funds from the vendor.

<u>Virginia Community College System Office Response</u>:

As noted in the APA finding, there have been no completed energy performance projects for which to measure savings as of this response date. In June 2006, VCCS Facilities Management Services developed detail procedures to monitor and verify energy savings as recommended in the finding. These procedures will be sent to all colleges in the VCCS.

Implementation Date for Corrective Action: June 2006

Title of Position Responsible for Corrective Action: College Vice Presidents and Vice Chancellor for Facilities Management Services

Include Operating System and Infrastructure Changes in the Change Management Process

Applicable to: Virginia Community College System Office

The System Office has not included all operating system and infrastructure device changes in their current change management process. Currently, the System Office uses IssueTrak, an automated change management system, to record and approve necessary application changes. However, the System Office does not use IssueTrak for hardware changes due to the security risk caused by the individual college's ability to view IssueTrak documentation. While we agree with this decision, we found that the System Office has not adopted an alternative change management process for infrastructure device and operating system changes. An approved, documented process would include procedures for requesting, reviewing, adequately testing, and approving changes such as applying patches and releases to network devices and operating systems.

We recommend that the System Office create and approve policies and procedures as well as a manual tracking process that will provide for control over operating systems and infrastructure device changes. While we recognize that the System Office is currently researching automated systems to provide for change management over these areas, such a system would not replace the need for approved, documented policies and procedures as recommended above. Failure to adequately establish change management could result in a lack of audit trails, reduced staff accountability, and an increased risk that unauthorized or fraudulent changes could go undetected.

***Virginia Community College System Office Response*:**

VCCS concurs with the base finding and has submitted a funding request for the FY07 budget year to purchase the required hardware and software. The goal is to have the system fully operational twelve months after the resources are acquired.

Responsible Manager: Director of Client Services

Implementation Date: Ongoing

Properly Calculate Accruals for Financial Reporting

Northern Virginia Community College does not have procedures and trained staff in place to calculate the accrual of payroll expense at fiscal year end. Northern Virginia has improperly calculated the accrual of payroll expense for the current and prior fiscal years. This improper calculation resulted in material audit adjustments to the overall Community College System financial statements of $1,869,682 in fiscal year 2005 and $764,103 in fiscal year 2004.

The American Institute of Certified Public Accountants recently issued Statement on Auditing Standards (SAS) 112, Communicating Internal Control Related Matters Identified in an Audit, which becomes effective in fiscal year 2007. Under SAS 112, material audit adjustments, such as this finding at Northern Virginia, have the potential to be a material weakness in internal controls over the preparation of the financial statements. A material weakness indicates that internal controls are not sufficient to ensure that the financial statements do not contain material misstatements.

To establish good internal controls and prepare for this new auditing standard, Northern Virginia should establish procedures and train staff to properly perform the accrual calculation. In addition, the System Office should continue to ensure that they review financial information reported by each of the 23 community colleges for consistency and reasonableness before inclusion in the Community College System's statewide financial statements.

***Northern Virginia Community College Response*:**

During FY 2005, NVCC's Payroll Director resigned, leaving inadequate written processes to guide year-end payroll processing and reconciliation. The NVCC Controller's Office recognized this weakness too late to prevent the errors noted by the auditors. However, prior to the auditor's visit, the problem was revealed and action taken to prevent any reoccurrence of the errors they noted. Written protocols have been developed and several members of the payroll staff have been trained in these processes, providing back up in case of further turnover. Our processes now included a review of the schedules by the College Controller who will conduct a variance/trend analysis and review the submission for accuracy.

Implementation Date for Corrective Action: June 2006

Title of Position Responsible for Corrective Action: Controller

Follow System Access Policies and Procedures

Applicable to: Central Virginia Community College
Danville Community College
Germanna Community College

Employees at each of these colleges had unauthorized access to financial or administrative computer systems either because the access had not been properly approved, they had terminated employment, or the access was not necessary for their job function. Central Virginia did not revoke access to computer systems promptly after employees terminated with a lag time of up to seven months. Danville and Germanna did not properly approve access granted to employees due to a lack of approval signatures on the request forms. Additionally, Danville granted inappropriate systems access to an employee that allowed her to update CARS even though her job function did not require this level of access.

We recommend that all Colleges follow established procedures relating to approval and termination of access to the College's financial and administrative computer systems. This includes proper approval prior to granting access and prompt revocation of access upon termination of employment. Failure to restrict computer access to current employees who need such access to perform duties places the College at risk for inappropriate changes or disclosures of important financial and administrative information.

***Central Virginia Community College Response*:**

Due to the criticality of managing system access and since the procedure for managing system access requires steps to be performed by every department within the college, the President's Staff is taking direct ownership in the correction of this deficiency. The President's Staff will meet during the month of June to identify the cause(s) of the deficiencies and take the necessary correction action(s) before July 1, 2006.

Title of Position responsible for the corrective action: VP Information Technology

Danville Community College Response:

The DCC Security Policy has been rewritten to replace the SIS/Subsystem Manager approval with approval by the data owners in PeopleSoft. It has been determined that the data owners have more knowledge concerning access to their components of the system than the Registrar. New forms have been created and will be used in the future. All existing forms have been reviewed and signed by the SIS/Subsystem Manager and the Information Security Officer. Additionally, a thorough review has been performed on all model operator ID's, the employees assigned to those ID's, as well as the access granted to each. Approvals by all supervisors were acquired during the review process.

Implementation Date for Corrective Action: April 2006

Responsible Individual: Information Security Officer

Germanna Virginia Community College Response:

Germanna concurs that it failed to properly approve access granted. In two cases, the access was initiated remotely via email and telephone; however, the College failed to secure the approval signature on the appropriate document. Those signatures have been affixed to the documents. On another issue, the College could not locate a screen access document for an employee who transferred from another VCCS institution in 1997. The College believes a form was created; however, it cannot be located. The College has completed and retained documentation on all changes made to that employee's access since the employee started work at Germanna and had records of that access via the FRS005 Report, which have been audited multiple times. The College will ensure documentation of access granted to employees will be created and retained. Implementation of the corrective actions will occur immediately and the Vice President for Administrative Services shall be responsible for the corrective action.

Additionally, Germanna Community College implemented a new "Check-In, Check-out" automated system as of March 31, 2006. With the implementation of the new system, Germanna Community College is in compliance with COV ITRM Standard SEC2001-01.1 for Granting and Revoking network Access and critical application access.

Implementation date of corrective action: March 31, 2006

Title of person responsible for corrective action: Technical Support Service Manager

Properly Administer Return of Title IV Funds

Applicable to: Blue Ridge Community College
Dabney S. Lancaster Community College
J. Sargeant Reynolds Community College
New River Community College
Southside Virginia Community College
Southwest Virginia Community College
Thomas Nelson Community College
Virginia Western Community College

Blue Ridge, Dabney S. Lancaster, J. Sargeant Reynolds, Southside Virginia, and Southwest Virginia did not return Title IV refund amounts timely. Southside Virginia, Southwest Virginia, and J. Sargeant Reynolds did not notify students promptly of grant overpayments. Dabney S. Lancaster, Thomas Nelson, New River, and Virginia Western did not identify students who unofficially withdrew timely. This resulted in untimely Title IV refund calculations and returns to the U. S. Department of Education. There are no questioned costs reported because the colleges have returned all identified funds.

The Code of Federal Regulations, 34 CFR Part 668.22 (c), requires that colleges have a mechanism in place to identify students who have withdrawn or ceased attendance, in order to promptly and properly calculate any return of Title IV funds. Part 668.22 (e) sets forth the manner to properly calculate the refund amounts due to Title IV programs. Part 668.22 (j) requires that colleges return unearned Title IV funds as soon as possible to the U. S. Department of Education, but no later than 30 days after the college determined the student withdrew. Part 668.22 (h) requires that within 30 days of the date that the college determines that the student withdrew, the college must send a notice to the student notifying them of any over-award amounts owed.

Colleges should follow the return of Title IV fund procedures prescribed by the federal government to ensure that they properly identify students who withdraw, calculate refunds, notify students of over-award amounts owed, and return the funds to the U. S. Department of Education promptly.

Blue Ridge Community College Response:

Blue Ridge Community College acknowledges the finding and will take the appropriate steps to ensure that Title IV funds are returned to the U.S. Department of Education in a timely manner. Recent changes to the VCCS SIS System will enable the College to efficiently identify students who have withdrawn from the college, both officially and unofficially. Thus, R2T4 calculations and the actual returns of funds to the appropriate aid program can be accomplished promptly.

Date for the Corrective Action:

New procedures for last date of attendance implemented 1/22/06.

Title of Position Responsible:
Director of Financial Aid
Business Manager
Director of Business and Facilities

Dabney S. Lancaster Community College Response:

Faculty will report students who have stopped attending and the date they last attended at the 60% point in the term. Unofficial withdrawals will be caught and processed in a timely manner. Beginning with the Spring 2006 semester, the Financial Aid Officer will process the query to identify students who have withdrawn on a weekly basis. Title IV calculations will be processed and forwarded to the business office within two weeks of identification. In addition, the Financial Aid Officer will train another person in the identification and calculation process. This person will serve as a back up and cross check for accuracy.

Responsible Party: Director of Financial Aid

J. Sargeant Reynolds Community College Response:

To address the timely processing of Return to Title IV, JSRCC has done the following:

- *Developed and implemented a Return to Title IV policy during the spring 2005 term that requires reporting by faculty of students' last date of attendance in those instances of unofficial withdrawals. Within this policy, lines of communication have been established to effectively inform all interested offices of each student's status as it relates to this process.*

- *Hired a part-time specialist in June 2005 whose primary responsibility is to calculate students' Title IV eligibility based on the last date of attendance documented through the institution's official withdrawal or Return to Title IV processes.*

- *The Financial Aid Department has improved the timeliness of the Return to Title IV calculations and notification to students about grant and loan overpayments, completing these activities within 30 days of the school determining the student's date of withdrawal.*

- *Hired an experienced Financial Aid Director in April, 2006*

- *To address the timely return of funds to the Federal Aid Programs, the Accounting Department will be coordinating R2T4 activities with Financial Aid to ensure funds will be returned within 45 days of the school's determination that the student has withdrawn. Effective July 1, 2006 the Higher Education Act has eased the timely repayment requirements to allow institutions 45 days rather than 30 days to return unearned funds. Additionally, a compliance report will be provided several times per semester to the Vice President of Finance and Administration and to the Vice President of Student Affairs to assist with on-going monitoring of the Return to Title IV process.*

Implementation Date for Corrective Action: August 2006

Title of Position Responsible for Corrective Action: Accounting Manager

New River Community College Response:

Management's Response: NRCC developed and implemented a policy that insures compliance with federal regulations regarding return of Title IV funds.

Implementation Date for Corrective Action: Fall 2005

Title of Position Responsible for Corrective Action: Vice President for Instruction and Student Services

Southside Virginia Community College Response:

Southside Virginia Community College's financial aid office now identifies withdrawn students and makes refund calculations weekly beginning at the end of the drop/add period and continuing through the end of each term. Students are identified, recalculated and notified and then refunds are made to the Department of Education. This keeps us well within 30 days on every student.

Implementation Date for Corrective Action: July 2005

Title of Position Responsible for Corrective Action: Director of Financial Aid

Southwest Virginia Community College Response:

Every two weeks after the last day to enroll the withdrawal report will be run. Refund calculations will be done. The students will be notified of overpayment and repayment amounts.

Implementation Date: Fall 2005

Position Responsible: Associate Vice-President of Student Development

Thomas Nelson Community College Response:

The APA finding is correct as stated. Students, who unofficially withdrew, or students who never attended classes or discontinued class attendance, are now identified by faculty members in a timely manner. This information is reviewed by Financial Aid personnel to determine if a student has unofficially withdrawn from the college. If appropriate, refund calculations and returns are then made in a timely manner.

This process was implemented in the Summer 2005 semester.

Responsibility for reporting of drops/withdrawals: Vice President of Academic Affairs

Responsibility for unofficial withdrawal determination and return of Title IV funds: Director of Student Financial Aid

Virginia Western Community College Response:

Management Response:

In spring 2005, the policy was changed and Virginia Western also incorporated into our procedures a review at the end of each semester. Faculty now report last dates of attendance for students receiving all non-passing grades, so that we can determine if an unofficial withdrawal prior to the 60% mark was involved.

Implementation Date for Corrective Action:
Spring 2005

Position Responsible for Corrective Action:
Dean of Students and Accountant for Accounts Receivable

Disburse Federal Drawdowns Timely

Applicable to: New River Community College

New River did not disburse two out of seven federal drawdowns timely, with time lags ranging from six to ten days. Additionally, New River does not have policies and procedures to ensure the disbursement of drawdowns in accordance with Student Financial Aid Regulations. There are no questioned costs since New River has disbursed the funds and any accrued interested was less than $10,000.

34 CFR 668.162(b)(3) requires institutions to disburse funds requested as soon as administratively feasible but no later than three business days following the date the institution received the funds.

New River should develop policies and procedures to ensure disbursements of drawdowns within the required three business days. The College should properly define, disseminate and adhere to these policies and procedures.

<u>New River Community College Response</u>:

Disbursements from the local federal checking account will occur typically within two business days, but no later than three business days after federal funds are deposited into this account. The policy of NRCC's Business Office is to comply with the requirements of the federal "Blue Book" and 34 CFR 668.162 (b) (3).

Implementation Date for Corrective Action: April 1, 2005

Title of Position Responsible for Corrective Action: Business Manager
Associate Vice President for Finance and Technology

<u>Continue to Improve Capital Asset Management and Reporting</u>

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

VCCS reports capital assets for all 23 Community Colleges in the System, which includes Land, Land Improvements, Buildings, Infrastructure, Construction-in-Progress, Equipment, Library Books, and Works of Art. During fiscal year 2005, VCCS reported $477 million in capital assets, net of depreciation. Individual Colleges are primarily responsible for entering equipment information in the Fixed Asset Information System (FAIS), performing inventories, and tracking locally-funded assets.

During the fiscal year 2005 audit, we found Central Virginia, Tidewater, and Virginia Western Community Colleges did not properly maintain asset records or adequately record changes in assets throughout the year.

The Commonwealth's accounting policies and procedures require agencies to record disposed assets in the fiscal year when the disposal occurs. Central Virginia and Virginia Western did not remove assets promptly from FAIS. Additionally, the Commonwealth's accounting policies require assets not in current use and located on-site be shown as surplus assets. Tidewater recorded two assets as active, which were in the warehouse unused. Central Virginia could not locate four surplused assets on the campus.

The Commonwealth's accounting polices also require agencies to record assets within 60 days of receipt and acceptance. Agencies should capitalize and record assets at market value. Tidewater did not record three assets totaling $22,500 donated to the college in September 2001.

By failing to follow polices and properly maintain the Fixed Asset Inventory System, VCCS could have in a material misstatement to the financial statements. VCCS should ensure that each college properly maintains and records capital assets in FAIS.

Central Virginia Community College Response:

The College will ensure that FAIS is updated in a timely manner in the future.

The finding that the college could not locate four surplused assets was the result of the College's use of the Dyntek Surplus Contract to surplus our outdated computers and printers. The contract states that Dyntek will only collect what has been included on the manifest report submitted to them; however, they collected four printers that were not included on the manifest. This has been discussed with Dyntek and they will ensure that this does not happen in the future.

Regarding the finding that assets should be recorded within 60 days of receipt and acceptance, the asset that was not properly tagged had been recently installed with an attached security device. We do not tag these ceiling projectors until the installation is complete to ensure that our tag does not interfere with the attached security device. We will ensure that these items are tagged in a timely manner in the future.

The implementation date for the corrective action: June 2006

Title of position responsible for the corrective action: Purchasing Manager

Tidewater Community College Response:

Continue to Improve Capital Asset Management and Reporting

Tidewater Community College recorded two assets as active which were surplused and located in the warehouse. Additionally, the college did not record three assets totaling $22,500 donated to the college in September 2001. Current procedures specify that all surplus items be reflected in FAACS/FAIS as surplus once they are taken out of use; the misclassification of the surplus items was an oversight. Procedures also specify that donated assets be recorded in FAACS/FAIS; the paperwork for donated items was not received in the Office of Material Management so that they could be reported.

The College has added additional oversight for the inventory function this past year by increasing the focus of our Assistant Director of Material Management. The Assistant Director has reviewed all policies and procedures concerning asset management, and as a result of this review, the college has invested in a fixed asset barcode system to track inventory. Staff is currently entering approximately 8,000 pieces of equipment into the system and is reconciling the barcode data to FAIS. The new barcode system will enable staff to better record, change, and track the college's inventory.

Implementation Date: *June 30, 2006.*

Position Responsible: *Director of Material Management.*

Virginia Western Community College Response:

Virginia Western has revised the time of year the physical inventory is being taken each year to coincide with the purging of inactive records. The inventory clerk is performing monthly spot checks of inventoried assets. The facilities management department is providing signed listing of equipment being surplus and the campus police are providing reports of missing or stolen equipment to the inventory clerk. The college is going to place forms for tracking disposal of assets on our web site and maintain copies of completed forms by fiscal year. The college is going to continue to be more active in this task.

Implementation Date for Corrective Action:
December 31, 2006

Position Responsible for Corrective Action:
Administrative & Financial Specialist-Cashier

Maintain and Renew Contracts

Applicable to: Eastern Shore Community College

Eastern Shore did not maintain three revenue generating contracts and procurement files for vending and phone services. Eastern Shore has not been able to locate the contracts for several years. All three of these contracts come up for renewal since 2003; therefore, Eastern Shore is participating in these vending and phone services without a current contract. Additionally, Eastern Shore cannot verify if they are receiving the correct revenue commissions and services originally guaranteed.

Eastern Shore should properly maintain all contracts and procurement files by ensuring they have proper record retention procedures in place. Record retention is a key component of any college and critical to its accountability and performance. Eastern Shore should also establish procedures to ensure timely renewal of contracts.

Eastern Shore Community College Response:

Eastern Shore Community College agrees with the finding and will contact the applicable vendors for renewal agreements.

Implementation date: Summer 2006

Position: Vice President, Financial and Administrative Services

Improve Bank Reconciliation Process

Applicable to: J. Sargeant Reynolds Community College

J. Sargeant Reynolds does not adequately perform monthly bank reconciliations of their Local Funds Bank Account. The three monthly bank reconciliations reviewed did not reconcile. The reconciling differences were immaterial; however, these unexplained differences varied in two out the three months. One of the reconciling items on the June 2005 reconciliation was a check included on the outstanding check list that had actually cleared the bank over a year earlier. On the February 2006 reconciliation, J. Sargeant Reynolds had 15 checks, totaling $392.48 outstanding for over a year. J. Sargeant Reynolds voided 14 of these checks totaling $377.48 and sent the funds to the Treasurer of Virginia Division of Unclaimed Property in October 2005. The remaining check for $15 is still outstanding because the payee remains unresponsive to the college's directives to deposit the check. Still, J. Sargeant Reynolds erroneously listed the 14 checks on the February 2006 reconciliation as outstanding. Proper exclusion of these checks would have resulted in a larger, unreconciled difference. Additionally, J. Sargeant Reynolds did not post interest, bank fees and charges to the Financial Reporting System for up to four months after reconciliation.

J. Sargeant Reynolds should properly perform monthly bank reconciliations. The college should identify all reconciling differences and post any necessary adjustments or transactions promptly to the Financial Reporting System. Additionally, J. Sargeant Reynolds should ensure that its reconciling items do not include cleared or voided checks. Inadequate controls and procedures over the reconciliation process can increase the risk and opportunity for fraud to occur.

J. Sargeant Reynolds Community College Response:

The College agrees with the Management Point and is taking corrective action including:

- *Reviewing previous months bank reconciliations to resolve any unexplained differences*
- *Reviewing the outstanding checks to ensure that voided checks are not listed as outstanding*
- *Posting monthly bank interest, bank fees and charges*
- *Reconciling the bank account monthly and submitting it to the Director of Financial Operations for review.*

Implementation Date for Corrective Action
Immediately

Title of Position Responsible for Corrective Action
Accounting Manager

Develop and Update Accounts Receivable Policies and Procedures

Applicable to: Blue Ridge Community College
Danville Community College
Northern Virginia Community College

Blue Ridge does not have Accounts Receivable Policies and Procedures as required by the Commonwealth's accounting polices to cover the establishment, administration, collection and write-off of receivables. In addition, the Business Manager, who currently supervises the accounts receivable function, is approving all write-offs. Internal controls suggest that upper management should approve accounts receivables write-off. Approvers could include the Vice President of Finance and Administration, the President, or a designee in the System Office.

Additionally, Danville has not updated their policies and procedures pertaining to the collection of past-due receivables since July 1998. As a result, the policies do not reflect changes resulting in the implementation of PeopleSoft. Northern Virginia did not report an allowance for doubtful accounts due to problems the college experienced in obtaining accurate data from PeopleSoft relating to this estimate. This resulted in an overstatement of Northern Virginia's receivables; however, the overstatement was not material and did not result in an adjustment.

These colleges should develop and update accounts receivable policies and procedures. Failure to develop and update policies and procedures, which establish strong internal controls, can increase the risk of improper write-offs and allowances for bad debt.

Blue Ridge Community College Response:

Blue Ridge Community College acknowledges the above finding. An accounts receivable policy has been established for the college. Write-off approval now rests with the Vice-President of Finance and Administration and the President of the college, only.

Date for the Corrective Action:

Completed 1/31/2006

Title of Position Responsible:

Director of Business and Facilities Services

Danville Community College Response:

A target date of July 31, 2006 has been set to update the accounts receivable policies and procedures to reflect the implementation of PeopleSoft and lost LRC materials.

Implementation: July 2006

Responsible individual: Business Manager

Northern Virginia Community College Response:

Northern Virginia Community College concurs that an allowance for doubtful accounts should be established for financial statement reporting purposes. The College will analyze the percentage of debts written off in past fiscal years, estimate an appropriate allowance percentage, and apply the percentage against receivables reported in the FY2006 financial statements. NVCC will document the allowance calculation procedures.

Implementation: July 2006

Responsible Person: Controller

Follow Virginia Sickness and Disability Program Policies and Procedures

Applicable to: Lord Fairfax Community College

Lord Fairfax improperly approved and overpaid an employee under the Virginia Sickness and Disability Program (VSDP). VSDP policies and procedures require agencies and colleges to adjust short-term benefits by any payments the employee receives or is eligible to receive. A Lord Fairfax employee received full short-term benefit pay along with pay for a separate contract with the college. Lord Fairfax did not adjust the short-term benefit pay by the contract pay.

After paying the employee, Lord Fairfax realized the error and overpayment. However, management chose to allow the overpayment instead of requesting a reimbursement. The Virginia Sickness and Disability Program policies and procedures do not give agencies and colleges the authority to approve short-term benefit overpayments.

Lord Fairfax should ensure short-term disability benefits are not overpaid. Additionally, Lord Fairfax should not approve short-term disability benefit overpayments and should request reimbursements for any outstanding overpayment. Lord Fairfax should follow Virginia Sickness and Disability Program policies and procedures.

Lord Fairfax Community College Response:

The isolated case in question involved a contract with a faculty member for teaching an on-line class from September 11 – December 9, a total of 13 weeks. This was not part of the employee's regular duties and responsibilities (contract on own time). The employee began a pregnancy disability leave on October 20, thus the first 6 weeks of the contract were fulfilled prior to the start of leave. The contract was for $910.00. While we realize that under the disability program that extra pay is not allowed, because the employee was fulfilling this responsibility from home and it did not require the same physical demands that the position required, we felt the employee earned the income and we did pay the compensation. However, to comply with the policy, we adjusted the employee's pay by $490.00 which is the portion the employee would have earned while on disability.

Implementation Date for Corrective Action: June 2006

Title of Position Responsible for Corrective Action: Human Resources Manager

Strengthen Internal Controls over the Small Purchase Charge Card Program

Applicable to: Thomas Nelson Community College

VCCS has issued charge cards to over 1,080 employees at the System Office and Community Colleges for purchasing of various goods and services. VCCS employees purchased over $20.1 million under the program during fiscal year 2005. VCCS and each of the colleges have developed policies and procedures for the program to ensure compliance with state guidelines. However, we found Thomas Nelson did not follow the established procedures.

Thomas Nelson did not maintain receipts and invoices for purchases made with the Small Purchase Charge Card. Additionally, Thomas Nelson paid sales tax when purchasing tax-exempt items on the Small Purchase Charge Card.

The Commonwealth's accounting policies requires agencies to maintain all receipts and invoices for purchases made with the small purchase charge card. Additionally, the policies require that small purchase charge cardholders not pay Virginia Sales tax on goods and services. Individual cardholders who mistakenly pay sales tax should take necessary steps with the vendor to credit their account with the amount of the tax paid.

Thomas Nelson should ensure that cardholders are aware of policies and procedures regarding maintaining support for all purchases and the tax-exempt nature of purchases. Additionally, cardholder supervisors should review all purchases to ensure that purchases comply with policies and procedures.

Thomas Nelson Community College Response:

The APA finding is correct as stated. Cardholders will be trained in the policies and procedures regarding maintaining support for all purchases and the tax-exempt nature of purchases. In addition, cardholders' supervisors will be required to review and approve all card purchases.
The training and procedure change will be completed by September 30, 2006.

Responsibility: Associate Vice President for Finance and Administration

VIRGINIA COMMUNITY COLLEGE SYSTEM

STATE BOARD FOR COMMUNITY COLLEGES

As of June 30, 2005

Constance R. Kincheloe, Chair

Chris A. Lumsden, Vice Chair

Shahnaz M. Ahmed
Mark R. Graham
Gary C. Hancock
Nathaniel Xavier Marshall
Bruce J. Meyer
R. Michael Mohler
Willis A. Morris
Michael Petters
William E. Porter
Robert W. Shinn

Alan G. Toxopeus

CHANCELLOR

Dr. Glenn DuBois

COMMUNITY COLLEGE PRESIDENTS

As of June 30, 2005

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