VIRGINIA MILITARY INSTITUTE

LEXINGTON, VIRGINIA

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2003

APA
Auditor of
Public Accounts
COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of Virginia Military Institute for the year ended June 30, 2003, found:

- the financial statements are presented fairly, in all material respects;
- no internal control matters that we consider to be material weaknesses;
- no instances of noncompliance required to be reported; and
- adequate corrective action of prior audit findings.

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Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

April 9, 2004

The Honorable Mark R. Warner
Governor of Virginia

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

The Board of Visitors
Virginia Military Institute

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

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

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

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

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

The Management's Discussion and Analysis on pages four through nine is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting

Standards Board. We applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of Virginia Military Institute. The Schedule of Auxiliary Enterprises Revenues, Expenditures, and Changes in Fund Balances is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The Schedule of Auxiliary Enterprises Revenue, Expenditures, and Changes in Fund Balances has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statement taken as a whole.

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

In planning and performing our audit of the financial statements of Virginia Military Institute as of and for the year ended June 30, 2003, we considered internal controls over financial reporting and tested compliance with certain provisions of laws, regulations, contracts, and grants in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards.

Compliance

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

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Institute's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Status of Prior Findings

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

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

EXIT CONFERENCE

We discussed this report with management at an exit conference held on April 30, 2004.

AUDITOR OF PUBLIC ACCOUNTS

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MANAGEMENT'S DISCUSSION AND ANALYSIS

"UNAUDITED"

Overview

Virginia Military Institute is pleased to present its financial statements for the fiscal year ended June 30, 2003, along with comparative data for fiscal year 2002. This management's discussion and analysis is designed to help readers understand the accompanying financial statements and provides an objective, easily readable analysis of the Institute's financial activities based on currently known facts, decisions, and conditions. This discussion focuses primarily on fiscal year 2003 and includes highly summarized data that should be read in conjunction with the accompanying financial statements, notes to the financial statements, and other supplementary information.

Three basic financial statements are presented: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. The following analysis discusses elements from each of these statements, as well as an overview of the Institute's activities.

Executive Summary

The state's sluggish economy resulted in a $1.4 million (9.9 percent) cut in state funds support for VMI in FY 2003. However, VMI managed to end the year with total revenues of $46.7 million, an increase of $2.9 million over FY 2002. Total revenues consist of $19.5 million in operating revenues (41 percent), $13.6 million in state funds support (29 percent), and $13.8 million in private fund support (30 percent). Operating revenues increased $1.9 million (11.0 percent) due primarily to tuition and fee increases. Private fund support increased by $2.6 million (23.7 percent) and reflects a change in the VMI Foundation's administrative fee policy.

Expenses totaled $46.7 million, an increase of $3.2 million (7.3 percent). The increase includes nine new positions (primarily strategic plan initiatives), higher health insurance rates, cadet uniform cost increases, higher cadet meal rates, a new library system, and interest on debt.

The excess of revenues over expenses for the year totaled $250,462. While not a substantial increase in net assets, it reverses the decrease that occurred in FY 2002 and is significant given the reduction in state funds. This brings total net assets to $72.7 million as of June 30, 2003. This includes $8.0 million in unrestricted net assets, an increase of $1.5 million (23.0 percent). Total assets increased by $5.0 million (or 6.2 percent) to $86.2 million and include cash of $7.8 million, an increase of $.6 million (8.2 percent).

VMI initiated $19.3 million of capital renovation projects in FY 2003 to include the Nichols Engineering Building ($14.7 million), Jackson Memorial Hall ($2.5 million), and an addition to Cocke Hall ($2.1 million). VMI has requested an additional $3.0 million in state funds for equipment for Nichols Engineering Hall. Plans are also underway to start the $10.6 million renovation of Crozet Hall in FY 2004 and the $9.1 million renovation of Mallory Hall in FY 2006. These $42.0 million of capital projects will allow VMI to provide modern and technologically-equipped facilities for its nationally-ranked programs.

Statement of Net Assets

The Statement of Net Assets presents the Institute's assets, liabilities, and net assets as of the end of the fiscal year. This statement presents a fiscal snapshot at June 30, 2003. Readers of the Statement of Net Assets should be able to determine the assets available to continue the Institute's operations and how much the Institute owes vendors, creditors, and others.

Net Assets are divided into three major categories. The first category, "Invested in capital assets, net of related debt," provides the Institute's equity in property, plant, and equipment. The next category is

"Restricted" net assets, which comprises two subcategories, expendable and nonexpendable. Expendable restricted resources are available for expenditure by the Institute in accordance with the stipulations of donors and/or other entities that have placed time or purpose restrictions on the use of the assets. Nonexpendable restricted resources typically represent the corpus of endowments and are available only for investment purposes. The final category, "Unrestricted," includes net assets available for any lawful purpose of the Institute.

Statement of Net Assets

	June 30, 2003	June 30, 2002
Assets:		
Current assets	$13,613,491	$11,988,236
Capital assets, net	51,001,042	50,454,038
Other noncurrent assets	21,605,363	18,722,791
Total assets	86,219,896	81,165,065
Liabilities:		
Current liabilities	5,643,469	5,370,788
Noncurrent liabilities	7,823,664	3,291,976
Total liabilities	13,467,133	8,662,764
Net assets:		
Invested in capital assets, net of related debt	49,134,144	48,432,850
Restricted – expendable	11,008,236	12,977,578
Restricted – nonexpendable	4,517,247	4,515,837
Unrestricted	8,093,136	6,576,036
Total net assets	$72,536,353	$72,502,301

VMI's current assets increased by $1.6 million (13.5 percent) and primarily reflect an increase of $1.1 million in cash and cash equivalents. The increase in cash is largely attributed to greater private gifts and income support from the VMI Foundation, some of which was committed for strategic and other initiatives and will be spent in FY 2004. It also includes an increase in cash from tuition and fees collected in advance for the next academic year. This cash is reflected as deferred revenue at year end. The overall increase in cash explains a significant portion of the increase in unrestricted net assets.

The $2.9 million increase in other noncurrent assets primarily reflects the net effect of $4.6 million of unspent bond proceeds as of June 30, 2003, offset by a $1.8 million decrease in noncurrent cash and investments. Loans receivable (Perkins Program student financial aid loans) also increased by $.1 million. The decrease in cash and investments primarily reflects a net loss of $.4 million in investment activity for the year plus the spending of investment income for operations. This also explains the decrease in restricted-expendable net assets. These net assets also decreased because of a $.5 million reduction in state maintenance reserve funds.

The unspent bond proceeds are temporarily invested with the Treasury of Virginia and pertain to two capital projects: the renovation of Jackson Memorial Hall (auditorium and museum) and construction of an addition to Cocke Hall (physical education facility). Planning is underway for these projects with construction scheduled to commence in late fall 2004. VMI debt financed these projects through the Virginia College Building Authority (VCBA) resulting in issuance of a note payable to the VCBA for $4.6 million, which primarily accounts for the corresponding increase in noncurrent liabilities.

Statement of Revenues, Expenses, and Changes in Net Assets

Changes in the total 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. The purpose of this statement is to present the Institute's operating and nonoperating revenues recognized and expenses paid and any other revenues, expenses, gains, and losses received or incurred by the Institute.

Operating revenues are generally recognized when goods and services are provided to students and other constituencies of the Institute. Operating expenses are the cost incurred to acquire or produce the goods and services provided and to carry out the Institute's programs and activities.

Nonoperating revenues generally represent income and support for which goods and services are generally not provided. For example, it includes state appropriations received from the state legislature for which goods and services are not directly provided by VMI.

Statement of Revenues, Expenses, and Changes in Net Assets

	Year Ended June 30, 2003	Year Ended June 30, 2002
Operating revenues:		
Tuition and fees	$ 8,742,716	$ 7,898,929
Grants and contracts	914,448	604,429
Auxiliary enterprises	7,889,225	7,460,416
Unique military activities	916,059	821,966
Other sources	1,089,738	865,596
Total operating revenues	19,552,186	17,651,336
Operating expenses:		
Educational and general	29,881,903	28,964,069
Auxiliary enterprises	12,265,577	11,194,496
Unique military activities	3,907,288	3,202,910
Other operating expenses	-	2,298
Total operating expenses	46,054,768	43,363,773
Operating loss	(26,502,582)	(25,712,437)
Nonoperating revenues (expenses):		
State appropriations	12,553,013	13,461,380
Private gifts and contributions	13,303,221	10,402,752
Other	(630,651)	(588,317)
Net nonoperating revenues	25,225,583	23,275,815
Income loss before other revenues	(1,276,999)	(2,436,622)
Other revenues	1,527,461	2,301,399
Increase (decrease) in net assets	250,462	(135,223)
Net assets – beginning of year	72,502,301	72,637,524
Net assets – end of year	$ 72,752,763	$ 72,502,301

Operating revenues increased by $1.9 million (10.7 percent) and primarily reflect an overall increase in tuition and fee rates of approximately 6.7 percent and increases in federal, state, and private grants and contracts. Enrollment remained relatively stable at 1,330 cadets in the fall of 2002 and 1,355 in the fall of 2001, a decrease of 25 cadets (1.8 percent).

Operating expenses increased by $2.7 million (6.2 percent) and consist of increased expenditures in the Educational and General Program, $.9 million (3.2 percent); Auxiliary Enterprises Program, $1.1 million (9.6 percent); and the Unique Military Activities Program, $.7 million (22.0 percent). Auxiliary expenditures include increases in outside contractor food service rates (Mess Hall cadet meals), repairs and maintenance on the VMI barracks and employee housing, and indirect costs paid to the Educational and General Program for administrative and physical plant costs. The increase in military program expenses primarily reflects the normalization of cadet uniform costs in FY 2003 compared to FY 2002. Cadet uniform costs for FY 2002 were lower than normal because of a $.6 million increase in the cadet uniforms inventory that occurred due to the implementation of a new policy that requires all graduating cadets to return substantially all uniforms to VMI for reissue if appropriate.

The $1.9 million increase in nonoperating revenues primarily reflects the net effect of a $2.9 million increase in gifts and grants (primarily private funds) that was offset by a $.9 million decrease in state appropriations and a $.1 million increase in other capital expenditures. The increase in gifts and grants reflects increased support from the VMI Foundation, Inc., that was due largely to an internal change in its administrative fee and income spending policy. The reduction in state appropriations resulted from actions of the General Assembly and the Governor to address shortfalls in state revenues.

Other revenues decreased by $.8 million and consist primarily of a reduction in state maintenance reserve funds and to the completion in FY 2002 of debt service on Cameron Hall. VMI had received $.4 million in private fund support annually through FY 2002 to pay this debt service.

Statement of Cash Flows

This statement presents detailed information about the Institute's cash activity during the year. It is divided into five parts: operating activities, noncapital financing activities, investing activities, capital and related financing activities, and reconciliation of the net cash used to the operating income or loss reflected on the Statement of Revenues, Expenses, and Changes in Net Assets.

Statement of Cash Flows

	Year Ended June 30, 2003	Year Ended June 30, 2002
Net cash used by operating activities	$(24,020,607)	$(24,243,469)
Net cash provided by noncapital financing activities	25,936,909	24,005,510
Net cash used by capital and related financing activities	(2,639,088)	140,834
Net cash provided by investing activities	1,308,408	1,102,435
Net increase (decrease) in cash	585,622	1,005,310
Cash – beginning of year	8,630,017	7,624,707
Cash – end of year	$ 9,215,639	$ 8,630,017

Net cash provided from noncapital financing activities consists largely of state and private fund support of operations.

The $2.6 million of net cash used by capital and related financing activities includes: equipment purchases (state equipment trust fund and other equipment); maintenance reserve expenditures (replacement of the Cameron Hall air conditioning system and swimming pool repairs); improvements to buildings and infrastructure (Scott Shipp Hall's retaining wall and the renovation of the Shirley House at New Market); and construction-in-progress (the renovations of Nichols Engineering Hall and Jackson Memorial Hall and the addition to Cocke Hall). It also includes debt service payments on the Barracks Network and the Jackson Memorial Hall and Cocke Hall revenue bonds.

Capital Asset and Debt Administration

Fiscal year 2003 marked the beginning of a period of major capital renovations for VMI that will last for several years. Funding from the Virginia Higher Education Bond Referendum approved in fall 2002 and "jumpstart" funds provided by the legislature ensured the financing of $14.7 million for the renovation of VMI's Nichols Engineering Hall and $9.1 million for the renovation of Mallory Hall's mathematics, computer science, and physics departments. These projects are being funded from state general obligation bonds payable by the state. The Nichols Engineering Hall renovation began in fall 2003 and is expected to be complete in December 2005. The Mallory Hall renovation is scheduled to begin in 2006.

VMI also simultaneously began renovation of Jackson Memorial Hall (auditorium and museum) and the construction of an addition to Cocke Hall (physical education facility). VMI has contracted with a single architectural/engineering firm to plan and bid these two projects jointly with the Nichols Engineering Hall project because of the close proximity of all three projects and the resultant cost savings. The Jackson Memorial Hall and the Cocke Hall projects are being funded from revenue bonds issued by the Virginia College Building Authority (VCBA) in October 2002 on behalf of VMI. VMI executed a 20-year $4.6 million note to the VCBA for the bond proceeds ($2.5 million for Jackson Memorial Hall and $2.1 million for Cocke Hall) with the note payments established to fund debt service on the bonds. The annual debt service approximates $360,000 including interest at approximately 5.2 percent and is being funded from auxiliary revenues (primarily cadet fees) and private funds.

VMI expects to incur approximately $10.6 million in additional long-term debt during FY 2004 in connection with the renovation and expansion of its Crozet Hall dining facility. Project construction is scheduled to commence in spring 2004 and end in August 2005. Annual debt service payments are projected to approximate $819,000 per annum based on an estimated 4.5 percent rate of interest over 20 years.

Economic Outlook

The state's sluggish economy continued to create revenue shortfalls resulting in the 2003 General Assembly further curtailing state general fund appropriations to all higher education institutions for FY 2004. VMI's share of the additional reduction totaled $1.4 million as compared to FY 2003 and brings the total reduction in state operating funds since FY 2002 to $3.1 million, or 23 percent.

State general funds comprised approximately 28 percent of VMI's total operating revenues in FY 2003 and are expected to drop to approximately 24 percent in FY 2004. Further reductions in state general funds for FY 2004 and the following 2004-2006 biennium appear to be a reasonable possibility based on indications from state officials. The amount of the future reductions, if any, cannot be readily determined at this time.

VMI is also facing a reduction of approximately $1.1 million in gifts and grants from private sources in FY 2004 compared to FY 2003 due to the downturn in the stock market the past few years that has adversely impacted the level of spendable income support (or gifts and grants) for VMI. VMI is currently working with the VMI Foundation, Inc., to implement a plan effective for FY 2005 that will help to stabilize the amount of income support provided to VMI for the next few years.

VMI continues to implement plans and actions to reduce costs and increase efficiencies while preserving and enhancing its mission. The FY 2004 budget includes savings of approximately $1.2 million in various programs through the freezing of vacant positions, reductions in part-time employment, and cuts in supplies, equipment, and travel across the board.

Because of the magnitude of the state and private fund reductions, VMI also raised its tuition and fee rates an average of approximately eight percent for FY 2004 to help supplant the loss of these funds. VMI increased funding for cadet financial assistance in FY 2004 to help assure that eligible cadets continue to receive sufficient financial aid. VMI enrolled 1,362 cadets in fall 2003, an increase of 32 cadets (2.4 percent) over fall 2002.

The reduction in state and private support for FY 2004 will likely result in some decrease of VMI’s net assets. However, management is committed to maintaining a strong financial position and will continue its efforts to reduce costs and increase revenues as appropriate to minimize any erosion of its net assets.

VIRGINIA MILITARY INSTITUTE
STATEMENT OF NET ASSETS
As of June 30, 2003
With comparative figures for 2002

	2003	2002
ASSETS		
Current assets:		
Cash and cash equivalents (Note 3)	$ 8,118,719	$ 6,971,440
Cash equivalent held with Treasurer of Virginia (Note 3)	-	35,721
Collateral held for securities lending (Note 3)	365,747	361,187
Accounts receivable, Net of allowance for doubtful accounts of $45,343 in 2003 and of $79,145 in 2002 (Note 4)	652,721	398,930
Due from the Commonwealth (Note 9)	32,780	22,636
Prepaid expenditures	593,545	538,334
Inventory (Note 5)	3,089,317	2,823,537
Loans receivable	760,662	836,451
Total current assets	13,613,491	11,988,236
Noncurrent assets:		
Cash and cash equivalents (Note 3)	1,096,920	1,658,577
Cash and investment with trustees (Note 3)	15,086,462	16,385,569
Investments held with the Treasurer of Virginia (Note 3)	4,630,282	1,223
Notes receivable	210,000	210,000
Loans receivable, Net of allowance for doubtful accounts of $34,154 in 2003 and of $32,217 in 2002	581,699	467,422
Nondepreciable capital assets (Note 6)	3,697,290	2,947,251
Depreciable capital assets, Net of accumulated depreciation (Note 6)	47,303,752	47,506,787
Total noncurrent assets	72,606,405	69,176,829
Total assets	86,219,896	81,165,065
LIABILITIES		
Current liabilities:		
Accounts payable and accrued expenses (Note 7)	2,940,499	2,830,465
Deferred revenue	895,060	767,966
Obligations under securities lending	365,747	396,908
Deposits held for others	550,653	366,630
Long-term liabilities-current portion: (Note 8)		
Compensated absences	640,409	682,396
Notes payable (Note 9)	235,000	230,000
Capital lease payable (Note 9)	5,885	83,662
Installment purchase obligation (Note 9)	10,216	12,761
Total current liabilities	5,643,469	5,370,788

VIRGINIA MILITARY INSTITUTE
STATEMENT OF NET ASSETS
As of June 30, 2003
With comparative figures for 2002

	2003	2002
Noncurrent liabilities:		
Accrued liabilities (Note 7)	42,759	-
Federal loan program contributions refundable	1,199,912	1,178,971
Retainage payable (Note 10)	37,224	27,338
Long-term liabilities-noncurrent portion: (Note 8)		
Compensated absences	595,010	486,041
Notes payable (Note 9)	5,925,234	1,560,000
Capital lease payable (Note 9)	8,200	14,085
Installment purchase obligation (Note 9)	15,325	25,541
Total noncurrent liabilities	7,823,664	3,291,976
Total liabilities	13,467,133	8,662,764
NET ASSETS		
Invested in capital assets, net of related debt	49,134,144	48,432,850
Restricted-Nonexpendable		
Endowment	4,517,247	4,515,837
Restricted-Expendable		
Scholarships and other	1,269,380	1,125,171
Loan funds	482,712	481,764
Quasi-endowment-restricted	8,757,423	9,954,886
Capital projects	498,721	1,415,757
Unrestricted	8,093,136	6,576,036
Total net assets	$ 72,752,763	$ 72,502,301

The accompanying notes to financial statements are an integral part of this statement.

VIRGINIA MILITARY INSTITUTE
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2003
With comparative figures for 2002

	2003	2002
Operating revenues:		
Tuition and fees, Net of scholarships allowances of $3,311,569		
in 2003 and $3,183,200 in 2002	$ 8,742,716	$ 7,898,929
Federal grants and contracts	725,760	556,306
State grants and contracts	53,547	23,022
Private grants	135,141	25,101
Sales and services of educational departments	68,512	22,210
Auxiliary enterprise, Net of scholarship allowances of $2,830,429		
in 2003 and $2,913,767 in 2002	7,889,225	7,460,416
Unique military activities, Net of scholarships allowances of		
$342,375 in 2003 and $328,948 in 2002	916,059	821,966
Other sources	1,017,200	840,245
Interest on student loans	4,026	3,141
Total operating revenues	19,552,186	17,651,336
Operating expenses:		
Educational and general:		
Instruction	12,931,651	12,287,073
Research	316,587	149,866
Public service	1,026,134	1,125,320
Academic support	5,260,382	4,526,136
Student services	2,747,980	2,723,621
Institutional support	3,417,171	3,954,621
Operation and maintenance of physical plant	3,409,286	3,453,987
Scholarships and related expense	772,712	743,445
Auxiliary enterprises	12,265,577	11,194,496
Unique military activities	3,907,288	3,202,910
Other operating expenses	-	2,298
Total operating expenses (Note 11)	46,054,768	43,363,773
Operating income (loss)	(26,502,582)	(25,712,437)
Nonoperating revenues/(expenses):		
State appropriations (Note 12)	12,553,013	13,461,380
Private gifts and contributions	13,303,221	10,402,752
Investment income (loss)	17,697	(423,435)
Interest on capital asset - related debt	(225,578)	(132,116)
Loss on disposal of plant assets	(422,770)	(32,766)
Net nonoperating revenues	25,225,583	23,275,815

VIRGINIA MILITARY INSTITUTE
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2003
With comparative figures for 2002

	2003	2002
Income (loss) before other revenues	(1,276,999)	(2,436,622)
Other revenues:		
State appropriations-capital	978,959	1,555,828
Grants and gifts-capital	481,822	742,429
Investment income-capital	66,680	3,142
Total other revenues	1,527,461	2,301,399
Increase/(Decrease) in net assets	250,462	(135,223)
Net assets - beginning of the year	72,502,301	72,637,524
Net assets - end of the year	$ 72,752,763	$ 72,502,301

The accompanying notes to financial statements are an integral part of this statement.

VIRGINIA MILITARY INSTITUTE
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2003
With comparative figures for 2002

	2003	2002
Cash provided/(used) by operating activities:		
Tuition and fees	$ 8,804,367	$ 7,936,655
Federal grants and contracts	725,760	556,306
State grants and contracts	53,547	23,022
Private grants	40,613	25,101
Sales and services-educational and general	90,846	48,934
Auxiliary charges	7,964,695	7,467,963
Unique military activity charges	882,355	820,280
Other operating receipts	933,386	839,896
Payments to employees for salaries and benefits	(25,801,311)	(25,345,509)
Payments for supplies and services	(16,929,755)	(15,908,676)
Payments for scholarships and fellowships	(771,591)	(718,775)
Loans issued to students	(271,372)	(213,644)
Collections of loans from students	257,853	224,978
Net cash used by operating activities	(24,020,607)	(24,243,469)
Cash provided/(used) by noncapital financing activities:		
State appropriations	12,553,013	13,461,380
Gifts and grants for other than capital purposes	13,303,221	10,402,752
Federal Direct Lending Program-receipts	2,515,352	2,562,104
Federal Direct Lending Program-disbursements	(2,515,352)	(2,562,104)
Agency receipts	2,853,301	2,967,217
Agency disbursements	(2,772,626)	(2,825,839)
Net cash provided by noncapital financing activities	25,936,909	24,005,510
Cash provided/(used) by capital and related financing activities:		
Capital appropriations	975,670	3,116,593
Capital gifts	481,822	742,429
Proceeds from sale of capital assets	4,361	40,404
Purchase and construction of capital assets	(3,650,477)	(2,791,347)
Principal paid on capital debt, leases and installments	(363,523)	(856,572)
Interest paid on capital debt, leases and installments	(153,621)	(113,815)
Investment income-capital	66,680	3,142
Net cash used by capital and relating financing activities	(2,639,088)	140,834
Cash provided/(used) by investing activities:		
Interest on investments	187,918	244,914
Investment/Endowment income	213,490	268,573
Sale of investments	929,500	1,114,468
Purchase of investments	(22,500)	(525,520)
Net cash provided by investing activities	1,308,408	1,102,435

VIRGINIA MILITARY INSTITUTE
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2003
With comparative figures for 2002

	2003	2002
Net increase/(decrease) in cash	585,622	1,005,310
Cash - beginning of year	8,630,017	7,624,707
Cash - end of year	$ 9,215,639	$ 8,630,017
Reconciliation of cash and cash equivalents to the Statement of Net Assets:		
Cash and cash equivalents classified as current assets	$ 8,118,719	$ 6,971,440
Cash and cash equivalents classified as noncurrent assets	1,096,920	1,658,577
Total cash - end of year	$ 9,215,639	$ 8,630,017
Reconciliation of net operating expenses to net cash used by operating activities:		
Operating loss	$ (26,502,582)	$ (25,712,436)
Adjustments to reconcile net operating expenses to cash used by operating activities:		
Depreciation expense	2,815,286	2,802,361
Changes in net assets and liabilities:		
Accounts receivable	(207,979)	70,514
Inventories	(265,781)	(631,195)
Prepaid expenditures	(55,211)	32,156
Due from Commonwealth	(6,855)	(13,034)
Accounts payable and accrued liabilities	(51,467)	(774,268)
Deposits held in custody for others-security deposits	45,601	226,325
Deferred revenue	127,094	(4,020)
Loans receivable	(38,487)	(160,598)
Retainage payable	9,886	(191,335)
Notes payable-note issuance cost	21,964	-
Compensated absences	66,982	20,972
Other liabilities	-	(80,000)
Federal loan program contributions refundable	20,942	171,089
Net cash used in operating activities	$ (24,020,607)	$ (24,243,469)
Noncash investing, noncapital financing, and capital related financing transactions:		
Fixed assets acquired by incurring capital lease obligations	$ 25,948	$ 25,948
Principal and interest on capital lease debt paid by State agency on behalf of the Institute	$ 59,374	$ 198,519
Change in fair value of investments recognized as a component of investment income/(loss)	$ 703,407	$ (3,970,912)

The accompanying notes to financial statements are an integral part of this statement.

VIRGINIA MILITARY INSTITUTE

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of Virginia Military Institute (VMI) have been prepared in accordance with generally accepted accounting principles for colleges and universities. The significant accounting policies followed by the Institute are as follows:

A. Reporting Entity and Mission

Virginia Military Institute believes that the measure of a college lies in the quality and performance of its graduates and their contributions to society.

Therefore, it is the mission of Virginia Military Institute to produce educated, honorable men and women prepared for the varied work of civil life, imbued with love of learning, confident in the functions and attitudes of leadership, possessing a high sense of public service, advocates of the American Democracy and free enterprise system, and ready as citizen-soldiers to defend their country in time of national peril.

To accomplish this result, Virginia Military Institute shall provide to qualified young men and women undergraduate education of highest quality – embracing engineering, science, and the arts – conducted in, and facilitated by, the unique VMI system of military discipline.

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

B. Financial Statement Presentation

The Institute's accounting policies conform with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB) pronouncements, as well as applicable Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The financial statements have been prepared in accordance with GASB Statement 34, *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities.* As a component unit of the Commonwealth of Virginia, the Institute was required to adopt GASB Statements 34 and 35 effective July 1, 2001. The financial statement presentation required by GASB Statements 34 and 35 provides a comprehensive, entity-wide perspective of the Institute's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows and replaces the fund-group perspective previously required.

C. Basis of Accounting

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

D. Investments

In accordance with GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools,* purchased investments, interest-bearing temporary investments classified with cash, and investments received as gifts are recorded at fair value. All investment income, including changes in the fair value of investments (unrealized gains and losses), is reported as nonoperating revenue in the Statement of Revenues, Expenses, and Changes in Net Assets.

E. Capital Assets

Capital assets include land, buildings and other improvements, library materials, equipment and infrastructure assets such as sidewalks, steam tunnels, and electrical and computer network cabling systems. Capital assets are generally defined by the Institute as assets with an initial cost of $5,000 or more and an estimated useful life in excess of two years. Buildings and equipment are stated at appraised value or actual cost where determinable. Land is stated at cost. Library materials are valued using published average prices for library acquisitions. Expenses for major capital assets and improvements are capitalized (construction in progress) as projects are constructed. Operating expenditures of $10,000 or greater for renewals and replacement are capitalized only to the extent that such expenditures represent long-term improvement to properties. Interest expense relating to construction is capitalized net of interest income earned on resources set aside for this purpose. The costs of normal maintenance and repairs that do not add to an asset's value or materially extend its useful life are not capitalized.

Depreciation is computed using the straight-line method over the estimated useful life of the asset. Useful lives by asset categories are listed below:

Buildings	50 years
Other improvements	10-30 years
Equipment	5-25 years
Library materials	10 years

F. Inventories

Inventories are valued at cost using the first-in, first-out method.

G. Deferred Revenue

Deferred revenue represents revenues collected, but not earned as of June 30, 2003 and 2002. This is primarily composed of revenue for student tuition and fees received in advance of the next semester or term.

H. Accrued Compensated Absences

Nonfaculty, salaried employee's attendance and leave regulations make provisions for the granting of a specified number of days of leave with pay each year. Instructional personnel do not earn leave. The amount of leave earned, but not taken as of June 30, 2003 and 2002 is recorded as a liability on the Statement of Net Assets. The liability reflects all earned vacation, compensatory, and overtime leave not taken, as well as the amount payable under the Commonwealth of Virginia's sick leave payout policy upon termination, which is the lesser of 25 percent of sick leave not taken or $5,000 per employee with five or more years of service. The last element reflected in the liability is social security and Medicaid taxes to be paid by the Institute on all accrued compensated absences.

I. Federal Financial Assistance Programs

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

J. Net Assets

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

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

Restricted net assets – nonexpendable: Nonexpendable restricted net assets consist of endowment funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity and invested for the purpose of producing present and future income, which may either be expended or added to the principal.

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

Unrestricted net assets: Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the Institute and may be used at the discretion of the governing board to meet current expenses for any purpose. These resources also include auxiliary enterprises, which are substantially self-supporting activities that provide services for students, faculty, and staff. Also included in unrestricted net assets are funds that have been set aside by the Board of Visitors as quasi-endowments. These funds are treated as true endowment funds, however, unlike true endowments they may be expended.

The Institute has no policy regarding flow assumption to determine which assets (restricted or unrestricted) are being used when both restricted and unrestricted assets are available for the same purpose. Our practice is to allow department heads to make this determination and they typically spend unrestricted assets prior to spending restricted resources.

K. Classification of Revenues

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

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

Nonoperating revenues: Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, and other revenue sources that are defined as nonoperating revenues by GASB Statement 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting,* GASB Statement 33, *Accounting and Financial Reporting for Nonexchange Transactions,* and GASB Statement 34, such as state appropriations and investment income.

Scholarship Discounts and Allowances: Student tuition and fee revenues are reported net of scholarship discounts and allowances in the Statements of Revenues, Expenses, and Changes in Net Assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the Institute and the amount that is paid by students and/or third parties making payments on the students' 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 Institute's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees, the Institute has recorded a scholarship discount and allowance.

2. AFFILIATED ORGANIZATION

The financial statements do not include the assets, liabilities, and fund balance of the Virginia Military Institute Research Laboratories, Inc. The VMI Research Laboratories, Inc., a private, non-profit Virginia corporation, was established to encourage and promote scientific investigations and other types of research by the faculty, staff, and students. The Research Laboratory was audited by other auditors whose report was furnished to the Institute. Amounts summarized below are based solely upon the report of the other auditor.

Following is a condensed summary of the financial position of the VMI Research Laboratories, Inc., as of June 30:

	2003	2002
Assets	$541,419	$474,290
Liabilities and fund balance:		
Liabilities	$327,275	$309,282
Fund balance	214,144	165,008
Total liabilities and fund balance	$541,419	$474,290

The cash receipts and disbursements of the VMI Research Laboratories Inc., were $1,009,550 and $961,136 respectively, for the year ended June 30, 2003, and $750,854 and $749,854 respectively for the year ended June 30, 2002.

3. CASH AND CASH EQUIVALENTS AND INVESTMENTS

A. Cash Equivalents

All of VMI's cash is maintained in accounts that are collateralized in accordance with the Virginia Securities for Public Deposits Act, Section 2.2-4400, et. seq., Code of Virginia. In accordance with the GASB Statement 9 definition of cash and cash equivalents, cash represents cash with the Treasurer, cash on hand, and cash deposits including certificates of deposits and temporary investments with original maturities of three months or less.

B. Cash and Investments with Trustees

VMI's investments are categorized below to give an indication of the level of credit risk assumed by the Institute at June 30, 2003 and 2002. Credit risk is the risk that the Institute may not be able to obtain possession of its investment or collateral at maturity.

Category 1 – Insured or registered securities or securities held by the Institute or its safekeeping agent in the Institute's name.

Category 2 – Uninsured or unregistered with securities held by the counter party's trust department or agent in the Institute's name.

Category 3 – Uninsured or unregistered with securities held by the counter party or by its trust department or agent, but not in the Institute's name.

	Fair Value June 30, 2003	Fair Value June 30, 2002
Cash:		
Deposits with financial institutions	$ 2,101,821	$ 1,026,458
Cash with Treasurer of Virginia	5,978,446	6,576,008
Petty cash	13,570	11,275
Total cash	8,093,837	7,613,741
Cash equivalents:		
Repurchase agreement (Category 3)	1,121,802	1,016,276
Cash and investments with trustees:		
Noncategorized	15,086,462	16,385,569
Investments with the Treasurer of Virginia:		
State Non-Arbitrage Program (SNAP)	4,630,282	1,223
Collateral held for securities lending	365,747	361,187
Cash equivalent - Securities lending	-	35,721
Total investments with Treasurer of Virginia	4,996,029	398,131
Total cash, cash equivalents, and investments	$29,298,130	$25,413,717

C. Securities Lending Transactions

Collateral held for securities lending and the securities lending transactions reported on the financial statements represent the Institute's allocated share of securities received for securities lending transactions held in the General Account of the Commonwealth. Information related to the credit risk of these investments and securities lending transactions held in the General Account is available on a statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report.

D. Funds Held In Trust By Others

Assets of funds held by trustees for the benefit of the Institute are not reflected in the accompanying Statement of Net Assets. The Institute has irrevocable rights to all or a portion of the income of these funds. However, assets of the funds are not under the management discretion of the Institute according to the trust agreements. Income from funds held by trustees for the benefit of the Institute totaled $101,841 for the year ended June 30, 2003, and is included in the endowment income.

4. ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following at June 30:

	2003	2002
Student tuition and fees	$123,619	$166,043
Other educational and general	7,933	40,934
Auxiliary enterprises	11,115	11,753
Unique military activity	45,143	11,313
Agency funds	233,942	225,229
Other	59,902	22,803
Total	481,654	478,075
Less: Allowance for doubtful accounts	45,343	79,145
Net accounts receivable	$436,311	$398,930

5. INVENTORIES

Inventories consisted of the following at June 30:

	2003	2002
Physical plant	$ 206,456	$ 131,069
Military store	2,774,112	2,586,716
Museums	104,473	99,517
VMI hospital	4,276	6,235
Total	$3,089,317	$2,823,537

6. CAPITAL ASSETS

A summary of changes in the various capital asset categories is presented as follows:

	Beginning Balance July 1, 2002	Additions	Reductions	Ending Balance June 30, 2003
Nondepreciable capital assets:				
Land	$ 1,667,896	$ -	$ -	$ 1,667,896
Construction-in-progress	1,279,355	1,541,074	(791,035)	2,029,394
Total nondepreciable capital assets	2,947,251	1,541,074	(791,035)	3,697,290
Depreciable capital assets:				
Buildings	84,070,692	1,622,855	-	85,693,547
Land improvements	2,222,155	75,109	-	2,297,264
Equipment	9,074,001	1,111,060	(1,051,730)	9,133,331
Library books	9,325,521	230,357	(32,366)	9,523,512
Total depreciable capital assets	104,692,369	3,039,381	(1,084,096)	106,647,654
Less accumulated depreciation for:				
Buildings	43,088,419	1,735,079	-	44,823,498
Land improvements	1,147,424	128,967	-	1,276,391
Equipment	4,996,786	708,360	(624,600)	5,080,546
Library books	7,952,953	242,880	(32,366)	8,163,467
Total accumulated depreciation	57,185,582	2,815,286	(656,966)	59,343,902
Depreciable capital assets	47,506,787	224,095	(427,130)	47,303,752
Total capital assets, net	$ 50,454,038	$1,765,169	$(1,218,165)	$ 51,001,042

	Beginning Balance July 1, 2001	Additions	Reductions	Ending Balance June 30, 2002
Nondepreciable capital assets:				
Land	$ 1,667,896	$ -	$ -	$ 1,667,896
Construction-in-progress	799,720	814,012	(334,377)	1,279,355
Total nondepreciable capital assets	2,467,616	814,012	(334,377)	2,947,251
Depreciable capital assets:				
Buildings	83,358,653	712,039	-	84,070,692
Land improvements	2,147,453	74,702	-	2,222,155
Equipment	9,077,114	751,844	(754,957)	9,074,001
Library books	9,144,705	221,408	(40,592)	9,325,521
Total depreciable capital assets	103,727,925	1,759,993	(795,549)	104,692,369
Less accumulated depreciation for:				
Buildings	41,353,040	1,735,379	-	43,088,419
Land improvements	1,033,789	113,635	-	1,147,424
Equipment	4,629,965	715,066	(348,245)	4,996,786
Library books	7,755,265	238,280	(40,592)	7,952,953
Total accumulated depreciation	54,772,059	2,802,361	(388,837)	57,185,582
Depreciable capital assets	48,955,866	(1,042,368)	(406,712)	47,506,787
Total capital assets, net	$ 51,423,482	$ (228,355)	$(741,089)	$ 50,454,038

7. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

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

	2003	2002
Employee salaries, wages, and benefits payable	$2,321,277	$2,235,687
Vendors and supplies accounts payable	524,828	564,443
Accrued interest payable	94,394	22,802
Other accrued liabilities	42,759	7,533
Total accounts payable and accrued liabilities	$2,983,258	$2,830,465

8. NONCURRENT LIABILITIES

The Institute's long-term liabilities primarily consist of long-term debt (further described in Note 9) and accrued compensated absences. A summary of changes in long-term liabilities for the years ending June 30, 2003 and 2002, is presented as follows:

	Beginning Balance July 1, 2002	Additions	Reductions	Ending Balance	Current Portion June 30, 2003
Long-term debt:					
Notes payable	$1,790,000	$4,612,877	$ (242,644)	$6,160,233	$235,000
Capital leases	97,747	-	(83,662)	14,085	5,885
Installment purchases	38,302	-	(12,761)	25,541	10,216
Total long-term debt	1,926,049	4,612,877	(339,067)	6,199,859	251,101
Accrued compensated absences	1,168,438	817,005	(750,024)	1,235,419	640,409
Total long-term liabilities	$3,094,487	$5,429,882	$(1,089,091)	$7,435,278	$891,510

	Beginning Balance July 1, 2001	Additions	Reductions	Ending Balance	Current Portion June 30, 2002
Long-term debt:					
Bonds payable	$ 409,489	$ -	$ (409,489)	$ -	$ -
Notes payable	2,010,000	-	(220,000)	1,790,000	230,000
Capital leases	287,344	25,948	(215,545)	97,747	83,662
Installment purchases	60,628	-	(22,326)	38,302	12,761
Total long-term debt	2,767,461	25,948	(867,360)	1,926,049	326,423
Accrued compensated absences	1,147,466	795,809	(774,837)	1,168,438	682,396
Total long-term liabilities	$3,914,927	$821,757	$(1,642,197)	$3,094,487	$1,008,819

9. LONG-TERM INDEBTEDNESS

Notes payable are debt obligations between the Virginia College Building Authority (VCBA) and the Institute. VCBA issues bonds through the Pooled Bond Program and uses the proceeds to purchase debt obligations (notes) of the Institute. The barracks wiring and Jackson Memorial Hall renovation notes are secured by funds paid by the VMI Foundation, Inc., on a year-to-year basis as a gift to the Institute. Should the gift be discontinued, repayment will be made from the general revenues of the Institute. The Cocke Hall Annex note will be paid from auxiliary reserve funds, which consist predominantly of cadet fees.

	Interest Rates (%)	Maturity	2003	2002
Revenue bonds 9(d):				
Barracks wiring, Series 1998A	3.70 – 4.10	2008	$1,560,000	$1,790,000
Cocke Hall annex, Series 2002A	4.00 – 5.25	2022	2,136,642	-
J.M. Hall renovation, Series 2002A	4.00 – 5.25	2022	2,463,592	-
Total notes payable			$6,160,234	$1,790,000

Maturities of notes payable for years succeeding June 30, 2003, are as follows:

Year	Notes Payable
2004	$ 235,000
2005	385,000
2006	405,000
2007	425,000
2008	440,000
2009-2013	1,240,000
2014-2018	1,225,000
2019-2023	1,565,000
Plus: Unamortized premium	240,234
Total future principal requirements	$6,160,234

Installment Purchase Obligations

The Institute has future obligations under installment purchase agreements. The book value of the assets capitalized under these installment purchase agreements is $51,080 with no interest. A summary of future obligations under these agreements as of June 30, 2003, follows:

Year Ending June 30,	Principal	Interest	Total
2004	$10,216	$ -	$10,216
2005	10,216	-	10,216
2006	5,109	-	5,109
Total	$25,541	$ -	$25,541

Capital Leases Payable

VMI is the lessee of equipment under capital leases expiring in various years through 2005. The assets under capital leases are recorded as property, plant, and equipment at the lower of the net present value of the minimum lease payments during the lease term or the fair market value of the asset.

VMI received allocations made by the Virginia College Building Authority from the Higher Education Equipment Trust Fund for the purpose of acquiring equipment under leasing agreements with the Authority.

For all capital leases, the minimum lease payments together with the present value of the net minimum lease payments as of June 30, 2003, are as follows:

Year Ending June 30,	Other Capital Leases
2004	$ 9,960
2005	8,916
2006	3,280
Total minimum lease payments	22,156
Less: Executory costs	6,364
Interest	1,707
Present value of net minimum lease payments	$14,085

Interest rates on capitalized leases vary from 5.5 percent to 6.75 percent.

Equipment Trust Fund

The Equipment Trust Fund (ETF) program was established to provide state-supported institutions of higher education bond proceeds for financing the acquisition and replacement of instructional and research equipment. The Virginia College Building Authority (VCBA) manages the program. VCBA issues bonds and uses the proceeds to reimburse the Institute and other institutions of higher education for equipment purchased. For fiscal years prior to 1999, VCBA purchased the equipment and leased it to the Institute. For fiscal years 1999 and following, financing agreements for ETF were changed so that the Institute now owns the equipment from the date of purchase.

The Statement of Net Assets line "Due from the Commonwealth of Virginia" totaling $32,780 includes $29,492 for equipment purchased by the Institute that was not reimbursed by VCBA as of June 30, 2003.

Operating Leases

VMI is committed under various operating leases for equipment. Operating leases do not give rise to property rights or lease obligations and therefore, the results of the lease agreements are not reflected in the Institute's Statement of Net Assets. In general, the leases are for a three year term and the Institute has renewal options. In most cases, the Institute expects these leases will be replaced by similar leases in the normal course of business. Rental expense was approximately $98,466 for the year ended June 30, 2003.

Year Ending June 30,	Amount
2004	$ 72,271
2005	42,653
2006	23,400
2007	12,577
2008	4,320
Total	$155,221

10. RETAINAGE PAYABLE

At June 30, 2003, $37,224 was held by the Institute as retainage on various contracts for work which had been performed. The retainage will be remitted to the various contractors upon satisfactory completion of the projects. At June 30, 2002, the Institute reflected $27,338 as retainage payable.

11. EXPENSES BY NATURAL CLASSIFICATION

The Institute's operating expenses by natural classification were as follows:

Year Ended June 30, 2003

Program	Personal Services	Supplies	Contractual Services	Equipment	Utilities	Student Aid	Other Operating Expense	Depreciation Expense	Total
Instruction	$10,696,006	$ 325,839	$ 674,301	$ 264,071	$ -	$ -	$ 62,197	$ 909,237	$12,931,651
Research	172,428	26,927	52,884	108	-	-	36,094	28,146	316,587
Public service	525,673	161,984	291,295	10,597	-	-	1,044	35,541	1,026,134
Academic support	3,045,947	106,842	884,276	421,140	-	-	160,290	641,887	5,260,382
Student services	1,679,999	168,631	539,827	55,580	-	-	94,712	209,230	2,747,980
Institutional support	2,332,315	92,626	724,281	65,289	6,827	-	112,209	83,624	3,417,171
Operation and maintenance of plant	1,666,411	449,498	461,861	2,901	500,545	-	101,363	226,708	3,409,286
Student aid	1,121	3,090	37,485	-	-	731,016	-	-	772,712
Auxiliary enterprises	3,351,456	341,860	4,918,481	222,541	263,406	-	2,644,665	523,168	12,265,577
Unique military activities	2,482,529	676,191	97,211	57,313	-	-	436,299	157,745	3,907,288
Total	$25,953,885	$2,353,488	$8,681,902	$1,099,540	$770,778	$731,016	$3,648,873	$2,815,286	$46,054,768

Year Ended June 30, 2002

Program	Personal Services	Supplies	Contractual Services	Equipment	Utilities	Student Aid	Other Operating Expense	Depreciation Expense	Total
Instruction	$10,428,936	$ 280,970	$ 530,907	$ 64,743	$ -	$ -	$ 60,404	$ 921,113	$12,287,073
Research	86,425	24,005	23,845	2,552	-	-	13,039	-	149,866
Public service	595,041	188,112	292,483	10,163	-	-	2,629	36,892	1,125,320
Academic support	2,669,792	94,405	637,702	288,878	-	-	157,858	677,501	4,526,136
Student services	1,387,968	143,302	818,524	52,702	-	-	118,944	202,181	2,723,621
Institutional support	2,488,680	140,804	904,945	130,439	6,979	-	201,177	81,597	3,954,621
Operation and maintenance of plant	2,159,510	406,036	-	71,466	560,215	-	88,588	168,172	3,453,987
Student aid	24,670	1,714	32,652	12	-	679,580	4,817	-	743,445
Auxiliary enterprises	3,128,469	531,076	4,290,773	308,354	233,448	-	2,154,476	547,900	11,194,496
Unique military activities	2,392,445	116,375	65,763	27,488	-	-	433,834	167,005	3,202,910
Other operating expenditures	-	-	-	-	-	2,298	-	-	2,298
Total	$25,361,936	$1,926,799	$7,597,594	$956,797	$800,642	$681,878	$3,235,766	$2,802,361	$43,363,773

12. STATE APPROPRIATIONS

Virginia Military Institute receives state appropriations from the General Fund of the Commonwealth of Virginia. The Appropriation Act specifies that such unexpended appropriations shall revert, as specifically provided by the General Assembly, at the end of the biennium. For years ending at the middle of the biennium, unexpended appropriations that have not been approved for reappropriation in the next year by the Governor become part of the General Fund of the Commonwealth and are, therefore, no longer available to VMI for disbursement. Fiscal year 2003 is the first year of the 2002-2004 biennium.

During the fiscal years ended June 30, 2003 and 2002, the Institute received the following supplemental appropriations and reversions in accordance with the Appropriation Act:

	2003	2002
Original legislative appropriation:		
Educational and general programs	$ 9,878,630	$11,018,318
Unique military activity	4,150,853	4,150,853
Student financial assistance	540,596	519,851
Adjustments:		
Prior year balance adjustment	-	686,267
Mandated budget reductions	(478,443)	(331,165)
Additional budget reductions	-	(786,267)
Salary adjustments	345,354	31,868
Fringe benefit adjustments	(350,768)	(271,456)
Airline ticket savings	(4,639)	-
e-Procurement savings	(16,039)	-
Insurance premium adjustments	-	(6,095)
Utility adjustments	-	(12,212)
ETF lease payment – NGF portion	(22,690)	(22,690)
Appropriation transfers:		
Authorized FY 04 transfer - E&G	(150,000)	-
SCHEV programs	23,258	51,408
Virginia Tech	(1,199,503)	(1,305,300)
Virginia Tech – Reversion	-	(34,000)
Virginia Tech – Budget reduction	(139,797)	-
Mary Baldwin – Reversion	-	(228,000)
Mary Baldwin – Budget reduction	(23,799)	-
Adjusted Appropriations	$12,553,013	$13,461,380

13. RETIREMENT AND PENSION SYSTEMS

Employees of the Institute are employees of the Commonwealth of Virginia. Most full-time classified salaried employees of the Institute participate in the defined benefit retirement plan administered by the Virginia Retirement System (VRS). The Institute post police officers participate in the Virginia Law Officers Retirement System (VaLORS) instead of VRS. Both VRS and VaLORS are agent multiple-employer public employee retirement systems (PERS) that acts as a common investment and administrative agency for the Commonwealth of Virginia and its political subdivisions.

The Institute’s payroll costs for employees covered by VRS were $11,826,657 and $11,898,707 for the years ended June 30, 2003 and 2002, respectively. The Institute’s total payroll costs were $22,420,909 and $21,301,245 for the years ended June 30, 2003 and 2002, respectively.

Information regarding types of employees covered, benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions, as well as employer and employee obligations to contribute are established can be found in the Commonwealth’s Comprehensive Annual Financial Report (CAFR).

The Institute’s total VRS contribution was $716,709 and $970,759 for the years ended June 30, 2003 and 2002, respectively, which included the five percent employee contribution assumed by the employer. These contributions represent 6.07 percent and 5.83 percent of covered payrolls for 2003 and 2002, respectively.

The Institute’s payroll costs for employees covered by VaLORS were $182,275 and $189,729 for the years ended June 30, 2003 and 2002, respectively. The Institute’s total VaLORS contributions were $32,601 and $29,171 for the years ended June 30, 2003 and 2002, respectively, which represents 18.42 percent and 6.10 percent of the covered payrolls for fiscal years 2003 and 2002.

VRS does not measure assets and pension benefit obligations separately for individual state institutions. The CAFR provides disclosure of the Commonwealth’s unfunded pension benefit obligation at June 30, 2003. The same report contains historical trend information showing VRS’s progress in accumulating sufficient assets to pay benefits when due.

TIAA/CREF Insurance Company ORP

Some full-time faculty and contracted administrative staff participate in a retirement annuity program through TIAA/CREF Insurance Companies rather than the VRS. This is a fixed-contribution program where the retirement benefits received are based entirely upon the employer’s (10.4 percent) contributions, plus interest and dividends, with the employer assuming the employee’s contribution share.

Individual contracts issued under the plan provide for full and immediate vesting of both the Institute’s and the employees’ contributions. Total pension costs under this plan were approximately $508,684 and $461,640 for years ended June 30, 2003 and 2002, respectively. Contributions to the TIAA/CREF Insurance Companies were calculated using the base salary amount of approximately $4,891,190 and $4,438,836 for fiscal years 2003 and 2002, respectively.

Other Defined Contribution Pension Plans

The Institute also contributes to four other defined contribution pension plans, which are insignificant in relation to VRS and TIAA/CREF. Full-time faculty, certain administrative staff who hold academic rank, and athletic coaches are eligible to participate in several optional retirement programs (ORP) other than VRS and TIAA/CREF. Retirement benefits received are based entirely upon the employer’s (10.4 percent) contributions, plus interest and dividends, with the employer assuming the employee’s contribution share.

Amounts contributed to VALIC were calculated using the base salary amount of approximately $298,926 and $246,186 for fiscal years ended June 30, 2003 and 2002, respectively. Total pension costs under this plan were approximately $31,088 and $25,603 for fiscal years 2003 and 2002, respectively.

Amounts contributed to Fidelity Investments were calculated using the base salary amount of approximately $493,069 and $541,044 for fiscal years ended June 30, 2003 and 2002, respectively. Total pension costs under this plan were approximately $51,279 and $56,269 for fiscal years 2003 and 2002, respectively.

Amounts contributed to T. Rowe Price were calculated using the base salary amount of approximately $387,928 and $409,886 for fiscal years ended June 30, 2003 and 2002, respectively. Total pension costs under this plan were approximately $40,345 and $42,628 for fiscal years 2003 and 2002, respectively.

Amounts contributed to Met Life were calculated using the base salary amount of approximately $67,408 and $45,370 for the fiscal years ended June 30, 2003 and 2002, respectively. Total pension costs under this plan were approximately $7,011 and $4,718 for fiscal years 2003 and 2002, respectively.

14. POST-EMPLOYEMENT BENEFITS

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

15. RISK MANAGEMENT

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

16. CONTINGENCIES

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

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

17. PENDING GOVERNMENTAL ACCOUNTING STANDARDS BOARD STATEMENT

Governmental Accounting Standards Board Statement 39, *Determining Whether Certain Organizations Are Component Units*, issued May 2002, will be effective for the fiscal year ending June 30, 2004. This statement provides additional guidance to determine whether certain organizations for which the Institute is not financially accountable should be reported as component units. Generally, it requires reporting as a component unit, an organization that raises and holds economic resources for the direct benefit of the Institute. As a result, the Institute will be required under GASB Statement 39 to include selected foundations in the body of its financial statements. The Institute has determined that the VMI Alumni Association, the VMI Foundation, Inc., the VMI Development Board, Inc., the VMI Keydet Club, Inc., and the VMI Research Laboratories, Inc., should be included as component units.

18. SUBSEQUENT EVENTS

Effective December 12, 2003, the Institute obtained a Treasury Loan in the amount of $10 million for a term of 12 months in order to provide cash for the payment of obligations incurred prior to the sale of 9(c) revenue bonds for the renovation and enlargement of Crozet Hall and parking.

VIRGINIA MILITARY INSTITUTE
STATEMENT OF OPERATIONS - AUXILIARY ENTERPRISES
For the Year Ended June 30, 2003

	Food Services	Residential Facilities	Laundry
Operating revenues:			
Cadet fees	$ 3,162,364	$ 1,399,575	$ 197,769
Sales and services	244,135	300,304	-
Total operating revenues per SRECNA	3,406,499	1,699,879	197,769
Federal funds-Work study	-	-	-
Add back items netted on SRECNA:			
Scholarship allowances for auxiliary fees	1,309,195	574,515	84,297
Auxiliary sales to other Institute departments	-	57,140	3,462
Total operating revenues	4,715,694	2,331,534	285,528
Operating expenditures:			
Personal services	-	398,795	156,628
Supplies and materials	24,067	104,697	16,206
Equipment	614	76,416	-
Contractual services	3,377,964	378,839	-
Continuous charges	576,282	1,273,305	24,594
Cost of goods sold	-	-	-
Depreciation expense	27,895	102,633	8,210
Total operating expenses per SRECNA	4,006,822	2,334,685	205,638
Add back items netted on SRECNA:			
Expenses for auxiliary sales to Institute departments	-	57,140	3,462
Depreciation expense	(27,895)	(102,633)	(8,210)
Total operating expenses	3,978,927	2,289,192	200,890
Net income (loss) from operations	736,767	42,342	84,638
Nonoperating revenues (expenses):			
Investment income	-	-	-
Gifts	-	-	-
Net nonoperating revenues (expenses)	-	-	-
Net income (loss) before transfers	736,767	42,342	84,638
Transfers: Nonmandatory			
Transfers (to)/from endowment	-	-	-
Transfers (to)/from net invested in plant	(16,194)	(20,839)	-
Transfers (to)/from retirement of indebtedness	-	-	-
Transfers (to)/from renewals and replacements	-	-	-
Transfers (to)/from unrestricted	-	19,912	-
Net increase (decrease) for the year	$ 720,573	$ 41,415	$ 84,638
Fund balance at beginning of year			
Fund balance at end of year			

A These expenditures are related to the Auxiliary Administration account and the Auxiliary Contingency account and are not identified with a specific auxiliary.

B Interest earned on the auxiliary reserve cash balance at the Commonwealth, not allocable to any particular auxiliary enterprise.

Student Health	Stores and Shops	Student Union	Parking	Cameron Hall	Athletics	Other	Total
$ 137,504	$ 81,177	$ 556,033	$ -	$ 186,160	$ 1,059,806	$ -	$ 6,780,388
-	30,117	278	8,910	1,250	522,999	844	1,108,837
137,504	111,294	556,311	8,910	187,410	1,582,805	844	7,889,225
495	-	4,210	-	-	-	-	4,705
56,414	34,367	237,976	-	79,758	453,906	-	2,830,428
-	1,025	-	-	-	-	-	61,627
194,413	146,686	798,497	8,910	267,168	2,036,711	844	10,785,985
129,753	2,484	157,492	-	71,236	2,228,065	207,003	3,351,456
10,922	-	50,679	-	8,332	87,200	3,825	305,928
2,443	-	43,465	-	-	98,991	612	222,541
10,935	56,826	254,239	-	22,958	790,275	26,445	4,918,481
16,239	12,999	276,045	-	121,273	605,729	1,605	2,908,071
-	35,932	-	-	-	-	-	35,932
2,232	13,782	73,267	6,580	30,789	242,586	15,194	523,168
172,524	122,023	855,187	6,580	254,588	4,052,846	254,684	12,265,577
-	1,025	-	-	-	-	-	61,627
(2,232)	(13,782)	(73,267)	(6,580)	(30,789)	(242,586)	(15,194)	(523,168)
170,292	109,266	781,920	-	223,799	3,810,260	239,490	11,804,036
24,121	37,420	16,577	8,910	43,369	(1,773,549)	(238,646)	(1,018,051)
-	-	-	-	-	-	170,673	170,673
6,945	-	11,066	-	-	1,390,179	-	1,408,190
6,945	-	11,066	-	-	1,390,179	170,673	1,578,863
31,066	37,420	27,643	8,910	43,369	(383,370)	(67,973)	560,812
-	(380,000)	-	-	-	140,000	-	(240,000)
-	-	-	-	(37,214)	(76,594)	-	(150,841)
-	-	(6,360)	-	-	-	(33,050)	(39,410)
-	-	-	-	-	-	(500,000)	(500,000)
-	-	-	-	-	112,798	(15,440)	117,270
$ 31,066	$ (342,580)	$ 21,283	$ 8,910	$ 6,155	$ (207,166)	$ (616,463)	(252,169)
							3,881,730
							$ 3,629,561

VIRGINIA MILITARY INSTITUTE
Lexington, Virginia

BOARD OF VISITORS
As of June 30, 2003

ADMINISTRATIVE OFFICERS

Brigadier General Robert L. Green, Acting Superintendent