VIRGINIA COLLEGE SAVINGS PLAN

RICHMOND, VIRGINIA

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2002

Auditor of Public Accounts
COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the Virginia College Savings Plan for the year ended June 30, 2002, found:

- the financial statements are presented fairly in accordance with generally accepted accounting principles;
- reportable conditions in the internal control over financial reporting; however, we do not consider the findings to be material weaknesses; and
- no instances of noncompliance that are required to be reported.

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Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

December 13, 2002

The Honorable Mark R. Warner
Governor of Virginia

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

Board Members
Virginia College Savings Plan

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

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the enterprise fund, which is a major fund, and the private-purpose trust funds of the Virginia College Savings Plan (Plan) as of and for the year ended June 30, 2002, which collectively comprise the Plan's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Plan's management. Our responsibility is to express opinions 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 opinions.

As discussed in Note 1, the basic financial statements of the Plan are intended to present the financial position and the changes in financial position and cash flows of only that portion of the business-type activities, major enterprise fund, and aggregate remaining fund information of the Commonwealth of Virginia that is attributable to the transactions of the Plan. They do not purport to, and do not, present fairly the Commonwealth of Virginia's overall financial position as of June 30, 2002, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the enterprise fund and private-purpose trust funds of the Virginia College Savings Plan as of June 30, 2002, and the respective changes in its financial position and its cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 12, the Plan has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, as of June 30, 2002.

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

In planning and performing our audit of the financial statements of the Virginia College Savings Plan as of and for the year ended June 30, 2002, we considered internal controls over financial reporting and tested compliance with certain provisions of laws, regulations, and contracts, 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 Plan's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, 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 Plan'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 assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Plan's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are discussed in the section titled "Internal Control Findings and Recommendations."

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected 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 are material weaknesses.

Status of Prior Findings

The Plan has not taken adequate corrective action with respect to the previously reported findings "Develop Comprehensive Policies and Procedures Manual" and "Ensure Timely Completion of Actuarial Valuation," which is now included in the finding titled "Improve Timeliness of Financial Reporting." Accordingly, we included these findings in the section entitled "Internal Control Findings and Recommendations." The Plan has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

Report Distribution and Exit Conference

The "Independent Auditor's Report on Compliance and Internal Control Over Financial Reporting" is intended solely for the information and use of the Governor and General Assembly of Virginia, the Board members 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 public record and its distribution is not limited.

We discussed this report with management at an exit conference held on January 22, 2003.

AUDITOR OF PUBLIC ACCOUNTS

SAH:whb
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INTERNAL CONTROL FINDINGS AND RECOMMENDATIONS

Transitioning Board Governance

The Virginia College Savings Plan (Plan) is a relatively new organization that has been in existence since 1995. Both management and the Board have concentrated on getting various programs up and running and responding to new state and federal legislation, which has occurred almost every year since the start of the Plan. Management and the Board need to continue their transition from the initiation of the Plan to a mature organization. This transition includes continuing to move towards an anticipatory rather than reactive approach to operations.

In making the transition, management and especially the Board need to continue their current efforts to develop a process that involves both management and the Board in the policy setting, planning, and oversight functions. Additionally, the Board should set forth its expectation of management and the information and policies it needs to review to exercise its oversight responsibilities.

The Board should enhance its committee structure to address the key components of the Plan's operations and should continue to refine and review the function, roles, and responsibilities of each committee. The enhancement of standing committees will provide the Board with a framework for making decisions that have a significant impact on the Plan. How the Board enhances its committees, whether by subject matter or operational function, is not as important as making sure the Board sets a structure that provides both the committees and the Board with information in the following key areas.

- Investment Management – The Board should use its Investment Committee as a model when considering how to establish other committees. The Investment Committee should continue to regularly receive information concerning investment performance and activity that allows it to monitor investments within the guidelines and policies established by the Board. The Committee's ongoing review determines if its investment guidelines and policies require revision. The Board should work with the Committee to determine what type of information it needs to make decisions.

- Actuarial Assumptions and Contract Pricing – The Board should consider establishing an anticipated schedule that allows for the receipt of all key information from the actuary, financial reporting, marketing and other external groups deemed necessary to evaluate, consider, and decide on the appropriate pricing of contracts. In order to achieve this objective the Board will need to continue working with management and its outside consultants to ensure that all parties understand their duties and responsibilities in providing the Board information. The Board should clearly articulate its needs and hold all parties accountable for providing timely information.

- Financial Performance, Budgetary, and Other Monitoring – The Board needs to review periodically its requirements for information including the frequency, format, and content of the reports it expects from management and others. Some of the information requirements may be as basic as monthly budget versus actual spending reports or as complex as actuarial information and its impact on pricing considerations. The Board should continue to examine what it considers necessary to make sound business decisions and then assure themselves that management has complied with their needs. The Board should recognize that over time these baseline information requirements will change to meet changing needs.

The Board, as part of its regular meeting schedule, should arrange to have those individuals and organizations that support the Plan to discuss their progress in meeting the Board's objectives and goals. Clearly, the Board does meet with the actuary and investment consultant, but this schedule should also include the external auditor and other experts the Board thinks can assist them in performing their oversight responsibilities.

The items above are a partial list of items that the Board may wish to consider and review. None of these suggestions are a reflection on the current Board or management, but are an indication of the need to continue the transition into an organizational approach to issues and other considerations facing the Board.

Improve Timeliness of Financial Reporting

Management and the Board need to recognize the necessity of having timely financial statements and related fiscal information, when considering the pricing of contracts. A key component of both the financial statements and the pricing is the actuarial valuation. The actuarial valuation is a key factor in measuring historical performance and determining the Plan's future needs to fund contracts.

In addition to management and the Board's need for timely financial statements, the Plan is a critical component of the Commonwealth of Virginia's Comprehensive Annual Financial Report (CAFR). The proper and timely preparation and inclusion of all critical components of the Commonwealth in the CAFR is essential in the Commonwealth maintaining its Triple A bond rating. An opinion qualification resulting from the exclusion of a critical component such as the Plan could jeopardize the bond rating.

It has historically taken the Plan's Director of Finance between four to five months to complete the statements, although the Plan must submit financial statements including footnotes to the Department of Accounts within 60 days of fiscal year-end. One of the limitations in the current financial reporting process is the receipt of the actuarial valuation which, according to the current contract, the actuary must complete by September 1.

The actuary did not provide the final valuation until January 2003. The actuary did provide preliminary valuation amounts to the Plan on October 29 and a draft of the valuation report on November 15, which was earlier than previous years. The Plan worked more closely with the actuaries during the past year to provide the actuary with information needed to perform the valuation. However, the Plan needs to continue to work with the actuary, as well as other external parties involved in the valuation process, to ensure completion of the final valuation report by the contractual deadline.

The second limitation to the timely preparation of financial statements is the commitment of sufficient resources to complete the financial statements. Currently, the Director of Finance prepares the financial statements and attempts to perform all her other duties. As a result, the Director of Finance did not complete the statements until November, which was three months after the Department of Accounts deadline.

The Plan provided the Department of Accounts preliminary financial statements only within the 60 days allowed, however, these statements did not include footnotes and required several material adjustments to properly show the Plan's financial condition. Further, the Plan could not provide support for the amounts on these statements at the time of submission. For fiscal year 2003, the Plan has hired additional staff that will be available at year-end to assist in the accumulation of data and preparation of financial statements.

The final limitation in the financial reporting process is the Plan's use of the Commonwealth's statewide accounting system. In order to facilitate timely reporting, the Plan is implementing its own accounting system, rather than relying on the statewide accounting system, which will better accommodate the nature of the Plan's complex transactions. In addition, this new system will eliminate double keying of accounting data, providing additional staff hours to assist in the preparation of financial statements. By completing implementation within the next year, the Plan will eliminate inefficiencies in its current operations and gain more flexibility for obtaining relevant and timely financial data.

Develop Operating Policies and Procedures Manual

The Plan administers three programs that require the processing of numerous complex accounting and other information transactions. While the Plan has documented some policies and procedures in the form of "desk procedures," the Plan lacks a comprehensive document that includes all processes, manual and automated, necessary to administer its programs.

Documenting critical operating policies and procedures will ensure the continuity of operations in the event of the loss of key personnel. It is important that management take a proactive approach in developing policies and procedures for each program and activity of the agency. Having these policies will assist management in ensuring uniformity and consistency in day-to-day operations, analyzing performance, and recording transactions in the records management and accounting systems.

As recommended in the two previous audit reports, management should develop a comprehensive operating policies and procedures manual. This manual should also address the following activities.

Reconciliation procedures – The Plan is enhancing its procedures for reconciling activity in the records management system to the Commonwealth Accounting and Reporting System (CARS). Management should document these reconciliation procedures, as well as its procedures for reconciling the records of its external investment managers and Master Custodian.

Financial analysis and forecasting – Management should document procedures for analyzing the financial performance of each program and the administrative costs for operating the programs.

Recording financial transactions – Management should complete documentation of its procedures for recording financial transactions in CARS and for financial reporting purposes.

Contract management policies and procedures - Management should document standard procedures for entering into contracts, monitoring contract performance, contract record keeping, and the renewal of contracts.

Information technology policies and procedures – Management has documented some of its policies and procedures related to information technology. However, management should strengthen its documentation related to access controls and controls over its production network.

Since its inception eight years ago, the Plan has undergone significant changes from enhancements to its programs, the introduction of new programs, and changes imposed by new federal tax laws, regulations, and requirements. These changes, along with the increased workload of staff, have prevented the Plan from completing the development of formal policies and procedures. With the addition of new staff members in the past few years, the Plan has cross-trained and spread crucial knowledge across a larger number of employees decreasing the risk of a disruption in operations in the event of an unexpected loss of personnel. In addition, in the past year the Plan has continued to develop "desk procedures" for its critical operations. However, as noted above, the time has come for management to transition from the initiation of the Plan to a mature organization and the completion of an operating policies and procedures manual is a necessary step in this process.

FINANCIAL STATEMENTS

VIRGINIA COLLEGE SAVINGS PLAN
STATEMENT OF NET ASSETS - ENTERPRISE FUND
VIRGINIA PREPAID EDUCATION PROGRAM
As of June 30, 2002

ASSETS	
Current assets:	
Cash and ash equivalents (Note 1D)	$ 41,712,051
Investments held by treasurer (Note 3)	570,984
Interest receivable	1,681,223
Accounts receivable (Note 1F)	200,806
Total current assets	44,165,064
Noncurrent assets:	
Investments (Note 1D and 2)	398,951,866
Tuition benefits receivable (Note 1E)	281,977,291
Depreciable capital assets, net (Note 1G and 5)	212,322
Total noncurrent assets	681,141,479
Total assets	725,306,543
LIABILITIES	
Current liabilities:	
Accounts payable	501,324
Due to program participants, escrows, and providers (Note 1H)	65,388
Obligations under securities lending (Note 3)	627,455
Tuition benefits payable (Note 4 and 7)	20,300,000
Compensated absences (Note 1I and 4)	21,546
Total current liabilities	21,515,713
Noncurrent liabilities:	
Tuition benefits payable (Note 4 and 7)	761,527,291
Compensated absences (Note 1I and 4)	179,890
Total noncurrent liabilities	761,707,181
Total liabilities	783,222,894
NET ASSETS	
Unrestricted (Note 8)	(57,916,351)
Total net assets	$ (57,916,351)

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

VIRGINIA COLLEGE SAVINGS PLAN
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
ENTERPRISE FUND - VIRGINIA PREPAID EDUCATION PROGRAM
For the Fiscal Year Ended June 30, 2002

Operating revenues:	
Charges for sales and services	$ 2,408,839
Interest, dividends, rents and other investment income	18,745,284
Net decrease in fair value of investments	(24,373,624)
Tuition contributions	86,232,619
Actuarial tuition contributions	76,507,531
Other	208
Total operating revenues	159,520,857
Operating expenses:	
Personal services	2,261,068
Contractual services	3,262,624
Supplies and materials	59,792
Depreciation	44,693
Rent, insurance, and other related charges	157,432
Tuition benefits expense	2,028,023
Actuarial tuition benefits expense	250,857,531
Expendable equipment	25,660
Other	120,865
Total operating expenses	258,817,688
Operating income (loss)	(99,296,831)
Transfers:	
Transfers to the General Fund of the Commonwealth	(73,243)
Change in net assets	(99,370,074)
Net assets - July 1, 2001	41,453,723
Net assets - June 30, 2002	$ (57,916,351)

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

VIRGINIA COLLEGE SAVINGS PLAN
STATEMENT OF CASH FLOWS - ENTERPRISE FUND
VIRGINIA PREPAID EDUCATION PROGRAM
For the Fiscal Year Ended June 30, 2002

Cash flows from operating activities:	
Receipts for sales and services	$ 2,113,612
Internal activity - payments to other funds	(380,616)
Payments to suppliers for goods and services	(94,337)
Payments to employees	(2,123,684)
Contributions received	86,202,380
Other operating revenue	208
Payments for contractual services	(2,783,771)
Tuition benefit payments	(2,028,023)
Other operating payments	(6,250)
Net cash provided by (used for) operating activities	80,899,519
Cash flows from noncapital financing activities:	
Transfer to the General Fund of the Commonwealth	(73,243)
Net cash provided by (used for) noncapital financing activities	(73,243)
Cash flows from capital and related financing activities:	
Acquisition of fixed assets	(139,161)
Net cash provided by (used for) capital & related financing activities	(139,161)
Cash flows from investing activities:	
Purchase of investments	(1,264,484,017)
Proceeds from sales or maturities of investments	1,098,696,041
Interest income on cash, cash equivalents, and investments	18,177,773
Net cash provided by (used for) investing activities	(147,610,203)
Net increase (decrease) in cash and cash equivalents	(66,923,088)
Cash and cash equivalents - July 1, 2001, as restated (Note 9)	108,635,139
Cash and cash equivalents - June 30, 2002	$ 41,712,051

VIRGINIA COLLEGE SAVINGS PLAN
STATEMENT OF CASH FLOWS - ENTERPRISE FUND
VIRGINIA PREPAID EDUCATION PROGRAM (continued)
For the Fiscal Year Ended June 30, 2002

Reconciliation of operating income to net cash provided by operating activities:	
Operating income (loss)	$ (99,296,831)
Adjustments to reconcile operating income to net cash provided by (used for) operating activities:	
Depreciation	44,693
Interest, dividends, rents and other investment income	(18,304,272)
Net decrease in fair value of investments	24,373,624
Changes in assets & liabilities:	
(Increase) decrease in receivables	(472,786)
(Increase) decrease in tuition receivable	(76,507,531)
Increase (decrease) in accounts payable	164,905
Increase (decrease) in amounts due to program participants	(23,852)
Increase (decrease) in current tuition benefits payable	20,300,000
Increase (decrease) in current compensated absences	21,546
Increase (decrease) in noncurrent tuition benefits payable	230,557,531
Increase (decrease) in noncurrent compensated absences	42,492
Net cash provided by (used for) operating activities	$ 80,899,519

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

VIRGINIA COLLEGE SAVINGS PLAN
STATEMENT OF FIDUCIARY NET ASSETS -
PRIVATE-PURPOSE TRUST FUNDS
As of June 30, 2002

	Virginia Education Savings Trust	CollegeAmerica	Total
Assets:			
Cash and cash equivalents (Note 1D)	$ 4,570,427	$ -	$ 4,570,427
Receivables:			
Interest and dividends	180,119	-	180,119
Investments: (Note 1D and 2)			
Mutual funds	66,909,552	1,012,267,452	1,079,177,004
Index funds	39,142,446	-	39,142,446
Guaranteed investment contracts	24,759,442	-	24,759,442
Common stock	14,661,479	-	14,661,479
Total investments	145,472,919	1,012,267,452	1,157,740,371
Total assets	150,223,465	1,012,267,452	1,162,490,917
Liabilities:			
Due to program participants, escrows, and providers (Note 1H)	72,653	-	72,653
Total liabilities	72,653	-	72,653
Net assets held in trust for program participants	$ 150,150,812	$ 1,012,267,452	$ 1,162,418,264

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

VIRGINIA COLLEGE SAVINGS PLAN
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS -
PRIVATE-PURPOSE TRUST FUNDS
For the Fiscal Year Ended June 30, 2002

	Virginia Education Savings Trust	CollegeAmerica	Total
Additions:			
Contributions:			
From participants	$ 101,488,505	$ 1,005,682,266	$ 1,107,170,771
Charges for services	707,040	-	707,040
Investment income:			
Net increase (decrease) in fair value of investments	(7,260,229)	15,200,582	7,940,353
Interest, dividends, and other investment income	4,832,369	3,509,188	8,341,557
Total investment income	(2,427,860)	18,709,770	16,281,910
Less investment expenses	(905,310)	(1,044,880)	(1,950,190)
Net investment income (loss)	(3,333,170)	17,664,890	14,331,720
Other	1,611	-	1,611
Total additions	98,863,986	1,023,347,156	1,122,211,142
Deductions:			
Tuition benefits paid	10,879,852	1,347,635	12,227,487
Shares redeemed	-	9,732,069	9,732,069
Other expenses	707,040	-	707,040
Total deductions	11,586,892	11,079,704	22,666,596
Net increase	87,277,094	1,012,267,452	1,099,544,546
Net assets held in trust for program participants:			
July 1, 2001 as restated (Note 9)	62,873,718	-	62,873,718
June 30, 2002	$ 150,150,812	$ 1,012,267,452	$ 1,162,418,264

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

NOTES TO FINANCIAL STATEMENTS

VIRGINIA COLLEGE SAVINGS PLAN

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2002

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Virginia College Savings Plan (the Plan), an independent agency of the Commonwealth of Virginia, was created in 1994 by the Virginia General Assembly and its enabling legislation is codified at §23-38.75 through §23-38.87 of the Code of Virginia, as amended. The Plan operates the Commonwealth's IRC §529 qualified tuition program, which offers three options, the Virginia Prepaid Education Program (VPEP), the Virginia Education Savings Trust (VEST), and CollegeAmerica.

VPEP is a defined benefit program, which offers contracts, for actuarially determined amounts, guaranteeing full future tuition and mandatory fee payments at State higher education institutions. The contract provisions also allow benefits to be used at private or out-of-state institutions with a payout based on the amounts charged by the State's higher education institutions. VPEP has a limited enrollment period each year, and is open to children in the ninth grade or younger if the child or participant is a Virginia resident. During the six enrollment periods to date, approximately 50,000 accounts have been opened, with contributions and net earnings of approximately $441 million as of June 30, 2002. The program invests contract payments to meet future obligations. Operating costs are paid from program earnings. The Plan does not receive any general fund appropriations. The program's assets and income are exempt from federal, state, and local income taxation. Legislation was passed in 1998 to provide a financial guarantee to cover VPEP contractual obligations in the event of a funding shortfall.

VEST is a defined contribution program, which allows participants of all ages to save for qualified higher education expenses, including tuition and fees, at any qualified higher education institution by making contributions into the investment portfolio(s) of their choice. Participants are allowed to select from among twelve investment portfolios. The VEST program, which is open year round, has no age or residency restrictions, and carries no legislative guarantee of return of principal. VEST accounts are subject to market investment risk, including the possible loss of principal. VEST began operation in December 1999. As of June 30, 2002, over 28,000 accounts have been opened with a net asset value of approximately $150 million. Investment management fees and VEST operating expenses are paid on a pro-rata basis by each VEST account owner and vary according to the portfolio selected. VEST accounts provide investors with the same federal and state tax benefits available to participants in the prepaid program.

In 2001, the Board of the Virginia College Savings Plan entered into a 15-year contract with Capital Research and Management Company, American Funds Distributors, Inc., and American Funds Service Company, Inc. (together, the American Funds) to administer a broker-sold IRC §529 college savings option using twenty-one of the American Funds. This new program, called CollegeAmerica, is a defined contribution plan which launched on February 15, 2002. The American Funds acts as program manager and provides all back office and operational activities for the program. As a result of this structure, the Plan's staff has minimal day-to-day administrative responsibility, other than program oversight and review.

Like VEST, CollegeAmerica allows participants of all ages to save for qualified higher education expenses by selecting from among the twenty-one offered funds. CollegeAmerica is available year round, has no age or residency restrictions, and carries no legislative guarantee of return of principal. Accounts are subject to market risk, including the possible loss of principal. As of June 30, 2002, approximately 143,000 unique accounts had been opened with net assets in excess of $1 billion. Fees and expenses of the program are also paid on a pro-rata basis by each account owner and vary according to the fund and share class selected. CollegeAmerica provides investors with the same federal and state tax benefits available to participants in VPEP and VEST.

An eight-member Board administers the Plan, consisting of four members who sit on the Board by virtue of the state offices they hold and four citizen members appointed by the Governor. The ex-officio members are the Director of the State Council of Higher Education for Virginia, the Chancellor of the Virginia Community College System, the State Treasurer, and the State Comptroller. State law mandates that the four citizen members have significant experience in finance, accounting, and investment management.

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 Plan is an integral part of the reporting entity of the Commonwealth of Virginia and is included in the general-purpose financial statements of the Commonwealth.

The following is a summary of significant accounting policies employed by the Virginia College Savings Plan.

A. Basis of Presentation

The accompanying financial statements have been prepared in conformance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Account Standards Board (GASB) and the Financial Accounting Standards Board (FASB).

B. Reporting Entity

The accompanying financial statements report the financial position, and the changes in financial position and cash flows of the Plan as of and for the fiscal year ended June 30, 2002. For financial reporting purposes, the Plan includes all funds and entities over which the Plan exercises or has the ability to exercise oversight authority.

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The Plan reports the activity of the Virginia Prepaid Education Program as an enterprise fund, which is a type of proprietary fund. Enterprise funds account for transactions related to resources received and used for financing self-supporting activities of the Plan that offer products and services on a user-charge basis to external users. All operating expenses and all administrative fee revenue collected to support Plan operations, including administrative revenue and expenses of VEST and CollegeAmerica, are reflected in the enterprise fund.

The Plan reports the activity of the Virginia Education Savings Trust and CollegeAmerica as private-purpose trust funds, which is a type of fiduciary fund. Private-purpose trust funds account for transactions of trust arrangements in which the principal and income benefit individuals, private organizations, or other governments.

The financial statements of the proprietary and fiduciary funds are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recognized when a liability is incurred, regardless of the timing of related cash flows.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating. The principal operating revenues of the Plan are tuition contributions for program participants and investment income. Operating expenses of the plan include tuition benefits expense and contractual and personal services.

GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, provides governments two options for using proprietary fund activities. All proprietary funds reported herein apply all applicable Governmental Accounting Standards Board pronouncements and all Financial Accounting Standards Board Statements and Interpretations, Accounting Principle Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, unless they conflict with or contradict GASB pronouncements.

D. Cash Equivalents and Investments

Money market investments of the Plan, which are deemed short-term, highly liquid investments, are reported at amortized cost. Long-term investments of the Plan are recorded at fair value based upon quoted market prices. Cash equivalents are investments with an original maturity of three months or less.

The Plan also participates in the Commonwealth's General Account pool, which is managed by the State Treasurer. These pooled investments are valued on an amortized cost basis. The Plan receives income on a quarterly basis from the Commonwealth based on the Plan's relative participation during the quarter. The Plan receives no additional distribution of unrealized gains or losses in the fair values of the pool's investments.

E. Tuition Contributions Receivable

Tuition contributions receivable represents the actuarially determined present value of future payments anticipated from contract holders.

F. Accounts Receivable

Accounts receivable represents the amount loaned by the Plan to the Virginia College Dream Foundation, a 501(c)(3) tax-exempt charitable foundation, for organizational startup.

The amount may be repaid from any unrestricted contributions to the Foundation. In addition, accounts receivable include the amount due from the American Funds for second quarter administrative fees collected on behalf of the Plan from the CollegeAmerica program. The American Funds pays the Plan an annual fee equal to one tenth of one percent (.10 percent) of the average daily net asset value of the underlying funds held in CollegeAmerica. This fee is accrued daily and paid to the Plan on a quarterly basis.

G. Property, Plant, and Equipment

Fixed assets are capitalized and depreciated on a straight-line basis over their useful lives. Fixed assets are valued at historical cost. The Plan capitalizes all property, plant, and equipment that have a cost or value greater than $5,000 and an expected useful life of greater than two years; however, all computer equipment is capitalized regardless of cost or value. Equipment currently owned by the Plan has an estimated useful life of five years.

H. Amounts Due To Program Participants

Amounts due to program participants reflects amounts due to participants who cancelled prepaid tuition contracts or savings trust accounts prior to June 30, 2002, but had not yet received a refund. Additionally, this amount includes distributions processed from active accounts at June 30, 2002, for which a check had not yet been written.

I. Accrued Leave Policy

Employees accrue annual leave at a rate of four to seven hours semimonthly, depending on their length of service. The maximum accumulation is dependent upon years of service, but in no case may it exceed 42 days. All employees leaving the agency are paid for accrued vacation leave up to the maximum calendar year limit at their current earnings rate.

In conformance with Section C60 of GASB Codification, the monetary value of accumulated annual leave payable upon termination is included in the accompanying financial statements. The liability at June 30, 2002, was computed using salary rates effective at that date and represents vacation and compensatory leave earned up to the allowable ceilings. In accordance with GASB Statement No. 16, *Accounting for Compensated Absences*, included in the liability is the agency's share of FICA taxes on leave balances for which employees will be compensated.

Employees of the Plan have elected to participate in the Virginia Sickness and Disability Program. The Virginia Retirement System (VRS) administers the program to provide income protection for absences due to sickness or disability from the first day on the job. After a seven calendar-day waiting period following the first incident of disability, eligible employees receive short-term disability benefits ranging from 60 to 100 percent of compensation up to a maximum of 125 work days, based upon months of State service. After a 180 calendar-day waiting period (125 work days of short-term disability) eligible employees receive long-term disability benefits equal to 60 percent of compensation until they return to work, until age 65, or until death. Employees enrolled in this program are not eligible for disability retirement benefits under the VRS.

All State agencies are required to contribute to the cost of providing disability benefits. Initial contribution requirements to fund the program were determined by the VRS actuary based on an estimate of the amount of the liability for disability benefits that would transfer from VRS to the new program. The contribution requirement was 0.83 percent of payroll for State employees. Further information about this program can be found in the Commonwealth of Virginia's Comprehensive Annual Financial Report.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS

The Board of the Virginia College Savings Plan has full power to invest funds in accordance with §23-38.80 of the Code of Virginia, as amended. This section requires the Board to discharge its duties in a manner which will provide the investment return and risk level consistent with the actuarial return requirements and cash flow demands of the Plan and conforming to all statutes governing the investment of Plan funds. The Board shall exercise the judgment of care under the circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but to the permanent disposition of funds, considering the probable income as well as the probable safety of their capital when investing funds. In order to meet the return requirements, the Plan's portfolio shall be invested in a broadly diversified portfolio of domestic and foreign stocks, bonds, and cash equivalent investments, which are defined as investments with an original maturity of three months or less. The Board's allocation target for the overall VPEP portfolio, at market value, is 50 percent investment in equity securities and 50 percent investment in fixed income instruments. The Board's allocation targets for the VEST program vary according to the investment objective of each portfolio. To assist in with the investment of the Plan assets, the Board has selected a group of eleven external managers and/or funds. In addition, the Plan has monies invested by the State Treasurer as part of the Commonwealth's General Account for both VPEP and VEST.

The Board authorized its partner, the American Funds, to offer twenty-one of their mutual funds to investors in CollegeAmerica. The Board has oversight and review authority for the investment activity and operations of the CollegeAmerica program. The American Funds is required to seek renewed approval of the use of these mutual funds on an annual basis.

Investments held in the VPEP, VEST, and CollegeAmerica programs at June 30, 2002, have been categorized according to the level of credit risk associated with its custodial arrangements at fiscal year end. Credit risk refers to the risk that the Plan may not be able to obtain possession of its investments in the event of default by a counterparty. Category 1 includes investments that are insured or registered or for which securities are held by the Plan or its agent in the Plan's name. Category 2 includes uninsured and unregistered investments for which securities are held by the counterparty's trust department or agent in the Plan's name. Category 3 includes uninsured and unregistered investments for which securities are held by the counterparty, or by its trust department or agent, but not in the Plan's name. Certain investments cannot be categorized because they are not evidenced by physical securities. VPEP investments, reported in the enterprise fund at June 30, 2002, were categorized as follows.

	Fair Value
Category 1:	
U.S. Treasury and agency securities	$ 48,518,644
Common and preferred stocks	82,144,510
Corporate and other bonds	100,586,480
Non-categorized:	
Mutual, Money Market Funds	82,708,339
Index Funds	76,410,112
Guaranteed Investment Contracts	45,865,435
State Treasurer General Account Investment Pool	4,430,397
Total cash equivalents and investments	$440,663,917

Investment holdings of the VEST and CollegeAmerica programs, reported as private- purpose trust funds, were categorized as follows.

	Fair Value
Category 1:	
Common and preferred stocks	$ 14,661,479
Non-categorized:	
Mutual, Money Market Funds	1,081,308,128
Index Funds	39,142,446
Guaranteed Investment Contracts	24,759,442
State Treasurer General Account Investment Pool	2,439,303
Total cash equivalents and investments	$1,162,310,798

3. SECURITIES LENDING TRANSACTIONS

Investments held by the Treasurer of Virginia represent the Plan'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.

4. LONG-TERM LIABILITIES

Long-term liabilities of the Plan include tuition benefits payable, which represents the actuarially determined present value of future obligations anticipated for payment of benefits and administrative expenses for the Virginia Prepaid Education Program. Also, reflected in the enterprise fund are the accrued compensated absences for the Plan's employees.

Enterprise Fund	July 1, 2001	Increases	Decreases	June 30, 2002
Compensated Absences	$ 137,398	$ 165,471	$ 101,433	$ 201,436
Tuition Benefits Payable	530,969,760	261,683,307	10,825,776	781,827,291
Total	$ 531,107,158	$261,848,778	$10,927,209	$782,028,727

5. PROPERTY, PLANT, AND EQUIPMENT

The following schedule presents capital asset activity of the Plan for the year ended June 30, 2002.

Enterprise Fund	July 1, 2001	Increases	Decreases	June 30, 2002
Depreciable Capital Assets:				
Equipment	$ 201,183	$ 139,161	$ -	$ 340,344
Less Accumulated depreciation for:				
Equipment	83,329	44,693	-	128,022
Total Depreciable Capital Assets, net of accumulated depreciation	$ 117,854	$ 94,468	$ -	$ 212,322

6. RETIREMENT AND PENSION PLAN

Employees of the Plan are employees of the Commonwealth of Virginia. The employees participate in a defined benefit pension plan administered by the Virginia Retirement System (VRS). The VRS also administers life insurance and health related plans for retired employees. Information relating to these plans is available at the statewide level only in the Commonwealth of Virginia's Comprehensive Annual Financial Report. The Commonwealth, not the Plan, has overall responsibility for determining contributions to these plans.

7. ACTUARIAL VALUATION

An actuarial valuation is completed annually to determine the present value (APV) of future tuition obligations for the Virginia Prepaid Education Program. The valuation method used reflects the present value of estimated tuition benefits that will be paid in future years and is adjusted for the effects of projected tuition increases and the termination of contracts.

APV of future benefits and expenses payable	$ 781,827,291
Net assets available	$ 723,910,939
Projected Unfunded Actuarial Liability	$ (57,916,362)

During fiscal year 2002, investment performance in general continued to worsen while Virginia's public colleges and universities increased tuitions and mandatory fees. This resulted in the actuarial results declining from an overfunding situation (or surplus) of $45.2 million in 2001, to the underfunded (or deficit) of $57.9 million reflected above. There are several assumptions used in performing the actuarial valuation. The two most significant assumptions are the rate of investment returns and future tuition growth. The actuaries projected an expected rate of return on investments of 7 percent, which represents a 0.50 percent decrease from the 7.5 percent investment return assumption used in the prior year's valuation. The expected rate of tuition growth is 11.8 percent for a three-year period beginning with the Fall 2003 tuition and 6.0 percent thereafter for university tuition and 15 percent for a three-year period beginning with the Fall 2003 tuition and 6.0 percent thereafter for community college tuition. The projected tuition increase used in the prior year's valuation was 7 percent for both university and community college tuition. In addition to the above assumptions, weighted average tuition for four-year public universities was adjusted with a 5.0 percent load to add a bias for matriculation at more expensive schools. The expenses included in the present value of future obligations are those relating to an annual maintenance expense per contract of $41.20 and an annual distribution cost per contract in payment status of $10.30. The actuaries assume that expenses will increase annually at the rate of inflation plus 0.5 percent. A copy of the actuarial valuation can be obtained by contacting the Plan.

8. DEFICIT NET ASSETS (ENTERPRISE FUND)

The deficit net assets amount at June 30, 2002 reflected in the enterprise fund corresponds to the projected unfunded actuarial liability disclosed in the previous footnote. The actuarial deficit is due to the severe downturn in the stock market, coupled with significant current and projected tuition increases, including unprecedented mid-year tuition increases in the 2002-2003 academic year. Given the long-term nature of the program, it is anticipated that tuition increases will moderate over time, and that investment returns will also improve as the stock market recovers.

It is the Board's intention to reduce the actuarial deficit over time by creating an actuarial reserve and implementing appropriate pricing, taking into account the current tuition pricing environment, including the mid-year tuition increases. The Board will continue to work with the VPEP actuary and investment consultant to review the investment allocation and determine if there should be any additional diversification or expansion into other investment strategies in order to ensure the highest possible returns at the lowest possible risk.

In response to the projected increases in tuition and mandatory fees, the Board has elected to increase prices for VPEP contracts for the 2003 enrollment period by 25 percent. The new pricing includes an 8 percent reserve that is intended to provide a margin to cover possible future adverse experience. Further, the Plan expects that sales of new contracts at this price level will eliminate, over time, the current unfunded actuarial liability.

As with other Commonwealth of Virginia agencies, the Virginia College Savings Plan will undertake significant operating expense reductions, including leaving projected vacancies unfilled, and substantially reducing its advertising and marketing budget, to attain cost savings and help lessen the impact of current economic conditions.

9. ADJUSTMENTS TO NET ASSETS (FIDUCIARY FUNDS)

In fiscal year 2002, activity of the Virginia Education Savings Trust was reclassified to a private-purpose trust fund. Previously, all assets and offsetting liabilities of the program had been reflected in the enterprise fund along with the Virginia Prepaid Education Program and the balance of the Plan operations. VEST activity in the enterprise fund was reflected on the Balance Sheet only, as cash, cash equivalents, and investments and interest receivable assets with an offsetting tuition benefits payable liability. Therefore, VEST activity was not included in the prior year's net asset amount (e.g. retained earnings) and did not require an adjustment to beginning net assets in the enterprise fund. However, beginning cash and cash equivalents on the Statement of Cash Flows for the enterprise fund has been adjusted by $1,745,170, as a result of this reclassification. Beginning net assets on the private-purpose trust fund Statement of Changes in Fiduciary Net Assets, in the amount of $62,873,718, reflects the tuition benefits payable amount reported for the VEST program in 2001.

10. RISK MANAGEMENT

The Virginia College Savings Plan 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 Plan 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 Plan 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.

11. VIRGINIA COLLEGE DREAM FOUNDATION

The Virginia College Dream Foundation (VCDF) is a private, non-profit 501(c)(3) scholarship foundation founded in 1997. The VCDF enables individuals, organizations, community groups, corporations, and trusts to make charitable contributions, which are then used to purchase VPEP tuition and fee contracts and to open VEST accounts for at-risk youth. The mission of the VCDF is to work with community partners to make the dream of college a reality for deserving youth in Virginia and to create a model for helping at-risk students through state-sponsored college savings programs nationwide.

At June 30, 2002, the VCDF owned 35 VPEP contracts and 7 VEST accounts.

12. IMPLEMENTATION OF GASB STATEMENT

GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, issued June 1999, became effective for the fiscal year ending June 30, 2002, and imposes new standards for financial reporting. The Plan implemented the necessary changes to be in compliance with this Statement. As part of the implementation, the Plan has reclassified the VEST program as a private-purpose trust fund. In prior years, this activity has been reported as an enterprise fund. It was determined that the CollegeAmerica program also met the definition of a private-purpose trust fund. There were minimal changes to the Plan's reporting of the VPEP program, as its activity is accounted for in an enterprise fund.

VIRGINIA COLLEGE SAVINGS PLAN
Richmond, Virginia

BOARD MEMBERS

As of June 30, 2002

William H Groseclose, Chairman

Lee B. Krumbein, Vice Chairman

Jody M. Wagner, Secretary / Treasurer

Julie Cox

Dr. Glenn DuBois

Robert P. Hanrahan

Phyllis A. Palmiero

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EXECUTIVE DIRECTOR

Diana F. Cantor