

**NORFOLK STATE UNIVERSITY
NORFOLK, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2003**



AUDIT SUMMARY

Our audit of Norfolk State University for the year ended June 30, 2003, found:

- the financial statements present fairly, in all material respects;
- internal control matters that we consider to be reportable conditions; however, we do not consider any of these to be material weaknesses;
- no instances of noncompliance that are required to be reported; and
- corrective action on prior audit findings except for “Enhance Small Purchase Charge Card Controls.”

Collect and Correct Accounts Receivables

As of June 30, 2003, student tuition and fees account receivable balances equaled \$6.8 million or 6 percent of the University’s annual operating budget. During fiscal year 2003, the balance grew by \$2.1 million. The University is failing to collect significant financial resources and has known of the problem since we first reported the problem in our fiscal year 2000 audit report.

Previous audit reports have cited the need to collect and correct account receivables as a significant accounting and internal control issue at the University. When we prepared our audit report for fiscal year 2002 audit in the spring of 2003, the University provided the auditors with a corrective action plan to collect and correct its receivables. The auditors reviewed the University’s plan to address this issue, which included the resources to correct past problem and maintain current operations. The auditors concurred that, if implemented, the plan would address the University’s problem; however, a year later, the University has not implemented the plan or committed the resources to correct the problem.

In the past five years, the various components of the accounts receivable balance have continued to grow. By not adequately addressing this issue in a timely manner, the University has lost revenues, spent time and resources attempting to bill and collect incorrect and erroneous balances, and may have incurred liabilities to students and some third parties for not properly applying payments or refunding monies when a student drops out of school.

While there are numerous reasons why the problem exists, it is important that University management commit to correcting the problem. It is clear that the University is capable of understanding the issues and developing a plan to address the problem. However, the University needs to follow through with the plan and implement it with the appropriate resources to correct the problem.

In addition, the University’s Board of Visitors and management need to establish an oversight group to review and monitor the correction of the existing problem and to develop policies, procedures, and follow through actions that will prevent this problem in the future. When approximately 90 percent of the student body receives some form of student financial assistance, it is important the University demonstrate that it can properly manage and apply these funds to individual student accounts.

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UNIVERSITY RESPONSE

UNIVERSITY OFFICIALS



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

June 29, 2004

The Honorable Mark R. Warner
Governor of Virginia

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

Board of Visitors
Norfolk State University

We have audited the accounts and records of **Norfolk State University**, 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 Norfolk State University, 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 University's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Norfolk State University 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 six through nine is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting

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

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of Norfolk State University. The Schedule of Auxiliary Enterprises – Revenues and Expenditures is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The Schedule of Auxiliary Enterprises - Revenues and Expenditures has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements 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 Norfolk State University 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 University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

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

Status of Prior Findings

The University has not taken adequate corrective action with respect to a previously reported finding “Enhance Small Purchase Charge Card Controls.” Accordingly, we included this finding in the section entitled “Internal Control Findings and Recommendations.” The University has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

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

EXIT CONFERENCE

We discussed this report with management at an exit conference held on August 3, 2004.

AUDITOR OF PUBLIC ACCOUNTS

NJG/kva

kva:

INTERNAL CONTROL FINDINGS AND RECOMMENDATIONS

Collect and Correct Accounts Receivables

As of June 30, 2003, student tuition and fees account receivable balances, equaled \$6.8 million, or 6 percent of the University's annual operating budget. During fiscal year 2003, the balance grew by \$2.1 million. The University is failing to collect significant financial resources and has known of the problem since we first reported the problem in our fiscal year 2000 audit report.

Previous audit reports have cited the need to collect and correct account receivables as a significant accounting and internal control issue at the University. When we prepared our audit report for fiscal year 2002 audit in the spring of 2003, the University provided the auditors with a corrective action plan to collect and correct its receivables. The auditors reviewed the University's plan to address this issue, which included the resources to correct past problem and maintain current operations. The auditors concurred that if implemented the plan would address the University's problem; however, a year later, the University has not implemented the plan or committed the resources to correct the problem.

In the past five years, as shown in the table below, the various components of the accounts receivable balance have continued to grow. By not adequately addressing this issue in a timely manner, the University has lost revenues, spent time and resources attempting to bill and collect incorrect and erroneous balances and may have incurred liabilities to students and some third parties for not properly applying payments or refunding monies when a student drops out of school.

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Accounts receivable: Student tuition and fees	\$1,359,847	\$3,525,181	\$4,789,355	\$ 4,204,296	\$ 6,765,880
Less: Allowance for doubtful accounts	(690,835)	(1,110,188)	(1,559,628)	(2,107,110)	(2,429,218)
Accounts receivable: Write offs	538,232	186,238	549,497	2,078,507	1,297,091
Student account credit balances	(299,238)	(334,558)	(492,149)	(1,242,289)	(1,389,379)

*The 2004 Student tuition and fees receivable data was not available at the issue date of this report.

While there are numerous reasons why the problem exists, it is important that University management commit to correcting the problem. It is clear that the University is capable of understanding the issues and developing a plan to address the problem. However, the University needs to follow through with the plan and implement it with the appropriate resources to correct the problem.

In addition, the University's Board of Visitors and management need to establish an oversight group to review and monitor the correction of the existing problem and to develop policies, procedures and follow through actions that will prevent this problem in the future. When approximately 90 percent of the student body receives some form of student financial assistance, it is important the University demonstrate that it can properly manage and apply these funds to individual student accounts.

Enhance Small Purchase Charge Card Controls

As noted in previous audits, the University needs to follow its policies and procedures for the Small Purchase Charge Card (SPCC) program and improve management's oversight. The University has issued charge cards to approximately 127 employees for purchasing various goods and services and employees made purchases of over \$450,000 during fiscal year 2003. While the University has improved their compliance with its policies and procedures, we found the following specific internal control weaknesses.

- Three cardholders split the charges for purchases to avoid the purchase transaction limit established by management. Split charges represent dividing one purchase into multiple transactions to make it appear as separate purchases. In each instance, the cardholder's supervisor did not catch the split charge during the supervisory review of the monthly purchases.
- Two cardholders did not prepare a log for their purchases. In preparing the purchase log, the cardholder certifies they made the purchases following the University's guidelines. The cardholder's supervisor is also required to approve the purchase by reviewing and signing the log. Since the cardholders did not prepare a purchase log, there is no indication of supervisor approval or legitimacy of the purchases made.
- Four of five the cardholders tested exceeded their monthly transaction limit by an average of \$775. One cardholder exceeded the monthly transaction limit by \$1,268. Management sets the monthly transaction limit based on the user's purchasing needs. In each instance, the cardholder's supervisor did not follow the proper guidelines to have the cardholder's account suspended in accordance with state guidelines.
- Four of five cardholders tested erroneously paid a total of \$148 in sales tax during fiscal year 2003. In each instance, the cardholder's supervisor did not catch the overpayment during the supervisory review of the monthly purchases.

Management should ensure that cardholders and supervisors are properly trained and informed of all state regulations, policies, and procedures. The supervisor's approval is a crucial control over the SPCC program to ensure that employees are not abusing the program. Management should take the appropriate corrective action when cardholder and supervisors do not comply with the University's policies and procedures.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(unaudited)

The following Management's Discussion and Analysis is required supplemental information under the Governmental Accounting Standards Board (GASB) reporting model. It is designed to assist readers in understanding the accompanying financial statements and provides an objective, easily read analysis of the University's financial activities based on currently known facts, decisions, and conditions. This discussion includes an analysis of the University's financial condition and results of operations for the fiscal year ended June 30, 2003. Comparative numbers, where presented, are for the fiscal year ended June 30, 2002. Since this presentation includes highly summarized data, it should be read in conjunction with the accompanying financial statements, notes to financial statements, and other supplementary information. University management is responsible for all of the financial information presented, including this discussion and analysis.

Statement of Net Assets

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

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

Statement of Net Assets

	<u>As of June 30, 2003</u>	<u>As of June 30, 2002</u>
Assets:		
Current	\$ 15,224,434	\$ 15,082,377
Capital, net of accumulated depreciation	62,749,861	60,159,884
Other noncurrent	<u>6,994,843</u>	<u>9,369,665</u>
Total assets	<u>84,969,138</u>	<u>84,611,926</u>
Liabilities:		
Current	14,828,730	13,446,824
Non-current	<u>19,586,361</u>	<u>22,080,347</u>
Total liabilities	<u>34,415,091</u>	<u>35,527,171</u>
Net assets:		
Invested in capital assets, net of related debt	42,416,639	37,462,853
Restricted	6,107,540	9,548,705
Unrestricted	<u>2,029,868</u>	<u>2,073,197</u>
Total net assets	<u>\$ 50,554,047</u>	<u>\$ 49,084,755</u>

The University's total assets increased by \$357,212 due to an increase in accounts receivable and capitalized assets. The increase in accounts receivable is attributable to tuition and fee rate increases in 2003. Capitalized assets increased \$2.6 million due to an increase in construction projects for fiscal year 2003. Total liabilities decreased by \$1,112,080 primarily due to a reduction in bonds and capital leases payable.

Statement of Revenues, Expenses, and Changes in Net Assets

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

Generally speaking, operating revenues are received for providing goods and services to students and other constituencies of the institution. Operating expenses are those expenses incurred to acquire or produce the goods and services provided in return for the operating revenues and to carry out the University's mission.

Nonoperating revenues are revenues received for which goods and services are not provided. For example, the University's state appropriations are nonoperating because they are provided by the state legislature without the legislature directly receiving commensurate goods and services for those revenues.

Revenues, Expenses, and Changes in Net Assets

	<u>Year Ended June 30, 2003</u>	<u>Year Ended June 30, 2002</u>
Operating revenues:		
Student tuition and fees, net of scholarship allowances of \$7,262,662 and \$5,496,349	\$ 16,645,293	\$ 15,978,501
Federal grants and contracts	23,365,379	20,284,355
State grants and contracts	1,532,959	2,463,412
Nongovernmental grants and contracts	1,439,612	877,653
Auxiliary enterprises, net of scholarship allowances of \$4,846,743 and \$4,963,322	17,357,689	17,665,467
Other operating revenues	<u>371,197</u>	<u>705,630</u>
Total operating revenues	<u>60,712,129</u>	<u>57,975,018</u>
Operating expenses:		
Instruction	28,029,339	29,002,473
Research	5,319,381	5,033,260
Public service	1,562,945	1,369,850
Academic support	9,752,505	10,003,942
Student services	4,940,031	4,673,232
Institutional support	15,769,142	15,042,698
Operation and maintenance of plant	7,658,283	6,789,124
Depreciation	5,291,525	5,234,104
Student aid	9,486,993	6,571,329
Auxiliary activities	15,281,083	16,640,984
Other expenses	<u>252,931</u>	<u>-</u>
Total operating expenses	<u>103,344,158</u>	<u>100,360,996</u>

Operating loss	(42,632,029)	(42,385,978)
Net nonoperating revenues and expenses	<u>42,059,859</u>	<u>41,061,464</u>
Loss before other revenues, expenses, gains or losses	(572,170)	(1,324,514)
Other revenues	<u>2,041,462</u>	<u>164,024</u>
Increase (Decrease) in net assets	1,469,292	(1,160,490)
Net assets - beginning of the year, as restated	<u>49,084,755</u>	<u>50,245,245</u>
Net assets - end of year	<u>\$ 50,554,047</u>	<u>\$ 49,084,755</u>

Operating revenues primarily include tuition and fees, auxiliary enterprises, and revenues from grants and contracts. Tuition and fees revenue increased \$666,792 due to an increase in rates. Although there was an increase in auxiliary fees, revenues remained constant in the current year due to prior period revenue adjustments recorded in fiscal 2002. A substantial increase in operating revenues is attributed to new grants and contracts for the fiscal year ended June 30, 2003. Operating expenses increased slightly due to a new contract for computer services, special projects related to plant operations, and increased utility usage.

Nonoperating revenue increases are attributable to increases in state appropriations. Other revenues and expenses include an increase in capital appropriations for fiscal 2003 and a decrease in reversions to the Commonwealth of Virginia.

Statement of Cash Flows

The final statement presented by the University is the Statement of Cash Flows. This statement presents detailed information about the University's cash activity during the year. Operating cash flows shows the net cash used by the operating activities of the University. Significant sources of cash include student tuition and fees (\$14,427,947), grants and contracts (\$26,251,988), and auxiliary enterprises receipts (\$17,349,979). Major uses of cash include payments for salaries, wages, and fringe benefits (\$56,929,825), payments for services and supplies (\$17,065,440), payments for scholarships and fellowships (\$14,861,715), and payments for noncapitalized plant improvements and equipment (\$6,273,163).

The next section reflects the cash flows from noncapital financial activities and includes state appropriations for the University's educational and general programs and financial aid of \$42,902,187. The cash flows from the capital financing activities section reflect cash used for capital and related items. Primary sources of cash include capital appropriations net of reversions of \$2,041,462. Significant cash outflows include the purchase of capital assets (\$7,900,820) and the repayment of principal and interest on capital related debt (\$2,896,097). Cash flows from investing activities show \$23,821 in interest expense on investments.

The final section of the cash flow statement reconciles the net cash used by operating activities to the operating loss reflected on the Statement of Revenue, Expenses, and Changes in Net Assets.

	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Cash flows from operating activities	\$(37,451,511)	\$(36,042,056)
Cash flows from noncapital financial activities	42,902,187	42,118,425
Cash flows from capital financing activities	(8,690,934)	(8,663,217)
Cash flows from investing activities	<u>(23,821)</u>	<u>61,209</u>
Net (decrease) in cash	(3,264,079)	(2,525,639)
Cash, beginning of year	<u>14,330,464</u>	<u>16,856,103</u>
Cash, end of year	<u>\$ 11,066,385</u>	<u>\$ 14,330,464</u>

The University's cash flow from operating activities increased by \$1,409,455 primarily due to an increase in payments for payroll-related and scholarship and fellowship expenses. The \$783,762 increase in noncapital financial activities is attributable to the increase in state appropriations for the University's educational and general programs and financial aid. The \$85,030 decrease in cash flows from investing activities is attributable to less interest revenue earned on investment accounts.

Capital Asset and Debt Administration

Overall, invested in capital assets increased by \$4.9 million. This change was primarily due to net capital assets additions of \$2.6 million and a reduction in long-term debt principal of \$2 million. The University is in the planning stages of issuing 9D bonds to renovate and construct an addition to the student union building during fiscal year 2005. In fiscal year 2004, the University received \$3 million in state funds to purchase and begin renovation of Norfolk Community Hospital. Once renovated, the property will provide much needed space for student services and instructional functions.

The University decreased its total long-term debt from \$22,047,273 in fiscal year 2002 to \$20,099,349 in fiscal year 2003. As calculated under the State Council of Higher Education for Virginia's formula, the University's 2003 debt service to expenditures ratio was 2.6 percent. Additional information relating to long-term debt can be found in the Notes to Financial Statements in Notes 7 and 8.

Overall, unpaid construction and other related contractual commitments decreased from \$5,288,475 in 2002 to \$508,431 in 2003. Unpaid commitments at June 30, 2003, primarily reflect ongoing renovations in the Wood Science, Fine Arts, and Teacher Education buildings. Construction-in-progress on these contracts totaled \$2,966,285 as of June 30, 2003. Additional information relating to commitments can be found in the Notes to Financial Statements in Note 14.

Economic Outlook

The University's economic outlook is closely related to its role as one of the Commonwealth's comprehensive higher education institutions. As such, it is largely dependent upon ongoing financial and political support from the state government.

State revenue shortfalls again resulted in general fund reductions for state agencies in fiscal year 2003. While the University's budget absorbed general fund reductions of \$1.8 million for fiscal year 2002, the governing board increased tuition and mandatory fees by 24 percent and 7 percent, respectively, to offset a \$3 million reduction in the budget for fiscal 2003.

The University's overall financial position remains strong. Despite general fund reductions, revenue shortfalls, and economic uncertainty, the University generated an overall increase in net assets during the fiscal year of 2003.

NORFOLK STATE UNIVERSITY
STATEMENT OF NET ASSETS
As of June 30, 2003

ASSETS	
Current assets:	
Cash and cash equivalents (Note 3)	\$ 6,420,230
Short-term investments (Note 3)	356,288
Accounts receivable (net of allowance for doubtful accounts \$2,444,514) (Note 4)	7,121,869
Prepaid expenses	1,118,038
Inventory	4,966
Notes receivable (net of allowance for doubtful accounts of \$213,873)	<u>203,043</u>
Total current assets	<u>15,224,434</u>
Noncurrent assets:	
Restricted cash and cash equivalents (Note 3)	4,646,155
Other long-term investments (Note 3)	581,400
Notes receivable (net of allowance for doubtful accounts of \$1,924,860)	1,767,288
Nondepreciable capital assets (Note 5)	7,432,033
Depreciable capital assets, net (Note 5)	<u>55,317,828</u>
Total noncurrent assets	<u>69,744,704</u>
Total assets	<u>84,969,138</u>
LIABILITIES	
Current liabilities:	
Accounts payable and accrued expenses (Note 6)	5,520,706
Deferred revenue	4,851,654
Obligations under securities lending	72,843
Deposits held in custody for others	617,120
Long-term liabilities - current portion (Note 7)	<u>3,766,407</u>
Total current liabilities	<u>14,828,730</u>
Noncurrent liabilities (Note 7)	<u>19,586,361</u>
Total liabilities	<u>34,415,091</u>
NET ASSETS	
Invested in capital assets (net of related debt)	42,416,639
Restricted for:	
Expendable:	
Scholarships and fellowships	364,208
Research and public service	30,812
Debt service	1,291,527
Capital projects	2,251,282
Loans	2,169,711
Unrestricted	<u>2,029,868</u>
Total net assets	<u>\$ 50,554,047</u>

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

NORFOLK STATE UNIVERSITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2003

Operating revenues:	
Student tuition and fees (net of scholarship allowances of \$7,262,662)	\$ 16,645,293
Federal grants and contracts	23,365,379
State grants and contracts	1,532,959
Nongovernmental grants and contracts	1,439,612
Auxiliary enterprises (net of scholarship allowances of \$4,846,743) (Note 10)	17,357,689
Other operating revenues	371,197
Total operating revenues	<u>60,712,129</u>
Operating expenses (Note 11):	
Instruction	28,029,339
Research	5,319,381
Public service	1,562,945
Academic support	9,752,505
Student services	4,940,031
Institutional support	15,769,142
Operation and maintenance of plant	7,658,283
Depreciation	5,291,525
Student aid	9,486,993
Auxiliary activities (Note 10)	15,281,083
Other expenses	252,931
Total operating expenses	<u>103,344,158</u>
Operating loss	<u>(42,632,029)</u>
Nonoperating revenues (expenses):	
State appropriations (Note 12)	42,705,603
Investment income net of investment expense	(23,821)
Interest on capital asset - related debt	(994,691)
Gifts	329,069
Grant and contract nonoperating revenue	43,699
Net nonoperating revenues	<u>42,059,859</u>
Loss before other revenues, expenses, gains or losses	<u>(572,170)</u>
Capital appropriations	4,923,759
Capital reversion	(2,882,297)
Net other revenues	<u>2,041,462</u>
Increase in net assets	1,469,292
Net assets - Beginning of year as restated (Note 2)	<u>49,084,755</u>
Net assets - End of year	<u><u>\$ 50,554,047</u></u>

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

NORFOLK STATE UNIVERSITY
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2003

Cash flows from operating activities:

Student tuition and fees	\$ 14,427,947
Grants and contracts	26,251,988
Auxiliary enterprises	17,349,979
Other receipts	2,897,577
Payments to employees	(45,907,843)
Payments for fringe benefits	(11,021,982)
Payments for services and supplies	(17,065,440)
Payments for utilities	(3,300,069)
Payments scholarships and fellowships	(14,861,715)
Payments for noncapitalized plant improvements and equipment	(6,273,163)
Collections of loans from students	360,274
Loans issued to students	(309,064)

Net cash used by operating activities (37,451,511)

Cash flows from noncapital financing activities:

State appropriations	42,705,603
Gifts and grants for other than capital purposes	308,247
Direct lending receipts	20,223,873
Direct lending payments	(20,223,873)
Agency receipts	1,380,724
Agency payments	(1,098,568)
Other nonoperating expenses	(393,819)

Net cash provided by noncapital financing activities 42,902,187

Cash flows from capital financing activities:

Capital appropriations	4,923,759
Appropriation reversions	(2,882,297)
Capital gifts	64,521
Purchase of capital assets	(7,900,820)
Principal paid on capital debt, leases, and installments	(1,934,617)
Interest paid on capital debt, leases, and installments	(961,480)

Net cash used by capital financing activities (8,690,934)

Cash flows from investing activities:

Loss on investments	<u>(23,821)</u>
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Net cash provided by investing activities (23,821)

Net decrease in cash (3,264,079)

Cash and cash equivalents - Beginning of the year 14,330,464

Cash and cash equivalents - End of the year \$ 11,066,385

NORFOLK STATE UNIVERSITY
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2003

Reconciliation of Net Operating Loss to Net Cash

used by operating activities:

Operating loss	\$ (42,632,029)
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Adjustments to reconcile net loss to net cash used by operating activities:

Depreciation expense	5,291,525
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Changes in assets and liabilities:

Receivables, net	(2,206,243)
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Due from the Commonwealth	1,009,080
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Notes receivable, net	127,527
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Prepaid expenses	(14,745)
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Accounts payable and accrued expenses	(471,892)
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Deferred revenue	<u>1,445,266</u>
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Net cash used by operating activities	<u><u>\$ (37,451,511)</u></u>
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The accompanying Notes to Financial Statements are an integral part of this statement.

NORFOLK STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2003

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

Norfolk State University (University) is a comprehensive university that is a part of the Commonwealth of Virginia's statewide system of public higher education. The University's Board of Visitors, appointed by the Governor, is responsible for overseeing the governance of the University. A separate report is prepared for the Commonwealth of Virginia, which includes all agencies, higher education institutions, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority. The University is a component unit of the Commonwealth of Virginia and is included in the basic financial statements of the Commonwealth.

The University has no component units, as defined by the Governmental Accounting Standards Board (GASB) Statement 14, *The Financial Reporting Entity*; however, the University does have related party corporations whose combined financial conditions are stated in Note 13. These organizations are separate legal entities from the University and the University exercises no control over them. For these reasons, the University's related parties are not included in these financial statements.

B. Basis of Presentation

The University's accounting policies conform with generally accepted accounting principles as prescribed by GASB, including all applicable GASB pronouncements, as well as applicable Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The financial statements have been prepared in accordance with GASB Statement 34, *Basic Financial Statement – and Management's Discussion and Analysis – for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public College and Universities*.

C. Basis of Accounting

The University's financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. All significant intra-agency transactions have been eliminated.

D. Cash and Cash Equivalents

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

E. Investments

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

F. Receivables

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

G. Capital Assets

Capital assets include land, buildings and other improvements, library materials, equipment, and infrastructure assets such as parking lots, sidewalks, campus lighting, and computer network cabling systems. The University generally defines capital assets as assets with an initial cost of \$5,000 or more and an estimated useful life in excess of two years except for assets acquired under the Higher Education Trust Fund that is capitalized at \$500 as required by the State Council of Higher Education. Library materials are valued using published average prices for library acquisitions. Such assets are recorded at historical cost or estimated historical cost except for land acquired prior to 1979, which is valued at appraisal value. Donated capital assets are recorded at the estimated fair market value at the date of contribution. Expenses for major capital assets and improvements are capitalized (construction-in-progress) as projects are constructed. There was no interest expense relating to construction for the year ended June 30, 2003. The costs of normal maintenance and repairs that do not add to an asset's value or materially extend its useful life are not capitalized.

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

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

H. Noncurrent Cash and Investments

Cash and investments that are externally restricted to make debt service payments or maintain sinking or replace reserve funds are classified as noncurrent in the Statement of Net Assets.

I. Deferred Revenue

Deferred revenue primarily includes amounts received for tuition and fees, certain auxiliary activities, and advance payments on grants and contracts prior to the end of the fiscal year, but related to the period after June 30, 2003.

J. Accrued Compensated Absences

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

K. Noncurrent Liabilities

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

L. Federal Financial Assistance Programs

The University 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.

M. Net Assets

GASB Statement 34 requires that the Statement of Net Assets report the difference between assets and liabilities as net assets rather than fund balance. Accordingly, the University's net assets are classified as follows:

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

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

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

N. Revenue and Expense Classifications

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

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

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

O. Scholarship Discounts and Allowances

Student tuition and fees revenues and certain other revenues from students are reported net of scholarship discounts and allowances in the Statement of Revenue, Expenses, and Changes in Net Assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the University and the amount that is paid by students and/or third parties making payments on the student's behalf. Certain governmental grants, such as Pell grants, and other federal, state, or nongovernmental programs are recorded as either operating or nonoperating revenues in the University's financial statements. To the extent that such revenues are used to satisfy tuition and fees and other student charges, the University has recorded a scholarship discount and allowance.

2. **RESTATEMENT OF BEGINNING NET ASSETS**

The following is the prior period adjustment made to the beginning net assets previously reported in the University's financial statements at June 30, 2002:

Net assets reported at June 30, 2002	\$48,156,792
Correction of prior year capitalized assets	<u>927,963</u>
Restated beginning net assets	<u>\$49,084,755</u>

3. **CASH AND CASH EQUIVALENTS AND INVESTMENTS**

The following information is provided with respect to the credit risk associated with the University's cash and cash equivalents and investments at June 30, 2003.

A. Cash and Cash Equivalents

Pursuant to Section 2.2-1800, et seq., Code of Virginia, all state funds of the University are maintained by the Treasurer of Virginia, who is responsible for the collection, disbursement, custody, and investment of state funds. Certain deposits held by the University are maintained in accounts that are collateralized in accordance with the Virginia Security for

Public Deposits Act, Section 2.2-4400, et seq., Code of Virginia or covered by federal depository insurance. Under this act, banks holding public deposits in excess of amounts insured by FDIC must pledge collateral in the amount of 50 percent of excess deposits to a collateral pool in the name of the State Treasury board. Savings institutions are required to collateralize 100 percent of deposits in excess of FSLIC limits. In accordance with 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. Investments

The investment policy of the University is established by the Board of Visitors and monitored by the Audit and Finance Committee of the Board. Credit risk is the risk that the University may not be able to obtain possession of its investment instrument at maturity. The University's investments are in investment pools held by the Treasurer of Virginia and are not categorized as to level of risk.

	<u>Market Value</u>
Cash and cash equivalents:	
Deposits with financial institutions	\$ 2,330,995
Money market funds	718,068
Cash with the Treasurer	<u>8,017,322</u>
Total cash and cash equivalents	<u>\$11,066,385</u>
Investments:	
Investments with the Treasurer of Virginia	\$ 864,845
Securities lending transactions	<u>72,843</u>
Total investments	<u>\$ 937,688</u>

C. Securities Lending Transactions

Collateral held for securities lending and the securities lending transactions reported on the financial statements represent the University'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. ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following at June 30, 2003:

Student tuition and fees	\$ 6,765,880
Federal, state, and nongovernmental grants and contracts	2,609,451
Other activities	<u>191,052</u>
Gross receivables	9,566,383
Less: Allowance for doubtful accounts	<u>(2,444,514)</u>
Net accounts receivable	<u>\$ 7,121,869</u>

5. CAPITAL ASSETS

A summary of changes in the various capital asset categories for the year ending June 30, 2003, is presented as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Nondepreciable capital assets:				
Land	\$ 3,721,564	\$ -	\$ -	\$ 3,721,564
Construction-in-progress	<u>2,756,193</u>	<u>2,670,383</u>	<u>1,716,107</u>	<u>3,710,469</u>
Total nondepreciable capital assets	<u>6,477,757</u>	<u>2,670,383</u>	<u>1,716,107</u>	<u>7,432,033</u>
Depreciable capital assets:				
Buildings	109,406,008	3,766,550	-	113,172,558
Infrastructure	4,740,157	541,857	-	5,282,014
Equipment	21,126,242	2,370,321	157,228	23,339,335
Other improvements	34,840	-	-	34,840
Library materials	<u>6,105,919</u>	<u>248,962</u>	<u>19,306</u>	<u>6,335,575</u>
Total depreciable capital assets	<u>141,413,166</u>	<u>6,927,690</u>	<u>176,534</u>	<u>148,164,322</u>
Less accumulated depreciation for:				
Buildings	65,205,446	3,431,290	-	68,636,736
Infrastructure	4,063,502	115,060	-	4,178,562
Equipment	12,543,730	1,681,136	156,764	14,068,102
Other improvements	-	1,742	-	1,742
Library materials	<u>5,918,361</u>	<u>62,297</u>	<u>19,306</u>	<u>5,961,352</u>
Total accumulated depreciation	<u>87,731,039</u>	<u>5,291,525</u>	<u>176,070</u>	<u>92,846,494</u>
Depreciable capital assets, net	<u>53,682,127</u>	<u>1,636,165</u>	<u>464</u>	<u>55,317,828</u>
Total capital assets, net	<u>\$ 60,159,884</u>	<u>\$4,306,548</u>	<u>\$1,716,571</u>	<u>\$ 62,749,861</u>

Capital assets' beginning balance was adjusted by the University due to projects that should have been capitalized in fiscal year 2002 and were inadvertently expensed.

6. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following at June 30, 2003:

Employee salaries, wages, and fringe benefits payable	\$ 3,095,656
Vendors and suppliers accounts payable	2,191,541
Accrued interest payable	<u>233,509</u>
Total accounts payable and accrued liabilities	<u>\$ 5,520,706</u>

7. NONCURRENT LIABILITIES

The University's noncurrent liabilities consist of long-term debt (further described in Note 8) and other noncurrent liabilities. A summary of changes in noncurrent liabilities for the year ending June 30, 2003, is presented as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Long-term debt:					
Bonds payable	\$19,077,898	\$10,066,617	\$11,637,898	\$17,506,617	\$1,702,555
Capital leases	265,047	-	265,047	-	-
Notes payable	<u>2,704,328</u>	<u>-</u>	<u>111,596</u>	<u>2,592,732</u>	<u>113,769</u>
Total long-term debt	<u>22,047,273</u>	<u>10,066,617</u>	<u>12,014,541</u>	<u>20,099,349</u>	<u>1,816,324</u>
Accrued compensated absences	3,232,030	2,010,565	2,061,029	3,181,566	1,894,603
Capital projects retainage payable	<u>145,888</u>	<u>55,480</u>	<u>129,515</u>	<u>71,853</u>	<u>55,480</u>
Total long-term liabilities	<u>\$25,425,191</u>	<u>\$12,132,662</u>	<u>\$14,205,085</u>	<u>\$23,352,768</u>	<u>\$3,766,407</u>

8. LONG-TERM DEBT

The University has issued two categories of bonds pursuant to Section 9 of Article X of the Constitution of Virginia. Section 9(d) bonds are revenue bonds, which are limited obligations of the University payable exclusively from pledged general revenues and are not debt of the Commonwealth, legally, morally, or otherwise. Pledged general fund revenues include general fund appropriations, tuition and fees, auxiliary enterprise revenues, and other revenues not required by law to be used for another purpose. The University issued the 9(d) bond directly through underwriters and also participates in the Public Higher Education Financing Program (Pooled Bond Program) created by the Virginia General Assembly in 1996. Through the Pooled Bond Program, the Virginia College Building Authority (VCBA) also issues 9(d) bonds and uses the proceeds to purchase debt obligations (notes) of the University and various other institutions of higher education. The University's general revenue also secures these notes.

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

full faith, credit, and taxing power of the Commonwealth of Virginia. Listed below are all bonds outstanding at June 30, 2003.

	<u>Interest Rates (%)</u>	<u>Maturity</u>	<u>Outstanding Balance at June 30, 2003</u>
Revenue bonds:			
Dormitory:			
Series 2003(c)	2.500 – 5.000	2010	\$ 1,947,884
Series 2003(c)	2.500 – 5.000	2011	5,133,152
Athletic Facility:			
Series, 1996(d)	5.15 – 5.375	2018	7,440,000
Health:			
Series 2003(c)	2.500	2004	239,456
Cafeteria:			
Series 2003(c)	2.500 - 5.000	2011	<u>2,234,139</u>
Total revenue bonds			16,994,631
Deferred gain on advance refunding			<u>511,986</u>
Net revenue bonds			17,506,617
Notes payable:			
Dormitory, Series 1985(d)	3.00	2022	2,461,624
Brambleton Center, Series 1998		2019	<u>131,108</u>
Total notes payable			<u>2,592,732</u>
Total			<u>\$20,099,349</u>

Long-term debt matures as follows:

<u>Year Ending:</u>	<u>Principal</u>	<u>Interest</u>
2004	\$ 1,750,700	\$ 903,579
2005	1,555,163	852,945
2006	1,636,462	774,109
2007	1,705,556	696,295
2008	1,776,359	614,526
2009-2013	6,713,652	1,816,202
2014-2018	3,869,310	665,607
2019-2023	580,162	35,026
Refunding gain	<u>511,985</u>	<u>-</u>
Total	<u>\$20,099,349</u>	<u>\$6,358,289</u>

9. BOND DEFEASANCE

During fiscal years 2003, 1996, and 1994, certain 1990B, 1991A, 1993B, and 1993A General Obligation Bonds were defeased by the University. The net proceeds from the sale of those bonds were placed in an irrevocable trust with an escrow agent to provide for all future debt service on the refunded bonds. Accordingly, the trust account assets and the related liability for the defeased bonds are not reflected in the University's financial statements. At June 30, 2003, the following amounts of the defeased bonds were outstanding:

1990 Series B	\$ 2,020,000
1991 Series A	7,535,000
1993 Series B	9,826,203
1993 Series A	<u>240,414</u>
Total	<u>\$19,621,617</u>

10. AUXILIARY ACTIVITIES

Auxiliary operating revenues and expenses are distributed as shown in the following table for the year ended June 30, 2003. Additionally, the University used auxiliary revenues to pay debt service of \$2,672,667. This amount is not included in the auxiliary operating expenses below.

Revenues:

Residential, net of scholarship allowances of \$1,734,809	\$ 5,448,645
Athletics, net of scholarship allowances of \$1,434,220	5,132,304
Food services, net of scholarship allowances of \$916,379	3,185,064
Auxiliary enhancement, net of scholarship allowances of \$77,746	652,938
Student activities, net of scholarship allowances of \$215,419	917,385
Other student fees and sales and services, net of scholarship allowances of \$468,169	<u>2,021,353</u>
Total auxiliary enterprises revenues	<u>\$17,357,689</u>

Expenses:

Residential	\$ 3,789,063
Athletics	4,672,779
Food services	2,671,192
Auxiliary enhancement	315,009
Student activities	1,059,269
Other auxiliary activities	<u>2,773,771</u>
Total auxiliary enterprises expenses	<u>\$15,281,083</u>

11. EXPENSES BY NATURAL CLASSIFICATIONS

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

	Salaries and Wages	Fringes Benefits	Services and Supplies	Scholarships and Fellowships	Utilities	Plant and Equipment	Depreciation	Total
Instruction	\$22,869,308	\$ 4,294,209	\$ 1,289,059	\$ 201,531	\$ -	\$ (624,768)	\$ -	\$ 28,029,339
Research	1,671,826	261,023	1,385,255	529,616	-	1,471,661	-	5,319,381
Public service	834,793	85,483	410,399	48,806	-	183,464	-	1,562,945
Academic support	5,623,361	850,865	1,841,670	154,852	-	1,281,757	-	9,752,505
Student services	3,245,250	381,725	1,060,912	31,563	-	220,581	-	4,940,031
Institutional support	8,328,224	1,106,867	5,623,443	525	-	710,083	-	15,769,142
Operation and main- tenance of plant	2,120,299	300,488	2,503,636	(53,496)	1,597,219	1,190,137	-	7,658,283
Depreciation	-	-	-	-	-	-	5,291,525	5,291,525
Scholarships and fellowships	-	-	-	9,486,993	-	-	-	9,486,993
Auxiliary activities	4,251,025	712,492	7,584,675	1,053,612	778,547	900,732	-	15,281,083
Other expenses	-	-	-	-	-	252,931	-	252,931
Total	\$ 48,944,086	\$ 7,993,152	\$ 21,699,049	\$ 11,454,002	\$ 2,375,766	\$ 5,586,578	\$ 5,291,525	\$ 103,344,158

12. STATE APPROPRIATIONS

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

Original legislative appropriation per Chapter 1073:

Educational and general programs	\$41,008,242
Student financial assistance	3,915,124

Adjustments:

Reductions per Chapter 899	(565,459)
Governor budget reduction	(1,973,779)
Airline ticket savings	(6,988)
Bonus funding for higher education employees	863,419
E-Procurement charge	(17,513)
Employer fringe benefit reductions	(122,053)
Reversions to the general fund of the Commonwealth	(425,256)
Eminent Scholar	<u>29,866</u>

Adjusted appropriation	<u>\$42,705,603</u>
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13. AFFILIATED FOUNDATIONS

The financial statements do not include the assets, liabilities, and fund balances of the Athletic Foundation of Norfolk State University, Inc., and the Norfolk State University

Foundation, Inc., which were audited for the year ended June 30, 2003, by independent certified public accountants.

The following is a condensed summary of the audited financial conditions, which the foundations have submitted to the University.

	Norfolk State Athletic Foundation at June 30, 2003	Norfolk State University Foundation at June 30, 2003
Assets	<u>\$300,951</u>	<u>\$10,361,656</u>
Liabilities	\$ 4,145	\$ 99,144
Net assets	<u>296,806</u>	<u>10,262,512</u>
Total liabilities and net assets	<u>\$300,951</u>	<u>\$10,361,656</u>

The aggregated revenues and expenditures of these organizations were \$2,656,276 and \$1,512,074, respectively.

14. COMMITMENTS

At June 30, 2003, the University was committed to construction contracts totaling approximately \$508,431. Construction-in-progress on these contracts totaled \$2,966,285 as of June 30, 2003.

The University is committed under various operating leases for equipment and facilities. In general, the leases are for a one-year term and the University has renewal options on equipment and facilities for another one-year term. In most cases, the University expects that in the normal course of business, these leases will be replaced by similar leases. Rental expense for the fiscal year ended June 30, 2003, was \$1,025,698.

The City of Newport News lease contains an escalated clause, which allows for a base rent adjustment at the beginning of the third year of the initial term and every two years thereafter. The percentage increase is equal to one-half of the percentage increase of the consumer price index for Urban Wage Earners and Clerical Workers (CPI-W), South Urban Region, (1982-84=100), for the corresponding period.

The University has, as of June 30, 2003, the following total future minimum rental payments due under the above leases:

<u>Year Ending June 30,</u>	<u>Operating Lease Obligation</u>
2004	\$ 1,039,354
2005	990,081
2006	356,535
2007	652,396
2008	677,038
2009-2013	3,949,153
2014-2018	2,709,609
2019-2023	<u>1,209,285</u>
Total	<u>\$11,583,451</u>

15. STATE STUDENT LOAN FUND

The University makes loans to qualified students from its Commonwealth of Virginia Student Loan Fund. During the fiscal year, new loans totaling \$24,096 were made to 14 students. At June 30, 2003, total loans outstanding were \$245,509 and the allowance for doubtful accounts was \$94,133. Summarized below is the fund activity of the state Student Loan Fund for the fiscal year ended June 30, 2003:

Beginning fund balance	\$293,680
Interest income and collection fees	72,426
Loan write-offs and expenses	<u>(58,085)</u>
Ending fund balance	<u>\$308,021</u>

16. RETIREMENT AND PENSION SYSTEMS

Virginia Retirement System

Employees of the University are employees of the Commonwealth of Virginia. Substantially all full-time classified salaried employees of the University participate in a defined benefit retirement plan administered by the Virginia Retirement System (VRS). VRS is an agent multiple-employer public employee retirement system (PERS) that acts as a common investment and administrative agency for the Commonwealth of Virginia and its political subdivisions.

The VRS does not measure assets and pension benefit obligations separately for individual state institutions. Therefore, all information relating to this plan is available at the statewide level only and can be found in the Commonwealth's Comprehensive Annual Financial Report (CAFR). The Commonwealth of Virginia, not the University, has the overall responsibility for contributions to this plan. The CAFR provides disclosure of the Commonwealth's unfunded pension benefit obligation at June 30, 2003. The same report contains historical trend information showing VRS's progress in accumulating sufficient assets to pay benefits when due.

Optional Retirement Plans

Full-time faculty and certain administrative staff participate in a defined contribution plan administered by five different providers other than the VRS: TIAA/CREF Insurance Companies, Fidelity Investments Tax-Exempt services and MetLife Resources, Great-West Life Assurance Co., T. Rowe Price Associates, and VALIC. This plan is a fixed-contribution program where the retirement benefits received are based upon the employer's (5.4 percent) and employee's (5.0 percent) contributions, plus interest and dividends. Individual contracts issued under the plan provide for full and immediate vesting of both the University's and the employee's contributions. Total pension costs under this plan were approximately \$1,085,959 for year ended June 30, 2003. Contributions to the optional retirement plan were calculated using the base salary amount of approximately \$10,441,913 for fiscal year 2003.

17. POST-EMPLOYMENT BENEFITS

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

18. CONTINGENCIES

Grants and Contracts

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

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

Litigation

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

19. RISK MANAGEMENT AND EMPLOYEE HEALTH CARE PLANS

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

20. PENDING GOVERNMENTAL ACCOUNTING STANDARDS BOARD STATEMENT

GASB Statement 39, *Determine Whether Certain Organization 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 organization for which the University 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 University. As a result, where in the past the University presented summary financial information of certain of its foundations in the Notes to Financial Statements, the University will be required under Statement 39 to include selected foundations in the body of its financial statements. The University is in the process of assessing which of the foundations should be included as component units.

NORFOLK STATE UNIVERSITY
SCHEDULE OF AUXILIARY ENTERPRISES - REVENUE AND EXPENDITURES
For the Year Ended June 30, 2003

	Food Services	Residential Facilities	Student Activities	Student Center	Athletics	Parking
Revenues:						
Student fees	\$ 375,168	\$ -	\$ 942,592	\$ 351,206	\$ 5,928,825	\$ 370,201
Sales and services	3,681,467	7,112,699	154,649	43,336	447,283	287,006
Investment income	-	8,684	1,029	-	-	-
Other fund addition	-	-	20,599	-	-	-
	<u>4,056,635</u>	<u>7,121,383</u>	<u>1,118,869</u>	<u>394,542</u>	<u>6,376,108</u>	<u>657,207</u>
Expenses of operation:						
Personal service	-	689,706	15,807	160,056	1,766,398	264,613
Fringe benefits	-	191,332	1,349	46,256	420,604	72,777
Contractual services	3,512,670	1,198,314	344,493	327,953	675,017	98,265
Supplies and materials	517	223,811	245,662	20,736	147,158	12,302
Current charges and obligations	7,463	1,160,129	68,094	138,821	672,147	-
Equipment	7,459	819,981	13,541	3,923	24,079	14,185
Scholarships and fellowships	-	702,411	448,164	-	1,724,020	-
Auxiliary administration expense	42,776	530,752	124,571	74,279	627,291	59,762
	<u>3,570,885</u>	<u>5,516,436</u>	<u>1,261,681</u>	<u>772,024</u>	<u>6,056,714</u>	<u>521,904</u>
Excess (deficiency) of revenues over (under) expenses of operation before transfers	485,750	1,604,947	(142,812)	(377,482)	319,394	135,303
Nonoperating revenue:						
Gifts and grants	-	-	-	-	204,006	-
Transfers:						
Mandatory:						
Debt service and sinking fund	(364,816)	(1,360,915)	-	-	(946,936)	-
Nonmandatory - (To)/From other funds	-	48,759	(33,324)	167,174	6,965	6,965
Net increase (decrease) in fund balances	120,934	292,791	(176,136)	(210,308)	(416,571)	142,268
Fund balances at July 1, 2002, as restated (Note 1)	492,289	366,705	349,338	811,132	(802,256)	633,955
Fund balances at June 30, 2003	<u>\$ 613,223</u>	<u>\$ 659,496</u>	<u>\$ 173,202</u>	<u>\$ 600,824</u>	<u>\$ (1,218,827)</u>	<u>\$ 776,223</u>

Note 1: Beginning fund balances have been restated for prior period accounts receivable and auxiliary administrative allocation corrections.

Note 2: This schedule is prepared on the cash basis of accounting and does not support the basic financial statements

Printing Services	Auxiliary Administration	Contingency Fund	Auxiliary Security	Fitness Center	Telephone Services	Auxiliary Enhancement	Total
\$ -	\$ -	\$ 413,780	\$ 804,314	\$ -	\$ -	\$ 327,837	\$ 9,513,923
349,175	51,961	61,603	1,530	-	2,105	365,383	12,558,197
-	-	-	-	-	-	-	9,713
-	-	-	-	-	-	-	20,599
349,175	51,961	475,383	805,844	-	2,105	693,220	22,102,432
34,301	304,005	-	454,698	50,236	-	-	3,739,820
7,697	101,361	-	98,686	11,976	-	-	952,038
43,886	104,824	298,458	61,012	-	-	215,673	6,880,565
9,919	-	60,477	36,953	1,917	-	-	759,452
424,649	-	22,340	131,567	8,206	-	-	2,633,416
6,495	12,614	-	4,139	12,230	-	-	918,646
-	-	-	-	40,602	-	-	2,915,197
76,336	(470,843)	-	83,785	13,324	-	162,845	1,324,878
603,283	51,961	381,275	870,840	138,491	-	378,518	20,124,012
(254,108)	-	94,108	(64,996)	(138,491)	2,105	314,702	1,978,420
-	-	-	-	-	-	-	204,006
-	-	-	-	-	-	-	(2,672,667)
-	-	(6,647)	-	41,794	-	-	231,686
(254,108)	-	87,461	(64,996)	(96,697)	2,105	314,702	(258,555)
(184,463)	11,500	5,055,147	(531,636)	224,029	150,663	1,716,145	8,292,548
<u>\$ (438,571)</u>	<u>\$ 11,500</u>	<u>\$ 5,142,608</u>	<u>\$ (596,632)</u>	<u>\$ 127,332</u>	<u>\$ 152,768</u>	<u>\$ 2,030,847</u>	<u>\$ 8,033,993</u>



NORFOLK STATE UNIVERSITY®

Vice President of Finance and Business

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August 3, 2004

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

Dear Mr. Kucharski:

Attached is management's response to address the findings in Norfolk State University's audit report for the year ended June 30, 2003. Please contact me should you have any questions.

Sincerely,

A handwritten signature in black ink that reads 'Kevin Appleton'. The signature is written in a cursive, flowing style.

Kevin Appleton
Vice President for Finance and Business

Enclosure

cc: Dr. Alvin J. Schexnider
Acting President

Dr. Joyce E. Bozeman
Assistant Vice President of Finance

Mr. Tony Valentine
Assistant Vice President of Business

Mrs. Michelle Martin
Controller

Mr. Ernest Ellis
Internal Auditor

Collect and Correct Accounts Receivables

Management Response and Corrective Action

The University concurs with the finding. The corrective action plan, to collect and correct receivables, that is referred to in the management point was developed in response to the FY 2001 audit. The plan was reviewed by auditors who concluded that, if implemented, it would address the university's issue with accounts receivables. The university did implement that plan, but has now determined that additional action is necessary.

Credit balances for fiscal year 2003 increased slightly over fiscal year 2002. However, extensive efforts towards research and corrections have reduced the credit balances by 47% as of June 30, 2004, with no funds having been determined due to third parties.

Effective with the Fall 2004 semester, the University has changed its business practices so that all students are required to pay their entire outstanding balances before being allowed to register for the current semester. Additionally, students will be required to pay the current semester balances by established due dates at the beginning of the semester, or have satisfactory payment arrangements through scholarships, financial aid, third party billing or approved installment payment plans, to avoid cancellation of their registration. The system will capture all students who are not in compliance with these standards. These changes in business practices will further strengthen our internal controls over receivables, reduce the number of delinquent accounts and reduce the number of accounts that are written off to bad debt. Due to the timing of audits and corrective actions, the results of these changes will not be reflected in FY04 financial reports. The University's corrective action is ongoing.

Policies and Procedures for Small Purchase Charge Card (SPCC) Program

Management's Response and Corrective Action

The University concurs with the finding. However, several instances of noncompliance noted in the audit year took place prior to the completion of the FY02 audit and work plan. As a result of FY02 work plan, management's effort to improve oversight of the SPCC program will not be reflected until the completion of the FY04 audit.

In an effort to ensure cardholders and supervisors are thoroughly familiar with SPCC policies and procedures, management is now requiring that all cardholders and supervisors attend training prior to receiving the SPCC for the first time or renewal of the card. , This policy went into effect on July 1, 2004 and as of July 30, 2004, 90% of cardholders and supervisors on campus have been trained. Cardholders and supervisors are also required to sign the American Express Corporate Card Employee agreement before the issuance of a new card or the renewal of an existing card. This agreement confirms that cardholders and supervisors understand their responsibility to comply with state regulations, and NSU policies and procedures, when utilizing the SPCC..

If cardholders do not comply with policy and procedures after training has been provided, management will enforce the policies and procedures governing the program and the necessary corrective actions will be taken accordance with University policy and state guidelines. The University's corrective action is ongoing.

NORFOLK STATE UNIVERSITY
Norfolk, Virginia

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