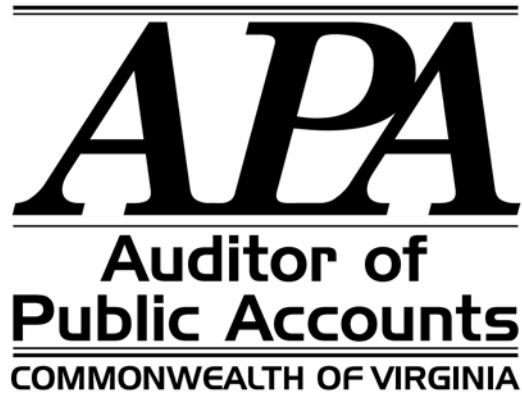


VIRGINIA COMMUNITY COLLEGE SYSTEM

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2004**



AUDIT SUMMARY

Our audit of the Virginia Community College System for the year ended June 30, 2004, found:

- the financial statements are presented fairly, in all material respects;
- internal control matters that we consider reportable conditions; however, we do not consider any of these to be material weaknesses;

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

- instances of noncompliance required to be reported that are described fully in the section of the report entitled “Internal Control and Compliance Findings and Recommendations;” and
- adequate corrective action of prior audit findings except that J. Sargeant Reynolds, Virginia Western, Wytheville, and Patrick Henry Community Colleges have not improved their capital asset management and reporting. Additionally, access to critical systems is still not revoked timely at Central Virginia Community College.

- TABLE OF CONTENTS -

AUDIT SUMMARY

INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL STATEMENTS:

Statement of Net Assets

Statement of Revenues, Expenses, and Changes in Net Assets

Statement of Cash Flows

Notes to Financial Statements

INDEPENDENT AUDITOR'S REPORT:

Report on Financial Statements

Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters

SYSTEM RESPONSE TO INTERNAL CONTROL AND COMPLIANCE
FINDINGS AND RECOMMENDATIONS

SYSTEM OFFICIALS

COLLEGES OF THE VIRGINIA COMMUNITY COLLEGE SYSTEM
AND COMMUNITY COLLEGE PRESIDENTS

INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Finalize and Improve Information Systems Security Plans

Applicable to: Piedmont Virginia Community College
Southwest Virginia Community College
Virginia Community College System's Office

The System Office, Southwest Virginia and Piedmont Virginia have not completed the update of their Information Systems Security Plans. Both the Auditor of Public Accounts and the VCCS Internal Auditor reported the outdated and incomplete plans in fiscal year 2002 audits. Since then the System Office, Southwest Virginia, and Piedmont Virginia have taken steps to draft Information Systems Security plans, however, the plans are still not complete.

The System Office's current draft contains some variations with its current operating environment that VCCS needs to address. A good Information Systems Security Plan sets the tone and provides the necessary guidance to staff for protecting sensitive and critical data. In our review of the Security Plan, we noted several instances where the Security Plan set specific operating standards, however, the agency Risk Assessment identified that VCCS was not meeting that standard and is willing to accept those risks, without documenting the compensating controls or mitigating factors. Finally, the System Office does not have documented standard configurations for its RACF security.

Additionally, Southwest Virginia and Piedmont Virginia's plans have either not addressed or identified potential threats and vulnerabilities to sensitive assets. The plans also do not identify or address the physical security of sensitive assets. Southwest Virginia's plan does not address logical security access, and Piedmont Virginia's plan does not address monitoring and periodic reviews of logical access. Furthermore, Piedmont Virginia's Plan does not have procedures to store back-up data at an off-site location.

We recommend that the System's Office, Southwest Virginia, and Piedmont Virginia complete its Information Systems Security Plan and then review all operating policies and procedures to ensure consistency with the Information Security Plan. Updating the specific operating policies and procedures will nullify any variations between the College's actual operating environment and its security plan and increase the validity of the College's policies and procedures.

The System Office should review its Business Recovery Plan and Risk Assessment and add any missing risks such as not using a fire suppression system in their Network Operations Center. As well, assessing more risks will strengthen VCCS' disaster recovery plan and procedures. Once VCCS has updated the Security Plan and operating policies and procedures, VCCS management should ensure all staff are aware of the applicable portions of the Information Systems Security Plan and operating policies and procedures related to their job. Finally, VCCS should review and approve all policies and procedures periodically to ensure the policy conforms to current business and technology practices. Documenting the review and approval process will also increase the validity and enforcement of VCCS policies, procedures, and standards.

Follow Procedures for Computer System Access

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

Employees at three colleges had unauthorized access to the financial, payroll, or administrative computer systems either because they had terminated employment or the access was not necessary for their job function. Central Virginia and Piedmont did not revoke access to computer systems promptly after employees terminated. Germanna granted inappropriate systems access to employees based on their job function. Additionally, Danville does not periodically review employee's access to Peoplesoft to ensure it is still appropriate.

We recommend that all Colleges follow established procedures relating to the monitoring and deletion of access to the College's financial, payroll, and administrative computer systems. This includes periodic monitoring by supervisors for the need for continued access for employees and the prompt revocation of access upon termination of employment. Failure to restrict computer access to current employees who need such access to perform duties places the College at risk for inappropriate changes or disclosure of important financial, administrative, and personal information.

Continue Improving Capital Asset Management and Reporting

VCCS reports capital assets for all 23 Community Colleges in the System, which includes Land, Land Improvements, Buildings, Infrastructure, Construction-in-Progress, Equipment, Library Books, and Works of Art. During fiscal year 2004, VCCS reported \$455 million in capital assets, net of accumulated depreciation. Individual colleges are primarily responsible for entering equipment information in the Fixed Asset Information System (FAIS), performing inventories for equipment, and tracking locally-funded assets.

During the fiscal year 2004 audit, we found the following colleges did not properly maintain asset records or adequately record changes in assets throughout the year.

Applicable to: J. Sargeant Reynolds Community College
Patrick Henry Community College
Virginia Western Community College
Wytheville Community College

The Commonwealth's accounting policies require agencies to record disposed assets in the fiscal year the disposal occurred. J. Sargeant Reynolds, Virginia Western, and Wytheville did not remove assets promptly from FAIS. In addition, each of these colleges did not maintain the proper documentation for the disposal of assets.

The Commonwealth's accounting policies also require agencies to record assets within 60 days of receipt and acceptance. Agencies should capitalize and record assets at market value. Virginia Western did not record two out of five assets purchased. Additionally, one asset was under valued in FAIS by \$10,000.

In addition, Patrick Henry improperly capitalized software licenses and maintenance agreements. The Commonwealth's accounting policies requires agencies to expense these items since they can not modify or sell them at a later date.

Failure to comply with policies and properly maintain the Fixed Asset Inventory System could result in a misstatement to the financial statements. VCCS should ensure that each college properly maintains and records capital asset information in FAIS.

Improve Cash Management Controls

Applicable to: Southside Virginia Community College

Southside Virginia does not have proper internal controls over the receipting, depositing, and reconciling of cash receipts. The Cashier receives the cash, enters the transactions in Peoplesoft, reconciles the cash to Peoplesoft, prepares the deposit, deposits the cash, and enters the transactions into the Financial Reporting System. To compensate for this lack of separation of duties, the Business Manager or Vice President of Finance review and approve the Daily Cash Settlement Reports, however, Southside Virginia is not performing this review and approval process adequately or timely.

The Business Manager and the Vice President of Finance did not review four out of ten (40%) Daily Cash Settlement Reports timely, with a delay of as much as seven months between the receipt date and the review date. The Cashier did not prepare three of the Reports timely, with a delay of up to four months between receipt and preparation date. Review of the Daily Cash Settlement Report is the main control over cash receipts and deposits. Without this control in place and working properly, Southside Virginia risks recording and reporting improper cash and revenue and increases the potential for fraud.

Additionally, Southside Virginia had 17 checks outstanding for more than one year, totaling \$9,467 at year-end. Twelve of the checks, totaling \$3,307 are from the Federal Fund Account, and Southside Virginia has not returned these funds to the Department of Education.

Southside Virginia should prepare, review and approve the Daily Cash Settlement Reports timely. In addition, Southside Virginia should separate the cash functions between multiple individuals to provide adequate internal controls over cash to reduce the risk of improper recording and reporting of cash or fraud from occurring.

Properly Report and Track Accounts Receivable

Applicable to: Danville Community College
J. Sargeant Reynolds Community College

VCCS reported \$8.7 million in accounts receivables at the end of fiscal year 2004. These receivables consist of tuition and fees, auxiliary enterprises, federal, state, local, and nongovernmental grants, gifts, contracts, and other activities. During the fiscal year 2004 audit, we found two colleges did not properly report accounts receivables at year end or track aging receivables.

J. Sargeant Reynolds did not properly report accounts receivable at June 30, 2004. The College reported fifteen receivables that they collected prior to June 30, 2004. The inaccurate reporting caused a \$109,337 overstatement of Accounts Receivables.

Danville does not have an adequate system for tracking and aging receivables. As a result, Danville does not properly report aging receivables to the VCCS Central Office or the Department of Accounts. Furthermore, management is not able to make informed decisions for allowance for doubtful accounts and write offs.

The Colleges should ensure accurate and timely reporting of accounts receivables to reduce the risk of misstating the financial statements.

Properly Administer Return of Title IV Funds

Applicable to: Danville Community College
Lord Fairfax Community College
Rappahannock Community College
Tidewater Community College

Tidewater failed to properly calculate Title IV refund amounts. Danville and Lord Fairfax performed Title IV refunds accurately. However, Lord Fairfax did not return federal funds to the U. S. Department of Education timely, and Danville did not return any federal funds to the U. S. Department of Education in the 2003-2004 academic year. Danville has since returned all identified funds to the U. S. Department of Education. Lord Fairfax did not notify students of grant overpayments promptly. Danville did not notify the U. S. Department of Education of students who had not repaid any overpayments within the required time period. Additionally, Tidewater and Rappahannock do not have adequate procedures to identify students who withdraw or cease attendance without notifying college staff.

There are no questioned costs reported because at three of the four institutions, the known or likely questioned costs are less than \$10,000, and the fourth institution subsequently returned all identified funds.

The Code of Federal Regulations, 34 CFR Part 668.22 (c), requires that colleges have mechanism in place to identify students who have withdrawn or ceased attendance, in order to promptly and properly calculate any return of Title IV funds. Part 668.22 (e) sets forth the manner to properly calculate the refund amounts due to Title IV programs. Part 668.22 (j) requires that colleges return unearned Title IV funds as soon as possible to the U. S. Department of Education, but no later than 30 days after the college determined the student withdrew. Part 668.22 (h) requires that within 30 days of the date that the college determines that the student withdrew, the college must send a notice to the student notifying them of any over-award amounts owed. This part also requires that the College turnover any over-award amounts owed by the student to the Department of Education for collection if the student has not responded within 45 days after notification.

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

Strengthen Petty Cash Procedures

Applicable to: J. Sargeant Reynolds Community College

J. Sargeant Reynolds does not follow the Commonwealth's accounting policies regarding Petty Cash. Agencies should not use a petty cash fund when they can arrange an agency billing or when they can pay through the normal vendor payment process. Agencies should use petty cash only for emergency purchases or services or for immediate payments where vendors will not provide goods or services without immediate payment.

Three petty cash transactions reviewed were for non-emergency purchases. Additionally, someone could have made these purchases using the small purchase charge card or through normal vendor payment processes. When possible, J. Sargeant Reynolds should use Small Purchase Charge Cards in lieu of petty cash.

Strengthen Internal Controls over the Small Purchase Charge Card Program

Applicable to: Thomas Nelson Community College

VCCS has issued charge cards to over 990 employees at the System Office and Community Colleges for purchasing various goods and services. VCCS employees purchased over \$17.4 million under the program during fiscal year 2004. VCCS and each of the colleges have developed policies and procedures for the program to ensure that all purchases made using the Small Purchase Charge Card follow state guidelines. However, we found Thomas Nelson did not follow some established procedures.

Thomas Nelson paid sales tax when purchasing tax-exempt items on the Small Purchase Charge Card. All of the Small Purchase Charge Card holders reviewed paid sales tax on more than one occasion on purchases that should have been tax-exempt.

The Commonwealth's accounting policies require that small purchase charge cardholders not pay Virginia sales tax on goods and services. Individual cardholders who mistakenly pay sales tax should take necessary steps with the vendor to credit their account with the amount of tax paid.

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

Strengthen Internal Controls over Payments

Applicable to: Thomas Nelson Community College

Thomas Nelson does not properly maintain expenditure vouchers and supporting documentation. Thomas Nelson could not provide six out of 36 total vouchers and batch headers requested (17%). Three of the six missing documents were for payments made by Thomas Nelson to the Thomas Nelson Community College Educational Foundation. The total of the missing voucher packages equaled \$13,802. Without access to these missing vouchers, we cannot review the expenditures for proper review, approval and proper coding. However, we did not note any exceptions for the vouchers we did review.

The Commonwealth's accounting policies require all state entities maintain payment documents for three years. Thomas Nelson should take the necessary steps to maintain records in an organized fashion. Poor maintenance of files could allow for the loss of sensitive information or for an unauthorized individual to possibly misuse the information.

MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited)

The following discussion and analysis provides an overview of the financial position and activities of the Virginia Community College System (VCCS) for the year ended June 30, 2004. It also includes a comparative analysis of prior year financial data. This discussion has been prepared by management and should be read in conjunction with the financial statements and footnotes.

The VCCS implemented GASB 39, *Determining Whether Certain Organizations are Component Units*, in fiscal year 2004. This statement addresses the conditions under which institutions should include associated fund-raising foundations as component units in their financial statements. Under the new standards, the foundations of the Virginia Community College System meet the criteria for component units. The foundations are included in the accompanying financial statements in a separate column. However, the following discussion and analysis does not include the financial condition and activities of the foundations.

Financial Highlights

The following events impacted the net assets of the VCCS in fiscal year 2004:

The general fund base budget for the VCCS was reduced \$47.1 million in fiscal year 2004. This permanent reduction is associated with budget cuts that resulted from the Commonwealth's general fund budget shortfall in fiscal year 2003. In addition, the VCCS lost a total of \$5.4 million in general funding from the maintenance reserve fund and the equipment trust fund program. The overall impact of these cuts resulted in a decrease in non-operating revenues and operating expenses of \$52.5 million.

In response to the general fund budget cuts in fiscal year 2002 and fiscal year 2003, tuition was increased in the summer 2002 (\$3.34 per credit hour to in-state students and \$15.39 per credit hour to out-of-state students) and the spring 2003 (\$12.25 per credit hour to all students). These actions generated approximately \$45 million in new tuition dollars in fiscal year 2004 as compared to \$25.6 million in fiscal year 2003 since full year collections were not realized. As a result, the overall increase on operating revenues and expenses in fiscal year 2004 is approximately \$19.4 million.

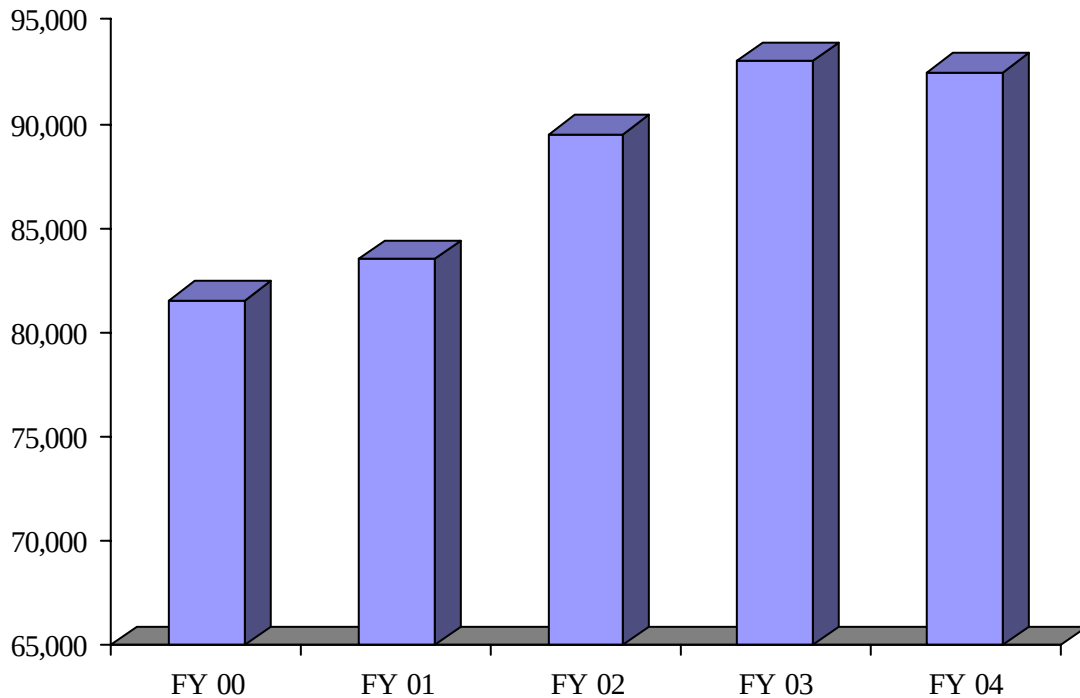
The State Board for Community Colleges voted to increase tuition and fees by \$6.89 per credit hour to all students in the fall 2003. These actions increased operating revenues and expenses by an additional \$16.4 million in fiscal year 2004.

Net assets increased by \$22 million principally due to increased investment in capital assets, net of related debt of \$9 million and \$10 million in cash restricted for the acquisition of capital assets.

Enrollment Information

Below is a chart depicting full-time equivalent students attending the VCCS over the past five years. The VCCS mission is to provide comprehensive higher education and workforce training programs and services of superior quality that are financially and geographically accessible and that meet individual, business, and community needs of the Commonwealth.

VCCS Annual Enrollment Full Time Equivalents



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

Financial Statements

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

Statement of Net Assets

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

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

	<u>2004</u>	<u>2003</u>
Assets:		
Current assets	\$101,769	\$ 96,975
Capital assets, net	454,768	445,402
Other non-current assets	<u>36,560</u>	<u>22,066</u>
Total assets	<u>593,097</u>	<u>564,443</u>
Liabilities:		
Current liabilities	65,585	63,627
Non-current liabilities	<u>66,256</u>	<u>61,936</u>
Total liabilities	<u>131,841</u>	<u>125,563</u>
Net assets:		
Invested in capital assets, net of debt	412,654	403,425
Restricted-nonexpendable	430	429
Restricted-expendable	22,984	14,435
Unrestricted	<u>25,188</u>	<u>20,591</u>
Total net assets	<u>\$461,256</u>	<u>\$438,880</u>

* in thousands

Current assets consist of \$83 million in cash and investments, accounts and notes receivable of \$12 million, prepaid expenses of \$5 million and inventories of \$2 million. Current assets increased by \$5 million due to higher receivables of \$4 million and higher prepaid expenses of \$1 million.

Net capital assets increased by \$9 million. Capital additions were equipment, land improvements, and library book purchases of \$11, \$5.2 and \$2 million, respectively. Construction-in-progress additions of \$22 million were principally comprised of \$5 million at JSRCC for the Downtown Parking Deck, \$4 million at GCC for the Fredericksburg Campus, \$4 million at CVCC for the Manufacturing Technologies Building, \$3 million at NVCC for various projects, \$1 million at VWCC for the College Services Building and \$1 million at MECC for renovations. These projects were funded with appropriations and bond proceeds. Current year depreciation expense was \$26 million. Net retirements were \$1 million.

At June 30, 2004 the VCCS had future commitments for construction contracts totaling \$19.5 million. Commitments are primarily comprised of \$.9 million for the Manufacturing Technologies Building at CVCC, \$3.1 million for the Regional Center for Applied Technology at DCC, \$.5 million for the Fredericksburg Campus at GCC, \$.7 million for the Downtown Parking Deck and \$.3 million for Phase IV of the Parham Road Campus at JSRCC, \$.8 million for the Laboratory Science Building at LFCC, \$.4 million for renovations at MECC, \$3.9 million for renovations at NVCC, \$.5 for the Learning Resource Center at SWVCC, \$.7 million for renovations at VWCC, \$1.2 million for the Sciences Building at TCC, \$.8 million for roof replacements, \$1.9 for maintenance buildings at LFCC, PDCCC and DSLCC and \$1.3 million for major mechanical projects at BRCC, SWVCC, TNCC and VHCC.

Other noncurrent assets were principally comprised of cash held for the acquisition of capital assets. This cash increased by \$14 million due to additional funds that were available for capital spending.

Current liabilities consist primarily of accounts payable of \$11 million, accrued compensation of \$32 million, deferred revenue of \$14 million, debt obligations of \$5 million and deposits of \$2 million. Current liabilities did not change significantly from fiscal year 2003. Noncurrent liabilities are comprised of accrued leave of \$14 million, long-term debt of \$47 million and amounts due to the federal government of \$5 million. Noncurrent liabilities increased by \$4 million principally due to additional notes payable on VPBA bonds.

Statement of Revenues, Expenses, and Changes in Net Assets

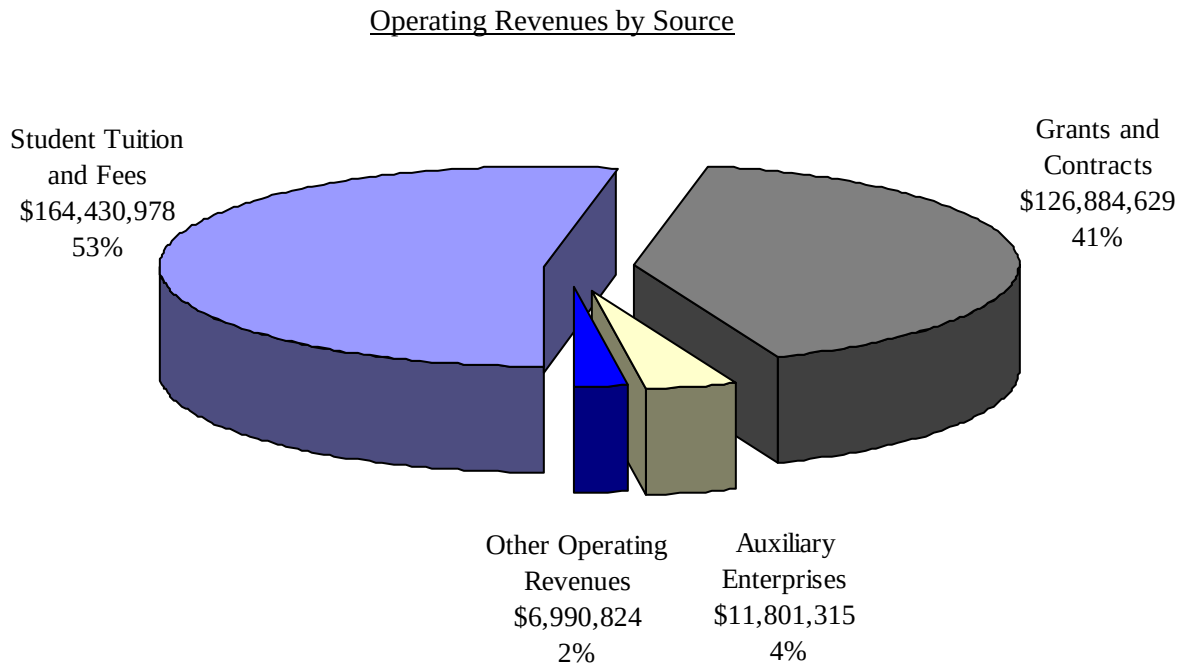
The purpose of the Statement of Revenues, Expenses, and Changes in Net Assets is to present operating and non-operating revenues received by the institution, operating and non-operating expenses incurred and any other revenues, expenses, gains and losses. Changes in net assets as presented on the Statement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

A summarized statement of revenues, expenses and changes in net assets for the years ended June 30, follows:

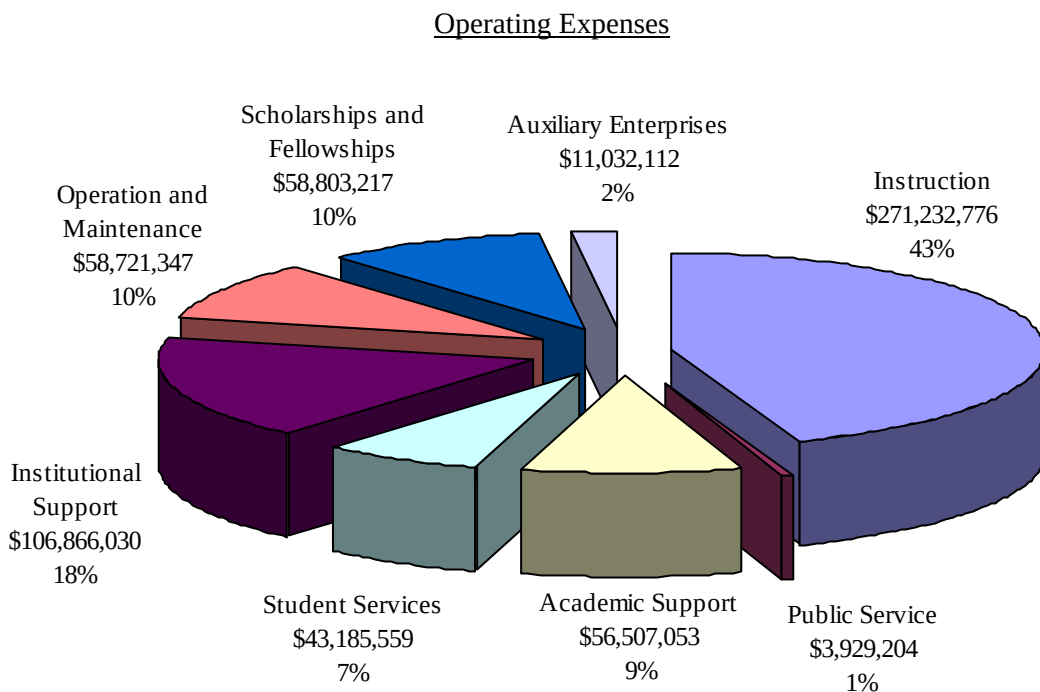
	<u>2004</u>	<u>2003</u>
Operating revenue	\$ 310,108	\$ 275,669
Operating expenses	<u>610,394</u>	<u>575,605</u>
Operating loss	<u>(300,286)</u>	<u>(299,936)</u>
Nonoperating revenues(expenses):		
State appropriations	280,484	282,879
Local appropriations	1,872	1,807
Private gifts and grants	5,567	808
Investment income	1,173	1,244
Interest expense	(1,631)	(1,798)
Other	<u>(776)</u>	<u>(773)</u>
Net nonoperating revenue	<u>286,689</u>	<u>284,167</u>
Loss before other revenues, expenses, gains or losses	<u>(13,597)</u>	<u>(15,769)</u>
Capital appropriations-state	29,940	22,372
Capital appropriations-local	3,586	3,466
Capital gifts and grants	<u>2,447</u>	<u>3,540</u>
Increase in net assets	22,376	13,609
Net assets – Beginning of year	<u>438,880</u>	<u>425,271</u>
Net assets, end of year	<u>\$ 461,256</u>	<u>\$ 438,880</u>

* in thousands

A graphic presentation of fiscal year 2004 operating revenues by source is below:



A graphic presentation of operating expenses by major function is below:



Statement of Cash Flows

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

	<u>2004</u>	<u>2003</u>
Cash received from operations	\$ 309,808	\$ 278,172
Cash used in operations	<u>579,970</u>	<u>546,916</u>
Net cash used in operations	(270,162)	(268,744)
Net cash provided by non-capital financing activities	281,965	286,609
Net cash provided by (used in) capital and related financing activities	285	(21,122)
Net cash provided by investing activities	<u>944</u>	<u>1,031</u>
Net increase (decrease) in cash and cash equivalents	13,032	(2,226)
Cash and cash equivalents, beginning of year	<u>99,257</u>	<u>101,483</u>
Cash and cash equivalents, end of year	<u>\$ 112,289</u>	<u>\$ 99,257</u>

* in thousands

Cash and cash equivalents increased by \$12 million in FY04 compared to a \$2 million decrease in FY03. Net cash used in operating activities in fiscal year 2004 was \$270 million. This was not a significant change from FY03. Net cash provided by non-capital financing activities decreased by \$5 million compared to FY03 principally due to \$2 million in lower state appropriations, \$1.5 million of additional agency fund disbursements and a \$1 million reduction in loan borrowings. Net cash provided by capital financing activities increased by \$21 million due to an increase in capital appropriations of \$7.6 million, increased bond proceeds of \$4.7 million and lower spending on capital projects of \$8.7 million.

Economic Outlook

The State Board for Community Colleges approved a tuition increase of \$4.10 per credit hour applicable to all students effective fall 2004. It is anticipated that this will generate an additional \$9.8 million in fiscal year 2005. These dollars are critical in helping the VCCS achieve its strategic plan approved by the State Board for Community Colleges in fiscal year 2003. The plan, entitled *Dateline 2009*, outlines seven strategic directions for the VCCS that are to be accomplished by fiscal year 2009 to achieve the ultimate goal of world-class status. A significant part of this initiative relies on expansion of the VCCS funding base. The VCCS will continually strive to obtain new federal, state, local, and private funding (including donations to VCCS foundations) to support the *Dateline 2009* initiatives.

In the fiscal year 2005 budget, the VCCS received approximately \$22 million in new general funding specifically earmarked to address base funding needs identified by the Joint Subcommittee of Higher Education Funding Policies. This amount reflects a portion of general fund support needed to provide adequate base support of the VCCS's core academic function. These additional funds will allow the VCCS to serve more students, retain existing students more effectively, increase the number of students receiving a degree or certificate, and enhance the quality and rigor of academic programs.

In November 2002, voters in the Commonwealth of Virginia passed a bond resolution that will ultimately provide \$159 million to the VCCS for more than forty-five construction and renovation projects. The VCCS began construction on 25 of these projects in fiscal year 2004. Total fiscal year 2004 expenditures charged to general obligation bond projects were \$2,292,756. Due to significant increases in the cost of construction materials and labor, it is estimated that the VCCS will not be adequately funded for projects originally approved under the general obligation bond campaign in fiscal year 2003. The funding shortage is estimated to be \$60 million. The VCCS will work with the colleges, the Department of Planning and Budget, and the General Assembly to address this shortfall.

VIRGINIA COMMUNITY COLLEGE SYSTEM
STATEMENT OF NET ASSETS
As of June 30, 2004

	VCCS	Component Units Foundations
ASSETS		
Current assets:		
Cash and cash equivalents (Note 2)	\$ 79,547,457	\$ 7,747,908
Short term investments (Note 2)	3,460,904	4,793,969
Accounts receivable (Note 3)	8,680,874	1,467,889
Pledges receivable (Note 3)	-	2,761,753
Due from Commonwealth	2,106,884	-
Interest receivable	27,682	68,684
Prepaid expenses	4,826,456	32,053
Inventories	2,142,775	-
Notes receivable (Note 3)	975,591	3,209
Total current assets	101,768,623	16,875,465
Noncurrent assets:		
Restricted cash and cash equivalents (Note 2)	23,149,299	-
Cash with trustees (Note 2)	9,232,033	-
Endowment cash and cash equivalents (Note 2)	360,280	610,557
Endowment investments (Note 2)	-	34,655,121
Other long-term investments (Note 2)	-	30,191,906
Investments in real estate	-	2,680,942
Pledges receivable (Note 3)	-	4,876,699
Notes receivable (Note 3)	3,818,487	34,298
Non-depreciable capital assets (Note 5)	59,443,294	-
Depreciable capital assets, net (Note 5)	395,324,590	3,276,219
Total noncurrent assets	491,327,983	76,325,742
Total assets	593,096,606	93,201,207
LIABILITIES		
Current liabilities:		
Accounts and retainage payable (Note 6)	11,424,181	447,484
Accrued payroll expense	21,240,832	35,305
Deferred revenue	14,094,869	16,328
Long-term liabilities-current portion (Note 8)	16,422,085	209,563
Due to Commonwealth	165,750	-
Deposits	2,237,361	-
Total current liabilities	65,585,078	708,680
Noncurrent liabilities:		
Deferred revenue (Note 8)	28,569	11,170
Account payable for noncurrent assets (Note 6)	8,091	-
Long-term liabilities (Note 8)	61,408,919	508,516
Due to federal government (Note 8)	4,810,047	-
Total noncurrent liabilities	66,255,626	519,686
Total liabilities	131,840,704	1,228,366

	NET ASSETS	
Invested in capital assets, net of related debt	412,654,006	3,276,219
Restricted for:		
Nonexpendable	430,384	30,629,834
Expendable	22,984,122	35,249,783
Unrestricted	25,187,390	22,817,005
Total net assets	\$ 461,255,902	\$ 91,972,841

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

VIRGINIA COMMUNITY COLLEGE SYSTEM
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2004

	VCCS	Component Units Foundations
Operating revenue:		
Tuition and fees (net of scholarship allowances of \$42,865,324)	\$ 164,430,978	\$ -
Federal grants and contracts	118,942,157	20,020
State and local grants	3,115,296	-
Nongovernmental grants	4,827,176	1,520,001
Sales/services of education department	524,514	-
Auxiliary enterprises (net of scholarship allowances of \$3,492,879)	11,801,315	-
Gifts and contributions	-	11,337,814
Endowment income	-	3,488,330
Other operating revenues	6,466,310	458,055
Total operating revenue	310,107,746	16,824,220
Operating expenses:		
Instruction	271,232,776	914,947
Public service	3,929,204	28,615
Academic support	56,507,053	710,120
Student services	43,185,559	-
Institutional support	106,866,030	4,510,212
Operation and maintenance	58,721,347	889,851
Scholarships and fellowships	58,803,217	2,403,981
Auxiliary enterprises	11,032,112	-
Fundraising	-	986,301
Other expenses	116,366	23,819
Total operating expenses	610,393,664	10,467,846
Operating income (loss)	(300,285,918)	6,356,374
Nonoperating revenues (expenses):		
State appropriations (Note 7)	280,484,235	-
Local appropriations	1,871,850	-
Grants and gifts	5,567,469	-
Investment income	1,173,357	3,019,752
Interest on capital asset related debt	(1,631,260)	-
Other nonoperating revenue (expense)	(776,386)	61,217
Net nonoperating revenue	286,689,265	3,080,969
Income before other revenues, expenses gains or losses	(13,596,653)	9,437,343
Capital appropriations-state	29,940,067	-
Capital appropriations-local	3,585,517	-
Capital gifts, grants and contracts	2,447,347	308,449
Additions to permanent and term endowments	-	3,261,378
Increase in net assets	22,376,278	13,007,170
Net assets - beginning of year	438,879,624	78,965,671
Net assets - end of year	\$ 461,255,902	\$ 91,972,841

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

VIRGINIA COMMUNITY COLLEGE SYSTEM
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2004

Cash flows from operating activities:	
Tuition and fees	\$ 162,450,606
Grants and contracts	127,073,525
Payments to suppliers and others	(115,472,839)
Payments for employee wages	(319,158,574)
Payments for employee fringe	(73,407,109)
Payment for scholarships	(60,851,355)
Payments for utilities	(9,846,610)
Sales and services of education department	524,514
Auxiliary	11,834,864
Loans issued to students	(1,233,549)
Loans collected from students	1,301,359
Other	6,623,571
	<u>(270,161,597)</u>
Net cash used by operating activities	
Cash flows from non-capital financing activities:	
State appropriations	280,484,235
Local appropriations	1,871,850
Grants and gifts	897,492
Agency receipts	6,306,092
Agency disbursements	(6,956,236)
PLUS, Stafford and Direct Lending loan receipts	22,816,965
PLUS, Stafford and Direct Lending loan disbursements	(23,326,724)
Borrowings	1,466,740
Loan repayments	(1,597,829)
Other non-operating revenue	2,639
	<u>281,965,224</u>
Net cash provided by non-capital financing activities	
Cash flows from capital financing activities:	
Capital appropriations-state	27,988,373
Capital appropriations-local	3,585,517
Capital grants and gifts	583,844
Purchase of capital assets	(35,712,071)
Proceeds from sale of capital assets	15,294
Proceeds from bond issue	8,950,000
Debt interest payments	(624,566)
Debt principal payments	(4,502,139)
	<u>284,252</u>
Net cash provided by capital financing activities	
Cash flows from investing activities:	
Purchases of investments	(7,123,896)
Sale of investments	6,873,451
Investment income	1,194,134
	<u>943,689</u>
Net cash provided by investing activities	
Net increase in cash and cash equivalents	13,031,568
Cash and cash equivalents - beginning of year	<u>99,257,501</u>
Cash and cash equivalents - end of year	<u>\$ 112,289,069</u>

Reconciliation of operating income (loss) to net cash used in operating activities	
Operating income (loss)	\$ (300,285,918)
Adjustment to reconcile operating income (loss) to net cash used in operating activities	
Depreciation expense	26,528,145
Changes in assets and liabilities:	
Accounts receivable, net	(2,728,254)
Prepaid expenses and other	1,384,477
Accrued compensation and leave	1,582,891
Accounts payable and other	1,788,546
Deferred revenue	1,531,075
Deposits pending distribution	<u>37,441</u>
Net cash used in operating activities	<u>\$ (270,161,597)</u>
Noncash transactions:	
ETF equipment	\$ 6,150,451
Assets acquired through capital leases or installment purchases	1,348,001
Donated fixed assets	343,872
Debt principal and interest payments made by Treasury	1,951,694
The accompanying Notes to the Financial Statements are an integral part of this statement	

VIRGINIA COMMUNITY COLLEGE SYSTEM

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Virginia Community College System (VCCS) was established as an institution of higher education in 1965. The System includes the State Board for Community Colleges, a System Office located in Richmond, 23 community colleges located on 40 campuses throughout the Commonwealth and the Information Technology Utility. The State Board for Community Colleges is the governing body and is charged with the responsibility to establish, control, and administer a statewide system of publicly supported comprehensive community colleges. The System therefore functions as a statewide institution of higher learning.

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

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

B. Accounting Policy Changes

The VCCS adopted the following accounting and reporting change for the year ended June 30, 2004:

GASB Statement 39, *Determining Whether Certain Organizations Are Component Units*, an amendment of GASB Statement 14, *The Financial Reporting Entity*. This statement addresses the conditions under which institutions should include associated fund-raising or research foundations as component units in their basic financial statements; and how such component units should be displayed in the financial statements. This statement is effective for the fiscal year ending June 30, 2004.

Previously, the VCCS had no component units, as defined by GASB Statement 14. However, under Statement Number 39 standards, the foundations at every college meet criteria qualifying it as a component unit of the college. The foundations are legally separate, tax-exempt organizations formed to promote the achievements and further the aims and purposes of the colleges. The foundations accomplish their purposes through fundraising and funds management efforts that benefit the colleges and their programs. Although the colleges do not control the timing or amount of receipts from the foundations, the majority of resources, or income thereon, that the foundations hold and invest are restricted to the activities of the colleges by the donors. Because these restricted resources held by the foundations can only be used by, or for the benefit of the colleges, the foundations are

considered component units of the colleges and are discretely presented in the financial statements.

During the year ended June 30, 2004, the foundations distributed \$5,201,172 to the colleges for both restricted and unrestricted purposes. Complete financial statements for the foundations can be obtained by writing the VCCS Office of Fiscal Services, 101 N. 14th St., Richmond, VA 23219.

C. Basis of Accounting

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

Revenues and expenses of the summer academic term occur within two fiscal years, because the term extends from May through August and the fiscal year ends on June 30. Expenses and an equal amount of revenue have been reported in the current period for the portion of the summer academic term from May 16 through June 30, 2004.

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

The foundations are private, nonprofit organizations that report under FASB standards, including FASB Statements 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB. No modifications have been made to the financial information of the foundations in the financial statements of the VCCS.

The financial statements for the foundations are for the year ending June 30, 2004 except for Danville, John Tyler and Virginia Western that are as of December 31, 2003.

D. Inventories

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

E. Investments

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

F. Capital Assets

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

G. Accrued Compensated Absences

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

H. System Office Expenditures

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

I. Classification of Revenues and Expenses

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

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

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

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

J. Scholarship Discounts and Allowances

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

K. Net Assets

Net assets are classified as follows:

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

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

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

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

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

2. CASH AND INVESTMENTS

Cash and Cash Equivalents

Cash of the Virginia Community College System that is maintained by the Treasurer of Virginia is invested and collateralized pursuant to Section 2.2-1800, et seq., Code of Virginia (1950), as amended, who is responsible for the collection, disbursement, custody and investment of State funds.

Local deposits with banks and savings institutions not with the Treasurer of Virginia are covered by federal depository insurance or collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 et seq., of the Code of Virginia.

Cash equivalents maintained by the System are investments with maturities of less than three months.

Investments

Certain deposits and investments are held by the System. Such investments are reported separately from cash and cash equivalents. Investments represent securities with maturities of more than 3 months and for which management intends to hold the securities to maturity.

Credit Risk

The System's cash equivalents and investments are categorized below to give an indication of the level of credit risk assumed by the System at June 30, 2004. Credit risk is the risk the System may not be able to obtain possession of its investment instrument or collateral at maturity.

- Category 1 - Insured or registered securities or securities held by the Virginia Community College System or its agent in the name of the Virginia Community College System.
- Category 2 - Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the name of the Virginia Community College System.
- Category 3 - Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the name of the Virginia Community College System.

Categorization of cash equivalents and investments held at June 30, 2004:

	<u>Category 1</u>	<u>Category 2</u>	<u>Fair Market Value</u>
Cash	\$ -	\$ -	\$ 76,521,578
Cash equivalents:			
Categorized:			
U.S. government securities	2,354,052	-	2,354,052
Certificates of deposit	6,064,758	-	6,064,758
Repurchase agreements	310,880	2,405,924	2,716,804
Non-categorized:			
Money market	-	-	629,360
Local Government Investment Pool	-	-	24,002,517
Investments:			
Categorized:			
U.S. government securities	2,899,510	-	2,899,510
Non-categorized:			
Mutual funds	-	-	561,394
 Total	 <u>\$11,629,200</u>	 <u>\$2,405,924</u>	 <u>\$115,749,973</u>

Community College Foundations

The foundations had the following cash, cash equivalents, and investments as of June 30, 2004:

Cash and cash equivalents	<u>\$8,358,465</u>
Investments:	
Mutual funds	\$30,784,560
Stocks	10,069,683
U.S. government securities	9,954,855
Common fund	8,514,631
Corporate bonds	4,532,913
UVA investment fund	2,635,888
Certificates of deposit	1,117,579
Split-interest agreement	528,095
Commercial paper	445,085
Cash surrender value of life insurance	427,422
Cash and cash equivalents	368,020
Municipal securities	102,628
Mortgage-backed securities	86,205
Limited partnership	36,603
Short-term bank notes	<u>36,829</u>
Total	<u>\$69,640,996</u>

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

3. RECEIVABLES AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

The following receivables included an allowance for doubtful accounts at June 30, 2004:

Gross accounts receivable:	
Tuition and fees	\$6,824,366
Auxiliary enterprises	784,440
Federal, state, local and nongovernmental grants, gifts, contracts	1,193,909
Other activities	<u>443,091</u>
Total gross accounts receivable	<u>9,245,806</u>
Less: Allowance for doubtful accounts	<u>564,932</u>
Net accounts receivable	<u>\$8,680,874</u>
Gross loans and notes receivable	\$4,955,203
Less: Allowance for doubtful accounts	<u>161,125</u>
Net loans and notes receivable	<u>\$4,794,078</u>

The only receivables not expected to be collected within one year are \$3,818,487 in notes and loans receivable.

Community College Foundations

The foundations had the following receivables as of June 30, 2004:

Gross accounts receivable:	\$1,510,313
Less: Allowance for doubtful accounts	<u>42,424</u>
Net accounts receivable	<u>\$1,467,889</u>
Pledges receivable:	
Due in one year	\$2,795,499
Due in one to five years	5,230,796
Due in more than five years	4,500
Less: Allowance for doubtful accounts	181,822
Present value discount	<u>210,521</u>
Net pledges receivable	<u>\$7,638,452</u>
Gross loans and notes receivable	\$ 37,965
Less: Allowance for doubtful accounts	<u>458</u>
Net loans and notes receivable	<u>\$ 37,507</u>

The only receivables not expected to be collected within one year are \$34,298 in notes and loans receivable and \$4,876,699 in pledges receivable.

4. PENSION PLAN

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

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

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

Individual contracts issued under the ORP plan provide for full and immediate vesting of the VCCS contributions. Total pension costs under this plan were \$3,919,328 and \$3,831,950 for years ended June 30, 2004 and 2003, respectively. Contributions to the ORP plan were calculated using the base salary amount of \$37,685,846 and 36,845,673 for fiscal years 2004 and 2003. The VCCS total payroll for fiscal years 2004 and 2003 was \$316,892,165 and \$307,215,106 respectively.

5. CAPITAL ASSETS

Changes in capital assets for the year ended June 30, 2004 are as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Non-depreciable capital assets:				
Land	\$ 26,047,337	\$ 8,177	\$ -	\$ 26,055,514
Land improvements	8,531,207	1,358,938	-	9,890,145
Inexhaustible works of art	83,242	-	-	83,242
Construction in progress	<u>50,878,058</u>	<u>22,063,877</u>	<u>49,527,542</u>	<u>23,414,393</u>
Total non-depreciable capital assets	<u>85,539,844</u>	<u>23,430,992</u>	<u>49,527,542</u>	<u>59,443,294</u>
Depreciable capital assets:				
Buildings	387,387,626	45,523,837	293,450	432,618,013
Infrastructure	18,940,650	723,191	-	19,663,841
Equipment	109,653,703	11,155,056	5,315,686	115,493,073
Land improvements	40,479,737	3,861,110	22,740	44,318,107
Library books	<u>38,630,599</u>	<u>1,917,047</u>	<u>1,315,112</u>	<u>39,232,534</u>
Total depreciable capital assets	<u>595,092,315</u>	<u>63,180,241</u>	<u>6,946,988</u>	<u>651,325,568</u>
Less accumulated depreciation for:				
Buildings	(106,531,716)	(9,581,689)	-	(116,113,405)
Infrastructure	(7,285,620)	(1,098,243)	-	(8,383,863)
Equipment	(66,917,658)	(12,785,494)	(4,441,967)	(75,261,185)
Land improvements	(24,225,933)	(1,376,014)	-	(25,601,947)
Library books	<u>(30,268,975)</u>	<u>(1,686,705)</u>	<u>(1,315,102)</u>	<u>(30,640,578)</u>
Total accumulated depreciation	<u>(235,229,902)</u>	<u>(26,528,145)</u>	<u>(5,757,069)</u>	<u>(256,000,978)</u>
Depreciable capital assets, net	<u>359,862,413</u>	<u>36,652,096</u>	<u>1,189,919</u>	<u>395,324,590</u>
Total capital assets, net	<u>\$ 445,402,257</u>	<u>\$ 60,083,088</u>	<u>\$50,717,461</u>	<u>\$ 454,767,884</u>

Construction-In-Progress additions include capitalized interest of \$654,596.

Community College Foundations

The foundations had the following capital assets as of June 30, 2004:

Non-depreciable capital assets:	
Land	\$1,158,815
Works of art	<u>235,197</u>
Total non-depreciable capital assets	<u>1,394,012</u>
Depreciable capital assets:	
Buildings	1,763,772
Equipment	1,016,201
Infrastructure	<u>558,570</u>
Total depreciable capital assets	3,338,543
Less: Accumulated depreciation	<u>1,456,336</u>
Depreciable capital assets, net	1,882,207
Total capital assets, net	<u>\$3,276,219</u>

6. ACCOUNTS AND RETAINAGE PAYABLE

Accounts and retainage payable consisted of the following as of June 30, 2004:

Vendor payables	\$10,001,394
Retainage payable	1,425,916
Taxes payable	<u>4,962</u>
Total	<u>\$11,432,272</u>

7. STATE APPROPRIATIONS

All Commonwealth Unrestricted Revenues must be appropriated by the Legislature and are provided on an annual basis. Unspent balances of these appropriations at the close of the fiscal year revert to the Commonwealth's General Fund. These reverted funds are eligible for reappropriation in fiscal year 2004-05 provided that the VCCS meets the Management Standards established by the Secretary of Education and the Secretary of Finance and approved by the Governor.

During the year ended June 30, 2004, the Virginia Community College System received the following supplemental appropriations in accordance with the Appropriation Act of 2003, Chapter 1042, and Appropriation Act of 2004, Chapter 943, Acts of Assembly.

Original Legislative Appropriations	\$264,122,320
Less: Governor's amendment – 2004 session COVANET savings reduction	(3,211)
Appropriated-Chapter 1042	264,119,109
Additions:	
Transfers from central appropriations:	
Property insurance	61,302
Employee health care insurance premium increase	3,527,181
VSDP rate increase	553,356
Classified salary increase - 2.25% scale	694,968
Faculty salary increase – 2.25%scale	1,767,270
Reductions:	
Retirement rate decrease	(745,250)
Group life insurance rate decrease	(1,143,177)
Retiree health credit savings	(370,279)
VSDP rate reduction	(273,958)
Airline ticket savings	(20,929)
Other:	
FY03 prepayment of across-the-board reversions, returned in FY04	5,000,000
FY03 reappropriation of E & G cash balances	652,095
Transfer from Program 534 for costs of reversions	159,913
Transfer from SCHEV – cost of inter-library lending	18,921
General fund reversion	(3,531,091)
Philpott Manufacturing	(508,140)
Equipment Trust Fund lease payment	(512,750)
Retirement rate decrease	(329,960)
Group life rate partial suspension	(506,007)
Transfer capital fee	(258,960)
Retiree health credit reduction	(163,940)
IHRIS loan payment	(159,457)
VSDP rate reduction	<u>(121,294)</u>
Adjusted unrestricted appropriations	<u>\$267,908,923</u>

Other restricted appropriations were \$12,575,312 for a total of \$280,484,235.

8. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2004 is as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Bonds payable	\$ 2,030,348	\$ -	\$ 395,530	\$ 1,634,818	\$ 175,138
Notes payable:					
Capital leases	24,371,291	896,333	1,310,314	23,957,310	1,381,142
Installment purchases	7,518,777	827,328	3,326,295	5,019,810	1,506,862
Pooled bonds	11,755,000	8,950,000	415,000	20,290,000	825,000
Other notes payable	<u>1,767,829</u>	<u>1,466,740</u>	<u>1,597,829</u>	<u>1,636,740</u>	<u>1,636,740</u>
Total bonds, notes and capital leases	<u>47,443,245</u>	<u>12,140,401</u>	<u>7,044,968</u>	<u>52,538,678</u>	<u>5,524,882</u>
Other liabilities:					
Compensated absences	25,110,208	14,659,014	14,476,896	25,292,326	10,897,203
Deferred revenue	49,624	5,593	26,648	28,569	-
Federal loan program contributions	<u>4,642,708</u>	<u>167,376</u>	<u>37</u>	<u>4,810,047</u>	<u>-</u>
Total other liabilities	<u>29,802,540</u>	<u>14,831,983</u>	<u>14,503,581</u>	<u>30,130,942</u>	<u>10,897,203</u>
Total long-term liabilities	<u>\$77,245,785</u>	<u>\$26,972,384</u>	<u>\$21,548,549</u>	<u>\$82,669,620</u>	<u>\$16,422,085</u>

9. BONDS PAYABLE

Long-term debt in the form of bonds payable of the System as of June 30, 2004, consists of the following:

Higher Education Refunding Bonds, Series 1999, issued \$1,868,800 to advance refund a portion of the Higher Education Bonds, Series 1992A. The balance is payable in annual installments ranging from approximately \$175,000 to \$240,000 with an average coupon rate of 4.32% payable semiannually. The final installment of \$239,167 is due June 1, 2012. The outstanding balance at June 30, 2004 is \$1,634,818.

Aggregate annual maturities of bonds payable for fiscal years after 2004:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 175,138	\$ 73,259	\$ 248,397
2006	178,778	65,377	244,155
2007	185,933	58,048	243,981
2008	200,833	48,751	249,584
2009	207,909	40,215	248,124
2010 - 2014	<u>686,227</u>	<u>63,342</u>	<u>749,569</u>
Total debt service requirements	<u>\$1,634,818</u>	<u>\$348,992</u>	<u>\$1,983,810</u>

10. NOTES PAYABLE

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

Parking improvements for the Midlothian campus of John Tyler Community College. The balance is to be repaid in ten annual installments ranging from \$35,000 to \$45,000 with an average coupon rate of 3.07% payable semiannually. The final installment of \$45,000 is due September 1, 2008. The outstanding balance at June 30, 2004 is \$215,000.

Parking garage for the Medical Education campus of Northern Virginia Community College. The balance is to be repaid in twenty annual installments ranging from \$270,000 to \$555,000 with an average coupon rate of 4.43% payable annually. The final installment of \$555,000 is due September 1, 2021. The outstanding balance at June 30, 2004 is \$7,020,000.

Parking garage for the J. Sergeant Reynolds Community College. The balance is to be repaid in twenty annual installments ranging from \$135,000 to \$330,000 with an average coupon rate of 5.09% payable annually. The final installment of \$330,000 is due September 1, 2022. The outstanding balance at June 30, 2004 is \$4,105,000.

Parking deck for the Annandale Campus of Northern Virginia Community College. The balance is to be repaid in twenty annual installments ranging from \$310,000 to \$400,000 with an average coupon rate of 4.39% payable annually. The final installment of \$400,000 is due September 1, 2023. The outstanding balance at June 30, 2004 is \$7,910,000.

Parking and access road improvements for John Tyler Community College. The balance is to be repaid in ten annual installments ranging from \$70,000 to \$130,000 with an average coupon rate of 4.21% payable annually. The final installment of \$130,000 is due September 1, 2013. The outstanding balance at June 30, 2004 is \$1,040,000.

Other notes payable of \$1,636,740 represents advances received from the Commonwealth of Virginia in anticipation of federal grant funding. Scheduled maturities of notes payable are as follows:

Year Ending June 30,	Principal	Interest	Total Payments
2005	\$ 2,461,740	\$ 907,908	\$ 3,369,648
2006	950,000	882,023	1,832,023
2007	975,000	850,435	1,825,435
2008	1,000,000	810,158	1,810,158
2009	1,020,000	768,429	1,788,429
2010-2014	5,295,000	3,122,990	8,417,990
2015-2019	5,420,000	1,844,756	7,264,756
2020-2024	<u>4,805,000</u>	<u>488,455</u>	<u>5,293,455</u>
Total	<u>\$21,926,740</u>	<u>\$9,675,154</u>	<u>\$31,601,894</u>

11. LEASE COMMITMENTS AND INSTALLMENT PURCHASES

The System is committed under various capital lease, operating lease, and installment purchase agreements. The cost of assets capitalized under capital lease and installment purchase agreements total \$32,990,074 and \$7,616,239, respectively. Rent expense under operating lease agreements amounted to \$7,088,116 for the year. A summary of future obligations under lease agreements as of June 30, 2004, follows:

<u>Year Ending June 30</u>	<u>Capital Lease Obligations</u>	<u>Installment Purchase Obligations</u>	<u>Operating Lease Obligations</u>
2005	\$ 2,530,692	\$1,630,842	\$ 2,364,815
2006	2,349,764	1,564,643	1,905,220
2007	2,425,507	1,296,908	1,529,681
2008	2,393,106	654,880	1,378,640
2009	2,387,923	126,048	1,035,115
2010-2014	11,931,422	-	2,917,871
2015-2019	8,094,217	-	1,730,840
2020-2024	<u>1,478,373</u>	<u>-</u>	<u>345,000</u>
Total obligation and gross minimum lease payments	33,591,004	5,273,321	<u>\$13,207,182</u>
Less: Interest	<u>9,633,694</u>	<u>253,511</u>	
Present value of minimum lease payments	<u>\$23,957,310</u>	<u>\$5,019,810</u>	

12. EQUIPMENT TRUST FUND

The System participates in the Higher Education Equipment Trust Fund of the Virginia College Building Authority (VCBA). The Higher Education Equipment Trust Fund provides funds to public colleges and universities for equipment acquisition. In prior years, funds were provided in the form of a lease. During the year ended June 30, 2004, the VCBA financed the ETF program with state funds, which will not require repayment.

13. COMMITMENTS

At June 30, 2004, the VCCS had future commitments for construction and architectural/engineering contracts totaling approximately \$19,508,169. The System held \$1,425,916 as retainage payable on construction and architectural/engineering contracts for work performed. The retainage payable will be remitted to the various contractors upon satisfactory completion of the construction projects.

14. DONOR-RESTRICTED ENDOWMENTS

VCCS has two donor-restricted endowments totaling \$14,000 in restricted principal. The net appreciation on investments of donor-restricted endowments that is available for expenditure by the governing board for the year ended June 30, 2004 is \$175. These amounts are reported as restricted expendable net assets. Total-return policy is followed for authorizing and spending investment income.

15. CONTINGENCIES

Grants

The VCCS receives assistance from non-state grantor agencies in the form of grants. Entitlement to these resources is generally conditional upon compliance with the terms and conditions of grant agreements. Substantially all grants are subject to financial and compliance audits by the grantors. All disallowances as a result of these audits become a liability of the VCCS. As of June 30, 2004, the VCCS estimates that no material liabilities will result from such audits.

16. RISK MANAGEMENT

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

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

17. POST-EMPLOYMENT BENEFITS

The Commonwealth participates in the VRS-administered statewide group life insurance program which provides post-employment life insurance 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. OPERATING EXPENSES BY NATURAL AND FUNCTIONAL CLASSIFICATIONS

VCCS operating expenses for the year ended June 30, 2004 were as follows:

Functional Classification	Natural Classification					Supplies, Services and Other	Total
	Salaries and Benefits	Utilities	Scholarships	Depreciation			
Instruction	\$226,269,653	\$ 77,190	\$ 1,257,772	\$14,259,328	\$ 29,368,833	\$271,232,776	
Public service	2,211,798	25	-	90,595	1,626,786	3,929,204	
Academic support	42,440,953	37,863	55,804	2,956,775	11,015,658	56,507,053	
Student services	37,675,536	86	132,346	85,197	5,408,760	43,301,925	
Institutional support	70,198,164	3,743	-	7,969,828	28,694,295	106,866,030	
Operation and maintenance of plant	13,886,058	9,829,408	29,380	1,166,422	33,810,079	58,721,347	
Scholarships and fellowships	-	-	58,803,217	-	-	58,803,217	
Auxiliary enterprises	<u>1,617,553</u>	<u>76,604</u>	<u>375,988</u>	<u>-</u>	<u>8,961,967</u>	<u>11,032,112</u>	
Total	<u>\$394,299,715</u>	<u>\$10,024,919</u>	<u>\$60,654,507</u>	<u>\$26,528,145</u>	<u>\$118,886,378</u>	<u>\$610,393,664</u>	

19. ACCOUNTING CHANGES – REPORTING ENTITY

As of July 1, 2004, the Information Technology Utility was combined with the System's Office. This reflects operational changes only. There was no effect on the total net assets of the VCCS.

20. COMPONENT UNIT FINANCIAL INFORMATION

The System's component units are presented in the aggregate on the financial statements. Below is a condensed summary of the major foundations and an aggregate summary of the non-major foundations. The System has four major component units – Northern Virginia Community College Educational Foundation, Lord Fairfax Community College Educational Foundation, Patrick Henry Community College Educational Foundation, and Southwest Virginia Community College Educational Foundation. Additionally, the system has twenty-two non-major component units – Blue Ridge Community College Educational Foundation, Central Virginia Community College Educational Foundation, Dabney S. Lancaster Community College Educational Foundation, Danville Community College Educational Foundation, Eastern Shore Community College Educational Foundation, Germanna Community College Educational Foundation, J. Sargeant Reynolds Community College Educational Foundation, J. Sargeant Reynolds Community College Real Estate Foundation, John Tyler Community College Educational Foundation, Mountain Empire Community College Educational Foundation, New River Community College Educational Foundation, Paul D. Camp Community College Educational Foundation, Piedmont Community College Educational Foundation, Rappahannock Community College Educational Foundation, Southside Virginia Community College Educational Foundation, Thomas Nelson Community College Educational Foundation, Tidewater

Community College Educational Foundation, Virginia Highlands Community College Educational Foundation, Virginia Western Community College Educational Foundation, Wytheville Community College Educational Foundation, Wytheville Community College Scholarship Foundation, and Community Colleges of Virginia Educational Foundation. These organizations are separately incorporated entities and other auditors examine the related financial statements.

VIRGINIA COMMUNITY COLLEGE SYSTEM FOUNDATIONS
STATEMENT OF NET ASSETS
As of June 30, 2004

	Northern Virginia Community College Educational Foundation	Lord Fairfax Community College Educational Foundation	Patrick Henry Community College Foundation	Southwest Virginia Community College Educational Foundation	Combined Non-Major Component Units	Total Component Units
ASSETS						
Total current assets	\$ 5,488,122	\$ 553,756	\$ 308,255	\$ 1,629,467	\$ 8,895,865	\$ 16,875,465
Noncurrent assets:						
Other noncurrent assets	5,756,681	7,742,273	8,296,054	5,797,962	45,456,553	73,049,523
Capital assets, net	-	179,650	-	602,830	2,493,739	3,276,219
Total noncurrent assets	5,756,681	7,921,923	8,296,054	6,400,792	47,950,292	76,325,742
Total assets	11,244,803	8,475,679	8,604,309	8,030,259	56,846,157	93,201,207
LIABILITIES						
Total current liabilities	132,804	2,898	5,364	1,358	566,256	708,680
Noncurrent liabilities:						
Long-term liabilities	-	-	-	-	508,516	508,516
Other noncurrent liabilities	-	-	-	-	11,170	11,170
Total noncurrent liabilities	-	-	-	-	519,686	519,686
Total liabilities	132,804	2,898	5,364	1,358	1,085,942	1,228,366
NET ASSETS						
Invested in capital assets, net of related debt	-	179,650	-	602,830	2,493,739	3,276,219
Restricted for:						-
Nonexpendable	1,901,203	2,184,074	5,629,071	-	20,915,486	30,629,834
Expendable	2,415,553	6,831,380	1,849,251	3,851,829	20,301,770	35,249,783
Unrestricted	6,795,243	(722,323)	1,120,623	3,574,242	12,049,220	22,817,005
Total net assets	\$ 11,111,999	\$ 8,472,781	\$ 8,598,945	\$ 8,028,901	\$ 55,760,215	\$ 91,972,841

VIRGINIA COMMUNITY COLLEGE SYSTEM FOUNDATIONS
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2004

	Northern Virginia Community College Educational Foundation	Lord Fairfax Community College Educational Foundation	Patrick Henry Community College Foundation	Southwest Virginia Community College Educational Foundation	Combined Non-Major Component Units	Total Component Units
Total operating revenue	\$ 587,157	\$ (266,317)	\$ 1,696,033	\$ 1,149,669	\$ 13,657,678	\$ 16,824,220
Total operating expenses	1,127,846	175,766	850,795	1,167,176	7,146,263	10,467,846
Operating income (loss)	(540,689)	(442,083)	845,238	(17,507)	6,511,415	6,356,374
Nonoperating revenues (expenses):						
Investment income	558,131	207,770	92,535	752,118	1,409,198	3,019,752
Other nonoperating revenue (expense)	-	(1,011,377)	-	1,099,283	(26,689)	61,217
Net nonoperating revenue	558,131	(803,607)	92,535	1,851,401	1,382,509	3,080,969
Income before other revenues, expenses gains or losses	17,442	(1,245,690)	937,773	1,833,894	7,893,924	9,437,343
Capital gifts, grants and contracts	-	-	-	-	308,449	308,449
Additions to permanent and term endowments	1,335,116	55,267	177,517	-	1,693,478	3,261,378
Increase (decrease) in net assets	1,352,558	(1,190,423)	1,115,290	1,833,894	9,895,851	13,007,170
Net assets - beginning of year	9,759,441	9,663,204	7,483,655	6,195,007	45,864,364	78,965,671
Net assets - end of year	\$ 11,111,999	\$ 8,472,781	\$ 8,598,945	\$ 8,028,901	\$ 55,760,215	\$ 91,972,841



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

May 16, 2005

The Honorable Mark R. Warner
Governor of Virginia

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

The State Board for Community Colleges

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic financial statements of Virginia Community College System, a component unit of the Commonwealth of Virginia, and its aggregate discretely presented component units as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the System's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the component units of the System, which are discussed in Note 1. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the component units of the System is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the component units of the System that were audited by other auditors upon whose reports we are relying were audited in accordance with auditing standards generally accepted in the United States of America, but not in accordance with Government Auditing Standards. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Virginia Community College System and of its aggregate discretely presented component units as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in the notes to the financial statements, the System has implemented the provisions of Governmental Accounting Standards Board Statement 39, *Determining Whether Certain Organizations are Component Units*, which addresses the conditions under which institutions should include associated foundations as component units and how such component units should be displayed in the financial statements.

The Management's Discussion and Analysis on pages 6 through 12 is not a required part of the basic financial statements, but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

Internal Control Over Financial Reporting

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

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards. Instances of noncompliance and other matters are described in the section titled "Internal Control and Compliance Findings and Recommendations."

Status of Prior Findings

The System and its Colleges have not taken adequate corrective action with respect to the previously reported findings “Improve Capital Asset Management and Reporting” and “Improve Procedures for Computer System Access.” Accordingly, we included these findings in the section entitled “Internal Control and Compliance Findings and Recommendations.” The System and its Colleges have taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

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

EXIT CONFERENCE

We discussed this report with management at an exit conference held on June 8, 2005.

AUDITOR OF PUBLIC ACCOUNTS

DBC/kva



VIRGINIA COMMUNITY COLLEGE SYSTEM

James Monroe Building • 101 North Fourteenth Street • Richmond, Virginia 23219

June 2, 2005

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

Dear Mr. Kucharski:

We are providing this letter in response to your report on the audit of the financial records of the Virginia Community College System for the fiscal year ended June 30, 2004.

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

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

Sincerely,

A handwritten signature in black ink, appearing to read 'Glenn DuBois', is written over the typed name and title.

Glenn DuBois
VCCS Chancellor

GD/dsm

Enclosure

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

INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Finalize and Improve Information Systems Security Plans

Applicable to: Piedmont Virginia Community College
 Southwest Virginia Community College
 Virginia Community College System's Office

The System Office, Southwest Virginia and Piedmont Virginia have not completed the update of their Information Systems Security Plans. Both the Auditor of Public Accounts and the VCCS Internal Auditor reported the outdated and incomplete plans in fiscal year 2002 audits. Since then the System Office, Southwest Virginia, and Piedmont Virginia have taken steps to draft Information Systems Security plans, however, the plans are still not complete.

The System Office's current draft contains some variations with its current operating environment that VCCS needs to address. A good Information Systems Security Plan sets the tone and provides the necessary guidance to staff for protecting sensitive and critical data. In our review of the Security Plan, we noted several instances where the Security Plan set specific operating standards, however, the agency Risk Assessment identified that VCCS was not meeting that standard and is willing to accept those risks, without documenting the compensating controls or mitigating factors. Finally, the System Office does not have documented standard configurations for its RACF security.

Additionally, Southwest Virginia and Piedmont Virginia's plans have either not addressed or identified potential threats and vulnerabilities to sensitive assets. The Plans also do not identify or address the physical security of sensitive assets. Southwest Virginia's plan does not address logical security access, and Piedmont Virginia's plan does not address monitoring and periodic reviews of logical access. Furthermore, Piedmont Virginia's Plan does not have procedures to store back-up data at an off-site location.

We recommend that the System's Office, Southwest Virginia, and Piedmont Virginia complete its Information Systems Security Plan and then review all operating policies and procedures to ensure consistency with the Information Security Plan. Updating the specific operating policies and procedures will nullify any variations between the College's actual operating environment and its security plan and increase the validity of the College's policies and procedures.

The System Office should review its Business Recovery Plan and Risk Assessment and add any missing risks such as not using a fire suppression system in their Network Operations Center. As well, assessing more risks will strengthen VCCS' disaster recovery plan and procedures. Once VCCS has updated the Security Plan and operating policies and procedures, VCCS management should ensure all staff are aware of the applicable portions of the Information Systems Security Plan and operating policies and procedures related to their job. Finally, VCCS should review and approve all policies and procedures periodically to ensure the policy conforms to current business and technology practices. Documenting the review and approval process will also increase the validity and enforcement of VCCS policies, procedures, and standards.

Piedmont Virginia Community College Response:

The College is finalizing the update of its Information Security Plan to incorporate all needed changes. The update will include a procedure for monitoring and periodic review of logical access. The College will conduct a new threat analysis to identify potential threats and vulnerabilities to sensitive data. In addition, all college operating policies and procedures will be reviewed to ensure consistency with the Information Security Plan.

In order to provide for adequate back-up and off-site storage of all college data, PVCC will purchase and install a central file server that will be backed-up on a daily basis. The back-up data will be stored at an appropriate off-site location. Funds to purchase the central file server (the estimated cost is \$30,000 to \$35,000) will be included in the college's 2005-2006 operating budget. As an interim measure, the College has set-up a small central file server for storage and back-up of critical administrative files. The update of IT Security Plan and review of college policies and procedures will be complete July 31, 2005. The provision for college-wide data back-up and off-site storage will be complete November 30, 2005.

Southwest Virginia Community College Response:

The College has assembled a team to make the necessary revisions and additions to strengthen information technology security policies and procedures and bring them into full compliance with SEC2001-01. This team will be lead by the Information Technology Manager.

The following areas are being addressed:

Risk Assessment: All risk assessment documents are in the process of being converted to one document for ease of understanding. Risks have been assessed, documented and will continue to be updated.

Disaster Recovery Plan: SWVCC's team will meet April 11-12, 2005 to review the College's Disaster Recovery Plan and make the changes necessary to bring the College into compliance with SEC2001-01 standards.

Once SWVCC's Risk Assessment and Disaster Recovery Plans are complete, the College's Information Technology Department procedures and policies will be updated to correspond with the plans. All actions outlined above will be completed by June 30, 2005

System Office Response:

VCCS Governance will be presented with an updated information security model and supporting guidelines that address VCCS security requirements as well as the standards outlined in COV ITRM Guideline SEC2001-01.1 currently being updated by the Virginia Information Technology Agency (VITA). The System Office will complete a comprehensive update of the System Office Business Recovery plan no later than June 30, 2006. The specific findings outlined in this report will be addressed and appropriate actions taken no later than October 31, 2005.

Follow Procedures for Computer System Access

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

Employees at three colleges had unauthorized access to the financial, payroll, or administrative computer systems either because they had terminated employment or the access was not necessary for their job function. Central Virginia and Piedmont did not revoke access to computer systems promptly after employees terminated. Germanna granted inappropriate systems access to employees based on their job function. Additionally, Danville does not periodically review employee's access to Peoplesoft to ensure it is still appropriate.

We recommend that all Colleges follow established procedures relating to the monitoring and deletion of access to the College's financial, payroll, and administrative computer systems. This includes periodic monitoring by supervisors for the need for continued access for employees and the prompt revocation of access upon termination of employment. Failure to restrict computer access to current employees who need such access to perform duties places the College at risk for inappropriate changes or disclosure of important financial, administrative, and personal information.

Central Virginia Community College Response:

The College agrees with the audit finding and will strengthen its processes by July 1, 2005 to reduce the likelihood of these occurrences.

Danville Community College Response:

The College agrees that the policies should be followed as outlined in the VCCNet/DCCNet Access Policy. The workload involved with the conversion from legacy to PeopleSoft 7.6 and conversion to PeopleSoft V8 has not allowed the necessary time to devote to this function. By October 1, 2005, the Information Security Officer will have met with each supervisor and explained the access that each employee reporting to him/her has and will address any changes that need to be made which involves deleting or adding access depending on the employee's job duties.

Germanna Community College Response:

A complete review of all access to screens has been accomplished and the necessary modifications have been made. Expanded monthly review procedures have been put into place incorporating individual screen access for each user.

Piedmont Virginia Community College Response:

The College is updating its employee "Transfer or Separation from Employment" policies and procedures to insure that all full-time and part-time employees are removed from access to college computer systems upon termination of employment, and that appropriate changes in access are made when an employee transfers within PVCC. In addition to the existing separation checklists, employees who terminate or transfer will be required to complete an "Account Termination Request Form" to be signed by the employee and her/his supervisor which will be provided to the IT department for necessary action to remove or change access to automated systems and accounts. Update will be complete by July 1, 2005.

Continue Improving Capital Asset Management and Reporting

VCCS reports capital assets for all 23 Community Colleges in the System, which includes Land, Land Improvements, Buildings, Infrastructure, Construction-in-Progress, Equipment, Library Books, and Works of Art. During fiscal year 2004, VCCS reported \$455 million in capital assets, net of accumulated depreciation. Individual colleges are primarily responsible for entering equipment information in the Fixed Asset Information System (FAIS), performing inventories for equipment, and tracking locally-funded assets.

During the fiscal year 2004 audit, we found the following colleges did not properly maintain asset records or adequately record changes in assets throughout the year.

Applicable to: J. Sargeant Reynolds Community College
Patrick Henry Community College
Virginia Western Community College

Wytheville Community College

The Commonwealth's accounting policies require agencies to record disposed assets in the fiscal year the disposal occurred. J. Sargeant Reynolds, Virginia Western, and Wytheville did not remove assets promptly from FAIS. In addition, each of these colleges did not maintain the proper documentation for the disposal of assets.

The Commonwealth's accounting policies also require agencies to record assets within 60 days of receipt and acceptance. Agencies should capitalize and record assets at market value. Virginia Western did not record two out of five assets purchased. Additionally, one asset was under valued in FAIS by \$10,000.

In addition, Patrick Henry improperly capitalized software licenses and maintenance agreements. The Commonwealth's accounting policies requires agencies to expense these items since they can not modify or sell them at a later date.

Failure to comply with policies and properly maintain the Fixed Asset Inventory System could result in a misstatement to the financial statements. VCCS should ensure that each college properly maintains and records capital asset information in FAIS.

J. Sargeant Reynolds Community College Response:

Under the direction of the new Vice President of Finance and Administration, the College has taken steps to improve business processes for the control and reporting of equipment including the timely recordation and documentation of disposed assets. The College has created a Fixed Asset Coordinator position responsible for implementation of the Intellitrac© Bar Code System to enhance the tracking of College equipment. This system will enable improvements in our periodic inventory procedures and in the recording of equipment in the Fixed Asset Inventory System (FAIS) used for financial reporting. Benefits from the above-mentioned improvements are expected to be realized in approximately one year.

Patrick Henry Community College:

The Business Office will work more closely with our Information Technology Department to ensure a clear understanding of the type of asset to correctly classify new technology related purchases. PHCC has deleted the improperly capitalized assets from its inventory.

Virginia Western Community College Response:

The Fixed Asset Coordinator is increasing emphasis on the fixed asset inventory with a higher degree of attention being devoted to old and disposed items. We are changing the time of year we actually take the physical inventory to coincide with the end of each fiscal year and the purging date of the VCCS. We have asked all departments to denote any donated equipment not showing on their inventory as well as any other equipment in their possession and not showing on the inventory. We have asked all departments to review any old equipment on their inventory for accuracy. We are increasing communications with the departments on campus handling the moving/renovation and surplus of equipment. We are performing more frequent spot checks on campus of various departments' inventory. The Fixed Asset Coordinator is going to visit another community college to observe their inventory procedures and organization.

The facilities management department has been notified to make sure a listing of all items being surplus are provided to the fixed asset coordinator. The campus police have been notified to report any stolen equipment at the time of the incident to the coordinator also. Implementation date of these corrective actions is June 30,

2006.

Wytheville Community College Response:

Prior to this finding, the Inventory Clerk had been located in the Maintenance Department area so he could assist the Maintenance Department staff. With this finding, the Coordinator of Business and Facilities Services requested that the Inventory Clerk be relocated to the Business Office. After the move, the Inventory Clerk completely revised the College's inventory process and the inventory records to comply with State directives. The Inventory Clerk has taken the necessary steps to comply with the FAIS Policies and Procedures to include proper documentation for the disposal of assets. Actions completed November 2004.

Improve Cash Management Controls

Applicable to: Southside Virginia Community College

Southside Virginia does not have proper internal controls over the receipting, depositing, and reconciling of cash receipts. The Cashier receives the cash, enters the transactions in Peoplesoft, reconciles the cash to Peoplesoft, prepares the deposit, deposits the cash, and enters the transactions into the Financial Reporting System. To compensate for this lack of separation of duties, the Business Manager or Vice President of Finance review and approve the Daily Cash Settlement Reports, however, Southside Virginia is not performing this review and approval process adequately or timely.

The Business Manager and the Vice President of Finance did not review four out of ten (40%) Daily Cash Settlement Reports timely, with a delay of as much as seven months between the receipt date and the review date. The Cashier did not prepare three of the Reports timely, with a delay of up to four months between receipt and preparation date. Review of the Daily Cash Settlement Report is the main control over cash receipts and deposits. Without this control in place and working properly, Southside Virginia risks recording and reporting improper cash and revenue and increases the potential for fraud.

Additionally, Southside Virginia had 17 checks outstanding for more than one year, totaling \$9,467 at year-end. Twelve of the checks, totaling \$3,307 are from the Federal Fund Account, and Southside Virginia has not returned these funds to the Department of Education.

Southside Virginia should prepare, review and approve the Daily Cash Settlement Reports timely. In addition, Southside Virginia should separate the cash functions between multiple individuals to provide adequate internal controls over cash to reduce the risk of improper recording and reporting of cash or fraud from occurring.

Southside Virginia Community College Response:

The College will separate cashiering duties as follows:

- o The cashier will receive cash, enter receipts into PeopleSoft, prepare deposits and deposit the cash.
- o A part-time staffer not working in the cashier's office will reconcile the cash to PeopleSoft and other sources (prepare daily cash settlement reports). The Daily Cash Settlement Reports will be reconciled and prepared within 2 days of receipts.
- o The Computer Operations Technician will enter receipts into FRS (DC's).

- All actions will be completed by June 1, 2005.

Applicable to: Danville Community College
Lord Fairfax Community College
Rappahannock Community College
Tidewater Community College

Tidewater failed to properly calculate Title IV refund amounts. Danville and Lord Fairfax performed Title IV refunds accurately. However, Lord Fairfax did not return federal funds to the Department of Education timely, and Danville did not return any federal funds to the federal Department of Education in the 2003-2004 academic year; however Danville has since returned all identified funds to the federal Department of Education. Lord Fairfax did not notify students of grant overpayments promptly. Danville did not notify the federal Department of Education of students who had not repaid any overpayments within the required time period. Additionally, Tidewater and Rappahannock do not have adequate procedures to identify students who withdraw or cease attendance without notifying college staff.

There are no questioned costs reported because at three of the four institutions, the known or likely questioned costs are less than \$10,000, and the fourth institution subsequently returned all identified funds.

The Code of Federal Regulations, 34 CFR Part 668.22 (c), requires that colleges have mechanism in place to identify students who have withdrawn or ceased attendance, in order to promptly and properly calculate any return of Title IV funds. Part 668.22 (e) sets forth the manner to properly calculate the refund amounts due to Title IV programs. Part 668.22 (j) requires that colleges return unearned Title IV funds as soon as possible to the federal Department of Education, but no later than 30 days after the college determined the student withdrew. Part 668.22 (h) requires that within 30 days of the date that the college determines that the student withdrew, the college must send a notice to the student notifying them of any over-award amounts owed. This part also requires that the College turnover any over-award amounts owed by the student to the Department of Education for collection if the student has not responded within 45 days after notification.

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

Danville Community College Response:

The College will ensure that Title IV funds owed to the U.S. Department of Education are returned within 30 days of the date the College becomes aware of the student withdrawals. The College will ensure that student repayment obligations are reported to the Department of Education if students fail to repay within 45 days.

Lord Fairfax Community College Response:

The College has implemented the process of contacting professors at the sixty percent point in the semester for attendance verification instead of waiting for grades to be posted after the semester has ended. This allows the College to notify the students of grant overpayments and return Title IV funds to the Department of Education on a timely basis.

Rappahannock Community College Response:

The College handbook has been updated to require instructors to report the last date of attendance on the grade roster for all students who receive a grade of failing or unsatisfactory. In order to properly calculate a return of Title IV funds, the Financial Aid Office utilizes the last date of attendance on the instructor's grade roster to identify financial aid students who withdrew or ceased attendance prior to the sixtieth percentile point of the semester without notifying college staff. In addition, the Financial Aid Officer has reinstated the class attendance verification notifications. In the past, the Financial Aid Office sent email reminders to any faculty member whose students have all failing, withdrawal or unsatisfactory grades that had not notified the Admissions and Records or Financial Aid Office. If no response was received, it was assumed attendance was not a problem. Follow-up notices are now sent to all faculty that do not respond to the first reminder to ensure accurate information is recorded on the student's record for processing return of Title IV funds.

Tidewater Community College Response:

The College converted to the PeopleSoft Student Information System (SIS) during summer semester 2003 and began using the return of Title IV calculations in PeopleSoft for fall 2003. Several system problems were encountered in the student records and financial aid modules. The College actively sought solutions working with other colleges and with the VCCS. As a result of these problems, return to Title IV calculations were done manually. Staff turnover contributed to the calculation errors.

The SIS problems have since been corrected. The College has established a new procedure that requires faculty to verify student attendance at specific intervals. The administration will complete withdrawals for students that have ceased attendance.

Strengthen Petty Cash Procedures

Applicable to: J. Sargeant Reynolds Community College

J. Sargeant Reynolds does not follow the Commonwealth's accounting policies regarding Petty Cash. Agencies should not use a petty cash fund when they can arrange an agency billing or when they can pay through the normal vendor payment process. Agencies should use petty cash only for emergency purchases or services or for immediate payments where vendors will not provide goods or services without immediate payment.

Three petty cash transactions reviewed were for non-emergency purchases. Additionally, someone could have made these purchases using the small purchase charge card or through normal vendor payment processes. When possible, J. Sargeant Reynolds should use Small Purchase Charge Cards in lieu of petty cash.

J. Sargeant Reynolds Community College Response:

The College will review its policies regarding the use of the petty cash fund and will make appropriate changes by July 2005.

Strengthen Internal Controls over the Small Purchase Charge Card Program

Applicable to: Thomas Nelson Community College

VCCS has issued charge cards to over 990 employees at the System Office and Community Colleges for purchasing various goods and services. VCCS employees purchased over \$17.4 million under the program during fiscal year 2004. VCCS and each of the colleges have developed policies and procedures for the program to ensure that all purchases made using the Small Purchase Charge Card follow state guidelines. However, we found Thomas Nelson did not follow some established procedures.

Thomas Nelson paid sales tax when purchasing tax-exempt items on the Small Purchase Charge Card. All of the Small Purchase Charge Card holders reviewed paid sales tax on more than one occasion on purchases that should have been tax-exempt.

The Commonwealth's accounting policies require that small purchase charge card holders not pay Virginia sales tax on goods and services. Individual cardholders who mistakenly pay sales tax should take necessary steps with the vendor to credit their account with the amount of tax paid.

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

Thomas Nelson Community College Response:

Cardholders are continually reminded of the rules regarding the use of the SPCC. Each cardholder must sign an Employee Agreement form acknowledging understanding of the requirements and they are briefed by the SPCC Program Administrator. In addition, mandatory training was done for all cardholders in March, 2003. An e-mail was sent in October 2004 reminding employees that claims for reimbursement could not include sales tax since the college is tax exempt. Finally, on March 8, 2005, an e-mail was sent to all cardholders clearly stating that purchases with the SPCC were not to include sales tax. While the Program Administrator reviews the master bill on a monthly basis for non-compliant transactions, sales tax is not separately shown, making this very difficult to track. We will continue to remind cardholders of the requirements. Supervisors of cardholders have also been briefed on watching for sales tax entries when approving the monthly purchase.

Strengthen Internal Controls over Payments

Applicable to: Thomas Nelson Community College

Thomas Nelson does not properly maintain expenditure vouchers and supporting documentation. Thomas Nelson could not provide six out of 36 total vouchers and batch headers requested (17%). Three of the six missing documents were for payments made by Thomas Nelson to the Thomas Nelson Community College Educational Foundation. The total of the missing voucher packages equaled \$13,802. Without access to these missing vouchers, we cannot review the expenditures for proper review, approval and proper coding. However, we did not note any exceptions for the vouchers we did review.

The Commonwealth's accounting policies require all state entities maintain payment documents for three years. Thomas Nelson should take the necessary steps to maintain records in an organized fashion. Poor maintenance of files could allow for the loss of sensitive information or for an unauthorized individual to possibly misuse the information.

Thomas Nelson Community College Response:

The vouchers were apparently misplaced by an employee no longer employed by the College; a total search of the office, to include removal of all furnishings, did not reveal the document. Internal controls have been reviewed. Training in office procedures, internal controls and office organization has been initiated and made a priority. Voucher books are assigned to a specific individual and must be secured nightly.

VIRGINIA COMMUNITY COLLEGE SYSTEM

STATE BOARD FOR COMMUNITY COLLEGES

Robert C. Wrenn, Chair

Edward J. Fuhr, Vice Chair

Shahnaz M. Ahmed
Linwood M. Cobb, III
B. Mark Fried
Mark R. Graham
Constance R. Kincheloe
Chris A. Lumsden

Bruce J. Meyer
R. Michael Mohler
Willis A. Morris
William E. Porter
Wilbur E. Thomas
Alan G. Toxopeus

CHANCELLOR

Dr. Glenn DuBois

COMMUNITY COLLEGE PRESIDENTS

As of June 30, 2004

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