VIRGINIA COLLEGE SAVINGS PLAN

RICHMOND, VIRGINIA

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2001

Auditor of Public Accounts

COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the Virginia College Savings Plan for the year ended June 30, 2001, found:

- the financial statements are presented fairly in accordance with generally accepted accounting principles;

- reportable conditions in the internal control over financial reporting; however, we do not consider the findings to be material weaknesses; and

- no instances of noncompliance that are required to be reported.

- T A B L E   O F   C O N T E N T S -

Commonwealth of Virginia

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

Walter J. Kucharski, Auditor

January 14, 2002

The Honorable Mark R. Warner
Governor of Virginia
State Capitol

The Honorable Vincent F. Callahan, Jr.
Chairman, Joint Legislative Audit
and Review Commission

Board of Directors
Virginia College Savings Plan

We have audited the accounts and records of the **Virginia College Savings Plan** as of and for the year ended June 30, 2001, and submit herewith our complete reports on financial statements, compliance, and internal control over financial reporting.

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the balance sheet of the Virginia College Savings Plan (Plan) as of June 30, 2001, and the related statement of revenues, expenses, and changes in retained earnings and statement of cash flows for the year then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on the financial statements based on our audit.

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

As discussed in Note 1, the financial statements of the Plan are intended to present the financial position and results of its operations and cash flows on only that portion of the financial reporting entity of the Commonwealth of Virginia that is attributable to the transactions of the Plan.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Virginia College Savings Plan as of June 30, 2001, and results of its operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

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

In planning and performing our audit of the financial statements of the Virginia College Savings Plan as of and for the year ended June 30, 2001, we considered internal controls over financial reporting and tested compliance with certain provisions of laws, regulations, and contracts, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards.

Compliance

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

Internal Control Over Financial Reporting

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

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

Status of Prior Findings

The Plan has not taken adequate corrective action with respect to the previously reported finding "Develop Comprehensive Policies and Procedures Manual." Accordingly, we included this finding in the section entitled "Internal Control Findings and Recommendations."

Report Distribution and Exit Conference

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

We discussed this report with management at an exit conference held on January 25, 2002.

AUDITOR OF PUBLIC ACCOUNTS

SAH:aom
aom: 44

INTERNAL CONTROL FINDINGS AND RECOMMENDATIONS

Segregate Activity of VPEP and VEST Programs

The Plan combines the assets of the Virginia Prepaid Education Program (VPEP) and the Virginia Education Savings Trust Program (VEST) for investing purposes. The Plan does not allocate and separately track the interest, dividends, and gains earned by the individual programs or the administrative expenses for each program. The Plan should develop procedures that provide a separate accounting of revenues and expenses at the program level. Further, the Plan should develop a method to allocate revenue and expenses for activities that it cannot segregate. This accounting will provide a better mechanism for evaluating the overall results of each program and determining whether the programs are meeting established objectives. In addition, this will simplify the financial reporting process and ensure the proper presentation of program activity in the Plan's financial statements. An audit adjustment was necessary for the fiscal year 2001 financial statements to properly report the financial activities of these programs.

Management initiated a project in September 2001, prior to this recommendation, to provide for a more complete segregation of assets between VPEP and VEST at the custodial account level. The Plan has already transferred some funds to new accounts. Management is currently working with its Master Custodian and external investment managers and expects to achieve complete segregation at the investment manager account level by June 30, 2002.

Develop Comprehensive Policies and Procedures Manual

The Plan has some of its policies and procedures documented; however, they have not documented all of the day-to-day operating procedures, including the automated processes necessary to administer the program. Significant changes from enhancements to its programs, introduction of new programs, and changes imposed by new federal tax laws, regulations, and requirements have impacted the Plan. In addition, the workload of Plan staff has increased due to the maturation of existing participant accounts and establishment of new accounts. Due to these changes and the increased workload of staff, they have been unable to complete the development of formal policies and procedures.

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

As recommended in the prior year audit report, management should develop a comprehensive operating policies and procedures manual. In addition to the Plan's day-to-day operating procedures, the manual should also address the following activities.

> *Cash management policy* – Management should improve the documentation of its policies and procedures for investing funds, transferring funds to the account managers, and recording investment income.

Reconciliation procedures – The Plan should enhance its procedures for reconciling activity in the records management system to the Commonwealth Accounting and Reporting System (CARS) and to the monthly statements from its custodian. In addition, management should document all reconciliation procedures.

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

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

Investment policies and procedures – The Plan should update its investment policies and procedures to ensure they reflect current practices performed internally by Plan staff and externally by its investment managers, consultants, and Master Custodian. As part of this process, the Plan should document its procedures for reconciling the records of its external investment managers and Master Custodian.

With the addition of new staff members, the Plan has cross-trained and spread crucial knowledge across a larger number of employees to decrease the risk of a disruption in operations in the event of an unexpected loss of personnel. In addition, some staff members have documented "desk procedures" for certain critical processes; however, the Plan has not included them in a formal document. Finally, the Plan is working with its investment consultant and plans to present updated investment policies and procedures to its Board in March 2002.

Ensure Timely Completion of Actuarial Valuation

The Plan did not receive its actuarial valuation in a timely manner. The current contract requires the actuary to complete and deliver the actuarial valuation report by September 1st of each year; however, the actuary did not complete the final report until January 11, 2002. The actuarial valuation is necessary to record the present value of estimated tuition benefits and contract payments in future years for current prepaid contracts. The Plan reports these amounts as tuition contribution receivable and tuition benefits payable in its financial statements, which are also included in the Virginia Comprehensive Annual Financial Report (CAFR).

During fiscal year 2001, the Plan contracted with a new actuary to perform the annual valuation, which contributed to the delay. Plan management and the actuary have initiated efforts to contribute towards timely delivery of the final report in subsequent years. Plan staff have maintained a document file and copies of all data files provided to the actuary in electronic form. Management intends to update these files periodically to facilitate timely submission to the actuary in future years. In addition, management believes that the actuary's historical file and current year experience will contribute to a timely report in subsequent years.

Plan management should continue to communicate to the actuary the impact the actuarial valuation has on its financial statements and the annual deadline for providing its financial statements for CAFR reporting. The Plan should continue to work with the actuary to ensure timely delivery of the final report in subsequent years. Finally, management should take appropriate action if the actuary does not meet its contractual deadlines.

Develop Disaster Recovery and Contingency Plan

Management should work with SCT Software & Resource Management Corporation (SCT) to develop a disaster recovery and contingency plan that meets the requirements of the Department of Technology Planning's information technology security standards. The Plan relies on SCT to maintain its data and application software, BANNER, and the Colorado Student Obligation Bond Authority in Denver, Colorado has the hardware. The Plan does not have its own disaster recovery and contingency plan, but relies on SCT for such procedures. SCT's plan does not meet the requirements of the information technology security standards. These standards require that agencies develop, document, maintain, and periodically test a contingency plan that will provide reasonable assurance that critical data processing support can continue, or resume within an acceptable time frame, if there is an interruption to normal operations of the system. In addition, according to the standards, agency management should ensure the necessary allocation of resources for the development and maintenance of a contingency plan for critical information technology systems for the support of critical business functions.

Management has hired an employee to design, implement, document, and test a new disaster recovery and contingency plan and will work with SCT to develop a plan sufficient to meet the standards.

FINANCIAL STATEMENTS

VIRGINIA COLLEGE SAVINGS PLAN
BALANCE SHEET
As of June 30, 2001

ASSETS

Cash, cash equivalents, and investments (Notes 1E and 2)	$ 428,736,903
Tuition contributions receivable (Note 1F)	205,469,760
Investments held by the Treasurer of Virginia (Note 3)	3,179,247
Interest receivable	1,503,516
Accounts receivable (Note 1G)	32,225
Property, plant, and equipment (net) (Notes 1H and 4)	117,854
Total assets	$ 639,039,505

LIABILITIES AND EQUITY

Liabilities:	
Accounts payable	$ 336,419
Amounts due to program participants (Note 1I)	89,240
Obligations under securities lending (Note 3)	3,179,247
VPEP tuition benefits payable (Note 1J and 6)	530,969,760
VEST tution benefits payable (Note 1J)	62,873,718
Accrued liability for compensated absences (Note 1K)	137,398
Total liabilities	597,585,782
Equity:	
Retained earnings	41,453,723
Total liabilities and equity	$ 639,039,505

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

VIRGINIA COLLEGE SAVINGS PLAN
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN RETAINED EARNINGS
For the Fiscal Year Ended June 30, 2001

Operating revenues:	
Interest, dividends, and rents	$ 24,373,403
Net decrease in fair value of investments	(22,080,292)
Tuition contributions	46,986,428
Actuarial tuition contributions	42,593,776
Application fees	815,893
Other revenue	364,700
Total operating revenue	93,053,908
Operating expenses:	
Personal services	1,563,044
Contractual services	3,540,920
Supplies and materials	37,338
Expendable equipment	245,288
Depreciation	38,370
Rent, insurance, and other related charges	150,074
Tuition benefits expense (payouts)	737,432
Actuarial tuition benefits expense	129,707,579
Total operating expenses	136,020,045
Operating loss	(42,966,137)
Nonoperating revenues (expenses):	
Income from securities lending transactions	91,496
Expenses for securities lending transactions	(87,646)
Total nonoperating revenues	3,850
Loss before transfers	(42,962,287)
Transfers:	
Transfers to the General Fund of the Commonwealth	(29,113)
Net loss	(42,991,400)
Retained earnings - July 1, 2000	84,445,123
Retained earnings - June 30, 2001	$ 41,453,723

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

VIRGINIA COLLEGE SAVINGS PLAN
STATEMENT OF CASH FLOWS
For the Fiscal Year Ended June 30, 2001

Cash flows from operating activities:	
Receipts from contract purchasers	$ 93,172,990
Payments to suppliers for goods and services	(425,535)
Payments to employees	(1,520,617)
Payments for contractual services	(3,548,367)
Tuition benefits expense	(4,996,319)
Other	2,885
Net cash provided by operating activities	82,685,037
Cash flows from noncapital financing activities:	
Transfers to the General Fund of the Commonwealth	(29,113)
Net cash used for noncapital financing activities	(29,113)
Cash flows from capital and related financing activities:	
Acquisition of fixed assets	(18,675)
Net cash used for capital and related financing activities	(18,675)
Cash flows from investing activities:	
Purchase of investments	(1,136,214,207)
Proceeds from sales or maturities of investments	1,040,233,626
Interest on cash, cash equivalents, and investments	26,370,233
Net cash used for investing activities	(69,610,348)
Net increase in cash and cash equivalents	13,026,901
Cash and cash equivalents - July 1, 2000	97,353,408
Cash and cash equivalents - June 30, 2001	$ 110,380,309

VIRGINIA COLLEGE SAVINGS PLAN
STATEMENT OF CASH FLOWS (continued)
For the Fiscal Year Ended June 30, 2001

Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	$ (42,966,137)
Adjustments to reconcile operating loss to net cash provided by (used for) operating activities:	
Depreciation	38,370
Interest on investments	(24,043,132)
Net decrease in fair value of investments	22,080,292
Changes in assets and liabilities:	
(Increase) decrease in interest receivable	(302,693)
(Increase) decrease in tuition contributions receivable	(42,593,776)
Increase (decrease) in accounts payable, deposits, and other liabilities	(28,717)
Increase (decrease) in due to program participants	(327,204)
Increase (decrease) in tuition benefits payable	170,776,151
Increase (decrease) in compensated absences	51,883
Net cash provided by operating activities	$ 82,685,037
Reconciliation of cash, cash equivalents, and investments:	
Per the balance sheet:	
Cash, cash equivalents, and investments	$ 428,736,903
Less:	
Investments with original maturities greater than three months	(318,356,594)
Cash and cash equivalents per the statement of cash flows	$ 110,380,309

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

NOTES TO FINANCIAL STATEMENTS

VIRGINIA COLLEGE SAVINGS PLAN

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2001

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

VPEP is a defined benefit program, which offers contracts, for actuarially determined amounts, guaranteeing full future tuition payments at State higher education institutions. The contract provisions also allow benefits to be used at private or out-of-state institutions at a prorated amount based upon the amounts charged by the State's higher education institutions. VPEP has a limited enrollment period each year, and is open to children in the ninth grade or younger if the child or participant is a Virginia resident. During the five enrollment periods to date, approximately 40,000 accounts have been opened, with contributions and net earnings of approximately $366 million as of June 30, 2001. The program invests contract payments to meet future obligations. Operating costs are paid from program earnings. The program's assets and income are exempt from federal, state, and local income taxation. Legislation was passed in 1988 to provide a financial guarantee to cover VPEP contractual obligations in the unlikely event of a funding shortfall.

VEST is a defined contribution program, which allows participants of all ages to save for qualified higher education expenses, including tuition and fees, at any qualified higher education institution by making contributions into the investment portfolio(s) of their choice. Participants are allowed to make an initial selection from among seven investment portfolios. The VEST program, which is open year round, has no age or residency restrictions, and carries no legislative guarantee of return of principal. VEST accounts are subject to market investment risk, including the possible loss of principal. VEST began operation in December 1999. As of June 30, 2001, over 12,500 accounts have been opened with a net asset value of approximately $62 million. Investment management fees and VEST operating expenses are paid on a pro-rata basis by each VEST account owner and vary according to the portfolio selected. VEST accounts provide investors with the same federal and state tax benefits available to participants in the prepaid program. Unlike VPEP, VEST investments do not carry a legislative financial guarantee.

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

A separate report is prepared for the Commonwealth of Virginia, which includes all agencies, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority. The Plan is an integral part of the reporting entity of the Commonwealth of Virginia and is included in the general-purpose financial statements of the Commonwealth.

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

A. Basis of Presentation

GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, provides governments two options for reporting their proprietary fund activities. The accompanying financial statements have been prepared and apply all applicable Governmental Accounting Standards Board (GASB) pronouncements and all Financial Accounting Standards Board Statements and Interpretations, Accounting Principle Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, unless they conflict with or contradict GASB pronouncements.

B. Reporting Entity

The accompanying financial statements report the financial position, results of operations and cash flows of the Fund as of and for the fiscal year ended June 30, 2001. For financial reporting purposes, the Virginia College Savings Plan includes all required funds and account groups, and all entities over which the Fund exercises or has the ability to exercise oversight authority.

C. Plan Structure

The accounts of the Virginia College Savings Plan are organized in accordance with the Commonwealth Accounting and Reporting System, which has been established to account for specified financial activities of the Commonwealth. The activities of the Plan are accounted for in an enterprise fund. The enterprise fund accounts for resources received and used for financing self-supporting activities of the Virginia College Savings Plan that offer services on a user-charge basis to the general public.

D. Basis of Accounting

The financial statements are presented on the accrual basis of accounting whereby revenues are recognized when earned and expenses are recognized when the liability is incurred.

E. Investments

Money market investments of the Plan, which are deemed short-term, highly liquid investments, are reported at amortized cost. Long-term investments of the Plan are recorded at fair value based upon quoted market prices.

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

F. Tuition Contributions Receivable

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

G. Accounts Receivable

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

H. Property, Plant, and Equipment

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

I. Amounts Due to Participants

Amounts Due to Participants reflects amounts due to program participants who cancelled prepaid tuition contracts prior to June 30, 2001, but had not yet received a refund.

J. Tuition Benefits Payable

Tuition benefits payable represents the actuarially determined present value of future obligations anticipated for payment of benefits and administrative expenses for the VPEP program and the market value of the pooled assets available to contributors in the VEST program. In the VEST program, contributions are recorded and distributions are valued to participant accounts based upon a daily net asset value calculated by the program's custodial bank.

K. Accrued Leave Policy

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

In conformance with Section C60 of GASB Codification, the monetary value of accumulated annual leave payable upon termination is included in the accompanying financial statements. The liability at June 30, 2001, was computed using salary rates effective at that date and represents vacation and compensatory leave earned up to the allowable ceilings. In accordance with GASB Statement No. 16, *Accounting for Compensated Absences*, included in the liability is the agency's share of FICA taxes on leave balances for which employees will be compensated.

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

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

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS

The Board of the Virginia College Savings Plan has full power to invest funds in accordance with §23-38.80 of the Code of Virginia, as amended. This section requires the Board to discharge its duties in a manner which will provide the investment return and risk level consistent with the actuarial return requirements and cash flow demands of the Plan and conforming to all statutes governing the investment of Plan funds. The Board shall exercise the judgment of care under the circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but to the permanent disposition of funds, considering the probable income as well as the probable safety of their capital when investing funds. In order to meet the return requirements, the Plan's portfolio shall be invested in a broadly diversified portfolio of domestic and foreign stocks, bonds, and cash equivalent investments, which are defined as investments with an original maturity of three months or less. The Board's allocation target for the overall VPEP portfolio, at market value, is 50 percent investment in equity securities and 50 percent investment in fixed income instruments. The Board's allocation targets for the VEST program vary according to the investment objective of each portfolio. To assist in with the investment of the Plan assets, the Board has selected a group of 11 external managers and/or funds. In addition, the Plan has monies invested by the State Treasurer as part of the Commonwealth's General Account.

Investments held by the Plan at June 30, 2001, have been categorized according to the level of credit risk associated with its custodial arrangements at fiscal year end. Credit risk refers to the risk that the Plan may not be able to obtain possession of its investments in the event of default by a counterparty. Category 1 includes investments that are insured or registered or for which securities are held by the Plan or its agent in the Plan's name. Category 2 includes uninsured and unregistered investments for which securities are held by the counterparty's trust department or agent in the Plan's name. Category 3 includes uninsured and unregistered investments for which securities are held by the counterparty, or by its trust department or agent, but not in the Plan's name. At June 30, 2001, the Plan's mutual, money market funds, index funds, guaranteed investment contracts, and funds held in the State Treasurer's Investment Pool are non-categorized.

	Fair Value
Category 1:	
U.S. Treasury and agency securities	$ 48,158,073
Common and preferred stocks	72,777,689
Corporate and other bonds	72,125,808
Non-categorized:	
Mutual, Money Market Funds	80,161,589
Index Funds	96,063,296
Guaranteed Investment Contracts	35,890,491
State Treasurer General Account Investment Pool	23,559,957
Total cash equivalents and investments	$428,736,903

3. SECURITIES LENDING TRANSACTIONS

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

4. PROPERTY, PLANT, AND EQUIPMENT

The following schedule presents property, plant, and equipment of the Plan at June 30, 2001:

Equipment	$201,183
Less: Accumulated depreciation	(83,329)
Total property, plant, and equipment	$117,854

The following summary presents changes in property, plant, and equipment during the year:

July 1, 2000, Property, plant, and equipment (net)	$ 137,549
Add: Acquisitions	18,675

Less: Depreciation expense	(38,370)
June 30, 2001, Property, plant, and equipment (net)	$117,854

5. RETIREMENT AND PENSION PLAN

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

6. ACTUARIAL VALUATION

Annually an actuarial valuation is completed to determine the present value (APV) of future tuition obligations for the Virginia Prepaid Education Program. During fiscal year 2001, the Plan contracted with a new actuary to perform the annual valuation. The valuation method used reflects the present value of estimated tuition benefits that will be paid in future years and is adjusted for the effects of projected tuition increases and the termination of contracts.

APV of future benefits and expenses payable	$530,969,760
Net assets available	$576,165,787
Actuarial surplus	$ 45,196,027

During fiscal year 2001, the actuarial surplus declined from $89.5 million to $45.2 million, which is primarily the result of changes in the actuarial assumptions used to perform the valuation and unfavorable investment results. The purpose of the actuarial surplus is to help absorb the risk of adverse deviations from the actuarial assumptions used to perform the valuation.

The following assumptions were used in the actuarial determination of tuition benefits payable:

Rate of return (investment of current and future assets)	7.5%
Projected tuition increases	7.0%

7. RISK MANAGEMENT

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

8. VIRGINIA COLLEGE DREAM FOUNDATION

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

At June 30, 2001, the VCDF was the owner of 35 VPEP contracts and 6 VEST accounts.

9. PENDING GASB STATEMENT

GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, issued June 1999, will be effective for the Commonwealth for fiscal year ending June 30, 2002. This Statement imposes new standards for financial reporting. The changes to the Plan's financial statements will be minimal since its activity is accounted for in an enterprise fund. However, the Plan's management will be required to provide a management's discussion and analysis that gives readers an analysis of the agency's overall financial position and results of operations including a comparison of current year results with the prior year. The Plan has identified necessary changes and is preparing to implement this Statement.

VIRGINIA COLLEGE SAVINGS PLAN
Richmond, Virginia

BOARD MEMBERS

As of June 30, 2001

William H. Groseclose, Chairman

William E. Landsidle, Vice Chairman

Mary G. Morris, Secretary / Treasurer

Jennifer F. Duffy

Robert P. Hanrahan

Lee B. Krumbein

Arnold R. Oliver

Phyllis Palmiero

EXECUTIVE DIRECTOR

Diana F. Cantor