

INTERNAL CONTROL FINDING AND RECOMMENDATION

Improve Financial Statement Preparation Process

The current financial statement preparation process puts the University at risk of losing its decentralized delegation of authority. The AICPA has adopted new auditing standards effective with the audit for the year ended June 30, 2007, and had we conducted the current audit following these standards, we would have reported a material weakness in internal controls. Having a material weakness in internal control for two years would result in the loss of decentralized delegation of authority.

The new auditing standard will require the auditor to review the financial statement preparation process including the gathering of all information from throughout the campus and determining the adequacy of support for all information in the statements and related journal vouchers. The auditor must also determine if a proper segregation of duties exists within the process. Finally, the auditor must determine if the process is sufficiently comprehensive to produce financial statements without the auditor finding any material audit adjustments, which, even if recorded, could result in a material weakness.

We have reported in several past audits the need to improve the financial statement preparation process. We were under the impression that as part of the University's new financial system implementation process, that management would address these prior audit findings. As noted below, financial statement preparation process still remains in the same state that it was before the implementation of the new financial system.

The University Comptroller has not documented the process used to prepare the annual financial statements. Without a documented financial statement preparation process, it is difficult to evaluate the controls over financial reporting, key reconciliations, and procedures necessary to ensure accurate and consistent financial statements. Additionally, without a documented process for financial statement preparation, other staff would find it difficult to aid in the preparation of the financial statements.

The University Comptroller completes the financial statements with little involvement of other University staff. The situation creates a lack of segregation of duties between the preparation and the internal review of the financial statements. Also, without documented procedures, there is little or no cross-training and there is serious doubt as to whether any current University employee or new employee could replicate the current financial statement preparation process in the absence of the Comptroller.

The University Comptroller prepares the financial statements in addition to performing all of her other duties; as a result, the Comptroller has not had the opportunity to document the financial statement preparation process or train other individuals to assist in the process. Documenting and organizing the process is a starting point to providing cross-training. The University has hired an experienced individual to lead financial statement preparation and to work with the University Comptroller in documenting the financial statement preparation process.

Finally, the University Comptroller uses extensive manual processes in the preparation of the University's financial statements. Using manual processes increases the risk of errors or misstatements in the financial statements and greatly increases the time and effort necessary to complete the financial statements. The University needs to be able to rely more on its financial accounting system to assist in the financial statements preparation process.

If we had conducted the current audit following the new auditing standard, we would have reported a material weakness in internal controls. The new auditing standard will become effective with the audit of the financial statements for the year ended June 30, 2007. Given the University's resources and the scope of the issue, it may take the University until fiscal 2008 to have the processes in place to correct this situation completely. If the University does not address this issue, the fiscal 2008 audit would result in the University receiving its second material weakness in internal controls. University senior management must commit the resources to improve the financial statement preparation process, if it is to avoid risking the loss of its decentralized delegation of authority.

Improving the financial statement preparation process should include ensuring that the process is documented sufficiently to ensure that the financial statements are completed consistently and all appropriate control procedures are followed. The University must continue to ensure that financial reporting responsibilities are cross-trained to other staff to aid in their development, provide separation of duties, and allow for proper succession planning. University financial management and staff should continue to work with the financial system vendor, along with the other state universities using the Banner financial system, to improve reports from the financial system to streamline financial statement preparation. With improvements in the financial statement preparation process, the University would ensure that each year accurate financial statements are completed using processes that ensure adequate controls are followed and its tradition of excellent financial reporting is maintained.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(unaudited)

Accounting Standards

The following Management's Discussions and Analysis (MD&A) is required supplemental information under the Governmental Accounting Standards Board (GASB) reporting model. It is designed to assist readers in understanding the accompanying financial statements and provides an objective analysis of the University's financial activities based on currently known facts, decisions, and conditions. The discussion includes an analysis of the University's financial condition and results of operations for the fiscal year ended June 30, 2005, with comparative numbers for the year ended June 30, 2004. This presentation includes highly summarized data, and should be read in conjunction with the accompanying financial statements, notes to financial statements and other supplementary information. University management is responsible for all of the financial information presented, including the discussion and analysis.

The Christopher Newport University Educational and Real Estate Foundations, Inc. (Foundations) are component units and are included in the accompanying financial statements in a separate column. However, the following discussion and analysis does not include the Foundations' financial condition and activities.

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

Statement of Net Assets

The Statement of Net Assets presents the assets, liabilities, and net assets of the University as of the end of the fiscal year. The purpose of this statement is to present a fiscal snapshot at June 30, 2005. The data presented indicates the assets available to continue the University's operations as well as show the amounts the University owes to vendors and creditors.

Statement of Net Assets

	<u>As of</u> <u>June 30, 2005</u>	<u>As of</u> <u>June 30, 2004</u>	<u>Variance</u>	
			<u>Amount</u>	<u>Percent</u>
Assets:				
Current assets	\$ 20,564,704	\$ 20,104,058	\$ 460,646	2%
Capital assets, net	213,358,460	168,279,764	45,078,696	27%
Other non-current assets	<u>32,162,111</u>	<u>25,992,250</u>	<u>6,169,861</u>	24%
Total assets	<u>266,085,275</u>	<u>214,376,072</u>	<u>51,709,203</u>	24%
Liabilities:				
Current liabilities	21,357,889	17,882,244	3,475,645	19%
Non-current liabilities	<u>113,248,920</u>	<u>94,277,157</u>	<u>18,971,763</u>	20%
Total liabilities	<u>134,606,809</u>	<u>112,159,401</u>	<u>22,447,408</u>	20%
Net assets:				
Invested in capital assets, net of related debt	105,718,904	79,844,697	25,874,207	32%
Restricted, non-expendable	2,924,153	2,597,603	326,550	13%
Restricted, expendable	10,534,473	8,504,749	2,029,724	24%
Unrestricted	<u>12,300,936</u>	<u>11,269,622</u>	<u>1,031,314</u>	9%
Total net assets	<u>\$131,478,466</u>	<u>\$102,216,671</u>	<u>\$29,261,795</u>	29%

Net assets are divided into three major categories: the first category, “Invested in Capital Assets, Net of Debt,” provides the University’s equity in property, plant, and equipment owned by the University. The next category is “Restricted Net Assets,” which is divided into two categories: expendable and non-expendable. Expendable restricted resources are available for expenditure by the University, but must be spent for purposes as determined by donors and/or other entities that have placed time or purpose restrictions on the use of the assets. The corpus of non-expendable restricted resources is available only for investment purposes. Unrestricted net assets are available to the University for any lawful purpose of the University.

The University’s total assets increased \$51,709,203, while, the University’s total liabilities increased by \$22,493,130. The University expended \$11,539,682 in Virginia College Building Authority and General Obligation bond proceeds, federal grants, private gifts and University funds on the Ferguson Center for the Arts and \$6,115,061 in general obligation bond proceeds on the Library Information Technology Center. The University also expended \$22,367,599 in revenue bond proceeds for various Auxiliary facilities to include the Student Union, for which revenue bonds of \$22,275,000 were issued in October 2004, Potomac River Residence Hall, Parking Deck and various Athletic facilities, during fiscal year 2005. Amounts expended for these projects have been added to construction-in-progress. In addition, the University received appropriations of \$8,819,874 for the Library Information Technology Center. The combination of the increase in total assets and the increase in total liabilities resulted in an increase in net assets at June 30, 2005 of \$29,216,073.

Statement of Revenues, Expenses and Change in Net Assets

Changes in total net assets as presented on the Statement of Net Assets are based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of this statement is to present revenues received by the University, both operating and non-operating, and expenses paid by the University, operating and non-operating, and any other revenues, expenses, gains and losses received or spent by the University.

Statement of Revenues, Expenses, and Changes in Net Assets

	<u>Year Ended</u> <u>June 30, 2005</u>	<u>Year Ended</u> <u>June 30, 2004</u>	<u>Variance</u>	
			<u>Amount</u>	<u>Percent</u>
Operating revenues:				
Student tuition and fees	\$ 14,722,381	\$ 13,143,515	\$ 1,578,866	12%
Federal grants and contracts	3,637,617	4,143,687	(506,070)	(12%)
Non-governmental grants and contracts	1,173,502	1,156,359	17,143	1%
Auxiliary enterprises	30,737,149	26,359,422	4,377,727	17%
Other	<u>656,715</u>	<u>349,325</u>	<u>307,390</u>	88%
Total operating revenues	<u>50,927,364</u>	<u>45,152,308</u>	<u>5,775,056</u>	13%
Operating expenses:				
Instruction	18,251,208	16,311,236	1,939,972	12%
Research	2,063,372	2,005,164	58,208	3%
Public service	1,303,046	890,839	412,207	46%
Academic support	6,109,882	4,988,411	1,121,471	22%
Student services	3,482,275	3,184,185	298,090	9%
Institutional support	5,751,357	4,903,162	848,195	17%
Operation and maintenance of plant	5,033,247	6,487,021	(1,453,774)	(22%)
Depreciation	4,102,027	3,981,785	120,242	3%

Student aid	1,785,253	2,467,302	(682,049)	(28%)
Auxiliary enterprises	<u>22,719,095</u>	<u>20,155,721</u>	<u>2,563,374</u>	13%
Total operating expenses	<u>70,600,762</u>	<u>65,374,826</u>	<u>5,225,936</u>	8%
Operating loss	(19,673,398)	(20,222,518)	549,120	3%
Non-operating revenues	<u>23,949,282</u>	<u>20,381,592</u>	<u>3,567,690</u>	18%
Income before other revenues	4,275,884	159,074	4,116,810	>100%
Net other revenues	<u>24,985,911</u>	<u>18,596,258</u>	<u>6,389,653</u>	34%
Increase in net assets	29,261,795	18,755,332	10,506,463	56%
Net assets – beginning of year	<u>102,216,671</u>	<u>83,461,339</u>	<u>18,755,332</u>	22%
Net assets – end of year	<u>\$131,478,466</u>	<u>\$102,216,671</u>	<u>\$29,261,795</u>	29%

Generally, operating revenues are received for providing goods and services to the various customers and constituencies of the University. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the University. Non-operating revenues are revenues received for which goods and services are not provided. The University's state appropriation is non-operating revenue because it is provided by the state legislature without the legislature directly receiving commensurate goods and services for these revenues.

Operating revenues include tuition and fees and auxiliary enterprises revenues. Tuition and fee revenues increased by \$1,578,866. Tuition was increased by 11.87 percent for fiscal year 2005. Auxiliary revenues increased due to an increase in comprehensive fees of 21.46 percent, an increase in room and board of seven percent, and the opening of Potomac River Residence Hall resulting in increased revenue of \$4,377,727. Operating expenses increased \$5,225,936 primarily due to increases in instruction, academic support, and auxiliary activities. The increases in instruction and academic support expenses are mainly attributable to increased salaries for faculty and staff as well as increased expenses due to increases in enrollment. The increase in auxiliary enterprises expenses is related to increases in room charges due to the completion of the Potomac River Residence Hall and related increases in food service contracts. The net operating loss decreased from the prior year by \$549,120, or three percent.

The non-operating revenue increase is attributable to the increase in state appropriated dollars of \$3,426,622, to address base budget adequacy, salary increases, and increased dollars for financial aid. The University sells revenue bonds to finance the construction auxiliary facilities including \$22,275,000 in fiscal year 2005 for construction of the new Student Union. The proceeds from bond sales are invested with the Bank of New York until the funds are needed for construction expenditures. At June 30, 2005, \$15,232,825 was still held and invested by the Bank of New York, resulting in an increase in investment income. During fiscal year 2005, approximately \$22,367,599 was expended to construct facilities.

Other revenues including capital appropriations and capital gifts increased by \$6,389,653 as funds were received from state appropriations and from gifts to the University for the capital projects planned and under construction. The primary component of the increase in net assets represents additions to capital projects as discussed below.

Statement of Cash Flows

The Statement of Cash Flows presents the detailed information pertaining to the cash activity of the University during the year. The statement is divided into five parts. The first part deals with operating cash flows and shows the net cash used by operating activities of the University. Significant sources of cash include: student tuition and fees (\$15,149,377), auxiliary enterprises receipts (\$32,534,814) and grants and contracts (\$4,614,993). Major uses of cash include payments for salaries, wages and fringe benefits (\$38,694,424), payments for supplies and services (\$20,166,830) and payments for scholarships (\$4,920,489).

The second section reflects cash flows from non-capital financing activities and includes the state appropriations for the University's educational and general programs and financial aid of \$25,008,016, which is an increase from the prior year of \$3,426,622.

The cash flows from capital financing activities reflects cash used for the acquisition and construction of capital related items. The primary source of cash was proceeds from the issuance of revenue bonds for new Student Union, and the completion of the Potomac River Residence Hall, the Parking Deck, and various projects for athletic expansion for facilities and fields. In addition, the construction continued on the Ferguson Center for the Arts with in excess of \$11.5 million in state funds, federal, local government and private gift funds being expended. In addition, in excess of \$6 million was expended from general obligation bond proceeds for the Library Information Technology Center.

The fourth section reflects cash flows from investing activities, and includes interest on investments and purchases of investments.

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

Statement of Cash Flows

	Year Ended	Year Ended	Variance	
	June 30, 2005	June 30, 2004	Amount	Percent
Cash flows from operating activities	\$(14,445,820)	\$(16,493,795)	\$2,047,975	12%
Cash flows from non-capital financing activities	25,035,268	22,133,162	2,902,106	13%
Cash flows from capital financing activities	(2,214,639)	(1,814,792)	(399,847)	(22%)
Cash flows from investing activities	<u>(2,081,093)</u>	<u>1,187,299</u>	<u>(3,268,392)</u>	(>100%)
Net change in cash	<u>\$ 6,293,716</u>	<u>\$ 5,011,874</u>	<u>\$1,281,842</u>	26%

Capital Asset and Debt Administration

Overall, invested in capital assets increases reflect the continued substantial campus construction taking place at the University. Significant fiscal year 2005 capital projects include the Ferguson Center for the Arts, the Library Information Technology Center, the Student Union, and the completion of the Potomac River Residence Hall, the Parking Deck, and the Athletic Facilities. The Center for the Arts is funded through state appropriations, grants from federal and local government, and private gifts; and the Library is funded through state appropriations. The remaining projects were funded through the issuance of 9(d) Revenue Bonds.

The University's long term debt increased by \$22,275,000 at June 30, 2005. In fiscal year 2005, three revenue bond series were defeased resulting in an accounting loss of \$228,465.

Overall unpaid construction commitments increased by \$7,903,305 from \$16,279,128 to \$24,182,434 in 2005 due to beginning of the Student Union and Library Information Technology Center, and the completion of several auxiliary facilities. Unpaid commitments at June 30, 2005 primarily reflect the Student Union and the Library Information Technology Center. Further information relating to capital assets, construction, and capital debt is included in the Notes to the Financial Statements in Note 4 and 7.

Economic Outlook

The University's economic outlook is closely related to its role as one the Commonwealth of Virginia's (Commonwealth) comprehensive higher education institutions. As such, it is largely dependent upon on-going financial support from the state government. In fiscal year 2005 the University's state appropriations increased by \$3,426,622 or 15.88 percent. The University's governing board increased tuition by 11.87 percent for 2005, comprehensive fees by 21.46 percent and room and board by seven percent. The tuition increase permitted the University to hire 30 new faculty members.

FINANCIAL STATEMENTS

CHRISTOPHER NEWPORT UNIVERSITY
STATEMENT OF NET ASSETS
As of June 30, 2005

	Component Unit	
	Christopher Newport University Educational and Real Estate	
	University	Foundations
ASSETS		
Current assets:		
Cash and cash equivalents (Note 2)	\$ 1,274,314	\$ 5,555,816
Cash and cash equivalents with the Treasurer of Virginia (Note 2)	14,237,249	-
Cash and cash equivalents - securities lending (Note 2)	3,196,498	-
Accounts receivable, net of allowance (Note 3)	465,987	2,110,476
Contributions receivable, net of allowance (Note 3)	-	1,637,943
Prepaid expenses	549,755	13,122
Inventory	840,901	-
	<hr/>	<hr/>
Total current assets	20,564,704	9,317,357
Non-current assets:		
Cash and cash equivalents (Note 2)	13,253,809	-
Restricted investments (Note 2)	2,924,153	6,322,035
Other investments (Note 2)	15,984,149	577,347
Contributions receivable, net of allowance (Note 3)	-	2,698,060
Other restricted assets	-	601,415
Other assets	-	1,286,402
Non-depreciable capital assets (Note 4)	128,396,159	34,106,350
Depreciable capital assets, net of accumulated depreciation (Note 4)	84,962,301	26,174,180
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Total non-current assets	245,520,571	71,765,789
	<hr/>	<hr/>
Total assets	266,085,275	81,083,146
LIABILITIES		
Current liabilities:		
Accounts payable and accrued expenses (Note 5)	10,790,875	2,384,808
Deferred revenue	584,159	-
Obligations under securities lending	3,875,734	-
Deposits held in custody for others	592,997	2,791,987
Long-term liabilities - current portion (Note 6)	5,382,252	14,878,036
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Total current liabilities	21,226,017	20,054,831
Non-current liabilities (Note 6)	113,380,792	52,161,854
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Total liabilities	134,606,809	72,216,685

NET ASSETS		
Invested in capital assets, net of related debt	105,718,904	1,275,078
Restricted for:		
Non-expendable:		
Scholarships and fellowships	2,924,153	3,396,099
Expendable:		
Scholarships and fellowships	114,443	350,939
Academic support	-	440,277
Capital projects	10,347,942	4,263,351
Other	72,088	2,098,943
Unrestricted	12,300,936	(2,958,226)
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Total net assets	<u>\$ 131,478,466</u>	<u>\$ 8,866,461</u>

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

CHRISTOPHER NEWPORT UNIVERSITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGE IN NET ASSETS
For the Year Ended June 30, 2005

	Component Unit	
	University	Christopher Newport University Educational and Real Estate Foundations
Operating revenues:		
Student tuition and fees, net of scholarship allowance of \$713,458	\$ 14,722,381	\$ -
Federal grants and contracts	3,637,617	-
Non-governmental grants and contracts	1,173,502	-
Gifts and contributions	-	3,682,795
Auxiliary enterprises, net of scholarship allowance of \$2,615,562 (Note 8)	30,737,149	-
Lease and rental revenue	-	3,196,179
Other	656,715	51,446
Total operating revenues	<u>50,927,364</u>	<u>6,930,420</u>
Operating expenses (Note 9):		
Instruction	18,251,208	-
Research	2,063,372	-
Public service	1,303,046	-
Academic support	6,109,882	-
Student services	3,482,275	-
Institutional support	5,751,357	909,826
Operation and maintenance of plant	5,033,247	5,221,965
Depreciation	4,102,027	1,190,866
Student aid	1,785,253	193,748
Auxiliary enterprises (Note 8)	22,719,095	346,623
Total operating expenses	<u>70,600,762</u>	<u>7,863,028</u>
Operating loss	<u>(19,673,398)</u>	<u>(932,608)</u>
Non-operating revenues/(expenses):		
State appropriations (Note 10)	25,008,016	-
State grants and contracts	491,179	-
Gifts	267,450	-
Investment income, net of investment expense	1,532,750	(851,178)
Interest on capital asset related debt	(3,094,852)	(2,099,653)
Loss on early extinguishment of debt	(228,465)	-
Loss on disposal of plant assets	(26,796)	-
Net non-operating revenues/(expenses)	<u>23,949,282</u>	<u>(2,950,831)</u>
Income before other revenues and gains	<u>4,275,884</u>	<u>(3,883,439)</u>
Capital appropriations	17,611,864	-
Capital gifts and grants	7,201,631	1,787,334
Additions to permanent endowments	172,416	154,305
Total other revenues	<u>24,985,911</u>	<u>1,941,639</u>
Increase/(decrease) in net assets	29,261,795	(1,941,800)
Net assets - beginning of year	<u>102,216,671</u>	<u>10,808,261</u>
Net assets - end of year	<u>\$ 131,478,466</u>	<u>\$ 8,866,461</u>

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

CHRISTOPHER NEWPORT UNIVERSITY
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2005

Cash flows from operating activities:	
Student tuition and fees	\$ 15,149,377
Grants and contracts	4,614,993
Auxiliary enterprises	32,534,814
Other receipts	657,232
Payments to employees	(29,442,783)
Payments for fringe benefits	(9,251,641)
Payments for services and supplies	(20,166,830)
Payments for utilities	(2,546,857)
Payments for scholarships and fellowships	(4,920,489)
Payments for plant improvements and equipment	(1,074,617)
Loans issued to students and employees	(277,355)
Collection of loans from students and employees	278,336
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Net cash used by operating activities	(14,445,820)
Cash flows from noncapital financing activities:	
State appropriations	25,008,016
State grants and contracts	171,990
Gifts and grants for other than capital purposes	439,867
Stafford loan receipts	8,701,170
Stafford loan disbursements	(8,701,170)
PLUS loan receipts	3,640,915
PLUS loan disbursements	(3,640,915)
Agency receipts	678,574
Agency payments	(1,263,179)
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Net cash provided by noncapital financing activities	25,035,268
Cash flows from capital financing activities:	
Capital appropriations	19,909,392
Capital gifts and grants	6,964,145
Proceeds from sale of bonds	22,381,946
Purchase of capital assets	(43,631,762)
Principal paid on capital debt, leases, and installments	(4,743,508)
Interest paid on capital debt, leases, and installments	(3,094,852)
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Net cash used by capital financing activities	(2,214,639)
Cash flows from investing activities:	
Interest on investments	467,560
Sales of investments	19,726,347
Purchases of investments	(22,275,000)
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Net cash used by investing activities	(2,081,093)
Net increase in cash	6,293,716
Cash and cash equivalents beginning of the year	<hr/> 22,471,656
Cash and cash equivalents end of the year	<hr/> <u>\$ 28,765,372</u>

Reconciliation of net operating loss to net cash used by operating activities:	
Operating loss	\$ (19,673,398)
Adjustments to reconcile net loss to net cash used by operating activities:	
Depreciation expense	4,102,027
Changes in assets and liabilities:	
Receivables, net	(143,433)
Prepaid expenses	341,642
Inventory	11,485
Accounts payable and accrued expenses	942,414
Deferred revenue	(154,257)
Accrued compensated absences	127,700
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Net cash used by operating activities	<u>\$ (14,445,820)</u>
Non-cash investing, non-capital financing, and capital and related financing transactions:	
Capitalization of interest expense	\$ 1,213,834
Change in fair value of investments recognized as a component of investment income	\$ 148,155

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

NOTES TO FINANCIAL STATEMENTS

CHRISTOPHER NEWPORT UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The University is a comprehensive university that is part of the Commonwealth's statewide system of public higher education. The University's Board of Visitors, appointed by the Governor, is responsible for overseeing governance of the University. A separate report is prepared for the Commonwealth, which includes all agencies over which the Commonwealth exercises oversight authority. The University is a component unit of the Commonwealth and is included in the basic financial statements of the Commonwealth.

Effective June 30, 2004, the University implemented 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 foundations as component units in their basic financial statements and how they should be displayed.

The Foundations are legally separate, tax-exempt component units of the University. The Foundations act primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. Although the University does not control the timing or amount of receipts from the Foundations, the majority of resources, or income thereon, which the Foundations hold and invest, are restricted to the activities of the University by the donors. Because these restricted resources held by the Foundations can only be used by, or for the benefit of, the University, the Foundations are considered component units of the University and are discretely presented in the University's financial statements. The Foundations are each governed by the same Board and are consolidated for financial statement purposes.

During the year ended June 30, 2005, the Foundations distributed \$4,871,209 to the University for both restricted and unrestricted purposes. Separate financial statements for the Foundations can be obtained by writing the Chief Financial Officer, CNU Foundations, 1 University Place, Newport News, Virginia 23606.

B. Basis of Presentation

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

Public College and Universities. The University now follows Statement 34 requirements for “reporting by special-purpose governments engaged only in business-type activities.” The financial statement presentation provides a comprehensive entity-wide presentation of the University’s financial activities.

The Foundations are private, non-profit organizations that report under Financial Accounting Standards Board (FASB) standards, including FASB Statement 117, “Financial Reporting for Not-for-Profit Organizations.” As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition and presentation features. No modifications have been made to the Foundations’ financial information in the University’s financial reporting entity for these differences.

C. Basis of Accounting

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

D. Investments

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

E. Capital Assets

Capital assets include land, buildings and other improvements, library materials, equipment and infrastructure assets such as sidewalks. Capital assets are defined by the University as assets with an initial cost of \$5,000 or more and an estimated useful life in excess of one year. Donated capital assets are recorded at fair market value at the date of the donation. Expenses for major capital assets and improvements (construction-in-progress) are capitalized as projects are constructed. The costs of normal maintenance and repairs that do not add to the asset’s value or materially extend its useful life are not capitalized. Plant assets, at the time of disposal, revert to the Commonwealth for disposition. Proceeds, if any, are returned to the University.

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

Buildings	40-50 years
Other improvements and infrastructure	15 years
Equipment	5-25 years
Library materials	5 years

F. Inventories

Inventories are valued at the lower of cost (first-in, first-out), or market. The inventory held by the University consists of expendable supplies and items for resale. The cost of inventories are recorded as expenditures when consumed or sold, rather than when purchased.

G. Non-Current Cash and Investments

Cash and investments that are externally restricted to construct capital and other non-current assets are classified as non-current assets in the Statements of Net Assets.

H. Deferred Revenue

Deferred revenue includes amounts received for tuition and fees and grants and contracts prior to the end of the fiscal year, but related to the period after June 30, 2005.

I. Accrued Compensated Absences

Accrued leave reflected in the accompanying financial statements represents the amount of annual, sick and compensatory leave earned but not taken as of June 30, 2005. The amount represents all earned vacation, sick and compensatory leave payable under the Commonwealth's leave pay-out policy and the University Handbook, for all administrators holding faculty appointments, upon employment termination. The applicable share of employer related taxes payable on the eventual termination payments is also included.

J. Federal Financial Assistance Programs

The University participates in federally-funded Pell Grants, Supplemental Educational Opportunity Grants, and Federal Work-Study programs. In addition, the University has numerous federal research grants. Federal programs are audited in accordance with the Single Audit Act Amendments of 1996, the Office of Management and Budget Revised Circular A-133, Audit of State, *Local Governments and Non-Profit Organizations*, and the Compliance Supplement.

K. Net Assets

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

- Invested in Capital Assets, Net of Related Debt - consists of total investments in capital assets, net accumulated depreciation, and outstanding debt obligations.
- Restricted Net Assets – Non-expendable - includes endowment and similar type assets whose use is limited by donors or other outside sources, and as a condition of the gift, the principal is to be maintained in perpetuity.
- Restricted Net Assets - Expendable - represents funds that have been received for specific purposes, and the University is legally or contractually obligated to spend the resources in accordance with restrictions imposed by external parties.

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

When an expense is incurred that can be paid using either restricted or unrestricted resources, the University's policy is to first apply the expense toward restricted resources, and then toward unrestricted resources. Restricted funds remain classified as such until restrictions have been satisfied.

L. Revenue and Expense Classifications

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

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

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

M. Scholarship Discounts and Allowances

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

2. CASH AND CASH EQUIVALENTS AND INVESTMENTS

GASB Statement 40, *Deposit and Investment Risk Disclosures*, became effective for periods beginning after June 15, 2004. This statement amends GASB Statement 3, *Deposits with Financial Institutions*, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements. GASB Statement 40 eliminates the custodial credit risk disclosures for Category 1 and 2 deposits and investments. However, this statement does not change the disclosure requirements for Category 3 deposits and investments. The University has no Category 3 deposits or investments for 2005. The following risk disclosures are required by GASB.

Credit Risk – The risk that an issuer or other counterparty to an investment will not fulfill its obligations. This statement requires the disclosure of the credit quality ratings of all investments subject to credit risk. Information with respect to University deposit exposure to credit risk is discussed below.

Concentration of Credit Risk – The risk of loss attributed to the magnitude of a government’s investment in a single issuer. This statement requires disclosure of investments with any one issuer that represents five percent or more of total investments. However, investments issued or explicitly guaranteed by the U.S. government, investments in mutual funds, external pools, and other pooled investments are excluded from the requirement.

Interest Rate Risk – The risk that changes in interest rates will adversely affect the fair value of an investment. This statement requires disclosure of the terms of the investments with fair values that are highly sensitive to changes in interest rates. The University does not have investments or deposits that are sensitive to change in interest rates as of the close of business on June 30, 2005.

Foreign Currency Risk – The risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The University has no foreign investments or deposits for 2005.

A. Cash and Cash Equivalents

The Treasurer of Virginia pursuant to Section 2.2-1800, et seq., Code of Virginia, is responsible for the collection, disbursement, custody, and investment of state funds and holds all state funds of the University. Each fund’s equity in pooled state funds is reported as “Cash” on the accompanying Statement of Net Assets and is not categorized as to credit risk. The University also holds certain deposits. Deposits with banks and savings institutions are covered by Federal depository insurance or collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400, et seq., Code of Virginia. Under the Act, banks holding public deposits in excess of the amounts insured by FDIC must pledge collateral in the amount of 50 percent of excess deposits to a collateral pool in the name of the State Treasury Board. Savings institutions are required to collateralize 100 percent of deposits in excess of FSLIC limits.

In accordance with the GASB Statement 9 definition of cash and cash equivalents, cash represents cash with the Treasurer, cash on hand, and cash deposits including certificates of deposits and temporary investments with original maturities of three months or less.

B. Investments

The Board of Visitors establishes the University’s investment policy which is monitored by the Board’s Investment Committee. Authorized investments are set forth in the Investment of Public Funds Act, Section 2.2-4500 through 2.2-4517, et seq., Code of Virginia. Investments fall into two groups: short-term and long-term. Short-term investments have an original maturity of over 90 days, but less than or equal to one year. Long-term investments have an original maturity greater than one year

Cash and cash equivalents:	
Deposits with financial institutions	\$ 648,618
Money market and mutual funds	829,951
Cash with the Treasurer of Virginia	<u>30,687,558</u>
Total cash and cash equivalents	<u>32,166,127</u>
Investments:	
State non-arbitrage program (SNAP)	15,232,825
Collateral held for securities lending	679,236
Money market and mutual funds	<u>2,791,987</u>
Total investments	<u>\$18,704,048</u>

C. Securities Lending Transactions

GASB Statement 28, *Accounting and Financial Reporting for Securities Lending Transactions*, establishes accounting and financial reporting standards for security lending transactions. In these transactions, governmental entities transfer their securities to broker, dealers and other entities for collateral and simultaneously agree to return the collateral for the same securities in the future. Collateral held for securities lending and the securities lending transactions reported on the financial statements represent the University's allocated share of securities received for securities lending transactions held in the General Account of the Commonwealth. Information related to the credit risk of these investments and securities lending transactions held in the General Account is available on a statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report (CAFR).

Christopher Newport University Educational and Real Estate Foundations - Cash and Investments

The following information is provided with respect to the credit risk associated with the Foundations' cash and cash equivalents and investments at June 30, 2005.

The Foundations maintain several bank accounts. Accounts at financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000. At June 30, 2005, the Foundations had bank cash deposit balances of approximately \$5,406,751 in excess of FDIC insured amounts. In addition, the Foundations maintain cash balances with brokers that are not insured by the FDIC. These balances totaled approximately \$98,873 at June 30, 2005.

Investments are carried at their market value determined at the date of the statement of financial position. Income from investments, including the unrealized gains and losses, is accounted for as an increase in unrestricted, temporarily restricted, or permanently restricted net assets, depending upon the nature of donor restrictions.

Summarized below are investments recorded at market value at June 30, 2005:

Money market and mutual funds	\$4,107,395
Managed investments	<u>2,791,987</u>
Total investments	<u>\$6,899,382</u>

Investments are recorded on the statement of financial condition as follows:

Unrestricted	\$ 577,347
Funds invested for related entities	2,791,987
Temporarily restricted	1,216,136
Permanently restricted	<u>2,313,912</u>
Total investments	<u>\$6,899,382</u>

3. ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following at June 30, 2005:

Student tuition and fees	\$ 84,419
Auxiliary enterprises	291,404
Grants and contracts	123,376
Other	<u>2,298</u>
Gross receivables	501,497
Less: allowance for doubtful accounts	<u>(35,510)</u>
Net accounts receivable	<u>\$ 465,987</u>

Christopher Newport University Educational and Real Estate Foundations Pledges Receivable

The Foundations have on-going fundraising campaigns to benefit the University. The carrying amounts of the pledges and pledges receivable approximate fair value because they have been discounted to their net present value. The discount rate employed by the Foundations is six percent. The pledges receivable are unconditional.

At June 30, 2005, pledges receivable are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Receivable in less than one year	\$ 26,356	\$1,643,483	\$ 303,592	\$1,973,431
Receivable in one to five years	29,458	2,361,821	730,365	3,121,644
Receivable in more than five years	<u>10,000</u>	<u>677,598</u>	<u>-</u>	<u>687,598</u>
Total unconditional pledges	65,814	4,682,902	1,033,957	5,782,673
Less:				
Discount to net present value	(6,202)	(506,120)	(79,496)	(591,818)
Allowance for uncollectible pledges receivable	<u>(35,755)</u>	<u>(660,943)</u>	<u>(149,154)</u>	<u>(854,852)</u>
Net pledges receivable	<u>\$ 23,857</u>	<u>\$3,506,839</u>	<u>\$ 805,307</u>	<u>\$4,336,003</u>

4. CAPITAL ASSETS

A summary of changes in the various capital asset categories for the year ending June 30, 2005, is as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Non-depreciable capital assets:				
Land	\$ 7,110,829	\$ 1,283,276	\$ -	\$ 8,394,105
Construction-in-progress	<u>74,726,347</u>	<u>45,360,444</u>	<u>84,737</u>	<u>120,002,054</u>
Total non-depreciable capital assets	<u>81,837,176</u>	<u>46,643,720</u>	<u>84,737</u>	<u>128,396,159</u>
Depreciable capital assets:				
Buildings	94,385,879	1,269,532	-	95,655,411
Infrastructure	83,864	24,187	-	108,051
Equipment	7,943,373	886,852	28,380	8,801,845
Other improvements	7,996,654	-	-	7,996,654
Library materials	<u>8,278,597</u>	<u>467,966</u>	<u>6,576</u>	<u>8,739,987</u>
Total depreciable capital assets	<u>118,688,367</u>	<u>2,648,537</u>	<u>34,956</u>	<u>121,301,948</u>
Less: accumulated depreciation:				
Buildings	17,359,750	2,373,215	-	19,732,965
Infrastructure	6,854	6,178	-	13,032
Equipment	4,895,976	911,257	1,584	5,805,649
Other improvements	2,938,127	366,601	-	3,304,728
Library materials	<u>7,045,073</u>	<u>444,776</u>	<u>6,576</u>	<u>7,483,273</u>
Total accumulated depreciation	<u>32,245,780</u>	<u>4,102,027</u>	<u>8,160</u>	<u>36,339,647</u>
Depreciable capital assets, net	<u>86,442,587</u>	<u>(1,453,490)</u>	<u>26,796</u>	<u>84,962,301</u>
Total capital assets, net	<u>\$168,279,763</u>	<u>\$45,190,230</u>	<u>\$111,533</u>	<u>\$213,358,460</u>

Christopher Newport University Educational and Real Estate Foundations - Capital Assets

The Foundations hold capital assets consisting of land, buildings, equipment, furniture and collections. Capital assets greater than \$500 are carried at cost or, if donated, at their estimated fair value at the time of donation. Depreciation of buildings, furniture, and equipment is computed by the straight-line method over the estimated useful lives of the respective assets. Collections of works of art and other historical treasures are not held for resale and, therefore, depreciation is not recorded on such items because their economic benefit or service potential is used up so slowly that their estimated useful lives are extraordinarily long.

Land, buildings, furniture, and equipment as of June 30, 2005 are summarized as follows:

Property held for investment	\$53,618,105
Furniture and equipment	<u>613,227</u>
Total depreciable capital assets	54,231,332
Less: accumulated depreciation	<u>(1,448,402)</u>
Total capital assets, net	<u>\$52,782,930</u>

Depreciation charged to expense, including depreciation on buildings, furniture, equipment, and property held for investment, totaled \$1,209,755. Interest expense capitalized during 2005 totaled \$998,425.

5. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following at June 30, 2005:

Employee salaries, wages and fringe benefits payable	\$ 2,595,117
Vendors and suppliers accounts payable	5,712,137
Retainage payable	<u>2,483,621</u>
Accounts payable and accrued expenses	<u>\$10,790,875</u>

6. NON-CURRENT LIABILITIES

The University's non-current liabilities consist of long-term debt (further described in Note 7), and other non-current liabilities. A summary of changes in non-current liabilities for the year ending June 30, 2005, is presented below:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Long-term debt:					
Revenue bonds	\$59,270,000	\$23,445,000	\$3,290,000	\$ 79,425,000	\$2,165,000
General obligation bonds	38,792,874	21,258,465	23,275,556	36,775,783	1,922,646
Capital leases	51,735	-	21,953	29,782	17,575
Installment purchase	<u>-</u>	<u>1,780,000</u>	<u>356,000</u>	<u>1,424,000</u>	<u>356,000</u>
Total long-term debt	98,114,609	46,483,465	26,943,509	117,654,565	4,461,221
Accrued compensated absences	<u>981,917</u>	<u>1,212,589</u>	<u>1,086,027</u>	<u>1,108,479</u>	<u>921,031</u>
Total long-term liabilities	<u>\$99,096,526</u>	<u>\$ 47,696,054</u>	<u>\$ 28,029,536</u>	<u>\$118,763,044</u>	<u>\$5,382,252</u>

7. LONG TERM DEBT

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

Section 9 (c) bonds are general obligation bonds issued by the Commonwealth on behalf of the University, which are secured by the net revenues of the completed project and the full faith, credit and taxing power of the Commonwealth.

In October 2004, the University issued Series 2004A, 9(d) Revenue Bonds through the VCBA's Public Higher Education Financing Pooled Bond Program in the amount of \$22,275,000. Proceeds from the bonds will be used to construct a new Student Union. The bonds were issued with interest rates varying from 3.0 percent to 5.0 percent and mature in 2025.

Description	Interest Rates	Maturity	Outstanding Balance at June 30, 2005
Revenue bonds:			
Athletics, Series 1998A	4.53	2019	\$ 6,835,000
Series 2002A	3.0 – 5.25	2023	5,555,000
Series 2002A	3.0 – 5.25	2023	1,255,000
Series 2003A	2.0 – 5.00	2024	1,235,000
Series 2004R	3.0 – 5.00	2014	1,130,000
Student Center, Series 2001A	3.0 – 4.87	2021	1,015,000
Series 2002A	3.0 – 5.25	2023	310,000
New Student Center, Series 2002A	4.0 – 5.25	2023	8,525,000
Series 2004A	3.0 – 5.00	2026	22,275,000
Parking Deck I, Series 2002A	4.0 – 5.25	2023	8,110,000
Residence Hall IV, Series 2002A	4.0 – 5.25	2023	<u>23,180,000</u>
Total revenue bonds			<u>79,425,000</u>
General obligation revenue bonds:			
Dormitory and dining hall:			
Series 1997	4.7 – 5.1	2021	1,789,987
Series 1998R	3.5 – 4.7	2015	2,833,041
Series 1998R	3.5 – 4.3	2008	158,017
Series 1999	4.8 – 5.3	2019	2,330,000
Series 2001	2.1 – 4.9	2021	7,825,000
Series 2003R	2.5 – 5.5	2011	947,087
Series 2003R	2.5 – 4.0	2006	70,000
Series 2004R	4.0 – 5.0	2019	8,240,372
Series 2004R	4.0 – 5.0	2020	<u>12,582,279</u>
Total general obligation bonds			<u>36,775,783</u>
Total bonds payable			116,200,783
Capital leases	Various	2007	29,782
Installment purchases	3.0	2009	<u>1,424,000</u>
Total			<u>\$117,654,565</u>

Long-term debt matures as follows:

	<u>Principal</u>	<u>Interest</u>
2006	\$ 4,461,222	\$ 5,662,994
2007	5,365,354	5,468,418
2008	5,572,719	5,253,493
2009	5,852,978	4,986,122
2010	5,734,939	4,706,130
2011-2015	31,793,616	18,677,466
2016-2020	36,388,737	10,253,330
2021-2025	20,815,000	2,325,666
2026	<u>1,670,000</u>	<u>39,662</u>
Total	<u>\$117,654,565</u>	<u>\$57,373,281</u>

Defeasance of Debt

On October 7, 2004, the VCBA issued \$112,945,000 in Educational Facilities Refunding Revenue Bonds, Series 2004A, with interest rates ranging at 5.0 percent. The sale of these bonds enabled the University to advance refund \$1,170,000 of Revenue Bonds, Series 1998, with interest rates ranging from 3.0 percent to 5.0 percent to finance the construction of the Freeman Sports Center.

On November 18, 2004, the Commonwealth issued \$170,530,000 in General Obligation Refunding Bonds, Series 2004B, with interest rates ranging from 4.0 percent to 5.0 percent. The sale of these bonds enabled the University to advance refund \$20,990,000 of General Obligation Revenue Bonds, Series 1999 and 2001, with interest rates ranging from 4.75 percent to 5.25 percent, to finance the construction of James River and York River Residence Halls.

The proceeds of the refunding bonds were deposited into irrevocable trusts with escrow agents to provide for all future debt service payments on the refunded bonds. As a result, these bonds are considered to be defeased and the liability associated with these bonds has been removed from the long term liabilities.

The advance refunding of October 7, 2004 resulted in the recognition of an accounting gain of \$40,000 and the aggregate debt service payments will be decreased by \$65,946 over the next nine years and an economic gain of \$55,114 (assuming a discount rate of 3.64 percent).

The advance refunding of November 18, 2004 resulted in the recognition of an account loss of \$268,465, however, the aggregate debt service payments will be decreased by \$1,371,836 over the next 15 years and an economic gain of \$1,064,288 (assuming a discount rate of 4.74 percent) will be obtained.

During fiscal years 1994, 1997, 1998, and 2004 certain 1992C and 1994 General Obligation Bonds were defeased by the University. The net proceeds from the sales of these bonds were placed in an irrevocable trust with an escrow agent to provide for all future debt service on the refunded bonds. Accordingly, the trust account assets and the related liability for the defeased bonds are not reflected in the University's financial statements. At June 30, 2005, \$33,680,000 of the bonds considered defeased remained outstanding.

Christopher Newport University Educational and Real Estate Foundations - Long-Term Debt

A. Bonds Payable

In March 2001, the Foundations entered into an agreement with the Industrial Development Authority of the County of James City, Virginia, under which the Authority issued \$8 million of variable rate bank-qualified tax-exempt bonds. The Foundations used the proceeds from the bonds to finance the acquisition of various properties in the immediate vicinity of the University deemed essential for its enhancement and future expansion. At June 30, 2005, the balance outstanding on the bonds was \$8 million. The bonds are payable interest only until July 2006 at which time principal curtailments are scheduled to begin. The bonds mature June 2011.

In November 2001, the Foundations entered into an agreement with the Industrial Development Authority of the County of James City, Virginia, under which the Authority issued \$10 million of variable rate bank-qualified tax-exempt bonds. The Foundations used the proceeds from the bonds to finance the acquisition of various properties in the immediate vicinity of the University deemed essential for its enhancement and future expansion. At June 30, 2005, the balance outstanding on the bonds was \$9,624,637. The bonds were payable interest only until October 2003 at which time principal curtailments began. The bonds mature September 2013.

In July 2002, the Foundations entered into an agreement with the Industrial Development Authority of the County of James City, Virginia, under which the Authority issued \$5.5 million of variable rate bank-qualified tax-exempt bonds. The Foundations used the proceeds from the bonds to finance the acquisition of various properties in the immediate vicinity of the University deemed essential for its enhancement and future expansion. At June 30, 2005, the balance outstanding on the bonds was \$5,314,718. The bonds were payable interest only until October 2003 at which time principal curtailments began. The bonds mature September 2013.

In July 2004, the Foundations entered into an agreement with the Industrial Development Authority of the City of Newport News, under which the Authority issued \$26.9 million of variable rate bank-qualified tax-exempt bonds. The Foundations used the proceeds from the bonds to finance the acquisition of various properties in the immediate vicinity of the University deemed essential for its enhancement and future expansion. At June 30, 2005, the balance outstanding on the bonds was \$26,900,000. The bonds were payable interest only until November 2005 at which time principal curtailments began. The bonds mature May 2019.

In July 2004, the Foundations entered into a note agreement with Towne Bank for \$1,342,000. The Foundations will pay the loan in six annual principal payments of \$25,000 each, with the first principal payment due December 2005. Interest is paid monthly at the rate of prime, less 0.5 percent (5.0 percent at June 30, 2005). Maturity date is December 31, 2011. The Foundations' final payments will be for all remaining principal and any accrued interest not paid. At June 30, 2005, the outstanding balance of the note was \$1,341,465.

In July 2004, the Foundations entered into a construction note agreement with Old Point National Bank for \$2,800,000. Monthly interest only payments are due at 5.375 percent, starting September 2004. Principal and interest payments of \$19,186 began January 2006. Maturity date is August 2014. The Foundations' final payment will be for all remaining principal and any accrued interest not paid. At June 30, 2005, the outstanding draws on the construction loan were \$1,316,691.

The bond commitment documents contain certain financial covenants pertaining to debt service coverage and lease payment coverage. At June 30, 2005, the Foundations were in compliance with all financial covenants.

Long-term debt and bond maturities for the fiscal years ending June 30 are as follows:

Year Ending <u>June 30,</u>	<u>Amount</u>
2006	\$ 5,007,130
2007	717,896
2008	751,963
2009	837,095
2010	926,458
Thereafter	<u>44,256,968</u>
Total	<u>\$52,497,510</u>

B. Notes Payable

Notes payable at June 30, 2005 consists of the following:

Towne Bank, unsecured, interest only payments at 6.8 percent. Principal due in February 2006	\$1,500,000
Towne Bank, unsecured, interest at Prime less .25 percent due monthly. Principal due in February 2006	<u>1,742,053</u>
Total	<u>\$3,242,053</u>

C. Lines of Credit

At June 30, 2005, the Foundations had available a \$7,500,000 line of credit facility with Bank of America. The line of credit matures on October 15, 2005. Borrowings under this facility pay interest at the one month London Interbank Offered Rate plus 1.45 percent (4.86 percent at June 30, 2005). The purpose of the credit facility is to provide temporary funds for the acquisition of certain properties in the immediate vicinity of the University deemed essential for its enhancement and future expansion, and to provide bridge financing for various projects deemed beneficial to the University. At June 30, 2005, borrowings under this line of credit facility totaled \$6,496,735.

D. Fair Value of Hedge Transactions

The Foundations utilize derivative financial instruments to reduce exposure to market risks from changes in interest rates. By entering into interest rate swaps, the Foundations limit exposure to changes in variable interest rates. The Foundations formally document all hedging relationships and assess hedge effectiveness both at inception and on an ongoing basis.

The fair values of the interest rate swap agreements are the estimated amounts the Foundations would receive or pay to terminate the agreements as of the reporting date.

The fair value of the interest rate swaps at June 30, 2005 is as follows:

<u>Instrument Value</u>	<u>Variable Rate</u>	<u>Fixed Rate</u>	<u>Expiration</u>	<u>Fair Value</u>
\$ 7,500,000	65% of LIBOR +0.82%	5.22%	June 2011	\$ (376,268)
5,500,000	65% of LIBOR +0.88%	5.23%	September 2013	(579,894)
10,000,000	65% of LIBOR +0.88%	5.14%	September 2013	(983,354)
26,900,000	Flexible Rate	3.73%	May 2019	<u>(2,135,400)</u>
Total				<u><u>\$(4,074,916)</u></u>

8. AUXILIARY ENTERPRISE ACTIVITIES

Auxiliary operating revenues and expenses are distributed as shown in the following table for the year ended June 30, 2005. Additionally, the University used auxiliary revenues to pay debt service and capital improvements of \$7,477,106 and \$238,781 respectively. Those amounts are not included in the auxiliary operating expenses below.

Revenues:	
Room contracts, net of scholarship allowance of \$1,372,034	\$11,079,323
Food service contracts, net of scholarship allowance of \$494,865	4,180,546
Comprehensive fee, net of scholarship allowance of \$748,663	8,294,894
Other student fees and sales and services	<u>7,182,386</u>
Total auxiliary enterprises revenues	<u><u>\$ 30,737,149</u></u>
Expenses:	
Residential facilities	\$ 7,728,408
Dining operations	5,561,207
Athletics	4,397,486
Bookstore	2,794,222
Parking services	179,883
Other auxiliary services	<u>2,057,889</u>
Total auxiliary activities expenses	<u><u>\$22,719,095</u></u>

9. EXPENSES BY NATURAL CLASSIFICATION

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

	Salaries and Wages	Fringe Benefits	Services and Supplies	Scholarship	Utilities	Plant and Equipment	Depreciation	Total
Instruction	\$13,026,011	\$3,376,814	\$ 1,627,663	\$ -	\$ -	\$ 220,720	\$ -	\$18,251,208
Research	1,024,742	221,190	749,343	45,187	-	22,910	-	2,063,372
Public service	657,381	109,553	474,114	-	-	61,998	-	1,303,046
Academic support	2,556,314	981,303	2,231,859	-	-	340,406	-	6,109,882
Student services	1,819,557	466,517	1,159,444	-	-	36,757	-	3,482,275
Institutional support	3,297,991	1,032,495	1,338,802	18,006	-	64,063	-	5,751,357
Operation and maintenance	1,791,361	826,628	1,284,316	-	936,459	194,483	-	5,033,247
Depreciation	-	-	-	-	-	-	4,102,027	4,102,027
Scholarships	-	-	-	1,722,060	-	-	-	1,722,060
Auxiliary activities	<u>6,446,598</u>	<u>1,746,353</u>	<u>11,998,916</u>	<u>-</u>	<u>1,582,771</u>	<u>944,457</u>	<u>-</u>	<u>22,719,095</u>
Total	<u>\$30,619,955</u>	<u>\$8,760,853</u>	<u>\$20,864,457</u>	<u>\$1,785,253</u>	<u>\$2,519,230</u>	<u>\$1,885,794</u>	<u>\$4,102,027</u>	<u>\$70,600,762</u>

10. STATE APPROPRIATIONS

The University receives state appropriations from the General Fund of the Commonwealth. The Appropriation Act specifies that such unexpended appropriations that remain on the last day of the current year, ending June 30, 2005, shall be reappropriated for expenditure in the first month of the next year, beginning on July 1, 2005, except as may be specifically provided otherwise by the General Assembly. The Governor may, at his discretion, unallot funds from the reappropriated balances that relate to unexpended appropriations.

The following is a summary of state appropriations received by the University including all supplemental appropriations and reversions.

Original legislative appropriations:	
Educational and general programs	\$22,071,183
Student financial assistance	2,806,498
Supplemental adjustments:	
Salary increases	61,069
Fringe benefit rate changes	40,731
Military tuition waivers	42,512
Miscellaneous	<u>(13,977)</u>
Adjusted appropriations	<u>\$25,008,016</u>

11. COMMITMENTS

At June 30, 2005, the University was committed to construction contracts totaling approximately \$123,102,808 of which \$98,920,374, had been incurred and is recorded as construction-in-progress.

The University is committed under various operating leases for buildings and equipment. In general, the leases are for a one year term and the University has renewal options on these leases for up to three additional one year terms. In most cases, the University expects that in the normal course of business, these leases will be replaced by similar leases.

On August 1, 2002 the University entered into a lease with the Christopher Newport University Educational Foundation, Inc. for a term of 15 years for the lease of residential facilities for student housing.

Rental expense for the fiscal year ended June 30, 2005 was \$3,135,913. The University has, as of June 30, 2005 the following total future minimum rental payments due under the above leases:

<u>Fiscal Year</u>	<u>Operating Leases</u>
2006	\$ 4,737,822
2007	4,791,937
2008	4,878,471
2009	4,940,427
2010	4,940,427
2011-15	24,702,135
2016-20	<u>24,702,135</u>
Total	<u>\$73,693,354</u>

12. DONOR-RESTRICTED ENDOWMENTS

Investments of the University's endowment funds are pooled and consist primarily of gifts and bequests, the use of which is restricted by donor-imposed limitations.

The Uniform Management of Institutional Funds Act, Code of Virginia, Title 55, Chapter 15, Sections 268.1-268.10, permits the spending policy adopted by the Board of Visitors to appropriate an amount of realized and unrealized endowment appreciation as the Board determines to be prudent. In determining the amount of appreciation to appropriate, the Board is required by the Act to consider such factors as long - and short-term needs of the University, present and anticipated financial requirements, expected total return on investment, price level trends, and general economic conditions.

13. RETIREMENT PLANS

A. Virginia Retirement System

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

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 and can be found in the CAFR. The Commonwealth, not the University, has the overall responsibility for contributions to this plan. The CAFR provides disclosure of the Commonwealth's unfunded pension benefit obligation at June 30, 2005. The same report contains historical trend information showing VRS's progress in accumulating sufficient assets to pay benefits when due.

The University's expenses include the amount assessed by the Commonwealth for contributions to VRS, which totaled \$1,415,044 for the year ended June 30, 2005. These contributions included the employee contribution assumed by the employer, at a rate of 8.91 percent. Contributions to the VRS were calculated using the base salary amount of approximately \$15,881,527 for the fiscal year ended June 30, 2005. The University's total payroll was approximately \$32,717,336 for the year ended June 30, 2005.

B. Optional Retirement Plans

Full-time faculty and certain administrative staff participate in a defined contribution plan administered by two different providers other than the VRS. Effective July 1, 2004, the previous five providers were reduced to TIAA/CREF Insurance Companies and Fidelity Investments Tax-Exempt Services. This plan is a fixed-contribution program where the retirement benefits received are based upon the employer's (5.4 percent) and employee's (5.0 percent) contributions, plus interest and dividends.

Individual contracts issued under the plan provide for full and immediate vesting of both the University and the participant's contributions. Total pension costs under this plan were approximately, \$1,281,203 for the year ended June 30, 2005. Contributions to the optional retirement plan were calculated using the base salary amount of approximately \$12,319,258. The University's total payroll in fiscal year 2005 was approximately \$32,717,336.

14. 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 insurance premiums of its retirees who have at least 15 years of service and participates in the state health plan. Information related to these plans is available at the statewide level in the Commonwealth's CAFR.

15. CONTINGENCIES

A. Grants and Contracts

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

In addition, the University is required to comply with various federal regulations issued by the Office of Management and Budget. Failure to comply with certain systems requirements of these regulations may result in questions concerning the allowability of related direct and indirect charges pursuant to such agreements. As of June 30, 2005, the University estimates that no material liabilities will result from such audits or questions.

B. Litigation

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

16. RISK MANAGEMENT AND EMPLOYEE HEALTH CARE PLANS

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

17. SUBSEQUENT EVENTS

In October 2005, the University issued 2005A, revenue bonds through the Building VCBA's Public Higher Education Financing Pooled Bond Program in the amount of \$2,010,000. Proceeds from the bonds will be used to construct Parking Deck II. The bonds were issued with interest rates varying from 3.0 percent to 5.0 percent and mature in 2025.

Christopher Newport University Educational and Real Estate Foundations - Subsequent Event

In September 2005, the Foundations received a commitment for a gift of \$5 million dollars. A portion of the gift will be used to fund scholarships, while the remaining funds will be used to support and advance the most important priorities of the University and the School of Business.

SUPPLEMENTARY INFORMATION

CHRISTOPHER NEWPORT UNIVERSITY
SCHEDULE OF AUXILIARY ENTERPRISES - REVENUES AND EXPENSES
For the Year Ended June 30, 2005

	Auxiliary Services	Dining Services	Housing Operations	Intercollegiate Athletics
Revenues:				
Sales and services	\$ 461,003	\$ 1,925,057	\$ 202,076	\$ 216,240
Student fees	2,366,850	4,675,411	12,451,357	5,863,817
Other	371,539	-	-	-
Total revenues	3,199,392	6,600,468	12,653,433	6,080,057
Cost of sales	-	2,209,519	-	-
Net revenues	3,199,392	4,390,949	12,653,433	6,080,057
Expenses:				
Personal services	1,255,236	1,863,094	2,173,415	2,439,901
Contractual services	393,473	401,201	840,604	711,012
Supplies and materials	88,257	154,891	373,081	366,958
Transfer payments	88	155,924	334,625	25,333
Continuous charges	252,547	682,094	3,562,440	747,311
Equipment	68,288	94,484	444,243	106,971
Total expenses	2,057,889	3,351,688	7,728,408	4,397,486
Excess of revenues over expenses before transfers	1,141,503	1,039,261	4,925,025	1,682,571
Mandatory transfers:				
Allocation of work study program	4,392	-	6,259	17,901
Debt service	(514,229)	(433,265)	(4,386,612)	(1,445,035)
Non-mandatory transfers	(573,055)	-	-	-
Total transfers	(1,082,892)	(433,265)	(4,380,353)	(1,427,134)
Net increase/(decrease) for the year	58,611	605,996	544,672	255,437
Fund balance/(deficit) at beginning of year	301,718	(165,929)	1,103,143	(217,653)
Fund balance at end of year	\$ 360,329	\$ 440,067	\$ 1,647,815	\$ 37,784

This schedule is prepared using the modified accrual basis of accounting.

This schedule accounts for purchases of capital assets as expenses and does not include depreciation. Additionally, all revenues are recorded as charged including student charges and internal activities. Management uses this method of accounting to monitor individual enterprises and set rates.

Parking Services	University Bookstore	Total
\$ 880,563	\$ 3,062,934	\$ 6,747,873
40,505	-	25,397,940
-	62,974	434,513
921,068	3,125,908	32,580,326
-	2,157,719	4,367,238
921,068	968,189	28,213,088
113,248	352,830	8,197,724
16,310	112,022	2,474,622
5,451	18,324	1,006,962
404	10,684	527,058
43,654	107,135	5,395,181
816	35,508	750,310
179,883	636,503	18,351,857
741,185	331,686	9,861,231
1,278	-	29,830
(697,965)	-	(7,477,106)
100,000	(1,699,201)	(2,172,256)
(596,687)	(1,699,201)	(9,619,532)
144,498	(1,367,515)	241,699
-	2,984,409	4,005,688
\$ 144,498	\$ 1,616,894	\$ 4,247,387



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

June 16, 2006

The Honorable Timothy M. Kaine
Governor of Virginia

The Honorable Thomas K. Norment, Jr.
Chairman, Joint Legislative Audit
and Review Commission

The Board of Visitors
Christopher Newport University

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic financial statements of **Christopher Newport University**, a component unit of the Commonwealth, and its discretely presented component unit as of and for the year ended June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of the University'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 unit of the University, 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 the amounts included for the component unit of the University 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 unit of the University 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 University and of its discretely presented component unit as of June 30, 2005, 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.

The Management's Discussion and Analysis on pages 3 through 7 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.

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

INDEPENDENT AUDITOR'S REPORT ON 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 University'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 a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the University's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition, entitled "Improve Financial Statement Preparation Process" is described in the section titled "Internal Control Finding and Recommendation."

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 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 the reportable condition described above is not a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and 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 no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Status of Prior Findings

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

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 26, 2006



AUDITOR OF PUBLIC ACCOUNTS

JHS:sks
sks: 49



June 27, 2006

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

Dear Mr. Kucharski,

The Auditor of Public Accounts presented an audit finding in the area of financial reporting for the year ended June 30, 2005. The University has addressed this finding as reported below:

On February 26, 2006, CNU hired a new Manager of Financial Reporting, whose primary responsibility will be in the preparation of the University's financial statements as well as all templates and attachments required by the Department of Accounts. This individual has 10 years of financial reporting experience in the Commonwealth of Virginia, in Higher Education, in addition to SCT/ Banner experience. This will allow the University Comptroller to provide review oversight into the process without actually preparing the statements, thus providing better internal controls over financial reporting. Both the University Comptroller and the Manager of Financial Reporting will be capable of producing financial statements in the future.

Documentation of the financial statement preparation procedures has begun and will be finished before June 30, 2007. The Manager of Financial Reporting will be following the new guidelines that have already been documented as we begin preparing the June 30, 2006 statements. This documentation will be periodically revised and we will continue to document all remaining procedures throughout the next year. We hope that we will have the opportunity to consult with your staff throughout the year to insure that our efforts fully comply with SAS 112 standards.

The degree of documentation that will be required is dependent on the SCT/GASB module working properly. The University has been communicating with SCT Consultants since August 2005 to fix the GASB module. The University last had an SCT consulting visit in May 2006 and mapping the chart of accounts for the GASB statements has been completed. However, the GASB module process continues to not work properly and SCT is actively involved in trying to resolve the problems. Upon resolution, CNU will then evaluate whether this is a



viable solution to producing the University's financial statements or if another report writing tool is required.

Lastly, it should be noted that the financial statements for the year ended June 30, 2005 required no audit adjustments and all Department of Accounts and Auditor of Public Accounts deadlines were met.

I would like to commend the efforts of you and your staff on another successful year and I look forward to working with you and your staff in the future.

Sincerely,

William L. Brauer
Executive Vice President

CHRISTOPHER NEWPORT UNIVERSITY

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