

***West Virginia Higher Education
Policy Commission***

*Financial Statements and
Additional Information for the
Year Ended June 30, 2002, and
Independent Auditors' Reports*

WEST VIRGINIA HIGHER EDUCATION POLICY COMMISSION

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West Virginia Higher Education Policy Commission
Management Discussion and Analysis
Fiscal Year 2002

Overview of the Financial Statements and Financial Analysis

The Governmental Accounting Standards Board (GASB) issued new directives for presentation of college and university financial statements that have been adopted for presentation in Fiscal Year 2002 by the West Virginia Higher Education Policy Commission (the "Commission"). The previous reporting format presented financial balances and activities by fund groups. The new format places emphasis on the overall economic resources of the organization. This is the first fiscal year for this new format.

The following discussion and analysis of the Commission's financial statements provides an overview of its financial activities for the year and is required supplemental information. The emphasis of discussions about these statements will focus on current year data. There are three financial statements presented: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and, the Statement of Cash Flows.

Statement of Net Assets

The Statement of Net Assets presents the assets, liabilities, and net assets of the Commission as of June 30, 2002. The Statement of Net Assets is a point of time financial statement. The purpose of the Statement of Net Assets is to present to the readers of the financial statements a fiscal snapshot of the Commission. The Statement of Net Assets presents end-of-year data concerning Assets (current and noncurrent), Liabilities (current and noncurrent), and Net Assets (assets minus liabilities).

From the data presented, readers of the Statement of Net Assets are able to determine the assets available to continue the operations of the Commission. They are also able to determine how much the Commission owes vendors, investors and lending institutions.

Finally, the Statement of Net Assets provides a picture of the net assets (assets minus liabilities) and their availability for expenditure by the Commission.

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the Commission's equity in furniture and equipment owned by the Commission. The next asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. Nonexpendable restricted net assets are for the Endowment Program where funds are invested and the earnings are available for expenditure but the original investment is not. Expendable restricted net assets are available for expenditure by the Commission but have a specific purpose. The

final category is unrestricted net assets. Unrestricted assets are available to be used for any lawful purpose of the Commission.

Net Assets

(In thousands of dollars)

	June 30, 2002
Assets:	
Current Assets	\$ 30,560
Other Non-Current Assets	222,349
Capital Assets, net	<u>398</u>
Total Assets	<u>\$ 253,307</u>
Liabilities	
Current Liabilities	\$ 21,779
Noncurrent Liabilities	<u>235,758</u>
Total Liabilities	<u>257,537</u>
Net Assets (Deficit)	
Invested in Capital Assets, net of debt	(19,253)
Restricted – expendable	12,787
Restricted – nonexpendable	862
Unrestricted	<u>1,374</u>
Total Net Assets	<u>(4,230)</u>
Total Liabilities and Net Assets	<u>\$ 253,307</u>

Major items of note in the Statement of Net Assets include:

- Due to the new accounting and reporting changes required by GASB Statements No. 34 and 35, only the current year's Statement of Net Assets is presented. In future years, comparative statements will be presented.
- At June 30, 2002, the Commission's financial statements reflect a receivable from the higher education institutions (an internal obligation) for principal payments owed on system-wide debt obligations. In prior financial reports, the system debt was reflected as an obligation of the Commission, but the obligation of the institutions to contribute funds to repay this debt was only disclosed in a footnote. The internal assignment of this liability is shown as a transfer in the Statement of Revenue, Expenses and Changes in Net Assets. On the Statement of Net Assets as of June 30, 2002, a receivable has been recorded for institutional obligations totaling \$202.3 million out of the total of \$221.9 million in outstanding system-debt. The remaining \$19.6 million continues to be reflected as a deficit in the Net Assets Invested in Capital Assets, and will be allocated to certain institutions on an annual basis over the remaining term of the bonds. This change in reporting

- results in a more equitable presentation of net assets for both the Commission and the institutions.
- Total current assets of \$30.6 million exceed total current liabilities of \$21.8 million. By the very nature of the Commission, significant funds flow through the operations reported in these financial statements with further distribution to the West Virginia public institutions.
 - Cash balances of \$18.2 million in current assets include \$5.5 million of funding received in late June 2002 that will flow to the institutions to fund the PROMISE scholarship program.
 - Current receivables from the institutions total \$8.6 million, which represents an allocation to the institutions of principal payments to be paid in fiscal year 2003 related to the system-wide bond obligations.
 - Current liabilities total \$21.8 million, with \$10.2 million related to the current principal portion of system-wide bond obligations, \$3.5 million in interest payable on the system debt, and \$5.5 million in funding deposited for the PROMISE scholarship program.
 - Non-current assets total \$222.7 million and non-current liabilities total \$235.8 million.
 - The primary non-current asset represents a \$193.7 million receivable from the institutions related to the system-wide bond obligations. Also included is \$9.4 million in cash earmarked for capital improvements at the institutions, primarily resulting from the receipt of special lottery funding in June 2002.
 - Investment balances total \$19.2 million, which primarily represent capital improvement funds from a 2000 bond issue that will be expended as those capital projects move to completion. A non-current payable to West Virginia University has been recorded to reflect the future payments.
 - The other major non-current liability represents the actual system-wide bonds outstanding, as further described in Note 8 to the financial statements.
 - Total net assets of the Commission is a deficit of \$4.2 million.
 - Net assets invested in capital assets is a deficit of \$19.3 million, reflecting the system debt that is currently not allocated to specific institutions as described above.
 - Funds restricted for scholarship programs total \$2.8 million.
 - Funds restricted for capital projects total \$9.0 million.
 - Unrestricted funds total \$1.4 million, and represent funds retained by the Commission for ongoing capital projects and Commission initiatives, but that are not legally restricted.

Statement of Revenues, Expenses and Changes in Net Assets

Changes in total net assets as presented on the Statement of Net Assets are based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of the statement is to present the revenues of the Commission, both

operating and nonoperating, and the expenses of the Commission, operating and nonoperating, and any other revenues, expenses, gains and losses of the Commission.

Operating revenues are fees from the institutions that the Commission by statute can assess them to support the Commission operations and various initiatives. Revenue is also received in the form of federal and State grants. Operating expenses are those expenses incurred in the form of staff salaries, benefits and various goods and services to carry out the mission of the Commission. Revenues for which goods and services are not provided are reported as nonoperating revenues. For example State appropriations are nonoperating because they are provided by the Legislature to the Commission without the Legislature directly receiving commensurate goods and services for those revenues.

**Revenues, Expenses and Changes in Net Assets
(In thousands of dollars)**

	FY 2002
Operating Revenues	\$ 8,569
Operating Expenses	<u>9,125</u>
Operating Loss	(556)
Net Nonoperating Revenues	<u>9,849</u>
Income Before Other Revenues, Expenses, Gains or Losses	9,293
Other Revenues, Expenses, Gains or Losses	<u>(37,838)</u>
Decrease in Net Assets before Transfers	(28,545)
Transfer of Debt Obligations to Institutions	<u>180,652</u>
Increase in Net Assets	152,107
Net Assets (Deficit) – Beginning of Year (As Restated)	<u>(156,337)</u>
Net Assets-End of Year	<u><u>\$(4,230)</u></u>

Major items of note in the Statement of Revenue, Expenses and Change in Net Assets include:

- Due to the new accounting and reporting changes required by GASB Statements No. 34 and 35, only the current year’s Statement of Revenues, Expenses and Change in Net Assets is presented. In future years, comparative statements will be presented.

- Operating income of the Commission totaled \$8.6 million.
 - Fees collected from higher education institutions for the operations of the Commission and for special projects for higher education totaled \$4.3 million.
 - Other state and federal grants totaled \$4.3 million, and represent funding for various programs including the TRIO program, National Science Foundation, Veterans Administration, Eisenhower Professional Development Program and Vocational & Technical Education.
- Operating expenses totaled \$9.1 million.
 - Other operating expenses totaled \$9.1 million, and consist primarily of staff salaries, benefits, and other operating expenses for Commission initiatives and various federal and state funded programs.
- Net non-operating revenue totaled \$9.8 million.
 - State general revenue appropriations totaled \$3.0 million and were expended as budgeted in support of the Commission's operating expenses.
 - Lottery funding totaled \$39.7 million, and provides funding for scholarship programs as well as other pass-through funding to the institutions.
 - Pass-through expenditures for scholarships and financial aid totaled \$23.3 million. Funding for these programs comes from the West Virginia Lottery.
 - Payments for interest on indebtedness are offset by payments from the institutions for debt service totaling \$21.2 million
 - Other non-operating expenses totaled \$20.8 million, and primarily represent transfers to the institutions for operations and special projects.
- Capital funds of \$7.5 million were received in late June 2002, and will result in allocations to the institutions in future periods. Capital projects payments totaled \$45.3 million and represent expenditures of the proceeds from the 1998 and 2000 bond issues. Primarily as a result of these payments under the bond programs, there was a reduction in net assets for the year of \$28.5 million.
- Transfers of debt obligations to the institutions totaled \$180.7 million as of June 30, 2002. As noted in the description of the Statement of Net Assets, this related to the recording of a receivable from the institutions related to their obligations for debt principal on the system-wide bond programs.

Statement of Cash Flows

The final statement presented by Commission is the Statement of Cash Flows. The Statement of Cash Flows presents detailed information about the cash activity of the Commission during the year. The statement is divided into five parts. The first section deals with operating cash flows and shows the net cash used by the operating activities of the Commission. The second section reflects cash flows from noncapital financing activities. This section reflects the cash received and spent for nonoperating, noninvesting, and noncapital financing purposes. The third section reflects the cash flows from investing activities and shows the purchases, proceeds, and interest received

from investing activities. The fourth section deals with cash flows from capital and related financing activities. This section deals with the cash used for the acquisition and construction of capital and related items. The fifth part reconciles the net cash used to the operating income or loss reflected on the Statement of Revenues, Expenses, and Changes in Net Assets.

Statement of Cash Flows
(In thousands of dollars)

	FY 2002
Cash Provided (used) by:	
Operating Activities	\$ 92
Noncapital Financing Activities	2,198
Capital and Related Financing Activities	(44,299)
Investing Activities	<u>46,187</u>
Increase in Cash and Cash Equivalents	4,178
Cash and Cash Equivalents, beginning of year	<u>14,018</u>
Cash and Cash Equivalents, end of year	<u><u>\$ 18,196</u></u>

Major items of note in the Cash Flow Statement include:

- Due to the new accounting and reporting changes required by GASB Statements No. 34 and 35, only the current year's Statement of Cash Flows is presented. In future years, comparative statements will be presented.
- Net cash provided by operating revenues offset cash expended for operating activities. Major variances from that reported on the Statement of Revenue, Expenses and Changes in Net Assets include depreciation expense and accruals for compensated absences.
- Net cash provided from Noncapital Financing Activities totaled \$2.2 million, and results from the reporting of West Virginia Lottery and other State and federal funding in this category.
- Net cash used by Capital Financing Activities totaled \$44.3 million primarily for capital construction payments under bonds issued in 1998 and 2000
- Net cash provided from Investing Activities totaled \$46.2 million and resulted from a reduction in investments to fund expenditures for construction projects.
- Net cash for the year increased by \$4.2 million. This increase primarily relates to funding received in late June 2002 related to PROMISE scholarship program and for the Higher Education Improvement Fund for capital projects.

Other Factors Impacting the Financial Position and Results of Operations of the Commission

The mission of the Commission is to align the West Virginia higher education system to contribute to the long-term growth and diversification of West Virginia's economy as outlined in It All Adds Up: Compact for the Future of West Virginia. (the "Compact") focuses on goals in the following six major areas: Preparation, Participation, Affordability, Competitive Work Force, Economic Development, and Accountability.

The achievement of the goals for the higher education system as described in the Compact are dependent upon many factors, one of which is adequate resources to implement the strategies necessary to achieve the goals. At the present time the Commission itself maintains a strong financial condition. Although the net asset position of the Commission is reported as a deficit of \$4.2 million, this deficit does not include the \$19.6 million in net system bond indebtedness that will be allocated to the institutions as the debt is repaid over the next ten years. The vast majority of the funding which is reported in the financial statements of the Commission is ultimately assigned to the public higher education institutions in the State for capital projects, grants, scholarships and special projects. This funding is critical to the success of the higher education system in meeting the Compact goals.

General revenue funding for the Commission's operations are being reduced by 3% for fiscal year 2003 as compared to fiscal year 2002 due to budget constraints imposed upon virtually all state agencies. For fiscal year 2004, all state agencies are being requested to submit a general revenue budget appropriation request with a 10% budget reduction. The strategies for implementing the budget reductions for fiscal year 2004 are currently in the process of being evaluated prior to implementation.

INDEPENDENT AUDITORS' REPORT

To the West Virginia Higher Education
Policy Commission

We have audited the accompanying financial statements of the West Virginia Higher Education Policy Commission as of June 30, 2002 and for the year then ended, listed in the foregoing Table of Contents. These financial statements are the responsibility of the management of the Commission. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Commission at June 30, 2002 and the changes in net assets (deficit) and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the financial statements, the Commission changed its financial statement presentation to adopt the provisions of the Governmental Accounting Standards Board ("GASB") Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, as amended by GASB Statements No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus*, and No. 38, *Certain Financial Statement Note Disclosures*, as of July 1, 2001.

The Management's Discussion and Analysis on pages 1 to 7 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Commission's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have issued a report dated October 11, 2002, on our consideration of the Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

October 11, 2002

WEST VIRGINIA HIGHER EDUCATION POLICY COMMISSION

STATEMENT OF NET ASSETS

JUNE 30, 2002

ASSETS:

Current assets:

Cash and cash equivalents	\$ 18,195,987
Investments	371,506
Appropriations due from Primary Government	1,642,406
Accounts receivable, net	669,910
Interest receivable	1,091,708
Receivable from institutions - current portion	<u>8,588,207</u>

Total current assets 30,559,724

Noncurrent assets:

Cash and cash equivalents	9,421,501
Investments	19,236,282
Receivable from institutions	193,691,394
Capital assets, net	<u>397,784</u>

Total noncurrent assets 222,746,961

TOTAL ASSETS \$ 253,306,685

(Continued)

WEST VIRGINIA HIGHER EDUCATION POLICY COMMISSION

STATEMENT OF NET ASSETS JUNE 30, 2002

LIABILITIES:

Current liabilities:

Accounts payable	\$ 1,328,682
Accrued liabilities	493,522
Deposits	5,500,000
Deferred revenue	390,836
Compensated absences, current portion	302,088
Interest payable	3,548,421
Bonds payable, current portion	<u>10,215,000</u>
Total current liabilities	<u>21,778,549</u>

Noncurrent liabilities:

Compensated absences	535,653
Deferred interest payable	4,644,798
Due to West Virginia University	18,861,687
Bonds payable	<u>211,715,868</u>
Total noncurrent liabilities	<u>235,758,006</u>
Total liabilities	<u>257,536,555</u>

NET ASSETS (DEFICIT):

Invested in capital assets	(19,253,483)
Restricted for:	
Expendable:	
Scholarships	2,834,851
Sponsored projects	113,876
Capital projects	9,027,470
Debt service	371,506
Other	<u>439,668</u>
Total restricted expendable	12,787,371
Nonexpendable	862,000
Unrestricted	<u>1,374,242</u>
Total net assets	<u>(4,229,870)</u>

TOTAL LIABILITIES AND NET ASSETS \$ 253,306,685

See notes to financial statements (Concluded)

WEST VIRGINIA HIGHER EDUCATION POLICY COMMISSION

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (DEFICIT) YEAR ENDED JUNE 30, 2002

OPERATING REVENUES:

Fees from higher education institutions	\$ 4,259,750
Contracts and grants:	
Federal	1,357,560
State	2,938,474
Miscellaneous - net	<u>13,125</u>
Total operating revenues	<u>8,568,909</u>

OPERATING EXPENSES:

Salaries and wages	3,408,342
Benefits	923,280
Supplies and other services	4,484,606
Depreciation	<u>308,727</u>
Total operating expenses	<u>9,124,955</u>

OPERATING LOSS (556,046)

(Continued)

WEST VIRGINIA HIGHER EDUCATION POLICY COMMISSION

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (DEFICIT) YEAR ENDED JUNE 30, 2002

NONOPERATING REVENUES (EXPENSES):	
State appropriations	\$ 2,973,750
Lottery surplus	39,679,134
Investment income	3,253,146
Institutional debt service payments to Commission	21,225,635
Interest on indebtedness	(13,184,586)
Student financial aid payments to institutions	(23,298,036)
Other payments to institutions	<u>(20,799,545)</u>
Net nonoperating revenues	<u>9,849,498</u>
INCOME BEFORE OTHER REVENUES, EXPENSES, GAINS OR LOSSES	9,293,452
Capital appropriations	7,506,041
Construction bond payments to institutions	<u>(45,344,703)</u>
DECREASE IN NET ASSETS BEFORE TRANSFER	(28,545,210)
TRANSFER OF LIABILITY TO INSTITUTIONS	<u>180,651,875</u>
INCREASE IN NET ASSETS	152,106,665
NET ASSETS (DEFICIT), BEGINNING OF YEAR (AS RESTATED)	<u>(156,336,535)</u>
NET ASSETS (DEFICIT), END OF YEAR	<u>\$ (4,229,870)</u>
See notes to financial statements	(Concluded)

WEST VIRGINIA HIGHER EDUCATION POLICY COMMISSION

STATEMENT OF CASH FLOWS YEAR ENDED JUNE 30, 2002

CASH FLOWS FROM OPERATING ACTIVITIES:	
Fees from higher education institutions	\$ 4,365,228
Contracts and grants	4,197,832
Payments to and on behalf of employees	(4,194,197)
Payments to suppliers	<u>(4,276,728)</u>
Net cash provided by operating activities	<u>92,135</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:	
State appropriations	2,973,750
Lottery surplus	45,179,134
Payments to institutions	<u>(45,954,841)</u>
Net cash provided by noncapital financing activities	<u>2,198,043</u>
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:	
Capital appropriations	7,506,041
Institutional receipts for debt service	21,225,635
Purchases of capital assets	(179,516)
Principal paid on bonds	(9,710,000)
Interest paid on bonds	(10,922,733)
Capital projects construction bond payments	(45,344,703)
Increase in noncurrent cash and cash equivalents	<u>(6,873,186)</u>
Net cash used in capital financing activities	<u>(44,298,462)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Receipts from sale of investments	45,344,703
Interest on investments	<u>841,976</u>
Cash provided by investing activities	<u>46,186,679</u>
INCREASE IN CASH AND CASH EQUIVALENTS	4,178,395
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>14,017,592</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 18,195,987</u>

(Continued)

WEST VIRGINIA HIGHER EDUCATION POLICY COMMISSION

STATEMENT OF CASH FLOWS YEAR ENDED JUNE 30, 2002

RECONCILIATION OF NET OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:

Operating loss	\$ (556,046)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation expense	308,727
Changes in assets and liabilities:	
Accounts receivables, net	(165,225)
Accounts payable	404,384
Accrued liabilities	36,488
Compensated absences	158,085
Deferred revenue	<u>(94,278)</u>

NET CASH PROVIDED BY OPERATING ACTIVITIES \$ 92,135

See notes to financial statements. (Concluded)

WEST VIRGINIA HIGHER EDUCATION POLICY COMMISSION

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2002

1. ORGANIZATION

On March 19, 2000, the West Virginia Legislature enacted Senate Bill No. 653 (“S.B. 653”), which restructured public higher education in West Virginia. S.B. 653 created a transition year board, the West Virginia Higher Education Interim Governing Board (the “Interim Governing Board”) which replaced the Board of Trustees of the State University System of West Virginia and the Board of Directors of the State College System of West Virginia (the “former College and University System Boards”) effective June 30, 2000. The Interim Governing Board was granted all powers, duties, and authorities of the former College and University System Boards and was transferred each valid agreement and obligation previously transferred to or vested in the former College and University System Boards. The Interim Governing Board was comprised of nine persons appointed by the Governor with the advice and consent of the Senate.

S.B. 653 also created the West Virginia Higher Education Policy Commission (the Board of the West Virginia Higher Education Fund), which is responsible for developing, gaining consensus around and overseeing the implementation and development of a higher education public policy agenda. The West Virginia Higher Education Policy Commission (the “Commission”) replaced the Central Office for the State College and University Systems of West Virginia.

Effective July 1, 2001, certain powers of the Interim Governing Board were transferred to thirteen newly created Governing Boards (the “Governing Boards”) at each institution within the West Virginia higher education system. Each Governing Board has certain powers and duties including but not limited to, the power to determine, control, supervise and manage the financial, business and educational policies and affairs of the institution(s) under its jurisdiction, the duty to develop a master plan for the institution, the power to prescribe the specific functions and institution’s budget request, the duty to review at least every five years all academic programs offered at the institution, and the power to fix tuition and other fees for the different classes or categories of students enrolled at the institution(s).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Commission have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (“GASB”), including Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, and Statement No. 35, *Basic Financial Statements and Management’s Discussion and Analysis of Public Colleges and Universities* (an Amendment of GASB Statement No. 34). The financial statement presentation required by GASB Statements No. 34 and No. 35 provides a comprehensive, entity-wide perspective of the Commission’s assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows and replaces the fund-group perspective previously required.

The Commission follows all GASB pronouncements as well as Financial Accounting Standards Board (“FASB”) Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989, and has elected not to apply the FASB Statements and Interpretations issued after November 30, 1989, to its financial statements.

Reporting Entity—The Commission is an operating unit of the West Virginia Higher Education Fund and represents separate funds of the State that are not included in the State’s general fund. The Commission is a separate entity which, along with all State institutions of higher education and the West Virginia Network for Educational Telecomputing (“WVNET”), form the Higher Education Fund of the State. The Higher Education Fund is considered a component unit of the State, and its financial statements are discretely presented in the State’s comprehensive annual financial report.

Financial Statement Presentation—During fiscal 2002, the Commission adopted GASB Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities* as amended by GASB Statements No. 37, *Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments: Omnibus*, and No. 38, *Certain Financial Statement Note Disclosures*. These statements establish standards for external financial reporting for public colleges and universities and require that financial statements be presented on a basis to focus on the Commission as a whole. Previously, financial statements focused on the accountability of individual fund groups rather than on the Commission as a whole. GASB Statement No. 35 reports equity as “net assets” rather than “fund balance”. Net assets are classified into four categories according to external donor restrictions or availability of assets for satisfaction of Commission obligations. The Commission’s net assets are classified as follows:

- *Invested in capital assets, net of related debt*—This represents the Commission’s total investment in capital assets, net of outstanding debt obligations related to capital assets, including those on individual institutions financial statements. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.
- *Restricted net assets, expendable*—This includes resources in which the Commission is legally or contractually obligated to spend resources in accordance with restrictions imposed by external third parties.

The West Virginia Legislature, as a regulatory body outside the reporting entity, has restricted the use of certain funds by Article 10, “Fees and Other Money Collected at State Institutions of Higher Education” of the West Virginia State Code. These restrictions are primarily for the following: debt service; graduate or branch colleges; off campus instruction; student unions; public interest research group; libraries, library supplies, and improvement in student services; faculty improvement; health education student loan fund; health sciences education; athletic programs; student activities; auxiliary operations; bookstore operations; and special programs. These activities are fundamental to the normal ongoing operations of the related institutions. These restrictions are subject to change by future actions of the West Virginia Legislature. The Commission does not have any such Code restricted net assets at June 30, 2002.

- *Restricted net assets, nonexpendable*—This includes endowment and similar type funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to principal.

- *Unrestricted net assets*—Unrestricted net assets represent resources derived from student tuition and fees, state appropriations and sales and services of educational activities. These resources are used for transactions relating to the educational and general operations of the Commission, and may be used at the discretion of the Board of Governors to meet current expenses for any purpose.

GASB Statement No. 35 requires the statements of net assets, revenues, expenses, and changes in net assets, and cash flows to be reported on an entity wide basis. The provisions of GASB Statement No. 35 have been applied to the year presented. Following is a reconciliation of total June 30, 2001 fund balances (deficit), as previously reported, to the restated net asset (deficit) balances for the same date:

	June 30, 2001
Combined fund balances (deficit), as previously reported	\$ (155,433,789)
Accumulated depreciation	(417,632)
Reclassification of grant and contract revenue	<u>(485,114)</u>
Combined fund balances (deficit), restated as net assets (deficit)	<u>\$ (156,336,535)</u>

Basis of Accounting—For financial reporting purposes, the Commission is considered a special-purpose government engaged only in business-type activities. Accordingly, the Commission’s financial statements have been prepared on the accrual basis of accounting with a flow of economic resources measurement focus. Revenues are reported when earned and expenditures when materials or services are received. All intercompany accounts and transactions have been eliminated.

Cash and Cash Equivalents—For purposes of the statement of net assets, the Commission considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Cash and cash equivalents balances on deposit with the State of West Virginia Treasurer’s Office (the “State Treasurer”) are pooled by the State Treasurer with other available funds of the State for investment purposes by the West Virginia Investment Management Board (the “IMB”). These funds are transferred to the IMB and the IMB is directed by the State Treasurer to invest the funds in specific external investment pools. Balances in the investment pools are recorded at fair value, which is determined by a third-party pricing service based on asset portfolio pricing models and other sources, in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments for External Investment Pools*. The IMB was established by the State Legislature and is subject to oversight by the State Legislature. Fair value and investment income are allocated to participants in the pools based upon the funds that have been invested. The amounts on deposit with the State Treasurer are available for immediate withdrawal and, accordingly, are presented as cash and cash equivalents in the accompanying financial statements.

Investments—The Commission’s investments are on deposit with the Municipal Bond Commission or with external financial institutions. These funds primarily represent unexpended proceeds of bond issuances, and are restricted to expenditures for capital improvements and bond related costs. Funds on deposit with external financial institutions are invested in repurchase obligations. These funds are classified as investments due to the restrictions on expenditure, but are available for immediate withdrawal. Investments are recorded at fair value.

Allowance for Doubtful Accounts—It is the Commission’s policy to provide for future losses on uncollectible accounts, contracts, grants and loans receivable based on an evaluation of the underlying account, contract, grant and loan balances, the historical collectibility experienced by the Commission on such balances and such other factors which, in the Commission’s judgment, require consideration in estimating doubtful accounts.

Noncurrent Cash and Cash Equivalents—Cash, that is (1) externally restricted to make debt service payments or to maintain sinking or reserve funds, and (2) to purchase capital or other noncurrent assets, is classified as a noncurrent asset in the statement of net assets.

Capital Assets—Capital assets include furniture and equipment. Capital assets are stated at cost at the date of acquisition or construction, or fair market value at the date of donation in the case of gifts. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 3 to 10 years for furniture and equipment.

Compensated Absences—The Commission accounts for compensated absences in accordance with the provisions of GASB Statement No. 16, *Accounting for Compensated Absences*. This statement requires entities to accrue for employees’ rights to receive compensation for vacation leave, or payments in lieu of accrued vacation or sick leave, as such benefits are earned and payment becomes probable.

The Commission’s full-time employees earn up to two vacation leave days for each month of service and are entitled to compensation for accumulated, unpaid vacation leave upon termination. Full-time employees also earn 1-1/2 sick leave days for each month of service and are entitled to extend their health or life insurance coverage upon retirement in lieu of accumulated, unpaid sick leave. Generally, two days of accrued sick leave extend health insurance for one month of single coverage and three days extend health insurance for one month of family coverage. For employees hired after 1988, the employee shares in the cost of the extended benefit coverage to the extent of 50% of the premium required for the extended coverage. Employees hired July 1, 2001 or later will no longer receive sick leave credit toward insurance premiums when they retire.

The estimate of the liability for the extended health or life insurance benefit has been calculated using the vesting method in accordance with the provisions of GASB Statement No. 16. Under that method, the Commission has identified the accrued sick leave benefit earned to date by each employee, determined the cost of that benefit by reference to the benefit provisions and the current cost experienced by the Commission for such coverage, and estimated the probability of the payment of that benefit to employees upon retirement.

The estimated expense and expense incurred for the vacation leave, sick leave or extended health or life insurance benefits are recorded as a component of benefits expense on the statement of revenues, expenses and changes in net assets.

Classification of Revenues—The Commission has classified its revenues as either operating or non-operating revenues according to the following criteria:

- ***Operating revenues***—Operating revenues include activities that have the characteristics of exchange transactions, such as (1) fees from higher education institutions, (2) most Federal, state, local, and nongovernmental grants and contracts, and (3) federal appropriations.

- *Nonoperating revenues*—Nonoperating revenues include activities that have the characteristics of non-exchange transactions, such as gifts and contributions, and other revenues that are defined as nonoperating revenues by GASB No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting* and GASB No. 34, such as state appropriations and investment income.

Use of Restricted Net Assets—The Commission has not adopted a formal policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available. Generally, the Commission attempts to utilize restricted funds first when practical.

Government Grants and Contracts—Government grants and contracts normally provide for the recovery of direct and indirect costs, subject to audit. The Commission recognizes revenue associated with direct costs as the related costs are incurred. Recovery of related indirect costs is generally recorded at fixed rates negotiated for a period of one to five years.

Income Taxes—The Commission is exempt from income taxes, except for unrelated business income, as a nonprofit organization under federal income tax laws and regulations of the Internal Revenue Service.

Cash Flows—Any cash and cash equivalents escrowed, restricted for noncurrent assets or in funded reserves have not been included as cash and cash equivalents for the purpose of the statement of cash flows.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recent Statements Issued by the Government Accounting Standards Board—The GASB issued Statement No. 39, *Determining Whether Certain Organizations are Component Units* (an amendment of GASB Statement No. 14). This statement is effective for periods beginning after June 15, 2003. The Commission has not completed the process of evaluating the impact, if any, that will result from adopting GASB Statement No. 39. This statement, when adopted, could result in additional entities being included in the Commission’s financial statements.

3. CASH AND CASH EQUIVALENTS

The composition of cash and cash equivalents was as follows at June 30, 2002:

Cash on deposit with the State Treasurer:	
Current	\$ 18,195,987
Noncurrent	<u>9,421,501</u>
	<u>\$ 27,617,488</u>

Cash on deposit with the State Treasurer is a noncategorized deposit in accordance with GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*.

4. INVESTMENTS

The composition of investments was as follows at June 30, 2002:

	Current	Noncurrent	Total
Money Market Funds	\$ 371,506	\$ 409,003	\$ 780,509
Repurchase Obligations	<u> </u>	<u>18,827,279</u>	<u>18,827,279</u>
	<u>\$ 371,506</u>	<u>\$ 19,236,282</u>	<u>\$ 19,607,788</u>

Investments in repurchase obligations provide for guaranteed rates of return ranging from 5.4% to 6.7%.

5. ACCOUNTS RECEIVABLE

Accounts receivable were as follows at June 30, 2002:

Student receivables, net of allowance for doubtful accounts of \$180,000	\$ 251,331
Grants and contracts receivable	43,893
Due from higher education institutions	361,561
Other accounts receivable	<u>13,125</u>
	<u>\$ 669,910</u>

Effective June 30, 2002, an estimate of the obligation of each institution related to bonds payable by the Commission (see Note 8) has been transferred to each institution and a related receivable has been recorded by the Commission. Additionally, a payable for unexpended construction bond proceeds has been recorded effective June 30, 2002, (see Note 7). The net transfer of liability to institutions is \$180,651,875.

6. CAPITAL ASSETS

The following is a summary of capital asset transactions for the Commission for the year ended June 30, 2002:

	Beginning Balance	Additions	Reductions	Ending Balance
Furniture and equipment	\$ 944,597	\$ 179,546	\$ (374)	\$ 1,123,769
Less accumulated depreciation	<u>(417,632)</u>	<u>(308,727)</u>	<u>374</u>	<u>(725,985)</u>
Capital assets, net	<u>\$ 526,965</u>	<u>\$ (129,181)</u>	<u>\$ -</u>	<u>\$ 397,784</u>

Title to certain real property at the institutions is held by the Commission by virtue of legislative assignment from prior system-wide governing boards. Title can be transferred from the Commission to the Institutional Governing Boards upon mutual agreement. Regardless of title, all real property at the institution is recorded in the institution's financial statements.

7. CHANGES IN LONG-TERM LIABILITIES

The following is a summary of long-term obligation transactions for the Commission for the year ended June 30, 2002:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Bonds payable	\$ 231,640,868	\$ -	\$ 9,710,000	\$ 221,930,868	\$ 10,215,000
Other long-term liabilities:					
Accrued compensated absences	679,656	158,085		837,741	302,088
Deferred interest payable Due to West Virginia University	2,253,035	2,391,763		4,644,798	
	<u> </u>	<u>18,861,687</u>	<u> </u>	<u>18,861,687</u>	<u> </u>
Total long-term liabilities	<u>\$ 234,573,559</u>	<u>\$ 21,411,535</u>	<u>\$ 9,710,000</u>	<u>\$ 246,275,094</u>	<u>\$ 10,517,088</u>

Additional information regarding bonds payable is included in Note 8.

8. BONDS PAYABLE

The State chartered the former University System of West Virginia and the former State College System of West Virginia with the responsibility to construct or renovate, finance and maintain various academic and other facilities of the State's higher education institutions. Financing for these facilities was provided through revenue bonds issued by the former State Board of Regents, the former College and University System Boards, the Interim Governing Board or the Commission. All bonds payable are administered by the Commission, as successor to the various former governing boards.

The Commission has the authority to assess each institution of the West Virginia Higher Education Fund for payment of debt service on these system bonds. The tuition and registration fees of the institution's are generally pledged as collateral for the Commission's bond indebtedness. Student fees collected by an institution in excess of the debt service allocation are retained by the institution for internal funding of capital projects and maintenance. The bonds remain a capital obligation of the Commission.

Bonds payable consisted of the following at June 30, 2002:

	Maximum Interest Rate	Range of Annual Principal Installment Due	Principal Amount Outstanding
Series 1992 University System Bonds, due through 2012	6 %	\$5,030,000 to \$8,450,000	\$ 65,990,000
Series 1996 University System Bonds, due through 2016	5.75 %	\$600,000 to \$1,185,000	11,945,000
Series 1997 University System Bonds, due through 2027	5.25 %	\$245,000 to \$795,000	11,645,000
Series 1998 University System Bonds, due through 2028	5.25 %	\$1,020,000 to \$3,625,000	53,105,000
Series 2000A University System Bonds, due through 2031	6.26 %	\$1,018,912 to \$3,263,864	36,590,868
Series 2000B University System Bonds, due through 2025	5.96 %	\$200,000 to \$670,000	8,885,000
Series 1992 College System Bonds, due through 2012	6 %	\$2,925,000 to \$3,065,000	24,620,000
Series 1997 College System Bonds, due through 2027	5.25 %	\$195,000 to \$625,000	<u>9,150,000</u>
			<u><u>\$ 221,930,868</u></u>

A summary of the annual aggregate payments for years subsequent to June 30, 2002 is as follows:

Year Ending June 30	Principal	Interest	Total
2003	\$ 10,215,000	\$ 10,558,772	\$ 20,773,772
2004	10,745,000	10,011,287	20,756,287
2005	10,250,000	9,427,970	19,677,970
2006	10,785,000	8,804,391	19,589,391
2007	11,360,000	8,196,937	19,556,937
2008 and Thereafter	<u>168,575,868</u>	<u>152,652,163</u>	<u>321,228,031</u>
	<u><u>\$ 221,930,868</u></u>	<u><u>\$ 199,651,520</u></u>	<u><u>\$ 421,582,388</u></u>

The higher education institutions' tuition and fees generally are pledged as collateral for the Commission's bond indebtedness.

9. COMPENSATED ABSENCES LIABILITY

The composition of the compensated absences liability was as follows at June 30, 2002:

Health and life insurance	\$ 397,709
Accrued vacation liability	<u>440,032</u>
	<u>\$ 837,741</u>

For the year ended June 30, 2002, the amount paid by the Commission for extended health or life insurance coverage retirement benefits totaled \$19,756. As of June 30, 2002, there were five retirees currently receiving for these benefits.

10. RETIREMENT PLANS

Substantially all full-time employees of the Commission participate in either the West Virginia Teachers' Retirement System (the "STRS") or the Teachers' Insurance and Annuities Association - College Retirement Equities Fund (the "TIAA-CREF"). Previously, upon full-time employment, all employees were required to make an irrevocable selection between the STRS and TIAA-CREF. Effective July 1, 1991, the STRS was closed to new participants. Current participants in the STRS are permitted to make a one-time election to cease their participation in that plan and commence contributions to the West Virginia Teachers' Defined Contribution Plan. Contributions to and participation in the West Virginia Teachers' Defined Contribution Plan by the Commission's employees have not been significant to date.

The STRS is a cost-sharing, defined benefit public employee retirement system. Employer and employee contribution rates are established annually by the State Legislature. The Commission accrued and paid its contribution to the STRS at a rate of 15% of each enrolled employee's total annual salary for the year ended June 30, 2002. Required employee contributions were at the rate of 6% of total annual salary in 2001. Participants in the STRS may retire with full benefits upon reaching age 60 with five years of service, age 55 with 30 years of service, or any age with 35 years of service. Lump-sum withdrawal of employee contributions is available upon termination of employment. Pension benefits are based upon 2% of final average salary (the highest five years salary out of the last 15 years) multiplied by the number of years of service.

The TIAA-CREF is a defined contribution benefit plan in which benefits are based solely upon amounts contributed plus investment earnings. Employees who elect to participate in this plan are required to make a contribution equal to 6% of total annual compensation. The Commission matches the employees' 6% contribution. Contributions are immediately and fully vested.

Total contributions to the STRS for the year ended June 30, 2002 were \$78,611, which consisted of \$56,151 from the Commission and \$22,460 from covered employees. Total contributions to the STRS for the year ended June 30, 2001 were \$82,030, which consisted of \$58,593 from the Commission and \$23,437 from covered employees. Total contributions to the STRS for the year ended June 30, 2000 were \$89,485, which consisted of \$63,918 from the Commission and \$25,567 from covered employees.

The contribution rate is set by the State Legislature on an overall basis and the STRS does not perform a calculation of the contribution requirement for individual employers, such as the Commission. Historical trend and net pension obligation information is available from the annual financial report of the Consolidated Public Retirement Board. A copy of the report may be obtained by writing to the Consolidated Public Retirement Board, Building 5, Room 1000, Charleston, WV 25305.

Total contributions to the TIAA-CREF for the year ended June 30, 2002 were \$346,992, which consisted of \$173,496 from the Commission and \$173,496 from covered employees. Total contributions to the TIAA-CREF for the year ended June 30, 2001 were \$300,058, which consisted of \$150,029, from the Commission and \$150,029, from covered employees. Total contributions to the TIAA-CREF for the year ended June 30, 2000 were \$309,236, which consisted of \$154,618 from the Commission and \$154,618 from covered employees.

The Commission's total payroll for the year ended June 30, 2002 was \$3,429,629; total covered employees' salaries in the STRS and TIAA-CREF were \$374,338 and \$2,891,607, respectively.

11. OPERATING LEASES

Future annual minimum lease payments on operating leases for years subsequent to June 30, 2002 are as follows:

Year Ending June 30	
2003	\$ 399,477
2004	409,434
2005	<u>137,584</u>
	<u>\$ 946,495</u>

Total rent expense for the year ended June 30, 2002 was \$366,415.

12. CONTINGENCIES

The nature of the educational industry is such that, from time-to-time, claims will be presented against the Commission on account of alleged negligence, acts of discrimination, breach of contract or disagreements arising from the interpretation of laws or regulations. While some of these claims may be for substantial amounts, they are not unusual in the ordinary course of providing educational services in a higher education system. In the opinion of management, all known claims are covered by insurance or are such that an award against the Commission would not impact seriously on the financial status of the Commission.

Under the terms of federal grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures under the terms of the grants. Such audits could lead to reimbursement to the grantor agencies. The Commission's management believes disallowances, if any, will not have a significant impact on the Commission's financial position.

13. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

For the year ended June 30, 2002, the following table represents operating expenses within both natural and functional classifications:

	Salaries and Wages	Benefits	Supplies and Other Services	Depreciation	Total
General institutional support	\$ 3,408,342	\$ 923,280	\$ 4,484,606	\$ -	\$ 8,816,228
Depreciation	<u> </u>	<u> </u>	<u> </u>	<u>308,727</u>	<u>308,727</u>
Total	<u>\$ 3,408,342</u>	<u>\$ 923,280</u>	<u>\$ 4,484,606</u>	<u>\$ 308,727</u>	<u>\$ 9,124,955</u>

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the West Virginia Higher Education
Policy Commission

We have audited the financial statements of the West Virginia Higher Education Policy Commission (the "Commission") as of and for the year ended June 30, 2002, and have issued our report thereon dated October 11, 2002, which contains a consistency paragraph for the adoption of Governmental Accounting Standards Board ("GASB") Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*. 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.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Commission'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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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. We noted no matters involving the Commission's internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the West Virginia Higher Education Policy Commission, management of the Commission, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

October 11, 2002