CHRISTOPHER NEWPORT UNIVERSITY

REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2004

APA
Auditor of Public Accounts
COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of Christopher Newport University for the year ended June 30, 2004, found:

- the financial statements are presented fairly, in all material respects;

- internal control matters entitled, "Assess Risk of Lack of Environmental Controls in the University's Data Center," and "Lack of Written Policies and Procedures Pertaining to the University's Information Technology Environment," that we consider to be reportable conditions; however, we do not consider any of these to be material weaknesses;

- no instances of noncompliance or other matters required to be reported; and

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

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INTERNAL CONTROL FINDINGS AND RECOMMENDATIONS

Assess Risk of Lack of Environmental Controls in the University's Data Center

The University has not assessed the risk of loss of equipment and data from fire in its risk assessment. In addition, the University lacks any type of automated fire suppression system and a water detection system in its computer center, which houses servers running critical applications, firewalls, and various network equipment.

The lack of an automated fire suppression system and water detection system greatly increases the risk of loss of equipment and data in the event of a fire or flood. This loss can result in downtime of operations and unnecessary expense in the replacement of lost equipment.

The University should document its assessment of risk to its operations in the event of a fire or flood in their computer room. Based on this assessment, the University should implement appropriate environmental controls in the main data center to protect property and data.

Lack of Written Policies and Procedures Pertaining to the University's Information Technology Environment

The University has not documented their policies and procedures covering the management and operation in the following areas of their information technology environment:

- Logical security access
- Oracle security policies and procedures

A review of University practices found adequate security procedures; however, these procedures depend on a few critical personnel enforcing security. Without written policies and procedures in these areas, the University is at risk that the loss of some key personnel could lead to compromises in the security procedures and inexperienced staff would not know what procedures to follow.

The University should document its policies and procedures for all areas of their systems environment and ensure that they are readily available to the appropriate University employees. The University Administration and Information Systems Security Officer should approve all policies, procedures, and device settings. In the future, the University should keep all policies, procedures, and drafted configurations updated and approved as necessary.

CHRISTOPHER NEWPORT
UNIVERSITY

March 21, 2005

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

Dear Mr. Kucharski,

The Auditor of Public Accounts presented its audit findings in the area of information security for the year ended June 30, 2004. The University has addressed these findings as reported below:

1. IT Services is re-assessing the risk of not having a fire-suppression system in its machine room. As a consequence of the initial analysis, IT Services will upgrade its sensor system in the ITS machine room this summer, replacing the temperature-sensing Sensaphone with more sophisticated devices. Furthermore, tape backups of all critical data are now stored in a fireproof safe (FireKing UL 3-hour, Class 125) and are located outside of the ITS machine room. The University will explore the feasibility of purchasing and installing a fire-suppression system. An RFP has been prepared which will address the costs and logistics of this work.

2. IT Services has documented its policies related to information system development, configuration management, and security in a comprehensive document entitled "IT Services Standards and Practices". Security configurations and procedures have been documented for key security systems such as the firewall and main router. Documentation on other security devices will be completed within the next 6 months. Logical security is governed by the campus-wide "CNU Administrative Data Management and Access Policy". The procedures associated with account set-up, authorization, and removals related to the Oracle and Banner environment have been documented in the "Security-Banner and Oracle" document. Remaining is the documentation of the various security classes and the default grants associated with different groups of accounts. Similar documentation related to the Microsoft Windows domain is likewise under development.

Thank you for the efforts of you and your staff on another successful year.

Sincerely,

William L. Brauer
Executive Vice President

Office of the Executive Vice President
1 University Place Newport News, Virginia 23606-2998
Telephone (757) 594-7040 Fax (757) 594-7864 E-mail: wbrauer@cnu.edu

MANAGEMENT'S DISCUSSION AND ANALYSIS
(unaudited)

Accounting Standards

In June 1999, the Governmental Accounting Standards Board (GASB) released Statement 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments,* which established a new reporting format for the annual financial statements. In November 1999, GASB released Statement 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities,* which applies the new reporting standard to public colleges and universities. Christopher Newport University implemented GASB Statement 35 in fiscal year 2002. These statements differ significantly, in both the form and the accounting principles utilized, from prior financial statements presented. The financial statements presented in prior years focused on the accountability of funds, while these statements focus on the financial condition of the University, results of operations, and cash flows of the University as a whole.

In May 2002, the Governmental Accounting Standards Board (GASB) released Statement 39, *Determining Whether Certain Organizations Are Component Units,* which establishes the conditions under which institutions should include certain associated organizations for which the primary government is not financially accountable, but based on the nature and significance of their relationship to the primary government, they raise and hold economic resources for the direct benefit of the governmental unit. Under the new standards, the Christopher Newport University Educational and Real Estate Foundations, Inc., meet the criteria of a component unit. The Foundations 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, 2004. The data presented indicates the assets available to continue the University's operations, as well as shows the amounts the University owes to vendors and creditors.

Statement of Net Assets

	As of June 30, 2004	As of June 30, 2003
Assets:		
Current assets	$ 20,104,058	$ 14,878,196
Capital assets, net	168,279,764	125,323,379
Other noncurrent assets	25,992,250	52,678,709
Total assets	214,376,072	192,880,284
Liabilities:		
Current liabilities	17,836,522	12,502,214
Noncurrent liabilities	94,277,157	96,916,731
Total liabilities	112,113,679	109,418,945
Net assets:		
Invested in capital assets, net of related debt	79,844,697	66,048,123
Restricted, nonexpendable	2,597,603	2,248,362
Restricted, expendable	8,504,749	5,598,465
Unrestricted	11,269,622	9,566,389
Total net assets	$102,216,671	$ 83,461,339

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 nonexpendable. 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 nonexpendable 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 $21,495,788, while the University’s total liabilities increased by $2,694,734. The University expended $15,309,167 in Virginia College Building Authority and general obligation bond proceeds and private gifts on the Ferguson Center for the Arts and $1,438,474 in bond proceeds on the Library Information Technology Center during fiscal year 2004, which has been added to Construction-in-Progress. The combination of the increase in total assets and the increase in total liabilities resulted in an increase in net assets at June 30, 2004 of $18,755,332.

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 nonoperating, and expenses paid by the University, operating and nonoperating, and any other revenues, expenses, gains, and losses received or spent by the University.

Statement of Revenues, Expenses, and Changes in Net Assets

	Year Ended June 30, 2004	Year Ended June 30, 2003
Operating revenues:		
Student tuition and fees	$13,143,515	$10,772,370
Federal grants and contracts	4,143,687	4,589,204
Nongovernmental grants and contracts	1,156,359	705,743
Auxiliary enterprises	26,359,422	22,603,844
Other	349,325	403,339
Total operating revenues	45,152,308	39,074,500
Operating expenses:		
Instruction	16,311,236	16,806,286
Research	2,005,164	2,706,677
Public service	890,839	284,507
Academic support	4,988,411	4,503,756
Student services	3,184,185	2,897,498
Institutional support	4,903,162	4,133,821
Operation and maintenance of plant	6,487,021	3,218,756
Depreciation	3,981,785	3,493,219
Student aid	2,467,302	1,219,773
Auxiliary enterprises	20,155,721	18,535,372
Total operating expenses	65,374,826	57,799,665
Operating loss	(20,222,518)	(18,725,165)
Nonoperating revenues:		
State appropriations	21,581,394	22,342,802
State grants and contracts	451,129	81,706
Gifts	279,117	250,019
Investment income	747,987	3,658,243
Interest on capital asset related debt	(2,614,083)	(2,163,636)
Loss on disposal of plant assets	(63,952)	(4,304,922)
Net nonoperating revenues	20,381,592	19,864,212
Income before other revenues	159,074	1,139,047
Net other revenues	18,596,258	20,318,323
Increase in net assets	18,755,332	21,457,370
Net assets - beginning of year	83,461,339	62,003,969
Net assets - end of year	$102,216,671	$83,461,339

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. Nonoperating revenues are revenues received for which goods and services are not provided. The University's state appropriation is nonoperating 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 $2,371,145. Tuition was increased by 8.2 percent for fiscal year 2004 and the Commonwealth began assessing an annual capital fee to out-of-state students of $50 per full time student. Auxiliary revenues increased due to an increase in comprehensive fees of 21.67 percent and an increase in room and board of 5.5 percent.

The nonoperating revenue decrease is attributable to the decrease in investment income of $2,910,256. In October 2002, revenue bonds were sold to finance the construction of numerous new facilities. The proceeds from the bonds totaling $48,730,000 were invested by the Bank of New York until the funds were needed for construction expenditures. At June 30, 2003, $44,718,857 was still held and invested by the Bank of New York. During fiscal year 2004, more than $30 million was expended to construct facilities, with a remaining cash balance of $15,707,743 at June 30, 2004. The majority 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 ($13,717,928), auxiliary enterprises receipts ($27,774,427); and grants and contracts ($5,204,132). Major uses of cash include payments for salaries, wages and fringe benefits ($33,767,985); payments for supplies and services ($18,175,451); and payments for scholarships ($4,721,166). The net cash used by operating activities was $16,493,795.

The second section reflects cash flows from noncapital financing activities and includes the state appropriations for the University's educational and general programs and financial aid of $21,581,394, which is a decrease from the prior year of $633,578.

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 the construction of the University's fourth residential facility, parking deck, new student center, and athletic expansion for facilities and fields. In addition, the construction continued on the Ferguson Center for the Arts with in excess of $15,309,167 in state funds, local government and private gift funds being expended.

The fourth section reflects cash flows from investing activities and includes $917,544 proceeds from closing the bookstore investment account.

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 June 30, 2004	Year Ended June 30, 2003
Cash flows from operating activities	$(16,493,795)	$(14,615,533)
Cash flows from noncapital financing activities	22,133,162	22,555,618
Cash flows from capital financing activities	(1,814,792)	2,906,238
Cash flows from investing activities	1,187,299	212,536
Net change in cash	$ 5,011,874	$ 11,058,859

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 2004 capital projects include the Ferguson Center for the Arts, Library Information Technology Center, Potomac River Residence Hall, Parking Deck, Student Center, and Athletic Facilities. The Center for the Arts is funded through state appropriations, grants from local government and private gifts. The remainder of the projects were funded through the issuance of 9(d) revenue bonds.

The University's long term debt decreased by $1,398,166 at June 30, 2004. In fiscal year 2004, two bond series were retired to include the Athletics Track and the Student Center.

Overall unpaid construction commitments decreased by $31,575,814 from $47,854,942 to $16,279,128 in 2004 due to substantial completion of several auxiliary facilities. Unpaid commitments at June 30, 2004 primarily reflect the Ferguson Center for the Arts, Residence Hall IV, Parking Deck I, Student Center, and various athletic facilities. Further information relating to capital assets, construction, and capital debt is included in the Notes to Financial Statements in Notes 5, 7, and 8.

Economic Outlook

The University's economic outlook is closely related to its role as one the Commonwealth's comprehensive higher education institutions. As such, it is largely dependent upon ongoing financial support from the state government. In fiscal year 2004, the University's state appropriations decreased by $761,408 (3.4 percent). The University's governing board increased tuition by 8.2 percent for 2004, comprehensive fees by 21.67 percent, and room and board by 5.5 percent. The tuition increase will help offset the reduction in the state appropriated funds.

CHRISTOPHER NEWPORT UNIVERSITY
STATEMENT OF NET ASSETS
As of June 30, 2004

	Christopher Newport University	Component Unit: Christopher Newport University Educational and Real Estate Foundations
ASSETS		
Current assets:		
Cash and cash equivalents (Note 2)	$ 2,925,162	$ 2,227,627
Cash and cash equivalents with Treasurer of Virginia (Note 2)	15,112,559	-
Accounts receivable, net of allowance (Note 3)	322,554	138,327
Pledges receivable, net of allowance (Note 4)	-	2,628,577
Prepaid expenses	891,397	20,154
Inventory	852,386	-
Total current assets	20,104,058	5,014,685
Noncurrent assets:		
Cash and cash equivalents (Note 2)	4,433,935	485,480
Restricted investments (Note 2)	2,596,982	3,791,434
Other investments (Note 2)	18,961,333	847,069
Pledges receivable, net of allowance (Note 4)	-	2,440,894
Other restricted assets	-	548,383
Other assets	-	4,047,109
Non-depreciable capital assets (Note 5)	81,837,176	-
Capital assets, net of accumulated depreciation (Note 5)	86,442,588	40,061,118
Total noncurrent assets	194,272,014	52,221,487
Total assets	214,376,072	57,236,172
LIABILITIES		
Current liabilities:		
Accounts payable and accrued expenses (Note 6)	7,843,522	6,306,311
Deferred revenue	738,416	-
Obligations under securities lending	3,253,590	-
Deposits held in custody for others	1,181,625	3,693,894
Long-term liabilities - current portion (Note 7)	4,819,369	9,170,478
Total current liabilities	17,836,522	19,170,683
Noncurrent liabilities (Note 7)	94,277,157	27,257,228
Total liabilities	112,113,679	46,427,911
NET ASSETS		
Invested in capital assets, net of related debt	79,844,697	748,648
Restricted for:		
Nonexpendable - scholarships and fellowships	2,597,603	3,241,794
Expendable:		
Scholarships and fellowships	119,936	660,608
Academic support	-	337,875
Capital projects	8,359,984	4,373,026
Other	24,829	1,727,334
Unrestricted	11,269,622	(281,024)
Total net assets	$ 102,216,671	$ 10,808,261

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

CHRISTOPHER NEWPORT UNIVERSITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2004

	Christopher Newport University	Component Unit Christopher Newport University Educational and Real Estate Foundations
Operating revenues:		
Student tuition and fees, net of scholarship allowance of $723,846	$ 13,143,515	$ -
Federal grants and contracts	4,143,687	-
Nongovernmental grants and contracts	1,156,359	-
Auxiliary enterprises, net of scholarship allowance of $1,723,248 (Note 9)	26,359,422	-
Gifts and contributions	-	3,565,449
Lease and rental revenue	-	3,155,403
Other	349,325	110,599
Total operating revenues	45,152,308	6,831,451
Operating expenses (Note 10):		
Instruction	16,311,236	-
Research	2,005,164	-
Public service	890,839	-
Academic support	4,988,411	187,894
Student services	3,184,185	-
Institutional support	4,903,162	1,782,414
Operation and maintenance of plant	6,487,021	4,600,000
Depreciation	3,981,785	933,003
Student aid	2,467,302	158,427
Auxiliary enterprises (Note 9)	20,155,721	-
Rental expense	-	830,394
Total operating expenses	65,374,826	8,492,132
Operating loss	(20,222,518)	(1,660,681)
Nonoperating revenues (expenses):		
State appropriations (Note 11)	21,581,394	-
State grants and contracts	451,129	-
Gifts	279,117	-
Investment income, net of investment expense	747,987	1,616,972
Interest on capital asset related debt	(2,614,083)	(1,888,081)
Gain (loss) on disposal of plant assets	(63,952)	10,336
Net nonoperating revenues (expenses)	20,381,592	(260,773)
Income before other revenues	159,074	(1,921,454)
Capital appropriations	13,607,067	-
Capital gifts and grants	4,989,191	-
Additions to permanent endowments	-	1,219,637
Total other revenues	18,596,258	1,219,637
Increase (decrease) in net assets	18,755,332	(701,817)
Net assets - beginning of year	83,461,339	11,510,078
Net assets - end of year	$ 102,216,671	$ 10,808,261

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, 2004

Cash flows from operating activities:	
Student tuition and fees	$ 13,717,928
Grants and contracts	5,204,132
Auxiliary enterprises	27,774,427
Other receipts	349,227
Payments to employees	(26,082,180)
Payments for fringe benefits	(7,685,805)
Payments for services and supplies	(18,175,451)
Payments for utilities	(2,124,561)
Payments for scholarships and fellowships	(4,721,166)
Payments for plant improvements and equipment	(4,752,668)
Loans issued to students and employees	(239,129)
Collection of loans from students and employees	241,451
Net cash used by operating activities	(16,493,795)
Cash flows from noncapital financing activities:	
State appropriations	21,581,394
State grants and contracts	100,650
Gifts and grants for other than capital purposes	280,105
Stafford loan receipts	8,918,716
Stafford loan disbursements	(8,918,716)
PLUS loan receipts	2,664,032
PLUS loan disbursements	(2,664,032)
Agency receipts	8,257,160
Agency payments	(8,086,147)
Net cash provided by noncapital financing activities	22,133,162
Cash flows from capital financing activities:	
Proceeds from investments	39,282
Proceeds from capital appropriations	10,480,160
Capital gifts and grants	4,853,354
Proceeds from sale of revenue bonds	31,512,270
Purchase of capital assets	(43,404,352)
Principal paid on capital debt, leases, and installments	(2,681,423)
Interest paid on capital debt, leases, and installments	(2,614,083)
Net cash used by capital financing activities	(1,814,792)
Cash flows from investing activities:	
Interest on investments	269,755
Proceeds from investments	917,544
Net cash provided by investing activities	1,187,299
Net increase in cash and cash equivalents	5,011,874
Cash and cash equivalents - beginning of year	17,459,782
Cash and cash equivalents - end of year	$ 22,471,656

Reconciliation of net operating loss to net cash used by operating activities:	
Operating loss	$ (20,222,518)
Adjustments to reconcile net loss to net cash used by operating activities:	
Depreciation expense	3,981,785
Changes in assets and liabilities:	
Receivables, net	(53,571)
Prepaid expenses	(653,051)
Inventory	(325,854)
Accounts payable and accrued expenses	563,769
Deferred revenue	124,761
Accrued compensated absences	90,884
Net cash used by operating activities	$ (16,493,795)
Noncash investing, noncapital financing, and capital and related financing transactions:	
Capitalization of interest expense	$ 2,268,039
Change in fair value of investments recognized as a component of interest income	$ 281,595

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

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

The financial reporting entity, as defined by Governmental Accounting Standards Board (GASB) Statement 14, *The Financial Reporting Entity*, consists of the primary government organizations for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion could cause the financial statements to be misleading or incomplete. Effective for the fiscal year ended June 30, 2004, the University implemented GASB Statement 39, *Determining Whether Certain Organizations are Component Units*. This statement addresses the conditions under which institutions should include associated fund-raising and research foundations as component units in their basic financial statements and how such component units should be displayed in the financial statements.

The University did not have any component units as defined by GASB Statement 14 prior to fiscal year 2004. The Christopher Newport University Educational and Real Estate Foundations are legally separate, tax-exempt organizations that act primarily as fund-raising organizations to supplement the resources that are available to the University in support of its programs. The Foundations are each governed by the same Board and are consolidated for financial statement purposes. Although the University does not control the timing or amount of receipts from the Foundations, the majority of resources or income thereon, that the Foundations hold and invest are restricted to the activities of the 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 a single component unit of the University under GASB Statement 39 standards and are discretely presented in the financial statements.

During the year ended June 30, 2004, the Foundations distributed $4,880,054 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.

Basis of Presentation

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 Colleges and Universities*. The financial statement presentation required by GASB Statements 34 and 35 provides a comprehensive entity-wide look at the University's financial activities and replaces the fund-group perspective previously required.

GASB Statements 34 and 35 standards are designed to provide information that responds to the needs of three groups of primary users of general purpose external financial reports: the citizenry, legislative and oversight bodies, and investors and creditors. Under this guidance, the University is required to include a management's discussion and analysis (MD&A), basic financial statements, notes to the financial statements, and supplementary information other than the MD&A.

The Foundations are private, nonprofit 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 statements for these differences.

Basis of Accounting

For reporting purposes, the University is considered a special-purpose government engaged only in business-type activities. Accordingly, its statements have been presented using the economic resource measurement focus and the accrual basis of accounting whereby revenues are recognized when earned and expenses are recorded when an obligation has been incurred, regardless of the timing of related cash flows. All intra-agency transactions have been eliminated.

The University's accounting policies conform with generally accepted accounting principles as prescribed by the GASB, including all applicable GASB pronouncements, as well as applicable 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 University has the option to apply all FASB pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The University has elected not to apply the FASB pronouncements issued after the applicable date.

Cash and Cash Equivalents

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

Investments

The University accounts for its investments that are purchased at fair value. Investments received by gift are carried at fair value at the date of acquisition in accordance with GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. All investment income, including changes in the fair value of investments (unrealized gains and losses), is reported as nonoperating revenue in the Statement of Revenues, Expenses, and Changes in Net Assets.

Receivables

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

Capital Assets

Capital assets include land, buildings and other improvements, library materials, equipment and infrastructure assets such as campus lighting and sidewalks. Capital assets are generally defined by the University as assets with an initial cost of $5,000 or more and an estimated useful life in excess of two years including assets acquired under the Higher Education Trust Fund. Such assets are recorded at actual cost or estimated historical cost if purchased or constructed. Library materials are valued using purchase price for library acquisitions. Donated capital assets are recorded at the estimated fair market value at the date of donation. Expenses for major capital assets and improvements are capitalized (construction-in-progress) as projects are constructed. The costs of normal maintenance and repairs that do not add to an asset's value or materially extend its useful life are not capitalized.

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

Buildings	40-50 years
Other improvements and infrastructure	15 years
Equipment	2-15 years
Library materials	5 years

Inventories

Inventories are valued at the lower of cost (generally determined on the first-in, first-out method) or market and consist primarily of expendable supplies held for consumption and items for resale.

Noncurrent Cash and Investments

Cash and investments that are externally restricted to make debt service payments, reserve funds, or to purchase or construct capital and other noncurrent assets are classified as noncurrent assets in the Statement of Net Assets.

Deferred Revenue

Deferred revenue primarily includes amounts received for tuition and fees and certain auxiliary activities prior to the end of the fiscal year, but related to the period after June 30, 2004 and certain grants that have received advance funding, but have not met their restriction prior to year end.

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, 2004. The amount reflects all earned vacation leave, sick, and compensatory leave payable under the Commonwealth of Virginia's sick leave pay-out policy and the University's faculty administrators' leave pay-out policy upon employment termination. The applicable share of employer-related taxes payable on the eventual termination payments is also included.

Noncurrent Liabilities

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

Federal Financial Assistance Programs

The University participates in federally-funded Pell Grants, Supplemental Educational Opportunity Grants (SEOG), Federal Work-Study, Stafford Loans, and Parent Loans for Undergraduate Students (PLUS). Federal programs are audited in accordance with the Single Audit Act Amendments of 1996, the Office of Management and Budget Revised Circular A-133, *Audit of States, Local Governments and Non-Profit Organizations*, and the Compliance Supplement.

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 - Nonexpendable - 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. Restricted funds remain classified as such until restrictions have been satisfied.

Classification of Revenues and Expenses

The University presents its revenues and expenses as operating or nonoperating based on the following criteria:

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

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

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

Scholarship Allowances

Student tuition and fee revenues and certain other revenues from charges to students are reported net of scholarship allowances in the Statements of Revenue, Expenses, and Changes in Net Assets. Scholarship allowances are the difference between the actual charge for goods and services provided by the University and the amount that is paid by students and/or third parties on the students' behalf. Student financial assistance grants and other federal, state or nongovernmental programs are recorded as either operating or nonoperating revenues in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. To the extent that revenues from these programs are used to satisfy tuition, fees, and other charges, the University has recorded a scholarship allowance.

2. CASH AND CASH EQUIVALENTS AND INVESTMENTS

Cash with the Treasurer of Virginia

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.

Investments

The Board of Visitors establishes the University's investment policy. Credit risk is the risk that the University may not be able to obtain possession of its investment instrument at maturity. The University's investments at June 30, 2004 are with the Treasurer of Virginia or held in money market funds and, therefore, are not categorized by credit risk.

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.

Cash and cash equivalents:	
Cash with the Treasurer of Virginia	$19,546,494
Money market and mutual funds	2,152,623
Deposits with financial institutions	772,539
Total cash and cash equivalents	$22,471,656
Investments:	
State non-arbitrage program (SNAP)	$15,707,743
Collateral held for Securities Lending	3,253,590
Mutual funds	2,596,982
Total investments	$21,558,315

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

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, 2004, the Foundations had bank cash deposit balances of approximately $2,512,000, 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 $1,386,000 at June 30, 2004.

Investments are carried at their market value determined at June 30, 2004. 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:

Money market and mutual funds	$ 4,638,503

Investments are recorded on the Statement of Net Assets as follows:

Unrestricted	$ 847,069
Temporarily restricted	1,987,978
Permanently restricted	1,803,456
Total	$4,638,503

3. ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following at June 30, 2004:

Student tuition and fees	$ 44,141
Auxiliary enterprises	218,342
Grants and contracts	88,012
Other	2,877
Gross receivables	353,372
Less: Allowance for doubtful accounts	(30,818)
Net accounts receivable	$322,554

4. PLEDGES RECEIVABLE

The Foundations have on-going fundraising campaigns to benefit the University. Pledges receivable consisted of the following unconditional pledges at June 30, 2004:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Receivable in less than one year	$ 23,296	$2,863,557	$ 292,163	$3,179,016
Receivable in one to five years	3,241	1,885,660	927,029	2,815,930
Receivable in more than five years	-	651,464	55,000	706,464
Total unconditional pledges	26,537	5,400,681	1,274,192	6,701,410
Less:				
Discount to net present value	-	(803,007)	(144,651)	(947,658)
Allowance for uncollectible pledges receivable	(23,711)	(483,887)	(176,683)	(684,281)
Net pledges receivable	$ 2,826	$4,113,787	$ 952,858	$5,069,471

5. CAPITAL ASSETS

A summary of changes in the various capital asset categories for the year ending June 30, 2004 is presented as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Nondepreciable capital assets:				
Land	$ 6,040,221	$ 1,070,608	$ -	$ 7,110,829
Construction in progress	32,262,500	44,932,916	2,469,069	74,726,347
Total nondepreciable capital assets	38,302,721	46,003,524	2,469,069	81,837,176

Depreciable capital assets:				
Buildings	94,385,879	-	-	94,385,879
Infrastructure	83,864	-	-	83,864
Equipment	7,678,322	632,132	367,081	7,943,373
Other improvements	5,567,647	2,429,007	-	7,996,654
Library materials	7,963,513	360,806	45,722	8,278,597
Total depreciable capital assets	115,679,225	3,421,945	412,803	118,688,367
Less accumulated depreciation:				
Buildings	14,973,004	2,386,746	-	17,359,750
Infrastructure	1,262	5,591	-	6,853
Equipment	4,402,246	842,581	348,851	4,895,976
Other improvements	2,660,671	277,456	-	2,938,127
Library materials	6,621,384	469,411	45,722	7,045,073
Total accumulated depreciation	28,658,567	3,981,785	394,573	32,245,779
Depreciable capital assets, net	87,020,658	(559,840)	18,230	86,442,588
Total capital assets, net	$125,323,379	$45,443,684	$2,487,299	$168,279,764

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.

The Foundations held capital assets in the following categories at June 30, 2004:

Land and buildings	$ 5,360,901
Collections	95,520
Equipment and furniture	613,227
Property held for investment	34,461,444
Capital assets	40,531,092
Less: Accumulated depreciation	(469,974)
Capital assets, net of accumulated depreciation	$40,061,118

6. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following at June 30, 2004:

Employee salaries, wages, and fringe benefits payable	$2,009,343
Vendors and suppliers accounts payable	3,468,036
Retainage payable	2,366,143
Accounts payable and accrued expenses	$7,843,522

7. NONCURRENT LIABILITIES

The University's noncurrent liabilities consist of long-term debt (further described in Note 8), and other noncurrent liabilities. A summary of changes in noncurrent liabilities for the year ending June 30, 2004 is presented as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Long-term debt:					
Revenue bonds	$ 58,635,000	$1,265,000	$ 630,000	$59,270,000	$2,080,000
General obligation bonds	40,825,482	-	2,032,608	38,792,874	1,849,742
Capital leases	52,293	18,256	18,814	51,735	21,952
Total long-term debt	99,512,775	1,283,256	2,681,422	98,114,609	3,951,694
Accrued compensated absences	890,644	999,938	908,665	981,917	867,675
Total long-term liabilities	$100,403,419	$2,283,194	$3,590,087	$99,096,526	$4,819,369

8. LONG-TERM DEBT

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

Section 9(c) bonds are general obligation bonds issued by the Commonwealth of Virginia 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 of Virginia.

Description	Interest Rates	Maturity	Outstanding Balance at June 30, 2004
Revenue 9(d) bonds:			
Athletics:			
Series 1998A	4.53	2019	$ 8,415,000
Series 2002A	3.0–5.25	2023	5,745,000
Series 2002A	3.0–5.25	2023	1,300,000
Series 2003A	2.0–5.00	2024	1,265,000
Student Center:			
Series 2001A	3.0-4.87	2021	1,055,000
Series 2002A	3.0-5.25	2023	320,000
New Student Center, Series 2002A	4.0–5.25	2023	8,815,000
Parking Deck I, Series 2002A	4.0–5.25	2023	8,385,000
Residence Hall IV, Series 2002A	4.0–5.25	2023	23,970,000
Total revenue bonds			59,270,000
General obligation revenue 9(c) bonds:			
Dormitory and dining hall:			
Series 1997	4.7–5.1	2021	1,801,759
Series 1998	3.5–4.7	2015	3,074,987
Series 1998	3.5–4.3	2008	159,523
Series 1999	4.8–5.3	2019	11,135,000
Series 2001	2.1–4.9	2021	21,400,000
Series 2003R	2.5–5.5	2011	1,079,193
Series 2003R	2.5–4.0	2006	142,412
Total general obligation bonds			38,792,874
Total bonds payable			98,062,874
Capital leases:			
Other capital leases	Various	2007	51,735
Total			$98,114,609

Long-term debt matures as follows:

	Principal	Interest
2005	$ 3,951,695	$ 4,787,036
2006	4,105,222	4,617,905
2007	4,284,354	4,434,204
2008	4,471,719	4,233,466
2009	4,686,039	4,025,662
2010-2014	26,283,857	16,568,169
2015-2019	31,441,723	9,374,152
2020-2024	18,890,000	1,913,315
Total	$98,114,609	$49,953,909

Defeasance of Debt – Prior Years

During fiscal years 1994, 1997 and 1998, 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, 2004, $11,850,000 of the bonds considered defeased remained outstanding.

Subsequent Event

On October 7, 2004, the University issued 2004A, 9(d) revenue bonds through the Virginia College Building Authority's (VCBA) 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 Center. The bonds were issued with interest rates varying from three to five percent and mature in 2026.

Christopher Newport University Educational and Real Estate Foundations Long Term Debt

The Foundations' long-term liabilities consist of bonds payable, notes payable, lines of credit, fair value of hedge transactions, and other liabilities as shown in the following schedule:

Bonds payable	$24,593,578
Notes payable	1,906,697
Lines of credit	6,917,157
Fair value of hedge transactions	2,382,419
Other	627,855
Total long-term debt	$36,427,706

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, 2004, 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 in 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, 2004, the balance outstanding on the bonds was $9,833,653. The bonds are payable interest only until October 2003 at which time principal curtailments begin. The bonds mature in 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, 2004, the balance outstanding on the bonds was $5,417,925. The bonds are payable interest only until October 2003 at which time principal curtailments begin. The bonds mature in September 2013.

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. Interest at 3.5 percent will be paid monthly. The maturity date is December 31, 2011. The Foundations' final payments will be for all remaining principal and any accrued interest not paid.

The bond commitment documents contain certain financial covenants pertaining to debt service coverage and lease payment coverage. At June 30, 2004, the Foundations were in compliance with these covenants.

Bond maturities for the succeeding fiscal years ending June 30 are as follows:

2005	$ 328,948
2006	5,346,526
2007	428,148
2008	449,395
2009	471,375
Thereafter	17,569,186
Total	$24,593,578

Notes Payable

Notes payable consist of two unsecured notes with variable interest rates and payments due monthly. Of the total notes payable, $1,742,000 is due in July 2004.

Lines of Credit

At June 30, 2004, the Foundations had available a $7,500,000 line of credit facility with Bank of America maturing on October 15, 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 and to provide bridge financing for various projects deemed beneficial to the University. Borrowings under this line of credit facility totaled $6,917,157 at June 30, 2004.

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 value of interest rate swap agreements are the estimated amounts the Foundations would receive or pay to terminate the agreements as of June 30, 2004.

Instrument Value	Variable Rate	Fixed Rate	Expiration	Fair Value
$7,500,000	65% of LIBOR +0.82%	5.22%	June 2011	$ (490,373)
5,500,000	65% of LIBOR +0.88%	5.23%	September 2013	(480,609)
10,000,000	65% of LIBOR +0.82%	5.14%	September 2013	(805,393)
26,900,000	Flexible rate	3.73	May 2019	606,044
Total				$(2,382,419)

9. AUXILIARY ENTERPRISE ACTIVITIES

Auxiliary operating revenues and expenses are distributed as shown in the following table for the year ending June 30, 2004. Additionally, the University used auxiliary revenues to pay debt service and capital improvements of $5,291,286 and $1,131,420, respectively. This amount is not included in the auxiliary operating expenses.

Revenues:	
Room contracts, net of scholarship allowance of $765,369	$ 9,755,074
Food service contracts, net of scholarship allowance of $293,633	3,136,809
Comprehensive fee, net of scholarship allowance of $664,246	6,969,990
Other student fees and sales and services	6,497,549
Total auxiliary enterprises revenues	$26,359,422
Expenses:	
Residential facilities	$ 6,587,309
Dining operations	5,078,895
Athletics	4,010,772
Bookstore	2,633,614
Other auxiliary services	1,845,131
Total auxiliary activities expenses	$20,155,721

10. EXPENSES BY NATURAL CLASSIFICATIONS

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

	Salaries and Wages	Fringe Benefits	Services and Supplies	Scholarships	Utilities	Plant and Equipment	Depreciation	Total
Instruction	$11,496,375	$3,094,545	$ 1,458,465	$ -	$ -	$ 261,851	$ -	$16,311,236
Research	956,241	224,099	782,779	-	-	42,045	-	2,005,164
Public service	630,742	114,496	134,147	-	-	11,454	-	890,839
Academic support	1,841,543	780,610	1,618,733	-	-	747,525	-	4,988,411
Student services	1,454,545	405,374	1,235,381	-	-	88,885	-	3,184,185
Institutional support	2,972,167	975,758	814,064	18,735	-	122,438	-	4,903,162
Operation of plant	1,493,185	664,228	989,882	-	793,204	2,546,522	-	6,487.021
Depreciation	-	-	-	-	-	-	3,981,785	3,981,785
Scholarships	-	-	-	2,467,302	-	-	-	2,467,302
Auxiliary enterprises	5,522,051	1,562,604	11,278,005	-	1,367,908	425,153	-	20,155,721
Total	$26,366,849	$7,821,714	$18,311,456	$2,486,037	$2,161,112	$4,245,873	$3,981,785	$65,374,826

11. STATE APPROPRIATIONS

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

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

Original legislative appropriation:	
Educational and general programs	$19,013,745
Student financial assistance	2,036,265
Supplemental adjustments:	
Salary increases	208,405
Fringe benefit rate changes	88,867
Student financial assistance	273,808
Miscellaneous reductions	(52,279)
Other	12,583
Adjusted appropriation	$21,581,394

12. COMMITMENTS

At June 30, 2004, the University was a party to construction and other contracts totaling approximately $84,902,317 of which $68,623,189 has been incurred.

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, 2004 was $3,165,531. The University has, as of June 30, 2004, the following total future minimum rental payments due under the above leases:

Year Ending June 30,	Operating Lease Obligations
2005	$ 3,043,284
2006	3,007,531
2007	3,067,921
2008	3,119,157
2009	3,145,110
2010-2014	13,184,011
2015-2017	8,578,810
Total	$37,145,824

13. 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.

14. RETIREMENT PLANS

Substantially all full-time classified salaried employees of the University participate in the defined benefit retirement plan administered by the Virginia Retirement System (VRS). Information relating to this plan is available at the statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report (CAFR). The Commonwealth, not the University, has overall responsibility for contributions to this plan.

Full-time faculty and certain administrative staff are eligible to participate in other retirement plans. These are fixed contribution programs where the retirement benefits received are based upon employer contributions of 5.40 percent and employee contributions of five percent, and interest and dividends. Individual contracts issued under the plans provide for full and immediate vesting of both University and employee contributions. Total pension costs under these plans were approximately $1,183,148 for the year ended June 30, 2004. Contributions to other retirement plans were calculated using the base salary amount of approximately $11,376,420.

15. POST-EMPLOYMENT BENEFITS

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

16. CONTINGENCIES

Grants and Contracts

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

In addition, the University is required to comply with the various federal regulations issued by the Office of Management and Budget. Failure to comply with certain system 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, 2004, the University estimates that no material liabilities will result from such audits or questions.

17. RISK MANAGEMENT AND EMPLOYEE HEALTH CARE PLANS

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

CHRISTOPHER NEWPORT UNIVERSITY
SCHEDULE OF AUXILIARY ENTERPRISES - REVENUES AND EXPENDITURES
For the Year Ended June 30, 2004

	Auxiliary Support	Dining Services	Housing Operations	Intercollegiate Athletics	University Bookstore	Total
Revenues:						
Sales and services	$ 606,055	$ 1,612,952	$ 193,791	$ 211,784	$ 3,017,873	$ 5,642,455
Student fees	1,756,690	3,430,442	10,520,443	4,792,160	-	20,499,735
Miscellaneous	-	75,000	-	152,381	47,544	274,925
Total revenues	2,362,745	5,118,394	10,714,234	5,156,325	3,065,417	26,417,115
Cost of sales	-	2,254,733	-	-	2,093,614	4,348,347
Net revenues	2,362,745	2,863,661	10,714,234	5,156,325	971,803	22,068,768
Expenses:						
Personal services	1,116,507	1,704,712	1,664,115	2,208,502	329,598	7,023,434
Contractual services	389,730	320,681	536,218	660,581	94,273	2,001,483
Supplies and materials	82,695	108,557	267,873	288,468	17,003	764,596
Transfer payments	5,890	4,841	393,448	35,915	-	440,094
Continuous charges	207,392	630,082	3,499,696	676,891	79,326	5,093,387
Equipment	42,917	55,289	225,959	140,415	19,800	484,380
Total expenses	1,845,131	2,824,162	6,587,309	4,010,772	540,000	15,807,374
Excess of revenues over expenses before transfers	517,614	39,499	4,126,925	1,145,553	431,803	6,261,394
Mandatory transfers:						
Allocation of work study program	11,573	-	10,634	14,915	-	37,122
Debt service	(265,896)	(214,400)	(3,631,883)	(1,179,107)	-	(5,291,286)
Nonmandatory transfers	(847,600)	-	-	105,000	(191,605)	(934,205)
Total transfers	(1,101,923)	(214,400)	(3,621,249)	(1,059,192)	(191,605)	(6,188,369)
Net increase (decrease) for the year	(584,309)	(174,901)	505,676	86,361	240,198	73,025
Fund balance (deficit) at beginning of year	886,027	8,972	597,467	(304,014)	2,744,211	3,932,663
Fund balance (deficit) at end of year	$ 301,718	$ (165,929)	$ 1,103,143	$ (217,653)	$ 2,984,409	$ 4,005,688

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.

Commonwealth of Virginia

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

February 18, 2005

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Lacey E. Putney
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 of Virginia, and its discretely presented component unit as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the 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 is discussed in Note 1. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to 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 was audited by other auditors upon whose report we are relying was 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 report of other auditors provide a reasonable basis for our opinion.

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 Christopher Newport University and of its discretely presented component unit as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

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

The management's discussion and analysis on pages 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 Expenditures 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 statements 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 assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the University's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions entitled "Assess Risk of Lack of Environmental Controls in the University's Data Center" and "Lack of Written Policies and Procedures Pertaining to the University's Information Technology Environment" are described in the section of the report titled "Internal Control Findings and Recommendations." Management's response to these findings and recommendations is included in the section of the report titled, "University Response."

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 March 14, 2005.

AUDITOR OF PUBLIC ACCOUNTS

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